

# **INTERNATIONAL SOURCING: A MUST OR A CHOICE? A PERSPECTIVE ON THE ROLE OF LOCAL SUPPLIER RELATIONSHIPS IN THE ITALIAN MECHANICAL INDUSTRY**

**Competitive paper**

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## **Abstract**

Studies on international sourcing strategies and practices are mainly concerned with the behaviour of large firms, which are able to interact with various supply sources in different markets and detain organisational capabilities to engage in such activities. Only a few studies enter into the detail of SME's international sourcing behaviour. Therefore the main goal of this paper is to investigate whether mid-sized companies might choose to remain closely integrated within the local supply network and which are the main conditions influencing their approach. The research methodology is qualitative and based on the investigation of three case-studies of Italian companies selected among the leading firms in specific sub-sectors of the mechanical industry in the light of their size, performance and international profile. The empirical analysis shows that the three companies under examination pursue a gradual and balanced approach toward international sourcing opportunities, which are exploited mainly for commercial parts and only to a limited extent for customized parts and components. Local suppliers have been playing the role of “sources” of value in different ways in distinct historical phases, contributing actively in terms of knowledge and competence development, production flexibility and delivery performance, and price efficiency. Within such context, the three companies over time have shown a capacity to adapt their supply management approach to changing market conditions, with the emergence of hybrid and segmented buyer-supplier relations in different historical phases.

Keywords: supplier relationships, local/international sourcing, clusters, Italian mechanical industry

## INTRODUCTION

This paper is based on a long-term longitudinal research on mid-sized Italian companies that are international leaders in specific niches of the mechanical industry. The study concerns changes affecting these companies' supplier relationships as they have to face the fast global economic change. In particular, the paper focuses on the role played by the local set of co-localized long-term supplier relationships.

In recent years a great attention has been paid to globalization of markets and supply chains. Thus it has been emphasized that globalization induces companies to develop new business models aiming to exploit comparative advantages through operations at different locations worldwide and to involve external partners in operational activities. In particular, a recent stream of management research highlights the growing adoption of international sourcing strategies, based on the search, selection and integrated management of supply networks on an international scale (Hines, 1994; Trent and Monczka, 2003; Axelsson *et al.*, 2005; Quintens *et al.*, 2006). Companies engaged in such behaviour pursue mainly cost and innovation advantages (Gadde and Håkansson, 2001) getting access to components, materials and knowledge and capabilities of worldwide dispersed providers.

Empirical studies are mainly concerned with the international sourcing behavior by large-sized firms, which are able to interact with various supply sources in different markets and detain organisational capabilities to engage in such activities. Only a few studies enter into the detail of SME's international sourcing behaviour (Knudsen and Servais, 2007). Within this stream of the literature interesting analyses are developed on the behavior of industrial clusters' companies, mainly those reaching medium size, which are increasingly involved in supply relationships with foreign partners, in relation to the increasing pressure in mature manufacturing sectors (textile, cloth and footwear, mechanical) by emerging economies, such as China and India (Chiarvesio and Di Maria, 2009; Camuffo *et al.*, 2006).

However, it could be argued that pursuing the international sourcing strategy might not be the only option to organize production activities for cluster mid-sized companies. Most of the literature is concerned with analyzing the opening of international sourcing relationships and the advantages connected, and shows a limited attention to the main features of the changing role of local suppliers that have been historically connected to these companies, being part of their traditional way of organizing their production activity (Tunisini and Bocconcelli, 2009; Håkansson *et al.*, 2006). We think that further research is needed in this respect and that a particular attention should be devoted to the renewed role of local supplier relationships when companies "open" their supply side to the international supply market.

Thus the paper debates the following questions: is the "local" dimension of business supplier relationships still a feasible and effective path? Under which conditions local supplier relationships provide strategic advantages for firms engaged in international markets? If and when the local set of supply relationships plays a relevant role, does it resemble traditional patterns of buyer-supplier relations or show new features? Therefore the main goal of this paper is to investigate whether companies might choose to remain closely integrated within the local supply network and which are the main conditions – both internal and external - influencing their approach. The research methodology is qualitative and based on a limited number of case-studies: the empirical investigation concerns three companies selected among the leading firms in specific sub-sectors of the mechanical industry in the light of their size and international profile.

The empirical analysis shows that the three companies under examination pursue a gradual and balanced approach toward international sourcing opportunities, which are exploited mainly for commercial parts and only to a limited extent for customized parts and components. Local and domestic suppliers have been providing strategic advantages in

different ways in distinct historical phases, contributing actively in terms of knowledge and competence development, production flexibility and delivery performance, and cost efficiency. Within such context, the three companies over time have shown a capacity to adapt their supply management approach to changing market conditions, with the emergence of hybrid and segmented buyer-supplier relations in different historical phases.

The paper is structured as follows. In the next section (*Theoretical background*) a literature review on the issue of local/global sourcing is presented. In particular we shall focus on perspectives in literature on the value of international and domestic sourcing especially for SMEs. In the third section (*The empirical research*) the aim and methodology of the study is described, followed by the analysis of the three case studies. In section four (*Interpretation of empirical results*) the main findings of the study are presented and discussed. The last section (*Conclusions*) is dedicated to final considerations and further research directions.

## THEORETICAL BACKGROUND

Advantages and disadvantages of international sourcing have been discussed by many streams of literature that have especially focused on the determinants that explain companies' search for international sourcing. One main advantage is the access to suppliers highly competitive on costs, which are increasingly located on low-cost emerging and developing countries and are able to provide standard level production and organisational capabilities: lower costs might also derive from establishing partnerships with global suppliers able to achieve economies of scale on an international level. Another major advantage is the development of relationships with foreign suppliers detaining valuable technological capabilities and innovative products, thus providing leading edge solutions not available in the domestic market. Moreover, in terms of supply strategy international sourcing allows for the possibility to switch between different supply sources. Lastly, well-performing and trusted foreign suppliers might represent valuable resources to collect final market information and establish relationships with new customers operating in the local market.

At the opposite side of the coin, international sourcing activities might be difficult and complex due to the need to deal with foreign cultures, thus leading to communication and language problems with foreign suppliers. Communication and knowledge exchanges might also be impaired by physical distance. Moreover, the predicted gains in production efficiency might be offset by quality problems, high transportation costs and supply chain uncertainty in terms of logistics and delivery performance (Fawcett, Birou, 1993; Trent and Monczka, 2005; Axelsson et al., 2005). Such difficulties might have highly negative consequences if companies are engaged in lean production and JIT approaches.

The search and actual exploitation of such advantages on an international scale implies relevant changes in the organisational configuration of both buyers and suppliers. Firms actively engaged in international sourcing increasingly upgrade their organisational configuration in alignment with such new sourcing activities, which require additional management and coordination costs; suppliers instead develop new coordination mechanisms to improve their service level and undertake new strategic paths, such as global supply projects and international strategic partnerships, to strengthen their position in the increasingly international supply chain (Pagano, 2009).

Studies have mainly analysed the companies' processes of international sourcing with attention to large and MNCs, while the attention to SMEs has been much more limited (Agndal, 2006). Within the traditional small business literature, the process of international development of SMEs have been analysed especially from the sales side while the supply

side has not been object of particular interest. This is probably due to two main reasons. Firstly, the process of international development on the supply side is mostly driven by the growth of the company on the market side and when studies refer to small companies they are mostly interested to their processes of sales internationalization. Secondly, small companies' lack managerial and organizational capabilities to set up and handle a set of worldwide dispersed sourcing activities. So that literature has always been mostly attracted by large companies and their sourcing strategies. Taking the perspective of SME's, and focalizing on a number of case studies, especially concerning the growth of small companies and the mid-sized organizational dimension, some researchers have observed an increasing sensibility to international sourcing by SMEs (Sculley and Fawcett, 1994). In particular, international sourcing is particularly due to cost reasons, sometimes to look for better quality (Overby and Servais, 2005). A relevant problem however, for SMEs looking for competence-based suppliers on the international markets, is to become attractive as customers (Steinle and Schiele, 2008).

Some other researchers have observed that, even if SMEs can be increasingly interested in international sourcing, this process is an emergent strategy more re-active than proactive, aimed at catching unexpected opportunities in the market, and that these opportunities are captured without any planned action when there are not serious domestic alternatives (Servais and Møller Jensen, 2001; Quintens, et al., 2006), thus stressing a perspective that goes in favor of a significant presidium of the domestic sourcing.

This reactive emergent approach to international sourcing as well as the empirical observations of the restricted use of international sourcing, have been discussed in a renewed perspective recently. Even if at large extent small companies are born and grown according to business model based on domestic sourcing two phenomena have attracted scholars attention. The first one concerns the so-called "born-global companies", i.e. small companies established and developed with a global perspective both on the downstream and the upstream market (Oviatt and McDougall, 1995; Korhonen et al., 1996).

The second phenomenon refers to those mid-sized companies that have been defined as "Micromultinationals" (Dimitratos et al., 2003; Mediobanca-Unioncamere, 2010). These are companies borne and developed through business models based on a set of domestic suppliers' constellation participating to the production and innovation of their product (Lorenzoni and Ornati, 1988) but then grown up and playing at leading actors in specific international market niches. If we consider the Italian industrial set, these mid-sized companies, that are "big among small", represent about the 25% of the Italian added value. The interesting thing is that the added value increases up to the 35% if we consider their extensive set of domestic suppliers and sub-suppliers (Mediobanca-Unioncamere, 2010).

The sustainability and the growth of their international positioning make them sensitive to international rather than domestic sourcing because of the cost advantages and the easier access to the internationally dispersed knowledge. That could become a serious threat to the sustainability of local set of domestic suppliers. That is highlighted in studies on clusters and industrial districts. Scholars in fact put into evidence the strategic role of mid-sized leading companies in driving the development of the whole district (Varaldo, Ferrucci, 2006; Lazerson, Lorenzoni, 1999). In this respect, they agree upon the fact that the local set of a company' suppliers have always been considered a strategic resource of value for the leading companies. It is recently observed that such entirely local and self-contained entrepreneurial mechanisms have been recently threatened by the 'international fragmentation of production' (Feenstra, 1998; Arndt and Kierzkowsky, 2001; Gereffi et al., 2005). It is thus considered possible that leading firms' value chains will be disarticulated, and the phases thus isolated are relocated internationally, emphasizing cross-border linkages between firms in global production and distribution systems, rather than local linkages (Mariotti et al., 2008).

In front of the increasing advantages of international sourcing the leading mid-sized companies could thus gradually dismantle the traditional set of domestic supplier relationships with considerable negative effect on the manufacturing set of long-term domestic competences. The question is relevant even if many scholars stress the numerous benefits connected to continuous local sourcing. In particular, it has been observed that local clusters of suppliers make it possible the access to a safe source of qualified labor and that is the reason why many companies will preserve domestic suppliers (Porter, 1990, 1998; Camuffo *et al.*, 2006). Moreover, long term ties with domestic suppliers and the value of the social dimension of the business relationship make it possible knowledge exchanges a better integration in the innovation process, thus making domestic suppliers valuable to preserve and enhance product quality and innovation. The value of social relationships is gradually lost as the distance increase and that is another reason that could make the companies preserve domestic suppliers (Sorenson and Baum, 2003). Some researches add that when the demand is fluctuant, as in periods of crisis, it is better to have an agile domestic supply chain (Jin, 2004).

From a competence point of view, the ability to combine international and domestic sourcing by the company can be a mean to support the development of their local clusters of suppliers thanks to the process of learning that can stem from their interaction with international suppliers (Steinle and Schiele, 2008). The care of the local set of suppliers occurs at least until their competences make the real difference in the supply chain processes of value creation for customers. That explains why for example in the footwear sector the cutting of the leather and the assembling of the final product are made by domestic suppliers (Camuffo *et al.* 2006) and in the mechanical sector, very specific metal working processes are made by local suppliers (Håkansson *et al.*, 2006).

This paper enters into this debate and aims at deepening the topic adopting the perspective of three micro-multinationals. In particular the paper analyses how and why local set of supplier relationships play an important role for companies that develop their action and their business model according to an international perspective.

## THE RESEARCH

### AIM AND METHODOLOGY

This paper aims to explore the evolution of the role of local suppliers for companies increasingly facing growth in international markets, but also with a business history strongly based on long-term relationships with local suppliers. The study of their view of present and future role of local suppliers is also contextualized to the global economic crisis.

In particular we aim to address the following questions:

- is the “local” dimension of business supplier relationships still a feasible and effective path in the current global economic and market context?
- when and under which conditions local supplier provide strategic advantages to the benefit of customer firms engaged in international markets?
- if and when the local set of supply relationships plays a relevant role, does it resemble traditional patterns of buyer-supplier relations or show new features?

The research methodology is based on qualitative research following the multiple case-study, which is particularly suitable when dealing with research questions that try to identify some behavioural aspects of companies’ action (Eisenhardt, 1989; Yin, 1994), within a research project based on exploratory objectives. Thus three case studies of Italian companies have been developed. Such firms have been selected according to the following criteria:

- they are medium-size companies; this requirement allows for the examination of firms already engaged in growth process;
- they belong to the mechanical sector, which is traditionally characterized by technological complexity and by a large base of local suppliers active in the production of systems, components and in design activities.
- they are market leaders in their specific niche; this allows for examining firms continuously attempting to protect and improve their competitiveness;
- they have developed a strong international profile, thus gaining an awareness of cost and benefits of strategic options in international markets.

Thus the selected firms are three mid-sized Italian mechanical companies which are leader in their market niches and have developed over time a significant international configuration of sales and production activities: Cefla Group, SCM and Schnell.

The empirical analysis has been developed adopting a longitudinal approach to case studies development, allowing to examine complex internationalization processes followed by firms (Melin, 1992) and to highlight change over time in specific variables and their effect (Pettigrew, 1997). This approach seemed very fruitfully to address the main object of the paper that is to investigate whether companies might choose to remain closely integrated within the local supply network and which are the main conditions – both internal and external - influencing their approach.

With regard to collection of data we proceeded by performing interviews in the three companies, selecting managers with longstanding and deep knowledge of the evolution of sourcing policies and practices. In Cefla Group we conducted in total six interviews from 2005 to 2009 with the Head of Purchasing in Cefla Finishing division and with the CEO of Sorbini, a CEFLA owned company. In SCM we conducted eight interviews from 2004 to 2009 to the Director of a specific BU and to the Purchasing Manager (respectively Head of Minimax BU and Head of the Central Purchasing). In Schnell we conducted in total six interviews with the Chief Executive Officer (who is one of the owners of the company), the Purchasing Manager and Production Manager together (respectively Head of the Purchasing Central Department and Head of the Production Department), to the Purchasing Manager alone. Data collected through interviews has been combined with official company documents, information provided by corporate web sites and secondary data from specialized press reports.

#### THE EMPIRICAL ANALYSIS

This section develops the analysis of the evolution of local and international sourcing policies and practices by each of the three selected companies. Table 1 provides basic information about Cefla Group, SCM and Schnell

Table 1. List of selected companies

	<b>Location</b>	<b>Sectors</b>	<b>Turnover (millions in Euro)</b>	<b>Employees</b>
<b>Cefla Group</b>	Imola (Emilia- Romagna)	Civil and industrial installations, retail outlets for the distribution sector, wood finishing and dental technologies	348	1600
<b>SCM Group</b>	Pesaro (Marche)	Wood-working machineries	600	3700
<b>Schnell Group</b>	Montemaggiore (Marche)	Rebar processing machineries	102	400

### *Cefla Group*

Cefla Group has been established in 1932 in Imola, a town close to Bologna in Italy. CEFLA reached a level of Euro 348 millions turnover in 2008 and is currently active in four main sectors: civil and industrial technological installations, retail outlets for the modern distribution sector, systems for wood finishing and dental technologies. Over time the firm has changed its organizational structure to adapt to its main markets, developing a divisional organization. Cefla Finishing Group, established in 1960, is the division in charge of managing finishing-related activities and is currently the market leader in wood-finishing complete production lines, having reached a turnover of Euro 113 millions in 2008. In addition to wood-related applications the company is very active also in the plastic and glass sectors for finishing activities. Cefla Finishing supplies with its process technology large and international customers such as the Swedish company Ikea and the US firm Masco.

The current profile of Cefla Finishing is the outcome of a growth process marked by acquisitions of complementary and technologically advanced companies. During the '90s Cefla acquired Falcioni, a mechanical firm in the close area of Pesaro engaged in finishing activities for windows. In the mid of 2000s Cefla acquired Delle Vedove Group, which controls prestigious brands as DVD and Düsphohl and produces sanding machines and finishing lines for picture frames, profiles for furniture, doors and windows. In 2007 Cefla acquired Cattinair Finishing, a French company active in finishing for shaped panels. Another main step in the growth process in 2007 was the acquisition of Sorbini by Cefla Group, which took control of 60% of the company based in Pesaro, after buying 20% of the shares in 1994 and 40% in 2006. Therefore in 2007 Sorbini formally became an internal unit of CEFLA Finishing Division. Since the end of the '80s Cefla has set up a partnership with Sorbini, which controls a technology complementary to CEFLA Finishing offering. Cefla and Sorbini developed a strategic alliance for the expansion of sales in foreign markets and for cooperating in R&D activities.

Cefla Finishing competitive strategy is the outcome of a main effort pursued along two main dimensions: technologically advanced, innovative and high quality products on one hand and close proximity to the market and to customers on the other. Cefla Finishing aims to provide process technologies able to make a surface perform at its best in terms of resistance and design. The effort by Cefla in technological innovation is recently marked by the launch of 10 new products at the 2009 Ligna Fair in Hannover, thus showing an increased dynamism

in comparison to previous years. Cefla Finishing over the years 2000s pursued the exploitation of its knowledge base concerning finishing automation by developing and selling solutions suitable for different surfaces, notably plastic and glass: the contribution of sectors other than wood reached 15% of turnover in 2006. The search for high performances has concerned also the production dimension – in addition to the product one - in terms of quality level: in 1996 Cefla Finishing obtained the ISO 9001, being the first player in its sector.

Cefla Finishing products are sold world-wide and foreign markets represent 80% of its turnover. Thus Cefla Finishing over the years implemented a strong international presence in terms of production facilities and commercial units and partners. Cefla Finishing currently controls production facilities in Italy, Germany, United States and China, after recently dismissing a plant in Brazil, previously established in 2002. Such network of production units allows Cefla Finishing to exploit local advantages in terms of technological capabilities on one hand, and cost level, as in its China operations, on the other. Foreign production sites play also a strategic role to maintain closer relationships with the main customers, which are active in both advanced and emerging markets.

This strategic orientation and the organizational configuration allow Cefla Finishing to be the world leader in its market. The level of turnover by Cefla Finishing reached Euro 115 millions in 2006, being Euro 400 millions the size of the international market. However, since the mid of 2008 the global economic crisis is putting a strong pressure on Cefla Finishing Group and on its group companies. Sales in the wood-finishing sector have decreased of about 50% in the light of the sharp market fall in the furniture and building industry, both in US and in Europe. Only the Chinese market continues to increase thanks to the measures adopted by the Chinese government for the building sector. The hard market constraints pushed Cefla Finishing to launch major changes and innovations in its division, in order to make it fit better with the market features which would emerge when the economy starts to recover. On one hand Cefla Finishing is currently devoting resources to launch innovative products in line with emerging market needs, on the other it is implementing organisational measures aimed at improving efficiency levels.

During the '80s Cefla Finishing products were mainly mechanical and to a large extent produced internally, while only commercial parts are bought from local small distributors. At the beginning of the '90s the great success of the new automatic spraying machine pushed up sales and Cefla Finishing started to actively involve local suppliers for customized inputs, while commercial parts were supplied by large distributors and producers, including foreign suppliers. In this phase 70% of the value of production was generated by internal activities and the remaining 30% was split between 15% of customized parts by local suppliers and 15% of commercial parts.

During the '90s sales increased about 15% yearly and new large customers, such as Ikea and Masco, require strict compliance with delivery schedules. Thus Cefla was pushed to search for local suppliers able to match both the upsurge in production and the tight delivery requirements imposed by foreign customers. In this phase Cefla implemented a flexible and to some extent “adversarial” approach with its local suppliers. These small companies had limited information about production planning and thus did not invest in new process technologies; moreover, when Cefla was not satisfied with their performance the involvement of new suppliers was very likely. This was possible also because development and design of machineries have become more accurate and based on standard methodologies; thus transferring technical know-how to new suppliers had become easier. On its side Cefla was very committed to control its suppliers, placing emphasis on their technical capabilities and thus attempting to monitor any significant change in their skilled workforce, fearing the exit of valuable technicians. In this period the Purchasing Department gained an autonomous



position from the production department and started to implement more advanced planning techniques.

At the beginning of 2000 competition in International markets increased and price becomes a relevant factor, thus the Purchasing Department was pushed to contribute in terms of efficiency by reducing costs of external supplies. Cefla undertook a reconfiguration of its local supply base placing more emphasis on more capital-intensive suppliers, increasingly involved in the product innovation process, and pushing its “buy” share to almost 60%, while almost 40% were represented by customized parts provided by external companies. Another relevant shift was the development of close relationships with local design firms, in some cases established by former employees, for development activities, which were coordinated by an internal team of four engineers, who were responsible of the concept of new products. At the end of 2000 also the design unit set up in the new plant in the Chinese town of Suzhou has been involved in more low-level development activities.

During the 2000s Cefla undertook new supply relationships with three plants located in Puglia in the South of Italy and three plants in Romania. These plants were owned by existing Cefla suppliers located around Imola, which have started new production units in other areas to reduce costs thanks to government tax incentives in the South of Italy and to low cost workforce in Romania. These suppliers were active in the production of customized mechanical parts. One feature of the operational pattern was the willingness to keep the well-established interaction and communication flows: Cefla Purchasing personnel kept on addressing and solving problems by meeting its suppliers sales managers in Cefla offices or in their home plant in Imola area. The relationship between Cefla and one Italian-invested supplier based in Romania became more structured: the plant in Romania overtime took responsibility of supplying a whole system and both companies jointly engaged in searching new suppliers and negotiating with them. In this phase Cefla Finishing had 12 strategic suppliers, including four suppliers having production units in Puglia and Romania.

In the second half of 2000s Cefla Finishing has been also active in operations of acquisitions, thus gaining access to new supplier networks.

In the same period Cefla Finishing took a more active approach towards International sourcing. In 2007 a subsidiary - Cefla Finishing Equipment Suzhou – has been set up in China, whose goal was to assemble production lines already designed in Italy for local customers engaged in exports of furniture to United States and Europe. Local suppliers have been continuously assessed and in some cases have been involved in supply relationships with Cefla Finishing production units. Another major project has been the establishment of Cefla Trading Suzhou in China at the beginning of 2009 to exploit local sourcing opportunities for all the divisions of Cefla Group, including Cefla Finishing. The company searched for lower costs and the development of specific purchasing capabilities for the Chinese market. The unit is responsible for searching local supply sources for both customized and standard inputs and for monitoring suppliers involved in sourcing activities. Components and parts sourced in China need to show specific features. Firstly, they should require easy planning in terms of quantity and timing and concern large volumes orders. Secondly, they should be labor intensive and highly competitive in terms of costs when compared to production capabilities detained by Cefla or its current suppliers. Thirdly, they should not concern technologies deemed strategic in terms of development and design or protected under patents. Lastly, in any case sourcing in China should be planned within a double supply source approach.

The economic crisis started in the mid of 2008 changed the whole scenario for sourcing activities, both locally and internationally. Cefla opted for vertical integration of various production activities previously sourced externally, bringing the buy share of customized inputs to only 30%; this has been possible thanks to the decision to maintain internal

production resources and technical competences during the 2000s. At the same time Cefla Finishing reduced by 50% the size of its production activities, but also invested in a new laser equipment deemed as the main technological innovation for finishing activities, instead of buying parts processed by external suppliers already adopting such technical solution. These choices had a deeply negative impact on local suppliers: some companies did not manage to survive in the market, while other firms actively searched for new customers in related markets. Sourcing from China has been slowed down by Cefla Finishing, in the light of the low volumes of input purchases and the need to pursue flexibility in delivery to match existing orders, which only small suppliers in the Imola area are able to fulfil. Some signs of recovery in the last months are pushing Cefla Finishing to involve again external suppliers located closely to its plant in Imola, in a buyer-supplier interaction pattern which resembles the relationship developed during the '80s.

### *SCM Group*

SCM is one of the leading companies in woodworking machineries production competing internationally with just two competitors (one German and one Italian). The three companies account for the 60-70% of the total market segment. SCM's turnover was about 600 millions Euros in 2007. SCM employs more than 1500 people in its productive plants in Italy and accounts for about 3700 people all over the world.

SCM was founded in 1965 in a geographical area that had an historical concentration of important Italian furniture companies. Over time the company has changed considerably its organizational structure due to a fast process of growth. In fact, originating around the great intuition and capacity of the owners, the company grew considerably in the '80s thanks to the demand expressed by the local customers. The growth in these years was accompanied and addressed by an intensive merger and acquisition strategy, mainly directed at controlling all the technologies involved in the production processes of their customers: wood, stone, glass and metal working technologies for furniture producers. SCM started the process of acquisitions in the early 1980s with five companies in the woodworking machinery industry. In the 1990s this process continued with the acquisition of four other firms respectively specialized in the production of stone, glass, metal, plastic processing machineries.

In the '90s the company faces an increasing presence in international market, mainly through an expansion of its commercial structure abroad to effectively serve different customers' needs in different markets: SCM accounts for around 35 commercial subsidiaries all over the world.

In the early 2000s SCM become a group based on a series of production units/companies in the local industrial district and throughout Italy. SCM, in its process of growth, chose to maintain all production activities in Italy. This has been considered a basic strategy with respect to the demand expressed by emerging markets, even those presenting very different features from the traditional ones. In fact, the idea behind the production choices was that it was necessary to maintain the "made in Italy" image of all over the world, even with respect to new customers in the emerging markets.

In these last years, SCM has started to adopt a new perspective in the organization of its activities, characterized by an opening to the international markets also from a productive perspective. This process has been accelerated by the economic crisis that has strongly impacted on the company's performances and on the sector in general. In particular, in 2009 the company established a commercial/productive subsidiary in Brazil to assemble machineries for the Brazilian market.

This choice, even if it is mainly addressed to avoid the enormous entrance duties for foreign products, constitutes a very important step for SCM that is accompanied to a parallel reconsideration of the whole organizational structure.

In fact, SCM, that had traditionally encouraged a rigorous autonomy of its production units/plants in Italy, that were responsible for their own productive performances and for the management and control of their suppliers' network, proceeded in 2009 to a significant change in its organizational structure, mainly based on principles of centralization and on efficiency's rationales. In this respect, we assist in the last months to the shutdown of one plant and to the move of the entire production activities to the central productive site in Rimini.

SCM competitive strategy has been always based on the capacity to offer a complete range of solutions for its customers that need to process complex and variable production phases in a customized way and to a strong proximity to different markets. To accomplish this task SCM is now organized internally in 5 main Business Units (BUs) responsible each for different range of products: BU Components (mechanical components), BU Minimax (small and more standardized machines for artisans), BU SCM (woodworking machineries-high segment), BU Furniture (woodworking machinery-lower market segment), BU Housing (machineries for houses' frames production and working). The 5 BUs cross, in a matrix organizational structure, 4 Technological Units (TUs) each of them specialized in different technological components, material, process and solutions.

Since its origins SCM has relied on a large number of co-localized suppliers for customized components that have over time developed specific competences in relation to their main customer. This is particularly relevant if we consider that the production structure in SCM has always been based on a relative low degree of vertical integration. In terms of value of a single machinery, 35-45% is represented by internally produced customized components and assembly activities (in particular assembly account for 10%), while the remaining 55-65% is represented by components bought in the external market (around 45% are customized components).

After a rationalization of the supply base, mainly consequent to the period of growth in the '90s, SCM has continuously promoted and implemented a strict connection with local suppliers. SCM considered the local relationships as the primary resource to invest in and decided to preserve and valorise them. Traditionally, and accordingly to the competitive strategy, the Italian network of suppliers has been considered one of the most important leverage of the "made in Italy" image and quality in foreign countries for SCM. This choice has been accompanied by the rigorous monitoring of supplier performance. For customized components, local suppliers were also privileged for logistics and cost reasons. For more standardized components, international alternatives have been evaluated only if some Italian actors decreased their own performance.

SCM has maintained this general approach to the management of its local supply base during years.

However in the last period, due to the crisis and after the changes occurred to the organizational structure, the company is adopting a parallel and "new attitude" to international sourcing. In particular, we can observe that the crisis caused an automatic rationalization of some small local suppliers that failed. SCM from its part, through the reorganization of the Purchasing Department, implemented a stricter supplier evaluation and selection process that involves also the internal *BU components*, that is now not just considered as an internal productive site, but a company's division with its own market's objectives and thus competing with external suppliers.

These processes are accompanied to a higher consideration of the opportunities stemming from international sourcing markets. In this respect we can see SCM monitoring

constantly some foreign markets and in particular Chinese market (mainly through the commercial subsidiary in China). In the last few months has been established an “International sourcing committee”, and it is under evaluation the opportunity to place in the Chinese commercial subsidiary a Purchasing Referee (probably a Chinese manager) to evaluate emerging opportunities in the Chinese market. The International sourcing committee should act as a point of reference for the evaluation of emerging opportunities

Actually, SCM is using these actions mainly as a leverage to involve, promote and stimulate local suppliers, in a competitive logic. In fact, at the moment, local suppliers remain as the main point of reference for SCM productions.

### *Schnell Group*

Schnell is leader in the production of machineries for rebar processing used mainly by companies in the building sector. The company employs 400 people and presents a turnover of 115 millions Euros in 2007 and of 102 millions Euros in 2008.

Schnell has two main competitors, which are an Italian and a German/Danish firm. The company covers the 25% of the market with an average sales’ rate of growth of 30% in the last four years. The company accounts for 8 productive sites (6 in Italy, one in Brazil and one in China), one software company in Spain, 5 “service” companies working as small productive an logistics centres, and around 30 agents and importers that are also responsible for assistance and post-sales services in the major international markets. The company has always based its competitiveness on Research & Development and innovation activities (123 patents registered from 1987 in Europe and abroad) that lead to serve in a customized way a great variety of customers all over the world asking for particular features, linked for example to different building safety standards or different construction technologies.

Schnell was founded in 1962 in Montemaggiore, a small town in the centre of Italy, and it has developed its activities due to the experience gained through the interaction with a lot of similar companies (industrial equipment) and their suppliers. The company effectively combined and exploited these spread competences and resources to enter into a particular and very promising market niche. This opportunity emerged in the early 1980s, due to a reorganization of the construction sector characterized by the development of large multinational companies in iron and steel commercialization. These companies pursued a vertical downstream integration, offering finished products that previously were processed by hand with rudimentary machines by workers in the construction companies.

The ‘80s are characterized by a consistent and rapid growth of the company that was accompanied by an acquisition strategy directed to the control of all the complex technologies involved in the production processes of their customers: automatic processing and assembling for large rebar processing companies. In the late 1980s, Schnell started a progressive process of acquisitions of diverse “complementary” companies in which they held majority stakes that from 1995 turned into a complete control over 4 of them. In a couple of years (1995/1997) Schnell acquired another two companies specialized in different mechanical working processes. Contemporarily the company faced an increasing commercial internationalization by establishing over time 16 commercial and post-sales subsidiaries in the main markets abroad.

The company proceeded to reorganize its activities in the early 2000s by becoming a group based on a series of production units/companies in the local industrial district and throughout Italy.

In 2000, Schnell entered a new production activity in Brazil developing the same products as those produced in Italy but for the South and Central American market.

In 2005 Schnell started a new productive venture in China. “Schnell China” has been established to pursue the same objective of the Brazilian “sister”. In fact, after a first attempt of starting there a new commercial subsidiary, the internationalization process in the Chinese market rapidly turned from a commercial strategy to a productive one. The Chinese market was impossible to penetrate by a simple commercial unit: small local Chinese producers mostly control the market that is very closed to foreign productions.

Schnell’s competitive strategy, as pointed above, has been traditionally customer oriented and based on a dominant “commercial soul”. This is why the company presented since the beginning a very low degree of vertical integration: Schnell performs internally just the assembly and testing activity of a machinery and this accounts for a 16% of the total value of it. The local (both regional and Italian) suppliers contribute significantly to the value of the product with a percentage of 50-60% on the total value.

In this perspective become apparent that suppliers relationships have been always considered as critical in relation to company’s objectives and performances. In particular, local suppliers for customized products and components constitute for Schnell a very important source of value, since they accumulated specific competences in relation to their main customer.

In the 2000s Schnell started some process of reorganization of its network of suppliers mainly addressed to efficiency and rationalization. During this process international sourcing strategies have been also taken into account but just referred to some standardized components for large volumes purchased. In general the local network of suppliers remained almost the same as it is considered as the first source of flexibility for the company at all level.

The recent economic and financial crisis accelerated this process and in some cases changed drastically some paths that have been initiated.

This is particular evident if we take into account the new venture in the Chinese market. The process of internationalization in the Chinese market followed a different pattern of development in respect to the Brazilian one as we are going to describe in the following paragraph. These two different approaches had a different impact on Schnell sourcing strategy especially in relation to local suppliers.

The production site in Brazil relies on a few selected suppliers for some components and systems (20 at the moment, mainly involved in the production of some standardized components and in some surfacing treatments). Schnell promotes a strict complementary coordination between the local supply base in Brazil and the local supply base in Italy. That has been possible because of the long-lasting relationships with some suppliers in Italy for strategic components and systems (motor gears, control panels, screens). These suppliers are mainly suppliers that have jointly invested with Schnell in research and innovation for a long time. Over 20-25 years, they have developed high problem solving capabilities regarding activities carried out by Schnell that can now be exploited by the company for some specific issues related to the Brazilian production. The suppliers cooperate with the Italian engineers and directly with the production manager in Brazil. Schnell sends weekly the so-called “assembling-kits” from Italy to the Brazilian site that are “assembled” at the company’s site from the different components made by the Italian suppliers. In this respect we can observe how Schnell used the local and international suppliers in a synergic perspective.

China has been considered a great opportunity from the commercial point of view and a first step of internationalization was the establishment of a commercial subsidiary in 2002. This strategy rapidly revealed its weaknesses because of the market power of small local producers, which can offer similar equipments at very competitive prices, and the correspondent closure of Chinese customers to foreign products. Schnell thus decided in 2005 to directly invest in a productive site in China for some basic and standardized products for

the Chinese market leveraging on supposed lower production costs mainly related to the use of local suppliers. Very few Italian suppliers have been maintained for just a couple of strategic components and systems (motor gears and electronics). But since the beginning things become much more complicated than what had been planned. Difficulties emerged with a very low productivity of the Chinese plant.

The crisis of the 2008 accelerated the need to increase the productivity of the Chinese subsidiary and this has been mainly addressed by investing the management with an important task: to hugely invest into the search, evaluation and selection of Chinese suppliers. An actual sourcing strategy is now in act in the Chinese market and this effort will not only finalized to the Chinese production but also to the domestic one.

This is one of the most important effects of the internationalization process that Schnell started some years ago. The impact of this evolving situation on the Italian network of suppliers is not easy to predict. Local suppliers are still considered by the company as the most important source of value in relation to product and processes innovation especially in relation to customized products and components. Currently the top management is not planning to change this scenario, but at the same time the company does not exclude that in future some considerations could be made also in relation to these kind of suppliers.

## INTERPRETATION OF RESULTS

In order to discuss the results of the empirical analysis, we address the three questions introduced in the first section as main goals of our research.

The first question investigates the local dimension of business supplier relationships as a feasible and effective path. Our analysis shows that the three companies under examination over time have been relying to a great extent on the local network of suppliers, which mainly provides customized parts and components; since the '90s the three companies have gradually opened their supply network to international producers of commercial parts. However, two considerations are deemed necessary. Firstly, the micro-multinationals under analysis use a pro-active approach in their sourcing strategies. In fact, the three companies have been able to develop over time a coherent and balanced strategy based both on local and international sourcing. Companies are fully aware about benefits and costs connected to interactions and interdependences with co-localized suppliers. A careful analysis of benefits and costs lead to choices concerning the structuring and processes of their supply networks. Secondly, international sourcing is not perceived as a "must" due to inevitable efficiency reasons; rather it is a deliberate choice that is carefully analyzed as option and that can be reviewed in favor of strategies of local sourcing or, even, of re-internalization of manufacturing processes. Such approach is also influenced by the overall strategic orientation in terms of markets to be covered and make or buy options adopted.

Figure 1:

	Hybrid buyer-supplier relations	Segmentation of suppliers (partnership and market based relations)	Hybrid buyer-supplier relations
<b>Cost efficiency</b>	CEFLA = SCM ↑ Schnell ↑	CEFLA ↑ SCM ↑ Schnell ↑	CEFLA ↑ SCM ↑ Schnell ↑
<b>Knowledge and innovation development</b>	CEFLA = SCM ↑ Schnell ↑	CEFLA ↑ SCM ↑ Schnell ↑	CEFLA = SCM ↑ Schnell ↑
<b>Production flexibility /delivery performance</b>	CEFLA ↑ SCM ↑ Schnell ↑	CEFLA = SCM ↑ Schnell ↑	CEFLA ↑ SCM ↑ Schnell ↑
	<b>1990s</b>	<b>2000-2007</b>	<b>2008-2009</b>

The second question aims to assess whether and how local suppliers still provide strategic advantages for leading firms engaged in international markets. Figure 1 attempts to portray the evolution of the contribution of local suppliers with respect to three distinct “advantages”: knowledge and competences development, production flexibility and delivery performance, cost efficiency. Knowledge and competence development refers to the fact that local suppliers own product and production knowledge and capabilities that improve the quality and the level of innovation of the companies’ offerings. Production flexibility and delivery performance refer to the great support that local suppliers are able to give to the companies’ ability to change volumes and characteristics of the offerings and to accelerate and rapidly modify the terms of delivery. Cost efficiency refers to the ability of local suppliers to reduce costs of production and of other processes, thus contributing to a final cut of total costs and to a price reduction for customers.

During the 1990s the fast growth in the final market pushes the three companies to involve a wider network of local suppliers to match the increasing number of orders. Production capacity and delivery performance are the main evaluation criteria to select suppliers, followed by the ability to undertake technical upgrading processes, often with the informal support of the customer. In the next decade (2000-2007), shaped by the sharp upsurge of market demand, competition for companies under examination increases in the light of globalization processes and entry of new competitors. Such a competition is mostly faced by high investments in technology, innovation and customization. Products are more technologically advanced and sophisticated and thus some suppliers – perceived as strategic suppliers – are actively involved in innovation processes. In 2008-09 the global economic and financial crisis changes dramatically the market dynamics and represents a point of strong discontinuity for all the three micro-multinationals under examination. Great decrease in national and international demand combined with strong market unpredictability have

forced the three companies to place higher emphasis on cost efficiency and again on production flexibility and delivery performance by their suppliers, which are now under strong pressure to reduce costs and in many cases cannot match the new market conditions. Companies search for alternative suppliers in the region or in Italy and also local suppliers show some efforts in attempting to diversify their customers' portfolio. Higher uncertainty on both final and supply markets is faced by the three companies in some cases through a major effort in restructuring their operations and internalizing some of the strategic production processes previously performed by local suppliers. In the meanwhile international sourcing projects have been slowed down because of low volumes and low efficiency of the logistics dimension of the supply chain. Thus in the recent period the main strategic advantages - production flexibility and delivery performance and cost efficiency - pursued by the three companies resemble those emerging in the early '90s.

The third and last question concerns the evolution of the main features of relationships patterns with local suppliers. During the 1990s as a general approach the three companies focused on compliance with production scheduling and thus search for exchange conditions allowing for easy supplier switching decisions. However, technical capabilities gradually become a main criterion to select valuable suppliers and therefore the three companies under examination showed a propensity to implement hybrid patterns of buyer-supplier relationships in respect to local suppliers, combining in various degrees partnership-based with transaction-oriented behavior. In the 2000s the market evolution pushed the three companies to upgrade the role of their main suppliers. Supplier segmentation's efforts emerge in the light of the strengthening, mainly in terms of technological cooperation, relationships with a selected group of strategic suppliers providing customized parts and in some cases, as the Cefla example shows, also design and development outputs. The economic crisis and the following fall of market demand undermines such pattern of buyer-supplier relations. Both customers and suppliers undertake steps to survive, thus pushing the relationships towards hybrid patterns resembling the approaches emerging during the early 1990s. Companies are fully aware of the vertical integration option, in some cases put in practice, and show a preference for maintaining alternative supply sources, also monitoring foreign-based suppliers. In the same time they are interested in preserving relationships with those local suppliers able to match new target costs and unpredictable terms and quantities of delivery. Under the pressure of costs, however some suppliers do not manage to financially survive and the client company sometimes supports them if their product competences are not easily and rapidly replaceable; sometimes suppliers fail, thus creating serious problems to the customer company which is forced to rapidly find new suppliers and sub-suppliers capable to adapt to its business needs.

The come-back of flexible and hybrid buyer-supplier relations in recent years is not accompanied by innovative behavior of suppliers in terms of strategic and organisational configuration of customer management. According to the examined buyer companies, there is no evidence of relevant shifts such as global supply projects, follow sourcing strategies or strategic alliances implemented by the main suppliers.

## CONCLUSIONS

This paper aims to uncover the change affecting the local supply relationships by Italian micro-multinational companies active in the mechanical sector and open to international sourcing opportunities. Notably, the empirical analysis concerns the behavior of three mid-sized companies based in Italian industrial clusters located in the centre-North of Italy. The empirical analysis leads to three distinct considerations, related to the main research questions. Firstly, the three companies under examination show a gradual and balanced



approach toward international sourcing opportunities, which are exploited mainly for commercial parts and only to a limited extent for customized parts and components. Local and domestic suppliers have been always perceived as a valuable resource, even though customers have chosen different supply management approaches overtime due to changing market conditions. In this respect differently from what literature on SMEs highlights, the three companies show a mature approach to sourcing, assessing and selecting co-localized, national and international suppliers. This is coherent with their status of “micro-multinationals” and our research highlight how this type of companies behave on the upstream side implementing original business models that only partially reflect those typical for SMEs and for MNCs.

Secondly, local suppliers have been providing “strategic advantages” in different ways in distinct historical phases. Starting in the early ‘90s they are providers of production capacity, under the technical guidance of their customers; in some cases have been able to become strategic partners during the years 2000s because of their product and production competences. That is what is mainly stressed by literature dealing with the topic that tend to distinguish between sourcing of commodities and sourcing of long term know-how and capabilities observing that domestic suppliers are not easily replaceable in the second case. However, being cost efficiency the new value driver in the mid-2000s, local suppliers have started to face on one hand restructuring processes and on the other the challenge of the development of international sourcing by their customers. After the break-out of the effects of the economic crisis in 2008, suppliers have been pushed to play the role already practiced during the ‘90s, providing a production “buffer” support, even if in a weakened position in the light of the threats posed by vertical integration and alternative sourcing choices by their customers.

Thirdly, the three companies over time have shown a capacity to adapt their supply management approach to changing market conditions. The search for capable suppliers in terms of production and delivery skills during the 1990s has been possible thanks to a hybrid approach, combining partnership-based and transaction-oriented behaviors. Higher product technological requirements in the years 2000s have been faced by the three companies by actively involve strategic suppliers in their innovation processes. The dramatic change in market conditions at the end of current decade has been tackled by a substantial reconfiguration of make or buy policies and a renewal of hybrid approaches to supply management, while enlarging the supply base on a national and international basis.

The future is uncertain. The positive aspect is that the crisis has probably accelerated a process of rapid reconfiguring of supplier relationships according to a cost perspective that helps to recover margins over competitors. The negative aspect is that stress on costs and delivery performance reduces emphasis on innovation capabilities and improved know-how by suppliers.

Under a managerial point of view, the empirical analysis highlights three distinct strategic dimensions of sourcing behavior implemented by the companies under examination. Firstly, all companies have been capable to develop and actively nurture a local supply network characterized by high interaction in terms of social relationships and knowledge flows. Even though in the various phases the leading companies valued in different ways local suppliers’ capabilities, the ability to leverage on the local dimension helped them to face both growth phases and market crises. Secondly, some of the companies show the benefit of a strategic assessment over the development of internal technical capabilities. Despite the diffusion of fashionable outsourcing trends during the early 2000s, some of the companies have been capable to react very rapidly to the sharp reduction in market demand in 2008 by choosing the in-sourcing option for some intermediate production processes. Thirdly, all companies show an incremental and cautious approach while implementing international

sourcing projects, which are not perceived as the only solution to achieve new efficiency targets. Potential opportunities are assessed and organizational mechanisms – such as ad hoc purchasing units - are set up to support international sourcing projects.

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