

East German enterprises' profitability and financing in 1996

The analysis of 3,420 sets of annual accounts of east German enterprises for the year 1996 shows hardly any further improvement in profitability overall. The manufacturing, construction and wholesale/retail trade firms included in the study remained "in the red" in 1996 on balance. The problematic profitability level in that year was due in large measure to the still slack economic momentum in Germany and to the process of structural adjustment in the east German construction industry. At the same time, there are quite a few enterprises in the eastern part of Germany which by virtue of their growing competitiveness, if not yet profitable, are at least breaking even; on the other hand, many firms are labouring under cost pressures and inadequate productivity and are finding it hard to make up the lost ground. On average the financing of the enterprises included in the study was satisfactory; this was especially true of their level of own funds. However, the gap between enterprises with a weak capital base and firms with a strong capital base has widened. Greater viability for heavily indebted enterprises, in particular, can be attained only through a sharp and sustained increase in their profitability.

Macroeconomic background

Overall development in eastern Germany

The process of economic reconstruction in eastern Germany clearly lost momentum in 1996; the growth of real GDP came to 2 %, compared with just over 5 % in 1995 and 9½ % in 1994. This was caused in part by the relatively subdued level of economic activity in western Germany, which also had a knock-on effect on the new Länder, but above all by factors specific to eastern Germany. Thus the previously high level of investment in the region declined, despite extensive government promotional measures, which particularly hit the construction industry. In addition, that industry's comparatively large share of the region's aggregate value added meant that the inclement weather at the start of the year had a greater adverse impact on overall output in eastern Germany than in western Germany. In the course of 1996, however, the process of structural change in the east was given fresh impetus through a strengthening of the region's industrial base and a lessening of the over-preponderance of the construction sector.

Economic trends in construction, ...

The strongest retarding influences on east Germany's overall economic development came from the construction industry. This is clearly shown by the fact that the real gross value added by that sector fell for the first time since 1991 by a margin of 2 %. This slump came as no surprise, however, as the number of buildings available had outstripped the demand in some market segments in the preceding years as a result of the surge in construction activity, and the number of vacant properties had increased

perceptibly. The decline in construction output was especially marked in industrial and commercial construction, not least because many investment projects aimed at building, extending and modernising factories and offices had been carried out in the preceding years. Construction investment in the public sector also decreased in 1996, although this represented something of a return to normal after the most pressing bottlenecks in the public infrastructure of east Germany had been overcome. By contrast, residential construction activity increased by 13 %, measured by construction turnover. It has to be remembered, however, that the number of rented dwellings completed in 1996 was considerably inflated by projects brought forward in anticipation of the reduction in government fiscal incentives from the beginning of 1997.

Real gross value added by the wholesale/retail trade sector in 1996 increased by only 2½ %, compared with 7 % in the previous year. One of the factors responsible for the deceleration in the business trend in the wholesale trade was the falling demand for building materials and the initially subdued level of industrial activity. The retail trade was adversely affected by the fact that the consumption climate worsened with the further deterioration on the labour market. Furthermore, the rate of expansion in this field in Germany – as in the preceding years – did not keep pace with the general trend in private consumption.

Given the more difficult macroeconomic environment in both western and eastern Germany, the expansionary forces in the east

... in wholesale/retail trade and ...

... in manufacturing

German manufacturing sector also faltered temporarily. Its net output, which had grown by almost one-tenth in 1995, expanded by "only" 4% in 1996; but the trend in industrial output in the east was again appreciably better than that in the west, where production stagnated in 1996. Another positive feature was that foreign turnover (+6%) grew more strongly than domestic business (+2%), as a result of which the export ratio increased slightly; but at just over one-tenth, it was still considerably lower than the comparable west German value of almost one-third. There is some evidence, however, that much of this export success was attained at the cost of price concessions, so that the growth of revenue was smaller than the increase in volume.

With a view to bringing wage costs in the new Länder more into line with labour productivity, the number of employees was cut noticeably and adherence to the collectively negotiated pay conditions was weakened further. This made it possible for east German industry, in particular, to narrow the competitive gap in relation to the old Länder. Even so, the unit labour costs of east German producing enterprises were still distinctly higher in 1996 than in western Germany.

Structural features of the sample analysed

Scope of the sample

The source material used for analysing the profitability and financing of east German enterprises has improved continuously since 1993, the year in which the first such study was carried out. From a starting base at that

time of 863 sets of annual accounts covering the 1991 financial year, the volume of balance sheet material has increased four-fold since then. Moreover, around 90% of the firms included in the study also provided additional data on their level of employment at the end of the financial year. The period covered by the study embraces the years 1995 and 1996.¹ The results of the present study are only partly comparable with those of earlier analyses because the composition of the sample has changed; but the main profitability and financing ratios in the respective overlapping years of the samples studied to date match quite closely, which does imply a certain continuity of the source material.

Broken down by economic sector, this sample comprises the annual accounts of 1,214 manufacturing firms, 522 construction enterprises and 1,684 firms in the wholesale/retail trade sector.² The relative significance of the individual sectors differs from that in western Germany in that the manufacturing sector in eastern Germany is far more weakly represented, and the construction and wholesale/retail trade sectors considerably more strongly represented. The divergencies in the structure of the source material are also accentuated by the fact that the share of incorporated

Breakdown by economic sector and legal form

1 Naturally, it would be better if the study could cover the more recent past, but that is not possible as many financial statements are submitted to the Bundesbank relatively late.

2 The outturn of the corporate balance sheet statistics for eastern Germany presented here is based for the first time on the Federal Statistical Office's EU-wide harmonised classification of economic sectors (WZ 93). For further details see Deutsche Bundesbank, West German enterprises' profitability and financing in 1996, Monthly Report, November 1997, page 45 ff.

enterprises within the east German sample is far higher, at 70 %, than in the old Länder (53 %).³ These tend to have a very different financing structure, in particular, from unincorporated enterprises, both in western and eastern Germany. Such structural differences need to be taken into account in comparing profitability and financing ratios between the old and new Länder. In addition, the data analysed here for eastern Germany do not give a representative picture of the economic conditions of enterprises in the three aforementioned sectors on account of the still rather small size of the sample. However, the conclusions that have been drawn are corroborated, at least in part, by statistics and surveys of other institutions, such as the Federal Statistical Office's cost structure statistics.

Annual results

*Process of
loss reduction
halted*

The faltering economic trend in 1996 had a substantial negative impact on the profitability of the 3,420 east German enterprises examined; the process of loss reduction which had made considerable strides in the preceding years largely came to a halt. The aggregate loss before taxes on income and before profit transfers amounted to DM ½ billion in 1996, which was only marginally lower than the 1995 figure; as a percentage of turnover it remained virtually unchanged at ¾ %.⁴ From 1994 to 1995 the losses per unit of turnover had declined from 2 ½ % to ¾ %. After taxes on income, the corresponding ratio for 1996 was – 1 %. In western Germany the annual result in 1996 was actually

lower than that for 1995 on account of the sluggish overall economic setting described above; however, the profit-turnover ratio, at + 2 ½ %, was distinctly higher than in the new Länder.⁵ The continuing gap can be seen from the fact that "only" one-quarter of the west German firms covered by the corporate balance sheet statistics in 1996 were "in the red", compared with one-third in eastern Germany.

Firms in the east German manufacturing and wholesale/retail trade sectors experienced a relative improvement in their profitability in 1996, whereas in the construction sector the losses increased as expected. The 1,214 firms from the manufacturing sector were able to reduce their gross deficit on balance from 1¼ % to 1 % of turnover. This is consistent with the finding that the share of profitable firms increased by almost 4 percentage points compared with 1995 to 60 %. All in all, considerable progress has been made from 1991 in reducing the level of losses, particularly in the manufacturing sector; in that year's

*Divergent
profitability
trends in the
different
economic
sectors*

³ For further details see Deutsche Bundesbank, East German enterprises' profitability and financing in 1993, Monthly Report, July 1995, page 56.

⁴ The annual result used here corresponds to the profit for the year before profit transfers and provides a more informative picture of the real profitability of the enterprises analysed than does the profit for the year, as many firms are affiliated by means of profit/partial profit transfer agreements with enterprises which are not recorded in the corporate balance sheet statistics (e.g. holding companies) to which they transfer their profits or which assume their losses.

⁵ Comparisons with the profitability and financing of west German enterprises in the year under review are no longer based, as in earlier studies, on the published expanded results but instead on a cylindered sample of enterprises whose definition and structure are more akin to the source material on which the study of the east German firms is based.

Selected ratios from the annual accounts of east German enterprises *

Item	All enterprises ¹		Manufacturing		Construction		Wholesale and retail trade ²		Memo item West Germany; all enterprises ³
	1995	1996	1995	1996	1995	1996	1995	1996	
	% of balance sheet total ⁴								
Balance sheet ratios									
Assets									
Tangible fixed assets ⁵	40.9	40.6	46.1	46.6	24.1	23.0	36.2	34.7	19.2
Stocks ⁶	21.8	22.2	15.2	15.7	40.2	40.3	29.0	29.2	23.0
Cash ⁷	7.7	5.3	9.2	5.3	7.4	8.2	4.0	4.0	5.1
Debtors	26.6	28.3	25.5	27.8	26.7	27.0	29.3	30.2	32.9
Short-term	25.7	27.3	24.4	26.6	26.0	26.3	28.6	29.5	30.7
Long-term	0.9	1.0	1.1	1.2	0.7	0.8	0.7	0.7	2.2
Investments	0.4	0.4	0.5	0.6	0.2	0.2	0.1	0.1	3.4
Participating interests	2.3	2.6	3.2	3.6	0.4	0.4	0.8	1.2	16.1
Liabilities									
Own funds ^{4, 8}	22.6	22.3	27.8	28.0	7.8	6.5	17.1	16.1	23.8
Creditors	67.5	68.3	60.6	60.9	82.7	84.1	77.1	78.2	50.9
Short-term	45.4	46.6	37.6	38.1	68.3	71.5	53.7	55.2	41.6
Long-term	22.1	21.7	23.0	22.8	14.4	12.6	23.4	23.0	9.3
Provisions ⁸	9.8	9.4	11.6	11.1	9.5	9.3	5.8	5.6	25.2
Profit and loss account ratios									
% of total output									
Cost of materials ⁹	68.4	69.1	62.8	62.9	56.5	57.5	79.0	79.5	64.8
Labour cost ¹⁰	17.0	16.7	19.9	20.0	30.3	29.7	9.6	9.5	17.9
Depreciation	6.3	6.0	8.5	8.0	5.7	6.1	3.7	3.5	3.2
Interest paid	2.2	2.0	2.5	2.4	1.7	1.8	1.8	1.7	1.0
Taxes	0.8	0.8	1.2	1.2	0.4	0.4	0.5	0.4	3.7
Other cost	13.5	13.2	17.5	17.0	12.3	13.1	8.8	8.7	13.1
Gross income	31.6	30.9	37.2	37.1	43.5	42.5	21.0	20.5	35.2
Interest paid (net) ¹¹	1.7	1.6	1.9	1.8	1.4	1.4	1.5	1.4	0.3
% of turnover									
Profit for the year	-0.9	-0.7	-1.3	-1.1	-1.5	-1.3	-0.3	-0.1	1.4
Annual result ¹²	-1.1	-1.0	-1.4	-1.2	-1.4	-1.6	-0.6	-0.5	1.6
Annual result before taxes on income ¹³	-0.8	-0.7	-1.3	-1.0	-1.2	-1.3	-0.2	-0.1	2.5

* Results of a two-year cylindered sample of 3,420 manufacturing, construction and wholesale/retail trade enterprises. — ¹ Consolidated results. — ² Retail trade, wholesale trade and commission trade. — ³ Results of a cylindered sample of 38,000 enterprises for 1995 and 1996 from the corresponding economic sectors. — ⁴ Less adjustments to capital accounts. — ⁵ Including intangible assets. — ⁶ Including contracts in progress. — ⁷ Notes and coins and bank balances. — ⁸ Including pro rata share of special re-

serves — ⁹ Including expenditure on goods and services purchased. — ¹⁰ Wages, salaries, social security contributions and voluntary social security expenditure. — ¹¹ Balance of interest paid and interest received. — ¹² Profit for the year before profit/loss assumptions and profit/loss transfers. — ¹³ Taxes on income and earnings; in the case of partnerships and sole proprietorships trade earnings tax only.

sample a loss of more than DM 20 was made on every DM 100 of turnover on average.

The wholesale and retail trade enterprises, which had already come quite close to profitability in 1995, almost achieved a break-even annual result before taxes in 1996. At the same time the share of firms in profit increased from 66½% to 69%, which was well above the corresponding ratio in the other two sectors. The positive profitability trend was confined to retail trade firms, however. By contrast, the wholesale trade recorded a small loss on balance, as in 1995. Taking the wholesale/retail trade sector as a whole, the negative result – after deducting taxes on income and earnings (which have a greater effect in the wholesale/retail trade sector than in the other two sectors on account of its better earnings situation) – still amounted to ½% of turnover.

In the construction sector the annual result worsened in line with the decline in business activity, with the result that the “negative profit-turnover ratio” hardly deteriorated at all and remained more or less at – 1¼%. The share of loss-making enterprises simultaneously increased by 1½ percentage points to 33%. One notable feature is that, as the building boom tailed off, the east German construction industry lost the relatively “favourable” starting position compared with other sectors which it had enjoyed immediately after the fall of the Berlin wall – which had been reflected in a very small loss ratio of ¼% of turnover in 1991 – and most recently fared worse than the other two sectors – just as in western Germany.

In the new Länder there is a strong contrast between the successful enterprises and the firms with weak profitability and financing which is concealed when average values are considered. For this reason – as in the studies carried out in previous years – the dispersion of the individual results around the respective average will also be examined below in respect of the profit-turnover ratio (and in connection with analysing the financing of the own funds ratio).

The enterprises in the lowest quartile (numbering 855), ranked by profit-turnover ratio in ascending order, recorded a loss of 9½% of turnover in 1996, whereas the firms in the highest quartile generated a positive profit-turnover ratio of + 7½%. In the two intermediate quartiles the ratio was just below the break-even point and almost + 1½%, respectively. Over the years the spread between the bottom and top quartiles, which in the year 1992 in an earlier study had ranged from – 30½% to + 11½%, has narrowed considerably. Apart from the differences in the level, the spreads in 1996 were only slightly larger than in western Germany. The manufacturing industry continues to display the strongest contrasts in the pattern of dispersion, while the profit-turnover ratios of firms with poor profitability and those with good earning results in the construction and wholesale/retail trade sectors were much closer together.

Breaking the figures down by size category, the small enterprises moved into profit in 1996 while the medium-sized firms almost broke even. On the other hand, the earnings position of the big firms deteriorated in 1996;

*Dispersion
between
profitable and
unprofitable
firms ...*

*... and by size
category*

Profit-turnover ratio by quartile *

%				
Quartile(s)	All enter- prises	Manu- facturing	Con- struction	Whole- sale and retail trade
Lowest				
1995	- 11.8	- 18.6	- 9.7	- 5.7
1996	- 9.3	- 16.1	- 8.5	- 5.3
25 % to less than 50 %				
1995	- 0.2	- 1.1	0.1	0.0
1996	- 0.1	- 0.9	0.1	0.1
50 % to less than 75 %				
1995	1.2	1.4	1.4	0.9
1996	1.3	1.9	1.5	1.0
Highest				
1995	7.3	10.0	6.0	4.3
1996	7.3	9.2	5.5	4.3
All				
1995	- 0.8	- 1.3	- 1.2	- 0.2
1996	- 0.7	- 1.0	- 1.3	- 0.1
		Enterprises with a turnover of ...		
		... less than DM 5 million	... DM 5 million to less than DM 50 million	... DM 50 million or more
Lowest				
1995	- 11.8	- 11.4	- 10.1	- 14.5
1996	- 9.3	- 11.1	- 9.0	- 14.9
25 % to less than 50 %				
1995	- 0.2	- 0.2	- 0.2	- 0.5
1996	- 0.1	0.0	0.0	- 1.3
50 % to less than 75 %				
1995	1.2	1.7	1.0	1.0
1996	1.3	1.8	1.1	0.7
Highest				
1995	7.3	8.8	5.9	7.7
1996	7.3	9.5	7.2	6.5
All				
1995	- 0.8	- 0.3	- 0.8	- 0.9
1996	- 0.7	0.1	- 0.2	- 1.2

* Average values per quartile. To determine the quartile categories enterprises were sorted separately by profit-turnover ratio for each year per sector and per size category. The profit-turnover ratio is the annual result before taxes on income as % of turnover.

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their losses rose to more than 1% of turnover. These disparate trends are mirrored in the various quartiles, too, albeit to a varying extent. Specifically, the firms in the bottom and top segments belonging to the two smallest size categories fared less badly and considerably better, respectively, than the large enterprises. When comparing the different size categories, it has to be borne in mind, however, that the small firms and in some cases the medium-sized firms are largely operated as unincorporated enterprises so that the imputed entrepreneur's remuneration forms part of the annual result, whereas in the case of incorporated enterprises the management remuneration is included under labour cost.

Income and cost

The total output (i. e. turnover plus change in stocks of own products and other capitalised production) of the enterprises included in the study expanded by only 6 ½ % under the impact of the above-mentioned general slackening of growth and the downturn in construction activity in the new Länder, after having increased by 12 % in the previous year – according to the figures published in 1997. But this overall result masks very different trends in the individual sectors. In the construction industry total output declined by 3 ½ %, with construction turnover falling by 2 %; this result is confirmed by the official statistics on construction turnover in eastern Germany. By contrast, manufacturing firms boosted their business by 6 %.

Total output

An above-average growth of total output was recorded by the wholesale/retail trade sector (+ 9 %), with the 943 retail trade firms showing an even more dynamic development. This finding does not concur with the position which the retail trade statistics indicate for the new Länder. A possible explanation for this is that the corporate balance sheet statistics for eastern Germany tend to contain more medium-sized and larger specialised trading units, which fared comparatively well in 1996.

Cost of materials

At just over 7 %, the amount which firms spent on materials went up by a slightly faster rate than total output. That is true both as an overall trend and in the individual sectors; in the case of the construction firms, this meant that this expense item contracted less sharply. Consequently, the cost of materials, which includes the labour cost of the suppliers, increased further to 69 % of total output, compared with 65 % in western Germany. This difference between the old and new Länder was confined to the manufacturing sector, however, whereas the respective weighting of expenditure on materials and goods in the wholesale/retail trade sector was equal in the two parts of Germany and the corresponding ratio in the east German construction industry was actually a little below that in the western part of the country. There are many indications that the profound restructuring of east German industry, not least under the impact of international competitive pressures, has increasingly been used as an opportunity to implement modern manufacturing strategies oriented towards "lean production".

Profit and loss account of east German enterprises in 1996 *

Item	All enterprises 1	Manufacturing	Construction	Wholesale and retail trade 2
DM million				
Turnover	67,282	33,079	6,851	27,352
Total output 3	67,708	33,317	6,985	27,407
Interest received	293	190	25	78
Other income	4,535	3,259	484	791
Total income	72,536	36,766	7,494	28,276
Cost of materials 4	46,755	20,964	4,016	21,775
Labour cost 5	11,341	6,654	2,074	2,613
Depreciation	4,047	2,662	424	962
Interest paid	1,369	786	126	456
Taxes	553	409	27	118
on income and earnings 6	182	72	17	93
Other cost	8,965	5,668	916	2,382
Total cost	73,031	37,143	7,582	28,306
Profit for the year	- 495	- 377	- 88	- 30
Memo items				
Annual result 7	- 647	- 412	- 108	- 128
Annual result before taxes on income 8	- 465	- 339	- 91	- 35
Change from previous year in %				
Turnover	7.0	7.3	- 2.1	9.2
Total output 3	6.3	6.2	- 3.7	9.2
Interest received	- 5.4	- 8.0	- 0.7	- 0.1
Other income	4.0	- 0.5	34.6	9.3
Total income	6.1	5.5	- 1.9	9.2
Cost of materials 4	7.2	6.5	- 1.9	9.9
Labour cost 5	4.6	6.6	- 5.5	8.6
Depreciation	1.0	0.1	3.2	2.8
Interest paid	- 0.7	- 0.5	0.3	- 1.4
Taxes	3.6	5.3	- 1.1	- 0.9
on income and earnings 6	18.0	72.8	- 2.9	- 2.4
Other cost	4.4	3.5	3.0	7.5
Total cost	5.9	5.4	- 2.1	9.0
Change from previous year in DM million				
Profit for the year	71	15	17	40
Memo items				
Annual result 7	38	30	- 7	15
Annual result before taxes on income 8	66	60	- 8	13

* Results of a two-year cylindered sample of 3,420 manufacturing, construction and wholesale/retail trade enterprises. — 1 Consolidated results. — 2 Retail trade, wholesale trade and commission trade. — 3 Turnover plus change in stocks of own products and other capitalised production. — 4 Including expenditure on goods and services purchased. — 5 Wages, salaries, social security contributions and voluntary social security expenditure. — 6 In the case of partnerships and sole proprietorships trade earnings tax only. — 7 Profit for the year before profit/loss assumptions and before profit/loss transfers. — 8 Taxes on income and earnings.

Labour cost

In 1996 the increase in labour cost (+ 4½ %) was again lower than the overall rise in expenditure and total output, and was a major factor behind the slight improvement in the annual results. Much of that improvement was due to the ongoing reduction of jobs. Thus the 3,105 firms which also provided details of their staffing levels at the end of 1995 and 1996 cut their workforce by 1½ %. Thanks to this measure the increase of 6 % in labour cost per employee, reflecting the continuing strong upward pressure of wages in the year under review, was cushioned to some extent. The very great impact which labour cost has on the profit and loss accounts of east German enterprises can also be seen from the fact that the share of labour cost in gross income (i.e. total output less the cost of materials), at 54 %, was 3 percentage points higher than the corresponding figure in the old Länder.

Jobs were shed by construction firms, in particular, with the result that their labour cost declined to a greater extent than their business activity. By contrast, the number of employees in the wholesale/retail trade firms included in the study actually went up by 3½ % which, together with the sharp rise in average costs per employee, pushed up labour cost by 8½ %. The manufacturing sector likewise recorded a substantial increase in personnel expenses of just under 7 % per employee. The main reason for this was that negotiated wages and salaries (on a monthly basis) in the metalworking and electrical industries were raised in mid-1996 from 94 % to 100 % of the level in western Germany in line with an agreement made in 1993 and

that the west German pay settlement for 1996 was additionally adopted. For these reasons, labour cost in east German industry expanded by 6½ % despite the slight fall in employment levels.

The growth of overall expenditure was also slowed by the level of depreciation, which was only 1 % higher than in the previous year. This was due primarily to the fact that the "consumption of fixed capital" as recorded in the accounts was 1½ % less than in the year before. As there was no change in the depreciation modalities in 1996, that may suggest a reduction of asset formation, although this cannot be ascertained from the balance sheet data of a two-year reporting sample. According to the ifo investment survey of manufacturing firms in the new Länder, however, fixed asset formation in this sector decreased in 1996 for the first time since the survey began in 1991, dropping by 6 %. In the construction industry spending on new machinery, equipment and buildings fell by no less than one-quarter compared with 1995 and by one-half compared with 1993. There is a close link between gross fixed asset formation and the consumption of fixed capital in that the latter tends to be fairly heavily concentrated on the first few years of an asset's useful life owing to the widespread use of the diminishing-balance depreciation method and the extensive special depreciation facilities available in eastern Germany.

By contrast, the item "other depreciation", which mainly embraces losses on debtors and value adjustments on investments and participating interests, increased by around one-

Depreciation

quarter. In the construction industry alone the size of this item doubled, which above all is attributable to the sharp increase in the number of insolvencies of east German building firms (+ 42 %) and the resultant higher (intra-sectoral) losses on debtors. In the new Länder as a whole the anticipated debtors in connection with insolvencies expanded by one-third in 1996 and amounted to 28 % of the volume outstanding in the whole of Germany. Together with the very high incidence of insolvencies in the eastern part of Germany, this is a further indication of the fragile financial base of many east German firms.

Interest paid

The interest paid by the east German firms covered by the study decreased by ½ % in 1996. This was due mainly to the fact that interest rates fell further during the course of the year across the entire maturity range. However, the cost relief afforded by this was lessened by the rise in the stock of interest-bearing creditors, which was 5½ % higher at the end of 1996 than at the end of 1995 (a comparison of the level of creditors on an annual average, which would be more informative in this context, is not possible in a two-year cylindered sample). As one would expect, the decline in interest rates was of most benefit to the firms in the bottom quarter of the earnings scale, which often tend to be fairly heavily indebted. The interest payments of this group absorbed "only" just over 2½ % of total output, compared with just under 3½ % in the year before. The corresponding interest burden ratio for all enterprises included in the study was 2 % in 1996, which was 1 percentage point more than the

equivalent west German figure. As interest received tended to fall even more than interest paid, owing to a decline in credit interest rates and a decrease in the stock of debtors, net interest paid rose slightly (+ ½ %).

Balance sheet trends and structures

The balance sheet total of the firms analysed expanded by 3½ % in the 1996 financial year and thus by a distinctly smaller margin than the total assets/liabilities of the enterprises analysed in the preceding years, which between 1993 and 1995 had grown by approximately one-tenth each year. However, this was probably due only in part to the weaker growth in business activity since the expansion of the balance sheet total in the manufacturing sector, at 2½ %, was even smaller than that in the construction sector (+ 3 %). Only in the wholesale/retail trade sector did the growth of assets and liabilities (+ 6 %) match the picture of a sharp rise in turnover.

Balance sheet total

The asset-side structure, which is characterised by the preponderance (63 %) of total fixed assets (i.e. tangible fixed assets plus stocks), appears to be becoming more and more firmly entrenched; there are at any rate no signs yet of any approximation to the much lower ratio in the old Länder (42 %). It is true that an expansion of the stock of debtors is hampered by the persistently poor level of profitability on average. But that alone cannot explain the disparity as numerous firms with healthy earnings would be well able to build up sizeable stocks of financial assets. One major factor may be that many

Asset structure

east German firms are operated as subsidiaries of west German or foreign enterprises which prefer to concentrate and manage their financial assets within the parent enterprise. Part of the reason may also lie in the liabilities-side structure: hitherto east German firms have set up next to no provisions for pensions, which means that they have fewer available resources to invest.

Total fixed
assets

Although tangible fixed assets grew by just under 3 % in 1996, this was due mainly to a substantial increase in the stock of payments on account (of fixed assets) and tangible assets in course of construction, which was principally registered by manufacturing firms and is a reflection of large-scale projects of individual enterprises. The items in which fixed asset formation is usually mirrored, i. e. "land and buildings", and "moveable tangible fixed assets", together were only a little higher in 1996 than in the previous year, which accords with the weak or declining propensity to invest in the manufacturing and construction sectors. The stocks of raw materials and supplies and other work in progress grew in 1996 largely in line with total output. One interesting feature is that the east German manufacturing firms included in the study turned over their stocks during the year under review almost as frequently as their counterparts in western Germany, whereas the rate of turnover in the wholesale/retail trade sector was distinctly lower.

Financial assets

The structure of the financial assets, which in the aggregate likewise grew by just under 3 % in 1996, showed a noticeable change. The previously very high level of cash was run

Balance sheet data of east German enterprises in 1996 *

Item	All enterprises 1	Manufacturing	Construction	Wholesale and retail trade 2
DM million				
Assets				
Tangible fixed assets 3	19,831	14,025	1,341	4,464
Stocks 4	10,846	4,735	2,348	3,763
Cash 5	2,599	1,602	477	520
Debtors	13,813	8,354	1,576	3,883
Short-term	13,329	8,005	1,531	3,793
of which				
Trade debtors	6,663	3,117	1,039	2,507
Long-term	484	350	44	90
Investments	219	192	11	16
Participating interests	1,263	1,088	22	152
Prepayments and accrued income	216	86	53	77
Liabilities				
Own funds 6, 7	10,859	8,409	377	2,074
Creditors	33,307	18,332	4,903	10,072
Short-term	22,739	11,464	4,170	7,105
Long-term	10,568	6,868	733	2,968
Provisions 7	4,588	3,326	544	718
Accruals and deferred income	32	16	4	12
Balance sheet total 6	48,786	30,082	5,828	12,876
Change from previous year in %				
Assets				
Tangible fixed assets 3	2.8	3.5	- 1.7	1.7
Stocks 4	5.6	5.8	3.1	6.9
Cash 5	-28.3	-41.0	14.2	6.1
Debtors	10.0	11.6	4.3	9.3
Short-term	10.0	11.7	4.0	9.2
of which				
Trade debtors	10.6	11.3	6.5	11.5
Long-term	10.1	9.6	14.0	10.0
Investments	30.6	31.3	-13.0	88.5
Participating interests	18.8	15.1	- 2.4	60.0
Prepayments and accrued income	- 1.9	0.8	- 8.7	0.3
Liabilities				
Own funds 6, 7	1.7	2.9	-14.9	0.2
Creditors	4.6	2.9	4.7	7.7
Short-term	6.1	3.7	7.8	9.0
Long-term	1.5	1.6	-10.0	4.6
Provisions 7	- 1.0	- 2.1	1.3	2.4
Accruals and deferred income	- 2.8	-35.2	372.4	54.2
Balance sheet total 6	3.4	2.3	2.9	6.1

* Results of a two-year cylindered sample of 3,420 manufacturing, construction and wholesale/retail trade enterprises. — 1 Consolidated results. — 2 Retail trade, wholesale trade and commission trade. — 3 Including intangible assets. — 4 Including contracts in progress. — 5 Notes and coins and bank balances. — 6 Less adjustments to capital accounts. — 7 Including pro rata share of special reserves.

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down by almost 30 % and, at 5 ½ % of the balance sheet total, reached a ratio that was only a little higher than the comparable figure in the old Länder. It is not possible to say specifically how these liquid resources were redistributed, but the figures suggest that all the other major financial asset items increased appreciably. This also applies to the debtors arising from participatory relationships, which expanded by 17 % in the short-term range and by 13 % in the longer-term segment; this was mirrored by a strong growth in the corresponding short-term creditors on the liabilities side. This is a reflection not least of the increasing financial integration of many east German firms that are operated as subsidiaries of west German or foreign enterprises within corporate groups.

*Provision with
own funds*

One notable feature in analysing the liabilities side is that the growth of own funds of the east German enterprises covered by the study in 1996 did not quite keep pace with the expansion of the balance sheet total. As a result, the own funds ratio, which – according to earlier studies – had risen by a total of 10 percentage points in 1994 and 1995 thanks to the debt remission granted to large-scale enterprises by the Treuhand agency and its successor organisations, declined slightly to just under 22 ½ %; this was 1 ½ percentage points below the comparable west German ratio.⁶

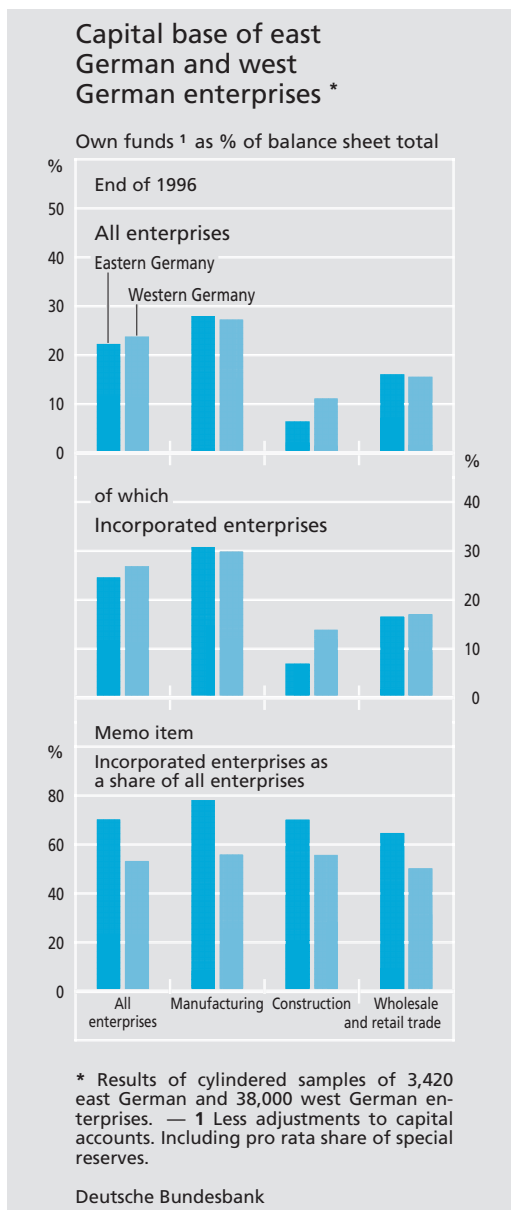
But several factors need to be taken into account when making such a comparison. Thus incorporated enterprises, which – as mentioned at the beginning of this article – are relatively strongly represented in the new

Länder, traditionally have a broader liable capital base in their balance sheets than unincorporated enterprises.⁷ A counterbalancing factor, however, is that the east German own funds ratio is depressed to a greater extent than that of west German firms by the greater preponderance of construction enterprises, which as a rule have a very weak capital base. Furthermore, young enterprises probably tend to have a smaller capital base than older, established firms.⁸ The corporate ties between western and eastern Germany no doubt also play a role. It is therefore advisable to supplement the average view by comparisons of the capital structures between the two parts of Germany broken down by sector and legal form. This reveals that the own funds ratio of east German incorporated enterprises in the manufacturing sector in 1996, at 31 %, was even a little higher than the cor-

⁶ The own funds ratio for western Germany in 1996, calculated on the basis of the expanded balance sheet data, amounted to 18 %. The pronounced deviation from the corresponding ratio from the cylindered sample is due to the fact that small enterprises, which on average have a fairly low provision with own funds, are given a much larger weighting through the expansion.

⁷ This is largely attributable to the fact that the annual accounts of sole proprietorships and partnerships do not show all the assets that are actually available for safeguarding the enterprise's liquidity and creditworthiness. For one thing, it is very difficult to distinguish in legal terms between private and corporate assets and, for another thing, the allocation of assets to an entrepreneur's private account (and of creditors to the business account) has significant tax advantages, which is why capital tends to be withdrawn from enterprises organised in these legal forms. See Deutsche Bundesbank, Comparison of the annual accounts of small and medium-sized enterprises organised in different legal forms, Monthly Report, October 1993, page 33 f.

⁸ In this context it may also be surmised that west German enterprises have substantially greater undisclosed reserves than firms from the new Länder. However, the latter were given an opportunity to close this gap to some extent, *inter alia* through the granting of generous special depreciation facilities, which reduce the book values of tangible fixed assets in the balance sheet by a far greater margin than would have been warranted by actual technical wear and tear.



responding ratio in the old Länder. By contrast, the capital base of east German incorporated enterprises in the construction sector was significantly poorer, whereas in the wholesale/retail trade sector the own funds level was only marginally less favourable than in the west. In the case of unincorporated enterprises, only the wholesale/retail trade firms in eastern Germany had a stronger capital base than their counterparts in the west.

The divergencies in the provision with own funds between the different sectors in eastern Germany increased further in 1996. Whereas the average own funds ratio of manufacturing firms rose slightly to 28 %, it declined in the construction sector by 1½ percentage points to 6½ % and in the wholesale/retail trade sector by 1 percentage point to 16 %. The decomposition into quartiles also reveals that the degree of dispersion between financially weak firms and financially strong enterprises widened in 1996. Thus the balance sheet overindebtedness of the enterprises in the lowest quartile increased noticeably once more across all three sectors. In the manufacturing sector, however, this effect on the overall result was more than offset by an improvement in the provision with own funds in the third and fourth quartiles. In the construction sector, by contrast, the countervailing forces in the two highest quartiles were not strong enough, and in the wholesale/retail trade sector the level of liable capital tended to fall in all segments in relation to the sharply expanded balance sheet total.

Marked differences between sectors

When broken down by size category, too, the dispersion of the own funds ratios widened. The main factor responsible for this was that in the case of small firms with a turnover of up to DM 5 million the own funds ratio declined by around 2 percentage points, whereas in the case of medium-sized and large enterprises it was only marginally lower than in the previous year. In the group of small firms the average own funds ratio amounted to only 8½ %. However, in view of the financing patterns favoured by the mainly

Dispersion of the own funds ratios between small and large firms

Own funds ratio by quartile *

%				
Quartile(s)	All enter- prises	Manu- facturing	Con- struction	Whole- sale and retail trade
Lowest				
1995	- 16.8	- 22.4	- 11.8	- 6.7
1996	- 19.7	- 26.1	- 16.2	- 10.9
25 % to less than 50 %				
1995	4.0	6.9	2.4	3.3
1996	4.0	6.9	1.7	3.2
50 % to less than 75 %				
1995	12.8	18.9	8.1	10.5
1996	12.4	20.0	8.3	9.9
Highest				
1995	44.6	52.8	20.8	40.4
1996	43.3	53.0	22.5	39.7
All				
1995	22.6	27.8	7.8	17.1
1996	22.3	28.0	6.5	16.1
		Enterprises with a turnover of ...		
		... less than DM 5 million	... DM 5 million to less than DM 50 million	... DM 50 million or more
Lowest				
1995	- 16.8	- 20.3	- 11.0	- 12.1
1996	- 19.7	- 26.2	- 13.6	- 11.3
25 % to less than 50 %				
1995	4.0	1.8	4.7	12.2
1996	4.0	1.1	4.7	12.1
50 % to less than 75 %				
1995	12.8	10.2	11.9	24.7
1996	12.4	9.2	12.4	25.6
Highest				
1995	44.6	39.4	37.7	58.9
1996	43.3	40.5	38.5	58.4
All				
1995	22.6	10.3	13.3	31.0
1996	22.3	8.5	13.2	30.8

* Average values per quartile. To determine the quartile categories enterprises were sorted separately by own funds ratio for each year per sector and per size category. The own funds ratio is the own funds as % of the balance sheet total (less adjustments to capital accounts).

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small sole proprietorships and partnerships as outlined above, the actual financial base is probably much better in many cases than the position suggested in the balance sheet.

The creditors owed to banks increased by 6 % in 1996, with a shift towards shorter maturities; this trend is discernible in all three sectors. This may have something to do with the fact that, in view of the decline in investment, the demand for additional long-term bank creditors was likewise depressed. But in the aggregate east German enterprises are much more heavily indebted to banks than is the case in western Germany, a fact which is likely to be attributable in part to the high volume of promotional credits. Another factor which no doubt plays an important role is that the provisions shown in the annual accounts of east German firms, with a share of 9½ % of the aggregate balance sheet total, have a much smaller weight than in the old Länder (25 %). This difference is caused mainly by provisions for pensions, which remain insignificant in eastern Germany, accounting for only ½ % of the balance sheet total.

*Bank creditors
and provisions*

The 3,420 enterprises covered by the study displayed a quite satisfactory financing position on average in 1996. This also applies to their level of own funds; no general capital gap is apparent in an east-west comparison. It has to be pointed out, however, that the structural picture reveals sharp contrasts; thus half of the firms analysed did not have an adequate capital base. There will be no radical improvement in the situation as long as a substantial portion of east German enterprises remain below the profitability thresh-

*Sustained cost
relief remains
imperative*

old. In the long run it will only be possible for them to achieve a sustained strengthening of their profitability and financing through a market-oriented product range, up-to-date plant and production processes and an efficient organisational structure, including ef-

fective procurement and distribution channels. But that requires substantial financial investment as a rule. Many enterprises which currently have a weak financial base will be able to afford to take such a step only after their cost burden has been lastingly eased.