

## »» M&A deals in the German SME sector – manufacturers are most sought after

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Author: Dr Juliane Gerstenberger, phone +49 69 7431-4420, [juliane.gerstenberger@kfw.de](mailto:juliane.gerstenberger@kfw.de)

Small and medium-sized enterprises (SMEs) in Germany are sought-after targets of mergers and acquisitions (M&As), according to an analysis conducted by KfW Research on the basis of the Zephyr database. On average from 2005 to 2017, slightly more than 1,100 M&As targeting a German SME were conducted each year. Most of them involved the full takeover of the business (53%). Only 17 and 13% of M&A deals, respectively, were minority or majority investments. Mergers were even less common (6%).

Investors were particularly interested in manufacturing SMEs (34%) and information and communication technology enterprises (19%). In around 60% of all M&A deals, the acquirer and the target firm came from the same business sector. The share of manufacturing among the acquirers was therefore on a similar level as well (29%). Enterprises from the finance and insurance sector were the second largest group (21%). Here, financial investors, such as portfolio and investment companies, played a major role.

German SMEs are sought-after targets for M&A, both domestically and abroad. So far, domestic acquirers have dominated (average share in 2005–2017: 58%). Since 2013, however, activities of foreign investors have picked up noticeably. Their share in all M&A transactions in the SME sector rose to 49% in 2017. Contributors were also Chinese firms, which appear increasingly on the acquirer side. Manufacturing SMEs are particularly popular among non-German investors, taking a share of 43% (German investors 29%).

The coming generational change in the leadership of many German SMEs in the years ahead (some 500,000 enterprises by 2022) could again lend impetus to the M&A market in the SME sector.

### **M&A deals: SMEs are also sought after**

It is not just business start-ups and insolvencies that are constantly altering the picture of the corporate sector. Mergers and acquisitions (M&A) are also an expression of a dynamic corporate landscape. From the desire to implement a growth or internationalisation strategy to developing new expertise or financial motives – businesses have a wide range of reasons for merging, acquiring or investing equity in another company.

M&A deals continue to attract media attention in Germany as well, particularly in the segment of large enterprises. Not only are they associated with very high transaction volumes, they can also have far-reaching consequences for employees, suppliers and partner businesses. What is often overlooked here is that small and medium-sized enterprises (SMEs) – which make up the vast majority of around 99% of Germany's businesses – are also often involved in mergers and acquisitions. Their high competitiveness and innovative force makes them a popular target for M&As – both at home and abroad.

KfW Research has analysed the development and structural composition of M&A transactions in the German SME sector for the first time on the basis of the Zephyr M&A database.<sup>1</sup> The analysis covered full and partial acquisitions and mergers targeting German businesses with an annual turnover of up to EUR 500 million during the period from 2005 to 2017 (see box).<sup>2</sup> Acquirers and merger partners (hereinafter referred to simply as acquirers or investors) were domestic and foreign enterprises irrespective of size class.

### **M&A market largely follows cyclical trend**

First, the development of M&A activities in the German SME sector since 2005 displays a pattern that largely follows the business cycle (Figure 1). During the economic upswing between 2005 and 2007, the number of mergers and acquisitions targeting a German SME grew significantly (+30%). Some 1,300 M&A deals were recorded in the year 2007. But with the outbreak of the economic and financial crisis in 2009, the M&A market collapsed in Germany, too. The number of transactions in the SME sector dropped by around one fifth.

Despite the economic recovery, this decline continued until 2011 and the situation did not ease until the year 2012. The number of M&A transactions grew again significantly to more than 1,200 by 2015. Recently, however, the M&A market in the German SME sector has cooled down again. This contrasts with global M&A activities. Owing to the favourable borrowing environment and the economic recovery taking place in many countries, the number of deals and their volumes worldwide have continued to grow significantly in the past two years.<sup>3</sup> On the basis of the data at our disposal, however, such a pronounced M&A boom cannot be observed anymore for German SMEs.

**Figure 1: No recent growth in M&A deals in the German SME sector**



Source: Zephyr, own calculations

**Manufacturing is particularly popular**

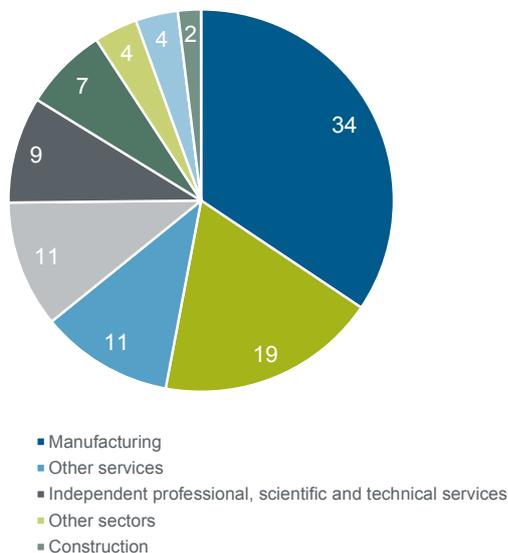
M&A deals in the German SME sector cover the entire range of sectors (Figure 2a). Particularly sought-after, however, are manufacturing SMEs. More than one third of all M&A deals during the period 2005–2017 targeted a business from this sector. That puts the M&A share of this sector significantly higher than its share in the whole population of SMEs (7%). Among other things, this circumstance reflects the high competitiveness and attractiveness of these enterprises.

Businesses in the field of information and communication technology (ICT) have been sought-after targets of mergers and acquisitions not just since the growth of digitalisation. Between 2005 and 2017, an average one in five targeted SMEs operated in this area. That is significantly more than the share of ICT businesses in the total SME population (5.6%).

**Figure 2: Manufacturing predominates in acquirers and target businesses**

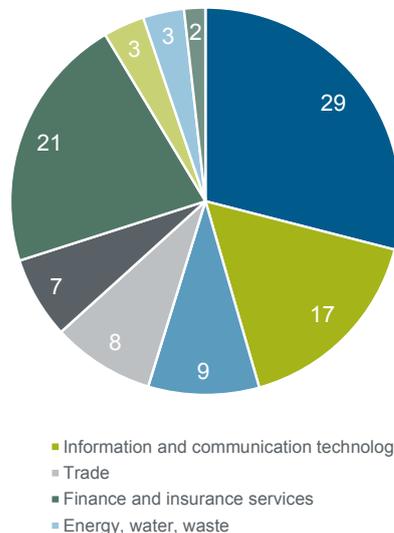
**a) Sectoral distribution of target enterprises**

Percentage of target enterprises (mean value 2005–2017)



**b) Sectoral distribution of acquirers**

Percentage of acquirers (mean value 2005–2017)



Source: Zephyr, own calculations

Even if the relative share of ICT in all M&A transactions in the SME sector has remained relatively constant since 2005, there have been structural shifts within this sector nonetheless (Figure 3). Companies in the ICT subareas ‘provision of information technology services’ (such as software firms) and ‘information services’ (e.g. web portals and hosting providers) are today much more sought-after than in the mid-2000s. The shares of M&A transactions in the subareas ‘telecommunications’, ‘radio broadcasters’ and ‘film and music’, on the other hand, have fallen.

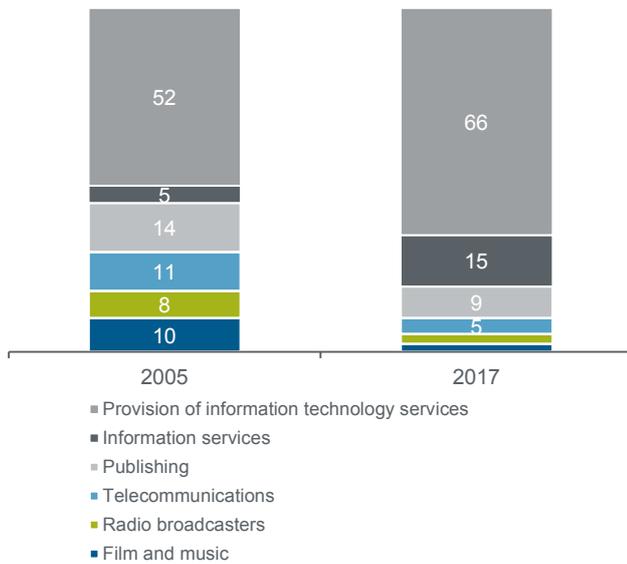
With shares of around 10% each, SMEs in the retail and services sector (self-employed professionals as well as providers of scientific and technical services and other service providers) are less common targets of mergers or acquisitions. Compared with the high share of these economic sectors in the total population of SMEs (75% overall), this is surprisingly little. The M&A share of small and medium-sized financial and insurance service providers is a modest 7% – although the number of mergers and acquisitions in the banking sector has increased in the past years. SMEs in the construction, energy, water and other sectors are relatively seldom acquisition targets of M&A transactions.

**Manufacturing also predominates on the acquirer side**

Manufacturing clearly dominates on the acquirer side as well (Figure 2b). Around 29% of acquirers came from this economic sector. Enterprises from the finance and insurance sector were the second largest group. They are on the acquirer side in round one in five M&A deals in the German SME sector. This relatively high share is due to the high activity of portfolio and investment companies in the M&A market. The share of acquirers in the ICT sector is also a relatively high 17%.

**Figure 3: Shifts in the ICT sector**

Percentage of M&A deals in the ICT sector



Source: Zephyr, own calculations

With shares of less than 10%, retailers (8%), independent professional, scientific and technical services (7%) and other services (9%) appear relatively less frequently as acquirers or merger partners of SMEs in Germany. Enterprises in the construction, energy, water and other sectors are also rarely active in the M&A market.

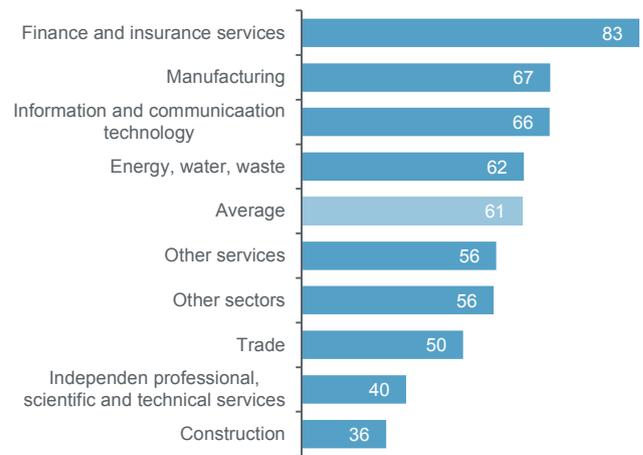
**Acquirers are often from the same sector as their targets**

On average, acquirers and targets are from the same economic sector in around six out of 10 M&A deals.<sup>4</sup> But there are clear differences between sectors (Figure 4). Financial and insurance service providers above all tend to stick with their own kind in M&A deals. On average between 2005 and 2017, 83% of acquirers of financial or insurance service providers also came from this sector. This is also an expression of the growing consolidation process in the banking sector. High pressure from low interest rates, stricter regulation and competition has fuelled the trend to more mergers among finance institutions in particular. The proportion of mergers in all M&A deals is therefore high in this sector as well (23 vs. 6% for all sectors). In M&A transactions that targeted manufacturing and ICT SMEs as well, 67 and 66%, respectively, of acquirers were from the same economic sector.

Construction SMEs, on the other hand, are more likely to be an M&A target of acquirers unrelated to their sector. These are lateral transactions. On average, only 36% of acquirers were also from the construction sector. Around 16% were manufacturers and 15% finance institutions. SMEs providing independent, scientific and technical services were also targeted by an acquirer from the same sector in only 40% of cases. Lateral M&A transactions are often driven by the acquirer’s goal of diversifying their own product portfolio and spreading their risk. Where financial investors act as

**Figure 4: Acquirers and targets are often from the same sector**

Percentage share of all M&A deals (mean value 2005–2017)



Source: Zephyr, own calculations

acquirers, expected returns can also play a key role.

**Most acquirers are from Germany**

The majority of M&A deals in the German SME sector had a domestic acquirer (58% on average over the years 2005–2017).<sup>5</sup> Foreign acquirers were involved in only around four out of ten deals (Figure 5a). These cross-border transactions are often associated with greater challenges for the acquisition target than domestic transactions. Cultural barriers, legal differences and language barriers can make such M&A deals very complex and hamper the integration of the target enterprise. This is compounded by the – often unfounded – fears that the foreign investor is merely interested in the target enterprise’s expertise or technology and not in preserving jobs. At the same time, cross-border transactions can also provide clear advantages for the target SMEs, such as access to the acquirer’s domestic market.

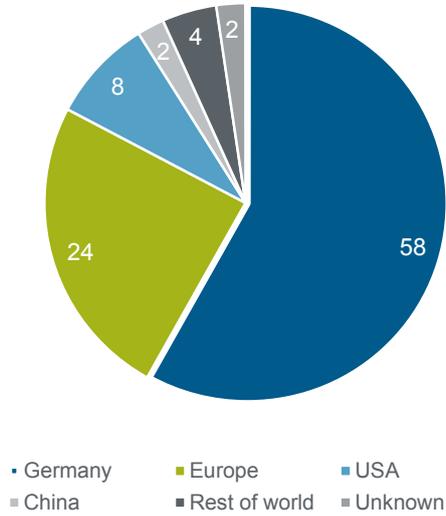
With respect to the share of domestic and foreign acquirers, two anomalies were notable (Figure 5b): First, during the crisis year 2009 the share of German acquirers was 72%, significantly above the average for the years 2005–2017. This was the result of the noticeable restraint of foreign investors. In that year, the number of M&A deals with foreign acquirers dropped by 40%, whereas the number of M&A deals with German acquirers fell by only 7%.

Second, at the current margin the share of German acquirers is at the lowest it has been in the past 13 years (51%). This trend is also an expression of the investment restraint of German enterprises that has prevailed in the past years. The activities of foreign investors have grown at the same time. The number of M&A deals with an acquirer from outside Germany increased by 19% from 2013 to 2017.

**Figure 5: German acquirers are still slightly more common but foreign investors are growing in number**

**a) Origin of acquirer**

Percentage share of all M&A deals (mean value 2005–2017)



**b) Variation in the share of domestic acquirers**

Number and share in M&A deals



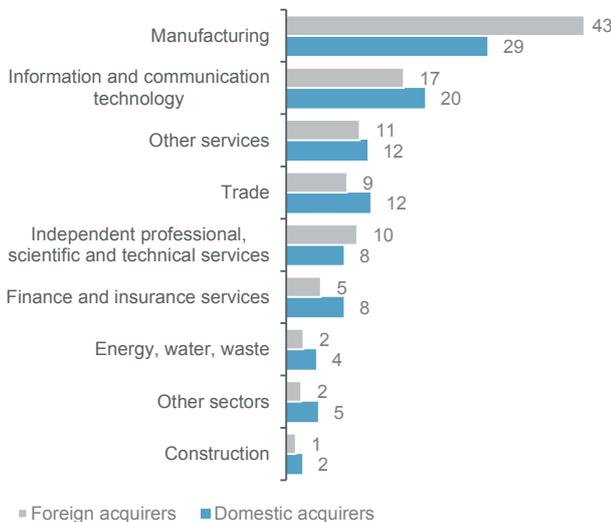
Source: Zephyr, own calculations

**Foreign acquirers are particularly interested in manufacturers**

An analysis by economic sector also illustrates that domestic and foreign acquirers generally have similar sector preferences. The only exception is that a significantly higher number of foreign investors are interested in manufacturers than their German counterparts. The difference between 2005 and 2017 was around 14 percentage points on average (Figure 6).

**Figure 6: Foreign acquirers are more interested in manufacturers**

Percentage share of all M&A deals in each acquirer group (mean value 2005–2017)



Source: Zephyr, own calculations

Foreign investors have a particular penchant for what are referred to as ‘hidden champions’ in manufacturing – enterprises that are European or world market leaders in a niche segment.

**European countries are the most active acquirer group**

Europe dominates the group of foreign acquirers. Around one quarter of all M&A deals in the German SME sector has an acquirer from a European country (Figure 5a). Companies from the United Kingdom are particularly active, accounting for an average of around 5% of all M&A deals. This is due to the relatively high activity of British financial and insurance service providers – led by portfolio and investment companies. Enterprises from Germany’s neighbouring countries Switzerland (3.9%), the Netherlands (3.0%), France (2.7%) and Austria (2.3%) were also involved in many M&A deals in the SME sector. The number one country of origin, however, is the United States. Acquirers from the US accounted for around 8.3% of M&A deals between 2005 and 2017. Here, financial investors also play a large role.

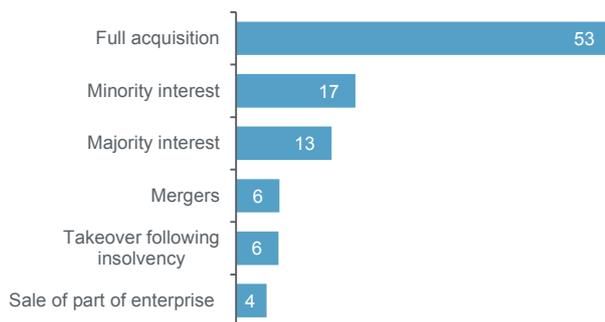
The share of Chinese acquirers was a negligible 2.2% over the period under review. The trend, however, has been rising since 2010. The share of Chinese acquirers peaked at 5.9% in 2016, its highest level yet, but in the following year it dropped again to around 4.2%.<sup>6</sup> And current figures suggest that Chinese investors appear to be showing restraint again in 2018. The causes for this include increased political resistance to M&A deals with Chinese participation but also problems in the Chinese domestic market.<sup>7</sup>

### Full acquisition is most common

One important characteristic in the classification of M&A transactions is the level of participation in the acquisition target. An acquirer may take over a target enterprise in full or only shares of its equity. The more equity an acquirer purchases, the more influence it can usually exert over the acquisition target. In the database analysed by KfW Research, full acquisition of the target clearly predominated. Around one in two M&A deals consisted of a 100% acquisition of the SME.

### Figure 7: Full acquisition is most common

Percentage share of all M&A deals (mean value 2005–2017)



Source: Zephyr, own calculations

In the period analysed, acquirers purchased less than 50% of the capital of the acquisition target (minority interest) in 17% of M&A deals. This limits their possibilities to exert an influence on the business activities of the target enterprise. This contrasts with a majority interest in which the acquirer takes ownership of more than 50% of the capital. It gives the investor controlling influence over the target enterprise. This was the case in 13% of the M&A deals in the German SME sector.

Mergers of businesses were much less common (6%). More than one quarter of them took place in the financial sector. Takeovers following insolvency were equally uncommon. In around 4% of the M&A deals analysed by KfW Research, only part of the enterprise (for example a business unit) was sold.

### Conclusions and outlook

M&A activities in the German SME sector remain very lively despite moderate declines in the past years. Foreign investors, in particular, appear to be showing renewed interest in small and medium-sized enterprises in Germany. This is also a reflection of Germany's attractiveness as an industrial location and the stable economic situation it has recently enjoyed. Nevertheless, it is difficult to predict how M&A deals in the SME sector will develop in the future. The incipient monetary policy normalisation which will be accompanied by rising interest rates has the potential to make financing conditions more difficult for acquisitions.

At the same time, however, the generational change in the leadership of many SMEs that is coming in the next years may provide renewed impetus to the M&A market in the SME sector. More than half a million owner-managers of small and medium-sized enterprises are planning to transfer ownership and control of their business by 2022.<sup>8</sup> If they fail to find a suitable or willing successor within the family or the company, selling to another business may be an option. How many SMEs currently preparing their succession will ultimately be sold to a domestic or foreign company, however, cannot be predicted with accuracy. At the moment, at least, 42% of SMEs can imagine selling to an external party – including to another business. ■

#### Box: Database

The analysis was based on the Zephyr database of Bureau van Dijk. Zephyr supplies up-to-date detailed information on M&A, IPO and private equity transactions around the world. Our research covered only M&A transactions with target enterprises in Germany that generate an annual turnover of not more than EUR 500 million. The analysis did not include start-ups or the sale of specific assets (restaurants, factories, branches, etc.). It covered around 13,700 M&A deals concluded between 2005 and 2017. The figures used here refer to transactions completed during the period under review.

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<sup>1</sup> The transaction database used is subject to subsequent amendments and supplements. The database analysed by KfW Research therefore does not claim to be exhaustive.

<sup>2</sup> This paper does not address German SMEs' international M&A activities.

<sup>3</sup> Data from the Institute for Mergers, Acquisitions and Alliances.

<sup>4</sup> The analysis was performed at the level of the 21 sections (divisions) according to NACE Rev.2.

<sup>5</sup> The acquirer's nationality is based on the registered office of the parent company.

<sup>6</sup> Gerstenberger, J. (2018), M&A China, Focus on Economics, forthcoming, KfW Research.

<sup>7</sup> Ernst and Young (2018), Chinesische Unternehmenskäufe in Europa - Eine Analyse von M&A-Deals 2006–2018 (*Chinese acquisitions in Europe - an analysis of M&A deals 2006–2018* – our title translation, in German only), Düsseldorf.

<sup>8</sup> Schwartz, M. (2018), **Wave of successions in German SMEs: 240,000 successors wanted by 2019**, Focus on Economics No. 197, KfW Research