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Jonathan Steenberg, Economist for Ireland, the Nordics and the United Kingdom, based in London, UK

United Kingdom: Corporate insolvencies are going from zero to a hundred after end of government support measures

EXECUTIVE SUMMARY

In 2022, around 23,400 companies went bankrupt in the United Kingdom, causing corporate insolvencies to reach its highest levels since the 2009 Global Financial Crisis "GFC". This rapid rise in insolvencies came after two years of a noticeably low level of insolvencies, thanks to active government support measures after the COVID-19 pandemic ("pandemic"). The government support measures and temporary changes in insolvency proceedings completely turned previous dynamics of economic activity and insolvencies upside down, and the subsequent dramatic increase in insolvencies in 2022 have made headlines in domestic and international news.

The current corporate insolvency situation in the United Kingdom is, however, more complex than these headlines. It is true that corporate insolvencies rose from their pandemic lows to the highest level in a decade – 26% higher than in 2019. However, this increase was centralised around smaller companies and has mainly been driven by a specific type of insolvency proceeding : creditor's voluntary liquidations.

In absolute numbers, corporate insolvencies were high in 2022, yet comparing this to the number of active companies in the United Kingdom, the relative number of companies that went insolvent in 2022 was still low compared with past decades. Moreover, companies that went insolvent in 2022 were still predominantly micro companies whereas insolvencies in larger companies were still below their 2019 level.

Yet, indications from the first quarter of 2023 are so far showing that it might be the first full year in which insolvencies will behave more conventionally. Early signs from actual insolvencies and winding up petitions (WUPs) filed in Q1 2023, point towards at the very least a first half-year with insolvencies continuing to rise. However, unlike 2022, this will not be as heavily concentrated around micro- and small companies, which means that these bankruptcies will have a larger effect on jobs lost as well as liabilities affected.

Overall, this year will be a difficult one for companies that have to act in a world with still elevated cost lower demand, high interest rates and tightening credit standards from their banks, especially after the turmoil seen in the banking sector in March 2023, following the collapse of Silicon Valley Bank.

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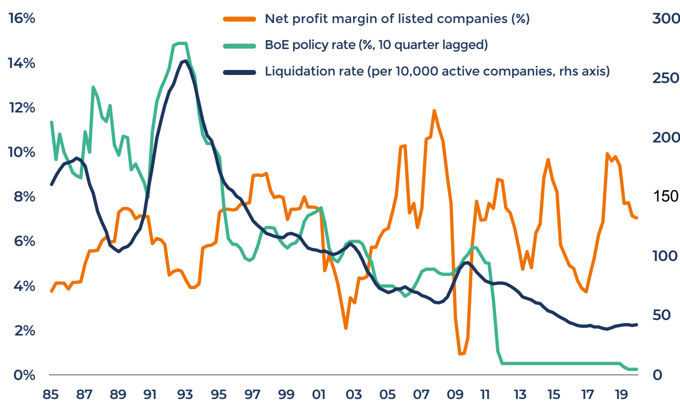
Before 2020: a pre-pandemic world with low insolvencies

In the years leading up to the pandemic, corporate insolvencies had generally been relatively stable with around 16,500 companies going insolvent a year between 2015-19, rising by 4% annually after essentially six years of decline, notwithstanding a small uptick in 2011 during the European Debt Crisis. However, much of the increase between 2015 and 2019 actually stems from an increase in active companies in the United Kingdom. When looking at the liquidation rate – corporate insolvencies per 10,000 active companies – it actually receded further in these years, from 47 to 42 insolvencies per 10,000 active companies. When looking at the relative relationship between corporate insolvencies and active companies in the United Kingdom, it generally supports that corporate insolvencies were relatively low in 2019. They had fallen from a rate of around 250 insolvencies per 10,000 active companies in 1992-93, after the recession in the early 1990s – which came after a period of high inflation and rising interest rates – to around 40 per 10,000 active companies **(Chart 1)**. The relative number of companies going insolvent decreased by a factor of five over 25 years.

This dramatic fall in the liquidation rate is partly due to a better macroeconomic situation in the pre-pandemic period compared with 1992-93 as well as some stronger fundamentals – net profit margins of listed companies were around 4.3% in 1992-93 compared to 7.6% in 2017-19. Additionally, some of the fall in corporate insolvencies comes down to changes in legislation, such as making alternative solutions, like restructuring, easier. This includes the Company Voluntary Arrangement (Insolvency Act 1986) or the Scheme of Arrangement (Companies Act 2006).
However, a large part of the fall in the liquidation rate is due to falling interest rates over the past thirty years. Bank of England's key policy rate peaked at 15% in the early 1990s, a far cry from the low interest rates that companies found themselves in after the GFC, when the average rate of the Bank of England was around 0.5%. Given that a company goes insolvent if it is not able to pay its debt obligations, it is not surprising that higher interest rates, result in more insolvencies.

Chart 1 - Liquidation rate, policy rate and corporate profitability

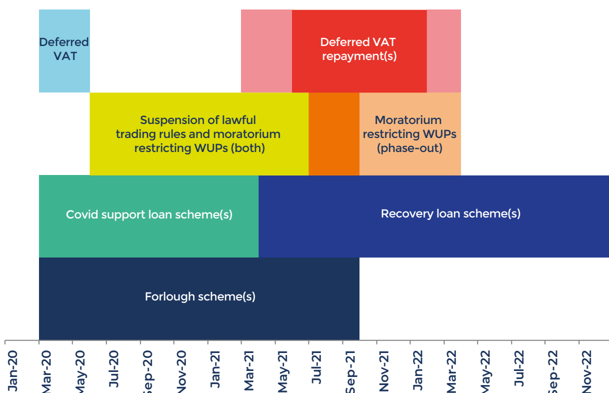


Sources: BoE, Datastream, Insolvency Service, Coface

2020 to 2021: the Government Support Era

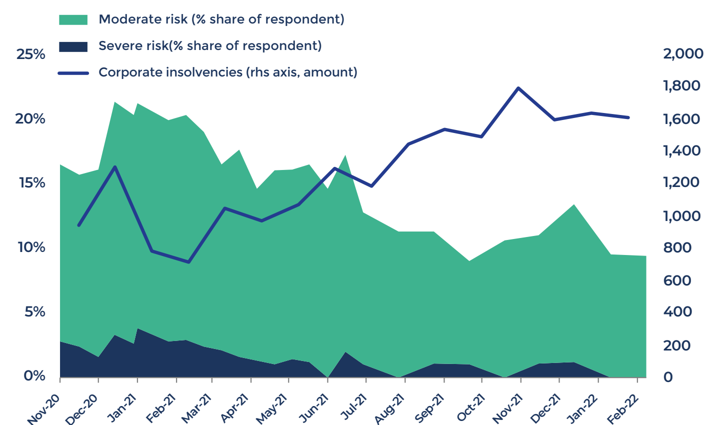
With the onslaught of the pandemic, the previous framework around insolvency proceedings had to be rethought to ensure that a wave of companies would not go insolvent as lockdown measures were introduced across the United Kingdom. In this way, 2020 was a transformative year with the many government measures to support companies during lockdowns completely altering the normal insolvency dynamics. These schemes **(Chart 2)**, such as the furlough schemes, Covid support loans, as well as a suspension of *lawful trading rules*[1] and a moratorium restricting winding up petitions, meant that the number of corporate insolvencies actually fell dramatically in 2020 (-28%) and remained historically low for the first half of 2021 as well.
This fall in insolvencies in 2020 goes completely against the normal dynamics in which a fall in business activity, such as the one seen during 2020, would lead to a rapid and substantial rise in corporate insolvencies. The divergence can be seen when looking at the disconnect between how many companies believe they are in risk of insolvency against the actual figures. The Business Insights and Conditions Survey (BICS) found that the share of companies that stated they were in high or moderate risk of insolvency fell from around 20% in early 2021 **(Chart 3)**, when insolvencies were historically low, to around 9% in February 2022, when insolvencies had conversely more than doubled compared with the previous year.

Chart 2 - Overview and timeline of government support measures



Note: Covid support loan schemes include Coronavirus Business Interruption Loan Scheme (CBILS), Coronavirus Larger Business Interruption Loan Scheme (CLBILS), and Bounce Back Loans Scheme (BBLS)
Sources: Gov.uk, Coface

Chart 3 - Corporate insolvencies and share of companies indicating they are in moderate to severe risk of insolvency



Sources: BICS, Insolvency Service, Coface

1 - According to the legislation on *wrongful trading*, any director who concludes "that there is no reasonable prospect of the company avoiding an insolvent liquidation" must initiate an insolvency proceeding, failing which he will be held personally liable

As these schemes were phased-out and support loans, including deferred VAT, had to be repaid along with the end of the moratoriums, corporate insolvencies started to behave more typically.

After the end of the suspension of *lawful trading rules* in July 2021, the number of creditors' voluntary liquidations (CVLs) started rising quickly with the monthly number of insolvencies being 17% higher three months later and more than 50% higher ten months after **(Chart 4)**. It can be noted that CVLs had already started to increase after the end of Covid support loans – CVLs were already almost 30% higher in June 2021 than in March 2021, the last month of support loans – with some evidence that many companies that used one of such loans decided to close operations after the loans ended[2].

Compulsory liquidations saw an even more significant rise in the number of insolvencies after the final end of the moratorium restricting winding up petitions in February 2022[3]. This immediate uptick was clear as insolvencies generally were around 50% more frequent in the immediate months after and were almost 3 times higher after six months.

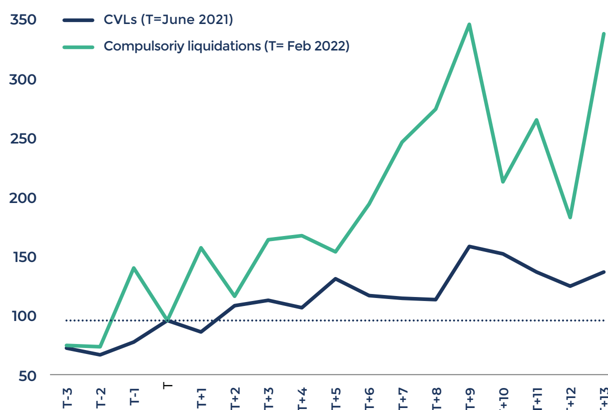
The different paces at which government support measures were phased-out had a direct impact on the composition of how companies go insolvent, as well as which companies ended up going bankrupt. Before the pandemic, around two-thirds (67%) of companies went insolvent using CVLs, but due to the changes in legislation and different speeds of phase-outs, the share of companies using CVLs rose to 89% in 2021 and 84% in 2022 **(Chart 5)**.

Corporate insolvencies rose by 11% in 2021 and a further 57% in 2022, meaning they surpassed the pre-pandemic level (2019) by 26%, the highest since 2009. The rise in insolvencies during the latter half of 2021 and 2022 was driven by CVLs, which are more common among small- and micro companies. While micro companies made up 73% of insolvencies in 2019, this share rose to 81% in 2022. When excluding micro companies, corporate insolvencies actually remained 9% lower in 2022 relative to 2019. Thus, while the number of companies going insolvent rose, the consequences of it, such as jobs lost or liabilities affected, were more limited.

2023 and onwards: a well-known but dire landscape

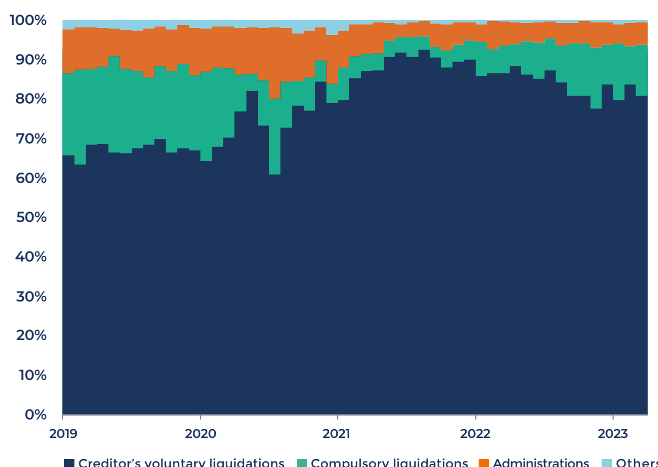
As British companies now find themselves in a post support measures world where corporate insolvencies are once again determined by companies' liquidity, profitability and their ability to meet financial obligations, the situation is familiar but not necessarily easy.
Many companies accumulated significant debt during the lockdowns and this debt will have to be repaid or rolled over during the next few years. This heightened interest burden happens at the same time as running costs are elevated with energy and other commodity prices as well as wages running high. On top of that, consumers are strapped for cash with their real disposable income falling for a second consecutive year in 2023, and they will have to cut down on their spending, thereby changing their habits towards buying essential goods and services.
On top of this difficult environment to act in for companies, another important factor that has changed compared to before the pandemic is the low interest rate environment, which helped many companies to thrive and some to simply to survive since the Great Financial Crisis. To put the difference into perspective, floating interest rate to private non-financial corporations have gone from averagely 3.1% in 2019 to 6.0% in the first quarter of 2023 , almost doubling **(Chart 6)**. With current expectations for Bank of England's policy rate – in which maintaining the rate until the end of the year is a probable scenario – this will worsen somewhat for the remainder of the year.

Chart 4 - Change in corporate insolvencies after end of support measures and moratoriums



Sources: Insolvency Service, Coface

Chart 5 - Share of corporate insolvencies by type



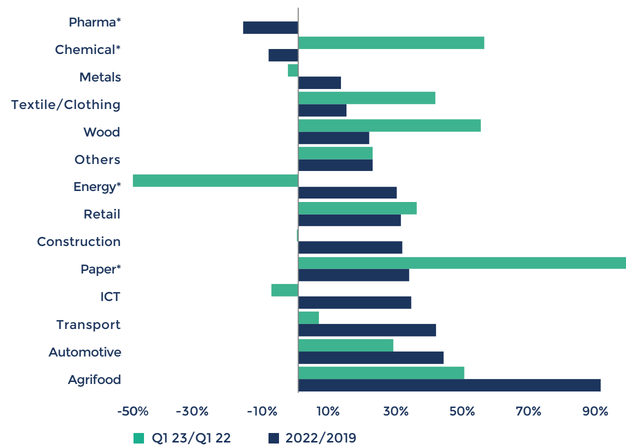
Sources: Insolvency Service, Coface

Chart 6 - Lending rate to non-financial corporations and liquidation

Sources: BoE, Insolvency Service, Coface

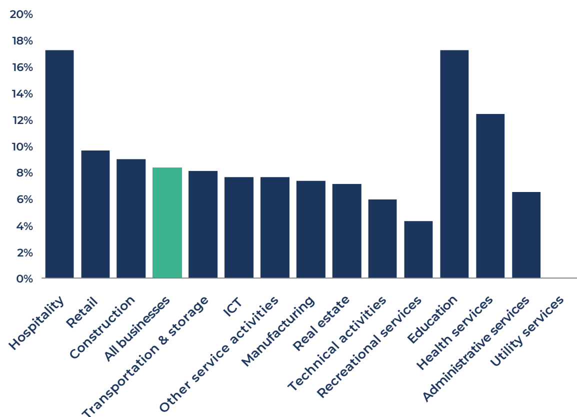
2 - A study be Synetics Solutions, 2021, estimated that around 10% of Bounce Back Loans could be fraudulent and Bank Underground, 2023, show that 60% of insolvencies from May 2020 to March 2022 were firms that had taken a Bounce Back Loan.
3 - There was a phase-out period in which the required amount owed to present a winding up petitions was temporary increased from GBP 750 to GBP 10,000 that already resulted in insolvencies doubling from September 2021 to February 2022

Chart 7 - Change in corporate insolvencies by sector



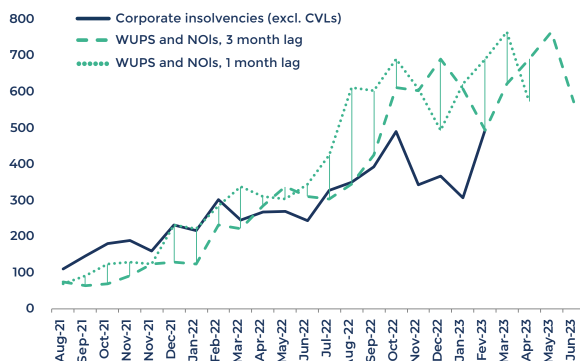
Note: An asterisk (*) indicate less than 125 insolvencies in 2022.
Source: Insolvency Service, Coface

Chart 8 - Share of companies indicating they are in moderate to severe risk of insolvency in January-April 2023



Sources: BICS, Coface

Chart 9 - Corporate insolvencies, winding up petitions (WUPs) and notice of intentions (NOIs)



Source: Insolvency Service, Coface Business Information

The current and immediate outlook for the interest rate environment has only deteriorated since the collapse of Silicon Valley Bank in March 2023. Banks were already tightening credit standards for corporates before the collapse and are now only expected to tighten further over the coming months. This tightening will mean higher spreads for corporate loans, especially for SMEs and medium sized companies, on top of the high policy rate. This could potentially start a spiral in which rising insolvencies cause restrictive bank lending, which in turn hurts companies' viability, thereby resulting in further insolvencies.

Some sectors have been and are more exposed to the current trends than others, with insolvencies in sectors, such as pharmaceuticals and chemicals[4], still being around their 2019 levels in 2022. A sector that has had a particularly difficult time since the invasion of Ukraine has been the agri-food sector, hurt by rising costs and unstable supply chains. Almost 300 companies went insolvent in 2022, an 83% rise from 2019 **(Chart 7)**, with the first quarter of 2023 pointing towards a continuing trend: insolvencies grew by 50% in Q1 2023 compared with Q1 2022.. Heavier industries, such as automotive, transport, energy and construction, have equally seen large increases in corporate insolvencies, with construction being the sector in which most companies went insolvent in 2022 – around 5200 companies, a 34% increase from 2019.

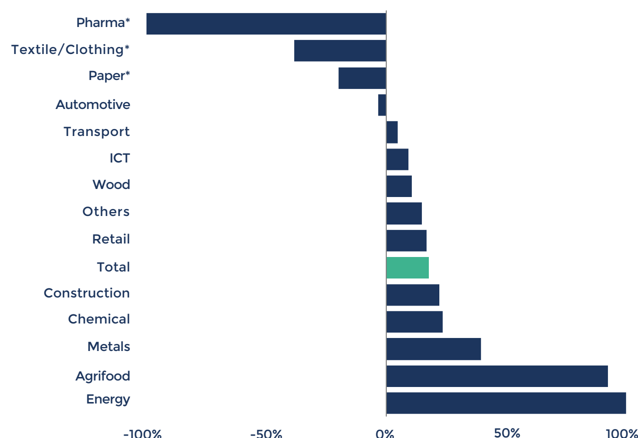
When looking at the coming months, companies in sectors such as hospitality, retail and construction indicate that they are in moderate to severe risk of insolvency more frequently than the average. On average, 8.4% of respondents were in moderate to severe risk of insolvency according to the four BICS surveys in 2023 **(Chart 8)**. Almost one-fifth of companies in hospitality indicate this risk, being highly vulnerable to wage and energy price rises as well as changing consumer habits, while around one in ten companies in retail and construction believe they are in moderate to severe risk of insolvency.

Winding up petitions filed and notice of intentions made are the clearest indicators of corporate insolvencies (excl. CVLs) in the coming months as it usually takes around one to three months to liquidate a company from when a winding up petition is filed. It can take longer, up to years, depending on the size and complexity of the company and its creditors. Using the range of lagged petitions as an indicator of where corporate insolvencies (excl. CVLs) will be in the coming months along with the current trend for CVLs, these together indicate that corporate insolvencies in the first half of 2023 will be between 15-22% higher than the same period in 2022 **(Chart 9)**.

Looking at winding up petitions filed and notice of intentions made at a sector level **(Chart 10 - see next page)**, it signals further increases in insolvencies across most sectors. Here, heavier industries such as metals, chemicals and construction – that were already recording a rise in the first quarter of 2023 – will likely see more companies go insolvent. They are operating in a landscape of falling demand, while their costs remain elevated due to the fact that they are energy intensive sectors. This is one of several reasons as to why Coface places these sectors in '**High risk**' and '**Very high risk**' in the United Kingdom[5] **(Chart 11 - see next page)**.

4 - These are both sectors that generally do not see many insolvencies; 112 companies went insolvent in Chemicals and 6 in Pharmaceuticals in 2019. There are also fewer active companies compared to other sectors.
5 - Coface Barometer: From excessive pessimism to excessive optimism? 6 February 2023. *https://www.coface.com/News-Publications/Publications/From-excessive-pessimism-to-excessive-optimism-Coface-Barometer-Q4-2022*

Chart 10 - Change in winding up petitions and notice of intentions for February-April 2023 compared to previous three months



Note: An asterisk (*) indicate less than 10 fillings. Source: Coface Business Information

Chart 11 - United Kingdom Sector Risk Assessments

	United Kingdom
Agrifood	● (orange)
Automotive	● (dark brown)
Chemical	● (orange)
Construction	● (dark brown)
Energy	● (orange)
ITC*	● (yellow)
Metals	● (orange)
Paper	● (orange)
Pharmaceuticals	● (yellow)
Retail	● (orange)
Textile-Clothing	● (dark brown)
Transport	● (dark brown)
Wood	● (orange)

* Information and Communication Technoligoes
Source: Coface

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COFACE SA
1, place Coste et Bellonte
92270 Bois-Colombes
France

www.coface.com

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