

Euler Hermes: French company investment spending flat despite healthy cash positions

75% of companies have healthy cash reserves; only 20% plan to increase investment spending in 2014

PARIS – 10 DECEMBER 2013 – Euler Hermes, the leader in credit insurance, leveraged its 23 French regional offices to conduct a proprietary survey of 800 small- and medium-sized businesses (SMBs) in the third quarter of 2013. Examining markets, investments and cash positions in an economic environment where demand is anemic:

- Profit margin levels represented the largest challenge faced by 88% of companies in 2013
- Companies adjusted both overcapacity and cash positions: three out of four SMBs have healthy cash positions
- Only one in five companies expects increased investment spending in 2014, mainly due to limited order book visibility

I – The dry spell in demand has taken its toll on profit margins

Companies continued to feel the negative impact of the depressed economy in 2013 (+0.2% growth), notably in private consumption which barely remained in positive territory (+0.4% annualized growth). In this environment, profit margin levels were the main challenge faced by 88% of companies in 2013, well ahead of financing difficulties (23%).

“Caught in the crossfire of increased pricing competition and a contraction in demand, companies sacrificed their margins. As a result, profit margin levels for French companies¹ reached an all-time 25-year low, with declines of more than three percentage points since 2007,” noted Nicolas Delzant, chairman of the Board of Management of Euler Hermes France.

For 2014, Euler Hermes forecasts +0.6% growth in France, with anemic demand and competitive pricing pressures continuing to erode company profit margins. Without a significant improvement in demand, companies have already begun to focus on operating costs. More than 70% of the companies surveyed perceive cost pressures - in both labor and materials - as a major risk weighing on their profitability in the coming year. However, French companies appear to be less vulnerable to the external market environment. Of the companies surveyed, only 10% are concerned about fiscal volatility, and less than 5% are worried about access to credit.

Overall, this greater resiliency could backfire on French companies if they do not recognize their strengths or the more robust external environment in 2014.

II – Financial fundamentals remain sound while cash flow is well managed (perhaps too well?)

French companies currently have sound fundamentals. In particular they have sound balance sheets, with 40% equity on average, compared to 37% for German companies.²

Moreover, since the financial crisis they have made the necessary adjustments to offset demand weakness:

- Production capacity has been slashed to minimize the impact of declining volume. In 2013, four out of five companies had capacity utilization rates above 80%, compared with only three out of four in 2012.
- Three out of four companies reported improved or stabilized cash positions in 2013, reflecting better financial management.

¹ Non-financial companies

² Sources: ECB, Bach database, Euler Hermes

- Invoice payment time also remained satisfactory for two out of three companies despite the difficult economic environment. This improved receivables position is less evident in two sectors: construction and services.

“The discipline adopted by French companies in their production capacity and cash management is clear,” said Ludovic Subran, chief economist, Euler Hermes. “However, companies currently appear to be too narrowly focused on the near term. Of the companies surveyed, 75% are concentrating on their working capital positions and 30% have even gone so far as to retain all surplus cash. For national economic growth to resume, companies will need to break with the cash hoarding trend. It was just this transition from the phenomenon of cash hoarding to a new investment dynamic by businesses that truly signaled the American economic recovery at the beginning of 2012.”

III – 2014: the third consecutive year without investment?

According to the survey, 66% of all companies estimate that investment represented less than 5% of their revenues in 2013. For 2014, 20% of companies plan to increase investment spending, compared with 25% in 2013. The reluctance to invest is more pronounced for the larger medium-sized firms than for SMBs - only one in six of the latter plans to invest in 2014, compared with one in three in 2013.

Lack of demand and order book visibility are weighing on investment decisions. Some 80% of companies cite expectations of future business activity as the determining factor in their investment decisions, well ahead of financing conditions (10%) or public subsidies and assistance (10%). Moreover, nearly 50% of companies reported less than six months of order book visibility; for one out of three companies this visibility is less than three months.

Investment quality will also continue to deteriorate in 2014. For the third consecutive year, French companies will favor defensive investments (six out of 10 companies in 2014) over more expansionary investment projects. This defensive posture is most pronounced in the construction and trade sectors. Manufacturing and services, meanwhile, will account for 66% of expansionary investment such as capacity increases, R&D and diversification.

“This extreme caution in investment spending appears to be the missing link for a genuine recovery in France in 2014,” said Ludovic Subran. “Yet the will is there: 38% of the companies surveyed intend to produce higher-value products and diversify, and 16% wish to expand into export markets in 2014.”

Euler Hermes estimates that global demand for French products will increase by 4% in 2014 (or +€18 billion), including €8.3 billion for the euro zone alone.

Subran concluded: “The time has come for companies to make the most of their successful competitive adjustments and seek new opportunities in France and abroad through high-quality investment. They have the means and the desire. The need now is to take action.”

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Euler Hermes France

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