



FEATURE

The pandemic has forced corporate debt higher

But is that a bad thing?

Patricia Buckley, Akrur Barua, and Monali Samaddar

Corporate debt went up and earnings took a hit during the pandemic. However, worries about companies' lower ability to repay debt may likely be offset if companies raise their productivity-enhancing investments.

BEFORE COVID-19 HIT US shores, the country was experiencing the longest economic expansion on record. As it happens every time when things are going well, many economists and financial analysts began hypothesizing about what could go wrong. One of the suspects in the list of possible triggers for the next recession—none of which included a pandemic as far as we know—was the high level of corporate debt.¹ Corporate debt was edging up since 2010 as the economy recovered from the previous recession. And by Q3 2019, outstanding debt of the nonfinancial business sector, including corporates, had reached new highs compared to the size of the economy.² The pandemic then became a catalyst in pushing debt even higher.

Corporate debt was edging up since 2010 as the economy recovered from the previous recession.

There is, however, a fair bit of variability in debt levels among companies. Analysis of company-level data³ reveals that some of the largest companies, especially those in information technology, communication services, and health care, have been leading the debt binge since 2010. Fortunately, this group appears to be better placed in its ability to repay debt than its counterparts in other sectors.

Rising debt in an expanding economy with low interest rates may not necessarily be a bad thing if companies are increasing investments as well. The data⁴ suggests that a sizeable share of companies is

doing just that. And some of these investments may well add to productivity growth in the wider economy in the medium to long term.

Debt rose sharply in 2020 for nonfinancial businesses

At the end of 2020, the total debt outstanding for nonfinancial⁵ businesses in the United States was about US\$17.7 trillion. Between 2010 and 2019, debt grew at an average annual rate⁶ of 5.5%, but in 2020, growth jumped to 9.1%. The surge in debt in 2020 was likely due to at least one of three factors. First, some businesses were forced to borrow more to keep operations running as large parts of the economy slowed or shut down. Second, some businesses had to invest in technology to support remote work, wherever possible, while others had to reconfigure workplaces to ensure social distancing in jobs that required in-person work. Finally, not all businesses were worse off due to COVID-19. Key businesses in sectors such as information technology, health care, consumer products, and communication services witnessed strong demand growth, a trend that is likely to sustain at least in the near to medium term. Consequently, some of these businesses are likely to have borrowed more to expand the size and array of goods and services they produce.

No matter the reason, rising leverage last year added to already high levels of debt that existed before the pandemic. In Q3 2019, for example, nonfinancial business debt outstanding was about 75% of GDP, the highest ever at that time. With GDP declining sharply in Q2 2020, the debt-to-GDP ratio shot up during the quarter, before going down as an economic recovery took shape in the

second half of the year. But, at 82.4% at the end of 2020, overall debt relative to the size of the economy is still high even by prepandemic standards.

Of all the debt outstanding of nonfinancial businesses in the economy, corporates account for the largest share—about 63% in 2020. And just like total nonfinancial business sector debt, corporate debt—both the level of debt and its size relative to GDP—has been edging up since 2010. The pandemic has made it a tad worse than what it was in 2019 (figure 1).

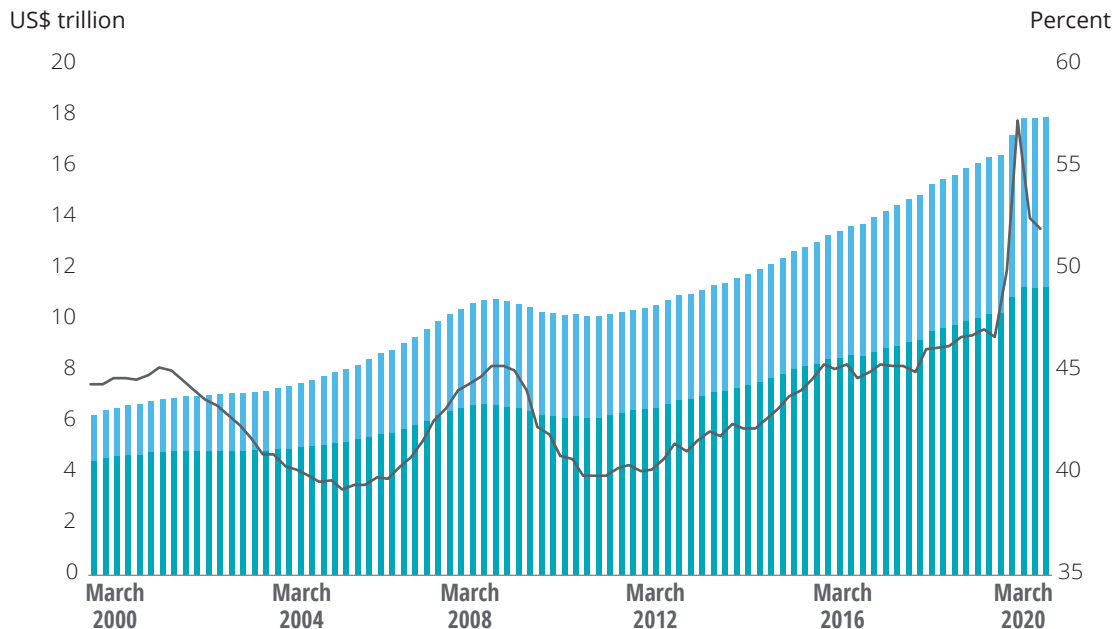
Decoding the drivers of corporate debt and corporations' ability to repay: A look at company-level data

Which companies have been driving the debt binge over the past decade and during the pandemic? How are companies placed financially to repay this debt, given the decline in economic activity last year? And have investments increased along with debt, especially last year?

FIGURE 1

The nonfinancial corporate-debt-to-GDP ratio is higher than it was before the pandemic

- Outstanding debt of nonfinancial corporations (left axis)
- Outstanding debt of nonfinancial businesses excluding corporations (left axis)
- Outstanding debt of nonfinancial corporations as a percentage of GDP (right axis)



Sources: United States Federal Reserve (sourced through Haver Analytics); Deloitte Services LP economic analysis.

To find answers, we looked at key financial data for the top 1,000 nonfinancial corporations by market value as of April 2021 from S&P Capital IQ.⁷ We first ranked companies in descending order of market value and then created five cohorts: top-10, 11–50, 51–100, 101–500, and 501–1,000. Top-10 refers to the 10 highest-valued companies, 11–50 refers to the group of 40 companies that follow the top-10, and so on. We also organized the data by sector and analyzed trends in debt, ability to pay, and investments for the 10 primary sectors in which these 1,000 companies operate.

As the economy changes, so do companies that drive debt accumulation

Since 2000, total long-term debt for these 1,000 companies has grown at 9.2% on average per year to US\$5.8 trillion in 2020. More debt was

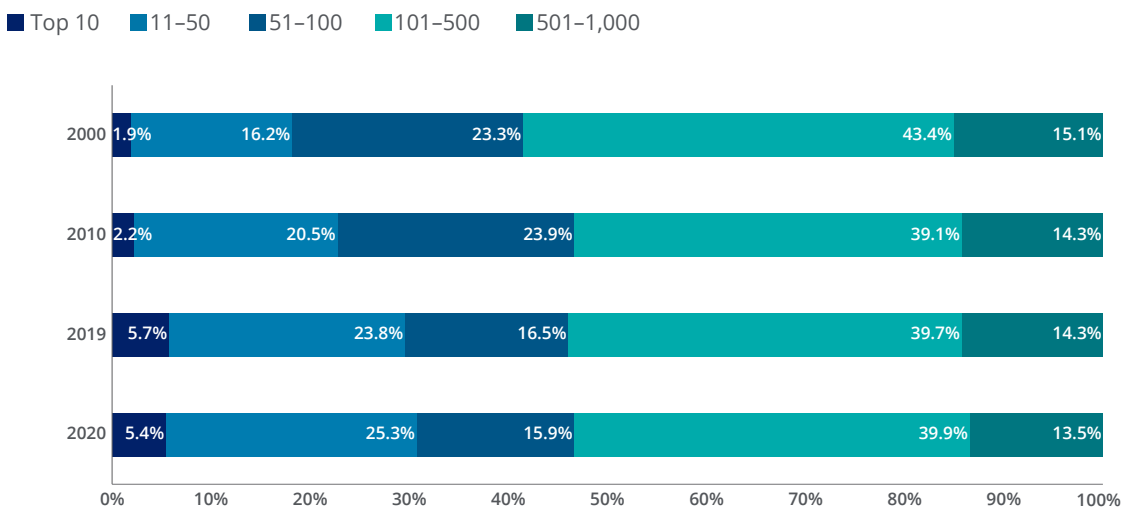
accumulated since 2010 compared to between 2000 and 2010. For example, between 2010 and 2019, long-term debt grew at an average annual rate of 9.7%, higher than the 8.2% rise in 2000–2010. And in line with the trend for total nonfinancial corporate debt in the economy, debt for the 1,000 companies in our research universe increased at a faster pace in 2020 (14.5%) compared to the year before (8.5%).

Analysis of the data by cohorts reveals that the top 50 companies by market value are leading the debt surge. Between 2010 and 2019, the share of the top-10 in total debt for the 1,000 companies more than doubled to 5.7%, before declining slightly last year. During this period, the share of the 11–50 cohort also went up, but at a slower pace than the top-10. This broad trend in rising shares for the 50 largest companies, taken together, has mostly been at the expense of the 51–100 cohort (figure 2).

FIGURE 2

Top 5% of the 1,000 companies analyzed accounted for 30.7% of total debt for the group

Shares in total long-term debt of the top 1,000 nonfinancial corporations (percent)



Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

Figure 2 also reveals that a mere 5% of these 1,000 companies accounted for 30.7% of the group’s total long-term debt, much higher than what the share was 10 years back.

Three sectors—information technology, communication services, and health care—have been leading debt growth since 2010 (figure 3), corresponding to these sectors’ growing prominence in the wider economic and business activity. The average annual growth in long-term debt in 2010–2019 for information technology was 20.1%, and for communication services it was 13.4%. Not just that, these sectors rapidly increased

their debt even during the pandemic. Rising debt for these sectors isn’t surprising given that in the top-10 cohort, four companies are from information technology, two from communication services, and one from health care. And in the 11–50 cohort, 65% of companies are from these three sectors. Even in some other sectors, such as consumer discretionary, we find the influence of technology through the presence of companies such as Amazon and Tesla. In contrast, the share of industrials and utilities in long-term debt has gone down, in line with their contribution to the wider economy. In 2020, however, industrials led debt growth with a 24.9% increase.

FIGURE 3

Information technology, communication services, and health care have been leading the debt surge since 2010, thereby increasing their share in total long-term debt

Shares in total long-term debt of the top 1,000 nonfinancial corporations (percent)

	2000	2010	2019	2020
Communication services	13.3	10.3	13.8	14.0
Consumer discretionary	10.7	9.9	9.7	10.3
Consumer staples	10.6	9.8	8.5	8.1
Energy	6.2	9.0	10.0	9.7
Health care	4.8	10.2	14.7	14.2
Industrials	21.7	24.4	12.8	13.9
Information technology	6.8	6.2	14.0	13.4
Materials	5.8	5.0	4.4	4.3
Real estate	0	0.1	0.2	0.2
Utilities	20.2	15.2	11.9	11.7

Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

Ability to repay debt has deteriorated for all companies, except very large ones

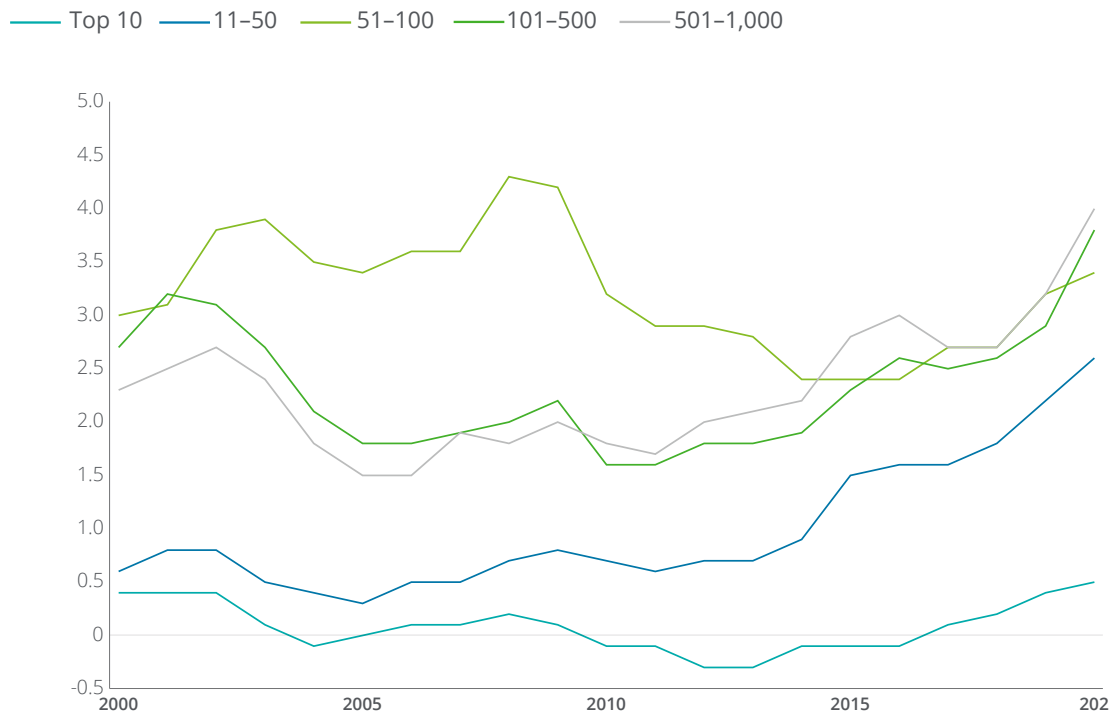
For most groups of companies, rising debt has accompanied deteriorating ability to repay. The ratio of net debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) has been increasing since early- and mid-2010s. Worryingly, in the pandemic earnings dropped even as debt increased, thereby denting companies' ability to repay debt (figure 4). For example, EBITDA declined by 18.2% for the 501–1,000 cohort and by 16.7% for the 101–500 one in 2020. The top-10 cohort, however, appears to be better placed than others in its net-debt-to-EBITDA ratio.



FIGURE 4

The ratio of net-debt to EBITDA shot up in 2020 for all groups of companies other than the top-10

Net debt/EBITDA (number)



Source: S&P Capital IQ; Deloitte Services LP economic analysis.

In 2020, EBITDA declined the most for energy (42.7%)—most likely due to a sharp drop in oil prices last year—and industrials (33.8%). This, in turn, ensured that their net-debt-to-EBITDA ratios deteriorated sharply, given that net debt soared (figure 5). The rise in the ratio for industrials reverses the improvement since 2009. The oil industry witnessed a sharp drop in earnings in 2020 due to falling oil prices that year, likely contributing to declining net-debt-to-EBITDA for the overall energy sector. Oil also faces medium- to long-term growth challenges due to climate change and efforts worldwide to transition away from fossil fuels.

The pandemic also dented companies' ability to pay interest on their debt. The interest coverage ratio, a ratio of earnings before interest and taxes (EBIT) to interest expenses, fell for all cohorts other than the top-10 in 2020, with the quantum of decline being the highest for the 101–500 cohort. While low interest rates helped in keeping interest expenses in check for all cohorts last year, it was the sharp fall in earnings that dented some cohorts' interest coverage ratio. For example, EBIT fell by 40.3% last year for the 501–1,000 cohort and by 28.5% for the 101–500 one. And, as with net-debt-to-EBITDA ratio, larger companies as a group seem to be better placed than their smaller counterparts

FIGURE 5

The net-debt-to-EBITDA ratio deteriorated the most in 2020 in the energy sector

Net debt/EBITDA (number)

	2000	2010	2019	2020
Communication services	2.3	1.3	1.9	2.0
Consumer discretionary	3.1	1.5	2.8	3.9
Consumer staples	1.6	1.4	2.4	2.6
Energy	0.8	0.7	2.5	4.9
Health care	0.3	0.5	1.9	1.9
Industrials	3.3	3.9	2.8	4.5
Information technology	-0.2	-0.8	0.4	0.5
Materials	2.4	1.2	2.5	2.5
Real estate	1.9	2.2	4.0	3.2
Utilities	4.1	3.5	5.1	5.3
Top 1,000 companies	1.9	1.3	2.2	2.5

Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

in terms of interest coverage (figure 6). For example, in 2020, the interest coverage ratio for the top-10 was 24.3, much higher than the 1.9 ratio for the 501–1,000 cohort.

The question to ask here is whether this debt surge since 2010, including in 2020, has been matched by an increase in investments.

Among key sectors, information technology had the highest interest coverage ratio in 2020, unchanged from the previous year. The number, however, has gone down sharply over the years (figure 7). The energy sector has witnessed a similar trend. With earnings being hit in 2020, most sectors saw

declines in the interest coverage ratio. The energy sector was the worst hit (figure 7).

The question to ask here is whether this debt surge since 2010, including in 2020, has been matched by an increase in investments. If investments have grown in line with debt, it should be a positive trend for the economy. If not, this high level of debt may become a problem.

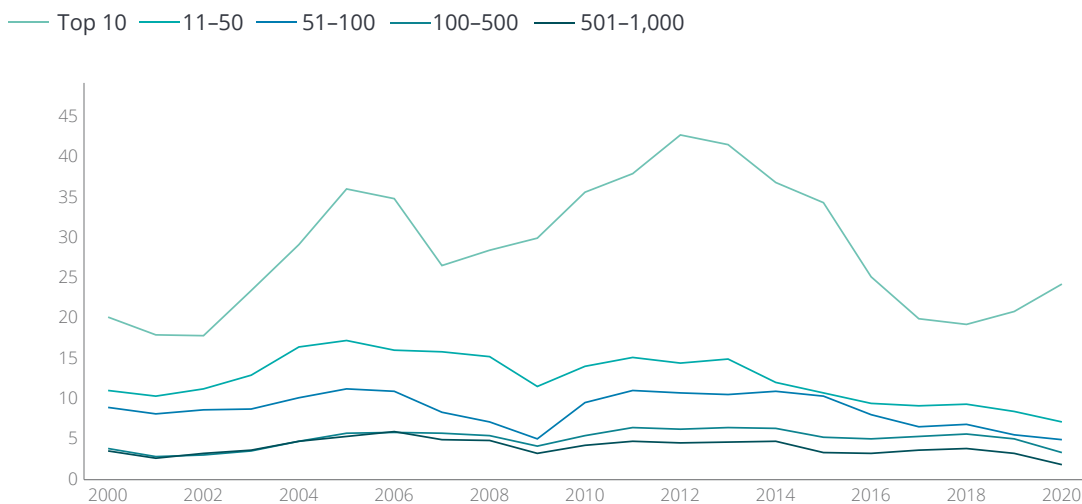
Capital expenditure hasn't kept pace with debt, with 2020 being an especially bad year

Data on investments by these 1,000 companies reveals that overall capital expenditure (capex) hasn't kept up with debt growth. Between 2010 and 2019, for example, capex grew by 6.7% on average per year, lower than the corresponding growth in long-term debt (9.7%). And even as debt grew in 2020, capex fell by 9.4%—but there is quite a bit of

FIGURE 6

In 2020, the interest coverage ratio strengthened only for the 10 largest market cap companies

Interest coverage ratio (number)



Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

FIGURE 7

A hit to earnings impacted interest coverage ratios for most sectors in 2020

Interest coverage ratio (number)

	2000	2010	2019	2020
Communication services	2.8	5.9	6.0	5.8
Consumer discretionary	5.6	5.6	7.1	4.4
Consumer staples	8.5	9.3	7.8	7.9
Energy	11.7	15.2	4.2	-0.3
Health care	12.0	11.2	7.5	8.2
Industrials	6.5	6.9	6.1	2.8
Information technology	19.9	25.5	10.4	10.4
Materials	3.5	5.1	5.2	4.7
Real estate	2.8	2.8	3.6	2.7
Utilities	2.2	3.0	2.6	2.6
Top 1,000 companies	6.2	8.1	6.4	5.2

Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

variation within company cohorts. The top-10 group, which has led debt expansion, has also increased capex faster than others (figure 8). This group is the only cohort that increased capex amid the pandemic and that too at a healthy pace. Oddly, the 11–50 group, which like the top-10 contributed strongly to overall debt expansion between 2010 and 2019 (and 2020), witnessed slower capex growth on average during this period compared to 2000–2010.

Capex growth has been the highest since 2010 for consumer discretionary, information technology, and health care, while it has contracted for energy. In fact, capex fell by a staggering 38.3% last year for energy, a contrast to strong growth in long-term debt for the sector that year. Within the energy sector, oil is a special case—oil prices fell

last year and there remains headwinds for the industry, such as climate concerns and potential reduction in commuting, as remote work trends continue.

So, is rising debt a problem? Not necessarily.

The capex trend in 2020 could well give a misleading impression of the most important trends in economywide business investment and, therefore, a misleading impression of the direction of future productivity growth. First, capex includes investment in structures (which are not closely associated with productivity improvements, as well as in maintenance). Second, although business investment fell in the first half of 2020, the types of

business investment most closely tied to productivity growth staged a remarkable recovery in the second half that has continued into the first quarter of 2021. For a more detailed picture of what new investments businesses are making (albeit without the size or sector detail⁸), we turn to the US National Income and Product Accounts data. According to this government data, investment in structures was particularly hit hard in 2020 that continued into 2021. Since structures are not a type of investment closely associated with productivity improvements, a decline in this type of investment is not very concerning from the perspective of potential economic growth.

Two types of investments are mostly associated with the economy’s productivity growth—investment in information processing equipment (includes investment in computers, communications, medical, and accounting

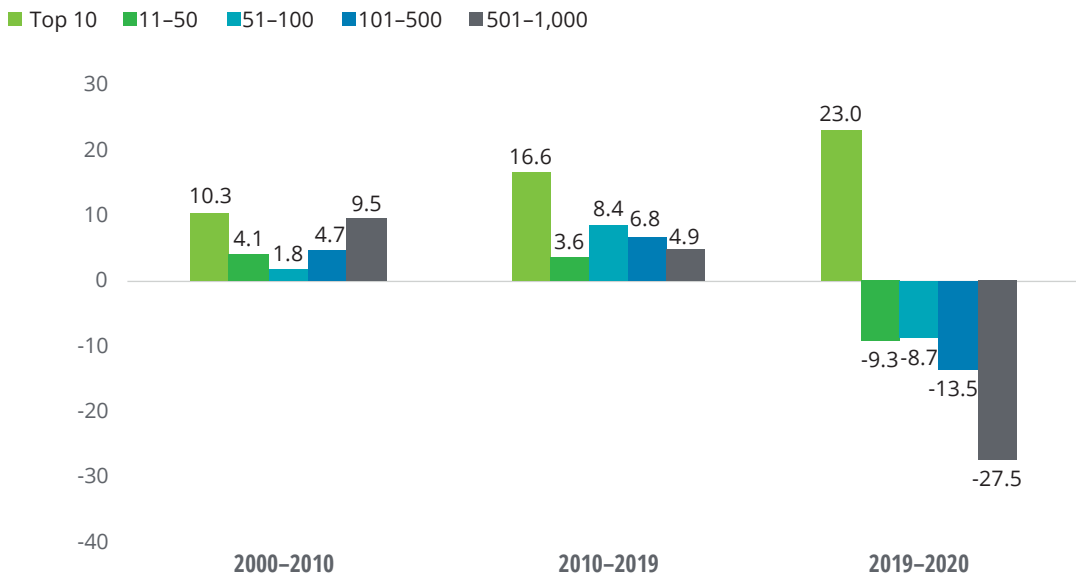
equipment) and investment in software. Both types expanded rapidly during the pandemic. After falling in Q1 2020, investment in information processing equipment exploded as businesses worked to adapt to a host of challenges posed by COVID-19.⁹ Investment in software did not see explosive growth, but after falling in Q2 2020, this investment class has been growing faster than its prepandemic rate.

In such a low interest-rate environment, higher debt levels are not necessarily a bad thing, although we are concerned about a deterioration in the ability to repay. The ultimate impact on the economy and the businesses themselves hinges on how this debt is used. And preliminary data suggests some of the investments that companies are making are smart ones—ones that will augment productivity in the medium to long term.

FIGURE 8

The 10 largest nonfinancial corporations have led capex growth since 2000

Average annual growth in capex (percent)



Sources: S&P Capital IQ; Deloitte Services LP economic analysis.

Endnotes

1. Akrur Barua and Patricia Buckley, *Rising corporate debt: Should we worry?*, Deloitte Insights, April 15, 2019.
2. United States Federal Reserve data, sourced through Haver Analytics in May 2021. Economywide debt data used in this paper is taken from this source.
3. S&P Capital IQ data, sourced in May 2021.
4. Ibid; United States Bureau of Economic Analysis, National Economic Accounts data, sourced in May 2021.
5. Throughout this paper, we only focus on trends for nonfinancial companies.
6. Average annual rate cited here is compound annual growth rate (CAGR). Throughout the paper, CAGR is used to calculate average growth per year.
7. S&P Capital IQ data, sourced in May 2021.
8. The industry detail provided in the S&P Capital IQ data is the industry in which each corporation is categorized. The investment detail provided by the NIPA is by type of investment irrespective of the industry making the investment. For example, the information technology industry in the S&P data is a grouping of corporations producing IT goods and services. The information processing equipment investment in the NIPA data describes investment in this particular type of equipment by all US businesses and nonprofits.
9. United State Bureau of Economic Analysis, National Economic Accounts data, sourced in May 2021.

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