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18-Jun-20 | 1

Entrepreneurship in the East German Transformation Process – Implications for Korea ?

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Bundesministerium
für Bildung
und Forschung



Aims and scope

- › How did the former socialist firms perform in this transformation process? (*Top-down component*)
- › What is the role of newly founded businesses in the transformation of the East German economy following German unification in 1990? (*Bottom-up component*)
- › Policy implications: What may be learned from these developments for Korea?



Top-down transformation: Performance of former socialist enterprises

- Replacing capital stock of incumbent firms *not* sufficient – productivity still at about 75% of West German level.
 - High subsidies for capital investment favored capital intensive production in later stages of product life-cycle.
 - Little engagement by firms from outside East Germany despite high investment subsidies.
 - Vast majority of firms not sufficiently competitive (most firms did not survive)
- ⇒ **Top-down strategy turned out to be very expensive and rather ineffective !!!**



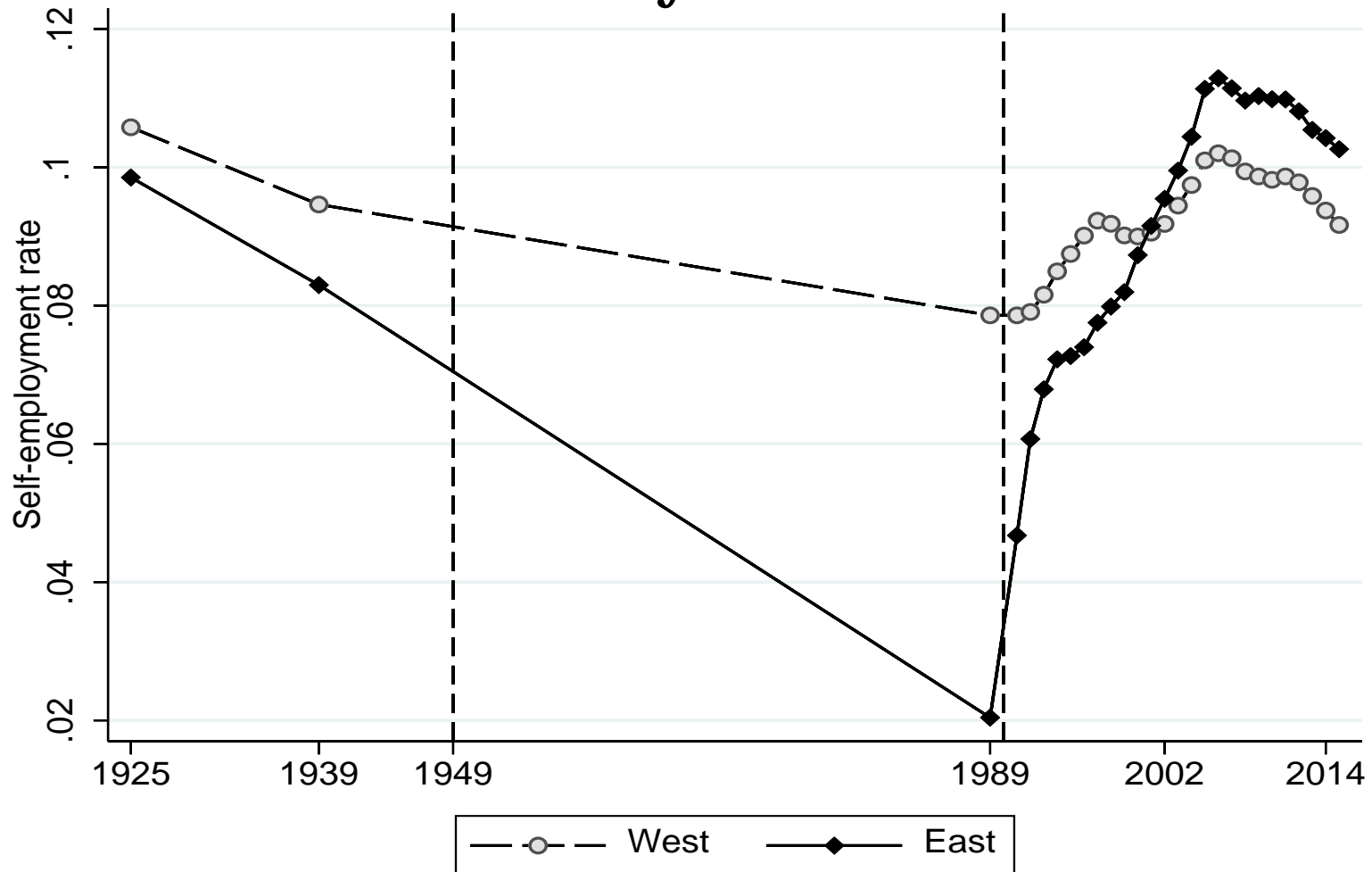
Bottom up transformation: The role of entrepreneurship

- Liberalization of e'ship induced start-up boom! Self-employment reached West German level around year 2000
- New firms played key role in transition process and made a key contribution to economic development.
- Foreign investment played minor role in most regions.
- Regions with high historical self-employment (= "culture of entrepreneurship") performed relatively well.

⇒ Bottom-up component (start-ups) was much more important than top-down component (privatization) !!!

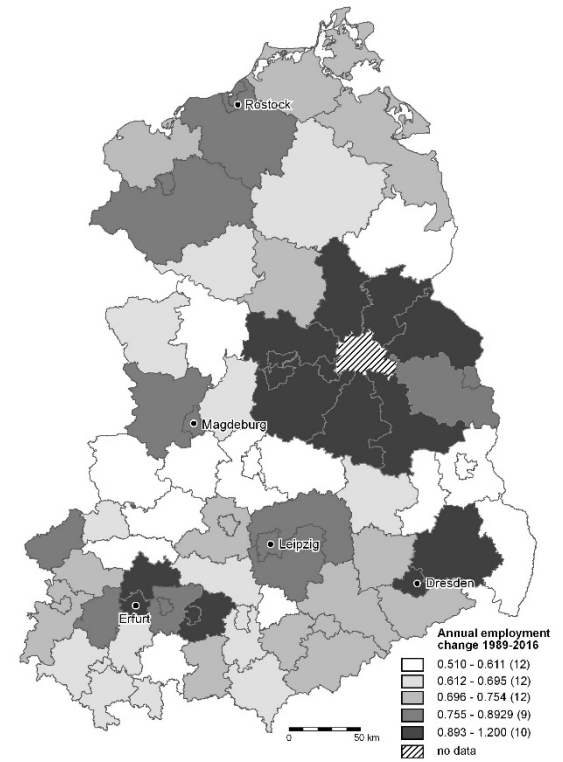
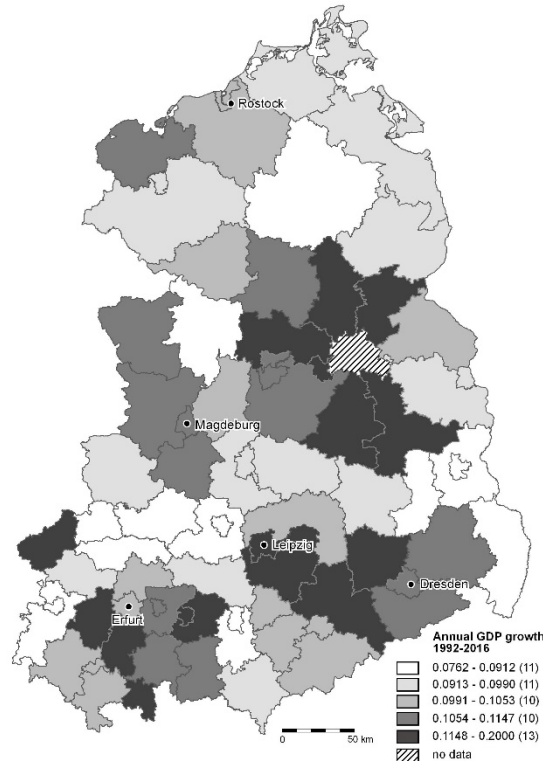
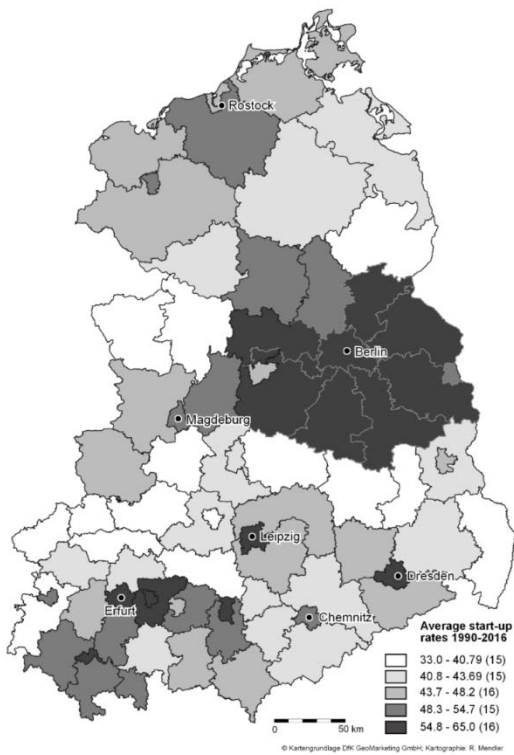


The development of self-employment in Germany: 1925-2015





Performance of East German regions since 1989





Why such a surge in start-up activity? – an institutional interpretation

- Many authors regard ruling institutions as key determinant of number and type of emerging new businesses.
- *William Baumol* (1990): Level of potential entrepreneurs approximately the same in all societies but proportion of people making productive use of their talent by running their own business depends on ruling institutions.
- Characteristics of East German entrepreneurs (age, qualification, personality etc.) similar to West German founders
- Many East German founders had already performed managerial functions in the socialist system.



Policy implications: How to deal with the former socialist firms ?

- Public or private: How to privatize ?
 - Transfer to outside investors?
 - Management buy-outs? Capital required!
- Exchange of capital stock is by far not enough to make former socialist firms competitive.
- Intensive know-how transfer needed.
- External control of firms that became subsidiaries of outside investors (“extended workshop benches”).
- Significant employment decline in most privatized firms.



Policy implications: Entrepreneurship I

- **Creating e'ship-facilitating institutional framework**
 - Avoidance of unnecessary market barriers
 - Clear definition of property rights
(no „restitution claims first“-policy!!!)
 - Insolvency laws tailored to needs of new (innovative) firms



Policy implications: Entrepreneurship II

- **Development of e'ship supporting infrastructure**
 - e.g. business incubators, networking activities, business plan competitions, availability of start-up finance
- **Provision of knowledge regarding general functioning of market economy and “classical” aspects of start-up processes**
 - How to write a business plan, marketing, accounting, ...
 - Entrepreneurship education at schools and universities



Policy options for (North) Korea

- Stimulating positive perception of entrepreneurship among the local population and entrepreneurial initiative
 - Promoting social acceptance of market economy and e'ship (e.g. awareness campaigns, show cases)
 - Fostering entrepreneurial values (e.g. strive for autonomy, risk tolerance)
- Promoting culture of entrepreneurship
- Policy should focus on the promotion of new firms (rather than subsidizing uncompetitive incumbents) !
- Policy should have a long-term orientation and should be region-specific (place-based) and decentralized!



Specific literature

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Thank you for your attention!