

PROFITABILITY OF SPANISH NON-FINANCIAL CORPORATIONS

Between 2007 and 2013 the non-financial corporations sector underwent a severe crisis, which prompted considerable deterioration in their activity, profit and employment levels. Six years after the end of the downturn, this box compares the sector's present situation with both the pre-crisis and peak-crisis levels. The analysis concentrates on corporate profitability, as this variable is a good indicator not only of firms' economic and financial situation but also of their resilience to adverse shocks and their propensity to invest. The exercise draws on the Integrated Central Balance Sheet Data Office Survey (CBI), which has data up to 2017 for more than 600,000 non-financial corporations, and on the Central Balance Sheet Data Office Quarterly Survey (CBQ) which provides more recent data (up to June 2019) for a more limited sample (800 to 1,000 firms) where large corporations are over-represented. The measure of profitability used is the ordinary net profit to equity ratio.¹

The CBI data show that return on equity in the corporate sector fell sharply as a result of the crisis, down from 14.5% on average in the period 2003 to 2007 to 5.2% in 2013 (see Chart 1). The indicator then started to rise gradually in line with the macroeconomic recovery, reaching 9.7% in 2017 (the last year for which CBI data are available). The breakdown by firm size shows that profitability patterns at large corporations and at SMEs are similar to the patterns for the sector overall, although large corporations consistently record higher profitability levels than small firms.

However, the breakdown by sector reveals an uneven profitability recovery. Thus in 2017 profit levels in industry, in wholesale and retail trade and accommodation and food service activities and in transport and storage were similar to or higher than those of the period 2003 to 2007. Yet in construction, where profitability was negative in 2013, in 2017 it was still very distant from the pre-crisis level. Lastly, both the energy and the information and communications sectors recorded a sharp decline in profitability up to 2013, not only as a consequence of the crisis but also on account of the impact of the growing competition in both areas. This last factor continued to affect both sectors in the subsequent recovery and this is why, conversely to the other sectors, their average profitability levels continued to fall, albeit much less markedly, up to 2017.

An analysis of profitability distribution shows that between 2003 and 2007 the percentage of firms recording positive returns rose, reflecting the growth in the period (see Chart 2). Subsequently, as was to be expected, in 2013 a shift is observed in the distribution towards lower levels compared with the pre-crisis situation. This is explained both by the increase in the percentage of firms recording negative returns and the decrease in the percentage of firms with profitability levels over 10%. Following the recovery, the profitability distribution again shifted to the right. However, compared with the pre-crisis situation, in 2017 there is a greater concentration of firms with positive albeit moderate profitability levels, while the percentage of firms with relatively high profitability levels (over 10%) is lower than in 2007. Irrespective of the average level of corporate profitability in 2017, the fact that the distribution shows a very significant percentage of firms with relatively low (albeit positive) profitability would suggest that a considerable proportion of the companies analysed might still be quite sensitive to a possible adverse macro-financial shock.

It is also useful to examine the contribution made by the various different components of Ordinary Net Profit (ONP), which is the numerator of the profit ratio considered here. In this respect, Chart 3 shows that Gross Operating Profit (GOP) is the most important component underpinning the patterns observed, having made the largest contribution both to the decline in profitability during the crisis and to its subsequent recovery. There are, however, two additional elements that might also help explain the developments in return on equity. First financial costs, which fell as a proportion of total ONP over the period analysed, especially in the SME segment, owing to the deleveraging undertaken in the sector in recent years and, in particular, to the successive declines in interest rates in the period. And second, the significant increase in equity (the denominator) between 2007 and 2013, which drove down profitability in the period, most markedly among large corporations and in certain specific sectors (energy, construction, and information and communications). This increase in equity would be explained, *inter alia*, by significant capital increases made (for instance, through corporate debt to equity swaps) and by increases in reserves (arising, for example, from changes to dividend distribution policies or from extraordinary profits linked to investments in financial assets).

¹ The results obtained using alternative measures of profitability, such as return on net assets, are consistent with those obtained here.

PROFITABILITY OF SPANISH NON-FINANCIAL CORPORATIONS (cont'd)

Chart 1
RETURN ON EQUITY (R.2) (a)

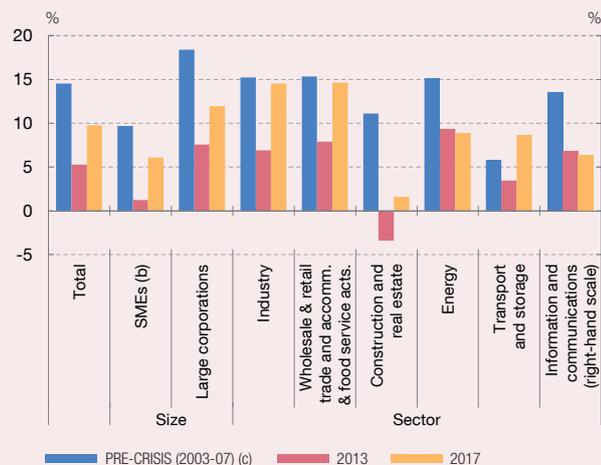


Chart 2
DISTRIBUTION OF R.2 PER YEAR (d)

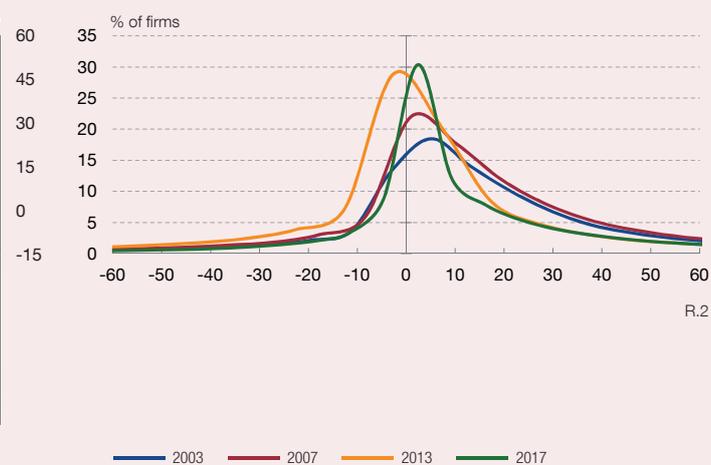


Chart 3
BREAKDOWN OF RETURN ON EQUITY (R.2)

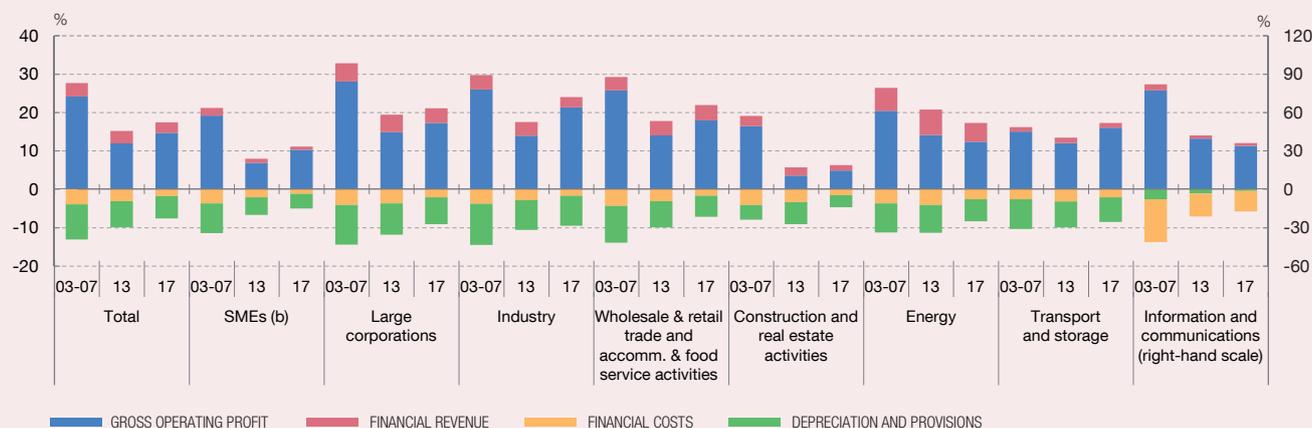
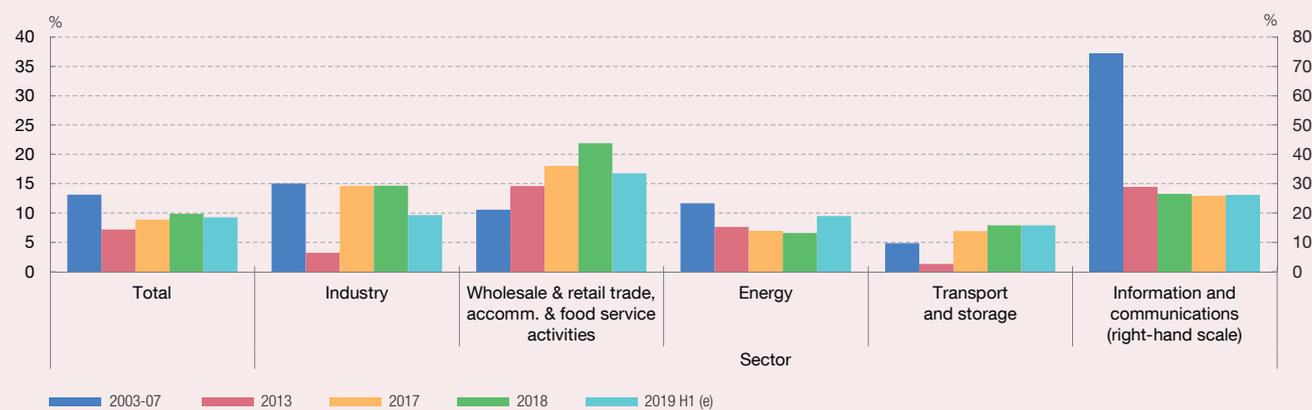


Chart 4
RETURN ON EQUITY (CBQ)



SOURCE: Banco de España.

- a Return on equity is defined as Ordinary net profit / Equity.
- b Definition of firm size as per Commission Recommendation 2003/361/EC.
- c Pre-crisis profitability calculated as the GVA weighted average of profitability levels in the years 2003 to 2007.
- d Excludes all firms with equity less than or equal to zero.
- e Profitability for 2019 corresponds to H1, annualised to facilitate comparison with the previous years.

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Lastly, drawing on CBQ data, we analyse how corporate profitability has evolved in the more recent period.² These data show that, for the quarterly sample as a whole, average profitability levels continued to grow in 2018, before falling slightly in 2019 on data to June (see Chart 4). The main reason for this decline in profitability in recent

months appears to be the deterioration in operating activity in the period, against a backdrop of economic slowdown, prompting a widespread drop in Gross Operating Profit in all the main sectors covered by the quarterly sample, with the exception of energy which is the only sector that shows a somewhat more expansionary pattern.

2 The profitability levels reflected in the CBQ and the CBI are not directly comparable, either in terms of totals or breakdown by sector, owing to the lower number of firms reporting to the CBQ and the over-representation of large corporations. However, the CBQ is useful to assess more recent corporate profitability patterns.