

# MITTELSTANDSMONITOR 2004

TAKING OPPORTUNITIES FOR AN UPTURN



Annual report on cyclical and structural issues relating to small and medium-sized enterprises – Abridged version.

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## **Preface**

In Germany more than 99% of all enterprises are SMEs. They produce nearly half the enterprise sector's gross value added. Their main qualitative feature is that owners and responsible management are identical. The vast majority of the small and micro enterprises - which factually include all start-ups and most young enterprises - belong to this sector as do larger enterprises with several hundred employees and a leading position in the world market. With their diversity they ensure economic stability and form an integral part of a balanced enterprise size structure that facilitates structural change, promotes innovation and thus ultimately contributes to more growth and prosperity of a national economy. Despite the enormous economic importance rightly attributed to small and medium-sized enterprises time and again in the debate about economic and social policy, the economic situation of SMEs is not apparent in the official statistics.

Only a few institutions possess sufficient statistical information bases of their own that would put them in a position to make regular observations on issues concerning SMEs. However, reliable data and an unbiased - empirical - formation of opinions are necessary if the debate about central issues of economic life is to be conducted in an objective manner. For this reason the Verband der Vereine Creditreform (Creditreform), the Institut für Mittelstandsforschung (IfM Bonn), the Rheinisch-Westfälisches Institut für Wirtschaftsforschung (RWI) and the Zentrum für Europäische Wirtschaftsforschung (ZEW) have joined an initiative of KfW to publish the MittelstandsMonitor, which is a joint annual report on cyclical and structural aspects relating to small and medium-sized enterprises. The key idea is to collect and compare new expert findings in order to subsequently present them to the public in a concise form. The prime objective is to conduct an analysis based strictly on objective facts. The exclusive databases of the partners complement each other and provide a comprehensive empirical basis for the MittelstandsMonitor.

The assessment of the cyclical economic situation of small and medium-sized enterprises and the development of company start-ups and liquidations represent a firm element of the report. Different focal topics concerning the small and medium-sized enterprise sector that are of current economic interest are added each year. The 2004 issue is dedicated to be topics "Contributions of Small and Medium-sized Enterprises to Employment" and "Technology Transfer between Universities/Research Institutes and Small and Medium-sized Enterprises". A new edition to this issue is the "Chronology of Events in SME Policy".

The project partners have decided to give the MittelstandsMonitor 2004 the title

**"Taking opportunities for an upturn"**

This is intended to express the notion that economic policy should make use of the economic turnaround initiated by exports (Chapter 1) in order to make determined progress in the structural reforms in financial and social policy that have been started. After all, successful reforms are a precondition for a long and self-sustaining upswing. In this, small and medium-sized enterprises play a key role, particularly in solving the problems of the job market. Only if SMEs, which by and large direct their operations at the domestic market, are convinced of a durable revival of domestic demand, will they play out their substantial employment potential (Chapter 3). In addition, the bottoming out of the start-up slump (Chapter 2) and the provision of access to research findings for enterprises, which is important to an economy's innovative strength, hold further opportunities to turn the nascent recovery into a genuine upswing. Researchers who are experienced in partnerships now generally consider cooperating with SMEs to be just as valuable as cooperating with large enterprises (Chapter 4), so that in the future the possibilities which the research sector offers SMEs might be better utilized than in the past.

The participating institutions, February 16, 2004

## Summary

### Chapter 1: The economic situation of small and medium-sized enterprises

#### *Slowly emerging from deep slump*

The profound cyclical weakness of the small and medium-sized enterprise sector was in its fourth consecutive year in 2003. Once again, SMEs were suffering under the absence of dynamic force in the domestic economy. However, beginning in the second half of the year the economic environment gradually improved as the global economy started to recover after the war in Iraq ended and the SARS epidemic subsided. In this setting, on the basis of indicators that had reached multi-year lows (KfW Small and Medium-Sized Enterprise Business Cycle Indicator, Creditreform business climate indicator), a moderate recovery of the SME business cycle set in towards the end of the year that was supported by the slight economic improvement that began in the course of 2003 but mainly by cautiously optimistic expectations for 2004.

Eastern German SMEs coped relatively better with the stagnation but western German SMEs are more optimistic about 2004. While the structural decline in the construction industry slowed, service companies and manufacturers in particular, but also the retail sector, started the New Year with a bit more optimism. As in 2001 and 2002, small and medium-sized enterprises on balance did not have any positive impact on the labour market last year either. The share of companies that reduced employment was a good 13 percentage points higher last year than the share of companies that created new jobs. Only around 12% of SMEs consider themselves in a position to hire additional personnel in 2004. Hoping to achieve more or at least constant sales and more stable earnings prospects, more SMEs are ready to make capital expenditures than in the previous year (31% as opposed to 25%), but their figure will remain noticeably below the 48% average of the past years.

Thus the prospects for small and medium-sized enterprises at the beginning of 2004 are generally better than a year before even if the decisive risk factors in the overall economic framework (latent terror threat, the abrupt euro surge, continued weak domestic demand) must not be played down. The somewhat more positive business situation following the prolonged downturn as well as the moderate optimism that returned in the last quarter do not appear to be short-lived but should rather be taken to signal the rise from the deep slump. The institutions assume that the cyclical outlook for SMEs will further brighten in the wake of the overall economic recovery, albeit only slowly and at first without any significant impact on employment and with merely moderate capital expenditure increases.

## Chapter 2: Business Fluctuation – Driving Force for Economic Dynamism

### *Decline in company start-ups has bottomed out, but no general turnaround yet*

Business fluctuation makes an important contribution to structural and technological change in the economy. It ensures that around one fourth of existing enterprises nowadays enter or leave the market within one year.

The applied start-up indicators provide a very uniform picture of the business start-ups going on in Germany. While the downward trend slowed in eastern Germany in 2002 it was stopped in the West, mostly due to the positive development in the commerce sector. Still worrying, however, is the persistent decline in the intensity of business start-ups in the information and communications technologies (ICT) and the high-tech sectors, as well as the still comparatively low level of business formation intensity in the eastern German states. The number of business start-ups is likely to have risen again in 2003. The increase in start-ups from unemployment deserves to be emphasized as well.

The shrinking number of eastern German companies leaving the market – their number has been falling since 1999 – is due mainly to a decline in the number of start-ups in the region since the latter half of the 1990s. In contrast, in the West there are more liquidations. The rate of insolvencies, which are part of liquidations, has risen further and reached historic highs in the past two years. The main reason for this is the new insolvency statute, which makes it easier to initiate insolvency proceedings.

By introducing the insolvency statute the legislators intended to give enterprises more possibilities to restructure. For this purpose the restructuring instrument "insolvency plan" was introduced into the law. To date, however, enterprises have been very reluctant to make use of this restructuring possibility. This has to do with the still low degree of recognition of this instrument, coupled with fear of being stigmatized by insolvency. Although the procedure offers attractive benefits both for the debtor and for the creditor, it is not yet acknowledged as a restructuring alternative.

In the process that begins with the wish to start a business and moves through the planning of its establishment to implementation, the number of potential business founders declines significantly. In the end, only a good one out of six people wanting to set up a business are still among the business founders-to-be. Reasons for abandoning the plan to start up a business are the weak economy, the notion that the business concept appears unlikely to succeed for lack of demand, and fear of being socially stigmatized in case of failure.

### **Chapter 3: The Contribution of Small and Medium-sized Enterprises to Employment**

#### ***Despite economic problems, SMEs are still very important for employment***

In the public discussion about growth and employment, many hopes are pinned to SMEs. The purpose of Chapter three is to examine the significance of SMEs for employment in Germany.

The available data have only a limited value for quantifying the contributions SMEs make to employment. Comprehensive and differentiated data on the development of employment are available only at the level of individual business operations. At the enterprise level, in turn, there are no data on the analysis of how employment has been developing in SMEs. However, larger enterprises in particular often consist of several operations so that the analysis at the level of individual operations only gives an uncertain picture of the shares of employment of SMEs.

Just under 80% of all employees who are subject to social security contributions now work in a small or medium-sized business. Between 1991 and 2002 their share rose from 72% to 77% in western Germany and from less than 60% to 86% in eastern Germany. On the basis of our analyses of additional data we estimate the actual employment share of the small and medium-sized enterprises to be between 60% and 74% today.

Over 70% of new jobs that are subject to social insurance contributions are being created by start-ups and small businesses with fewer than 50 employees. These, in turn, account for only a little over 60% of job cuts. An examination of the absolute figures serving as a basis shows that on balance, small companies created jobs these past years, whereas in net terms mid-sized and large companies with 50 or more employees have reduced the number of jobs subject to social insurance.

Start-ups have a lasting positive effect on the job market. New studies revealed that they stimulate the creation of jobs even years after the business was set up. In the 1990s as many as 11% of all gainfully employed people worked for businesses that were not older than 4 years.

The number of gainfully employed individuals working as self-employed entrepreneurs increased significantly in the 1990s. In the year 2002 the share of self-employed professionals out of all gainfully employed persons reached a new high of 10%. This growth is being driven particularly by self-employed persons who do not employ any associates. Their share increased from just under 4% to 5% of all gainfully employed persons between 1989 and 2000. These days, every other self-employed person is working solo.

## **Chapter 4: Technology Transfer between Universities/Research Institutes and Small and Medium-sized Enterprises**

### ***SMEs are in a good position to intensify technology transfer***

Within the debate about innovation policy, the structures for the transfer of knowledge and technology and, hence, the possibilities of enterprises to access the knowledge of universities and public research institutes are still considered sub-optimal. In particular, critics claim that small enterprises are at a disadvantage against larger enterprises in the transfer of research and technology between universities and industries. These claims were empirically examined with the aid of an online poll of university professors and an analysis of interviews with enterprises.

The survey of 582 university professors/institute directors showed that both the universities/research institutes and the enterprises are willing to cooperate. Small and medium-sized enterprises are quite present in the transfer of knowledge and technology between universities/research institutes and industry. Differences do exist, however, in the technological cooperation of universities/research institutes with SMEs and larger enterprises with regard to the universities' motivation to cooperate and the specific problems enterprises have when entering into a cooperation.

Universities/research institutes expect cooperation with large enterprises to enhance their reputation and noticeably improve their own financial situation. The main reason for universities to cooperate with small and medium-sized enterprises is that it enables them to carry out interesting research projects in a comparatively short period of time. The enterprises participating in a technology transfer appreciate not only the problem-solving competence of the universities/research institutes but also the opportunity to gain access to new research findings/new technical fields.

From the perspective of the universities/research institutes, finding appropriate partner enterprises and obtaining state assistance are among the main problems.

Although the cooperation between universities/research institutes and - particularly small and medium-sized - enterprises runs relatively smoothly and successfully, incentive systems to improve cooperation should not be dispensed with. This includes improving regulations governing the rights to utilize new technological developments, intensifying the creation of networks, and specific promotion.