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International business in times of multiple crises: SMEs achieved a record result in 2022

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International business in times of multiple crises: SMEs achieved a record result in 2022

The long-term consequences of the COVID-19 crisis and the dramatic impacts of Russia's attack on Ukraine created extremely difficult conditions for internationally active SMEs in 2022. And yet: the international turnover of SMEs reached a record high level that year. Aggregate international turnover increased year-over-year by around 14%, or EUR 84 billion, to a nominal EUR 701 billion. And even taking into account the high inflation, that was a decent plus of 8% on a price-adjusted basis.

In the difficult year 2022, international business proved to be a strong pillar for an SME sector that also grew overall. SMEs generated around one in eight euros of their total turnover – a share of 13.2% – outside Germany. On average, internationally active SMEs achieved around 27% of their turnover abroad.

The upturn in international business in 2022 was spread across many shoulders and occurred across the breadth of the SME ecosystem. The number of internationally active firms grew strongly to a total of 879,000 businesses. At 23.1%, almost one in four SMEs was competing internationally, the highest level in 13 years.

At the same time, small businesses increased their internationalisation activities at an above-average rate. The heavyweights of foreign trade continue to be found among large enterprises and industrial SMEs, to be sure. Manufacturing enterprises alone account for 41% of all international turnover generated by SMEs. Nonetheless, it is evident that services businesses are continuously increasing their share in SMEs' international turnover (+8 percentage points since 2010), while industrial SMEs have lost importance (-10 PP since 2010). International business is not immune to the growing tertiarisation of the economy either.

Europe was and continued to be undisputedly the most important sales market. This is where SMEs realised 69% of their foreign turnover. However, they achieved the highest growth rates outside Europe, as was already the case in the previous year. Thus, business outside Europe turned out to be the growth driver in 2022.

The bulk of internationally active businesses rely on direct (69%) or indirect (23%) export activities as a way of serving foreign markets. Entrepreneurial risk, capital requirements and use of resources are largely manageable under this approach. One in five enterprises achieve foreign turnover using digital distribution channels (23%).

Only few enterprises, and mostly large ones, take the extra step to direct investment. In the 2019–2022 period, only around 1.7% of all SMEs made foreign investments to the tune of EUR 10–15 billion. That was around 65,000 of the 3.81 million small and medium-sized enterprises in Germany (2012–2015: 3.5%). By far the most important motive for foreign investment is to tap into new sales markets. Even if individual countries are becoming more attractive for foreign investors, there are no signs that foreign investment by small and medium-sized enterprises will rise sharply in the coming years as a result of increasing site relocations of SMEs.

However, despite the record result, SMEs were again unable to keep up with Germany's total international trade. In 2022, the international turnover generated by German SMEs represented around 35.4% of Germany's total goods and services exports, a share that was around seven percentage points lower than in the past ten years.

Whereas the year 2022 was still characterised by a relatively good overall economic situation (as the effects of the interest rate turnaround were not yet being fully felt), by 2023 the global economic environment began to cloud over. Internationally active businesses are still feeling the pressure, and the global economy and global trade continue to feel the impact of the crises. The global recovery remains subdued. Nevertheless, the start of the year 2024 has shown a budding improvement and optimism. The export activities of German businesses are picking up pace again. The foreseeable interest rate reductions in the course of the year will give new momentum to international demand and stimulate foreign trade. That will also benefit SMEs.

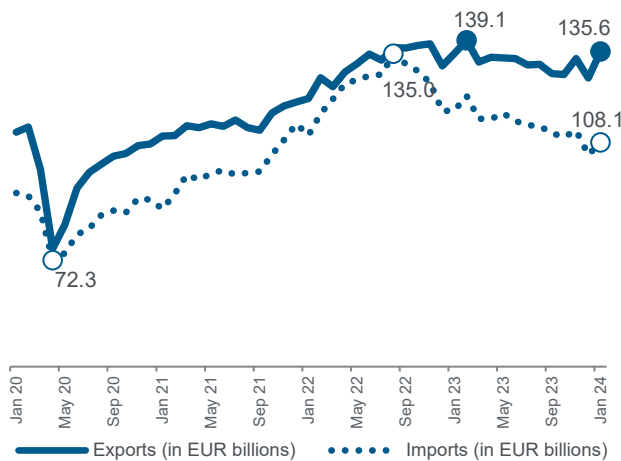
Global trade is recovering in small steps, new impetus expected for foreign trade in 2024

The consequences of the crises are still affecting the global economy and global trade, even if small signs of a recovery are now visible. The forecasts for global trade growth in 2024, for example, currently range from 2.3% (World Bank) to 3.3% (International Monetary Fund¹). These are positive signs, not least because most major economies have proven to be quite resilient even in the face of multiple burdens from geopolitical crises.

Nonetheless, the global recovery remains subdued and global demand for capital goods and intermediate goods is still muted. Already in 2023, Germany's exports had fallen by 1.4% on a calendar and seasonally adjusted basis (nominal: -2.0%).² The low international demand as a result of high inflation rates and the high interest rate level were too much of a burden on the shoulders of businesses. For the year 2024, too, the economic research institutes contributing to the joint economic forecast predicted a decline in exports of 1% in their spring forecast (March 2024).³ However, most recent data shows that a recovery of exports already became apparent at the start of the year (Figure 1). In addition, key interest rate reductions are to be expected globally in the further course of the year, which will encourage investment and exports.

Figure 1: Germany's external trade

Calendar and seasonally adjusted exports and imports.



Source: Destatis.

Hopeful start to the new calendar year for SME exporters

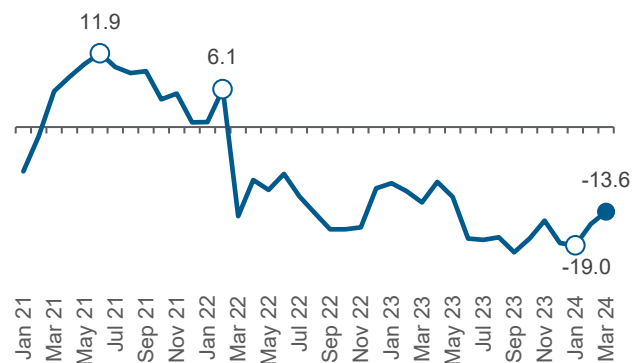
The subdued growth expectations are reflected in the assessments by industrial SMEs in Germany. These have been continuously negative since the beginning of

the Ukraine war in early 2022 (Figure 2), mainly as a result of the accompanying effects of Russia's war of aggression against Ukraine and the energy crisis it triggered. This was compounded by generally dampened growth prospects, high inflation, significantly higher borrowing costs and stubborn supply bottlenecks. In addition, internationally active German enterprises reported rising trade barriers and, thus, growing protectionism in their international business for the year 2022 in particular.⁴ In this context, the ongoing global fragmentation is leading to location competition even among countries with close economic ties, prompting them to focus on strengthening their domestic business sector.

In the past two years, conditions were anything but easy – not just for internationally active SMEs. The export expectations of SMEs (Figure 2) surveyed under the KfW-ifo SME Barometer remained clearly negative throughout all of 2023 (-14.9 on average). Expectations were characterised by pessimism in a long-term comparison at the start of 2024 as well.

However, there is an upward trend at the current margin. Businesses' export expectations have brightened for the second consecutive month already. Thus, from the perspective of internationally more active SMEs, the start to the new calendar year has been a hopeful one.

Figure 2: Export expectations of SME manufacturers captured in the KfW-ifo SME Barometer



Note: Balance (in percentage points) of percentages of positive and negative responses on export expectations for the coming three months (seasonally and mean adjusted). Enterprises are generally classed as small to medium-sized if they employ a workforce of not more than 500 and record an annual turnover not exceeding EUR 50 million.

Source: KfW Research, Ifo Institute.

Despite the dismal mood: SMEs' international turnover reached a record high in 2022

The KfW Internationalisation Report on the situation and development of SMEs' international business in the year 2022 demonstrated that contrary to the dreary mood and the subdued export expectations of companies, which plunged in response to the difficult conditions since the spring of 2022 and have since been very muted, the export turnover of SMEs exhibited a clearly positive trend in 2022. Aggregate international turnover increased year-over-year by around 14%, or by a nominal EUR 84 billion. This strong result must also be seen in light of the generally still good overall economic situation in Germany in the year 2022. Adjusted for price and calendar variations, GDP grew by 2.0%. However, the full impact of the interest rate turnaround has not been priced in here. Thus, the global economic environment already clouded over noticeably in 2023, as reflected in the clearly negative business sentiment up to the current margin (Figure 2).

In 2020, the pandemic had caused German SMEs' international turnover to plunge to EUR 533 billion – the lowest level in more than ten years. Businesses had already recovered well from this shock in the previous year, when they recorded another nominal increase of EUR 84 billion. This strong growth was now repeated in the year 2022. With a total of EUR 701 billion (in nominal terms), the turnover generated abroad was not just significantly above the level of the previous year – which was still marked by the pandemic – but well above the pre-crisis level of EUR 596 billion in the year 2019.

To be sure, the additional turnover from international business must be seen against the backdrop of the extraordinarily high inflation of the year 2022 (+7.9% on average for the year⁵). Even adjusting for prices⁶, however, the growth in turnover for the year 2022 was still respectable. The price-adjusted growth of absolute aggregate international turnover in the SME sector was around 8%. That means inflation was not the sole driver of the growth in turnover. For reasons of comparison, in the following we will predominantly refer to nominal values.

International business is a strong pillar for an SME sector that has grown overall: Companies earn around one in eight euros abroad

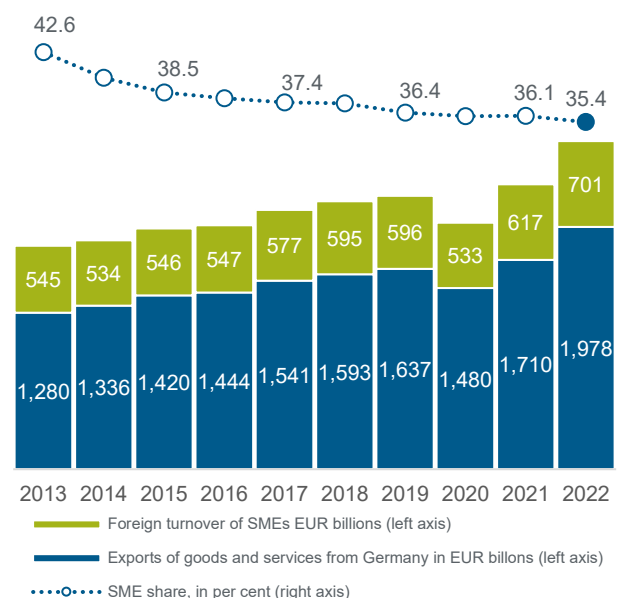
It can be stated that after several rather modest years, international operations again proved to be a strong mainstay of SMEs' business success in 2022. Their internationalisation activities clearly appear to have emerged from the trough caused by the crises.

However, not just the international turnover picked up noticeably in 2022. The general surge in prices also caused SMEs' total turnover to grow strongly, even slightly more than their international turnover. In 2022 their total turnover grew by a nominal EUR 742 billion or +16% on the previous year, reaching a volume of EUR 5,322 billion (2021: EUR 4,580 billion). But even on a price-adjusted basis, the entire SME sector generated additional turnover of 10%. Pronounced pandemic catch-up effects played a particular role here (for example, consumption of hospitality and catering as well as recreational, cultural and entertainment services).

Across all businesses – including those without international activities – the turnover from internationalisation activities thus contributed 13.2% to total turnover volume in the SME sector in 2022. This share was slightly above the level of the pre-crisis year 2019 (12.9%) and significantly above the crisis year 2020 (12.3%) – although the long-term average varies only slightly.

Figure 3: International turnover in the SME sector and Germany's total goods and services trade

Turnover volume in EUR billions (nominal); dotted line: Share of SMEs in per cent.



Source: Destatis, KfW SME Panel 2014–2023.

Germany's total external trade reached a new record level in 2022. SMEs are steadily losing significance

Irrespective of this strong growth in international turnover in 2022 – both nominally and in price-adjusted terms – SMEs could not quite keep up with the overall volume of Germany's external trade (Figure 3). Aggre-

gate exports grew by a nominal 15.7% or EUR 268 billion in 2022. Thus, the value of goods and services exported amounted to EUR 1,978 billion (2021: EUR 1,710 billion).⁷

In a year-over-year comparison, SMEs accounted for around 31% (EUR 84 billion) of the additional aggregate EUR 268 billion in export turnover in 2022. That is a good share ‘by SME standards’. SMEs’ international turnover thus represented around 35.4% of Germany’s total goods and services exports in 2022 (2021: 36.1%). Irrespective of the strong year, SMEs thus were unable to gain any ground – nor did they fall behind much, however. Nonetheless, a moderate upward trend is obvious. In the past ten years, the significance of SMEs for Germany’s total external trade fell by around 7 percentage points.

Non-European business is proving to be a driver of growth

In terms of growth rates, non-European markets turned out to be a stronger driver of international turnover for SMEs in 2022 as well, as they already did in 2021 (Figure 4). After recording a 19% increase already the year before, non-European sales were again strong, growing by 16%. The turnover of SMEs in regions outside Europe increased by EUR 29 billion to now EUR 217 billion. That was also around EUR 26 billion more than in 2019, before the COVID-19 pandemic.

Turnover outside Europe thus continued on the growth trajectory that began already in 2021. This is a good sign, as the collapse in the first COVID-19 crisis year was a particularly steep -17%.

And yet, Europe still ranks first

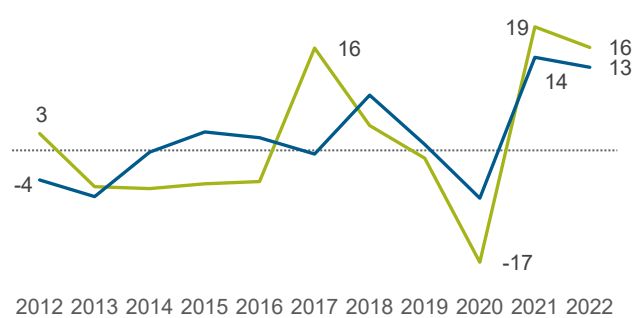
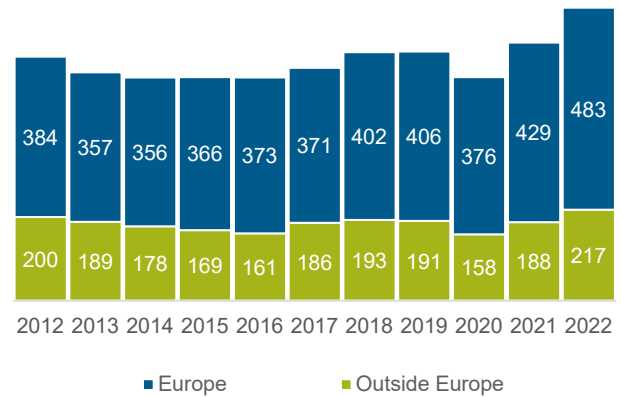
Despite good growth rates in other parts of the world, Europe remains by far the dominant foreign market for small and medium-sized enterprises. SMEs’ turnover in European markets reached a nominal EUR 483 billion in 2022, the highest turnover volume ever achieved by SMEs in Europe. European turnover grew significantly for the second consecutive year, as did non-European turnover, although at a slightly lower rate than the growth outside Europe. In total, businesses generated EUR 54 billion in additional turnover year-over-year within Europe.

In general terms, Europe is undisputedly the most important sales region for SMEs. In the past ten years, turnover in European countries accounted for around

two thirds of SMEs’ total international turnover. In the past three years, that share was even a relatively high 69% to 71%.

Figure 4: SMEs international turnover by region – volumes and growth rates

Top: SMEs’ foreign turnover in and outside Europe in EUR billions
Bottom: Growth rates of international turnover by region and in per cent.



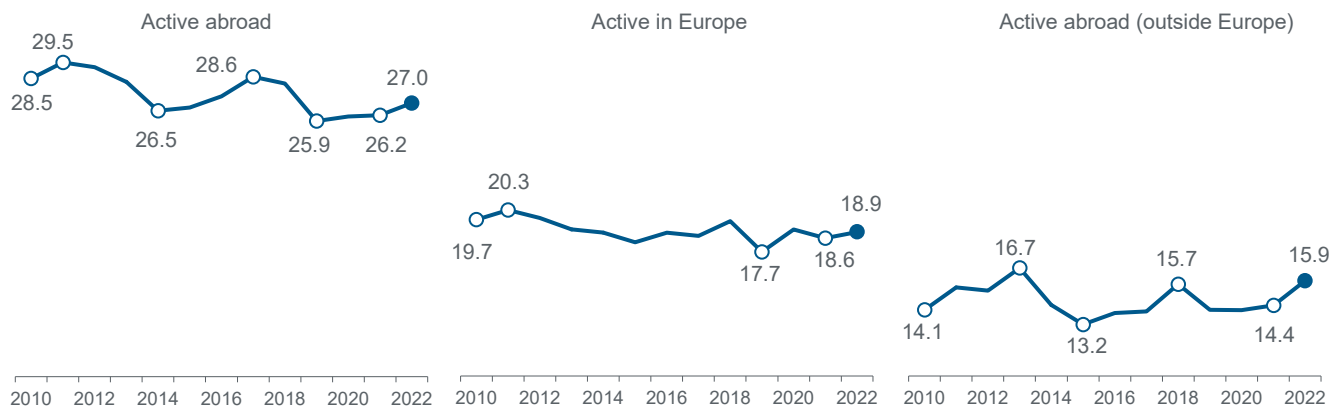
Source: KfW SME Panel 2013–2023.

Contribution of international turnover to business success increased for the third straight year

It is interesting to see what importance international business mainly has for those enterprises that actually operate internationally. There is good news here. The share of international turnover in total turnover of internationally active SMEs has already increased for the third consecutive year (Figure 5). In 2022, internationally active businesses on average generated approx. 27% of their turnover outside Germany. The international contribution may thus be approaching the previous record highs of 28% in the years 2017/2018.

Figure 5: Share of international turnover in total turnover by sales region

In per cent.



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.

Source: KfW SME Panel 2011–2023.

The relatively strong growth of total turnover generated outside Europe is also reflected in the average share of turnover achieved in this region. In 2022, enterprises that were generally active outside Europe generated almost 16% of their total turnover there. That was a considerable rise of 1.5 percentage points. The corresponding contribution to turnover in businesses that were active in Europe increased as well but at a much lower rate of +0.3 percentage points.

International activity increased broadly: More enterprises were internationally active than they have been for a long time

In 2022, not just the absolute volume of international turnover and the average contribution of international business to turnover increased. There were also significantly more internationally active enterprises. The share of SMEs with international turnover grew sharply by 23.1% in 2022 (2021: 20.8%). That was the equal highest in 13 years, on a par with 2009, when 24.6% of SMEs were still active internationally (Figure 6).

In other words: The upswing in international business recorded in 2022 did not originate in few enterprises with very strong growth. Rather, it was spread across many shoulders and occurred across the breadth of the small and medium-sized business ecosystem. Thus, around 879,000 of the 3.8 million SMEs exported their products or services, while a significantly lower number sold them abroad through a foreign sales subsidiary (+89,000 enterprises compared with 2021).

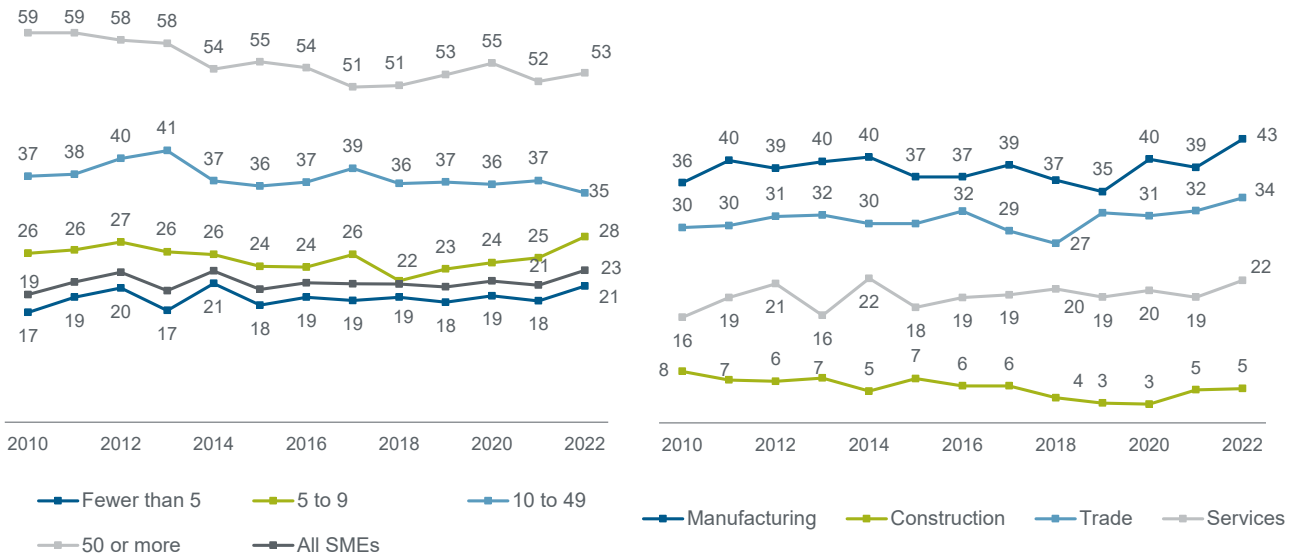
Small businesses significantly increased their degree of internationalisation, but economic weight is concentrated in large SMEs

International activity increased primarily among businesses of the smaller size classes in 2022 (Figure 6, left). Among micro-businesses with fewer than five employees and smaller SMEs with five to nine employees, the share of internationally active businesses grew by three percentage points in each group. Because of their large weight within the SME sector, these two particular size segments determine the increasing degree of internationalisation – 89% of all SMEs alone have fewer than ten employees.⁸

Nonetheless, smaller businesses accounted for only a small share of the volume of international turnover. In 2022, micro-businesses contributed only around 11% of total international turnover with a volume of EUR 75 billion – but with a nominal increase of around 9% on 2021. Among internationally active micro-businesses, the external contribution of internationalisation activity was also on a comparatively high level of 28% on average. The average volume of international turnover, however, was only around EUR 132,000 because of the smaller size of the businesses (long-term average in 2010–2022: EUR 128,000), well below the level of the larger size classes.

Figure 6: Share of internationally active enterprises by size class and sector

Percentages of internationally active businesses, note: Size classes by number of full-time equivalent employees.



Source: KfW SME Panel 2011–2023.

Overall, 53% of larger SMEs were internationally active in the year 2022 (+1 percentage point) and generated 10% more turnover than in 2021. Businesses with 10 to 49 employees were slightly less internationally active, with a share of 35% (-2 percentage points on 2021) but still recorded a nominal growth in international turnover of 22% (plus EUR 36 billion). Taken together, the two largest size classes generated around 84% of the SME sector’s total international turnover.

Strong orientation towards services limits degree of internationalisation in the SME sector

The extremely high share of services enterprises in the SME sector is a major reason that SMEs do not compete more on the international stage and do not have a higher degree of internationalisation. In 2022, services segments alone comprised 77.6% of all SMEs, employing around 75% of all workers in the SME sector. And the importance of the services sector is growing.⁹

Other services play a key role alongside knowledge-intensive services¹⁰ such as architecture or engineering firms, tax or management consultancy services, where 1.5 million businesses alone operate. These include, for example, personal services, catering and hospitality, broad sections of the tourism industry, nursing

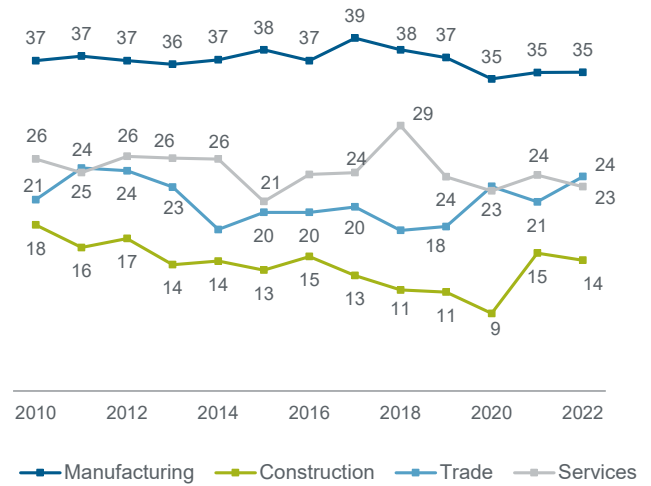
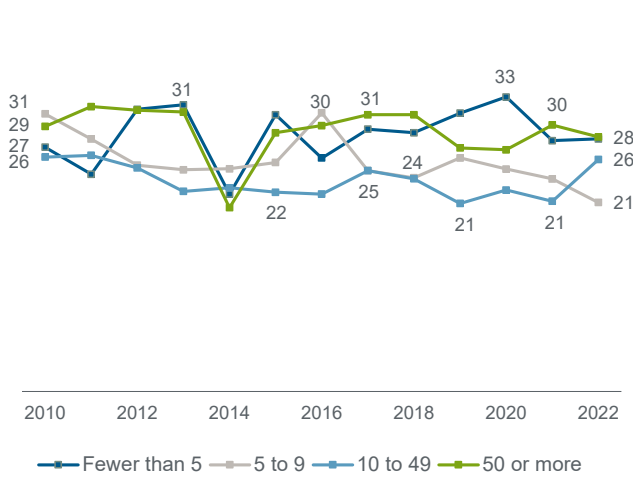
care, training and education as well as arts, culture and sports. A large portion of these enterprises often have a very strong local orientation and offer rather limited potential for internationalisation.

The proportion of internationally active SMEs in services segments increased by three percentage points in 2022 to now 22%. This is a welcome trend, but the gap to trade (34%) and manufacturing (43%) still remains very wide. This is all the more significant as the share of internationally active businesses has reached a new high in each of these two segments. Never before have so many businesses there generated turnover from international activities as in the year 2022.

SME construction firms came in last again. Only 5% of these enterprises generated turnover abroad in 2022. The total turnover of EUR 8 billion represents a share of only 1.1% of total international turnover in the SME sector.

Figure 7: Share of international turnover in total turnover by size class and sector

Average share of international turnover in total turnover in per cent



Source: KfW SME Panel 2011–2023.

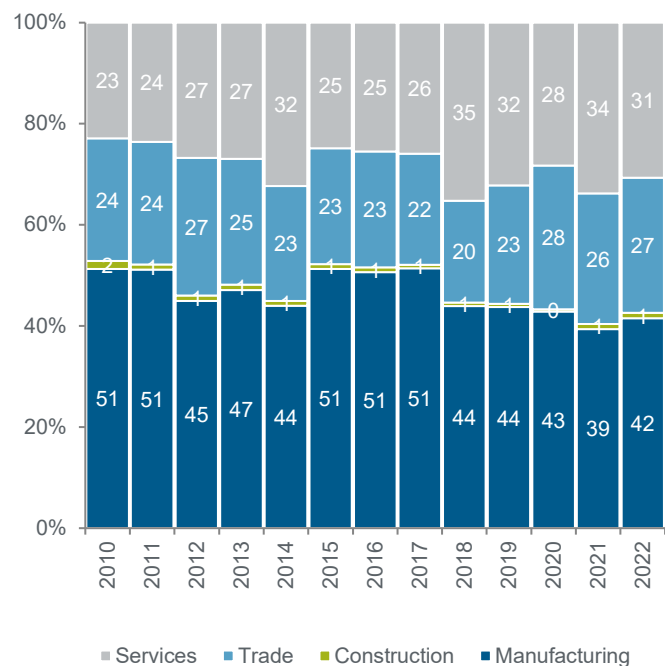
Industrial SMEs have strongest international focus and activities, but services are catching up

The high significance of international business is reflected in the contribution of external trade, and primarily for manufacturing SMEs. Internationally active industrial SMEs generate 35% of their total turnover outside Germany. In 2022, manufacturing enterprises accounted for 41% of all international turnover generated by SMEs – EUR 291 billion. These businesses accounted for a share of 57%, or EUR 48 billion, of the increase of EUR 84 billion in the year 2022.

From a longer-term, structural perspective, however, it is also evident that services enterprises are expanding their relative importance for SMEs' overall international business – irrespective of their less pronounced international orientation (Figure 8). Since the year 2010, their share has grown from 22% to now 31% in total international turnover. At the same time, manufacturing is 'losing weight', dropping from 51% then to now 41%.

Figure 8: Share of sectors in SMEs' total international turnover

Sectoral shares in per cent.



Source: KfW SME Panel 2011–2023.

Exports dominate the distribution channels of small and medium-sized enterprises

Business size and field of activity essentially determine the external interlinkages of enterprises. Of course, this applies first and foremost to the degree of international activity. But the type of international activity also depends to a great extent on the size of the enterprise and the sector in which it operates (Figure 9).

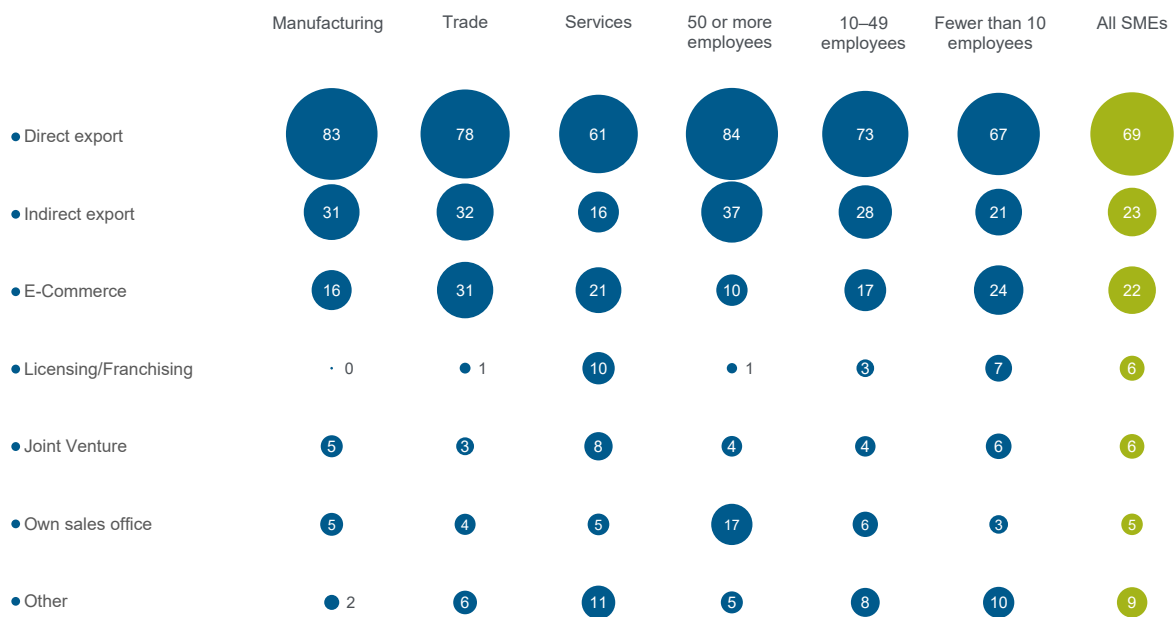
Direct exports are by far the most important distribution channel for small and medium-sized enterprises. It is used by 69% of internationally active SMEs alone. In the manufacturing sector it is even 83%. The reasons for the great importance of direct export activities are obvious: The entrepreneurial risk of exporting is relatively low compared with establishing a sales subsidiary. Export activities – especially when setting up international business – can usually be carried out with a low input of capital. They also require less in-depth knowledge of the foreign market, and the human resources requirements are usually moderate (at first). This distribution channel therefore has advantages for smaller businesses. Cross-border trade relations through the direct export of goods and services are therefore the norm for many internationally active SMEs. And this applies to both regionally and culturally closer European markets and non-European markets (Figure 10).

Alongside the option of direct export, in which the exporter directly takes charge of selling the goods and services in the target market, the indirect sale of exported goods also plays a crucial role for a number of enterprises. A total of 23% of internationally active SMEs use the channel of indirect exports. This involves selling their own products or services through a German intermediary (for example, a foreign trade company) in the relevant target markets. This strategy reduces risks, the need for comprehensive knowledge of the external markets, the effort of market cultivation and, not least, the need for capital (no stockpiling, no need to establish contacts with purchasers, etc.). Supplying slightly more remote sales markets in this way is therefore a plausible choice (Figure 10).

Indirect export activities are rather less relevant than average in the case of services enterprises (16%). These businesses often require personal interaction with the final customers. The mode of indirect exports is used roughly twice as often by manufacturing SMEs (31%) and larger SMEs with 50 and more employees, where the figure is even 37%. This is obvious because as the size of the enterprise increases, so, too, often does the number of target markets, so that direct exports to all foreign markets are possible only with a high input of resources.

Figure 9: Use of different international distribution channels

Share in all internationally active SMEs in per cent



Source: KfW SME Panel 2022.

One in five businesses generate foreign turnover using digital distribution channels

E-commerce as a distribution channel ranks almost equal third as a mode of serving international markets.¹¹ This includes digital marketplaces, online shops, procurement platforms and automated data exchange between businesses, for example. Around one in five internationally active enterprises uses this distribution channel (22%). The share of internationally active SMEs using e-commerce is 23%, almost exactly the same as for the entire SME sector in 2022 (here: enterprises that generated turnover using e-commerce). In the period under review, EUR 290 billion was earned by SMEs in Germany and abroad using digital distribution of goods and services, which represented around 5.5% of their total turnover. Assuming that this ratio also applies for the sub-segment of international turnover, that would translate into around EUR 39 billion in international turnover generated by SMEs via e-commerce in 2022.

Pandemic-induced restrictions, in particular, provided a significant boost to digital distribution channels. Businesses were often able to prevent a sharper decline in turnover or mitigate turnover losses by shifting to, adding or expanding digital distribution channels. Today e-commerce plays a key role as an important element for generating turnover in many small and medium-sized enterprises. The gradual consolidation of the 'digital sales pathway' is likely to increase as a mode of serving international markets as well. It is likely to gain in importance. At present, smaller enterprises with fewer than ten employees and retail and wholesale SMEs use e-commerce at a disproportionately high rate.

In general terms, the issuance of licences and franchising models for serving international markets play a role only for smaller businesses with fewer than ten employees and services businesses. Only around 6% of internationally active SMEs use this type of distribution channel. The same applies to joint ventures (6%) and to the establishment of own foreign sales subsidiaries (5%). Large SMEs, however, use the latter distribution channel at a disproportionately higher rate.

Foreign direct investment is generally very uncommon for SMEs and declined again in the pandemic

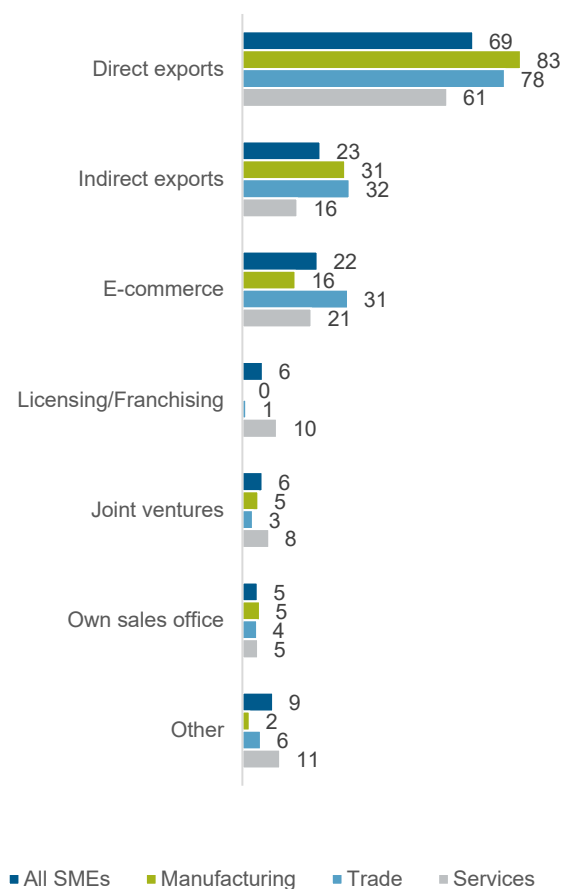
The general public primarily associates SMEs' internationalisation activities with exports. Enterprises can also be internationally active by making direct investments. However, it is usually only larger enterprises that already have (long and intensive) experience and knowledge as exporters that commit to a direct

investment.

Unlike exports, direct investments involve higher expenditure and risks for businesses. For example, the need to tie up larger amounts of capital for a longer term increases the financial risk compared with export activities. Furthermore, direct investments are often more worthwhile than exports only when export costs are high. For example, businesses opt to establish an own sales subsidiary significantly more often for non-European sales markets (Figure 10).

Figure 10: Use of various distribution channels by target region

Share in all internationally active SMEs in per cent.



Source: KfW SME Panel 2022.

There can be many motives for foreign investment. Long transport distances, high export volumes, existing trade barriers and exchange rate influences can play a role. Lower production costs and market access, as well as more broadly the ability to benefit from the locational advantages of foreign markets should not be underestimated either (see also Figure 13 and the relevant statements in this report).

Thus, foreign investment is an expression of long-term,

strategically oriented business decisions. Foreign investment comprises, among other things, the establishment, expansion or modernisation of an own production or distribution facility outside Germany or a participation of at least 10% in foreign enterprises.¹²

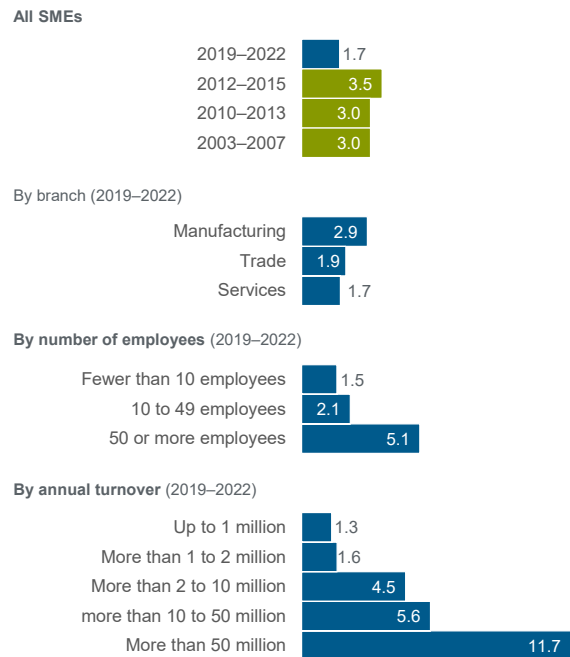
The already low share of small and medium-sized enterprises with cross-border investments fell yet again during the COVID-19 crisis. In the 2019–2022 period, only around 1.7% of all SMEs made foreign investments. That was around 65,000 of the 3.81 million small and medium-sized enterprises in Germany. During the 2012–2015 period, that share was still around 3.5%. In other words, the number of businesses that undertook foreign investments was twice as high, at nearly 130,000. The corresponding share was 3% in each of the two earlier periods. The overall volume of SMEs' foreign investment during the 2019–2022 period can be estimated at EUR 10 to 15 billion and is thus on a similar scale as it was in 2012–2015.¹³

Only larger SMEs are likely to carry out foreign investments more often (Figure 11). This is mostly due to the enormous human and financial resources required by such investments. It is generally not worthwhile for companies that generate only limited production and sales quantities to distribute them across multiple locations. It is obvious that foreign investment is a mode for serving foreign markets that SMEs generally use to a very limited extent. Moreover, against the backdrop of the ongoing debate around a possible advancing deindustrialisation of Germany, at the current margin there continues to be a persistently weak tendency among SMEs to relocate business activities abroad.

The trend towards foreign investment is likely to remain on a similar high (or low) level in the future as before the pandemic. Thus, not more than 3.8% of all 3.81 million SMEs in Germany plan to invest abroad in the next three to five years. Even if individual countries are becoming more attractive for foreign investors, there are no signs that foreign investment by small and medium-sized enterprises will rise sharply in the coming years as a result of increasing site relocations of SMEs.¹⁴

Figure 11: Share of SMEs with foreign investments

In per cent.



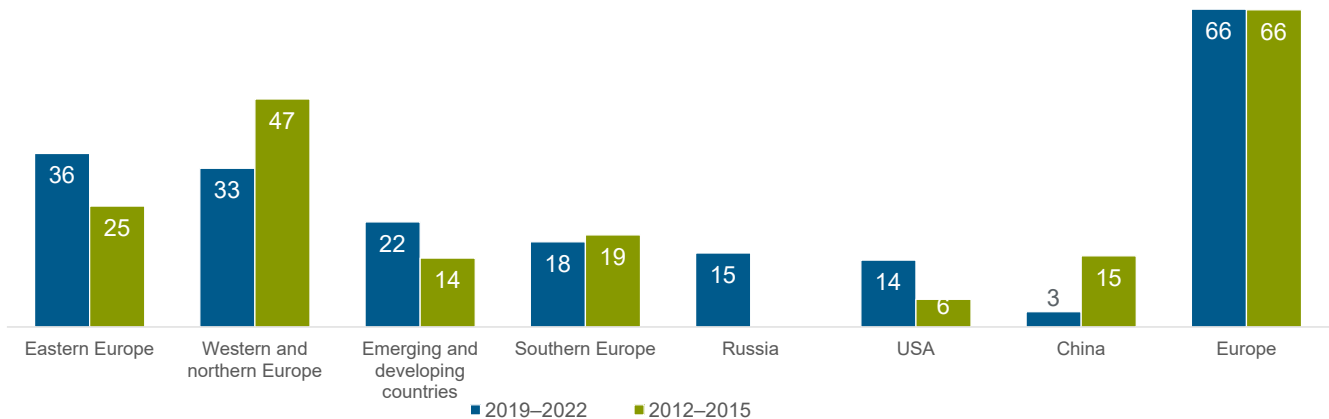
Source: KfW SME Panel.

Europe dominates, China loses, US wins

Europe is and remains the most important target region for cross-border investment by German SMEs. Around two thirds of all small and medium-sized enterprises that invested abroad in the 2019–2022 period invested in Europe (Figure 12). Eastern Europe has continued to gain in importance as an investment destination for SMEs. Poland, in particular, with its growing transport infrastructure, abundant supply of highly qualified skilled workers and dense network of suppliers has evolved to become an attractive production location directly bordering on Germany. Western and northern Europe, on the other hand, has become less attractive as an investment destination. Not least, this can likely be traced to Brexit, which was completed in early 2020.¹⁵ Southern Europe remains the destination for around one in five foreign investors.

Figure 12: Target regions of SMEs' foreign investment

Share of all SMEs with foreign investment for the relevant target region, in per cent



Note: Multiple responses were possible. Europe comprises the target regions of eastern, western, northern and southern Europe.

Source: KfW SME Panel 2023

Also worth noting is China's lower importance as an investment destination for SMEs. Just barely 3% of all SMEs that invest abroad have established or modernised production or distribution locations in the country or acquired a participation in Chinese companies (-12 percentage points compared with 2012–2015).¹⁶ The US, on the other hand, has gained in attractiveness. More than 14% of all SMEs that invested in the 2019–2022 period did so in the US (+8 percentage points compared with 2012–2015). In addition to high sales potential, the main advantage of the US is lower energy costs compared with many European countries.¹⁷ At the same time, the US has set targeted incentives for investment by foreign companies in the US with its Inflation Reduction Act.

Some 15% of the 65,000 SMEs invested in Russia in the past four years, a proportion that mainly reflects the situation prior to the outbreak of the war in Ukraine and is likely to have decreased substantially since then, not least as a result of the state sanctions imposed by the EU and retaliatory measures by Russia.

Main purpose of foreign investment is to open up new sales markets

By far the most important motive for foreign investment is to tap into new sales markets. This was one of the key motives for around 60% of all businesses that

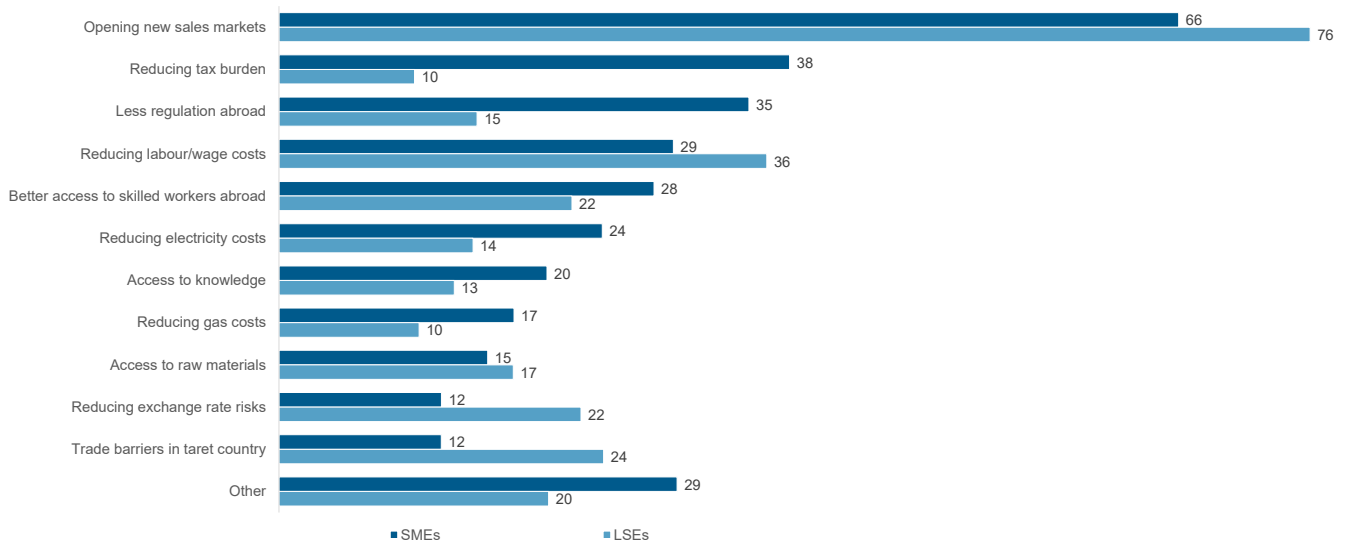
invested abroad during the 2019–2022 period (Figure 13). Accessing new markets is also an important motive for around two thirds of businesses that want to invest abroad in the future. This shows that investment activity in the SME sector is clearly driven by the desire to grow. Given that Germany is the world's second largest exporter of environmental and climate-smart goods, the green transition is likely to play a role here.¹⁸

Lower tax burden and less regulation

While growth motives are clearly paramount, some SMEs also invest with the aim of reducing their tax burden. This is an important motive for 38% of all businesses that plan to invest. A similar proportion – 35%, to be precise – are hopeful that shifting some of their activities abroad will result in a lower burden from regulatory requirements. This does not allow conclusions as to what requirements enterprises in Germany regard as particularly onerous. Labour market regulations, environmental and climate requirements, but also the new German Act on Corporate Due Diligence Obligations in Supply Chains, for example, could play a role here. The fact that they perceive taxes, levies and red tape as risks for SMEs' future competitiveness at their German location was also highlighted by the KfW Internationalisation Report 2023.¹⁹

Figure 13: Tapping into new markets is the predominant motive for investing abroad

Share of enterprises for which the aspect listed is a key motive for investing abroad as a percentage of all enterprises that planned or completed foreign investments in the 2019–2022 period.



Source: KfW SME Panel 2023.

Lower labour costs and improved availability of skilled workers

Reducing labour costs is a key motive for around three in ten SMEs that plan to invest abroad in the next three to five years. This cost motive is likely to play an important role particularly for investments in eastern Europe.²⁰

Not only do many of these countries have lower labour costs, they also provide access to skilled workers. The share of highly skilled workers – university graduates as well as individuals with qualifications such as master craftsman or technician – has grown significantly in almost all EU countries in the past years.²¹ At the same time, while the shortage of skilled labour is also a growing problem in most EU countries, it is not nearly as pronounced yet as in Germany.²² And for some investors, this also matters. Around 29% regard the improved availability of skilled workers as a major reason for their planned foreign investment.

Energy costs are not among the main drivers

Reducing electricity costs is a major motive for only one in four businesses, and lowering gas costs even for only one in six enterprises with cross-border investment plans. To be sure, reducing energy costs – especially electricity costs – plays a more important role for companies that want to invest abroad in the coming years than for those that invested abroad during the 2019–2022 period. But it is not among the main drivers of foreign investment by SMEs. This is likely due to the fact that SMEs broadly regard energy costs as manageable and most of them do not perceive them as a serious disadvantage in international

competition.²³ Other studies have also come to the conclusion that energy costs are not among the key drivers of location decisions, although they are important for individual energy-intensive industrial segments such as the metal or basic chemicals industry.²⁴

Access to expertise – and raw materials

For around 20% of all SMEs with cross-border investment plans, access to expertise is also an important motive. This applies to services businesses, which can expand their knowledge and skills by taking over or acquiring an interest in a foreign business, but also for manufacturing SMEs as a way to access new production technologies. On the other hand, access to raw materials – a major motive for around 15% of investment planners – is relevant primarily for manufacturing enterprises.

SMEs have a strong foundation but are well advised to work harder to maintain and expand their competitiveness

SMEs have demonstrated that they are able to successfully perform in international markets even in the face of multiple crises. The foundation for their international business to continue evolving positively appears to be secured, especially since international demand is likely to pick up again in the foreseeable future, which is likely to benefit small and medium-sized enterprises in Germany as well.

However, it is rarely a good idea to rest on one's laurels. In the long term, how well SMEs succeed in asserting themselves over foreign competitors will be

crucial. This goes for all companies that compete internationally – for those with international operations and for those with no international business of their own, which are impacted by competitive pressure from imports. German SMEs see themselves as performing well in many aspects.

Qualified workers, the positive image of Germany as a business location, the degree of innovation and the quality of products and services as well as the costs of labour, raw materials, intermediate products and energy – these are all points in which SMEs regard themselves as being well-positioned.²⁵

But there are weaknesses, too. Businesses see bureaucracy, taxes and charges as well as environmental and climate action requirements at the German location as risks to their competitiveness. And many SMEs are also behind in price competition and digitalisation.²⁶

The specific approaches to shaping the conditions for maintaining and expanding the international competitiveness of German enterprises are obvious. Policy-makers and businesses continue to be equally called upon to take action. Reducing bureaucracy, addressing the skilled labour shortage and digitalisation efforts are likely among the agenda items.

KfW SME Panel

The KfW SME Panel (KfW-Mittelstandspanel) has been conducted since 2003 as a recurring postal survey of small and medium-sized enterprises 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 11,328 SMEs took part in the current wave.

The KfW SME Panel is used as the basis for analyses of long-term structural developments in the SME sector. It provides 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 provides a unique 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 2022 and the population of employees at SMEs in 2022, the German Company Register (Unternehmensregister) and the official employment statistics (Erwerbstätigenrechnung) were used as a starting point for the 2022 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: type of promotion, branches, 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/extrapolated. 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 GfK GmbH 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 21st wave was conducted in the period from 6 February to 16 June 2023.

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

¹ International Monetary Fund (IMF) (2024), Word Economic Outlook Update, January 2024, <https://www.imf.org/-/media/Files/Publications/WEO/2024/Update/January/English/text.aspx>

² Federal Statistical Office (Destatis) (2024), Exports in December 2023: -4.6% on November 2023, press release No. 044 dated 5 February 2024, Wiesbaden.

³ Projektgruppe Gemeinschaftsdiagnose (2024), Gemeinschaftsdiagnose #1-2024. Spring 2024: Deutsche Wirtschaft kränkelt – Reform der Schuldenbremse kein Allheilmittel (*German economy is ailing – debt brake reform is not a cure-all* – our title translation, in German), Kiel.

⁴ Association of German Chambers of Industry and Commerce (2003), Going International 2023 Erfahrungen und Perspektiven der deutschen Wirtschaft im Auslandsgeschäft – Ergebnisse einer Unternehmensumfrage (*Going International 2023 – experiences and perspectives of German companies in international business – results of a business survey* – our title translation, in German), Berlin.

⁵ Federal Statistical Office (Destatis) (2023), Inflation rate was +7.9% in the year 2022, Press release No. 022 of 17 January 2023, Wiesbaden.

⁶ There is no general deflator for aggregate turnover volume or a general price index that could be applied to turnover volume in the business sector. The Federal Statistical Office uses different deflators for various economic sectors or segments, and some of them are very detailed. There are very few possibilities for making such a distinction on the basis of the KfW SME Panel. For this reason we applied the deflator of gross domestic product to adjust SME turnover for prices.

⁷ Federal Statistical Office (Destatis) (2024), foreign trade. Total development of German foreign trade from 1950 (preliminary results), as at: 18 March 2024, Wiesbaden.

⁸ Schwartz, M., and Gerstenberger, J., (2023), KfW SME Panel 2023: SMEs' resilience is being put to the test. So far, they have come away with few bruises, but now they are increasingly nervous, KfW Research.

⁹ There are many different causes for the overall shift towards services. One of them is outsourcing or contracting of what were previously in-company services to third-party companies (for example, IT maintenance, data storage, personnel recruitment, legal affairs and tax matters). Another factor is that structural developments have created an increased demand for services for some time now (driven by demographic change and the growing proportion of small households, for example).

¹⁰ Knowledge-intensive services comprise service subsectors with an above-average share of university graduates in total employment, or services with a strong focus on technology. 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)'.

¹¹ The German Federal Statistical Office defines e-commerce as the buying and selling of products and services through electronic networks, especially via the internet or an EDI (electronic data interchange between computer systems of different enterprises). In order to count as e-commerce, the activity must involve ordering products or services using these electronic networks. Payment and delivery can be made using conventional means. A large portion of e-commerce involves automated transmission and further handling of recurring and easily predictable orders as part of business processes between enterprises.

¹² It does not include the acquisition of purely financial assets such as bonds or shares.

¹³ This means the average investment budget has grown since the period before the COVID-19 crisis. Compared with the total foreign direct investment made by German businesses, which amounted to around EUR 196 billion in 2022 alone, SMEs' foreign investment volume remains low. It also continues to play a minor role compared with SMEs' overall investment volume – around EUR 754 billion in the 2019–2022 period.

¹⁴ The share of businesses that ultimately invest abroad is likely to remain even below 3.8% because not all of them will actually realise their investment plans for the coming years.

¹⁵ Planning and legal uncertainties have led to a retreat of many European businesses from the United Kingdom and to a slump in foreign direct investment in the country that used to be the preferred investment destination in the EU. Cf. Matthes, J. (2018): Brexit führt zu Investitionsschwäche im Vereinigten Königreich (*Brexit leads to investment weakness in the United Kingdom* – our title translation, in German), IW Short Report 44/2018 and, without author (2023): Sieben Jahre Brexit-Referendum: Der Brexit ist ein wirtschaftliches Desaster für beide Seiten des Kanals (*Seven years of Brexit referendum: Brexit is an economic disaster for both sides of the Channel* – our title translation, in German), WirtschaftsWoche of 22 June 2023

¹⁶ The COVID-19 crisis has made the country less attractive. Its economic development has fallen behind expectations, while geopolitical tensions have further escalated. The supply chain disruptions of past years have prompted many companies to reassess their value chains and reduce their economic dependence on China by diversifying their supply chains. Furthermore, state subsidies for domestic enterprises and strict regulation of market access for foreign investors in China create unequal competitive conditions that make it difficult for smaller German SMEs in particular to gain a foothold there. – Cf. GTAI (2023): Ist weniger China bald mehr? (*Is less China soon more?* – our title translation, in German) and GTAI (2023): Deutsche Unternehmen haben es in China zunehmend schwer (*German businesses face growing difficulties in China* – our title translation, in German)

¹⁷ German Council of Economic Experts on Economic Development (2022): Managing the energy crisis in solidarity and shaping the new reality, Annual Report 2022/23

¹⁸ Abel-Koch, J. and Brüggemann, A. (2023): Großunternehmen halten Klimaneutralität und Wettbewerbsfähigkeit für vereinbar (Large enterprises regard climate neutrality and competitiveness to be mutually compatible – in German), Economics in Brief No. 26, KfW Research.

¹⁹ Abel-Koch, J. (2023): KfW Internationalisation Report 2023 – Many SMEs currently perform better than their foreign competitors but see need for action to secure their future competitiveness, KfW Research.

²⁰ See also Abel-Koch, J. (2016): SMEs' value chains are becoming more international – Europe remains key, Focus on Economics No. 137, KfW Research.

²¹ Geis-Thöne, W. (2023): Bildungsstand der Bevölkerung im europäischen Vergleich (*Education level comparison between EU countries* – our title translation, in German), IW-Report 3/2023

²² Cf. Peichl, A., Sauer, S. and Wohlrabe, K. (2022): Fachkräftemangel in Deutschland und Europa – Historie, Status quo und was getan werden muss (*Skills shortages in Germany and Europe – history, status quo and what needs to be done* – our title translation, in German), ifo Schnelldienst 75/2022.

²³ Abel-Koch, J. (2023): KfW Internationalisation Report 2023 – Many SMEs currently perform better than their foreign competitors but see need for action to secure their future competitiveness, KfW Research.

²⁴ Bialek, S., Schaffranka, C. und M. Schnitzer (2023): Kein Grund zur Panik: Die Energiekrise ist kein Game Changer, aber sie beschleunigt den ohnehin anstehenden Strukturwandel in der Industrie (*No reason to panic. The energy crisis is not a game changer, but it does accelerate the already imminent structural transformation in industry* – our title translation, in German), ifo Schnelldienst 3/2023.

²⁵ Abel-Koch, J. (2023): KfW Internationalisation Report 2023 – Many SMEs currently perform better than their foreign competitors but see need for action to secure their future competitiveness, KfW Research.

²⁶ Abel-Koch, J. (2023): KfW Internationalisation Report 2023 – Many SMEs currently perform better than their foreign competitors but see need for action to secure their future competitiveness, KfW Research