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Businesses in Greece: finally, a fresh start?

With Greece about to pull out of its third bailout package, signs of economic recovery are multiplying: 2017 was a year marked by the return of positive growth (+1.4%), and –despite weakening growth in the eurozone– Greek GDP growth is expected to be close to 2% in 2018, with Greek households and businesses remaining more optimistic in the first half of the year than in 2017. The recent improvement in the economic momentum is far from removing the stigmata of the crisis: from 2008 to 2015, GDP and investment fell respectively by 25% and 60%, the unemployment rate reached 28%, and business turnover collapsed by a third. Wages and property prices halved. Greek banks – despite their recapitalization in 2015 – are still recording high rates of non-performing loans. The International Monetary Fund (IMF) and the European Commission estimate that it will take 10 years before the economy returns to its pre-crisis level. However, reforms undertaken since 2008 have led to a consolidation of the public accounts, which have posted primary surpluses since 2016. The fiscal and current account imbalances that underpinned the crisis have been partly addressed through significant fiscal adjustments and a severe internal devaluation. Fiscal credibility has been reinforced, allowing the country to make its return to international markets and to lift part of the capital controls. Companies have become more competitive and have reduced their debts. They are now more export-oriented, which has helped new sectors to develop, allowing the productive fabric to evolve. Further confirming these funding changes is the fact that the uncertainties currently hanging over Greek companies are more related to the external environment (slowing growth in the rest of the euro area, multiple political risks) than the domestic one – a first since 2008.

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The aftermath of the crisis remains visible

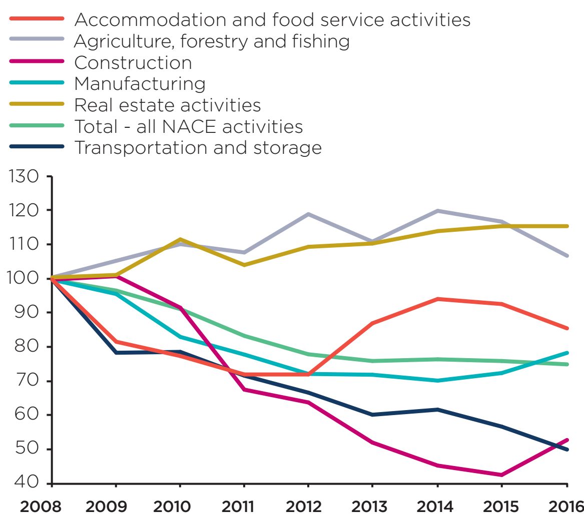
The Greek crisis[1] was characterised by three distinct but related shocks: a sovereign debt crisis, a banking crisis, and a "sudden stop" (capital flight)[2].

As a result, between 2008 and 2016, Greece lost 25% of its GDP and investment contracted by 60%. The sectors exposed to the domestic market were the most severely impacted: between 2008 and 2016, trade, transport, accommodation and catering, construction, ICT[3], and the extractive industries saw their value added fall by more than 40%. The production of low value-added goods, such as furniture, textiles and paper and cardboard, was the hardest-hit, with a fall of over 70%. The automotive and shipbuilding industries also experienced heavy losses (-55%) (**Chart 1**).

It is no surprise that firms paid a heavy price during the crisis: between 2008 and 2016, the value added of non-financial firms fell by 30%, their profit rate by 37%, and their investment rate by 49% (**Charts 2 & 3**). Microenterprises and Small- and Medium-sized Enterprises (SMEs), which employ over 60% of the labour force, have been the most vulnerable to the supply shortages and financing difficulties. According to the National Bank[4] of Greece, about 250,000 SMEs declared bankruptcy between 2008 and 2016, resulting in a loss of production of nearly 25 billion euros (EUR), while the sales of those that survived fell by 30%. Companies with more than 250 employees were more resilient to the crisis. The turnover of listed companies fell by "only" 20% over the same period. But this resilience came at a cost: their net margin was divided by four.

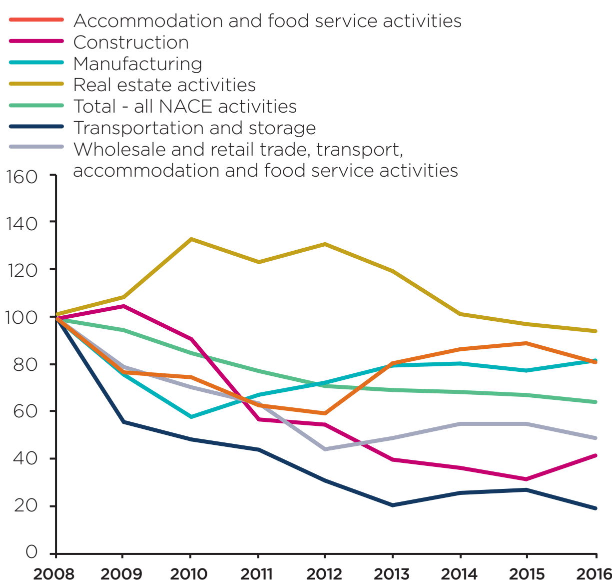
Although Greek companies have a low level of indebtedness (their debt ratio was only 50% of GDP in 2009 and has declined since), their ability to service their debt has remained limited. As a matter of fact, Greek companies are far from having recovered their pre-crisis turnover (see **Chart 3**) and are still facing liquidity shortages, which increase their default risk. This poses a continuing risk to the banking system. In March 2018, the gross value of non-performing loans totalled EUR 98 billion, equivalent to 45% of total loans. Greece's share of non-performing exposures (NPEs) – which, in addition to loans and advances, includes debt securities other than held-for-trading – stood at 41%, while NPE were down to 11% in Portugal, 9% in Italy and 7% in Ireland. Non-performing loans continue to weigh on banks' profitability and creditworthiness, despite their recapitalization in 2015. Combined with weak deposit growth, which constrains their liquidity, their exposure to non-performing loans limits their ability to finance the economy (**Chart 4**).

CHART 1
Gross Value added, by sector (2008=100)



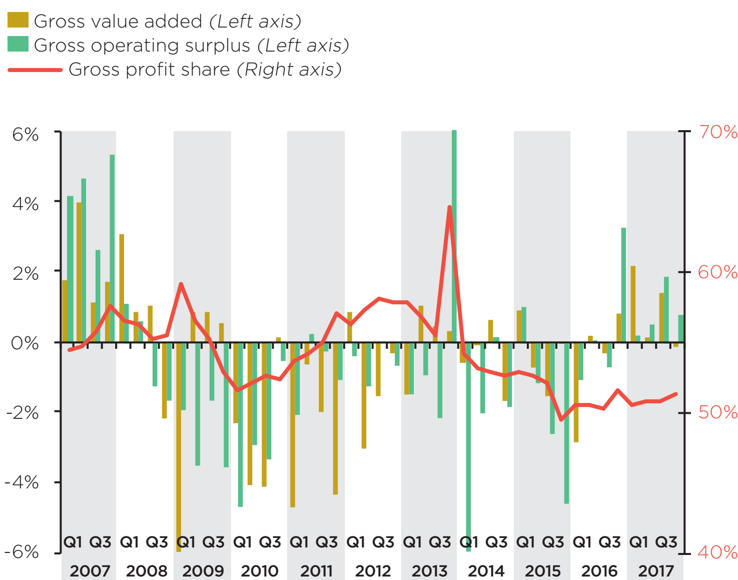
Source: Eurostat

CHART 2
Operating surplus and mixed income, by sector (2008=100)



Source: Eurostat

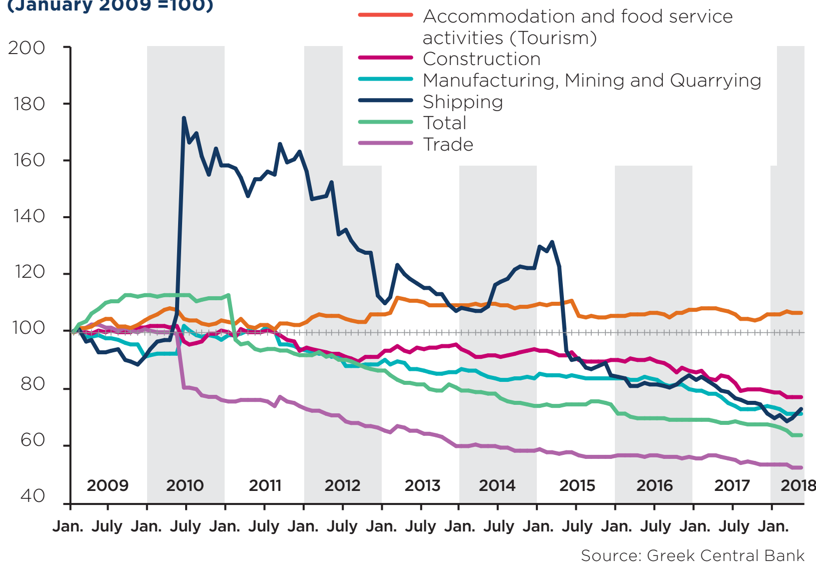
CHART 3
Gross profit share of NFCs



Source: Eurostat

1 Gourinchas, P.O., Philippon, T. and Vayanos, D., 2017. The analytics of the Greek crisis. *NBER macroeconomics Annual, 31*(1), pp.1-81.
2 Other commentators point to a fourth shock related to the severity of fiscal adjustment and show that the fiscal consolidation imposed by the three successive plans in exchange for the 280 billion US dollars in assistance since 2008 has not helped to revive growth.
3 Information & Communication Technologies.
4 Voumvaki, J. & al; Enterprises that survived the crisis have become fundamentally sounder, National Bank of Greece. January 2018.

CHART 4
Bank credit to businesses (January 2009 =100)



Source: Greek Central Bank

However, even though bank interest rates remain higher on average than in the rest of the euro area, they have regained their pre-crisis levels. Credit conditions have eased since the peak of the crisis, but remain restrictive. As a result, non-financial corporate credit, which has been declining since 2011, continues to decline in all sectors except tourism.

In order to address the NPE resolution issues, authorities have adopted a set of measures that seek to improve the regulatory framework for bankruptcy and make debt collection processes more efficient. According to Greek official data (to which the IMF has access), the number of bankruptcies is decreasing and would be lower than before the crisis. The IMF[5], however, considers that this data does not reflect the current state of insolvency, since it only includes formal liquidation procedures, without taking into account pre-insolvency ones. These procedures are more widely used by debtors as a means of blocking creditors' access to information.

Although the regulatory framework has become more transparent, the judicial liquidation process remains slow due to successive reforms (out-of-court dispute resolution, accelerated debt settlement, electronic auctions). Indeed, the average time to recover claims after bankruptcy is 3.5 years, compared to the OECD[6] average of 1.9 years[7]. This inefficiency tends to tie up capital in less productive companies and promotes the survival of zombie companies. A study published by the OECD using data from 2013[8] suggests that the share of irrecoverable capital in Greek zombie companies stood at 28%. Removing barriers to business consolidation could reduce this number to 9%. Among OECD countries, Greece has the highest share of zombie companies accounting for 16% of Greek companies and 18% of employment in 2013.

Greek companies have been forced to modernise

On the plus side, the crisis has enabled companies that have survived to clean up their balance sheets. The contraction in wages has contributed to lower production costs and thus improved profitability. Eurostat's quarterly non-financial corporation figures underpin this finding: the margin rate of Greek enterprises has been improving since the second quarter of 2016[9].

According to a survey conducted by the Greek national bank[10], the gross margin of SMEs increased by 4 percentage points (pp) between 2008 and 2016, rising from 24% to 28%, i.e. above the European average. Conversely, the increase in the margin rate was paradoxically followed by a continuous decline in the gross operating surplus (in absolute terms), as value added decreased at a faster pace. Indeed, the fall in sales led to an increase in fixed operating costs (mainly rents, insurance premiums and administrative costs), which weighed on the gross operating surplus. EBITDA (earnings before interest, taxes, depreciation, and amortization) decreased by 3pp between 2006 and 2016 (from 10% to 7%). In a nutshell, businesses are starting to restore their margins, but weak domestic demand is limiting the extent of the upturn. The gradual recovery in domestic demand in 2019 should therefore be mirrored by a rapid improvement in corporate profitability ratios. In this slightly more favourable context, companies are starting to invest again. Their investment rate has also increased by 30% on average between the low point of 2014 and 2017.

In the same vein, the introduction of capital controls in 2015 designed to protect the banking system from the fall in deposits posed enormous challenges for businesses, and particularly SMEs. At the same time, it made them more resilient and agile. While 87%[9] of companies said they suffered from negative externalities related to capital control three months after its implementation, only 56% said they did so for 15 months after the control was put into place. The liquidity constraint has pushed them to improve debt collection and cost management by accelerating the digitisation of their cash via Enterprise Resource Planning (ERP) systems and point-of-sale terminals. Although the number of new businesses has remained modest (the creation rate is among the lowest in the euro area at 5.1%, according to Eurostat), Greek businesses' survival rate has improved and stands above the European average (80%). 90% of Greek companies created in 2014 still existed in 2015, according to Eurostat.

Companies are becoming more export-oriented

Greece's accession to the euro area in 2001 favoured a wage growth faster than the increase in productivity, leading to the gradual erosion of the country's price-competitiveness, even though the network of exporting firms was small. In 2008, exports accounted for 22% of GDP against 38% in the eurozone, which was 33% below the potential export of Greek companies[11].

5 IMF, *Insolvency and enforcement issues in Greece*, January 2017.
6 Organisation for Economic Co-operation and Development
7 OECD, *Economic Survey of Greece*, 2016.
8 Adalet McGowan, M., D. Andrews and V. Millot (2017), *Insolvency regimes, zombie firms and capital reallocation*, OECD Economics Department Working Papers, No. 1399, OECD Publishing, Paris.
9 As measured by the ratio of Gross Operating Surplus to Value Added source: Eurostat.
10 Voumvaki, J. & al; Enterprises that survived the crisis have become fundamentally sounder, National Bank of Greece. January 2018.
11 Böwer, U., Michou, V. and Ungerer, C., 2014. *The puzzle of the missing Greek exports* (No. 518). Directorate General of Economic and Financial Affairs (DG ECFIN), European Commission.

CHART 5
Harmonised price competitiveness indicators based on unit labour cost indices 2007=100

Source: BCE

However, the internal devaluation induced by the crisis has enabled Greece to improve its cost competitiveness vis-à-vis its European partners. Unit labour costs fell by 22% between 2008 and 2017. Over the same period, exports increased by 27%. Excluding maritime transport (down 88%), exports of goods have even increased by almost 40%. Nevertheless, due to numerous export obstacles – such as lack of investment, the small size of companies, or an initial orientation towards the domestic market –, the share of exports in value added only increased by 10pp between 2008 and 2017. Nevertheless, some sectors seem to be doing well and have taken advantage of the gains in competitiveness to go international, which is particularly true for some manufacturing industries. Greece has therefore specialised in oil refining. Coking and refining production has quadrupled and now accounts for 45% of manufacturing output. Greece has established itself as a key supplier in the Levantine basin (Turkey and Egypt)[12] and has seen its oil exports increase by 133%. The value added of the pharmaceutical industries also increased by 23%, and that of the chemical industry was maintained. However, these sectors are mainly composed of medium and large companies, who have benefited the most from price competitiveness gains, and who have been more numerous to internationalise. The share of exporting companies with more than 250 employees increased from 39% to 49% in 2015, and their contribution to gross value added increased from 29% to 36% between 2008 and 2017. However, Greek SMEs are also starting to become more export-oriented: the share of exporting SMEs has therefore increased by almost 10pp in the manufacturing sector.

Finally, service exports from certain sectors are recovering. While total services export growth has been negative over the last decade, the figure hides uneven trends: the rise in tourism over the past eight years contrasts with the decline in maritime transport services (-60%) and bunkering and hardware services (-49%), which have been strongly impacted by weaker growth in world trade. Following the Arab Spring and the security problems that have hit the North African countries, Greece has profited from tourism's reorientation to the Mediterranean. Greece's tourism sector has proven resilient: foreign tourist arrivals have increased by 82% and tourism receipts by EUR 3 billion over the last ten years.

12 Tozy, S., London, M., & Trifaia, A. (2018, 4 April). *The new Mediterranean trade routes.* Accessed 7 August 2018, at: http://www.coface.com/News-Publications/Publications/The-new-Mediterranean-trade-routes

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