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The EU's support measures for sustainable financing - implications for the Mittelstand

On behalf of the regional savings banks and Volksbanks in Siegen-Wittgenstein and Olpe and the Chamber of Industry and Commerce Siegen

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Abstract

The EU Commission seeks to mobilise private funds for the sustainability transformation of the European economy through several regulatory measures. This study investigates the impact of this regulatory development on the German Mittelstand, i.e., owner-managed companies. Apart from direct effects, such as new reporting obligations, we investigate indirect effects, such as new informational needs of business customers and financial partners.

JEL: D04, G38, Q58

Keywords: *EU Taxonomy, Sustainable Finance, Mittelstand, owner-managed firms, SME*

The study was conducted on behalf of the regional savings banks (Sparkassen) and Volksbanks in Siegen-Wittgenstein and Olpe, and the Chamber of Industry and Commerce (IHK) Siegen. In detail, these are:

Sparkasse Siegen, Sparkasse Olpe-Drolshagen-Wenden, Sparkasse Burbach-Neunkirchen, Sparkasse Wittgenstein, Sparkasse Attendorn-Lennestadt-Kirchhundem,

Volksbank Sauerland eG, Volksbank Olpe-Wenden-Drolshagen eG, Volksbank Wittgenstein eG, Volksbank Freudenberg-Niederfischbach eG, Volksbank in Südwestfalen eG, and the

Siegen Chamber of Industry and Commerce.

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Executive summary

The EU Commission has launched a series of regulatory measures to mobilise public and private funding for the sustainability transformation of the economy. For example, from 2025, larger Mittelstand companies without a capital-market orientation will also be obliged to publish sustainability information in their non-financial report. They are thus directly affected by the regulatory measures of the EU Commission. So far, only about half of those businesses who will be required to report in the future are aware of this. There is a need to raise awareness in the coming months to give companies the necessary preparation time to comply with the legal requirements.

The majority of small and medium-sized enterprises indirectly affected

Many SMEs already have to provide various data to large customers. This is especially true for industrial companies: almost one in two has already been asked for sustainability information. The EU regulation will expand these information needs, as companies subject to reporting requirements will have to show the sustainability of their supply chain, and banks and savings banks will have to show the sustainability of their loan portfolio. Companies already anticipate an increased need for information in the supply chain - also due to the German Supply Chain Act (Lieferkettengesetz). They do not yet see the increased need for information arising among their financing partners.

Need to catch up on CO_2 emissions recording

Many companies already collect a range of consumption data, for example for electricity, water, or fuel. The additional collection effort from the regulation is therefore limited in this area. On the other hand, there is a need to catch up when recording their own CO_2 emissions and breaking down consumption and emissions data to individual customers and orders. The companies attribute a high level of effort to collecting this data.

Multi-layered challenges in financing the transformation

Two out of three companies plan to invest in more sustainability in the next three years. They want to finance these - in addition to using equity capital - primarily through bank and promotional loans. Thus, the sustainability transformation depends decisively on access to credit and the credit conditions for SMEs. Some factors make financing more difficult: for example, there is still uncertainty about the extent to which the market will reward investments in greener production

processes. The lack of infrastructures, such as access to green electricity and hydrogen, also makes it difficult to plan and assess the profitability of such investments.

Impact on lending to SMEs difficult to foresee

The impact of the regulation on SME financing is currently difficult to assess. It depends heavily on how banks will specifically take ESG criteria into account when granting loans in the future. Loan financing is made more difficult by a flaw in the taxonomy regulation: loans to SMEs currently negatively impact a bank's sustainability balance sheet. This error must be eliminated promptly. Otherwise, there is a risk of credit hurdles and problems for banks financing SMEs. These credit hurdles can lead to SMEs not investing in sustainable technologies or only to a lesser extent.

EU must think at an early stage about information needs arising indirectly

The EU Commission's intent to introduce simplified reporting standards for SMEs is to be welcomed. However, it should proceed quickly here, as SMEs already face information demands from various sides. In the future, the indirect effects of regulatory interventions on SMEs - especially newly arising information needs - should be taken into account at an early stage to avoid a proliferation of information requests and, thus, an uncontrolled increase in the bureaucratic burden.

1 Introduction

Policymakers are currently adapting the economic framework conditions to counteract climate change. At the European level, this is regulated by the so-called Green Deal. It consists of a bundle of measures presented by the EU Commission in 2019 and adopted by the EU Parliament the following year. The main goal is to create a competitive, climate-neutral economy in Europe by 2050. A crucial component of this is the transformation of the economy and companies so that their products and production processes become more sustainable. To achieve this, public and private capital flows must be channelled into sustainable economic activities. To this end, the EU Commission has drafted a "Sustainable Finance Strategy" (European Commission 2021).

To steer investments specifically towards sustainable activities, investors first need reliable information on the sustainability of the various economic activities. To create such transparency, the EU Commission pursues three interconnected approaches: the EU taxonomy defines under which conditions an economic activity is considered sustainable. The aim is to prevent so-called greenwashing in the context of reporting on sustainable economic activities and to make the information more comparable. Secondly, the obligations of large companies for non-financial reporting with regard to ESG (Environment, Social, Governance) criteria will be expanded. Thirdly, the EU Commission obliges financial service providers to use the sustainability information of companies to calculate and publish the degree of sustainability of their investment portfolio.

Current regulatory approaches and the resulting obligations are primarily aimed at large companies. However, indirect effects on non-reporting companies, such as small and medium-sized enterprises (SMEs), are also foreseeable. As large companies have to report on the sustainability of their value chain, they will eventually need corresponding information from the SMEs in their supply chain. Banks also need corresponding information from their corporate customers, regardless of their size, so that they can report on the sustainability of their loan portfolio in the future.

The study aims to examine the effects of European legislation on sustainable financing on the German Mittelstand, i.e., owner-managed companies. Specifically, the aim is to analyse to what extent and, if applicable, in what Mittelstand companies are directly or indirectly affected by the regulation. This also includes clarifying how the new regulation affects the relationship between Mittelstand companies and lenders.

2 Strategy for financing a sustainable economy

2.1 Current developments in regulation

In order to channel additional private capital into sustainable economic activities, the EU Commission has drafted a "Sustainable Economy Financing Strategy" (European Commission 2021).

This strategy comprises three elements: (1) the EU taxonomy, (2) disclosure and reporting requirements for companies, and (3) further instruments:

(1) EU taxonomy

The EU taxonomy is a system that defines which economic activities are considered sustainable (Regulation (EU) 2020/852). For this purpose, a detailed and comprehensive catalogue was drawn up to determine which corporate activities are to be classified as sustainable. This helps to prevent so-called greenwashing, i.e., the misleading suggestion of sustainability by companies, e.g., for marketing purposes.

The sustainability assessment of an economic activity is done in two steps. The first step is to determine whether an activity is "taxonomy eligible". From a purely technical point of view, taxonomy-eligibility simply means that it is an activity listed in the taxonomy and thus considered to have the potential to contribute to the achievement of the EU sustainability goals. However, it does not assess whether an unlisted activity is detrimental to these objectives or does not contribute. The second step is to determine whether an activity is "taxonomy aligned". To be taxonomy-aligned, the activity must meet three conditions:

Requirement 1: The activity must contribute significantly to achieving at least one of the six environmental objectives. These are:

- Climate change mitigation
- Climate change adaptation
- Sustainable use and protection of water and marine resources
- Transition to a circular economy
- Pollution prevention and control
- Protection and restoration of biodiversity and ecosystems.

For each taxonomy-eligible activity, the taxonomy offers technical screening criteria to determine under which circumstances a contribution is deemed significant. The contribution can be direct or indirect, for example, if a company produces a product that enables other companies to produce their products or services with less CO_2. Furthermore, an activity can significantly contribute to the environmental goal of "climate change mitigation" if it has a low emission value measured against the industry standard, as long as no (economic) emission-free alternative exists for it.

Condition 2: The activity must not cause significant harm to any of the environmental objectives.

Requirement 3: The activity is provided within the framework of minimum social standards in accordance with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights.

The taxonomy is an instrument to make sustainable activities more transparent for stakeholders and more comparable between companies. The information on which activities of a company are taxonomy-aligned is used, among other things, for the non-financial reporting obligations of companies.

(2) Reporting and disclosure requirements

Above a certain size, companies are not only obliged to report on their financial activities and thus on their economic success in a year by preparing a balance sheet but must also provide information on topics such as the environment, labour and human rights, bribery and corruption as part of non-financial reporting.

So far, companies that fall under the Non-Financial Reporting Directive (**NFRD**) (Directive 2014/95/EU as a supplement to Directive 2013/34/EU) are obliged to report. These are capital market-oriented companies, banks, insurance companies and investment fund companies with more than 500 employees and at least €40 million in annual turnover or a balance sheet total of at least €20 million.

With regard to the taxonomy, from 2023 onwards, companies must publish three key figures concerning the first two of the six environmental goals (climate change mitigation and adaptation) for the 2022 fiscal year: The

- Share of taxonomy-eligible activities in turnover.
- Share of taxonomy-eligible activities in capital expenditure (CapEx).
- Share of taxonomy-eligible activities in operating expenses (OpEx).

From 2024 onwards, these indicators must be reported in terms of taxonomy alignment - and no longer only in terms of taxonomy eligibility - as well as concerning all six environmental goals.

Financial market participants, such as banks, must report the proportion of taxonomy-eligible assets in their portfolio via the "green asset ratio" (GAR) for the first time in 2023 for the 2022 fiscal year and the proportion of taxonomy-aligned assets from 2025 for the 2024 financial year. These assets include, among others, loans to companies. The European Banking Authority (EBA) also requires the publication of a "banking book taxonomy alignment ratio" (BTAR) from 2024 onwards (EBA 2022). The two metrics GAR and BTAR differ primarily in how business activities with companies without reporting obligations on their taxonomy eligibility/alignment are treated.

In addition to information on taxonomy alignment, other sustainability information is becoming relevant in lending (cf. Buchmüller et al. 2022). According to the European Banking Agency (EBA) guidelines, ESG criteria should be considered when granting loans. This applies both to the assessment of credit risk and to that of loan collateral. Furthermore, the EBA is increasingly looking at the extent to which banks are affected by climate risks (climate stress test). Finally, the introduction of a "green supporting factor" (GSF) is also being discussed. Regardless of the outcome of the discussion on the GSF, banks will increasingly have to identify sustainability risks in their business activities and obtain information from their loan clients in this regard.

(3) Further instruments

In addition to taxonomy and reporting requirements, instruments such as benchmarks and the EU Green Bond Standard should make it easier for investors to consider the EU's sustainability goals in their investment strategy.

2.2 Outlook: Further development of regulation

In the course of the revision of the NFRD, the Corporate Sustainability Reporting Directive (**CSRD**) will extend the non-financial reporting obligation from 2025 to all companies - regardless of capital market orientation - that meet at least two of the following three criteria:

- More than 250 employees,
- At least € 40 million turnover,
- At least € 20 million balance sheet total.

Furthermore, from 2026, all capital market-oriented companies - including SMEs - will be subject to reporting requirements (European Commission 2021b), only micro enterprises are exempt.

In addition to the group of reporting entities, the reporting obligations themselves will be expanded. In the environmental area, a variety of other sustainability information will become relevant in addition to taxonomy-related information. This includes, among other things, the amount of energy and the energy mix consumed by a company, the company's emissions (categorised into Scope 1-3 emissions), the company's emissions targets until 2030/2050 and milestones of the company's contribution to climate neutrality, as well as the climate risks that are relevant to the company's business and the company's influence on various climate risks ("double materiality"). Furthermore, the CSRD provides for a standardisation of reporting formats and contents in the future, so that the sustainability information must be published in the management report, and externally audited.

In addition to the expanded group of addressees and the additional reporting obligations, the taxonomy will also be adjusted over time. So far, the taxonomy has revolved around identifying those activities that significantly contribute to sustainability transformation. It remains unclear whether those activities that are not listed run counter to the sustainability goals or simply have no significant impact on the environment. In the future, it should be possible to differentiate here. In addition, it is planned that activities will be listed that do not (yet) make a significant contribution but represent clear progress towards more sustainability (SF Platform 2022b). In addition to increasing the degree of differentiation, work is being done on expanding the taxonomy to include social and governance criteria (SF Platform 2022a).

3 Possible effects of regulation on Mittelstand companies

3.1 Effects of the reporting obligations

Mittelstand companies are directly or indirectly affected by the EU's regulatory measures. On the one hand, Mittelstand companies can fall directly under the reporting obligations according to NFRD or CSRD. The number of companies subject to reporting requirements under the CSRD will increase significantly throughout Germany due to the lowering of the required number of employees to 250 and the elimination of the capital market orientation requirement.

Furthermore, the regulations will affect Mittelstand companies even if they do not fall directly under the reporting obligation. This indirect impact results from two typical characteristics of the German Mittelstand. First, its members are often integrated into supply chains with larger companies. This means that they have business relationships with reporting partners. Second, credit financing by house banks is of great importance for the Mittelstand.

In the following, we will discuss the extent to which these two aspects lead to Mittelstand companies being indirectly affected.

Large companies cannot fulfil some reporting requirements, for instance, on their Scope 3 emissions or the climate risks affecting them, without information from their value chain. Therefore, even non-reporting companies must expect requests from their customers or suppliers. If they cannot provide the information, they may face negative consequences, up to and including termination of the business relationship. A breach of the reporting obligation can entail management liability risks for larger companies.[1] Therefore, SMEs with corresponding business relationships will have to collect more sustainability information and, if necessary, break it down to individual orders and customers. In general, SMEs are disproportionately affected by the costs of collecting the required information. The fixed costs associated with the collection effort entail a higher burden for SMEs than for larger companies.

The additional effort that the regulation creates for individual companies depends heavily on the extent to which sustainability information is already being

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1 Recently, reporting entities were granted a three-year transition period with regard to the collection of information from non-reporting entities in their value chain (Committee of Permanent Representatives 2022).

collected. Not only customers and suppliers, but also other social actors have an interest in sustainability information. Certain information is already being collected depending on the industry because authorities ask for it. At the same time, many companies are interested in collecting certain information because it is relevant to their business. In energy-intensive industries, energy consumption is often measured, as is fuel consumption in logistics companies, simply because these are important cost factors in production.

On the part of the regulators, there is currently a growing awareness that the indirect costs for SMEs represent a burden. Thus, the European Financial Reporting Advisory Group (EFRAG), which is entrusted with developing proposals for concrete reporting standards, proposes that, in the spirit of proportionality, separate reporting standards should be developed for SMEs (EFRAG 2021). It is noteworthy that not only a simplification of the rules is demanded here, but its own rules. These are necessary because SMEs are not primarily distinguished from other companies by their small size, but also by the instrumental role of the entrepreneur/owner-management and the simpler/more direct organisational structures (EFRAG 2021, pp. 52-54). Obviously, there is a growing awareness that the indirectly affected SMEs are mainly owner-managed SMEs, and the unity of ownership and management of the companies justifies its own reporting standards. While the general reporting standards under CSRD are expected to be adopted in autumn 2022, the simplified reporting standards for SMEs are not expected before the end of 2024.

3.2 Effects on corporate financing

Banks are obliged to report on the taxonomy eligibility or alignment of their portfolio in the form of the "green asset ratio" (GAR) and the "banking book taxonomy alignment ratio" (BTAR). They must obtain the necessary information from their business clients during loan negotiations. For loans granted to SMEs, a "grace period" is envisaged in the calculation of the GAR. Information on the taxonomy alignment of companies that do not fall under the reporting obligation may only be included in the calculation of the GAR from 2025. Therefore, for the time being, the banks' need for information could concentrate on companies subject to reporting requirements. Nevertheless, banks can consider their loans to SMEs within the framework of additional voluntary reports.

At the same time, the concrete implementation of the grace period leads to possible disadvantages. This is because all loans to SMEs are still to be included in the denominator of the GAR. The grace period regulation merely stipulates that taxonomy-aligned loans to SMEs are not included in the numerator of the GAR. This means that loans to SMEs are effectively counted as "not taxonomy-aligned" across the board. This has two effects: first, banks with a relatively high share of corporate loans to SMEs will have a lower GAR than credit institutions with a lower share. This will distort competition between banks if banks with a low share of SMEs in their loan portfolio can present themselves as "greener" than banks with a high share of SMEs (cf. Bankenverband 2021, p.10; EBF & UNEPO-FI, p. 50). This is to the detriment of regional banks, which primarily finance SMEs.

A second consequence of the blanket approach is that every loan to an SME reduces a bank's GAR - completely independent of whether it serves sustainable goals or not. It might therefore be of interest to banks that need to refinance on the capital market to reduce lending to SMEs in general. The attempt to temporarily spare SMEs from information demands could thus de facto develop into a credit hurdle for SMEs. Due to the high importance of credit financing, this design flaw in the GAR undermines the actual intention of the EU Commission to provide financial resources to companies for the sustainability transition.

In fact, this seems to be an important reason why the European Banking Authority requires the additional publication of the BTAR. The BTAR, unlike the GAR, takes into account the taxonomy alignment of SME lending and thus allows banks to make an unbiased estimate of the sustainability of their loan portfolio.

There are also developments that will ensure that SMEs will have to provide sustainability information to their lenders even before the end of the grace period in 2025. According to the requirements of the banking supervisory authority, sustainability aspects are to be considered increasingly in the assessment of credit risks. Regardless of how these requirements are implemented, banks and savings banks can only consider sustainability aspects when granting loans if they obtain corresponding information from their loan customers, including SMEs. Depending on how the requirements are put into concrete terms, it is also possible that companies with a poor sustainability record will find it more difficult to access loans, even if the loans are to be used to improve their own sustainability. This would slow down the necessary sustainability transformation of these companies.

In addition to lending, regulation for sustainable financing is also gaining importance for the issuance of corporate bonds. If the financial resources from the bond flow into taxonomy-aligned activities, the bond can be issued as a "green bond" according to the European Green Bond Standard (EUGBS). The EUGBS is a voluntary standard that allows the issuer to distinguish itself from other labels or standards. Green bond financing can be very attractive should the current high demand for sustainable investment opportunities continue or even increase further. However, green bonds are more likely to play a role for larger Mittelstand companies, as the associated reporting burden is too high for most SMEs. The advantages of green bonds will thus lie more with larger companies that already issue bonds and have to report on their taxonomy alignment anyway. Nevertheless, it should be noted that the possibility of green bonds is also a potential advantage for non-reporting companies that are considering voluntary reporting.

Sustainability information is also used when awarding government subsidies such as development loans. Access to this funding is linked to the fulfilment of technical criteria, the proof of which often requires the collection and documentation of sustainability information such as consumption and emission data.

4 Empirical analysis

4.1 Methodology

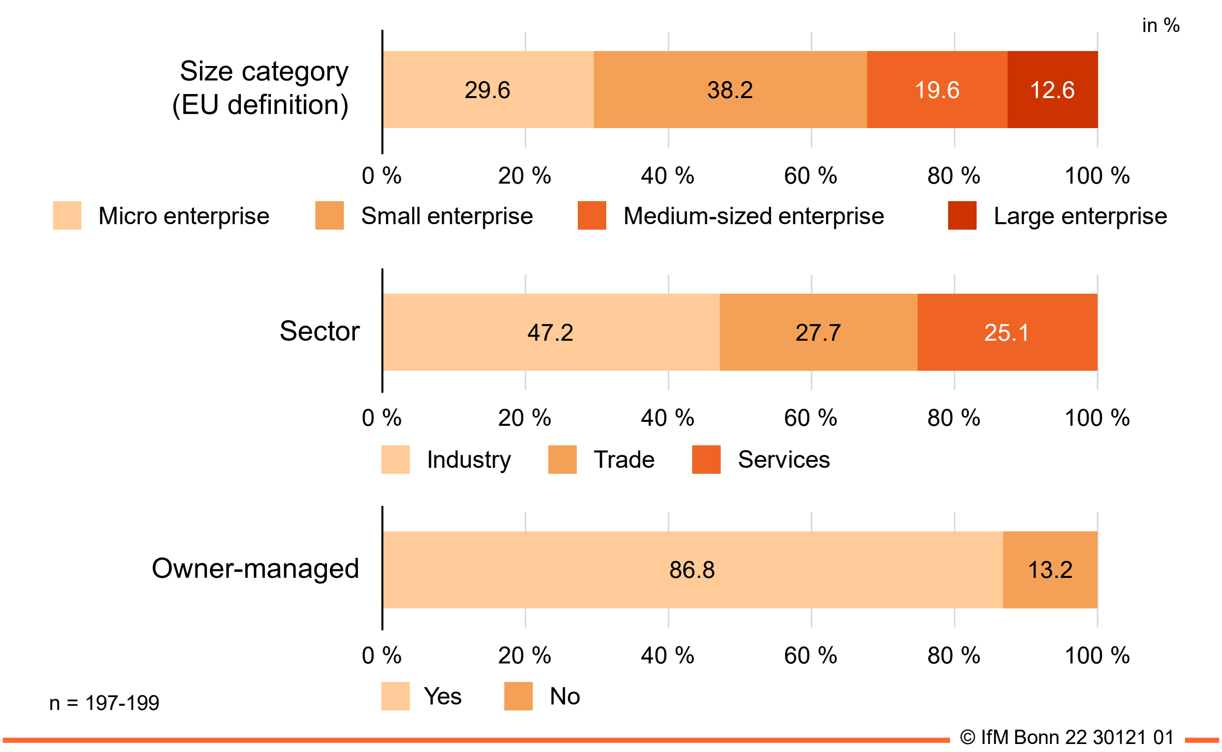
Concrete research questions can be derived regarding the effects of EU regulation, which are to be answered in the course of a company survey. The survey questionnaire addresses, among other things, the extent to which the companies have already dealt with the relevant regulation, which sustainability information is already being collected and the effort associated with the collection. It also includes the current extent of demand for sustainability information from different stakeholders of the company. Finally, assessments are requested on the companies' own investment in sustainability and whether the increasing sustainability regulation could impact access to credit.

In the run-up to the company survey, four qualitative interviews were conducted, each with an expert from the EU Commission, a management consultancy, a banking association, and the managing director of a company in the energy-intensive industry. These were based on semi-structured interview guidelines. The interviews helped to develop a deeper understanding of the topic and the relevance of individual aspects.

The data basis for the quantitative analysis is an online survey among the Chamber of Industry and Commerce Siegen members in June 2022. A total of 199 companies filled out the questionnaire completely. However, the number of observations may vary due to missing information for individual questions.

Following the survey, a two-hour focus group discussion was held with 20 participants. Among them were seven representatives of industrial companies in predominantly energy-intensive industries, seven representatives of local savings banks and Volksbanks, and a total of six further representatives of associations, a management consultancy, and from academia. The initial results of the survey were presented and discussed. The focus of the discussion was on the challenges faced by the companies and banks as well as possible political courses of action.

Figure 1: Sample composition



Source: IfM Bonn 2022.

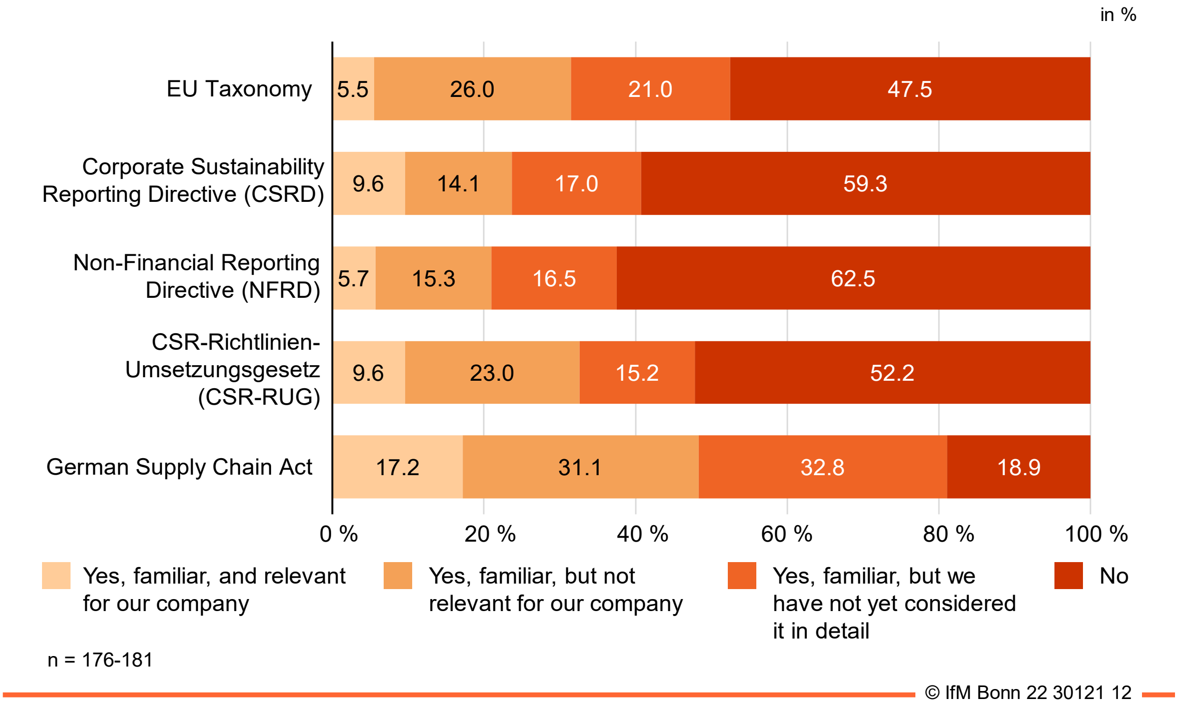
A look at the companies that took part in the survey makes it clear that almost nine out of ten are SMEs. Compared to the general size distribution of all companies in Germany, larger companies are overrepresented in the survey, while micro-enterprises are underrepresented. Almost half of the companies are active in the industry. About a quarter each are in the trade and the service sector. The share of participating industrial enterprises is thus higher than in the German business landscape. This is advantageous with regard to our research question, as industrial companies are generally more energy-intensive than companies from the trade or service sectors. Consequently, they are more affected by the sustainability transformation of the economy. A clear majority of the companies is owner-managed.

4.2 Results

4.2.1 Awareness

Only a minority of companies are familiar with the relevant regulations at the EU level (EU taxonomy, NFRD, CSRD) or their implementation in German law (CSR-RUG) (cf. Figure 2). Most companies are not (yet) aware of the EU regulation on sustainable financing or its possible consequences for their own company. In comparison, the German Supply Chain Act (Lieferkettengesetz) is much better known. The comparison to the EU regulation on sustainable financing is interesting because the Supply Chain Act is also a regulation that directly addresses only large companies, but indirectly affects SMEs through their position in larger companies' supply chains. The difference in the level of awareness is probably because most of the EU regulations are more recent, and the discussion about their design has mainly taken place at the European rather than national level.

Figure 2: Familiarity with legislation



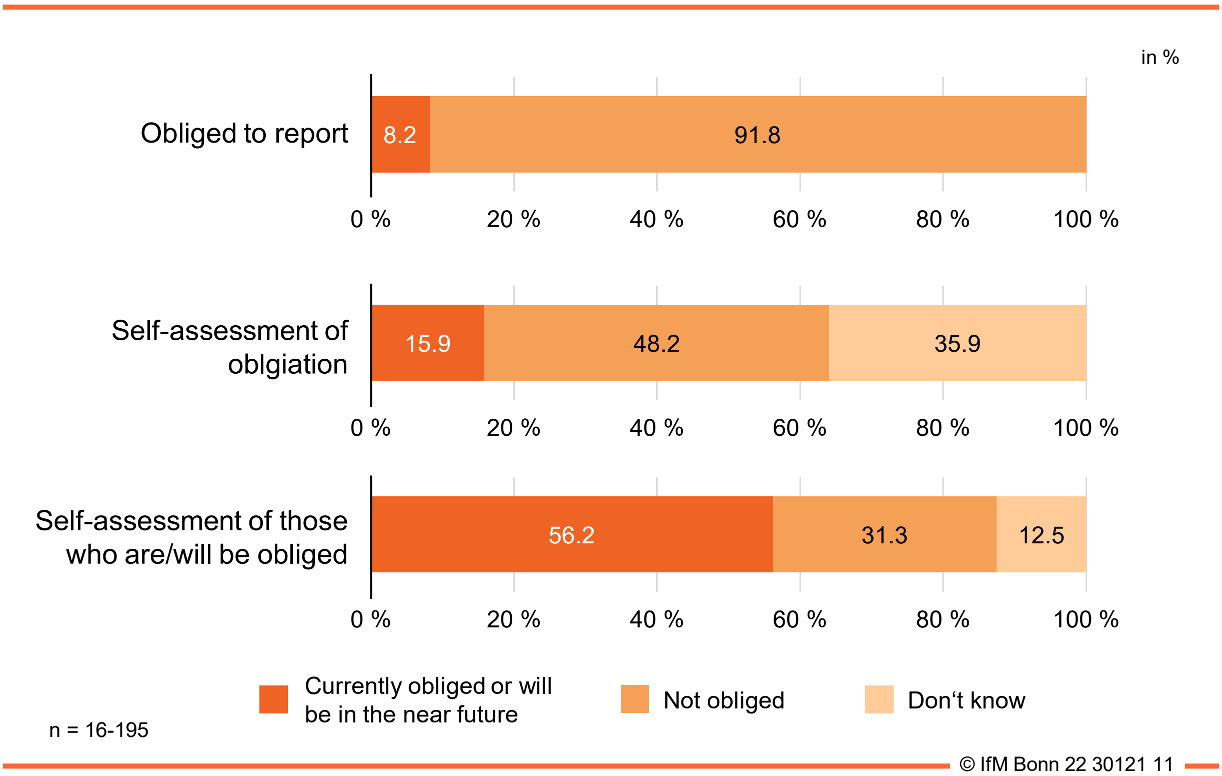
Source: IfM Bonn 2022.

4.2.2 Reporting requirements: Direct and Indirect Affectedness

Companies may be aware of their affectedness and reporting obligations without knowing the exact legal provisions. Based on the turnover and employment figures, we can determine how many companies will be required to do non-financial reporting after the upcoming expansion of the group of reporting companies by the CSRD. Among the survey participants, at least 16 companies (8%) are or will be obliged to do non-financial reporting under CSRD (cf. Figure 3). [2]

In addition to the lack of basic awareness of the topic, there is also a lack of clarity about who exactly is directly affected by the reporting obligation and who is not: twice as many companies stated that there is an obligation for them than is actually the case. On the other hand, more than four out of ten companies that are currently or will be obliged to report are not aware of this fact. In relation to all companies, more than one-third could not assess whether there is an obligation for non-financial reporting for their own company. This may be due, among other things, to the fact that the corresponding directive (CSRD) has not yet been finally adopted.

Figure 3: Reporting obligation

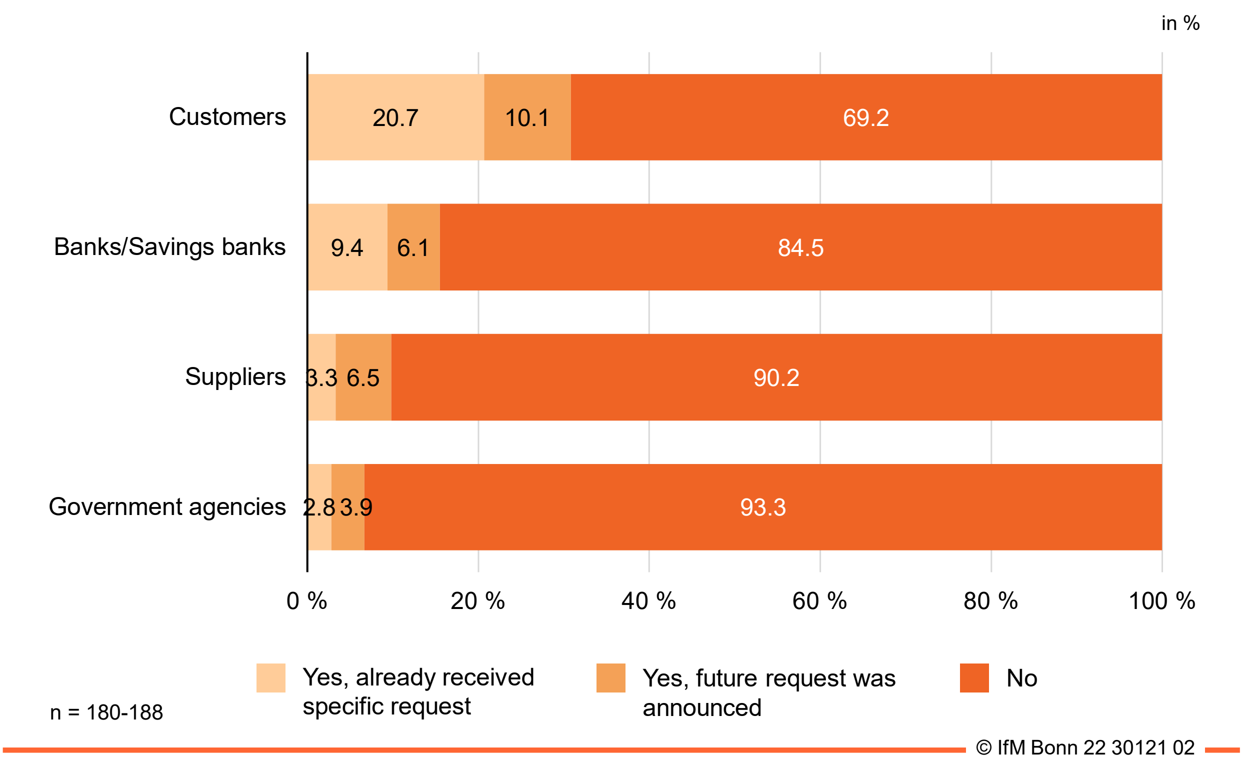


Source: IfM Bonn 2022.

2 Since the balance sheet total of the companies was not queried, only the turnover and employment criteria are used. This means that companies that meet the balance sheet and employment criteria, for example, are not taken into account. Since turnover and the number of employees correlate strongly with the balance sheet total, it is not to be assumed that the share of future reporting agents is significantly underestimated.

Although the first non-financial reports of the newly obligated companies are not due before 2026, the associated compliance effort is very high in some cases and much of the information required for this must already be collected in 2025, so that a certain familiarization period will be necessary. When asked about the biggest hurdles in implementing non-financial reporting, most companies named the collection of necessary information in the company (60.0%) and the procurement of information along the value chain (59.8%). Fewer companies see the hurdles of such reporting in the continuous change of the legal framework (44.7%) or the lack of know-how (39.7%).

Figure 4: Requests for sustainability information from external interested parties

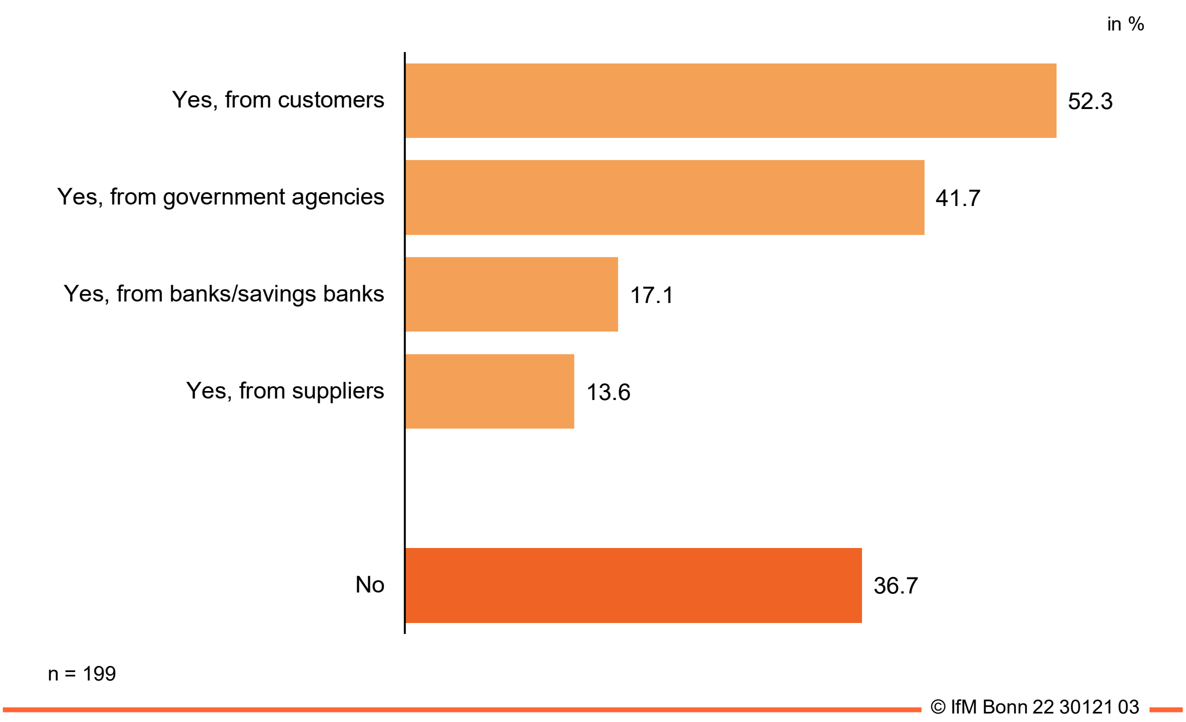


Source: IfM Bonn 2022.

As expected, most companies are not directly affected by the regulation but indirectly via the supply chain. The biggest driver of the indirect impact is the need for information from other companies. Around 85.2% of the companies surveyed stated they had large companies - and thus potentially reporting companies - among their customers and/or suppliers. One-third of them has already received requests or an announcement of future requests for sustainability information from customers (Figure 4). Especially in the industry sector, customers' current and future information needs are high, with 43.3% of companies reporting requests. This is because industrial companies' customers are often larger, and they demand greater transparency or information about the value-creation processes of their suppliers. In some sectors - such as the automotive industry - it is already common for smaller supplier companies to transmit a large amount of sustainability data to their customers. This does not have to be a direct consequence of the new EU regulations on sustainable financing, but of various other legislative measures such as the Supply Chain Act. There is thus a risk of parallel structures, i.e., that different stakeholders request similar information, but the requests differ in structure, format, or precision, so the administrative burden on the companies is significantly increased.

Looking ahead, the companies expect a clear dynamic with regard to enquiries from external parties: More than half expect an increased information demand from customers in the next two years (Figure 5).

Figure 5: Increased demand for sustainability information expected in the next two years



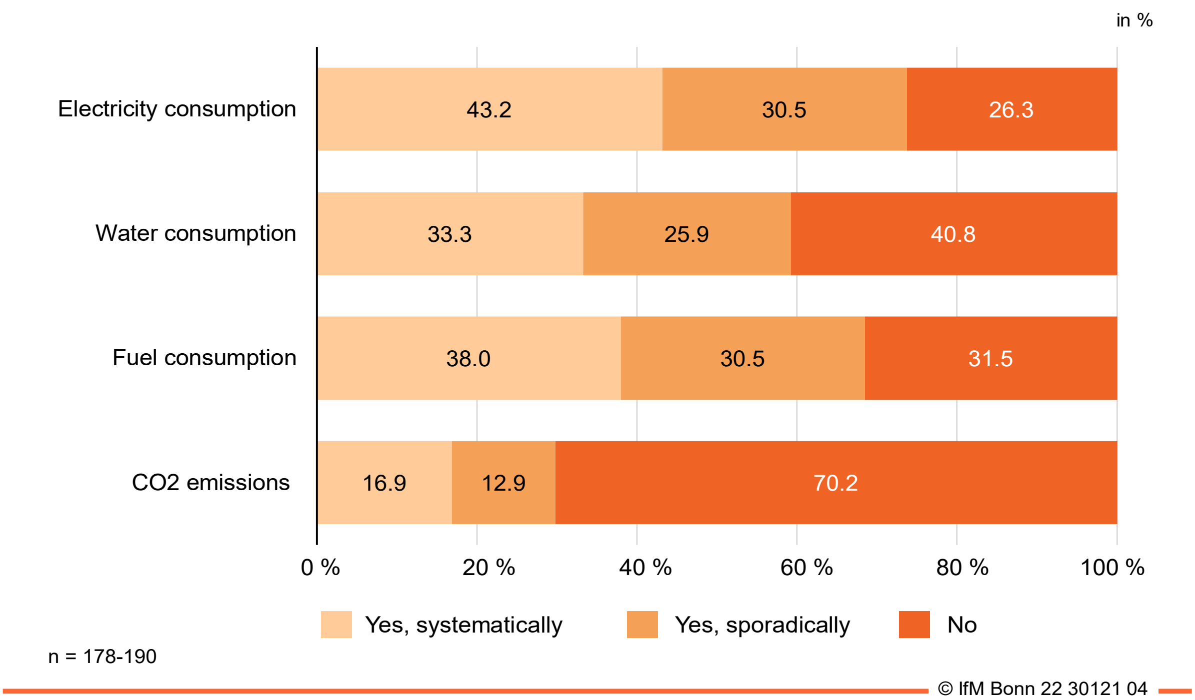
Source: IfM Bonn 2022.

So far, interest from banks and savings banks has been the lowest: Only 6.7 % of the companies surveyed reported that they had already received a request or the announcement of a future request for sustainability information from banks or savings banks. Only 17.1 % of the companies expect a corresponding interest from this side in the future. Therefore, the companies do not yet sufficiently associate banks and savings banks with a need for sustainability information. One reason for this is probably that the concrete ways in which banks and savings banks want to take sustainability risks into account in their lending are currently still being worked out. Therefore, the banks' information needs have so far played a minor role in customer contact with their SME customers.

4.2.3 Status of the collection of sustainability information

There are clear differences in the actual collection of sustainability information. Standard consumption data such as water, electricity, or fuel are collected much more frequently than emissions data such as CO_2 emissions. More than four out of ten companies stated that they systematically collect data on their electricity consumption (cf. Figure 6). In the industry sector, 54.6 % of the companies do so. Almost every third company collects this data at least sporadically. Overall, data on the consumption of water, electricity, and fuels are collected at least occasionally by more than half of the companies. In contrast, more than seven out of ten companies state that they do not measure their CO_2 emissions. 16.9% collect this data systematically, and just one out of eight (12.9%) does so sporadically. In the industry sector, CO_2 emissions are already measured systematically by one in five (21.3%) and at least sporadically by one in eight (12.5%).

Figure 6: Status of the collection of sustainability information



Source: IfM Bonn 2022.

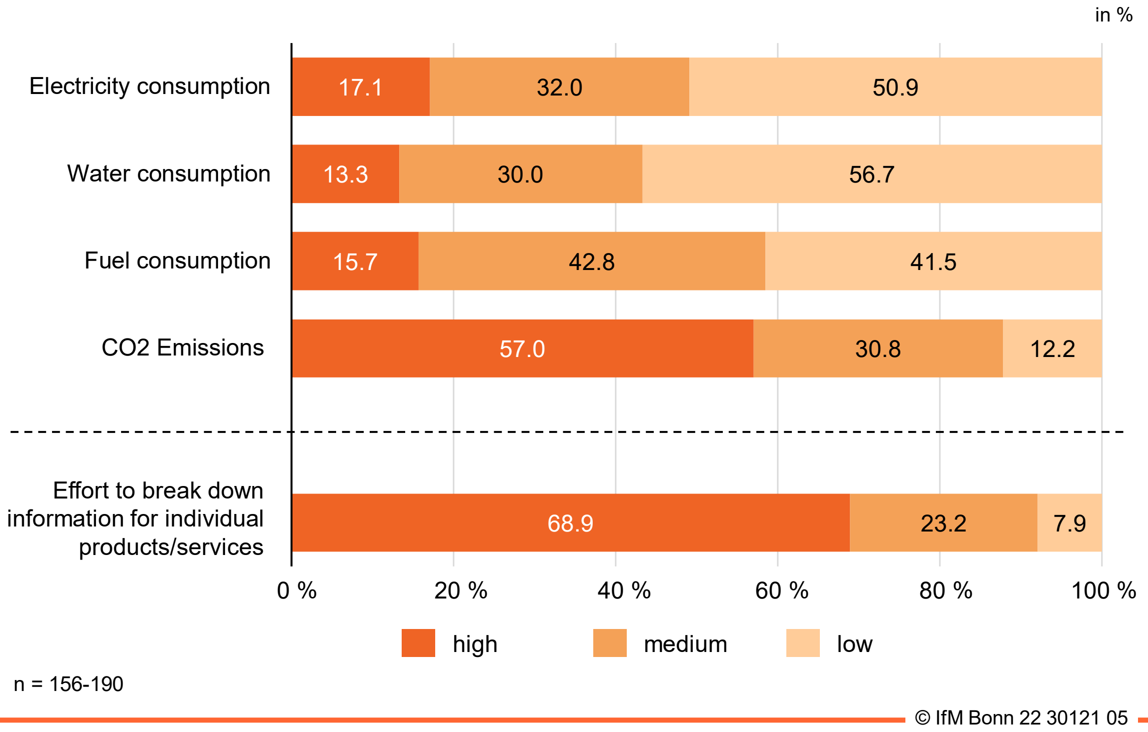
One reason for the different behaviour could lie in the effort required to collect emissions data. In addition, the strong contrast to the collection of consumption data may be obvious, as the latter represents operating costs, the management of which requires the collection of information. Savings have a direct positive effect - especially in industrial companies. CO_2 emissions, on the other hand, only cause direct operating costs for companies that are obliged to participate in emissions trading. Accordingly, for most companies, the systematic measurement of their climate "footprint" is still in its infancy.

It can be assumed that in the course of the enormous rise in energy prices, triggered by Russia's military invasion of Ukraine, the systematic recording and management of energy costs will become significantly more important. At the latest, when existing contracts with fixed prices expire, industrial companies will try to identify and exploit further savings potential.

4.2.4 Hurdles and benefits of collecting sustainability information

The estimated effort to collect various sustainability information varies strongly (cf. Figure 7). For example, only a minority of respondents consider the effort required to collect typical consumption data such as electricity, water, and fuel to be high. In contrast, a clear majority perceives the effort required to determine their own CO_2 emissions as high. This may be another reason why a systematic emissions measurement has so far only been carried out by a minority. The high assessment of the effort could also simply be a consequence of a lack of experience. For most companies, the so-called Scope 1 and Scope 2 emissions, i.e., the emissions that are produced directly in the company or indirectly through the purchase of electricity and heating/cooling, can be largely determined from the frequently collected consumption data such as electricity or fuel using suitable conversion factors.

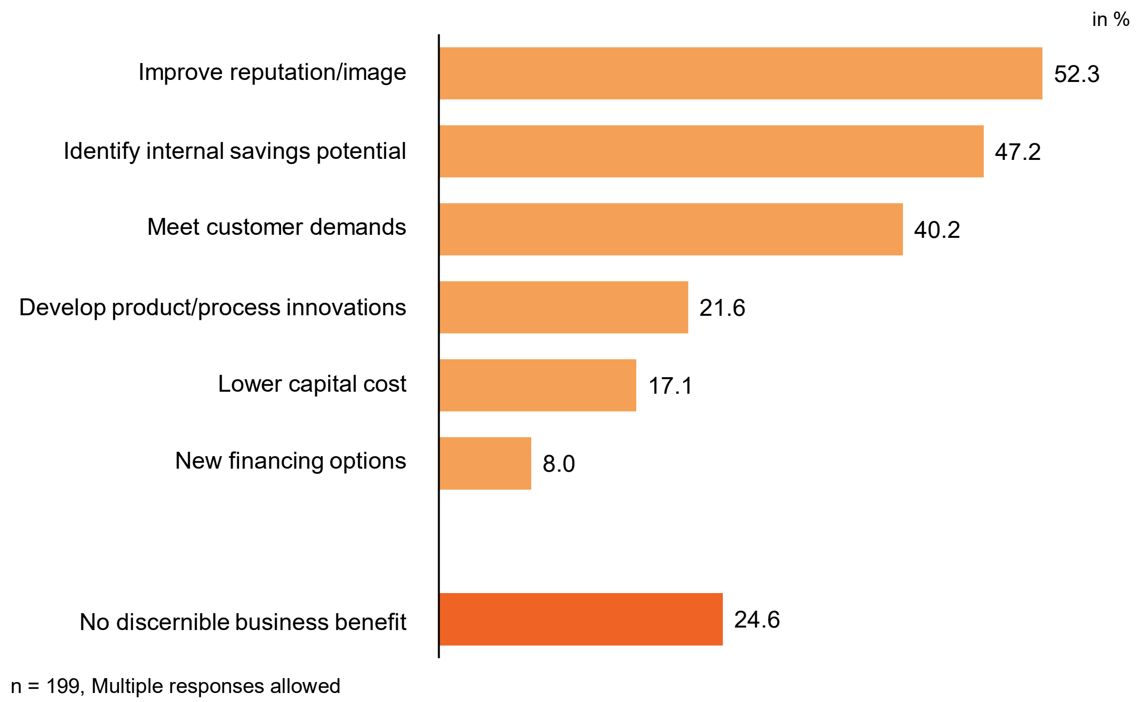
Figure 7: Effort required to collect sustainability information



Source: IfM Bonn 2022.

An important prerequisite for the disclosure of sustainability information to third parties, such as reporting customers, is the possibility to break down consumption and emission data for individual clients. This is because a customer is more interested in the sustainability balance of the purchased products and services than in the overall balance of the supplier. Banks also have to assess the taxonomy alignment of their loans, for example, according to how sustainable the corporate activities financed with them are. Only for general corporate loans does the overall sustainability of the company play a role. The effort required for this breakdown is considered high by a clear majority of the companies surveyed (68.9 %).

Figure 8: Business benefits of sustainability information



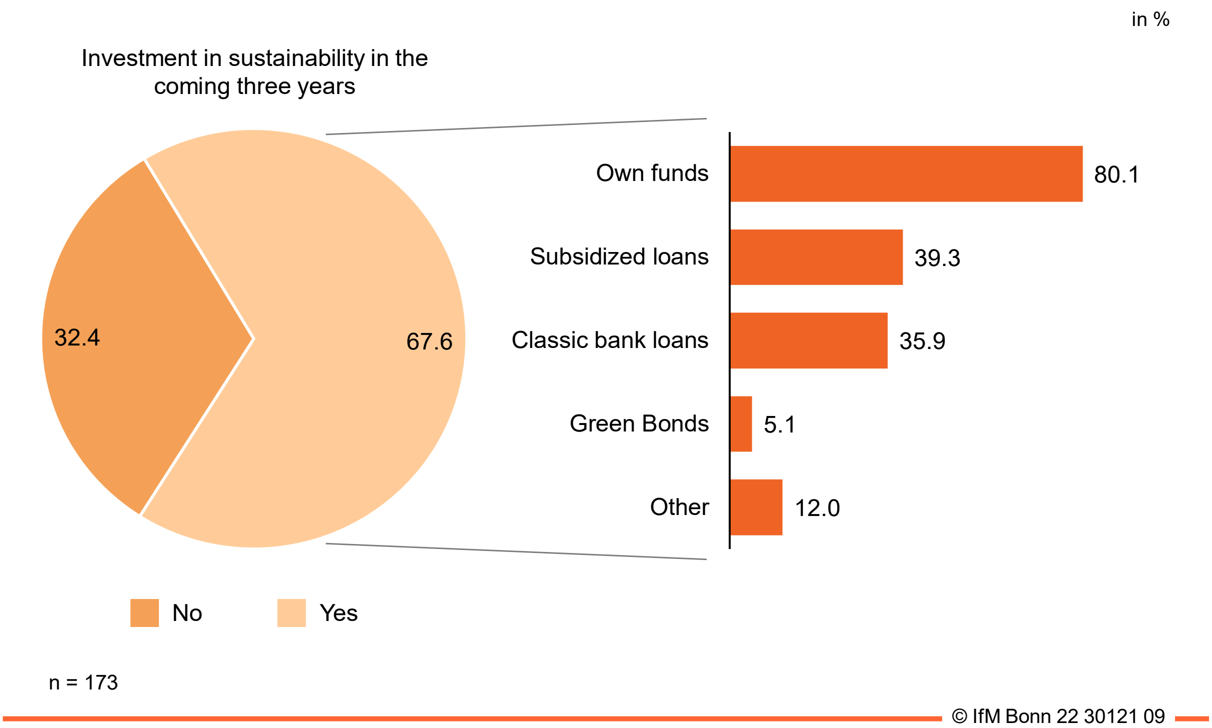
Source: IfM Bonn 2022.

However, the effort involved in collecting sustainability information is also offset by a potential business benefit - apart from the fulfilment of regulatory requirements. It is evident that a large proportion of the companies surveyed recognise this benefit (cf. Figure 8): More than half of the companies surveyed see a benefit in using this information to improve their reputation. Almost half see it as a way to identify internal savings potential. Four out of ten companies expect a better ability to satisfy customer wishes. However, only a small proportion of companies perceive the positive effects of corporate financing, such as the reduction of capital costs or the possibility of new financing options, as a possible benefit. Just under a quarter of the companies do not recognise any business benefits from collecting sustainability information.

4.2.5 Importance of the banking relationship for sustainable investment and the impact of regulation

More than two-thirds of the companies surveyed are planning to invest in more sustainability soon (cf. Figure 9). This shows that the companies are already in the middle of the desired sustainability transformation. After using their own funds, financing through subsidised or classic bank loans are the most frequently envisaged forms of financing. Overall, more than half of the companies plan to finance sustainable investments through loans. This underlines the high importance of banks and savings banks as financing partners for the sustainability transition of Mittelstand companies.

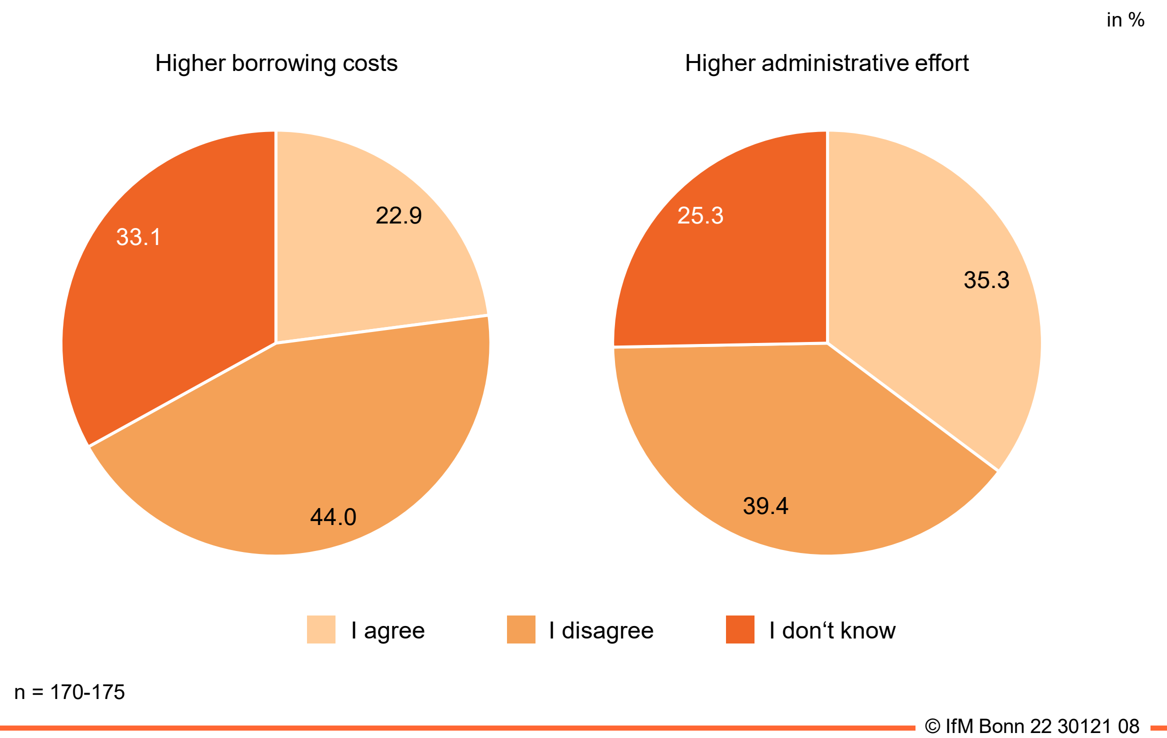
Figure 9: Investment in sustainability and its financing



Source: IfM Bonn 2022.

All this is reason enough to take a closer look at the likely impact of sustainability regulations on bank financing. Among those companies that dare to make an assessment, optimistic views predominate. Only a minority expects rising borrowing costs or administrative effort for receiving loans (cf. Figure 10). However, there is also great uncertainty among the companies in this regard: one-third and one-fourth of the companies are not sure about the effects of increasing sustainability regulations on the cost of credit and the administrative effort required to obtain credit.

Figure 10: Expected impact of sustainability regulations on bank financing

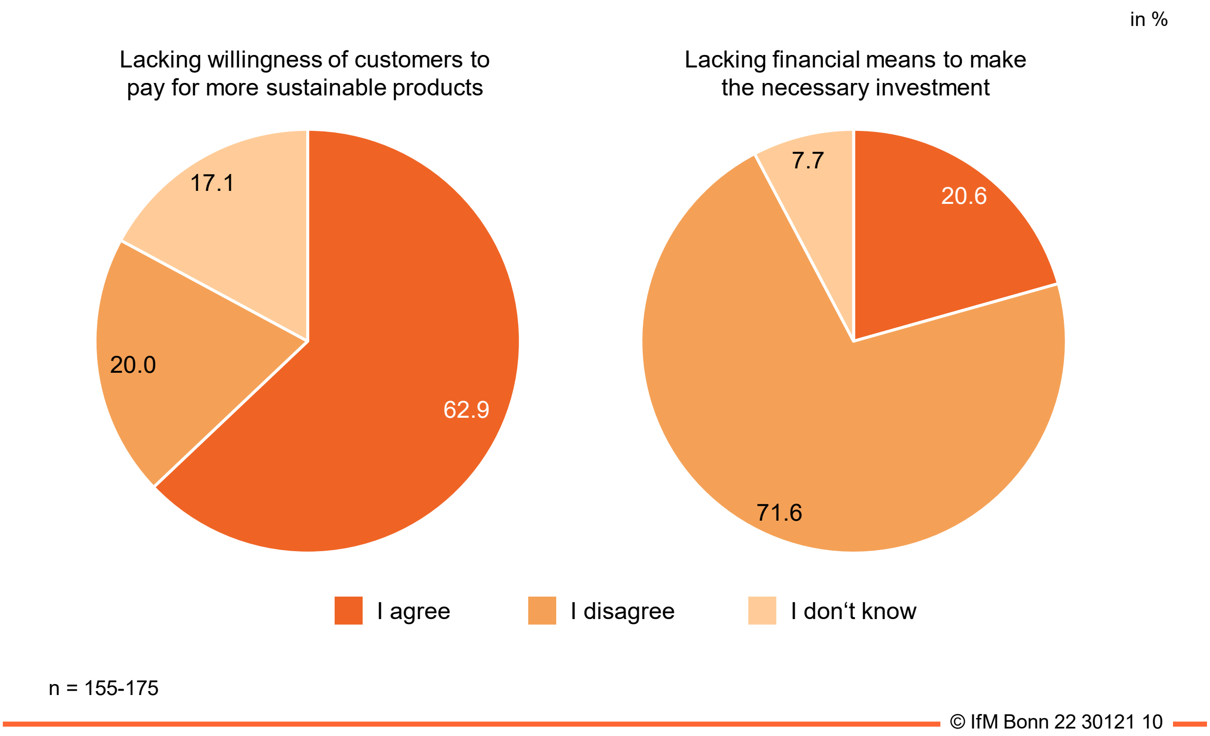


Source: IfM Bonn 2022.

In general, the surveyed companies seem to be optimistic about their ability to finance sustainable investments. Only one-fifth perceive a lack of financial resources as an obstacle to more sustainability (cf. Figure 11). Seven out of ten companies disagreed with the statement that a lack of financial resources prevents a more sustainable production by their company. It is to be expected, however, that this positive assessment will deteriorate in the future by the currently worsening business outlook and the rising interest rate level.

Currently, the companies assess the demand side as more problematic. Almost two-thirds of the companies surveyed believe that their customers do not have the willingness to pay for more sustainable products.

Figure 11: Barriers to more sustainable production



Source: IfM Bonn 2022.

5 Conclusion

The new EU regulations on sustainable financing affect the German Mittelstand in several ways: on the one hand, the number of companies that have to report will increase in the foreseeable future. On the other hand, many small and medium-sized enterprises will indirectly face the regulation's effects. Those companies that act as suppliers to large companies already have to provide their customers a great deal of information. At the same time, however, our results also show that only some companies are aware of the new reporting obligations and the increasing need for information and are making appropriate preparations. Since the additional collection and compliance effort can be very high overall, it is worthwhile to increase awareness of the new reporting obligations and information requirements early, among companies not subject to reporting requirements.

The multitude and complexity of information needed by an increasing number of stakeholders threaten to overwhelm SMEs. They often do not have the necessary resources to meet these demands. The EU is currently developing adapted reporting options for SMEs concerning non-financial reports. This is welcome, but only a first step. The aim must be to design these reports in a way that parallel structures are avoided: the simplified reports should be structured in such a way that they cover the information needs of large companies, banks and savings banks, and regional and national authorities. Otherwise, there is a risk of an increasing proliferation of formal and informal standards that could overwhelm smaller companies in particular.

This harmonisation is not only crucial for SMEs. The fundamental question arises as to the motive for including non-capital-market-oriented companies in the reporting obligation. Only a fraction of Mittelstand companies are active on the capital market. It is largely unclear what is the use of the information provided in their non-financial reports. In principle, the opportunity arises that the reporting standards will lead to a standardisation of already existing or foreseeable information needs of different stakeholders. However, this requires less of a reporting obligation for companies than an adaptation of the reporting standards to the existing information needs (and vice versa). Without such an adjustment, the effort of non-financial reports by companies without capital market orientation is not offset by much.

The new regulatory requirements also increasingly demand sustainability information for corporate lending. Here, too, the scope of the necessary information should be adapted to the possibilities of smaller companies. In addition, the current distortion in the calculation of GAR to the detriment of financial institutions with a high SME share among corporate customers should be removed to avoid unnecessary credit hurdles and possibly higher credit costs for SMEs. The initially intended relief for SMEs can be achieved by not including SME loans in the GAR calculation for a transitional period.

On the path to more sustainability, the diversity of SMEs and the differing starting positions of individual SMEs must be considered. For some companies, the green transformation is less challenging than for others, who must make greater investments and efforts. Incentives should be set so that companies invest in sustainability, even if this does not yet achieve full CO_2 neutrality. This includes encouraging or not hindering such efforts' credit financing. The EU Commission's considerations to expand the taxonomy to include a category of partial progress are, therefore, welcomed.

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