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Strategies of Italian firms in Romania. Evidence from selected case studies.

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The aim of this paper is to analyze the internationalization of Italian firms in Romania, operating in the sectors of footwear, furniture and industrial refrigeration. After describing and quantifying the internationalization process between Veneto and Romania, we discuss for each of the sectors, the changes that occurred in the organisation of the production processes within the firms, and particularly how such processes have been fragmented.

This article draws on numerous case studies, posits different models of value chain governance, and discusses their implications for regional development and sustainability.

Key words: Internationalization, Romania, Italy, Organization of Production

JEL classification: F23, L22, L23, L67

1. International fragmentation of production

Italian firms started to outsource their production processes abroad in the mid-1990s. A number of factors played a crucial role in prompting this phenomenon: the strengthening of the exchange rate after Italy's decision to join the Euro; the intensification of competition at the international level; the global decline in tariffs and transport costs (Lawton and McGuire 2005:8); and the opening up of a number of new countries, especially in Central and Eastern Europe (CEE), to the market economy.

On average, countries in CEE offer a well-trained and low-cost labour force,¹ an existing area of industrial specialisation (in the case of Romania, within the apparel and footwear sector), a stable political environment and friendly regulations that attract foreign direct investment (FDI). Thus, many countries in this region offered favourable conditions to the entrance of Western firms. Up to the present day, Italian outsourcing of production abroad has grown considerably (Istat, 2008), and is considered a specific feature of the regional model of industrial development in the Veneto region (Crestanello and Tattara, 2005).

Prior to the 1990s, many firms located in the Veneto region, especially those operating in the so-called 'made in Italy' sectors, had fragmented their value chain, turning to outsourcing to small firms which were often located in the same district. In order to be successfully established, fragmentation requires a certain degree of functional independency between the various phases of the production process so that they can be performed separately.² Successful fragmentation therefore depends on the ability of the subcontractor to codify knowledge and standardise products exchanged among the various firms of the productive network (Gereffi, Humphrey and Sturgeon, 2005).³

In both the footwear and woodworking-furniture industries, the high degree of standardisation of operations, the specific kind of technologies used, and the way the process is organised, allow for the slicing of the production chain into relatively autonomous operations which do not require spatial contiguity (Schmitz, 2006; Scott, 2006; Gereffi, 2007). Since the middle of the 1990s, Italian firms operating in these sectors have

¹ For data on wages, see Crestanello and Tattara, 2006 (p.192), and Schmitz, 2006.

² According to Brusco (1975, p.106), small firms can also enjoy the economies of scale coming from the fragmentation of the production process, as long as the segments have an optimal minimum size. Efficiency is measured with respect to the production segment, and not to the firm's production.

³ These characteristics are typical of manufacturing operations performed within most labour-intensive sectors, where production is generally standardised and employs traditional technologies; by contrast, operations like design and marketing require very specific skills.

found it profitable to subcontract (parts of) their production process to foreign firms, although providing the latter with the technical specifications of the product and a certain degree of supervision at various levels.

This paper draws on research which focused on several firms in the three industrial districts mentioned above, in the footwear, furniture, air conditioning and refrigeration sectors, all of which have plants within the Veneto region as well as in Romania.⁴ Through detailed semi-structured interviews with chief-executives and/or managers at different levels, conducted in 2003 and 2005, we analysed the relationship between the Italian firms and those located in Romania, which are either (partially) owned by the former or working for them, under sub-contracting agreements or at times, as independent suppliers in their own right. Our goal was to observe the interactions between the Italian firms and their counterpart(s), and to capture the main changes that occurred in the governance of the chain controlled by the Italian firms.

The rest of the paper is organised as follows: in sections 2, 3 and 4, on the basis of empirical evidence, we highlight for each of the sectors, the changes that occurred in the organisation of the production processes within the firms, and particularly how such processes have been fragmented. In section 5 we draw some conclusions, referring to the theory of global value chains, and focusing particularly on the relations between the various operations along the chain. In our opinion, relationships based mainly on technology transfers such as those described by Gereffi, Humphrey and Sturgeon (2005) do not adequately account for the specific role played by actors in the network within a context of economic underdevelopment.

2. Internationalisation processes within the footwear district of Montebelluna

Footwear firms in the district of Montebelluna manufacture high quality sport shoes. These firms are generally driven to internationalise their production by fierce price competition at the international level.⁵ The delocalisation is mainly directed towards countries of CEE, and concerns leather footwear.⁶ According to the annual report by the Osservatorio sull'Economia del Montebellunese (OSEM, 2002), 90 out of the 400 firms included in the report in the early 1990s internationalised their production, shifting abroad 272 “phases of the production process”; of these, around 200 delocalised to CEE, and 116 (a large majority) to Romania. Cutting and hemming were the operations most frequently outsourced; these accounted for 40 percent of all operations shifted abroad (OSEM, 2002)⁷.

⁴ This paper is based mainly on “A study of the penetration of Italian firms in Romania and on the effects of delocalisation on the sport-system district of Montebelluna, the wood and furniture district of Treviso province, and the air conditioning and refrigeration district of Veneto region”, by Florentina Constantin and Giovanna De Giusti, supervised by Prof. Giuseppe Tattara.

⁵ Within the footwear industry, net wages in Romania amount to one tenth of those in Italy and the proportions are similar within both the wood and furniture industry and the light-mechanic industry. According to a number of Italian chief-executives, “the ratio between the salaries” is around one third, but it is most likely that they meant to refer to the ratio between the overall labour costs, differences in productivity and transport costs included. These estimates have changed in the course of the last two years because of the high rise in wages (since 2005 wages in the footwear sector have more than doubled), the alleged shortage of workers, and the increase in the unit costs of production due to the appreciation of the Romanian currency with respect to the Euro. For Romanian wage increases, see: Eurostat. Monthly cost of labour.

⁶ Sports shoes (like tennis shoes, basketball and football shoes/trainers, etc) that require a higher use of textile materials, are nowadays almost exclusively manufactured in Asia.

⁷ According to OSEM, hemming a cycling shoe cost only 2.5 Euros in Romania compared to 6 Euros in Italy in 2004. Production unit costs in Romania were therefore 40 percent of the production unit costs in Italy (OSEM, 2002:4).

However, the whole production process is often moved abroad, and this makes up 30 percent of the total sample observed by the OSEM, a quota that has recently increased (OSEM, 2006).

Within the district we interviewed four firms. The first was Geox, a large firm that employed more than 500 workers in Montebelluna and is the biggest Italian footwear producer and one of the largest in the world. We then interviewed three medium sized firms (employing 50 to 60 workers): Aku, Bonis, and Fratelli Cunial. The first one manufactured its own brand footwear for trekking (the traditional product of the district). Bonis produced leather sport and fashion shoes, almost entirely for world-wide known clients (Tommy Hilfiger, Levi's, Diesel, Clark, Napapijri), who bought the finished shoes produced by the Italian firm on the basis of the technical specifications provided by the clients. Finally, Fratelli Cunial manufactured parts and components (counters, toe puffs, and insoles) for major footwear producers, including the three mentioned above. For all these firms, the proportion of production manufactured abroad was very significant and generally higher than the part realised within the district.⁸

The delocalisation takes place mainly through FDI, but may also involve subcontracting. In 2000, Geox set up a large plant in Timișoara, Technic Development, which was entirely owned by the Italian firm, and at the time of the interview, in 2003, employed 1,500 workers, operated 3 shifts per day and generated a significant quota of the group's total turnover. Technic Development subcontracted to six or seven firms in Romania, creating a network that involved six to seven hundred workers. Aku resolved to open a plant in Cluj, Romania, after subcontracting unsuccessfully to a firm owned by an Italian entrepreneur operating in Alba Julia, Romania, and a firm in Hungary. Bonis owned a plant in Cluj and one in Timișoara and also subcontracted part of the production to a big Romanian firm, Banatim, in Timișoara.

The preference showed by many Italian firms for the areas surrounding Cluj and Timișoara is explained by the high local specialisation in shoes manufacturing prior to the fall of the Soviet Union. The story of Banatim, is closely related to the story of Timișoara: the factory was founded at the end of the nineteenth century, and at its peak it employed around 3,000 workers; in 2005, when we visited the plant, it employed 250 workers, and had been subcontracted by two foreign enterprises – the Italian company Bonis and the German company Rieker. Filty, which was founded in 1921, also operated in Timișoara, it employed around 400 workers and was subcontracted mainly by Italian footwear companies. Another important Romanian firm was Guban. Finally, the Timiș county comprises of a large number of small firms as well; in 2005 the footwear industry employed around 4,000 workers – very close to the number of employees counted in Italy within the district of Montebelluna during the 1970s.⁹

Shoes manufacturers in Romania rely heavily on the processing trade:¹⁰ they process the (raw and auxiliary) materials provided by the foreign enterprise (parent firm, partner or contractor) charging the foreign party only a processing fee and re-exporting the finished products. All the firms observed manufactured shoes of medium-high quality and therefore paid great attention to the details and accessories. Hence, in order to ensure the quality of

⁸ A difficult estimate when only uppers are outsourced abroad, since their value will depend on the transfer prices computed by the Italian parent firm.

⁹ During those years the footwear industry within the province of Treviso employed around 4,000 people.

¹⁰ The processing trade (in Romanian *lohn*) is an international contract through which the producer commits to produce a good following the technical specifications of the contractor, and charges a fee as remuneration for its activity. Italian firms have been taking advantage of this duty system since the early 1990s (Graziani, 1998; World Bank, 2004).

the product, all materials (leather and textiles), components and parts used in the production process were sourced from Italy.

The delocalisation of parts of the production process to Romania engendered a demand for semi-finished products and components that local firms - still relatively backward - were not able to fulfil.¹¹ Local firms sometimes supplied the dies, extremely simple metallic moulds used for cutting leather,¹² and in general, they also supplied materials like glue, sticky tape and wrappings. Italian entrepreneurs claimed that the limited resort to local suppliers was due to the inability to fulfil the required standards in terms of quality, continuity of supplies, and delivery time. Obviously, Italian firms operating in Romania would find it more profitable to source the needed materials and services locally, explaining the decision of some Italian producers of parts and components to follow their clients and localize their production in Romania. This was the case of Fratelli Cunial, a producer of components for shoes, which since 2002, owned a plant in Romania which was built in Geox's premises. In this scenario, the evident scope was to ensure Geox with the continued and regular supply of components, namely insoles. Within the district of Montebelluna, by contrast, supply networks were strong and easy to set, and all materials and components needed for the production could be conveniently sourced locally.

Firms producing fashion shoes globalise the value chain in a very distinctive way as compared with firms that manufacture sports shoes, since they generally move the entire production process abroad. On average, these firms delocalise all the operations required to process the shoes to Romania, and these operations are performed there either directly within own plants (Bonis in Cluj and Timișoara, and Geox in Timișoara), or through firms which have been subcontracted, like large Romanian companies such as Banatim and Filty. One example of the latter is L'Avventura, which was founded in Timișoara by two entrepreneurs from Varese. At the time of the interview in 2003, it employed 200 workers in total and specialised in the production of women's shoes. The subcontracted firms received production lots, which consisted of raw and auxiliary materials, exactly weighted for the production of the agreed amount of shoes. These firms therefore performed the entire production process, from the cutting of leather (quite a complex operation), to hemming, assembly, finishing, and finally, quality control and packing. They sometimes subcontracted one part of the production to others; This, for instance, was common practice for Filty and for L'Avventura, in order to fulfil their obligations towards Geox. Subcontracting gave the contracting firm a large degree of production flexibility. Following the plans defined by the Italian parent firm, Bonis sold part of the finished products to its Western clients directly from the Romanian plants. By contrast, Geox distributed the whole production from its headquarters in Montebelluna. All the three producers interviewed within the district, namely Geox, Aku and Bonis, also subcontracted to firms located in China, buying from them the finished products as produced according to a set technical specifications; for Geox the production realised in China was the most relevant as it represented 80 percent of the firm's total production (and all of the firm's production of sports shoes), whereas this was not the case for Aku and Bonis.

We now turn to Aku, the manufacturer of trekking shoes. In 2005 Aku delocalised only part of the production process and this firm provides a picture of a situation that was common for firms belonging to the Montebelluna district. Aku delocalised only the simplest operations of its production chain. In fact, within AkuEst, in Romania, uppers were assembled without injection of the soles: for the time being, the injection could only be performed in the plant located in Italy, since it required more complex machines and

¹¹ This is a common sentiment expressed by several Italian entrepreneurs during the interviews.

¹² Agri Prod S.R.L. in Oradea is the supplier of cutting dies for the firms in our study. The Romanian firm started its activity in 1997.

procedures. This way of fragmenting the value chain was typical of many producers within the district and as a result the moulding of the soles was executed mostly in Italy. According to OSEM, only 11 out of 148 firms that shifted operations abroad delocalised the moulding process (OSEM, 2002).

Figure 1 shows the production process of Aku, distinguishing between the operations performed in Montebelluna and those performed in Cluj. AkuEst strictly followed the specifications sent from the Italian parent firm, and employed materials (leather, clothes), parts (soles) and accessories sent from Italy with only a few components sourced from the local market. The shoes were then priced, packed and sent back to Italy. As mentioned earlier, in the Romanian plant only traditional operations which required simple skills and standardised technology were performed, whilst more complex operations were (still) performed in Italy. Thus, it is evident that the main reason for setting the activity in Romania was to access the cheaper workforce.

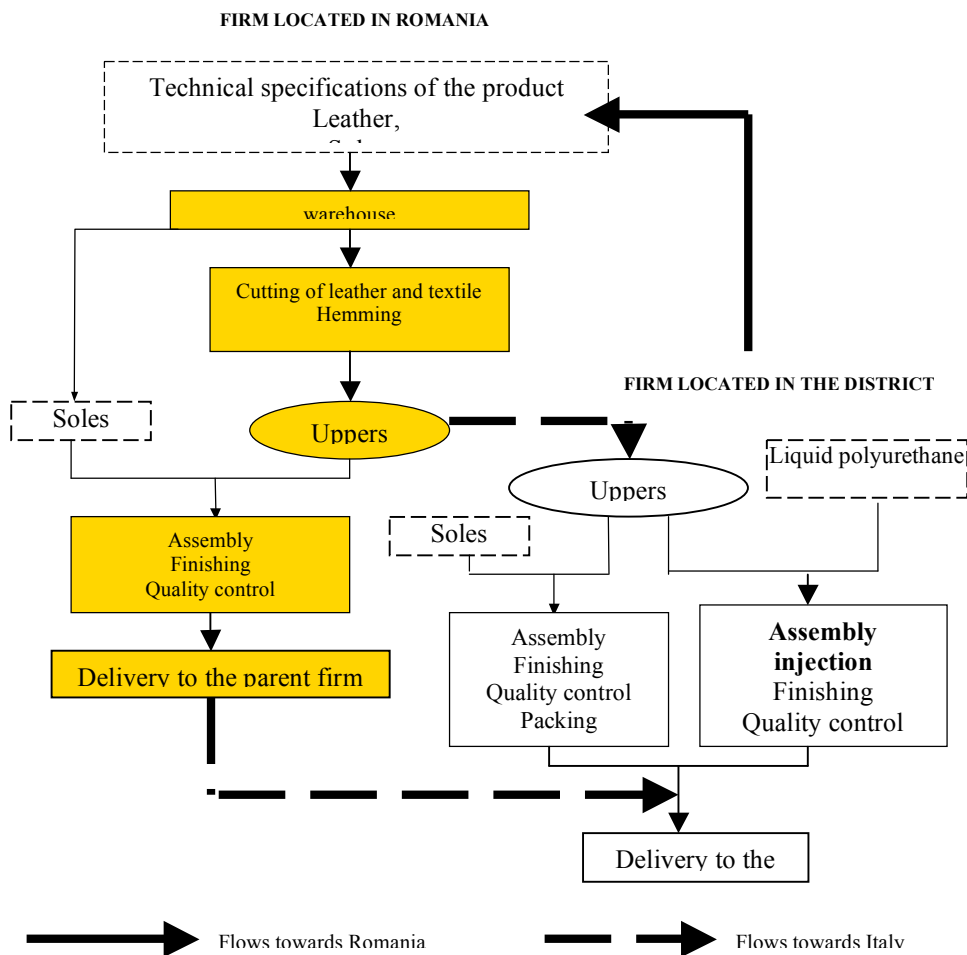
However, in the months that followed our interview, the manager of Aku opened a second assembly line and transferred the injection of the soles to the Romanian plant, thus boosting the production of AkuEst while at the same time reducing the number of workers employed in the Italian factory. A number of other firms of the district that manufacture the same kind of product have already shifted the entire production line to Romania. This is the case of Scarpa S.p.A. that owns Acellum S.R.L. in Timișoara, which employs 200 workers, produces own brand shoes (Contour) and performs the entire production process internally, including the moulding of the soles.

The process of the upgrading of Romanian production is documented by aggregate trade data. In 1995, when delocalisation was at its inception, finished shoes represented 41 percent of Romanian total exports of footwear to Italy (Standard International Trade Classification 3¹³, codes 85-8519), whilst 59 percent were components (mainly uppers, SITC.3, code 8519); 12 years later, finished shoes represented 71 percent of Romania's total exports of shoes to Italy, whereas uppers were only 29 percent. This striking change is a clear testimony of the steady shift of the entire production process by Italian firms towards Romania and of the gradual upgrading of the firms producing in Romania.¹⁴

¹³ Standard International Trade Classification, revision number 3, United Nations.

¹⁴ Kaminsky and Ng analyse the connections between the strong expansion of Romanian exports since 2000 and the upgrading of production processes performed within the country, drawing optimistic conclusions about the capacity of the country to internalise the benefits coming from openness to trade (Kaminsky and Ng, 2004; see also World Bank, 2004). For a theoretical discussion on the role played by FDI in the upgrade of national production see Markusen and Venables, 1999.

Figure 1. The Aku value chain



3. The wood and furniture district of Livenza

The firms operating in the furniture district of Livenza¹⁵ that internationalise their production are primarily interested in gaining access to the raw materials required in production, namely beech, cherry-wood and oak. Many of these firms turned to Romanian woods at the time when the war in the Balkans destabilised the economies of the former Yugoslavian Republic and affected the relationships with local suppliers of beech wood. In Romania, the wood was purchased by the Italian firms directly or through intermediaries (Italian or foreign), but also through Italian-owned firms that operated in Romania. Buying wood directly from local suppliers and processing it in Romania allows a considerable reduction of production costs, compared with the traditional procedure which consists of importing the unprocessed wood, or purchasing the semi-finished products from other firms. At the time of the interviews, there were no Romanian firms able to meet the quality required by international demand of semi-finished products. In the Livenza district,

¹⁵ The firms belonging to this district are mainly specialised in the production of modern furniture.

we identified two producers that had set up a direct investment in Romania (two sawmills) in order to purchase locally the raw materials and to provide the Italian plants with semi-finished products.

One of the biggest furniture producers of the district owned one sawmill in Romania.¹⁶ The sawmill supplied semi-finished wood products (plywood) to the plant located in the district as well as to Stratusmob, a local producer. The latter received other materials (small metal auxiliary materials, paints and so on) from the Italian firm. The Italian firm also imported finished furniture from producers located in Romania and in Thailand, which it then sold on the international market with its own brand. In order to govern these complex relationships, the Italian parent company created a trading company in Romania.

According to the manager of the Italian firm, at the very beginning, outsourcing to Romania allowed them to cut production costs by around 30 percent and although in 2005 this advantage halved due to the currency appreciation and the higher cost of labour, buying wood in Romania directly and processing it there in order to import the semi-finished products was still very profitable.¹⁷ Setting up a plant in Romania radically changed the network organisation of the firm, resulting in the abandonment of ten suppliers of semi-finished products within the district.

Besides classic furniture, the district of Livenza specialises in the production of components for the furniture industry (Tattara, 2001:113) and a large number of firms manufacture kitchen doors, plans and drawers that are sold to producers world-wide. During our research, we interviewed the chief-executive of Valencassetti, a large producer of drawers. The firm manufactured a wide array of products, ranging from standardised products to drawers for kitchens customised on the basis of the client's requirements; drawers feature various types of slides and joints and were provided within assembly kits or assembled before delivery. Products were made with Russian birch wood (60 percent) and beech wood (40 percent). Valencassetti was the main enterprise and parent firm of Valengroup. Valengroup included two other plants: ValenEst located in Surduc, Romania, working exclusively for the Italian parent firm, which owned 66 percent of it; and Valendrawers located in the United States, which was 100 percent owned by the Italian firm and accounted for 40 percent of the group's total turnover. The factory located in the district processed only birch plywood made of Russian birch, whilst the Romanian plant manufactured only beech wood sourced locally.

Figure 2 shows the value chain of Valencassetti and its Romanian network. In the Romanian plant, the raw materials used in the production process were beech trunks, which were provided by eight to ten Romanian firms. The wood logs purchased from forest exploiting companies were sawed in trunks, transformed into planks, naturally and artificially dried. The products were further processed in order to obtain the components required for the drawers. Wood represented 90 percent of all materials used in the production process.¹⁸ The remaining 10 percent were auxiliary materials (glue, metal parts and so on) purchased in Italy from firms operating within the Livenza district or in other regions. The plant in Romania did not manufacture the entire product; only the edges of the components were varnished, since the varnish of the flat areas is more delicate; the semi-finished components were sent to the plant in Italy, where varnishing was completed with

¹⁶ Under explicit request by the director of this firm, the names of the companies belonging to the group are not mentioned.

¹⁷ According to the chief-executive of another Italian firm, the reduction in costs compared to the situation in which the raw material is imported and entirely processed in Italy, amounts to at least 50 percent.

¹⁸ In the form of raw-material, semi-finished products, and coating materials.

more advanced machineries. However, at the time of our visit to the Romanian plant, attempts to varnish the flat areas were underway.¹⁹

Whereas the production process for drawers was still incomplete, the manufacturing of cutlery trays, much simpler articles than drawers, was entirely executed in the Romanian plant. Most of the components for drawers and the cutlery trays produced in Romania were sent to the parent firm in Italy. The remaining part was then sent to the plant in the United States, which supplied the local market.

Backward and forward linkages created in Romania were still extremely limited and mainly related to the provision of packing and of small metal components; the only service provided by Romanian firms was transport, usually by lorry. Italian entrepreneurs who experienced relationships with Romanian counterparts (as potential suppliers or partners) often lamented the lack of an ‘entrepreneurial mentality’ and a low propensity towards risk by Romanian firms; in contrast, local entrepreneurs during the interviews complained about the lack of finance as a binding constraint to the development of their activity. Almost all the materials used in the production performed in Romania were manufactured abroad and imported, or produced within the country by multinational enterprises. The machines employed had been transferred from the Italian parent firms, and were similar to those used within the district, most of the times they were second-hand. When the management is in the hand of Romanian staff (as in the case of ValenEst), more attempts were made to build linkages with local firms due to a higher knowledge of the local environment and an awareness of the importance of creating connections and use personal relations.²⁰

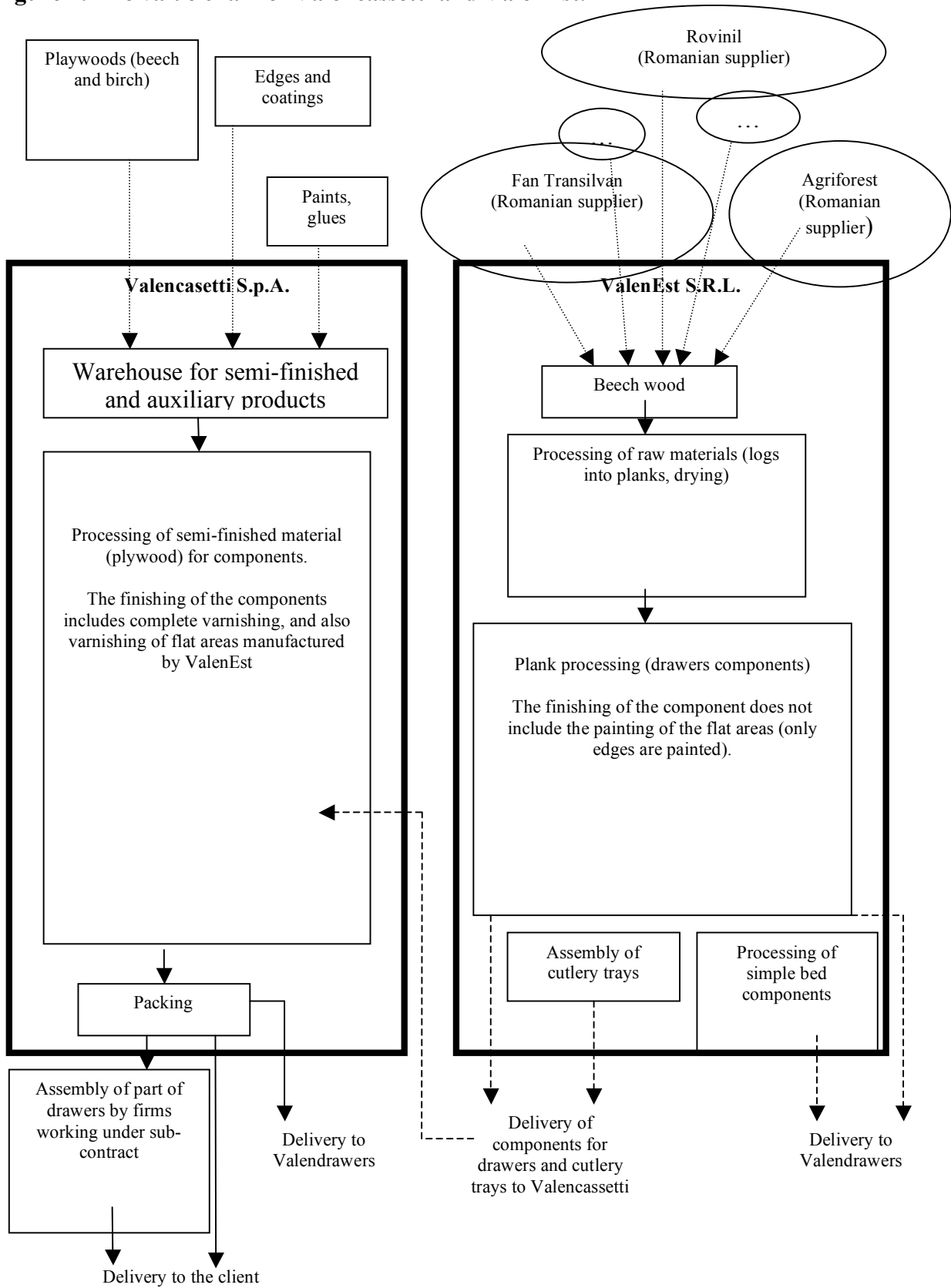
For firms that set up a plant in Romania the reduction in production costs was due not only to the direct sourcing of wood, but also to the availability of a larger workforce and its lower cost compared to Italy. The majority of entrepreneurs interviewed in the Livenza furniture district complained about the scarcity of qualified workers, but nowadays the availability of workers with generic skills in Italy is also very limited.²¹ Though the abundance of low-cost labour was widely recognised as the biggest competitive advantage for Romania, one of the largest furniture producers of the district stressed that the high level of specialisation of Romanian workers within the sector played a major role in the decision to source finished furniture in Romania. Other factors that favoured the delocalisation were the low cost of land, widespread tax breaks and fiscal advantages.

¹⁹ According to the Romanian director, carrying out the entire task of varnishing within the Romanian plant enabled the firm to hire six to ten additional workers, employing the whole workforce for three shifts per day.

²⁰ The Romanian directors of ValenEst have made significant efforts to reduce the dependence of the firm on imports of materials from the Italian parent firm, investigating the opportunities offered by the local market and creating linkages with Romanian suppliers, thus contributing to the development of local networks.

²¹ Within this scenario, foreign workers represent a major resource for the firms belonging to the district. The limits to the number of immigrants allowed to access Italy imposed by the Law Bossi-Fini, were judged negatively by some of the entrepreneurs, as they strongly limited the possibility to source workers outside the national boundaries.

Figure 2. The value chain of Valencassetti and ValenEst.



4. The air conditioning and refrigeration district

In Veneto region the district of air conditioning and commercial refrigeration systems represents the second most important production cluster at the national level (the first being the district located in Lombardia); the district includes around 600 firms and produces 14 percent of national production.²² Italy is a major manufacturer in Europe for this category of products.

In order to analyse the dynamics of internationalisation taking place within the firms belonging to the district, we interviewed five enterprises that belonged or were related to the group Arneg, an Italian-based multinational and one of the world's largest manufacturers of commercial refrigeration and shelving units for supermarkets. We carried out interviews with chief-executives and managers at Arneg (leader of the group), Oscar Tielle Est Europa, and Unicomp (retailer for Arneg and Incold). One firm belonging to the group, Oscar Tielle, recently opened a factory in Cluj, Romania, under the name of Oscar Tielle Est Europa.

Arneg has specialized in the manufacturing of refrigerated cabinets, isothermal doors, cold rooms, shelving, check-out counters, and in the development of projects for the complete outfitting of commercial outlets. Particular attention has been devoted to aesthetic features and the design that distinguishes Arneg on the market.

Final producers within this industry carry out the assembly of components that are purchased either on the international market or by subcontractors; yet the accuracy required in the process and the high degree of personalization of the products require high-level technologies and high capital investments. Costs of raw materials and labour represent only a tiny part of the total costs, and in any case never more than 15 percent, whereas 80 percent of the production cost is made by the value of parts and components purchased from other firms and subsequently assembled. These products range from engines (heat exchangers, evaporators and similar), usually standardised products purchased from multinational firms, electronic components (that can be more or less personalised), and other components like pipes, steel printed sheets, glass (the latter can be standardized or manufactured following specific requirements, which is important for the personalization of the final product (Camuffo, Furlan and Romano, 2006). It is not profitable to outsource assembly operations abroad as gains in terms of lower costs of production (and especially the cost of labour) are modest, whereas losses in terms of efficiency might be very relevant. The cost of logistics can reach 30 percent of the total cost. Thus, within this sector the drive towards internationalisation is explained by the desire to expand sales towards new markets.

In 2005 Arneg was the only group based in Veneto that operated in Romania through its own plants. The investment in Romania was part of the group's strategy of expansion towards new markets, in order to contrast the competition by other big producers, especially the U.S.-based multinational corporations, Hussman and Carrier,²³ which together with Arneg controlled the world production of air conditioning and refrigeration systems. Considering the size of its population, Romania represents the second largest consumers market within CEE (the first being Poland) and, though its per capital income is rather limited (US\$6150 in 2007), it exhibits a good potential for development in the

²² See <www.distrettidelveneto.it> and CCIIA, 2003.

²³ Carrier expanded into the European market by a policy of acquisitions: in 2004 it acquired the refrigeration division of its main European competitor, the German company Linde A.G., and in 1999 the one of the Italian Group Electrolux (<http://www.referenceforbusiness.com/industries/Machinery-Computer-Equipment/Refrigeration-Heating-Equipment.html>).

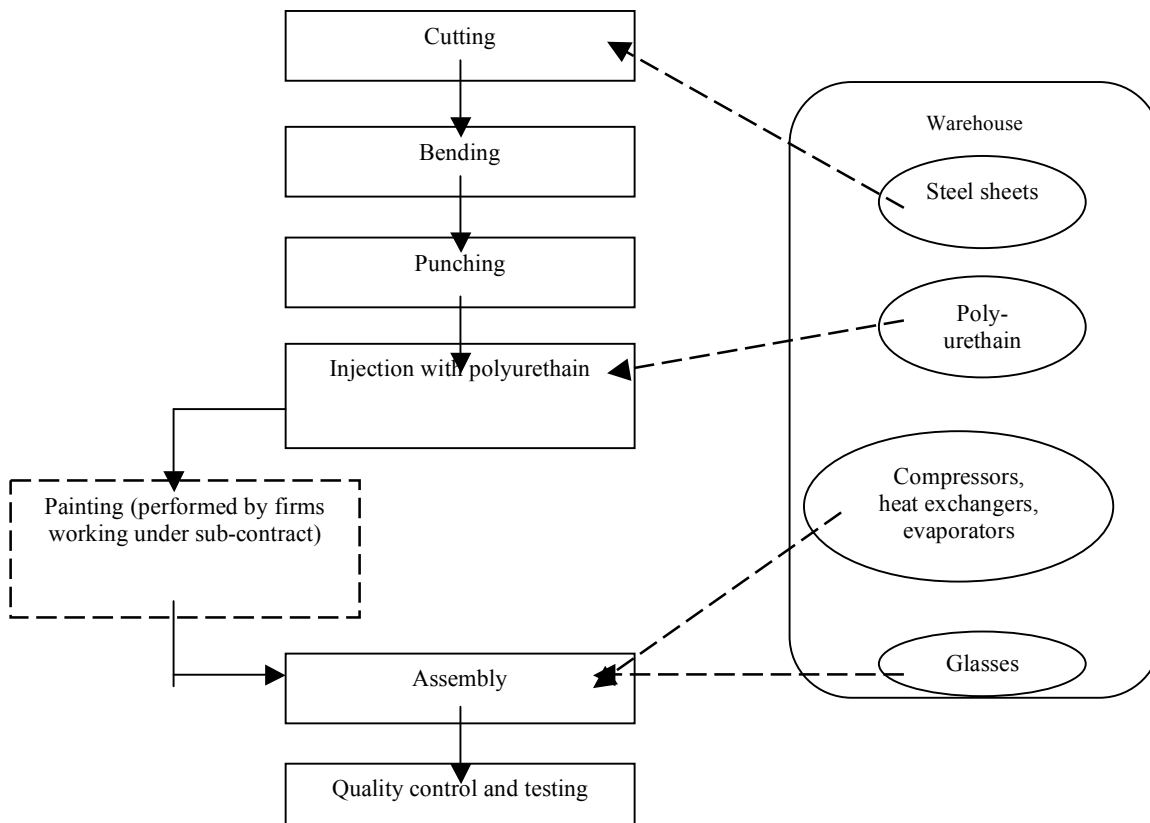
medium-term, especially because of the penetration of big international retailing chains, but also because of expectations of an amelioration in the population's standard of living. The failure to penetrate the Polish market in the recent past,²⁴ led Arneg to change its strategy and to set activities within emerging markets before the rise of local competitors, or the entry of foreign companies. In Romania, there were no local competitors, yet the Italian group feared the competition of Hussman and Carrier, both of which had plants in Hungary, and products coming from Asia, which exhibited a lower quality but cheaper prices. Another factor of attraction towards Romania was given by the central position of the country within CEE; moreover, with the development of trans-European transport networks the country was becoming an ideal bridge between the west and other eastern countries, like Turkey and Ukraine.

Figure 3 shows the production process taking place at Arneg. The products of the group exhibited a modern design, based on a number of standardized models that were then customized in order to satisfy every request. The Italian firm controlled the design and the industrialization plan.²⁵ Within the plants located all over the world the projects were then modified and adapted to the specific requirements of the local markets. The logistics were controlled by the Italian parent firm, and the choice of suppliers was therefore centralized, whereas each plant autonomously managed assembling and distribution. Some semi-finished products or materials of primary importance (like steel sheets, compressors, heat exchangers, evaporators, and so on) were sourced from European or Asian markets, where the suppliers – mostly multinational enterprises – are trusted for high quality and continuity. Other components that are relevant for product customization and represent a significant part of total production costs were sourced from the Italian district, where transactions are based on strong and long-lasting relationships among specialized suppliers. Standard components were supplied by firms which were subcontracted and that manufactured the products following the contractor's strict specifications. As to these components, Arneg sought to favour, within the country where the activity was set, local supply networks able to operate in the long run and to satisfy the quality standards required for the certification of the product (ISO9000/VISION2000). In Romania, therefore, the firm had a network of small suppliers that performed simple operations (welding, glass cutting, sheet metal working and similar) or provided semi-finished products (marble, non-curved glass, thermoforming), and packaging. The major limitations of Romanian suppliers were, once again, the lower quality of their products and the low level of trustworthiness when it came to fulfilling the contractual obligations (Javorcik, 2004; Kaminski and Ng, 2004).

²⁴ The attempt to penetrate the Polish market failed because, from the onset, the Italian company underestimated the strength of local competitors. Polish firms are currently important competitors, not only on the national market but also on the Czech and German markets.

²⁵ The group cooperates with local universities, international research centres, and independent certification laboratories.

Figure 3. The Arneg production chain.



5. Linkages and competencies in the governance of global value chains

The linkages that arise within the country of settlement, thanks to the outsourcing of Italian firms, can take various forms. Firms belonging to the footwear sector, which stipulated either subcontracts or made direct investments abroad, used to provide raw materials and accessories to local firms. Firms located in Romania had therefore a low potential to create linkages with the local economy;²⁶ sometimes these firms processed only part of the product that was sent back to Italy for assembling, but most of the time the process ended with the finished, packed, footwear ready for distribution. Often the subcontractor was also required to organize production, in order to face fluctuations of the demand. The chief executive at Bonis, whose firm satisfied orders by important fashion houses, claimed that the decision to delocalise production was driven primarily by the necessity of gaining higher production flexibility in order to fulfil the vagaries of the clients' demand. In order to gain flexibility, Filty, one of the Romanian firms subcontracted by Geox, used to devolve part of the orders received from the Italian contractor to a network of second-tier suppliers, which it managed directly. Firms located in Romania underwent in the last 15 years a relevant upgrading of production organization that postulates business relations primarily based on trust. Suppliers who had been sub-contracted provided the contractor with the production flexibility that the contractor did not have; their relationship with the contractor was of a mutual and not-exclusive dependency. As a matter of fact, the

²⁶ On the scarce capacity of this kind of FDI to contribute to the development within the receiving country see the cases of the apparel industry in Honduras and Mexico, analysed by Gereffi (Gereffi, 2007); on the footwear industry see Schmitz, 1999 and 2004.

Romanian firms Banatim, Filty and Acellum, at the time of our visits, were firms with high productive capacity that generally supplied other clients apart from the Italian brands, and therefore did not depend exclusively on the contracts with a unique Italian partner. In more general terms, the type of relationship between the contractor and its supplier varies with the degree of development of the country where the supplier operates and with the necessities of the contractor.

Fig. 4. Product and market relations of firms operating in Romania in connection with Italian firms.

sector	production process			market			link with the Italian firm
	single parts and components	final product		raw materials	parts and components	final products	
		from raw materials	assembling of parts				
footwear							relational
furniture							captive
Industrial refrigeration							captive

Darker colours indicate a more intense relation.

In their classification of linkages between the several parts involved in the functioning of global value chains, Gereffi Humphrey and Sturgeon stress the pivotal role played by the typology of the products and the technological aspects that affect the relations between clients and sellers (Gereffi, Humphrey and Sturgeon, 2005). In our opinion, the classification described by the authors must be contextualized and understood in relation to the socio-economic context. Prior to internationalisation, small firms within the Montebelluna district were subcontracted to hem and process uppers and the relation between the lead firm and the subcontractor in the local district was basically a market relation: it was relatively easy to find firms working under a sub-contract and able to grant high quality standards at the stated costs, and the costs of switching to new partners were low for both parties. The same relations change within a less developed socio-economic context. Here, the subcontracted firm needs the technical and organizational involvement by the contractor and this makes its dependency more evident. However, at the same time, the supplier cannot be easily substituted by other local firms because the market is rather thin and the number of potential producers is therefore limited; the interactions between buyers and sellers are thus long term relations based on trust.

In the mid 1990s, firms belonging to the footwear district of Montebelluna had implemented significant investments in Romania. Nowadays, these firms seek to expand towards new markets or to regain traditional markets that they lost by actuating new strategies of delocalisation in China and reducing the activities they set in Romania. The latter remains in fact an important production pole for products directed towards Europe and, generally, for leather footwear. One such example is represented by the large production of leather work and safety shoes recorded during the last years, mainly produced in Romania. Romania will remain, for Italian firms, a production hub to provide

the European market with niche products sold in small scale,²⁷ while the production of sports shoes that require materials others than leather has already been shifted to Asia.²⁸ As for the import of shoes, in 2003 Romania was, for Italy, the first trade partner; However, China has gained ground very rapidly and in 2007 the value of Italian imports from the latter surpassed the value of imports from Romania.

The dynamics observed within the wood and furniture industry also showed a progressive upgrading of production skills along the outsourced process. Valencassetti, a firm that internationalised its production process, retained the control over upstream operations along the value chain, i.e. the pivotal operations of conception, designing, and projecting of the products, which it performed autonomously or in cooperation with its clients. Valencassetti planned the logistics, organized the transport to and from abroad, and managed the relationships with suppliers and clients. However, logistic functions were locally sourced when the management was delegated to Romanian personnel, as in the case of ValenEst, the producer of components for drawers. Sometimes a part of the production process was completed within the plant in Italy because of the lack of specific and more advanced competencies (like the ability required to perform accurate varnishing). However, a progressive and remarkable transfer of operations to the Romanian plants seemed to be in place. In the case of ValenEst, at the inception of the activity all the materials employed in production (glue, paints etc.) were sent from Italy and production was constantly monitored by the Italian staff. But, after being appointed the Romanian director promoted the local sourcing of materials, accessories, and cartons (from Rondo Carton, which is part of the group Rondo Ganahl A.G.). In 2005, Italian staff visited the plant only occasionally and the entire process of varnishing was expected to move to Romania.

In the furniture sector, in general, the nature of the relationship between the contractor and the subcontractor may be quite complex. On the one side, firms producing classic furniture exhibited integrated processes, and when possible they internationalised the sourcing of raw materials. The majority of the firms that shifted their production to Romania were producers of classic furniture or of components (doors, planks, drawers), mainly using hard wood. For these firms, outsourcing abroad proved easy, as their production process was relatively simple, made up of a series of operations that could be easily transferred and reproduced, and required standardized technologies. Moreover, once the raw materials were provided, classic furniture did not require many strong linkages with other firms for the supply of intermediate goods or services. On the other side, firms producing modern furniture for kitchens and bathrooms, the most dynamic and profitable segments of the Livenza furniture district (see Baldin, 2008), did not have any interest in outsourcing production abroad. These firms employed mainly veneered plywood, which could be easily purchased from large transnational enterprises, while other components made of all-wood or other materials (steel, plastic, glass) were supplied by firms operating within the district or by other firms, Italian or foreign, located in Turkey or in Asia.²⁹ They needed a complex,

²⁷ On the relative improvement of the comparative advantage of the country within this sector see also Hanz Weiß, 2004.

²⁸ The case of Bonis is particularly interesting: at the time of our interview, the Italian manager was planning to open a plant in China for the production of shoes for its main client, Tommy Hilfiger, exclusively directed to the US market, where consumers pay attention firstly to the price of the product. On the contrary – the manager added - European consumers require primarily high quality standards, especially regarding materials, and seem still to distrust products made in China. Two years later, by the end of 2008, in a second interview, the manager told us that a large quota of production was now outsourced in East Asia (Vietnam and Cambodia) and the capacity utilization of the Romania plants had been drastically curtailed. At the same time he no longer showed the alleged dislike of Europeans for Asian products.

²⁹ The manager of Legnox, a district firm producing bathroom furniture, explained to us that the various components assembled in the final products (i.e. taps, ceramics ware, and bathroom steel

strong and wide-ranging network of suppliers that encompassed firms operating in several fields, concerned innovative products, and that could not be easily established, particularly within the context of low socio-economic development.³⁰ Moving the production to Romania would have required the creation of local supply networks similar to those operating within the district, a remote possibility at present.³¹ The figures on trade between Italy and Romania show a gradual increase of Italian furniture imports and raw materials from Romania.³²

Firms belonging to the air conditioning and refrigeration industry created a network abroad for the supply of standard components, and, to enter this network, local firms had to prove their ability to fulfil precise and certified standards. Oscar Tielle Est Europa established more intense relationships with local suppliers as compared with the firms belonging to the other two sectors: such relationships involved cooperation with engineering firms that manufactured semi-finished products (though at a very initial state of processing), retailers, and firms providing post-sale services.³³

At the time of our interviews, the Italian firms that governed the value chains retained within the district most of the immaterial functions, which have a higher value-added and play a major role in determining the competitiveness of the product. Nevertheless, there were interesting perspectives for a change. In fact, some of the Italian brands moved to Romania complex operations (and therefore the machines required to perform these activities), like the injection of the soles in the case of Aku, footwear model-making in the case of Geox, and the varnishing of drawers in the case of Valencasetti. Whether this

accessories) were designed in Italy where the prototypes of the bathroom components were manufactured. The prototypes were then sent to Asia via a couple of intermediaries for further processing and the products were subsequently re-imported and assembled by the Italian firm.

³⁰ At the border of the Livenza district, several firms manufactured metal and plastic components, as a result of the abilities acquired during the 1960s and 70s, producing for the Zanussi group. During that time, in fact, the outsourcing of stainless steel manufacturing and of plastic moulding by the Group promoted the generation of supply networks of moulder producers that played a major role in the development of the furniture district (Tattara, 2001).

³¹ The strategy of Veneta Cucine, one of the major manufacturers of kitchen furniture in the Livenza district, of stipulating a joint-venture with a Chinese partner to produce for the local market, lead to a comparison with the experience of other firms from the district which conversely relocated to Romania. Veneta Cucine could rely on China's existing, well-developed network of local suppliers and therefore sent only the design and the industrial schedule to its Chinese partner, while all components were provided locally.

³² None of the firms that delocalized their production process to Romania was interested in selling to the local market: for the firms of the district of Livenza, specializing in modern furniture, the Romanian market was not attractive due to the low average income, and to the general preference towards classic furniture.

³³ As for downstream operations along the value chain, the group relied on various channels for the distribution of its products, and the choice of the channel depended on the typology of the client. When retailing involved large firms that operated internationally (Billa, Metro, and Carrefour) negotiation was centralised, and the big retailer dealt directly with the Italian head company. In all other cases, retailing occurred through local agents and these were generally local retailers with a well-established activity and a well-defined market. In contrast with Carrier, which employed its own agents, Arneg preferred to stipulate joint-ventures with local companies, such as Unicom. The latter was a medium-size retailer with a number of offices in Romania and an exclusive trader of refrigeration systems for Arneg Group. According to the chief executive of Arneg, such a form of organization was more profitable than direct distribution. Unicom provided transport services (employing Romanian carriers), assembly, maintenance, and after-sale services. The relationship with the Italian group was hierarchical: the Romanian retailing company did not enjoy any degree of autonomy and the producer was not obliged to inform the retailer about changes in its production or distribution strategies.

specialisation will be the premise for the generation of a local manufacturing activity is difficult to say, mainly due to the difficulties experienced by local firms with selling in the final market and monitoring consumer tastes. Our evidence shows that there was a strong tendency, especially in the later years, for Italian firms to outsource an increasing number of operations of the production process to Romania.³⁴ However, the skills developed by Romanian firms were related to production and to the management of a small segment of the production network. No local firms sold directly on the foreign markets, and sales in the national market were marginal. Selling directly to the (national or foreign) market would imply the development of different competences, it would require a certain degree of autonomy on the production side, but also considerable organisational capacities and the ability to learn about designing (upstream), and retailing and marketing (downstream), a functional upgrading that was still far from being implemented in Romania.³⁵

It is however difficult to forecast the future scenario. As stressed by Kaminski and Ng, the sustainability of the good performances that Romania has shown throughout recent years in its exports towards Western markets depends on keeping wage increases in line with the labour productivity growth (Kaminski and Ng, 2004). In other CEE countries, the rise of wages³⁶ consequent to the inward-sourcing by Western firms and to the amelioration of life style has eroded the competitive advantage given by the cheaper cost of labour. This seems to have happened in Romania as well, with the recent upsurge in wages and the Leu appreciation that has further increased the cost of Romanian labour for foreign firms. But the main problem is the scarcity of labour due to the emigration of Romanian workers - mainly to Italy and Spain - intensified by the entrance of Romania to the EU. This in turn has led several Italian clothing firms to hire workers from East Asia (Bangladesh, China, Philippines) in order to fill the gap.

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34 At the time of the interviews, some firms had started to shift some of these operations to Romania: Geox started to move one part of its model-making activity, though the firm was still managing the distribution of all the finished products from Italy; for Bonis model-making was still exclusively performed in Italy, while the finished shoes were partially distributed from Romania, though the logistics are centralised in Italy.

35 Of the firms observed, the Romanian Banatim, Filty and Acellum sold a small part of their products within the local market, though this market was in 2005 rather narrow and the firms attached little importance to it; domestic sales were inferior to 10 percent of the total production. Schmitz, 1999, and Navas-Alemán and Bazan, 2003, analyse the upgrading of the footwear district of Sinos, Brazil. Navas-Alemán and Bazan highlight how local firms understood the importance of selling their product into the national market within a strategy of risk diversification and functional upgrading (in marketing, designing and branding).

36 Feenstra and Hanson, 1997, and Egger and Stehrer, 2001, show how outsourcing had a positive impact on the salaries of the less-qualified workers in Mexico, Czech Republic, Hungary and Poland.

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