



## RISK MANAGEMENT IN SMES: STATUS QUO AND AREAS FOR FUTURE RESEARCH IN THE GERMAN LEASING INDUSTRY

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### ABSTRACT

**PURPOSE:** The purpose of the present research note is to give an overview of research in the field of risk management in leasing SMEs as well as to present fields for future research. It intends to encourage other researchers to fill the current gap in research on risk management in general and on risk management in (German leasing) SMEs in particular.

**DESIGN/METHOD:** The research note is based on interviews with 40 German leasing firms, thereof 35 SMEs. Qualitative research was chosen due to the nascent knowledge area and to explore cause-effect-relationships as well as to gain a deeper understanding of the practical requirements on risk management.

**RESULTS/FINDINGS:** A research framework was presented based on the findings of the literature review. Based on the interviews, the framework could be drilled down into more operative, leasing-specific topics. Amongst others, it could be found that the risk management organisation is greatly shaped by the underlying risk strategy, the motivation for risk management, as well as the essential risks. These three elements form the basis for the operative and strategic risk management practice. Furthermore, it was differentiated in the different lifecycle phases of risk management.

**ORIGINALITY/VALUE:** The presented research note is based on the first known research in the field of risk management for German leasing SMEs with a comparable number of interviews. Therefore, this research note includes a high degree of novelty. Adapting the findings in practice as well as combining it with other research questions might add significant value to risk management research as well as practice not only limited to the German leasing industry.

**KEYWORDS:** risk management, small and medium-sized enterprises (SMEs), leasing, financial services, Germany.

**JEL:** A12, D81, G32.

## 1. INTRODUCTION

While there is a broad consensus that small and medium-sized enterprises (SMEs) are highly significant for economic activity in general and the German leasing industry in particular, empirical research on them is nevertheless very scarce. As of 2018, nearly 3.5 million companies were defined as SMEs, which represents 99.6% of all German companies (IfM, 2018). These SMEs employed nearly 18 million employees, which represents 58% of all employees that are subject to social insurance contributions. Small and medium-sized enterprises are very important for Germany as a business location. This also applies in particular to the leasing industry, which is strongly anchored in and with SMEs. The large majority of the leasing companies are SMEs (BDL, 2021). As of October 2021, more than 300 leasing companies have the permission of the banking supervision Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) to offer finance leasing in Germany, thereof far more than 250 SMEs (BaFin, 2021; Bisnode, 2016). Therefore, SMEs can be seen as the backbone of the German leasing industry.

When comparing global studies on the process of risk management, the structure and process organisation of risk management, etc., numerous differences can be identified in the employee threshold as a distinguishing characteristic for SMEs. In the UK and EU, the threshold is typically less than 250 employees, while in the US, it is not uncommon for companies with up to 500 employees to still be considered SMEs (Dana, 2006, p. 3; e.g. Ibrahim, 2012; Matthews & Scott, 1995; Perry, 2001). In order to nevertheless make the different research results reasonably comparable with one another, the EU criterion for the size of SMEs is used throughout the following. The size threshold was also carefully examined for each study included.

After conducting a literature review and presenting the current state of knowledge for risk management in SMEs in general and risk management in the leasing industry in particular, the research note presents the respective findings. The general research question is:

*Which major requirements and limitations need to be considered for small and medium-sized (leasing) companies when it comes to risk management?*

Based on this, the aim is to structure the findings of research on risk management in SMEs and, using leasing companies as an example, to develop a framework that can be just as helpful in practical design as in the theoretical, academic examination of the topic. This framework will serve as the basis for further research recommendations before limitations of the research are presented.

## 2. RISK MANAGEMENT IN THE GERMAN LEASING INDUSTRY

The year 2009 marked a turning point for the German leasing industry, as it has been subject to banking supervision since then. Analogous to banks, finance leasing companies must now also comply with the so-called "Minimum Requirements for Risk Management" (MaRisk) and the "German Banking Act" (KWG). This compliance is audited at least annually as part of the annual financial statements. Here, the focus is particularly on governance, risk organisation and risk culture (Gontarek, 2016). The requirements must be implemented largely irrespective of the size of the institution, although certain provisions of the KWG, such as capital adequacy, are not relevant for leasing companies. Therefore, there is a high practical relevance and added research value to/from the risk management practices of leasing companies.

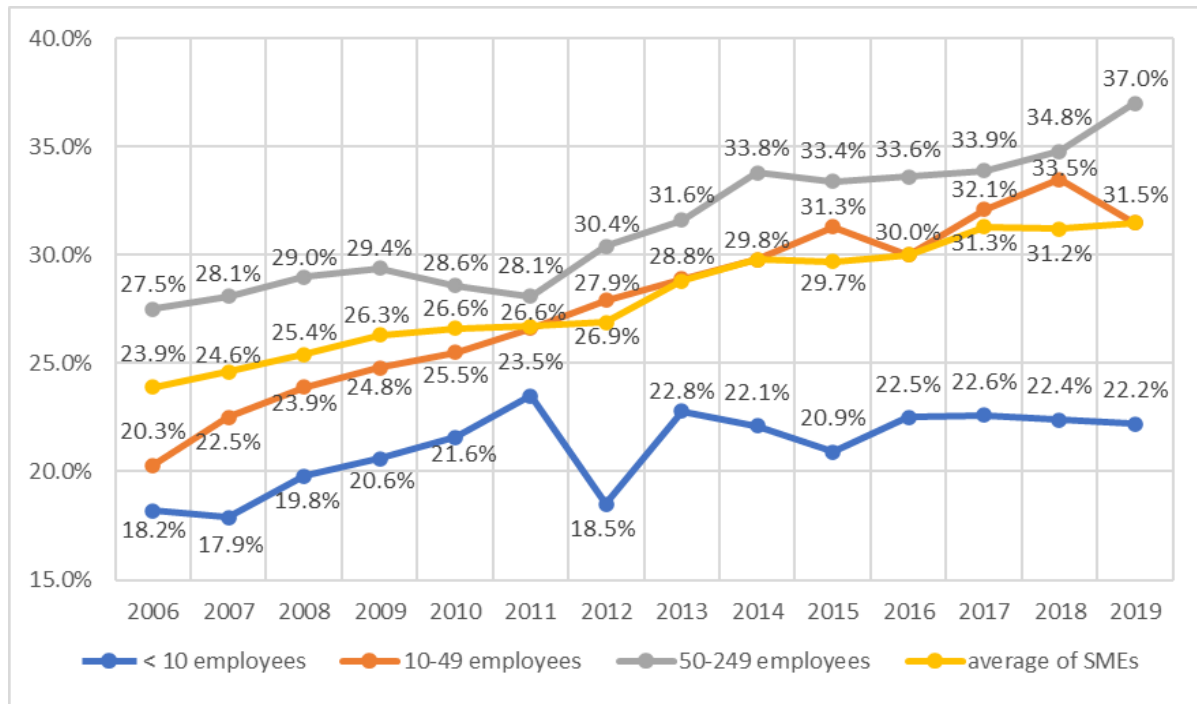
Relevant studies have shown that leasing is comparatively low-risk, especially compared to traditional lending (Deloitte, 2013; Pirotte & Vaessen, 2008; Schmit, 2004). For the years between 2005 and 2011, Deloitte analysed a total of 1.5 million leasing contracts from ten European leasing companies with only small and medium-sized customers. It found that default rates were very low. A similar statement is also

evident in the losses incurred (Deloitte, 2013; Grunert & Weber, 2005; Pfungsten, Kaposty, & Löderbusch, 2016). A frequent explanation for this low risk is found in the high level of object knowledge and the strong focus on a narrow market niche (BDL, 2015; Deloitte, 2013). In particular, leases that have already been in place for a long time have little residual risk or, in some circumstances, even excess cover, so that market prices can quickly exceed the outstanding installments (De Laurentis & Riani, 2005; Hartmann-Wendels & Elbracht, 2010; Pfungsten, Kaposty, & Löderbusch, 2016; Pirotte & Vaessen, 2008; Schmit, 2004).

Especially since the regulation, a consolidation process of leasing companies can be observed. From 2010 until 2014 about 25% of all German finance leasing companies were mainly acquired by larger existing companies (Städtler, 2014). Due to high entry barriers mainly related to regulation, there are de facto no foundations of new leasing companies any more (BDL, 2021). In Germany, leasing is the most important source of external financing. More than 50% of the externally financed investments in 2019 were financed via leasing (BDL, 2020a). The newly concluded leasing contracts in 2020 amounted to more than 70 billion EUR (BDL, 2020b).

The latest regulatory initiatives in the banking and leasing environment and an increasing number of risk management literature mark the rise of enterprise risk management (ERM) or at least some elements of ERM in the financial services industry in general and the leasing industry in particular (Whitman, 2015). However, only little is known about the status quo of risk management in German leasing SMEs. Questions on the organisational role, employed approaches to risk management and their limitations, or the connection of risk management and strategic planning in leasing firms are mainly unanswered. Advocates of an integrated approach see enterprise risk management as an “integral part” of – sound business management and emphasise its strategic potential (Butterworth, 2001; Carey & Turnbull, 2001). The importance of strategic planning can also be seen in the fact that the main reasons for bankruptcies of companies are inadequate management skills and decision-making as well as inadequate strategic planning (Almus, 2004; Brouthers, Andriessen, & Nicolaes, 1998; Euler Hermes, 2006; Günterberg & Kayser, 2004; Henschel & Durst, 2016). Although ERM has captured growing academic interest (e.g. Brustbauer, 2016; Hoyt & Liebenberg, 2010; Kaplan & Mikes, 2012; Nocco & Stulz, 2006), it remains quite elusive with a broad focus. Mikes & Kaplan (2014, p. 3) are even convinced that “risk management approaches are largely unproven and still emerging”. Alquier & Tignol (2006, p. 277) and Hoitsch, Winter & Baumann (2006, p. 69) explain this nascent state of research by pointing out that risk management is a comparatively young discipline of business management theory where no standards have been developed yet (Henschel & Durst, 2016; Marcelino-Sádaba, Pérez-Ezcurdia, Echeverría Lazcano, & Villanueva, 2014; Verbano & Venturini, 2013). This can also be seen in Falkner & Hiebl’s (2015) study who reviewed 27 papers on risk management in SMEs. The literature reviews of Ferreira de Araújo Lima, Crema, & Verbano (2019), as well as Crovini, Ossola, & Britzelmaier (2020) draw a similar picture of the state of risk management in SMEs.

It can be seen that SMEs neglect risk identification, risk assessment, and/or risk monitoring as they suffer from resource scarcity (Brustbauer, 2016). Moreover, the risk management process is not integrated into a (strategic) management control system (Britzelmaier, Häberle, & Landwehr, 2015) which indicates that ERM is probably not the main focus of most SMEs. However, the reasons why the risk management systems of most SMEs is not as mature as of larger firms are not (yet) identified in academic studies. The focus of research on risk management is mainly on large companies and neglects small and medium-sized enterprises (Alquier & Tignol, 2006; Blackburn & Kovalainen, 2009; Gao, Zhang, & Sung, 2013; Henschel & Durst, 2016; Herbane, 2010; Hessels & Parker, 2013; Verbano & Venturini, 2013). Due to the higher vulnerability of small companies, it is existentially important for them to be able to manage their risks properly. The following Figure 1 shows that the smaller an SME, the lower its equity ratio is. However, with a lower equity ratio also the vulnerability changes, and therefore the importance of risk management increases (Trautvetter, 2011).

**Figure 1.** Average equity ratios for SMEs with less than 10 employees up to more than 50 employees (2006-2019)

Source: Statista (2020).

### 3. THEORETICAL BACKGROUND

A review of academic literature and relevant studies on the practical design of risk management in SME leasing firms highlighted the very limited state of research in this topic area. Compared to earlier research by the author (Glaser, 2019), the situation is thus largely unchanged. Both national and international contributions and research on the lived risk management of small and medium-sized enterprises are extremely sparse – both in the German (Arnsfeld, Berkau, & Frey, 2007; Gleißner, Lienhard, & Stroeder, 2004; Henschel, 2010; Kirchner, 2002) and in the global environment (Virdi, 2005). Specifically, there is no comprehensive research on which methods and processes are used, which fundamental considerations take place on approaches and the linking of strategic planning and/ or risk management. This situation is commonly explained by the fact that the function of risk management as a sub-field of business management is still relatively new (e.g. Alquier & Tignol, 2006, p. 277; Hoitsch, Winter, & Baumann, 2006, p. 69).

In the further course, a holistic, integrated risk management approach is pursued. The prevailing view is that such enterprise-wide risk management is closely interwoven with management behaviour, performance measurement approaches such as the balanced scorecard, and strategic planning. Since there is neither a uniform understanding of what exactly is subsumed under holistic risk management, nor any relevant standards or one overarching theory, the figure is derived from important contributions on the topic (e.g. Hardy, 2010; Henschel, 2007, p. 23; Smallman, 1996, p. 15; Spikin, 2013, p. 101) based on empirical research both nationally and internationally. The presented close connection of the important management subsystems that are regularly discussed in the context of risk management will support in answering the research question and achieving the research objectives of the present study.

Furthermore, the literature review indicated that the mindset and attitude of the acting persons is elementary for the behaviour and the willingness to take risks. The lack of advanced theoretical knowledge and lack of expertise of strategic planning tools show further starting points for improvement.

Figure 2 summarises a research framework that was developed based on the literature review presented. It shows very clearly that the trio of management behaviour, strategic planning and performance measurement form the basis of integrated risk management. This in turn depends very strongly on the organisational structure and process organisation as well as on individual motivation.

The framework presented served as the basis for a data analysis based on it, which is dedicated to an integrated approach to risk management for medium-sized leasing companies and was developed by the author in an earlier research (Glaser, 2019).

Even to this day (10/2021), there are very few studies and research contributions on risk management in the German (e.g. Hartmann-Wendels & Elbracht, 2010; Hartmann-Wendels, Miller, & Töws, 2014) or the global (e.g. De Laurentis & Riani, 2005; Deloitte, 2013; Gholamreza Farsad, 2016; Gholamreza Farsad & Jorah Binti, 2016; Pirotte & Vaessen, 2008; Schmit, 2004; Tot, 2017; Vasiliauskaitė & Cvilikas, 2008) context with a focus on leasing companies. In particular, no study is known that focuses on a risk management approach with a focus on leasing SMEs – no matter if in a German or international context. Therefore, the primary objective of this research report is to fill this gap.

**Figure 2.** Research framework on the basis of a recent literature review



Source: Own illustration based on Glaser (2019).

## 4. RESEARCH METHODOLOGY AND FINDINGS

The overall aim of this research note is to develop an understanding of the risk management process in German small and medium-sized leasing companies. The research objectives were to evaluate the risk management process and incorporated the following:

1. Critically examine existing risk management methods and procedures used by small and medium-sized German leasing firms in terms of strengths and weaknesses, as well as improvement potentials.
2. Determine to what extent risk management is connected with strategic planning and how this connection might be improved.
3. Develop a framework of enterprise-wide risk management appropriate to the German small and medium-sized leasing sector especially considering SME's limited resources.

Based on the findings of the literature review in the preceding section and the researchers' prior knowledge, the following expectations were subject to falsification according to Popper (2002):

1. Due to limited resources, German leasing SMEs focus on only a few (less than three) and simple risk management models.
2. German leasing SMEs mainly focus on default and market price risks.
3. Operational risks and liquidity risks are often neglected by German leasing SMEs.
4. Historic data are omnipresent in the risk management of German leasing SMEs.
5. German leasing SMEs use highly manual tools, dynamic systems are only seldom used by German leasing SMEs.
6. Risk management is performed rather isolated with very limited resources; there is mainly no enterprise-wide organisation.
7. Risk management and strategic planning of German leasing SMEs are not connected closely.

According to Popper, hypotheses or expectations do not have to involve numbers but they need to be as precisely stated as possible. The more falsifiable, and not the more verifiable they are, the stronger is the theory and this is what distinguishes science from pseudoscience in his opinion (Popper, 2002).

It is typical of studies in nascent research areas that the focus is on identifying patterns and understanding specific relationships. This was also the case in the present research. Based on 40 interviews with 35 SMEs and 5 large firms from the German leasing industry, the presented framework was drilled down even more to practical SME particularities to enable a leaner practical implementation (Glaser, 2019). The number of interviews was based on saturation concerning the research findings. To ensure plausibility and feasibility of the research findings, a validation of the results was conducted in four additional interviews, thereof three risk managers of German leasing SMEs and one division leader of the German leasing association.

The findings confirmed the major assumptions of the presented framework and helped to drill it down into more operative, leasing-specific topics. Amongst others, it could be found that the risk management organisation is greatly shaped by the underlying risk strategy, the motivation for risk management, as well as the essential risks. These three elements form the basis for the operative and strategic risk management practice. They are strongly influenced by the (owner-)manager(s). Whereas "management behaviour" summarises the basic risk management and tasks, it can be seen that smaller firms tend to have a more informal approach in place than larger firms, although this might change due to external crises as well as more regulative requirements. One representative of a small firm therefore stated (Glaser, 2019):

"While we were able to handle things on an informal basis in the past, we are now forced more often to get processes described and created in a more formal way".



Especially status-quo reporting and the connection of development and budgeting seem to be highly under-developed in many small leasing firms. This might be explained due to the company size and lack of resources, as well as the (allegedly) limited benefit. Furthermore, small firms focus more on single exposures than on portfolio-wide actions:

“We are still very strongly involved on a single exposure and less on a portfolio level. [...] This situation is also driven by our vendor partners and our focus on specific industries and assets”.

“We cannot adequately implement global, economic scenarios in the stress tests due to our limited IT as well as HR capacities”.

On the other hand, flat hierarchies seem not to need ultimately highly formal planning and reporting as due to informal communication, the core information is addressed to the managers anyways:

“Due to our flat hierarchies, of course, the proportion of informal data and processes is higher than in larger firms”.

Furthermore, it was differentiated in the different lifecycle phases of risk management. Nevertheless, there is still further research needed to strengthen the robustness of the drawn conclusions as well as to adapt it to the ever-changing environment.

Therefore, the researchers have conducted a questionnaire aiming to answer the research question: “How can small and medium-sized leasing firms operate in a more effective approach to risk management?”. The underlying research goals are:

1. Validating and trying to falsify the presented framework on risk management of German leasing SMEs of Glaser (2019) and identifying potential difficulties in practical use.
2. Identifying the reasons why certain elements are not applicable for practical use.
3. Identifying limitations of meaningfulness and possible transfer or validation in other industries/regions.

The results of this survey are currently in the analysis stage and will be published shortly.

## 5. CONCLUSIONS

Although it is widely recognised that SMEs form the backbone of many industries, they are still under research. Little has changed in this regard in recent years. However, this needs to change, for several reasons. A resilient economy needs well-positioned and crisis-resistant SMEs. Crises and hazardous situations are becoming more frequent; one needs only to think of the Covid pandemic, cyber risks, or even the latent euro debt crisis. This list could be continued endlessly. Well-functioning risk management is a key competitive factor, often even more important than the sales function, because even the best sales department cannot prevent a company from going bust, if it has the wrong risk policy/strategy. However, sales and risk management – i.e. opportunity and risk – go best hand in hand in strategic corporate management.

In order to sustainably advance academic research in the field of risk management in general and risk management of/for SMEs in particular, it is essential that different research questions, frameworks and models are put up for discussion. Only through a continuous critical discourse and the attempt to falsify these approaches can they be continuously improved in an iterative process in the sense of Karl Popper. This is also the intention of this note, which on the one hand has presented the state of research of risk management for German leasing SMEs and on the other hand has presented a general framework summarising the current state of research as well as suggesting fields for future research activities. The two authors of this research note are currently conducting questionnaire-based research in which the findings of the framework will be critically reviewed and questioned from further perspectives. This should shed more light on the research on risk management in SMEs.

## 6. LIMITATIONS AND RECOMMENDATIONS FOR FURTHER RESEARCH

The research was conducted mainly in the pre-covid-years as well as exclusively in the German leasing industry. Therefore, the results cannot simply be transferred to companies of other industries, sizes or countries.

### *Generalisability of results to larger firms and/or firms in other industries and countries*

The present research is limited due to the choice of sample. Although five leasing institutions were interviewed, a larger sample might lead to more robust conclusions. It would also be interesting to see to what extent cultural differences play a role. A comparison with leasing SMEs from countries could yield interesting results, as could a cross-industry comparison.

### *Proof of concept for risk management*

In particular, demonstrating the benefits or usefulness of the risk management approach is always a major challenge. Despite a wide variety of opportunity cost calculations, it is difficult to almost impossible to quantify the exact contribution to results of an integrated risk management approach. Therefore, a longitudinal study with comparable samples could add great value in answering these very questions.

### *Objectifiability of recipes for success*

A fundamental question is certainly also the extent to which SMEs can be compared with large companies and, subsequently, their requirements for enterprise-wide risk management. This also includes the question raised at the outset as to why SMEs often do not have so advanced and more mature risk management system as large companies. After all, on the other hand, small and medium-sized companies that have been active for years (or even decades) do not seem to be doing everything wrong, even though they have not implemented a comprehensive risk management system. Rather, flexibility and resilience may also be important factors.

### *Flexibility and quick decisions vs. rigid structures*

A very key difference between small and large companies is often the decisiveness of individuals and thus speed in actions. Of course, this can be a double-edged sword: on the one hand, many owner-managed, small companies often do not have a second management level and thus no further validation, but on the other hand – assuming the right decision is made, of course – this ensures a significant acceleration in the company's day-to-day operations. Especially in crisis situations, on the other hand, it is particularly important to react quickly and authoritatively with clear responsibilities. All of this seems to be a major advantage for many SMEs.

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