The German *Mittelstand* – an Overview

Introduction

As an essential driver of innovation, competition and economic dynamism, small and medium-sized enterprises (SME) are considered to play an essential role in creating jobs and income. The German *Mittelstand* is often depicted as one of the success models for SMEs realizing their role as drivers for economic development. In order to gain more insight into the phenomenon of the German SME sector and possibly to learn from this particular experience, this paper provides a brief overview of the German *Mittelstand* landscape by looking at its main characteristics, its relevance for the national economy and the system of SME promotion in Germany.

Definition: “What is the German *Mittelstand*”?

Although the term “SME” is widely used in economic analysis worldwide, there is no common definition. Even within Germany institutions did not agree on a common grid. In quantitative terms, the definition by the European Union (EU, Figure 1) and that by the *Institut für Mittelstandsforsschung* (IfM, Figure 2) are mainly referred to.

![Figure 1: EU quantitative Definition of Mittelstand](image1)

![Figure 2: IfM quantitative Definition of Mittelstand](image2)

However, the German *Mittelstand* is also characterized by qualitative dimensions which are strongly influenced by German history and will be explained hereafter:

The German *Mittelstand* and its meaning in the German Economy and Society

The roots of the German *Mittelstand* go back to the social order of the middle age when family held mid-sized enterprises, often simultaneously corresponding to a certain class (*Stände*), were assigned to certain responsibilities. In this sense a definition of a German *Mittelstand* company cannot be restricted to the value of its assets or the amount of its turnover.

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1. *Mittelstand* is used in Germany synonymously as the term SME.
2. The defining criteria are differing, however, “number of employees” or “annual turnover” “are frequently used in European and North American definitions. In India, for instance, the investment capacity in plant and machinery (manufacturing sector) or equipments (service sector) are the defining parameters for SMEs.
The *Mittelstand* is characterized by certain convictions and attitudes in the context of socio-economic processes: The ownership structure of German SMEs is usually private and in many cases family-owned.\(^3\) As a result, there is a strong link between the enterprise’s owner and its management, going along with certain forms of organizational and financing behavior, of leadership and entrepreneurial attitudes, i.e. flexible decision-making, long-term investment planning or loyalty with employees.

Some characteristics of the German *Mittelstand* adding value to the German economy are:

- **High degree of specialization:** German SMEs often produce specific products, product components, services either for larger companies or for niche markets, and also often customized products in close interaction with the customer. That’s why they are assumed to have a large aptitude for innovation and often they are definitely highly innovative.\(^4\) The high specialization of the German *Mittelstand* also contributes to its strong export performance.

- **Flexibility:** As management and ownership of the company in many cases lie with one single person or a small group of people, decision-making is easier and companies are able to react quickly to changes.

- **Long term orientation and responsible organizational culture:** Family ownership and management help to build long-term relationships with stakeholders, especially with employees: more than i.e. global players SMEs feel responsible for their work staff and in times of recession they rather try to hold on to them as long as possible.\(^5\)

- **Long-term vocational training:** Especially in the German craft sector (*Handwerk*) the quality is maintained by the *Meister* (kind of foreman), who has gone through an extensive, multi-year vocational training, which entitles the person to run a *Handwerk* firm by him/herself. This symbol of quality strongly contributes to the good reputation of the German craft sector worldwide.\(^6\)

- **Decentralized presence:** A majority of *Mittelstand* companies have their head offices and/or production sites in rather rural areas—usually due to their family ownership—thereby creating job opportunities. That’s why larger SMEs often have become the most important source of jobs for an entire region.

Today, the German SME sector still has an excellent reputation as being creative, quality-conscious and technology-oriented. However, critics describe the German SME also as being characterized by paternalistic, conservative management structures, with a low market- and demand orientation. Given the mentioned strong interaction with the customer this must be read as SME being risk-averse and also weak in tapping new markets - especially in comparison with North American or Japanese SME. This could be the other side of the coin of a long-term family-owned structure and reflects some concern about sufficient innovation capacities of SME for today’s challenges. Some critics even neglect the always asserted role of SME as a job motor since the definitely increased number of newly created jobs by SME (minus the lost ones) could not be empirically proven.\(^7\)

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\(^3\) For a more detailed description see BMWi (2007): pp. 9-11.

\(^4\) However, many companies have very little own R&D capacity. That’s why many public promotion programs particularly aim at supporting applied research and innovation development in *Mittelstand* companies.


\(^6\) Large companies on the other hand see the number of employees rather as a strategic parameter, which is reduced and increased in accordance with economic cycles.

\(^7\) Richter, M (2008):: p.1
Nevertheless, the *Mittelstand* is still regarded the backbone of the German economy:

### The German *Mittelstand* in Numbers

<table>
<thead>
<tr>
<th>Category</th>
<th>SME (%)</th>
<th>Other Businesses (%)</th>
<th>Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Businesses*</td>
<td>99.27%</td>
<td>0.73%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Employees*</td>
<td>58.26%</td>
<td>41.74%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Gross Added Value*</td>
<td>33.64%</td>
<td>66.36%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Apprentices**</td>
<td>82.94%</td>
<td>17.06%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

*Numbers based on SME Definition by the EU, 2007
**Numbers based on SME Definition by IfM, 2009

*Figure 3: The macro-economic significance of the German *Mittelstand**

The overall turnover of SMEs may be not as high as the one of large companies but is still essentially higher than in other OECD countries. A look at the number of employees reveals the relevance of the *Mittelstand* for jobs and income. In addition, it supports a large part of vocational education where SMEs work closely together with public schools to assure a high quality apprenticeship - another welfare effect of the *Mittelstand*.

### The German SME Promotion System

*The policy level* After World War II and especially after the 1960s SME promotion in Germany received rising consideration forced by the significant structural changes large-scale traditional industries were undergoing that were leading to considerable job losses. Since Germany is a social market economy there is a widespread agreement that the government can play an active role in the economy. Accordingly, an explicit *Mittelstand* policy was introduced in 1970 in order to create adequate framework conditions for SME: to alleviate market failures and to compensate the disadvantages given by their small size. Today, this policy is guided by the Small Business Act of the EU ("think small first"), transforming its recommendations in accordant regulations. As a result, today SMEs in Germany are considered to face stable political and regulatory framework conditions and a comparatively limited anti SME bias. They barely encounter systemic obstacles in terms of access to credit, time a business has to spend to deal with government regulations, legal means of conflict resolution or enforcement of property rights.

*The institutional landscape:* Germany is characterized by a highly differentiated system of SME promotion including public and private actors at European, federal (*Bund*), state (*Laender*) and local level. At all these levels SME promotion programs are launched and also implemented.

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That’s why programs initiated by the Bund are often carried out also by institutions at Laender level. Some 1000 organizations are somehow involved in economic promotion programs. The implementing structure is quite elaborated and well organized. Critical voices say, however, that the promotion system in Germany is pretty intransparent, existing programs are insufficiently coordinated, a systematic cost-benefit analysis does not exist and it can be assumed that their administrative costs often prevail their benefit.

Some of the most important implementing bodies are described hereafter. Most of them can be found at European, Bund, Laender and/or local level.

**Banks**
Banks are providing financial SME promotion instruments, i.e. loan guarantees, sharing financing start-ups or certain innovative investments. Main objectives are to strengthen the capital structure of SMEs, to improve the equity situation with the help of venture capital and to facilitate the consumption of consulting services, especially at the beginning of their existence. The federal KfW Banking Group implements the federal promotion instruments of the Bund; the banks of the Laender (Landesbanken) implement the instruments of the Bund and the Laender accordingly.

**Business Associations and Chambers**
Besides advocating the interests of their members (Mittelstand) and the provision of business services like legal support or advisory for investments they often run so-called Starter Centers or business incubators that support the development of early-stage enterprises. Usually, they do not offer own funding instruments rather than consultancy services as to how to apply for and make use of the existing ones. To this end, they cooperate with credit institutions, development banks, job centers, tax consultants and communities, acting as a sort of one-stop-shop for SMEs.

**Economic promotion agencies (regional or municipal level) and project organizations**
These agencies are located at local or regional level and have a particular interest in the economic development of their region. They are mandated to implement public promotion programs and release public structures in doing so. In many cases they show a public-private-ownership. That should ensure that public promotion programs are designed and used according the needs of the private sector. Furthermore, the Bund often implements promotion programs via project organizations (so called Projektträger), proving the general tendency for outsourcing public promotion programs.

### Some examples of instruments for the promotion of Innovative SME Practice in Germany

The active promotion of SMEs funded by public resources has to be in line with European regulations on competition and public procurement in order to preventing interference in the market. To this end, the governmental promotion programs usually are designed to facilitating the innovation potential inherent in SMEs rather than providing direct support to companies, i.e. supporting start-ups or applied research. Another area of promotion is the development of specific sectors considered as of particular importance for the national, local or regional economy.9

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8 In the course of the Lisbon Process and the recent Europe 2020 strategy, funding by the EU has increased and further diversified the existing landscape. Whereas the EU focus especially on infrastructure projects, research & innovation, and the enhancement of foreign trade, the German Bund focus on research & innovation, energy & environment, and business start-ups. At Laender level, promotion is particularly aimed at improved local economic development and competitiveness of the region, at preventing emigration of local work force etc.

9 Current examples at national level are the promotion of energy efficiency or the extension of broad band devices.
One of the current initiatives is the so-called *Mittelstandsinitiative* (initiative for supporting SME), which consists of various promotional tools to further improve the terms for entrepreneurship. Focus areas are the promotion of innovation, training and start-ups, SME financing, energy and resource efficiency and also the reduction of red tape. Some examples:

**Innovation Vouchers**

Innovation (Research or Knowledge) Vouchers are available for SME at institutions such as chambers. They are an instrument for cost-sharing between the SME and the supporting consultancy or research institution, thus ensuring that (a) SMEs are encouraged to innovate, and (b) SMEs make careful use of the vouchers as part of their overall investment. SMEs can also use them to form clusters and to pool their resources and interests in order to realize a more extensive project. For more information see: [http://www.bmwi-innovationsgutscheine.de/](http://www.bmwi-innovationsgutscheine.de/)

**Central Innovation Program for the Mittelstand (ZIM)**

The purpose of ZIM is similar to that of innovation vouchers but provide grants to specific larger-scale research projects. An evaluation showed that the total of grants given (€ 1.3 bio.) led to a total added value of € 3.9 bio. in the German economy. For more information see: [http://www.zim-bmwi.de/](http://www.zim-bmwi.de/)

**EXIST**

EXIST seeks to support university students and researchers in setting up their own business. With a monthly scholarship, grants for material expenses and individual coaching, young people with a business idea in the field of innovative technology or innovative knowledge-based services are supported in realizing their business plan. For more information see: [http://www.exist.de/](http://www.exist.de/)

A try to give an overview on instruments and the accordant implementing bodies is made by the Federal Ministry of Economy and Technology (BMWi) at [www.foerderdatenbank.de](http://www.foerderdatenbank.de).

**Learning from the German *Mittelstand***?

The strong performance of SME in Germany can be attributed to a whole range of determining factors: a value system which encourages entrepreneurship (metalevel), a political system committed to shape a business-friendly environment especially addressing SME (macrolevel), a strong basic business support structure like institutions with a clear focus (mesolevel) and a long-term, quality-based pattern of economic acting (microlevel). SMEs and SME support are essential elements of this system.

A differentiated system of SME promotion as it exists in Germany needs a very mature institutional environment and a proper interrelation between the different levels. However, even with a mature environment in place as a result of its particular historical development, the German SME promotion system has still room for improvement: sometimes it turns out to be too complicated for SMEs so they can’t really use it. It is criticized as being supply-driven rather than performance-based and as supporting a subsidized consultancy industry in the first place. Some even say the perception of the SMEs role as a job motor is not science-based but politically determined.

In countries being in another stage of entrepreneurship development as e.g. Germany, there are often shortcomings on all of the levels mentioned above. Economies which for a long time have been based on the extraction of natural resources with only few big companies will not

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10 ZIM finances up to 350,000 Euro per project. The SME needs to bear at least 50% of the total project costs.
turn into a knowledge economy based on SMEs just by introducing SMEs supporting programs. Favorable conditions have to be created and developed from the micro to the metalevel and only the functioning interrelations and interdependencies between them enable competitive advantages for SME. However, this can be done neither by the regulative state nor the market alone.

Even if it is not possible to directly transfer the German experience of SME promotion to other countries, there are some possible areas for exchange and supportive interventions:

**Metalevel:**
- Improve relationship and communication channels between government and private sector
- Strengthen the commitment of the political system to shape a supportive environment for companies/SME

**Macrolevel:**
- Improve framework conditions securing a competitive structure of markets and compensation of market failures (access to finance, time a business has to spend to deal with the government…)
- Support key factors like enforcement of property rights, means of conflict solutions…

**Mesolevel:**
- Create SME support institutions with a clear focus (i.e. associations)
- Strengthen business support structures for SME, i.e. microfinance or specific SME programs which address specific challenges
- Support functioning of decentralized self-help organisations for addressing specific problems of SMEs (often localised)

**Microlevel:**
- Support a quality-based pattern of competition
- Strengthen SME as suppliers to large companies within a functioning Value Chain

**Sources**


