KFW ECONOMIC RESEARCH

# KfW-Mittelstandspanel 2012

*(KfW SME Panel)*

## Strong Performance – Increasing Risks

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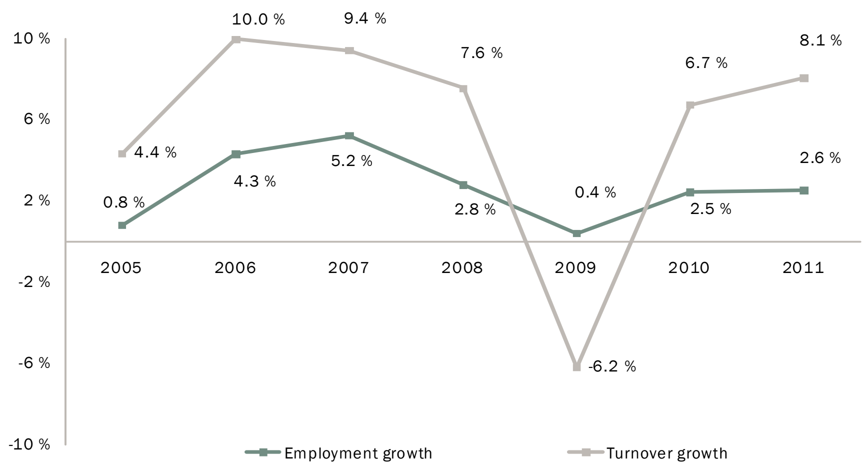
The KfW SME panel (*KfW-Mittelstandspanel*) – the first and only representative survey among German small and medium-sized enterprises (SMEs) – shows that SMEs are continuing their course of stabilisation and growth following the economic and financial crisis. The SMEs were also the "job engine" of the German economy in 2011, creating 925,000 jobs.

*Performance 2011:* SMEs are abandoning their reticence to invest. The demand for debt financing is decreasing. This is indicative of a high level of equity financing capacity among SMEs. The decisive factor here is the positive performance of turnover, return on sales and equity ratios. Access to loans remained good – loan rejections have fallen again.

*Outlook 2012:* In anticipation of an ongoing economic slowdown, SMEs are expecting a tightening of lending policies. Access to loans is becoming more difficult. Business expectations for the period up to 2014 are falling, as is willingness to invest.

*The situation in September 2012:* Even in the third year of the Euro crisis, uncertainty among SMEs remains high. A large number of companies are assuming that the Euro crisis will continue. Only 1 % of SMEs have currently made provisions against the crisis worsening again and an escalation of the crisis would therefore catch the entire spectrum of SMEs unprepared.


**Figure 1: Annual growth rates of employment and turnovers**



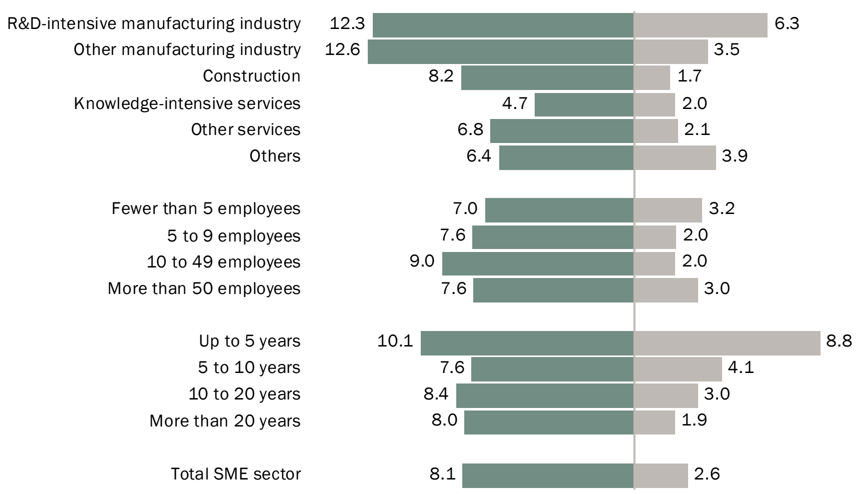

Notation: Extrapolated with the number of employees. Extrapolations including other industries. Missing indications about employees are imputed.

Source: KfW SME panel 2006–2012.

The KfW SME panel has been providing a unique instrument for analysing SMEs in Germany for the past 10 years. The 2012 survey shows that SMEs continued to grow in 2011. Recovery continued in turnover and employment. Turnover and employment amongst SMEs both increased again year on year (figure 1). Turnovers increased at a rate of 8.1 %, meaning that the rate of turnover growth was even higher than in 2010 (+6.7 %). As they did in 2010, the segments of the SME sector which suffered most in 2009 under the financial and economic crisis showed the highest grow rates in 2011 (figure 2, left-

**Figure 2: Turnover growth (green) and employment growth (grey)**

Changes in 2011 compared to 2010 (in percentage terms)




Notation: Extrapolated with the number of employees.

Source: KfW SME panel 2012.

hand side): companies in R&D-intensive manufacturing[1] (+12.3 %), companies in other manufacturing (+12.6 %) and young SMEs no more than five years old (+10.1 %).

### "The SME job engine"

Driven by strong performance of turnover, the number of total employees increased substantially in 2011. The sector's 29.1 million employees meant that, for the first time, over 70 % of all people in work were employed in SMEs (71 %).[2] Whereas large corporations and the public sector employed around 530,000 fewer staff, SMEs employed around 925,000 more people than in 2010 (+3.3 %). The net increase of 394,000 in the number of people in work in the economy as a whole is completely attributable to SMEs. These are proving themselves to be cornerstones of the job market as they did from 2007 to 2010. Over the past five years, SMEs increased the total number of employees by around 2.5 million.

Full-time employment had a growth rate of 2.6 % in 2011.[3] The employment growth came from across-the-board in the SME sector (figure 2, right-hand side). Employment is rising across all SME segments. R&D-intensive sectors (+6.3 %) and companies up to 5 years old (+8.8 %) report particularly high rates of growth. The SMEs are increasingly using full-time employees (+4.7 %). This development is closely connected with a simultaneous decline in numbers of part-time employees (-6.2 %).

### Activities abroad on the increase

Foreign sales have grown even more strongly than total sales – SMEs generated EUR 597 billion in foreign markets. This corresponds to a growth in the volume of foreign trade of 11 % year-on-year (2010: EUR 537 billion) and around 50 % of the export volume for the German economy as a whole in 2011.[4] This increasing international engagement of the SME sector is thus gaining importance for the economy as a whole.

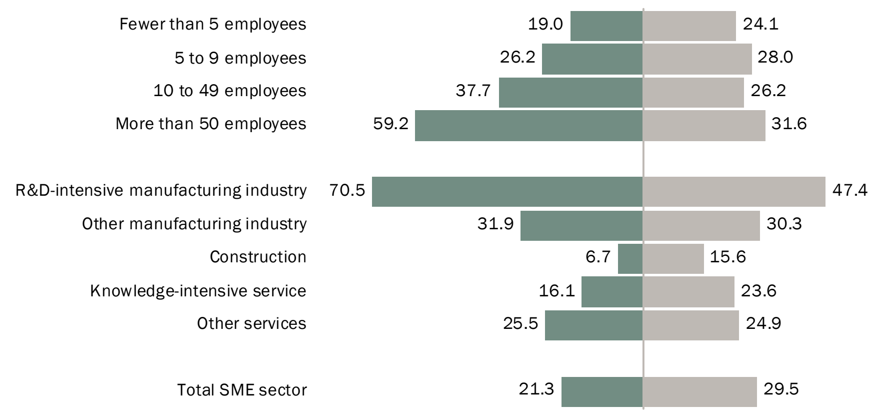
The number of SMEs active abroad has increased by 4.5 % year-on-year: 21.3 % of all SMEs were active in foreign markets (2010: 19.4 %). This corresponds to around 700,000 SMEs. The companies active abroad generate on average 29.5 % of their total revenues outside Germany (figure 3). The larger SMEs (50 or more employees) are particularly active abroad: 59.2 % of all companies in this segment generate revenues abroad. Due to effects of firm-size these SMEs have advantages when it comes to fixed costs, efficiency and specialisation. This contributes to increasing international competitiveness. In smaller SMEs, financial barriers and bottlenecks regarding staff are often crucial obstacles to increased international activity – as is shown by a study recently published by KfW on internationalisation by SMEs.[5]

Import activities were first surveyed in this 10th wave of the KfW SME Panel (figure 4): almost one in three SMEs purchase intermediate goods and services from foreign suppliers (30.4 %). The import ratio of domestic-market-oriented segments, such as the construction industry and knowledge-intensive services, is lower. In contrast, both segments of the manufacturing sector have a high share of imports. This increases with the size of the company. SMEs which import goods or services make purchases from abroad amounting to 24.7 % of their turnover on average.

The SME sector's high level of integration in the world economy is an expression of the growing need for SMEs to be present on international markets, in part due to lower rates of growth in domestic demand. The emphasis placed on this topic by the KfW SME panel 2012 is a recognition of the importance of this issue. The consequences of increasing (international) intensity of competition for SMEs will be examined in special analysis (publication in spring 2013).

**Figure 3: Activities abroad and foreign sales of SME in 2011**

Share of companies active abroad (green) and share of foreign sales in total sales in percentage terms

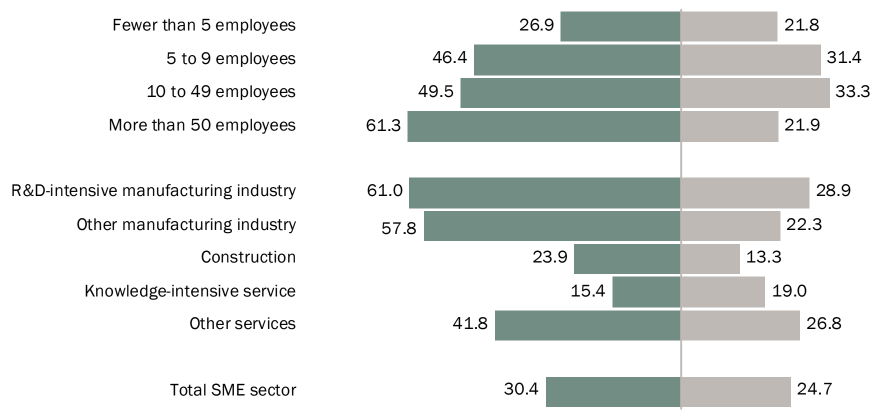



Notation: Shares in total revenue extrapolated with the number of employees weighted with the revenue.

Source: KfW SME panel 2012.

**Figure 4: SME's import activities in 2011**

Share of importers (green) and imports relative to the total revenue (grey) in percentage terms




Notation: Imports are defined as a share of intermediate consumption (raw, auxiliary and operating material, traded commodity and contract work) of foreign suppliers 2011. Share of imports are extrapolated with the number of employees and weighted with the revenue.

Source: KfW SME panel 2012.

### Increasing returns on sales

Both indicators gathered in the KfW SME panel on companies' creditworthiness – the return on sales[6] and the equity ratio[7]– have again improved. This is highly significant, as these indicators are key criteria for evaluating borrowers when making lending decisions. Accordingly, the ability of SMEs to access investment loans is linked to these figures.

The stability of SME returns on sales seen in the past was further confirmed during the crisis period and continued in 2011. The average return on sales in the SME sector increased 0.1 percentage points compared to 2010 to 5.7 % in 2011 (figure 5).

Another manifestation of the improved returns on sales has been the proportion of SMEs making a loss, which fell from 16 % in 2009 and 13 % in 2010 to 12 % in 2011. At the same time, 55 % of SMEs were able to realise high returns on sales of over 10 %, which is more than in previous years (2010: 53 %, 2009: 54 %).

The tendency towards increasing returns on sales continues for small SMEs with fewer than 10 full-time employees. They reported an 8 % increase in returns on sales, i. e. 0.8 percentage points, and were again able to exceed the results achieved in the previous year (11.4 %). By contrast, larger SMEs ceded the increases achieved in 2010 in the course of 2011.

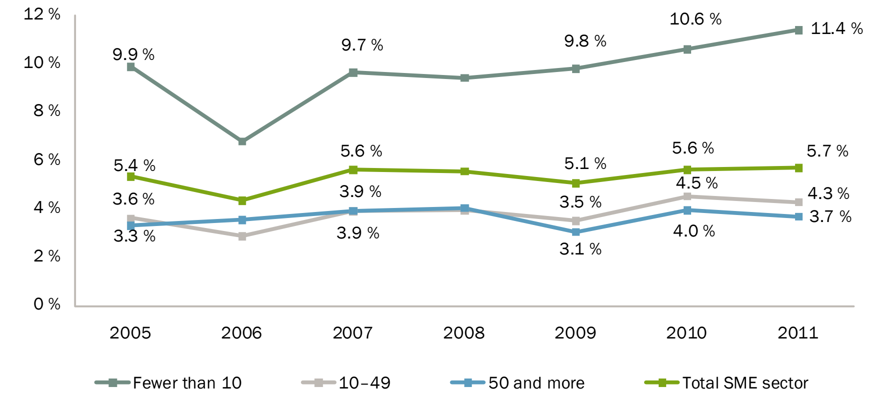
Regarding branches (table 1), knowledge-intensive services continue to show the highest returns on sales (10.1 %). Both segments of the manufacturing sector have maintained the previous year's increased returns on sales, which had previously fallen due to the crisis. The drop in 2009 has thus proved temporary.

### Increasing equity base – particularly among small SMEs

The positive performance of returns on sales once again enabled SMEs to improve their equity base in 2011 (figure 6). The average equity ratio increased 0.3 percentage points to 26.9 % at present compared to 2010 (26.6 %). As in the previous year, small enterprises realised the highest growth rate, which again markedly increased their equity ratio (+9 % or +1.9 percentage points to 23.5 %). A

### Figure 5: Returns on sales of SME from 2005 to 2011

Size classes by full-time equivalent employees

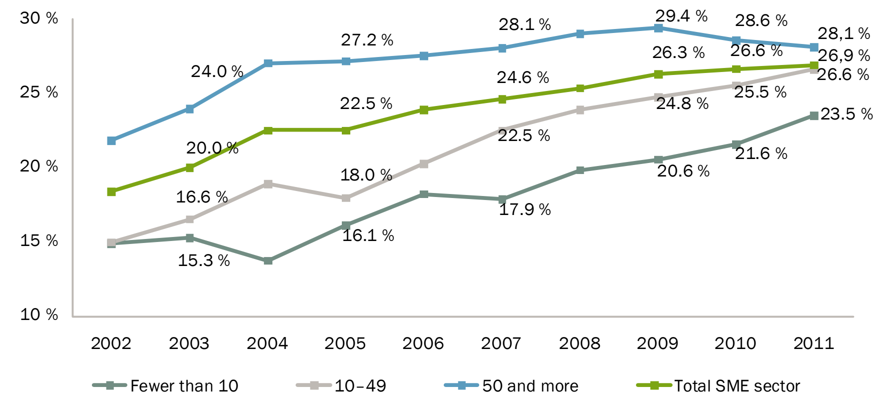



Notation: Extrapolated with the number of employees. Mean values weighted with the revenue.

Source: KfW SME panel 2006–2012.

### Figure 6: Equity ratio of SME from 2005 to 2011

Size classes by full-time equivalent employees




Notation: Extrapolated with the number of employees. Mean values weighted with the revenue.

Source: KfW SME panel 2003–2012.

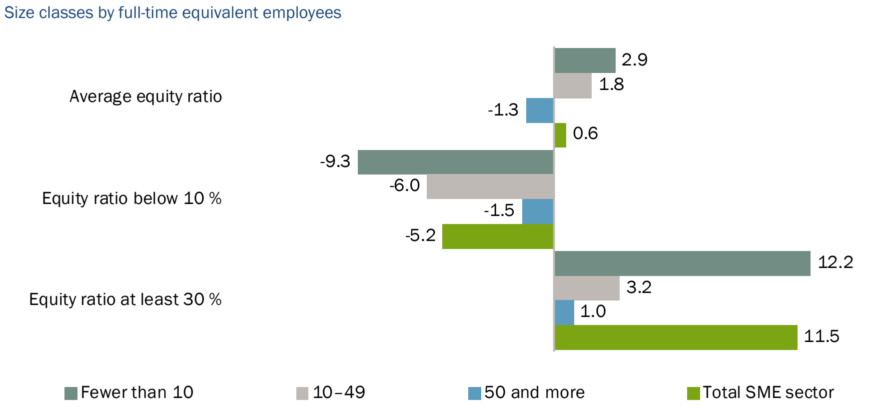
### Table 1: Equity ratio and returns on sales by industries

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| | Equity ratio (in percentage) | | | | |
| R&D-intensive manufacturing industry | 27.4 | 28.1 | 29.0 | 28.9 | 29.5 |
| Other manufacturing industry | 29.0 | 32.7 | 32.9 | 33.5 | 35.9 |
| Construction | 19.7 | 17.3 | 18.8 | 20.0 | 19.4 |
| Knowledge-intensive services | 25.4 | 25.1 | 24.9 | 24.1 | 23.5 |
| Other services | 21.4 | 23.3 | 24.4 | 25.8 | 24.7 |
| | Returns on sales (in percentage) | | | | |
| R&D-intensive manufacturing industry | 5.2 | 5.5 | 4.4 | 5.7 | 5.7 |
| Other manufacturing industry | 4.7 | 4.9 | 3.4 | 4.7 | 4.6 |
| Construction | 6.2 | 6.2 | 6.7 | 7.0 | 6.6 |
| Knowledge-intensive services | 8.9 | 8.4 | 8.9 | 9.6 | 10.1 |
| Other services | 4.6 | 4.4 | 3.9 | 4.2 | 4.0 |

Notation: Extrapolated with the number of employees. Mean values weighted with the revenue.

Source: KfW SME panel 2008–2012.

Figure 7: Changes in equity base of the SME sector between 2009 and 2011 (in percentage points)




Notation: Extrapolated with the number of employees and weighted with its total assets.

Source: KfW SME panel 2010–2012.

– somewhat lower – increase of 4 % or 1.1 percentage points to 26.6 % was seen for medium-sized companies. Larger SMEs had falling equity ratios for the first time in 2010. This decline continued in 2011 – large SMEs saw a fall in their equity ratios of 0.5 percentage points to 28.1 %. This might be a sign of easier access to, and more attractive terms for, debt financing.

Irrespective of the slight declines in the equity capital bases of large SMEs, it remains the case throughout the entire observation period that the average equity ratio increases with the size of the company. At the same time, the gap between the smaller (fewer than 10 employees) and larger companies (50 or more employees) has been constantly declining. In 2005, the difference was still 11.1 percentage points. By 2009 it had already fallen to just 8.8 percentage points and it currently stands at 4.6 percentage points. The gap has thus more than halved.

It is to be assumed that SMEs will react to the tightening of financing conditions. A further slight increase in equity ratios, particularly for small and mid-sized SMEs, should be anticipated as they prepare themselves for increasingly difficult credit negotiations with banks.

The proportion of SMEs with negative equity ratios has proven stable – as in the previous year it has remained at 6 %, having been 9 % in 2009. Figure 7 again reflects the improved equity situation amongst SMEs, which has persisted since the economic and financial crisis in 2009 – the proportion of SMEs with a relatively low equity ratio of below 10 % has fallen across the entire SME sector (from 35 % in 2009 to 30 % in 2011). At the same time, the proportion of SMEs with a high equity ratio of at least 30 % has risen (from 35 % in 2009 to 46 % in 2011). The shifts are most clearly evident for smaller companies.

## Investment activity increases – but smaller enterprises still reticent

Still unfazed by the current economic slowdown, SMEs gave up their reluctance to invest in 2011. Following the slow recovery in investment activity in 2010, total investment expenditure increased by EUR 18 billion (10 %) to EUR 195 billion.

Investment expenditure in new equipment and buildings (gross fixed capital formation) also increased, by 9 % to EUR 156 billion. It thus increased more than the gross fixed capital formation of the corporate sector as a whole, which rose in 2011 by 7.6 % to around EUR 280 billion, according to KfW's Investment Barometer.[8] As measured by the barometer, SMEs were responsible for 56 % of total corporate investments last year (+1 percentage point compared to 2010). The share of SME investment in total gross fixed capital formation remained unchanged at 33 %.[9]

Although SMEs are noticeably more willing to invest, the pre-crisis level of 2008 remains far away. In particular, the investment willingness of small and young SMEs clearly lags behind the performance of large and more established companies (table 2). While investment volume of larger SMEs has risen by EUR 13 billion (+19 %), reticence is in evidence among smaller SMEs. This was expressed in a decline in investment volume of EUR 7 billion (-13 %).

Investment expenditure by companies over 20 years old and by those with 50 or more full-time employees has even hit an all-time high. Service sector SMEs also report

Table 2: Investment volume of SME from 2007 to 2011

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Industries | | | | | |
| R&D-intensive manufacturing industry | 13 | 14 | 8 | 7 | 7 |
| Other manufacturing industry | 33 | 31 | 24 | 24 | 30 |
| Construction | 6 | 6 | 6 | 5 | 6 |
| Knowledge-intensive services | 36 | 46 | 43 | 37 | 43 |
| Other services | 47 | 47 | 45 | 38 | 44 |
| Full-time equivalent employees | | | | | |
| Fewer than 5 employees | 59 | 57 | 43 | 55 | 48 |
| 5 to 9 employees | 19 | 19 | 12 | 12 | 11 |
| 10 to 49 employees | 42 | 48 | 43 | 34 | 42 |
| More than 50 employees | 75 | 78 | 72 | 67 | 80 |
| Age of companies | | | | | |
| Up to 5 years | 22 | 11 | 6 | 7 | 3 |
| 5 to 10 years | 12 | 12 | 10 | 11 | 11 |
| 10 to 20 years | 25 | 32 | 25 | 28 | 23 |
| More than 20 years | 71 | 86 | 83 | 65 | 93 |

Notation: Extrapolated with the number of employees. Size classes analysis without companies with less than five full-time equivalent employees.

Source: KfW SME panel 2008–2012.

a strong propensity to invest: the increases in comparison to the previous year in knowledge-intensive services[10] as well as in other services each amount to EUR 6 billion (+16 %).

Investment projects are on average becoming larger and fewer in numbers: paralleling the increase in investment expenditure, the percentage of SMEs which have undertaken investment projects declined on the previous year from 47 % to 43 % (figure 8). The increase of three percentage points realised in 2010 (equivalent to around 110,000 enterprises) was completely rolled back last year (a decrease of around 150,000 enterprises). In 2011, 1.6 million SMEs undertook investments.

The percentage of investors fell in nearly all SME segments. The proportions of SMEs making investments increased slightly in the R&D-intensive manufacturing industry (+2 percentage points to 62 %), among enterprises with 10–49 employees (+2 percentage points to 70 %) and among enterprises that have been on the market for 10–20 years (+1 percentage points to 43 %).

Overall, increasing (decreasing) investment volumes were reported in those SME segments in particular which reported decreasing (increasing) investment expenditure the previous year. 2011 SME investment activity was thus conducted by larger and older enterprises and service-sector SMEs.

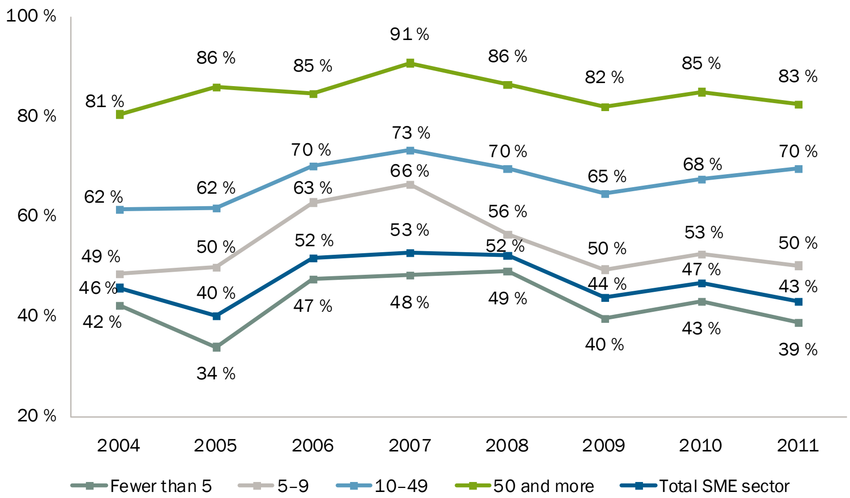
Due to the persistent crisis of confidence, declining SME investment is expected for the current year (see results of the 2012 supplementary survey). This is in line with current estimates by the KfW-Investment Barometer, which indicates reticence in corporate investment as a result of the Euro zone recession in the 2nd quarter of 2012.[11]

### Declining demand for loans as a result of increasing equity financing capacity

SMEs have the capacity to finance many of their investments with their equity. The planned credit requirements for investment financing fell for the third year in a row and totals EUR 100 billion (-5.7 %) with an increase in investment expenditure of EUR 18 billion in 2011 (figure 9). Realised equity, which significantly increased to EUR 104 billion, is also an indicator of this.

Figure 8: Share of SMEs with investment projects from 2004 to 2011

Size classes by full-time equivalent employees



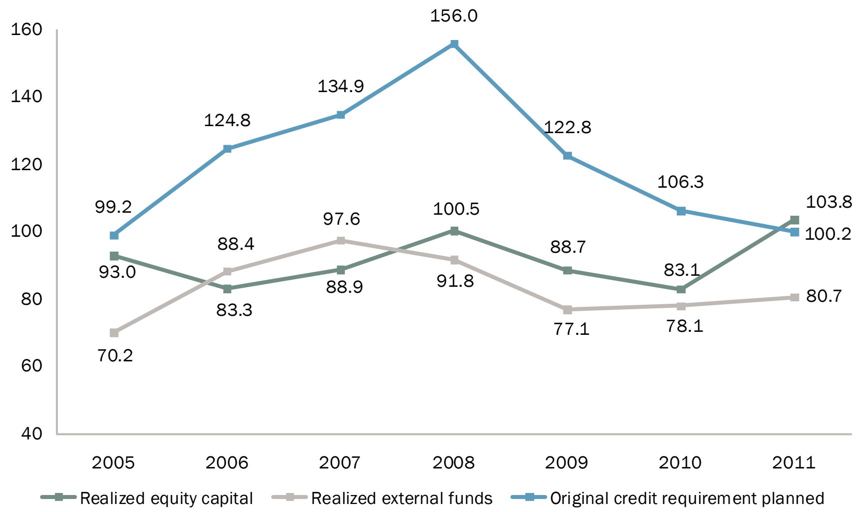

Source: KfW SME panel 2005–2012.

Overall, SMEs employed equity as a means of financing 54 % of their investment volume (figure 10). Equity thus remains by far the most important source of SME investment financing.

While the equity financing ratio reaches its highest ever value for the entire observation period (2004—2011), the share of bank loans in investment volume has remained nearly unchanged since 2008, with a slight declining tendency. Bank loans currently constitute 29 % (approximately EUR 59 billion). An additional 11 % of SME investment volume was financed through promotional funds. The total volume of external funds realised (bank loans plus promotional funds) has thus slightly increased to EUR 81 billion (figure 9). Other sources (e. g. mezzanine or venture capital) amount to 6 %.

Figure 10 also shows that small SMEs in particular significantly increased the equity share in investment volume (+12 percentage points), and reduced bank loans as a result (-8 percentage points). Against the general trend, larger SMEs slightly increased their ratio of bank loans in 2011.

Figure 9: Realized financing volume and originally planned credit requirements from 2005 to 2011 (in billion EUR)



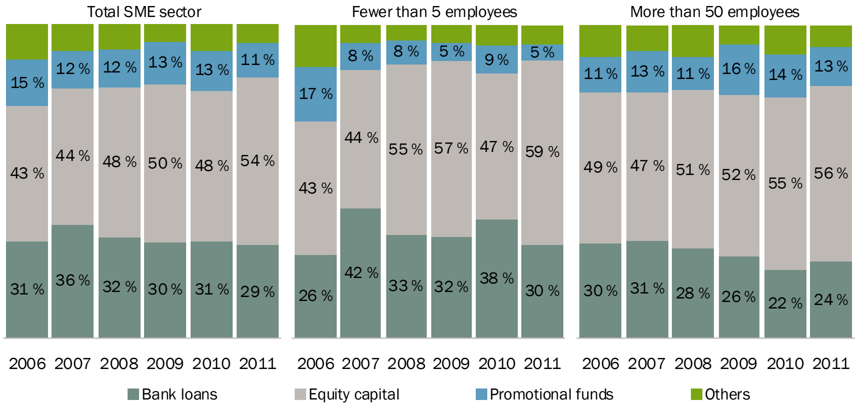

Notation: Extrapolated with the number of employees.

Source: KfW SME panel 2006–2012.

It is clear that all SMEs have open access to investment loans. The difference between the ***original credit requirements planned*** and the actual volume of external funds realised was at its lowest level since 2005. Only EUR 19 billion of the planned credit requirement was not covered through external funds (a decrease of 32 % on 2010). KfW's 2012 Business Survey revealed a similar development: The enterprises surveyed rated the borrowing situation in 2011 as relaxed.[12]

**Figure 10: Investment finance sources from 2006 to 2011**

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




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

Source: KfW SME panel 2007–2012.

The originally planned demand for loan financing was also revised in 2011: 28 % or EUR 26 billion in loans were no longer required (due to changes in SME financing or investment plans). This ratio of plan revisions, which was relatively low in a year-on-year comparison, reflected a strong economy in 2011 – as did the previous year's (2010: 25 %).

## Small gap in credit supply

The *actual credit supply gap* decreased once again in 2011: the total level of SME demand for loans that could not be satisfied due to lack of credit availability stood at EUR 4 billion. This corresponds to 6 % of *actual credit demand* (the plan revisions are subtracted from the originally credit requirement to calculate actual credit demand). Thus, credit availability to SMEs has continuously improved since 2008 (figure 11). In 2008 the credit supply gap was 14 % (EUR 13 billion), in 2009 11 % (EUR 8 billion) and in 2010 10 % (EUR 7 billion).

Nonetheless, SMEs did not profit equally across all segments from the improvement in credit availability. Larger SMEs further reduced their share of credit demand that was not realised due to the lack of a loan offer by the bank (1.4 %). Meanwhile, smaller enterprises, by contrast, again face a greater gap in credit supply (23.7 %).

## Decreasing rates of loan rejection

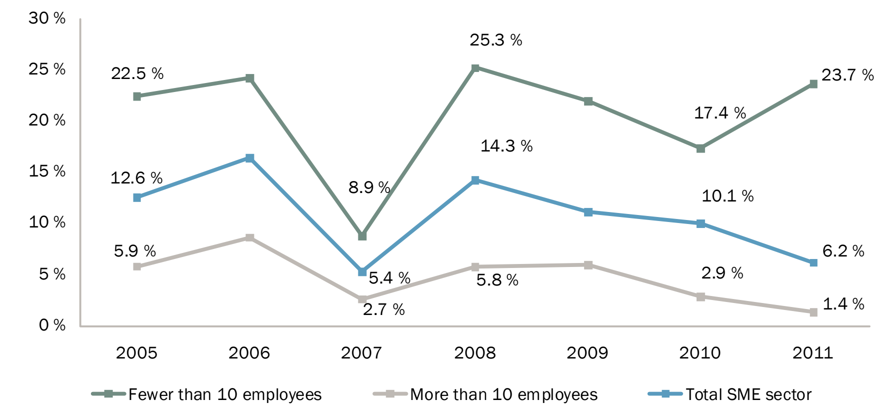
The development of loan rejection rates reflects increased returns on sales and equity ratios (figure 12). More restrictive lending was not observed in 2011. On the contrary, the continual decrease in the credit rejection rate has persisted since 2008: the share of SMEs for whom all negotiations on investment loans have failed due to a lack in bank loan offers has decreased to 17 %. A decline was also observed in the share of enterprises for whom at least one negotiation has failed due to a lack of loan availability (24 %). Parallel to this development, the proportion of successful loan negotiations remains unchanged at 56 %.

The positive assessment of the situation concerning access to investment loans is reinforced by an increase in the percentage of SMEs which themselves have rejected a loan offered by a bank (from 17 % in 2010 to 20 % in 2011). This in turn reflects the strong internal financing ability of SMEs.

According to KfW's September 2012 Credit Market Outlook (available in German only), companies' access to credit remains good.[13] However, in light of the economic slowdown, stricter lending policies can be expected, meaning that credit access is likely to become more difficult again in the fourth quarter of 2012. There are already indications that this development will affect SMEs too.

**Figure 11: Estimated share of credit demand that was not realized due to lack of loan offer by the bank (in relation to actual credit demand)**

Size classes by full-time equivalent employees




Notation: The shares underlying volumes are extrapolated with the number of employees. To calculate the shares, original credit demand is reduces by plan revisions. The resulting actual credit demand is contrasted with the volume of realized external funds. The difference is understood as a “credit supply gap”. For calculation details see Reize (2011).

Source: KfW SME panel 2006–2012.

## Why loan negotiations fail

Figure 13 shows that between 2007 and 2011, the most frequent reason why SMEs rejected loan offers was that the interest rates quoted by the banks were too high (46 %). This percentage has hardly changed since – despite historically low rates of interest. In many cases, enterprises are unable to pledge the collateral demanded (35 %). Small-sized enterprises are particularly affected. With time, however, the frequency with which rejection is based on too-high demands being placed for collateral has become more equally balanced between large and small SMEs – there is currently only a slight “overhang” to the disadvantage of smaller SMEs.

Conversely, larger SMEs more frequently reject loans due to receiving a better alternative offer. Accordingly, they have more financing options than small enterprises, which tend to accept loan offers on unfavourable terms for lack of alternatives. Small enterprises also reject offers considerably more frequently due to poor advice. Offer rejection due to poor advice has been cited particularly frequently (mainly by small SMEs) in recent times.

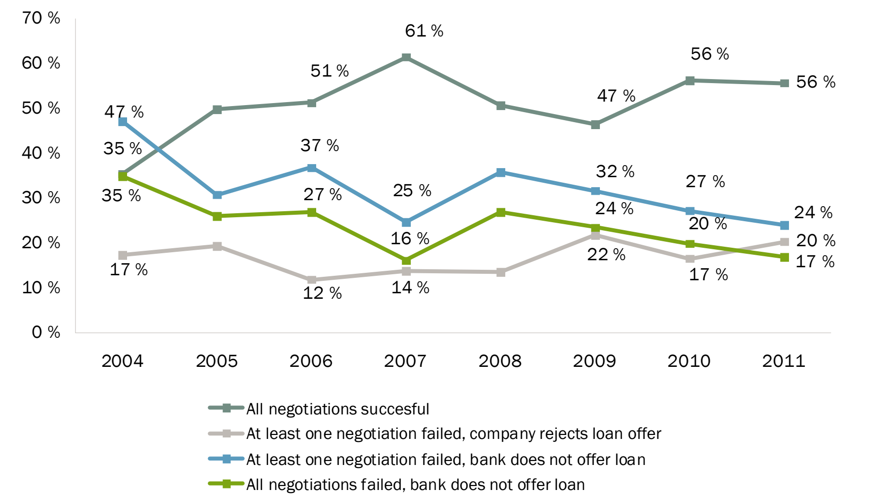
Banks cite insufficient collateral as the most frequent reason for rejecting loans applications (58 %) during the entire period. Insufficient creditworthiness or equity capital is also cited nearly as frequently as reasons for rejecting SME requests for loans (53 %). A change in bank business policy is, by some margin, the third most frequent reason for rejection of a loan (27 %). Larger SMEs are affected by this slightly more often than smaller ones.

Overall, the order of reasons why loans are rejected has remained stable over time. There are, however, some slight shifts in how frequently specific reasons occur. This is particularly the case when enterprises reject loans, whereas banks seem to vary less in their reasons for rejection. Due to the relevance of the topic, KfW Bankengruppe is currently dedicated to a research project conducting a detailed analysis of loan rejection reasons for SMEs. The results will be published in spring 2013.

## Strong investment capacity

The outcome of lending negotiations plays a key role in determining SME investment volumes (figure 14). Companies that suc-

### Figure 12: Outcome of loan negotiations from 2004 to 2011



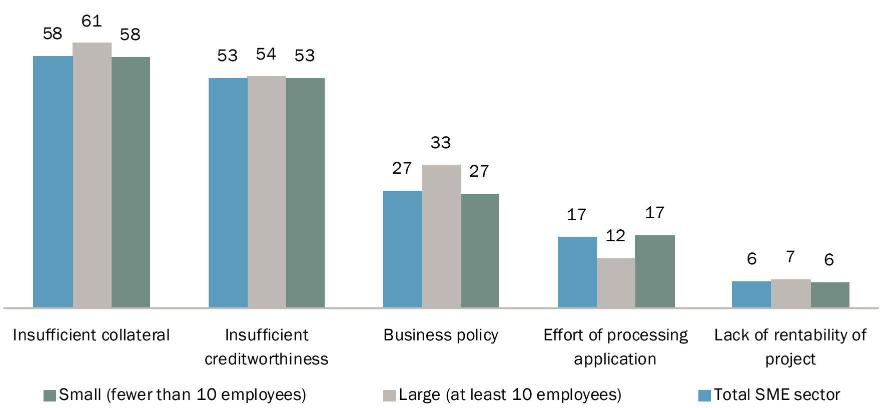

Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2005–2012.

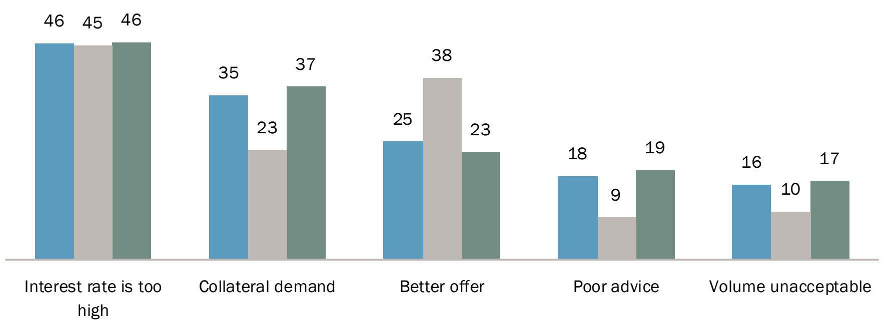
### Figure 13: Reasons for failing loan negotiations

Size classes by full-time equivalent employees (company shares in percentage terms)

#### Why banks reject a loan application



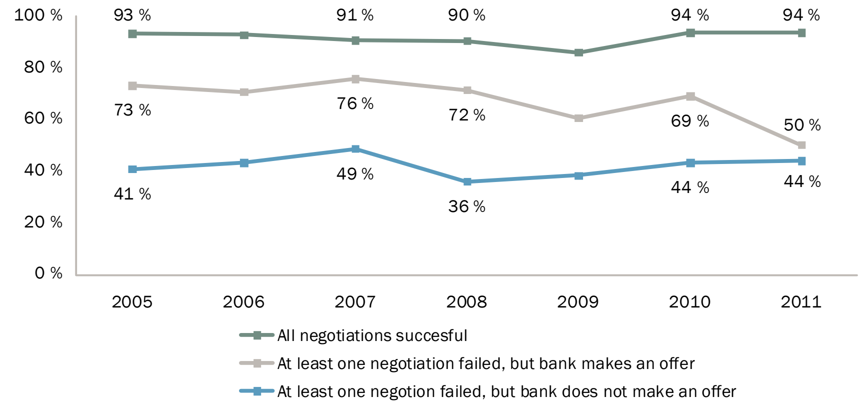

#### Why companies reject a loan offer




Notation: Data base of companies’ rejections: All companies, who rejected at least one loan offer of a bank and whose loan negotiations fail due to this rejection. Data base of banks rejections: All companies who did not get a loan offer of a bank at least in one case and whose loan negotiations fail due to this fact. Mean value of year’s specific extrapolated shares. Extrapolated with the number of SMEs. Extrapolations without companies of other industries. Multiple answers possible.

Source: KfW SME panel 2008–2012.

Figure 14: Share of realized investment volume in the planned investment volume when loan negotiations failed




Notation: The shares underlying volumes are extrapolated with the number of employees. For calculation details see Reize (2011).

Source: KfW SME panel 2006–2012.

cessfully concluded all lending negotiations invested 94 % of the investment volume they had originally planned in 2011, as in the previous year. If the negotiations fail and the bank does not make an offer, the proportion of realised investments comes in at 44 %: this, in turn, corresponds to a total amount of EUR 6.9 billion, or 3.1 % of the total planned SME investment volume which was not invested due to restrictive bank lending behaviour. This means that, in 2011, the impact of loan financing restrictions was at the lowest level seen in the entire observation period (2005–2011). If the bank does not make an offer, larger SMEs manage to implement 71 % of their total planned investments, with smaller SMEs realising 33 % in such cases. As a result, smaller SMEs once again had considerably more problems finding alternative financing solutions after their loan applications were rejected in 2011.

There was a marked drop in the proportion of investments that were actually realised in cases where SMEs rejected a bank lending offer (50 %). More detailed analyses show that this was triggered by the investment behaviour of small SMEs (companies with a workforce of less than 10): in cases in which they rejected bank lending offers themselves, these companies only realised 37 % of their investment plans (long-term average for the period 2005-2010: 62 %). Larger SMEs (with 10 or more employees), on the other hand, realised 69 %.

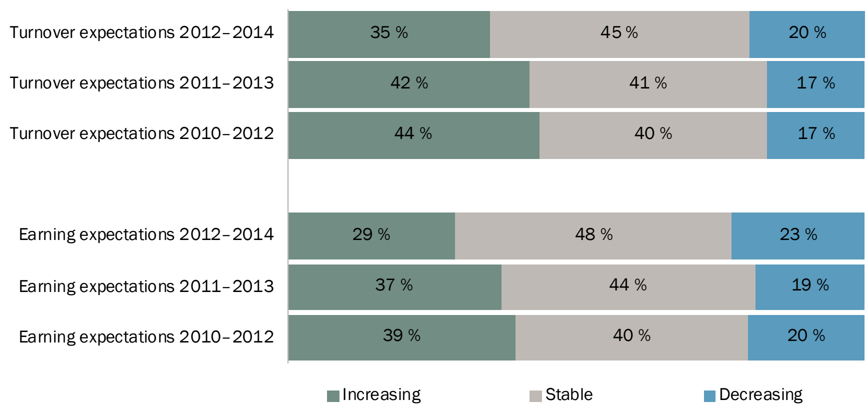
## Crisis of confidence weakens business expectations - nevertheless, SMEs expect positive developments up to 2014

The economic slowdown in 2012 and the Euro sovereign debt crisis is not letting the SME sector escape entirely unscathed. Nevertheless, SMEs remain cautiously optimistic as far as the next three years are concerned. Positive expectations outweigh any negative outlook in terms of both turnover and earnings development (figure 15). Compared with expectations in previous years, however, there is no doubt that the outlook has deteriorated slightly. Whereas in 2009 and 2010, the share of positive expectations outstripped the share of negative expectations by 27 and 25 percentage points (turnover) and by 19 and 18 percentage points (earnings), these differences have narrowed to a current level of 15 and 6 percentage points respectively – this translates into a deterioration of -40 % and -67 % respectively in a year-on-year comparison.

Combining the two sub-indicators to one single indicator of "business expectations"[14] also shows that SMEs are less optimistic about the future: positive expectations outweighed their negative counterparts by +12 percentage points in 2011. In the previous year, this figure was still as high as +26 percentage points, with the value for 2009 coming in at +27 percentage points. As far as the various segments are concerned (figure 16), established SMEs are comparatively pessimistic (-1 percentage point in total), as are – and this comes as something of a surprise – construction companies (+/-0). As in previous years, large SMEs (+40 percentage points) and SMEs in the R&D-intensive manufacturing industry (+38 percentage points) are more positive in their outlook. Companies that are more active economically - investors, exporters and, first and foremost, SMEs with ongoing R&D activities - are also very positive in their business expectations.

In the past, the turnover expectations of SMEs have proven to be a good predictor of actual developments. Based on this outlook, slower business development appears to be on the cards in the medium term. The further development of the Euro crisis – which remains unresolved - and the associated impact on the SME sector will be particularly decisive to further development. As a result, the KfW SME Panel 2012 has been expanded to include an additional survey in September 2012

Figure 15: Turnover and earning expectations




Notation: Extrapolated with the number of SMEs.

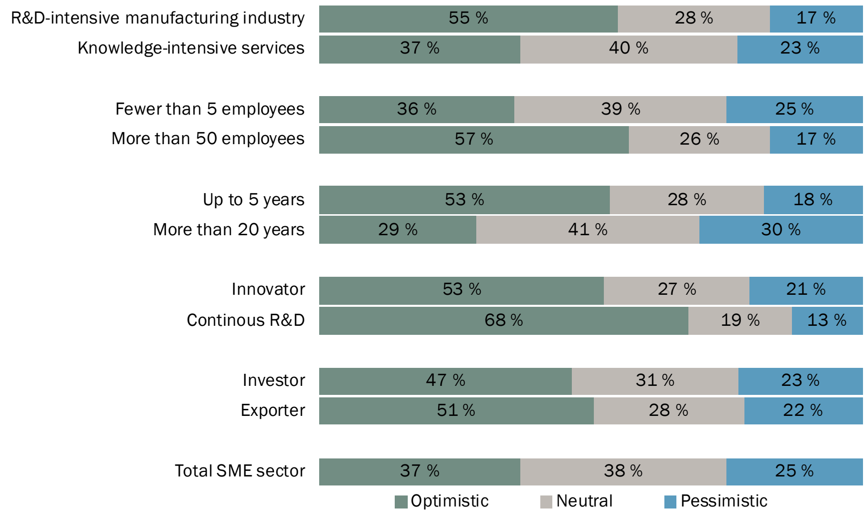
Source: KfW SME panel 2010, 2011, 2012.

– which is also representative of Germany's entire SME sector.[15]

## High levels of uncertainty surrounding consequences of the Euro crisis in the SME sector at present

The current situation in the SME segment in September 2012 is characterised by even more uncertainty surrounding the possible consequences of the Euro crisis (figure 17) than in the first half of the year. One third of all SMEs (32 %) feel that it is currently impossible for them to assess the impact of the Euro crisis on their own company. This applies in particular to young companies (less than 10 years old: 41 %) and SMEs in the manufacturing industry (46 %).

Figure 16: Business expectations until 2014

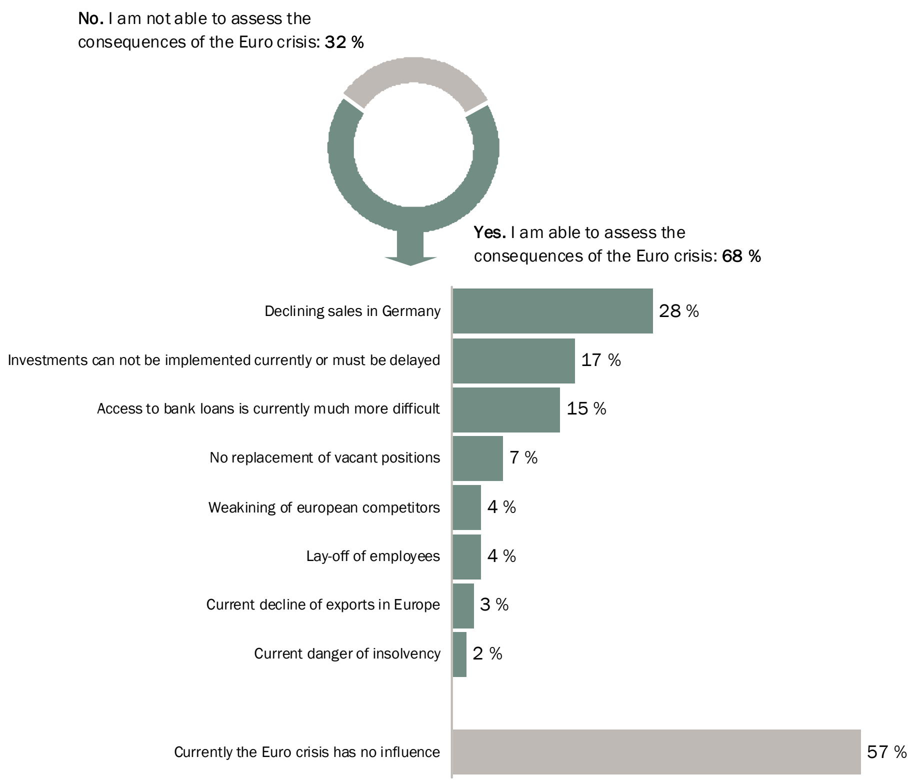



Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2012.

45 % of those SMEs that feel unable to assess the impact of the Euro crisis at present say that this is because they are unaffected by the crisis due to their lack of foreign business relationships. 37 % say that the situation has become so complex that they are unable to gain a clear overview. A further 14 % feel that the Euro crisis is not relevant to their business. This clearly shows that the uncertainty among SMEs is still considerable, even in the third year of the Euro crisis. Furthermore, a large proportion of companies are barely aware of what the consequences of a further escalation of the crisis could be, or ultimately expect the Euro area to remain intact.

Figure 17: Assessment of the consequences of the Euro crisis for the SMEs




Notation: Extrapolated with the number of SMEs. Lower figure: Restricted to companies that are capable of assessing the consequences of the Euro crisis.

Source: KfW SME panel 2012 (Supplementary survey September 2012).

Two thirds of SMEs state that they can assess the impact of the Euro crisis on their current business situation. Of these companies, more than half believe that the Euro crisis is not having any impact at all on their business activities at present (57 %). This assessment can be found, with only a few exceptions, in all segments of the SME sector, i.e. in all branches, size and age classes. Even SMEs with activities abroad and innovative SMEs are similarly optimistic. 51 % and 46 % of these companies, respectively, do not currently expect to see any consequences.

Out of those SMEs that believe they can assess the consequences of the Euro crisis on their current business situation, 43 % expect the crisis to have a negative impact. This is clearly reflected in the turnover and earnings outlook for 2012: companies that currently expect the Euro crisis to have a negative impact are more pessimistic than they are optimistic, namely by 2 percentage points in terms of turnover and 7 percentage points in terms of earnings.

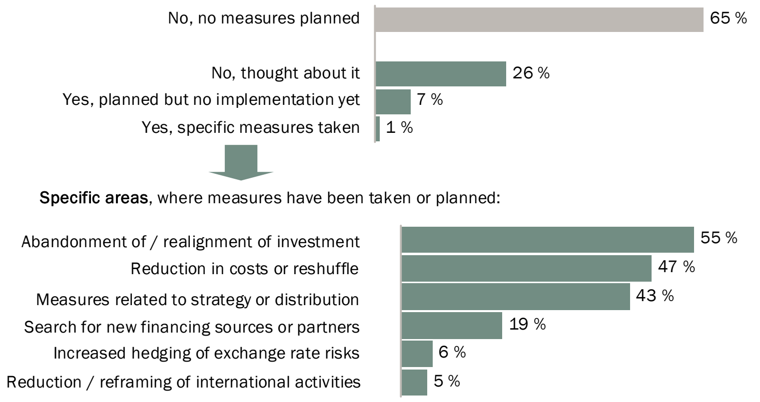
## Drop in turnover and reluctance to invest already making themselves felt

Out of all of the current effects of the Euro crisis, the impact that is most frequently cited by SMEs is a drop in domestic sales (28 %). This is mentioned in particular by innovators (42 %) and exporters (38 %). 17 % of companies feel that they cannot implement, or have to delay, their investment plans due to the Euro crisis. The construction sector is the hardest hit in this respect (23 %), with trading enterprises the least affected (5 %). Around one in six companies are currently experiencing specific difficulties getting bank loans (15 %). More difficult access to bank loans is a problem that is affecting the SME segment across the board. The manufacturing industry (8 %) and larger SMEs (9 %) are currently somewhat less affected, while investors (18 %) and construction companies (18 %) reported problems more frequently. 7 % of SMEs are currently not refilling vacant positions, with a further 4 % forced to let staff go as a result of the Euro crisis. The construction segment, in particular, is feeling the heat of the Euro crisis in this respect (23 %). 4 % of companies currently feel that less competition from other European countries has boosted their competitive standing. 3 % of SMEs are currently seeing their export revenue in Europe decreasing. As expected, this applies more to export-focused segments, i.e. larger companies and the manufacturing industry (12 % in each case). Only 2 % of SMEs currently believe that they are at a real risk of insolvency.

### SMEs have faith in the Euro

The KfW SME Panel shows a solid SMEs sector on the whole. Nevertheless: if the Euro crisis were to escalate further, this would currently catch the German SME sector **unprepared** – and **across the board**. Only 1 % of SMEs have already taken specific measures (figure 18) to prepare for an escalation of the crisis. A further 7 % of companies are planning measures but have yet to put them into practice. Roughly one in four companies say that they have thought about measures, but have neither made plans nor taken specific steps to date (26 %). In terms of how frequently companies take or plan specific measures, there are no differences between the individual segments, or based on whether companies can yet assess the impact of the Euro crisis or not. However, exporters (37 %), innovators (36 %) and young SMEs (31 %) are particularly focused on thinking about specific measures: they are hit directly by the recession on Europe's periphery. 65 % of SMEs are currently not planning any measures at all. Companies in the construction segment are particularly inactive in this respect (73 %).

Figure 18: Measures to be prepared for an escalation of the Euro crisis




Notation: Extrapolated with the number of SMEs. Lower figure: Restricted to companies that state to have implemented, planned or thought about implementing measures. Multiple answers possible.

Source: KfW SME panel 2012 (Supplementary survey September 2012).

Where specific measures have already been taken, are currently being planned, or have been considered,[16] these involved a decision either not to make investments at all or to revise investment plans for 55 % of companies. 47 % of SMEs are implementing, or planning, cost-cutting or cost-restructuring measures. At 43 % of SMEs, specific measures relate to the fields of strategy and sales. The search for new sources of financing, or financing partners, is currently relevant for 19 % of companies. Only 6 % of companies cited stepping up their focus on hedging against exchange rate risks. Similarly, moves to reduce or reorganise international business activities are hardly being considered by any SMEs in Germany at the moment (5 %).

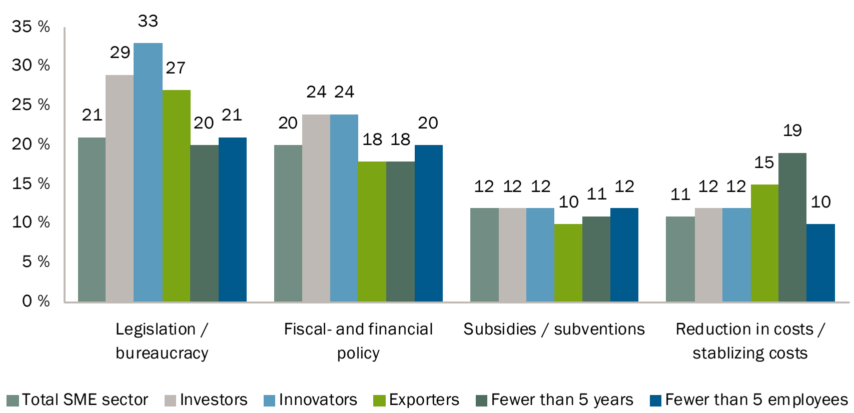
### Investors and innovators see the most pressing need for political action

The KfW SME Panel asked companies where they believe there is a need for economic policy action. 65 % of SMEs expect policymakers to take action in order to improve the overall environment for their company.

The most urgent need for action (figure 19) is believed to be in the areas of "Legislation and reducing bureaucracy", which was cited by 21 % of companies. This relates, among other things, to the tender process for, and award of, public-sector contracts (easing of award regulations, simplified documentation requirements). 20 % of SMEs believe that "Tax and financial policy" is an area that has to be tackled, e. g. in respect of simplified tax substantiation requirements and shorter retention periods

Figure 19: In which areas do companies see the most pressing need for political action?

The four most mentioned areas (answers in percentage terms)




Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2012.

for relevant documents. Next, albeit cited by considerably fewer survey participants (12%), is the area of "Promotional policy and subsidies." SMEs put the area of "Cost reduction and stabilisation" in fourth place (11%). SMEs mention a reduction in ancillary wage costs and the aspect of rising energy prices relatively frequently within this context.

Particularly in respect of the two areas cited most frequently, the assessments vary from segment to segment, although the differences between different branches and size classes are strikingly small. Companies who introduced an innovation between 2009 and 2011 (innovators) are more likely than average to refer to a need for action in terms of "Legislation and reduced bureaucracy" (33 % - non-innovators: 16 %). The same applies for investors (29 % - non-investors: 15 %) and SMEs that are active abroad (27 %). Furthermore, innovators and investors are more likely to mention "Tax and financial policy" than other SMEs (24 % in each case) as an area in which measures could be taken to improve the entrepreneurial framework. Very young companies with less than five years under their belt also mention "Cost reduction and stabilisation" measures far more often than other SMEs do (19 %).

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 an 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 in the German SME sector, making it the most important source of data on issues relevant to the SME sector. Due to its representativeness for SMEs of all sizes and from all branches in Germany, the KfW SME Panel supports **projections for even the smallest companies with fewer than five employees**. 11,031 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, lending demand or equity ratios.

The 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 2011 and the population of employees in SMEs in 2011, the German Company Register (*Unternehmensregister*) and the official employment statistics (*Erwerbstätigenrechnung*) were used for the 2012 survey.

The KfW SME Panel sample is designed in such a way that it can generate representative, reliable data that is precise as possible. The sample is split into four groups: type of promotion, branches, firm size as measured by the number of employees, region. In order to be able to draw conclusions as to 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. The extrapolation 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 in SMEs in Germany.

The survey is conducted by the market research division of GfK SE on behalf of KfW Bankengruppe. Academic advice for the project was provided by the Centre for European Economic Research (ZEW) in Mannheim. The main survey for the 10th wave of the KfW SME Panel was conducted between 17 February 2012 and 22 June 2012.

### The structure of the SME sector in 2011

The SME sector comprises all companies in Germany whose annual turnover does not exceed EUR 500 million. Based on this definition, there were 3.76 million SMEs in Germany in 2011. As a result, the SME segment makes up 99.96 % of all companies in Germany.

### SMEs are small...

The vast majority of SMEs in Germany are small (figure 20). 88 % of the companies (or just under 3.3 million) have annual turnover of less than EUR 1 million. Fewer than 1 % (or just shy of 17,000) of SMEs generate annual turnover in excess of EUR 50 million.

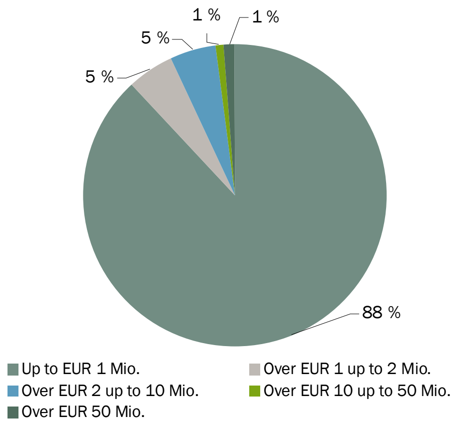
The small-scale structure of the SME segment is also reflected in the number of employees (figure 21). 84 % of SMEs have fewer than 5 employees (3.15 million). 1.5 % of SMEs have a workforce of 50 or more. The small-scale structure of the SME segment has become more pronounced in recent years due to 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 22): 2.83 million – or 76 % of all SMEs – operate in service industries, 1.33 million of them as knowledge-intensive service providers. 1.5 % of all SMEs (around 56,000 companies) belong to the R&D intensive manufacturing industry).

Around 3.08 million SMEs are based in the former West German federal states (82 %). 18 % (or 677,000) are headquartered in the federal states located in the former East Germany.

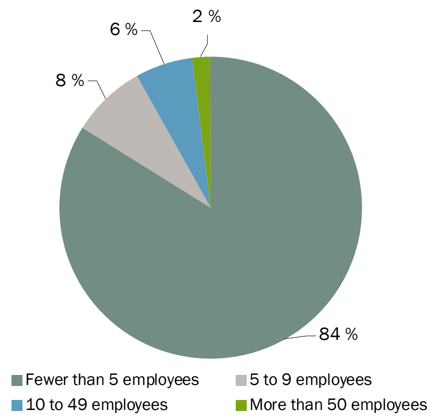
Figure 20: SMEs according to annual turnover in 2011




Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2012.

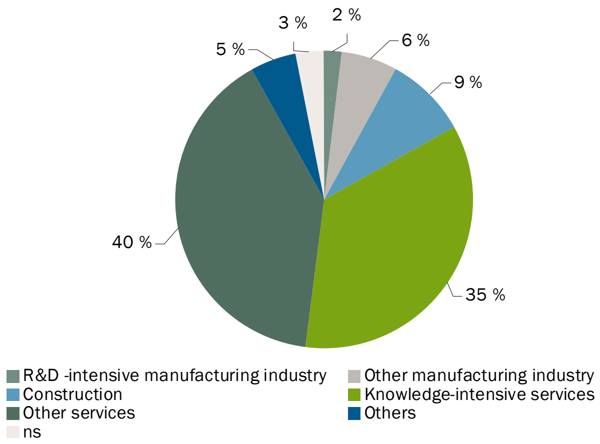
Figure 21: SMEs according to employees in 2011




Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2012.

Figure 22: Sector distribution in SMEs in 2011




Notation: Extrapolated with the number of SMEs.

Source: KfW SME panel 2012.

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

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

[3] The employment growth rate 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 from the number of full-time employees (including owners) plus the number of part-time employees multiplied by a factor of 0.5. Trainees are not taken into account.

[4] Data on the total German export volume in 2011 has been taken from the Federal Statistical Office (2012): Foreign trade. Order of rank of Germany's trading partners (with turnover and foreign trade balance). Wiesbaden.

[5] See Brutscher, P., Raschen, M., Schwartz, M. and V. Zimmermann (2012): Internationalisation among German SMEs: Step by step to becoming a global player. (available in German only) KfW Research, KfW Bankengruppe, Frankfurt am Main.

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

[7] 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.

[8] 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. (2012): KfW Investment Barometer, June 2012, Germany. Corporate investments: Slow start to year, weak recovery throughout rest of year, great risk of slowdown. KfW Bankengruppe, Frankfurt am Main.

[9] See the data on total gross fixed capital formation in 2011: Federal Statistical Office (Destatis) (2012): National accounts. Investment supplement. Wiesbaden.

[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] See Hornberg, C. (2012): KfW Investment Barometer Germany (September 2012). Corporate investments: Autumnal mood. (available in German only) KfW Bankengruppe, Frankfurt am Main.

[12] See Schwartz, M. and V. Zimmermann (2012): KfW Business Survey 2012 (available in German only). Corporate financing stable despite Euro crisis. KfW Bankengruppe, Frankfurt am Main.

[13] See Hornberg, C. (2012): KfW Credit Market Outlook (September 2012). New lending business: Golden summer, golden autumn? (available in German only) KfW Bankengruppe, Frankfurt am Main.

[14] For details, see Reize, F. (2011): KfW SME panel 2011. SMEs well equipped to handle increasing financing risks and economic slowdown. (available in German only). KfW Bankengruppe, Frankfurt am Main.

[15] The supplementary KfW SME Panel survey on the current impact of the Euro crisis on the SME sector was conducted online in the period from 10 September to 30 September 2012 (again by the market research institute GfK). The survey targeted all companies that had already taken part in the main survey of this year's KfW SME Panel and that had a valid e-mail address. The data collection methods were assessed in a pre-test prior to the actual survey. Answers from a total of 2,867 companies were received for analysis, which corresponds to a response rate of around 49 %.

[16] No extrapolated figures have been produced for various SMEs segments at this point, as the sample size is, in some cases, too low.