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TITOLO

# OFFSHORING: Theories and practices of Italian SMEs

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## I - Introduction

History is made of cyclical periods: moments in which people raise barriers among them, and phases in which they struggle to destroy such obstacles to be closer to each other.

Of course, nowadays society is trying to shorten the distances through the development of technology. Planes connect far countries, internet allows the instant share of data and institutions promote integration.

The reasons of such a context are various. On the one hand, people are moved by social and relational drivers that aim at a perfect mixture of different cultures and at knowledge spillovers. On the other hand, distances are taken down to create new economic opportunities that permit the creation of a greater and greater value.

The before mentioned process of integration must be considered as part of the concept of Globalization.

The possibility of moving capitals, and sometimes labor, across countries has changed the rules of the game. Protectionism is slowly fading away and each state is trying to adapt itself to the new environment which is very selective and competitive.

In fact, firms and industries perceive this phenomenon differently. On the one hand, globalization helps the share of knowledge and creates new markets opportunities. On the other hand, by allowing foreign firms to enter their local market, native firms lose part of their customer base incurring in lower economic and competitive power.

When we deal with Globalization, we must understand which the processes that are used to pursue the creation of a unique Global Market are. In fact, different processes are undertaken to reach all the multiple set of goals of Globalization.

On the economic side of the issue, the main tools used are: Foreign Direct Investment, Outsourcing and Delocalization. On the social side, we have Institutional convergence, supranational coordination and Cultural integration.

Among these different processes, the focus of this thesis will be on the Delocalization activities undertaken by Italian Industries.

According to that, the aim of my research would be the comprehension of Italian SMEs' behavior when choosing whether or not to relocate part of their value chain functions for competing with foreign firms.

Reasons for relocating all or part of the value chain activities may be mostly resumed in one main class of motivations: there may be more favorable conditions and some comparative advantages that foreign countries offer for producing in their land.

Of course, this driver suggests that producing at home could be less profitable than doing it abroad. This is possible due to many different reasons that I will discuss in the next chapters.

Anyway, all these reasons seem to allow the division of countries in two groups: one with relatively lower labor cost, and the other showing high labor cost and high percentage of skilled workers.

Despite some similarities may suggest to, it is necessary to distinguish the concept of offshoring with the one of FDI and the one of Outsourcing, which has different roots and characteristics.

So that, I will ask myself some questions: are Italian SMEs taking part in the international mixing of capitals, or are they trying to keep production inside the country? Are SMEs experiencing the advantage of foreign favorable conditions, or are they leveraging on the concept of “Made in Italy Production”? Should they prefer one way or the other? What changes if we analyze the primary, the secondary and the tertiary sectors separately?

Of course, our economy has to deal with such a big issue, of which it is necessary to enlighten all the likely scenarios and to address, if possible, one best pattern of solutions.

For carrying out such research, I will follow some steps. First of all, it is necessary to comprehend Italian economic history and its strategic advantages, to understand at which stage the offshoring process is actually taking place and to figure out all the differences arising from industries specificities.

After that, I will try to understand which sectors may get a higher benefit from delocalization and to estimate the threshold up to which this process is positive. When taking all these steps I will mainly pay attention to the changes occurring to productivity, employment and culture.

Of course, before taking all these steps, I will focus on what has already been investigated by the economic literature on the offshoring phenomenon and on the Italian economy, trying to perceive the state of the debate in order to give a contribution to it.

For what concerns what has already been investigated of the Italian economy, I will start by analyzing country's peculiarities.

As stated by Carlo Cipolla in his book *Storia Economica Italiana (2002)*[1], Italy has always been an exporting country. This particularity is due to the fact that, since the country has very few raw materials (exception made for marble and some crops), it is obliged to export in order to earn enough and then buy other inputs.

It has two main implications. On the one side, importing for adding value on raw materials in order to export finished or semi-finished good has been the constant root followed is Italian economy. On the other side, since Italian main source of differentiation is in the high quality of the processes needed to transform input into output, delocalization seems to be in contrast with industries heritage.

For identifying the characteristics of offshoring, I first of all accurately specify what we define as delocalization process. Although everybody may intuitively understands that the term regards the transfer of activities from a nation to a foreign one, nowhere in the literature we find a standard definition making reference. As underlined

[1] Carlo Cipolla, Storia facile dell'economia italiana dal Medioevo a oggi, Il Mulino, 2009.

by Grignon[2] (2004 - Délocalisation des industries demain d'œuvre), "*this process refers to changing the site of a given production unit. Then, a foreign unit is open while a national unit is closed, not impacting the destination of the final output".* Of course, some differences arise when some variable changes. That is the case of when delocalization is perceived as international outsourcing and finished or semi-finished goods are then re-imported in the home territory, and the case of when new units are opened without closing any home unit.

Of course, dealing with delocalization it is necessary to see this process through the lenses of Ricardian theories on international trade, the theories of perfect competition in open markets, and the Creative Destruction nature described by Shumpeter.

The first one suggests that a nation will tend to specialize itself in the sectors where it has a comparative advantage, and gives some evidence of what supports the process of delocalization.

The theories on open markets explain the rules of international trade and, consequently, of the transfer of capitals.

Schumpeter's theories describe that the main changes of the market are due to innovation. When it creates big profits, it attracts entrepreneurs that enter the market increasing the international competition. Higher competition makes firms interested in being more and more efficient, also by finding more favorable place where to locate their production, thus incurring in the delocalization process.

[2] Grignon, *Délocalisation des industries demain d'œuvre, 2004 Rapport d'information n° 374, Commission des Affaires Economiques et du Plan, Sénat, Paris.*

Last but not least, we have to comprehend the relevant relation between delocalization and Foreign Direct Investments (FDI). In fact, when studying this relation, despite many similarities, many differences emerge:

- The definition of FDI and delocalization is not worldwide shared. Some define delocalization as kind of FDI whereas others assume that the delocalization process can occur without FDI, such as the case in international outsourcing.
- The problem of production transfer. According to the different definitions, activities transferred from the origin to the host country may or may not be a necessary condition for delocalization.
- Their partially different goals. These goals vary from cost reduction (for the most restrictive definitions) to foreign market conquest (for the largest definitions).

After having analyzed Italian economy heritage and delocalization processes patterns, I will combine the results subtracting the negative aspects from the positive ones and then try to identify the best practices that allow firms to be more productive.

**Research method**

I will firstly check on the literature how Offshoring activities are dealt with. I will pay attention both to the Italian economic heritage and to the theories of globalization and capitals transferability trying to understand how much “open” the Italian economy should be in order to maximize the benefit of international integration, not affecting local industries.

On the one hand, I will produce primary data, collecting them from as many Italian SMEs as possible through questionnaires and interview, with the goal of understanding at which level firms are relocating and what is the rational beyond their decisions.

These data will be analyzed both qualitatively and quantitatively, thus giving a broader picture of the phenomenon.

In addition, I will try to develop a model based on the offshoring connections between two countries (Italy and Albany), and then analyze the main variables, such as employment, prices, exports, imports, knowledge spillovers and productivity variations.

## II. OFFSHORING

### 2.1 Global context

In the last decades, the entire world seems to be led by the forces of Globalization, a concept that may be broadly defined as the process of cultural, social, economic, politic and technologic integration.

In fact, despite many supports that Globalization's roots are to be found in the economic side of the issue, it is quite obvious that market integration is only a small part of the story.

On the one hand, the main drivers that allowed the rise of this process come from the necessity that most of the economic entities have in gaining from international trade and in saving from foreign favorable productive condition.

On the other hand, it is impossible not to perceive that despite the causes are mainly economic; the effects are social and cultural too. Races get mixed up, cultures adopt different and positive foreign attitudes and barriers among countries are slowly taken down. In addition, institutions like the World Trade Organization[3], the International Monetary Fund[4] and the World Bank[5] are increasing their fields of action in order to regulate the global marketplace and to encourage the establishment of multinational treaties to manage the open business system.

[3] The World Trade Organization (WTO) is an organization that intends to supervise and liberalize international trade.

[4] The International Monetary Fund (IMF) is an international organization that was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29 member countries.

[5] The World Bank is a United Nations international financial institution that provides loans to developing countries for capital programs.

Of course, it is quite clear that firms have to comprehend foreign cultures in order to exploit and to approach foreign markets, to adapt themselves to the new environment and to manage their integration in the new global marketplace.

This is why economic and cultural sides of the issue work together. What supports this symbiosis is the great number of studies that analyze these two cooperating parts of Globalization.

This is the case of Hofstede's studies for instance. His model, that I will analyze later on, is based on the cultural differences of countries and represents the perfect mixture of social theories applied to economic purposes.

As stated on Hofstede's official web-site, "*In times like this, it is more important than ever to get the most out of our investment in HR capital. Taking different cultural background into account will increase motivation, reduce turnover, and help keep your best people. Managers can be more effective in coping with the global economic crisis if they simplify the way they manage their staff, taking into account the different cultural background of their team member and the different cultures in which their business operate. Global practices need to be adapted to local cultural values to increase efficiency"*[6].

This quote perfectly analyzes all the relevant aspects of the issue:

- HR capital is playing a central role in the creation of value and in the reduction of costs;

[6] Source: geert-hofstede.com

- To cope with the global economic crises, it is now necessary to combine all the different strengths worldwide available (in terms of resources, technologies, cultures, practices and Human capital);

- To be internationally efficient, each economic entity must perfectly balance global and local values.

The studies of the economist T. Levitt[7] are another important contribution to the relation between the social and the economic sides of Globalization.

His approach on this process of integration is based on four assumptions:

1. The world is becoming a Global Village;
2. Market dimensions are no more national, but global;
3. Urban style prevails on the others;
4. Many new peculiar trends are arising (increasing individualism, third-age emancipation, young people Americanization and so on).

From these assumptions, Levitt indentifies three hypotheses: needs are becoming homogeneous under the pressure of Technology, markets are controlled by price competition and firms undertake scale economies.

Again this theory of homogenization stresses how culture and economy are bound together in a unique process.

[7] T. Levitt, The Globalization of Markets, Harvard Business Review, May–June 1983.

A similar perception of the global trend is shared by the economist Ohmae, who describes the convergence of needs and wants as the reason for which firms have to embrace the new global values.

## 2.2 Economic Globalization

As stated by Rakesh Mohan Joshi[8], "*Economic globalization is the increasing economic interdependence of national economies across the world through a rapid increase in cross-border movement of goods, service, technology and capital*".

In fact, thank to the improvements in transportation and communication, international business is increasing rapidly. International business includes all marketable transactions that take place between two or more regions, countries and nations beyond their political boundaries.

Globalization phenomenon is propelled by the rapid growing significance of information in all the different kind of productive and marketing activities, and the evolution of science and technologies.

Economic globalization regards different field of action. Production, markets, competition, technology, and corporations and industries are the main ones. Despite economic globalization started several hundred years ago (due to the emergence of

[8] Joshi Rakesh Mohan, *International Business*, Oxford University Press, New Delhi and New York, 2009

international trades), its impact increased over the last three decades, under the framework of General Agreement on Tariffs and Trade[9] and World Trade Organization.

In fact, these international institutions made countries to gradually cut down barriers and open up their current accounts and capital accounts. This recent and intense growth has been largely accounted by developed economies integrating with less developed economies.

Despite it can be argued that economic globalization may cause both positive and negative effects, there are several significant result of this phenomenon. In fact, on the one side, there is statistical evidence for positive financial effects and, on the other side, it is quite clear that globalization creates a sort of power imbalance between developing and developed countries in the world economy.

The process of economic globalization must be considered as a double faced process: on the one side, firms want to experience advantages by increasing the number of their costumers, attracting foreign consumers; on the other side, they may be interested in having access to peculiar resources or to lower the production costs.

Of course, according to the different aims, firms employ diverse kind of tools and modes of entry in the foreign country.

The main tools undertaken are:

[9] The General Agreement on Tariffs and Trade (GATT) was a multilateral agreement regulating international trade.

1. Foreign Direct Investment; direct investment into production or business activities in a host country. There are three main types of FDI: Vertical, Horizontal and Platform.

2. Outsourcing; contracting out of a business process to a third-party.

3. Export activities (direct and indirect); the process of selling to another country may be direct or indirect depending on the presence of a sale representative in the host country.

4. Licensing; agreement that allows foreign firms, either exclusively or non-exclusively, to manufacture a proprietor's product for a fixed term in a specific market.

5. Franchising; system in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system.

6. Joint Venture; agreement between two firms that create a new entity aiming at a specific purpose during a specific time period.

Despite all these modes of entry show some similarities and may seem to pursue a common aim, some of them are more likely to be used for marketing purposes and others for cost reduction and for increasing the quality of production.

In fact, we can segment them according to the benefit they carry.

A first cluster is made of the activities aiming at marketing purposes. The modes of entry that embodies this attitude are exports, licensing and franchising since their approach is toward the conquest of a larger customer base.

A second group is made of the modes of entry that aim at high production quality and/or cost reduction. These modes of entry are outsourcing and most of the Joint Ventures (because of the knowledge transfer among the firms that create the new more productive economic entity).

The third segment is maybe the less definable and is made of all the different kind of Foreign Direct Investments. This is due to the fact that FDI embrace some approaches of the before mentioned other modes of entry. In fact, these investments may pursue many different aims, may assume different organizational structures and may adapt better to the foreign country conditions.

By the way, I will analyze FDI more carefully in the next chapter, by making a comparison with Outsourcing.

In order to choose the proper mode of entry and the right host country, firms have to analyze some main variables. These key points on which to build the appropriate strategy are: trade barriers level, tax environment, labor cost and skills, host country economic policies, availability of the resources and technological knowledge.

Analyzing the level of the trade barriers, firms are able to choose whether to export to the foreign market or to produce directly in the host country.

Understanding the tax system, it is possible to decide the appropriate country that offers the most favorable conditions, in order to reduce taxation payments as much as possible.

Studying labor variables is fundamental too. If fact, according to their strategies, firms may look for countries that offer a low labor cost or for countries that propose high skilled and multilingual workers. In addition, analyzing host country economic policies it is possible to experience favorable condition and to adapt the mode of entry to the local environment.

Last but not least, firms are interested in foreign countries according to the availability of the resources they need in their own sector and to the right technological knowledge they may need.

All these variables suggest firms which strategy to undertake and which country to enter.

## 2.3 Cultural Globalization

As said before, Globalization must not be considered as a merely economic process, where firms want to increase their profits and to exploit new market opportunities. In fact, while economic drivers and purposes play a prominent role, cultural integration and knowledge spillovers are very important too.

Culture may be defined as the set of values and norms shared by a group of people, usually living within a certain country. Of course, despite cultures and societies do not perfectly represent a well-defined country, local peculiarities embodies the heritages of a particular region.

If we add to such an assumption that improvements in transportation and communication are boosting Globalization, it is quite intuitive that by reducing distances, different cultures get in contact and employ integrative activities.

This socio-cultural collision reflects itself in many field of action:

1. Languages play a prominent role; some of them, especially English, are becoming fundamental when coping with such an international context.

2. Supranational institutions, such as the European Union, the WTO, the G8 or the International Criminal Court, are slowly replacing and/or extending national functions to facilitate international agreement.

3. Internet usage is increasing very rapidly, allowing a quicker access to information, data and fast communication.

4. Local peculiar values and habits are now perceived as key issues that must be understood and appreciated. Despite Globalization leads to a convergence of these values and habits, their standardization results successful only if it is not too invasive and if it does not destroy completely national heritages that, in a certain way, remain unique.

5. Last but not least, religion takes part in Globalization processes and, in a certain way, may be perceived as the first social sphere that crossed national borders creating a common set of shared values.

Despite all these elements suggest the convergence of different cultures; it is important to understand that some the local peculiarities remain unchanged. In fact, as stated by Andrea Riccardi[10], "*Despite Globalization makes all the cultures a little bit more half-caste, we cannot forget that, during this process, each national identity re-discovers itself".*

Based on this assumption, many studies approach cultural differences among countries in order to help integration and diversity respect. In fact, in order to understand diversities and to join a common global world, it is necessary to be aware of different values and habits.

As I said before in this chapter, this is the case of Hofstede's studies. His work aims at perceiving cultural differences among countries by grouping them into five different dimensions: Power Distance, Individualism/Collectivism, Masculinity/Femininity, Uncertainty Avoidance, and Long-Term Orientation.

This is how Hofstede defines these trajectories:

"*The Power Distance dimension expresses the degree to which the less powerful members of a society accept and expect that power is distributed unequally. The fundamental issue here is how a society handles inequalities among people. People in societies exhibiting a large degree of power distance accept a hierarchical order in which everybody has a place and which needs no further justification. In societies with low power distance, people strive to equalize the distribution of power and demand justification for inequalities of power*".

[10] Andrea Riccardi is the founder of the Community of Sant'Egidio and Professor of Contemporary History at the University of Rome III in Rome, Italy.

*"The high side of the second dimension, called individualism, can be defined as a preference for a loosely-knit social framework in which individuals are expected to take care of only themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives or members of a particular in-group to look after them in exchange for unquestioning loyalty. A society's position on this dimension is reflected in whether people's self-image is defined in terms of "I" or "we."*

For what concerns the third trajectory, "*The masculinity side of this dimension represents a preference in society for achievement, heroism, assertiveness and material rewards for success. Society at large is more competitive. Its opposite, femininity, stands for a preference for cooperation, modesty, caring for the weak and quality of life. Society at large is more consensus-oriented*."

"*The uncertainty avoidance dimension expresses the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. The fundamental issue here is how a society deals with the fact that the future can never be known: should we try to control the future or just let it happen? Countries exhibiting strong UAI maintain rigid codes of belief and behavior and are intolerant of unorthodox behavior and ideas. Weak UAI societies maintain a more relaxed attitude in which practice counts more than principles".*

The fifth dimension describes societies' time horizon. "*Long term oriented societies attach more importance to the future. They foster pragmatic values oriented towards rewards, including persistence, saving and capacity for adaptation. In short term oriented societies, values promoted are related to the past and the present,* *including steadiness, respect for tradition, preservation of one's face, reciprocation and fulfilling social obligations".*

Along these trajectories, Hofstede identifies the differences that make each culture relatively unique.

In fact, while it can be argued that the current new generation is growing up in a digital internet based world with a global political-socio-economic context, we may still observe socio-cultural differentiations as espoused by Hofstede.

In addition, as stated by Frederick G. Kohun[11] and Vladimir Burčik[12] in a study dealing with Hofstede's dimensions, "*To perfectly understand this differentiation is fundamental to a knowledge management and decision making frame in a world increasing succumbing to a globalization phenomenon".*

## 2.4 Offshoring: Definition of the process

As stated in the previous chapter, the so called Globalization phenomenon is allowing firms to reduce distances and to experience advantages by cooperating en exploiting new foreign markets.

In order to profit from such a process of internationalization, firms undertake different activities. Outsourcing, international trades, Foreign Direct Investments, Franchising/licensing and offshoring are only some of them.

[11] Fred G. Kohun, Ph.D. University Professor of Computer & Information Systems.

[12] Vladimir Burčik, Professor of Psychology at Bratislava University.

Among all these activities, I am going to pay attention especially to Offshoring processes.

Offshoring may be defined as the relocation of a business process done in one country to the same or another company in another foreign country. Often times, activities are moved due to a lower cost of operations in the new location. More recently, offshoring reasons also include access to qualified workers abroad, in particular in technical professions, and increasing speed to market.

In fact, when we deal with Offshoring, we refer to the increasing vertical specialization occurring to national economies: part of the production activities of a firm are located abroad, looking for advantages related to low labor cost, high comparative advantage, favorable fiscal and non fiscal policies.

By the way, it is necessary to remember that the processes located abroad may remain into firm borders, when activities are carried out by a foreign subsidiary or by a firm belonging to the same group, or may be outsourced to other firms. This distinction perfectly represents the differences between Offshoring and Outsourcing.

Of course, not all the activities of a value chain are easily transferable abroad.

Production offshoring, known as *physical restructuring* of already existing products, involves the relocation of physical manufacturing activities to a more favorable destination and is the most common offshored function.

Differently from production offshoring, product design, R&D and all the function leading to new products, are quite difficult to offshore. This is due to the fact that research and development activities, in order to increase products quality and to create new reference designs, need high skilled people, something that is not so easy to find in countries with low labor cost. For this reason, often times, only the manufacturing processes are offshored by a company wishing to reduce costs.

## 2.5 Offshoring drivers

Offshoring has been a contentious phenomenon stimulating debates among economists, some of which are strictly linked to the issue of free trade.

This process is perceived as benefiting both the home and host country through increasing trades, creating job opportunities for the destination country and lowering the cost of goods and services to the origin country. In fact, empirical data suggests that offshoring makes both sides experience an increase in gross domestic product (GDP) and increase the occupation rate in both countries. This last thing is supported by the fact that the workers that lose their job in the home country are able move to higher-value jobs in which their nation shows a comparative advantage.

Despite these positive trends, job losses and wage erosion in advanced countries represent the detracting side of the issue. Economists argue that the number of new jobs created in developed countries is less than those lost and that these new opportunities tend to offer lower wages.

In addition, experts that are against this phenomenon, say that currency manipulation by governments and their central banks causes the difference in labor cost creating an illusion of comparative advantage.

Further, they point out that even more skilled and highly trained workers with higher-value jobs such as software engineers, accountants, radiologists, and journalists in the developed world have been displaced by highly educated and cheaper workers from India and China.

Beside this dispute that seems not to be winnable by any parts, it is necessary to analyze why this process is actually taking place.

There are four main drivers boosting this phenomenon:

- Firms are interested in lowering production costs. Different markets offer different labor and capital costs thus becoming attractive for foreign industries.
- Foreign governments may sometimes offer really favorable conditions, in terms of taxes, bureaucracy and national subsidies.
- Corporations may be interested in having access to peculiar sources. Raw materials, technological knowledge and Human Capital are some examples.
- In order to provide the desired quality, firms may be interested in locating their production in the so called specialized districts. These districts are geographic areas where a number of firms belonging to the same industry settle down in order to experience spillover effects and logistic advantages.

## 2.6 Offshoring and the other internationalization strategies

As before mentioned, the process of internationalization offers different tools and alternatives to the reorganization of corporations' structures and strategies.

In such a context, firms employ different modes of entry each aiming at some specific purposes.

In fact, internationalization strategies are often time based on International Trades, Franchising/Licensing, Joint Ventures, Foreign Direct Investments, Outsourcing and Offshoring.

*International trade*. It regards the exchange of capital, goods and services across national borders. This strategy aims especially at finding new foreign demand for firms' output. The main driver of such a strategy is the level of transportation costs. In fact, if trade costs are low, firms that want to go international undertake export activities. Last but not least, corporations may decide whether to create its own foreign sales force or to rely on other entities for selling their product, according to the level of control they want to keep and to the investments they are able to afford.

*Franchising*. This strategy refers to selling the right of using firm's successful business model, reputation and image. On the one hand, for the franchisor, this process represents a different option to creating chain stores to distribute products. In fact, one of the main advantages carried by this choice is avoiding the high investments and liability required by a chain. On the other hand, the franchisor's success depends on the affirmation of the franchisees. In fact, the franchisee is commonly believed to experience a greater incentive than a direct employee. This peculiarity is due to the fact that he or she has a direct stake in the business. In terms of distribution, the franchisor may be considered a supplier who gives franchisee the right to employ his trademark and to distribute his goods. In return, the operator compensates this right paying the supplier a fee.

*Licensing*. The term License regards the permission granted by a party, the "licensor", to another party, the "licensee", to use some certified materials. Of course, the aim of such a contract is for the licensee to carry business activities adopting an already existing brand, know-how and image and for the licensor to profit without incurring in high investments. In fact, in order to exploit of some licensor's assets, the licensee has to pay a fee to the owner of the property licensed.

Objects of a license may be brands, symbols, machineries, know-how and products. This strategy is widely undertaken by many international firms. The reason of such a strategy must be found in the fact that the original owner of an asset is able to profit from its already existing property, without incurring in high risks. By the way, the dark side of this strategy is the fact that the licensor does not have control of the use of its licensed property. This sometimes leads to improper uses of the asset, something the negatively impact licensor's image.

*Joint Venture.* This economic strategy is based on a business agreement in which two or more sides agree to start and run, for a given period of time, a new enterprise and new assets by contributing equity. All the parts manage and control the new economic entity and share revenues, expenses and assets. The main advantages of this agreement are the sharing of risk, the lowering of costs and the conquest of a new foreign market. For this reasons, it is quite common to observe JV in which a foreign firm cooperates with a local one, trying to entering its market by exploiting the home corporation's awareness of its country.

*Foreign Direct Investment*. This tool refers to the direct investment into production or business that a company makes in a foreign country. For doing so, the company may purchase an already existing business in the target country or create its own subsidiary in that country.

Foreign direct investment must be considered as an active investment that requires control and implies high risk, differently from portfolio speculation that is a passive investment in the securities of another country such as stocks and bonds.

By the way, firms undertaking FDI may be oriented to conquest a new market, to improve their productivity or to have access to some particular resources. According to their aim, FDI can be grouped in horizontal-FDI, in the case of market seeking, and vertical-FDI, in the case of production improvement.

In addition, firms investing directly abroad may decide the form of their investment. It may be a Greenfield one, which regards the establishment of a completely new subsidiary in the foreign country, or a merger/acquisition of an already existing business.

*Outsourcing*. The economic concept of outsourcing regards the strategy through which a firm contract out a part of its activities to another company. Of course, the main aim of this strategy is to lower the cost structure or improving the quality of a product by relying on highly specialized corporations.

Of course, it is clear that the last three described strategies have some similarities that make them the more suitable for firms aiming at reorganizing efficiently their value chain. In fact, differently from the first three strategies that must be considered only oriented to the acquisition of new foreign markets and customers, the last and the process of Offshoring are oriented to the improvement of production efficiency and efficacy too.

In addition, some argues that Outsourcing and vertical-FDI are the main two strategies through which companies redesign their activities of the value chain.

## 2.7 Offshoring and Outsourcing

Offshoring and outsourcing main difference is the fact that, in the first case, the activities moved remain under firm's control, and, in the second case, those activities are contracted out to another economic entity.

Offshoring is a long-term relationship where local headquarters and foreign subsidiary undertake different activities of the value chain but remain part of a same economic entity. They are dependent on each other in seeking benefits and minimizing risks.

Nevertheless, despite such big difference, Offshoring may be considered a strategy similar to that of Outsourcing. To some extent, both are linked to the choice of firms to acquire assets from foreign providers (services or goods before purchased from a local provider or produced internally).

It is not a case that the most common services reallocated abroad are programming, designing, ITC systems, telephone/call centers, accounting, data management and R&D. In fact, just like outsourcing, offshoring is neither a rigid type of partnership or agreement nor a mere subcontracting.

However, companies that want to keep control of their business functions are able to afford a high investment and accept high risk, tend to prefer Offshoring. This is mainly due to the fact that, by undertaking outsourcing strategies, corporations contract out a part of their value chain activities thus not being able to improve or adapt directly the quality and the features of their products to their needs.

### 2.8 Offshoring and FDI

For what concerns the relation with Foreign Direct Investment, things are slightly different. In fact, knowing that FDI represents the investment made in foreign countries by companies aiming at controlling production, we can give Offshoring a similar definition.

In advanced countries, both FDI and Offshoring practices are justified by the real differences existing in the production costs. Both this strategies depend on the same drivers: size of the market, cost of production, labor flexibility, trade openness, deregulation and privatization of the market.

In addition, it is possible to compare the advantages of FDI defined by the OLI Model proposed by Dunning[13] with those of Offshoring.

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[13] Dunning, John H. (2000-4*). The eclectic paradigm as an envelope for economic and business theories of MNE activity*. Retrieved 2011-10-12.

This theory, known as Eclectic Theory, tries to explain which the pros of undertaking Foreign Direct Investments are. The advantages may be grouped in three categories: ownership advantages, location advantages and internalization advantages.

Of course, this model is based on some assumption:

- For experiencing ownership advantages, companies must have a higher ability in managing assets. This firm specific advantage is usually intangible and may be transferred within the company at low cost (e.g., technology, brand name, benefits of economies of scale). The advantage leads both to higher revenues and/or lower costs that compensate the costs of operating far from the home headquarter, in a foreign country.
- In order to benefit of location advantages, firms must be able to perfectly evaluate the environment, perceiving the economic, social, cultural and institutional drivers. This analysis is fundamental to determine the right location offering the most favorable conditions. This is really important, because FDI and Offshoring are tools through which corporations enter foreign regions once having estimated that country's specificities, according to the peculiar business.
- The international advantages refer to gaining by directly producing rather than contracting out production to a partner. By doing so, firms can exploit their core competences and, in addition, such kind of advantage allows companies to be aware of the foreign target market.

| Source Dunning | **Ownership adv.** | **International adv.** | **Location adv.** |
|---|---|---|---|
| **Outsourcing** | yes | | |
| **Exporting** | yes | yes | |
| **FDI** | yes | yes | yes |

Once a company perceive these aspects, it has to evaluates its objectives and specificities and determine if and where to locate its investment.

There are many variable to be taken into account.

The potential market and the market size are two of the investment location discriminating factors. Companies are in fact interested in seeking new markets with growth opportunities.

The remaining variables are: the degree of commercial openness, the presence of skilled workers and the cost of production. In addition, also the abundance of resources and the political, social and cultural elements take part in the location choice.

As evident, FDIs seem strictly correlated to the Offshoring phenomenon by sharing advantages, objectives and discriminating factors.

Despite some differences, the relation between Offshoring and FDI does not change if we analyze a horizontal or a vertical foreign direct investment.

On the one hand, a v-FDI aims at reallocating part of the value chain activities for reducing cost. Actually, different function of the same production cycle take place in different countries.

On the other hand, an h-FDI is not aiming at reallocating part of the value chain. It aims at duplicating all the activities done in the home country, creating a new complete subsidiary able to manage all the processes. In such a case the main purpose of the firm won't be production rationalization but market seeking.

## 2.9 Offshoring and Joint Ventures

As a vertical FDI, a Joint Venture is one of tools that firms employ when they are interested in undertaking offshoring strategies.

However, differently from v-FDI that imply a total control of the subsidiary, JVs create new economic entities between two or more parties.

There are many reasons why lots of companies employ this internationalization tool:

- When entering a new country, signing an agreement with a local partner gives the possibility to rapidly integrate itself in the new environment;
- Despite the presence of more than one parties that imply less control, risks are shared;
- Countries' regulations may require a local partner if a foreign firm wants to enter their nation.

Despite these advantages, JVs tend to last for a short period of time. This is due to the fact that the parties having signed the agreement have a propensity to preserve their own identity and not incurring in know-how losses.

However, there are some successful and long-lasting JVs like the two I will discuss in the forth chapter[14].

## 2.10 Theories supporting Offshoring practices

With reference to classical economic theories, there are three factors of production: land, labor, and capital. According to such an assumption, offshoring exploits the mobility of two of these factors. In fact, the impact of offshoring processes on different economies depends on how easily capital and labor can be reorganized (of course, land is the factor perceived as the non transferable one).

The impact of capital mobility on offshoring has been widely analyzed through different lenses. On the microeconomic side, a firm must be able to invest enough capital to meet the expense of the initial costs of offshoring. On the macroeconomic side, the more barriers among countries are taken down, the more offshoring may be successful. As a consequence, those who favor offshoring wish for capital mobility, and those who oppose to this phenomenon support greater regulation.

Labor mobility represents a major issue too. In fact, since computers and Internet made work portable, the forces of open markets increased job mobility.

[14] Chapter 4: case analysis Sprech Ltd.

By the way, offshore is a double faced coin. On the one side, offshoring seems to hurt domestic workers by moving abroad their jobs, forcing them to accept lower wages or to retraining themselves in a new industry. On the other side, offshoring benefits foreign workers through new job opportunities, higher wages and better lifestyles.

Such a debate is not so easy to be solved. Those supporting Offshoring argue that moving jobs abroad helps domestic firms in experiencing greater profits. This profit is somehow spilled in the home country differently repaying the society for the jobs lost. Those against this phenomenon affirm that the benefits produced abroad do not completely indemnify fired workers.

By the way, it is necessary to analyze offshoring through the lenses of the economic literature. In fact, it is possible to find some justifications, some assumptions and some directives in many economic theories. Among these studies, I will mainly pay attention to David Ricardo’s Competitive advantage, Schumpeterian Creative Destruction and Geographic Theories applied to economy.

### 2.11 Ricardian Comparative Advantage

Despite the concept of comparative advantage was firstly introduced by Adam Smith's *The Wealth of Nations*[15] ("*If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage*")

[15] Adam Smith, *The Wealth of Nations*, 1776 London edition.

David Ricardo investigated and formulated in detail this law in his book *On the Principles of Political Economy and Taxation*.[16]

He starts his analysis to justify and identify the benefits of international trade between two countries: England and Portugal.

He assumes that both the countries manufacture to different goods: cloths and wine. This model analyses the marginal cost of producing the before mentioned good in Portugal and England and tries to determine how these countries may benefit from international trades exploiting their own characteristics.

The entire model is based on some assumptions:

- There is a perfect competition;
- The cost of production is expressed in terms of Labor;
- Labor is the only factor of production;
- Labor is homogenous in terms of efficiency;
- Labor is perfectly mobile within a country, and immobile between countries;
- There are no international trade restrictions;
- Production is subject to constant returns to scale;
- There is no technological change;
- Full employment exists in both the countries;

[16] D. Ricardo, *On the Principles of Political Economy and Taxation*, 1817.

- There is no transportation cost.

Ricardo argues that Portugal industries require less hours for producing both Wine and Cloths. Despite Portugal may not need to trade its goods, since it produces both the commodities at a lower cost, Ricardo tries to prove that the country may gain from specializing in the commodity in which it has a bigger comparative advantage and from exporting it. A similar trend may be observable in England. There the economic system may benefit from specialize itself in the sector where it has the lower comparative disadvantage, cloths.

Thanks to such a strategy, England will have access to a cheaper wine by importing it, and Portugal will gain by exporting its product.

The conclusion drawn is that each country is able to profit by specializing in the good where it has comparative advantage, in order to export it at a cheaper price.

As stated by Ricardo, "*Comparative advantage refers to the ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. Even if one country is more efficient in the production of all goods (absolute advantage in all goods) than the other, both countries will still gain by trading with each other, as long as they have different relative efficiencies*"[17].

This quote, which summarize perfectly Ricardian theories, states that different countries have different production functions in terms of ability to produce at a lower marginal and opportunities costs and justify international trade.

*But, Why Ricardian Theories implicitly support offshoring?*

[17] David Ricardo, *On the Principles of Political Economy and Taxation*, 1817.

Of course, despite Ricardian theories mainly deal with international trade rather than offshoring, it is quite clear that countries' differences support such a process too.

In fact, Ricardo's theories on countries differences and their comparative advantage implicitly allow some justifications to the offshoring phenomenon. This is due to the fact that most of the before mentioned assumptions of Ricardian Model do not hold in the real world.

Let's analyze all Ricardian assumptions through the lens of offshoring.

*Labor is the only factor of production.* Actually, production is the results of two variables: labor, capital. Capital can be considered as a completely transferable input. This peculiarity allows firms to choose whether to locate their capitals in order to maximize their revenue and/or to minimize their costs. For pursuing such a strategy, one of the alternatives is offshoring.

*Labor is homogenous.* Labor is simply not identical in efficiency worldwide. Due to this, different regions offer a different level of labor quality, thus inducing corporations to settle their activities in the most favorable countries, thus supporting offshoring.

*Labor is perfectly mobile within a country, and immobile between countries.* The process of Globalization is rapidly shortening the distances among people and places. Differently from the past, this trend is making labor a more mobile input which is now allowed to move across countries and to increase the share of knowledge. This mobility boost offshoring: employees of the home country are now able to move to the host country in order to implement and train the new foreign subsidiary/workers.

*There are no international trade restrictions.* This assumption support Offshoring per se. In fact, it can be easily proven that the decreasing level of international barriers is allowing firms to choose whether to locate their activities.

*Production is subject to constant returns to scale.* Actually, production is not subject to constant returns to scale. Returns to scale may be increased by increasing the specialization in a certain function/sector. Knowing that the economies of scale are influenced by technological knowledge, abundance and cost of resources and organizational strengths, it is quite clear that the Offshoring process offers alternatives to firms looking for increasing returns to scale.

*There is no technological change.* The number of Technological breakthroughs is increasing enormously thus changing the rules of the game continuously. In order to remain competitive, a corporation must invest in its R&D activities massively. Due to this, it is fundamental to reduce costs, save money and invest smartly. One of the main tools employed to reduce costs is Offshoring.

*Full employment exists in both the countries.* Unfortunately, this assumption does not hold in the real world. However, things change when we perceive the world not as single market, but a unique global one. Moving production abroad allows firms to increase their efficiency and their profit. Thanks to such a profit, corporations are able to invest thus creating new job opportunities worldwide.

*There is no transportation cost.* Actually, these costs exist. In fact, when these costs are high, firms are induced to locate their production activities in the chosen foreign country. This strategy allows corporations to serve their target market from inside without incurring in the high transportation costs, and to exploit foreign comparative advantages. As stated by Krugman, all the changes in the transportation costs are variables impacting the global set of trades.

On the one side, if trade costs decrease, something often times related to new technologic discoveries, international exchanges are supposed to increase. On the other side, if trade costs increase or if production costs decrease, trades are expected to decline and transportation costs become a major barrier. Such a case gives some support to the process of Offshoring and comparative advantages in manufacturing may be experienced.

Having analyzed and adapted Ricardo's assumption to the real world makes us able to drawn a new conclusion. If Ricardo ended in justifying international trade as a benefiting tool for countries, I conclude that if we sum these new assumptions to countries' specificities, cost structures and peculiar infrastructures we find support to the process of Offshoring.

### 2.12 Schumpeterian Creative Destruction

Despite firstly introduced by Karl Marx[18], the concept of Creative Description is mostly related to the works Joseph Schumpeter[19] undertook in the 1950s. He adapted Marx's notion and made it famous as a theory dealing with economic innovation and business cycle.

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[18] Karl Heinrich Marx (5 May 1818 – 14 March 1883) was a German philosopher, economist, sociologist, historian, journalist, and revolutionary socialist.

[19] Joseph Alois Schumpeter (8 February 1883 – 8 January 1950) was an Austrian American economist and political scientist.

The expression comes from Marxist economic theory. In such a context, it refers to accumulation and dissipation of wealth due to capitalism, concepts that derived from *The Communist Manifesto*, and the analyzed in depth in *Grundrisse* and Das *Kapital*.

Accordingly to Marx's perception, the process of Creative Destruction illustrates the cycle through which capitalism creates a very high value out of the annihilation of some existing economic system. In addition, Marxist Creative Destruction do not only implies that capitalistic economies accumulate wealth thanks to prior order reorganization. It does imply that the systems continuously destroy existing wealth to prepare the ground for a completely new one, even by undertaking wars and economic crises.

Differently from Marx, in *Capitalism, Socialism and Democracy*, Joseph Schumpeter redesigned and expanded this concept. Schumpeterian Creative Destruction became famous within the neoliberal and free-market economies. In such a context, this notion explains the disruptive process implied in innovation patterns.

*"Capitalism [...] is by nature a form or method of economic change and* only *never is but never can be stationary. [...] The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates. [...] The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process of industrial mutation [...] that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative*

*Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in"*[20].

According to Schumpeterian perception of capitalism, the destroying forces that boost economic growth are represented by the innovative entries of new entrepreneurs. In fact, he argues that even if these new entries disrupt the value of already existing companies that experienced some degree of monopoly power coming from prior technological, strategic, organizational, regulatory and/or economic advantages.

Producing such effort makes capitalism broke not only the barriers that obstacle its progress, but raise also structures that prevent its collapse.

This continuous pattern must not be considered merely a matter of eliminating institutional deadwood, but of removing

*"In breaking down the pre-capitalist framework of society, capitalism thus broke not only barriers that impeded its progress but also flying buttresses that prevented its collapse. That process, impressive in its relentless necessity, was not merely a matter of removing institutional deadwood, but of removing partners of the capitalist stratum, symbiosis with whom was an essential element of the capitalist schema. [...] The capitalist process in much the same way in which it destroyed the institutional framework of feudal society also undermines its own."*[21]

By the way, how can I reinterpret such a complex concept to find some justification to the Offshoring phenomenon?

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[20] J. Schumpeter, *Capitalism, Socialism and Democracy*, 1942.
[21] J. Schumpeter, *Capitalism, Socialism and Democracy*, 1942.

*But, Why Schumpeter's Theories implicitly support Offshoring?*

By comparing the process through which a corporation moves its production abroad with the innovative entries of entrepreneurs described by Schumpeter, it is possible to find some similarities.

In both the cases, a new way of doing business, being it new machinery introduced in the foreign country or a technological breakthrough, destabilize the old market.

In fact, knowing that corporations move their production abroad mainly for reducing costs, it is interesting to understand what happens to the "exploited foreign market".

On the one hand, local firms are put under the pressure exercised by the entrants that introduce new standards and may absorb part of their market share. On the other side, by introducing know-how in a foreign country, it is possible to observe spillover effects. In such a case, local firms are sometimes able to adapt the new introduced knowledge which may improve their productivity.

This double faced process seems to give some support to the Offshoring process. In fact, the first effect before mentioned justify firms' strategy to move their production abroad; the second effect, makes local market interested in attracting foreign corporations and knowledge.

In addition, it is interesting to analyze Schumpeterian perception of capitalism since it somehow justifies the offshoring phenomenon too.

According to Schumpeter, capitalism must be considered as a force that destroys all the barriers that obstacle its progress. Somehow, it is possible to link this concept to the one of Globalization. In a certain sense, Globalization is integrating all the single markets turning them into a unique global one. For doing so, this phenomenon is destroying all the barriers that keep the distances among people to much long.

Since Globalization may be considered as partially derived from capitalistic impulses and since Offshoring is one of the main tools undertaken by Global corporations, it is possible to indentify a parallelism between the concepts described by Schumpeter and the international strategies employed by firms.

## 2.13 Geographic theories applied to economy

Dealing with Offshoring requires an analysis on why corporation should care about space. Trying to summarize an answer to this question, there are three main reasons that make firms care about geography:

- Knowledge spillovers;
- Social capital;
- System of innovation;

*Knowledge spillovers*. Quoting Krugman, "*knowledge flows are invisible; the leave no paper trail by which they may be measured and tracked, and there is nothing to prevent theorists from assuming about them that she likes*".[22] Starting from this quote, it is possible to define what Knowledge spillover is. This concept refers to the

[22] Krugman, *Geography and Trade,* Gaston Eyskens Lecture Series, August 1991.

knowledge produced firms (and sometimes by universities and other institutions) that generate positive externalities in the geographic area around them. It regards the positive effects of scientific and technologic breakthrough on corporations' productivity that neither made the discovery themselves, nor licensed their use from the holder of the intellectual property rights.

In addition, thanks to Feldman studies, it has been possible to understand that the impact of such a process is directly dependent to the distance between the source of knowledge and the place of the "receiving" firm. Somehow, knowledge seems to be bounded in space, implying that corporations located close to the sources experience a higher advantage than those located farer.

This peculiarity is supported by the fact that knowledge has two attributes that make geographic proximity fundamental. Knowledge is tacit and complex. Both these characteristics make information difficult to be codified and, consequently, it is much more easily transferable through face-to-face communication. Of course, geographic proximity is important for such a kind of communication.

*Social Capital*. Accordingly to Woolkock and Narayan definition, "*social capital is the norms and the networks that enable people work collectively*".[23] This key point is relevant for many reasons.

1. Social capital connects people across different organizations and mixes their knowledge components.
2. Enforce corporations' ability to identify and interact with local external knowledge.

[23] Michael Woolcock and Deepa Narayan, 2000, *Development Theory, Research, and Policy*.

3. Enhance firm's ability to understand the demand, better perceiving users' needs.

Thanks to such a research, it has been proved that these characteristics lower barriers to entry, ease access to funding and increase chances of surviving for new and young firms.

*Systems of innovation*. Innovation, and more in general development, must be considered as an interactive and socially embedded process. These attributes suggest that firms do not innovate and evolve in isolation, but collectively. This process of development passes through different activities that are not all included into firms' boundaries and regards different actors (firms, banks, universities, institutions, governments etc). To sum up, it is possible to define the concept of System of innovation as the set of interconnections among different actors that undertake activities aiming at implementing new production processes or produce and commercialize new products.

All these assumptions give some support and a certain direction to the process of Offshoring. In fact, when deciding where to move its production, a firm must choose a given region according not only to its own sector and specificities, but also to the target country's characteristics.

Many examples perfectly embody this strategy. India and the Silicon Valley for the IT sector, China for manufacturing and Ireland for many different industries are just some instances. The agglomeration of similar corporation within a same territory often times surpass the contrasts arising among competitors settled nearby.

## III. Italian economic system

### 3.1 Introduction

Despite its long and complex history, Italian economic system as we know it may be considered a relatively new one, due to its only 150 years of history.

As stated by Franco Amatori, Matteo Bugamelli and Andrea Colli in their *Italy and the World Economy*[24], 1861-2011, produced for Banca d'Italia, "*The economic performance of a country depends, among other things, on the characteristics of and the strategies adopted by its firms. It is firms and their entrepreneurs that, given the macroeconomic environment, the institutions and the policies, choose how to face competitors and hook up with demand cycles, whether to adopt new technologies and innovate products and processes*".

Aware of such an assumption, it is quite clear that in order to evaluate Italian economic system performance it is necessary to estimate its strengths, weaknesses and heritage.

In addition, when analyzing Italian firms, being able to understand their relation with globalization and innovation is fundamental. For this reason, some factors become crucial: the shape of the competitive environment, country's competitive advantages, the level and peculiarities of the market and the demand and the level of productivity.

The three economists before mentioned identify three major technological revolutions that impacted Italian economic system since it got united:

[24] Amatori F. and Bugamelli M., 2011, *Italy and the World economy*, Bank of Italy release.

- The breakthroughs related to the steam engine occurred in the end of the 18th century. This revolution busted the productivity of the entire system, especially whit respect to the textile, the metallurgy and the mining industries. The new technologies introduced changed the transport and the communication systems thus resulting in the first wave of Globalization.

- The second revolution is linked to the introduction of electricity, occurred in the first quarter of the 19th century. This innovation is strictly related to the development of mass-production techniques (just like the assembly line). In such a context, steel, chemicals, pharmaceuticals, refining, food processing industries experienced a big boom.

- Last but not least, the ultimate revolution occurred in the last three decades. It refers to the discoveries in physics, information and communication technologies. These new fields of action led to the creation and the evolution of products like semiconductors, computer and software and biotechnologies adapted in many technology- and science-intensive industries.

Supported by these technological discoveries that reduced the “size of the world”, Italian economic system has turned into a more global and opens one aiming at affirming itself world widely.

It seems interesting to notice what data suggests clearly: since 1890s Italian firms have been able, despite some delay with respect to the main advanced economies but before many others, to handle the first two technological revolutions, to benefit from the first globalization wave and, in the period between the two world wars, to switch from an autarchic and protective perspective to a more open and global one.

This process led to a “golden age” period, in which the Italian economic system experienced a high growth rates combine with a strong development of the productive system, especially thanks to big privately-owned and State-owned firms. In fact, it is a matter of fact that the industrial sector performed relatively well from the end of the 19th century until 1970.

By the way, such a process is not so evident for what concerns the last technological revolution.

In fact, though the Italian economic system was meant in the 1960s to be able to benefit the opportunities offered by ICT, this did not happen; As stated by Bugamelli and Brandolini (2009)[25], signs of the diffusion of the ICT sector in Italy show a relevant delay in the adoption of the new technologies and a significant distance from the technological leaders.

As a consequence, Italian firms seem to have suffered comparatively more, than the other European rivals, the augmented competition from low-cost goods and services produced within emerging and developing countries.

Despite many causes concur to create such difficulties; one may be considered the most relevant: it has been proved that the size of a firm is positively correlated with the level of innovation, internationalization and competitiveness.

In fact, in addition to political, micro and macroeconomic, local and foreign turbulences, such peculiarity of the Italian economic system seems to be in contrast with the before mentioned assumption.

[25] Bugamelli and Brandolini, *Paper produced for the Bank of Italy*.

By the way, this assumption seems to be supported by the fact that big companies have an easier access to financial resources, skilled workers and new efficient management practices.

### 3.2 Italy between its unification and the World War I

At the beginning of its history as a united state, Italy was in the middle of the international trade yet. In fact, all the small sub-states which compose the future Italy were involved in the international flows of goods and investments.

Despite southern wines, citrus, olive oil, minerals and northern foodstuff and wool were traded mostly with English and French merchants, interstates flows were very scarce. In fact, Italian regions were disconnected mostly due to the poor infrastructural internal networks.

In addition, Italy experienced big competitive advantages basically in the agricultural sector. Peasantry and farming pervaded all the regions, though with lots of specificities in terms of productivity, resource endowment, technological dynamism and innovation. For instance, we can consider the most "industrial" product of that time raw silk, something that was coming from the countryside, produced by farmers.

On one hand, the economic heritage built before the unification – of which artisanal skills, home production and commercial traditions were the key elements – was a rich soil for the new manufacturing practices, also thanks to the existence of a persistent system and network of technical schools and professional associations.

On the other hand, it was almost not viable to separate – as in Britain and Germany – the "industrial" activities from agriculture. In fact, in this starting step of the industrialization process, the main manufacturing sectors had strong and strict linkages with agriculture. This was the case of the textiles, metallurgy, food processing and non-organic chemical fertilizers sectors. The countryside was, in fact, both the provider of raw materials and labor force and the main marketplace for small mills and craft shops' owners.

All these peculiarities of the Italian Peninsula made the country a target market for foreign entrepreneurs.

Some examples have been identified by Hertner in its book *Free-standing companies in Italy*[26]. In cotton, not only after the unification, Swiss entrepreneurs were settling their factories both in the North and in the South, profiting from the cheap and rigorous field of workers. In the mechanic and metallurgy sectors, German, French and British investments may be found in main towns, where public procurement offered huge opportunities. Capitals, expertise, technology and know-how were coming to Italy also thanks to the presence of auto-financed corporations, mainly Belgian and French. These companies invested capitals, collected in their domestic market, in mining, utilities, gas networks and local transports all over the Peninsula.

Despite such positive elements, one main disadvantage was still thwarting Italian economy development: the leading and omnipresent primary sector, based on self-production and low income levels, made the local market demand limited and slow-growing, not resulting in a big industrial development.

[26] P. Hertner, 1998, *Free-standing companies in Italy*.

### 3.3 Italy between the World War II and the Golden Age (1970)

In contrast with what a war represents, such a catastrophic incident that stopped the first wave of globalization may be considered the external stimulus that boosted Italian industrial modernization.

In fact, the world war offered new occasions for growth. Three cases illustrate perfectly this assumption:

- War allowed hydroelectric sector's companies to complete their capital intensive investments very rapidly and at a low cost, due to the very high inflation.
- In the chemical industry, the conflict gave Montecatini, a corporation operating in the fertilizers sector, the resources for an ambitious expansion strategy of downward integration.
- Revenues and profits obtained from the WWI by Fiat made the company able to open a new automobile plan the Lingotto. This plant, European biggest one was endowed with the most advanced techniques available at that time.

As before mentioned, the occurring of the war corresponded to the end of the first wave of globalization. This coincidence, despite worsened by the Great Depression, was followed by autarchic and protectionist policies that, somehow, had some positive effect too.

On the one side, autarchy allowed home firms to consolidate their internal market and their customer base.

On the other side, though, it turned countries in as a sort of iron prison. Italian market dimension was too much small, thus not allowing great developments. Such a context prevents Italian firms from benefiting from international relations, at that time limited by the worldwide economic depression.

This peculiarity must be considered as the fundaments of nowadays Italian economic system. In fact, such a context was not the proper one for allowing the establishment and the growth of big companies, thus inducing the whole system to built its strengths on small-medium-enterprises (SME), mainly focused on the domestic market.

Things changed after the World War II. In fact in the late 50s and in the 60s the second industrial revolution was actually taking place. Most of the employment was concentrated in capital intensive industries such as oil refining, automotives, chemicals, rubber, heavy mechanics, cement, steel and shipbuilding.

In the 70s, the results of Italian economy development were clearly visible. The country was under a massive modernization, consumptions were increasing drastically, and the quality of life was generally improving. Just for taking a look to some macroeconomic variables, GDP per capita increased by 20% from 1975 to 1978.

### 3.4 From the Golden age to nowadays

After the economic boom of the 60s and the 70s, the economic development reduced its increasing starting from the end of the 80s. Such a decrease must be considered linked to the raise of the third industrial revolution.

As argued by Amatori e Colli, the roots of such revolution are to be found in the new discoveries in the semiconductor industry. The coming out of this sector led to the massive production of personal computers, the birth of new and new software and the invention of new materials. All this evolution was just a starting point: the origin of the aerospace sector, the general technological progress of pharmaceuticals, biotechnologies and nuclear energy are just some examples.

The industrial uprising was originally built thanks to physic studies undertaken by scientists promoted/financed both by public and private entities.

The huge amount of money needed to support this revolution created a sort o barrier to entry, surrounding these new sectors. For these reason, the main private players taking part in the game were especially big and powerful companies that able to effort huge investments especially in the Research & Development function.

Given this for assumed, it is quite clear why Italian economy was not able to continue its boom and became a world leader in the ITC (which is completely based on the innovations occurred in the semiconductor and software industries: the whole system was based on Small-Medium-Enterprises not able to afford such massive investments.

### 3.5 Italian companies' characteristics

The Italian Golden Age tuned the economic system of the Peninsula into a highly industrialized, numbered among the top countries in the world.

By the way, Italian system has some peculiarities that collide with the characteristics of the other advanced economy.

As stated by Manfra Pellegrino[27] on the *Journal of Entrepreneurial Finance*, Italy has "*a market structure that is highly dualistic - a very active and vigorous private sector accounting for a preponderance of small and medium-sized firms and a few extremely large public enterprises*".

To support such an assumption, it is possible to analyze the backbone of Italian economy. In fact, the whole system rely heavily on SMEs, that account up to 76% of the total labor force and that may be considered one of the main source of new job opportunities, especially in the south of the Peninsula.

For this reason, analyzing SMEs in depth became fundamental.

SMEs are characterized by some similarities. They:

- Are mainly familiar companies, in which most of the strategies and the decisions are taken by one person, the owner. Despite this peculiarity partially eliminate agency problems, the familiar approach of Italian SMEs implies a sometime lower degree of management specialization.

[27] Manfra Pellegrino, *Entrepreneurship, Firm Size and the Structure of the Italian Economy*, December 2002.

- Have strong ties with the region in which they operate, thus being perceived as integrating part of the socio-cultural tissue.

- Tend to be concentrated in districts. These areas are conglomerates of companies, oftentimes of the same sector, that exploit knowledge spillovers and exchange and high load of information.

- Are export oriented. Istat (Italian institute of statistics) data show that ca. the 65% of SMEs' production is sold abroad.

- Tend to invest relatively more than big enterprises. For instance, studies carried by Istat show that SMEs invest ca. 1% more than big firms in marketing innovation.

These characteristics make SMEs one of the main players in the Peninsula's economic system, and their surviving is strictly linked to the development of Italian economy.

It is quite clear that the increasing global competitiveness, the crisis of the internal market (that represents Italian SMEs' customer base) and the need of increasing production efficiency and efficacy make them interested in internationalizing their activities.

SMEs have two main alternatives:

1. Find a new customer base abroad, by exporting or establishing new subsidiary in a foreign country;

2. Keep serving the Italian market, thus needing to reduce its costs for compensating the domestic demand crisis.

In such a context, offshoring assumes a big relevance and try to give answers to entrepreneurial needs. In fact, offshoring both allows entrepreneurs to move activities abroad for reducing costs and/or permits them to transfer some functions in order to get new foreign customers to sustain their business.

### 3.6 Italy's comparative advantage

The whole Italian economic heritage since the unification occurred in 1861 stresses the existence of an interdependence between international trade and economic development.

In fact, Italian economic growth is strictly related massive increase in its integration with international commodity markets. This relation is so strong that data state that foreign trade tends to grow faster than the overall economy.

Furthermore, it is interesting to observe the evolution of Italian comparative advantage which has changed dramatically since the country's unification.

Before understanding in which sector Italy has a comparative advantage, it is necessary to notice that Italian firms had not been always interested in exporting or, generally, to sell abroad.

Their main objective was to cover the domestic demand thus not caring about foreign market.

By the way, after the hostility to international trade pick reached during the Fascist period, things slowly changed. In fact, as argued by Ciocca in its *Ricchi per sempre,* after the WWII "*Exports were regarded as an essential source of aggregate demand and as a strong stimulus to increase the competitiveness of Italian industry*"[28].

Such a process, clearly boosted by technology discoveries and globalization first appearance, leads us to analyze which are the industries that represent particularly strong to conquest foreign market.

In order to answer this question, it is possible to take a look on OECD statistics. Data openly shows that in the last two decades Italian experienced a big comparative advantage in machinery and equipment production, engines/motors for vehicle and textile manufacturing.

In fact, despite lots of analysts and economists of the past identified Italian comparative advantage in the primary sector, where agriculture and breeding play a prominent role, things have changed dramatically.

This comparative advantage, that resulted fundamental for the economic boom in the post WWII, slowly become limiting because of the uprising technological revolution. The high profits made after the second world conflict slowly rapidly away due to the entrance of developing countries in the global market.

[28] P. Ciocca, *Ricchi per sempre? Una storia economica d'Italia*, Bollati Boringhieri, 2007.

In fact, differently from what happened before, when the only countries taking part in international trade were the developed ones, the appearance of developing nations slowly eroded this comparative advantage. Those developing countries characterized by even lower cost of production in the primary sector were in fact overtaking Italian leadership.

Despite such a context motivated the evolution of Italian industries, some strategies remains dubious.

Already in the middle of the 19th century, the politician and philosopher Richard Cobden notoriously argued that Italy's ultimate specialization was to grow oranges and produce silk, thus stressing Peninsula's not structured industries at that time; by the way, as stated by Gianni Toniolo in its book *Italian Economy Since Unification*,, "*in its 150 years of history as a unified country, Italy has proved Cobden wrong. Although Cobden was correct at the time, he did not expect the situation to change in the future. Since the 1930s, Italy has exported more manufactures than primary products and currently it is the third largest exporter of manufactures in the European Union and sixth in the world. Exports of industrial products have arguably been the most dynamic sector of its ailing economy in the last few decades*[29]*".*

This quote perfectly reflects the evolution occurred to the Italian economic system.

By the way, having identified the main sectors in which Italy has a comparative advantage, it is interesting to understand if it impact or not companies' strategy related to the offshoring phenomenon.

[29] G. Toniolo, *Italian economy since unification*, Oxford Handbook, 2013.

### 3.7 Offshoring trends in the Italian economic system

If we consider offshoring as the process through which companies relocate abroad part or all of their functions for remaining competitive, it is possible to observe that the first cases of production transfer already occurred sometimes in the past: about three decades ago FIAT established some factories in Poland, after having produced vehicles in the ex URSS for years.

In addition, a sort of domestic offshoring was already implemented during the 50s when public and private companies were establishing plants in the south of Italy, moving them from the North.

By the way, despite the before mentioned case refers to a big company, small and medium enterprises play a prominent role too.

The Italian system, mainly built on SMEs, has always been linked to niche markets in which those small firms found their customer base, and the changes occurred to the economic environment made them interested in adopting location strategies.

In fact, the evolution of the economic system changed the rules of the game. While in the past companies used to locate their production close to the natural resources they needed, nowadays strategies are different. Just think of the high revenues of Italian gold-working industry (about half of world revenues) which is settled in the Peninsula despite it does not provide any grams of gold.

Nowadays location strategies are much more related to favorable fiscal policies, low labor cost and logistic/transport efficiency. For this reason, it is proper to argue that most of the employed offshoring processes are low cost oriented.

The offshoring age, opened by big companies such as FIAT about thirty years ago, is now spreading all over the Peninsula, where small and medium enterprises are getting more and more interested in moving their production abroad.

For instance, this is the case of Venetian SMEs that moved their production to Slovenia about fifteen years ago, mainly due to the favorable Slovene fiscal policy that was ca. 22% cheaper than the Italian one.

Just as Venetian industries, Tuscan leather sector mostly moved to Romania, Morocco and Tunisia for fiscal and labor reasons. In fact, in addition to the more favorable fiscal policy faced abroad, those Italian companies moved their functions to East-European countries due to their low labor cost.

By the way, it is interesting to notice that most of the elite brands (Tod's, Hogan etc) decided to remain in Italy thus creating a strong connection between their product and the concept of Made in Italy. In particular the design, research and development functions tend to be kept within Italian borders to identify a certain concept of Fashion and Creativity linked to Peninsula's heritage.

Aware of such a developing phenomenon, Italian institutions started dealing with offshoring during the early 90s. Aiming at promoting and assisting this process of internationalization, an institution called *Società Italiana per le imprese Miste* *all'Estero* (SIMEST) was funded. In addition, two laws (56/05 and 80/05) were promulgated in order to support offshoring in non EU countries.

Furthermore, this new set of laws is oriented to help and support those firms that offshore without impacting their domestic activities. Somehow, institutions aim at making Italian companies more competitive in the international market, but support this phenomenon only if local firms keep in caring about Peninsula's economy, employment and technological development. Incentives are given to those companies both investing at home and in the host target country.

However, Italian institutions' approach seems to be contradictory as the whole process of offshoring. On the one hand, this approach is positive when firms are interested in moving part of their value chain without impacting domestic employment and knowledge. On the other hand, this approach seems negative when transferred activities are meant to be substituted and not assisted by the new plant established abroad. In fact, in such a case, operations are moved together with know-how and capitals, and domestic employment decrease.

Somehow, when this process turns into a negative one, it reveals itself as a vicious circle:

1. Local companies move abroad their production.

2. Fires their local employees.

3. Fired workers lose their wages.

4. Domestic consumption collapses.

5. Local companies lose their home customer base, thus losing part of their competitiveness.

However, the period in which small firms were strictly tied to their territory is finishing. Capitalism has evolved thanks to the Globalization. It is turning from export-oriented to offshored.

As stated in an article of a daily newspaper, *Il Fatto Quotidiano*, despite the crisis seems to have slowed companies use of offshoring, data gathered by the *Confederazione Generale Italiana dell'Artigianato (CGIA)* still suggest that firms keep on employing such internationalization strategy. In fact, despite the number of companies undertaking offshoring activities increased by 65% from 2000 to 2011 (from 16.477 to 27.191), starting from 2010 it grew slowly by only 1, 2% per year[30].

As stated by Giuseppe Bortolussi, CGIA's secretary, despite Offshoring must be considered a developing phenomenon all over the world, Italian firms seem to be much more interested in moving operations abroad than other similar countries. Bortolussi argues that this is due to the fact that being an entrepreneur in Italy is not so easy. High Taxes, slow bureaucracy, high labor cost, strong labor unions, low infrastructure quality, high commodities' price and difficult access to credit are just some of the barriers.

It is interesting to notice that, according to CGIA's data, there are three main groups of countries where Italian firms establish their plants: Advanced countries

[30] Source: Il Fatto Quotidiano

(European and North American), East-European developing market and Extra-UE developing countries (China and South American countries

Trying to understand why companies prefer one group to the others is vital for understanding the drivers of offshoring.

As stated by Bortolussi, France is the first country in terms of Italian firms settled abroad (9,4% of all the companies employing offshoring) because payment are never delayed and always certain (French laws work, and punish those who does not pay). USA and Germany, destinations that account respectively 8,9% and 7,7% of all the Italian companies offshoring, are characterized by similar conditions.

Differently from these advanced countries, Romania, Poland, Hungary and Czech Republic are chosen due to their low taxes and costs (production and labor). All these nations together account up to 12,6% of Italian firms abroad.

For what concerns non-EU countries, (mainly China, Brazil and Argentina) drivers of offshoring regard both low cost seeking and market seeking.

Keeping taking a look on CGIA's data helps to estimate which are the main sectors of the Italian economy that undertake offshoring activities. It is easy to notice that wholesale trading businesses are the most offshored ones (48,3%). This sector embeds food dealers, machinery and equipment reseller etc. It is interesting to understand that this sector is the mostly impacted by offshoring because it is strictly related to the evolution of exporting activities. By establishing sales and services functions abroad, exports are converted in offshoring activities.

Right after wholesale trade in terms of percentage, Manufacturing is heavily offshored (28,6%). Among all the manufacturing business, it is interesting to observe that machinery, equipment and metallurgy sector are the most offshored, in contrast to furniture, pharmaceutical, mining and oil refining sectors. The reason of such a difference is related to the peculiar input of each sector: metallurgy, equipment and machinery manufacturing may be settled anywhere depending mainly on costs; furniture, mining and oil refining industries are much more related to the input materials, something that require entrepreneurs to maintain their activities close to them.

### 3.8 Offshoring VS Made In Italy

Simplifying the aims of this phenomenon, it is possible to argue that Offshoring is built on the assumption that moving production activities to foreign countries provides some advantages in terms of cost efficiency and/or new market opportunities.

In addition, in order to support such an assumption, companies estimate the advantages experienced by moving activities abroad much more relevant than the disadvantages faced at home.

However, this presupposition raises a question mark: How much does customers' perception of a product impact firms' decision to offshore?

Actually, firms must care about both their value chain activities and their customers' expectations.

This statement is the base of Made In Italy success.

The expression Made In Italy is a concept based on the assumption that some products offers high quality standards due to the fact that are designed, developed, produced and packed in Italy, adopting Peninsula's heritage, know-how and raw materials.

Despite all Italian products may aim at being certified as Made in Italy, there are four main sectors in which this certificate is particularly adopted: food, fashion, furniture and automotive industries.

Made In Italy heavily relies on the increasing perception of Italian product by foreign customers. In fact, since the late 90s, foreign consumers' positive expectations on Italian products gave to these four industries a relevant competitive advantage.

In a global and evolving market, being perceived as high quality manufactures is really fundamental.

However, the competitiveness increased by Made In Italy certification seems to be in contrast with the process of offshoring that follows different location advantages. For a company aiming at acquiring new foreign markets through the exploitation of this certificate, offshoring is absolutely a losing strategy.

Despite this self-evident truth, it is interesting to observe that many typical Italian companies are transferring their operation abroad ignoring the partial loss of reputation.

Many famous Italian brands, such as Orzo Bimba, Chianti, Fiorucci, Parmalat and Star, are moving abroad their production renouncing to the benefits of being a Made In Italy product. As stated by Coldiretti (Italian organization of farm entrepreneurs), this process is negatively impacting Italian productivity, causing the closure of many plants and the loss of hundreds of jobs.

However, there are still many successful examples of Mede In Italy firms not transferring abroad their activities.

This is the case of Gucci. Ppr, the holding owning Gucci and many other companies operating in the Peninsula's textile industry, does think that Italian fashion heritage is something to be protected and exploited. Defending points of excellence and artisanal patrimony is fundamental for responding to international customers' expectation. In order to do so, Ppr invests heavily in the Italian territory, not employing offshoring strategies.

Similar strategies are adopted by SMEs too. That's the case of 3.6.5.srl, an Italian company operating in the furniture industry. This company decided not to relocate its production of wooden product betting and supporting the industrial design and the artisanal heritage of Italy.

This apparently normal strategy becomes interesting if analyzed as part of the systemic design process actually taking place in Italy.

This practice, aiming at producing green, ethic and fair goods without impacting the economic results, is based on the assumption: avoiding wastefulness companies are able to drastically reduce their costs. Of course, if a firm is able to reduce costs internally, it does not need to employ offshoring activities and may protect domestic heritage.

However, the process of internalization is a double faced coin. On the one hand some Italian companies decide to go abroad transferring production or sale force. On the other hand, many international firms and holdings are acquiring Peninsula's corporations.

In fact, Italy has become a shopping center for big international companies. Big holdings and corporations are actually acquiring Made In Italy firms, investing in their concept of high quality. However, sometimes international acquisitions result not only in a loss of identity but also in a loss of their production centers.

This increasing number of foreign acquisitions (in the last four years the ownership of about 500 brands passed to international investors) is not slowing its run. After the acquisition of PoltronaFrau (by the American Haworth), Krizia has been acquired by Chinese investors.

The real negative effect is that despite all these acquisition amounted to ca. 55 billions of dollars, these financial resources are not always reinvested in the territory.

## IV. Questionnaire and case analysis.

In addition to the theoretic approach of the previous chapter, it is necessary to analyze the reality in which the Offshoring phenomenon actually takes place.

To this extent, I designed a questionnaire (submitted to Italian SMEs) and an analyzed the peculiar cases of two companies employing offshoring strategies: Sergio's Ltd (and the shoe district of Casarano and Tricase) and Sprech Ltd.

I decide to analyze these two companies because they perfectly represent cases of Italian SMEs that operate in the manufacturing industry and exploit the opportunities that foreign countries offer, in order to cope with the increasing global competitiveness.

### 4.1 Questionnaire analysis.

In order to give some support to what stated in the previous chapters, I decided to submit a questionnaire to as many SMEs as possible and to interview some directors of Italian companies employing offshoring activities.

(The final number of firms actually answering to the questionnaire is 37[31]).

The main objective is to capture the trend and the strategies of Italian small-medium enterpriser and to define, if possible, a guide of best practices in order to enhance their internationalization without impacting too negatively Peninsula's economic system.

[31] The sample is not so big if we consider that there are ca. 27thousands (source: CGIA) of Italian firm undertaking offshoring strategies. However, these interviewed companies are heterogeneous and their answers may result a relevant starting point for my analysis.

In order to do so, I designed a questionnaire that may be considered divided in three parts (plus a focus on the HR Management side of the process):

1. A first part regarding some basic information of the interviewed firm (sector, domestic location, foreign location)

2. A second part dealing with the drivers of their offshoring strategies (objectives, country selection process)

3. A third part analyzing ex-post some key elements of this phenomenon (success factors, main obstacles faced abroad, HR implications, functions moved abroad)

***Basic Information.***

The first set of answers giving some basic information about the interviewed firm stimulates some interesting reflections. Firms employing offshoring strategies mainly belong to manufacturing (60%) and to the ICT sectors (16%). Of course, these percentages support what already argued in the previous chapters.

SMEs operating in these sectors are much more autonomous in terms of location strategies. In fact, Italian agricultural, buildings and service companies tend to be anchored to their base territory, thus serving their customer base.

If the ties between the domestic territory and the agricultural sector may be considered predictable, especially with regards to small firms, building and service companies tend to remain in their home country for different reasons. In fact, as suggested by questionnaires' results, companies belonging to these industries aim at expanding their market abroad rather than transferring their production in a foreign country, thus not incurring in offshoring strategies.

A similar approach is shared by logistic firms that implement their presence abroad not moving their activities but offering their services to foreign countries too.

However, among the different manufacturing industries, equipment, machinery and (partially) textile companies are the most attracted by offshoring advantages.

With regards to interviewed companies' origins, data suggests that Campania, Lombardy, Veneto, Puglia, Tuscany and Piedmont are the region with the higher number of SMEs undertaking offshoring activities.

However, analyzing the location of the interviewed companies' headquarters may result not interesting because of the sample that contemplates a different number of cases per Italian region.

For what concerns the attractiveness of the different possible target countries, data collected through the questionnaires partially support the results obtained by CGIA research mentioned in the previous chapter.

Despite the difference in the sample size, data confirm that Italian companies mainly move their activities to Eastern European countries (35%), Asia (16%, especially China and India) and South America (16%). For what concerns advanced countries, Western Europe (11%, especially France) and North America (8%) are the preferred ones.

Despite it is quite clear to predict why those countries are the most targeted, it is necessary to go deeper in the analysis of the drivers of such a choice.

Here I attach the results of the first section regarding companies' basic information.

- Could you please indicate which your business typology is:

| **SECTOR** | **#** | **%** |
|---|---|---|
| Agriculture, fostering | 1 | 4% |
| Manufacturing | 22 | 60% |
| Real estate, buildings | 3 | 8% |
| Logistic | 4 | 10% |
| ITC | 6 | 16% |
| Services | 1 | 2% |
| Others . . . | - | - |
| TOTAL | 37 | 100% |

- Could you please indicate the location of your headquarters:

| **REGION** | **#** | **%** | **REGION** | **#** | **%** |
|---|---|---|---|---|---|
| Valle d'Aosta | 0 | 0% | Umbria | 1 | 3% |
| Piedmont | 3 | 8% | Lazio | 2 | 5% |
| Lombardy | 3 | 8% | Abruzzo | 1 | 3% |
| Trentino Alto Adige | 1 | 3% | Molise | 0 | 0% |
| Friuli Venetian Giulia | 1 | 3% | Sardinia | 1 | 3% |
| Veneto | 5 | 14% | Campania | 5 | 14% |
| Emilia-Romagna | 1 | 3% | Basilicata | 1 | 3% |
| Liguria | 1 | 3% | Puglia | 6 | 16% |
| Toscana | 4 | 11% | Calabria | 0 | 0% |
| Marche | 1 | 3% | Sicilia | 0 | 0% |

- Could you please indicate towards which region did you company moved part/all of you production:

| **REGION** | **#** | **%** |
|---|---|---|
| Asia | 6 | 16% |
| Middle Asia | 3 | 8% |
| Eastern Europe | 13 | 35% |
| Western Europe | 4 | 11% |
| North America | 3 | 8% |
| South America | 6 | 16% |
| Africa | 2 | 6% |
| Australia | 0 | 0% |
| TOTAL | 37 | 100% |

***Drivers of offshoring.***

In order to understand which are the causes that make these industries interested in moving their functions abroad I analyzed data coming out from the second part of the questionnaire.

In this second section the aim of the questions is focused on the reasons that make Italian entrepreneurs interested in moving functions abroad. Identified the main drivers, it is necessary to understand which are the criteria used for deciding the appropriate country where to settle the new plants.

According to the answers collected, it clearly results that there are three main determinants impacting firms' choice to transfer activities abroad:

1. Cost reduction mainly due to a low labor cost;

2. Favorable foreign condition in terms of taxes, incentives and economic policies;
3. New market opportunities.

In fact, the final grade of importance attributed to the first driver was 4,5/5. This high result perfectly respond top what stated in the previous chapters: in a challenging global market firms are interested in lowering their cost strategy to remain competitive.

For what concern the second set of drivers, things are slightly different. In fact, despite an high final grade (3,9 out of 5), entrepreneurs are much more attracted by low taxes and incentives than by institutions' policies and infrastructure.

In fact, if we analyze the incidence of taxes, incentives, foreign economic policies and infrastructures separately, their perception is very different. In fact, taxes and incentives importance are much higher than the relevance of policies and infrastructures.

The reasons of such an internal difference among these determinants are many. Taxes are the most important because the high level of Italian ones (Italian fiscal pressure is about 54% of the GDP) makes companies interested in finding more favorable conditions abroad.

Despite a similar approach regards incentives too, what is really different is the lower importance of economic policies and infrastructure. In fact, since Italian companies transfer their activities mainly towards East Europe, China, South America and India, it is clear that they are not interested in looking mainly for high quality infrastructures.

However, entrepreneurs decide to offshore also to increase their customer base abroad. This is due to the crisis al Italian internal consumption, which is lowering the profit of lots of SMEs.

Despite not indicated among the different alternatives, many companies indicate another driver: the certainty of payment. This is the case of many firms moving especially to France and USA, where regulations punish and incentivize regular and on time payments.

Having analyzed the reasons why Italian SMEs are interested in offshoring, it is now important to identify the criteria on which entrepreneurs base the decision of a certain country in lieu of another.

Of course, linked to what stated before, one of the main aspect to take in account is the tax structure (4,5/5). In addition to this, also the level of labor cost (4,2/5) and the strategic position (3,9/5) of a country are relevant.

Of course, the decision of a country depends on its strategic position. In fact, despite most of the companies employing offshoring activities are cost-reduction-oriented, settling a plant in a foreign country creates some new markets opportunities in terms of customers' acquisition and brand awareness.

Differently from the previous determinants, what seems not really attracting for companies is the availability of financial resources in the foreign target countries. In fact, since most of the invested capitals come from the home market there is no need to target a country according to such a peculiarity.

Here I attach the results of this section.

1) Considering your offshoring activities (already implemented or only planned), could you please rate the importance to the following drivers**?** (1: not important at all; 2: moderately important; 3: important; 4: very important; 5: necessary)

| **DRIVERS** | **Avg. On a scale from 1 to 5** |
|---|---|
| Production Cost reduction | 4,5 / 5 |
| Market opportunities | 3,5 / 5 |
| Access to particular natural resources | 1,9 / 5 |
| Favorable local condition (taxes, institutions, infrastructure, policies etc) | 3,9 / 5 |
| Access to high skilled workers | 1,8 / 5 |
| Others… (Certainty of payment) | 2,1 / 5 |

2) Considering your offshoring activities (already implemented or only planned), could you please rate the following factors determining the decision of the country? (1: not important at all; 2: moderately important; 3: important; 4: very important; 5: necessary)

| **DETERMINING FACTORS** | **Avg. On a scale from 1 to 5** |
|---|---|
| Country's natural resources | 1,9 / 5 |
| Cost of labor | 4,2 / 5 |
| Cost of capital | 2,3 / 5 |
| Taxes | 4,5 / 5 |
| Geographic strategic position | 3,9 / 5 |

***Obstacles faced abroad***

The third part of the questionnaire refers to an ex-post analysis on offshoring procedures already undertaken.

The interest of this last part is to identify the obstacles faced abroad, the activities mostly transferred, the impact on employment in the home and in the host countries and the main success factors.

Moving production abroad imply some difficulties and some adjustments. Of course, in addition to the usual internal efforts needed (massive capital investment, reorganization of company's structure, reallocation of tasks etc), companies undertaking offshoring activities have to adapt themselves to the new environment in which they want to enter.

After having asked which of the different obstacles Italian entrepreneurs perceive as the most obstructing, it results that biggest challenge is to cope with a completely new set of regulations and institutions.

In fact, due to the high number of structural differences, many Italian entrepreneurs understood the importance of relying on a local partner to facilitate the entrance in the foreign country.

In addition to this, if a firm prefers not to cooperate with a local associate, it may rely on *Italian Chambers of Commerce Abroad* (CCIE). The aim of these chambers is to assist Italian SMEs in the process of internationalization and to promote the success of Made In Italy.

For doing so, CCIE gives support in terms of strategies development, organization design and bureaucracy simplification. CCIE conduct represents Italian public lobbying.

Apparently, the other possible obstacles are not as obstructing as they may appear.

Corruption is seen as part of the game. This approach comes from Italian peculiar perception of the phenomenon. In fact, as stated by the *Corruption Index*[32], since Italy is perceived as a partially corrupted country, Italian entrepreneurs going abroad are not so much afraid of facing this plague in a foreign country. Furthermore, they think that sometimes corruption is necessary to make investment works properly.

Communication problems are not limiting the process of internationalization too. The use of computers and the socio-cultural process of globalization are helping reducing the distances among strangers.

Italian entrepreneurs are neither afraid of the scarce scientific and technologic knowledge they meet abroad. This is due to the fact that often times they bring their specific know-how in the foreign country thus preparing and training local workers.

Logistics and Transportation costs are not perceived as a problem too. The fact that Italian firms tend to move their production toward less developed country implies that they are not going to face high costs in terms of transportation.

Here I attach the results of this section.

[32] Italy perception of corruption is relatively high. It is 43/100, making the country the 69th in the relative rank. (source: CORRUPTION Index 2013, transparency.org)

3) Considering your offshoring activities (already implemented or only planned), could you please rate the barriers faced abroad? (1: not important at all; 2: moderately important; 3: important; 4: very important; 5: necessary)

| **FOREIGN BARRIERS / OBSTACLES** | **Avg. On a scale from 1 to 5** |
|---|---|
| Corruption | 2,1 / 5 |
| Language problems | 1,6 / 5 |
| Logistics | 2,1 / 5 |
| Adaptability to the new environment (regulations, bureaucracy etc) | 3,9 / 5 |
| Trade costs | 1,6 / 5 |
| Scarce Technological knowledge | 1,9 / 5 |

***Factors of success***

In order to evaluate the impact of offshoring and to replicate these advantages, I asked which the factors of success that make this process convenient are.

In addition to the ability of reducing costs, there are two main factors that make offshoring successful: having a local partner and a right HR approach.

For what concerns the first factor, it is quite intuitive that, as stated previously, having a local partner is fundamental.

There are three reasons that support this thesis:

- A local partner knowing the habits and the testes of his own country helps in better understanding the market. Knowing the new environment is necessary to design a proper strategy and to exploit all the opportunities;

- The regulations of some countries may require the presence of a local partner to establish plants in their country (India[33] for instance). In such a case, having a local associate is a sort of pass allowing foreign investment;

- A local partner may be able to overcome bureaucracy obstacles thus easing the entrance of a foreign company in his home country.

However, the answers collected seem not to support these assumptions. The rate of the importance of having a local partner is not so high (3,5/5). An explanation of this peculiarity may be found in the fact that many small companies undertaking offshoring activities are familiarly conducted. This approach tends to favor the concentration of the powers in one ore few people, thus not fitting in with the presence of a foreign partner.

With regards to the second factor of success, data gathered through the questionnaire suggest that adopting the proper HR strategy is fundamental. Entering a new country is always a matter of combining and adapting life-styles and culture, of accepting diversities and exploiting their opportunities. In addition, often times new foreign workers hired need to be trained and made aware of company's value.

It is not a case that often times Italian entrepreneurs move some domestic worker to the foreign country. The purpose of this process is to integrate and prepare new workers to be part of the firm.

[33] A foreign company willing to set up business operations in India may enter the country through a Joint Venture or a Wholly Owned Subsidiary; anyway, it is strictly required a local partner. Moreover regulations is very severe about determinate sectors, forbidding or strongly limiting FDI toward some industries (manufacturing is not among them).

In fact, the results of the questionnaire state that employing domestic worker and managers to establish a new plant abroad is an important practice.

4) Considering your offshoring activities (already implemented or only planned), could you please rate the importance to the following success factors? (1: not important at all; 2: moderately important; 3: important; 4: very important; 5: necessary)

| **SUCCESS FACTORS** | **Avg. On a scale from 1 to 5** |
|---|---|
| Cost reduction | 4,6 / 5 |
| Local Partner | 3,5 / 5 |
| Good HR practices | 3,8 / 5 |
| Increasing economies of scale | 3,1 / 5 |
| Moving domestic workers/managers abroad to easy the integration | 3,2 / 5 |

***Functions mostly moved abroad.***

Understanding which of the different value chain activities mostly transferred abroad is fundamental to better evaluate the process of offshoring.

Data collected state that companies are mainly interested in moving to the foreign target market manufacturing. In fact, most of the interviewed answered that they moved their production (operations) abroad.

The reasons of such a peculiarity may be found in one of the drivers of offshoring: cost reduction. Knowing that companies transfer their activities abroad in order to reduce costs, it is clear that SMEs are interested in moving manufacturing. In fact, companies exploit countries with low labor cost and low taxes.

The relation between labor cost and manufacturing makes this last the most transferred activity.

However, the aim of profiting thanks to low taxes makes SMEs interested in offshoring some other functions too. This assumption is the reason why companies are interested in transferring abroad Sales and to settle Firm Infrastructures in a foreign country. In fact, these two activities of companies' value chain are the most impacted by high taxes.

5) Considering the functions moved abroad, could you please indicate which one has been offshored? At which rate are these function duplicate or partially moved abroad?

| **FUNCTION MOVED** | **Percentage of firm moving the function** |
|---|---|
| Manufacturing/Operations | 76% yes |
| Research & Development | 10% yes |
| Procurement | 8% yes |
| Logistic | 17% yes |
| Sales | 46% yes |
| Firm Infrastructures | 38% yes |

***HR management procedures.***

As stated previously, a proper HR strategy is a factor positively impacting the success of offshoring.

Of course, in order to design the perfect HR approach it is necessary to estimate the impact offshoring has on jobs.

Among the 37 companies interviewed, 17 stated that they moved workers abroad. In addition, 10 of them answered that the number of Italian employees moved ranges between 10 and 24. Their main purpose is to train new employees and to help their integration in the company. This assumption support what stated before when analyzing the success factors of offshoring.

However, Italian SMEs move these employees just for a limited period: often times (65%), Italian workers are moved only for training local ones, and then come back.

For what concerns the management side, analyzing the answers to the questionnaires suggest that firms transferring their activities abroad do not use to hire so many new managers. The average number of new manager hired is between 1 and 10 (54%). Only 3% of the interviewed companies hire more than 10 new managers. The reason of these small numbers may be attributed to the fact that company tend to move Italian people abroad and to cooperate with a foreign partner in the management tasks.

Offshoring activities may have a positive effect on foreign employment too. In fact, the 65% of SMEs hire between 25-50 new workers and 21% from 10 to 24. Of course these numbers vary according to the size of the enterprises interviewed.

However, offshoring is a double faced coin in terms of employment. In fact, Despite offshoring do not require essentially that activities moved abroad are closed at home, Italian SMEs tend to follow this trend. This concurs to a decrease of home employment.

Here I attach some tables summing up the results of the 37 answers to the HR section of the questionnaire.

6) Considering your offshoring activities (already implemented or only planned), could you please rate the following procedures related to the employment? Are them undertaken or not?

| **EMPLOYMENT** | **NO (0)** | **1-10** | **10-24** | **25-50** | **50 +** |
|---|---|---|---|---|---|
| Italian employees moved abroad | 54% | 20% | 58% | 14% | 8% |
| % of Italians coming back | 65% | | | | |
| Number of jobs lost in Italy | 21% | 13% | 29% | 24% | 3% |
| Number of jobs created abroad | 0% | 5% | 21% | 65% | 9% |
| Hiring of a coordinating managers | 43% | 54% | 3% | 0% | 0% |

## 4.2 CASE ANALYSIS 1: The Shoe District of Casarano and Tricase

### *District history*

The whole history of the district is built on the operations of two companies: Adelchi ltd and Filanto ltd. Both of them passed through successes, falls, rises, opportunities missed and possibilities exploited.

The companies, settled in two proactive villages in the province of Lecce (Casarano and Tricase), were part of an active region operating in the shoe industry. (If we take a look on the highest peak of its employment, it counted up to 9000[34] workers).

[34] Adelchi and Filanto, the two biggest companies of the district, accounted ca. 5500 workers. The rest were distributed among the other numerous small firms cooperating with these two giant enterprises (Source: IlSole24Ore).

Adelchi and Filanto histories start in the middle on the last century. Prices are low (ca. 20.000 lire per unit), the average quality is medium and the local market seems able of absorbing a massive production.

Despite Adelchi Sergio (Sergio is the surname) and his brother in law Antonio Filograna (owner of the other big enterprise of the district, Filanto ltd) export to four continents obtaining high profits, things change in the early nineties.

As argued by Vincenzo Chierca in 1991[35], in this period Taiwanese and Korean exports inflict massive attacks to the district, exploiting their lower labor cost.

This is the stage in which Adelchi Sergio starts its first partial offshoring strategy, moving some of company's production toward Albany. Also Filograna starts moving part of the production abroad (Albania is the major destination, again). However, Filanto Ltd still keeps 4 plants in the province of Lecce, employing ca 3000 workers.

As stated by Mariano Maugeri[36], in the early nineties the main problems of the district were especially due to three structural limits:

- The huge number of workers employed (that counted up to 2300 units);
- The average quality; with the entrance of Taiwanese and Korean low cost products, the quality of district's shoes appears not to be enough high to justify the differences in price;

[35] Vincenzo Chierchia, IlSole24Ore, 28-Aug-1991.

[36] Mariano Maugeri, IlSole24Ore, 24-Sept-2012.

- The companies of the district did not owned any brand; they were not able to adjust a positioning strategy to cope with the new challenging global market.

The fall of Berlin wall and the rising Globalization make Adelchi and Filanto face all this three issues.

On the employment side, last years have registered a high number of firings, aiming at slimming companies' structures. 2500 employees[37] of the district are fired and survive only thanks to social security cushions.

In such a context, the old Adelchi Group closed and Adelchi's son, Luca Sergio, set up company a new smaller firm called Sergio's with an average of 120 employees[38] in Italy and ca. 500 abroad. (I will analyze the case deeply in the next paragraph).

For what concerns the quality issue, new entrepreneurs and local institutions are designing a new strategy based on two points:

- The creation of a Fashion University that may increase the quality of the designing; a first investment of 500.000 € has been made in order to renovate an old farmhouse (located in Nardò) that will host the school;

- The strengthening of the relations with famous firms of the sector that assure high reputation and require high quality; that's the case of Tod's shoes, that are partially now outsourced to the district.

[37] Considering both the firings of Adelchi ltd and Filanto ltd.

[38] Source: direct interview with Luca Sergio, Adelchi's son and owner of the reshaped company.

In addition, two new entrepreneurs entered the district bringing an innovative input to the business: Luciano Barbetta and Giuseppe Baiardo.

The first one, born in the 1947, is the owner of Barbetta ltd, a firm operating in the fashion industry, cooperating with many famous companies such as Gucci, Cucinelli, Lanvin and Stella Mc Cartney.

It is easy to understand his vision through his words: "Luxury *comes from the Latin word* Lux *that means* Light. *This concept tells us that luxury products only come from emotions and wisdom. My grandfather had a mechanical workshop in Brescia, and each part sold was literally the result of a birth. I do share this vision"*[39]

On the other hand, Giuseppe Baiardo is the other new entrepreneur having entered the district. He does support offshoring strategies, having moved part of his upper-shoe manufacturing in Albania.

However, he argues that fashion industry and offshoring strategies may coexist only if it is possible to balance the different stages of the production process.

All this elements contribute to the development of the district that, although slowly, is renovating itself.

***Interview with Luca Luigi Sergio, owner of Sergio's Ltd.***

Having the possibility to ask Luca Sergio some question about the relations between its company, Sergio's ltd, and offshoring is really enlightening.

[39] Source: ilSole24Ore interview, 2012.

Son of Adelchi Sergio, the founder of Adelchi group, he gave me some information about its company.

Settled in Tricase, Sergio's ltd is a company operating in the shoe manufacturing industry. The firm is distributed among different plants, most of which are in the Eastern Europe (mainly in Albania).

The choice of moving part of the value chain activities abroad are the results of some peculiar drivers. In fact, when asked about this issue, Sergio answers that there are three main determinants:

- The possibility of exploiting lower labor cost;
- The access to new market opportunities; Easter European countries represent growing markets able to absorb a part of the production;
- Eastern European countries offer favorable business conditions (Sergio argues that the main advantages come from low taxes and high incentives).

However, settling a plan in a foreign country implies some change in the procurement side, thus requiring a firm interested in having access to local resources both in terms of materials and human capital.

When I asked why he decided to move mainly towards Albania, Sergio identifies some peculiar criteria:

1. the strategic position of the country; Albania is not far from the south of Italy (where Sergio's ltd has its headquarter) and is able to serve both the Asian and the European markets;

2. Taxes are low;

3. Labor cost is one of the lowest in Europe.

After having obtained this basic information of the company, and after having identified the main drivers and the main criteria on which Sergio builds its firm's strategy, I had the opportunity to analyze the offshoring processes already implemented.

In this *ex-post* analysis, I decided to focus on four main dimensions:

- The obstacles faced abroad;
- The success factors that make offshoring an advantageous strategy;
- The composition and the nature of the activities moved to the target foreign country;
- The HR practices and the implication for home and host countries' employment.

For what concerns the first issue, Sergio told me that the obstacles faced abroad are not so insuperable (communication problems are easily overcome, for instance).

However, offshoring strategies imply some difficulties.

On the one side, moving to a foreign country require the firm to have a certain level of adaptability to the new environment (different language and culture, not well-know market and tastes, etc).

On the other side, another obstacle is the fact that offshoring indirectly make company's structure more complex, thus requiring a higher level of coordination and investments. However, these efforts are justified in order to experience offshoring advantages.

When asked about the factors that make offshoring successful for Italian entrepreneurs, Sergio argues that this strategy may benefit the company accordingly to three main reasons:

1. Cost reduction; it allows companies to make greater profits and to save money to be reinvested along all the value chain activities;

2. Having a local partner ease the integration of the company in the new foreign market, thus permitting to estimate local tastes and to overcome some bureaucracy obstacles;

3. Investing in cheap markets and exploiting new customers' bases allow an increase of the production volume, thus having positive impacts on the economies of scale.

In addition to these factors of success, Sergio argues that having proper HR practices and moving some Italian workers and managers abroad result to be successful. These factors may are important for implementing the new plants opened abroad and the involvement of new foreign employees (however I will discuss HR practices later on).

For what concerns the composition and the nature of the activities moved abroad, Sergio told me that his company mainly focused on the production and the sales functions when undertaking offshoring strategies.

Of course, this is strictly related to the kind of industry Sergio's ltd operates in.

The shoe manufacturing business's profits are highly impacted by the cost of production, thus requiring entrepreneurs to always look for cheaper way of manufacturing, maintaining a certain level of quality.

For this reason Sergio moved abroad ca. 90% of the production function. The same occurs for the sales one.

In fact, as stated before, one of the main aims of company's strategy is to acquire new customers and to exploit new markets' opportunities.

Of course, moving abroad the manufacturing and the sales activities implies that also logistics must be adapted to the new environment.

This is partially the case of Procurement activities too. Sergio argues that, despite most of the production is located abroad, there is not a specific need to find new suppliers in the host country. However, this is sometimes necessary and for exploiting geographic closeness ca. 50% of the procurement has been moved.

Summing up, Sergio told me that about 70% of firm's infrastructures are in a foreign country, giving some support to the fact that international markets are crucial for his company.

In addition, it is quite evident that such a context implies a focus on the HR management side of the company.

Entering a foreign country means to integrate different cultures, to find a balance among different values and to create shared objectives in order to benefit from offshoring strategies.

To these extents, 12 Italian employees were sent to the new foreign plants. Their main role is to implement local productivities and to train new hired workers.

However, differently from the results I got thanks to the questionnaire analysis, these 12 workers have not been sent for a limited period just to increase new plants practices. Sergio does support a full integration in which employees of different nationalities create a whole family.

However, if compared to the number of foreign workers hired, the Italians moved are very few. Sergio's created about 500 new job positions abroad, thus hiring a lot of foreign workers.

On the negative side of the phenomenon, ca. 50 Italian workers were fired for implementing this offshoring strategy (I will discuss this aspect later on).

In addition to all these numbers, the entrepreneur told me that 3 new managers have been hired to better handle the process on internationalization. They have one main role: to manage the operations of the foreign plants and to report to Sergio.

This support the conclusion of the questionnaire I described before.

*Conclusion: Sergio's Ltd.*

According to this interview, it is obvious that offshoring practices offer big opportunities to the Sergio's Ltd.

If compared to the shoe district of Casarano and Tricase, it is easy to understand why Sergio's Ltd decided to move toward foreign countries: they allow cost reduction and give new market opportunities, thus making the firm much more competitive in the global environment.

Once again, it results that implementing such an internationalization strategy is a double face coin: on the one hand, Sergio's Ltd is able to experience all the advantages before identified; on the other hand, moving activities abroad often times correspond to a reduction of home firm's infrastructure and employment.

These negative aspects stimulate some considerations:

- The profit coming from foreign markets and the money saved thanks to global favorable conditions may be invested in the R&D function, which is still kept in Italy; this may increase home employment and create new opportunities (it may boost the quality of district's products for instance).

- Home firm infrastructures may be devoted much more to coordination tasks; this would distinguish home from foreign activities, thus allowing a specialization in each function of the value chain.

These two strategies may overcome the negative aspects of the offshoring phenomenon, thus making it a more accepted, shared and profitable tool.

## 4.3 CASE ANALYSIS 2: Sprech ltd

### *Sprech ltd beginning*

Sprech srl is a family owned company settled in Martano[40] operating in the textile architecture industry. Its owner, Pasquale Rescio, is a self-made man, started to work as an employee in a firm that produced tarps for trucks; this was the place where Rescio entered in touch with the processing of PVC[41].

Company's success comes from the moment he patented his innovative idea: a basic modular gazebo - the ancestor of the products that Sprech offers nowadays.

It is made of four steel legs and a plastic canvas, that can be easily carried, assembled and dismantled. The business gets off the ground and Rescio understands that his base product has the advantage of being diversifiable in an infinite number of solutions. He begins to accept some more customized requests, his customers are satisfied and the company starts to grow. The step from 2 to 100 employees is short.

### *Sprech ltd growth*

Nowadays, the core business of the firm is the production of tensile structures, gazebos, pagodas, pavilions and modular canopies. It designs, realizes, rents and sells textile infrastructures, it delivers highly customizable top level structure-works and

[40] Small village in the province of Lecce, Puglia.

[41] Polyvinyl chloride, commonly abbreviated PVC, is the third-most widely produced polymer, after polyethylene and polypropylene. PVC is used in construction because it is more effective than traditional materials such as copper, iron or wood in pipe and profile applications.

PVC membranes suitable to fulfill several needs, both for private residences and for public access places such as fairs, restaurants, parking lots and so on.

At the beginning of its journey, the headquarter of Sprech was a little plant, but the companies grows: they now account for 5 Italian local production sites in addition to the headquarter. In each one of the displaced factories, different steps of the supply chain and of the manufacturing process are carried on. The local sites are located in different towns of the neighborhood – ideally around the headquarter in Martano – such as Calimera, Corigliano, Maglie, Carpignano; while Maglie is specialized in woodcraft and heavy steel structure-work, in Corigliano there are high skilled workers specialized in PVC tarpaulins manufacture. Calimera is the site where the company invested in a R&D centre, with the aim of developing new solutions to be applied in the production and realization processes.

The headquarter is the operative center of the company.

Here the engineer works constantly together with the two designers, in the same office where the accountant works and the salespersons communicate with more than 25 countries all over the world. Meetings are taken here, in the modern conference room on the first floor, and here is where you usually find Rescio: he works together with his employees, sharing the same office.

Now Sprech has developed a full corporate mission and philosophy, that can be described with the concepts of “Strength and Lightness”: these values are commonly shared among all employees, who make their effort to make Sprech an efficient and proactive company, able to easily satisfy customers’ needs.

Anyway, spreading this vision among every worker is not easy: the company employs an average of 100 workers, with pre crisis peaks of 130 (the actual number of workers is 105); in turn, they are segmented as follows: 74 workmen, divided in at least 5 different areas of competence (assembler, welder, steel manufacturer, PVC manufacturer, woodworker); 21 office clerks: two engineers, three designers, one accountant, twelve salespersons, and, obviously, Rescio together with his wife and the older among his children. The other ten are equally divided between the hotel and the manor farm (sectors in which Sprech diversifies).

Sprech ltd has earned in its international reputation as well: last data say that 2012's exports represent the 27% of its production.

As said before, the company exports all over the world. On the one hand, its European most important markets are France, Holland, Germany, Great Britain, Spain and Cyprus. On the other hand, its extra EU most important markets are Switzerland, Libya, Turkey, Cuba, Ile de La Reunion: in each of these countries there's at least one reference sales.

***Sprech Organizational Chart & Business Model***

Sprech organization is designed in a hierarchical structure, whose head obviously is Pasquale Rescio, who owns 53.71 of the shares of the company; Rescio is the sole administrator, but he actually shares the management with his wife, Rita Ruffo; she owns the remaining shares of the firm (46,29%) and she manages the firm in a very proactive way; she perfectly knows every aspect and every step of the production process.

According to one of the workers, Massimo - who looked to be pretty serious while talking – Rita is more scaring than Pasquale: she obviously doesn't beat anyone (!), but this statement gives evidence about Rita's importance in the firm.

In the first lower layer of responsibility – that directly report to the direction - there are the responsible for safety and quality of every production site that are, in turn, organized hierarchically as well. In the offices the main referent is always Rescio, or, alternatively, Rescio's daughter, Angela.

Company's approach in selling is mostly B2B (more than 95% of sales are made to other companies).

The only privates SPRECH sells to are locals; it has been a natural evolution of the business, mainly as a consequence of two reasons:

- Initially, Sprech basic products where so easy to be assembled that privates with basic skills could afford to do it. However, with the passing of time they got more complex and require some skilled workman to assemble them;
- Sprech strongly differentiation of products allowed them to satisfy an always larger range of customers: to be sustainable, this rapid expansion had to rely on other companies with both great selling capacity and high-skilled installer.

***The opportunity to go international***

Rescio always cared interpersonal relations; in fact, part of his success directly derives from his unquestionable capacity to establish friendly relationships that go beyond the mere business interests.

This attitude allowed him to trust his collaborators and principal customers, abroad as well. This is what he underlines when he talks of the way he launched Sprech India and Sprech Brazil with Pariket Naran and Sander Dijkstra respectively.

Both of them were formerly SPRECH's customers and Rescio's friends, who knows them since long time: he met his actual Indian partner even fifteen years ago in one of the international fairs that Sprech was used to join. The collaboration with Dijkstra is more recent. In India, Rescio establish a plant in 2008, in Brazil in 2012.

***Country selection criteria (SWOT analysis)***

Most important *opportunities* are the same for the two countries: in fact, in both cases, the outlook shows two fast growing countries that are favoring inward FDI, with a large population, a rapidly increasing GDP and a high disposable income both for private citizens and for institutions. This last peculiarity implies that these actors are able to play a prominent role in Sprech's business; obviously this growing process walks together with an increase in the need for infrastructures; moreover, in Brazil, there will soon be a great inflow of money coming from the sports events programmed for the following years (World FIFA Cup and Olympic games).

Even *threats* show several common points:

- High corruption;
- Economic policies that hamper imports; this is one of the reasons that made Sprech interested in producing directly from inside these markets.
- The long geographical distance;

- The increasing competition.

One more threat, peculiar of the Indian culture, is the very rigid caste system: the problem related to this issue is that it may happen that workers won't put much effort in working, because they know that it's not possible for them to make a social climbing. Anyway, Rescio ensures that it's not the case in his firm, where workers are very proactive and eager to learn.

The peculiar threat of Brazil is instead the communication, deriving from a lack of English-speaking labor force.

However, Sprech has some advantages:

- It has a very good international reputation, that can be exploited abroad as well;
- A deep knowledge of production processes; the ability to exploit both economies of scope and economies of scale, thanks to a very diversified product portfolio;
- The ability to manage even very great commissions and projects;
- A very experienced and able management (especially in Italy and in India).

Of course, the company has some *weaknesses* too. The main derives from the lack of experience in managing international operations, but it can easily be overcome with the passing of time. Moreover, there's one additional weakness for SPRECH Brazil: probably the Dutch partner is not still ready to properly manage operations there, but the collaboration is recent and operations can still be improved.

Following, the analysis will proceed through the launch of the Indian subsidiary, to get, in a second instance, to the Brazilian one.

### *The Indian Subsidiary*

At the end of 2007, Naran presented a proposal to Rescio: he offered him to launch a settle a plant in India, establishing a subsidiary of the Italian Sprech. Rescio, without disregard to his managerial abilities, glimpsed an opportunity to bring the company to a higher international level, entering a new market which seemed to have great possibilities of growth. The entrance occurred in 2008.

### *India: outlook* [42]

Located in the Southern Asia, with a population accounting for 1.147.996.000 inhabitants (over one seventh of the world population) India is one of the so-called BRICS countries; its GDP in 2007 resulted in USD $ 1,238,700,195,644, with an expected growth rate for 2008 of 9%, which actually realized to be 7.4% (a good result in any case, especially if compared with the world growth rate of 3.1 %).

In the previous 3 years (2005-2006-2007) the growth rate of the Indian economy was slightly less than 9% on average.

During the middle of the first decade of 2000, India was gaining more and more attention as a potential destination of FDI. In the five years going from 2004 to 2008, India has been able to increase its net inflows of FDI of about eight times, from $ 5.7

[42] Source: data.worldbank.org

billion to $ 43.4 billion (It's accounted as net inflows investments minus disinvestments).

***India: FDI regulations***

Below are listed the relevant regulations concerning FDI in India, in particular the ones more strictly related to the case of Sprech.

A foreign company willing to set up business operations in India may incorporate a company under the Companies Act, 1956, as a Joint Venture or as a Wholly Owned Subsidiary; foreign investment is reckoned as FDI only if the investment is made in equity shares; an Indian company issuing shares/convertible debentures under FDI Scheme to a person resident outside India is allowed to receive the amount of consideration under several different forms: the analysis is limited to the case in examination, where it has been paid by inward remittance through normal banking channels. Moreover regulations are very strict about determinate sectors, forbidding or strongly limiting FDI toward them, but not manufacturing.

***Cultural differences and Hofstede analysis: India vs. Italy***

*November 2008: Pasquale Rescio enters in one of the two districts of his subsidiary in India, in Gujarat. Indian workers are used to work on the floor – barefoot in addition – he knows it, but, this time, he is well determined to change their habits: he suggests to a worker – who was welding a steel piece – to work while setting the piece down on the table; after showing him how to do, he continues his walking and then goes away. The day after, he comes back to the production site. He looks for the same worker*

*– Kamal his name - of the previous day, and the scene he faces is the following: Kamal actually works leaning on the table, but he was SAT ON the table while welding!*

This is just a small example that allows understanding why a firm has to identify and respect the cultural and social aspect of the target country, in order to successfully transfer some activities there.

For these reason it is important to analyze these differences between India and Italy along Hofstede's five dimensions.

In all the five indexes, great divergences emerge. India has a high power distance (it may even be a result of the caste system that doesn't allow significant upward mobility of workers and citizens); in the specific case of our firm, it reflects into a very obedient labor force. Rescio strongly stresses this peculiarity, also providing the anecdote at the beginning of this paragraph.

However, there are some aspects in contrast with Rescio's experience, among which the low uncertainty avoidance. Despite it may depend on the European oriented mind of his partner – Naran, Rescio argues that his Indian subsidiary is very careful in managing all bureaucratic stuff and the suppliers relations.

Evidences of the higher collectivism can be found in the behavior of employees, who tend to help each other at a very large extent.

Masculinity index could be considered irrelevant, since the sector in which Sprech operates is mostly male-oriented (anyway Rescio underlines the importance of the woman in his firm, starting from his wife, up to the saleswoman and the designers).

No evidences about long term orientation were found.

### *Sprech India*

Sprech undertook a horizontal-FDI, deciding to enter India with a market-seeking objective; the entire supply chain has been brought there, with a total replication of the structure of the firm, apart for one function – the design of new solutions – that is still kept in Martano.

The Indian subsidiary autonomously produces all the basic products in the Dehors and Events sectors.

Sprech India accounts for two production sites, both in Gujarat: the home replication process arises even from the organization of the plants, in fact one of them is dedicated to implementation of steel and aluminum parts, while the other one deals with the creation of PVC canvas and coverings.

The workload is divided among thirty-two employees, segmented as follow: six workers for PVC coverings, twenty-one workers for the metals sector and six clerks.

As Sprech ltd, Sprech India sells products through the B2B channel as well.

An interesting aspect to focus on is the choice of the location where to set up the business: Rescio and Naran – after the creation of a Joint-Venture - made a Greenfield investment in Gujarat. In fact, this part of India is strongly industrialized, and, beyond a good road network, the government of Gujarat has kept bureaucracy to a minimum, there are low level of corruption, if not at all, and there are no interferences with entrepreneurial corporations; moreover, there are less onerous labor laws, electricity procurement is constant and reliable (differently from the other Indian regions).

When I asked Rescio about the performance of the Indian subsidiary, he looks extremely satisfied: according to him, Sprech India is proving to be a successful experiment for several reasons:

- It's giving to the Italian headquarter clear directions about the behaviors to be held in dealing with International players and about the response of the Indian market to company's products.

- It's a step back in the past: he again deals with forecasting needs, working in a market that, in a certain sense, looks like the Italian one some 30 years ago, and that is now understanding that it has new needs. Sprech is there to anticipate and fulfill these needs.

- Indian market is a great window on a different world: it can give directions and guidelines on how to deal with the Asian culture.

- Sprech India is a strategic outpost, from which implementing exports toward other Asian countries.

- He company gains in popularity and increases the chances to receive large commission from abroad even for the Italian plant; Rescio proudly shares the vicissitudes that led SPRECH Italia to receive and fulfill a commission for the casing of a stadium in Malaysia: through the Indian channel, in fact, they have been able to overcome competition coming from the German firm that had originally installed the covering; this huge work has been performed in the

Italian plant, since the Indian one could not afford the realization of such a great commission.

- Last, but absolutely not least, Rescio's happiness is money; Sprech India represents an important investment both in terms of money and opportunity cost, and now the company is gathering the results coming from this investment.

***The Brazilian subsidiary***

In 2011 Sander Dijkstra, a Dutch guy submitted a proposal to Rescio: entering the Brazilian market not only in terms of commercial activities but in production too. In fact, the company had already implemented some commercial operations.

Dijkstra had been living in Brazil for years and he knew the Brazilian environment.

Rescio accepted and the entrance occurred in 2012.

***Brazil: Outlook***[43]

Brazil, the largest among Latin American countries, has a population of 193 million inhabitants. Despite it's one of the BRIC countries, the most important number for estimating Brazilian economy is 8.3%: this is the astonishing average growth rate of Brazilian GDP from 2008 to 2012 according to UNCTAD statistics.

[43] Data Source: Unctad stats

Two negative peaks in 2009 and 2012 (minus 2% and minus 9% respectively) were largely counterbalanced by the positive peak of 32% in 2010 and the strong sign of recovery after 2012.

While the first negative peak is obviously a consequence of the financial crisis of 2008, it's necessary to underline that Brazilian economy is strongly related to the trend of western countries, toward which the bulk of Brazilian exports are directed: form here it follows that the second negative peak occurred consequently to the commodity crisis of 2011. In fact, Brazil is a great exporter of a list of commodities, among which coffee, sugar, tobacco and, to a larger extent, of products related to the primary sector.

Exports are an important driver for the Brazilian economy, and the positive peaks after the negative ones, are attributable to an increase in exports. The trade balance is largely positive, and government, through ad-hoc policies, tries to hamper imports while favoring exports.

According to this, there are very high trade barriers for inward flows of goods and services that, together with the depreciation of the Real, make inconvenient exporting toward Brazil.

For years, Brazil registered an important upward trend in inward FDI from the rest of the world, especially from Europe and North America, but, during last years, the magnitude of the growth strongly decreased, still maintaining an upward trend; conversely, the outward flow of FDI, as a consequence of the growth of Brazilian economy, increased, especially toward Europe and neighboring countries of the Latin America.

### *Brazil: FDI regulations*

Nowadays, all foreign investments shall be registered electronically through the Brazilian Central Bank, in the so called Electronic Declaratory Registry of Direct Foreign Investment implemented by the Central Bank.

Investments in cash are recorded in the amount of the foreign currency transferred to Brazil. "Assets in-kind" may also be contributed by foreign investors into Brazilian companies. However, the contribution of noncash items may be more cumbersome, and in some instances requires feasibility analysis.

Brazilian law requires that foreign capital that is brought into the country on account of direct investment must be registered with the Brazilian Central Bank in order to guarantee remittances of dividends, interest, and return of original invested capital without taxation thereon.

### *Cultural differences and Hofstede analysis: Brazil vs. Italy*

The analysis of the cultural elements comes out with some interesting evidences.

First of all, the high power distance doesn’t find validation in Rescio’s words; he argues that, though having sent some Italian workers to train local employees, he’s still having some problems with the labor force and he complains about their laziness and lack of attention.

This is probably due to the high collectivistic culture, that leads workers to be even too supportive one with another: this aspect finds evidence in the low level of the individualism index of Brazil according to Hofstede’s analysis.

India and Brazil share the same level of uncertainty avoidance, but show a very different result in the long term orientation: at the moment, there's no evidence that stresses the importance of these two aspects in the relations between Sprech Italia and the Brazilian subsidiary.

The same applies for the masculinity index.

***Sprech Brazil***

Facing the decision of how to manage the new transoceanic adventure, Rescio opted for a horizontal FDI, moved by market seeking purposes.

He made, with Dijkstra, a Greenfield in Natal, on the east coast of Brazil. The investment regarded a replication of the home organizational structure in all its functions, apart for the designing and projecting ones.

Sprech Brazil consists of only one production site, where all activities are carried on by 5 employees - three workers and two clerks.

These numbers are quite modest, but this subsidiary is at an early stage of life, thus not being as structured as the Indian one.

When Rescio is asked about the reasons of this underperforming, he answers that *the firm is still young*.

Anyway, the investment is important, and he's well determined to make it profitable; first of all, he's now trying to cope with the problem of the lazy workforce that is, in his opinion, not as good as the Indian one.

Moreover Rescio says that he’s facing some difficulties in contracting new commissions, and he’s now waiting for enough assignment to make production start more intensively and exploit economies of scale.

Currently Sprech Brazil does not manufacture very technologic and complex products, but only focuses on the most basic ones, while carrying on commercial operations, among which the activity of renting structures for international fairs and exhibitions.

There’s one more important concern: trade barriers (high import taxes).

Rescio says that the cost of an import, almost double on the frontier: it’s quite intuitive that this condition forces the company to limit imports (both of semi-finished and finished products) and to increase the prices of the final product, thus losing in terms of competitiveness.

Moreover, Sprech Italia can even join a learning effect from the Indian subsidiary, and, working as a technology source, it can be able to boost Brazilian operations, putting in practice improvements in management and in technology coming from India.

***Conclusion: Sprech experience***

What Sprech case tells us is that managing the process of internationalization is always a matter of combining different cultures and indentifying proper strategies.

According to Rescio’s objectives, the choice of the target country is taken observing its market size and opportunities and exploiting personal relations.

It is quite obvious that the Indian success and the establishment of the Brazilian plant represent the results of three main causes:

- The high importance that Rescio attributes to high quality HR practices;
- The peculiar and innovative know-how exported to developing and unaware countries;
- The help and the collaboration of local proactive partners that allow Sprech integration in the foreign culture and values.

Thanks to these peculiarities and to the foreign market opportunities, deciding to move the production abroad results to be a winning choice.

The high Indian revenues and the opportunity to exploit Brazilian growing market are possible only thanks to this offshoring strategy. This is mainly due to the fact that conquering Indian and Brazilian markets through export is too expensive in terms of transport costs and import tariffs.

## V. CONCLUSIONS

### 5.1 Model of offshoring

The results of my research allow me to build a model based on two countries in which offshoring strategies are actually employed by an Italian SME.

In order to exploit the results of my analysis, these two countries will be Italy and Albany[44] (According to my extent, the assumptions from which building this model regards: labor cost, tax structure, employment, prices, exports/imports and knowledge spill over).

Differently from Albany, Italy is an advanced country, characterized by high labor cost[45], high taxes[46] and increasing unemployment[47]. These differences are the most attractive for Italian SMEs deciding where to offshore part of their value chain activities.

These countries differ with respect to prices too. Italian population has a higher income with respect to those of Albanian one, thus making Peninsula's market much more expensive.

I addition, Italian technological knowledge is significantly higher than Albanese's one, thus making the Peninsula a source of spillovers. The possibility of

[44] The case analysis of Sergio's Ltd and the geographical proximity to Italy are the reasons of this choice.

[45] Italian labor cost per month is 2013 was 28,1€ (Source: Eurostat); Albanese one was 2,35 € (Source: IMFstats).

[46] Just think that Italian fiscal pressure is 54% of GDP (Source: IlSole24Ore)and Albanese profit taxes are 10% (Source: IlSole24Ore).

[47] Italian unemployment rate was 12,5 in 2013; Albanese one is 17% (Source: IMFstats).

transferring knowledge makes the productivity of Albany (low technological knowledge) increase quicker than its labor and cost structure.

In fact, assuming that the Production (P) is function of Labor (L) and capital (K) and vary according to the productivity (A), it is quite clear that transferring knowledge abroad increase foreign efficiency.

$P = L \times K \times A$ [48]

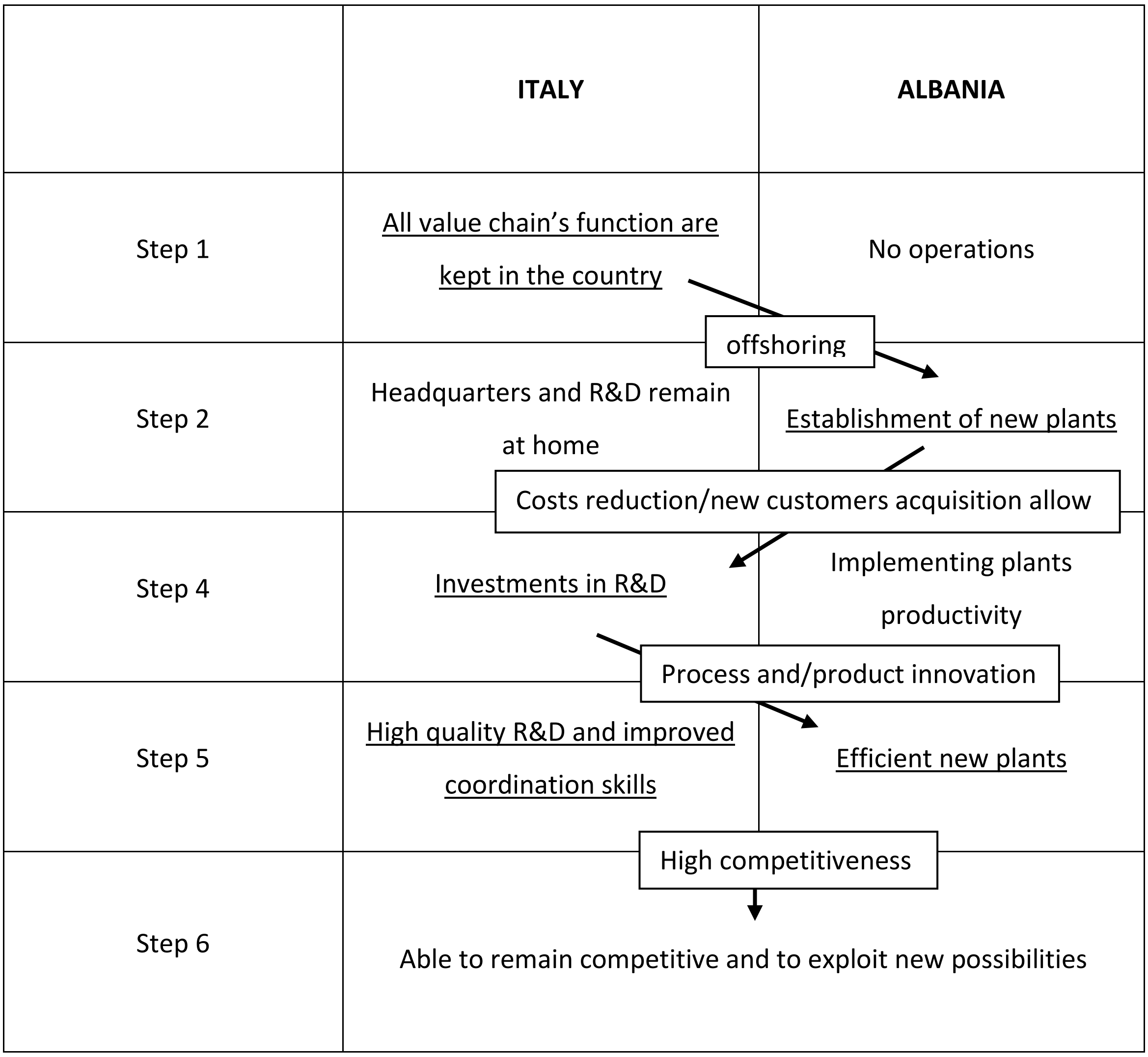
$0 < A < 1$ productivity related to technological knowledge.

So that, Italian SMEs moving towards developing countries may increase the foreign lower productivity transferring knowledge abroad, while benefiting from the low cost structure.

According to what stated, I attach the structure of the model focused on the different stages of offshoring activities. (The determination of these particular steps has been obtained thanks to the questionnaire and the interviews before analyzed; this model represents a sort of guide of best practices aiming at making offshoring successful).

Here I attach a formalization of the model.

[48] Despite the classic approach to production describes it as function only Labor and Capital (K,L), the existence of different levels of technological knowledge explains why plants and/or companies have diverse and increasable efficiency.




This chart clearly resumes the steps that firms have to take when employing offshoring strategies.

However, as stated in the previous chapters, moving abroad part of the value chain activities implies some negative aspects too.

The main three are:

- Job loss in the home country;
- Investments reduction in the home country;

- Know-how transfer, which may favor the rise of new foreign competitors.

Nevertheless, some practices may reduce the impact of these negative aspects, sometimes turning them into positive opportunities.

For what concerns the first issue, it is quite obvious that offshoring implies some home firings in order to implement foreign plants. However, companies are mainly interested in moving manufacturing and sales functions, thus keeping their Headquarters and their Research & Development Centers in Italy.

According to this peculiarity, R&D function may become a destination for new investments and a more efficient source of innovation. In fact, investing in this part of the value chain leads both to the creation of new job opportunities in the home country and to the increase of moved functions' quality (coming from R&D development).

Of course, investing in the R&D solves also the second negative aspect before mentioned: investments reduction in the home country.

However, companies may be able to invest in their home R&D centers only if they reduce costs or increase sales. These two alternatives are viable through offshoring.

If companies employing offshoring are able to exploit foreign favorable conditions and properly reinvest the resources obtained abroad, a perfect balance between home and host operation assure the development of both the countries.

Last but not least, the risk of creating new foreign competitors when offshoring is often times high.

In fact, despite the operations moved abroad remain within firm's boundaries, transfers of know-how to the new foreign plants imply a certain level of knowledge spillovers.

This is mainly due to two reasons:

- Competitors settled in the country of destination may observe company's practices from a closer point of view, thus adopting positive procedures and competing vehemently;

- Implementing operations abroad often times implies a certain level of cooperation with local partners and/or businesses, thus including them into know-how sharing. In these cases, if the relations with those entities are not strong and long-term oriented, collaborations may result in the rise of new competitors.

In order to avoid these risks, it is necessary to employ some precautions.

For what concerns the firs risk, companies may avoid being source of innovation for competitors by keeping their R&D in the home country and by adopting patents and others security measures.

In order to eliminate the risk of creating new competitors through the cooperation with local associates, Italian SMEs may decide to entrust logistic, marketing and bureaucratic tasks to the foreign partner, keeping the manufacturing (production) function under their control.

In that way, Italian entrepreneurs are able to benefit from local partners' awareness of the market, set of regulations and local logistic while protecting the production processes of the business.

**Sum up**

The increasing integration of the markets forces firms not to ask themselves *whether to employ or not internationalization strategies*. It forces companies to ask themselves *how to find a perfect balance between domestic and foreign operations*.

Nowadays global context require firms to be efficient and effective, thus making them interested in exploiting all the possibilities that foreign countries offer. These opportunities allow enterprises to reduce their cost structure and/or to conquest new markets, increasing their customer base.

However, as said before, offshoring strategies are not positive per se. These processes need to be adapted both to the characteristic of the company and to the peculiarities of the target country.

This need for adaptation is the reason why not all the people support offshoring.

In fact, moving functions abroad is a double faced coin. On the one side, the positive one, firms employing offshoring strategies are able to remain or to increase their competitiveness thus not incurring in profits erosion or investments reduction. On the other side, the negative one, people against offshoring argue that firms prefer to move their functions without caring of home activities.

Unfortunately, this is partially true. The most difficult challenge the firms employing internationalization strategy have to face is that of properly balancing home and foreign activities, without focusing too much on one of the two sides. This inability of appropriately managing home and foreign functions may lead to job losses and investments reduction in the home country, something that negatively impact companies' business in the long run.

To sum up, offshoring is a fundamental tool that offers a lot of opportunities and boosts company's performance. However, as many other tools, the success and the benefits that it provides are subjected to a proper design o the whole internationalization strategy.

This strategy must be created according to firm's objectives, structure, know-how, resources and core business.

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