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In this number :
Financial Situation of Industrial Enterprises

FINANCIAL SITUATION OF INDUSTRIAL ENTERPRISES

Summary and main points in brief

In 1993 in general, the performance of European industrial enterprises was back at its 1984 level, wiping out the gains registered between 1984 and 1992. They were unable to improve their financial structures any further and remained extremely sensitive to variations in interest rates, particularly short–term rates. Small and medium–sized enterprises (SMEs) seem to have coped better with the effects of the deterioration in the economy than large enterprises.

In 1993, US enterprises, being in a more advanced phase of the economic cycle and taking advantage of particularly low short–term interest rates, markedly outperformed their European and Japanese counterparts.

In 1995, the profitability of European enterprises, especially the large groups, should benefit from the improvement in economic activity. Financing increased activity and rapidly growing investment does, however, raise the question of European enterprises' ability to self–finance against a background of high real interest rates.

A. Europe, United States, Japan: contrasting trends

In 1993, US enterprises generally ***outperformed*** *their European and Japanese counterparts. As a result of the economic recovery which began in 1992, there was a distinct improvement in gross and net profit margins in the United States in 1993, with increases of 0.9 and 1.6 percentage points respectively between 1992 and 1993. In Europe and Japan, however, they contracted further. The rebound in the financial profitability of US enterprises is spectacular (improving by a factor of 2.8 between 1992 and 1993); in Japan, financial profitability halved over the same period and in Europe the decline will probably be even more severe.*

The ***financial constraint*** *is easing substantially in the United States: financial charges as a proportion of both turnover and gross profit almost halved between 1992 and 1993; the overall ratio of indebtedness is consistently lower than in Europe and Japan, and debt is more favourably structured. As a result of the fall in interest rates, Japanese enterprises are managing to contain financial charges as a proportion of their turnover and gross profit and to stabilize their financial structures (slight improvement in the overall debt ratio and in the structure of debt). Conversely, the financial constraint is tightening on average in Europe. The general increase in financial charges as a proportion of turnover and gross profit which was observed in 1992 continued in 1993 in the countries for which data are available, the debt–shedding process has been halted and the improvement in the structure of debt is marking time.*

B. Marked deterioration in the performance of European enterprises

Between 1989 and 1993 the situation of European enterprises steadily deteriorated as industrial activity declined. In 1993, financial profitability in European countries reached the lowest levels recorded since 1985, with a very sharp fall between 1992 and 1993. This situation partly explains investors' increasing tendency to steer clear of stock–exchange investments and take advantage of rising interest rates available on risk–free long–term investments.

By contrast, between 1982 and 1989 European enterprises had improved their financial performance appreciably, increasing their gross profit ratios (gross profit in relation to turnover) by 3.1 percentage points and their net profit ratios (net profit in relation to turnover) by 3.6 percentage points. In 1989, financial profitability, which is of direct interest to shareholders (net profit in relation to equity capital), thus significantly outstripped the return on risk–free long–term investments (+4.7 percentage points), promoting financial flows to enterprises. The strong convergence in the financial situation of European enterprises in 1989 subsequently gave way to a more divergent trend. The maximum spread of financial profitability between Member States thus widened from 7.1 percentage points in 1989 to 19.8 percentage points in 1992. The steady deterioration in the situation of manufacturing industry has therefore affected Member States differently.

C. Sharp rise in the financial charges of European enterprises

Over the period from 1984 to 1993 the relative share of purchases of goods and services (equivalent to some 63% of turnover) declined, mainly as a result of the fall in raw material prices (by 1 to 2 percentage points). Changes in the share of staff costs (i.e. wages and social security contributions, around 22%) showed a rather uneven pattern over the period from 1982 to 1989, but increased steadily between 1989 and 1993 with the progressive slowdown in industrial activity. The ***gross profit*** *realized by an enterprise is what is left after purchases of goods and services and staff costs have been covered; it represents some 11% to 12% of turnover. In view of the tighter control of charges as a proportion of turnover, the recovery in economic activity should automatically be reflected in 1995 in an increase in the gross profit of European enterprises, unless the trend of raw material prices or wage claims becomes more unfavourable.*

Financial charges*, which are the remuneration paid to lenders of capital (3.5% of turnover in 1992), are directly influenced by the amount of debt contracted by enterprises and by the movement of interest rates. The burden of financial charges eased considerably between 1982 and 1988 (from 3.9% to 2.3%) but after 1988 increased again sharply, reaching in 1992 and 1993 levels comparable with those obtaining at the beginning of the 1980s.*

D. Debt stabilization

Between 1989 and 1993 the slowdown in economic activity led to a sharp fall in net profits, the source of self–financing, and European enterprises managed to stabilize their debt ratios only as a result of the reduced need to finance investment. Previously, between 1982 and 1989 the overall ratio of indebtedness (share of debt in balance sheet) had fallen steadily in Europe (from 63.2% to 56.6%). From 1995 the recovery in activity (forecast rise of 3.8% in output and 9% in investment) will push up enterprises' funding needs. With real long–term interest rates expected to remain high (forecasts of 5.7% in 1995 and 5.4% in 1996), enterprises are unlikely to change their preference for reducing debt. The question is therefore whether self–financing will be sufficient to fund the recovery?

E. SMEs better equipped to cope with the recession than large enterprises

SMEs have run up more debt than large enterprises since 1988. Although they have generally recorded lower gross profit ratios than large enterprises, they have been more successful in coping with the effects of the deterioration in the economy than large enterprises; in 1992, for the first time, their gross profit ratio exceeded that of large enterprises (11.3% for SMEs as against 11.1% for large enterprises). An analysis of net profit ratios confirms that large enterprises generally benefit more than SMEs from high–growth years (1988 and 1989) but that their results are more sensitive to a decline in activity.

By contrast, the financial profitability of SMEs is generally greater than that of large enterprises (1989 being the sole exception). The financial profitability gap in favour of SMEs widened to as much as 7.1 percentage points in 1992, SMEs' position in niche markets working to their advantage during times of recession.

In 1992, with broadly the same debt ratios, the indebtedness of SMEs was more short–term, and they faced a consistently higher apparent rate of interest over the period from 1984 to 1992. The sensitivity of SMEs to changes in interest rates is therefore greater than that of large enterprises.

INTRODUCTION

Manufacturing industry has a relatively limited share (some 20% of GDP) in the economies of the EC Member States, the United States and Japan, even though industrial products are at the heart of those countries' trade. Being a sector that has been thrown wide open to international competition, manufacturing industry is particularly sensitive to changes in the competitiveness of the economies under consideration. An increase in investment is contingent on enterprises' capacity to finance such investment, which is in turn linked to their profitability and financial structure. From the aggregated accounts of enterprises supplied by national bodies responsible for centralizing balance–sheet data, the European Commission has created a harmonized data bank – the BACH data bank – that provides access to the necessary financial statistics. Drawing on that data bank, this study sets out to compare the trends over the last ten years in the costs, profit or loss, and financial structures of industrial enterprises in the EC Member States, the United States and Japan.

This supplement to European Economy provides, on the basis of financial information, an annual **comparison of the profit or loss and financial structures of industrial enterprises in the EC Member States, the United States and Japan.** This second issue looks in detail at changes in enterprises' performance (gross profit, net profit, financial profitability), their charges (purchases, staff costs, financial charges) and their financial structure (overall debt ratio, structure of debt). The fourth section examines the situation of European small and medium–sized enterprises.

Box 1

BUSINESS ACCOUNTS HARMONIZED DATA BANK (BACH)

As an accompaniment to its tools for economic analysis, the Commission of the European Communities (DG II) created in 1985 **a data bank made up of the annual accounts, aggregated at different sectoral levels, of several EC countries, Japan and the United States.** To that end, it contacted the national bodies responsible for centralizing balance–sheet data, which supplied it with aggregated sectoral information. The Commission departments assumed that the samples used were representative since the data are generally published and analysed by those bodies.

In order to allow comparative analyses to be made, **the basic accounts were reworked for the purposes of harmonization according to a single accounting layout consistent with the Fourth Directive.** This produced time series of accounting data aggregated by sector and, in most cases, by size of enterprise, thus **improving the comparability of balance–sheet structures and profit and loss accounts between countries.**

Harmonization was at the centre of this project, with comparability the main objective, sometimes **to the detriment of detail.** However, the specific nature of national accounting methods, together with the difficulty of compiling accounting documents *a posteriori* according to a common layout, restricted the degree of harmonization of the data in some respects. Consequently, **although comparisons of trends are possible, comparisons of levels are trickier** (and indeed impossible in some cases) **and require a sound prior knowledge of each country's accounting and financial environment**. DG II is a permanent associate member of the *Comité Européen des Centrales de Bilans*, which brings together national experts of the various bodies centralizing balance–sheet information that supply data to BACH.

The sectoral nomenclature has also been standardized and comprises 22 sectors or subsectors.

At present the data bank covers eleven countries:

- Belgium (source: Banque Nationale de Belgique)
- Germany (source: Deutsche Bundesbank)
- Spain (source: Banco de España)
- France (source: Banque de France)
- Italy (source: Centrale dei Bilanci)
- The Netherlands (source: Centraal Bureau voor de Statistiek)[2]
- Portugal (source: Banco de Portugal)
- The United Kingdom (source: Dable, DG III)
- The United States (source: Department of Commerce)[2]
- Japan (source: Ministry of Finance)
- Austria (source: Oesterreichische Nationalbank).

The **"EUROPE" row in the tables,** specifically calculated for the purposes of this study, has been **obtained by taking the average for the eight European countries weighted by each country's relative weight in industrial manufacturing output. The combined industrial manufacturing output of these eight countries accounts, on average, for 97% of industrial manufacturing output in the European Union of Twelve.**

[1] Data for the United Kingdom are taken from the DABLE data base. They contain consolidated accounts of 569 enterprises. The DABLE data base is administered by DG III.

[2] Consolidated accounts.

1. PERFORMANCE OF EUROPEAN ENTERPRISES

An enterprise is subject to various financial constraints: a profitability constraint if it is to survive and safeguard its development; a financial equilibrium constraint if it is to avoid liquidity crises and excessive dependence on banks in particular. International comparisons of the performances and financial situations of enterprises are necessary but difficult. Profound differences exist between the various countries' accounting methods; financing methods are often specific to each country, especially in the area of short–term financing; the concepts used may vary.

In an attempt to overcome some of these difficulties, the European Commission created BACH, a harmonized data bank drawing on the accounts of enterprises, with the support of national public or semi–public bodies responsible for centralizing balance–sheet data (see Box 1).

The performances of enterprises are assessed here on the basis of a set of three indicators (see Box 2 for definition of these indicators).

- Overall gross profit ratio (gross profit in relation to turnover)
  The overall gross profit provides a measure of an enterprise's capacity to generate an overall profit from all its activities before deduction of taxes, remuneration of investors and allocations to provisions.

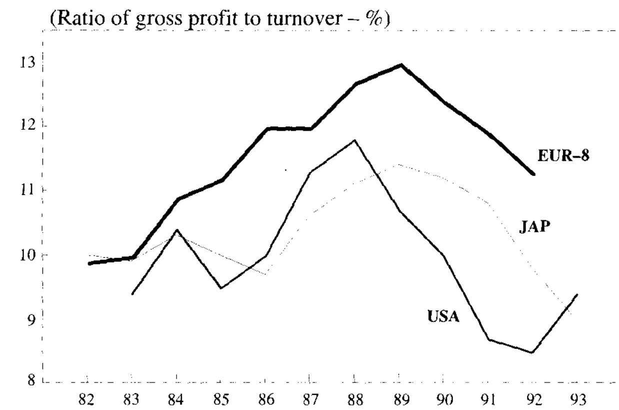
- Net profit ratio (net profit in relation to turnover)
  The net profit is calculated by deducting financial charges, taxes and depreciation from the gross profit. It is sensitive to tax rules and regulations in particular and to changes in interest rates.

- Financial profitability (net profit in relation to equity capital)
  This ratio is of particular interest to shareholders. Calculated in relation to equity capital employed, it gives an indication of the profitability of the private sector and of any incentive to switch to risk–free fixed–interest investments.

1.1. Overall gross profit ratio (gross profit in relation to turnover)

Over the period from 1985 to 1992 the gross profit ratio of European enterprises grew more strongly and more steadily than that of US and Japanese enterprises. On average, it is still above that of US and Japanese competitors.

GRAPH 1 : **Overall gross profit ratio – Manufacturing industry**



Source : BACH.

Between 1982 and 1989 European enterprises saw their gross profit ratios rise appreciably from 9.9% to 13%, giving a 3.1 percentage point increase over seven years. That increase was particularly marked in certain countries (the Netherlands (9%), France (5.3%) and the United Kingdom (5%)) and was much weaker in Italy and Germany (1.1%). A point of convergence was reached in 1987 when the spread between the highest and lowest figures was 1.5 percentage points, compared with 4.4 percentage points in 1982. The trend was reversed from 1989, and in three years (1989–92) Europe lost the gains made over the preceding four years (1985–89). The fall continued in 1993, at least in those countries for which data is available.

TABLE 1 : **Overall gross profit ratio – Manufacturing industry** (in %)

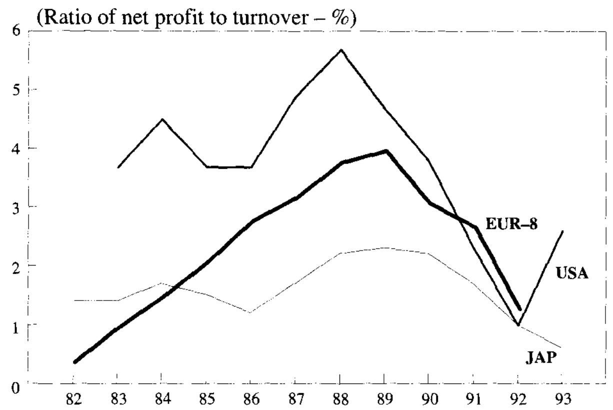
	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	6.9	7.5	8.5	5.8	8.0	9.5	10.7	10.7	10.3	11.5	10.4	8.9
Belgium	9.9	8.6	9.9	10.0	11.6	11.6	12.1	13.8	12.8	12.2	12.2	12.2
Germany	9.7	9.6	9.8	10.1	10.5	9.7	10.3	10.3	10.5	10.4	10.0	–
Spain	10.6	10.7	11.6	11.0	11.6	13.1	14.5	13.9	11.6	9.9	8.0	5.0
France	7.3	7.7	9.1	10.9	11.3	12.4	13.1	12.7	12.1	11.6	11.0	10.3
Italy	11.7	12.2	13.1	12.8	13.7	12.8	12.5	12.8	12.0	11.3	11.2	–
Netherlands	7.4	9.0	10.4	9.5	10.6	12.5	14.8	16.4	15.2	16.1	15.3	14.9
Portugal	–	–	–	14.8	16.4	17.7	17.1	16.9	16.4	15.6	14.4	–
United Kingdom	11.3	11.4	12.3	12.6	14.0	14.3	15.3	16.6	15.6	15.2	14.2	–
EUR–8 (1)	9.9	10.0	10.9	11.2	12.0	12.0	12.7	13.0	12.4	11.9	11.3	–
United States	–	9.4	10.4	9.5	10.0	11.3	11.8	10.7	10.0	8.7	8.5	9.4
Japan	10.0	9.9	10.3	10.0	9.7	10.6	11.1	11.4	11.2	10.8	9.8	9.0

(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

The fall in the gross profit ratio after 1989 was due principally to the steady decline in activity by manufacturing industry. While the turnover of European enterprises rose sharply from 1983 to 1989 (18% in volume terms over the period), the annual rate of growth at constant prices fell steadily after 1989 (4.7% in 1989, 3.1% in 1990, 1.4% in 1991, –0.5% in 1992 and –3.7% in 1993). By 1993, industry had returned to a turnover level comparable in volume terms to that recorded in 1989. This reduction in turnover of course brought about an appreciable fall in the rate of utilization of production capacity, down from 85.6% in 1989 to 77.6% in 1993 (i.e. almost 8 percentage points less).

1.2. Net profit ratio (net profit in relation to turnover)

GRAPH 2 : **Net profit ratio – Manufacturing industry**



Source : BACH.

From an enterprise's viewpoint, the net profit ratio is particularly important since it is the final result, i.e. the enterprise's actual profit which, after payment of taxes and financial costs, will be the source either of shareholder remuneration – in the form of dividends – or of self-financing by allocations to reserves. Movement of this indicator will therefore determine an enterprise's investment potential.

Unlike the gross profit ratio, the net profit ratio of European enterprises is on average lower than that of US enterprises. At the beginning of the 1990s, however, there was strong convergence between the United States, Japan and the European Union.

From 1982 to 1989 European enterprises saw a spectacular tenfold improvement in their net profit ratios (from 0.4% in 1982 to 4% in 1989). Three countries – Spain, France and Italy – even reversed a situation which was negative in 1982. In the case of Spain, the ratio remained negative until 1985 but then exceeded the European average (4%) in 1989 (4.8%). Germany maintained positive and relatively stable performances throughout the period. Its ratio stood at 2.4% at the end of this eight–year period, i.e. below the European average. The greatest convergence seems to have occurred in 1990, except for the Netherlands and the United Kingdom where the existence of consolidated balance sheets improves this type of ratio. The maximum divergence from the average was 1.8 percentage points compared with 3.1 percentage points in 1982.

From 1989 there was a continuous sharp threefold decrease in the net profit ratio (from 4% in 1989 to 1.3% in 1992). In 1992 it reached its lowest level for nine years. In those countries for which data were available, this fall continued and even worsened in 1993.

For the first time in ten years, a number of countries again recorded negative ratios in 1992 (Spain –3.0%, Italy –1.5% and Portugal –0.7%).

1.3. Financial profitability

At the beginning of the 1990s the financial profitability of European enterprises was very similar to that of their US and Japanese counterparts. From 1982 to 1989 European enterprises saw a constant and sustained improvement in their financial profitability ratio, which rose from 1.6% to 14.4%, giving a ninefold rise in seven years (a discounted rate

TABLE 2 : **Net profit ratio – Manufacturing industry** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	–1.1	–0.2	0.8	–1.5	0.3	1.9	3.1	3.2	2.5	3.3	2.2	0.5
Belgium	0.9	0.4	1.7	1.8	2.2	2.1	2.5	4.0	2.5	1.4	1.0	0.5
Germany	1.5	1.8	2.0	2.3	2.5	2.3	2.6	2.4	2.5	2.1	1.4	–
Spain	–2.9	–2.7	–1.5	–0.3	0.9	3.1	4.7	4.8	2.2	0.0	–3.0	–6.6
France	–1.3	–0.8	–1.3	0.5	1.2	2.7	3.6	3.6	2.7	2.1	1.2	0.6
Italy	–1.8	–0.7	0.8	1.3	2.4	2.1	1.9	2.4	1.3	0.2	–1.5	–
Netherlands	1.3	2.6	4.4	3.6	4.0	5.3	6.9	8.4	6.4	7.3	6.0	5.9
Portugal	–	–	–	–2.5	–0.6	2.7	2.8	3.4	3.2	1.3	–0.7	–
United Kingdom	3.6	4.4	4.9	5.2	6.1	6.6	7.4	7.6	6.4	6.1	5.1	–
EUR–8 (1)	0.4	1.0	1.5	2.1	2.8	3.2	3.8	4.0	3.1	2.7	1.3	–
United States	–	3.7	4.5	3.7	3.7	4.9	5.7	4.7	3.8	2.3	1.0	2.6
Japan	1.4	1.4	1.7	1.5	1.2	1.7	2.2	2.3	2.2	1.7	1.0	0.6

(1) EUR–8 is made of B, D, E, F, I, NL, P and UK.
Source : BACH.

of increase of 36.9% a year). A number of countries, starting from negative situations (Spain –8.8%, France –8.6% and Italy –7.6%), achieved spectacular improvements. But there was an appreciable improvement in all European countries: Portugal, which was still in a negative position in 1986, recorded 8.9% in 1989; Belgium improved its performance threefold; Germany maintained a constantly positive position well above the European average.

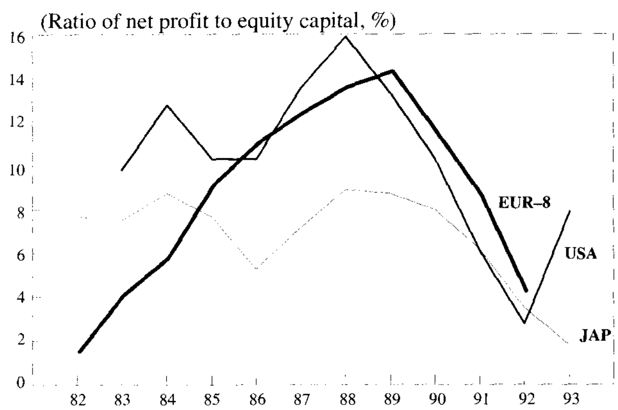
In 1989, the level of European convergence seemed very high. But a process of sharp deterioration then set in, and the average financial profitability of European manufacturing industries has steadily declined for five years. In 1992 it touched its lowest level for nine years (4.4%). In that year a number of countries recorded negative financial profitability: Spain (–8.7%), Italy (–5.3%) and Portugal (–1.7%). In 1993 those countries for which data were available again saw their performance levels of the previous year halved.

The majority of shareholders of European manufacturing enterprises have thus been hard hit by the recession, which could have an impact on the attractiveness of equity investment in the private sector. Furthermore, the scope for self–financed growth has diminished.

The difference between the financial profitability of European enterprises and nominal long–term interest rates in the public sector narrowed steadily between 1982 and 1985, largely as a result of the improved performance of enterprises. In 1986, for the first time since the beginning of the 1980s, the financial profitability ratio exceeded long–term interest rates (by 2.3 percentage points). From 1987 to 1990, despite a steady rise in the cost of money, the difference remained positive, reaching a maximum of 4.7 percentage points in 1988 and 1989.

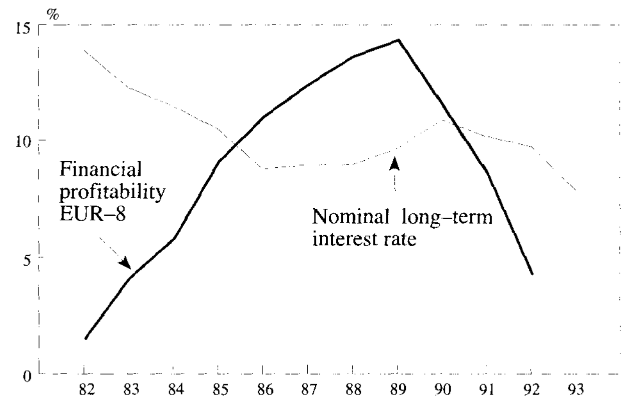
From 1991, despite a new fall in interest rates, the gap became negative (–5.4 percentage points in 1992); then, after that, European enterprises were faced with both a continued fall in their financial profitability and a resumed upward movement in interest rates on long–term public–sector bonds. The fall in share prices which occurred clearly owed much to the low level of European enterprises' financial profitability compared with the return on government bonds.

GRAPH 3 : **Financial profitability – Manufacturing industry**



Source : BACH.

GRAPH 4 : **Financial profitability of enterprises and long–term interest rates – Manufacturing industry**



Source : BACH.

TABLE 3 : **Financial profitability – Manufacturing industry** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	–8.0	–1.3	5.6	–11.0	2.0	10.0	16.2	16.4	12.0	13.6	6.8	1.6
Belgium	4.3	2.0	7.9	7.7	8.4	7.9	9.4	13.5	8.0	4.2	3.0	1.5
Germany	10.7	13.0	14.7	16.4	16.0	14.3	16.3	15.9	16.2	13.6	9.1	–
Spain	–8.8	–8.2	–4.4	–1.0	2.5	8.6	12.1	11.8	5.6	–0.1	–8.7	–21.1
France	–8.6	–5.5	–10.0	3.0	6.7	13.2	15.4	14.9	10.6	7.5	4.1	2.0
Italy	–7.6	–2.8	3.2	5.2	9.1	7.8	7.1	8.9	4.5	0.8	–5.3	–
Netherlands	3.9	7.6	12.3	10.1	10.3	12.3	15.4	18.2	13.4	13.4	11.1	10.0
Portugal	–	–	–	–12.1	–2.3	9.4	7.8	8.9	7.1	3.0	–1.7	–
United Kingdom	8.7	10.9	12.1	12.8	14.3	16.1	15.8	17.6	15.2	12.9	10.6	–
EUR–8 [1]	1.6	4.2	5.9	9.2	11.1	12.5	13.7	14.4	11.6	8.7	4.4	–
United States		9.8	12.8	10.3	10.3	13.6	15.9	13.3	10.3	6.1	2.8	7.9
Japan	7.7	7.5	8.7	7.7	5.3	7.2	8.9	8.7	8.0	6.2	3.5	1.8

(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

1.4. Conclusion regarding performances

Between 1982 and 1989 there was a remarkable improvement, thanks in particular to the greater efficiency of productive equipment, in the performance of European enterprises as measured by gross profit ratios (+3.1 percentage points) and net profit ratios (+3.6 percentage points). A very unfavourable situation in 1982 (financial profitability of 1.6%, i.e. a differential of –7.1 percentage points in relation to inflation and of –11.1 percentage points in relation to long–term interest rates) was turned into a favourable situation in 1989 (financial profitability of 14.4%, i.e. a differential of +9.7 percentage points in relation to inflation and of +4.7 percentage points in relation to long–term interest rates). Enterprises then clearly enjoyed a positive leverage effect. The income of shareholders could be increased by using borrowed funds. Once the economic profitability of a firm exceeds the rate of interest on borrowings, financial profitability improves all the more as the debt ratio rises; this is the positive leverage effect.

Between 1989 and 1992 the situation changed radically: all performance indicators became negative. In 1992 the differential between financial profitability and the rate of inflation again became negative (–0.2 of a percentage point), as did that between financial profitability and nominal long–term interest rates (–4.4 percentage points).

Continuation of this sort of situation could prompt shareholders to shun investment in manufacturing industry, although the high elasticity of financial profitability with respect to economic improvement gives investors cause to expect an improvement in their situation.

2. CHARGES BORNE BY ENTERPRISES

On average, purchases of goods and services are the main item of expenditure for enterprises (equivalent to some 60% of turnover). This **relative share of purchases** of course depends both on the cost of raw materials and business services and on the degree to which recourse is had to subcontracting. **Staff costs** (equivalent to some 20% of turnover) comprise wages and salaries, including all social security contributions. The **gross profit** realized by an enterprise is what is left once purchases of goods and services and staff costs have been covered. The performances of enterprises described in the previous section therefore depend to a large extent on changes in those charges. Finally, this section examines the **share of financial charges**, i.e. the necessary remuneration of providers of external capital. The share of financial charges will depend on financing structures and movements in interest rates.

2.1. Purchases as a proportion of turnover

The proportion of purchases of goods and services in relation to turnover differs appreciably from one European country to another. It is very high in Italy, the Netherlands and Belgium (approximately 72% in 1992) but is appreciably lower in Germany and Spain. These differences can be explained by a whole range of factors: specialization by industry in sectors that are raw–material intensive to differing degrees, varying degree of subcontracting, and, of course, the relative share of other charges. It is therefore more instructive to analyse this ratio in terms of trend. Viewed from this angle, the cost of purchases of goods and services remained fairly stable throughout the 1980s (64.3% in 1982, 63.9% in 1990). From 1990 there was a steady fall in this ratio, which continued in 1993. Reductions in the cost of raw materials played a major part in this trend.

The sharp downward movement in raw material prices which characterized the 1984–88 period led to a two–percentage–point reduction in the share of purchases, a substantial change given the inertia of this ratio.

After 1989, the elasticity of the share of purchases with respect to changes in raw material prices seems to have been less pronounced. The rise in raw material prices which began in 1993 could lead, however, to an increase in the share of purchases in the turnover of enterprises.

It does not therefore look as if the deterioration in the performances of European enterprises from 1989/90 has been

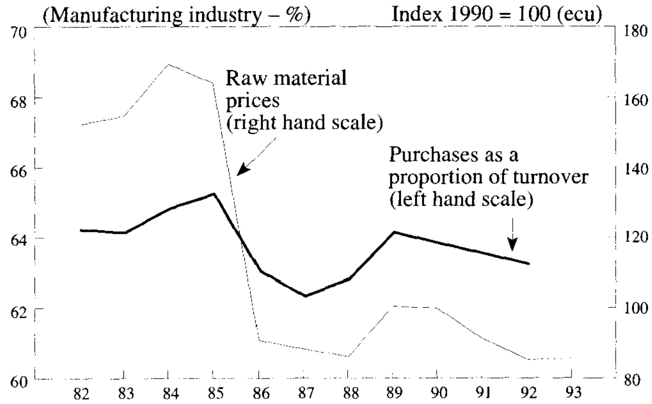
TABLE 4 : **Purchases of goods and services as a proportion of turnover – Manufacturing industry** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	54.5	54.3	58.5	58.3	53.4	53.6	52.2	54.2	54.5	53.8	52.3	52.0
Belgium	74.2	75.9	74.8	74.8	72.3	72.1	72.9	74.2	73.8	73.6	73.0	72.0
Germany	56.1	55.7	56.6	56.9	54.3	53.0	53.3	54.7	54.0	53.5	52.6	–
Spain	54.4	55.6	55.0	55.6	54.4	53.8	54.8	55.6	54.6	56.2	57.6	57.5
France	68.9	68.9	69.3	69.7	67.2	66.3	67.1	69.0	69.5	69.3	69.5	68.5
Italy	72.4	72.0	73.6	73.5	72.2	72.8	73.2	74.4	74.1	73.4	73.0	–
Netherlands	75.8	74.8	76.1	76.5	74.3	72.1	71.5	72.2	72.7	71.9	72.0	71.8
Portugal	–	–	–	70.0	69.2	68.5	69.7	69.2	69.7	69.5	69.3	–
United Kingdom	–	–	–	–	–	–	–	–	–	–	–	–
EUR–8 (1)	64.3	64.2	64.9	65.3	63.1	62.4	62.9	64.2	63.9	63.6	63.3	–
United States	–	–	–	–	–	–	–	–	–	–	–	–
Japan	75.1	75.7	74.9	75.1	75.3	73.9	73.8	74.0	74.4	74.0	73.6	73.5

(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

due to an increase in the share of purchases of goods and services.

GRAPH 5 : **Raw material prices and enterprises' purchases as a proportion of their turnover**



Sources : – BACH.
– UNO and IMP for historical data (DG II).

2.2. Trend in staff costs

Staff costs, which serve to measure the cost of labour, cover social charges (compulsory contributions by employees and employers) as well as wages and salaries. They constitute a heavy burden on enterprises (second largest item after purchases) and vary with changes in the compensation of employees and the taxation of labour.

The level of staff costs also depends on the extent to which external labour is taken into account, the existence of employee participation schemes and the inclusion of pension fund provisions in the accounts. The ratio used here measures such costs in relation to turnover, i.e. in relation to the level of activity of the enterprise. The differences in level between countries may be explained by differences in the levels of productivity (turnover per employee), compensation of employees and social charges.

The limited weight of staff costs in relation to turnover in Japan compared to the European average can be explained partly by high labour productivity, by the low level of social security contributions and by the greater use of subcontracting in Japan than in Europe. The level of staff costs in Germany, which fluctuates between 23.5% and 25.7% of turnover, is well above the level in the other countries (especially after 1986). In 1992 it rose to virtually its highest level ever (25.6%). Part of the explanation clearly lies in the fact that German pension fund provisions are included in staff costs and boost their share; this situation does not seem detrimental to German enterprises since, while not disbursed, these provisions are an element of self–financing in the same way as depreciation allocations. The high level of wages and salaries in Germany is also a contributory factor. At the other end of the scale, Portugal recorded ratios ranging from 15.7% to 18.5% over the period 1982–92; this is in part explained by low levels of remuneration. It will also be noted that the level in Austria is consistently above the European average and close to that in Germany. However, the gap is tending to narrow (for example, it was 3.8 percentage points in 1988 but was down to 1 percentage point by 1992).

Taking the average for European enterprises, the trend of staff costs as a proportion of turnover was fairly uneven over the period from 1982 to 1989. Periods of increase alternated with periods of decline, but changes were limited in magnitude. From 1990, however, a steady upward movement began, with the average proportion rising from 20.9% in 1989 to 22.2% in 1992 (+1.3 percentage points). This unfavourable trend seems to have persisted in 1993. Furthermore, the share of staff costs has not followed the same trend in the eight European countries.

Between 1982 and 1989 most of the countries experienced an appreciable reduction in staff costs, except for Germany and the Netherlands, where they rose from 1985 onwards, and Portugal which, except in 1989 (15.8%), saw a steady increase from 1985. Over this same period, the largest reductions in staff costs were recorded in France (–5 percentage points), Spain (–4.2 percentage points) and Belgium (–2.9 percentage points); this tallies with observations made regarding the sharp decline in the corrected wage

TABLE 5 : **Staff costs as a proportion of turnover** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	24.9	24.9	24.3	24.1	25.9	25.9	25.3	24.5	24.9	24.4	24.3	24.2
Belgium	21.4	20.4	19.5	19.5	20.1	20.3	19.2	18.5	19.4	20.5	20.8	21.4
Germany	24.6	24.3	23.8	23.5	24.8	25.7	25.1	24.4	24.7	25.0	25.6	–
Spain	23.7	22.2	21.2	20.2	20.4	19.7	19.3	19.5	20.7	21.4	21.1	22.6
France	24.5	24.0	23.0	22.7	22.2	21.9	20.7	19.5	19.7	20.1	20.4	20.7
Italy	20.1	19.9	18.5	18.3	18.2	18.4	18.0	17.9	18.3	19.2	19.2	–
Netherlands	18.9	18.6	16.3	16.1	17.5	18.8	18.0	17.1	17.4	18.2	18.2	18.7
Portugal	–	–	–	15.7	16.9	16.8	16.5	15.8	17.2	18.2	18.5	–
United Kingdom	24.1	23.9	23.1	23.2	22.8	22.6	22.3	21.6	22.0	22.5	23.1	–
EUR–8 (1)	23.2	22.8	21.9	21.6	21.9	22.2	21.5	20.9	21.3	21.8	22.2	–
United States	–	–	–	–	–	–	–	–	–	–	–	–
Japan	16.1	15.6	15.9	16	16.3	16.5	16	15.6	15.5	16.1	17.1	17.8

(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

share in those three countries. From 1990 a general increase in staff costs as a proportion of turnover can be seen, with especially sharp rises in Portugal (+2.7 percentage points), Spain (+1.6 percentage points, followed by an improvement in the ratio in 1992), Belgium (+2.3 percentage points, followed by a further deterioration in the ratio to 21.4% in 1993) and the United Kingdom (+1.5 percentage points). This increase can be attributed to a combination of rising labour costs and slackening business activity (time needed for adjustment of wage bill).

2.3. Trend in financial charges

An enterprise's financial charges essentially constitute interest paid on loans, even though the concept of "financial charges" used here, for reasons inherent in the technical problems of international comparability, is broader than the traditional concept of "interest paid". In certain countries in particular, it includes negative foreign–exchange differences (such differences represent varying proportions of financial charges depending on the country in question and range from 5% to 15%). Financial charges therefore principally reflect the cost of a firm's debt, and their level is directly influenced both by size of the debt and by movements in interest rates.

In theory, enterprises should tend to run down debt in periods of rising interest rates and, conversely, increase their debt when interest rates are low. In practice, for very diverse reasons (organization of capital markets, credit policies, historical circumstances, etc.), enterprises do not always have sufficient room for manoeuvre to retain control over their financial strategy.

By comparison with their US counterparts, European and Japanese enterprises have historically faced a greater burden of financial charges (averaging 3.0% and 2.8% respectively over the period 1982–91, as against 0.6% in the United States over the period 1986–91, the years for which data are available). The main explanation for this lies in a higher level of debt.

In 1992, however, the gap narrowed considerably: the rise in short–term interest rates in the United States, where debt is frequently denominated in variable rates, caused the ratio to increase sharply to 3.2%, a level very close to that in Europe (3.5%, the narrowest gap over the period reviewed) and even above that in Japan (2.8%, where, moreover, there was a 0.2 percentage point reduction in that year). But in 1993 there was a substantial fall in financial charges in the United States and Japan, whereas for those European countries for which data are available no such fall has yet been noted.

In Europe the period between 1982 and 1988 was marked by a continual and significant reduction in financial charges as a proportion of turnover, from 3.9% to 2.3%. In 1982 the difference between the highest and lowest levels of financial charges was 6.1 percentage points. Spain and Italy had particularly high levels (8.1% and 7% respectively), while Germany, the Netherlands and the United Kingdom had the most favourable levels (2.5%, 2.3% and 2.3% respectively).

GRAPH 6 : **Financial charges as a proportion of turnover – Manufacturing industry**

Source : BACH

TABLE 6 : **Financial charges as a proportion of turnover – Manufacturing industry** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	3.6	3.1	2.7	2.7	2.5	2.1	1.8	1.8	2.1	2.2	2.4	2.2
Belgium	3.7	3.0	2.9	2.8	3.0	2.6	2.4	3.0	3.4	3.8	4.1	4.3
Germany	2.5	1.9	1.9	1.7	1.7	1.5	1.6	1.7	1.9	2.3	2.7	–
Spain	8.1	8.1	7.4	5.8	4.8	4.2	3.3	3.2	3.6	4.1	5.0	5.9
France	3.7	3.5	4.1	3.7	3.2	2.8	2.4	2.4	2.8	2.7	2.9	2.7
Italy	7.0	6.4	5.7	5.0	4.1	3.4	3.5	3.6	4.2	4.3	5.2	–
Netherlands	2.3	2.0	1.8	1.6	1.7	1.7	1.7	2.1	2.7	3.0	3.4	3.3
Portugal	–	–	–	9.9	9.3	7.4	6.2	6.0	6.5	6.8	7.1	–
United Kingdom	2.3	1.7	1.8	1.8	1.8	1.6	1.7	2.4	2.8	2.7	2.7	–
EUR-8 [1]	3.9	3.5	3.4	3.1	2.8	2.4	2.3	2.5	2.9	3.1	3.5	–
United States	–	–	–	–	0.4	0.2	0.3	0.6	0.9	1.4	3.2	1.8
Japan	3.3	3.1	2.9	2.8	2.8	2.6	2.3	2.6	2.8	3.0	2.8	2.5

(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

TABLE 7 : **Apparent rate of interest** (in %)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	8.2	7.1	6.8	7.0	6.0	5.1	4.6	4.7	5.2	5.6	6.4	5.9
Belgium	11.6	10.4	11.1	11.5	11.3	9.5	8.5	9.7	10.3	10.2	10.4	10.2
Germany	–	–	–	–	–	–	–	–	–	–	–	–
Spain	13.5	12.9	13.5	12.3	11.2	11.1	9.9	10.2	10.5	13.8	15.1	15.3
France	14.1	12.8	10.6	10.8	10.0	9.5	8.8	8.9	9.7	9.3	10.1	9.5
Italy	14.8	14.6	13.0	12.2	10.2	8.1	8.2	8.5	8.9	9	10.7	–
Netherlands	6.6	5.6	5.5	4.9	4.9	4.5	4.5	5.1	5.8	5.8	6.2	–
Portugal	–	–	–	20.1	19.5	16.8	15.0	14.6	16.4	16.9	17.3	–
United Kingdom	10.0	7.6	7.3	7.7	6.6	6.2	6.3	6.9	6.8	6.2	5.4	–
EUR–8 [1]	11.7	10.2	9.6	9.5	8.6	7.6	7.5	7.9	8.5	9.0	9.8	–
United States	–	–	–	–	1.4	0.8	0.9	1.6	2.5	3.7	8.6	4.9
Japan	9.6	9.1	8.5	8.2	7.6	6.9	6.4	6.8	7.4	7.7	6.6	5.8

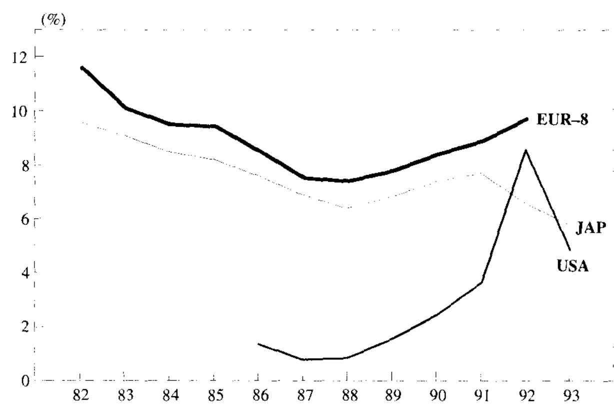
[1] EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

The subsequent general reduction in the relative share of financial charges was particularly marked for those countries with a high level at the outset. Thus, between 1987 and 1988, levels in Spain, Italy, Portugal, France and Belgium moved much closer to those in Germany, the United Kingdom and the Netherlands. The spread in ratios between the seven countries that were recorded at the outset fell back to 1.9 percentage points in 1988.

From 1989 there was a radical reversal of trend, and the average proportion of financial charges in Europe increased from 2.5% to 3.5% in 1992, thus returning to its 1983 level. The pace of increase varied between countries: it was fairly rapid in Belgium and the Netherlands, where the level in 1991 was higher than that in 1982 (as early as 1990 in the United Kingdom), but was more modest overall for the other countries. The gap between the highest and lowest ratios (as represented by Portugal and Germany respectively) was 4.4 percentage points in 1992, as against 4.6 percentage points in 1988. The change of trend after 1988 was not due to an increase in corporate indebtedness but was caused instead by the renewed rise in interest rates. Changes in the financial charges of European enterprises remain closely linked to movements in interest rates. A combination of factors is at work here: monetary policies pursued, the balance between savings and investment, and microeconomic structural conditions.

Examination of the **apparent interest rate**, which relates financial charges to balance–sheet debt (bearing in mind, however, that the debt at the balance–sheet date may

GRAPH 7 : **Apparent rate of interest – Manufacturing industry**



Source : BACH

TABLE 8 : **Ratio of financial charges to gross profit**

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	51.6	42.6	32.7	37.0	31.6	23.3	17.5	17.1	20.5	21.4	27.6	25.5
Belgium	45.1	37.4	34.7	34.3	30.0	25.1	21.6	27.7	34.5	40.8	45.4	48.9
Germany	31.0	23.2	22.4	20.0	19.4	17.6	17.5	19.5	21.4	27.6	34.7	–
Spain	82.9	85.1	65.4	59.0	44.8	37.5	26.8	28.3	39.6	53.5	73.5	134.6
France	48.8	45.0	45.2	38.5	29.8	24.8	20.1	20.8	26.0	25.5	29.0	30.3
Italy	69.0	62.7	51.3	46.1	35.0	30.3	30.8	35.3	42.5	47.5	58.0	–
Netherlands	40.9	28.9	23.4	21.0	19.3	17.1	15.6	18.6	26.0	29.4	33.9	35.1
Portugal	–	–	–	71.4	65.5	49.7	43.0	40.0	47.8	55.8	63.1	–
United Kingdom	22.8	16.7	16.4	16.4	14.5	12.6	12.2	17.2	20.8	20.5	20.0	–
EUR–8 [1]	44.4	38.3	34.3	31.2	25.9	22.3	20.5	23.3	28.2	32.2	38.7	–
United States	–	–	–	–	4.0	2.4	2.6	5.5	9.3	15.5	34.7	18.2
Japan	41.3	39.8	34.4	34.9	37.5	30.7	25.7	27.6	31.0	34.7	35.2	35.9

[1] EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

differ widely from average debt over the financial year), confirms the previous conclusions. Compared with their Japanese competitors, European enterprises pay a higher apparent interest rate (higher by almost 3 percentage points in 1992).

Since 1988 enterprises have had to allocate a growing proportion of their gross trading result (or gross profit) to the remuneration of borrowed capital.

The last decade divides into two diametrically opposed phases: from 1982 to 1988 this proportion fell from 44.4% to 20.5%; after 1988 it rose continually to 38.7% last year. The trend is similar in the United States and Japan. The dispersion between European countries is again very high, ranging from 73.5% in Spain to 29% in France in 1992.

3. FINANCIAL STRUCTURES OF EUROPEAN ENTERPRISES

3.1. Analysis of indebtedness

By analysing the indebtedness of enterprises it is possible to identify the choices made by them in financing their activities. In very simple terms, an enterprise has two major sources of finance: first, its own funds, which it builds up by calling on shareholders or through self–financing (allocating profits to reserves) and, second, funds it obtains from external lenders, essentially banks but also bond markets.

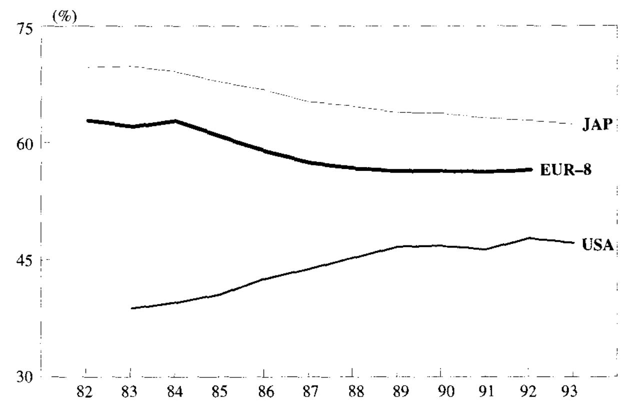
Analysing an enterprise's financing structure thus provides valuable pointers not only to the reasons for the level of its performance, but also to its degree of dependence on external lenders. The concept of debt used here is the overall indebtedness ratio, which reflects the proportion of debt in the balance sheet. All debt is taken into consideration, i.e. not only bank debt, which accounts for the bulk of total debt, but also bond issues, commercial, tax and social security debts, any intra–group debt, etc.

In general, enterprises in Europe and Japan have structurally higher levels of debt than those in the United States, where capital markets are traditionally a much more important source of finance and where there is far less recourse to inter–company loans. The United Kingdom is similar to the United States in this respect.

Nonetheless, the overall ratio of indebtedness of European enterprises fell from 1983 to 1989 in parallel with that of Japanese firms, whereas US enterprises saw an appreciable increase in their debt ratios over the same period (from 38.9% in 1983 to 46.7% in 1989), which thus moved much closer to European levels.

Over the period 1982 to 1987, the overall debt ratios of enterprises moved downwards in all the European countries, at a faster rate in the countries where they were highest (France, Spain and Portugal) than elsewhere (Germany, the United Kingdom and the Netherlands). However, in the first three years of this period, France was unusual in having an opposite trend: French enterprises' ratio of indebtedness, already the highest in 1982, continued to rise and peaked at 77.7% in 1984.

GRAPH 8 : **Overall indebtedness ratio – Manufacturing industry**

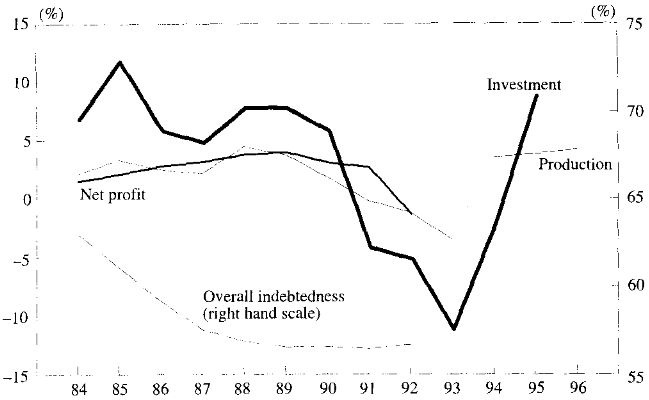


Source : BACH

After 1987, the move to reduce debt stalled in some countries (Belgium, Germany) and there was even a slight increase in debt in others (United Kingdom, Netherlands, Italy); the process of reducing debt continued up to 1992 in France and in Portugal and up to 1991 in Spain (followed by an appreciable rise of 3.1 percentage points in 1992). In 1992 the spread between the lowest and highest overall indebtedness ratios narrowed (17.6 percentage points as compared with 25.5 percentage points in 1982). Thus, since 1982, European enterprises have made substantial progress overall in consolidating their financial structures: by reducing the proportion of debt in their financing, they have given a strong boost to equity capital. This change in balance–sheet structures reflects a radical improvement in the financial independence of firms, although the process has marked time since the cyclical downturn (stabilization of the overall debt ratio).

From 1990 there was a marked slowdown in activity in manufacturing industry and a decline in the volume of investment (1991–93 period). This caused net profits of European enterprises to fall sharply. Their capacity to build up reserves as an internal source of capital was thus diminished. The process of overall debt reduction, significant over the period from 1984 to 1989, came to a halt. A further consequence was a reduction in funding needs for the operating cycle and equipment. This development compensated for the effect of the fall in profitability on the level of overall indebtedness.

GRAPH 9 : **Indebtedness, activity and profit – Manufactruring industry**



Source : BACH, DG II.

3.2. Changes in the structure of debt

By studying the composition and nature of indebtedness by debt maturity, it is possible, in theory, to evaluate part of the financial constraints borne by enterprises. Long–term debt, traditionally more stable and less expensive, reflects the degree of confidence placed in them by the banking system. However, it is awkward to make international comparisons in this area because of the differences in behaviour and habits within each country (banking traditions, method of commercial financing, role played by real or personal guarantees, etc.). US enterprises continue to have a more stable debt structure, with a ratio consistently more than some 30 percentage points above the European average over the period 1989–92; this is all the more remarkable in that their overall indebtedness ratio has remained some 7 percentage points below the European average for the last four years.

Over the eleven years from 1982 to 1992, the average general trend reflects an increase in the long–term debt of European enterprises expressed as a proportion of total indebtedness (ratio up from 29.3% to 31.1%). This general picture conceals a number of differences and contrasting developments within the eight European countries studied. Italy and Spain rely more heavily than average on short–term debt for their financing. In Italy this reliance has even increased since 1986, while Spain made up a slight amount of leeway in 1992. France, which had a high proportion of short–term debt in 1982, had, by the end of the period and following a series of marked fluctuations, become one of the four countries in the European sample (United Kingdom, the Netherlands, Belgium and France) that have greatest recourse to medium– or long–term borrowing (33.9%).

Throughout the ten years from 1982 to 1992, the trend in financial charges borne by European enterprises closely correlated (coefficient of 0.84) that of both short–term and long–term interest rates. Any one percentage point movement in interest rates was reflected in an approximate 0.5 percentage point change in financial charges in relation to turnover. The high share of short–term debt in the overall indebtedness of European enterprises (70.7% on average over the period from 1982 to 1992) makes them more sensitive to changes in short–term interest rates. Over the period from 1989 to 1992, the inversion of the interest–rate curve showed up in financial charges; as a proportion of gross profits they rose from 23.3% in 1989 to 38.7% in 1992. From 1994, the decline in short–term interest rates should directly benefit the profitability of European enterprises.

Conclusion regarding structures

European enterprises steadily shed debt between 1982 (overall indebtedness ratio of 63.2%) and 1989 (overall indebtedness ratio of 56.6%) despite a sharp fall in profits (loss of 2.7 percentage points net profit and 10 percentage points financial profitability over the period). The situation

TABLE 9 : **Overall indebtedness ratio**

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	66.6	64.8	61.9	62.5	60.2	57.7	56.6	55.4	54.7	51.7	48.9	48.1
Belgium	66.4	63.7	62.0	59.1	57.2	56.7	57.7	57.6	57.5	58.5	59.2	58.5
Germany	55.9	54.8	53.4	52.2	50.4	49.0	49.1	50.1	50.0	50.4	50.0	–
Spain	68.3	68.8	64.9	61.9	60.2	56.4	52.9	50.6	52.7	55.9	59.0	62.3
France	70.3	71.0	77.7	73.6	71.0	67.5	64.4	62.0	61.8	60.1	58.5	58.0
Italy	69.0	66.7	67.5	66.1	64.7	65.0	66.1	66.3	65.9	65.1	66.5	–
Netherlands	51.5	51.1	49.2	49.4	47.7	47.1	47.4	48.2	49.4	49.5	50.2	50.6
Portugal	–	–	–	72.3	67.0	64.7	59.3	56.9	51.1	53.6	52.7	–
United Kingdom	–	–	–	–	–	–	–	–	–	–	–	–
EUR–8 (1)	63.2	62.4	63.0	61.1	59.2	57.6	56.9	56.6	56.6	56.5	56.7	–
United States	–	38.9	39.6	40.7	42.6	43.9	45.3	46.7	46.9	46.4	47.8	47.2
Japan	69.7	69.9	69.1	67.8	66.8	65.3	64.7	63.9	63.7	63.2	62.8	62.3

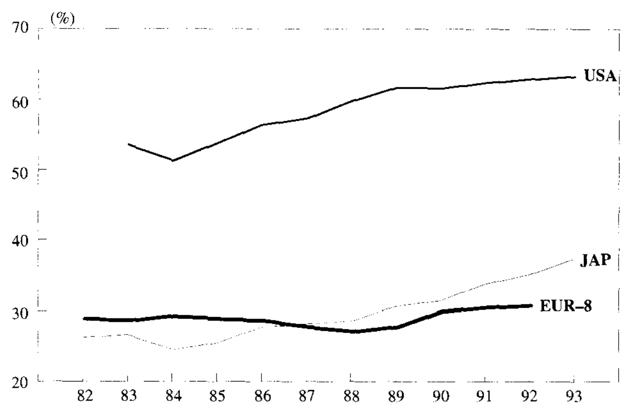
(1) EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

TABLE 10 : **Debt structure**

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Austria	31.5	33.9	32.2	32.1	34.4	30.6	29.8	29.4	28.5	28.1	29.2	29.2
Belgium	28.5	25.3	23.8	22.8	25.4	28.7	29.1	29.7	–33.2	33.6	34.4	35.5
Germany	29.6	30.1	29.2	29.3	30.0	28.8	28.5	27.1	26.3	25.6	25.5	–
Spain	33.2	30.5	29.8	29.0	27.9	25.9	25.6	22.9	21.6	23.1	25.1	25.1
France	26.8	28.4	34.5	33.7	32.2	30.7	29.3	30.9	32.8	33.5	33.9	34.1
Italy	23.7	22.96	20.1	20.1	17.7	17.6	16.7	16.1	16.7	17.1	17.1	–
Netherlands	34.7	35.5	33.2	30.9	32.5	34.2	34.9	32.8	38.0	36.8	36.0	37.5
Portugal	–	–	–	33.1	35.6	38.3	35.9	33.3	34.4	33.4	31.4	–
United Kingdom	34.8	32.9	35.6	34.8	36.0	33.1	32.5	39.8	50.1	53.0	53.8	–
EUR-8 [1]	29.3	29.0	29.6	29.2	29.0	28.0	27.4	28.1	30.3	30.8	31.1	–
United States	–	53.6	51.4	53.9	56.4	57.4	59.9	61.8	61.7	62.5	63.0	63.4
Japan	26.3	26.6	24.5	25.5	27.7	28.2	28.6	30.7	31.5	33.8	35.1	37.3

[1] EUR–8 is made up of B, D, E, F, I, NL, P and UK.
Source : BACH.

GRAPH 10 : **Debt structure – Manufacturing industry**



Source : BACH

in 1989 was then maintained until 1992 (overall indebtedness ratio of 56.7%), largely as a result of the decline in activity and fall in the volume of investment. From 1995, the upturn in activity (manufacturing output forecast to rise by 3.8%) and investment (forecast growth of 9% in volume terms) will impose increased funding needs on European enterprises. The continuation of high real long–term interest rates (forecast to be 5.7% in 1995 and 5.4% in 1996) is unlikely to alter European enterprises' preference for reducing debt. Will self–financing be sufficient to finance the recovery?

4. THE SITUATION OF EUROPEAN SMEs

This section compares the financial situation of SMEs with that of large enterprises in manufacturing industry. Performances (section 1), charges (section 2) and financial structure (section 3) are covered in turn.

However, not all the national data necessary for comparing the situation of SMEs with that of large enterprises are available. Only six countries provide comparisons by size of enterprise: Belgium, Spain, France, Italy, the Netherlands and Portugal. The analyses set out here are therefore not representative of all countries available in BACH. The figures for SMEs and large enterprises given here are a weighted average of the EUR 6 countries for which this comparison is available. The share of each of these countries in the six countries' total manufacturing output is used here.

4.1. Performances of European SMEs

4.1.1. Overall gross profit ratio

Over the period 1984 to 1992, the overall gross profit ratio of European SMEs was more stable than that of large enterprises. The maximum deviation from average was limited to 0.8 of a percentage point, compared with 1.6 percentage points for large enterprises. Over the period from 1984 to 1990 the gross profit ratios of European SMEs were consistently below those of large enterprises.

TABLE 11 : **Overall gross profit ratio – (industry)**

	84	85	86	87	88	89	90	91	92
SMEs	10.1	10.4	11.3	11.7	11.8	11.8	11.8	11.4	11.3
Large enterprises	11.8	12.1	13.1	13.3	14.0	14.2	12.8	12.0	11.1
Output	2.0	3.3	2.4	2.1	4.4	3.7	1.8	–0.2	–1.2

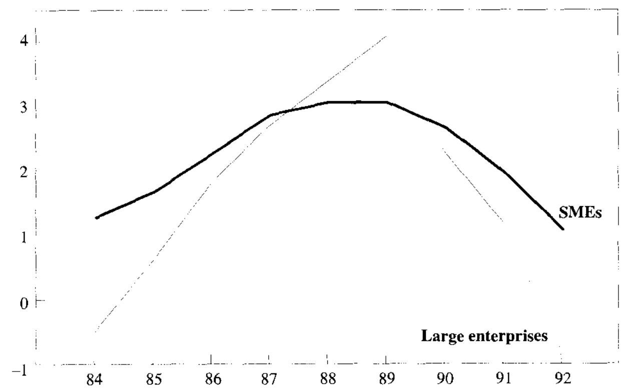
Sources : – BACH.
– Eurostat, DG II.

During periods in which economic activity is growing SMEs fail to improve their performances at the same pace as large enterprises. In periods of recession the gap tends to narrow. In 1992 the gross profit ratio of SMEs exceeded that of large enterprises by 0.2 of a percentage point. SMEs therefore appear to be more resistant to economic recession than large enterprises.

4.1.2. Net profit ratio

The relative trends of European SMEs' net profit ratios with those of large enterprises are more uneven than those of gross profit ratios. From 1984 to 1987 the net performance of SMEs was better than that of large enterprises and – a point to note – SMEs recorded no negative ratio, unlike large enterprises (–0.5% in 1984).

GRAPH 11 : **Net profit ratio– Manufacturing industry**



Source : BACH

By contrast, in 1988 and 1989, years in which industrial output grew strongly, the net profit ratio of large enterprises exceeded that of SMEs. Finally, the general fall from 1990 in the net profit ratios of European enterprises was less pronounced in the case of SMEs. Their net profit ratio again exceeded that of large enterprises.

4.1.3. Financial profitability

TABLE 12 : **Financial profitability**

	84	85	86	87	88	89	90	91	92
SMEs	5.9	7.6	10.1	11.6	12.4	11.9	9.7	6.7	3.7
Large enterprises	–5.0	2.1	6.1	9.5	10.8	12.5	6.7	2.9	–3.4

Source : BACH.

Over the period 1984 to 1992, European SMEs' financial performance was much better than that of large enterprises. The financial profitability of large enterprises exceeded that of European SMEs only once, in 1989.

The financial profitability ratios of European SMEs and large enterprises show rather uneven trends. Large enterprises recorded negative performances in 1984 and 1992. This never happened in the case of SMEs over the same period. From 1986 a quite marked convergence was noted, both in the common trend towards an improvement in the financial profitability ratio and in the levels achieved: 12.4% in 1989 for SMEs compared with 10.8% for large enterprises. In 1989 both categories showed a fall, although this was clearly less pronounced in the case of SMEs, whose position in niche markets is more favourable at times when economic activity is slowing or contracting. In 1992 SMEs established a considerable lead of 7.1 percentage points.

4.2. Charges borne by European small and medium–sized enterprises

4.2.1. Purchases as a proportion of turnover

TABLE 13 : **Purchases as a proportion of charges borne by enterprises**

Purchases/ turnover	84	85	86	87	88	89	90	91	92
SMEs	71.2	71.0	69.6	69.2	69.8	70.6	69.7	69.1	68.7
Large enterprises	68.5	68.8	66.9	66.8	67.1	68.7	69.2	69.2	69.4

Source : BACH.

Between 1984 and 1990 SMEs consistently recorded higher purchases as a proportion of turnover than large European enterprises. From 1990 the gap reversed in favour of SMEs (–0.7 of a percentage point in 1992). Faced with the same trends in raw material prices and other operating charges, European SMEs seem to have managed to reorganize their production. Following a movement favourable to SMEs, purchases as a proportion of turnover showed a distinctly convergent trend between SMEs and large enterprises from 1990.

4.2.2. Staff costs

TABLE 14 : **Staff costs**

	84	85	86	87	88	89	90	91	92
SMEs	19.1	18.8	18.9	19.2	18.7	18.5	19.1	19.8	20.3
Large enterprises	21.7	21.1	21.1	20.8	19.9	19.2	19.7	20.3	20.4

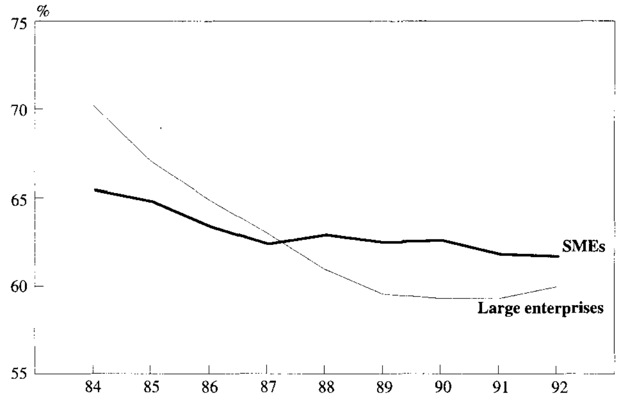
Source : BACH.

Over the period from 1984 to 1992, European SMEs experienced an increase in their staff costs in relative terms from 19.1% to 20.3%, whereas the ratio for large enterprises fell from 21.7% to 20.4%. This partly reflects a sharp reduction in the workforces of large enterprises over that period.

4.3. Financial structures

4.3.1. Indebtedness

GRAPH 12 : **Overall indebtedness – Manufacturing industry**



Source : BACH

The overall indebtedness of European SMEs gradually fell between 1984 (65.5%) and 1992 (61.8%). However, the general debt–shedding process between 1984 and 1991 was less pronounced in the case of SMEs than in that of large enterprises. Having carried appreciably less debt than large enterprises from 1984 (–4.7 percentage points) to 1987 (–0.5 of a percentage point), SMEs have borrowed more since 1988. In 1992, the debt ratio of SMEs stood at a level (61.8%) similar to that of large enterprises (60%).

4.3.2. Structure of debt

The overall indebtedness of SMEs is geared more towards short–term debt (in 1992, 75.7% of their debt was short–term, compared with 72% for large enterprises). However, the tendency for the proportion of medium– and long–term debt to increase was maintained from 1984 (21.5%) to 1992 (24.3%), whereas large enterprises experienced a reverse trend over the same period (30% in 1984, 28% in 1992). Carrying more debt, particularly short–term debt, SMEs were consistently required to pay a higher apparent rate of interest over the period from 1984 to 1992. The year 1992, however, saw a quite strong convergence of rates (gap limited to 0.8 of a percentage point).

TABLE 15 : **Debt structure**

Structure	84	85	86	87	88	89	90	91	92
SMEs	21.5	21.4	22.3	22.5	22.7	22.4	23.4	23.8	24.3
Large enterprises	30.0	29.7	27.6	27.1	25.9	25.8	27.1	27.7	28.0

Source : BACH.

Box 2

DEFINITIONS OF RATIOS USED

(letters and numbers correspond to the Bach nomenclature)

1	**OVERALL GROSS PROFIT RATIO:** Ratio of net profit or loss +tax on profits + financial charges + depreciation and provisions to turnover exclusive of tax	7+13+14+21/1
2	**NET PROFIT RATIO:** Ratio of net profit or loss for the year to turnover exclusive of tax	21/1
3	**FINANCIAL PROFITABILITY:** Ratio of profit or loss for the financial year to equity capital	21/L–A
4	**RELATIVE SHARE OF PURCHASES:** Ratio of purchases to turnover exclusive of tax	5/1
5	**RELATIVE SHARE OF STAFF COSTS:** Ratio of staff costs to turnover exclusive of tax	6/1
6	**RELATIVE SHARE OF FINANCIAL CHARGES:** Ratio of financial charges to turnover exclusive of tax	13/1
7	**APPARENT RATE OF INTEREST:** Ratio of financial charges to debt owed to short–term credit institutions + other short–term debt + long–term debt (more than one year)	13/I+F02+F08
8	**FINANCIAL CHARGES AS A PROPORTION OF GROSS TRADING RESULT:** Ratio of financial charges to gross trading result	13/V+7
9	**OVERALL INDEBTEDNESS RATIO:** Ratio of short–term debt +long–term debt (more than one year) to balance–sheet total	F+I/XX
10	**DEBT STRUCTURE:** Ratio of long–term debt to long–term debt (more than one year) + short–term debt	I/I+F

Principal economic policy measures – December 1994

Community (EUR-12)
5.12 EcoFin Council approves the Annual Council Report on the Implementation of the Broad Economic Policy Guidelines.
5.12 EcoFin Council approves the new convergence programme of the Netherlands.
9–10.12 Essen European Council establishes a set of guidelines to consolidate growth, improve EC competitiveness and create more jobs.
13.12 Commission approves Annual Economic Report for 1995.

Belgium (B)
None.

Denmark (DK)
13.12 The Minister for Economic Affairs declares that schemes for temporary withdrawal from the labour market should be financed by employers and unions and not by the government. A number of minor measures will be taken immediately, allowing persons opting for such schemes to withdraw savings from private pension funds so as to supplement government grants.
13.12 The government plans increased "green" taxes on trade, industry and agriculture. The main taxes will be those on CO_2, SO_2, pesticides, waste water, solvents and cadmium. They will bring in some DKR 7 billion a year when fully introduced in 1998. The yield will be transferred back to business by means of grants, lower income taxes, lower company taxes and improved opportunities for depreciation of investments.

Germany (D)
None.

Greece (GR)
1.12 The central government incomes policy for 1995 provides for nominal wage increases of 3% on 1 January and 1 July 1995.
28.12 The 1995 budget forecasts a central government deficit of 9.8% of GDP, down from 12% of GDP in 1994. The primary surplus is projected at 3.4% of GDP in 1995, up from 2% of GDP in 1994.

Spain (E)
20.12 A three–year wage agreement between local authorities and unions ensures that local civil servants' wages will grow in line with predicted inflation in 1995–97.

France (F)
None.

Ireland (IRL)
None.

Italy (I)
20.12 The budget law for 1995 is approved by Parliament. It aims for a government sector deficit of LIT 138 trillion, or 8.0% of GDP, to be achieved through a fiscal package amounting to LIT 48 trillion, or 2.8% of GDP.

Luxembourg (L)
None.

Netherlands (NL)
None.

Portugal (P)
None.

United Kingdom (UK)
7.12 The Bank of England raises its base rate by ½ % to 6.25%.

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