

Trend in the financial structure and results of firms in 2006

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Introduction

Every year, in the December Economic Review, the National Bank describes the developments taking place in the annual accounts of non-financial corporations. 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. This year, the article includes in addition an analysis of the recent changes in corporate income tax.

This article comprises four sections. Section 1 briefly describes the methodology and sample used. Section 2 presents an extrapolation of the main profit and loss account items. Section 3 assesses the financial situation of companies, particularly their level of profitability, solvency and liquidity. Finally, the last section focuses on an analysis of the latest tax changes.

1. Methodology and constant sample

1.1 Characteristics of the data used and 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 2006 – raises methodological questions.

The population of annual accounts relating to 2006 is incomplete, mainly because some firms are late in filing their annual accounts. Moreover, those same firms are often in a structurally less favourable financial position than firms which file their accounts in time to meet the deadline. Previous editions of this article have highlighted the significant differences between firms according to the date on which they file their annual accounts. In all probability, the data currently available for 2006 present an over-optimistic view of reality.

Owing to these problems, the 2006 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 2005-2006 comprises firms which filed annual accounts for both 2005 and

TABLE 1 COMPOSITION AND REPRESENTATIVENESS OF THE CONSTANT SAMPLE 2005-2006

	Firms in the 2005-2006 sample	All non-financial corporations in 2005	Representativeness of the sample, in p.c.
Number of firms	152,989	272,146	56.2
Large firms	6,181	8,365	73.9
SMEs	146,808	263,781	55.7
Manufacturing industry	13,622	22,896	59.5
Non-manufacturing branches	139,367	249,520	55.9
Balance sheet total (millions of euro)⁽¹⁾	830,518	1,003,407	82.8
Large firms	706,959	815,352	86.7
SMEs	123,559	188,055	65.7
Manufacturing industry	229,432	240,790	95.3
Non-manufacturing branches	601,086	762,618	78.8

Source : NBB.

(1) For firms in the constant sample, the balance sheet total taken into account is the 2005 figure.

2006.⁽¹⁾ The method consists in extrapolating the 2006 results on the basis of the trends found in the constant sample: the 2006 figures are obtained by taking the final figures for 2005 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, that assumption is largely borne out since, in the vast majority of cases, the estimates give an accurate representation of the direction and scale of the actual movements. Table 1 shows the constant sample for 2005-2006.

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 their own branch of activity, and these are generally reflected in the movement in their annual accounts.

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

- firms employing over 100 people, as an annual average, or
- firms which exceed at least two 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.⁽²⁾

Firms which do not meet these criteria, i.e. SMEs, can draw up their annual accounts in an abridged 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

(1) In order to be included in the sample, firms must also 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 2005 were filed before 31 August 2006;
 – the annual accounts relating to 2006 were filed before 31 August 2007.

(2) Details of these criteria may be found in Article 15 of the Companies Code.

are thus no longer included in the population of large firms but are placed in the SME category.⁽¹⁾

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 2.

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

2.1 General trends and cyclical context

After slowing down in 2005, GDP growth (at constant prices) came to 2.8 p.c. in 2006, almost equalling the 2004 figure (+ 3 p.c.). Overall, the economic environment was broadly favourable to businesses in 2006: expanding export markets, a stable currency, slowing of the rate of

oil price rises, low long-term interest rates and rising stock markets. The economic expansion was in fact based on the main components of both domestic demand (private consumption, investment, change in stocks) and foreign demand (exports).

In that context, the value added of non-financial corporations followed the trend in GDP: its growth rate in fact accelerated in 2006, to reach 6.3 p.c. at current prices, a level comparable to that of 2004 (cf. table 2). Total value added, i.e. the difference between sales revenues and the cost of goods and services supplied by third parties, thus came to almost 155 billion euro (at current prices).

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 reflects the firm's current industrial and commercial efficiency, independently

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

TABLE 2 MAIN COMPONENTS OF THE PROFIT AND LOSS ACCOUNT

	Percentage changes compared to the previous year					Millions of euro	Percentages of value added
	2002	2003	2004	2005	2006 e	2006 e	2006 e
Value added	1.4	4.4	6.6	4.6	6.3	154,994	100.0
Staff costs (-)	3.2	1.6	3.4	3.0	4.7	86,270	55.7
Depreciation, downward value adjustments and provisions (-)	-2.3	-2.9	-1.8	4.3	8.7	27,163	17.5
Other operating expenses (-)	-2.1	9.3	9.7	5.1	3.1	8,849	5.7
<i>Total operating expenses</i>	<i>1.5</i>	<i>1.0</i>	<i>2.7</i>	<i>3.4</i>	<i>5.5</i>	<i>122,282</i>	<i>78.9</i>
Net operating result	0.7	25.5	26.5	9.2	9.2	32,712	21.1
Financial income (+)	24.5	6.8	-12.4	-4.4	11.4	46,678	30.1
Financial charges (-)	38.9	4.6	-15.9	-10.9	9.2	36,785	23.7
<i>Financial result</i>	<i>42.2</i>	<i>31.8</i>	<i>18.0</i>	<i>36.5</i>	<i>20.8</i>	<i>9,893</i>	<i>6.4</i>
Ordinary result	11.3	26.7	24.9	14.1	11.7	42,605	27.5
Exceptional result ⁽¹⁾ (+)	-	-	-	-	-	9,181	5.9
Net result before tax	26.9	77.0	2.3	47.4	5.1	51,785	33.4
Taxes on profits (-)	-5.0	7.0	11.5	10.9	4.9	8,546	5.5
Net result after tax	34.5	112.1	-0.1	57.7	5.1	43,239	27.9
<i>p.m. Net result after tax excluding the exceptional result</i>	<i>13.7</i>	<i>34.8</i>	<i>29.2</i>	<i>15.0</i>	<i>13.6</i>	<i>34,059</i>	<i>22.0</i>

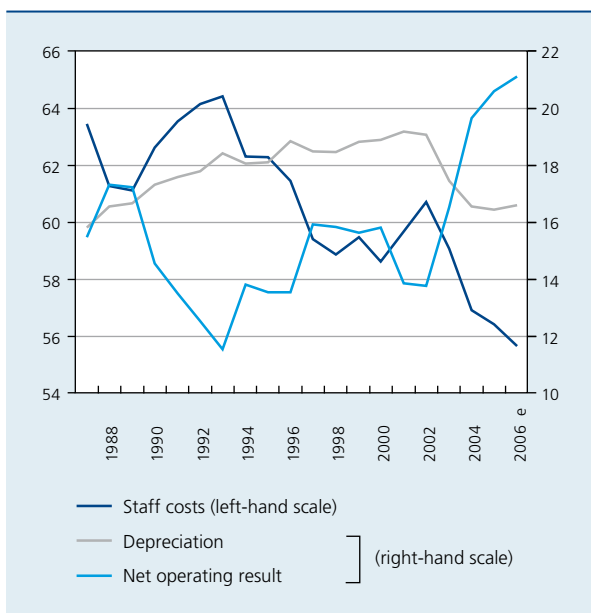
Source: NBB.

(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.

of its financing policy and any exceptional items. Staff costs traditionally account for by far the major part of the operating expenses: in 2006, they represented almost 56 p.c. of the value added of non-financial corporations. In parallel with the further strengthening of employment growth, staff costs increased by 4.7 p.c. in the year under review. While this was the largest increase since 2000, the rise in staff costs nevertheless lagged behind the growth of value added for the fourth consecutive year. After staff costs, depreciation is by far the most significant operating expense. In 2005, after shrinking for three successive years, depreciation allowances recorded a marked increase. This was amplified in 2006, reflecting the substantial investments recorded in 2005, particularly in the transport sector.

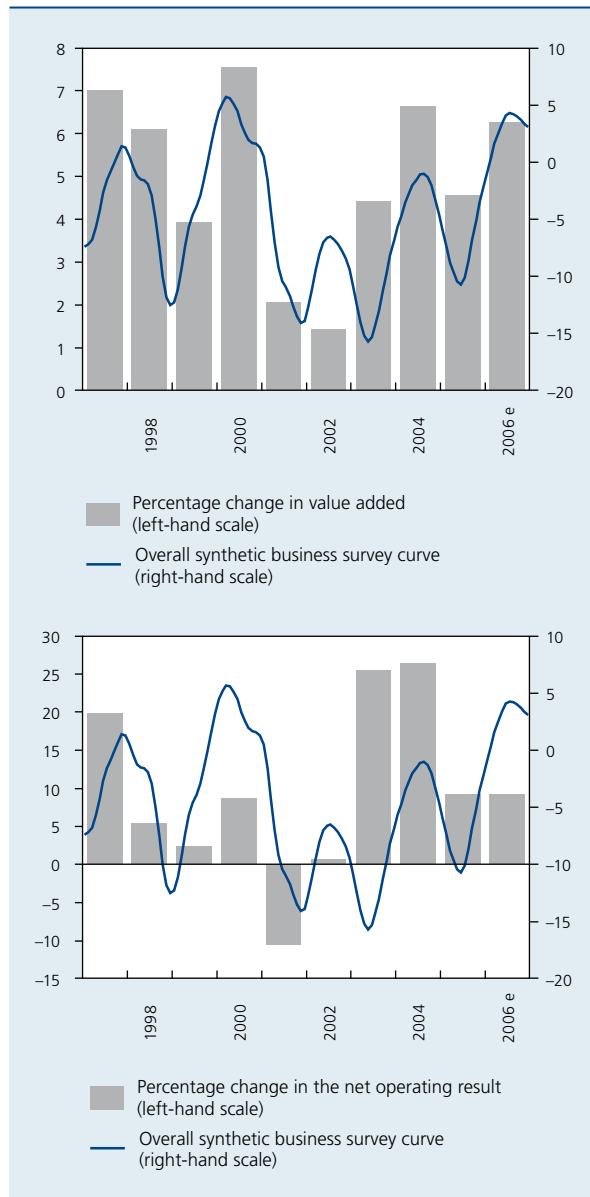
Driven mainly by the trend in staff costs and depreciation, the increase in total operating expenses accelerated again in 2006 to reach 5.5 p.c. While that was the steepest rise since 2000, the growth of value added nevertheless continued to outpace the rise in operating expenses. Consequently, the net operating result, which had already increased dramatically in the preceding three years, recorded a further significant rise (+9.2 p.c.). In the space of four years, the net operating result thus virtually doubled, rising from 17 billion in 2002 to almost 33 billion euro in 2006.⁽¹⁾ That achievement – which is exceptional in historical terms – is broadly due to cost control in a

CHART 1 CHANGE IN THE BREAKDOWN OF VALUE ADDED
(percentages of value added)



Source : NBB.

CHART 2 VALUE ADDED, NET OPERATING RESULT AND BUSINESS SURVEY INDICATOR



Source : NBB.

generally favourable economic context. Belgian companies as a whole are displaying hitherto unprecedented ability to generate profits by pursuing their commercial activity.

Chart 1 places recent trends in a longer-term perspective, with details of the changing breakdown of value added between staff costs, depreciation and operating results, the three main possible allocations. Thus, it is evident

(1) It should be remembered that in 2000, i.e. at the peak of the previous business cycle, the operating result stood at 19 billion euro.

that the proportion allocated to the operating result increased considerably over a 20-year period, from 15 p.c. in 1987 to 21 p.c. in 2006. That increase is largely mirrored by the reduction in the share represented by staff costs, down from 63 to 56 p.c. over the same period. It is also apparent that these changes are even more marked from 1993 onwards, which was the last year of economic recession in Belgium so far. Having gradually increased up to 2001, allocations to depreciation declined significantly in subsequent years, echoing the reduced investment in tangible fixed assets.

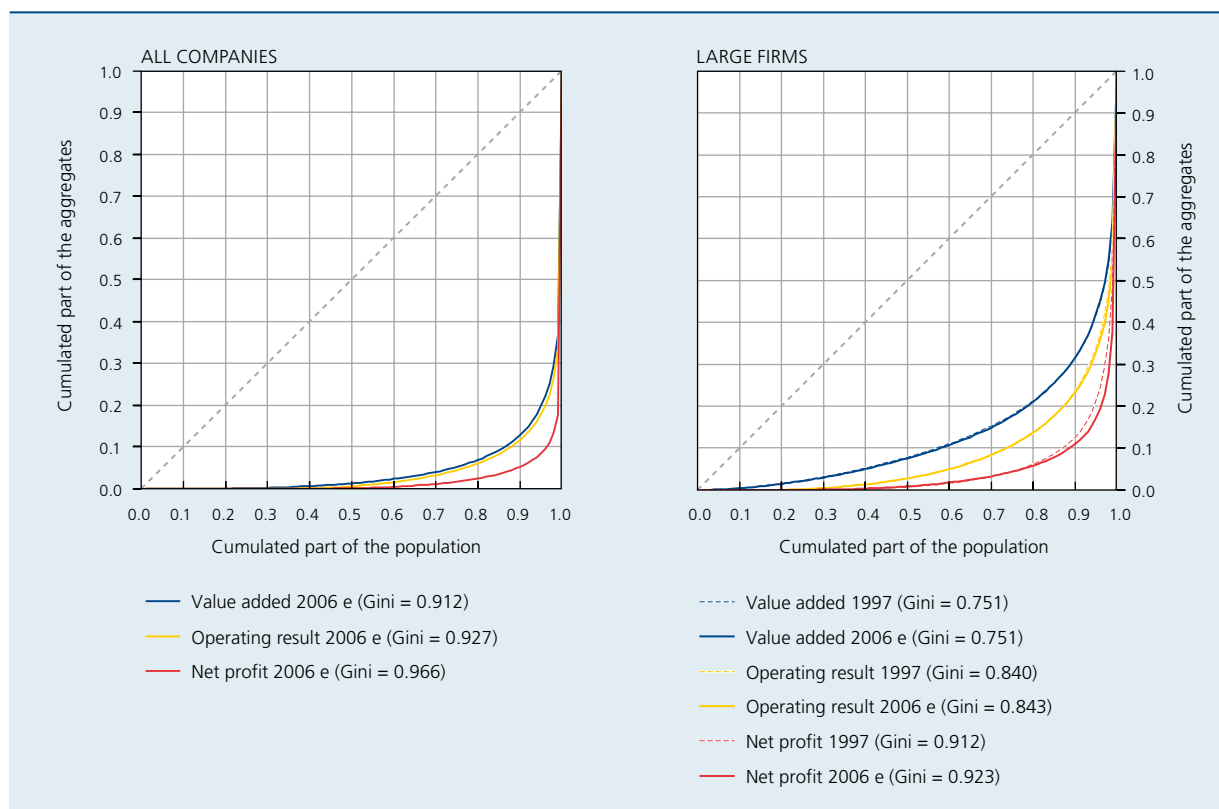
The movements in corporate value added and operating results can also be compared with the movement in the Bank's business survey indicator, which measures business confidence (cf. chart 2). Following a dip in mid 2005, this indicator rose steadily until July 2006. Although the indicator did decline slightly in the final months of the year, it still remained at a very high level in relation to the figure for the past ten years.⁽¹⁾ That picture is linked to the accelerating growth of value added, which in 2006 reached a level well above the average for the preceding years. As for the operating result, while growth remained constant at the 2005 level it should be remembered that

substantial gains had been made in the previous three years, certainly exhausting most of the scope for improvements, especially in regard to cost cutting.

In line with the trend seen over the past decade, the financial result increased again during the year under review, and now totals almost 10 billion euro. As in 2005, the net exceptional result was decidedly positive, the main factors being the capital gains on the realisation of assets in the energy sector. After deduction of taxes on profits, financial corporations made a total net profit of more than 43 billion euro in 2006, up by around 5 p.c. compared to the previous year. The profit excluding the exceptional result climbed almost 14 p.c. to 34 billion euro. These movements recorded in 2006 are in line with the trend towards a dramatic recovery in corporate results, apparent since 2003. It should be remembered that the profit excluding the exceptional result came to only 15 billion in 2002.

(1) Moreover, as stated in the Bank's annual report, the gross indicator attained its highest value since calculations began according to the current methodology, i.e. since 1980.

CHART 3 LORENZ CURVES AND GINI INDEX FOR SOME COMPONENTS OF THE PROFIT AND LOSS ACCOUNT



Source : NBB.

It is worth mentioning that, as every year, the overall developments presented above mainly reflect the situation of a relatively small number of large and very large companies whose results have a major influence on the overall total. Chart 3, which presents the Lorenz curves for all companies and for large firms on their own, bears witness to the degree of concentration of the main profit and loss account balances.

A Lorenz curve⁽¹⁾ determines the percentage of an aggregate represented by various portions of a population, the latter being arranged in ascending order according to the values of that aggregate. For example, if all firms produce the same value added, the Lorenz curve of value added will coincide with the diagonal. Conversely, if the value added is concentrated in just one firm, the Lorenz curve will be confined to the lower right-hand corner of the chart. The degree of concentration can also be summarised

numerically by the Gini coefficient. Its numerator is equal to the area between the Lorenz curve and the diagonal, while its denominator is equal to the whole of the area beneath the diagonal. This coefficient ranges from 0 (perfectly even distribution) to 1 (total concentration in a single firm).

The first part of chart 3 presents some results relating to Belgian corporations in general. It reveals the large concentration of components of the results within a small fraction of firms. For example, 87 p.c. of the total value added is generated by 10 p.c. of companies. This result is due to the existence, in the population studied, of very large firms alongside a multitude of small entities. Moreover, the lower one "descends" in the profit and

(1) Named after M.-O. Lorenz who, at the beginning of the 20th century, developed ways of measuring the concentration of wealth. See Lorenz M.-O. (1905), *Methods of measuring the concentration of wealth*, American Statistical Association, New Series, n° 70.

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 2006 e
	2005	2006 e	2005	2006 e	
Manufacturing industry	2.2	6.0	5.7	13.6	32.0
of which:					
Agricultural and food industries	2.0	-0.4	1.4	-0.9	4.0
Textiles, clothing and footwear	-8.5	-0.1	-10.8	1.2	1.2
Timber	1.6	6.3	14.2	10.2	0.6
Paper, publishing and printing	-2.4	3.4	-11.4	9.2	2.2
Chemicals	7.2	8.6	9.3	13.5	9.0
Metallurgy and metalworking	-1.5	6.8	2.2	19.7	4.6
Metal manufactures	2.8	11.6	27.0	30.3	7.0
Non-manufacturing branches	5.7	6.4	10.9	7.2	68.0
of which:					
Retail trade	4.8	5.3	3.9	11.8	8.2
Wholesale trade	6.2	6.2	17.5	10.0	12.9
Horeca	7.2	2.3	16.4	-9.2	1.7
Transport	8.0	4.6	104.6	11.3	7.8
Post and telecommunication	0.5	2.4	0.5	0.1	4.8
Real estate activities	6.9	5.3	3.2	8.1	3.1
Business services	8.3	8.7	8.1	5.4	13.1
Energy and water	-1.9	9.5	-6.3	-3.1	4.0
Construction	5.9	8.9	24.8	14.8	6.3

Source: NBB.

loss account, the more the balances tend to converge. In particular, the larger concentration of net profits is due to the concentration of financial and exceptional results. Finally – though this is not apparent from the chart – the degree of concentration has not changed significantly in the past ten years, so that the 1997 curves are almost the same as those for 2006.

The second part of the chart relates only to large firms. Similar conclusions can be drawn, with a few minor variations. Although, as one would expect, the concentration is less pronounced in this sub-population, it is still substantial, particularly as regards the net profit, with 89 p.c. of the total originating from fewer than 10 p.c. of firms in 2006. Furthermore, there has been no significant change in the appearance of the curves in ten years, except for the curve showing the net profit, which has shifted slightly towards the lower right-hand corner.

2.2 Results by branch of activity

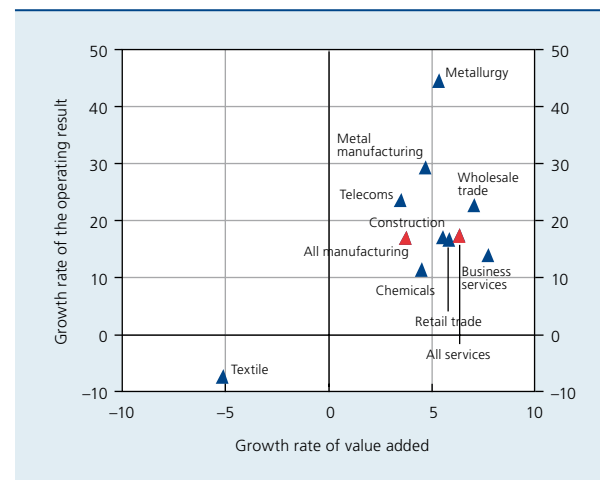
In contrast to the previous year when the industry had suffered from the deterioration in the international environment, the expansion of manufacturing activity was particularly vigorous in 2006 (+6 p.c., cf. table 3). Belgian industry taken as a whole benefited from the strong expansion of its main export markets, namely the countries of the euro area. Moreover, the Belgian economy was less affected by adverse shocks than in the past: the euro exchange rate changed little during the year under review, while the rise in the price of oil slowed down. Logically, industrial expansion was driven by the branches with the strongest export focus, namely chemicals, metal manufactures and metallurgy. It was these same three branches that made the biggest contribution to the rise in the industrial operating result, particularly via the control of staff costs. On that subject, it is notable that the jobs gained in chemicals and metallurgy in 2006 were largely counterbalanced by the jobs lost in metal manufacturing.

In the non-manufacturing branches, activity remained robust, with value added growing by more than 5 p.c. for the fourth consecutive year. Overall, as in 2005, these branches were bolstered by the dynamism of domestic demand. Thus, construction benefited from household expenditure on house building and renovation.⁽¹⁾ The operating result also showed a significant increase in the service branches. In that respect, too, construction was the branch that produced the strongest performance.

Finally, chart 4 depicts the movement in value added and operating results from 2002 to 2006 for a number of branches. That period corresponded in fact to a continuous

CHART 4 MOVEMENT IN VALUE ADDED AND OPERATING RESULTS BETWEEN 2000 AND 2006

(geometric averages of annual percentage changes)



Source : NBB.

and sustained improvement in the overall financial position of enterprises, following the adverse effects, particularly in terms of profitability and financial risks, caused by the deteriorating economic situation in 2001 and 2002. The operating result increased at much the same pace in the manufacturing and non-manufacturing branches (taken as a whole), despite the significantly smaller rise in the growth of value added in manufacturing. This result is closely linked with the performance recorded in metallurgy and metalworking, where operating expenses increased far more slowly than value added. In particular, the overall job losses during the period considered drove down staff costs in these two branches. Finally, it should be pointed out that only the textile industry falls into the lower left-hand quadrant, indicating a decline in both value added and net operating result. This is due to the structural problems with which the branch has been struggling for many years, particularly the competition from low-cost countries. Textile exports are the ones hardest hit by the appreciation of the euro in recent years.

3. Financial situation of firms

The financial analysis which follows is based on the theory of interpretation of the annual accounts, from which a number of ratios have been taken.⁽²⁾

(1) See the Bank's Annual Report on this subject.

(2) Since the concepts used cannot be explained in detail in this article, the reader is requested to consult the reference works on the subject.

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 and dividing it by the sum of their denominators. 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 ratio below it. 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, regardless of size.

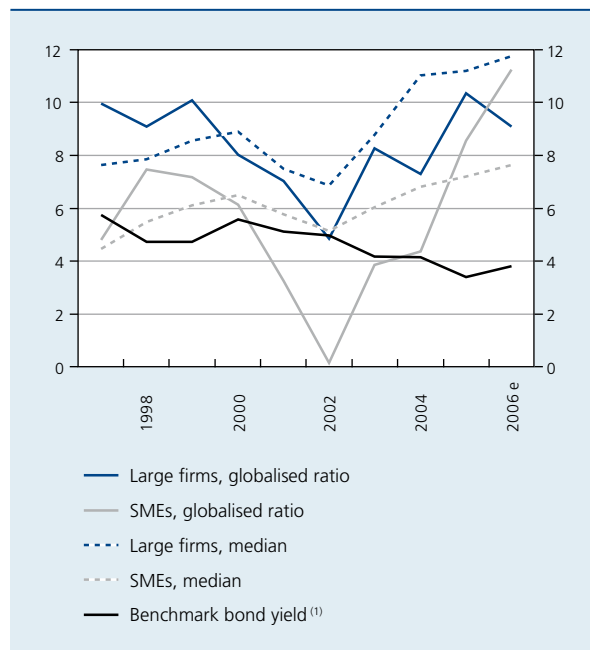
3.1 Profitability

Profitability concerns 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, also known as the return on equity (ROE), expresses the net profit after tax as a percentage of the equity capital. It therefore indicates the return which shareholders receive after deduction of all expenses and taxes. Over a sufficiently long period, the return on equity has to exceed the return on a risk-free investment in order to provide shareholders with a premium to compensate for the risk to which they are exposed: this is known as a risk premium.

In 2006, the globalised return on equity came to 9.1 p.c. for large firms and 11.2 p.c. for SMEs (cf. chart 5). SMEs therefore achieved higher profitability than large firms, which is the exception to the historical rule. The globalised profitability of large firms declined in 2006, mainly because of the strong growth of the equity, which itself seemed to be dictated by the recent changes in the tax rules (cf. section 4). However, analysis of the medians indicates that profitability has risen again in the majority of large firms, as it also has in SMEs. Taken overall, and whatever the approach adopted, Belgian companies' 2006 profitability figures were the highest for almost twenty years, though it should be remembered that, every year, over a quarter of Belgian companies are loss-making.

The globalised return of large firms can be compared to the yield on government bonds. In 2002, for the first time since 1994, the profitability of large firms had fallen below the benchmark yield on linear bonds. Since then it has climbed rapidly, and that combined with the downward trend in yields on government bonds has given shareholders an increasingly substantial risk premium. From the investor's point of view, equity investments

CHART 5 RETURN ON EQUITY AND BENCHMARK BOND YIELD⁽¹⁾
(percentages)



Source: NBB.
(1) Average yield on ten-year linear bonds.

have therefore become progressively more attractive in the past few years. That trend is also reflected in the stock market indices. Thus, the BEL 20 began rising again from the beginning of 2003. This comparison should be viewed with caution for two reasons: equities and government bonds are different financial instruments, and many of the large firms considered are not listed on the stock market.

3.2 Solvency

Solvency concerns the ability of firms to honour all their short-term and long-term financial commitments. This article analyses it 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, if necessary, the firm can easily contract new debts on favourable terms. The degree of financial independence

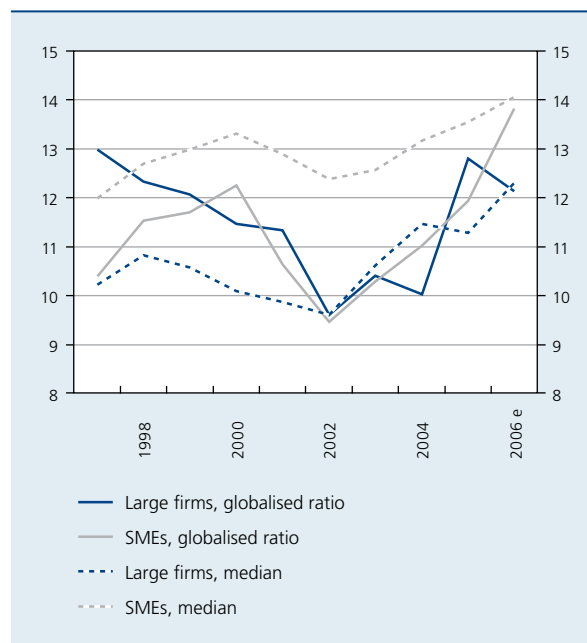
can also be interpreted as a measure of the firm's financial risk, since the remuneration of third parties is fixed, unlike the firm's results which fluctuate over time.

In 2004, globalised financial independence stood at 47.3 p.c. for large firms and 37.3 p.c. for SMEs, which traditionally record a lower figure (cf. chart 6). In both categories of firms, the globalised ratio has been rising for the past fifteen years: between 1997 and 2006 it gained 9 p.c. in the case of large firms and 4 p.c. for SMEs. The upward trend in the globalised ratio gathered pace in the last two years under review, mainly on account of the changes to the tax rules (cf. section 4). The increased financial independence also applied to the majority of firms, as is evident from the rise in the median ratio. While chart 6 presents a sound and stable picture of corporate solvency, it must be stressed that a number of companies – often small ones – experience serious problems regarding their financial independence. Thus, the tenth percentile of SMEs is equal to -20 p.c. For these firms the situation has deteriorated further, since that same percentile had a value of -13 p.c. ten years earlier.

The degree of financial independence and its reciprocal, the debt level, provide a picture of the general balance of the assets and liabilities. While this picture is necessary to diagnose solvency, it is not sufficient since it does not

CHART 7 DEGREE TO WHICH BORROWINGS ARE COVERED BY CASH FLOW

(percentages)

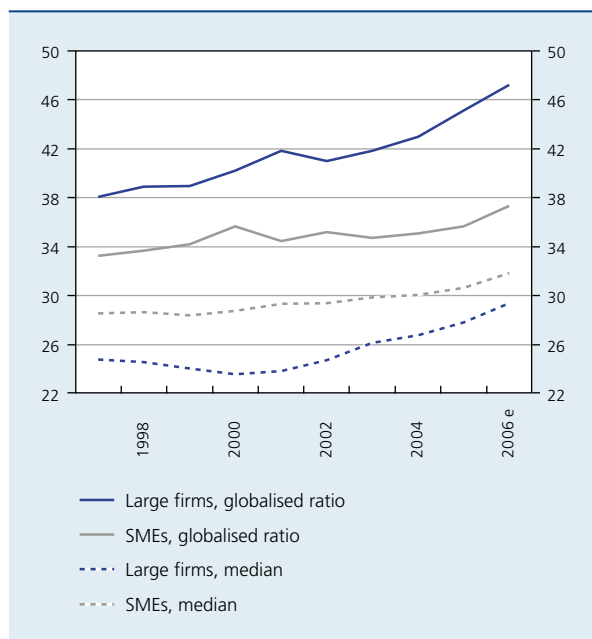


Source : NBB.

permit appraisal of the firm's ability to repay their debts, nor the level of charges which they incur. These two concepts will be addressed below.

CHART 6 DEGREE OF FINANCIAL INDEPENDENCE

(percentages)

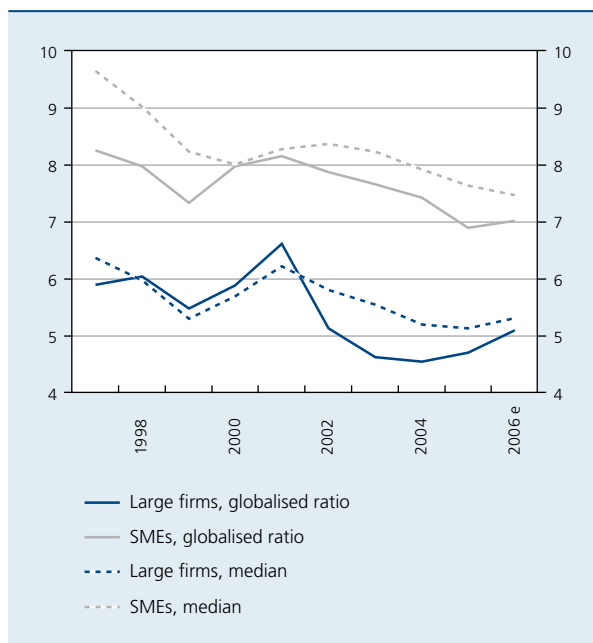


Source : NBB.

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, 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. The information supplied by this ratio supplements that provided by the ratio of financial independence, as a high level of indebtedness may very well be mitigated by a substantial repayment capability, and vice versa.

In 2006, large firms and SMEs recorded divergent movements in their globalised cover rates of borrowings (cf. chart 7). Following a marked recovery in 2005, the ratio of large firms dipped slightly in 2006 to 12.1 p.c., as the increase in the cash flow was not enough to offset the rise in debts. However, the ratio remained well above the average for the last decade. The continuing rise in the median ratio of large firms also indicates that the cover rate of borrowings has improved for the majority of firms in this sub-population. In the case of SMEs, both the globalised ratio and the median improved again in 2006,

CHART 8 AVERAGE INTEREST CHARGES ON FINANCIAL DEBTS
(percentages)



Source : NBB.

bringing these ratios to their highest level in the period under review.

The average interest charges on financial debts provide a means of assessing the cost of recourse to borrowings. In 2006, in globalised terms these charges came to 5.1 p.c. for large firms and 7 p.c. for SMEs (cf. chart 8). For both categories of firms, charges edged upwards again in 2006, owing to a small rise in market interest rates. Nonetheless, both interest rates and the cost of borrowing are still at historically low levels. Since the early 1990s, average interest rates have in fact fallen by around 5 percentage points for SMEs and 4 percentage points for large firms. Moreover, the interest charges paid by large firms are structurally lower than those incurred by SMEs. For the same method of financing, SMEs generally have to pay a risk premium because lenders consider their financial profile to be less sound. They also make greater use of cash loans, which are a more expensive form of credit.

3.3 Liquidity

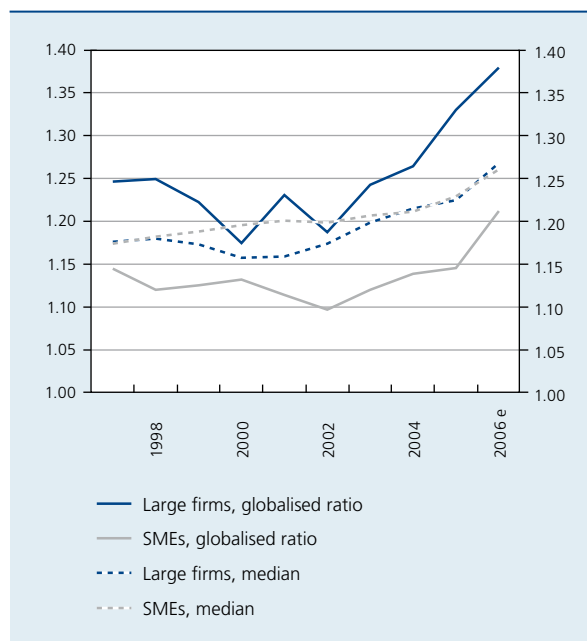
Liquidity indicates the capacity of firms to mobilise the cash resources needed to meet their short-term commitments. It is traditionally assessed as the liquidity ratio in the broad sense. This ratio, derived from the concept

of the net working capital, 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. In particular, if the ratio is higher than 1, the net working capital is positive.

In 2006, the globalised ratio reached 1.38 for large firms and 1.21 for SMEs (cf. chart 9). In both categories of firms, liquidity has been rising since 2003, and reached record levels in 2006. This improvement in the balance of asset and liability maturities applies to the whole population of companies, as is evident from the movement in the median ratios. Finally, as in the case of the other ratios, the serene image presented by the globalised ratio and the median may mask the disparities between firms. Thus, over 35 p.c. of the companies considered have liquidity in the broad sense which is less than 1, and therefore negative net working capital.

The situation of companies whose liquidity is precarious can be ascertained by examining the overdue debts payable to the tax authorities and the NSSO, mentioned in the annex to the annual accounts. Arrears of payments to these two preferential creditors are usually synonymous with an acute cash flow crisis for a firm; they also serve as "warning lights" for the investigation departments of

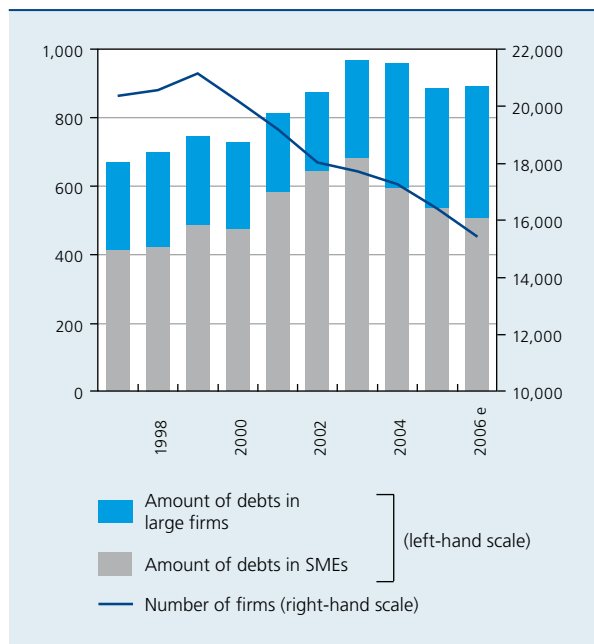
CHART 9 LIQUIDITY IN THE BROAD SENSE



Source : NBB.

CHART 10 OVERDUE DEBTS TO THE TAX AUTHORITY AND THE NSSO

(millions of euro, unless otherwise stated)



Source : NBB.

the commercial courts in their work of tracking down firms in difficulties.

In 2006, around 15,500 companies, the very great majority being SMEs, reported overdue debts to the tax authority and the NSSO totalling almost 900 million euro (cf. chart 10). The textile industry, construction and the hotel and restaurant trade were among the branches most affected. Since 2003, the total amount of these debts has been declining, and the number of firms affected has fallen steadily since 1999. This marked tendency towards a reduction in the cash flow risks is one of the consequences of the recent improvement in the financial position of firms.

4. Corporate income tax

4.1 Corporate income tax revenues

The analysis which follows focuses on a series of recent tax reforms concerning non-financial corporations. Up to 2006, revenues generated by corporate income tax moved in parallel with the ratio between corporate income tax and value added (cf. chart 11). Since 2002, corporate income tax revenues have risen each year,

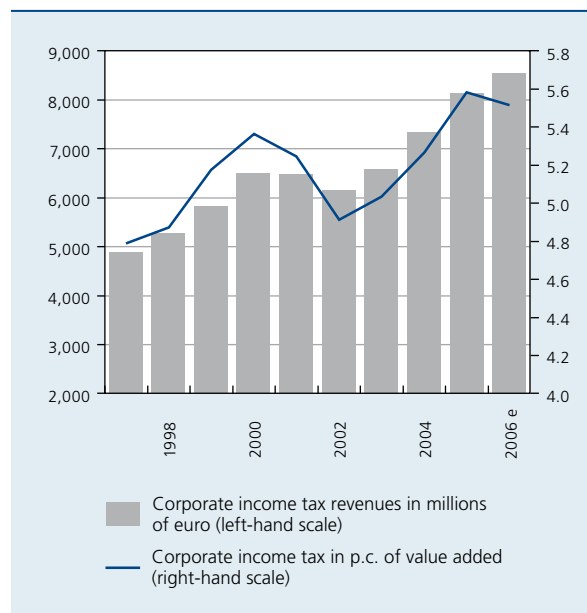
increasing by 11.5 p.c. in 2004 and 10.9 p.c. in 2005. In 2006, following the introduction of the new rules on corporate income tax authorising the deduction of risk capital, those revenues have increased by only 4.9 p.c. (cf. 4.3. The tax reforms).

The ratio between corporate income tax revenues and value added also increased (by 0.7 percentage point) between 2002 and 2005. However, that upward trend was halted in 2006, and revenues generated by this tax subsided by 0.1 percentage point. That decline was due both to the slower growth of corporate income tax revenues and the substantial expansion of value added (+6.3 p.c.).

The decline in tax revenues recorded from 2003 following the first corporate income tax reform was more than outweighed by the expansion of the tax base resulting from the increase in the net operating surpluses of companies. In 2006, corporate income tax revenues reached a new record of 8.5 billion euro.

However, it would be wrong to conclude that the tax burden has risen since 2003. Although corporate income tax revenues expressed as a percentage of value added have increased since 2002, the implicit rate has fallen over the same period (cf. chart 12). The High Council

CHART 11 CORPORATE INCOME TAX REVENUES
(millions of euro and percentages of value added)



Source : NBB.

of Finance⁽¹⁾ considers that the implicit tax rate (cf. 4.2. Tax burden) is the only accurate way of measuring the real tax burden. The ratio between the revenues generated by this tax and value added is not a reliable indicator of the tax burden. Although the numerator of the ratio of these tax revenues expressed as a percentage of value added corresponds to the tax paid, the denominator differs from the tax base, as the growth of corporate profits considerably outpaces the rise in operating expenses.

4.2 Tax burden

Various indicators can be used to measure the burden of taxation on corporate profits.⁽²⁾ International companies generally base their investment decisions on the standard nominal rate. That rate is currently 33 p.c. (33.99 p.c. including the crisis contribution), but SMEs may qualify for a progressive reduced rate.⁽³⁾

Companies may be able to deduct various items thereby reducing the tax base. Consequently, the real tax burden may differ from the standard nominal rate. One of the indicators offering a more accurate idea of the real tax burden is the implicit rate, namely the ratio between corporate income tax and the tax base.

By calculating the implicit rate on the basis of the annual accounts of non-financial corporations it is possible to limit the tax base to profitable companies only. If the losses incurred by firms were included in the denominator, that would make the implicit rate sensitive to the economic cycle. Loss-making firms do not have to pay any tax, so that – since losses cannot be identified in the denominator – that results in overestimation of the real tax burden in periods of weak economic activity.

The drawback of this method of calculating the implicit rate lies in the fact that it does not permit adequate adjustment of the denominator in the event of double counting of profits between companies paying dividends and those collecting them. The profits are included in the tax base of these two types of companies, whereas in reality the profit paid out is recorded in the tax base only of the companies paying the dividends, and is deducted from the taxable profit of the companies receiving them. Consequently, the denominator of the implicit rate is overestimated, while the real tax burden is underestimated.

This method has a second drawback in that the numerator includes not the tax actually payable but the figure recorded in the profit and loss account of the annual accounts. That figure includes the estimated tax calculated

on the basis of the expected profit in the current calendar year and the regularisations. These may be either positive or negative, and result from a tax inspection, an underestimation or even an overestimation of the tax actually payable and imputed to a previous financial year.

The conclusion is therefore that the implicit rate calculated on the basis of the annual accounts of non-financial corporations must be used with caution, and that it represents only an indication of the difference between the nominal tax rate and the real tax burden.

The globalised implicit rate based on the annual accounts of non-financial corporations hovered around a constant level of 21 p.c. up to 2002 (cf. chart 12). In 2003, this indicator of the tax burden on corporate profits recorded a decline,⁽⁴⁾ which may be due to the introduction of the first tax reform (cf. 4.3. The tax reforms). In 2006, the second tax reform again reduced the tax burden: it led to a decline in the implicit rate, which eventually came to around 16 p.c. However, account must also be taken of the impact of both the exemption applicable to the profits of the coordination centres and the deduction of finally taxed incomes (FTI),⁽⁵⁾ available to only a small number of companies. These two factors contribute to the underestimation of the tax burden.

The median of the implicit rate, which is less sensitive to the influence of tax measures applied to a small number of companies, is higher for both large firms and SMEs, except that the tax burden on SMEs is lower owing to the reduced rate applicable to them. Here, too, the effect of the two tax reforms is undeniable, and the measures adopted have reduced the tax burden on both categories of firms. In 2003, the median of the implicit rate declined by 5.9 p.c. for both large firms and SMEs. The second tax reform led to a larger reduction in the tax burden on large firms (–3.8 p.c.) than on SMEs (–2.4 p.c.) in 2006.

(1) High Council of Finance (2001), *The corporate income tax reform: the framework, the issues, the possible scenarios*.

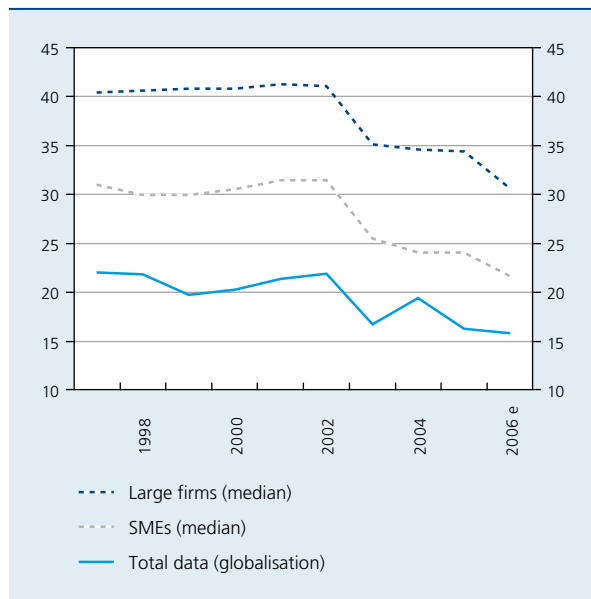
(2) For an overview of the various indicators, see the article "Recent trends in corporate income tax", published in the June 2007 Economic Review.

(3) That rate (plus the 3 p.c. crisis contribution) comes to:
– 24.25 p.c. on taxable incomes between 0 and 25,000 euro;
– 31 p.c. on taxable incomes between 25,000 and 90,000 euro;
– 34.5 p.c. on taxable incomes between 90,000 and 322,500 euro.

(4) The real tax burden was underestimated in 2003 owing to the considerable capital gains in excess of 5.9 billion euro realised on shares in the telecommunications branch. This category of capital gains is totally free of tax.

(5) The system of finally taxed incomes (FTI) avoids double taxation on the payment of dividends. The profits paid out appear exclusively in the tax base of the paying company, whereas 95 p.c. of the dividend income is kept separate from the taxable profits of the company receiving the dividend. The other 5 p.c. constitutes a fixed amount corresponding to the costs entailed in collecting the dividend.

CHART 12 IMPLICIT CORPORATE INCOME TAX RATE
(percentages)



Source : NBB.

4.3 The tax reforms

Belgium has carried out two successive corporate income tax reforms. The first⁽¹⁾ was intended to improve corporate competitiveness, from the 2004 tax year, by cutting the nominal rate of tax from 40.17 to 33.99 p.c. (taking account of the 3 p.c. complementary crisis contribution) and lowering the reduced basic rates for SMEs. The tax status of SMEs was also improved: profits imputed to an investment reserve are now exempt and there is no tax surcharge payable in the event of a shortfall or absence of advance payments during the first three years following a company's establishment.

Apart from the tax cuts, a number of compensatory measures were adopted in order to ensure that the corporate income tax reform was neutral in its effect on the budget. The application of a 10 p.c. withholding tax on the profits from liquidation, a change in the depreciation rules, the introduction of new conditions for application of the FTI scheme and reinforcement of the rules on deductions relating to regional taxes are all compensatory measures which augment the tax base by reducing tax-deductible expenses.

The second corporate income tax reform⁽²⁾ aimed to attenuate, from the 2007 tax year, the discrimination between risk capital and borrowings. Previously, only the interest charges on borrowed capital were tax deductible.

The introduction of tax relief for risk capital, also known as the "notional interest deduction", ended the inequality of tax treatment between these two forms of financing. Combined with the abolition of the 0.5 p.c. registration fee on capital contributions or issue premiums, this tax allowance encourages companies to consolidate their equity capital. By implicitly reducing the real tax rate, the measure should also make Belgium more attractive to foreign investors from the tax angle. Moreover, it is an alternative to the coordination centre arrangements which are to be abolished in 2010.

The notional interest deduction allows companies to calculate annual notional interest on their capital and to deduct that from the tax base. The basis for calculating the risk capital allowance is the amount of equity capital "adjusted" at the end of the tax period preceding the one in which the deduction is requested. The adjustment is intended to prevent a "cascade" of deductions between companies in the same group,⁽³⁾ to reject assets on which incomes are not taxable under double taxation treaties,⁽⁴⁾ and to prevent certain abuses whereby certain tangible assets are artificially lodged with a company.⁽⁵⁾ A weighted average was applied to the changes in the basis of calculation or the adjustment factors during the tax period.⁽⁶⁾

The notional interest rate applied to the amount of the basis of calculation is the annual average of the interest rates on 10-year linear bonds (OLOs) published each month by the Securities Regulation Fund. The interest rate applicable for each tax year is the rate for the penultimate calendar year preceding the tax year. However, the interest rate thus fixed cannot differ by more than one percentage point from the rate applied during the previous tax year, and cannot exceed 6.5 p.c. For the 2007 tax year, the interest rate for the notional interest deduction is 3.442 p.c. That rate is increased by 0.5 percentage point for SMEs, bringing it to 3.942 p.c.⁽⁷⁾

(1) Law of 24 December 2002 amending the rules on the taxation of corporate incomes and introducing a system of advance decisions on taxes.

(2) Law of 22 June 2005 introducing a tax deduction for risk capital.

(3) Shares in profits are excluded from the basis of calculation in order to prevent the parent company and the subsidiary from both receiving a tax allowance based on the same capital.

(4) A company which has a permanent establishment in a country party to the convention and whose income is exempt in Belgium cannot apply any risk capital deduction to the part of the capital attributable to that establishment.

(5) The basis of calculation is reduced by the net accounting value of the tangible fixed assets to the extent that those fixed assets are unreasonably excessive compared to the needs of the business, assets which do not produce any taxable periodic income and are held by way of an investment, and property held for private purposes.

(6) Considering that the change took place on the first day of the calendar month following its occurrence.

(7) For the 2008 tax year, the rate will be higher owing to the increase in interest rates between 2005 and 2006. It will thus rise to 3.781 p.c. for large firms and 4.281 p.c. for SMEs.

If the company has insufficient taxable profits to take full advantage of the notional interest deduction, the exemption not granted can be carried forward successively to taxable profits in the next seven financial years. However, it cannot be carried forward in the event of a takeover or change of control over the company which does not correspond to legitimate economic or financial objectives.

This reform also made provision for a number of compensatory measures aimed at budget neutrality. Tax incentives, such as the tax credit for SMEs, were abolished, the rate of the investment allowance (single or staggered)⁽¹⁾ was cut to zero and the legal definition of the concept of "capital gains" was amended.⁽²⁾ The measure relating to the tax-exempt investment reserve for SMEs was not abolished, but cannot be applied at the same time as the notional interest deduction. SMEs which form an investment reserve during a given tax period cannot deduct notional interest for that period or for subsequent tax periods.

4.4 Financial behaviour of firms

By introducing the tax relief for risk capital, the authorities hope to encourage firms to invest more by means of their own capital, either by issuing new shares or by making use of reserved profits. Since it came into force in 2005,

the measure has had a structural impact on the financial behaviour of firms (cf. charts 13 et 14). It is even probable that there has been a dynamic effect, with firms trying to increase the impact of the notional interest deduction by specifically targeted optimisation techniques, such as increasing the equity capital, reducing the amounts of adjustment items, or restructuring.

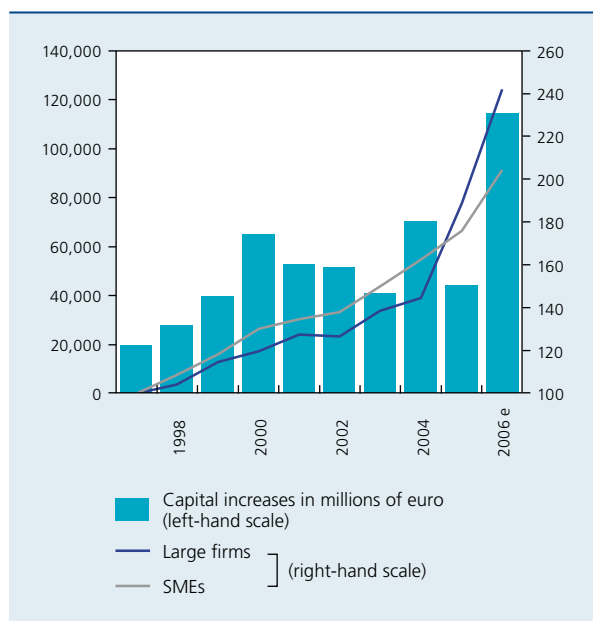
The movement in the adjusted equity capital can be compared with the figures on capital increases published in the annexes to the *Moniteur belge*. These two variables generally follow a similar pattern. Chart 13 shows, in addition to capital increases via share issues, the positive adjusted capital of non-financial corporations excluding coordination centres. Only firms with positive adjusted capital can in fact claim the notional interest deduction. Moreover, the measure does not apply to companies eligible for an excessively generous tax scheme under ordinary law, such as the coordination centres.

In 2006, share issues reached a record level of 114 billion euro, representing an increase of more than 250 p.c. against 2005.⁽³⁾ In regard to capital increases, many firms therefore seem to have waited until 2006 before adjusting their financial structure.

The adjusted equity capital reached a record level in 2006, for both large firms and SMEs. This upward trend had already begun in 2005 for both categories of firms, but it was mainly large firms that recorded a break in the trend from 2005. Their adjusted equity capital in fact increased by around 30 p.c. for two consecutive years, whereas it had never previously risen by more than 14 p.c.

Although SMEs qualify for a 0.5 percentage point higher deduction, it is mainly international firms and those with substantial financial resources that are restructuring their capital. The notional interest deduction is in fact more attractive for the most heavily capitalised firms. Apart from the notional interest deduction, SMEs are still able to opt for the investment reserve. Several factors influence that choice, such as the amount of the (adjusted) equity capital, the investment forecasts, profit forecasts and dividend policy.

CHART 13 ADJUSTED EQUITY CAPITAL AND CAPITAL INCREASES
(index 1997 = 100)



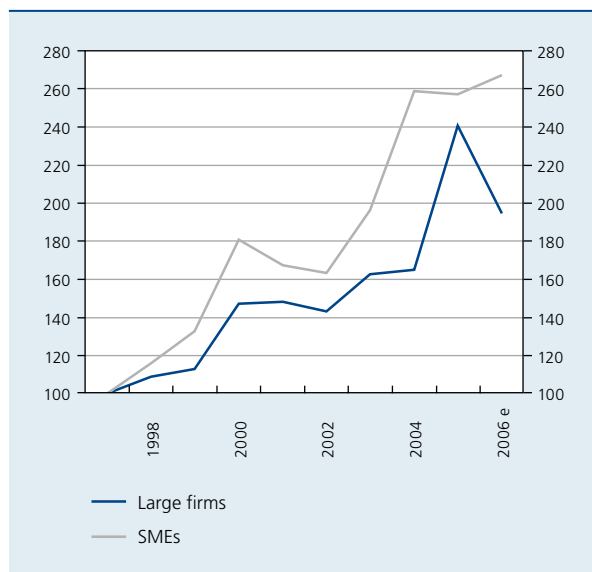
Source : NBB.

(1) But the increased deduction for investments continues to apply to patents, investments in research and development, energy-saving investments, investments designed to secure business premises, or investments intended for the production of reusable containers for drinks and industrial products.

(2) From the 2007 tax year, the exemption is explicitly limited to the net capital gain, and the costs entailed in realising a capital gain can no longer be deducted from the exempt amount.

(3) A large part of the transactional value is generally imputable to a small number of firms. The high level attained in 2004 is attributable exclusively to a single coordination centre whose capital increased by 11 billion euro.

CHART 14 DIVIDENDS PAID OUT
(index 1997 = 100)



Source : NBB.

The difference in the financial behaviour of large firms and SMEs is very clear from their dividend policy (cf. chart 14). Since 2003, both categories of firms have recorded a large increase in dividends paid out, owing to the profit growth achieved. Dividends paid out by SMEs reached a record level of 2 billion euro in 2004 and fluctuated around that level in 2005 and 2006. Dividend payments by large firms reached a record level of 24.4 billion euro in 2005. There was then a break in the trend in 2006, when they fell by 20 p.c. The introduction of the notional interest deduction reinforces the attraction of equity capital.

Conclusion

Overall, the economic environment in 2006 was largely favourable to businesses: expansion of the export markets, a stable currency, slowing of the pace of oil price rises, low long-term interest rates and rising stock markets. In that context, the value added of non-financial corporations mirrored the trend in GDP: its growth rate in fact accelerated in 2006, to reach 6.3 p.c. at current prices, a level comparable to that of 2004 (cf. table 2). While the rise in total operating expenses was amplified again in 2006, to reach 5.5 p.c., it still remained below the rise in value added. Consequently, the net operating result, which had already increased dramatically in the three preceding years, recorded a further strong rise (+9.2 p.c.). In the space of four years, the net operating

profit thus virtually doubled from 17 billion in 2002 to almost 33 billion euro in 2006.

In line with the trend seen over the past decade, the financial result increased again during the year under review, and now totals almost 10 billion euro. As in 2005, the net exceptional result was decidedly positive, the main factors being the capital gains on the realisation of assets in the energy sector. After deduction of taxes on profits, financial corporations made a total net profit of more than 43 billion euro in 2006, up by around 5 p.c. compared to the previous year. The profit excluding the exceptional result climbed almost 14 p.c. to 34 billion euro. These movements recorded in 2006 are in line with the trend towards a dramatic recovery in corporate results, apparent since 2003. It should be remembered that the profit excluding the exceptional result came to only 15 billion in 2002.

The financial situation of companies continued to improve in 2006. Both the globalised ratios and the distribution figures indicate the – in historical terms – exceptionally high levels attained by the profitability, solvency and liquidity of Belgian firms. Nonetheless, some firms are in a precarious position: thus, a quarter of Belgian companies are loss-making, while 16 p.c. of them have negative equity.

A record level of corporate income tax revenues totalling 8.5 billion euro was recorded in 2006 in the case of non-financial corporations. However, the increase in those revenues was less marked in 2006 (+4.9 p.c.) than in 2004 and 2005 owing to the effect of the notional interest deduction. That effect is also apparent in the ratio between corporate income tax revenues and value added. Following an upward trend during the period 2002-2005, that ratio declined by 0.1 percentage point in 2006. Yet the growth of corporate income tax revenues does not mean that the tax burden has risen since 2003. The globalised implicit rate declined in 2003, perhaps on account of the first tax reform, before falling further in 2006 to around 16 p.c. as a result of the second tax reform. The latter has probably had a structural influence on corporate financial behaviour. Share issues reached a record total of 114 billion euro in 2006, an increase of more than 250 p.c. against 2005. The adjusted equity capital – which forms the basis for calculating the amount of the tax relief for risk capital – also reached a record level in 2006. It is mainly large firms that have recorded a break in the trend since 2005, as their adjusted equity capital increased by around 30 p.c. for two consecutive years. The difference between large firms and SMEs is also apparent in their dividend policy. Large firms paid out 24.4 billion euro in dividends in 2005, a record figure, but in 2006 there was a 20 p.c. decline in the profits distributed.

Annex 1

MOVEMENT IN THE MAIN COMPONENTS OF THE PROFIT AND LOSS ACCOUNT BETWEEN 1997 AND 2006

(millions of euro)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 e
Value added	102,066	108,272	112,546	121,045	123,532	125,295	130,829	139,504	145,872	154,994
Staff costs	60,637	63,756	66,960	70,986	73,734	76,114	77,326	79,973	82,367	86,270
Depreciation, downward value adjustments and provisions	20,176	21,397	22,163	24,434	25,695	25,104	24,380	23,947	24,980	27,163
Other operating expenses	4,960	5,933	5,793	6,456	6,956	6,808	7,442	8,165	8,581	8,849
Total operating expenses	85,773	91,085	94,917	101,876	106,386	108,025	109,148	112,084	115,927	122,282
Net operating result	16,293	17,186	17,629	19,169	17,146	17,270	21,681	27,420	29,945	32,712
Financial income	24,974	23,259	25,774	35,724	37,655	46,875	50,061	43,829	41,888	46,678
Financial charges	23,249	20,820	22,258	29,620	30,979	43,015	44,975	37,830	33,699	36,785
Financial result	1,724	2,440	3,516	6,104	6,676	3,859	5,085	5,999	8,189	9,893
Ordinary result	18,017	19,626	21,145	25,273	23,822	21,129	26,767	33,419	38,134	42,605
Exceptional result ⁽¹⁾	2,583	2,911	5,798	2,822	1,438	-2,665	5,922	7	11,145	9,181
Net result before tax	20,600	22,537	26,943	28,095	25,261	18,465	32,689	33,426	49,279	51,785
Taxes on profits	4,890	5,276	5,822	6,491	6,479	6,156	6,587	7,347	8,145	8,546
Net result after tax	15,711	17,261	21,121	21,604	18,782	12,309	26,102	26,078	41,133	43,239
p.m. Net result after tax excluding the exceptional result	13,128	14,350	15,323	18,782	17,344	14,973	20,179	26,071	29,989	34,059

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.

Annex 2

SECTORAL CLASSIFICATION

	NACE-Bel reference
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 telecommunication	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 3

DEFINITION OF THE RATIOS

	Item numbers allocated	
	full format ⁽¹⁾	abridged format
1. 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:		
12-month financial year		
10/15 > 0 ⁽²⁾		
2. Degree of financial independence		
Numerator (N)	10/15	10/15
Denominator (D)	10/49	10/49
Ratio = N/D × 100		
3. 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		
4. 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		
5. 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		
6. Implicit rate of corporate income tax		
Numerator (N)	67/77	67/77
Denominator (D)	9903 – ((280 + 282 + 284) / 28) × 750	9903
Ratio = N/D × 100		
Conditions for calculation of the ratio:		
9903 > 0		
If 28 = 0, then D = 9903 (full format)		
(9903 – (((280 + 282 + 284) / 28) × 750)) > 0 (full 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.