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Don't be afraid of zombies: Debt sustainability is not a problem for 95% of SMEs in Germany

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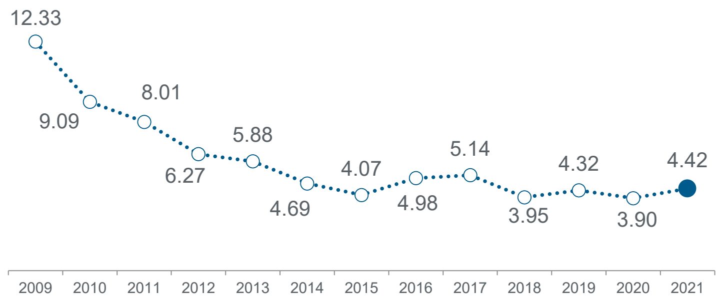
SMEs with critical debt sustainability ('zombie companies')

Percentage of businesses in total SME sector



Note: For the purpose of operationalisation, interest obligations were compared with income from operational activity (i.e. earnings before interest, taxes and depreciation (EBIT)). If the quotient of operating profit and interest expenses (interest coverage ratio) is less than 1, an enterprise is classified as a zombie company. The classification also assumes a minimum age of ten years.

Source: KfW SME Panel

No sign of an increase in the number of zombie companies

According to a special analysis conducted by the KfW SME Panel, there is no reason to be concerned over an increased 'zombification' of small and medium-sized enterprises (SMEs). This is generally defined as a situation in which low profitability prevents a company from meeting its interest obligations. In 2021 the share of German SMEs with such critically low debt sustainability was a manageable 4.42%. That means some 168,000 SMEs were unable to meet their interest obligations from their operating profit. Or phrased the other way, 95% of all businesses are sufficiently capable of servicing their debts. That means there has been hardly any change worth mentioning since the year 2012 (6.27%).

Neither low interest rates nor COVID have led to 'zombification'

The debate around zombie companies is not new. They are associated with weak growth, reluctance to invest or productivity deficits. A few years ago, the low-interest-rate environment was seen as a potential driver. It was to serve as a lever for creating incentives to invest more. The concern was that continuing to inject capital would enable even financially weak businesses to remain in the market with support. However, there was nothing to suggest that the share of financially weak enterprises may have grown.

Concerns were recently intensified by the failure of the wave of insolvencies predicted to be triggered by the impact of the pandemic. The opposite was the case, as significantly fewer businesses closed during the pandemic than before. The economic policy support packages played a (significant) role in this. They helped avert a number of potential insolvencies of structurally sound businesses. But this is not the only explanation. The adaptability and financial strength of SMEs, which enabled them to survive the years 2020 and 2021 well, also deserve to be highlighted.

Business models and cost structures were adapted

Many SMEs were able to mitigate turnover losses by swiftly adapting business models. Product and process innovations were also widely introduced in response to the crisis. The stronger focus on digital sales channels, above all, was a successful model. Cost structures were also adapted to the weaker turnover trend. SMEs in Germany therefore generally got through the coronavirus crisis with few bruises.

Crisis-proof earning power even during a pandemic

SMEs generally exhibit an extremely steady income situation even in times of crisis. So, too, in the coronavirus years 2020 and 2021. Their profit margin hardly changed and recently stood at 7.4%. The share of SMEs with losses was also on a 'normal level' of 12 and 8%, respectively.

Reduced vulnerability thanks to solid financial basis

The strong resilience of SMEs also rests on a broad, solid financial basis. Businesses entered the coronavirus crisis with a high equity ratio of 30% on average. Increased borrowing to bridge liquidity bottlenecks put pressure on their equity but less than expected. Their equity ratio fell only moderately to 30.1% in 2020. It recovered again significantly in 2021 already, returning to roughly the pre-crisis level (31.4% on average).

Financial buffers, adaptability and innovative capacity enabled SMEs in Germany to get through the coronavirus crisis well. This shows yet again what an important role strong innovative capacity plays for the resilience of businesses. It must be strengthened further.

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