

Hidden Champions of the Chinese Economy: Implications for Korea

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I. Introduction

China's policy of nurturing hidden champions is being promoted on the basis of a systematic development system, which has been established by consolidating the economic development policies scattered in each province by linking them to the national strategy. The aim of this system is to nurture “hidden champions,” sometimes referred to as “little giants,” in the manufacturing industry to strengthen the foundation of the manufacturing industry and improve the localization rate of key basic parts and materials by 2025, which is the goal set by the “manufacturing powerhouse” strategy at the national level. After classifying small and medium-sized enterprises by growth stage, China is nurturing companies that can fill the

technological gap in the supply chain by focusing technology and capital.

As Korea and China's complementary division of labor structure between industries has weakened over the years, the scalability of Korea-China trade is declining in the intermediate goods sector, which has led Korea-China trade and investment exchanges. Competition with China is expected to grow more intense in the future as the fields in which the Chinese government is nurturing small and medium-sized enterprises overlaps with Korea's materials, parts, and equipment industries and areas to develop advanced technologies.

As Korea-China economic relations undergo

these structural changes, it is necessary to understand and prepare countermeasures against changes in the competitiveness of the Chinese industry, which will change due to the growth of China's small and medium-sized enterprises.

II. China's Policy of Nurturing Hidden Champions

The Chinese government is expanding its establishment of national manufacturing innovation centers necessary to promote national strategies. The main areas of establishment are high-tech areas such as optoelectronics, displays, robotics, lightweight materials, semiconductors, and batteries. These national-level manufacturing innovation centers receive financial support from the government when established. In addition, they are designed in a structure in which all parties enjoy the intellectual property rights developed within the center, with the participation of research institutes, universities, and private companies for strategic technology research.

In particular, in the semiconductor industry, which has recently increased in strategic importance, three innovation centers are already in operation, and core process technologies are being developed by concentrating resources under the leadership of leading companies. In addition, participating SMEs are also building an open system to access the infrastructure and databases of these innovation centers.

As of 2023, there are 12,950 hidden champions in China, exceeding the 2025 target of 10,000. In particular, the share of companies

in the new materials, next-generation information technology, and advanced machinery industries increased significantly from about 17% in 2019 to 25.7% in 2023. This seems to be due to the Chinese government's expansion of support to sectors that are more exposed to U.S. sanctions.

Financial support strategies for hidden champions are divided into initial government subsidies and tax incentives, and sustainable financial support using private capital. The various methods of financial support are of great importance in that they provide financial resources to SMEs with an established history of operations but find it difficult to obtain additional support to enhance the competitiveness of the company and prepare new growth engines.

The Chinese government plays a very important role in the financial support process for these hidden champions. This is because the government certification process to identify hidden champions is linked to direct and indirect financial support using government and private capital. Since the government certification is to ensure a company's industrial competitiveness, it is related to both attracting seed investment to companies after direct government incentives and tax incentives, and liquidity support policies through listing on the capital market. Therefore, financial support for SMEs can be interpreted as a strategy to improve corporate competitiveness through investment in government finances and private capital based on government guarantees. And in this process, the Chinese government is expanding its scope

from government-led projects to marketization strategies by linking private capital with companies subject to government policy support in addition to government funding.

III. The Competitiveness of Hidden Champions

In order to understand the competitiveness of hidden champions that the Chinese government is promoting, this report attempts to analyze the management situation and export competitiveness of listed hidden champions. The targets of analysis were 692 listed companies for which corporate information could be obtained, among the 12,950 national-level hidden champions announced by the Chinese government.

Looking at the distribution by industry in which the listed companies are engaged, a total of 563 companies are engaged in 10 industries, including dedicated facility manufacturing, computer, communication, and other electrical equipment manufacturing. Among the above 10 industries, the U.S.-designated core science and technology industries are mainly concentrated in five industries: software and ICT services; computer, communication, and other electronic equipment manufacturing; general equipment manufacturing; special equipment manufacturing; and chemical raw materials and products manufacturing.

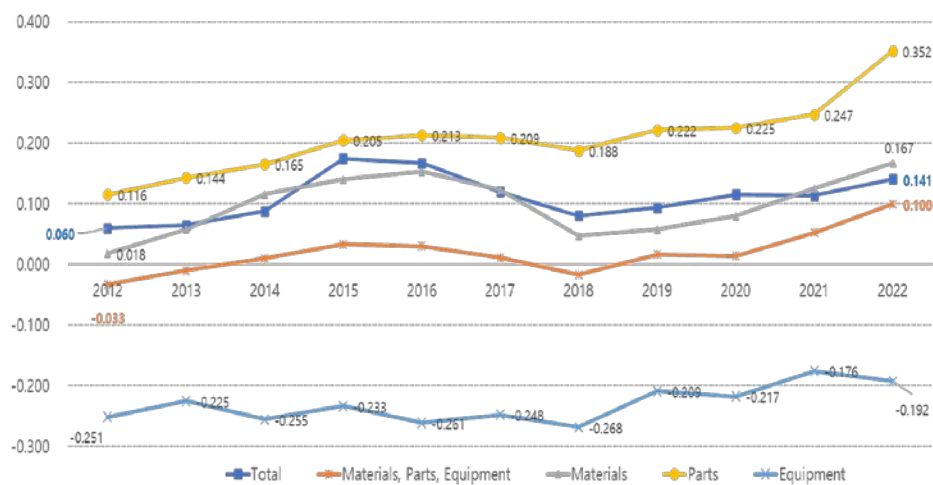
Accordingly, in this study, the strategy of nurturing hidden champions promoted by China in response to U.S. efforts to contain its technological progress was derived by analyzing the

cases of representative enterprises showing excellent performance in the above five industries.

As derived from our analysis of the case companies, China's strategy for hidden champions was identified as: ① promoting corporate growth through successful localization in response to the U.S. strategy toward China in key technologies, ② fostering enterprises by expanding demand for niche markets following digital and green transformation, ③ promoting mass production of essential materials through cooperation with large companies related to the supply chain, ④ expanding its influence through participation in national industrial standards in China in special fields, ⑤ taking advantage of the domestic capital market through the Beijing Stock Exchange, ⑥ creating a technology ecosystem in China by acquiring foreign enterprises with technology competitiveness, and ⑦ strengthening competitiveness by supporting key enterprises in the global supply chain.

Considering the difficulty of obtaining trade statistics for each detailed item of hidden champions, this study classified the entire trade statistics into materials, parts, and equipment industries where hidden champions are mainly positioned to examine the trade situation and analyze competitiveness. As a result of analyzing the trade statistics of materials, parts, and equipment from 2012 to 2022, when China's policy of cultivating foster hidden champions was fully implemented, the global trade balance of the China's materials, parts, and equipment industry increased significantly from a

Figure 1. Changes in the Trade Specialization Index (TSI) of China's Materials, Parts and Equipment Industry



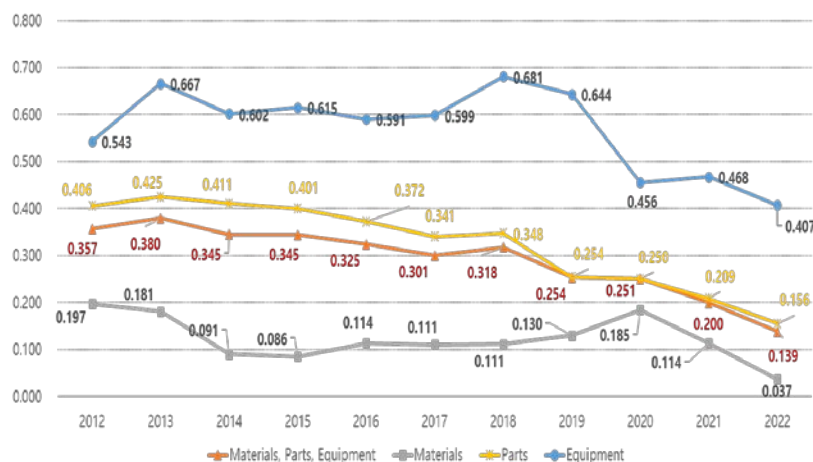
Source: K-Stat. Chinese Customs Statistics (2023).

deficit of \$55.6 billion in 2012 to a surplus of \$264.1 billion in 2022.

The improvement of China's competitiveness in the fields of materials, parts, and equipment can also be seen as a change in the trade specialization index (TSI) of the materials, parts, and equipment industries. Looking at China's global trade specialization index for materials,

parts, and equipment, it was import-specialized at -0.033 in 2012, but rose to 0.100 in 2022, improving export competitiveness. On the other hand, the trade specialization index for Korea's materials, parts, and equipment industry with China was found to have slowed down more significantly from 0.357 in 2012 to 0.139 in 2022.

Figure 2. Changes in Korea's Materials, Parts and Equipment Industry's Trade Specialization Index (TSI) with China



Source: SOBUJANG.net (2023)

Among the materials, parts, and equipment industries, in particular, Korea's imports to China increased and exports to China decreased or export growth slowed, as China's exports increased and import growth slowed, especially in the areas of semiconductor and display equipment, precision processing equipment, general machinery parts, industrial process equipment, and precision equipment parts. In turn, the five materials, parts, and equipment industry items mentioned above are related to the industries of computer, communication, and other electronic equipment manufacturing; general equipment manufacturing; dedicated equipment manufacturing; and chemical raw materials and products manufacturing. These are industries in core science and technology sectors that the United States has designated among the industries that China's hidden champions are mainly engaged in. This can be interpreted as China replacing foreign import demand with domestic products as the effect of nurturing China's hidden champions gradually emerges.

The above industries are the areas where China is expanding R&D investment in response to U.S. sanctions, and in the industries where there are already competitive hidden champions, competition with Korea is likely to intensify in the future. Although a more detailed industry-wide comparative analysis of competitiveness has not been carried out between Korea and China, considering the competitiveness of the two countries in the materials, parts, and equipment industries, as measured by trade statistics, our findings suggest that Korea is likely

to face a situation where risks outweigh opportunities. This is because Korea's imports to China are likely to expand rather than exports of Korean products to China increasing due to the rapid growth and demand in key new industries following China's hidden champions strategy, which has been given a boost by the strengthening of technology controls and sanctions against China by Western developed countries led by the United States.

IV. Policy Implications

China is Korea's largest export and import partner for materials, parts, and equipment, while the materials, parts, and equipment industry is a major contributor to Korea's trade surplus. As a result, Korea needs to make efforts to address sluggish exports to China by diversifying its trading partners for materials, parts, and equipment, and actively responding to China's strengthening competitiveness in the materials, parts, and equipment industry.

Korea should recognize the changes in the trade and industrial structure between Korea and China and form a new paradigm of economic cooperation to overcome the limitations of economic exchanges between the two countries. China, which used to be seen as a manufacturing base for other countries, must now be seen as an advanced country in new industries with which the current structure of economic cooperation structure must be modified accordingly. China has become a world leader in new industries based on the strong support of hidden champions with competitiveness. Some hidden

champions in China also have global competitiveness in the materials sector of high-tech industries.

Now, it is judged that there is no need to be cautious about the growth of China's hidden champions. In preparation for China's improvement in competitiveness of materials, parts, and equipment in high-tech fields, it is necessary to double the competitiveness of Korea's materials, parts, and equipment industries, and to find a way for cooperation between the two countries by making use of China's comparative advantage in the materials, parts, and equipment industries.

In addition, against the backdrop of the development of new industries, we need to establish and expand the foundation for cooperation between Korea and China in new areas suitable for the era of digital and green transformation. To this end, efforts to build an institutional cooperation base for new industrial fields must first be strengthened. **KIEP**

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