

The Mittelstand: a Specific Entrepreneurial Profile of the Social Market Economy

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Abstract: Mittelstand companies are the backbone of the German economy: they constitute the vast majority of enterprises in Germany, contribute to employment, and are a pillar of the German apprenticeship system. The specific ownership–management structure of the Mittelstand used to go hand in hand with social, intergenerational, and regional responsibility. However, today’s very small and young entrepreneurs do not perceive themselves as Mittelstand; many entrepreneurs do not intend to employ others, and structural changes in the economy have also resulted in fundamental changes of the Mittelstand. This paper explores the characteristics of the Mittelstand and its future, asking whether Mittelstand will continue to play a fundamental role in the social market economy in Germany.

Keywords: *Mittelstand • SME • Context • Entrepreneurship • Germany*

JEL: *L26 • M20*

1. Introduction

The Mittelstand, which refers to owner- and family-managed and owned enterprises, is the backbone of the German economy. If we look at the key data for small- and medium-sized enterprises (SMEs), which constitute the majority of Mittelstand firms, they accounted for 3.45 million of all enterprises in Germany (99.6%) in 2015. SMEs generated 35% of the total turnover of German enterprises and the greater part of the total net value added (55%), accounted for 17% of the total German export turnover, offered jobs to nearly 60% of all employed persons, and trained 82% of all apprentices in Germany (IfM Bonn 2018). Mittelstand differs from SMEs: while the latter are defined by size-related criteria (employees, turnover), Mittelstand is characterized by the specific ownership and management structure of a company and does not include any limits in enterprise size.

The Mittelstand model can be traced back to pre-industrialization, and in Germany it gained importance throughout the industrialization (Berghoff 2006). Nowadays, the Mittelstand model has come under pressure because of structural changes, including the emergence of the service-based economies, Information and communication technologies (ICT), digitization, and globalization – to name but a few. The specific governance of the Mittelstand favors the emergence of strong social, intergenerational, and regional values and a feeling of responsibility which reaches beyond the enterprise and its employees, implicitly supporting the evolvement of a constituent feature of the social market economy model in Germany.

However, today’s very small and newly started entrepreneurs do not perceive themselves as Mittelstand (Welter et al. 2015); many entrepreneurs do not intend to grow their ventures and to employ others, and the

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evolution of the Mittelstand no longer is a quasi-automatic result of “starting small and growing the business to a size the owner can still control.” The question remains as to whether the Mittelstand, which is an integral element of the social market economy in Germany, will continue to play a fundamental role in economy and society in Germany in the future? This paper sets out to explore the origins, characteristics, and changes of the Mittelstand in Germany. The following section characterizes the Mittelstand from various perspectives, before the author turns to discuss the future of the Mittelstand. The paper concludes with a short outlook.

2. Characterizing the Mittelstand

2.1. Historical roots

Historians trace the origin of this concept back to medieval times when a class of well-off and better educated citizens emerged, frequently operating as merchants or craft entrepreneurs. This class was situated “in the middle,” that is between the gentry and priests, on the one hand, and the bonded peasants, on the other hand. Since the early 20th century, the term “Mittelstand” changed its meaning and was seen as mainly covering economic units. For example, in 1919, the then constitution postulated that the self-employed Mittelstand in agriculture, industry, and trade had to be safeguarded against its absorption, both legally and by the public administration. Ludwig Erhard (1897–1977), Federal Minister of Economic Affairs since 1949 and later Chancellor of the Federal Republic, defined the (economic) Mittelstand as those persons who are willing to ensure their own economic existence and take responsibility for their own – economic – achievements and success.

Mittelstand is deeply embedded in economy and society in Germany, not least because of its historical roots. The sense for responsibility that Mittelstand firms show, the emotional attachment of entrepreneurs to their businesses, and the preference for independence appear to have (some of) their origins in medieval times. Vocational training traditionally has been a stronghold of the guilds (Wengenroth 2010). Apprentices were bound to their masters for the term of their apprenticeship, and they lived in the households and families of their masters. Guilds had set up strict rules on who could set up, run, and inherit a craft business. They also registered new businesses – and until today, craft enterprises are registered in the register of craftsmen (*Handwerksrolle*) instead of the commercial registry. In addition, without the strong regional embeddedness of small firms which

was favored by the guild system, today’s hidden champions could not have emerged. These are Mittelstand companies that are firmly rooted in oftentimes peripheral regions, extending their responsibility toward the regions, and which at the same time are global market leaders (Simon 1992). Such place attachment is important for knowledge transfer (apprenticeship), and it fosters common values, attitudes, and aspirations of people (Landes 2006).

Mittelstand firms became the backbone of Germany’s industrialization in the 19th century. A specific variety of family capitalism emerged (Berghoff 2006; James 2008) with the new industrial entrepreneurs showing strong social responsibility toward their workers (Berghoff 1997). For example, Alfred Krupp (1812–1887) placed a higher value on worker satisfaction than solely on profit. Already in 1836, he introduced a (voluntary, later mandatory) health insurance system for his employees. In addition, he introduced housing and shops exclusively for his factory employees in the 1860s. On the one hand, with this attention to health care and social security of workers, these and similar efforts of several other industrialists created the foundations for modern social welfare systems that emerged in the 19th century (Abelshauser 2001). On the other hand, in turn, for their social assistance, entrepreneurs also demanded absolute loyalty of their workers, hoping to undermine the emerging worker’s movements and the resulting emancipation of their workers. The patriarchal business culture, Berghoff (2006) outlined as fundamental characteristic of the traditional Mittelstand, had its origin in these times.

At the same time, guilds lost most of their power in regulating business and private affairs, while organizations evolved that still govern modern business relations. For example, chambers of crafts took over responsibility for the apprenticeship system in the later 19th century; cooperative banks and saving banks laid the ground for today’s relationship-based banking system; wage negotiations, which initially took place at enterprise level, were handed over to trade unions and employer associations, resulting in today’s tripartite social dialog between government, employer, and employees (Abelshauser 2001). The variety of capitalism we can observe in Germany is oriented toward consensus, social responsibility, and collaborative stakeholder relationships. This culminated in the introduction of the *Soziale Marktwirtschaft* (social market economy) after the Second World War, as a model of a socially oriented and inclusive market economy which played as well as reflected the strengths of the Mittelstand. Values and attitudes such as efficiency, responsibility, and freedom, that are fundamental elements of

social market economy, are also inherent in the Mittelstand as they have emerged over the centuries (Welter et al. 2016).

2.2. Between size, governance, and ownership

Official statistics do not provide data on the Mittelstand, and therefore, much research has a tendency to reduce Mittelstand to a “generic label [...] to describe all SMEs” (Logue et al. 2015, 23). SMEs are defined by size-related thresholds such as the number of employees, annual turnover, or balance sheet sums,¹ while the Mittelstand is characterized by its ownership and management structure and exhibits a specific governance and ownership structure which “(...) encompasses both legal and sociocultural features.” (Berghoff 2006, p. 271). Figure 1 illustrates the distinctive governance and ownership structure of Mittelstand businesses. Businesses that are independently owned and owner or family managed² fall into the category of “core Mittelstand.” In these businesses, entrepreneurs are (still) actively involved in the strategic development and decision making (management) of their companies, and they bear the entrepreneurial risks and liabilities of these decisions (Gantzel 1962). Extended Mittelstand refers to businesses that are – partially – owned by the entrepreneur or a family, but where external managers have been included in the governance of the business. In these businesses, owners/families still control their business to a large extent, but they have handed over (some of the) management tasks to nonfamily members.

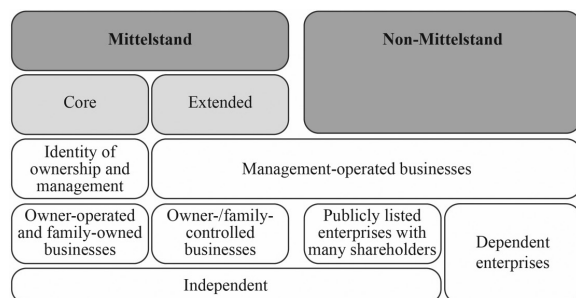


Figure 1. Governance and ownership characteristics of the Mittelstand.

Source: Adapted from Welter et al. (2014, p. 8) (Figure 2).

- 1 The European Union defines SME as enterprises with up to 249 employees. The Institut für Mittelstandsforschung (IfM) Bonn defines SME as enterprises with up to 499 employees.
- 2 For empirical studies, the IfM Bonn operationalizes Mittelstand as follows: 1) up to two natural persons or their family members (directly or indirectly) hold at least 50% of the company shares and 2) these natural persons also belong to the management of the enterprise. Mittelstand, family enterprise, and owner-managed businesses are considered synonyms.

Based on a representative survey of more than 500 enterprises across all size classes,³ we have empirically analyzed governance and ownership characteristics of Mittelstand businesses in more detail (Welter et al. 2015). Our results illustrate how specific governance and ownership structures characterize the core Mittelstand as well as how this changes over time as firms move from belonging to the core segment of the Mittelstand toward becoming “non-Mittelstand” (see Figure 1). Owner-managers play a key role in the core Mittelstand firms: 61% of these companies are owned by one person, and only 15% employ external managers. The latter share increased, not surprisingly, with enterprise age – the older the firm, the higher the share of external managers. In Mittelstand companies that were more than 25 years old, every fifth company had hired external managers; in those that were more than a century old, external managers were employed in every third company. In those businesses with more than one owner, the majority owner on average hold 83% of the capital, thus still bearing the major responsibility and entrepreneurial risk.

Family-controlled firms, i.e., the extended Mittelstand, already have lost some of these specific governance features: the share of firms employing external managers has increased to 22%. Moreover, ownership is much more dispersed in comparison to core Mittelstand enterprises with the majority owner on average holding only 42% of capital. Non-Mittelstand firms no longer show any Mittelstand-specific ownership structure, and two-thirds of them employ external managers.

The Mittelstand concept as such does not include a size or an age restriction of the business. It comprises new and old businesses, solo entrepreneurs, SMEs, and larger family enterprises – all as long as they are owner managed and independent. In other words, Mittelstand does not equal SME, as much research on small firms assumes. The small size rather reflects respectively is a result of key governance characteristics of Mittelstand businesses. For example, the smaller and newer a business, the higher the probability that it is purely owner or family managed and owned, i.e., core Mittelstand. Vice versa, the larger a business, the higher the probability that the firm has gone public and/or has hired external managers – it is no longer owner managed and family owned, albeit it may in many instances still be family controlled. Not surprisingly, the categories of small enterprise (defined by size-related criteria) and Mittelstand (defined by governance and ownership criteria) overlap as shown in Figure 2. The majority of all

- 3 A stratified random sample of 14,397 enterprises was drawn from Creditreform’s largest database which covers about 3.5 million German firms. The stratification of the sample was based on industry affiliation and total annual sales. The response rate was close to 4%.

SMEs are also Mittelstand businesses, although this decreases substantially with growing enterprise size. Of micro and small firms, 88% and three-quarters, respectively, qualify as Mittelstand. Of medium-sized firms, a small majority still is Mittelstand. Of those enterprises with more than 250 employees, 41% can be defined as Mittelstand – that is they are owner managed.

Surprisingly and contrary to common sense, the share of Mittelstand companies is lower than anticipated in the smaller size groups and higher for the larger enterprise sizes. This implies that the economic importance of the Mittelstand is increasing. However, our survey data also raise the question of why some, especially the smallest and smaller, enterprises do not qualify as Mittelstand? Enterprises are not only created *de novo* but also increasingly set up through spin-offs and by splitting up large entities, which attempts to model the more flexible structure of small firms. Where those small entities that emerge remain economically dependent on their mother company, they are not defined as Mittelstand.

2.3. Beyond governance and size: a sense of belonging and a value-oriented community

So far, the author has outlined how Mittelstand can be understood through its governance structures. Mittelstand, however, also is characterized by emotions and feelings; it is often seen as a particular mindset (Fear 2014). The term has a very positive connotation in Germany. For example, a few years ago, the *Handelsblatt*, one of the Germany's leading economic newspapers, stated that Mittelstand is a German feeling. This is also reflected in our recent study where the results showed that many more enterprises identify with this segment than belonging to it as per our definition (Welter et al. 2015). We asked entrepreneurs whether they perceive themselves as part of the Mittelstand. We then checked which part of those

that perceived themselves as Mittelstand, still belong to the core segment. Figure 3 illustrates that Mittelstand by definition (i.e., identity of ownership and management) and Mittelstand by perception (i.e., self-identification of entrepreneurs) are by no means congruent, and this differs substantially across enterprise size. The smaller the business, the higher the share of those that feel they do not belong – vice versa, the larger the business, the higher the share of those that feel as Mittelstand. Only 40% of the smallest enterprises see themselves as Mittelstand, although 88% of them are defined as Mittelstand. This perception of “not belonging” is most widely spread among newly found and younger businesses, among solo entrepreneurs where the unity of ownership and management is obviously given, among those in newer business fields such as internet-driven sectors, and among those operating in business services and services in general. The reasons are manifold, not least due to the structural changes over the past decades which have fostered a growing heterogeneity of the Mittelstand as discussed in Section 3.

On the other hand, many of the large enterprises show a pronounced sense of belonging to the Mittelstand. As per our definition, the majority of them are enterprises where the identity of ownership and management no longer exists. Ninety one percent of large enterprises *perceive* themselves as Mittelstand, but only 41% still are *defined* as Mittelstand. In other words, with regard to their governance, they have grown out of our core Mittelstand category, but with regard to their sense of belonging, they still feel as Mittelstand. A closer look reveals that it is mainly older family firms that already exist since several generations which demonstrate this strong feeling – that is, firms that have developed over decades, sometimes centuries. For them, Mittelstand is much more than visible in governance and ownership structures; it is a sense of belonging to a tradition which has shaped and is shaping the economy and society in Germany.

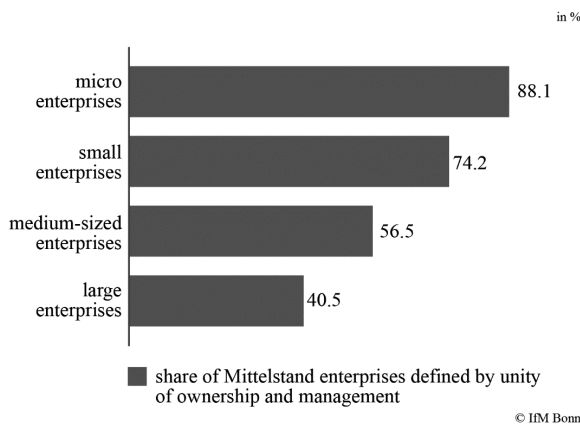


Figure 2. Comparison of Mittelstand and SMEs.
Source: Adapted from Welter et al. (2015, p. 7).

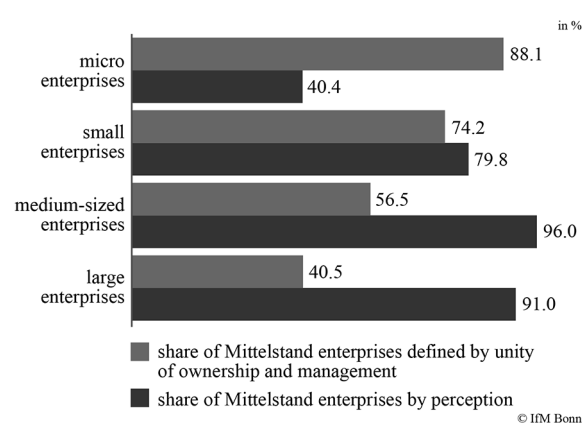
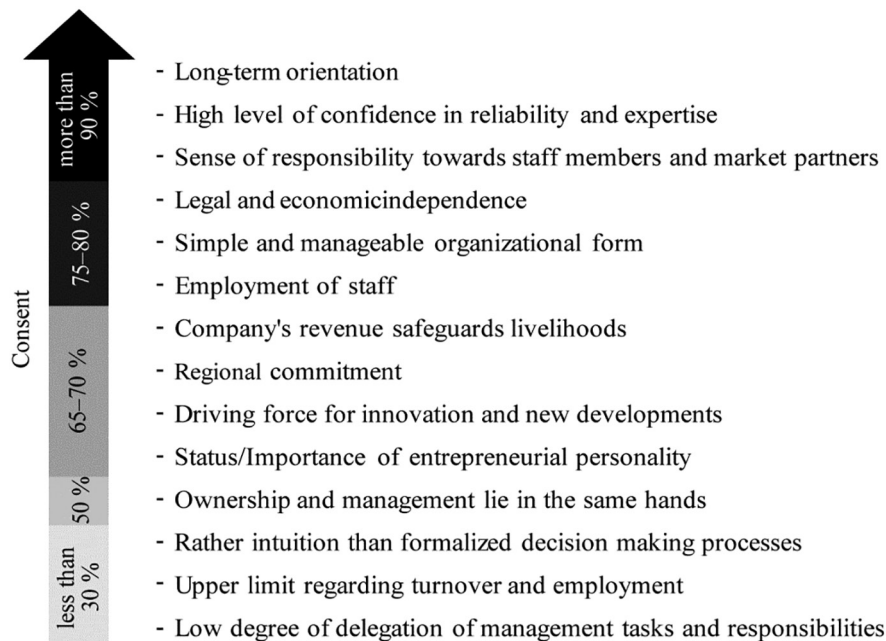


Figure 3. Mittelstand as feeling.
Source: Adapted from Welter et al. (2015, p. 7).



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Figure 4. Typical characteristics of the Mittelstand.
Source: Adapted from May-Strobl and Welter (2016).

In line with this tradition, the economic historian Berghoff (2006) described Mittelstand as a business model that combines governance, ownership, leadership, and organizational characteristics with individual values and attitudes. Mittelstand ventures are said to be characterized by a patriarchal culture together with flat hierarchies and informality, which is reflected in trust-based internal and stakeholder relationships. Their strategic behavior is supposed to be long-term orientated, which is reflected in, for example, business succession within the owner family. Entrepreneurs strongly identify with their businesses and employees. They value their economic and personal independence, as reflected, for example, in a widespread preference for self-financing. Are these characteristics myths or facts? In our study (Welter et al. 2015), we set out to analyze whether and to what extent these characteristics exist and whether and to what extent today's Mittelstand companies are still exhibiting a distinct business model.

We asked entrepreneurs to assess typical characteristics of Mittelstand businesses (Figure 4). Our definitional criterion (the identity of ownership and management) is not what constitutes Mittelstand according to the surveyed entrepreneurs who on the contrary emphasized strategic orientation and behavior as well as the key role of entrepreneurs. Nine out of 10 entrepreneurs agreed on long-term business orientation, trust, and responsibility toward employees as main elements of the Mittelstand. Close to four

out of five entrepreneurs settle on legal and economic independence, simple organizational structures, and, interestingly, at least one employee as typical criteria for Mittelstand companies. Two-thirds saw a sufficient income from the entrepreneurial activities, regional embeddedness, and responsibility as well as the entrepreneur as the initiator of innovation and novelties as important elements (May-Strobl and Welter 2016). Less than 30% understood an upper size limit as constitutive feature of the Mittelstand.

To sum up, Mittelstand is a trust- and value-based business model with a pronounced long-term orientation, strong sense of belonging to a tradition, and a strong sense of responsibility toward regions and people. It both is a constitutive feature of the social market economy and contributes to its persistence over time. But, is Mittelstand a model that can persist in future? The author turns to briefly discuss this question in the next section.

3. A bleak future for the Mittelstand?

Prophets of a perceived doom of the Mittelstand have been many – already in 1848, Karl Marx and Friedrich Engels forecasted the demise of the Mittelstand, similar to the Social Democratic Party in its 1891 program (Pahnke and Welter 2018). In the 19th century when industrialization started, Mittelstand was perceived as old fashioned and backwards, not capable of keeping up with the rapid pace of industrialization, instead

longing for a “stable precapitalist economic order” (von Saldern 1992, 31). Today’s calls for a modern and vibrant start-up economy in Germany seem to echo those doom prophets. Numerous reports and headlines in Germany outline the Mittelstand as a model whose times have passed, emphasizing the continuous decline in start-up rates (DIHK 2017), the “entrepreneur” as dying species (DIHK 2013), the low innovativeness of German enterprises, and a worrying decrease in the number of innovators (Zimmermann 2017) and internationally extremely low rates of nascent entrepreneurs (Sternberg and von Loh 2017). Interestingly, opinions regarding the future of the Mittelstand are divided. While politicians and entrepreneurs from Germany enthusiastically travel to the Silicon Valley, to search for the features of what they perceive as the only successful entrepreneurial model for future Germany, other countries around the world dig deep into Germany’s “secret weapon” (Ross Range 2012), asking whether the “Brittelstand” can rival Germany’s Mittelstand (Ellyat 2014), how to export the Mittelstand to Korea (Da-ye 2016), or why France has a blind spot when it comes to “le Mittelstand” (Walter and Mey 2017).

The Mittelstand model has come under pressure because of fundamental structural changes that appear to diminish its contribution to economy and society and to question its fundamental role for the social market economy. Those include the emergence of the service-based economies, the growing digitization of economies and societies, and globalization – to name but a few. Since the 1950s, economies around the world are undergoing fundamental sectoral changes, developing toward service-based economies. For example, in Germany in 1950, around one-quarter of all entrepreneurs operated in the service sector, compared to 60% in the primary sector – in 2013, this has been reversed: three-quarters of all entrepreneurs were service based, compared to only 7% in the primary sector (Welter et al. 2014). Especially, the liberal professions and knowledge-intensive services, mainly enterprise oriented such as consultancy and similar, have gained importance together with an increase in academic start-ups. Academic entrepreneurs contribute to the push toward a knowledge-based economy. Industrial entrepreneurship is still of importance, then and now around 17% of all entrepreneurs own manufacturing businesses.

Sectoral changes are going hand in hand with substantial changes in the nature of entrepreneurship, including enterprise size and organizational structures. Technological changes contribute to a decrease in optimal enterprise size. Nowadays, many entrepreneurs start and operate a venture on their own. Between 1992 and 2012, for example, solo entrepreneurship had increased by 83%.

In services, entrepreneurs need less financial capital, compared to the creation of an industrial enterprise. Moreover, the increasing digitization fosters business internationalization regardless of enterprise size. Solo entrepreneurship used to be seen as an early stage in enterprise development. Statistical data, however, confirm that the majority remain small with three-quarters of solo entrepreneurs having worked on their own for more than 10 years (Welter et al. 2014). Solo entrepreneurship is there to stay as one particular form of entrepreneurship. The majority of solo entrepreneurs are to be found in the liberal professions and academic and technology-oriented business services. This reflects the ongoing structural change of employment toward knowledge-based professions. In addition, solo entrepreneurship has increased in the creative industries. Entrepreneurship has lost its exclusivity, not least because the boundaries between work and private lives are increasingly blurred. The Swiss writer Robert Nef, in a private communication to the author, labeled this as *Lebensunternehmertum* (life entrepreneurship) – entrepreneurship as part of everyday life and as an attitude toward life and not solely toward work. Examples include platforms such as eBay where consumers – temporarily – turn into providers of services and goods or the sharing economy where services, that oftentimes have been offered for free within the neighborhood, are commercialized and the basis for profitable global business models.

The trend toward solo entrepreneurship also implies that entrepreneurs are no longer merely interested in growing their venture as big as possible. Although researchers and policy makers alike always seem to have favored the image of the entrepreneur setting up a small business which over time grows into a family-owned larger company, ultimately spanning over family generations, enterprise development has never been a linear process in the sense of “start small, grow big.” Instead, enterprise growth has become much more of a temporary phenomenon: digitization and technological progress allow solo entrepreneurs to form temporary and project-based networks, if needed, around the world. Even in Germany, where enterprise creation and development implicitly has been understood as a task for life, more and more business founders develop into serial entrepreneurs. They set up one business today, sell it tomorrow and either go back into wage employment or set up their next business. Exit, and not necessarily generational continuation of the business, is one option, particularly with younger entrepreneurs.

Together with changing attitudes toward entrepreneurship, organizational boundaries are dissolving and the boundaries between entrepreneurship and wage employment are becoming more fluid.

Solo entrepreneurs are entrepreneurial in the sense that they market their own manpower (Voß and Pongratz 1998). However, solo entrepreneurship also has a dark side, in those cases where solo entrepreneurs work for one main contractor – although they bear the entrepreneurial risk, they do not influence the strategic development of their activities. In other words, they are dependent entrepreneurs and, in many instances, may also be involuntary self-employed. Scholars have identified this form of entrepreneurship as precarious entrepreneurship, in those cases where it cannot guarantee sufficient income (Pongratz and Simon 2010; Dangel-Vornbäumen 2010). Such forms of entrepreneurship are on the rise, resulting from the increasingly blurred boundaries between wage employment and self-employment. Freelancers, subcontractors, and entrepreneurs working for one or a few main contractors are typical facets of a fluid labor market. Not surprisingly, these individuals do not perceive themselves as Mittelstand – nor are they perceived as Mittelstand by other entrepreneurs.

In those cases, where individuals are simultaneously employed and self-employed, they fall into the category of hybrid entrepreneurship, another typical facet of a fluid labor market. Hybrid entrepreneurship also refers to frequent changes between wage and self-employment (Folta et al. 2010), which has been shown to be a constitutive feature of today's entrepreneurial careers in Germany (Suprinovic et al. 2016). Hybrid entrepreneurship no longer is the entry path into full-time self-employment or into the development of more substantial business activities. Instead, it is another indicator for the increasing heterogeneity of entrepreneurship which is becoming much more of a short-term episode where individuals frequently move back and forth between wage and self-employment.

The trends and developments the author outlined in this section result in an increasingly heterogeneous Mittelstand which is spanning different sizes and industries: it ranges from solo entrepreneurs – as long as entrepreneurs can sustain their living with their entrepreneurial ventures, entrepreneurs in the liberal professions,

craft entrepreneurs to large family owned and family controlled ventures. The forms of entrepreneurship we observe today clearly demonstrate the fluidity and volatility of what constitutes entrepreneurship and an enterprise in the 21st century. Is the future bleak for the Mittelstand, then? It is bleak if we only look at the economic contribution of Mittelstand businesses because naturally solo entrepreneurs, for example, contribute to fewer employment possibilities. It is brighter if we acknowledge that the function and role of the Mittelstand are wider than visible in its economic contribution for employment and innovation. Individual responsibility for one's own future and entrepreneurial risk taking, as shown by all, even the smallest Mittelstand business and by each solo entrepreneur, play an important role in sustaining the social market economy nowadays and in future.

4. Outlook

Entrepreneurship scholars recently have brought the “everydayness” of entrepreneurship to the forefront, calling for a wider understanding of what constitutes entrepreneurship and its contributions to both economy and society (Welter et al. 2017). Such an understanding of entrepreneurship questions our excessive focus on technology businesses, venture-capital backed and high-growth firms - in short: on the Silicon Valley model of entrepreneurship where businesses are set up with lots of external funding from outside investors, scaled up rapidly and then are taken public (Aldrich and Ruef 2018). Most entrepreneurship, not only in Germany but also worldwide, does not fall into this category. Rather, businesses stay small and do not want to grow, but they contribute to new ideas and innovations that tackle the big problems of our societies and provide employment, if not for others, at least for their founder and entrepreneurs. Mittelstand businesses are an excellent example of such everyday entrepreneurship. They demonstrate the importance of looking beyond high growth and high technology toward entrepreneurship which is value driven and people oriented.

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