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# **Entrepreneurship, Firm Size and the Structure of the Italian Economy**

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Since World War II, Italy's economic growth has been one of the highest in the world. The objective of this study is to examine the structure of the Italian economy and causes of this growth. It was found that small and medium-sized firms, most of them family-owned, have been the dynamic force behind the country's extraordinary economic performance. The vital role of the family and that of the entrepreneur – as the supreme spirit of enterprise and initiative - has been paramount in this process. Production by small and medium-sized firms have concentrated in a specific geographical area called “industrial districts” and are capable of great cooperation with other firms, leading to increased production, efficiency and employment. In addition, it was found that small Italian firms have been very successful in the age of globalization, better able to take advantage of their small size by means of flexible strategies to innovate, invest and increase their export. Contrary to conventional wisdom, modernization theories (so widespread in the 1950s and 1960s) indicate that large firms have been models for growth in other industrialized countries and have exerted a passive role in the structure and development of the Italian economy.

## **Introduction**

For some time now Italy has been numbered among the top industrialized countries in the world. In terms of the gross domestic product (GDP), the Italian economy is the fifth largest, behind the United States, Japan, Germany, and France and ahead of the United Kingdom. It was in 1987, the year of the *sorpasso*, in which Italy surpassed Great Britain as economic power. Italy's GDP became 10% bigger than Britain's and its GDP per capita became 9% larger. Real GDP growth from 1970 to 1985 was over 3% - that was the highest in Europe - and during the 1990s reached to 2.9 for the decade. These figure shook up the industrialized West. However, aside from its economic size and growth, which makes it a key member in the European Economic Union (EEC), the Italian economy is of interest to foreigners because of its unique

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characteristics. It is regarded by many economists as the most dynamic Western economy; a market structure that is highly dualistic - a very active and vigorous private sector accounting for a preponderance of small and medium-sized firms and a few extremely large public enterprises. By contrast, very little is known about small firms that make up the backbone of the Italian economy, employing about 76% of the labor force. In the last decade small and medium-sized firms have been the source of most new jobs and have been making significant contributions to innovations and high-technology employment. In addition, they are of considerable importance for regional development, particularly in the south. Moreover, the level of government intervention in the economy is very high, the highest among OECD countries. However given this handicap, since World War II, Italy's economic growth has been the highest in the world - surpassing the average growth rate of Japan and equal that of Germany.

Thus the major concern of this article is to examine why small and medium-sized firms have done so well in the framework of the Italian economy. An overview is presented concerning small and medium-sized firms characteristics and policies, and how they perform and function in an industrial setting. Specifically, the article examines how "these small firms" function in an age of globalization, and their future contributions and outlook is addressed. To examine these issues, the nature and accomplishments of small and medium-sized firms operating in "industrial districts" is investigated. The source for the economic growth in the last quarter century will be analyzed and the fundamental economic framework of the Italian economy will be evaluated. The vital role of the entrepreneur and the ability to save and invest has been paramount in the growth process of the Italian economy. Schumpeter of course was correct when he postulated that entrepreneurial activity is at the root of a country progress and development. Certainly this was the case in Italy.

Small and medium-sized firms, most of them family owned, have been the most vital and dynamic sector of the economy, producing a substantial amount of the economy's output and employing millions of workers. The key objectives of Italy's small and medium-sized firms have been: job creation, economic growth, innovation technological development, and human capital development. Finally, the issue as to what contribution and role that small and medium sized firms have made to Italy's enormous economic development can be examined.

In addressing these key issues the article is divided into several parts. Part One and Part Two provide a broad overview of the structure of the Italian economy and the theoretical and empirical reasons for the growth. Part Three: the role of the entrepreneur-with its supreme gift of innovation and production is addressed with the essential characteristics of family business. Part Four presents the literature review on the small and medium-sized firms and Part Five presents the model of the firm within the environment of the "industrial districts" in an industrial organization setup. Part Six: the structure of firm is examined in the framework and context of globalization. Part Seven undertakes in depth analysis in the existence of small firm in the broader context of "industrial districts" - its development, production and examining the reasons why small and medium-sized firms have done so well in this historical setting, location context and industrial sector. The final part, Part seven summarizes the conclusion of the article.

## **I. The Structure of the Italian Economy**

Two important features of Italian industrial structure are the dominant size of the public sector on the one hand and the coexistence of a very significant small firm sector and few number of very large firms on the other. In the late 1960s and 1970s, when industrial output and

productivity were growing rapidly, it was the large-scale firms in both the private sectors that were regarded as the success stories of the Italian industry. While private companies such as Fiat, Olivetti and Pirelli competed successfully in export markets (in the field of motor vehicles, electronic, tires and cables respectively) to become household names all over the world. These three large companies with a certain reputation for style and design together with the public sector in the form of the state holding companies have made considerable contribution to the Italian economy. These are state-owned conglomerates covering a wide range of activities, and principal among them are the Ente Nazionale Idrocarburi (ENI) and the Istituto per la Ricostruzione Industriale (IRI). IRI in particular has an immense presence in Italian industry, over a wide range of industrial and service sector interests, contributing about 5% of the country GDP.

During the 1950s and 1960s many economists saw the state holding sector as a model for state intervention in the modern economy, as large-scale investment projects were carried out in basic sectors such as steel and chemicals, and at the same time some of those investment were directed towards ameliorating the severe imbalance between North and South. Moreover, in both the public and the private sector the widespread belief in the importance of economies of scale and investment in the new technologies nurtured the view that “big was beautiful” This was reflected in the increasing concentration of production into larger plants in the encouragement of mergers, the most important of which was the Montecatini-Edison merger to form Montedison, in the field of chemicals, in the early 1970s - Montedison in turn merged with Ferruzzi.

In 2000 there were only three Italian companies that ranked among the worlds’ 100 largest - Fiat, Eni Group, and Feruzzi/Montedison - and nine in the top 500 - measured in term of sales listed by Fortune - compared with 55 for United Kingdom, 38 for Germany, and 23 for France. Thus, the structure of Italian economy is much more small firms than other OECD country and the small and medium-sized firms are every bit representative of modern Italy as these few large corporations.

## **II. Economic Boom - 1980s**

By the end of the 1980s, Italy had become one of Europe’s great success stories. From 1970 to 1985, Italy’s economic growth rate was the highest in Europe over 3% annually, and reaching 2.9% during the decade of the 1990s. Suddenly, the country had become a land of upward mobility, with a vital computerized industry, with bustling young business managers and slick middle-aged tycoons. Even the English, long critical of Italy, at the end of the 1980s were saying the Italians must have been doing something right, and doing it despite a political and administrative system that remains the least adapted to the requirements of modern, efficient government in Western Europe.

It seems that Italy understood at the end of the 1970s what Americans have yet understood today: “flexible production” that is, a new, more cooperative way of organizing relations between firms; a populist sense of who has useful knowledge about how to manufacture things; a recognition that small firms highly motivated, with skilled workers can be more responsive to market changes than multibillion-dollar institutions with dozens of layers of supervision and hundreds of operating manuals. Moreover “flexible production” can respond better to consumer markets where tastes changes rapidly because a premium can be put on design qualities and craft skills, on workers who can take initiative. Flexibility enables workers to develop craft skills, to reacquire the technical knowledge monopolizing by management.

In Italy, “flexible production” has featured the rise of small and medium-sized regional firms. A lot of the same industries that New York City planners wrote off as too small and too high-cost to compete globally fared well in Italy. Firms all over Italy exploited their flexibility; they moved products from design to market very quickly. The more successful firms have invested intelligently in new equipment, have pushed productivity up and have given technical innovation its head. As a result, Italy has moved into the forefront of advanced technology, able to export massively both her products and her know how.

The world of small firms in Italy is a fascinating one. It was during the 1980s that increased in economic importance in Italy with a high proportion of craftsmen enterprises. Small and medium-sized firms have been the source of the country job creation and have made a significant contribution to innovation and high technology employment. To avoid ambiguity, the concept of small enterprises and industrial systems need to be defined. “Small” is a relative concept and in this article “small” is defined as establishments with less than 100 employees - commonly used measurement in Europe.

The production structure of Italy is much more small-scaled than in other major countries. In fact Italy ranks alongside Japan as having the highest proportion of small and medium-sized firms - and employees in them - among the OECD countries. Small and medium-sized firms in 1999 accounted for 99.6% of manufacturing firms and more than 99% of firms in many services and utilities. Small and medium-sized firms (fewer than 100 employees) represent 94% of manufacturing firms and at least 99% in the quasi-totally services. Small and medium-sized firms amount to 3.5 million as they employ more than 18 million people - 76% of the labor force, and at least 90% of employment in construction and most services categories (wholesale and retail trade, hotels and restaurants, business services, real estate, etc.) Small and medium-sized firm represented 53% of manufacturing employment and 85% of employment in many services categories.

In manufacturing, self-employment accounted for 16% of total employment in Italy compared with 12% in Japan, Spain with 8%, France and Germany 5% and the United Kingdom 4%. Italy’s economic structure is indeed unique among industrialized countries: more than 94% of the businesses have fewer that 100 employees, almost 5% employees between 100 and 500 people, and less that 1% have more that 500 employees.

This would indicate that modernization theories, so widespread in the 1950s and 1960s with their expectation of linear development (from pre industrial to postindustrial methods of production and their “predictable” accompanying conditions) have not been borne out by Italian reality. Because of the proliferation of small firms, it is only natural that family values continued to prevail, although whenever feasible, modern ones were infused. The small and medium-sized firms are particularly visible and strong in metal product and carpentry, machines and mechanical materials, plant construction and installation, transformation of agro-food, textiles, clothing, leather, footwear, timber and furniture, newsprint and the publishing trade.

The Italian economy has experienced rapid growth due in part to the mushrooming of small, family firms. Between 1985 and 1995 the output of industrial firms with 20 to 100 employees grew by an average of 4% a year, and their employment 1.2%. In contrast, during the same period employment in large firms fell by 2% a year. In 1995, 59% of Italian manufacturing employment was in firms of less than 100 employees, as compared with 55% in 1980. In the United States, the United Kingdom and Germany are roughly 20%.

A subset of high-growth small and medium-sized firms has been important for both innovation and economic growth. Such high-growth small and medium-sized firms are viewed as the top of 10% of growing firms. Young entrants who are also exceptional performers with regard to innovation and job creation dominate these fast growers. In Italy, in the last two decades, their job creation rates exceed those of larger companies. High-growth firms have been found most frequently in knowledge-intensive service sectors and in regions characterized by intense economic activity and “industrial district”. They tend to be integrated into formal and informal networks of enterprises and other economic actors.

It is true that large firms are most likely to conduct research and development (R &D), and these research efforts grow proportionally as firms size increase. However, some 50% of firms in Italy are now characterized as innovative. About 10% of small and medium-sized (the high performers) conduct research, and smaller firms receive a significant portion of government financing for private sectors research and development efforts and may be innovative without undertaking research, especially as regards to commercialization of existing technologies.

Competitive processes in industries also fuel productivity growth. Which, to a large extent, are built on the birth and death, entry and exit of small firms. Alfred Marshall identified this process as “creative destruction” which fosters innovation and growth. The share of small and medium-sized firms in total turnover for the manufacturing sector in 1999 was 55%, while their share in turnover was approximately 90% for several service categories. The small and medium-sized firms have continued to exhibit remarkable dynamism and their contribution both overall productivity and growth in the economy, to exports and the balance of payments, has been a key feature of Italian post-war industrial development. Revenue from their exports played a crucial role in funding reconstruction and industrialization after World War II.

### **III. The Role of Entrepreneurship**

Post war Italy was shown to provide a most fertile soil for entrepreneurs. This was probable due to its mix of an established middle class with access to opportunities and class-related education and knowledge. The country developed a working class that was eager for upward mobility and it's under class equally eager to enter industrial employment. In addition the role of the government was important enacting legislation to facilitate entrepreneurial aims. Thus the particular conditions which engender the emergence of entrepreneurship - demand for industrial products, availability of required labor and raw materials, level of taxation, ease of importing essential inputs and favorable markets - were all evidence as Schumpeter postulated in reducing the entrepreneurial role to decision making under uncertainty. So in spite of the very different historical, social, and cultural conditions, and of educational and religious traditions, Italian entrepreneurs, in the 1970 and early 1980s, tended to be perceived as culture heroes.

Entrepreneurship, the process of identifying economic opportunities is central to the functioning of market economies. Entrepreneurship is key to exceptional growth, employment creation, and innovation - not only seeks out and identifies potentially profitable opportunities, but also assumes risks in realizing their judgment. Italy has been a country characterized by substantial entrepreneurship activity and is likely to be constantly generating new products and services to replace older ones. According to one study, Reynolds (1999) measured average business start-up rates per 100 persons, Italy ranked as having one of the highest business start-up rates in the world. This very active entrepreneur culture is probably associated that citizens value entrepreneurship and the independence associated with starting and managing a business; high

mobility in labor markets; a high tolerance for high-risk; and framework conditions which make both starting a new venture and obtaining finance relatively easy. Such a process clearly covers all economic activity and is not just confined to particular business functions. Moreover, entrepreneurship in Italy is characterized by actions of companies, both new and well established that some have historical roots tracing back to the Middle Ages. In view of the nature of the concept, no precise measurement of entrepreneurship is available for Italy (or any other country). However in empirical applications, there have been two recurring feature in characterizing entrepreneurship: new or young firms and innovations. Entrepreneurship is frequently associated with the process of business start-ups and business creation. These are important manifestations of entrepreneurial activity. As empirical studies have shown, *de-novo* entrants are always small. Audretsch (1995), for example, identifies entrepreneurship as the extent to which an industry is comprised by new and young firms, thus placing the age of enterprise as the central parameter defining entrepreneurial activity.

Schumpeter postulated that entrepreneurial activity is at the root of a country progress and development. I find Schumpeter's ideas most suitable in the structure of the Italian economy, viewing the entrepreneur as a catalyst of innovation and development. It is more applicable when examining entrepreneurship - its rise and functions - in relation to a nation's economy than looking at a specific segment of entrepreneurs. Observing the framework of the Italian economy it seems to verify again that Schumpeter's observation that even when entrepreneurs' class origins are bourgeois they soon become assimilated into that class, by adopting interests, values, and attitudes.

Many areas not touched by industrialization saw a spectacular increase and spread of small and medium sized firms in a short period of time during the 1970s and 1980s - many were family run businesses. The structure of the Italian economy is unique; 94% of business enterprise has less than 100 workers. Because of the proliferation of small firms and medium-sized firms, it is only natural that family values continue to prevail, although whenever feasible, modern ones are infused.

As Schumpeter stated the concept of an entrepreneur is more of an innovator, not as a manager hiring or supervising departments, an entrepreneur or specialist who creates new products or methods of production; but also a spontaneous individual reacting to specific market conditions. If entrepreneurial activity is the capacity and willingness to take risks, to be innovative and to exploit business opportunities in a market environment, well-established and large firms play an important part as entrepreneurs. As Symeonidis (1996) postulated that above a certain threshold of firm size, research and development rises more or less proportionally with size. For special activities, size does matter: in the presence of large fixed costs - to innovate - large firms will have an advantage; when it comes to flexibility and ability to exploit market, small firms are likely to immerge as innovators. This is confirmed by studies done by Cohen (1995) and Cohen and Levin (1989). Thus, while size does play a role for different types of innovation processes, the relationship can go different ways and is difficult to establish *a priori* whether entrepreneurial activity is related to firm size.

The entrepreneur of the small Italian firm is one of flexibility in responding to changing demand patterns and technologies, and the ingenuity in style and marketing - even in export markets. Production lines are chosen which are within the cultural horizon and the technical and financial capacities of local entrepreneur. As stated above, small firms frequently enjoy external economies of scale, as geographical concentration of certain industries where a large number of

important “industrial districts” have deep cultural roots and tradition - some even go back to the Renaissance era. Moreover “smallness” allows faster adaptation to the continually changing markets and technologies. In the first place, the small entrepreneur, who is less bound than the large businessman by bureaucracy and trade union rules, is quicker to modify the allocation and size of the labor force and other resources. Second, a system of small enterprise makes it possible, by simply transferring production to sub-contractors to solve cases, which would require closures and reallocation of personnel in a large firm system.

#### **IV. Literature Review - Industrial District**

The economist Alfred Marshall was the first to coin the term ‘industrial district’ by which he meant a concentration of large numbers of small business of a similar kind in the same locality. Different districts have had different origins, primarily due to particular physical conditions. However according to Marshall, they all have a few characteristics in common, namely of highly specialized machinery, the constant spread of innovation and the combination of social and economic forces. The viability of industrial districts was attributed to Marshall to the presence of external economies and to an unspecified ‘industrial atmosphere’ that guaranteed that vital information and innovation was shared by all. For example industrial districts have been mushroomed all over Italy: the leather industry in the lower Arno river (Florence), the shoe industry in the Marche region (Central East), the silk in the Como region (North Central), ceramics in Sassuolo in Emilia region (North East) and the furniture industry in the Natisone valley in Friuli (North East).

In light of Marshall thought, rediscovering and discussing his ideas on the basis of Italy’s small business communities, many economists have emphasized that the industrial district itself, rather than the individual firm or the industrial sector, should be focus of the Italian economic growth and success. Any analysis of industrial district must overcome the traditional division between economic sectors (primary, secondary, tertiary) and sub-sector (textile, metalworking, shoemaking, etc.) each district does indeed possess a ‘core’ manufacturing industry; textiles, furniture-making or light engineering. However, it is also characterized by the existence of a vertical value-chain which may extend on the one hand to the making of the machinery needed at each stage of the production process and on the other hand to wholesalers, trade intermediaries and making agencies.

Economists in analyzing Italy’s economic structure have postulated a variety of theories. Several definitions of the industrial district phenomenon have been put forward, some of them more of an operational type, others of a more theoretical nature. Brusco and Sabel (1981) described small firms in an industrial district as producing for a national and international market, being connected by subcontracting linked operating in a highly competitive environment. Garofoli (1995) chose to coin a new term, that of ‘system-areas’ each containing a high number of small firms producing the same goods or specializing in different stages of the production process, thus complementing each other.

#### **V. Model of Small Firm Production**

Having looked at the literature review, the attention in this section is focused on internal characteristics, structure and operation of small firms in the “industrial districts”. Do small firms in the “industrial districts’ fit the sophisticated ‘model’ put forward by the theorists? The answer is by and large they do. For example not all firms operate in an industrial district such as the case



in the city of Como, those that do account for a relevant proportion of the province's economy. Each of the province's three main towns in an industrial center which specialize in a particular industrial branch: if Como is renowned for silk manufacturing, Lecco is a well-known metalworking center and Cantu' a carpenters' town. Each has a satellite area made up of its immediate neighboring villages, which gravitates towards their own center main industrial activity. A series of industrial districts and sub-districts succeed each other from north to south and from east to west, particularly in the hill parts of the province. Most of these districts are characterized by market division of labor between firms, constant innovation, high levels of investment and the use of skilled labor. The results are very positive. The silk industry, for example, exported about 70% of its production throughout the 1990s, accounting for nearly 10% of the total surplus made by Italy textiles-clothing sector. It has come to dominate the lucrative American market.

Indeed, the whole northern strip of the Pre-Alps from Piedmont through Lombardy to Venezia can be described as a series of local agglomerations of small firms, whose present-day characteristics appear to be an efficient and competitive organization of production. Wool textiles at Biella, light engineering at Bergamo, steel (Brescia), arms (Gardone Val Trompia), domestic appliances (Lumezzane), tights and stockings, lighting (Castel Goffredo), ski boots (Montebelluna) are just some further examples of competitive industries whose products are well known both within and outside Italy.

Like the family, the community does not simply represent a socio-cultural referent, but an economic quasi-organization that can be described and analyzed in its own right. The dynamism of the family depends on the various members' pooling skills and resources: similarly, the dynamism and growth of the district depends on the success of individual firm which are part of it, in far as these are able to contribute to each other's competitiveness. Thus local firms, despite being small, achieve a *de facto* complementarily and interdependence. As the family, in its function as an entrepreneurial unit, blurs and overcomes occupational divisions and social statuses, so the community as a quasi-organization stretches across different economic activities.

The literature on industrial districts has, for some time now, crossed paths with the literature on the development of Italy. In the 1960s and 1970s, in fact entire regions of Italy were able to industrialize, following the creation of a myriad of new small and family-run firms in traditional manufacturing sectors, particularly textiles and clothing, shoes and leather goods, woodworking and furniture making as well as light engineering. The regions affected - collectively named by Bagnasco (1977) the *Third Italy* to distinguish them from both the northwestern industrial triangle and the underdeveloped southern areas - were Venezia, Emilia-Romagna, Tuscany, the Marches and Umbria. While Venezia, like Northern Lombardy and other sub-Alpine areas, shares a similar economic background, having been the site of earlier, silk-related industrialization, the other regions present a different economic profile, having remained in some cases predominantly agricultural until very recent times.

## **VI. Small and Medium-sized Firms and Globalization**

One of the most striking peculiarities of the Italian economy has been remarkable strength of the exports sector, which in some ways is a paradigm of Italy's economic performance. In the fashion world Italian clothing, furniture, wine, food furniture, and textiles have emerged as world leaders, while in some industrial areas, such as machine tools and robotics, ceramics; Italian products have earned an outstanding reputation for quality and won a share of the world experts.

Because of their exceptional ability to sense changing consumer demand and to produce attractive goods, Italian exporters have been highly agile in shifting into new markets and alternative products. These products are all labor intensive, with high level of specialization and diversification. In these industries, the bulk of productions have been carried out by small and medium sized firms with artisan traditions and talent are clearly evident and innovations are essential for competition, with advanced productive process and sophisticated machine and industrial tools.

The Italian export industry is remarkable for its ability not only to move quickly into geographic areas but also to change into the production of items for which the demand is on the rise. The achievement in this area are all the more impressive since small and medium sized firms have rarely received help from government, either through assistance in penetrating world markets or through export credits. The trade policy, as a result of free-for-all agreements, greatly helped the Italian economy.

In 2000, total Italian world exports were \$249 billion, an increase of 9% from the previous year. Italian export ratio to GDP is about 18%, the third largest after Japan and Germany. Moreover, exports have been increasing for the last decade at a rate of 5% annually.

Traditionally small and medium sized firms have focused on domestic markets and many will continue to rely heavily on local markets, however in the last decade, many have adopted a global focus. In 2000, about 38% of manufacturing small and medium sized-firms exported their goods and services abroad and this share is likely to increase in the future. At present, small and medium-sized firms are more involved in international strategic alliances and joint venture both among themselves and together with other larger multinationals. More generally, networking allows small and medium-sized firms to combine the advantages of small-scale production, e.g. as regards to flexibility, with the economies of scale and scope provided by firms groups.

One path to globalization has been electronic commerce, which will increasingly allow smaller firms to expand their customer base and enter new markets. Small and medium-sized firms are gradually filling the existing gap in the adoption of the Internet in comparison with larger firms. This includes startups created to operate in electronic markets and existing firms that migrate to electronic commerce. Although firms generally adopt technologies at lower rate than average, they are adopting Internet technologies at a new pace. The most connected small and medium-sized firms will be in strategic business services, following by finance, wholesale trade and manufacturing sectors.

The success achieved by small and medium-sized firms has given evidence that Italy will be able to sustain the assault that will be coming from developing countries. In fact, the industrial sector, which was behind the economic boom of the 1990s, and the most outstanding trait of the country's current industrial structure and the most dynamic anywhere in Europe. In 2000, Italian exports by small and medium-sized firms reached a record 38% the highest among the OECD countries compared to 27% of the Netherlands, 23% for the United Kingdom, 21% of Germany, and 18% for France.

## **VII. The "Italian Model" Small Scale Industry**

There are a number of reasons why small and medium-sized firms have increased in importance in Italy. The literature on this topic is vast - only the main interpretations are reviewed, which be broadly grouped into three categories, political, socio-historical and economics.

Small and medium size-firms have always been looked upon favorably in Italy. In 1959, legislature was enacted that provided subsidized loans to which were reinforced by various tax concessions in 1975 and 1977. Thus laws were institutionalized in the regions as real centers of policy makers. Since then, they have played an important role as providers of advance services to industry to contain the costs of innovation and restructuring of productive capacity and to secure new markets. In addition, small firms were not covered by job protection legislature until 1990, and furthermore they afford greater opportunities for tax evasion.

Originally most of these small and medium-sized firms were set up to escape the trade union regulations since firms with fewer than fifteen employees need not be unionized or pay standard wages and social benefit. They therefore operated at great cost efficiency and high productivity and without risk of strikes. There was still another impetus. Firms with annual incomes below \$75,000 were not required to make books available to income tax authorities. The astonishing consequence of this has been that starting in 1984 fully 95% of Italian firms declared incomes of less than that figure!

Since the production of these small and medium-sized firms escapes official records, the country's real GDP and statistics are appreciably higher than official accounts would indicate. It is estimated that in 1999 the underground economy employs anywhere from 2 to 4 million persons and produces fully 20 to 30% over the official GDP. Weiss (1988) thesis for the success of small and medium-sized firms is the central government played a much bigger role in promoting small-business development than is generally acknowledge. The Christian Democratic Party, in particular, had a strong ideological commitment to small entrepreneurs and self-employed, and introduced supportive legislation as well as providing economic incentives. Nanetti (1988) put forward the hypothesis that the success of small firms was due in no small part to the active involvement of political institutions, especially after the establishment of the regions as autonomous administrative entities. Bagnasco(1977) and Paci (1982) identified the small firms' production with a common rural origin. These were all sharecropping areas, based on extended peasant families that were used to heavy working routines and an internal division of labor. Such families functioned almost like entrepreneurial, self-sufficient units and found it easier, when the sharecropping system disintegrated in the 1950s and 1960s, to move into the industrial sector as independent producers (artisans and small-scale entrepreneurs) rather than as wage-earners.

In common with the socio-historical interpretation, the economic interpretation of the revival of small firms has been considerably influenced by the Italian experience, though for different reasons. In the late 1970s Italy went through a process of industrial decentralization, due to the high costs and rigidity of the labor force in larger firms. Accordingly the economic literature argues that the high number of small firms is mainly the outcomes of new management strategies and the wider use of subcontractors on the part of large firms. Brusco (1977) sees this explanation as applicable to some recently formed areas of diffused industrialization, such as Castel Goffredo, Reggio Emilia and Modena. Basing their observations empirical evidence gathered at Prato (Tuscany) Lorenzini and Ornati (1988) have also argued that a large firm, by following a strategy of deintegration, encourages the formation of smaller firms, though independent, are increasingly drawn together till they form interlocking networks.

Alongside the incentives to establish and operate small family owned enterprises existed a number of impediments to the creation of large companies. These included lack of venture capital and underdeveloped securities markets. In addition, controls on capital outflows,

abolished in 1990, held back foreign inward investment thereby further weakening the drive towards mergers and acquisition. As a consequence, no new major companies were created in the 1980s despite intensive industrial restructuring. Thus the distribution of employment in manufacturing has remained skewed towards small enterprises, concentrated in traditional consumer goods (clothing, textiles, leather, household appliances, footwear) and engineering industries.

There was an industrial restructuring in the early 1990s with a tripling of mergers and acquisitions in the chemical, food, mechanical, electronics industries, and the banking sector. Simultaneously, purchases of foreign companies by Italian firms, mostly in the European Economic Community surged, but compared to other countries the total stock of outward direct investment abroad has remained small.

Has the dominance of small firms enhanced the shock-absorbing power of the economy as a whole or has it impeded structural adjustment? In the 1970s, helped by technological innovation, small and medium-sized firms adapted well to the demand for increasingly differentiated products. Given the sophisticated demand of Italian consumer in the domain of cloths, shoes and accessories, small firms have often acted as pace-setters in terms of style, design and quality. As a result, output, investment and productivity of small firms expanded faster than large companies. Finally, there is unquestionably a cultural dimension to the prevalence of small firms in a society where the family remains a strong and cohesive unit.

### **VIII. Conclusion**

The economic growth and development of Italy in the postwar era has been extraordinary. One of the most striking peculiarities of the economy has been the large number of small and medium-sized firms, most of them family-owned, that have been the dynamic force behind the country's extraordinary economic performance. Many theories in the literature have been examined to explain the development of small firm production in Italy. First the origins were analyzed, both in terms of historical roots and development. Second, the political, sociological and economic development dimensions of the firm in the "industrial district" were examined. Industrial districts have mushroomed all over Italy in the leather industry, the shoe industry, the silk and textile industry, ceramics, and the furniture industry, with high output, investments and exports. Such industrial districts encourage the pooling of resources for a variety of reasons and yield positive externalities through cooperation, specialization and flexibility. The vital role of the family and that of the entrepreneur has been important in this process. In addition, small and medium-sized firms have consistently exhibited faster growth of productivity, and employment than the larger firms.

The overview presented the outlook for small and medium-sized firms' performance and trends, which most likely will be the core of future economic growth of the country. Italy is a country whose impressive economic performance was achieved in spite of the double disadvantage of an inefficient public sector with its associated deficit and underdeveloped south, which also contributes to the treasury's deficit. The key to its success lies in Italy's dynamic manufacturing sector, and especially in the small and medium-sized firms, with their vibrant spirit of entrepreneurship, that have consistently exhibited greater growth of productivity, output, employment and investment than the larger firms. Productivity growth and overall economic growth will continue to be strongly influenced by the dynamism of the small and medium-sized firms sector.

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