The Internationalization Process in the Small and Medium Sized Firms: A Case Study on the Italian Clothing Industry

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ABSTRACT. In this research we use a data-base that reveals the propensity for contractual ventures and direct investments (1051 operations) of the clothing Italian companies during the period 1987–1991, on a national (342 operations) and international level (709 operations). The latter were analyzed with reference to the internal (412) and external growth strategies (297), cooperative (362) and non-cooperative (347) deals. Our analysis focuses on the different strategies that SMEs, on one hand, and large companies, on the other hand, show in the internationalization process. Main results of the study are:

- the international growth of the SMEs takes place mainly through contractual agreements (68%), more so than with non-cooperative operation (32%), whereas in large companies the non-cooperative strategies slightly prevail (54%). Consequently, the external growth strategy is very important for the SMEs (72%) and somewhat less important for the large companies (54%);
- the cooperative growth is usually seen by SMEs as an expansion both of the commercial (48% of the operations involves commercial purposes) and of the production areas (48% of the cases). This could indicate that SMEs try to organize on an international level the same network model used in Italy: SMEs decentralize their production within the country through networks of companies and industrial districts, whose horizontal connections (among SMEs themselves) and vertical connections (with large companies) provide flexibility and low costs;
- large companies' expectations of the Single European Market have brought a great number of international operations in Europe (24%), notwithstanding the notable importance of Japan (23%) and U.S. (17%); on the contrary, SMEs focus on "niche and rich markets" as Japan (40%); but as far as the contractual agreements are concerned, both types of firm privilege the Japanese market: almost 50% of SMEs' international agreements are directed towards Japan (33% in the large company's case);
- large companies and SMEs in the middle and high segments of the market carry out more operations than companies operating in the low quality and casual segments;
- generally speaking, in Italy there is an urgent need for industrial policies promoting SMEs access to cooperative instruments ("learning by cooperating").

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I. Introduction

Due to the relevance of the clothing industry within the Italian industrial system, and its good performance on the foreign markets, we have implemented a data-base monitoring the internationalization process of the sector (Berra, Piatti and Vitali, 1992). The degree of internationalization of an industrial sector is usually measured by studying the flow of exports and of foreign direct investments (FDIs) in the country of reference. This analysis can be integrated with the examination of other forms of operations, definable as "intermediate": these operations specifically concern companies' international growth strategies based mainly on contractual or equity agreements.

Our data-base therefore includes:

- cooperative operations, such as commercial and distribution agreements, manufacturing licencing, long term subcontracts, commercial licencing, transfer of trade-marks and of granting patents, management contracts, transfer of know-how and turnkeys contracts, portfolio investments;
- non-cooperative operations, such as direct

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investments, companies' acquisitions greenfield plants, factories, branches, openings of points of sale.

The purpose of this research is to describe and evaluate the strategies of production and commercial internationalization followed by the Italian clothing companies in the period 1987–1991. Besides, this contribution tries to shed light on the different aspects that the internationalization process has with regard to the dimension of firms, and specifically to small and medium-sized enterprises (SMEs).

The main results of our analysis show a good degree of international involvement of SMEs, especially as far as the cooperative strategies are concerned. This is due not only to country factors (low degree of internationalization of the Italian industry as a whole) or to industry factors ("maturity" of production and low technological innovation of the clothing sector) but also to the economic cycle (general decrease of the demand at the beginning of '90s) and to structural changes in the competitive context (expectations about the single European Market, GATT agreements, Eastern Europe development). As background framework, an analysis of the internationalization strategies adopted by the major industrialized countries is carried out in the following section,while the Italian case is dealt with in detail in section 3. The main characteristics of the data-base are highlighted in section 4, while the subsequent section presents the empirical evidence concerning the different approaches followed by large companies and SMEs. In the last section we try to summarise the main results of the analysis and to outline the new pattern of growth followed by the Italian clothing industry within the world markets.

II. The internationalization strategies of foreign competitors

There are some general characteristics of the clothing industry that influence the internationalization process of the sector (CEPII, 1987 and Cainarca and Mariotti, 1986):

- a high intensity of the labour factor determines a competitive advantage for countries with low labour costs and favours the exports both of medium and low quality products and of semi-finished goods (outward processing traffic (OTP)[1]) from developing countries to industrialized countries;
- few opportunities for technological innovations, conditioned by the difficulty to join production automation (now possible in many phases of the manufacturing process) to the quality of the finished garment.

These structural features have favoured an international division of labour that has produced an intensive flow of trade, notwithstanding the protectionism through a system of quotas provided by the GATT special rules for the textile and clothing sector (Multifiber Agreement). However, the evolution of this structural framework shows a growing importance of barriers to entry (in the past, lower barriers had permitted a higher presence of SMEs) because of the importance of non-price factors (the clothing production is very differentiated) and distribution chains (EC Commission, 1989a).

This is why in the '80s clothing firms of the OECD countries have continued to pursue product differentiation ("griffe" and trademarks), shifts toward high fashion segments (or other unelastic segments, such as sportswear), decentralization and international relocation of production. Beside, in some OECD countries a partial abandonment of the sector in favour of high-tech industries has been registered (with an increasing rate of job losses inside the sector).

It is necessary however to clarify that different industrialized countries have followed different models (OECD, 1988):

- Japan has made intensive use both of international sub-contracting through the large trading companies, and of FDIs in South-east Asia (Mussati, 1988);
- the United States have adopted off-shore assembly strategies in the "neighbouring" countries (the Philippines, Mexico, and Latin America), performed both with independent partners and with subsidiaries or branches of American MNEs (Hamill and Young, 1987). Moreover, in the second half of the '80s investment activity picked up in favour of the Nafta integration area (Canada-USA-Mexico);
- in the case of Germany the internationalization

process developed especially through the relocation and redeployment of the more labour intensive manufacturing phases to areas of the CMEA and Yugoslavia (Hamill and Taggart, 1987b);

- France and England have traditionally made productive FDIs in their former colonies (North Africa and areas of the Commonwealth respectively) (Hamill, 1987).

III. The internationalization strategies of Italian firms

The structural characteristics of the Italian clothing industry has influenced in different ways the internationalization process of the sector.

It is well-known that the clothing sector in Italy is characterized by a forcible polarization: a limited number of large companies counters numerous SMEs, that are specialized in some phases or types of production, and positioned in various market niches.

When in the middle of the '70s the economic context changed suddenly – consumption models and lifestyles changed, the cost of factors rose, new actors appeared in the arena of competition, and the demand decreased – the response of the sector's firms in the major industrialized countries was, as we have already pointed out, connected to a vigorous intensification of the international decentralization and redeployment, and to protectionist policies.

In Italy the sector was also threatened by the crisis, but it did not undergo great occupational losses, nor did it experience a massive international production decentralization or commercial trade deficits as other industrialized countries did. All of this was due to the competitive advantage reached through organizational innovation: the deverticalization and decentralization processes occurred within national boundaries, by virtue of the peculiar production network made up of small and flexible units, and the type of products offered, which allowed for recovery regarding the factor costs and the sale prices of the final products (Lorenzoni and Ornati, 1988). For the Italian clothing sector, in fact, the production decentralization had a dual function: it turned out to be an instrument aimed at efficiency, but also an implementation formula of a strategy based on the diversification and differentiation of the product, due to the availability of flexible and specialized structures and the presence of coordinated production poles.

The organizational model, typical of the Italian industrial structure, is based on decentralization and deverticalization for each manufacturing phase (Locke, 1990). Significant industrial entities which are modelled within a reticulate logic are created; others adapt themselves quickly to the new model and consolidate the multipolar structures (Beccattini, 1990). At one extreme of the model we find the "network-company", closely linked to a network of suppliers specialized in manufacturing phases or parts of the product; at the other extreme we find the "global integrated company" that seeks the competitive advantage in the synergies of dimensional growth for vertical and horizontal integration; between the two poles there are "company networks" that characterize the structure of industrial districts specialized by product (Vaccà, 1986).

SMEs expend thorough vertical and horizontal integration, creating other small firms that they control. Greater reliance by small companies upon burocratic relations is frequently compensated by their increased dependence on market relations through intensified sub-contracting (Lazerson, 1988).

The firms usually remain strictly independent legal entities, with separated accounting procedures, work forces and workshops. These "network-firms" represent an attempt to preserve the special characteristics of small firms thorough loosely-coupled units, exploiting some of the advantages offered by more diversified economic groups. The economic vitality of these small firms mainly rests on a particular social order: the continued existence of the "extended family" provides a foundation for economic relations based upon cooperation and trust.

The importance of such non-market relations for economic success also explains the heavy reliance ex-workers owners place on turning to friends and former colleagues in their search for employees. These social factors are reinforced by some local policies; besides, there is a rich network of private associations and political organizations that promote cooperative behaviour and provide small firms with the infrastructural needs that they could not afford alone or that the national States does not provide.

In this industrial context based upon few large companies and a network of SMEs, with a high economic vitality but also with scarse financial resources, the delay in internationalization that already characterized the Italian clothing industry has further increased: it seems that the sector's international growth process is predominantly based on policies of commercial penetration through exports, rather than on the use of FDIs and contractual agreements.

The strength and importance of the Italian clothing exports are self-evident: in 1992 the export/production ratio of the sector, joined with the textile sector, was approximately 28%, whereas the import/production ratio reached only 15%; the commercial balance (14,500 billion of Italian lire in 1992) is structurally positive with a normalized value of 0.37 (ICE, 1993). Such values are clearly more positive than the average of the national industrial complex, regarding both the first and second ratio, and allow the sector to bring about 12% of the total Italian exports.

At the beginning of the '90s, the positive performance of the sector is threatened by strong import dynamics. This increase of imports was caused, on the one hand, by a loss of price competitiveness of the Italian companies (especially in the low quality segments) and, on the other hand, by an increase in the purchases of basic products and semi-finished goods due to the greater international integration of the production cycle (Bipe-Ifo-Prometeia, 1991): in both cases the role of LDCs and NIEs suppliers characterized by a low cost of labour became more important. In the medium quality segments Italian companies have also confronted the competition of industrialized countries that use automation and new technologies to a very large extent, as in the case of the German industry.

Regarding FDIs, some research carried out halfway through the '80s (Barbieri, 1985) on the international growth strategies of the Italian textile and clothing companies reveal that, in the 1975–1985 period, FDIs – more often commercial than productive – were quite scarse and were mainly addressed toward industrialized countries, especially Europe and the USA. The market penetration goal was prevalent in comparison with the cost saving motive. In the second half of the '80s the sector again experienced a very poor flow of both incoming and outgoing FDIs with respect to the other Italian manufacturing industries (R&P, 1991). But other research (Bursi, 1992) found that since 1987 the internationalization process has had a dramatic increase, using all the different growth strategies and instruments (FDIs and contractual agreements).

The analysis and interpretation of this recent evolution is the main object of the next two sections.

IV. Main characteristics of the database

The research conducted on the internationalization process of the clothing industry in the 1987–1991 period, with particular attention to the relation between firms's size and growth strategy, relies on a data-base that the authors have implemented by integrating different sources.[2] The data-base contains all the operations performed by the Italian clothing companies that have equity and non-equity, cooperative and non-cooperative, external and internal growth characteristics, on a national and international level.

Because of the peculiar nature of the phenomenon in question we have chosen to give priority to the fundamental distinction between cooperative and non-cooperative growth strategies at the international level, as briefly defined in section 1. Particular emphasis has been given to the cooperative strategies, because it is supposed that in the next decade they will become more and more important with respect to the traditional non-cooperative behaviour. The greater risks of the former are toned down by the brilliant results obtainable in the case of a successful operation and by the continuous improvement of managerial capabilities in the management of cooperative strategies ("learning by cooperating").

This research has examined, more specifically, the categories of cooperation that refer to commercial agreements (distribution agreements, marketing and trade-mark licences, new points of sales established by an agreement or a joint-venture with another company), technological agreements (transfer of know-how and technological licences, granting patents), production agreements (including manufacturing licences, joint manufacturing, long term sub-contracting of intermediate, finished or semi-finished goods). These cooperative operations might be equity (joint-ventures and non-controlling shares), or non-equity (pure contractual agreements).

As regards the non-cooperative deals, such strategies are followed in the case in which the company wants to internalize its own competitive advantage. The research has examined the cases of growth based on the establishment of new factories (greenfield plants), the establishment of new branches (generally commercial companies), the opening of points of sales (corners, show-rooms, mono and multi-brand boutiques, franchising shops and chains) and, finally, acquisitions of companies already existing (controlling interests).

Within the great number of definition of SMEs we have chosen to refer to the Italian "SME's Incentive Law" (n.317/91), that states in 200 employees the maximum SME size (or 50 billion Italian Lire of turnover, when the employment figure is not available in our data-base).

The total number of operations registered for the period 1987–91 is 1.051, and the number of companies involved is 150. The international operations are 709 (362 cooperative and 347 on-cooperative; 412 definable as internal growth strategies and 347 as external growth strategies.[3]

V. The relation between firm's size and growth strategy

Clearly, the international operations were predominantly carried out by large companies (78%), even though the participation of the SMEs is nonetheless significant, not only for the amount of operations performed (22%), but also for the number of the firms involved (83 SMEs as opposed to 67 large companies). A preliminary insight can be found in the implementation methods of international growth: a significative chi-square (at 1% level) shows a relationship between firm's size and firm's strategy (see Table I). Production and commercial agreements have a greater weight for SMEs than for large companies; all the remaining implementation methods, especially those of internal growth (new branches, factories or points of sale) have a greater weight in the internationalization process of large companies. This is noticeable for joint-ventures as well and for technological agreements (for which it is usually the large company that provides technology to non-industrialized countries).

The relationship between firm's size and growth strategy is clear as far as cooperative or non-cooperative operations are concerned: the SMEs mainly internationalize their activity using contractual agreements (68%) more so than non-cooperative operations (32%), whereas in large companies the non-cooperative strategies slightly prevail (54%). Consequently, the external growth strategy is very important for the SMEs (72%) and somewhat less important for the large companies (54%).

Most likely the large investments necessary to open new factories, to establish new commercial branches or to acquire already existing companies cannot be afforded by the SMEs, that try to penetrate international markets in partnership with local operators.

As contractual agreements are becoming a key factor in the internationalization process of the Italian SMEs, we will go on deeply in this analysis.

As regards the purposes of international agreements (bearing in mind that the same objectives

TABLE I
Italian clothing industry (1987–1991): International operations by type (%)

	CA	PA	TA	JV	ACQ	SHOP	B	GP	Total	Number
SMEs	30.2	31.4	1.9	5.0	3.8	23.3	4.4	0.0	100	159
Large companies	18.2	15.1	2.5	10.2	8.0	36.4	6.5	3.1	100	550

Chi-square = 45.253 (significative at 1%)

Source: CERIS-CNR.
Legend: CA = Commercial agreements; PA = Production agreements; TA = Technological agreements; JV = Joint ventures; ACQ = Acquisitions; SHOP = Shops; B = Branches; GP = Greenfield plants.

can be reached with different methods, whether equity or non-equity, cooperative or non-cooperative, external or internal growth), they seem to be affected by the willingness to reach distribution and commercial economies of scale within the organizational model of the sector (see Table II), even if some differences appear.

TABLE II
Italian clothing industry (1987–1991): International agreements by purpose (%)

	Large companies	SMEs
Commercial	49.4	47.7
Production	34.0	47.7
Com/Prod	9.9	1.8
Financial	1.2	0.0
Technological	5.5	2.8
Total	100.0	100.0
Number	253	109

Chi-square = 12.964 (significative at 5%).
Source: CERIS-CNR.

Within cooperative deals the SMEs have carried out both production (48%) and commercial agreements (48%), partly opposed to what happens for large companies (49% of commercial and 34% of production agreements), with a significative chi-square at 5% level. The relevance registered for production agreements carried out by SMEs could indicate that SMEs try to organize on an international level the same network model used in Italy.[4] Furthermore, complex agreements, with commercial and production goal simultaneously, are less often exploited by SMEs, which indicates that these strategies are difficult to be managed. As far as financial and technological agreements are concerned, we clearly find they are a large companies' attributions. The former are mainly carried out in Europe and North America, the most evoluted financial markets; the latter regard Eastern European countries or LDCs, where large companies sell process innovations.

Further differences in company strategies can be singled out by examining the geographic areas of destination of investments and agreements (see Table III, with a significative chi-square at 1% level).

Europe confirms the role of domestic market, both for the large companies and for SMEs. Within

TABLE III
Italian clothing industry (1987–1991): International agreements by country (%)

	Large companies	SMEs
Africa	2.8	0.0
Other Asia	7.5	1.8
Other Europe	8.7	8.3
Latin America	2.8	4.6
France	12.6	17.4
Japan	32.8	47.7
North America	15.8	10.1
Germany	4.7	7.3
East Europe	12.3	2.8
Total	100.0	100.0
Number	253	109

Chi-square = 23.815 (significative at 1%).
Source: CERIS-CNR.

Europe, Italian industry has strong relations with French manufacturers.

The large number of deals on the North American market can surely be correlated to the vastness and wealth of that area, and also to the expectations of protectionist practices. Large companies seem more interested the SMEs in this market.

The internationalization process also involves to a considerable degree of non-industrialized countries. The contact with non-OECD countries has a higher incidence for the large companies (28%), interested in decentralizing part of production to areas with low labour costs, than for SMEs (9%), interested in penetrating the "affluent societies". This difference is evident particularly in Eastern Europe – where 11% of the operations of large companies are concentrated, but only 3% of the SMEs operations – and in the Asian NIEs (8% against 2%).

Finally, it is worth noticing the primary role played by Japan. As far as SMEs are concerned, the dynamism of Italian entrepreneurs emerges: roughly one out of two agreements is aimed at penetrating the Japanese market (73% of the SME's Japanese agreements have a commercial purpose). As soon as interesting commercial developments come up in a very wealthy area, SMEs try to be present immediately in that market with the best of their products (46% of the agreements performed by SMEs in Japan are in the high fashion segment). The strategy adopted in this country mainly makes use of commercial agreements with the local trading companies, because the Italian companies do not have a thorough knowledge of the country and the market is in any case highly protected by the distribution system. However, there is the possibility to use the non-cooperative strategy based on new shops (high fashion boutiques) so that, due to the homogenization of demand, SMEs can sell the same Western production too.

A more detailed analysis of the end segment of market in which the companies operate (see Table IV) shows a substantial incidence of the high and medium end segments both for the SMEs and for the large companies deals (chi-square in the Table IV is not significative). This is due to the importance of the Italian fashion in the international markets, that affects the type of segment involved in the international deals.

TABLE IV
Italian clothing industry (1987–1991): International agreements by segment of market (%)

	Large companies	SMEs
High	37.5	26.6
Middle	38.3	45.0
Low	0.4	0.9
Casual	23.7	27.5
Total	100.0	100.0
Number	253	109

Chi-square = 4.3101 (no significative at 5%).
Source: CERIS-CNR.

VI. Conclusions

The evolution of the international process of the Italian clothing sector has been affected by the changing conditions of the world competition and of the new international division of labour (Boussemart and De Bandt, 1988). Besides, while the uncertainties linked to the renewal of the Multifiber Agreement has induced companies to review their own competitive position in the world market, the expectations of the Single European Market favoured their reinforcement in the European countries (EC Commission, 1989b).

These changing conditions imposed the Italian companies to rationalize the structure of the production costs (labour and capital factors), distribution costs (reorganization of the commercial chain and transportation services), and organizational costs (broadening of the marketing services and promotion). Expecially SMEs have been seriously engaged in looking over their international placing, using not only the traditional instruments of international growth (such as FDIs), but mainly cooperative strategies.

However, at the beginning of the '90s the SME's traditional strong points related to non-price competitive advantages - high quality and product image, production flexibility, rapid placing on faster growing markets - have become weaker and weaker. The process of internationalization of SMEs tries to overcome these difficulties too.

On the basis of these considerations it is clear that the Italian model of penetration in the international markets on the one hand cannot continue to rely on exports, and on the other hand does not have the enormous resources to manage a FDI policy abroad: a feasible growth strategy is therefore related to international contractual agreements, which would allow an immediate and lasting expansion of the world market of destination and sources of production (Zanfei, 1985).

After having modified the internal organization of a company (renovation of plants, recovery of efficiency and, if possible, automation of the manufacturing phase) and the organization of the relations between companies (decentralization and deverticalization model of the production), the path chosen by the Italian clothing companies to face international competition uses instruments that are completely different from those used in the past. Our analysis has showed a great number of agreements made on an international level. Within such a growth model, cooperative operations stand out for the weight they hold and for their strategic role. By combining the source/destination relationship, the company tries to exploit the positive characteristics of any market: low labour costs (LDCs and NIEs), wealth and stable demand (Europe), favorable evolution of the consumer models (Japan), and technological externalities of some areas (Germany and the U.S.) (Kazis, 1990).

The choice to follow mainly cooperative or non-cooperative type strategies corresponds to a clear-cut difference in the internationalization model as well as in the growth model pursued by the company: on one extreme there is the network-company that fully exploits all cooperative international agreements to externalize the non-strategic manufacturing phases; on the other extreme there is the integrated company, that – with its predominantly non-cooperative strategies – exploits all the synergies of its internal growth for vertical and horizontal integration at the international level.

As in our analysis cooperative strategies has been most of all followed by SMEs – notwithstanding the difficulties made worse by the fact that in such a growth strategy the managerial resources are one of the keys to success – we underline the dynamism of Italian manufactures facing world competition.

As agreements are moreover a strategic choice for companies with limited financial and managerial resources, this could confirm the theoretical approach to cooperative strategy based on the necessity of acquiring complementary assets (Richardson, 1972 and Teece, 1986): likely, SMEs cannot control all the indispensable assets to exploit the opportunities of the business using a traditional growth. On the one hand, financial constraints limited the use of acquisitions, on the other hand, the rapid change of the competitive context limit the use of traditional growth strategies (internal resources invested in new factories, new shops, new branches).

In addition we could underline that agreements represent an "hybrid mode" of coordination (Williamson, 1991). For medium degrees of asset-specificity the growth strategy based on agreements combine the incentive properties of markets with the control intensity of hierarchies. In same case, especially when the frequency of "disturbances" is low, a cooperative growth can guarantee a rapid and vast entrance of a market - though with same risks of failure and opportunistic behaviour of the partner (Williamson, 1983).

This growth strategy created an industrial structure that showed great vitality, flexibly and some kind of optimalities as well. The network-firms that have been generated by this economic context were useful vehicles to launch new products and facilitate access to new markets and technologies. This is now leading to a growing importance of international alliances and foreign operations.

Notes

[1] Outward processing traffic (OPT) is a well-known mechanism in the clothing industry, according to which raw materials and semi-finished products are temporarily exported to countries with low labor costs where they undergo further processing, and then are reimported, with duties levied only on the added value produced abroad. It is widely used in Germany and in other Northern Europe Countries.

[2] The data-base has been created by using articles from business newspapers (Sole 24 ore, different years), financial reports from the major groups of the sector, data-base on the equity operations and FDIs (Nomisma, different years and R&P, 1991) and a great deal of information made available by the Economics Research Department of Gruppo GFT.

[3] Beside the dichotomy between cooperative and non-cooperative strategies, there is also the distinction between internal and external growth, which the internal growth strategies including only a section of the non-cooperative deals: the opening of points of sale, new production plants and the establishment of new branches.

[4] In the case of non-cooperative operations, the commercial objective is prevalent in all company sizes, but more so for the small ones (88%) than for the large ones (77%). It is clear that for the former this objective is pursued almost exclusively through the opening of new points of sales, rather than through the founding of new branches or the acquisition of already existing companies (as large groups usually do).

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