

Schumpeter

## Mittel-management

Germany's mid-sized companies have a lot to teach the world

Nov 25th 2010 | from PRINT EDITION



MANAGEMENT gurus are constantly scouring the world for the next big idea. Thirty years ago they fixated on Japan. Today it is India. The more restless are already moving on to Peruvian or Zulu management. Yet in all this intellectual globe-trotting the gurus have sorely neglected the secrets of one of the world's great economies. Germany is the world's largest goods exporter after China despite high labour costs and a strongish euro. It is also stuffed full of durable companies that have survived hyperinflation and two world wars. Faber-Castell, a giant among pencilmakers, boasts that Bismarck was a customer.

Thankfully, a couple of management thinkers have defied the boycott on Germany. On November 18th Bernd Venohr, of the Berlin School of Economics and Law, gave a fascinating talk on the "secret recipe" of the country's *Mittelstand* at the second annual Peter Drucker Forum in Vienna. Last year Hermann Simon, of Simon-Kucher & Partners, a consultancy, published an even more gripping sequel to his 1996 book on "Hidden Champions". Put the two together and you get a good idea of the management theory at the heart of Germany's success.

Although the term *Mittelstand* is sometimes applied to quite small, parochial firms, the most interesting ones are rather bigger and more outward-looking. Most shun the limelight: 90% of them operate in the business-to-business market and 70% are based in the countryside. They are run by anonymous company men, not hip youngsters in T-shirts and flip-flops.

They focus on market niches, typically in staid-sounding areas such as mechanical engineering rather than sexy ones like software. Dorma makes doors and all things door-related. Tente specialises in castors for hospital beds. Rational makes ovens for professional kitchens. This strategy helps them avoid head-to-head competition with global giants ("Don't dance where the elephants play" is a favourite *Mittelstand* slogan). It has also helped them excel at what they do.

Globalisation has been a godsend to these companies: they have spent the past 30 years of liberalisation working quietly but relentlessly to turn their domination of German market niches into domination of global ones. They have gobbled up opportunities in eastern Europe and Russia. They have provided China's "factory to the world" with its machine-tools.

The *Mittelstand* dominates the global market in an astonishing range of areas: printing presses (Koenig & Bauer), licence plates (Utsch), snuff (Pöschl), shaving brushes (Mühle), flycatchers (Aeraxon), industrial chains (RUD) and high-pressure cleaners (Kärcher). Kärcher's dominance of the high-pressure market is so complete that in 2005 Nicolas Sarkozy caused a scandal, after a spate of riots, by calling for a crime-ridden *banlieue* to be cleaned out "*au Kärcher*".

How durable is the *Mittelstand* model? Sceptics worry that it will eventually become the victim of globalisation: emerging-world companies will learn to produce their own clever machines at a fraction of the cost. They also worry that *Mittelstand* companies are too conservative. American start-ups can become global giants in a generation (Wal-Mart, now the world's biggest retailer, was not even listed on the stock exchange until 1972). German companies are content to remain relatively small.

The first criticism is overstated. *Mittelständler* have not only focused on sophisticated niches that are hard to enter. They have thrown their energies into building up ever more powerful defences. They constantly innovate to stay ahead of potential rivals. They are relentless about customer service. Their salespeople are passionate about their products, however prosaic, and dogged in their determination to open up new markets. Mr Simon's "hidden champions", mostly German *Mittelstand* firms, typically have subsidiaries in 24 foreign countries, offering service and advice. Many get the bulk of their revenues from service rather than products. Hako, which makes cleaning equipment, generates only 20% of its revenue from sales of its machines.

The second criticism has more substance. Germany has a poor record at generating start-ups or at quickly turning smallish firms into giants. *Mittelstand* firms are finding it increasingly difficult to persuade the world's best and brightest to make their careers in rural backwaters. But for all that, the record of the *Mittelstand* over the past three decades has been a history of global conquest rather than missed opportunities. Koenig & Bauer, for example, gets 95% of its revenue from outside Germany.

### **German lessons**

So the *Mittelstand* is likely to keep powering Germany's export machine for years to come. But does it have any lessons for the rest of the world? Mr Simon says that although 80% of the world's medium-sized market leaders are based in Germany and Scandinavia, successful *Mittelstand*-style companies can be found everywhere from the United States (particularly the Midwest) to northern Italy, so the model does seem to be transferable.

Three general lessons—for politicians as well as corporate strategists—follow from this. First, you do not need to try to build your own version of Silicon Valley to prosper; it is often better to focus on your traditional strengths in "old-fashioned" industries. Second, niches that appear tiny can produce huge global markets.

The third lesson is that Western companies can preserve high-quality jobs in a vast array of industries so long as they are willing to focus and innovate. Theodore Levitt, one of the doyens of Harvard Business School, once observed that "sustained success is largely a matter of focusing regularly on the right things and making a lot of uncelebrated little improvements every day." That is a lesson that the Germans learned a long time ago—and that the rest of the rich world should take to heart.

[Economist.com/blogs/schumpeter](http://www.economist.com/blogs/schumpeter) (<http://www.economist.com/blogs/schumpeter>)