Diversity is crucial: how the SME sector in Germany compares with others in Europe

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Why do many countries see the German SME sector – the Mittelstand – as a role model? And why is it that, up to now, SMEs here in Germany have come through the current crisis relatively unscathed? In brief: What makes up the German Mittelstand? This paper demonstrates that, above all, diversity is crucial. Large, evenly distributed, industrial, innovative – these are just some of the ingredients in the success of the Mittelstand.

In Europe, small and medium-sized enterprises (SMEs) are receiving particularly close attention at present. Germany’s success in tackling both the current crisis and previous ones – a success in which the Mittelstand has played a significant part – is pushing this sector more and more into the spotlight of European economic policy. The German SME sector is proving to be strong and in robust health, and access to financing here remains largely unaffected. However, there are also structural differences between small and medium-sized enterprises in Europe. And a particularly important difference is diversity.

Large SME sectors in virtually every country in Europe

SMEs are ubiquitous throughout Europe. In virtually every part of the continent, the proportion of SMEs stands at over 99 %. Furthermore, based on current EU data, there are more small and medium-sized enterprises in other large European states than in Germany – such as Spain (+16 %), Italy (+80 %), and France (+12 %). Clearly, the existence of SMEs does not in itself suffice to explain the strength of the German Mittelstand. So why is it that SMEs here in Germany managed comparatively better during the crisis? The German Mittelstand has certainly benefited substantially from the country’s credit rating, which has been consistently at the top level, as well as from investor confidence. Wage restraint and labour market reforms have also made a contribution over the last decade.

In other words, the average size of SMEs is higher in Germany than in other countries. At around 7.4 employees, it is almost double that of the other three countries. The sales situation is similar. According to EU figures, average turnover is significantly higher in Germany (EUR 1.3 million) than in France (EUR 0.9 million), Spain (EUR 0.5 million), and Italy (also EUR 0.5 million).

Value added contribution from larger SMEs is at 150 percent in Germany

The diversity in size strengthens the vertical value chain and ensures a continuity of flow down that chain. Large corporations can shift parts of their value chain onto large SMEs; these can in turn move parts of theirs to medium-sized SMEs, which can pass parts of theirs to small businesses.

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tor ("tertiarisation"), the German SME sector still retains a strong industrial focus. Whilst within the EU-27 an average of 41% of SME revenue comes from industrial activity, the figure in Germany is 46%. This small difference masks a major beneficial effect: in Germany, there is a more even distribution across different sectors – and this provides stability against external shocks. If individual branches of the economy are adversely affected by external shocks – as were export-oriented sectors during the 2008/2009 crisis – then other sectors are investing. That provides an important stimulus for growth, and raises the competitiveness of the economy as a whole. This group often includes "hidden champions", companies which are global market leaders in their field.

Regional clusters with a widespread geographic distribution

German SMEs benefit from the advantages provided by regionally concentrated supplier-customer structures, known as clusters. Clusters offer multiple advantages. It has been empirically demonstrated that companies operating in clusters enjoy superior growth, survive longer, and are more actively engaged in innovation. In particular, the favourable environment which geographic proximity offers for the exchange of technological knowledge and know-how is deemed to have a decisive impact. Furthermore, key infrastructure facilities – such as universities and transport infrastructure (usually of a very high standard) – tend to develop in regional business agglomerations like these.

Compared to the rest of Europe, Germany has a greater number of such clusters (many of them in high-technology areas); moreover, these clusters are geographically more widely spread than in other countries. Examples of well-known German clusters may be offered here, such as those in the areas of biotechnology and life sciences (e.g. Munich-Martinsried, and the Rhine-Neckar biotech cluster); aviation (Hamburg); and photovoltaics / solar technology (e.g. Central Germany, Baden-Württemberg). These clusters are, not least, a tangible expression of the support provided explicitly for clusters over recent decades by Germany’s federal government, states and municipalities.

Innovation guarantees long-term competitiveness

SMEs in Germany are – still – significantly more innovative than those in other countries. Even though the proportion of innovators in Germany fell during the 2008/9 crisis and has not yet recovered, it is still higher than in any other large European country (Figure 3). Innovation ensures that the competitiveness of individual companies – and hence of the economy as a whole – is maintained for the future. Over the past ten years, innovative manufacturing companies have achieved an employment growth rate of 2.2% – almost double that of those SMEs which do not innovate (1.2%).

Strategic factors for success from the Mittelstand perspective

Quality, service, and reliability. In the opinion of German SMEs, these are the strategic factors for success, and these are the strengths on which they build and expand their competitive advantage.

Based on its own assessment, the manufacturing industry in particular, which is extremely active in R&D and is of such importance in Germany (see above), scores highly against interna-
Germany, financing costs rose by only a moderate amount, and then only for a short time to enable them to recover. Furthermore, German politicians reacted very quickly whenever the situation became critical, introducing the “Konjunkturpaket” stimulus package and measures to stabilise the labour market, thereby making a substantial contribution to restoring confidence in economic affairs. Rounding off the list of ingredients for success are a capable education and innovation system, a low level of social inequality, and supportive cultural attitudes. All these factors have had a positive influence on the diversity of the Mittelstand and have thereby served to increase resilience and promote stability.

Europe – promoting growth and increasing diversity

What can other European countries learn from Germany? Adopting an economic policy which aims to help SMEs grow and strengthen their competitiveness will pay for itself. To this end, it is necessary to identify the country-specific obstacles to growth, and to overcome them on a permanent footing. In most European countries, a key short-term challenge is to improve access to financing for small and medium-sized enterprises, and – most of all – access to credit on appropriate terms. For small companies in particular, loan financing offers, in most cases, the only realistic opportunity of raising external funding.

Another strategy to foster growth is to focus on existing regional clusters and support their development. Setting up new strategic clusters, which also serves to stimulate investment in infrastructure projects, could be a further option.

European SMEs and politicians need to focus more intensively on innovation as a long-term driver of growth. Innovation boosts competitiveness, increases investment, and creates employment. Economic policies which aim to foster innovation in small and medium-sized companies can be – and must be – designed with the long term in mind. Only then can they be crowned with success.

And last but by no means least: diversity must be increased. Support for the SME sector should not have a too narrow focus on specific branches. It is much more advisable to support the competitiveness of the SME sector across its full width. This gives space for SMEs to evolve and diversity to develop. And diversity will be crucial in the future as well.

1 See Schwartz, M. (2013), Loans for SMEs – gap in Europe widens further. Focus on economics no. 16, KfW Bankengruppe, Frankfurt am Main.
2 The analyses used in this paper are largely based on the European Commission’s SME Performance Review and the raw data provided with the Review.
3 The beneficial “cushioning” effect of having a regional economic structure which, from a sectoral viewpoint, is more broadly distributed – and hence more diversified – is well known in the literature.
4 In principle, the term “cluster” is understood as a group of companies – either from the same branch of economic activity, or from related branches of economic activity – or organisations (e. g. scientific institutions, or sector associations, which are located in geographic proximity to each other). See, for example, Porter, M. E. (1998), Clusters and the new economics of competition. Harvard Business Review, Vol. 76, pp. 77–90.
7 Prominent examples of clusters elsewhere in Europe include: the automotive industry in the Poland-Czech Republic-Slovakia triangle; biotechnology, nanotechnology and ICT in Cambridge (UK); microtechnology, nanotechnology and biotechnology in Lyon/Grenoble (France); and the “Third Italy” (textiles and other products).
8 See the following by way of example http://www.clusterplattform.de/de/downloads/Clusterpolitische_Massnahmen.pdf.
10 A detailed study into the competitive situation in the German Mittelstand will be published in the Summer of 2013.