



KfW Research

»»» KfW Internationalisation

Report 2021

Coronavirus crisis sends SMEs' international business tumbling

Imprint

Published by

KfW Group
Economics Department
Palmengartenstraße 5-9
60325 Frankfurt/Main
Phone +49 69 7431-0, Fax +49 69 7431-2944
www.kfw.de

Edited by

KfW Group
Economics Department
research@kfw.de

Dr Jennifer Abel-Koch
Phone +49 69 7431-9592

Copyright cover image
Source: Thinkstock/iStock / Rrainbow

Frankfurt/Main, May 2021

Coronavirus crisis sends SMEs' international business tumbling

Depressed foreign demand, disruptions to international supply chains, transport difficulties and border controls have led to a dramatic slump in German exports during the coronavirus crisis. Germany's total goods and services exports fell by 10.1% to around EUR 1,477 billion in 2020.

The coronavirus pandemic and associated restrictions in Germany and abroad have also had a severe impact on Germany's small and medium-sized enterprises. SMEs that generate part of their turnover outside Germany were hit particularly hard. They were more likely to experience turnover losses, shrinking sales markets and supply chain disruptions than SMEs that generate all of their turnover within the country.

Estimates put the decline in SMEs' international turnovers at a significant 17% in 2020, down to around EUR 494 billion after some EUR 596 billion in the pre-pandemic year 2019. The smaller businesses among the 781,000 SMEs that are internationally active are particularly pessimistic about how their foreign turnovers will develop.

The experience of the crisis will lead to lasting changes in many areas. This includes SMEs' international integration, where a mixed trend is expected. Just under 40% of SMEs that are active internationally, particularly those that have so far supplied only few foreign markets, intend to focus more on the domestic market in the next five years. At the same time, 23% of internationally active firms intend to diversify their exports more in the future. Larger and more experienced exporters in particular are considering entering additional foreign markets – not least because, unlike smaller businesses, they have the necessary financial and human resources. SMEs believe that countries in Europe will tend to become more important for them – with the exception of the United Kingdom. But emerging and developing countries might also play a larger role as sales markets for SMEs in the future.

Some German enterprises are closely integrated into foreign markets, not just on the sales side but on the procurement side as well. The coronavirus crisis, as well as more recent events such as the obstruction of the Suez Canal by the accidental grounding of the 'Ever Given' container vessel, have highlighted how

disruptions in international supply chains can continue and adversely impact production in the SME sector as well. This has again centred the spotlight on questions about the resilience of value chains.

The willingness of SMEs to sacrifice cost advantages in order to make their own value chain relations more resilient, however, is limited. Large enterprises in particular are clearly against strengthening the resilience of their value chains if it is to the detriment of efficiency. To be sure, three in ten SMEs intend to focus more strongly on the domestic market. But only very few intend to withdraw partly or completely from global value chains.

The benefits of the international division of labour continue to apply despite the coronavirus crisis. Nonetheless, there is a need to reflect on how international value chains can be made efficient, crisis-resilient in the long term and, above all, sustainable at the same time – and what enabling conditions and incentives are necessary to achieve this.

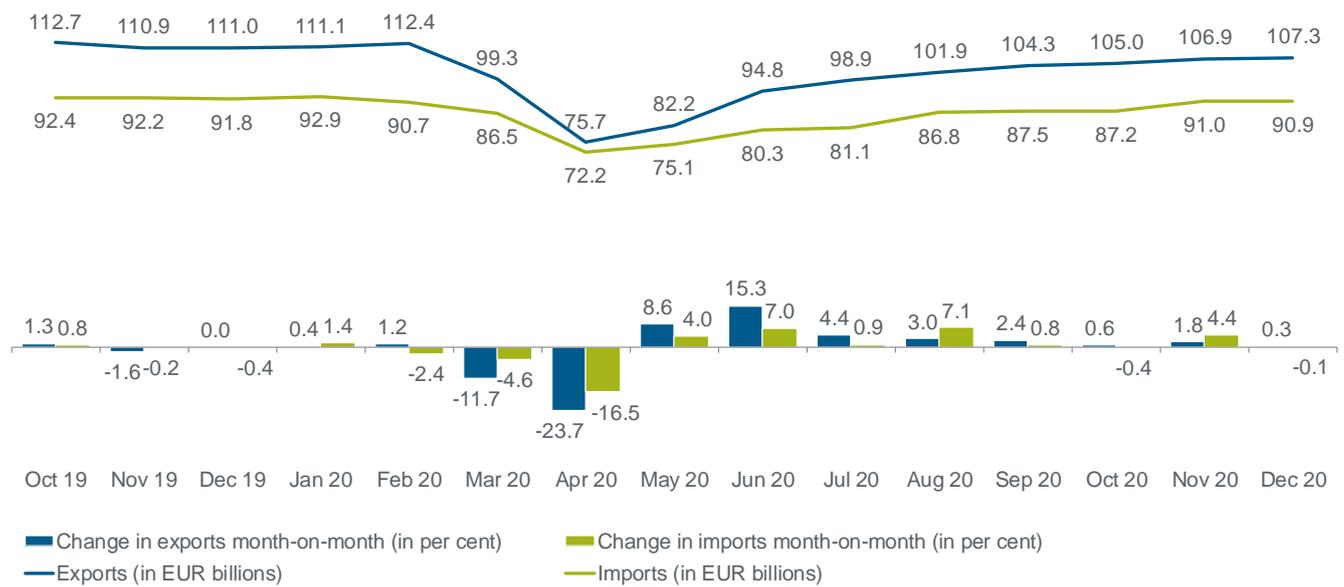
Pandemic has led to a slump in Germany's foreign trade

With the global spread of the coronavirus and far-reaching restrictions imposed in many countries to contain the pandemic, conditions for Germany's international trade worsened substantially in spring of last year. Depressed foreign demand, disruptions to international supply chains, transport difficulties and border controls led to a dramatic slump in German exports and imports.

Exports plummeted by 11.7% year-on-year in March and by a further 23.7% in April 2020. Imports also dropped sharply by 4.6% in March and by 16.5% in April.¹ With the arrival of summer the pandemic situation eased slightly in Germany and other countries and a strong recovery of cross-border goods trade began. Towards the end of the year, however, export and import growth slowed down again. In December 2020, exports grew by 0.3% compared with the previous month while imports remained on the November level (Figure 1).

The trend was similar in trade in services, although imports here decreased much more than exports. While services imports dropped by approx. 19.2% month-on-month in April 2020, services exports fell by

Figure 1: Germany's foreign trade plunged in the coronavirus crisis



Note: Goods trade, calendar- and seasonally adjusted data.

Source: Federal Statistical Office of Germany.

only around 15.4%.² Tourism accounted for a substantial portion of the decline in services trade and it remains significantly reduced in many countries as a result of travel and contact restrictions.

Germany's total goods and services exports fell by 10.1% to around EUR 1,477 billion in 2020. Goods and services imports amounted to around EUR 1,296 billion in 2020, around EUR 144 billion less than the previous year.³

Internationally active SMEs were hit particularly hard by the coronavirus crisis

The coronavirus crisis and the restrictions imposed at home and abroad left a deep mark on Germany's SMEs as well. SMEs that generate part of their turnover outside Germany were hit particularly hard (Figure 2).

More than three quarters of them suffered turnover losses in April 2020 as a result of declines in demand, compared with 60% of SMEs operating exclusively in the domestic market. The sales region shrunk significantly for almost one in three internationally active SMEs as a result of the coronavirus crisis. It was mainly the foreign markets that likely dried up, whereas the sales region contracted for just 12% of SMEs with purely domestic operations – a much lower proportion.

Indeed, economic activity was significantly curtailed in many countries from mid-March 2020 and some businesses classified as non-essential for the supply of the population had to close. Measured against German

exports and imports of the year 2019, more than 90% of the value of German trade between mid-March and the end of December 2020 involved countries in which the closure of businesses or home working schemes were imposed or at least recommended in individual sectors or for individual groups of workers. In addition, many countries imposed more or less severe restrictions on international travel. At the end of April, borders were closed in countries accounting for a total of 36% of the value of German trade of 2019.⁴

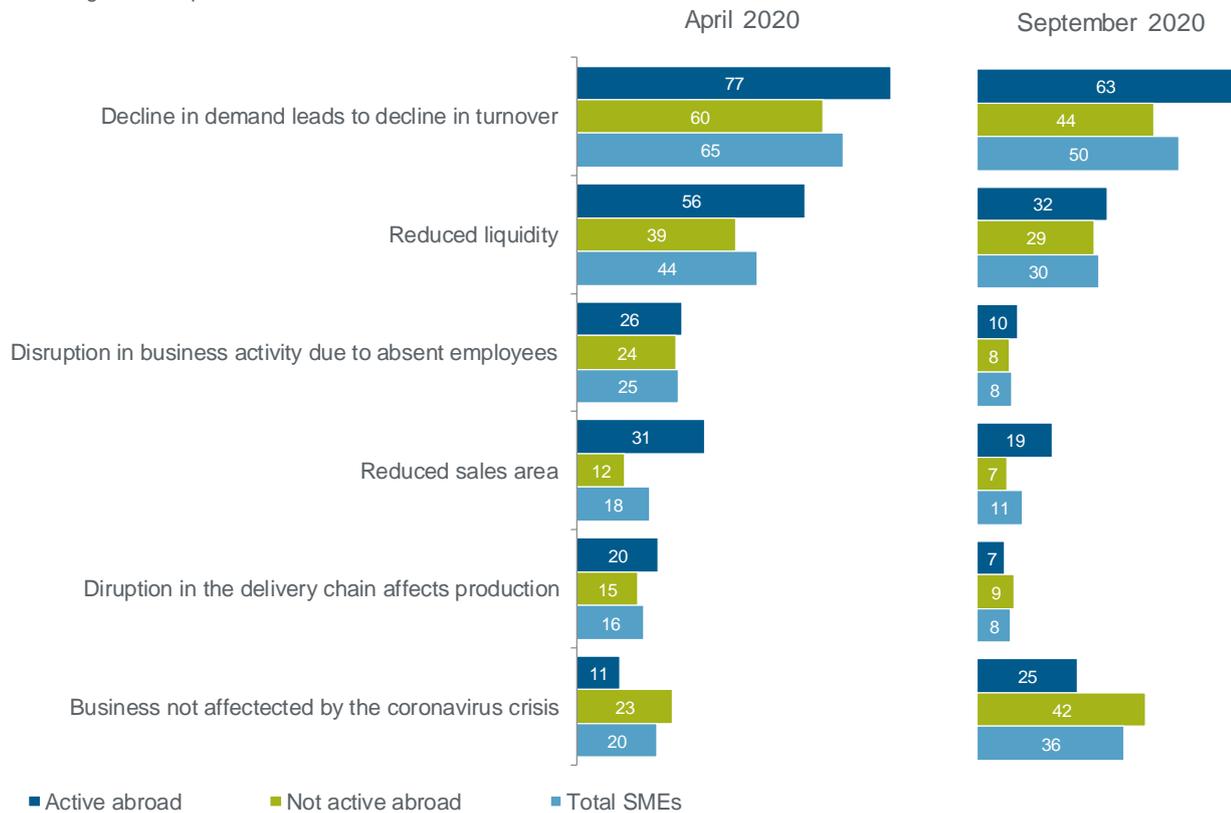
The coronavirus crisis thus affected Germany's international trade much more than trade in goods and services within Germany.

A clear connection between international activity and the likelihood of a company suffering a downturn in demand and turnover losses is also evident when controlling for characteristics such as the size, sector or innovation and digitalisation activities of the business. The same applies to the likelihood of a business suffering a reduction in the size of its sales region.

Not just in April but also in the further course of the year, depressed demand affected internationally active businesses much more than those with purely domestic operations, even if the impact decreased overall. In September, 63% of exporting SMEs suffered turnover losses – around 19 percentage points more than non-exporting SMEs. Internationally active ones were also more likely to be affected by turnover losses during the

Figure 2: Internationally active SMEs more affected by the coronavirus crisis

Percentage of enterprises



Note: Share of enterprises affected by the coronavirus crisis in the manner described in April and in September 2020. Values extrapolated on basis of the number of employees.

Source: Supplementary surveys to the KfW SME Panel in April and September 2020

second lockdown in January. They have been affected not just by restrictions on economic activity in Germany but also by restrictions in important trading partners.

SMEs' turnover losses have ultimately had an impact on their liquidity situation as well. It deteriorated in around 56% of internationally active enterprises in April, compared with 39% of firms without international business.

Internationally active enterprises were also slightly more affected by supply chain disruptions. In April 2020, problems with suppliers disrupted the production of around one fifth of them but of only 15% of purely domestic SMEs. However, the fact that pandemic-induced supply chain disruptions affect exporters more often is not so much due to their export activity itself. Rather, exporters are very often importers at the same time and therefore more heavily dependent on international value chains than businesses that trade exclusively in the German market.⁵ The production downturn in China, where the pandemic began in the spring of 2020, has hit international value chains – and the enterprises that depend on them – particularly hard. Throughout the summer the situation in major supplier

markets eased somewhat, so that in September 2020 production outages resulting from supply chain disruptions occurred much less often in internationally active businesses as well.

No major differences exist in worker absenteeism due to disease, quarantine or a shortage of childcare services. This affected internationally and domestically operating businesses in nearly equal measure, due not least to the fact that only a very small portion of German SMEs maintains sales or production locations abroad. SMEs achieve the largest portion of foreign turnover by far from exports. Hardly any SMEs employ workers abroad. Possible national differences in infection rates, quarantine requirements or school and child daycare closures do not, therefore, play a particular role here.

Majority of internationally active firms expect a decline in international turnover

In light of these developments it is hardly surprising that most export-oriented German SMEs expect their foreign turnover to have dropped in 2020 (Figure 3). In September, just under 62% of internationally active SMEs expected their foreign turnover in 2020 to be

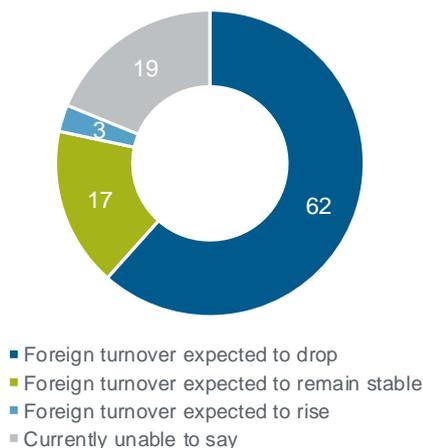
lower than in the previous year. Around 17% estimated their foreign turnover to remain stable despite the coronavirus crisis, while only a very small share of 3% of internationally active SMEs expected it to exceed that of the year 2019. Around one in five exporting SMEs found it difficult to estimate the development of their foreign turnover for the year 2020 at the time of the survey in September. This indicates the scale of uncertainty involved in forecasts about the further progression of the pandemic and, thus, the development of the economy in Germany and abroad.

Larger exporters benefit from greater regional diversification of their international business

Large SMEs were slightly less pessimistic. Whereas more than 62% of exporters with fewer than ten employees estimated lower foreign turnover in 2020, the figure is around 54% for exporters with 50 and more employees. The share of businesses expecting unchanged or even growing foreign turnover is around 15 percentage points higher among larger exporters, at 33%, than among smaller exporters.

Figure 3: Export expectations for 2020 mostly negative

Percentage of internationally active enterprises



Note: Values extrapolated on the basis of the number of enterprises.

Source: Supplementary survey to the KfW SME Panel in September 2020.

A likely reason for this is that larger exporters operate in more countries, including outside Europe. Smaller exporters with fewer than ten employees operate on average in around three different target regions, while larger exporters with 50 and more employees are active on average in more than six. Of the internationally active SMEs with fewer than ten employees, only one in ten generate turnover in China, while this applies to nearly one in three of those with 50 or more employees. Entering a new foreign markets usually involves high costs – for analysing the market, setting

up new sales channels or adapting products – and is not worthwhile unless it promises sufficiently high turnover.⁶

Stronger regional diversification enables larger exporters to offset at least part of the turnover losses they suffer in one foreign market with higher turnovers they generate in another foreign market. This was also the case during the coronavirus crisis, which has spread across the entire world but has affected individual countries with varying intensity and at different times. Particularly in the second half of 2020, pandemic activity and, hence, its economic impact was regionally more differentiated.⁷ German exports also reflect this. For example, in the fourth quarter of 2020 exports to France fell by around 7.3% compared with the same quarter of the previous year, while exports to the USA dropped by only 2.6%. Exports to Poland, on the other hand, rose by 6.6% in the same period and exports to China even by 8.6%.

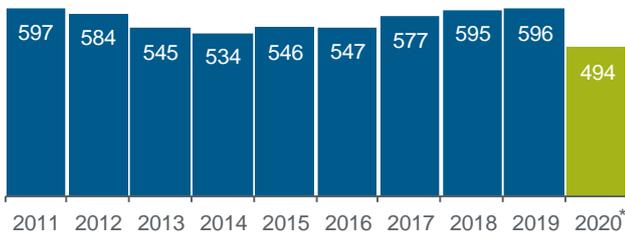
In addition to company size, the sector in which the company operates also plays an important role for export expectations. In the manufacturing sector 42% of internationally active companies expected their foreign turnover to decline. In the services sector, which is particularly affected by restrictions on personal contacts, in September more than 66% of businesses expected lower foreign turnover in 2020 than in the previous year.

Export slump is significant

The findings of the supplementary survey to the KfW SME Panel in September 2020 show that the extent of the expected export slump is considerable. The nearly two thirds of internationally active firms expecting a decline in international turnover see an average drop of 26% in all of 2020 compared with 2019. The decline in foreign turnover for the SME sector as a whole can be estimated at around 17%. The foreign turnovers of SMEs in Germany could thus turn out more than EUR 100 billion lower in 2020 than in 2019. While SMEs sold goods and services worth EUR 596 billion in 2019, the volume for 2020 is estimated at only around EUR 494 billion (Figure 4). As the growing spread of infections in the fourth quarter made it necessary to tighten restrictions and reduce economic activity again in Germany and Europe, actual foreign turnover may even fall below these expectations.

Figure 4: SMEs' international turnover plunged in 2020

SMEs' total international turnover in EUR billions



Note: Values extrapolated on basis of the number of employees. Value for 2020 estimated.

Source: KfW SME Panel 2012–2020.

Owing to the size of the sample, the estimate of international turnover for individual segments of internationally active businesses is subject to a certain variability. Nevertheless, it is evident that smaller exporters not only tend to be more often affected by decreases in international turnover, their losses are also much higher in relation to their total international turnover. While foreign turnover of exporting SMEs with 50 and more employees dropped by a good one tenth on average, it fell by around one third in exporters with fewer than ten employees. At the same time, foreign turnover fell relatively more in the services sector than in the manufacturing sector.

The particularly sharp drop of SMEs' international turnover in relation to the overall trend of German goods and services exports is probably due to company size effects, but also to the high share of services enterprises among SMEs.

International business was lacklustre even before the coronavirus crisis

German SMEs' international business was already relatively weak even before the coronavirus crisis struck. In 2019 SMEs' international turnover was around EUR 596 billion, just barely above the level of 2018. This reflects the development of Germany's exports overall, which reached a new high in 2019 but have grown much less dynamically than in the preceding years. In 2019, German goods exports amounted to around EUR 1,328 billion, which was just 0.8% above the previous year's level. In 2018, German exports still grew by 3% and in 2017, they grew by as much as 6.2%.

The rather weak development of German exports and SMEs' international turnover in 2019 reflects the slowdown in global economic growth and ongoing trade uncertainty. Europe, which is of particular importance

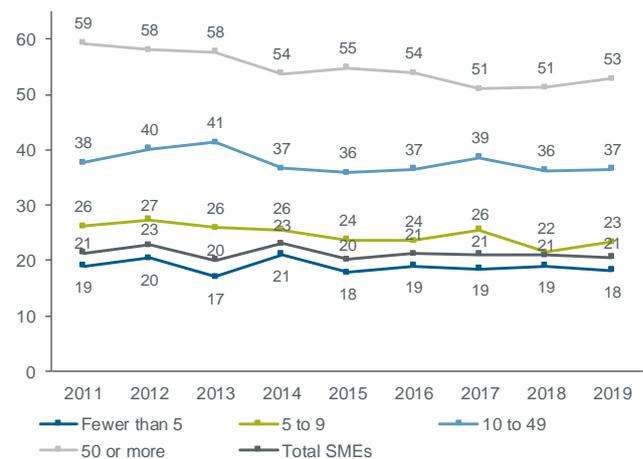
for SMEs' foreign activities, provided hardly any impetus for Germany's export business either. In addition, the inability to reach an agreement about Brexit led to a further decline in exports to the United Kingdom, a country that was previously among the five most important target countries of German exports and contributed to the turnover of one in four internationally active SMEs.

Nearly one in five SMEs generated international turnover in 2019

The share of internationally active businesses in the approx. 3.79 million SMEs in Germany was just under 21% in 2019, as it was in 2018. Among larger SMEs with more than 50 employees, it increased slightly but still remained below the level at the beginning of the previous decade (Figure 5). The share of internationally active among enterprises with fewer than five employees was 18% in 2019, slightly lower than in the previous year. Overall, around 781,000 SMEs generated turnover outside Germany before the beginning of the coronavirus crisis.

Figure 5: Share of internationally active businesses has stagnated

Percentage of enterprises which were internationally active



Note: Size classes by number of full-time equivalent employees. Values extrapolated on basis of the number of enterprises.

Source: KfW SME Panel 2012–2020.

Share of international turnover fell in 2019

The share of foreign turnover in total turnover of internationally active businesses continued to decline in 2019 (Figure 6). Whereas goods and services sold across borders still accounted for around 30% of exporters total turnover at the beginning of the last decade, that share was a mere 26% in 2019.

In a sector comparison, manufacturing continues to stand out as strong in exports. The global industrial slowdown of 2019 did little to change that. More than

one in three manufacturing SMEs are internationally active, generating on average around 37% of their total turnover outside Germany – far more than SMEs in any other sector. As before, the construction sector comes in last. Here, barely 3% of SMEs operate across borders. The share of international turnover in total turnover is just 11% overall.

Figure 6: Share of international turnover in total turnover has dropped



Note: Only internationally active enterprises. Values extrapolated on basis of the number of employees.

Source: KfW SME Panel 2012–2020.

In the services sector the share of internationally active firms was around 19% in 2019, roughly on the previous year’s level. However, international turnover accounted for only around 24% of their total turnover. In total, international turnover of service SMEs amounted to

EUR 192 billion in 2019, roughly EUR 18 billion less than in the previous year. Growth in trade and services is taking a break – at least in Germany’s SME sector.

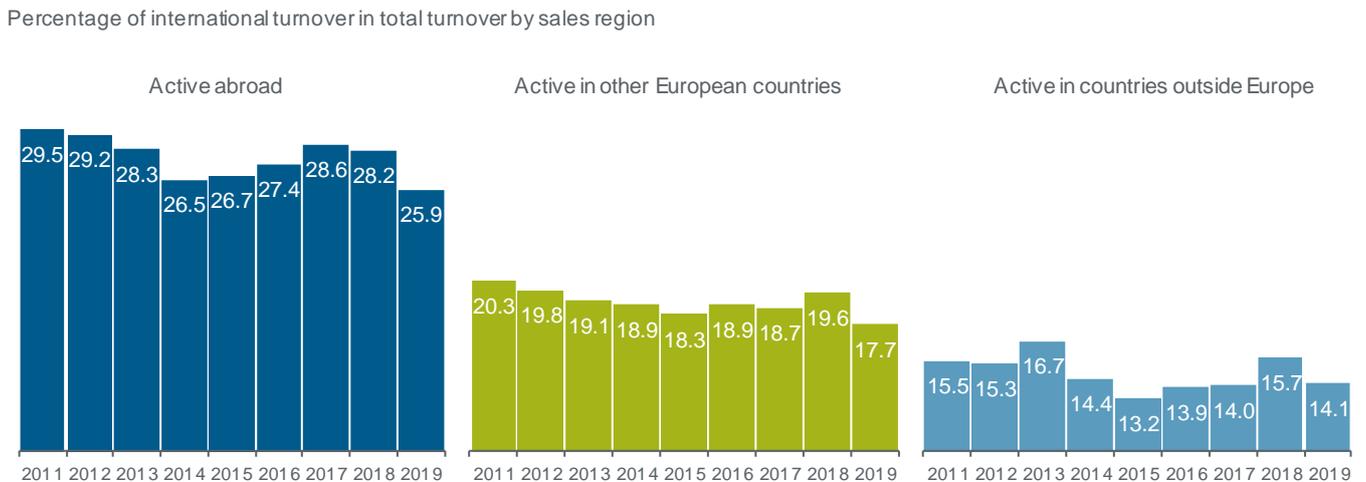
Turnover outside Europe was particularly weak in the pre-crisis year 2019

Inside Europe, the international operations of Germany’s SMEs grew only moderately in 2019. Turnover in the most important export region of SMEs rose by just under 1% on the previous year to around EUR 406 billion. Thus, Europe accounted for more than 68% of SMEs’ total international turnover in 2019. SMEs’ business outside Europe was even weaker, generating around EUR 191 billion in turnover in 2019, down from EUR 193 billion the year before.

In relation to the total turnover of SMEs operating in the respective region, international turnover dropped slightly in 2019. Turnover in Europe made up less than 18% of the total turnover of SMEs active in Europe. Turnover from outside Europe accounted for just 14% of the total turnover of SMEs active outside Europe (Figure 7).

The share of international turnover is likely to have fallen further during the coronavirus year 2020. While businesses estimated a loss of around 12% in total turnover in 2020 last September, they expected a much more pronounced decline in international turnover by about 17%. In future, domestic customers may become even more important as many SMEs intend to adapt their export strategy in response to their experience of the crisis.

Figure 7: Share of international in total turnover declines in all sales regions



Note: The values shown refer to those enterprises that generated international turnover in the corresponding region. The individual figures for SMEs active in Europe and for those active outside Europe therefore do not add up to the figure for all internationally active enterprises. Values extrapolated on basis of the number of employees.

Source: KfW SME Panel 2012–2020.

In response to the coronavirus crisis, SMEs will focus more on the domestic market ...

Nearly four in ten internationally active SMEs want to focus more strongly on domestic customers in the future (Figure 8). Only in the fewest of cases is this likely to mean a complete withdrawal from international business. Many previously successful export relationships will probably outlast the coronavirus crisis and will be intensified again when the pandemic subsides and the economy at home and abroad recovers. Nevertheless, this finding indicates that international business will likely become less important for SMEs in the future. This development is probably not due to the coronavirus crisis alone but to the slowdown in globalisation even before the beginning of the pandemic. Since the beginning of the global financial crisis in 2008, global goods trade in relation to global gross domestic product decreased from 51 to 44% in the year 2019. Goods trade, measured as the sum of exports and imports, accounted for around 71% of gross domestic product in Germany in 2019, the same volume as in 2008. However, Germany's foreign trade was also unable to resume the strong growth recorded prior to the financial crisis, when trade more than doubled in relation to gross domestic product between 1993 and 2008. A study commissioned by KfW Research that will be published shortly examines various globalisation scenarios up to the year 2030 and lays out possible adaptation strategies for businesses. It also arrives at the conclusion that a stronger focus on the domestic market could be a valuable option for some of the exporting enterprises.

... but also diversify their international business more

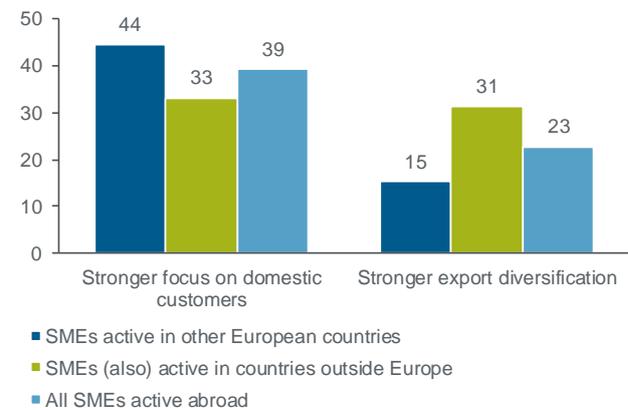
A stronger focus on the domestic market could help SMEs better overcome possible crises of global dimensions in the future. Wagner et al. (2013) demonstrates that German exporters were less likely to survive the global economic and financial crisis than non-exporters.⁸ Also in the coronavirus pandemic, which has affected almost all the world's countries, internationally active businesses were generally much more often and more severely affected by depressed demand and turnover losses than purely domestic SMEs.

Crises of a global dimension such as the financial crisis and the coronavirus pandemic are relatively rare, however. Country-specific shocks, on the other hand, are much more common.⁹ When they occur, international business has an important insurance function. After all, when enterprises operate in various domestic and international markets, decreases in demand in one market can be at least partly offset by increases in turn-

over in other markets. The risk of suffering high turnover losses from regional shocks is lower.¹⁰ In the coronavirus crisis, too, which hit individual countries with different intensity at different times, it is likely that greater diversification has ultimately helped limit the relatively high turnover losses of exporters.

Figure 8: Many SMEs intend to realign their export strategy

Percentage of internationally active enterprises planning to make the respective adjustment in the next five years



Note: Values extrapolated on basis of the number of enterprises.

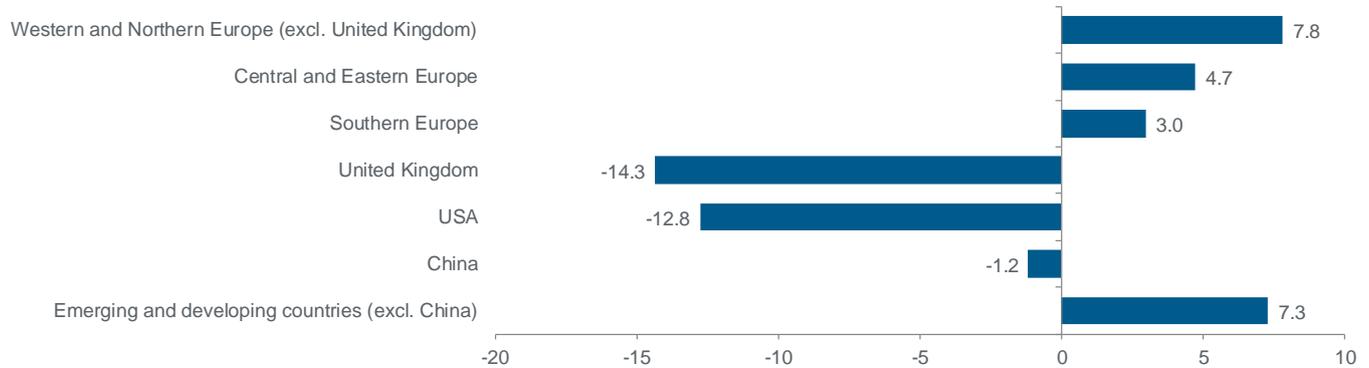
Source: Supplementary survey to the KfW SME Panel in September 2020.

Improved risk diversification is also likely to be a key motive of SMEs that plan to diversify their exports more in the future. Just under one quarter of internationally active companies intend to tap into additional export markets or attract additional customers in the next five years (Figure 8). Many of them are businesses that have already gathered experience in markets outside Europe. Almost a third of these companies – which make up around 46% of all internationally active companies – intend to enter new export markets. By contrast, only 15% of businesses that have so far been active only in the European market are considering that as an option.

Conversely, around 44% of the rather smaller exporters that operate only within Europe plan to focus more closely on the domestic market in the future. A much lower share of companies doing business outside Europe – 33% – regard that as an option. Differing experiences of the crisis are probably one reason for these diverse responses from enterprises. What likely plays a major role as well is the fact that tapping into new export markets requires financial and human resources which smaller exporters with less export experience often do not have.

Figure 9: European countries are becoming more important for internationally active enterprises

Change in the importance of different regions as sales markets in the coming five years



Note: Balance of the share of internationally active enterprises that responded to the question 'How do you expect the importance of the following regions to develop for your company's sales in the coming five years?' with 'will strongly/mostly increase' and 'will strongly/mostly decrease'. Values extrapolated on basis of the number of enterprises.

Source: Supplementary survey to the KfW SME Panel in September 2020.

Overall, the findings suggest a bifurcated development. While some, especially smaller exporters, will focus more strongly on the domestic market, others, especially larger and already more diversified exporters, are set to tap into new export markets and attract new foreign customers. In this context, European countries tend to gain in importance – with the exception of the United Kingdom.

European countries are moving into the spotlight as export markets

Around 24% of internationally active SMEs expect Western and Northern Europe to play a more important role as sales markets for their enterprise in the next five years. At the same time, only around 16% of internationally active SMEs believe that this region will become less attractive. On balance, therefore, just under 8% of exporting SMEs expect this region to gain in importance (Figure 9).

However, around 33% of internationally active companies also expect the importance of Western and Northern Europe as an export destination to remain unchanged. A further 28% do not see Western and Northern Europe as a relevant sales market for their business either today or in the future. This shows that the regional orientation of SMEs' international business will not change fundamentally in the medium term.

SMEs also see a minor increase in the importance of Central and Eastern Europe as sales markets. Before the coronavirus crisis began, trade with Poland in particular was growing strongly. The sixth largest economy of the EU is now one of Germany's most important trading partners. Should firms shift their production capacities from Asia to Europe as a consequence of

the coronavirus pandemic, a move known as nearshoring, that should provide another boost to Poland and other Central and Eastern European countries and stimulate demand for capital goods.

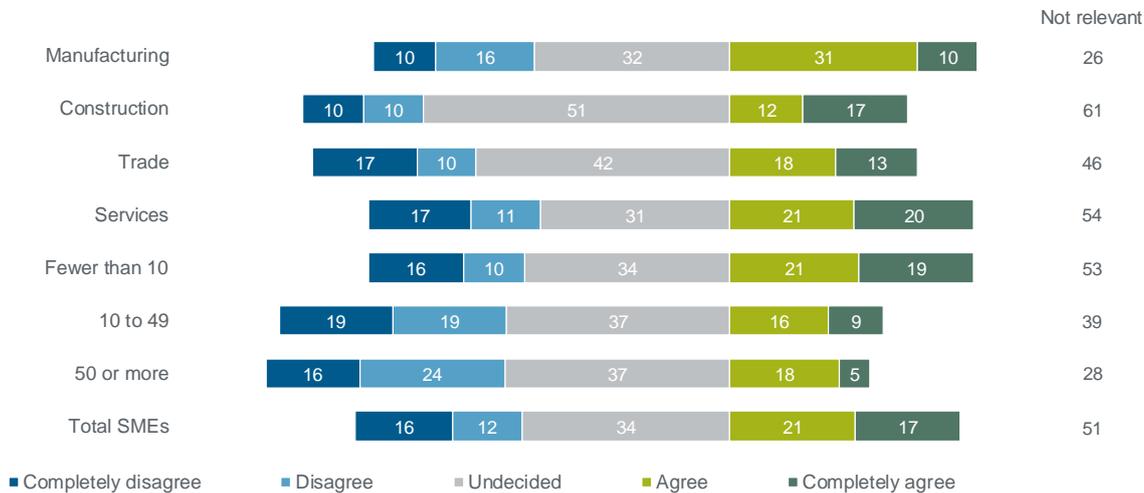
The balance for Southern Europe is still positive but on a lower level. Spain, Italy and Portugal are among the EU countries whose economies were hit hardest by the coronavirus crisis – not least as a result of the sharp drop in international tourism. The growth outlook is relatively bleak for Italy in particular, where an urgent need for reform remains and government debt has skyrocketed.

On balance, exporting SMEs rate the United Kingdom significantly lower. Around 21% of internationally active companies expect the United Kingdom to decline in importance as a sales market for their business, while only 7% believe it will gain in importance. After Brexit, which was completed after lengthy negotiations in January 2021, the United Kingdom is no longer a member of the EU internal market. More complicated customs regulations and logistical challenges make exporting unattractive for smaller exporters in particular. The findings of the September 2020 survey probably pre-empted this.

German SMEs take a similarly negative view of how the US is developing as an export destination. This view is shaped by the conflict-laden trade policy of the former US president Donald Trump. Under a Joe Biden-led US administration, multilateralism is gaining ground again and trade policy is becoming more reliable. And yet, European exporters will not obtain much easier access to that market any time soon.

Figure 10: Foregoing cost advantages to strengthen the resilience of value chains

Percentage of enterprises



Note: Percentage of enterprises that agree with the statement 'We will forego cost advantages in order to make our value chains more resilient' with a view to the next five years, applicable to all enterprises for which the issue is of relevance. Size classes by number of full-time equivalent employees. Values extrapolated on basis of the number of enterprises.

Source: Supplementary survey to the KfW SME Panel in September 2020.

China and other emerging and developing economies remain markets that are of relevance to only few SMEs. Around one third of all internationally active firms see possibilities to sell their own products or services there today or in the future. On balance, SMEs do not expect China to gain further in importance. The situation is different for the remaining emerging and developing economies. Just under 16% of internationally active businesses expect these countries to play a more important role for their sales in the coming five years than today. Only a good 8% expect their importance to diminish. Particularly for more experienced exporters, emerging and developing economies offer further opportunities for growth amid otherwise weak globalisation momentum.

SMEs' value chain relations are being put to the test

Sales relationships are just one aspect of the value chain links of Germany's SMEs in domestic and international markets. On the sourcing side, too, SMEs directly or indirectly depend on suppliers in Germany, Europe and around the world. The coronavirus crisis has very clearly shown how failures and disruptions in international supply chains can propagate and adversely impact on production in the SME sector as well.

How strongly individual events can affect global value chains was recently highlighted by the accidental grounding of the Ever Given container vessel in the Suez Canal. The ship, with a cargo capacity of more

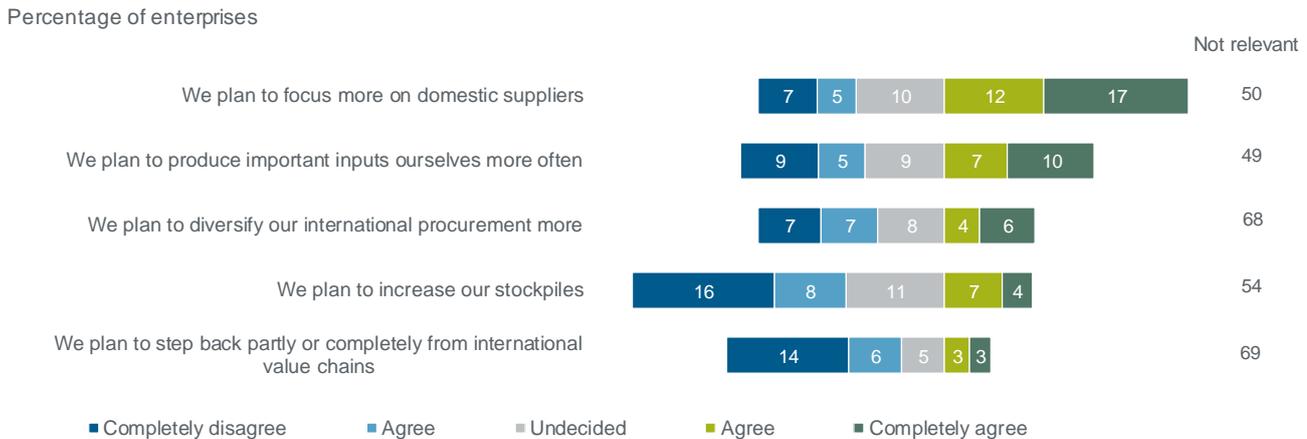
than 20,000 containers, had blocked the canal, holding up several hundred freighters waiting for their passage for many days. Around 13% of global trade traverses the waterway. The losses caused by the one-week blockage are estimated to range between six and ten billion US dollars.¹¹ German value chains also depend on the Suez Canal, particularly in the automotive and mechanical engineering industries. In total, up to 9% of Germany's exports and imports pass through the waterway and around 98% of all container vessels that move between Germany and China sail through it.¹²

The power blackouts in Texas caused by winter storms at the beginning of the year, the fire at a factory in Japan and the most recent drought in Taiwan, which mainly affected the semiconductor industry and have led to a shortage of computer chips, are sure to have further accentuated the issue of value chain relations.

Only some SMEs want to give up cost advantages in exchange for higher resilience

In the SME sector, the resilience of value chains is mainly an issue for manufacturers. It is of relevance for nearly three quarters of enterprises (Figure 10). However, their willingness to give up cost advantages in exchange for greater resilience is very mixed. Around 41% of enterprises want to accept efficiency losses in order to make their supply chains less vulnerable to crises. A further 32% are at least considering this. However, one in four affected SMEs in the manufacturing sector dismiss this.

Figure 11: SMEs want to redefine their value chain relationships



Note: Percentage of enterprises that agree with the corresponding statement with a view to the next five years. Values extrapolated on basis of the number of enterprises.

Source: Supplementary survey to the KfW SME Panel in September 2020.

In other sectors such as construction, but also in trade and services, value chain links are less complex, so resilience is a relevant issue for fewer enterprises. Some of them – up to 41% of service providers – are willing to give up cost advantages in exchange for more resilient value chains. But even in these sectors, a significant share of enterprises opposes adjustments that make their operations less efficient.

There are very clear differences between enterprises of different sizes. The larger the enterprise, the more likely the resilience of value chains is a relevant issue. At the same time, however, the larger the enterprise, the less willing it is to give up cost advantages in exchange for making its own value chain more resilient. Tough competition, especially in international markets, and urgent pressure to earn profits are likely to be the main drivers.

Many businesses want to focus more strongly on domestic suppliers

In realigning their value chains in response to the coronavirus crisis, many SMEs specifically want to focus more on domestic suppliers. Just under 30% of all SMEs plan to proceed in this manner in the next five years, while a further 10% are at least open to the idea.

A domestic focus does not necessarily make their supply chains more crisis resilient, as it makes them more susceptible to regional shocks – including on the sales side. By contrast, a greater diversification of the supplier basis, including in geographical terms, has a risk-reducing effect. It does, however, increase the cost of supplier management. It also reduces the respective purchase quantities and, thus, scope for negotiation with individual suppliers.¹³

Consequently, only 10% of SMEs want a stronger diversification of purchases abroad, while more than 14% oppose this. Many SMEs have no direct relationships with foreign suppliers. The issue of diversifying purchases abroad is therefore not relevant for some 68% of SMEs.

A conceivable response to the experiences of the coronavirus pandemic also consists in reintegrating previously outsourced production stages into the enterprise’s own operations. Around 17% of SMEs want to produce important intermediate inputs themselves in the future. That would make them less dependent on suppliers. But they would still need to source necessary raw materials, including from abroad. At the same time, intermediate input production efficiency would decrease simply because of the reduced scale.

Increasing stockpiles would also make production less vulnerable to supply chain disruptions. Around 11% of SMEs want to take this approach in the coming years. But increasing stockpiles is also associated with higher storage costs, for example for necessary storage areas, but also for the capital tied up in stockpiles. These are probably the key considerations of the approximately 24% of SMEs that oppose increasing their stockpiles. This response was probably also influenced by the experiences of many SME retailers who were stuck with stockpiles of seasonal goods they could not sell as a result of coronavirus-related business closures.

A broad withdrawal from global value chains is not foreseeable

Although some SMEs want to focus more strongly on domestic suppliers, only very few businesses are considering a full or partial withdrawal from international value chains. Only around 6% do not want to rely on global supply chains anymore in the future. By contrast, almost one in five enterprises categorically rule out withdrawing from international value chains. The issue is of relevance for less than one third of SMEs, particularly for larger enterprises in the manufacturing sector.

Outlook

The coronavirus crisis has hit the global economy hard and sent international trade tumbling. Small and medium-sized exporters have been hit particularly hard by the consequences of the pandemic and many have recorded a sharp drop in turnover from international activities. SMEs' international turnover is estimated to have plummeted by 17% or more in 2020 on the pre-crisis year 2019, much more steeply than all of Germany's exports of goods and services.

The experience of the crisis will lead to lasting changes in many areas. This also applies to German SMEs' integration into international markets. Smaller exporters in particular will focus more on the domestic market in the future. Also on the procurement side, SMEs will take a closer look at domestic suppliers. However, it is highly unlikely that there will be a broad retreat from international business. After all, SMEs that are heavily export-oriented and integrated into global value chains recognise the opportunities offered by a geographically diversified sales and procurement strategy. The coronavirus crisis has not eliminated the benefits of the international division of labour. Integration into global value chains enables efficiency gains that contribute to securing the international competitiveness of German enterprises – and thus to growth and prosperity.

Internationally active businesses were hit particularly hard by this global crisis. Their export activities, however, are also likely to contribute significantly to their rapid and comprehensive recovery from this shock. This applies above all to enterprises that place their international operations on as broad a footing as possible. Around 53% of enterprises that plan to diversify their exports more in the future expect their turnover to grow in the next three years. Among the enterprises that want to diversify their international procurement more, that figure is 46%.

Across the SME sector as a whole, however, only 27% of businesses expect their turnover to grow in the medium term. Strong international operations therefore remain an important driver of growth, as do innovation and digitalisation activities.

Nonetheless, there still needs to be a rethink about how international value chain relations can be made not just efficient but crisis resilient in the long term as well. Environmental factors such as extreme weather events and natural disasters caused by advancing climate change poses a particular risk here.¹⁴ This also raises the question how transnational supply chains can be made ecologically sustainable and what frameworks and incentives policymakers need to create here at national, European and global level.

In the coming months, the primary concern for Germany and major trading partners will be to ramp up vaccinations and testing and accelerate the economic recovery. As restrictions are gradually lifted, international trade and, with it, SMEs' international business should pick up again as well. Yet amid the short-term responses required by the pandemic, it is absolutely imperative not to lose sight of the long-term challenges facing international trade and global value chain relations.

KfW SME Panel

The KfW SME Panel (KfW-Mittelstandspanel) has been conducted since 2003 as a recurring postal survey of SMEs in Germany with annual turnover of up to EUR 500 million.

With data based on up to 15,000 companies a 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. As it is representative of all SMEs of all sizes and across all industries in Germany, the KfW SME Panel offers the possibility to conduct projections for micro-businesses with fewer than five employees as well. A total of 9,889 SMEs took part in the current wave.

Analyses of long-term structural developments in the SME sector are performed on the basis of the KfW SME Panel. It gives a representative picture of the current situation and the needs and plans of SMEs in Germany. It focuses on annually recurring information on companies' performance, investment activity and financing structure. This tool is the only way of determining quantitative key figures for SMEs such as investment spending, loan demand and equity ratios.

The basic population used for the KfW SME Panel comprises all SMEs in Germany. These include private-sector companies from all sectors of the economy with annual turnover of not more than EUR 500 million. The population does not include the public sector, banks or non-profit organisations. Currently there are no official statistics providing adequate information on the number of SMEs or the number of people they employ. In order to determine the population of SMEs for 2019 and the population of employees at SMEs in 2019, the German Company Register (Unternehmensregister) and the official employment statistics (Erwerbstätigenrechnung) were used as a starting point for the 2020 survey.

The KfW SME Panel sample is designed in such a way that it can generate representative and reliable data. The sample is split into four groups according to the type of promotion, branch, firm size as measured by the number of employees, and region. In order to draw conclusions on the basic population based on the sample, the results of the survey are weighted. The four main group characteristics are used to determine the extrapolation factors. These factors look at the distribution in the net sample (in line with the four group characteristics) in relation to their distribution in the population as a whole. Overall, two extrapolation factors are determined: an unlinked factor for extrapolating qualitative parameters to the number of SMEs in Germany, and a linked factor for extrapolating quantitative parameters to the number of employees in SMEs in Germany.

The survey is conducted by the Financial Services Division of GfK SE on behalf of KfW Group. The project received expert advice from the Centre for European Economic Research (ZEW) in Mannheim. The main survey of the 18th wave was conducted in the period from 10 February 2020 to 19 June 2020.

Supplementary coronavirus surveys to the KfW SME Panel

The analyses undertaken to determine the effect of the coronavirus crisis on SMEs are based on four supplementary surveys conducted as part of the KfW SME Panel. To this end, the Financial Services Division of GfK SE conducted a representative online survey of SMEs on the current impacts of the coronavirus crisis on behalf of KfW Group (2–14 April 2020, 2–12 June 2020, 1–14 September 2020 and 12–22 January 2021).

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 3,400 enterprises were evaluated in the first survey, from 3,000 enterprises in the second and from 2,800 enterprises each in the third and fourth surveys. As the supplementary survey was linked to the main database of the KfW SME Panel, its results provide a representative picture of the current coronavirus impact.

Further information can be obtained at www.kfw-mittelstandspanel.de.

¹ Calendar- and seasonally adjusted data from the foreign trade statistics of the German Federal Statistical Office.

² Balance of payments of the Deutsche Bundesbank.

³ Federal Statistical Office and Deutsche Bundesbank, own calculations.

⁴ Cf. Köhler-Geib, F., Scheuermeyer, P. and Ullrich, K. (2021): The coronavirus and foreign trade – the crisis accentuates long-term trends, Focus on Economics No. 323, KfW Research.

⁵ In the year 2018 around 74% of SME exporters were also importers; SMEs are businesses with fewer than 250 employees according to the EU definition, Eurostat TEC Database

⁶ Smaller exporters on average supply three different target regions, larger ones six. Cf. Abel-Koch, J. (2017): The world is not a village – geographic proximity to export markets is crucial to SMEs, Focus on Economics No. 182, KfW Research

⁷ Cf. Abel-Koch, J. and Ullrich, K. (2020): Short-term shock with lasting effects: The coronavirus crisis and international value chains, Focus on Economics No. 309, KfW Research.

⁸ Cf. Wagner, J. and Weche Gelübcke, J. P. (2014): Risk or Resilience? The Role of Trade Integration and Foreign Ownership for the Survival of German Enterprises During the Crisis 2008–2010, Jahrbücher für Nationalökonomie und Statistik, Vol. 234(6), p. 757–774. By contrast, during the financial crisis of 2008–2010, import activity was associated with a higher likelihood of survival than export activity. One possible explanation is that a global recession leads to decreases in demand for exporters and, at the same time, improved conditions for importers in the markets for factors.

⁹ Cf. Abel-Koch, J. and Ullrich, K. (2020): loc cit.

¹⁰ Cf. also Caselli, F., Koren, M., Lisicky, M. and Tenreyro, S. (2020): Diversification Through Trade, The Quarterly Journal of Economics, Vol. 135(1), p. 449–502, and Herskovic, B., Kelly, B., Lustig, H. and Van Nieuwerburgh, S. (2020): Firm Volatility in Granular Networks, Journal of Political Economy, Vol. 128(11), p. 4097–4162, They demonstrate that small firms whose business focuses on few customers have higher volatility.

¹¹ See <https://www.rnd.de/wirtschaft/wann-ist-der-suezkanal-wieder-frei-wirtschaft-furchtet-folgen-eines-langeren-staus-HBJQKY2BTMSJZB-CHUITZ5ESUFA.html>

¹² See also an analysis by the Kiel Institute for the World Economy, <https://www.ifw-kiel.de/de/publikationen/medieninformationen/2021/maritimer-handel-stau-im-suezkanal-verschaerft-folgen-der-corona-krise/>

¹³ Cf. Abel-Koch, J. and Ullrich, K. (2020): loc cit.

¹⁴ Cf. Abel-Koch, J. and Ullrich, K. (2020): loc cit. and World Economic Forum (2020), The Global Risks Report 2020.