

BUSINESS BIRTHS AND DEATHS SINCE THE ONSET OF THE PANDEMIC

Mario Izquierdo

This early-release box was published on 17 March

A priori, growth in the number of firms in the economy would be expected to tend to behave cyclically, accelerating during upswings and slowing, or even turning negative, during recessions. In principle it is also plausible that, in gross flow terms, the peak of the business cycle would be accompanied by higher and lower business birth and death rates, respectively, than during the business cycle's trough. From a more structural standpoint, sizeable increases in the total number of firms would in theory be associated with a greater accumulation of factors of production (jobs and capital) and faster productivity gains. Higher business churn rates could indicate a high level of competition in the economy and an appropriate reallocation of resources to their most productive uses.

Against this backdrop, it is useful to analyse business demography data in the current crisis. The pandemic and the attendant restrictions on economic activity and movement have entailed a marked drop in income for many firms and, therefore, a decline, often steep, in their liquidity flows. The authorities have attempted to mitigate the effects of these developments by deploying a raft of measures, such as ICO-backed bank loans, moratoria on taxes and loan repayments, and waivers of employer social security contributions under the short-time work schemes (ERTE by their Spanish initials). However, certain firms will conceivably not have managed to survive, even with the measures implemented, either because of their pre-crisis vulnerabilities or because the impact of the crisis has been particularly severe. Conversely, a source of economic policy concern that will become increasingly relevant in the future is the possibility of some elements of the measures' design delaying the necessary discontinuation of activity by non-viable firms. This would hinder productive resources from being shifted towards activities benefiting from the structural transformations in the economy, some of which have been triggered by the pandemic.

According to the Statistics of Firms Registered with Social Security, the number of active firms had decreased by

almost 50,000 (3.6%) between February 2020 and February 2021.¹ The largest drop (almost 8%) since the onset of the crisis was recorded in April (see Chart 1). In the following months the fall-off in the number of firms moderated significantly as the restrictions were gradually eased. However, in step with activity, this relatively more favourable behaviour flagged after the summer months and the declines stabilised at their current levels.

The pronounced heterogeneity of the effects of COVID-19 at the sectoral and regional levels has also been reflected in the unevenness of the decrease in the number of firms across sectors and regions, such that the decline has been much steeper in the hardest-hit productive activities and geographical areas. By sector, the steepest decreases were recorded in the services that have borne the brunt of the various pandemic containment measures (see Chart 2). Specifically, in hospitality and arts and recreation the number of firms is currently more than 8% lower than the pre-crisis level. Similarly, very contrasting developments have been recorded by region, with a much larger decrease in the number of firms in certain regions, such as the island regions. In the Balearic Islands and the Canary Islands, the number of firms has decreased by 6.7% and 6.6%, respectively. This is consistent with the greater weight of the hardest-hit services activities in their productive structures.

It is often argued that smaller firms are more vulnerable to the effects of the pandemic.² However, this assertion would be subject to two qualifications were the materialisation of vulnerability to be measured by the figures for deaths of businesses registered with social security by firm size bracket (where size is defined by staff headcount) since the onset of the COVID-19 pandemic. First, the lowest business death rate appears to have arisen in micro-enterprises (fewer than ten employees). It only seems to be above that threshold where an inverse relationship between firm size and death rate since the onset of the pandemic has been observed (see the red bars in Chart 3). Specifically, the number of active firms

1 In these statistics, firms are deregistered when they have no employees registered for social security purposes. Consequently, the deregistration of a firm is not necessarily linked with its definitive winding-up, since it may decide to rehire once the crisis has been overcome. It may however be considered an approximate indicator of the effects of the crisis on business demography.

2 Drawing on firm-level microsimulations, financial pressure on Spanish firms as a result of COVID-19 seems to have increased more markedly at smaller firms. See R. Blanco, S. Mayordomo, Á. Menéndez and M. Mulino (2020), "The impact of the COVID-19 crisis on the financial position of non-financial corporations in 2020: CBSO-based evidence", Analytical Articles, *Economic Bulletin*, 4/2020, Banco de España. Furthermore, the magnitude of the drop in turnover and employment induced by the health crisis appears to have decreased as firm size increased. See A. Fernández Cerezo, B. González, M. Izquierdo and E. Moral-Benito (2021), "The economic impact of COVID-19 on Spanish firms according to the Banco de España business activity survey (EBAE)", Analytical Articles, *Economic Bulletin*, 1/2021, Banco de España.

BUSINESS BIRTHS AND DEATHS SINCE THE ONSET OF THE PANDEMIC (cont'd)

Chart 1
FIRMS REGISTERED WITH SOCIAL SECURITY

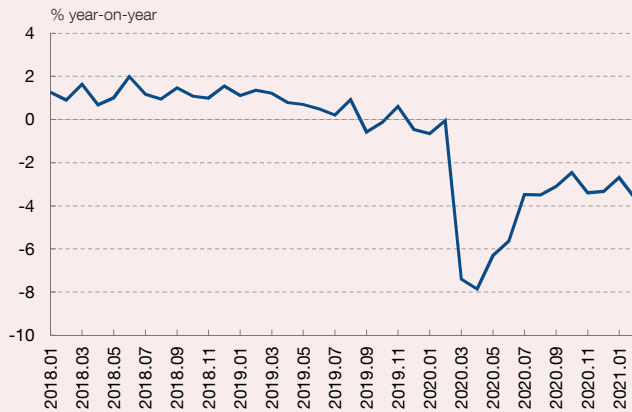


Chart 2
Y-O-Y CHANGE IN NUMBER OF FIRMS AND EMPLOYEES IN FEBRUARY 2021 BY SECTOR

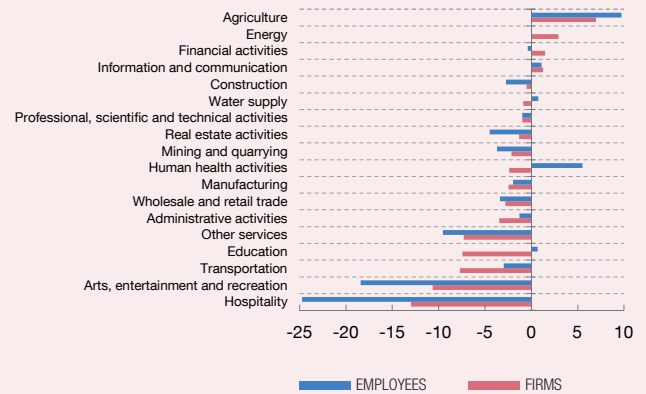


Chart 3
Y-O-Y CHANGE IN NUMBER OF FIRMS BY SIZE IN FEBRUARY 2021

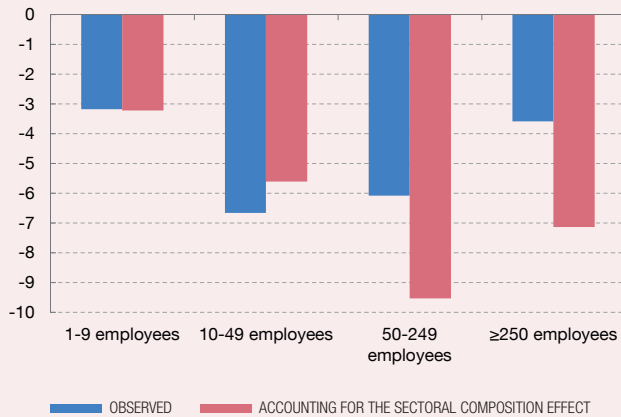


Chart 4
ANNUAL CHANGE IN NUMBER OF FIRMS REGISTERED WITH SOCIAL SECURITY

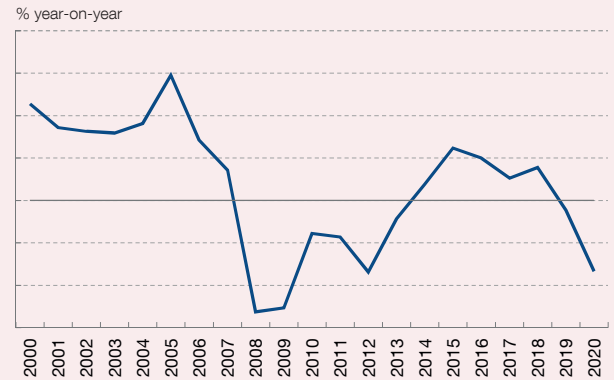


Chart 5
Y-O-Y CHANGE IN REGISTRATIONS AND DEREGISTRATIONS OF CONTRIBUTION ACCOUNT CODES IN THE SOCIAL SECURITY SYSTEM

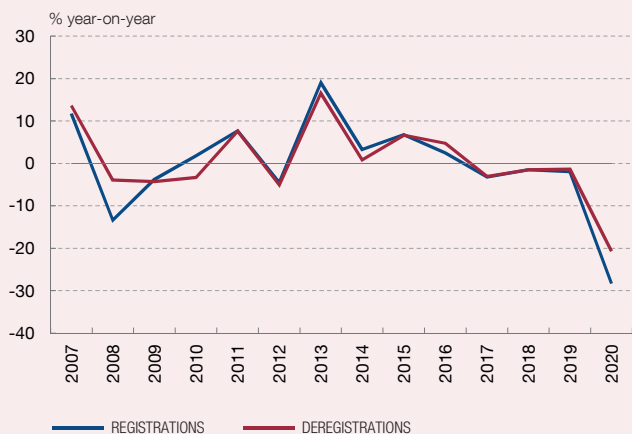
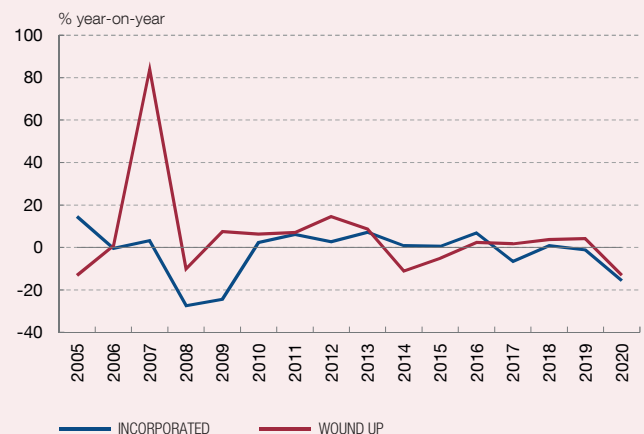


Chart 6
Y-O-Y CHANGE IN FIRMS INCORPORATED AND WOUND UP



SOURCES: Statistics of Firms Registered with Social Security (Ministerio de Inclusión, Seguridad Social y Migraciones) and Mercantile Companies Statistics (INE).

BUSINESS BIRTHS AND DEATHS SINCE THE ONSET OF THE PANDEMIC (cont'd)

with between 10 and 49 employees has decreased by almost 6.7% to February compared with 3.6% in the case of firms with 250 or more employees. Second, a portion of this gap is also related to the average firm size being larger in the case of those operating in sectors whose activity has been less affected by the crisis. In particular, larger firms are more common in manufacturing or the energy sector, such that when correcting for this sectoral composition effect, the correlation between firm size and changes in the stock of active firms tends to invert (see the blue bars in Chart 3).³

In terms of calendar-year average rates, in 2020 the percentage decrease observed in the number of firms was lower than in the first two years of the previous crisis (2008 and 2009), and comparable to that of 2012 (see Chart 4), although the fall-off in activity was far greater in 2020. This divergence could be a reflection of how the two crises differ as regards two, interrelated, dimensions: their causes, associated with a build-up of imbalances in the previous recession and exogenous in the present crisis, and their degree of persistence, which should in principle be lower this time around.

Separate analysis of the gross flows of business births and deaths reveals that a marked decline in new registrations⁴ lies behind the decrease in the total number of firms in the current crisis. Specifically, the number of firms registered in 2020 was 28.3% lower than in the preceding 12 months (see Chart 5). However, it is striking that no increase has yet been observed in the flows of business deregistrations, but instead, a notable decrease, albeit smaller than in the case of business registrations (-20.7%). Consequently, there has been a sharp drop in the business churn rate, defined as the sum of business births and deaths, a variable which posted a year-on-year fall of 24.5% in 2020, considerably higher than in 2008, at the onset of the previous recession (-8.7%).

The Mercantile Companies Statistics also reflect this downward trend in the flows of business births and deaths

in 2020, with declines in the number of newly incorporated and wound-up firms of 15.8% and 13.1%, respectively, compared with the previous year (see Chart 6). Similarly, the Bankruptcy Proceedings Statistics showed a decrease in the number of firms subject to insolvency proceedings in 2020 as a whole (14.4%), as a result of the insolvency moratorium approved last April.⁵

In short, the significant decline in the indicators of the flow of business deaths since the start of the pandemic seems rather counterintuitive, compared to what would be expected in a recession. Along with the temporary nature of the shock, this decline may be explained by the effects of the support measures adopted. In principle, the interpretation is a positive one, insofar as these measures have been effective in preserving the productive system. However, looking ahead, two contrasting considerations should be added. First, the prolongation of the crisis suggests that it would be advisable to extend the measures over time for viable firms, shifting the focus of the support provided from liquidity considerations to solvency concerns, in keeping with the measures recently approved under Royal Decree-Law 5/2021, which include direct financial assistance amounting to €7 billion for firms with solvency problems, but still economically viable, from the sectors most affected by the crisis.

Second, the authorities must remain watchful in order to prevent economic policy actions from hindering the process of reallocating the economy's resources to their most efficient uses, which would occur if the measures were to contribute to delaying the exit from the market of non-viable firms. In this connection, the transposition to Spanish law of the EU Directive on insolvency proceedings should be taken as an opportunity to encourage the use of pre-insolvency arrangements as a way of avoiding congestion in the competent courts when the insolvency moratorium expires, and to implement mechanisms for the swift and efficient winding up of non-viable firms.

3 To distinguish the effect of the sector of activity, what the rate of change in number of firms would have been for each of the size brackets had the sectoral structure been that of the economy as a whole rather than that actually observed has been calculated.

4 This information is available for registrations and deregistrations of contribution account codes, not for registered firms, the difference being that a firm may have more than one contribution account code. Consequently, although these flows do not refer strictly to registered and deregistered firms, they could be considered a good approximation.

5 Recently extended until end-2021 under Royal Decree-Law 5/2021.