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# *Global niche market leaders in emerging Asia and the necessity to become market insiders*

In the present article we will focus on the implications that the Emerging Asia growth trend implies for medium-sized companies from Germany that are market leaders or a top 3 supplier in their respective niche or market segment (aka 'Global Niche Market Leaders'). We find that only a small portion of the companies considered have developed insidership on the Asian continent in general and in China in particular. We contend that this can put a mortgage on the strength of their global market position in the mid-term. We argue that it is recommendable to adopt a more assertive approach towards the Asian/Chinese market, implying a stronger emphasis on other foreign entry modes than export and a redoubling of R&D assets between -in this case- a German *Standort* and an Asian one. Similarly, we conclude that succeeding in Asia is becoming less and less a question of following a trickling up strategy (positioning oneself first in lower-end market segments and moving up gradually) as the continent is acquiring a lead market status for several high-tech industries.

En este artículo nos centramos en las implicaciones que el crecimiento de Asia Emergente tiene en empresas de tamaño medio de Alemania, líderes o que se encuentran posicionadas entre los tres primeros proveedores en sus respectivos nichos o segmentos de mercado (también conocidas como 'Líderes de Nicho en Mercados Globales'). Encontramos que, en general, solo una pequeña parte de estas empresas ha tenido en algún momento relaciones mercantiles con el continente asiático, con China en particular, y sostenemos que esto puede hipotecar su posición en el mercado global a medio plazo. Para ello, consideramos recomendable adoptar un planteamiento más asertivo hacia el mercado asiático/chino, poniendo mayor énfasis en otros modos de acceso a mercados extranjeros que el basado en las exportaciones, y redoblar los activos de I+D entre -en este caso- las empresas alemanas y las asiáticas. Concluimos que tener éxito en el mercado asiático es, cada vez menos, una cuestión de continuar con la estrategia de 'goteo hacia arriba' (posicionándose primero en los segmentos inferiores para subir gradualmente), debido a la posición de liderazgo que, para las industrias de alta tecnología, tiene en la actualidad dicho continente.

Artikulu honetan suspertzen ari den Asiako hazkundeak Alemaniako tamaina ertaineko enpresetan dituen ondorioetan jartzen dugu arreta. Enpresa horiek liderrak dira edo beraien merkatuko-nitxoko edo merkatu-segmentuko lehen hiru hornitzaileen artean kokatuta daude («nitxoko liderrak Merkatu globaletan»). Ikusi dugunez, enpresa horietatik gutxi batzuek baino ez dute garatu lehen eskuko informazioaren trafikoa kontzeptua Asian, orokorrean, eta bereziki, Txinan. Uste dugu horrek beren merkatu globaleko posizioa hipotekatu dezakeela epe ertain batean eta uste dugu gomendagarria dela asiar/txinatar merkatuarekiko planteamendu asertiboagoa hartzea, esportazioetan eta -kasu hone-tan- kokaleku alemaniar eta txinatar baten arteko I+G aktiboak handitzean oinarritzen ez den atzerriko merkatuetara sartzeko beste era batzuetan indar gehiago jarrita. Era berean, Asiako merkatuan arrakasta izatea, «goranzko tanta-jario» deritzon estrategia (lehendabizi beheko segmentuetan posizioa hartzea gorantz aurrera-apurka-apurka joateko) jarraitzean gero eta gutxiago datza, kontinentea teknologia handiko industria batzuentzako merkatuko lidergoa lortzen ari den heinean.

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## 1. INTRODUCTION

For Western companies that aspire to be a worldwide leader in their target markets, the rise and opening up of emerging markets have two broad-based implications.

On the one hand, it requires these companies to develop a foothold in new market as they open up (by offering adequate value propositions for the potential customers on these markets).

On the other hand, it creates a need for them to demonstrate their ability to compete with new (global) contenders that arise from those markets.

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Particularly Emerging Asia with three strong sub-regions (Greater China, ASEAN and potentially India)<sup>1</sup> is manifesting itself as a region where expanding market opportunities unfold, and where contenders for global market domination emerge, including in high-tech industries like mobile phones and electric cars. Economic growth across these sub-regions has been buoyant over the past years, with average annual economic growth rates of respectively 9.4%, 7.4% and 5.2% for the Chinese, Indian and ASEAN sub-regions between 2005 and 2016 (own calculations based on IMF and WEF). Moreover, if one zooms in on new, digital, economy market segments like e-commerce payments, it turns out that between 2005 and 2016 China's share in the total value of e-commerce transactions rose from less than 1% to over 40% (MGI, 2017).

The outcome of the former trends is that Emerging Asia is becoming a very important place-to-be for Western companies that have global leadership aspirations. At present, for most industry sectors; particularly China is turning into the largest single market area.

Moreover, the thought that the Asian market can be conquered with defeated or last season products of Western origin (cfr. the IPLC model, see Vernon, 1966) or via reverse innovation thinking and trickling up strategies (see e.g. Govindarajan and Ramamurti, 2011; Ramamurti, 2012) has today only partial applicability. On the one hand, it may still be relevant for e.g. the Indian and Indonesian (or broader ASEAN) market. On the other hand, in the case of China it seems to lose ground, as it is turning increasingly into a hub for innovation and for the launch of new product generations in its own right (German Chamber of Commerce in China 2017), has turned.

Given the economic growth of the region and the modernity of customer preferences, it is clear that global product-market strategies will have to factor in the preferences of customer groups from Emerging Asia. Alternatively -due to the sheer size of these markets and their possible local specificities, they increasingly legitimize a targeted and locally responsive strategy in their own right. Similarly, to be able to compete on a level playing field basis with competitors from Emerging Asia and to act from close range, it is also becoming indicated to be on-site.

In other words, attaining an 'insider status' becomes an increasingly important issue for companies that come from outside Emerging Asia -or China in particular. Achieving 'insidership' on foreign ground (developing localized operations in sales, marketing, logistics, manufacturing, and R&D) is challenging due to the financial and management resources required. Particularly for mid-sized companies this (sup)poses unique challenges. In the present article we will focus on

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<sup>1</sup> According to present classifications from e.g. IMF, China is still considered as a part of Emerging Asia. Hence, we stick to that labelling in this paper, but readers should keep in mind that certain market segments in China are developing very fast and have the potential to function as global lead markets already today.

the implications that the Emerging Asia growth trend implies for medium-sized companies that are market leaders or a top 3 supplier in their respective niche or market segment. Since a larger number of these companies are based in Germany (Simon, 1996, 2009), we will focus on Germany-based companies with a 'Hidden Champion' profile, referring to them as 'Global Niche Market Leaders' (hereafter also: GNMLs).

The rest of the paper is structured as follows. First, we conceptualize the terms «GNMLs» and «market insidership». After describing the methods and sources that were used for our empirical research, we assess to what extent a group of German-headquartered GNMLs has attained a status of market insiders in some of the main markets in Emerging Asia. These are followed by a discussion of the findings. We finish by outlining implications, limitations and suggestions for further research.

## 2. THEORIZING GLOBAL NICHE MARKET LEADERS AND MARKET INSIDERSHIP

While the present paper draws upon empirical data, we also believe that it is indicated to reflect in a constructive manner on the concept of «Hidden Champion» and how to operationalize it.

The term «Hidden Champion» was coined by Theodore Levitt in a conversation with Hermann Simon about the reasons behind Germany's export success. Consequently, Simon launched a series of works on this phenomenon (1990, 1996, 2009, 2012) in which he described the following criteria that companies must meet to be considered a «Hidden Champion» (Simon 1996, p. 5-6; Simon 2009, p. 15):

- Number one or two (alternatively: 'top three') in the world market, or number one on the European market (alternatively: 'the main continent that a company is based on), determined by market share.
- Revenue below \$1 billion (raised to 4 or 5 billion USD in later publications)<sup>2</sup>.
- Low public visibility and awareness.

While both the term and the research line that Simon put on track have been very appealing, it is also true that they have posed researchers wanting to follow in his tradition with difficulties. In fact, this may have been one of the reasons why it has become more popular among practitioners than scientists (Landau, Karna and Taube, 2016). For an overview of analytical problems that the Hidden Champions 'framework' causes to academic researchers, see e.g. Venohr and Meyer (2007), Venohr (2010) and Boga (2012).

<sup>2</sup> <https://hbr.org/2017/05/why-germany-still-has-so-many-middle-class-manufacturing-jobs>

In line with the former, it seems to us that the term «Hidden Champion» in itself may form a key hindrance for pursuing rigorous research. Particularly, the ‘hiddenness’ of these firms is a relative and probably fading aspect behind their performance. Originally, Simon stated that many Hidden Champions actually preferred to stay unknown, because they did not want to alert actual and potential competitors (Simon 1996, p. 3-5). More than 20 years later, though, many companies that were labelled ‘Hidden Champion’ have grown much in size and cannot remain unknown very easily. Moreover, over time the internet has increased the visibility of businesses significantly, e.g. through company review sites like «Glassdoor» or «kununu». In addition, new financial reporting and disclosure regulations require even privately-owned German companies to fully disclose their financial results. Similarly, many B2B companies form an integrated part of global value chains and must be very transparent *vis-à-vis* their customers and in many cases the general public as well (sustainability reports, ecological footprint and other issues of societal concern).

Finally, and perhaps most importantly, given the severe shortages in qualified labor that these companies face (particularly the many cases that are located in rural areas) it has become rather costly for them to hide since high-potential employees want to have information about their potential employers.<sup>3</sup>

In other words, while the term is very eye-catching towards the general media, from an analytical perspective it is deemed that terminological progress must be made to come to insightful research.

## 2.1. Coming to an eclectic framework for GNMLs

As indicated previously, we propose to use the term ‘Global Niche Market Leaders’ since it seems to us that it lends itself better for operationalization and methodological research purposes, and since it expresses better «what are we actually talking about». when we refer to companies that act in upstream segments of B2B markets in which they hold a leading position on a global scale (which is essentially what ‘Hidden Champions’ stand for).

In the following we will attempt to make the different facets of the construct GNML clearer.

### Product-market combination

The firms under consideration act in clearly defined niche markets that do not draw a lot of attention from the public media and big consumer public. The pursuit of niche market positioning becomes viable when customer needs vary,

<sup>3</sup> See e.g. [http://www.markenartikel-magazin.de/no\\_cache/unternehmen-marken/artikel/details/1009636-employer-branding-hidden-champions-mit-vermarktungsproblem/](http://www.markenartikel-magazin.de/no_cache/unternehmen-marken/artikel/details/1009636-employer-branding-hidden-champions-mit-vermarktungsproblem/)

and companies can create a competitive advantage by offering differentiated products and services, appealing to a particular segment of the market. Kröger *et al.* (2006) argue that going after niche audiences is typical for companies that operate in highly differentiated B2B markets, whereas it is more unusual to observe in B2C markets, where customer profiles tend to be more homogeneous globally. Accordingly, many B2B markets consist of numerous submarkets or market segments that differ in a number of characteristics. The companies then usually try to define an attractive segment for themselves, e.g. a specific customer group with similar needs. Consequently, and since they do not have the resources to fight head-to-head battles against large competitors, they seek out niches that are either unknown to large competitors or too small to attract them (Clifford and Cavanagh, 1985).

The target customer group is then served with specific products and services tailored to its needs, while the putting in place of a unique value chain -optimized for the target audience and driven by the unique competence set of the niche company in question- serves as an entry barrier *vis-à-vis* larger competitors. The former implies that the focus for spotting GNMLs should be placed upon, especially upstream, B2B markets where products in the form of components or machinery are traded.

### **Global Market leadership**

In the niches that GNMLs attend, the companies in question should play a leading role from a market share perspective, and form part of the global top 3 in that regard. Typically, these companies compete on value for the customer instead of price and they try to meet the customer needs in a distinctive way through value innovation tactics (Clifford and Cavanagh, 1985; Kim and Mauborgne, 1997).

Occupying a vanguard position, particularly in technology can underpin such market leadership, but cannot substitute for it and should not be a ground to consider a specific company to be a global market leader.

Global market leadership always implies the presence of current, past or potential competitors against which GNMLs must prevail. An exception here can be formed by pioneers that command wholly new markets, in which no competitors exist yet. When dealing with internationally relevant products, these cases are rare and tend to be only temporary, since customers do not want to be dependent on one supplier and the supply side typically amplifies once demand comes on steam.

Take note that the reliability with which market shares can be established may be problematic, since it frequently depends on self-assessments by the firms under consideration. Similarly, market share in a specific niche on behalf of a particular company is not equal to the overall sales figure of a company in question, for only seldomly

companies get their entire revenues from a single product and/or a single market (segment). Hence the degree of diversification of a company must be factored in.

### International footprint

Assuming that GNMLs hold a leadership position in international markets, we posit that a minimum share of a GNML's turnover comes from sales abroad. To set a minimum threshold of 50% seems fair (Kamp, 2017). That way it can be avoided that companies that dominate specific niche markets, which are essentially national or even regional, are categorized as international niche market leaders (Venohr, 2010).

Whether this 50% threshold is reached via export from the home country of the firm (+ international sales and service operations) or by means of fully integrated foreign operations (including manufacturing and R+D in addition to sales and services) is of secondary importance. However, it can be expected that over time the companies in question build up substantial operations abroad.<sup>4</sup>

### Company size

While many GNMLs maintain an SME mentality and act in narrowly defined niches, the fact that they have managed to internationalize broadly implies that a considerable part of them employ more than 250 persons. This bites with the generally accepted definition of the European Institutions on what an SME is and means -on the one hand- that the lower limit for «GNML territory» should not be set too low. On the other hand, if we assume that GNMLs are niche players and act primarily in smaller segments of larger markets; then it makes little sense to posit that these firms can invoice up to 5 billion euros a year.

As an intermediate solution we propose connecting to the framework of the «middle market» and put forward that GNMLs ought to be sought among the range of firms with an annual turnover between 20-1.000 million euros a year.<sup>5</sup>

In addition, and to avoid that the importance of a particular product-market combination for a GNML is of limited importance (see also the earlier point on «diversification»), we postulate that the sales in the market in question should at least represent 10 million euros in turnover per year for the company under scrutiny.<sup>6</sup>

<sup>4</sup> Which is also in line with the insiderisation thesis of the present paper.

<sup>5</sup> GE Capital and Warwick Business School (2013), *The Mighty Middle: Growth and opportunity in the UK's mid-market*, London.

<sup>6</sup> That way we ensure that we are focusing on companies that are specialized in a particular product-market combination and that we are not dealing generalist for whom a specific market segment is just one of out many.

## Market volume and global character of the market

To ensure that we are not dealing with residual (niche) markets, we opine that a minimum threshold should apply as well to the overall size of the global market niche served by companies. As a tentative rule we forward that the annual market value should at least be 50 million for a well-defined product category.

In addition, we argue that this market value should at least be based on significant business in 3 different continents across the globe to warrant the global character of the market in question.

Admittedly, this criterion may be smoothened in the case of new product markets for which specific countries or a single continent act initially as lead market(s). In such cases, the early stage demand will be geographically concentrated. By all means, also in these cases, it should be foreseeable that a worldwide market will unlock and that these products will eventually tap into a global pocket of demand.

### 2.2. Market insidership

In line with the idea that GNMLs should not *per sé* be considered as «hidden» actors who move in concealed ways, we also argue that conquering prominent market positions on foreign ground can only be achieved to a limited extent by operating from behind the fence.

While this has arguably always been the case, in the current context of globalization it is becoming increasingly imperative to go beyond the practice of exporting to establish and maintain market leadership across multiple continents. The practice on behalf of GNMLs to engage in Foreign Direct Investment and developing a physical overseas presence was perhaps underexposed or underestimated in the early works on Hidden Champions as they emphasized more the link between these companies and the export success story and the positive foreign trade balance of countries like Germany (Simon, 1992, 1996, 1996b). However, over the past decade the FDI propensity of GNMLs has been brought more clearly to the front. I.e., Venohr and Meyer (2007) contend that GNMLs count with significant overseas manufacturing presence and prefer greenfield investments as foreign entry mode. Simon (2009), on his part, concluded that owning foreign manufacturing subsidiaries is a very typical trait among Hidden Champions, whereas Witt (2015) showed how GNMLs deploy substantial foreign direct investment in addition to conducting mere foreign trade activity.

Apart from the choice between low and high equity entry modes (mainly: exporting or FDI), there is the question of opting for wholly owned subsidiaries abroad or making use of partnerships with local allies. In this regard, most literature on Hidden Champions states that these firms are clearly in favor of going-it-alone.



Among others, Simon (2009), Witt (2010) and Witt and Carr (2013) point at this preference for moving abroad alone and to avoid partnerships.

Evidently, from the perspective of developing insidership in foreign places going-it-alone or joining forces with local partners can make a big difference, both in terms of the level and speed with which local embeddedness can be established.

From a theoretical perspective, the notion of 'building up insidership in multiple places to lead a market across the globe' can be underpinned by considering the following schools of thought.

### **Interpretation of business internationalization as a process or stages model**

According to Johanson and Vahlne (2009) internationalizing companies typically go through stages starting of with export operations to neighbouring countries. Over time, these companies acquire more knowledge about conducting international business and about more distant markets (also in a cultural sense). Hence, they dare to commit more resources and higher equity entry modes to foreign markets. Similarly, they evolve from merely selling abroad to manufacturing and developing products on off-shore locations.

As such, this internationalization process model aligns very well with the spirit of market leaders that we are addressing in the present paper. For these are typically longstanding and resilient companies that grow in a gradual manner; companies that develop and expand their market presence in a well thought through manner, without rushing things necessarily.

Both the internationalization process model and the way that the growth path of GNMLs are typically presented,<sup>7</sup> indicate that there is an organizational growth rationale that induces firms to amplify their international business behaviour, both in terms of the geographical markets they address and the entry modes they deploy.

Johanson and Vahlne (2009) consider an internationalization process (or foreign entry process) to be accomplished when a firm reaches the status of insidership in a foreign business network. A practical way of interpreting insidership comes from Hilmersson (2013), who considers that insidership is attained when business relationships with relevant actor(s) in a specific territory have reached a long-term character.

In line with the former ideas of creating foreign subsidiaries that take on functions with regard to product portfolio development; foreign subsidiaries can

<sup>7</sup> Slow but steady and organic growth instead of (explosive) «speedbred chicken» croissence by means of take-overs of peers or absorbing upstream or downstream actors of the value chains in which they act (Simon 1996, p. 11; Venohr and Meyer 2007, p. 15).

be expected to become embedded in the local environment (Vahlne *et al.*, 2012). This typically involves taking up R&D activities (Forsgren *et al.*, 2005; Meyer, Mudambi, and Narula, 2011) and allowing foreign subsidiaries to develop entrepreneurial activities (Birkinshaw, 1997; Vahlne *et al.*, 2012).

### **Diversity in markets qua demand characteristics and idiosyncrasy of buyer-supplier networks**

Next to the fact that the maturing of internationalizing firms leads them to consider building up a more prominent presence in foreign markets (organizational growth rationale), there can also be a market pull rationale that induces firms to develop a particular footprint in foreign markets.

Despite the globalization of business, it is incorrect to assume that customer preferences are the same everywhere and that the chances to attain market share on a particular continent are equal for those that count and those that do not count with local presence. In particular *vis-à-vis* markets that count with high dynamism or lead market characteristics for specific product groups,<sup>8</sup> it can be detrimental to keep an arm's length relationship and supply them from a distance. Moreover, in line with findings from Rugman and Verbeke (2004) and Oh and Rugman (2014) still today there are many industries whose buyer-supplier networks are organized on a regional or continent-per-continent basis. This implies particularly for companies who are active in B2B circuits that getting a foothold outside their continent of origin is imperative. More and more, getting such a foothold means going beyond recurrent trade relationships with specific partners in the region, and instead requires the development of multiple business functions in the region in question, like R&D (cfr. embedded subsidiaries of multinational enterprises, Forsgren *et al.*, 2005).

Altogether, it seems that companies with activities on site have a far better sense of market-specific customer requirements, and can tailor products and services to the needs and specificities of target markets abroad. In addition, such presence forms an essential source of innovation and offers attractive revenue potential in product-related services.

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<sup>8</sup> When connecting the concept of «niche» with «lead market» we also realize that companies can face demand that evolves over time and which does not have to represent the same volume in different places or continents. I.e., what starts out as a niche (in a lead market) may turn into something big over time in the place/market where demand took off, whereas the evolution of demand in other places may catch up but with a time lag. As such, niches can also be regional rather than global. Similarly, what is a niche market in one place at T1, may be a mass market elsewhere at that point in time. Consequently, besides considering regional differences, GNMLs need to be aware that niche markets may become mass markets in the course of time. As a consequence, GNMLs need to evaluate and (re)define the appropriate niches for them, and be open to niche adaptations. As an alternative to operating in a niche, they may opt for leaving the niche, but then they must fully understand and meet the requirements of operating in mass markets.

### 2.3. Conceptual model and test-setting to assess the degree of market insidership among GMNLs

#### Framework for analysis

While there are several well-known frameworks to analyze and describe the internationalization patterns of companies e.g. the previously mentioned IPM or Uppsala model), we propose to use an adapted and significantly extended version of Ohmae's Five-Stage Model (Ohmae, 1990). Principally because the model is considered to be suitable for GNML-type of firms since it applies very well to one-product companies or other kind of product specialists.

Ohmae (1990) argues that in order to compete successfully on global markets, a company needs to increasingly transfer key activities and competencies to its main foreign markets and ultimately become fully globalized. Evidently, there is organizational choice involved in such processes and also the sectorial context in which a company operates will co-determine what the optimal stage for internationalization will be for a firm. In addition, the cultural/national background of companies will influence their international strategies. For instance, German companies that sell products at the cutting edge of technology, rely upon close cooperation between engineers and manufacturing workers when coordinating different phases of production from design to market. Physical proximity of all key functions, a highly skilled and experienced employee base, home-based intellectual property management as well as trusted supplier networks are all key factors to success. Therefore, German companies -instead of splitting their value chains and performing activities in locations where the required skills and materials are available at lowest cost- still favor an integrated value chain including a tightly-knit supplier base.

This approach is very different from the approach preferred by many US manufacturing companies, who outsource and offshore manufacturing operations to Asian contract manufacturers. German companies rely much more upon integrated value chains and rather pursue a dual strategy in globalization – slowly building one or more international hubs over time with the objective of replicating their German home base (thus creating a «second home»), while still keeping significant manufacturing as well as product definition, R&D, design and logistics functions at their main German home base.

Hence, and referring to the five stages model, for German firms attaining stage 4 is kind of the highest aspiration level, whereas US firms go much more after the stage 5 level. One way or another, both stages suppose a considerable level of insidership implying among others the maintenance abroad of comparable manufacturing and R&D facilities to those in the home country.

## Research context

Given that Germany is considered to be the home to many GMNLs and the Asian continent has developed into a market place that internationally active companies should take into their stride (Buse and Tiwari, 2014; Landau *et al.*, 2016), we argue that assessing the extent with which Germany-headquartered GMNLs are developing market insidership on the Asian continent forms an interesting test case. Hence, in the following we report on the way that such an assessment has been undertaken and the findings it led to.

## 3. METHODS AND SOURCES

For the empirical part of this paper the main source of information is formed by a study that was aimed at understanding how Germany-headquartered firms could best capture growth opportunities in Asia, with the target group of this study being German GNMLs. The study was commissioned by the Singapore Economic Development Board (EDB), was supported by the Singaporean-German Chamber of Industry and Commerce (SGC), the German Centre for Industry and Trade Singapore, Future Ready Singapore and the German AHKs in other parts of Asia, and was carried out under the guidance of the lead author of the present paper.

Figure 1. FIVE STAGE COMPANY GLOBALIZATION MODEL

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5
<b>Main thrust</b>	Export only	Establish local marketing sales and service operations [subsidiaries]	Add local manufacturing	Achieve insiderisation by adding R&D	Achieve complete globalisation
<b>Value chain split</b> (headquarters / region)	Fully based in home country; all or part of local marketing, sales, distribution and on-site servicing outsourced to distributor/local agent, if necessary	Own representative office or branch with local sales (application engineering), service and marketing operations	Manufacturing operation is added (component production and/or final assembly)	Firm has 'cloned' itself: performs almost the full range value creating activities in the region. It will also locate important infrastructural activities such as for instance IT, HR, finance in the region.	Worldwide network structure: local operations are 'centres of excellence' and fully integrated; people, raw material, technology and capital are sourced where they are best and cheapest; develop and manufacture products wherever they find the best resource base and sell globally
<b>Governance</b> (split of decision making power between global headquarters and region)	All management decisions are taken in the home country	Certain decisions are delegated from the home country headquarter to the country subsidiaries like distributor management, perhaps product portfolio or minor adaptation decisions, and recruitment of local staff	Additional responsibilities regarding the localisation of procurement and logistics and of local outsourcing of certain manufacturing steps are delegated to regional subsidiaries	Regional management will often control important decisions on investment, product and pricing strategy and core staff	Power decentralised; global mindset; 'virtual headquarters' structure; board members are placed in key regions (large markets; resource hubs)

Source: Bruche and Venohr (2015) based on Ohmae (1990) and Ping Bu Loke, former Centre Director Europe, EDB Singapore (unpublished presentation material).

The EDB-commissioned study relied on the following methods: an online survey and management interviews with owners, CEOs or Board Members of GNMLs operating in Asia. The online survey was distributed among Singapore-based executives and Germany-based executives overseeing Asia operations. The survey questions focused on three themes: general company information; current company footprint in Asia; plans for expansion in Asia.

A total of 597 company executives were invited to participate in the online survey (345 Singapore-based; 252 Germany-based). Care was taken that only one executive from each company was approached. In total we received 81 valid responses,<sup>9</sup> of which two thirds came from Germany-based executives and one third from Singapore-based executives.<sup>10</sup> Reviewing the answers there were no significant differences in the results between these two sub-groups. Of the 81 valid contributions, only 6 corresponded to firms with an annual turnover of more than 1,000 million euros a year. As such, over 90% of the responses came from middle market firms as proposed under the GNML framework in section 2-1.<sup>11</sup>

The management interviews were conducted face-to-face and aimed at refining and deepening the insights gained through the quantitative online survey. A total of 22 senior executives with successful business operations in Asia were interviewed.<sup>12</sup> The interviews lasted between one and two and a half hours and were conducted in person at the companies' headquarters in Germany. The interviews were semi-structured with an outline of about 15 questions. Certain company executives were interviewed a second time, mostly over the phone and in writing.

The harvest from the survey and the personal interviews was subsequently analyzed through a comprehensive approach consisting of quantitative and qualitative research incorporating substantial amounts of external data sources as well.

Since the field work for the study was carried out in 2015, we first present the results from it *as is* under chapter 4 (Findings), but analyze the findings afterwards also in the light of current evolutions on the Asian market under chapter 5 (Discussion).

<sup>9</sup> The responding companies operate as suppliers in a variety of B2B markets, ranging from automotive over machinery, domestic appliances, capital goods, pharmaceutical and medical apparatuses, to IT and automation devices.

<sup>10</sup> To profile the respondents further: roughly 15% of the Germany-based respondents had personal expatriate experience in Asia and 100% of the Singapore-based respondents had personal expatriate experience in Asia.

<sup>11</sup> Moreover, the lion share of these firms had a family business character.

<sup>12</sup> Of the 22 firms to which the interviewees pertained, 20 were family-owned (thereof 3 were listed on the stock market, albeit under family control). Furthermore, there was one company that operated as a foundation and another that is a subsidiary of a large publicly listed corporation.

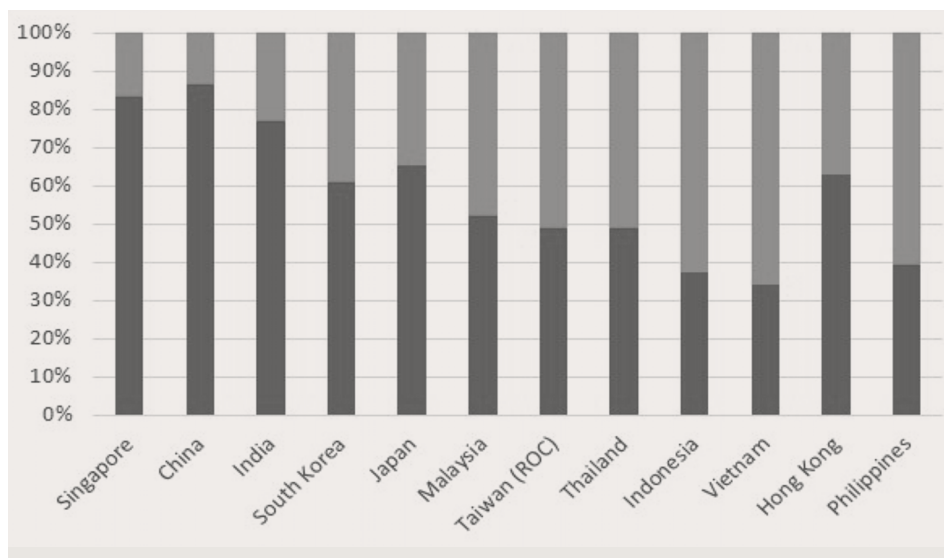
## 4. FINDINGS

### 4.1. The growing economic importance of the Asian market for GNMLs

The survey results demonstrate clearly that Asia is becoming an increasingly important business arena for the respondents. At the time of the survey Asia accounted for about 20% of the global revenues of the research sample. Moreover, in the following 3 years more than half of the companies expected double digit annual revenue growth from their Asian operations. This implies that for many of them, Asia had become the most important continent for sales after Europe. Most firms had been active in Asia since the mid to late 1990s or early 2000s, meaning that on average they have been active for two decades in this continent.

In general, we observe that there is a preference to keep sales activities under the own roof and to engage with local sales intermediaries for explorative market operations. I.e., for the markets that offer a sufficient business potential, the GMNLs prefer to conduct sales via a direct presence, while relying on external sales agents and distributors to address countries that are yet too small to justify a wholly-owned operation. The next graph illustrates this point by revealing that only in the less advanced countries from the ASEAN trade block the indirect routes to market outweigh the direct ones. Overall, 93% of all respondents reported that their companies have a direct presence via fully or partially-owned organizational units in Asia. In practice, it can be understood that the lion share of these units are under full control of the German-headquartered firms.

Graph 1. PRESENCE OF GNMLS IN SELECTED ASIAN COUNTRIES



Source: Own elaboration.

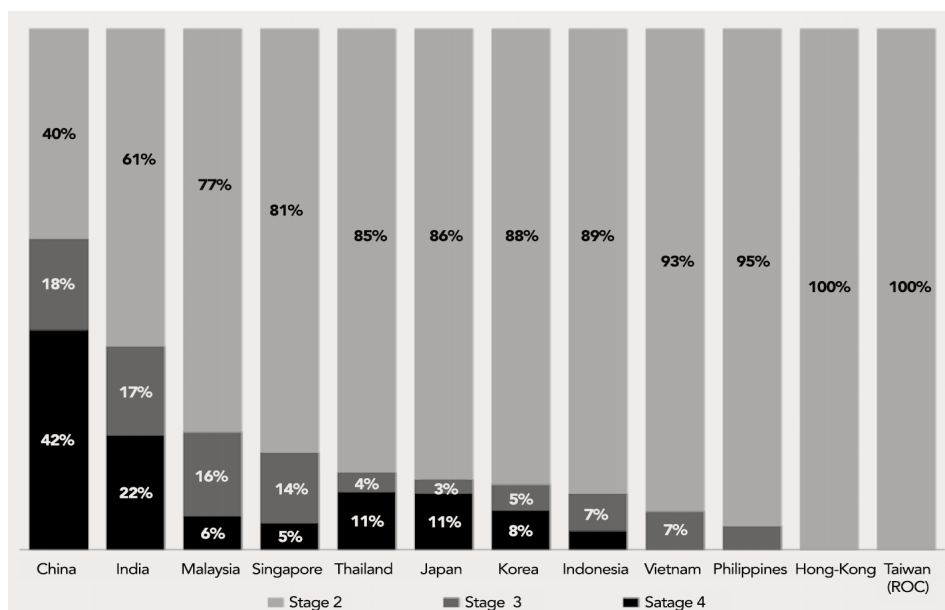
## 4.2. Asia as a place to locate higher added value business functions

Despite the rising importance of the Asian market for their business, there is no uniform pattern as to how the companies in question translate this into an organizational structure redesign and into decisions on allocating key activities and competencies abroad.

In fact, most firms have –beyond the upgrading of their commercial apparatus in this continent and tightening its grip on it – developed a rather modest production and R&D profile in the Asian region.

If we single out the firms that have reached stage 3 (adding local manufacturing to their foreign sales & service operations), we clearly see how China stands out and that this represents a substantial share of the German-headquartered GNMLs in India, whereas it is a marginal affair in the rest of the countries. Some 60% of the companies had manufacturing operations in China, whereas this was the case for some 40% of the sampled firms in India. Beyond these two countries the percentages are much more modest, ranging from 22% for Singapore to 5% in the Philippines.

Graph 2. PROPORTION OF STAGE 2 – 4 COMPANIES PER COUNTRY



Source: Primary data from Quantitative Survey.

When looking at the portions of companies that carry out -in addition to sales and manufacturing- R&D activities in Asia (stage 4), we observe sharp differences across countries. Particularly in China we find a large number of GNMLs with pro-

duction and R&D operations on site: for 42% of the companies that were surveyed this is the case. These numbers are a reflection of the strategic importance of the country. The percentages are substantially lower for other countries. In India, it only applies to 22% of the sample and in Thailand and Japan for only 11% of the surveyed companies.

If we take a company and cross-regional perspective, about 42% of the companies analyzed are «insiders» in the region (this means that they conduct stage 4 operations in at least one of the key sub-regions –either in China, ASEAN and/or India). At the same time, we observe how only 3% of the companies surveyed are ‘insiders’ in all three sub-regions.

All in all, the expansion model pursued by GNMLs still seems to be focused largely on strengthening sales and service operations, with less of a focus on becoming a true insider (with production and R&D activities on site).

Hence, as illustrated in the next graph, only a minority of the companies attain the fourth stage in the previously presented growth stages model in globalization.

Finally, if we look at the plans of the surveyed companies in terms of staff expansion plans for Asia and the business functions the new recruits should be working on, we see that the proportion of firms that plan to increase their personnel in Asia for product development and research is substantial (more than half of the considered firms plan to do so). At the same time, the proportion of firms that plan to commit additional human resources in Asia for e.g. sales, marketing, procurement or management and administration are clearly higher.

#### 4.3. Coordinating company activities across the Asian continent

Establishing regional headquarters (RHQs) is one way for companies to deal with the challenges of coordinating their global activities. Usually, key objectives for establishing regional headquarters are to exercise greater control over a number of smaller country subsidiaries separated by vast geographical distance, as well as to shift certain management responsibilities to these regional units to be closer to local market conditions so that faster decisions can be made (Amann, Jaussaud and Schaaper, 2014). For the purpose of the present study RHQs is defined as follows: a RHQ is a corporate unit with two or more country subsidiaries reporting to it. The management of the RHQ has relatively high decision-making autonomy in key functional areas like product portfolio and pricing, hiring of key personnel, and investment choices.

The survey results show that 72% of the companies had already established one or more regional headquarters in Asia, expressing that most firms have matured beyond a country-by-country approach for the region. Moreover, both the survey and the interviews pointed out that -given the vast magnitude of the Asian continent



and the diversity of markets in terms of maturity and sophistication- the idea of creating multiple sub-regional headquarters is gaining ground. Of the surveyed companies that operate a regional headquarter in Asia, one quarter have split responsibilities into two or more sub-regional headquarters in Asia. The interviews also indicated that establishing a regional headquarters is a critical step in a regionalization strategy, helping companies both to exercise better control over their country subsidiaries and to get closer to local market conditions by shifting a certain amount of decision-making authority.

## 5. DISCUSSION

In line with what can be expected from their global leadership position, Asia is clearly on the radar of the surveyed GNMLs. Moreover, both in terms of sales value and building up business structures to support Asian operations, the continent is gaining in importance for the companies in question. It can be expected that this situation will become strengthened as about 50% of the global GDP growth until 2020 will come out of Asia (IMF, World Economic Outlook database).

The survey data also show that the sampled firms hold ambitious plans in store for Asia in the future, yet their plans are mostly focused on building sales and service capabilities, while they remain hesitant to shift manufacturing and –even more so– R&D activities to the region.

When it comes to governing production activities and sales channels in Asia, the GNMLs clearly show a preference for internalization arrangements instead of going for networked solutions.

As far as the surveyed companies have set up partnerships with local businesses, this has largely been done to compensate for a lack of means to set up shop on site on their own account, or due to the initial stage character of their foreign market entry or due to the initial size of a foreign market and taking a cautious stance towards it. The choice for partnering with local parties in the form of a strategic alliance and as a deliberate strategy to develop insidership, however, remained out of sight.

The former is coherent with the ‘do-it-yourself’ mentality that is considered characteristic for the preference of Hidden Champions to address foreign markets with their own sales and service subsidiaries. This inclination is arguably driven by the business focus of these companies; instead of selling commodities or mass-market products, specific products and solutions are developed in close cooperation with customers. While this kind of *modus operandi* seems to be widespread among German-headquartered GNMLs, it is possible that they might have to consider this kind of entry modes in the future. Both for the sake of foreign market entry speed and the ability to gather sufficient resources and the vigor with which an outside company can position itself in the Asian continent.

As for the setting up of R&D activities in the Asian region, this is a practice that is moving forward, although without too much impetus. This situation may (have to) alter, therefore.

Firstly, in the light of the experiences that the early movers of the GNML sample underwent in this regard: companies that have built up R&D capacity in Asia stressed the advantages of internationally organized R&D functions, as they improve market understanding and proximity to foreign customers.

Secondly, in view of the growing evidence that the context for innovating is improving considerably in Asia, and China in particular. The Made in China 2025 scheme, which channels vast resources into domestic R&D, is one of the conducive powers behind this. This expectation is mirrored through the Greater Shanghai Innovation Survey (German Chamber of Commerce in China, 2017), which finds that German firms will use China increasingly as a *Standort* for R&D activities. Similarly, it finds that a growing number of German firms plans to cooperate with third parties for R&D in China. In addition, the survey points out that half of the respondents considers acquiring local parties to drive their innovation agenda forward. Finally, around a quarter of the surveyed German firms suggests that their R&D activities in China serve to conceive products for the entire world as opposed to local-for-local product development or the adjustment of elsewhere conceived products.

Altogether, asset-wise the situation as documented via the survey shows a picture of moderate insidership among German-headquartered GNMLs in Asia; a situation that may witness changes in the coming years.

Governance-wise, though, the situation seems to be more advanced and appears to provide good ground to move forward and seize further ‘insiderisation’ opportunities, particularly if more assets and activities are established in Asia. I.e., the practice of installing regional headquarters and delegating powers or autonomy to these centres has become a common feature among the surveyed firms.

## 6. IMPLICATIONS, LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

### Implications

We argue that it will be necessary for German GNMLs to shift gears and step up the process to become full-grown insiders in Asia. This will probably need to begin first in China. Many companies may otherwise risk becoming marginalized on the global market in the mid-term. Full ‘insiderisation’ in the way that we portray it means the maintenance of comparable manufacturing facilities and R&D facilities in Asia to those in the home country; a situation that is still the exception for most GMNLs, according to our findings.

In terms of the market segments to target, the 2015 report of Bruche and Venohr echoed the idea that many reverse innovation scholars (like Govindarajan and Ramamurti, 2012, or Buse and Tiwari, 2014) have advocated. I.e., that in many industrial and B2B sectors the market segments for de-featured products with prices 30–50% lower compared to the premium segment would undergo the largest and fastest demand growth in the foreseeable future. Consequently, it could be expected that pressure would mount on German-based GNMLs to enter such mid-tier segments and make their mark there. Firstly, to exploit the sales potential that these segments shelter. Secondly, to get to grips with good-enough products and technology as a way to compete with local challengers. Thirdly, entering the mid-tier market segment may also help GNMLs to better protect against local competitors trying to enter the premium segment resp. addressing the niches that GNMLs dominate.

Meanwhile, we believe that it is necessary to rectify or at least nuance this viewpoint. On the one hand, we continue to think that Emerging Asia, especially China, will be the key battleground for the determination of future global market leadership in many product categories. To state the obvious: a company needs to be No. 1 in Asia (especially China) if it wants to defend its leading position in the world market. On the other hand, instead of arguing that global leadership of GNMLs depends on conquering the mid-tier and lower echelons of the market through locally designed and manufactured products, we contend that in many product and technology markets we will start to witness a clash between Western and Asia-based contenders in the premium segment.<sup>13</sup> This will particularly be the case in China. The enormous push by the Chinese Government to upgrade its industrial base and assist companies to move into the premium market segments and compete eye to eye with high-end manufacturers from the West will be instrumental in this regard. For instance, the stated objective of the programme «Made in China 2025» (published in May 2015) is for China to become a major competitor in advanced manufacturing activities, a sector that is currently dominated by high-income, developed countries, such as Germany.<sup>14</sup> On the back of heavy investments in dedicated research and innovation, China is also expected to become a significant competitor in high-tech are-

<sup>13</sup> This implies that Germany-based GNMLs can expect to face more Asian competition in the premium niches in which they are active. Consequently, instead of fighting for market share in lower tier market segments, they will already have to upgrade their fitness to outperform the growing competition. There is another, perhaps subtler, reason why GNMLs might not want to focus on the mid-tier segments in Emerging Asia and that is related to the fact that many mid-tier markets in places like China are not niches, but mass markets. Thus, being a GNML does not imply having to be active in a non-niche market (like a large-scale middle market segment). So, both from a point of focusing on a specific range of products and qualities, and from a market segmentation perspective, it can make a lot of sense for GNMLs to pick their battles selectively and stick to their guns.

<sup>14</sup> See: <https://www.csis.org/analysis/made-china-2025> and [https://www.uschamber.com/sites/default/files/final\\_made\\_in\\_china\\_2025\\_report\\_full.pdf](https://www.uschamber.com/sites/default/files/final_made_in_china_2025_report_full.pdf)

as, such as Artificial Intelligence and robotics.<sup>15</sup> In the words of a representative of one of the GNMLs interviewed: «In many fields, China has gone beyond the stage of catching up and looking at others as their point of reference. Chinese firms used to be famous for imitating, but how is that even possible anymore? We move with our own projects now, with more demanding requirements if we compare them to those in the Western world – so who can we copy?» The former emphasizes the point that acting in the Chinese market will increasingly call for its own «insiderisation» strategy.

In parallel, for the Indian and ASEAN markets a «good enough» product design market strategy may be more indicative. However, it remains to be seen whether such market positioning is in line with the business philosophy of niche players in the first place (see footnote 13). Moreover, if GNMLs want to pursue such a market strategy it will likewise require a strengthening of their insidership in those markets because getting a real feel for the wants of mid-tier or bottom-of-the-pyramid customers can not be obtained with a tele-lens from a headquarters in distant Europe (Kamp, 2012).<sup>16</sup> Moreover, there is also a severe risk for Western firms in targeting segments that thrive on price competition. In the words of one participating firm in the survey: «Localization is imperative for a true globalized approach. However, it is absolutely critical to avoid localization which focuses only on a cost down strategy. This can result into a «trap» into which a number of multinationals have fallen when they went to the extreme to compete with local competitors in Asia».

For Western firms in general and (German) companies that aspire to become or remain GNMLs, the former implies that they will need to get «inside» the Asian market in a more vigorous way. This will arguably require a much stronger emphasis on FDI, on relating with partners from the Asian continent and a broadening of the scope of business functions rolled out *sur place*, notably functions of a higher added value nature (including R&D affairs).<sup>17</sup> Consequently, in many cases this will demand an acceleration of the process to reach stage 4 of the previously presented globalization model.

<sup>15</sup> See also: <https://www.ft.com/content/cdc53aee-bc2e-11e8-94b2-17176fbf93f5> ; Tom Hancock, China's relentless export machine moves up the value chain, in Financial Times September 23, 2018.

<sup>16</sup> Or as stated by Peter Löscher of Siemens (in: FT 12/3/12): «I would not be able to produce a 'good-enough ultrasound', exporting from Germany, never ever, [I couldn't use] my high-end engineers to think about what is 'best functionality' for a low-end ultrasound».

<sup>17</sup> Admittedly, these evolutions may go faster in one sector than another, so the sense of urgency for setting up R&D assets in Asia may be higher for companies acting e.g. in the automotive industry than for those in the sector of pharmaceutical devices. Also, concerns about knowledge leaks from R&D activities in Asia remain an issue and also the appearance of cyberattacks or data phishing may make companies wary of delocating (or multi-localizing) R&D activities off-shore.

In line with the development of business towards Emerging Asia, GNMLs will also need to adjust their management processes and structures. While we have only dealt with shifting or duplicating primary value chain functions in this paper, a careful reconsideration of governance and company-cultural issues is necessary as well. This implies, for example, a redefinition of decision-making powers between the German headquarters and overseas headquarters to facilitate optimal decisions, while balancing regional and global considerations and ensuring the appropriate checks and balances. Another key challenge is the recruitment and retention of qualified local staff and management. If not addressed appropriately, the latter could turn into a chicken-and-egg problem: on the one hand, achieving a strong position in Asia requires establishing stronger regional functions in Asia with the potential to acquire global mandates and to attract senior talent. On the other hand, qualified senior personnel can only be attracted if attractive positions with decision-making power are created in a continent like Asia.

Altogether, for the near future we postulate that more GNMLs will coordinate their Asian operations by means of one or more Asian hubs, which—together with the German headquarters—can come to form a cornerstone of a fully globalized company. Such fully globalized companies may take the shape of a ‘differentiated network’ or ‘federated structure’ where embedded subsidiaries hold specific and increasingly global mandates, and where key value chain activities from certain locations are integrated globally, forming nodes that work as centers of excellence for the whole organization.

### Limitations

Our results should be taken as a first indication only, as they are based on a survey that was carried out among a limited audience from a single country. Generalization of the results can therefore only be done to a limited extent.

As regards the correct measuring of the scale and depth of specific business operations in Asia on behalf of the surveyed firms, we also have to be careful. Without in-depth interviews or on-site visit, it is difficult to assess the exact nature of manufacturing operations reported by the respondents—whether the operations focus on certain components only or on the final assembly of certain products; whether they rely on imported components from Germany or are full replicas of the German headquarters operations. Similarly, R&D activities reported via the survey can also be of various kinds.

The fact that a large part of the Germany-based respondents to the survey had no personal expatriate experience in Asia may lead to an underestimation of the speed with which business developments unfold on this continent, and the implications this can have for the market segments that GNMLs should target. We have addressed this issue under section 6. From a methodological point of view, however, we believe that future research into these matters should either source from experi-

enced expatriates only, or make a distinction between the perceptions expressed by business people with or without personal expatriate experience in Asia.

### **Suggestions for further research**

The issue of building up market insidership on overseas continents is an issue that is not only relevant for Germany-headquartered firms. Therefore, it would be interesting to analyze the state-of-play among collectives of GNMLs from other places and to see how they are dealing and progressing with this challenge. In other words, a replication of the research presented here within other contexts is deemed relevant. Within the German context, a systematic following up on the situation into the future by means of a longitudinal analysis also seems worthwhile, both from a business and policy perspective.

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