

Trend in the financial structure and results of firms in 2005

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Introduction

Every year, in the fourth quarter's Economic Review, the National Bank describes the developments taking place in the annual accounts of non-financial corporations⁽¹⁾. By the autumn, the Central Balance Sheet Office in fact already has a representative sample of the annual accounts relating to the previous year. The conclusions drawn on the basis of that sample can therefore be extrapolated relatively reliably to the population as a whole.

Historically, this article consisted essentially of a study of developments in the profit and loss accounts of firms. In recent years, that study has been gradually supplemented by a financial and microeconomic analysis, not only of the profit and loss accounts but also of the balance sheets and the annexes to the annual accounts. For the past two years, an appraisal of the financial risks incurred by firms has also been presented on the basis of the results of an internal business failure prediction model.

This article is in three sections. Section 1 briefly describes the methodology and sample used. Section 2 presents an extrapolation of the main profit and loss account items. Finally, section 3 assesses the financial situation of companies, particularly their level of profitability, solvency, liquidity and financial risk.

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⁽¹⁾ It should be remembered that this analysis concerns the statutory annual accounts and not the consolidated accounts. The introduction of the IAS/IFRS standards has had no impact on the data presented in this article, since those standards are currently only compulsory in the case of consolidated accounts.

⁽²⁾ It is also necessary to note that, every year, there are some firms which fail to submit annual accounts, despite the statutory obligation. The percentages given inevitably disregard those firms.

1. Methodology and constant sample

1.1 Characteristics of the data used and construction of the constant sample

Since the late 1970s, the Central Balance Sheet Office has collected data on the accounts of non-financial corporations each year. For that purpose, the firms are required to submit their annual accounts using a standard form by no later than seven months after the end of the financial year. The data are then adjusted as necessary to meet the required quality standards; after that, an initial analysis can be conducted from September onwards. However, each year the nature of the data available for the latest financial year examined – in the present case 2005 – raises two methodological questions.

First, the population of annual accounts relating to 2005 is incomplete. The reason for this situation is that many sets of annual accounts are filed late or do not pass the arithmetical and logical checks conducted by the Central Balance Sheet Office. Every year, the proportion of accounts not filed or not capable of inclusion in the analysis on 31 August exceeds 20 p.c. Since these problems mainly concern fairly small firms, these missing accounts represent less than 10 p.c. of the value added of all non-financial corporations: a small proportion but nonetheless significant⁽²⁾.

Second, firms whose annual accounts are available late are in a structurally less favourable financial situation than the others. Previous editions of this article have highlighted the significant differences between firms

according to the time of filing their annual accounts: firms which filed their accounts late are significantly less liquid, less solvent and less profitable. In all probability, the data currently available for 2005 therefore present an over-optimistic view of reality.

Being subject to this double bias, the 2005 data are not directly comparable with those for previous years. In order to ensure comparability, the constant sample method is used. The constant sample for 2004-2005 comprises firms which filed annual accounts for both 2004 and 2005, and which meet the following conditions:

- both sets of annual accounts relate to a financial year lasting 12 months;
- both sets of annual accounts met the quality requirements of the Central Balance Sheet Office;
- the annual accounts relating to 2004 were filed before 31 August 2005;
- the annual accounts relating to 2005 were filed before 31 August 2006.

The method consists in extrapolating the 2005 results on the basis of the trends found in the constant sample: the 2005 figures are obtained by taking the final figures for 2004 and applying the rates of change recorded in the sample. It is therefore assumed that the trends seen in the sample are representative of the trends occurring in the population as a whole. As verified in previous editions of this article, the estimates may be considered satisfactory since, in the vast majority of cases, they give an accurate representation of the direction and scale of the actual movements.

1.2 Classification of firms by size and branch of activity

Non-financial corporations form a heterogeneous population within which very divergent trends may be recorded. The tendencies detected by analysis of the overall results therefore have to be refined by analysis according to the size and branch of activity of the firms. For one thing, the corporate financing method and, more generally, the corporate financial position varies according to whether the firm is large or small. Also, firms are subject to cyclical

movements specific to each branch of activity, and these are generally reflected in the movement in the annual accounts.

The distinction in terms of size is based on the criteria set out by the Companies Code. According to it, the following are classed as large:

- firms employing over 100 people, as an annual average, or
- firms which exceed more than one of the following limits:
 - annual average number of employees: 50;
 - annual turnover excluding VAT: 7,300,000 euro;
 - balance sheet total: 3,650,000 euro⁽¹⁾.

Firms which do not exceed these criteria, i.e. SMEs, can draw up their annual accounts in an abbreviated format, unlike large firms which are obliged to use the full format. However, not all SMEs make use of the option available to them. As a result, the population of sets of annual accounts filed in accordance with the full format contains not only the annual accounts of large firms, but also those of a significant number of SMEs. Every year, almost half of the sets of full-format accounts relate to SMEs. The firms therefore cannot be classified strictly by size according to the type of format used. For that reason, since 2001 the distinction has no longer been based on the type of format used but is based on strict compliance with the Companies Code criteria. SMEs filing full-format accounts are thus no longer included in the population of large firms but are placed in the SME category⁽²⁾.

The distinction according to the branch of activity is based on the NACE-BEL nomenclature of activities, used in most of the statistics offering a breakdown by branch in Belgium. The composition of the branches of activity considered is shown in Annex 1.

1.3 Representativeness of the constant sample

The constant sample for 2004-2005 is shown in table 1. It contains 149,818 firms, or almost 57 p.c. of the total number of sets of annual accounts filed in 2004. As in previous years, the level of representativeness measured in relation to the balance sheet total is considerably higher, since it exceeds 82 p.c. The reason is that the representativeness is traditionally greater for large firms than for SMEs. In the sample for 2004-2005, the cover rate for large firms is thus over 18 points higher in terms of the number of firms and the balance sheet total. Large firms in fact have a natural tendency to submit their annual accounts more promptly; in addition, they are the focus of special attention on the part of the Central Balance

(1) Details of these criteria may be found in Article 15 of the Companies Code. The criteria relating to turnover and balance sheet total underwent slight adjustment recently, following a European Directive: for turnover, the threshold was increased from 6,250,000 to 7,300,000 euro, and for the balance sheet total it was raised from 3,125,000 to 3,500,000 euro. These amounts were transposed into Belgian law by the Royal Decree of 25 May 2005 (Moniteur belge of 7 June 2005). The new thresholds apply to annual accounts closed on or after 31 December 2004. For the purposes of this article, in order to ensure intertemporal comparability, the historical data distinguishing between firms according to size have been revised by applying the new criteria to them. The scale of the modifications entailed in that revision is minimal.

(2) For more details on this reclassification, see the article published in the Economic Review for the 4th quarter of 2003.

TABLE 1 COMPOSITION AND REPRESENTATIVENESS OF THE CONSTANT SAMPLE FOR 2004-2005

	Firms in the 2004-2005 sample	All non-financial corporations in 2004	Representativeness of the sample, in p.c.
Number of firms	149,818	264,666	56.6
Large firms	6,117	8,171	74.9
SMEs	143,701	256,495	56.0
Manufacturing industry	13,832	22,897	60.4
Non-manufacturing branches	135,986	241,769	56.2
Balance sheet total (millions of euros)⁽¹⁾	784,833	952,928	82.4
Large firms	667,035	777,749	85.8
SMEs	117,798	175,179	67.2
Manufacturing industry	220,466	226,719	97.2
Non-manufacturing branches	564,367	726,209	77.7

Source: NBB.

(1) For firms in the constant sample, the balance sheet total taken into account is the 2004 figure.

Sheet Office, which makes sure that it obtains a high level of representativeness as quickly as possible in terms of value added. Moreover, essentially owing to the predominance of large firms, manufacturing industry has a higher cover rate than non-manufacturing branches.

2. Movement in the main components of the profit and loss account

2.1 General trends and cyclical context

In 2005, the total value added created by non-financial corporations, i.e. the difference between sales revenues and the cost of goods and services supplied by third parties, totalled almost 145 billion euro (at current prices). Value added thus increased by almost 4 p.c. in 2005, i.e. at a slower rate than last year when growth attained 6.6 p.c. (table 2).

This trend, which is also evident in the national accounts, is occurring in the context of a less prosperous economic situation in 2005 than in 2004. Whereas, following three successive years of weak expansion in activity, 2004 brought a marked acceleration in GDP growth (at constant prices) to 3.0 p.c., growth declined to 1.1 p.c. in 2005. In reality, it was in late 2004 and the first half of 2005 that activity slowed, as a result of weakening demand both at home and abroad.

The growth of domestic expenditure dropped from 1.5 p.c. in 2004 to 0.9 p.c. in 2005, mainly as a result of the fall in both private consumption and corporate gross fixed capital formation. Foreign demand was affected both by the soaring commodity prices, particularly the price of petroleum products, and by the strong euro appreciation. From October 2005, when the euro exchange rate and oil prices became gradually less unfavourable and growth was restored in Europe, the Belgian economy recovered a degree of impetus, though it was insufficient to offset the slowdown of the preceding months.

The value added created by a firm enables it to cover its operating expenses, with any surplus recorded as a net operating profit. That profit measures the firm's current industrial and commercial efficiency, independently of its financing policy and any exceptional items. Staff costs traditionally account for the major part of the operating expenses: in 2005, for example, they represented almost 57 p.c. of the value added of non-financial corporations. In parallel with further employment growth, staff costs continued to rise in 2005 (+2.7 p.c.), a slightly less sustained pace than in the previous year (+3.4 p.c.). They were therefore outpaced by value added, as had already been the case in 2003 and 2004. After staff costs, depreciation is by far the most significant operating expense. In 2005, after shrinking for three successive years, depreciation allowances recorded a net increase. This was due to the trend in investment in tangible fixed assets, which in 2005 continued the revival which had begun in 2004.

TABLE 2 MAIN COMPONENTS OF THE PROFIT AND LOSS ACCOUNT

	Percentage changes compared to the previous year					Millions of euros	Percentages of value added
	2001	2002	2003	2004	2005 e	2005 e	2005 e
Value added	2.1	1.4	4.4	6.6	3.9	144,987	100.0
Staff costs	3.9	3.2	1.6	3.4	2.7	82,121	56.6
Depreciation, downward value adjustments and provisions	(-) 5.2	-2.3	-2.9	-1.8	2.5	24,534	16.9
Other operating expenses	(-) 7.7	-2.1	9.3	9.7	5.5	8,611	5.9
<i>Total operating expenses</i>	<i>4.4</i>	<i>1.5</i>	<i>1.0</i>	<i>2.7</i>	<i>2.8</i>	<i>115,265</i>	<i>79.5</i>
Net operating result	-10.6	0.7	25.5	26.5	8.4	29,722	20.5
Financial income	(+) 5.4	24.5	6.8	-12.4	12.2	49,192	33.9
Financial charges	(-) 4.6	38.9	4.6	-15.9	8.8	41,153	28.4
<i>Financial result</i>	<i>9.4</i>	<i>-42.2</i>	<i>31.8</i>	<i>18.0</i>	<i>34.0</i>	<i>8,039</i>	<i>5.5</i>
Ordinary result	-5.7	-11.3	26.7	24.9	13.0	37,761	26.0
Exceptional result ⁽¹⁾	(+) -	-	-	-	-	10,985	7.6
Net result before tax	-10.1	-26.9	77.0	2.3	45.8	48,746	33.6
Taxes on profits	(-) -0.2	-5.0	7.0	11.5	8.8	7,992	5.5
Net result after tax	-13.1	-34.5	112.1	-0.1	56.3	40,754	28.1
<i>p.m. Net result after tax excluding the exceptional result</i>	<i>-7.7</i>	<i>-13.7</i>	<i>34.8</i>	<i>29.2</i>	<i>14.2</i>	<i>29,769</i>	<i>20.5</i>

Source: NBB.

(1) There is very little sense in calculating a percentage change for this aggregate, which may be either positive or negative and does not lend itself to reliable estimation.

Largely owing to the trend in staff costs and depreciation, total operating expenses increased by 2.8 p.c. in 2005. For the third consecutive year, the growth of value added thus exceeded the increase in operating expenses. This situation led to a further considerable rise in the net operating result (+8.4 p.c.), which had already produced an exceptional increase in 2003 and in 2004. In the space of three years, the operating result of non-financial corporations gained around 12 billion euro, a rise of almost 70 p.c., achieved mainly by the control of operating expenses in a generally favourable economic climate. This was the largest increase ever recorded since the Central Balance Sheet Office began collating the annual accounts; that is evidence of the current ability of firms to generate profits by pursuing their commercial activities.

The trend in the value added and operating results of non-financial corporations can be compared with the movement in the Bank's business survey indicator, which measures business confidence (chart 1). These three variables generally follow a similar pattern. This proved to be the case once again in 2005, since the slowdown

in the growth of value added and operating results corresponded to the low point reached by business confidence in mid 2005.

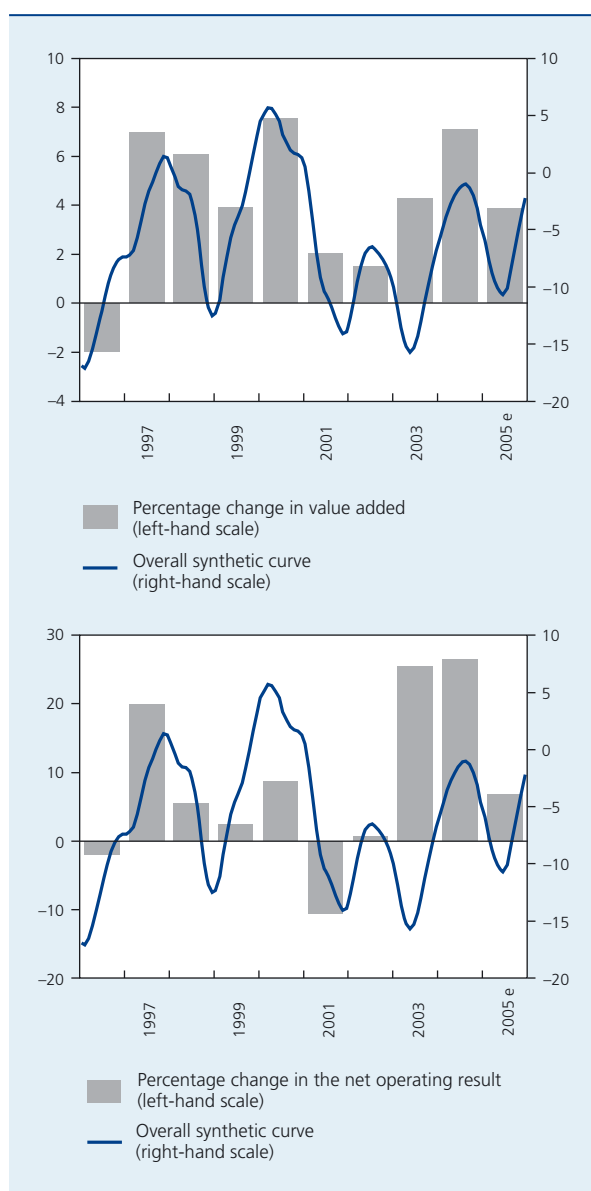
The financial result expanded strongly once again in 2005, to reach approximately 8 billion euro. As emphasised in previous editions of the Economic Review, the past decade has seen considerable growth in the financial result, the main factor being the rising proportion of corporate balance sheets represented by financial assets⁽¹⁾. After recording a balance of practically zero in 2004, the exceptional result attained a record level of close to 11 billion euro in 2005, following various adjustments to the value of financial fixed assets⁽²⁾. Finally, the amount of tax paid by companies increased for the third consecutive year. Of course, this increase is linked to the rise in the operating result, which is by far the largest component of corporate taxable incomes.

(1) Financial assets means long-term investments and current assets bearing interest (including cash investments and liquid assets).

(2) These revisions occurred mainly in connection with asset disposals.

Once all the components of the profit and loss account were aggregated, non-financial corporations made a record net profit of almost 41 billion euro, over 50 p.c. more than in 2004. This further substantial rise was due to simultaneous increases in the operating, financial and exceptional results. Owing to the increasingly volatile impact of the exceptional result on final profits⁽¹⁾, it is also interesting to examine the behaviour of the net result excluding the exceptional result; this fluctuates less widely and is more representative of recurrent corporate performance. In 2005, that figure came to almost

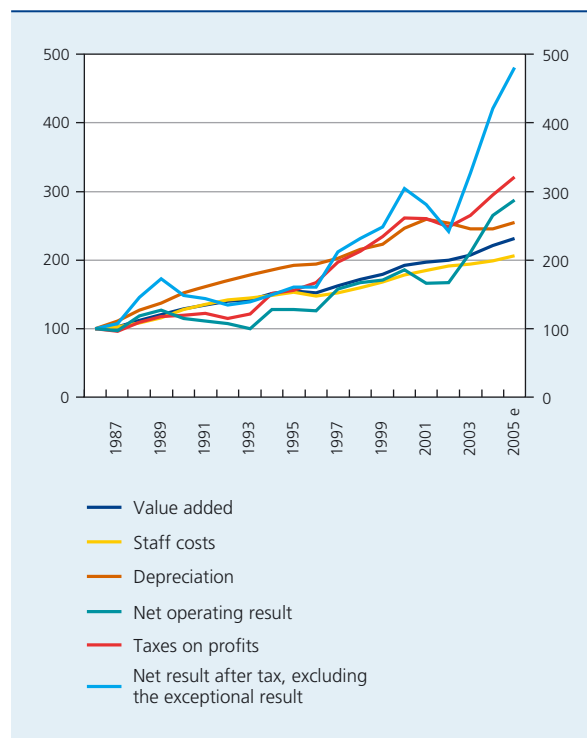
CHART 1 VALUE ADDED, NET OPERATING RESULT AND BUSINESS SURVEY INDICATOR



Source : NBB.

CHART 2 MOVEMENT IN THE MAIN COMPONENTS OF THE PROFIT AND LOSS ACCOUNT

(Indices 1986 = 100)



Source : NBB.

30 billion euro, an increase of 14 p.c. against 2004. For the record, it has doubled since 2002.

In a historical perspective, the scale of the increase in profits recorded since 2002 is exceptional. Chart 2, which shows the movement in the main components of the profit and loss account over the past twenty years, bears witness to that. It is from the mid 1990s onwards that the net result after tax (excluding the exceptional result) has begun to grow at a decidedly more sustained rate than the other profit and loss account components, particularly value added. In the end, the 2001 and 2002 profits correction was only a digression, since it was more than offset in a single year in 2003. The divergent trends in the net result after tax and the operating result are evidence of the growing share of corporate profits represented by the financial result.

(1) The share of the profit after tax represented by the exceptional result thus fell from 23 p.c. in 2003 to 0 p.c. in 2004, before climbing back to 27 p.c. in 2005. The exceptional result may make a negative contribution to the profits, and did so in 2002.

TABLE 3 VALUE ADDED AND NET OPERATING RESULT BY BRANCH OF ACTIVITY

(Percentage changes compared to the previous year)

	Value added		Net operating result		<i>p.m.</i> Percentage share of the branches in total value added in 2005 e
	2004	2005 e	2004	2005 e	
Manufacturing industry	3.5	2.0	26.4	3.6	32.2
of which:					
Agricultural and food industries	4.9	0.7	19.6	-3.9	4.3
Textiles, clothing and footwear	-2.6	-7.8	7.0	-29.7	1.3
Timber	-7.9	0.8	37.1	20.2	0.6
Paper, publishing and printing	3.8	-0.4	24.0	-5.3	2.4
Chemicals	2.3	6.0	14.6	5.9	8.7
Metallurgy and metalworking	16.5	0.3	121.9	4.4	4.7
Metal manufactures	6.0	3.0	3.5	26.2	6.7
Non-manufacturing branches	8.2	4.9	26.5	10.8	67.8
of which:					
Retail trade	6.5	4.3	28.6	6.2	8.3
Wholesale trade	8.1	6.5	42.7	14.9	13.0
Horeca	4.6	1.1	12.8	8.2	1.6
Transport	10.7	5.8	237.6 ⁽¹⁾	125.3 ⁽¹⁾	7.8
Post and telecommunications	7.7	3.2	48.3	1.1	5.2
Real estate activities	8.1	8.1	21.3	5.4	3.2
Business services	8.8	6.4	20.6	8.3	12.7
Energy and water ⁽¹⁾	12.7	-2.1	-9.7	-7.8	3.9
Construction	4.7	3.4	17.2	16.5	6.1

Source: NBB.

(1) The substantial variations in the operating results in the transport branch are due mainly to the practically zero (but positive) value of that aggregate in 2003.

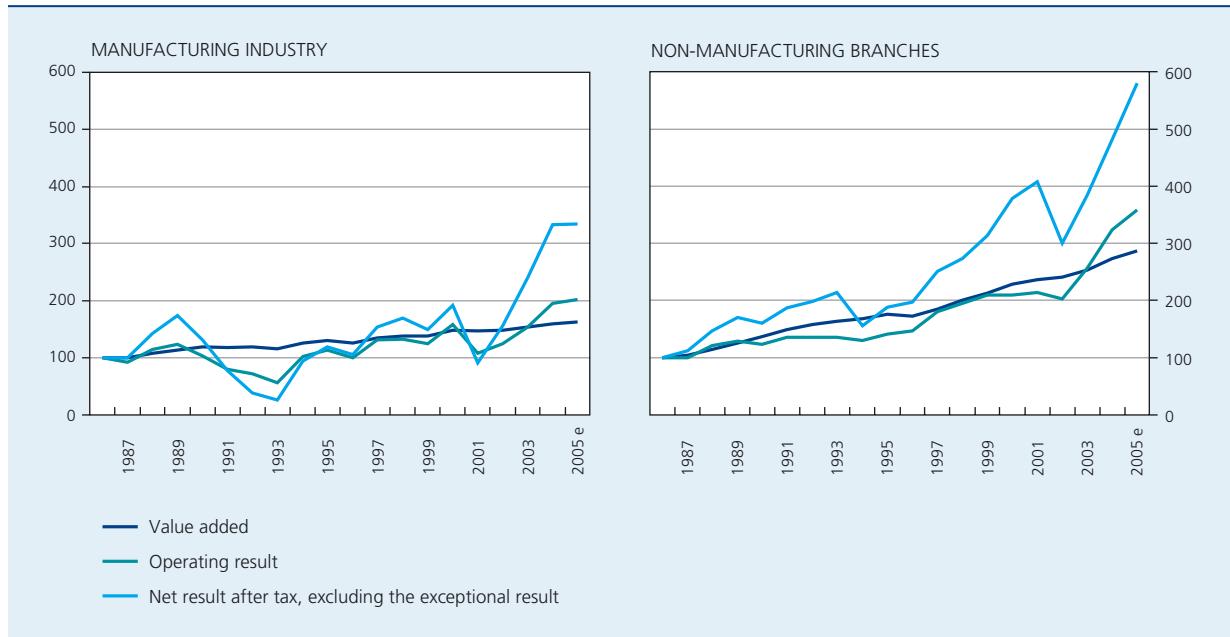
2.2 Results by branch of activity

In manufacturing industry, value added growth slowed in 2005, dropping to 2 p.c. (table 3). In the first part of 2005, Belgian industry was particularly affected by the deterioration in the international environment, owing to the importance of foreign markets and the high energy content of production. It was the metallurgy and metalworking branches, being among the most open sectors of the Belgian economy, that were the primary contributors to the slowdown in manufacturing activity. Conversely, the chemical industry was one of the few to see growth accelerating. In basic chemicals in particular, value added increased despite the downturn in production, as firms were able to pass on the higher commodity prices in their producer prices.

After increasing by 80 p.c. between 2001 and 2004, the operating result of industry continued to rise in 2005, but at a decidedly more moderate pace (+3.6 p.c.): while the growth of value added came to a halt, total operating expenses surged after three years of decline. The main reason was the substantial increase in intangible fixed assets on the balance sheet of certain pharmaceutical companies⁽¹⁾, which gave rise to large amounts of depreciation. In metallurgy, following the exceptional performance seen in 2004, the operating profit showed hardly any increase in 2005, owing to the weakening global demand for the products of that branch; however, it should be remembered that the metallurgy branch had produced a five-fold increase in its operating result in the preceding three years. Finally, despite the downgrading of growth, the metalworking branch experienced a surge in its operating profit in 2005, in contrast to the industry as a whole. That movement was due mainly to the reduction in staff costs, which itself reflects a decline in the number of workers employed in the branch.

(1) This mainly concerns capitalised research and development expenditure, but also patent costs.

CHART 3 MOVEMENT IN SOME COMPONENTS OF THE PROFIT AND LOSS ACCOUNT
(Indices 1986 = 100)



Source: NBB.

In the non-manufacturing branches, the expansion of activity also slackened pace significantly in 2005 (+4.9 p.c. against 8.2 p.c. in 2004). The main reason for this slowdown was the less buoyant domestic demand. In particular, while household consumption had made an active contribution to growth in 2004, it flagged somewhat in 2005, and the majority of the non-manufacturing branches suffered. The operating profit of the non-manufacturing branches continued to grow at a sustained rate in 2005 (+10.8 p.c.). Although this was slower than the 2004 growth rate, it must be stressed that the operating profit had grown by around 60 p.c. in the preceding two years. Overall, like their counterparts in industry, the service firms therefore did more than consolidate their operating profit at the record level achieved in 2004.

Chart 3 places these recent sectoral developments in a long-term perspective. It depicts the variations in value added, operating result and net result after tax (excluding the exceptional result) over the past twenty years, presenting them separately for the manufacturing and non-manufacturing branches. The fact that value added is growing much faster in the latter than in the former

is evidence of two strong fundamental trends, namely de-industrialisation and globalisation⁽¹⁾. As regards the ability of firms to generate profits, it is notable that in 2002 the operating result and net profit in industry had both fallen back to their 1986 levels. To put it mildly, this finding reveals the structural problems experienced by industry over the past twenty years. Non-manufacturing firms saw a six-fold increase in their profits over twenty years, attributable both to their commercial performance (reflected in the operating result) and to their financial results, whose growing impact on profits has already been mentioned.

2.3 Profit margins

An additional indicator can shed light on the analysis of the results of non-financial corporations, namely the movement in the profit margin, a ratio involving the turnover variable⁽²⁾.

The gross profit margin represents the profit (or loss) on commercial or industrial activity excluding unpaid expenses. It is therefore equal to the ratio between the sum of the operating result, depreciation and downward valuations on stocks and provisions for liabilities and charges, on the one hand, and the turnover plus other operating income less operating subsidies on the other.

(1) The impact of these two phenomena in Belgium was analysed recently by Dresse L. and B. Robert (2005), "Industry in Belgium: past developments and challenges for the future", Economic Review III-2005, National Bank of Belgium, Brussels.

(2) Since mentioning the "turnover" (item 70) is optional in accounts filed in the abbreviated format, only 27 p.c. of SMEs are taken into account in this section, on average, over the period 2003-2005.

TABLE 4 PROFIT MARGINS (GLOBALISATION⁽¹⁾)
(Percentages)

	Large firms			SMEs		
	2003	2004	2005 e	2003	2004	2005 e
Manufacturing industry						
Gross margin	9.7	9.3	9.0	8.1	8.3	8.3
Net margin	4.4	5.2	5.0	2.8	2.9	3.3
Non-manufacturing branches						
Gross margin	6.4	7.1	6.8	8.0	8.5	8.7
Net margin	3.5	4.2	4.1	3.4	4.0	4.3
All branches together						
Gross margin	7.5	7.9	7.5	8.0	8.5	8.6
Net margin	3.8	4.5	4.4	3.3	3.8	4.2

Source : NBB.

(1) For clarification, see section 3.

The net profit margin concerns the firm's performance after depreciation, downward valuations on stocks and provisions for liabilities and charges. It divides the sum of the operating result and capital subsidies by the same denominator as the gross margin.

As shown by table 4, gross and net margins were eroded slightly in 2005 in the case of large firms, while the opposite happened for SMEs, thus confirming their good performance in 2004.

In large firms, the decline in the gross margin concerned the timber industry (manufacturing) and the energy and water supply sector (non-manufacturing), which were directly affected by the rise in commodity prices, and also real estate activities. Conversely, this margin increased slightly in the chemical industry, which saw significant export growth, in metalworking, an industry which withstood the rise in commodity prices thanks to the recovery in the second half of 2005, and also in the post and telecommunications sector. The gross margin increased in SMEs manufacturing textiles, timber products, and chemicals, and in non-manufacturing SMEs in the hotel & restaurant sector, while reductions were recorded in the paper industry, the post and telecommunications sector and the energy and water supply sector.

Except in a few cases, the net margin followed the same pattern as the gross margin in the same branches. Among the large firms, it nevertheless increased in the timber and real estate industry which, in contrast to the decline

in their gross margin, indicates a substantial reduction in depreciation and downward value adjustments in those branches. The relative increase in the net margin in SMEs follows the positive movements recorded in the majority of manufacturing branches, but with the exception of the paper industry, and in the wholesale trade, the hotel & restaurant branch and real estate. Altogether, the branches produced positive net margins except for SMEs in the energy & water sector, transport, and post and telecommunications, branches affected respectively by the surge in commodity prices and competition from large groups. If a firm faces a negative net margin for an extended period, it can no longer cover the remuneration on the equity capital and borrowings. That applies to around 9 p.c. of SMEs, and 18 p.c. of large firms.

3. Financial situation of firms

The analysis of the financial ratios which follows is based on the theory of interpretation of the annual accounts. The ratios are presented both in global form and as a median. The globalised ratios are obtained by taking the sum of the numerators for all firms considered and dividing it by the sum of their denominators. The second ratio, the median, is the central value in an ordered distribution : for a given ratio, 50 p.c. of firms have a ratio above the median and 50 p.c. of firms have a lower ratio. The two measures are complementary as they reflect different realities. Since it takes account of each firm according to its real weight in the numerator and the denominator,

the globalised ratio primarily reflects the situation of the largest firms. In contrast, by indicating the situation of the central firm, the median reflects the movement in the population in general, as the median is influenced equally by each of the firms examined, regardless of size.

3.1 Profitability

3.1.1 Return on equity after tax

Profitability is defined as the firms' ability to generate profits. It can be assessed, in particular, on the basis of the net return on a firm's own capital. This ratio expresses the net profit after tax as a percentage of the equity capital, and corresponds to the return on equity (ROE). It indicates the return which shareholders can expect after deduction of all expenses and taxes. The risk premium, i.e. the financial compensation for the risk incurred by shareholders over a given period, is measured as the difference between the return on equity and the return on a risk-free investment. The latter is calculated on the basis of the benchmark loan or ten-year linear bonds (OLOs), and is shown in chart 4.

In 2005, the globalised return on equity came to 10.1 p.c. for large firms and 8.4 p.c. for SMEs (chart 4), an upward trend being recorded in both cases. The main factors

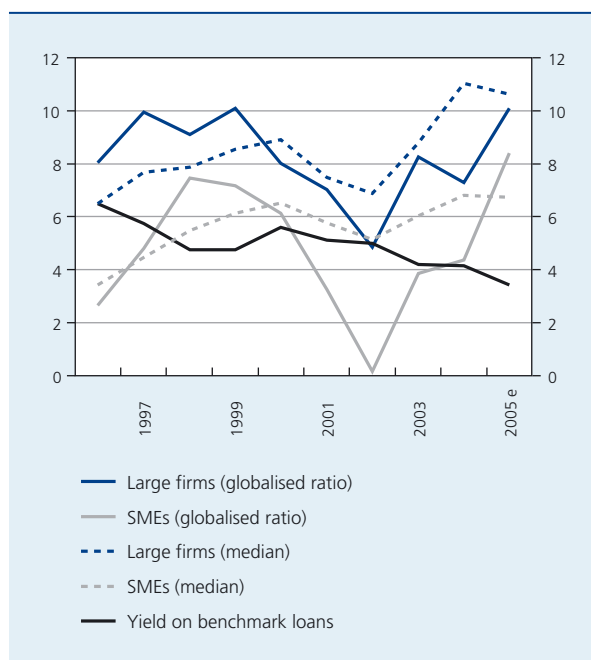
behind these increases are the jump in the financial and exceptional results of a number of large non-financial corporations, particularly in chemicals, metalworking and wholesale trade. The operating result was also up, though to a lesser extent (see above).

Chart 5 depicts the globalised profitability of large firms and SMEs, with and without the exceptional result⁽¹⁾. The latter exerts a considerable influence on the return on equity after tax. The globalised profitability of large firms can be compared to the yield on government bonds. Following the falls in 2002 and 2004, the profitability of the biggest companies climbed back in 2005 to a level more than twice the benchmark bond yield, thus offering their shareholders a substantial risk premium. In 2005, equity investments therefore proved more attractive, in comparative terms, than they had in the preceding years⁽²⁾. The globalised profitability of SMEs was also well above this benchmark level.

Chart 5 reveals the impact of the exceptional result on the profit ratio. In the large firms the high exceptional result of 1999 (left-hand chart) occurred mostly in wholesale firms connected with petrochemicals. The subsequent peaks were due to exceptional income in energy and telecommunications, in 2003, and in petrochemicals and the wholesale trade in 2005. The exceptional result accounted for more than half of the globalised profit ratio in SMEs (right-hand chart) from 1998 to 2000, years dominated by exceptional revenues in business services. In 2002, substantial exceptional expenses were recorded in telecommunications and business services, thus accounting for this reversal of the situation. In 2005, large exceptional revenues were recorded by SMEs in energy and business services.

The median profitability, less sensitive to isolated variations, and therefore to the impact of the financial or exceptional results, was down slightly to 10.6 and 6.7 p.c. respectively for large firms and SMEs. Table 5 shows these movements for the main branches of activity. It should be remembered that the median highlights the changes recorded in the population as a whole. In 2004, this median ratio had peaked in non-financial corporations in general. In 2005, a slight dip was recorded in large firms in both the manufacturing and non-manufacturing sectors. However, in metalworking, the retail trade, hotels & restaurants, post and telecommunications, real estate activities and

CHART 4 RETURN ON EQUITY AND YIELD ON BENCHMARK LOANS
(Percentages)

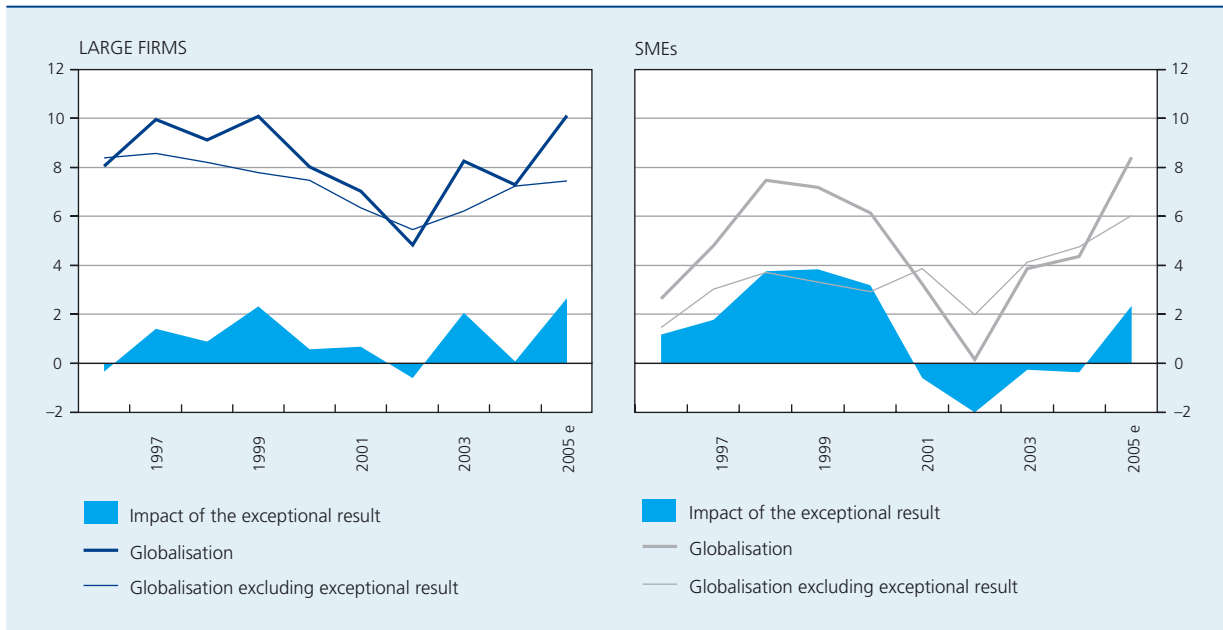


Source : NBB.

(1) The exceptional result in 2005 is the sum of the exceptional results of firms filing their annual accounts with a closing date of 31 August 2006 and not the extrapolation of the figures obtained from the constant sample.

(2) This comparison disregards two practical points: equities and government bonds are two different financial instruments, and many large firms are not listed on the stock market. It must therefore be treated with caution.

CHART 5 RETURN ON EQUITY AFTER TAX AND INFLUENCE OF THE EXCEPTIONAL RESULT
(Percentages)



Source : NBB.

construction, the trend in profitability was more favourable. In SMEs the picture is more mixed; large increases were recorded in certain manufacturing branches, such as metallurgy and metalworking, tempered by falls in the non-manufacturing branches of transport and energy & water. The return on equity after tax also remains negative in more than a quarter of SMEs.

3.1.2 Leverage effect

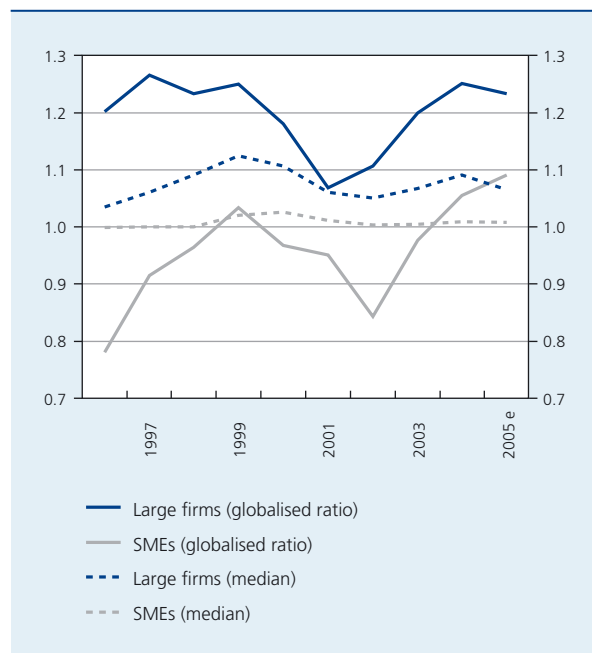
The return on equity after tax offers an indication of a firm's profitability. Another indicator supplements the analysis of profitability: the leverage. This is the ratio between the return on equity and the return on capital raised⁽¹⁾, both being calculated before tax and exceptional results. Leverage is defined by the following ratio:

$$\frac{\text{current result} / \text{equity capital}}{(\text{current result} + \text{cost of debt}) / \text{capital raised}}$$

By thus comparing a firm's financial return with its economic return, this multiplier indicates the positive effect – if it is greater than 1 – or the negative effect – if it is

less than 1 – which borrowings exert on the return on equity. If the economic return exceeds the average cost of borrowings, that produces a positive leverage effect

CHART 6 LEVERAGE EFFECT



Source : NBB.

(1) Capital raised means equity capital and financial liabilities, i.e. funds provided by third parties who are remunerated by the income generated by the assets which they have financed. This concept is preferred to the concept of total assets for assessing a firm's economic return in the context of leverage. The method of calculation is presented in the annex. For more information, visit the Central Balance Sheet Office website: www.nbb.be.

TABLE 5 RETURN ON EQUITY AFTER TAX BY BRANCH OF ACTIVITY (MEDIAN)
(Percentages)

	Large firms			SMEs		
	2003	2004	2005 e	2003	2004	2005 e
Manufacturing industry	7.3	10.0	9.2	5.3	6.7	6.8
of which:						
Agricultural and food industries	7.8	10.7	9.9	6.1	7.5	8.0
Textiles, clothing and footwear	4.2	6.4	5.2	2.8	3.3	3.7
Timber	3.5	9.9	9.4	4.0	5.7	4.9
Paper, publishing and printing	9.7	12.0	8.1	5.4	6.8	5.7
Chemicals	9.3	9.6	8.8	5.5	6.5	6.0
Metallurgy and metalworking	7.7	13.0	11.9	6.7	7.9	8.6
Metal manufactures	5.8	10.7	12.1	6.2	7.9	8.4
Non-manufacturing branches	9.5	11.6	11.5	6.1	6.8	6.7
of which:						
Retail trade	10.0	12.5	12.5	6.8	7.8	7.2
Wholesale trade	10.9	13.3	13.3	6.3	6.9	6.6
Horeca	5.3	6.9	7.2	4.3	4.0	4.6
Transport	8.8	10.9	10.4	7.5	7.6	6.5
Post and telecommunications	7.7	9.5	10.0	8.8	8.0	8.4
Real estate activities	5.0	6.0	6.5	1.4	1.6	2.1
Business services	6.3	9.5	8.4	9.1	10.4	10.1
Energy and water	9.8	6.9	6.1	3.9	8.4	3.4
Construction	8.3	9.6	12.2	8.0	9.1	8.7

Source: NBB.

enabling the firm to make a higher return on equity than the return on all its assets. The leverage effect therefore depends on the relative size of the financial debts, which are encouraged if the leverage effect is positive and discouraged if it is not.

The structural difference in the return between large firms and SMEs (see above) is reflected in the leverage effect which is mainly high in the case of large firms. Although the median is close to 1 in both cases, while favouring large firms, the globalised ratio takes better account of the movement in the results of the main non-financial corporations (chart 6). Although it is still clearly positive, the globalised leverage effect declined slightly in large firms in 2005. That applies, for instance, to the timber and chemical industries. This decline was tempered by favourable movements in some non-manufacturing branches, such as energy & water, hotels & restaurants, and transport, and the restoration of a positive leverage effect in real estate. It continued the rise which had begun in 2003 in SMEs, where it was positive for the second consecutive year as a result of the positive difference between a high

financial return on equity and historically low interest rates. Attention should be drawn here to the increase in the ratio in the majority of manufacturing branches in 2005, including chemicals and metalworking, the leverage effect reverting to positive in this last branch.

In recent years, the leading non-financial corporations therefore presented a particularly favourable picture in terms of their financial debt burden, from an accounting point of view. The debt level remained stable over the period, and actually declined somewhat in 2005, falling below 29 p.c. of the total liabilities in non-financial corporations as a whole. That decline is due partly to the lower leverage in large firms, recorded in the same year. The same applies to total debts⁽¹⁾, which levelled out at 55 p.c. of the total liabilities of large firms and 65 p.c. of the total for SMEs. This is connected partly with the economic uncertainty in the last year or two, which has delayed substantial investments, and partly with the increasing

(1) Sum of short-term and long-term debts.

return on equity mentioned earlier, making this method of financing highly attractive to shareholders, sometimes to the detriment of borrowings. Another factor, relating to corporate taxation, also played a part. It is analysed in detail in the next section.

3.2 Solvency

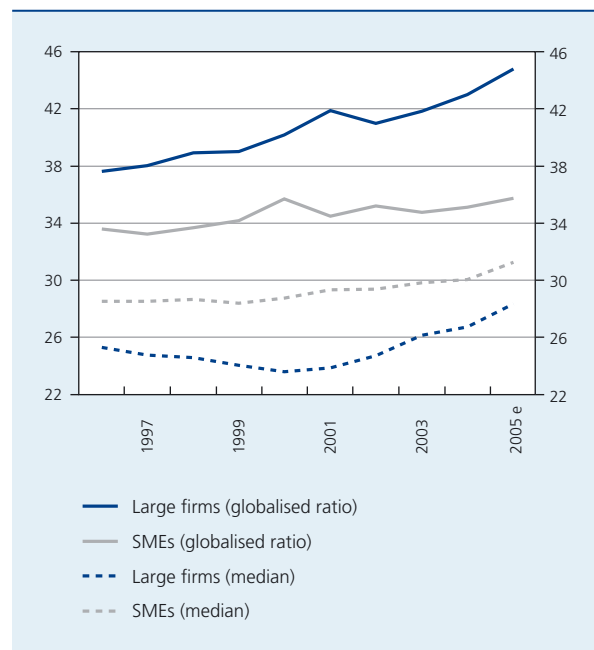
Solvency corresponds to the ability of firms to honour all their short-term and long-term financial commitments. It is analysed on the basis of three concepts: the degree of financial independence, the degree to which borrowings are covered by the cash flow, and the interest charges on financial liabilities.

The degree of financial independence is equal to the ratio between equity capital and total liabilities. If the ratio is high, the firm is independent of borrowings. This has two beneficial effects: first, financial expenses are low and therefore exert little downward pressure on profits; also, the firm has more scope for contracting new debts on favourable terms. Analysed in these terms, solvency can also be interpreted as a measure of the firm's financial risk, since the remuneration of third parties is fixed, unlike the firm's results. In 2005, globalised financial independence stood at 44.8 p.c. in large firms and 35.7 p.c. in SMEs, an increase against the previous year. The difference between these two values is structural, and has actually tended to widen since 2003 (chart 7), owing to the increase in the proportion of equity capital in the largest firms. Companies as a whole have seen their financial independence increase since 2001, as is evident from the two median ratio curves. There was therefore an increase in the percentage of total liabilities represented by the equity over this period, and especially in 2005, the year in which a new corporation tax system was introduced, concerning the notional interest deduction (see box 1). The median for SMEs is higher than for large firms.

The order is therefore the reverse of that for the globalised curves, the main reason being the existence of a large number of SMEs making little use of borrowings⁽¹⁾. But around these central values, the ratio distribution is such that almost 16 p.c. of the firms considered present negative financial independence, as a result of losses carried forward in excess of the sum of the subscribed capital and reserves. That observation tempers the positive picture presented above.

(1) This need not mean that the proportion of SMEs with a high debt ratio is lower than for large firms.

CHART 7 DEGREE OF FINANCIAL INDEPENDENCE
(Percentages)



Source : NBB.

Box 1

The equilibrium thus achieved in the balance sheet figures forms the basis of the reasoning behind the design of the new scheme concerning the "notional interest" deduction. Synonymous with a risk capital allowance, this device offers an incentive to take risks for firms which are subject to Belgian corporation tax. Before the scheme's introduction by the legislature in June 2005 in the income tax code, it was normally only borrowed capital that gave rise to an allowance for interest charges, while the remuneration of the capital provided by shareholders was included in the corporate tax base. The introduction of a risk capital allowance reduces the difference between the cost of capital according to source. The tax base can thus be reduced by a notional amount of interest on



the equity, calculated at the reference rate on 10-year bonds. These new provisions will take effect from the 2007 fiscal year, the equity capital as at 31 December 2005 being taken, in principle, as the basis for calculating the first allowance⁽¹⁾. At the same time, share issue rights (0.5 p.c.) were abolished at the beginning of 2006. The government expects that this device for reducing the corporate tax burden will boost capital investment in Belgium and augment the tax efficiency of inter-group financing, while providing an alternative to the coordination centre arrangements which are being terminated. It should also result in a relative reduction in the debt levels of companies taxed in Belgium, as already mentioned in section 3.1.2; that is apparently borne out by the movement in the financial independence ratio in 2005 (see above). However, the scheme does not allow for any differentiation according to the use to which the capital is allocated.

(1) 31 December 2005 was taken as the date for all firms with a financial year corresponding to the calendar year. Calculated *pro rata temporis* for any increase in the equity capital recorded from 1 January 2006 onwards. For details, see the Financial Stability Review 2006 and www.fiscus.fgov.be.

There are two other elements which complete the solvency analysis: the ability of firms to repay their debts, and the cost of those debts. These are concepts relating to the possible consequences of corporate financial dependence.

As a measure of the percentage of its debts that the firm could repay by allocating the whole of the year's cash flow to that purpose⁽¹⁾, the degree to which borrowings are covered by cash flow indicates the firm's repayment capability. The converse of that ratio indicates the number of years which it would take to repay all the debts at a constant cash flow. A low level of financial independence associated with a high level of indebtedness may very well be mitigated by a substantial repayment capability indicated by this ratio, and vice versa.

In 2005, the globalised cover rate of borrowings increased in both large firms and SMEs (chart 8). Following a decline in 2004, this ratio made a significant recovery the next year in large firms to reach 12.6 p.c., a level close to that achieved in 1997. The stagnation of debts combined with a substantial increase in the leading companies' cash flow – sometimes including large exceptional results – explains a phenomenon seen mainly in the manufacturing branches of chemicals and metalworking, but also in the non-manufacturing branches of transport and post and telecommunications. The globalised ratio also improved in SMEs, rising to 11.7 p.c. Together, these increases plus growing financial independence contribute towards a real increase in the solvency of non-financial corporations.

As regards the population as a whole, the median ratio for large firms, which had peaked in 2004, remained stable in the following year at 11.4 p.c. In contrast, in SMEs it attained a record for the period at 13.3 p.c. These levels are significantly different from the globalised values, underlining the potential influence of a small number of companies on the numerators and denominators in the calculation of the global figure.

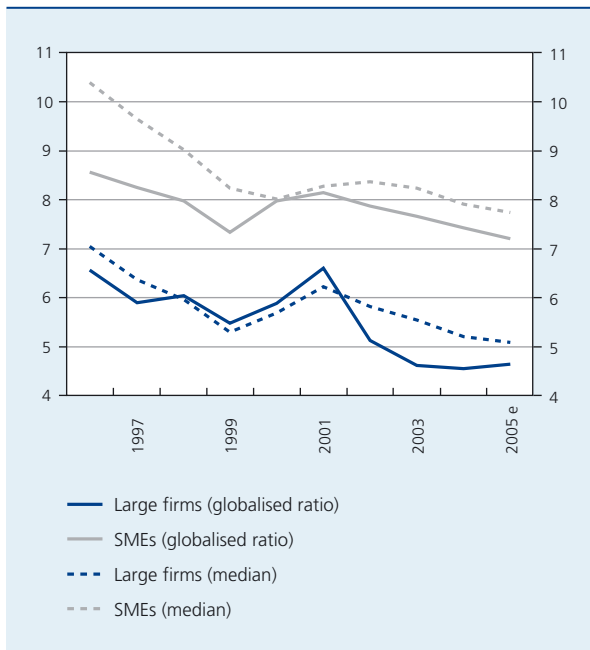
CHART 8 DEGREE TO WHICH BORROWINGS ARE COVERED BY CASH FLOW
(Percentages)



Source: NBB.

(1) This means the net flow of cash generated by the firm, equal to the difference between incoming revenue and outgoing expenditure.

CHART 9 AVERAGE INTEREST CHARGES ON FINANCIAL DEBTS
(Percentages)



Source : NBB.

The cost of borrowing is assessed as the average interest charges on financial debts. In 2005 these charges, in globalised terms, came to 4.6 p.c. in the case of large firms and 7.2 p.c. for SMEs, levels comparable to those recorded in the previous year (chart 9), the main reason being that market interest rates remained at a historically low level. Combined with a financial debt level remaining stable over time (see above), the lower interest rates led to a decline in charges from 2002 onwards, regardless of the size of the firms. Structurally, this ratio is lower in large firms than in SMEs. The reason is that lenders consider the financial profile of SMEs as a whole to be less sound than that of large firms for the same method of financing, hence the supplementary risk premium applied to SMEs⁽¹⁾. Although the difference between the financial charges of these two categories of firms has varied over time, it does seem to have diminished since 2003, the year in which it reached a peak. The median values also indicate a decline in interest charges.

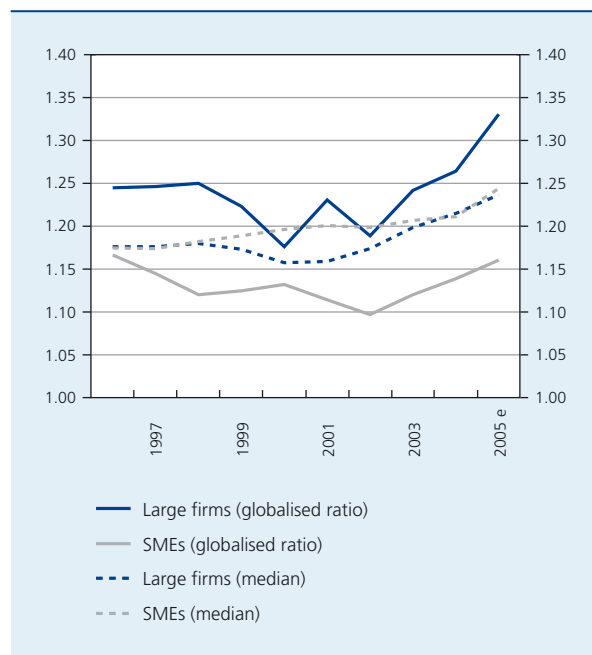
(1) SMEs also make more use of cash loans, a more expensive form of credit.

3.3 Liquidity

Liquidity indicates the capacity of firms to mobilise the cash resources needed to meet their short-term commitments, i.e. to repay debts falling due during the year. The liquidity ratio in the broad sense is commonly used for that analysis. This representation of the net working capital in the form of a ratio compares the total assets realisable and available (stocks, claims at up to one year, cash investments, liquid resources and accruals and deferrals) with the short-term liabilities (debts at up to one year and accruals and deferrals). The higher the liquidity in the broad sense, the more capable the firm of meeting its short-term financial commitments. If the ratio is higher than 1, the net working capital is positive.

In 2005, the globalised ratio was 1.33 for large firms and 1.16 for SMEs, having risen steadily since 2003 (chart 10). Firms achieved a financial balance which, overall, was better than in recent years, improving their ability to meet their short-term debt repayments. Among large firms the situation showed a marked improvement in chemicals, metalworking, energy and water, construction, post and telecommunications, real estate and business services. In the case of SMEs, large increases were recorded in metalworking, energy and water, and business services. Median liquidity also continued to rise in 2005, as the curves for large firms and SMEs converged. It should be remembered that the globalisation accords more weight

CHART 10 LIQUIDITY IN THE BROAD SENSE



Source : NBB.

to large firms and is therefore only a partial reflection of reality, while the median disregards the size disparities between players. The good performance shown in chart 10 therefore conceals the fact that over 38 p.c. of firms have negative net working capital. Furthermore, the liquidity ratio in the broad sense takes no account of a key dimension of business cash flow management, a defect which the next chart attempts to rectify.

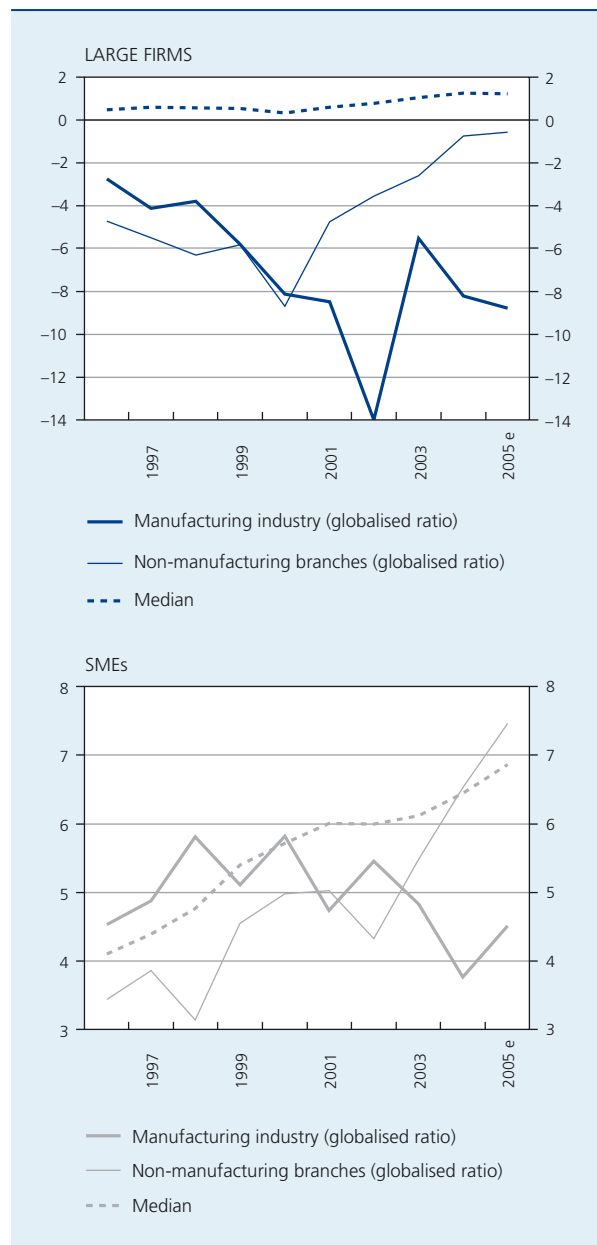
The picture presented by liquidity may in fact vary considerably according to the ratio used for its analysis. Thus, the ratio of net cash flow to total assets, shown in chart 11, plainly shows that the largest firms have negative net cash flow, while their liquidity in the broad sense is high.

The net cash flow is calculated as the difference between active cash flow (cash investments and liquid assets) and the passive cash flow (short-term financial liabilities). In large firms, the globalised ratio indicates that the former tends to be exceeded by the latter, since this ratio is negative here, despite a relative increase since 2003. That situation implies that the net working capital falls short of the need for working capital, a dimension which is specifically disregarded by the preceding ratio. The requirements associated with the firm's operating cycle are therefore no longer covered simply by its net working capital. The largest variations, both up and down, during the period were recorded in large firms in the non-manufacturing sector providing business services – coordination centres⁽¹⁾ and financial services – and in the manufacturing sector in chemicals and petrochemicals. The cash flow of large non-manufacturing firms was close to equilibrium in 2005, whereas it continued to decline in manufacturing industries in the paper and metallurgy branches, further widening the gap between the two categories of firms. The higher net cash flow recorded by SMEs in the same year is due to the increases in metalworking and energy & water, tempered partly by the falls in chemicals and post and telecommunications.

The median values are positive whatever the company size, but are 5 points higher in SMEs. The difference between the net cash flow of large firms and SMEs is due to the fact that, in collecting their financial debts, large firms have substantial room for manoeuvre accorded by their claims and stocks. In addition, they are granted a median period of supplier credit greater than that of SMEs. From a more theoretical point of view, the companies with a negative net cash flow have to act rapidly to rectify that imbalance by optimising their cash management, which amounts to improving their net working capital.

The situation of firms with an adverse cash flow can be ascertained from an examination of overdue debts to the tax authority and the NSSO, mentioned in the annex to the annual accounts. Although the number of firms concerned here has fallen, the amounts involved have continued to rise, both in large firms and in SMEs. However, this finding can be qualified by considering the movement in the ratio between these amounts and the total assets of only those firms concerned (chart 12), though it must be

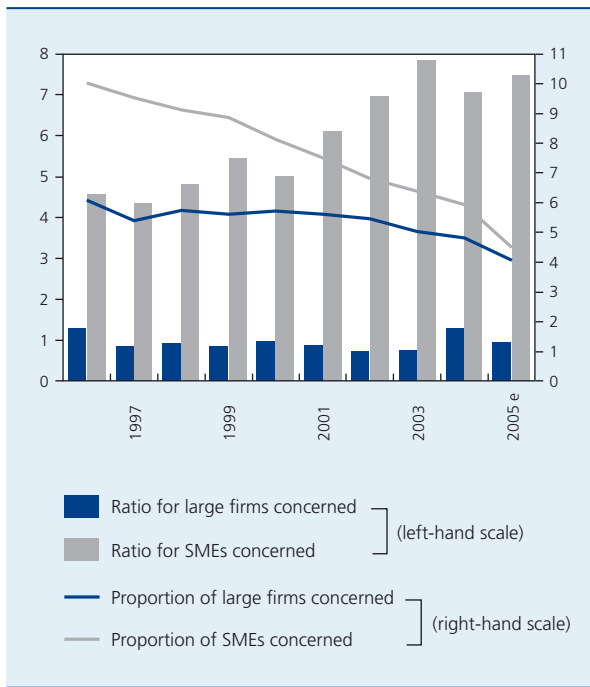
CHART 11 NET CASH FLOW IN RELATION TO TOTAL ASSETS
(Percentages)



Source: BNB.

(1) The large negative cash flow of the coordination centres is inherent to their definition and functions.

CHART 12 OVERDUE DEBTS TO THE TAX AUTHORITY AND THE NSSO IN RELATION TO TOTAL ASSETS (GLOBALISATION)
(Percentages)



Source: NBB.

stressed that this ratio is structurally higher in SMEs than in large firms. The left-hand scale presents, according to size, the percentage attained by that globalised ratio in firms with overdue debts to the tax authority and the NSSO. The right-hand scale indicates the proportion which these firms represent of the population considered.

Almost all the firms with overdue debts to the tax authority and the NSSO, namely 97 p.c., are SMEs. But in 2005, this percentage was only slightly higher than the percentage of SMEs in the total population. The proportion of large firms and SMEs in that situation in fact converged in that year, being 4.1 p.c. for the former and 4.5 p.c. for the latter. The improvements already mentioned concerning the financial situation of SMEs appear to be confirmed here. But while the ratio of overdue debts to total assets dropped below 1 p.c. in large firms, it began rising again in SMEs in 2005, at 7.5 p.c., following a year of decline. The first branches to be affected by this rise were chemicals and textiles. The decline in large firms occurred mainly in the non-manufacturing branches, such as wholesale trade and business services.

(1) In the previous article the median value of the investment ratio was calculated by taking all firms into account. In this article, the median value is calculated solely on the basis of firms which effected investments (namely acquisitions of tangible fixed assets not equal to zero). As a result, the median ratios are below the 2004 levels.

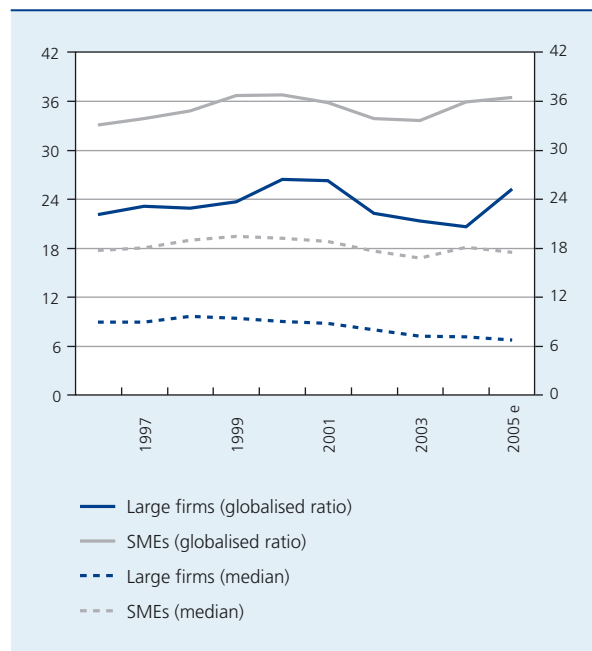
3.4 Investment

The amount which firms devote to investment can be assessed by the rate of investment, which is the ratio between acquisitions of tangible fixed assets and the value added for the year. A high ratio indicates that firms have invested substantially during the year under review.

The year 2005 brought a revival in total investment following a marked decline in the preceding years. This seems to reflect an effort to catch up, following a period in which investments were postponed pending more favourable economic conditions. The investment growth was more marked in large firms (chart 13 globalised ratio), where the rate increased by almost 5 points in a single year to 25.3 p.c. in 2005. It rose to 36.5 p.c. in SMEs in the same year, following a more modest increase (0.6 point). Despite this difference and the apparent dominance of large firms, the ratio of acquisitions of tangible fixed assets to value added remained higher in SMEs. Their lead is due to the fact that their value added is structurally lower than that of large firms as a percentage of the sums invested.

In contrast to the global figures, the median indicates a slight fall in the investment rate in both large firms and SMEs in 2005⁽¹⁾. That finding tends to show that the major part of the relative growth of investment is

CHART 13 INVESTMENT RATE
(Percentages)



Source: NBB.

attributable to only a small number of large firms, and does not reflect what is happening in non-financial corporations as a whole.

For 53 p.c. of all firms, the investment ratio did not exceed 20 p.c. Moreover, 16 p.c. of them recorded a ratio in excess of 100 p.c.

The sectoral analysis shows that this strong rise in the globalised ratio for large firms is due essentially to the non-manufacturing branches (chart 14), and more particularly to construction and transport. This almost exclusively concerns the BNRC group, split into three companies since January 2005 (BNRC, Infrabel and NNRC Holding), which developed a substantial investment plan for 2005-2007. The marine transport branch also saw heavy investment in 2005, such as the renovation and enlargement of the fleet of vessels. In the case of SMEs, the majority of the branches recorded a relatively stable investment ratio, both as a median and in globalised form.

In manufacturing industry, large firms saw their investment shrink, especially in the metallurgy and metalworking branches, petrochemicals and textiles. The decline in investment in the textile branch is in line with the cuts in the production volume (relocation of production to

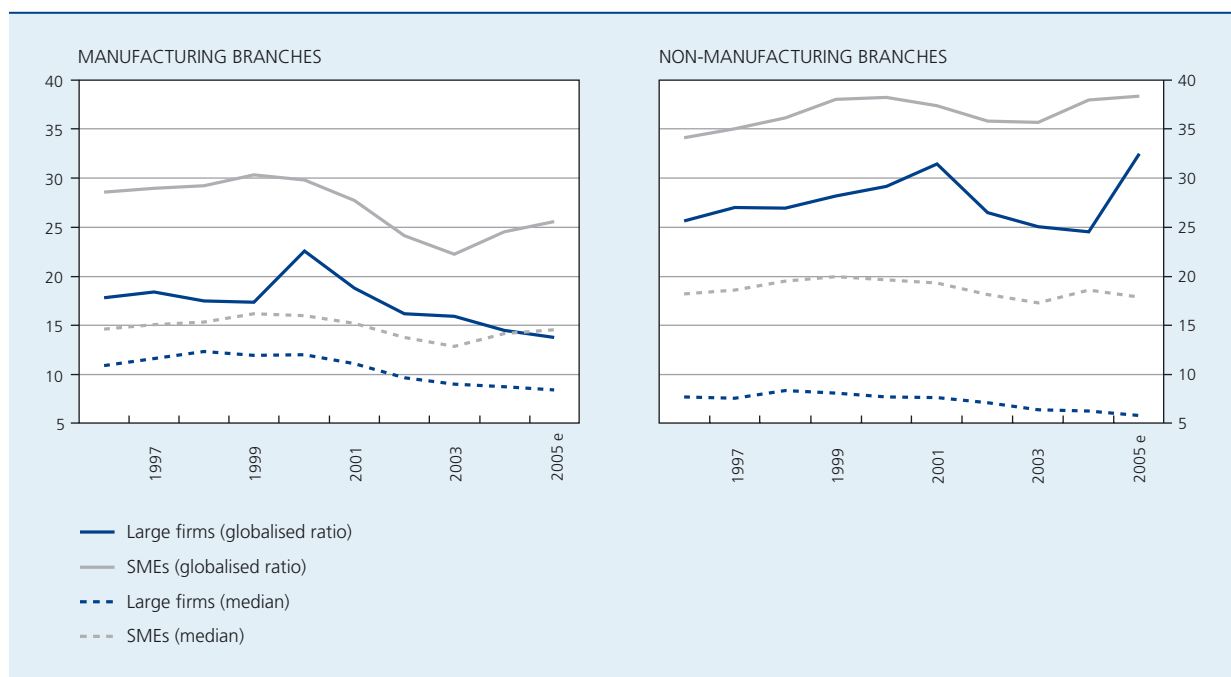
low-wage countries, except for logistics). In the case of SMEs, the branches which invested most heavily in relative terms are metallurgy and metalworking, oil refining and the paper industry. The median figures follow a similar pattern to the globalised figures.

Chart 15 reveals the link between the investment rate and the capacity utilisation rate in manufacturing firms. For 2005, the decline in investment was accompanied by a fall in the average capacity utilisation rate. The investment rate, falling by half a point over the year to 15.2 p.c., reached in 2005 its lowest level for the past ten years. These findings are in line with a downward trend in investment in manufacturing industry.

Up to now, it is only the ratio between acquisitions of tangible fixed assets and value added that has been reported. However, the annex to the annual accounts also provides information on intangible fixed assets, including research and development costs⁽¹⁾.

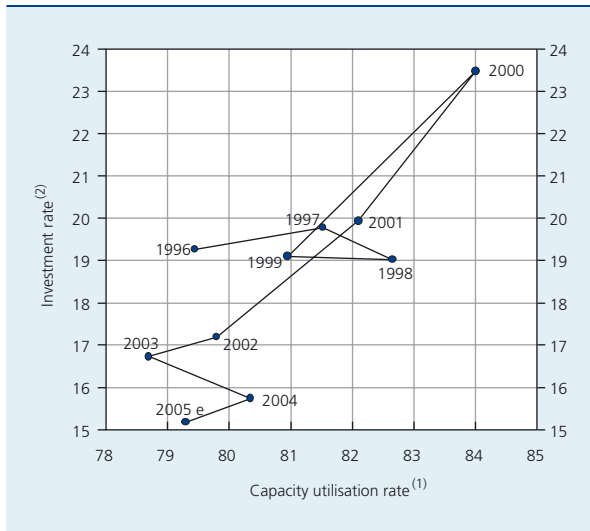
(1) The information is available only for firms filing full-format accounts. Research and development costs should be understood as the cost of research, manufacture and development of prototypes, products, inventions and know-how useful in the firm's future activities (Royal Decree of 30 January 2001 implementing the Companies Code, Article 15).

CHART 14 INVESTMENT RATE
(Percentages)



Source : NBB.

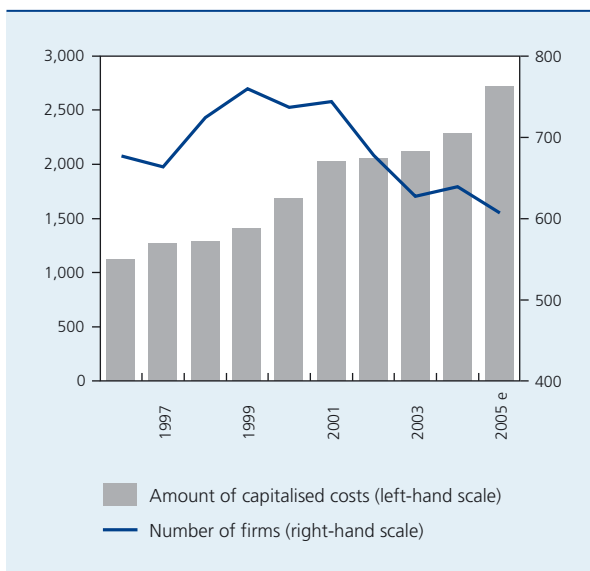
CHART 15 INVESTMENT RATE AND CAPACITY UTILISATION RATE IN MANUFACTURING INDUSTRY



Source : NBB.
 (1) Annual average.
 (2) Globalised for manufacturing firms in general.

Chart 16 shows that the number of firms investing in research and development has tended to decline for some years now, falling to 607 in 2005. However, the total amounts invested in this area have increased to

CHART 16 CAPITALISED RESEARCH AND DEVELOPMENT COSTS⁽¹⁾
 (Millions of euros, unless otherwise stated)



Source : NBB.
 (1) Acquisitions for the year, including capitalised production costs.

2.7 billion euro. The 426.8 million euro increase in 2005 is attributable to large firms, especially in the petrochemical branch and, to a lesser extent, metalworking and business services. In the chemicals branch, despite the fact that investment was down for the third consecutive year, expenditure on research and development continued to rise. In 2005, chemicals, including pharmacy, accounted for around two-thirds of all private sector research and development expenditure in Belgium.

3.5 Financial risks

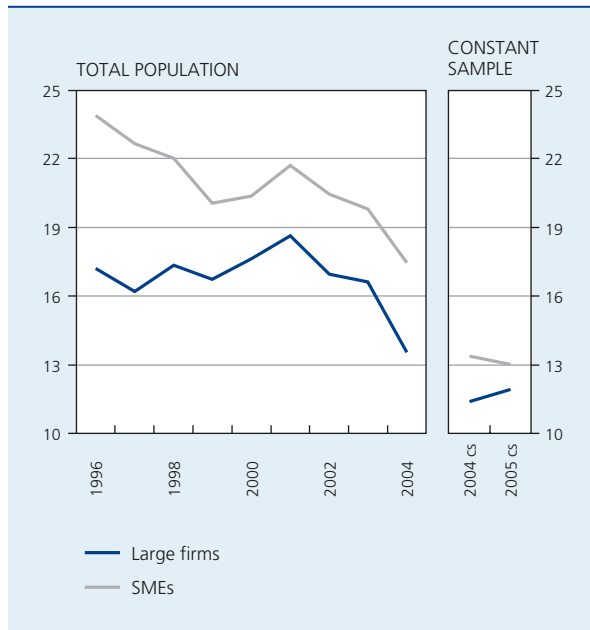
In order to assess the financial risks incurred by firms, the National Bank has developed an internal business failure prediction model, presented in previous editions of this article⁽¹⁾. The main attraction of the model is that it summarises all aspects of a firm's financial situation in a single figure: the risk score L. On that basis, four risk classes were defined, corresponding to intervals in the score L. They divide firms into homogenous risk zones on the basis of the percentage of failing firms:

- class 1: $L < -0.84$: healthy firms with practically zero risk of failure within three years;
- class 2: $-0.84 \leq L < 0.21$: neutral firms, where the probability of failure within three years is comparable to the average;
- class 3: $0.21 \leq L < 1.10$: firms in difficulty, where the probability of failure within three years is 3 to 4 times higher than average;
- class 4: $1.10 \leq L$: firms in great difficulty, where the probability of failure within three years is more than 10 times higher than average.

This classification of the firms must be used with caution. For one thing, only a tiny proportion (between 1.5 and 2 p.c. depending on the year) of the firms examined will actually go bankrupt or apply for judicial composition. The classification should therefore be viewed as an indication of financial health rather than a true prediction of failure: firms in classes 3 and 4 are not necessarily destined for bankruptcy, but they are prone to serious financial problems. Bankruptcy aside, those problems are liable to lead to delay in repaying debts or paying suppliers, redundancies, restructuring or cessation of activity. Another important point is that a number of Belgian firms in difficulty are members of multinational groups which are prepared to provide financial support, at least temporarily. Moreover, the classification is an incomplete

(1) See the Economic Review editions IV-2004 and IV-2005. A more detailed description of the methodology was published in Coppens F., A. Hermesse and D. Vivet (2004), "The ICT sector in Belgium", Economic Review I-2004, National Bank of Belgium, Brussels.

CHART 17 PERCENTAGE OF FIRMS IN CLASSES 3 AND 4



Source : NBB.

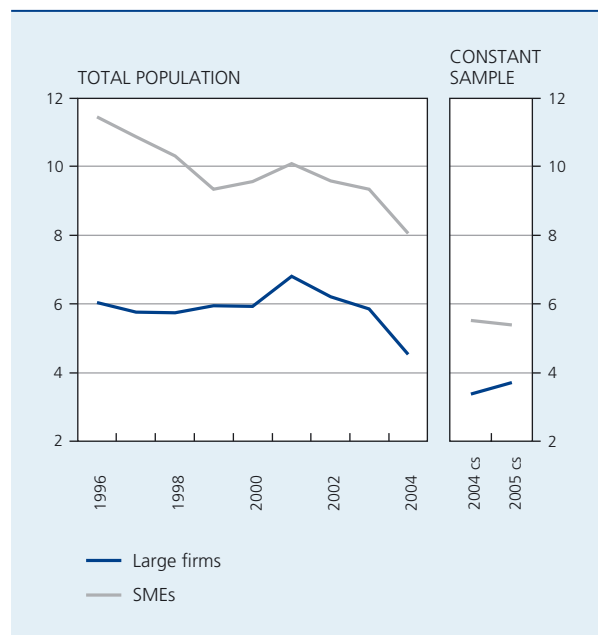
assessment of the firms' economic situation, as it is based only on analysis of the annual accounts. Other important aspects, such as management quality, the competitive environment, the economic situation and development prospects, are therefore disregarded. Thus, the classification must be viewed as a strictly financial assessment of the firms at a particular moment.

As pointed out in the first section of this article, the annual accounts filed late come from firms whose financial profile is less favourable overall. These filing delays are particularly significant in the case of firms in classes 3 and 4, which are therefore decidedly under-represented in the annual accounts currently available for the 2005 financial year. Tests conducted on previous years show that the trend in the risks observed in the constant sample is not systematically representative of the real trends; that applies particularly to SMEs, which form the very large majority of firms filing their accounts late. This methodological problem is the reason why the comments here are confined to the level of risk up to 2004. In order to provide an initial impression of the latest tendencies, the trends apparent in the constant sample are also presented, but separately.

In 2004, the proportion of firms placed in classes 3 and 4 came to 13.5 p.c. for large firms and 17.5 p.c. for SMEs (chart 17). Those firms employ a total of 172,000 workers, including 62,000 in class 4. During the three years which followed the cyclical trough of 2001, the risks have steadily waned (regardless of company size), reflecting the general improvement in the profitability, solvency and liquidity of Belgian firms, described earlier. According to the initial indications obtained from the constant sample, this downward trend was halted for large firms and slowed significantly for SMEs in 2005. In the case of large firms, the recent increase in the risks is due mainly to industry, but also to certain service branches such as construction and trade. As regards the risks facing SMEs, while they are stable or declining slowly in the majority of branches, they are climbing sharply in chemicals and metallurgy. Today, however, it is textiles and hotels & restaurants which have the largest number of vulnerable firms, with one quarter of firms in classes 3 and 4.

Chart 17 shows that, in line with the statistics on bankruptcies and judicial composition proceedings, the proportion of firms at risk is structurally higher for SMEs than for large firms. In addition, as is evident from chart 18, that difference is due almost exclusively to the proportion of firms in great difficulty (class 4). While the percentage of SMEs in class 3 is practically the same as that for large firms, the same cannot be said of class 4: in 2004, 4.5 p.c. of large firms were in great difficulty, compared to 8.1 p.c. of SMEs.

CHART 18 PERCENTAGE OF FIRMS IN CLASS 4



Source : NBB.

Conclusion

In 2005, the economic context was less favourable than in 2004, owing to the weakening of both foreign and domestic demand. In these circumstances, the growth of the total value added generated by non-financial corporations slowed down, falling from 6.6 p.c. in 2004 to 4 p.c. in 2005. At the same time, operating costs increased more slowly than value added for the third consecutive year. That situation led to a further significant rise in the net operating result (+8.4 p.c.), which had already produced an exceptional increase in 2003 and 2004. In the space of three years, the operating result increased by around 12 billion euro or almost 70 p.c., essentially thanks to the control of operating costs in a generally favourable economic climate.

The financial and exceptional results recorded a very large net profit in 2005. After aggregation of all the profit and loss account items, non-financial corporations made a record net profit of almost 41 billion euro, over 50 p.c. higher than in 2004. Excluding the exceptional result, profits came to almost 30 billion euro. For the record, the net result excluding exceptional results has doubled since 2002.

Strongly influenced by fluctuations in the exceptional result, the return on equity after tax increased significantly in the leading firms in 2005. With slightly lower leverage in large firms, financial liabilities were down and financial independence remained strong. Thanks to the persistently low interest rates, average interest charges continued to fall. The net working capital of large firms and SMEs did increase, although it remained negative for more than one-third of the population. The net cash flow analysis over the period 1996-2005 also reveals that the working capital requirement of large firms tends to exceed their net working capital. The year 2005 saw the leading companies, mainly large non-manufacturing firms, catching up on their investment, after several quiet years. However, according to the median approach investment was down. The decline recorded in manufacturing industry was accompanied by a fairly significant fall in the capacity utilisation rate. The amounts invested in research and development expanded once again, but concerned a smaller number of firms. Finally, after a marked fall in preceding years, the financial risks appear to have stabilised in 2005. The vulnerability of large firms even increased slightly in 2005.

Annex 1 : Sectoral classification

SECTORAL CLASSIFICATION

	NACE-Bel code
Manufacturing industry	15-37
of which:	
Agricultural and food industries	15-16
Textiles, clothing and footwear	17-19
Timber	20
Paper, publishing and printing	21-22
Chemicals	24-25
Metallurgy and metalworking	27-28
Metal manufactures	29-35
Non-manufacturing branches	01-14 and 40-95
of which:	
Retail trade	50-52
Wholesale trade	51
Horeca	55
Transport	60-63
Post and telecommunications	64
Real estate activities	70
Business services	72-74 ⁽¹⁾
Energy and water	40-41
Construction	45

(1) Except 74,151 (management of holding companies).

Annex 2 : Definition of the ratios

DEFINITION OF THE RATIOS

	Item numbers allocated	
	full-format ⁽¹⁾	abbreviated format
1. Gross margin on sales		
Numerator (N)	70/64 + 64/70 + 630 + 631/4 + 635/7	70/64 + 64/70 + 630 + 631/4 + 635/7
Denominator (D)	70 + 74 – 740	70
Ratio = N/D × 100		
Condition for calculation of the ratio:		
	70 > 0 (abbreviated format) ⁽²⁾	
2. Net margin on sales		
Numerator (N)	70/64 + 64/70 + 9125	70/64 + 64/70 + 9125
Denominator (D)	70 + 74 – 740	70
Ratio = N/D × 100		
Condition for calculation of the ratio:		
	70 > 0 (abbreviated format) ⁽²⁾	
3. Return on equity		
Numerator (N)	70/67 + 67/70	70/67 + 67/70
Denominator (D)	10/15	10/15
Ratio = N/D × 100		
Conditions for calculation of the ratio:		
	Exercice comptable de 12 mois	
	10/15 > 0 ⁽²⁾	
4. Leverage effect		
Numerator (N)	(70/65 + 65/70) / (10/15)	(70/65 + 65/70) / (10/15)
Denominator (D)	(70/65 + 65/70 + 650) / (10/15 + 170/4 + 43 + 8801)	(70/65 + 65/70 – 65) / (10/15 + 170/4 + 42 + 43)
Ratio = N/D		
Conditions for calculation of the ratio:		
	12-month financial year	
	10/15 > 0 ⁽²⁾	
	10/15 + 170/4 + 43 + 8801 > 0 (full format) ⁽²⁾	
	10/15 + 170/4 + 42 + 43 > 0 (abbreviated format) ⁽²⁾	
5. Degree of financial independence		
Numerator (N)	10/15	10/15
Denominator (D)	10/49	10/49
Ratio = N/D × 100		

(1) In which the profit and loss account is presented in list form.

(2) Condition valid for the calculation of the median but not for the globalised ratio.

DEFINITION OF THE RATIOS (continued)

	Item numbers allocated	
	full-format ⁽¹⁾	abbreviated format
6. Degree to which borrowings are covered by cash-flow		
Numerator (N)	70/67 + 67/70 + 630 + 631/4 + 6501 + 635/7 + 651 + 6560 + 6561 + 660 + 661 + 662 – 760 – 761 – 762 + 663 – 9125 – 780 – 680	70/67 + 67/70 + 8079 + 8279 + 631/4 + 635/7 + 656 + 8475 + 8089 + 8289 + 8485 – 9125 – 780 – 680
Denominator (D)	16 + 17/49	16 + 17/49
Ratio = N/D × 100		
Condition for calculation of the ratio:		
12-month financial year		
7. Average interest charges on financial debts		
Numerator (N)	650	– 65 – 9125 – 9126
Denominator (D)	170/4 + 42 + 43	170/4 + 42 + 43
Ratio = N/D × 100		
Condition for calculation of the ratio:		
12-month financial year		
8. Liquidity in the broad sense		
Numerator (N)	3 + 40/41 + 50/53 + 54/58 + 490/1	3 + 40/41 + 50/53 + 54/58 + 490/1
Denominator (D)	42/48 + 492/3	42/48 + 492/3
Ratio = N/D		
9. Net cash in relation to total assets		
Numerator (N)	50/53 + 54/58 – 43	50/53 + 54/58 – 43
Denominator (D)	10/49	10/49
Ratio = N/D × 100		
10. Investment rate		
Numerator (N)	8169 + 8229 – 8299	8169 + 8229 – 8299
Denominator (D)	70/74 – 740 – 60 – 61	70/61 + 61/70
Ratio = N/D × 100		
Conditions for calculation of the ratio:		
70/74 – 740 – 60 – 61 > 0 (full format) ⁽²⁾		
70/61 + 61/70 > 0 (abbreviated format) ⁽²⁾		

(1) In which the profit and loss account is presented in list form.

(2) Condition valid for the calculation of the median but not for the globalised ratio.