KfW SME Panel 2014

SMEs feeling the impact of weak growth in Europe, and bracing for harder times ahead

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In 2013 small and medium-sized enterprises (SMEs) again demonstrated the key role they play in the German economy, but proved unable to escape the effects of zero growth in Germany and Europe. SMEs enjoyed no growth advantage in relation to GDP. There is no prospect of a sustainable recovery from the previous year's somewhat tense situation. SMEs continue to play a waiting game.

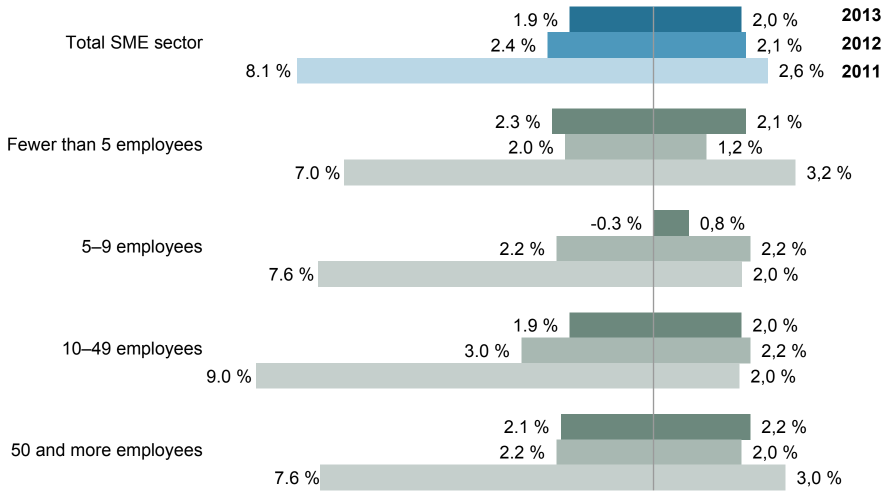
Turnover and *employment* are rising. However, growth rates are falling for the second time in a row and remain below growth in GDP. There is not a single segment that is returning to its former strong growth. *International activities* are being dealt a tangible blow. Europe above all is losing momentum, while the number of firms operating abroad and the amount of turnover achieved abroad are decreasing, particularly in the manufacturing industry.

Nonetheless, *profitability* is robust overall and even on the rise. In most cases, profits are being retained by companies as financial assets. Reserves are being expanded further. *Equity* is repeatedly increasing.

Loan demand is picking up visibly. It is more and more the case that larger volumes are being requested by companies. The credit supply gap is virtually zero. However, *investments* have yet to benefit from this. The volume is decreasing slightly and remains at about the previous year's level. Investment in expansions is down.

Outlook: Business expectations are currently being revised slightly downwards. There is little probability of higher growth: no revival in investment is foreseeable for 2014. SMEs have concerns regarding falling sales prices and demand. On the other hand, the consequences of the conflict in Ukraine are as yet unclear.

Figure 1: Annual turnover growth (left) and employment growth (right) 2011 to 2013 by size category in the SME sector



Notes: Extrapolated with the number of employees. Extrapolations include other industries. Missing information about the number of employees was imputed.

Source: KfW SME Panel 2012–2014.

Turnover dynamic still weak in 2013

In 2013, the growth rates for SMEs' turnover across almost all size categories and sectors continued the trend of the poorer figures of the previous year and declined further: the growth rate for turnover was 1.9 % on average. It contracted by a fifth versus the previous year.

This meant that the development of turnover lagged behind nominal GDP growth (2013: 2.2 %). This has only occurred once in the last ten years, specifically in the crisis year of 2009. No segment managed a return to the strong growth experienced in 2011 (figures 1–2). On average, smaller SMEs with between five and nine employees even had to accept a slight drop in turnover.

In view of the stagnation in Germany, one positive feature is the consistent nature of SME growth rates, albeit at a low level (see the extensive documentation in *Tables for KfW SME Panel 2014*[1]). In light of the increasing competitive pressure from abroad[2], the economic weakness of key sales markets and uncertainty that remains high, this is a good result all in all.

Turnover decreases primarily abroad – SMEs less active internationally

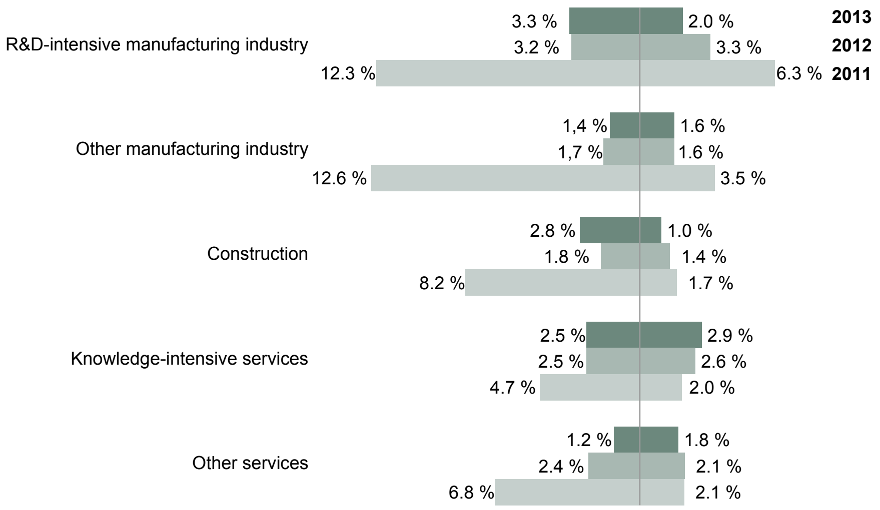
Germany's SMEs feel well-equipped for global competition as the KfW Competition Indicator demonstrates.[3] The international activities of SMEs nevertheless came under slight downward pressure in 2013.

Following two consecutive periods of growth, the number of SMEs operating abroad (figure 3) fell significantly by three percentage points: 19.9 % of companies were active in foreign markets (2012: 22.8 %). In total, 720,000 SMEs generated sales abroad. At the same time, international turnover is repeatedly decreasing, with a palpable minus of near on 7 %. In 2012 the volume of foreign sales was EUR 584 billion, while in 2013 a mere EUR 545 billion was generated abroad (2011: EUR 597 billion). The international activities of SMEs reached 28.3 % of their overall turnover abroad (2012: 29.2 %). This proportion had not been so low since 2008.

As a comparison, Germany's total exports fell by just 0.2 % in 2013. Accordingly, SMEs lost rather a lot of ground. The traditionally very internationalised R&D-intensive manufacturing industry[4] (for example, mechanical engineering) is particularly affected. In the last two years, the proportion of internationally active enterprises in this segment decreased by 5 %. With an 18 % drop in the volume of foreign trade in 2012, a further decrease of 14 % was recorded for 2013.

These SMEs in particular are extremely important to Germany's competitiveness.[5]

Figure 2: Annual turnover growth (left) and employment growth (right) 2011 to 2013 by sector



Notes: Extrapolated with the number of employees. Extrapolations include other industries. Missing information about the number of employees was imputed.

Source: KfW SME Panel 2012–2014.

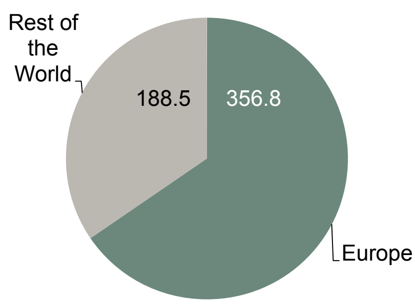
Europe above all is struggeling ...

In the previous year, total foreign turnover fell moderately by 2 %. A greater decrease was seen for 2013. The relatively weaker tendency of German SMEs[6] compared to other countries to focus on international trade had notable consequences in 2013 owing to the economic weakness of the eurozone.

- Turnover generated elsewhere in Europe shrank by EUR 27 billion to EUR 357 billion (figure 4).
- Year-on-year, 2 % fewer SMEs were active in Europe (figure 5).
- Europe's share in international turnover of SMEs fell for the third time in a row to 65 % (figure 5).

Figure 4: Sales generated abroad 2013

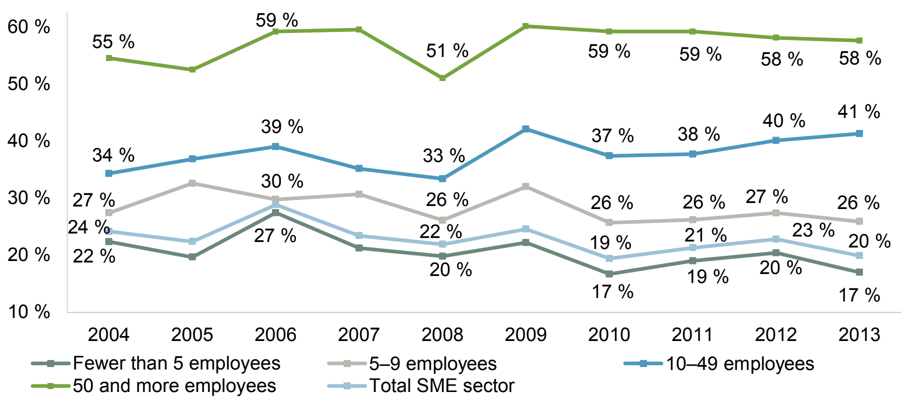
Figures in EUR billion



Source: KfW SME Panel 2014.

Figure 3: Share of companies active abroad

Size classes by full-time equivalent employees

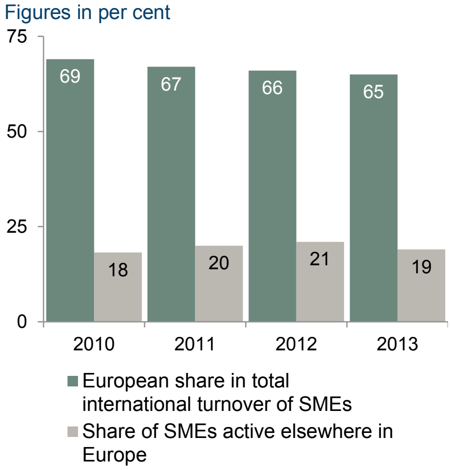


Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2005–2014.

Figure 5: SMEs in Europe

Figures in per cent



Source: KfW SME Panel 2011–2014.

Employment growth in Germany repeatedly created by SMEs alone

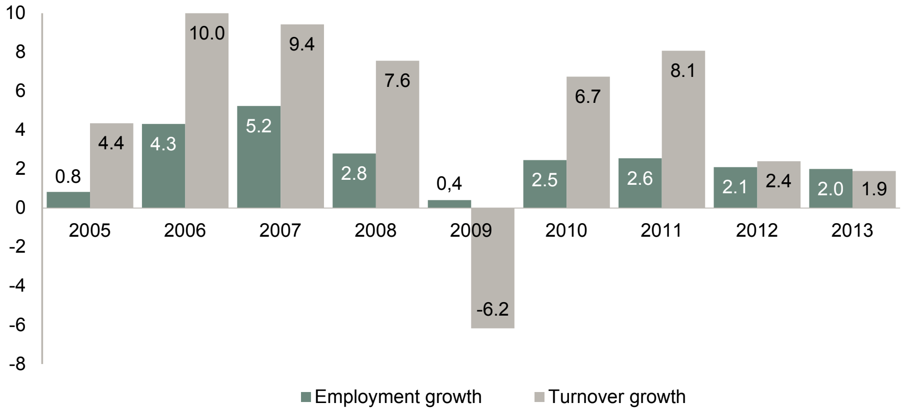
The labour market in Germany is stable. At 41.8 million people, the number of people in employment reached the highest level ever in 2013.[7] Of these, 28.6 million worked for small and medium-sized enterprises (+1.9 % on 2012). Employment at SMEs thus rose more sharply than in the economy as a whole (+0.6 %). The share of all those in employment correspondingly increased slightly to 68.3 %. While large companies and the public sector saw a decrease of about 1.7 % in the workforce (-226,000 people), around 522,000 more workers were employed at SMEs than had been in 2012. After a slight phase of weakening the previous year, SMEs consequently accounted for the entire growth in 2013 of 296,000 employees.

SMEs also continue to be a guarantor of the success of the dual training system in Germany. In 2013, 87 % of all trainees started their training in SMEs[8], the highest figure ever (10 percentage points up on in 2005).

The average growth rate for full-time equivalent employees[9] in 2013 was 2.0 % and consequently at about the same level as the previous year (2012: 2.1 %). When divided up into segments, the results are mixed. Knowledge-intensive services[10] saw the highest growth, reaching +2.9 %. This may be seen as a reflection of the knowledge-based society and of an increasing tertiarisation of the economy (for example, through the outsourcing of formerly internal departments). On the other hand, it also indicates the high domestic-market orientation of this segment. It can therefore be concluded that low European growth momentum is less relevant.

Figure 6: Annual growth rates of employment and turnover

Figures in per cent



Notes: Extrapolated with the number of employees. Extrapolations include other industries. Missing information about the number of employees was imputed.

Source: KfW SME Panel 2006–2014.

Overall rise in productivity, losses among small SMEs

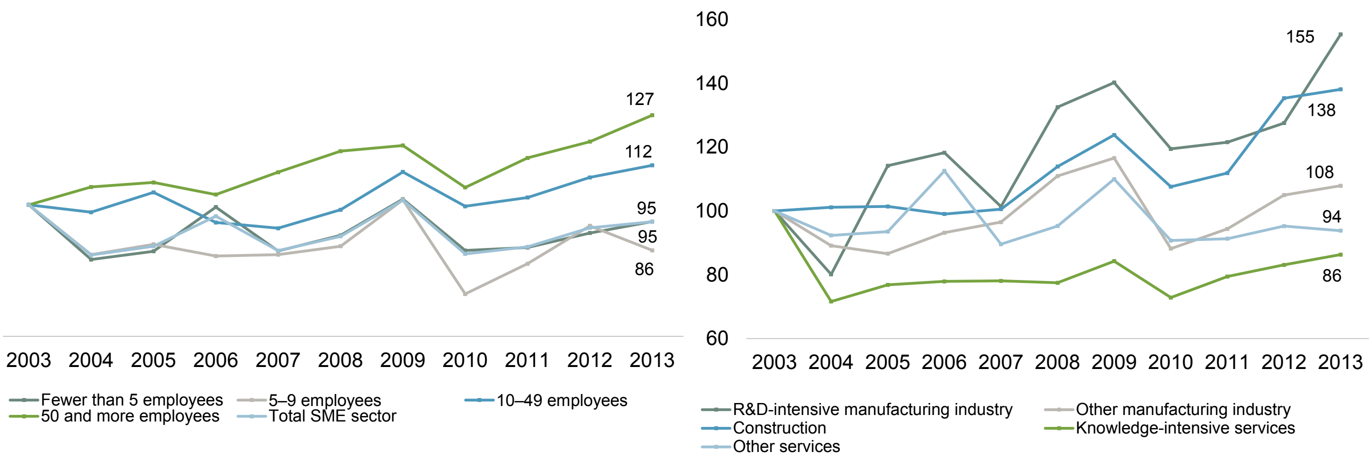
As with turnover and employment, productivity among SMEs in 2013 remained positive.[11] Compared to the base year (2003=100 index points), SMEs have an average of 95 index points (+2 as compared to 2012), equivalent to turnover of around EUR 124,000 per FTE (+EUR 3,000). This is the third increase in a row and the trend for SMEs is positive overall (figure 7).

However, a further increase in the productivity gap between large companies and SMEs is identified. A certain degree of relationship to size is normal and of a structural nature. Larger SMEs profit from benefits arising from lower fixed costs, higher efficiency and greater specialisation that small SMEs can only achieve to a limited extent. Nonetheless, productivity is a decisive factor in future competitiveness.

For this reason, the difference in productivity[12] between small (fewer than five employees) and large SMEs (50 or more

Figure 7: SME productivity by size category (left) and sector (right)

Size classes by full-time equivalent employees



Note: Indexed figures (2003=100) of labour productivity (turnover per full-time equivalent employee). Missing turnover and employment data were imputed. Extrapolated with the number of employees.

Source: KfW SME Panel 2004–2014.

employees), which has increased to 39 %, is cause for concern (2012: 37 % / 2003: 18 %). Expressed in terms of index points, small SMEs achieve a value of 95 (+4) and large SMEs a figure of 127 (+8).

In the long term, large SMEs and the R&D-intensive manufacturing industry (often the same) are revealed to be the main drivers of productivity growth in SMEs. These segments in particular are also dependent on good productivity development in the future, as they are exposed to strong international competition and shape the international competitiveness of SMEs. Greater productivity is, however, needed across the board, since only 1.7 % of all SMEs belong to the R&D-intensive manufacturing industry. It is the small companies that have the most catching up to do.

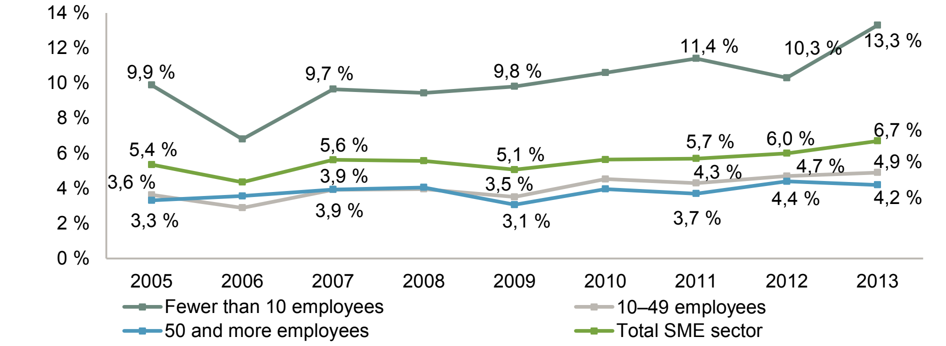
There are a variety of reasons for the overall increase in labour productivity. There has at least been no rise in labour productivity at the expense of employees, when one considers that turnover and employment have developed almost identically. It is therefore necessary to consider the reasons in process optimisation, the use of improved technologies, more highly qualified employees or an increase in product quality to achieve higher end-customer prices.

Returns on sales still high despite slower growth

In 2013 as well, the average return on sales[13] among SMEs proved to be robust in the context of fluctuations growth (figure 8).[14] It fell by a notable 0.7 percentage points to 6.7 % as compared to the previous year (2012: 6.0 %). At 11 %, the proportion of companies with negative returns on sales (losses) remained constant in 2013. Although no further improvement can be discerned for the first time in four years, from a historical perspective this proportion should be viewed positively. The corresponding value in 2009 was 16 %. At the same time, with high returns (of over 10 %) the corporate share has now risen to 60 % (2012: 56 % – since 2009: +6 percentage points). In the broader picture, SMEs in Germany are operating more profitably than at any point since this key figure began to be surveyed in the KfW SME Panel.

Figure 8: Returns on sales at SMEs

Size classes by full-time equivalent employees



Note: Extrapolated with the number of employees. Mean values weighted with turnover.

Source: KfW SME Panel 2006–2014.

Rather surprisingly, in 2013 small SMEs were able to more than make up for their losses in the previous year (decrease in returns of 1.1 percentage points). This segment's profitability now stands at 13.3 % (+3 percentage points). Large SMEs generally remain stable (-0.2 percentage points).

In the case of SMEs with declining profitability as well, the situation also looks stable. Compared to 2012, 38 % of SMEs report lower returns on sales (multi-year average between 2001–2013: 41 %). Among these SMEs, returns on sales decreased by an average of 2.5 percentage points. At around 4 percentage points, this figure is significantly below those experienced in the crisis years.

Risk potential already rising with stagnation

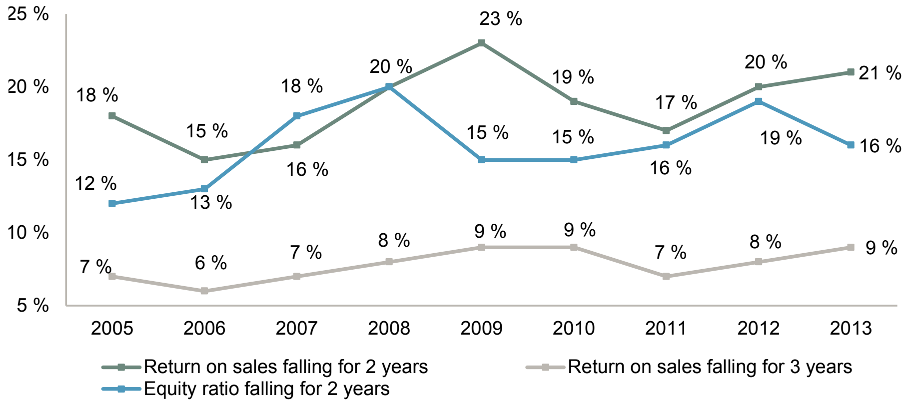
In aggregated form, the overall picture is stable. The impression is only a little less bleak when one looks at the crisis indicators provided by the KfW SME Panel for the first time in the previous year (figure 9).[15]

Both indicators for returns on sales imply an only slightly increased risk potential for SMEs in 2013. They each rose moderately by one percentage point.[16] The share for SMEs whose profitability fell for the second time in a row has increased to 21 % compared to 9 % for SMEs with a return that has already fallen three times in a row (several-year average: 7 %). As a consequence, 2013 also saw a continuation of the trend towards a small increase in the risk potential that was identified last year.

Equity ratios remain strong

The all-time high for returns on sales is having a major impact on the capital resources of SMEs. The average equity ratio[17] of SMEs rose to 28.6 % in 2013. This is equivalent to an increase of 1.2 percentage points (2012: 27.4 %) and thus represents the strongest gain in

Figure 9: SMEs with risk potential



Source: KfW SME Panel 2006–2014.

close to a decade.

This development is seen across all SMEs, i. e. in all size categories and sectors. The clear rise in profitability among small SMEs (fewer than five employees) is shown by a recovery of their equity base. The equity ratio leapt from 18.5 to 22.8 % in 2013 (+4.3 percentage points). Large SMEs (50 and more employees) proved able to increase their equity for the second year in a row (2013: 31.6 %; 2012: 30.4 %). Consequently, these SMEs too achieved a historic maximum value.

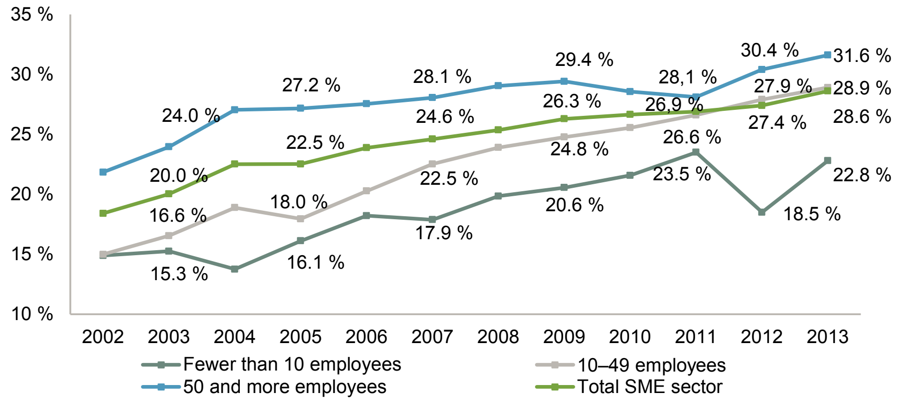
Two other indicators reveal a positive development. On the one hand, the share of SMEs with a negative equity ratio fell by two percentage points to 10 %. After a doubling in 2012, there was a move back in the direction of a "normal state" (values between 6 and 9 %). On the other, the proportion of enterprises with a relatively low equity ratio (less than 10 %) eased to now 34 % (2012: 36 %). There was also an easing of the equity ratio indicator within the framework of the analysis of risk potential among SMEs (Figure 9). This decreased by three percentage points compared to the previous year (2013: 16 %; 2012: 19 %).

Profits retained

The development of all the indicators relating to SMEs' equity leads to the conclusion that the incentives to accumulate equity increased in 2013. SMEs' profits, which had risen in the previous year, were mostly retained by the companies

Figure 10: Equity ratios of SMEs

Size classes by full-time equivalent employees



Note: Extrapolated with the number of employees. Mean values weighted with turnover.

Source: KfW SME Panel 2003–2014.

(see also the section on investment behaviour). It may be assumed that SMEs are anticipating growing restrictions on credit and weak economic phases so that, if necessary, they can respond with a greater deployment of equity and existing reserves. The general economic uncertainty may also be playing a role here, expressed in subdued business expectations. Finally, the administrative expenses involved in taking out a loan are constantly increasing. In other words, SMEs are playing a waiting game, appreciating their financial independence and arming themselves well with reserves in the face of potential forthcoming downward risks.

Investment also restrained in 2013

The investment activities of small and medium-sized enterprises in 2013 remained virtually unchanged and were therefore also restrained. Easy access to credit proved unable to shift the cautious position of SMEs.

Investment spending in new facilities and buildings (gross fixed capital formation) fell by EUR 1 billion or 0.7 % to EUR 144 billion (2012: EUR 145 billion). Total investment expenditure in new *and used* facilities and buildings decreased by EUR 1 billion to EUR 190 billion (2012: EUR 191 billion). According to calculations by KfW, total corporate investment stood at EUR 271 billion in 2013 (-1.5 % versus 2012). Investment on the part of SMEs consequently contracted less dramatically than the investment volume of large enterprises in Germany; the SME share in corporate investment remained at 53 %, the previous year's level. The contribution made by SMEs to gross fixed capital investment in the economy as a whole fell somewhat: In 2013 it amounted to 30.5 % (2012: 31 %).[18]

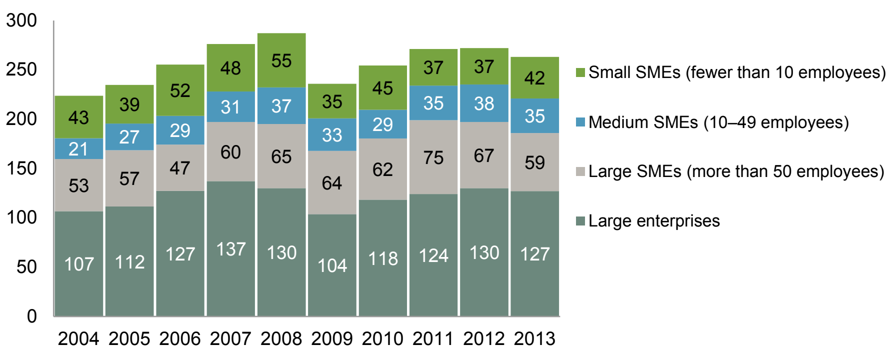
[*Note:* The consequences of the most recent general revisions of the national accounts and the associated changes in the concept of investment have not yet been taken into account].

Net investments positive in 2013

Despite a stagnation in new investment, the volume still exceeds the simultaneous loss in value of companies' capital stock (depreciation). As in past years, net investments by SMEs were positive in 2013 (+ EUR 32 billion – figure 12).[19] Thus, there is no sign of asset erosion due to negative net investments. There was also an increase in investment cov-

Figure 11: Investment volume in the corporate sector by size category

Figures in EUR billion; size classes by full-time equivalent employees



Note: The extrapolations by employment size category do not include companies in other industries. As a consequence, the individual data of SME size categories do not add up to the total amount of gross fixed capital formation referred to in the text.

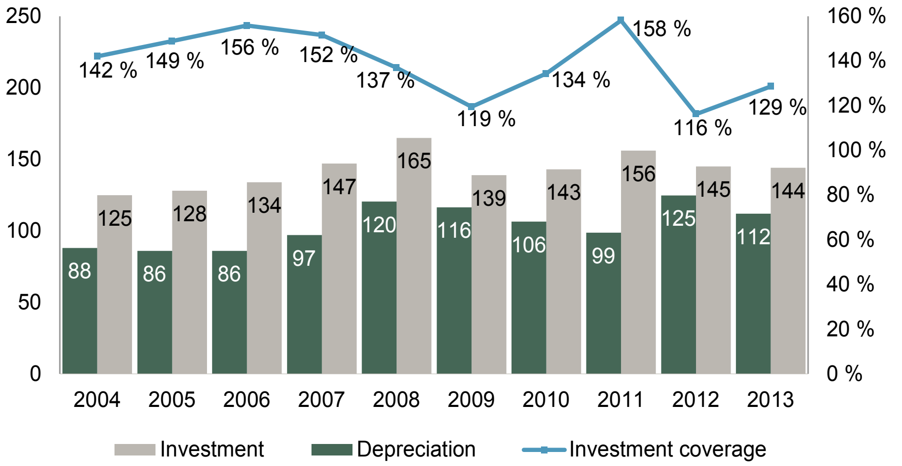
Source: KfW SME Panel 2005–2014.

erage, as the relationship between new investments and depreciation[20]; this rose to 129 % (2012: 116 %).

Solid performance, high competitiveness and positive net investments – despite relatively cautious approach to new investment? There is some evidence that SMEs in Germany are taking an efficient approach to investment.[21] This could also be an indication of a change towards less capital-intensive growth overall. In this case, "less" would not be the same as "too little". However, in the KfW Competitiveness Indicator the internationally operating SMEs assess their future potential competitiveness far more negatively than most international competitors.[22] Attention should be paid to how this situation develops.

Figure 12: Net investments, depreciation and investment coverage

Figures indicated by the bars in EUR billion



Note: Investment coverage describes the ratio of the investment volume to depreciation. The calculation details are set out in note 20.

Source: KfW SME Panel 2005–2014.

... but capacity expansion is being rolled back

It is also worth noting that in 2013 the firms again invested less in capital expansions: 52 % of the total investment volume was devoted to this (-4 percentage points compared to 2012). Conversely, rising volumes for replacement investments can be ascertained (+5 percentage points from 2012 to 41 %).[23] This is putting a break on all new investment, as current KfW analyses[24] show: When an investor undertakes expansion investment, his total investments is roughly four times as much as in the case of pure replacement investments. At 61 %, more SMEs are also repeatedly showing negative net investments than in the previous year (56 %). These SMEs are investing, but this is not enough to compensate for the ageing of their capital stock. All SME segments are affected, small SMEs (fewer than 5 employees) at 63 % more so than large SMEs (50 and more employees) at 50 %.

Inclination to invest: more SMEs investing, but investing less on average

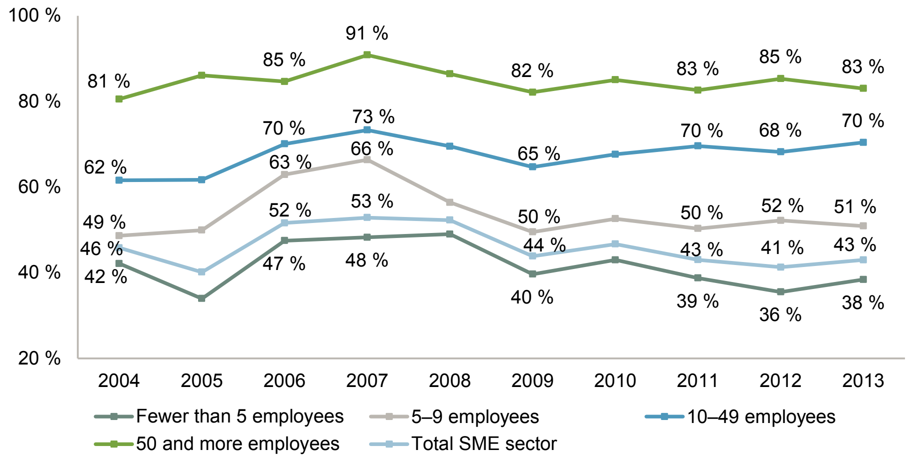
For the first time since 2007, more SMEs have again been making investments (figure 13). The proportion of SMEs with investment projects in 2013 increased by 1.7 % to 43 % (2012: 41.3 %). SMEs with fewer than five employees are the main deciding factor here. They have been abandoning their persistent reluctance. Their readiness to invest increased by 2.9 % in 2013. As large SMEs slightly cut back on their investments (-2 % to 83 %), the investment gap between large and small SMEs, a measure for the structural relationship between the size of a company and its growing willingness to invest, has been narrowing to about 45 % percentage points (-4 percentage points).

More investors with a comparable volume: The other side of the coin is the parallel year-on-year 13 % decline in the average amount invested per employee (investment intensity; for detailed segment-related figures, see *Tables for KfW SME Panel 2014*). While more SMEs are making investments, their volumes are, on average, lower. This also shows that the majority of SMEs are not using their additional turnover and profits for investment purposes.

The investor trend in the manufacturing industry raises some concerns. In particular, there is less inclination to invest not only in the R&D-intensive manufacturing industry (-7.2 %), but also in the other manufacturing industry (-2.1 %). Companies have not been this unwilling to invest in eight years. As a comparison, since the record figure in 2006, the willingness to invest fell by 20 percentage points up to 2013 (R&D-intensive manufacturing industry) and 10 percentage points (other manufacturing industry). Similar rates of change can be identified for the investment intensity as a measure

Figure 13: Share of SMEs investing

Size classes by full-time equivalent employees



Source: KfW SME Panel 2005–2014.

for the average size of investment projects per employee (-20 % and -7 % respectively). The latter is primarily attributable to strong growth in employment (constantly positive except 2009) while there was almost no change in overall investment. This means that investments have not kept pace with growth in employment.

Loan demand no longer sluggish, larger volumes of lending requested

Loan demand for investment purposes among SMEs picked up tangibly in 2013. The trend, which was already visible in 2012, is continuing with growth in the original demand for loans of EUR 16 billion (+16 %) to around EUR 119 billion (figure 14).

Thus upturn in demand was expected, but the extent thereof was not. The exceptionally low external financing costs seen last year, which were triggered by monetary measures by the European Central Bank (ECB), are increasingly incentivising SMEs to try to obtain credit financing for their investment projects.

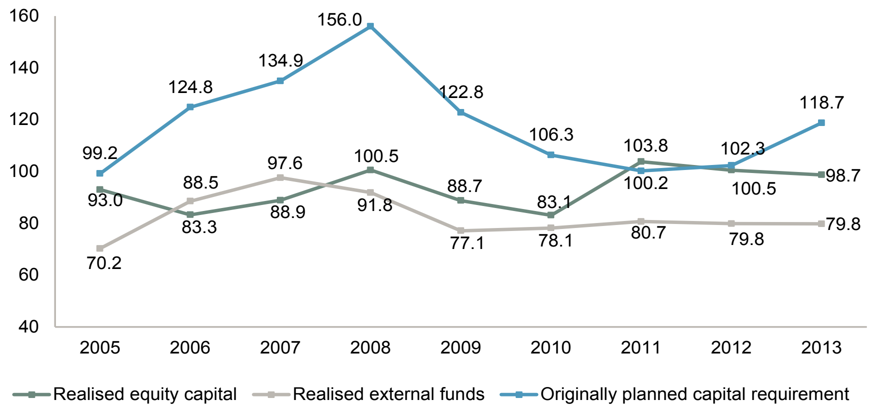
However, the rise in the volume of credit demand in 2013 cannot be attributed to greater general interest in external financing on the part of SMEs. The proportion of firms applying for investment loans from banks and savings banks stagnated in 2013 at 32 % (of investing companies) and 13 % (of all SMEs). Roughly 473,000 companies took part in loan negotiations. As a comparison, the long-term average between 2006 and 2013 was 622,000 SMEs (figure 15).[25]

It is rather the case that the share in large volumes of credit demand of EUR 50,000 or more has increased considerably (figure 16). In contrast to the above-mentioned trend observed of an increase in the importance of small-volume demand up to EUR 20,000, these loans were only applied for by 26 % of SMEs (-16 percentage points).

Caution among small SMEs

Accordingly, very small SMEs (fewer than five employees) are not participating in the credit demand upturn. They are taking a cautious line and increasingly strengthening their equity base. This can be traced back to a significantly more pessimistic attitude about the future. The balance between optimistic and pessimistic small SMEs (fewer than five employees) is a mere +13 balance points, while in the case of large SMEs (50 and more employees) it stands at +44 balance points.

Figure 14: Realised financing volume and originally planned credit requirements in EUR billion

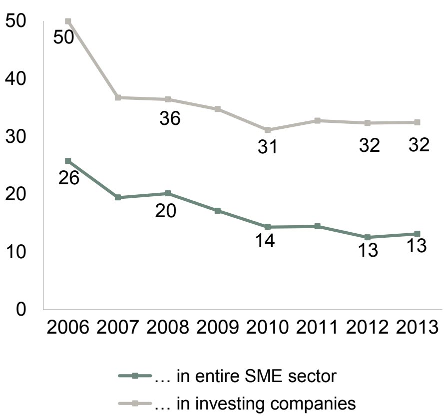


Note: Volume extrapolated with the number of employees. Extrapolations include other sectors. It should be noted that the originally planned demand for credit is almost never fulfilled Most of all, planned revisions due to changed corporate strategies should be taken into consideration. The actual loan demand of SMEs is therefore lower. A detailed discussion of the analytical consideration as part of the KfW SME Panel can be found in Reize (2011).

Source: KfW SME Panel 2006–2014.

Figure 15: Companies with loan negotiations

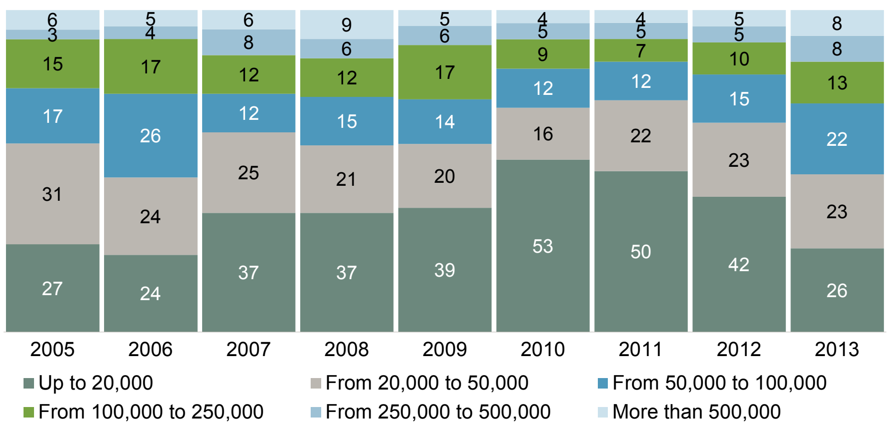
Figures in per cent



Source: KfW SME Panel 2007–2014.

Figure 16: Credit demand among SMEs

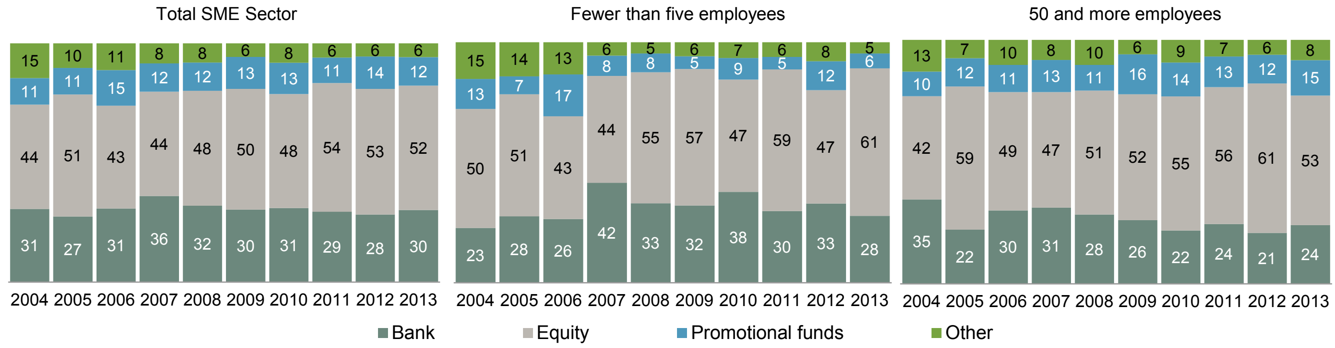
SME share with respective demand for credit in per cent



Source: KfW SME Panel 2006–2014.

Figure 17: Investment financing among SMEs

Funding sources by full-time equivalent employees (share of investment volume in percentage)



Note: Extrapolated on the investment volume in SMEs with the number of employees. Others include venture capital and mezzanine financing.

Source: KfW SME Panel 2005–2014.

Another important point is that the amounts invested and therefore the loan demand of small SMEs are generally relatively low. For many lenders, the costs and work involved in lower demand volumes are too high and the reporting duties for SMEs are correspondingly stringent (e. g. requirement of documentation and disclosure of business figures). Consequently, small SMEs' credit negotiations fail five times more often (17 %) than negotiations of large SMEs (3 %).

All in all, this is leading to restraint on the part of small SMEs. They prefer to remain cautious and have thus decreased their total volume from EUR 32 billion to EUR 29 billion year on year. Large and chiefly medium-sized SMEs (11 to 49 employees), on the other hand, are substantially increasing their demand volume.[26]

Bank loans for large SMEs attractive once again; small SMEs relying on self-financing

There were few changes in investment financing for all SMEs in 2013. Equity, which remains SMEs' most important source of financing, is down one percentage point, as in the previous year. Yet it remains the case that more than half of the SME investment volume is financed by means of equity (52 %). This is equivalent to some EUR 99 billion. The proportion accounted for by bank loans rose by 2 percentage points to 30 % (approx. EUR 57 billion). Promotional funds make up 12 % of the investment volume (approximately EUR 23 billion) and a further 6 % were funded from other sources (for example, mezzanine capital or venture capital).

Figure 17 also reflects the increase in equity ratios of the *small SMEs*. The impact on self-financing capacity is visible: 61 % of investment expenditure in 2013 came from companies' own funds (+14 percentage points). After the slump in 2012 (-12 percentage points), which resulted from a meltdown in profitability and equity ratios[27], the small SMEs are again significantly increasing their share in equity financing. Conversely, small SMEs are reducing bank loans and correspondingly their demand volume has decreased.

By contrast, large SMEs are increasingly turning to bank loans as a method of financing investments (+3 percentage points). Promotional funds are also being used more often (likewise +3 percentage points). On the other hand, equity is being used less frequently (-8 percentage points to 53 %). They are using the historically good access to credit more. However, this is not affecting their investment volume.

The originally planned credit requirement of EUR 119 billion, was also subject to a revision of planning (change in the financing intentions or investment plans). Similarly to previous years, this resulted in a plan revision ratio of 22 %, i. e. EUR 26 billion was no longer required.

Fewer credit negotiations proving successful

The year 2013 saw a significant rise in loan demand among SMEs by 16 %, but the borrowing ultimately used to finance investments remained constant (figure 14). What is the explanation of this gap in the context of historically good conditions for accessing credit? It can be found not only in the above-mentioned revisions of planning, but also results from a slight shift in the outcome of credit negotiations.

On the one hand, at 14 % there still is a historically low proportion of SMEs for which *all negotiations* fail due to the bank not offering a loan (figure 18). This is constant across all size categories (cf. table 18 in the *Tables for KfW SME Panel 2014*). It remains the case that small SMEs' (fewer than five employees) credit negotiations still fail far more frequently than those of larger SMEs (50 employees and more): 17 % as compared to 3 % in 2013.

On the other hand, the share of successful negotiations decreased by 10 percentage points from all-time high of 67 % in 2012 to 57 % in 2013. At the same time, SMEs more often report that *at least one negotiation* has failed, either due to no offer being made by the bank (+6 percentage points to 23 %) or because they themselves rejected the offer of a loan (+3 percentage points to 20 %).[28] This is the case for SMEs in all size categories.

Credit supply gap vanishes, good ability to invest

Nonetheless, the SME's *credit supply gap* was almost zero in 2013. Only SME loan demand of EUR 500 million was not able to be satisfied *due to a lack of offers* *by banks* (approx. 0.8 % of the actual demand for credit – calculated as the difference between the original loan demand and the plan revision). This is the fifth decrease in a row. Since 2008, there has been a continuous improvement in the availability of credit for both smaller and larger SMEs.

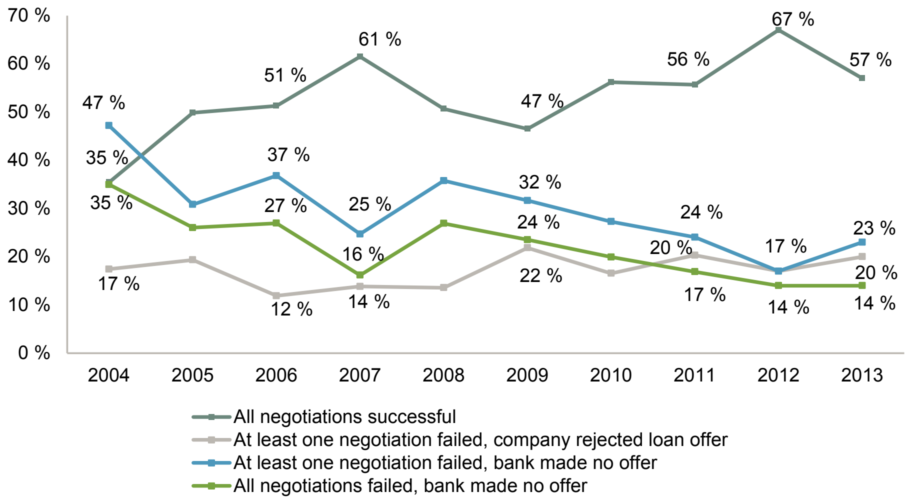
SMEs also exhibited a high, and in 2013 further increased, ability to invest despite failed loan negotiations (figure 19). Most interesting of all is the further slight increase in the proportion of investments actually realised in cases where the SMEs reject the banks' offers of loans (81 %). The equity resources of SMEs remain strong, enabling them to reject loan offers when the terms do not meet their expectations.

SMEs playing a waiting game

In 2013, however, this ability to invest was increasingly used to maintain the existing capital stock. It may be assumed that riskier projects, which nonetheless boost competitiveness, are currently being put on ice. One indication of this is the decrease in the companies' activities abroad. But precisely these investments are needed if the currently still good ability to compete internationally is to be preserved.[29]

In view of the generally bleaker business expectations, it is at least questionable whether a significant increase in investments among SMEs is in the cards this year.

Figure 18: Outcome of loan negotiations



Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2005–2014.

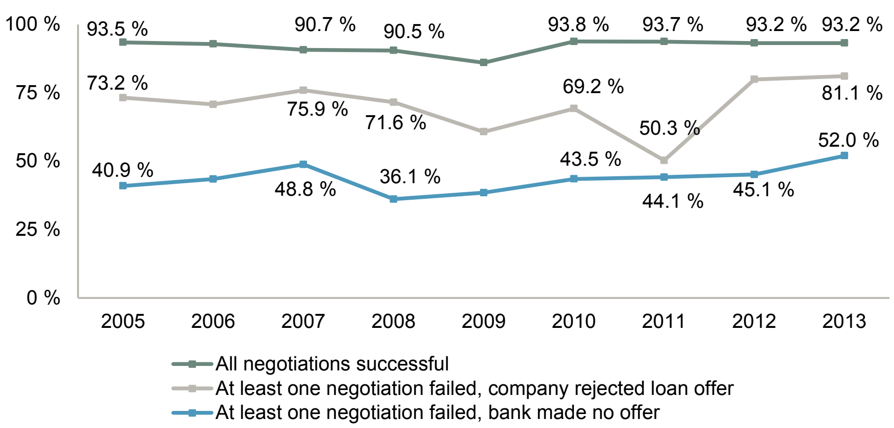
Business expectations up to 2016 provide little hope of revival

The turnover and earnings expectations for 2014–2016 remain cautious, at almost the same level as the previous year (figure 20).

In balance-sheet terms the prospects for both turnover and income development are (traditionally) positive: 14 percentage points (-2 on the previous year) for turnover and 11 percentage points (+2 on the previous year) for earnings. Scarcely any change versus the previous year is seen from grouping the two partial indicators to create a consolidated "business expectations" indicator[30]. The balance between optimistic and pessimistic entrepreneurs in 2013 is +15 percentage points (2012: +14).

Despite expectations being largely stable, the deterioration in sentiment of recent years is clear. The proportion of optimists has decreased and a neutral attitude towards the future is dominating. This is problematic since, if SMEs are neutral, they act in an almost identical way to SMEs that have a pessimistic view of the future. Only when their expectations are positive will companies act with an increasing readiness to invest (factor 1.5), a higher investment volume (factor 1.3) and more capacity expansions (factor 1.6).

Figure 19: Share of realized investment volume in the planned investment volume when loan negotiations failed



Note: The proportions are based on volumes extrapolated with the number of employees. For details on the calculation, see Reize (2011).

Source: KfW SME Panel 2006–2014.

Outlook for 2014: Currently even more "wait and see"

The current year of 2014 is hardly expected to see any revival in the performance of SMEs. Along with SMEs' business expectations, a number of other sentiment indicators point in this direction.[31] While the German economy began the current year comparatively strongly with GDP growth of 0.7 %, in the second quarter it surprisingly contracted by 0.2 % on the previous quarter.[32]

A recovery from the slightly tense situation of last year does not seem likely from the current perspective. Rather, SMEs prefer to wait and see and securing stability has the highest priority. Furthermore, SME business sentiment worsened again recently.[33] The main factor here is that growth in Europe is weaker than expected.

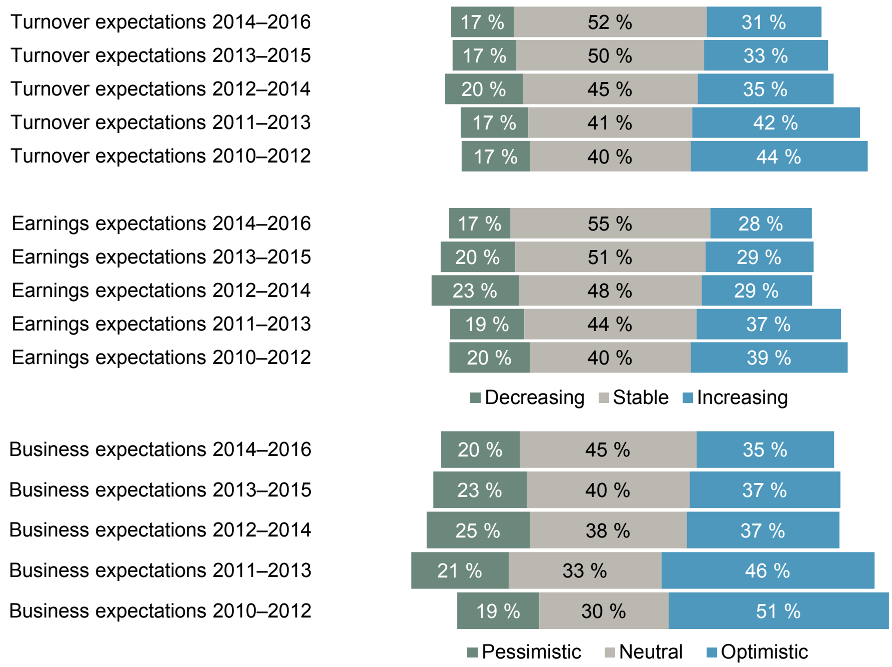
Conflicts increase uncertainty, but Germany and Europe worry

The impact of the crises in Eastern Europe and the Middle East on SMEs is rather indirect. The sentiment among the companies deteriorated significantly recently. Uncertainty in Europe is very high. However, only 20 % of SMEs report indirect negative consequences for their business as a result of the additional uncertainty that arose from the Ukraine conflict this spring. (Figure 21 – For a supplementary KfW SME Panel survey, see box on page 12). This assessment is principally driven by larger SMEs in the manufacturing industry. Over half of the SMEs in this segment (51 %), more than 2.5 times as many as for all SMEs, mention this consequence. This is hardly surprising, as these SMEs have many more international links.

The direct effects of the Ukraine conflict are even fewer. At present, roughly 13 % of SMEs see potential direct consequences of the Ukraine conflict for their own supply-chains and distribution (figure 21). This assessment in turn is also far more pronounced among larger SMEs from the manufacturing industry (one in three companies). Overall, 9 % of SMEs expressed fears that energy prices might rise.

As the large SMEs within the manufacturing industry view themselves as being seriously affected, it cannot be ruled out that the heavy turnover losses in the Eastern European business will ultimately turn out greater than the sentiment indicators for SMEs as a whole currently lead one to believe.

Figure 20: Business expectations among SMEs through 2016



Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2010–2014.

Reluctance to invest greater in 2014

A hesitant stance towards investment on the part of SMEs can be seen for 2014. By September, 45 % of SMEs had postponed, downscaled or abandoned at least one planned investment project (figure 22). If the trend were to remain the same, this would result in a volume of about EUR 41 billion worth of originally planned investments that were not realized. This is more than in the previous two years (EUR 31 billion in each case) but still far below the revision volume of the crisis years 2008/2009, each at over EUR 60 billion.

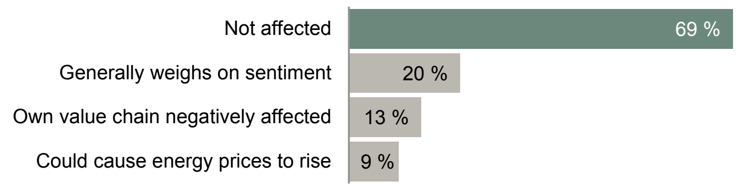
Main reason is concern regarding the economy

The poor economic situation dominates as the reason behind the reluctance of SMEs to invest. One in three SMEs not realizing formerly planned investments in 2014 gives uncertain sales price expectations as a reason (35 %). This is accompanied by great uncertainty over the domestic demand trend (32 %). The most recent GfK consumer climate index supports their view. A further drop in sentiment among consumers has put the brakes on private consumption. This points to a weakening of domestic demand, meaning that a further decrease in the rates of turnover growth can be expected for the year as a whole.

The expectation of falling sales prices also reflects increasing competitive pressure from Europe, where in many regions the ability to compete internationally is growing. Moreover, the findings may be interpreted as an indication of uncertainty when forming price expectations. Current data support this way of thinking: according to Eurostat, the annual inflation rate in the eurozone in September 2014 had fallen to a five-year low of 0.3 %.[34]

Financing difficulties are strikingly often perceived as an obstacle to investment (33 %). It should be noted here that this is based solely on assessments by those

Figure 21: Ukraine crisis in September 2014 and its impact on SMEs



Note: Extrapolated with the number of companies. Multiple answers possible for the potential effects of the Ukraine crisis

Source: KfW SME Panel 2014 (additional survey September 2014).

SMEs that have revised their 2014 investment planning. As a comparison, when investments were postponed, downscaled or abandoned in 2013 on the whole, there were problems with 77 % of the related credit negotiations. To that extent, the finding can rather be regarded as evidence of SMEs' very good access to credit at the moment.

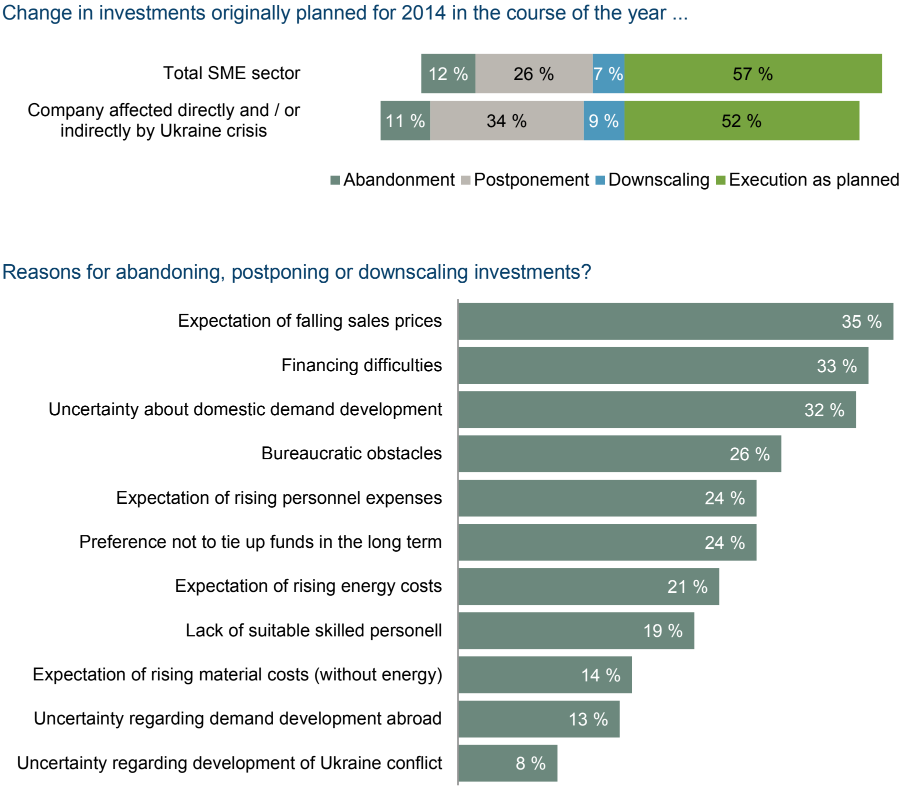
Influence of Ukraine conflict on investments not yet foreseeable

At present there is great uncertainty among SMEs, which is reflected in a persistent reluctance to invest. To date, the conflict in Ukraine has not additionally slowed down investment as greatly as had been assumed. It has not yet resulted in investments being abandoned completely. Nonetheless, the proportion of SMEs postponing projects in on the rise (figure 22).

At present, it is not possible to seriously estimate how large the "loss" of investment volume resulting from this geopolitical conflict will actually be. A significantly higher revision volume than the one currently determined is by no means impossible. This will depend greatly on the extent to which large SMEs, primarily in the manufacturing industry, are affected.

It can essentially be said that only certainty and confidence lead to investments by SMEs. A consistent, growth-oriented course for Europe, an increase in public investment to provide impetus, and confidence in the energy turnaround are desirable elements of future economic policy.

Figure 22: Investment behaviour in 2014



Note: Responses to the reasons for abandonment, postponement or downscaling on a five-point scale ranging from 1 "Has played a major role" to 5 "Has not played any role". The combined data for the first two categories are presented.

Source: KfW SME Panel 2014 (additional survey September 2014).

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. Due to the fact that it is representative for SMEs of all sizes and from all branches in Germany, the KfW SME Panel offers ***projections for even the smallest companies with fewer than five employees***. A total of 10,515 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. The KfW SME Panel gives a ***representative picture*** of the current situation, and the needs and plans of SMEs in Germany. It focuses on annually recurring information on business 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 or 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 no more than EUR 500 million. The population does not include the public sector, banks or non-profit organisations. There are currently 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 2013 and the population of employees at SMEs in 2013, the German Company Register (Unternehmensregister) and the official employment statistics (Erwerbstätigenrechnung) were used for the 2014 survey.

The KfW SME Panel sample is designed in such a way that it can generate representative, reliable data that are as precise as possible. 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. Two extrapolation factors are determined in total: an unlinked factor for the extrapolation of qualitative parameters based on the number of SMEs in Germany, and a linked factor for the extrapolation factors of quantitative parameters based on the number of employees at SMEs in Germany.

The survey is conducted by the market research division of GfK SE on behalf of the KfW. Academic advice for the project was provided by the Centre for European Economic Research (ZEW) in Mannheim. The main survey for the 12th wave of the KfW SME Panel was conducted between 1st February 2014 and 30th May 2014.

A **supplementary survey for the KfW SME Panel in autumn 2014** on the impact of the current tension in Eastern Europe and on investment behaviour in 2014 was also conducted by GfK SE as part of an online survey between 8th September 2014 and 17th September 2014. All of the companies that had already participated in the main survey of this year's wave of the KfW SME Panel and for whom a valid e-mail address was known were surveyed. Responses from a total of 2,285 companies were included. Given the connection to the main data record of the KfW SME Panel, these findings also provide a representative picture.

Structure of the SME sector in 2013

The SME sector comprises all companies in Germany whose annual turnover does not exceed EUR 500 million. Based on this definition, there were 3.61 million SMEs in Germany in 2013. This means that the SME segment makes up 99.95 % of all companies in Germany.

SMEs are small ...

The vast majority of SMEs in Germany are small (figure 23). Eighty-six percent of the companies (or just under 3.1 million) have annual turnover of less than EUR 1 million. Fewer than 0.5 % (or just shy of 14,000) of SMEs generate annual turnover in excess of EUR 50 million.

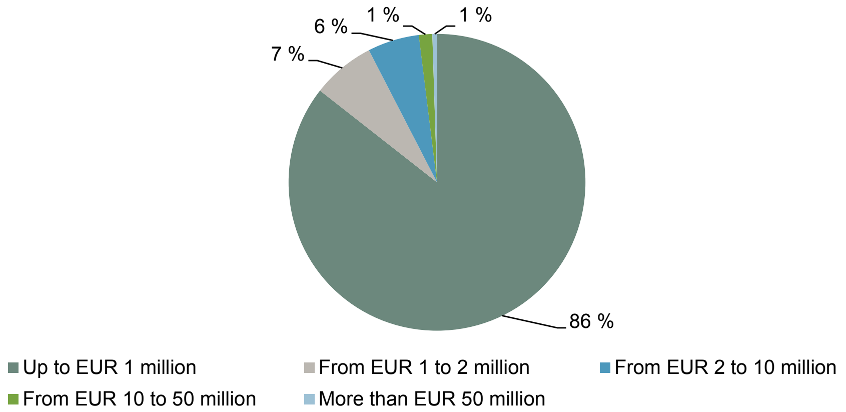
The small-scale structure of the SME segment is also reflected in the number of employees (figure 24). Eighty-two percent of SMEs have fewer than five employees (3.0 million). Of all SMEs, 1.8 % have a workforce of 50 or more employees. The small-scale structure of the SME segment has become more pronounced in recent years due to increasing tertiarisation and the fact that the number of companies being set up exceeds those going out of business.

... and service-oriented

The majority of SMEs are service companies (Figure 25): 2.73 million – or 75 % of all SMEs – operate in service industries, 1.31 million of them as knowledge-intensive service providers, and the trend is rising. Of all SMEs, 1.7 % (around 61,000 companies) belong to the R&D-intensive manufacturing industry.

Roughly 2.95 million SMEs are based in federal states in western Germany (82 %). Eighteen percent (or 664,000) are based in federal states in eastern Germany.

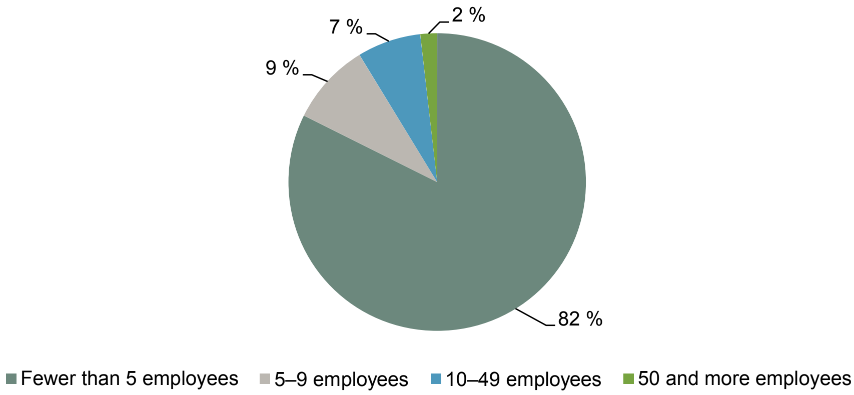
Figure 23: SMEs according to annual turnover in 2013



Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2014.

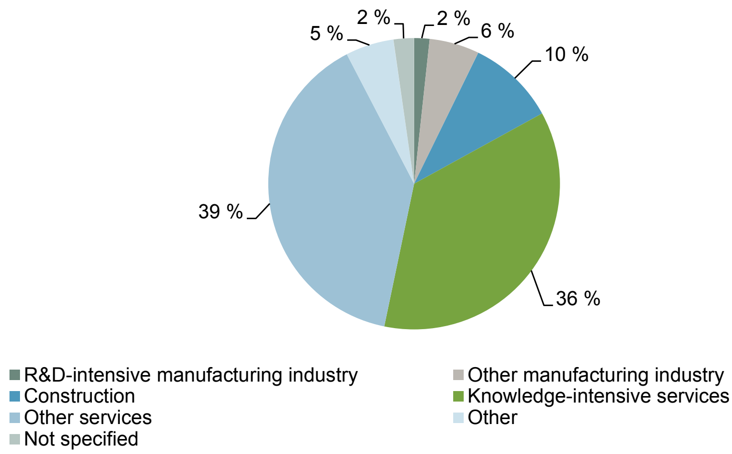
Figure 24: SMEs according to number of employees in 2013



Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2014.

Figure 25: Sector distribution among SMEs in 2013



Note: Extrapolated with the number of companies.

Source: KfW SME Panel 2014.

Table: The SME sector at a glance – key figures

	2007	2008	2009	2010	2011	2012	2013
Investments							
Investor share – total	53	52	44	47	43	41	43
Investor share < five FTE employees	48	49	40	43	39	36	39
Investor share ≥ 50 FTE employees	91	86	82	85	83	85	83
Investment volume – total (EUR billion)	204	210	176	177	195	191	190
Investment volume < five FTE employees (EUR billion)	59	57	43	55	48	50	44
Investment volume ≥ 50 FTE employees (EUR billion)	75	78	72	67	80	75	69
Volume of investment in new facilities and buildings (EUR billion)	147	165	139	143	156	145	144
Investment financing							
Originally planned credit requirements (EUR billion)	128	151	118	106	100	102	119
Realised borrowing volume – total (EUR billion)	98	192	177	178	81	80	80
Credit supply gap (EUR billion)	5	113	18	17	4	2	1
Return on sales							
Average return on sales	5.6	5.6	5.1	5.6	5.7	6.0	6.7
Average return on sales < 10 FTE employees	9.7	9.4	9.8	10.6	11.4	10.3	13.3
Average return on sales ≥ 50 FTE employees	3.9	4.1	3.1	4.0	3.7	4.4	4.2
Share of loss-making SMEs	18	15	16	13	2	11	11
Equity capital base							
Average equity ratio	24.6	25.4	26.3	26.6	26.9	27.4	28.6
Average equity ratio < 10 FTE employees	17.9	19.8	20.6	21.6	23.5	18.5	22.8
Average equity ratio ≥ 50 FTE employees	28.1	29.0	29.4	28.6	28.1	30.4	31.6
Share of SMEs with negative equity ratios	10	10	9	6	6	12	10
Employment trend							
Employment growth rate – total	1.7	2.1	1.5	2.5	2.6	2.1	2.0
FTE growth rate < five FTE employees	5.0	3.1	2.5	2.5	3.2	1.2	2.1
Turnover trend							
Turnover growth rate – total	9.4	7.6	-6.2	6.7	8.1	2.4	1.9
Turnover growth rate < five FTE employees	11.7	10.0	-4.5	6.0	7.0	2.0	2.3

[1] Tables for KfW SME Panel 2014 can be downloaded here: https://www.kfw.de/KfW-Konzern/KfW-Research/KfW-Mittelstandspanel.html. (available in German only)

[2] Cf. Schwartz, M. (2013), Tough climate for German SMEs: competition increases, the three 'I's promise success, Focus on Economics No. 27, KfW Economic Research, Frankfurt am Main.

[3] Abel-Koch, J. and J. Gerstenberger (2014), KfW Competitiveness Indicator: International comparison of SMEs' competitiveness – Germany still among the leaders, KfW Economic Research, Frankfurt am Main. This sets out and compares the ability of SMEs to compete internationally in ten important industrialised and emerging countries by different measures.

[4] R&D-intensive manufacturing is classified as the sectors of manufacturing with an average research and development intensity (R&D intensity: ratio of R&D expenditure to turnover) of over 3.5 %.

[5] cf. Tchouvakhina, M. and M. Schwartz (2013), Diversity is crucial: how the SME sector in Germany compares with others in Europe, Focus on Economics No. 24, KfW Economic Research, Frankfurt am Main.

[6] Cf. Tchouvakhina, M. and M. Schwartz (2013), Diversity is crucial: how the SME sector in Germany compares with others in Europe, Focus on Economics No. 24, KfW Economic Research, Frankfurt am Main.

[7] Data on the number of people employed in the economy as a whole are taken from the employment accounts of the Federal Statistical Office (Erwerbstätigenrechnung).

[8] The total number of trainees in SMEs decreased by about 20,000 (-1,7 %). However, at the same time there was a far greater reduction in the total number of trainee contracts in Germany (-2.7 %); provisional figures from the German Federal Statistical Office (2014), press release No. 176 of 21st May 2014.

[9] The growth rate for the number of people in employment is calculated on the basis of full-time equivalents (FTE). In contrast to an approach that simply counts the number of people engaged in economic activity, this reflects the actual demand for labour. The number of FTEs is calculated by taking the number of full-time employees (including proprietors) and adding the number of part-time employees multiplied by a factor of 0.5. Trainees are not taken into account.

[10] Knowledge-intensive services comprise service industries with an above-average share of university graduates or with a strong focus on technology. These include, for example, architecture and engineering offices, law, tax and management consultancies, or real estate and housing services.

[11] Measured as indexed figures (2003=100) of labour productivity (turnover per full-time equivalent employee). Missing turnover and employment data were imputed. Adjusted and extrapolated data.

[12] Measured as the difference in labour productivity between large SMEs and small SMEs, in relation to the value for large SMEs.

[13] The return on sales is defined as the ratio of pre-tax profit to turnover. The average returns on sales weighted by turnover are reported in each case.

[14] Cf. similar findings in Zimmermann, V. (2014), Unternehmensbefragung 2014: Finanzstark, energiebewusst, standortsensibel, (available in German only), KfW Economic Research, Frankfurt am Main.

[15]For more on identifying, preventing and overcoming crises, cf. Tchouvakhina, M. and P. Stöver (2013), How companies recognise, exploit and overcome crises, Focus on Economics No. 29, KfW Economic Research, Frankfurt am Main.

[16] The data include all companies for which the required data were available in each year of the analysis period. Outliers were removed separately in each wave. The results are not representative due to the long analysis periods used when calculating the crisis indicators, i. e. including several waves of the KfW SME Panel. Longitudinal extrapolation factors would be necessary here, which are not available.

[17] The equity ratio is defined as the ratio of equity to total assets. The average equity ratios weighted by total assets are reported in each case. For the purpose of the calculations, only companies required by law to submit financial statements have been included.

[18] Corporate sector gross fixed capital formation comprises equipment investments plus construction investments (housing construction excluded) of the private sector. Corporate investments are measured by means of the KfW Investment Barometer. See Hornberg, C. (2013): KfW Investment Barometer Germany, February 2013. Corporate investments: Gradual recovery. KfW Economic Research, Frankfurt am Main.

[19] The large enterprises are also following the (negative) trend of previous years: their capital stock is losing value, while depreciation (EUR 147 billion) exceeds new investment (EUR 127 billion). The investment coverage is once again below the 100% threshold (86%; 2012: 99%). For a detailed comparison of new investments by company size category, see Schwartz, M. and J. Gerstenberger (2014), Investments: SMEs still in the black, large companies long since in the red, Focus on Economics No. 61, KfW Economic Research, Frankfurt am Main.

[20] To determine the absolute volumes of net investments in SMEs and in the German corporate sector as a whole, first of all the data in the KfW SME Panel was linked with investment data for the entire corporate sector, as provided by the Federal Statistical Office . The volumes of investment and depreciation among SMEs are assessed as part of the KfW SME Panel. Total corporate investment is calculated by adjusting gross fixed capital formation for public-sector investment and residential construction investment. Depreciation in the corporate sector is calculated in a similar way. The underlying data is taken from Subject-matter series 18, Series 1.4 (last updated: March 2014) at the Federal Statistical Office. The investment and depreciation volumes of large companies (with annual turnover of more than EUR 500 million) are calculated by deducting the volumes determined for SMEs from the relevant figures for the entire corporate sector.

[21] See also, in particular, Deutsche Bank Research (2014), Focus Germany: Ice bucket challenge and structural investment gap, 2[th] September 2014.

[22] Abel-Koch, J. and J. Gerstenberger (2014), KfW Competitiveness Indicator: International comparison of SMEs' competitiveness – Germany still among the leaders, KfW Economic Research, Frankfurt am Main.

[23] All missing data relate to the category "Miscellaneous", which includes innovation, rationalisation, renovation, restructuring and repairs.

[24] Cf. Gerstenberger, J. and M. Schwartz (2014): Unsicherheit kostet mittelständische Investitionen: Sichere Rahmenbedingungen nötig (available in Germany only, Focus on Economics No. 66, KfW Economic Research, Frankfurt am Main.

[25] On average, an SME negotiates with 1.8 banks or savings banks. Almost half of SMEs only negotiate with one credit institution (46 %). This underscores the great important of the regular bank for the SME.

[26] A detailed analysis of loan demand among SMEs over time can be found in Schwartz, M. (2014), Wie viel Kredit darf's sein? Kreditnachfrage für Investitionen im Mittelstand vor – nach – in der Krise, Focus on Economics No. 55, KfW Economic Research, Frankfurt am Main.

[27] For more details, cf. Schwartz, M. (2013), KfW SME Panel 2013. Solid overall impression despite sand in the works, KfW Economic Research, Frankfurt am Main. Schwartz, M. (2013),

[28] The increased frequency of rejection by banks is primarily attributable to a changed business policy (+14 percentage points on 2012). Companies often reject offers of loans because the interest rate demanded by the bank is too high (+7 percentage points on 2012).

[29] Abel-Koch, J. and J. Gerstenberger (2014), KfW Competitiveness Indicator: International comparison of SMEs' competitiveness – Germany still among the leaders, KfW Economic Research, Frankfurt am Main.

[30] Two indicators can be created on the basis of the SME Panel to assess the expectations of entrepreneurs: turnover expectations and income expectations. These are surveyed for each of the next three years and can take on the following three forms: falling turnover / income compared to the survey year (-1 = negative expectations), constant income / turnover (0 = neutral expectations) and rising income/turnover (1 = positive expectations). The two indicators were then combined to create a single indicator for business expectations. The following three categories are defined for this: "pessimists": 2 ≤ (turnover expectations + income expectations) ≤ -1 / "neutrals": (turnover expectations + income expectations) = 0 / "optimists": 1 ≤ (turnover expectations + income expectations) ≤ 2.

[31] In particular, the ifo Business Climate Index (as at August 2014), the ZEW indicator of economic expectations (as at August 2014) and the KfW-ifo-SME Barometer (as at July 2014) indicated a downturn in sentiment. See also EY (2014), KfW-ifo SME Barometer August 2014, Ernst & Young GmbH.

[32] German Federal Statistical Office (2014), press release No. 287 of 14[th] August 2014.

[33] KfW-ifo SME Barometer (2014), August 2014: SMEs revise business expectations significantly downwards, KfW Economic Research, Frankfurt am Main.

[34] Cf. Eurostat (2014), Flash estimate – September 2014: eurozone annual inflation down to 0.3%, press release 145/2014 from 30[th] September 2014, http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-30092014-AP/DE/2-30092014-AP-DE.PDF