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Based on the

EFIGE Policy Report

STILL STANDING: HOW EUROPEAN FIRMS WEATHERED THE CRISIS

SUMMARY

Introduction

Still standing: how European firms weathered the crisis, written by Gábor Békés, László Halpern, Miklós Koren and Balázs Muraközy, is an EFIGE Policy Report. It has been prepared jointly by the Institute of Economics of Hungarian Academy of Sciences (www.iehas.hu) and Bruegel (www.bruegel.org) for the project 'European Firms in the Global Economy: Internal Policies for External Competitiveness' (www.efige.org). This brief summarises the main results and policy implications of the report.

The Great Recession of 2008 and 2009 brought about a 6.5 percent decline in world industrial production and a 12.8 percent decline in world merchandise trade in 2009, with an even sharper decline during late 2008 and early 2009. Europe was particularly affected. Industrial production and merchandise trade in the European Union declined by 13.7 and 15 percent, respectively. Businesses, policymakers and academics would like to understand the causes and the consequences of the crisis, with the hope of avoiding or mitigating future ones.

Most policy reports to date analysed the macro-economic context of the crisis, assessing countries' fiscal or trade policies for restarting economic growth. The policy report is different because it asks how the Great Recession impacted European firms. Using new data from seven European countries, the results shows that there is significant heterogeneity across countries and firms in terms of how they were affected by, or responded to, the crisis. Identifying which firms suffered the most from the crisis is important for at least two



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reasons. First, one can identify which firms are most vulnerable in another, similar crisis. Second, one can evaluate the policies that were implemented in the midst of the crisis with limited information about the scope and nature of the events. Identifying firms that fared better may help design more effective and better-targeted policies.

This report is the second to explore systematically the interaction between firm and country characteristics, using the newly compiled EFIGE survey of about 15,000 manufacturing companies in seven EU countries (Austria, France, Germany, Hungary, Italy, Spain and the United Kingdom).

Evidence and analysis

The study, *'Still standing: how European firms weathered the crisis'*, on which this Policy Brief is based, finds:

1. Performance heterogeneity: Sector and country differences are less important than within-sector/within-country heterogeneity in explaining firm-level performance. In terms of the variance in change in sales, sector affiliation explains 9.6 percent, and the country of origin accounts for just 3.4 percent, together explaining only 13 percent of the total variation. The remainder is a consequence of firm heterogeneity. During the crisis, 10-20 percent of firms managed to grow even in the hardest hit industries and countries. Firm size did not matter; small and large firms performed similarly.

2. Employment: While a temporary reduction of output may be weathered by the firm, the loss of jobs has more long-lasting effects. Firms with a greater drop in sales also laid off more workers, but the relationship was less than proportional. Firms with many part-time employees and many unskilled workers experienced greater layoffs. This suggests that during crises firms try to protect the human capital embodied in skilled blue-collar and white-collar workers, while some types of workers are seen as more easily replaceable should the recovery arrive.



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3. Trade and crisis transmission: Exporters contracted more than non-exporters. The average exporter suffered a 3.2 percentage points greater decline in sales than the average non-exporter within the same country. Importing firms, however, performed better than average. The difference in the sales decline between exporters and non-exporters was the greatest in Austria, France and Germany.

4. Linkages: Firms that outsource and firms that control other companies fared better during the crisis. Outsourcers witnessed a 1.8 percentage points smaller reduction in sales. Firms in a controlling position within their company network laid off 1.3 percentage points fewer workers. By contrast, among those firms that saw their sales decline more than 30 percent, those that are controlled by other companies reduced their workforces by up to an extra 4.2 percentage points. This suggests that the place of the firm in the production and ownership chain is an important determinant of the effect of the crisis. We also confirm this finding with technological indices: industries that sell mostly to other industries have contracted more.

5. Credit and finance: Firms relying on external finance and experiencing financial constraints to growth experienced greater sales declines. The use of trade credits by itself did not prove to be a significant factor. Firms with larger pre-crisis tangible assets-to-total-assets ratios suffered from the declining valuations of these assets, and the lack of financing led to lower sales and exports. Large loans backed up by property turned out to be a curse during the crisis. This is true after controlling for other size and financial-health variables such as total assets and cash flow. The crisis transmission to manufacturing firms did not really come through major international banks, but rather through smaller domestic banks.

6. Role of the state: Relaxed fiscal policies and public programmes have helped to stabilise demand in two ways that we can detect in our data. First, countries that were in a good fiscal position before the crisis could expand easily and without an increase in yields, and help stabilise the economy. In these countries, firms were hurt less while exporters experienced a relatively greater decline owing to worse performance of



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Policy implications and recommendations

foreign markets. Second, governments were somewhat effective in boosting demand for firms with public-sector clients, but this did not have any extra effects on employment beyond the indirect effect of greater sales.

The findings presented in this Policy Report lends support to:

1. Heterogeneity of firms: Policymakers can learn from studying the experience of firms that were relatively successful in weathering the crisis. This heterogeneity also suggests that one-size-fits-all policies might be ineffective. Understanding the patterns emerging from this heterogeneity may enable governments to better target spending and regulations.

2. Short-time work: While short-time work in Europe may be the right instrument to dampen the effect of crises on employment, this report found no support for this. Moreover, our results suggest that temporary workers were fired first, with firms with larger pools of temporary workers actually shedding more employees. In terms of the labour market, we found that skill-composition seems to matter more, as firms with less-skilled workers had to lose more jobs than those with more white-collar and skilled blue-collar labour. Firms prioritised the retention of human capital embodied in skilled labour during the crisis.

4. Network position of firms: Dominant firms centrally placed in the technology, trade and ownership network fared better. Hence, in crises, policy should focus on helping stabilise firms that are in weaker positions, that are owned by foreign firms and producing less skill-intensive and/or specific products for large customers. This raises an important policy trade-off. On the one hand, while export-oriented strategies may improve competitiveness, they also bring about greater exposure to foreign crises. Accessing foreign markets may help firms attain bigger scale, improve productivity or upgrade



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their products in stable times, but such firms, sectors and countries will also be more vulnerable to crises. The flip side of the same trade-off is that outsourcing to other countries has distinct stabilisation benefits. While many see competition by lower-wage countries as a threat, it should also be clear that these supply chain linkages give greater flexibility when responding to a demand shock. These additional gains from trade for rich countries imply that protectionist instincts during the crisis may be misguided.

5. Credit and finance: Anecdotal evidence suggested that as banks collapsed, trade credit dried up and hence exports fell more sharply than output. Yet, earlier studies found mixed evidence regarding the effect of trade finance. This report falls in line with other papers, finding no convincing result. However, it confirms the importance of pre-crisis external constraints, and adds that a greater reliance on external finance had a negative impact on sales during the crisis. As a further contribution, the report detected that the financial crises affected firms not through major international banks but through smaller and financially weaker local banks. Of course, this may have been a result of government intervention shoring up the capital positions of some large and important banks. Whichever is the case, strengthening local banks may help firms to cope with the consequences of crises.

6. Fiscal policy: While fiscal policy was the main policy tool used by governments, with sizeable new government purchases from the private sector, evidence on the role of the state is scant. The report confirms the role of the general fiscal policy stance and the role of public-sector orders from companies in helping mitigate declining sales.

Research parameters

Scientific approach

- Investigate the interactions between the strategic decisions of European firms determining their international



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competitiveness.

- Study the feedbacks between the ability of firms to compete in foreign markets and their reliance on local as well as global production networks.
- Identify the bottlenecks to internationalisation stemming from firm size, innovation, access to financial markets, governance and organisational modes, the skill composition of the labour force, regional characteristics.
- Understand the impact of European integration on the external competitiveness of European firms with a special focus on the effects of the single currency on firms' trade and production decisions.

The EFIGE survey

The EFIGE survey gathered both qualitative and quantitative information at the firm level through a detailed questionnaire containing more than 150 items related to the international operations of firms and collected via CATI (Computer Assisted Telephone Interview) and CAWI (Computer Assisted Web Interview) approaches. In order to ensure that the collected data is standardised and statistically representative, an initial target was set of around 3,000 firms for France, Germany, Italy and Spain, 2,100 firms for the UK, and 500 firms for smaller countries (Austria and Hungary), i.e. a total of 15,100 valid questionnaires. The exact numbers by country deviated slightly from the targets as the result of appropriate sampling procedures. Survey questions cover the following drivers of the competitiveness of European manufacturing firms: size and productivity; organisation; geographical scope; skills and tasks; innovation; financial constraints; and use of the euro.

PROJECT IDENTITY

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Coordinator	Gianmarco Ottaviano Bruegel
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For more information	info@efige.org