

Original Paper

Hidden Champions in the Chinese Century: Ascent and Transformation

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Abstract

Hidden Champions, little-known global market leaders, are extremely important for the export performance of countries. They are a little-used source of management knowledge. No country has more Hidden Champions than Germany. After a phase of hyper globalization the Hidden Champions are facing new challenges, especially from rising Chinese competitors. They have to increase their R&D activities once again and include unfamiliar areas of knowledge in the process. They need to relocate their centers of excellence to the best place, which is often China. New drivers such as digitalization, business ecosystems and sustainability require them to adapt and open up their traditionally closed corporate cultures. This applies equally to cooperation partners and foreign environments.

Keywords

hidden Champions, globalization, China, digitalization, business ecosystems, strategy

1. Introduction

Hidden Champions are companies that are among the top three in their market worldwide, have revenue of less than 5 billion euros and are little known to the general public. Germany has more of these unknown world market leaders than any other country. On a per-capita basis, Austria and Switzerland have a roughly equal density of around 19 Hidden Champions per million inhabitants. Hidden Champions are the reason why among the large countries Germany has by far the highest per-capita exports. Because of their low profile, they are rarely used as a source of management wisdom. This is unfortunate because these companies are extremely successful and do not follow short-term fashions in their strategies. In recent years, Chinese Hidden Champions are increasingly

appearing on the global stage and are likely to become the fiercest challengers to the German champions.

2. Ascent

I coined the term Hidden Champion in 1990. In 1995, the 457 German Hidden Champions I identified at the time generated average sales of 95 million euros. Today, the 1,573 German Hidden Champions currently recorded report an average revenue of 467 million euros. The main driver of their growth has been globalization. The second source of their growth is innovation.

The Hidden Champion concept has attracted worldwide attention. On the Internet more than 500,000 entries appear when “Hidden Champions” is called up. The concept made it into the Grand Coalition agreement of the German government, China launched a program to create 1,000 Hidden Champions in early 2021, and the Japanese Ministry of Economy, Trade and Industry (METI) classified them as “extremely important.” Hidden Champion awards and Hidden Champions Institutes have been established in numerous countries. My books on the Hidden Champions have appeared in 25 languages. More than 100 scientific articles have been published on the subject. The reason for the great interest is that on the one hand, Hidden Champions do not fit into the classic pattern of medium-sized companies, and on the other hand, they are not comparable with the world’s largest corporations such as the Fortune Global 500, whose average revenue is \$64 billion. The Hidden Champions form a new category of companies that are mid-sized but global. In Germany, the Hidden Champions employ more people and create more new jobs than the largest corporations, the DAX 40. They are the drivers of Germany’s continuing export success and at the same time have a presence in all important countries with their own subsidiaries.

3. From Hyper Globalization to Relative Deglobalization

But the Hidden Champions in Germany and other countries are facing enormous challenges. The rules of the game are changing, not least due to the role of China. China has become the most important market for these companies, and this applies not only to sales, but increasingly to manufacturing as well as to research and development. And it even applies to the introduction of new products because Chinese consumers adopt innovations very fast.

Globalization, until now the main driver of the enormous growth of Hidden Champions, has changed and will continue to change. 1990 to 2010 was the era of “hyper globalization,” meaning global goods exports grew about twice as fast as global Gross Domestic Product (GDP). Since 2010, and especially sharply since 2014, the relationship between these growth rates has reversed. Global goods exports are growing much more slowly, at about only 0.6 times of the global GDP. Note that the process of “relative delocalization” began before Donald Trump and before Corona. Relative delocalization does not bring the end of globalization. However, the rules of the game are changing, with serious consequences for Hidden Champions in Germany and other countries:

- Exports of goods are increasingly replaced by foreign direct investment.
- We observe a dematerialization of international exchange. Service exports and, above all, data exports are growing faster than GDP. Technologies such as 3D-printing allow that products are no longer transported to the destination country, but printed out there.
- Each activity should be done where the best conditions are available for precisely this activity. The German Hidden Champions Schenck and Scharf, for example, have relocated their competence centers for mining technology to China. Mining still exists there, whereas it has disappeared in Germany. Similarly, some Hidden Champions are locating their centers of excellence for Artificial Intelligence (AI) to China because they believe that better conditions for AI development prevail there.
- This development is taken even further with the establishment of legally independent headquarters in the European Union, the USA, and China. Dortmund-based Wilo, a Hidden Champion for high-tech pumps, is setting up three regional headquarters in those three markets. At my company Simon-Kucher, we already have a similar setup with legally independent holdings in Europe, the USA, and Asia. Behind these moves is the expectation that it will become more difficult to trade between these regions in the future, both for political and environmental reasons.

4. The New Game in Globalization

What are the effects of these new rules of the game for Germany and German Hidden Champions? Spontaneously, one might fear that negative effects will dominate. However, I do not see this happening. Reciprocal to German direct investments in China and other countries, not least the USA, I expect a strong inflow of direct investments into Germany. In a meeting with more than one hundred Chinese automotive suppliers, they all said that they want to manufacture in Germany and intend to build new factories or acquire German suppliers for this purpose. According to their reasoning this is the only way to do business with German automakers worldwide. Almost 60 percent of German Hidden Champions already manufacture in China. The number of German factories in China is over 2,000, whereas there are currently only four Chinese green field factories operating in Germany. Chinese companies have a lot of catching-up to do with regard to global presence, especially manufacturing. Large projects such as the CATL battery factory in Thuringia show that the race has begun. Germany also remains an attractive investment location for Americans, as the huge Tesla plant near Berlin or the announcement of INTEL to build eight gig factories in Europe illustrate. This also applies to research and development. Most Chinese automakers have a design and development center in Germany. Similarly, leading American tech companies such as Google or Microsoft have set up development centers in Germany and recently announced that they are investing several billion dollars there.

Globalization is thus advancing at a rapid pace. However, it is no longer doing so via hyper globalization of goods exports, but by relocating value-chain activities to the best location in the world. Most Hidden Champions have understood these new rules of the game and are taking them to heart. Culturally, however, this transformation involves major challenges. It means giving up some of the ties

to the traditional location in favor of a consistent openness to the world.

For the global strategy, the regional focus will become even more important than in the past. If we look ten years ahead to 2030, the “first global league” will consist of the USA, China, and the European Union. These three regions account for around 60 percent of the global gross domestic product. All other regions and countries will lag far behind. This is not because their growth rates are too low, but because of their modest starting levels, particularly in India and Africa. The African population will double by 2050. By 2030, however, Africa’s share of the global GDP will only have increased from 3 to 3.3 percent. In absolute terms the inequality between the regions is increasing. Since the Hidden Champions are primarily active in high-tech markets, they will focus on the top global league. This is not necessarily politically desirable, but it is the reality.

5. The New Driving Forces

If we now move from the macro level to the “operational engine room,” we encounter four decisive new driving forces:

- Innovation
- Digitalization
- Business ecosystems
- Sustainability

5.1 Innovation

Innovation has always been the second most important driver of growth for Hidden Champions after globalization. In this respect, this driving force is not fundamentally new. However, it is becoming even more important, i.e. its weight is increasing compared to globalization. One reason for this is that many sectors, such as mobility, energy, healthcare, and the environment, are facing transformational challenges that can only be overcome with technical innovations. Historically, the Hidden Champions are well positioned in terms of innovativeness. They have 31 patents per 1,000 employees, while large companies have only six. Breakthrough innovations, particularly in new areas, often come from SMEs. Examples from Germany include BioNTech’s Corona vaccine, electric flying machines such as Volocopter (electrical helicopter), Lilium (vertical take off aircraft), HY4 (hydrogen aircraft), and plasma analysis for generating hydrogen. A second reason for the more critical role of innovation is the rise of China. In 2005, China entered the top 10 in the number of international patents for the first time and overtook Germany in 2012. Today, China is number one, even ahead of the United States. Adjusted for size, Chinese Hidden Champions employ about three times as many people in research and development as their German counterparts. For example, Carl Zeiss, a world market leader in photonics, and Trumpf, number one in industrial lasers, have 484 and 596 R&D-employees per billion euros in revenue, while Chinese Hidden Champions Lens Technologies and Hikvision report 2,156 and 1,256 people in R&D per billion in revenue. There can be little doubt that the Chinese will become the fiercest competitors of the German Hidden Champions.

5.2 Digitalization

In digitalization, it is important to distinguish between consumer and industrial markets. The consumer markets are an American and Chinese game in which German and European companies play no role. In my opinion this will not change. In contrast, many Hidden Champions are leading the way in industrial digitalization. Teamviewer, the world market leader in remote screen control, is installed on more than 2.5 billion devices. The LSTM (for Long Short Term Memory) software, which goes back to Professor Jürgen Schmidhuber of the Technical University of Munich, is behind Apple's Siri, Amazon's Alexa, and many similar artificial intelligence systems. LSTM is used on more than 3 billion smart phones. As proven in numerous tests, Cologne-based Deepl offers the best translation program in the world. Celonis is number one in so-called process mining and is valued at \$11 billion. Further examples are RIB Software in construction software, Leanix in cloud governance, Control Expert in automatic processing of accident claims, and Riskmethods in early warning systems for global supply chains. Apple has the incredible number of 767 suppliers in Germany, and Tim Cook, CEO of Apple, said: "Germany plays in the very top group. The air is pretty thin up there. The culture of precision is just found here." But all these Apple suppliers operate below the surface visible to consumers; they remain "hidden."

Is it a problem that German Hidden Champions are not represented in the major digital consumer markets? The answer is mixed. In principle, it is not a problem as long as these companies remain leaders in their industrial markets. The same is true of Germany's position in traditional markets. Germany doesn't have world-leading consumer goods companies like Coca-Cola, Procter & Gamble or consumer service providers like McDonald's, Starbucks or Marriott. But Germany is very strong in industrial markets. One problem, however, arises from the fact that historically unprecedented profits and market capitalizations are being achieved in digital consumer markets. They result from a unique constellation of the three profit drivers sales, cost, and price. Sales go to billions of customers, marginal costs are zero or close to zero, and prices are high due to monopoly-like market positions. The danger that the financial power resulting from such constellations will spill over into industrial markets cannot be ruled out. If they wanted to, Microsoft, Google, Facebook or Alibaba could buy German Hidden Champions with "petty cash."

5.3 Business Ecosystems

In a business ecosystem, companies share their capabilities. They can do so cooperatively, competitively, or in a mix of both in order to bring new products to market, better meet customer needs, and ultimately drive further innovation. I use the lithography ecosystem for the semiconductor industry as an illustrative example. With the advance of Extreme Ultraviolet Lithography (EUV), which enables further miniaturization of integrated circuits and microchips, complexity has increased to the extreme. The Dutch Hidden Champion ASML is the world's only manufacturer of EUV lithography machines, has more than 80 percent of all chipmakers as customers and a global market share of 65 percent for lithography systems. However, the world-class expertise behind this does not lie with ASML alone as

the high-power laser from Trumpf for the EUV light source and the optical system from Zeiss SMT are key components of ASML machines. Behind this global success is the business ecosystem with the three Hidden Champions ASML, Trumpf, and Zeiss.

The customers of these systems invest billions in new chip factories. The ASML lithography systems form the core. For their part, Trumpf's high-power lasers are extremely complex, with 450,000 components. Zeiss contributes the optics, which are not less complex. Both supply relationships in this ecosystem are exclusive. We are dealing with an interwoven ecosystem in which three independent companies enter a very close cooperation and are thus able to offer a product that none of the three would be able to produce on their own. In complex technologies, the competition of the future will increasingly take place between such ecosystems and less between individual companies.

5.4 Sustainability

"Sustainable is the next digital." This statement may prove visionary. Among the drivers mentioned, sustainability has the greatest momentum. And Hidden Champions are playing at the forefront. One cotton shirt requires 2,700 liters of water and six square meters of cultivated land. A shirt made from wood fibers by the Hidden Champion Lenzing uses only 180 liters of water and 0.6 square meters of land. The markets for sustainable products and processes are just emerging, and most innovations in this sector don't come from large companies but from Hidden Champions. German Hidden Champions often have competitive advantages over American and Asian competitors because environmental regulations are stricter here. The entire topic of sustainability offers great potential opportunities, especially for Hidden Champions.

6. Conclusion

The German Hidden Champions have experienced an impressive ascent. Today, they are five times larger than they were 25 years ago. The main drivers of growth were globalization and innovation. But the rules of the game are changing. Hyperglobalization is giving way to relative deglobalization. Exports of goods are increasingly being replaced by direct investments. The international exchange of goods is undergoing dematerialization. The need to carry out each activity at the best location requires Hidden Champions to change their culture and even set up regional headquarters with fully integrated value chains.

At the operational level, innovation is becoming even more important, as many industries are facing radical transformation and an innovation tsunami is rolling in from China. In digitalization, a focus on industrial markets appears to be the most promising path for the Hidden Champions. As markets become more complex, competition will increasingly take place between business ecosystems and less between individual companies. It will therefore be important for the Hidden Champions to integrate themselves into highly competent ecosystems. This requires a change in culture, as many of these companies have traditionally been rather closed-minded lone wolves. Sustainability brings great opportunities for the Hidden Champions. This is because the solutions often lie in specialized

technologies. Europe and Germany have a competitive edge in this area. With the exception of “sunset industries,” such as combustion technology, the future prospects of Germany’s Hidden Champions are positive. However, to take advantage of the opportunities that present themselves, they will have to adapt their cultures and become “global citizens” to an even greater extent than before.

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