



'Mittelstand' drives Germany's cleantech boom

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Published 2009-01-09 11:53

Germany has become synonymous with solar in the cleantech sector, driving both demand and high-quality manufacturing along the value chain.

That strength in solar made Germany the top European country for cleantech investment in 2008, with \$383 million in capital—an increase of 217 percent from 2007 (see [Record 2008 for cleantech with \\$8.4B in investments](#) [1]).

But Germany has a much broader cleantech sector, characterized by the 'Mittelstand,' a German term for small-to-medium companies that have technologies and revenue but often off the radar of traditional private equity investments. The value in these companies is the lack of debt and decades of experience.

Munich, Germany's Pinova Capital thinks the time has come for the Mittelstand to be in the spotlight.

Pinova Capital has closed on two-thirds of its €150 million (\$220 million) fund, from which the company plans to make investments of about €8 million into Mittelstand companies.

Pinova Capital Partner Marko Maschek talked to the Cleantech Group about why the current financial crisis is boosting the profile of the normally behind-the-scenes business unique to Germany.



Marko Maschek, partner at Pinova Capital, spills Germany's secrets.

What's the Mittelstand?

In English, it's what you call 'small to medium sized enterprises,' or SMEs. There's no clear-cut definition, but generally companies that generate about €50 million in revenue and have less than 250 employees. Anything higher is considered midcap. At Pinova, we do smaller-spectrum investments. Many of these SMEs were started after WWII up to the '70s. So these are established companies and the backbone of the German economy.

How are these companies unique?

In Germany, the number of large companies is quite small compared to other economies. Our economy

here is predominantly a production economy, so most of these companies make products. The service sector is smaller than in the Anglo-Saxon countries. In total, there are 3.6 million companies here in Germany, so there's a higher density of companies in general and a higher number of small companies. That's what we refer to as the Mittelstand, and quite a number of them are involved in cleantech, but we don't call it that because the expression is not understood. They fill small niches and are often global leaders; the "hidden champions," they're sometimes called.

Why is this a phenomenon of Germany?

It's for historic reasons that the economy has grown in a different way because there were always many more small companies than in the UK and U.S. compared to GDP, many more production companies. With the U.S, you look at them and say this is a leading country in so many sectors: semiconductors, Internet, biotech, but not so much car production, precision engineering, machine equipment and the like. The Germans are good at quality engineered products but less so at delivering quality service. We have many more small production companies compared to other nations but fewer very large ones.

How does this appeal to investors in cleantech?

I'm not aware that anyone in cleantech is looking at that angle. We are not a focused cleantech fund. Firms like [Nth Power](#) [2], Braemar, or [DFJ Element](#) [3], they exclusively focus on cleantech. We don't. They mostly do investments in venture-type technologies that have the potential to change the world. We see so many interesting companies in the Mittelstand that have been involved in cleantech for a very long time without realizing it. And the concept of cleantech in Germany goes back a long time to the '80s. There was a broad consensus in the general public and in politics back then that "going green" was a good thing and you had to promote it, even if it was not economical.

A whole industry was created at that time, so therefore there is a sort of lead position still, if you look at the solar or the water industry. If you look at solar, the U.S. has few independent players in the industry, one that comes to mind is [First Solar](#) [4]. In Germany there are many more of those, a lot of smaller players that make high precision quality products. They operate maybe without the hype of the average venture-backed cleantech company, like an equipment company that makes air filtration products for mines or big construction projects. You have filter the air in these types of environments so human beings can work there. To me that's the purest form of cleantech because clean air is provided in environments that would otherwise be harmful. That's probably different from what you see in the United States, where cleantech means companies that are making products hoping to solve all our energy needs.

You say part of the Mittelstand culture is that there are clusters of businesses. Can you give me some examples?

There's the solar cluster in Dresden, in eastern Germany. That's probably the most established one. There has traditionally been a semiconductor base around Dresden, so there was a pool of labor from the semiconductor industry that made the chips for the Eastern Block, used for example for the Russian space programs.

There's the wind industry in the northern part of Germany because of the North Sea coast is close. If you look at Hamburg, there's [REpower](#) [5], which belongs to Suzlon, and there's also independent manufacturers like [Enercon](#) [6]. Some of the larger banks have expert people based in the Hamburg area who are familiar with the wind industry.

The automotive industry does a fair amount of research into electric vehicles, storage technologies and

the like. There's two locations firstly Munich and secondly Stuttgart. Stuttgart is home to Robert Bosch GmbH, Porsche and Daimler. They're working on how to improve the drivetrain and efficiency technologies. In Munich and close by you find BMW and the Schaeffler Group, a large auto parts business owned by the Schaeffler family that has become prominent attempting to take over Conti (a public auto supply business).

So in these clusters, small and large companies are working in unison, complemented by university and applied R&D institutes, such as Fraunhofer.

Why are these companies that already have technology looking for your money? What can you offer them?

We solve a problem for them. These companies often have no debt, they're very profitable so they don't need money. In some cases we solve a succession issue. These entrepreneurs have been running their businesses for a number of decades, and they might not have family members to take over. They want to sell their companies so we structure a management buyout. We would come in and work with them, and we would complement that team with people from the outside if necessary.

The second instance is corporate spinouts. The larger corporates, they can be quoted or nonquoted, they have bought a number of small companies to complement their product portfolio. They now are spinning out these companies to obtain cash. It is a chief means for them to generate liquidity because obtaining banks loans is difficult, corporate bonds likewise.

The third is when there's a number of shareholders, such as two family tribes. One family might want to continue but the second tribe might want to sell that stake and we buy it and continue the business with the incumbents.

The fourth event is capital increases. Some people do need money to expand geographically or product wise, but in most cases people don't really need money from us.

So investors are starting to take note of this category?

It's very attractive. We've only been around for a year or so and we're on our first fund, so it's typically very hard to raise a new private equity fund in the current environment. Limited partners like our product because you find investing in those Mittelstand companies you can have relatively high returns, and the financing risk is less than if you had a venture proposition.

They've been operating for decades, making quality products, they're established in the market. They're profitable or very profitable, so there's little risk that they go out of business.

Our positioning resonates limited partners because a lot of them are exposed to large cap buyouts, but that is now hard because there's no cheap money available in the market anymore.

Also, Germany is a geography that's not been much exposed to private equity if you look at a private equity to GDP metric. When compared to the GDP, Germany is actually below the EU level, in terms of private equity, Germany is almost like an "emerging economy." So to operate in Germany you need investment managers who understand these family entrepreneurs, who understand these deals. That's the reason this industry in Germany has not been very much institutionalized.

In 2008, Germany's cleantech companies actually raised the most venture capital of any country in Europe. How does that figure in?

If you look at it in terms of how many companies there are in Germany, or the whole private equity sector, it's a very small amount, and cleantech is just one sector.

It could be that 2008 was skewed because it was a very particular year. Traditionally the UK was leading in terms of dollars invested into cleantech. Now the UK seems to be suffering more than Germany economically. It has focused a lot more on services and banking, so I think their economy has been impacted more. This could be one reason. It also seems plausible that most of the cleantech companies in the UK have already been "discovered" for private equity.

Do you expect to see more VCs in this space?

I do expect it, but it's very hard to do that from an office in London flying in. The industry is not as institutionalized as in the UK, where there are standard term sheets and standard agreements. Here you want to use the German language. And law, taxes, etc. are very different. But yes, over time you'll see more people wanting to do investments here.

Since it's difficult for other investors come into Germany, are there lessons that can be applied elsewhere?

Mittelstand companies embrace these "old virtues" that we previously thought until a year ago were outdated. Previously we thought the more you borrow and the more cash you burn the better, money was "cheap" that was never the case with Mittelstand companies. Another feature is that most of these Mittelstand companies operate very secretly. They have none of the features of a venture company, publishing papers and creating a buzz, which drives up interest and eventually helps them get a better valuation. The Mittelstand people have remained relatively modest and mostly under the radar screen, mostly not publishing, mostly being very conservative about the growth of the company. They financed their growth through sweat and hard work, and it seems to me that this down-to-earth approach is very sought after globally.

They make very good products and make some good money selling them. The venture environment of sometimes being larger than life and not necessarily being able to deliver on promises has not been the cultural DNA of these companies. But we are here to bring a little more of that marketing spirit to them. They innovate and have a lot of IP. They have products being bought in India and China, but it's been undermarketed. We have that global perspective and network which helps them.

Can you give me examples of some of these businesses?

We haven't invested in any yet. We looked at 300 last year, I think 30 percent in cleantech. One Mittelstand business makes capital equipment for the semiconductor industry. It's equipment that absorbs technical gases in fabs. They've been around for 20 years with offices in Asia and Europe. There's a steady flow of business and a razor-blade business model because consumables are part of their offerings. So you can take this technology and slightly adapt it to solar cell manufacturing as well. There's several water companies making capital equipment for the shipping industry or large sewage plants. They are very successful in the U.S. and the Middle East.

So is Mittelstand something VCs elsewhere should search for?

We started Pinova 1, our first fund, in January 2008, and we didn't know what we'd see in terms of cleantech companies. We knew there would be interesting targets around however. The conclusion is there really is a lot in the broader spectrum of what we would consider cleantech. Cleantech Mittelstand companies are the lower hanging fruit if you know how to access them.

If we were in the United States we would not be investing in companies with these characteristics because the category doesn't exist. This is a peculiarity of Germany that we're using as a basis for our business.

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