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Family Owned Hidden Champions in Russia: Innovations, Human Capital and Internationalization

Danica Purg[1], Olga Saginova[2], Irina Skorobogatykh[3]* and Zhanna Musatova[3]

[1]CEEMAN is International Association for Management Development in Dynamic Societies; Danica.Purg@iedc.si
[2]Department of Entrepreneurship and Logistics, Plekhanov Russian University of Economics, Moscow, Russian Federation; Saginova.OV@rea.ru
[3]Department of Marketing, Plekhanov Russian University of Economics, Moscow, Russian Federation; skorobogatykh.II@rea.ru, Musatova.ZhB@rea.ru

Abstract

Background/Objectives: This study attempts on the family owned Russian companies which were identified as Hidden champions according to Simon's methodology. Research defines key success factors of these companies: marketing strategies, internationalization, leadership styles, entrepreneurship approaches and customer value creation patterns. **Methods/Statistical Analysis:** Complex methodology of data collection was employed. Researchers used and adopt the Simon's questionnaire to obtain information about performance of 29 identified family-owned Russian companies as a Hidden Champions. Different aspects of the performance of these companies were studied. The variety of questions with 1-7 Likert scale closed were used. Researchers focused more on local causalities rather than following some universal laws to collect primary data about Russian family owned HC performance. **Findings:** The research reports that most of identified companies from the different sectors of business are successfully carving new marketing niches in their markets on the local, national or even global scene. Using resource-based theory the authors pay special attention to human and social capital, its innovativeness and the influence of early internationalization on companies' survival and growth. Family-owned Hidden Champions in Russia show-case HC key success factors, including innovative product portfolio regularly updated to maintain high technology leadership and customized to meet the specific requirements of key clients; early internationalization through expansion to foreign markets with bigger demand or better access to high price/low volume segments; building professional communities and networks to maintain and develop company's social capital. **Improvements:** Continuing research on HCs in Russia identified candidate companies outside the two metropolitan areas, in the Russian regions. Studies of successful and innovative family owned businesses can go beyond H. Simon's methodology of Hidden Champions and consider regional leaders in Russia of the niche markets.

Keywords: Dynamically Developing Markets, Early Internationalization, Family Owned Hidden Champions, Human Capital, Innovations, Key Success Factors, Market Niche, Social Capital

1. Introduction

Business success nowadays is measured not by company size or its publicity, like being in the Fortune Global 500 companies. In Germany, for example, 6 times number one in exports in the last 10 years, more than two-thirds of the exports come from companies with less than 2000 employees[1]. Central and East European countries have very few companies in the Fortune Global 500 list, but can achieve outstanding export success through mid-sized companies and thus contribute to global economy, create high quality jobs and build economic future for their countries' economies.

"Hidden Champion" (HC) is a term, which was used by Hermann Simon[2], who studied small and medium sized companies from Germany playing an important

*Author for correspondence

role in increasing the export potential of the country, and therefore making an important contribution to the national economy. Simon's research first in Germany in 1996 and then in Austria in 2009[2,3] showed these companies were stable to crises, creating new jobs at a higher rate than on the average in their industries, spending twice as much on technology development and showing better results than the 1000 biggest innovative companies in the world[4]. According to Simon, these companies can serve as an evidence of the market maturity and stability[3].

Hidden Champions are usually working in niche markets, often in the B2B sector, and produce components or semi-finished products, and they achieve world or regional leadership position in their market niches. With all the results achieved, these companies prefer to keep a low profile, they are "hidden" or "silent" and therefore mass markets do now know them. Their products and services are well known by a limited number of specialists. Many of them being innovative, Hidden Champion companies operate in high risk markets, often creating new product categories and carving new market niches. There are several sources for HCs in dynamically developing markets: private family enterprise, private partnerships and restructuring of former government owned companies. Many of these companies start as family companies and some stay family owned throughout their growth and development using pooled personal resources that family members contribute as well as social links and networks companies' founders and leaders develop in their professional areas. The paper focuses on those family owned HCs and analyses how key success factors of HCs are combined with advantages and limitations of family businesses using selected Russian HC case-studies.

2. Research Methodology and Process of Data Collection

International research project initiated in 2011 by the International Association for Management Development in Dynamic Societies (CEEMAN)[5] and supported by the Russian Association of Business Education (RABE) and Polish Association of Management Education (FORUM) was conducted by research teams from Central and Eastern Europe, Russia, Turkey and Kazakhstan. The main goal of the project was to find out if the dynamically developing economies of the participating countries have companies which can be identified as Hidden Champions in 17 East European countries[1].

Multiple methods of data collection, including qualitative and quantitative methods, were employed. In addition to original diagnostic Simon's questionnaire to identify the HC in different countries (including Russia), the in-depth interviews, observations and desk research of secondary data were used. Researchers focused more on specific local causalities of doing business in Russia rather than following some universal laws for Western European HC.

The research primarily registered the Hidden Champions through the eyes of their leaders (founders and/or CEOs, members of the Board who usually also were co-owners). Subjectivity was reduced by using media publications, financial reports, company strategies and other archival data.

In the process of data collection about potential HCs researchers scanned various sources, including national and international statistical reports, economic and industrial studies, data bases of research and educational institutions, articles in business media, information available through chambers of commerce, etc. Comparison of the selection criteria used in the project with standard H. Simon's methodology is given in Table 1.

After making the list of HCs researchers completed H. Simon's diagnostic questionnaire covering the following issues: general information about the company, nature of market leadership, main indicators of growth, geographic coverage, nature of competition, diversity of customers and drivers of their buying behavior, company products characteristics (life-cycle, complexity, innovative nature), company competence areas (leadership, patents, financial strength, history), performance indicators. Each issue was assessed through multiple questions and cross-examined using both closed and open questions and applying Likert scale 1-7 to closed questions. It should be noted that the original questionnaire was first tested in Poland and then abridged to be used in other countries and in Russia. Abridged version addressed the same concepts but used fewer indicators for each concept.

After filling in diagnostic questionnaires, researchers conducted in-depth interviews with company leaders (founders/ owners or CEOs). Out of 29 companies identified as potential HCs in Russia 14 interviews were conducted, in 6 cases more than one interview was used, in 2 cases other members of senior management team were interviewed. (6) In each interview after stating the purpose of the research the interviewee was asked to explain the company's market leadership and approach to

Table 1. Comparison of criteria for selection of Hidden Champions in CEE countries and Russia

Criteria	Hidden Champions (Simon's methodology)	Hidden Champions in dynamically developing economies
Market position	No. 1 in Europe or top 3 in the World	Global / Europe / CEE / Regional leaders
Average revenues (per annum)	€326 million	€141 million
Revenue growth (within the last10 years)	8,8%	10,4%
Export (% of revenues)	61,5% (51,1% 10 years ago)	62,1% (58,2% 10 years ago)
Productivity (revenue per employee)	€160.039	€99.240
Median age of the companies (years)	61	19
R&D expenses (% of revenue)	6%	16,4%
Number of patents per 1000 employees	30,6	41,98
ROI (%)	13,6%	32%

(Source: *Hidden Champions in Central and Eastern Europe, and Dynamically Developing Environments. Research Report 2011*)[5]

its development and strengthening. When visiting companies' premises and sometimes production and research facilities researchers supplemented the interviews data with their own observations. The majority of interviews were audiotaped and then transcribed, or initial notes of the interviewers made during the interview were then developed into extensive field notes.

Following this initial research stage which identified HC companies in Russia more in-depth analysis was undertaken for family owned businesses among them. Out of 14 interviewed companies 50% were started as private partnerships, 25% were Soviet times government owned enterprises, and 25% were identified as family owned. As there is no one definition for family enterprise, we relied on the definition[6,7] that family companies are those in which the family controls the business through involvement in ownership and management positions. Additional interviews with family owned HCs were conducted to clarify issues concerning their attitude to innovations (new technologies use and new products development); human capital potential (education and skills development, using family pooled resources and attracting external talent); and internationalization strategies (goals for expanding to international markets and influence of internationalization to company survival and success). Research team also analyzed HCs which started as family businesses and after 10 or more years went public through IPO or strategic partnerships with other public companies. Interviewing CEOs and owners of those companies, questions focused on the years of family ownership of the company and reasons to trade family control over business for growth opportunities.

3. Main Findings

Most Hidden Champions in the dynamically developing markets and in Russia studied were established in the beginning of 1990-s with the start of market reforms, and some were founded in late 1990-s – early 2000. All HCs can be divided into two groups (Figure 1) using the parameters of age and market leadership.

Though both groups were identified as Hidden Champions their patterns of value creation are different: while companies in the first group were offering tech-

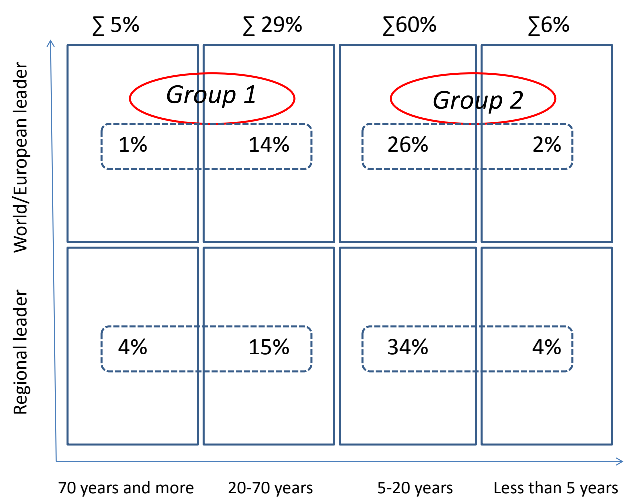

Figure 1. Hidden Champions groups.

nologically complex but standard products, companies in the second group were selling research intensive and customized solutions. Competitive advantages of the first group were based on price-value relationship, while second group companies were leading due to product design and innovations. Companies in the first group are building their own supply chain while the second group is treating their suppliers as partners and trying to create additional value for them. Economies of scale are used to decrease costs by companies in the first group; intellectual leadership and knowledge management are drivers for the second group.

HCs throughout countries researched attribute their foundation and success to visionary, passionate and expert leadership in building organisations. Vision is leadership for the future, practice that brings together and leads them to achieve future goals. Leaders' passion spurred people into action, their enthusiasm fired their entrepreneurial skills to see market opportunities and establish successful organisations. Vision and passion were accompanied by expert knowledge of the founders/ leaders and/or people they recruited.

An important element of success of HCs was not just vision, passion and expertise, but an environment they managed to create, where people feel they belong, care, work for some shared values. These community cultures were created by HCs not just internally; they demonstrate a shared understanding that they are part of a bigger system – local, regional or international – more pervasive than the organisations themselves.

Many of the HC companies started as family businesses and quite a few remain family owned even after growing into mid-sized businesses. It was partially due to founder's key role in company management and authoritarian leadership style, and partially because of the involvement of family employees in new products development and marketing. Research findings revealed that family companies are innovate not to remain competitive and survive, but because they operate in a turbulent and dynamically changing environment, which encourages the development of radical new products in niche markets. The findings are consistent with the opinions of some authors who argued with the conclusions of earlier literature on family companies' innovativeness[8,9]. The findings show that family companies explore new markets, which often are not within national borders. Early internationalisation, characteristic of many HCs is triggered by their search of market demand for their products and leads these companies to developing new distribution channels and supply chain partnerships. Family owned HCs are using family members' contacts and competencies to select new markets.

Usually when family companies evolve into the later stages of their development, the family social capital is no longer sufficient for sustaining the required level of innovation or quality and scale of management. This raises the issue of the use of employees from outside the family[10]. Our findings reflect on the social network theory, proving that companies concentrate on closest relations (or strong ties) at the beginning of the entrepreneurial process and then extending their networks to include external members. This study also suggests that innovation has an effect on small companies' growth. However, many family owned HCs prefer controlled growth and remain medium sized companies to maintain founder/ owner's control of business.

4. Hidden Champions in Russia

The potential for Russian HCs is determined by 3 main factors:

1. A long period of centrally planned economy resulting in lack of international involvement, low or no competition, undeveloped entrepreneurial skills and attitudes;
2. Specific transition period with a shift to oligarchic economy with significant role of the state, high barriers for new businesses and high risks for small and medium enterprises;
3. National economy based to a large extent on natural resources with a relatively small number of companies accounting for a large portion of the total market capitalization.

Large corporations dominate key Russian export sectors. The share of SMEs is low, accounting for 15% of GDP and employing only 20% of the total workforce.

In Russia researchers shortlisted 6 companies from the initially selected 29 organisations to be studied in more detail. Most of the identified companies started their business in the beginning of 1990-s, when social and economic reforms began in the country. In Russia researchers identified several companies which were established during Soviet times, and are still successful. Some IT companies were established in the beginning of 2000-s, with growing Internet penetration and IT market development.

Russian HCs were selected on the basis of their products novelty, successful marketing strategies, strong presence on the international and national markets, innovative approach and R&D, sustainable development orientation, and talents management.

The majority of manufacturing and hi-tech companies in Russia are located in the central metropolitan cities: Moscow and Saint-Petersburg. This is a common pattern for Russia: most of the innovative enterprises are located close to the human resources and higher education institutions.

In terms of industry distribution Hidden Champions in Russia are split as shown in Figure 2: 35, 7% in IT and telecommunications; 18, 4% in machine building; 11, 2% in electrotechnology and electronics.

The key Russian export sectors are dominated by large corporations either owned by the state or often informally affiliated with the state administrations and political leadership.[11] Russian HCs managed to penetrate big business dominated export operations in the following sectors, where they took leading positions (top 3) either worldwide or regionally (Europe and CIS):

- IT (software production, IT-consulting, IT-outsourcing):
- Transport manufacturing (yachts, helicopters);
- Hi-Tech (scientific instruments, nano-technology, scanning probe microscopes, navigation systems for sea ships and aircrafts);
- Pharmaceuticals (generics, anti-flu vaccines);
- Consumer products (sports clothes, ballet and dance shoes, sparkling wines);
- Metallurgy (titan and zinc supplies for automotive producers).
- The "supply" products: equipment, materials, components

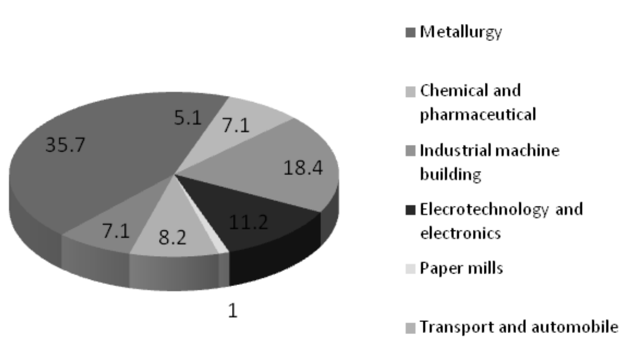

Figure 2. Russian Hidden Champions by industry.

Family owned HCs in Russia were found in hi-tech, consumer goods and IT sectors.

5. Resources of Family Owned HCs

Russian Hidden Champions are leaders in their industries. Research has shown that founders, owners, or CEOs are leaders in their professional areas just as they are leaders in their companies. All of the owners of Russian HCs are founders or active members of professional associations or societies (setting up professional association as NT-MTD head Victor Bykov or participating in several professional bodies as Nicolay Grishko from "Grishko" company) and they created partnership networks, which include customers, suppliers, educational institutions, research centers.

The resource-based theory developed by Wernerfelt[12] and Barney[13] describe company's resources as assets, capabilities, organizational processes, attributes, information, knowledge, etc. controlled by a company and enabling it to plan and implement strategies that improve its efficiency and effectiveness. Resources that have the potential to generate a competitive advantage usually have to be valuable (source must have the potential to influence efficiency and effectiveness in a positive way), they must be unique and only available to one company, and must be inimitable. Sustainable competitive advantages can only be generated if competitors cannot copy a resource or capability. Non-substitutability of the resource is thus an important characteristic. Family owned companies' resources may also arise from the interaction between a family, its members, and the business and are inimitable for each family business. Simon and Hitt[14] identified several family companies-specific resources that can lead to competitive advantages for such companies. Most important of these resources are human capital and social capital (survivability capital, patient financial capital, and governance structure also mentioned by these authors were not studied during this research of Russian HCs).

Human capital (knowledge, skills, and capabilities of an individual) in family businesses, can have both positive and negative effect. On the one hand, family members are often more committed to the company, relationships are informal and friendly and there can be company-specific knowledge. On the other hand, there is a possibility of employing incompetent employees just because of the family affiliation. In the context of innovations, human capital is an important source of knowledge, which is not available in non-family companies. Company-specific knowledge can improve decision-making regarding innovations or other strategic issues.

Russian family owned HCs rely on company specific knowledge and skills both in their core business (new product development and technology improvement) and management issues (developing distribution channels or marketing research), but also use external human capital resources at the early stages of their development. N. Grishko found and appointed as chief engineer the author of unique research on ballet shoes construction when he realized that the old craftsman shop could not support reasonable volume of sales. V. Bykov from NT-MTD employed external experts to expand the company's sales to foreign markets though relied on family members to manage its marketing activity.

Social capital describes the relationships between individuals or between organizations. Our research proved literature findings about gradual extension of family businesses social capital through recruiting external employees and creating professional networks and partnerships. N. Grishko is heavily involved in networking and developing ties among the ballet dancers' community and wider theatre audiences. The company has been supporting Russian ballet schools for over 10 years now providing special scholarships (in the form of ballet shoes provision) to the best students, and now developed ballet class uniforms for students of Vaganova ballet school. The company started cooperation and co-branding programs with Russian fashion designers invites Russian prima ballerinas to participate in defile of Russian designers, launched a new product line of ballet fashion for rehearsals, ballet classes and performances.

NT-MTD company continues and develops its activities in the education sector, besides cooperating with research universities in providing training for faculty members in using company's research equipment, the company established a training center for school teachers in developing courses in nanotechnology for secondary schools.

6. Innovations

In recent decades, economists have been identifying knowledge creation as the major determinant of economic growth. Most family owned Russian hidden champions succeed because they produce high quality innovative products. Modern stage of economic and social development is chracterised by increasing influence of science and technology. Top 50 world companies from the hi-tech industries are twice more profitable than companies in the traditional sectors of economy.

At the same time marketing new hi-tech innovative products is much more risky due to higher uncertainty of the environment, specific consumer behavior and reciprocating life-cycle model. When new high-tech products are launched they attract the attention of a narrow group of innovators. Their demand is saturated quite quickly either because they are not numerous or because some product defects are registered. Companies usually are closely monitoring the demand of these opinion leaders and make special efforts to improve the products, so the demand again starts to grow. That is why this life cycle model was called reciprocating[15]. Constant product improvements following the changing needs of their customers is one of the success factors of Russian Hidden Champions from the hi-tech industries. One of the HC companies show-cased - NT-MTD, provides a new service for their current customers – modernization and upgrade of research instruments produced by the company.

The distinction between "innovators" and "reproducers"[16] helps to understand the differences not only between the products entrepreneurs launch into the market, but also between their core competences and organisational skills. Reproducer organizations are those whose routines and competencies do not vary from those of the existing organizations in established sectors. They bring little or no incremental knowledge to the markets they enter, organize their activities in much the same way as other organizations in the same sector. Innovator organizations are started by entrepreneurs whose routines and competencies vary significantly from those of the existing organizations. Most entrepreneurs simply reproduce the structures, competencies, and routines of the existing organizations. Thus, most entrepreneurs start as small reproducers and not as innovators.

Founders of small businesses can begin as innovators and manage to build on or enhance the existing routines and competencies, which can be adopted by other organizations. It is competence-destroying innovations which give entrepreneurs clear competitive and survival advantages. Competence-destroying innovations require new knowledge, routines, and competencies in the development and production of a product/service. They fundamentally alter the set of relevant competencies required. Accordingly, they put existing organizations at a disadvantage, because such organizations are often not flexible enough to change. By contrast, because the main advantages of family owned small businesses are their flexibility and their ability to change, they can out-perform their bigger but slower rivals[17].

Russian HCs in hi-tech and IT industries started as innovators, basing their products on innovative ideas and patents developed and owned by the company's founders. These ideas were so different from the existing market propositions that these SMEs could compete in their market niches with bigger and more established rivals.

Most HCs are working or at least start their business in market niches. In marketing literature innovative niches or marketing niches for innovative products are defined by a number of parameters, including a limited number of consumers, specific product usage, limited sales volumes, and highly individualized customers' requirements. Market niches for innovative products are characterized by new technologies in production and product usage and high speed of change of niche parameters. Market niches for innovative products can develop in three possible ways: (1) grow to become a segment with growing demand and competition; (2) remain stable for some period of time if it is either not noticed or not attractive for competitors, before a new technology replaces the basic innovation for this niche; (3) disappear after a short period due to low demand or company inability to serve the niche.

Russian family-owned HCs are developing their market segmentation using customized and niche marketing. Their efforts are either targeting niche growth into a segment and securing company's leadership by unique competences, after-sales services, and product customization (the case of IPG Photonics, producer of high-performance fiber lasers, fiber amplifiers and diode lasers which was successful with its IPO at NASDAQ after 14 years of family-controlled growth); or stabilising the niche by individual customer service, additional products and services and exceptional product quality (the case of Grishko and NT-MTD).

7. Internationalization

According to Schumpeter, technological change in a free market consists of three parts: invention (conceiving a new idea or process), innovation (arranging the economic requirements for implementing an invention), and diffusion (when people and organizations adopt or imitate the new product or service). It is fundamental for understanding of the nature of innovation to recognise that uncertainties are at the heart of innovative activities. Even if new scientific knowledge does emerge from research findings it may never lead to a new marketable product. Even if research does eventually lead to a product concept, demand for these innovations is needed for successful innovation diffusion. Providing favorable conditions for start-ups developing new ideas and knowledge into innovative products and services in technoparks and business incubators is not enough for modernizing economy basing on innovations. Research[18] showed that for innovative companies with turnover USD10-100 bln the main barrier for further development is not lack of capital or limited access to loans but limited market demand. To grow and be successful hi-tech companies need market demand for their innovative products. Russian HCs were looking for this demand in overseas markets.

The existing body of literature on liabilities of newness and smallness positions new, small companies as generally having a higher risk of failure compared with large, established rivals. Early internationalization is among the factors that may explain why some companies survive these risks. The results of some researche[19] showed that rather than add additional risks due to "foreignness," as some suggest,[20,21] entry into foreign markets can increase SME survival. The literature on the internationalization of SMEs explains the existence and level of internationalization[22-24]. Most of them agree that internationalization can be accompanied by additional risks of foreignness. New small companies are subject to a higher risk of failure compared to older and more established companies because they are less efficient and lack external support[25]. Older and more established organizations have better survival prospects because they have established relationships and access to resources, small new companies lack brand recognition, market acceptance of their products, economies of scale and other advantages of larger companies[26]. However internationalization may balance the risk of newness. It can help small companies expand beyond the limits of domestic markets, enhancing their survival and growth[27]. Although large companies may conquer domestic markets with their brand, market acceptance, and economies of scale, they have fewer advantages in foreign markets, and SMEs may be able to escape high competition in their home markets by capitalizing on international opportunities.

Internationalization through serving the target markets beyond domestic borders was one of hidden champions' success factors. Reasons for this early internationalization included existing demand in foreign markets, when the domestic market was not yet ready for the product. as was with Grishko pointe shoes in the 1990-s when only professional ballerinas or students of ballet schools in Russia bought these shoes while a much larger group of amateurs took ballet classes as hobby or fitness activities in Japan or Italy and hence needed a constant supply of pointe shoes. Internationalisation motivation was also strengthened by the existence of high-price/low-volume segment in the foreign markets,[28] which was the case with Luxoft unique IT solutions for banking services and automotive manufacturers, or NT-MTD probe microscopes. Early exports provided Russian HCs possibility to broaden customer base through entering new markets and achieve a larger volume of production.

Family-owned Russian HCs were often relying on the founder's personal contacts or those of their family members to select foreign markets to enter. This decreased to some extent the risks of foreignness and lack of knowledge about the new markets. (See Table 2.)

8. Conclusion and Further Research

Hidden Champions international research project proved that companies meeting the Hidden Champions criteria are present in Russia, as well as in Central and Eastern Europe (Slovenia, Czech Republic, Serbia, Macedonia, Poland, Ukraine, Belarus, Estonia, and Latvia) Turkey and Kazakhstan.

Hidden Champions selection criteria differ from those identified by H.Simon due to dynamically developing markets characteristics. Companies' value creation patterns, leadership styles and years of experience in the market provide the basis for their classification into two groups, and behavior patterns in each group showed similarities across the markets involved in the research.

Family-owned Hidden Champions in Russia showcase HC key success factors, including innovative product portfolio regularly updated to maintain high technology leadership and customized to meet the specific requirements of key clients; early internationalization through expansion to foreign markets with bigger demand or better access to high price/low volume segments; building professional communities and networks to maintain and

Table 2. Russian family-owned Hidden Champions show-cases

Company information	**Grishko** Established in 1989 Number of employees in 2011 – 500 Pointe shoes, dancing shoes and costumes
Nature of market leadership and competitive advantage	High quality pointe shoes made of natural materials using technology to minimize foot deformation
Core lessons learned and business success	Superior quality at affordable price Value chain control Developing customer base through relationship marketing Wide corporate social responsibility programs Niche marketing

Company information	**NT-MTD** Established in 1990 Number of employees in 2011 – 300 Probe microscopes and nanotechnology research instruments
Nature of market leadership and competitive advantage	Unique product design Choice of high technology industries to serve Provide complex research solutions
Core lessons learned and business success	Commercializing a research idea Research community networking Products as educational systems Niche marketing

develop company's social capital. Russian family-owned HCs, though not numerous, are good illustrations of using family firms' advantages to overcome the limitations of SMEs in highly competitive and turbulent environments: using family firms-specific resources (human and social capital) to build sustainable competitive advantage the interaction between a family, its members, and the business and are an inimitable resources for each family business. Russian family owned HCs attract external resources at early stages of their development to provide unique knowledge for innovative products development; new technologies access as well as managerial competences lead to the company growth. Some HCs started as family-owned businesses chose to go public through successful IPO or strategic partnerships with other public companies. However, there are still HCs which chose a controlled growths strategy and are still owned and managed by their founders and members of their families.

Continuing research on HCs in Russia identified candidate companies outside the two metropolitan areas, in the Russian regions. Possible research focus could be to see if family ownership of such companies can have some regional characteristics in access to resources or different scope of social contacts. Studies of successful and innovative family owned businesses can go beyond H. Simon's methodology of Hidden Champions and consider regional leaders of the niche markets.

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