

»» Demographic change bolsters private consumption and SME growth

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Demographic change is altering the demand for goods and services, even in the short term. Year after year, the ageing of the population is shifting consumption patterns. But what does this mean for small and medium-sized enterprises in Germany?

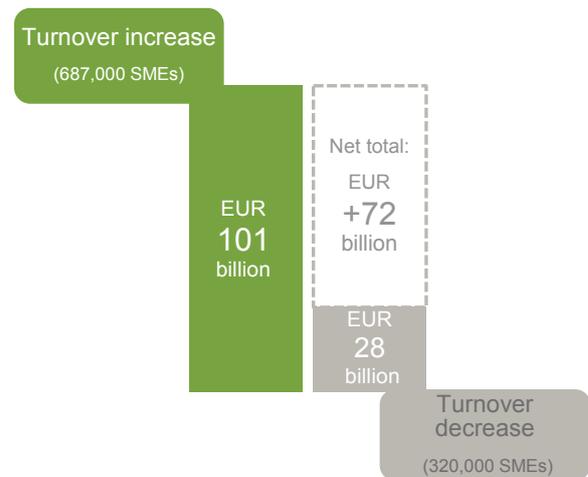
A special analysis of the KfW SME Panel has revealed that demographic factors have a significant impact on short-term turnover expectations of small and medium-sized enterprises (SMEs). On balance, the effects are positive and amount to annual growth contributions of EUR 24 billion between 2014 and 2016. Thus, roughly one fifth of the currently subdued turnover growth in the SME sector can be attributed to demographic change on the sales markets. Ageing and immigration are proving to be important pillars of growth for SMEs in the short term.

Overall, 19% of SMEs expect changing sales markets to bring about demographically induced turnover increases. Service providers are particularly well represented among these 'demographic winners'. At the same time, 10% of enterprises fear losses, especially in the manufacturing sector.

Demographic change is also having an impact on investment, as structural changes in demand require realignments of product ranges or marketing strategies, for instance. Even if not all affected SMEs are taking action, 20% of current investment growth is, all the same, a response to demographic changes of sales markets.

For businesses, demographic change does not just cause problems such as skills shortages and succession issues¹ it also offers opportunities. Its impacts on sales markets have not yet received much attention. The ageing of the population alters the patterns of consumption of goods and services as older consumers spend their money on different kinds of goods – more on health and housing and less on mobility and clothing. As the share of older consumers continues to grow, their demand is gaining increasing importance in the context of overall economic consumption (see box on page 2 for details). In addition, the high migrant intake of the past few years has been boosting consumption and the continuing migration from the countryside to the cities is shifting demand along geographic lines.

Figure 1: Expected changes in SMEs turnover due to demographic change, 2014–2016



Source: KfW SME Panel 2014–2015.

Demographically induced shift in demand boosts turnover in the short term

Even in the short term, this has direct impacts on enterprises' business development. A special analysis of the KfW SME Panel² shows what demographically induced changes in turnover SMEs expect.

On balance, SMEs expect demographic change to generate additional turnover of EUR 72 billion in the years 2014 to 2016 (Figure 1). They anticipate an increase of EUR 101 billion, but some EUR 28 billion in losses. The net annual effect amounts to EUR 24 billion. Measured against the total turnover of the SME sector of EUR 344 billion in 2013, this represents an annual share of approx. 0.7%.

Demographics counteract slow growth

This may seem moderate, but the demographic contribution to turnover growth is significant. Thus, SMEs attribute a good one fifth (21%) of the 3.3% turnover growth in 2014 to demographic change. This is very important, especially since growth in the SME sector has been subdued for several years now. After increases of 8% to 10% in the pre-crisis years and 7% to 8% in 2010/2011, the momentum has now dropped significantly to growth rates of 2% to 3% (Figure 2).

Consumption expenditure and demographic change

Germany's population will decrease in the long term as a result of persistently low fertility. Although migrant intake is currently high, the population is expected to decrease by some 2% by the year 2030. In the population aged 20 to 64 years, the core group of the workforce, this decline will be even more pronounced (-12%). Reduced overall labour supply will exert considerable downward pressure on Germany's growth potential in the medium and long term.³ With respect to private consumption, however, this decline will be overcompensated on the demand side for some time through changes in household structures.

The reason is that the phenomenon of "singularisation" – the trend towards more single-person households, single parents and more childless couples – will increase the number of households from 40.8 million today to 41.5 million up to around the year 2025.⁴ This will also raise private consumption, the crucial parameter of which is the number of households, because people consume living space, household amenities and durable goods jointly, for example.

Shopping baskets change with age

Demographic change affects not only the level of consumption, but also its structure. Consumers are ageing – and older consumers want other products and services. This is illustrated by the comprehensive Sample survey of Income and Expenditure conducted by the Federal Statistical Office.

As the population ages, an increasingly larger share of consumption goes to healthcare. While healthcare expenditure accounted for around 3% of total consumption expenditure of young households in 2013, it was around 7% in elderly households (Figure 3). Expenditure on housing also rises with age.⁵ In contrast, expenditure on clothing and mobility (essentially, on cars) decreases. With age, consumption expenditure generally shifts to services.⁶

The elderly are becoming more numerous and more affluent

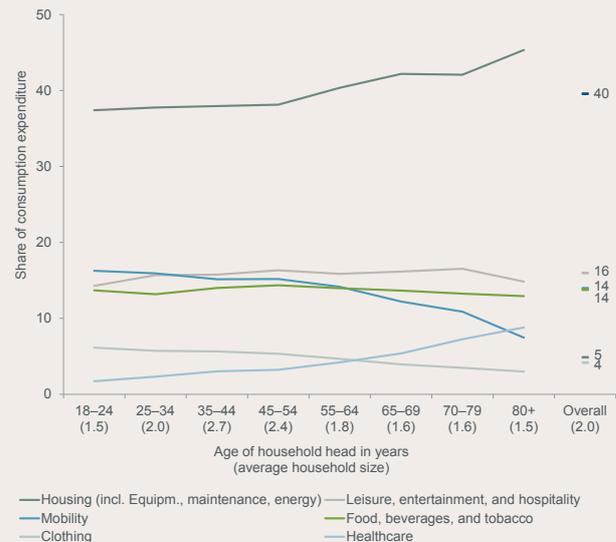
The specific consumption pattern of elderly households is becoming increasingly important to the overall economy. As the population ages, the proportion of elderly has been rising for years now. Ageing will soon accelerate noticeably because the roughly 20 million baby boomers will be reaching retirement age in the next 15 to 20 years (Figure 4). At present, 36% of private households are headed by a person aged 60 or over, and in 2030 this proportion will be 44%.⁷

The consumption footprint of elderly households will not increase solely because of their growing numbers, but also because of intergenerational income differentials and behavioural differences (which is referred to as cohort effects). Thus, today's elderly in Germany have higher incomes than their previous cohorts – and also spend a

higher proportion of those incomes. As a result, total consumption expenditure by elderly households has recently risen more than average. In fact, the real consumption increase between 2003 and 2013 can be attributed almost exclusively to the – more numerous and more affluent – elderly households.⁸

Figure 2: Consumption expenditure by groups of goods and age (2013)

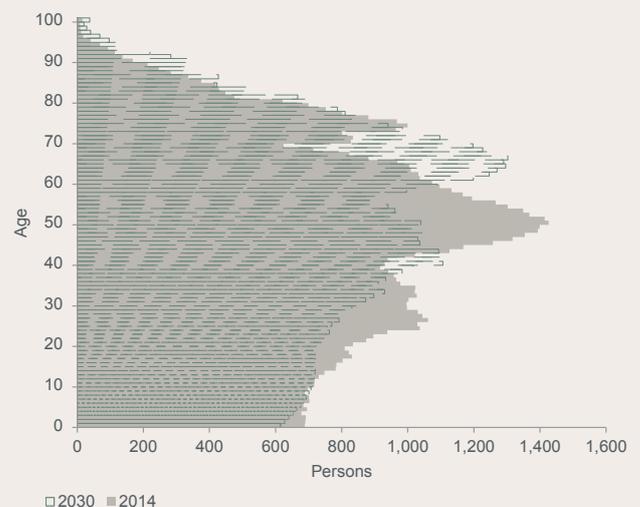
In per cent of consumption expenditure of an average household in the respective age group



Note: Allocations to sections of the Systematic List of Income and Expenditure of private households (in German: Systematisches Verzeichnis der Einnahmen und Ausgaben der privaten Haushalte – SEA): food, beverages, and tobacco=01, 02; clothing=03; housing=04, 05; healthcare=06; mobility=07; leisure, entertainment, and hospitality=09, 11.

Source: Sample survey of Income and Expenditure 2013, Federal Statistical Office (2015).

Figure 3: Demographic development 2014–2030



Source: 13th coordinated population projection, Variant 1, Federal Statistical Office (2015).

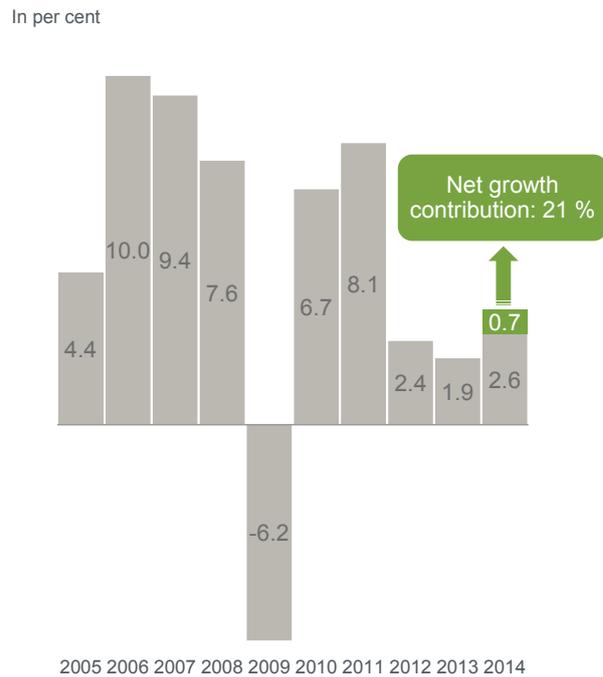
Despite robust profitability and increasing investment activity, a renewed growth surge is yet to materialise. Productivity growth is too weak, having declined for the fourth time in the past ten years. The setbacks in foreign trade have also been too strong, where SMEs have lost some EUR 60 billion in turnover since 2011. This makes demographically induced consumer demand an important pillar of growth for small and medium-sized enterprises – comparable in intensity with a roughly five per cent increase in foreign turnover.

Two scales: one in five SMEs benefit, one in ten lose

However, demographic change definitely does not benefit all SMEs, as 19% of them anticipate turnover increases, but 10% fear losses (table). The vast majority of 71% do not expect demographic developments to have any significant impact on demand in the short term.

The heavier scale is made up of around 687,000 SMEs that regard their business model as 'beneficiaries' of demographic change. They expect demand for their products and services to increase significantly between 2014 and 2016 – by an average 16.4% (in total: by EUR 101 billion, or an average of EUR 49,000 per enterprise per year). The lighter scale contains around 320,000 SMEs whose demand will decrease by an average 13.5% as a result of demographic change (in total: by EUR 28 billion, or an average EUR 29,000 per enterprise per year).

Figure 4: Annual turnover growth of SMEs and demographic effect



Source: KfW SME Panel 2006–2015.

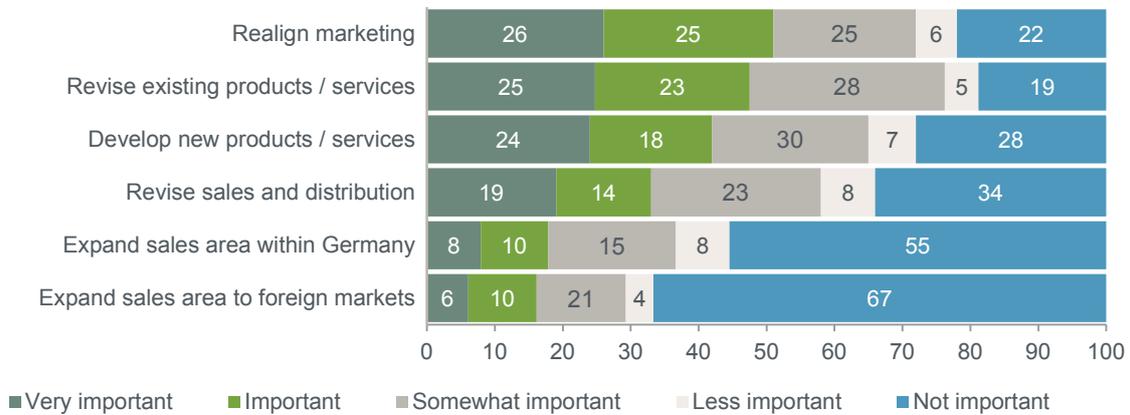
Table: Expected turnover variations due to demographic change in 2014–2016 by segment

	Change in demand until 2016 (share of SMEs in per cent)			Expected changes in turnover (in per cent)		Volume of change in turnover until 2016 (in EUR billion)		Net effect
	Increasing	Decreasing	No change	Increasing	Decreasing	Increasing	Decreasing	
Size classes								
Small SMEs (fewer than 10 employees)	19	10	71	19.0	-19.2	50.7	-8.1	42.6
Medium and large SMEs (10 and more employees)	22	12	66	14.3	-12.1	50.4	-20.2	30.2
Sectors								
Manufacturing	11	16	73	11.5	-13.2	10.3	-3.4	6.9
Construction	15	11	74	12.4	-17.8	4.4	-1.0	3.4
Trade	19	18	63	12.3	-13.2	15.0	-9.1	5.9
Services	21	7	72	19.2	-11.2	70.1	-10.3	59.8
Age of business								
Up to 10 years	18	7	75	18.6	-18.6	14.7	-2.2	12.5
Over 10 years	20	12	68	16.7	-13.2	81.5	-25.6	55.9
Region								
Eastern states	21	14	65	15.1	-11.3	12.7	-3.4	9.3
Western states	19	10	71	16.5	-13.8	88.4	-24.9	63.5
Population density								
Urban areas	17	8	75	16.3	-15.4	54.5	-12.8	41.7
Rural areas	17	12	71	11.5	-11.5	12.0	-8.8	3.2

Source: KfW SME Panel 2014.

Figure 5: Measures to counteract demographically induced decreases in turnover

In per cent



Source: KfW SME Panel 2014.

Turnover losers – turnover winners? Service providers are optimistic, but manufacturers are cautious

Demographically induced turnover expectations vary significantly from one sector to another. While manufacturing is dominated by pessimists, the services sector boasts a clear majority of optimists. A good one fifth of service providers expect demographic change to generate short-term turnover growth. Construction firms that expect higher turnovers slightly outnumber those that expect lower turnovers. The retail sector is particularly affected (37% of businesses), although winners and losers roughly balance each other out.

In a comparison of rural and urban areas, the picture is as expected, given the current migration pattern. In rural areas, the number of SMEs that expect decreasing turnovers is slightly higher than in the towns and cities. The situation is the same in the eastern and western German states. In contrast, whether an SME regards itself as a winner or loser of demographic change is largely independent of its size.

The responses of demographic losers: realign marketing, revise product range

Enterprises that expect demand for their products and services to decline have to react swiftly. After all, once they have lost customers and turnover, they are hard to recover. Demographic change not only shifts demand between different groups of goods, that is, alters the question of *what* to consume (box). It also affects the *how*. Expectations with regard to advice, contact with sales consultants, ingredients, packaging etc. change from generation to generation. In the opinion of SMEs, their most important response is therefore to realign their marketing and the products and services they offer (Figure 5).⁹

Of the demographic losers, 51% consider it important to adjust their marketing. In the eyes of many experts, this is not so much about 'marketing to seniors', where the product purpose and elderly target group are addressed directly – and which the latter may regard as discriminatory. Instead,

they recommend 'intergenerational marketing' that addresses consumers in an age-neutral manner and highlights product features without explicit reference to consumer age (e.g. easy-to-use, proven quality).

Of the demographic losers, 48% attach more importance to adapting their existing range of products. For consumer goods, their main focus is most likely on usability, which includes clear labelling and directions of use, or smaller package sizes. Moreover, they have to address the quality expectations of experienced consumers, which makes product samples, warranties etc. more important. Service providers are responding to quality-conscious customers who need extensive sales support by training staff accordingly and making their business premises more age-appropriate. Slightly fewer of the negatively affected SMEs (42%) regard the development of completely new products or services as important.¹⁰

Adapting sales channels and tapping new markets – a less common strategy

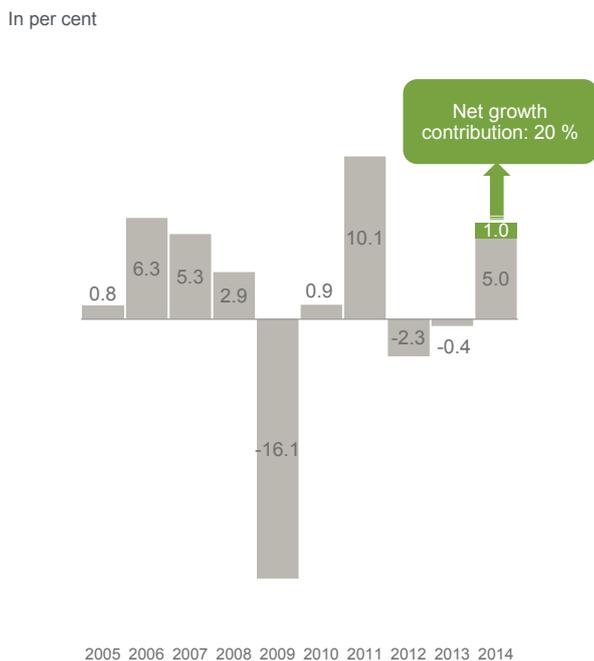
Sometimes sales channels have to be realigned with changing target groups, e.g. through specific multipliers, by intensifying personal contacts or through home delivery services, mobile services and direct shipment. One third of the demographic losers consider such sales modifications important.

Geographic expansion of the sales region – to demographically more favourable regions, for example – is a less common response. Adding sales markets within Germany is of major importance for only 18% of the affected SMEs while 16% plan to expand sales to foreign markets. Geographic expansion of the customer base is not relevant at all for the majority of the affected SMEs. This reflects the fact that many SMEs are firmly settled in their location, particularly in the services sector.

Only one third respond by investing

Changes require investment. This also applies to demographic shifts on sales markets. Potential demographic losers must adapt their products and marketing, among other things, in order to prevent or mitigate declines in turnover. For SMEs operating in sectors that benefit from demographic change, expansion investment may be a good way to meet rising demand in their segment and achieve turnover growth after all.

Figure 6: Annual growth in investment expenditure of SMEs and demographic effect



Source: KfW SME Panel 2006–2015.

However, just under one third (31 %) of enterprises, the positively as well as the negatively affected ones, see a need

(and possibilities) to invest in the short term in response to demographic change on their sales markets.¹¹ In other words, two thirds of enterprises affected by changes in demand do not see a need for action and regard themselves as sufficiently well-positioned to respond to the challenges – both the positive and the negative ones.

Of the SMEs that do not expect demographic change to have any short-term effects on their turnover, 6 % attribute part of their investment to this area. This investment may be just what prevents looming declines in turnover.

Nevertheless, there is a clear investment stimulus

Overall, 12 % of all SMEs (416,000 enterprises) are stepping up their investment activity between 2014 and 2016 in response to the consequences of demographic change. Larger SMEs (with ten or more employees) are particularly active. Their demographically-induced willingness to invest is 23 %, more than twice as high as among small SMEs with fewer than ten employees (11 %). Moreover, above-average investment activity is being considered by 17 % of SMEs in the manufacturing sector, 16 % of wholesale and retail businesses and 16 % of SMEs in the eastern German states. When SMEs do invest, it is with high amounts. Demographically induced investment averages some 21 % of the respective business investment volume. For the SME sector as a whole, this results in an investment stimulus of EUR 2.5 to 3 billion annually.¹²

SMEs' investment expenditure on new and second-hand machinery, equipment and buildings increased by EUR 12 billion or 6 % in 2014. The share of demographically induced investment in total investment growth thus amounted to some 20 % (Figure 6). Businesses are displaying a noticeable direct response to demographic change on their sales markets.

Demographic change offers opportunities for turnover and investment in the SME sector

In the SME sector, the demographic change taking place in Germany presents itself with many facets. Skills shortages, succession problems and the declining investment propensity of ageing business owners are one such facet.¹³ But demographic change also means opportunities. The present analysis demonstrates that demographic change on sales markets triggers short-term growth and investment stimuli in the SME sector.

From a broad perspective, this is good news for both SMEs' turnover growth and investment activity. After all, the shift in consumption demand can be a significant mainstay of SME growth in the short term. This is all the more important in times when other growth drivers are not in sight. The impact is potentially significant because past experience has shown that when domestic demand is on track, optimism and investment in the SME sector follow.

Contours of the latter are already becoming visible, because enterprises are hard pressed to invest in their response to changing consumer behaviour. It is true that investment activity by SMEs has recently come out of the slump to reach the highest level in six years, buoyed by low interest rates. In a historic comparison, however, investment is still low. At the same time, the proportion of investing enterprises has stagnated on a low level for years. Further investment stimuli are urgently needed. ■

The KfW SME Panel (KfW-Mittelstandspanel) has been conducted since 2003 as a postal tracking survey of small and medium-sized enterprises in Germany. The parent population of the KfW SME Panel includes all private-sector companies from all industries with annual turnovers of up to EUR 500 million.

With a database of up to 15,000 companies per year, the KfW SME Panel is the only representative survey of the German SME sector and thus the most important source of data on issues relevant to the SME sector. The main survey of the 13th wave was conducted in the period from 23 February 2015 to 26 June 2015.

Further information and the current annual report can be obtained at <https://www.kfw.de/KfW-Group/KfW-Research/KfW-Mittelstandspanel.html>.

¹ Cf. Leifels, A. (2015), Recruitment of skilled workers in SMEs: Optimism must not distract from qualification problems, Focus on Economics No. 100, KfW Research, Frankfurt am Main.

² For the current report on results see Schwartz, M. (2015): KfW SME Panel 2015 – With growing confidence, German SMEs are starting to invest again, KfW Research, Frankfurt am Main.

³ Borger, K. (2016): 'Germany's demographic trap: integrating refugees is only part of the solution', Focus No. 124, KfW Research, Frankfurt am Main.

⁴ Source: Household forecast 2035 of the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR).

⁵ The relative increase in expenditure on housing is mainly due to the fact that total consumption expenditure is lower among the elderly – whose incomes are lower – while the living space they use is often not reduced (this is referred to 'as remanence effects'). In order to allow comparability of data, expenditure on housing also includes fictional rental for owner-occupied homes.

⁶ Source: Own calculations on the basis of the 2013 income and consumption sample collected by the Federal Statistical Office.

⁷ Source: Household forecast 2035 of the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR).

⁸ Source: Own calculations on the basis of the 2003 and 2013 income and consumption samples collected by the Federal Statistical Office.

⁹ In all segments and size classes of small and medium-sized enterprises, marketing and realigning the range of products and services are clearly discernible priorities.

¹⁰ In a similar way as with intergenerational marketing, product design 'for all' is also widespread. Such product design does not involve products intended specifically for ageing consumers, but embraces target groups that are as broad as possible and can be reached by highlighting easy and convenient use. This applies equally to services (e.g. catering strategies that target as many age groups as possible).

¹¹ SMEs that regard themselves as winners of demographic change are slightly more willing to invest than the losers. This is reflected both in the proportion of enterprises that invest and in the amounts they invest.

¹² Across the 2014 to 2016 analysis period, this additional requirement roughly corresponds to EUR 7.2 to 8.8 billion in annual investment – depending on the calculation method. Small businesses with fewer than ten employees account for just over EUR 2 billion of this amount, while larger SMEs with ten or more employees take the lion's share of more than EUR 5 billion. Across the sector, services are the dominant segment with nearly EUR 5 billion, followed by manufacturing with roughly EUR 1 billion. Retailers and construction are far behind, with EUR 0.7 billion and EUR 0.4 billion, respectively.

¹³ Cf. Gerstenberger, J. et. al. (2015), Demografie im Mittelstand – Alterung der Unternehmer ist nicht nur Nachfolgethema (*Demographics in SMEs – ageing entrepreneurs is not just a succession issue*), Focus on Economics No. 92, KfW Research, Frankfurt am Main (in German).