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Romanian insolvencies remain at a level twice as high as the average in Central and Eastern Europe

In 2017, in Romania, 8,256 new insolvency proceedings were opened, by 3% more than in the previous year, when 8,053 insolvencies were opened. Despite the minimum level of the insolvencies registered in the last 15 years, Romania reports an average rate of the ratio between the number of insolvent companies and 1.000 active organizations is of 2.4%, almost twice the average in the Central and Eastern Europe.
In this context, it is more important to evaluate the size of the insolvent companies, in terms of financial losses caused to creditors and of social dimension through the lost jobs. From this perspective, some stabilization of the insolvent companies with revenues over 1M EUR, namely of a number of 326 companies, was experienced in 2017, compared with a number of 333 companies registered in the previous year. Despite this fact, in 2017, the losses, caused to creditors by the insolvent companies, amounted to 9.6B RON, having an increase by 13% compared to the 8.5B RON registered in the previous year. However, the number of jobs reported by the insolvent companies in 2017 amounted to only 47,578, by 32% lower than the number registered in the previous year.

The 3 major errors of the insolvent companies, that caused their default, are:

- **Poor funding of investments,** by using the short-term attracted resources to fund the long-term needs. Virtually, 7 out of 10 insolvent companies paid their suppliers latter than the average receivable collection and stock sale period of time, due to the following reason: 60% purchased tangible assets (i.e. lands, machines, machinery), 30% partially paid their debts to the banks (in order to reduce the cost with the interests paid) and the dividends to the shareholders, while 10% credited different companies, most of them being members of the same group of companies (shareholders and/or directors coincident with or having an affinity/close friendship with the concerned company's ones);

- **Bad investments**: 75% of the insolvent companies incurred a cost for funding the business (weighted average cost of capital) higher than the return on assets, because the expected investment result was not materialized. When the return on assets (the effect) is lower than the funding cost (the effort), the company status deteriorates and the insolvency risk increases;

- **Aggressive dividend policy:** one third of the insolvent companies distributed most of the net profit as dividends, in an accelerated manner, before the activity cessation time, without any compensating factor for the consolidation of the liquidity status (i.e. increase of the profits or turnover obtained). This led to the increase of the vulnerability degree of the relevant companies, as well as to a higher dependence on external funding.

Errors of the insolvent companies

Out of the total of 8,256 insolvent companies in 2017, a number of 4,185 companies filed financial statements before defaulting. For those companies, the financial indicators for the last previous financial exercises are calculated, the figures being consolidated at the level of the entire sample of insolvent companies. Thus, we conclude the following aspects:

- **The level of revenues has significantly decreased in the last 3-4 years prior to the entrance under the incidence of insolvency.** The average turnover during 2016 was of 2.1M RON, by 28% less than in the previous year and by 30% less than the turnover in 2012 which was the top level for the revenues of those companies;
- **In the context of a significant decrease of revenues, those companies showed a limited capacity for restructuring.** The reduced flexibility of those companies and their incapacity for effective restructuring were caused by the very high level of the fixed expenses. The later are due to the major investments in fixed assets, when their weight in the total assets constantly increased from 36% in 2012, to 44% in 2016. Thus, the consolidated losses, before the entrance under the incidence of insolvency, amounted to 9.3% of the turnover rate;
- **The indebtedness degree of such companies constantly increased, from 85% in 2012 to approximately 104% in 2016.** This dynamics was caused by the accumulation of losses which eroded the level of equity, the very low capitalization contribution of the shareholders, and the necessity of supplementing debts in order to manage the pressure on liquidity;
- **The coverage level for debts by means of the level of sales decreased from 103% in 2012 to just 75% in 2016;**
- **The money conversion cycle (calculated by the accrued level of stock and receivable rotation minus the average payment term of suppliers) became negative in 2016,** which means that the main funding source was the increase of short-term debts, whose weight in the overall borrowed capitals increased from 48% (in 2012) to 75% (in 2016).

Industries with the highest number of insolvencies

For the sectorial distribution, the industries with the highest number of insolvent companies per 1,000 active companies are: manufacture of textile products, generation and supply of electricity, clearance and removal of garbage, mining and construction industry.

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In 2017, a significant increase in the number of newly established companies occurred, as the number of LLC registered was almost 100,000, coming back at the number in 2008, before the impact of the global financial crisis at local level.

It is noticeable that the trend of registrations depending on the business sector varies greatly from one sector to the other. As such, the highest increase is seen in sectors like the manufacturing industry (+122%), recreational, cultural and entertainment activities (+73%) and other activities and services (+60%). In turn, trade and financial brokerage are the only sectors which have seen a decrease of newly registered companies, by -10% (per only 29,555) and -22% (per 1,455).

"Despite the record economic growth and significant increase in consumption by almost 10% over the previous year, in 2017 the number of insolvencies registered a slightly increase. This development shows that after the accelerated decline in insolvency over the past 3 years, amid liquidity growth in the market, the effect is beginning to disintegrate, and I estimate that in the coming period we will see more companies unable to pay. This estimate is also based on Coface's analysis, which shows that in the economy the number of companies that are not profitable and have poor solvency is important (1 out of 3 companies would fall into this category) which are extremely exposed to difficulties in paying debts, as liquidity will become less accessible or more expensive. Coface evaluates a large number of companies each year, which achieves over 80% of the local economy's turnover, and an analysis of this portfolio shows that only one in four companies has a low insolvency risk", said Eugen Anicescu, Country Manager, Coface Romania.

"From the perspective of the general Romanian business framework, we cannot find an explanation that can substantiate the increase of number of companies in 2017: the average pay in the private sector has gone up by almost 15%, the fiscal and legal frameworks were highly instable, the cost of credits has increased at the end of the year, public investments have gone down as opposed to the previous year, while foreign investments have been at a standstill in the key sectors. The only explanation we can find for the increase by 32% in the number of newly established companies is the basic effect. Local business sector has lost about one million companies in the last 10 years, with a number of companies which have discontinues their activity four times higher than the regional average. More to the point, for each company newly established between 2008-2016, a number of 2.2 companies has discontinues the activity. Hence, Romania has seen only 23 companies per 1,000 inhabitants, the lowest level in the EU after Serbia (which has 19 companies per 1,000 inhabitants). Currently, the local business sector is in the incipient phase given that half of the operational companies are registered after year 2009 and have not been subjected to the financial crisis turbulence. This process of destructive regeneration has left a significant gap in the business sector, which may be currently occupied by the newly registered companies, in the context where the very high level of economic growth and the still low credit cost are providing interesting opportunities at this time", stated Iancu Guda, Services Director, Coface Romania.

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About Coface

Coface, a world-leading credit insurer, offers 50,000 companies around the globe solutions to protect them against the risk of financial default of their clients, both on their domestic and export markets. The Group, which aims to be the most agile global credit insurer in the industry, is present in 100 countries, employs 4,300 people and posted consolidated turnover of €1.411 billion in 2016. Coface publishes quarterly country and sector risk assessments, based on its unique knowledge of companies' payment behavior and on the expertise of its 660 underwriters and credit analysts located close to clients and their debtors.

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