

Increasingly, European companies look at foreign countries to produce and sell their goods and services. Central and Eastern Europe is one of the preferred destinations of foreign investments from “old Europe”. Through a series of interviews to foreign entrepreneurs in the countries, the main drivers of internationalization have been analyzed and compared. Croatia is a relevant destination of foreign investments, especially from neighboring Italy and Austria

## Croatia: an outlet market for Italians

GLOCALIST LEADERS 2

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**D**eveloping new opportunities in the local market rather than taking advantage of lower production costs seems to be the main driver for the presence of foreign companies in Croatia. Foreign direct investments are, to a large degree, “market seeking” (aimed at finding new opportunities in local market), rather than “efficiency seeking” (aimed at taking advantage of lower costs). Despite being small, with less than 4.5 mln inhabitants, the Croatian market appears to be rather attractive, because the population is relatively well-off and sophisticated in its demand. It is not a surprise that the majority of FDI in Croatia has been directed towards the service sector (financial sector, ITC, retail and wholesale trade, etc.).

Due to the war, Croatia lost out on the first wave of European eastern delocalisation in the 1990s, and later it started competing for foreign investments with lower income countries. More generally, the competitiveness of manufacturing is hindered to the extent that there was not enough greenfield FDI which would have upgraded the technological level of production and because some important industries (such as shipbuilding, metal complex, production of petroleum products) have not been restructured and privatised. Thus, Croatia is not a preferred destination in the region for delocalisation of production in labour



intensive sectors (textile industry, leather, manufacturing of wooden products, etc.). Still, it can be considered quite attractive, especially for some higher quality/value-added forms of production. Although labour cost can be considered relatively high compared to neighbouring South Eastern European countries, productivity is also high. Calzedonia, a leading Italian firm in the textiles/clothing sector, is an interesting example in this sense. Calzedonia produces socks and stockings, with well-known brands as Calzedonia, Intimissimi and Tezenis, with different plants in Italy, Eastern Europe (Croatia,



Bulgaria and Romania) and Asia (Sri Lanka). Calzedonia entered the Croatian market considering it, at the beginning, only as a possible market of destination. Later on the company decided to start production in the country through a greenfield investment in a specific district with a strong tradition in the textile industries. Calzedonia decided to produce in Croatia medium and high value added range of products, claiming that although labour costs are relatively high with respect to other CEE countries, labour costs adjusted for productivity cannot be considered high and this opens up the possibility to produce high quality goods. It was easier in Croatia to reach the desired level of cost-quality balance. It is interesting to note the choice regarding management. Calzedonia's companies outside Italy are very often managed by Italians from the parent company. The Croatian company, however, is run by Croatian top management; and Croatia is now even "exporting" managers to run companies in other Eastern European countries. By the same logic – productivity and quality and not simply costs as the main driving force – other Italian companies have recently been showing interest in launching production in

\_Calzedonia first considered Croatia only as a possible market of destination. Later on the company decided to start production in the country through a greenfield investment in a district with a strong tradition in the textile industries

Croatia: this is the case of Same Deutz-Fahr, producing agricultural tractors, and Snaihero, for kitchens: both entered the market through acquisitions of local companies.

Sectors with higher skilled labour force are internationally competitive: these sectors include the chemical and petroleum industry, some parts of the electrical and optical equipment industry, as well as the telecommunications and ICT sectors.

Croatia, in comparison with other Eastern European countries, is considered a centre of knowledge, a good location to develop many high-tech activities, especially in the field of services and assistance.

Universities, and more generally the educational system, produce highly skilled graduated and employees. The experience of Siemens, the German global company leader in ICT and knowledge-based activities, is important in this sense.

Siemens entered Croatia in 1995 via some acquisitions. At the same time, Siemens expanded in many other Central-Eastern



\_Croatia is already a very stable, low-risk country, and the economic and social situation is positively affected by this stability. Photo, right: Croatian President Stipe Mesic

European countries, and the CEE market now accounts for a relevant share of the global business of the company. At the group level, their Croatian R&D department became a leader in certain activities, while the Croatian company is also an important centre of remote help for many other countries in CEE and even Western Europe. Ericsson also has its development centre in Croatia. In many cases the presence of companies in Croatia represents part of a more general strategy to create regional networks. All the local companies have relevant synergies by being present in many different countries. This is the case of Siemens, the major Austrian retailer Billa (part of the German Rewe Group) and also the Austrian construction company Strabag. Siemens is expanding its activities in IT services, serving different clients from different countries. Billa, part of the Rewe group since 1995, started a process of internationalisation in the Czech Republic and Poland in the mid-1990s. It

entered Croatia in 1999 and later Bulgaria and Romania. The expansion in CEE is part of a global strategy: the group is also present in Russia and in some Asian countries. Strabag is involved in building roads and motorways and also started to move eastwards in the mid-1990s. In particular, Strabag is developing the road network in countries whose infrastructures need to be modernised. The group's presence encompasses 29 countries: it has sister companies in Croatia and also in Bosnia, Slovenia, Serbia, Montenegro and other CEE countries, such as Bulgaria, Romania, Poland, and Hungary. The presence in Hungary and Poland dates back to the beginning of the 1990s. In some cases Croatia is considered not only part of a strategy to expand in CEE countries, but also a "bridge" to access other markets of the former Yugoslavia (especially Bosnia). This is the case, for instance, of the Italian Ferrero, producing food products (chocolate, snacks, candies) in Italy and in Poland, and adopted a specific strategy to find new markets in order to expand its business. From Croatia, initially via a representative office in Zagreb, the company is serving not only the Croatian market but also a wider zone in the Balkans, including all the countries

of ex-Yugoslavia, Albania and Bulgaria. Many of the ex-Yugoslavian markets are considered particularly difficult, due to the instability of the last decade, and are rather small. Ferrero, for instance, already with a long experience in the area (serving Yugoslavia since end-1970s), has been able to serve those markets from Croatia, hence reducing costs and risks. In the future a representative office in Serbia is going to be opened also.

Geographical proximity – especially with Austria, the Italian North-East, which is one of the main production regions in Italy, and the Adriatic Italian regions (important for tourism) – is a key variable when considering the establishment of activities in Croatia. Proximity is important for logistics, especially in the case of retail and wholesale trade, but also for the development of human resources. This is a very important aspect, considering the need for a highly skilled labour force in strongly value-added activities. Management, trainers and employees can reach Zagreb or the Adriatic coast in less than one hour by plane (and few hours by car) from the parent company in Italy or Austria, and vice versa. Regarding the issue, it is worth mentioning that only two Italian regions out of 20 (Veneto and Friuli Venezia Giulia, in the North-East of Italy), account for almost 50% of total manufacturing trade flows between Croatia and Italy. Proximity and size of the Croatian market make the country particularly suitable for investments by small and medium-sized enterprises. This is particularly relevant for Italy, as SMEs are the backbone of the Italian manufacturing sector. SMEs usually find it difficult to establish and develop new businesses or even networks in big Western European countries or in the far Asiatic countries. Regarding SMEs, the experience of Bonfanti is significant: the Italian coffee producer “started from scratch” and in less than a decade has been able to establish a popular coffee brand in Croatia (Bonfanti Espresso Italiano) that competes, with a relevant market share, with other international players. These opportunities are not so common in countries that are big (where economies of scale play a relevant role) and which are

already “saturated”. Expanding abroad, rather than in the mother country, small and medium-sized enterprises are able to increase their size and hence benefit from this expansion (economies of scale, knowledge and experience, relationship with banks).

The long, beautiful and well-known coast of the Adriatic Sea offers important opportunities in the tourism sector as well. These opportunities could be particularly relevant for the Italian entrepreneurs which are already active on the other side of the Adriatic Sea. In general, the quality and quantity of services related to tourism still do not correspond with the potential (and also with the expectations of foreign tourists). Opportunities are still present in the different areas that concern the sector: a) construction, of hotels, houses, camping sites, villages, as the old structures are rather obsolete; b) management of facilities, taking advantage of the experience developed in other Italian seaside resorts; c) tour operators, both in Croatia and Italy. And there is also the possibility of establishing links and synergies among these activities. The tourism related to business is also not developed as it could be. In general, there is strong demand but not enough quality supply for tourism in Croatia. In the next future, the ongoing privatisation process in the tourism sector, that is still very fragmented, is likely to attract strong interest. For this reason, more investments via acquisitions of local structures are expected, together with an acceleration of the privatisation process.

Infrastructure is relatively well developed and is one of major potential sources of competitiveness of the country in the future with potential of further upgrading, especially in railways, ports, pipelines and energy production. Some problems could arise with infrastructure connections to neighbouring countries: the efficiency of transportation in Croatia will be inevitably related with efficiency of transportation in Slovenia and Bosnia, for instance, and the need of coordination of the different infrastructure projects (probably at the European level) will be crucial.

Fiscal treatment of entrepreneurship is on a comparable level with other CEE



\_Tourism and tourism-related areas is a sector that still has remarkable potential

countries, but as regards business climate, despite the improvements related to e-government and industrial zones, there are still considerable bureaucratic obstacles; weak urban planning and protection of property rights in real estate market are among other inefficiencies.

On the negative side, some entrepreneurs claim a sort of protectionism that sometimes is the occasion to safeguard local business at the expense of the activity of foreign entrepreneurs, limiting competition. This attitude is of course related with the bureaucratic system as it concerns movements of goods at the borders or authorisations from local authorities.

Regarding the future, all the companies interviewed continue to see good opportunities in the Croatian market, especially in the service sector. In particular, the potential of sectors such as retail trade and tourism has not been fully exploited yet. Entrepreneurs already see relevant and fast improvements in many fields (infrastructure and bureaucratic overall), and they expect further

improvements together with the convergence process towards Europe. The EU convergence process is considered by foreign entrepreneurs to be an important element. Croatia is already a very stable, low-risk country, and the economic and social situation is positively affected by this stability. Croatia started accession negotiations in October 2005. The EU convergence process will spark competition (and efficiency in many fields) and contribute to the opening of the local market to private investors. EU funds are stimulating also demand for infrastructure, hence creating opportunities in the building activity. Probably, the business environment of Croatia will also be affected by the EU convergence process of the other ex-Yugoslavian countries through the Stabilization programmes: Croatia can benefit from the stabilisation and growth of the whole area. ▬