How to Compete Against the New Breed of National Champions

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SHARON POCZTER, ALDO MUSACCHIO, AND SERGIO G. LAZZARINI

Going up against the latest wave of state-supported competitors requires a new playbook for Western companies.

On March 12, 2018, the U.S. government blocked Broadcom Inc.’s proposed merger with Qualcomm Inc. on the grounds of national security. The presumption was that the merger of the two chipmakers would have resulted in a third company, China’s Huawei Technologies Co. Ltd., gaining a dominant position in the market for 5G mobile network technologies. Huawei is a “national champion” — a company that is heavily subsidized (either implicitly or explicitly) or, in some cases, owned by a government — and the U.S. government is concerned that its growth could provide the Chinese government with undue access to and control over U.S. communication networks.

While the threat posed by national champions is nothing new, their essential character has substantially changed, and the competitive advantage of national champions in the global marketplace has become more pronounced. Today’s national champions are much more sophisticated, competing in more industries, and harder to spot than ever before. As a result, Western companies need a new strategic guide for competing against them.

A New Breed of Competitor

Traditionally, national champions have been large industrial companies, subject to a high degree of direct governmental oversight and intervention. Typically, they are unresponsive to global competitive forces, depending instead on explicit government subsidizes and protection. For instance, Indonesia’s state-owned electricity provider, Perusahaan Listrik Negara, enjoys a government-created monopoly, but its inability to satisfy growing domestic
demand has resulted in a costly and unreliable energy supply in the world’s fourth most populous country. ¹

Today, however, there is a new breed of national champions. They differ from traditional champions in two principal ways: the form and degree of their government connections, and their basis of competition.

Modern national champions can be hard to identify. Their connections to government take a variety of forms, both corporate and noncorporate (via sovereign and other investment funds). The degree of government ownership and intervention in these national champions also varies widely. Sometimes governments hold explicit majority or minority ownership stakes in these companies, but increasingly, government involvement is more implicit.

This involvement includes restrictions on foreign competition, preferred access to government financing, funding through sovereign investment funds, preferential government contracts, and privileged access to natural resources. In Russia, for instance, the government’s internet firewall protects national champions, such as Yandex NV and Mail.ru Group Ltd., from direct competition with Western competitors, such as Google. In the U.S., Fannie Mae is supported with a direct line of credit from the U.S. Treasury, and solar panel producer Solyndra LLC enjoyed guaranteed loans and lucrative government contracts (which still weren’t enough to prevent its bankruptcy in 2011).

These kinds of implicit support provide national champions with the financial stability and wherewithal that they need to compete on the basis of innovation versus relying on explicit protectionism. As a result, more national champions are appearing in innovation-driven sectors, such as biotechnology and semiconductor manufacturing.

Often, this change is being driven by the desire of emerging-economy governments to avoid the so-called middle-income trap, ² in which rising wages make their goods less competitive in global markets. China, for example, is attempting to sidestep the trap by transitioning to a technology and service economy. It has pledged to surpass the United States in terms of R&D investment in companies by 2025. ³ Toward that end, China invested heavily in national research centers that are providing its national champions with access to technology that can be commercialized. Recent research suggests this effort is progressing, with China’s national research centers and its national champions producing patents at an increasing rate. ⁴

With the kinds of support described above, today’s national champions can respond to demand and competition in domestic and global markets as quickly and independently as Western companies. Thus, the landscape of global competitiveness is being altered by the transition of national champions from slow-moving industrial giants in highly distorted local markets to innovation-focused companies vying for market share in highly competitive markets — with the implicit support of their governments.

**New Competitors Require New Strategic Responses**

Given the new competitive challenges that national champions pose, the leaders of Western companies facing them in domestic and international markets should
rethink their competitive strategies. In studying hundreds of national champions over the past 15 years, we have identified four strategies that work with varying degrees of effectiveness depending on the kind of national champion involved. Two strategies involve head-to-head competition with national champions; two involve enlisting the support of government to more effectively compete against them. (See “Four Strategies for Competing Against National Champions.”)

A market-offense strategy entails challenging national champions in their home markets and capitalizing on the same local conditions that benefit them. For instance, Ford has built a vertically integrated, self-sustaining production ecosystem in India to better compete against national champion Tata Motors.

A market-defense strategy, alternatively, involves competitive actions that protect a company’s share of its domestic market in the face of expansion efforts by foreign national champions. In the United States, for example, the world’s largest market for mobile phones, Apple Inc. and Google Inc. have signed bundling deals with carriers including AT&T Inc. and Verizon Communications Inc. to block Huawei’s U.S. expansion efforts.

A political-offense strategy involves stimulating government action, either through industry influence or specific actions and/or relationships, to help companies gain a competitive advantage in national champions’ home markets. These strategies are becoming increasingly important as Western companies look to emerging economies for revenue growth. For instance, in 2018 the U.S. government blocked ZTE Corp., a Chinese telecom equipment maker, from buying chips from American suppliers. This supply chain disruption caused ZTE to shut down operations, providing an opportunity for U.S. smartphone producers to increase their presence abroad, particularly in China. (Editor’s note: The situation regarding ZTE is being hotly debated among U.S. lawmakers at the time of publication.)

A political-defense strategy entails a company working with its government to establish policies and regulations that prevent national champions from competing in their own domestic markets. More in line with traditional protectionism, political defense is aimed at erecting barriers against foreign national champions. For example, U.S. steel and aluminum makers worked closely with the Trump administration to impose trade tariffs to defend their domestic market share against various foreign competitors. Similarly, the regulatory rules and restrictions imposed by the U.S. Food and Drug Administration have been instrumental in blocking the expansion of India’s pharmaceutical companies into the U.S. market.

Four Strategies for Competing Against National Champions

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Market
investment, including partnerships and growth

Market Defense
- Head-to-head competition without coordination with government involvement
- Protect home country market share by blocking national champion expansion
- Common forms: domestic partnerships and alliances

Political
export subsidies; government-sponsored funds

Political Defense
- Industry or company
- Protect home country market share by blocking national champion expansion
- Common forms: import tariffs; government-sponsored funds

Choosing Among the Competitive Strategies

A company should consider the four strategic options in light of the type of national champion that it is competing against and the context of that competition.

Majority government-owned national champions look like the national champions of the past. Because these national champions are subsidized, protected, and controlled by their home governments, Western companies should avoid playing market offense. Instead, companies should focus on political defense and market defense to protect their home markets from the expansion efforts of these national champions. In the United States, for example, companies have enlisted the support of the Committee on Foreign Investment in the United States (CFIUS) to successfully fend off acquisitions that could provide foreign national champions with footholds in domestic markets.

Minority government-owned national champions enjoy some governmental protection in their home markets, but they are not unassailable, because the degree of government involvement in their markets and industry landscape is less intense. In this case, Western companies can consider playing market offense. Through Legend Holdings Corp., the Chinese government owns a minority, albeit large, indirect ownership stake in technology company Lenovo Group Ltd., but U.S. and European tech companies are able to compete with Lenovo in China. While it is hard for Western companies to use political defense strategies on their home turf against such minority-owned foreign national champions (Lenovo computers are used by the Pentagon, for example), there are political-defense strategies that can be used to fend off these companies in sensitive areas (Lenovo cannot supply communications equipment to the U.S. military).

Implicitly supported national champions represent the greatest competitive threat to Western companies because they enjoy the benefits of government support without the limitations of government oversight and control. As a result, these national champions have the advantage in their domestic markets, as well as the ability to nimbly enter and compete in Western markets. To compete against these national champions, Western companies
may need to use all four strategies to avoid disruption at home and the loss of existing market share and opportunities abroad.

Take the global enzymes market, where a number of smaller Chinese producers, such as Shandong Longda Bio-Products Co. Ltd., Shanghai Youtell Biochemical Co. Ltd., and KDN Biotech Group, were once relegated to the low-price segment of their domestic market and did not compete internationally. Now, with support from China’s national research centers and universities, they are not only eating into the high-end market share of Western companies in China, but they are also acquiring subsidiaries in the United States and competing in that market, too. To counter these moves, Western companies need a market-offense strategy to fend off competition in China — indeed, companies such as Denmark’s Novozymes A/S are launching low-end brands to prevent Chinese competitors from gaining strength. They also need to enlist their home governments in political offense to gain some of the types of advantages that the Chinese national champions enjoy.

In today’s aggressive trade environment that may soon include outright trade wars, companies are increasingly likely to encounter a new, more competitive breed of national champions in their home markets and abroad. To protect and win market share against these financially advantaged, innovation-driven, government-supported champions, competing companies will need a new and more proactive strategic toolkit.
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