

## **ENHANCING ECONOMIC SECURITY AND COMPETITIVENESS – THE UNTAPPED POTENTIAL OF THE EU’S MID-CAPS**

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### **THE NEED FOR A BETTER LEVERAGING OF THE EU’S BUSINESS FABRIC**

Profound technological shifts and dramatic changes in the global geo-economic landscape have put the EU’s existing business model into question, and with it its ways to regulate and support its businesses. An increasing weaponisation of economic dependencies and a rise of supply chain homeshoring, industrial policy and trade barriers has challenged the EU’s reliance on global markets and posed challenges to its competitiveness and economic security.

To meet these challenges the EU does not only need to better protect its trade interests, build reliable international partnerships, promote its industry and reduce red tape as stipulated in the EU’s economic security strategy, or the EU Strategic Agenda 2024-2029. It also needs a **smart and evidence-based approach to better leverage its business fabric.**

Economic security - and the green and digital transitions which are closely

linked to it - brings with it a greater **need for investment, speed, directionality and above all scale.** While the EU has many innovative startups and SMEs, there is a shortage of successful scale-ups that can turn new technologies into flourishing business models and **gain sufficient market share to become global champions.** As China and the US have been massively subsidising their strategic industries, the EU has struggled to rapidly build up manufacturing capacity in critical sectors. It is arguably this **scale-up gap where the EU most lags behind its competitors in the US and in Asia.**

However, the EU’s regulatory and support framework does not sufficiently address these issues. It has **mainly been geared towards SMEs** and one of the key principles of EU law making has been the “think small principle” at a time when scale-up thinking is more important than ever. Recent research points to the **great and often unfulfilled potential of mid-caps** for improving competitiveness and economic

security.<sup>1</sup> But despite their role as hidden champions, mid-caps lack a clear EU-wide statistical identity and are regulated like large companies.

### **MID-CAPS' IMPORTANCE FOR THE EU'S COMPETITIVENESS AND ECONOMIC SECURITY**

Mid-caps have been defined by the EIB as companies between 250 and 3000 employees. Some of them are **hidden champions with sufficient size to claim European or global leadership in certain innovative niche markets**, while others are **scale-ups in the middle of their growth path**. Mid-caps account for more than 17% of overall employment and 21% of turnover in the EU's business sector and represent more than half of the value added of the EU's manufacturing sector. While still relatively small and agile, they are **often key elements of the 14 industrial ecosystems<sup>i</sup> highlighted in the EU's Industrial Strategy**. Most of those, such as Electronics, Health, Energy/Renewables and Aerospace & Defence (see annex) are crucial for competitiveness and economic security.

In today's technological and industrial race, investment is crucial to maintain an edge. Mid-caps excel in this important metric as they are **more likely to invest compared to SMEs and large firms** and their investment volumes per employee are

disproportionately high. This is particularly so in the manufacturing sector, which is crucial for economic security.

#### *INVESTMENT CHAMPIONS*

For example, German solar power company AE Solar plans to invest 1.07 billion Dollars to set up a new 10 GW solar module manufacturing plant in Romania and FertigHy from Spain recently announced an investment of 1.3 billion Dollars to set up a new low carbon fertiliser plant in Languedoc, France.

These are just two examples of mid-caps playing a crucial role in building up European manufacturing capacity across the Single Market, in these cases for more energy and food security, helping to reduce dependencies on China (solar modules) and Russia (fertiliser).

Mid-caps also play a disproportionately important role in innovation and they are **well represented in the 10 critical technology areas<sup>ii</sup> identified in the Commission's Recommendation to member states for economic security risk assessments** (see annex). Mid-caps are **significantly more likely to invest in R&D and to innovate than SMEs**, while performing almost on the same level as large firms. They are also much more likely to prioritise investments in new products and services than SMEs.<sup>2</sup>

<sup>1</sup>E.g.: Maurin, Laurent; Delanote, Julie; Tran, Huyen; Riekeles, Georg; and Lausberg, Philipp (2024), "Hidden champions, missed opportunities: Mid-caps' crucial roles in Europe's economic transition", Brussels: European Investment Bank and European Policy Center.

<sup>2</sup> Ibid.

#### TECH LEADERSHIP

**Highly innovative mid-caps** like the Dutch *BE Semiconductor Industries* specializing in semiconductor assembly equipment, *Basler AG* a German producer of industrial cameras for factory automation, or *Ynsect* from France focusing on insect protein production for animal feed are global leaders in fields which are of great importance to the EU's competitiveness and economic security.

They hold significant shares of their markets while operating at the technological cutting edge. Such kinds of companies can be indispensable elements of global value chains, not only making the EU less dependent on foreign expertise and imports, but also increasing the EU's bargaining power in the global geo-economic competition.

**Some mid-caps have been subject to export controls**, demonstrating their technological leadership and strategic importance.

#### EXPORT CONTROLS

Examples are *Hensoldt*, a German company specializing in sensor solutions for defense and security applications, the French *Lacroix Group* producing defense electronics and pyrotechnics, or the Italian aerospace company *Avio* involved in rocket propulsion and space launch systems.

#### UNTAPPED POTENTIAL: THE INADEQUATE REGULATORY AND SUPPORT FRAMEWORK FOR MID-CAPS

But despite the important role mid-caps are playing for the EU's competitiveness and economic security, they are often **operating below their potential**. Their limited size and strong internationalisation and dependence on inputs have put them at the hard edge of recent crises.<sup>3</sup> Many mid-caps have experienced supply chain disruptions or skills shortages.

#### SUPPLY CHAIN DISRUPTIONS/SKILLS SHORTAGES

Examples are German semiconductor equipment company *Aixtron SE*, the Belgian *IBA SA* which specializes in proton therapy and radiopharmacy solutions or the German *TeamViewer AG* which provides remote connectivity solutions.

Moreover, high compliance costs and regulatory uncertainty are often disproportionately hurting mid-caps. SMEs are exempt from some regulatory requirements as they are subject to a simplified reporting regime and have been granted derogations in many areas, such as competition rules, taxation and company law. Although mid-caps fall just beyond the SME threshold of 250 employees they are classified as large companies with all the concomitant regulatory burdens. This regulatory treatment can work as a break to innovation for mid-caps. For example, a manufacturer of a 10-piece series will think twice before introducing new

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<sup>3</sup> Ibid.

innovative processes that require lengthy and costly third-party certifications, whereas larger companies producing 500.000 pieces might see 6-digit-compliance costs and slow certification processes as less of a problem.

**Mid-caps are more likely to report investment gaps than SMEs and large companies.** But despite often having difficulties accessing finance<sup>4</sup>, mid-caps receive **less public support in form of grants or bank finance on concessional terms** than large firms and SMEs. Innovation support is a further example of this. At present, EU and member state **R&D programmes primarily target SMEs**, while the largest companies are the ones that have the most resources to apply for support schemes.<sup>5</sup> As a consequence support will tend to favour small companies in local markets or major projects led by large companies, with insufficient support in between to meet the needs and potential of mid-cap companies.<sup>6</sup>

**These issues also lie at the heart of Europe's scale-up problem**, one of the key hurdles to more competitiveness and economic security in the EU. Threshold effects linked to benefits and exemptions under the SME definition discourage SMEs to scale-up and grow into mid-caps, and mid-caps are themselves held back on their growth path by lack

of recognition, regulatory burdens and an insufficiently supportive economic framework.

The lack of deep capital markets in the EU plays an important role here, but the constraining regulatory environment exacerbates this problem

**Many innovative start-ups grow to become mid-caps but do not continue expanding to become large enough to turn into global leaders.**

As a result, many particularly **innovative firms have been bought by foreign investors**, or they have dislocated to the US or China before they could gain a critical size and concentration in the market. Dislocations have been on the rise substantially in the past years. The number of dislocations of industrial companies from Germany for example over the past 4 years have been half as many as over the whole previous 20 years combined. Among those dislocating are many innovative mid-caps in strategic sectors.

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<sup>4</sup> Mid-caps are less likely to issue new equity compared to other firm sizes. Despite being larger and better capitalised than SMEs, mid-caps often lack the financial resources and creditworthiness of larger firms, making it difficult to issue bonds or equities in the capital markets (Didier, Levine, & Schmukler, 2016). Only 1.5% and 4.3% of small and large mid-caps in Europe report having newly issued bonds compared to 19% among XL firms.

<sup>5</sup> Dachs, Bernard; Siedschalg, Iulia; Yan, Weijie; Yoveska, Maria; Boeira, Fernanda; and Ivory, Sean (2022), Study to map, measure and portray the EU mid-cap landscape, Brussels: Austrian Institute of Technology, The Economic and Social Research Institute, and Integral Research, p.78.

<sup>6</sup> KPMG Private Enterprise (2022), "Bridging the mid-cap gap. A proposal to recognise, promote and support the growth of mid-caps companies in the European Union", p.25.

### FOREIGN ACQUISITIONS

For example, the globally active Spanish mid-cap *Igenomix* specialising in reproductive genetic testing was acquired by the US company *Vitrolife* in 2021 and in the same year, the Dutch aluminium manufacturer *ALDEL* was taken over by a US private equity fund to prevent bankruptcy because of an uncertain investment climate in the EU.

Moreover, **rising numbers of investment screening cases** demonstrate not only an increasing awareness of EU member states of the threats to economic security, but also imply that European companies have to turn to foreign investors for

investment in sensitive technology areas.

### INVESTMENT SCREENING

Mid-caps that have undergone investment screening include leading global seed production firm *Verisem* from Italy and the German firm *Elmos* which is producing semiconductors for the automotive sector.

These examples demonstrate the importance of many mid-caps for economic security and point at the inadequate European regulatory and support system to fully develop these companies' potential.

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## ANNEX

<sup>i</sup> **The fourteen ecosystems identified by the Commission's 2021 Industrial strategy:**

1. Aerospace and defence
2. Agri-food
3. Construction
4. Cultural and creative industries
5. Digital
6. Electronics
7. Energy intensive industries
8. Energy-renewables
9. Health
10. Mobility - transport - automotive
11. Proximity, social economy and civil security
12. Retail
13. Textile
14. Tourism

<sup>ii</sup> **The four most critical technology areas identified by the Commission's Economic security strategy:**

1. **Advanced Semiconductors technologies** (microelectronics, photonics, high frequency chips, semiconductor manufacturing equipment)
2. **Artificial Intelligence technologies** (high performance computing, cloud and edge computing, data analytics, computer vision, language processing, object recognition)
3. **Quantum technologies** (quantum computing, quantum cryptography, quantum communications, quantum sensing and radar)

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4. **Biotechnologies** (techniques of genetic modification, new genomic techniques, gene-drive, synthetic biology)

To which **six additional areas** were added:

5. **Advanced connectivity, navigation and digital technologies**
6. **Advanced sensing technologies**
7. **Space and propulsion technologies**
8. **Energy technologies**
9. **Robotics and autonomous systems**
10. **Advanced materials, manufacturing and recycling technologies**