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Are start-ups the same throughout Germany? Hardly! A comparison of German states

Author: Dr Georg Metzger, phone +49 69 7431-9717, research@kfw.de

Entrepreneurs are an important driver of economic development. This is why the KfW Start-up Monitor provides regular reports on business start-up activity in Germany. This survey focuses for the first time on how start-up activity varies from one state to another and demonstrates how important it is to view start-up activity in a more sophisticated manner. Start-up activity varies greatly from one region to another. There is even a substantial difference in the start-up activity within individual states, with 2.4 times as many new entrepreneurs in the best-performing state as there are in the worst. There are just as many differences when it comes to industry structure, female participation and entrepreneurs' motives.

However, there are some similarities between neighbouring states with regard to the type of people who become entrepreneurs and the type of projects they engage in. We can split the states into four typical categories: a) Northern and Central Germany; b) Southern and Western Germany; c) Eastern Germany; d) city states, as a distinct category, separate from the regions in which they are located.

Despite the major differences, all of the states have one thing in common: the most budding entrepreneurs are discouraged from putting their plans into effect because they lack the willingness or capacity to accept financial risk. The second most important obstacle in all but one of the states is how to overcome the problem of obtaining start-up funding. The financial aspects of becoming self-employed are of equal concern to everyone, ir-

respective of where they (want to) set up their business.

Entrepreneurs help to improve the effectiveness of the economy as a whole. They keep the pressure on existing businesses, fuel technological and industrial change and create jobs – very often in markets that did not exist before they came along. All sorts of positive economic effects can, therefore, be traced back to thriving levels of business start-up activity. Consequently, improving framework conditions for entrepreneurs is a constant concern for economic policy makers.

The KfW Start-up Monitor regularly provides comprehensive information regarding the characteristics of new entrepreneurs and their businesses, as well as on new trends in business start-up activity. The main focus of the reports is on Germany as a whole. For the first time this survey seeks to put a spotlight on how start-up activity varies from one state to another. The report uses data collated from KfW Start-up Monitors covering the period 2009 to 2014.

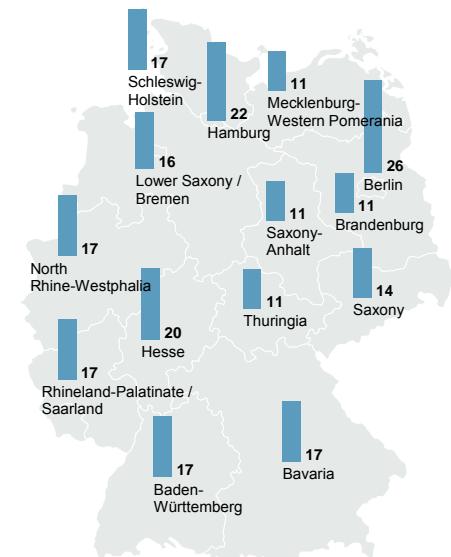
City states dominate

There are significant differences in business start-up activity in individual states. Berlin and Hamburg occupy the top spot. This can be seen in the comparison of entrepreneur figures (Figure 1, expressed as number of new entrepreneurs per 1,000 of population aged 18 to 64). The city states were the only states to achieve average annual start-up figures in excess of 2 % between 2009 and 2014. This also applies to Bremen (2.08 %), which is evaluated in Figure 1 as a region comprising itself and Lower Saxony. For methodological reasons,

Rhineland-Palatinate and Saarland have been combined as one region. After the city states, the next highest start-up rates can be found in the western German states, while the eastern German states come bottom in the start-up rankings.

Figure 1: Berlin is top of the league

Number of new entrepreneurs per 1,000 people of working age p.a.



Note: Annual average number of new entrepreneurs per 1,000 of the population aged 18 to 64 in the period 2009 to 2014.

Source: KfW Start-up Monitor

The city states are urban centres where large numbers of people live within a relatively small area. This is beneficial to business start-up activity, as physical proximity is particularly advantageous for service and trading businesses, i.e. for sectors with traditionally high levels of self-employment. Consequently, lower population density in Eastern German probably explains partly why they appear at the bottom of the rankings.

Differences in the economic structure of the states are also relevant, with the proportion of freelance entrepreneurs in Berlin and Hamburg higher than elsewhere (Figure 2). This is due to the strength of the media and IT sectors in those areas.¹ By contrast, areas with a

more industrial background tend to have lower levels of start-up activity. In these states it is easier to obtain a well-paid job in an SME or major corporation. The opportunity cost of making a move into self-employment (foregoing a well-paid job) is, therefore, relatively high in these areas. Balancing up the pros and cons of these alternative ways of earning a living tends not to favour the self-employment option.

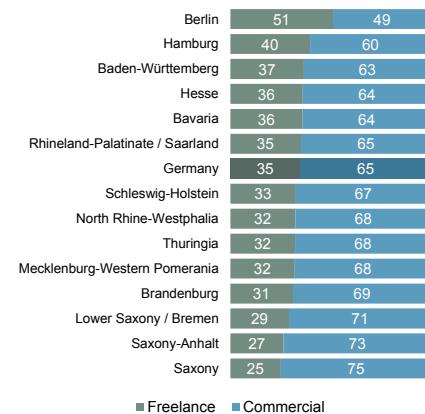
It is striking that, in general terms, Eastern Germany has a higher proportion of new full-time entrepreneurs (Figure 4) and a correspondingly low proportion of new sideline business starters (30 to 50% below the German national average). The reason for this can be found in the structure of labour market participation in Eastern Germany. When unemployed people make the move into self-employment, they do so predominantly on a full-time basis (two out of three).² People who are neither economically active nor unemployed prefer to start on a sideline basis (72%).² In Eastern Germany, the proportion of unemployed people is significantly higher than the national average while the proportion of economically inactive people, in the majority of cases, is lower than the national average. As a result, start-up activity tends to be observed much more commonly as a full-time role.

However, the position occupied by individual states in the start-up rankings is much the same in the case of full-time self-employment as in the case of sideline self-employment. The only states to display significantly different results are Rhineland-Palatinate/Saarland and Saxony. Saxony performs much better when it comes to new full-time entrepreneurs (third place, as opposed to twelfth place for new sideline entrepreneurs), while the reverse applies in the case of Rhineland-Palatinate/Saarland (fourth and tenth places respectively).

Places occupied in the start-up rankings change significantly over time.³ Differences in the pace of development in regional labour markets are a major cause of such variations. They are also affected by differences in the various sector economies which can influence companies' recruitment behaviour. Insolvencies

Figure 2: Freelance professions popular with entrepreneurs in city states

Fields of activity, in per cent



Note: Start-up distribution by field of activity between 2009 and 2014.

Source: KfW Start-up Monitor

factoring industry.

The proportion of industrial start-ups is well above average in Thuringia and Brandenburg at 9 and 12% respectively. By contrast, the Berlin figure is very low (2%). Brandenburg and Schleswig-Holstein are notable for the fact that a good one in ten business start-ups occurs in the construction sector (12 and 11%). By contrast, the corresponding figures in Saarland and Baden-Württemberg are a mere 2 and 3% respectively. There are also major variations in other types of manufacturing industry (energy production, water supply, waste disposal) and primary production (agriculture and forestry etc.), ranging from 1% in Hamburg to 9% in Lower Saxony/Bremen.

Hamburg and Berlin are notable for their particularly high number of business start-ups in the economic services sector (45 and 41%). By contrast, only one in four start-ups in Brandenburg, Lower Saxony/Bremen and Saxony-Anhalt focuses on providing services to other businesses. The large numbers in Hamburg and Berlin are due to high levels of business start-up activity in freelance professions. Noteworthy are the fields of management consultancy, advertising, journalism and software engineering. The proportion of start-ups offering personal services ranges from 23% in Schleswig-Holstein to 37% in Berlin. Berlin, therefore, comes top of the league for the service-provider sector, with at least eight out of ten start-ups fo-

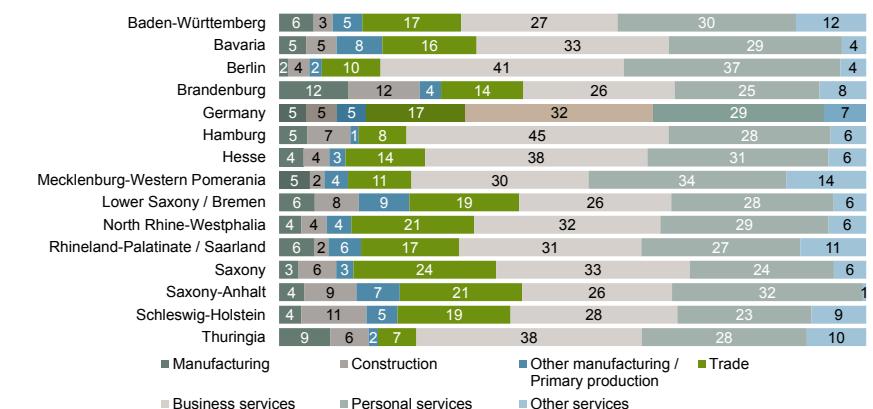
in major corporations also play an important role.

Greatest start-up differences seen in service-provider sector

Germany, along with all other OECD countries, is on its way to becoming a service-based economy and entrepreneurs are playing an important part in this industrial change. Across Germany as a whole, almost 70% of new entrepreneurs each year focus on providing services to other businesses or to end consumers in the finance sector or in the field of transport and logistics (Figure 3). A further 20% focus on trade. Only one in twenty start-ups focuses on the manu-

Figure 3: Poles apart! In Berlin most entrepreneurs go into the service sector, while in neighbouring Brandenburg the fewest entrepreneurs do so

Percentages by sector



Source: KfW Start-up Monitor

cusing on this field.

Female participation in start-up activity growing

The growing numbers of women participating in the labour market over the last decade⁴ can also be seen in the number of start-ups carried out by women, which reached a record high in 2013 and 2014 of 43% of all new entrepreneurs, as compared to an average of 40% for the period 2009 to 2014.

The lower proportion of women engaged in start-up activity is also reflected in the number of female entrepreneurs relative to women as a whole. During the period in question, just under 2% of men (1.99%) became self-employed, while the equivalent figure for women was just 1.37% (Figure 4).

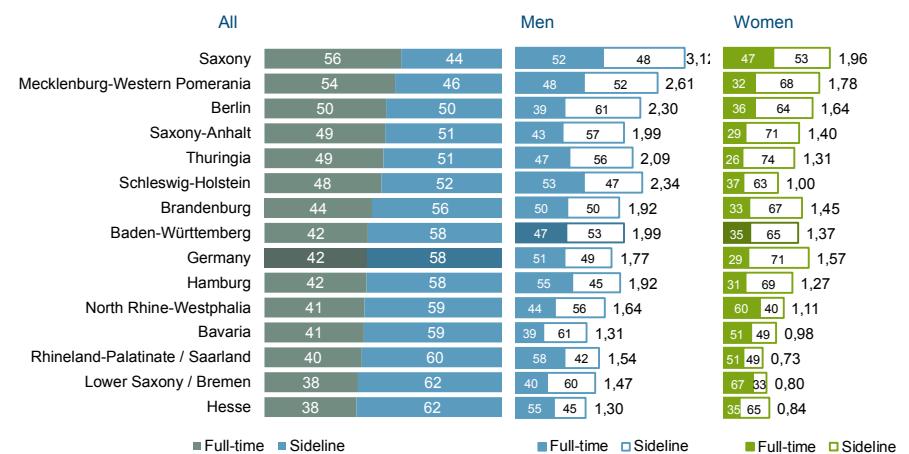
Levels of male entrepreneurs in Berlin are 50% higher than the national average

A look at state rankings reveals very little difference in the relative positions of men and women. The states with the highest proportion of start-ups are Berlin and Hamburg – for both men and women. The male rate in Berlin even exceeds the 3 per cent mark – an achievement unmatched by any other state.

The only states to reveal a striking difference in league-table positions are Schleswig-Holstein and Baden-Württemberg. Men in Schleswig-Holstein (third place) are much more active than

Figure 4: Baden-Württemberg top for business start-ups by women, but just average for start-ups by men

Entrepreneurs in per cent (proportion of full-time / sideline entrepreneurs in per cent)



Note: Average annual proportion of entrepreneurs within the population aged 18 to 64 during the period 2009 to 2014.

Source: KfW Start-up Monitor

women (eleventh place) when it comes to start-ups. By contrast, Baden-Württemberg women (fourth place) participate much more actively than their male counterparts (tenth place) in start-up activity. However, Schleswig-Holstein and Baden-Württemberg have one thing in common: when women start a business, they do so predominantly on a sideline basis (71%).⁵ Not so in Saxony-Anhalt though where the majority of women run their start-up businesses on a full-time basis (two out of three). Most men, on the other hand, opt to do so on a sideline basis (six out of ten).⁶

Most entrepreneurs are under 40

One in every three entrepreneurs is

30 years old or younger with a further 27% aged no more than 40. Six in every ten entrepreneurs, therefore, become self-employed in the early stages of their working life. Why is this?

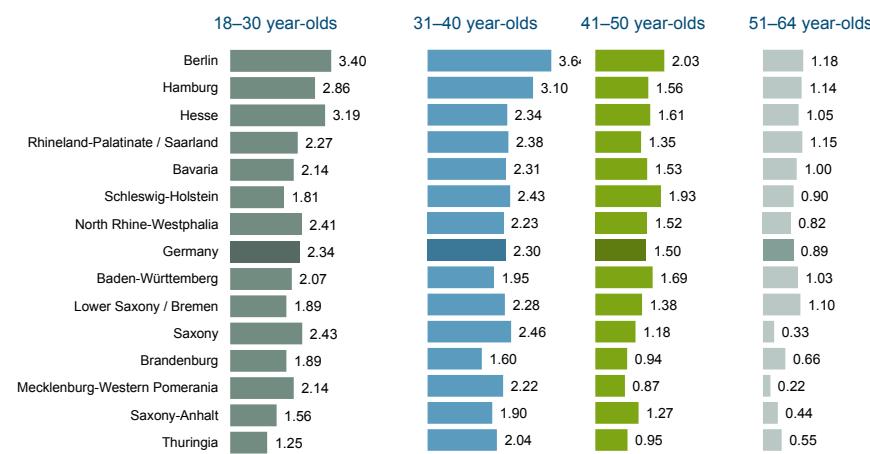
As people grow older, they tend to have more resources. They have greater financial freedom, greater wealth of experience, a more extensive personal network and are restrained much more by family considerations. However, the increasing resources at their disposal can also act as a barrier, preventing them from starting up their own business. They are "trapped" within their personal network, acquire too much specialist knowledge, become too financially dependent on their employer and are bound much more strongly to their family. This is often referred to as having "career handcuffs", "golden handcuffs" and "family handcuffs".⁷

Each year between 2009 and 2014, around 23 Germans in every 1,000 aged 18 to 30 became self-employed (Figure 5). The rate was the same for 31 to 40-year-olds. From age 40 onwards, however, business start-up propensity tailed off significantly. In the 41 to 50 age group, only 15 people in every 1,000 became self-employed each year, while the figure fell even further in the 51 to 64 age group to just 9 in every 1,000.

It would appear that the "handcuffs" mentioned above get a great deal tighter when people turn 40. The pattern is

Figure 5: Over-50s squeeze business start-up rate in Eastern Germany

Start-up rate as a percentage



Note: Average annual proportion of entrepreneurs within population aged 18 to 64 during the period 2009 to 2014.

Source: KfW Start-up Monitor

much the same throughout Germany as a whole. Schleswig-Holstein is the only state in which business start-up propensity is higher in one of the older age groups than in one of the younger ones. Between 2009 and 2014, 19 people in every 1,000 in the 41 to 50 age group became self-employed each year, the corresponding figure in the 18 to 30 age group being just 17 per 1,000.

Age-specific rankings are fundamentally very similar to the overall business start-up rankings. It is striking, however, that in three of the eastern German states, the over-50s age group performs extremely poorly. Achieving just 25 to 50 % of the national average, Saxony-Anhalt, Saxony and Mecklenburg-Western Pomerania are distinctly lacking in "silver entrepreneurs". Why is that? The very low numbers of business starters aged over 50 cannot be traced back to a single cause. Seniors in these states

- generally participate much less commonly in the labour market (at least in Saxony and Saxony-Anhalt),
- are less inclined to start their own business,
- are much less likely to think seriously about becoming self-employed, and
- those who do are more likely to abandon their plans.⁸

Over a third of the population in these states is now over 50 years old. In the light of demographic developments, this group is likely to grow in size in the foreseeable future, meaning that, barring counter-measures, we can assume that there will be an above-average decline in start-up activity in this area.

One way forward would be to break down the barrier that make seniors in Saxony-Anhalt, Saxony and Mecklenburg-Western Pomerania significantly more likely to abandon their business start-up plans than seniors elsewhere or than younger people in the same states: problems gaining access to customers.

Implementation and funding risks prove the most crucial test for budding entrepreneurs

The greatest hurdles along the road to self-employment are financial risk and ini-

itial funding. Full-time entrepreneurs earn most of their net household income from their self-employment activities (2014: 60%).⁹ In view of the fact that business start-ups are very fragile in their early stages (the failure rate in the first three years is around 30 %), entrepreneurs put their income at considerable risk. Add in the fact that they often (have to) take on new financial obligations, such as acting as guarantors for loans, employing staff or paying up-front for stock, and it can be seen that they put their wealth significantly on the line.

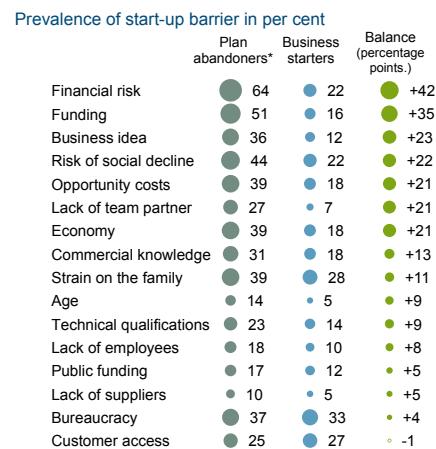
As Figure 6 demonstrates, most budding entrepreneurs are held back from taking the final step into self-employment by a lack of willingness or capacity to accept risk.¹⁰ Three out of four plan abandoners (64 %) cite financial risk as a barrier to starting up their own business, whereas "only" 22 % of those who actually proceed do so. With a gap of 42 percentage points, the willingness or capacity to accept financial risk is the highest hurdle facing budding entrepreneurs. The more seriously it affects plan abandoners compared to those who proceed with business start-ups, the more prohibitive a barrier it can be said to be. If a particular barrier is cited just as frequently by plan abandoners as by actual business starters, it can be regarded much less as a barrier and much more as an incidental consideration routinely associated with starting a business.

The next highest obstacle is putting funding in place. Over half (51 %) of all plan abandoners experienced funding problems because they

- had no funds of their own,
- were unable to obtain a sufficiently high bank loan or to obtain one on reasonable terms, or
- did not receive any support from public funds etc.

By contrast, only 16 % of those who proceeded reported any funding difficulties. With a gap of 35 percentage points, initial funding is therefore the second highest hurdle along the road to self-employment and one which many budding entrepreneurs fail to clear – often because their business idea is not viable

Figure 6: Financial risk is the number one fear amongst budding entrepreneurs



*Plan abandoners: people who have seriously considered becoming self-employed but who have abandoned their plans to do so.

Explanation: bureaucracy is cited by 37 % of plan abandoners as a barrier to starting a business. 33 % of entrepreneurs also regard bureaucracy as a barrier to starting a business. The gap between planners and "doers" is therefore quite narrow at just four percentage points, meaning that, in reality, bureaucracy dissuades only a small number of planners from proceeding.

Source: KfW Start-up Monitor

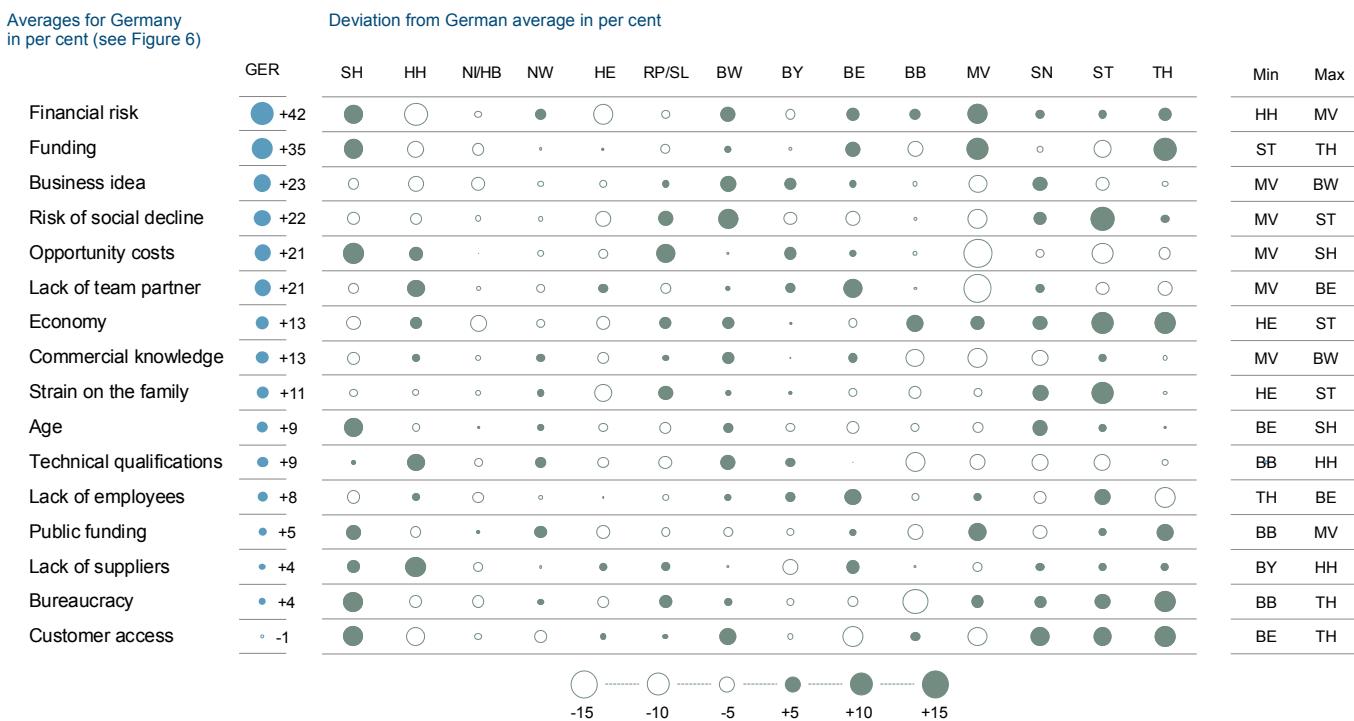
or because they are unable to prove its feasibility. It follows from this that doubting the viability of their own business idea is the third highest hurdle that causes budding entrepreneurs to falter. The next highest hurdles holding budding entrepreneurs back include the risk of social decline, concerns regarding the benefits of being employed (opportunity costs) and the lack of team partners.

Bureaucracy: Often cited but not much of a barrier in practice

Bureaucracy is a good example of an obstacle that is less of a barrier and more of an incidental consideration routinely associated with starting a business. Bureaucratic hurdles are seen by 37 % of plan abandoners as a hurdle to starting a business – and 33 % of actual entrepreneurs feel the same. There is, therefore, a wide divergence between the perception of bureaucracy as an obstacle and the extent to which it has an actual prohibitive effect. However, this should not obscure the fact that complying with administrative obligations can be a burden to entrepreneurs in their day-to-day work.¹¹

Difficulty in gaining access to customers is a rather curious factor to cite as a barrier to starting a business. Although problems with winning contracts and es-

Figure 7: The state with the lowest proportion of budding entrepreneurs deterred from becoming self-employed as a result of start-up barriers is Hesse



Note: Average figures for the period 2009 to 2014.

Abbreviations: Germany (GER), Schleswig-Holstein (SH), Hamburg (HH), Lower Saxony/Bremen (NI/HB), North Rhine-Westphalia (NW), Hesse (HE), Rhineland-Palatinate/Saarland (RP/SL), Baden-Württemberg (BW), Bavaria (BY), Berlin (BE), Brandenburg (BB), Mecklenburg-Western Pomerania (MV), Saxony (SN), Saxony-Anhalt (ST), Thuringia (TH)

Source: KfW Start-up Monitor

tablishing customer contact are cited by 25% of plan abandoners, they are also cited by 27% of actual business starters. This is the only barrier to starting a business that is cited more frequently by actual business starters than by plan abandoners – an indication that many prospective entrepreneurs imagine customer access as being easier than it really is.

Funding aspects in almost every state

To what extent do individual barriers hinder start-ups in each of the states? With one exception, the biggest hurdles are financial risk and funding problems. These barriers are experienced a great deal more commonly by plan abandoners than by actual business starters (widest gaps). It is only in Saxony-Anhalt that the risk of social decline deters more budding entrepreneurs from becoming self-employed than are deterred by funding problems. However, financial risk is the most prohibitive factor in Saxony-Anhalt, just as it is elsewhere. After this, the order in which the next highest barriers are cited varies substantially from one state to the next.¹²

Financial risk and funding problems constitute the greatest obstacles almost everywhere but there are differences between the regions as to just how significant they are. Figure 7 provides information on where the barrier effect of the various obstacles is higher or lower than the national average. For example, financial risk deters budding entrepreneurs in Mecklenburg-Western Pomerania a great deal more than budding entrepreneurs across Germany as a whole (50 vs. 42%). By contrast, the prohibitive effect of financial risk in Hamburg is lower than anywhere else in the country (30%). And it is a similar story with funding problems: more budding entrepreneurs are deterred by this factor in Thuringia (46%) than in any other state (national average 35%). Hamburg, once again comes out lowest (at 29%). Doubts about their business idea lead more budding entrepreneurs to resile from their projects in Baden-Württemberg¹³ than in any other state (29% vs. a national average of 23%), whereas Mecklenburg-Western Pomerania¹⁴ is least affected by this factor (16%).

Entrepreneurs often go it alone

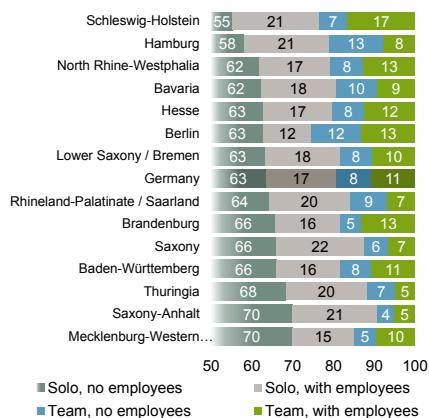
Most entrepreneurs rely on their own efforts to build up their business. Less than two thirds have co-founders or employees (Figure 8). The proportion of solo business starters in individual states ranges between 70 and 55 %. Schleswig-Holstein comes top for entrepreneurs starting a business with the aid of at least one other person – typically an employee. Teams of entrepreneurs are most commonly found in Berlin, where one in four entrepreneurs sets up a business in collaboration with one or more team partners. This is all the more striking given the fact that the absence of team partners is cited more frequently in Berlin than in any other state as having a prohibitive effect on starting a business. Team start-ups would, therefore, occur much more frequently in Berlin if there was an improvement in bringing prospective entrepreneurs together.

Most entrepreneurs are opportunists

Opportunists seek to use a specific business idea. People forced into self-employment have no better alternative method of earning a living. Between

Figure 8: Majority of entrepreneurs start off on their own - no team and no employees

Manpower in per cent



Note: In order to make the figures easier to read, the horizontal axis begins at 50%. Rounding differences are possible.

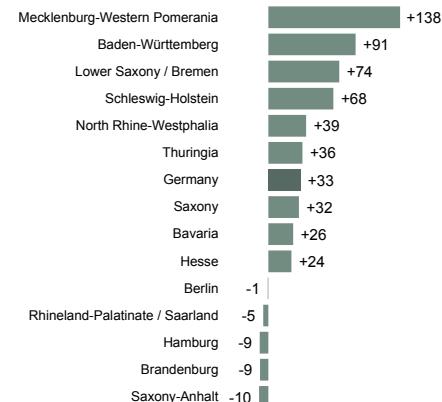
Source: KfW Start-up Monitor

2009 and 2014 throughout Germany as a whole there were roughly one third more opportunist business starters each year than people forced into self-employment (Figure 9). This statistical advantage can be regarded as positive for the economy as a whole. While it is true that the specific business ideas pursued by opportunists are neither inherently unique nor guaranteed to succeed, they tend, nonetheless, to introduce greater innovation to the market, employ more staff and last longer than businesses established by people forced into self-employment.

The ratio of opportunist to forced entrepreneurs varies considerably from one state to the next. The starker difference is in Mecklenburg-Western Pomerania which has 2.4 times as many opportunists as forced business starters each year. Opportunists also occupy a dominant position in Baden-Württemberg (+91%), Lower Saxony/Bremen (+74%) and Schleswig-Holstein (+68%). Although the city states account for the highest proportion of entrepreneurs across the country as a whole, opportunists are relatively poorly represented within the total. In Berlin the numbers are fairly evenly balanced, whereas in Hamburg there are roughly 10% fewer opportunist entrepreneurs than people forced into self-employment. The same applies in Brandenburg and Saxony-

Figure 9: Opportunist entrepreneurs lag behind in Berlin and Hamburg

Gap between opportunist and forced starters in per cent



Note: Classification based on answers to the question: "What was your main reason for becoming self-employed? Was it to exploit a business idea [opportunist business starters], because there was no better alternative [forced business starters] or some other reason?"

Explanation: In Mecklenburg-Vorpommern the proportion of opportunist starters outweighs the proportion of forced starters by 138%, i.e. it is approx. 2.4 times higher. In Berlin the numbers are fairly evenly balanced.

Source: KfW Start-up Monitor

Anhalt.

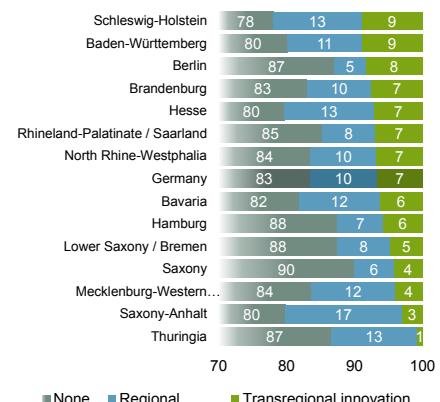
The relationship between the two types of entrepreneurs in individual states is determined by how a number of different factors interact with one another. States with high proportions of entrepreneurs tend to have a lower ratio of opportunists to forced business starters, albeit with Brandenburg and Saxony-Anhalt forming a clear exception to the rule. Men tend to be more strongly represented amongst opportunist entrepreneurs than amongst forced entrepreneurs. Opportunist entrepreneurs are also more likely to start their business on a sideline basis, to be in one of the middle age groups and to have academic qualifications. They are also more likely to start their business straight from an existing employment relationship, whereas people forced into self-employment are more likely to have been unemployed beforehand. States whose business starters are more likely to betray one or more of these characteristics or which have lower unemployment rates ought to have a more positive ratio of opportunist to forced entrepreneurs.

Innovative entrepreneurs key to future viability

The degree of innovation within the start-up sector is an important factor in as-

Figure 10: Max. one in ten entrepreneurs is responsible for transregional innovation

Business starters with innovations in per cent



Note: In order to make the figures easier to read, the horizontal axis begins at 70%. Rounding differences are possible.

Source: KfW Start-up Monitor

sessing its usefulness to the economy as a whole. The degree of innovation is a yardstick by which the future viability of technologies and markets can be measured. Every year since 2009 across Germany as a whole, 7% of new entrepreneurs have introduced transregional innovations to the market. The geographical dimension of such innovations is significant, as new businesses with regional innovations can often be part of a (continuous) diffusion process by which new services are spread from urban areas into rural areas. Transregional innovations, on the other hand, are more likely simply not to have existed previously.¹⁵ They therefore arise much less frequently.

The state with the highest annual proportion of business start-ups featuring market innovations is Schleswig-Holstein (at 22%) (Figure 10). Of this 22% total, 13% is accounted for by entrepreneurs bringing regional innovations to the market, while the remaining 9% relates to transregional innovations, placing Schleswig-Holstein top of the league in this category. Second and third places go to Baden-Württemberg (9%) and Berlin (8%). The city state of Berlin is the only state in the country in which transregional innovations are more common than regional innovations.¹⁶

Three in every four entrepreneurs inject financial resources

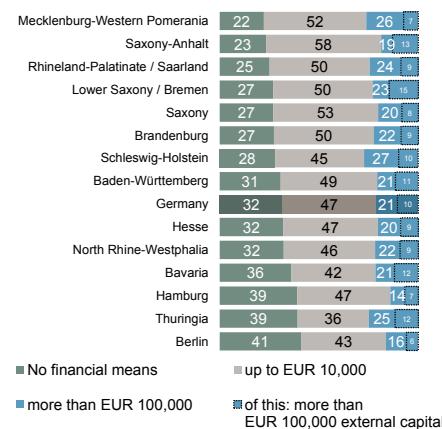
As we saw from the analysis of start-up barriers, funding issues are of key importance to potential entrepreneurs. In reality, however, one in every three entrepreneurs in Germany makes no use whatever of financial resources (Figure 11). They often cope by injecting other resources, such as personal tangible means like their private notebook, into the new business.

Entrepreneurs' use of funding resources varies enormously from one state to the next. Whereas just under a quarter of business starters in Mecklenburg-Western Pomerania, Saxony-Anhalt and Rhineland-Palatinate/Saarland make no use of financial resources, four in every ten do so in Hamburg, Thuringia and Berlin.

The extent to which service-based start-ups occur in an individual state, especially in freelance professions, largely determines entrepreneurs' need for funding support. Start-ups by freelance professionals are quite prevalent in Berlin and Hamburg, which explains why these states have such low numbers of business starters requiring financial resources. At the same time, fewer entrepreneurs in these states engage in trading activities – a field more likely to require the injection of capital resources. Trade-orientated start-ups are also less prevalent in Thuringia. The need to make use of financial resources arises more commonly in Mecklenburg-Western Pomerania than in other states. This is due to a number of factors: the importance of working on a full-time basis, a high proportion of opportunist entrepreneurs and a low female participation rate. Saxony-Anhalt is another state in which levels of full-time working are reflected in a more frequent need to obtain financial resources. And then there is the high proportion of entrepreneurs in commercial fields of activity, trade and manufacturing industry. Rhineland-Palatinate/Saarland is affected by its high proportion of older entrepreneurs who are much more likely to make use of financial resources than younger entrepreneurs.

Figure 11: Start-up funding manageable in most cases

Use of financial resources in per cent



Source: KfW Start-up Monitor

Across Germany as a whole, one in every five entrepreneurs injects personal or external financial resources in excess of EUR 10,000. The proportion of entrepreneurs injecting over EUR 10,000 ranges from 14 % in Hamburg to 27% in Schleswig-Holstein. The factors referred to above that determine the frequency with which financial resources are employed are almost equally influential when it comes to the level of financial resources used.

A high proportion of service-based start-ups, especially in the freelance professions, goes hand-in-hand with a lower need to employ financial resources. Berlin and Hamburg are perfect examples. By contrast, a high proportion of full-time and opportunist entrepreneurs or start-ups by men, as is the case in Mecklenburg-Western Pomerania, makes the need to employ financial resources more likely. The same applies in cases where the manufacturing industry is strongly represented (Thuringia) or where older people are heavily involved in start-up activity (Rhineland-Palatinate/Saarland).

Across the country as a whole, one in ten business start-ups is accompanied by the injection of external capital in excess of EUR 10,000. This can be seen most commonly in Saxony-Anhalt and Lower Saxony/Bremen where between one in six and one in seven entrepreneurs makes use of external funding in excess of EUR 10,000. The use of external funding is least common in Berlin

and Hamburg where it applies to only one in every twenty entrepreneurs. One thing is absolutely clear: Berlin is Germany's favourite location for growth oriented start-ups¹⁷ that often require very large sums of money. But, first and foremost, the entrepreneurs there are self-employed to earn a living rather than to achieve rapid growth.

Four types of state

Entrepreneurs and their projects vary a great deal from one state to another. There can be enormous differences in the proportion of entrepreneurs to the economically active population as a whole, industry structure, female participation and the size of individual businesses etc. That said, it is possible to group states together based on their level of start-up activity and certain characteristics that they have in common (see descriptions). There are four groups of states (table):

1. The **city states** of Berlin and Hamburg. Main characteristics: very high start-up rates and a large number of new entrepreneurs in freelance professions. However, their ratio of opportunist/forced entrepreneurs is very low.
2. The **southern and western states** of Bavaria, Baden-Württemberg, Hesse, North Rhine-Westphalia and Rhineland-Palatinate/Saarland. Main characteristics: low proportion of business starters in full-time positions, high female participation rate. They also have a moderate to high ratio of business start-ups and a moderate proportion of business starters in freelance professions.
3. The **northern states** of Lower Saxony/Bremen, Mecklenburg-Western Pomerania and Schleswig-Holstein together with the **central German state** of Thuringia. Main characteristics: low rate of female participation, strong opportunist/forced entrepreneurs ratio. They also have a low to moderate ratio of business start-ups and a low to moderate proportion of new entrepreneurs in freelance professions.
4. The **eastern states** of Brandenburg, Saxony and Saxony-Anhalt. Main characteristics: very low business start-up rate, very high proportion of new entrepreneurs in commercial fields of activity,

Table: Business start-up activity in Germany: Four groups of states

Features	Group 1: City states BE, HH	Group 2: Southern / Western Germany BY, BW, HE, NW, RP/SL	Group 3: Northern / Central Germany NI/HB, MV, SH, TH	Group 4: Eastern Germany BB, SN, ST
	<i>high start-up rate, focused on freelance, high job alternative</i>	<i>moderately start-up active, focus on sideline, high female participation rate</i>	<i>less start-up active, low female participation, mainly opportunist</i>	<i>low start-up rate, mainly commercial, focus on full-time less opportunist.</i>
Start-up rate	++	o/+	--/o	--
Proportion freelance fields of activity	++	o	--/o	--
Proportion full-time	o	--/o	--/++	o/++
Proportion women	o	o/++	--/o	-/+
Ratio opportunist/forced starters	--	-/+	o/++	--/o

Explanation: (--) well below average, (-) slightly below average, (o) average, (+) slightly above average, (++) well above average.

Abbreviations: Germany (D), Schleswig-Holstein (SH), Hamburg (HH), Lower Saxony/Bremen (NI/HB), North Rhine-Westphalia (NW), Hesse (HE), Rhineland-Palatinate/Saarland (RP/SL), Baden-Württemberg (BW), Bavaria (BY), Berlin (BE), Brandenburg (BB), Mecklenburg-Western Pomerania (MV), Saxony (SN), Saxony-Anhalt (ST), Thuringia (TH).

Source: KfW Start-up Monitor

high proportion of entrepreneurs in full-time positions. They also have a low opportunist/forced entrepreneurs ratio.

Despite the major differences, there is at least one factor that affects business start-up activity to the same extent across the board: the financial risk involved in starting a business is the barrier that causes most budding entrepreneurs to abandon their plans. Funding problems are also significant across the board and, with one exception, constitute

the second-highest hurdle facing entrepreneurs.

Financial risk is an inherent part of being self-employed and is impossible for entrepreneurs to avoid. There are ways of limiting financial risk, for example by choosing a limited-liability legal form for the business. Governments have also introduced initiatives to reduce financial risk¹⁸ but it is impossible to avoid it altogether.

It goes without saying that business start-up projects are inherently less se-

cure than projects undertaken by established companies, meaning that entrepreneurs are more frequently confronted with funding problems. It is the task of economic policy makers to balance out this implicit disadvantage. Support programmes at both federal and state level can help entrepreneurs get their funding up and running. ■

¹ FAZ.NET (2015), Programmiert doch in Berlin! <http://www.faz.net/aktuell/beruf-chance/it-freiberufler-programmiert-doch-in-berlin-13763500.html>, info obtained on 12.10.2015. (Only available in German)

² Own analysis of the KfW Start-up Monitor 2009–2014.

³ Metzger, G. (2015): Business start-up activity increasing – freelance professions dominate, KfW Start-up Monitor 2015, the KfW Group, Frankfurt am Main.

⁴ Between 2001 and 2012 the proportion of people of working age (the total number of people in active employment plus the unemployed aged between 15 and 64 as a proportion of the entire population in the same age group), rose from 64.9 to 71.6% (women) and from 80.1 to 82.2% (men). At the same time, the total number of people in active employment as a proportion of those of working age rose from 58.8 to 67.6% (women) and from 72.7 to 77.1% (men). Source: Federal Employment Agency (2013): Labour market report: The labour market in Germany, women and men in the labour market in 2012, Nuremberg 2013.

⁵ The only region with a higher rate of female sideline start-ups is Rhineland-Palatinate/Saarland (74%). The strong focus on sideline self-employment leads to structural extremes in Schleswig-Holstein and Baden-Württemberg. For this reason, and also because of low rates of female participation in general, a mere 20% of full-time start-ups in Schleswig-Holstein are activated by women (31% of total start-ups). No other state has such low figures. In Baden-Württemberg, with its relatively high level of business start-up activity by women, some 58% of all sideline start-ups are activated by women (47% of total start-ups). No other state has such high figures.

⁶ Saxony-Anhalt shares top place with Brandenburg when it comes to full-time start-ups by women (48%). By contrast, its corresponding sideline figure is only 23% – the lowest of any of the states.

⁷ Wasserman, N. (2012), The founder's dilemmas: anticipating and avoiding the pitfalls that can sink a start-up, Princeton University Press.

⁸ The proportion of people who can fundamentally imagine becoming self-employed, irrespective of the circumstances applicable at the time, declines significantly with age. Source: Metzger, G. (2015): Where there's a will, there's a way? Barriers to becoming self-employed, Focus on Economics No. 82, the KfW Group, Frankfurt am Main.

⁹ Own analysis of the KfW Start-up Monitor 2014.

¹⁰ Metzger, G. (2015): Where there's a will, there's a way? Barriers to becoming self-employed, Focus on Economics No. 82, the KfW Group, Frankfurt am Main.

¹¹ An unscientific survey conducted amongst its members (N=134) by the "Junge Unternehmer" (*Young Entrepreneurs*) association revealed that eight out of ten companies had to spend over five hours a week "dealing with bureaucratic regulations and obligations". Source: Die Jungen Unternehmer (2015), Umfrage zum Thema Unternehmensgründungen, 09.03.2015,

http://www.junge-unternehmer.eu/uploads/tx_wfmedienpr/umfrage_unternehmensgruendungen.pdf, info obtained on 30.10.2015. (Only available in German)

¹² Doubting their business idea is the third-most cited factor in Bavaria, Brandenburg, North Rhine-Westphalia and Saxony that deters budding entrepreneurs from becoming self-employed. Third place in Schleswig-Holstein, Lower Saxony/Bremen and Rhineland-Palatinate/Saarland, on the other hand, is occupied by opportunity costs. Finishing third in Hamburg, Hesse and Berlin we have lack of co-founders. Baden-Württemberg and Thuringia go for risk of social relegation, while Mecklenburg-Western Pomerania cites economic uncertainty.

¹³ Certain states, including Baden-Württemberg, reveal mainly positive variances. In other words, the gaps between their figures and the national average are often larger, meaning that budding entrepreneurs in these states suffer above-average levels of discouragement. By contrast, other regions, such as Lower Saxony/Bremen, Hesse and Brandenburg, reveal mainly negative variances, meaning that the prohibitive effect of individual barriers is weakest in these states.

¹⁴ The prohibitive effect of start-up barriers is generally quite variable in Mecklenburg-Western Pomerania. Whereas doubting their business idea, the risk of social relegation, opportunity costs, the absence of team partners and concerns regarding the extent of their business knowledge deter fewer budding entrepreneurs here than in other regions, the same Mecklenburg-Western Pomerania budding entrepreneurs are put off more than their counterparts in other states by financial risk, funding problems or problems in obtaining support from public funds.

¹⁵ Although market innovations can often be technical in nature, this is not inevitably the case. According to figures provided by business starters themselves, one in ten of them carried out research and development (R&D) in 2014 in order to ensure their technical innovations were ready for market launch. Above all, it is these innovative entrepreneurs who, as Schumpeter put it, act in a "creatively destructive" manner by contributing to technological progress and giving impetus to structural change. It is not currently possible to evaluate technologically innovative business start-ups by individual state. However, given that technological innovations are closely linked to transregional innovations – roughly four in ten business starters with transregional innovations in 2014 had carried out R&D – those states, according to this indicator, that have large numbers of entrepreneurs coming to the market with new transregional services, ought to be well ahead of the rest.

¹⁶ The very low proportion of entrepreneurs coming to the market with regional innovations is likely to be linked closely to Berlin's strong position on transregional innovations, as, when these innovations initially come onto the market in Berlin, the city's geographical restrictions mean that it no longer has any "regional markets" in which such innovations could be regarded as new.

¹⁷ EY (2015), Start-up-Barometer Germany, August 2015, [http://www.ey.com/Publication/vwLUAssets/EY-Start-up-Barometer-2015/\\$File/EY-Start-up-Barometer-2015.pdf](http://www.ey.com/Publication/vwLUAssets/EY-Start-up-Barometer-2015/$File/EY-Start-up-Barometer-2015.pdf).

¹⁸ The fact that the financial risks associated with unemployment act as a barrier to business start-ups has long been a topic for political debate. The 1999 insolvency law reform also witnessed an attempt to alleviate the consequences of that risk. It was this reform that introduced the possibility of obtaining discharge of residual debt. The Insolvency Code requires defaulters to "be of good conduct" for a certain length of time (the probationary period) before they can become debt-free. However, this loosening of insolvency law has so far failed to have any significant effect on business start-up activity. Source: Metzger, G. (2015): Where there's a will, there's a way? Barriers to becoming self-employed, Focus on Economics No. 82, the KfW Group, Frankfurt am Main.