

EVOLUTION OF LOCAL SYSTEMS IN THE CONTEXT OF ENLARGEMENT: THE
CASE OF THE SHOES DISTRICT OF MARCHE*

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SOMMARIO

La finalità del contributo è dare rilievo ai processi di cambiamento in atto in uno dei principali distretti italiani in relazione al processo di transizione dei Paesi dell'Europa centrale e orientale. La recente evoluzione del distretto calzaturiero delle Marche viene interpretata sulla base di due prospettive complementari. In particolare, i contributi della letteratura sullo sviluppo locale vengono integrati con quelli forniti dalla *value chain analysis* e fanno da sfondo all'interpretazione dei risultati dell'indagine sul campo.

La crescente integrazione economica europea, e la relativa riconfigurazione dei network produttivi, suggerisce infatti di ripensare il distretto oltre la sua tradizionale connotazione locale. I confini territoriali diventano sempre più confusi e, sotto la spinta di una nuova 'disobbedienza dei fatti', in alcuni casi, sembra più appropriato considerare il distretto come nodo di sistemi produttivi sovranazionali.

* An earlier version of this paper is published as SEI Working Paper N.67, University of Sussex, Brighton (UK).

1 INTRODUCTION

This paper investigates a particular form of the process of globalisation that is taking place in the well-known footwear district located in Central Italy. Some of the firms operating in this area have activated international outsourcing processes in order to benefit from the cheaper wages of developing countries, especially European peripheral countries. Clearly, the transition process that central and eastern European countries have been experiencing in the last decade has opened up a range of new location possibilities. Indeed, the geographic proximity -and the consequent lower transport costs- is a source of comparative advantages with respect to the opportunities offered by other developing countries.

When the increasing attention of local firms to cross-border business relations arose as important competitive strategy, the prime concern of local development research agenda - namely the focus on the internal structure of industrial districts- turned out to be a shortcoming. In fact, the districts' literature have devoted less attention to outer economic relationships of local firms. Even if not completely disregarded, these ties have not been studied in depth within this strand. To this end, the theoretical integration with the *value chain analysis* framework, mainly focused on global systems of production, may lead to a better understanding of the recent evolutions of industrial districts.

The paper is organised as follows. Section 2 presents a combined interpretative framework to the analysis of the evolutionary tendencies of the international fragmentation of production processes. Section 3 is devoted to the main results of the field study carried out in the shoe-manufacturing district of Marche from December 2000 to August 2001. A particular attention is placed to delocalisation. This process, initiated in the late eighties, is still underway in the local system under observation. The information presented has been collected through in-depth face-to-face interviews given by the entrepreneurs of local leader firms. Finally, Section 4 concludes.

2 INTEGRATING LOCAL DEVELOPMENT THEORY AND VALUE CHAIN ANALYSIS: INSIGHTS AND LIMITS

2.1 Industrial district literature

During the late 70s a new strand in regional studies arose in Italy. The empirical observation of unexpected paths of development experienced by clusters of small and medium enterprises paved the way for the literature on industrial district. Local productive systems were mainly located in the so-called *Third Italy*, an expression coined by Arnaldo Bagnasco (Bagnasco, 1977) to emphasise the necessity of reconsidering the north-south duality which was the hitherto dominant perception of the Italian regional landscape. From a geographical point of view the area overlap the NEC Italy (Fuà, 1983) , the north-eastern and central part of the country.

The Italian experience attracted the attention of social scientists at the international level. Piore and Sabel extended the research on industrial districts in different advanced countries. Some forms were found in North America and Europe, particularly in West Jutland in Denmark, Baden-Württemberg in Germany and several regions in Spain (Pyke e Sengenberger, 1992). The acknowledgement that the industrial district is not a perfect model did not prevent further research focused on the possibilities to apply the positive perspectives and lessons to developing countries (Schmitz, 1994). The aim is to discover existing dormant clusters and turn them into viable local systems.

From the theoretical debate the main attributes of an industrial district have been identified: the concentration of the same industrial sector, the geographical proximity, trust and cooperation in some economic relations in a general competitive local environment, the social embeddedness of economic agents, adaptable workforce. The collective efficiency is one of the most important systemic properties outlined by the literature. It may be defined as a relational asset encompassing both intentional and unintentional characteristics (namely *joint action* and *external economies*).

In spite of the above-mentioned distinguishing characteristics, the forms and structures of industrial districts have changed, particularly in recent years. These processes of change should not have been surprising if one bears in mind that industrial districts are endowed with intrinsic evolutionary properties. Two basic modifications are particularly evident, one change deals with the internal organisation and the other one affected the external relationships with other localities.

Firstly, the homogeneity and unity assumed by the external observer rarely exists. The internal heterogeneity is a common characteristic of several industrial districts both in

developed and developing countries (Rabellotti e Schmitz, 1999). Local firms are different not only as far as the size is concerned, but also in the governance of the relationship among them and with wider value chains.

Secondly, firms are experiencing a spatial extension of the network they refer to. This expansion can be *passive* or *active*. The first case occurs when a firm is absorbed by existing value chain, whilst the second one takes place when the firm decides to spreading its network out. These transformation tendencies have brought to light the main shortcoming of this field of study.

When the international integration of productive processes was growing, it became increasingly evident that the main focus of the analysis -the internal organisation- was not sufficient to deeply understand the recent development pattern of industrial districts. Nonetheless, it is misleading to state that the relevance of outward relationships was completely disregarded by the Italian local development literature. In fact, the industrial district was conceptualised since the beginning as an open system because of its relations with the wider political, economic and social environment and with other local systems¹. The metaphor of network was the focal reference of the theorisation of the cross-border relationships. A locality was envisaged as a node of a global network and the self-organisation at the local level was considered to be dependant on the coherence with the whole network (regional, national or international). Starting from a territorial standpoint, Dematteis emphasised not only the embeddedness of an industrial district in a territorial basis but also the necessary existence of linkages with other local systems. According to him

“Local development is nothing but the valorisation of given environmental conditions and endowments (vertical relationships) through the interaction with networks of production and exchange of a wider spatial dimension (horizontal relationships)”, (Dematteis, 1989, cit., p. 135).

In other words the vertical relationships are the linkages with the territory so they can be defined as self-contained ties within the local system while the horizontal relationships are the connections with other local systems. Sometimes the linkage with the global environment was envisaged as a source of disruption of local knowledge. Becattini e Rullani tried to overcome this misleading perspective stating that the more a local system is willing to face the global competition the more it increases its viability (Becattini e Rullani, 1993).

¹The difficulty in drawing its territorial boundaries is a clear evidence of its openness.

2.2 Value chain analysis

The value chain analysis represents an insightful framework which is useful to complement the analysis of the recent local development pattern. In the value chain analysis each *filière* (local, European or global) is an inclusive process describing the full range of activities related to production, exchange, distribution and consumption of a given product or service. This approach is a theoretical development of the global commodity chain. This may be analysed in terms of three different standpoints: a productive perspective, a territorial perspective and a governance perspective.

The first view recalls the *backward and forward linkages* analysis (Hirschman, 1958). As a matter of fact global commodity chains have a specific input-output structure, which links various modes of production, distribution and consumption into a chain of economic activities in which value added is produced.

The second level of analysis is connected with the literature on local development. Each *filière* has a territoriality in the sense that the various activities, nodes and flows within a chain are geographically located. The territorial embeddedness of the chain has implications for the levels and processes of development of each locality. In fact the development pattern is affected by the position -in term of the governance structure- of a local system within a chain.

Governance along a value chain represents the third level of analysis. This dimension represents an interesting connection between the two strands. The type of governance along the value chain shapes different relations between places. It therefore gives rise to hierarchies of places or networks across places. Therefore, the levels and processes of development depend upon the position of localities within the chain.

The level of the governance is defined as the authority and power relationships that determine how financial, material and human resources are allocated and flow within a chain. In order to understand the governance it is useful to think about who takes the decision on parameter setting and enforcement, especially decisions about what and how to produce, and how the flow of the product along the chain has to be handled. In other words, governance involves the coordination between economic actors located in different stages of the value chain. The reasons of coordination is to contain risk. In this respect Gereffi (Gereffi and Korzeniewicz, 1994) firstly introduced a distinction between *producer* and *buyer-driven* chains: in the first case the producer is the leader of the chain while in the second case the control belong to the buyer. This division allows to account for the dependency of some localities inserted out of the leadership position within the value chain.

Kaplinsky reconsidered Gereffi's dichotomy and proposes three types of value chain governance. The first form is *Supplier-pulled chain* that arises when the producer plays a key

role because of his higher technology endowment. The second type is *Producer-pushed chain*, which is characterised by governors that push change up the chain towards their customers. The third configuration is *buyer-pulled chains*. In this case the final retailer is the governor of the chain, even if it has little knowledge about the challenge at the producers stages (Kaplinsky, 2001).

Four types of relationships have been identified by Humphrey and Schmitz (Humphrey e Schmitz, 2001):

- *Arm's length market relations*. Market coordination underpins the relations between buyer and supplier. They are connected in open linkages because the buyer's requirements could be met by a range of firms as the object of transaction is a standard product (potential multiplicity/multiple relations).
- *Networks*. The relation between firms is close and even. Cooperation on product development and production scheduling is widespread, as well as interdependence and the sharing of competencies. The buyers may set specific product or process standards but the supplier has to be able to work out how to met them.
- *Quasi hierarchy*. Asymmetrical relationships underpin the linkage between economic agents. One firm exercises a high degree of control over the others by specifying the characteristics of the product, the production process or the control mechanisms. This form of coordination arise when there are some doubts about the competence of the supplier. This is the typical form of governance in a buyer-driven value chain.
- *Hierarchy*. Firms are vertically integrated so that the lead firm takes the direct ownership of the operations along the chain.

According to Humphrey and Schmitz governance is the coordination of activities through non-market relationships. Therefore only the last three categories can be considered as economic governance (Humphrey e Schmitz, 2001). A wider definition of governance is provided by Williamson: in this case governance is defined as any type of coordination including markets, firms and networks. In a narrow perspective governance are identified only with the network form (Williamson, 1985).

The value chain analysis has identified a number of tendencies in the world towards quasi-hierarchy. Gereffi emphasised the importance of what he called *buyer-driven global commodity chain* in which the parameters are specified by large retailers or brand-name companies organising production systems that integrated producers in different countries but without themselves owning any manufacturing facilities.

Evolution of the relationships within European value chains is an important process to understand the changing territorial landscape in Europe. As a matter of fact the inclusion in a

node of a value chain is not a static matter because many chains evolve over time as well as the trajectories at the governance level. The upgrading strategy represents one of the main opportunities for a firm and a locality to overcome a pattern of dependency.

Humphrey and Schmitz provide a firm-centred typology for upgrading. *Process upgrading* occurs when the reorganisation of the production system allows to transforming inputs and outputs in a more efficient way. This process takes place mainly by introducing superior technology that turn out to increase the competitiveness position in relation to rivals. *Product upgrading* deals with the movement into more sophisticated lines of products. *Functional upgrading* is related to the change of the range of activities undertaken by the firm. It usually involves the acquisition of new functions (core competencies), or the focus on the higher value added activities such as design or marketing. *Organisational and managerial upgrading* is the acquisition of new forms of organisational and managerial methods, such as teamwork, involvement of workers, application of ISO that allow to improving the efficiency and effectiveness of production and non-production activities (Humphrey and Schmitz, 2001; Kaplinsky *et al.*, 2001).

Even if it provides a useful starting point the global commodity chain analysis is affected by some limits. The first major pitfall is that “it does not take under consideration processes that are external to the particular chain under analysis and internal to the nodes’ or sites of production and retailing within the chain” (Smith *et al.*, 2000, *cit.*, p. 9). In other words institutional and local characteristics are neglected because the focus of the value chain is only in the production structure. This perspective leads for example to a lack of attention to labour processes and conditions of work within the nodes in the chain. Instead, in the local economic development literature, labour is not merely a factor of production but it recovers its qualitative dimension. The expertise and flexibility are recognised as important characteristics of the workforce capable to affect the district’s adaptability to external changes. This is particularly important if one considers that, in recent years, the dispersion of specific skills and know-how is becoming one of the main concern of local firms. A second limitation is linked to the *excessive stylisation*; indeed the dichotomy between buyer-driven and producer-driven modalities is not supported by the empirical evidence. As a matter of fact the two ideal-types may coexist within sectors and product markets across diverse national contexts and they may also change. A third concern is related to the *multilevel embeddedness* of value chains. The global dimension seems to be the most important one in the value chain analysis; instead it is necessary to stress to the dialectic relationships between chains and their national, regional and local contexts (Smith *et al.*, 2000).

3 RETHINKING LOCAL SYSTEMS: THE CASE OF THE SHOES DISTRICT OF MARCHE

3.1 *From local clusters to international network: a twofold viewpoint*

From a local perspective the transition process occurring in central and eastern Europe can be conceptualised as a modification of the external environment of the Italian district explored. Basically these changes in the external environment lead to an internal restructuring of production. The reaction of local firms to the new global opportunities and challenges leads to the necessity of considering the district beyond its local dimension. In fact, in order to cope with the new global competition, local firms choose to take part in global value chain. In this way, outer linkages turn out to be much more important than before. As the district is naturally envisaged as an open system, its boundaries are increasingly blurring because the level of openness has increased. Therefore, even though *proximity* has not lost its relevance, it is also important to consider clusters as part of a wider value chain to understand the evolution of competitiveness strategies. In this respect, the value chain analysis is important to explore the way in which emerging and longstanding localities feed into global or European value chain.

In particular, it is the allocation of the different functions along the value chain that is important to understand the governance of the international productive network. For example, the specialisation in a low value added phase of production leads the local system to *functional downgrading*.

Most of the Marche's shoes enterprises seems to adopt a diversification of risk strategy. For example many firms turned out to be involved in at least two (or more) different productive systems because they manufacture two lines of product: for example a high quality line and an economic line. That is to say that reality is more complex than the typologies emerged in the value chain analysis. Nonetheless, it is possible to sketch three main options undertaken by firms.

The first strategy is the insertion in *top brand value chain* which results in functional downgrading for local firms. Indeed, this option involve becoming subcontractor of high fashion companies situated either inside the district or in other localities. In this case the value chain is a *buyer-driver* type, in fact, the firm loses the direct contact with the market lowering, in this way, its degree of independence.

The second one is the choice to operate for buying groups, this option brings about a *functional upgrading* because the core competencies (i.e. branding, marketing, advertising) are generally maintained within the district boundaries. However, to operate for buying groups does not means an automatic functional upgrading. As a matter of fact, some small

firms are becoming simple satellites of buying groups located in European core countries (i.e. Germany, Netherlands). In the latter case *functional downgrading* seems to be the case because firms do not carry out the product development but they simply realise models of product decided by their customer.

Outsourcing, which represents the third option, is the main focus of this paper. It is deemed to lead to both *functional upgrading* and *product downgrading*. As a matter of fact, on one side, firms tend to limit the outsourcing process only to low value added manufacturing activities, retaining the strategic competencies like marketing and distribution. On the other side, outsourcing results in a lowering of the product quality that the firm receives and sells to consumers.

The interest in the evolving relationship across the localities belonging to the same *filière*, leads us to look at the local system of arrival. A central question is whether the dependant take off may turn out to be the first stage of a self-sustained path of development. In this respect, it is important to transform the receiving local system into a *learning region* to avoid any *path dependency* and *lock-in* processes.

The nature of the outsourcing processes as an opportunity or as a threat for Candidate Countries cannot be anticipated. At the microeconomic level, the possibilities of upgrading are related to the way each firm is inserted in the European value chain in a specular manner with respect to what is taking place in the local system of origin. Delocalisation can also be regarded as a source of backward and forward linkages (Hirschman, 1958) in the host region so that a *circular and cumulative causation* process may start (Myrdal, 1957). It may raise the demand for intermediates, which cause the domestic production of intermediate goods to expand. Furthermore, other channels are supposed to positively affect the regional development in the absence of backward and forward linkages: increased competition, technology and skills transfer (tacit and codified knowledge transfer), rising access to world markets. Starting from an institutional approach, the outcome is likely to depend on the way the new economic activity intermingles with social and cultural factors (the institutional environment).

Besides, the outcome in the regional distribution of economic activities is connected to the relative dominance of *spread* (centrifugal) and *backwash* (centripetal) effects (Myrdal (1957), pp.27-31). Therefore, it is difficult to anticipate if the 'germination' of new industrial production due to relocation process will result in concentration or diffusion of development. In the case analysed in this paper concentration seems to arise.

Generally speaking, relative cheaper wages, compared to other eastern European countries, underpins the preference for a specific country. But it is at the microeconomic level that it is possible to find the reasons of the emergence of spatially well-defined growing points in the main host country. Indeed, the establishment of long distance production networks requires a great amount of information on overseas partners and an initial investment in *customisation*

(Grossman e Helpman, 2002) which together constitute important sunk costs. These factors limit the exploration process towards a limited number of localities. Besides, although the main reason is the cheaper wages compared to other CEECs, it is possible to argue that the *precipitation* of the outsourcing process toward a well-defined area in Romania is rooted in the social structure of the local system of origin. As a matter of fact, the predilection for a particular locality may also be explained in terms of *social capital theory*². The presence of trust in social and economic ties and the easy flow of information are causal factors of *imitation* either in the assessment on the outsourcing strategy or in the location option.

3.2 Outsourcing as a side of a dual strategy

The shoe-manufacturing district has to deal with typical problems of those sectors which, having reached a mature phase, have to undertake process and organisational upgrading in order to satisfy a final demand that is more and more sophisticated and unpredictable. These problems require the activation of a twofold strategy, that, on the one hand aims to combine flexibility and high quality of the final product, and on the other hand must contain costs of production, particularly with reference to some initial phases, at a low knowledge level, of the production process. Delocalisation is exactly one implementation of the dual strategy. This perspective helps to account for the presence of firms positioned in a high quality chain which do not completely disregard outsourcing.

The sample of firms was composed of 35 firms specialised in the production of medium to high quality goods located in the shoes industrial district of Marche. In the course of the history of the firms, 22 of them have delocalised at least one phase of the production process. Of these 22, 20 have expressed an interest to move further along in this strategic direction.

²For a survey of social capital theories developed in different authors (Jacobs, Coleman, Putnam and Fukuyama) see Bagnasco (1999).

Table 1 Substitution of local subcontractors actual and prospective

			Prospective		Total
			Yes	No	
Actual	Yes	Count	7	2	9
		% within Actual substitution	77.8%	22.2%	100.0%
		% within Prospective substitution	46.7%	20.0%	36.0%
		% of Total	28.0%	8.0%	36.0%
	No	Count	8	8	16
		% within Actual substitution	50.0%	50.0%	100.0%
		% within Prospective substitution	53.3%	80.0%	64.0%
		% of Total	32.0%	32.0%	64.0%
	Total	Count	15	10	25
		% within Actual substitution	60.0%	40.0%	100.0%
		% within Prospective substitution	100.0%	100.0%	100.0%
		% of Total	60.0%	40.0%	100.0%

In general, the decentralisation of production towards the countries of central and eastern Europe is part of the dual strategy that has just been described. It constitutes an innovation of location that modifies either the *horizontal* (along the value chain) or the *vertical* (within the industrial district) relations of the firms involved. While, in past decades, the vertical disintegration of the production process in the local context provided the reduction of costs, through external economies, today, the externalisation occurs in a national or international context. While it does not represent a modification of strategy, it may be regarded as a spatial extension of the production network that is being referred to. However, the delocalisation is not a simple territorial transformation from a local division of labour to an international fragmentation of the productive process. In fact it brings about a reorganisation of the local economic structure. Firstly, delocalisation leads to the substitution of some local subcontractors (see table 1) and a *selection* by firms of a local network that is able to realise the highest levels of qualitative performance and productive efficiency.

Secondly, at a systemic level, as competition of price has increased a *crowding out* of firms producing a low quality product is occurring inside the district. The substitution and the crowding out effects are deemed to undermine the stability of the district.

One of the differences between the vertical disintegration that is taking place inside the district and delocalisation is rooted in the different entity of *transaction costs*³ . One of the

³ Williamson defined transaction costs as market frictions of economic system. They are affected by the specificity of the object, by the frequency and uncertainty of the negotiation. See Williamson (1985), p. 52.

firms that were interviewed brought up the problem of the lack of information about subcontractors that operate outside the district particularly in some central European countries. However, one can say that the lower prices of unfinished goods offset the higher transaction costs.

On the basis of the information drawn from our small sample the size of the firm seems to be a relevant factor for undertaking strategies of outsourcing (See table 2). It would seem that having reached a certain size threshold, firms begin to activate strategies of delocalisation.

Table 2 Relationship between turnover and outsourcing strategy

			Outsourcing		Total
			Yes	No	
Range turnover (Millions of Euro)	Less than 1	Count		4	4
		% within Range turnover (Millions of Euro)		100.0%	100.0%
		% within Outsourcing		30.8%	11.4%
		% of Total		11.4%	11.4%
	From 1 to 2.5	Count	1	1	2
		% within Range turnover (Millions of Euro)	50.0%	50.0%	100.0%
		% within Outsourcing	4.5%	7.7%	5.7%
		% of Total	2.9%	2.9%	5.7%
	From 2.5 to 5	Count	5	1	6
		% within Range turnover (Millions of Euro)	83.3%	16.7%	100.0%
		% within Outsourcing	22.7%	7.7%	17.1%
		% of Total	14.3%	2.9%	17.1%
	From 5 to 7.5	Count	2	4	6
		% within Range turnover (Millions of Euro)	33.3%	66.7%	100.0%
		% within Outsourcing	9.1%	30.8%	17.1%
		% of Total	5.7%	11.4%	17.1%
	From 7.5 to 15	Count	8	1	9
		% within Range turnover (Millions of Euro)	88.9%	11.1%	100.0%
		% within Outsourcing	36.4%	7.7%	25.7%
		% of Total	22.9%	2.9%	25.7%
	From 15 to 30	Count	2	1	3
		% within Range turnover (Millions of Euro)	66.7%	33.3%	100.0%
		% within Outsourcing	9.1%	7.7%	8.6%
		% of Total	5.7%	2.9%	8.6%
	More than 30	Count	4	1	5
		% within Range turnover (Millions of Euro)	80.0%	20.0%	100.0%
		% within Outsourcing	18.2%	7.7%	14.3%
		% of Total	11.4%	2.9%	14.3%
Total		Count	22	13	35
		% within Range turnover (Millions of Euro)	62.9%	37.1%	100.0%
		% within Outsourcing	100.0%	100.0%	100.0%
		% of Total	62.9%	37.1%	100.0%

The turnover threshold that permits relocation is 1 millions Euro (See table 2). It is worth noting the rank between 7.5 and 15 millions Euro, in which 89 of the firms have delocalised. A general remark is that this result is consistent with the general absence of delocalisation both in artisan firms and in firms that make products of very high quality. From an economic point of view, for some economic operators it has been a reaction to the strategies of pioneer entrepreneurs rather than a completely free choice. This has highlighted the positive feedback processes derived from imitation among entrepreneurs in order to continue to be competitive. From a wider perspective, social capital theory provide a useful framework to understand either the self-reinforcing process underpinning the relocation strategy or the preferential connection with an emerging cluster in a particular host country. Trust behind economic and social relations among local actors in the system of origin and the ease of exchange of information is leading to a *precipitation* of the outsourcing process toward a well-defined area.

Incentives and constrains to relocation of production

With reference to the sample of firms interviewed, cheaper wages compared to their national context is the main reason attracting entrepreneurs towards CEECs. Other advantages are connected to a less restrictive legislation regarding trade unions and mandatory costs⁴. The availability of workforce in CEECs is another reason strictly connected to the skill mismatch between demand and supply in the local labour market. As a matter of fact the structural shortage of unskilled labour in the local context (given that the district is located in a region characterised by almost full employment) is coupled with the abundance of skilled workers that regard local footwear industry as not appealing in terms of job opportunities.

⁴And the less strict custom controls too.

Table 3 Incentives and obstacles to relocation

	Incentives		Obstacles
Microeconomic level	<i>In general</i>	Availability of work force Cheaper labour costs	Transaction costs Lack of information Low level of quality Technical assistance Initial investment in <i>customisation</i> Territorial loyalty
	<i>Romanian case</i>	Presence of <i>know how</i> (legacy of the planned economy system)	Lack of trust in the partner <i>Moral hazard</i> associated with quality control
Macroeconomic and Institutional level	<i>In general</i>		Political and social instability Institutional uncertainty Lack of personal security
	<i>Romanian case</i>	Less restrictive legislation regarding trade union and mandatory costs Less strict custom control Cultural affinity	

Some constraints to outsourcing exist however. The most important complication seems to involve the possibility to reach the desired standards of quality. In general, the firms that do not resort to international fragmentation are those producing very high quality goods. Firms inserted in high quality chains tend to privilege the district when constructing a network. Besides, technical assistance represents a relevant implicit cost for the firms interviewed. The machinery used for production must be repaired in quick time. This does not lead to a problem within the district, whilst it becomes an obstacle in non-district contexts. In the latter situation, to recruit technicians and to send for replacement parts from Italy requires time, in this way preventing firms from fulfilling the forecasted production times.

If we shift our attention from the local system of arrival to the local system of departure, other reasons -not strictly economic- emerge that prevent firms from resorting to delocalisation. They involve a sort of reluctance to go outside the invisible -but relevant- boundaries of the district because of what we can define as *territorial loyalty*. Although they are aware of the disadvantages in terms of lowering costs some entrepreneurs do not opt for international fragmentation because of a sense of belonging to the territory. They want to prevent the

dissemination of the local knowledge heritage that has developed and accumulated in the district over time. This choice is not without consequences as it force firms to undertake different strategy in order to cope with the growing local competition. Sometimes the embedded firms realise *product upgrading* by acquisition of licensed brand: they feed into higher quality value chain becoming subcontractors of one or more high-fashion companies. In this way they avoid and the consequent risk of *product downgrading* relocation of production but they result in *functional downgrading*⁵.

When territorial loyalty is a determining factor in the localisation choice, it influences both the decision making process regarding the opportunity of outsourcing and regarding the intensity of the process of vertical disintegration. Concerning this last aspect, one can observe that the only firm that, even if the loyalty feature is presents, has decided to decentralise, has only externalised one phase. However, a threshold size exists beyond which territorial loyalty ceases to be a relevant factor in strategies of delocalisation.

3.3 The intensity of the process of vertical disintegration

From the perspective of the firms located in the Italian local system the relocation process is a source of *functional upgrading*. A partial internationalisation -involving only some phases of the production process- is the widespread modality observed in the sample. Only three firms of the sample have delocalised the entire production process.

Table 4 Intensity of the outsourcing process

	Count	Frequency (%)	Cumulative Frequency (%)
The whole production process	3	25	25
Two stages	6	50	75
One stage	3	25	100
Total	12	100	
Missing	10		

As a matter of fact all the firms interviewed relocate the manufacturing phases (namely sewing/hemming), an element that was observed in all the firms is the maintenance of the strategic functions such as planning, design, marking, commercialisation and management of

⁵ The same process is now taking place in the industrial district of Brenta, in the Veneto case the relative importance of the two processes (relocation of production and the inclusion in high fashion value chain) is reversed in the sense that the latter is more important than the former compared with the present case. Cfr. Rabellotti (2001).

credit. When this is not possible - for example, in the case of quality control - Italian management are entrusted with it in the area of relocation.

Table 5 Ownership rights

	Count	Frequency (%)	Cumulative Frequency (%)
Ownership	3	14	14
Participation with italian partners	1	5	19
Majority participation with host country's partners	2	10	29
International subcontracting	15	71	100
Total	21	100	
Missing	1		

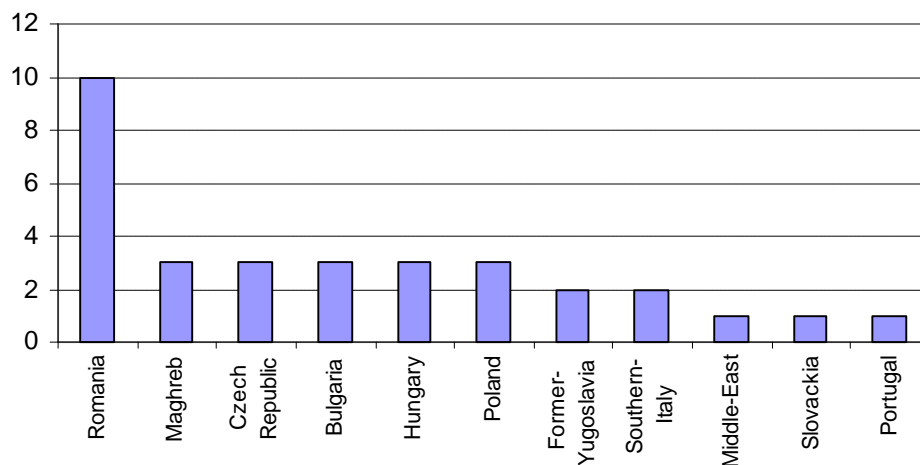
The forms of juridical relations and property rights that underlie the integration of production with countries of central Europe and the Balkans are strictly connected to the intensity of the process of vertical disintegration that has been realised. Forms of property and shared property with Italian partners are more common within the firms that outsource the whole production process. Similarly, firms that decentralise only some phases of production -usually the labour-intensive ones- use less restrictive relationships like *international subcontracting*. Very often the organisations that are entrusted with the work belong to Italians that reside in the host local system.

3.4 The preference for Romania and the exploration of new directions

The delocalisation process seems to work in multiple directions, while 9 firms have only one outsourcing direction (one nation), the other 8 have multiple relations. The choice of the host local system seems to be influenced by a cyclical process that favours from time to time areas characterised by a combination of advantages relating to labour costs and transport costs as well as institutional factors. One can observe an obvious preference for Romania when looking at the strategies of the firms interviewed. Romania⁶, in the last decade has been the main country for delocalisation in the shoe- making district of the Marches (See figure 1).

⁶It seems that a twin local system is arising in Romania (particularly in Timisoara and Arad). Indeed, one of the entrepreneurs that run a commercial firm of shoes accessories within the Italian district opened a retailer branch in the Romanian town in order to fulfil the same function.

Figure 1 Directions of outsourcing by receiving country



The choice of Romania is rooted in lower wages compared to other countries of the area. There are however other factors that increase the interest in Romania as a country of arrival for processes of internationalisation. Satisfying production standards, due to the existence of *know how*, is among these factors. The availability of skilled labour, a legacy of the planned economy system, is another incentive. In fact, large state run factories in the shoe-manufacturing sector operated in this area. Finally, proximity, both in its geographical and social connotation, is another relevant factor. The accessibility in term of transport system seems to be of a significant importance. Besides the presence of a cultural affinity - especially a linguistic affinity - that facilitates communication play a relevant role. One can however observe that the second factor that have just been mentioned are considered to be reproducible and also the obstacles posed by cultural and linguistic differences can be overcome.

In spite of a *preferential direction* towards a specific Romanian local system, recently, some changes of geographical direction have emerged. Other countries of central and eastern Europe are becoming interesting. The new tendencies involve firstly Poland, Czech Republic and secondly Hungary, Bulgaria, Macedonia and Serbia. Not only the saturation of the Romanian market but also the negative experiences of some entrepreneurs are the cause of the current widening of the area that is attracting relocation of production. It seems that a process of activation is occurring. Some productive structures located in Poland, Bulgaria and Hungary have contacted some of the interviewed firms, proposing themselves as subcontractors.

The main reason from a microeconomic perspective that has induced some firms to interrupt their experience of delocalisation consists in the lack of trust in the partner. At a macroeconomic and institutional level the main reasons involve the presence of political and social instability, institutional uncertainty, and the lack of personal security in some countries. The insufficient level of quality and the untrustworthy behaviour of the partner are the main

motives that have induced at least four firms of the sample to change track. The experience of one of these firms is particularly interesting. During the years 1995-1996 it made two attempts at delocalising in Romania. Both practises failed because of the absence of people who were responsible for production *in loco*. The firm had to deal with problems related to the level of quality, which was strictly dependent on the presence of an Italian supervisor. For this reason, the firm decided to delocalise in Poland, Tunisia and Southern Italy.

3.5 Connection between delocalisation and search of new markets

The above example gives us an opportunity to introduce the subject of the substitution effects that operates within the delocalisation process. When looking at the investments made in the countries of the EU and the countries of central and eastern Europe no substitution effects were revealed. These effects exist instead with other developing countries or with spatial extensions of the network that concern the area of Southern Italy. Two of the 3 firms of the sample that have not delocalised in the countries of central and eastern Europe have made investments or installed subcontracting relationships with partners located in Southern Italy.

As far as the firms that have been observed are concerned, delocalisation does not seem to be considered as a mean for access to market as stressed in the literature (Feenstra e Hanson (1996), Feenstra (1998), Hummel *et al.* (1998)). In general central and eastern Europe are considered more interesting as areas of decentralisation of production rather than as a potential market. The main export market continues to be the EU. Nonetheless, some cautious attempts to expand the commercial channels in CEECs have been made with the expectation that such countries will be able to offer a sustained demand in the future. The strategies of commercial exploration are especially oriented towards Russia and Poland where sophistication of consumers' tastes is occurring. From the field-study no strict synchronisation between relocation and commercial expansion seems to exist at the firm level. In general, the two strategies are disconnected (See table 6)⁷.

⁷Where $\frac{EE}{TE}$ is the share of firm's total exports directed towards Central and Eastern European Countries.

Table 6: *Relationship between relocation and export towards CEECs*

Range EE/TE			Outsourcing process towards CEECs		Total
			Yes	No	
Less than 25%	Count		10	15	25
		% within Range EE/TE	40.0%	60.0%	100.0%
		% within Outsourcing process towards CEECs	71.4%	71.4%	71.4%
		% of Total	28.6%	42.9%	71.4%
	From 25 to 50%	Count	4	5	9
		% within Range EE/TE	44.4%	55.6%	100.0%
		% within Outsourcing process towards CEECs	28.6%	23.8%	25.7%
		% of Total	11.4%	14.3%	25.7%
	From 75 to 100	Count		1	1
		% within Range EE/TE		100.0%	100.0%
		% within Outsourcing process towards CEECs		4.8%	2.9%
		% of Total		2.9%	2.9%
Total	Count		14	21	35
		% within Range EE/TE	40.0%	60.0%	100.0%
		% within Outsourcing process towards CEECs	100.0%	100.0%	100.0%
		% of Total	40.0%	60.0%	100.0%

For example a firm that was interviewed exports 70 % of its turnover to CEECs but has not activated delocalisation. Another firm that, after experiences of failure to delocalise, chose instead to enhance the level of quality of the product, producing entirely in the district exports 20 % of its turnover to central and eastern Europe. This disconnection does not take place in only one case. This case involves a firm that constitutes an exception both for the intensity of the process of delocalisation and for the connection between delocalisation and commercial penetration. The firm we are referring to has established a productive link with Czechoslovakia since 1976, holding 55 % of the capital of a firm that had recently been sold. In 1989, the same firm bought a plant in Hungary, situated near the border with Ukraine. The Italian firm deals with planning, the making up of the collections, the commercialisation of the product, the management of credit, financing, obtaining credit and contacts with clients. The place of production represents, in part, the destination of the product - that is not imported in Italy- since the quota of shoes produced in Hungary is sold directly in Hungary. Another quota is exported in Poland and in Russia, the latter market being the one that absorbs the highest percentage of production.

4 CONCLUDING REMARKS

The exploratory case study presented in this paper has highlighted the relevance of the transformation processes that the industrial district of Marche has been experiencing in the last decade. Local networks of production have acquired an international dimension. The area of destination of outsourcing in the sample is mainly central Europe and the Balkans. A preferential territorial linkage has been established with the twin Romanian cluster of Timisoara and Arad. The disconnection at the microeconomic level between relocation and export directions shows that central and eastern Europe is more interesting as area of outsourcing rather than a potential market and that the relocation is not functional to the search of access to market as stressed in the literature. The size of the firm seems to be a relevant factor for undertaking strategy of delocalisation. The relocation of one or two stages of the production process is the widespread modality. A close relation between type of ownership rights and intensity of the process of relocation has emerged as a characteristic of the governance of the relations. As a matter of fact the more the relocation of production is extreme the more the juridical relation is restrictive.

The decision process of local firms about relocation is driven by incentives such as the availability of work force and the lower labour costs, the presence of know how, less restrictive legislation and custom controls, cultural affinity. Nevertheless, relocation assessment is constrained by transaction costs, lack of information, low level of quality, delays related to technical assistance, moral hazard behaviours, territorial loyalty, political and social instability, institutional uncertainty. The coexistence of positive and negative aspects of relocation make it difficult to envisage the final outcome of the process and the existence of a stable equilibrium.

Outsourcing has some effects on the internal organisation of the industrial district of Marche. Firms that are following this option result in *functional upgrading* and *product downgrading*. In contrast, firms that choose to feed into high fashion value chains are experiencing *functional downgrading* and *product upgrading*. Firms that undertake neither the first strategy nor the second one are exposed to the risk of being *crowded out* by the increased competition emerging from the transformation processes. The substitution of local subcontractors by overseas subcontractors is shaping a selection process and is producing indirect effects on local employment.

Taking a twofold perspective raises the necessity to undertake a case study focused on the area of arrival rather than looking at the evolving relationship only from one locality viewpoint.

5 ACKNOWLEDGEMENTS

I wish to express my gratitude to Antonio G. Calafati who supervised this field study carried out for the research project '*Vantaggi competitivi dinamici e apprendimento collettivo nelle economie locali: aree di specializzazione e aree ad elevata diversificazione produttiva a confronto*', national coordinator Roberto Camagni, local coordinator Giuliano Conti (Murst 40%, 1999). I also wish to thank Michael Dunford - the supervisor of my Marie Curie visiting at the Sussex European Institute (University of Sussex, Brighton). Any errors are my responsibility.

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ABSTRACT

The aim of this paper is to outline the main patterns of change in one of the most important Italian districts in relation to the transition process occurring in the central and eastern European Countries. The increased economic integration raises the necessity of rethinking the industrial district as a part of a wider framework of production. Therefore the internal reorganisation at the local level is interpreted combining two different approaches: the *territorial perspective* that is rooted in local development literature and the *productive stages* perspective, typical of the value chain analysis. After an overview of the main characteristics of the two complementary frameworks I will provide an interpretation of the recent evolution of the shoes industrial district of Marche. The information presented in the empirical session is based on a field study carried out during the period from December 2000 to August 2001. The research method relied on in-depth interviews with thirty-five local entrepreneurs.