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**The secret behind Germany’s thriving ‘Mittelstand’ businesses is all in the mindset**

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Germany’s envied “Mittelstand” of modest, family-owned companies which have underpinned the country’s emergence from the financial crisis has given Europe a problem. It has helped turned the country into an export juggernaut which some say is serving to hinder recovery among the continent’s struggling nations.

It has put Germany under pressure. The [European Commission](http://uk.reuters.com/article/2014/04/15/uk-germanycurrentaccount-idUKBREA3E1I520140415)and the [United States](http://www.spiegel.de/international/germany/germany-defends-trade-surplus-after-critical-us-treasury-report-a-931126.html) have both criticised it for persistently high current account surpluses. The German finance ministry now expects first-quarter growth to be relatively robust based on strengthening domestic demand, but it is the export performance of smaller firms which has delivered the bedrock for growth.

Some accuse Germany of dampening domestic demand and keeping a lid on wages that Germans might spend on Spanish vacations, Italian shoes, or Greek yoghurt. Germans counter that the surplus is due to the attractiveness of technologically innovative, complex products and that the surplus stems from mostly outside the eurozone. The surplus also keeps the euro exchange rate higher than it would otherwise be, precisely when it needs to fall to stimulate growth in poorer member states.

It’s a problem many countries would love to have. At the beginning of 2014, Germany’s surplus was much higher even than export leader, China, [according to the Institute for Economic Research](http://www.reuters.com/article/2014/01/14/us-germany-economy-trade-ifo-idUSBREA0D0MU20140114). In absolute terms, between 2003 and 2008, Germany was the world’s leading manufacturing exporter. Since being surpassed by China in 2009, it has raced neck-and-neck with the US for the number two position. This is all in spite of the fact that Germany absorbed an entire Eastern bloc country 25 years ago and spent around €2 trillion to upgrade and integrate eastern Germany.

And it is unlikely that the German export machine will slow anytime soon if the eurozone and global economy continue to grow, simply because of its high exposure to world trade.

**Small firms, global outlook**

While the European Union constitutes the bulk (about 60%) of German trade, its firms are oriented globally, increasingly to faster growing East Asian markets. More remarkably, one study by the [leading institute for small and medium-sized business (SME) research](http://www.ifm-bonn.org/statistiken/mittelstand-im-einzelnen/#accordion=0&tab=5) found that those SMEs with export presence also generated about 20% of their revenues from exports, and of that percentage, about 45% from non-EU countries.

Why? Clearly big businesses such as BMW, Daimler-Benz or Siemens are global players, yet Germany succeeds in global competition also because of companies such as [Micon](http://www.micon-drilling.de/en/about.php) in Nienhagen (drilling equipment that helped save those trapped Chilean miners), [Poly-Clip System](http://www.polyclip.com/) in Hattersheim (the ubiquitous clip at the end of sausage or meat packaging), [Tetra](http://www.tetra.net/) in Melle (fish food), [Ableton](https://www.ableton.com/en/trial/?gclid=CLTKu9bj-70CFdShtAodQHQAxA) in Berlin (electronic music mixing software and hardware for DJs), [Arnold & Richter Cine Technik](http://www.arri.com/) in Munich (professional cameras for Hollywood), [Mennekes](http://www.mennekes.co.uk/) in Kirchhundem (charging apparatus for electric vehicles as the new EU standard), or [Elektrisola Dr. Gerd Schildbach](http://www.elektrisola.com/de/home.html) in Reichshof-Eckenhagen (premium enamelled wire for specialty electronic uses including the Mars Rover).

These midsize firms form the heart and soul – really the mindset – of the broader German economy. They’re not household names; if you want to find and understand them, you have to resort to Google and Google Maps. And if you want to copy them, then you have to mimic more than just the nuts and bolts of their operations. There is a fundamental way of thinking at play too.

These firms have a global orientation (their websites are also in English), and are sometimes multinationals with production sites around the globe. For example, Elektrisola Dr. Gerd Schildbach [set up plants in Italy as early as 1964](http://www.elektrisola.com/history/companies.html), New Hampshire in the mid-1970s, Malaysia and Mexico at the beginning of the 1990s, and China after 2006. This was not outsourcing or offshoring but moving closer to their customers to reduce trade barriers and delivery times. And, in fact, while Elektrisola employed in 2010 about 300 in Germany, it employed over 2600 globally.

A recent IKB Deutsche Industriebank study found that the fastest growing sector are those firms with revenues between €50 million to €1 billion, which are exactly those firms moving out of the “classic” Mittelstand definition into a new type of global firm with international presence yet still rooted in often small towns throughout Germany. They are often hidden multinationals that seek to retain traditional German Mittelstand virtues, while moving abroad. It is particularly this sector of firms that has proven the envy of the world.

In 2011, Britain’s chancellor George Osborne, stated: “We should all learn the lessons from the successful Mittelstand model”. In December 2013, the University of Edinburgh hosted a [“McMittelstand” conference](http://www.mackayhannah.com/conferences/mcmittelstand). The lessons drawn are often decidedly “old school” virtues combined with a new global orientation. Studies have also found that the Mittelstand generated jobs in the midst of the financial crisis rather than cutting them – and continued to invest in research and development.

**All in the mind**

But what does it actually mean? The Germans use “Mittelstand” in two ways. The first is an official statistical definition. They are small to midsize enterprises (SMEs) that employ fewer than 500 employees and attain less than €50 million in revenues. Officially then Mittelstand accounts for 99.6% of all firms, for 60% of all employees and 36% of total sales. The companies train 83% of all apprentices, and account for 52% of economic output (in 2011). Mittelstand firms are the crucial link between the envied German apprenticeship system and firm-level skill building.

Yet the second usage is more crucial because it bundles together subjective attitudes toward what a firm is and how it should behave. Within Germany, “Mittelstand” has serious positive connotations, so much so, that even large companies such as Wuerth, STIHL, or Robert Bosch consider themselves Mittelstand in their attitudes, which is famously long-term in its outlook. Almost all of such Mittelstand firms are family enterprises, whereby ownership, control, and risk remain bound together. Almost all corporate governance literature since the 1930s stresses the [principal-agent problem](http://brousseau.info/pdf/cours/grossman_hart_83.pdf), that is, the separation of ownership and control, but in these firms there is no such separation.

Because of this family ownership, these firms tend to follow conservative financing strategies (retained earnings and bank loans) that maintain family control. These export-oriented Mittelstand firms tend to follow a focused international niche strategy based on premium products; they are midsize “global players” just like the larger firms. If they move abroad they tend to prefer wholly owned firms rather than joint ventures where possible in order to retain family control and keep watch on quality. They focus intensely on service, on responding to customer demands, and on constant upgrading of products.

Because of the technical expertise and quality controls, firms are loath to lose key workers even in downturns. In fact, many of those employees live in small towns alongside these technically minded owner-entrepreneurs. “Old school” social relations like this help create a bedrock of solidarity that feeds into firm operations long-term.

In short, there is no secret to Mittelstand success at the operational level; the virtues are “old school” business virtues. But it is no easy trick attempting to reintroduce those virtues into an economy which has evolved like the UK’s. If Osborne’s hopes come to fruition then Mittelstand might be destined to become an everyday English word like kindergarten; get it wrong and it might be more like schadenfreude.