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Zombie Firms in Italy: A Critical Assessment

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Abstract


This note shows the consequences of different methodological choices for the estimates of the incidence of zombie firms in Italy. We use as a benchmark the influential measure proposed by the OECD (Adalet McGowan et al. 2017a and 2017b) which identifies zombie firms based on a combination of firm age and values of the interest coverage ratio (operating profits to interest expenses). We show that a key decision is whether operating profits are taken before or after amortization and depreciation and we argue that using profits after amortization and depreciation has several undesirable characteristics: i) it overestimates the share of capital “trapped” into zombie firms, and, to a smaller extent, the share of zombie firms; ii) it is worse in predicting the future performance of firms; iii) it is more likely to classify as zombies in a given year firms which invested heavily in previous years and amortized that investment quickly (for example to enjoy tax breaks); iv) it is especially inappropriate for cross-country comparisons.

Keywords: zombie firms, productivity, misallocation

JEL Classification: D24, L25, O47

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