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FRENCH COMPANIES: IMPROVED BUSINESS ENVIRONMENT BUT MIND CYCLICAL RISKS

Stéphane Colliac

According to insolvencies and corporate margins figures, the situation of French companies has improved significantly between 2016 and 2021. Business insolvencies are down roughly 50%. According to our estimates, this has contributed to save 210,000 jobs over the period, including 170,000 jobs during the pandemic alone. Corporate margins have improved by 1.4pp during the last five years and taxation has decreased.

Public finance support has been a key driver of this improvement, including through lower corporate and production taxes and, during the pandemic, higher subsidies to production.

In 2022, this improvement should reverse partially, mainly because of higher inflation. Higher commodity costs are expected to slash nearly 1 percentage point off corporate margins on average, although they should have a much bigger impact on margins in transport services, the agri-food industry and construction.

These costs will hurt companies at a time when they are engaged in significant but costly investments. French industry needs these investments to close the gap in terms of production capacities, without which it would continue to be at a disadvantage relative to its European competitors.

FRANCE: BUSINESS INSOLVENCIES (ACTUAL)

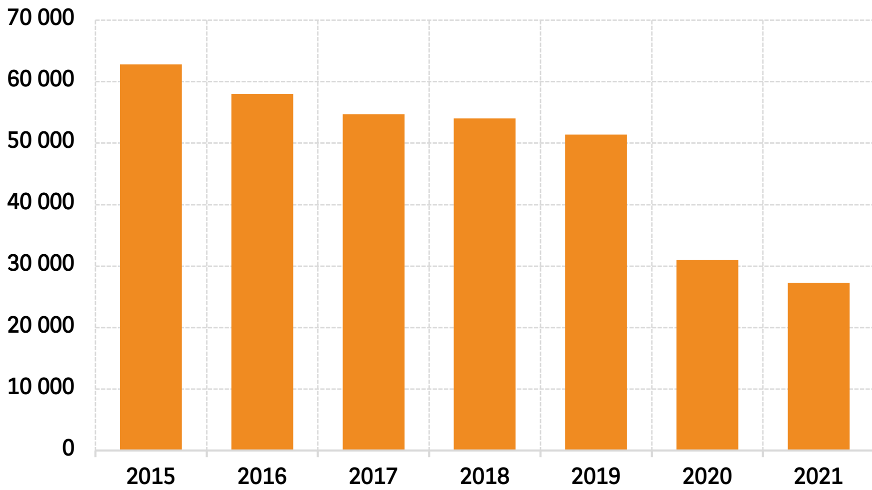

CHART 1

SOURCE: BANQUE DE FRANCE

In 2021, France reported the fewest business insolvencies on record (statistics are beginning in 1990), with nearly 27,500 companies entering court-ordered administration or liquidation proceedings according to Banque de France data. This is about half of the insolvencies reported in 2016 (which was quite comparable to its long-term average). The decline started before the Covid pandemic, with insolvencies down 15% between 2016 and 2019, and accelerated during the pandemic with the implementation of "whatever it costs". This decline in business insolvencies not only reflects a more buoyant economy, but also a corporate situation that has generally improved in recent years.

FRENCH COMPANIES HAVE SEEN AN IMPROVEMENT OF THEIR BUSINESS ENVIRONMENT

Companies have benefited from a buoyant economic environment, as illustrated by the dynamic pace of turnover growth. In manufacturing industry and construction in particular, it rose by 11% and 30%, respectively, between 2016 and 2021 (despite the pandemic), compared to declines of 1% and 2.5%, respectively, during the previous five-year period.

After a severe shock, the pandemic did not jeopardize overall companies' financial situation. Strong fiscal support contributed to a further significant decrease in terms of insolvencies.

ECONOMIC RESEARCH

Moreover, as emphasized by the Coeuré report[1], massive public finance support did not increase zombification (lending to non-viable companies, i.e. in which gross operating profit was not enough to cover financial expenses over a 3-year period) beyond the usual weight of zombie companies within the economy. This reduces the risk of a massive upturn in insolvencies once public support is withdrawn.

The decline in insolvencies can also be seen in the resilience of the labour market during the pandemic. In other words, the decline in business insolvencies reduced the number of job destructions (chart 2), saving a cumulative total of nearly 170,000 jobs according to our estimates for the 2-year period 2020-2021 (or 210,000 jobs between 2016 and 2021). We obtained these results by comparing the number of job destructions linked to insolvencies that actually occurred with the number of job destructions based on a counterfactual scenario of unchanged insolvencies (using Altarès statistics on jobs threatened by insolvencies).

It is worth noting that the decline in insolvencies prior to the pandemic also helped preserve jobs (although the number was more limited), except in 2018-19. Although there were fewer insolvencies during that period, they tended to involve bigger companies, with a more negative net impact on employment.

At the same time, there has been a substantial wave of business creations in recent years (+42% in 5 years). This even applies to industry, where in 2021 there were twice as many business creations as in 2016. For the economy as a whole, in 2021, the total number of new enterprises even exceeded the symbolic threshold of one million, although this was mostly due to the self-employed business status.

In addition to the favourable economic environment, lower taxation is another factor. Companies' tax contribution consists essentially of employer social welfare contributions paid on wages, corporate taxes and production taxes. In 2016, tax contribution (net of subsidies to production) reached about 70% of the gross operating surplus (GOS). Taxation was lower in other countries (e.g. 49% in Germany or 40% in high income OECD members, according to World Bank data). The tax contribution has been significantly reduced in France, but still reaches 56% in 2021 (chart 3). Social welfare contributions were reduced by 6 percentage points in 2019 to replace the CICE tax credit, which essentially simplified taxation. The corporate tax rate was reduced from 33% to 25% according to a timetable spread out over the full 5-year term of president Macron. Lastly, production taxes were cut by EUR 10 bn as of 2021.

The improvement in profitability is another factor that contributed to the decline in business insolvencies. Between 2016 and the start of the pandemic, corporate margins' rate have improved by about 1.5pp. Fiscal support during the pandemic led to a further, temporary, increase, in Q4 2020 and H1 2021, by nearly 2 percentage points. Yet these gains were largely due to a lag between the total wage bill paid by companies (which were covered in part by the state) and production, which rebounded even before the subsidies for job retention schemes were fully withdrawn. Their withdrawal as of H2 2021 has already erased most of the observed improvement in margins, which for non-financial companies has fallen back to the pre-Covid level of 32.8% (chart 4).

1"Comité de suivi et d'évaluation des mesures de soutien financier aux entreprises confrontées à l'épidémie de covid-19" Report, July 2021

FRANCE: SAVED JOBS AS A RESULT OF LOWER BUSINESS INSOLVENCIES (ACTUAL)

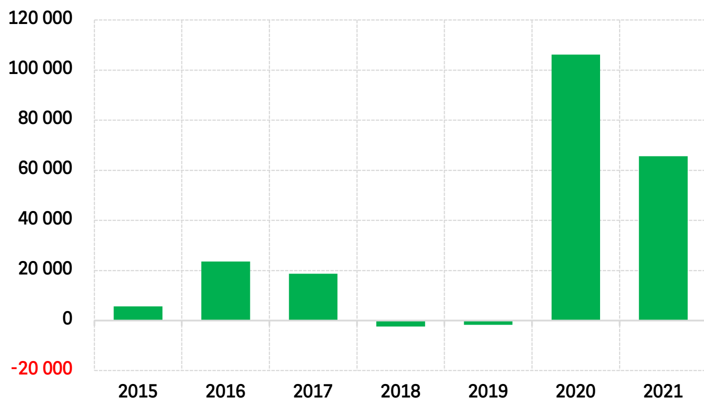

CHART 2 SOURCE: ALTARÈS, BNP PARIBAS CALCULATIONS

FRANCE: CORPORATE'S TAX CONTRIBUTIONS IN % OF THE GROSS OPERATING SURPLUS

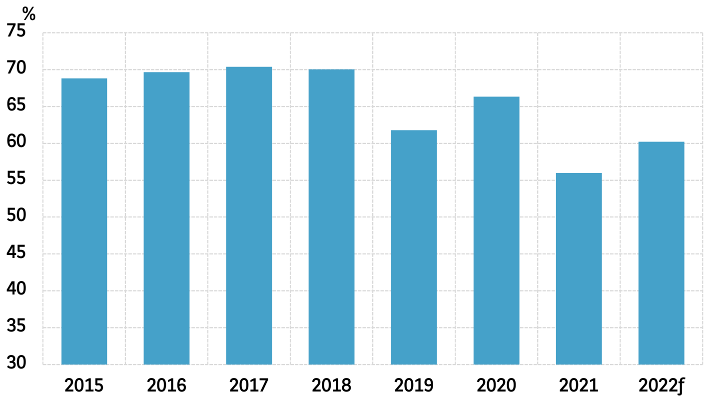

CHART 3 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

FRANCE: CORPORATE MARGIN RATE IN % OF GROSS OPERATING SURPLUS

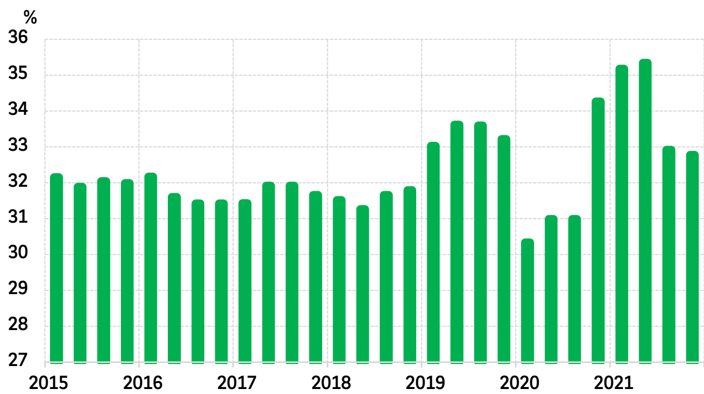

CHART 4 SOURCE: INSEE

A SLIGHT DETERIORATION IS LIKELY IN 2022

Both taxation and insolvencies should increase in 2022, and corporate margins are likely to erode.

Higher tax contribution is the most certain factor, through lower subsidies. Production subsidies were increased during the pandemic and should now be cut. These subsidies have already declined from H2 2021 but were very strong during H1 2021. As a result, their 2022 level will be lower than the 2021 total. All in all, companies' tax contribution is expected to rise from 56% of the GOS to 60% in 2022.

In 2022, corporate margins are also likely to be squeezed by an inflationary effect since higher input prices are not fully passed onto sales prices. This could erode the margins of non-financial companies by nearly 1 percentage point based on the past impact of similar increases in oil prices. The impact should be higher in transport services, the agri-food industry, accommodation and catering services and construction (chart 5), based also on past oil price shocks of the same magnitude (other things being equal).

Lastly, we should begin to see an upturn in business insolvencies in 2022 as exceptional public support is gradually withdrawn. Retail and construction, the two sectors with the highest insolvency level (43% of the total in 2021), are likely to be hit hardest. Retail companies continue to be strapped by structural cash flow problems, even though they are not as high as the long-term average. Although late payments in the construction sector are still historically low, they are nonetheless significant and concern nearly 25% of companies according to Insee data.

In the first weeks of 2022 insolvencies have already increased (+18% y/y), but they are still 40% below their 2019 level.

TRANSFORMATIONS ACROSS THE BOARD

French companies continue to operate with lower margins than their German and Italian counterparts (38.9% and 42.7% respectively in Q3 2021 versus 32.8% in France), which implies a smaller buffer for absorbing shocks.

The level of French corporate taxation of 60% of GOS in 2022 is partly explained by higher production taxes. For non-financial companies, these taxes still account for nearly 15 points of GOS. Moreover, they are treated unequally since these companies generate a little less than half of the GOS of French companies, but pay nearly two-thirds of total production taxes.

Employer social contributions account for nearly 70% of the tax contribution (social contributions + corporate tax + production taxes – production subsidies) of companies.

This tax burden is a handicap at a time when French companies seem to be lagging somewhat in their transformation. This lag can be seen in terms of the number of robots per 10,000 employees: in 2020, France had about 194, compared to 371 in Germany, 224 in Italy and 203 in Spain, according to the International Federation of Robotics. The good news is that this density increased by 17 robots per 10,000 employees in France relative to the 2019 figure, compared to 12 in Italy and Spain. Clearly, investment efforts are beginning to pay off, even though they need to be continued.

Yet these transformations are costly. Automation requires major and constant investments as some of this equipment becomes obsolete more rapidly. Rapid depreciation, which is especially characteristic of digital investments, means that the higher value of gross corporate investment is not necessarily reflected in net investment (chart 6), despite strong spending: corporate investment in digitalisation is expected to reach the symbolic threshold of EUR 100 bn in 2023 according to our estimates.

On top of any possible new tax cuts, companies benefit from public support under the France Relance stimulus plan, with provides financial incentives for investments (EUR 3.5 bn at year-end 2021 according to government figures). The France 2030 plan provides additional support, with priority on the green transition, which should benefit primarily the energy and transport sectors.

FRANCE: CORPORATE MARGIN RATE IN % OF GROSS OPERATING SURPLUS

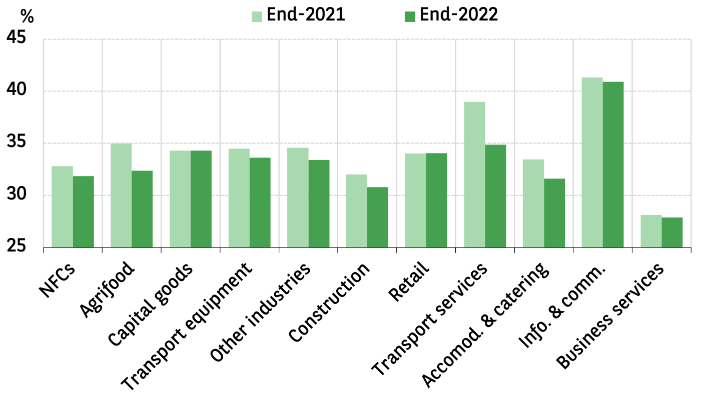

CHART 5 SOURCE: INSEE, BNP PARIBAS FORECASTS

FRANCE: CORPORATE INVESTMENT RATIO (GROSS VS. NET)

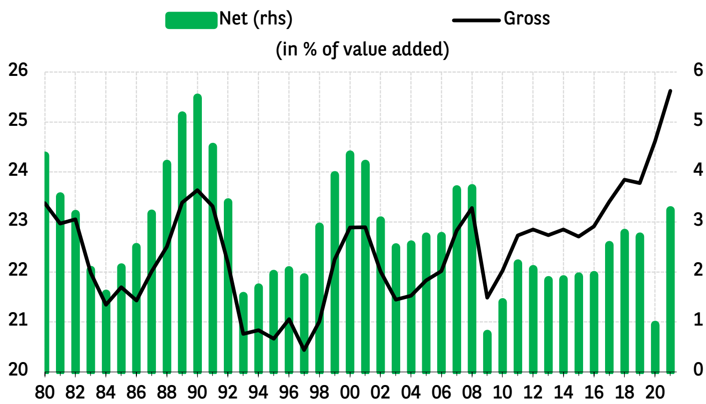

CHART 6 SOURCE: INSEE, BNP PARIBAS CALCULATIONS

Stéphane Colliac
stephane.colliac@bnpparibas.com

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com

OECD ECONOMIES AND STATISTICS

Hélène Baudchon Head - Eurozone, Germany - Climate	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Guillaume Derrien Southern Europe, Japan - International trade	+33 1 55 77 71 89	guillaume.a.derrien@bnpparibas.com
Stéphane Colliac France	+33 1 42 98 43 86	stephane.colliac@bnpparibas.com
Veary Bou, Patrick Capeillère, Tarik Rharrab Statistics		

ECONOMIC PROJECTIONS, RELATIONSHIP WITH THE FRENCH NETWORK

Jean-Luc Proutat Head - United States, United Kingdom	+33 1 58 16 73 32	jean-luc.proutat@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+33 1 40 14 30 77	thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure Head – Argentina	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Stéphane Colliac Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	stephane.colliac@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Perrine Guérin Africa (English-speaking countries)	+33 1 42 98 43 86	perrine.guerin@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com

CONTACT MEDIA

Mickaelle Fils Marie-Luce	+33 1 42 98 48 59	mickaelle.filsmarie-luce@bnpparibas.com

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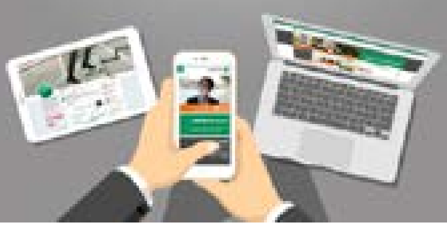

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Head office: 16 boulevard des Italiens – 75009 Paris France / Phone : +33 (0) 1.42.98.12.34
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