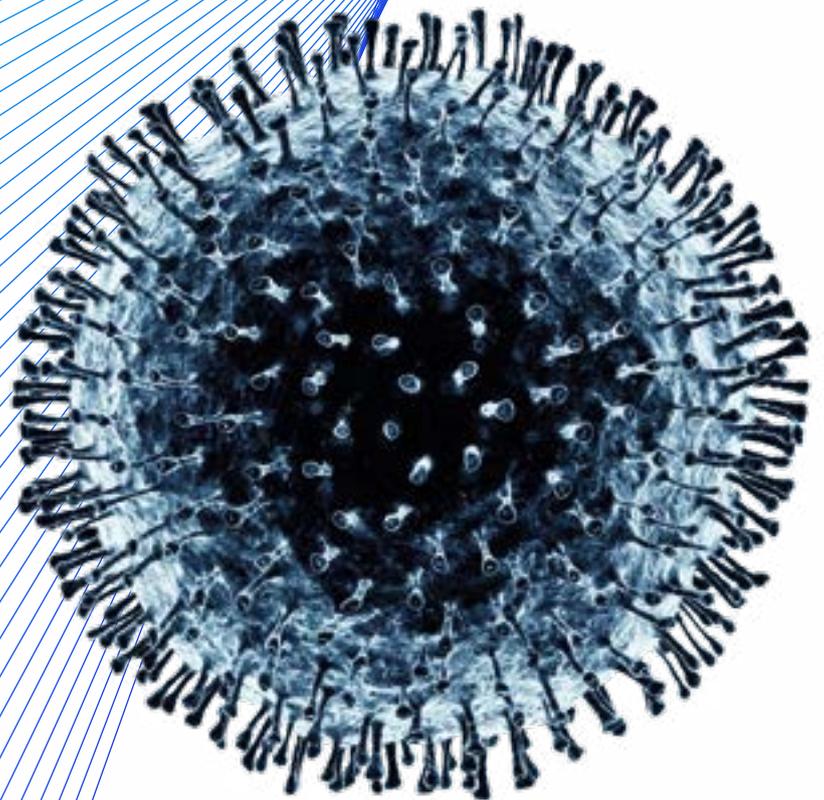


How the German Mittelstand is mastering the COVID-19 crisis

Digitalize Go-To-Market, Develop New Business Models
and Reduce Slack



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Key insights

- Survey among 500+ German Mittelstand enterprises shows that COVID-19 has hit most of them hard: 73 percent state they are experiencing or have experienced supply chain issues.
- Despite poor short-term revenue expectations in most cases, 77 percent of the enterprises surveyed have a positive outlook on the future. The German Mittelstand has confidence in their own strength – and this is well-grounded.
- 79 percent of the business leaders state they are acting counter-cyclically to the crisis, but only 17 percent have actually initiated the changes necessary to gain a competitive advantage.
- We identified a set of priorities, commitments, and actions that can help quickly get the German Mittelstand back on track.

Overview of survey parameters

Period of survey: April 24-28, 2020

522
respondents

29
questions

Respondents

66% Men, 34% Women

70% leading employees

30% CEOs

By industry, percent

Automotive	7
Construction	8
Electronics	11
Finance and Insurance	14
Health	10
Retail	11
IT- and Telecommunication	16
Mechanical and plant engineering	8
Other	15

By state, percent

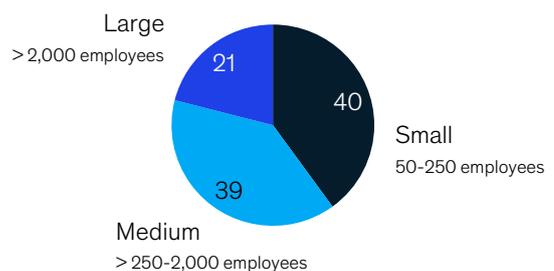
Baden Wuerttemberg	9
Bavaria	13
Berlin	16
Brandenburg	1
Bremen	1
Hamburg	7
Hesse	7
Mecklenburg-Western Pomerania	1
Lower Saxony	8
North Rhine-Westphalia	22
Rhineland-Palatinate	3
Saarland	1
Saxony	5
Saxony-Anhalt	2
Schleswig-Holstein	2
Thuringia	2

Size of company, percent

By annual turnover

32	< EUR 50 m
37	EUR 50-250 m
20	> EUR 250 m to 1 bn
11	> EUR 1 bn

By employees



Source: McKinsey

Executive summary

When the COVID-19 crisis became evident in Europe, Germany put strict measures in place beginning mid-March, including school closures and store lockdowns. The government gradually began relaxing those measures at the end of April. By mid-May, all shops and stores, regardless of their size, reopened with certain conditions in place. Though the federal and state governments are trying to reopen the German economy, nine weeks of lockdown have had a tremendous effect on enterprises of all sizes, including the German Mittelstand¹. As a category, these businesses account for 57.6 percent of employment in the country and 34.4 percent of national revenues.² There are 2,700 “hidden champions”³ worldwide – almost half of them are German Mittelstand enterprises.⁴

The crisis has called many things that have long seemed natural in the German business landscape into question. It has also revealed the necessity to make structural changes and innovate within the German economy. Among these structural changes is the need to digitalize. A recent analysis by McKinsey indicates that if the German economy continues its digital structural changes and if the damage done stays within the projected range, by 2028 it will be able to return to the growth path it would have been on had the pandemic never occurred.⁵

McKinsey sought to better understand the economic impact of the COVID-19 crisis on the Mittelstand given its significant structural relevance to Germany’s economy. A comprehensive survey of Mittelstand enterprises shed light on their outlook, key success factors in mastering the shutdown, and the way out of the crisis. Our key findings are summarized in this document.

COVID-19 hit most German Mittelstand enterprises hard, but they remain optimistic

For the majority of surveyed enterprises the practical lockdown of the economy has significantly disrupted operations, as stated by their CEOs or other members of leadership. More than half the surveyed enterprise leaders stated that as of the end of April⁶ their enterprises were still not fully back to business (41 percent were only partially back to business and 15 percent not back at all). 17 percent needed to put the business on hold due to the crisis, while 27 percent had no need to shut down the business (Exhibit 1).

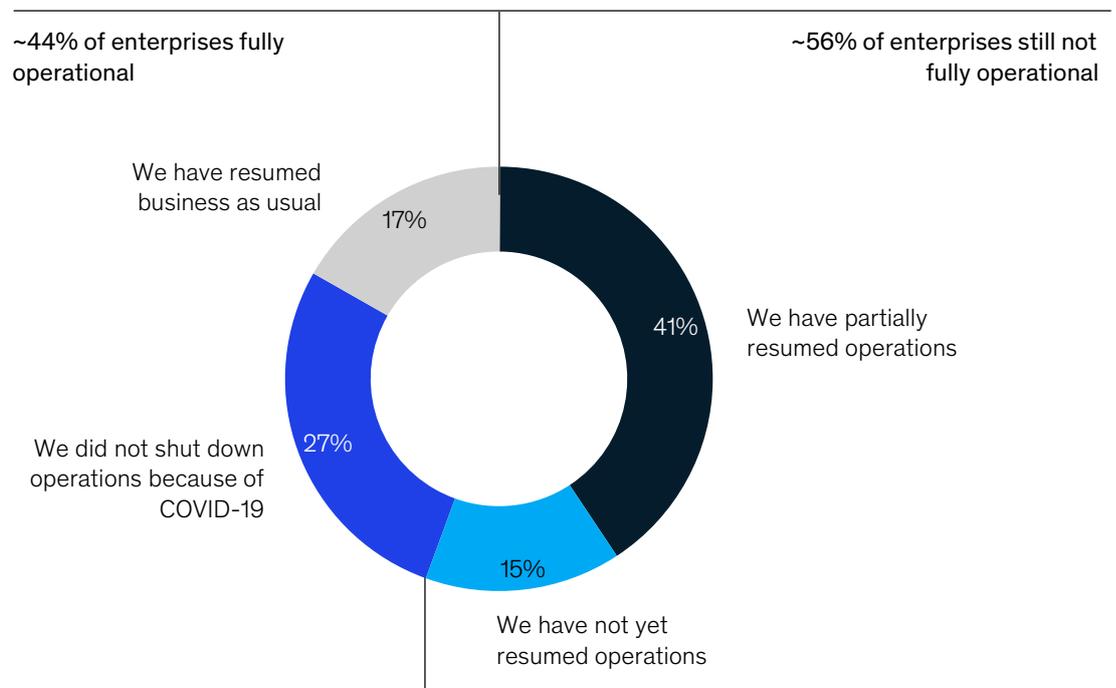
73%

experienced supply chain issues

Exhibit 1

56% of enterprises are still not back to business as usual

Which of the following scenarios best describes the state of your SME and your crisis response?



Source: McKinsey

2/3

expect turnover losses in the second quarter due to COVID-19

Even for the businesses that were able to avoid a nationwide shutdown in production, the crisis has significantly strained their revenues, profits, and resources. More than 60 percent of surveyed enterprises expect a decline in turnover for the current quarter, and nearly 10 percent expect the decline to exceed 50 percent. But, there are also winners: 11 percent of the enterprises surveyed expect revenue growth in the second quarter (Q2) of 2020. Furthermore, one in four enterprises expects stable revenues with slight fluctuations between negative 5 percent and positive 5 percent.

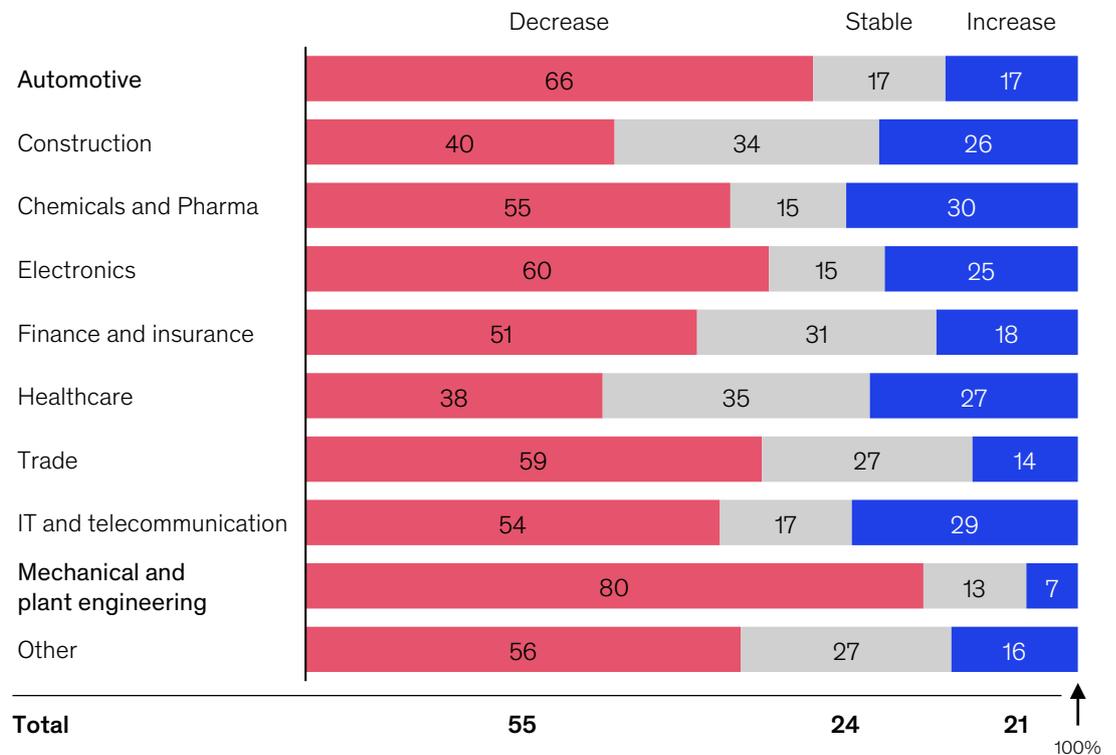
Businesses that largely depend on global supply chains, such as mechanical and plant engineering, automotive, electronics, and retail are being hit much harder by the crisis. This is evident by the large share of respondents in these sectors expecting revenue decreases, while construction and healthcare are the least likely to project Q2 revenue decreases. In contrast, the chemicals and pharma, IT and telecommunication, and healthcare sectors – given their increase in demand with their roles in fighting the virus and leveraging technology to enable working from home – were the most likely to expect revenue increases in the shorter term.

Exhibit 2

German Mittelstand enterprises expect significant turnover losses in Q2 2020

Revenue outlook for Q2 2020 among German Mittelstand enterprises

Percent



Note: Due to rounding, percentages may not always appear to add up to 100%.

Source: McKinsey

Despite the negative effects, the German Mittelstand remains optimistic: A surprising 77 percent of the enterprises surveyed have a positive outlook on the future. This optimism displayed by the business leaders in the survey cannot be explained mono-causally. Certainly, there is a psychological effect, the so-called informed optimism. However, despite poor short-term revenue expectations in most cases, the German Mittelstand has confidence in their own strength – and this is well-grounded. We clearly see this positive trend in the survey with almost one in four consumers assuming that the economy will recover within two to three months and then grow just as strongly or even more strongly than prior to the outbreak of the pandemic⁷.

Overall, we identified a set of priorities, commitments, and actions that can help get the German Mittelstand back on track faster.

1. Act counter-cyclically

History shows that crises help redistribute markets in favor of the strong. The sectors that are not only affected by the COVID-19 crisis but also face important structural challenges can and should use the crisis as an opportunity to go beyond firefighting.

Like in many critical situations, some players act slowly or only focus on tactical measures. However, there seems to be a big difference between the players that believe they are acting

counter-cyclically and the ones that are actually doing so. Of the enterprises we surveyed, 79 percent of their leaders state they are acting counter-cyclically to the crisis, but only 17 percent have actually initiated the types of changes necessary to gain a competitive advantage. This gap between perception and reality is remarkably large, and leaders should wonder if they truly recognize the opportunity for change.

2. Rethink customer engagement

A look at the toolbox of crisis measures reveals the following picture: In response to the sudden emergency lockdown, many enterprises – almost nine out of ten – took ad hoc action to support business continuity with short-term measures, such as short-term labor and reducing both administration costs and indirect spending. Enterprises with a negative perspective on their economic futures tend to be more rigorous in reducing direct costs and optimizing their cash flows.

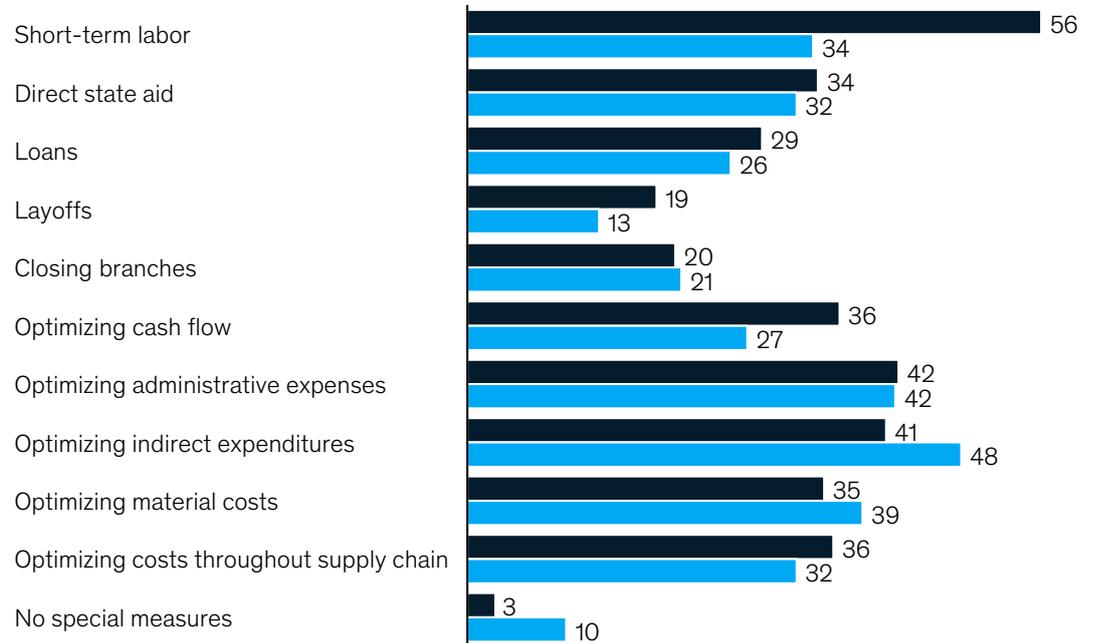
A slightly different picture emerges when looking at measures or actions taken to stabilize or increase revenue. Leaders from enterprises with positive revenue expectations seem to be one step ahead when it comes to doing this. A key measure that separates these revenue-positive Mittelstand enterprises from their more negative counterparts is the increase in customer contact.

77%

are optimistic about the future

Potential winners focus on future growth opportunities

Actions for business continuity



Actions for revenue stabilization or increase



Enterprises expecting revenue decrease for Q2
 Enterprises expecting revenue increase for Q2

Source: McKinsey

Those enterprises whose businesses are at a standstill or are hard to virtualize need to invest in their customer relationships in an effort to hold on to them. Mittelstand enterprises that have intensified customer contact to show customer commitment and care have the best revenue outlooks for the year 2020. Many of them have been throwing out the old assumptions that govern how they do business, as they rethink how to interact with customers: Distilleries started producing disinfectants, car manufacturers started developing a new filter for the interior of the car, and fashion labels introduced style guides that helped customers online. The ability to understand and meet their customers' evolving crisis-related needs has proven to be a wise customer-centric strategy.

All these measures cannot prevent the full impact of a demand shock dealt by the pandemic. Optimizing operating costs and investing in customer relationships need to go hand in hand. These developments will also persist into the "After COVID-19" era, where the advantages of newly learned business habits will continue and define the new normal.

3. Closing the digital gap and launching new digital businesses

An infrastructure that enables digital work from anywhere and at any time has become an acute necessity due to the COVID-19 pandemic. But, that is just the beginning. The need for social distancing will increase the use of robots and automation tools. Robots will progressively be used to perform roles workers cannot do at home and help maintain a high level of business continuity that wouldn't have been possible a short while ago. The extraordinary constraints and imperatives drive the need for complete digital transformations in weeks rather than months or years. As Microsoft's CEO (Satya Nadella) puts it "2 years' worth of digital transformation in 2 months" is happening in all enterprises due to COVID-19 – and this is the spirit of leading German Mittelstand enterprises.

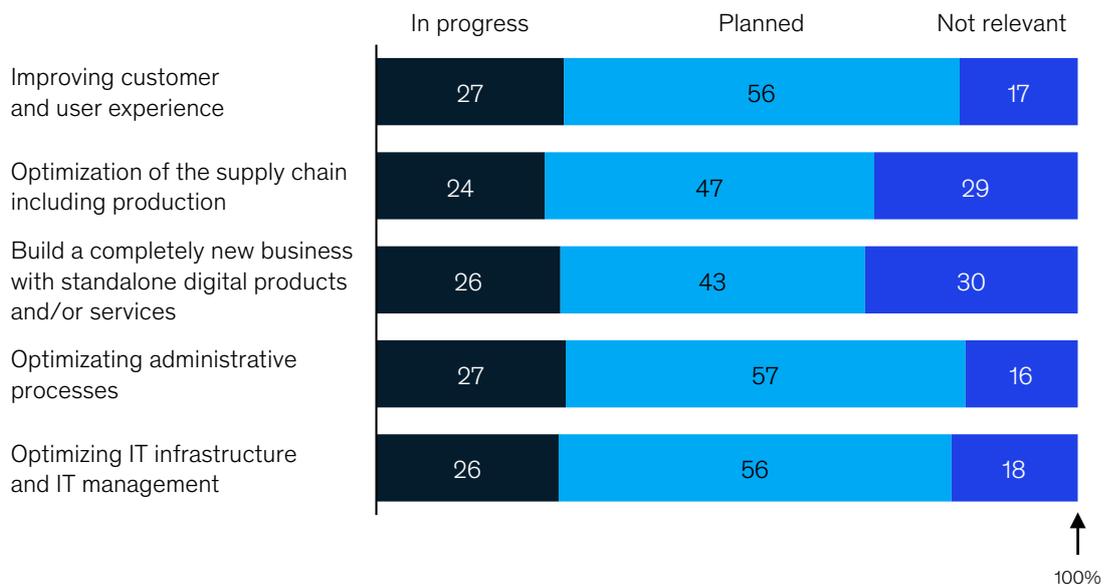
In that sense, digitization remains a priority for 89 percent of respondents with 34 percent reporting that it increased in significance during the crisis. The dilemma: Although the immediate crisis is increasing the pressure to digitalize, it is also pausing ongoing digital projects. Some industries are experiencing the pressure to digitalize more than others.

Exhibit 4

German enterprises still pursuing their digital projects

Which digital projects are you planning or are already in progress?

Percent



Note: Due to rounding, percentages may not always appear to add up to 100%.

Source: McKinsey

54 percent of enterprises in the financial and insurance sectors and 45 percent of those in chemicals and pharma state that digitization has moved up on their list of priorities during the current crisis.

A closer look at the action list reveals the nature of digital projects the surveyed enterprises are currently planning or realizing.

The more progressively enterprises interpret their digital projects, the better their own revenue forecasts. Creating new digital businesses is the leading success factor separating the wheat from the chaff among the respondents. 68 percent of growing enterprises are building new digital businesses, but “only” 39 percent of those experiencing stagnation or decline are doing the same. They are formulating new solutions to both help resolve the crisis and reimagine their industries in the aftermath. They iterate rapidly and work in an agile fashion rather than engage in lengthy planning processes. Interestingly, Mittelstand enterprises with more dismal revenue reports tend to be more inward-focused with their digital efforts concentrating mainly on internal process automation.

4. Tackling supply chain risks

While the financial crisis of more than a decade ago made enterprises focus on increased global competition, consumer expectations, and volatility of customer demand⁸, COVID-19 has exposed the global trade and supply networks of the German Mittelstand. Despite their size, the majority of the surveyed enterprises are impacted: 73 percent state they are or have experienced supply chain issues. As a result 43 percent of these enterprises are committed to acting and plan on modifying their supply chains. IT, telecommunications, finance, and insurance are urged to act even more: Over 70 percent are prepared to reevaluate the structure of their supply chains.

A large shift in the supply network and local demand in Germany and across Europe is ahead of us. With enterprises bringing suppliers closer, several core competences could be brought back to Europe to reduce both the supply

chains' and enterprises' vulnerability to global disruptions. But obviously this is not a question of “either or.” Enterprises need to evaluate the potential increase in costs of a more local supply chain, driven by higher production costs, a more saturated labor market, and higher wages. This will result in a mix of global and local supply chain solutions that finds the right balance between higher costs and reduced risks.

5. Making flexible working models stick

Before the crisis, nobody could have imagined the stellar rise of remote work we are currently experiencing. Board meetings, project kick-offs, or even recruiting are just some of the tasks we thought were only possible in person. Additionally, the daily working routine has changed for many: Home offices, video conferences, and thinned-out shifts are only a few of these changes. 88 percent of the responding leaders reported their enterprise having mandatory in-person work requirements before the crisis. While on-site work for employees remains essential for many business types – e.g., plants and factories – operations centered around “desk jobs” might experience a big change. The increased flexibility has changed the view on what it means to “go to work” and with this change comes new expectations. 81 percent of all surveyed enterprises want to hold on to the flexible working models they've implemented even after the pandemic. The first US-based tech enterprise has already proclaimed that its employees can work from home forever if they want to.⁹

Still, the challenge will lie in enterprises' ability to successfully examine how they think about control related to performance. Many supervisors fear efficiency losses if they lose the ability to directly control the presence and actions of their employees. But remote work is teaching us that productivity does not have to suffer under a change in work setups. While full-time remote work might not be the one-size-fits-all answer, flexibility – relieving some of the strain and burden of commuting – might be a win-win.

81%

of surveyed Mittelstand enterprises expect that the COVID-19 crisis will make working models in their enterprise more flexible in the long run

6. Rethink competition by joining ecosystems

With the arrival of digital platforms comes a shift in enterprises' understanding of the nature of competition. We are moving towards more cooperative ecosystems, where players of all kinds and across all parts of a particular sector pool their insights and combine their profound customer understanding and relationships, establish industry-specific networks, and highly complementary value chains to create true value-add for their end customers.

For some time now, large retail and technology giants have already been using their digital expertise to enter distant markets and in doing so have become a threat to various B2B industries, e.g., after-sales and services within the manufacturing industry. No B2B enterprise can rival the software and IT capabilities of a technology giant. However, as part of a system that includes other market players – ones who serve a similar customer base and whose offers are complementary – enterprises can fend off the new wave of tech competition by developing the capacity to deliver innovative digital products and services.

Enterprises will still hold on to their individual aspirations for success, but the current crisis has also led many to recognize the benefit of partnerships. In fact, 81 percent of our respondents agree that joining a new or existing ecosystem would be highly beneficial for them – and 51 percent are expected to do so. The German Mittelstand sees three key specific advantages of participating in ecosystems:

- Attaining new value through partnerships
- Increasing the competitiveness of the German Mittelstand as a collective ecosystem internationally
- Substantially improving customer experience

Although the focus of ecosystem-building may vary by industry, attaining new value potentials is the

leading driver. What all industries have in common is that for an ecosystem to succeed, all parties represented in it must rethink their approach and view their sector and its players in a completely new light: Other players are no longer just competitors in product distribution, but partners in value creation.

7. Consolidating beyond optimizing costs

In the first wave of the pandemic, enterprises of every size tried to stabilize their businesses. The second wave could lead to an increase of mergers and acquisitions, especially as “hidden champions” tended to increase their equity ratio in the last years. Enterprises may look to take over direct competitors to combine their strengths and streamline their costs. The survey results confirm this hypothesis as 60 percent of enterprise leaders are either planning or have begun acquiring and taking over competitors. Overall, nearly one out of four enterprises is already dealing with consolidation measures like strategic alliances, mergers, co-operations, purchase of critical intellectual property, or as stated: acquisitions and takeover of competitors. Among enterprises with the most positive revenue prospects for Q2, half are already acting on their consolidation plans.

Research has shown that 80 percent of an enterprise's growth is driven by market growth in the industry segments where it competes and 20 percent by revenue gained through mergers and acquisitions.¹⁰ Similarly, mergers and acquisitions can be a way of regaining relevance for enterprises that have fallen behind in digitization.¹¹

Again, there is a link between action and positive turnover expectations: Around 50 percent of enterprises with positive revenue prospects for Q2 plan to take action toward consolidation, while less than one third of the others plan to do so. Enterprises with expected revenue decline tend to state that these topics are not of relevance to them.

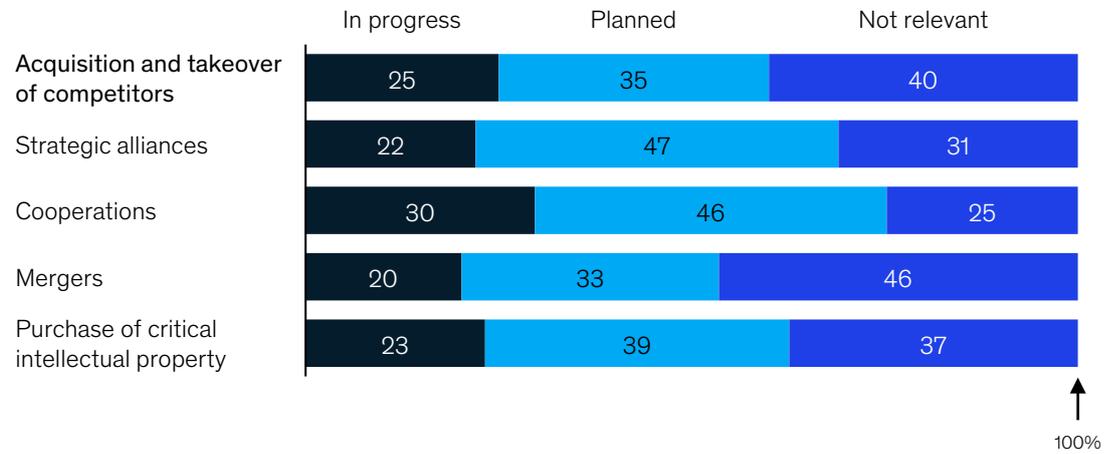
51%

expect a stronger participation and involvement in ecosystems that include competitors and other market players

Local M&A market will gain traction

Which of the following consolidation activities are you already pursuing, currently planning, or are not relevant?

Percent



Note: Due to rounding, percentages may not always appear to add up to 100%.

Source: McKinsey

Outlook

Like businesses of all sizes and in all regions, the German Mittelstand is experiencing the negative effects of the COVID-19 crisis. Whatever the length of the shock, we believe that German Mittelstand enterprises that act now, adapting their business models to weather the storm, can recover faster and be better prepared for future crises. In some cases, they may even emerge from the crisis stronger than ever. Despite not all enterprises being impacted the same, a common set of strategic actions in response to the crisis seems to be creating more favorable outlooks for business success and revenue growth.

As enterprises continue to navigate their way through this crisis, ask yourself:

- Are we using this “slow-down” as an opportunity to adapt our models and innovate our business, or are we simply slowing down?
- Are we increasing the investment in our relationships with customers – particularly our digital relationship, or are we “socially distancing” from them?
- Have we taken our foot off the “consolidation pedal,” or are we using this moment to accelerate our plans for strategic mergers, alliances, and acquisitions?

Now is the time for the German Mittelstand to take decisive and forward-looking action instead of just “putting out fires” in an effort to keep the industry afloat. What separates the good from the great is a confident commitment to investing in a solid path toward growth rather than a focus on mere survival, after all, diamonds are formed under pressure.

Endnotes

1. The IfM Bonn defines Mittelstand enterprises by the unity of ownership and management. In a Mittelstand enterprise up to two natural persons or their family members (directly or indirectly) hold at least 50 percent of the company shares and these natural persons also belong to the management of the enterprise. There is a large overlap between Mittelstand enterprises/family enterprises and independent small and medium-sized enterprises (SMEs). Nonetheless, also large enterprises with more than 500 employees or an annual turnover exceeding EUR 50 million are classified as Mittelstand/family enterprises if they fulfill the above-mentioned (qualitative) criteria.
2. Institut für Mittelstandsforschung, [IfM Bonn](#)
3. The term hidden champions refers to Mittelstand enterprises aspiration for gaining the market leadership position. This ambitious goal goes beyond just achieving a purely quantitative, static market share target but also implies dynamic aspects such as setting rules and influencing trends. Source: Schleppehorst, S., N. Schlömer-Laufen, M. Holz, Determinants of Hidden Champions – Evidence from Germany in: P. Büchler, Hidden Champions Case Compendium – Global Edition. Springer Verlag
4. Bundesverband mittelständische Wirtschaft Unternehmervverband Deutschland eV, [BVMW](#)
5. Cornelius Baur, Thomas Rudolph, Sebastian Stern, Eckart Windhagen, [COVID-19 als Startpunkt für Erneuerung in Deutschland, 2020](#) (German language)
6. Period of survey: April 24–28, 2020
7. “Consumer Sentiment Pulse Check”, <https://www.mckinsey.de/news/presse/2020-05-07-corona-consumer-sentiment-survey-wave-5>. Since March, McKinsey & Company has regularly surveyed consumers in over 30 countries worldwide, 10 of them in Europe.
8. The challenges ahead for supply chains: McKinsey Global Survey result, McKinsey, 2010
9. [The Guardian, May 12, 2020](#)
10. Mehrdad Baghai, Sven Smit, and Patrick Viguerie, “The Granularity of Growth,” McKinsey Quarterly, May 2007
11. Jacques Bughin and Tanguy Catlin, “3 Digital Strategies for Enterprises that have Fallen Behind,” Harvard Business Review, February 12, 2019

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