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THE NATUZZI GROUP AND THE BARI-MATERA (ITALY) UPHOLSTERED FURNITURE DISTRICT: A CASE STUDY OF INTERNATIONALISATION IN A TRADITIONAL INDUSTRY

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Abstract

The case-study focuses on the strategies adopted by the Natuzzi Group, world leader of the upholstered furniture sector, located in the Bari-Matera district (Southern Italy), to face increasing global competition and on their effects. In particular we consider the modes and determinants of productive internationalisation, carried out since 2000 by Natuzzi in China, Brazil and Romania to produce middle-low end products.

By improving the competitiveness of the price-sensitive segment, the strategy contributed to the successful expansion of the Group until 2002. However, high range products, manufactured in Italy, record decreasing sales especially on the US market, despite the company's efforts in R&D and marketing and its investments in information technology.

Moreover, due to Natuzzi's considerable weight in the district, the Group's performance impacts on the network of subcontracting firms, where a restructuring process is underway, raising questions about the evolution of the district.

Key words: Internationalisation, industrial district, subcontracting
JEL codes: F20, R32, L14

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1. Introduction and research motivation

Since the beginning of the Nineties, the upholstery sector has been in the throes of intense global competition and industrial countries have been facing increasing competitiveness from new emerging global players. Therefore, on the one hand, firms are introducing innovations to upgrade their products, services and production processes in order to move to higher value-added market segments (with high quality and design-intensive products) or specialised niches. On the other, they are reacting by introducing cost-saving strategies and restructuring their production processes, investing in new plants in low-wage countries or outsourcing part of their activities to those regions.

A first aim of this case study is to analyse, among the strategies for tackling increasing global competition, the international reorganisation of the production processes achieved by the Natuzzi Group, the world's leading upholstered furniture manufacturer located in the Bari-Matera district (Southern Italy).

As economic literature points out, progress in information and communication technologies (ICT) and the reduction of transportation costs have allowed for increasing geographical dispersion of economic activities. Greenfield investments, mergers and acquisitions (or intermediate forms like joint ventures) have been set up to duplicate most of the firm's activities (horizontal investments); alternatively there may be a "fragmentation" of production processes (Arndt, Kierzkowsky 2001) implying a vertical division of activities across different countries, leading to an increase in the trade of intermediate goods (Yeats 1998).
An interesting aspect refers to the determinants of horizontal and vertical FDIs, the former usually relying more on motivations related to access to the market (market-seeking) and to "trade costs" (packaging and transport, communication and co-ordination costs, import duties etc.), whereas the latter are more driven by price factor differentials, even though the distinction is not always clear cut (Barba Navaretti and Venables 2004).

ICT plays a crucial role in facilitating the coordination of geographically dispersed activities, as modern production techniques require *just-in-time* management and a high level of synchronization, with a greater propensity on the part of the larger companies to adopt and use those technologies in a more sophisticated manner. In this respect, the presence of an R&D function and of a skilled workforce is important, as information flows have to be codified and, in general, in order to "absorb" the change required by the new technological paradigm (Giunta and Trivieri 2007).

Moreover, from an organisational point of view, firms operating in different countries may prefer to keep some functions in-house, for example to avoid dissipation of internal assets, or they may rely on market relations (through *arm's-length contracts*) to buy components from independent foreign suppliers, despite disadvantages in terms of contractual incompleteness and other transaction costs (Antras and Helpmann 2004). After an initial phase where FDIs trigger imports of machinery, components and intermediate products from the home country, the latter choice may lead to the establishment of specialist local suppliers (Onida 2003) and to the development of "new" districts near to the foreign plants.

Considering this background, the study focuses on the main motivations that have led the Natuzzi Group to evolve from "lighter" forms of international presence to more "complex" ones[1] and on the organisational aspects that have been chosen, since 2000, to pursue the internationalisation of its productive activities. Furthermore, this paper offers a brief overview of the main strategies adopted to support the Group's reorganisation.

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[1] Internationalisation can involve different methods, differing degrees of risk, organisational complexity and costs, from serving international markets through exports from the country of origin or in an indirect form through agents or representatives, to foreign investments in distribution and in productive plants.

Another much debated issue relates to the effects of the internationalisation process on the company's competitiveness and on the home-based activities, considering in particular employment and output.
Economic literature suggests that local and foreign activities can be complements or substitutes: in general, complementarity seems to prevail, however, empirical evidence is not conclusive and investments of a horizontal or vertical nature may have a different impact. The determinants of each FDI play a crucial role, whereas horizontal investments seem more often to be substituting exports from the home country than vertical investments[2].
In any case, even if foreign activities are a substitute for national production, the increased competitiveness on international markets may still entail positive effects, allowing firms to create new activities and new jobs in the home country. The effects on employment can be negative or positive also depending whether the reference is short-term or medium-term, and whether both direct and indirect effects are considered (OECD 2007).

A number of studies have found that productive internationalisation processes, by enhancing competitiveness, do not imply a substantial reduction of workers in the parent company (for the Italian case see, among others, Barba Navaretti and Castellani 2003; Savona and Schiattarella 2005; Federico and Minerva 2006; Castellani and Mariotti and Piscitello 2006). In addition, internationalisation may increase skill-intensity in the home-based plants, in particular when firms invest in developing countries, as the so-called "headquarter services" (design, R&D, marketing, accounting etc.) usually remain in the home country, also multiple plants require more sophisticated coordination processes, and activities in the parent company become more value added.

Regarding these issues, the study offers some insights into how the adopted strategies are affecting Natuzzi's competitiveness and what have been – during the period considered - the effects of productive reorganisation on the national activities of the Group.

Furthermore, the choice of Natuzzi for this case study is motivated by its role in the Bari-Matera district, where the company carries considerable weight in terms of export turnover and employment, implying that its performance has a relevant impact on the performance of the whole area and on the activities of the local sub-supplier firms.
As mentioned, depending on whether foreign plants are more substitutes than complements to the economic activity in the home country, the internationalisation process may entail a reduction in exports from the district and the displacement of local sub-supplier firms. Some studies of the indirect effects at a cluster-level indeed suggest the existence of negative spillover on local suppliers, especially in contexts where networked firm situations prevail (Costa and Ferri 2008). As leading firms increasingly outsource lower and middle stages of production to remain competitive, a number of firms, particularly the smaller ones, are driven out of the market.
These restructuring processes raise questions about the future evolution of industrial districts, as they may eventually lead to the development of a more dynamic economy based on medium-sized firms (Monni and Spaventa 2005) or, as some observers fear, to their dissolution. In any case the transition phase calls for appropriate policy intervention, in particular to counteract job losses (OECD 2007).

In this view the case study provides some insights into the recent developments that have taken place in the Bari-Matera district and into the main strategies adopted by the subcontracting companies to overcome the crisis.

[2] For a literature review on these issues see Castellani (2007).

2. Methodology and data

The case-study refers to the period 2000-2006, however some more recent data are provided, when available, to show the latest developments. Information was collected through direct interviews[3] involving Natuzzi as well as other firms of the Bari-Matera district (both competitors and sub-suppliers), and a number of representatives of local institutions (industry associations, Matera District Committee, trade unions). Other relevant information was gathered from the Group's Annual Reports, other official documents and balance sheets.

The paper is organised as follows: section three provides a brief overview of the main world trends in the upholstered furniture sector, while the next section describes the characteristics and origins of the Bari-Matera industrial district. Section five analyses the organisation and strategies of the Natuzzi Group, focussing mainly on the productive internationalisation process, and provides some insights into the effects on the company's competitiveness and performance; section six deals with the recent developments in the Bari-Matera district following the leading firms' internationalisation processes and outlines the strategies adopted by sub-supplier firms to face the current crisis. The last section offers some concluding remarks.

3. World trends in the upholstered furniture sector

Upholstered furniture is a resource- and labour-intensive industry, characterised by low technology and relatively slow international demand, particularly vulnerable to the price increases of raw materials (such as wood, leather and polyurethane). Entry-barriers are low and, as production does not require huge investments in technology, new competitors from emerging and transition countries enter the market, marking a trend of overall falling prices. At the same time furniture demand is changing, showing growing complexity, and even if price-competitiveness is crucial, products and services need to be more customized, which drives the need for new and more complex organizational processes at the firm level.

About 40% of world upholstered furniture originates in emerging countries, whose role has been increasing in the last decade also as a consequence of internationalisation and the fragmentation of production processes towards low-wage countries. China has experienced very sharp growth, becoming the second largest producer, almost reaching the United States, and Poland has also been growing rapidly (Figure 1).

Italy is historically a leading player in the sector, with upholstered furniture production concentrated mainly in Lombardy (Northern Italy) and in the Apulia and Basilicata regions (Southern Italy). However, in recent years the sector has witnessed a considerable decrease in production in real terms (7% and 10% in 2005 and 2006), while Germany (the fourth world producer) has increased its production of upholstered furniture since 2004.

Consequently, while in 1997 developed countries accounted for 78% of world exports, in 2006 their weight had dropped to 46%[4]. China turned out to be the world's largest exporter in 2006, followed by Italy (which was the leading exporting country until 2005), while Poland now ranks third (Figure 2, Table 1A).

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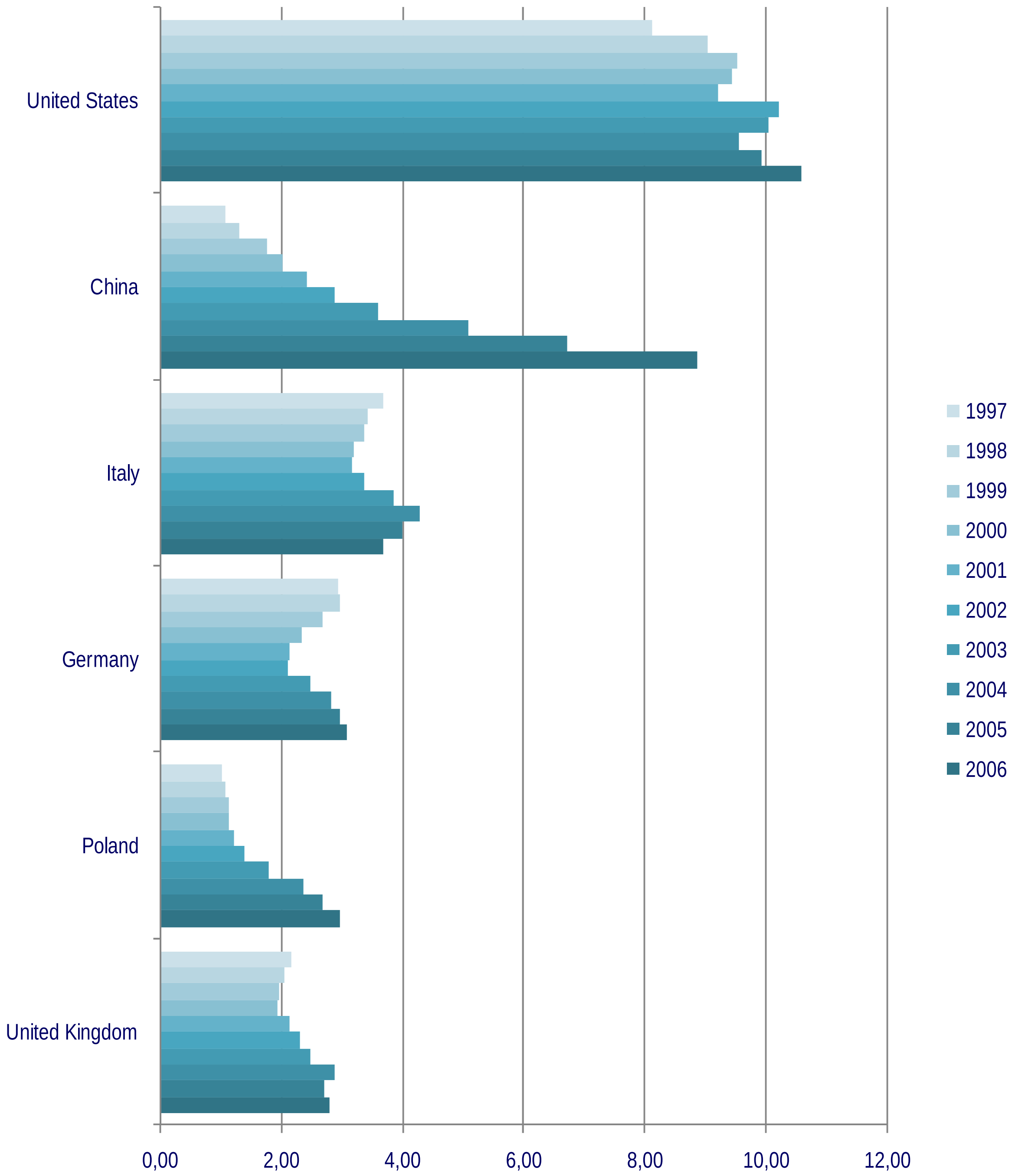
[3] Eight direct interviews were conducted between February and May 2008.

[4] CSIL estimates.

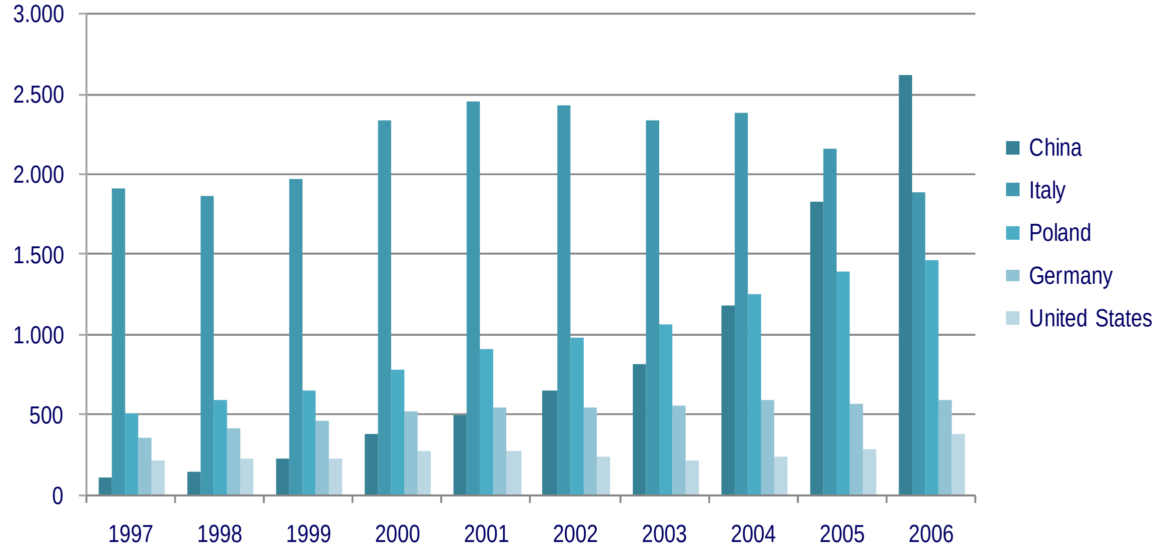
Figure 1
Five major upholstered furniture producing countries (Values in Euro billion)



Source: CSIL processing

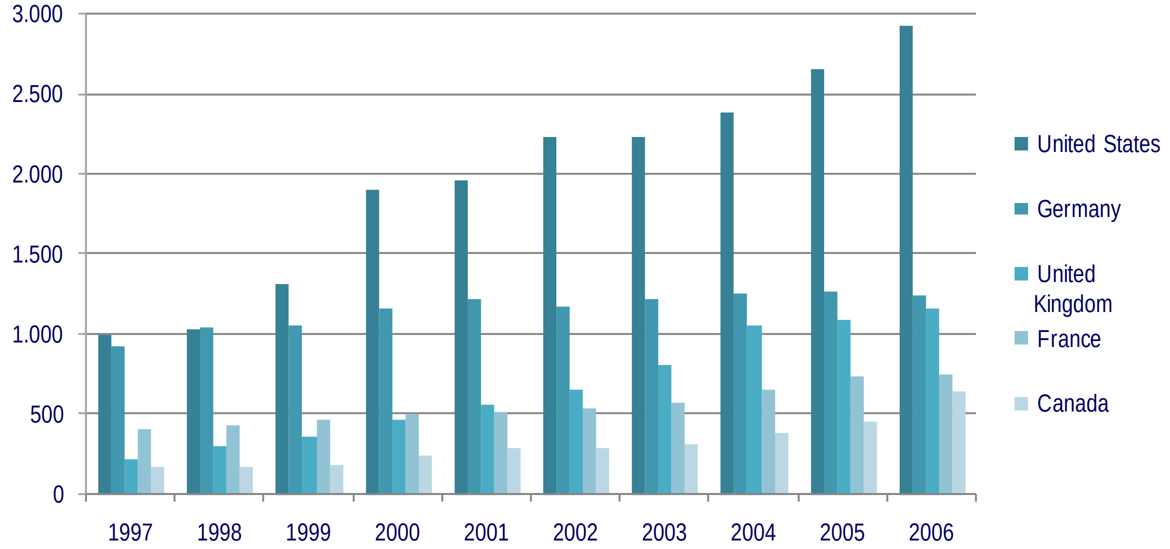
International demand for upholstered furniture has followed a growth trend over the last decade. The real driver is the United States, accounting for a quarter of world imports (Euro 2.9 billion in 2006), so that the ongoing economic slowdown in the US is likely to act as a brake for global demand. Other major importing countries are Germany and the United Kingdom, the latter showing a noticeable increase in its share over the last decade (Figure 3, Table 2A). World consumption of upholstered furniture experienced a period of growth, except for a phase of slowdown between 2002 and 2004, and totalled Euro 38 billion in 2006 (Figure 1A). The increasing openness and integration of the markets has also led to a rise in the ratio of upholstered imports to consumption, from 19% in 1997 to 29% in 2006, and reaching in 51% in Germany, 40% in the United Kingdom, 36% in France and 27% in the United States (CSIL 2007).

Figure 2
Five major upholstered furniture exporting countries (values in Euro million)



Source: CSIL processing

Figure 3
Five major upholstered furniture importing countries (values in Euro million)



Source: CSIL processing

4. The Bari-Matera upholstered furniture district

The Bari-Matera upholstered furniture industrial district is located in the Murge area (South Italy) with most companies based in the towns of Altamura, Santeramo in Colle (Apulia region) and Matera (Basilicata region). Already in the 1950s the area was involved in the manufacture of sofas and armchairs by a few craftsmen, so that there was some knowledge in upholstery production techniques coupled with an abundant workforce at a relatively low cost. The origin of the industrial district can be traced back to between the 1960s and the 1970s, with the launching of a production plant in Santeramo in Colle by Pasquale Natuzzi, a local entrepreneur, who decided to produce leather upholstered furniture on an industrial scale, despite the absence of specific locational advantages.

The 1980s witnessed the rapid growth of the industrial district, in terms of both turnover and the number of companies. Many new small enterprises were created (often established by former employees of the leading company) and worked for the final goods manufacturers, who dealt with demand peaks by transferring the excess orders to the sub-supplier firms, specialised in one or more production phases.

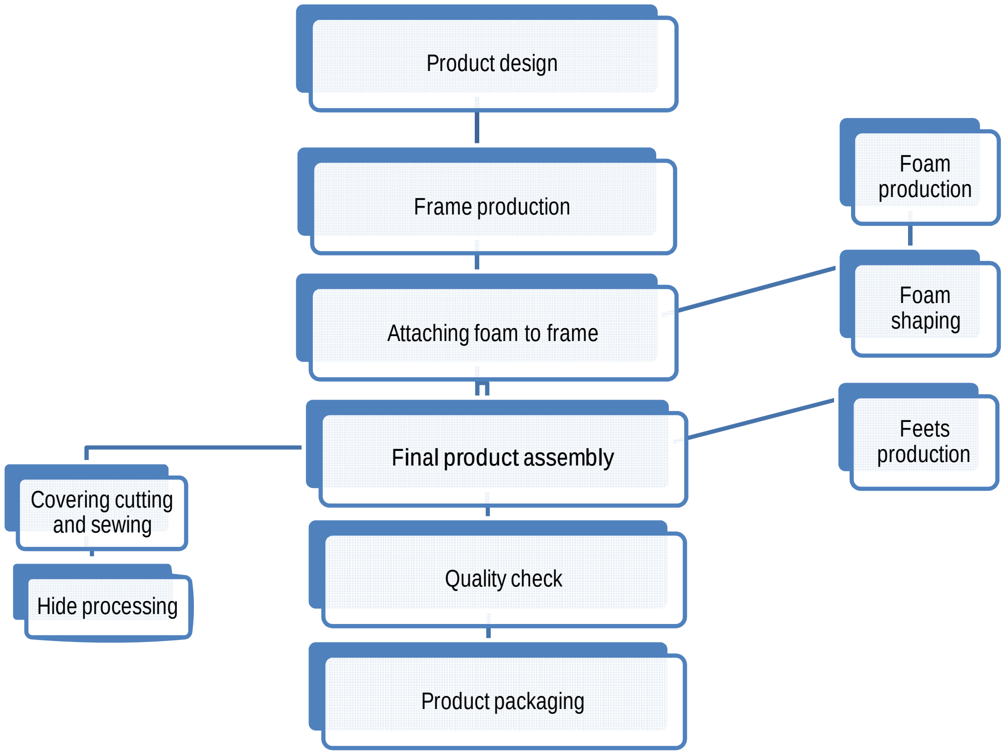
The production of upholstered furniture is mainly a labour intensive process[5]: some phases are more standardized while others are more labour- and skill-intensive, even though the leading companies have introduced automation in some processes and the use of more advanced technologies (like for example Cad-Cam[6] in the cutting process).
The polyurethane foam used for filling is usually supplied by external manufacturers, as it requires a huge investment, while the foam shaping phase is often performed by sub-suppliers. Frame production, which generally includes the attaching of the shaped foam, is frequently decentralised since it is rather simple to standardize and its contribution to the added value of the product is low, as is the manufacture of sofa feet. Also the hide processing phase (which consists of several sub-phases like tanning, colouring, softening and drying to obtain the finished leather) is often performed by sub-supplier firms. Conversely, cutting and sewing the leather or textile coverings is a crucial phase as regards the quality and the final cost, requiring greater skills, hence leading companies tend to control these processes directly, especially when producing top quality upholstered goods. Finally, the assembly phase is often carried out by the final goods producers, especially in the case of new models.

The district's growth continued unabated in the 1990s: while the development of other Italian industrial districts was mainly driven by the domestic market, the expansion of the Bari-Matera area was led by Natuzzi's export performance, triggered by US and European demand and by the devaluation of the Italian Lira in 1992. During this period, spin-offs and imitation processes led to the establishment of other important final goods manufacturers (such as Calia and Nicoletti), thus reducing the degree of productive concentration of the area.

[5] The upholstered furniture production chain comprises a series of phases related to the production of the necessary semi-finished products and components and the assembly of the final product. The main raw materials used in the production process are wood, metal, polyurethane foam, cattle hides and textiles.

[6] Computer Aided Design, Computer Aided Manufacturing, Sinisi (2008) p.40.

Figure 4
The upholstered furniture production chain



Source: Authors

As a result, in the late 1990s the area was an export-led district, characterised by three groups of companies: first, a host of larger players, such as Natuzzi, Soft Cover, Calia, Nicoletti and Contempo (in 2001, the five largest companies accounted for 64% of district turnover) with a structured organisation, externalising part of the production to gain efficiency and meet excess demand. Second, a number of small companies capable of manufacturing the finished product but lacking the complex structure of the leading firms, often depending on external suppliers for some of the production phases. Finally, a myriad of very small sub-suppliers specialised in one or more production phases, revolving around the leading final goods producers who represent a bridge between them and the rest of the world. This polarised structure has not changed over time, and there are virtually no medium-sized firms in the area.

Moreover, it is worth noting that the relationship between the final goods producers and the sub-supplier firms is mostly of a hierarchical nature, as sub-suppliers are usually merely suppliers, and work according to the design and quality specifications of the leading firms. Consequently sub-suppliers are highly dependent on their local customers and vulnerable to sudden cuts in production as their contracts are often short-term and sometimes even informal.

5. The Natuzzi Group

5.1. Origin and organisation

Natuzzi is a world leader and the largest Group in Italy for the design, manufacture and marketing of leather- and fabric-upholstered furniture, employing over 8,000 people at its production plants and commercial subsidiaries. It offers a wide range of upholstered models as well as other types of furniture (wall units, tables, lamps, carpets and other living-room accessories), following the concept of “total living”.

As mentioned above, the company was founded by Pasquale Natuzzi, who played a crucial role in the development of the company and is currently chairman of the board of directors. After starting with a small workshop, in 1972 he established the first industrial plant in Santeramo in Colle, introducing a number of product and process innovations to standardise the manufacturing process of the traditionally labour-intensive production of leather upholstered furniture (e.g. the simplification of the wooden structure and the use of polyurethane foam, as well as the automation of some production phases), achieving a very good price-quality ratio.

Natuzzi started exporting leather sofas in the 1970s, first to the Middle East and some European countries, but the turning point came when Natuzzi entered the US market in the 1980s, thanks to contracts with the major retail chains. Leather upholstered furniture was perceived in the US as a luxury product and Natuzzi was able to manufacture it at a remarkably low price, positioning itself in the low-middle market range. This enabled the company to quickly gain a substantial market share in the 1990s.

During this period the company gradually expanded, becoming an industrial Group including all the main production phases and obtaining ISO 9001 quality certification. Its success on foreign markets enabled Natuzzi to be listed on the New York Stock Exchange in 1993, being the only Italian sector company, though remaining under the control of the founder and his family[7]. Some years later, the “Natuzzi 2000” project (co-financed by public funds[8]) led to the rationalisation and concentration of the economic activities in three locations (Matera, Iesce and Altamura), in order to improve efficiency and reduce logistic costs.

At present the headquarters is based in Santeramo in Colle and seven manufacturing plants are located in Italy[9] (four of them close to Santeramo), employing around 3,500 people and operating throughout the whole production chain (Table 1).

While some final goods manufacturers were only involved in the assembly phase (Boscarelli 1993), the Natuzzi Group preferred a high degree of vertical integration, while decentralising part of the productive process to sub-suppliers located close to the headquarters.

Sub-suppliers working for Natuzzi are mainly involved in the phases related to the shaping of polyurethane, the production of wooden frames and the assembly process (Sinisi 2008), which represent (in Italy) around 64% of the total cost[10].

Following the principles of *just-in-time* and *lean production,* Natuzzi requires from its suppliers respect for pre-determined quality and productivity standards, on the one hand improving the efficiency and quality of the sub-suppliers themselves and,

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[7] Pasquale Natuzzi owns 47.5% of the issued and outstanding ordinary shares of the company (52.6% by adding the ordinary shares owned by his immediate family members). As a result, Mr. Natuzzi controls the company, including its management and the selection of its board of directors, Natuzzi Annual Report 2006, p. 7.

[8] The investment was co-financed through Italian Law 488/92, following the signature of a “planning contract”, Sinisi (2008) p.82 . Florio and Giunta (1998).

[9] As of March 2008, see SEC June 30 2008 p.14.

[10] Natuzzi’s estimate, reported in direct interview.

on the other, entailing a reduction in profits for those firms that were not able to meet Natuzzi's productivity standards (Viesti 2000).

The relationship with the sub-supplier firms has traditionally been dominated by the leading company: for example, contracts for the assembling sub-suppliers (usually placed within six weeks) and mutually rescindable, with between one and three months' notice[11]) state that Natuzzi provides the design and all the materials.

Table 1
Natuzzi Group - Production plants in Italy

Italy	Production Phases	Number of employees 2006
Natuzzi S.p.A.	Headquarters, prototyping, manufacture of wooden frames, leather cutting, sewing and product assembly	3,170
Natco S.p.A., Bari	Intra-group hide tanning	59
I.M.P.E. S.p.A., Qualiano	Polyurethane foam production	263
TOTAL		3,492

Source: Natuzzi - Annual Report 2006 and Balance Sheet 2006

5.2. Internationalisation process and fragmentation of production

The Group's growth has been export-led since the early stages of its activity, and foreign sales, which accounted for 87% in 2006, have always represented a very high percentage of the upholstered furniture turnover[12] (Table 3A).

North America soon became the main outlet market, providing 92% of the company's turnover in 1987, while the weight of the European area was around 6%. This concentration on one market was mentioned as one of the company's weaknesses in the 1990-94 development plan and led to a strategy of export market diversification in the following years, with the objective of expanding sales in Europe and in the Far East, as well as on the domestic market.

As a result, in 2006 43% of total foreign sales of upholstered furniture were made on European markets (especially Spain, 8%, and the UK, 7%, Table 4A), while the share of the Americas (mainly the US) had decreased from about 50% in 2001 to 37% (Table 2). However, considering the figures in volume (number of seats), exports are still highly concentrated: in 2006 over 45% of production was absorbed by the American market (mainly the US), which is not very different from the previous years (48% in 1998 and in 2001, with a peak of 55.5% in 2003, Table 3).

It should be noted that while other Italian companies focussed on the domestic market, characterised by a more fragmented distribution system and a different type of consumer, from the outset Natuzzi's industrial organization was more oriented towards standardised production, enabling the delivery of large volumes to the big retail chains (typically found in North America[13] and in some northern European countries) or to important global players, like IKEA[14].

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[11] Natuzzi interview: "*We live and work in a sector that by definition leaves no room for forward planning. If you ask me what margin we have in terms of useful life of orders received, I'll tell you that when things are going well our margin is no longer than six weeks… We were the first to rationalise: to provide written open-ended contracts, with advance notice from four weeks to three months; and this is the fruit of the reference market. Thus at the best of times our visibility is six weeks, and this also complicates our relationships.*"

[12]In addition to upholstered furniture, the Group sells part of the polyurethane foam and furniture/accessories for living rooms, reaching a total turnover of 87,913 thousand Euro, 75,089 thousand Euro, and 75,188 thousand Euro in 2004, 2005 and 2006, Natuzzi Annual Report 2006.

[13] According to an interview at Natuzzi company: "*The American distribution system is so well-organised that you only have to get one customer in order to sell incredible volumes … from the distribution point of view Europe is an extremely fragmented market with a completely different type of consumer than the American… In Europe in the great majority of cases the consumer wants a sofa of a different colour, or he asks for a different configuration, wanting a sofa that meets his own desires, but it is obviously impossible to do this in a logic of large volumes and a high level of standardisation.*"

[14] SEC June 30 2008, p. 20.

Since high market-concentration may represent a risk, Natuzzi continues to stress the aim of developing other outlet markets (in particular Eastern Europe, the Middle East, China and India)[15].

Table 2
Natuzzi Group - Sales of upholstered furniture. Geographic breakdown (values in Euro thousand)

	2001	2002	2003	2004	2005	2006
	Euro thousand					
Americas	356.4	366.4	320.1	279.4	241.7	245.4
Europe	*245.3*	*250.4*	*242.2*	*267.1*	*246.2*	*284.7*
Other countries	39.7	41.8	40.4	46.0	39.9	48.3
Italy	72.6	76.1	71.3	73.0	67.0	81.9
Total	714.0	734.7	674.0	665.5	594.8	660.3
	% share					
Americas	49.90%	49.90%	47.50%	42.00%	40.60%	37.20%
Europe	34.40%	34.10%	35.90%	40.10%	41.40%	43.10%
Other countries	5.60%	5.70%	6.00%	6.90%	6.70%	7.30%
Italy	10.20%	10.40%	10.60%	11.00%	11.30%	12.40%
Total	100%	100%	100%	100%	100%	100%

Source: CSIL processing of data from SEC-Security Exchange Commission Reports, Washington D.C.

Table 3
Natuzzi Group - Sales of upholstered furniture. Geographic breakdown (number of seats)

	2001	2002	2003	2004	2005	2006
	Number of seats					
Americas	1,376,818	1,572,879	1,699,190	1,564,900	1,386,329	1,364,873
Europe (1)	1,323,736	1,278,296	1,181,566	1,319,740	1,262,887	1,449,696
Other countries	175,704	176,483	178,109	186,330	162,523	202,133
Total	2,876,258	3,027,658	3,058,865	3,070,970	2,811,739	3,016,702
	% share					
Americas	47.90%	52.00%	55.50%	51.00%	49.30%	45.20%
Europe(1)	46.00%	42.20%	38.60%	43.00%	44.90%	48.10%
Other countries	6.10%	5.80%	5.80%	6.10%	5.80%	6.70%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

(1) including Italy
Source: Balance Sheets 2001-2006

5.2.1. The first phase

Natuzzi's internationalisation process can be divided in two distinct periods: until 2000 the Group pursued exclusively a strategy of "commercial" internationalisation. Despite the distance from raw material suppliers and from its main outlet markets, the high transportation costs and the poor local infrastructure, Natuzzi considered the experience and the know-how of local craftsmen a crucial competitive advantage, not easy to find in other countries[16]. Consequently, the company did not produce abroad and exported directly from Italy, mainly selling on a wholesale basis to large retailing companies.

[15] SEC June 30 2008, p. 9.
[16] ICE Annual Report 1998-1999, "Dal Mezzogiorno in 140 paesi: i divani Natuzzi", p. 242.

Over time the Group diversified its distribution channels, establishing increasing control over the whole distribution chain, a process which is still ongoing. Natuzzi invested both in commercial subsidiaries (Natuzzi Americas in the US and another six companies based in European countries[17]) and in a wide network of company-owned stores[18] to avoid the intermediation of local importing companies, provide better services to the customers and to increase brand awareness.

5.2.2. The second phase

The internationalisation process became more complex after 2000 when, due to the increasing competitiveness of producers located in emerging countries, Natuzzi decided to establish two factories in China (2000, 2004), two in Brazil (2001, 2003), and one in Romania (2002) (Table 4).
The Group aimed to produce the middle-low end products (brand Italsofa) in the three emerging countries, whilst at the same time investing in the Bari-Matera district to produce upper-end products (brand Natuzzi), and it changed its brand strategy accordingly in 2000.

Natuzzi started to operate in China through a partnership, while in Brazil and Romania it established Greenfield investments reaching a total of Euro 99.5 million between 2001 and 2006[19]. As a result of this process, in 2006 around 55% of total production was carried out in the three foreign plants and 45% in Italy, directly or through sub-suppliers.
Foreign investments recorded a steady increase in employment between 2001 and 2006, reaching 4,100 employees, and the Italian plants' share of the total Group workforce declined from 89% to 46% (Table 4-5). At the same time, there was a rapid increase in turnover, with foreign plants accounting for almost one third of production at the end of the period considered (see below, paragraph 5.3).

The determinants of foreign direct investments are both cost-saving and resource-seeking, due to lower labour and transportation costs and the proximity to important sources of raw materials (leather in Brazil and wood in Romania). At the same time, market-seeking motivations are very relevant, due to the fact that the subsidiaries serve as "export platforms", thus substituting foreign sales of middle-low range products previously manufactured in the Bari-Matera district. Italsofa products are manufactured in China and Brazil and destined for North America, serving the Western and Eastern coasts respectively (and some other countries in Asia and South America), while leather sofas from Romania are exported to Europe. In contrast, the importance of the local markets is limited: China and Brazil are still considered potential markets, while Romania's size is limited.

From an organisational point of view, there is not a high degree of fragmentation in the production process between the plants in the home country and those abroad (usually associated with "vertical" FDIs), since Natuzzi made the choice to keep most of its activity "internalised". Many phases have been duplicated in the foreign plants, from the production of polyurethane foam and of semi-finished products to assembly operations, so that they can be defined "horizontal" FDIs.
In addition, the plant in Romania operates in the wood and wood-manufacturing industry: part of its semi-finished production is sent to other Natuzzi plants (including those based in Italy[20], to improve their competitiveness), thus it can also be partly considered a "vertical" type of FDI.

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[17] Distribution in North and South America is handled by the subsidiary Natuzzi Americas and its sales representatives. In Europe the Group operates through six distribution subsidiaries, Natuzzi Annual Report 2006.
[18] 179 Natuzzi Stores and Divani & Divani by Natuzzi stores; 419 Natuzzi Galleries, store-in-store concept managed by independent partners. Moreover the Group has three outlet stores, five Italsofa stores, 14 concessions in the UK, one concession in Ireland (store-in-store concepts directly managed by the subsidiaries of the company), (source: Securities and Exchange Commission Washington, D.C. 30 June 2008).
[19] Natuzzi Annual Report 2005, p. 13.

While during the start-up phase most raw materials, components and semi-finished products were imported from Italy, the Group aims to make each plant as independent as possible of foreign supplies, and currently they are estimated to be autonomous for about 60%. However, part of the raw materials is sourced "globally" through the constant search for new suppliers offering the best price-quality ratio[21].

A relevant goal is to optimise intra-trade flows: as an example, for a certain period Natuzzi imported cattle hides from Brazil, processed the leather in Italy and exported a part back to Brazil, whereas now the leather is imported into Italy after having been processed directly overseas.

Natuzzi did not outsource any important parts of production to local suppliers through *arm's length contracts*, as local firms are not yet considered to have reached an adequate standard as regards quality and service. However, the Group aims to develop a network of local suppliers in the three hosting countries, so that in the long term there could be a deverticalisation process and the development of "new" local districts.

As mentioned, the headquarters and most production lines for the upper-end segment[22] have been maintained in Italy, where R&D, design, marketing, information and communication activities take place, as shown by the weight of intangible assets in Italy (Table 6). Accordingly, the share of the skilled workforce is higher in Italy than abroad (34% in Italy, compared to 4.2%, 6.5% and 9.6% in Romania, China and Brazil, respectively, Table 7).

Box 1

The internationalisation process: example of the Natuzzi plant in Romania

Internalised:
- all production phases, including semi-finished products and assembly

Sourced locally:
- wood, polyurethane foam, packaging material, mattresses, sofa feet
- part of the assembly operations

Imported
- from Italy: leather, fabrics for coverings (everything during the start-up phase)
- from other countries (China, Belgium): metal products, components for packaging

Exported
- to several plants of the Group (including Italy): wooden feet, wooden sofa frames

The trend is to source more semi-finished products and components from local suppliers in order to substitute imports.

Source: interviews at Natuzzi company

20 "In Romania construction has been completed of an industrial plant to produce semi-finished wood products, with fir and beech elements, wooden feet and polyester padding, the majority of which are sent to Italy, as well as sofas and armchairs for the Italsofa range for the European market,", Natuzzi Annual Report 2003, p. 11.

21 "The Group continuously searches for alternative supply sources in order to obtain always the best product at the best price", Natuzzi Annual Report 2006, p. 15.

22 However, at the beginning of 2006 the Group also started to produce some of the most popular models for the US market outside Italy, in order to further improve its competitiveness, Natuzzi Annual Report 2006, p 11.

Table 4
Natuzzi Group – Foreign production plants

		Year	Production Phases	Number of employees 2006
Brazil	Italsofa Bahia Ltd, Bahia	2001	Leather cutting, sewing and product assembly, manufacture of wooden frames, wooden feet, polyurethane foam shaping, fibrefill production	689
	Minuano Nordeste S.A., Pojuca	2003		722
China	Italsofa Shanghai Ltd, Shanghai	2000	Leather and fabric cutting, sewing and product assembly, manufacture of wooden frames, polyurethane foam shaping, fibrefill production	934
	Softaly Shanghai Ltd, Shanghai	2004		435
Romania	Italsofa Romania, Baia Mare	2002	Leather cutting, sewing and product assembly, manufacture of wooden frames, polyurethane foam shaping, fibrefill production and manufacture of wood and wooden product	1,339
TOTAL				4,119

Source: Natuzzi - Annual Report 2006 and Balance Sheet 2006

Table 5
Natuzzi Group – Employees in production plants (percentage share)

	2001	2002	2003	2004	2005	2006
Brazil	7.30%	10.30%	8.40%	14.00%	16.10%	18.50%
China	0.20%	16.70%	12.40%	9.70%	17.40%	18.00%
Romania	3.30%	8.10%	13.80%	17.80%	18.10%	17.60%
Italy	89.20%	64.90%	65.50%	58.50%	48.30%	45.90%
TOTAL	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Balance Sheets 2001-2006

Table 6
Natuzzi Group - Breakdown of total costs in 2006 (percentage share)

	Italy	Romania	China	Brazil
Workforce	32%	15%	8%	19%
General costs	3%	4%	6%	7%
Tangible assets	4%	3%	2%	3%
Intangible assets	21%	0%	0%	0%
Raw materials, semi-finished products	40%	78%	84%	71%
Total	100%	100%	100%	100%

Source: interview

Table 7
Natuzzi Group - Breakdown of total costs by workforce type in 2006 (percentage share)

	Italy	Romania	China	Brazil
Skilled workforce (white collar/blue collar)	33.97 %	4.25%%	6.47%	9.59%
Unskilled workforce (white collar/blue collar)	66.03%	95.75%	93.53%	90.41%
Total	100%	100%	100%	100%

Source: interview

5.2.3. Strategies supporting the internationalisation process

Natuzzi has adopted a mix of strategies to face the growing competition, aiming to upgrade the production maintained in the Bari-Matera district and to improve efficiency by reducing operating costs.

First, as mentioned above, the company innovated its brand portfolio strategy to support the internationalisation process, launching "Italsofa" for the lower price range in 2000 (manufactured in China, Brazil and Romania) and investing in the so-called "brand project for goods Made in Italy"[23] by introducing, for example, a new logo for Natuzzi upper-end products[24] to better define their image[25]. Furthermore, significant investments in the distribution network (commercial subsidiaries, *Natuzzi stores* and *galleries*) and in communications aim to support the sales of the two brands and of living room accessories.

Second, the Group has been focussing on R&D[26] to innovate and develop its products, also cooperating with the University of Bari. New models and furniture accessories are designed and projected at the *Natuzzi Style Centre* in Santeramo, with over 150 employees, as 100% of the design is performed in Italy.

Furthermore, the development of human resources represents another important aspect, leading to the establishment of a centre for professional training in Altamura and resulting in a relatively higher level of human capital, compared to the smaller firms in the district (Boscarelli 1993, Sinisi 2008[27]).

Third, several measures have been taken to introduce a better organization and to raise productivity (e.g. in the Italian plants there have been improvements in logistics and in the automation of packaging lines).

A crucial strategy accompanying the ongoing globalisation process involves the integration of operations worldwide (headquarters, foreign plants, commercial subsidiaries), in order to reduce industrial costs and improve customer services. ICT plays a central role in managing production, finances, stocks, logistics and in facilitating communication with suppliers and customers, for which the Group invested Euro 28 million during the period 2000-2006[28].

In addition to the endowment of basic technologies like Internet/Intranet/Extranet, Natuzzi has an ERP (Enterprise Resource Planning) management system to improve worldwide integration and provide information from different management functions and countries[29]. The Group is equipped with technologies for the electronic exchange of information (EDI) and makes use of VoIP (Voice over Internet Protocol) systems to enhance communication, while CAD-CAM computer software is used in the planning phases.

Computer applications play a relevant role in managing the supply chain (through Supply Chain Management systems) with the aim of optimising worldwide orders, production, warehouses, payments, shipping etc.: Natuzzi's planning activities (finished goods load optimization, customer order acknowledgement, production and suppliers' planning) are synchronized in order to guarantee that during the production process the correct materials are located in the right place at the right time, thereby achieving a maximum level of service while minimizing handling and transportation costs.

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23 Between 2002 and 2007 the company, by self-financing, invested Euro 371 million in the brand project, see "Le condizioni per la difesa del Made in Italy" Industrial Plan 2008-2010, May 27 2008.

24 The Natuzzi brand comprises by two collections: Pasquale Natuzzi Collection for upper-end products and Natuzzi Retail Collection for the upper-middle segment.

25 SEC June 30 2008.

26 Natuzzi invested Euro 126 million over the period 2002-2007, Industrial Plan 2008-2010 "Le condizioni per la difesa del Made in Italy", May 27 2008.

27 Sinisi (2008) reports that at the end of the 1990s 3% of the workforce were graduates, 25.8% possessed a school-leaving certificate while 63.4% achieved only compulsory education.

28 Data provided during the direct interview.

29 A new ERP system was introduced, SEC, June 30 2008, p.7.

As an example, a new intranet portal (Worldwide Demand Planning tool) is to further support corporate logistics and operations managers in better forecasting the future demand for the Group's products, so as to improve the lead time from material supply to sales delivery[30]. Moreover, in 2007 Natuzzi introduced a new retail system portal[31] to support the activities of its direct sales channel and manage all the processes of the Natuzzi stores (from customer profiling to delivery tracking, which includes selecting the models to be purchased, defining their characteristics, confirming orders, invoicing and warehouse management), integrating these activities with the Group's existing back-end systems. Between 2007 and 2008 280 stores are expected to be connected.

Specific software solutions have also been developed in conjunction with local and foreign universities (Bari and Copenhagen) to optimise the loading of containers[32], as transport is a relevant cost component; other developments are planned in the field of transportation management to improve the delivery system[33].

5.3. The performance

A relevant issue relates to the effects of the internationalisation process (and of the other corporate strategies) on the company's competitiveness and on domestic operations. This section provides some insights into the performance of the home-based company (Natuzzi S.p.A.) and into the contribution of the Group's foreign plants to the overall results.

The turnover of Natuzzi S.p.A. recorded progressive growth until 2001 (reaching Euro 830 million), after which it experienced a considerable decrease that led to a turnover of Euro 549 million in 2006 (Table 5A). Consequently, as shown by ROS (Return on Sales) and other performance indicators (ROI-Return on Investment and ROE-Return on Equity), profitability has been declining since 2003 (Table 7A).

Conversely, the turnover of the foreign plants has been growing rapidly, to reach over Euro 220 million in 2006 as the subsidiaries in Brazil, China and Romania recorded increasing exports to the American region (mainly the US) and to European markets (Table 6A).

Due to lower costs (of labour and transportation) the Italsofa brand has considerably gained in competitiveness: lower-middle range products accounted for 37% of turnover at the end of 2006, while sales of higher-priced goods produced in the Bari-Matera district have shown a progressive decline (Figure 5, Table 8A).

A sharp contraction occurred especially on the US market where the sales of the upper-end range fell by over 80% (from 606,000 seats to 101,000[34]), determined by the increasing price competition (notably from Chinese products, partly manufactured by Italian competitors who invested in China[35]), growing raw material prices, the devaluation of the US dollar and the sluggish growth on the American market, but also to difficulties in repositioning the brand at the upper-end, as

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30 SEC, June 30 2008.

31 BEA Customer Case Study "Natuzzi Group" http://whitepapers.zdnet.com/abstract.aspx?docid=358658

32 "With the aim of decreasing costs and safeguarding product quality, the Group attains optimum load levels for shipping by using software developed through a research partnership with the University of Bari and the University of Copenhagen, completed in June 2006. This software manages customers' orders to be shipped by sea with the goal of maximizing the number of orders shipped in full containers. If a customer's order does not make optimum use of container space, revisions to the order quantities are suggested. A prototype of this software was delivered to the Group in November 2007. The Group expects conclusive testing of this prototype to be completed in September 2008", SEC June 30 2008.

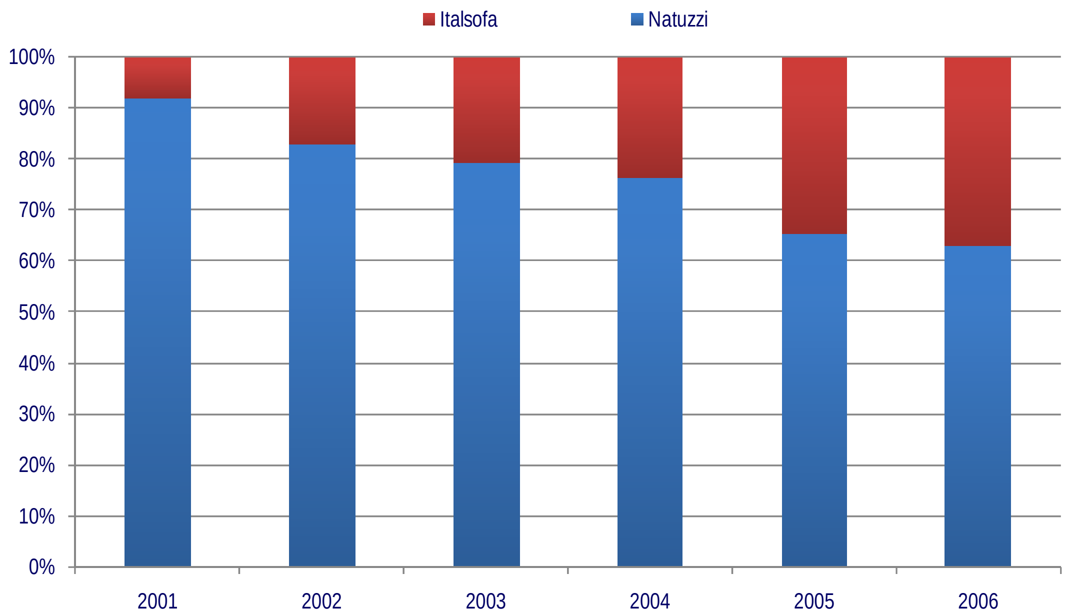
33 The Bari Polytechnic and Natuzzi launched "SOFAPACKER", a unique software for upholstered furniture logistics, in November 2007. www.poliba.it/Attivita/Comunicato_stampa_SofaPacker_.pdf

34 Industrial Plan 2008-2010 "Le condizioni per la difesa del Made in Italy", May 27 2008.

35 The loss of market share on the US market in favour of low-end products is partly due to Italian competitors that have established production plants in China, like the firm De Coro (Schiuma 2007c; Sinisi 2008).

Natuzzi products have been known mainly for their good price-quality ratio[36]. In addition there has been a reduction of sales in the UK, which was the second outlet market until 2005, due to difficulties with the local retailer.

Figure 5
Breakdown by brand of the Natuzzi Group turnover



Source: Balance Sheets 2001-2006

Looking at the effects on employment, Natuzzi S.p.A. experienced progressive growth in the number of employees until 2004, with a sharp increase in 2003-2004 mainly due to merger operations within the Group (Table 8), at the same time showing the increasing weight of labour costs on turnover and added value (Table 9A).

In the following two years the workforce decreased from 3,410 to 3,170 (-7.5%), substantially in line with the overall trend in the upholstered furniture sector, and the adoption of temporary work force reduction measures (through a legislative tool known as "Cassa Integrazione Guadagni - CIG")[37], as well as a temporary reduction in working time[38], contributed to maintaining the level of employment.

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36 According to one interview: "*Instead Natuzzi had great problems in repositioning itself, because especially in the USA (its leading outlet market) it has long been considered a firm with an excellent price-quality ratio, so it was extremely difficult to change the perception of its brand.*" [interview with Spinelli].

37 In 2005 the measures affected 1,320 positions, but 90% were recalled in September 2005 due to a recovery in orders. In June 2006 the Group obtained an extension of the temporary work force reduction from the Italian Government to cover the period June 2006-June 2008 in order to recover profitability specifically in the Italian plants, which affected 508 workers, SEC June 30 2008, p.19.

38 Natuzzi Annual Report 2006, p. 10.

Table 8
Natuzzi Group – Number of employees in production plants

Plant	Country	2001	2002	2003	2004	2005	2006
Italsofa Bahia	Brazil	156	337	459	606	684	689
Minmano Nordeste	Brazil	n.a.	n.a.	n.a.	296	505	722
Italsofa Shanghai	China	4	549	680	622	934	934
Softaly Shanghai	China	n.a.	n.a.	n.a.	n.a.	353	435
Italsofa Romania	Romania	71	265	759	1,146	1,338	1,339
Total foreign plants		231	1,151	1,898	2,670	3,814	4,119
% increase		n.a.	398,3	64,9	40,7	42,8	8
Natuzzi S.p.A.	Italy	1,497	1,714	3,198	3,364	3,201	3,170
IMPE	Italy	53	57	56	59	60	59
Natco	Italy	360	361	342	334	303	263
Total Italian plants		1,910	2,132	3,596	3,757	3,564	3,492
% increase		n.a.	11.6	68.7	4.5	-5.1	-2
Total production plants		2,141	3,283	5,494	6,427	7,378	7611
% increase		n.a.	53.3	67.3	17	14.8	3.2

Source: Balance Sheets 2001-2006

Moreover, after 2002 the composition of the workforce in Natuzzi S.p.A. became more skill-intensive, a trend that is frequently associated with productive internationalisation processes, due to the fact that R&D, design, marketing and ICT functions usually remain based at the headquarters and that there is an increased need for skilled workers to coordinate the foreign operations (Table 9).

Table 9
Natuzzi S.p.A. - Composition of the workforce

	2001	2002	2003	2004	2005	2006
	Number of employees					
Managers	44	50	61	65	57	58
Managerial staff	8	13	73	78	75	87
White collar workers	65	71	435	463	438	441
Workers	1,380	1,580	2,635	2,804	2,631	2,584
Total	1,497	1,714	3,204	3,410	3,201	3,170
	% share					
Managers	2.9%	2.9%	1.9%	1.9%	1.8%	1.8%
Managerial staff	0.5%	0.8%	2.3%	2.3%	2.3%	2.7%
White collar workers	4.3%	4.1%	13.6%	13.6%	13.7%	13.9%
Blue collar workers	92.2%	92.2%	82.2%	82.2%	82.2%	81.5%
Total	100%	100%	100%	100%	100%	100%

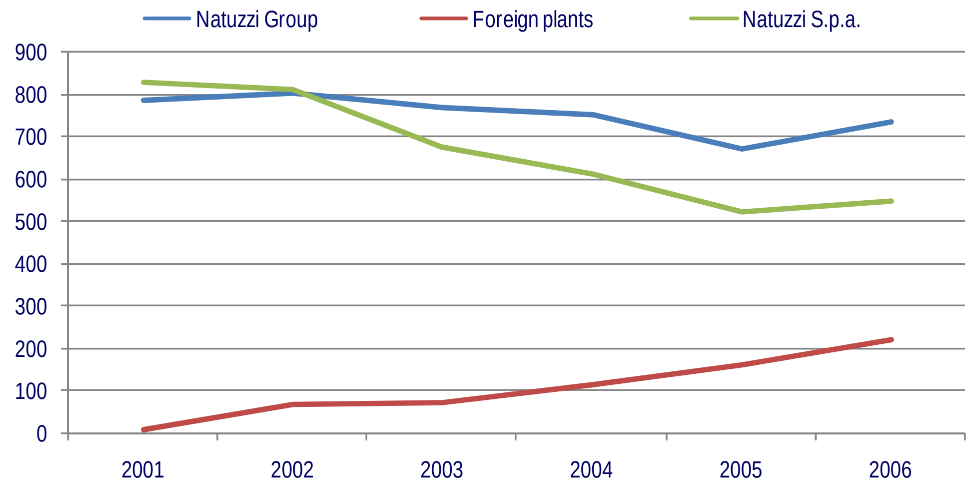
Source: Balance Sheets 2001-2006

Considering the Group as a whole, despite the contribution of the foreign subsidiaries to the Group's competitiveness (Figure 4), total turnover decreased from Euro 805 million (2002) to Euro 735 million (2006), leading for the first time in 2005 to a net loss (Euro 14.6 million[39]). Performance indicators – which were very positive until 2002 (ROS was more than 12%) – also recorded a slowdown for the entire Group after 2003 (Table 7A).

39 Natuzzi Annual Report 2005.

More recent data reported a net loss of Euro 62.6 million for 2007, versus net earnings of Euro 12.3 million the previous year, and the industrial plan for 2008-2010[40] announced redundancies in Italy (over 1,200 workers) and at the Brazilian plant[41].

Figure 4
Turnover of the Natuzzi Group (Euro million)



Source: Balance Sheets 2001-2006

6. Impact of the restructuring process in the Bari-Matera district

Besides Natuzzi, most other final goods manufacturers have decentralised their low-end production since 2001 in order to gain competitiveness (Nicoletti, Calia, Incanto, Contempo, as well as smaller firms like Max Divani[42]), establishing FDIs or joint ventures in China, Brazil, Romania, Bulgaria and Lithuania and investing at the same time in distribution, direct presence on foreign markets and branding.

Some of them have experienced growth in turnover, employment and market share, depending mainly on their product diversification and on the positioning in the market (Viesti and Prota 2007). Among them one prominent example is the firm Incanto, founded in 2001 when the Contempo company was split in two, and specialising in the upper-end segment.

Despite some success stories, overall the leading companies based in the Bari-Matera district did not succeed in compensating exports of low-end products (manufactured abroad) with sales of upper-end goods (produced in the district). Consequently, the district experienced a contraction in production and exports and an even sharper one in the number of firms (especially sub-suppliers) and total employment.

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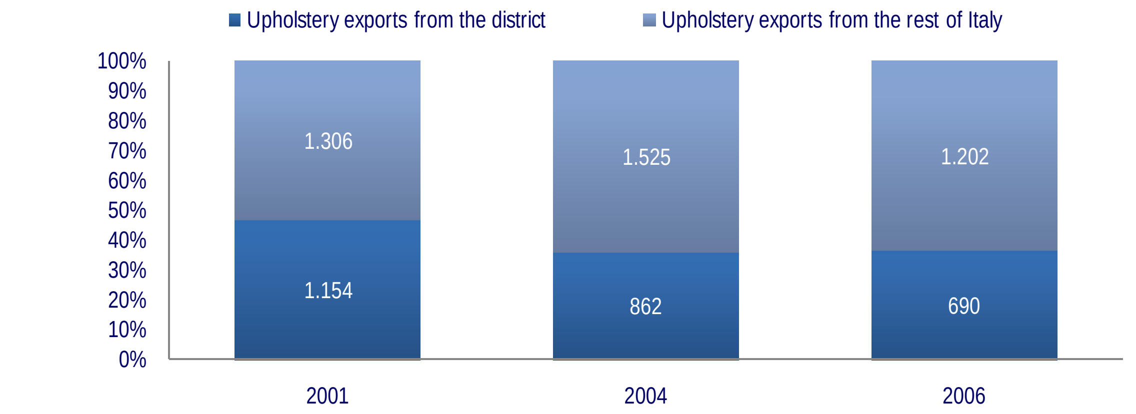
[40] Industrial Plan 2008-2010 “Le condizioni per la difesa del Made in Italy”, 27 May 2008.

[41] In May 2008 the Group announced a further extension of the temporary work force reduction in Italy involving 1,200 positions for twelve months. Moreover, the Group announced lay-offs at its Brazilian plants involving about 570 workers, SEC June 30 2008, p.19.

[42] Viesti and Prota (2007), Schiuma (2007b).

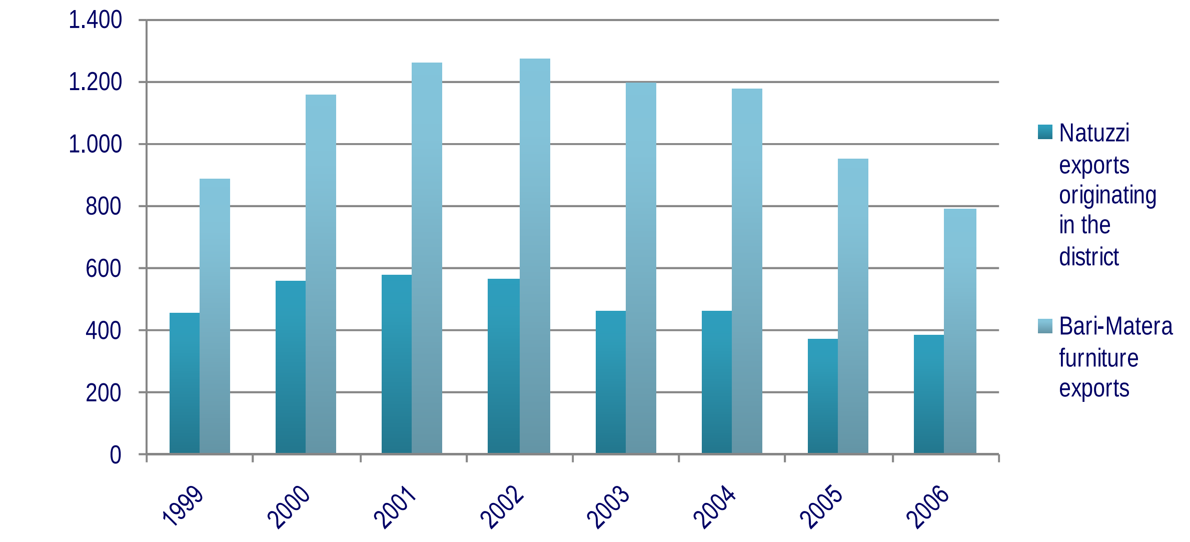
The district's turnover declined from around Euro 2 billion in 2001 to Euro 1.1 billion in 2006, with the five largest companies (Natuzzi, Calia Italia, Incanto, Nicoletti, Softline and Sofaland) accounting for 80% of it (Figure 2A). In the same years exports dropped from over Euro 1.1 billion to Euro 690 million: while in 2001 47% of Italy's upholstered exports originated from the Bari-Matera district, by 2006 the share had dropped to 36% (Figure 6, Table 3A).

Figure 6
Share of the Bari-Matera district of Italy's upholstered furniture exports



Source: CSIL processing

Figure 7
Foreign sales of Natuzzi S.p.A. and furniture exports from the Bari-Matera district (Euro million)

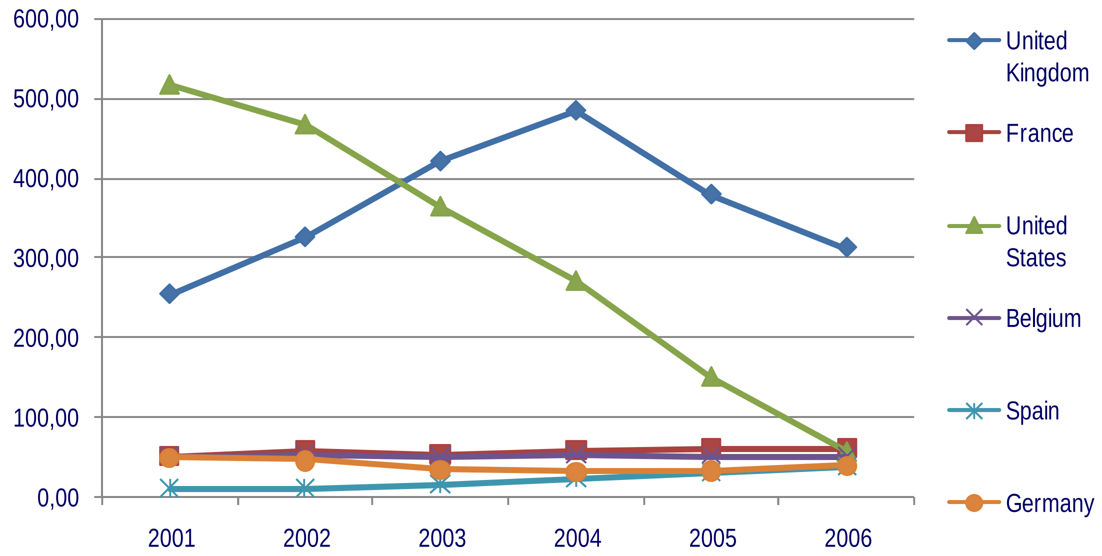


Source: CSIL processing

Also the geographical breakdown shows a considerable change during this period, substantially reflecting Natuzzi's exports, which account for about half of the district's foreign sales of furniture (Figure 7). In 2001 the United States was by far the largest outlet market, absorbing 40% of the district's exports (Euro 518 million), followed by the United Kingdom with a 20% share (Euro 254 million). In contrast, in 2004 the situation was radically different: the United States accounted for a share of 22% while the United Kingdom had become the leading market claiming Euro 458 million of upholstered furniture exports (a

39% share). Lastly, in 2006, the volume of exports to the United States became comparable to those to other European countries, such as Germany and Belgium, and the United Kingdom (which absorbs a quarter of the district's exports) showed a considerable decline, too (Figure 8, Table 10A).

Figure 8
Main export markets of the Bari-Matera district (Euro million)



Source: CSIL processing of ISTAT official data

The number of companies in the Bari-Matera district decreased sharply between 2002 and 2006: while there were 534 firms active in 2002, by 2006 the number had dropped to 190 and over the same period the workforce declined from 14,000 to 8,000 (Table 10).

Table 10
Number of enterprises and workforce of the Bari Matera district (units)

	2002	2006
Number of enterprises	534	190
Workforce	14.000	8.000

Source: Lieg-University of Basilicata

Compared to sub-suppliers the leading companies seem to have experienced a lower reduction in employment, also because of publicly supported measures to temporarily reduce the workforce[43].

Several factors have contributed to the very critical situation of the sub-supplier firms: their limited size, below the national average[44], the prevailing hierarchical relationship with the final goods manufacturers and their lack of managerial and

[43] A survey conducted in the Bari-Matera area (2005) reports that without the intervention of public support measures to temporarily reduce the workforce, the increase in unemployment would have been much higher, Viesti, Prota (2007), p.53.

[44] In Apulia firms in the manufacturing sector have an average of 5.79 employees, compared to an Italian average of 7.84 employees (SRM-IAI, p. 43).

organizational capacity. As a study of the Apulia region shows, compared to other areas the level of human capital endowment is relatively low and workers have fewer opportunities to move across sectors[45].

Even if during the first months of 2008 a number of displaced workers found jobs in newly established firms, which were able to employ skilled workers at a lower cost (almost half) because of public re-employment incentives[46], this trend is not considered capable of entirely compensating the reduction in employment.

Recent developments show that a selection process of sub-supplier firms is taking place, based on factors like higher quality standards, flexibility, respect for delivery time, which have become almost a pre-condition for sub-suppliers to survive (Schiuma 2007b). Final good producers are choosing their local suppliers according to their ability to satisfy the specific needs of their customers, implying a more limited volume of production and reduced delivery times, in line with market demand[47], a process that stimulates the upgrading of the more dynamic enterprises and represents an evolution of the traditional hierarchical relationship, requiring a higher degree of cooperation, if not true "co-makership".

In addition to meeting the requirements of the leading final goods producers, a limited number of sub-suppliers were able to react successfully to the crisis in the district by diversifying their activities[48]. Some enterprises have in turn become final goods producers, often specialising in the top furniture range, improving quality and service, sometimes cooperating with other companies to integrate their offer of upholstered furniture with other accessories and furniture complements.

Other firms have diversified their products and clients by entering the market of hotel-contracting or yacht furniture.

However, these strategies have been successfully adopted by sub-suppliers that were already involved in the production of final goods for the leading companies; in contrast, for firms specialising in single productive phases (e.g. wooden frames or polyurethane filling), both product- and customer-diversification appears to be much more difficult to achieve, as companies lack the necessary skills[49] .

Internationalisation is not a widespread strategy among sub-supplier firms seeking to expand sales and diversify their customer portfolio. On average, the area is characterised by a very low degree of international openness[50]: on the one hand, there is a limited number of larger companies that have established foreign production plants (adopting "complex" forms of internationalisation) and, on the other, there are many small local firms, usually family-run, that are not active on international markets in either form, mainly because of their small size and of their poor managerial and organisational structure.

For instance, none of the interviewees reported examples of sub-suppliers establishing their own production plants abroad, near the leading companies ("following the client" strategy). Conversely, a few examples of "lighter" forms of internationalisation were reported, with the decentralisation of some processing phases (e.g. leather- and fabric-cutting) in Eastern European countries (Albania, Romania and Croatia).

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45 SRM-IAI 2007, p. 228.

46 "*This crisis situation was offloaded to a great extent onto the welfare support provisions, which basically allowed for people not to be laid off and have to emigrate, but to remain in the area. There was widespread recourse to both the Cassa integrazione straordinaria (extraordinary redundancy fund) and to labour mobility. There was a great "decontribution", i.e. lowering of the firm's social contribution rate, from 40% to 5%. And if the firm offered the worker a permanent position, it would receive 50% of the mobility allowance that would have been due to the worker. In these sectors especially, having the labour cost practically halved is an enormous incentive. If recovery does effectively continue I think we'll just manage to maintain the current numbers. Thus there is the problem of a few thousand workers who will not find jobs within the district.*" Interview with Delicio-UIL.

47 *"A new relationship is developing between some of the leader firms and a very select number of sub-suppliers. In fact, some large firms have begun to repatriate the production of some lines destined for the more demanding customers and they have asked their usual sub-suppliers to increase the levels of finishing and to considerably reduce production lots, drastically speeding up the frequency of deliveries, and orienting themselves towards a 'pull from market' production system."* Interview with Santilio

48 According to one interview, only 20-25% of the district's sub-suppliers have successfully diversified their activities. Interview with Santilio

49 *"I don't see any chance of reconversion in our sector (frames). It is too specialised at both a product and a machinery level to be able to carry out any conversion."* Interview with a local entrepreneur

50 The Bari province shows a relatively high propensity to internationalisation because of the furniture sector; however, the overall degree of international openness in the Apulia region is below the Italian average, which is in turn one of the lowest in Europe (SRM-IAI 2007, p. 87).

Furthermore, cooperative strategies among local firms, which could be adopted to centralize purchases of raw materials (for example), have not been pursued so far[51].

The question of the future evolution of the district remains open. Not all final goods producers are considered capable of repositioning their products successfully in the upper segment; therefore orders for the sub-supplier firms may decline even more. This seems to be confirmed by some recent developments: in the first half of 2008 Calia and Nicoletti had to close down, and even Incanto declared the need to reduce the number of workers in Italy[52], mainly because of the slowdown on the UK and US markets, and has adopted temporary work reduction measures.

Among subcontracting firms, the restructuring process and the selection of the more dynamic companies might lead to a different structure of the local economic system, with a limited number of more efficient companies of a larger size. However, according to several observers, not many sub-suppliers seem to be capable of reacting and of adopting adequate strategies to face the current crisis, and a further decrease in the number of firms is likely to occur.

According to local stakeholders, public policies, especially at local level, should accompany this restructuring process. In addition to investing in infrastructures, which is currently an important disadvantage for the companies operating in the area, several measures could be useful: providing funds to promote innovation (product, process and organization), supporting the qualitative upgrading of products and their distribution, encouraging the use of ICT, facilitating start-ups, supporting firms to diversify their client portfolios and expand on international markets[53], encouraging cooperative actions among firms.

Special attention should be given to social policy measures helping displaced workers to find new employment opportunities and to initiatives to enhance the quality and the endowment of human capital in local firms. Support measures are planned at both national and local level (by the regions Apulia and Basilicata); in part financed by EU structural funds, and some initiatives specifically address the upholstered furniture district[54].

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51 "*We could create a cartel for the purchase of raw materials. We could source wood and polyurethane; use the district as a tool for the combined purchase of our raw materials*". Interview with Di Maggio:

52 Press release of Fillea-Cgil Matera (trade unions) of July 15 2008.
http://www.filleacgil.it/Documenti_Strutture/VertenzeNicoletti-Incanto15lug08.htm

53 However, in the Apulia region there is limited expenditure capacity for resources destined to support internationalisation, both at a national and at a regional level (SRM-IAI, p. 33).

54 While Basilicata has formally recognised the existence of the upholstery district (Law no.1 of 23 January 2001), an act that enables the adoption of a specific programme for the development of the district, the Apulia region has not yet approved a similar regional law. Moreover, a Task Force composed of the leading district companies is calling for State intervention on the grounds of the 181/89 law for industrial sectors in crisis.

7. Conclusions

To face increasing global competition, in recent years the Natuzzi Group has been pursuing a complex internationalisation process, shifting abroad the middle-low end production and investing at the same time in R&D, human capital, organisational innovation, branding and distribution to upgrade its home-based production, facilitated by its relatively considerable size and financial capacity.

Foreign subsidiaries take the form of horizontal FDIs, representing a duplication of the home-based plants with the exception of highly skilled functions (R&D, design, marketing, information and communication department), which have been maintained at the Italian headquarters and have contributed to increasing the workforce's skill-intensity. FDIs are determined at the same time by cost-saving (labour and transportation costs) and market-seeking factors (shorter distance from the main outlet markets, which are served directly from the subsidiaries), as well as by resource-seeking motivations, given the proximity to important sources of raw materials.

For its foreign subsidiaries Natuzzi has chosen a highly vertically integrated organisation, internalising most of the production phases, in order to reduce imports and due to the fact that local suppliers are not yet considered reliable in terms of quality and service. Acting as export platforms, Natuzzi's FDIs have mainly been substituting exports from the home-based plants and do not seem to have triggered an increase in imports from the domestic district (except in the start-up phase). This trend is set to continue, as the Group aims to source components and semi-finished products locally in order to substitute imports as far as possible, and to support the development of specialist suppliers, which may in future lead to the creation of "new" local districts. This productive organisation is backed by a wide and relatively sophisticated use of ICT tools, crucial to integrate information, coordinate the operations worldwide, and to improve logistics and efficiency.

The internationalisation of production succeeded in improving the company's competitiveness in the low-middle product range, as Natuzzi's subsidiaries in Brazil, China and Romania enabled the Group to lower costs and to gain in efficiency, making an important contribution to its successful performance until 2002.
However, this development was not sufficient to contrast the decrease in total turnover, which led to a net operating loss in 2007. Despite considerable efforts in marketing, innovation and product development, the company has not yet been able to compensate exports of low-middle end products (manufactured abroad) with sales of upper-end goods produced in the Bari-Matera district.
Foreign sales of upper-end products are declining both in volume and in value, especially in the US, which is still Natuzzi's main outlet market. Diversification of markets, which has been a core objective for the Group since the early Nineties, has been achieved only in part and the high level of product standardisation that enabled Natuzzi to gain a remarkable market share in the US is now probably a disadvantage when approaching other more fragmented markets.

Following the declining trend in turnover and profitability, employment at the Italian plants recorded a moderate reduction during the period 2001-2006, substantially in line with the overall trend in the upholstered furniture sector, also because the Group benefitted from state supported temporary workforce reduction measures. However, after the negative financial results of 2007, more redundancies were announced at the Italian plants as well as the necessity to reduce industrial costs and increase productivity.

Future developments of the home-based plant depend to a great extent on Natuzzi's ability to expand exports of upper-end products and to reduce its concentration on the US market, where the Group faces increasing competitive pressure (in

particular from China), a slowdown in demand, and difficulties in repositioning the "Natuzzi" brand, coupled with the weakness of the dollar and the rise in raw material prices.
In other words, further developments depend on Natuzzi's ability to achieve a higher degree of market diversification and to successfully upgrade its production, as Natuzzi can be considered a prominent example of the "Italian specialisation model", characterised by exports in traditional sectors, particularly subject to the competitive pressure of new labour-abundant entrants (unless the production is successfully repositioned at the high-end), and also by a market-sector combination subject to relatively slow growth in international demand[55].

Considering the role and the weight of the Natuzzi Group in the Bari-Matera district, the marked slowdown in the economic activity of the Italian plants has impacted on the district (along with most other final goods producers), contributing to the displacement of sub-supplier firms and to the reduction in employment. Overall, it is likely that the negative impact on employment has been far greater for the sub-suppliers than for Natuzzi and the other leading firms.

As to the future evolution, some observers are very sceptical about the survival of the Bari-Matera district and expect a further contraction. This negative trend could be offset if, on the one hand, the leading firms improve their competitiveness at the upper-end of the market by manufacturing products of excellent quality and design (and there have been some recent successful cases), thus enhancing the local demand for sub-suppliers. On the other, sub-supplier firms have to be able to meet the higher standards required by the final goods producers, and possibly to diversify their clients both on the domestic and international markets.

In any case, the restructuring and selection process underway seems to imply a profound change in the district's structure, which might, at the end of the selection process, be made up of fewer firms of a larger size. Public policies, especially at a local level, should effectively accompany this restructuring process by setting appropriate investment incentives and helping displaced workers to find new job opportunities.

[55] Together with an overall slowdown in productivity and the appreciation of the European currency, these structural factors affect the expansion of Italian exports to a considerable extent. Further details on the "dynamic inefficiency" of the Italian specialisation model are found in the ICE Annual Report 2005-2006 and in Giovannetti and Mazzeo (2008).

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Appendix

Table 1A

Five major upholstered furniture exporting countries (Euro million)

Country	Upholstered Furniture Exports									
	EUR Million									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
China	122	148	240	388	500	659	825	1,185	1,835	2,625
Italy	1,913	1,872	1,975	2,341	2,460	2,441	2,340	2,387	2,168	1,892
Poland	515	598	663	791	914	984	1,074	1,259	1,395	1,466
Germany	362	423	465	533	557	552	563	601	576	595
United States	228	235	235	283	277	247	221	251	295	385
World Total *	6,073	6,244	6,598	6956	7142	7806	9499	11460	12,308	13,510
	% share									
China	2%	2%	4%	6%	7%	8%	9%	10%	15%	19%
Italy	31%	30%	30%	34%	34%	31%	25%	21%	18%	14%
Poland	8%	10%	10%	11%	13%	13%	11%	11%	11%	11%
Germany	6%	7%	7%	8%	8%	7%	6%	5%	5%	4%
United States	4%	4%	4%	4%	4%	3%	2%	2%	2%	3%
World Total *	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

* 60 countries

Source: CSIL processing

Table 2A

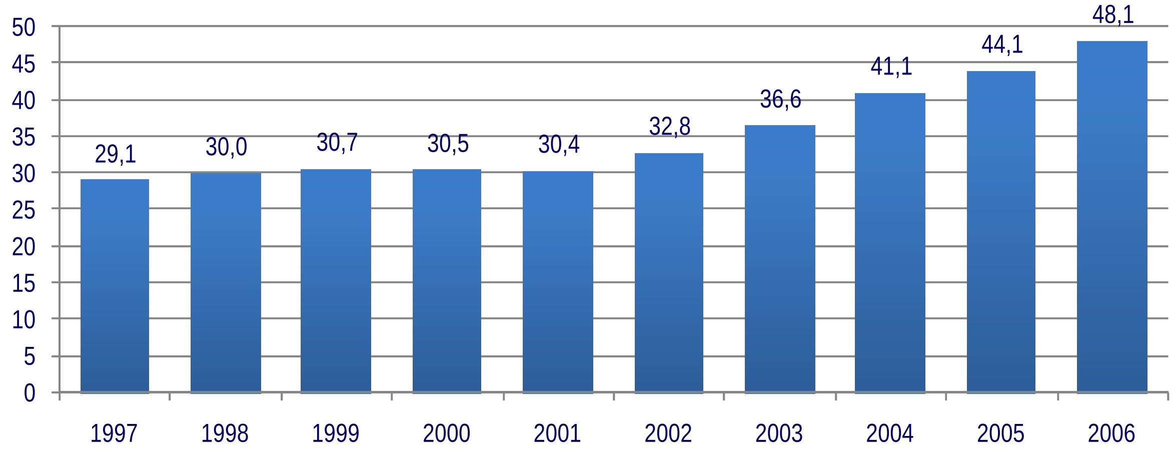
Five major upholstered furniture importing countries (Euro million)

Country	Upholstered Furniture Imports									
	EUR Million									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
United States	1,000	1,032	1,312	1,907	1,968	2,232	2,241	2,392	2,655	2,932
Germany	929	1,042	1,063	1,161	1,229	1,182	1,225	1257	1,271	1,245
United Kingdom	229	304	367	471	569	660	815	1060	1,091	1,164
France	414	437	467	509	522	544	574	653	739	758
Canada	175	177	188	248	294	296	314	393	463	643
World Total *	5,021	5,292	5,875	7,269	7,697	8,149	8,532	9,483	10,284	11,523
	% share									
United States	19,9%	19,5%	22,3%	26,2%	25,6%	27,4%	26,3%	25,2%	25,8%	25,4%
Germany	18,5%	19,7%	18,1%	16,0%	16,0%	14,5%	14,4%	13,3%	12,4%	10,8%
United Kingdom	4,6%	5,7%	6,2%	6,5%	7,4%	8,1%	9,6%	11,2%	10,6%	10,1%
France	8,2%	8,3%	7,9%	7,0%	6,8%	6,7%	6,7%	6,9%	7,2%	6,6%
Canada	3,5%	3,3%	3,2%	3,4%	3,8%	3,6%	3,7%	4,1%	4,5%	5,6%
World Total *	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

* 60 countries

Source: CSIL processing

Figure 1A
World consumption of upholstered furniture (Euro billion)



Source: CSIL processing

Table 3A
Natuzzi Group – Sales of upholstered furniture. Breakdown by countries (Euro thousand)

Country	2001	2002	2003	2004	2005	2006
USA	317,9	330,6	280,8	238,8	207,2	204,3
Spain	12,0	11,5	14,0	27,6	35,7	46,0
United Kingdom	51,5	56,2	80,4	83,4	50,8	39,9
Canada	35,6	32,6	37,9	38,2	31,6	36,2
France	19,1	24,4	23,4	26,0	24,6	33,6
Germany	40,0	37,9	25,4	19,7	24,3	30,9
Belgium	21,1	17,4	16,0	20,0	20,8	28,0
Australia	12,1	13,2	15,4	19,4	16,5	18,3
The Netherlands	23,3	16,9	14,0	13,1	13,7	16,6
Sweden	n.a.	n.a.	n.a.	8,7	10,8	12,2
Norway	12,0	13,3	10,1	12,2	11,3	10,5
Other countries	97,0	104,8	85,4	85,5	80,5	101,8
Total foreign sales	641,4	658,6	602,7	592,5	527,8	578,3
Italy	72,6	76,1	71,3	73,0	67,0	81,9
Total sales	714,0	734,8	674,0	665,5	594,8	660,3
% share of foreign sales	89,80%	89,60%	89,40%	89,00%	88,70%	87,60%

Source: Natuzzi Annual Report 2006

Table 4A
Natuzzi Group – Foreign Sales of upholstered furniture. Breakdown by countries (percentage share)

Country	2001	2002	2003	2004	2005	2006
USA	49,6%	50,2%	46,6%	40,3%	39,3%	35,3%
Spain	1,9%	1,7%	2,3%	4,7%	6,8%	7,9%
United Kingdom	8,0%	8,5%	13,3%	14,1%	9,6%	6,9%
Canada	5,5%	4,9%	6,3%	6,4%	6,0%	6,3%
France	3,0%	3,7%	3,9%	4,4%	4,7%	5,8%
Germany	6,2%	5,8%	4,2%	3,3%	4,6%	5,3%
Belgium	3,3%	2,6%	2,6%	3,4%	3,9%	4,8%
Australia	1,9%	2,0%	2,5%	3,3%	3,1%	3,2%
The Netherlands	3,6%	2,6%	2,3%	2,2%	2,6%	2,9%
Sweden	0,0%	0,0%	0,0%	1,5%	2,0%	2,1%
Norway	1,9%	2,0%	1,7%	2,1%	2,1%	1,8%
Other countries	15,1%	15,9%	14,2%	14,4%	15,3%	17,6%
Total foreign sales	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Natuzzi Annual Report 2006

Table 5A
Natuzzi S.p.A. – Turnover (Euro million)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Natuzzi Spa	584,5	585,7	595,8	759,7	830,2	813,6	675,8	612,4	521,6	549,3

Source: Balance sheets 1997-2006

Table 6A
Turnover of foreign production plants (Euro million)

Company	Country	2001	2002	2003	2004	2005	2006
Italsofa Bahia	Brazil	7	18,7	23,5	30,4	29,6	30,9
Minuano Nordeste	Brazil	n.a.	n.a.	n.a.	2,4	18,3	24,7
Italsofa Romania	Romania	0,2	18,7	23,9	46,3	62,1	75,7
Italsofa Shanghai	China	n.a.	31,2	26,1	34,5	45,7	63,6
Softaly Shanghai	China	n.a.	n.a.	n.a.	n.a.	6,7	27,8
Total		7,1	68,6	73,5	113,6	162,4	222,7

Source: Balance sheets 1997-2006

Table 7A
Natuzzi S.p.A. - Performance Indicators

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
ROS	5,3	6,9	8,9	8,3	3,6	0,5	-2,6	4,0	-1,7	-0,7
ROI	9,2	10,5	15,9	16,2	6,3	0,6	-2,9	4,1	-1,5	-0,6
ROE	25,8	31,7	13,9	10,5	10,2	47,1	-3,0	-4,1	-8,4	-4,2
ROS Natuzzi Group	-	-	-	18,4	12,4	12,6	5,5	5,3	-2,2	2,2

Source: Balance sheets 1997-2006

Table 8A
Natuzzi Group - Sales of upholstered furniture. Breakdown by brand

	2001	2002	2003	2004	2005	2006
	Thousands euro					
Natuzzi	657,0	609,4	533,0	507,0	387,8	416,2
Italsofa	57,0	125,3	141,0	158,5	207,0	244,1
Total	714,0	734,7	674,0	665,5	594,8	660,3
	% share					
Natuzzi	92,0%	82,9%	79,1%	76,2%	65,2%	63,0%
Italsofa	8,0%	17,1%	20,9%	23,8%	34,8%	37,0%
Total	100%	100%	100%	100%	100%	100%

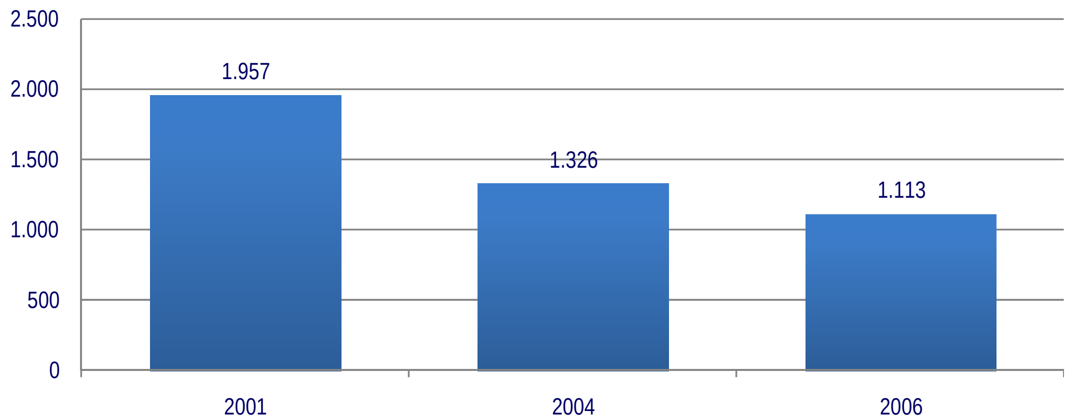
Source: SEC Reports, Washington DC

Table 9A
Natuzzi S.p.A. - Growth of labour cost (Euro million)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Labour cost	29,7	31,3	35,5	41,6	43,1	48,0	92,6	105,1	99,4	98,7
Labour cost/Turnover (%)	-5,1	-5,3	-6,0	-5,5	-5,2	-5,9	-13,7	-17,2	-19,1	-18,0
Labour cost/Value added (%)	-43,8	-39,5	-37,8	-37,3	-54,2	-79,0	-105,5	-72,7	-90,1	-85,8

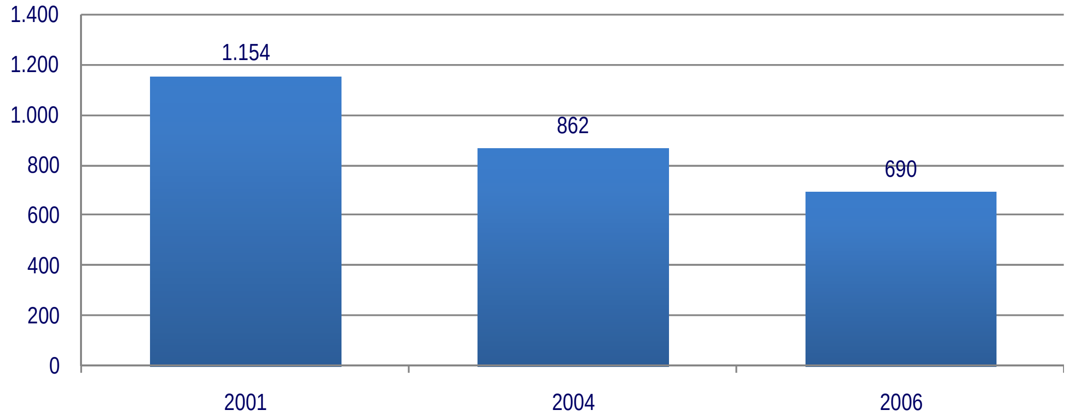
Source: Balance sheets 1997-2006

Figure 2A
Upholstered furniture turnover in the Bari Matera district (Euro million)



Source: CSIL processing

Figure 3A
Upholstered furniture exports of the Bari-Matera district (Euro million)



Source: CSIL processing

Table 10A
Main upholstered furniture export markets of the Bari Matera district (percentage share)

2001		2004		2006	
Country	% on the district	Country	% on the district	Country	% on the district
United States	41%	United Kingdom	39%	United Kingdom	25%
United Kingdom	20%	United States	22%	France	5%
Netherlands	4%	France	5%	United States	5%
Belgium	4%	Belgium	4%	Belgium	4%
France	4%	Germany	3%	Germany	3%
Germany	4%	Netherlands	2%	Spain	3%
Canada	3%	Canada	2%	Netherlands	2%
Israel	2%	Spain	2%	Australia	2%
Japan	2%	Ireland	2%	Ireland	1%
Sweden	2%	Australia	2%	Romania	1%

Source: CSIL processing