Humble but nimble

Europe's smaller firms are coping fairly well with the recession, in spite of their banks' reluctance to increase lending.

Illustration by David Simonds

Not much about Die Königliche Porzellan-Manufaktur, a royal porcelain factory, has changed since it was taken over in 1763 by Frederick the Great. Privatised by the state of Berlin in 2006, the firm still moves to a slow rhythm; it makes its tableware mainly by hand, and each of its painters is trained for three and a half years before starting work. Its products are expensive, at about €80 ($110) for a cup and saucer, and are hardly essential. Yet despite this the firm and its 180 employees are doing well amid the economic crisis. That is partly because customers are still willing to pay for its high-quality products, and partly because the company invested and hired prudently in recent times. "Conditions in our industry have been challenging, so we are well prepared for any downturn," says Christiane von Trotha, the firm's marketing director.

In contrast to the doom and gloom coming from Europe's biggest firms, many small and medium-sized enterprises (SMEs) are cautiously optimistic. The main umbrella organisation for Germany's more than 4m SMEs predicts that its members' sales will contract by only 2% this year. The country's renowned Mittelstand will therefore outperform the economy as a whole, which the government expects to shrink by 6%. A survey last month of 804 French SMEs found that just over half of them expected revenues to either stay flat or increase in 2009. "I was surprised by how good the numbers were," says Jean-François Roubaud, president of a French lobbying group for SMEs, "and the data confirms what I see out in the field."

That is good news for governments, because Europe's SMEs, defined as firms with fewer than 250 employees, collectively employ 88m people and account for two-thirds of private-sector employment. As big companies send jobs overseas in an effort to reduce costs, smaller firms are becoming increasingly important as domestic employers. And although most SMEs are tiny mom-and-pop operations, with little capacity or desire to grow, their number also includes fast-growing, innovative firms which, if properly nourished, could become tomorrow's champions.

To be sure, SMEs are facing tough times. They have fewer assets and smaller cushions of retained earnings than big firms. They often depend on a small number of customers, and they are unable to spread business risk by operating across several product lines and geographies. Along with falling demand, they face an unprecedented shortage of bank credit.

Five weeks ago, for example, Laurent Vronski, managing director of Ervor, a French manufacturer of air compressors, decided to test the loyalty of his banks, HSBC and Société Générale, by asking them for a larger overdraft. Although Ervor has the highest credit rating awarded by the Bank of France for a company of its size and expects the same sales this year as last, Mr Vronski is still waiting for an answer. “I don’t like that,” he says, “especially since banks wanted us to leverage up to our necks two years ago.”

So far, however, it appears that the majority of SMEs are finding ways to cope. In Britain, the number of corporate liquidations jumped to 4,941 in the first quarter of this year, up by 56% compared with the same period a year earlier. Most victims were SMEs. But a recent survey by the Federation of Small Business, which represents the smallest SMEs in Britain, found that 60% of businesses were performing as well as or better than last year.

In Germany the corporate death-toll for January and February was little changed from a year earlier. That is in large part because German domestic consumption is holding up, and SMEs serving the home market are doing relatively well. Exporting firms, by contrast, are in acute pain. Machine-tool manufacturers expect sales to slump by 60%, for example. Even at such firms, however, job losses are expected to be below the national average, because their employees’ skills are so valuable. In France the corporate bankruptcy rate jumped by 21% for the first quarter of 2009, but 70% of the failures were at the very tiniest firms with no employees other than their founders, and so have limited impact.

Although SMEs are always more vulnerable to downturns than big firms, argues Ludo Van der Heyden, a professor at INSEAD, a French business school, they are also much better at managing through them. To start with, they are usually more efficient and flexible. They “tend not to make the kind of stupid responses that big companies make, such as cutting costs deeply and indiscriminately, so they recover faster”, he says. SMEs are much closer to their customers and there is often more trust between managers and workers, meaning greater labour flexibility. One example is Sonogar 5, a retailer based in Paris which sells fancy multimedia and navigation equipment for cars. Its owner, Hugo Delpierre, has cut his own salary and plans to halve the firm’s shop-floor space in central Paris and share with another firm, “in order to survive”, he says.

Big companies are of course the main recipients of state aid so far, but small businesses are getting help, too. Governments are ordering banks to lend to them, providing credit guarantees, suspending some tax obligations and forcing public bodies to pay up more quickly. Belgium, France and Italy have taken the hardest line with banks; Belgium and France have both introduced nationwide networks of credit mediators, with powers to intervene with banks on behalf of SMEs, and Italy is monitoring its banks. The mediators can be highly effective, say businesspeople, although most SMEs are too frightened of angering their bankers to use them.

Eyetronics, a 10-year-old Belgian firm which does three-dimensional scanning for Hollywood films and for video games, took seven months to secure financing for its next phase of growth, despite a successful record. It is young, innovative SMEs that are most threatened by the credit crunch and recession and most need government support, argues Reinhilde Veugelers of Bruegel, a think-tank in Brussels, since their products are new and not yet widely accepted. Banks have long been wary of lending to them, preventing most innovators from growing into giants.

Only three firms founded in Europe since 1975 have joined the ranks of the world's 500 biggest listed companies, according to Bruegel, compared with 25 in America and 21 in emerging economies. European countries have particular reason, therefore, to help their most innovative SMEs through the crisis.

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