

# »» Foreign workers in German SMEs: a strong plea for free labour markets

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Germany is an immigration country and will remain dependent on immigration because its demographic outlook is unfavourable. It has a growing need to harness foreign workforce potential in order to offset labour supply shortages.

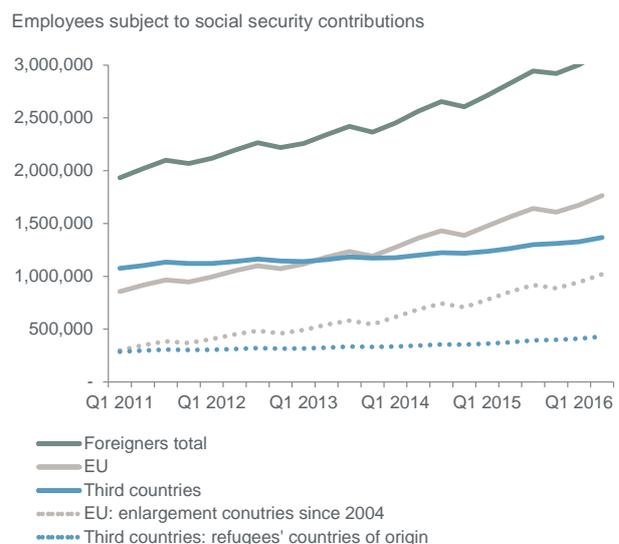
More than three million foreigners work in Germany, and the trend is rising. This is also reflected in the workforces of Germany's small and medium-sized enterprises, most of them from the EU. Three in four SMEs currently employ foreign workers. Around half of all SMEs specifically plan to hire foreign workers by the year 2021.

Small and medium-sized employers therefore regard free European labour markets as a precious asset. SMEs that operate in the United Kingdom and Eastern Europe make a particularly clear plea in favour of free movement of workers. Labour mobility and other European achievements are currently the subject of heated debate in these regions.

In the long term, the recent refugee migration may also contribute to reducing the labour shortage. In this context, the KfW SME Panel has found that the number of employment relationships with refugees is (still) modest. In the past five years, SME employers have entered into around 200,000 apprenticeship, temporary employment or internship agreements with refugees. Higher-skilled employment is far less common: SMEs have hired around 49,000 refugees as skilled workers during this five-year period.

Germany has been a traditional immigration country ever since the 1950s. Between 1950 and 2015, more than 700,000 people migrated to Germany each year.<sup>1</sup> After deducting outward migration, average net immigration during this period was a good 190,000 persons. Roughly one in ten inhabitants of Germany do not have a German passport and one in five have a migrant background.<sup>2</sup> The German economy will be especially dependent on immigration in the future because the post-war baby boomer generation will retire between 2020 and 2040 and leave a gap in the potential size of the workforce. As a consequence, recruitment problems and skills shortages will rise noticeably.<sup>3</sup> In addition to increasing the labour market participation of women and older persons, migration into the labour market is a key antidote.

**Figure 1: Germany increasingly relies on foreign workers**



Source: Employment statistics of the Federal Employment Agency

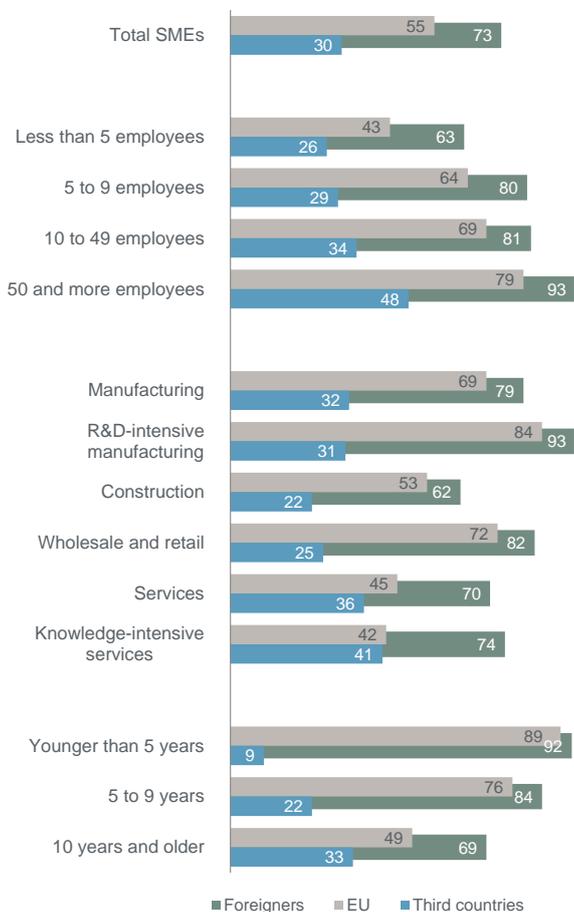
## Three million workers do not have a German passport

At the end of the second quarter of 2016, 3.1 million foreign workers were in employment subject to social security contributions in Germany (Figure 1).<sup>4</sup> Thus, the proportion of foreigners is now 10.0%, whereas five years ago it was still 6.8% (1.9 million, Figure 1). Employment of EU citizens in particular has increased in the past years; they have outnumbered citizens of third countries (non-EU nationals) since early 2013. Currently 56% of foreign workers in Germany are from EU member states. This shift is the result of intense labour migration from the eastern and south-eastern European countries which joined the EU in 2004, 2007 and 2013 and some years later were granted unrestricted access to the German labour market (see box).<sup>5</sup>

An additional survey conducted by the KfW SME Panel<sup>6</sup> shows that a purely German workforce is now clearly the exception among German enterprises. Overall, 73% of SMEs employ foreign workers. EU-citizens are not only more numerous but also more broadly spread across the SME sector, as 55% of SMEs have workers from the EU and 30% have non-EU citizens in their workforce (figure 2; 13% of SMEs have both).

**Figure 2: Foreign workers in SMEs in 2016**

Percentage of SME employers who had at least one foreign employee in September 2016



Note: Multiple answers were possible. The figures for the EU and third countries therefore do not add up to the proportion of SMEs that had at least one foreign employee.

Source: KfW SME Panel 2016 (additional survey conducted in September 2016).

**Even micro-businesses are staffed internationally**

The more workers a company has, the more likely it is that at least one of them is a foreigner. Thus, almost all large SMEs (with 50 or more employees) have foreigners on their payroll. In addition, 63% of micro-businesses (with fewer than five employees) have international staff. These size differences alone mean that in the research and development-intensive manufacturing sector, for example, the vast majority of enterprises have foreign employees (93%) because businesses in this sector are larger than average.

Even accounting for the sectors' different size structures, international workforces in the construction industry are less common while wholesalers and retailers have a very high number of non-German employees. Four out of five workers here are foreigners. Retailers and manufacturers employ particularly high numbers of EU citizens. Service providers, on the other hand, employ an above-average share of third-country nationals, especially in the knowledge-intensive service industries.

**Recruitment of foreign labour is becoming more important for SMEs, demand for third-country workers will rise**

A previous study conducted by KfW Research showed that the more difficult it is for enterprises to find skilled labour, the more often they recruit skilled workers from abroad.<sup>7</sup> SMEs' recruitment plans also reflect their growing need to offset labour supply shortages by harnessing foreign labour potential. Whereas 38% of SME employers have deliberately recruited foreign workers in the past five years, 52% are planning to do this for the next five years (Figure 3).

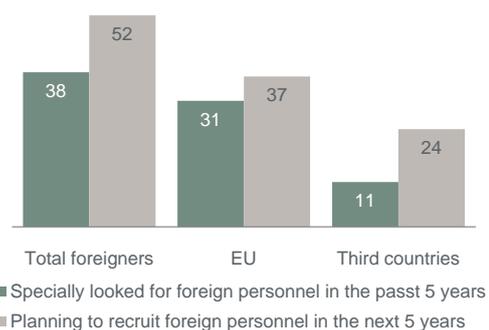
This rising importance of foreign labour is characterised by the fact that SMEs have shifted their focus on workers from non-EU countries. Whereas only 11% of SMEs have targeted their hiring efforts at third-country nationals in the past five years, that proportion will more than double (24%) over the next five years.

**The EU labour market is important for SMEs and the free movement of workers paves the way**

However, workers from other EU states will remain most important for SMEs. The free movement of labour within the European Union is a fundamental acquis of the EU that guarantees equal access to labour markets for all citizens of the Union (see box). In a common economic region such as the EU, this mobility essentially contributes to making labour markets more efficient and helps to correct economic imbalances.<sup>8</sup> After all, 8 million EU citizens are currently enjoying this free movement of labour. In Germany alone, 1.8 million employees from the remaining 27 member states are making a large contribution to value added.

**Figure 3: SMEs' targeted hiring of foreign nationals will intensify up to 2021**

Percentage of SME employers



Source: KfW SME Panel 2016 (additional survey conducted in September 2016).

**Free European labour markets – SMEs are clearly in favour**

Accordingly, SME employers in Germany regard free labour markets as a precious asset, and many of them attach great importance to EU labour mobility specifically. This is particularly true of SMEs that are active abroad, as they likely benefit from the linguistic and market knowledge and networks of foreign workers or even depend on this for their foreign operations. Of the 520,000 SMEs that generate turnover

outside Germany, 43% regard EU labour mobility as very important for their business (Figure 4). The growing importance of foreign skilled workers is also becoming apparent in SMEs' expectations. Already, 59% consider the free movement of workers important with a view to the next five years.

**The key EU right of free movement of workers**

Article 15 of the EU Charter of Fundamental Rights states that “every citizen of the Union has the freedom to seek employment, to work, to exercise the right of establishment and to provide services in any Member State.” The Treaty on the Functioning of the European Union also prohibits any discrimination based on nationality as regards employment, remuneration and other conditions of work and employment.

In the EU enlargements, most member states delayed the granting of equal access to their labour markets for new EU citizens. Germany is one of the countries that kept access to their labour markets restricted for the longest period after the most recent enlargement rounds. Unrestricted free movement of workers has been in effect in Germany for the accession countries of the first EU enlargement of 2004 (including Poland, the Czech Republic, Slovakia and Hungary) since the year 2011. In January 2014, free movement of workers was extended to Bulgaria and Romania (which acceded to the EU in 2007) and in July 2015 to Croatia (which joined in 2013).

**SMEs are concerned about anti-European trends in the UK and Eastern Europe**

As was expected, SMEs that generate foreign turnover in the United Kingdom have made a particularly clear plea for free movement of skilled workers. Sixty per cent of them regard labour mobility as very important and therefore, in the wake of the Brexit decision, are much more sensitised to the

challenges than the broad SME sector.<sup>9</sup> SMEs that do business in Poland, the Czech Republic and Slovakia also emphasise the importance of free movement of workers more than average (46%) because Eurosceptical parties have recently been particularly successful in these countries and in some cases form part of government.

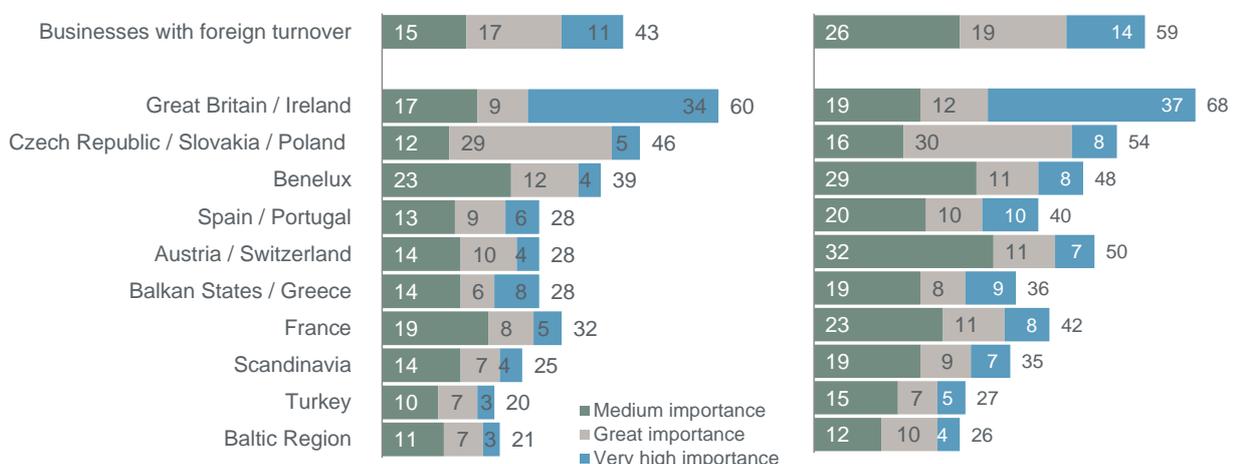
**Integrating refugees holds potential for the future**

German SMEs have a higher than average proportion of foreign nationals and benefit greatly from immigration into the labour market. This openness to – and reliance on – foreign workers raises the question what contribution SMEs can make to the economic integration of the many people who have recently sought refuge in Germany.

Labour and refugee migration are fundamentally distinct. However, many refugees will remain for a long time – and can generally contribute to mitigating imminent labour shortages. Compared with labour migrants, refugees on average bring unfavourable characteristics to the German labour market. A fundamental prerequisite for integration into the labour market is language. Yet around 90% of the refugees have no knowledge of German at all when they arrive and some 30% of them claim to have a good command of English.<sup>10</sup> But problems also exist with their skills. Vocational education and training is less institutionalised in their countries of origin, which explains why only around one fifth of the adult refugees have vocational or academic qualifications. It therefore requires a great effort to determine to what extent their individual capabilities can be put to use on the German labour market. These barriers often mean it can take very long for refugees to find employment. It took around five years for at least half of previous refugee generations to find employment. Convergence with the employment rates of labour migrants (around 75%) takes an estimated 15 to 20 years.<sup>11</sup>

**Figure 4: Importance of EU labour mobility in 2016 and in the next 5 years**

Percentage of SME employers who attach medium to very high importance to the free movement of workers within the EU for their business. Only applies to businesses with foreign turnover in the stated region.



Source: KfW SME Panel 2016 (additional survey conducted in September 2016).

The labour market success of people who have fled to Germany in the past years can only be estimated on the basis of nationality because the official employment statistics do not sufficiently capture their residence status. At the end of June 2016, approx. 430,000 citizens of the main countries of origin of asylum seekers (primarily Syria, Afghanistan, Iraq, the Balkan states) were in employment subject to social security contributions in Germany (Figure 1).<sup>12</sup> They represent 14% of foreign workers and 73% of them work in SMEs, which is above average.

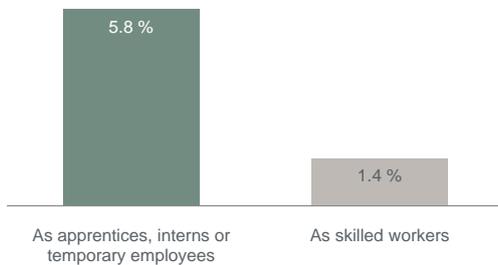
**SMEs employ refugees, but rarely as skilled workers**

The KfW SME Panel allows new employment relationships entered into between SMEs and refugees between 2011 and 2016 to be quantified for the first time (Figure 5). In the past five years, some 144,000 SME employers have hired refugees as skilled workers, apprentices, interns or temporary employees. Around 250,000 persons were hired.<sup>13</sup>

More highly qualified employment is significantly less common among refugees than apprenticeships, internships and temporary jobs – which illustrates their often unfavourable situation. In the past five years, only around one per cent of SME employers have hired refugees as skilled workers (33,000 SMEs). Overall, some 49,000 employment contracts of this type can be assumed to exist.

**Figure 5: Hiring of refugees in SMEs in the past five years**

Percentage of SME employers



Note: Multiple answers were possible.

Source: KfW SME Panel 2016 (additional survey conducted in September 2016).

**200,000 apprenticeship, temporary employment or internship agreements concluded with refugees between 2011 and 2016**

Substantially more SMEs have filled temporary employment positions, apprenticeships and training places with refugees, specifically around 113,000 companies or 6% of SME employers. They amount to a good 200,000 of these more basic employment relationships, which can prove to be a valuable path towards integration. It enables refugees to shake off inertia very quickly, gain a foothold in working life and acquire valuable everyday skills accompanied by language instruction and further vocational training.

Because they have greater scope for allocating labour, larger SMEs were twice as active (12% compared with 5% for smaller SME employers). On average, larger employers entered into 2.1 apprenticeship, temporary employment or

internship agreements over the five-year period while smaller employers naturally concluded slightly fewer, or 1.8 on average. However, the proportions belie the significance of smaller SMEs. It is true that they hire refugees less often, but because of their large numbers this segment accounts for 98% of all apprenticeship and internship agreements.

Furthermore, there are important sectoral differences (table). One in ten SME employers in the construction industry (11%) and in the crafts sector (10%) have hired refugees as apprentices, temporary employees or interns in the past five years. Language barriers appear to play a less significant role in these sectors. One indication of this is that, in particular, segments with more intense customer interaction and extensive communication are less active. Only 3 to 4% of the SME employers in wholesale and retail and in the service sector have hired refugees.

**Table: Refugees as apprentices, temporary employees or interns by segment**

Percentage of SME employers

	Refugees as apprentices or interns
<b>FTE-employment size class</b>	
Smaller SMEs (less than 30 employees)	4.8
Larger SMEs (30 and more employees)	12.2
<b>Sectors</b>	
Manufacturing	7.1
Construction	10.7
Wholesale and retail	3.4
Services	3.8
<b>Region</b>	
Eastern Germany	2.7
Western Germany	6.2
<b>Total SMEs</b>	<b>5.8</b>

Source: KfW SME Panel 2016 (additional survey conducted in September 2016).

**Conclusion: an ageing economy needs foreign labour**

One in ten employees subject to social security contributions in Germany is a foreign national. The continuing trend can be seen in the German population pyramid: the importance of foreign workers will continue to grow because baby boomers are approaching retirement age.

The proportion of employees from other EU states is currently particularly high because the strong German labour market is creating high demand within Europe. For this reason alone there are economic arguments for defending Europe's great achievement of free movement of workers against anti-European, anti-migration sentiment across broad areas in Europe.

The share of EU workers will probably diminish in the long term. First, return migration can be expected when other labour markets in Europe strengthen (again). Second, and this is the main reason: almost all EU states are facing

similar demographic challenges and it will just take a bit longer for the problems they pose to become evident. The labour force potential is shrinking across the EU, making labour migration from third countries to the EU increasingly important in the future.

The data of the KfW SME Panel show that the focus of SMEs is already shifting towards labour migration from third countries. The institutional prerequisites are good as Germany has recently evolved “quietly and surreptitiously” into a modern, liberal immigration country – for example by issuing additional residence permits for qualified non-university graduates and highly skilled jobseekers, and by allowing a broad interpretation of the EU Blue Card. Remaining challenges, however, include reducing the complexity of the existing legal framework and, in particular, framing a clear communication strategy. Growing competition for foreign skilled workers will make “immigration marketing” increasingly important.

The many people who came to seek refuge in Germany in the past years play a special role. They have the potential in principle to contribute to offsetting demographic constraints. The starting position is a difficult one, however. The language barriers and skills gaps are so significant for many of them that it will take many years to integrate them into the labour market. Realistically, therefore, the outlook is a long-term one. This is also illustrated by the moderate number of skilled employment relationships with refugees in the SME sector. The significantly higher number of internships, temporary jobs and apprenticeships shows how labour market integration could work. When conditions are right, vocational training is the ideal solution for young refugees. For others it can make sense to put their vocational abilities to use

through internships and less demanding activities. But accompanying language instruction and target-group specific further training are indispensable. For Germany, and thus also for small and medium-sized enterprises, integrating refugees into the labour and education market will be a major feat of strength in the years ahead. ■

## Database: the KfW SME Panel

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, making it the most important source of data on issues relevant to the SME sector. The main survey of the 14th wave was conducted in the period from 15 February 2016 to 10 June 2016.

The findings presented here are based on a supplementary survey to the KfW SME Panel 2016. This survey was conducted in the period from 13 to 23 September 2016. All enterprises that had already participated in this year's main survey and had provided a valid email address were surveyed. Responses from a total of 2,211 enterprises were evaluated. Owing to their connection to the KfW SME Panel, the special evaluations presented here provide a representative picture as well.

Further information can be obtained at:  
[www.kfw-mittelstandspanel.de](http://www.kfw-mittelstandspanel.de)

<sup>1</sup> Source: Federal Statistical Office, Fachserie 1, Reihe 1.2.: “Bevölkerung und Erwerbstätigkeit – Wanderungen” (*Population and employment – migrations* – our title translation; in German).

<sup>2</sup> Persons with a migrant background are all immigrants who arrived after 1949, all non-German residents born in Germany, and their children.

<sup>3</sup> Cf. Leifels, A. (2015), Recruitment of skilled workers in SMEs: Optimism must not distract from qualification problems, KfW Research, Focus on Economics No. 100, Frankfurt am Main.

<sup>4</sup> There are an additional 655,000 only minimally employed foreigners who represent 12.7 % of all only minimally employed persons in Germany.

<sup>5</sup> The biggest group of foreign workers now includes Poles, Romanians and Croatians. By far the biggest group, however, are Turks, who represent 16.5% of all foreign workers.

<sup>6</sup> For a detailed report on the situation in the German SME sector, see Schwartz, M. (2016): KfW SME Panel 2016 – Businesses are using their financial strength, but not boosting investment, KfW Research, Frankfurt am Main.

<sup>7</sup> Cf. Leifels, A. and J. Zeuner (2015), Refugee immigration calls for investment in housing, schools and minds, KfW Research, Focus on Economics No. 108, Frankfurt am Main, p. 6 (Box 3.)

<sup>8</sup> This is all the more true in a currency union, as imbalances cannot be offset by exchange rates. This macro-economic significance of inner-European labour migration is the subject of another current study by KfW Research: Ehmer, P. (2017), Arbeitsmärkte im Euroraum: Reformerfolge sind gutes Zeichen für Beschäftigung (Labour markets in the euro area: reform successes are good news for employment), KfW Research, Focus on Economics No. 155, Frankfurt am Main.

<sup>9</sup> Cf. Abel-Koch, J., Leifels, A. and M. Schwartz (2016), Germany's SMEs after US election and before Brexit: keep markets open!, KfW Research, Economics in Brief No. 121, Frankfurt am Main.

<sup>10</sup> Cf. Brücker, H. et al. (2016), Flucht, Ankunft in Deutschland und erste Schritte der Integration (*Flight, arrival in Germany and first steps towards integration* – our title translation), DIW Weekly Report No. 46, Deutsches Institut für Wirtschaftsforschung, Berlin (in German).

<sup>11</sup> Cf. Leifels, A. and J. Zeuner (2015), p. 6f.; Brücker, H. et al. (2015): Flüchtlinge und andere Migranten am deutschen Arbeitsmarkt: Der Stand im September 2015 (*Refugees and other migrants on the German labour market: the status in September 2015* – our title translation), Institute for Employment Research, current reports 14/2015 (in German).

<sup>12</sup> Source: Employment statistics of the Federal Employment Office dated 30 June 2016. The countries defined here and in the source as countries of origin of asylum seekers are: Albania, Bosnia and Herzegovina, Macedonia, Kosovo, the Russian Federation, Ukraine, Serbia, Eritrea, Nigeria, Somalia, Afghanistan, Iraq, Iran, Pakistan and Syria. If we include the minimally employed workers from the countries of origin of asylum seekers, the employment rate is a low 34 %. It must be taken into account, however, that the recently arrived refugees do not effectively obtain access to the labour market until their asylum proceedings have been completed. The employment rate here is calculated as a quotient between employees (including minimally employed workers) and the population aged 15 to 64 years; as at 31 December 2015.

<sup>13</sup> Owing to the recent increase in refugee migration, however, the numbers are anything but evenly distributed across the years. Instead, it must be assumed that actual figures exceeded this mean value in later years and remained below it in earlier years. It also has to be kept in mind that individuals may have been hired more than once by the same or a different company.