ARTICLE – Company bankruptcies on the rise

The number of company bankruptcies has increased and between January 2022 and September 2023, over 12,000 limited liability companies went bankrupt, which is more than the average of the last 5 years. So far, however, the rapid increase in bankruptcies has been mainly concentrated in a few sectors and most companies have had few employees. The Riksbank has analysed the companies that have gone bankrupt and the vulnerability of companies that are still active. The article shows that the companies that have gone bankrupt have been highly indebted in relation to their assets and had weak cash flows for many years. However, the size of the aggregate loans was limited and the bankruptcies have therefore had a limited impact on banks' loan losses. However, the article shows that there are still about 40,000 active companies with similar attributes. They could cause larger loan loss provisions for Swedish banks if they encounter problems.

More bankruptcies after several years of economic shocks

Since the beginning of 2022, economic conditions have been characterised by high inflation, falling growth and rising interest rates. As a result, the financial position of many companies has gradually deteriorated. The number of bankruptcies has gradually increased since the summer of 2022 and the bankruptcy rate is now higher than normal (see Chart 35).

The Riksbank has studied the majority of the over 12,000 companies that went bankrupt during the period January 2022 to September 2023 (hereafter referred to as bankrupt companies).[87] In addition, companies that are still active (hereafter referred to as remaining companies) have been studied to investigate how many could be vulnerable in the current economic environment and could cause larger loan loss provisions for Swedish banks (hereafter referred to as vulnerable companies).[88] The analysis is based on the Serrano database, which contains annual report data for Swedish-

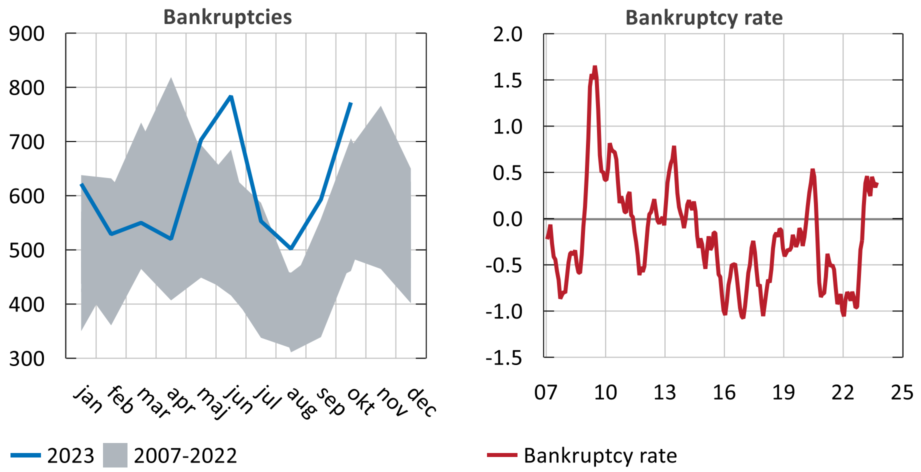
[87] The sample is based on the limited companies that went bankrupt during the period January 2022 to September 2023 according to data from Creditsafe. The analysis does not therefore cover the other 772 limited liability companies that went bankrupt in October 2023.

[88] Vulnerable companies are defined as companies with a leverage ratio above 200 per cent and an interest coverage ratio below 1.5.

registered limited companies over the period 1998 to 2021.[89] The database provides information on the financial position of companies in 2021 for 7,000 of the bankrupt companies and 545,000 remaining companies. The analysis treats all companies as independent, regardless of whether they belong to a corporate group.

Chart 35. Number of company bankruptcies has increased

Number of bankruptcies, standard deviation from the mean



Note. The chart on the left shows the number of bankruptcies per month for the years 2007 – 2023. The grey range shows the minimum and maximum number of bankruptcies in a single month. The chart on the right shows bankruptcies among limited companies in relation to the total number of registered companies. The number of registered companies in 2023 is assumed to be the same as in 2022. The bankruptcy rate refers to a 6-month moving average, normalised values. A value above zero indicates more bankruptcies than normal.

Sources: UC and Statistics Sweden.

More bankruptcies but mainly in a few sectors

During the pandemic, many companies, particularly in the trade, construction and restaurant sectors, benefited from fiscal support measures such as loan guarantees and tax forbearance.[90] The support probably helped some companies to survive somewhat longer than would otherwise have been possible and keep bankruptcies relatively low during the pandemic.[91] Today, over 24,000 companies still have outstanding

[89] Taking the limited companies that were active in 2021 as a starting point, the Riksbank has selected companies belonging to the category non-financial companies and that submitted an annual report to the Swedish Companies Registration Office for the financial year 2021. This was just over 545 000 companies. For 7,000 of the bankrupt companies, we have company-specific information from their annual reports up to and including 2021 – i.e. up to 1.5 years before the actual bankruptcy.

[90] Loan guarantees are when the state guarantees the loans of companies to a certain extent. For example, in the state's emergency loan guarantee scheme, up to 70 per cent of the loans for SMEs were guaranteed. However, the state is not the lender here. It is banks and other credit institutions that are the lenders and they also do the actual credit checks. Tax forbearance helps strengthen a company's liquidity as its tax payments are deferred. If an application is granted, the forbearance amount is subject to interest and fees.

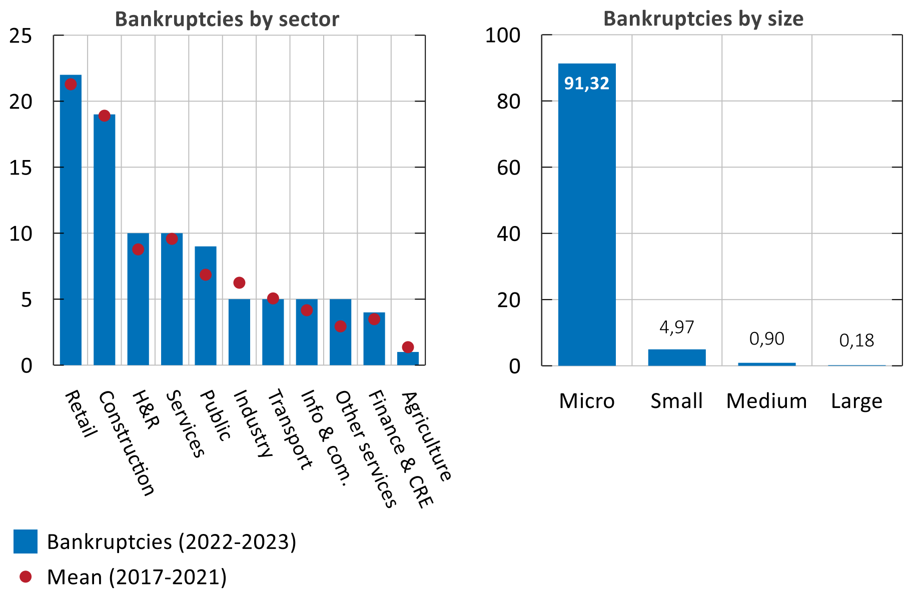
[91] See the article Bankruptcies during the initial phase of the coronavirus pandemic in *Financial Stability Report*, 2020:2, Sveriges Riksbank, and C. Cella (2020), "Bankruptcy at the time of COVID-19 - The Swedish experience", *Staff memo*, Sveriges Riksbank.

unpaid taxes.[92] This past year, as a result of high inflation and rising interest rates, companies have faced significantly higher costs and lower demand. This has worsened the profitability of some companies and thus their financial position.

Of the 12,000 companies that went bankrupt between January 2022 and September 2023, the highest share was among companies operating in the trade and construction sectors. These sectors accounted for around 20 per cent each. Next came hotels and restaurants and business services[93], all at around 10 per cent. Other service companies, in various sectors, which are not primarily aimed at other companies, together accounted for almost 10 per cent (see Chart 36). The distribution of bankruptcies by sector does not differ significantly from the historical distribution.

Chart 36. Bankruptcies by sector and size

Per cent



Note. Share of the total number of bankruptcies by sector and size class during the period January 2022 to September 2023. H&R stands for hotel and restaurants. The red circle indicates the average share over the period 2017-2021. Micro companies are defined as companies with 0-9 employees, small companies with 10-49 employees, medium-sized companies with 50-249 employees and large companies with more than 250 employees.

Sources: Creditsafe and UC.

Small companies account for the largest share of bankruptcies

The companies that have gone bankrupt during the period studied were mostly small and had few employees (see Chart 36). In our sample period, the average company

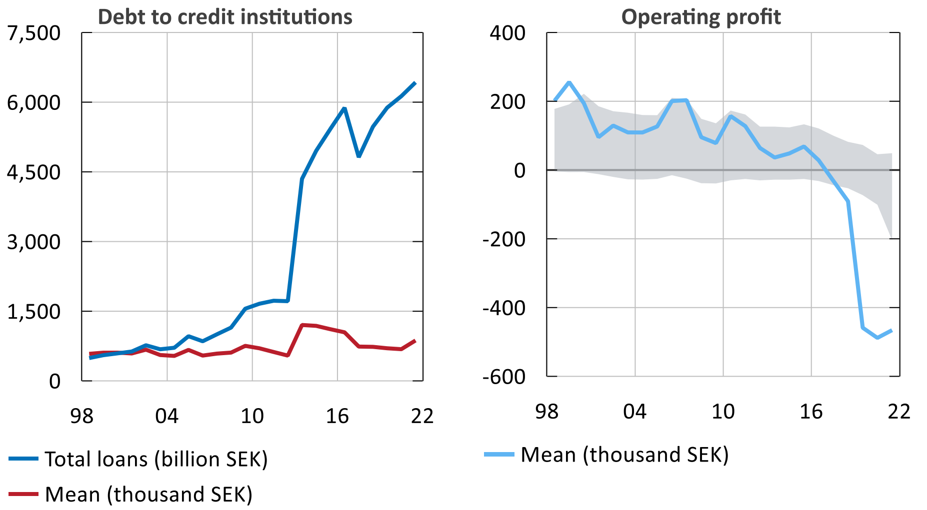
[92] See Swedish Tax Agency (2023): Anstånd med betalningar på 45 miljarder | Skatteverket [Deferred payments of SEK 45 billion] (press release).

[93] Service companies refer to companies active in the legal, economic, scientific and technical fields that primarily provide services to other companies (Swedish Standard Industrial Classification (SNI) group M).

had 4.8 million in total assets, but half of the companies had less than SEK 725,000 in total assets. Furthermore, more than 40 per cent of companies had no employees and 50 per cent of them had between 1 and 9 employees in 2021. The average company had just under 4 employees.[94] Information from the annual reports of these companies suggests that they have progressively disposed of employees before the actual bankruptcy. One reason why many companies did not have any employees may also be that they were relatively new. Around 25 per cent of companies filed their first annual report after 2018.

Chart 37. Small loans among bankrupt companies

SEK



Note. The chart on the left shows the total and average amount owed to credit institutions according to companies' annual reports in 2021. The chart on the right shows the average operating profit/loss before depreciation, interest and tax of the companies in the sample. The grey range refers to operating profit in the 25th to 75th percentile.

Sources: Dun & Bradstreet (Serrano Database) and the Riksbank.

Smaller companies tend to have little or no loans. This is illustrated by the fact that the bankrupt companies had on average just under SEK 1 million in loans from credit institutions, while the median company had no loans at all in 2021. In total, these companies had almost 6.5 billion in loans from credit institutions in 2021 (see Chart 37). The amount of loans among these companies has been too small to have a significant impact on the banks.

The companies had been financially weak for a long time

Some companies that went bankrupt during the sample period already started to deteriorate after the 2008 global financial crisis. Of the bankrupt companies, the average company has made an after-tax loss since the financial crisis. Behind these figures

[94] See Chart A.14 in the Chart Appendix.

there is a small proportion of companies that made relatively large losses. However, the fact that a company makes a loss after tax in an individual year or a few years is not necessarily a problem if their cash flow has been positive. The average company in our sample had a positive operating profit until 2016 (see Chart 37).

If a company is temporarily making a loss, it can use available cash or sell liquid assets, or raise liquidity through loans or capital injections from shareholders. Many of the bankrupt companies appear to have had this opportunity, as the average cash liquidity was above 100 per cent until 2020.[95] In addition to having loans from credit institutions, they also had other types of debt that contributed to their high indebtedness. The debt-to-equity ratio amounted to 145 per cent on average among the bankrupt companies in 2021 and the median was 260 per cent. This was significantly higher than the median debt-to-equity of the remaining companies, which amounted to 60 per cent. The debt-to-equity ratio is strongly related to the equity-to-assets ratio, i.e. the proportion of a company's assets financed by equity. The equity-to-assets ratio was significantly lower among the bankrupt companies compared to the remaining companies.

In addition, the companies that went bankrupt had difficulty paying their borrowing costs. The average interest coverage ratio was -2 for the bankrupt companies, while the remaining companies had an interest coverage ratio of 3.6 in 2021. Overall, many of the bankrupt companies appear to have been in a relatively weak position before inflation and interest rates started to rise, judging by their financial position in 2021.

Data indicate that there may be many vulnerable companies

To assess whether there are vulnerable companies that could cause banks to have higher loan loss provisions, all limited liability companies have been categorised according to their financial position in 2021. Table 3 categorises the remaining companies according to their debt-to-equity and interest coverage ratios. An interest coverage ratio below 1 means that the company is unable to pay its interest costs with the income from its current operations. An interest coverage ratio close to 1 indicates that the company may be financially strained.[96] A company is therefore considered vulnerable – be more likely to become insolvent – if it has an interest coverage ratio below 1.5 and a debt-to-equity ratio above 200 per cent.

Of the more than 545,000 remaining companies, around 116,000 had loans from at least one credit institution. In total, these companies had SEK 2,202 billion in loans from credit institutions in 2021.[97] Among the remaining companies with loans, more than 29,000 companies, or 25 per cent, were classified as vulnerable (see red field in Table 3). In total, these accounted for almost 35 per cent of the loans, corresponding

[95] The gradual increase in the debt-to-equity ratio may be a result of some companies making losses for several years and using equity to cover this.

[96] Companies with an interest coverage ratio below 1 need to use liquid funds, sell assets, take out new loans or issue new shares to pay their interest costs and avoid insolvency.

[97] This can be compared to the SEK 2,593 billion that represents the banks' total outstanding corporate lending in Sweden in December 2021 according to Statistics Sweden's financial market statistics.

to SEK 760 billion. To the group of vulnerable companies, we also add companies that had a negative interest coverage ratio but a low debt-to-equity ratio, as they could face liquidity problems if their income has not improved since 2021. This includes loans corresponding to just over SEK 355 billion, just over 16 per cent of total loans (see yellow field in Table 3).

In total, there were 38,000 companies classified as vulnerable. These accounted for just over half of the total loans from credit institutions, corresponding to just over SEK 1,120 billion. The largest share of vulnerable companies' loans belongs to companies operating in the property and services sectors. An important limitation of the analysis is that it does not take into account the fact that a large share of the companies belong to a corporate group. Of the 38,000 companies, 40 per cent belonged to a corporate group and these accounted for 90 per cent of the loans, i.e. SEK 1,024 billion in loans. The proportion of vulnerable companies may therefore be overestimated in the analysis, as other parts of the group may be in a stronger financial position and better able to pay the group's overall borrowing costs, including those of the individual subsidiary.

Table 3. Proportion of remaining companies that are vulnerable

	Low debt-to-equity			High debt-to-equity		
	ICR<0	ICR (0, 1.5)	ICR>1.5	ICR<0	ICR (0, 1.5)	ICR>1.5
Number of companies	9,081	2,111	36,529	19,255	9,758	39,119
Share of companies, per cent	*8*	*2*	*32*	*17*	*8*	*34*
Loans from credit institutions (SEK million)	355,055	59,981	252,812	450,955	312,701	770,216
Share of total loans, per cent	*16*	*3*	*11*	*20*	*14*	*35*

Note. The interest coverage ratio (ICR) is calculated as operating profit/loss in relation to financial expenses. The debt-to-equity ratio is calculated as the ratio of total adjusted liabilities to adjusted equity.

Sources: Dun & Bradstreet (Serrano Database) and the Riksbank.