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The role of Italian FDI in Southeast Europe's international integration. A focus on investors from the Marche region

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Abstract

Southeast European countries have experienced significant economic integration into the world economy since 2000, through international capital flows and especially foreign direct investment (FDI). The work sheds light on recent trends in Italy-Western Balkans economic integration through FDI and other non-equity modes (NEMs). The methodology applied is based on country-level analysis, enriched by a case study approach. Main trends, characteristics and motivation of investments in the area are investigated. Based on this evidence, we suggest that the phenomenon of Italian integration in the Western Balkans is broader than official statistics would indicate, since Italian firms often set up subsidiaries through various non-equity arrangements. The surge in FDI in the area is recent, therefore it is not surprising that the main determinants are cost reductions and new market opportunities. What is interesting in this context is that local entrepreneurs regard efficiency-seeking investments as profitable only if they are connected to market-seeking goals. We find evidence also of localized industrial development stimulated by the entry of Italian firms, which is activating subcontracting relationships with existing companies in the host region. Further and in depth studies are needed to investigate the phenomenon.

JEL Classification: F21, F23, P20

Keywords: FDI; Southeast Europe; case study

Introduction

During the first decade of 2000, Southeast European (SEE) countries experienced significant economic integration into the world economy through international capital flows and especially foreign direct investments (FDI). This area of Europe has become an increasingly popular destination for FDI by EU member countries and overseas multinationals, and is benefiting from the recent World-wide surge in investment flows. During the period 2003-07, the average growth rate of inflows to SEE was 50%, much higher than the rise experienced by the developing (25%) and developed countries (30%). Geographically, two large countries - Croatia and Serbia and Montenegro - account for 77% of world investment in the Western Balkans[3] in the period 2003-07. Their role is comparatively still smaller than the roles of other main Balkan countries - namely Romania and Bulgaria, but since Croatia and Serbia and Montenegro are demonstrating resilience to the global financial crisis (GFC), their importance is likely to increase.

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[2] Department of Law, University of Macerata, e-mail: Uspigarelli@unimc.itU. We want to thank ICE, Simest, API Pesaro, Confindustria Macerata for their support in collecting data and information, as well as in contacting companies for the case study analysis. We are grateful to all people interviewed in the case study analysis, for their kind cooperation.

[3] We focus mainly on the six countries of the Western Balkans (SEE-6 countries), namely Albania, Bosnia-Herzegovina, Croatia, Macedonia, Serbia and Montenegro; however some of our analyses includes Bulgaria and Romania in order to enable a comprehensive comparative view.

Several factors have contributed to recent trends: relatively low labour costs, increased institutional and political stability, and a general expectation that the more advanced countries in the region will join the EU. In fact, even if initially economic integration of the "Old Europe" mainly involved the Central and Eastern European (CEE) countries, it has later broadened including SEE. In this respect, political actions, such as the Adriatic-Ionian Initiative (AII), are promoting greater integration – even at the economic level – between the two areas. The AII involves three EU member countries (Italy, Slovenia and Greece) and five Western Balkans countries in the pre-accession stage (Serbia, Croatia, Montenegro, Bosnia-Herzegovina and Albania)[4]. At the inter governmental level, there is a proposal to set up an Adriatic-Ionian Macro Region, with the aim of developing strategic actions, using a cooperative approach, to encourage inclusion of the Balkans in the EU[5]. Other initiatives include the Adriatic Euro region and the IPA Adriatic Cross-border Programme[6].

Analysing macro data on FDI, we find out that Italy ranks among the ten major investors in most of the Balkan countries, and in 2007-2009, SEE has become increasingly important as a destination for Italian FDI, in the context of the Balkan area as a whole. Serbia, Croatia and Albania - the main Western Balkans recipient countries - attracted substantial shares of Italian FDI to the area - 46%, 28% and 19% respectively during the most recent period (2007-2009).

While the main economic activities involving Italian FDI in the 2000s were privatization-related sectors, in 2007-09, the sector receiving the most Italian FDI was manufacturing. We identify two main patterns of economic integration through FDI: basic integration related to delocalization of labour-intensive tasks (first tier) and more complex integration (second tier). The former type of integration is typical of the economic relationships between Italy and the Western Balkan countries - such as Serbia, Bosnia-Herzegovina, Albania, Macedonia - and involve mostly traditional manufacturing industries such as textiles, clothing, footwear and furniture. Second tier integration pertains predominantly Croatia, Romania and Bulgaria which seem to have embarked on a second level of integration that includes traditional, capital-intensive and high-tech manufacturing industries (see Section 3).

In our analysis, we pay particular attention to the Marche region (central Italy, Adriatic coast) for two main reasons. First, because of its relevance for commercial flows, outward processing flows and manufacturing FDI in the Balkans area. The Marche region has exhibited a recent and increasing propensity to invest in the area, and especially in the Western Balkans. Since 2005, the Marche region FDI in SEE has increased continuously at an average annual growth rate of 46%. Today, the Marche region accounts for almost 12% of total Italian FDI in the Western Balkan countries,

[4] The AII was primarily aimed at strengthening regional cooperation among the Adriatic coastal countries, developing common solutions to common problems related mainly to security and stability, and environmental protection of the Adriatic and Ionian Seas.
See: http://www.esteri.it/MAE/EN/Politica_Estera/Aree_Geografiche/Europa/Balcani/IAI.htm?LANG=EN

[5] Italy, Greece and Slovenia are the EU member promoters of the Macro Region; the project is scheduled for completion in 2014. The Macro Region will provide a forum for the discussion of and solution to common problems related to the environment, transportation, fishing, coastal supervision, small and medium companies, tourism, culture, etc. The Italian regions involved in the project are: Friuli Venezia Giulia, Veneto, Emilia Romagna, Marche, Abruzzo, Molise, Basilicata, Calabria, Sicilia, Puglia. The Balkan countries involved are: Albania, Bosnia-Herzegovina, Croatia, Montenegro, Serbia.

[6] The IPA Adriatic Cross-border Programme is a cross-border programme co-financed by the European Commission through the Instrument of Pre-accession Assistance (IPA), designed to assist both candidate countries (Croatia) and potential candidate countries (Albania, Bosnia and Herzegovina, Montenegro and Serbia). For further information see: http://www.adriaticipacbc.org.

with a particular concentration in Serbia, Croatia and Albania. It is an important investor, particularly in some of the traditional manufacturing industries typical of the Italian specialization pattern. In fact, the Marche region accounts for significant shares of the national FDI in textiles, wearing apparel and footwear (64%), electrical equipment (42%) and food products (39%).

Second, the Marche region is characterized by a high specialization in traditional manufacturing industries with a high incidence of industrial districts and small and medium-sized firms: two distinguishing characteristics of the so-called Italian "anomaly".

The focus on this region – made also via case study - enables a deeper analysis of the phenomenon under study: it serves as a laboratory to closer observe transnational corporations that have built or extended their international production networks in the Balkans through equity holdings (FDI) or even through contractual relationships with partner firms, without equity involvement (i.e. non-equity modes - NEMs)).

Grasping indepth information on such a recent issue, this exploratory study aims at identifying possible areas for further and deeper academic inquiry and to give some first policy suggestions to foster and improve economic integration via FDI and other NEMs.

The paper is organized as follows. Section 1 reviews the literature; Section 2 describes the data and the methodology used. Section 3 provides an overview of the country-level evidence based on secondary data sources and Section 4 analyses the Marche region in terms of FDI towards the Balkans. Section 5 presents some case studies of Marche region companies that have invested in Balkan countries. The final section concludes and discusses some future developments of this research.

1. Literature review

This exploratory study is grounded on three main research strands in the literature: the international fragmentation of production and FDI, the international business literature based on the Dunning's OLI paradigm, and the Global Value Chain approach.

As for the theoretical issues of FDI and the international fragmentation of production, the topic has been discussed, extensively and separately, in the international economics literature, typically in relation to their macroeconomic effects (e.g. Feenstra and Hanson 1996; Feenstra 1998, Arndt and Kierzkowski 2001, Hummel et al. 1998, Deardorff, 2001, Baldone et al., 2007, Markusen, 1995, Markusen and Venables, 1999). However, very few works have examined the interplay between fragmentation of production and FDI activity. Since the sourcing strategies of business firms have become more complex, some models consider heterogeneous firms in terms of either their internalization decisions (outsourcing versus integration) (Grossman and Helpman, 2002, 2003), or location choices related to outsourcing (home versus abroad) within the context of incomplete contracts (Grossman and Helpman, 2005). This body of work focuses on why some companies source inputs abroad primarily via FDI, while others use the strategy of outsourcing for the same purpose. Grossman and Helpman (2003) find that outsourcing is more prevalent in larger markets and that the availability of higher quality contracting institutions abroad and lower customization costs, increase the prevalence of outsourcing over FDI. Grossman and Helpman (2005) see the cost of customization as central for deciding about the acquisition of intermediate inputs at home or abroad. Therefore, differences across countries in terms of their legal systems and institutions related to contract enforcement, may explain the pattern of international outsourcing and FDI across countries.

On the empirical ground, a large body of country-level analysis are available, but only a few provide evidence of the involvement of Western Balkan countries in international capital flows and their role in the global fragmentation of value chains (Brada et al., 2004; Damijan et al., 2006; Redzepagic and Richet, 2008; Dragusha and Bejleri, 2008). Studies focusing specifically on Italy-Western Balkans economic relationships are even more scarce (Coletti and Panizza, 2007; Giovannetti and Luchetti, 2007; Simest, 2010).

The case study analysis developed in this paper is specifically related to the literature on international business and industrial organization, and, more generally, to the Global Value Chain approach. The OLI (Ownership, Location, Internationalization) paradigm[7] addresses three main aspects from the investor standpoint: (1) the reasons why firms go abroad (O); (2) the location of the investment (L); (3) the mode of entry in foreign markets (I). The locations chosen for firms' investment abroad is based on a combination of the ownership-specific advantages of the firm (Dunning, 2002a, pp. 134-135) and the location-specific advantages of the host country (Dunning, 2002a, pp. 135-136), that the firm wants to exploit through internationalization (through intra-firm rather than arm's-length transactions).

The underlying principles for investing abroad may be: resource seeking, market seeking, efficiency seeking and strategic asset seeking (Dunning, 1977, 1993). Resource seeking investment is aimed at accessing natural, physical or human resources; market-seeking investment is driven by the search for domestic, adjacent or regional markets. Efficiency-seeking investment is aimed at rationalizing production to exploit economies of specialization and scope across or along value chains, i.e. product or process specialization; strategic-asset-seeking investment is aimed at advancing the company's regional or global strategy or linking into foreign networks of created assets, such as technology, organizational capabilities and markets.

In this respect, Dunning (1980, 1996) distinguishes between the main motives for initial investment – namely (natural) resource-seeking and market-seeking- and the main motives for sequential investment- efficiency-seeking and strategic-(created-) asset-seeking.

In the past, Transnational Corporations (TNCs) primarily built their international production networks through FDI (equity holdings), creating an internalized system of affiliates in host countries owned and managed by the parent firm. Nowadays, TNCs increasingly manage global value chains through externalization, and thus relying on various non-equity modes such as partial ownership, joint venture, strategic alliances, concessions, subcontracting arrangements and various contractual forms. NEMs of coordination along the value chain are not mutually exclusive and they can be as much complements as substitutes as FDI, with the choice based on relative costs, benefits and associated risks (Unctad, 2011, p. 124). From the perspective of the firm that coordinate the global value chain (usually based on advanced countries), NEMs are driven by a number of factors, including their relatively lower upfront capital requirements, reduced risk exposure and greater flexibility in adapting to change,

[7] For a complete review of the theoretical literature on FDI determinants, see Faeth (2009).

allowing TNCs to leverage their core competencies (Unctad, 2011, pp. 130, p. 142). In turn, the integration of firms locate in emerging countries into global value chains can represent a viable way to access to international markets and support the build-up of productive capacity (Narula and Dunning, 2010), giving a positive contribution to manufacturing employment, and to diffuse technology and skills which, nevertheless, crucially depend on local absorptive capacity (Unctad, 2011, p. 157).

Apart from this set of tangible and intangible assets that NEMs bring to a host country, there are also concerns related to long-term dependency, limited value added and "footlooseness" (Unctad, 2011, p. 161). In this respect, clustering may be an important source of collective advantage able to reduce the risk of TNCs shifting production to other locations, on the basis of purely efficiency-seeking reasons.

The development implications of NEMs in the host country depend on the value chain segments in which they take place. The consolidation and upgrading capabilities of local firms in the host region, following their subordinate insertion in international productive networks, have been extensively studied by the recent literature on industrial clusters in emerging countries in a Global Value Chain perspective (Courlet, 2006; Schmitz, 1995, Humphrey and Schmitz, 2002; Cassiolato et al. 2003; Giuliani et al., 2005; Schmitz, 2005; Scott and Garofoli, 2007 among many others).

Global Value Chains (GVCs) are an important unit of analysis for understanding enterprise competitiveness in the global economy. In the value chain analysis each *filière* is an inclusive process, describing the full range of activities related to production, exchange, distribution and consumption of a given product or service.

Coordination along the value chain depends on the authority and power relationships that determine how financial, material and human resources are allocated and flow within a chain. Specifications may relate to, for example, the design and quality of the product or service to be delivered, the process and standards of production, or the business model that the partner firm must adhere to. Different modes of coordination (governance) are possible. After the dichotomy introduced by Gereffi (Gereffi and Korzeniewicz, 1994) between producer and buyer-driven chains, Humphrey and Schmitz (2002) distinguished more nuanced governance structures (Arm's length market relations, networks, Quasi hierarchy, and Hierarchy). Basically, upgrading of firms and localities depends on the position of firms in the host country and the type of governance structure of the GVC they are inserted in (Humphrey and Schmitz (2002).

The extensive research through case studies – mainly in Latin America, Southeast Asia and Sub-Saharan Africa - uncovered that quasi-hierarchy is the predominant mode of governance resulting in a functional lock-in of firms and industrial clusters inserted in intermediate positions along the GVCs. Although, quasi-hierarchy may enhance product and process upgrading (Humphrey and Schmitz, 2002). In fact, in a quasi-hierarchy structure, "the host-country partner firm have to make capital expenditure, change processes, adopt new procedures, improve working conditions, use specified suppliers, and so forth" (Unctad, 2011, p. 127).

It is also shown that clusters in developing countries are usually organized as a simple collection of independent small-scale firms or they are dominated by few "fordist giants"(Schmitz, 1995). The predominance of large-scale production plants which undertake production delocalized by European firms is also evidenced by the enquiries on Mediterranean Africa (Morocco in particular) (Courlet, 2006; El Kadiri and Lapèze, 2007). There is little evidence of the emergence of a local division of labour in the host regions following the insertion of local firms in international chains of production. Instead, the entry of foreign firms have been found to produce some destructuring effects in existing national filières (Courlet, 2006).

2. Data and methodology

The study is based on a mixed-method approach. First, in order to ascertain the magnitude and main characteristics of Italian FDI in the WB, from a national and a regional perspective, we analyse secondary data sources. Then, we use primary data, collected through direct interviews to complete the picture, and also shed light on NEMs.

For the country-level overview, we rely on two statistical sources: (1) a database produced by the External Trade Statistical Division of the Bank of Italy (for the period 2007-2009); and (2) the Reprint database produced by Politecnico di Milano-ICE. The Bank of Italy database is based on Italian balance of payments statistics and provides detailed information on Italy's FDI outflows, disaggregated by industry and destination country. The main advantage of this dataset is that it covers a wide range of equity-type internationalization of production, including greenfield investments and foreign takeovers. Our main sources of secondary data were complemented by and cross-checked with two more sources of information: the ICE country reports and the Simest (2010) report.

In the analysis of the Marche region, we integrate national statistics sources with the Fondazione Merloni database (FMDB). On the basis of firms' financial statements, FMDB collects information on more than 200 medium-sized and large companies (the biggest in terms of turnover) located in the Marche region. The FMDB gives information on the number and location of foreign companies over which the parent company has direct control. It focuses on companies with turnovers of more than €30m. and some others who joined the database on a voluntary basis. The FMDB is generally statistical representative of the set of local companies with turnovers ranging from €10-30m. No statistical significance is assigned to companies with turnovers of between €5m. and €10m.

Secondary data give the ground to the direct source analysis, based on case studies. The approach we followed is that of Yin (Di Minin et al., 2010), as "how" or "why" questions can have significant explanatory power, specifically through case studies. "Such questions deal with operational links needing to be traced over time, rather than mere frequencies or incidence" (Yin, 1994, p. 6). "Explanatory" case studies use deductive logic to test propositions and establish causal relationships (Yin, 2009). They are suited to the verification and not just discovery of new theory (Welch et al., 2010). In this sense, we use case studies to verify Dunning's motivation of FDI in the context of WB.

We rely on information from entrepreneurs and managers of medium-sized and large firms involved in FDI in Balkan countries, derived from interviews based on a semi-structured questionnaire. We chose a multi-case study approach to perform case analysis replication and cross-case comparison. This allows us to distinguish among the findings from a simple case study that are unique, or applicable to the other cases (Chiesa and Frattini, 2007; Eisenhardt, 1989; Eisenhardt and Graebner, 2007). We used the direct interview method, as it allows researchers to develop deeper relationships with interviewees (Daniels and Cannice, 2004) and to grasp more information on the phenomenon under study. Interviews were conducted between February and July 2010. We selected five companies, following the logic of theoretical sampling and pre-selected cases belonging to different industry, host location, unit size and set-up time. This because we wanted each case to be a "distinct experiment", providing evidence from several perspectives (Creswell, 1998; Eisenhardt, 1989).

The case study approach is used to investigate the specific motivations of companies' investment strategies, the strengths and weaknesses of different Balkans territories, the problems and opportunities encountered in the investment and the advantages or barriers related to managing the foreign unit. Although the main focus was qualitative information, quantitative data are also analysed. Some basic quantitative indicators collected through interviews with entrepreneurs (turnover, numbers of employees, share of export in turnover) helped to construct a general profile of the firms (see section 3.2).

3. An overview of Italian-Balkan countries' FDI

FDI inflows to the Western Balkans were $188m in 1995. In 2007 this figure was $13bn. Investments increased substantially in the post-1990s period and especially in 2003-07. During the most recent worldwide economic expansion the average growth rate of inflows to SEE was 50%, much higher than the rise experienced by the developing (25%) and developed countries (30%) (Figure 1). It is believed that the prospect of EU membership and the Stabilization and Association Agreements in force or being negotiated for most countries in the region[8] contributed significantly to the considerable increase in inward FDI in recent years since foreign investors anticipate completion of reforms in a more stable political and economic environment (Bevan et al., 2001).

The main sources of FDI are the developed countries, which are mostly EU members.

Italy ranks among the ten major investors in most of the Balkan countries: it is the most prolific investor in Albania, where roughly 48% of FDI is from Italy and 34% from Greece (Redzepagic and Richet, 2007). It is ranked fourth among investors in Montenegro, after Greece, Slovenia and Russia, and fifth for Serbia, after Austria, Greece, Norway and Germany (Simest, 2010; ICE, Country reports, various years).

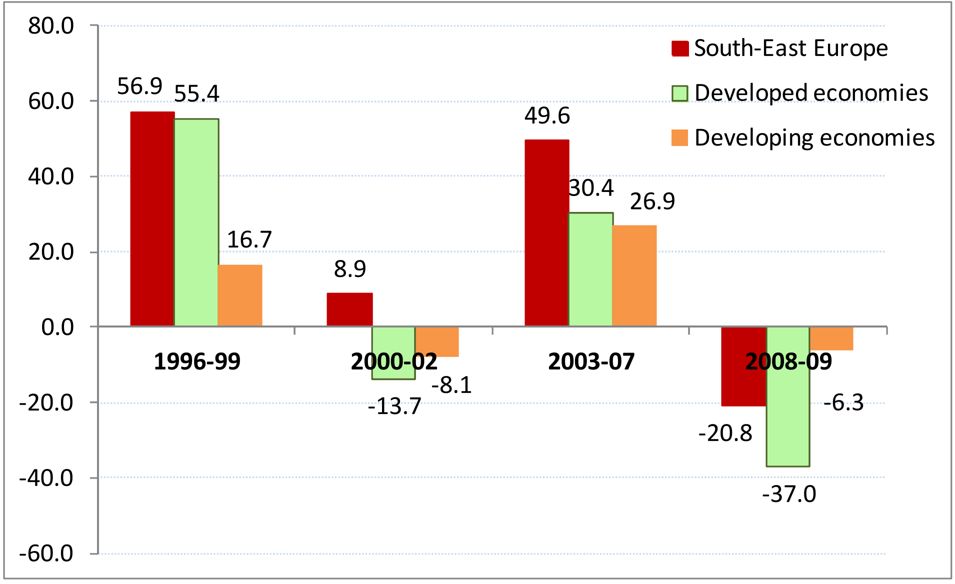
In 2007-2009, the importance of SEE as a destination for Italian FDI has increased, in the context of the Balkan area as a whole.

Italian investments in the Western Balkans have remained fairly stable despite the worldwide economic downturn, while Italian FDI in Bulgaria and Romania decreased by 88% (from €993m to €116m). In 2009, Italian FDI to the Western Balkans

[8] 20 years after the collapse of the iron curtain, SEE countries have begun a process of closer political and economic integration with the Old Europe and are looking to become members of the EU. Negotiations for EU accession progressed in Croatia in 2008 and Macedonia was granted candidate status in December 2005. Stabilization and Association Agreements (SAA) were signed with Albania in June 2006, with Montenegro in October 2007 (and came into force in May 2010) and with Serbia in May 2008 (ratification of SSA with Serbia was unblocked in June 2010). Source: Füle, 2010.

accounted for almost two-thirds of total flows to the whole Balkans area[9] (Figure 2). Serbia, Croatia and Albania are confirmed to be the main Western Balkans recipient countries, as attracted substantial shares of Italian FDI to the area - 46%, 28% and 19% respectively during the most recent period (2007-2009).

Figure 1. Average annual growth rate (%) of FDI inflows, by period



Source: UNCTAD database and Unctad (2010)

Table 1. Italian FDI in the Balkans area (€million)

	2007	2008	2009
Western Balkans	162	108	181
Bulgaria	38	23	7
Romania	337	970	109

Source: External Trade Statistical Division, Bank of Italy

The main economic activities attracting Italian FDI in the 2000s were privatization-related sectors and manufacturing. Financial intermediation and insurance investments were dominant: the major Italian bank holding companies (Unicredit and Intesa San Paolo) control large shares of the national credit markets in the Western Balkan countries: 50% in Croatia, 30% in Bosnia-Herzegovina, 25% in Serbia. The second most important privatization-related investment is public utilities (mainly gas distribution, electricity) (ICE, Country reports, various years).

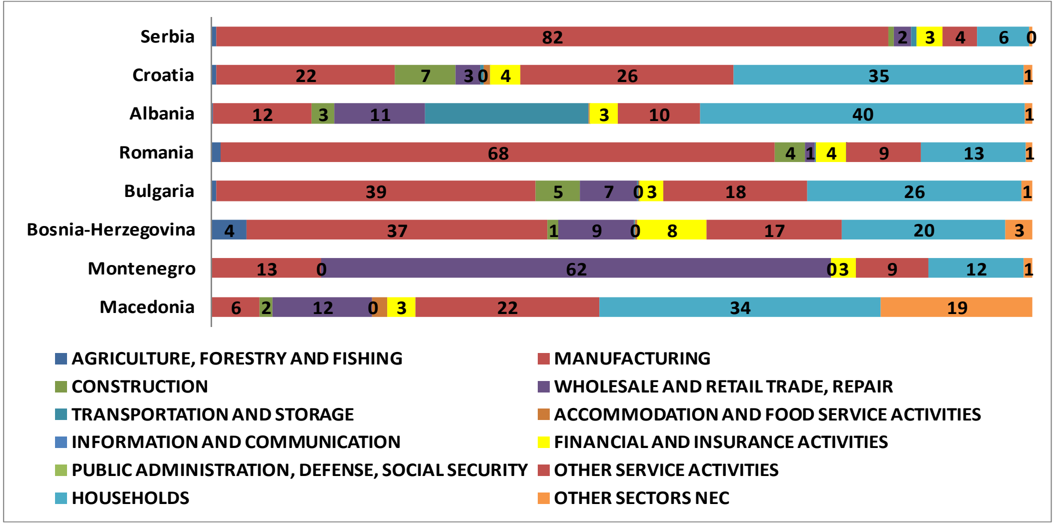
Acquisition of manufacturing companies and the establishment of cooperation agreements related to the outward processing mode of production, mirror the Italian pattern of specialization with Italian FDI concentrated mainly in the traditional industries of textiles, clothing, footwear and furniture. In addition to Bulgaria and

[9] Recall that Italian investment in Balkan countries was exceptionally high in 2008 due to the huge Italian investments in manufacturing in Romania related to "coke, refined petroleum".

Romania, investments were particularly important in Albania, Bosnia-Herzegovina, Croatia, Serbia and Macedonia.

Focusing on more recent years (2007-09), manufacturing has attracted most of flows, particularly in Serbia, Albania, Croatia, Bulgaria and Romania (Figure 2). This result is related to the outward processing mode of production, which has underpinned economic relations between Italy and Romania since the early 1990s and is now (since 2000) becoming important for economic relations between Italy and the Western Balkans[10].

Figure 2. Sectoral composition of Italian FDI, by receiving country 2007-09 (%)



Source: External Trade Statistical Division, Bank of Italy

Detailed analysis of the industry composition in the manufacturing sector allows us to identify two main patterns of economic integration through FDI: a basic integration related to delocalization of labour-intensive tasks (first tier) and more complex integration (second tier). The former type of integration is typical of the economic relationships between Italy and the Western Balkan countries -such as Serbia, Bosnia-Herzegovina, Albania, Macedonia- and involve mostly traditional industries such as textiles, clothing, footwear and furniture. A second tier integration involves predominantly Croatia, Romania and Bulgaria which seem to have embarked on a second level of integration that includes traditional and high-tech industries (Figure A1, Appendix 1).

On the basis of additional regional data, analysis of the Marche region-Balkan countries' economic integration helps to quantify this phenomenon and, more important, accounts for some qualitative research. After examining investments flows between these areas, the main results of case-study analysis are reported in the next section.

[10] Note that the share of Italian FDI in financial and insurance activities is underestimated because most bank acquisitions are managed by means of third financial institutions located in foreign countries.

4. Italian investments in Balkan countries: the case of the Marche region

The Marche region has exhibited a recent and increasing propensity to invest in the area, and especially in the Western Balkans. Since 2005, the Marche region FDI in SEE has increased continuously at an average annual growth rate of 46%. This trend is particularly significant in relation to Italian FDI to the whole Balkans area which experienced a substantial upward trend in 2005-07, followed by a sharp decline in 2008-10 (-19%). The Marche region accounts for almost 12% of total Italian FDI in the WB countries, with a particular concentration in Serbia, Croatia and Albania.

In terms of Italian manufacturing FDI (and the usual focus on *nearshoring*) to the area, we note that the Marche region is an important investor, particularly in some of the most relevant traditional Italian specialization industries. Table 2 reports the industry composition of manufacturing FDI from the Marche region to the Balkans in the period 2007-09. Data shows that it accounts for almost half of overall Italian manufacturing FDI in these industries and that the region holds a significant share of the national FDI in textiles, wearing apparel and footwear (64%), electrical equipment (42%) and food products (39%).

Table 2. Outward FDI towards Balkans countries, by manufacturing industries, cumulative flows 2007-09 (€'000)

	Marche	Italy	%
Textiles, wearing apparel, leather and footwear	50,577	78,550	64.4
Of which: Serbia	*48,225*	*62,066*	*77.7*
Romania	*2,152*	*11,468*	*18.8*
Bosnia-Herzegovina	*200*	*3,117*	*6.4*
Electrical equipment	7,000	16,536	42.3
Food, beverages, tobacco	6,470	16,487	39.2
Other non-metallic mineral products	440	13,084	3.4
Chemicals and chemical products	100	9,246	1.1
	64,587	133,903	48.2

Source: External Trade Statistical Division, Bank of Italy

The main destination countries for manufacturing FDI from the Marche region are Romania, Serbia and Albania. International capital flows in the textile, clothing and footwear industries are mainly directed to Serbia and Romania. Within the traditional light industry sectors, the region is an important source of Italian FDI flows to Serbia, accounting for 77.7% of the total FDI flows in this sector. These results may be due to international outsourcing of lower value added tasks by firms in the footwear district of the region (Cutrini, 2011).

Investments in the food industry involve Albania and Romania. Romania is also the only country attracting investments from the region in electrical equipment during the observed period. Finally, investments in chemical products and other non-metallic mineral products are directed only to Albania.

4.1 Main FDI flows to the Balkans: a microdata analysis

FMDB data provides information on the number and locations of foreign subsidiaries of local companies. Some interesting trends emerge, as for WB destinations.

First, there is increasing interest in the Balkans, although it might be seen as marginal in the context of the overall internationalization of local firms. Only the more economically advanced Balkan countries are targeted by local firms, namely Croatia, Bulgaria, Romania, Serbia.

The relevance of Marche region investments in the Balkans increased in the period 1999-2009. In 1999 subsidiaries in the Balkans accounted for just 9% of total units controlled outside the EU. In 2008 this raised to 16%. Between 1999 and 2009 there was a substantial acceleration of internationalization activity among local companies abroad. The number of foreign subsidiaries more than doubled, although investments in the Balkans area did not increase by as much as investment in East Asia and especially China, which hosted 25% of foreign units in 2008. In 2009 the global financial crisis have frozen investments in general and the number of foreign units in the Balkans has not changed: 17 foreign subsidiaries were localized in the Balkans, accounting for about 1% of Italian companies in the area[11]. Ten units were placed in Romania, compared to 1,091 Italian units in total in this country, and four were in Bulgaria, compared to a total 201 Italian units.

Romania retains its dominant position within the group of destination countries: there were investments in all the sectors considered in at least one year in the period 1999-2009.

However, note that while Romania attracted the most investment, in some cases companies showed a short term interest. Serbia and Croatia attracted much lower numbers of investment projects (1 or 2), but investors seem to take a long term perspective as foreign subsidiaries are kept throughout the period. Bulgaria gained increased attention in 2007 and 2008.

If we focus on sectors, firms from the footwear industry resulted to be the main investors in the area, in terms of both business to consumer and business to business FDI. The volatility of investment, especially high in 2004-2006, can be interpreted perhaps as a symptom of the short term perspective of entrepreneurs, but further research would be needed to confirm this proposition.

Firms from the mechanics industry are becoming more interested in investing in the Balkans, while only a few subsidiaries are related to clothing, electrical tools, furniture and food. Compared to Bank of Italy data on FDI, there are evident differences, related specifically to the clothing industry, where investment flows show a dominant share of FDI from the Marche region to the Balkans. This could be related to the fact that even small companies – generally excluded from the FMDB - are involved in internationalization through direct investment.

Subsidiaries in WB have several common features. They are mostly greenfield initiatives, with high control over invested capital (more than 50%, and most close to 100%). Where information was available, we checked for the role and specific functions of the subsidiary in the group. We find that subsidiaries most often are the production units of parent companies.

[11] We compared the FMDB and Reprint database since both refer to medium and large firms and therefore are comparable.

5. Strengths and weaknesses of some Balkans countries: a case study analysis

Five case studies were chosen with the help of local branch of Confindustria (national association of entrepreneurs). They all provided interesting information on the recent internationalization process of Marche region firms, focused on the Balkans, in terms of the reasons for going abroad and expectations. We summarize the results of the case study analysis and then discuss the motivations for and characteristics of their investments in more detail.

The set of companies interviewed belong to the main sector of Italian specialization, namely textiles, clothing and footwear industries, and the mechanics industry. They are medium-sized and large companies: turnovers are between €9m. and €60m., the average being €37m. for firms in the mechanics industry and €43m. for firms in the textiles, clothing and footwear industries. Average firm size is 55 and 88 employees, respectively. The firms interviewed are quite heterogeneous in terms of their export orientation. Generally, mechanics industries export less than firms in the traditional industries, with an export propensity of 23% and 43% respectively.

Table 3 presents the main characteristics of the nine investments in the Balkan countries surveyed through the 5 case studies. The recipient countries are Romania, Serbia, Croatia, Albania and Moldavia.

Table 3. A summary of the case-study analysis

	Case Study 1		**Case Study 2**		**Case Study 3**
Sector	shoes industry		Mechanics industry		Clothing industry
	I_1	I_2	I_3	I_4	I_5
Host country	Serbia	Serbia	Croatia	Romania	Romania
Year of investment	2004	2006	1995	1999	1997
Main reason	Efficiency-seeking	Efficiency-seeking	Market-seeking	Efficiency-seeking/Market-seeking	Efficiency-seeking
Mode of entry	Non greenfield	Non greenfield	Greenfield	Greenfield	
Stage outsourced	Production plant	Tannery	Commercial office	Production plant/Commercial office	Production plant
Ownership structure	100% ownership	66% ownership, Partnership with a Serbian entrepreneur	80% of capital control	100% of capital control	No capital control
N. of employees	1000	150	7	46	200

Table 3. (continued)

	Case Study 4		**Case Study 5**	
Sector	Mechanics industry		Textile industry	
	I_6	I_7	I_8	I_9
Host country	Moldavia	Romania	Romania	Albania
Year of investment	2004	2008	2001	2010
Main reason	Efficiency-seeking	Efficiency-seeking/Market-seeking	Efficiency-seeking/Natural resource-seeking	Efficiency-seeking/Market-seeking
Mode of entry		Greenfield	Non greenfield	Non greenfield
Stage outsourced				
Ownership structure	70% ownership, Partnership with an Italian entrepreneur	80% ownership, Partnership with a Romanian entrepreneur		Joint venture with majority control
N. of employees	12	12	35	

The case study analysis[12], even at this early stage, suggest some important findings. The phenomenon of transnational companies from the Marche region to the Balkans is more widespread than represented in the official statistics, because of the increasing role played by several contractual forms of governance of the value chain different from FDI (specifically, NEMs). During the past years, transnational corporations located in the Marche region have extended their international production networks in the Balkans not only through equity holdings (FDI) but also through contractual relationships (NEMs). In fact, we found that some partner firms or subsidiaries are created without formal or direct capital control. The companies interviewed reported the presence of many Italian (and particularly from the Marche region) small entrepreneurs who have invested in local companies or developed subcontracting relationships with local producers. Since small companies are involved in this internationalization process, and are not recorded in national databases, it is difficult to map the real scale of Italian investment in the area.

Some of our findings looks consistent with the results of the literature surveyed in Section 1. The predominance of efficiency-seeking and market-seeking motives seems to be related to the fact that these investments are relatively recent (Dunning, 1980, 1996; See Section 1, *Infra*). In the search for greater efficiency, companies have primarily looked for lower costs of production.

From the case study we found that the gains from the reduction of labour costs or other production inputs, alone, are not sufficient to justify the investment. When investment in the Balkans is driven by efficiency seeking reasons exclusively, they seem to be less competitive and rewarding. Labour costs are increasing, and utilities and services are particularly expensive. If delocalization is driven by the search for cost competitiveness, other important areas – such as SouthEast Asia - could be a better solution and provide greater scope for simple reductions in production costs. The

[12] For a detailed description of the case studies see the Appendix 2.

Balkan area, however, is well placed strategically and is also a potentially good market for Italian products, both business to consumer and industrial production goods. The interviewees suggested that when considered as a destination market or logistic hub for reaching other emerging/growing markets, investment in the Balkans is regarded as valuable and profitable. In this case, even the global financial crisis has not changed firms' positive evaluations of investment in the Balkans, despite the reduction in orders and production.

As for the main governance structure of the new European value chains, we found a predominant role played by quasi-hierarchy which is consistent with previous studies on developing and emerging countries (Humphrey and Schmitz, 2002; See Section 1, *Infra*). Moreover, given that we have found small-scale plants, we may infer that Fordist organization of production – that was usually found in other emerging countries (Courlet, 2006; El Kadiri and Lapèze, 2007, Section 1, *Infra*) - is not always the case here. Large-scale production plants in the shoes and clothing industry seem to be related to the efficiency-seeking motives of the investment.

Finally, it is interesting to point out that, contrary to previous results on industrial clusters in developing countries, the Italian FDI have engendered positive effects in terms of localized industrial development. In fact, a sort of "district effect" in the recipient country has been reported by some interviewed firms. Italian units in the Balkans support local subcontractors taking on specific phases of production. The involvement of further subcontractors in the host region is supposed to favour the development of a local cluster. Agglomeration and growing division of labour may enhance the future prospects of the host regions in terms of stability of employment and long term industrial development, thus reducing the risk of "footlooseness" (Unctad, 2011; Section 1, Infra).

Two lessons from our case-study analysis have important implications for local policies in the area of origin and in the destination country. First, small Italian companies do not use the support of Italian public agencies and bodies to explore investment opportunities in the area. It seems there is an information gap between companies and institutions, bringing to a waste of opportunities.

Second, companies underlined the need for specific training activities of the administration staff in the Balkans to meet Western business standards, methods and techniques. While they are satisfied with the production workforce, the knowledge and expertise of administrative staff is less satisfactory. There is a lack of specific expertise in the use of techniques and instruments crucial for the management of relationships with suppliers and banks by employees responsible for administrative tasks.

From a policy perspective, to enhance and reinforce economic integration between Italy and the neighbouring Western Balkan countries there is the need for a better provision of information to Italian local companies on the support for internationalization, and to improve management competences in the WB workforce, maybe even pushing cooperation among Italian and WB Universities.

Finally, relationships with banks are difficult. There is no access to "traditional" and simple financing instruments – even asset backed ones - and credit is issued at expensive rates. Italian companies try to overcome this problem with intra-group financial planning but more efforts at government level are needed to push Italian banks that have assumed a leadership position in the Balkans, to support the development of Italian business relationships in the area.

Concluding remarks and further developments

Despite the broad consensus that the involvement of Balkan countries in the context of the EU accession process is having an impact on their international economic integration, up to date evidence on inward FDI in the area is limited.

This exploratory work tries to shed light on the magnitude of the phenomenon and unravel the main determinants and characteristics of Italian FDI and other NEMs in the area, helping us to define appropriate research hypothesis to be tested in the future steps of our research project. We relied on a mixed-method analysis referring to secondary sources of data and to original information collected through case-studies.

In the light of the specific political actions designed to strengthen political and economic integration between Italy and the SEE (e.g. the Adriatic-Ionian Initiative and previous initiatives such as the Adriatic Euro region and the IPA Adriatic Cross-border Programme), this article contributes to the knowledge on the state of economic integration reached so far, with the aim of helping the formulation of appropriate policies in a multilayered perspective, encompassing EU, national and regional levels. A deeper understanding of the different forms of economic integration should help to support the most efficient use of existing EU instruments and funds at national and regional levels, to enhance the governance and economic capabilities of the Western Balkan countries.

The evidence provided may give a better understanding of the nature of the internationalization process of Italian firms in the Balkans area.

The study's findings on the Marche region carry several policy implications to support the internationalization and restructuring of other local economies characterized by a high incidence of industrial clusters and by a high specialization in labor intensive traditional industries.

To have a clear and reliable view of the topic, several issues require further analysis, at national and regional level. In the next phase of our research project, the integration of trade between Italy (the Marche region) and the Balkans should be analysed. The typology of import and export flows and the magnitude of outward processing trade need to be assessed in order to evaluate the role and importance of international outsourcing in explaining Italy-SEE relationships. At the same time, the role of the different forms of contractual links (e.g. cooperation agreements, non equity joint ventures, ...) between Italian and Balkan companies, particularly small and medium companies, requires further in depth study. In this respect, more case studies are needed, as official statistics cannot disclose this phenomenon.

More analysis on the field is fundamental, even because analysing FDI trends in the Balkans, as well as investment from the Marche region, we found that sometimes investments in some areas are highly volatile. It is important to understand whether companies' behaviour is being driven by exploration purposes with a view to evaluate successive investments or rather by a short term investment strategy. It would be interesting to know if this phenomenon is typical of some country or if it is due to poor definition of corporate strategies by Italian investors. It could also be related to a specific sector – mainly the footwear. However, at this stage of our research, the case study approach has not enabled deeper exploration of this aspect. Different investment strategies and behaviours towards different Balkan countries might be related to the institutional environment (country's regime type, level of property rights protection, quality of education, government policies and incentives, etc.) or to the market/firm/industry characteristics (such as host market size, wage rates, transport costs, level of foreign competition, industrial disputes, etc.). An in depth analysis of single Balkan countries perspective, at macro and micro level, is therefore required.

Finally, we found evidence also of localized industrial development stimulated by the entry of Italian firms, which is activating subcontracting relationships with existing firms in the host region. Future analysis should therefore explore the role of Italian FDI in integrating firms in SEE into value chains with particular impacts on local and regional development processes in the area.

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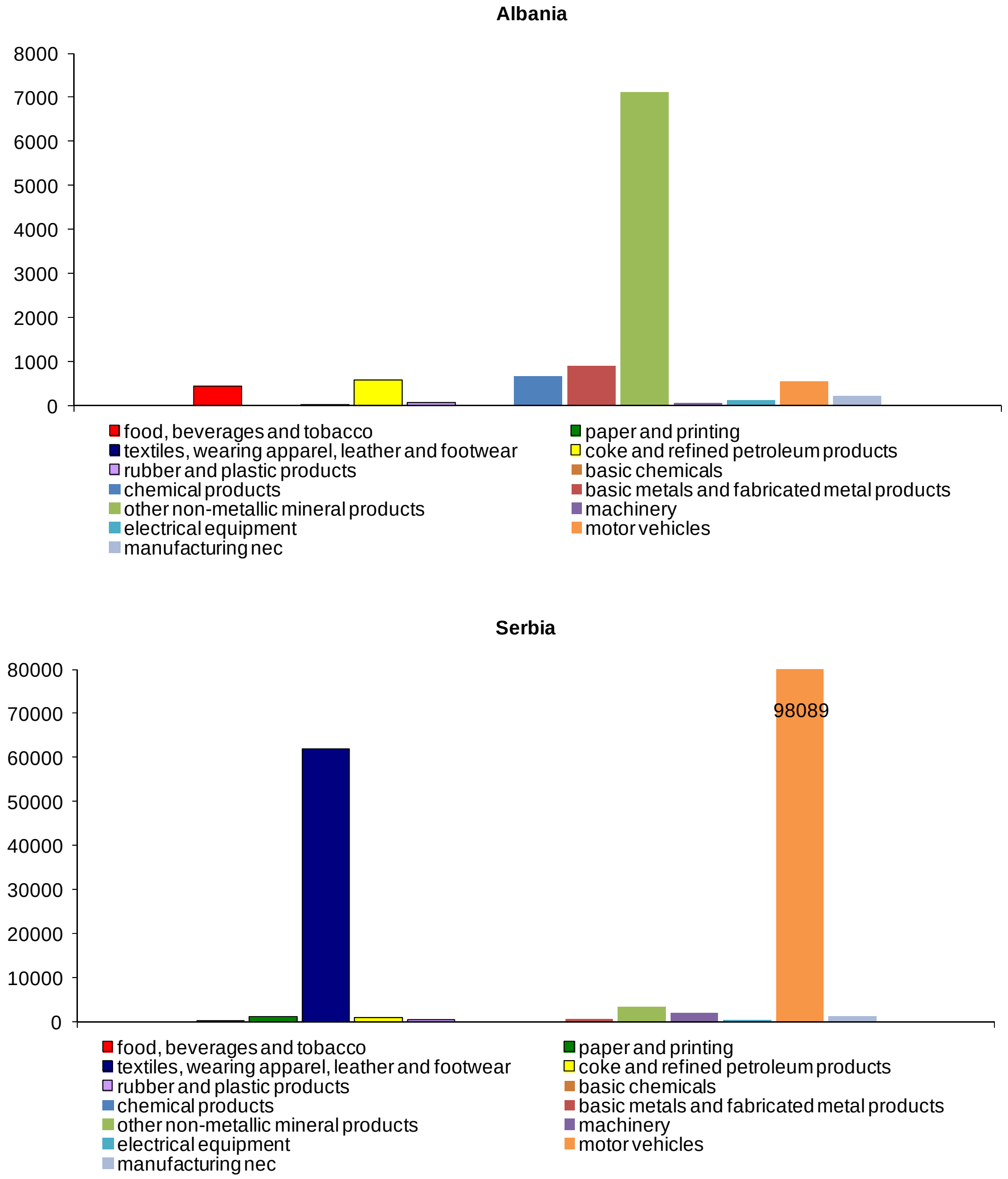
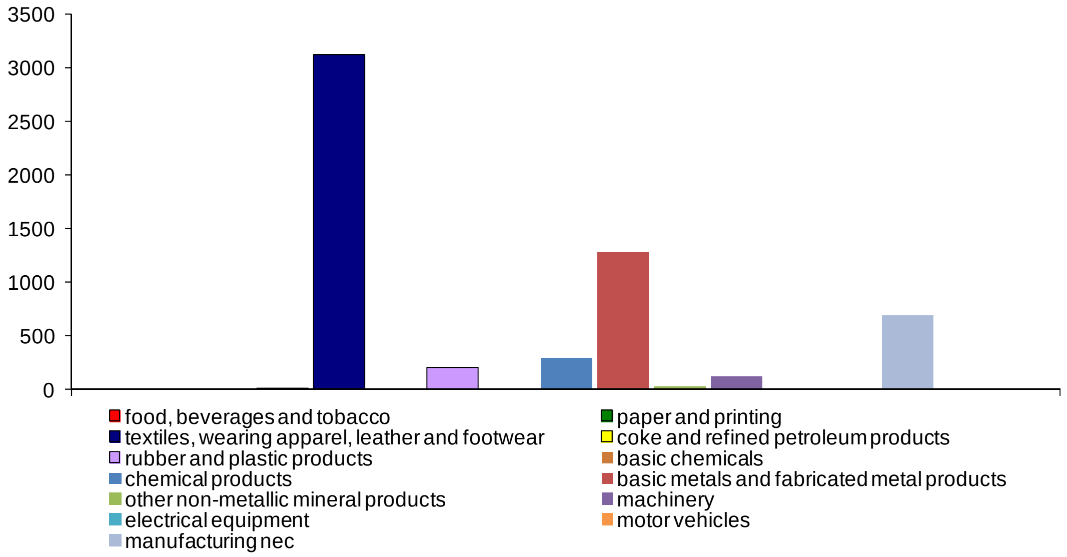
APPENDIX 1

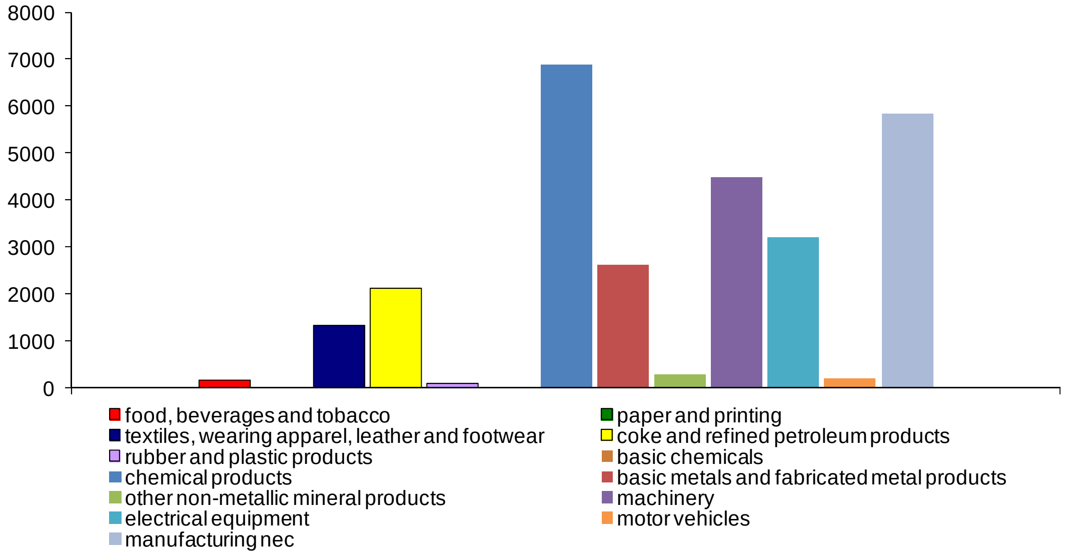
Figure A1- Composition of Italian manufacturing FDI towards selected Balkan countries, 2007-2009 cumulative flows (Millions of euro)

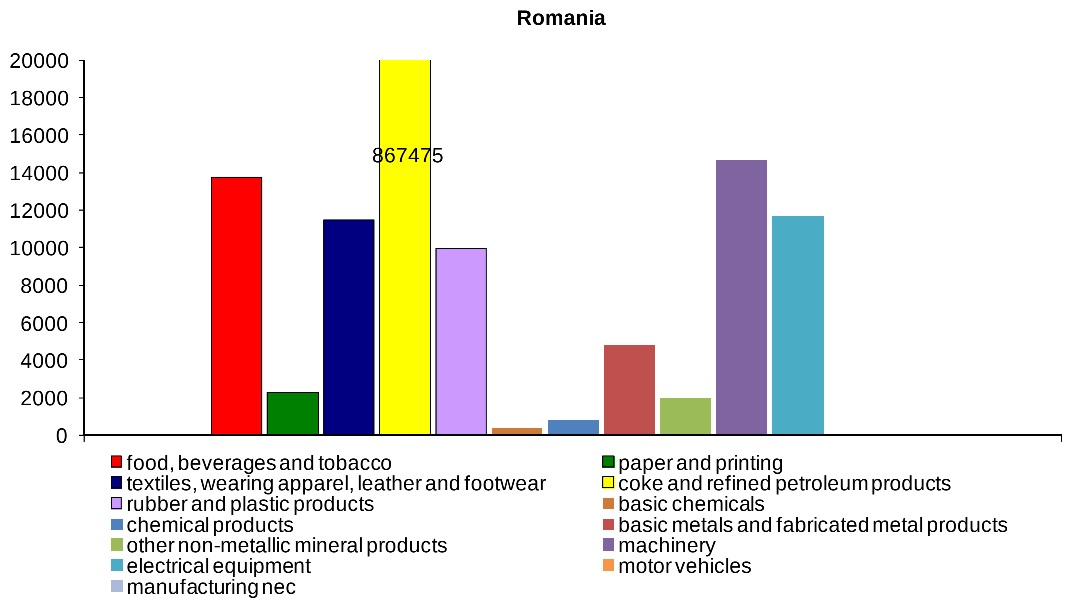


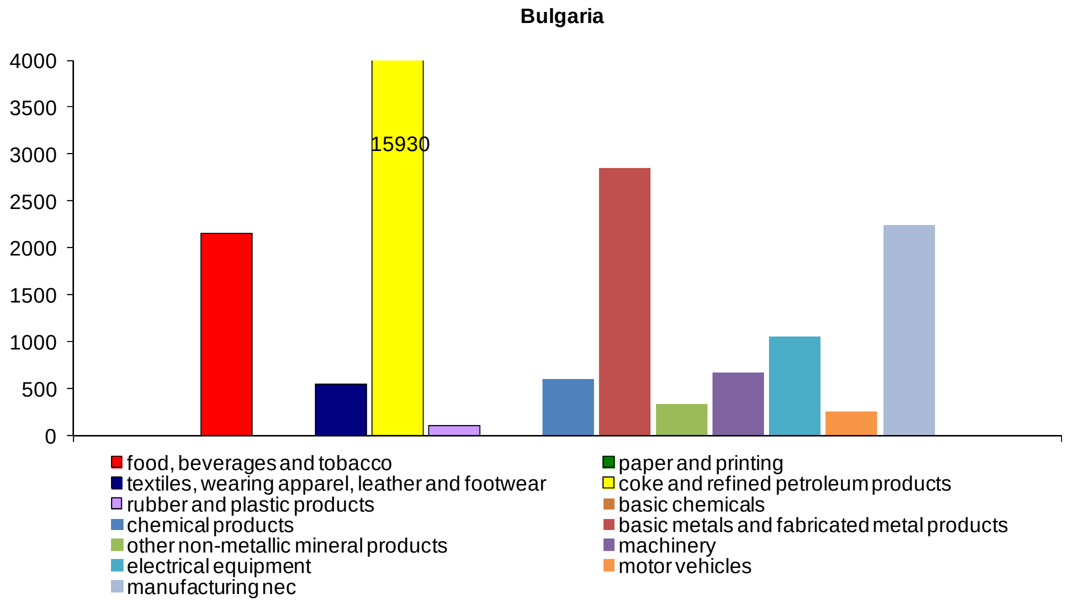
Bosnia-Herzegovina



Croatia







Source: External Trade Statistical Division, Bank of Italy

APPENDIX 2: A report of the case studies

Case study 1

Case 1 is a study of investment in Serbia. The parent company is in the footwear industry, and is specialized in the design and production of shoes. It has production plants in Italy, China and Serbia.

The company made two non-greenfield investments in Serbia: a production plant (100% owned), with 1,000 employees, and a tannery, owned 66% in partnership with a Serbian entrepreneur, with 150 employees. The two companies are located in different areas of Serbia, 300 km apart. The approach adopted to investment in Serbia has been gradual, part of a strategy that might be defined as "explorative". Serbia was selected after investigating various countries for the outsourcing of phases of production. Romania and Poland were considered not sufficiently competitive in terms of labour cost advantages, due to their EU accession; Serbia on the other hands has comparatively low labour costs and advantages in terms of an experienced available work force. Many local firms in the footwear industry have acted as international subcontractors for Western companies, especially German and US firms. In the 1990s discussions began about the possibility of outsourcing some production phases to Serbian subcontractors. Initially, some small and marginal production tasks were outsourced. After a period of "testing", the privatization of state owned enterprises in Serbia allowed the case company to consolidate its presence in the country.

Currently, a complex structure has been set up to manage the entire production process, with the result that for some footwear lines the finished shoes are made entirely by the Serbian unit. The two companies located in Serbia are run by Italian managers and production activities are supervised by Italian technicians. It is interesting that the production plant is linked to other small subcontractors located nearby to which specific phases of production are outsourced, giving rise to a local division of labour typical of an industrial district.

The reasons driving the investment in Serbia in this case can be "classified" as efficiency seeking. The low labour costs and availability of skilled and trained workers were fundamental to the delocalization strategy. However, the area was also seen as a strategic location to reach Eastern European countries as well as the CIS and Russia. The Serbian unit acts as logistic pole in the group, which indicates an asset seeking strand to the investment strategy. Despite the savings in labour costs, the case study reveals a persistence in the characteristics of employees working for local branches, that are typical of their state-owned heritage. Poor management control techniques and managerial skills imply additional costs, beyond the coordination and monitoring costs. The interviewees did not see corruption, relations with local public institutions, or political instability as critical, and were of the opinion that they were not much different from conditions in Italy. However, it was acknowledged that relationships with local banks are difficult since credit is not competitive. Financial needs are resolved by intra-group flows.

Case study 2

The second case study deals with a mechanics industry firm which made two investments, in Croatia and Romania. The company produces pipes, evacuation and water treatment systems, complete sewerage systems, waterworks, gas pipelines and drainage systems. The Croatian company was created, as a greenfield initiative, in 1995, with 80% of capital control. It comprises a commercial office, located in Split, with 7 employees: 2 in sales, 1 in administration, 1 in logistics. The Croatia investment was driven by market seeking motivations. The company wanted access to what it saw as becoming a new and promising market, once post-war reconstruction was completed. This relatively small investment gave the opportunity to explore actual interest in the Croatian market prior to more intense investment in the form of a production plant or warehouse.

The parent company decided to invest in the country since, in the mid-1990s, Croatia was a growing market with prospects of significantly increased domestic demand. It was also geographically well placed near to areas with potential high demand for primary infrastructure works, such as other former Yugoslavia countries and the CIS. Finally, Croatia has a good transportation system which enables the movement of goods. At the time of writing, and perhaps as a result of the global financial crisis, demand for infrastructure works is declining in Croatia (but increasing in neighbouring countries) and there are delays in payments due to freezing of public funds. The same firm's investment in Romania shows slightly different characteristics and underlying motives. The Romanian subsidiary was created in 1999, with 100% capital control. The unit acts as both a production plant and a commercial office. It is located in Suceava and has 46 employees. Romania was considered important in terms of providing access to a new market and in being a geographically strategic location. The local administration and the EU were providing investment facilities which, at the time, reduced the cost of the greenfield investment. All efficiency-seeking advantages were associated with reduced labour costs which promoted efficiency gains. Romania did not seem to suffer from any particular critical aspects apart from the persistence of informal institutions and workforce habits which hindered communication with the Italian employees. The Romanian subsidiary activated collaborations with local suppliers of accessories for the installation of pipes, and with local subcontractors willing to undertake parts of the production process, evidence again of a district effect.

Case study 3

The third case study is a clothing company, that designs and produces to order under customers own brands. Exports represent 75% of production. In 1997, the entrepreneur made the decision to invest in Romania and, currently, 40% of production is located there, the remaining 60% being in Italy. The Romanian subsidiary is located in Alba Julia and employs about 200. It is run by an Italian managing director and production activities are supervised by Italian technicians.

There is no formal capital control over the Romanian unit, which acts as a unique supplier to the Italian parent company. It is specialized in the production of trousers: the raw materials are supplied by the Italian company and the semi-finished trousers are re-imported into Italy for final finishing. The Romanian company relies on a number of local subcontractors. Similar to case study 1, it is a hub in the territory, around which a local division of labour typical of industrial districts has emerged.

The quality of production is considered good; there are no language difficulties and, more importantly, employee turnover is low. It should be noted that the advantages of this location, mainly the labour cost differential, which drove the original investment are no longer available in Romania. Currently, delays in production timing –the major disadvantage - are no longer balanced by efficiency savings. The company continues just because of the problems involved in disinvesting. The infrastructures and services in

Romania did not evolve as expected and EU accession in 2007 has not enhanced the quality of the business environment.

Case study 4

The fourth case study is a company in the mechanics industry. Its activity is related to moulding of ferrous materials, and production and co-design assistance in various sectors (white goods, automotives, furniture, weapons, etc…). The company has made two investments in the Balkans - the first in Moldavia and the second in Romania.

The Moldavian company was created in 2004, in a 70%:30% partnership with an Italian entrepreneur living in Moldova. It is located in Chisinau and has 12 employees. The subsidiary carries out assembly operations for the automotive sector using spare parts produced by the parent company in Italy. It undertakes production to order in welding, manual and mechanical assembly, and also moulding. The Moldavian company relies on local subcontractors for particular paint procedures, and has emerged as a hub of the district that has developed in the area, with a local organization of production similar to those in case studies 1 and 3. Initially, the company found it very difficult to source even the simplest components and machinery/equipment. It had to get everything from Italy ("even wrenches"). When the first contact with a local subcontractor was established, getting reliable quotes was a problem. However, procedures and work flows have been standardized and commercial relations in the area are good.

The decision to invest in Moldavia was based on efficiency considerations: Moldavia offers low labour costs, economic and political stability and low risk for investors. Its national company law was inspired by the European model, especially in relation to property rights and intellectual property protection. The workers have good mastery of the Italian language and there are Italian banks in the area. Customs duties on good exported to the CIS are favourable making products/services sold to these markets through Moldavia more price competitive. Despite these advantages, certain problems have emerged. Investment is required in workforce training to enable achievement of required quality standards. Logistics management is strategically important because transportation costs and the costs related to customs procedures are very high.

The second and more recent investment was in Romania in 2008. This was a greenfield initiative, in partnership (80%) with a Romanian entrepreneur (20%) who previously had worked in Italy. The company is located in Arad and has 12 employees: 3 in administration and 9 in production. It is run by the Romanian partner with production activities supervised by Italian technicians. It is specialized in powder coatings to order. This investment in Romania was driven by market seeking and efficiency seeking motives. The country offered internal market opportunities based on increasing domestic demand. A subsidiary in Romania was seen as important to align with the internationalization processes of big customers that had delocalized in the country and to exploit a timing advantage compared to other European competitors. There were no similar companies in the area at the time of the investment. The city of Arad was close to local mechanics firms that required painting services. Geographical proximity is crucial to reduce the costs and risks of damage to painted parts. The subsidiary's location was strategic in terms of its proximity to interesting and promising markets, such as Hungary, and Old Europe (there are good motorway connections). In addition, this greenfield investment was made to transfer to Romania an Italian plant, which was inefficient due to the high labour costs in Italy. Moreover, there was a vast net of local suppliers in the area since many Western industrial groups were already located there. Unfortunately, punctuality, cost and quality of the service were unsatisfactory and not competitive. Relationships have been developed with the Romanian branch of an Italian supplier, which is providing important competitive advantages in terms of flexibility (time/mix of products available) and costs.

There are also some downsides to investing in Romania. These are related mainly to the quality of bureaucracy, the legal system and the financial institutions. Establishing a utility requires long and time-consuming procedures. The high costs of services/utilities and rentals tends to counterbalance the competitive costs of labour. There is a lot of time wasted on the requirements of the fiscal and labour agencies.

Relationships with the banks, even local branches of Italian financial institutions, are critical. Credit costs are high, even when backed by assets. There is no easy access to "traditional" and simple financing instruments.

Finally there is a lack of specific expertise in the use of techniques and instruments crucial for the management of relationships with suppliers and banks by employees responsible for administrative tasks. This is another example of the inconsistency between the new economic environment and the inherited social systems that include education systems that do not include training and qualification in economics or management.

Case study 5

The last case study involves two investments in the Balkans, in Romania and Albania, by a medium sized company in the textile sector engaged in special finishes to goods and fabrics related to dyes, wear and tear, etc.

The investment in Romania was made in 2001 to diversify the group's activities in the production and manufacture of wood for stripped wood and parquet flooring. It was a non-greenfield initiative: the entrepreneur and another private Italian investor, decided to acquire a Romanian company in order to take advantage of the good availability of high quality, solid oak and low labour costs. After the acquisition the company was completely renewed. All equipment was imported from Italy to build a new plant that conformed to EU rules and requirements. There are currently 35 persons working in the company, which is managed by locals. Negative aspects of location in Romania relate to microeconomic characteristics and the macroeconomic environment, namely lack shortage of entrepreneurial perspective, and lack of a potential domestic market.

The same parent company invested in Albania in 2010, through a joint venture with a group of Albanians who had worked for the company in Italy on the sandblasting process. The Italian company, which has majority control, transferred the knowhow and technical equipment; the Albanian partner provided a skilled workforce, entrepreneurship and knowledge of the internal market. The specific advantages of Albania are related low labour costs and the fact that in the effort to anticipate the future investment strategies of other clothing industry companies, several important high-fashion groups have invested in the area. The company is planning to establish a production plant in Albania and become the leader for sandblasting. Fiscal facilities are available.