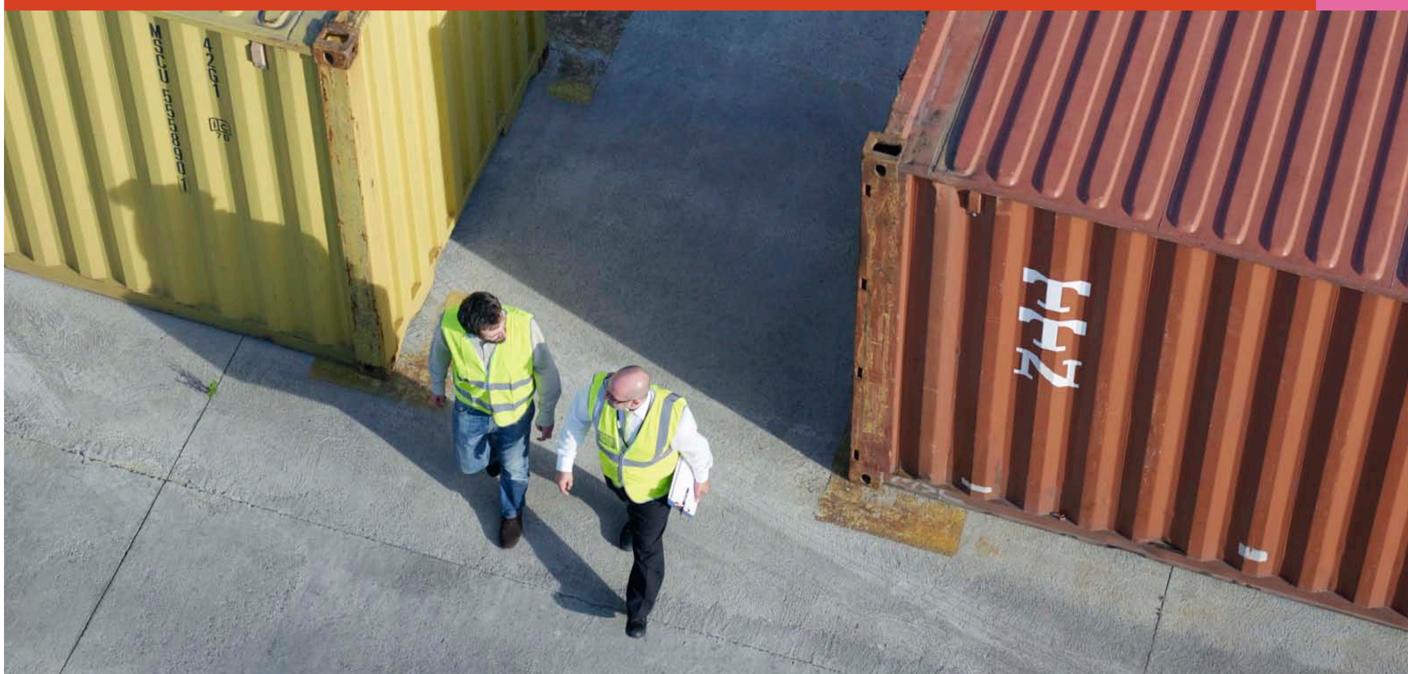
www.pwc.com/it

Delocalisation in foreign countries

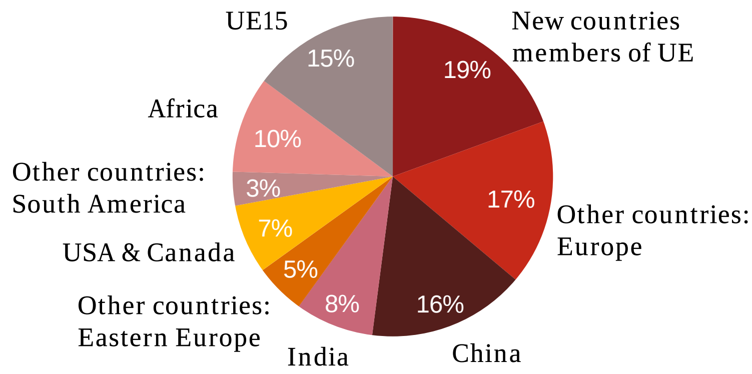
Strategic issues for Italian companies active in the Retail&Consumer sector



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.

Delocalisation of Italian companies in the period 2007-2009 by geographical destination:



Notes:
Source: Fondazione Metes, "L'industria Italiana e il fenomeno delle delocalizzazioni", IlSole24Ore su dati ISTAT (International sourcing – Dinaminche e modalità di internazionalizzazione attiva delle imprese italiane), www.businesson line.it, UGL, "La Delocalizzazione delle Imprese in Italia"

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:

Resource seeking ***defensive delocalisation strategy*** → i.e. Moving manufacturing operations to low-cost countries to benefit of lower cost of key resources (i.e. cost of labour)	**Market seeking** ***offensive delocalisation strategy*** → i.e. Seeking new markets internationally to sell products/services (low-cost/emerging countries not only as production platforms)
Tariff jumping Benefit of tax advantages or access to particular forms of business facilitation measures existing in some foreign markets	**Strategic asset seeking** ***defensive delocalisation strategy*** → i.e. Proximity to Key Clients to better support them

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.

From Resource Seeking

To Market Seeking

From “Trade in goods”

To “Trade in tasks”

Source: www.pambianconews.com, www.ilsole24ore.com, Osservatorio Filas, “Delocalizzazione: perchè le imprese puntano sull’estero?”, Banca d’Italia, “Le imprese italiane tra crisi e nuova globalizzazione”

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

Urbanisation

- 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

Emerging middle class

- 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

Changing labour markets

- 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.

Emerging competitors

- Between 2005 and 2009, over 2,000 companies in emerging markets began investing abroad. Some are becoming industry leaders.

Currency movements

- 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.

Source: PwC, "Rethinking emerging markets"

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**.

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

		Sales (%)			Sales (€/million)
Company	Segment	Italy	Europe	Rest of the world	Total
Luxottica	Accessories	n.d.	21%	79%	5,798
Parmalat	Food	25%	3%	72%	3,965
Indesit	Electronics	18%	78%	5%	2,613
Ferrero	Food	59%	26%	15%	2,571
Benetton	Clothing	n.d.	79%	21%	2,053
De Longhi	Electronics	17%	56%	28%	1,626
Prada	Luxury	22%	24%	54%	1,531
Bulgari	Luxury	12%	26%	62%	927
Geox	Footwear	39%	42%	19%	850
Ermenegildo Zegna	Luxury	n.d.	30%	70%	797

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 **build 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:

Delocalisation of production
- **20%** in Eastern Europe in own plants
- **80%** in Eastern Asia with third party suppliers

Geox international presence
- **344** shops in Italy (39% of sales in 2010)
- **695** shops in the rest of the world (61% of sales in 2010)

GEOX BREATHES

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.

Source: Il Fisco, "Delocalizzazione delle attività produttive e fattore fiscale", www.trevisancuonzo.com, "Il made in: giungla legislativa e mutamenti strutturali", Marilena Garis, "Marchi Italiani e "Made in Italy", 5° summit Made in Italy

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).

From "Product Origin"

To "Brand Origin"

GUCCI PRADA BVLGARI D&G DOLCE & GABBANA Ermenegildo Zegna

Source: www.econ.uniurb.it, www.livemint.com

Who are we?

Nicola Anzivino

Partner, PwC Advisory
Strategy Leader

Telephone: +39 02 80646374
Mobile: +39 348 8519842
Email: nicola.anzivino@it.pwc.com

Marco Lazzaro

Senior Manager, PwC Advisory
Strategy - Retail&Consumer Expert

Telephone: +39 02 80646.379
Mobile: +39 348 1554541
Email: marco.lazzaro@it.pwc.com