Indebtedness and deleveraging of non-financial corporations

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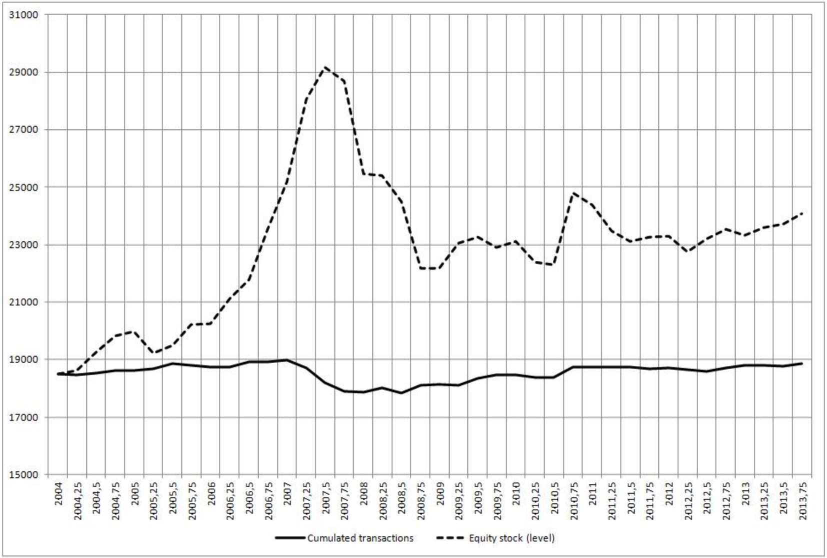
Equity in nonfinancial corporations

- Question: How much funds and in which form (debt, equity) flow to firms?
  - Evidence from the flow-of-funds; focus on equity
  - To remove valuation effects (not an in- or outflow of funds), use accumulated flows
  - Focus on nonfinancial corporations (NFC)
  - Use statistics on a consolidated basis, i.e., remove inter-firm equity holdings
- $\Rightarrow$ During the boom, equity **in**creased if one looks at the raw series, but the actual inflow of equity to nonfinancial firms **de**creased
- Recent improvement is gradual

Equity in NFC - Flow of funds



Measures of indebtedness

- Issue: Investigate the evolution of indebtedness of NFCs over time
- Results presented are for manufacturing (but similar for other sectors)
- Focus on two ratios (robust to alternatives):
  1. Debt ratio

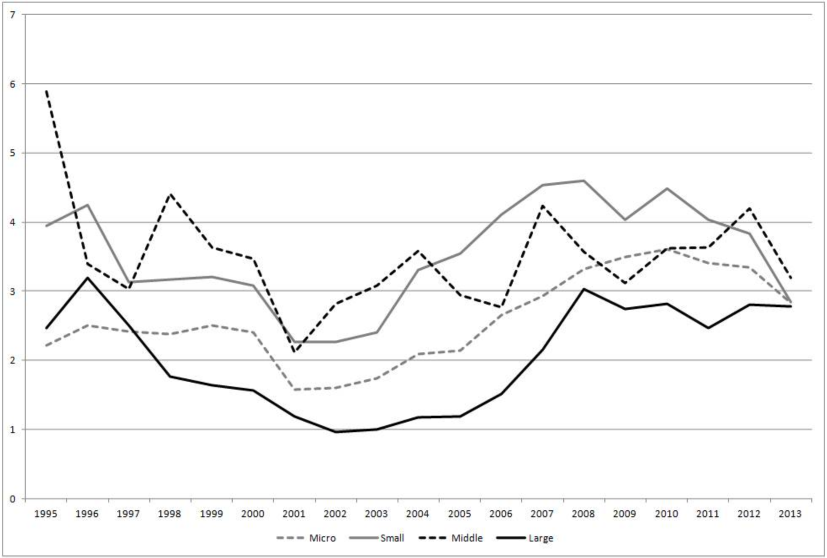
$$\textit{Financial debt to equity} = \frac{\textit{Financial liabilities}}{\textit{Equity}}$$

  2. Years to repay debt (here EBITDA includes write-offs)

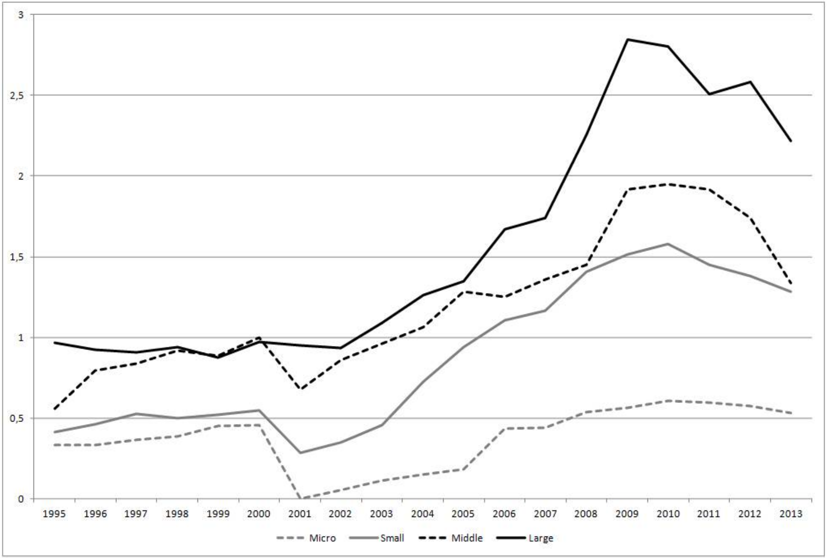
$$\textit{Years to repay} = \frac{\textit{Financial liabilities}}{\textit{EBITDA}}$$

Debt ratio: median

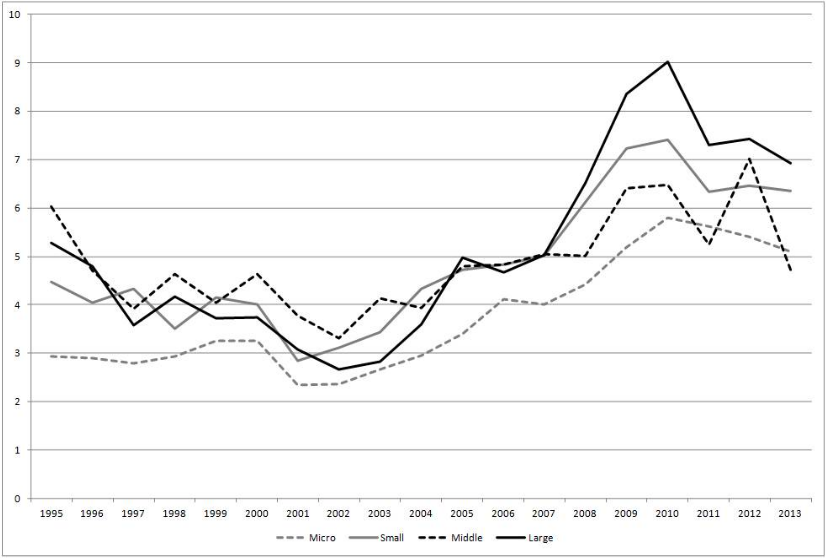
Debt ratio: interquantile range (p10 - p90)



Years to repay: median



Years to repay: interquantile range (p10 - p90)

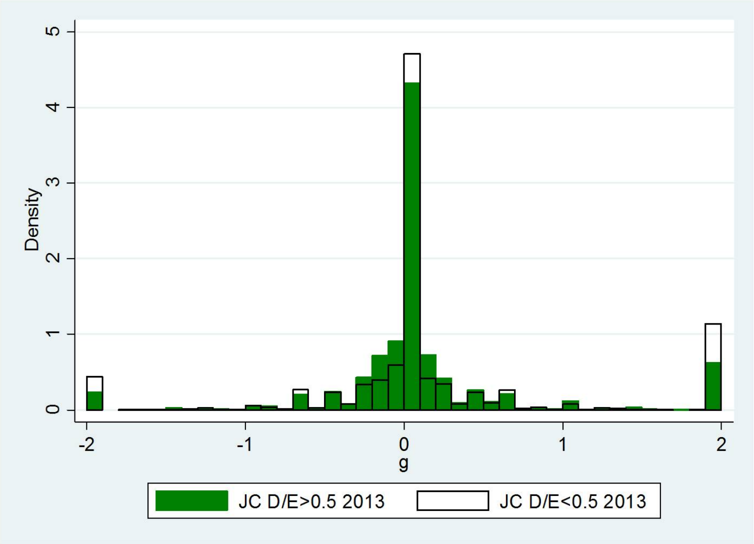


Indebtedness

- With an increase in debt (decrease in liquidity), dispersion across firms has also increased
- The above findings are similar across most industries
- There is deleveraging (reasons: true deleveraging, but also exits)
- Supported by the flow of funds accounts: Firms are net savers for almost 2 years

- What are the implications for growth?
- Some prima-facie (but weak) evidence that less indebted firms tend to create more (destroy less) jobs (but careful with interpretations!)

Implications for growth - a teaser



Way forward

How to proceed with deleveraging?

1. Identify viable businesses
   - If viable, agree od debt restructuring; do it **quickly**
   - If not viable, terminate or restructure the business (not debt); do it **quickly**, recognise losses
   - Should be the job of (commercial) bankers, ideally in cooperation with owners
2. Some options
   - Write-off debt (partially), restructure (interest, maturity), swap debt to equity, leave it to occur naturally
3. Be careful to consider...
   - Incentives and potential time inconsistency of incentives
   - Choose the option for deleveraging based on what went wrong with the firm
   - Be careful to keep profitable business lines as a core