

Corporate Sector in the Czech Republic: What is the Role of Ownership in the Dissolution of Company?¹

Drahomíra Dubská² | *University of Economics; Czech Statistical Office, Prague, Czech Republic*

Abstract

Empiric analysis of the sector of non-financial corporations in the Czech Republic shows history of their terminations during the period 1995–2011. The purpose was to observe, what differences in the evolution of terminations (bankruptcies) of companies are connected with the predominant form of their ownership (only legal persons were analysed). Therefore, selected methods of the companies' terminations were monitored according to a group of legal persons with prevailing domestic private capital and also group with predominance of the public capital. Also, the firms under foreign control were analysed. The companies with prevailing private domestic capital have dominated due to their largest number. However, the foreign-controlled companies have showed faster pace of the terminations during the analysed period and also their greater sensitivity to the economic cycle has been demonstrated. Liquidation was the most common method of the companies' termination (roughly two-thirds of the total number of terminations in 2011). Dissolution without liquidation with successors represented one tenth of the terminations in the segment with predominance of private national capital and 15% in the segment of foreign-controlled companies.

Keywords

Non-financial corporations, ownership, liquidations, bankruptcy

JEL code

M2, O12, L16, L26

INTRODUCTION

Besides the view through branches of the economy it is possible to observe the sector of non-financial corporations also from point of view of their ownership. This is not very often used preview but it can provide especially in the long-term analyses of transitive economies very interesting information

¹ This paper is designed as one of the outputs of the research project "The development of the transaction costs of Czech businesses in bankruptcy proceedings, the possibility of their reducing on the level common in the EU by improving legislation, the possibility of improving statistics insolvency proceedings and creating a model of financial fragility of households" which is registered with the Technology Agency of the Czech Republic under the registration number TD 010093. The international scientific team is coordinated by the University of Economics in Prague.

² University of Economics, Nám. W. Churchilla 4, 130 67 Prague, Czech Republic; Czech Statistical Office, Na padesátém 81, 100 82 Prague, Czech Republic. E-mail: dubd00@isis.vse.cz, drahomira.dubska@czso.cz.

including the lifetime of companies by type of ownership. This analysis regards the institutional sector of non-financial corporations which is divided into the groups of the firms with the prevailing ownership of the capital of public sector of the Czech Republic and of so-called private national corporations and also private foreign-controlled companies. The choice is primarily focused on legal persons because of their weight in producing gross value added in the Czech economy.

As regards the shares of institutional sectors in the Czech economy, in 2011 the firms under foreign control accounted for 68% of total turnover of the non-financial corporations and in the manufacturing even 83%. The private national corporations participated just only from one fifth in the mentioned total turnover and the rest (ie. 12%) represented the firms with the prevailing ownership of the capital of public sector. If we watch on the proportion on employment, almost three fifths (59%) of employed persons of the non-financial firms were working in the foreign-controlled segment while just only one fifth in the private national segment. The firms with the prevailing ownership of the public sector capital of the Czech Republic employed 17% of the total number of employed persons of the non-financial sector. Finally, the firms with the prevailing ownership of the capital of public sector of the Czech Republic were providing the job to 17% of the total number of employees of the non-financial sector. The proportions between the achieved turnover and employment, of course, reflects the level of labor productivity in the analyzed segments.

Therefore, the results of the analysis must be viewed through the prism of the position of each institutional sector in the Czech economy.

METHODOLOGY

Data regarding numbers of the corporations which ceased their activities (ie. deaths, terminations of firms, their downfall, extinction, the companies which were on the decline or ended their activities) during 1995–2011 were available by selection from the register of economic entities, ie. Business Register (BR) which is created and managed by the Czech Statistical Office (CZSO).³ However, the CZSO is not primarily the place which should show the state of the company in the phase of insolvency and even in the foreseeable future it will not be possible to concentrate such information there. Therefore, the company at the stage of insolvency can be included into the Business Register of this official national statistics only when any form of death of such company is notified. Then, the statistics is available with the code of list defining the form of deaths. The code of list in the CZSO defines twelve variants of possible deaths of legal (artificial) persons and household-trades (i.e. enterprising individuals, natural persons).⁴

There is no ambition of this article to analyse the forms of death of the number of registered economic subjects in the Czech Republic in total due to considerable robustness of the topic and the size of the database. Therefore, for the purpose of this analysis non-financial corporations by the type of ownership were chosen only and the attention was concentrated on legal persons. As well only some forms of deaths of legal persons were selected of the institutional sector of non-financial corporations which are divided by the type of ownership in the system of the ESA 95 (European System of Accounts). They are three types of entities in this system: Public non-financial corporations, National private non-financial corporations

³ Thus, synonymous with defunct in this analysis is extinction, dissolution, termination, death, annulment. In this sense a defunct company is the company which had ceased its activity and was deleted from the Commercial Register.

⁴ The code of list defines these forms of the death of legal persons and household-trades (enterprising individuals): 00 Not identified, 01 Annulment of legal entities by liquidation, 02 Cancellation of legal entities without liquidation with one successor, 03 Cancellation of legal entities without liquidation with more successors, 04 Cancellation of legal persons without liquidation without successors, 05 Notification of the household-trade about termination, 06 The decision to withdraw authorization for a household-trade, 07 The death of household-trade, 08 Moving out of the district, 09 Decision because of the non re-registration, 10 Unauthorized extradited Identification Numbers Organisation (IC), 11 Ending of Registration of the duplicate Identification Number (IC).

and Foreign-controlled non-financial corporations (in the next text and also in the chart labels, the titles of these entities are presented in abbreviated form as "public", national private" and "foreign-controlled"). Only these forms of deaths of companies are considered in this article:

- Annualment of legal persons by liquidation,
- Annualment of legal persons without liquidation,
- Annualment of legal persons without liquidation with one successor,
- Annualment of legal persons without liquidation with more successors.

In order to capture the longest time horizon and to track changes in selected sector of the firms, the interval from 1995 to 2011 was chosen. Relations in a broader sense enabled through data within the Business Register (BR) are analysed of period 2005–2010.

1 PROPORTION OF THE INSTITUTIONAL SECTORS IN THE BUSINESS REGISTER OF THE CZECH REPUBLIC

In 2008, the number of the economic subjects registered in the Czech Republic⁵ for the first time exceeded the level of 2.5 million entities. At the end of 2010 a total 2 637 thousand entities were registered, according to official data available. Regarding the numbers, household-trades (ie. individuals or in other words entrepreneurs with Identification Number) dominate the file of registered subjects. Their number exceeded the level of two milion entities at the end of 2010. Regarding others, there was a total of 2 164 companies from the financial sector⁶ and 17 956 from the government sector which includes also the municipalities, cities and counties. Economic entities of institutional sector named Non-profit institutions serving household (NPISHs) is also a relatively high number (118 848 at the end of 2010) while non-residents registered as an economic entities in the Czech Republic were only hundreds and reached even only 0.1 % of the total number of entities listed in the BR.

The institutional sector Non-financial corporations (in the text of this post as "corporates") participated in the total number of economic entities in the Czech Republic less than one fifth (18.9%) at the end of 2010. However, its share has increased over the time to 15% in 2005. At the end of 2010 almost half a milion (497.8) of non-financial corporations existed in the Czech Republic.

In 2010, full three-quarters of registered economic entities in the Czech Republic, ie. 75.9%, were entrepreneurs in the household sector, ie. household-trades. Their proportion, on the contrary, decreased during the second half of last decade because in 2005 it represented 78.6% of total registered economic entities. This may be obviously explained by development of the economic cycle at this time which passed through reversals. The other institutional sectors of the Czech economy made only a very little part in total number of economic entities – in total, according to data from the end of 2011 it was only 5.3%.

In spite of the mentioned decrease of the share of entrepreneurs in household sector (household-trades) during period 2006–2010, their absolute number has increased (+6.6%). However, the figures regarding registered non-financial companies has increased much more rapidly (+38.7%). As for the other institutional sectors of the Czech economy, the number of financial institutions grew only slightly (2%) and the number of institutions in the government sector and the non-profit sector on the contrary declined (–2.8% and –9.7%, respectively).

⁵ The Business Register is not a perfect database as regards the accuracy and timeliness of the classification of the economic entities according various criteria (incl. problem with the principal activity which may change over time and the companies often do not give the important information to the database administrators note immediately). However, it is the only source of official statistics of this magnitude.

⁶ Institutional sector of financial institutions consists of the central bank, other monetary-financial institutions, ie. above all commercial banks and savings construction banks, credit unions and other financial intermediators as the leasing and factoring companies and the hire purchase companies). In addition to these entities, this sector includes so called financial auxiliaries such as brokers and also the insurance companies.

1.1 The structure of non-financial corporations in the BR by form of ownership

Looking at the structure of non-financial companies registered in the BR by form of ownership we can see long-term growth of number of private national corporations, but especially of foreign-controlled companies. During 2005–2010 in both segments their numbers increased by 31.2%, and by 52.7%, respectively. This trend reflects the slowly lingering period when the companies with the prevailing public ownership have been long-term retreating due to privatisations. In spite of it also during the second half of last decade their number decreased by more than one fifth (–21.5%) though the main stream of privatisation had passed significantly before.

With the rapid growth in the number of the foreign-controlled companies registered in the BR, their weight reached two-fifths (40.1%) of the total number of registered non-financial corporations in 2010 when in 2005 it was 36.4%. The increase in their number during the robust boom of the Czech economy in 2005–2008 was likely erased on a larger scale in 2009, the year of the economic crisis. The post-crisis year 2010 showed the decreasing share of number of foreign-controlled companies (by 0.6 pp) but it had been caused above all by development of their numbers in the segment households-trades. Probably it was related to the deterioration in the labour market. The employment is the macroeconomic indicator for which it is characteristic the lagging of pace of development (in both directions) against the development of real economy according changes in GDP. Therefore, it is possible to suppose that the unsatisfactory labor market had made a lot of non-residents working in the CR in 2010 on the Trade Licencing to abolish their entrepreneursh.

Private national corporations still dominate the number of non-financial companies in the CR in stratification according type of ownership. Nevertheless, their share weakens and in 2009, for the first time, fell below the level of three-fifths (58.9%). In 2010 the share of the private national non-financial companies approached again to the three-fifths (+0.7 pp) due to weakened dynamics of the numbers of registered foreign controlled firms. The number of companies controlled by the public sector in terms of ownership has become practically negligible in the Czech Republic. In 2009 and 2010 it represented only 0.4% of the total number of registered non-financial corporations (in 2005 the share was still 0.7%).

2 THE OWNERSHIP STRUCTURE OF THE DEFUNCT LEGAL ENTITIES IN THE CORPORATE SECTOR IN THE CZECH REPUBLIC

Firms owned by the public sector are overwhelmingly legal entities in terms of types of companies in the sector of non-financial corporations. Also, the private national corporations has taken predominantly form of legal entities (Table 1). For private firms under foreign control, this effect is not noticeable, but it should be borne in mind that while domestic households-trades are recorded in the statistics of BR in the household sector, in the case of non-residents' household-trades (ie. those which are foreign-controlled), these entities are considered as a part of non-financial sector (not as a part of household sector). Logically, the number of such companies (under foreign-controlled enterprising individuals) then increases the number of entities in this sector. Consequently, a change in the numbers of these non-residents working in the Czech Republic on the Trade Licensing obviously affects the figures relating to the numbers of the non-financial entities.

Table 1 Representation of legal persons in the total number of registered businesses in the non-financial sector in 2009

	Legal persons	Entities in total	Share
Public sector ownership	1 944	1 995	97.4%
Private national corporations	268 069	277 862	96.5%
Foreign-controlled companies	79 417	191 829	41.4%

Source: CZSO, withdrawals from database BR

2.1 Comparison of dissolution (termination) of legal persons in the sector of non-financial corporation

Graphical analysis of the dissolution of legal persons in the Czech Republic in the years 1995-2011 shows (Figure 1), that the largest numbers of terminations occurs in the segment of private national companies. This is not surprising given that this segment has the greatest weight in the structure. Numbers of dissolutions of legal persons with a predominance of private national capital were below the trend line in period 1997–2002, according to the equalizing line of regression analysis with a relatively high reliability coefficient. So it was in a period of relatively strong wave of privatization in the Czech Republic. Also in 2005 and 2006 the number of dissolved companies in the Czech Republic was lower, i.e. below the trend line. It was the period when the Czech economy grew at its fastest rate in its history. On the contrary, higher numbers of dissolutions of the legal persons with the predominance of private national capital compared to the trend of total period are seen in years around the currency crisis at the turn of the 90th years (Figure 1). The same development, although somewhat weaker but consistent, can be observed in the pre-crisis period and in subsequent years at the end of the last decade and the beginning of this decade.

For terminations of legal persons under foreign control a similar trend is monitored like in the analyzed segment of firms with prevailing domestic capital. But regression analysis (again, with a relatively high reliability coefficient) also shows higher numbers of dissolutions from 2007 to 2011. Nevertheless, during relatively long period 1999–2006, the numbers of legal persons' terminations in the segment of firms under foreign control were slightly lower than would correspond linear equalizing.

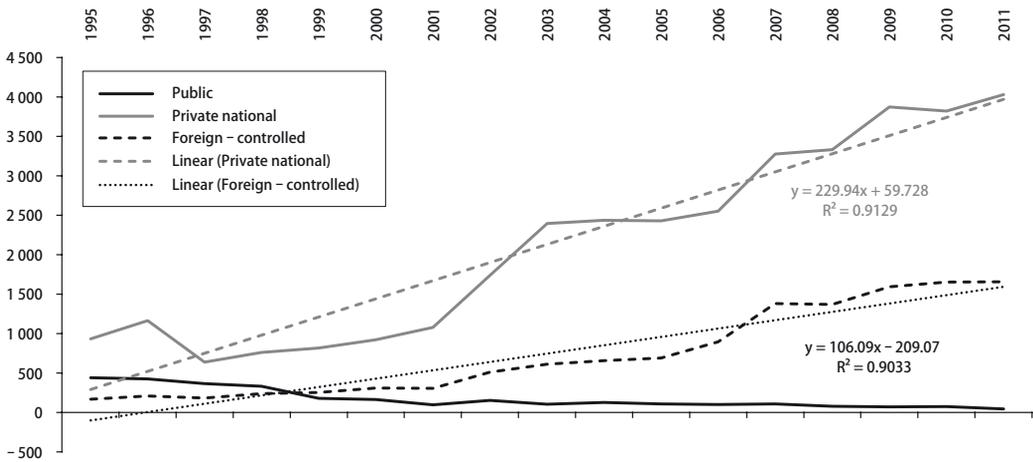
2.1.1 Dynamics of extinction and feedback on the performance of the economy

If we will use the annual changes in numbers of defunct firms for comparison legal persons' terminations in various forms of ownership, i.e. how many of them were more or less than a year ago, the results are different compared to absolute data which we observed in Figure 1 – the legal persons under foreign control were disappearing more quickly. During the period 1995–2011 their numbers were going down by on average 17% annually while in case of the private national firms by 12%.

On the contrary, the deaths of the legal persons with dominancy of the capital of the public sector were decreasing by 9.9%, on average, against previous year. However, partly it is attributed to the significant fading of this type of companies from the map of economic subjects registered in the Czech Republic. Another part of this explanation may lie in certain stability of these companies arising from their position in the industry with a predominance of public ownership. Namely they were able in spite of the crisis to overcome relatively very well the adverse conditions in demand during 2009. The output of electricity sector grew due to the results of company *Ceske energeticke zavody* (CEZ) and a performance of forestry increased also with the company *Lesy CR*. In health care gross added value rose, year-on-year, by about one tenth in 2009. The increase was recorded also in land transport and transport via pipeline as well as in the performance of the *Ceska posta* (Czech Post).

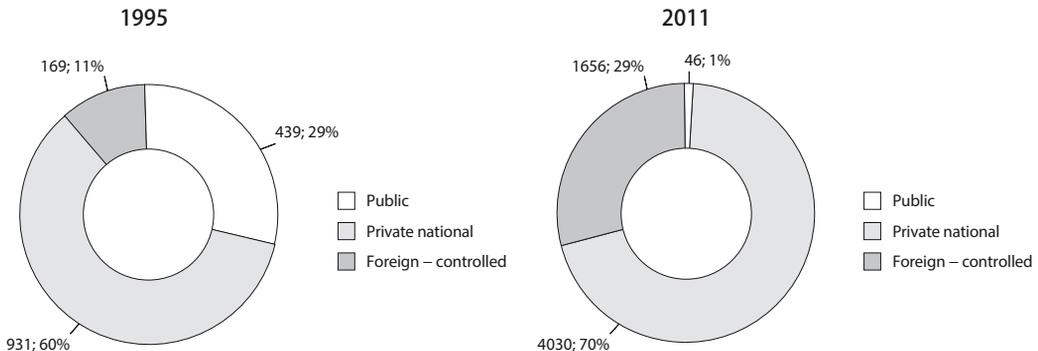
The correlation between the pace of economic growth on one hand and the intensity of the dissolving of legal persons on the other hand – according to the level of correlation coefficient – confirms with a relatively high probability the hypothesis that the faster an economy grows, the lower should be the activity in the deaths of the companies. This applies to a greater degree to legal entities under foreign control (with correlation coefficient -0.65), but relatively significantly also to legal persons in corporate sector which are controlled by private national capital (with correlation coefficient -0.61). The specificity of the results of the correlation analysis for the legal persons owned by the public sector consists in the fact that the number of deaths has been reduced significantly due to the decrease in the number of these entities objectively (of privatization).

Figure 1 The numbers of deaths of legal entities by type of ownership (1995–2011, end of the year)



Source: CZSO, withdrawals from database BR, author's own calculations

Figure 2 Share of dissolution of the legal persons in the corporate sector by type of ownership (absolute data; % of total number of dissolution of legal persons in corporate sector according three analyzed forms of ownership)



Source: CZSO, withdrawals from database BR, author's own calculations

3 MAIN FORMS OF DISSOLUTION OF LEGAL PERSONS IN THE CORPORATE SECTOR OF THE CZECH REPUBLIC

Now, we focus on the main ways of the deaths of the companies according the Nomenclature of the BR concerning legal persons (more on the Methodology citations, footnote 4): ie. terminations of legal persons through liquidation or without liquidation, namely with one successor or with multiple successors. The selection was also done in the "Not identified" where the numbers of dissolutions were very strong in 1995–1996 (about 1 500 extinction), although since 1999 strongly reduced to a few dozen per year. The rest of total numbers of dissolution of legal persons, taking into account the above-defined forms of extinction, was the dissolution of the legal entity without liquidation without successors.

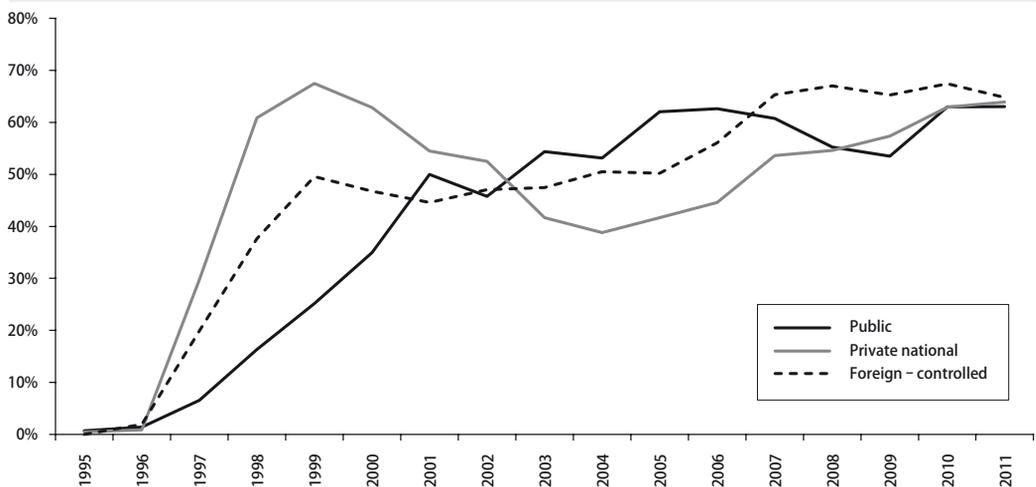
3.1. Dissolution of legal person through liquidation

In the Czech economy the termination of the legal persons through liquidation has gradually become a predominant mode of termination of legal entities in each of the forms of their ownership. Figure 3

depicts the massive increase in the share of extinction of private national companies through liquidation during period 1997–1999. At that time the Czech Republic has undergone a shallow recession after the currency crisis with a decline in GDP in real terms by 0.9% in 1997 and 0.2% in 1998. But, undoubtedly, also the important fact played a role and namely that in this period the number of undetected ways of death declined significantly. It naturally resulted in an increase in recorded cases of termination of liquidation, as well as dissolution without liquidation. Also, annual dynamics of terminations through liquidation seemed to be very strong during this period. In 1996 only 10 private national legal persons ceased to exist through liquidation according data in the BR. But in 1997 already it was 189 and in 1998 even 464 dissolutions through liquidations.

At the end of the analyzed period, in 2011, a total 2 575 of legal persons in private ownership ended through liquidations. It was almost two-third of total number 4 030 dissolutions of legal persons of this form of ownership that disappeared in the Czech Republic. In the case of legal persons under foreign control was a similar proportion of subjects in the numbers 1 073 against 1 656 defunct legal persons. In the segment of public ownership of legal entities, then it was 29 against 46 defunct legal persons. In all cases, liquidations in 2011 accounted for almost two-thirds of dissolutions of legal persons in each of the analyzed forms of ownership compared with about one-half at the beginning of the last decade.

Figure 3 Termination of legal persons through liquidation (the share on the total deaths of legal persons according respective forms of ownership, in %)



Source: CZSO, withdrawals from database BR, author's own calculations

3.2 Dissolution of legal persons without liquidation

In 2011, total 357 legal entities with the control of private national capital were dissolved without liquidation with one successor or without liquidation with more successors. In the segment of legal persons under foreign control it was 225 subjects and six legal entities with a prevailing of public ownership. At the beginning of the last decade, ie. in 2011, analogous numbers were 142, 39 and 19. So, the numbers of dissolutions with successors showed the fastest growth in the segment of the foreign-controlled.

In 2011, the distinctive retreat of the number of dissolutions without liquidation in favor of the dissolutions with liquidation was seen. In the segment of legal entities owned by the private national capital it was 357 against 2 575, ie. exceeding more than 7 times. In the segment of legal

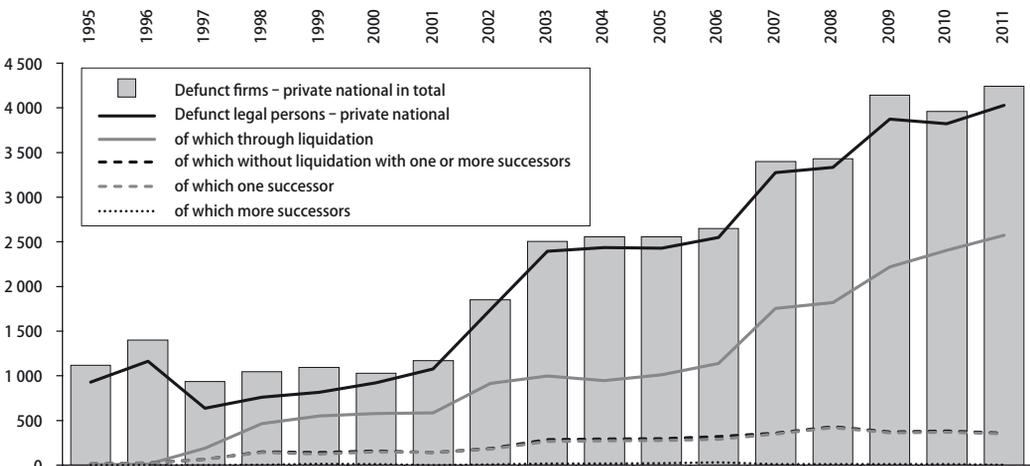
persons under foreign control the comparable data (225 against 1 073) meant the increase in the number by approximately 5 times.

Cases when the dissolving company (legal person) was taken over by only one successor were far more common than with more successors. Cases with more successors were only of the order of units among the firms under foreign control with exception of the year 2000 (13 cases). For companies which were controlled by the public capital these cases were more frequent during period 1997–2000. It was an average of 19 per year but for example 31 in 1997. During 2009–2011 it was not a single case. Also the numbers of dissolutions without liquidation in this period were negligible in this segment (11 cases in 2009, 8 in 2010 and 6 cases in 2011). Firms controlled by private domestic capital which were ceasing to exist without liquidation with more successors showed in the numbers of cases per year since 2006 a gradual decrease (from 32 to 5 cases in 2011).

3.3 Overview of deaths of legal entities in the sector of non-financial corporations by ownership and development during period 1995–2011

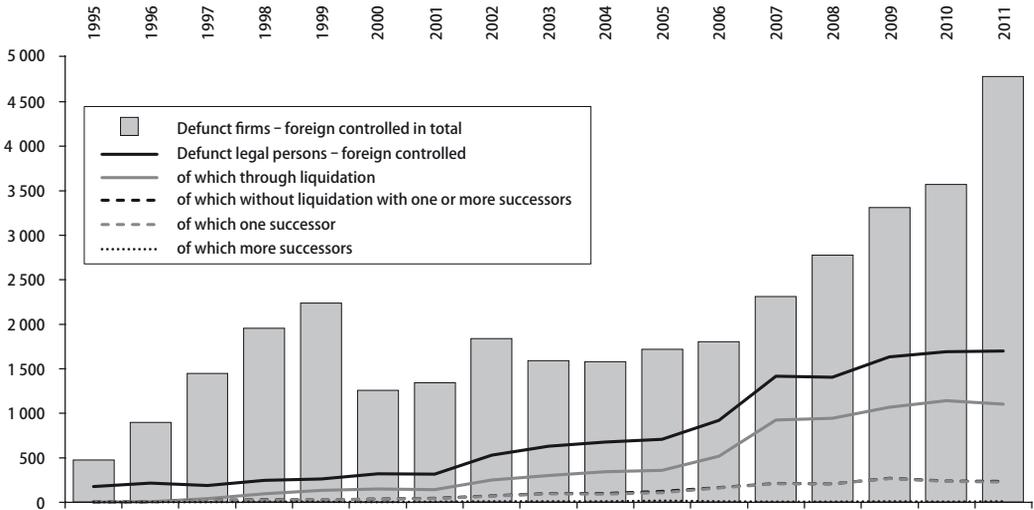
A comprehensive view on the development in the period 1995–2011 according to the analysed types of the dissolution of legal persons according to their form of ownership is provided by a graphical analysis (Figures 4, 5, and 6). The curves in these graphs illustrate the above-mentioned conclusions with the important role of foreign household-trades (non-residents working in the Czech Republic on the Trade Licensing) in the total number of dissolution of companies under foreign control (Figure 5). Roughly, since 2001, the trend in development of the dissolution of legal entities under the control of a private national capital through liquidation is practically identical to the development of these total deaths in this segment (ie. legal persons plus household-trades with dominance of private national capital) as shown on Figure 4. Figure 6 shows a decrease in the numbers of termination of the companies which were controlled by public capital. This is primarily due to the decreasing numbers of subjects with this form of ownership.

Figure 4 Development of dissolution of legal persons with a predominance of private national capital and their selected forms (numbers at the end of year)



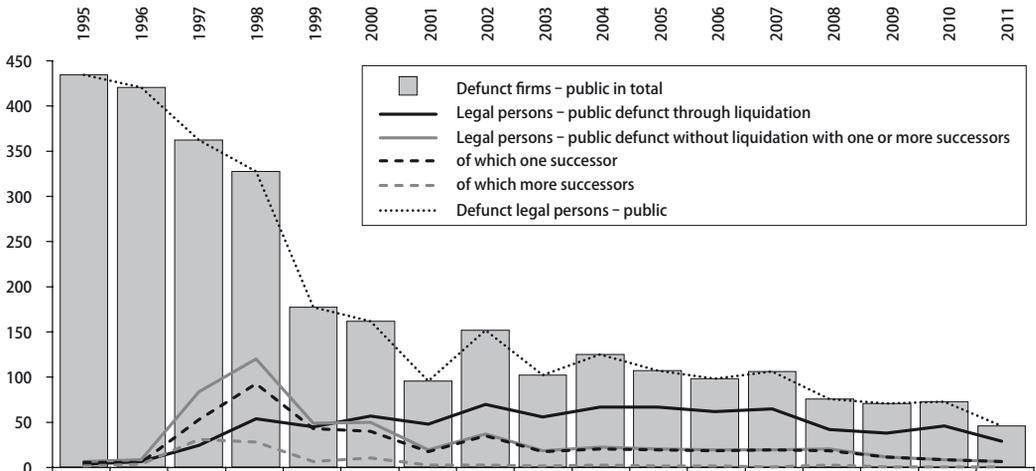
Source: CZSO, withdrawals from database BR, author's own calculations

Figure 5 Development of dissolution of legal persons under foreign control and their selected forms (numbers at the end of year)



Source: CZSO, withdrawals from database BR

Figure 6 Development of dissolution of legal persons with predominance of public capital (numbers at the end of year)



Source: CZSO, withdrawals from database BR

CONCLUSION

In the period 1995–2011 the organizational structure of the corporate sector in the Czech Republic (non-financial corporations) passed through significant changes in the ownership of companies. These were caused both by the privatization into domestic hands, and, secondly through a strong inflows

of foreign direct investment. Due to this a very strong segment of the firms under foreign control has appeared in the Czech Republic.

Most numerous group of legal entities under the control of domestic private capital showed logically the highest numbers of dissolution. However, according to annual dynamics it is possible to observe that faster, i.e. an average of 17% per year, numbers of termination of foreign-controlled companies increased compared to the private national (+12%).

Termination through liquidation has become the predominant mode of termination of legal entities in each of forms of non-financial companies' ownership in the Czech Republic. In 2011, less of companies under foreign control disappeared through liquidation than in 2010 (this was the first annual decline since 2002). For private domestic firms, the number of dissolution through liquidations grew in 2011. But this growth was the slowest since 2009 in which 400 private national legal persons ceased to exist. In 2011, roughly two-thirds of all cases of termination of companies in each of three analyzed forms of ownership ceased through liquidation.

Dissolution without liquidation with one or more successors is not so frequent in the Czech Republic, especially with more successors. During the period 2000–2011, the numbers regarding dissolution of legal persons without liquidation with the successors represented annual average of less than 12% of the defunct legal persons with domestic private capital and in case of legal persons under foreign control roughly 15%.

Correlation of deaths of companies with the development of business cycle in the Czech Republic is relatively significant.

References

- BALLEISEN, E. *Navigating Failure: Bankruptcy and Commercial Society in Antebellum America*. Chapel Hill: University of North Carolina Press, 2001, p. 322. ISBN 0-8078-2600-6.
- CZSO. *Annual national accounts* (database) [online]. Prague: Czech Statistical Office. <<http://apl.czso.cz/pll/rocenka/rocenka.indexnu>>.
- CZSO. *Institutional sector accounts* (database) [online]. Prague: Czech Statistical Office. <<http://apl.czso.cz/pll/rocenka/rocenkavyber.sek>>.
- CZSO. *Business Register* [online]. Prague: Czech Statistical Office. <http://www.czso.cz/csu/redakce.nsf/i/organizacni_statistika>.
- Demografie podniků v ČR – výsledky za roky 2000 až 2005* (Demography of enterprises in the Czech Republic – results for the years 2000–2005). Prague: Czech Statistical Office, 2008.
- DUBSKÁ, D. Impact of the Economic Crisis on the Institutional Sectors of the Czech Economy. *Statistika: Statistics and Economy Journal*, No. 4/2011. pp. 4–21.
- DUBSKÁ, D. *Krise: kdo z ní vyšel nejlépe?* Analýza institucionálních sektorů české ekonomiky. Vystoupení na semináři (Analysis of the institutional sectors of the Czech economy. Presentation at the seminar). Prague: Czech Statistical Office, February 2011.
- KISLINGEROVÁ, E. *Podnik v časech krize* (The company in times of crisis). Prague: Grada, 2009, p. 208. ISBN 978-80-247-3136-0.
- KORÁB, V., MIHALISKO, M., VAŠKOVIČOVÁ, J. *Založení a řízení podniků* (Establishment and management of enterprises). Brno: CERM, 2008, pp. 3–155. ISBN: 978-80-214-3792-0.
- NEČADOVÁ, M., BREŇOVÁ, L. Změna ve výkonnosti firem v podmínkách krize a jejich adaptace na změněné tržní podmínky (Changes in the performance of companies in times of crisis and their adaptation to the changed market conditions). *Ekonomika a management*, 4/2010, pp. 2–17.