GENERAL INTRODUCTION

With contributions by Concepción Artola, Ana Esteban, Ignacio Hernando, Manuel Ortega, Annie Sauvé, Teresa Sastre, André Tiomo and Alain Tournier.
These represent the authors' personal opinions and do not necessarily reflect the views of the Banque de France and Banco de España

1. THE NEED FOR THE ANALYSIS OF EUROPEAN INDUSTRIAL CORPORATIONS

The 20th century, like those preceding it, has been marked by such significant milestones that it is difficult to agree on what is the phenomenon that has best characterised the flux of events over the past 100 years. Nonetheless, from the fresh perspective of the century in which this document has been drafted (with its accompanying information and communications technologies), it would not be out of place in the economic sphere to highlight the *paramount importance of industry during the recently concluded last century.* A straightforward comparison between 1900 and 2000 of citizens' daily life and of the societies in which they are organised offers clear evidence of the impact that industrial activity has had. As it advanced the 20th century witnessed the gradual population shift from rural areas to the cities and, in parallel, from agriculture and animal husbandry to industrial activities, with a subsequent move from the latter to services. The slow loss of weight of industrial activity across the global economy in recent decades in favour of services does not lessen the significance of industry. This is because of the continuing interrelatedness between the two and the *great significance of the study of industrial activity, due to its link to the business cycle and to the fact it is the driving force of cyclical accelerations and slowdowns.* Further, it is industrial activities which have been most affected by the opening up of domestic economies and, in this respect, *they have been first in line to face the challenges that competition and market globalisation* pose for corporate structures in terms of costs, margins and prices, and – in sum – of employment-generating capacity and competitiveness.

This change and challenge has proven to be of key importance in Europe. The latter part of the century saw, as a feature distinguishing Europe from other economic areas, the construction of a single market culminating in the emergence of a common currency. That more than justifies interest in gaining detailed knowledge of how European industrial corporations have evolved, from both an aggregate and macroeconomic perspective, and from a microeconomic or business standpoint. The latter may be done on the basis of the individual information available on the companies that report to the European Central Balance Sheet Data Offices, a task in fact pursued by the Committee of European Central Balance Sheet Data Offices (ECCB) since it was set up in 1987. The experience gained from the creation and use of the BACH (1) project, which revealed the problems of homogeneity in European accounting information, spurred the ECCB to undertake comparative studies among its member countries with a different methodological base. The documents "Equity of European Industrial Corporations. CECB,

(1) The BACH (Bank for the Accounts of Companies Harmonized) project was launched and promoted by the European Commission. Its participants are the central balance sheet offices or corresponding statistical services of the European Union countries, the United States and Japan.

1997" and "Corporate Finance in Europe from 1986 to 1996. CECB, 2000" looked into the differences in the level of capitalisation of German, Austrian, French, Spanish and Italian manufacturing companies, and the relation to the assets in which companies invest. These papers highlighted the *importance of analysing, along with the annual accounts of the non-financial corporations available, the information on the economic scenario,* which is important when explaining the differences found among countries and, in particular, on institutional factors. Briefly, these studies, which are available to those readers interested, revealed the existence of significant differences in financial structures, which are linked rather to the size of corporations than to their sector of activity. Finally, as stated, institutional factors (tax regime, bankruptcy law, access to financing from the banking system and bank-company relationships, etc.) were seen to exert considerable influence, providing, summing up, for the division of the countries analysed into two behavioural blocks [France and Spain share many aspects, compared with the group made up of Austria, Germany and Italy (the latter to a lesser extent)], although these factors could not be analysed in detail.

The findings of the studies confirmed the validity of the approach of using the data in the hands of central balance sheet data offices (CBSDO) (although these, as will later be seen, do not constitute a sample in statistical terms) and the advisability of pursuing the analysis of the corporate environment by means of bilateral country studies. The French and German central banks decided to build on prior studies, preparing in this connection the document "Corporate Finance in Germany and France. 1999". The findings of this work have been widely disseminated through full editions and also in abridged versions in the economic bulletins of the two institutions.

2. FRENCH AND SPANISH INDUSTRIAL CORPORATIONS

Following the substantive approach described in the previous section, i.e. using corporations' individual annual accounts and studying significant institutional factors, the Banque de France and Banco de España Central Balance Sheet Data Offices have analysed the aggregate of both countries' industrial corporations over the period 1991-1999. The study did not confine itself to analysing financial structure, as was previously the case in the above-mentioned references. Rather, it widened the subject of study to analysing corporations' results, in the broad sense of the term, namely the content of the profit and loss account (income, expenditure and surpluses), and derived ratios (from the P&L account directly or through comparing balance sheet data, as is the case with profitability or average collection and payment periods). To give a full picture of the position of and developments in industrial businesses, information on employment is included in the study, relating it to the significant accounting variables. Work has had to be conducted using a highly detailed volume of information. Thus, although on one hand previously undisclosed data have been provided, on the other, this means the timeframe of the study is restricted to 1999, and that data for 2000 are not included despite being available at the time of publication at both central balance sheet offices, since such data were being edited when the document was being drafted. The absence of data for 2000 in this study does not affect the main results obtained, given the nature of the work: *the aim of the analysis is to detect the differences and similarities between both countries' industrial corporations, rather than to conduct a short-term economic study on recent developments relating to the aggregate.*

It was considered preferable to provide potential interested readers with all the information compiled on drafting the document and, at the same time, to minimise as far as possible the content of the main body of the text. Accordingly, the four chapters into which the document is divided, which are presented in the following points, have been relieved to some extent of references to the long-term macroeconomic environment, the descriptive sections relating to institutional factors and the detailed statistics (the main statistics are included twice: in the text alongside the commentary and in the statistical annex), which are published at the end of the text in the form of annexes. The statistical annex is only published in the electronic version.

2.1. Gradual convergence between Spain and France. The macroeconomic environment

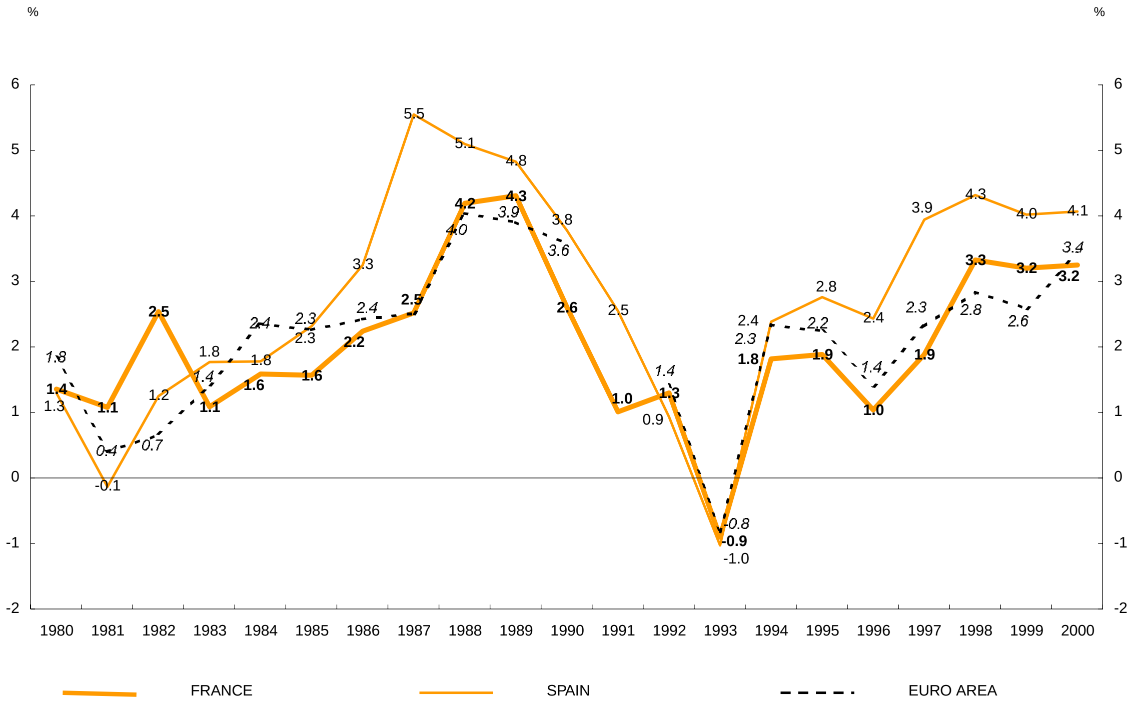
The analysis of both countries' Balance of Payments data highlights both the growing degree of interdependence between both economies and the need to acquire information about the similarities and differences between the two countries' non-financial corporations. While *France is Spain's most important trading partner* (in 1999, 13% of Spanish goods exports were for France and 15% of Spain's goods imports were from its neighbour), it is no less notable that bilateral trade between the two countries in the nineties was clearly in France's favour. At the end of the nineties, Spanish economy was more opened up than French economy. In Spain the weight of the exports over Spanish GDP was 27% and the weight of the imports was 29% while in France, these figures were 26% and 24% respectively. Chapter I ("The French and Spanish economies: a macroeconomic perspective") helps explain the rapid *convergence* between both economies over the past decade and offers some references that frame industrial corporations within their macroeconomic setting (economic growth, foreign trade, saving, investment and financing, the labour market, costs and prices, and monetary and financial conditions). Moreover, these references explain some of the reasons behind the balance sheet and ratio differences detected between both countries. However, the nominal convergence of the nineties has not prevented differential aspects remaining in place. Thus, for instance, the strong reduction in the price gap exists alongside *the dual inflation phenomenon,* which have a major intensity in the Spanish case. And net lending shown by the national accounts in the second half of the nineties, in a context of increase in national gross saving, came together with net financing to the external sector provided by the French economy, while in Spain, with the intense investment made by *the Spanish economy, in step with the catching-up process.* Annex I ("Fundamentals of the economic growth in France and Spain") briefly reviews the *process of convergence* between both countries over the *last 30 years,* which have seen Spain gradually catching France and Europe up. Connected with this process have been the changes in the Spanish labour market and the intensity of public investment in this period. Annex I addresses the conditioning factors of the process and underscores the determinant factors of *competitiveness and of productivity* in both countries *(infrastructure, human capital and investment in technology), where France has a clear advantage in relation to Spain.* Lastly, annex II summarises current French and Spanish labour market regulations, in those areas that may influence in the hiring process (minimum wage, collective bargaining arrangements, dismissal conditions, types of contract, regulation of the working day length, etc.). It further makes, in Spain's case, a historical reference to the main changes of recent years in connection with labour market liberalisation.

2.2. Population of corporations, samples and accounting standardisation

To analyse properly the results obtained from the study of the annual accounts reported by corporations to central balance sheet offices, the following should be defined beforehand: the portion of the differences attributable to the different composition of the population of corporations; the samples available (that are not statistically representative of the former); and lastly, the accounting practices used in both countries. Chapter II and its accompanying statistical annex provide full breakdowns of the composition of the population of French and Spanish non-financial corporations, of the industrial sector as a whole and, finally, of the samples used. It further addresses the general characteristics of the Spanish and French central balance sheet

GRAPH I.1

REAL GDP GROWTH



Source: OECD ADB database.

offices. Finally, it gives the methodological references on how the data for both countries have been homogenised to strip out the accounting differences in the underlying information, entailing the elimination of certain items and the estimation of others. As will later be seen in connection with the population structure, the study highlights both the bigger average dimension of French corporations compared with their Spanish counterparts, in all size brackets, and the slightly greater service-based orientation of French companies. The samples available show a bias in both countries towards large corporations and industries.

2.3. Results of the comparison between Spanish and French industrial corporations

Chapter III gives the results of the comparison of the information available in the French and Spanish central balance sheet offices on both countries' industries. The results are outlined in a text, a statistical annex and several text annexes (annexes III to VIII), allowing interested readers to learn of the degree of influence of the so-called institutional factors in the differences detected.

The chapter comprises two main sections, the first of which analyses the main differences between balance-sheet structures. Some of the conclusions reached in relation to this part of the study are highlighted:

- *Greater weight of tangible fixed assets in Spanish industries* compared with their French counterparts (13 percentage points on average). As will be seen, this does not affect the profitability ratios. Several factors account for this difference, including most notably the different weight of leased assets (this is greater in France) which, moreover, have not been included in the balance sheet, so as to be able to homogenise the information between the two countries. Annex III offers a detailed review of the characteristics of asset leasing arrangements in both countries.

- *Greater maturity of French industries in organising French companies into corporate groupings.* Spanish corporations are lagging here, having only begun to follow this pattern at the end of the decade. The greater weight of financial investment in the shares and participations of French corporations (8 percentage points above Spain) would appear to demonstrate this. Annex IV, which gives an overview of the French and Spanish financial systems, may help clarify the interrelatedness of balance-sheet structural characteristics (on both the asset and liabilities sides) and how the respective financial systems are organised. Testifying to the improvement in *management techniques, inventory stocks have fallen uninterruptedly in both countries* over the period considered.

- Gradual *convergence in the weight of commercial assets and liabilities in both countries,* with notable differences based on company size, owing to the favourable relative bargaining position of large corporations.

- *Average maturity period collection from customers has not converged in all the sizes of corporations: it remains greater in small and medium corporations Spain's case.* That might be considered indicative of the commercial practices used in Spain, and represent an extra implicit financial cost arising for Spanish small and medium companies compared with their French counterparts.

- *Gradual convergence in both countries in their financing structures and in the division between fixed and current assets.*

- *Loss of weight of financial debt and, hereunder, bank-intermediated financing* in both economies. Annex V reviews legislation and specific procedures under bankruptcy law in both countries, the treatment of business failure and suspensions of payments to creditors, showing the similarity between both systems. Such is the similarity between both systems that it may be concluded that any differences in the financial structure of corporations will not arise from this factor.

  Regarding financing structures, annex VI examines the social welfare systems financed or promoted by corporations for their employees (pension funds in both countries; Épargne Salarial in France), which explain the relatively low weight of these liabilities in companies' balance sheets.

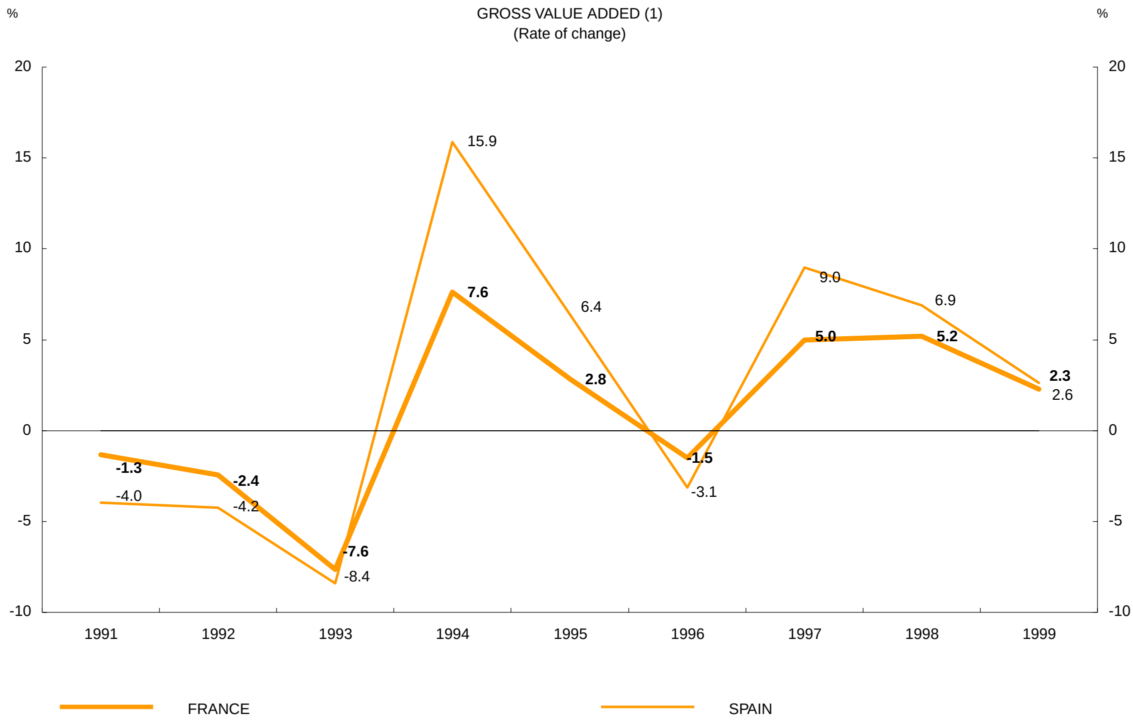
The second section studies the current flows included in the profit and loss accounts, employment developments, performance and the data available on investment. The study does not set about analysing financing flows directly, though it does so indirectly through analysis of changes in the aforementioned balance sheets. As regards this second part of the chapter, the following aspects are of note:

- The two countries' industries show that their *activity and fund-generation capacity are tightly linked to developments in the general business cycle.* In Spain's case, fluctuations are relatively sharper than in France, during both growth phases and downturns.

- Both countries' industries have undergone *pressure on their surpluses owing to the fact that average compensation has outgrown the general level of prices.* Such behaviour, which

GRAPH III.2.1

TOTAL INDUSTRY (SAMPLE)



Sources: Banco de España and Banque de France.
(1) Rate of change deflated by industry GDP deflator

might be prompting a loss of competitiveness vis-à-vis agents in other regions, did not affect the employment-generating capacity of Spanish industrial corporations and to a smaller extent of French firms. The analysis of the weight of the personnel expenses over net turnover shows that both countries have reduced the participation of these costs in the sales, but the reduction was more intense in the Spanish firms. This reduction is influenced for the different contributions of the firms to the social security system in each country. Annex VII goes deeper on this issue.

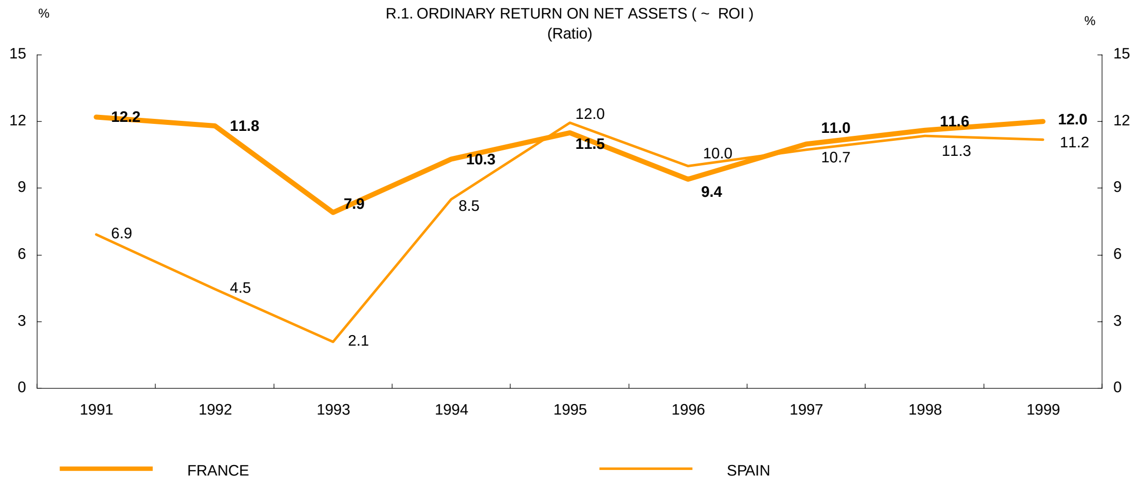
- Conversely and positively, both Spanish and French industries, which have benefited from the creation of the single currency, have seen an *unprecedented fall in nominal and real interest-bearing debt.* Practically up to the end of the decade, this was accompanied by a parallel reduction in their financial costs.

- That has freed resources for investment in a broad sense (i.e. not only gross capital formation, but also the taking of positions in corporations in other sectors and economies). At the end of the period, both countries' corporations are on an equal competitive footing in this area, having to face virtually identical borrowing costs. The reduction of the financial costs over net turnover, has contributed to the increase of the funds generated inside the companies. Thus, companies could afford in better conditions their investment projects.

- The gradual convergence between industries in the two countries is accurately reflected in their *profitability ratios, which practically overlapped at the end of the decade.*

GRAPH III.2.10

TOTAL INDUSTRY (SAMPLE)



Sources: Banco de España and Banque de France.

Despite its sound level, investment, which is theoretically influenced by these ratios, moved on a similar trend during the decade, and followed a dissimilar one in the two final years in both economies (in 1998 and 1999: on a rising trend in Spain and on a falling one in France). The data for 2000 and 2001 will show a decline in investment in the Spanish industries too, against a background of high profitability levels. This highlights two phenomena:

1. The path pursued by French industrial corporations, which have opted to invest outside their borders in meeting the challenge of internationalisation and globalisation, is one Spanish corporations are now beginning to follow. This may perhaps be a symptom of the maturity of the industries of these two economies, but it is doubtless also a warning of a change in the rules of the eminently domestic game, only too well known by these firms; the expected returns they find in these investments, could also be associated with a higher degree of uncertainty and risk. However, it is clearly not possible to stand back from this process of globalisation.

2. The picture given by the data provided by the firms qualifies the information obtained from the National Accounts aggregates, insofar as it refers specifically to certain particular firms (the larger firms which, as mentioned above, bias the aggregate studied). This fact, besides explaining the greater intensity of the rates of change of investment of these companies, confirms the interest in carrying out this kind of study, based on the annual accounts of the corporations, and serves as a contrast for business trends and for macroeconomic analysis.

2.4. Investment and financial constraints in France and Spain: a study based on individual firm data

A final aim of the joint research project presented in chapter IV has been to determine whether France and Spain share the same patterns of behaviour in the investment decisions of their industrial corporations, in the face of liquidity or financing constraints. To this end, a test of excess sensitivity of investment to the internal generation of funds based on the estimation of a standard Euler equation investment model derived from Bond and Meghir (1994) is presented.

The analysis performed uses as a source of information a significant sub-set of the corporations used in chapter III, enabling one of the main problems facing this kind of work to be avoided, namely, lack of homogeneity in the basic information of the countries subject to comparison which, as explained in chapter II, has been almost completely eliminated in this document. The study shows in both countries (for which no significant differences are found) the sensitivity of investment to the trend in the corporations' capacity to generate internal funds (cash-flow) and, at the same time, defines a useful signal for the analysis of business investment: the dividend policy (specifically, its absence), is an indicator of the potential presence of financial constraints affecting gross capital formation.