From: Jeremy M. Kronick and William B.P. Robson
To: Bill Morneau, Minister of Finance
Date: May 21, 2020
Re: MAKING SURE ZOMBIE FIRMS AREN’T PROPPED UP POST-COVID

COVID-19 has put much of Canada’s economy on life support. As we emerge from the crisis and resume more normal activity, a challenge awaits. We do not want viable businesses to disappear. But we also do not want zombie firms to live on indefinitely.

Early in the crisis, governments reasonably prioritized supporting households and businesses through central banks, government lenders and transfer payments. Going big and broad made sense to help us survive the sudden stop.

We now need to navigate a different problem: letting firms go. In an ordinary year an amazing number of businesses in Canada appear and disappear. In 2017, 143,000 businesses came into existence – about one for every eight that already existed. That same year, 127,000 businesses went out of existence – about one in nine. That is normal and healthy, part of the innovation and adaptation that over time give us higher incomes and better goods and services.

As we reopen and explore the changed domestic and international landscape, the goal is an economy full of businesses that can thrive in the post-COVID world. Some are good to go now. Some will require new, patient capital. Others may need restructuring, even complete reorganization, but with the right steps they can emerge on the other side with a bright future. Yet others are still to be born.

The danger is that in our desire to help healthy companies survive we continue to support companies that, unfortunately, have no future in a world in which people will live, work and shop differently. That way lies zombie-land: too many businesses that cannot make the investments in physical and human capital to produce better products, pay higher wages and increase our living standards; and too few enterprises that can.

The federal government’s new Large Employer Emergency Financing Facility appears set to accept conditions different from those private lenders would want. As we reopen, however, it should be up to private investors to determine where –and where not – to lend, so that rewards for good decisions and punishments for bad ones once again steer saving to where it can do the most good.

There is plenty else for governments to do. Changing regulations that limit lending by banks and insurance companies in the post-COVID world probably makes sense. That kind of change is neutral: it does not disproportionately prop up one sector at the expense of another. Other changes that can help private capital fill in as government lenders withdraw should also help transition to the new environment without encouraging lending to businesses that can do no better than stagger along.

Governments will also have to wind down their crisis transfer payments – the federal wage subsidy – without replacing them with sectoral supports that impede the adjustments Canadians need to thrive in the long run. We and our customers abroad will still eat, use telecommunication and transportation services, and consume fossil fuels. But we will consume many of these things differently. Some business models that looked viable in 2019 will not be right for 2021.

Better than propping up zombies is an assisted exit and, if firms move quickly, perhaps no exit at all, with restructured businesses emerging livelier and more productive on the other side. In normal times, bankruptcy carries a stigma: nobody goes into business to fail. In a pandemic, stigma may not be such a problem. Our bankruptcy laws are about allowing businesses to reorganize and restructure through negotiations with creditors. Canada has plenty of success stories of companies entering insolvency and coming out stronger. Time is of the essence, however. Ottawa should find ways to streamline the insolvency process, lowering its cost and complexity so surviving firms get up and running as soon as possible.

Governments have blunted the crisis but they cannot remake the world the way it was before COVID-19. Some businesses can survive without the crisis supports. Others would have disappeared anyway or will not survive in the new world. We do not want zombies. We want dynamism and innovation. Businesses that cannot succeed need to wind down so that businesses that can succeed will thrive. Governments should not be choosing which businesses stay upright – private lenders and investors should make those calls. Governments should, on the other hand, use our suggestions to ensure the calls get made.

Jeremy M. Kronick is Associate Director, Research at the C.D. Howe Institute where William B.P. Robson is President and CEO.
To send a comment or leave feedback, email us at blog@cdhowe.org.
The views expressed here are those of the authors. The C.D. Howe Institute does not take corporate positions on policy matters.
(A version of this originally appeared in The Financial Post.)

Trusted Policy Intelligence / Conseils de politiques dignes de confiance