Finanzgruppe
Deutscher Sparkassen- und Giroverband

DIAGNOSE
MITTELSTAND
2023

German SMEs in transition

Three out of four companies in Germany are customers of the Savings Banks Finance Group. Advising and financing small and medium-sized enterprises in Germany is the core business of the Savings Banks and Landesbanken. To this end they use their strengths – a detailed knowledge of their customers and their personal situations as well as a nationwide presence throughout Germany's regions.

With the SME Diagnosis 2023, the German Savings Banks Association (DSGV) presents the 23rd collection of representative data on the current situation of SMEs in Germany.

The S-Financial Climate Index of the DSGV and Deka is again integrated into this survey. This is based on quarterly surveys on economic developments conducted among the management boards of German Savings Banks.

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Foreword

“The most important guarantee of future prosperity is having a sufficient number of hard-working and capable people. People who continue to renew the wealth that exists today through their efforts – thereby maintaining its value.”

HELMUT SCHLEWEIS
President of the German Savings Banks Association

Ladies and Gentlemen,

The German SME sector is robust and innovative, but many entrepreneurs are currently feeling held back. They would like to invest in energy-efficient production, push ahead with digitalisation and make a fresh start after the long years of crisis. But the hurdles are often too high.

Above all, the excessive bureaucracy and the shortage of skilled labour, as well as the high energy and wage costs are seen as obstacles to investment – as the members of the Savings Banks' management boards hear from their customers.

"We need to drive forward the energy transition and keep energy affordable. We need to invest in education and promote the immigration of people who are eager to work. In addition, digitalisation must be implemented quickly and comprehensively."

Many small and medium-sized companies have recently shown how they can succeed even under difficult conditions. Our analyses show that turnover rose by an average of 14 percent and profits by as much as 17 percent in 2022.

Companies have saved energy and expanded their warehouses in order to better manage bottlenecks. They have compensated for price increases on the purchasing side with higher sales prices.

But of course, individual sectors have serious problems – especially the construction industry, gastronomy and retail.

Numerous German companies are now considering emigrating or are already relocating parts of their production and jobs abroad.

Politicians are therefore called upon to increase their commitment to SMEs by setting the course for the future in the areas of energy, digitalisation and education.

Obstacles to the sustainable engagement of small and medium-sized enterprises must be removed without subjecting these companies to new notification and reporting obligations.

Less bureaucracy and efficient regulation can provide real economic stimulus and offer SMEs cost-effective new prospects.

SMEs form the strong economic foundation of our country. But even this foundation must not be overburdened.

Financing the transformation will not be a problem: the average equity ratio for SMEs is around 38 percent. Liquid funds are not currently seen as a bottleneck. Savings Banks, Landesbanken and Deutsche Leasing are on hand and have the capacity to provide comprehensive support for investments, particularly in the area of transformation.

This “SME Diagnosis 2023” describes and evaluates the challenges facing small and medium-sized enterprises in an economic world characterised by crises. This publication also incorporates Deka’s S-Financial Climate Index, which is based on quarterly surveys of the boards of directors of German Savings Banks on economic trends. With the “SME Diagnosis”, the Savings Banks and Landesbanken, as the most important financial partners of SMEs, make their knowledge available to the public.

Let’s work together to drive change and unleash the power of the SME sector. The future is in our hands and we are ready to help shape it.

Berlin, November 2023

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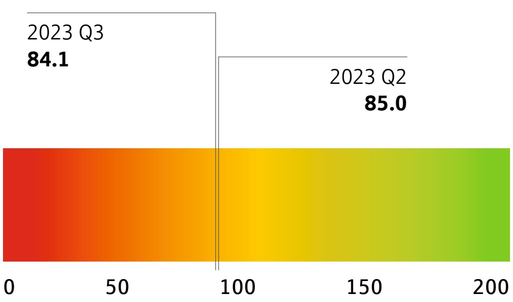
Deka S-financial climate in the 3rd quarter of 2023

Forwards into standstill

The Deka S-financial climate, the mood barometer for the economic situation from the perspective of the Savings Banks in Germany's regions, signaled SOS for the operating conditions of local companies in the third quarter. Previous assessments confirm that excessive bureaucracy, a shortage of skilled workers and a lack of digitalisation are increasingly hampering economic activity. Currently, however, there is an unsettling message: the financial managers surveyed doubt that this situation will change in the foreseeable future. Although the diagnosis of the problem now seems to have reached everyone, the will to reform is lacking. No "jolt" is sweeping through Germany. As a result, the current assessment of the economic situation is also sobering. After the relief that the energy crisis failed to materialise had already passed in the previous quarter, the economic climate deteriorated further – sharply, from 89.9 to 75.7 points. The fact that the overall S-financial climate only fell by just under one point from 85.0 to 84.1 points is due to the strengthening of the banking sector as a result of the return of interest rates. → chart 01

Deka S-Financial Climate Q3 2023 chart 01



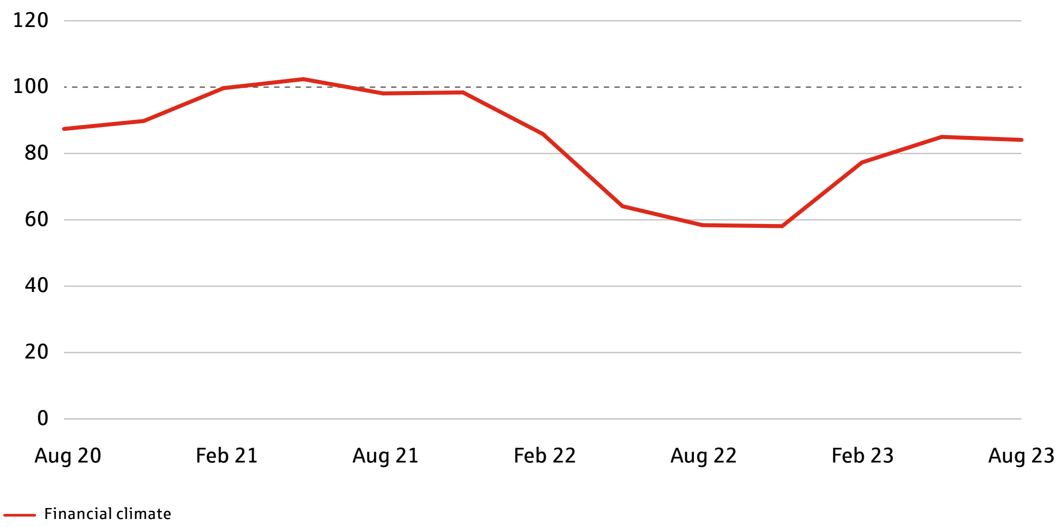
Sources: DekaBank, Research Centre for Savings Banks Development

Economic and structural pessimism

Two trends characterise the S-financial climate in the 3rd quarter. Firstly, the rise in interest rates is strengthening the German banking sector's business model, as loans are once again generating higher interest income. This is an important counterforce to the valuation risks that such a turnaround in interest rates also entails. This trend has already boosted the financial climate in recent quarters and remains intact. This is also reflected in the Savings Banks' continued high level of willingness to lend, even if this declined slightly in the current survey. → chart 02

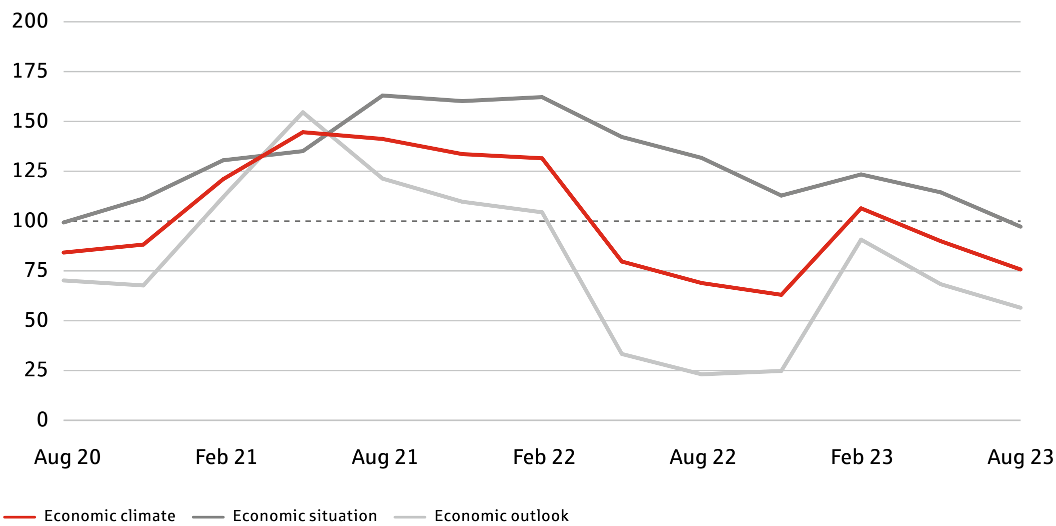
The second trend lies in a significant economic slowdown, which replaced the relief at the absence of the energy crisis at the beginning of the year from the second quarter onwards. This trend is also ongoing. The economic climate as part of the S-financial climate fell from 89.9 points to 75.5 points. A neutral economic assessment is a value of 100 points; above-average economic assessments achieve values above this. → chart 03

Recovery of the S-financial climate paused chart 02



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

Economic climate back in reverse gear chart 03



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

From a macroeconomic perspective, two factors are at work here. Firstly, the German economy is very strongly affected by the current global weakness in demand for capital goods (particularly in China) due to its industrial and export-oriented structure. These are problems that similarly structured economies such as South Korea or, to some extent, Japan are also currently experiencing.

Secondly, the German economy is increasingly suffering from location weaknesses. These have been known for some time and have now triggered a discussion about the need for reform in Germany. What is explosive about the current S-financial climate survey is that the board members of the German Savings Banks, who are very familiar with the issues facing local companies, express little hope of improvement: In the most pressing problem areas of bureaucracy/regulation, shortage of skilled labour and high energy costs, none of the experts see any improvement in the next five years.

Economic climate: the slowdown turns into a downwards slide

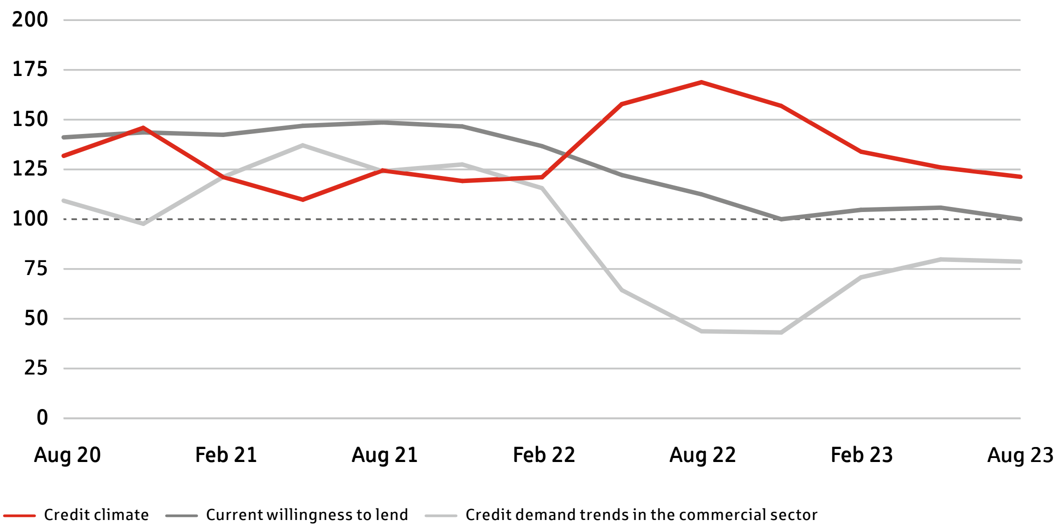
The economic climate within the S-financial climate fell to 75.5 points in the 3rd quarter. While the economic climate in the regions of Germany could previously be described as mediocre, it has now clearly fallen into the poor range.

The situation assessment has fallen the most. It had risen at the beginning of the year after the winter worries, but has now dropped for the second time in a row to 97.2 points. This is a slightly below-average assessment and is in line with the gross domestic product figures, which are hovering in no man's land between recession and stagnation. The real pessimism in the Savings Banks' current economic assessments is expressed in the expectations component. There has been a high level of scepticism here since the outbreak of the war in Ukraine. Expectations recovered slightly when the natural gas shortage failed to materialise, but pessimism has been on the rise again since the spring. Economic expectations are currently only at a modest 56.5 points. A declining order backlog, falling production figures and increasing problem pressure in individual industries such as the automotive and construction sectors are the data-based accompaniment to these assessments of recent weeks.

This is not yet the level of economic panic seen last autumn, but for a time without any new external shocks, this figure is remarkably poor. The current expectations of the Savings Banks give no hope of an economic upturn in Germany by the end of the year. This is in line with the current numerical formulations on the economic outlook by analysts: the Kiel Institute for the World Economy has lowered its GDP forecast for this year to minus 0.5 percent. We ourselves have maintained our view of minus 0.6 percent since the second quarter. In contrast to the institutes, however, we are only cautiously optimistic for the coming year. While most forecasts estimate growth of 1 to 2 percent, we expect the German economy to grow by just 0.9 percent in 2024 (as at September 2023).

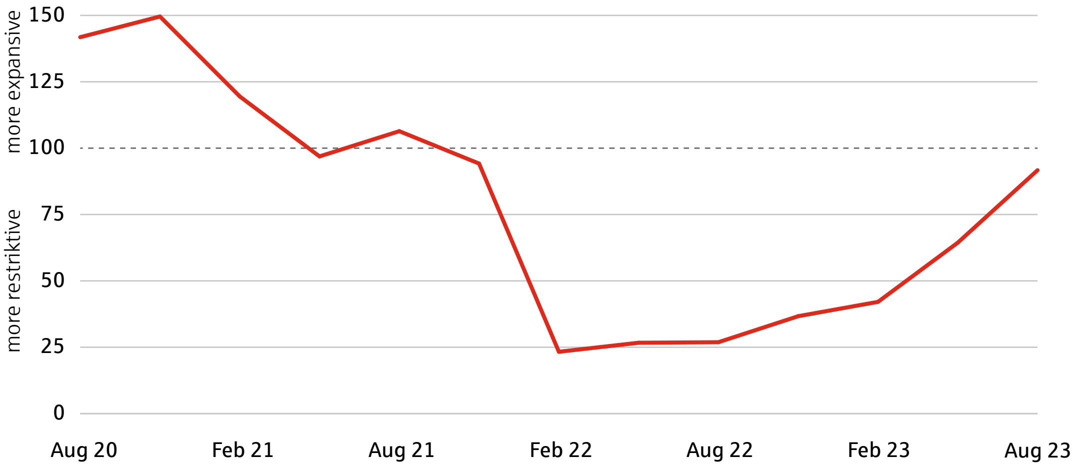
Credit climate

chart 04



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

Monetary policy has almost reached the highest level of restriction chart 05



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

Credit climate: remains stable

At 121.3 points (previous quarter: 126.0), the credit climate remained more or less unchanged. Demand for credit, which had picked up slightly in the previous quarter, remained constant in the third quarter, albeit at a below-average assessment level of 78.7 points. Demand for property loans in particular continues to show signs of a trend reversal. The low of 11.9 points at the end of last year highlighted the sudden and rapid slump in the construction sector, which was triggered by the ECB's sudden turnaround on interest rates. → chart 04

There were already signs of a bottoming out at a low level (69.2 points) in the second quarter, which has now continued with a further rise to 75 points. However, it is still too early to speak of a trend reversal in the granting of property loans. Rather, it is a process of becoming accustomed to a permanently higher interest rate level, which could also lead to a return to higher construction activity in the future. The willingness of the Savings Banks to grant loans, i.e. the terms of the loan offer, are in neutral territory at exactly 100 points. The fact that the overall credit climate score is still above average despite the current decline is due to the fact that the willingness to lend is still greater than the demand for credit.

Assessment of monetary policy

Credit demand and economic development are strongly influenced by expectations regarding monetary policy. After one of the fastest and strongest interest rate rises in recent decades, monetary policy expectations are slowly settling down. At 91.7 points, there is only a very small proportion of experts who expect monetary policy to be tightened further. This proportion will become even smaller after the European Central Bank's key interest rate rise in mid-September. → chart 05

The shift in opinion on monetary policy is making huge strides (last quarter: 64.4 points). This means that the Savings Banks' head offices now expect interest rates to remain unchanged for the next twelve months. This is remarkable in that a return to low interest rates has been ruled out for the time being. In view of the uncertainties surrounding the development of inflation, we expect this assessment to change again, particularly at the beginning of next year, when it becomes clear whether and how far inflation trends are still away from the central banks' 2 percent target.

Opportunities and risks for the banking sector

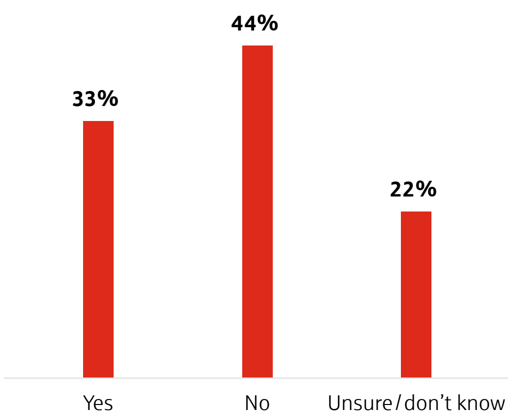
Rising interest rates are a double-edged sword for the banking sector. In principle, they support the business model because the spread between deposit and lending rates increases to some extent. So, while the end result of higher interest rates has a positive effect on the financial sector, the way there harbours a number of risks. Rising market interest rates initially lead to a reduction in the value of assets such as bonds, shares and property. If an economic slowdown is then added as a further risk, loan defaults can put additional pressure on balance sheets in the banking sector. In the USA, this has already led to considerable friction at some regional banks. Due to a deterioration in the economic situation, they have had to accept deposit outflows from their corporate customers and have subsequently had to sell securities at a loss.

Savings Banks board members in Germany have not seen any such reactions, although 72 percent of those surveyed believe it is likely that their customers in Germany will also react to the rise in interest rates. However, the most likely variant (68 percent) is expected to be a shift from bank deposits to longer-term deposits with higher interest rates, i.e. the conversion of sight deposits into term deposits and other on-balance-sheet forms of saving. The outflow of deposits towards money market funds and government bonds is expected by 55 percent, while only 31 percent expect investments in shares and other securities.

The Savings Banks therefore do not see a similar development to that of the US regional banks for their own sector. Nevertheless, financial managers are still aware of the risks of rising interest rates for the banking sector: when asked whether the friction emanating from the US banking sector had now been overcome, only 33 percent responded with confidence. → chart 06 In addition to the equally high proportion of undecided respondents, 44 percent of Savings Banks board members remain cautious about the further impact on the banking system of the historic interest rate reversal.

In March 2023, there was uncertainty on the markets due to developments in the US and Swiss banking markets. Do you consider this turbulence to be over?

Friction in the banking sector chart 06



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

Germany: economic problem child

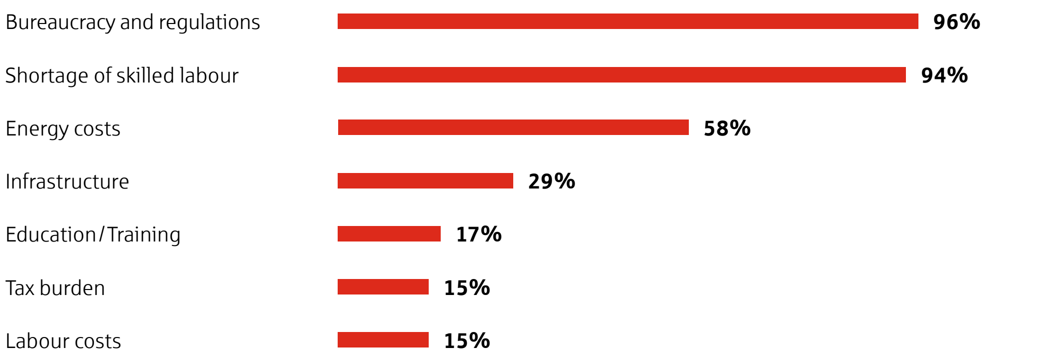
The recent debate about Germany as a business location is also keeping Savings Banks managers very busy. They experience the business reality at grassroots level first-hand every day. The special questions on the S-financial climate in the third quarter therefore focused on the problems that Savings Banks are being made aware of from their corporate customers. From the Savings Banks' perspective, excessive bureaucracy and the shortage of skilled labour are the biggest obstacles for German companies. Compliance with and monitoring of rules have now even slightly overtaken the lack of labour (94 percent), with 96 percent of respondents citing this issue. → chart 07

The third substantial negative factor is energy costs (58 percent). In contrast, general infrastructure issues or education and training levels are far behind the major problems mentioned. Even labour costs are seen as the most manageable challenge.

The top items on the problem list are also considered to have seen the greatest deterioration in the last ten years. → chart 08 However, the next item on the list is wage development, which has accelerated significantly, particularly in the recent past. In contrast to many excited voices in the location debate, the tax burden on companies has only deteriorated slightly. The fact that Germany has nevertheless fallen behind here in recent years is more due to its international competitors, in whose countries the tax burden has been reduced. As you can see: Standing still often results in taking a step backwards.

In your opinion, what are the three biggest challenges for Germany as a business location?

Challenges for Germany as a business location chart 07

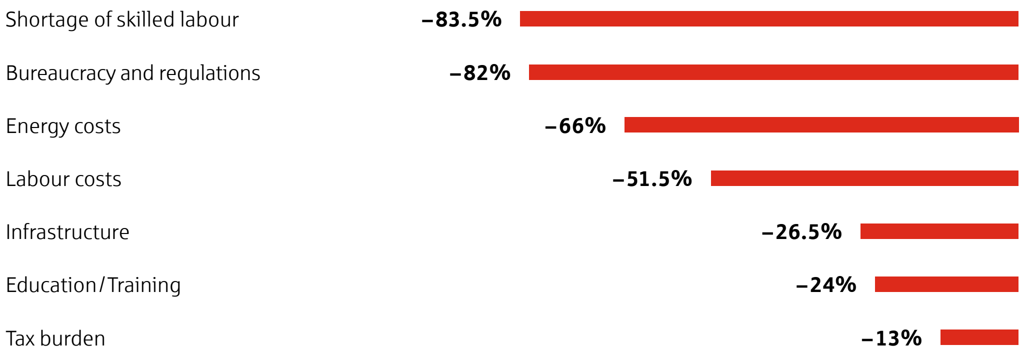


Source: DekaBank, Research Centre for Savings Banks Development, DSGV

How have location conditions changed with regard to these factors in the last decade?

Change in site conditions

chart 08



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

No sign of optimism

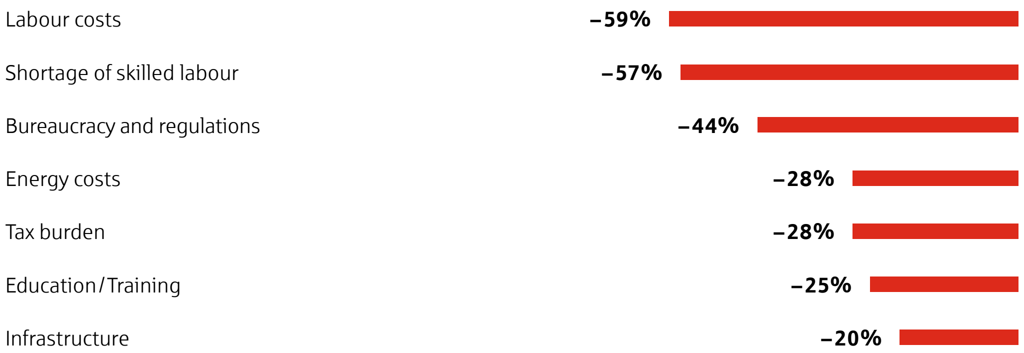
After the diagnosis comes the treatment. Reducing regulations and restoring greater entrepreneurial freedom, targeted recruitment of skilled labour as part of an immigration policy and increasing the energy supply could be ways out of the predicament. However, the assessment of the solution to the problems is sobering. The Savings Bank experts do not expect any improvement in any of the key location factors over the next five years. The current wage dynamics are viewed most critically. → chart 09

This appears to represent a serious cost burden in the coming years, which will either lead to further price increases or rationalisation of the labour factor. It is almost equally clear that regional financial managers do not expect the supply of skilled labour to improve. And the doubts that the regulatory environment for economic activities is likely to relax are just as great. The preponderance of pessimism is slightly lower, but still pronounced, when it comes to energy, education and the tax burden. Scepticism is still lowest in the area of physical infrastructure.

The Savings Banks board members are therefore not confident about the future of Germany as a business location. The Savings Banks do not see a "jolt" going through the country, as the then Federal President Herzog demanded in a widely-acclaimed speech in 1997 in the run-up to the then implemented labour market reforms. According to these observations from the world of the Savings Banks, Germany is not ready for reform.

How do you rate the chances of improvement through politics in these factors over the next five years?

Will it get better or worse? chart 09



Source: DekaBank, Research Centre for Savings Banks Development, DSGV

Summary: Deka S-Financial Climate Index Q3 2023

Key economic indicators table 01

	2023 Q3	2023 Q2	
S-financial climate	**84.1**	85.0	↓
S-economic climate	**75.7**	89.9	↓
S-credit climate	**121.3**	126.0	↓
Economic situation	**97.2**	114.4	↓
Willingness to lend	**100.0**	105.8	↓
Regulatory framework	**28.7**	34.6	↓
Cost of capital	**53.3**	59.8	↓
Profitability	**173.8**	163.7	↑
Economic outlook	**56.5**	68.3	↓
Credit demand (commercial)	**78.7**	79.8	↓
Demand for real estate loans	**75.0**	69.2	↑
Personnel planning	**86.1**	90.4	↓
Expectations of monetary policy	**91.7**	64.4	↑

“Interpretation guide: The indicators can have values between 0 and 200. Firstly, the balances are calculated from the proportions of positive and negative answers. These can be between –100 (only negative answers) and + 100 (only positive answers). The value 100 is then added. The financial climate of 84.1 therefore means that the balance was –15.9, i.e. there were more negative responses.
For the additional question, the proportion of those expecting a later interest rate turnaround was deducted from the proportion expecting an earlier one. Neutral was standardised to 100.”

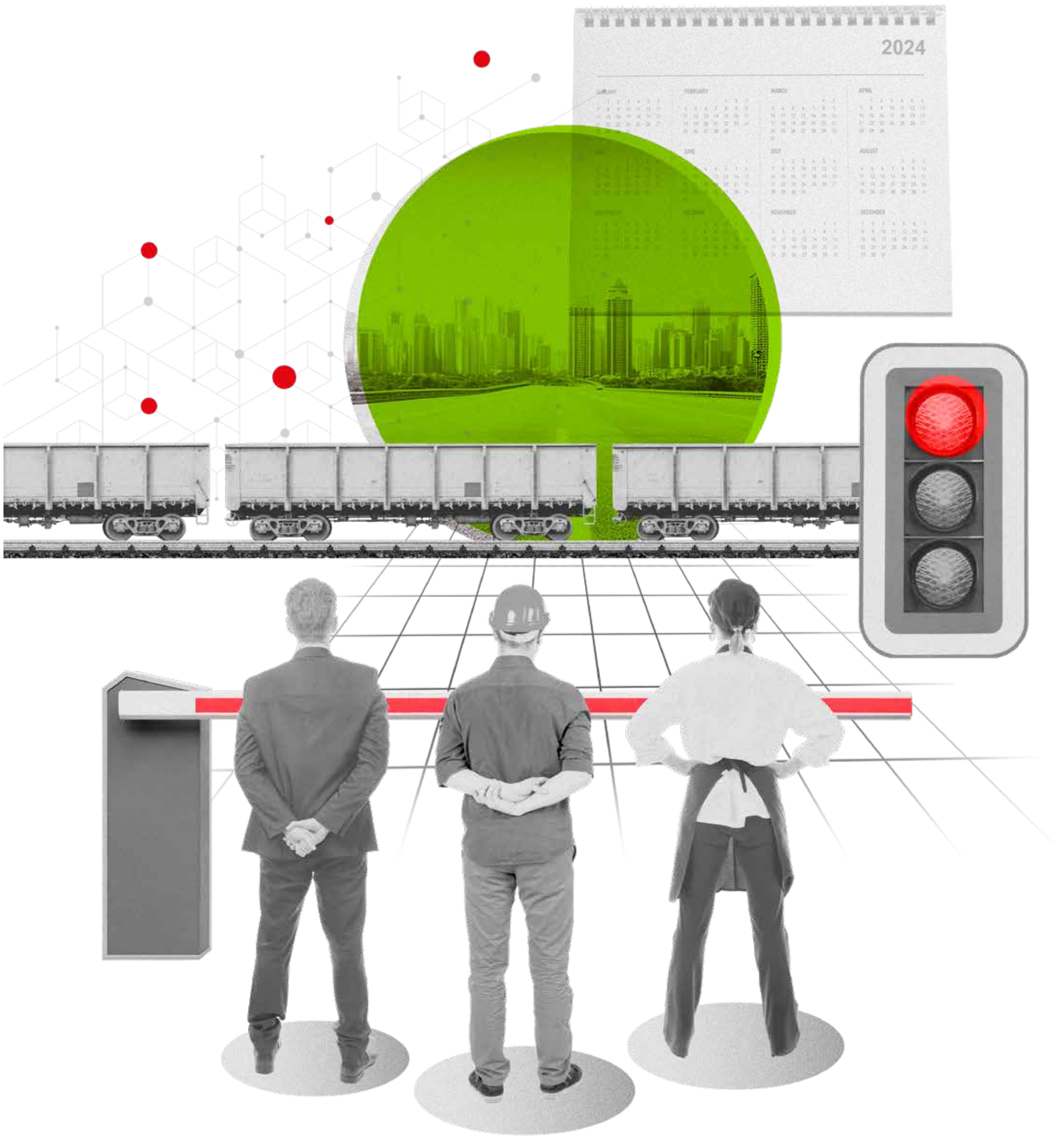
Focus topic

SMEs in transition – mastering the balancing act between economic policy constraints and sustainable positioning

Economic framework conditions and effects on the German SME sector

The signs for the German economy point to stagnation. Companies of all sizes across almost all sectors are still feeling the direct or indirect economic consequences of the on-going combination of the war in Ukraine and other global geopolitical tensions, high energy costs, inflation together with a loss of purchasing power and rapidly rising interest rates.

This is also reflected in the data: Price-adjusted gross domestic product (GDP) stagnated in the second quarter of 2023 – once again. The first quarter of the year was no better and was even slightly below zero. Together with the weak performance in the second half of 2022, this means that Germany's value added is once again operating below the previous year's level. Germany is



the only industrialised nation to shrink, according to the International Monetary Fund (IMF) in its autumn economic forecast. The IMF assumes that German economic output for 2023 as a whole will fall by – 0.5 percent, compared to its forecast of – 0.3 percent in the summer. The slightly positive forecast for 2024 has also been revised downwards from 1.3 percent to 0.9 percent. According to the IMF, the reason for this is that the inflation rate will only fall to 3.5 percent in the coming year. The financial experts see this primarily as an after-effect of the energy shock. Although Germany has always demonstrated economic adaptability and a high degree of flexibility in the past, Europe's largest economy is currently falling behind in international comparison.

Consumption, construction investment and exports are all contributing to the current weakness. Energy prices and, as a result, the import-export price ratios in overall foreign trade have now recovered somewhat from their extreme values in 2022. Nevertheless, a structural effect remains. Germany is at risk of losing competitiveness in the long term. This is also being felt by the small and medium-sized corporate customers of the Savings Banks. The 2023 annual expert survey of Savings Banks' commercial customer advisors revealed that almost 66 percent of corporate customers assessed their current business situation to be worse than in the previous year. In 2022, the figure was only 41 percent. Only just over 4 percent of those surveyed dared to venture a positive outlook for the next twelve months.

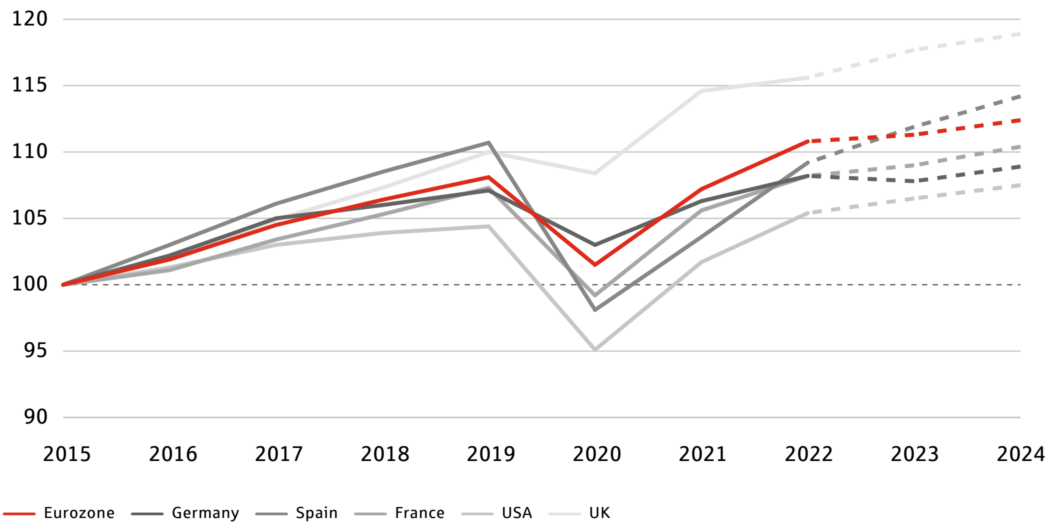
The continuing high inflation rate in conjunction with the loss of purchasing power is also a key reason for the weak real economic development. In addition, two aspects must be taken seriously as particular economic challenges:

→ the duration of the phase of weakness that has accumulated and

→ the already mentioned poor performance in international comparison. → chart 10

Poorer performance of the German economy in comparison with industrialised countries is increasingly coming into focus

Long-term GDP development in international comparison chart 10



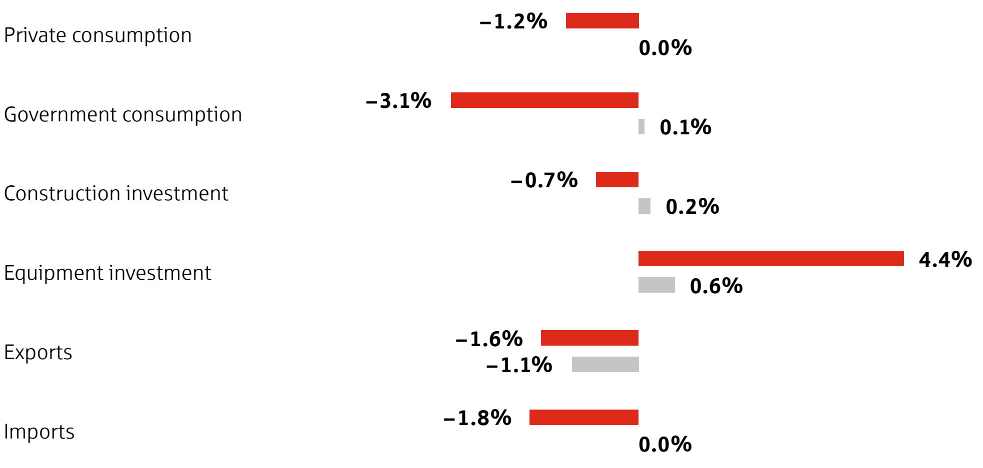
(price-adjusted, indexed (2015 = 100), forecast values from 2023)
Source: Destatis, FED, ONS, 2023/2024 for eurozone and Germany updated from the Joint Forecast, the others from the IMF's July WEO

A closer look at the breakdown of GDP development shows that the economic weakness forecast for 2023 has a very broad impact on practically all sectors. → chart 11

The reasons for this largely universal weakness can be quickly identified: Private consumption is suffering from the loss of purchasing power due to inflation, which is expected to remain high at 6.1 percent in 2023. Although this is a slight decline compared to the 2022 inflation rate of 7.9 percent, there is still a long way to go before inflation falls to the European Central Bank's target level of around 2 percent. Energy and food prices in particular continue to drive the consumer price index. → chart 12

The sharp rise in consumer prices has a direct, albeit delayed, impact on wage trends. Although nominal wages will rise sharply in 2023, real wages will fall again compared to the same period last year due to high inflation. According to the Federal Statistical Office, however, real wage losses have slowed somewhat. Nevertheless, an unfortunate trend is continuing: inflation is making people poorer in real terms, which is having a negative impact on consumer spending. At the same time, high nominal wage increases mean that inflation remains high, as companies transfer these cost increases to their products. → chart 13

Areas of GDP application in Germany in the second quarter of 2023 chart 11

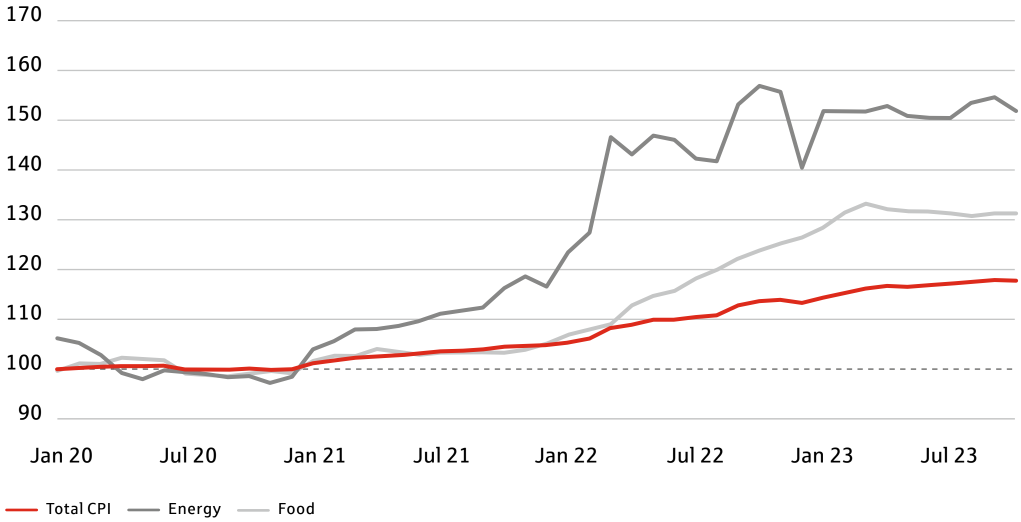


Change compared to the same quarter of the previous year, price-adjusted
Change compared to the previous quarter, seasonally and price-adjusted

Note for interpreting the chart: Private consumption and imports are not missing as changes on the previous quarter in the chart, but are exactly 0.0.
Source: Destatis

Consumer price indices for Germany

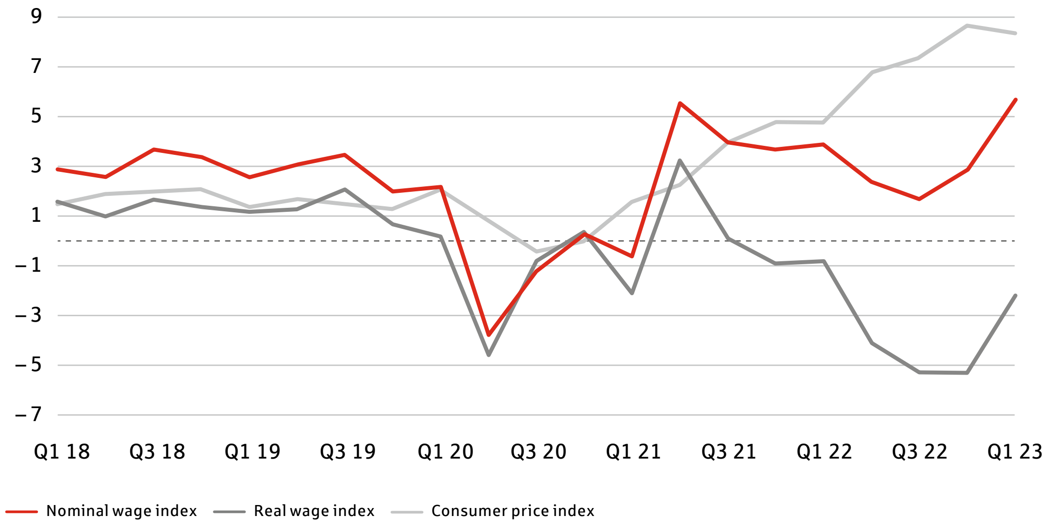
chart 12



Source: Destatis

Development of nominal and real wages

chart 13



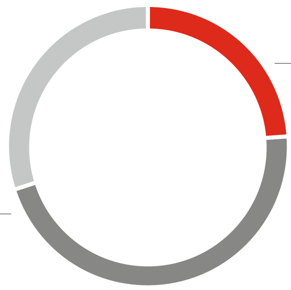
Source: Destatis

Public spending is being sensibly scaled back following the government's interventions in the pandemic, the war and the energy crisis. Construction investment is falling ever more sharply in the pincer between rising material prices and interest rates. And exports remain sluggish due to the weak global economy and the declining competitiveness of German export companies.

The only positive exception is investment in equipment. This continues to be unaffected by the interest rate environment and will increase both in real terms by mid-2023 and in the further projected development – proof of the great structural need for equipment in Germany in the areas of digitalisation and energy efficiency. These projects are also being implemented in the face of significantly higher interest rates. According to the survey, almost half of the Savings Banks' SME customers want to invest in these two areas of transformation. Even the sharp rise in interest rates for long-term investment loans has only had a limited impact on this. For example, 46 percent of respondents stated that, in contrast to material or personnel expenses, interest expenses play a secondary role for most of the companies surveyed and do not have a significant impact on investments. → chart 14

Rising interest rates and investments chart 14

Interest expenses play a very important role in the investment decisions of almost all corporate customers. The rise in interest rates significantly impairs investment.
30%



Rising interest rates are having an impact on investment decisions in certain sectors (especially construction and property).
24%

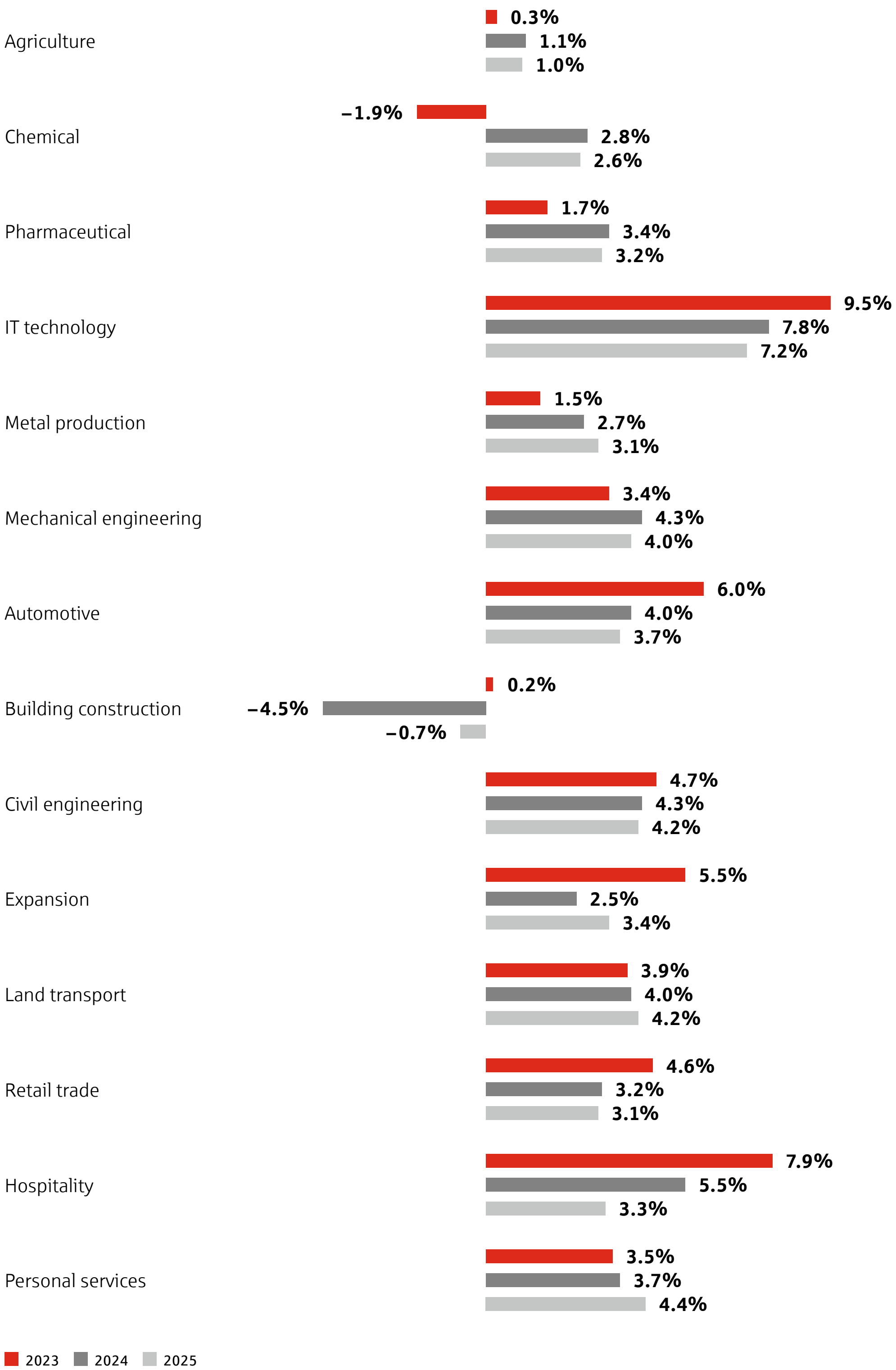
For most corporate customers, interest expenses tend to play a secondary role compared to material or personnel expenses, for example, and will therefore not have a significant impact on investments.
46%

How are SMEs currently performing?

Despite the very difficult overall economic situation, the German SME sector has so far been very robust. The turnover and profits of most of the Savings Banks' corporate customers – particularly in sectors such as IT technology and hospitality – increased once again in 2022. The main driver of the very high revenue growth of 14 percent was high inflation, as companies were able to price high cost increases into their products in the past. → chart 15

Sales growth impacted by inflation

chart 15

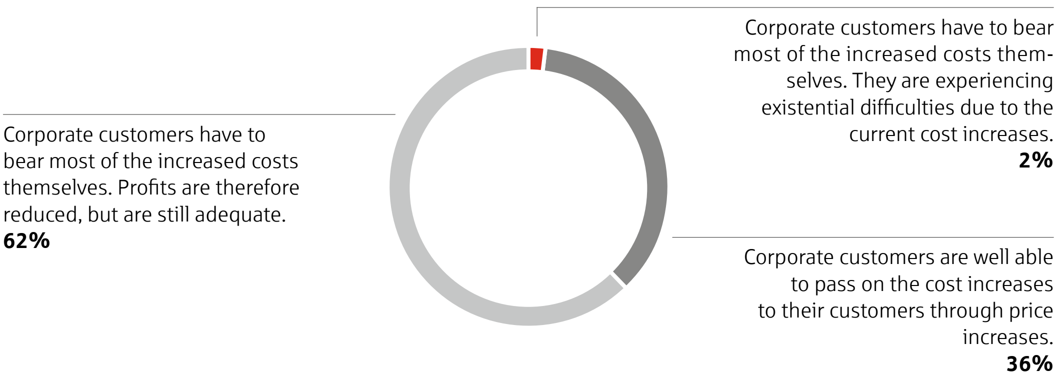


Source: DSGV industry service

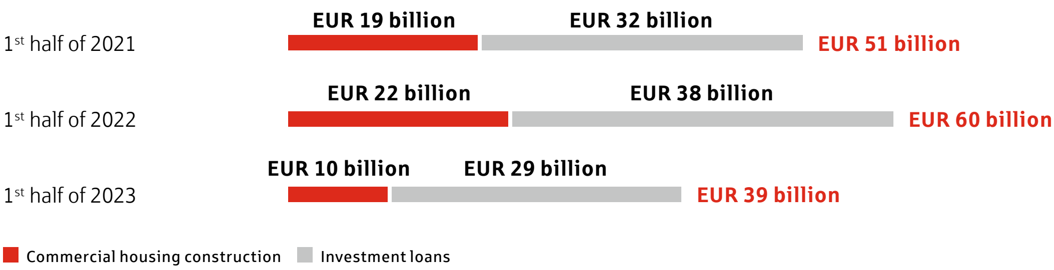
With a simultaneous increase in profits of 17 percent, SMEs have even managed to increase their return on sales. This means that they have benefited from the development so far. However, the combination of strong nominal wage increases, persistently high commodity prices and declining purchasing power is likely to make such a development more difficult in the future. For example, 62 percent of respondents in the expert survey stated that corporate customers are now largely bearing the increased costs for raw materials or energy themselves, which will reduce profits.
→ chart 16

Even if the tense economic situation is not yet reflected in turnover and profits, it is already having an impact on new lending business with companies and the self-employed. The negative

Cost increases and profit situation chart 16



Savings Banks' loan commitments to companies and the self-employed chart 17



Source: DSGV industry service

trend here has remained unchanged since the beginning of 2023. New commitments, particularly for investment and working capital loans, are clearly in negative territory and have now reached the level of 2016/17. → chart 17

The difficult economic conditions and the associated uncertainties are causing companies to deliberate on investment decisions for a long time. At the same time, however, the need for financing and investment across all sectors is medium to high according to the Savings Banks survey and the need for advice among SMEs has even increased for almost half of corporate customers, particularly in the area of transformation financing. Nevertheless, fewer are taking the step from advice to a loan agreement – especially when it comes to improving energy efficiency, which is crucial for sustainable transformation. Possible reasons for this could be the bureaucratic requirements, which are still considered to be very high, and the uncertainty in connection with new legislative initiatives such as the Supply Chain Duty of Care Act or the Building Energy Act. Bureaucratic hurdles and planning uncertainty are two of the most important factors for paralysis in investment decisions.

Earnings situation remains tense in many sectors

Another significant factor in SMEs' reluctance to borrow could be the negative outlook for earnings despite a good equity ratio and reassuring liquidity reserves. In particular, the persistently high costs of energy, raw materials and other materials are placing a considerable burden on some sectors and reducing profit prospects. According to the Savings Banks experts, this will also have an impact on the repayment of existing loans. Around 89 percent of those surveyed expect their corporate customers to have a higher loan default rate in the future. → table 02

Cost and profit forecast for selected sectors table 02

Sector	Cost of materials ratio	Personnel expense ratio	Return on investment
Chemical	→	↑	↓
Pharmaceutical	→	↓	↑
IT technology	↓	↑	↑
Metal production	↑	↑	↓
Mechanical engineering	→	↑	→
Automotive	↑	↑	↓
Building construction	↓	↑	↓
Civil engineering	→	↑	↓
Expansion	↓	↑	→
Land transport	→	→	→
Retail trade	↓	↑	↓
Hospitality	↑	↑	↓
Personal services	→	→	→

Source: DSGV industry service

SMEs need a future

Small and medium-sized enterprises and Savings Banks have a long history together. The business model of the institutions under public-law, which is still valid today, is basically as old as the Savings Banks themselves. Around two hundred years ago, they were already accepting savings deposits and providing loans for investments in the regional economy. Even then, their customers included SMEs from their business areas. In this way, they provided local economic cycles with the necessary capital.

Against the backdrop of today's essential transformation process of the economy towards sustainable business practices, the Savings Banks are in the same boat as their business customers. They too must undergo the transformation process towards sustainable positioning and digitalisation. They also know their commercial customers, the region and the local conditions and are therefore ideally placed to support SMEs.

In view of challenges such as achieving energy efficiency, digital modernisation and the training of skilled workers, major structural investments are required for a sustainable future. This is not easy for many companies in the current difficult economic environment and with higher interest rates. Savings Banks are willing and able to provide SMEs with comprehensive support in their sustainable transformation with expert advice, customised financing offers and state subsidies. Proof of this is also the high market share of the Savings Banks and Landesbanken in corporate loans at 40 percent, which makes them by far the most important financier of German SMEs.

Savings Banks are right by your side

In order to be able to offer corporate customers tailor-made advisory concepts, financing and subsidies for sustainable investments, the Savings Banks Finance Group has taken a comprehensive look at the impact of the sustainable transformation on its business customers and has repositioned itself with advice, new products and all-round support.

As part of this process, a survey was conducted among its own customers to determine their needs, expectations and priorities. This revealed that around 99 percent of customers are not subject to the Corporate Sustainability Reporting Directive (CSRD) – which defines the scope and nature of sustainability reporting by companies – or the EU taxonomy – which formulates the criteria for sustainable economic activity – and that the need for investment in sustainable transformation is high.

In order to best support business customers and meet their financing needs, the Savings Banks Finance Group has developed products and processes that are based on EU taxonomy and at the same time enable loans to be classified in terms of a sustainability assessment without undue effort.

In order to make the progress of transformation financing in the Savings Banks transparent and measurable, a classification procedure for earmarked financing based on EU taxonomy was developed with the financing framework.

Investments that are classified as sustainable following an assessment by the financing framework can be financed in future using the S-transformation loan. The financing framework already includes specific promotional programmes from KfW and Landwirtschaftliche Rentenbank.

In addition, the Savings Bank's own ESG score (S-ESG score) has been developed: a special tool that has been used to identify and analyse potential sustainability risks for borrowing companies since summer 2021. In this way, SMEs from all sectors can be supported on their way to a more sustainable future.

Transformation financing involves much more than just providing green loans. Advice is therefore crucial.

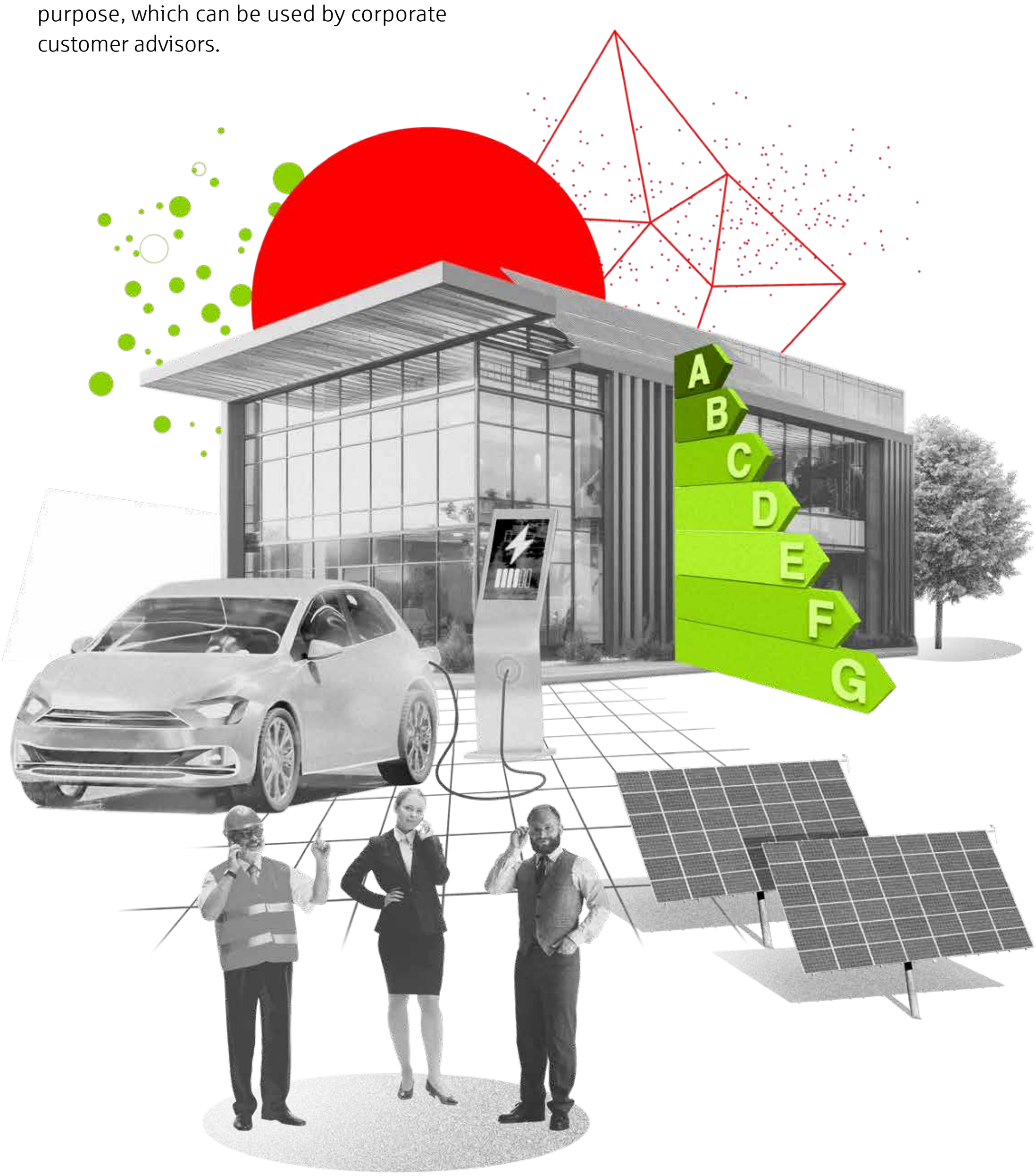
The Savings Banks Finance Group has developed a range of offers for advising commercial customers that build on each other and address the specific needs of customers. The central advisory solution for commercial customers is the Savings Banks finance concept. This has been expanded to include the "Sustainable Business" module. It is used for joint dialogue with commercial customers and provides impetus on the topics of real estate, machinery and vehicle fleets or resource management. As part of the Savings Banks finance concept, every customer is now advised on the potential for sustainable transformation.

A further offer is an initial assessment of all aspects of energy saving, which also provides for the subsequent involvement of an external energy consultant.

In order to be able to provide commercial customers with the best possible advice on the transformation, expertise in all aspects of the sustainable positioning of customers is required. Together with the regional Savings Banks academies, a standardised nationwide training concept with final certification has been developed for this purpose, which can be used by corporate customer advisors.

The Savings Banks are ready to play their part in the sustainable transformation of the economy with advice and products.

The willingness to lend, i.e. the supply of credit, remains at a stable level. Despite the current decline, the overall value of the credit climate is still above average, showing that the Savings Banks' willingness to lend continues to exceed demand. → chart 04



Necessary framework conditions for the continued economic success of SMEs

Regardless of current developments, SMEs make a significant contribution to Germany's economic success and secure the economic foundation of our country. At the same time, the effects of the recent crisis years are beginning to weaken the financial reserves of many SMEs. On the one hand, this development, together with other factors, is making it more difficult for companies to implement the investments required for a sustainable transformation process. On the other hand, many small and medium-sized enterprises from various sectors are already making decisive contributions with their innovative products, production processes and strategies. German companies therefore also have an opportunity in international markets to be pioneers and winners in global climate protection efforts.

In order to secure this commitment and enable the desired change, the right course must now be set by politicians. Too many regulations and too much bureaucracy as well as excessive EU taxonomy in terms of ecological sustainability goals must not be allowed to further impede the future sustainable focus. Instead, it is essential to provide SMEs with a reliable, customised and sufficiently resourced funding infrastructure to enable them to make the investments required to secure their own competitiveness in the more sustainable economic world of the future.

To implement the transformation, SMEs also need strong, regionally anchored credit institutions at their side. The Savings Banks have positioned themselves accordingly and are in a position to support this challenging process with advice and suitable loan offers. However, banking regulation continues to have a significant impact on their business development. That is why the state is also called upon to rein in the complex regulatory framework so that the Savings Banks can continue to fulfil their important public funding mandate.

Survey of Savings Banks experts

The survey of Savings Banks experts complements the results of the S-Financial Climate Index of the DSGV and Deka as well as the focus topic of the SME Diagnosis. For this purpose, a total of 280 business customer advisors from Savings Banks across Germany were surveyed between August and September 2023. Not only do they have in-depth knowledge of the small and medium-sized enterprise sector, they also regularly hold a large number of discussions with their SME customers. This enables them to provide a professionally sound and up-to-date assessment of the economic situation and the views and plans of their more than two million commercial customers.

German SMEs in transition

After almost two years of the coronavirus pandemic, there were high hopes of an economic recovery from spring 2022. However, in February 2022, the war in Ukraine dealt another severe blow to the German SME sector. The prevailing combination of soaring energy costs, inflation, a sharp rise in interest rates, dwindling purchasing power, major uncertainties regarding energy supplies, ongoing war and global geopolitical tensions has had a severely dampening effect on the mood among German SMEs. The attack on Israel and the threat of an escalating conflict in the Middle East have further exacerbated the mood.

Just over half of those surveyed expect the business situation of SMEs to deteriorate over the next twelve months. Although this is less than in the previous year, for more than 65 percent of SMEs it is based on a declining business situation in the past year.

In addition to resolving geopolitical conflicts and economic uncertainties, almost 100 percent of Savings Banks experts believe that reducing bureaucracy and training skilled workers remain the decisive criteria for the future positive development of SMEs. New in the top five ranking of the greatest challenges are the financing costs for loans, driven by the sharp rise in interest rates over the last two years.

The current critical situation is exacerbated by the challenges of the necessary sustainable transformation of the German economy. For this to succeed, financial stability, predictability, the promotion of entrepreneurial spirit and innovation are absolutely essential.

The political and economic framework conditions will therefore be decisive for the future economic development of German SMEs. Intelligent foreign, economic, education and investment policies from the German government will provide German SMEs with a reliable framework to master the major current challenges and the changes of the future.

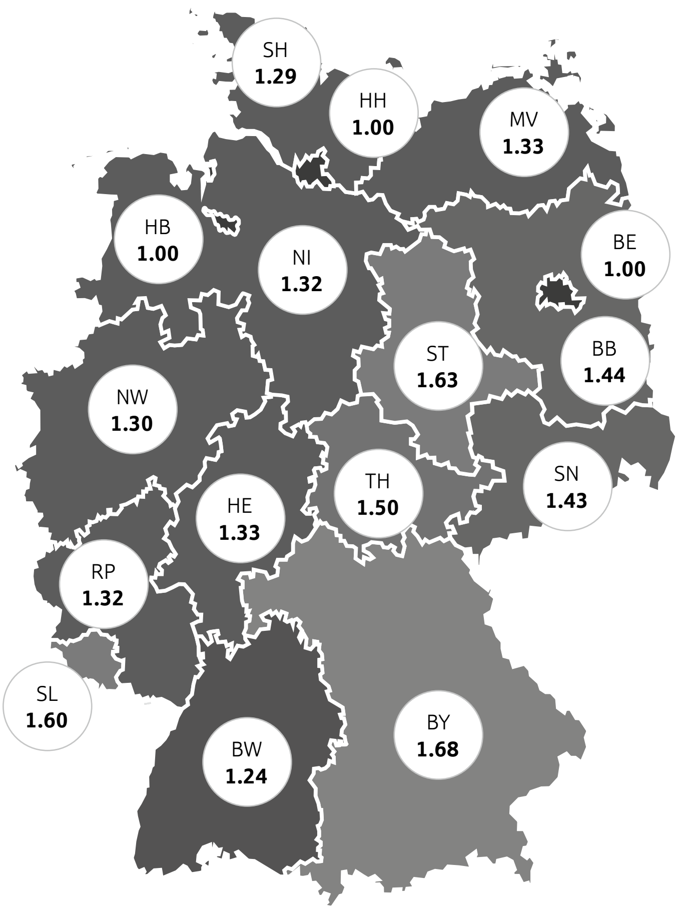
Part 1: Current business situation, outlook and economic conditions

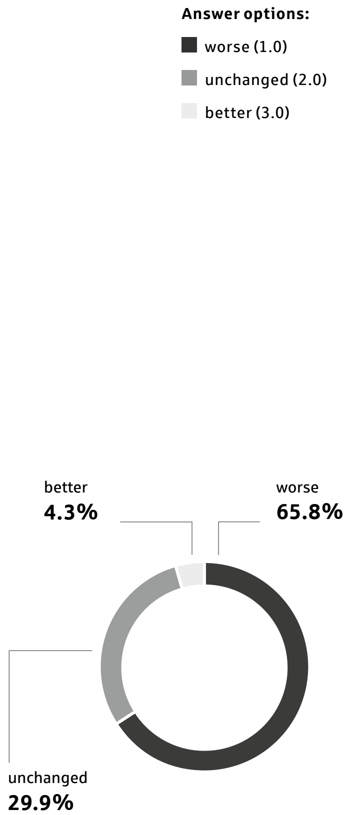
Question 1: How would you assess the current business situation (orders, turnover, earnings situation) of your SME business customers compared to the previous year?

The assessment of the current business situation has continued to deteriorate. Almost 66 percent of respondents rate their customers' current business situation as worse. This represents an increase of more than 20 percentage points compared to the previous year (41 percent). This assessment reflects the ifo Business Climate Index, which fell for the fourth time in a row in August 2023 from 87.4 points in July to 85.7 points.

Given the persistently difficult economic conditions, this is hardly surprising. Whereas last year recovery effects following the coronavirus pandemic led to an increase in GDP in the hospitality and cultural sector and in personal services, and therefore in private consumption, this year the business climate has cooled across all sectors. Consumption, construction investment and exports are all contributing to the current weakness, which is reflected in stagnating GDP in the second quarter of 2023. The German economy is therefore below the previous year's level.
→ chart 18

chart 18





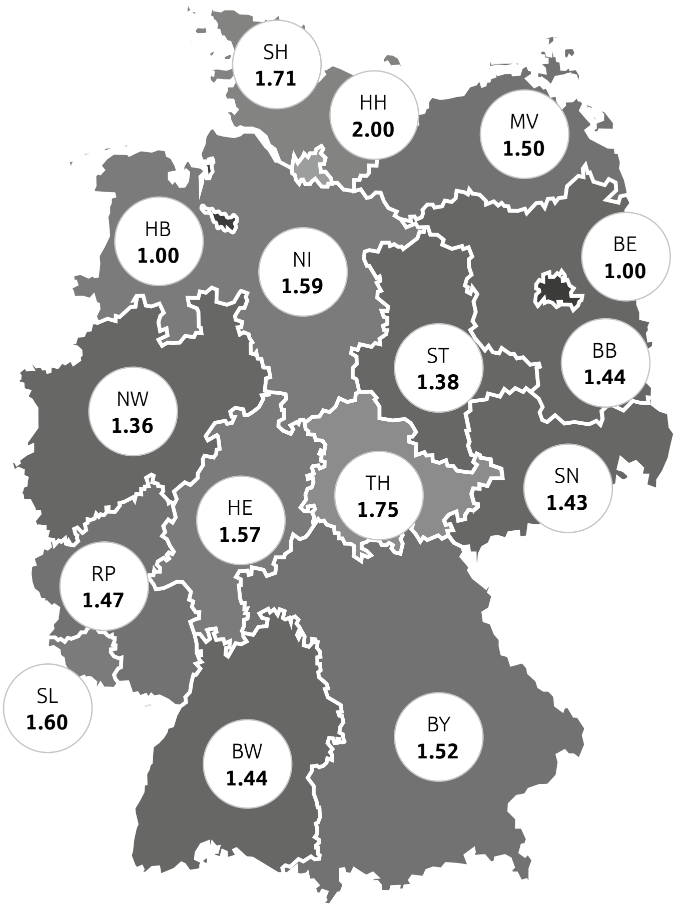
Question 2: Do your SME business customers expect the business situation to remain roughly the same, improve or deteriorate on average over the next twelve months?

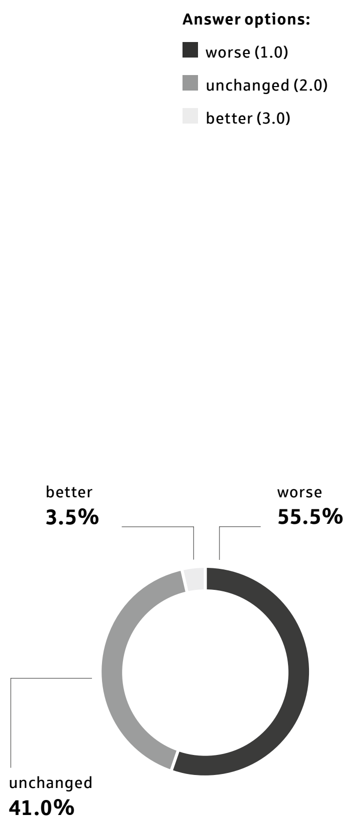
At around 55 percent, more than half of those surveyed still expect the economic situation of their business customers to deteriorate. Although fewer SME experts are pessimistic compared to the previous year (85 percent), 41 percent of those surveyed do not see any major positive changes. Only just under 4 percent expect the business situation to improve.

While energy prices have eased somewhat as a result of the German government's third relief package, the cost of housing, energy and food remains at a high level. This is leading to a loss of purchasing power and a partial reduction in consumption, which is having a negative impact on sectors such as trade, services and manufacturing.

The construction industry has been hit particularly hard. Material and supply bottlenecks have eased slightly. However, the sharp rise in interest rates in a very short space of time (from 1.25 percent in autumn 2022 to 4.5 percent currently) is making investments more expensive in addition to the high energy and material costs, which is leading to construction projects being postponed or even abandoned. Overall, there is still no sign of optimism among companies. → chart 19

chart 19





Question 3: How would the majority of your SME business customers assess the following factors with regard to the future development of their companies?

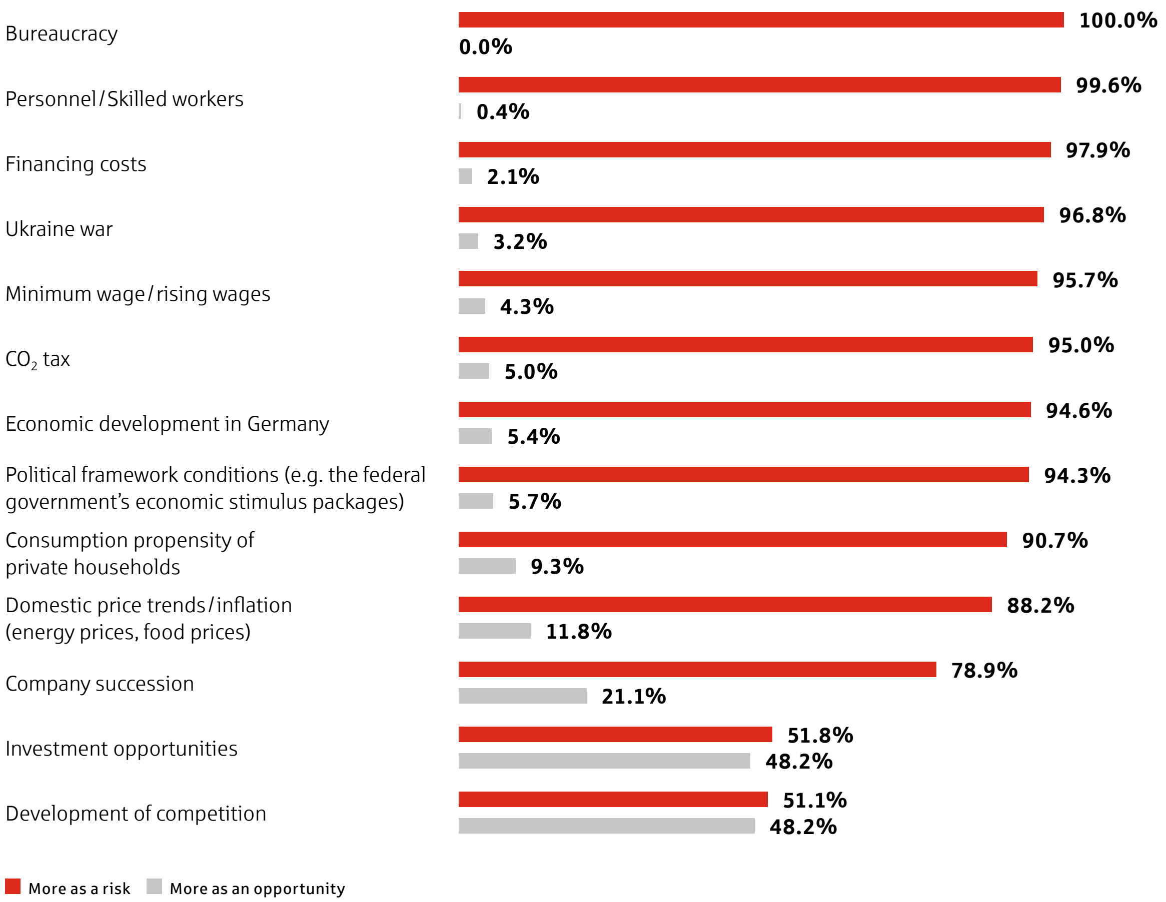
The top risks continue to be bureaucracy at 100 percent (previous year: 98.4 percent) and the shortage of staff and skilled workers at 99.6 percent (previous year: 99.6 percent), followed by financing costs at just under 97.9 percent (previous year: 96.0 percent) and the war in Ukraine at 96.8 percent (previous year: 100 percent).

Bureaucracy has thus moved into first place and, together with the shortage of skilled labour, continues to be the biggest obstacle to the development and growth of companies.

It is worth noting that 94.3 percent of respondents now consider the political framework conditions to be problematic, compared to just 43.1 percent in the previous year. This could be linked to the perceived excessive complexity of bureaucracy. Several new laws and legislative initiatives were introduced last year, such as the Building Energy Act (also known as the Heating Act) and the Supply Chain Duty of Care Act. These have led or will lead to additional bureaucracy for companies.

Overall, the risks have increased compared to the previous year, and it is to be hoped that political decision-makers will recognise this and take the necessary measures to create a sustainable economic policy in the interests of German SMEs.
→ chart 20

chart 20



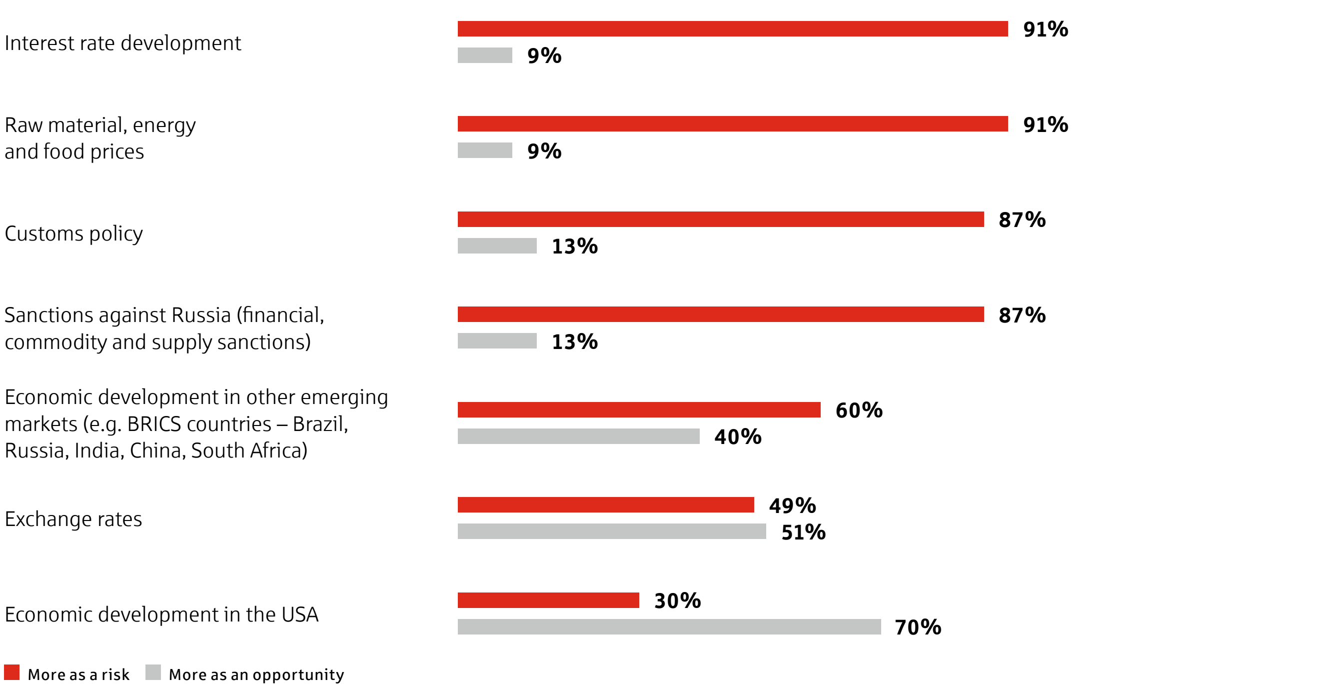
Question 4: How do the majority of your SME business customers assess the following global economic factors with regard to the future development of their companies?

On a global scale, the rise in interest rates and the continued high prices for raw materials, energy and food in Germany are once again seen by 91 percent of respondents (previous year 98 and 99 percent respectively) as the main negative factors for the future development of their businesses. Despite the slight decline, this is understandable. The sharp rise in interest rates within the space of a year has added to the existing cost pressure caused by high raw material and energy prices in an international comparison and represents a clear competitive disadvantage, particularly for export-orientated German SMEs.

Although the risks associated with customs policy and sanctions against Russia were both rated as slightly lower by 87 percent of respondents (previous year: 92 and 96 percent respectively), they continue to represent a burden for small and medium-sized enterprises. Similarly, 60 percent of respondents (previous year: 70 percent) consider the economic development in emerging countries such as the BRICS states (Brazil, Russia, India, China and South Africa) to be a risk.

These two aspects can be linked. The sanctions against Russia, particularly in the context of the Ukraine conflict, are not only having an impact on international trade between German companies and Russia, but are also affecting the development of the BRICS countries, which include Russia. At the same time, political and economic relations with China, the economically most important BRICS country, have deteriorated. However, the inclusion of six new members in the BRICS states in January 2024 (Saudi Arabia, Iran, the United Arab Emirates, Egypt, Argentina and Ethiopia) is a positive development. This strengthens the international significance of this group and could lead to positive economic development, which could also benefit export-oriented German SMEs. → chart 21

chart 21



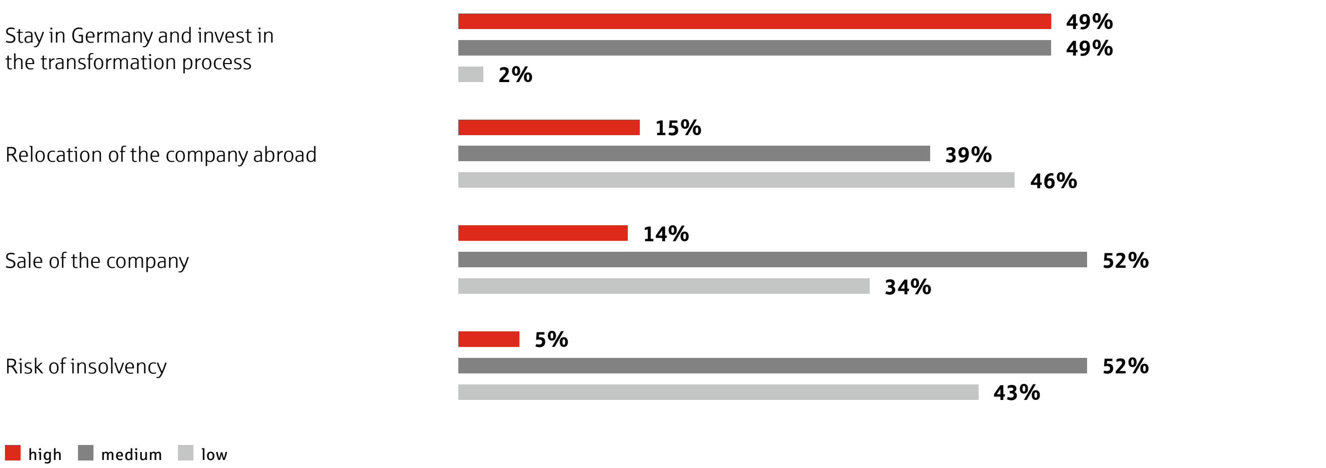
Part 2: German SMEs in transition

Question 5: How would you rate the relevance for your business customers of the following scenarios which have been caused by changes in external framework conditions?

The majority of respondents (85 percent) consider the likelihood of small and medium-sized enterprises (SMEs) migrating abroad to be rather low. This is in line with the belief of 98 percent of respondents that the likelihood of these SMEs wanting to stay in Germany and invest in the transformation process is considered medium to high. This generally indicates that companies are preparing for change. On the other hand, it is important to note that smaller companies usually face greater challenges when it comes to relocating their production abroad. It is therefore crucial that Germany remains an attractive business location for these companies and continues to offer them good opportunities for entrepreneurial success. Appropriate economic policy framework conditions play a key role here.

This is also underlined by the Savings Banks experts' assessment of the risk of insolvency among SMEs. In fact, more than half of them believe that the risk of insolvency and having to sell the company is very real. → chart 22

chart 22



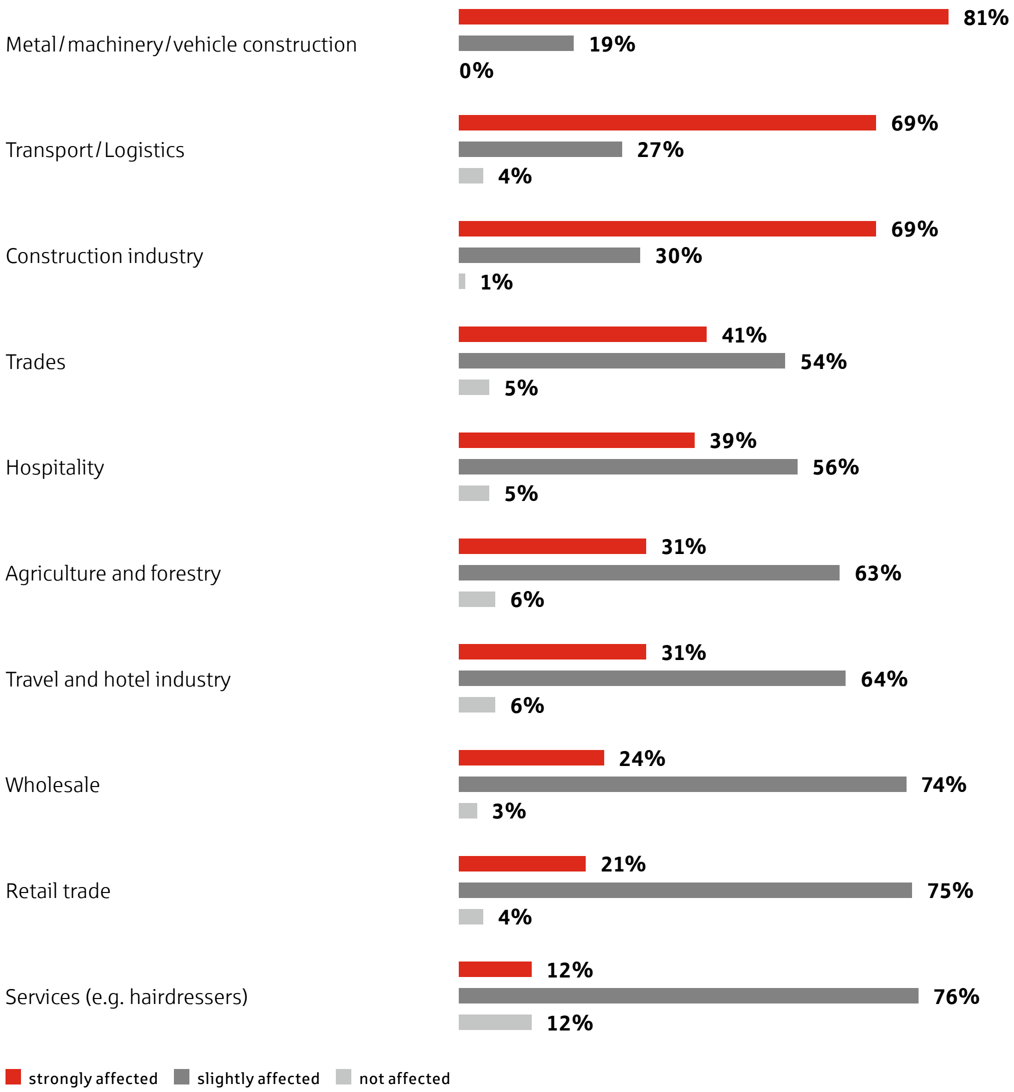
Question 6: How would you assess the consequences of the German government’s energy and sanctions policy for the following sectors in your region?

Well over three quarters of respondents consider metal, mechanical and vehicle engineering, transport and logistics and construction to be the sectors most affected by the energy and sanctions policy. This assessment is not surprising, as all three sectors have a high demand for raw materials and energy and are therefore particularly affected by rising prices and material shortages.

Only a small proportion, around a tenth or less of Savings Banks experts, state that the impact of energy and sanctions policy is negligible across all sectors.

The incoherent energy and sanctions policy not only contributes to the existing financial burden on companies and impairs international trade, but could also fuel uncertainty and reduce the willingness to invest in the future. → chart 23

chart 23



This is also reflected in our survey: 64 percent of respondents stated that their business customers' requests for financing in connection with "green" transformation projects had not increased in the last six months.

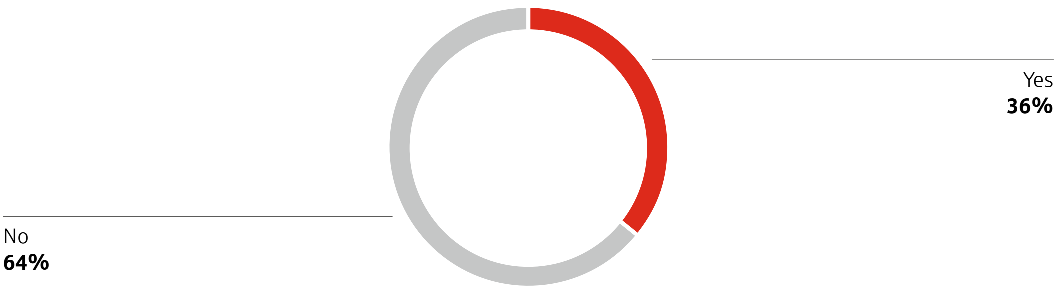
Nevertheless, the demand for advice for business customers remains high or has even increased.

This underlines the interest in and importance of Savings Banks as regional financial institutions for supporting companies with transformation financing and reflects the trust that customers place in Savings Banks.

Question 6.1: In the past six months, have your business customers requested more financing for the further development of digital business models, the switch to CO_2-free production or the improvement of energy efficiency?
→ chart 24

Question 6.2: How has the need for advice from your business customers regarding the financing mentioned in question 15 developed since the beginning of the year? → chart 25

chart 24



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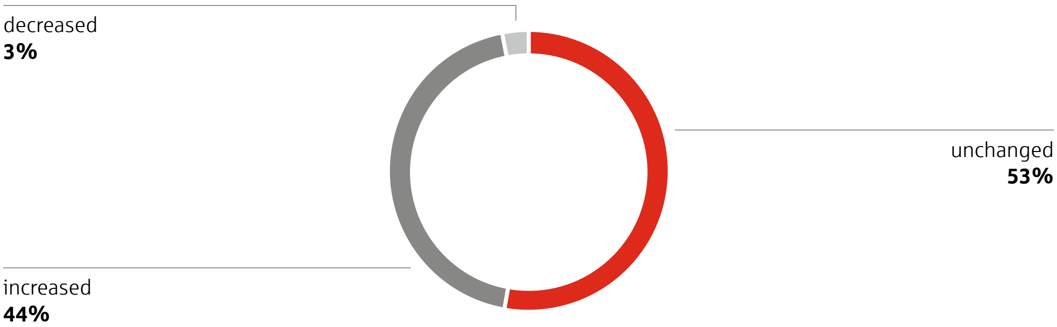


Question 7: Will the risk of loan defaults among your business customers increase and if so, what do you think will be the causes?

89 percent of respondents expect more customers to be unable to repay their loans. Difficult economic conditions are cited as the reason for this. In addition, 62 to 65 percent state that persistently high energy prices and rising wages and social security contributions due to inflation are contributing factors. Almost half of those surveyed believe that high commodity prices and rapidly rising interest rates could increase the risk of loan defaults. → chart 26

Although the credit supply from Savings Banks remained stable in Q3 2023 (source: DekaBank) and the willingness to lend outstrips demand, it is likely that the deterioration in the general economic situation and economic outlook will result in a higher credit risk for companies. This could lead to a deterioration in creditworthiness and stricter lending criteria, which in turn could result in higher collateral requirements and ultimately lead to rising ancillary lending costs.

Question 8: In your opinion, how will the ESG criteria affect ancillary lending costs?

In this context, it is positive that 63 percent of Savings Banks experts do not expect higher ancillary lending costs as a result of the integration of ESG criteria into the lending process and expect lending to remain constant. The Savings Banks' own ESG score, which has been available since summer 2021, therefore appears to have been well integrated into the analysis of sustainability risks in lending.

Only around a third of those surveyed expect lending to decline. → chart 27

Reasons for higher loan defaults chart 26

Question 9: Do you believe that the demand for credit from companies for the transformation process will increase despite interest rate hikes by the ECB?

Despite the difficult economic environment and the increase in the cost of loans, almost 60 percent of respondents believe that companies will demand more loans for promising investments.

This is a good sign and shows that companies have begun to embrace the transformation process and want to invest in Germany. → chart 28

chart 27

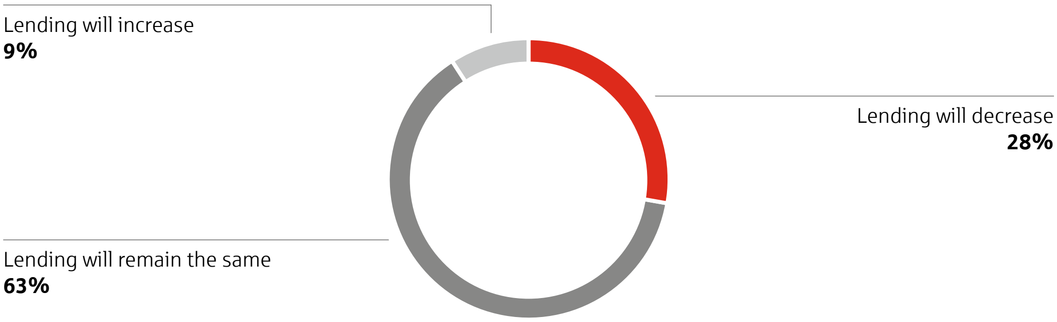
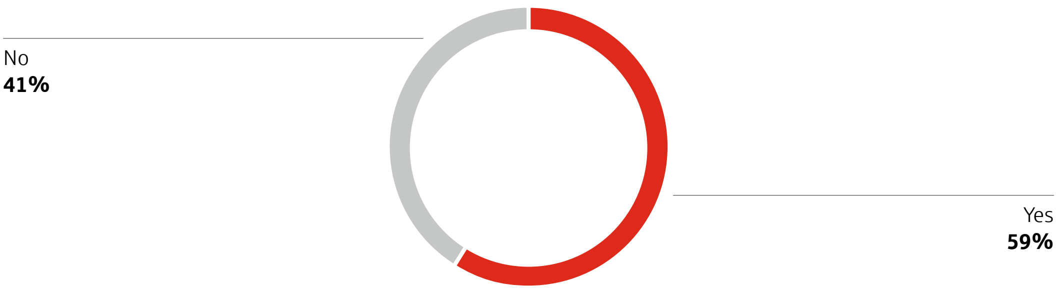


chart 28

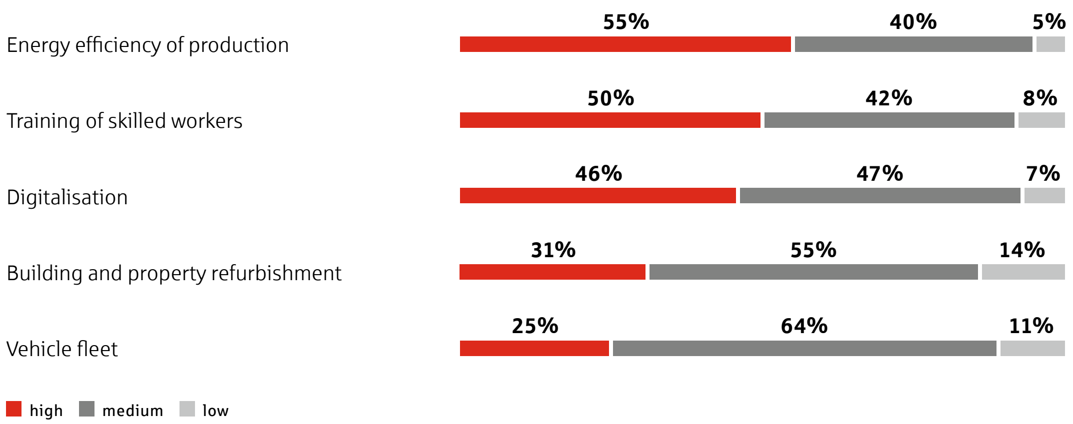


Question 10: What is the investment propensity or financing and investment requirements of your business customers in the following transformation areas?

An overwhelming majority of Savings Banks experts rate the willingness of companies to invest as medium to high. Around half of those surveyed consider investments in energy-efficient production, specialist training and digitalisation to be particularly important. It appears that the fundamental interest and need of small and medium-sized enterprises to invest in the future is higher than their current propensity to invest. One example of this is that the actual willingness of small and medium-sized enterprises to take out loans has remained unchanged in the last two quarters according to the Deka Financial Climate Index.

SMEs are motivated to make changes, but due to the unfavourable micro and macroeconomic conditions, in particular the sharp rise in interest rates over the last twelve months, there appears to be a lack of momentum for investment. This is also reflected in the Savings Banks' investment loans. In the first half of 2023, loan commitments to companies fell by around a third compared to the first half of 2022, reaching the level of 2016/2017 (source: DSGV industry service).
→ chart 29

Challenges for Germany as a business location chart 29



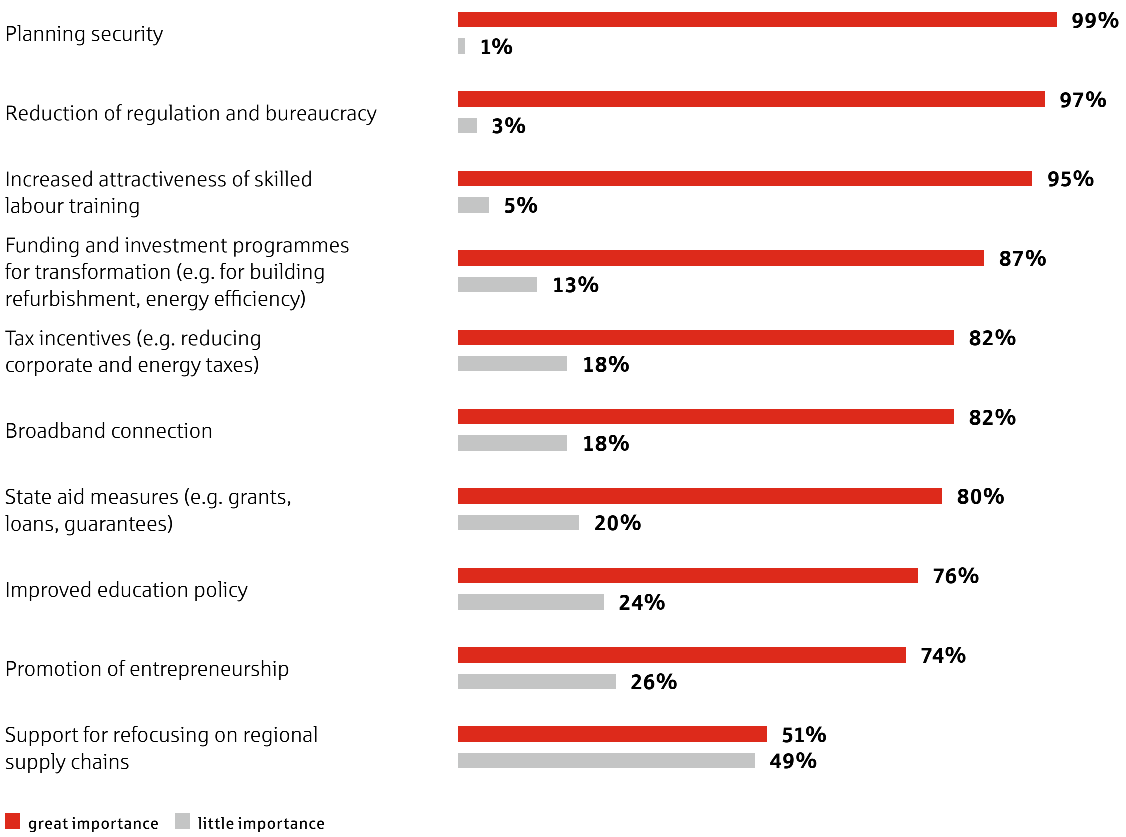
Question 11: In the opinion of your business customers, which of the following framework conditions and political measures are most important for economic recovery?

Almost 99 percent of companies in Germany are part of the SME sector, and they have made a significant contribution to the German economy over decades through innovative production methods and business models. They form the backbone of the German economy in terms of value creation, employment and training.

The almost unanimous opinion among the Savings Banks experts is that these companies need planning security, less regulation and bureaucracy as well as well-trained specialists in order to recover from the economic fallout and successfully manage the sustainable transformation process. In addition, more than 70 percent of those surveyed believe that support and investment programmes for transformation, tax incentives and an improved education policy are of major importance.

These results highlight the need for appropriate political decisions to ensure better conditions in the long term and to support and expand the commitment of SMEs. → chart 30

chart 30



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Deutscher Sparkassen- und Giroverband e. V.
Charlottenstraße 47
10117 Berlin
Phone: +49 30 20225-0
Fax: +49 30 20225-250
www.dsgv.de

Contact
Dr Thomas Keidel
Director / Representative of the Board for Financial Market Relations
Head of the Financial Markets & Economics Department
Phone: +49 30 20225-5280
thomas.keidel@dsgv.de

Antje Klober
Financial Markets / International
Telefon: +49 30 20225-5282
antje.klober@dsgv.de

Jana Gieseler
Financial Markets / International
Telefon: +49 30 20225-5287
jana.gieseler@dsgv.de

Concept, design, illustrations
RYZE Digital
www.ryze-digital.de

Photography
PixeloneStocker via Getty Images (cover picture)
Sparkassen-Bilderwelt (U2)
Laurin Schmid (p. 4)
Alessandro Biascioli – stock.adobe.com (p. 28)

Illustrations
A. Hartung – stock.adobe.com
K.-U. Häßler – stock.adobe.com
bruno135_406 – stock.adobe.com
W. Heiber Fotostudio – stock.adobe.com
ghoststone – stock.adobe.com
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The SME 2023 diagnosis is available in German and English.
Both versions are available on the internet for download and online at:

→ dsgv.de/sparkassen-finanzgruppe/publikationen/diagnose-mittelstand.html

In case of discrepancies, the German version is definitive.

Compilation of the Deka S-Financial Climate Index

The Deka S-Financial Climate Index was developed in cooperation between the Research Centre for Savings Banks Development at the University of Magdeburg, headed by Professor Horst Gischer, and DekaBank, with the involvement of the German Savings Banks and Association (DSGV). The index is calculated from the results of a quarterly survey of 361 Savings Banks. It consists of ten subject areas, each of which can be subdivided into perspectives on the current situation and future expectations.

In addition, there are varying special questions relating to the current economic or monetary situation.

The evaluation algorithm is based on the balance of positive and negative answers to each question. A completely neutral result results in an index value of 100, while a completely positive assessment in all questions by all participants signifies an index value of 200 points. In the opposite negative variant, the index value is zero.

German Savings Banks Association (Deutscher Sparkassen- und Giroverband e. V.)

Charlottenstraße 47
10117 Berlin

www.dsgv.de