EUROPEAN ECONOMY

EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

Supplement A
Economic trends
No 4 – April 1996

In this number :
Financial situation of industrial enterprises

Summary and main points in brief

I. The financial performances of European enterprises improved markedly in 1994 but are still below the levels achieved in 1989

The financial performances of European industrial enterprises showed a clear improvement at the end of 1994: the ratio of gross profit to turnover was up by 1.2 percentage points and that of net profit to turnover by 1.8 percentage points. This improvement went a long way towards offsetting the deterioration recorded between 1989 and 1993, even though at the end of 1994 performances were still below the 1989 level (1 percentage point less for the gross profit ratio). US enterprises improved their financial performances more than European enterprises. Furthermore, the financial profitability of European enterprises is still lower than nominal long–term interest rates in the public sector, unlike in the United States. This situation has an impact on the choices made by investors between shares and bonds. The excellent performances of Wall Street are an illustration of this.

The financial structures of European enterprises improved in 1994: the proportion of own funds and provisions in the balance–sheet total increased, while that of debt fell. The improvement in financial structures is comparable in the United States and Europe, and the proportion of own funds in balance–sheet totals is now similar in Europe, the United States and Japan.

II. The improvement in financial performances has been brought about by the upturn in economic activity and boosted by wage moderation and the reduction in the burden of financial charges

The improvement in the performance of European enterprises in 1994 was made possible by the upturn in economic activity. However, in a climate of keen competitive pressures, the price increases introduced by enterprises remained moderate, and the improved performance of European enterprises in 1994 was due mainly to the fall in wage costs in relation to turnover (–1.5 percentage points) and the significant reduction in financial charges as a proportion of turnover (–0.7 of a percentage point).

Financial charges thus stood at only 30% of the gross profits of enterprises in 1994 (compared with 47.6% in 1993). The fall in short–term interest rates was one of the main reasons for this favourable trend since short–term debt accounts for the bulk (76.6%) of the total debt of enterprises.

In 1996, the declining trend fall in short–term interest rates could benefit European enterprises by reducing their financial charges. It could also prompt large enterprises to abandon short–term financial investments – now less remunerative – in favour of real investment. This presupposes, however, that the outlook for demand improves in mid–1996 and that the trend of long–term rates is favourable. The upward trend in long–term interest rates between 1993 and 1995 had the effect of inhibiting investment decisions.

III. The improvement in the performance of SMEs was not so great in 1994. The differences between SMEs and large enterprises are taking time to narrow

In 1994 the gross profits of European SMEs improved less than those of large enterprises (by 0.8 of a percentage point compared with 1.5 percentage points). Their wage costs fell less because their workforces are less exposed to the restructuring carried out by large enterprises. The net profits of European SMEs also improved less than those of large enterprises. SMEs paid out more in financial interest. They also received less financial income.

European SMEs were in general markedly more indebted than large enterprises between 1987 and 1994 (58% for SMEs compared with 50% for large enterprises). They do not benefit from the substantial provisions for liabilities and charges through which large enterprises finance themselves to a large extent (16.4% of the balance–sheet total for large enterprises, compared with 8% for SMEs).

SMEs and large enterprises react differently to the changes in the economic cycle. In periods of economic recession or slowdown, SMEs seem to cope better than large enterprises from the viewpoint of profitability, although they are quicker to go under. When economic activity is expanding, however, SMEs are unable to improve their performance at the same pace as large enterprises.

SMEs in the United States seem to be in a more favourable position than European SMEs. From 1984 to 1994 (apart from 1987), the financial profitability of US SMEs was markedly greater than that of European SMEs. The share of own funds in the balance sheets of US SMEs is noticeably higher than that of European SMEs, and their overall debt ratio is lower.

IV. The differences between European countries are considerable but less marked in the case of large enterprises

At the end of 1994, some countries – Germany, Austria, the Netherlands, Belgium and France – were virtually back to their 1989 performance levels. Other countries were below the levels reached in 1989 (the United Kingdom) or very much below (Spain, Italy and Portugal). There seems to be less of a difference in the financial structures of European enterprises than in their performances. The proportion of debt in the balance–sheet total is roughly comparable in the different countries, except for Italy where the proportion is higher (substantial credit between enterprises) and for Germany where it is lower (substantial provisions for liabilities and charges).

Generally speaking, large enterprises from different countries resemble each other more than SMEs and large enterprises from the same country and the same sector. This similarity stems from the integration of markets and competitive pressure, which take no account of specific national characteristics. There is an exception, however, in the case of very large German enterprises, whose overall debt ratio is significantly lower than that of their European counterparts because of their provisions for liabilities and charges (including provisions for pension funds).

INTRODUCTION

This supplement to European Economy provides, on the basis of financial information on the situation of enterprises (see Box on BACH), an annual **comparison of the profit or loss and financial structures of enterprises in manufacturing industry[1] in the EC Member States, the United States and Japan.** This third issue looks in detail at changes in the performance of enterprises (gross profit, net profit, financial profitability), their charges (intermediate consumption, value added, staff costs, financial charges) and their financial structure (own capital ratio, overall debt ratio, structure of debt, provision ratio). The fourth section examines the situation of European small and medium-sized enterprises.

[1] Including the oil industry for Germany.

Box 1

BUSINESS ACCOUNTS HARMONIZED DATA BANK (BACH)

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. Drawing on that data bank, this study sets out to compare the trends in the costs, profit or loss, and financial structures of enterprises in manufacturing industry in the Member States, the United States and Japan.

To that end, it contacted the national bodies responsible for centralizing balance–sheet data, which supplied it with aggregated sectoral information. The Commission has 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 that was consistent with the Fourth European Accounting 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. The BACH accounting layout was revised in 1995.

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 work of the Comité Européen des Centrales de Bilans enables steady progress to be made in the harmonization of data and their level of detail.

The sectoral nomenclature has also been standardized in accordance with the NACE nomenclature, and comprises 22 sectors or subsectors.

At present the data bank covers twelve countries. For industry, the degree to which the files are representative is the following:

Country	Source	Number of enterprises	Coverage (%)	Years available
Germany	Deutsche Bundesbank	11000	54 % of turnover	1989–1994
Austria	Oesterreichische Nationalbank	1309	59% of turnover	1984–1994
Belgium	Banque Nationale de Belgium	19238	99.6% of employees – exhaustive file	1984–1994
Spain	Banco de España	small : 5387 medium : 1338 large : 434	14% of turnover 19% of turnover 67% of turnover	1984–1994
Finland	Statistics Finland	7.070	59.1 of employees	1989–1994
France	Banque de France	26860	64.6% of employees	1984–1994
Italy	Centrale dei Bilanci	19576 (the BACH file is a sub–set of this file)	45% of value added	1984–1994
The Netherlands	Central Bureau Voor de Statistiek[2]	1324	statistically representative of total activity	1984–1994
Portugal	Banco de Portugal	6829	60% of corresponding GDP (current prices)	1984–1994
United Kingdom	Dable DG III[2]	873	65% of GDP	1984–1994
Japan	Ministry of Finance	n.s.	100 % of national employment by extrapolation	1984–1994
United States	Bureau of the Census	15.079	100 % of national employment by extrapolation	1984–1994

The "EUROPE" row in the tables, specifically calculated for the purposes of this study, has been obtained by taking the average for the ten European countries weighted by each country's relative weight in industrial manufacturing output. The industrial manufacturing output of these ten countries represents a high proportion (93.3%) of industrial manufacturing output in the European Union of Fifteen.

In most of the countries the 1994 data are provisional.

[2] Consolidated accounts, therefore domestic activity of the companies not distinguished from foreign activities.

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.

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 (overall gross profit in relation to turnover)
- Net profit ratio (net profit in relation to turnover)
- Financial profitability (net profit in relation to own funds)

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

The gross profit ratio examined here is the overall ratio. It consists of the gross operating surplus (balance on the ordinary activities of the enterprise), financial income and the extraordinary profit or loss (balance on the extraordinary activities of the enterprise).

The overall gross profit enables the enterprise to create the necessary provisions, to meet its financial charges and to pay tax on the results.

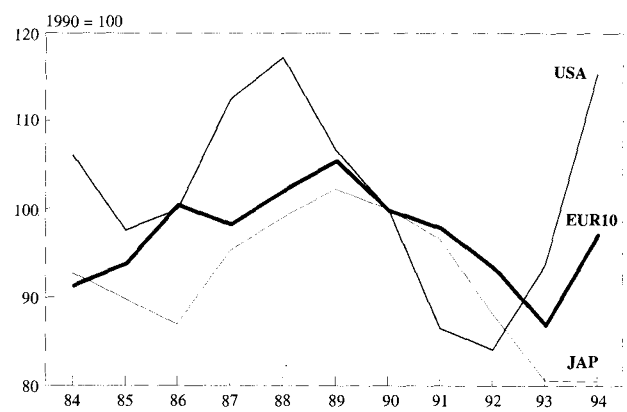
In 1994 the overall gross profit ratio of European enterprises picked up markedly, increasing from 10.6% to 11.8% (+1.2 percentage points), though the improvement was smaller than that observed in the United States. The overall gross profit ratio of US enterprises went up from 9.4% in 1993 to 11.6% in 1994, an increase of 2.2 percentage points. However, Japanese enterprises did not improve their overall gross profit ratio in 1994: at 9% it was the same as in 1993.

The recovery in the overall gross profit ratio in Europe and the United States in 1994 was mainly due to the significant improvement in economic activity in manufacturing industry. In 1994 the volume of industrial production increased by 5.1% in Europe compared with 5.4% in the United States and only 1.2% in Japan. In Europe the level of capacity utilization reached 79.7% (+2.1 percentage points) in 1994. The increase in volumes produced permits a better distribution of the operating charges of enterprises when production capacity is not saturated. Enterprises can then improve their gross operating margin (gross operating surplus), the main item in the overall gross profit ratio. In 1995, the pace at which industrial activity was increasing slowed down in Europe and this trend is likely to continue in 1996. If the trends observed continue, the overall gross profit ratio of European enterprises should start coming down.

The improvement in the overall gross profit ratio of European enterprises also stems from the relative fall in the weight of staff costs (–1.5 percentage points on average between 1993 and 1994). However, real earnings in Europe have been increasing at a faster rate since 1994, making a smaller contribution to the improvement in the overall gross profit ratio in 1995 and 1996. In the United States the adverse effect of the slowdown in industrial production could be offset by a slowdown in earnings. In Japan, the pace at which industrial activity has been increasing has been accelerating since 1995. The rate of increase of real earnings in Japan is moderating. Therefore, over the period 1995–97, Japanese enterprises are likely to experience a significant increase in their overall gross profit ratio.

Within Europe the improvement seen in 1994 occurred in all countries. The most significant increases were achieved by Spain (+3.8 percentage points), the Netherlands (+3.2 percentage points) and to a lesser extent Austria (+2.2 percentage points). The rate of increase in the overall gross profit ratio was the same in France and Germany (+1.1 percentage point). The smallest increases were to be seen in Italy and the United Kingdom (+0.7 point), which is all the more surprising given that those countries' enterprises experienced a currency depreciation in that year.

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



Source : DGII, BACH.

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

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	9.9	10.5	10.5	10.5	10.4	10.0	9.0	10.1	1.1
Austria	8.0	7.4	9.4	9.7	10.8	10.9	10.3	11.3	10.6	8.9	11.1	2.2
Belgium	10.0	10.0	11.5	11.6	12.1	13.8	12.7	12.2	12.2	12.3	13.8	1.5
Spain	11.4	11.8	12.7	13.3	14.4	14.1	12.2	11.2	8.7	5.8	9.6	3.8
Finland	–	–	–	–	–	20.9	15.2	15.4	15.5	15.3	16.7	1.4
France	9.8	11.5	11.9	12.9	13.3	12.9	12.4	12.1	11.6	11.1	12.2	1.1
Italy	12.5	12.1	12.7	12.3	11.9	12.1	11.6	11.1	11.0	9.9	10.6	0.8
Netherlands	8.5	7.5	8.3	9.6	10.8	13.1	11.9	13.4	12.9	12.4	15.6	3.2
Portugal	–	14.8	16.4	17.7	17.1	16.9	16.5	16.5	14.8	15.1	–	–
United Kingdom	12.3	12.3	13.3	14.4	15.4	16.2	15.1	14.8	14.0	14.3	15.0	0.7
EUR10	11.1	11.4	12.2	12.0	12.4	12.8	12.2	11.9	11.4	10.6	11.8	1.2
Japan	10.3	10.0	9.7	10.6	11.0	11.4	11.1	10.8	9.8	9.0	9.0	0.0
United States	10.6	9.8	10.0	11.3	11.8	10.7	10.0	8.7	8.4	9.4	11.6	2.2

Between 1984 and 1989 European enterprises saw their overall gross profit ratios rise appreciably from 11.1% to 12.8%, giving a 1.7 percentage point increase over five years. That increase was particularly marked in certain countries (the Netherlands +4.6%, Belgium +3.8% and the United Kingdom +3.9%). The increase was also significant in France (+3.1%) and Spain (+2.7%). However, in Italy the overall gross profit ratio fell by 0.4 of a point between 1984 and 1989. A point of convergence was reached in 1990 with seven countries then less than two percentage points from the European average. The trend was reversed from 1989, and in four years (1989–93) Europe lost the gains made over the preceding five years (1984–89). In 1993 the European average for the overall gross profit ratio (10.6%) was lower than in 1984 (11.1%).

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 enterprises in European manufacturing industry rose sharply over the period from 1984 to 1989[3](31% in volume terms over the period), the annual rate of growth at constant prices fell steadily from 1989 to 1993 (10.2% in 1989, 5.4% in 1990, 3.5% in 1991, 0.5% in 1992 and –4% in 1993). By 1993 industry had returned to a turnover level that was comparable in volume terms to that recorded in 1990. This reduction in turnover of course brought about an appreciable fall in the level of utilization of production capacity, which fell 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)

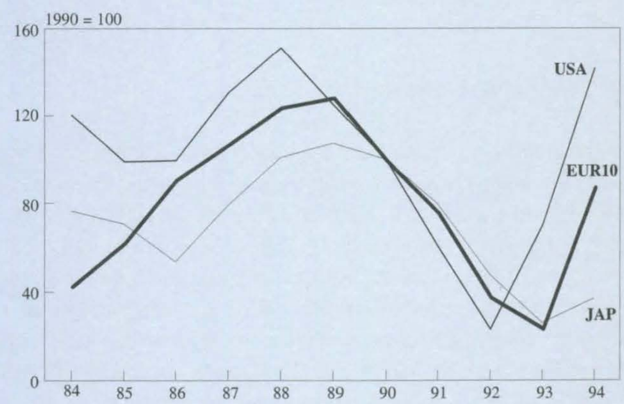
The net profit corresponds to the final profit or loss for the financial year (as a percentage of turnover). It is calculated by deducting sums set aside for provisions (value adjustments in respect of financial and non–financial assets), financial charges and the tax on the result from the gross profit ratio. 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 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.

In 1994 there was a very marked pick–up in the net profit ratio of European enterprises, which increased from 0.7% to 2.5% (+ 1.8 percentage points). This improvement was, however, smaller than that seen in the United States. The net profit ratio of US enterprises rose from 2.6% in 1993 to 5.3% in 1994, an increase of 2.7 percentage points. However, Japanese enterprises improved their net profit ratio by only 0.2 of a percentage point (1993 0.6%, 1994 0.8%) in 1994. The increase in the net profit ratio in 1994 in Europe and the United States, like that of the overall gross profit ratio, can be explained by the significant improvement in economic activity in manufacturing industry.

The recovery in the net profit ratio in 1994 in Europe and the United States is, however, greater than that of the overall gross profit ratio. **This difference is mainly due[4] to the significant reduction in financial charges borne by enterprises.** In 1994, the share of financial charges fell by 0.7 of a percentage point in Europe and 1.3 points in the United States (0.2 of a percentage point in Japan). In Europe the decline in the share of financial charges in 1994 was greatly assisted by the fall in short–term interest rates which began at the end of 1992 (1992 11.2%, 1993 8.5%, 1994 6.5%).[5] In 1995, short–term interest rates stabilized in Europe at 6.6%, so that the share of financial charges was unable to fall further. A fresh improvement in the net profit ratio of enterprises in 1996 does not therefore seem possible against the foreseeable background of a slowdown in the growth of industrial activity in Europe.

In Europe 1994's improvement in the net profit ratio occurred in all countries. The most significant increases were achieved by Spain (net profit ratio +6.1 percentage points, share of financial charges –2.2 percentage points) and Finland (net profit ratio +3.3 percentage points, share of financial charges –3.1 percentage points). Thanks to taxes declining as a share of results (–0.2 of a point), Austria improved its net profit ratio

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



Source : DGII, BACH.

[3] Source VISA.

[4] Sums set aside for provisions have remained particularly stable. The share of tax in the result has fallen slightly.

[5] Long–term interest rates were edging up in Europe in 1994 (1993 8%, 1994 8.2%).

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

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	1.7	2.0	2.0	1.8	1.6	0.9	0.5	1.5	1.0
Austria	1.2	0.9	2.1	2.1	3.1	3.3	2.5	3.2	1.9	0.1	2.6	2.4
Belgium	1.7	1.8	2.2	2.1	2.5	4.0	2.5	1.4	1.0	0.5	2.8	2.4
Spain	–2.0	–0.2	1.3	3.0	4.6	4.7	2.3	0.0	–3.2	–5.8	0.3	6.1
Finland	–	–	–	–	–	1.1	2.7	1.4	0.6	1.4	4.7	3.3
France	–1.3	0.5	1.2	2.7	3.6	3.6	2.7	2.1	1.2	0.6	2.4	1.8
Italy	0.6	1.0	1.8	2.2	1.7	1.9	1.3	0.2	–1.5	–2.1	0.2	2.3
Netherlands	4.4	3.6	4.0	5.3	6.9	8.4	6.4	7.3	6.0	5.6	7.4	1.8
Portugal	–	–2.5	–0.6	2.7	2.8	3.4	3.2	1.4	–0.7	–1.0	–	–
United Kingdom	5.0	5.0	5.7	6.9	7.6	7.6	6.2	5.4	4.9	5.9	6.6	0.6
EUR10	1.2	1.8	2.6	3.1	3.5	3.7	2.8	2.2	1.1	0.7	2.5	1.8
Japan	1.7	1.5	1.2	1.7	2.2	2.3	2.2	1.7	1.0	0.6	0.8	0.2
United States	4.5	3.7	3.7	4.9	5.7	4.7	3.8	2.3	0.9	2.6	5.3	2.7

without the proportion of financial charges really falling (net profit ratio +2.4 percentage points, share of financial charges –0.3 of a point). In Belgium, the net profit ratio increased by 2.4 percentage points and the share of financial charges fell by 0.7 of a percentage point. The rate of increase in the net profit ratio was the same in France and the Netherlands (net profit ratio +1.8 points, share of financial charges –0.5 of a percentage point in each case). The smallest increases were found in Germany (net profit ratio +1 point, share of financial charges –0.1 of a point) and the United Kingdom (net profit ratio +0.6 of a point, proportion of financial charges –0.2 of a point).

From 1984 to 1989, European enterprises enjoyed spectacular improvement in their net profit ratios, which increased threefold (from 1.2% in 1984 to 3.7% in 1989). Two countries – Spain and France – even reversed a situation which was negative in 1984. In the case of Spain, the ratio remained negative until 1985 but then exceeded (4.7%) the European average (3.7%) in 1989. Germany maintained positive and relatively stable performances throughout the period. Its ratio stood at 2% in 1989, 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: seven countries were less than one point from the European average.

From 1989 to 1993 there was a continuous sharp decrease in the net profit ratio (from 3.7% in 1989 to 0.7% in 1993). In 1993 it reached its lowest level for ten years. In 1992 negative net profit ratios started to reappear in Spain (–3.2%), Italy (–1.5%) and Portugal (–0.7%), and worsened in 1993 (–5.8%, –2.1% and –1% respectively).

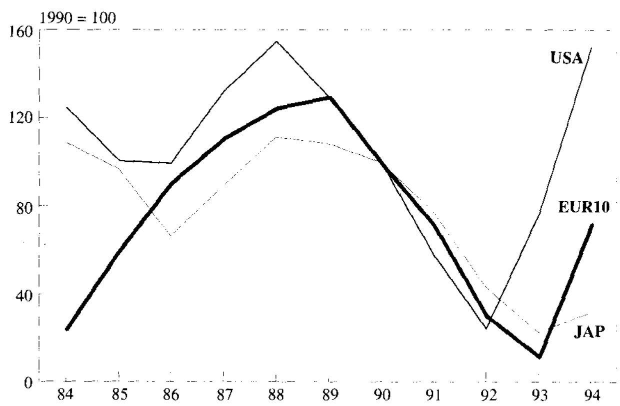
1.3. Financial profitability

Financial profitability is obtained by dividing the net profit or loss for the financial year by the own funds of the enterprise. It gives an indication of the profitability of the funds invested in the private sector for a majority shareholder.[6] The net result is then either distributed in the form of dividends (which provide a return on the funds invested by the shareholder) or allocated to reserves and incorporated in own funds (which provides an increase in value for the funds invested by the shareholder). This increase in value can be seen on stock markets[7] mainly in the medium term. The existence and development of stock markets dealing in equities therefore seem essential for the development of European enterprises. These markets enable shareholders to observe the increase in value in the funds they have invested and possibly to realize that increase. It is therefore possible for them not to insist that the profit of the enterprise be fully distributed. Undistributed results consequently increase the own funds of enterprises and therefore their capacity for borrowing and expansion.

In 1994, there was a marked pick-up in the financial profitability of European enterprises, which increased from 1.2% to 7.1% (+5.9 percentage points), i.e. about its average level for the last eleven years (7.3%). This improvement is, however, smaller than that seen in the United States. The financial profitability ratio of US enterprises rose from 7.9% in 1993 to 15.6% in 1994, an increase of 7.8 percentage points. However, Japanese enterprises improved their financial profitability ratio by only 0.7 of a point in 1994.

The improvement in the financial profitability of European enterprises is more spectacular (+5.9 percentage points) than the improvement in the overall gross profit ratio (+1.2 point) and in the net profit ratio (+1.8 point). This effect is largely due to the method of calculating the financial profitability ratio, since the net profit or loss has increased appreciably more than own funds.[8] The influence of the net profit ratio is therefore crucial for the movement of the financial profitability ratio.

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



Source : DGII, BACH.

[6] The minority shareholder is more interested in the dividend which will be distributed. As a provider of capital, he in theory requires his shares to yield at least as much as risk–free long–term investments on the market. All shareholders, even those with small holdings, may also be looking for a capital gain.

[7] It is still possible to dispose of shares outside the stock market. However, the conditions relating to valuation, transaction time and the security of transactions are often less advantageous.

[8] The numerator "net profit or loss" has increased very markedly (from 0.7 to 2.5, an annual increase of 257%). The denominator "own funds" has increased slightly (from 32.4 to 33.3, an annual increase of 2.7%).

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

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	8.0	9.6	9.9	9.0	7.9	4.3	2.0	6.1	4.1
Austria	8.3	6.6	12.9	10.9	16.4	16.8	11.8	13.0	6.8	0.5	8.8	8.3
Belgium	7.6	7.4	8.0	7.4	8.8	12.3	7.5	3.9	2.9	1.3	7.4	6.2
Spain	–6.3	–0.7	3.7	8.4	11.7	11.8	5.7	–0.1	–9.0	–17.8	0.8	18.6
Finland	–	–	–	–	–	4.5	8.5	3.9	1.4	3.4	10.3	7.0
France	–10.0	3.0	6.6	13.2	15.3	14.9	10.6	7.5	4.1	2.0	7.5	5.5
Italy	2.6	4.0	6.6	8.0	6.5	7.4	4.8	0.7	–5.4	–7.4	0.8	8.2
Netherlands	13.8	11.1	11.4	13.9	18.0	22.1	15.4	15.4	12.3	10.1	13.5	3.4
Portugal	–	–12.1	–2.3	9.4	7.8	8.9	7.1	3.2	–1.5	–2.1	–	–
United Kingdom	13.7	13.4	15.8	18.3	19.1	20.1	16.5	13.5	11.7	14.5	15.7	1.3
EUR10	2.4	5.9	8.9	10.9	12.2	12.6	9.7	7.0	3.0	1.2	7.1	5.9
Japan	8.7	7.7	5.3	7.1	8.9	8.6	8.0	6.2	3.5	1.8	2.5	0.7
United States	12.8	10.4	10.2	13.6	15.9	13.3	10.2	6.0	2.5	7.9	15.6	7.8

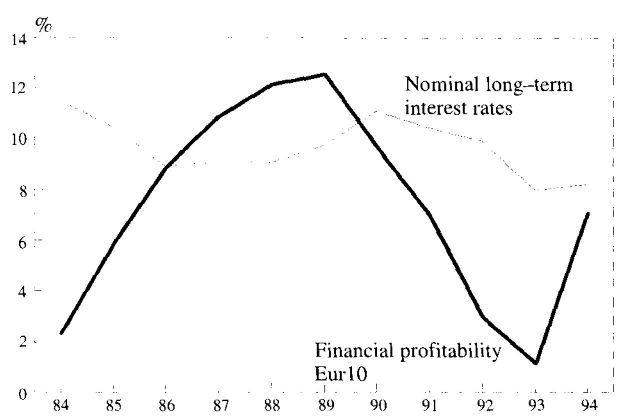
Inside Europe, the improvement in the financial profitability ratio occurred in all countries. The most spectacular increase was achieved by Spain, where financial profitability had been extremely negative in 1993 (financial profitability ratio + 18.6 points in 1994). Significant improvements were observed in Austria (+8.3 percentage points), Italy (+8.2 percentage points) and Finland (+7 percentage points). The financial profitability ratio increased by less than the European average (+5.9 percentage points) in France (financial profitability ratio +5.5 percentage points), Germany (+4.1 percentage points) and the Netherlands (+3.4 percentage points). The smallest increase is to be seen in the United Kingdom (financial profitability ratio +1.3 percentage points).

From 1984 to 1989 European enterprises saw a constant and sustained improvement in their financial profitability ratio, which rose from 2.4% to 12.6% (a compound rate of increase of 39.3% a year). A number of countries, starting from negative situations (Spain –6.3%, France –10%), 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; Italy achieved a 2.8–fold increase in its performance, and Belgium a 1.6–fold increase.

In 1989, the level of European convergence seemed very high. In the early 1990s, the financial profitability of European enterprises was very close to that of US and Japanese enterprises. But a process of sharp deterioration then set in, and the average financial profitability of European manufacturing industries steadily declined for five years. In 1993 it touched its lowest level for nine years (1.2%) with a number of countries recording extremely negative financial profitability: Spain (–17.8%), Italy (–7.4%) and Portugal (–2.1%). The scope for self–financed growth narrowed from 1989 to 1993 and the attractiveness of equity investment in the private sector diminished. Most shareholders of European manufacturing enterprises were clearly hard hit by the recession.

In 1994, the financial profitability of European enterprises (7.1%) was lower than nominal long–term interest rates in the public sector (8.2%), but the difference between these two indicators has narrowed substantially (–1.1 percentage points), thanks to the improvement in enterprises' performance. In the United States, the financial profitability of enterprises has outstripped nominal long–term interest rates in the public sector since 1993 (a situation observed eight times over the last eleven years). In Europe nominal long–term interest rates in the public sector stabilized in 1995 (1994: 8.2%, 1995: 8.3%). The foreseeable stabilization, or even decline, in the net profit ratio of European enterprises in 1995 and 1996 means that the average financial profitability ratio in Europe will still be lower than long–term interest rates in 1995 and 1996.

GRAPH 4 : **Financial profitability and nominal long-term interest rates – Manufacturing industry**



Source : DGII, BACH.

In 1994 there were sharp contrasts in the financial profitability situation of different European countries. The financial profitability ratio in the United Kingdom and the Netherlands[9] was well above nominal long–term interest rates in the public sector in those countries (a positive difference of 7.6 percentage points in the United Kingdom and 6.3 percentage points in the Netherlands). The financial profitability ratio in Austria and Finland was significantly higher than nominal long–term interest rates in the public sector there (a positive difference of 2.1 percentage points in Austria and 1.9 percentage points in Finland). In France the financial profitability ratio was virtually identical to the nominal long–term interest rates in the public sector (a positive difference of 0.1 of a percentage point). The financial profitability ratio in Germany and Belgium was lower than the nominal long–term interest rates in the public sector (a negative difference of –0.6 of a percentage point in Germany and –0.4 of a percentage point in Belgium). In Spain and Italy the ratio was much lower than the nominal long–term interest rates in the public sector (a negative difference of –8.7 percentage points in Spain and –7.4 percentage points in Italy).

From 1984 to 1989, European enterprises achieved significant improvement in their financial profitability as compared with nominal long–term interest rates in the public sector. The difference between the financial profitability of European enterprises and nominal long–term interest rates in the public sector was negative in 1984 and 1985. In 1986 the financial profitability ratio was the same as long–term interest rates. From 1987 to 1989, despite a gradual rise in the cost of money, the difference had become positive, reaching a maximum of 3.1 percentage points in 1988. In 1990 the difference again became negative (–1.4 percentage points) and European enterprises faced a situation in which their financial profitability continued to fall and the interest rates of long–term public sector bonds started to climb again. The subsequent fall in share prices on the stock market can of course be partly explained by the weakness of the financial profitability of European enterprises compared with that of government bonds. From 1990 to 1993, despite a further fall in interest rates, the gap between the financial profitability of European enterprises and nominal long–term interest rates in the public sector remained negative in Europe.

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. Purchases of goods and services do not represent the total amount of charges borne by enterprises. There may also be a variety of other operating charges and taxes, sometimes representing a large amount, depending on accounting practices in the various countries. **Value added**, the difference between produc-

[9] However, it should be borne in mind that in these two countries the financial profitability ratio is improved by the technique of balance sheet consolidation.

tion in a financial year and the total consumption of goods and services supplied by third parties, more precisely measures the value created by enterprises in their ordinary activity. The value added ratio averages around 30% of operating income in Europe. **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, other operating charges and taxes, 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

In 1994, purchases of goods and services as a proportion of turnover increased slightly in Europe (+0.3 of a point). In Japan it diminished slightly (–0.2 of a point). In its production process, the enterprise uses raw materials which it processes, and semi–finished products which it incorporates into its product. It also uses outwork and services. The price of these different charges may vary according to the influence of a number of factors (competitive position, technological changes, variation in raw material prices, etc.). The behaviour of raw materials is an important element in the proportion of charges borne by enterprises in manufacturing industry, and special emphasis must be placed on it. The increase in the weight of purchases of goods and services observed in 1994 is not in line with the movement of raw material prices, which fell by 0.4 of a point in 1994 (1993 85.7, 1994 85.3[10]). In 1995 the ecu–denominated prices of raw materials fell by some 1.4%. The weight of purchases of goods and services was therefore bound to fall in Europe in 1995. In 1996 and 1997 ecu–denominated raw material prices are climbing.[11] In view of the competitive pressure in manufacturing industry, it is possible that European enterprises may be unable to pass on these increases in their selling prices. The weight of purchases of goods and services could therefore increase in Europe in 1996 and 1997.

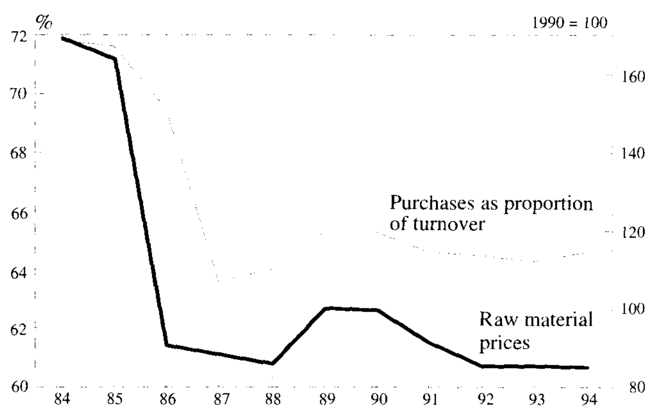
The proportion of purchases of goods and services in relation to turnover differs appreciably from one European country to another. It is very high in Belgium, Italy, the Netherlands and Spain (approximately 73% in 1994) but is appreciably lower in Germany and Austria. These differences can be explained by a whole range of factors:[12] specialization by industry in sectors that are raw–material intensive to differing degrees, varying scale of subcontracting, and, of course, the relative share of other charges. It is therefore more instructive to analyse this ratio in terms of trend.

In 1994 the proportion of purchases of goods and services changed in different ways in EU countries. It diminished in Spain (–1.3 points) and the United Kingdom (–0.7 of a point), and remained virtually unchanged in Belgium (+0.1 point) and Germany (+0.2 of a point). The proportion of purchases of goods and services increased by the European average in France and the Netherlands (+0.3 point). A fairly appreciable increase can be seen in Austria (+1.2 points), Italy (+1.6 points) and above all Finland (+2.5 points).

From 1984 to 1989 there was a steady fall in the average European ratio (71.8% in 1984, 65.3% in 1988). The reduction in the cost of raw materials played a major part in this trend. The sharp fall in raw material prices which was a feature of the period 1984 to 1988 led to a 6.5 percentage point reduction in the share of purchases, a substantial change given the inertia of this ratio.

The cost of purchases of goods and services remained fairly stable in the period 1989–94 (65.3% in 1989, 64.6% in 1994). The positive or negative variations in raw material prices had virtually no impact on purchases as a proportion of the turnover of European enterprises. It does not therefore look as if the deterioration in the performances of European enterprises from 1989 to 1993 was due to an increase in the share of purchases of goods and services. Similarly, the improvement in these performances in 1994 is not due to a reduction in the share of purchases of goods and services.

GRAPH 5 : **Purchases and raw materials**



Source : DGII, BACH.

[10] Base 1990=100, in ecus.
[11] Mainly due to the rise in agricultural raw materials used for foodstuffs.
[12] Apart from differences in accounting methodology.

TABLE 4 : **Relative share of purchases of goods and services – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	53.5	53.7	55.7	55.4	54.2	53.6	53.1	53.3	0.2
Austria	59.7	58.8	54.0	54.4	52.9	54.6	55.1	54.3	52.3	53.8	55.0	1.2
Belgium	75.0	75.0	72.5	72.3	73.1	74.3	74.0	73.6	73.0	72.1	72.2	0.1
Spain	73.0	71.1	69.2	69.9	70.2	71.3	71.1	70.8	72.7	74.3	73.0	–1.3
Finland	–	–	–	–	–	54.9	57.6	59.3	58.6	57.7	60.2	2.5
France	69.3	69.7	67.2	66.3	67.1	69.0	69.5	69.3	69.5	68.5	68.8	0.3
Italy	73.8	73.8	72.3	72.5	73.1	74.1	74.0	73.2	73.2	73.1	74.7	1.6
Netherlands	76.1	76.5	74.3	72.1	71.5	72.2	72.7	71.9	72.0	72.7	73.0	0.3
Portugal	–	70.0	69.2	68.5	69.7	69.2	69.9	69.2	69.5	67.9	–	–
United Kingdom	–	–	–	–	–	–	–	–	–	65.0	64.3	–0.7
EUR10	71.8	71.6	69.5	63.6	64.0	65.3	65.3	64.6	64.5	64.3	64.6	0.3
Japan	74.8	75.0	75.3	73.9	73.7	73.9	74.4	73.9	73.5	73.4	73.2	–0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–

2.2. The value added ratio

Value added expresses the creation of value by the enterprise during the production process.[13] It is calculated by deducting operating charges (consumption of goods and services + other operating charges and taxes) from total income for the financial year (turnover + change in stock + own work capitalized + other operating income).[14] The ratio used here measures value added as a proportion of total income for the financial year. The level of value added may vary with national accounting practices.[15]

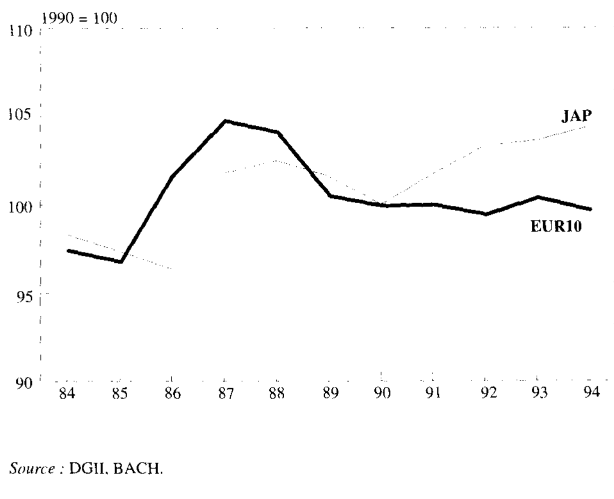
In manufacturing industry, however, value added is an important tool for analysing the potential result of enterprises. During a financial year value added is distributed to staff and social welfare agencies (staff costs), the public authorities (taxes and profits taxes), providers of capital (financial charges, dividends) and the enterprise itself (self–financing). The level of the value added therefore determines manufacturing industry's potential for self–financed growth. Value added is also an indicator of the extent to which the enterprise is integrated. As a rule, the higher the value added ratio, the more the enterprise is integrated. It then itself carries out a greater number of stages in the manufacture of its products (from raw materials to production of finished goods) without having recourse to the services of other enterprises or subcontracting. Depending on the choices made, the level of value added may thus differ without prejudice to the final performance.

In 1994 the value added ratio of European enterprises fell slightly (–0.2 of a point). In Japan it increased slightly (+0.2 point). The movement of the value added ratio in Europe is slightly more favourable than that of the share of purchases of goods and services (+0.3 point). **The competitive position in manufacturing industry did not therefore allow European enterprises to take advantage of the improvement in economic activity to increase their value added ratio.** In 1994 industrial production increased by 5.1% in Europe whereas the average value added ratio fell by 0.2 of a point. The general pick–up in the performance of European enterprises seen in 1994 does not therefore stem from an improvement in value added (the average value added ratio fell from 29.7% in 1993 to 29.5% in 1994).

In 1994, the value added ratio changed in different ways in EU countries. It fell fairly markedly in Italy (–1.1 percentage points), Finland (–1 percentage point) and Germany (–0.7 of a percentage point). It remained unchanged in Belgium (+0.0 percentage point). The value added ratio rose by roughly the same as the European average in France and the Netherlands (+0.3 of a percentage point). A fairly appreciable increase can be seen in the United Kingdom (+0.7 of a point), Spain (+0.7 of a point) and above all Austria (+0.9 of a point). In 1994 the value added ratios of European enterprises were fairly convergent (around 29%) in the group of countries consisting of Germany, Austria, Belgium, Finland and France. However, the value added ratio was lower in Spain and Italy (around 26%).

Over the period 1984–88, European enterprises achieved a significant improvement (+2 percentage points) in their value added ratio (from 28.8% in 1984 to 30.8% in 1988). This increase was particularly marked in certain countries – the Netherlands (+4.7 percentage points), Austria (+4.3 percentage points) and Belgium (+2.1 percentage points). The increase was also significant in France (+1.6 points) and Portugal (+1.3 points between 1985 and 1988). In Italy the value added ratio remained stable between 1984 and 1988. A point of convergence was reached in 1988, with all the countries then less than 2.5 percentage points from the European average. From 1989 the trend was reversed. The average value added

GRAPH 6 : **Value added ratio – Manufacturing industry**



Source : DGII, BACH.

13 Caution is required when comparing value added calculated on the basis of enterprises accounts with value added calculated on the basis of national accounts.

14 The bulk of this income is received during the financial year (sales of manufactures and goods); the rest is recorded in the accounts but its possible receipt is deferred (change in stock of finished goods, own work capitalized).

15 Differences in accounting methods relate to the inclusion in the accounts of taxes paid or levied on certain goods such as spirits (excise duty, etc.), the extent to which ancillary costs on purchases are included in the accounts, whether or not operating grants which supplement the selling price are taken into account, the method of including stocks or capitalized production in the accounts, whether or not costs of external labour are taken into account, the possible inclusion in the accounts of payments due on leasing, and in particular only exceptionally taking provisions for depreciation of current assets into account.

TABLE 5 : **Value added ratio – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	32.3	32.3	30.6	31.2	30.9	31.1	30.2	29.5	–0.7
Austria	29.0	27.9	31.8	32.5	33.3	32.6	32.3	32.5	31.8	30.7	31.6	0.9
Belgium	26.8	26.6	28.9	29.3	28.9	27.9	28.1	28.6	28.8	29.4	29.4	0.0
Spain	30.1	29.9	31.5	30.4	30.4	29.6	29.0	28.8	27.0	25.0	25.7	0.7
Finland	–	–	–	–	–	37.4	32.2	30.4	30.9	30.9	29.9	–1.0
France	30.5	30.8	31.6	32.1	31.6	29.9	29.3	29.5	29.3	29.0	28.7	–0.3
Italy	28.3	27.9	29.0	28.8	28.5	27.7	27.5	27.8	27.7	27.0	25.9	–1.1
Netherlands	24.1	23.8	26.1	28.3	28.8	28.1	27.5	28.3	28.2	27.5	–	–
Portugal	–	28.7	30.1	30.7	30.0	29.9	29.6	29.8	29.0	29.5	–	–
United Kingdom	–	–	–	–	–	–	–	–	–	35.0	35.7	0.7
EUR10	28.8	28.7	30.1	31.0	30.8	29.7	29.6	29.6	29.4	29.7	29.5	–0.2
Japan	25.2	25.0	24.7	26.1	26.3	26.1	25.6	26.1	26.5	26.6	26.8	0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–

ratio fell by 1.1 point in 1989 and since that date has been at a level lower than in 1986 (30.1%). This fall was particularly marked in some countries. In Finland the value added ratio fell from 37.4% in 1989 to 30.9% in 1993, in Spain from 29.6% to 25%, and in Italy from 27.7% to 27%. Belgium was the only country to improve its value added ratio over the period 1989–93 (from 27.9% in 1989 to 29.4% in 1993). The reversal in trend observed in 1989 on the average value added ratio in Europe was correlated with the slowdown in the growth of industrial production (industrial production 1988 +4.4, 1989 +4%, 1990 +2%, 1991 –0.3%, 1992 –1.2%, 1993 –3%).

2.3. 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 earnings and 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, the inclusion of pension fund provisions in the accounts and the payment of pensions for which there are no provisions. 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), earnings and social charges.

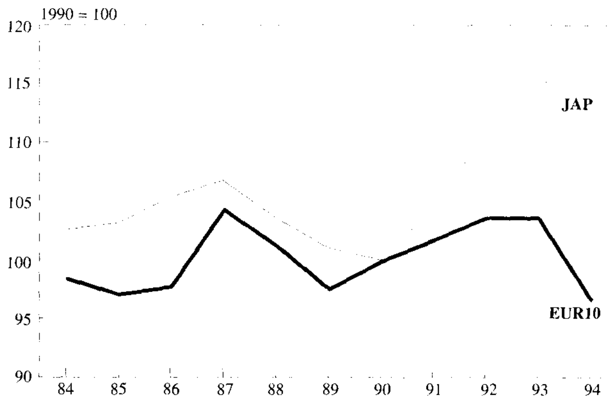
In 1994 staff costs as a proportion of turnover diminished appreciably in Europe, falling from 22.1% to 20.6% (–1.5 percentage points). In Japan the proportion fell only very slightly (–0.1 of a percentage point). In Europe in 1994 the recovery in economic activity and the widespread wage moderation permitted a substantial fall in staff costs as a proportion of turnover. **The general pick-up in the performance of European enterprises seen in 1994 is therefore largely due to the reduction in the proportion of staff costs.**

In Europe the improvement in the proportion of staff costs seen in 1994 occurred in virtually all the countries. The most significant falls were achieved by Spain (–3.9 percentage points) and Germany (–2.1 percentage points). The proportion of staff costs fell at the same rate in Italy (–1.5 percentage points) and Belgium (–1.4 percentage points). In the Netherlands it fell by 1.2 percentage points. Smaller falls can be seen in France (–0.9 of a point), the United Kingdom (–0.6 of a point) and Finland (–0.4 of a point). However, Austria did not improve the proportion of staff costs borne by its enterprises (+0.1 of a percentage point).

The limited weight of staff costs in relation to turnover in Japan compared to the European average is to be seen mainly in large enterprises. It can be explained partly by high labour productivity, the low level of social security contributions and the greater use of subcontracting in Japan than in Europe (which is confirmed by Japan's lower value added ratio). The level of staff costs in Germany and Austria, at 23.9% and 23.6% of turnover respectively, is consistently well above the level in the other countries. In these two countries much of the explanation clearly lies in the high level of wages, and the fact that staff costs include pension fund provisions and the servicing of pensions for which there are no provisions. At the other end of the scale, Portugal recorded ratios ranging from 15.7% to 18.7% over the period 1985–93; this is in part explained by low levels of remuneration. It will also be noted that the level in Italy is consistently below the European average and close to that in Portugal and the Netherlands.

Taking the average for European enterprises, the trend of staff costs as a proportion of turnover was fairly uneven over the period from 1984 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 20.8% in 1989 to 22.1% in 1993 (+1.3 percentage points). The proportion of staff costs did not follow the same trend in the ten European countries. Between 1984 and 1989 most of the countries experienced an appreciable reduction in staff costs, except for Austria 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 (–2.3 percentage points), Spain

GRAPH 7 : **Relative share of staff costs – Manufacturing industry**



Source : DGII, BACH.

TABLE 6 : **Relative share of staff costs – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	25.8	25.1	24.1	24.3	24.4	25.3	26.0	23.9	–2.1
Austria	22.8	22.5	24.5	25.3	24.8	24.0	24.2	24.0	24.3	23.6	23.6	0.1
Belgium	19.4	19.3	20.0	20.2	19.1	18.4	19.3	20.5	20.8	21.3	20.0	–1.4
Spain	21.0	20.3	21.3	20.2	19.3	19.6	20.6	21.1	21.3	22.0	18.2	–3.9
Finland	–	–	–	–	–	18.1	21.4	21.3	19.6	18.1	17.8	–0.4
France	23.0	22.7	22.2	21.9	20.7	19.5	19.7	20.1	20.4	20.7	19.8	–0.9
Italy	18.3	18.1	18.4	18.2	18.0	17.9	18.6	19.1	19.1	18.4	16.9	–1.5
Netherlands	16.3	16.1	17.5	18.8	18.0	17.1	17.4	18.2	18.2	18.3	17.1	–1.2
Portugal	–	15.7	16.9	16.8	16.5	15.8	17.2	18.0	18.5	18.7	–	–
United Kingdom	*23.1*	*23.2*	*22.8*	*22.6*	*22.3*	*21.6*	*22.0*	*22.5*	*23.1*	22.0	21.5	–0.6
EUR10	20.9	20.7	20.8	22.2	21.6	20.8	21.3	21.7	22.1	22.1	20.6	–1.5
Japan	15.9	16.0	16.3	16.6	16.1	15.7	15.5	16.2	17.2	17.9	17.8	–0.1
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 7 : **Staff costs relative to value added – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	77.0	75.2	75.3	74.8	75.8	78.4	83.3	78.2	–5.2
Austria	74.6	76.1	73.5	73.4	70.6	69.3	70.3	70.1	73.3	74.1	71.6	–2.6
Belgium	69.8	70.2	67.0	66.5	63.5	63.3	66.0	68.6	69.4	70.2	65.6	–4.6
Spain	65.9	65.9	65.5	64.8	61.6	63.7	69.1	71.5	77.0	86.3	69.6	–16.7
Finland	–	–	–	–	–	47.8	64.9	68.3	62.0	57.6	58.0	0.3
France	71.8	70.3	67.6	66.0	63.1	62.8	64.7	65.4	67.0	69.9	66.7	–3.3
Italy	62.5	63.1	61.8	61.8	61.4	62.9	65.6	67.3	67.6	67.1	64.1	–3.0
Netherlands	67.4	67.2	66.8	66.1	62.2	60.3	62.9	64.1	64.6	66.6	–	–
Portugal	–	–	–	–	–	–	56.0	58.5	62.1	62.3	–	–
United Kingdom	–	–	–	–	–	–	–	–	–	62.9	60.1	–2.8
EUR10	67.4	67.3	65.5	69.2	67.2	67.0	68.8	70.1	71.8	72.9	68.8	–4.2
Japan	63.1	64.2	66.1	63.4	61.2	60.2	60.5	62.1	64.9	67.4	66.5	–0.9
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 8 : **Gross operating profit – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	7.7	8.3	7.9	8.2	7.8	7.0	5.2	6.7	1.5
Austria	7.8	7.1	8.8	9.1	10.3	10.7	10.2	10.2	8.9	8.2	9.4	1.2
Belgium	8.4	8.2	9.8	10.2	10.9	10.6	9.9	9.4	9.1	9.1	10.5	1.4
Spain	10.9	10.5	11.2	11.0	12.1	11.1	9.2	8.4	6.4	3.5	7.9	4.4
Finland	–	–	–	–	–	19.7	11.6	9.9	12.1	13.3	12.9	–0.4
France	9.0	9.6	10.7	11.3	12.1	11.6	10.8	10.6	10.0	9.0	9.9	0.8
Italy	11.0	10.6	11.4	11.3	11.3	10.6	9.7	9.3	9.2	9.0	9.5	0.5
Netherlands	7.9	7.8	8.7	9.6	10.9	11.2	10.2	10.2	10.0	9.2	–	–
Portugal	–	–	–	–	–	–	13.5	12.7	11.3	11.3	–	–
United Kingdom	11.4	12.0	13.2	12.5	13.1	13.2	12.7	12.5	12.7	13.0	14.3	1.3
EUR10	10.1	10.2	11.2	10.2	10.8	10.6	10.0	9.6	9.1	8.3	9.5	1.2
Japan	9.3	9.0	8.4	9.6	10.2	10.4	10.1	9.9	9.3	8.7	9.0	0.3
United States	10.2	9.5	9.6	10.4	10.6	10.1	9.7	8.8	9.3	9.9	11.1	1.3

(–1.7 percentage points) and the United Kingdom (–0.8 percentage points); this tallies with the observations made regarding the sharp decline in the corrected wage share in those three countries. From 1990 to 1993 a general increase in staff costs as a proportion of turnover can be seen, with especially sharp rises in Germany (+1.7 percentage points), Belgium (+2 percentage points), Portugal (+1.5 percentage points) and Spain (+1.4 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).

Staff costs are traditionally calculated as a proportion of value added in order to measure the distribution of incomes within the enterprise. During a financial year value added is distributed to staff and social welfare agencies (staff costs), the public authorities (taxes and profits taxes), providers of capital (financial charges, dividends) and the enterprise itself (self–financing).

In 1994 staff costs as a proportion of the value added of European enterprises fell sharply, from 72.9% in 1993 to 68.8% in 1994 (–4.1 percentage points). This fall is greater than that seen in Japan (–0.9 of a percentage point). The fall in staff costs as a proportion of value added increases the residual income potentially available for enterprises.

In Europe the fall in staff costs as a proportion of value added seen in 1994 occurred in virtually all countries. The most spectacular fall was achieved by Spain (staff costs as a proportion of value added –16.7 percentage points). Significant falls were registered in Germany (–5.1 percentage points), Belgium (–4.6 percentage points) and France (–3.2 percentage points). Staff costs as a proportion of value added fell at a similar rate in Italy (–3 percentage points) and the United Kingdom (–2.8 percentage points). However, Finland did not improve the proportion of staff costs in value added borne by its enterprises (+0.4 of a point).

In 1994 staff costs as a proportion of value added were fairly convergent in the group of countries consisting of Belgium (65.6%), France (66.7%) and Italy (64.1%). Japan achieved a similar result (66.5%). The choice of greater recourse to subcontracting in Japan reduces the value added ratio but does not therefore alter staff costs as a proportion of value added in relation to this group of countries.

Staff costs as a proportion of value added are distinctly higher in the group of countries consisting of Germany (78.2%) and Austria (71.6%). In these two countries the proportion is influenced by the fact that staff costs include pension fund provisions and the servicing of pensions for which there are no provisions, and in Germany by the high level of wages. The gross operating profit measured by the gross operating surplus[16] (value added – staff costs) is consequently lower in Germany, and to a lesser extent in Austria, than in the other European countries.

On the other hand (see point 3.3), enterprises in these latter two countries have the benefit of the internal financing resource consisting of pension fund provisions. This internal financing resource is a either a cheaper source of financing for the activities of the enterprise, or a source of financial income.[17] In Germany's case, financial income has since 1987 permanently exceeded financial charges (see point 3.3). Therefore in Germany more than in other countries, the final profitability of enterprises[18] has the benefit of a positive financial result (financial income higher than financial charges).

[16] The strict application of the accounting principle of prudence in these two countries should not be ignored, in particular the methods of including stocks and capitalized production in the accounts and the presence of various provisions allowed for tax purposes in "other operating charges".

[17] Clearly, financial income is not received solely from the investment of pension fund provisions.

[18] Apart from the countries which present consolidated accounts.

2.4. 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 also include sums repaid to the group and to associated enterprises, in respect of amounts which are sometimes large, particularly in Germany. Financial charges, however, 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 their debt in periods of rising interest rates and, conversely, to 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.

In 1994 the average proportion of financial charges borne by European enterprises fell very markedly, from 3.4% to 2.7% (– 0.7 of a percentage point), though by less than in the United States. The proportion of financial charges borne by US enterprises fell from 1.8% in 1993 to 0.5% in 1994, i.e. by 1.3 percentage points. Japanese enterprises reduced the proportion of financial charges by only 0.2 of a percentage point. The fall in the proportion of financial charges in Europe and the United States can naturally be explained by the significant improvement in economic activity in manufacturing industry.

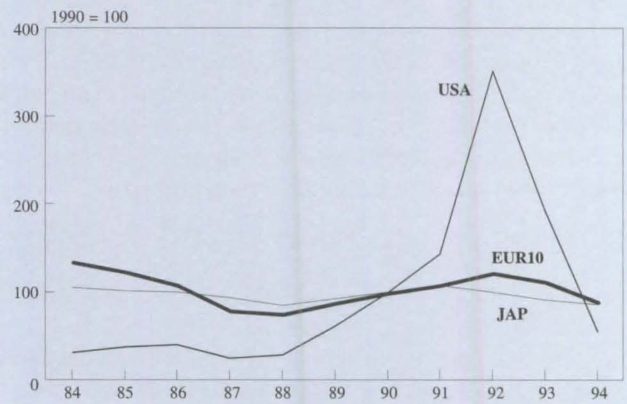
The fall in short–term interest rates (1992 11.2%, 1993 8.5%, 1994 6.5%) also strongly influenced the favourable trend in the burden of financial charges in Europe in 1994. Short–term debt accounts for the bulk (76.6%) of the total debt of European enterprises. In the United States, however, the burden of financial charges fell in 1994 even though short– and long–term interest rates were rising. In Japan the continuation of historically low short– and long–term interest rates did not result in any significant reduction in financial charges as a proportion of turnover.

In Europe the burden of financial charges eased in all countries in 1994. The most significant reductions were seen in Finland (–3.1 percentage points), Spain (–2.2 percentage points) and Italy (–1.2 percentage points). In Belgium the burden of financial charges fell at the European average rate (–0.7 of a percentage point). The other countries recorded below–average reductions in the burden of financial charges: France and the Netherlands (–0.5 of a percentage point), Austria (–0.3 of a percentage point), the United Kingdom (–0.2 of a percentage point) and Germany (–0.1 of a percentage point).

By comparison with their US counterparts, European and Japanese enterprises have historically faced a greater burden of financial charges (averaging 3.1% and 2.7% respectively over the period 1984–94, as against 0.9% in the United States). 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 3.3%, a level very close to that in Europe (3.7%, the narrowest gap over the 1984–94 period) and even above that in Japan (2.8%, where, moreover, there was a 0.2 percentage point reduction in that year). But in 1993 a substantial fall in financial charges in the United States and Japan had the effect of restoring the traditional gaps between them and Europe.

In Europe the period between 1984 and 1988 was marked by a continual and significant reduction in financial charges as a proportion of turnover, from 4% to 2.3%. In 1984 the difference between the highest and lowest levels of financial charges was 5.7 percentage points. Spain and Italy had particularly high levels (7.5% and 5.7% respectively), while Austria, the Netherlands and the United Kingdom had the most favourable levels (2%, 1.8% and 1.8% respectively).

GRAPH 8 : **Relative share of financial charges – Manufacturing industry**



Source : DGII, BACH.

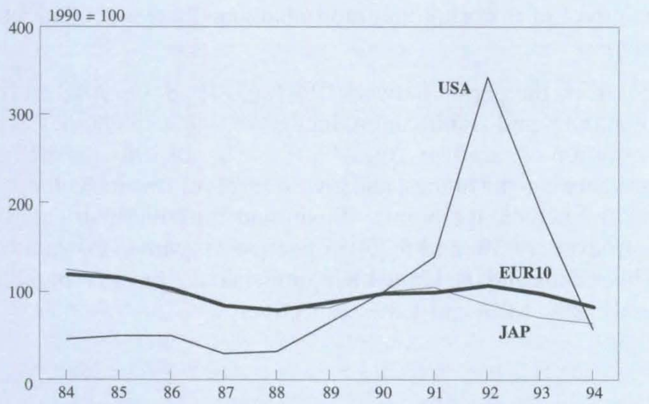
TABLE 9 : **Relative share of financial charges – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	1.5	1.6	1.8	1.9	2.3	2.7	2.5	2.4	–0.1
Austria	2.0	2.0	2.1	2.1	1.8	1.8	2.0	2.2	2.4	2.3	1.9	–0.3
Belgium	2.9	2.8	2.9	2.5	2.3	2.9	3.4	3.8	4.1	4.3	3.7	–0.7
Spain	7.5	6.0	5.0	4.2	3.4	3.2	3.6	4.1	5.0	5.7	3.5	–2.2
Finland	–	–	–	–	–	6.3	6.2	9.4	10.5	8.5	5.4	–3.1
France	4.1	3.7	3.2	2.8	2.4	2.4	2.8	2.7	2.9	2.7	2.3	–0.5
Italy	5.7	5.0	4.3	3.5	3.4	3.7	4.1	4.2	5.2	4.8	3.7	–1.2
Netherlands	1.8	1.6	1.7	1.7	1.7	2.1	2.7	3.0	3.4	3.2	2.7	–0.5
Portugal	–	9.9	9.3	7.4	6.2	6.0	6.5	6.8	7.1	7.4	–	–
United Kingdom	1.8	1.8	1.7	1.4	1.6	2.5	3.0	3.1	2.9	2.1	1.9	–0.2
EUR10	4.0	3.7	3.2	2.4	2.3	2.6	3.0	3.2	3.7	3.4	2.7	–0.7
Japan	2.9	2.8	2.8	2.6	2.3	2.6	2.8	3.0	2.8	2.5	2.4	–0.2
United States	0.3	0.4	0.4	0.2	0.3	0.6	0.9	1.3	3.3	1.8	0.5	–1.3

TABLE 10 : **Apparent rate of interest on financial debt – Manufacturing industry**

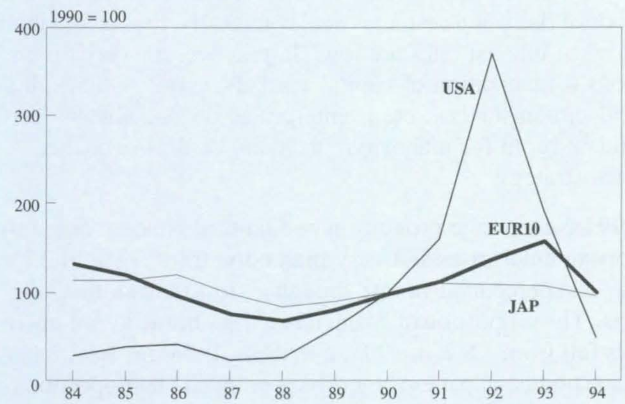
	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	5.8	5.3	6.2	6.9	7.4	8.6	7.9	7.1	–0.9
Austria	6.3	6.3	5.9	5.4	4.8	4.9	5.4	6.0	6.6	6.1	5.0	–1.2
Belgium	12.4	11.7	10.7	9.7	8.7	9.1	10.0	10.6	10.8	10.3	9.1	–1.2
Spain	13.4	12.3	11.3	12.0	11.4	12.1	12.0	11.6	11.4	11.0	10.1	–1.0
Finland	–	–	–	–	–	9.0	11.2	11.5	11.7	11.4	9.6	–1.7
France	9.5	9.4	8.5	7.9	7.0	7.3	8.0	8.1	8.6	8.0	6.8	–1.2
Italy	17.8	16.6	14.6	12.6	12.0	12.6	13.3	12.8	14.6	13.6	10.8	–2.8
Netherlands	5.5	4.9	4.9	4.5	4.5	5.1	5.8	5.8	6.2	5.9	–	–
Portugal	–	20.1	19.5	16.8	15.0	14.6	21.7	22.2	22.4	23.8	–	–
United Kingdom	4.8	5.1	4.2	3.6	3.8	5.8	7.4	7.4	6.4	5.1	4.5	–0.6
EUR10	10.8	10.6	9.4	7.7	7.2	8.1	9.0	9.0	9.7	9.0	7.6	–1.4
Japan	9.1	8.5	7.3	6.3	5.9	6.0	7.3	7.6	6.3	5.2	4.7	–0.5
United States	1.0	1.1	1.1	0.6	0.7	1.4	2.1	3.0	7.2	4.0	1.2	–2.8

GRAPH 9 : **Apparent interest rate on financial debt – Manufacturing industry**



Source : DGII, BACH.

GRAPH 10 : **Financial charges as a proportion of gross trading result – Manufacturing industry**



Source : DGII, BACH.

The subsequent general reduction in the burden of financial charges was particularly marked for those countries with a high level at the outset. Thus, between 1984 and 1988, levels in Spain, Italy, Portugal, France and Belgium moved much closer to those in Germany, the United Kingdom and the Netherlands. The maximum spread in ratios between the seven countries that were recorded at the outset narrowed to 1.8 percentage points in 1988.

From 1989 there was a radical reversal of trend, and the average proportion of financial charges in Europe increased from 2.6% in 1989 to 3.7% in 1992, thereby returning to its 1985 level. The pace of increase varied between countries: it was fairly rapid in Belgium, the Netherlands and the United Kingdom, where the level in 1992 was the highest recorded since 1984. The pace of increase was more modest overall for the other countries. The gap between the highest and lowest ratios (as represented by Germany and Finland respectively) widened sharply to 7.8 percentage points in 1992, as against 4.6 percentage points in 1988 between Germany and Portugal. 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. In 1993 the appreciable fall in interest rates in Europe (short–term nominal rates fell from 11.2%in 1992 to 8.5% in 1993 and long–term nominal rates from 9.9% to 8%) triggered a further easing of the average burden of financial charges in Europe (from 3.7% to 3.4%).

TABLE 11 : **Financial charges as a proportion of gross trading result – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	19.4	19.0	22.3	23.7	28.9	38.9	47.1	35.5	–11.6
Austria	25.9	28.9	23.5	22.8	17.3	16.7	19.9	21.2	27.5	27.4	20.5	–6.9
Belgium	34.2	34.1	29.9	24.9	21.4	27.6	34.4	40.7	45.2	47.8	35.0	–12.9
Spain	69.3	57.0	44.6	38.0	27.9	28.5	39.5	48.2	78.9	163.9	44.2	–119.7
Finland	–	–	–	–	–	32.1	53.2	94.9	87.0	63.7	41.6	–22.1
France	45.2	38.5	29.8	24.7	20.1	20.8	26.0	25.5	28.9	30.2	22.8	–7.4
Italy	51.9	47.0	37.4	31.2	29.9	34.8	42.4	45.3	56.3	53.2	38.5	–14.7
Netherlands	23.3	20.9	19.3	17.1	15.6	18.5	25.9	29.3	33.9	34.9	27.0	–7.9
Portugal	–	71.4	65.5	49.7	43.0	40.0	47.9	53.2	63.1	65.8	–	–
United Kingdom	15.6	15.1	12.7	11.0	11.8	18.6	23.9	24.9	22.9	16.2	13.3	–2.9
EUR10	39.7	36.1	29.1	23.0	20.9	24.5	29.8	33.9	41.5	47.6	30.3	–17.3
Japan	31.1	31.1	32.9	27.0	22.9	24.6	27.4	30.1	29.8	29.2	26.5	–2.8
United States	2.8	3.7	4.0	2.3	2.5	5.8	9.5	15.3	35.4	18.3	4.7	–13.6

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 differ widely from average debt over the financial year), confirms the previous conclusions. Compared with their Japanese and US competitors, European enterprises have historically paid a higher apparent interest rate. Over the period from 1984 to 1994, the difference averaged 2.2 percentage points with Japanese enterprises and 6.7 percentage points with US enterprises.

In 1994 the burden of financial charges as a proportion of the gross profit of European enterprises eased considerably, from 47.6% to 30.3% (a reduction of 17.3 percentage points). This reduction was more substantial than that recorded in the United States (–13.6 percentage points) and Japan (–2.8 percentage points). In Europe the fall in the ratio of financial charges to gross profit in 1994 was experienced by all countries. A spectacular reduction of 119.7 percentage points was recorded in Spain; the ratio of financial charges to gross profit had reached virtually intolerable levels there in 1992 and 1993 (78.9% and 163.9% respectively). Significant reductions were seen in Finland (–22.1 percentage points), Italy (–14.7 percentage points), Belgium (–12.9 percentage points) and Germany (–11.6 percentage points). The ratio of financial charges to gross profit fell at a similar rate in the Netherlands (–7.9 percentage points), France (–7.4 percentage points) and Austria (–6.9 percentage points).

From 1988 to 1993 enterprises had to allocate a growing proportion of their gross trading result (or gross profit) to the remuneration of borrowed capital. The period 1984–93 divided into two diametrically opposed phases: from 1984 to 1988 this proportion fell from 39.7% to 20.9%; from 1988 to 1993 it rose continually and stood at 47.6% in the latter year. The trend was roughly similar in the United States and Japan. The situation in 1994 was comparable to that in 1990.

3. FINANCIAL STRUCTURES OF EUROPEAN ENTERPRISES

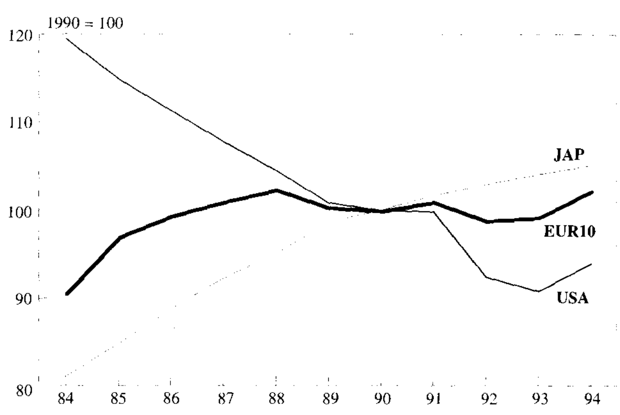
By analysing enterprises' liabilities it is possible to identify the choices made by them in financing their activities. In very simple terms, an enterprise has three major sources of finance: first, its **own funds**, which it builds up by calling on shareholders or through self–financing (allocating profits to reserves); second, funds it obtains from **external lenders**, essentially from banks but also through bond markets or through short–term commercial credit between enterprises; third, the **general provisions** it retains until the risks covered materialize. Theoretically, there is no established hierarchy between an enterprise's financing sources, debt or own funds. Any financing structure combining own funds and debt is neutral in its effect on the weighted average cost of the different financing sources, i.e. on the value of the enterprise. An increase in indebtedness leads to greater financial risk which prompts holders of the capital to demand a higher rate of return. Own funds are not free and can be more costly than debt. While an enterprise's financing sources cannot thus be given a ranking, an analysis of the structure of an enterprise's liabilities provides valuable pointers not only to the reasons for the level of its performance but also to its degree of dependence on external lenders.

3.1. Analysis of own funds

The importance of own funds is generally recognized. An adequate level of own funds in the productive system and favourable profit prospects encourage investment. This increase in the propensity to invest has a positive impact on the growth of the economy and the level of employment. Particularly in the case of new and innovative enterprises, whose exposure to risk is higher owing to weaker self–financing capacity when they start up, an insufficient initial level of own funds is a major obstacle to investment. Consequently, structural changes necessitated by technological innovation can be impeded. The long–term growth potential of the economy is affected in this way.

Own funds are also a key aspect of enterprises taken individually. The own funds ratio provides a means of assessing the financial solidity of an enterprise and hence its solvency. This ratio indicates to what extent an enterprise's shareholders underwrite its risks. The prime function of own funds is to underwrite risk in the event of loss and therefore to reduce the danger of insolvency for external lenders of funds. An enterprise's borrowing capacity therefore depends directly on the level of its own funds. The possibility of obtaining the borrowed funds

GRAPH 11 : **Own funds ratio – Manufacturing industry**



Source : DGII, BACH.

TABLE 12 : **Own funds ratio – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	30.3	30.1	29.3	29.6	30.0	29.5	30.0	31.6	1.6
Austria	19.6	19.1	20.5	22.2	22.7	23.8	24.9	28.2	30.6	30.9	31.1	0.2
Belgium	35.0	37.9	39.5	40.6	39.7	41.6	40.4	39.0	38.0	37.8	40.3	2.5
Spain	29.2	33.4	35.8	38.3	42.8	44.8	42.3	39.4	36.7	32.1	35.1	3.0
Finland	–	–	–	–	–	20.2	24.6	25.6	26.2	27.2	31.8	4.7
France	15.9	20.5	23.0	26.9	30.1	32.8	33.0	34.1	34.9	35.6	36.2	0.5
Italy	26.0	26.8	28.7	29.0	27.3	27.6	28.3	29.0	26.7	26.7	26.5	–0.2
Netherlands	38.4	39.2	40.6	40.4	39.4	37.6	38.9	39.4	40.0	43.0	45.2	2.2
Portugal	–	22.0	28.7	30.5	36.4	38.3	42.7	41.2	40.8	42.3	–	–
United Kingdom	46.6	47.8	44.0	45.2	44.7	39.7	37.1	37.4	36.4	36.4	36.8	0.5
EUR10	29.5	31.6	32.4	32.9	33.4	32.7	32.6	32.9	32.2	32.4	33.3	1.0
Japan	25.2	26.4	27.6	28.7	29.5	30.7	31.1	31.6	32.0	32.4	32.7	0.3
United States	47.6	45.8	44.4	43.0	41.7	40.2	39.8	39.8	36.8	36.2	37.4	1.2

needed to develop the enterprise (financing of investment), and occasionally those essential for its survival, is therefore linked to the level of own funds. Banking terms obtained (rates, duration, guarantees, etc.) will also depend on the level of own funds. Protection against the dangers of interest–rate variations is thus implicitly provided by the own funds ratio.

Own funds are made up of share capital, share issue premiums, revaluation reserves, reserves, accumulated profits and operating profits for the year. Operating profits are shown before allocation in most cases. The ratio used here makes it possible to measure own funds, net of the proportion not yet paid by shareholders, in relation to total assets. Total assets can be affected by the customary means of financing an enterprise's current activities. Substantial use of the payment periods granted by suppliers can alter total short–term debts and therefore total liabilities.

Furthermore, despite the harmonization brought about by the fourth company–law Directive, own funds are shown differently according to the country in question.[19] National legislation and financing customs may also have an impact on the very level of own funds.[20] Finally, tax rules can have many effects on the level of own funds.[21] The own funds ratio must therefore first be analysed in terms of its trend.

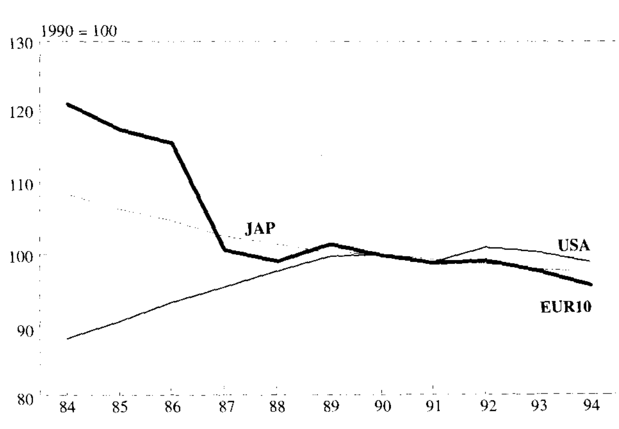
In 1994 the own funds ratios of European enterprises increased appreciably, from 32.4% to 33.3% (0.9 of a percentage point). However, this increase was less than that recorded in the United States (1.2 percentage points). Japanese enterprises, by contrast, managed to improve their own funds ratios by no more than 0.3 of a percentage point. The improvement in the own funds ratios recorded in Europe and the United States was due mainly to the increase in net profits in 1994 in these two geographical areas. Net profits, less dividends distributed to shareholders, are incorporated in own funds. In Europe the improvement in the own funds ratio recorded in 1994 was reflected in all countries except for Italy (ratio down by 0.2 of a percentage point). The most significant improvements were made by Finland (4.7 percentage points), Spain (3 percentage points), Belgium (2.5 percentage points) and the Netherlands (2.2 percentage points). A clear improvement was also made in Germany (1.6 percentage points). The weakest improvements were recorded in France (0.5 of a percentage point), the United Kingdom (0.5 of a percentage point) and Austria (0.2 of a percentage point).

Between 1984 and 1988 European enterprises increased the proportion of own funds in their balance–sheet totals from 29.5% to 33.4%. That period saw a rapid expansion of financial markets in continental Europe and the liberalization of capital movements. The growth in own funds was particularly marked in France (from 15.9% in 1984 to 30.1% in 1988) where the financing of the economy underwent major reforms. The own funds of enterprises also increased appreciably in Spain (from 29.2% in 1984 to 42.8% in 1988) and Portugal (from 22% in 1985 to 36.4% in 1988). In Germany, Italy and the Netherlands, by contrast, the situation was very stable. In 1989 the average own funds ratio in Europe fell (by 0.7 of a percentage point) and then marked time until 1993. Enterprises were no longer able to self–finance the increase in their own funds. However, some countries continued to improve their ratios, notably France, Belgium, the Netherlands and in particular the new countries of the Union. The own funds ratio thus rose in Austria from 23.8% in 1989 to 30.9% in 1993 and in Finland from 20.2% to 27.2%. By contrast, it fell in the United Kingdom from 39.7% in 1989 to 36.4% in 1993 and in Spain from 44.8% to 32.1%.

In general, enterprises in Europe have structurally lower levels of own funds than those in the United States where capital markets are traditionally a more important source of finance. However, European enterprises have structurally higher levels of own funds than their counterparts in Japan, whose financing through debt may be facilitated by the existence of group banks. From 1984 to 1994 the overall own funds ratio of European enterprises rose in parallel with that of Japanese enterprises. Over the same period, US enterprises experienced an appreciable reduction in their capitalization.

At the end of this process, in 1994, own funds ratios were roughly similar in Europe (33.3%), Japan (32.7%) and the United States (37.4%).

GRAPH 12 : **Overall debt ratio – Manufacturing industry**



Source : DGII, BACH.

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[19] Firstly, own funds may include substantial revaluation reserves; in some cases, such reserves are even incorporated in capital and are no longer identifiable. Statutory revaluation of balance sheets is practised to varying degrees. In Portugal, for example, the possibility of a revaluation of balance sheets is examined annually in tax legislation (method of the constant purchasing power monetary unit); three statutory revaluations were authorized in Italy in 1975, 1983 and 1990 and in Spain in 1981, 1983 and 1991 (geographically limited). The last statutory revaluation occurred in France in 1978; while, in Belgium, there is no statutory revaluation, it may be carried out following an official appraisal of the assets approved by the annual general meeting of shareholders, with the profit being taxed only on resale. In Germany statutory revaluation is not possible, and assets continue to be entered in the accounts at historical cost. Secondly, regulated provisions, i.e. those benefiting from favourable tax treatment (provisions for rising prices, exchange rate fluctuations, establishment abroad, etc.), reserves set aside free of tax and additional or exceptional depreciation are, according to the country in question, incorporated to a greater or lesser extent in own funds. In Germany, for example, these variables are included only up to 50% in order to neutralize the latent taxation. Thirdly, public subsidies may be entered in the accounts in different ways according to the country in question: in Spain and Italy, for example, they are included in own funds; in France there is a choice between inclusion in own funds or transfer to exceptional profits for the year; in Germany they are deducted from asset acquisition costs or included in a liabilities correction item.

[20] In an economy oriented towards financial markets, enterprises can more easily raise funds on the capital markets. This may lead, where stock market conditions are favourable, to the recording of substantial issue premiums under own funds. In an economy oriented towards borrowing or where preferential relationships exist between enterprises and the banking system (e.g. the "Hausbank" phenomenon), the financing requirements of enterprises are more easily met by bank loans.

[21] For example, the variations in the taxation of distributed or non–distributed profits from one country to another may have different effects on the choices made by holders of capital. National tax provisions giving preferential treatment to own funds have also altered the structure of corporate balance sheets. Enterprises not using the financial markets have no need to fear the markets' negative reactions to their profit levels. It is then in their interests to minimize their profits for accounting purposes in order to reduce their tax base, which reduces the level of own funds all the more.

TABLE 13 : **Overall debt ratio – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	38.1	37.4	38.9	38.6	38.5	38.3	37.3	34.3	–3.0
Austria	58.5	58.9	57.9	57.8	56.6	54.8	54.1	51.0	48.9	49.8	49.6	–0.2
Belgium	59.5	56.6	54.9	53.7	54.6	53.5	54.6	56.0	57.0	57.0	54.7	–2.3
Spain	67.5	62.7	60.1	57.3	52.5	50.8	52.6	55.8	58.1	61.8	58.6	–3.2
Finland	–	–	–	–	–	72.1	67.0	67.6	68.9	63.9	58.2	–5.7
France	77.7	73.6	71.0	67.5	64.4	62.0	61.8	60.1	58.5	58.3	57.5	–0.7
Italy	64.5	63.6	61.9	61.9	62.9	63.3	62.5	61.8	64.1	64.0	64.5	0.5
Netherlands	44.7	45.2	43.5	42.2	42.6	43.6	45.0	43.9	44.5	43.8	47.4	3.6
Portugal	–	72.3	67.0	64.7	59.3	56.9	51.2	52.7	52.8	51.5	–	–
United Kingdom	48.9	47.8	50.8	48.6	49.2	54.8	50.9	49.1	48.8	45.6	46.1	0.6
EUR10	62.7	60.8	59.9	52.1	51.3	52.5	51.7	51.1	51.3	50.6	49.5	–1.1
Japan	69.1	67.8	66.8	65.3	64.7	63.9	63.7	63.2	62.8	62.3	62.1	–0.2
United States	49.0	50.3	51.8	53.0	54.2	55.4	55.5	55.0	56.0	55.7	54.9	–0.8

3.2. Analysis of indebtedness

3.2.1. Overall indebtedness ratio

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 1994 the overall debt ratio of European enterprises fell appreciably, from 50.6% to 49.5% (a reduction of 1.1 percentage points). This improvement was more marked than that recorded in the United States (0.8 of a percentage point) and Japan (0.2 of a percentage point). Enterprises rid themselves of debt where they consider real interest rates to be too high, where their profitability enables them to self–finance all their investment projects or where the outlook for demand does not encourage them to carry out investment projects beyond their self–financing capacity. It is impossible to identify one sole cause for the fall in the overall indebtedness ratios of European enterprises in 1994. European enterprises thus made substantial progress overall in consolidating their financial structures (in 1994) by reducing the proportion of debt in their financing. They thereby increased their financial independence.

The reduction in the overall indebtedness ratio recorded in 1994 in Europe was not reflected in all countries. The largest reductions were achieved in Finland (–5.7 percentage points), Spain (3.2 percentage points) and Germany (–3 percentage points). An appreciable reduction was also achieved in Belgium (–2.3 percentage points). The smallest reductions were recorded in France (–0.7 of a percentage point) and Austria (–0.2 of a percentage point). By contrast, the overall indebtedness ratio rose in the United Kingdom (by 0.6 of a percentage point), in Italy (0.5 of a percentage point) and particularly in the Netherlands (3.6 percentage points).

Over the period from 1984 to 1988, the overall debt ratios of enterprises moved downwards in almost all the European countries, at the fastest rate in those countries where they were originally higher (France, Spain and Portugal), except for Italy. The fall was less marked in the other countries (Germany, Austria, Belgium and the Netherlands). Only the United Kingdom recorded a slight rise in its overall indebtedness ratio. From 1988 until 1992, the general debt–shedding process came to a halt, with European countries showing widely differing trends. The overall indebtedness ratio increased appreciably in Spain, Italy and Belgium. A more moderate increase was recorded in Germany and the Netherlands. In the other countries, the overall indebtedness ratio continued to fall (Austria, Finland, France and the United Kingdom). In 1993 European enterprises resumed their reduction of debt, to a fairly marked extent in Germany, Finland and Belgium, and at a more moderate pace in France and the United Kingdom.

In general, Japanese enterprises have structurally higher levels of debt than their US and European counterparts. Until 1986 European enterprises had appreciably higher levels of debt than US enterprises. From then on, the situation reversed, with the reduction in the debt of European enterprises (from 62.7% in 1984 to 49.5% in 1994) being accompanied by an appreciable increase in the debt of US enterprises (from 49% in 1984 to 54.9% in 1994). This positive trend may, however, conceal a less buoyant investment situation.

3.2.2. 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 (more than one year), 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 customs within each country (banking traditions, method of commercial financing, role played by real or personal guarantees, etc.).

TABLE 14 : **Debt structure** (ratio of debt of more than one year to total debt) – **Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	19.4	18.7	17.7	17.3	16.7	16.1	17.5	14.1	–3.4
Austria	28.7	29.8	31.7	30.8	30.0	28.9	27.7	28.1	29.2	29.5	31.5	2.0
Belgium	24.5	23.5	26.1	29.5	29.9	30.4	34.0	34.3	35.1	36.1	35.7	–0.4
Spain	31.1	28.7	28.5	25.7	25.7	23.2	21.6	23.1	25.2	24.6	22.0	–2.6
Finland	–	–	–	–	–	65.1	54.2	56.9	55.9	52.9	48.4	–4.5
France	34.5	33.7	32.2	30.7	29.3	30.9	32.8	33.5	33.9	34.1	30.7	–3.4
Italy	22.1	21.5	20.8	19.7	18.3	18.6	19.1	19.1	19.0	17.3	16.7	–0.6
Netherlands	36.5	33.7	35.7	38.2	38.9	36.3	41.6	41.4	40.6	42.6	38.0	–4.6
Portugal	–	33.1	35.6	38.3	35.9	33.3	34.6	32.9	31.2	34.4	–	–
United Kingdom	29.1	28.3	28.2	26.5	27.8	32.4	34.6	35.2	33.5	31.5	30.1	–1.3
EUR10	28.9	28.0	27.8	24.6	24.1	25.4	26.0	26.2	25.9	25.8	23.4	–2.4
Japan	24.5	25.5	27.7	28.2	28.6	30.7	31.5	33.8	35.1	37.3	36.3	–1.0
United States	41.6	43.6	46.3	47.5	50.1	52.2	52.2	53.0	53.7	53.7	52.5	–1.2

US enterprises continue to benefit from a more stable debt structure, with a ratio of debt in excess of one year to total debts consistently more than some 23 percentage points above the European average over the period from 1984 to 1994. Over the eleven years from 1984 to 1994, the average general trend reflects a reduction in the long–term debt of European enterprises expressed as a proportion of total indebtedness (ratio down from 28.9% to 23.4%). This general picture conceals a number of differences and contrasting developments within the European countries studied. Italy and Germany rely more heavily than average on short–term debt for their external financing. In Italy this reliance has even increased since 1984. Finland, the Netherlands, Belgium and Austria are the four countries in the sample that have greatest recourse to medium– and long–term borrowing.

Throughout the ten years between 1984 and 1994, the trend in financial charges borne by European enterprises was closely correlated with that of both short and long–term interest rates. The high share of short–term debt in the overall indebtedness of European enterprises (74% on average over the period between 1984 and 1994) makes them more sensitive to changes in short–term interest rates. Over the period from 1989 to 1993, the inversion of the interest–rate curve showed up in financial charges; as a proportion of gross profits, they rose from 24.5% in 1989 to 47.6% in 1993.

In 1994 the one–percentage–point reduction (from 4.3% to 3.3%) in short–term real interest rates (deflated by the rise in consumer prices) directly boosted the profitability of European enterprises. The burden of financial charges as a proportion of gross profits fell from 47.6% to 30.3% (a reduction of 17.3 percentage points). In 1995, with short–term real interest rates increasing slightly (from 3.3% to 3.6%), financial charges inevitably increased as a proportion of gross profits given the substantial share of short–term debt in the overall indebtedness of European enterprises.

3.3. Analysis of provisions for liabilities and charges

Provisions for liabilities and charges include provisions for pensions and similar obligations and other provisions. Legally speaking, such provisions are debts, for example to staff or former employees in the case of provisions for pensions and similar obligations. However, they do not constitute financial indebtedness since they have not been specifically negotiated to procure resources for enterprises. They may also partly contain true reserves akin to own funds. From a solvency viewpoint, however, they have to be included among debts. Provisions for liabilities and charges also constitute a means of accumulating resources within enterprises and they thus reduce the need for external financing.[22] Being available over the long term in an enterprise, provisions for liabilities and charges can be regarded, from a financing viewpoint, as being closer to own funds.

European countries divide into two sharply different categories. German and Austrian enterprises accumulate substantial resources in their provisions. More than 30% of the balance–sheet totals of German enterprises consist of provisions for liabilities and charges, more than 15% of which are provisions for pensions. In Austria provisions for liabilities and charges account for some 20% of the balance–sheet total, 10% of which are provisions for pensions. In all the other European countries,[23] provisions for liabilities and charges are very low, averaging some 5%.

By reducing the need for external financing, provisions accumulated in enterprises have the effect of easing the burden of interest paid on financial debts.[24] Over the period from 1987 to 1994, interest paid on financial debt amounted on average to 1.1% of turnover in Germany, as compared with an approximate average of 2.8% for the five countries providing this information (Belgium, France, Spain, Italy and the Netherlands).

Provisions accumulated in enterprises are also a source of profits. The investment of such sums increases the financial income normally obtained from the investment of an enterprise's liquid funds. Financial charges are deducted from financial income to calculate the net financial result. The net financial result can be related to value added. The indicator obtained determines the extent of the effect of an enterprise's financial activity on the value created by its current activity.

In 1994 the net financial result of European enterprises improved markedly, from –2.5 percentage points of value added to –1.2 of a percentage point of value added. In Japan, by contrast, the net financial result worsened slightly from –1.9 percentage points of value added to –2.1 percentage points (0.2 of a percentage point).

In Europe the improvement in the net financial results in 1994

[22] There is a cost attached to these provisions. For example, provisions for pensions are remunerated at a rate applied internally within the enterprise; the amounts in question entail an additional allocation to provisions for the financial year. Not being paid out, this additional provision benefits the enterprise's liquidity position.

[23] Some countries, notably Belgium, also have extra–statutory or voluntary provisions for pensions. In most cases, the funds are paid out and entrusted to third–party managers, frequently insurance companies.

[24] This item in the Bach profit and loss account (interest paid on financial debt) is for the moment imperfectly harmonized. However, there can be no doubting the general trend towards an easing of the burden of such interest brought about by internal resources (provisions).

TABLE 15 : **Ratio of provisions for liabilities and charges – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	31.5	32.2	31.7	31.6	31.3	31.9	32.5	33.9	1.4
Austria	21.8	21.9	21.5	20.1	20.7	21.4	21.0	20.8	20.5	19.3	19.2	–0.1
Belgium	3.7	3.8	4.1	4.2	4.4	3.6	3.7	3.8	3.7	4.1	3.9	–0.1
Spain	0.6	1.0	1.3	1.5	1.8	2.7	3.8	4.3	4.7	5.7	5.4	–0.3
Finland	–	–	–	–	–	7.7	8.5	6.7	4.9	8.9	9.8	0.9
France	5.4	4.9	5.2	5.0	4.9	4.6	4.6	5.1	6.0	6.0	5.6	–0.4
Italy	7.1	7.3	7.2	7.0	7.7	7.0	7.1	7.2	7.2	8.0	8.0	0.0
Netherlands	7.4	7.3	7.3	7.2	6.4	6.2	6.0	5.4	5.3	5.3	–	–
Portugal	–	–	–	–	–	–	1.6	1.4	1.3	1.2	–	–
United Kingdom	4.5	4.4	5.3	6.2	6.1	5.6	12.1	13.6	14.9	18.1	17.0	–1.0
EUR10	5.9	5.8	6.1	13.8	14.2	13.6	14.6	14.8	15.3	16.3	17.1	0.8
Japan	4.7	4.8	4.6	4.8	4.7	4.3	4.1	4.1	4.1	4.2	4.0	–0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 16 : **Financial result relative to value added – Manufacturing industry**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
Germany	–	–	–	2.2	1.9	1.7	1.4	1.1	0.9	3.8	3.3	–0.6
Austria	–6.6	–6.9	–6.2	–6.1	–5.1	–5.1	–5.6	–3.7	–1.9	–1.8	–0.9	0.9
Belgium	–4.0	–2.8	–2.6	–1.6	–0.8	0.4	–0.9	–2.0	–3.8	–3.0	–2.8	0.3
Spain	–20.0	–15.7	–11.6	–8.2	–6.2	–4.7	–5.7	–7.6	–10.8	–13.8	–7.3	6.5
Finland	–	–	–	–	–	–8.9	–5.9	–14.3	–18.2	–14.0	–2.7	11.2
France	–5.8	–4.9	–3.2	–2.3	–1.6	–1.5	–2.4	–2.3	–1.9	–1.2	0.6	1.7
Italy	–12.1	–10.4	–7.8	–6.2	–6.0	–7.1	–7.9	–8.3	–11.3	–9.2	–6.0	3.2
Netherlands	3.2	0.8	2.6	5.2	7.1	7.6	2.4	9.7	4.9	6.0	–	–
Portugal	–	–	–	–	–	–	–14.2	–14.8	–15.8	–16.1	–	–
United Kingdom	–	–	–	–	–	–	–	–	–	–2.8	–2.9	–0.1
EUR10	–9.0	–7.7	–5.5	–1.7	–1.3	–1.6	–2.6	–2.8	–4.0	–2.5	–1.2	1.3
Japan	–3.7	–2.9	–1.9	–1.6	–1.3	–1.0	–1.8	–2.8	–2.6	–1.9	–2.1	–0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–

was reflected in a large majority of countries.[25] The greatest improvements were seen in Finland, Spain and Italy. An appreciable improvement was recorded in France where the net financial result of enterprises became positive for the first time since 1984. A less marked improvement was seen in Austria and Belgium.

Over the period from 1984 to 1994, European enterprises saw a spectacular easing of the burden of their net financial result as a proportion of value added, from –9 percentage points in 1984 to –1.2 percentage point in 1994. The reduction amounted in Spain to 12.7 percentage points, in France to 6.4 percentage points, in Finland to 6.2 percentage points (between 1989 and 1994) and in Austria to 5.7 percentage points. **Germany has benefited continually from a positive net financial result since 1987, which increases the wealth created by enterprises by 2 percentage points of value added on average.[26]**

4. THE SITUATION OF EUROPEAN SMES

This section compares the financial situation of SMEs with that of large enterprises in manufacturing industry.[27] Performances (section 1), charges (section 2) and financial structure (section 3) are covered in turn.

[25] The net financial result for the Netherlands should be viewed separately. The financial consolidation technique improves the net financial result by its very nature.

[26] This positive net financial result stems from large German enterprises. The net financial result for small and medium-sized German enterprises was negative between 1987 and 1994.

[27] Activity in manufacturing industry is fairly heavily concentrated, with less than 10% of the enterprises accounting for more than 60% of total turnover.

As the following table shows, not all the national data necessary for comparing the situation of SMEs with that of large enterprises are harmonized. Each country supplying data to BACH is responsible for its definition of small, medium-sized and large enterprises. The analyses set out here are therefore based on those national definitions.[28,29]

4.1. Performances of European SMEs

4.1.1. Overall gross profit ratio

In 1994 the overall gross profit ratio of European SMEs picked up, rising from 9.9% to 10.7% (an increase of 0.8 of a percentage point). This improvement was less marked, however, than that recorded by large European enterprises (increase of 1.5 percentage points). The upturn in economic activity in manufacturing industry thus benefited SMEs less than large enterprises. **This less marked improvement in the overall gross profit ratio was due to a more moderate reduction in the burden of staff costs in SMEs (down by 0.6 of a percentage point) than in large enterprises (down by 1.4 percentage points).**

[28] Statistical tests carried out on the national samples show that the use of a common criterion in Europe, for example the turnover level, does not alter the distributions and significance of the data. As from 1996, however, a common criterion will be used in the BACH database: small enterprises will be those with turnover below ECU 7 million, medium-sized enterprises will be those with turnover between ECU 7 million and ECU 40 million, and large enterprises will be those with turnover in excess of ECU 40 million.

[29] The amounts expressed in ecus have been converted at the average ecu rate for the 1990–95 period.

COUNTRY	PERIOD	SMALL AND MEDIUM-SIZED ENTERPRISES	LARGE ENTERPRISES
GERMANY	(87–94)	Turnover < DM 100 million (ECU 50.6 million)	Turnover > DM 100 million (ECU 50.6 million)
AUSTRIA	(84–94)	Fewer than 1 000 employees	More than 1 000 employees
BELGIUM	(84–94)	Fewer than 100 employees and turnover < BFR 145 million (ECU 3.5 million) or balance-sheet total < BFR 80 million (ECU 1.95 million)	More than 100 employees or turnover > BFR 145 million (ECU 3.5 million) or balance-sheet total > BFR 80 million (ECU 1.95 million)
SPAIN	(84–94)	– Small enterprises – fewer than 100 employees and total assets < PTA 5 000 million and total expenditure < PTA 5 000 million (ECU 34.8 million) – Medium-sized enterprises – 101 to 500 employees or total assets > PTA 5 000 million or total expenditure > PTA 5 000 million (ECU 34.8 million)	More than 500 employees or total assets > PTA 50 000 million or total expenditure > PTA 50 000 million (ECU 348 million)
FINLAND	(89–94)	Fewer than 100 employees	More than 100 employees
FRANCE	(84–94)	Fewer than 500 employees	More than 500 employees
ITALY	(84–94)	Fewer than 500 employees	More than 500 employees
NETHERLANDS	(84–94)	Fewer than 500 employees	More than 500 employees
PORTUGAL	(90–94)	Fewer than 500 employees	More than 500 employees
UNITED KINGDOM	(84–94)	Fewer than 500 employees	More than 500 employees
JAPAN	(84–94)	Capital < YEN 1 billion (ECU 6.7 million)	Capital YEN 1 billion (ECU 6.7 million)
UNITED STATES	(84–94)	Balance-sheet total < USD 25 million (ECU 20 million)	Balance-sheet total USD 25 million (ECU 20 million)

TABLE 17 : **Overall gross profit ratio – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	11.0	11.6	11.7	11.1	11.3	11.2	11.2	10.9	10.5	9.9	10.7	0.7
Japan	8.3	8.1	8.0	9.0	9.3	9.8	9.5	9.7	9.0	7.7	7.7	0.0
United States	7.8	7.1	7.1	7.1	7.5	7.3	6.9	6.4	7.0	7.3	8.2	0.9
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	11.5	11.8	12.7	12.3	12.8	13.3	12.4	12.1	11.4	10.3	11.9	1.5
Japan	12.6	12.2	11.8	12.6	13.0	13.2	12.8	11.8	10.7	10.3	10.4	0.1
United States	13.6	13.0	13.8	15.0	15.4	14.5	13.5	12.2	11.8	12.9	14.7	1.7

TABLE 18 : **Net profit ratio – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	3.5	3.5	3.5	3.2	3.3	3.0	2.6	2.0	1.1	0.9	2.0	1.1
Japan	1.1	1.0	0.8	1.4	1.7	1.7	1.5	1.2	0.7	0.1	0.3	0.2
United States	2.9	2.4	2.4	2.5	3.3	3.2	3.0	2.5	3.1	3.4	4.3	0.8
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	0.8	1.5	2.5	3.1	3.5	3.8	2.8	2.0	0.7	0.0	2.1	2.1
Japan	2.3	2.1	1.6	2.1	2.7	3.0	2.8	2.2	1.3	1.0	1.3	0.3
United States	5.1	4.2	4.2	5.6	6.2	5.1	3.9	2.3	0.4	2.7	5.5	2.8

Over the period from 1984 to 1994, the overall gross profit ratio of European SMEs was more stable than that of large enterprises. The maximum deviation from average was limited to 0.7 of a percentage point, compared with 1.7 percentage points for large enterprises. SMEs appeared to be more resistant to economic recession or slowdown than large enterprises, but it should be borne in mind that SMEs have higher mortality rate. From 1988 to 1993, the gross profit gap between SMEs and large enterprises narrowed (from 1.48 percentage points to 0.38 of a percentage point). During periods in which economic activity is growing, however, SMEs fail to improve their performances at the same pace as large enterprises. In 1994 the gross profit gap between SMEs and large enterprises again widened (to 1.16 percentage points).

Over the period from 1984 to 1994, the gross profit ratios of European SMEs were consistently below those of large enterprises (1 percentage point lower on average). US and Japanese SMEs also record overall gross profit ratios which are consistently lower than those of large enterprises in those countries, although the differences are greater (3.2 percentage points on average in Japan and 6.4 percentage points in the United States).

4.1.2. Net profit ratio

In 1994 the net profit ratios of European SMEs improved markedly, rising from 0.9% to 2% (an increase of 1.1 percentage points). However, this improvement was less substantial than that recorded by large European enterprises (2.1 percentage points). The upturn in activity in manufacturing industry, which prompted the rise in net profit margins in Europe in 1994, thus benefited SMEs less than large enterprises. This less marked improvement in net profit ratios was not due to the burden of financial charges borne by SMEs. That burden was slightly less in SMEs in 1994 (2.5% of turnover) than in large enterprises (2.8%). **The more moderate improvement in net profit ratios in SMEs in 1994 was due to a lesser capacity to generate financial income.** The net financial results of European SMEs (financial income – financial charges) were less favourable in 1994 than those of large enterprises.[30]

The net profit ratios of European SMEs show a very much less favourable trend than those of US SMEs. In 1994 the net profit ratios of US enterprises were more than twice as high as those

[30] This situation is particularly affected by the German data. Over the period from 1987 to 1994, the net financial results of German SMEs were consistently negative, whereas those of large German enterprises were consistently positive.

TABLE 19 : **Financial result relative to value added – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	–9.8	–8.9	–7.5	–4.8	–4.4	–5.0	–5.5	–5.8	–6.5	–5.0	–4.1	0.9
Japan	–4.2	–4.0	–3.3	–2.9	–2.5	–2.5	–3.9	–4.7	–4.1	–3.1	–2.4	0.7
United States	–	–	–	–	–	–	–	–	–	–	–	–
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	–8.5	–6.8	–4.0	–0.4	0.0	–0.1	–1.2	–1.2	–2.6	–1.2	0.2	1.4
Japan	–3.2	–1.5	0.2	0.2	0.5	0.9	0.7	–0.2	–0.5	–0.4	–1.8	–1.4
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 20 : **Financial profitability – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	10.6	10.1	11.4	11.6	12.6	12.6	11.1	8.0	3.9	2.9	7.0	4.1
Japan	8.6	8.1	5.8	9.4	11.8	11.2	10.1	8.0	4.4	0.5	1.7	1.2
United States	13.6	11.3	10.7	11.4	15.4	15.5	13.7	11.4	14.3	16.0	20.4	4.4
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	–0.5	4.5	7.9	10.4	11.6	12.7	9.1	6.3	1.5	–1.2	5.9	7.1
Japan	8.7	7.5	5.1	6.1	7.6	7.5	7.2	5.5	3.1	2.3	2.9	0.6
United States	12.5	9.9	9.7	12.9	14.6	11.9	8.9	5.0	1.0	6.6	13.4	6.8

of European SMEs. From 1984 to 1991, by contrast, the net profit ratios of European SMEs were very similar to those of US SMEs. Finally, over the period from 1984 to 1994, large US enterprises consistently recorded net profit ratios that were well above those of large European enterprises (except in 1992).

4.1.3. Financial profitability

In 1994 the financial profitability ratios of European SMEs improved markedly, rising from 2.9% to 7% (an increase of 4.1 percentage points). This improvement was less substantial than that recorded by large enterprises (7.1 percentage points), which started from a negative financial profitability ratio in 1993.

Over the period from 1984 to 1994, European SMEs' financial performance was almost always appreciably better than that of large enterprises. Large enterprises recorded negative performances in 1984 and 1993. This never happened in the case of SMEs over the same period.[31] From 1986 to 1989 a quite marked convergence was noted, both in the common trend towards an improvement in the financial profitability ratio and in the levels achieved: 12.6% in 1989 for SMEs and 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 1993 SMEs established a considerable lead of 4 percentage points, although that lead was cut to 1 percentage point in 1994.

In Europe the return on equity capital invested in SMEs is significantly higher than that on equity capital invested in large enterprises. This situation could promote the development of stock markets specifically designed for SMEs.

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

4.2.1. Purchases as a proportion of turnover

In 1994 European SMEs' purchases of goods and services as a proportion of turnover fell very slightly (by 0.1 of a percentage point). This situation was similar to that recorded for large European enterprises (reduction of 0.3 of a percentage point).

Between 1984 and 1989, SMEs consistently recorded higher purchases of goods and services as a proportion of turnover than large European enterprises. From 1990 the gap reversed in favour of SMEs (–1 percentage point in 1994). 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.

Purchases of goods and services would therefore no longer seem to be a distinguishing feature separating SMEs and large enterprises in Europe.

4.2.2. Value added

In 1994 the value added ratio of European SMEs increased very slightly (by 0.1 of a percentage point). This trend was similar to that recorded by large European enterprises. Since 1989 the value added ratio of European SMEs seems to have stabilized at a level above that of large enterprises, irrespective of the situation of the economic cycle. The level of activity integration seems to be higher in SMEs, which have less systematic recourse to subcontracting. The competitive effect of the internal market also seems to be spreading more slowly among European SMEs than among large enterprises.

In Japan the value added ratio of SMEs is distinctly higher than that of large enterprises (2.2 percentage points higher on average over the period from 1984 to 1994).

4.2.3. Staff costs

In 1994 staff costs borne by European SMEs fell slightly in relation to turnover from 23.8% to 23.2% (a reduction of 0.6 of a percentage point). This reduction is markedly less than that recorded by large enterprises (–1.4 percentage points).

Over the period from 1984 to 1994, European SMEs experienced a marked increase in their staff costs, from 19% to 23%, whereas the ratio for large enterprises fell from 21.4% to 20.7%. This reflects a sharp reduction in the workforces of large enterprises over that period as a result of restructuring.

[31] The statistical technique of the two-year constant revolving sample may partly explain the clearly better performances of SMEs. When in difficulty, SMEs file for bankruptcy more quickly than large enterprises and so disappear from the sample. This improves the average profitability. However, the statistical samples are still representative of the national economies. When active, European SMEs would seem to provide a better financial return on capital than large enterprises.

TABLE 21 : **Relative share of purchases of goods and services – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	72.5	72.4	70.9	63.3	64.0	64.8	63.9	63.2	62.7	63.2	63.1	–0.1
Japan	73.0	73.3	73.8	72.1	71.9	72.4	72.5	71.3	70.4	70.6	70.8	0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	70.8	70.6	68.0	63.0	63.1	64.6	65.2	64.6	64.5	64.4	64.2	–0.3
Japan	76.8	77.0	77.2	76.0	75.8	75.7	76.2	76.6	76.6	76.3	75.7	–0.6
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 22 : **Value added ratio – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	27.4	27.3	28.4	31.5	31.3	30.6	31.2	31.6	31.8	31.6	31.7	0.1
Japan	27.0	26.7	26.2	27.9	28.1	27.6	27.5	28.7	29.6	29.4	29.2	–0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	30.1	29.8	31.6	31.5	31.5	30.2	29.6	29.6	29.2	29.4	29.4	0.0
Japan	23.2	23.0	22.8	24.0	24.2	24.3	23.8	23.4	23.4	23.7	24.3	0.6
United States	–	–	–	–	–	–	–	–	–	–	–	–

TABLE 23 : **Relative share of staff costs – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	19.0	18.7	18.9	22.9	22.6	22.1	22.7	23.2	23.8	23.8	23.2	–0.6
Japan	19.2	19.0	18.8	19.4	19.1	18.4	18.3	19.3	20.7	21.5	21.3	–0.2
United States	–	–	–	–	–	–	–	–	–	–	–	–
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	21.4	21.3	21.8	22.7	21.8	20.9	21.2	21.6	21.9	22.1	20.7	–1.4
Japan	12.3	12.6	13.2	13.2	12.6	12.6	12.6	13.0	13.7	14.3	14.2	–0.1
United States	–	–	–	–	–	–	–	–	–	–	–	–

4.3. Financial structures

4.3.1. Indebtedness and own funds

In 1994 the overall debt ratio of European SMEs remained stable (at 57.9%). By contrast, the overall debt ratio of large European enterprises showed a fairly distinct fall, from 49% to 48% (–1 percentage point).

In 1994 the overall debt ratio of European SMEs stood at an appreciably higher level (57.9%) than that of large enterprises (48%). This situation may reflect increased recourse to borrowing due to greater growth in investment. It also indicates the difficulty encountered by European SMEs in obtaining equity capital funding for themselves. The European financial markets are still largely out of the reach of European SMEs. But this situation also reflects the special importance of large German enterprises in European manufacturing industry. The massive provisions for liabilities and charges made by large German enterprises reduce the need for external financing in large European enterprises, taken on average.

From 1984 to 1994, the overall indebtedness of European SMEs increased slightly (from 56.6% to 57.9%). The general debt–shedding process between 1984 and 1994 in Europe was therefore due largely to large enterprises. From 1984 to 1986 European SMEs carried appreciably less debt than large enterprises (–6.8 percentage points in 1984 and –3.2 percentage points in 1986). Since 1987 European SMEs have carried more debt[32] than large enterprises.

In Germany and Austria the overall debt ratios of SMEs are very much higher than those of large enterprises (difference of 25.4 percentage points and 10.7 percentage points respectively). The same applies to Portugal (difference of 12.8 percentage points) and Finland (difference of 9.7 percentage points). The gap between the overall debt ratios of SMEs and those of large enterprises is limited in Italy (4 percentage points) and in Belgium (5.2 percentage points). The overall debt ratios of SMEs are very similar to those of large enterprises in France (difference of 0.4 of a percentage point). In the other countries, the overall debt ratios of SMEs are lower than those of large enterprises: the Netherlands (–1.3 percentage points), Spain (–6.2 percentage points) and the United Kingdom (–8.2 percentage points).

In 1994 the own funds ratio of SMEs increased slightly, from 32.4% to 32.7% (increase of 0.3 of a percentage point). This increase was slightly less than that recorded by large European enterprises (+0.6 of a percentage point). Over the period from 1984 to 1994, the own funds ratio of European SMEs fell from 37.4% to 32.7%. Over the same period, the ratios of large enterprises improved from 27.1% to 32.4%.

Since the beginning of the 1990s, the own funds ratios of SMEs and large enterprises have been fairly similar in Europe. By contrast, US SMEs have higher own funds ratios than large US enterprises. In Japan large enterprises have significantly higher own funds ratios than SMEs. In 1994 US SMEs seemed to be better capitalized than their European and Japanese counterparts. This situation may be due to better access to start–up capital. In 1994 large Japanese enterprises had higher own funds ratios than large European and US enterprises.

[32] The statistical effect arising from the start–up of the German data series in 1987 should not, however, be disregarded. Provisions for liabilities and charges are significantly lower in German SMEs than in large enterprises. This increases the external financing needs of SMEs compared with large enterprises and hence their overall debt ratio.

TABLE 24 : **Overall debt ratio: difference between SMEs and large enterprises – Manufacturing industry**

	Average 1984 – 1994		Difference
	SME	**Large enterprises**	
Germany	60.0	34.6	25.4
Austria	59.4	48.7	10.7
Belgium	60.5	55.2	5.2
Spain	53.6	59.9	–6.2
Finland	75.0	65.3	9.7
France	64.9	64.5	0.4
Italy	65.1	61.1	4.0
Netherlands	42.9	44.2	–1.3
Portugal	60.7	47.9	12.8
United Kingdom	41.0	49.2	–8.2
EUR10	57.6	52.8	4.8
Japan	74.3	57.3	16.9
United States	53.0	52.5	0.5

TABLE 25 : **Overall debt ratio – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	56.6	56.4	56.5	55.9	56.7	59.1	59.0	58.6	58.7	57.9	57.9	0.0
Japan	75.4	75.0	74.2	73.3	73.9	74.0	74.6	73.9	73.9	74.3	74.2	–0.1
United States	53.4	54.0	53.4	53.3	53.6	52.8	52.8	52.3	51.9	52.4	53.1	0.7
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	63.4	60.8	59.7	50.8	49.7	50.6	49.8	49.1	49.6	49.0	48.0	–0.9
Japan	64.1	61.9	60.3	58.6	57.1	55.8	55.9	55.6	54.8	53.7	53.0	–0.7
United States	46.5	48.2	50.0	51.2	52.8	54.2	54.5	54.2	55.7	55.5	54.7	–0.8

TABLE 26 : **Own funds ratio – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	37.4	37.6	36.4	34.1	33.4	30.9	31.3	31.9	31.5	32.4	32.7	0.3
Japan	19.4	19.6	20.8	21.0	20.8	21.1	20.9	21.6	21.6	20.8	21.3	0.5
United States	45.7	45.0	45.3	45.6	45.4	46.1	46.1	46.4	46.9	46.6	45.8	–0.8
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	27.1	29.9	30.8	32.4	32.9	32.8	32.8	33.2	32.1	31.8	32.4	0.6
Japan	29.8	31.9	33.5	35.2	36.7	38.3	38.5	38.9	39.6	40.6	41.2	0.6
United States	49.6	48.0	46.9	46.0	44.6	42.8	42.7	42.6	39.4	38.9	40.4	1.5

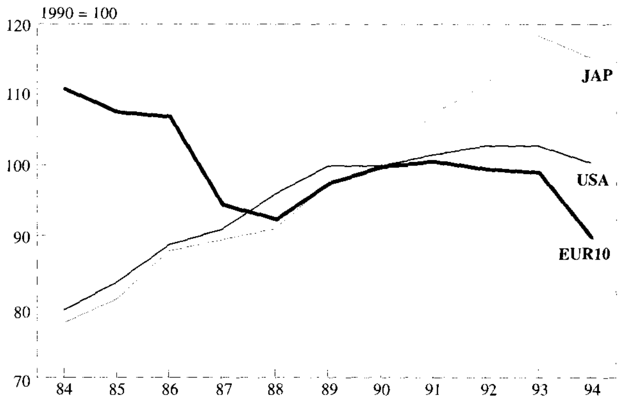
4.3.2. Structure of debt

In 1994 the long–term debt of European SMEs fell appreciably, as a proportion of their total debt, from 24.9% to 23.1% (a fall of 1.8 percentage points). However, this reduction is smaller than that recorded for large enterprises (–3 percentage points).

In 1994 the debt structure of European SMEs was very similar to that of large enterprises. The proportion of short–term debt carried by SMEs was 76.9%, as compared with 77.2% in the case of large enterprises. From 1984 to 1994, the share of medium– and long–term debt in the overall indebtedness of SMEs increased significantly, from 19.5% to 23.1%. Large enterprises experienced a reverse trend over the same period (31% in 1984, 22.7% in 1994).

In 1994, therefore, the apparent rate of interest paid by European SMEs on financial debt (7.7%) was very close to that paid by large enterprises (7.6%). Over the period from 1984 to 1994, the apparent rate of interest borne by European SMEs was 1 percentage point higher on average (9.5% for SMEs and 8.5% for large enterprises).

GRAPH 13 : **Debt structure – Manufacturing industry**



Source : DGII, BACH.

TABLE 27 : **Debt structure (ratio of debt of more than one year to total debt) – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	19.5	20.4	22.8	22.5	22.1	23.0	22.9	23.8	24.1	24.9	23.1	–1.9
Japan	26.0	27.2	29.2	30.0	30.6	31.5	33.3	35.5	38.0	40.0	39.4	–0.6
United States	36.4	36.8	36.7	36.1	37.0	38.2	38.0	38.6	38.1	39.0	38.3	–0.7
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	31.0	30.1	29.6	25.2	24.4	25.7	26.5	26.6	26.0	25.7	22.7	–3.0
Japan	23.0	23.8	26.1	26.2	26.6	29.9	29.8	32.1	32.3	34.6	33.0	–1.6
United States	44.4	46.9	49.6	51.0	53.6	55.5	55.3	55.8	56.4	56.2	54.7	–1.5

TABLE 28 : **Apparent rate of interest on financial debt – Manufacturing industry**

SME	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	11.3	11.1	10.0	8.3	8.0	8.8	9.8	9.8	10.2	9.5	7.7	–1.8
Japan	9.0	8.7	7.7	6.6	6.2	6.3	7.9	8.7	6.9	5.6	4.9	–0.7
United States	1.9	2.2	2.1	2.5	2.4	3.2	3.1	3.4	3.6	3.3	3.1	–0.2
Large enterprises	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	94–93
EUR10	10.4	9.9	8.7	7.3	6.9	7.7	8.7	8.7	9.5	8.8	7.6	–1.2
Japan	9.2	8.3	6.9	5.8	5.4	5.5	6.6	6.4	5.4	4.7	4.4	–0.3
United States	7.1	7.7	8.2	6.9	6.5	7.7	7.9	8.9	13.5	9.8	6.2	–3.7

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 + value adjustments to financial and non–financial assets to turnover exclusive of tax	7+12+13+Y+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 year to equity capital	21/L–A
4	**RELATIVE SHARE OF PURCHASES OF GOODS AND SERVICES:** Ratio of consumption of goods and services to turnover exclusive of tax	5/1
5	**VALUE ADDED RATIO:** Ratio of Bach value added to operating income	T/S
6	**RELATIVE SHARE OF STAFF COSTS:** Ratio of staff costs to turnover exclusive of tax	6/1
7	**STAFF COSTS RELATIVE TO VALUE ADDED:** Ratio of staff costs to Bach value added	6/T
8	**GROSS OPERATING PROFIT:** Ratio of gross operating profit or loss to turnover exclusive of tax	U/1
9	**RELATIVE SHARE OF FINANCIAL CHARGES:** Ratio of interest and similar charges to turnover exclusive of tax	13/1
10	**APPARENT RATE OF INTEREST ON FINANCIAL DEBT:** Ratio of interest paid on financial debt to debt owed to credit institutions with a remaining period to maturity of less than one year + other short–term financial debt + financial debt with a remaining period to maturity of more than one year + bonds *NB:* 13a, F101 and I101 are replaced by 13, F10 and I10 where the former are not available	13a/F2+F101+I1+I2+I101
11	**FINANCIAL CHARGES AS A PROPORTION OF GROSS TRADING RESULT:** Ratio of interest and similar charges to gross trading result	13/U
12	**OWN FUNDS RATIO:** Ratio of own funds less unpaid share capital to balance–sheet total	L–A/FL
13	**OVERALL DEBT RATIO:** Ratio of debt with a remaining period to maturity of more than one year + debt with a remaining period to maturity of less than one year to total liabilities	F+I/FL
14	**DEBT STRUCTURE:** Ratio of debt with a remaining period to maturity of more than one year to debt with a remaining period to maturity of more than one year + debt with a remaining period to maturity of less than one year	I/I+F
15	**RATIO OF PROVISIONS FOR LIABILITIES AND CHARGES:** Ratio of provisions for liabilities and charges to balance–sheet total	J/FL
16	**FINANCIAL RESULT RELATIVE TO VALUE ADDED** Ratio of financial income – interest and similar charges to Bach value added	9/11 – 13/T

Further details about the ratios:

The overall gross profit ratio (ratio of gross profit to turnover)

The overall gross profit is used to measure an enterprise's capacity to realize an overall profit from all of its activities before taxes, remuneration of lenders of capital and allocations to provision accounts.

The net profit ratio (ratio of net profit to turnover)

The net profit is calculated by deducting financial charges, taxes and depreciation from the gross profit. It is sensitive to tax legislation in particular and to movements in interest rates.

Financial profitability (ratio of net profit to equity capital)

This ratio is of particular interest to shareholders. It gives an indication, relative to the funds they provide (equity capital), of the profitability of the private sector and the switching possibilities vis–à–vis risk–free fixed–income investments.

Principal economic policy measures – February/March 1996

Community (EUR–15)

6.3 Commission adopts the 1996 Annual Economic Report.

Belgium (B)

1.2 The central bank reduces its central rate from 3.40% to 3.30% and its rate on advances within the ceiling from 4.65% to 4.55%.

Denmark (DK)

8.2 The National Bank lowers the repo rate by 10 basis points to 4.25%.

6.3 The central bank reduces its discount rate by 25 basis points to 3.75%. The repo rate is cut by 15 basis points to 4.10%.

21.3 The central bank cuts the repo rate by 10 basis points to 4.00%.

Germany (D)

13.2 A revised regulation on early retirement comes into force, with the aim of counteracting the recent significant rise in costs. Until now, workers could retire at 60 with a full pension if they had been unemployed for at least one year. This system has been modified, with a gradual increase in the age requirement and with it still being possible to receive a pension at 60 but at a reduced rate. The savings will materialize from 1998 onwards.

28.2 The Bundestag approves the reform of the law on social security (*Bundessozialhilfegesetz*). The aim of the reform is to give those receiving income support a greater incentive to find employment. Other new measures introduced include financial incentives for employers and employees, as well as retraining grants. In addition, penalties for refusing to accept a job and a minimum gap between the level of government transfers and the lowest wage level have been introduced.

Greece (GR)

14.2 The Bank of Greece announces that the commission paid to banks is to be reduced:

- for compulsory deposits, to 1.6% (from 1.8%) on March 1 and to 1.4% on June 1;
- for non–compulsory deposits, to 0.7% (from 0.8%) on March 1.

For the second half of the year, the Bank of Greece intends to make a further reduction (from the present level of 70%) in the foreign–exchange deposits that banks are required to hold with it.

21.2 The Bank of Greece announces its monetary policy for 1996. The primary objective is a further reduction of inflation, as measured by the consumer–price index, to 5% at year–end or to 7% on average. To achieve the inflation objective, the programme sets M3 growth at 6%–9%, which is consistent with domestic credit growth of 5%–7%, and targets a broadly constant rate of the drachma against the ecu.

Spain (E)

6.3 The Spanish Ministry of Finance decides to cut public expenditure in 1996 by a further PTA 165 billion. Investment is to be reduced by PTA 140 billion and current spending by PTA 25 billion.

13.3 At the regular ten–day repurchase tender for central bank certificates the Bank of Spain cuts its key money rate by 50 basis points to 8.25% .

France (F)

1.2 The Bank of France cuts its intervention rate to 4.05% from 4.20%.

7.2 The Government adopts the draft law laying down various economic and financial provisions. The draft law is the legislative embodiment of commitments entered into by the Government. It relates in particular to the implementation of the plan for SMEs presented at the end of November and to the measures to underpin economic activity that were announced on 21 December 1995 and 30 January 1996.

8.2 The Bank of France cuts its intervention rate to 3.9% from 4.05%.

5.3 The Industry Minister announces FF 2.1 billion in aid for the textile industry. The package consists of a reduction in employers' social security contributions and other charges in return for a commitment that they will promote recruitment of young people, and of a restructuring of working time.

7.3 The Bank of France cuts its intervention rate to 3.80% from 3.90% and its five–to–ten–day rate to 5.50% from 5.60%.

14.3 The Finance Minister announces that a spending appropriation of FF 20 billion will be frozen in the 1996 budget.

21.3 The Prime Minister announces a tax reform spread over a five–year period. Its purpose will be to:
- end the exceptional tax increases decided in order to reduce deficits;
- simplify and reduce income tax;
- reform the financing of the social security system.

Ireland (IRL)

None.

Italy (I)

None.

Luxembourg (L)

None.

Austria (A)

2.2 The Austrian National Bank reduces the GOMEX rate from 3.65% to 3.5%.

Netherlands (NL)

1.2 The Nederlandsche Bank decides to reduce its rate on special advances from 3.20% to 3%.

7.2 Subject to certain conditions, the Senate adopts the reform of the law on employees' sickness insurance which had been proposed by the labour/liberal coalition. This will enable the new legislation to be brought in on 1 March 1996 and will abolish assistance which the State has provided since 5 June 1913. Under the new law, firms will be required to pay employees 70% of their wages for 52 weeks, but will be able to take out insurance against the risk of their employees falling ill.

28.3 The Nederlandsche Bank cuts its central rate from 2.75% to 2.50% and reduces its rate on special advances from 3% to 2.90%.

Portugal (P)

1.2 The Banco de Portugal reduces its discount rate from 9.5% to 8.75%.

20.2 The Banco de Portugal cuts its repo rate by 1/8 of a percentage point to 8%.

6.3 The budget for 1996 is approved by the Parliament. It predicts an overall deficit of 4.2% of GDP.

11.3 The Banco de Portugal cuts its money market intervention rates. The repo rate is reduced by 10 basis points to 7.9%. The overnight standing facility and the rate for draining liquidity are lowered by 25 basis points to 10.25% and 7.5% respectively.

26.3 The Banco de Portugal reduces its repo rate by 10 basis points, to 7.8%.

Finland (FIN)

12.2 The Government decides on a supplementary budget for 1996, with expenditure increases amounting to about 1% of GDP, most of which goes to the financing of the higher–than–expected level of unemployment and to new employment programmes such as renovations of public buildings and subsidies to shipyards.

12.2 The Government adopts annual ceilings for central government expenditure in 1997–99, with the volume of expenditure due to remain unchanged in 1997 before contracting by 1.4% in 1998 and then showing an unchanged level again in 1999.

13.3. The Bank of Finland cuts its tender rate, which is the benchmark for market interest rates, from 4.25% to 3.75%. In addition, the interest rate on banks' excess reserves held at the Bank of Finland is cut from 2.25% to 1.75%. The cuts are justified by a lowering of the Bank's inflation forecast to 1.5–2%

15.3 Government submits to Parliament a bill amending the Currency Act, which would allow the markka to join the ERM. However, the decision to join the ERM will have to be taken separately: the amended law by itself will not prevent the currency from continuing to float. If Finland joined the ERM, the Government could, on a proposal from the Bank of Finland, authorize the Ministry of Finance to decide on changes in the external value of the markka.

Sweden (S)

13.2 The Central Bank lowers the repo rate by 15 basis points to 8.30%

22.2 The Central Bank lowers the repo rate by a further 25 basis points to 8.05% and narrows the "corridor" by 50 basis points to 7.5%–9%.

5.3 The Swedish central bank, the Riksbanken, cuts the repo rate by a further 20 basis points to 7.85%.

19.3 The central bank cuts the repo rate by a further 25 basis points to 7.60%.

21.3 The Governing Board of the central bank cuts its lending and deposit rates, the "corridor", by 75 basis points to 6.75–8.25%.

26.3 The central bank lowers the repo rate by a further 20 basis points to 7.40%.

United Kingdom (UK)

8.3 The Chancellor of the Exchequer cuts the base rate to 6%.

27.3 The European Commission officially confirms a world–wide ban on British beef exports.

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CM-AS-96-004-EN-C