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Executive Summary

Financial structures and financing strategies of German SMEs: a status report

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Since 2003, equity ratios of German small and medium sized enterprises (SMEs) have been well on track. Previous differences between the equity ratios of SMEs and large enterprises have therefore strikingly decreased. Small and mediums sized enterprises even have larger equity ratios on average than large enterprises at the current edge of the observation period (2013), while only micro enterprises still have relatively small equity ratios on average despite very high growth rates. The proportion of micro enterprises without equity capital has also remarkably decreased. However, this figure still remains much greater when compared with enterprises of other size classes.

Capital structures of SME are hard to explain in theory

The observed changes in the capital structures of SMEs are hard to explain with existing theoretical approaches. On the one hand, there are several competing, to some extend conflicting theories which, on the other hand, are also based on assumptions that do not fully apply to SMEs. But existing research still allows the identification of possible determinants of the capital structure of SMEs. In particular, these are characteristics of the firm and the entrepreneur being important for finance, besides accessible sources of business financing, and finally relevant aspects of the business environment.

Bank borrowings are still the most important source of debt financing

While financing costs of large enterprises considerably declined as a result of the financial and economic crisis, interest rates generally paid by SMEs did decrease less strongly. This is largely because of the limited access of SMEs to the capital market and the stronger impact of the Second or Third Basel Accord on bank lending for SMEs. Hence, the so-called "credit hurdle" is higher for small enterprises in comaparison to larger ones; albeit on a historical low level. In general, SME have easy access to bank borrowings which still are their most important source of debt financing

Bank loans become less important

However, the share of liabilities to banks in balance sheet total is continuously declining. While SMEs mainly reduce short-term obligations to credit institutions, these liabilities are not substituted by other sources of debt financing such as trade credits. Admittedly, there is a general increase in loans to affiliated companies. But this effect is not large enough to counteract the growing importance of self-financing in SMEs.

Internal financing capability of SMEs is notably strenghtened

In general, the improved internal financing capability of SMEs can be affected by either means of an increase in (equity) capital or by means of self-financing such as the retention of earnings. The results show that the increase of the equity ratio of SMEs is rather driven by growing returns on sales, high cash flow ratios, and therefore increasing corporate earnings than external equity capital

Impact of business policies on SME funding has to be clarified

Since most of the German SMEs are run by the owner, retention of financial and economic independence is very important to them. Hence, it is possible that this unity of owner- and leadership in most German SMEs also affects their business policies and decisions about company funding. But to answer this question in more detail further research is needed that goes beyond the sole analysis of balance sheet data.

Specific economic policy actions are barely required

The current financial situation of German SMEs is generally good. By the ability to retain profits, they have been able to increase their equity ratio and their financial independence on external investors. Regarding economic policy, the results of the study do not imply a specific need for action. However, especially very small and therefore probably also young enterprises still have a relatively low equity ratio and most likely difficulty obtaining credits. Hence, current political measures to support company founders are evidently justified.

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