Mergers and Acquisitions (M&As) in the Luxury Business

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Company Growth

4.1 The Growth of the Company

A company might be seen as a “system”\textsuperscript{1} or a homogeneous entity, based on the direct or indirect relations among its components\textsuperscript{2}.

Such a system encompasses a human and a material element. The former is represented by the individuals or group of individuals who work within a mutual relationship\textsuperscript{3}: their work is paid for with a salary. The human element is crucial in luxury companies, as it contributes inspiration, creativity and attitudes. In addition, it plays a key role in terms of innovation, which is of the essence in this context. For instance, the engineer who designs new car models and the designer who creates a new collection are both key figures in determining their company’s success or failure. The material element is represented by the means of production together with the financial capital\textsuperscript{4}.

It is thanks to the interrelations between these two complementary elements that business takes place\textsuperscript{5}: the human element provides labour; the material element is crucial for the company to function. It follows that such elements are inseparable and that companies are holistic systems\textsuperscript{6}. Considered as a system, a business has features that differ from those of the single parts

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\textsuperscript{1} Ferrero G., Impresa e management, Giuffré, Milano, 1987, p. 5. This part concerning the definition and the characteristics of “company system” is taken and elaborated from Giacosa E., L’economia delle aziende di abbigliamento, Giappichelli, Torino, 2011, pp. 30 ff. We refer only to Italian studies, focusing on the company as a system.


\textsuperscript{3} Ferraris Franceschi R., L’azienda: forme, aspetti, caratteri e criteri discriminanti, Edizioni Kappa, Roma, 1995, p. 21.

\textsuperscript{4} Besides the human and material factors, which are easily recognisable, the organisational factor also contributes to this system. This can be defined as the way through which the human element dynamically combines with the material one. Caramiello C., L’azienda. Operazioni di gestione e “dinamica dei valori”, Giuffré, Milano, 1989, p. 35.

\textsuperscript{5} Ferrero G., Impresa e management, cit., p. 6.

\textsuperscript{6} Melis G., Elementi di Economia Aziendale, Giuffré, Milano, 2001, p. 35.
comprising it; such elements cannot be disjointed, and each business can be identified through the relationships established among them. Any change occurring to any one component impacts on the others and the very existence of a company depends on coordination among the elements. These components are diverse but also complementary, interrelated and interdependent: as such, they make each company system unique.

Furthermore, each company is complementary to the market system, which in turn influences business. Consequently, although each company does maintain its economic autonomy, it cannot operate or survive by itself. On the contrary, it consistently interacts with its context through various relations.

In addition, no company is self-sustained and this explains the fact that all businesses have to interact with their context in order to gain or maintain a competitive advantage, share resources and acquire knowledge in order to reach a common goal. The choice of cooperating or teaming up with other businesses is an opportunity in terms of economic advantage. Since each company interacts with its context, this can be described as an “open” system. On the contrary, in closed systems, the relations among the components are defined and developed within certain boundaries. More precisely, if a company tends to be influenced only by the positive factors of its environment, or by factors that could be selected, it is a “selectively open” system; its movement

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10 Farneti G., Economia d’Azienda, Franco Angeli, Milano, 2007, p. 3.
12 Zappa G., Il reddito d’impresa, cit., p. 12.
14 Ferrero G., Istituzioni di economia d’azienda, cit., pp. 8 ff.
15 Azzini L., Autonomia e collaborazione tra le aziende, Giuffrè, Milano, 1974, p. 63.
17 Farneti G., Economia d’Azienda, cit., p. 3.
18 Vermiglio F., Il bilancio sociale nel quadro evolutivo del sistema di impresa, Grafo, Messina, 1984, p. 54.
towards the context would be relative, not absolute. As an open system, each company establishes various relations with other companies or individuals: companies exchange products and services with consumers, and companies transfer money to employees in exchange for labour or to shareholders for capital. Other relationships take place between production companies in the supply of inputs to be used in the production process, etc.

In addition to these, companies might establish other relations, with different strategies and intensities, which fit into a sort of puzzle within the eco-

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19 Besides being open systems, companies are also characterised by the following, which actually make them companies (Giacosa E., *L'economia delle aziende di abbigliamento*, cit., pp. 32 ff.):

- social systems: companies are made up of groups of individuals who work together in order to reach certain economic objectives. Businesses can be seen as economic units created between humans and society (Ceccherelli A., *Economia Aziendale e amministrazione delle imprese*, Barbera, Firenze, 1948, p. 53. Beretta Zanoni A., *Strategia aziendale*, Cedam, Padova, 2008, p. 71). Therefore, companies are the means through which humans operate in the economy, and companies represent social institutions: they are created by individuals in order to reach human goals within a given community (Bertini U., *Il sistema d'azienda*, Giappichelli, Torino, 1990, p. 34). In performing such a social function (Ferraris Franceschi R., *Finalità dell'azienda e condizioni di funzionamento*, Seu, Pisa, 1984, p. 231. Cricchio S., *Il sistema informativo del bilancio di esercizio*, Giuffré, Milano, 1997, p. 17), companies mirror the cognitive processes of the individuals who created them;

- teleological systems: since companies are the means through which humans operate in the economy, they do not have their own goals. They actually aim at satisfying human needs;

- economic systems: any companies uses economic goods available in limited quantities. Consequently, the management has to prioritise their use. Such a process is informed by the principle of rationality (Pastore A., *La funzionalità economica dell'impresa*, Cacucci, Bari, 1984, p. 23); and

- dynamic systems: companies have to detect the ever-changing stimuli coming from the contexts surrounding them. They have to respond to such stimuli in a flexible way; they must seize opportunities, handle restrictions and adapt to the conditions of such an environment in a dynamic way. Dynamism is crucial to reach a position of dynamic balance, without which companies cannot last long. The attitude to consistently exist in mutability (Zappa G., *Il reddito d'impresa*, cit., p. 12. Onida P., *Economia d'azienda*, cit., p. 4) enables the system to last a long time, despite the fact that internal and external conditions might change.


nomic context. Such relations are aimed at finding new and better conditions in terms of:

a) growth: defined as the increase in company size, which can be assessed through quantitative elements (turnover, added value, staff, investments, market share, etc.) . Consequently, growth is achieved whenever size increases in a given period of time. Growth is intrinsic to companies inasmuch as the element of challenge pertains to individuals, who transfer it to the companies that they manage. The goal represented by growth might be related to both internal factors (stimulated by the management) and external elements (opportunities provided by the context in which the company operates); and

b) development: this might be seen as a qualitative improvement in the business. In other words, development occurs when company size achieves a qualitative improvement thanks to better perspectives of economic and financial balance in the long term, after having gained a clear competitive advantage. Therefore, development is aimed at creating perspectives of stable profitability, which is related to the acquisition of new skills or to the creation of valid synergies among the elements that comprise the company.

Although growth and development often occur together, they are not mutually necessary. In other words, growth is not sufficient to guarantee development. An increase in size might not be necessary in order to stimulate development, at least from a theoretical perspective. Nevertheless, the qualitative con-

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ditions that favour development do have an impact on the role that a company plays within its context and might also result in growth\textsuperscript{28}. In practice, any qualitative growth is usually followed by quantitative growth\textsuperscript{29} in the near or distant future.

The objectives of growth and development are crucial to the survival of companies in the long term. During a company’s lifecycle, decisions are taken with a view to encourage future growth and development. Also, in the course of a crisis, when the main goal is to preserve the operational scope or even save the company from bankruptcy\textsuperscript{30}, choices are made with consideration for future growth and development. Growth is consistently pursued during the whole lifecycle of a company\textsuperscript{31}.

Each and every strategic choice comes after the assessment of both the role and the competitive position that the company holds in its context. This is also due to the fact that companies diffuse not only financial resources but also elements, attitudes and restrictions, which might cause a given policy to be beneficial or detrimental in terms of growth or development. Moreover, any decision that impacts on such processes has to be carefully assessed; for example, an increase in size might force the company to deal with unpredictable consequences such as meeting new needs, finding alternative suppliers, operating in larger target markets, coordinating different aspects of management, etc. When not properly managed, an increase in size might be detrimental to the company or companies involved, including in terms of profitability.

Growth should not be seen as a necessary condition for companies to function in the long run. This is the case with small businesses that operate in market niches and that are competitive even though they do not increase their size\textsuperscript{32}.

In order to grow, businesses should aim towards goals that favour the


\textsuperscript{28} Cescon F., \textit{Il controllo di gestione nello sviluppo e nel risanamento aziendale}, Cedam, Padova, 1988, p. 34.

\textsuperscript{29} Coda V., \textit{L’orientamento strategico dell’impresa}, Utet, Torino, 1988, p. 5.


\textsuperscript{32} Cortesi A., \textit{La crescita delle piccole imprese}, cit., pp. 51 ff.
premise of growth:

a) in terms of production, companies should reach a good level of productivity compared with that of their competitors. If they fail to do so, their line of products would lose attractiveness, which would affect business in terms of size growth. Productivity has a positive effect on profitability, competitiveness and social performance, all of which favour the creation of new resources that might be invested to achieve growth. Poor productivity jeopardises the beneficial effects of growth, since it causes the company to be easily outperformed by its competitors. Furthermore, businesses should aim to develop their line of products through substantial investments in R&D and innovation; the level of innovation of both products and processes has a flywheel effect on growth. Innovation results in reduced manufacturing costs, a more efficient production cycle and a more attractive line of products with new or improved items. Furthermore, innovation should be aimed at updating operational and logistic skills with the purpose of improving both effectiveness and efficiency; and

b) in terms of sales, businesses should improve their market reach by targeting new geographical areas along with new segments of customers. In order to do so, they have to adapt to a rapidly changing environment, especially when they operate in a global context. More scrupulous attention to customer care might encourage loyalty, which is a necessary condition for a company to guarantee adequate turnover.

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4.2 The Process of Company Growth

The process of growth might be defined in terms of the strategies through which it is achieved:

a) internal growth; and
b) external growth.

Such strategies share a number of general features, in addition to the elements that specifically characterise a given company and its context. Defining these general features might be useful for the purpose of assessing the costs and benefits associated with each kind of growth strategy.

When comparing internal and external solutions, advantages and disadvantages might be weighed up by considering the various variables of decision making: the extent to which a decision is reversible, the level of risk, the impact of any decision and the soundness of alternative choices. Although internal growth is usually juxtaposed with external growth, internal and external development strategies are often undertaken in a converging way: external growth and internal growth are complementary.

Internal growth is pursued through the use of internal and external financial resources together with the technological, managerial and entrepreneurial skills owned by the company. Businesses operate according to their own potential in terms of organisational structure, manufacturing system and financial resources.

Internal growth is favoured by various factors, such as the growth trends in the relevant sector and the availability of proactive human resources with a

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talent for innovation. Internal growth is closely related to the presence of entrepreneurship, aimed at appreciating the skills and resources available in the company. This can be attained by encouraging staff to make suggestions and to create conditions that are favourable to business.

Internal growth is ultimately aimed at gaining a greater market share in contexts where the company already operates; alternatively, it is directed at penetrating new markets, enlarging the line of products or undertaking a process of diversification. Moreover, internal growth occurs at a level of risk that the company deems acceptable.

The main advantages related to internal growth are the following:

- companies use an appropriate amount of resources thanks to a consistent assessment of financial compatibility. Internal growth makes it possible to adapt investments to the actual needs of the company. Not only is it compatible to the company’s structure and skills, but it is also in line with the real identity of the company;
- new investments are more rapidly integrated into the company structure, which saves both money and time. This is due to the fact that, before starting a process of internal growth, the process itself is adapted to the size and the organisational structure of the company; and
- decision making becomes shorter and leaner: internal growth involves only one entity (the company), and it is not subject to any form of contract.

However, internal growth sets certain limits on the potential increase in company size: adopting a resource-based approach, businesses use internal knowledge, skills and financial resources and all of which are limited. In addition, it takes a longer time to get returns on investments, since businesses stand
alone when trying to sell their products, enter new markets and strengthen their presence in existing ones. When business opportunities outsize such potential, companies are forced to choose between two options: either give up their projects or favour external growth.

What follows is an analysis of external growth, which is the focus of this chapter.

Strictly speaking, external growth occurs in the operations through which companies acquire shares or assets from other businesses, in order to control them. Companies pursue external growth by combining with other companies through more or less intense and formalised deals. Such combination results in synergies that pertain to both large and small businesses. In large companies, synergies enable the newly established corporation or the informal cluster of companies involved to obtain economies of scale. In small businesses, synergies are aimed at exploiting the knowledge and skills owned by niche companies, which are usually characterised by a considerable attitude towards innovation.

The relations between companies are directed to use complementary resources that belong to different subjects with the purposes of gaining direct or indirect control of such resources as well as generating synergies. In order to do so, business combination is deemed to be effective inasmuch as it favours access to the resources of the partner(s), which might be necessary because of the changeable conditions of the given context. Moreover, jobs undergo a process of reorganisation; the skills and attitudes of the involved parties are enhanced. In the case of small companies, business combination enables them to deal with financial and structural shortages by exploiting unused creative potential.

Any process of external growth shares one of the following strategies:

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a) neither lines of products nor market segments are modified. Companies aim at taking advantage of unexploited potential demand and obtaining economies of scale. In order to improve their market reach, companies have to attract their competitors’ customers. The company tries to improve the visibility of their existing products;

b) market segments are not modified, but lines of products are either expanded or renewed. The purpose is to increase the demand by differentiating the company’s products from those of their competitors. Companies aim at consolidating or expanding their market reach by differentiating or renewing their own line of products;

c) lines of products are not modified, but new markets are reached, both in a geographical sense (for instance, when new stores are opened in the Asian market) and in terms of new market segments (for example, through brand extension). Also, this strategy focuses on existing lines of products; or

d) both lines of products and market segments are modified. This strategy is coherent with diversification policies\(^\text{49}\), in that companies aim at expanding their lines of products as well as reaching new segments and markets, defined in a geographical sense or in terms of customer segments\(^\text{50}\). Usually, companies pursue diversification when the market and/or the sector in which they operate is saturated and consequently does not guarantee an adequate level of profitability, neither in current nor in perspective terms\(^\text{51}\). Product diversification might be implemented through an expansion of the line of products, penetration into new sectors and markets (considered as geographical areas as well as customer segments), the use of new technologies and the use of different distribution channels\(^\text{52}\).


Companies that decide to implement diversification strategies usually produce heterogeneous outputs\(^{53}\), which do not depend on company size\(^{54}\). In particular, products are not diversified if they show only intrinsic differences; the output might be considered “diverse” when different products target different markets or when the resources and the skills used to manufacture one specific product cannot be used to manufacture another.

Diversification strategies might be classified on the basis of various criteria. When such strategies are implemented within one sector, it is defined as single-sector diversification; on the contrary, when diversification stretches to more than one sector, it is described as multi-sector diversification. On the basis of the technology level of a company’s line of products, diversification might be lateral or conglomerate. The first involves new products that maintain the same technology level as existing products; usually, such diversification is pursued through internal growth, i.e. the company has set up new manufacturing units. In the latter, not only does the new line of products achieve a different technology level, but also the markets and sectors involved are different. Usually, such diversification is pursued through external growth, i.e. with two or more companies involved\(^{55}\).

The literature has analysed the impact of diversification on resource investment\(^{56}\), business growth\(^{57}\) and company performance\(^{58}\). Diversification


strategies might improve performance thanks to the creation of synergies\textsuperscript{59}. Such influence might vary in relation to the kind of strategy implemented; diversification in new or existing markets may require similar managerial skills whose availability does not incurring new costs. Alternatively, diversification might require new skills and consequently further investments\textsuperscript{60}. A number of researches have focused on the relation between diversification strategies and risk\textsuperscript{61}. Diversification strategies are implemented with the purpose of mitigating risk, in that companies attain various business scopes\textsuperscript{62}: negative performance in one sector might be counterbalanced by positive performance in another. In addition, diversification allows for companies to increase their size and gain a leading position in relevant markets.

The following table outlines the four strategies of external growth (Figure 4.1).


External growth has a number of advantages:

- goals are pursued more rapidly and in a more cost-effective way than through internal growth. Synergies between actors already operating in the business make it possible for the subjects involved to share existing knowledge and resources, which are often limited. These include technological resources, know-how, a consolidated presence in markets that are characterised by barriers to entry and a well-functioning structure. In this sense, the immediateness factor \(^{63}\) is deemed crucial for the success of any growth strategy;

- thanks to the integration of all parties involved, resources from other companies are made available. Such resources might be material, like labour, raw materials, machinery and equipment; or immaterial, such as information, know-how and organisational structures. Some of these are not easily accessible through traditional market transactions, in that they are strictly related to the context in which they have been created. This is the case with the know-how acquired by a niche company with which a business combination is arranged;

- companies strengthen their competitive position in the market and improve corporate visibility. Companies often buy a competitor, although weaker, in order to gain a greater market share and achieve both a dominating role and a

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competitive advantage\textsuperscript{64}. Sometimes, they aim at overcoming barriers to entry\textsuperscript{65} in contexts asking for requisites that the partner company has. Whenever businesses achieve control of a resource that is not easily accessible by their competitors, they make it difficult for other companies to create a certain product;
- companies gain financial and tax benefits that could not be gained otherwise, especially when business combination takes place with companies that have specific characteristics or are located in certain countries; and
- the financial resources needed to reach a certain size are less conspicuous than those needed in contexts of internal growth requiring a financial investment.

Beside these advantages, external growth also entails some disadvantages:

- the differences in the management style attitudes of the companies involved might cause problems from a strategic point of view in the subsequent post-combination integration and thus might affect business, especially in the medium/long run\textsuperscript{66};
- differences in corporate culture\textsuperscript{67}, as well as in well-established operational and organisational models that might be difficult to integrate, might cause problems of post-combination integration. Such differences might cause the company to bear adaptation and implementation costs\textsuperscript{68};
- business combination may cause duplicate resources or cause unnecessary


resources to become available, since each company involved contributes their existing resources; and
- a partner’s potential might be over- or under-estimated, which would create a situation quite different from the intended scenario. When partners are not sufficiently engaged, or are unable to engage, these strategies might lose scope and be doomed to fail.

The following table contrasts internal and external growth in relation to growth mechanisms, advantages and disadvantages (Figure 4.2).

<table>
<thead>
<tr>
<th>Kind of growth</th>
<th>Growth mechanisms</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal</td>
<td>Investment of financial resources (with internal and external origin), technologies and managerial skills available in the company</td>
<td>Investments are not over- or under-sized</td>
<td>Companies can count only on their attitudes, know-how and skills</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New investments are rapidly integrated into the existing structure</td>
<td>Longer investment cycles</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Leaner decision-making processes</td>
<td></td>
</tr>
<tr>
<td>External</td>
<td>Formal and informal combinations with other companies</td>
<td>Objectives are reached more rapidly and cost-effectively</td>
<td>Different management attitudes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Resources of other companies are made available</td>
<td>Different corporate culture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Competitive position becomes stronger</td>
<td>Difficulties in integrating existing operational and organisational models</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial and tax benefits</td>
<td>Duplication of resources or unnecessary resources made available</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Need for less conspicuous financial resources</td>
<td>Incorrect assessment of partner's potential</td>
</tr>
</tbody>
</table>

*Figure 4.2  Internal and external growth: a contrast

*Source: Personal elaboration*

The concept of external growth is further developed in the following sections.

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4.3 Business Combination in the Context of External Growth

Since companies are not self-sufficient, it is not possible for them to acquire and manage all the resources that might be needed for them to develop and expand. Therefore, they may need to obtain resources and skills from other companies. It is in view of their future that businesses carry out business combination.

Business combination\(^\text{70}\) is defined as a deal (to various extents of formalisation) that causes part of a company or the whole of it to share certain objectives with other companies or to pursue a given development path. The ensuing relationships, when properly managed, enable each of the subjects involved to operate in a more cost-efficient way. This happens when, for instance, two companies reach a deal to jointly acquire means of production or to jointly undertake R&D activities.

Although, generally speaking, business combination does bring advantages in terms of financial and economic balances, it might also limit a company’s autonomy. Such limitation might be more or less severe depending on the kind of relationships existing among the businesses involved. This can be seen from different perspectives. From an objective point of view, it is related to the autonomy in reaching the balances that enable companies to exist in the long run. From a subjective point of view, it is defined as the possibility to direct business towards set objectives. Even though deals among companies are diverse, they are, generally speaking, aimed at maintaining, improving or retrieving the balances of the company\(^\text{71}\).

The operations related to business combination are influenced by a company’s goals in terms of size\(^\text{72}\): when businesses are driven by the objective of


increasing their size, they might be driven towards new types of combination that increase business opportunities.

The relationship required in business combination might have different economic characters, depending on the kind of economic relations existing among the companies involved and on the circumstances that have led to the combination itself. Business combination is often a Hobson’s choice when competition is so fierce as to require a vast range of skills that might be difficult for companies to acquire by themselves. In such a scenario, cooperation among two or more companies makes it possible for them to carry on business in a more competitive way.

The literature has listed other criteria to classify combinations, such as the extent to which the subjects involved are interrelated, which impacts on the possibility of reversing the post-combination scenario.

According to some scholars, by relating the post-combination transformation to the intensity of the integration among the companies involved, it is possible to identify the following types of business combination: formal corporations, characterised by close integration and a formalised deal (acquisitions and joint ventures); networks, in which integration is weak and non-formalised (as in all cases of informal cooperation); and formalised relations, which are considered a between category in which deals might be more or less formalised and integration has mid-span intensity (franchising, consortia, and

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deals of exclusivity with customers and suppliers\textsuperscript{76}.

Other scholars have combined different criteria, such as the kind of integration required in the post-combination stage, the extent to which deals are formalised, and the number of companies involved. The following types of business combination have been defined: groups, characterised by one economic subject, a number of companies and either vertical or horizontal post-combination integration (joint ventures); formal associations of companies, in which a number of companies reach a formal deal without identifying one economic subject (cartels, consortia and franchising associations); and informal associations of companies, in which a number of companies arrange an informal deal with no economic subject (subcontracting networks and districts)\textsuperscript{77}.

Another widely used criterion is the extent of formalisation characterising the business combination, according to which the following types might be identified\textsuperscript{78} (Figure 4.3):

1) formal combinations: they result from deals that are made official through juridical ties, which define the kind, scope and duration of the deal. Such deals (generally in the medium/long term) allow for the joint use of the resources and the skills of the parties involved, in order to carry out a shared project of development. They include strategic alliances, company leases, consortia and franchising; and

2) informal combinations: they result from deals that are not made official through any juridical tie. They occur among companies that have established economic, financial and sales relations. Such deals are reached among companies that remain juridically autonomous and that agree to undertake to cooperate with the purpose of reaching a profitable coordination for each and every subject involved\textsuperscript{79}. Such coordination might be related to any function\textsuperscript{80}: production and logistics, R&D, marketing, human resources, etc. This type of combination is based on the need to find complementary resources at a given time. In order to get such resources, companies have a number of strategic op-

\textsuperscript{76} Boldizzoni D., “La crescita per linee estere delle piccole imprese”, \textit{Sviluppo e Organizzazione}, 131, maggio/giugno, 1992.


\textsuperscript{78} Giaccari F., \textit{Le aggregazioni aziendali}, cit., p. 64 ff.


tions: they might pursue internal growth, purchase resources on the market or cooperate with other businesses\textsuperscript{81}. Such cooperation may also be occasional. The synergies created assist in maintaining or reaching conditions of “economisation”\textsuperscript{82}: they make informal deals a no minor means\textsuperscript{83}. Such deals might

\textsuperscript{81} Cortesi A., \textit{La crescita delle piccole imprese}, cit., p. 125.

also be arranged within a competitive scenario: when two or more competitors reach a cooperation deal, they establish competitive cooperation.

Informal combinations might generate various relationships among the companies involved:

a) horizontal relationships: cooperation is established among companies operating in similar activities. This drives them to share certain activities. It follows that the risks associated with the joint project are mitigated. Moreover, each company acquires the knowledge and skills of the partner(s);

b) vertical relationships: cooperation takes place between a company and other subjects that play a role at an earlier and/or later stage of the supply chain. Cooperation is focused on labour specialisation, as well as on the exploitation of the distinctive skills of the companies involved. The assumption here is that the existing know-how and the pre-combination background are asymmetrical; and

c) transverse relationships: they refer to companies operating in different manufacturing and distributive contexts. This is the case, for instance, with a watch manufacturing company that decides to cooperate with a distributor operating in the clothing industry.

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The reasons behind informal combinations are various:

a) technical-productive and commercial reasons: regarding the former, companies combine with others in order to acquire greater flexibility in production, obtain economies of scale, increase specialisation and gain a greater market share. Moreover, whenever deals are focused on transferring technology, they are also aimed at exploiting other companies’ resources and knowledge. Regarding the latter, companies combine in order to gain a greater market share, either by reducing the times and costs related to reaching new markets or by strengthening their presence in existing contexts. This category includes: subcontracting networks, constellations and industrial districts;

b) personal reasons: combinations are accounted for by the sense of honour and responsibility of the subjects involved. This is the case of gentlemen’s agreements; and

c) financial reasons: companies combine with others in order to obtain financial resources from other subjects, on whom they grow dependent.

The strongest forms of combination are mergers and acquisitions, whereas cooperation deals (that might be more or less formalised) are the weakest.

In conclusion, business combination might pursue various objectives (Figure 4.4):
a) integration among the companies involved: when the relationships among the companies are strong and their interest to cooperate is not occasional, mergers and acquisitions (M&A) often occur. The purchasing company acquires the resources of another one, which loses its decision-making autonomy. In order to complete this process, post-combination integration is crucial;

b) cooperation among the parties involved: when companies do have stable relations among them, they can cooperate and maintain their juridical and economic autonomy at the same time. Such cooperation might be mutual and require a considerable degree of post-combination integration. This is the case with strategic alliances; and

c) collaboration among the parties involved: when the relationships among companies are not stable over time, companies might choose to cooperate while maintaining their juridical and economic autonomy. Such cooperation does not require a considerable degree of post-combination integration. This is the case with deals.

Figure 4.4  
Types of business combination in relation to objectives

*Source: Personal elaboration*

There might also be various types of business combination according to the extent to which they are reversible. The most reversible operations are those that require the lowest degree of integration among the companies involved,
i.e. deals between companies. The least reversible are mergers, in that they require a high degree of integration among the parties involved. Acquisitions are less reversible than joint ventures, in which parties maintain their juridical, financial and economic autonomy (Figure 4.5).

![Diagram](image)

**Figure 4.5** The reversibility of combinations  
*Source: Personal elaboration*

The following paragraphs analyse two types of business combination that are frequent in the context of luxury business:

a) strategic alliances, as an example of formal business combinations; and
b) subcontracting, as an instance of informal business combinations.

### 4.3.1 Strategic Alliances

Strategic alliances are defined as cooperation deals allowing for external growth in the medium and long term. They are negotiated between a company and one or more third parties, which become its manufacturing and/or commercial partners and maintain their juridical autonomy at the same time. One of the companies involved plays a leading role; it is often a very important customer, if not the only one, of the subjects involved. It performs the func-

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tions of leading and coordinating the operations carried out by the other partners, whose organisational ties are often large and highly complex. Therefore, alliances represent a form of growth along with other third parties (make together).

Partners are assigned one or more activities that would otherwise have been carried out by the company itself. Therefore, strategic alliances might be considered one of the means through which contractual growth takes place. Other forms of contractual growth included in Faulkner’s model are the following:

a) stable supply networks, in which the customer-supplier relation develops, becomes stronger and ultimately leads to stable forms of cooperation between the parties;

b) weak cooperation networks, resulting from deals aimed at systematic cooperation that do not provide for sanctions towards non-complying companies;

c) Japanese keiretsu, which are stable supply relations resulting from corporate relations; and

d) licensing, in which companies that own a brand license third parties to use the brand when manufacturing and/or marketing specific products.

Licensing is especially frequent in the context of fashion and luxury goods, where it achieved a worldwide turnover in terms of royalties of about 200 billion dollars in 2011. The vast majority of this revenue is ascribable to the top 125 licensors. The royalties received by Italian licensors amounted to 350 million euros, with an increase of 6% compared to 2010. Some important companies have recently decided to revoke licences in order to manage activities internally; Burberry, for instance, has decided to manage its beauty segment internally. On the contrary, licensing is still used by companies that own a medium-profile brand, as it allows for a less rigid manufacturing structure. Licensing favours brand stretching policies, in that it expands brand presence to

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92 Conca V., *Le acquisizioni*, cit., p. 17
new merchandise categories. When licensing is applied to accessories (such as shoes, bags and glasses), the strategy favours exports, inasmuch as accessories are usually the first products with which companies enter foreign markets. The most profitable categories are accessories, apparel and merchandising. For instance, licensing is particularly frequent in the segment of eyewear: large groups, such as Luxottica, Safilo, Marcolin and De Rigo, own the vast majority of licences.

In the context of strategic alliances, partners are chosen among subjects who are complementary from a manufacturing point of view, with the purpose of improving the company’s manufacturing mix by using the partner’s specific skills. In some cases, partners might be chosen among the company’s competitors; the synergies created with them might be profitable. Often, the strategic alliance is set up with foreign partners in order to enter or consolidate the presence in an international market.

Strategic alliances might be carried out in different ways: in the form of simple access to the partner’s knowledge, a transfer of know-how or in the joint creation of new knowledge. This not only brings a series of economic advantages to the partners involved.
advantages to the subjects involved but also creates a number of mutual obligations.

Alliances allow for the creation of a network or “companies network” in which companies, though maintaining their juridical autonomy, are related because of these obligations. A “business network” is defined as an organisational solution directed at combining the know-how and skills of the companies involved. Business networks are aimed at increasing interaction and cooperation among the parties involved with the purposes of creating incentives to innovate and increasing their competitive advantage. Companies maintain their juridical and decision-making autonomy: they each manage their own business.

Business networks mirror the tendency of companies to expand their activities beyond its borders. “Business borders” are defined by applying the criterion of the subjective independence of each company in relation to external economic subjects. This definition makes it possible to distinguish a company from its context by drawing up virtual borders within which the company operates. It allows the identification of “what is inside the company”, “what is outside of it” and “what is neither inside nor outside of it”. It has been argued that business borders separate the governance of a given company from that of another company.

When companies operate beyond their business borders, they are driven by strategies of product diversification, as well as by the wish of reaching new markets and of integrating themselves with other companies. The ultimate

impianto teorico ed una proposta metodologica”, Finanza, Marketing e Produzione, 17(1), 1999, pp. 7 ff.


Ferrero G., Istituzioni di economia aziendale, cit., p. 85.


goal is to improve efficiency while increasing their competitive advantage\textsuperscript{106}.

Borders are re-defined by establishing new types of relations with suppliers, which translate into forms of management cooperation as well as into lines of products with higher technology and innovation contents\textsuperscript{107}. Cooperation is not only aimed at moving products or materials more efficiently; it is also directed at mutually involving the partners in transferring information, providing services which enhance the supplying relationship, sharing responsibilities within the supply chain\textsuperscript{108}.

Business networks can be classified on the basis of various criteria\textsuperscript{109}:

- a) network field of action: networks might be defined as internal or external. The former are created within a company; that is, among business units that are independent from an operative point of view. The latter are created with subjects external to the company with the purpose of generating synergies with the context; and
- b) the intensity of the relations among the companies involved: networks might be described as stable or dynamic. The former are based on the stable involvement of a leading company in a number of companies, with the role of control and coordination; each single company might either operate within one network or work for a number of networks. The latter are short lived and have specific objectives related to their products, with the purpose of taking advantage of occasionally favourable situations.

A joint venture is an instance of a strategic alliance\textsuperscript{110}: two or more eco-

\textsuperscript{106} Cavalieri E., Ranalli F., \textit{Economia aziendale}, cit.
\textsuperscript{109} Giaccari F., \textit{Le aggregazioni aziendali}, cit., p. 94 ff.
economic subjects create a new company by contributing capital. Although the partners do hold its shares, the start-up is juridically independent. Also, the companies involved maintain their juridical identities, and their pre-joint venture assets change only in relation to the capital contributed.

The literature has delved into the issue of joint ventures and provided various definitions\(^{111}\), which all share the following characteristics\(^{112}\): partners show the will to combine with one another, with the purpose of reaching a common goal in terms of profitability; and after creating the joint venture, the partners maintain their autonomy in terms of management, organisation legal status. Ventures are juridically autonomous, but the various partners exercise powers of management and control. Usually, joint venture control regulates all aspects related to the setting up of a venture, as well as the obligations and powers of the partners involved.

By setting up a joint venture, partners can carry out a common project, which is usually temporary and which can only be completed by uniting the strengths and skills of all the partners involved. Consequently, joint ventures do represent a form of partial business combination that allows for a reduction in the transaction costs typically associated with acquisitions\(^ {113}\), especially when the companies involved operate in different economic sectors.

Different types of joint venture might be identified in relation to various criteria\(^ {114}\):


\(^{114}\) Giaccari F., *Le aggregazioni aziendali*, cit., p. 89 ff.
1) on the basis of the way in which the joint venture is set up:
   a) joint venture corporations: two or more companies contribute capital in order to create a new company, usually a limited company referred to as a joint venture, of which they hold the shares. By contributing capital, companies sometimes aim at increasing their stake in existing companies. Generally, such shares are given to the partners in equal parts. The founding companies maintain their economic and juridical autonomy and continue to carry out their business separately from the start-up. A joint venture corporation is aimed at establishing a long-lasting alliance, with the purpose of completing complex projects that require considerable resources and sophisticated skills; and
   
   b) contractual joint ventures: two or more companies reach a formal deal in order to undertake a common activity. In this case, no start-up is created, but the purpose is the same as in joint venture corporations, i.e. to jointly reach a common goal;

2) on the basis of the purpose for which the joint venture is set up:
   a) manufacturing joint ventures: the main goal is to generate synergies in manufacturing, in relation not only to the manufacturing system but also to hiring staff;
   
   b) sales joint ventures: their purpose is to improve marketing and sales by reaching new markets, expanding their market share and fully exploiting the existing sales network;
   
   c) R&D joint ventures: they are focused on basic and applied research. The former is aimed at gaining new scientific and technological skills, which pave the way for further analysis and experiments, i.e. applied research. Although such activities do not have short-term goals, they are crucial in that they allow applied research to be carried out. This is aimed at reaching specific objectives in terms of products and processes by gaining technological knowledge. This will be used in the development stage to create new products;

3) on the basis of the ways in which the venture is managed and controlled:
   a) independent joint ventures: these are independent from a decision-making point of view, since the partners cannot intervene in strategic and management decisions. Consequently, the venture does maintain a remarkable

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degree of autonomy in decision making;

b) jointly managed joint ventures: unlike the previous type, these ventures maintain their autonomy to a limited extent. The partners retain a right to interfere as far as strategies and management are concerned. This right is usually defined during the negotiation stage preceding the setting up of the venture;

c) controlled joint ventures: these ventures have no autonomy in decision making, in that strategies and management are dictated by the partners who manage all aspects of the venture’s life.

The luxury business has often witnessed strategic alliances and joint ventures focused on manufacturing and distribution and created within the same sector or in different ones. Here follows a list of the main alliances formed in the luxury sector.

Giorgio Armani Group has always had a key role in strategic alliances. They have reached a deal with Luxottica Group, with effect from January 2013, with the purpose of manufacturing and marketing glasses and sunglasses with the brands Giorgio Armani, Emporio Armani and A/X Armani Exchange in international markets.

The Group has formed an alliance with Reebok International with the purpose of developing a new concept of Activewear. Reebok have contributed their technology and innovation to appealing brands such as EA7 and Emporio Armani in sportswear and created the collections EA7/Reebok and Emporio Armani/Reebok, characterised by style, design and comfort.

Giorgio Armani has also formed strategic alliances with some important companies in the clothing industry, such as Ermenegildo Zegna for the manufacturing and distribution of Armani Collezioni and Mani Uomo; with Vistantenta, for the first Giorgio Armani collection for men and women.

In 2010, Ermenegildo Zegna Group set up a joint venture with Reliance Brands Ltd, of Reliance Group, which is an important Indian manufacturing company. The venture, named Zegna South Asia Private Ltd, was 51% held by Ermenegildo Zegna Group and 49% held by Reliance Brands Ltd. On the one hand, Ermenegildo Zegna can take advantage of new opportunities in the Indian luxury market, use the knowledge that Reliance Retail has of the Indian market and diffuse the Zegna brand; on the other hand, Reliance Group can exploit the level of quality and innovation typically associated with Zegna products, together with the experience that the Italian group has gained in retailing luxury products. Ten new boutiques will be opened from 2010 to 2015: thanks to this, by the end of 2015, India might become the most important market in South-East Asia for Ermenegildo Zegna Group. The Indian market is undoubtedly a strategic target for the Group, which was one of the first lux-
ury companies to be established in India, following the wave of retail liberalisation promoted by the Indian government.

In 2002, Ermenegildo Zegna set up a joint venture with Salvatore Ferragamo Group. The venture, ZeFer, in which the two groups hold 50% each, was created to manage the global growth of the brand Ermenegildo Zegna in the segments of shoes and leather accessories. It is based on the manufacturing and logistics know-how of Salvatore Ferragamo Group and on the use of dedicated areas in Zegna’s boutiques, as well as other deals with international distribution groups. This venture is aimed at, on the one hand, using the experience and quality level gained by Ferragamo Group and, on the other hand, taking advantage of a style that is appreciated worldwide as Zegna’s. Another strategic alliance was formed by Ermenegildo Zegna with Gianni Versace for male collections.

In 2012, Canali Group created a joint venture with Genesis Luxury Fashion Private Ltd, an Indian company which distributes the brand Canali in the Indian market. The venture, which is 51% held by Canali and 49% held by Genesis Luxury Fashion Private Ltd, is aimed at marketing Canali collections in India on an exclusive basis. Prior to the deal, Genesis Luxury Fashion took care of sales in the Indian market on the basis of a distribution agreement. Through this alliance, Canali Group aims at strengthening their leadership in the Indian market of luxury garments for men, which is considered a strategic segment. For Genesis Luxury Fashion Private Ltd, this joint venture represents a further development of the business built up with Canali Group, as well as an opportunity to strengthen their brand presence in India through the opening of 10 to 15 new boutiques in the next three to four years.

In 2003, Gucci Group formed a joint venture with ND Logistics, a leading company in European transport and logistics. The venture, L.G.L. (Luxury Goods Logistics), 51% held by Gucci Group and 49% held by Norbert Dentressangle, is a cutting-edge logistics platform that takes care of all aspects of logistics for brands such as Gucci, Yves Saint Laurent, Bottega Veneta, Alexander McQueen, Balenciaga and Stella McCartney.

In 2011, Prada Group set up a joint venture with Al Tayer, an important retailer in the Arab Emirates, with the purpose of marketing the brands Prada and Miu Miu in the Persian Gulf area, especially in Bahrain, Saudi Arabia, Oman, Kuwait and in the Arab Emirates.

In order to exploit the potential of e-business, in August 2012 PPR formed a joint venture with Yoox with the purpose of creating a partnership for the on-line retailing of luxury products. The deal allows for the expertise of both players to be combined: the appeal of the brands of PPR and Yoox’s expertise in managing on-line single-brand stores. The venture capital is 51% held by
PPR and 49% held by Yoox Group. Their goal is to strengthen the presence of PPR brands on the internet (Bottega Veneta, Yves Saint Laurent, Alexander McQueen, Balenciaga and Sergio Rossi) by improving the existing online stores. The on-line shops of Sergio Rossi and Bottega Veneta will be opened by the end of 2012. On-line stores are scheduled to be activated worldwide by the end of 2013. The Group might include other brands in this joint venture in the future. Each brand will manage its own on-line stores by taking care of stock, choosing web contents, outlining artistic direction and conducting digital communication. They will take advantage of the logistics platform of Yoox, which currently manages high-precision logistics in more than 100 countries, China included. The deal provides for a revenue-share model in favour of Yoox.

Luxury hotels have been associated with a number of strategic alliances. In 2010, Versace Home reached various deals with Damac Properties to build the Damac Tower in Beirut, and with Century Properties to build a 53-storey tower in Manila. Also, Missoni has entered this segment and reached a deal with the Belgian chain Rezidor Hotel Group. In 2001, Bulgari formed an alliance with Luxury Group (the luxury hotel division of Marriott) with the purpose of creating an exclusive chain of luxury hotels and resorts in the best locations and most important cities in the world; Bulgari’s philosophy on contemporary luxury has been combined with the managerial skills of Ritz-Carlton. Thanks to this alliance, Bulgari has entered the hotel industry and achieved their objective of brand extension, after having achieved good results with perfumes, accessories and watches. In 2005, Giorgio Armani created Armani Hotels & Resorts by forming an alliance with Emaar Properties (real estate agents), with the purpose of building and managing luxury hotels, resorts and residences in the most exclusive locations in the world.

Also, the luxury car industry has witnessed important alliances. Ferrari has been increasing its number of stores in the Middle East. The venture, Fadar, has been developing a retail project for all Ferrari stores, not only in the Middle East but also in the Persian Gulf area. It was created by Al Fahim Enterprises (founded by the Al Fahim family, who are leaders in luxury retailing, beauty and fashion products) together with Aldar Properties (a building company that owns the Mubadala fund of the Arab Emirates Government and is one of the shareholders of Ferrari). The Ferrari stores sell clothes for men, women and children, as well as leather accessories, electronic gadgets, books, toys and memorabilia.

A number of alliances have also been formed between the fashion industry and the aircraft industry. Karl Lagerfeld, for instance, has accessorised a luxury Agusta AW139 helicopter.
Important players from the fashion and luxury yacht industries have also allied. In 2008, Hermès and Wally set up the joint venture Wally Yachts-Hermès, which built the first triangle-shaped yacht in the world, the “WHY”. It is characterised by new features in shapes, volumes and performance: all under the sign of a new concept for motor-yachting.

Also, the watch industry has witnessed the creation of various joint ventures. In 2009, Ralph Lauren set up a joint venture with Richemont (held by both companies, with 50% each) with the purpose, for the former, of reaching the segment of luxury watches by exploiting the expertise and the prestige of a luxury tycoon. The latter has seized the opportunity to use the global fashion brand of Ralph Lauren.


- a) horizontal cooperation: cooperation is sought within one specific activity, regardless of the sectors in which the companies involved operate. This might involve competing businesses or companies manufacturing a diversified production. In both cases, the parties involved decide to cooperate in order to reach objectives that they could not easily achieve by working individually. The success of such strategies is related to the synergies created with external resources and the skills contributed by the subjects involved. The companies involved are complementary from a technical and economic point of view to an extent that usually makes it difficult to relate performances to the subjects involved\footnote{Ferrero G., Istituzioni di economia d’azienda, cit., p. 69 ff.}.

- b) vertical cooperation: cooperation is promoted beyond specific activities. The companies involved operate along the same supply chain, although at different stages. They are often suppliers and customers. Such cooperation is\footnote{Della Corte V., Sciarelli M., La coopetition e le scelte di governo possono rappresentare una fonte di vantaggio competitivo sostenibile per i sistemi strategici? Il caso del settore turistico, in Maggioni V., Potito L., Viganò R., Corporate governance: governo, controllo e struttura finanziaria, Il Mulino, Bologna, 2009, p. 305.}
similar to vertical integration\textsuperscript{119} to a certain extent, in that companies are not complementary from a technical point of view, even though they do share an interest in reaching common goals. For instance, they might jointly carry out research in order to reduce the costs borne by each company; and

c) diagonal cooperation: the cooperation is transverse, i.e. it works both horizontally and vertically. The companies involved carry out various activities along the supply chain and operate in different sectors.

\subsection*{4.3.2 Subcontracting}

Subcontracting is a practice related to outsourcing strategies: the management of a product is permanently assigned to a third party that might be based in the country where the company is headquartered or in a different one\textsuperscript{120}. Subcontracting follows a make or buy decision\textsuperscript{121}: when buying is more profitable, companies might opt for outsourcing.

Strategic alliances and subcontracting are different. In the former, the parties involved interact and cooperate permanently in order to reach a common goal in the medium/long term. In the latter, the subcontractor operates to meet the requirements of the general contractor, within a relation that might also be temporary.

Coordination between the general contractor and their subcontractors is important to the success of any subcontracting deal, in that it guarantees the control of each player in the supply chain\textsuperscript{122}. While sourcing used to be focused on products (the best product for the cheapest price), nowadays this philosophy has changed: companies aim at providing not only products, but also services (R&D, logistics and manufacturing) together with management transparency, intensified information exchanges\textsuperscript{123} and increased cooperation with the other players along the supply chain\textsuperscript{124}.

\begin{thebibliography}{9}
\bibitem{119} Cesaroni F.M., \textit{La funzione di produzione nelle piccole imprese}, Aspi, Urbino, Ins-Edit, Genova, 1997, p. 113 ff.
\bibitem{120} Giacosa E., \textit{L’economia delle aziende di abbigliamento}, cit., p. 272 ff.
According to this new concept of partnership with one’s subcontractors, cooperation goes beyond the exchange of goods and services and reaches the strategic level: it might entail joint developments of products, joint R&D activities and improved manufacturing systems. Such cooperation becomes more difficult to manage when subcontractors are based in far-off countries, where such interactions lose some of the advantages typically associated with subcontracting.\(^{125}\)

The supply chain is a key element for luxury companies, in that networks of suppliers and subcontractors need to be carefully selected and consolidated over time. For instance, in 2011, Gucci\(^{126}\) prompted their strategic leather suppliers (the business of leather accessories accounts for 58% of the brand’s turnover) to form alliances in an attempt to improve not only the competitiveness but also the economic and social sustainability of their business. Three business networks have thus been created in order to improve innovation in technology and organisation, cost-effectiveness, quality and safety standards. Such networks allow for greater transparency in the margin flow along the chain, so that each player can be aware of the mark-up of each subject that makes up their chain. This is aimed at avoiding low-profit subcontracting. Furthermore, in order to spread innovative management policies, Gucci is planning to diffuse the culture typical of a big multinational to its supply chain, thus fostering its growth.

The three networks are made up of 24 small and medium suppliers and subcontractors of the brand Gucci, with a total turnover of 76 million euros and 635 members of staff. Gucci sponsors the three networks by providing consultancy about organisation, technology, training and finance, with the purpose of not dispersing the excellence of the supply chain. In the area around Florence only, Gucci works with 60 suppliers and dozens of subcontractors.

Subcontracting is a common practice in the luxury sector, since it allows

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for higher profitability in the manufacturing process. This strategy is implemented when the general contractor does not have the skills and the manufacturing system that are necessary to undertake specific processes or the whole manufacturing process. This type of subcontracting is also defined “speclality subcontracting”\textsuperscript{127}, and it enables companies to expand their lines of products by using the skills of third parties.

In addition, subcontracting is chosen whenever the manufacturing system is momentarily unable to meet orders and its extension would be difficult to manage at a later stage, or whenever outsourcing is deemed more profitable. Specific processes are assigned to third parties, who are often standardised. Companies manage to maintain their leadership by exploiting the manufacturing potential of other businesses\textsuperscript{128}.

Subcontractors often get orders from the general contractor without having the possibility of intervening in the decision-making process. Moreover, the manufactured products can be sold only to the contractor. This generates risks for the subcontractors, which might be severely affected by a crisis of the general contractor\textsuperscript{129}. This new approach to supply chain management poses the challenge of also involving suppliers of subcontractors, whose contribution affects the performance of suppliers\textsuperscript{130}.

Product subsystems or a whole stage of the manufacturing cycle might be outsourced. In the first case, subcontractors focus on manufacturing a product or taking care of specific processes, by complying with the specifications outlined by the general contractor; any other stage of the manufacturing process is managed by the general contractor: designing the product, making a prototype of it, acquiring raw materials (which are supplied for manufacturing purposes) and carrying out quality control. In the second case, subcontractors are commissioned to take care of various stages of the manufacturing cycle (including the acquisition of raw materials) up to the sale of products to the general contractor, which only designs the product\textsuperscript{131}. Therefore, subcontractors are giv-


\textsuperscript{129} Giaccari F., \textit{Le aggregazioni aziendali}, cit., p. 66.


\textsuperscript{131} Giacosa E., \textit{L’economia delle aziende di abbigliamento}, cit., pp. 275 ff.
en a lot of responsibility: they have to manage their own suppliers, comply with delivery times and focus on innovation and design\textsuperscript{132}.

Subcontracting is prevalent for activities characterised by low added value, i.e. activities that contribute to the value created by the company in a marginal way. On the contrary, core business activities are not outsourced: they substantially contribute to the creation of value and differentiate the company from its competitors. Activities such as product design and development, process monitoring, quality control of products not manufactured by the company and marketing are not usually outsourced. Therefore, businesses focus their skills and resources on activities with higher added value, with the purpose of increasing specialisation and obtaining economies of scale in terms of quantity, quality and time\textsuperscript{133}.

In order for products to meet the standards required, general contractors have to select their subcontractors carefully. Moreover, they have to monitor their activities through the mechanisms of trade monitoring.

Italian companies are often selected as subcontractors, especially in the fashion sector, thanks to the high levels of quality and expertise that are typically associated with Italian manufacturers. In particular, the vast majority of Italian subcontractors are based in industrial districts\textsuperscript{134}. A district is a group of small and medium-sized companies that are commercially interrelated through both formal and informal relations. They are usually clustered in specific geographical areas\textsuperscript{135}.

Districts are pervaded by an innovation-oriented entrepreneurial culture, which is transferred from one company to the others. Such businesses operate in the same sector and are often complementary because all of them are niche oriented. They carry out a single, highly specialised stage of the manufacturing cycle, while groups allow for business integration thanks to the synergies


\textsuperscript{135} Giaccari F., Le aggregazioni aziendali, cit., p. 71. Giacosa E., L’economia delle aziende di abbigliamento, cit., p. 75.
generated among the companies involved. Therefore, the manufacturing cycle is divided into stages, which are assigned to a group of district companies with the purpose of achieving higher efficiency. The fact that companies are complementary does not exclude competition, which in fact improves efficiency. It follows that districts might also be defined from a geographical point of view and by considering the relevant sector, as a group of companies and institutions that, through cooperating with external businesses (i.e. general contractors), promote higher corporate efficiency, as well as closer integration between the subjects involved and their context.

In Italy, the main industrial districts are defined on the basis of the manufacturing processes that are carried out: knitwear in Carpi and in other areas around Treviso, Vicenza, Bari and Varese; shoes on the Riviera of Brenta; wool in Prato; woollen garments for men in Biella; silk in Como; and leather accessories in Arezzo and Florence.

Through subcontracting, the general contractor gains various advantages:

a) more flexible manufacturing structure: subcontracting prevents the manufacturing structure from being oversized and therefore difficult to manage at a later stage. Leaner manufacturing systems allow for flexible adaptation to changeable market needs. In other words, by using the manufacturing potential of subcontractors, companies are more flexible in satisfying human needs. This provides opportunities to improve performance and, ultimately, be more competitive;

b) higher quality: when subcontractors are carefully selected and product quality is systematically monitored, the quality level of a given line of products might be increased by exploiting the know-how and skills of subcontractors; and

c) energies are focused on core business activities, i.e. activities that contribute higher added value to the manufacturing process.

However, subcontracting might also entail some disadvantages:

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136 Albertini S., La gestione delle risorse umane nei distretti industriali, Etas, Milano, 2002, p. 3.
a) product quality might not meet specifications: when subcontractors are not closely monitored, the quality level required might not be guaranteed. In order to avoid such problems, general contractors usually employ quality control staff;

b) considerable dependency on subcontractors: the latter might hold a strong negotiation position and decide to suddenly terminate the contract. This is especially the case when subcontractors have skills that are not easily replicable and which consequently make them irreplaceable partners. In order to mitigate such risks, companies might diversify their subcontracting strategies and work with various partners, including competing ones; and

c) subcontractors might try and manufacture similar products: after having acquired key information about the manufacturing process, subcontractors might manufacture their own lines of products in an attempt to imitate the ones commissioned by the general contractor. This is highly detrimental to the image and competitiveness of any general contractor.