ABOUT THE INSOLVENT FIRMS IN ROMANIA IN THE PERIOD 2010- 2015

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Abstract

Insolvency is that state of an enterprise's patrimony which is characterized by insufficiency of the financial funds available for the payment of outstanding debts. In Romania, the 2010- 2015 period is characterized by a very high level of insolvencies, which affected the national economy as a whole and the business environment, through financial and social losses (employment).

In our paper we present the concept of insolvency and its determinants and try to highlight the situation of insolvent companies in Romania in the period 2010- 2015, emphasizing the insolvent firm's profile. In this regard we use a descriptive methodology, using statistics of National Trade Register Office and economic studies of Coface, an expert in commercial risks.

Kez words: *firm, insolvency, economic results, interruptions*

Jel Classification: G30, G33, G34

1. Theoretical aspects about insolvency procedure

According to Law 151/2015 Insolvency of individuals, published in Official Monitor no. 464/2015, insolvency is that state of patrimony of an enterprise which is characterized by insufficient financial funds available for the payment of outstanding debts. In other words, when the debtor has no "cash" amounts with which to pay his debts, he is in insolvency.

It should be noted that a debtor in insolvency has the opportunity, if he meets certain conditions expressly provided by law, to enter into a phase of reorganization of the activity according to a plan approved by creditors and confirmed by the syndic judge. If thus the reorganized activity is profitable and allows the payment of all debts, according to the terms and conditions established in the plan, the debtor emerges from insolvency, maintains his legal personality and will continue to operate without any judicial administrator or syndic judge intervention.

If the debtor's activity does not comply with the plan, then the debtor emerges from reorganization phase and goes into bankruptcy. Now the debtor's activity is under the command of the judicial liquidator, who will start evaluating and capitalizing goods and will pay debts from the collected amounts.

After completion of sale procedure of goods, the debtor will be removed from the register where it is inscribed, so it will cease his existence.

Usually, it is considered that the procedure of "insolvency" is the same as "bankruptcy" and regarding the "reorganization", this concept is associated with insolvency / bankruptcy. However, while the three concepts (insolvency, bankruptcy and reorganization) are related to each other, they have different meanings.

a) the "insolvency" procedure is that legal procedure that opens at the request of the debtor or creditors, if a firm is in insolvency. According to the insolvency law, represents that state of patrimony of a company that is characterized by insufficiency of financial funds available for the payment of certain, liquid debts.

b) "bankruptcy" procedure means the insolvency proceedings which applies to the debtor for liquidation of his assets to cover his liabilities, followed by the deletion from the register where the debtor was enrolled.

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c) the judicial "reorganization" procedure is the insolvency procedure applicable to the debtor for paying his debt, according to the payment programme of claims. This procedure involves the preparation, approval, implementation and adherence to a plan, called reorganization plan, which may provide, jointly or separately: the operational and / or financial restructuring of the debtor; corporate restructuring by changing the structure of capital; limiting of activities through liquidation of the debtor's assets.

The insolvency procedure is an "umbrella" procedure, which includes both the reorganization and the bankruptcy procedures. Therefore, the relationship between the other two sub-procedures (bankruptcy and reorganization), on the one hand, and the insolvency procedure, on the other hand, is the one of part to whole.

2. Insolvency influence factors

Usually, companies fall into default due to the critical financial mistakes they commit. It is recommended not to pay rates in advance and not to invest in the long term if there are not short-term resources.

The most important five mistakes related to the investment and cash flows management, that determine the firms to become insolvent, are:

- inadequate working capital. Working capital is part of the company's permanent capital used to finance current activity (exploitation activity); inadequate working capital implies the conversion rhythm of expenditures into payments faster than the rhythm of revenue collection.
- "inadequate" quality of revenue, respectively an unfavorable situation of liquidities available.
- insufficient operational yield for the debts cost - refers to companies which registered an operating profit, but its level (of profit) is enough only for coverage to limit of related interest expenses for the contracted debts.
- inefficient investment - aimed at companies that have registered significant investments, but reported revenues or profits in decline.
- return on investment, lower than the financing costs related to loans contracted to support these investments.

Most enterprises in insolvency are within a state of financial difficulty, aspect that is determined taking into account the profitability, losses and level of indebtedness. Basically, in the economy we have three categories of firms:

- firms with a healthy financial structure (profit, degree of indebtedness <70%);
- firms in difficulty (have an indebtedness degree between 70% and 100%, profit or loss);
- firms in imminent insolvency (loss, level of indebtedness> 100%)

3. Situation of insolvent firms in Central and Eastern Europe

Countries in the CEE region enjoyed good economic conditions in 2015 and this determined an improved situation for the enterprises in that area, the number of insolvencies being in decline in most of analyzed states.

Within the CEE region, the dynamics of insolvencies varied; the strongest decrease was recorded by Romania, which received significant tax incentives, and the largest increase was recorded by Ukraine, which experienced another year of recession caused by the conflict with Russia.

For most countries, the level of insolvencies has not yet returned to the level before the financial and economic crisis in 2008. In the Czech Republic, there were almost 4 times more insolvencies than in 2008, in Poland, 1,8 times more, in Slovenia, 2,2 times more. At the same time, insolvent firms in Slovakia and Romania are still below the pre-crisis levels.

Regarding the insolvencies in Romania, compared to similar countries in Central and South East Europe region, our country is still recording a very high incidence reported to the number of active companies.

Last year, insolvencies in Romania dropped by an impressive 49,5%. However, a more detailed analysis indicates that the highest decrease was among non-active companies - a phenomenon which resulted in a strong fall in total insolvencies. The share of companies which had zero turnover, or did not submit financial statements last year, amounted to 59%. The breakdown also shows that a further 23% share was taken by very small companies (with turnovers of up to 100.000 euro). Nevertheless, despite a contraction in the number of bankruptcies, Romania's insolvency rate remains the one of the highest among CEE economies. There were more than 2 bankruptcies per 100 active companies in 2015.

As shown in the following table, Romania and Serbia are the only countries that registered in 2014 more than 40 insolvencies reported 1.000 active firms.

Table no. 1 Central and Eastern Europe, insolvencies 2012- 2014

Country	Total insolvencies 2014	Total insolvencies 2013	Total insolvencies 2012	Total active firms
Romania	20.120	27.924	25.842	443.616
Serbia	4.773	8.498	8.333	115.692
Hungary	17.461	13.489	22.840	595.000
Lithuania	1.636	1.517	1.400	93.017
Croaţia	2.764	3.186	3.033	253.000
Czech Republic	12.772	10.653	8.045	1.471.000
Slovenia	1.446	994	980	185.500
Estonia	523	514	495	139.000
Latvia	853	818	883	229.600
Bulgaria	644	834	601	400.000
Slovakia	522	507	452	628.569
Poland	823	883	877	1.795.000
CEE Average	64.337	69.817		6.348.994

Source: Coface, 2016, Study of insolvencies in Romania

Though the number of insolvencies newly opened in 2015 showed a reduction by 51% compared with 2014, Romania shall be among the first countries, regionally, in terms of insolvencies per 1.000 active companies. We note that during the reported period, Romanian holds the first position in the ranking of insolvencies, followed by Hungary and the Czech Republic.

4. The situation of insolvent firms in Romania during 2010- 2015

The number of insolvencies opened in 2015 is down by approximately 51% compared to previous year. However, in Romania, the incidence of insolvencies per 1.000 active companies is more than 4 times higher than the average on the regional level (Central and Eastern Europe), local average being of 45 insolvencies per 1.000 active firms.

In terms of sectoral distribution, manufacture of textiles, clothing and footwear, sewage and garbage removal, sanitation and similar activities, construction, food and beverage industry, hotels and restaurants are the sectors with the highest number of insolvencies newly opened in 2015, reported per 1.000 active firms. As regards the territorial distribution, areas in Bucharest and North-West are the first two regions where there are the highest numbers of insolvencies, while the North-East, West and South-West remain on the latest positions in this regard.

According to statistics from the National Trade Register Office, in 2015 there have opened 9.886 new insolvency proceedings, in decrease with about 51% compared to previous year, when there were opened 20.170 insolvencies.

Table no. 2 Evolution of insolvencies in the period 2010- 2015

	2010	2011	2012	2013	2014	2015
Total insolvencies	19.650	21.499	25.842	27.924	20.170	9.886
Deviation		9%	20%	8%	-28%	-51%

Source: Coface, 2016, Study of insolvencies in Romania

During 2010- 2015, we observe a "peak" of insolvencies in 2012 and from 2014 their number begins to diminish, reaching a minimum in 2015.

The significant decrease in insolvencies recorded in 2015 compared to the previous year is relevant only from the statistical point of view, the dynamics being registered on the background of a basic effect, as well as the decline in the number of insolvencies among very small firms.

4.1. Financial situation of insolvent firms in the period 2010- 2015

We present below the main financial indicators of the companies that became insolvent during the period 2010 - 2015, based on financial statements filed a year before the moment of their entrance into insolvency (for example, for companies that became insolvent in 2012 were calculated financial indicators on the basis of the declarations submitted for 2011).

Table no. 3 Financial indicators of insolvent firms in 2010- 2015

Indicator	Insolvencies 2010	Insolvencies 2011	Insolvencies 2012	Insolvencies 2013	Insolvencies 2014	Insolvencies 2015
Turnover(mil lei)	1,75	1,35	1,47	2,19	2,04	2,74
Net result	-17%	- 17%	- 15%	- 10%	-12%	-7,9%
Level of indebtness	99%	112%	64%	101%	99%	123%
Turnover/ Debts	73%	55%	59%	91%	82%	69%
Fixed assets/ Assets	45%	48%	68%	47%	43%	40%
The average duration of debt recovery	179	199	188	134	166	181
The average duration of stock rotation	79	82	63	57	72	70
Suppliers rotation/ turnover	234	242	233	177	235	235
Operating cycle	258	281	251	191	238	251
Cash conversion cycle	24	39	18	14	3	16

Source: Coface, 2016, Study of insolvencies in Romania

Therefore, there are the following:

a) firms which became insolvent in 2015 present a better overall financial situation compared to that recorded by insolvent companies in the same period of 2010 -2014. The companies that became insolvent in 2015 record:

- an average level of the turnover of 2,74 million lei, higher than the average registered by the insolvent firms in the period 2010 -2014 (1,76 million lei);

- a much lower level of loss, of only -7.9%, compared with the loss of over 10%, recorded by insolvent companies in the period 2010-2014;

- an average duration of debt collection of 181 days, approximately one month more than the average recorded by insolvent companies in the period 2010-2014;

b) average values of financial indicators for companies that became insolvent in 2015 are better than insolvencies during the period 2010- 2014.

However, the level of indebtedness of the companies that became insolvent in 2015 (123%) is much higher than that reported by insolvent firms in the same period in 2010 - 2014 (95% on average). This caused a very high service of attracted debts, which had an impact on extending payment terms to suppliers.

It should also be emphasized that in terms of insolvencies among companies, a large number belongs to those which record a turnover of more than 1 million euro.

Table no. 4 Insolvent firms related to turnover, in 2010- 2014

Category of turnover, newly opened insolvent firms	2010	2011	2012	2013	2014	2015
1-5 mil euro	468	402	383	561	476	455
5-10 mil euro	65	45	57	112	79	66
10-50 mil euro	31	33	37	67	66	51
50-100 mil euro	2	2	5	10	8	3
> 100 mil euro	3		3	7	3	2
Total insolvencies	569	482	485	757	632	577

Source: Coface, 2016, Study of insolvencies in Romania

These firms represented the creditor final creditor of propagation the commercial credit between business partners. The number of insolvencies opened in 2015 among companies with turnover exceeding 1 million euro was 577 companies, above the level recorded in the period from 2010 to 2012, although the total number of insolvencies newly opened in the analyzed period declined below half.

4.2. Situation of insolvent firms according to territorial distribution

Bucharest and North-Western areas remain the first two regions where there are the highest numbers of insolvencies compared to the areas Northeast, West and South-West, which remain on the latest positions in this regard.

Table no. 5 Insolvencies related to territorial distribution

Region	Insolvencies 2015	Insolvencies 2014	Insolvency deviation 2015/ 2014
Buharest	1.718	3.473	-51%
N-V	1.638	2.946	-44%
S-E	1.385	2.635	-47%
S	1.220	2.627	-54%
Centre	1.122	2.919	-62%
N-E	1.054	1.764	-40%
V	1.041	1.845	-44%
S-V	708	1.961	-64%
Total	9.886	20.170	-51%

Source: Coface, 2016, Study of insolvencies in Romania

We also observe the significant decrease in insolvencies in 2015 than the previous year, in the areas of Bucharest, Centre, South West and South.

4.3. The situation of interruptions in the period 2010-2014

When referring to the term "interruption", we consider the categories: suspensions, dissolutions, erasures, respectively insolvencies.

Therefore, as stated below, the report between firms that have ceased activity (all forms) and the number of those newly registered (LLC) increased from the level recorded in 2010, namely 2,29, to nearly 2,32, the level in 2014. This confirms that the dynamics of interruptions was significantly higher than new business registrations, due to a very low entrepreneurial spirit and a fiscal framework that does not present a long-term predictability and sustainability.

Table no. 6 Report registrations vs activity interruptions

Interruption category	2010	2011	2012	2013	2014
Suspensions	24.398	21.221	21.086	24.078	15.788
Dissolutions	7.508	4.001	22.500	23.208	18.336
Erasures	58.726	46.245	71.746	80.786	76.483
Insolvencies	19.650	21.499	25.842	27.924	20.216
Total interruptions	**110.282**	**102.966**	**141.174**	**155.996**	**130.823**
Total registrations	119.048	130.162	125.603	124.816	101.627
Of which LLC	48.102	62.735	61.542	60.292	56.381
OUT/ IN Report (LLC)	**2,29**	**1,64**	**2,29**	**2,59**	**2,32**

Source: Coface, 2016, Study of insolvencies in Romania

According to the latest figures published by NOTR, 127.870 of companies have ceased activity in the first 11 months of 2015, in increase with 7% compared with 2014. Although the number of newly opened insolvencies fell by half, this contraction was compensated by the advance recorded for other forms of interruption, the largest increase being among dissolved companies, namely 46%.

5. Conclusions

2010- 2015 period is characterized by a very high level of insolvencies, which affected the national economy as a whole and business environment, these effects being evaluated from different perspectives:

- capping of economic growth: according to European Commission forecasts, the potential GDP of Romania for the 2011-2015 had an average of 3%, significantly below the 5% level recorded before the financial crisis impact (due to reduced foreign direct investment and modest absorption of European funds, low productivity and negative spore in evolution of employment).
- reducing the budget deficit by increasing tax revenues fueled by additional social Contributions.
- the losses caused to creditors.

Of all creditors of insolvent firms, providers recorded the largest losses, followed by credit institutions (banks, leasing companies), and state authorities.

The fact that suppliers have recorded the biggest losses because of companies that became insolvent in the period 2010-2015 was caused by increasingly stringent conditions for bank financing starting with 2009, private companies being forced to use more the credit supplier. Risk of default was amplified during 2010 - 2013 because:

- there was a generalized phenomenon, many companies promoting the same behavior in the same period;

- the phenomenon was amplified on marketing chain, as the requests for extension of deadlines for payment / collection progressed on the chain of supplier;

- the phenomenon has created increasing interdependence among firms, more businesses indicating temporary incapacity of payment on the background of not collecting receivables from important customers;

- duration of income conversion from receipts increased, while the pressure to materialize the expenditures into payments also increased, amplifying the pressure on the firms liquidities.

In this context, large and very large firms have progressively played the role of "commercial banks" for their customers, preferring to accept extended collection deadlines. SMEs have transferred in the post-crisis period a significant share of bank credit to the commercial credit (credit supplier), this being likely to intensify relations between private companies, which began to wear a significant financial form, not only one with commercial character. Given all these structural changes in the economy, the contagion effect and propagation of adverse shocks are much faster at present.

Therefore, the main causes of increased insolvencies in the analyzed period were:

- gradual disrupting of balance sheet structure. Those companies have attracted additional financial resources (indebtedness degree increased from 98% in 2010 to 123% in 2014), which were directed to the long-term investment;

- the latter did not generate additional revenue or an increase in productivity by improving operational edge. On the contrary, average income decreased by almost 5,3% in 2014, dynamics that was not coupled with a corresponding adjustment of expenditures, the consolidated level of losses increasing to 7,9%;

- in this context, coverage degree of debts through operating income decreased from 117% (level in 2010) to 69% (level in 2014);

- companies that became insolvent in 2015 have recorded a doubling of the average debt collection period from 2010 to 2014, the average duration of debt recovery increasing gradually from 118 days (in 2010) to 181 days (2014);

- despite this, the average payment to suppliers almost tripled in the same analyzed period, increasing from 89 days (2010) to 235 days (2014);

- conversion cycle of cash (calculated by cumulative level of stock rotation and receivables minus the average duration of payment of suppliers) decreased significantly in 2014, which means that the main source of financing the long-term investments was represented by debt increase on short term.

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