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What are the hallmarks of consistently successful businesses?

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KfW Research has been working with small and medium-sized enterprises in the KfW SME Panel for more than ten years. The companies have changed during this period. Today it is clear that the successful, fast-growing enterprises of the last ten years distinguish themselves from their less successful counterparts in a number of measurable traits.

Fast-growing SMEs employ university graduates more often, cooperate with other enterprises and research facilities more frequently and have more foreign operations. They pursue a strategy of differentiation more often in which they, above all, rely on innovations. In order to realise their expansion plans, fast-growing enterprises also invest more often and with higher amounts than other SMEs.

Moderately growing and stagnating companies, in turn, compete mainly on price.

What are the hallmarks of long-term success in business? What factors contribute to sustainable business growth? The responses to these questions were obtained from more than 520 SMEs that participated in the KfW SME Panel without interruption from 2005 to 2014 (Box).

From 2005 to 2014, these enterprises increased their turnover by an average of 2.5% per annum (in nominal terms). Of course, not all companies grew at the same rate. The majority grew between 1 and 5% (Figure 1).¹ One quarter of them achieved turnover increases averaging 6% or higher. In contrast, around one third of the enterprises failed to grow or even had to accept a decline in turnover during the ten-year period. The enter-

prises were divided into four groups for the survey.

The group of 'fast-growing enterprises' grew by an average 8.9% p.a. during the survey period (Table 1). By comparison, average nominal GDP growth during this time was 2.7% p.a. and average inflation 1.6% p.a. Over the ten-year period, the fast-growing enterprises thus increased their turnover nearly 2.4-fold. At the same time, they created an average of 25.4 new jobs (measured in full-time equivalents).

For comparison:

- The 'moderately growing enterprises' increased their turnover by a nominal 3.8% p.a. and created on average 12.2 new jobs (measured in full-time equivalents).
- The turnover growth of the 'stagnating enterprises' was 1.0% p.a. The number

of jobs in these enterprises dropped by an average 2.7.

- The 'shrinking enterprises' lost an average 3.8% p.a. of their turnover and 6.7 jobs.

Fast-growing SMEs exist in all economic sectors (Figure 2). However, they are more numerous in the manufacturing sector than in other sectors, at 33% (other manufacturing) and 11% (R&D-intensive manufacturing)². In the construction sector, fast-growing enterprises are far less common.

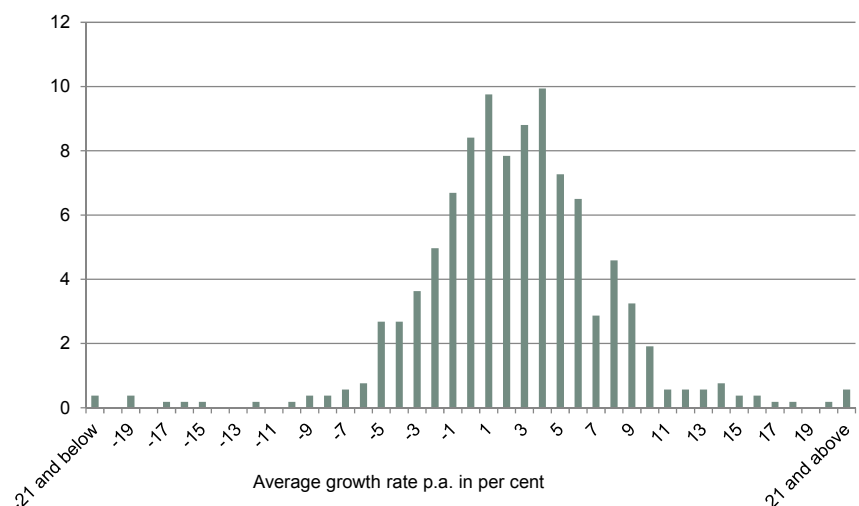
Factors that determine business growth

A uniform theoretical approach to explain the growth of enterprises does not yet exist. Various common hypotheses must, therefore, be explored and examined for their relevance. Generally, long-term business growth is the reflection of a successful business strategy aimed at gaining competitive advantages over existing and potential competitors. A particular aspect discussed here is the resources an enterprise has at its disposal.

Human capital as a success factor

Employees, or human capital, are among

Figure 1: Distribution of average annual turnover growth from 2005 to 2014
(in per cent)



Source: KfW SME Panel. own calculations

Table 1: Classification of businesses by long-term growth

	Average turnover growth 2005–2014 in per cent p.a.	
	Arithmetic mean	Median:
Fast-growing enterprises	8.9	7.7
Moderately growing enterprises	3.8	3.8
Stagnating enterprises	1.0	1.0
Shrinking enterprises	-3.8	-2.6
All enterprises	2.5	2.5

Source: KfW SME Panel, own calculations

an enterprise’s most important resources and regarded as a key success factor for obtaining competitive advantages.³ In addition, particularly in SMEs, the entrepreneurs themselves play the lead role in all business processes and decisions.⁴ That is why their qualifications should also be crucial to business success, particularly in the SME sector.

University graduates more often employed in fast-growing companies

Already at the beginning of the survey period, 76 % of the fast-growing enterprises were employing university graduates (Figure 3). Thus, the proportion of enterprises employing university graduates was 19 percentage points higher in fast-growing than in shrinking enterprises. That proportion drops continuously from the fastest-growing to the shrinking enterprises.

At 62 %, the proportion of fast-growing SMEs managed by university graduates is around 25 % higher. Unlike the employees, however, with regard to the entrepreneur’s formal qualifications there is no clear trend between the moderately growing, the stagnating and the shrinking companies.

Alliances and networks ...

Cooperative alliances and networks offer the possibility of drawing on external expertise and linking it with own skills. This allows a company to save resources, reduce risks to their success and realise potential synergies.⁵ These considerations suggest that enterprises which maintain cooperative alliances operate more successfully.

Alliances with research facilities in particular (e.g. universities and research in-

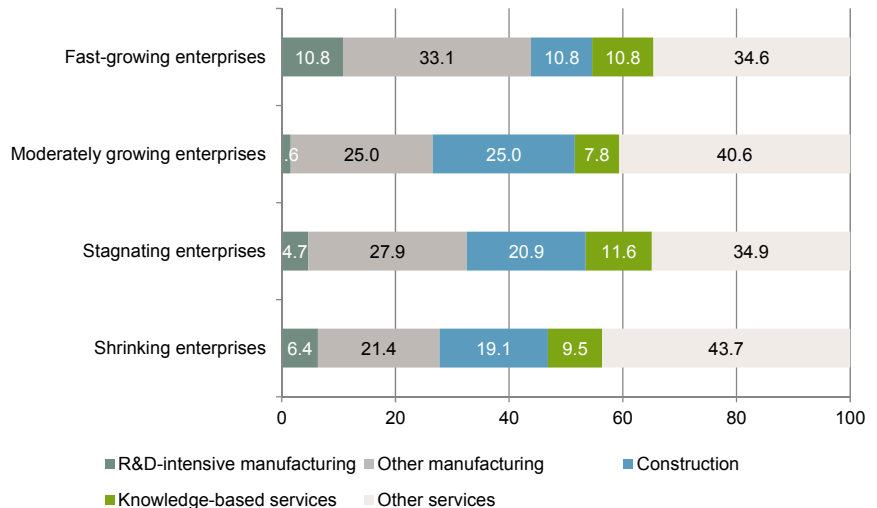
stitutes) help to transfer research findings to the enterprise. That requires an ability to absorb relevant external knowledge and process it internally to the benefit of the company.⁶ Whether an enterprise possesses such absorptive capacity depends crucially on its employees’ human capital.

... are drivers of growth

The proportion of SMEs cooperating (with other enterprises or research facili-

Figure 2: Sectoral distribution

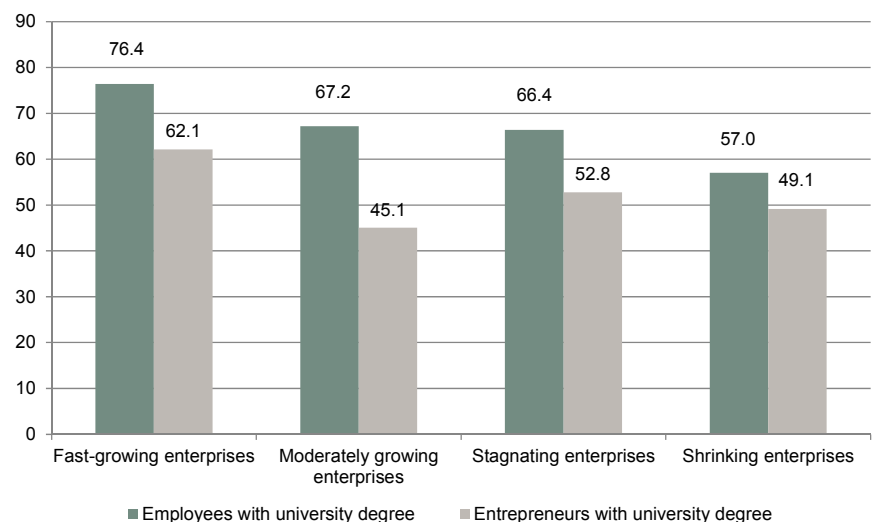
(Shares in per cent)



Source: KfW SME Panel, own calculations

Figure 3: Human capital – enterprises with employees and entrepreneurs with a university degree in 2005

(Shares in per cent)



Source: KfW SME Panel, own calculations

Box: Database for the survey

The database used for the survey consisted of those enterprises that had participated in the ten previous survey waves of the KfW SME Panel. The parameter for measuring business success was the relative nominal turnover growth achieved in the period between 2005 and 2014. It is not possible to make a distinction between organic and external growth (e.g. mergers and acquisitions). Given that small enterprises in particular, because of their low starting level, often achieve high relative growth rates, enterprises with fewer than five employees (measured as full-time equivalents) were excluded from the survey. Of the 794 enterprises that had participated in the panel without interruption during the ten-year period, 523 enterprises were available for the analysis after discounting the small enterprises (-144) and companies with missing turnover data for the years 2005 and 2014 (-127). The companies analysed were divided into four groups of equal size based on their turnover growth. The threshold values for average annual growth rates were -0.34, 2.46 and 5.36 %. The following key descriptive statistics were obtained for the four enterprise groups:

	Turnover in EUR thousands in 2005		Employees in full-time equivalents in 2005		Age of company in 2005	
	Arithmetic mean	Median:	Arithmetic mean	Median:	Arithmetic mean	Median:
Fast-growing enterprises	12,962.6	2,500.0	56.1	21	27.2	15
Moderately growing enterprises	10,350.7	3,800.0	55.8	30.8	46.9	28
Stagnating enterprises	8,732.6	2,086.0	54.9	19	38.8	22
Shrinking enterprises	6,349.5	1,930.0	39.2	19	33.9	23

ties) actually rises with the average turnover growth of the group of enterprises examined here. Among the fast-growing enterprises, the share of SMEs with cooperative alliances is 37 %, which is 15 percentage points higher than among the shrinking businesses (Figure 4).

Moreover, both fast and moderately growing enterprises cooperate more frequently with research facilities, in proportions of close to 8 % each, than the stagnating and shrinking companies (3 and 2 % respectively).

Internationalisation brings advantages

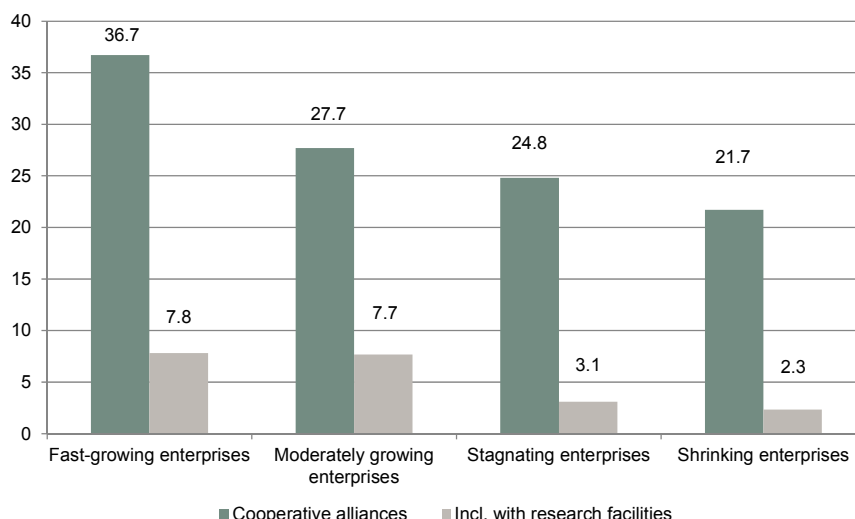
Through foreign operations, businesses can harness growth opportunities in different ways.⁷ For example, by tapping into foreign markets they increase demand for their products and services. They can also source from other countries production factors such as labour and capital, as well as raw materials and advance deliveries that are scarce or comparatively expensive on the domestic market. Not least, foreign activities facilitate the integration of knowledge and new technologies created abroad into their own businesses (spillovers).⁸ That leads to productivity increases, for example.

Fast-growing enterprises in particular are active abroad, with 53 % generating foreign turnover already at the start of the survey period. At the same time, these enterprises' sales area is less often confined exclusively to their home region than for the more slowly growing enterprises (Figure 5).

Another characteristic of the fast-growing enterprises is that almost 90 % of them succeeded in maintaining their initial foreign engagement consistently over the survey period, despite the economic and financial crisis. Only two thirds of the shrinking enterprises achieved this.

Figure 4: Cooperative alliances with enterprises and research facilities in 2006

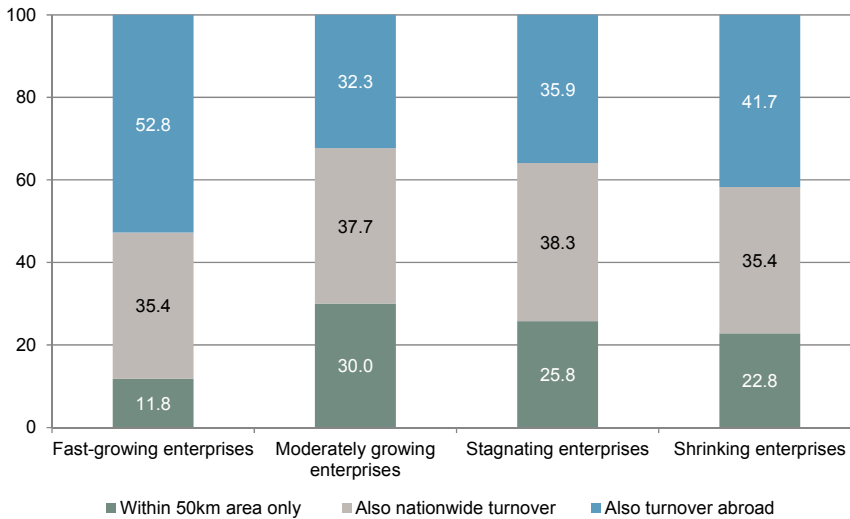
(Shares in per cent)



Source: KfW SME Panel, various years

Figure 5: Sales region in 2005

(Shares in per cent)



Source: KfW SME Panel, own calculations

Success strategies

Employing university graduates, networking with businesses and research facilities and internationalisation can be regarded as elements of a comprehensive business strategy aimed at achieving specific competitive advantages and directing demand to the own enterprise. What competitive advantages do the strategies of the particularly successful businesses aim for?

Specialisation in high-quality products or ...

Already at the start of the survey period, fast-growing enterprises see their strengths in a number of factors. More often than other enterprises they pursue a strategy of differentiation, that is, they aim to distinguish themselves from their competitors through the uniqueness of their products and services. In this strategy they focus primarily on innovative products and services and – with some exceptions – high quality consciousness, thus creating unique selling points compared with the more slowly growing enterprises (Figure 6).

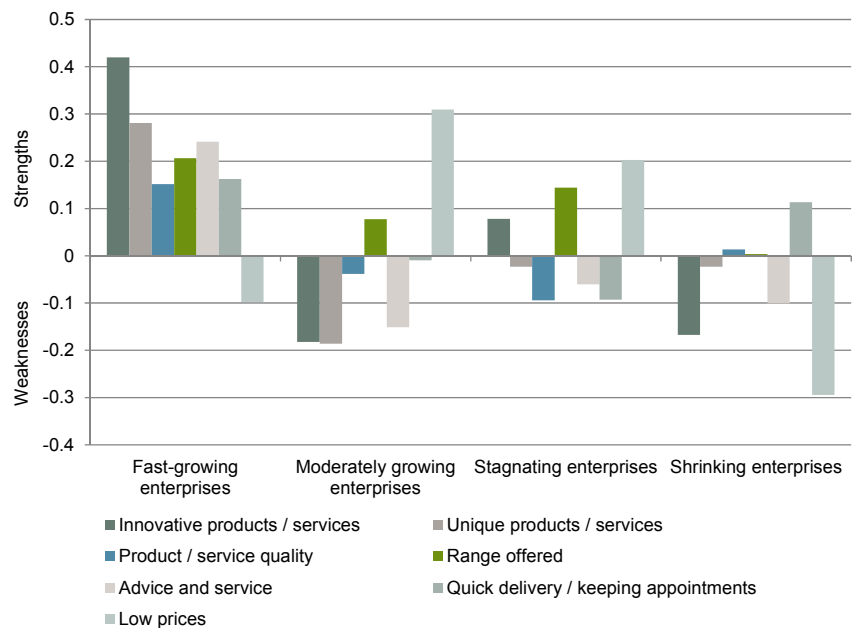
This strategy is supported by a broad range of products, advice and services around the products, as well as short delivery periods and punctuality. Enterprises thus positioned are particularly successful in the long term – in spite of disadvantages in price. This confirms that

the providers of high-quality products and services often succeed in evading pure price competition and pushing through a product price markup on the market.

... price strategy?

The moderately growing and stagnating enterprises in turn rely mainly on a price strategy in combination with a broad

Figure 6: Competitive advantages in 2006



Note: The competitive advantages were surveyed on a five-point scale where 1 = 'Does not apply at all' and 5 = 'Definitely applies'. The evaluation shows the averages across the enterprises' responses in their respective group. In order to clarify the strengths and weaknesses, the results in the individual groups were adjusted for the mean value in the overall sample.

Source: KfW SME Panel, own calculations

product range. Evidently, the moderately growing enterprises in particular succeed in compensating their lack of innovative strength and unique selling points with particularly low prices.

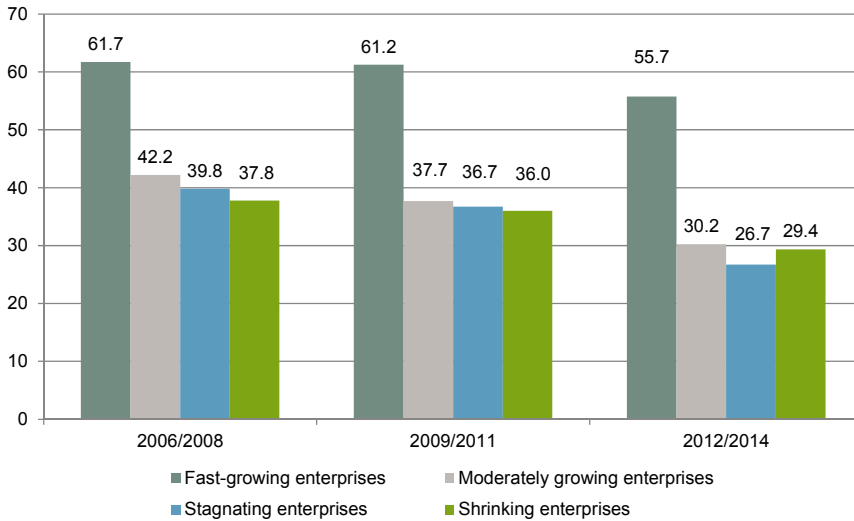
Shrinking enterprises, on the other hand, showed hardly any relative strengths already at the start of the survey period. They rated their prices and novel character of their products, in particular, more negatively than the other SMEs. Apparently, even across the surveyed ten-year period, these enterprises did not succeed in turning their business around and implementing a more dynamic business strategy.

Innovations lead to business success

The fact that precisely the group of fast-growing enterprises brings forth innovations particularly often underscores the high importance of innovative products and services for business success.⁹ The proportion of enterprises that introduced new or improved products (including services) or processes ranges from 56 to 62 % among the fast-growing SMEs, which is 20 to 29 percentage points higher than for the other enterprises across the entire survey period (Fig-

Figure 7: Enterprises with new or improved products or processes

(Shares in per cent)



Source: KfW SME Panel, own calculations

enterprises achieved this in seven of the nine years. In more than seven periods, or even across the entire period, none of the fast-growing SMEs made it into the group of enterprises with the strongest growth.

Growth requires investments

Hardly surprisingly, the fast-growing enterprises invest more often and higher amounts than other enterprises. Forty-five per cent of the fast-growing enterprises invested every year (Figure 10). Only around 11% of them invested merely three times or less frequently.

In contrast, around one third of the shrinking enterprises invested in only three years or even less frequently. In this group the proportion of enterprises investing each year was only 26 %.

At EUR 5.6 million, the average cumulative investment volume was more than twice as high in the fast-growing enterprises than in the stagnating enterprises. Compared with the shrinking enterprises, the fast-growing enterprises on average invested even seven times as much (Figure 11).

Conclusion

Even if business success definitely cannot be planned ahead and depends to a large extent on external factors, a number of features set SMEs that grow fast

ure 7).¹⁰

Over a long-term interval, the fast-growing enterprises also generate innovations more continuously than other enterprises, with 44 % having introduced innovations in all three observed periods. That is more than twice as many as for the shrinking enterprises (21 %).

Business growth is not steady over time

All four groups of enterprises grew at an unsteady pace. A pronounced slump in growth occurred during the economic and financial crisis of 2009 which hit the fast-growing enterprises hardest (Figure 8).

Despite the high volatility of growth rates among the fast-growing enterprises, a clear stratification between the groups is visible across the entire survey period. With one exceptional year, the fast-growing enterprises increased their turnover more strongly every year than the moderately growing enterprises. These, in turn, increased theirs more strongly than the stagnating SMEs etc.

The fast and moderately growing enterprises had clearly positive turnover growth every year except in the year of the economic and financial crisis. In contrast, the shrinking enterprises only achieved the zero line in times of comparatively good economic development.

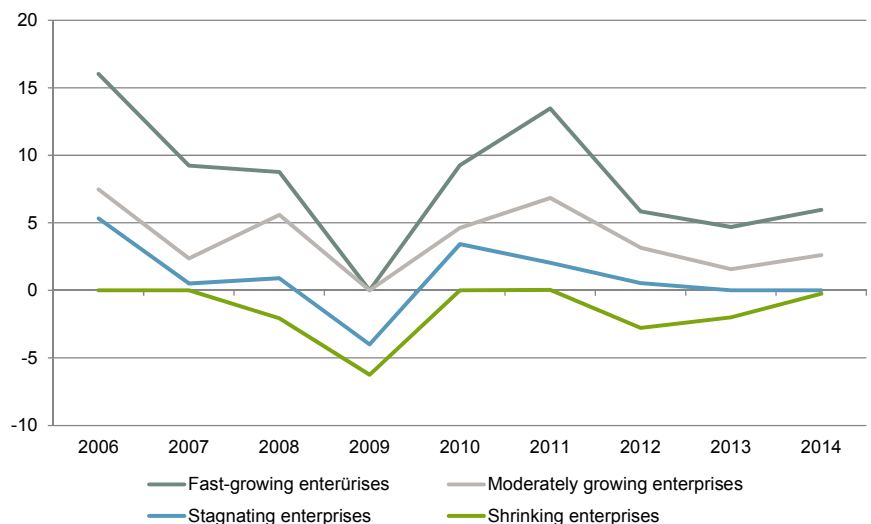
Fast-growing enterprises: one-hit wonders?

A look at the growth rates of the individual enterprises also reveals discontinuous growth. Figure 9 indicates how often a fast-growing enterprise was among the 25% enterprises with the highest turnover growth rates of a year during the survey period.

Twenty-nine percent of the fast-growing enterprises were among the enterprises with the highest growth rates for only four years. Only 3% of the fast-growing

Figure 8: Development of turnover growth 2006–2014

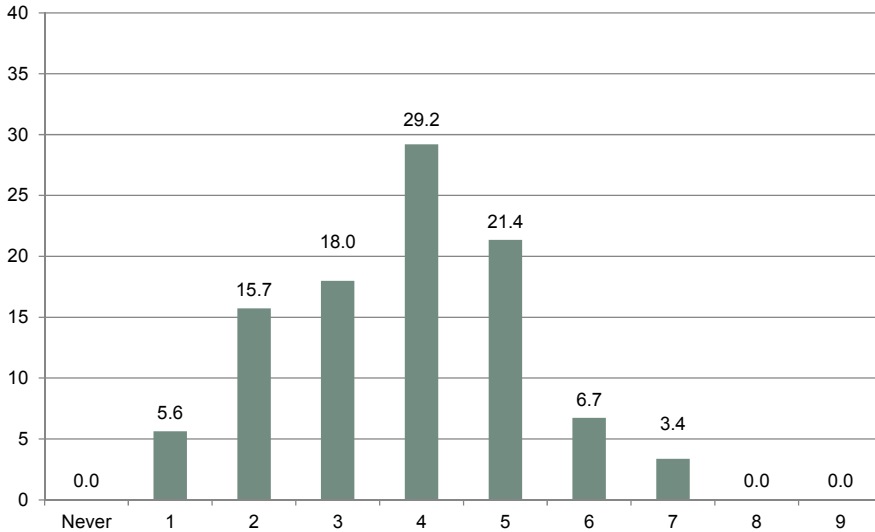
(Growth rates in per cent, median)



Source: KfW SME Panel, own calculations

Figure 9: Frequency of high turnover growth in fast-growing enterprises

Percentage of enterprises belonging x times to the 25% enterprises growing fastest in a year during the survey period



Guide: 29.2% of the SMEs growing fastest over the entire period were among the 25% enterprises growing fastest in the relevant year over four years.

Source: KfW SME Panel, own calculations

in the long term apart from their slower growing counterparts. Many different interdependencies exist between these features and business growth so that the correlations presented here cannot be interpreted as causal in every case.

Enterprises that grow fast in the long term are able to draw more often on the knowledge of university graduates, either as employees or as proprietors active in managing the business, more often incorporate the expertise of cooperation

partners from the business and the research sector and are more often internationally positioned.

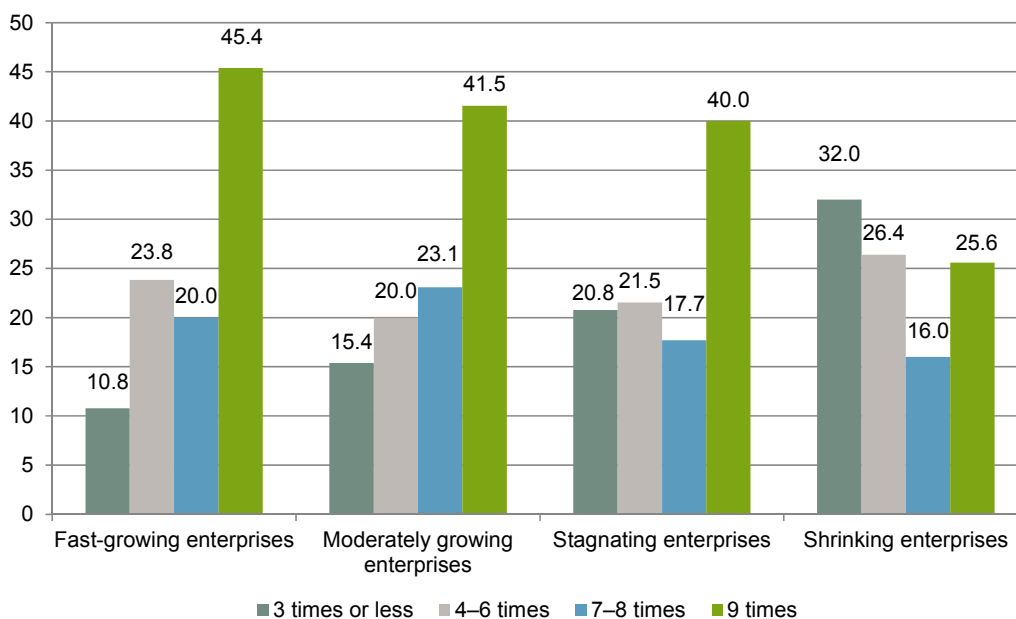
They pursue a strategy of differentiation more often, in which they rely on innovations above all. Fast-growing enterprises therefore generate innovations more frequently than other SMEs. In contrast, enterprises that see their competitive advantages mainly in their price are primarily among the groups of moderately growing and stagnating enterprises. In this context it must be taken into account that not all market segments offer the same possibilities for a differentiation strategy. Price competition and cost efficiency are the only way for many enterprises to set themselves apart from their competitors.

Expanding enterprises usually do not grow steadily but in waves. In order to realise high growth, fast-growing enterprises invest more frequently and with higher amounts than other enterprises.

Differentiation strategies that are grounded in the employees' and proprietor's expertise and focus on generating innovations thus prove to be especially

Figure 10: Frequency of investments 2006–2014

(Shares in per cent)

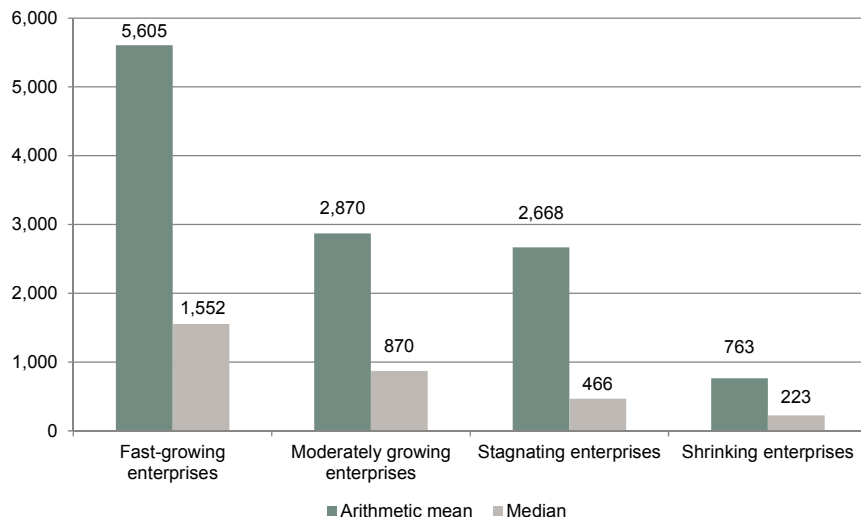


Note: The investment frequency shows in how many years an enterprise has made investments during the period from 2006 to 2014.

Source: KfW SME Panel, own calculations

Figure 11: Cumulative investment volume 2006–2014

(EUR in thousand)



Source: KfW SME Panel, own calculations

successful in the long term.

Existing hurdles must be removed so that as many enterprises as possible are

able to implement corresponding strategies and tap into growth potential. These include possible bottlenecks in the avail-

ability of qualified professionals. Close to three fifths of those SMEs that are hiring skilled workers currently anticipate recruitment problems.¹¹ From the middle of the coming decade the retirement of baby boomers in particular is likely to leave an enormous gap in the labour force potential.

The implementation of innovation activities is also hampered by a number of obstacles. They range from financing difficulties through bureaucratic hurdles to, again, a shortage of skilled workers.¹² Making optimal use of the existing skilled labour potential through mobilisation and qualification and removing specific obstacles to innovation are key tasks of economic policy. ■

¹ For the classification into groups the average annual growth rates were rounded to integers.

² R&D-intensive manufacturing includes, for example, engineering or the production of office and data processing equipment. Knowledge-based sectors in the services industry include IT and information providers, architecture firms, consulting engineers, law firms, tax accountants and management consultants.

³ Cf. Barney, J. (1991): Firm Resources and Sustained Competitive Advantage. *Journal of Management* 17/1: 99–120.

⁴ Cf. Burton, D. M. (2001): The company they keep: Founders' models for organizing new firms, in: Schoonhoven, C. B. and E. Romanelli (Hrsg.), *The Entrepreneurship Dynamic: Origins of Entrepreneurship and the Evolution of Industries*, S. 13–39. Stanford, CA, Stanford University Press.

⁵ Cf. in more detail Zimmermann, V. (2003): Kooperationen bei Innovationsvorhaben kleiner und mittlerer Unternehmen: Einbindung externen Wissens und Verteilung von Risiken und finanziellen Lasten, in: Fitzenberger, B.; Smolny, W. and P. Winker (publisher.): *Herausforderungen an den Wirtschaftsstandort Deutschland (in German)*, p. 109–122, Nomos, Baden-Baden.

⁶ Cf. Cohen W. and D. A. Levinthal (1989): Innovation and Learning: The two sides of R&D. *Economic Journal* 99: 569–596.

⁷ Of the above internationalisation aspects, the KfW SME Panel regularly surveys only foreign turnover.

⁸ Cf. Brutscher, P.; Schwartz, M. and M. Tchouvakhina (2013): Learning to succeed: how SMEs benefit from the international exchange of ideas. *KfW Research. Focus on Economics* No. 20, 2 May 2013

⁹ Cf. Zimmermann, V (2015): *KfW SME Innovation Report 2014. Standstill in Europe is slowing down innovation. KfW Special Publication*, or Zimmermann, V (2013): Innovation und Beschäftigung. Die Beschäftigungswirkung verschiedener Arten von Innovationen in expandierenden und schrumpfenden mittelständischen Unternehmen, *Journal of Business Economics, ZfB-Special Issue 4/2013 (in German)*: p. 131–149.

¹⁰ The KfW SME Panel captures the proportions of innovators for a three-year period using the method commonly applied across Europe.

¹¹ Cf. Leifels, A. (2015), Recruitment of skilled workers in SMEs: Optimism must not distract from qualification problems, *KfW Research, Focus on Economics* No. 100, 27 July 2015.

¹² Cf. Zimmermann, V. (2012): Barriers to innovation in SMEs, *KfW Research. Focus on Economics* No. 6, September 2012.