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Perspectives for Mittelstand businesses in the COVID-19 pandemic
Part 1: Challenges for Mittelstand policy

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1 Preface

The demands of business associations and Mittelstand enterprises regarding an opening perspective for currently closed economic sectors are getting louder and louder. Understandably, almost a year after the start of the pandemic, entrepreneurs from particularly hard-hit sectors such as the catering trade or tourism are pushing for the possibility to reopen. The population is waiting to go shopping again, do sports, or to be able to visit the cinema, theatre, or restaurant in person. Simultaneously, the global and asynchronous COVID-19 crisis, along with its new waves and mutations, is hitting the economy and society on a scale unheard of from the 2008/2009 financial crisis. These peculiarities of the COVID-19 pandemic also make it challenging to develop a longer-term strategy for Mittelstand policy. The identification of perspectives, however, is more critical now as the Mittelstand sector is much more affected than it was at the beginning of the pandemic. With the depletion of financial reserves, many small entrepreneurs are already drawing on their old-age reserves; debt counselling services report an increasing number of solo self-employed clients. Increasingly, entrepreneurs also feel personally affected by the pandemic.

In March 2020, the pandemic hit our society and economy abruptly. The emergency aid announced by the federal government for Mittelstand enterprises certainly helped to soften the psychological shock. However, the longer the pandemic lasts, the stronger grows the individual despair of those who have been unable to carry out their entrepreneurial activities for quite some time. In December 2020, the KfW-ifo Mittelstand-barometer already showed a significant drop in sentiment among the Mittelstand economy (Scheuermeyer 2020): In particular, those sectors significantly affected by the pandemic measures, such as retail, entertainment, sports and culture, saw a sharp drop in both assessments of the current situation and business expectations.

Against this background, we briefly outline in the following the concerns and preconditions for longer-term (opening) perspectives from the view of Mittelstand enterprises and policy before turning to possible key points – although, in the ongoing pandemic, our current assessments and considerations of possible starting points can only be provisional.

2 The concerns of Mittelstand enterprises as the basis for a long-term strategy

Any perspectives for the Mittelstand cannot focus solely on opening closed sectors or enterprises. In addition, the concerns of employees and society as well as the different ways in which companies are affected during the pandemic, must also be considered. Not only the measures taken against the pandemic but also the pandemic itself cause economic and societal damage: An unchecked pandemic would be accompanied by considerable uncertainty among consumers, which would lead to a sharp decline in demand. For example, if the general risk of infection were high, many consumers would withdraw as far as possible from public life and refrain from visiting cultural events or going out for dinner, even if restaurants were open.

In principle, (effective) anti-pandemic measures reduce the economic damage caused by the pandemic, but they also cause costs, which must be weighed against each other. From a purely economic point of view, tightening contact restrictions makes sense if the marginal costs of any additional measure are lower than the reduction in pandemic damage caused by this measure.

Regarding the Mittelstand, this consideration is by no means trivial in the prevailing situation. Even after one year, it is far from clear in which Mittelstand sectors the risk of infection is the greatest and in which ways the virus primarily spreads. Our knowledge about the spread of the virus and infection incidence has increased compared to the previous year, but the evidence base is still lacking. On the other hand, the anti-pandemic measures mainly affect those Mittelstand sectors that had to close (sometimes permanently) due to the pandemic situation (e.g., culture, catering trade, tourism, retail trade). In contrast, the positive effects of anti-pandemic measures benefit all enterprises equally. Examples include a (relatively) stable demand and the avoided additional absence of employees due to illness and quarantine, which would probably be more severe without the current closures and restrictions on social contacts.

However, only based on comprehensive data, anti-pandemic measures can be targeted precisely and specifically to Mittelstand enterprises, and the damage to society and the national economy can be kept to a minimum. We can only endorse the demands of Baumann et al. (2021, p. 25) and other scientists such as the Corona Expert Council of the North Rhine-Westphalian government (2020), who urgently call for the establishment of an evidence base of regional infection incidence and its dynamics. This could be done, for example, through the

systematic collection and evaluation of test data. However, any evidence base also would have to include the specifics and concerns of the Mittelstand.

In the end, entrepreneurs' main interest is to secure their enterprise's existence – and especially for the self-employed their own livelihood. Besides, there is societal recognition associated with entrepreneurial activity, even if this may initially recede into the background during the pandemic.

For employees in the Mittelstand, security needs are paramount. This includes job security, but also their own – and their family's – health. Then there are the social and individual needs that working life can cover, such as a sense of belonging, social exchange, trust, and success.

Therefore, for these two groups, any perspective means a clear answer to the question of when the enterprise can restart activities or when they might have to be restricted again. In addition, there are clear regulations that guarantee the safety of the employees and, at the same time, enable them to engage in social exchange under pandemic conditions.

For society, the focus is on maintaining the economic and societal contribution of the Mittelstand (cf. Welter et al. 2020). In addition to the diversity of the Mittelstand, this also includes, for example, its vocational training function. Here, perspective means dealing with the question of how these contributions can be maintained in the longer term.

3 Peculiarities of Mittelstand policy during the pandemic

There is no blueprint for Mittelstand policy during a pandemic. It is confronted with the task of finding the optimal mix of measures in which the pandemic is under control, but the social and economic costs remain within reasonable limits. Ideally, a crisis policy should provide short term support at the sectoral and company level to mitigate the short-term economic effects on the Mittelstand and to avoid longer-term economic damage. Ideally, the pandemic's longer-term impact on the Mittelstand should also be considered at an early stage. In such an exceptional situation, a temporary softening of framework-related regulatory policy principles as well as the setting of preferences regarding sectoral and company-related support is also justifiable.

From these points of view, the general orientation of the pandemic related Mittelstand policy in the past year can be evaluated positively. Initial emergency aid measures at the beginning of the pandemic were supplemented by measures to

revive the economy and preserve jobs in the long term. The Future Package has already provided an initial economic policy response to the crisis that goes beyond the immediate need for support and is oriented towards sustainable economic development based on renewal. However, the necessary structural approaches to stimulate entrepreneurial initiatives only played a subordinate role in the Future Package, although they would be necessary for the intended modernisation thrust (Welter/Wolter/ et al. 2020).

However, the asynchronous, erratic, and difficult-to-predict course of the COVID-19 pandemic poses a permanent challenge not only for society and the economy but also for Mittelstand policy. The shutdown of many sectors due to the pandemic's development in autumn was not predictable to the extent that it occurred and was not initially planned for. This forced policymakers to launch and implement further emergency aid measures in the short run. Reaction instead of proactive action currently dominates. At the same time, the impression is growing in the public that the additional support – in contrast to the emergency aid measures that were quickly handed out in the spring of 2020 – has only been announced in full since autumn but is not (any longer) reaching the entrepreneurs.

To be able to develop longer-term perspectives for the Mittelstand against this background, it is first necessary to clearly define the *understanding of what characterises Mittelstand policy in times of pandemic*: Policymaking under great uncertainty to keep the current and future impact of the pandemic on the Mittelstand (as) low (as possible). To this end, not only the immediate effects of pandemic-related decisions such as shutdowns, national border closures, etc. must be continuously considered for additional support, but at the same time, the risk of another exponential growth phase of the pandemic must be kept in mind. Such a phase would probably have devastating consequences for all economic sectors, with or without further closures. Quick course corrections – i.e., supposedly reactive action – dominate economic policy in such phases.

In general, Mittelstand entrepreneurs are no strangers to acting under great uncertainty and with many imponderables. In fact, it is a fundamental part of their daily business. However, in the pandemic, with no end in sight, there currently seems to be a lack of understanding of the challenges facing the other side and a lack of confidence among Mittelstand businesses in the proportionality of political decisions.

Therefore, *transparent, and timely communication of economic policymakers as well as constant dialogue with the Mittelstand* are even more important. We already pointed this out in spring 2020: “Business and politics must establish functional structures for mutual information and coordination to be able to react flexibly to changes and unknown challenges at any time. Reliable and clear announcements of economic policy are required here. This is the only way to secure the confidence of the economy in policymakers’ decisions. Under certain circumstances rapid course corrections will have to be made since neither the Mittelstand sector nor policymakers have any experience with such a comprehensive shutdown” (Welter/ Wolter/ Holz 2020a, p. 7). Clear communication also goes hand in hand with an *appreciation of the Mittelstand in all its diversity*, which is one of the main elements of the current government’s Mittelstand strategy. In the pandemic, appreciation of the Mittelstand means taking everyone on board, but also communicating clearly where the reopening seems – temporarily – not possible and which solutions Mittelstand policy can offer in this case. Mittelstand policy in the pandemic is also management of expectations.

4 Starting points for a longer-term perspective

There are no easy solutions for the exit from the current shutdown or from renewed closures in the future, should this be necessary again. In the following, we outline the state of knowledge on possible steering mechanisms, evaluate their suitability regarding the Mittelstand and discuss possible additional starting points from the Mittelstand perspective.

The question relating to the *appropriate thresholds* for opening or closing the Mittelstand economy is not easy to answer. Currently, the supposedly constantly decreasing incidence values for further opening steps are heavily criticised in public. However, the threshold values of 35 or 50 new infections per 100,000 inhabitants within seven days have already been set with the amendment of the Infection Protection Act of December 2020. With a threshold value of up to 35, protective measures are to support the control of the incidence of infection; with a threshold value of up to 50, broad-based protective measures must be taken to quickly mitigate the incidence of infection. If the threshold rises above 50, comprehensive protective measures are directed at containing the incidence of infection. Regional responsibility was also defined as long as higher national interests do not contradict this, but also the uniform national procedure if a threshold value of 50 is exceeded. Measures such as restricting business activity in specific economic sectors or company closures are mentioned but not

linked to the respective thresholds. Regionally differing opening strategies for the Mittelstand are, therefore, possible in general.

The scientific community argues for much lower thresholds for the relaxation of economic restrictions. According to ifo Munich and the Helmholtz Centre for Infectious Diseases Research (HZI), an economically efficient procedure is one that (1) lowers the reproduction value to 0.7 to 0.8 and (2) ensures the stability of the infection situation, at which economic areas are reopened (cf. Baumann et al. 2021, p. 22f.; Dorn et al. 2020). To this end, new infections and current case numbers would have to be brought to a low level and stabilised as a preventive measure (cf. Priesemann et al. 2021). According to epidemiological studies, the infection situation can only be stabilised at a maximum incidence of 10 persons per 1 million (cf. Contreras et al. 2020). Due to the currently rapidly spreading virus mutations, it is also assumed that the actual reproduction number could rise to 1.4 (cf. Priesemann et al. 2021, p. 2).

This means for the Mittelstand: To bring the infection under control again, even stricter measures would have to be taken at this time if necessary, and the mobility of the population and social contacts would have to be restricted even further. However, this would have a corresponding impact on Mittelstand enterprises and their employees. Conversely, openings in the closed Mittelstand sectors are only possible with significantly lower incidences and weakened infection dynamics, at least as long as infection occurrence is diffuse. The RKI (2021) points out that the sources of outbreaks are unknown in most cases of infection. However, if the infection clusters are known – such as in the case of the outbreaks in the meat industry or among fruit farmers – further openings are possible as long as the infection dynamics can be kept under control locally.¹ In this way, longer-term opening and closing perspectives could also be developed for the Mittelstand.

However, a longer-term perspective cannot be based solely on thresholds and infection dynamics. It must also consider the concerns of the Mittelstand as well as direct and indirect impacts. We exemplify this with the question of the optimal opening strategy. As before, we assume that the *exit from the shutdown can only take place gradually* (cf. Welter/Wolter/Holz 2020a, p. 4f.). Contrary to our considerations of April 2020, it is probably not tenable – based on today's

¹ Pössel (2021), for example, suggests a differentiated consideration of R-values according to the respective environment (private, education, work).

knowledge of the infection process dynamics – to open all currently closed Mittelstand sectors at the same time. Therefore, respectful communication towards the Mittelstand includes not only (indiscriminate) promises for re-openings but also an open discussion about industries and enterprises with a high risk of infection and longer-term perspectives for these sectors. This concerns those enterprises whose business model is based on gatherings of people and/or involves population mobility, such as the event industry, certain areas of the cultural sector, tourism, and, to a limited extent, the catering trade. For such businesses, it may be better to provide generous support over an extended period. However, longer-term declines in enterprise development may also have to be considered because consumer behaviour may change in the long run. In such cases, a larger number of insolvencies probably cannot be avoided.

This would, however, endanger the Mittelstand diversity, which is an outstanding strength, especially in the pandemic. Nor should the psychological effects be underestimated. After all, those affected could see this as an admission by politicians that certain Mittelstand sectors are not valued. For this reason, an opening strategy should not include any criterion based on economic value creation, as this would disadvantage large parts of the Mittelstand. On the other hand, the cautious opening of economic sectors that cover not only elementary basic needs, but also individual needs beyond that, should have a considerable motivational effect not only on the Mittelstand, but also on the entire population. Since this would also include many smaller enterprises, such an approach clearly shows the policymakers' appreciation for the entire Mittelstand, even if not all areas can open immediately.

The new epidemiological solutions, such as rapid tests, also make it possible to supplement the enterprises' existing hygiene concepts with a mandatory testing strategy. This could also make it possible to open areas with a high risk of infection in the foreseeable future.

In general, *new pandemic developments* (e.g., mutations) and *new epidemiological solutions* (e.g., rapid tests for everyone) should be continuously evaluated with a view to the Mittelstand and possible perspectives: Currently (February 2021), for example, the spread of the much more contagious mutations of Sars-CoV-2 is increasing. As a result, renewed, more in-depth and prolonged restrictions on societal and economic life could be decided at the next Bundesländer consultations. And even if sectors such as the retail trade and the catering industry are already allowed to open gradually, their economic activity could

remain impaired as long as customers and consumers fear the mutations and the associated increased risk of infection and therefore voluntarily restrict their radius of movement.

On the other hand, the planned introduction of easy-to-use rapid tests from March 2021 onwards offers additional security to employees and customers of the Mittelstand. The establishment of a comprehensive testing strategy at a regional and/or company level should therefore be a sensible and obligatory addition to the existing hygiene concepts of the Mittelstand. In perspective, this approach could mean foreseeable prospects of opening soon, despite infectious virus mutations.

Finally, opening and closing debates should ideally be conducted at the *European level*: Europe's member states are a common pandemic area and therefore cannot be considered in isolation from each other. Short-term border closures have more of a declaratory character than they could really prevent virus mutations from crossing national borders. However, they are associated with considerable short-term costs for the industrial Mittelstand, for supplier companies, for foreign self-employed with a business in Germany and cross-border commuters employed in the Mittelstand and consequently also have an impact on start-up dynamics in Germany (cf. Günterberg et al. 2020; Welter/ Wolter/ Holz 2020b). If national border closures are essential, they should be coordinated and ideally also carried out with an appropriate lead time. However, a strategy of coordinated and comprehensive testing and follow-up in national borders' vicinity seems to make much more sense.

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