FSA Working Group
eccbso
European Committee of Central Balance Sheet Data Offices

BRIEF NOTE ON TRANSITIONS ACROSS VULNERABILITY CATEGORIES BASED ON THE INTEREST COVERAGE RATIO OF NON-FINANCIAL CORPORATIONS IN EUROPEAN COUNTRIES

The purpose of this analysis is understanding how non-financial corporations' financial pressure, in terms of interest coverage ratio (ICR), evolved from the pre-covid period throughout the pandemics. Specifically, this brief note focuses on whether firms classified as weak (according to their ICR) remained weak the following year or became resilient, as well as on the transitions for firms classified as vulnerable, and on the extent to which resilient firms succeeded in staying in such category through the Covid crisis.

The main findings are:

- The transition matrices across ICR categories between 2020 and 2021 reveal, on average across for the five countries in our sample (Spain, France, Italy, Poland, and Portugal), a decrease of the percentage of non-financial companies that remained weak, with respect to the pre-covid period (2000-2018). Indeed, only 35% of firms classified as weak in 2020 were still so in 2021. While this finding holds true in each country, that percentage had temporarily risen in several ones (France, Italy, and Spain) between 2019 and 2020.

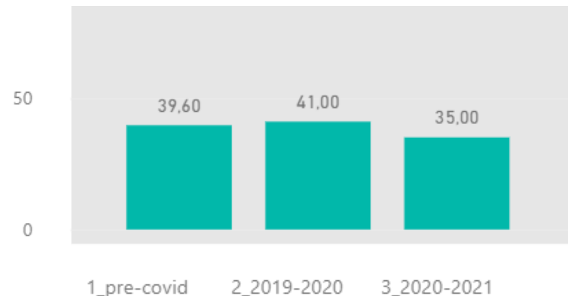

Figure 1 *- Weak firms (ICR < 1) that remained weak the following year (in %).*

- On average, the percentage of weak firms that became resilient increased from 25.8% in 2019-2020 to 38% in 2020-2021. This increase was observed across all countries, but more pronounced in Italy and Portugal (around 20 percentage points).

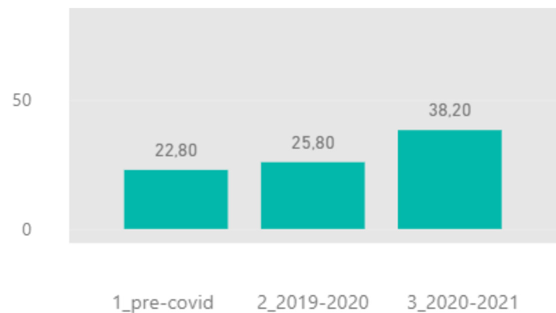

Figure 2 *- Weak firms (ICR < 1) that became resilient the following year (in %)*

- Similarly, the percentage of vulnerable firms that became resilient increased on average from 38.6% in 2019-2020 to 53.4% in 2020-2021.

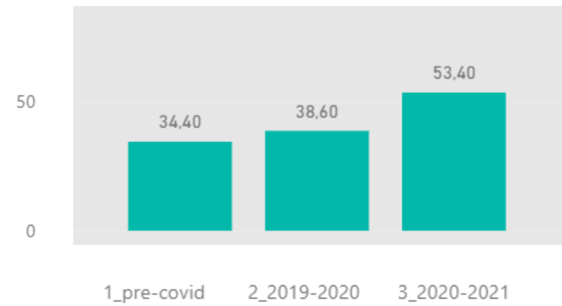

Figure 3 *- Vulnerable firms (1 <=ICR < 2 that became resilient the following year (in %)*

- Furthermore, the proportion of vulnerable firms transitioning to a weak state increased on average from 18.6% in pre-covid period (2000-2018) to 24.2% in 2019-2020 and decreased to 14.6% in 2020-2021. Among the countries analyzed, Spain exhibited the lowest percentage of firms moving from vulnerability to weakness.

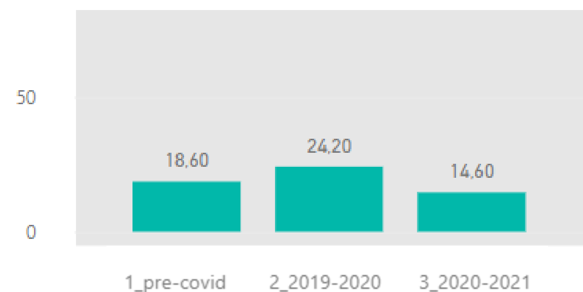

Figure 5 *- Vulnerable firms (1 <=ICR < 2) that became weak the following year (in %)*

- Moreover, the percentage of resilient firms that sustained their resilience declined on average from 72.2% in pre-covid period (2000-2018) to 69.8% in 2019-2020 and increased to 78.0% in 2020-2021. Among the countries analyzed, Spain had the lowest proportion of firms maintaining their resilience.

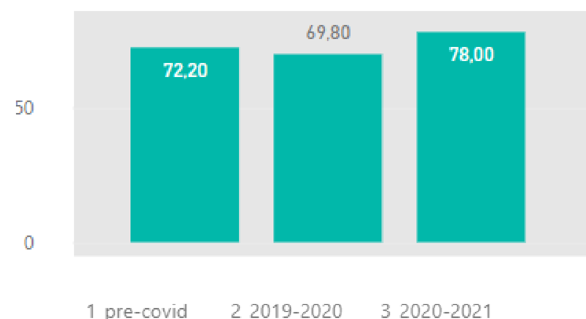

Figure 4 *- Resilient firms (ICR >= 2) that remained resilient the following year (in %)*

Appendix

Countries: Spain, France, Italy, Poland, and Portugal

Time periods: 1_pre-covid (average over 2000-2018), 2_2019_2020 (2019-20), 3_2020_2021 (2020-21)

Variable: Interest coverage ratio (ICR). The ICR is calculated according to the formula presented in Table 1 (based on BACH database items definitions).

Table 1 – Composition of Interest coverage ratio

Interest coverage ratio (ICR)	
Numerator	$EBITDA = I_1 + I_2 + I_3 + I_{41} + -I_5 - I_6 - I_7 - I_{81}$
Denominator	I_{10}
ICR (%)	$\frac{EBITDA}{I_{10}}$

Legend:

I₁

I_1: *Net turnover*

I_2: *Variation in stocks of finished goods and work in progress*

I_3: *Capitalised production*

I_{41}: *Operating subsidies and supplementary operating income*

I_5: *Cost of goods sold, materials and consumables*

I_6: *External supplies and services*

I_7: *Staff costs*

I_{81}: *Operating taxes and other operating charges*

I_{10}: *Interests on financial debts*

ICR classification:

i) Weak firms have ICR < 1
ii) Vulnerable firms have 1 <= ICR < 2
iii) Resilient firms have ICR >= 2

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Disclaimer: The views expressed in this brief note are those of authors and do not necessarily represent those of the ECCBSO or those of the national central banks. The financial cost indicator was computed using a harmonized definition. However, it is important to note that this indicator still reflects national charts of accounts, which might not be entirely harmonized across countries. Essentially, while the definition is consistent, the underlying accounting practices may vary.