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# Dauids and Goliaths: Hidden champions in an age of state capitalism

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## Abstract

We review the state of current industrial champions debate and make the case for small, nimble Davids, rather than resource-hungry Goliaths. These export-based SMEs have shown robust performance in recent years and may help economies increase their resilience in times of significant instability. They are more autonomous than traditional champions and they are already in our midst. The challenge for policy makers is how to foster an environment that supports Davids while keeping an eye on national strategic interests.

This last January, in his address to the European Parliament, President Macron reiterated the urgency to create and stimulate ‘European champions’. With the prospect of the Russian invasion of Ukraine looming on the horizon, Mr. Macron emphasized the need to invest more in the defence sector champions, as a means to “remain open without being dependent”. While recent, the content of the speech was neither surprising nor novel. Just two years prior – in the aftermath of the European Commission’s block of the rail merger between Siemens and Alstom – a similar push had been made. In a joint communication with the German Chancellor, the two leaders urged the European Commission to prioritize the strategic interest over antitrust policy. In chancellor Merkel’s words, Europe should follow the lead of countries such as the United States, South Korea, Japan, or China. In short, the EU “must not be afraid to have global champions, but we must work towards them”.

Typified in the two examples above is the growing political will to foster the development of large national (or in the case of the EU, regional), state-sanctioned conglomerates. These ‘Goliaths’, are colloquially known as champions and come in different guises. Broadly speaking, they can be defined as individual companies – or a set of oligopolistic firms – that add the strategic national interest to their more common value-maximizing mandate. Champions are either directly established by governments – as a form of state capitalism –

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or are private organizations that directly or indirectly benefit from preferential treatment by public authorities. Traditionally, champions operate within strategically sensitive, or critical industries, such as defence, commodities, or non-tradeable essential goods. They also tend to have a strong prevalence in natural monopolies – sectors where the significant weight of fixed costs requires few, large scale operators to attain competitiveness. These include utilities such as water, gas, or electricity and infrastructure, ranging from the road and rail network to wireless telecommunications.

## 1 The case for champions

In principle, there are many arguments to be made for the strategic and economic advantages of industrial champions. In critical sectors, they act as gatekeepers for national or regional interests. The previously mentioned EU defence argument used in President Macron’s speech is an example of this line of reasoning. There are, however, other instances in which this argument has been employed. During the rollout of the 5G wire-less network throughout Europe in 2019, strong political pressure from national governments and multilateral organizations (notably NATO) alike was put in favour of a European, rather than a Chinese backend operator ([Friis and Lysne, 2021](#)). The prospect that countries like the Czech Republic would have Huawei – a Chinese telecommunications company – rather than Ericsson – a Swedish telecom – as a provider in their networks generated a strong political backlash. While not explicitly a matter of territorial defence, the issue was categorized as one of national security, in which non-intervention could lead to “possible loss or interruption of availability, integrity or confidentiality in such systems” ([Kaska et al., 2019](#)).

A second, and increasingly popular, argument for the support of champions is that of supply chain resilience. The ongoing pandemic and its lockdowns and the invasion of Ukraine have led to growing calls for ‘onshoring’ or ‘reshoring’ production. The aim of such policies would be to mitigate the effects of price surges, shortages, and delivery fulfilments in a wide range of raw materials, intermediate components, and final goods ([Nikolopoulos et al., 2021](#)). This is, however, a multi-layered problem. Despite talk of ‘slowbalization’ and even deglobalization, the ever-increasing sophistication of consumer and business goods has made us heavily dependent on close-knit networks of highly skilled, specialist suppliers. Required resources and competencies in a complex production process make it virtually impossible for any given country to be able to be fully self-reliant. Additionally, the matter of raw material scarcity still plays a vital role. Responses such as former USA’s president Trump’s bilateralism or its more recent incarnation in the form of ‘friend-shoring’ or ‘ally-shoring’ demonstrate the implicit acknowledgement that even with active industrial policy, economic autonomy may remain a mirage for the foreseeable future.

The third set of viewpoints defending champions can be summarized as them bringing in a number of positive externalities. Large domestic groups frequently develop their own resources and knowledge base in-house. Theoretical support for this view can be grounded on Michael Porter’s notion of clusters and industrial districts – geographic concentrations of companies and institutions of a particular field ([Porter and Cluster, 1998](#)). Clusters use their local knowledge, relationships, and motivation to achieve a competitive advantage. In addition, clusters generate spill over effects and positive externalities in terms of employment,

taxation, and support industries (Delgado et al., 2014). Finally, the climate agenda and the control over emissions have also been pointed out as a reason for taking up industrial action at home (Rodrik, 2014).

## 2 But do we need champions?

Listing the pros of champions is naturally only one side of a story with a long and rich tradition in economic literature. Perhaps the single greatest concern with the promotion of industrial champions is the increase in market concentration it generates – and the subsequent reduction of competition and rise in prices it produces. Firms are only too aware of the effect that reduced competition has on their market power and often lobby for such policy outcomes. Unsurprisingly, the link between active industrial policy and political corruption has been verified in multiple instances and across contexts, syphoning public resources and eroding trust in institutions (Ades and Tella, 1997; Bahoo et al., 2021)

On the other hand, evidence in support of the level of innovations brought up by state-sponsored industrial champions is, at best, lacklustre. The issue seems to be not so much the difficulty in spawning innovations, but their adoption and distribution (Geroski, 1992). Here too, the monopolistic framework of analysis may be of use. Larger firms with a dominant position in the market will have little incentive to perform the necessary investments required to implement new innovations. At the core we have a type of agency problem: public officials are interested and will promote research and development at national champions while decision-makers at the firm level may be reluctant in facing the costs associated with operationalizing their own innovations (Musacchio et al., 2015).

Competition and anti-trust authorities also have it tough: being specifically mandated with targeting excessive market concentration, how to act when politicians ask for the opposite? Greater market share does contribute to market power and potential for abuse of dominant position by monopolistic players. That this may be a known – or even acceptable - risk has been acknowledged explicitly by politicians. In the speech from the opening example, President Macron expressed that competition law has perhaps been too focused solely on the consumer and not enough on defending European champions. But can this be a false trade-off?

## 3 The future is already here

Unlike many economic models, not everything else was held caeteris paribus as the debate on the merits and risks of promoting industrial champions unfolded. A strand of literature – mostly studying the export performance of German companies – has identified a set of relatively low-profile, small, and midsize, high-performance firms: the aptly named ‘hidden champions’. At first glance, these ‘Davids’ are the new champions that differ significantly from their older and larger siblings: they are not household names, ostensibly lack the ‘national interest’ mandate, and are not started by governmental decree. Their origins lie not in strategically ‘sensitive’ industries, but rather in knowledge-intensive, niche sectors, that enable these champions to establish long term, lock-in type of relationships with their

customers (Audretsch, Lehmann, and Schenkenhofer 2018). And while they compete in global markets, they do so not by virtue of their size, but rather via their superior export performance.

Figure 1 depicts the 2000-2021 series on the return on assets (ROA) for the BACH sample of 11 EU countries. The information pictured directly compares the performance of ex-ported small and medium-sized enterprises (SMEs) and large companies (with an annual turnover greater than € 50 million). While the comparison is merely exploratory and differences between sampled firms are modest, an observable switch in trend over the period of the analysis is present. Up until 2015, larger companies outperform SMEs. Afterwards, is the SMEs that lead.

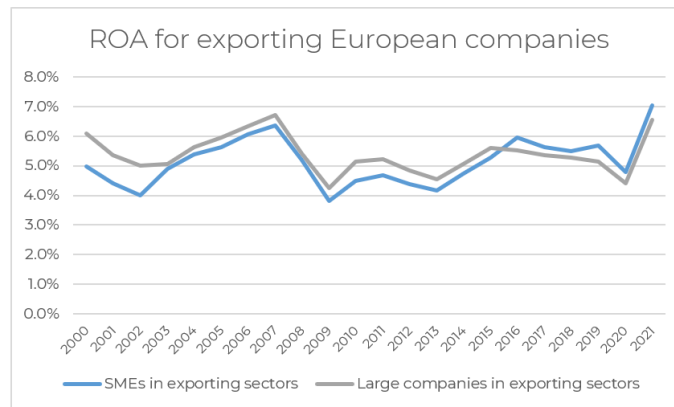


Figure 1: ROA of exporting SME and large companies. BACH European sample.

Source: *BACH/Banque de France*.

It may be premature to attribute the performance improvement of SMEs to the rise of hidden champions alone. However, it should be interesting to dwell into some of the underlying factors that contribute to the explanation of their success. A recent review identified quality of human capital (particularly at the managerial level), innovation in form of patented proprietary technologies, and nimbleness (a combination of flat organization structure with relatively small size) as the most distinct resources controlled by hidden champions (Schenkenhofer, 2022). Technological developments also play a role: recent experimental research has shown additive manufacturing techniques, such as 3D printing, to significantly reduce the levels output required to access the full extent of economies of scale (Baumers and Holweg, 2019). This de facto mitigates the size advantage of larger operators and may in the future dilute the power of some industrial champions operating in natural monopolies.

## 4 Conclusion

In the present piece, we reviewed the current state of the industrial champions debate and recentred the discussion on the rising phenomenon of hidden champions. The pre-sent climate of high uncertainty has sparked renewed calls for state intervention in sectors of the economy deemed sensitive for geopolitical and strategic reasons. The promotion of large industrial champions that can safeguard national interests and with-stand future shocks has been a

frequently voiced argument by policy makers. However, this option has in the past come at the expense of direct public funding, indirect preferential treatment, and increased industrial concentration – with all its implication in terms of higher prices and reduced innovation.

We instead made the case for the new ‘Davids’: the hidden champions. These export-based SMEs have shown robust performance in recent years and may help economies increase their resilience in times of significant instability. They are more autonomous than traditional champions and evidence shows they may be outperforming them. Rather than lobbying for state interventionism or for the scrapping of anti-trust mandates, hidden champions welcome global competition. They rely on high-quality human capital, patent portfolios, organizational nimbleness, and incisive usage of novel technologies like 3D printing to compete in global markets. In fact, they may be at the forefront of new businesses generating a global impact.

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