Delocalisation in foreign countries
Strategic issues for Italian companies active in the Retail & Consumer sector
The delocalisation of Italian companies, starting during the 90s, mainly aimed to seek resources at a competitive cost

- During the period 2001-2006 almost 3,000 Italian companies started delocalisation processes.
- Italian delocalisation in the R&C sector is still quantitatively limited: it involves about 4 percent of manufacturing companies, mainly large ones.
- Romania, Bulgaria, Albania, Poland and the Maghreb area are the main geographical destinations. Recently delocalisation to Russia, India and most of all China has started to grow very quickly.

Notes:
Nowadays “thinking global” is a “strategic must” for Italian companies active in the R&C sector

• In order to maintain and develop their competitive advantages, Italian companies of every size, active in the R&C sector, have to seek:

  1. **New markets** for their products;
  2. **New partners** with whom to cooperate to develop new technological knowledge;
  3. **New supply markets** to seek resources (labour force, energy) at competitive costs.

- **Internationalisation strategies** can be divided into the following types:

<table>
<thead>
<tr>
<th>Resource seeking</th>
<th>Market seeking</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>defensive delocalisation strategy</strong></td>
<td><strong>offensive delocalisation strategy</strong></td>
</tr>
<tr>
<td>i.e. Moving manufacturing operations to low-cost countries to benefit of lower cost of key resources (i.e. cost of labour)</td>
<td>i.e. Seeking new markets internationally to sell products/services (low-cost/emerging countries not only as production platforms)</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Tariff jumping</th>
<th>Strategic asset seeking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit of tax advantages or access to particular forms of business facilitation measures existing in some foreign markets</td>
<td><strong>defensive delocalisation strategy</strong></td>
</tr>
<tr>
<td>i.e. Proximity to Key Clients to better support them</td>
<td></td>
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</tbody>
</table>
In the future, international strategies of Italian companies should be more and more “Market Seeking” rather than only “Resource Seeking” to better exploit “the potential” of Emerging Markets

Some implications

**Reducing risk of direct investment**
- **Minor companies** should approach international markets mainly through **partnerships** to better support the high costs of investments.

**Country’s competitive advantages**
- A “**new way of doing business globally**”: delocalise single tasks in those countries that have high specialisation and lower execution costs.

**Tax issues**
- Delocalise production phases and the relative incomes (using appropriate **transfer prices**) in those countries that offer tax advantages and agreements to avoid double taxation.

Delocalising in Emerging Markets: this is not just more of the same. It’s no longer merely a story of basis products and low cost manufacturing

- India, China, ASEAN and Nigeria will increase with 1.3 billion urban residents between 2009 and 2050.
- The cities of the world will require tremendous infrastructure investments to support this growth.
- Shangai and Mumbai alone will generate 25 million more middle class households by 2025, but the new middle class will not be constrained to the world’s megacities.
- This will create substantial opportunities in consumer goods, whilst straining the agricultural capacity of the world.
- China may no longer be the world’s factory. Many emerging markets now have lower labour rates than China, and countries like Thailand and India could become more competitive.
- Between 2005 and 2009, over 2,000 companies in emerging markets began investing abroad. Some are becoming industry leaders.
- Currencies in Brazil, Vietnam and Indonesia are all expected to depreciate relative to the RMB, making these countries more competitive as a low manufacturing cost destination.

Some implications:

- Emerging countries represent huge market opportunities for Italian companies; a missed exploitation could affect competitiveness of Italian companies in the near future;
- Customers (actual and new customers) have to become key drivers of international development in emerging countries: understanding of buying factors represents the distinctive capability to achieve sustainable competitive advantages;
- An appropriate planning of the entry strategy could save time and money; also best followers could have great opportunities;
- In order to understand the main characteristics of each country and the impacts for Italian business, operative risks analysis and economics-financial assessments, have to be performed before every internationalisation process.

Source: PwC, “Rethinking emerging markets”
## Delocalisation: risks and opportunities for Italian companies active in the R&C sector

### Opportunities for Delocalisation Companies

- Labour costs reduction;
- Availability of raw materials and energy at low prices;
- Chance to remain in the market supporting increasing price competition;
- Presence in growing markets;
- Tax and legal advantages;
- Potential partnerships with competitors.

### Risks for Delocalisation Companies

- Country risk related to political and social instability;
- Transfer of production know-how to local competitors;
- Loss of reputation and price advantage that is normally recognised to high quality production entirely “Made in Italy”;
- Significant increase in logistics costs and in lead-time;
- Potential growth in labour costs in the coming years;
- Limited ability of the board in small-size companies in coordinating activities in different countries.

### Opportunities for Destination Countries

- Employment growth;
- Entry of foreign capital in the national economy;
- Transfer of know-how to local actors;
- Growth of domestic demand;
- Growth in tax base and tax revenue that can stimulate public investment.

### Risk for Italy

- Reduction of domestic employment (most of all in labour-intensive activities);
- Transfer abroad of production know-how;
- Use of the brand "Made in Italy“ on products made entirely in emerging markets;
- Slowdown of growth of domestic demand;
- Adverse effects on the whole supply chain in a productive context characterised by extensive networks of subcontracting.

Source: MPRA, “Produrre all’estero e fare profitti in patria: uno studio sulle imprese venete dell’abbigliamento e delle calzature”, Banca d’Italia, “Le imprese italiane tra crisi e nuova globalizzazione”
Only Italian companies active in the luxury segment highlight a relevant market penetration in international markets

Sales for geographical destination for main Italian Companies in R&C sector at December 2009, 31

<table>
<thead>
<tr>
<th>Company</th>
<th>Segment</th>
<th>Sales (%)</th>
<th>Sales (€/million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Italy</td>
<td>Europe</td>
</tr>
<tr>
<td>Luxottica</td>
<td>Accessories</td>
<td>n.d.</td>
<td>21%</td>
</tr>
<tr>
<td>Parmalat</td>
<td>Food</td>
<td>25%</td>
<td>3%</td>
</tr>
<tr>
<td>Indesit</td>
<td>Electronics</td>
<td>18%</td>
<td>78%</td>
</tr>
<tr>
<td>Ferrero</td>
<td>Food</td>
<td>59%</td>
<td>26%</td>
</tr>
<tr>
<td>Benetton</td>
<td>Clothing</td>
<td>n.d.</td>
<td>79%</td>
</tr>
<tr>
<td>De Longhi</td>
<td>Electronics</td>
<td>17%</td>
<td>56%</td>
</tr>
<tr>
<td>Prada</td>
<td>Luxury</td>
<td>22%</td>
<td>24%</td>
</tr>
<tr>
<td>Bulgari</td>
<td>Luxury</td>
<td>12%</td>
<td>26%</td>
</tr>
<tr>
<td>Geox</td>
<td>Footwear</td>
<td>39%</td>
<td>42%</td>
</tr>
<tr>
<td>Ermenegildo</td>
<td>Luxury</td>
<td>n.d.</td>
<td>30%</td>
</tr>
<tr>
<td>Zegna</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: Financial Statements – the table includes only main Italian company active in the R&C sector that highlights publicly revenues detail by geography
**Geox: key milestones of international growth**

**1990**
The founder discovered a revolutionary system: a micro-porous membrane placed on top of a perforated rubber sole that let heat and humidity into the shoes but keep water out.

**1997**
**Resource Seeking**
Geox builds first productive subsidiaries in Romania and Slovakia, creating a little “shoe district” and attracting Italian suppliers in the area.

**1999**
Thanks to a technological improvement, Geox entered into the clothing market, with a full line of breathable garments.

**2000**
**Market Seeking**
Geox started to penetrate into the international market.

**2003**
**Resource and Market Seeking**
Agreement with second larger Chinese shoes producer Aokang for the development and the delivery of products for the Chinese market.

**2005**
**Market Seeking**
Geox opened a 600 sm flagship store in Madison Avenue, in New York.

**Geox’s international Business Model:**

- **20%** in Eastern Europe in own plants
- **80%** in Eastern Asia with third party suppliers
- **344** shops in Italy (39% of sales in 2010)
- **695** shops in the rest of the world (61% of sales in 2010)
Impacts of delocalisation on “Made in Italy”: Brand Strategy and Regulation (1/2)

- Delocalisation of production activities in low-cost countries creates some conflict of interests:
  
  A. **Need to guarantee protection** to those companies that have based their brand strategy on “Made in Italy” as a way to be successful in the market;

  > **D.L. 135/2009:** “Recently a regulation for the valorisation of companies that design and develop entirely within the Italian territory, has introduced the brand concept of “100% Made in Italy”

  B. **Need to sustain competitive capability** of Italian companies, allowing them to realise delocalisation;

  C. **Right of consumers** to know exactly where a product is produced and to not be influenced by the “Made in Italy” brand in a misleading way.

- **Legal implications:**

  **Reg. CE N. 2913/1992:** “Made in Italy” can be affixed to a product even if goods are produced and worked in a foreign country, but it’s necessary that the last substantial transformation occurs in Italy, and that this last step represents a fundamental phase of the production process.

Impacts of delocalisation on “Made in Italy”: Brand Strategy and Regulation (2/2)

- **Business implications:**
  From a business point of view the “Made in Italy” brand represents globally:
  
  1. High quality;
  2. High design;
  3. Attention for details;
  4. Innovation.

  and not only where products are produced.

- Exploiting this perceived value, reactions of main Italian companies have been:
  
  ✓ Moving consumer’s attention **from “product origin” to “brand origin”**: Italian brands have to be assurance of quality and design rather than of origin → **“culture of quality”** (Prada’s brand strategy)
  
  ✓ Creating **desire** in the consumer to possess luxury goods (top buyer countries of luxury goods have changed completely in the last 10 years);
  
  ✓ Performing action to emphasize the perceived quality of products, passing **from material to intangible attributes** (design, style, Italian experience).

Who are we?

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