
Globalization, Eastern Germany and the "Mittelstand"

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Abstract

The pressures of globalization in general and the specific fact of declining inward investment represent together a formidable challenge not only to the German political economy itself, but also possibly to the relevance and viability of the "Rhineland" model of capitalism. In particular, growth and changes in financial markets and the role of banks transform these various challenges into potential threats. They exacerbate the problems and difficulties Germany is experiencing in modernising not just industrial structures, procedures and practices, but also indeed its distinctive industrial culture. Two exemplars of the current crisis are examined here in detail: eastern Germany, and the Mittelstand (Germany's SMEs). The present balance of evidence appears to indicate that successful adaptation is not occurring, with clear indications that it is primarily socio-cultural factors which are hindering the transformation process.

It would appear that it is not generally possible in practice to trace an irrefutable line of causality linking apparently global economic developments and trends on the one hand to specific impacts within particular nation-states on the other, whether the Federal Republic of Germany or elsewhere; at least not in the sense of describing an indelible and unambiguous pattern which would form the basis of a convincing and generally acceptable theory. Quite apart from substantial methodological problems for researchers, the major theoretical issues involved are still very much a matter of intense dispute between and among academics and business practitioners (Parnell, 1998) – Amin and Thrift (1995, pp. 257-60), for example, refer euphemistically to an "unresolved problem": the precise status of the term "globalization" itself. They offer one "strong" (partial) definition thereof, among many other possibilities, as a "structural process with a logic of its own which is unfolding". This element is consistent with Radice's (1997) "strong thesis" of globalization: "one of homogenization, according to which the supposedly irresistible social forces summarized in the term 'globalization' are breaking down national differences in economic institutions, practices and policies". This contrasts with a putative "weak thesis": "the view that economic life remains firmly embedded in distinct national systems, and these will persist because either globalization is not happening, or in so far as it is, it has no necessary effect on national differences" (Radice, 1997; see also Ohmae, 1995). However, Radice reminds us importantly of two further considerations: the term "globalization" implies a transition from national to global (which begs the question), and that world capitalism has always been national and global; this is not simply an either/or matter.

The present author's approach to these issues is eclectic and "agnostic", accepting (with qualification), with Amin and Thrift (1995, pp. v-viii), that "the context [is one] of an all-pervasive globalization of economic, political, social and cultural processes". However, "globalization does not represent the end of territorial distinctions and distinctiveness, but an added set of influences on local economic identities and development capabilities" (Amin and Thrift, 1995, p. 5; see also Ohmae, 1995). If this were not the case, there would be little point in attempting to explore in depth the implications of globalization for any one

particular political economy, including the German. A previous paper (Parnell, 1998) has already indicated how major, representative German policy-makers perceive globalization and its implications, directly and indirectly, for many key policy areas: economic, industrial, competition, and labour market, for example. Of considerable symbolic significance, is the reaction to global pressures and challenges by that seminal German institution, the Deutsche Bank, which, among other things, has attempted to establish a new, world-class investment bank: Deutsche Morgan Grenfell; basing it in London, with control located there, represented a revolution for the Deutsche Bank and a sea-change in its corporate culture (it is not clear whether recent personnel difficulties will lead to any permanent reversal in the source of policy direction). However, how fast the German financial services sector as a whole can modernise, to meet the highest standards prevailing internationally, is still an open question (see below).

Investment and FDI

The ability of the German economy as a whole to compete globally depends not least on continuing to maintain appropriate levels of investment, particularly in state-of-the-art industrial capacity. (See Porter, 1990, in particular "Companies not nations are on the front line of international competition".) The main issue is where that investment will take place. For German companies to invest abroad, whether to take advantage of lower production costs, to be nearer to key markets[1], or to access increasingly specialised, information-intensive technologies (in particular regions)[2] is unexceptional – transnational companies from all the advanced economies act similarly. The key issue is the balance of direct investment – disproportionate outflows can entail the hollowing-out of industry and pre-programming increasing unemployment (deindustrialization?), unless there is at least partial compensation from the services sector (which appears generally not to be happening in Germany; see also below). In 1996, foreign direct investment in Germany slumped to DM 1.14 billion, from DM 18.23 billion in 1995. The outflow rose to DM 38.8 billion, double the figure for 1993. According to *Business Week* (1997a), this "stream" of investment could become a "torrent": "if Europe, as planned, shifts to a single

currency in 1999, because German companies will no longer risk any negative exchange-rate effects if they relocate to, say, Spain or Portugal". *The European* (1997a) also pointed out that according to a National Chamber of Commerce and Industry survey, 28 per cent of 7,200 companies questioned planned to move their production base out of the country in the next three years. But it is questionable as to the extent to which such movement should be considered truly global – more than 70 per cent of German foreign direct investment finances takeovers within the European Union, with Britain and France the preferred destinations. Siemens, Germany's second largest employer, will soon have more staff employed abroad than at home. For example, it recently announced investment in Portugal of approximately DM 700 million in the microchip and related electronics sectors. Siemens already employs 5,000 employees in Portugal – in short, it is expanding in Portugal not Germany. While employment in Siemens as a whole rose by 2 per cent to 386,000, in Germany it cut 3,000 jobs; in the first nine months of 1997, the company created 10,000 jobs abroad (see also *Financial Times* (1997)).

In fact, German investment abroad, because of currency relativities, is actually understated by about DM 20 billion (*Frankfurter Allgemeine Zeitung/FAZ*, 1997a). Apparently, foreign investors in Germany are financing their much lower investment by selling off other German involvements or, for tax reasons, financing their new commitments via credits raised with German banks. According to *The European* (1997a), a significant level of divestment is being undertaken by companies who have been repaying loans to overseas parent companies rather than keeping the funds in Germany. In 1996, US companies repatriated DM546 million, Asian (mostly Japanese): DM536 million of capital. In the same year, the US invested DM355 million in Germany; Germany invested DM8.8 billion in the USA. *Business Week* (1997a) summarizes, foreign investment has dried up: "Last year [1996], foreign companies repatriated all their German profits, pulling a net \$2.6 billion out of Germany. That's the first outflow in years"[3].

Why are the prospects of investing in Germany apparently so unattractive? According to *Die Zeit* (1994), it is not so much because of the conventional reasons: high taxes and labour costs, and inflexible labour laws and

customs; it is primarily because: "there is a lack of that web of suppliers, buyers, associated companies and competitors which is what really makes efficient production possible; 'company clusters' are missing ... the prerequisite for globally competitive industry" (see also Parnell, 1998, Note 8, p. 86). Whether this assertion attempts to offer a complete or merely partial explanation of the phenomenon in question, it is irrefutable that total net investment in Germany in 1996 was one-tenth lower than in 1995. The investment "quota" that year barely reached 10 per cent, compared with about 11 per cent in 1994 and 1995. Gross investment by companies (excluding housing and financial services) was down by 4.5 per cent, to DM392 billion. Overall investment in manufacturing industries was just three-quarters of the level of 1995. There was only a recovery in export-oriented industries.

The German trade balance in 1996 was very positive, with a surplus of DM97.6 billion, the highest since 1989. Exports grew by 4 per cent, and were anticipated to grow by a further 6 per cent in 1997. However, the export surplus was really based more on weak import performance, due to the stagnant national economy. In previous years, export growth was averaging 9.2 per cent; the average for the whole period 1980–1996 was 5.2 per cent, so the 1996 figure did not even match that average. Although German exports increased by DM180 billion to DM5,100 billion, Germany's share of world trade actually fell by 0.6 per cent to 9.8 per cent, continuing an established trend since the mid-1980s. Since 1989, the relative German export performance had deteriorated by 22 per cent, in marked contrast to competitor nations like the USA, Spain and Sweden (*Welt am Sonntag*, 1997). However, in the very latest period, the strong US dollar has clearly helped German exports, even in the Far East. Yet despite this, Germany's exports to China in 1996, for example, only amounted to DM10.8 billion (although Germany is China's main trade partner in Europe), representing just 1.39 per cent of total German exports (Germany imported 2.62 per cent of its requirements from China, making a total trade volume of DM28.8 billion). Moreover, overall German direct investment in Asia is very low, Singapore being the only exception, receiving DM 1 billion of investment in a recent two-year period. The 1996 World Economic Forum report on global competitiveness ranked Germany 25th,

down from 22nd in 1995. Similarly, the Lausanne Management School, IMD, in its 1996 World Competitive Yearbook, places Germany 14th, after having been tenth in 1995. The general picture is one of steady, if inexorable, decline.

However, it is possible to present too black a picture – the German chemical industry, for example, albeit slowly, is responding and rising to the global challenges; for instance, Bayer, a world leader in chemicals and pharmaceuticals, had an excellent year in 1996 (*Wirtschaftskurier*, 1997). Bayer is also making particularly strenuous efforts in the bio-technology sector (after all, typical US companies have a seven-to-ten-year lead); it has, for example, set up a new risk capital fund of over DM 20 million. The fund is intended to assist new company start-ups in this area, particularly those arising as spin-offs from research conducted in institutions of higher education.

The German motor vehicle industry has experienced a remarkably positive turnaround in recent years: BMW, for example, with a DM52 billion turnover in 1996, had a record year. Despite only generating 28 per cent of its sales in Germany, the company invested DM2.3 billion domestically in 1996. BMW has created 3,000 new jobs in the last few years and most of the latest ones to be created by the new investment will be in Germany itself. Volkswagen (VW) has re-established itself as Europe's leading car manufacturer – its market share is rising, now (mid-1997) at 18 per cent, and expected to reach 20 per cent by the end of the year; its share price has doubled in just a few months. Its first quarter profits in 1997 were DM178 million, with DM600 million predicted for the whole year, on sales of DM100 billion; DM2 billion of profits have been predicted for 1998. The transformation at VW has been made possible more through product innovation than savage cost-cutting (productivity at the Wolfsburg headquarters is still three times lower than that at the new Opel plant in Eisenach, eastern Germany, and similarly lower than that at Japanese competitors). VW has replaced and revamped the whole range of cars offered through its four brands. By the end of 1997, it will have 11 models (with 80 per cent of manufacturing being based on three platforms) and the widest and youngest brand models of any European manufacturer. Yet Porsche, which is also booming, is planning to construct its latest Boxster model in Finland

and Mexico; VW itself now employs 55 per cent of its workforce abroad. So the question arises, how representative are these successful firms for German industry as a whole? Not very; at 15.5 per cent, Germany evidenced in 1996 the highest rate of increase in company insolvencies of any country in Europe – total cost to creditors and the state: DM80 billion.

Globalization, investment and Eastern Germany

In 1995, after thorough examination of the evidence available, Tüselmann (1995) was forced to conclude that Germany as an international manufacturing base was of poor and diminishing quality; above all, the location quality of eastern Germany appeared to be exceptionally poor. Just one year later, *Die Zeit* (1996) was reporting: "the economy in eastern Germany is not catching up, but falling [further] behind"; this despite annual transfers from the public exchequer in the order of DM130-150 billion – 11-12 billion going into direct industrial support (i.e. to companies). This "waste" of resources was not only failing to achieve a turnaround in eastern Germany, but also, pessimistically, this authoritative weekly was forced to conclude that no effective policy alternatives appeared to be on offer from any source. The precise transfer figures are as follows:

- (1) Direct from the Federal Exchequer:
 - DM75 billion – 1991;
 - DM135 billion – 1995;
 - DM133 billion – 1996;
 - DM128 billion – 1997.
- (2) From the Federal Labour Office:
 - DM33 billion – 1992;
 - DM33 billion – 1993;
 - DM21 billion – 1997.

The semi-state insurance institutions provided 17 per cent of the gross transfer in 1997; the regional and local governments together: 11 per cent. In 1991, DM33 billion was repatriated (in taxes and other remissions); in 1996: DM50 billion (*Die Welt*, 1997a).

One month later still, another prominent weekly, *Die Woche* (1996), was able to quote an official memorandum from the Federal Economics Ministry that: "the new Länder [eastern Germany] are far from achieving a largely self-sustaining economic development". It would appear that an "Italian situation" was developing, with a permanent

division between an affluent west and an impoverished east. Certainly, prospects for the next few years were bleak – according to the Munich-based IFO Research Institute, investment in eastern Germany will decline in 1997 by 5 per cent, with the region's overall contribution to German GDP still only amounting to about 9 per cent[4]. On such a basis, eastern Germany was "never" likely to attain western German levels.

Such negative development may strike many outside observers as unexpected, if not surprising and paradoxical, given the huge sums, outlined above, going to support eastern Germany, amounts which dwarf those going into other states of Central and Eastern Europe. A partial explanation is perhaps to be found in the political and "social" spheres – according to *The European* (1997b), with journalistic exaggeration, German reunification "was a political take-over with an economic price, an Anschluß with after effects". Gernot Grabher (quoted in Amin and Thrift, 1995) confirms, more objectively, that regional development in (eastern) Germany is now largely determined by West German investors: "only 10.7 per cent of investment and 9.1 per cent of job commitments related to the privatization of the eastern German economy are of non-German origin". But the implications of this are not purely economic or industrial: "unification has come to encourage cultural and political separation and even generate ... a distinct East German (GDR) ethnicity" (Grabher, 1995, p. 178). If this thesis is correct, and there is much evidence to support it, then two Germanies still very much exist, may not be growing closer together, with the additional danger that this bifurcation could undermine Germany's ability to rise to the general challenges of globalization and to the specific demands of European economic and monetary union (see below).

The failure of the two Germanies to integrate politically, socially and economically was manifestly not the policy objective of reunification. One approach towards a partial analysis of why "the eastern German problem" has taken the form it has, in the global context, could be offered by the concept of "embeddedness", i.e. "economic life is embedded in social relations and is therefore heavily dependent on a mix of cognitive, cultural, social and political institutions". Or, alternatively: "social and cultural factors also lie at the heart of economic success" (Amin

and Thrift, 1995, p. v, 14; see also chapter by Dicken *et al.*, pp. 23-45).

But the contemporary industrial restructuring of eastern Germany has led to an implosion of its productive system and the massive loss of production capacities and industrial skills. Moreover, this very destructive development represents both cause and effect, according to a convincing analysis by Grabher (in Amin and Thrift, 1995, pp. 182-3), of (the) "dissolution of basic social institutions which [could] have formed a nucleus for developing the institutional fabric of a modern (local) civil society"; not only that: "the atomization of social and economic relations in eastern Germany has in no sense unleashed market forces. Instead, it has blocked the generation of indigenous economic activity". As Amin and Thrift (1995, pp. vii-viii) themselves appropriately summarize the total situation: "the paltry local economic benefits and spin-offs associated with the 'truncated' industrialization of the east German regions in the hands of western investors; a process of inward investment which has swept aside or by-passed old socio-institutional traditions which once, at the very least, guaranteed a minimum level of local industrial 'embeddedness'". One industrial society seems to have been destroyed, but the difficulties of replacing it by something entirely new, effective and equitable, have been hopelessly underestimated by all relevant policy-makers. Irrespective of how long the "transition" period towards "joining the West German system" (which is itself in crisis), eastern Germany, at the moment, is a land which has developed a "capitalism without (eastern German) capitalists". It would seem very problematic as to how self-sustaining regional economic development can emerge while investment is largely in the hands of western German corporations.

One particularly central area of weakness which requires to be addressed as a priority is that of technology[5], innovation and "knowledge as a factor of production" (not least because the "distribution and exchange of knowledge is a crucial element of the global and local economic system on a scale that was never the case before") (Amin and Thrift, 1995, p. 3). Despite considerable progress in recent years, eastern Germany's industrial performance lags considerably behind western Germany's; in fact, the productivity gap has hardly narrowed at all in the last three years. The Halle Economic Research Institute has established that, in 1996, average productivity

levels were still only 55 per cent of the western German levels, severely limiting the ability to afford an equalization of wage incomes across the two Germanies (*Handelsblatt*, 1997). That is one reason, among many, why substantial financial transfers will have to continue to be made until well into the next century.

The Halle Economic Institute also established that the latest technology plays too subordinate a role in eastern Germany, standard technologies predominate. The number of patent registrations, calculated per capita and relative to the number of people employed in research and development in eastern Germany, yields the following:

	("old" - FRG)	(ex - GDR)
Manufacturing - Standard technology (%)	54.2	73.0
Higher level technology (%)	39.0	24.1
Top level technology (%)	6.8	2.9

For the whole of Germany, patents in the hi-tech sphere amounted to 12 per cent of all patents registered, approximately half the US percentage. In fact, even regarding western Germany alone, a large gap was evident in vehicle manufacture (in relation to Japan); electronics (Japan and the USA); and information technology (USA). The general picture is one of Germany being considerably behind in certain technologies, with eastern Germany falling especially far behind. Given the increasing transactionalization of technology, and that the "knowledge structure" (expert systems) is becoming less and less tied to particular national or local business cultures, what realistic chance does eastern Germany have of ever "catching up", given much more viable alternatives/opportunities elsewhere?

Eastern Germany appears not to be becoming a "magnet" in the following sense: "... (this unique ability to act) as a pole of excellence and to offer to the wider collectivity, a well-consolidated network of contacts, knowledge structures, and institutions underwriting individual entrepreneurship, which makes a centre a magnet for economic activity" (Amin and Thrift, 1995, p. 3). If eastern Germany represents, in an extreme form, a current general failure of the German political economy to adapt to global competition[6], then the implications for the wider European Union are profound.

The German government's latest attempt to deal with the parlous situation in eastern Germany was yet (another) "new" Eastern Initiative ("Ost-Initiative"), launched in May 1997 [7]. This initiative, led by the Federal Government, and supported by the governments of the eastern *Länder*, represented a "joint initiative" to create more jobs in eastern Germany, jointly, that is, with the employers and trade unions. Priority was to be given to reducing unit labour costs, through the established collective bargaining channels (with agreements permitting greater flexibility at factory level). Yet immediately, the customary schizophrenia of the government's approach manifests itself: on the one hand, the intentions of the initiative cannot be fulfilled without close co-operation and collaboration of employers and unions (along with appropriate support from the public offices) i.e. trust between capital and labour will be of the essence (as has been "customary" within modern organized capitalism). On the other, Hans Christoph von Rohr, managing director of the new Industrial Development Council GmbH (Bund-Länder-Marketinggesellschaft), designed to attract inward investment to eastern Germany (and granted a DM50 million budget for three years, until 1999), intended to use as one of his main "selling points" the fact that trade union membership in eastern Germany had halved since reunification and that now only half of eastern German companies are unionised [8]. Either the trade unions are valued and important partners in transforming eastern Germany for the better, or they are liabilities to be marginalised wherever possible; they cannot be both simultaneously [9].

Legitimate doubt and scepticism are possible regarding the likely effectiveness of measures to stimulate the eastern German economy: to overcome the severe competitive disadvantage, including unit labour costs 30 per cent higher than in the original Federal *Länder*, growth rates need to exceed 10 per cent for many years, entailing billions of DM-investment by the employers – is this at all likely? The urgency of the situation is demonstrated by the latest national unemployment figures, a post-war record, the official figures for eastern Germany reaching 18.3 per cent (August 1997). In an interview with *Business Week* (1997b), Gerhard Schröder, the premier of Lower Saxony and likely SPD-Chancellor candidate for the Federal elections in 1998, confirmed that without these transfers "the

eastern economy would break down". Moreover, this whole east German phenomenon is what, in his view, is preventing a major reform of the German tax system (one approach has been proposed by Helmut Kohl's coalition government), clear confirmation that eastern Germany is not a localised, regional problem, but something with multiple ramifications for many aspects of government policy. One of the main casualties of the unresolved issues could well be that king-pin of modern post-war German organized capitalism: "consensus" – in the words of *The European* (1997c): "an aggressive and confrontational style has grown up in the wake of unification" [10]. If the threat to (the indispensable) consensus is real and substantial (see Parnell, 1998) then, once again, Kohl's obsession with European economic and monetary union is comprehensible: to deal with the adverse consequences, in a sense, Germany needs Europe more than Europe needs Germany.

The "Mittelstand" in both Germanies

It would appear to be generally accepted by industrialists, academics and politicians that Germany's "Mittelstand", its small- and medium-sized enterprises (SMEs), represents not only the backbone of the economy, but also, indeed, of the latter's post-war renaissance. This sector possesses many strengths and advantages, not least its ability to "dominate global micro-niches" (Peters, 1992, p. 529). However, of the many issues appertaining to the performance of these companies, three predominate: what is the general industrial climate within which they operate; which specific challenges are to be addressed, perhaps ones applying generally to SMEs in any advanced industrial nation, or unique to Germany; and how problematic is the specifically eastern German context?

It is to be expected that SMEs represent the most dynamic element in a national economy, not least because, being smaller, they are "nearer to the market" and with short decision-chains can respond more quickly and flexibly to changing market circumstances – moreover, the profit-maximising owner/manager, the classic entrepreneur, seems to match more closely the models expressed in conventional textbooks of how market economies are supposed to function. Tom Peters' depiction of "the mighty German Mittelstand" represents a powerful paean of praise for its sterling

qualities. But a careful reading yields some blemishes: Kurt Gertler, managing director of Playmobil's Deitenhofen factory, laments the lack of worker motivation today, people apparently not wanting to take responsibility. Perhaps more significantly, at Trumpf, one of Germany's leading medium-sized companies, there is concern at "a shortage of the creative, entrepreneurial sorts needed to build a healthy future".

Such anecdotal evidence is consistent with Smyser's (1992, p. 97) assertion that the (industrial) "German style" minimizes risk – "it does not incline towards the establishment of new and different enterprises or industries". Yet it is precisely new industries and enterprises which are required, particularly in the service sector, to create employment to compensate for that lost in manufacturing – in mechanical engineering alone, approximately 140,000 jobs are being shed each year. However, although 70 per cent of job growth is occurring in services, most of it is taking place in low innovation areas like legal, tax and business consultancy. There are few part-time or contract jobs in Germany, unlike in The Netherlands, which also adheres to a model of Rhineland capitalism. A specific indication of an apparent lack of initiative was manifested by no German developer being prepared to undertake the Centre O project in Oberhausen, a retail and leisure complex which, now completed, is the biggest shopping centre in Europe. Peters (1992) commends the (allegedly) "decidedly non-bureaucratic, pro-competition Mittelstand", but this is hardly supported by evidence which indicates that in German industry generally (irrespective of company size) there is at least one white-collar worker for every production worker. This compares very adversely both with Japan and the USA where the equivalent ratio is approximately one-to-four.

The situation in eastern Germany is certainly no better, despite all the effort and capital going into creating a latter-day "economic miracle". Grabher (1995, p. 191) refers to the "cathedrals in the desert": major investments in the new *Länder*, such as in new motor vehicle manufacturing facilities and modernised energy production plant, which should have important, positive consequences for stimulating entrepreneurship among small suppliers in the surrounding regional economies. However, the "truncated functional status" of those "cathedrals" achieves the opposite effect: "the

lack of decision-making functions, especially those related to technical, scientific, and management tasks, is also an absence of the 'seedbed' that produces future entrepreneurs" [11]. Only three years later, *Die Zeit* (1997) found it necessary to stress that entrepreneurs were still sorely needed, ones with "ability, initiative and stamina. There are too few of them in the east, as in the west ... For in one thing 'Ossis' and 'Wessis' [easterners and westerners] are equal: ponderousness ('Schwerfälligkeit')". So a clear paradox is emerging: in the past, German SMEs have been a major source of dynamism and innovation within the economy (and some still are), whereas there seems to be much evidence to suggest that this vital sector is not, on the whole, as dynamic and innovative as it could and should be if Germany is to modernise appropriately. The acute problem of the "*Generationenwechsel*" [12] in recent years further underscores the seriousness of the situation.

There seems to be cross-national agreement that genuine entrepreneurs (whether owner-managers or small internal groups with an equivalent function) display "entrepreneurial" élan/flair; imagination, and the courage to abandon familiar paths: these qualities are prerequisites (if impossible to quantify) for commercial success. Yet *The European* (1996) reports an OECD study for 1992-93 that describes "Germany as one of the countries with the lowest percentage of self-employed people in Europe. Germany's small business sector comprised only 9 per cent of economic contributors." This is clear prima facie evidence that the distinct entrepreneurial desire to take the risk of becoming "*selbständig*" (literally, "independent") is underdeveloped in Germany. However, the typical hurdles facing German small businesses, like red tape, a suspicion of new ideas, limited funding possibilities and the guild system are, with the exception of the last-named factor, not unique to Germany. British SMEs, despite the much-vaunted venture capital industry and, more recently, business "angels", could probably mount a stronger complaint regarding funding support. The whole SME "sector" is also extremely multifarious and where "a suspicion of new ideas" obtains, this contradicts conventional notions of entrepreneurialism. More research is clearly needed into micro-companies both in Germany and on a cross-border basis [13].

One sphere in particular where there is disagreement over the performance of the German Mittelstand is marketing – Peters concludes forcefully with the Mittelstand's "symbiosis with the end user" and being "big spenders where it counts – i.e. for the customer" (Peters, 1992, p. 598). However, Professor Wildemann (1997) of the Technical University, Munich, argues that the products (of SMEs) typically need to become more "customer-specific", with companies needing to become customer rather than product led (with the implication that "benefits" take priority over "features"). An interim conclusion to research on export activity by the present author established: if the success of German small company exporters to the USA is generally representative of SME export success, then it appears, on the basis of the evidence provided by this research, not to be based on a dynamic, professional approach to marketing their products (Parnell, 1993). If major marketing deficiencies are apparent, then it is company management's responsibility to remedy them.

Logically, though, any company deficiency becomes a responsibility of management to resolve. Wildemann's research institute claims to have established that about 15 per cent of the current cost disadvantage of German products on world markets is directly attributable to wages, on-costs and working hours. Frequently, however, the German product is 20–40 per cent more expensive than competitive products. Consequently, approximately half of the negative cost differential is attributable to the "activity" (*Verhalten*) of managers and of the employees they direct. The main question which arises in this context for the current paper relates to how that "activity" might be influenced by globalization. Where globalization entails the development of "production networks" (abroad), according to Wildemann's institute, it is not sufficient for the managing director of an SME to rely on his/her (self-sufficient?) position as owner – SME managers must also learn an important new skill: managing networks of suppliers, producers and distributors (Wildemann, 1997). Not only that, as the global division of labour and increasing specialization advance, SMEs more frequently encounter financial bottlenecks, i.e. difficulties of access to capital. "Yet many 'mittelstanders' still insist on the 'master-in-one's-own-house' position, announcing not without pride, that they are independent of banks. But now they are being

faced by networks; they can no longer be owners of all resources. This demands co-operation – and presupposes a different kind of behaviour" (Wildemann, 1997). So it would appear that the Mittelstand, like so many other areas of the German economy, is far from immune from the exigencies of globalization. Moreover, to take a specific instance, by the mid-1990s, the German machine-tool industry had increased the value of subcontracted parts to 70 per cent, from 40 per cent only a few years earlier. With more of this increased outsourcing going outside Germany, Mittelstanders have the choice of also expanding abroad, or losing vital orders. The choices are stark.

Conclusion

Irrespective of whether a "strong" or "weak" view of globalization is taken, the phenomenon in question clearly represents numerous challenges and, in some respects, threats to the advanced nations of the industrialized world. One aspect of globalization, increased levels of capital and investment flows, and the increasing ease with which this occurs, poses a particular problem for Germany: irresistible evidence appears to be mounting and accumulating to the effect that the country seems to be becoming less and less attractive as a destination for capital investment (*viz.* "Standort-Deutschland" debate). One common view is that the general model of Rhineland Capitalism, and the particular version of it in Germany, is unsuitable, or no longer suitable, as a ("national") context and framework for appropriate economic and industrial development compatible with the "new" global environment (see Parnell (1998) and part II as yet unpublished). This paper has attempted, at least in part, to establish that the political, social and cultural dimensions of the relevant global and national developments, add further complexity to what is already a protracted and indeterminate debate and that, in some respects, these other aspects are as important as, if not more important than, what might be considered purely economic, industrial or even business considerations.

Two instances of the very complex interrelationships and interactions between global, national and regional factors have been provisionally examined here: eastern Germany, and SMEs (the Mittelstand) – they are intrinsically significant, yet also encapsulate and illuminate wider national dilemmas. It has been argued

and, one hopes, demonstrated, that attempts to rejuvenate that part of Germany which was formerly the German Democratic Republic have failed and are continuing to fail. The main implication is that this failure will continue unless certain key political and social issues are addressed as a matter of urgency. A sober and comprehensive analysis of the precise nature of, and reasons for, the current impasse is a vital and necessary prerequisite for the development of a new policy direction. There are, at present, seemingly few grounds for optimism that this will actually occur, certainly not before the Federal general election in 1998.

Germany's Mittelstand represents a key institution within the "national" political economy, not least through being heavily engaged in international trade; for example, SMEs in the speciality chemicals sector outperform the three giants Bayer, BASF and Hoechst. Nevertheless, increased and increasing competition from overseas, particularly from Japan, especially in sectors like mechanical and electrical engineering, is posing a substantial and, as yet, by no means conquerable challenge to existing structures and practices. It may be that certain social and cultural factors, indicative of a wider malaise, are inhibiting the Mittelstand in successfully combating the manifold and intensifying challenges from abroad. The Mittelstand is often at the cutting-edge of industrial innovation, but there are grounds for suspecting that the "psychological", social and institutional innovation which underpins technical and technological innovation is stultifying in Germany. An entrepreneurial culture is lacking, hi-tech innovation is failing to keep pace with that of the world leaders in the USA and Japan, and crucial SME marketing activity may well still be insufficiently professional.

So, at least in those two spheres, eastern Germany and the Mittelstand, there is little evidence to suggest that Germany is mastering its current industrial crisis. However, the precise nature of that crisis is so complex and controversial, the interpretation of which is rarely free of ideological undertones, that no patent recipes and panaceas offer themselves.

Notes

1 Both these reasons, for example, prompted and justified the major new manufacturing facilities erected by Mercedes and BMW in two southern states of the USA (both being "right-to-work" states).

- 2 Radice justifiably argues that "the technological base of production has itself become 'globalized' and that national business systems are tending to fuse together"; with one consequence that "MNCs' investments are often made to access the sector-specific technological capabilities of host economies" (Radice, 1997, pp. 525: 528).
- 3 This totally bleak picture appears to be completely contradicted by a *Guardian* (1997a) report which asserts, for a more recent period, that "German firms ... have overtaken British companies as the most attractive in Europe for foreign corporate investors". It refers to a recent KPMG study, according to which Germany attracted \$16.7 billion of foreign corporate investment in the first half of 1997. A main reason for this, according to a contemporaneous 3i's survey: companies are still attracted by German workers – the most efficient, best-educated, most loyal and hardest-working in Europe.
- 4 There were also 6,000 company bankruptcies in eastern Germany in 1995, with 7,500 projected for 1996.
- 5 Radice also noted that "the 'embedded' character of technology suggests ... that cultural and institutional factors are vitally important for success in innovation" (Radice, 1997, p. 527).
- 6 For example, even in Germany's hi-tech heartland: "in Baden-Württemberg, the pressures are global in the sense of there being a new production model and enhanced competition, primarily from Japan, in its core industries" Cooke and Morgan (1995, pp. 91-117). Regarding the machine tool industry: "Japanese firms are massively more productive, and more profitable with proportionately lower labour costs and lower inventory" (Cook and Morgan, 1995, p. 96).
- 7 In the manufacturing sector, for example, grants were to be increased from 5 per cent to 10 per cent. For SMEs, these "premiums" were to be increased from 10 per cent to 20 per cent. For further details, see *FAZ* (1997b).
- 8 There may be a certain irony in this hostility to a trade union involvement in the light of a *Guardian* (1997b) article which offers a digest of a recent OECD report, e.g.: "there is no link between the level of trade union activity and overall economic performance ... It could find no evidence that the existence of unions led to more unemployment or fewer jobs ... lack of unions and absence of collective bargaining were associated with a higher incidence of poverty pay ... no link between deregulation and earnings mobility". These findings appear to refute the conventional wisdom, as typically expressed by Lester Thurow (1997): "... muß die Arbeitslosigkeit immer und ewig zunehmen, solange irgendetwas (Sozialleistungen, Gewerkschaften, Arbeitsgesetze) verhindert, daß die Lohnkosten sinken. Genau das passiert zur Zeit in Europa. Hohes und lange gewährtes Arbeitslosengeld, die Verhandlungsmacht der Gewerkschaften und Arbeitsgesetze, die die Entlassung von Beschäftigten erschweren und verteuern, haben die Löhne, anders als in den USA, hoch gehalten." See also the mid-1997, half-yearly report of the IMF praising "labour market flexibility" and stressing the apparent need for continental European countries to "adopt labour market reforms" to overcome deep-seated problems in Europe's labour markets (*Guardian*, 1997c).

Other selling points included: the great, positive transformation of eastern Germany so far was evidence of how flexible and adaptable the east German labour force is, more so than in western Germany. Also, general averages about productivity levels in eastern Germany are misleading, the latest plants evidence productivity levels comparable with the best anywhere in Europe.

- 9 Further possible evidence of political "schizophrenia" occurred with later attempts to square the circle of cutting aid to eastern Germany, without reducing that aid! See *Die Welt* (1997): "... daß trotz der vereinbarten Kürzung der Fördermittel alle zugesagten Gelder auch ausgezahlt werden ... der erzielte Kimpromiß habe praktisch keine Auswirkungen auf die aus der Gemeinschaftsaufgabe Ost gezahlten Hilfen".
- 10 The article continues: "Said one Bonn journalist: 'Of course, the consensus has gone. We're a big country now and we don't have the money anymore. You need money to have consensus.'"
- 11 Grabher adds: "It will take a long time to create the cultural and institutional foundations for a new entrepreneurship which taps into local resources" (1995, p. 193).
- 12 As the entrepreneurs who pioneered Germany's post-war industrial resurgence retire, it is often difficult to find successors, in some cases impossible. There are extreme instances of healthy, viable firms having to close down.
- 13 My own investigations have indicated that most research in Germany into SMEs concentrates on medium-sized companies or combines both categories. Research into genuinely small companies (with less than 100 employees) is urgently needed, however difficult to undertake in practice, especially regarding micro companies (so many of which are to be found in Germany's Handwerk "sector").

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