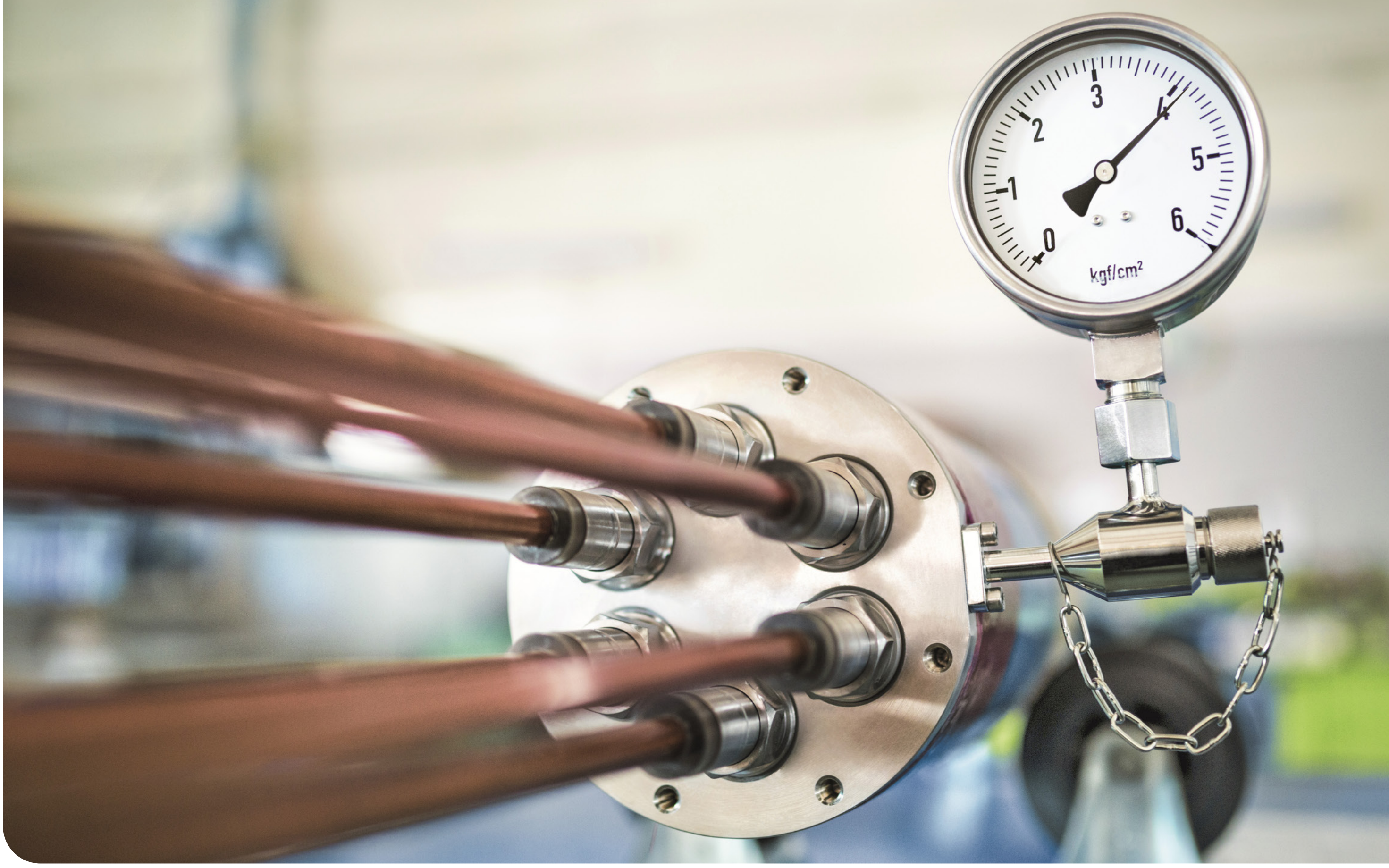

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KfW SME Panel 2024

German SMEs are not immune to the economic slowdown

Annual analysis of the structure and development of SMEs in Germany

Imprint

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German SMEs are not immune to the economic slowdown

The environment of persistent crisis conditions continued to exert significant pressure on SMEs last year. This is one of the findings of the KfW SME Panel 2024, which paints a detailed picture of both the present situation and the development of small and medium-sized enterprises during the past year.

Although inflation remained high in 2023, the turnover of small and medium-sized enterprises fell by a nominal 4.6% (-EUR 246 billion). The price surges for goods and services were insufficient to generate higher turnover for businesses. In real terms, **turnover losses** were even more pronounced (adjusted for prices, -10% across the entire SME sector). Businesses do not expect their turnover to improve much at all in 2024 either.

Against the backdrop of a persistently high cost level and weak turnover growth, the fact that **profitability** remained steady is good news, with profit margins remaining stable at 7.0%. However, there was a high level of heterogeneity. The earning power of smaller businesses and those of the knowledge-intensive services sector fell again. For micro-businesses it was the fifth straight decline. Their profitability fell to 11.3%, the lowest level in 11 years. They were able to pass cost increases on only to a limited extent. Many businesses anticipate further cost increases. Their income situation will therefore likely remain weaker in 2024 as well.

Irrespective of the difficult business development, SMEs proved to be the employment engine of the German economy again in 2023, posting considerable **employment growth** of around 494,000 workers. As a result, some 33 million people were employed in the SME sector, more than ever before. SMEs gained in importance as employers, providing work for nearly 72% of the whole workforce, which accounted for all of the employment growth across the economy last year. Employment will continue to grow across the economy in 2024, albeit at a slower pace. Lately, however, SMEs' employment expectations were falling.

The capital structure and **equity base** of small and medium-sized enterprises are generally stable. The equity ratio fell by a moderate 0.6 percentage points to an average 30.6%. Structurally, however, there was a deterioration, as more SMEs had a low equity ratio (+8 percentage points) and fewer SMEs had a high equity ratio (-13 percentage points). In addition, the gap between small and large enterprises widened yet again. Larger SMEs continued to increase their equity buffers, while the decline among micro-businesses continued.

The difficult environment weighed on SMEs' **investment appetite** in 2023. The share of SMEs with investment projects stayed just barely above the all-time low, dropping by 4 percentage points – or 141,000 enterprises – to 39%. The increased reluctance to invest was felt across all segments in the SME sector and was most prominent in the construction industry (-10 percentage points).

In total, (nominal) **new investment** by SMEs grew by EUR 8 billion or 4% in 2023 (EUR 219 billion). On a price-adjusted basis, however, the volume of investment was around 2% lower (new investment in real terms: EUR 205 billion). Replacement investments and investments in adaptations to technical innovations were at the top of SMEs' agendas. What weighed most on businesses' willingness to invest were the price level (for materials, energy and salaries) (54%), the overall economic development in Germany (53%) and legal requirements (49%). Financing charges and conditions were further down the list. Based on the views provided by SMEs, investment activity can be expected to remain weak in 2024 as well.

The **financing environment** for SMEs clouded over in the year 2023. High interest rates, tight lending policies and weak investment momentum have greatly diminished demand for investment loans from SMEs. Only one in four SMEs with investment projects conducted loan negotiations (-8 percentage points), the lowest rate ever. At the same time, the success rate for those that were in negotiations dropped (-7 percentage points) and the **loan rejection rate** increased by three percentage points to 12%. Hardly surprisingly, the level of interest rates was the overarching reason for the failure of loan negotiations (54%). However, it was mostly small businesses that had difficulty accessing loans in 2023. While the deterioration in financing conditions appeared to have left larger SMEs unscathed, the **structural disadvantages of small businesses** stood out more strongly again as a result of the tightening of credit supply. They were much more heavily affected.

In total, the number of businesses that had **bank loans** in the funding mix for their investments fell by 244,000 (-32%) to 519,000 in 2023. The decline took place in all segments but primarily among smaller enterprises. Despite this drop, the volume of loans from banks and savings banks actually used by SMEs to finance investments rose slightly (+EUR 3 billion to EUR 79 billion). The relatively small increase of large-volume loans (similar to the investment trend) had a very strong impact, offsetting the otherwise lower demand. The average volume of bank loans newly obtained to finance investments in 2023 thus increased by approx. 52% (EUR 152,000 for each business undertaking credit-financed investments).

The interest rate turnaround initiated in July 2022 left an imprint on the balance sheets of small and medium-sized enterprises. **Cumulative interest expenses** in 2023 totalled EUR 36 billion – a 40% year-on-year increase. They were borne equally by enterprises of all size classes. Despite the sharp increase in the interest burden, their **debt servicing capacity** remains decidedly high. The share of companies with critical **debt sustainability ratios** (‘zombie enterprises’) remained at a very low 3% in 2023. Or phrased the other way around, more than 97% of all SMEs have sufficient debt servicing capacity. Given the persistently high financing costs, interest expenses can be expected to continue rising considerably in 2024.

The German economy was still not back on track in late summer. After growing by 0.2% in the first quarter of 2024, GDP adjusted for price, seasonal and calendar variations shrank by 0.1% in the second quarter. Current economic output is therefore hardly any higher than before the outbreak of the COVID-19 pandemic. Low investment in construction and equipment was the main cause for the listless performance.

Nonetheless, the conditions for at least a moderate, spending-driven recovery remain intact thanks to a sharp drop in the inflation rate and rising real wages. After little more than stagnation this year, we expect real growth of around 1% in Germany for 2025. Gross fixed capital formation, however, is unlikely to grow again until next year. That is when the dampening effect of global monetary policy will ease noticeably, primarily benefiting construction and manufacturing as producers of capital goods.[1]

Sentiment among SMEs is showing a few bright spots

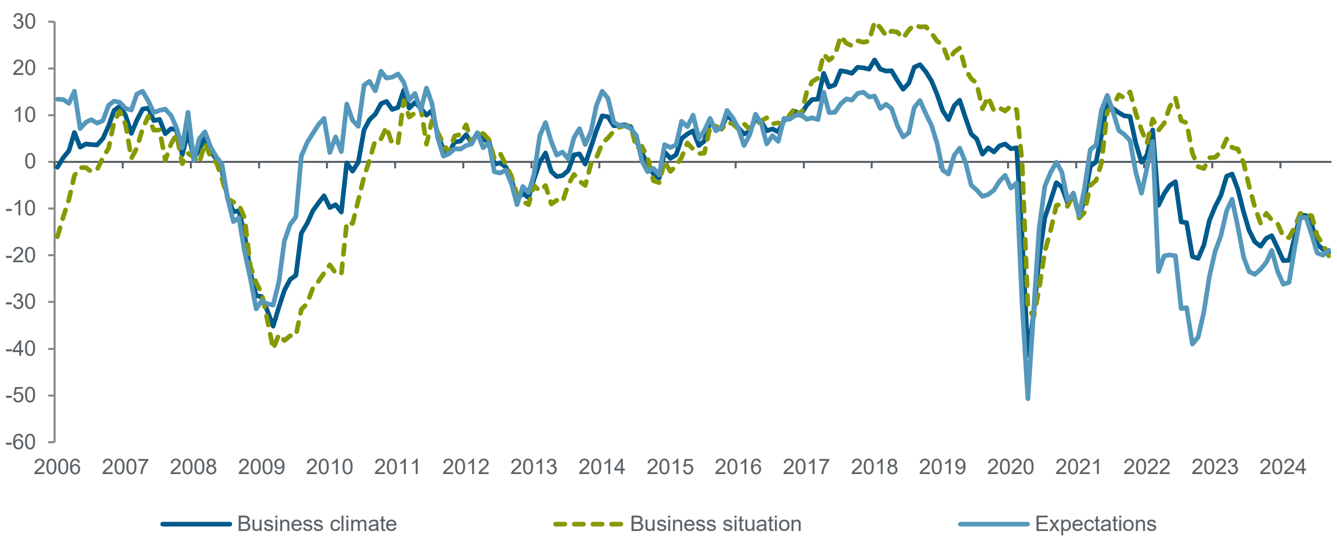
SMEs are not immune to the cyclical headwinds of the current year either. After sentiment among SMEs had brightened on a low level up until April, the most recent KfW-ifo SME Barometer revealed a broad decrease in sentiment (Figure 1).[2] September marked what was already the fifth consecutive decline in SME business sentiment. It has now dropped down to almost the level recorded at the height of the energy crisis in autumn of 2022.

The speed at which confidence has dropped among SMEs has at least slowed down lately. The unusually negative mood is most likely the result of the great uncertainty affecting businesses, which are facing a multitude of transformative challenges and persistent global crises.

The weak economic development is also reflected in insolvency activity. After a historic low during the COVID-19 pandemic, the number of business insolvencies increased noticeably in 2023 (+22% to 17,814). That trend has continued this year. Between January and June 2024, some 10,700 enterprises entered insolvency. Despite the increase, in a historic comparison the current number of insolvencies is still below the pre-pandemic level (the annual average in the 1999–2019 period was around 29,000).

The crisis conditions continued to exert significant pressure on SMEs last year as well. These are the findings of the 2024 KfW SME Panel. It is based on both the main survey of the year 2024 (February to June) and on the most recent findings of a representative supplementary survey of September 2024, painting a comprehensive picture of the economic situation of small and medium-sized enterprises in Germany.

Figure 1: KfW ifo Business Climate Index



Source: KfW Research, Ifo Institute.

SMEs' post-pandemic recovery stagnated in 2023: overall turnover is falling

In the years 2021 and 2022, small and medium-sized enterprises made an impressive recovery from the deep shock of the COVID-19 crisis.[3] However, the environment of persistent crisis conditions put an end to this development in 2023. The overall turnover of small and medium-sized enterprises in Germany decreased nominally by EUR 246 billion or -4.6% last year. On balance, their total turnover thus amounted to EUR 5,077 billion in nominal terms (2022: EUR 5,322 billion). Already in autumn of the previous year, SMEs voiced strong scepticism about how their turnover would develop.

This means that the inflation-driven surge in the prices of goods and services last year was not enough to boost SMEs' turnover overall. Taking into account inflation, which remained exceptionally high in 2023 as well (+5.9% on average for the year, after +7.9% in 2022[4]), turnover losses would have been even more pronounced: Adjusted for prices accordingly[5], the growth of absolute aggregate turnover in the SME sector would have been around -10%. Unless otherwise stated, in the following we will predominantly refer to nominal values to ensure comparability.

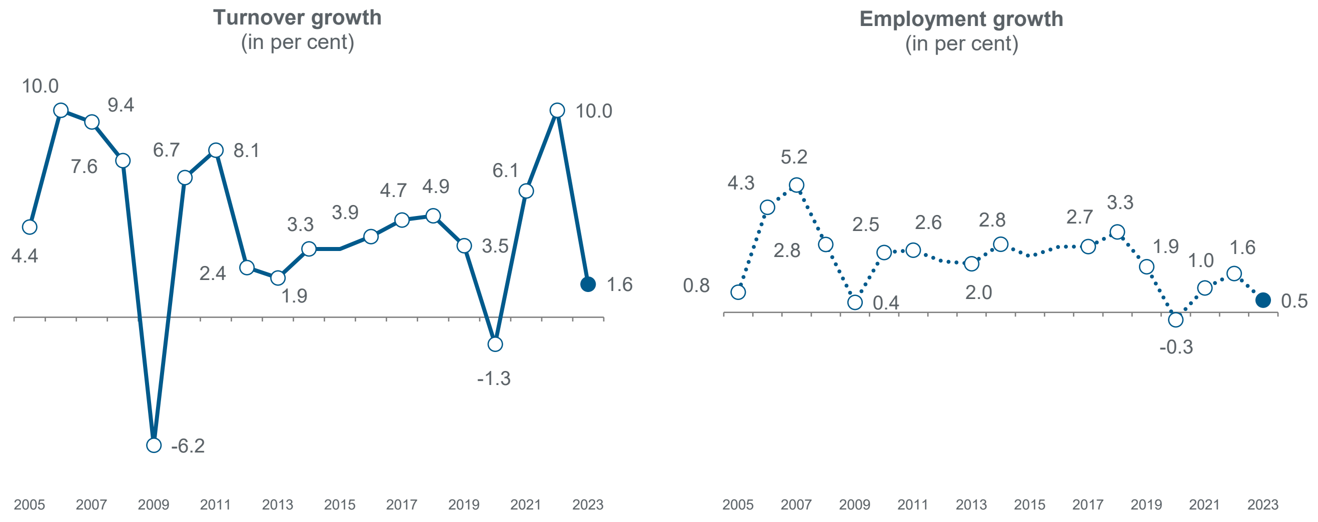
Average turnover growth also fell sharply in 2023

Average (nominal) turnover growth rates painted a similar picture (Figure 2). Unlike overall turnover, mean growth rates are influenced less by enterprises that experience very large variations in their absolute turnover. They would be reflected in aggregate volume but not in average growth rates.

The average (nominal) turnover growth in the SME sector stood at +1.6%. With the exception of the difficult COVID-19 year 2020, this rate represents the weakest average growth achieved by enterprises since the global economic and financial crisis – despite a very high average annual inflation rate in Germany that would have been expected to result in stronger nominal turnover growth. The slump is more than significant, particularly in comparison with the previous year's rate – the average turnover growth in 2022 was +10%.

The fact that the aggregate turnover of all enterprises fell despite a positive growth rate on average per company means that a number of SMEs experienced very large turnover losses in 2023. A closer look reveals that the decline in the overall volume among SMEs is largely attributable to declines in domestic turnover of large SMEs with 50 more employees and SMEs providing other services. These include, for example, personal services, catering and hospitality, broad sections of the tourism industry, nursing care, training and education as well as arts, culture and sports. In these segments, an above-average proportion of SMEs experienced very steep turnover declines from the previous year (irrespective of the positive annual growth rates across the average of the segments).

Figure 2: Average annual turnover and employment growth in the SME sector



Source: KfW SME Panel 2024

Multiple segments experienced losses in 2023 and micro-businesses faced challenging conditions

The weak growth affected all SME segments without exception (see Volume of tables relating to the KfW SME Panel 2024 for detailed data on each segment). R&D-intensive manufacturing enterprises[6] were the only ones to keep up in any way with the average growth rates of previous year. The average turnover growth rate was 4.7%. By contrast, (nominal) average turnover dropped among SMEs operating in other manufacturing[7] (-2.3%) and micro-businesses with fewer than five employees (-0.7%).

The situation has been difficult for micro-businesses in particular. They account for 81% of all SMEs in Germany and therefore shape the overall development of the SME sector. In the years 2021 and 2022, these enterprises on average achieved very positive growth rates – although amid a declining aggregate turnover volume. In both years, this was because a limited number of businesses in this size class suffered very high turnover losses in absolute terms. In 2023, however, the sluggish turnover affected the segment of micro-businesses rather more broadly. The only times this had happened before was in the crisis years 2009 and 2020.

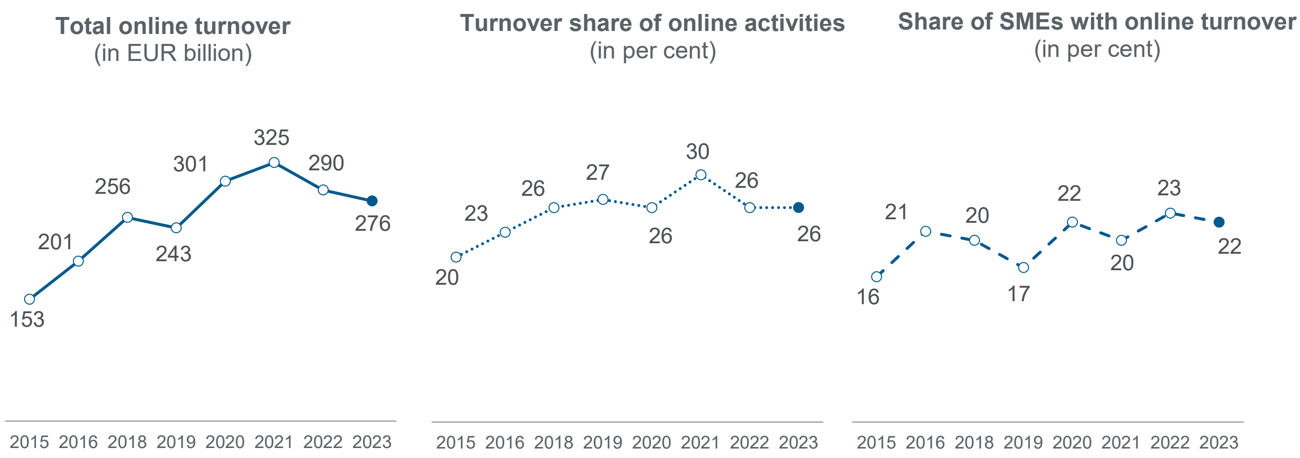
Businesses' online turnover fell again, 'pandemic effect' does not appear to be lasting

The online turnover of small and medium-sized enterprises presented a similar picture in 2023. Businesses generated EUR 276 billion in total with e-commerce[8], which includes digital marketplaces, online shops, procurement platforms and automated data exchange between businesses, for example (Figure 3). This represented a nominal loss of 5% or EUR 14 billion in the digital sale of products and services. Online turnover is thus approaching the pre-pandemic level again (2019: EUR 243 billion).

The renewed decline is therefore likely due primarily to the exceptionally high importance of online sales channels during the time of the COVID-19 pandemic. During the pandemic, businesses were able to prevent or offset a sharper downturn or losses in turnover (resulting from restrictions on retailers, sales forces or similar) by moving sales to digital channels or adding or expanding such channels.[9] This resulted in significant growth in online turnover. However, already in 2022 it became evident that after pandemic restrictions were lifted, digital sales channels fell behind traditional sales channels again, so that the growth trend reversed (nominal loss of -11% in 2022).

Macroeconomic data for the year 2023 suggests a similar trend, even if the negative trend is less pronounced. Online and mail order sales reported by Destatis fell by 0.4% in nominal terms and 3.9% in real terms in 2023.[10] Figures released by the German Retail Federation showed a nominal increase of 1% for online sales.[11] This shows that SMEs fell behind the overall economic development in this area.

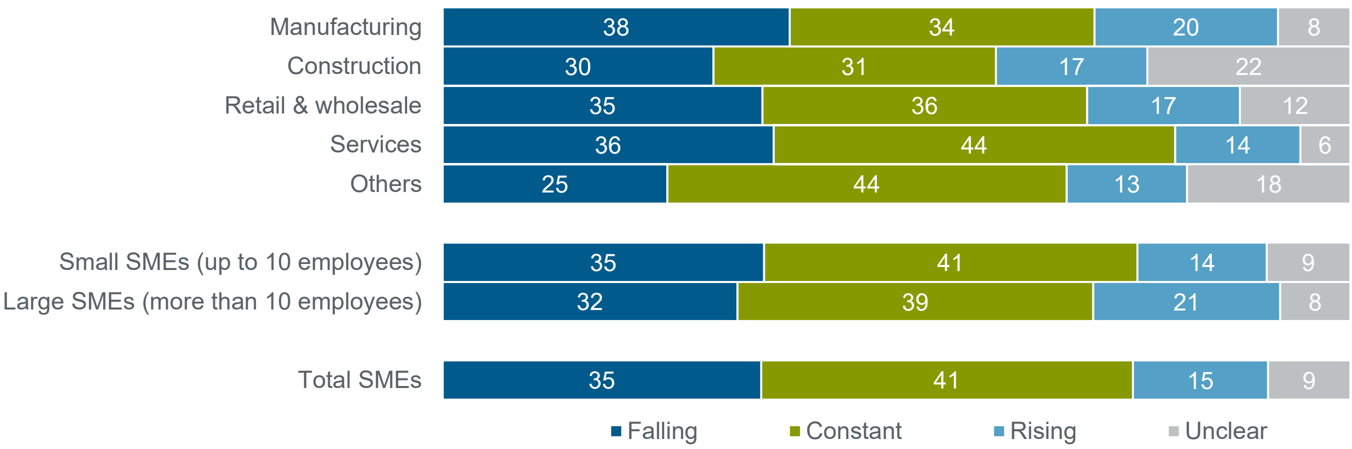
Figure 3: Key figures on online turnover in the SME sector



Source: KfW SME Panel 2024

Figure 4: SMEs' turnover expectations for the financial year 2024

In per cent



Source: Supplementary survey to the KfW SME Panel 2024, September 2024

In 2023, digital sales channels were at least being used by a similar number of businesses as before. The share of SMEs generating turnover online dropped slightly by one percentage point to 22%. That represented a total number of approx. 839,000 businesses with e-commerce activities. At the same time, the share of turnover among those that conducted online business hovered on the previous year's level. The contribution of e-commerce to total turnover was 26% in 2023 – in companies that generated online sales at all. This is another expression of the return to the 'normal level'. After surging to 30% in 2021 – as a result of the pandemic – that share of turnover is now back to the pre-pandemic level (2019: 27%).

While it remains to be seen how online turnover will evolve over the coming years, the most recent figures do not appear to make a sustained continuation of the 'COVID-19 boom' very likely. Taken together, this component of SMEs' turnover has fallen by around EUR 49 billion since its peak in the year 2021. At a relatively steady 5.4% (2022: 5.5%), its share in total SME turnover is definitely modest. Nonetheless, SMEs can be expected to continue at least gradually expanding digital sales channels.

SMEs' turnover expectations suggest little improvement in the current year

The subdued economic growth outlook for 2024 is also reflected in the expectations of SMEs around this year's turnover performance (Figure 4). Based on their assessment in the autumn of 2024, their view of the current situation has visibly dimmed. More than one third of SMEs (35%) expect their turnover to decrease in the current financial year. On average, the affected businesses anticipate that their turnover will fall by 19% on the previous year. SME manufacturers are currently particularly pessimistic, with around 38% of them expecting a lower turnover. Among the likely reasons are subdued investment activity in the business sector and weak export demand. However, in autumn of 2024 more than one third of SMEs in the services and retail sectors also expected their turnover to fall in the current year (36 and 35%).

At the same time, around 15% of SMEs expect their turnover to grow this year. On average, however, these enterprises expect an increase of only 15%. Larger SMEs with more than 10 employees in particular are more likely to be optimistic about the current financial year, with 21% of SMEs in this segment expecting higher turnover. In the services sector, on the other hand, only one in seven businesses expect a higher turnover this year (14%).

The balance of positive minus negative turnover expectations for 2024 was -20 points. The balance was negative in every single segment of the SME sector; in other words, negative expectations predominated. This was particularly pronounced in the services sector and in the group of small businesses with fewer than 10 employees, with the balance in both segments hitting -23 points and -21 points.

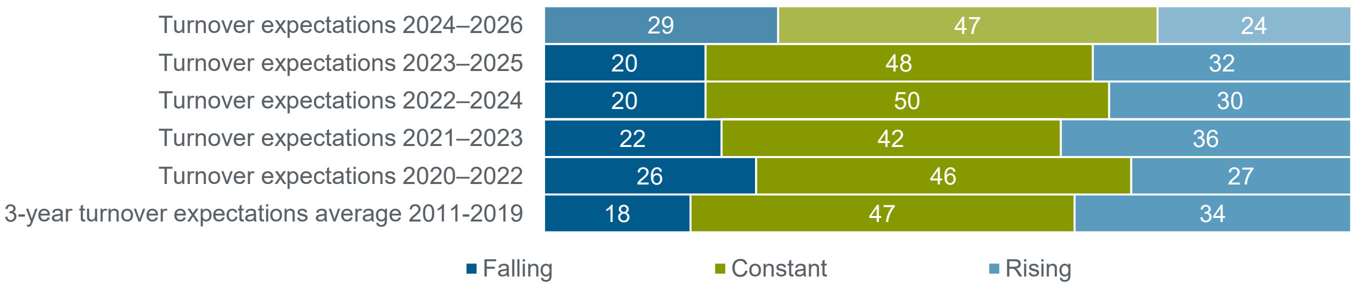
Pessimism prevails in businesses' medium-term expectations

The medium-term business expectations up until the end of the year 2026 that were expressed by businesses during the survey period of the KfW SME Panel (February to June 2024) suggest that overall sentiment is unlikely to brighten significantly (Figure 5). On the contrary. More enterprises than ever before, 29%, expect their turnover to remain below the previous year's level in the coming three years. At the same time, only 24% of SMEs expect turnover to pick up in the medium term – a decline of eight percentage points from the previous year. That puts the balance of positive minus negative turnover expectations at -5 percentage points, after a clearly positive +12 percentage points in the previous year. Thus, pessimism is clearly the prevailing mood within the SME sector – and compared with all previous periods.

Only few segments are able to shield themselves from the broad pessimism (Figure 6). Despite the economic weakness, larger businesses in particular are much more optimistic than micro-businesses and small SMEs. Young enterprises are also more positive about the years ahead. By contrast, construction SMEs have a more negative view of their turnover development up to the year 2026 than any other segment (on balance, -23 percentage points). That is a high level even for the traditionally rather pessimistic construction industry and a clear reflection of the difficult current situation in the property market.

Figure 5: SMEs' medium-term turnover expectations up to 2026

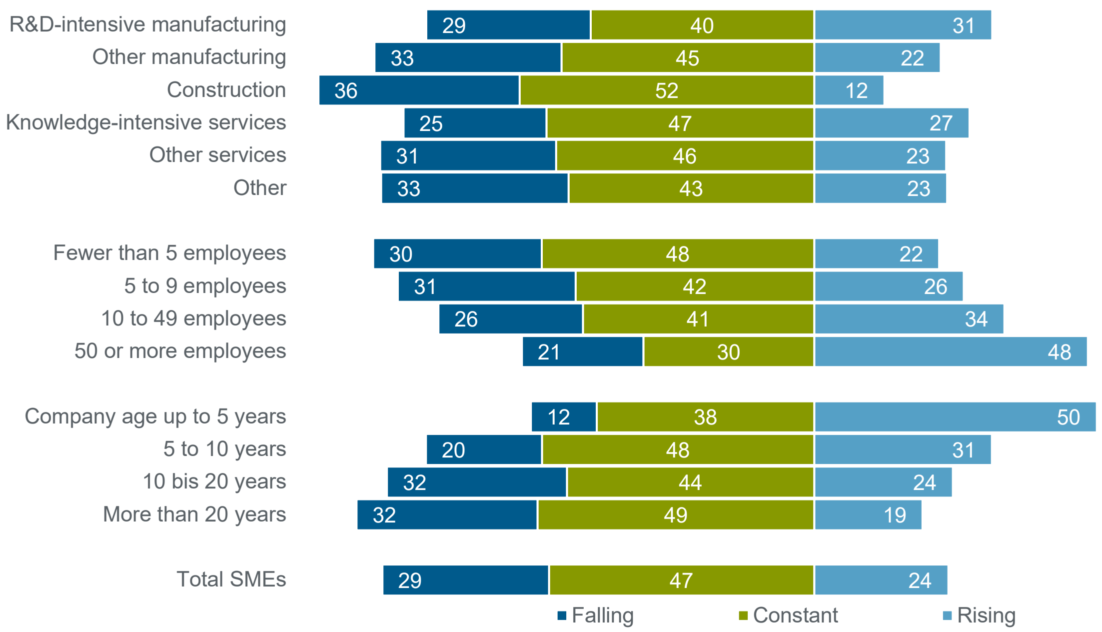
In per cent



Source: KfW SME Panel 2024

Figure 6: Medium-term turnover expectations by segment (2024–2026)

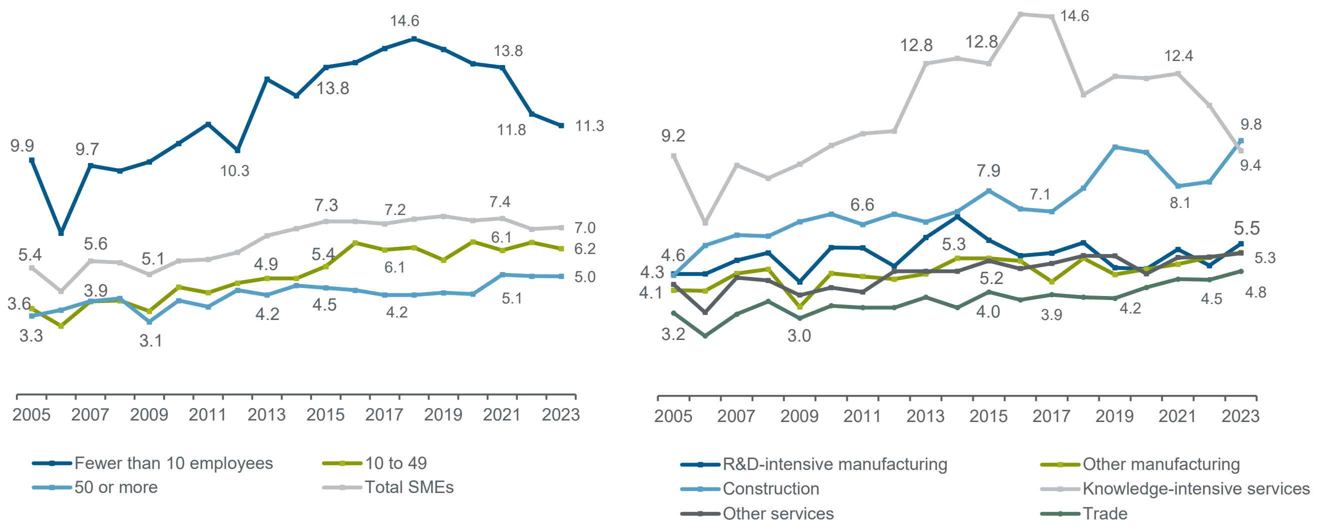
In per cent



Source: KfW SME Panel 2024

Figure 7: SME profit margins by size class (left) and sector (right)

Size classes by number of full-time equivalent employees, figures in per cent



Source: KfW SME Panel 2024

SMEs' profit margins are stable in the aggregate

SMEs already demonstrated in the past that they can continue operating profitably and generating profits despite crisis-driven turnover losses. This was evident in both COVID-19 years 2020 and 2021. Their profit margin hardly changed and averaged a steady 7.4% across the entire SME sector.[12] In 2022, the average profit margin in the SME sector fell from 7.4 to 7.0% as a result of significantly higher prices (Figure 7). The average profit margin in the SME sector remained on that level in 2023 (7.0%). Given the generally rather weak turnover growth (see above) and a continuing high cost level, this can be seen as a positive development. On average, SMEs have been able to keep their profitability steady despite the challenging environment.

Some SMEs were even able to increase it. Slightly more businesses exhibited very high profitability than in the previous year. The share of businesses with a relatively high profit margin of 10% and more rose by 3 percentage points to 63% in 2023. At the same time, however, more businesses fell into the red. The share of businesses with a negative profit margin rose to 11% in 2023 (10% in 2022, 8% in 2021). But a comparison with historic levels shows that these shares remain moderate. In the crisis year 2009, for example, 16% of SMEs were still suffering losses and in 2006 it was as many as 21%.

Profit margins continued to fall in the segment of micro-businesses

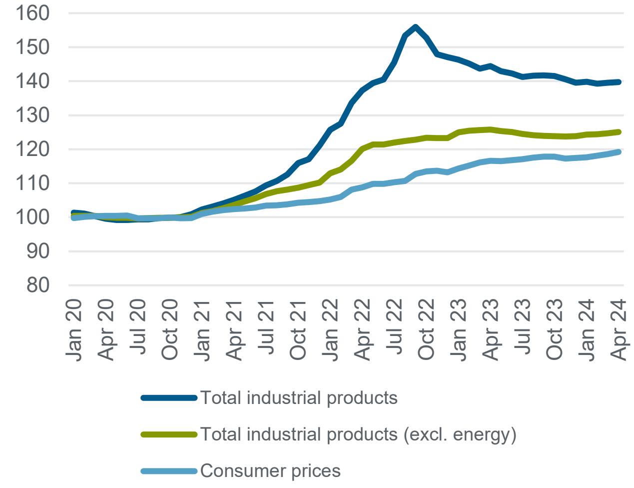
However, a closer look at the development of profitability in individual SME segments reveals great heterogeneity (Figure 7). Larger SMEs, for example, were able to keep their profit margins steady (+/-0 percentage points), while construction firms managed to increase them by a noteworthy +1.5 percentage points and R&D-intensive and other manufacturing firms achieved gains of +0.8 percentage points and +0.2 percentage points. Smaller enterprises and businesses offering knowledge-intensive services[13], on the other hand, faced another drop in profitability last year.

For micro-businesses with fewer than 10 employees, it was the fifth consecutive drop. That means they have been struggling with a continuing decline in profitability for some time now. Their profitability fell by 0.5 percentage points to 11.3% last year, the lowest level in 11 years. It was a 3.7-percentage-point decline from the previous all-time high of 2018. They shape the development of the entire SME sector because of their high number.

In the segment of knowledge-intensive services, too, which include architecture and engineering firms, law firms, tax and management consultancies, data processing and telecommunication services, businesses also regularly achieved lower profits from their turnover in recent years. Their profit margin fell again by 1.8 percentage points to 9.4% last year. Thus, their profitability is down by one third from its all-time high of 14.7% of 2016.

Figure 8: Development of producer and consumer prices in Germany

Index of producer prices for industrial products and consumer prices (2020=100)



Source: Federal Statistical Office, own rendition

Micro-businesses and service providers can pass on only some of the cost increases

The negative trend in profitability emerged already before the COVID-19 crisis in both micro-businesses and knowledge-intensive services, but it has picked up since 2021. One of the main reasons for this is likely the fact that micro-businesses in particular have limited options for adapting their cost structure, particularly for reducing fixed costs, and thereby maintaining their profit steady when turnover declines. Furthermore, micro-businesses, but also SMEs from the services segments, are also more likely to have less scope to pass all or at least large parts of the increased costs of materials, energy and wages on to their customers.

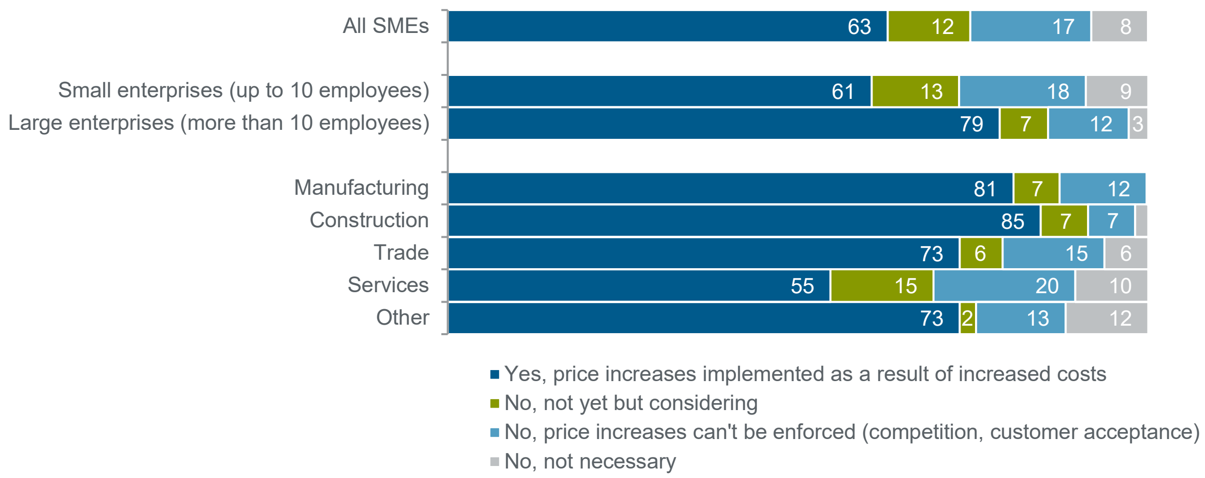
This is a particular disadvantage in the current situation. After all, the most recent crises have resulted in significant cost increases for small and medium-sized enterprises. In the year 2021, general producer prices for industrial products (and consumer prices) were roughly 10% (and 3%) above the previous year's level (see Figure 8). In 2022, they even rose by a further 30% (and 7%) on the previous year[14].

The rapid price increases have slowed significantly since the end of 2022. The latest inflation rate and, hence, the increase in consumer prices was only +2.2%, and producer prices have even dropped by 3.3% in the same period. Overall, however, prices still remain on a high level. Compared with the pre-crisis level (here: January 2020), producer prices have risen by 38% and consumer prices by 19%.

What is decisive for the ability to pass on increased costs is the competitive intensity prevailing for the individual business. For example, if customers can easily turn to alternative offers (high price elasticity of demand), this limits the option of passing cost increases on. These conditions – intense competitive situation and lower customer acceptance – are reflected by the fact that the share of enterprises in the segment of micro-businesses (and service providers) that enforced price increases was significantly smaller than in other segments (as at September 2023).[15] Around one in five SMEs in both segments were unable to enforce price increases due to higher costs (Figure 9). In other segments of the SME sector, that share was between 7% (construction) and 15% (retail and wholesale). The weak economic environment also had an adverse impact. These factors appear to have affected micro-businesses as well as services more strongly in the past years.

Figure 9: Price increases in 2022 as a result of increased costs, by SME segment

Shares of enterprises in per cent, as at September 2023.



Source: Supplementary survey to the KfW SME Panel 2023, September 2023.

SMEs expect further cost increases this year as well

The prospects for 2024 give little hope for a sustained recovery of profit margins. That is because many SMEs expect further cost increases this year as well, according to a supplementary survey to the KfW SME Panel that was conducted in April 2024 (Figure 10).[16] Under the survey, four in five SMEs (8%) responded that they expected further cost increases in at least one area in 2024 as a whole compared with 2023. Three cost items were mentioned most frequently: i) energy, ii.) materials, raw materials and inputs and iii.) wages and salaries. These three categories combined make up an average 68% of total costs incurred by small and medium-sized enterprises and thus represent their largest cost factors. The profit situation is therefore most likely to remain weak in 2024.[17]

Figure 10: Cost increases expected by SMEs for all of 2024 compared with 2023

Shares of enterprises in per cent

Source: Supplementary survey to the KfW SME Panel of April 2024

SMEs are still the employment engine of the German economy

Although the recent turnover trend in the SME sector can definitely be described as worrying, SMEs continue to demonstrate that they are the employment engine. Despite all economic worries, employment has continued to develop in an exceptionally positive way. The year 2023 saw significant employment growth of around 494,000 workers. That means a total of 32.83 million workers were employed by SMEs in 2023 (Figure 11, left) – another increase on the previous all-time highs recorded in the years 2022 and 2019.

The 14-year period of continuous employment growth in small and medium-sized enterprises came to a standstill in 2020, in the course of the COVID-19 crisis. The crisis-induced job losses, however, ended up being moderate and the pessimistic expectations expressed by businesses at the beginning of the pandemic came true to a limited extent only. The short-time work allowance, which gave many employers a chance to keep their workers on the payroll, was a factor that stabilised employment. In retrospect, that means the COVID-19 years forced a correction on employment in the SME sector that was only minor and quickly overcome.

Thus, employment in the SME sector generally continues to move in line with employment in the overall economy. On average for the year 2023, around 45.93 million people were gainfully employed in Germany – more than at any time since German unification in 1990. That represented a rise of 336,000 people (+0.7%).[18]

In general, it must be noted that businesses in the services sectors are particularly critical for the development of aggregate employment because of their very high number. In 2023, services segments alone (including retail and wholesale) comprised 77% of all SMEs, employing around 24.8 million people, or 75% of all workers in the SME sector.

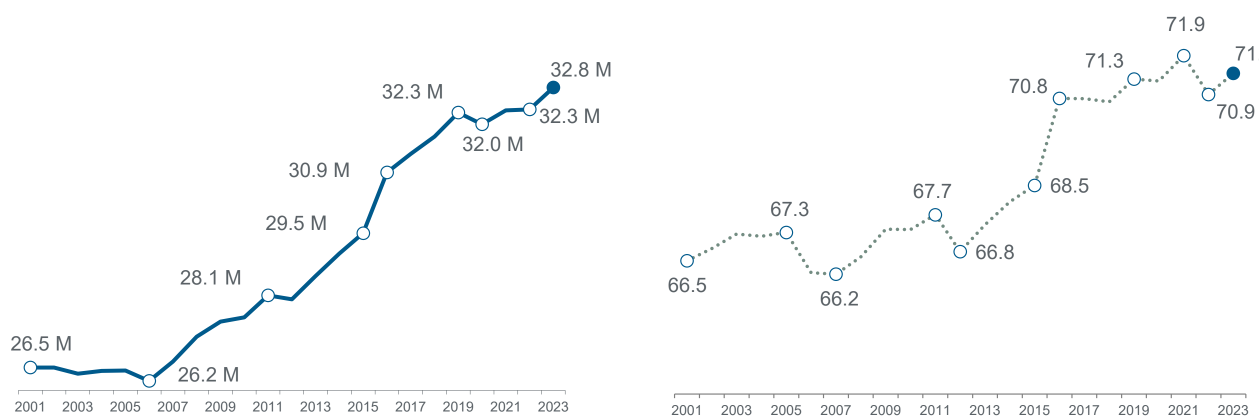
SMEs drove employment growth across the economy last year

With a view to total employment in Germany, it is also clear that small and medium-sized enterprises were responsible for the entire employment growth across the aggregate economy in 2023 as a result of the strong increase in their workforce. The absolute and relative increase in employment, too, was higher among SMEs last year than in the aggregate economy. SMEs thus gained in importance as employers.

As a direct consequence, the share of SMEs in overall employment rose to 71.5% (Figure 11, right). In contrast, large enterprises and the public sector lost employees in 2023 (-158,000 workers).

Figure 11: Employment in SMEs

Persons employed in the SME sector (left) / share of SME sector in aggregate employment in Germany in per cent (right)



Source: KfW SME Panel 2024

Labour market is likely to grow in 2024 as well but a question mark hangs over SMEs

Current economic figures on the development of employment in Germany indicate that employment will continue to grow in 2024[19] – if at a considerably slower pace than in 2023. In June 2024, around 46.0 million people in Germany were gainfully employed. Year-on-year, that amounts to a moderate increase of approx. 0.4%. For 2024, an upward trend is therefore foreseeable at least for the economy as a whole.

For SMEs, however, it remains to be seen how the difficult economic environment will impact on hiring plans in the current year. The KfW-ifo SME Barometer has already identified decreasing employment expectations of small and medium-sized enterprises for the year 2024 as a whole.[20] Employment expectations fell again at the current margin.[21] The ifo Employment Barometer has also reported cautious hiring plans among enterprises in Germany, which have been on the decline in 2024.[22]

Differences in employment trend between segments was quite pronounced in 2023

Full-time job equivalents (FTEs)[23] grew at an aggregate rate of approx. 0.5% on average in the year 2023. However, as was the case for the development of turnover, the only times when the average annual growth rate was lower were the crisis years 2020 and 2009.

In 2023, the employment growth rates were hardly distributed evenly between the segments, as was often the case in the past (Figure 12). The range was relatively wide. At sector level, other manufacturing stood out with an average employment reduction of 1.1%. SME construction firms also cut jobs on average (-0.3%). Quite the opposite was the case for knowledge-intensive services, which again underscored their position as growth leaders. Companies in this segment reported the highest average growth rate in FTE employees last year by far (on average +1.8%). These SMEs were on an above-average growth path already in the years 2022 and 2021 and even succeeded in expanding their workforce in the pandemic year 2020.

Larger SMEs also hired more workers than average. Jobs were lost on average by micro-businesses (-0.5% on average) and small SMEs (-0.3% on average) – for the third time already in the last four years. This shows that the recovery from the impact of the pandemic did not last long, given the troubled overall economic waters that had to be navigated in 2023.

Equity buffers remain on a high level despite moderate drop

After the turn of the millennium, SMEs have generally built up comfortable equity buffers. It has made them significantly more resilient to unexpected events. After all, a strong equity base not only enables them to absorb losses for longer in economically difficult times. It also strengthens their credit worthiness and helps keep access to debt capital open. The past years, which were marked by two consecutive crises, highlighted this most vividly.

To be sure, the COVID-19 crisis put the brakes on the trend of steadily rising equity ratios but the widely feared massive depletion of the equity base of SMEs did not materialise thanks to the adaptability which businesses exhibited (30.1% in 2020) (Figure 13, left). The decline in the first year of the-COVID 19 crisis was already followed by a relatively strong recovery in 2021 that saw equity ratios almost return to the pre-crisis level (31.4% in 2021).[24]

The economically challenging environment of the past two years, however, has put businesses' equity buffers under growing pressure. SMEs failed to resume the upward trend of the pre-crisis years already in 2022, when their equity ratio fell by a moderate 0.2 percentage points to 31.2%. That decline continued in 2023, when their equity ratio fell by a further 0.6 percentage points to 30.6%. In a historic comparison, however, it still remains very high and above the level of the year 2020.

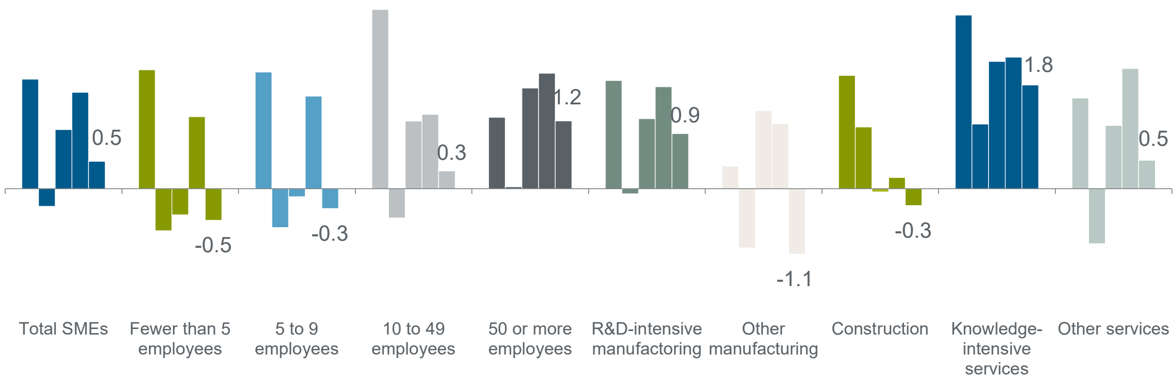
More SMEs have a low equity ratio

A look at the distribution of equity ratios within the SME sector shows that the reason the average equity ratio has fallen is because the equity situation has broadly deteriorated (Figure 13, right). The share of SMEs with low equity ratios of less than 10% has risen significantly – from 25.1 to 33.6%. In other words, around one in three SMEs had only a comparatively thin equity buffer in the past year. In addition, 12% of businesses had a negative equity ratio in 2023 – twice that of the previous year (6% in 2022). The last time such a high share was recorded was more than ten years ago (12% in 2012).

At the same time, the share of SMEs with a very high equity ratio of 30% and more dropped by 13 percentage points to 37.6%. As a result, the median equity ratio for the SME sector as a whole fell significantly and stood at a mere 22.7% last year (31.9% in 2022). That means half of all SMEs had an equity ratio below that level.

Figure 12: Annual employment growth in SMEs, by size class and sector (2019–2023)

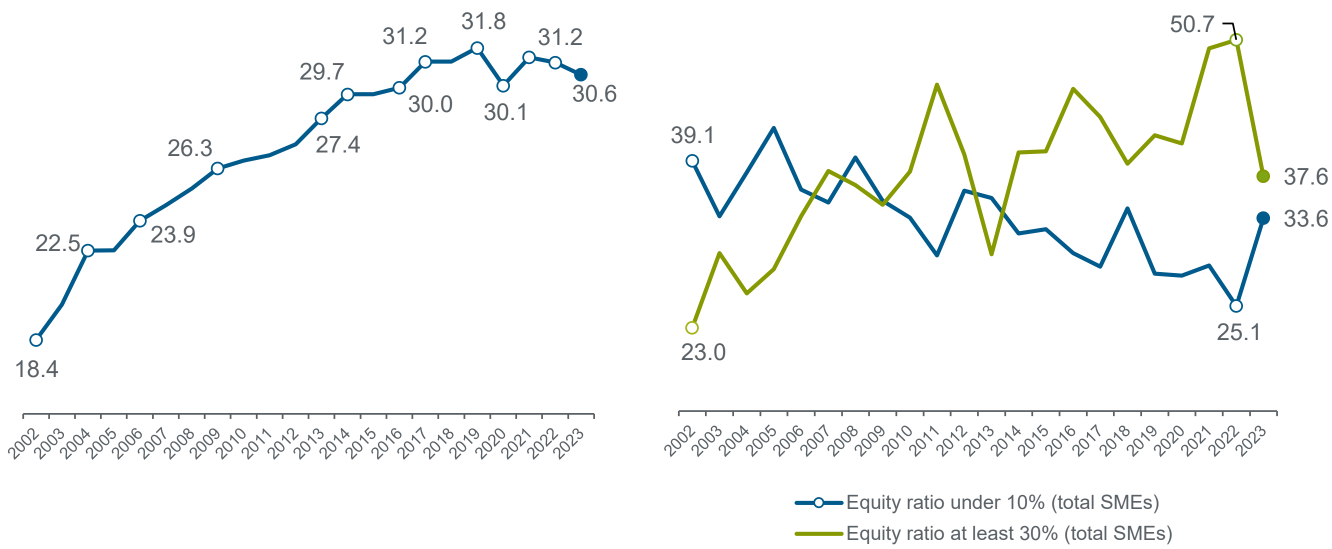
Size classes by number of full-time equivalent employees



Source: KfW SME Panel 2024

Figure 13: Basic equity ratio indicators in the SME sector

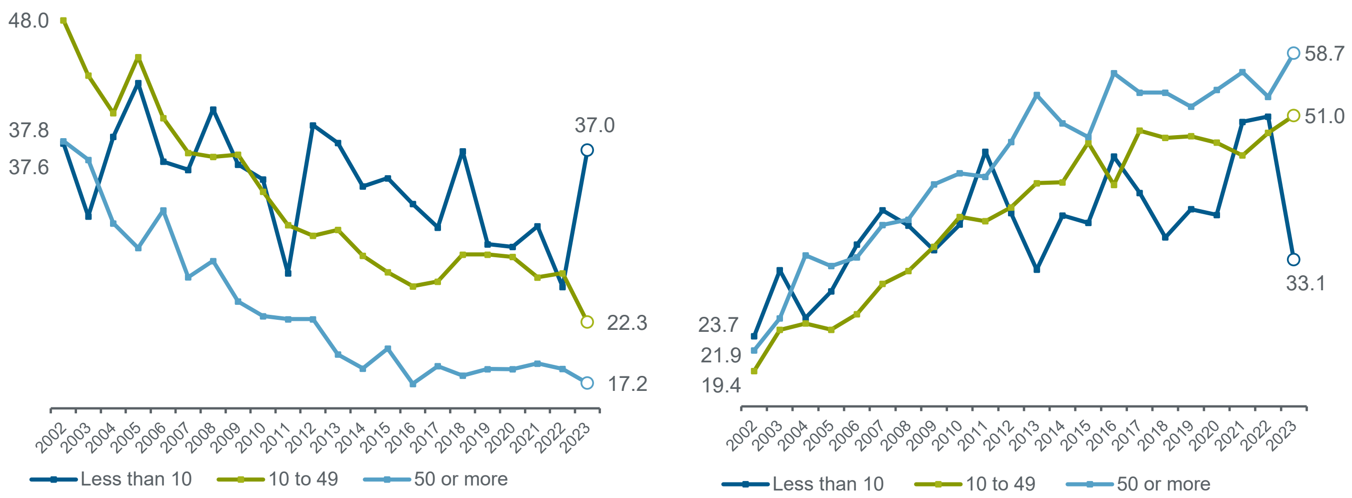
In per cent



Source: KfW SME Panel 2024

Figure 14: Businesses with a low (left) and high equity ratio (right)

Per cent of SMEs; size class by number of full-time equivalent employees



Source: KfW SME Panel 2024

Larger SMEs increased their equity buffers, while micro-businesses experienced ongoing decline

The fact that the average equity ratio has not fallen any more steeply among SMEs is mainly due to the positive development in the segment of larger SMEs (Figure 15, left). After this segment still had to deal with lower equity levels in the years 2020 to 2022, a recovery was discernible again for the first time in 2023. The equity ratio of businesses with 50 and more employees increased to 35.6% – a noticeable rise of 0.9 percentage points.

The situation was different for the segment of medium enterprises with 10 to 49 employees. Whereas this size class still presented itself as a mainstay of aggregate equity growth in 2022, the average equity ratio in this segment fell by two percentage points in 2023 to 29.1% (31.1% in 2022), the lowest level in ten years. Since it peaked at 33.5% in the year 2018, the average equity ratio in this segment has fallen by more than 4 percentage points.

Micro-businesses, too, (again) recorded lower equity levels. The average equity ratio in this size class fell by a further 0.6 percentage points to 22.3%. That was roughly the level of the pre-pandemic years. The share of SMEs with an equity ratio of less than 10% increased considerably in this size class and stood at 37% in 2023 (Figure 14). The further deterioration of micro-businesses' profitability in 2023 (see above) is likely to have played a major role in this development because it makes it harder for them to use retained earnings to build up their equity buffer.

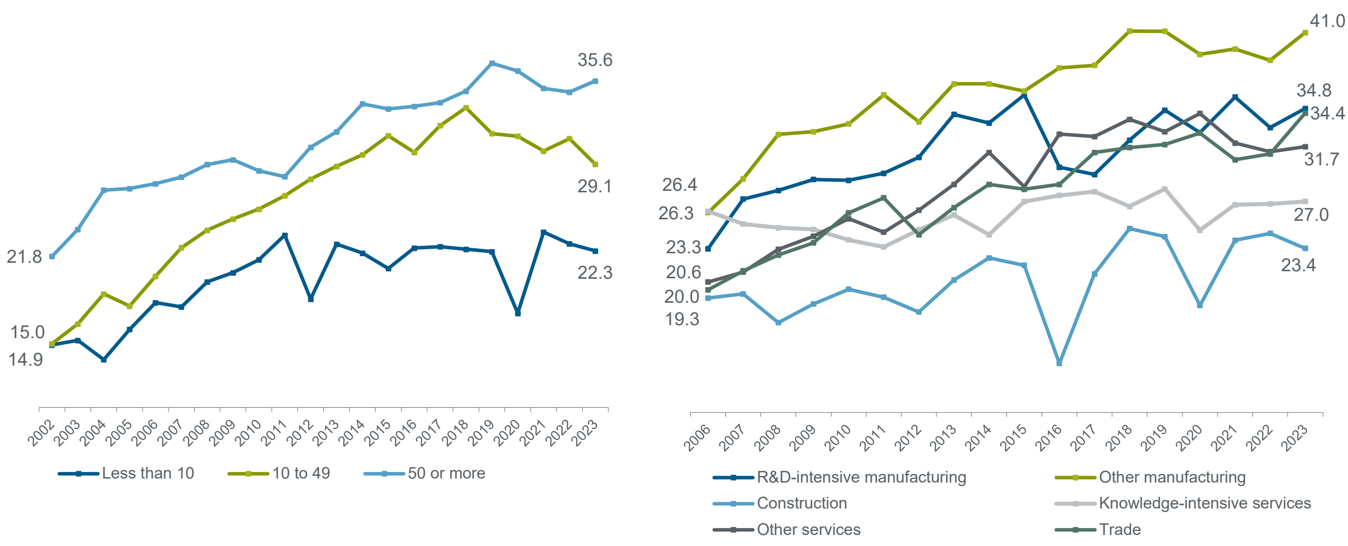
The detailed analysis by size class also illustrates that the gap between small and large SMEs which has become increasingly wider since 2011 is not set to close any time soon. While the gap was around 8.9 percentage points in the period between 2002 and 2011, it widened to 12.5 percentage points between 2012 and 2023. Whereas the equity ratios of small businesses with fewer than ten employees have hovered on a similar level since 2011, larger SMEs have significantly increased their equity ratios (+7.5 percentage points since 2011). But enterprises in the medium-sized segment, which easily kept pace with the development of larger SMEs up to the year 2018, are increasingly falling behind as well.

Equity base has recovered in manufacturing but fallen in the construction sector

A sector comparison shows that the economic challenges have had very different impacts on the capital structure of enterprises depending on what sector they belonged to (Figure 15, right). After manufacturing enterprises were still struggling to come to grips with a significant decline in their equity reserves in the year 2022, some of them were able to more than make up for it in the past year. The average equity ratio in other manufacturing grew by 2.3 percentage points to 41% (38.7% in 2022). It rose by 1.6 percentage points in R&D-intensive manufacturing to 34.8% (2022: 33.2%). The equity base of SMEs manufacturers thus remains on a very high level.

Figure 15: SMEs' equity ratios by size class (left) and sector (right)

Per cent of SMEs; size class by number of full-time equivalent employees



Source: KfW SME Panel 2024

SMEs in the services sector were also able to strengthen their capital structure last year. The average equity ratio of other service providers rose to 31.7% (2022: 31.3%) and that of knowledge-intensive service providers to 27.2% (2022: 27%). Despite this positive development, however, SMEs offering knowledge-intensive services have still not been able to make up for the high COVID-19-driven declines from the year 2020, as their average equity ratio remains below the pre-crisis level (2019: 28.2%).

SMEs in the construction sector, on the other hand, had to come to terms with a decline in their equity base for the first time since 2020. The average equity ratio fell by 1.2 percentage points to 23.4%. This was likely the result of weak construction activity last year. Rising costs of materials and supply bottlenecks as well as the high interest level afflicted the construction industry and put pressure on businesses' capital structure.

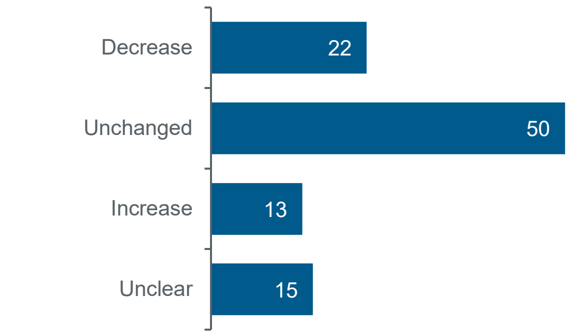
Further development of equity ratios: muted expectations for 2024 as a whole

Equity ratios are unlikely to rise noticeably across the broad SME sector in 2024. Because of the weak growth outlook for the current financial year, SMEs also have mixed expectations about how their equity ratios will develop (Figure 16).

In September 2024, more than one in five businesses (22%) expected their equity ratio to decline over the year as a whole. At the same time, only around 15% expected their equity base to develop positively, while a further 48% expected their equity ratio to remain roughly the same.

Figure 16: Expected development of equity ratio in the SME sector in 2024

Shares of enterprises in per cent



Note: Expected development compared with 2023

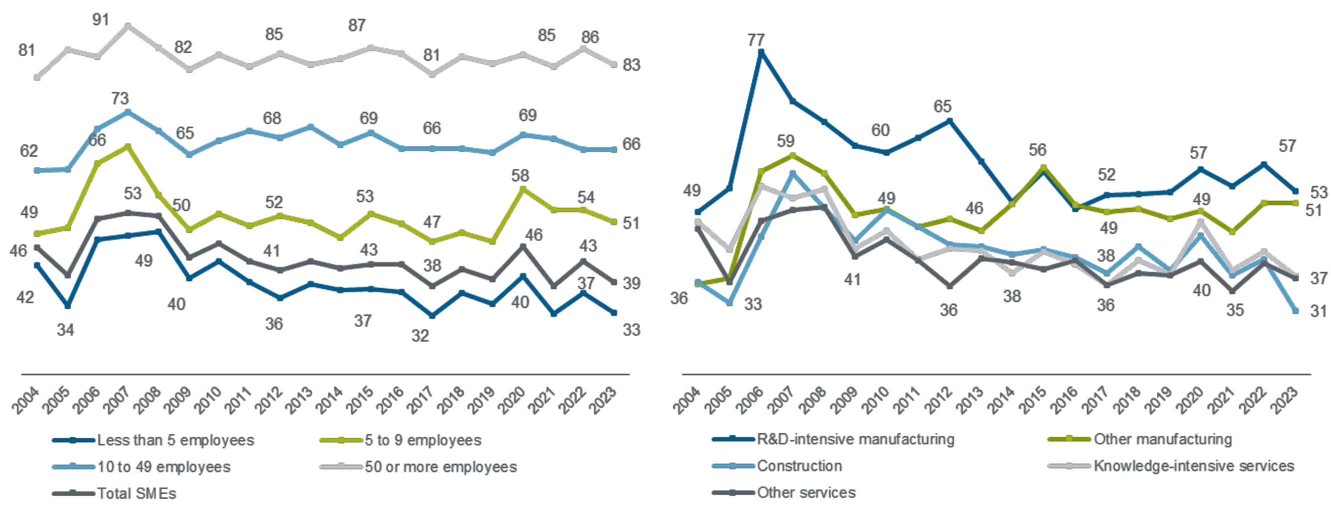
Source: Supplementary survey to the KfW SME Panel 2024, September 2024

Difficult environment is weighing on firms' investment propensity

Investment activity in Germany has stalled even though the investment needs are more urgent than ever. Investments are not just essential for businesses to secure their competitiveness. Now more than ever, the coming dual transformation requires them to redouble their efforts. The transition to a climate-neutral, sustainable economy requires high investment.[25] And businesses also have a lot of catching up to do in digitalisation.[26]

Figure 17: Percentages of investing SMEs by size class (left) and sector (right)

Size classes by number of full-time equivalent employees



Source: KfW SME Panel 2024

Last year, SMEs definitely showed little enthusiasm to invest. The difficult economic situation and high financing costs dampened the mood too much. The willingness of SMEs to initiate investment projects dropped again sharply last year and has now fallen very close to its all-time low: The share of SMEs with investment projects decreased by 4 percentage points to 39% (Figure 17).

That means around 1.48 million small and medium-sized enterprises carried out investment projects – around 141,000 fewer than in the previous year. The increased reluctance to invest was evident in all segments of the SME sector and most prominent in the construction industry, where the share of enterprises investing was down by ten percentage points year-on-year. This shows that the investment appetite of SMEs remained on a very low level again and even lower yet again in 2023. When it comes to safeguarding future competitiveness and the investment requirements emerging for the business sector from the dual transition, these developments are not very encouraging.

Will the interest rate turnaround also bring an investment turnaround? Investment is likely to remain subdued in 2024 as well

In the summer of 2024, the loosening of the ECB's monetary tightening that was initiated two years ago gave reason to hope. This interest rate turnaround was indeed implemented on 6 June 2024. The associated drop in interest rates on business loans was expected to give business investments new momentum, or so it was assumed.

The additional effect on investment activity that was actually triggered in the current year is likely to be positive, to be sure, but of modest intensity, as was revealed by a supplementary survey to the KfW SME Panel of mid-April 2024.[27] Around 5 to 6% of SMEs would most likely expand their investment activity beyond the level already intended in 2024 in the event of a key interest rate reduction. The majority of small and medium-sized enterprises, however, were rather impartial to an interest rate turnaround in April 2024. Either they had no investment plans for the current year 2024 anyway or no plans to take up a loan for the relevant investment projects, or the interest rate did not play a (decisive) role in their investment decisions.

Replacement investments were top of the agenda

Businesses that had investment projects in 2023 carried them out mainly to renew existing plants or machinery (Figure 18). Around 39% of investing SMEs completed such investments. As they contribute to maintaining or increasing businesses' productivity and efficiency, they are important for the overall economy. Projects designed to adapt the business to (technical) innovations were implemented at a similar rate (37%).

Investments aimed at increasing turnover were made by 33% of SMEs. At the same time, 31% of businesses undertook investments to expand their own capacities. Capacity expansion measures are a positive sign. They indicate that businesses have reached full capacity utilisation as a result of growing demand. Expansion measures, which tend to be costly (such as the acquisition of an additional production line), create additional growth and make a significant contribution to SMEs' future competitiveness.

Investments in energy efficiency (14%), sustainability and environmental protection (13%) and adaptation to climate change (13%) were rather less relevant for SMEs. Whether these activities are sufficient to satisfy the need to transform the business sector towards a sustainable economy is rather questionable given the investment surge that is needed. The fact that the interest rate turnaround can be expected to boost investment, particularly in the areas of climate action, energy efficiency and digitalisation, can therefore be interpreted as a positive sign. Four in ten enterprises want to use more favourable financing conditions to make additional investments in digital and sustainable projects.[28]

More investment projects were completely abandoned in the course of 2023

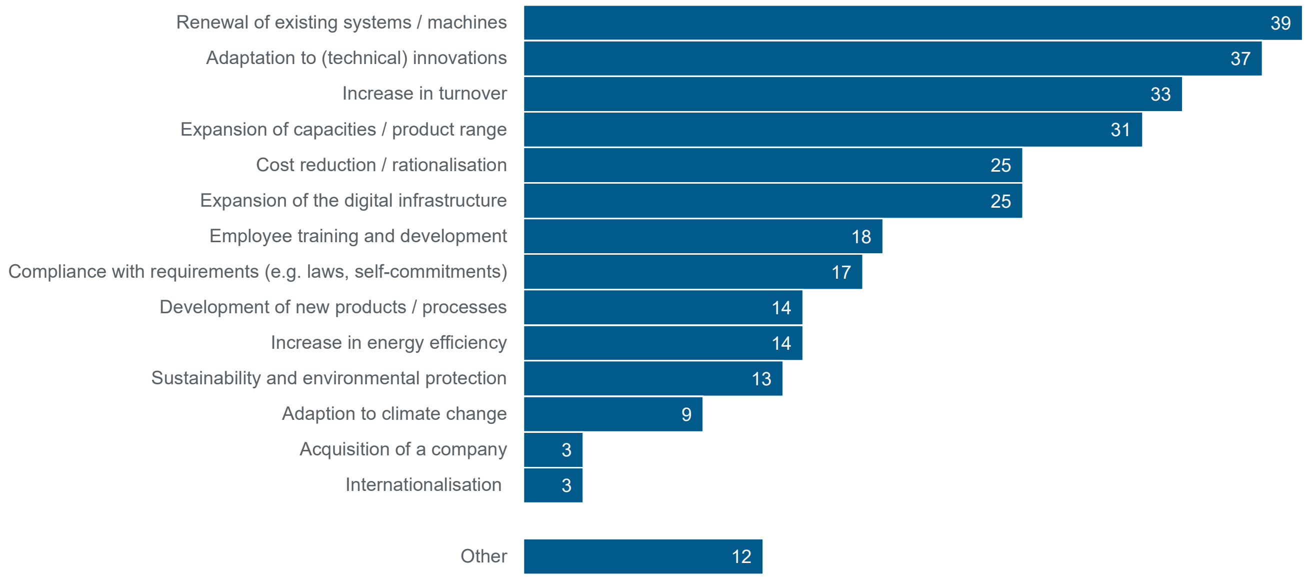
The data on adjustments to investment plans made in the course of the year are a clear sign of the uncertainty in the SME sector, which continued to be very pronounced in 2023 – and therefore hampered investment activity (Figure 19). A decrease in new investment is a sign that businesses are losing faith in the development of the economy.

The share of businesses that implemented their investment projects as planned stood at 60% in 2023, which was well below average. In the years before the COVID-19 pandemic (2012–2019), 75% of all projects were actually implemented each year on average. Last year, businesses fell well short of that level (as they did in the years before). The only year in which that rate was lower was 2020, when the COVID-19 crisis broke out.

Accordingly, the level of plan revisions was relatively high in 2023. Roughly one fourth of enterprises that had considered investing in their business in 2023 at the start of the year scaled back or deferred those investment projects to a later date. What is also worth noting is the very high share of enterprises that abandoned investment projects completely. Last year, that share was 13%. The only year that a similar level was recorded was 2009.

Figure 18: Investment goals of SMEs in 2023

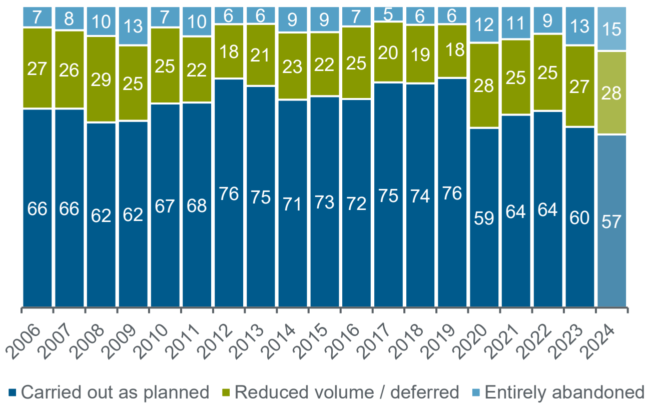
In per cent, multiple responses were possible



Source: KfW SME Panel 2024

Figure 19: Implementation of planned investment projects in the years 2023 and 2024

Percentage of enterprises



Source: KfW SME Panel 2024 in conjunction with supplementary survey of September 2024

Were financing costs a barrier to investment? Yes but other factors had a greater impact

SMEs broadly exhibited a lower propensity invest in 2023. The public debate (especially in connection with the interest rate turnaround) focused strongly on financing costs as a barrier to investment. An accurate picture – and possible explanations for the decrease in investment appetite – can be obtained from the analysis of barriers and drivers of investment in the SME sector (Figure 20).

It shows that around 41% of SMEs regarded financing conditions and costs as a factor that weighed on their own investment activity last year. At the same time, only 5% of businesses admitted that financing was a factor that drove their investment activity. Financing aspects thus ranked mid-range in terms of overall importance. Businesses believed that other factors played an at least as important, if not more important, role.

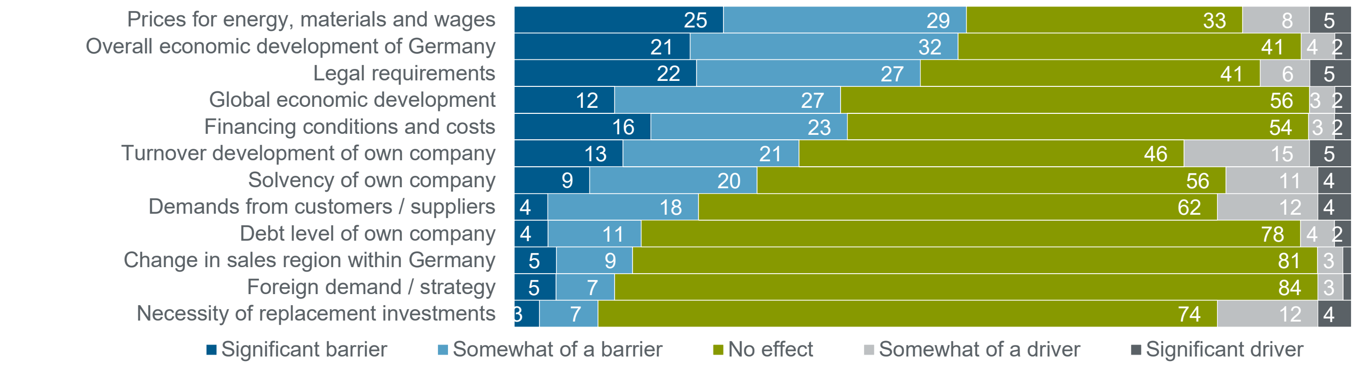
The level of prices (of materials, energy and wages) was regarded as a barrier by 54% of all SMEs, which saw them as having a more negative impact on investment activity. Their view of Germany's overall economic development followed closely behind (53%). This clearly reflects the difficult economic situation and, thus, the lack of certainty which businesses need. Germany's economic development in particular has prompted many businesses to give up their initial investment plans at the start of the year and refrain from investing, with 71% of these SMEs – again, a significantly higher share than the SME sector overall – pointing to the state of the overall economy as a hindrance. In general, and not very surprisingly, this group of businesses (investment planners, not all of which have ultimately invested) mentioned all of these barriers more often.

Businesses also described legal requirements as a relevant investment barrier (49%). Around one in three enterprises (34%) also regarded their own turnover (34%) or liquidity situation (29%) as a barrier to investment.

Investment drivers were few and far between in 2023. Businesses became active when they required replacement investments (16%) or when requirements along the value chain made investments necessary (16%). What is also evident is that the relevant business development provided impetus. Positive turnover (20%) and a satisfactory liquidity situation (15%) stimulated investment activity. As a mirror image of the inhibiting factors, the economic situation did not act as a major driver of investment. Only 6% of SMEs saw it as a driver of investment.

Figure 20: Barriers and drivers of investment in the SME sector in 2023

In per cent; in descending order by sum of mentions for 'a significant barrier' and 'somewhat of a barrier'.



Source: KfW SME Panel 2024

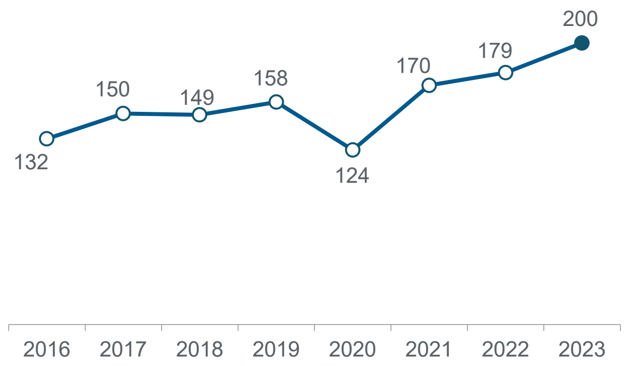
Data from April 2024 illustrates that hardly any major variations to the inhibiting factors or drivers should be expected in the current year.[29] Inhibiting factors will continue to dominate until the effects of the price increases of the past two years have been overcome and Germany's economy has gathered steam again.

Investment projects were much larger in scope on average in 2023; price rises just one factor, large-scale projects were drivers

The average (nominal) volume of investment projects increased once again. Thus, the average project volume rose again for the fourth time in 2023 (Figure 21). Among those small and medium-sized enterprises that invested, the average amount invested increased to EUR 200,000. That amounted to a nominal increase of 12% or EUR 21,000. Never before did investors take up more money than they did last year.

Figure 21: Average investment volume per company

EUR in thousand in nominal terms, only investing enterprises



Source: KfW SME Panel 2024

Nonetheless, it is important to take into account the sharp increases in prices last year, which drove the nominal investment volume sharply higher. The results remained steady even when applying the corresponding deflator of gross fixed capital formation. Even when adjusted for prices, average investment volume rose by around 5% to EUR 188,000.

The fact that the development in the year 2023 was driven by a comparatively small number of very large projects is also demonstrated by the median value. It remained steady year on year. Thus, half the investment projects had a volume of less than EUR 30,000 in 2023 (EUR 30,000 in 2022).

This development is corroborated yet again by data on investment intensity (investment volume per full-time equivalent employee). It rose in 2023 by a nominal 6% to an average of around EUR 9,300 (detailed figures can be obtained from the Volume of tables). In real terms, however, it stagnated.

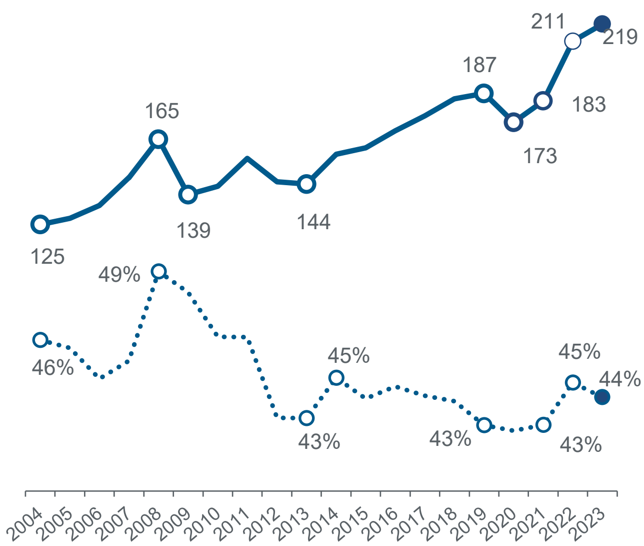
New investment by SMEs increased in nominal terms but fell on a price-adjusted basis

In the past year, small and medium-sized enterprises' (nominal) investments in new plant, equipment and buildings (gross fixed capital formation and new investment) increased by approx. EUR 8 billion, or 4% overall. New investments by SMEs thus amounted to approx. EUR 219 billion in 2023 (Figure 22). On a price-adjusted basis, however, the volume of investment was around 2% lower (new investment in real terms: EUR 205 billion). That means inflation was not the sole driver of the higher volume of investment by SMEs in 2023, since businesses scaled back their investments moderately in real terms.

SMEs invested slightly more in second-hand goods than in previous years (around EUR 31 billion in nominal terms – an increase of EUR 2 billion). The long-term average is EUR 41 billion (2004–2022). Companies have already been investing comparatively little in second-hand goods for some time now. In the aggregate, the volume of total investment in the SME sector rose by EUR 10 billion in nominal terms or 4.2% (-1.8% in real terms) to EUR 250 billion (EUR 235 billion in real terms).

Figure 22: New investment by SMEs

Solid line: Volume in EUR billions (nominal); dashed line: percentage of SMEs in total business investment



Source: KfW SME Panel 2024, Destatis

Services define investment activity in the SME sector more than ever before

A look across the different segments shows a mixed development (Figure 23). Larger SMEs accounted for most of the nominal increase in the volume of new investments in 2023. Businesses with ten or more employees recorded a combined growth of around EUR 21 billion (in nominal terms), while the segment of SMEs with fewer than ten employees experienced a cumulative decline of EUR 10 billion. This, too, can be interpreted as a sign that larger projects were increasingly being undertaken.

A look at the sectors reveals the familiar picture: Service businesses constitute the pillars and drivers of the investment volume.[30] In 2023, businesses in the relevant subsegments accounted for 61% of new capital expenditure and 58% of total capital expenditure. These shares were significantly higher than in 2022. At the current margin, services therefore have greater relevance for investment activity in the SME sector than ever before. This is attributable exclusively to a substantial increase in investments in the segment of knowledge-intensive services. In the aggregate, these businesses invested around 11.5% more than in the previous year and new investments even rose by around 24%. Thus, SMEs that provide knowledge-intensive services accounted for more than three in ten euros invested in 2023. In the segment of other services, on the other hand, investments were slightly lower in 2023 than in the previous year. New investments shrank by 2.5% and total investments fell by around 1%.

SMEs and large enterprises exhibited roughly equal investment momentum in 2023

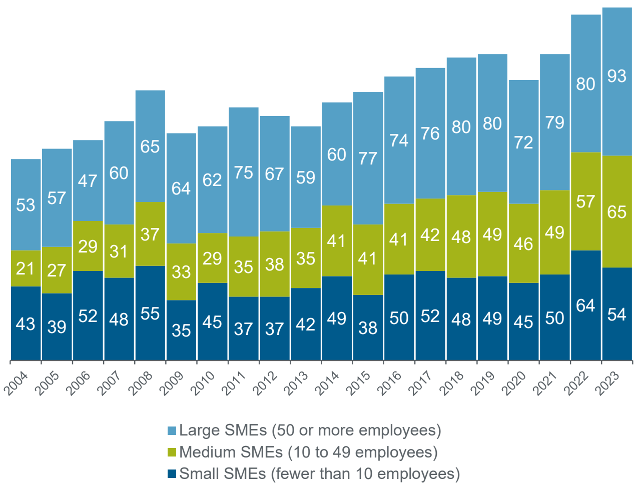
In 2023, small and medium-sized enterprises increased their investment activity by a slightly lower percentage than the entire corporate sector in Germany. Total gross fixed capital formation of all enterprises[31] rose by 5.4% in nominal terms to approx. EUR 496 billion (adjusted for prices, this would mean a drop of 1.5% to EUR 464 billion in real terms, down from EUR 470 billion in 2022 / calculated as at August 2024).

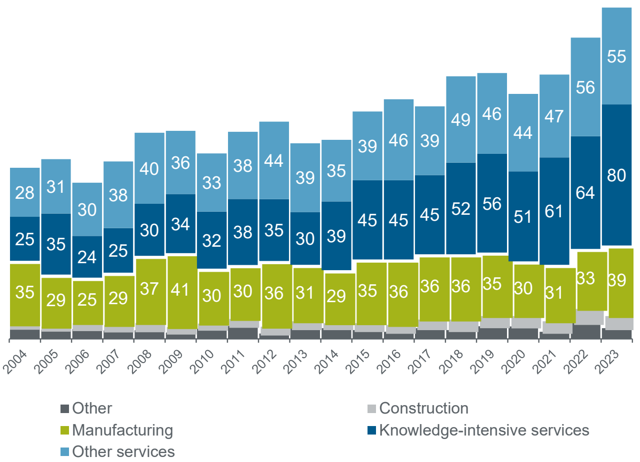
Large enterprises with an annual turnover in excess of EUR 500 million accounted for EUR 277 billion of this volume. Their new investment grew by 6.7% in nominal terms or EUR 17 billion (adjusted for prices, this would mean a moderate -0.3% decrease). In other words, last year's decline in corporate gross fixed capital formation in real terms was driven mostly by SMEs. But there were few differences between SMEs and large enterprises in 2023. Nonetheless, the share of SMEs in overall new business investment dropped slightly by one percentage point to currently 44% (Figure 22). In 2008, the share of SMEs in total business investment volume in Germany still stood at 49%.[32]

SMEs undertook new investments of EUR 219 billion (in nominal terms) and recorded around EUR 154 billion in asset depreciation in 2023 (also in nominal terms). Their net investment thus totalled EUR 65 billion (total business sector +EUR 8 billion).[33] The capital investment to depreciation ratio is on a very healthy level of 142%.

Figure 23: New investment in the SME sector by segment

EUR in billions (nominal); SME size class by number of full-time equivalent employees





Note: The extrapolation by employment size class of SMEs does not include companies of the remaining sectors. Consequently, the individual data on new investments undertaken by the SME size classes does not add up to the total sum of new investment (gross fixed capital formation) shown in the text.

Source: KfW SME Panel 2024

Investment is not very likely to recover in the SME sector in 2024

In light of the persistently difficult environment, small and medium-sized enterprises are not very likely to exhibit a greater willingness to invest in the course of this year. The outlook for the year 2024 is rather dim. The interest rate turnaround can at least help to stimulate investment activity (see above).

At present, however, the overall state of the German economy in particular is having a very adverse effect on investment. At the current margin, the decline in business investment has continued across the overall economy at an accelerated pace. Business investment fell for the fourth consecutive quarter, contracting by 2.2% on a price- and calendar-adjusted basis overall in the first half of 2024 compared with the same period last year. Private-sector investment in machinery, equipment and vehicles, which make up around half of all business investment, fell at a particularly steep rate of 8.2% in the first half of 2024.

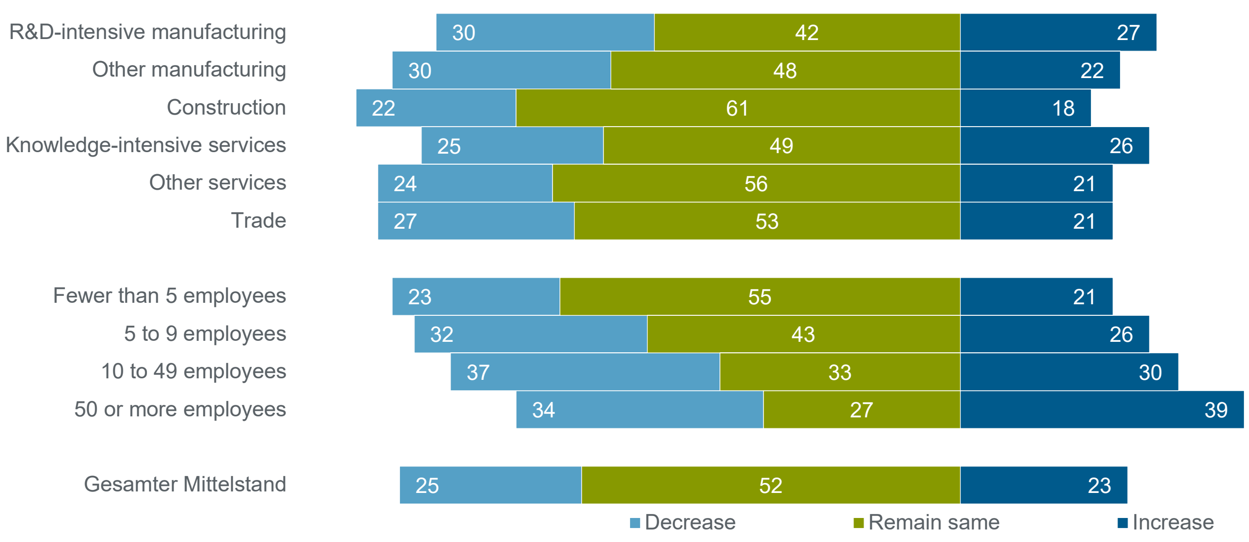
The expectation of a consumption-driven recovery of domestic demand in 2024, at least, holds promise for the very domestically focused SME sector (which generates 87% of total turnover within Germany) and provides some hope for a revival of investment.

The assessments by SMEs themselves also suggest a weak trend in investment activity (Figure 24), with 25% of SMEs reporting that they wanted to invest less in 2024, while around 23% are planning to invest more. The balance is negative, albeit only slightly. The generally rather negative pattern was broken by SMEs that offer knowledge-intensive services and larger SMEs. These segments, which had already accounted for almost all the investment growth of 2023, could therefore provide valuable impetus in 2024 as well.

In early September 2024, only around 48% of SMEs indicated that they had plans to invest in the current financial year. Of these, a mere 57% reported having implemented them as intended (Figure 19). This suggests that SMEs again modified their investment plans significantly in the course of the year. At the time of the survey, more than one in four businesses (28%) reported having postponed or scaled back the investment projects planned at the beginning of the year. Around 15% of SMEs stated that they completely abandoned their investment plans.

Figure 24: Variations in investment activity in the year 2024

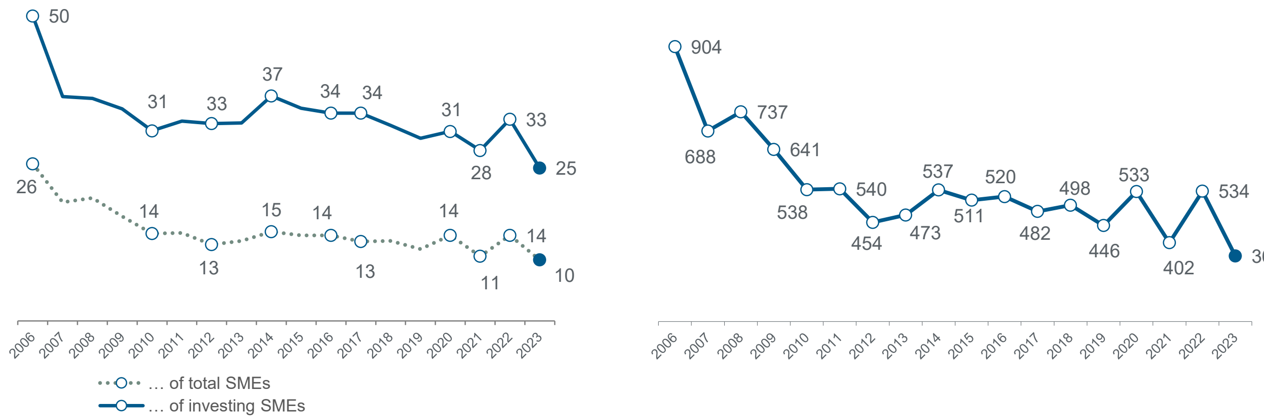
In per cent



Source: KfW SME Panel 2024

Figure 25: SMEs that were in loan negotiations

Shares in per cent (left); number of enterprises in thousand (right)



Source: KfW SME Panel 2024

Financing environment was much tougher for SMEs in the year 2023

High interest rates on business loans from banks, tight lending policies and the general slump in demand – resulting from weak investment momentum – have caused demand for loan negotiations from SMEs to virtually collapse. The readiness or appetite of SMEs to negotiate investment loans was lower in 2023 than ever before (Figure 25). While there was still an increase in credit financing of investments in the previous year, when many businesses were seeking to benefit from the still favourable borrowing conditions, the tide has turned. The financing environment was significantly tougher overall last year.

A mere 368,000 SMEs conducted negotiations with banks and savings banks on loans to finance all or part of their investment activities in 2023. Never before was a lower number of enterprises identified under the KfW SME Panel. The year-on-year decline was around 170,000 SMEs. That means just barely one in ten SMEs (-4 percentage points) and one in four SMEs with investment projects (-8 percentage points) chose the pathway of a loan negotiation.

The decreased willingness to negotiate can be observed across the breadth of the business landscape. R&D-intensive manufacturing businesses were particularly reluctant compared with the previous year (-16 percentage points), as were enterprises offering other services (-10 percentage points) and micro-businesses (-8 percentage points).

A foretold slump in demand

This massive decline is particularly noteworthy because the connection between small and medium-sized enterprises and the banking sector in Germany has traditionally been known to be very strong. Many businesses value and cultivate their relationships with credit institutions. Bank loans continue to be the most important external financing instrument for SMEs (see also the relevant section in this report). And yet: The strongest and fastest tightening of monetary policy observable since the creation of the euro area after a more than a decade-long low-interest policy has led to profound changes on the demand side. Already in autumn of 2023, a supplementary survey to the KfW SME Panel demonstrated that the willingness to even consider a bank loan to finance investment had fallen sharply.[34] The share of businesses that would generally consider a bank loan had fallen from 66% in 2017 to 42% in September 2023.

The figures for all of 2023 now show that this probably turned out to be an optimistic estimate. The number of SMEs that actually made their way to a bank or savings bank has recently fallen sharply yet again. Given that key interest rate cuts have so far been only minimal in the course of 2024, a drastic trend reversal cannot really be assumed to be occurring – although signs of a moderate upswing have recently become discernible.[35] Previous levels are likely still a long way off for SMEs, even despite signs of a recovery in the course of the year. For example, around 700,000 businesses were in loan negotiations at the time of the economic and financial crisis and more than 900,000 in the year 2006.

More restrictive lending policies – less success in negotiations

The past year 2023 had significantly more challenges in store for businesses in loan negotiations. The **success rate** of loan negotiations with banks or savings banks on investment loans fell noticeably. For 59% of SMEs that were in loan negotiations in 2023, all ended successfully – a seven percentage-point decline from the previous year (Figure 26, left).

Apart from the decreased success rate, the **loan rejection rate** also reflects the environment in which loan negotiations took place. It is expressed by the proportion of enterprises in which all negotiations on investment loans failed, that is, by the proportion of businesses that had no access at all to investment finance in the year 2023. The loan rejection rate increased from 9 to 12% last year (Figure 26, right) – an increase but one that generally remained moderate. By comparison, the historic average is 18% (2004–2022) and last year's levels were far from the previous record-high levels such as the 27% recorded in 2008.

Further indicators on the outcomes of loan negotiations confirm the gloomier overall picture of more restrictive credit access in 2023. Loan negotiations of SMEs failed more often because credit institutions failed to present a loan offer (Figure 26, middle). The corresponding percentage rose from 11 to 15% on the previous year.

This, too, is still a low rate in a historic comparison. The long-term average rate of **loan rejections** from banks (2004–2022) is 24%. In addition to these loan rejections, the share of **rejections of loan offers** by interested businesses increased by +2 percentage points to 25% (Figure 26, middle).

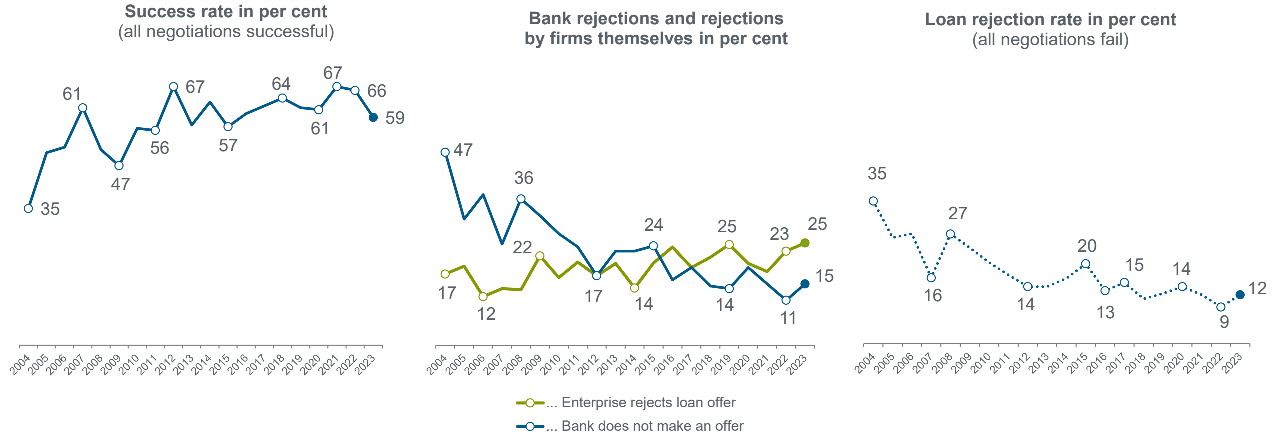
Why do loan negotiations of SMEs fail? Interest rates were the main reason in 2023

The overriding reason for negotiations on investment loans to fail in 2023 was the interest rate level (Figure 27). More than half the affected enterprises attributed the failure of their negotiations to unacceptably high interest rates charged by the banks (54%), among other reasons. Given the very high interest rates on corporate loans charged on average across the year 2023, this is hardly surprising (Figure 35, left side).

In around one in four failed negotiations, requirements to disclose business figures, insufficient equity, an inadequate financial standing or unacceptably lengthy processing and decision-making times played a role. Equally relevant was the aspect that applicant enterprises were unable to provide the collateral required by banks. Banks offering maturities or loan volumes regarded by enterprises as unacceptable, on the other hand, had a negligible influence. Overall, the quality of advice was also rather unlikely to contribute to the failure of businesses to obtain a loan.

The sustainability of the business model generally did not play a role as a reason for rejection last year. This was largely in line with the findings of a supplementary survey to the KfW SME Panel of autumn 2023.[36] It found that requests for information on sustainability were still relatively uncommon in loan negotiations across the SME sector. In 2022, the topic of sustainability was actually addressed at all in only around one in six loan negotiations with SMEs (and if so, largely also for larger SMEs). However, the demand for information about sustainability is likely to continue increasing in the future because of new regulatory requirements. Banks will require businesses to take greater account of sustainability risks in their business activities.

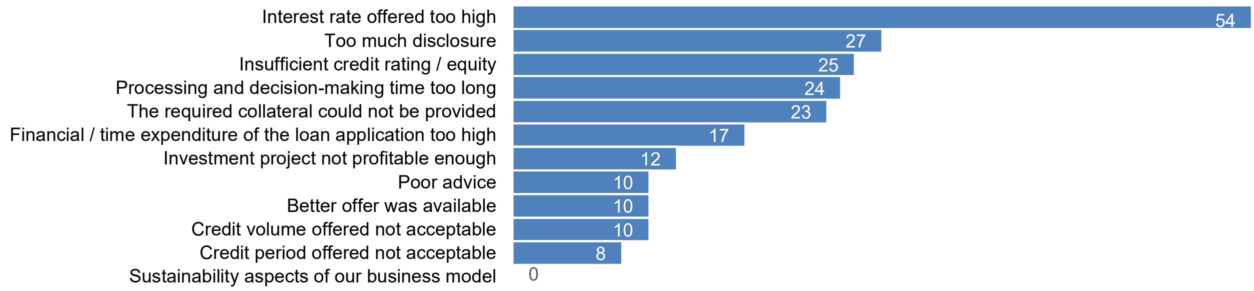
Figure 26: Indicators for the outcome of loan negotiations in the SME sector



Source: KfW SME Panel 2024

Figure 27: Reasons for the failure of loan negotiations in 2023

In per cent, multiple responses were possible



Note: Only enterprises with negotiations on investment loans in 2023 for which not all loan negotiations ended successfully. No distinction as to whether the failure of a loan negotiation was caused by a rejection on the part of the credit institution or on the part of the applicant business.

Source: KfW SME Panel 2024

In the medium term, meeting these regulatory requirements will likely be associated with a greater need for information between credit institutions and their clients. That will increasingly involve smaller SMEs as well.

Difficulties accessing credit mainly affected small businesses in 2023

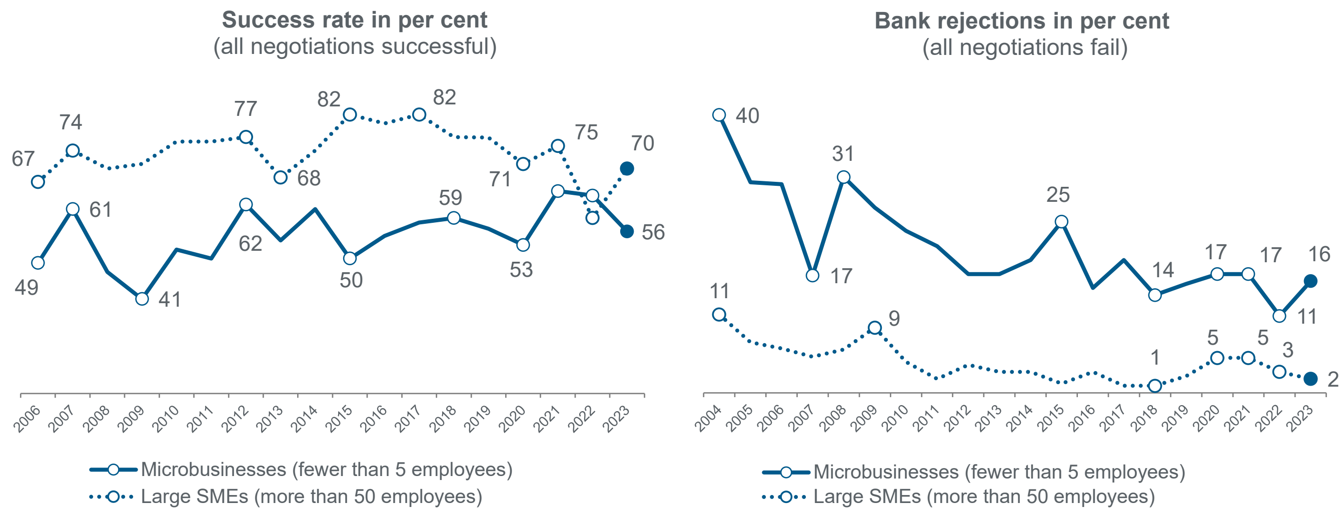
The deterioration in financing conditions last year did not have the same effect on all business segments. The tightening of lending policies left large SMEs with 50 and more employees largely unscathed (Figure 28). Their rate of successful negotiations on investment loans actually increased and their credit rejection rate fell further – from what was already a low level. The trends that emerged for the SME sector as a whole were exclusively driven by developments among smaller businesses.

Whereas large SMEs actually experienced improvements to the indicators, the loan rejection rate for micro-businesses with fewer than five employees increased by five percentage points compared with the previous year. Their success rate fell at the same time. It should also be emphasised that even for micro-businesses, these rates were still good in a historic comparison despite the visible deterioration in credit access.

Nonetheless, it cannot be overlooked that the different enterprises size classes experienced different impacts. Looking specifically at banks' rejections and applicants' rejections of loans, the same pattern emerged: more negative outcomes for small enterprises but more positive outcomes for large SMEs (see Volume of tables relating to the KfW SME Panel for detailed figures).

Figure 28: Loan rejection rate by SME size

Loan rejection rate in per cent (all negotiations failed), size class by full-time equivalent employees



Source: KfW SME Panel 2024

Tighter lending policies expose structural disadvantages of small businesses more clearly again

The fact that small SMEs have been experiencing greater difficulties accessing credit than larger enterprises is a clear expression of the structural disadvantages they have in obtaining capital. As a general rule, the asymmetrical distribution of information means that lenders often have great difficulty or incur high expenses in assessing the overall credit worthiness of these businesses or the likelihood of success of the projects for which they seek capital. Experience gathered and relationships that have grown between companies and lenders in the course of time and through repeated transactions can reduce these information deficits. External ratings also help lenders assess a company's credit worthiness. However, small and young enterprises often do not have a credit history or an established relationship with the lender. External ratings, too, are often not an option because of the associated costs for small businesses.

As a consequence, smaller businesses find it harder to provide lenders with credible assurances that they represent a low risk. Besides, they often apply for what financiers consider to be rather small loan volumes, so that there is an unfavourable ratio between the (largely fixed) transaction costs and the returns for the potential lender. Furthermore, small businesses only have limited tangible assets that they can use to collateralise loans. Lenders may therefore add risk premiums to the interest rate and require more collateral or documentation, or generally offer less capital. As a consequence, small and young enterprises thus have greater difficulty accessing credit than other enterprises.

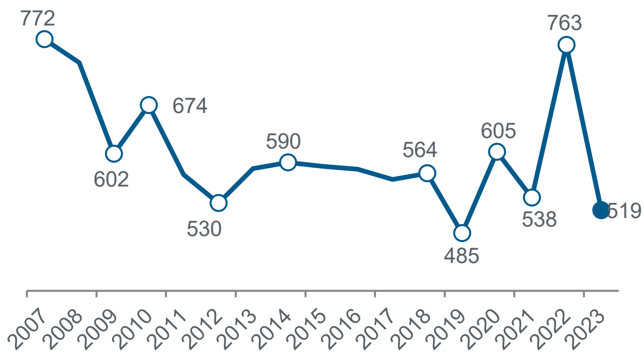
Less demand and less successful negotiations mean fewer borrowers

In 2023, small and medium-sized enterprises were less interested in entering into negotiations on investment loans than ever before. At the same time, the success rate for those that were in negotiations decreased. This is reflected in the number of businesses that ultimately used bank loans in their funding mix. The number of borrowing SMEs fell even more significantly than it had risen in the previous year, by 244,000 to a total of 519,000 businesses in 2023 (Figure 29).

The decline by around one third in the use of bank loans to finance investments (32% across the SME sector as a whole) is evident across all size classes. There are differences, however. Whereas the decline was 35% among micro-businesses and small SMEs with 5 to 9 employees, it was less pronounced for medium SMEs with 10 to 49 employees and larger SMEs with 50 employees and more, where the declines were 22% and 'only' 11% on the year 2022. In relative terms, smaller businesses thus refrained from borrowing for their investment projects at a disproportionately very high rate. The attractiveness of loans decreased more strongly for them than for large enterprises.

Figure 29: SMEs that borrowed (for investment purposes)

In thousands of businesses



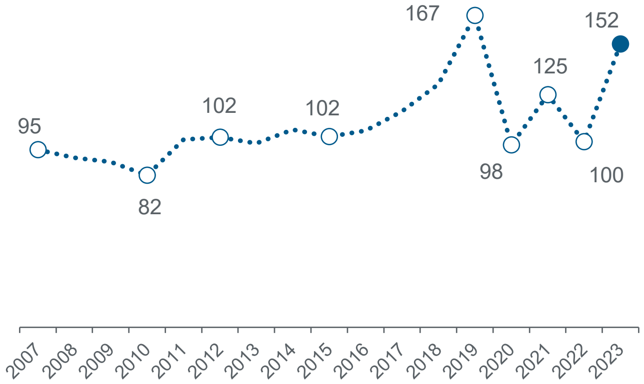
Source: KfW SME Panel 2024

Massive growth in average loan volumes was mainly driven by small increase in large-volume loans

The analysis of SMEs' investment activity in 2023 already illustrated that more large projects were undertaken. This development is also reflected in the average loan volumes taken up to finance investments (Figure 30). The average volume of bank loans newly obtained to finance investments in 2023 grew significantly by approx. 52% to EUR 152,000 per enterprise (+EUR 52,000 on average per business undertaking credit-financed investments).

Figure 30: Average loan amount (for investment purposes)

In EUR thousands; per business



Source: KfW SME Panel 2024

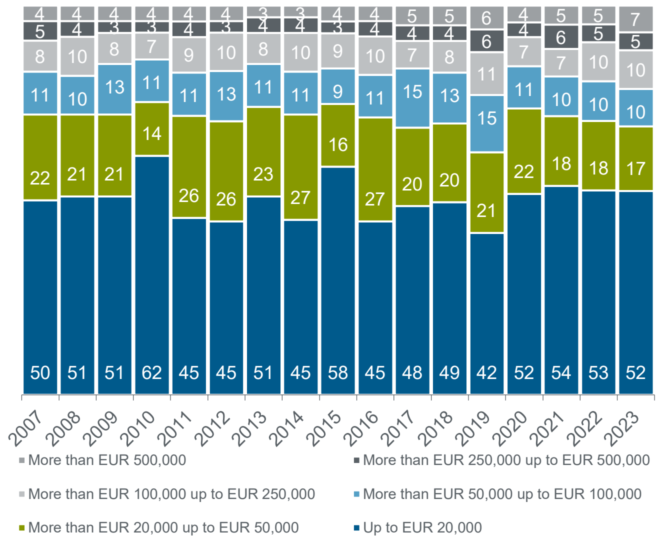
But despite all the reluctance to borrow: enterprises that engaged in negotiations and actually took up a loan increased their tickets significantly on average. Here as well, a general trend can be identified. All size classes have picked up. Micro-businesses increased their average volume by 17% to EUR 37,000 on average, which roughly corresponds with the long-term average for this segment (2007–2022: EUR 39,000). The average loan volume of large SMEs increased by 33% to around EUR 900,000, which was slightly above their long-term average (2007–2022: EUR 820,000).

In alignment with the scope of the investment projects, it was also found that a larger share of large-volume loans was taken up in 2023 (Figure 31). The share of very large investment loans exceeding EUR 500,000 rose from 5% to 7%. Although at first glance this appears to have been a small shift, it had a major effect on average volumes in the SME sector. Around EUR 5.2 billion in realised credit volume in the SME sector in 2023 alone can be attributed to this shift of just two percentage points – at a minimum. The actual effect is likely to be much higher. To put into perspective how much these large-scale loans lever: The aggregate volume of the two percentage-point shift amounts to at least the total loan volume of all microloans of the year 2023 combined (52% of all borrowers, Figure 31).

Purely in terms of their share in the total number of loans realised, micro-loans continue to dominate, as we can see by looking at the categories of loan amounts: 69% of all investment loans taken up in 2023 were for a maximum of EUR 50,000, and 79% of all investment loans had a maximum amount of EUR 100,000.

Figure 31: Bank loan amounts applied for by SMEs

Share of enterprises with bank loans exceeding a specified volume in per cent



Source: KfW SME Panel 2024

Total borrowings for investments rose again slightly in 2023

The slight increase in the share of large-volume loans last year offset the overall decline in demand for investment loans. The volume of loans from banks and savings banks actually used by SMEs to finance investments grew moderately (Figure 32). In 2023, SMEs borrowed a total of EUR 79 billion from banks and savings banks to finance their capital expenditure – around EUR 3 billion or +4% more than in the previous year. This includes only investment loans and excludes working capital loans.

Short-term and long-term loans both increased minimally in volume last year. The volume of such loans rose by EUR 2 billion to EUR 30 billion in 2023.

The volume of loans with short maturities of up to five years grew by EUR 1 billion to EUR 49 billion. Short-term borrowing has recently been very important for SMEs in any case. The respective shares in total investment volume remained on the previous year's level of 20% for short-term and 12% for long-term bank loans. The high relevance of short-term financing continues to reflect the widespread uncertainty in the corporate sector. Without optimism and certainty on which to base their planning, businesses tend to avoid longer-term financial obligations.

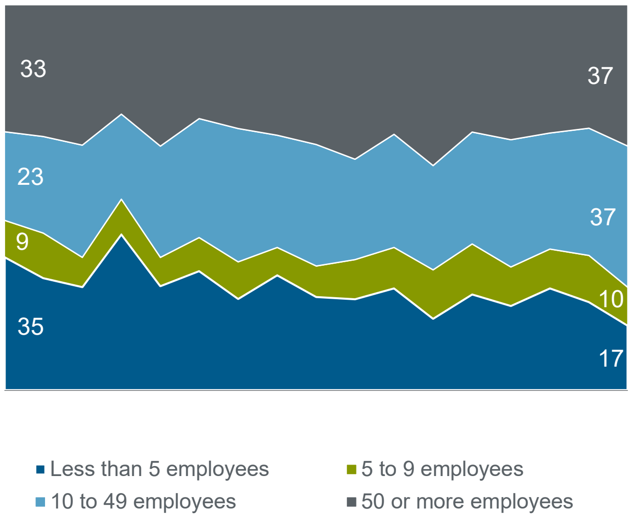
The share of loans in the funding mix for overall investment activity in the SME sector thus remained unchanged at 32% in 2023, continuing slightly above the long-term average. Among micro-businesses and small businesses, however, the share of bank loans in investment finance fell significantly on the previous year (Figure 34).

Smaller enterprises have been reluctant to borrow for some time now

The breakdown into the various enterprise sizes reveals two key insights (Figure 33). First, larger enterprises account for a significantly higher share of total credit volume at the current margin. SMEs of both larger classes have increased their share by 4 and 5%, while smaller size classes contributed proportionately less to the total volume. This again reflects the disproportionately steep decline in borrowing by small businesses in 2023.

Figure 33: Distribution of total investment loan volume by size class

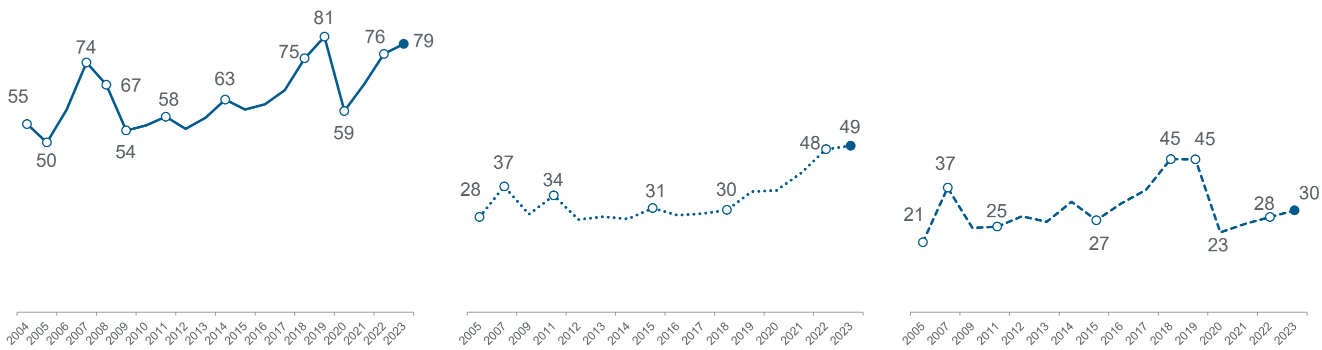
Size classes by number of full-time equivalent employees, in per cent



Source: KfW SME Panel 2024

Figure 32: Loan volume used for investment finance in the SME sector – total and by maturity

EUR in billions

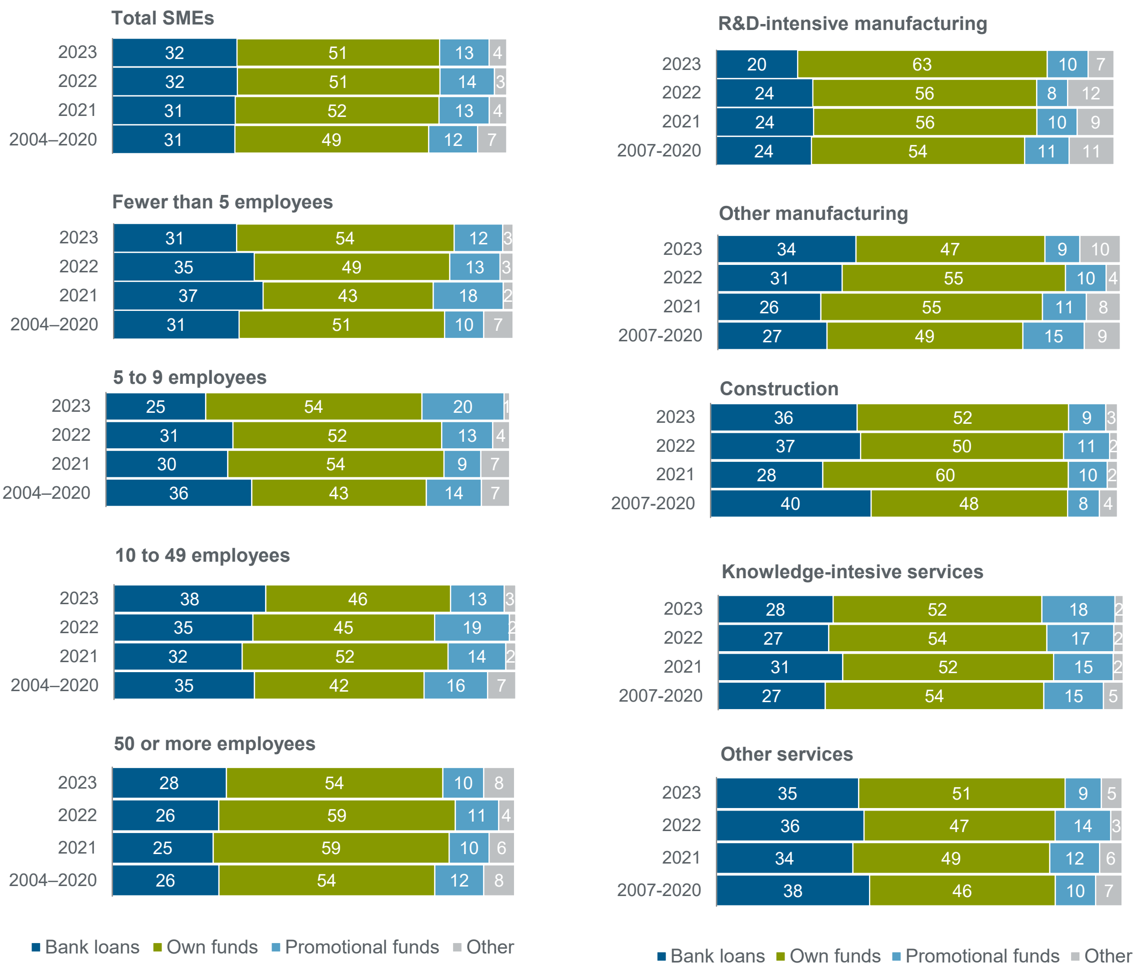


Source: KfW SME Panel 2024

Figure 34: SME investment finance by size class and sector

Size classes by number of full-time equivalent employees, percentage of investment volume

Note: The category ‘Other’ comprises, among others, mezzanine capital and private equity.



Source: KfW SME Panel 2024

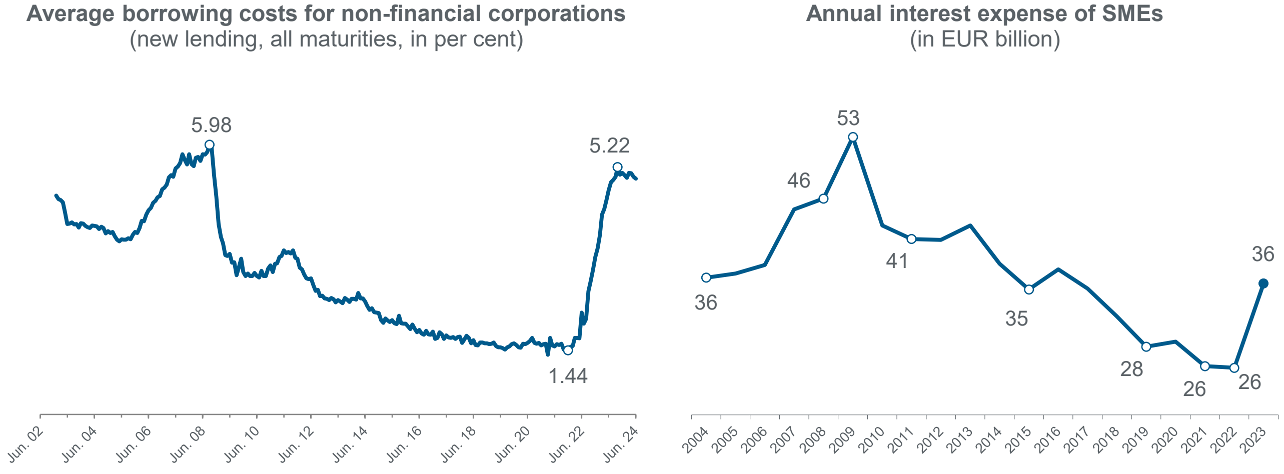
Second, the long-term view reveals the striking structural decline in the share of smaller enterprise size classes over the past 16 years. Taken together, SMEs with fewer than ten employees contributed more than one third less to annual credit volume in 2023 than in 2007 (from formerly 44 to now 27% in 2023). Never before did smaller SMEs account for a lower annual loan volume than last year.

Use of promotional funds dropped slightly

In addition to investment loans from banks and savings banks, the use of public promotional funds represented the second major building block of external funding for SMEs’ investment projects. In 2023, the volume of promotional funds used by SMEs for investment purposes amounted to EUR 31 billion, a decrease of EUR 2 billion on the previous year. The share of promotional funds in the financing of total investment volume fell by one percentage point to 13% (Figure 34). Despite this decline, in the aggregate with the share of bank loans, debt capital continued to play a very important role in investment finance, accounting for 44% (EUR 110 billion in total).

The fact that promotional funds did not play an even larger role is attributable to the sharply decreasing use of promotional funds in the financing of investments in the medium-sized segment of businesses with 10 to 49 employees. In that segment, the share of promotional funds in the funding mix fell – after rising significantly in 2022 – by 5 percentage points to 13%, with around EUR 3 billion less employed than in the previous year. The segment of micro-businesses and larger SMEs, too, used slightly lower amounts of promotional funds to finance investments (-0.4 and -0.7 percentage points). By contrast, the share of promotional funds used by small SMEs with five to nine employees increased by 7 percentage points. That was EUR 2.5 billion more than the year before.

Figure 35: Average credit charges and interest expenses incurred by SMEs



Sources: Figure on the left: Macrobond, EZB, KfW Research. Figure on the right: KfW SME Panel 2024.

At EUR 11 billion, other sources such as private equity or mezzanine capital were used slightly more than in previous years, representing a share of 4% of total financing volume (+1.4 percentage point or +EUR 3.7 billion compared with 2022). After the share of other funding sources had been on a continuous decline since 2015, that was the first increase. It remains to be seen whether this is a sustained trend reversal. The significance of other funding sources currently remains low compared with the mid-2000s, when their shares were sometimes well above ten per cent.

Use of funds to finance investments climbed to a new all-time high

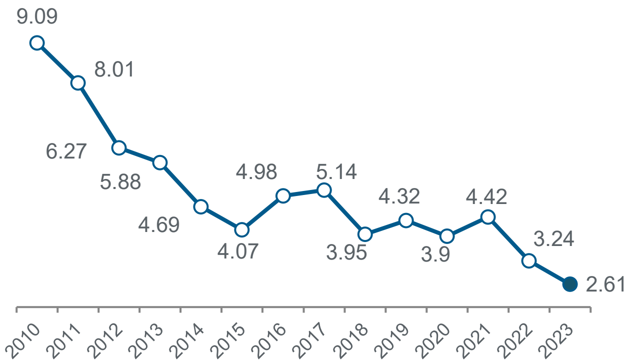
SMEs traditionally fund the lion's share of their investment expenditure with funds of their own (for example, via cash flow or reserves). That was also the case in 2023. The total volume of own funds employed by SMEs amounted to EUR 129 billion last year, an increase of 4.2% or +EUR 6 billion. That means small and medium-sized enterprises in Germany have never before employed such a high volume of own resources to finance their investment projects. The share of own funds in total funding was around 51%, the same level as in the previous year. SMEs with 10 to 49 employees employed the lowest proportion of own funds (45%). Own funds made up a disproportionately high share of 63% of total funding in R&D-intensive manufacturers last year.

Interest expenses rose noticeably – but debt servicing capacity remains very high

The high inflation rates in 2022, which were driven primarily by the sharp increases in energy prices due to the war in Ukraine, have led to a more restrictive monetary policy. After a low-interest policy that spanned more than a decade, the strongest and fastest tightening of monetary policy since the creation of the euro area took place between July 2022 and September 2023. The increases in key interest rates directly affected financing costs (Figure 35, left). In 2023, borrowing costs for non-financial corporations (new loans, all maturities) averaged 4.9%. Those rates were still 2.3% in 2022 and 1.5% in 2021.

Figure 36: SMEs with critical debt sustainability ('zombie companies')

Percentage of businesses in total SME sector



Note: For the purpose of operationalisation, interest obligations were compared with income from operational activity (i.e. earnings before interest, taxes and depreciation (EBIT)). If the quotient of operating profit and interest expenses (interest coverage ratio) is less than 1, an enterprise is classified as a zombie company. The classification also assumes a minimum age of ten years.

Source: KfW SME Panel 2024

After interest expenses had fallen to a record low in the years 2021 and 2022, the sharp increase in credit interest rates last year left behind a distinctive imprint on the balance sheets of businesses last year. The interest expenses incurred by small and medium-sized enterprises in 2023 totalled EUR 36 billion (Figure 35, right) – an increase of approx. 40%. They were borne equally by enterprises of all size classes.

Despite the sharp increase in the interest burden, SMEs broadly still have a good debt-servicing capacity. The proportion of what are referred to as zombie enterprises is an indicator of this.[37] These are generally defined as businesses whose low profitability prevents them from meeting their interest obligations. But the increase in interest expenses did not lead to a deterioration in debt sustainability last year. Rather, the share of companies with such critical debt sustainability ratios (‘zombie enterprises’) stood at a very low 2.61% in 2023 (Figure 36). Or phrased the other way around, more than 97% of all SMEs have sufficient debt servicing capacity.

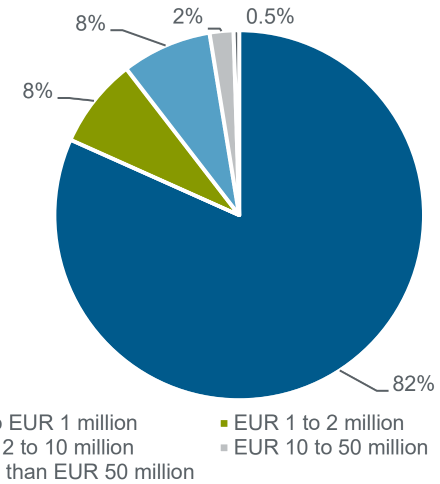
The structure of SMEs in 2024

Under the definition used here, the SME sector covers all enterprises in Germany with an annual turnover of not more than EUR 500 million. That means there were around 3.84 million SMEs in Germany in the year 2023. The SME sector thus accounts for 99.95% of all enterprises in the country. Around 3.1 million SMEs are domiciled in the western German states (82%), while 690,000 (18%) are domiciled in eastern Germany.

SMEs are very small on average

The vast majority of SMEs in Germany is small (Figure 37). A share of 82% (3.13 million businesses) generate annual sales turnover of less than EUR 1 million. Fewer than 0.5% (or approx. 19,000) SMEs generate annual sales turnover of more than EUR 50 million. The share of businesses with higher turnover grew in the past two years as a result of inflation.

Figure 37: SMEs by annual turnover in 2023

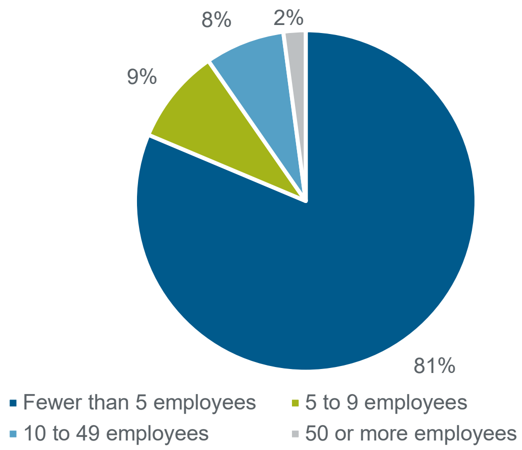


Source: KfW SME Panel 2024

The fragmented nature of the SME sector is also reflected in the numbers of employees (Figure 38). Eighty-one per cent of SMEs have fewer than five employees (micro-businesses, 3 million). That share has grown by around 2-3 percentage points since the turn of the millennium. Nine per cent of SMEs have five to nine employees (small firms), 8% have 10 to 49 employees and 2% have a workforce of 50 or more.

In 2023, the average SME size in Germany was 8.5 full-time equivalent employees (median is 2.5), or roughly 10.5 workers (median value: 3). The SME sector has become more fragmented in the past years, mostly as a result of increasing tertiarisation.

Figure 38: SMEs by number of employees in 2023

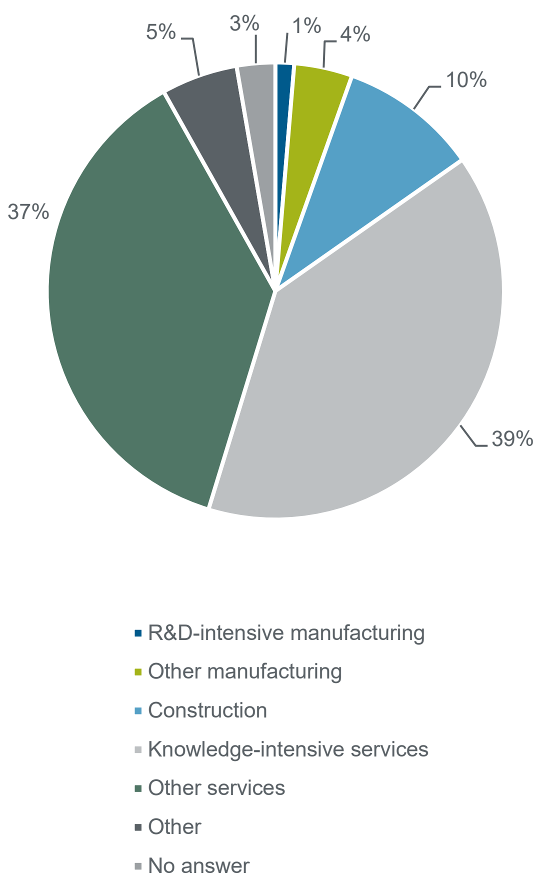


Source: KfW SME Panel 2024

Growing focus on services

Service industries are increasingly dominating economic activity. The majority of German SMEs are service providers (Figure 39), of which 2.94 million – or 77% of all SMEs – operate in service industries, with some 1.5 million of them providing knowledge-intensive services, a trend that continues to rise.

Figure 39: SMEs by sector in 2023



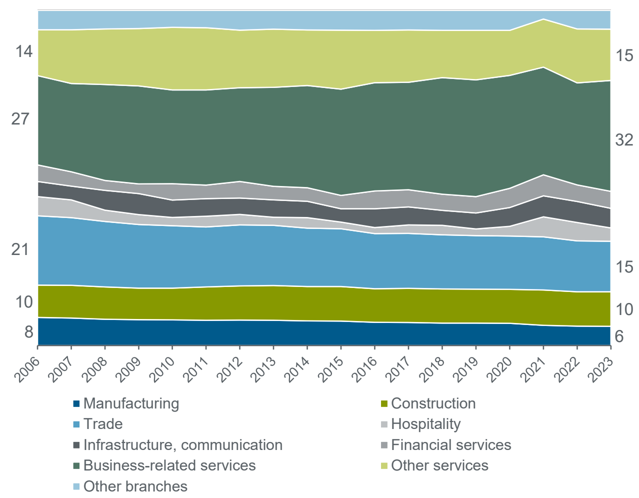
Source: KfW SME Panel 2024

There are many different causes for the shift towards services. One of them is the outsourcing or contracting of what were previously in-company services to third-party companies (for example, IT maintenance, data storage, personnel recruitment, legal affairs and tax matters). These decisions are based on considerations relating to costs, specialisation and division of tasks. Another factor is that structural developments have created more demand for services for some time now (driven by demographic change and the growing proportion of small households, for example). Among knowledge-intensive services, the subsegment of business-related services accounts for the largest and growing share (Figure 40).

In 2023, around 1.3% of all SMEs were R&D-intensive manufacturers (around 51,000 enterprises). Manufacturing generally accounts for a low share of approx. 5.4% of all small and medium-sized enterprises but employs approx. 16% of the entire workforce. On average, they have around 24 employees, a very high number.

Figure 40: Shifts in the sectoral structure of SMEs from 2006 to 2023

Shares of the largest sectors in per cent each year



Source: KfW SME Panel 2007–2024

SMEs at a glance

In per cent, unless otherwise specified

	2017	2018	2019	2020	2021	2022	2023
Investments							
Total share of investors	38	42	39	46	38	43	39
Share of investors <5 full-time equivalent employees	32	37	34	40	32	37	33
Share of investors ≥ 50 full-time-equivalent employees	81	85	83	85	83	86	83
Total investment volume (EUR in billions)	211	220	222	204	215	240	250
Investment volume <5 FTE employees (EUR in billions)	51	42	49	44	44	46	41
Investment volume ≥50 FTE employees (EUR in billions)	86	94	91	79	83	87	97
Volume of investment in new machinery, equipment and buildings (EUR in billions)	176	184	187	173	183	211	219
Investment finance							
Borrowings to finance investments (EUR billion)	65	75	81	59	67	76	79
Rate of loan denials (in per cent)	15	11	12	14	12	9	12
Net profit ratio[a]							
Average return on sales	7.2	7.4	7.5	7.3	7.4	7.0	7.0
Average return on sales <10 FTE employees	14.6	15.0	14.6	14.0	13.8	11.8	11.3
Average return on sales ≥50 FTE employees	4.2	4.2	4.3	4.2	5.1	5.0	5.0
Proportion of SMEs with losses	9	9	9	12	8	10	11
Equity base[b]							
Average equity ratio	31.2	31.2	31.8	30.1	31.4	31.2	30.6
Average equity ratio <10 FTE employees	22.6	22.4	22.2	17.4	23.7	22.8	22.3
Average equity ratio ≥50 FTE employees	33.9	34.8	37.0	36.4	35.0	34.7	35.6
Proportion of SMEs with negative equity ratio	8	8	4	4	5	6	12
Employment trends[c]							
Total employment growth rate	2.7	3.3	1.9	-0.3	1.0	1.6	0.5
FTE growth rate <5 FTE employees	1.6	2.1	2.0	-0.7	-0.4	1.2	-0.5
Development of turnover[c]							
Total turnover growth rate	4.7	4.9	3.5	-1.3	6.1	10.0	1.6
Turnover growth rate <5 FTE employees	2.8	6.1	3.9	-3.7	2.5	7.7	-0.7

* Note: [a] Mean values weighted with turnover. [b] Mean values weighted with total assets, projections only for enterprises with accounting obligations and excluding individual enterprises / sole traders. [c] Missing information on FTE employees and turnover was not imputed, calculations not including growth rates below the 1% and above the 99% quantile.

KfW SME Panel

The KfW SME Panel (KfW-Mittelstandspanel) has been conducted since 2003 as a recurring postal survey of small and medium-sized enterprises in Germany with annual turnover of up to EUR 500 million. Thus far, 22 waves have been completed.

With a database of 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 SMEs. As it is representative of all SMEs of all sizes and across all industries in Germany, the KfW SME Panel offers the possibility to conduct projections for micro-businesses with fewer than five employees as well. A total of 9,556 SMEs took part in the current wave.

The KfW SME Panel is used as the basis for analyses of long-term structural developments in the SME sector. It provides a representative picture of the current situation and the needs and plans of SMEs in Germany. It focuses on annually recurring information about companies' performance, investment activity, financing structure, and innovation and digitalisation activity. This tool offers a unique opportunity to determine quantitative key figures for SMEs such as investment spending, borrowing and equity ratios.

The basic population used for the KfW SME Panel comprises all SMEs in Germany. These include private-sector companies from all sectors of the economy with annual turnover of not more than EUR 500 million. The population does not include the public sector, banks or non-profit organisations. Currently there are no official statistics providing adequate information on the number of SMEs or the number of people they employ. In order to determine the population of SMEs for 2023 and the population of employees at SMEs in 2023, the German Company Register (Unternehmensregister) and the official employment statistics (Erwerbstätigenrechnung) were used as a basis for the 2024 survey.

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

The survey is conducted by GfK GmbH on behalf of KfW Group. The project received expert advice from the Leibniz Centre for European Economic Research (ZEW) in Mannheim. The main survey of the 22nd wave of the KfW SME Panel was conducted in the period from 12 February to 21 June 2024.

Supplementary survey to the KfW SME Panel 2024

The analyses on the situation of enterprises in 2024 were based on an additional supplementary survey to the KfW SME Panel 2024 conducted in early September 2024. All enterprises that had already participated in an earlier wave of the KfW SME Panel and had provided a valid email address were surveyed. Responses from a total of 2,494 enterprises were evaluated. As the supplementary survey was linked to the main database of the KfW SME Panel, its results also provided a representative picture.

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

[1] Borger, K.; Körner, J.; Scheuermeyer, P. and Schoenwald, S. (2024): KfW Business Cycle Compass August 2024. The sawtooth shape of Germany's business cycle is gradually levelling out, KfW Research.

[2] Scheuermeyer, P. (2024), KfW-ifo SME Barometer: September 2024. SME sentiment has fallen but remains slightly more stable than in large enterprises, KfW Research.

[3] For more on this, see Schwartz, M., and Gerstenberger, J., (2022), KfW SME Panel 2023: SMEs' resilience is being put to the test. So far, they have come away with few bruises, but now they are increasingly nervous, KfW Research.

[4] Federal Statistical Office (2024), Inflation rate was +5.9% in the year 2023, Press release No. 020 of 16 January 2024, Wiesbaden.

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

[6] Research- and development-intensive (R&D intensive) manufacturing is defined as those manufacturing subsectors whose average research and development intensity (R&D intensity: ratio of R&D expenses to turnover) is higher than 3.5%. The definition is based on what is known as the NIW/ISI list of research-intensive industries and services, which in turn follows the Federal Statistical Office's 'Classification of Economic Activities (WZ 2008)'. Engineering, medical technology, instrumentation and control technology, vehicles, pharmaceuticals and office equipment are of particular quantitative importance.

[7] The subsegment of other manufacturing (non-R&D-intensive manufacturing) is mainly represented by enterprises operating in the food industry, wood processing and the manufacture of metal products, as well as other manufacturing not further specified.

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

[9] Cf. Schwartz, M., and Gerstenberger, J., (2021), KfW SME Panel 2021: SMEs have have shown adaptability in the coronavirus crisis but cracks are appearing in the foundations of small businesses, KfW Research.

[10] Federal Statistical Office (2023), 2023 turnover in retail trade down a real 3.3% in 2023 on 2022, press release No. 041 of 31 January 2024, Wiesbaden.

[11] German Retail Federation (HDE) Umsätze im Onlinehandel in Deutschland: Erstmals mehr als 50 Prozent über Marktplätze – Smartphones immer wichtiger (*Turnover in online trade in Germany: 50 per cent via marketplaces for the first time – smartphones increasingly important* – our title translation, in German) – German Retail Federation (HDE)) (einzelhandel.de).

[12] Profit margin is defined as the ratio of pre-tax profit to turnover. The figure shows the mean values of profit margin weighted against turnover.

[13] Knowledge-intensive services comprise service subsectors with an above-average share of university graduates in total employment and services with a strong focus on technology. These include, for example, architecture and engineering firms, law firms, tax and management consultancies, data processing and telecommunication services. The definition is based on what is known as the NIW/ISI list of research-intensive industries and services, which in turn follows the Federal Statistical Office's 'Classification of Economic Activities (WZ 2008)'.

[14] Initially, this was mostly due to supply chain disruptions that emerged in the course of the COVID-19 pandemic. Many businesses were forced to scale back their capacities when the pandemic broke out and could expand them again only slowly. Measures adopted to contain the spread of the virus and worker absenteeism also hampered production. Further price increases then occurred in February 2022 when Russia invaded Ukraine. The sharp cuts in gas supplies from Russia in particular caused energy prices to spike up until mid-2022, further exacerbating the general price increase. This was worsened by bottlenecks in the supply of other raw materials and inputs (as a result of sanctions) as well as increased transport costs due to the loss of transport routes.

[15] Schwartz, M., Brüggemann, A. and Schwarz, M. (2022), Energiekosten im Mittelstand steigen: Unternehmen geben Preiserhöhungen weiter und ergreifen Maßnahmen zur Energieeinsparung (SMEs' energy costs are rising: businesses are passing price rises on and taking measures to save energy – in German), Focus on Economics No. 384, KfW Research.

[16] Grewenig, E. and Schwartz, M. (2024), Aktuelles Kostenniveau für die meisten Unternehmen tragbar – weitere Kostensteigerungen im Jahresablauf absehbar (Current cost level manageable for most enterprises – further cost increases foreseeable in the course of the year, in German only) Focus on Economics No. 465, KfW Research.

[17] This is indicated by findings from the spring, see: Creditreform Wirtschaftsforschung (2024), Wirtschaftslage und Finanzierung im Mittelstand: Frühjahr 2024 (Economic situation and financing in the SME sector – our title translation, in German), Verband der Vereine Creditreform e.V., Neuss: https://www.creditreform.de/fileadmin/user_upload/central_files/News/News_Wirtschaftsforschung/2024/Wirtschaftslage_Mittelstand/2024-04-23_AY_OE_MIT-fruehjahr-2024.pdf

[18] Federal Statistical Office (2024), Employment reaches a new high in 2023, Press release No. 001 of 2 January 2024, Wiesbaden.

[19] Federal Statistical Office (2024), Employment slightly up in June 2024, press release No. 293 of 31 July 2024, Wiesbaden.

[20] Scheuermeyer, P. (2024), KfW-ifo SME Barometer: July 2024: SME business sentiment: A summer slump, or a reversed upswing? KfW Research.

[21] [21] Scheuermeyer, P. (2024), KfW-ifo SME Barometer: September 2024. SME sentiment has fallen but remains slightly more stable than in large enterprises, KfW Research.

[22] Ifo Institute (2024), ifo Employment Barometer Falls (September 2024), Employment Barometer in Germany Falls (September 2024) | Facts | ifo Institute.

[23] The employment growth rate described here was determined on the basis of full-time equivalents (FTEs). As opposed to showing the number of persons in gainful employment, this concept maps actual labour demand. FTE employees are calculated from the number of full-time employees (including business owners) plus the number of part-time employees multiplied by a factor of 0.5. Apprentices are not included.

[24] The equity ratio is defined as the quotient of equity and balance sheet total. The figure shows the mean values of the equity ratio weighted against the balance sheet total. The calculations apply only to enterprises required to draw up balance sheets.

[25] Brüggemann, A., Grewenig, E., Römer, D. and Schwartz, M (2023): KfW Climate Barometer 2023. Despite the energy crisis: Climate investments by German enterprises grew by 18% in real terms in 2022, KfW Research.

[26] Zimmermann, V. (2024): KfW SME Digitalisation Report 2023: Digitalisation activities are defying the economic slowdown, KfW Research.

[27] Schwartz, M. and Gerstenberger, J.(2024), Zinswende mit überschaubarem Zusatzeffekt auf die Investitionen im Mittelstand (Interest reversal with moderate additional effect on SME investment – in German only), Focus on Economics No. 462 May 2024, KfW Research.

[28] Ibid.

[29] Ibid.

[30] In the past 15 years, the relative importance of service enterprises for SMEs' investment activity has grown by nearly one third. This also reflects the general transformation of the business landscape towards services. There are multiple reasons for this development. One of them is that businesses have been outsourcing or contracting what were previously in-company services to third-party companies. These decisions are based on considerations relating to costs, specialisation and division of tasks. Another factor is that structural developments have created increased demand for services for some time now (driven by demographic change and the growing proportion of small households, among other factors).

[31] Gross fixed capital formation in the business sector comprises private sector investment in machinery and equipment plus construction (without residential construction).

[32] The major revision of national accounts and the associated modification to the concept of investment has been applied since the 2015 reporting period of the KfW SME Panel. Of particular relevance for enterprises is expenditure on research and development, which is now reclassified as gross fixed capital formation since implementation in 2014 of the European System of National and Regional Accounts of 2010 (ESA 2010). All time series of national accounts that have been revised for conceptual reasons for the period from 1991 are available. This has led to an increase in the volume of gross fixed capital formation and depreciation across the entire economy in comparison with previously reported figures. For reasons of data collection, the revision cannot be applied to the investment and depreciation volumes of SMEs. The reported volumes thus do not change in comparison with earlier years. Instead, the volumes have been modified for the entire business sector, the overall economy and, consequently, also for large enterprises. Due to the limitations on the collection of data pertaining to the changed investment concept, the volumes relating to SMEs tend to be underestimated and, accordingly, those of large enterprises overestimated.

[33] In order to determine the absolute volumes of net investment overall in both the SME and overall business sector in Germany, KfW SME Panel data were coupled with investment data provided by the Federal Statistical Office on the entire business sector. Data on the investment and depreciation volume in the SME sector is collected in the context of the KfW SME Panel. Total business investment is calculated by adjusting gross fixed capital formation for public-sector investment and investment in residential construction. Depreciation in the business sector is calculated in the same way. The underlying data was obtained from Fachserie 18, Reihe 1.4 of the Federal Statistical Office. The investment volume and the depreciation volume of large enterprises (with an annual turnover of more than EUR 500 million) are determined by subtracting the volumes calculated for SMEs from the corresponding values for the entire business sector.

[34] Cf. Gerstenberger, J. and Schwartz, M. (2023): KMU verzichten häufiger auf Bankkredite – Zinsniveau spielt dabei eine große Rolle (SMEs forego bank loans more often – interest level plays a major role – in German only), Focus on Economics No. 443, KfW Research.

[35] ECB (2024), The euro area bank lending survey Second quarter of 2024.

[36] Gerstenberger, J. (2024), Bisher nur wenige KMU von Banken auf Nachhaltigkeitsinformationen angesprochen – Bedarf dürfte aber zunehmen (So far, only few SMEs have been requested by banks to provide sustainability information – but demand will likely grow – in German only), Focus on Economics No. 453, KfW Research.

[37] The debate around zombie companies is not new. They are generally associated with weak growth, reluctance to invest or productivity deficits. A few years ago, the low interest rate environment was seen as a potential driver. It was expected to act as a lever to incentivise more investment. The concern was that continuing to inject capital would enable even financially weak businesses to remain in the market with support. But there was nothing to suggest that the share of financially weak enterprises may have grown.