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## **In 2018, insolvencies in Romania remain at approximately the same level of 2017, but the forecasts show an increase of at least 20% in 2019-2020**

**The macroeconomic context becomes unstable, following the procyclical fiscal policies that cause the increase of a very high fiscal deficit in a period of attenuated economic growth. The number of insolvent companies in 2018 is similar to the one registered in the previous year, namely almost 8,200 companies, and continues to be on the level of the last decade. Moreover, there was a gradual decrease of insolvent companies with revenues over EUR 0.5 M (medium and large). The evolution it is also reflected in the reduction of financial losses, estimated by the differences between the level of debts and the level of assets related to insolvent and social companies, estimated by the number of jobs registered by the insolvent companies. The financial losses caused by the insolvent companies in the last three years were between RON 8 and 9 billion, much below the level reported in 2014-2015.**

The future prospects are pessimistic, because the vulnerability of the active business environment of Romania has increased in the last 10 years following: modest long-term investments, company decapitalization, short-term loss of financial independence because of negative work capital, the increase of systemic risk because of extending the invoice collection terms to record levels, inventory oversizing, increasing pressures over company profitability and encouraging a spiraling inflationist process because of cost increases, salary increases over the advancement of productivity, the polarization of revenues and liquidities in large companies in the context of a decreasing middle class, tensions in the labor market because of the depopulation of Romania and the under-development of the national network of road transportation.

*“The fiscal modifications which became effective at the beginning of this year, especially the excessive taxation of bank assets on the highest level in the world, will complicate the access to funding, and the banks will be much more careful about the entities to which they will grant credits, the inflation pressures will increase the funding costs, and the continued deceleration of consumption will decrease company revenues. The round-two effects will be even more disastrous - affected by the decrease of sales, the slower collection of receivables, the increase of funding costs and more complicated access to banking or commercial credits, several companies will lay off personnel, and will contribute to a new wave of decreases in consumption and company revenues”,* Iancu Guda, Services Director, Coface Romania, said.

### **Sectors most affected by insolvencies**

In most studies conducted by Coface Romania regarding the evolution of insolvencies, the first 10 sectors with the highest number of companies under insolvency remained the same, and the only changes were related to the ranking order, but with variations of one, maximum two positions.

The most open insolvencies in 2018 were **in constructions (1,321)**, followed by **retail (1,293)** and **wholesale and distribution (1,239)**. By analyzing the evolution of insolvencies in the last 5 years, we notice a trend to consolidate the concentration degree of the volumes from the first three, and the first five sectors, respectively.

### **Mixture of challenges and external risks, which will influence the evolution of insolvencies**

In the context of increasing external risks and internal macroeconomic unbalance, company vulnerability causes an increase in the number of insolvencies in 2019-2020 of at least 20%. The phenomenon becomes worrisome also because of the amplification of financial and social losses propagated by these factors in the context of the very high contagion effect from the business environment by the already much extended payment terms between companies.

*“The number of the companies which ceased their activities in 2018 exceeds the 140,000 threshold and is close to the maximum level of the last decade. At the same time, the number of newly registered limited liability companies decreased in 2018, by 9%, in the context of the high pressures of salary costs, workforce migration, increasing the funding costs and fiscal unpredictability. This may indicate the deterioration of trust in the long-term prospects of economy from current entrepreneurs or those that intend to incorporate companies”,* Eugen Anicescu, Country Manager, Coface Romania, said.

In addition, the increasingly restrictive US monetary policies, the commercial war between China and USA, the unprecedented volatility of stock exchange indexes in the last ten years, the deceleration of economic growth in China, and the geopolitical conflicts and tensions increase the risks of recession in 2019-2020.

### **Factors that indicate the increasing vulnerability of Romanian companies in the context of the next recession<sup>1</sup>:**

- **Long-term investments** are exceeded by amortization (asset obsolescence), given that their weight in the total decreased to 44% in 2017, compared to 63% in 2008, which reflects very modest long-term investments and a decrease in the competitiveness of active companies in Romania;

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<sup>1</sup> The press release indicated only 6 factors, please consult the Insolvency Study in order to see the other 4 vulnerabilities.

- **The capitalization degree** decreased to 25% at the end of 2017, compared to 35% a decade ago, which implicitly indicates an increase in company indebtedness and their vulnerability to the fluctuation of funding costs.
- **The book value of inventory almost doubled** in the last decade, as it increased from RON 113 billion (2006) to RON 204 billion (2017). The two maximum values registered in 2008 and 2018, when GDP increased to almost twice the potential level.
- **Loss of short-term financial independence** - the degree of covering short-term debts by current assets decreased to 95% in 2017, compared to 112% in 2008, which reflects the pressures and dependence of companies on short-term debt rollover.
- **Increase of systemic risk because of the extension of the receivable collection term** - business relations developed largely on trust and instinct. In this context, the average receivable collection term has significantly increased from the impact of the financial crisis to now, because receivables have increased in a more accelerated rate than revenues.
- **Pressures on company profitability** - the weight of raw material expenses significantly increased, from 22% in 2007 to 27% in 2017, and they were partially compensated by the decrease of commodity expenses, from 41% in 2007 to just 30% in 2017.

By analyzing the evolution for 2018 compared to the similar period of last year, we notice the triggering of a destructive spiral, which shows the decrease of trust in the prospects of the economy.

#### MEDIA CONTACT

Claudia POPA - T. 0374 670 780 - [claudia.popa@coface.com](mailto:claudia.popa@coface.com)

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