16 *Imitative offshoring strategies*

Lessons learnt from the Italian small domestic appliance industry

GABRIELLA LOJACONO
Bocconi University

OLGA ANNUSHKINA
SDA Bocconi School of Management

Introduction

Offshoring has been gaining momentum in the managerial and academic discussion of the activity of multinational enterprises (MNEs) and the organization of the value chain. There are several motivations to consider for the centrality of offshoring in the scientific debate. First, this phenomenon spread fast due to facilitating factors such as the diffusion of information and communication technologies (ICT) and the lowering of trade barriers. Second, the rapid diffusion of offshoring has radically changed the structure of many manufacturing and service industries (Davies, 2004).

In practice, the concept of offshoring is used to indicate various phenomena such as delocalization of firm's activities to remote and low-cost countries (Pfannenstein and Tsai, 2004; Robinson and Kalakota, 2004), foreign direct investment (FDI), international manufacturing and, more generally, relocation of value chain activities globally. Building on this broad definition, offshoring is simultaneously a cause and a consequence of international labor division and globalization (Jahns *et al.*, 2006).

Vertical disintegration (Jacobides, 2005) is driven by the desire of firms to match the comparative advantage of foreign locations with their own resources and competencies, so as to maximize their competitive advantage (Kogut, 1985; Mudambi and Venzin, 2008). The definition of entire industries and their competitive dynamics are changing radically, even for those firms that do not modify their level of vertical integration in the home country. On one hand, offshoring modifies the industry structure through the emergence of new intermediaries (and

new intermediate markets). On the other, imitation phenomena within the same industry may lead to an increasing homogeneity of business models: most competitors offshore the same value chain activities in the same countries according to the same motivating factors and, in the end, offer a similar product/service portfolio to the same clients. This leads to the "commoditization" of the entire industry. Unlike other facets of industry evolution (e.g., changes in technology), vertical disintegration and offshoring of value-chain activities may occur without changes in the final products, services, and technologies.

Based on observations made by Monczka *et al.* (2008) and Klingebiel (2005), in this chapter we distinguish between "offshoring to affiliates" and "offshoring to unaffiliated (contract) parties." Such a distinction is based on the "*ownership*" of activities being localized in distant countries. "Offshoring to affiliates" refers to activities carried out within the firm's boundaries but across borders (and the firm still has full control over the processes being localized overseas). "Offshoring to unaffiliated (contract) parties" is related to activities provided by suppliers in foreign markets (in this case, the contract supplier has control over the processes being outsourced). Our chapter is based on this important distinction in order to interpret better the empirical evidence herein illustrated.

Why do firms decide to locate activities outside the home country or to rely on foreign suppliers? The prime focus of traditional studies was on cost-saving opportunities that are particularly important for labor-intensive activities. In such a case, the decision about the activities' location depends on a worldwide comparison of labor costs, assuming similarities in performed tasks and in quality standards. The wage cost motivation must not neglect the additional managerial costs related to the transfer of knowledge, supervision of foreign operations, and learning of local culture and business ethics.

Over time, the need for operational flexibility, local capabilities exploitation (Bartlett and Ghoshal, 1998; Doz, 1986; Dunning, 1996, 2000), new innovation sources, and access to new markets became equally important driving forces for offshoring. These new location advantages explain why MNEs began offshoring high-value activities like R&D (Cantwell, 1995) as suggested by the case of Whirlpool Corporation. The successful introduction of microwave ovens in Europe combined with the Japanese/Korean expansion strategy convinced the Major Domestic Appliances (MDA) Division to initiate an agreement

with a local company (1984) for the purchase of low-cost microwaves manufactured in Japan. The alliance was aimed at complementing the product portfolio with cheaper products targeted at mass distribution. Then the local partner was substituted by another company (in 1986) and a new product range was developed thanks to joint efforts in R&D. The time was ripe to move to FDI. Operationally, Whirlpool entered into an alliance with a small Chinese producer as a preliminary step before the acquisition of its factory in 2003. Massive production capability for basic products was thus relocated to China for all subsidiaries giving the opportunity to local/regional subsidiaries' factories to concentrate on higher value and innovative product development and production. One year later, the R&D center for microwaves was located in China where there were valuable technological competencies. The Chinese R&D center served all subsidiaries even if initially only minor adaptation was possible locally. Similar experiments were undertaken in different product lines/categories. The Whirlpool case suggests that the offshoring process had been highly dynamic, allowing a quick adaptation to new challenges, opportunities, and knowledge.

Our chapter is organized in the following way: first, it briefly describes the changes in the global economic scenario for the domestic appliances industry since the mid-1990s. Second, we analyze the determinants of internationalization of production and supply. In the third place, we examine which activities were mainly involved in "delocalization" and how offshoring to unaffiliated (contract) parties resulted in vertical disintegration for the entire industry and the growing inability of former manufacturers to appropriate the results of investments in such high-value activities as research, design, and development. The chapter closes with a summary of key findings, implications for managerial work, and suggestions for future research.

Offshoring of production and small domestic appliance industry transformation

In many studies, competitive pressures and emergence of new fierce players are seen as important sets of triggers (Porter, 1980, 1985). In our study, both sets of triggers are seen. In the late 1990s, cost-based competition and the increasing bargaining power and strict requests of retailers led to offshoring decisions by some pioneering manufacturing

Table 16.1 *Export of electromechanical domestic appliances with self-contained electric motor (code 7757-sitc 3): top 15 countries in 2007*

	Country	Trade value 2007	%	Trade value 2006	%	Trade value 2005	%	Trade value 2004	%	Trade value 2003	%	Trade value 2002	%	CAGR 02–07
1	China	4,228,457,433	35%	3,536,501,813	31%	2,836,983,303	30%	2,394,490,828	24%	1,840,573,468	22%	1,339,465,300	19%	25.85%
2	Germany	1,484,818,000	12%	1,529,968,000	13%	1,421,056,000	15%	1,374,021,000	14%	925,816,000	11%	1,030,453,000	14%	7.58%
3	China, Hong Kong SAR	674,897,138	6%	693,621,708	6%	769,131,548	8%	711,525,400	7%	970,685,329	12%	998,294,957	14%	−7.53%
4	USA	574,320,141	5%	879,161,894	8%	959,753,005	10%	746,508,694	8%	675,592,946	8%	688,477,883	10%	−3.56%
5	Malaysia	553,774,838	5%	400,327,956	4%	331,654,962	4%	326,158,190	3%	158,781,973	2%	90,648,115	1%	43.61%
6	Mexico	538,520,919	5%	552,885,318	5%	528,100,771	6%	522,803,770	5%	501,821,072	6%	426,579,158	6%	4.77%
7	Rep. of Korea	476,896,550	4%	454,598,790	4%	573,935,894	6%	564,907,031	6%	425,562,688	5%	319,495,836	4%	8.34%
8	France	476,409,654	4%	439,154,526	4%	430,122,107	5%	437,467,039	4%	414,713,197	5%	382,934,061	5%	4.47%
9	Italy	419,716,186	4%	403,312,337	4%	381,547,057	4%	385,714,560	4%	354,244,681	4%	309,852,646	4%	6.26%
10	Hungary	411,010,000	3%	286,020,000	3%	264,117,000	3%	176,560,000	2%	125,473,000	2%	100,283,000	1%	32.59%
11	Slovenia	214,974,956	2%	235,450,302	2%	212,006,662	2%	202,805,905	2%	187,951,963	2%	157,603,262	2%	6.41%
12	Poland	214,881,513	2%	125,911,588	1%	113,196,457	1%	85,114,803	1%	66,259,000	1%	58,641,000	1%	29.66%
13	Belgium	195,403,455	2%	178,734,697	2%	170,205,279	2%	164,858,841	2%	140,002,909	2%	112,461,343	2%	11.68%
14	Spain	146,997,510	1%	195,301,753	2%	241,986,826	3%	229,430,275	2%	236,475,882	3%	195,192,048	3%	−5.51%
15	Czech Rep.	144,575,535	1%	113,866,940	1%	91,909,516	1%	70,932,312	1%	39,963,780	0%	33,964,051	0%	33.60%
	TOTAL	11,951,347,230	100%	11,361,598,909	100%	9,435,054,474	100%	9,856,857,537	100%	8,300,301,100	100%	7,211,978,364	100%	10.63%

Source: United Nations Commodity Trade Statistics Database.

companies. Widespread changes in production models were accompanied by a fundamental revision of logistics, purchasing practices, and investment structure. In some industries, product innovation, a distinguishing feature of many market players, gradually became less important than flexibility, variety of offered product categories, cost, and price level.

The domestic appliances and consumer electronics industries in the Far East were also undergoing relevant changes, presenting more specific triggers for Italian firms. The development of industrial networks and the start-up of many manufacturing companies at different stages of the value chain resulted in the availability of enormous production capacity and an array of product typologies and components. Daily relationships with Western clients increased the level of sophistication of production and stimulated the accumulation of new competencies in technology and product development. Worldwide, the Far East offered the cheapest local manufacturing costs relative to international competitors. As a result, there was unprecedented growth in the Far East's overall industrial production and export rate since the late 1990s. Table 16.1 shows export trade value in the period 2002–07 for small domestic appliances ("Electromechanical domestic appliances with self-contained electric motor," Code 7757-SITC REV.3, United Nations Commodity Trade Statistics Database). Today, China and Hong Kong represent 41 percent of global export while all other countries have an irrelevant market share. In the same table, important double-digit growth rates (cumulative average growth rate – CAGR) emerge for China, Malaysia, Hungary, Poland, and Czech Republic. The dominance of Low Cost Countries (LCCs) as main exporters is a confirmation of cost pressures that feature today's industry scenario. The main client for China is the USA with a 33 percent share of the total export trade value (see Table 16.2).

Facing adverse changes in the domestic markets, Italian firms made significant restructuring efforts. Sourcing from LCCs to reduce dependence on Italian production and suppliers was at the heart of firms' strategy. Some Italian firms also made attempts to strengthen their downstream strategies and to enter international markets to compensate declining domestic sales and to react to the worsening of the competitive scenario.

Following the example of their European peers and Italian importers, Italian manufacturers of small domestic appliances started exploring

Table 16.2 *Chinese export of electromechanical domestic appliances with self-contained electric motor (code 7757-sitc 3): first 3 partners*

Country	Trade value 2007	%	Trade value 2006	%	Trade value 2005	%	Trade value 2004	%	Trade value 2003	%	Trade value 2002	%	CAGR 02–07
USA	1,399,128,223	33%	1,161,637,700	33%	937,879,448	33%	763,688,189	32%	643,663,131	35%	493,331,576	37%	23.18%
Germany	343,317,892	8%	265,425,734	8%	270,092,043	10%	244,610,045	10%	162,430,546	9%	107,141,844	8%	26.23%
Japan	284,047,333	7%	276,112,545	8%	215,380,628	8%	202,540,945	8%	172,098,943	9%	104,550,002	8%	22.13%
Total export	4,228,457,433	100%	3,536,501,813	100%	2,836,983,303	100%	2,394,490,828	100%	1,840,573,468	100%	1,339,465,300	100%	25.85%

Source: United Nations Commodity Trade Statistics Database.

sourcing opportunities in such LCCs as China and Hong Kong. First, firms started experimenting with sourcing in LCCs by visiting the large trade fairs in Hong Kong and Canton once or twice a year. Italian operators had been returning to Italy with thousands of catalogues, price lists, and business cards as a basis for selection of potential sourcing partners. Later, sourcing from China became an obligatory choice for those products that were no longer produced in Europe or for products with a high labor content or whose technology was developed and exploited in China.

As a result, in 2007 Italy became the ninth largest importing country for domestic appliances (see Table 16.3) and China was the leading supplier with a share of 48 percent of the total import trade value (see Table 16.4), followed by Germany (26 percent) and France (10 percent). After a ten-year period of exploration, the nature of relationships between Italian companies and Chinese suppliers changed from a pure quantity–price negotiation to strong cooperation also in product design and development. Italian players had been making attempts to increase their level of control by frequent factory visits, introduction of different types of quality control (in-line, pre-shipment, on arrival), and creation of local branches. Given the average size of the firms, offshoring to unaffiliated (contract) parties was seen as the only viable option. Offshoring was gradually adopted not only for production activities but also for logistics, quality control, and product design and development. However, even though the majority of companies chose offshoring to unaffiliated companies, some specific overseas activities as suppliers' selection and negotiation, in-line quality control, and logistics management are usually performed by firms' local overseas branches which employ both local personnel and Italians.

Why did offshoring to unaffiliated (contract) parties become so popular for production activities? Interviews with industry opinion leaders (association of Italian producers of small domestic appliances) confirmed that often small and medium enterprises (SMEs) did not possess sufficient financial resources or were not eager to invest in remote locations that were perceived as particularly risky. FDI entry modes (starting from a preliminary joint venture with one or several local players) were mainly chosen by a few larger firms. Many firms still choose to produce in Italy some product categories with low labor content and low volumes that do not justify high transportation costs

Table 16.3 *Import of electromechanical domestic appliances with self-contained electric motor (code 7757-sitc 3): top 15 countries in 2007*

	Country	Trade value 2007	%	Trade value 2006	%	Trade value 2005	%	Trade value 2004	%	Trade value 2003	%	Trade value 2002	%	CAGR 02–07
1	USA	3,225,374,913	26%	3,186,004,787	27%	3,131,423,393	28%	2,868,816,666	28%	2,480,036,558	27%	1,993,772,446	26%	10.10%
2	Germany	925,388,000	7%	902,366,000	8%	969,793,000	9%	917,948,000	9%	741,093,000	8%	648,874,000	8%	7.36%
3	Japan	715,506,230	6%	692,742,703	6%	572,750,778	5%	499,354,175	5%	461,656,492	5%	380,910,114	5%	13.44%
4	United Kingdom	673,622,103	5%	690,060,177	6%	626,359,535	6%	672,534,826	6%	545,872,027	6%	448,934,448	6%	8.45%
5	France	620,904,327	5%	547,895,940	5%	516,767,717	5%	491,807,593	5%	416,907,696	5%	329,188,952	4%	13.53%
6	Russian Federation	505,512,307	4%	343,898,953	3%	272,426,863	2%	200,437,332	2%	130,868,569	1%	94,566,079	1%	39.83%
7	China, Hong Kong SAR	461,201,512	4%	525,789,255	4%	550,837,156	5%	543,127,106	5%	740,099,312	8%	793,758,393	10%	−10.29%
8	Canada	456,596,696	4%	400,472,805	3%	360,501,472	3%	315,928,647	3%	302,074,295	3%	282,415,809	4%	10.09%
9	Italy	413,410,139	3%	428,942,897	4%	407,673,273	4%	396,672,677	4%	354,965,914	4%	262,384,265	3%	9.52%
10	Spain	300,035,468	2%	299,314,436	3%	322,862,773	3%	271,620,597	3%	219,244,148	2%	212,640,656	3%	7.13%
11	Belgium	283,780,238	2%	284,305,187	2%	242,135,572	2%	232,120,980	2%	202,246,731	2%	163,516,966	2%	11.66%
12	Netherlands	257,021,359	2%	251,065,985	2%	248,052,190	2%	225,933,895	2%	225,393,982	2%	193,008,720	3%	5.90%
13	Australia	231,030,657	2%	214,346,476	2%	181,753,178	2%	170,530,130	2%	152,522,800	2%	126,606,352	2%	12.78%
14	Poland	221,656,445	2%	145,617,865	1%	116,638,358	1%	74,620,845	1%	61,488,000	1%	59,967,000	1%	29.88%
15	Sweden	215,489,820	2%	173,541,656	1%	154,424,428	1%	128,706,268	1%	104,429,503	1%	80,576,072	1%	21.74%
	TOTAL	12,444,318,228	100%	11,822,582,564	100%	11,309,139,309	100%	10,360,057,803	100%	9,089,431,159	100%	7,666,606,737	100%	10.17%

Source: United Nations Commodity Trade Statistics Database.

Table 16.4 *Italian import of electromechanical domestic appliances with self-contained electric motor (code 7757-sitc 3): first 3 partners*

Country	Trade value 07	%	Trade value 06	%	Trade value 05	%	Trade value 04	%	Trade value 03	%	Trade value 02	%	CAGR 02–07
China	200,091,814	48%	181,586,333	42%	159,650,022	39%	128,898,459	32%	88,048,736	25%	54,759,641	21%	29.58%
Germany	106,940,835	26%	128,900,471	30%	128,314,684	31%	136,391,900	34%	117,459,241	33%	97,188,372	37%	1.93%
France	41,596,943	10%	53,582,279	12%	52,180,200	13%	56,568,418	14%	61,706,216	17%	47,669,426	18%	−2.69%
Total import	413,410,139	100%	428,942,897	100%	407,673,273	100%	396,672,677	100%	354,965,914	100%	262,384,265	100%	9.52%

Source: United Nations Commodity Trade Statistics Database.

and long shipping times (around 75–90 days of transportation from China to Italy), unacceptable for modern distribution.

More recently, some benefits related to offshoring in China have weakened. Some factors have contributed to a 30 percent increase in purchasing costs: higher logistics and labor costs, change in workforce regulation, lower support of Chinese government to Western firms investing in China and to Chinese exporters, appreciation of HK dollar. As a consequence, some companies are evaluating: (1) in-sourcing of products with low labor content, large size products (that impact on transportation costs), and seasonal products (to be on time is a condition sine qua non); (2) moving to other countries like Turkey, Vietnam, or Albania. However, in these new areas the production activity is not so structured and organized as in China and the product variety is narrower.

Research questions

Concluding the description provided in the previous paragraphs, the following research questions (RQs) guided our investigation and the findings illustrated in this chapter: (1) Which driving factors, on the external and firm's levels, could explain the diffusion of offshoring to affiliates and to unaffiliated (contract) parties? (2) What kind of activities were delocalized over time by manufacturers? (3) How did the industry structure evolution impact the firms' high-value activities that were still performed in the home country?

In order to answer the above RQs, the remaining part of the chapter is structured as follows: as regards the first RQ, the next section discusses the drivers of decisions related to offshoring to affiliates and offshoring to unaffiliated (contract) parties. This will be followed by an exploration of the other two RQs.

Research design

Our statistical analysis showed that Italy was amongst the main importers of household appliances and that China is a leading exporter. So far, we have provided neither any interpretation of this phenomenon nor any analysis of the impact it had on the structure of the industry in Italy. To fill in details that cannot be addressed using only

quantitative data, our methodology is based on case studies (Eisenhardt, 1989, 1991; Gibbert *et al.*, 2008).

This study uses in-depth case studies from five Italian producers as the main data source to answer the above research questions. Our survey has been conducted between March 2008 and January 2009, with archival data being used to integrate information provided during interviews. The informants for this study's survey items are CEOs, Managing Directors, and purchasing managers.

Using mainly the definitions we mentioned earlier and referencing previous literature on the subject, we developed both a checklist for the qualitative interview and a survey questionnaire.

We organized a round table with three manufacturing companies, an importer, and a buyer from a large retailing chain to understand the competitive scenario (structure and dynamics) and the main related challenges. To gather preliminary information on the industry trends we were allowed to participate in an official meeting with the scientific committee of the national association of domestic appliance manufacturers (CECED Italia) with around 100 members (see Table 16.5) and asked their opinion and suggestions regarding clearness and appropriateness of the questions in the checklist and items in the questionnaire. We then revised the research document for data collection following the companies' feedback. The questionnaire was sent to all members of CECED Italia with a 25 percent response rate. Recording data for three years (1997, 2002, 2007), the questionnaire included the following sections: product portfolio, offshoring, international production, organizational structure to manage and supervise international activities, motivations for offshoring, results achieved with offshoring. The quantitative answers to the questionnaire provided a basis for the selection of case studies.

Amongst the manufacturers associated with CECED Italia, we selected five companies according to three selection criteria. In the first place, we focused on Italian manufacturing companies (the association includes also commercial subsidiaries of MNEs like Samsung and Bosch-Siemens). Second, we selected manufacturers that decided years ago to relocate some activities in remote locations (excluding delocalization and outsourcing in Europe) or that had been producing overseas since the start-up in 2006 (Company E). Lastly, we were obliged to consider companies that showed willingness to cooperate

Table 16.5 *List of CECED Italia members*

1	ADLER S.p.A.
2	AN CAMINI S.r.l.
3	ANGELO PO GRANDI CUCINE S.p.A.
4	ANTONIO MERLONI SPA
5	ARDES S.p.A.
6	ARGOCLIMA S.p.A.
7	ARIETE S.p.A.
8	ARO TUBI TRAFILERIE S.p.A.
9	BAXI S.p.A.
10	BEMATEC S.r.l.
11	BERTAZZONI S.p.A.
12	BERTO'S S.p.A.
13	BEST S.p.A.
14	BEZA S.r.l.
15	BRANDT ITALIA S.p.A.
16	BSD Srl
17	BSH ELETTRODOMESTICI S.p.A.
18	C.L.A.M. soc. coop. a.r.l.
19	CAMINETTI MONTEGRAPPA S.r.l.
20	CAMINI WIERER S.p.A.
21	CANDY HOOVER GROUP
22	CARRIER S.p.A.
23	CASTEL MAC S.p.A.
24	COLA S.r.l. – Gruppo Ferroli
25	COPRECI ITALIA S.r.l.
26	DAIKIN AIR CONDITIONING ITALY SpA
27	DE LONGHI APPLIANCES S.r.l.
28	DESMON S.r.l.
29	E.G.O. ITALIANA S.p.A.
30	ECR ITALY S.p.A.
31	ELECTROLUX ITALIA S.p.A.
32	ELECTROLUX PROFESSIONAL S.p.A.
33	ELETTROPLASTICA S.p.A.
34	ELFRAMO S.p.A.
35	ELICA S.p.A.
36	EUROTEC S.r.l.
37	EVEREL GROUP
38	EXPO INOX S.p.A.
39	FABER S.p.A.
40	FERROLI S.p.A.
41	FOINOX S.r.l.
42	FOX S.p.A. di R. Bompani & C.
43	FRANKE S.p.A.
44	FRIMONT S.p.A.
45	G.B.D. S.p.A.
46	GIRMI S.p.A.
47	GLEM GAS S.p.A.
48	GORENJE KORTING ITALIA S.r.l.
49	GROUPE SEB ITALIA S.p.A.
50	GRUPPO ALI
51	GRUPPO PIAZZETTA S.p.A.
52	HITACHI EUROPE SRL
53	IMMERGAS S.p.A.
54	INDESIT COMPANY S.p.A.
55	IRCA S.p.A.
56	ITW FASTEX
57	ITW ISPRA CONTROLS ACCENSIONE
58	ITW ISPRA CONTROLS ELETTRONICA
59	LG ELECTRONICS ITALIA S.p.A.
60	LIFE TOOL TECHNOLOGIES S.p.A.
61	LOFRA S.p.A.
62	MCZ S.p.A.
63	MERLONI TERMOSANITARI S.p.A.
64	MIELE ITALIA S.r.l.
65	MITSUBISHI ELECTRIC EUROPE B.V.

Table 16.5 *(cont.)*

66 MO.EL. S.r.l.	85 SAMSUNG Electronics Italia S.p.A.
67 MUSTER e DIKSON SERVICE SpA	86 SCHIEDEL S.r.l.
68 NARDI Elettrodomestici S.p.A.	87 SENSATA TECHNOLOGIES ITALIA S.r.l.
69 NILMA S.p.A.	88 SKF
70 O.L.S. S.r.l.	89 SMEG S.p.A
71 OFFICINE E SMALTERIE VICENTINE S.p.A.	90 SP.EL S.r.l. Spezia Elettrodomestici
72 OLIMPIA SPLENDID S.p.A.	91 TECNOWIND S.p.A.
73 PALAZZETTI LELIO S.p.A.	92 TENACTA GROUP S.p.A.
74 PANASONIC ITALIA S.p.A.	93 TERIM S.p.A.
75 PHILIPS S.p.A.	94 TERMOZETA S.p.A.
76 POLIEDRA S.r.l.	95 VAILLANT SUNIER DUVAL ITALIA S.p.A.
77 POLTI S.p.A.	96 VORTICE ELETTROSOCIALI S.p.A.
78 PROCTER & GAMBLE S.r.l.	97 VORWERK FOLLETTO S.r.l.
79 RIELLO S.p.A.	98 WHIRLPOOL EUROPE S.r.l.
80 ROBERT BOSCH S.p.A.	99 ZEPA S.p.A.
81 ROCCHEGGIANI S.P.A.	
82 SABAF S.p.A.	
83 SABIANA S.p.A.	
84 SAECO International Group S.p.A.	

Source: CECED Italy.

and to provide data for our research without any constraints. Using the above criteria, we settled on five manufacturing companies and analyzed their experience in offshoring to affiliates or to unaffiliated parties. All five cases are somewhat different in terms of year of foundation, product portfolio, company size, ownership structure, typology of clients, and organization of the vertical channel. The small sample therefore reflects the selection of multiple cases "suitable for illuminating and extending relationships and logic among constructs . . . chosen for the likelihood that they will offer theoretical insight" (Eisenhardt and Graebner, 2007: 27; Eisenhardt, 1991).

Company A was founded in 1964 in Tuscany. In 1995, it was acquired by a famous UK group and, then, in 2001 by an Italian competitor (also a member of CECED Italia). Export represents 60 percent

of total turnover. "A" is market leader in the segment of electronic cheese graters.

Company B was founded in 1957 in Lombardy for the fabrication of electrical engines and assembling of household appliances. In the following years, it introduced new product lines, still in the catalogue: heating systems, professional hairdryers, domestic appliances, vacuum cleaners, air purifiers. In 2000, "B" decided to acquire semi-finished products and components from around sixty Chinese manufacturers in order to be more competitive and flexible in Italy. There are around twenty-four clients and they participate actively in product development. Unlike the other case studies, "B" does not sell directly to retailers but to companies (e.g., manufacturers) that commercialize its products under their own brands.

Company C is a large group created in 1999 whose core business is domestic appliances sold in Italy with a well-known brand born in 1974 in Lombardy. This brand became famous with an innovative electric bed-warmer (leader in Europe in such a product category). "C" is Italian market leader in the segment of hairdryers. The group exports to UK, Germany, and the US.

Company D was founded in the mid-1950s in Lombardy and in 1992 was acquired by another Italian group operating in eighty countries. It exports around 16 percent of total sales in thirty countries (mainly in the EU). In 1997, "D" had an important cooperation with an MNE specialized in childcare based on a product (a baby's bottle warmer) that represented, for that year, around 20 percent of total turnover. "D" does offshore outsourcing mainly for personal care products and mini-fridges. Furthermore, components are bought for products assembled in Italy.

Company E was acquired in 2006 by a group established in the same year by a joint venture between an engineering company (belonging to a leading Italian group in major appliances with a turnover of around €4,000 million), leader in the transfer of technologies, and an Italian company with a world-class know-how and a leading brand in personal care products. The engineering company, with a turnover of around €60 million, has to date realized more than 100 production sites in twenty-five countries in the world. In particular, forty-two plants were realized in China, six of which were joint ventures with local partners. Following the acquisition, "E" was able to make use of the factory in the Far East built by the owning group in 2007. This

factory will be able to satisfy 100 percent production needs within the next two years. In the past, "E" relied on Chinese suppliers, but supervised the quality standards directly.

The composition of the product offering of the five companies is showed in Table 16.6. This table is organized by main product categories: small domestic appliances for the kitchen (e.g., mixers, blenders); house cleaning (e.g., vacuum cleaners, irons); personal care (e.g., hairdryers, razors); conditioning and heating systems, and other product items such as air purifiers, electromedical devices, mini-fridges, etc. For each category, we indicate the percentage of total turnover, specifying the area of production (Italy vs. foreign countries).

Table 16.7 presents a brief profile of the companies' structure and vertical channel organization. Lastly, Table 16.8 illustrates the economic profile of the analyzed companies. As regards Company "E", Table 16.8 reports the data for the controlling group. Before the acquisition, "E" achieved a turnover of 6,489,005 euro with ROA of 4.88 percent and ROE of 1.6 percent.

Of the five Italian firms in the sample, one (Company E) has combined offshoring to unaffiliated (contract) parties with offshoring to affiliates. The remaining four companies chose to offshore activities to unaffiliated parties.

During the interviews, we asked respondents to refer to the past ten years (if companies already had operations in 1998) as the time frame within which to answer questions regarding the evolution of the domestic appliances industry and the driving forces leading such a transformation of the competitive environment; the organization of the value-chain activities and the level of vertical integration; motivations of offshoring; "pros" and "cons" of offshoring; the dynamics in location decisions; the results achieved thanks to offshoring.

Why do firms localize value-chain activities internationally?

A theoretical explanation for offshoring is depicted in the following paragraph, followed by a brief discussion of the empirical evidence.

The traditional international business (IB) theory provides several motivations for international growth both on export markets and supplying markets. Firms choose to offshore their activities for similar reasons that they choose to internationalize. Any examination of the

Table 16.6 ***Product range by area of production (Italy vs. foreign countries): analysis of five cases from Italian small domestic appliances industry (% of total revenues, 1997–2002–2007)***

	Company A			*Company B*			*Company C*			*Company D*			*Company E*		
PRODUCT RANGE:	*Produced in Italy*	*Produced abroad*	*Total*	*Produced in Italy*	*Produced abroad*	*Total*	*Produced in Italy*	*Produced abroad*	*Total*	*Produced in Italy*	*Produced abroad*	*Total*	*Produced in Italy*	*Produced abroad*	*Total*
House cleaning appliances															
1997	35.0%	3.0%	38.0%	–	–	–	20.7%	2.3%	23%	–	–	–	–	–	–
2002	38.5%	3.1%	41.6%	–	–	–	23.1%	9.9%	33%	–	–	–	–	–	–
2007	1.8%	36.0%	37.8%	–	8.30%	8.3%	21.7%	9.3%	31%	–	–	–	–	–	–
Personal care appliances															
1997	–	1.0%	1.0%	–	–	–	27.0%	–	27.0%	–	–	–	–	–	–
2002	–	0.6%	0.6%	–	–	–	17.3%	1.9%	19.2%	–	13.0%	13.0%	98.0%	2.0%	100%
2007	0.4%	–	0.4%	–	22.7%	22.7%	29.6%	7.4%	37.0%	–	16.0%	16.0%	72.5%	6.0%	78.5%
Air conditioning/heating appliances															
1997	0.2%	–	0.2%	–	–	–	21.7%	9.3%	31%	–	–	–	–	–	–
2002	–	–		–	–	–	16.9%	13.95%	31%	–	–	–	–	–	–
2007	–	–		–	43.9%	43.9%	10.0%	10%	20%	25.1%	9%	34.0%	21.5%	0.0%	21.5%
Other domestic appliances															
1997	46.5%	6.0%	52.5%	–	–	–	19%	–	19%	55.0%	–	55.0%	–	–	–
2002	19.4%	33.1%	52.5%	–	–	–	17%	–	17%	35.5%	–	35.5%	–	–	–
2007	2.9%	46.5%	49.4%	–	3.8%	3.8%	12%	–	12%	19.5%	1.5%	21.0%	–	–	–
Other products															
1997	–	–	8.3%	–	–	–	–	–	–	45.0%	–	45.0%	–	–	–
2002	–	–	5.3%	–	–	–	–	–	–	51.5%	–	51.5%	–	–	–
2007	–	–	12.4%	–	21.2%	21.2%	–	–	–	23.0%	6.0%	29.0%	–	–	–

Source: company data.

Table 16.7 ***Structure and vertical channel organization: analysis of five cases from Italian small domestic appliances industry (1997–2002–2007)***

	Company A			*Company B*			*Company C*			*Company D*			*Company E*		
	1997	2002	2007	1997	2002	2007	1997	2002	2007	1997	2002	2007	1997	2002	2007
Workforce (total, no.): incl. workforce employed in:	64	73	67	23	14	25	70	93	127	3	17	25	–	7	13
Technical office and quality control (%)	8%	10%	9%	4%	21%	32%	2%	2%	2%	0%	12%	12%	–	14%	8%
Purchasing (%)	19%	19%	13%	4%	7%	8%	4%	3%	3%	33%	12%	16%	–	14%	23%
Product development (%)	28%	30%	30%	4%	7%	16%	10%	12%	15%	0%	12%	8%	–	14%	8%
Marketing and graphics (%)	9%	10%	12%	0%	0%	4%	10%	12%	15%	0%	6%	4%	–	14%	31%
Sales (%)*	17%	14%	19%	4%	7%	20%	9%	11%	11%	33%	24%	24%	–	29%	15%
Commercial dept. (%)	19%	18%	16%	4%	7%	20%	–	–	–	33%	35%	36%	–	14%	15%
Other employees, no.	97	161	44	80	52	20	130	139	149	36	35	49	–	6	11
Sales representatives, no.	21	21	21	0	0	0	31	36	33	13	17	24	–	17	27
Warehouse (m^2)	7.000	14.000	17.000	1.800	1.800	1.800	10.000	10.000	10.000	600	3.500	6.000	–	1.000	4.000
Product items, no.	630	815	950	60	58	66	200	250	300	15	95	170	–	75	120
Suppliers, no.	1.391	1.312	1.089	110	90	60	80	70	70	45	320	360	–	80	110
Italian clients, no.	n.a.	1.250	1.900	34	31	24	2300	2000	1700	400	900	1300	–	898	1979
Sales to organized ("modern") distribution, %	n.a.	41%	37%	n.a.	n.a.	n.a.	70%	75%	80%	5%	15%	22%	–	59%	37%
Clients belonging to organized ("modern") distribution, no.	n.a.	86	65	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5	12	18	–	186	516
Main 10 clients, % of sales	n.a.	30%	40%	n.a.	n.a.	90%	0,3	35%	40%	15%	20%	35%	–	40%	35%
Assistance centers, no.	255	260	267	1	1	1	300	300	300	0	70	160	–	0	1

Source: company data.

Table 16.8 *Analysis of five cases from Italian small domestic appliances industry: economic and financial data (2002–2007)*

COMPANY A	2007	2006	2005	2004	2003	2002
Turnover	84,947,844	93,356,703	96,811,944	118,590,262	113,906,669	119,984,402
EBITDA	6,194,612	6,011,326	6,319,672	14,274,006	14,745,166	15,485,643
ROS (%)	1.8	1.48	2.17	8.78	7.81	8
Net income	−3,972,236	−4,461,793	151,879	4,715,646	1,492,886	2,522,572
Total assets	83,132,981	82,723,985	88,705,776	67,976,495	61,460,332	62,543,934
Equity capital	25,230,504	29,202,744	33,664,538	18,552,651	13,836,998	13,194,125
ROA (%)	1.92	1.73	2.43	15.51	14.55	16
ROE (%)	−15.74	−15.28	0.45	25.42	10.79	19
Debt/equity ratio	0	0	0	0.01	0.06	0
Employees	111	127	143	152	144	234
COMPANY B						
Turnover	17,728,997	14,311,224	14,041,522	18,874,095	17,366,969	15,155,388
EBITDA	1,847,082	1,398,969	2,416,653	4,268,251	1,802,549	1,841,774
ROS (%)	7.37	5.64	13.14	16.52	3.03	7.32
Net income	492,988	440,533	945,905	2,198,428	155,092	964,955
Total assets	18,940,374	17,335,101	20,365,591	26,081,750	18,098,806	18,620,291
Equity capital	2,839,129	3,346,141	3,958,001	3,812,095	1,613,667	2,301,840
ROA (%)	6.92	4.67	9.09	11.97	2.92	5.96
ROE (%)	17.36	13.17	23.9	57.67	9.61	41.92
Debt/equity ratio	3.75	2.83	3.24	3.22	5.77	4.37
Employees	45	63	64	61	69	66
COMPANY C						
Turnover	132,296,000	111,252,000	102,457,000	101,360,000	91,376	–
EBITDA	16,102,000	13,943,000	16,734,000	16,201,000	10,252	–
ROS (%)	9.54	9.68	13.11	12.81	7.02	–
Net income	5,434,000	5,271,000	2,833,000	1,051,000	−381	–
Total assets	86,297,000	74,930,000	75,105,000	79,726,000	82,438	–
Equity capital	32,181,000	29,722,000	26,466,000	23,848,000	22,814	–
ROA (%)	14.92	14.61	18.18	16.51	7.93	–
ROE (%)	16.89	17.73	10.7	4.41	−1.67	–
Debt/equity ratio	0.47	0.52	0.88	1.26	1.61	–
Employees	283	259	259	276	276	–
COMPANY D						
Turnover	12,572,037	11,716,784	10,792,528	9,380,428	11,715,047	11,504,662
EBITDA	714,671	533,687	434,741	509,206	840,991	1,389,989
ROS (%)	3.4	2.02	0.9	1.8	4.12	8.59
Net income	107,659	−53,102	−190,529	−311,729	−54,472	472,225
Total assets	18,997,259	14,632,822	14,251,883	13,151,248	13,958,218	15,142,156
Equity capital	873,563	765,903	819,004	1,009,534	1,321,262	1,375,735
ROA (%)	2.3	1.64	0.69	1.31	3.52	7.02
ROE (%)	12.32	−6.93	−23.26	−30.88	−4.12	34.33
Debt/equity ratio	9.03	7.94	7.63	4.96	3.56	4.51
Employees	74	68	71	71	70	52
COMPANY E						
Turnover	26,234,355	14,546,718	–	–	–	–
EBITDA	1,503,810	690,997	–	–	–	–
ROS (%)	4.14	3.2	–	–	–	–
Net income	−399,066	−179,051	–	–	–	–
Total assets	28,286,988	20,263,220	–	–	–	–
Equity capital	2,643,119	3,042,184	–	–	–	–
ROA (%)	4.03	2.35	–	–	–	–
ROE (%)	−15.1	−5.89	–	–	–	–
Debt/equity ratio	6.23	4.26	–	–	–	–
Employees	24	29	–	–	–	–

Source: AIDA database.

drivers of offshoring is incomplete without starting from such a general framework.

There is an extensive body of literature dealing with the determinants of internationalization. Among these determinants, we report the following: to diversify risk, to tap the world market for goods and services, to respond to increased foreign competition, to reduce costs, to overcome protective devices (e.g., tariff barriers), and to take advantage of technological expertise (Rugman and Collinson, 2006). Also, internal market saturation could boost internationalization. As we see, some of the drivers go beyond the characteristics of the firm and the industry in which a company operates: differences in factor markets, tax and legal system, and financial market. This set of motivations could be enriched with strategic objectives consistent with the firm's growth strategy. It implies that firms expand abroad to increase their size (as measured as value of turnover and number of employees) and to improve their capabilities. Through the internationalization process, firms try to successfully combine firm-specific advantages (as defined as unique capabilities built on product, process technology, marketing, etc.) with country-specific advantages (based on natural resource endowment, labor force, or cultural factors; Ohlin, 1933).

As far as international production is concerned, Dunning (1981, 1988, 1998) suggests that possibilities to obtain ownership, location, and internalization (i.e., "OLI triad") advantages determine FDI and MNE choices. The extent to which the factors endowment is rich, transportation, production, and communication costs are low, and the degree of industrialization is high, will make a *location* attractive for foreign firms. The changing nature and importance of external economies has been set out in Krugman (1991) and Dunning (1998). Similarly, *ownership*-specific parameters (i.e., firm-specific) such as age, size, and strategy may stimulate companies to go abroad and to make internationalization more viable. Over the second half of the nineties, authors' approach to this subject has undergone considerable change. One group of scholars (typified particularly by Vernon, 1966) focused on the location variables; while a second strand concentrated on the ways in which foreign firms exploit their set of resources and competencies globally (Caves, 1982, 1996). Earlier in this chapter, we suggested that changes in the delocalization pattern ("what and where") of small domestic appliances firms have been similar to those of most firms, which could mean that the firm-specific variables

are less relevant in explaining the changes that have occurred in the industry.

Once a firm decides to match its competitive advantage with the comparative or competitive advantage of a foreign location, it has to face the *internalization* dilemma: offshoring to affiliates or offshoring to unaffiliated (contract) parties? Any theory of internationalization must then take account of how direct production may result in a different value-added and cost profile than that which would arise if production were carried out by local firms. Essentially, the firm will decide for direct operation or to rely on foreign suppliers according to a transaction cost analysis: in the case of market failure, FDI is more convenient. In particular, the firm is not incentivized to directly invest in a foreign market if the ownership-specific advantages are not sufficient to compensate for additional (compared to incumbent firms) costs and the effort of setting up and operating a foreign subsidiary (the so-called "liability of foreignness"). Dunning (1998: 53) also acknowledges some motivations that make transaction cost lower and FDI much easier: (1) the liberalization of cross-border markets; (2) the rootedness of affiliates in host economies; (3) the shift of location needs from those to do with natural resources, lower labor cost, and access to markets to those to do with access to knowledge and learning; (4) the decisive role of the physical and human infrastructure and institutional framework of the host country.

Although the outsourcing literature acknowledges that transaction cost economics (TCE) provides an exhaustive explanation of make-or-buy decisions, also in foreign locations, most studies in IB have analyzed the internalization of foreign operation by looking at the overall internationalization process. The direct control of delocalized activities is the last stage in the firm's involvement in a specific national market (Johanson and Vahlne, 1990; Johanson and Wiedersheim-Paul, 1975).

Following these general observations, the analysis of the specific driving forces for offshoring is recently beginning to catch the attention of IB researchers. More specifically, Jahns *et al.* (2006) differentiate between (1) environmental driving forces, and (2) company-level driving forces.

The former set of forces includes economic factors (e.g., wage differentials, interest rates), political-legal conditions (e.g., taxation and competition laws, trade barriers), socio-demographic driving forces

(e.g., population size, age structure, education levels); and technological drivers (e.g., transportation technologies, telecommunications). Although all decisions are strictly interconnected, this first set of drivers may have a greater influence on the decision about "where" to relocate a value chain activity (i.e., country selection).

The latter set of forces refers to three fundamental theories: transaction cost theory, the resource-based view, and the market-based view of the firm.

Transaction cost economics (Williamson, 1979) is used here in reference to "*how*" to relocate activities across borders, that is, whether the activity carried out across borders has to be kept under the MNE's legal control or to be outsourced to foreign suppliers. As in the home country, if the *ex-ante* and *ex-post* transaction costs and the purchasing costs are higher than the costs for internal production and the costs of internal coordination, to "make" is the best option. Building on arguments presented by the resource-based view (RBV) of the firm, it is possible to contend that through offshoring MNEs may, from one side, exploit their unique capabilities in other countries and, from the other, fill a competencies gap. This argument indicates that RBV supports the offshoring decisions in terms of "*whether*" and "*what*."

Finally, according to the market-based view, locations chosen for offshoring of some business activities today might also represent attractive customer markets tomorrow.

In incorporating all these previous contributions into our thinking, we were able to offer an explanation of the international allocation of economic activity. More specifically, we elaborated a framework for identifying and discussing the driving forces of offshoring, depicted in Table 16.9.

Indeed, to draw any conclusions about the relative impact of drivers on offshoring we must disentangle the effects on operative and strategic performance from external motivations, generation of business opportunities, and acquisition of new resources and competencies.

Motivation of offshoring to affiliates or to unaffiliated (contract) parties: empirical evidence

In this section, we revisit the empirical results using both questionnaires and interviews. As we reported, companies tend to assign to offshoring multiple objectives expressing high (and equal) importance

Table 16.9 ***Survey on driving forces of offshoring: analysis of five cases from Italian small domestic appliances industry***

	1	2	3	4	5
EXTERNAL					
To face competitive pressures					
To imitate competitors					
INTERNAL					
To improve economic and competitive performance					
– Increase of operating profitability					
– Cost savings					
– Increase of turnover					
– Reduction of financial needs (due to fixed costs)					
– Customer loyalty					
– Increase of market share					
To improve efficiency of key processes					
– Greater production capacity					
– Market responsiveness					
– Shifting management focus towards other tasks					
– Better quality					
– Higher flexibility					
– Faster order processing					
To get access to new competencies and to generate business opportunities					
– Skilled labor					
– New competencies					
– New markets					
– Larger product/service offer					
– Gaining access to new vertical channels					

Note: 1 ("not important") – 5 ("very important")

to many factors (in particular, Company E). However, both sets of data confirm the relevance of the cost minimization driver. All companies, without any exception, indicate "cost savings" as the primary factor explaining offshoring activities. Overall, they find that improvement of economic performance is the key driver, followed by external stimuli. Amongst the external circumstances, competitive pressures are considered much more important than imitation of competitors. Amongst

competitive pressures, the increasing bargaining power of retailers is referred as the more important driving force: "in Italy, a radical change in retailing has occurred in the last ten years, moving from a fragmented and traditional structure to an organized and specialised one, with an increasing bargaining power" (CEO, Company A). In light of the theoretical and empirical concerns raised above, we argue that offshoring decisions were driven mainly by tactical thinking rather than strategic reasoning. The acquisition of new competencies and access to new end markets are considered almost unimportant: "why should a Chinese consumer buy an Italian product made in China? China is by now considered as the specialised location for domestic appliances and consumer electronics. We do not have competitive advantage there nor a strong brand to justify local sale. Furthermore, cultural distance still matters. Maybe the only product Italian companies could sell in the Far East is a coffee machine, but it is a niche" (CEO, Company D).

However, these empirical findings are inconsistent with the criteria used for suppliers' selection (as revealed by our respondents) based more on experience and competencies than on costs: the competence-based approach is still diffused although offshoring practices started twenty years ago.

Finally, we consider the results companies achieved (as they declared) with offshoring. These include the widening of product offering and the increase of turnover and operating profitability at least until 2003. Still, recent economic data show that all firms have been affected by a worsening of operating and net profitability. Our research identified a number of factors in the five firms that partly account for their declining performance. In particular, the underlying tactical perspective on offshoring has tended to underestimate the complexities and costs of developing buying relations in remote locations privileging cost savings over other factors like innovation capabilities and reliability. Such an approach caused lowering of product quality, increase of organizational complexity, increase of returned products from clients, and in-shoring (e.g., hairdryer production for Company A) as documented in our field analysis. "The entire company must speak English, at least. This is a cultural change for a small company. Due to the different time zones, we should have flexible office hours. Complexity concerns especially logistics and production planning. From a certain point of view we have loosened flexibility because we interact with factories 6,000 km apart" (CEO, Company A).

"Competencies of purchasing departments have changed; besides order management, it is necessary to be professional in selecting and negotiating with suppliers" (Marketing Manager, Company C).

Vertical disintegration of the value chain and its impact on high-value activities

The spatial allocation of firms' value chains has been extensively analysed by a number of international business scholars (Africano and Magalhaes, 2005; Bartlett and Ghoshal 1998; Buckley and Casson, 1993; Diaz-Alejadro, 1977; Dunning, 1995; Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975; Kogut, 1985; Levitt, 1983; Nigh *et al.*, 1986; O'Brien, 1980). By contrast, few studies were dedicated to the *allocation* of value-chain activities among firms in the international context and to the dynamic analysis of the spatial allocation of value chains. The analysis of five Italian domestic appliances firms conducted in the period of the industry transformation enriches our understanding of the multiplicity of firms' reactions to the changes in the global external context and of the large range of firms' decisions regarding the spatial allocation of their activities in an international context.

We used Porter's (1985) value-chain framework to represent a spatial map of firms' activities and to detect the evolution of industry vertical disintegration (Jacobides, 2005). Preliminary interviews allowed us to disentangle activities aggregates as follows: (a) "operations" activities were split into production of components, moulding, painting, assembly, graphics, packaging, and quality control activities; (b) outbound logistics were analysed as logistics from the company to the clients and management of warehouses; (c) technology development was split into research, design, development, and prototyping and engineering activities; (d) procurement function was considered separately for moulds production and other suppliers' management. In order to find empirical evidence on the last two research questions ("what kind of activities were delocalized over time by manufacturers?" and "how did the industry structure modify?"), the interviewed firms were asked to identify activities that were outsourced in Italy or abroad in 1997, 2002, and 2007. Comparison among the five cases allowed us also to define how firms reacted to the increasing maturity of the industry with the growing importance of price

competition, increase in private brands, falling prices, and profitability (Porter, 1980). The activity mapping illustrated whether firms chose similar vertical strategies or they decided reactively and imitated one another (Kim and Mauborgne, 1999).

For the simplicity of representation, the results of empirical analysis of five cases are shown in two separate tables: Table 16.10 for firms' primary activities and Table 16.11 for firms' support activities.

The interviews showed that three companies out of five at the end of 2007 outsourced to foreign suppliers the production of components, whereas one company (Company D) that had been working with Italian and foreign suppliers decided to withdraw from contracts with foreign producers of components and in 2007 had been working primarily with Italian suppliers. One interviewed company (Company A) maintained the production of components internally.

Molding, painting, and assembly activities by the end of 2007 were outsourced to foreign suppliers by four companies out of five. Whereas Company D, by 2007, had decided, in the case of components production, to rely on Italian suppliers and, moreover, to maintain assembly activities internally. Most companies outsourced inbound and outbound logistics, whereas three companies out of five decided to outsource also management of warehouses in Italy.

Graphical design and packaging of finished products were outsourced mainly to specialized Italian suppliers, whereas very few companies decided to outsource quality control – an activity that was declared as one of the most crucial.

In general, the activities analysis showed that most companies decided to offshore to unaffiliated companies (mainly located in Asia) most production activities along with inbound and outbound logistics. Some high-value specialized activities, such as graphical design and packaging, were either maintained within firm boundaries or outsourced in the home country (Italy). While most companies declared that the decision to offshore production activities was caused by the necessity to implement cost-reduction strategy, the low degree of required coordination with other activities allowed companies to use foreign suppliers to outsource those activities.

Few companies, on the other hand, decided to externalize quality control, considered to be one of the most important activities. Out of five cases, Company D stood alone in its decision to produce in

Table 16.10 *Analysis of five cases from Italian small domestic appliances industry: outsourcing of primary activities (x = activity was fully outsourced; x (p) = activity was partially outsourced); location ("Italy" or "abroad") indicates the location of external contract provider of outsourced activities)*

		Location	Production of components	Molding	Painting	Assembly	Logistics from supplier to the company	Logistics from the company to the client	Warehouses	Graphics	Packaging	Quality control in Italy	Quality control abroad	Sales back-office
Company A	1997	Italy		X	X	X		X	X	X				
		Abroad												
	2002	Italy		X	X	X		X	X	X				
		Abroad		X	X	X							X(P)	
	2007	Italy						X	X	X				
		Abroad		X	X	X							X(P)	
Company B	1997	Italy					X	X						
		Abroad					X	X						
	2002	Italy					X	X						
		Abroad					X	X						
	2007	Italy				X	X	X			X			
		Abroad	X	X	X	X	X	X			X			
Company C	1997	Italy	X	X	X	X					X			
		Abroad												
	2002	Italy					X	X	X					
		Abroad	X	X	X	X					X			
	2007	Italy					X	X	X					
		Abroad	X	X	X	X					X		X	

(*cont.*)

Table 16.10 *(cont.)*

		Location	Production of components	Molding	Painting	Assembly	Logistics from supplier to the company	Logistics from the company to the client	Warehouses	Graphics	Packaging	Quality control in Italy	Quality control abroad	Sales back-office
Company D	1997	Italy	X	X	X		X	X		X	X			
		Abroad											X	
	2002	Italy	X	X	X		X	X		X	X			
		Abroad	X				X							
	2007	Italy	X	X	X		X	X		X	X			
		Abroad												
Company E	1997	Italy												
		Abroad												
	2002	Italy					X		X	X	X	X		X
		Abroad	X	X	X	X	X						X	
	2007	Italy					X		X	X	X	X		X
		Abroad	X	X	X	X							X(N)	

Source: company data and interviews.

Table 16.11 *Analysis of five cases from Italian small domestic appliances industry: outsourcing of support activities (x = activity was fully outsourced, x (p) = activity was partially outsourced); location ("Italy" or "abroad") indicates the location of external contract provider of outsourced activities)*

		Location	Research	Design	Development	Prototyping	Engineering	Production of molds	Selection and management of suppliers	Accounting	Finance	IT	HR management	Training
Company A	1997	Italy				X (P)		X						
		Abroad												
	2002	Italy				X (P)		X						
		Abroad						X	X (P)					
	2007	Italy				X (P)								
		Abroad						X	X (P)					
Company B	1997	Italy												
		Abroad												
	2002	Italy												
		Abroad						X(P)						
	2007	Italy												
		Abroad						X						
Company C	1997	Italy						X						
		Abroad												
	2002	Italy												
		Abroad						X						
	2007	Italy												
		Abroad						X						

(*cont.*)

Table 16.11 *(cont.)*

		Location	Research	Design	Development	Prototyping	Engineering	Production of molds	Selection and management of suppliers	Accounting	Finance	IT	HR management	Training
Company D	1997	Italy						X						
		Abroad												
	2002	Italy							X					
		Abroad												
	2007	Italy						X						
		Abroad						X						
Company E	1997	Italy												
		Abroad												
	2002	Italy						X	X	X	X	X	X	
		Abroad	X	X	X	X	X	X						
	2007	Italy	X	X					X	X	X	X	X	X
		Abroad	X	X		X	X	X						

Source: company data and interviews.

Italy (performing production activities internally or relying on Italian suppliers).

Most of the five companies maintained support activities that provided primary activities with most important inputs in the home country (Italy) only with several exceptions. Among support activities, research, design, and development were still considered by firms as the main value-adding activities. During interviews, firms were asked to define the concept of a "high-value" activity: most firms suggested that they consider an activity to add high value to the product if it allows the firm to differentiate itself from other competitors. Such a definition is very close to the classical definition of the value-added as a difference between sales revenues and costs (Grant, 2002): differentiating opportunities in terms of design, technical characteristics, and product quality may create additional revenue flows. Most firms used R&D, the selection of foreign suppliers, and quality checks as examples of the main value-adding activities, therefore justifying the choice to perform them internally.

Production of molds was outsourced initially in the home country (Italy) and later offshored to foreign (mainly Asian) suppliers by most of the companies interviewed. Company A had been partly outsourcing prototyping to Italian suppliers. During interviews, only the managers of Company E declared that since 2002 the company outsourced in Italy or offshored to unaffiliated companies its research, design, and development activities. In 2002, the firm also decided to offshore prototyping and engineering activities along with the production of molds. Since 2002, Company E had also been outsourcing most of the firm's infrastructure activities, such as accounting and finance, HR management and IT, to Italian suppliers.

Nevertheless, many support activities were considered by interviewed companies as the main contributors to the value-creation process and therefore were maintained inside the firm.

The dynamics of the delocalization of primary and support activities lead us to the following conclusions:

- Most producers of domestic appliances after 2002 had been drastically reducing activities performed inside the company and had been increasingly using outsourcing of main production activities to Asian and, in some cases, to Italian suppliers.

- Most outsourcing and offshoring decisions were taken by companies in the second half of the past decade (between 2002 and 2007).
- According to interviews, most outsourced activities were transferred to Asian suppliers (in fact, companies started accumulating significant capabilities of suppliers' selection and management); Italian suppliers managed to obtain outsourcing contracts for some activities that require high specialization (graphical design, prototyping, etc.) or strict interaction with other company activities (logistics, management of warehouses).
- Most companies intend to maintain research, design, development, prototyping, and engineering activities inside the company in Italy; however, the companies' decisions to outsource and to offshore most of their production functions may lead to the diminishing importance of those high-value activities as R&D can be expected to be gradually transferred "closer" to the production function, i.e., outside of companies.
- The quality control function in most cases remained inside companies and only a few companies declared the intention to use occasional external suppliers of quality control services (Company C declared that it used external controllers of quality mainly in the event of overcapacity during the "high season").

One of the most important questions facing most of the companies interviewed concerns the role of such high-value activities as research, design, and development. The overall value of R&D activities, separated by offshoring from production activities, is declining: many firms admit that R&D activities are reduced to suggestions on products' aesthetics to external suppliers. According to interviews with other companies, should the tendency to offshore the assembly function to non-affiliated suppliers continue, most companies would be forced to drastically reduce R&D activities performed in-house and to become importing companies that rely on Asian producers not only for assembly functions, but also for all research, design, and development activities.

According to the Marketing Manager of Company C, most industry players since the mid-1990s promote products as commodities, emphasising low prices and without dedicating due attention to products' performance and functionalities. The marketing manager of Company C suggested that it would be extremely important for the company to

maintain R&D and design and marketing activities in order to protect the firm's know-how and to be able to possess some differentiating capabilities.

The extensive use of offshoring to unaffiliated (contract) parties or to affiliates by the interviewed firms confirmed the structural changes in the industry structure (Invernizzi, 2004). Firms' strategies that rely extensively on external collaboration are not new to Italy (Lorenzoni and Lipparini, 1999). In an evolved global context, a firm's capabilities to benefit (and to coordinate such benefits) from differences among countries in terms of costs and market opportunities is crucial for its profitability (Kogut, 1984). Still, firms, unable to compete effectively on cost or to create a premium differentiating product, "follow the herd" and outsource some vital functions in the attempt to transfer risks (Grant, 2002) or to become more efficient (Puryear and Detrick, 2006). Diffusion of imitative strategies regarding offshoring to unaffiliated contractors (Kim and Mauborgne, 1999) may lead to the vertical disintegration of the industry. Statistical data on import and export, firms' financial reporting, and results of conducted interviews suggest that production activities in the small domestic appliances industry in Italy are becoming less and less important (with several exceptions), and that firms tend to adopt similar vertical structures (R&D, outbound logistics, and marketing in Italy, with most remaining activities offshored or outsourced). Firms try to differentiate from competitors by maintaining some R&D activities in Italy.

However, with assembly activities transferred to unaffiliated offshore companies, the results of R&D activities were also partly transferred outside of the firm as the quality of research, design, and development activities was negatively impacted by the artificial separation from the production floor. Moreover, the results of R&D activities had inadvertently been becoming indirectly (and legally or illegally) available to third parties. Offshoring strategies therefore resulted in the inability of former manufacturers to retain the proprietary advantages obtained through investments in R&D, and in the commoditization of final products that were no longer differentiated in the eyes of the final consumer. Imitative strategies and commoditization lead to price wars that inevitably result in falling prices and profits and in the redistribution of market share towards firms that are more competitive in terms of costs (Grant, 2002).

Conclusions

This study represents an exploratory research study. It is aimed at outlining an integrated framework that would allow one to explain decisions to offshore a firm's activities to unaffiliated (contract) parties or to affiliates. We seek to assess motivating factors (driving forces) for offshoring and trace the impact of offshoring on the structural evolution of an industry. Offshoring is an intensive and accelerated form of globalization that will have far-reaching effects on industry structures and organization of work. One contribution of this chapter was to portray five examples of Italian domestic appliances producers, and their key motivating factors for offshoring decisions, to detect shifts in the industry's structure, and to assess the possible impact of offshoring decisions on firms' high-value activities and possibilities to differentiate.

We saw how changes in the global scenario have been influencing decisions about location and control of some value-chain activities. Particular attention was devoted to the determinants of delocalization and motivations of offshoring. Over a six-year period (2002–07) most of the five analyzed firms decided to offshore some of their business activities, in particular the production function. Second, cost pressure, in particular from consolidated distribution channels, was still a key motivating factor for offshoring. Third, we analyzed which activities were offshored: the five domestic appliances producers tended to offshore activities that were considered as low-value, non-core, or non-specialist, or activities that would benefit from scale and scope economies or labor cost savings. However, interviewed managers admitted that offshoring low-value activities started having negative influences on the firms' abilities to perform or to appropriate the results of some high-value activities, for instance research and development and on the firms' ability to differentiate themselves from competitors.

What are the implications of our study for future academic research? First, to return to the theoretical debate mentioned in previous paragraphs, we believe that more attention has to be given to imitative offshoring strategies and the impact they had on the evolution of industry structures tending towards maturity (price competition, declining profitability) and decline.

Despite the recent explosion of offshoring research, there are still many unanswered questions: is the increasing localization of labor-intensive activities from developed to developing countries inexorable? What will be the impact on some of the larger offshoring destinations (e.g., China) or up-and-coming countries (Vietnam)? How might recession affect the pace and composition of offshoring?

Our study has several limitations that can be improved with further research. We analyzed only a small sample of firms belonging to the same industry. A follow-up survey, to be conducted in 3–4 years with the same firms, would also allow us to further analyze the evolution of firms' outsourcing and offshoring decisions and their possible longer-term impact on industry structure and profitability.

In terms of managerial implications, we suggest that firms should carefully analyze the long-term impact of mimetic offshoring strategies on an industry's ability to perform high-value activities, develop proprietary capabilities, face increasing price-based competition that leads to the erosion of industry profitability, and to the reduction of differentiation across firms in the sector.

References

Africano, A.P. and Magalhaes, M. 2005. "FDI and trade in Portugal," Working Papers (FEP) Universidade do Porto Apr. 64: 1–25.

Bartlett, C.A. and Ghoshal, S. 1998. *Managing Across Borders: The Transnational Solution*. 2nd edn. Boston: Harvard Business School Press.

2000. "Going global: lessons from late movers," *Harvard Business Review* Mar.–Apr.: 132–42.

Buckley, P.J. and Casson, M. 1993. "A theory of international operations," in P.J. Buckley and P. Ghauri (eds.), *The Internationalization of the Firm*. London: Dryden Press, pp. 45–50.

Cantwell, J.A. 1995. "The globalisation of technology: what remains of the product cycle model?" *Cambridge Journal of Economics* 19(1): 155–74.

Caves, R. 2007. *Multinational Enterprise and Economic Analysis*. 3rd edn. Cambridge University Press.

Davies, P. 2004. *What's this India Business? Offshoring, Outsourcing, and the Global Services Revolution*. London: Nicholas Brealey Publishing.

Diaz-Alejardro, C.F. 1977. "Foreign direct investment by Latin Americans," in T. Agmon and C.P. Kindleberger (eds.), *Multinationals from Small Countries*. Cambridge, MA: MIT Press, pp. 167–95.

Doz, Y. 1986. *Strategic Management in Multinational Companies*. Oxford: Pergamon Press.

Dunning, J.H. 1981. *International Production and the Multinational Enterprise*. London: Allen and Unwin.

1988. "The eclectic paradigm of international production: a restatement and some possible extensions," *Journal of International Business Studies* 19(1): 1–31.

1995. "Reappraising the eclectic paradigm in the age of alliance capitalism," *Journal of International Business Studies* 26: 461–91.

1996. "The geographical sources of the competitiveness of firms: some results of a new survey," *Transnational Corporations* 5: 1–29.

1998a. "Location and the multinational enterprise: a neglected factor?" *Journal of International Business Studies* 29(1): 45–66.

1998b. "The changing geography of foreign direct investment," in N. Kumar (ed.), *Internationalization, Foreign Direct Investment and Technology Transfer: Impact and Prospects for Developing Countries*. London and New York: Routledge, pp. 43–89.

(ed). 2000. *Regions, Globalization and the Knowledge-based Economy*. Oxford University Press.

Eisenhardt, K.M. 1989. "Building theories from case study research," *Academy of Management Review* 14(4): 532–50.

1991. "Better stories and better constructs: the cases for rigor and comparative logic," *Academy of Management Review* 16(30): 620–27.

Eisenhardt, K.M. and Graebner, M.E. 2007. "Theory building from cases: opportunities and challenges," *Academy of Management Review* 50(1): 25–32.

Gibbert, M., Ruigrok, W., and Wicki, B. 2008. "What passes as a rigorous case study?" *Strategic Management Journal* 29: 1465–74.

Giunipero, L.C. and Monczka, R.M. 1997. "Organizational approaches to managing international sourcing," *International Journal of Physical Distribution and Logistics Management* 27: 321–36.

Grant, R.M. 2002. *Contemporary Strategy Analysis: Concepts, Techniques, Applications*. Massachusetts: Blackwell Business.

Invernizzi, C. 2004. *Strategia e politica aziendale: testi*. Milan: McGraw-Hill.

Jacobides, M.G. 2005. "Industry change through vertical disintegration: how and why markets emerged in mortgage banking," *Academy of Management Journal* 48(3): 465–98.

Jahns, C., Hartmann, E., and Bals, L. 2006. "Offshoring: dimensions and diffusion of a new business concept," *Journal of Purchasing and Supply Management* 12: 218–31.

Johanson, J. and Vahlne, J.-E. 1977. "The internationalization process of the firm: a model of knowledge development and increasing foreign commitment," *Journal of International Business Studies* 8: 22–32.

1990. "The mechanism of internationalization," *International Marketing Review* 7: 11–24.

Johanson, J. and Wiedersheim-Paul, E. 1975. "The internationalization of the firm – four Swedish cases," *Journal of Management Studies* 12: 305–22.

Kim, W.C. and Mauborgne, R. 1999. "Strategy, value innovation and the knowledge economy," *Sloan Management Review* 3: 41–55.

Klingebiel, N. 2005. "Kostentransparenz bei offshoring-Projekten," *Zeitschrift für Controlling* 17: 637–44.

Kogut, B. 1984. "Normative observations on the international value-added chain and strategic groups," *Journal of International Business Studies* 2: 151–67.

1985. "Designing global strategies: comparative and competitive value-added chains," *Sloan Management Review* 26(4): 15–28.

Krugman, P. 1991. *Geography and Trade*. Cambridge, MA: MIT Press.

Levitt, T. 1983. "The globalization of markets," *Harvard Business Review* 61(3): 92–102.

Lorenzoni, G. and Lipparini, A. 1999. "The leveraging of interfirm relationships as distinctive organizational capabilities: a longitudinal study," *Strategic Management Journal* 20: 317–38.

Monczka, R.M., Markham, W.J., Carter, J.R., Blascovich, J.D., and Slaight, T.H. 2005. *Outsourcing Strategically for Sustainable Competitive Advantage*. CAPS Research Report: 1–99.

Monczka, R.M., Trent, R.J., and Petersen, K.J. 2008. "Getting on track to better global sourcing," *Supply Chain Management Review* 12(2): 46–53.

Mudambi, R. and Venzin, M. 2008. "Location, control and value creation," Paper presented at *Offshoring and Outsourcing: The Organizational and Geographical Relocation of High-Value Company Functions* conference, April 23–24, SDA Bocconi School of Management, Milan.

Nigh, D., Cho, K.R., and Krishman, S. 1986. "The role of location-related factors in US banking involvement abroad: an empirical examination," *Journal of International Business Studies* 17: 59–72.

O'Brien, P. 1980. "The new multinationals: developing country firms in international markets," *Futures* 12: 303–16.

Ohlin, B. 1933. *Inter-regional and International Trade*. Cambridge, MA: Harvard University Press.

Pfannenstein, L. and Tsai, R. 2004. "Offshore outsourcing: current and future effects on American IT industry," *Information Systems Management* 21(4): 72–80.

Porter, M.E. 1980. *Competitive Strategy: Techniques for Analysing Industries and Competitors*. New York: The Free Press.

1985. *Competitive Advantage*. New York: The Free Press.

Puryear, R. and Detrick, C. 2006. "Are you sending your problems offshore?" *Harvard Management Update* 11(2): 3–5.

Robinson, M. and Kalakota, R. 2004. *Offshore Outsourcing-Business Models, ROI and Best Practices*. 2nd edn. Alpharetta: Mivar Press.

Rugman, A.M. and Collinson, S. 2006. *International Business*. 4th edn. Essex: Prentice Hall.

Vernon, R. 1966. "International trade and international investment in the product life cycle," *Quarterly Journal of Economics* 80(5): 190–207.

Williamson, O. 1979. "Transaction cost economics: the governance of contractual relations," *Journal of Law and Economics* 22: 233–59.