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Mittelstand policy after the pandemic – for a sustainable future

Friederike Welter* & Britta Levering**

Covid 19 pandemic, digitalization, Green Deal – Mittelstand companies will face great challenges in the next years besides their sector and size-specific tasks. Derived from Mittelstand research, we outline which legislative motions and support measures policy makers need to pay attention to in order to sustainably strengthen Mittelstand companies' competitiveness and innovativeness.

Keywords: Mittelstand policy, Covid 19, Green Deal, digitalization, innovativeness, competitiveness

JEL: K20, A10

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1 Thoughts about the future of the Mittelstand policy

German Mittelstand¹ makes an essential contribution to our economy and society. It is a significant force in the education and apprenticeship system, creates and secures jobs, and provides goods and services for the population. Furthermore, during times of crisis, Mittelstand enterprises contribute to the stabilisation of economic and societal order. This could already be observed during the global economic and financial crisis of 2008/09, and now also during the pandemic. Mittelstand enterprises represent reliability and a sense of commitment towards their employees, customers and suppliers. Their values are reducing uncertainties for market participants. For example, during the last months of the pandemic, Mittelstand enterprises once again hoarded skilled labour as long as economically possible, as they had already done during the economic and financial crisis. However, entrepreneurial self-responsibility as well as the willingness and ability to create something new became apparent during the crisis. Low hierarchies made it easier for Mittelstand enterprises to react quickly to changing conditions. Flexibility, proximity to customers, and creativity became success factors for resilience in many sectors of the Mittelstand. Companies reorganised work processes completely; for instance, textile companies produced urgently needed everyday masks and retailers expanded their online sales. In turn, the population demonstrated its solidarity with the Mittelstand in many places, for example, by launching "buy-on-premises" initiatives (Welter et al 2020).

The examples prove that Mittelstand enterprises can recover from crises like the pandemic and adjust to different conditions. However, Mittelstand needs proper support for that. Last year, policy makers were in crisis mode and helped cushion the pandemic's negative effects on businesses. Now, however, a future oriented Mittelstand policy is needed. Mittelstand policy needs to be coordinated across policy fields and with the concerns of Mittelstand enterprises in mind - as one cross-sectional policy concern. Mittelstand policy should pursue the goal of maintaining or supporting the future viability of Mittelstand enterprises in all their diversity. This means, it is also essential to tackle current economic and socio-political challenges. We suggest that Mittelstand policy should focus on framework conditions that enable Mittelstand enterprises to master future challenges on their own.

¹ The IfM Bonn defines German Mittelstand by the unity of ownership and management. More: <https://www.ifm-bonn.org/en/definitions/mittelstand-definition-of-the-ifm-bonn>

2 Taking stock: Mittelstand policy during a crisis

When the pandemic reached Germany in March 2020, policymakers had to react quickly. There was no blueprint available: policymakers could not rely on experience from previous pandemics, nor was the situation comparable to past crises such as the financial and economic crisis. In addition, the asynchronous and unpredictable nature of the pandemic further complicated decision-making. Health policy considerations were the driving force. The anti-pandemic measures included contact restrictions, school and kindergarten closures, as well as (partial) lockdowns of entire sectors of the economy. However, each of these measures was associated with societal, social, and economic costs, which must be considered in post-pandemic Mittelstand policy (Welter & Wolter 2021a).

The pandemic was unique in the sense that it was not only the virus that threatened Mittelstand enterprises, but also the anti-pandemic measures imposed by policy. As a result, the entrepreneurial risk for some Mittelstand enterprises rose to a level that threatened their very existence (Welter and Wolter 2021b). Notably, in the consumer-related sector, the measures left companies with hardly any room for manoeuvre. Mittelstand policies were able to cushion the initial effects of the crisis, soften the psychological shock for Mittelstand entrepreneurs, as well as secure business liquidity and jobs by using short-term available financial aid (Welter, Wolter and Holz 2020; Block et al. 2020). Overall, long-term economic damage could thus be avoided.

At the same time, initial interviews from a current research project carried out by IfM Bonn on the entrepreneurial resilience of companies during the pandemic indicate that the aid provided to individual companies did not always have the desired effect. For example, in the summer of 2020 an exhibition booth construction company narrowly missed the eligibility criteria for the extended Bridging Assistance programme and ultimately had to file for insolvency, although it had been economically sound and viable before the crisis. By opening new business areas in the first weeks of the pandemic, such as shopfitting and interior design, the company had tried to avert complete closure and keep their employees. However, it briefly achieved such high turnover that it was above the threshold for financial support. Another company saved the money they received from the Bridging Assistance programme instead of investing it because the owner feared the payback.

Massive sectoral and company-related support was unavoidable due to the severity of the pandemic's consequences, nevertheless it might be the support itself that could turn problematic in the long term. Thanks to the COVID-19 assistance programmes and the suspension of the obligation to file for insolvency, companies that lacked future viability remained on the market. As a result, ailing companies supported by the state distort competition with sustainable start-ups in the long term, which hinders structural change. In addition, public debt increases without generating sustainable benefits. Consequently, public funds may lack elsewhere; for example, for the necessary investments in infrastructure and education, which also has negative consequences for the future viability of Mittelstand enterprises.

Given the reasons above, a prospective cross-sectoral Mittelstand policy should focus on regulative principles and empower businesses to master challenges on their own. The following sections show potential ways how this could be achieved.

3 Requirement: Embedding Mittelstand policy into other fields of policy

An essential precondition for a future-oriented cross-sectoral Mittelstand policy is acknowledging its cross-sectoral function because it addresses companies of diverse sizes in various regions and sectors. The economic and social contributions of Mittelstand companies are just as diverse as the enterprises themselves. This means we should position a cross-sectional Mittelstand policy in the context of economic policy and other policy fields (for example, coordination of Mittelstand policy with education/research policy, environmental/energy policy, labour/social policy, transport/infrastructure policy; Welter, Levering and May-Strobl 2016). On the one hand, Mittelstand enterprises fulfil functions that are under the responsibility of other policy areas. On the other hand, framework conditions and legal regulations initiated by various ministries affect the business activities of Mittelstand enterprises.

The Mittelstand-oriented policies during the pandemic can illustrate this cross-sectoral function. Last year, health, economic, and social policy requirements were continuously considered jointly. A policy field that is rather remote from the economy - health policy - had significant influence on Mittelstand enterprises through hygiene requirements and compulsory closures. At the same time, from the point of view of employment policy, one of the essential tasks of Mittelstand policy was to stabilise the labour market. This shows that the importance of particular areas for Mittelstand policy depends on the challenges Mittelstand

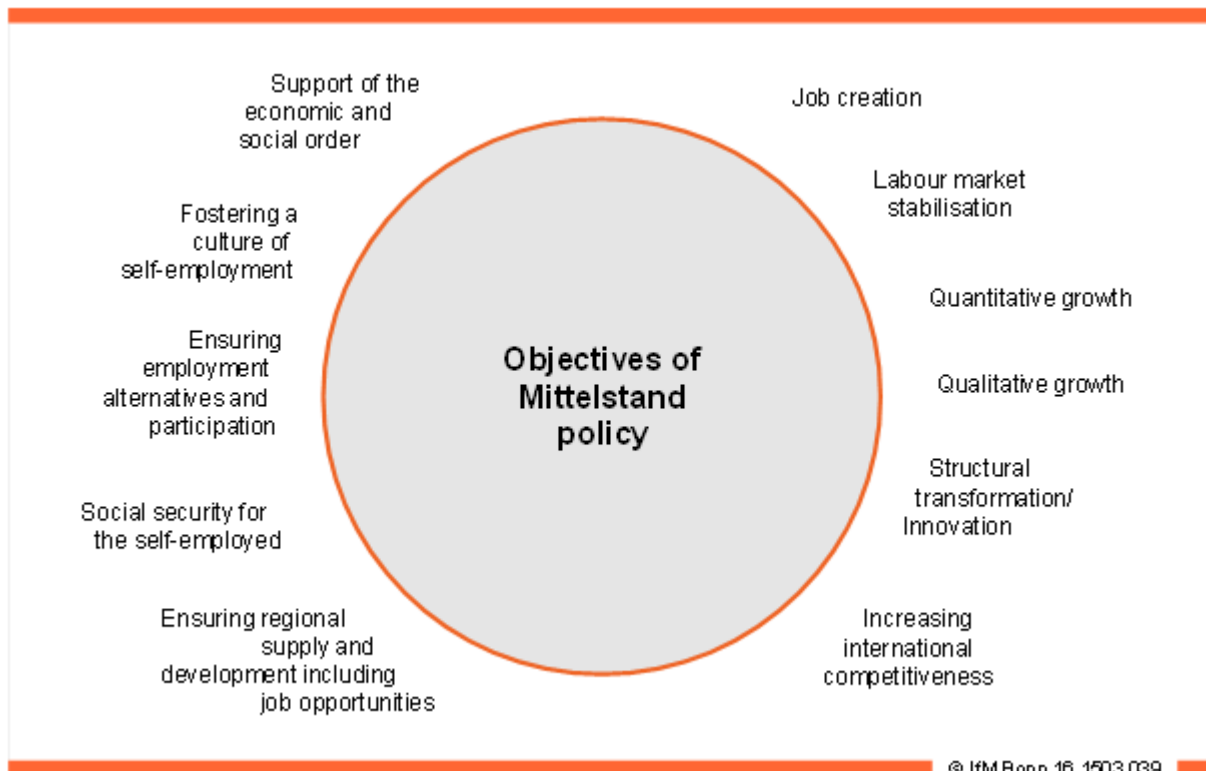
enterprises are currently facing and will face in the future and which of these challenges are seen as priorities.

At the same time, the priorities of Mittelstand enterprises do not always coincide with the challenges that economic policy or academia consider to be priorities. This is illustrated by the IfM Future Panel survey on the current and future challenges of Mittelstand enterprises conducted in March/April 2020 (Brink, Levering and Icks 2020). During the first pandemic wave, business and industry representatives ranked the ability to plan among the priority fields of action for Mittelstand policy, unlike experts from science and economic policy. In contrast, scientists were the only group who highlighted the importance of entrepreneurial resilience and thus adopted a future-directed perspective from early on. As the first wave of the pandemic subsided, issues of "innovation and competitiveness", "digitalisation", and "shortage of skilled workers" came back into the focus of experts. Compared to previous years, however, climate and environmental protection issues also gained importance.

For Mittelstand enterprises to be able to turn the above-mentioned challenges into opportunities, Mittelstand policy must recognise its embeddedness in a magnitude of political fields and fulfil this cross-disciplinary function. Among other, this means that for the next legislative period, Mittelstand policy should regulate in particular environmental standards in a way that does not contain any process-related cost depressions that may advantage larger companies. It also means that Mittelstand policy should ensure the successful and transparent transfer of information to Mittelstand enterprises (Welter, Levering and May-Strobl 2016). Furthermore, the infrastructure for digitalisation should be further improved. Skills relevant to Mittelstand enterprises such as digital education and environmental education should be considered by educational policy. The objectives that we thus derive for a cross-sectional Mittelstand policy, then depend on the Mittelstand policy's objectives.

4 Objectives of a prospective Mittelstand policy

Based on the examples discussed above, Mittelstand policy as a cross-sectoral policy has various implications. The objectives of Mittelstand policy have a significant influence on the concrete design of policy measures. Therefore, fundamental objectives (Figure 1) can be derived from the economic policy goals of the so-called magic polygon, which, in addition to stability and growth goals, also includes ecological balance and a fair distribution of income and wealth (Welter, Levering and May-Strobl 2016).

Figure 1: Mittelstand policy objectives

Source: Welter, Levering and May-Strobl 2016, p. 35

Since the outbreak of the pandemic, policies aimed at supporting the Mittelstand focused on stability and conservation of the status quo, protection of jobs, and stabilisation of the labour market. Mittelstand policy must act as broadly again in the next legislative period. It should create an economic basis for Mittelstand enterprises to cope with the medium to long-term consequences of the pandemic. At the same time, it should set the framework for Mittelstand enterprises to recognise structural changes as well as the goal of ecological balance as opportunities.

While the pandemic had hardly any negative effects on some companies, such as online retailers or the food industry, the economic situation of many entrepreneurs in the consumer-related sector deteriorated significantly. Companies in the latter sectors experienced a considerable drop in sales, which in some cases led them to fall back to make use of liquidity reserves and even to use their retirement provisions (Bertschek and Erdsiek 2020; Stiel, et al. 2021). Overall, the impact on Mittelstand enterprises varied greatly depending on the sector and region (Welter and Wolter 2021b), but the diversity of Mittelstand enterprises and the regional distribution of economic activities were nevertheless jeopardised. However, both should be retained in favour of overriding socio-political

goals. These include the creation of good living conditions, which Mittelstand enterprises help to establish. Mittelstand enterprises are supporting regional development and enable the improvement of life opportunities. If, in particular regions, many Mittelstand enterprises went bankrupt, this contribution would be endangered. Thus, the Mittelstand policy goal of ensuring a regional distribution of economic activities in the country is of significant relevance.

Furthermore, a heterogeneous Mittelstand makes an equally important contribution to the regional distribution of skilled workers through its high participation in apprenticeship training. During the pandemic, however, the willingness to train has declined in many sectors. Accordingly, this negatively affects the Mittelstand policy goal of participation and the regional distribution of economic activities. Participation is socio-politically important because working also enables participation in social life and thus contributes to the worker's quality of life. This, in turn, impacts people's satisfaction with democracy (Welter et al. 2020). The Mittelstand policy goal of participation should therefore also be the focus of a future-oriented Mittelstand policy.

Moreover, a future-oriented Mittelstand policy must support Mittelstand enterprises in coping with structural changes. It is evident that the pandemic has already exacerbated existing structural trends - especially regarding digitalisation, and that consumer behaviour has also changed.

Penultimately, in recent months, the existing trend towards regionalisation has intensified in the international value chains (Bunde 2021). Growing protectionism means that Mittelstand enterprises are increasingly confronted with uncertainties in the international movement of goods (Holz and Ptok 2019). Therefore, the two interrelated objectives of "increasing international competitiveness" and "strengthening the innovative capacity of Mittelstand enterprises and adapting to structural change" should be of great importance for Mittelstand policy. If a cross-sectoral Mittelstands policy also supports Mittelstand enterprises to turn the challenges of climate and environmental protection as well as digitalisation into opportunities for their own company, this also improves their international competitiveness. In that case, strengthened innovation capacity will also improve their international competitiveness. In addition, it is important to increase planning security in the international trade of goods.

Lastly, a central resource Mittelstand enterprises need regarding their future innovative capacity are well-trained and skilled workers. Today, the lack of knowledge-intensive skilled personnel is an obstacle to innovation (Hoffmann et

al. 2020). This situation is likely to worsen in the medium term. Since large companies are generally more attractive employers, smaller Mittelstand enterprises could have more significant problems recruiting new skilled workers in the long term. During the pandemic, education and training of their own staff are also likely to have suffered. This might also affect the innovation activity of Mittelstand enterprises (Brink, Nielen and May-Strobl 2018). At the same time, in addition to a decline in the number of training places, a decline in the number of applicants has been observed for some time (Pahnke, Icks and Brink 2020, p. 3 f.). This trend has also intensified as a result of the pandemic, which can be linked back to cancelled training fairs, a lack of career guidance and limited opportunities to complete internships. In addition, young people are facing psychological problems (Ravens-Sieberer et al. 2021) and significant gaps in education. The youth welfare offices expect a doubling of school dropouts for the pandemic years 2020/2021. As a result, pupils may not meet the requirements they need for apprenticeships in the Mittelstand. Mittelstand policy and education policy must work together to improve, for example, the training conditions and the placement of school graduates in Mittelstand enterprises.

5 Future-oriented Mittelstand policy as a framework

The pandemic demonstrated that sectoral and operational support is helpful in acute economic crises. However, they are not suitable as the single instrument of Mittelstand policy. Long-term support for Mittelstand enterprises strengthens the archaic image of Mittelstand enterprises as a sector of the economy in need of help, incapable of getting out of crises on their own. It is time for Mittelstand-focussed policies to return to regulatory principles and focus on shaping future-oriented frameworks. These are mainly those that boost start-up activity, enable rapid re-entry, and support the forward-thinking corporate development of Mittelstand enterprises.

Start-ups and the relaunch of insolvent entrepreneurs are both important for the diversity of the Mittelstand sector and the rejuvenation of the economy. Hence, trying to prevent every insolvency in the long term is not desirable. Alternatively, Mittelstand policy can facilitate the restart even beyond the existing discharge of residual debt and the newer rehabilitation proceedings. However, it must also remind that entrepreneurial failure must not be perceived as fundamentally negative.

A continuous problem for Mittelstand policy is the reduction of bureaucracy, which also ought to be one of its fundamental tasks. A significant discharge of

Mittelstand enterprises of bureaucratic obligations would set resources free that businesses could then invest in the development of new business models and forward-looking technologies. The launch of start-ups just as the rehabilitation of already existing enterprises can be eased by reducing bureaucracy. There is no doubt that climate protection, for example, will bring further need for regulation. However, it would be desirable for Mittelstand enterprises to be involved at an early stage. This would make it easier to achieve necessary regulations with adequate effort for the companies. Likewise, early involvement of the companies would make it easier for them to plan. Overall, it would help to foster the acceptance of new rules.

At present, Mittelstand enterprises perceive the bureaucratic burden as consistently very demanding (Holz et al. 2019). They criticise the high degree of regulation and question their sense. Every fourth company deliberately fails to accomplish individual bureaucratic requirements. The reason is that companies associate bureaucracy with far more than just the legally defined documentation and information obligations. Relief will, therefore, only be possible when Mittelstand policy takes stock of its bureaucracy in all areas. Only then can the term 'bureaucracy' regain positive associations in Mittelstand enterprises. After all, regulations are intended to create a reliable legal framework and planning security.

Lastly, Mittelstand enterprises require incentives for a modernisation push; for instance in regard to digitalisation. Although every third company increased their digitalisation activities during the pandemic, most of these investments were oriented towards adjustments in the short term rather than based on a long-term strategy. At the same time, debt levels increase, and the equity ratio decreases, especially in small companies. This leads to a corporate conflict of objectives between short-term crisis resilience and the improvement of long-term competitiveness (Zimmermann 2021). Therefore, the (renewed) build-up of equity capital in Mittelstand enterprises is of particular importance for the future viability of companies. After all, capital is not only needed for investment in digitalisation projects and other future-oriented projects such as climate and environmental protection measures. Finally, good capital stock figures are also a resilience factor for future crises (Di Bella 2014, p. 65).

6 Outlook: Mittelstand policy for the diversity of Mittelstand enterprises

Mittelstand enterprises face numerous challenges in the next years. Companies must not only cope with the economic consequences of the pandemic but also

observe and adapt to structural change and meet the requirements of climate and environmental protection. During the pandemic, many Mittelstand enterprises have demonstrated that they are able and willing to adapt to changing conditions and to overcome challenges on their own. The prerequisite for their success is a framework that allows Mittelstand enterprises to survive in all German regions and in all their diversity. The diversity of the Mittelstand is essential because Mittelstand enterprises perform as enabler in individual participation in working and social life and contribute to the quality of life of every citizen. This is extremely necessary at present and in the future, also when considering the ever-growing efforts to damage the fundamental democratic values in this country.

The main challenge for Mittelstand policy in the next legislative period will be the consideration of its cross-sectoral function. Policy must ensure that the concerns of Mittelstand enterprises are considered in all ministries involved in advance of legislation. Instead of sectoral and company-specific support, there is a need for framework-oriented measures that support Mittelstand enterprises in perceiving and using the challenges associated with structural and climate change as well as the digital transformation as opportunities. The representatives of Mittelstand enterprises should be more involved in shaping legislation, not least because politicians often set different priorities than entrepreneurs. The most important goal of Mittelstand policy must be securing the competitiveness of Mittelstand enterprises - also internationally - in the long term.

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