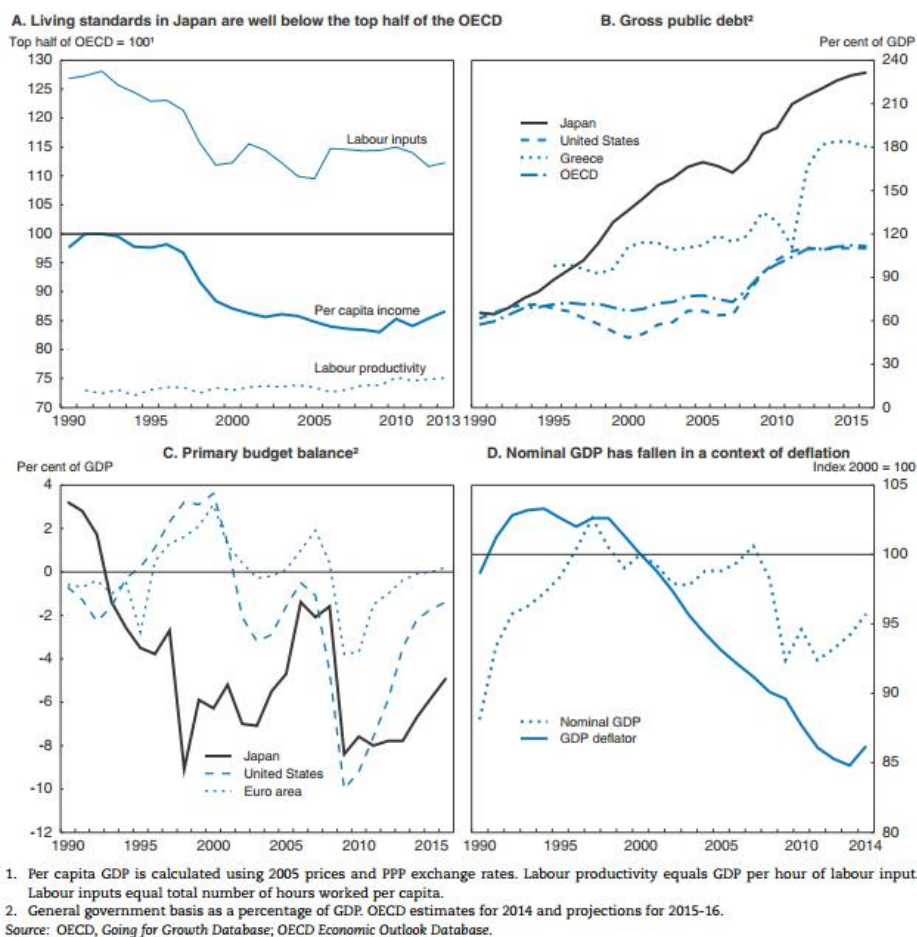


Zombie Firms

Zombie firms are a company which is still operating despite near bankruptcy status. It burdens with loss, obligations, and inefficiency for a long period resulting in financial insolvency and unprofitability. Actually, the zombie firms are able to afford only the general expenditure but not the large value of debts. Hence, the company requires subsidize to continue operation. Zombie firms cause several problems which affect bank stability and wastes opportunity cost which could be spent in growing business. The zombie firms were started in Japan and they came to China later.

Zombie firms were originated in Japan when Japanese company was subsidized by Japanese banks in 1990s after the economic bubble burst of the asset companies (Ahearne and Shinada, 2005). This case is originated in Japan. A few decades after World War II, Japan became one of the economic superpower. However, the economy of Japan has started to decline over the past decades. Japan has faced the problem of lower labor productivity growth, high proportion of public debt which is considered as the highest in the world, budget deficit, and long-term contraction of GDP followed by deflation. (The Economic and Development Review Committee of the OECD, 2015)



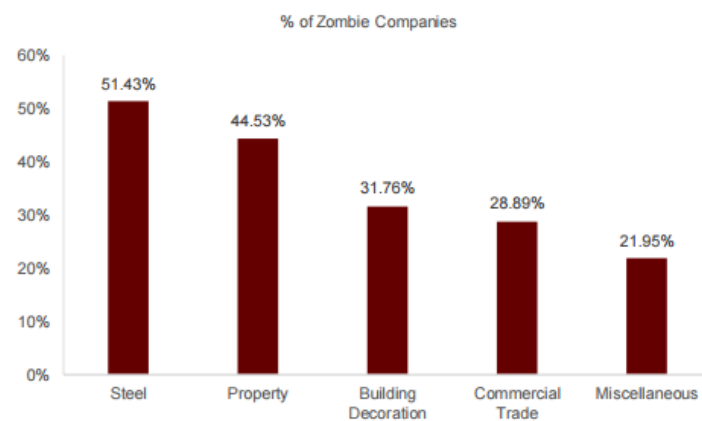
Sources: <http://www.oecd.org/eco/surveys/Japan-2015-overview.pdf>

One of the assumptions of weakness is the financial support from Japanese banks to the zombie firms. Japanese economy faces a declining productivity since the growth value of the firms has been low for several years (Ahearne and Shinada, 2005). Meanwhile, zombie firms do not allow firms with more productivity to get more market share. Consequently, they impact the growth in productivity of the economy. The industries with less competitiveness are more risky to become zombie firms. In other words, to avoid becoming a zombie firm, the company needs to be export-dependent. However, the banks still provide financial support to these zombie firms together with bad banking operation causing the trouble for the Japanese banks.

The Chinese government plans the policy of supply-side reformation. These policies force either to close down the zombie firms or to reduce unnecessary capacity (Collier, Zhou, and Li, 2016). According to the data, the proportion of zombie firms in China is thirteen percent (Collier, Zhou and Li, 2016). The zombie firms rely on loans from local banks.

Normally, significant local businesses are the biggest zombie firms so they have to be either shut down or restructured. However, several zombie firms are considered as ‘too big to fail’ because the closure of these firms offers the opportunity cost of losing income earned. Otherwise, in case of bankruptcy, hundreds of thousands of unemployment will occur. Therefore, the local governments support zombie firms to create job and decide to decrease capacity instead of closure of the operations of these firms (Collier, Zhou, and Li, 2016). This causes more difficulty to restructure the supply side.

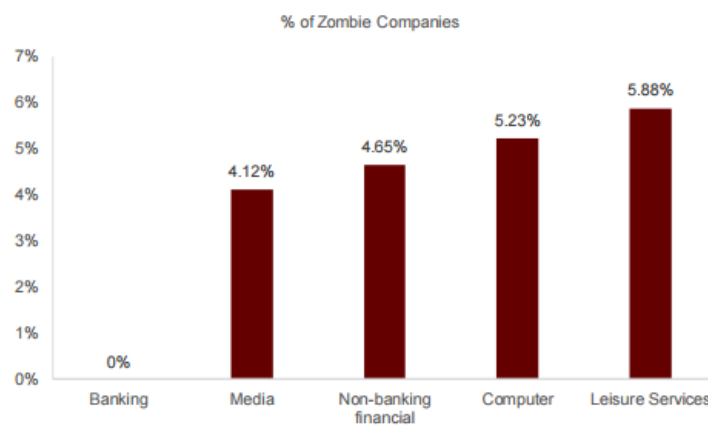
Top five industries with the greatest proportion of zombie companies



Source: NADS, Company data, OCR

Sources: <http://mansfieldfdn.org/mfdn2011/wp-content/uploads/2016/11/Chinas-Zombie-Companies.pdf>

The five healthiest industries with the least zombie companies



Source: NADS, Company data, OCR

Sources: <http://mansfieldfdn.org/mfdn2011/wp-content/uploads/2016/11/Chinas-Zombie-Companies.pdf>

In 2008, Chinese government introduced the economic stimulus policy during the financial crisis (Collier, Zhou, and Li, 2016). However, increasing capital flow causes more tendency of default risk of zombie firms. Hence, the policy results in excessive investment in many industries resulting in the zombie crisis in several years later (Collier, Zhou and Li, 2016). In China, steel, property, and building decoration businesses are the riskiest sectors to become zombie firms (Collier, Zhou and Li, 2016) but banking and media, computer and leisure services have the least proportion of zombie companies (Collier, Zhou and Li, 2016). Therefore, the Chinese government purposes the supply-side reformation policy to stimulate the downturn of steel companies and property businesses (Collier, Zhou and Li, 2016). Nevertheless, in fact, the policy pressures the banks to accept more obligations (Collier, Zhou and Li, 2016). According to the stimulus policy in the short-term, the regular industries have a higher share of zombie firms than key businesses (Collier, Zhou and Li, 2016). However, in the longer period with the effect of the stimulus policy, the important sectors will have more proportion of zombie firms than non-significant sectors (Collier, Zhou and Li, 2016).

In each region has different proportion of zombie companies. Although the coastal areas of China have the larger number of zombie firms, there is a potential to develop economy (Collier, Zhou and Li, 2016). However, several local governments in less economically developed area depend on these businesses to subsidize people and boost revenue (Collier, Zhou and Li, 2016). As the government concentrates on employment rate and the production of non-zombie firms to generate more income, the government offers bank loan to the non-zombie firms (Collier, Zhou and Li, 2016). In fact, these plans do not stop the closure of the operating zombie firms but support new smaller zombie firms instead followed by increasing number of zombie firms. Additionally, the government policies give a chance of merging companies.

According to the comparison between Japan with China, the zombie firms in Japan occur during the long-term economic contraction but in China, the zombie firms are created

during the economic boom. In Japan, there are concerns of labor productivity growth, high proportion of public debt, budget deficit, and declining value of GDP but in China the situation of these indicators are the opposite. Additionally, the overall production of Japan declines however the productivity of China increases which sometimes lead to overproduction of supply.

In conclusion, the zombie firms result in many problems because they required subsidizes especially from which banks for survival of the business. However, this effort wastes loans could be used for potential growing sectors. State-owned enterprises and big and older corporations are more likely to become zombie firms than private and foreign business. Actually, the government should let the zombie firms cease their own operations. However, several governments choose to set objective to eliminate inefficiency such as over-supply problem instead of shutdown because the closure of businesses causes potential to generate GDP and large number of unemployment. In fact, overproduction causes inefficiency and become another factor of zombie firms such as ghost cities in China (property business affected by asset bubble).

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