REPORT

Financing corporate transformation in an age of polycrisis

Where will the money come from? And what part can private debt play in today's uncertain world?

Roland Berger

Management summary

The escalating polycrisis since 2020 – shaped by the pandemic, climate change, interest rate shifts, surging energy prices, geopolitical conflicts, and rising protectionism – marks a pivotal turning point. We see three main challenges to the future prosperity of European businesses in general and German companies in particular.

The first is a radical change in the global economic order, as China's ascendency – coupled with declining US dominance – raises geopolitical tensions and fuels military spending around the globe. Second, Germany's Mittelstand in particular must rise to the urgent challenge of a transformational backlog. Since 2018, the German economy has effectively stagnated, falling behind European and global growth averages and delivering no real GDP growth. Competitiveness has eroded, such that companies are now under fierce pressure to transform their business models and get in shape for the future – in terms of innovation, digitalization and sustainability.

Third – and the key focus of this report – the era of cheap money is now over and will not return anytime soon. Interest rates will decline only if the current recession persists. So, as the present polycrisis potentially widens and as a full-fledged reorganization of the global trading system becomes a very real possibility, we explore strategies that can help German companies set about financing such far-reaching transformations.

Contents

Fast facts

1.0%

GDP growth leaves Germany lagging behind its rivals

EUR 46 bn

is the interest expenditure faced by German companies (effectively doubled between 2022 and 2024)

EUR 2.4 tn

should be the volume of global private debt by 2029

1

Germany's transformational backlog

Companies face a serious dilemma: How to invest heavily in multi-faceted transformation while economic growth and profits flatline

In the turbulent economic and geopolitical climate described above, three pivotal factors are presenting huge challenges to businesses in Germany. ▶ A

Heavy investment is needed in several areas to prevent German players from falling behind their peers in Europe and throughout the world. If business models are to be aligned with the need for digitalization and the rapid advance of artificial intelligence (AI), companies have no choice but to channel large amounts of money into leading-edge software tools and, in particular, high-performance data centers. At the same time, innovation is needed to master further challenges such as ever more complex regulatory requirements and radical demographic shifts. And all this must be done while verifiably stepping up efforts to decarbonize both products and production processes with a view to reaching net zero.

As if that were not enough, companies also have to square these circles in an economy whose GDP growth lags behind that of the EU and the global economy. While German economic expansion flatlines, the EU as a whole is plotting at least a mild upward course, while global GDP growth still looks generally healthy. In other words, comparative conditions for German players in many industries are worsening by the year.

Undoubtedly influenced by the first two factors, ifo Institute surveys find that the country's corporate mindset, too, is suffering. Business confidence is painfully low, with many companies simply no longer believing they can compete either within or outside the EU.

"In times of polycrisis, CFOs need to constantly evaluate all financing options – private debt is becoming increasingly relevant."

Dr. Matthias Holzamer, Senior Partner

A Why are German businesses under so much pressure to transform themselves?

Flat GDP, a loss of confidence and rapid advances in digitalization and AI are forcing the hand of German companies

Pressure to transform business models challenges most domestic industries

Digitalization/AI

Massive investment in data centers and software tools needed to adapt business models to AI and digitalization

Innovation

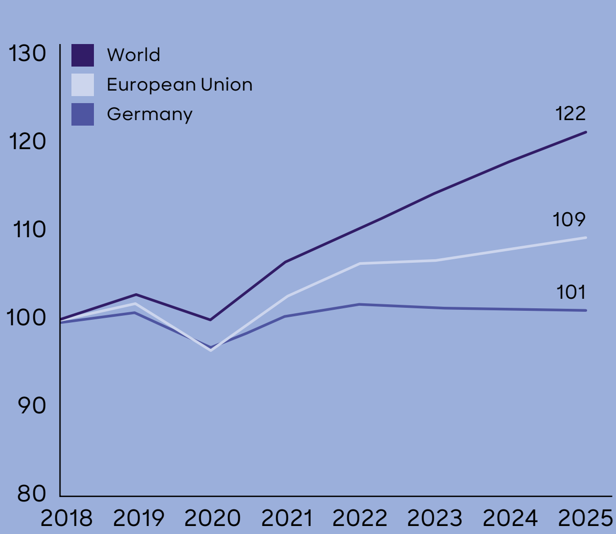
Regulatory complexity, demographic challenges and evolving market needs require investment in both internal and market-facing innovation

Sustainability/decarbonization

Regulations by the EU and Germany require companies to invest in decarbonizing their production and/or products

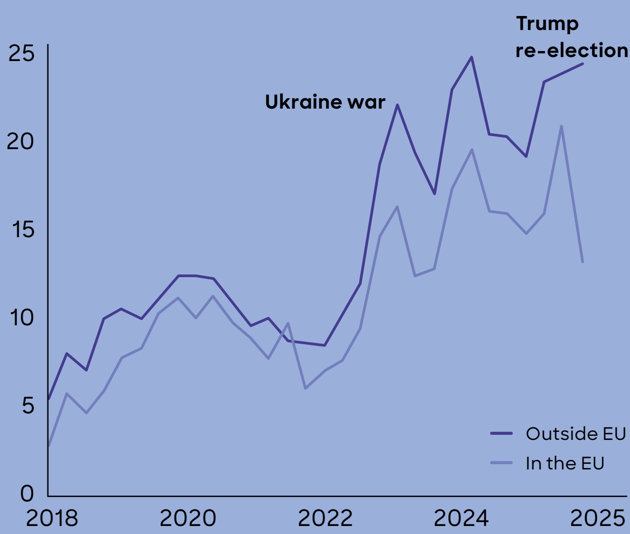
German GDP growth is lower than the EU and global averages[1]

Real GDP growth (indexed to 2018 levels)



German companies have lost confidence in their ability to compete[2]

Share of German companies that believe their competitiveness is lower than companies in the EU and outside the EU [%]



1 International Monetary Fund, real GDP growth rates 2 ifo Institute

Source: Real GDP growth, IMF 2025

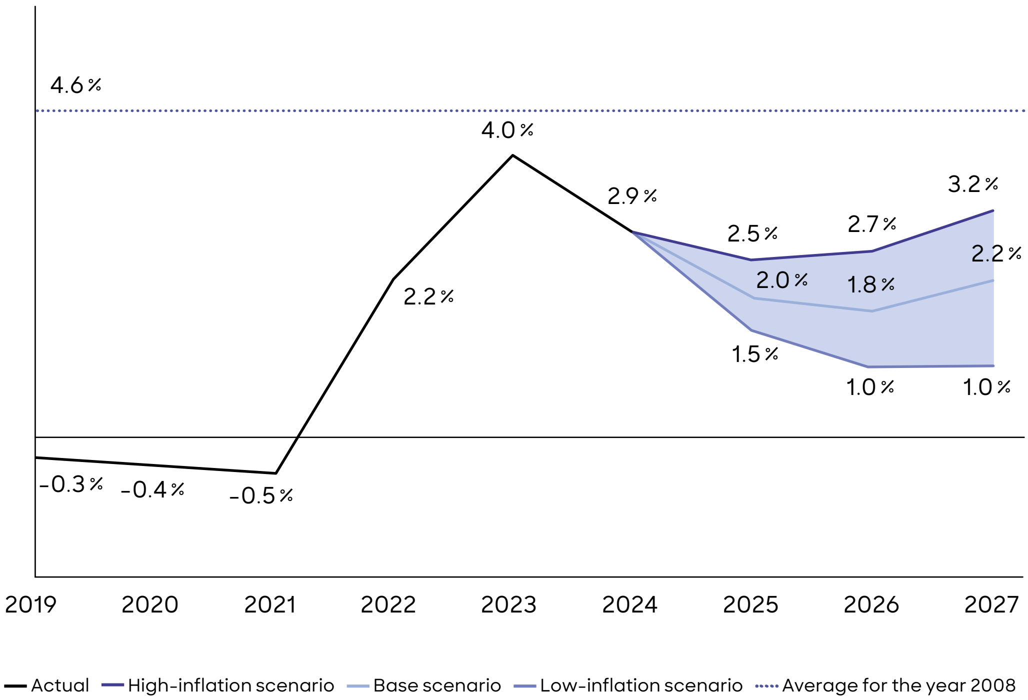
2

Financing overview – Expensive but stable for now

With cheap money off the menu, companies must face up to substantially higher interest costs – while future developments remain hard to predict

Given such a challenging environment, how can German businesses go about funding the multi-pronged investments they require? The first hard truth they must face is that the days of very low interest appear to be a phenomenon of the past. Financing terms appear to be generally stable for now, but they have certainly grown more expensive. ▶ B

B The era of cheap money will not return anytime soon – Interest rates will decline only if the recession continues
Historical and expected development of interest rates (3M EURIBOR, nominal) [%]



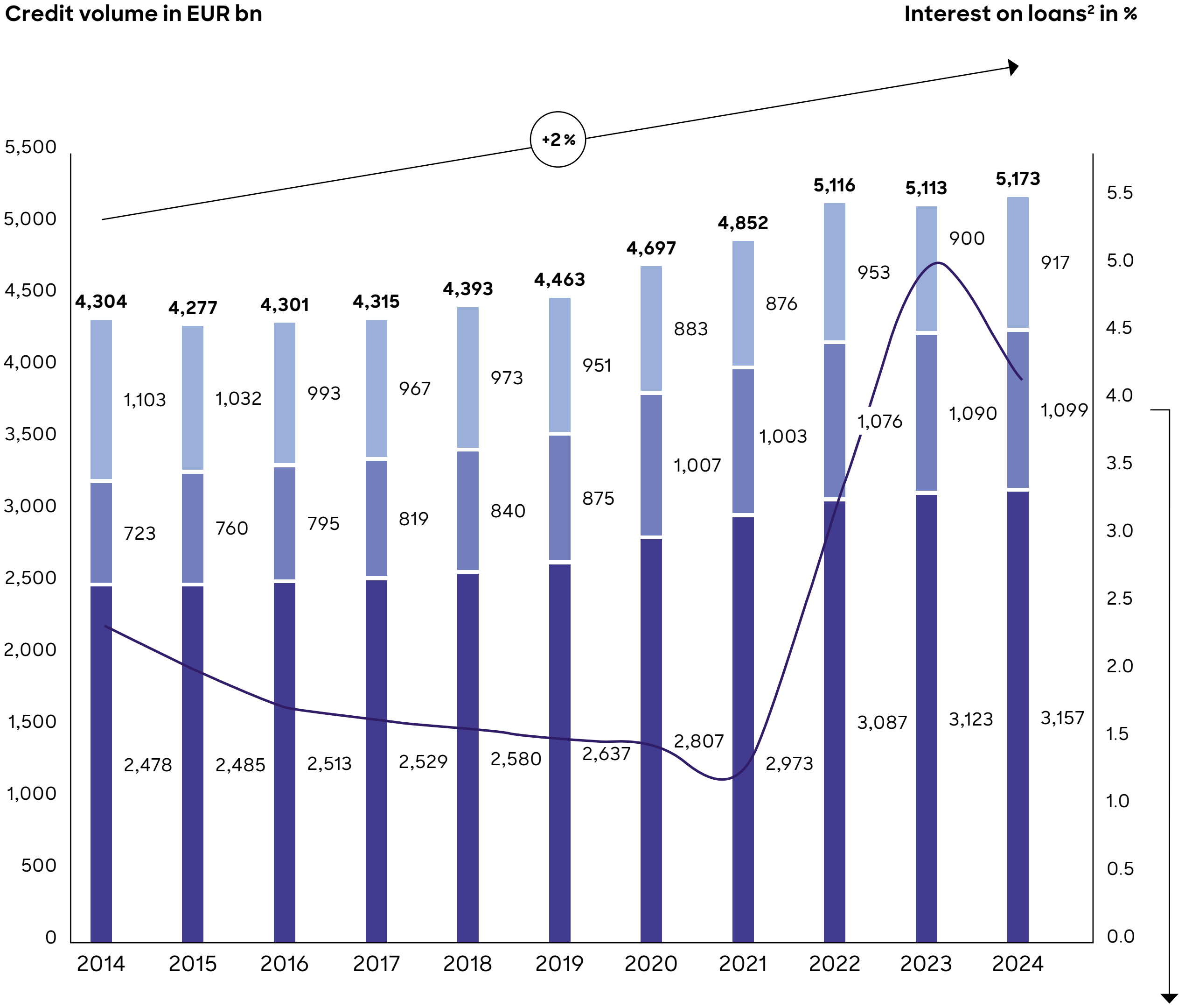
Source: Future Value Group (FVG), Roland Berger

After the latest peak in interest rates at the end of 2023, the chart shows three possible paths forward. In the base scenario, rates move sideways at roughly 2% through 2027. In the same period, the high-inflation scenario predicts a slight upward trend in interest rates. Conversely, a low-inflation scenario – including the assumption of monetary easing, but also of continuing recession – could see rates fall to around 1%.

Let us look at what these projections mean for the cost of capital at European and German companies.

C Rising interest rates are expected to add around EUR 32 billion to annual interest expenses for medium-term loans in the eurozone

Loans to companies[1] in the eurozone, 2014-24



EUR 1,099 billion in medium-term loans will have to be refinanced in the eurozone over the next **5 years** – resulting in **additional interest expenses of up to EUR 32 billion³ p.a.**

Long-term loans (>5 years) | Medium-term loans (1-5 years) | Short-term loans (<1 year) | Interest rate

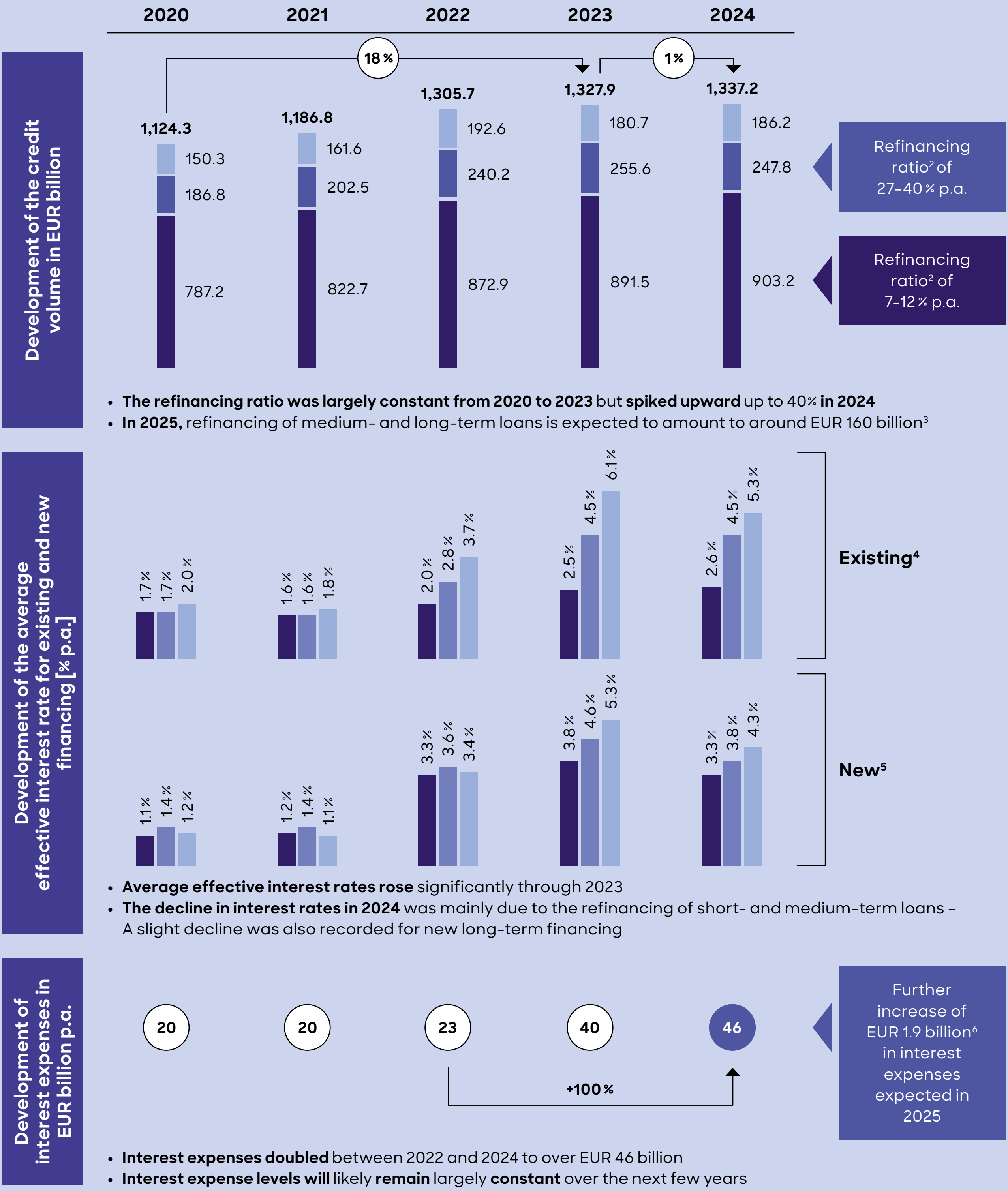
1 Non-financial corporations 2 ECB, cost of borrowing for corporations
3 Assumption: EUR 1,099 bn refinancing volume with 215 % higher interest costs (up from 1.4 % in January 2022 to 4.4 % in February 2024) will result in costs of up to EUR 32 bn per year

Source: Roland Berger, ECB

Although interest rates dipped again in 2024, European companies will still need to refinance their debts at higher levels after sharp rate rises in the preceding years. Specifically, medium-term loans totaling more than EUR 1 trillion are up for refinancing within the next five years. Based on current data, this will add extra interest expenses of as much as EUR 32 billion to companies' income statements. ▶ C

D In Germany, an increase in effective interest rates between 2022 and 2024 doubled companies' interest expenses to EUR 46 billion

Development of credit volume and interest expenses for companies[1] in Germany



Short-term loans (<1 year) Medium-term loans (1–5 years) Long-term loans (>5 years)

1 Non-financial corporations (including partnerships) 2 Newly concluded financing of loans in relation to year-end
3 Based on average values between 2020 and 2024 4 Average effective interest rate of existing loans at year-end
5 Average effective interest rate for refinancing at year-end
6 Calculation based on average historical values, constant credit levels and interest rates as per 12/2024
Source: Roland Berger, ECB

At German companies, the overall credit volume rose by 18 % between 2020 and 2023 and then increased by a further 1 % in 2024. In parallel, average effective interest rates rose significantly through 2023 before declining in 2024 – mainly linked to the refinancing of short- and medium-term loans. A slight drop was also observed for new long-term financing.

The key challenge, however, is that 7 to 12 % of long-term loans and 27 to 40 % of medium-term loans now need to be refinanced – and at significantly higher interest rates than those that prevailed in 2021. As a result, interest expenses doubled to over EUR 46 billion between 2022 and 2024. On top of this added burden, a further increase of roughly EUR 1.9 billion in interest expenses is anticipated in 2025, after which this item is likely to remain largely stable on a high level over the next few years. As positive as "largely stable" might sound, the result is that German companies will have to bear far greater interest expenses for the foreseeable future. ▶ D

However, average EBITDA margins in Germany shrank by 9 % between 2022 and 2024. Nevertheless, due to higher interest service payments – the result of more debt and higher interest rates – the interest coverage ratio sank by fully 52 % in the same period. Leverage rose by about 49 %.

In 2025, these trends will likely continue. An increase in interest expenses combined with still greater pressure on EBITDA margins is forecast to cause the interest coverage ratio to worsen further, from 9.5 in the last year to 9.1 in the current year ahead. ▶ E

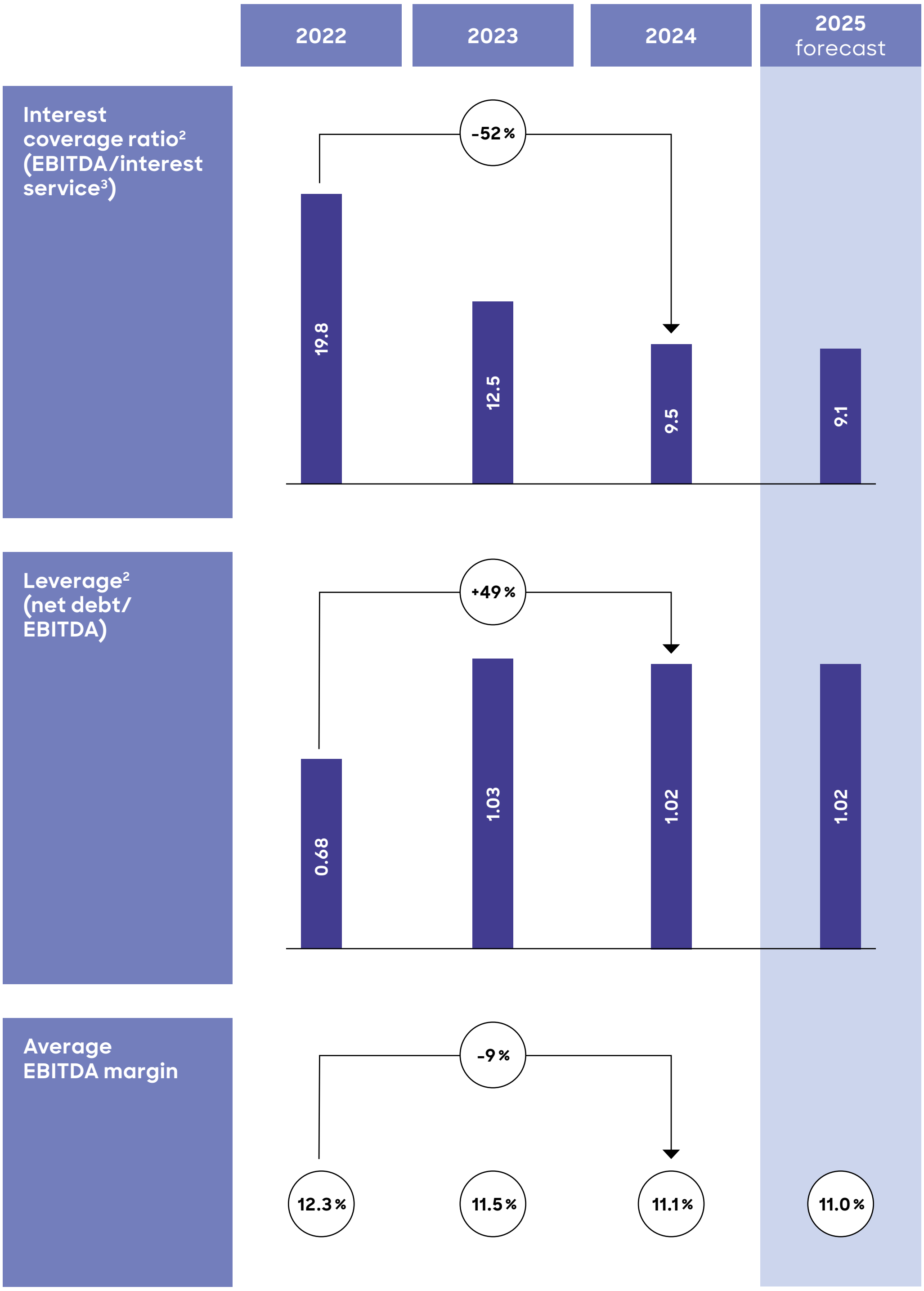
The implications are clear: Since there is as yet no sign of a recovery in the German economy, heavily indebted companies are going to find refinancing increasingly difficult.

"Financing transformation challenges are often dependent on hybrid or equity-like capital structure solutions, which in turn doom the transformation to success in order to regain equity value."

Markus Held, Partner

E With no sign of a recovery in the German economy in 2025, margins are being squeezed and refinancing remains a challenge

Selected financing ratios for German companies[1]



1 Data set: 344 representative companies from the DACH region with revenues ranging from EUR 50 m to EUR 18 bn across 19 industries
2 The median financing ratios across all companies (excluding the real estate industry) are shown
3 Interest: 3M-EURIBOR plus a 1.5 % average risk margin

Source: Roland Berger, Future Value Group

THE FINANCING OUTLOOK IS HARD TO CALL

For the time being, financing costs are high but still relatively stable. What the future will bring for the eurozone is nevertheless difficult to say in the current climate of uncertainty.

Several factors could conceivably contribute to lower financing costs. With US trade and economic policies appearing volatile and unpredictable, any perception of the eurozone as a (comparatively) safe haven could push long-term financing costs noticeably down. Similarly, any easing of global trade and geopolitical tensions could lower risk premiums and again improve financing conditions as a more optimistic mood sets in. Alternatively, if the recession continues, the European Central Bank (ECB) could be forced to cut its lead rates and ease monetary policy.

On the other hand, policy decisions such as the significant boost in German government spending could drive the cost of borrowing further up in what has been referred to as a "bazooka effect". Likewise, any escalation in the trade war and the geopolitical situation could throw supply chains into chaos and drive up both inflation and borrowing costs. Another consideration is that fresh growth impetus and an end to the recession could lead to monetary tightening and, again, higher interest rates.

It remains to be seen which (mix) of these factors pans out in reality. Whatever the case, companies faced with the need to transform must quickly develop a sound and workable financing strategy. Where, then, should they look?

3 Private debt – A viable alternative to classical channels?

As many organizations struggle to borrow more from banks or raise equity, private debt is increasingly stepping into the breach

Transforming any company requires significant investment and will usually also incur additional one-time expenses. Solid financing is therefore essential. Most organizations typically pursue one of two traditional avenues to fund these efforts: They either borrow money from banks or the wider capital markets, or seek to raise new capital (equity) from existing or new shareholders. ▶ F

In an economic climate such as the present one, however, many companies find that these traditional options are already exhausted. One option is therefore to turn to an alternative – in the form of private debt – to close the financing gap. Private debt is a catch-all term that essentially refers to the practice of borrowing money from non-bank sources such as institutional investors. And as we will see below, this is by no means an "easy option": Sourcing private debt brings with it its own challenges. Given the right preparations and conditions, however, it has repeatedly proven to be a viable alternative to traditional loan-based and equity financing.

F **Traditional financing options can still be tapped – But where these are exhausted, an alternative such as private debt can close the financing gap**

Options for financing the transformation

Company	Financing options	Free debt capacity	Equity reserve	Financing challenge
With free debt capacity	Companies with free borrowing capacity can (re)finance themselves on the conventional debt market by tapping • Bank loans • Capital market instruments (e.g., bonds)	✓	✓	**Low**
With equity reserves	Some companies have no free debt capacity but may still have equity reserves or the possibility of raising fresh equity from • Existing shareholders • New investors	✗	✓	
Without debt capacity or existing equity reserves	Where the possibilities of equity financing and classic debt financing are both exhausted, an alternative can provide a remedy in the form of • Loans from non-banks (private debt) Private debt presents a viable alternative to traditional loan-based and equity financing	✗	✗	**High**

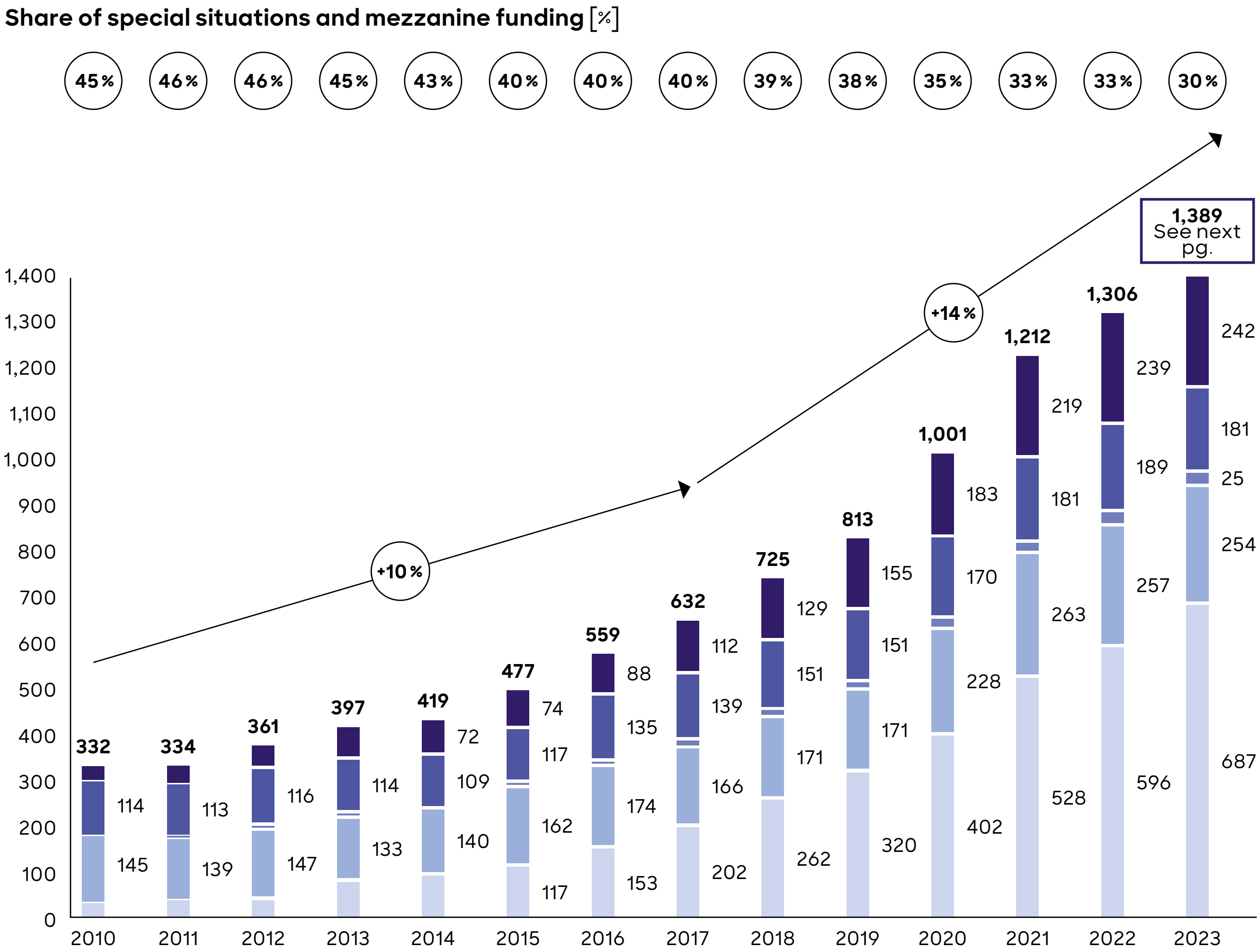
Source: Roland Berger

ANALYZING THE GLOBAL PRIVATE DEBT MARKET – FINDING SUITABLE OPTIONS

The global private debt market has enjoyed an unbroken boom over the past decade and a half. By 2023, assets under management (AuM) had already reached EUR 1.4 trillion (see chart below). ▶ G

Direct lending – the direct granting of senior loans, often for private equity players to finance acquisitions or organic expansion – is the largest segment of the private debt space. The two segments that are most relevant to the financing of transformation – special situations and mezzanine funding – together account for around 30% of the overall market. These options typically involve junior debt and/or convertible loans that allow investors to participate in future equity growth.

G Special situation and mezzanine funding – the two segments of relevance to transformation – account for around 30% of the overall private debt market
Development of the global private debt market by investment strategy [EUR bn][1]



Segments of relevance to transformation financing

Special situations	Mezzanine funding	Venture debt	Distressed debt	Direct lending
Debt financing for companies in special situations – such as M&As or organic expansion – involve a broadly diversified risk and return profile with specialized funds	Subordinated corporate loans are granted with correspondingly higher returns between secured loans and equity	Startup financing comes after initial equity rounds and is generally subordinated	Non-performing loans – typically with high-risk profiles – are acquired with the aim of restructuring or selling the company	Typically, senior loans are granted directly, often to finance acquisitions via private equity companies

Special situations | Mezzanine | Venture debt | Distressed debt | Direct lending

1 Source of market data in USD; applied exchange rate: EUR 1 = USD 1.08

Source: Preqin

A GROWING RESOURCE

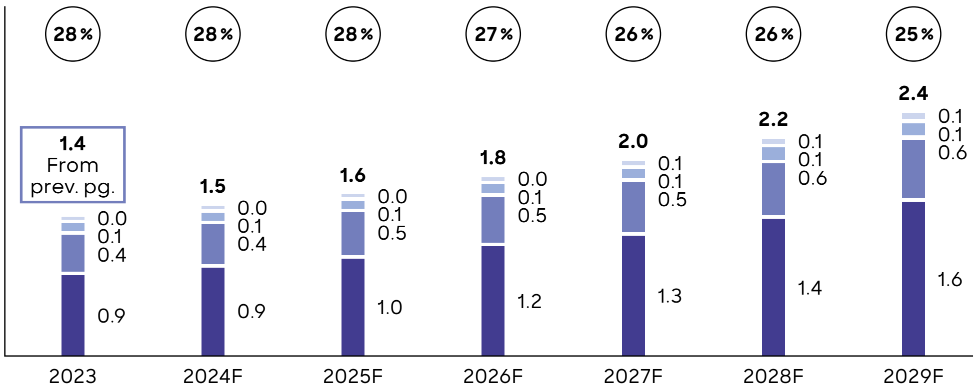
There is certainly no shortage of ready cash resources – "dry powder" is the commonly used term – available for companies keen to pursue the private debt option. ▶ H

Annual growth of around 10% is projected to add another trillion dollars in available funds and swell the global private debt market to EUR 2.4 trillion by 2029. While North America dominates this market, Europe has doubled its share to 28% since 2010 (according to data from 2023). This relative share is expected to slip to 25% in the years ahead, with both North America and the rest of the world gaining ground. In absolute terms, however, assets under management and available for private debt purposes in Europe will increase by around EUR 0.2 trillion by 2029. Across all private debt segments, dry powder in the region of EUR 146 billion will thus be available. ▶ I

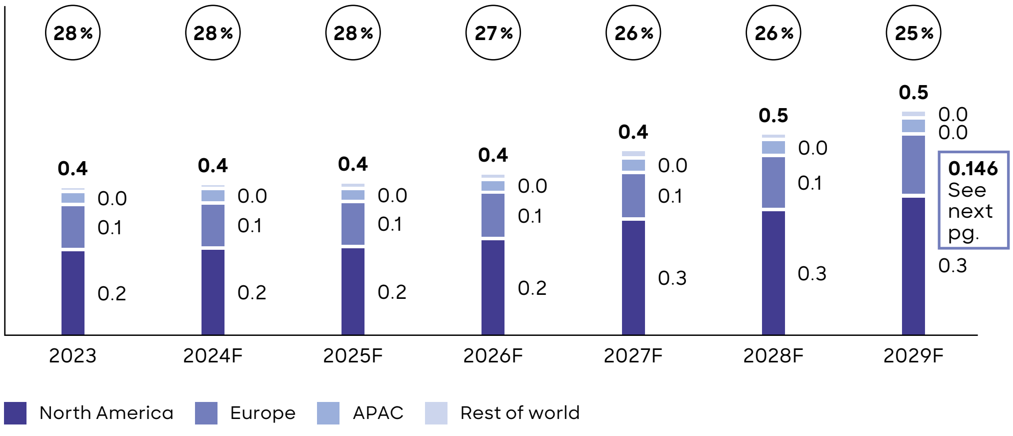
H The private debt market as a whole has sufficient dry powder – Europe's share should reach about EUR 146 billion by 2029

Development of the global private debt market by region [EUR tn][1]

Private debt AuM by region [Europe's share, %]



Private debt dry powder by region [Europe's share, %]

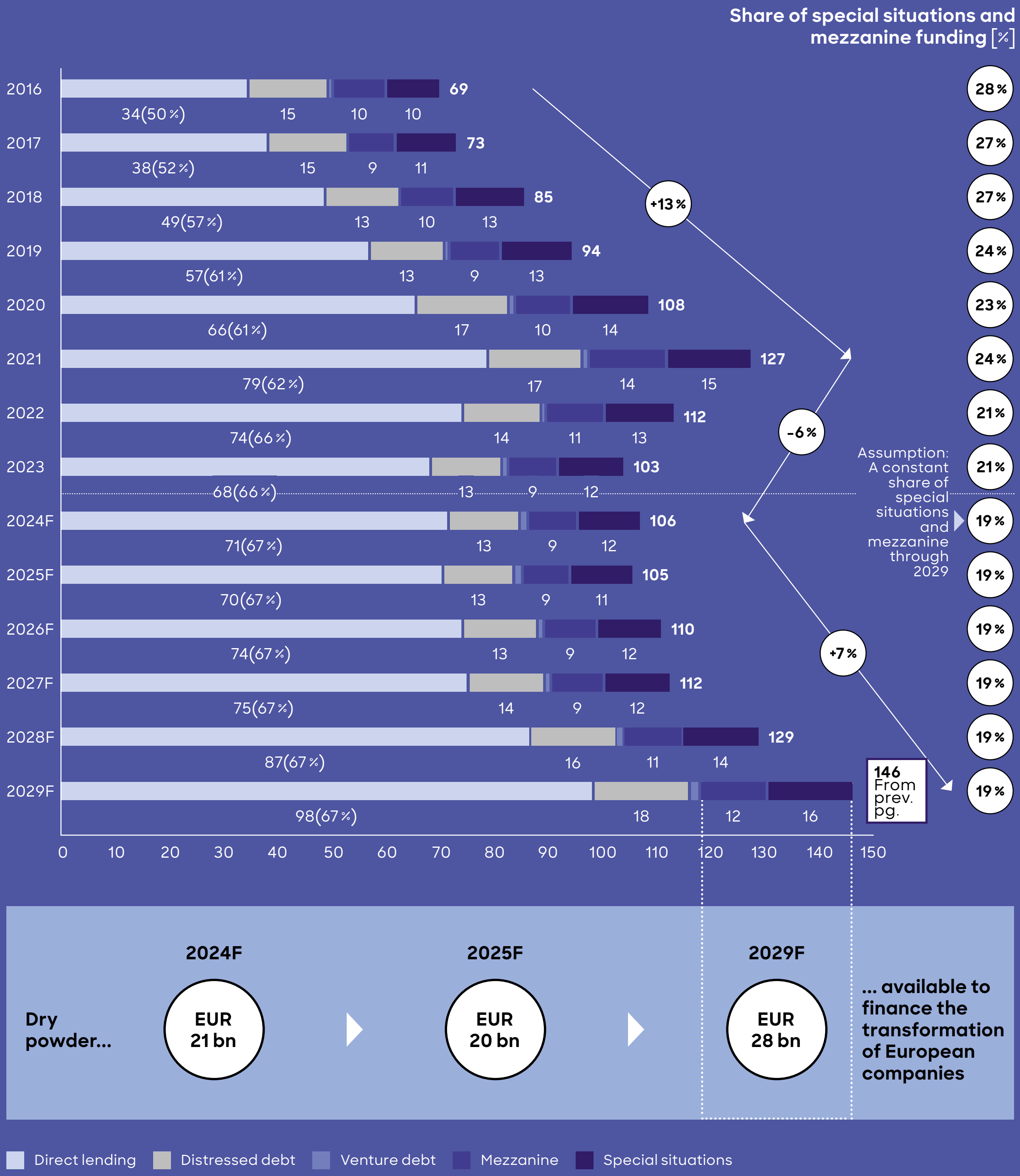


1 Source of market data in USD; applied exchange rate: EUR 1 = USD 1.08

Source: Preqin

By 2029, dry powder totaling around EUR 28 billion will be available in Europe from the special situations and mezzanine segments

European private debt as a source of potential transformation financing [EUR bn][1]



1 Source of market data in USD; applied exchange rate: EUR 1 = USD 1.08

Source: Roland Berger, Preqin

Of this overall volume, roughly two thirds will be held to service direct lending strategies, which compete directly with bank-based debt financing. However, assuming that the relative shares of the five private debt segments remain more or less constant between now and the end of the decade, that will still potentially leave as much as EUR 28 billion in the special situations and mezzanine segments – funding that is well suited to use in corporate transformation projects.

Clearly, enough money is there for companies willing to look beyond the traditional options of bank lending and equity funding. The question is: What must organizations do to secure the right private debt financing arrangements for their specific situation?

4

Challenges and consequences – The pressure to succeed

To pay back the high cost of private debt, companies have no choice but to make sure their transformations deliver the results – and the profits

Given the volume of funding potentially available via this channel, the notion of using private debt to fund corporate transformation is neither far-fetched, nor is it by any means a niche topic. It must also be noted that, in many cases, companies have already exhausted all the regular alternatives.

What is also true, however, is that sourcing private debt for a corporate transformation is a relatively complex process that requires careful preparation. And for those companies that do manage to acquire such funding, it brings with it huge pressure to make the transformation succeed. ▶ J

One source of risk (or incentive, depending on how you choose to see it) is that, it is usually subordinate to (typically senior) bank loans. In the case of subordinated or mezzanine financing, interest is often not paid in the form of periodic payments. Instead, it can be offset as payment in kind against the final maturity amount, or it can be converted to an option on an equity stake.

Another key consideration is quite simply that private debt does not come cheap. Where other options are no longer on the table, this is a bitter pill that companies must presumably swallow. The cost issue does, however, underscore perhaps the most important point of all: For private debt-financed organizations, failure is not an option. Successful transformation – meaning an increase in the value of the enterprise – becomes an absolute imperative to ensure that the funding supplied can be repaid in full.

J A successful transformation is crucial if companies are to boost their enterprise value and pay off private debt

How the private debt financing structure works

Source: Roland Berger

Recommendation

Bearing in mind the pressures and consequences described in the previous section, a professional approach tailored to the individual company's exact situation is vital to secure the right type of private debt financing at the right time. Specifically, our experience leads us to recommend a clear focus on five key aspects:

1. Draw up a credible business plan that reflects an in-depth understanding of your targeted business model and the wider industry environment
2. Be sure to draw on solid expertise and experience regarding the company's point of departure and the available financing options
3. Take the time to fully understand the objectives of all the stakeholders involved in the financing project
4. Build a broad network of contacts to banks, debt funds, institutional investors and private equity players
5. Develop (or call in) top-class process expertise and commit to thorough implementation

If you are interested in a closer look at how private debt might help finance your company's transformation, we would welcome the opportunity to talk to you.

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Further reading

- *CORPORATE FINANCING: THE BIG SQUEEZE*
- *RESTRUCTURING & TURNAROUND*
- *MERGERS & ACQUISITIONS*

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