LINKING ITALY'S BANKING AND INDUSTRY IN EASTERN EUROPE: INDUSTRIAL DISTRICT OUTSOURCING AND BANK FDI

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1.   Introduction

Eastern European countries suffered serious banking crises during their transition from planned to market economies. In response, governments throughout the region were induced to allow pervasive foreign bank entry. Foreign banks took advantage of the opportunity and by 2000 were serving, on average, almost one third of domestic banking markets in Eastern Europe. In some of these countries the share of foreign banks were even higher (62 per cent in Hungary, 85 in Estonia). Penetration becomes even greater if we focus on domestic banks beyond a minimum size. Limiting the calculation to those banks reported in Bankscope whose ownership structure can be identified, by the end of 2001 foreign bank penetration amounted to about three quarters of the market in the total weighted average of the countries considered in this chapter.[1] In addition, the same banks held approximately two-thirds of the market at the end of 1996, implying that foreign-acquired banks are also growing faster than other domestic banks.

Although the issue has already been addressed, many questions regarding the massive entry of foreign banks in Eastern Europe remain unanswered. In particular, this chapter focuses on whether Italian banks' entry is motivated by the need to follow their domestic customers already present in Eastern Europe, or by other reasons. In this regard, we observe that Italian banks which were previously little internationalized have recently made considerable investment to acquire a retail banking network in Eastern Europe. Moreover, in the last decade many Italian industrial

districts specializing in traditional goods have responded to growing competition from the emerging economies by moving into Eastern Europe. Specifically, these industrial districts have found a new way to safeguard their competitive hedge by outsourcing most of the heavy unskilled labour phases of production to low-labour-cost Eastern Europe. Our main aim is to shed light on whether the two moves into Eastern Europe – that of Italian banks and that of Italy's industrial districts – were (even unintentionally) related. The issue of whether national banks lead or follow their customers abroad is not novel to the literature (see, e.g., Yamori, 1997; Esperanca and Gulamhussen, 2001) but, as far as we know, the approach we take here is new.

Specifically, we tackle this issue using detailed data for Italy. By and large, the case of Italy exhibits two distinctive features: (i) intense productive outsourcing to Eastern Europe by Italian firms, especially small and medium-sized enterprises (SMEs) clustered in industrial districts, who have been attracted there by low labour costs since the mid-1990s; (ii) the more recent acquisition of a retail network in Eastern Europe by some large Italian banking groups. Our aim is to ascertain whether business interaction has intensified between the group of Italian banks entering the Eastern European markets and those industrial districts that have more forcefully outsourced their production to the area. Lacking data to assess business interactions in Eastern Europe between Italian banks and firms from Italian industrial districts, we inquire whether the market share of these banking groups in Italy increased precisely in those industrial districts which more forcefully moved their production to Eastern Europe.

We find that Italian banks acquiring a retail network in Eastern Europe also have a significantly better market share dynamics in Italy precisely in those industrial districts that more intensely moved production to Eastern Europe. Hence, although possibly triggered by other reasons as well, the move by Italian banks to Eastern Europe may also be interpreted as a strategy catering for the home market. Consequently, the chief result of our analysis is that the two moves appear to some extent related.

In the rest of this paper, section 2 briefly outlines the literature on the links between bank and firm internationalization. Section 3 describes the methodology we use to draw a map of Italian industrial districts' outsourcing to Eastern Europe, as well as a map of the retail presence of Italian banks in Eastern Europe, and presents the econometric analysis. In the last section, we review the chief results and lay out a research agenda for the future.

2. EU banks and firms into Eastern Europe: leaders and followers

Since the early 1990s, foreign direct investment (FDI) from the EU to Eastern Europe has played a primary role in shaping the economic reintegration of the Eastern European countries within an enlarged Europe. These FDI flows were mostly motivated by the need to reduce production costs in response to increasing competition from the emerging economies: indeed, EU manufacturing firms have fragmented their production process, relocating unskilled labour intensive phases to low-labour-cost transition economies (Arndt and Kierzkowski, 2001; Baldone *et al.*, 2001). Eastern Europe is the favoured destination for such outsourcing given its proximity and flexibility.

An important question at this juncture is whether there was any sequencing between manufacturing FDI and productive outsourcing from Western to Eastern Europe, on the one hand, and bank FDI from Western to Eastern Europe, on the other. We contemplate two alternative hypotheses. On one hand, FDI from EU banks to Eastern Europe might lead FDI in the area by their national manufacturing clients. This could happen if two facts are true: (1) opportunities for bank FDI in Eastern Europe materialized early on, and (2) EU firms wishing to enter Eastern Europe faced intense information asymmetries that could be reduced by the previous entry of their lending banks. The opposite view is that EU banks follow their customers to Eastern Europe. According to this hypothesis, EU manufacturing firms move first to Eastern Europe, either with their FDI or with their productive outsourcing. Their lending banks moved to Eastern Europe only later to: (i) improve their services (following their customers to avoid losing them), and (ii) keep track of the overall risk profile of their borrowers, which tend to become more opaque after shifting their activities to Eastern Europe.

While it is well known that total FDI flows from the EU to Eastern Europe were massive, little attention has been devoted to the bank component within such flows. Indeed, all transition economies suffered pervasive banking distress and closure in the years after 1989. Since then, the penetration of foreign banks in transition economies has become increasingly widespread: by the mid-1990s almost half of domestic bank assets were already in the hands of foreign (mostly EU) banks, twice as much as in Asia or Latin America (Claessens *et al.*, 1998).

A large retail presence of foreign banks may be desirable from the perspective of transition economies for two main reasons: (i) it may

improve the efficiency of the domestic banking system (Claessens *et al*., 1998; Focarelli and Pozzolo, 2000), and better management makes national banks more resilient to external negative shocks, and (ii) it may also perform a stabilizing role vis-à-vis such shocks thanks to the fact that local assets account for a small share of the total assets of the foreign bank to which the local unit belongs (Dages *et al*, 2000).[2] Thus foreign banks may cushion the shock to the local economy by providing more liquidity and possibly even preventing the occurrence of twin crises affecting the exchange rate and the banking system (Kaminsky and Reinhart, 1999; Reynoso, 2002).

Austria and Germany were the main countries of origin of bank FDI to Eastern Europe at the beginning of the 1990s, as will be discussed in detail below. Only later were they joined by other EU countries, such as France, Italy and the Netherlands (Papi and Revoltella, 1999).

Some specific considerations can be made regarding the internationalization of Italian manufacturing firms in Eastern Europe. Their small size can hinder internationalization. The few large Italian firms have undergone a downsizing process, while Italy has witnessed the vitality of its many local productive systems centred on small and medium-sized enterprises clustered within industrial districts. Thus, the internationalization of Italian firms mainly takes place alongside that of their production process which, given their small size, is likely to be channelled through forms of outsourcing (such as subcontracting) not involving outright FDI. In other words, we can assume that it is particularly difficult for productive systems based on SMEs to outsource production by directly acquiring productive capacity abroad. Nevertheless, this type of productive outsourcing to low-labour-cost countries (mainly in Eastern Europe) is vital if these firms are to safeguard their competitive edge in their traditional area of specialization (the so-called range of goods "made in Italy"), which imply considerable use of unskilled labour.

In fact, Italian SMEs have outsourced their productive processes mainly to Eastern Europe, where geographical vicinity is combined with large human capital endowment and low labour costs. Outsourcing has been most intense in those stages of production that can be most easily

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[2]   Some authors hold the opposite view: e.g. Weller (2000) remarks that foreign banks, rather than provide more liquidity, may abandon the country when the negative shock occurs as they have no commitment to stay there.

standardized and have the highest content of unskilled labour. The more skill-based stages of the production process tend to stay in Italy. This applies both to pre-manufacturing stages (e.g. design and definition of new products) and post-manufacturing stages (e.g. finishing and commercialization). In this sense, outsourcing has given rise to large flows of temporary exports (the so-called outward processing trade, OPT), followed by a large related flow of imports. Analyzing OPT by destination highlights the fundamental role played by Eastern Europe as the main partner for productive restructuring at Italian SMEs: for example, over 46 per cent of the OPT originating from manufacturing firms in Veneto goes to Eastern Europe (Gisolo and Iodice, 2002).

Given its highly fragmented nature, manufacturing internationalization in Italy might benefit more than in other countries from synergies with national banks' internationalization. It is difficult to imagine that the coordination mechanisms typical of industrial districts can easily apply to the development of a financial organization capable of supporting the internationalization of manufacturing firms. Accordingly, if their banking partners accompany them, it might be much easier for these firms to go international.

However, until very recently Italy's banks were little internationalized (De Bonis, *et al.*, 2000). Their significant M&A activity in Eastern Europe in recent years was their first real internationalization on a retail basis (at least in recent decades). It is therefore truly crucial to establish whether the productive outsourcing in Eastern Europe by Italy's SME-based industrial districts and the concurrent internationalization to Eastern Europe of Italy's leading banks were two related phenomena or whether they were independent from each other.

3. Mapping Italy's banks and industrial districts in Eastern Europe

3.1 *Our methodology*

The best approach to answer the research question we have just raised would be to study in the field, at banks and/or firms, whether and to what extent the two forms of internationalization to Eastern Europe have been interdependent. However, lacking such detailed information, we may still try to infer something by an indirect method. Our approach hinges on

evaluating whether the penetration in local credit markets by the industrial districts that have significantly outsourced production to Eastern Europe has recently increased for those Italian banking groups that at the same time acquired a retail network in Eastern Europe. To be sure, even if we were to find supportive evidence, it would provide neither a necessary nor a sufficient condition to ensure that the two types of internationalization were indeed interdependent. The finding would not constitute a necessary condition because those banking groups might have assisted Italy's SMEs in their outsourcing to Eastern Europe even without expanding their market share in traditional credit business back home. Nor would the finding be a sufficient condition, since even an increasing loan market share of such banks – in the industrial districts significantly outsourcing to Eastern Europe – might not automatically imply that they effectively assisted national SMEs in their Eastern European internationalization. Even so, it is quite clear that the finding of supportive evidence would lead us to presume that Italy's bank and SME internationalization to Eastern Europe were somewhat related.

Operationally, our analysis has three logical steps. First, we identify and assess the degree of productive outsourcing to Eastern Europe by each Italian industrial district. We can then draw a detailed map of such productive outsourcing, distinguishing which specific Eastern European country was the target.[3] Our second step is to draw a detailed map of the presence in each of the Eastern European countries of each of the Italian banking groups that have moved to the area with subsidiaries and/or branches. In the third step we use econometric models to test whether and to what extent the correspondence between the two maps delivers higher penetration in industrial districts for banks that have moved to Eastern Europe. At this point, however, we need to describe in greater detail how we structured the three steps just described.

The first problem was to identify the degree of productive outsourcing and the target country. In theory, we should consider both the intensity/destination of FDI and of outward processing trade (OPT). However, this was impossible because: (i) data on FDI for Italian

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[3]   The Eastern European countries we consider are the 10 where, by end 2001, at least one Italian bank was present with at least one subsidiary, that is: Bulgaria, Croatia, Czech Republic, Hungary, Macedonia, Poland, Slovak Republic, Romania, Slovenia, Ukraine.

Table 1

Industrial district intensity in Italian provinces

Provinces	District intensity.	Provinces	District intensity	Provinces	District intensity
PRATO	1,00	PAVIA	0,29	LATINA	0,00
ASCOLI PICENO	1,00	FERRARA	0,29	ROMA	0,00
LECCO	1,00	MILANO	0,28	PESCARA	0,00
PADUA	0,99	TRENTO	0,28	CAMPOBASSO	0,00
PISTOIA	0,99	ASTI	0,27	ISERNIA	0,00
TREVISO	0,98	BELLUNO	0,26	CASERTA	0,00
REGGIO EMILIA	0,98	FIRENZE	0,25	NAPOLI	0,00
MODENA	0,96	AVELLINO	0,20	SALERNO	0,00
COMO	0,95	PORDENONE	0,15	BRINDISI	0,00
CREMONA	0,95	BARI	0,15	LECCE	0,00
BIELLA	0,94	TARANTO	0,12	MATERA	0,00
PESARO	0,94	CUNEO	0,11	POTENZA	0,00
VICENZA	0,93	BOLOGNA	0,11	CATANZARO	0,00
TERAMO	0,93	RIMINI	0,11	REGGIO CALABRIA	0,00
BRESCIA	0,87	FROSINONE	0,11	CROTONE	0,00
PARMA	0,86	VERCELLI	0,10	AGRIGENTO	0,00
BERGAMO	0,82	ALESSANDRIA	0,08	CALTANISSETTA	0,00
MACERATA	0,77	CHIETI	0,08	CATANIA	0,00
LUCCA	0,75	FOGGIA	0,07	ENNA	0,00
LODI	0,74	VIBO VALENTIA	0,07	MESSINA	0,00
VARESE	0,73	VENEZIA	0,06	PALERMO	0,00
UDINE	0,73	BENEVENTO	0,06	RAGUSA	0,00
MANTUA	0,71	TORINO	0,05	SIRACUSA	0,00
AREZZO	0,70	BOLZANO	0,03	TRAPANI	0,00
RAVENNA	0,62	RIETI	0,03	CAGLIARI	0,00
FORLÌ	0,59	TERNI	0,02	NUORO	0,00
ANCONA	0,59	GENOVA	0,01	SASSARI	0,00
ROVIGO	0,54	SAVONA	0,01	ORISTANO	0,00
NOVARA	0,53	L'AQUILA	0,01		
SIENA	0,47	AOSTA	0,00		
PERUGIA	0,41	IMPERIA	0,00		
VERBANIA	0,40	LA SPEZIA	0,00		
VERONA	0,37	GORIZIA	0,00		
SONDRIO	0,35	TRIESTE	0,00		
VITERBO	0,34	GROSSETO	0,00	*AVERAGE*	*0,299*
PIACENZA	0,33	LIVORNO	0,00	*MEDIAN*	*0,106*
PISA	0,32	MASSA	0,00		

manufacturing firms are unsatisfactory, [4] and (ii) information on OPT published by Istat does not offer an adequate geographical breakdown. [5]

One can obtain a more detailed geographical breakdown using external trade data, detailing exports by province of origin (in Italy) and by individual country of destination, thus allowing us to identify trade vis-à-vis each country in Eastern Europe. Nevertheless, even these data can be useful to us only after making an additional hypothesis, namely after assuming that large flows of exports to Eastern Europe in those productive sectors typical of industrial districts specialized in "made in Italy" goods actually identify OPT and not sales of final goods. In other words, exports to those mid-low income countries in industrial districts' goods – typically directed to high-price segments of the market – conceal, in reality, either OPT or export flows prompted by productive fragmentation between industrial district SMEs and their Eastern European subsidiaries, acquired through FDI in the area. [6]

After accepting to use data on exports, we can start from the classification of the various industrial districts according to their main productive specialization. However, we must also tackle the additional constraint that the highest detail for export data is the individual province and not the individual Local Labour System (LLS). [7] To overcome this constraint we develop an index of "industrial district intensity" for province *i*, constructed as follows: [8]

$$x_i = \frac{\text{Number of industrial employees in the district LLS of province } i}{\text{Number of total industrial employees in province } i}$$

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[4]   See, e.g., Cominotti *et al.* (1999) for a presentation of the data on Italian FDI. See also Federico (in this volume). In Italy, as highlighted in ICE (2004), FDI data systematically underestimate more than in other countries the degree of internationalization of production by national firms. FDI, in fact, excludes all those forms of international fragmentation of production based on agreements among firms without direct investment, and these forms are particularly widespread at Italian firms, partly because of their small size and the prevalence of family control.

[5]   These data have a satisfactory breakdown by sector, but inadequate geographical detail for both the originating area (data are only broken down by region; regions are too large to capture the dynamics of industrial districts) and destination countries (all Eastern European countries are bunched in a single group).

[6]   On the relation between productive fragmentation and the internationalization of Italy's productive system, see Ferragina and Quintieri (2002).

[7]   Each LLS aggregates two or more municipalities belonging to the same economic gravitational area. LLSs provide a full partition of Italy. Approximately one out of eight LLSs is an industrial district.

[8]   This procedure is not entirely new. For instance, see Bronzini (2000) and Iuzzolino (2000).

where, of course, the "industrial district intensity" x_i varies between 0 and 1.[9]

Table 2

Specialization in the 37 provinces with high industrial district intensity (1)

Provinces	Specializations			
NOVARA	Mechanical engineering	Textiles & clothing		
BIELLA (*)	Textiles & clothing			
VERBANIA (*)	Mechanical engineering			
LECCO (*)	Mechanical engineering	Food & beverages	Textiles & clothing	
LODI (*)	Mechanical engineering	Petrochemicals		
BERGAMO	Petrochemicals	Mechanical engineering	**Textiles & clothing**	
BRESCIA	**Textiles & clothing**	Mechanical engineering	Metallurgia	**Petrochemicals**
COMO	Textiles & clothing	Furniture	Mechanical engineering	Petrochemicals	Food & Beverages
CREMONA	Food & beverages	Mechanical engineering	**Textiles & clothing**	Furniture	Metals
MANTUA	**Textiles & clothing**	Food & beverages	Furniture	Mechanical engineering
SONDRIO	Food & beverages	**Textiles & clothing**		
VARESE	Textiles & clothing	Petrochemicals		
PADUA	Mechanical engineering	**Textiles & clothing**	**Furniture**	
ROVIGO	**Textiles & clothing**			
TREVISO	**Leather & footwear**	**Textiles & clothing**	Furniture	Mechanical engineering
VERONA	Furniture	**Textiles & clothing**	**Mech.anical engineering**	**Leather & footwear**
VICENZA	**Textiles & clothing**	Gold & musical products	Paper & publishing	Furniture

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[9] It is worth highlighting that when an individual LLS belongs to two (or more) provinces, all its employees are computed as district employees in each of the two (or more) provinces. To check that this did not introduce biases in our data, we alternatively measured the industrial district intensity of the province attributing the employees of the district only to the "prevailing" province: results did not change significantly. In addition, we should point out that the data on employees refer to the 1996 Census. Finally, we use the map of industrial districts published by Istat and built on 1991 Census data.

(Table 2 contd)

UDINE	Furniture	Mech. eng.		
FORLÌ	Furniture	**Textiles & clothing**	**Paper & publishing.**	Leather & footwear
MODENA	Mechanical engineering	Textiles & clothing	Furniture	
PARMA	Food & Beverages			
PIACENZA	Mechanical engineering	Food & beverages		
RAVENNA	Food & beverages			
REGGIO E.	Mechanical engineering	Furniture	**Textiles & clothing**	
AREZZO	**Textiles & clothing**	Gold & Musical products	Furniture	**Paper and publishing**
LUCCA	Leather & footwear	Paper & publishing.	Furniture	
PISA	Leather & footwear			
PISTOIA	Textiles & clothing	Leather & footwear	**Mechanical engineering**	
SIENA	Furniture	Food & beverages	Leather & footwear	
PRATO (*)	Textiles & clothing			
PERUGIA	**Textiles & clothing**	Paper & publishing	Furniture	
ANCONA	Leather & footwear	**Textiles & clothing**	Gold & musical products	Food & beverages
ASCOLI P.	**Textiles & clothing**	**Leather & footwear**		
MACERATA	**Textiles & clothing**	Furniture	**Leather & footwear**	Gold & musical products.
PESARO	**Textiles & clothing**	Furniture		
VITERBO	**Furniture**			
TERAMO	Textiles & clothing	**Furniture**		

(1) Bold fonts identify: in the first column, the provinces with productive outsourcing to Eastern Europe; in the other columns, the specific industrial district specialization(s) for which outsourcing occurred. (*) New provinces created during the 1990s.

Table 1 reports the values of the index of "industrial district intensity" calculated as above. Classifying as high "industrial district intensity" those provinces (indicated in bold in the table) with a value of the index above the mean, we select 37 provinces (in decreasing order of "industrial district intensity"): Prato, Ascoli Piceno, Lecco, Padua, Pistoia, Treviso, Reggio Emilia, Modena, Como, Cremona, Biella, Pesaro,

Vicenza, Teramo, Brescia, Parma, Bergamo, Macerata, Lucca, Lodi, Varese, Udine, Mantua. Arezzo, Ravenna, Forlì, Ancona, Rovigo, Novara, Siena, Perugia, Verbania, Verona, Sondrio, Viterbo, Piacenza, Pisa.

As reported in Table 2, for each of the 37 provinces we count from a minimum of 1 to a maximum of 5 of the 9 identified industrial district specializations (food & beverages; textiles & clothing; leather & footwear; furniture; metals; mechanical engineering; petrochemicals; paper & publishing; gold & musical products, etc.). The few provinces with a single industrial district specialization are: Biella, Parma, Pisa, Prato, Rovigo, Verbania and Viterbo. Those with 5 specializations are: Como and Cremona.

Reasonably, outsourcing to Eastern Europe by industrial districts in province i can be measured by the exports to Eastern European countries from province i if these exports belong to the productive specialization of the industrial districts identified in province i.[10] Thus, we define an index of the "degree of outsourcing" by each industrial district specialization h of the industrial district province i to Eastern European country j:

$$x_{hij} = \frac{\exp_{hij}}{\exp_{hi}}$$

where $\exp_{hi}$ identifies the total exports in industrial district specialization h from province i, while $\exp_{hij}$ indicates the part (in absolute value) of $\exp_{hi}$ directed to Eastern European country j. Obviously, x_{hij} varies between 0 and 1. Values of x_{hij} significantly above 0 identify active loci where industrial district outsourcing took place. This completes our first logical step.

Next, we establish a double threshold to identify effective industrial district outsourcing. First, we consider as outsourced those specialization sectors of industrial district provinces for which the share of exports to Eastern Europe in total world exports is above 10 per cent, which is much

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[10] To give an example, if the province of Ascoli Piceno – where leather-footwear industrial districts are present – records large exports of footwear to Romania, this identifies industrial district productive outsourcing from Ascoli Piceno to Romania. If, instead, we come across exports of furniture from Ascoli Piceno to Romania, since in the province of Ascoli Piceno there is no industrial district specializing in furniture, this does not identify industrial district productive outsourcing from Ascoli Piceno to Romania.

higher than the roughly 7 per cent circa of Italy's overall exports going to the sum of Central Eastern European and South Eastern European countries.[11] By so doing, and by using data on exports for 2001, we obtain effective industrial district outsourcing for only 21 of the 37 provinces with high industrial district intensity and, more precisely, for 30 (those marked in bold in Table 2) of the 64 industrial district/province productive specializations relating to the 21 provinces.[12] Furthermore, in order to identify to which of the 10 countries such outsourcing was directed, we computed the share for each of the 10 countries and considered only those countries with an index above 12.5 per cent.

3.2   *Descriptive evidence*

We identify 63 outsourcing nodes in Eastern Europe for industrial district/province productive specializations (Table 3). More than half (35 nodes) pertain to textiles & clothing. The remaining industries rank as follows: leather & footwear (9 nodes), furniture (6 nodes), paper & publishing (6 nodes), petrochemicals (4 nodes) and mechanical engineering (3 nodes). The country receiving the largest number of outsourcing nodes is Romania at 25, while Poland has 13 nodes, Hungary 9, Bulgaria, the Czech Republic and Ukraine 4 each, Croatia 3 and Slovenia only 1. The provinces with the largest outsourcing nodes are Verona (6) and Arezzo, Brescia and Macerata (5).

Figure 1 reports the geographical distribution of outsourcing to Eastern Europe for the 21 provinces with high industrial district intensity and by country of destination, where this time the share relates not to the number of nodes but to the amount of exports to those nodes.[13] We notice again the prominent position of Romania, which receives 59.5 per cent of the exports to outsourcing nodes in Eastern Europe, followed by the other countries at a considerable distance: Hungary (14.6 per cent), Poland (10.5 per cent), Croatia (7.2 per cent), the Czech Republic (3.0 per cent), Bulgaria (2.8 per cent), Ukraine (2.4 per cent), Slovenia (0.03 per cent), with nil for both Macedonia and the Slovak Republic.

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[11]   Still referring to 2001, the share of exports to the sum of the 10 Eastern European countries we consider is 8.4 for the 37 industrial district provinces.

[12]   The share to the 10 countries over total exports from the 21 provinces with industrial district specializations outsourced to Eastern Europe rises to 9.8.

[13]   This index is constructed summing the absolute value of exports to outsourcing nodes in Eastern Europe (measured as described above) and computing its distribution across the 10 countries. In practice, summing the shares for the 10 countries adds up to 100.

Table 3

Destination countries for districts' outsourcing by specialisation (data for 2001)

Sector / Province	Country of productive outsourcing								
	Bulgaria	Croatia	Poland	Czech	Slovenia	Ukraine	Hungary	Romania	No counries
TEXTILES-CLOTHING									
BERGAMO			1					1	2
BRESCIA								1	1
CREMONA							1	1	2
MANTUA			1				1		2
SONDRIO			1						1
PADUA	1							1	2
ROVIGO								1	1
TREVISO		1					1	1	3
VERONA		1						1	2
VICENZA				1				1	2
FORLÌ								1	1
REGGIO EMILIA	1		1				1	1	4
AREZZO	1							1	2
PISTOIA			1					1	2
PERUGIA			1					1	2
ANCONA						1		1	2
ASCOLI P.								1	1
MACERATA						1		1	2
PESARO								1	1
SUB-TOTAL	*3*	*2*	*6*	*1*	*0*	*2*	*4*	*17*	*35*
LEATHER-FOOTWEAR									
TREVISO							1	1	2
VERONA								1	1
ASCOLI P.	1		1					1	3
MACERATA			1			1		1	3
SUB-TOTAL	*1*	*0*	*2*	*0*	*0*	*1*	*1*	*4*	*9*
FURNITURE									
PADUA			1	1					2
VITERBO						1			1
TERAMO		1	1					1	3
SUB-TOTAL	*0*	*1*	*2*	*1*	*0*	*1*	*0*	*1*	*6*
MECHANICAL ENGINEERING									
VERONA			1				1	1	3
PETROCHEMICALS									
BRESCIA			1	1			1	1	4
PAPER-PUBLISHING									
FORLI				1			1	1	3
AREZZO			1		1		1		3
SUB-TOTAL	*0*	*0*	*3*	*2*	*1*	*0*	*4*	*3*	*13*
TOTAL	***4***	***3***	***13***	***4***	***1***	***4***	***9***	***25***	***63***

Figure 1

**Distribution by country of industrial districts' outsourcing
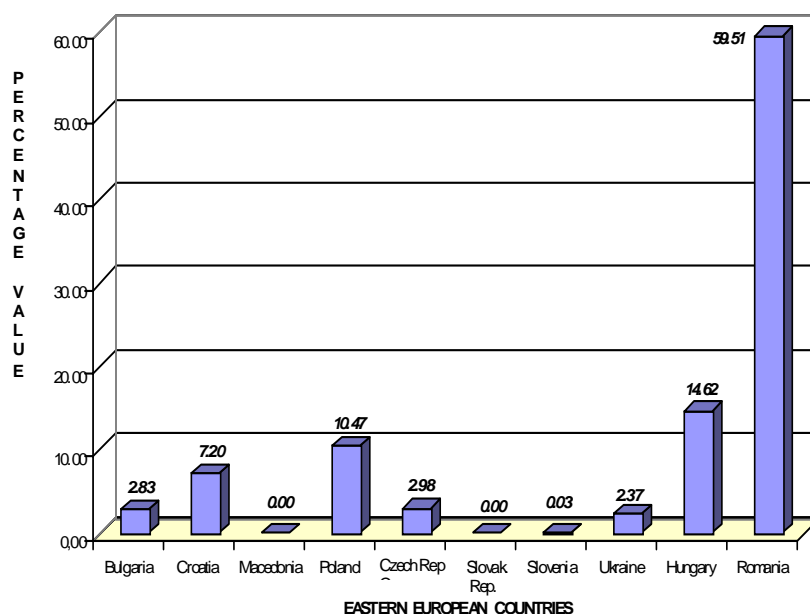to Eastern Europe**

Figure 2 presents the geographical distribution of the above outsourcing from Italy to Eastern Europe, by the macro area to which industrial districts belong (i.e. North-West, North-East and Centre; there were no district-intensive provinces in the South-Islands according to the 1991 Istat classification used here). Romania is the destination for outsourcing most widely selected in the North-East and the Centre, while the North-West outsources comparatively more to Poland and Hungary. Only the Centre outsources to Ukraine and Slovenia.

The intensity of productive outsourcing across the 9 sectors of industrial district specialization is highest for textiles & clothing, and is also above average for leather & footwear and paper & publishing, while it is below average for petrochemicals, furniture and mechanical engineering

(Figure 3). No outsourcing is detected for food & beverages, metals, gold & musical products, etc.

Distribution by country and Italy's industrial districts' outsourcing to Eastern Europe by areas
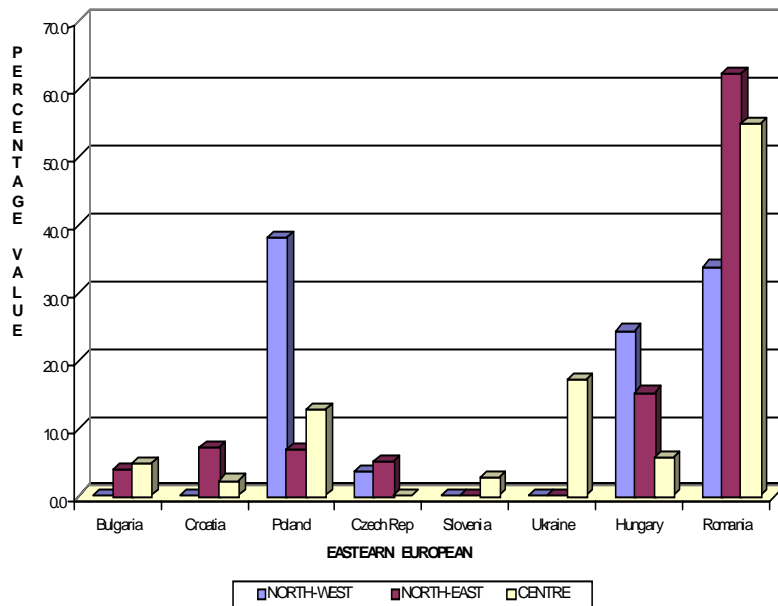

Finally, industrial district outsourcing to Romania is intense for all productive segments, although less so for furniture and paper & publishing. Romania is the only target for the segment leather & footwear and covers half of outsourcing in the sector textiles & clothing (Figure 4). Outsourcing in furniture goes to a large extent to Poland, Croatia and Ukraine, while that in paper & publishing is mainly to Hungary, Slovenia, Poland and the Czech Republic; mechanical engineering goes to Romania, Poland and Hungary.

The next step consists in drawing a map of the presence of Italy's banks in the same 10 Eastern European countries, distinguishing each of the 6 banking groups present in the area. In practice, for each banking

group *k*, we define a dummy b_{kj} taking value 1 in each Eastern European country where that group is present and 0 in the other countries. Non-zero values for b_{kj} identify active nodes of the presence of banking group *k*. This map is shown in Table 4. We can count 6 banking groups present in at least one of the 10 Eastern European countries we consider.[14] In terms of the number of countries, group B is present in 7 countries (with only Macedonia, Slovenia and Hungary absent), group A is present in 5 countries, while each of the other four is present in only one of the 10 countries.

Figure 3

**Index of outsourcing to Eastern Europe by industrial district specialization**
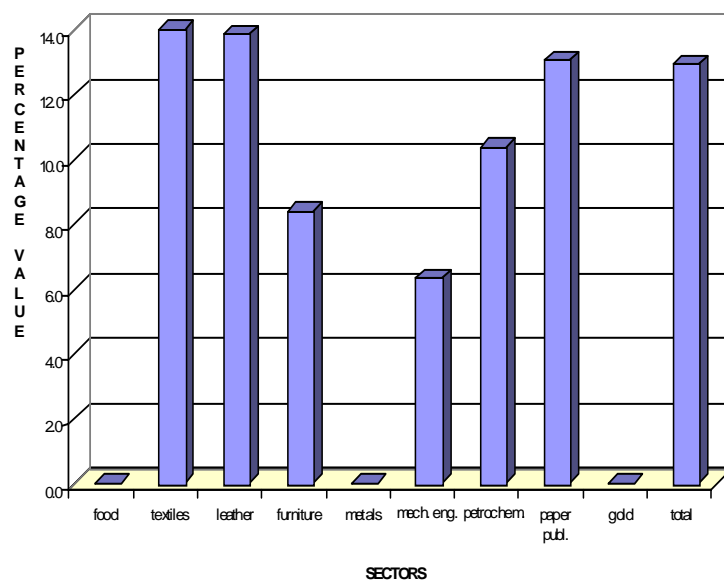
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The acquisition of a branch network in Eastern Europe by Italy's banking groups is a recent phenomenon (Figure 5).[15] By the end of 1996 only group C operated in one of the 10 countries. Group D shows up with one presence (in Romania) in 1997 and group A has one presence since 1998. Banking group presence grows from 2000 on, when the two largest players, groups A and B, upgraded their presence, respectively, from 1 to 3 countries and to 6 of the 10 countries. The prominent role played by Romania in trade and productive links with Italy is also confirmed, observing that 5 out of the 6 banking groups are present in Romania, while fewer of them are present in each of the other countries.

Figure 4

Outsourcing to Eastern Europe by country and industrial district specialization

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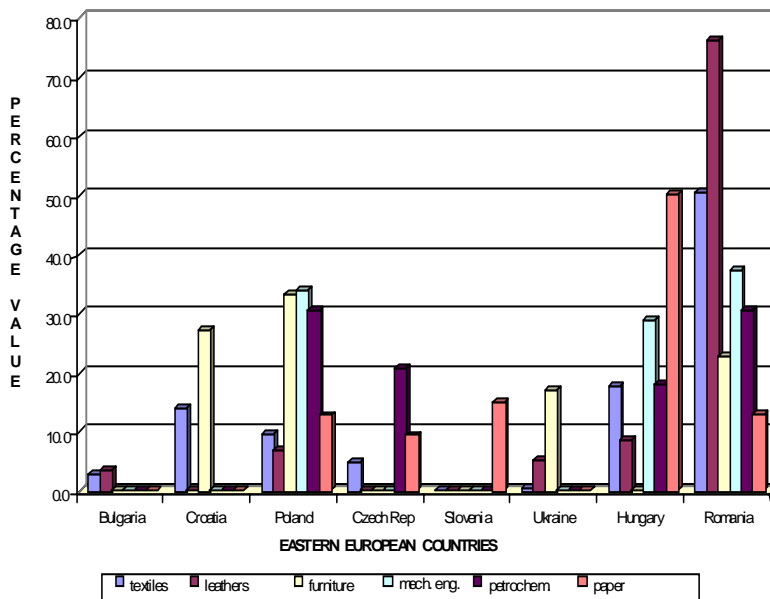
[15]   The presence of Italian banks in Eastern Europe expanded throughout 2003.

Our final step consists in checking whether when Eastern European nodes match the presence of banking group k and the outsourcing by industrial district specialization/province h_i, the loan market share of banking group k in industrial district specialization/province h_i then increases. Since both banking and outsourcing nodes have become active only relatively recently, we try to detect any impact on market shares over the period 1998-2002.

Figure 5

**The recent increase in the presence of Italian banks in Eastern Europe**
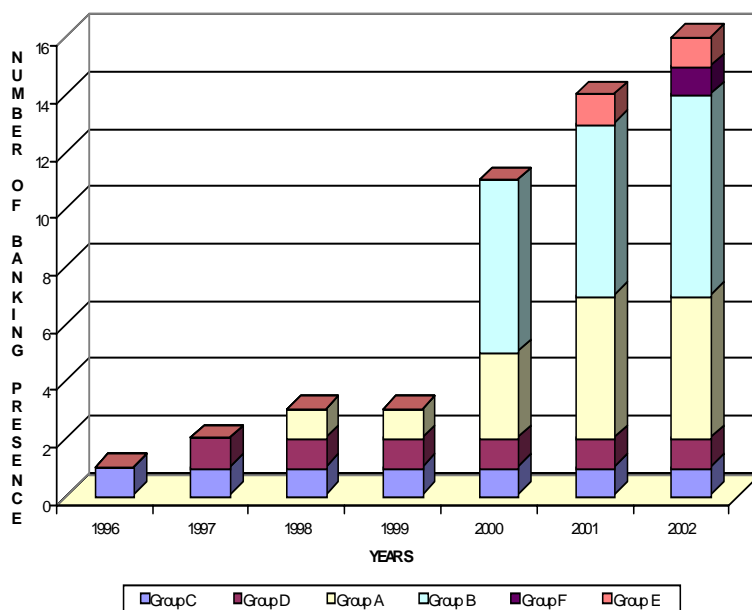
In particular, we study loan market shares – in industrial districts significantly outsourcing to Eastern Europe – over the years 1998-99 (on average) for the banking groups present in Eastern Europe. For the four most important countries of productive outsourcing, Figure 6 compares the market shares with those recorded (on average) over the years 2000-02, the

period in which the presence in Eastern Europe of Italian banks intensified.[16]

Prima facie, Figure 6 does not identify a decisive promoting effect on market shares: while for Croatia and Romania we detect a slight increase, for Poland and Hungary we notice a reduction, which is more marked in the case of the latter country Even if, instead of considering market shares by country, we evaluate the overall market share of the 6 banking groups over the industrial district nodes with significant

Figure 6

Market shares of the banks with a presence in Eastern Europe in the industrial districts heavily outsourcing to Eastern Europe


<hr>
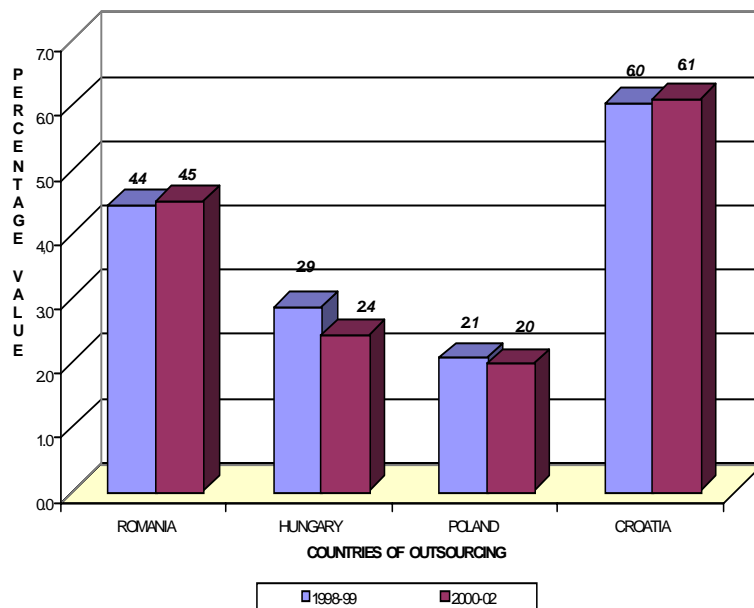
[16]   For each Eastern European country, market shares refer to the banking groups with an operational presence in the country that are located in the industrial districts which have heavily outsourced to the same country. For instance, in the case of Romania, market shares refer to loans granted by banking groups B, C, D, E and F (group A is not present) in industrial districts that outsource production to Romania, only for the sectors that are effectively outsourced (i.e. textiles & clothing for the industrial districts belonging to the province of Bergamo, textiles & clothing and petrochemicals for the industrial districts belonging to the province of Brescia and so on).

outsourcing to Eastern Europe, there is a decrease from 27.9 to 27.4 per cent over the two periods. Nevertheless, the decrease in market shares for the 6 banking groups in outsourcing industrial districts must also be evaluated in relation to the evolution of the overall market share (in the whole of Italy) of the 6 banking groups: over the two periods it decreases by more than 2 percentage points (Figure 7). This comparison leads us to conclude that the loss in the loan market share of the 6 banking groups with a presence in Eastern Europe was smaller in the industrial districts significantly outsourcing to Eastern Europe than in the rest of Italy. In addition, Figure 7 reports market shares in the industrial districts with lower outsourcing (the first quartile of the outsourcing index) and in those with higher outsourcing (the fourth quartile). The first group shows a decreasing market share (from 28.9 to 27.2 per cent), while the second reports an increase (from 37.7 to 39.0 per cent).

Figure 7

Loan market shares of banks with a presence in Eastern Europe in the industrial districts outsourcing to Eastern Europe and overall in Italy
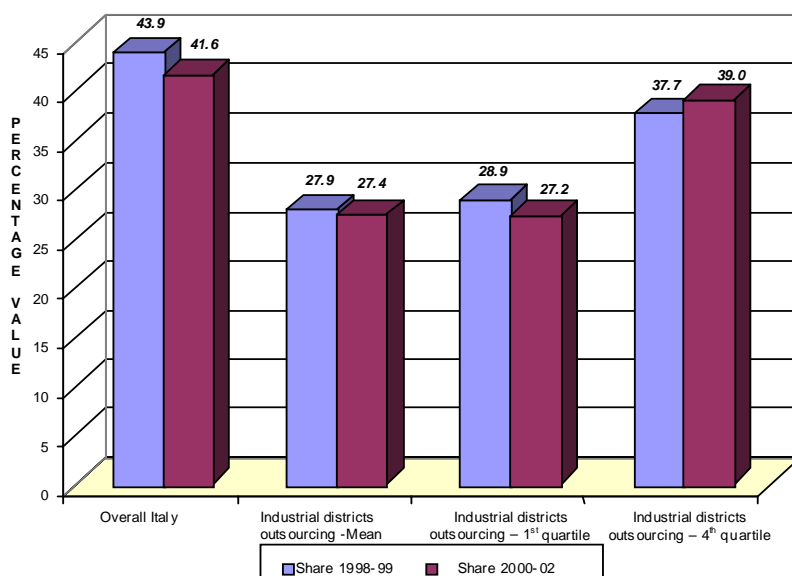
Table 4

Presence of Italian banking groups in Eastern Europe by end-2002 (1)

|	**Banking group**						
	A	**B**	**C**	**D**	**E**	**F**	**Total**
Bulgaria	0	1	0	0	0	0	1
Croatia	1	1	0	0	0	0	2
Czech Rep.	0	1	0	0	0	0	1
Hungary	1	0	0	0	0	0	1
Macedonia	1	0	0	0	0	0	1
Poland	0	1	0	0	0	0	1
Romania	0	1	1	1	1	1	5
Slovak Rep.	1	1	0	0	0	0	2
Slovenia	1	0	0	0	0	0	1
Ukraine	0	1	0	0	0	0	1
Total	5	7	1	1	1	1	

(1) The value 1 (0) indicates that the banking group is (is not) present in the country. The total by column counts the number of Eastern European countries where the banking group is present. The total by row counts the number of Italian banking groups present in each Eastern European country.

3.3 *Some econometric results*

Before settling on the previous inconclusive descriptive evidence, we test our hypothesis with a more rigorous regression analysis for at least two reasons. First, the evidence above does not allow a clearcut interpretation of the data, since aggregating the 6 banking groups does not let us control for the possibility that a generalized increase or decrease in loans might have occurred for a specific banking group, something that could depend on factors unrelated to the presence of the bank in Eastern Europe. Second, a more refined analysis must take into account the fact that the intensity of their presence in Eastern Europe varies among the 6 banking groups because establishment in the area occurred earlier on and/or was more widespread. For instance, on average for 2001-02, the weight of total assets in Eastern Europe as a ratio of total assets in Italy varies across banking groups from a maximum of almost 9 per cent to a minimum of almost nil (Figure 8).

Figure 8

Ratio of assets in Eastern Europe to assets in Italy
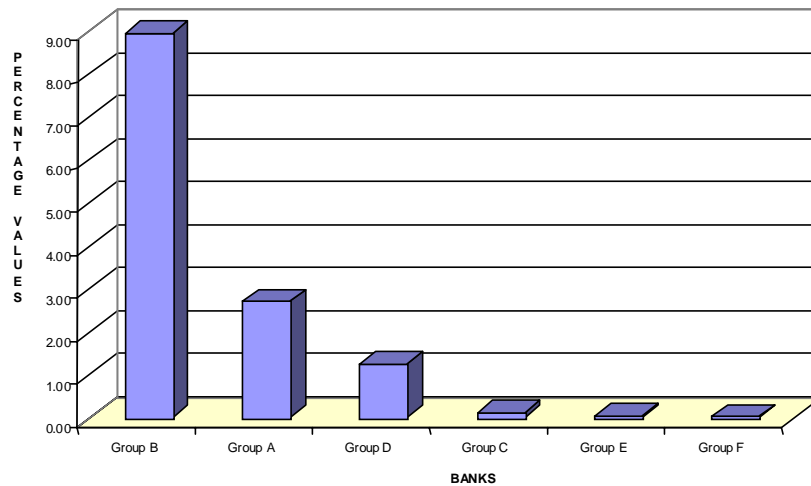
To overcome this problem, we estimate a regression with individual bank data. Specifically, we estimate the possible links between the change in the market share in loans to each one of the industrial districts significantly outsourcing to Eastern Europe. Thus, to gauge whether the presence in Eastern Europe promoted the penetration in traditional lending to local markets in the industrial districts that outsource considerably to Eastern Europe, we estimate the following equation:

[1] $MSH02_{ij} = \alpha + \beta_1 MSH01_{ij} + \beta_2 \Delta MSHB_i + \beta_3 LOTA_i + \beta_4 EETA_i + \beta_5 OLD_i + \beta_6 LTA_j + \beta_7 DCOU_j + \beta_8 DSECT_j + \varepsilon_{ij}$

where $MSH02_{ij}$ is the market share of bank group *i* in market *j* at the end 2002, $MSH01_{ij}$ is the same share at the end of 2001, $\Delta MSHB_i$ is the change in the overall (for the whole of Italy) market share of group *i* between the end of 2001 and the end of 2002,[17] $LOTA_i$ (the ratio between

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[17]   Since we are interested in testing whether the intensity of the presence in Eastern Europe has a positive impact, the market share of each banking group is computed as a ratio of the loans of the 6 banking groups with a presence in Eastern Europe.

loans and total assets for group *i*) controls for banks' lending propensity, LTA_i (the logarithm of the total assets of banking group *i*) controls for possible differential effects due to bank size, $EETA_i$ is the weight of group *i*'s total assets in Eastern Europe as a ratio of its total assets in Italy, OLD_i is a dummy index taking value 1 for the banking groups already present in Eastern Europe by 2000. To reduce problems of endogeneity (i.e. increasing market shares in outsourcing industrial districts might induce banks to open up in Eastern Europe, rather than the other way around), $EETA_i$ is calculated on the basis of he average for the previous two-year period (2000-01). Finally, we also insert 0-1 dummies to control for the sector of specialization and the country of outsourcing.

The results of the estimate are reported in Table 5. First, they confirm the strong persistence of market shares (the value of the coefficient of *MSH01* is close to 1). In addition, market shares in outsourcing industrial districts tend to increase for the banking groups that are concurrently experiencing increases in their overall market share and also for the banking groups that have a larger lending propensity, as indicated by a larger loan to total assets ratio. Furthermore, we detect an expansionary impact in the industrial districts outsourcing to Bulgaria or Croatia, while, on the contrary, there is a depressing effect for the industrial districts specializing in furniture. Nevertheless, the most relevant result for us is that, after controlling for the other factors mentioned, market shares in outsourcing industrial districts increase more for the banking groups that have already established a larger presence in Eastern Europe and/or have been operating there for longer.

All in all, this first result seems to support the conjecture that the presence in Eastern Europe is a promotional factor for traditional business in Italy, especially in the local markets of the industrial districts where firms have heavily outsourced production precisely to Eastern Europe. In addition, this promotional factor appears to strengthen as the presence of a banking group in Eastern Europe becomes more established: according to our estimates, an increase of 1 per cent in the ratio of Eastern European assets to assets in Italy for a specific banking group is associated with an average increase of 0.6 per cent in the market share of that group in outsourcing industrial districts and, ceteris paribus, market shares are 1 per cent higher for the banking groups that have already been operating in Eastern Europe for longer.

These outcomes are not entirely satisfactory, however. The performance of the 6 banking groups could be due to better results in the

sector specialization of the industrial districts rather than to their presence in Eastern Europe. In order to address this concern, we estimate an additional regression, focusing on the most important sector in terms of outsourcing (i.e. textiles and clothing) and introducing a control sample of industrial districts with no outsourcing to Eastern Europe. Our hypothesis will receive support if the loan market shares of our 6 banking groups increase significantly in the outsourcing industrial districts and do not in the non-outsourcing industrial districts.

We define a dummy for outsourced districts *OUTSD* (taking value 1 if the district *j* is outsourced and 0 otherwise) and generate two further interaction variables $EETAOUTSD_{ij}$ (given by $EETA_i*OUTSD_j$) and $OLDOUTSD_{ij}$ (given by $OLD_i* OUTSD_j$). The null hypothesis is to find a positive effect on market shares for the 6 banking groups in the outsourcing industrial districts (positive effect when $OUTSD_j=1$) and/or a positive effect for the banking groups with a longer (positive effect of $OLDOUTSD_{ij}$) and a stronger (positive effect of $EETAOUTSD_{ij}$) presence in Eastern European countries.

Table 5

OLS Regression on market share of individual banking groups moving to Eastern Europe

We estimate an equation in the following form:

$MSH02_{ij} = \alpha + \beta_1 MSH01_{ij} + \beta_2 \Delta MSHB_i + \beta_3 LOTA_i + \beta_4 EETA_i + \beta_5 OLD_i + \beta_6 LTA_i + \beta_7 DCOU_j + \beta_8 DSECT_j + \varepsilon_{ij}$

The dependent variable ($MSH02_{ij}$) is the market share of banking group (BG) *i* in local market *j* where an industrial district was present and significantly outsourced production to Eastern Europe (e.g. considering the case of textiles-clothing in the province of Bergamo, where an industrial district significantly outsources production to Romania, we take the ratio of the loans by each of the 5 BG present in Romania granted to the textiles-clothing sector in that industrial district and the total loans by the entire banking system to textiles-clothing in that industrial district) by end 2002 (data source: Banca d'Italia). $MSH01_{ij}$ is the same variable at end 2001. $\Delta MSHB_i$ is the change in the market share of total loans (taken as a ratio to the total for the 6 BG) of BG *i* between end-2001 and end-2002 (data source: Banca d'Italia). $LOTA_i$ is the ratio loans/total assets for BG *i* at end-2002 (data source: Banca d'Italia). $EETA_i$ is the ratio, for each BG, between total assets in Eastern Europe and total assets in Italy (evaluated on the 2000-01 average; data source: Banca d'Italia). OLD_i is a dummy variable taking value 1 for BGs (A, B, C, D) that established their presence in Eastern Europe earlier. LTA_i is the logarithm of total assets for BG *i* (evaluated at end-2001; data source: Banca d'Italia). $OPTIND_j$ is the value of the OPT index (calculated for 2001 on Istat foreign trade data). $DCOU_j$ (Bulgaria, Croatia, Czech Rep., Hungary, Poland, Slovenia, Ukraine and Romania) are dummies whose value is 1 if the industrial district outsources to that country and is 0 otherwise. $DSECT_j$ (textiles; leather; furniture; mechanics; petrochemicals; paper) are dummies 0-1 identifying the productive specialization of the industrial district. Reported *t*-statistics are obtained via the OLS method and are heteroschedastic consistent according to the Huber-White correction. ***, ** and * indicate, respectively, that the hypothesis of the coefficient being zero may be rejected at the 1 per cent, 5 per cent and 10 per cent confidence level.

Dep variable: MSH02	First specification Coeffic.	t-stat	Preferred specification Coeffic.	t-stat
MSH01	0.8180	15.13***	0.8205	16.46***
ΔMSHB	1.3963	1.85*	1.2809	1.93*
LOTA	0.3345	2.21**	0.3084	2.37**
EETA	0.5677	2.02**	0.5328	2.13**
OLD	0.0118	1.50	0.0102	1.85*
LTA	0.0018	0.52	-	-
OPTIND	-0.0468	-0.80	-	-
BULGARIA	0.0139	1.70*	0.0163	1.98**
CROATIA	0.0229	1.91*	0.0252	2.36**
POLAND	0.0026	0.46	-	-
CZECH REP.	-0.0121	-0.83	-	-
SLOVENIA	0.0055	0.22	-	-
UKRAINE	0.0091	0.60	-	-
HUNGARY	0.0062	1.02	-	-
ROMANIA	0.0058	0.40	-	-
TEXTILE	-0.0054	-0.22	-	-
LEATHER	-0.0042	-0.16	-	-
FURNITURE	-0.0176	-0.72	-0.0122	-2.29**
MECHANICS	-0.0066	-0.28	-	-
PAPER	-0.0132	-0.62	-	-
CONSTANT	-0.1861	-2.05**	-0.1551	-2.30**
No.° obs..	105		105	
F	(20.84)	59.58***	(8.96)	104.93***
R^2	0.918		0.912	

The estimated equation runs as follows:

[2] $MSH02_{ij} = \alpha + \beta_1 MSH01_{ij} + \beta_2 \Delta MSHB_i + \beta_3 LOTA_i + \beta_4 LTA_i +$
$\beta_5 EETAOUTSD_{ij} + \beta_6 EETAOUTSD^2{}_{ij} + \beta_7 OLDOUTSD_{ij} + \beta_8 DCOU_j + \varepsilon_{ij}$

where, besides the regressors above, the variable $EETAOUTSD^2{}_{ij}$ (the square of $EETAOUTSD_{ij}$) probably captures non-linearity with the dependent variable.

Results (Table 6) show no impact of the variable *OUTSD per se* but confirm a significant effect for the banking groups with a longer and stronger presence in Eastern Europe. This effect materializes only in outsourcing industrial districts where market shares are 0.9 per cent larger for a bank with a longer presence in Eastern Europe (vis-à-vis a junior bank) and about 2.5 per cent larger for a bank with a value of *EETAOUTSD* at the 75th percentile (compared with a 25th percentile bank).

Table 6

OLS Regression on market share of individual bank groups moving to Eastern Europe: textiles and clothing districts with and without outsourcing

We estimate an equation in the following form:

$$MSH02_{ij} = \alpha + \beta_1 MSH01_{ij} + \beta_2 \Delta MSHB_i + \beta_3 LOTA_i + \beta_4 LTA_i + \beta_5 EETAOUTSD_{ij} + \beta_6 EETAOUTSD^2_{ij} + \beta_7 OLDOUTSD_{ij} + \beta_8 DCOU_j \; \varepsilon_{ij}$$

The dependent variable ($MSH02_{ij}$) is the market share of banking group (BG) i in local market j where an industrial district was present and significantly outsourced production to Eastern Europe (e.g. considering the case of textiles-clothing in the province of Bergamo, where an industrial district significantly outsources production to Romania, we take the ratio of the loans by each of the 5 BG present in Romania granted to the textiles-clothing sector in that industrial district and the total loans by the entire banking system to textiles-clothing in that industrial district) by end-2002 (data source: Banca d'Italia). $MSH01_{ij}$ is the same variable at end-2001. $\Delta MSHB_i$ is the change in the market share of total loans (taken as a ratio to the total for the 6 BG) of BG i between end-2001 and end-2002 (data source: Banca d'Italia). $LOTA_i$ is the ratio loans/total assets for BG i at end-2002 (data source: Banca d'Italia). $EETAOUTSD_{ij}$ is the ratio, for each BG, between total assets in Eastern Europe and total assets in Italy (evaluated on the 2000-01 average; data source: Banca d'Italia) multiplied by the dummy *OUTSD* (which takes value 1 when the district is outsourced and 0 otherwise). $EETAOUTSD^2_{ij}$ is the square of $EETAOUTSD_{ij}$. $OLDOUTSD_{ij}$ is a dummy variable taking value 1 for BGs (A, B, C, D) that established their presence in Eastern Europe earlier multiplied by *OUTSD*. LTA_i is the logarithm of total assets for BG i (evaluated at end-2001; data source: Banca d'Italia). $DCOU_j$ (Bulgaria, Croatia, Czech Rep., Hungary, Poland, Slovenia, Ukraine and Romania) are dummies whose value is 1 if the industrial district outsources to that country and is 0 otherwise. Reported t-statistics are obtained via the OLS method and are heteroschedastic consistent according to the Huber-White correction. ***, ** and * indicate, respectively, that the hypothesis of the coefficient being zero may be rejected at the 1 per cent, 5 per cent and 10 per cent confidence level.

Dependent var.	First specification		Preferred specifications			
MSH02	Coeffic.	t-stat	Coeffic.	t-stat	Coeffic.	t-stat
MSH01	0.8991	22.29***	0.9082	25.36***	0.9124	24.94***
ΔMSHB	-0.1537	-1.07	-	-	-	-
LOTA	0.0837	1.51	0.1320	2.71***	0.0696	1.61
LTA	0.0101	2.27**	0.0111	2.41**	0.0068	2.16**
CZECH REP.	-0.05456	-6.94***	-0.0555	-8.87***	-0.05556	-7.09***
DEL	-0.0062	-1.66	-	-	-	-
OLDEL	0.0080	-1.66	0.00090	2.00**	-	-
EETADEL	0.7976	1.07	-	-	1.1216	1.80*
EETADEL2	-0.0009	-1.03	-	-	-0.0012	-1.64
CONSTANT	-0.0839	-2.07**	-0.1139	-3.14***	-0.0641	-2.38***
No. obs.	112		112		112	
F	(8,102)	203.50***	(4,106)	375.06***	(5,105)	254.11***
R^2	0.940		0.938		0.938	

4.   Concluding remarks

In the process of internationalization of production two new linkages have been established between Italy and Eastern Europe. First, many SME-based industrial district systems already enjoying a strong export performance for final goods (Bagella *et al.*, 1998) have outsourced to Eastern Europe many of the relevant phases of their productive process, attracted by the area's vicinity, relatively high human capital endowment and, above all, comparatively low labour costs. It is also thanks to this change in the organization of production that industrial district SMEs have been able to limit their declining competitiveness on international markets, where they were formidably challenged by exports from low-production-cost emerging economies. Furthermore, although Italy's banking system traditionally hesitated to go international, some Italian banks strategically entered retail banking markets in Eastern Europe.

In this chapter we analyzed whether the two phenomena were independent from each other or, rather, were somewhat related. Lacking direct information on the support given (or not given) by Italian banking groups with a presence in Eastern Europe to Italy's industrial district SMEs in their productive internationalization to Eastern Europe, we devised an alternative strategy. In particular, we argued that we could assume the two phenomena were related if we found that the banking groups that had gone international to Eastern Europe increased their market shares precisely in those industrial districts which more heavily outsourced production to Eastern Europe.

Surmounting various impediments to categorize the distribution of industrial districts' outsourcing to Eastern Europe, we were able to draw a map of the phenomenon. Concurrently, we also drew a map of the presence in Eastern Europe of Italy's banking groups: we found 6 of them. Finally, we tested whether the correspondence between a bank's internationalization nodes to a specific Eastern European country and productive outsourcing nodes to the same country from a specific industrial district has an impact on the market share of that bank in that industrial district. While the overall market share of the 6 banking groups as a whole declined between 1998-99 and 2000-02, we showed that the decline was smaller in the industrial districts outsourcing to Eastern Europe: hence, their presence in Eastern Europe seems to have provided these banks with a competitive edge in those local markets in Italy. Secondly, regarding each of the 6 individual banks' market shares between 2001 and 2002, we found

that these increased for the banking groups already present for a longer time in Eastern Europe and for those with larger presence in Eastern Europe in 2000-01; we would like to stress that this outcome is valid for the textile and clothing industrial districts which have outsourced production (indeed the bulk of industrial districts' outsourcing), while it is not observable for the districts which have not outsourced. Thus, we provide support for the hypothesis that the internationalization of Italian banks and that of Italian industrial district SMEs (both to Eastern Europe) were (possibly unintentionally) somewhat related.

This result does not amount to saying that Italian banks are doing all they can to help the productive internationalization of Italian industrial district SMEs, but at least we may rule out that the two forms of internationalization are independent of each other. Since productive outsourcing from industrial districts to Eastern Europe is so vital to safeguard manufacturing competitiveness, our results suggest that Italian banks are also playing a role in this respect. Obviously, the above is based mainly on some suggestive evidence and a reasonable argument, rather than on absolute certainty. But, if our assumption were confirmed, then we could play down the usual complaint that Italy's various institutional and economic actors are unable to "play as a team".

Our results have implications for Italy's banking structure. It is well known, in fact, that local banks (often cooperative ones) play a primary role in providing financial support to industrial district SMEs. However, will this hold for the future? If we look at internationalization to Eastern Europe, until now the main banking players have been some large banks, not local banks. Since the internationalization of their productive processes will be a key factor for industrial district SMEs in the near future, we may envisage that large national banks might increasingly challenge local banks in their traditional market niches, unless the latter also acquire a capacity to support the internationalization of SMEs.

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