INSIGHT

Staying Strong in Disruptive Times

Hidden champions are reinventing themselves while remaining true to the past.

A hidden champion is defined by three criteria," writes Hermann Simon, the German author and influential business thinker who coined the hidden champions term. "One, a company has to be among the top three in the world in its industry, and first on its continent; two, its revenue must be below €5 billion; and, three, it should be little known to the general public." According to Simon, there are 2,734 hidden champions worldwide, of which 1,307 are German.

That Germany is home to so many of these niche-focused companies is not coincidental to their success. According to Simon and others who have studied the German phenomenon, successful factors include deep and abiding ties with employees and communities, strong collaborations with local academic and scientific research institutions, an entrenched apprenticeship system for teaching trade to youth, and a market-driven research and development strategy that far outpaces their rivals in the corporate sector. An understanding for what hidden champions have and what they do might strengthen both competing corporations and hidden champions alike.

Old families, new futures

In every four of five cases, a hidden champion is owned or managed by a family. Most of these companies are not young – 61 years old on average – although some are more than 200 years old. While grounded in what some may label "a model of the past," these companies are at the forefront of a thriving economic future.

Frequentis, a Vienna-based company founded in 1947, is a typical example. Serving its customers around the world, they focus on control center solutions in air traffic control, both civil and defense, as well as in public safety, public transport, and maritime. While they only employ about 1,600 people and have a turnover of 250 million euro, they are the world’s market leader in their niche, which they define as safety-critical communication. Not known to the wider public, Frequentis is nevertheless a well-respected partner of all major air traffic control authorities worldwide. Being closely connected with its clients, Frequentis learns from them and develops innovative solutions for new challenges.

Long-term relationships

The model underlying the mindset of the hidden champions is, compared to the one prevalent in the corporate world, more self-actualizing than economic. This has direct consequences on performance, not only that of the individual manager but also of the firm. The downside to such a long-haul mindset is the potential for inertia and path dependency. The upsides include reliability and a deeply rooted interest in sustainable solutions for all areas, whether in customer relations, product development, resource orchestration, financing, or employee relationships.

On average, German hidden champions do not pay as well as their corporate competitors for similar jobs. While this brings into question their ability to recruit and keep top employees, experience shows that they do. The average board member’s tenure at a DAX company is approximately five years; the CEO of a hidden champion stays more than 20 years. Employee turnover is also dramatically lower. According to Simon, the long-term employee turnover rate among hidden champions is 2.7 percent; in German corporates the rate is 7.3 percent, in the US, it is 30.6 percent.

One of the underlying reasons for such high retention rates is that real compensation is in both financial and non-financial rewards. By offering job security and managerial discretion, for example, hidden champions provide more of those non-financial elements and, consequently, have an advantage when it comes to salary when compared to short-term-oriented corporations.

Community embeddedness also contributes to long-term employee relationships. German hidden champions especially have ground themselves in the rural areas in which they are located. By doing so, they greatly benefit from a pool of qualified and motivated employees. Being embedded in a rural community offers several additional advantages:

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the cost of living is lower, employee loyalty is higher, and the opportunity for “going global” is highly attractive for employees. Alternative employers are not around the corner; tenure is thus higher. Consequently, tacit knowledge develops and stays within the firm.

Financing the future

In disruptive times, future development is even more opaque than in normal times. Although choosing between short-term optimization and long-term success seems like the easier choice, integrating the two perspectives is crucial. Some of the business models of today’s hidden champions will be obsolete in the near future; they know it.

How to invent yourself anew? There are hidden champions that, instead of changing their actual business, start a completely new one on the side. They do so with the clear goal to substitute the old business with the new one. They can attempt this because they are independent from short-term requests from investors at the stock exchange or from financing institutions.

Independence is key. Hidden champions prefer self-financing to debt or external equity. Again, there are advantages and disadvantages of such an approach, including a potential lack of checks and balances on the downside, and speed and confidentiality on the upside. Furthermore, self-financing restricts the scope and speed of growth. For hidden champions, self-financing and niche focus are two sides of the same coin. With limited finances and scope, they cannot do too much at a time.

While competitors might be less restricted, self-financed hidden champions can pursue a long-term strategy focused on their customers rather than on investors’ needs. Concentrating on a niche, the hidden champion knows more about the product and service in relation to the customers’ needs. Moreover, going global is rewarded with varying experiences around the same market and product, which in turn fosters incremental innovation. Stability and flexibility equally characterize hidden champions. This mix helps them to stay strong in disruptive times.

Interview

with Alexander Knauf,
Managing Director of
Knauf Gips KG

What were your impressions as you first learned about the Hidden Champions Institute?
In Germany, there are many medium-sized family companies, which are market leaders in their segment. They form the backbone of our economy. These companies think and act much more long-term than, for example, large publicly traded companies. This applies in particular to the handling of employees and investments, as well as innovations and market development. I am thrilled that, with the HCI, ESMT Berlin is concentrating on exactly the success of this German economic phenomenon.

How will you get involved in the HCI?
I will be the chair of the advisory board. The advisory board gives the HCI impetus and promotes its activities.

Why is it important that the hidden champions strategy, which is so important for many large SMEs and family businesses, is embedded in an institute at ESMT?
ESMT’s teaching is broadly designed and appropriate for large enterprises. But it overlooks the unique features that make up the DNA of hidden champions. Therefore, it makes sense to set up an institute to draw out and teach these features.

What contribution should the HCI make to the development of the hidden champions strategy in the coming years?
The HCI should capture the real levers for the extraordinary success of hidden champions and prepare ESMT graduates for careers in such medium-sized, market-leading companies.

What contribution has the hidden champion strategy – realized and systematized by world-renowned author and business management consultant Hermann Simon – given to the further development of Knauf thus far?
While we did not specifically reference Mr. Simon’s work, our strategy development always focused on the same key issues, namely employees, market development, innovation, and investment.

Sabine B. Rau
Founding Director, Hidden Champions Institute, ESMT Berlin

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