

## Talking point

### German SMEs on a sounder financial footing

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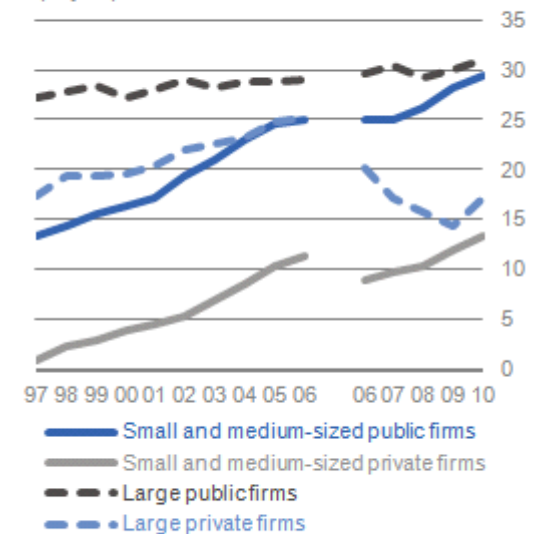
**Since 1997, small and medium-sized enterprises (SMEs) in Germany have raised their average equity ratio substantially from 6% to 22%, not least as a reaction to more stringent lending requirements by banks. At the same time, SMEs' dependence on bank loans declined whose share in total assets dropped to just 26% from 37%. Large differences remain between private and public firms.**

The small and medium-sized enterprises (SMEs) in Germany have fundamentally changed their financing structure in the last 15 years. This was most perceptible with regard to capital levels: between 1997 and 2010, the share of equity in the balance sheet total rose from no more than 6% on average to over 22%. By contrast, the capital ratio of large companies, i.e. those with annual turnover exceeding EUR 50 m, in the same period rose only slightly to 29% from 25%. One main reason for the considerable improvement of capital levels especially with regard to SMEs is likely to have been increased requirements by banks in the last few years: for the banks, with the introduction of Basel II, capital requirements for corporate loans became more differentiated according to the level of risk, i.e. loans to lower-rated borrowers have to be backed by more equity since then and are therefore more expensive. Companies for their part had an incentive to strengthen their balance sheets because this enabled them to reduce their financing costs.

However, the increase in SMEs' reported capital ratios is likely to overstate the actual improvement in the financial soundness of these companies. Indeed, in the 1990s, many very small firms and individual enterprises registered negative capital ratios, because part of their assets were legally assigned to the owner instead of the company. The considerable improvement of the equity ratio in the following years was thus in part simply reached by a different allocation between the privately held assets of the entrepreneur and the assets of the firm – which left the real economic strength of the company in the appropriate combined observation of company and owner unchanged, though.

#### German SMEs strongly improve their capital ratios

Equity capital in % of total assets



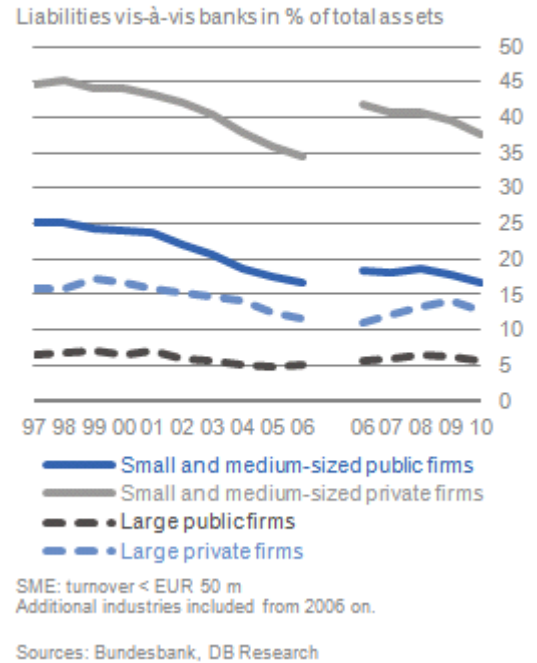
SME: turnover < EUR 50 m  
Additional industries included from 2006 on.

Sources: Bundesbank, DB Research

Nevertheless, one thing remained unchanged, also in the statistics, over the entire period: the large gap between the capitalisation levels of public and private firms. At 31%, private limited companies' (GmbHs) and joint stock companies' (AGs) average equity ratio (with a broader range in the case of GmbHs) continues to be roughly double as high as that of private firms (OHGs, KGs and GBRs), at approximately only 15%. On the one hand, this may be due to the fact that more corporations (above all listed companies) face public scrutiny – also because the number of larger companies is much higher in this segment. On the other hand, there are more options for corporations to strengthen their capital base as they usually have a broader set of owners and – as joint stock companies – can raise capital through the stock market if necessary.

How will the equity ratio of German companies and especially of SMEs develop in the next few years? There is much to suggest that the increase will continue for the time being. Nevertheless, there are certain signs that the trend is levelling off at ratios of over 30-35% – across all sectors of the economy but with clear differences by industry. The currently good earnings situation of many companies may favour a further increase, inter alia. The extremely low interest rate level, which encourages higher leverage, may have the opposite effect, as does the declining importance of bank loans for corporate funding: liabilities vis-à-vis banks account for only 26% of total assets for SMEs and 6.8% for large companies any more, compared to 37% and 8.7%, respectively, in 1997. This lower dependence on credit institutions also reduces the pressure of having to signal a good credit rating via a high capital ratio.

### SMEs become less reliant on bank loans



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