Summary

History is made of cyclical period: 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 this 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 also 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 Global Market are. In fact, different processes are undertaken to reach all the multiple set of goals of Globalization.

The main tools used are: Foreign Direct Investment, Outsourcing and Delocalization on the economic side of the issue; Institutional convergence, Supranational coordination and Cultural integration on the social side.

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

So 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.

In any case, despite some similarities may suggest to, it is necessary not to confuse the concept of Offshoring with that of FDI and Outsourcing, which have 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 relocation 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 delocalization process 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 have 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),* 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 manufacture imported inputs in order to sustain its economic system.

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.

To identify the characteristics of the delocalization, I first of all accurately specify what we define as Offshoring process. Although everybody understands intuitively that the term regards the transfer of production operations from a nation to a foreign one, nowhere in the literature we find a standard definition making reference. As underlined by Grignon (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 the production is then imported in the home territory, and the case of when new units are opened without closing any home unit.

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.

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.

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.

Among them, FDI, Outsourcing and Offshoring share many similarities that require a closer look into their interdependence.

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.

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 with those of Offshoring.

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 lead both to higher revenues and/or lower costs that can compensate the costs of operating far from the 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.

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

Of course, dealing with offshoring, it is necessary to see this process through the lenses of Ricardian theories on international trade, the geographic theories applied to economy, 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.

In addition, 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;

All these elements 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.

For what concern the last theory taken into account, Schumpeter's research describes the changes of the market 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.

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.

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.

Results

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[1] (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, high taxes and increasing unemployment. 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 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.

$P = L \times K \times A$ [2]

$0 < A < 1$ level of 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.

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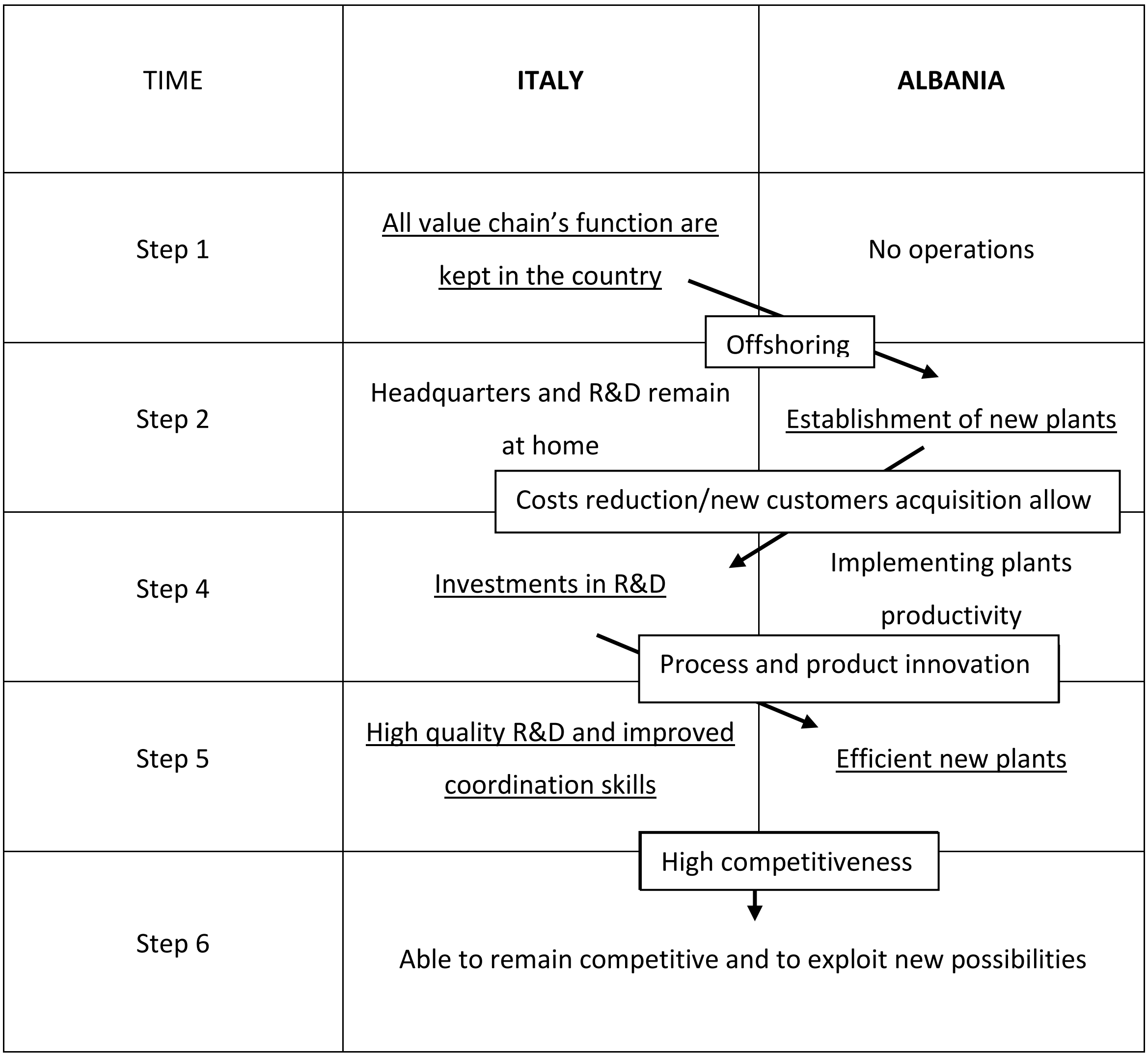
[1] The case analysis of Sergio's Ltd and the geographical proximity to Italy are the reasons of this choice.

[2] 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.

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 represent a sort of guide of best practices aiming at making offshoring successful).

Here I attach a formalization of the model.



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.