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SME borrowing: large loans in high demand

Author: Dr Michael Schwartz, phone +49 (0) 69 7431-8695, research@kfw.de

Variation in demand for loans amongst small and medium-sized enterprises (SMEs) is significant: around half of the total annual volume of borrowing required between 2008 and 2013 was accounted for by a mere 1.4 per cent of all companies seeking loans, in this case those SMEs needing to borrow at least EUR 1 million.

This modestly-sized segment (around 23,000 SMEs) is, therefore, the main component of SME demand for investment loans. The proportion of total borrowing accounted for by large loans has also now been rising consistently for several years, with more established and medium-sized businesses the main companies seeking credit.

Companies looking to borrow large amounts have somewhat more success in negotiating their loans – and a lower loan rejection rate. In 2013, it was as little as 3 per cent.

Monetary policy bearing fruit

There has recently been a rise in demand for loans amongst SMEs.[1] The lull in loan volume required by German small and medium-sized enterprises (SMEs) for investment purposes came to an end by 2013.

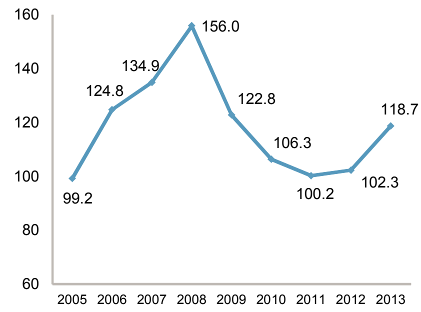
Relatively low borrowing costs and a loan rejection rate that was still at a historic low (2013: 14 per cent) fuelled demand amongst these companies, with the volume of loans required increasing by EUR 16 billion or 16 per cent to EUR 119 billion (Figure 2).[2]

There is, however, much to suggest that this is only a temporary interim high. Although demand for loans amongst companies and the self-employed in Germany was recently above the previous year's level (Q3 2014: +4.5 per cent), the KfW Credit Market Outlook[3] holds statistical factors primarily responsible.

A sustained upturn is unlikely at present as companies are remaining cautious with their investments. As things stand, we are only anticipating a marginal increase in corporate investment of just under 1 per cent in real terms for 2015, meaning that the pre-crisis level seen in 2008 remains a long way off.[4] This is not enough to stimulate demand for bank loans to any meaningful degree.

Figure 2: Total demand for loans amongst SMEs

Borrowing requirements originally planned in EUR billion

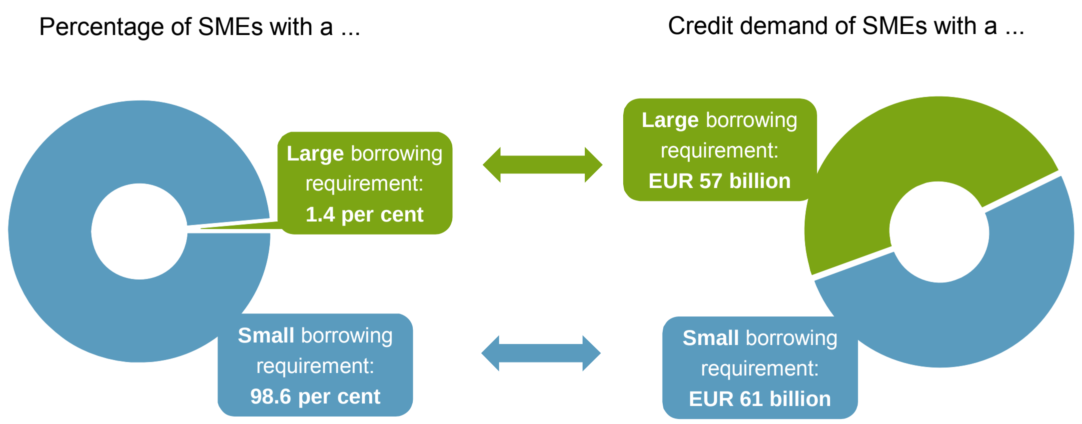


Source: KfW SME Panel 2006–2014.

Clear trend amongst SMEs: larger volumes required

Despite a marked increase in demand for loans amongst SMEs overall, this is not *at all* evenly spread out and it is not the case that more SMEs are applying for investment loans from banks and

Figure 1: Prominence of loans of at least EUR 1 million required by SMEs (mean values 2008–2013)

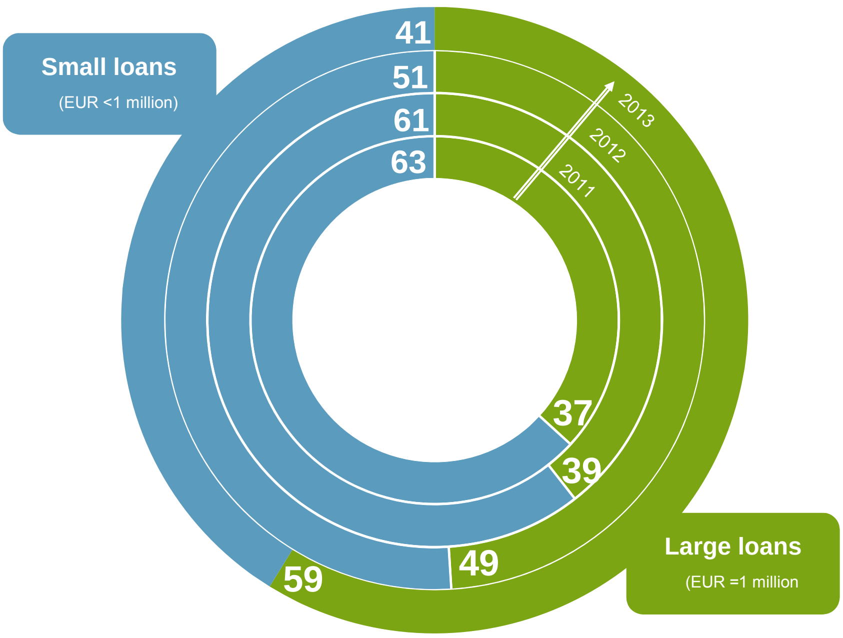


Notes: Large borrowing requirement = SME requiring a loan of at least EUR 1 million to finance investment. The figure shows averages from 2008 to 2013 in order to avoid distortions. The proportions and volumes vary accordingly from year to year.

Source: KfW SME Panel 2009–2014.

Figure 3: Prominence of large loans required 2010–2013

Share of total demand for loans in the corresponding year in per cent



Source: KfW SME Panel 2011–2014.

savings banks (2013: 32%). Rather, the KfW SME Panel has observed a sharp increase over the year in the prominence of loans being requested for at least EUR 1 million. This prompted KfW Research to look into the trend in more detail.

Few borrowers but a major impact

On average, some 23,000 SMEs required investment loans of EUR 1 million or over between 2008 and 2013 – just 1.4 per cent of all SMEs that held loan negotiations (Figure 1, left-hand side). Compared with the whole of the sector, this is no more than half of one per cent of all German SMEs. The number of companies seeking loans in this segment is therefore very small.

However, these comparatively few companies carry significant weight (Figure 1, right-hand side): between 2008 and 2013, SMEs seeking loans of at least EUR 1 million accounted for as much as EUR 57 billion, or 48 per cent of the total loan volume requested by the sector as an annual average.

The mean loan volume required for investment financing in this segment is approximately EUR 3.4 million (median: EUR 1.9 million), some 19 times higher than the average SME borrowing requirement in the period being studied.

Rapid gain in prominence

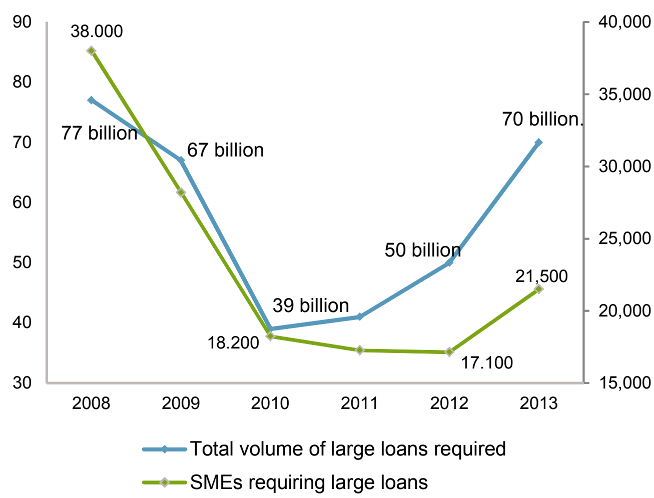
The percentage of the total SME borrowing requirement accounted for by large-volume loans has risen consistently and rapidly in recent times, up from 37 per cent in 2010 to 59 per cent in 2013 (Figure 3). This increase of over 20 percentage points in the space of four years has its consequences: the percentage is higher now in 2013 than it has ever been. Of the EUR 119 billion in investment loans required, as much as EUR 70 billion relates to large loans, spread across some 21,500 SMEs (Figure 4).

Long-established SMEs fuelling demand – start-ups on the back foot

A detailed analysis reveals that established companies that have been in business for over 20 years are the largest segment of companies seeking large loans (Figure 5, centre). These SMEs have made up (at least) half of companies seeking loans since 2010, while in 2013 nearly one in every three SMEs with a high borrowing requirement was a long-established business (Figure 5).

By contrast, fewer and fewer start-ups (companies founded up to five years ago) are seeking loans. Whilst they made up 28 per cent in 2009, by 2013 this figure had dropped to 3 per cent. This sharp fall is not restricted to the large loan segment either: it can also be seen in an analysis of total borrowing requirements (down from EUR 33 billion in 2007 to most recently EUR 8 billion in 2013). KfW Research has already commented on this trend.[5] A key factor behind it lies in the marked decline in start-up activity since the turn of the millennium – as the number of newly and recently established companies is falling,[6] it is inevitable that there will be fewer businesses seeking loans and a lower borrowing requirement overall from this segment.

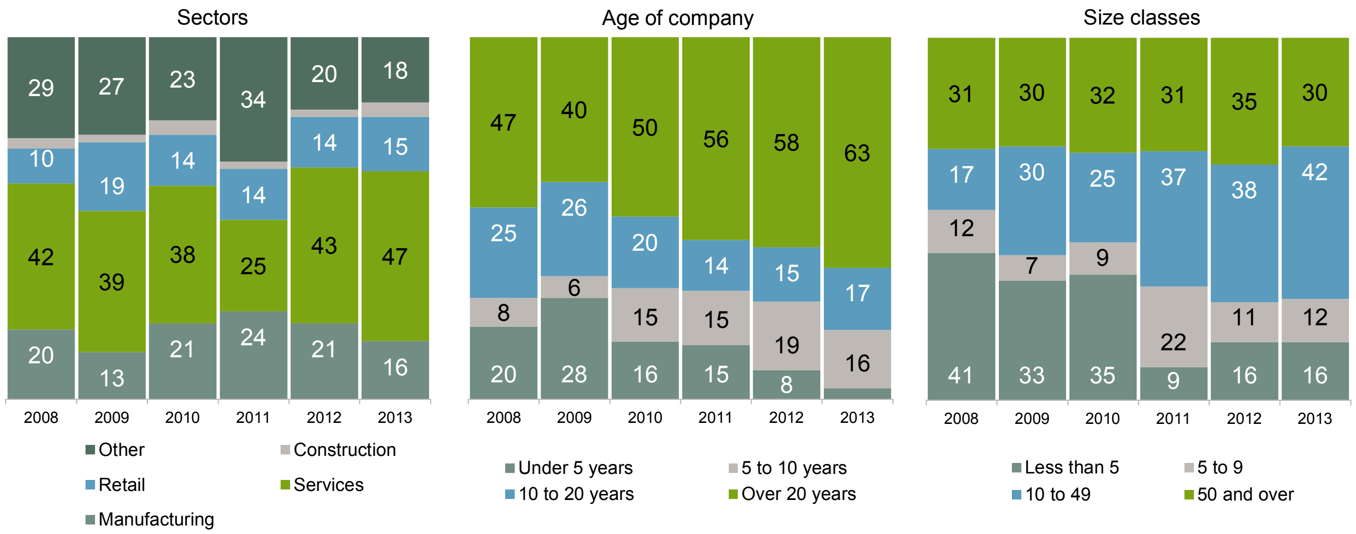
Figure 4: Key figures on the demand for large loans 2008–2013



Source: KfW SME Panel 2009–2014.

Figure 5: Breakdown of SMEs seeking large loans 2008–2013

Proportion of companies in per cent



Notes: Size classes determined by number of full-time equivalent employees (FTE).

Source: KfW SME Panel 2009–2014.

Industrial SMEs well represented

Some 7 per cent of all SMEs are in the manufacturing industry. However the percentage of SMEs in this sector seeking large loans in 2013 was nearly three times higher at 18 per cent (Figure 5, left-hand side). In previous years, the figure has been even higher (considerably so in some cases). Why is this? Manufacturing firms often make more use of external funding as their investment activities are more extensive than the average company's, with industrial SMEs making up as much as one-fifth of gross fixed asset investment amongst all SMEs in 2013.[7] In addition, capital-intensive activities such as foreign operations[8] and innovation activities[9] are much more common.

Medium-sized companies increasing noticeably in prominence

SMEs at the larger end of the scale are also fairly well represented (Figure 5, right-hand side). The medium-sized company segment (10–49 employees) in particular has grown more prominent over recent years, contributing 42 per cent of all SMEs seeking loans in 2013.

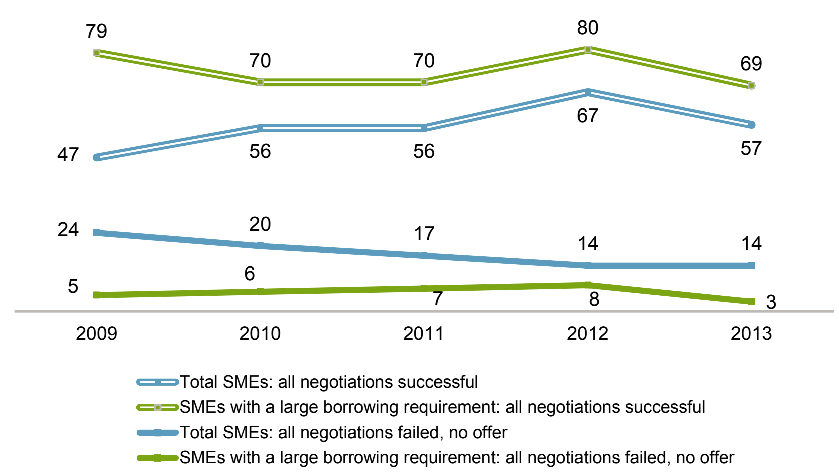
This high and growing degree of prominence results from the segment's investment behaviour: in terms of investment volume per FTE (known as investment intensity), these SMEs outperform every other size class with a figure of EUR 10,102. In other words, the scope of investment projects is larger in relative terms at these companies. What is more, the figure has risen by 48 per cent since 2010 (while investment intensity in the whole SME sector was virtually unchanged between 2010 and 2013). This high investment volume in relative terms also means a growing borrowing requirement.

Companies needing large loans are more successful negotiators

SMEs with a large borrowing requirement also enjoy more success in loan negotiations than an average SME (Figure 6). For loans of at least EUR 1 million, the percentage of companies that negotiated all their borrowing successfully is higher than the corresponding figure for all SMEs attempting negotiations – by between 12 and 14 percentage points in each of the past

Figure 6: Outcome of loan negotiations by borrowing requirement

Proportions in per cent



Notes: Not enough cases are available for 2008 to permit a reliable projection. Figures from that year were therefore not shown.

Source: KfW SME Panel 2010–2014.

four years.

At the same time, loan negotiations break down many times more often for SMEs as a whole (loan rejection rate 14 per cent in 2013) than for just those SMEs applying for large loan volumes (2013: 3 per cent).

Many of the reasons for this relate to how the companies seeking the loans are structured, with the segment of applicants for large loans dominated by older and larger SMEs (Figure 5). As many as 80 per cent of these SMEs have been in business for at least ten years, while 72 per cent of them are of above-average size, employing ten or more FTEs. It is to be assumed in this regard that the SMEs enjoy a firm, long-standing relationship with their banks and the advisors there. This means that the necessary documentation is often already to hand, the two parties trust each other and the bank is familiar with the company's history and can appraise its management capabilities. Any information gaps are thus relatively minor and can be filled easily.

By contrast, smaller and newer SMEs frequently find that, if banks or savings banks believe that the loan volume being applied for is (too) low, the lenders will often shy away from the time-consuming process of obtaining all the information they are missing. For instance, new companies (by their very nature) are unable to show a credit history, which would allow the bank to make a reliable assessment of their creditworthiness. This can be reflected in, for example, risk premiums applied to the interest rate or stringent collateral requirements.

For this reason, loan negotiations with SMEs at the smaller end of the scale (with fewer than five employees) still break down much more frequently than with their larger counterparts (with 50 or more employees) due to structural constraints – in 2013, the figures were 17 and 3 per cent respectively – despite the extremely favourable terms currently available for taking out bank loans.

Summary

This article illustrates for the first time the considerable prominence and rapidly growing significance of the demand for large loans (upwards of EUR 1 million) compared with the total annual borrowing requirement of small and medium-sized enterprises.

Despite a high level of relevance in volume terms, the segment is relatively small and dominated by older and larger companies, which commonly carry out much larger investment projects. Looking at the whole of the SME sector reveals a different picture: for instance, the average volume of investment financing required by an SME between 2005 and 2013 was "only" around EUR 162,000, while in about three quarters of all cases it was below EUR 100,000 (2013: 71 per cent). Put another way, demand for investment loans in the SME sector as a whole is generally relatively modest and influenced by problems of size and there are few signs that the situation will change in the future either. ■

The KfW SME Panel

The ***KfW SME Panel*** has been conducted since 2003 as a recurring survey of small and medium-sized enterprises in Germany. The basic population used for the KfW SME Panel comprises all private companies from all sectors with an annual turnover of no more than EUR 500 million. The sample is designed in such a way that it can generate representative, reliable data that are as precise as possible.

With data based on up to 15,000 companies a year, the KfW SME Panel is the ***only representative survey of German SMEs***, making it the most important source of data on issues relevant to this sector.

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[1] An SME's borrowing requirement is understood to mean the amount of credit that it has applied for from banks or savings banks in order to finance investment activity. In other words, it is exclusively the demand side of loan negotiations that is being studied here. It is therefore impossible to say how much in bank loans was ultimately used for investment financing.

[2] Schwartz, M. (2014), KfW SME Panel 2014: *SMEs feeling the impact of weak growth in Europe, and bracing for harder times ahead (Mittelstand spürt Wachstumsschwäche in Europa und rüstet sich für schwierigere Zeiten)*, KfW Economic Research, Frankfurt am Main.

[3] Richter, B. (2014), KfW Credit Market Outlook December 2014. *New lending: interim high rather than a sustained upswing (Kreditneugeschäft: Zwischenhoch statt nachhaltigem Aufschwung)*, KfW Economic Research, Frankfurt am Main.

[4] Cf. Borger, K. (2014), KfW Investment Barometer Germany: September 2014, KfW Economic Research, Frankfurt am Main.
Schwartz, M. (2014), KfW SME Panel 2014: *SMEs feeling the impact of weak growth in Europe, and bracing for harder times ahead (Mittelstand spürt Wachstumsschwäche in Europa und rüstet sich für schwierigere Zeiten)*, KfW Economic Research, Frankfurt am Main.

[5] Schwartz, M. (2014), *Wie viel Kredit darf's sein? Kreditnachfrage für Investitionen im Mittelstand vor – nach – in der Krise*, Focus Volkswirtschaft Nr55, KfW Research, Frankfurt am Main.

[6] Metzger, G. (2014), KfW Start-up Monitor 2014: *Revival in start-up activity – impulse from the sideline (Gründungstätigkeit wiederbelebt – Impuls aus dem Nebenerwerb)*, KfW Economic Research, Frankfurt am Main.

[7] See the volume of tables on the KfW SME Panel 2014, in this case Table 6, p. 8: https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-KfW-Mittelstandspanel/2014-Mittelstandspanel-Tabellenband_final.pdf

[8] See e.g. Brutscher, P., Raschen, M., Schwartz, M. and V. Zimmermann (2012): *Internationalisation in Germany's SME sector – Step by step to global presence (Internationalisierung im deutschen Mittelstand. Step by Step zum Global Player)*, KfW Research, KfW Bankengruppe, Frankfurt am Main.

[9] See e.g. Zimmermann, V. (2014), KfW SME Panel 2013: *How German SMEs finance their innovations (Wie Mittelständler ihre Innovationen finanzieren)*, Focus on Economics No. 50, KfW Economic Research, Frankfurt am Main. See also: Zimmermann, V. (2014), KfW SME Panel 2013: Innovation. *Are German SMEs finally in the starting blocks? (Steht der Mittelstand endlich in den Startlöchern?)* Focus on Economics No. 42, KfW Economic Research, Frankfurt am Main.