

COMPETITIVE STRATEGIES ON BEHALF OF INTERNATIONAL NICHE MARKET LEADERS: EVIDENCE FROM THE BASQUE COUNTRY

ESTRATEGIAS COMPETITIVAS DE LÍDERES EN NICHOS DE MERCADO INTERNACIONALES: HALLAZGOS DE CASOS VASCOS

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SUMMARY

This paper reviews the presence and strategic modus operandi of international niche market leaders from the Basque Country (Spain).

It shows how these companies contribute above par to the foreign trade performance of the Basque economy.

It reveals how the majority of them capitalize on first mover advantages by entering early into the niche markets they conquer.

Their first mover behaviour also manifests itself in the innovation initiatives these firms undertake. However, in that regard the paper observes how many of the “firsts” that international niche market leaders launch to market are not patented, and may thus fail to contribute to a sustained competitive advantage.

The paper concludes that this “patent paradox” is -together with the need for more “geographical ambidexterity” (entry into next frontier markets) and the risk of “niche lock-ins”- one of the potential threats to continued international niche market leadership that these firms should deal with.

Key words: Foreign trade, competitive strategy, international business, hidden champions.

RESUMEN

El presente artículo revisa la presencia y los modus operandi estratégicos de empresas vascas que son considerados como líderes en nichos de mercado internacionales.

Enseña como dichas empresas contribuyen más que sus pares al comercio exterior de la economía vasca.

Revela como la mayoría de ellos sacan provecho de “ventajas del primer entrante” al posicionarse de forma temprana en los nichos de mercado que se proponen conquistar.

Su tendencia de actuar como primer entrante también se manifiesta en su comportamiento innovador ya que suelen ser más activos que sus competidores en el lanzamiento de primicias al mercado. Sin embargo, al observar que dicho comportamiento no viene acompañado por una actividad patentaria correspondiente, el artículo señala que hay un riesgo de que los líderes en nichos de mercado internacionales no saquen todo el potencial de sus innovaciones.

El artículo concluye que esa “paradoja patentaria” constituye –junto con la necesidad de aumentar la “ambidestreza geográfica” de las empresas en cuestión y evitar que se queden atrapados en sus respectivos nichos- uno de los riesgos que los líderes en nichos de mercado internacionales tienen que abordar para consolidar su ventaja competitiva.”

Palabras claves: Comercio exterior, estrategia competitiva, internacionalización, campeones ocultos.

1. Introduction

When we describe enterprises as “international niche market leaders” (INMLs), we are referring to companies that align with the concept of “hidden champions,” as mainstreamed by Hermann Simon (1996, 2009). Simon observed, as did Venohr & Meyer (2007, p. 5), how a substantial part of the German foreign trade value did not stem from exports on behalf of big, well-known companies that act in sectors and product markets with high visibility (such as BASF, Siemens, Daimler-Benz, Bosch, Beiersdorff or Dr. Oetker) but rather from a large number of less well-known firms that act in niche markets and granular market segments and that do not receive much attention from the media and the wider public.

These highly internationalized companies allocate a large part of their production to exports. Moreover, a number of these enterprises can boast to be worldwide leaders in the niche markets they target.

Apart from the fact that the reduced size of the companies in question conceals them with lower visibility, the adjective “hidden” also applies to the kind of products they manufacture. These are typically items with a limited appeal to the general public and/or with low visibility to the public eye, as they are traded within *business-to-business* (B2B) markets and upstream segments of industrial value chains (like components that end up inside the final products purchased by end consumers). Similarly, INMLs typically act as developers and suppliers of production machinery, heavy duty equipment, precision technologies, advanced processed materials or functional devices that remain out of sight of consumers that buy finished products on *business-to-final-customer* (B2C) markets. Accordingly, their products often have a durable goods character, which also makes them different from the typical *fast-moving consumer goods* that are better known to the general public.

At the same time, the relative anonymity of these firms is deliberate, since they tend to act in a frugal manner when it comes to seeking publicity. Similarly, many of these firms argue that (media) attention can be a source of distraction, so they prefer to protect their privacy.

Finally, it can be argued that the hiddenness of INMLs is a consequence of the lack of attention that the economic press, business analysts and politicians have devoted to this kind of company over time. Whereas large-scale multinationals have always had their share of attention, lately there has been a growing interest from media and governments for start-ups, born global and other kinds of high and fast growth firms.¹ Until date, however, the attention for the kind of company that we will focus on in this paper—international niche market leaders—has been rather limited.

Nonetheless, on the back of a restored interest in the industrial branches of the economy², a growing appreciation for resilient firms (Dallago & Guglielmetti 2012)³ and the recognition that foreign trade and internationalization are crucial to economic prosperity, the relevance of INMLs and hidden champion firms should not be underestimated. Also since the share of firms that are active in B2B markets and/or mature industries is considerable, these firms can serve as useful points of reference.

Against this backdrop, this paper reviews the state of play among INMLs from the Basque Country, a European region whose economy continues to rely considerably on industrial activities (industry represented almost a quarter of total Basque Gross Value Added in 2014) and on foreign trade (more than a third of the Basque Gross Value Added stemmed from export in 2015). Take note that the lion's share of foreign trade power in the Basque economy corresponds to a mid-cap segment of firms,⁴ which is represented by the diagonally striped bars in the following graph.

¹ See, for instance: NESTA (2009, 2014), Storey (1996) or https://www.banque-france.fr/fileadmin/user_upload/banque_de_france/publications/QSA25-High-growth-SMEs.pdf.

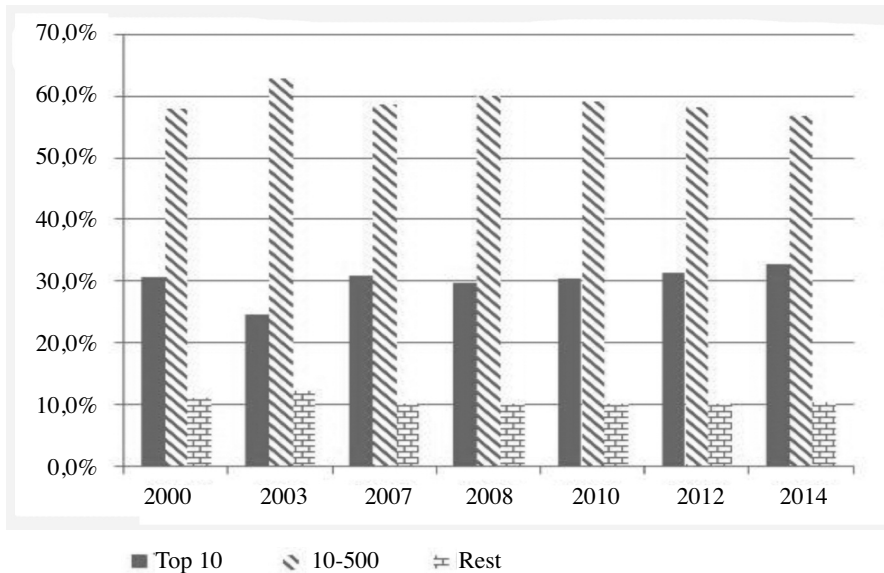
² See, for example: http://www.whitehouse.gov/sites/default/files/microsites/ostp/pcast_amp_steering_committee_report_final_july_17_2012.pdf ; <http://www.nist.gov/mep/data/upload/Manufacturing-the-Future.pdf>, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0582:FIN:EN:PDF>, and <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0582:FIN:EN:PDF>.

³ See: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2013/annual-report-smes-2013_en.pdf and “COM (2014) 14/02: For a European Industrial Renaissance.”

⁴ In line with the earlier quote of Simon (2009, p. 17), the export power of the Basque Country also relies heavily on companies of a lesser size than the blue chip firms that its economy shelters (e.g., Iberdrola, Gamesa and Petronor).

Graph 1

Segmentation of total Basque export value in terms contribution from 3 company strata



Source: Author adaptation based on ICEX.

The remainder of this paper is structured as follows. The first section reviews a series of characteristics and variables to put the (strategic) behavior of INMLs into perspective. The second section explains how our search and screening of Basque cases that fit with an INML profile took place. The next sections present and analyze characteristics and variables of the INML sample we established. The final section presents reflections on challenges that seem to be relevant for the sample of Basque INMLs we worked with.

2. Operationalizing international niche market leaders

When we refer to INMLs, we are describing:

- companies that act in narrowly defined niche markets in which they are leading in terms of market share:

- either the number one on the European continent
- or part of the top three on a global level
- companies with an outspoken international business outlook for whom doing business on a global scale is second nature:
 - Their founders/directors spend considerable time travelling across the globe visiting (potential) clients to have first-hand contact with the market
 - They demonstrate a clear “the world is flat” attitude (Gassmann & Keupp 2007) and consider the entire world as their market (Simon 2009).

The former translates into a geographical sales profile in which:

- production output is sold on either all continents and/or in dozens of countries
- the company’s foreign trade share (part of the company’s revenues that is obtained from sales outside its domestic market) is typically above 50%.

Further criteria that provide guidance to identifying INMLs include:

- size: companies with an annual turnover of up to 1 billion euros⁵
- sectoral categorization: companies with activities of primarily an industrial nature
- clientele: companies that sell their output chiefly in B2B markets. This criterion also ensures compliance with the aspect of operating in a niche or segment with limited visibility⁶ to the larger public.
- the sovereignty principle: companies that are either wholly autonomous or—if they pertain to a larger corporation or report to external (financial) stakeholders—have substantial freedom in strategic decision-taking and enjoy a high level of discretionary power (Birkinshaw 1996).

⁵ With regard to this variable, this paper deviates from Simon’s values, who has lifted the maximum threshold in his subsequent publications from 1 billion euros per year (1996) to 4 billion euros per year (2009) and finally to 5 billion euros as annual turnover (Simon 2012, p. 83). Take note that Venohr & Meyer (2007, 2009) continue referring to 1 billion euros as a ceiling for annual turnover in their studies.

⁶ “*Many of these companies operate in the ‘Hinterland’ of the value chain, supplying machinery, components or processes that are no longer discernible in the final product or service*” (Simon 2009, p. 13). Consequently, this paper focuses on firms that operate in niches with an industrial and product-centric character; that is, companies that are primarily active in B2B markets with products that are not destined for large public consumption and retail channels.

They form a silent backbone of the economy. See: <http://www.economist.com/news/business/21606834-many-countries-want-mittelstand-germanys-it-not-so-easy-copy-german-lessons>.

Apart from the former quantifiable parameters and metrics, a number of qualitative traits are also indicative of INMLs and their behavior:

- hiddenness qua acting: parsimony with public relations and name-building; low public visibility as a consequence, certainly beyond the home base of these firms (Collins & Porras 1994; Collins 2001) or the value chains they target (Simon 2009, p. 14)
- slow but steady and organic growth instead of (explosive) “speed-bred chicken” *croissance* 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 & Meyer 2007, p. 15)
- sticking to their knitting: no wild or all-over-the-place diversification with broad portfolios (Simon 1996, p. 11; Venohr & Meyer 2007, p. 15; Hilz 2013, p. 582)
- propensity to cherish local ownership and a strong bond with the original home base (Simon 2009, pp. 271-274)
- prevalence of family businesses,⁷ mostly not stock-listed,⁸ and with limited involvement of venture capital.⁹

3. Tracing international niche market leaders in the Basque Country

In the Basque Country, interest in the phenomenon of hidden champions or INMLs has been growing for some time now.

In our search for company cases that fit the INML mold, we encountered previous attempts to track these kinds of companies, as per the inventory *Euskadi, una industria de clase mundial*¹⁰ and *Multinacionales de nicho en el País Vasco*.¹¹ These seem to have been initiatives that—on the one hand—showcase a number of Basque companies and their products (in a non-exhaustive way) that are highly competitive on the global market and —on the other hand—line up a list of presumed INMLs but without a systematic validation *a posteriori* of the listed companies.

⁷ In Simon’s inventories (2009, p. 226) the following percentages are presented: 76.5% in 1996 and 66.3% in 2009.

⁸ In the Simon’s study from 1996, only 2.4% of the screened firms were stock-listed (Simon 1996, p. 10). In his sample of 2009, this was 9.5% (Simon, 2009, p. 226).

⁹ In 1996, 0% of the firms had private equity stakeholders, whereas in 2009 this percentage was 8.1% (Simon 2009, p. 226).

¹⁰ http://www.ogasun.ejgv.euskadi.net/r51-341/es/contenidos/noticia/descubre_euskadi_2006_3/es_industri/industria_vasca.html

¹¹ http://www.eldiario.es/norte/Euskadi-cuenta-lideres-mundiales-negocios_0_148035508.html

Amid these antecedents, Orkestra decided to develop its own sample by means of desk research activities, field work exercises and consultation of privileged witnesses, adhering to the criteria set that was presented in the previous paragraph.

After drawing up a long list of possible INML candidates, we organized an online survey among 183 companies during the spring of 2016. In total, 64 companies submitted answers, leading to a participation rate of some 35%. This percentage is high in view of similar polls among high-level business executives representing companies with discrete profiles (Finkelstein 1992; Waldman et al. 2001; Simon 2009).

All answer sets were subjected to a thorough screening for completeness and consistency. Extensive follow-up activities with the respondents were carried out in order to obtain additional inputs, to filter out (seeming) inconsistencies and to gather supplementary information in order to put the provided information into a better perspective and improve the interpretation of the data supplied.

To complete the data gathering, we developed time series on turnover and other business economic indicators for the sampled companies via SABI (the Spanish branch of the Amadeus database of Bureau Van Dijk). This served to gather further background data on the companies that participated in the survey.

On the basis of our different inquiries, we conclude that the Basque economy shelters some 30 INMLs that fit the criteria previously outlined. If we relate this number to the population of the Basque Country (approximately 2.2 million inhabitants), we get a ratio of 14 hidden champions per 1 million inhabitants. In comparison with a series of other territories where similar inventories have taken place (e.g., France, the United States or Japan, with ratios between 1 to 2 hidden champions per 1 million, or the Netherlands, where a ratio of 10 hidden champions to 1 million was established), this is a significant result. In fact, it is a ratio that is in line with countries such as Switzerland, Austria or Germany (with ratios of 14 to 16 per 1 million), which are considered to be the most endowed with hidden champions across the globe (Simon 2009). At the same time, and when looking at the level of NUTS 2 territories such as the German *Länder*, the ratio of 14 hidden champions per 1 million remains distant from the values that regions such as Baden-Württemberg and Hamburg exhibit, which reach up to 25 and 29 hidden champions per 1 million inhabitants.

By all means, to put the Basque ratios into a correct perspective, it is pertinent to underline that the German, Swiss and Austrian inventories include a wider spectrum of firms due to the application of more “elastic” selection criteria. As a matter of fact, these inventories also include:

- companies that devote themselves to B2C markets
- companies that can have an annual turnover of up to 5 billion dollars.

In sum, it seems fair to argue that the Basque Country provides a fertile ground for companies with an INML profile.¹²

4. Characterization of Basque international niche market leaders

In the following bulleted points, we provide a sketch of the Basque INMLs according to several structural variables, such as size in terms of turnover, year of creation, juridical person and the kind of actors who participate in the companies’ ownership.

- Size-wise, the cases reviewed range from below 20 million euros of annual turnover until just below 1 billion euros of annual turnover, with the highest concentration in the category 51 million to 100 million euros of annual turnover.
- The majority of the companies have *Sociedad Anónima* (public limited company) as their legal structure, followed by *Sociedad Limitada* (private limited company) and cooperative. While the latter is the least common legal entity among the sample, its presence is highly noteworthy, being also an expression of the singularity of the Basque economy in which cooperatives play a very prominent role.
- In terms of company age, the highest concentration of firms was created between 1980 and 1999, followed by those that were created after the year 2000 or in the time segment between 1960 and 1979. Almost a quarter of the companies have been operating for 60 years and longer.
- Regarding participants in the ownership structures of the companies, we observe how more than 60% of them include members from the founding families among their shareholders, showing that

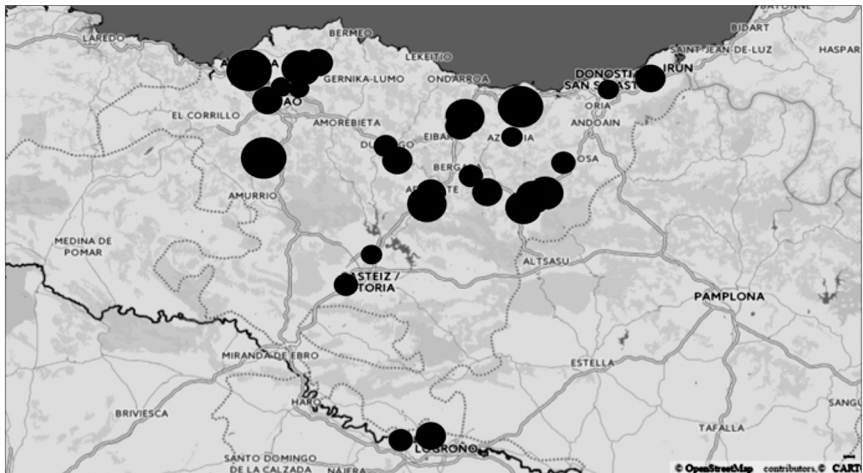
¹² http://ccaa.elpais.com/ccaa/2014/05/18/paisvasco/1400434907_485252.html

the companies reviewed often have a family business origin and tradition.

In terms of their respective locations, the following map shows where we find these companies across the Basque Country. Note: The size of the spheres portrays the respective size of each INML.

Illustration 1

Location of the Basque INMLs



What we observe from the above map is a rather spread-out presence of INMLs across the Basque territory, with certain concentrations around Vitoria, the South of Alava, the axis Bilbao-Durango, the Goierri-Alto Deba basin and Elgoibar.

4.1. *Contribution of international niche market leaders to macro-economic indicators*

In order to put the value and relevance of the sample INMLs for the overall Basque economy into perspective, we can apply the following factors:

- Whereas the sample of +/- 30 companies represents less than 2% of the total Basque Gross Value Added (GVA) in 2015, the companies in question contribute close to 15% of the total export value of the

- Basque economy. Consequently, their activities provide a highly positive contribution to the Basque trade balance, giving way to what can be called “the multiplier effect of INMLs on foreign trade.”
- Similarly, the rate of foreign trade over turnover among the INMLs reviewed is with 80% at a very high level, outperforming largely the overall average for the Basque economy (close to 35%). As such, it illustrates a further surplus value that these firms represent for the trade balance, a surplus value that we can label as “the INML dividend.”
 - Also, in terms of the number of countries and continents in which the INMLs sell, they surpass the rest of the pack. On average, the INMLs have commercial operations in more than 50 countries, whereas this number is substantially lower for the average company that qualifies as a regular exporter. Thus, the companies reviewed contribute and amplify in no small means to “the global footprint of the Basque economy across the world.”
 - Of the total amount of manufacturing seats that Basque companies have abroad, some 10% pertain to the INML sample we reviewed. If we look at the amount of individual Basque firms with at least one manufacturing seat abroad and we relate that number to the quantity of INMLs we reviewed, we get to a slightly higher percentage. This implies that the foreign trade behavior of INMLs is somewhat more export-driven than is the case for the entire group of Basque firms with one or more manufacturing seats abroad. That is, as the INMLs make use of foreign production as bridgeheads for their international footprint and overall company growth, the outcome tends to be a “win-win” situation between international operations from the home base and from overseas locations instead of a “zero sum game” due to off-shoring operations that lessen exports and overall growth from/in the home base.
 - In terms of Compound Annual Growth Rates, the INMLs under review also outpace the overall economy largely. Whereas the annual growth rate for the Basque GVA was a bit more than 3% between 2000 and 2015, the INMLs achieved a growth per annum of more than 5% in that same period. During the period 2008-2015 (a more turbulent timeframe due to the credit crunch and financial crisis), the disparity in growth performance was even more pronounced. Whereas the overall Basque GVA almost froze during this period, the INMLs grew at a similar rate as the average they

reached for the 2000-2015 timespan. The former provides an indication of “the resilience” of the group of companies under scrutiny.¹³

5. Market entry strategies and market structure characteristics

5.1. *First mover behavior versus diligent or fast followership*

When analyzing the strategic behavior of companies, a classic debate centers on the question whether successful firms have entered a market they come to dominate as a first mover or not. In this regard, authors such as Lieberman and Montgomery (1988), Carpenter & Nakamoto (1989) and Kim & Mauborgne (2005) argue that seizing first mover advantage is key for companies to set the pace in a new product-market combination and/or to benefit from a blue ocean strategy. Conversely, scholars such as Markides & Geroski (2005), Golder & Tellis (1993), and Tegarden et al. (1999) conclude that it is more rentable to act as a diligent or fast follower and to seize second mover advantage.

Among the sample of Basque INMLs, which are either a number one, two or three in their market segment on a continental or global scale, it turns out that:

- Almost 80% declare to have entered the market in which they currently hold a dominant position as a pioneer and thus enjoyed first mover advantage.
- The remaining minority of the sample declares to have reached niche market leadership by entering as a fast follower or as a slow follower.

Beyond the message that the Basque INMLs sample provides support to the postulations of Lieberman & Montgomery (1998) or Kim & Mauborgne (2005), it is important to make clear that hidden champion companies may be very different from the firms that scholars such as Kim & Mauborgne (2005) and Markides & Geroski (2005) focused on. Their research was largely concerned with highly visible and well-known products and companies. Conversely, INMLs and hidden cham-

¹³ Take note that these percentages are based on the evolutions at so-called “regular” INMLs, excluding the cases that were created after the year 2000 and that entered on a “gazelle-like” growth path showing even higher compound annual growth rates.

pion companies precisely move in market territories with low visibility as they concentrate on products that are unappealing to the larger public. This lack of public exposure may imply that these markets raise the chances for first movers to create durable advantages and that (potential) competitors find it harder to neutralize these advantages when entering these niche markets.¹⁴

Similarly, our findings show that certain INMLs position themselves in specific niches (long) before these convert into lucrative markets in which a growing demand unfolds. This kind of nesting behavior before a niche takes off is indicative of:

- displaying a focus strategy: deep specialization and running your own race (Kormann 2005)
- patience capital and endurance (Venohr & Meyer 2007, p. 12): INMLs often show clairvoyance power and the ability to anticipate on (latent) demand trends and future needs¹⁵
- discretion: neither looking for the limelight nor following fashions and passing waves (Collins & Porras 1994; Collins 2001)
- clever market segmentation skills (Abell 1980).¹⁶

5.2. *Attainment of market share*

If we look at the market power that the INMLs possess in the niches they address, we see the following:

- Almost a third of the companies declare to hold a market share of more than 50%.
- Almost a quarter contends to have a market share between 21% and 50%.
- Close to 40% state they have less than 20% market share.

¹⁴ The fact that certain niche markets do not look profitable during a long period makes a lot of potential competitors disregard them. This hampers their possibility to enter on time and or to apply a successful diligent follower strategy.

¹⁵ Implies also that they may have to educate the market and witness how demand only takes off slowly (Bhidé 1999, p. 81).

¹⁶ These firms stay away from classical definitions of markets and apply their own market delineations in an autonomous and innovative fashion. This way, they develop their own strategy to position and develop the businesses they want to be in. Often, this leads to “extreme” forms of segmenting markets and carving out the client segments these firms define as their target audience. It is with regard to these clients that hidden champions act as leaders in value supply (Venohr & Meyer 2007, p. 12) and value innovators (Kim & Mauborgne 2005).

These percentages show how some INMLs operate in highly oligopolized or quasi-monopolistic markets in which some of them attain a hegemonic power (Simon 2009, pp. 70-74). Alternatively, there are cases in which the companies in question operate in much more fragmented markets, with market leadership and shares in overall sales being much more levelled. Among this last group, in fact, a couple of firms assert to hold less than 10% of the global market sales in their business while still being a top-three player in it.

These figures show that the degree of rivalry and the number of direct competitors in a niche market vary considerably among the different INMLs detected. If we look at the number of strong competitors that the Basque INMLs face in their respective niche markets, we find that the vast majority declares to act in markets with a limited number of contenders that can really be considered as serious rivals (and who also hold a considerable market share).

This phenomenon has also been observed by Meyer (2006, p. 1109) while analyzing firms that practice an extreme form of *globalfocusing*: “Once a company develops into a global specialist in a confined niche, it tends to end up competing against just a few other firms that have specialized in the same business and which operate on a worldwide scale.”¹⁷

As such, we can argue that a sound segmentation of overall markets and a subsequent positioning in a segment or niche where a firm can excel and address a particular demand potentially offers a “niche premium”: by carving out a specific niche, the chances that one will have to compete against a large number of competitors decreases.

In regard to the increase or decrease of competition intensity in the niches that the different INMLs operate in, we see the following:

- Some 40% of the firms expect that market shares will become more concentrated in the hands of a few players during the coming years.
- Almost a third expects a status quo in this regard for the years ahead.
- Around 20% expect a further fragmentation of market power, implying a dilution of market shares over a growing number of competitors.

¹⁷ To illustrate this point, we can refer to studies by Gebauer et al. (2009) and Fear (2013), who report on highly internationalized firms from Switzerland and who both cite Swiss companies that are in direct competition with one of the global niche players that formed part of our Basque INMLs sample. Together, they represent the lion’s share of sales in their global market.

Going beyond these aggregate numbers, many companies indicate that while they have witnessed the downfall of certain (lifelong) competitors, it is typical that constant dynamism in terms of new entrants or the emergence of new opponents rules. In this context, many point at the increasing internationalization of economic life as an explanatory factor. Not only has this driven the Basque INMLs themselves to wander out across the world, but it has also instigated overseas' companies to spread their wings and enter into the traditionally captive markets or near shores of international niche market leaders from—in this case—the Basque Country. Consequently, the disappearance of classic competitors is alternated by the rise of new ones, which makes the marketplace look like a theatre plot where periodically there is a change qua scene-setting and in the actors that play a role (Ghemawat & Ghadar 2006).¹⁸ In addition, several companies point at new entrants as a consequence of sectoral diversification and due to the creation of wholly new companies, that is, startups that come anew to the scene.

5.3. Pareto rule versus long tail market situations

In line with concepts such as globalfocusing (Meyer 2006), it would be logical to think that INMLs aggregate demand from clients across the planet to achieve a sufficient critical mass of sales to build a rentable niche business upon.

The former relates to the concept of the “long tail” (Anderson 2006),¹⁹ which is opposite to the Pareto rule, where 80% of a company's sales come typically from 20%—or at least a limited set—of their clients.

¹⁸ Multiple INMLs indicate how they have seen the rise of potential rivals from emerging economies. Although competition from Asia and the like has always existed, a more recent phenomenon is when clients, due to their specialty products, actually refer to these contenders from emerging economies as real supply alternatives. Another menace in terms of “new entrants” they report on is connected to the practice of *spinning out* on behalf of—largely—Asian conglomerates; that is, conglomerates that externalize an in-house activity that instantly includes a launching customer (creating a kind of sheltered market for these new entrants) and supposes the possible loss of clientele for Basque INMLs that used to supply such conglomerates. This way, INMLs who have conquered a hard-fought incumbent status run the risk of becoming relegated to an outsider position. Allegedly, this happens especially with holdings from the Asian side of the Pacific Rim (South Korea, Japan, China and Southeast Asian countries).

¹⁹ In the context of international business, the long tail refers to a sales situation in which a company serves a large number of foreign buyers with each of them purchasing a little amount of goods (or spending a small amount of money) but who all together represent a sizeable revenue stream.

Among the INMLs reviewed, we observe the following:

- A little more than 10% of the companies obtain more than half of its turnover from their top-three clients.
- Almost half of the companies obtain between 21% and 50% from their top-three clients.
- Close to 40% state that their three most important clients account for 20% of their turnover or less.

As such, we see in practice that a minority acts in markets that follow the Pareto rule, whereas it is more typical to see signs of a long tail structure (Anderson 2006; Brynjolffson et al. 2011),²⁰ with demand being scattered across the globe and coming towards the INMLs in smaller portions from a larger number of buyers.

Another dimension of the Pareto rule or the long tail is when a company relies either strongly or only weakly on a single product or a small range of products for its total turnover. In this regard, companies that mirror the Pareto rule would depend heavily on a specific cash cow. Conversely, in a long tail situation, a company would get its overall income from a broader set of cash generators.

What we see among the INMLs of our sample is the following:

- A quarter of the companies rely on a specific niche product or product family for 75% or more of their turnover.
- Close to 40% rely on a specific niche product or product family for 50% to 75% of their turnover.
- Almost 30% obtain 20% to 50% of their overall income from a specific niche product or product family.
- Nearly 5% obtain less than 20% of their overall income from a specific niche product or product family.

Although less than a quarter of the companies exhibit a Pareto rule situation and the majority of firms have a more diversified portfolio of income generators, it appears that most firms get 50% or more from a specific niche product or product family. As such, the point of gravity on this dimension is arguably closer to the Pareto rule “pole” than to the

²⁰ In more than one case we observe how INMLs act in front of a collective of highly dispersed and fragmented clients across the world. By specializing in a very specific market segment where each client only represents a reduced demand vector, it is not viable to concentrate on a few clients only. Therefore, these INMLs end up roaming the earth to aggregate demand in order to make acting as a *supernichist* financially worthwhile. It also implies that they tend to be wary of exclusivity deals.

long tail “pole.” While this does not imply that (any of) the firms concerned are one-trick-ponies or single-product-firms, it does illustrate how reliant these niche players can become on a specific product or product line.

Consequently, while only a minority of our sample appears to operate in markets with pure Pareto rule features, the risk of becoming dependent on a small set of clients—or products—for a considerable share of the total revenues really is a potential menace for INMLs. In fact, the mere focus on confined niches makes this an inherent liability of the product-market positioning choices of these companies.

5.4. *Market structure*

If we combine the “number of competitors” (see §1.5.2) with the “number of clients” (see §1.5.3) that the INMLs are exposed to, as a measure of market structure (Williamson 1975, 1985; Scherer 1980; Caves 1987; Koch 1999; Porter 2008), we see little proof of “few buyers-many suppliers situations.” On the contrary, it is more typical to encounter “many buyers-few supplier markets,” underlining the possibility to reap a “niche premium.”²¹

In addition, many companies point at the existence of *lead users* (highly demanding clients that push their suppliers towards excellence and incite them to move towards the cutting edge of their product-market) in the markets they attend. It is this kind of client that INMLs are keen to serve as they can form a particularly rewarding target audience. Among other benefits, lead users tend to have a positive effect on INMLs’ commercial and product development skills (Lilien et al. 2002; Leadbeater 2007; Baldwin & Von Hippel 2011; Von Hippel et al. 2011); that is, clients of this kind tend to be trendsetters and/or act as launching customers for new pockets of demand. Hence, addressing their needs is key to occupying a prominent position in niche markets. Finally, lead

²¹ Various INMLs indicate that the bargaining power of their buyers tends to be high, though. First, they often occupy key positions towards downstream activities of the value chains to which they pertain. Second, they tend to be of significant size. Furthermore, several INMLs report about consolidation processes among their buyer audience, which increases their financial and negotiation muscle even further, while it can also lead to spin-offs that enter into competition with the proper INMLs (see footnote 18). Altogether, this typically alters the power balance of the buyer-supplier relationships in question, where many INMLs act on the supply side as the weight tilts over in favor of the buyers’ side. On a whole, the firms expect to see more concentration of actors on the demand side than a fragmentation of the buyer landscape.

users tend to generate positive *spill-over* effects by facilitating a broader global market entry as they function as reference buyers for other demand actors who follow market trends and look at peers who lead.

5.5. Market size

Being a niche market leader is one thing, but being one in a sizeable and expanding niche is another thing. Niches are not small per definition. They are narrow rather than anything else; and provided that they can be excavated “in depth” or can be scaled up on a global scale, their overall magnitude need not be small.

The size of the markets that our sample of INMLs addresses can be summarized as follows:

- Almost 70% operate in niches that move 500 million euros worldwide on an annual basis—we consider these to be small niches.
- Some 20% operate in niches that move between 500 million and 2 billion euros worldwide on an annual basis—we consider these to be mid-sized niches.
- Less than 10% operate in niches that move more than 2 billion euros worldwide on an annual basis—we consider these to be large niches.

If we combine the size of the niche markets that the respective INMLs address with their market share in those same niche markets, we conclude that:

- On the one hand, many INMLs are like “big fish in a small pond”;
- On the other hand, very few INMLs operate in markets that can be compared to an open sea. And those that do tend to be like a small or medium-sized fish swimming in it.

Consequently, there are many cases of INMLs in which the market size may form a liability to further (exponential) growth, meaning that pursuing such growth may have to come from, for example, diversification or the commercialization of adjacencies or servitization (or a further broadening of the countries and continents that INMLs address).

6. Internationalization behavior

6.1. Foreign entry mode choices

In general terms, the ways to conduct international business can be divided into market, network and hierarchy solutions (Brouthers &

Nakos 2004; Johanson & Vahlne 2009), referring, for example, to the commitment and equity devoted to each governance arrangement. Whereas market solutions refer to export operations, network arrangements refer to franchising, licensing and joint venture modalities, and hierarchy solutions stand for the creation of wholly owned subsidiaries abroad and other forms of foreign direct investment (FDI).

When these options are ordered on a continuum, often the hierarchy solutions are portrayed as the most “demanding” ones, since they are the most intensive in investment. However, from a control perspective, it is often the network arrangements that require the most efforts and skills, since they imply handing over or sharing responsibility of property to/with third parties. Consequently, firms often start deploying network solutions once they have come to grips with market and hierarchy-based foreign entry modes. Accordingly, the degree with which a company applies all three entry modes is frequently taken as a sign of its maturity and “ambidexterity” in the context of internationalization (Orkestra-IVC 2017b).

If we look at the entry modes that the INMLs apply in their internationalization process, we observe the following:

- Less than 10% rely on export (market arrangements) only.
- Nearly 50% apply both export and FDI modalities (market and hierarchy solutions).
- Close to 40% apply all three foreign entry modes (including network solutions).

These percentages show that the variety of entry modes deployed by the companies in question is rather broad, offering both a sign of maturity and versatility on behalf of the firms under consideration. Particularly, the percentage of firms with experience in joint ventures is high compared with the whole of internationalized companies from the Basque Country or the rest of Spain (Orkestra-IVC 2017a, 2017b).

The use of joint ventures can arguably be seen as something positive since it allows accelerating and amplifying the international outreach of the companies in question.

6.2. Business functions of foreign branch plants

Overseas subsidiaries can fulfill different roles and functions within the overall apparatus and organogram of a multinational corporation (Ferdows 1997; Kamp 2007). Here again, the more a company “multina-

tionalizes” (or multi-localizes) its sales, production and, for example, R&D competences, the more mature and ambidextrous²² it is typically considered. Moreover, when a firm reaches a stage where its production and R&D functions are not exclusively centralized at the headquarters’ home base, it can be considered to be truly global.

Of the INMLs reviewed, we establish that:

- some 90% of them has at least one or more commercial subsidiaries abroad
- almost half of them also has productive subsidiaries abroad
- more than 10% has R&D departments²³ abroad (on top of the overseas commercial and manufacturing units they have).

In terms of “spatio-functional” ambidexterity, we thus see that most firms follow a path of foreign market exploitation for sales and production purposes, rather than tapping into those markets for exploratory *casu quo* R&D tasks. While this is a typical sight to see, also as there is a tendency to centralize the most value added and strategic activities (like R&D affairs) at headquarters, to count with multiple R&D units across the globe can be a way to tap into knowledge pockets of particular lead markets of interest to firms (Forsgren et al. 2005). While a multinationalization of R&D assets and competences may not be indicated for all the firms we reviewed, we think that taking such a step also has to do with the stage of “maturity in internationalization” that some of the firms have reached. Consequently, we consider that developing an R&D apparatus that counts with foreign units is food for thought for the INMLs concerned.

6.3. Foreign trade indicators

6.3.1. Share of income from foreign sales

As indicated under §1.4.1, the Basque INMLs obtain on average more than 80% of their turnover from sales on foreign markets. This is a very high percentage, also in comparison with the shares that hidden

²² With ambidexterity, we refer to business functions of an exploitative and exploratory nature. Where exploitation refers to sales and production, and exploration refers to R&D (Birkinshaw & Gupta 2013; O’Reilly & Tushman 2013).

²³ With R&D departments, we refer to centers with genuine research and development activities for new products and/or technologies, not staff that provide local adaptations of base products in order to respond to local demand specifications or local regulations.

champions from other countries attain. Simon (2009, p. 20), for instance, calculates an average of 61.5% for his German sample of hidden champions, while a study by Nguyen (2013, p. 44) establishes a similar average for a sample of French hidden champions.

One reason for this comparatively high percentage of the Basque sample is that it is more likely that German or French INMLs supply more to industrial clients from their own home base than their Basque homologues do. The size of the domestic market for industrial goods in Germany and France, and the fact that more German and French companies act as pivots in global value chains, would back up this reasoning.

6.3.2. Geographical coverage

As mentioned under §1.4.1, on average the INMLs reviewed sell in more than 50 countries across the globe. Similarly, more than half of them have sales operations in five continents. Some 10% do business in all six continents (Africa, Asia, Europe, North America, South America and Oceania). As such, they largely outperform the average of the entirety of internationalized firms from the Basque Country or Spain, where approximately 90% sells in less than 20 countries (Orkestra-IVC 2017a). Similarly, the figures with regard to the number of continents in which INMLs do business are very high in comparison to the 8% of big firms from Spain that generate sales in at least three of the above-indicated continents (Caldart & Pisani 2016, p. 35).

If we look at the regions in the world where the analyzed firms have their production plants, China, Brazil, India, the USA and Mexico stand out. Clearly, foreign direct investment in production power is concentrated outside Europe, and -except for the factories the INMLs have set up in the USA— the focus is clearly placed on emerging economies.

A closer look at the places where these INMLs have established production plants reveals that there are few physical settlements in “next frontier” markets, such as Southeast Asia or Africa. This is arguably in line with the fact that most of the firms in question are B2B players that—from a geographical perspective—rather act as diligent followers (move into and exploit markets once their potential is proven; often triggered by follow-the-client dynamics) than as early or first movers (exploring new territories first-handedly). Hence, in terms of “geographic ambidexterity,” these companies may lean more towards exploitative than explorative behavior.

6.4. *Innovation behavior*

6.4.1. R&D expenditure

The majority of the Basque INMLs, if not all of them, have obtained a prominent position in their respective markets thanks to the continuous efforts they put into innovation activities. In fact, in the sample we reviewed, it is not uncommon to encounter companies that devote around 10% of their turnover to R&D. On average, the INMLs reviewed devote close to 7% of their turnover to R&D. On the one hand, this percentage is substantially higher than the average for the entirety of firms in either the Basque Country, Spain or the whole of Europe. On the other hand, it is in line with the percentage that Simon (2012, p. 266) establishes for his sample of hidden champions.

6.4.2. Launching of “firsts”

In itself, expenditures on R&D form a sterile indicator for the outcome of activities that aim to contribute to innovation and competitiveness of businesses. In fact, it is an input indicator, and a strong R&D effort does not necessarily translate into an avalanche of innovations that reach the marketplace. One way to deal with this constraint is to focus on global novelties (“firsts”) that the company launches as a proxy for its capacity to come up with innovations that are ahead of the competition and that actually get proposed to customers (and do not remain on the shelf as an in-house invention that never enters the marketplace).

If we inquire after the frequency with which the Basque INMLs launch such global novelties in comparison with their main rivals, we see that:

- two thirds of the reviewed INMLs declare to launch more frequently a worldwide first than their rivals
- close to 20% state that they are on par with their rivals in this regard
- around 15% indicate that their rivals are more active with launching global “firsts” than they are.

If we relate “expenditure in R&D as a percentage of overall turnover” with “the relative frequency of launching firsts,” we observe a kind of scaffold-wise relationship. Up to a certain percentage of R&D expenditure over a company’s turnover, it appears that INMLs lag behind their competitors in terms of frequency of launching global novelties, with the threshold or tipping point sitting around 3%. From that (tipping) point

onwards, we see how the INMLs in question reach a similar or higher frequency of launching firsts in comparison with their main rivals, as pictured in the following scheme:

Scheme 1

Relationship between R&D expenditure and frequency of launching firsts

Higher frequency to peers				
Equal frequency to peers				
Lower frequency than peers				
	1	3	5	7
	Expenditure on R&D as percentage of turnover			

Source: Author.

From the above scheme, it also follows that there could be some kind of law of decreasing marginal utility of the investments in R&D unfolds (cfr. first law of H. H. Gossen), in the sense that those who are more active in launching firsts to their target markets do not achieve this on the back of a more elevated expenditure of R&D. Instead, they seize other mechanisms to raise the frequency of introducing global novelties to the markets they address.

So, while R&D efforts exert an influence on the capacity to launch firsts, a linear and continuous relationship between the two items does not seem to exist.

We infer from the former that being on par with market rivals in terms of launching firsts requires a minimum, yet high, commitment to R&D. At the same time, from a certain level onwards, other variables (“*imponderabilia*”) gain in importance for explaining the frequency of introducing global novelties.

6.4.3. Patents

On average, the sampled Basque INMLs have approximately 40 patents registered. While this seems a considerable number, it is worth underlining that a considerable standard deviation applies to this average

value; that is, almost half of the companies have less than 10 patents registered while a couple of others have registered more than 100 patents.

If we combine the number of patents the respective firms hold in their portfolios with the company-specific percentages of R&D expenditure²⁴ on turnover, we establish a ratio of 7 patents per percentage point of R&D expenditure on turnover. Again, this average ratio is not all too representative, since the number of patents per company is quite disparate.

Overall, as regards the patenting propensity of the firms reviewed, we observe a kind of dual reality with a part of the firms acting in a clear patent-driven manner when it comes to managing their innovations and output of R&D. At the same time, another part of the population displays a “laissez faire, laissez passer” stance vis-à-vis patents.²⁵

7. Reflections and implications

This paper’s findings demonstrate that the Basque Country is a territory that is well endowed with companies that play a leading role in the international niche markets in which they operate. This establishment provides ground for optimism. However, an economy does not only depend or thrive on the basis of INMLs. In addition, dynamism is provided by a variety of other companies, such as start-ups and gazelle firms, as well as large-sized corporations.

Therefore, a first reflection must be to not become obsessed with the presence of INMLs in an economy or with ratios of hidden champions per million inhabitants.

In a similar fashion, although the Basque INML ratio is comparable with that of Germany, Austria and Switzerland, the average size of the Basque international niche market leaders is substantially smaller (factor 10) than that of its German-speaking homologues. It is true that this disparity is fueled by the fact that the inventories in German-speaking countries include firms with up to 5 billion euros in annual turnover, but that does not alter the fact that the Basque INMLs have on average a limited dimension. Consequently, pursuing a further growth path seems to be indicated. Whether such growth should be given shape and digested via homegrown means, or perhaps by a stronger reliance on external fun-

²⁴ Supposing that this percentage remains constant over time for each firm.

²⁵ Something that has also been observed in previous publications with regard to INMLs and hidden champions (Orkestra 2015; Simon 2012, p. 268).

ders, joint ventures and/or externally recruited professionals, is a matter of organizational choice.

At the same time, our study opens space for raising the question whether a company with a hidden champion profile can fall prey to its over-specialization in a narrow market area? Scholars such as Grabher (1993), Uzzi (1997) and Gustafsson and Autio (2006) warn against the risks of lock-in and path dependency if companies get hooked on a specific activity or environment.

In those cases in which INMLs rely heavily on a reduced market, a small set of clients and or a particular product or product line for their overall turnover, it seems indeed wise to advocate in favor of considering (light) diversification and branching out of current success markets into adjacent fields.

In a similar fashion—and while the INMLs under review show an extensive global footprint—as the world economy keeps changing, they need to remain on the lookout for new geo-economic market opportunities and implement effective entry strategies to penetrate new pockets of demand across the globe.

Finally, in regard to the innovation endeavors of the analyzed INMLs: for a number of these firms, it seems recommendable to consider raising their patenting propensity to combat a kind of “patenting paradox”; that is, pronounced innovation efforts (R&D expenditure) and outcomes (launching global novelties onto the market) but on a non-patented basis. While there will arguably be cases in which patenting is not really worthwhile, we suspect that there may also be a lack of sensitivity and culture for intellectual property among some of the companies analyzed. As a consequence, they may not reap the full yields of the innovations they develop and bring to market, as non-patented competitive advantage may be more fleeting than those that are protected by intellectual property rights.

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