COFACE ECONOMIC PUBLICATIONS

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PAYMENT SURVEY

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China Corporate Payment Survey 2018: payment delays increase despite rapid and robust growth

The Chinese economy staged a comeback in 2017. GDP ticked up from 6.7% in 2016 to 6.9% in 2017, favoured by strong demand, as well as loose monetary and fiscal policy settings. As a result, risk managers have become more complacent, both in terms of their economic expectations and their risk management procedures.

Coface has been conducting annual surveys covering companies' payment experiences in China since 2003. The aim of this exercise is to better understand corporate credit management practices and payment experiences. In our latest survey, data collection was conducted during the final quarter of 2017, and valid responses were received from 1,003 companies.

40% of those surveyed reported that they do not use any credit management tools. This is understandable in the context of improving payment conditions. Average payment terms in China increased to 76 days in 2017, up from 68 days in 2016. Moreover, fewer respondents stated that they saw an increase in payment delays (29% in 2017 versus 46% in 2016).

However, better headline figures notwithstanding, tail risks have continued to increase, despite better economic performance. The proportion of respondents experiencing payment delays exceeding 120 days increased to 26% in 2017 from 19% in 2016, while those experiencing ultra-long (more than 180 days) payment delays exceeding 2% of their annual turnover increased from 35% in 2016 to 47% in 2017.

More worryingly, those reporting that more than 10% of their annual turnover was tied up in ultra-long payment delays increased to 21% in 2017 from 11% in 2016. According to Coface's experience, around 80% of these ultra-long payment delays don't get paid at all. When these constitute a sizeable proportion of a company's total annual turnover, their cash flow may be at risk.

Some pockets of stress are notable within the Chinese economy. The energy (33%), construction (32%), and automotive (27%) sectors registered the highest proportion of ultra-long payment delays exceeding 2% of turnover. Paper and textile recorded the lowest (10%), followed by the pharmaceutical sector (15%).

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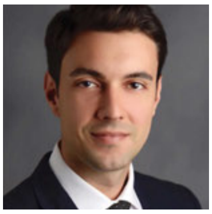

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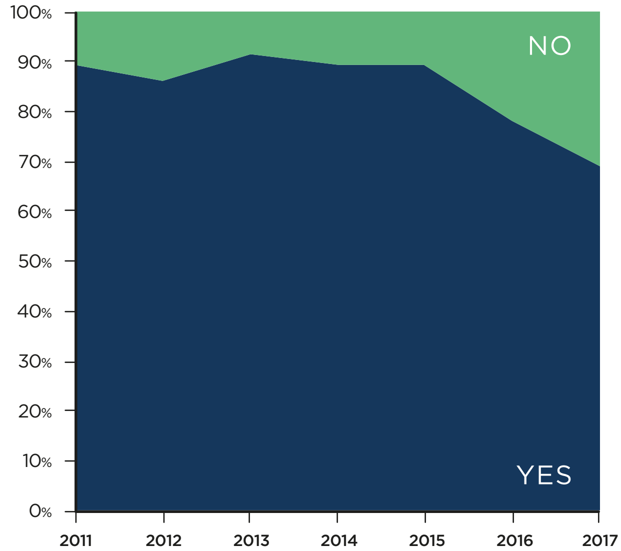
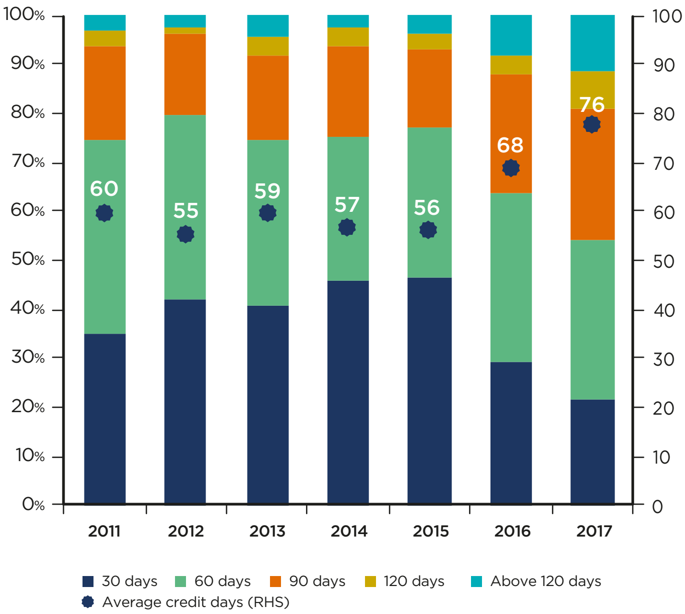
1 PAYMENT TERMS:
CREDIT TERMS INCREASE, BUT LESS COMPANIES OFFER SALES ON CREDIT

Chart 1:
Percentage of respondents offering credit sales



Source: Coface

Chart 2:
Average payment terms increased



Source: Coface

76 DAYS
AVERAGE CREDIT TERMS
increased from 68 days in 2016

- Despite improving economic conditions in 2017, there was a decline in the number of respondents offering credit sales. The main reason for this was a drop in market confidence, which went from being the main reason for offering credit sales in 2016 (38%), to second in 2017 (31%). This decline was not offset by an increase in respondents stating that they have more confidence in their consumers (31% in 2017 versus 26% in 2016).

- Average credit terms in China increased to 76 days in 2017, up from 68 days in 2016. This is in line with the trend observed since 2015. With that said, the average credit terms increased by 11% year-on-year (YOY), down from last year's record increase of 21% YOY.

- This increase in credit terms was brought about by a sharp rise in longer maturities, with fewer respondents offering credit terms below 30 days. Specifically, the percentage of respondents offering average credit terms exceeding 120 days increased from 12% in 2016 to 19% in 2017.

- Differences were also apparent across the different sectors covered by the survey. Average credit terms were the longest in the energy sector, with one third of respondents offering credit terms exceeding 120 days. The pharmaceutical, construction, transportation, and automotive sectors all offered credit terms above average – however, responses were more homogenously spread across the different maturities.

- On the other end of the spectrum, the agri-food sector offered the shortest credit terms, equivalent to 55 days in 2017. Most respondents in this sector (88%) recorded average credit terms under 60 days. The wood, textile, paper, retail, and metals sectors all reported credit terms below China's average of 76 days. This is reflective of different industry standards, as well as erosion in customer trust following a difficult 2015 and 2016.

Table 1:
Payment terms vary amongst the different sectors covered by the survey

	30 days	60 days	90 days	120 days	More than 120 days	Average credit terms	% offering credit sales	Coface assessment
Agri-food	33%	50%	17%	0%	0%	55	55%	
Automotive	26%	17%	37%	6%	14%	80	83%	
Chemical	16%	37%	25%	13%	9%	79	74%	
Construction	29%	24%	15%	15%	18%	80	65%	
Energy	21%	24%	24%	0%	31%	89	67%	
ICT*	16%	34%	31%	6%	12%	79	72%	
Metals	33%	33%	14%	5%	14%	70	78%	
Paper	23%	46%	31%	0%	0%	62	76%	
Pharmaceutical	14%	21%	43%	7%	14%	86	74%	
Retail	32%	33%	21%	10%	5%	67	68%	
Textile	25%	46%	25%	4%	0%	62	76%	
Transport	8%	42%	33%	8%	8%	80	71%	
Wood	50%	0%	50%	0%	0%	60	67%	
Others	25%	28%	26%	7%	14%	77	53%	N/A

** Information and Communication Technologies*

BUSINESS DEFAULT RISK: Low risk, Medium risk, High risk, Very High risk

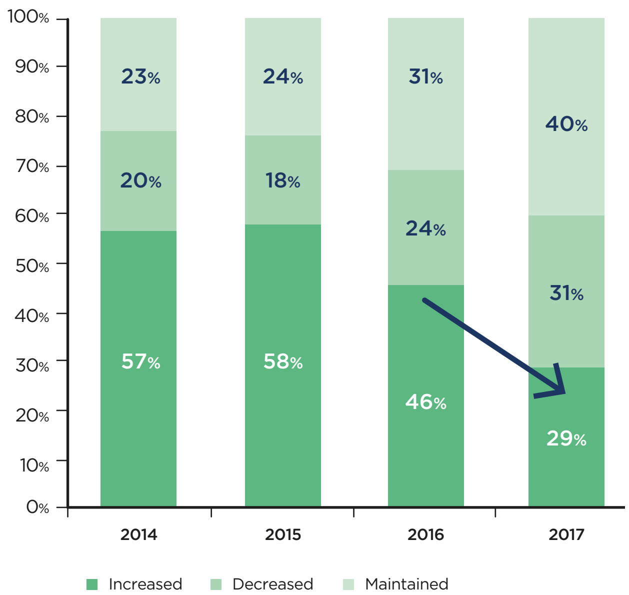
Source: Coface

2 PAYMENT DELAYS:
BETTER HEADLINE FIGURES HIDE POCKETS OF STRESS

- The situation for payment delays improved relative to last year. Just 29% of respondents stated that they recorded an increase in payment delays, lower than the 46% registered in 2016. It is also a significant improvement relative to the 21% YOY decline experienced in 2016. In line with this finding, a larger number of respondents recorded a decrease in payment delays compared to 2016 (31% versus 24%).

- A decline in payment delays may seem like encouraging news, but the devil is in the detail: while half of our sample stated that payment delays did not exceed 90 days on average, the proportion of those experiencing payment delays exceeding 120 days increased to 26% in 2017, up from 19% in 2016. The construction sector recorded the largest proportion of respondents experiencing payment delays exceeding 120 days (35%). This was followed by the pharmaceutical sector and the automotive sectors (both 31%).

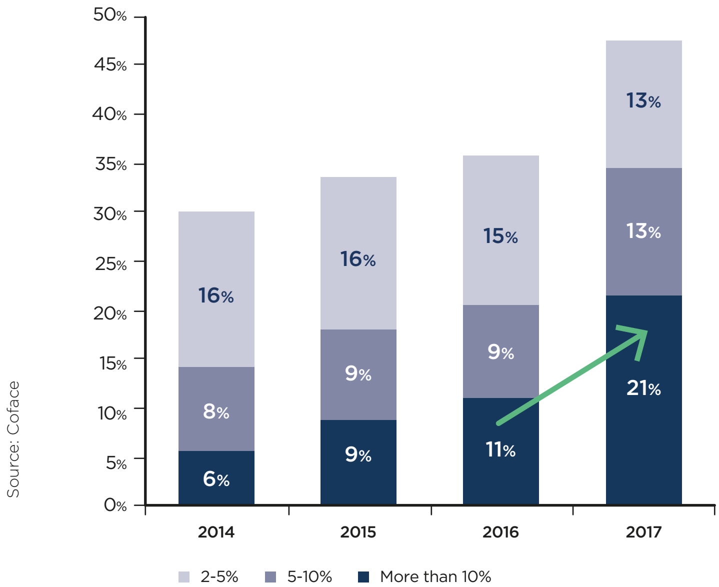
Chart 3:
Evolution of payment delays relative to 12 months ago



Source: Coface

47%
OF COMPANIES
experienced ultra-long payment delays exceeding 2% of annual turnover

Chart 4:
Ratio of ultra-long payment delays as a % of turnover



• Better headline figures conceal another important development: tail risks have continued to increase, despite better economic performance. Payment delays are not a good enough measure. In order to assess these risks, we need to examine the ratio of ultra-long payment delays (exceeding 180 days) as a percentage of total annual turnover. According to Coface's experience, 80% of these ultra-long payment delays are never paid. This means that a company's cash flow could be at risk when this ratio is elevated, even if the average length of its other overdue amounts is below 180 days.

• The proportion of respondents experiencing ultra-long payment delays exceeding 2% of their annual turnover increased from 35% in 2016 to 47% in 2017. More worryingly, those reporting that more than 10% of their annual turnover was tied up in ultra-long payment delays increased to 21% in 2017 compared to 11% in 2016. This constitutes a 90% increase YOY and is a telling sign that pockets of stress continue to exist in the Chinese economy (see Insert page 6).

• On a sectorial basis, this figure was highest for the energy (33%), construction (32%) and automotive (27%) sectors. Paper and textile recorded the lowest proportion of respondents experiencing ultra-long payment delays exceeding 10% of their annual turnover, followed by the pharmaceutical sector (15%). However, the latter had a large share of respondents reporting payment delays exceeding 2% of amount turnover, pointing to persistent but less acute stress.

Chart 5:
Average length of payment delays

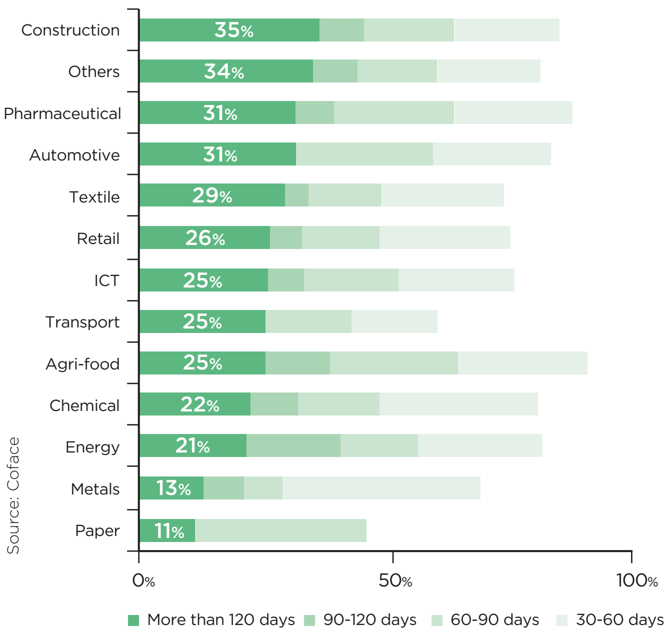
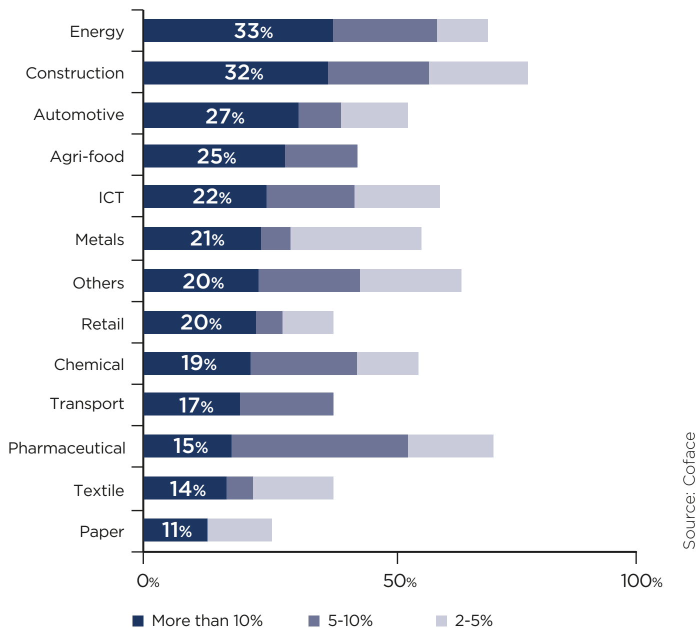


Chart 6:
More than 2% of total annual turnover in ultra-long payment delays



3 ECONOMIC EXPECTATIONS: STRONG GROWTH HAS FUELLED COMPLACENCY

- 2017 marked a turning point for the Chinese economy: exports grew by 7.7% YOY on average in 2017, compared to -7.6% YOY in 2016. It comes as no surprise that an overwhelming majority of respondents (67%) stated that they expect economic growth to continue to improve in 2018.

- This pick-up in activity has also translated into more favourable expectations from risk managers. 59% of respondents reported that their sales increased in 2017 relative to 2016, while 67% expect sales to improve further in 2018. Results were slightly more muted regarding cash flows: only 53% of respondents reported an improvement relative to 2016, while 61% expect cash flows to improve in 2017.

- Regardless of these results, better economic performance in 2017 has led to complacency amongst risk managers. Fewer than 20% of respondents declared using credit insurance or credit agency reports to mitigate their risks. The situation is worse for factoring and debt collection, with only 10% of those sampled reporting using these tools. 40% of respondents admitted that they use no credit management tools to mitigate credit risks.

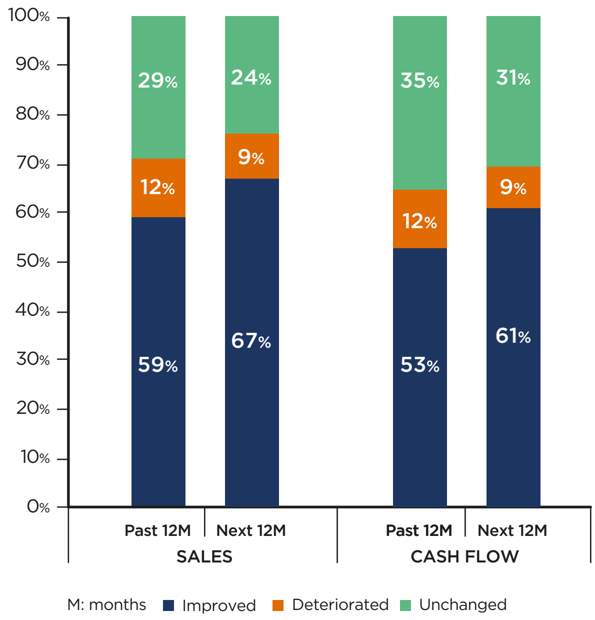
- The complacency of risk managers is a paradox in the context of China's pockets of stress. Economic expectations remain buoyant, but a large proportion of this recovery is also related to a build-up in liabilities. Standing at almost 250% of GDP (see **Insert** on page 6), overall debt levels remain exceptionally high in China relative to international standards, particularly given the country's level of development. Aggregate financing (a measure of credit) expanded slower than nominal GDP in 2017, reaching 9.2% YOY versus 11.2% YOY. This news is only mildly encouraging: it will not facilitate significant reductions to the high legacy debt levels.

- Almost half of all surveyed companies reported that "customers' financial difficulties" was the main reason behind their payment delays in 2017. Moreover, when asked about the main reason behind such financial difficulties, 46% reported "fierce competition impacting margins" and "lack of financial resources" as the main culprits.

- In the context of tighter monetary and fiscal policies in 2018, we expect more financial difficulties will be experienced by customers in sectors that are currently suffering from high debt levels, long payment delays, and a large proportion of ultra-long payment delays exceeding 2% of annual turnover.

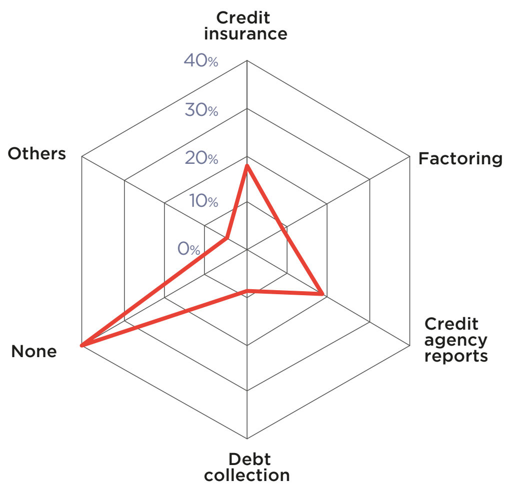
67%
OF COMPANIES
expect sales to improve

Chart 7:
Economic expectations (% respondents)



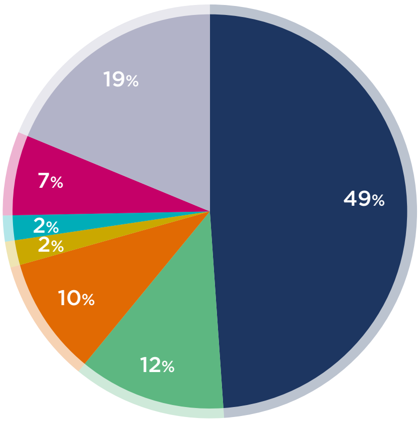
Source: Coface

Chart 8:
Use of credit management tools (% respondents)



Source: Coface

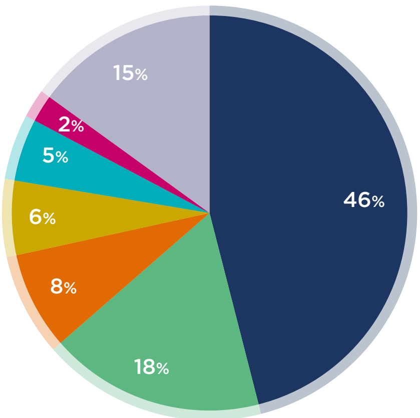
Chart 9:
Main reason behind payment delays



- Customers' financial difficulties
- Customers' management problem
- Fraud and lack of morality (attemps to delay payment)
- Commercial disputes
- Banking system / funds transfer inefficiency
- Organisational changes in the company structure
- Others

Source: Coface

Chart 10:
Main reason for financial difficulties



- Fierce competition impacting margins
- Lack of financing resources
- Rising raw material prices
- Slower economic growth in China
- Rising labour costs
- Lower international demand
- Others

Source: Coface

INSERT:

The "Zombie" threat: where are the main pockets of stress?

The Chinese economy still faces some pockets of stress, resulting from a two-speed economy. The "New China" – characterized by high-value added manufacturing as well as services – benefited from robust external and domestic demand in 2017. However, credit growth remains elevated relative to nominal GDP, a sign that "Old China" is still an integral part of the economic system. Growing amounts of credit (total social financing was up 12% YOY in 2017) are required in order to produce the same output. This is possible in the Chinese context, as many of these firms are State-Owned Enterprises (SOEs): despite being unprofitable, they manage to stay "alive" thanks to the government's implicit guarantees, i.e. they rely on evergreen lending with low interest rates by state banks. For these reasons, they are sometimes referred to as "Zombie Enterprises". Zombie firms are of growing concern in China, where they have come to represent 15% of total liabilities in 2016[1].

Zombie enterprises are more prominent in regions where heavy industry – characteristic of the "Old China" – still plays an important role for regional GDP and employment. One way to identify this is by looking at the proportion of firms that have experienced negative Returns On Assets (ROAs) for three consecutive quarters between 2014 and 2016 on a regional basis[2]. Unsurprisingly, our calculations show that the situation is worst in the North West (西北, Xīběi) and North East (东北; dōngběi) parts of the country. Almost 10% of all companies in these regions struggled with negative ROEs for more than three consecutive quarters, compared to just 3% in the industrial powerhouses of South and Central China. The proportion of firms struggling with declining (but not negative) ROAs is likely higher. The North West and North East are greatly dependent on extractive sectors and heavy industry. Moreover, their economies are less diversified than in other parts of the country, which have a more dynamic service sector.

Key financials further confirm this sectoral bias. Looking at the interest cover (EBITA[3]/interest) and debt ratio (total debt/total assets) for over 3,000 Chinese listed companies, we see diverging performance between sectors[4]. Over one third of energy companies reported insufficient earnings to cover their interest payments (EBITDA/interest expense below 1). This was the highest among all the sectors, followed by real estate and consumer staples. Struggling companies in these sectors might have had to default on their debt repayments, were they unable to access evergreen loans. Not surprisingly, the energy and construction sectors have some of the highest debt ratios in China, exceeding 100% of their assets.

Companies in the materials sector are also struggling with debt overhang – featuring one of the highest debt ratios, after real estate. However, the sector has gone through a lot of restructuring, including very high-profile mergers[(5)], which has led to a significant reduction in the proportion of entities struggling with debt service relative to previous years.

Going forward, we expect that the authorities will continue to implement reforms to address the pockets of stress in the Chinese economy. The Chinese Communist party passed a bankruptcy law to tackle zombie firms in 2006, but also intends to reform access to capital, especially for SOEs. President Xi Jinping pledged to intensify SOE reforms during the October Plenum, and targets are expected to be announced at the National People's Congress in March.

The latest bout of macro-prudential reforms, including the creation of a super-regulator and the merger of the insurance and banking regulators[(6)], further suggests that authorities are seeking more clout to crack down on riskier lending practices and reduce high corporate debt levels. Sectors where the debt overhang is worst, or where a larger proportion of companies are struggling with debt service (and therefore dependent on evergreen lending), will likely be impacted the most.

In practice, however, the reforms will likely be gradual. Some aspects related to regional performance are noteworthy. Firms that are not very profitable but weigh a lot in local employment and GDP[(7)] are expected to continue to benefit from state support in the form of government subsidies and bank loans with low rates and implicit government guarantees.

Chart 12:
Percentage of listed companies facing stress in debt service (EBITDA/Interest <1)

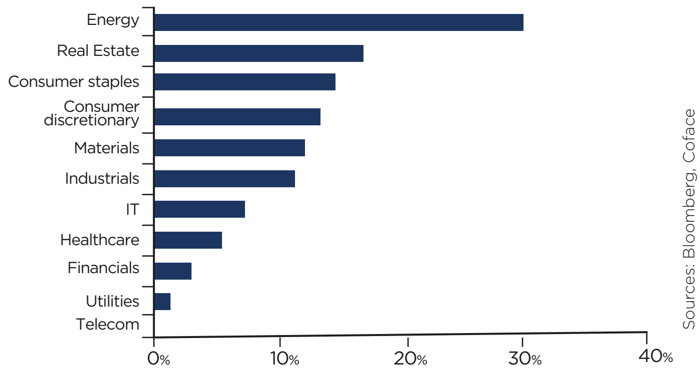


Chart 13:
Average Debt ratio

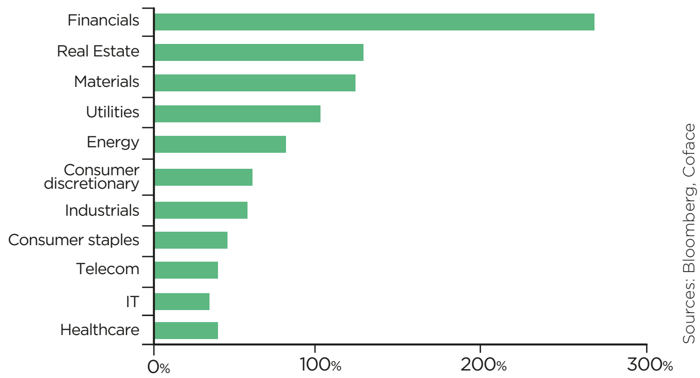
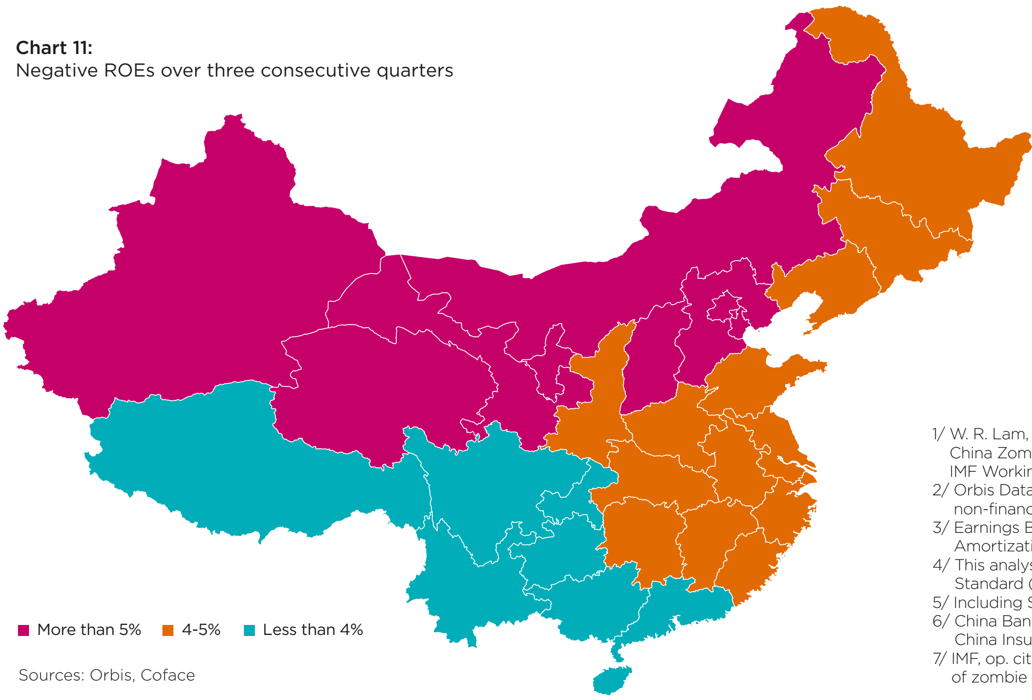


Chart 11:
Negative ROEs over three consecutive quarters



Sources: Orbis, Coface

1/ W. R. Lam, A. Schipke, Y. Tan and Z. Tan, Resolving China Zombies: Tackling Debt and Raising Productivity, IMF Working Paper, 2017
2/ Orbis Database, Bureau van Dijk (over 15k Chinese non-financial corporations covered in the sample)
3/ Earnings Before Interest, Taxes, Depreciation and Amortization
4/ This analysis uses Global Industry Classification Standard (GICS)
5/ Including Shenghua and Guodian in 2016
6/ China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC)
7/ IMF, op. cit. and X. Jiang, S. Li and X. Song, The mystery of zombie enterprises – *"stiff but deathless"*, 2017

APPENDIX
ABOUT THE RESPONDENTS

26%
WHOLLY-OWNED FOREIGN COMPANIES, STATE-OWNED COMPANIES, JOINT VENTURES

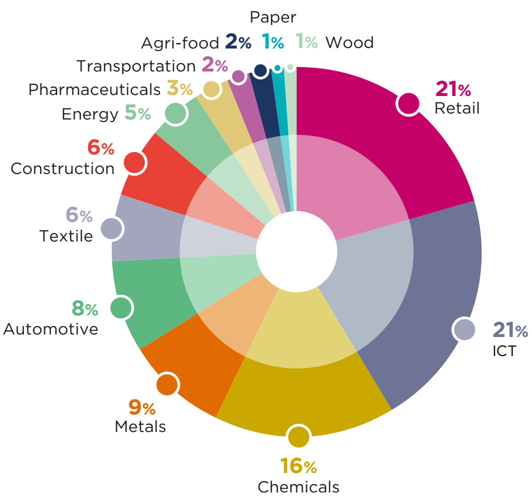
74%
PRIVATE COMPANIES

1,003
COMPANIES

SIZE BY TURNOVER

10%	**20%**	**15%**	**55%**
OVER 1,000M RMB	100 TO 1,000M RMB	50 TO 100M RMB	LESS THAN 50M RMB

SECTORS



GLOSSARY

CREDIT PERIOD
The time frame between when a customer purchases a product or service and when the payment is due

PAYMENT DELAY
The period between the payment due date and the date the payment is made

RESERVATION

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