A case study (with original fieldwork) is used to assess the mutual compatibility of final firm market power, stable supply relationships and productive cooperation in Italy’s regionally agglomerated industrial districts. Drawing on Michael Storper’s distinction between “untraded interdependency” (learning) and “transaction-cost” explanations of industrial district functioning, the paper argues that the intuition that concentrations of market power will undermine “competitive cooperation” follows from the latter. Given recent evolutions in the Italian industrial districts, the “transaction-cost” explanation could imply a dilemma in which the high final market rents available to particular district firms will lead them to withhold their private market information, causing a breakdown of cooperation as their suppliers retaliate by refusing to disclose their own productive information. I then present (in truncated version) some qualitative data gathered in 1999 in the Marche shoe district to show that such dilemmas of information hoarding do not hold empirically, and argue that the interviews tend instead to support an explanation of industrial district competitive advantage that is premised on learning, tacit knowledge and capabilities.

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It is not by chance that the huge international interest in the Italian case has focused almost completely on the industrial districts. The emphasis has been put on the widespread organization of the firms at the local level. In other words, it has been put in fact on groups of small and medium firms where the efficiency of the single ones comes from the positive sum economies of scale external to the firm yet internal to the area. The nature of these external economies of scale has been largely identified not only as know-how and market notions linked to particular methods of production, but also the shared sense of belonging to a social context, meaning lower transaction costs, as a result of the reciprocal trust among the firms of the district.

— Patrizio Bianchi, *Industrial Policy in Italy*, 1993

The “huge international interest” in the industrial districts was initially of an extremely optimistic nature, with the most exuberant pointing to the high wages and superior employment performance of northeastern and central Italian regions and hoping that a more humane capitalism had been uncovered. An explosion of social scientific literature on the topic emerged in the late 1980s and early 1990s, focused largely on Italian districts but including as well the discovery and discussion of similar phenomena in other countries. As this relatively sophisticated debate evolved, some of the initial optimism was worn down by books and articles nipping at the edges, emphasizing the reliance of some districts on lower paid homeworkers, pointing to coordination problems endemic to diffuse production, and questioning the model’s exportability and generality. However, by the mid-to-late 1980s, many Italian industrial districts had far greater problems than scholarly skepticism: they were suffering under the weight of competition from lower wage countries, a recovery of large firms and the need to defend changing market niches.

Despite disagreements over the details and relative importance of the various changes that began in the 1980s, there is a consensus that something happened. Dependent on ‘spontaneous coordination’ and easy firm-to-firm information flow via the ‘industrial atmosphere,’ the traditional district model is widely thought to be threatened by increasingly tight delivery times required by *pronto moda* and just-in-time production techniques, quality upgrading strategies necessitated by low-wage competition, a need for an active commercialization of products coupled with returns to scale in marketing, and problems keeping up in technology when R&D is scale-intensive or dependent on codified knowledge.
There is also agreement on some basic empirical “facts” of changing district structure. The market power of commercial firms has increased as firms are “specializing in their core business, externalizing irreversibly other productive stages.” In the fashion and furniture districts, this includes firms “who specialize in relationships with the final market, taking on functions traditionally reserved for buyers, and reducing the vertical integration of productive activity.” In general, district firms are “creating stable relationships with a restricted number or suppliers and increasing the levels of supply” (Innocenti 1998: 397). Groups of firms linked by formal ownership ties are becoming more common, and subcontracting relations are significantly more stable than they were in the past. Vertical cooperation is intensifying in an effort to coordinate production more quickly, to ensure adequate quality at all stages of the production process, and to safeguard investments in the capital goods required for product diversification strategies. Where once firms were content to leave agreements implicit and informal, now they are more likely to use written contracts, at times even tiering suppliers and maintaining “preferred” relationships with some of them.

These developments are contested in their interpretation, but have elicited voluminous comment in both the Italian and English language social scientific debates (for an overview see Whitford 2001). Some follow the “firm-centered” position taken by Varaldo and Ferrucci (1993: 85, 91) in the Italian debate that the future of the districts lies in a “re-composition of their structure” through “specific and original evolutionary pathways, followed by leader firms who distance themselves in culture, means, and strategic capacity from other district firms,” but skepticism about the model’s future abounds. Perhaps the most trenchant and best-known critic in American debates is the late Bennett Harrison, whose 1994 book, *Lean and Mean* argues that entry by conglomerates outside the districts or growth by firms internal to the districts will result in “leaders that then flex their economic muscle, imposing hierarchical rules of behavior onto what used to be a collaborative milieu” (Harrison 1994: 77, 88). He asks “whether cooperative competition, trust, and the other underlying principles that have been identified as the glue holding the distinctive Italian geographically based production networks together can withstand the intrusion of hierarchical, concentrated economic power in the region.”
Are final firm market power, stable supply relationships and cooperation mutually compatible?

Harrison raises an interesting and important question. In at least some Italian districts, strong leader firms with powerful positions on final product markets are forming relatively stable relationships with suppliers lacking similar options. Although some laud these developments as necessary in a globalizing economy, it remains essential to ask if such changes are consistent with the cooperative backbone of the industrial district model. Basing his analysis on a rereading of the case studies of others, and particularly on his interpretation of developments in Prato and with the SASIB and Benetton networks, Harrison suggests that concentrations of power will probably undermine “competitive cooperation.” However, he never offers a careful theoretical justification for this claim, nor does he clarify the meaning of cooperation in the context of within-district contracting; indeed, he seems simply to equate it with power equality. Harrison’s assertions, however, raise an interesting question. Are final firm market power, (relatively) stable supply relationships and cooperation mutually compatible in the industrial districts?

One way to look analytically at asymmetric power in contracting is through the prism of a prisoner’s dilemma with unequal payoffs. Note that game 1 is strategically equivalent to a “standard” prisoner’s dilemma: asymmetric power has not altered the ability of the players to cooperate. Were this an iterated game, it would become analytically equivalent to an assurance game, able to support cooperative equilibria. Harrison’s intuition stems instead from an implicit assumption that the players must share (at least relatively) equally in the gains from joint cooperation. Imposing this condition with large power differences (game 3; game 2 shows that minimal power differences with equal division do not reorder payoffs), player 1 will never cooperate, as the {NC, NC} payoff of 11 pareto dominates the {C, C} payoff of 8.

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Thus, the question becomes “which game is it, and why?” If the gains of cooperation are not shared equally, or at least relatively equally, does cooperation break down?
In the remainder of this paper, I draw on Michael Storper’s (1995) fundamental distinction between “untraded interdependency” (learning) and “transaction-cost” (allocational) explanations of industrial district functioning to argue that Harrison’s intuition follows from the latter story. That is, given recent evolutions in the industrial districts, the transactions-cost explanation could imply a dilemma in which the increased market power of district final firms will lead them to withhold their private market information, causing a breakdown of cooperation as supplier firms retaliate by refusing to disclose their own productive information. I then present (in truncated version) some qualitative data gathered in 1999 in the Marche shoe district to show that such dilemmas of information hoarding do not hold empirically, and argue that the interviews tend instead to support an explanation of industrial district competitive advantage that is premised on learning, tacit knowledge and capabilities.\

**Cooperation, quasi-rents and market power**

Transactions cost economics (TCE) explanations for industrial district competitive advantage depend (obviously), on lowered transactions costs for firms contracting within-district (for the usual reasons — reduced opportunism, perhaps general improvements in information flow, reputation, other agglomeration effects, etc.), but they also generally claim that production costs are kept low by high labor specialization and overall production volume (external scale economies). For a final firm \(F_d\) in the district and two subcontractor firms \(S_d\) and \(S_n\), identical except that \(S_d\) is in the district and \(S_n\) is not, if \(C_{dx}\) is the cost of a product made jointly by \(F_1\) and \(S_x\), then \(C_{dn} > C_{dd}\). Because they are less likely to be subjected to problems of hold-up in asset-specific contracting situations, \(F_d\) and \(S_d\) are compensated by efficiencies garnered from regular recourse to market transactions for disadvantages they suffer relative to firms paying lower wages or with superior internal scale economies outside the district. That is, within-district contracting provides firms a quasi-rent \((R = C_{dn} - C_{dd})\) that refers to any cost savings (or quality improvements) to be derived from the joint interaction of interdependent firms in the area.\

This text-book TCE explanation of industrial districts ascribes their success to the coordination of production through market mechanisms tempered by a set of customs, commitments and trust that mitigate opportunistic behavior. When information is freely shared without opportunism, ex-post
adaptation is more effective in markets, where firms can quickly switch partners and direct joint activity through the reciprocal discretion of bilateral or multi-lateral governance arrangements, in which all parties have non-trivial control of overall strategic direction. Unilateral governance by a single manager or entrepreneur is often subject to inefficiencies of inadequate information — the commanding firm cannot know the details of the others’ production processes (Dei Ottati 1995). Obviously, this does not fit easily with the recently observed external hierarchy and increasingly stable relationships between firms, and must thus be adjusted.

A careful reconciliation of these developments with the industrial district model is offered by Innocenti (1998: 402). He rebuts those the Italian debate who hold that “the survival of the district depends on beginning an internal process of ‘hierarchization’, constituted by the partial recomposition of the original productive fragmentation and by the appearance of medium sized firms who take on the role of coordinating and diffusing information flows,” and draws on 1991 and 1994 mediocredito data to show that on the whole, vertical integration is not happening. Instead, the number of firms working as subcontractors is growing, as is the percentage of subcontracting sales achieved in all size classes. Innocenti (1998: 397) argues that the increased subcontracting is motivated by reasons of specialization (the subcontractor is more efficient) and not simply about absorption of demand irregularities (capacity subcontracting). Rather, (especially small) firms in a globalizing world are pushed by technological requirements to “specialize in their core business, irreversibly externalizing the other productive phases and so creating stable relationships with a restricted number of subsuppliers and multiplying the number of levels of subcontracting.” He also points to an increased importance of codified knowledge, whose private but alienable nature discourages horizontal cooperation.

In this adjusted TCE story, cooperation remains fundamental, but it is found in the now more structured and formalized vertical relationships. Borrowing a concept formulated by Aoki (1988; 1990) to interpret the Japanese model, Innocenti suggests that the modern industrial district can be well understood as a “vertically organized market” in which relational quasi rents (R) may be created. These relational quasi-rents are information rents generated through participation, where each side holds information
essential to the other side that can be shared to produce a cooperative quasi-rent “the distribution of which is susceptible to bargaining among those agents” (Aoki 1990:28). The differential types of information possessed by commissioning and subcontractor firm are, respectively, “information on final markets” and “information of a technical character.”

This adjusted TCE story imputes the primary source of district competitive advantage to the mutually cooperative use of private information (each side refrains from short-term opportunistic exploitation). Whereas contracting under uncertainty is often likened to a prisoner’s dilemma, Innocenti (1998: 408) argues that in an evolving industrial district vertical market characterized by increasingly coordinated specialized activities is better understood as an assurance (coordination) game, as “the amount of competitiveness implied in the prisoner’s dilemma — more appropriate to horizontal relationships — appears disproportionate relative to the characteristics of vertical relationships between buyers and specialized suppliers who share a common interest in the creation and growth of relational quasi-rents.” Given sufficient interaction between the parties in the district and bounded rationality, one can expect the cooperative outcome to settle in as the unique equilibrium state, where the “district social network model” serves to “to give the institutional guarantees upon which the long term affirmation of cooperative behavior based on reputation depends, ensuring the information flows” so important to competing in high-end markets (Innocenti 1998: 408). It is sustainable, write Brusco and Bigarelli (1997), because “final and subcontractor enterprises acquiesce in accepting a climate of substantial cooperation and agree to coexist in a complicated system of rules that includes a highly structured, although unwritten, mixture of trust, inspections and sanctions. Relational quasi-rents result from the district’s ability to ensure long term cooperative behavior in the absence of fully specified long term contracts.

The clear positive of this interpretation is that it is not overly dependent on culture, norms, and institutions to ensure coordination; these need no longer fully reorder payoffs to resolve a perpetually fragile mass of prisoner’s dilemmas. But it does not account for another aspect of the evolving path of the industrial districts: as district firms focus on their “core capacities,” some of them might specialize in being final firms, perhaps limiting the final market access of stage (subcontractor) firms. In the past, these
stage firms were often contingently not on the final market in a given season though it remained theoretically a part of their feasible set. Now, if becoming a final firm requires considerable investment and specialization, some will be forced to cement themselves into the role of permanent suppliers. This alone is unproblematic, a mere furthering of the division of labor. Power imbalances do not necessarily follow a division of labor between producing and selling firms, depending instead on the vagaries of specific product markets and the relative supply of competencies in the economy (Kristensen 1996). However, Innocenti argues, it is very possible that an affirmation of the leadership of medium-sized firms coupled with the introduction of “lean production” models would “dismantle the incentive structure of a system characterized by equal relations (rapporti paritari) between firms, weakening the conditions that ensure the availability and circulation of information flows.” That is, an empowerment of final firms might provide them with product market rents and give incentives to use monopsony power vis-à-vis suppliers, possibly decreasing the overall efficiency of the district model and leading to a globally sub-optimal non-cooperative outcome.

The risk in the modified TCE story — if it is true — is that it contains the seeds of a “mutual rent incompatibility.” When firms work together on a project, both sides bring to the table a particular sort of private, alienable codifiable information. One party knows the size and location of product market rents, while the other has information about production costs and techniques. Relational quasi-rent creation derives from the marriage of these asset-specific informational bargaining chips that are shared only because of the “district social network model.” The assumption of “mutual rent incompatibility” can be interpreted to mean that when firms work together on a project, a refusal by final firms to share product market rents is viewed as a breach of the “complicated system of rules,” begetting in turn breach from the supplier who recognizes that his only bargaining chip is to withhold effort and/or information, leading finally to coordination failures and the non-creation of relational quasi-rents.

This fits nicely with the intuitive appeal of Bennett Harrison’s intimation that cooperation might not be able to “withstand the intrusion of hierarchical, concentrated economic power.” A potential dilemma arises as product market rents available to a limited number of firms (effectively, oligopoly
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rents) increase in magnitude, making it relatively less advantageous for them to share product market information, shifting us from an iterated version of game two to an iterated version of game three. Final firms exit the local system of rules, “turning to a wider population of suppliers and forming relationships characterized by regular renegotiation of the terms of trade. Such a policy impedes the formation of the relational quasi-rents, but permits the commissioning firm to continue to retain private information on the oligopoly rent and therefore not divide it with its suppliers” (Innocenti 1998: 409). This outcome favors individual leader firms to the overall detriment of the district.

Market power undermines cooperation in theory, but does it do so in practice?

Despite strong theoretical reasons to expect vertical market organization to undermine cooperation (given a reasonably well-accepted story of district operation and evolution), a case study of an important shoe producing district in the Marche region seems to indicate otherwise. Due to a combination of conjuncture and structural changes in the shoe industry, the initial conditions for “mutual rent incompatibility” are met in the Marche district: brands (product market rents) are increasingly important, competition from low wage countries is salient, firms are upgrading quality and groups are more prevalent and powerful than in the past as firms seek to collaborate. Even so, interview-based field research in the region in the summer of 1999 did not reveal a tradeoff between the subsumption of final market rents and the creation of relational quasi-rents.

Nevertheless, the above discussion remains a valuable negative heuristic for understanding developments in the district. Because the dilemma follows from the assumption that both sides possess codified, and thus potentially alienable, information that they withhold in an asset-specific bargaining relationship, its non-occurrence casts some doubt on TCE explanations of district advantage premised on the sharing of private information, and strengthens instead the claims of a leading competing explanation that finds district advantage in particular skills, tacit knowledge and untraded interdependencies (Storper 1995). Before returning to these theoretical concerns, I briefly present the case study, unfortunately truncating for space concerns all but the most relevant particulars.
The evolving Marche shoe district

The Marche shoe district represents some 30,000 workers in 2500 factories across two provinces with a population of 670,000, producing 25% of the shoes made in Italy (which is the largest per capita shoe producer in the world). While the shoe industry has had some ups and downs, and is particularly challenged by low-cost competition, “the stability of the Italian position is even more singular compared with the transitoriness of the competitive pressures of some developing countries, like the [east Asian] NICS” who went from 41% of the G7 import market in 1988 to 4% in 1997, replaced by China who went from 3.7% to 35.2% in 1997. While competitors come and go in price-sensitive markets, Italian producers rely on “product quality, creative capacity, and the specialization of the labor force, but also on recently developed instruments like the productive decentralization of some phases of the production process” (Saladini 1998: 207). Most relevant here, it is a district which exemplifies the pressures and challenges outlined above, and in which various factors have given considerable market power to select final firms.

A series of 26 interviews in the province of Ascoli Piceno revealed an industrial district in rapid evolution due to an overall slowing of demand, a move to higher quality products and away from the leather-soled shoes that are the Italian specialty, a dramatic increase in the importance of brands, and shrinking delivery times induced by pronto moda. In the words of the outgoing president of ANCI (the national shoe producers association) and head of the largest firm interviewed (with several important brands and a proprietary commercial network), “We will find ourselves with an Italy that is still the leader in the shoe industry, but probably smaller” (ridimensionato, literally, “re-dimensioned”), adding later that “it is a situation that will… penalize the small firms, but it will advantage firms with clear ideas, structures, brands, means, market power. There will be a strengthening of the big groups, as has happened, and there will be a very strong selection of firms.” We can expect a future, he said, in which “there will be a few excellent firms who will make a great deal on the market, and there will be others destined to the role of producers.” Some of these will manage to attach themselves to the big groups, and “will have this role, satellites to groups, and that is fine. Others will be in niche markets, because they will manage to build on a few products, and the others are destined to a experience a selection.” A move to
specialization in production by some and in sales and design by others is confirmed by other firm owners. One, explaining his decision to (partially) abandon his brand and form a partnership with a prominent northern Italian fashion house, commented:

Practically, with globalization … it was no longer sufficient to have a winning product, but you needed a strategy and market penetration, given that there was a recession. The brand, to be sold in the whole world, required an incredible strategy, you really need communication, a way of acting, a very precise way of commercializing, and all that is costly.

It is abundantly clear that brands and marketing are important, but intrinsic product quality is still quite relevant. The incoming vice-president of ANCI, whose firm controls several important brands, said that “I can guarantee that the value-added that the big brands, the designers, had until a few years ago was higher than it is now…. It is still important to have a brand, one of the most important in the world…, but it is not enough. The brand must be synonymous with quality, total quality…. We cannot think about selling with just the brand at certain prices.” Every firm I interviewed made shoes that they classified as mid-high or high in intrinsic quality, and quality, or that one “works well” was always a primary determinant in choosing a subcontractor. In a recent survey by the province of Ascoli Piceno, 89% of shoe firms classified their product as at least medium-high in quality (Gregori 1999).

The specialization of a few powerful firms in selling (as one says, “the important thing is having the right product, with a known brand and the right price. We can choose to produce it internally or externally”) results in fewer firms with a realistic shot at the final market. In the above cited provincial survey, commercial weakness was found to be a problem, not least because of the “diversification of the high fashion brands (firme, or ‘signatures’); this subtracts more and more space at point of sale from firms with lesser brands. Additionally, there is a worrisome loss of autonomy of some prestigious firms that have become substantially subsuppliers of the ‘signatures’ of the fashion system (sistema moda)” (Gregori 1999). According to a representative of the largest of the national union confederations, the CGIL (historically associated with the Italian Communist Party), in the province of Ascoli Piceno four major groups control a substantial portion of the final market, while many of the other firms work largely for these groups. This does not necessarily imply that these specific firms are using their oligopoly power
to limit the market access of the other firms in the district, but only that firms are crowded out by ongoing changes in the way the market operates generally, with limited space for “leader firms.”

Final firms who control important brands can do so well even now (not all do, but some) that one owner said “if this is crisis, I hope it continues for another 10 years…. We expect to grow by… close to 40% this year.” These are firms who have specialized to some extent in their “core capacity” of selling shoes and organizing production across subcontractors (though they generally still do some production, some more than others). I think it unarguable that these firms who (successfully) specialize in the marketing of their brands have access to a product market rent. The Marche district clearly presents the first of the criteria of the dilemma of “mutual rent incompatibility.”

**Final firms and quasi-final firms**

Firms with strong brands are not simply final firms who contract away various stages of production. Rather, they employ numerous other “quasi-final firms” that specialize in production. These “fashionisti” produce finished shoes, using models and materials supplied by the final firm, but organize independently relationships with stage firms like stitchers (stitching is the one phase that is virtually always outsourced, as well as the one most often sourced outside the district). The “true” final firm usually also has some productive capabilities, so an obvious interpretation of apparently stable relationships could be that they are simply shifting the risk of investment in productive capacity to these other factories, using them as a sort of “lung,” where the observed stability is simply a result of the obvious transactions costs to the final firm from switching and the absence of other trade partners for the quasi-final firm.

As the CGIL union representative explained, when the big groups grow, it is by decentralizing, which “permits, on the one hand, a flexibility in relation to the market, and on the other, big risks concentrated on small firms, maintaining the advantages of commercialization for those who have market power.” This can not simply be dismissed — there is clearly some risk-shifting, and the weaker firms are a little desperate — but it is by no means the entire story and misses the significant gains from vertical cooperation as well as the advantages final firms derive from access to the know-how and productive
specialization of suppliers. According to those interviewed, relationships between final firms and the firms that produce for them are quite stable, at times with ownership ties, at times without. Firms stressed that they strongly prefer long-term supply relationships, unsurprising given ever-present costs to changing. Also unsurprising, firms to which work was commissioned generally worked with the same customers. What is notable, however, are the lengths to which firms go to maintain these relationships, and the tightness of the ties even by the firms who control strong brands and so might be in a position to profitably auction the right to be a supplier. Final firms profit from the ability to adjust both the quantity and mix of products without being forced to invest in capacity, but they also depend very much on the specialized skills, know-how, and organizational talents of their suppliers. Interviews with both final firms and fasionisti showed that specialization and quality production were clearly important in choosing suppliers. Relations with suppliers tended to be stable and “embedded,” all things that point to the existence of the relational quasi-rents described in the previous section.

The importance of fasionisti to final firms was best explained by a successful firm that keeps tighter relations than most with its suppliers, and that is perhaps further along the “evolutionary curve” to more stable firm relationships, though with motivations behind its subcontracting choices generally similar to those of other district firms. With only 25 employees, the firm has 90% of its product made by other firms, all of whom produce exclusively for them “with a sort of particular agreement where we ask guarantees of them and they ask guarantees of us.” The main firm holds ownership stakes in some, while “the others have our know-how, or at least a particular interest towards us at many levels, financial and otherwise.” Currently the group is made up of six firms, five of whom were alone on the market before. Now, all produce only for the main firm, running their production operations substantially themselves, with assistance and quality control from the center, where all choices about the brand, designs, and communications are made. The owner stressed that “our firms are highly specialized…. This permits us volumes at an industrial level with the specialization and the attitudes of artisanal work,…in addition it gives us enormous flexibility. It is one thing to have a flexible firm, another is to have a flexible firm that is specialized — total flexibility.” Exclusive contracts with guaranteed minima are not unique to groups
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Tied by ownership, and a similar pattern was exhibited by other final firms. A firm that informally guarantees work to 10 factories (without contractually binding themselves) recognizes its superior bargaining position, but tries to keep long-term relationships because “there is collaboration. Today the market is made up of firms who collaborate with each other. At the level of mentality, we do not have an interest in taking advantage. Our interest is in having collaborators who are able to give us a service, a product, a good price.”

The manner in which these firms are chosen indicates both the importance of the district and of the skills of subcontractor firms. First, while some phase production, especially stitching, is external to the district, most fasionisti were based in the district. For within-district contracting, quality and trust were unequivocally the main criteria in choosing fasionisti. One suggested that in choosing partner firms, “the principal element is the trustworthiness of the firm.” He was echoed by others, one of whom said his were chosen because they were “people I know, from the area…. I choose them on the basis of seriousness, quality — especially quality — I do not look much at price because we make a product where the price…, 5000 lire does not change much.” The fasionisti interviewed give a similar interpretation. Even with no guarantees, one commented that “there is an unwritten agreement in which they know that we are there for them and we know that next season we will work for them,” adding that “changing is problematic, both for them and for us. There are a lot of little secrets in the work, and it takes time to optimize.” Another emphasized the importance of intrinsic quality in keeping a client. He had just started a new firm after closing one that failed with its own brand, but before beginning, he had used his long experience and reputation for quality to establish relationships with some strong final firms to guarantee himself adequate demand.

Final firms require stability and quality from their producers, and reputation and personal knowledge of the qualities of the subcontracting firm are important in awarding the contract, all things that might well be favored by being in an industrial district. Skilled labor, at least in certain phases of production, was agreed by all to be important to quality production. Perhaps the greatest evidence that producing in an area with a culture of shoe production matters, and that it is not simply a question of
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proximity, is “revealed preference.” The vast majority of firms continued and continue to locate in the district even though it lies just 25 km north of an area that had the Cassa del Mezzogiorno, a central government program to favor the industrialization of poor regions, “where,” a union representative said, “putting up a factory did not cost anything, but this sector did not move. It did not move because the entrepreneur, walking out his door and going to the neighbor found boxes, laces, he went around town and found everything.”

Hence, subcontracting is often specialized and final firms have a strong preference for long-term relationships, especially because it gives them the higher quality products they need to maintain their strong brands. Reputation, and especially the entrepreneurs’ talent for organizing production, are important in choosing the firms with whom to maintain these long-term relationships. This seems a description of industrial district production with stable relationships that might well be abstractly described as dependent on the gains from a series of relational quasi-rents that are particularly strong because they are formed in the institutionally thick context of an industrial district. However, given that final firms have access to a product market rent and seem to have organized themselves to some degree into within-district “vertical markets,” do they share those product market rents with their suppliers? If not, are suppliers unwilling to share their talents and information, destroying relational quasi-rents?

Both final firms and fasionisti made it quite clear that presently the advantage in bargaining rests with the firm that has direct access to the consumer market. In this district, particularly given the current crisis/restructuring, there is excess supply of productive capacity, of which both final firms and suppliers (often transformed final firms) are well aware. Nevertheless, final firms do not constantly play one potential supplier against another to lower prices. Rather, they maintain a core they know and trust to deliver the products they require, absorbing some risk but otherwise paying these suppliers only about what they (fasionisti) could obtain on the final market with their own brands (which is considerably less than the same product with an established and well-marketed brand). Final firms do not believe it in their interest to drive prices lower, instead seeing themselves as invested in long term relationships with a
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responsibility to at least minimally maintain the supplier at a level where he can make capital investments. When asked how the fasionisti earned, final firm entrepreneurs gave similar answers:

We do not make problems for them. We do not want to strangle them. We expect them only to work to our satisfaction. We give them what is right, what they would have made with their own product on the market.

I believe that it is a margin that is sufficient with respect to the average of the sector right now. Let’s say that it is in line with what the sector can give right now. We do not have an incentive to not make our firms earn, the ones who collaborate with us, because we have always set up the relations with these firms to last. We have to give sufficient motivation to these firms, and certainly you have to give adequate margin. It is also a motive to be able to ask for re-investment, and to follow the plans of our firm. We have every interest that they earn something, though certainly also that the margin be the fruits of good work.

We do not want to impose [a price]. We have to have a certain price, of course, but we also must be able to guarantee that the other firm gains, because if they do not gain, in the end…. Unlike clients in general, who want to obtain the maximum of personal benefits, we have a moral obligation to sustain them.

Although they do not significantly share in the high returns of their powerful partners, the fasionisti consider themselves quite lucky to have a spot working for an established brand. These firms are often relatively small and dominated by a single entrepreneur who runs everything, with a great deal of both his personal capital and life invested in the firm. Understandably, they cannot afford to take many risks and see being a weak partner to a powerful firm as an attractive hedging strategy, even as they hope their current difficulties to be largely conjunctural. They are trying to weather the current storm and earn poco ma sicuro, a phrase I heard often that means “little but sure.” One who reports that he now works for (quite important) others, because “on my own pays badly,” points out that “there are those who tomorrow might get up and close. I am safe. That is what I wanted…. Tomorrow if things take off again…, we can take steps forward and everyone can go on his own road.” Another who recently decided to let his brand languish to work for the most important group in the area, reports that “in normal conditions, you earn more on your own, without a doubt. When you can sell, you do better on your own, but even as a subcontractor, if you run things well…. In the last year his firm received more lucrative offers to work for less prestigious and established brands but turned them down because they were not sure they would be able to meet the orders without jeopardizing their main client.
When the final firms were asked why the fashionisti remained in these relationships, they too reported that it was for the security, and anticipated that even if the fashionista brand were to take off, that they would simply augment their production, but they would never let a brand like ours go…. They feel more secure working for a brand like this. They have the possibility of keeping their own brand afloat hoping that things change…. People are asking, ‘this crisis, is it momentary? Will it last forever, or should a small brand be let go because there is no space?’ And in the meantime, they survive. It is like a sick man without a precise diagnosis.

Another reports that “the crisis has made it such that often, firms look for this sort of relationship to have more guarantees, to not have to suffer, to not have to stay at all costs on the market, to not have to have a commercial network…. We give them the possibility of more tranquility.”

**To conclude: briefly interpreting the case study**

Interviews with firms in the Marche organized into vertical markets do not seem to indicate the dilemmas of information hoarding that would be expected given the “transactions-cost” story, in which firms are able to glean an allocational advantage through the mutually cooperative exploitation of alienable private codified information. There are final market rents, relations between firms are stable, production is extremely decentralized, and while capacity subcontracting plays a role, “specialized” subcontracting is probably more significant. Nevertheless, supplier firms remain willing to engage in long-term cooperative relationships, creating relational quasi-rents even though final firms only minimally share product market rents.

Without denying the importance, perhaps increasing, of codified knowledge, there is another very plausible interpretation of the recent observed tendency of district firms to decentralize as much production as possible and focus only on their “core business.” Rather than a walled-off stock of codifiable information, the “true” core of these firms may lie in an accumulation of tacit/contextual knowledge — an asset its contracting partners could not hope to “make” at a reasonably competitive price — so that within-district supplier firms compete directly only with each other. As commissioning firms take advantage of the specialized skills within the district, they can create “quasi-rents” by “fitting” their own production methods to this context. These specialized skills disproportionately favor those in the district because of embedded final firms’ ability to use their local knowledge of potential contracting
partner’s particular capabilities to coordinate “diffuse factories.” Vertical production models certainly can provide quasi-rents of mutual specialization, but in the Italian industrial districts, this mutual specialization is not necessarily about the retention of potentially alienable private information. As Balestri (1997) argues with respect to Prato, supplier firms know where the demand is, they just do not know how to market their products to take advantage of that information. Final firms know how to make shoes, but they are often not nearly as specialized in the production of particular models as their suppliers, and are in any case unlikely to be capable of managing themselves such a large operation and would suffer dramatic diseconomies of scale if they were to bring production in-house. Their real specializations are in coordination, design and marketing. The gains from district production come from firms co-location, fitting, and transfer of tacit skills and knowledge.14

If it is not merely a lack of information that prevents supplier firms from producing for the final market and commissioning firms find themselves strongly enough on a short side position in bargaining, one might expect them to be able to subsume almost the entire oligopoly rent without necessarily sacrificing gains from cooperation. This story more closely fits the interviews: suppliers know roughly how well final firms are doing, and final firms are perfectly aware of the their suppliers’ costs and pay them accordingly. It is still an assurance game — both sides most prefer to cooperate — but given that it is a buyers’ market, the suppliers are satisfied simply to stay in business and will work closely with buyers and provide them with their specialized skills. Final firms, for their part, recognize both their dependence on suppliers as well as their superior bargaining power. They pay enough to ensure medium-term survival of suppliers, ensuring that the “cooperate” cell is indeed marginally better. Furthermore, interviews indicate that the hoarding of private information is not a significant issue. Although it might seem reasonable to expect the sharing of high final market returns to be a norm enforced by the “highly structured, although unwritten, mixture of trust, inspections and sanctions” that undergird district contracting (Brusco and Bigarelli 1997), empirically, suppliers consider some notion of “what the market will bear” sufficient to buy their cooperation so long as they earn enough to survive.
What seems to most rankle critics of the industrial district model is the intimation that these are regional economies where the rules of international capitalism do not apply, where everybody gets along and nary an opportunist word is heard. And in a sense, my evidence agrees that the model may (and perhaps should) lose some of its cachet as a “fairer” way to run capitalism. Quoting again the ex-president of ANCI: things will go “like they have gone all over the world. It is nothing new — in other districts, in other sectors, in cars, in banks. I do not think the districts can expect [to be different].” At the same time, the industrial districts case should not be rejected altogether for a failure to live up to full billing. Harrison suggests that cooperation between firms in the industrial districts will be unable to survive the increasing ability of a few to shift the risks of uncertain markets onto their suppliers, but the Marche shoe district reveals a considerably more complicated picture. Final firms do not seem to significantly share their high returns on the final market with suppliers, but they also know that they derive gains from the relationship and are careful to pay enough to ensure the survival of key supporting players. Risk-spreading is a significant factor in final firms’ decision to decentralize production, but it is also not the whole story. The interviews reveal a picture in which the primary gains and hence the relational quasi-rents derive not from the sharing of private information but from final firms’ access to the specialized and organizational skills of the myriad small entrepreneurs who are responsible for so much of the actual production.

The many writers who argue that the industrial districts are probably changing to more closely resemble “real” capitalism are right, but they often err in the details. And at least in the case of the Marche shoe district, the details matter. Recognizing that tacit knowledge, specialization, and craft skills are the source of the district’s advantage vis-à-vis competitors alerts us to other more significant threats to the model. Cooperation in the industrial districts can survive power differences, but there is some evidence that suppliers declining returns and the more structured relations between firms may have the secondary effect of disincenting entry into the industry by the young, leading to a failure to recreate the “productive hinterland” central to the present success and perhaps future survival of the district. But that is a discussion best left for another paper.
Bibliography


See especially Piore and Sabel (1984) and the two ILO volumes (Pyke, et al. 1990; Pyke and Sengenberger 1992). For a good overview of the development of the concept (in English), see especially the essay by Sebastiano Brusco in the 1990 volume. A relatively concise definition of industrial districts is offered by Giuliano Bianchi (1994: 19): “a territorial agglomeration of small firms, normally specialized in one product, part of a product or phase of production, held together by interpersonal relationships, by the common social culture of workers, entrepreneurs, and politicians surrounded by an industrial atmosphere which facilitates the diffusion of innovation, generating, in this way, important flows of external economies that are still internal to the local productive system.” This is my own translation, as will be the case whenever Italian language sources are cited.
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involved in its production) remarked that it sold in specialty stores for exactly

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significant design.

multinational firm and has a fair amount of control of what it produces, while six are what are termed locally

association of shoe producers), one the incoming vice-president, and one is the head of the shoe section of the

and one with a representative of the Fermano Industrial Union (UIF). Additionally, three of the firm owners serve on

components, three with union representatives, two with directors of technical schools relevant to the shoe economy,

or non-cooperative relationships with district suppliers. There is not space to delve into the

categories that results from assuming quasi-rent creation to emerge from the sharing of information is not

problems do not lie in Aoki/Innocenti’s collapsing of many

distinction between rents created by using scarce information about the location of buyers and rents created by

withholding the use of the brand by competitors. Below, I do argue that the information paradigm used by Innocenti
does not adequately capture quasi-rent creation, but the problems do not lie in Aoki/Innocenti’s collapsing of many

elements into this one category.

There are multiple possible interpretations to exit in this sense. It can mean sourcing outside the district,

internalizing production, or non-cooperative relationships with district suppliers. There is not space to delve into the

respective implications of each, nor does it matter significantly within the scope of this paper.

Conducted by the author in Italian, interviews included 13 with firms producing shoes, seven producing

components, three with union representatives, two with directors of technical schools relevant to the shoe economy,

and one with a representative of the Fermano Industrial Union (UIF). Additionally, three of the firm owners serve on

the board of the regional business service center (SCAM), one was the outgoing president of ANCI (the national

association of shoe producers), one the incoming vice-president, and one is the head of the shoe section of the

Fermano Industrial Union. Of the firms producing shoes, six primarily sell brands (of varying strength) that they

own or license. Of those six, two control groups tied together by ownership. One is in partnership with a major

multinational firm and has a fair amount of control of what it produces, while six are what are termed locally

fusionisti, making shoes commissioned by another shoe firm, often not even buying their own materials or doing

significant design.

The markups on branded high-fashion shoes can be considerable, notwithstanding the many hands through which

they pass before ending up in stores. On a shoe for which the region is particularly famous one interviewee (not

involved in its production) remarked that it sold in specialty stores for exactly 10 times the cost of production.

I use the term “quasi-final firm” simply because at some level, they are still producing shoes ready for market,

except for quality inspection and probably packaging. Still, they do not really have strong final market access. Many

own a brand of their own as well, but one that is weak and poorly publicized.

The idea that district viability is dependent on locally specific skills is supported by Conti and Menghinello’s

(1998) claim that there has been a general reluctance to internationalize productive decentralization in ways that lead

to the externalization of phases, even if labor intensive, that depend heavily on conoscenze specifiche (regionally

specific knowledge), and thus constitute the strongest competitive points of the system.