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SMEs are firmly in the grip of the coronavirus crisis but (still) holding on strong

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The coronavirus crisis currently has a firm grip on Germany's SMEs. Losses in turnover, decreasing liquidity buffers and uncertain prospects about how the pandemic will progress and how long the containment measures will remain in effect have caused the previously positive sentiment to wane and are threatening the survival of many small and medium-sized enterprises (SMEs).

A current special survey by KfW Research on the specific consequences shows that more than 2.2 million SMEs suffered turnover losses in March as a result of the coronavirus crisis. Companies lost an average of 53% of their normally anticipated March turnover. That is roughly EUR 39,000 per enterprise. SMEs lost around EUR 75 billion or 2% of their annual turnover in March.

If the turnover losses remain on a similar level, half of SMEs will run out of liquidity reserves by the end of May. After that, they may have to shut down.

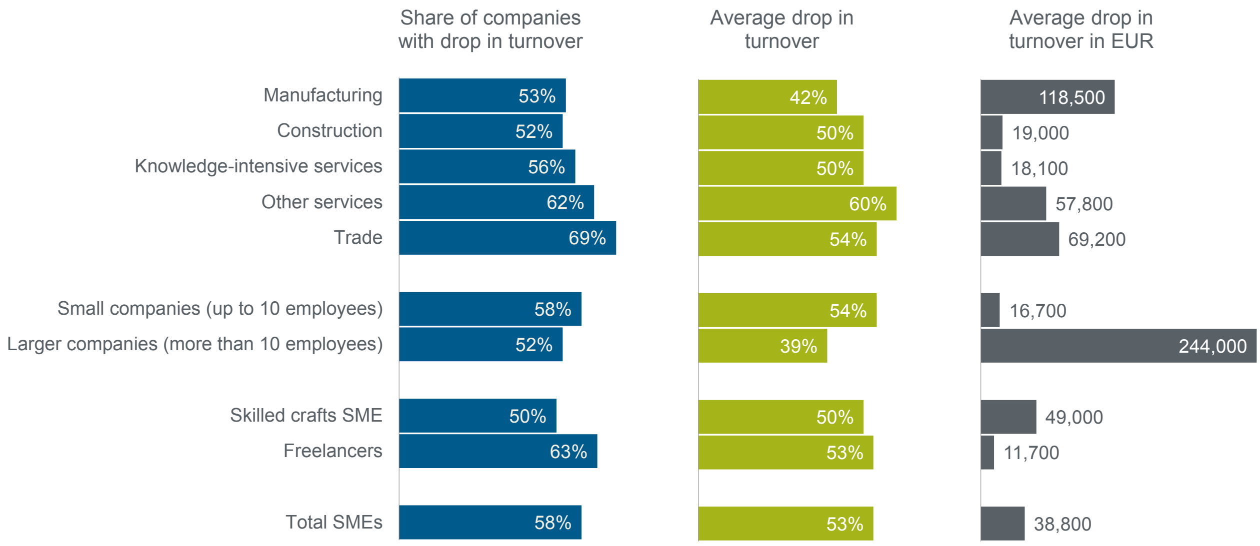
Despite all the tough coronavirus restrictions, the SME sector's resilience to unexpected developments has improved greatly in the past decade. In particular, the efforts many SMEs have made to improve their equity base are now bearing fruit. The financial buffers they built up in the recent past are helping them to temporarily absorb losses in the current crisis and reduce pressure on liquidity. SMEs have done their homework.

Nonetheless, it is foreseeable that a number of companies are at risk of falling into the red for all of the year 2020 as a result of the coronavirus crisis.

Restrictions have already been relaxed and further steps have been announced. This gives hope that the situation in the SME sector will ease. However, if the lockdown were to continue until the end of May, or if relaxations were to be rolled back, companies' turnovers would drop again.

As anticipated, the coronavirus crisis hit the SME sector with force. Business closures, distancing rules and travel restrictions are having the expected effects. According to the KfW-ifo SME Barometer, SME business confidence saw a plunge that was seldom so predictable, as well as unprecedented.[1]

Figure 1: The impact of the coronavirus crisis on SMEs' March turnovers by segment



Note: The chart shows the drop in turnover in March 2020 compared with the respective companies' average monthly turnover / normally anticipated March turnover. The absolute decline in turnover in euros is based on 2018 turnover figures.

Sources: KfW SME Panel 2019 in combination with the special coronavirus survey of the KfW SME Panel 2020 (6–14 April 2020).

In order to quantify the true extent of the impact of the coronavirus crisis on small and medium-sized enterprises, KfW Research conducted a special survey as part of the KfW SME Panel in early April 2020. It found that 80% of SMEs were affected by the coronavirus crisis at the beginning of April.

Turnovers are falling sharply

Of all the possible effects of the coronavirus crisis, decreases in demand are the main problem for enterprises. In March, more than half of all enterprises (2.2 million SMEs, or 58%) suffered declines in turnover as a consequence of the crisis. As expected, retailers and wholesalers were most affected. Small businesses were slightly more affected by decreases in turnover in March (58%) than larger SMEs.

Measured by actual turnover loss incurred (middle chart in Figure 1), other services topped the list with an average drop of 60%. Multiple overlaps with the retail sector exist in this segment. Moreover, it includes businesses that operate e.g. in the care industry, training, the arts and sport.[2]

Overall, manufacturing SMEs[3] and larger SMEs were more successful than others at managing the consequences of the coronavirus crisis in March, even though turnover losses also affected more than half of enterprises in these segments and were still a significant 42 and 39% on average.

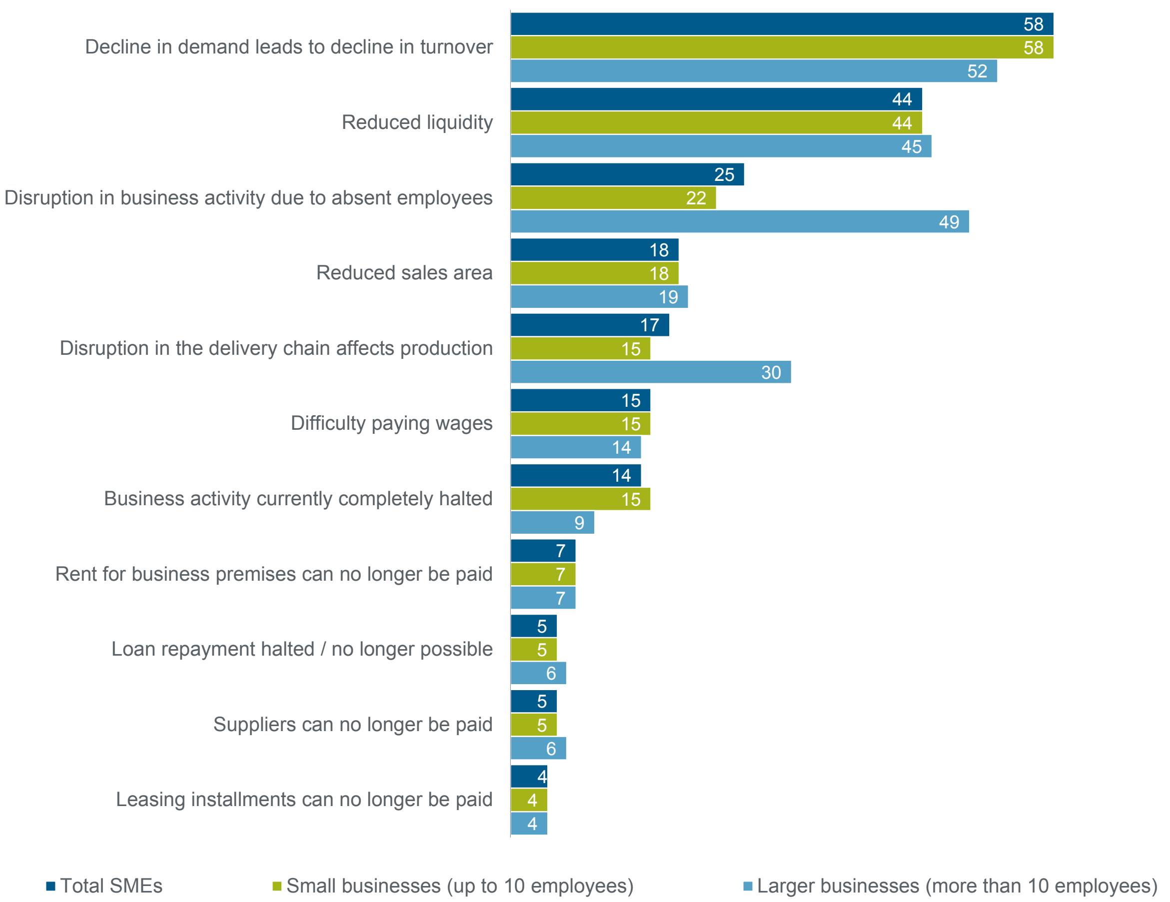
Turnover was down EUR 39,000 on average in March but half of SMEs only lost up to EUR 8,000

A look at the aggregate values in the SME sector shows that the affected enterprises lost an average of 53% of their normally anticipated March turnover.[4] That was an arithmetic mean of around EUR 39,000. This covers a broad spectrum, given the characteristics of the segments. Freelancers experienced the lowest average turnover decrease of EUR 11,700. By contrast, the March turnover of larger SMEs dropped by an average of EUR 244,000.

However, the median drop in turnover was much lower. Losses did not exceed EUR 8,000 in half the enterprises that suffered crisis-induced losses in turnover. This moderate drop is due to the fact that the overwhelming majority of SMEs is very small. For example, the median number of full-time equivalent employees[5] of SMEs in Germany is 2. Because they are so numerous, micro and small businesses play a crucial role in defining the aggregate values across the overall SME sector. This also means that segments with significantly higher losses in turnover, such as manufacturing and large enterprises, hardly make a difference in the aggregate analysis.

Figure 2: Current impact of the coronavirus crisis on SMEs (as at 14 April 2020)

Percentage of enterprises



Source: Special coronavirus survey of the KfW SME Panel 2020 (6–14 April 2020).

Special coronavirus survey in the KfW SME Panel

The current analysis is based on a special survey performed as part of the KfW SME Panel. The Financial Services Division of GfK SE conducted a representative online survey of small and medium-sized enterprises on the current impacts of the coronavirus crisis on behalf of KfW Group between 6 and 14 April 2020.

All enterprises that had already participated in an earlier wave of the KfW SME Panel and had provided a valid email address were surveyed. Responses from a total of 3,400 enterprises were evaluated (response rate approximately 50%). As the supplementary survey was linked to the main dataset of the KfW SME Panel, its results provide a **representative picture of the current coronavirus impact**.

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

Further information can be obtained **here**.

In March, SMEs lost 2% of their annual turnover, volume dropped by EUR 75 to 85 billion

Moreover, using data obtained from the special coronavirus survey, SMEs' total turnover losses in March are estimated at EUR 75 to 85 billion. Measured by the SME sector's aggregate annual turnover of around EUR 4,700 billion, this amounts to a loss of nearly 2% of that total in March.

Service segments alone account for 78% of this sum – roughly reflecting their overall weight in the SME sector (76% of all SMEs operate in service industries) – with other services clearly taking the largest share (60%). A comparison across business size classes shows that the volume is roughly equal between small SMEs with up to ten employees and larger SMEs.

Not all enterprises suffered turnover losses in March, with turnover remaining roughly unchanged for 40% of businesses. These are mainly SMEs in the skilled trades and crafts sector, larger SMEs and construction businesses. Some SMEs even achieved higher turnover in March but their share is a modest 2% (with an average turnover increase of 19%). Higher turnovers were more typically achieved by larger SMEs (5%), R&D-intensive manufacturers (7%) and SME retailers (8%).

These developments need to be seen in the context that containment measures were already being taken in mid-March (closures of catering and hospitality operations, bricks-and-mortar retail shops and many personal service businesses), and were not the same in all federal states. Nationwide physical distancing requirements were not imposed until 22 March. The decreases in turnover identified here were therefore not incurred in all of the month of March but specifically during the period in which the restrictions were in effect.

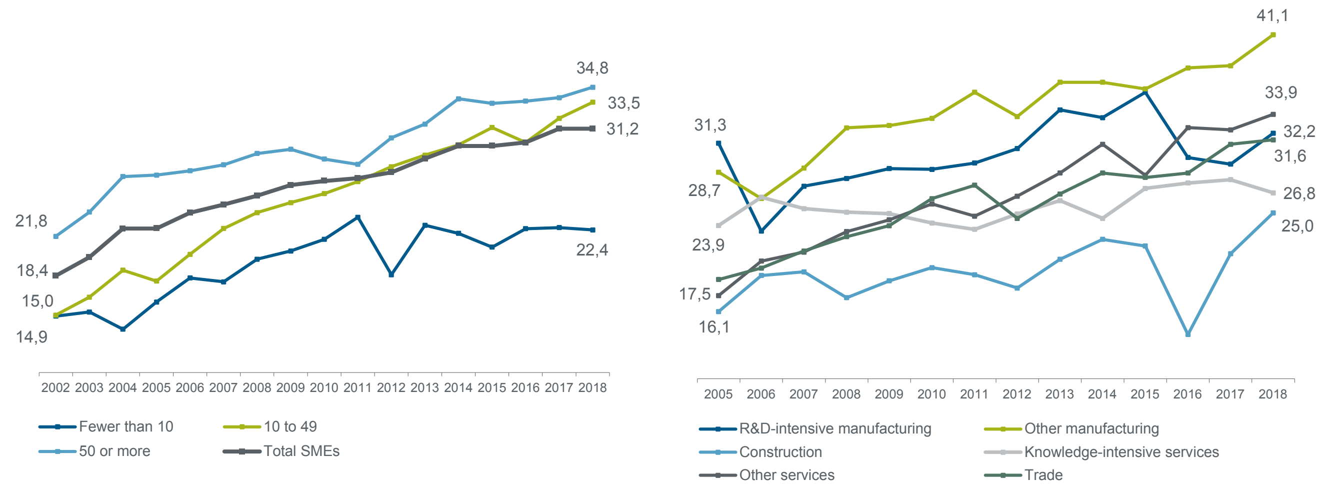
Thanks to their equity buffers, SMEs were very resilient before the coronavirus crisis

The losses in turnover outlined above may cause a good number of SMEs to post negative returns – meaning losses – for the year as a whole. These would reduce their equity capital. In order to mitigate such losses at least temporarily, a strong equity base is essential.

A look at the equity buffer of Germany's small and medium-sized enterprises shows that their resilience against unexpected events has grown strongly in the past – and the coronavirus crisis is one such event.[6] In particular, considerations on improving their credit rating, guarding their independence, maintaining their flexibility and a desire for greater resilience

Figure 3: Equity ratios in the SME sector

Size class by number of full-time equivalent employees; figures in per cent



Source: KfW SME Panel 2003–2019.

in times of crisis have recently led to a steady increase in SMEs' equity ratios.[7]

Around the turn of the millennium, the equity ratio[8] was still at around 18%. Since then, massive improvements have been achieved across the SME sector (Figure 3). On average, it increased by 13 percentage points between 2002 and 2018. SMEs achieved this increase primarily through the retention of earnings. But the subdued investment activity of the past years has also contributed to increasing equity ratios. Currently, that is prior to the coronavirus crisis, the equity ratio was on a very high average level of 31.2%. In addition, only 8% of SMEs have a negative equity ratio.[9]

Overall, most SMEs thus have a comfortable financial buffer. During the current crisis the high level of equity should help enterprises to carry losses over an extended period of time. Inversely, their lower debt levels preserve their liquidity by reducing the additional pressure of repayments of interest and principal.

However, high equity ratios and the resulting improved credit rating could also help SMEs access debt capital more easily in the current situation, for example in order to bridge any liquidity bottlenecks. As many SMEs had moderate debt levels at the beginning of the crisis (average debt ratio 68.8%), the risk that increased borrowing may push a large portion of them into excessive debt also remains manageable for now.

Half of SMEs will run out of liquidity reserves by the end of May

Besides decreases in turnover, a large number of SMEs deplore decreasing liquidity in particular, with 44% reporting a drop in liquidity reserves as a result of the coronavirus crisis (Figure 1).

Liquidity comprises monetary funds such as cash, bank deposits and cheques, which serve primarily to make payments in day-to-day business operation. Turnover losses mean many SMEs no longer have the capacity to adequately replenish liquidity reserves so that they are surviving on cash alone. The longer the lockdown remains in place, the more urgent this problem will become. Enterprises can run into payment difficulties when they no longer have sufficient liquidity to meet ongoing obligations. This can also affect businesses with a strong equity base.

Data from the Deutsche Bundesbank on liquidity in the business sector[10] indicate that SMEs (divergently defined here as enterprises with turnover of less than EUR 50 million) increased their liquidity buffers in the past years – from 7.1% of their balance-sheet total in 1997 to 11.5% in 2017. Other analyses show that enterprises with such buffers would theoretically be capable of covering expenditures such as employee payments, costs of materials and interest for at least one month. Smaller businesses generally have higher liquidity buffers (Table).

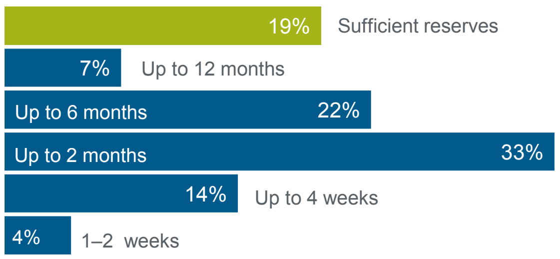
Table: Liquidity by turnover size class

Turnover size	Liquid funds / monthly turnover	Liquid funds / monthly expenditure
<EUR 2 million	142%	153%
2 to less than 10	108%	114%
10 to less than 50	88%	92%
>50 EUR million	48%	49%

Source: Deutsche Bundesbank.

These figures are also consistent with the results of our special coronavirus survey. The analysis revealed for all SME size classes and sectors that, as from 1 April 2020, around half of all enterprises will run out of liquidity in two months if the current situation continues with no improvement (Figure 4). That would mean a period up to the end of May. After that, they may have to suspend trading or close down permanently. Four per cent have enough cash for only 1–2 weeks, while 14% can hold out for up to one month. A prolonged lockdown could threaten these enterprises' survival. The liquidity reserves of 33% of all SMEs are sufficient to hold out for up to two months.

Figure 4: Liquidity reserves from April 2020



The question asked in the survey was: Assuming the current situation continues with no improvement: Starting from 1 April 2020, how long will your liquidity last (before you have to suspend or close down your business operations)?

Source: Special coronavirus survey of the KfW SME Panel 2020 (6–14 April 2020).

A surprisingly high proportion of 19% of all SMEs responded with generally having sufficient liquidity reserves. This is likely because the SME sector is characterised by a large number of micro-businesses and solo entrepreneurs. Many of them do not have to pay office rent, employee salaries or leasing instalments for machines. In other words, many are able to cover the cost of staying in business even when they lose turnover. Another 22% of enterprises have at least enough liquidity for up to six months and a further 7% have liquidity reserves for up to a year before facing the prospect of having to stop trading.

These figures do not take into account the gradual rollback of coronavirus restrictions announced by the federal and state governments on 15 April. This could mean that businesses were still expecting the lockdown to remain in place for longer when the special survey was conducted.

Lockdown until the end of May: SMEs would suffer higher turnover losses

As was done for March, SMEs' turnover losses can be estimated for the months of April and May as well (Figure 4). Accordingly, half of them would experience decreases in turnover in these two months because of the coronavirus crisis.

However, in comparison with March, it now becomes apparent that much fewer small businesses are now affected (-8 percentage points to 49%) while larger SMEs are slightly more affected (+2 percentage points to 54%). The number of businesses generally affected by turnover losses thus decreases slightly.

But the affected enterprises are missing out on slightly more turnover than in March, losing an average of 55% of turnover normally expected in April/May (+2 percentage points on March). This mainly affects larger SMEs, SME retailers and other service providers, where coronavirus-induced turnover losses are higher on a percentage basis.

A cross the overall two-month period, the arithmetic mean of absolute turnover losses in the SME sector thus amounts to approx. EUR 115,000. On a monthly basis, that amount is significantly higher than in March, as is the median value. For half the enterprises that suffered decreases in turnover because of the coronavirus crisis, the losses for April/May do not exceed EUR 20,000 (i.e. EUR 10,000 per month compared with EUR 8,000 for the month of March).

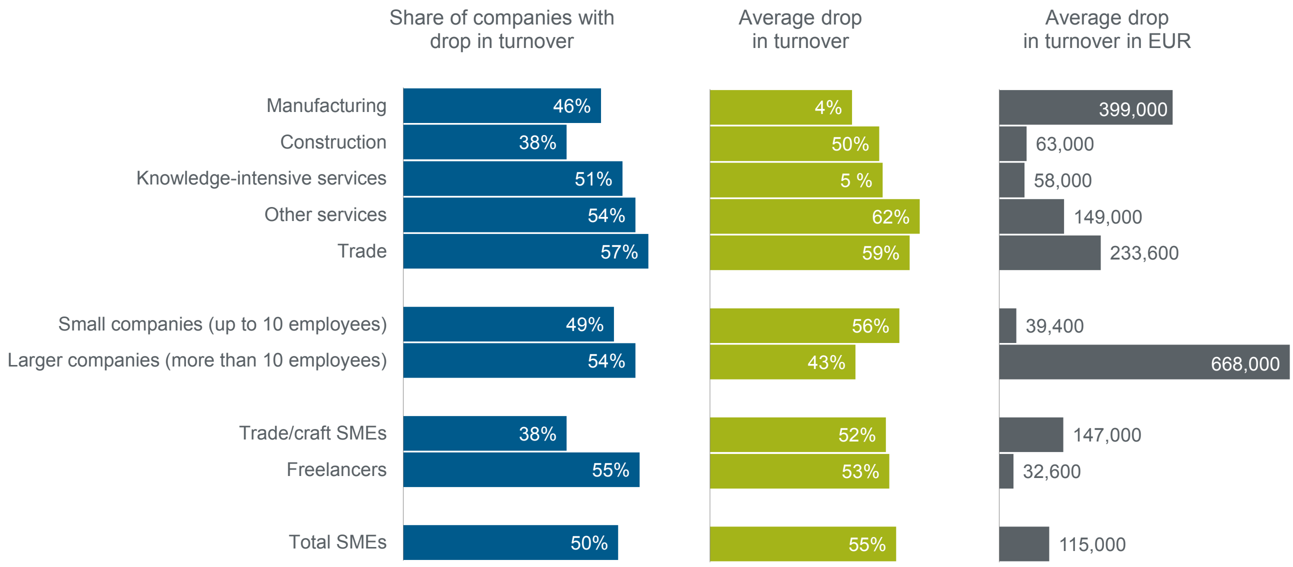
For the months of April/May, estimates can be made in the same way as for March on the basis of the special coronavirus survey. Thus, assuming SMEs were under lockdown for these two months, their total turnover losses amount to a combined EUR 185 to 205 billion. That would represent around 4% of aggregate annual SME turnover.

Without taking into account the relaxation of measures already announced and partly implemented, cumulative losses for the months of March up to the end of May would stand at EUR 260 to 290 billion, or 6% of all SMEs' turnover in a calendar year.

Consequences for profitability are to be expected

This relatively low volume may mean a sigh of relief. But it must be taken into account that the profit margin – the ratio of profit to turnover – was only 7.4% in the SME sector in 2018 (more recent data is not available).[11] The profit margin is lower, especially in segments that are more severely affected by coronavirus-induced turnover losses (Figure 6). Larger SMEs, in particular, have been struggling with low profit margins for a long time. Profit margins of SMEs with 50 or more employees have not improved for the fourth consecutive year. This is the enterprise size class with the lowest profitability growth since 2005. Their profitability has shown an almost continuous sideways movement since 2012.

Figure 5: Impact of the coronavirus crisis on SMEs' April and May turnovers by segment

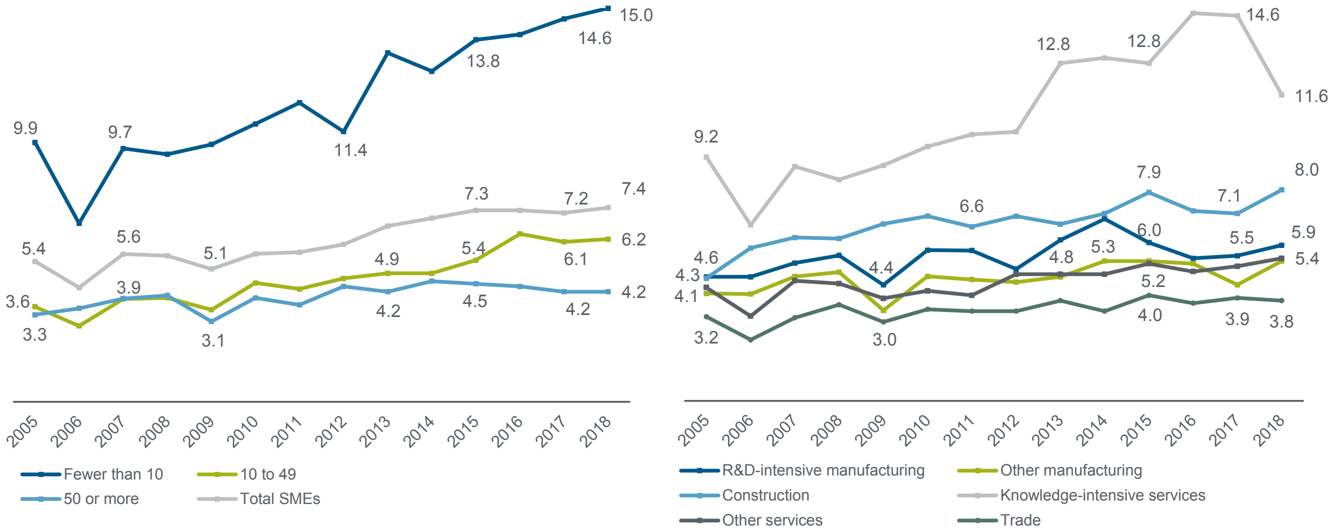


Note: The chart shows the drop in turnover in April and May 2020 compared with the respective companies' average monthly or normally anticipated turnover in these two months. The absolute decline in turnover in euros is based on 2018 turnover figures.

Sources: KfW SME Panel 2019 in combination with the special coronavirus survey of the KfW SME Panel 2020 (6–14 April 2020).

Figure 6: SME profit margins by size class (left) and industry (right)

Size class by number of full-time equivalent employees, figures in per cent



Source: KfW SME Panel 2006–2019.

Under the assumption that all enterprises are equally affected by a 6% decrease in turnover in 2020, it becomes clear that a number of enterprises are at risk of slipping into the red (negative profit margin) for the year as a whole. The share of SMEs with a negative profit margin last stood at a very low 9%. The key profit margin indicators can thus be expected to fall in the medium term.

[1] Scheuermeyer, P. (2020), **KfW-ifo SME Barometer: March 2020, SME business confidence collapses under the strain of the coronavirus crisis**, KfW Research. The KfW-ifo SME Barometer indicator family is based on a scale-of-enterprise evaluation of the ifo economic surveys which are used to calculate, among other things, the well-known ifo Business Climate Index. Each month about 9,500 enterprises from trade and industry, construction, wholesale, retail and services (without the banking and insurance sectors or the state) are polled on their business situation, among them some 8,000 SMEs. In deviation from the definition used in the KfW SME Panel, enterprises are generally classified here as small to medium-sized if they employ no more than 500 workers and generate annual turnover not exceeding EUR 50 million.

[2] The second largest segment of services – knowledge-intensive services – comprises other service industries with an above-average share of graduates in the overall workforce and services with a strong technology focus. These include, for example, architecture and engineering firms, law firms, tax and management consultancies, data processing and telecommunication services. The definition is based on what is known as the NIW/ISI list of research-intensive industries and services, which in turn follows the Federal Statistical Office's 'Classification of Economic Activities (WZ 2008)'.

[3] Here, manufacturing comprises R&D-intensive manufacturing and other manufacturing enterprises. Research- and development-intensive (R&D intensive) manufacturing is defined as those manufacturing sub-sectors whose average research and development intensity (R&D intensity: ratio of R&D expenses to turnover) is higher than 3.5%. The definition is based on what is known as the NIW/ISI list of research-intensive industries and services, which follows the Federal Statistical Office's 'Classification of Economic Activities (WZ 2008)'. Engineering, medical technology, instrumentation and control technology, vehicles, pharmaceuticals and office equipment are of particular quantitative importance.

[4] A further recent but not representative study on European SMEs arrived at similar values for German businesses. In that study, around 30% of SMEs across the EU reported a turnover loss of at least 80% as a result of the coronavirus crisis. Based on the special survey of the KfW SME Panel, the corresponding value is 25%. Moreover, the decreases in turnover of 50% for German SMEs reported in that study are comparable to the value presented here (53%). For details see: **https://smeunited.eu/admin/storage/smeunited/200417-covid19-impact1.pdf**

[5] In contrast with workforce participation, full-time-equivalents (FTEs) show actual demand for labour. FTE employees are calculated from the number of full-time employees (including business owners) plus the number of part-time employees multiplied by the factor 0.5. Apprentices are not included.

[6] Projektgruppe Gemeinschaftsdiagnose (2020), Gemeinschaftsdiagnose #1-2020: Wirtschaft unter Schock – Finanzpolitik hält dagegen (*Economy under shock – fiscal policy to the rescue –* our title translation, in German only).

[7] Gerstenberger, J. (2018), **Hohe Eigenkapitalquoten im Mittelstand: KMU schätzen ihre Unabhängigkeit** (*High equity ratios: SMEs value their independence* – in German only), Focus on Economics No. 206, KfW Research.

[8] The equity ratio is defined as the quotient of equity and balance sheet total. The figure shows the mean values of the equity ratio weighted against the balance sheet total. The calculations apply only to enterprises required to draw up balance sheets.

[9] For more details on the development and current state of equity ratios in the SME sector see Schwartz, M. (2019), **KfW SME Panel 2019: After a record year, dark clouds are gathering – businesses between all-time highs and recession fears**, KfW Research, Frankfurt am Main.

[10] Deutsche Bundesbank 2019: Verhältniszahlen aus Jahresabschlüssen deutscher Unternehmen von 2016 bis 2017 – Vorläufige Angaben (*Ratios of annual accounts of German companies from 2016 to 2017 – preliminary figures* – our title translation, in German)

[11] Profit margin is defined as the ratio of pre-tax profit to turnover. The figure shows the mean values of profit margin weighted against turnover.