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Number of start-ups in Germany was steady at 70,000 in 2019 – impact of the coronavirus crisis is uncertain

The number of innovation- or growth-driven young enterprises in Germany has stabilised. After rising in 2017 and 2018, the number of start-ups stayed at 70,000 in 2019. It is uncertain how the coronavirus crisis will impact the development of start-ups in 2020. More businesses will close their doors but entrepreneurs also have reason for hope. The coronavirus crisis has shifted the focus more strongly towards internet-based and digital business models, which is likely to bolster the number of start-ups. Whether the growth of new start-ups will overcompensate the closure of existing businesses remains to be seen.

One fifth of start-up founders (19%) plan to employ venture capital to finance their future growth. That is twice as many as in 2018 (9%). So the appetite for VC is growing, which also has to do with increased availability of venture capital. After all, greater availability has a positive effect on start-up activity.

The coronavirus crisis has brought start-ups more into focus

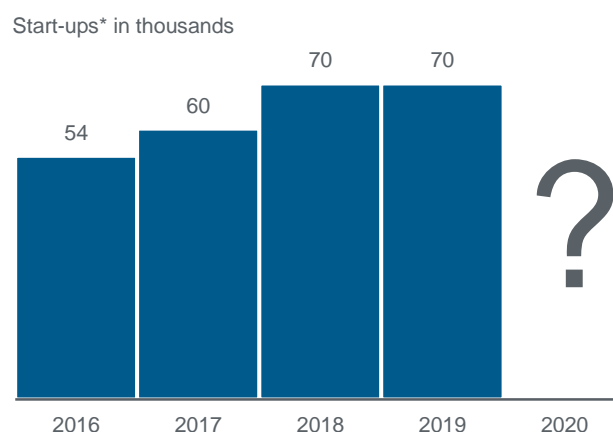
Start-ups are of great economic importance because these innovation- or growth-driven young enterprises hold important potential for renewal and employment. Germany risks losing a whole start-up generation to the coronavirus crisis. They have therefore moved higher up the economic-policy agenda, as highlighted by the government's quick decision on start-up assistance.

Before the crisis struck, the number of start-ups – innovation- or growth-oriented young enterprises (see box 'What are start-ups?') – stabilised in Germany. After rising in 2017 and 2018, the number of start-ups hovered at 70,000 in 2019 (Figure 1). The outbreak of the coronavirus crisis initially raised grave concerns for start-ups. Thus, in early summer many start-ups feared that the losses in turnover would force them to close before the end of the year. Some financing deals that were believed to be certain also fell through. The situation has generally eased in the meantime. Nevertheless, more businesses will close as a result of the crisis. Venture capital investors also expect a higher rate of defaults in their portfolios (Figure 2.)¹

Initially, things did not look good for entrepreneurs either. Many start-up plans were shelved because of the crisis. There will be more necessity start-ups as a result of higher unemployment but fewer than expected

thanks to the increased and extended short-time work allowance. The reluctance of opportunity entrepreneurs is therefore not likely to be offset by more necessity start-ups. However, necessity start-ups are less likely to be innovation- or growth-oriented, so they are less relevant for the number of start-ups in any case – as opposed to internet-based and digital start-ups. Social distancing regulations are pushing such business models more into the focus of entrepreneurs. Because newly founded internet-based and digital businesses are more likely to have start-up characteristics, the number of new businesses with start-up characteristics is likely to rise. However, it is still uncertain whether the growth of new start-ups will overcompensate the closure of existing businesses.

Figure 1: Number of start-ups is steady – how is the coronavirus crisis impacting them?



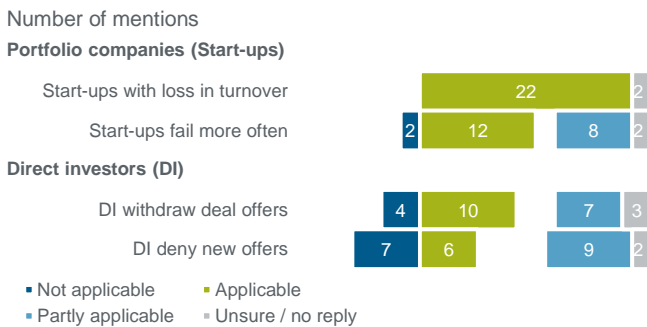
* For start-up definition see box 'What are start-ups?'

Source: KfW Entrepreneurship Monitor.

Box: What are start-ups?

Start-ups are young commercial enterprises founded no more than five years ago whose founders are **full-time** entrepreneurs, have a **team of founders or employees** and are **innovation- or growth-driven**, that is, conduct research and development in order to make a **technological innovation** market-ready or offer at least one **new-to-market innovation for Germany**.

Figure 2: Coronavirus crisis is weighing on start-ups and unsettling VC investors



Source: German Venture Capital Barometer supplementary survey Q2/2020¹

With an average team headcount of 1.8, the 70,000 start-ups represent around 127,000 entrepreneurs, of whom a good 24,000 are female entrepreneurs, putting the share of women at 19%. The characteristics of start-up entrepreneurs were analysed in greater detail in the KfW Start-up Report 2018. For example, they are younger and more academic than other young entrepreneurs.²

Start-ups often struggle to access finance

In order to be able to write success stories, start-ups require suitable finance. After all, the more innovative and growth-oriented they are, the less suitable classic debt finance, for example, is for them. But the road to steep growth is rocky and 'bootstrapping' often leads start-ups through the 'valley of death'. The 'valley of death' describes the early start-up phase in which a business incurs costs but has no customers through which to generate turnover, or is yet to demonstrate proof of concept. Entrepreneurs often go through these phases by what is referred to as bootstrapping, or working with as few resources as possible and with all available (usually private) funding options including

leasing or resource sharing approaches etc. In fact, four in five entrepreneurs (81%) of the 2019 start-up cohort so far have injected no more than EUR 100,000 in capital and contributed 84% of their funding from private resources.

More start-ups are seeking VC finance

Start-ups have problems specifically with classic debt finance. Loans fit neither with the cash flow profile of typical start-ups nor with their risk profile.³ Venture capital (VC), on the other hand, fits very well. Investors such as business angels and VC funds invest in start-ups with venture capital. The investment combines the high risk with strong opportunities for returns if the company value rises when they are successful. One in five start-ups (19%) plan to finance their further growth via VC in the coming years. That is twice as many as in 2018 (9%).

Although private VC funds typically set their sights on start-ups only when they have passed through most of the 'valley of death', the prospect of obtaining VC finance can be uplifting. For Germany and the US, for example, a positive supply-side effect of VC on start-up activity has already been demonstrated.⁴ The annual VC investment by institutional investors increased 2.8-fold since 2014 to around EUR 1.9 billion in the year 2019. The overall market climate (fundraising, demand, exit) has also improved significantly in the past years. Against this backdrop, the venture capital ecosystem is also sending out positive signals for the number of start-ups in 2020 because, contrary to all fears, the coronavirus crisis as not yet adversely impacted investment activity in the first half (Figure 2).⁵ However, the effects may not become visible until the second half of the year, when all deals initiated before the coronavirus crisis have been processed.

¹ Metzger (2020), [Coronavirus crisis has unsettled the VC market and changed the investor landscape](#), Economics in Brief No. 202, KfW Research.

² Metzger (2018), [KfW-Start-up Report 2018: Number of start-up founders increased to 108,000 in 2017](#), KfW Research.

³ Hall (2002), Start-ups and their financing in Europe, EU Monitor Global Financial Markets, Deutsche Bank Research.

⁴ It is possible that the number of start-ups with a potential need for VC may increase only when there is confidence in a sufficient supply of venture capital. For Germany, for example, a statistically significant effect of the amount of VC investment in one year on the number of high-tech start-ups in the following year has been evidenced (Brutscher and Metzger (2012), *Befördert Wagniskapital Hightech-Gründungen? (Does venture capital promote high-tech start-ups?)* Akzente No. 60, KfW Research (in German only). This supply-side effect on start-up activity has also been evidenced for the US (Samila and Sorenson (2011), *Venture Capital, Entrepreneurship, and Economic Growth*, Review of Economics and Statistics, Volume 93 (1), p. 338–349).

⁵ Metzger (2020), VC market in Germany: Reif für den nächsten Entwicklungsschritt (*Ready for the next development stage* - in German only), KfW Research.