

# **Banks, Services, and the State: the infrastructure supporting Italian SMEs abroad**

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## **Abstract**

*Il presente contributo discute il ruolo collettivo di istituti bancari, imprese di consulenza ed enti statali nel provvedere servizi all'internazionalizzazione delle piccole e medie imprese. Così facendo si identifica un'infrastruttura di servizi sia pubblici che privati che facilitano le imprese nel trasmettere informazioni e best practices su lunghe distanze, denominata Investment Promotion Community (IPC). In secondo luogo, si dimostra che le IPC hanno una struttura relativamente simile in aree geografiche anche molto diverse, mentre le relazioni all'interno dell'IPC tendono ad adattarsi alle realtà locali. I dati empirici sono basati su uno studio di imprese, banche e consulenti italiani in Timisoara in Romania e Shanghai in Cina.*

**Key words:** Italian banks and business services, investment promotion, Central Eastern Europe, China

## **1. Introduction.**

Investigations of cluster-networks have studied the structure of spatial networks generated by firms' value chains, between clusters, between city regions, and across different sectors. These discussions focus on the types of linkages and relationships that develop between cluster and the effects these linkages have on cluster performance and competitiveness. This paper focuses on the role of banks, together with service firms and state agencies such as ICE and various others that provide Italian small and medium enterprises (SMEs) with the services needed to operate over long distances. In so doing, we identify two gaps in the literature: first, the scarce treatment of knowledge transmission over long distance, and second, the lack of explanation of how internationalizing firms, especially SMEs, embed themselves in the host regional economies.

This paper makes two contribution to the literature. First, it detects a cross-scalar and cross-sectoral service infrastructure that facilitate both long distance knowledge transmission and firms' embeddedness. Such infrastructure began developing in the mid-1990s, the demand generated by manufacturers in the sending cluster led to internationalization in the banking, aimed at following clients. Once there, mergers and acquisitions and business opportunities expanded Italian banks to new clients and geographical areas, covering entire macro regions. After a certain point, banks would connect with service firms, corporate leaders, and also branches of ICE and other state agencies to build linkages of their own in key urban economies. By the mid-2000s or later according to the geographical area, these actors established communities of professionals supporting Italian manufacturers. This paper calls these communities 'investment promotion communities' (IPC). The second contribution consist in analyzing the relationship between internationalizing SMEs and IPC, showing the extent to which IPC have a common structure in different host regional economies vs. the extent to which they adapt to the local conditions.

The following research questions frame the contributions

- a) What are the functional synergies between banks, services, and public agencies such as ICE and others?
- b) What is the relationship between IPC and SMEs internationalization strategies?
- c) How do IPC adapt to the host regional economies?

The empirical material builds on interviews with Unicredit, Intesa San Paolo, private consultancies, business associations, and Italian state agencies. The focus is on Timisoara, Romania and Shanghai,

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China. The two areas are chosen because they are among the largest concentrations of Italian firms outside Italy, and because they present highly diverse host countries institutions. Research consisted in the collection of FDI and trade data, internal document of business association, and interviews. The authors conducted 18 interviews in Suzhou/Shanghai, and 11 in Italy between 2013 and 2015. One author also conducted 24 interviews in 2005-06 in Timisoara. In both areas interviewees were government officials, trade union leaders, bank managers, and business managers. They were selected with purposive sampling procedure wherein interviews with key consultants and leaders in business associations were used to identify and invite potential interview participants.

The paper is organized as follows. The first section discusses the paper's contribution to the literature on cluster-networks. After a brief methodological section, the empirical sections illustrate the evolution of the Italian clusters in Timisoara and Suzhou, emphasizing the structural similarities but relational differences among the two IPC. The final section summarizes the findings.

## **2. The State, value chains and cluster networks**

Bathelt and Li (2014) describe four major approaches to study transnational businesses in economic geography, each focusing on a specific scale or set of actors. None of these approaches however conceptualizes what makes foreign direct investments (FDIs) and, more in general, relations on the value chains durable, as opposed to short term trade. Drawing upon the four approaches, they propose the concept of a global-cluster network, which synthesizes the relationship between FDIs and clusters into a single framework. This paper attempts to address two problems Bathelt and Li did not address.

First, economic geographers have been interested in the ways in which different forms of knowledge are produced, circulated, and appropriated by firms in transnational businesses. In response to the literature on new regionalism, which argues that the local scale is the primary place of knowledge production, many scholars found that physical proximity is neither sufficient nor necessary for innovation (Amin and Cohendet, 2004; Bathelt, Malmberg, and Maskell, 2004; Storper and Venables, 2004). Long-distance innovative work may occur either through specialized teams in transnational corporations (A. Jones, 2007), or through regularly held international trade fairs (Bathelt and Schuldt, 2008). However, besides these studies, the institutional underpinnings of long-distance learning are scarcely investigated. Therefore, there is no clear understanding of how long-distance innovation is sustained over time, and why certain ventures succeed while others fail (R. Jones, 2008, p. 80).

The second problem lies with the literature on transnational communities focusing on the ethnic networks which neglects how the firms are embedded in institutional contexts (Hsu and Saxenian, 2000). There have been a number of attempts to use the concept of "embeddedness" to study transnational businesses such as in the global production networks literature (Coe, Hess, Yeung, Dicken, and Henderson, 2004). However, in many empirical studies the concept of social embeddedness tends to be over-territorialized – i.e. it neglects the practices of the actors working across territorial borders (Bathelt and Schuldt, 2008; R. Jones, 2008). More importantly, they cannot explain how actors involved in FDIs produce innovation and how they negotiate institutional contexts in the home and host countries (Yeung, 2008).

In this paper we identify several institutions aimed at supporting firms' local embeddedness by working across national borders. We called them IPC building on the work of Phelps and others (Drahokoupil, 2008; Phelps, Power, and Wanjiru, 2007). We propose the following conceptual boundaries for IPCs. At the core, there are public agencies of national and subnational governments. A second layer consists of public-private partnerships, which include not only for-profit entities with partial or total state ownership, but also chambers of commerce and business associations officially recognized by the state. A third layer consists of private consultancies or banks that provide services complimentary or overlapping with those of public agencies. We understand institutions not only as established organizations, but also as various kinds of customs, rules and routines of the none-firm organizations when working on transnational investment projects. We argue that these communities

have similar network structures in key locations of Italian investments; however, relations within networks vary according to each host area

### 3. Italian firms’ landscape in Timisoara and Shanghai/Suzhou

In an earlier paper (Sellar, 2015) the author argued that banks and services act as knowledge pipelines between cluster networks. In short summary, the demands of financial service by internationalizing firms was the first input leading to the internationalization of large banks such as Unicredit. Once established in foreign locations, initially throughout Central and Eastern Europe, and later further afield to include China, Unicredit established a division called ‘New Europe Desk’ with the specific role of assisting Italian firms in understanding the local market, but also local cultural specificities. The desk was later renamed International Desk, to signal a broadening focus beyond Italian firms to include all sort of crossborder investors.

In this paper we argue that banks and services are only one element of much larger IPC that do not only facilitate knowledge transfer, but also play a political role that facilitate firms’ embeddedness. The two areas in consideration have been particularly successful in embedding Italian firms. Table 1 presents a profile of Italian investments in both Suzhou/shanghai and Timisoara. At the respective time of interviews, both areas represented the strongest concentration of Italian firms outside Italy (Federico, 2006; Lan, Sellar, and Cheng, 2016). In both cases, manufacturing represented the lion share of investments; interviewees reported that supply chain relocation was a key reason why Italian FDI and expatriate entrepreneurs clustered. The main differences concern firm size – the closer Timisoara attracted firms on average smaller than the further away Suzhou/Shanghai – and reason for the investment: in Timisoara most firms adopted a strategy of cost containment to serve the Italian market; in Shanghai/Suzhou relocation closer to the main client as well as serving the Asian market were listed as main reasons for investment. Taken together, these data show that a) Italian firms internationalization is only for a small part driven by large corporation; expatriate entrepreneurs and suppliers of larger companies play the lion share; and b) internationalization has a specific time frame, occurring a decade earlier in the spatially and culturally closer Timisoara.

**Table 1.** Profile of Italian investments

<b>Timisoara 2005</b>	<b>Shanghai/Suzhou 2015</b>
# of registered firms: 2293	# of registered firms: 467 (387 Shanghai, 80 Suzhou)
Stock of registered capital: USD 188 Million	Stock of registered capital: USD 583 million (Suzhou only)
Predominant sectors N/A	Predominant sectors: Manufacturing 50% consultancies 25% rest logistics, banks, energy and telecom
Typical enterprise: mostly led by entrepreneurs, may or may not have parent company in Italy.	Typical enterprise: branch of ‘pocket multinational’ (small sized but successful MNC), led by CEO
Predominant reason: cost containment, serving the Italian or European market	Predominant reason: follow the main client, usually large MNC

Italian investments Started with subcontracting relations in labor intensive industries in 1990, by 1998 later larger technology intensive companies arrived.	Italian investments started growing around 2004
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#### **4. Services to internationalizing SMEs: structural isomorphism driven by home country institutions**

Our previous research in Slovakia (Sellar and Pástor, 2015) Romania (Sellar, 2013) and China (Lan, Sellar, Cheng 2016) shows a considerable degree of structural similarities among IPCs. These similarities originated in the conditions of Italy; more precisely, in the legislative reforms of the 1990s: in those years, the Italian government introduced new laws that supported firms abroad as a tool of foreign policy. In a parallel move, internationalizing SMEs began demanding their service providers financial and consulting support in their early foreign investments. Thus, IPCs acquired since the beginning a mixed public-private character, in which multiple organizations in both the public and private sector offer oftentimes overlapping services to firms. As a result of those legislative and social processes in the homeland, services to SMEs in Shanghai/Suzhou and Timisoara have a similar structure. In both areas there is a backbone of national state agencies that perform ‘higher order’ promotional activities, aimed at increasing the reputation of the ‘made in Italy’ brand, but also disseminate information about business opportunities. In Timisoara, these agencies coexist with initiatives by Italian regional governments, aimed at assisting firms from the regions represented. In Shanghai these regional agencies were established, but had to close due to lack of resources. In both areas, CEOs and expatriate entrepreneurs established business association and chambers of commerce as a form of bottom up organizations aimed at exert influence on the local governments, but also to officially partner with the Italian consulate. By the Italian law, these organizations enjoy a special recognition by the Italian State, attributing a hybrid public and private status. In both areas there is a significant presence of banks and consultancies. These private entities provide financing and more direct services to firms, such as legal and accounting services, as well as helping with cultural mediation with local labor and partners. Finally, the two tables show the evolution over time of the two IPCs: they follow closely the pattern of Italian investments, progressively adding organizations and functions while Italian firms grow in numbers and size.

#### **5. Operations in the IPCs: relational differences in host country contexts**

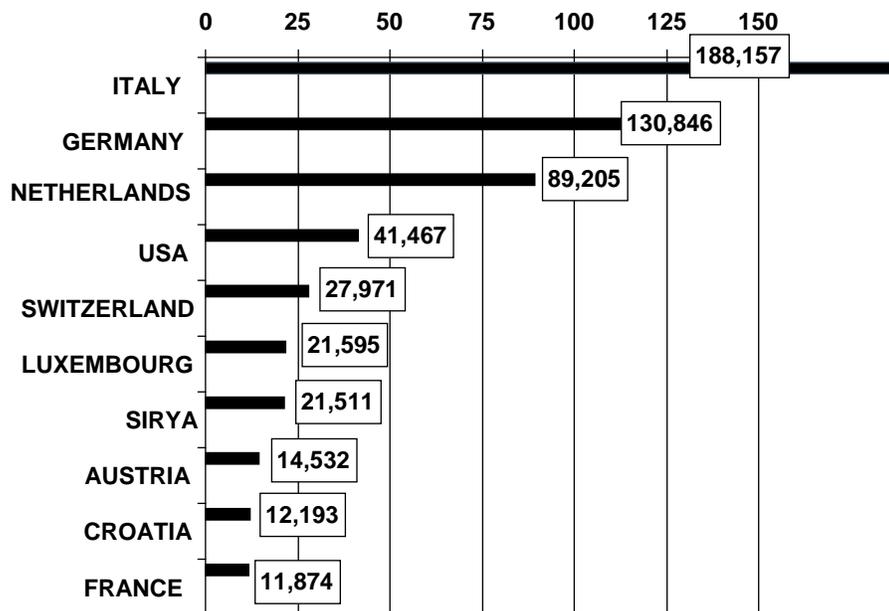
Albeit structurally very similar, the networks within the IPC and between IPC members and client firms are relationally very different. In a nutshell, the IPC in Timisoara is decentralized, there is considerable overlap among service providers, and firms interviewed sometimes complained about the quality of the services received. However, Italian firms – individually through their participation in the chamber of commerce and collectively through their own business association – may exert a considerable influence in the city – and Romania as a whole. On the other hand, the IPC in Shanghai is centralized under the leadership of the consulate, promotional initiatives are streamlined through strategic planning, and the IPC provides services to both Italian and Chinese firms. However, the relative importance of Italian firms in the urban economies of Shanghai and Suzhou is marginal, thus not allowing a degree of influence comparable with Timisoara. Table 2 summarizes the relational differences in the two IPCs; the remainder of this section presents supporting evidence from the interviews and data collected about the centralized vs. de-centralized nature of the two IPCs and the power influence vs. weakness of Italian firms in the two contexts.

**Table 2.** Relational differences in Italian IPCs in Timisoara vs. Shanghai/ Suzhou

	Timisoara	Shanghai/Suzhou
<b>Coordination within the IPC</b>	LOW	HIGH
<b>Importance of Italian firms in the local economy clientele</b>	HIGH	LOW
	Mostly Italian firms (except bank, who service all)	Italian and Chinese firms

The relative importance of Italy as a trade partner in Romania vs. China drives the stronger bargaining power of Italian firms in Timisoara vs Shanghai/Suzhou. At the national level, in 2014 Italy was Romania’s second trading partners after Germany, while in the same year Italy was China’s 22nd trading partner, similar to the position of Iran (UNCTAD 2015). By the mid 2000s, foreign firms represented 21% of the investment stock in the whole county of Timisoara; Italians lead both by number of firms and stock of capital (Figure 1).

**Figure 1.** Capital stock invested in foreign firms in Timisoara by nationality – million of US dollars

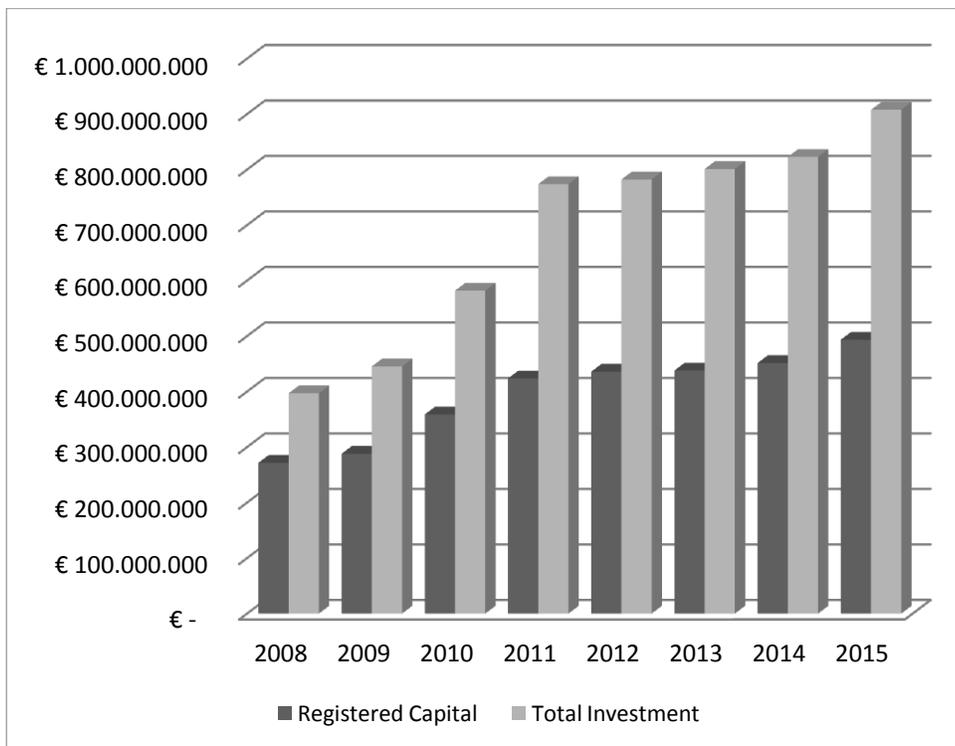


The large number of Italian firms attracted the attention of the largest business association in Italy, *Confindustria*. *Confindustria* sponsored the establishment of an association of Italian firms in Romania, *Unimpresa*, which became soon a major player in Romanian national politics, and also in Timisoara through its local branch (interview President. Timis branch, Unimpresa Romania. Interview. April 3 2006). In a nutshell, the chaotic emergence of Italian investments, together with the relative powerful position of Italian firms in the city economy did not require a particularly co-ordinated action in the IPC. As a result, Timisoara's IPC was a rather loose group of service providers, in which *Unimpresa* played the strongest role in representing Italian firms in the city.

Across Eurasia, the local context in Shanghai/Suzhou is in many respects the opposite of Timisoara. First of all, Italian firms have a marginal weight in both urban economies. Second, the culturally distant local governments never considered Italy a role model – or even a strategic partner. Third, Italian investments in the region developed largely after the crisis of 2008, in a situation in which Italian state agencies, but also service providers, have had fewer resources to invest. Therefore, the IPC had to increase its efficiency through leadership and centralization. Two enterprising consul general used their authority of representatives of the Italian government to exercise leadership on the IPC. First, they streamlined the work of Italian public agencies by introducing co-ordination in event planning. Second, they built synergies with Italian consultants and manufacturers by introducing strategic planning, regular stakeholders meetings, and information-sharing that involve both representatives of the Italian public agencies and businesses. To advertise those changes, the consulate and the Chamber of Commerce, branded the IPC in Shanghai as *Sistema Italia* (Italian System) (Consulate 2013). Thus, the loose set of relationships in the IPCs in Timisoara has been replaced by a much stronger and coherent “*Sistema Italia*” that plays a central role in facilitating both political appeals of the Italian government and economic ambitions of the Italian firms.

Firms, on average larger and more established than in the close-to-home Timisoara, contribute to the stability of *Sistema Italia*. In Suzhou only, Italian firms grew from 10 in 2005 to 80 in 2015, with low disinvestment. Their cumulative Investment stock in 2015 was 493 million Euros (538 million US dollars), with total investment 907 million euros (990 million US dollars) (Figure 2)

**Figure 2.** Italian investment in Suzhou



*Source: China Italy Chamber of Commerce 2015. 8th Suzhou Appreciation Meeting presentation delivered at the meeting between Italian entrepreneurs and Chinese authorities, Suzhou, China, May 27, 2015*

80 Italian firms in Suzhou have an investment stock nearly three times higher than two thousand plus firms in Timisoara. The following interview captures the connection between the bottom up initiative of firms in Suzhou, the Italian institutions in Sistema Italia, and the local Chinese government:

Back in 2004 my family and I were the only Italians...In 2007 my wife and I hosted a Christmas dinner, 20 people came ... At that first dinner in 2007 we acknowledged that we were few, and uninfluential. The Chinese government helps you a lot in the start up phase, but after you start working they stop supporting you. Our firms are too small to have weight with the local government. Thus in December 2007 we decided to meet once a month to talk about common problems. In 2008 we wanted to be better represented. We joined the Italy-China Chamber of Commerce; I became board member of the chamber. That way we attracted more attention from ICE and the consulate (interview General manager SIT Manufacturing (Suzhou) Co., Ltd, and Board director, China-Italy Chamber of Commerce April 20, 2015).

At a functional level, the network between firms' association and the consulate leads to access to the local government. While in Timisoara such access was easy to achieve – given the relatively small size of the city (around 600 thousand including the county) and the relative weight of Italian firms – in Suzhou it was very difficult. First, the Chinese government has a strong tradition in partnering with other governments rather than with firms directly. Second, by population only Suzhou counts 12 million of people, approaching the order of magnitude of the whole country of Romania. Thus, the access to officials described in the following excerpt was of critical importance for firms:

Every year at the end of May we hold a meeting (we call it 'appreciation meeting') companies come, accompanied by all Italian institutions, to meet with the highest levels representatives of the Suzhou government. The meeting occurs in the morning, followed by a luncheon where companies and Chinese authorities can network (interview General manager SIT Manufacturing (Suzhou) Co., Ltd, and Board director, China-Italy Chamber of Commerce April 20, 2015)

In a nutshell, the relatively weak position of Italian firms in China, the relative stability of the investment, and the good leadership of the consulate led to a highly integrated system promoting Italian businesses and providing services to firms, which is structurally similar to the IPC in Timisoara, but much more integrated and centralized.

## 6. Conclusion

The goal of this paper was to highlight the role of business services in the literature on cluster-networks. First, we argued that the role Italian banks in firms' internationalization should be understood in a much larger context of investment promotion communities (IPC). Second, IPC play two key roles in firms' internationalization: they support the transfer of knowledge between Italian firms and host economies, and aid firms' embeddedness. The paper specifically studied IPC in Timisoara, Romania, and Suzhou/Shanghai, China. Notwithstanding the differences in firms' size and motivation of investment the two IPCs have very similar structures, driven by institutions in Italy. At an organizational level, the two IPC have profound differences, driven by the political realities of host countries and cities. In sum, banks are part of a larger, public-private IPC, driven by institutions in Italy and highly adaptable to local conditions. As such, IPC are unexplored, have yet to attract the attention of academics, and have yet to become a conscious tool of national policies.

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