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The German model economy: A lesson for U.S. manufacturing?

July 2011 - Lately, much has been written about the loss of manufacturing jobs in the United States. Statistics show the United States has lost an estimated 3 million manufacturing jobs since 2000. Politicians, pundits and businessmen attribute the loss to several factors: a flight to low-wage countries, unfair trade policies by foreign governments, stricter U.S. environment regulations and lack of clear-cut policies in the United States to support and enhance manufacturing. Suggestions to improve the situation in the United States have included tax incentives, government support for R&D, increased valuation of the Chinese yuan, looser environmental policies and Buy America initiatives.

But manufacturing in at least one country, which faces the same global competitive issues as the United States, appears to be thriving. Germany's trade and current account balances are positive, and there is strong demand for its products. The IMF estimates Germany will have an account surplus of 5.5 percent of GDP in 2010, close to China's 6.2 percent. Its unemployment rate is at a 20-year low, reflecting efforts to address the economic challenges that plagued the country after reunification. Today, German manufacturers are reporting labor shortages.

Some of this success can be attributed to a reduction in real wages from 2000 to 2008, while real wages grew in other developed countries. In addition, the German economy benefited from an increase in both temporary and part-time employment, which resulted in a more flexible workforce. However, Germany sustained strength in the manufacturing sector despite (or possibly because of) a high national savings rate and without significant monetary or fiscal stimulus.

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This article seeks to identify characteristics of German manufacturers that could enhance U.S. initiatives to create a more successful manufacturing-based economy—especially in a soft consumption and higher savings rate environment where monetary and fiscal stimuli have been exhausted. We reviewed several analyses of the German business model to try to establish the basis of its success. One of these studies was particularly compelling. In 2007, Bernd Venohr and Klaus Meyer analyzed the long-term performance of successful, medium-size German companies identified by Hermann Simon 15 years earlier. They found that the German Model is predicated on several key factors, which were shared by many of these companies.

- **Specialization:** These German companies concentrate their resources on niche market segments in an effort to dominate them worldwide. These manufacturers pursue emerging markets aggressively. Their target segments are well-defined, and their products are focused on meeting the needs of those segments. Breadth of one's product line is not a priority.
- **Innovation:** Continued improvement in products and processes is critical. These companies commit significant resources to research and development. They tend to focus on traditional manufacturing sectors (e.g., industrial machinery and components, medical instruments and automotive parts) where technological breakthroughs are rare. Thus, even incremental innovation creates important positive product differentiation.
- **Strong customer service:** These German manufacturers are very close to their customers, especially their top customers. They are aware of their customers' needs and have a robust after-sales service orientation. They tend to sell on value instead of price and, as such, their goods appear to be less price-sensitive than those manufactured in other developed countries.
- **Flat organizational structure:** Typically, management behavior is predicated on flat hierarchies and informal channels of communication, which reflect the personal styles of the businesses' owners. This leads to a high degree of mutual trust and loyalty between management and employees. These companies possess strong corporate cultures coupled with excellent employee identification with their employers. In addition, their leaders possess strong characters and have long tenures with their companies.
- **Professional management:** Family-owned German firms are more likely to employ outside professional managers in leadership positions than firms in the United States, the United Kingdom and France. According to research by Venohr and Meyer, approximately 60 percent of family-owned companies in Germany hired outside professional managers. In the United States, the United Kingdom and France only 30 percent, 23 percent and 31 percent, respectively, hired outside professionals.
- **Operational excellence:** Most of these companies employ state-of-the-art lean manufacturing practices. They strive for operational effectiveness, continuously assimilating, attaining and extending best practices. They pursue aggressive cost management, including selective off-shoring of lower valued-added activities. Target setting and performance management are critical. These companies rely heavily on their own strengths. They do not rely on strategic alliances, and few are involved in large acquisitions and other risky game-changing strategic moves. They also prefer to minimize the use of outside financing to capitalize their businesses.

In addition, these companies are supported by an educational system that produces a skilled manufacturing workforce. Germany has a vocational training system that parallels its university system. As such, it has a lower percentage of university students than its developed country peers. Many occupations require vocational training, and these vocational students are taught by expert worker instructors. Employers place a major emphasis on apprenticeships for skilled positions.

Former U.S. Commerce Secretary Carlos Gutierrez noted the United States has tended to retain the manufacturing of items that are complex to produce—especially in high-tech industries such as medical devices, aerospace and pharmaceuticals. These industries require continuous research and development and demand specialized skills and training. It appears that German manufacturers have applied this same commitment to continuous improvement to a much broader array of products and industries.

By applying the same principles, U.S. manufacturers can identify business opportunities that will allow them to compete globally. The adoption of the focus and business practices of their German counterparts could help drive a sustainable advantage. With innovation as the historical mainstay of the U.S. economy from its inception, a reinvigorated U.S. manufacturing sector is a realistic and attainable objective given time and commitment. **MM**

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