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# **Internationalization towards emerging markets: an MCDA perspective on the case of Italian furniture firms in CIS countries**

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## INTRODUCTION

The growing role of emerging markets in the current world economy and the market opportunities arising in such markets have become important for Western companies. Firms from advanced markets are willing to explore business expansion opportunities in Asia, Latin America, as well as Russia and other CIS countries despite political, economic and legal risks they carry. Difficulties arise during the process of market selection and following market entry, especially in small and medium enterprises (SMEs). Limited international experience and budget constraints hinder the internationalization process of SMEs. For this reason, the role of governments is critical in providing the adequate support measures. In this study we aim to analyze the decision making in the market selection process from two points of view: firm and government. Through the application of MCDA techniques, this work is building a framework for foreign market selection.

The thesis is structured as follows. In the first chapter, after a short introduction of key concepts, the main internationalization theories are presented. The motivations behind the foreign market expansion and the factors affecting market selection process are discussed. In the entry mode selection process, the particular attention is paid for exporting, both direct and indirect. The main drivers behind SMEs internationalization and barriers encountered are described. The role of public incentives in firms' internationalization is discussed.

The second chapter looks on Italian furniture industry and the specificities of the internationalization process of Italian furniture firms. Characteristics of CIS countries as the destination for Italian furniture exports are described. In particular, Azerbaijan, Kazakhstan and Russia are the CIS countries analyzed for this study. Then, main public agents assisting the internationalization of Italian SMEs and incentives provided by the Italian government are described.

In the third chapter, the Multi Criteria Decision Analysis (MCDA) techniques used for building our model are described. Using the Analytic Hierarchy Process (AHP) and Smart Multi Attribute Rating

Technique (SMART), we try to capture the complexity of market selection process. After applying each method, we study how different variables influence the decision making process.

## CHAPTER 1 - Internationalization

*The aim of this chapter is to present some theoretical aspects of the internationalization of Small-Medium Enterprises (SMEs). In particular, the following concepts will be introduced: internationalization, SMEs and emerging markets. The main internationalization theories will be briefly described, with particular attention paid to the Uppsala model. Reasons behind the decision of foreign expansion, foreign market selection and various entry modes are explained as well. The peculiar characteristics of SMEs internationalization process, including main drivers are discussed. Finally, the role of export promotion programs and their impact is observed.*

## 1.1 Key concepts

### 1.1.1 Internationalization

Over the last decades, the prevalence of international business activity has increased exponentially due to political, economic and technological forces of globalization. As a result, the abolition of trade barriers has encouraged companies to enter the new markets. This internationalization process, perceived as increasing involvement in international operations, still lacks generally agreed definition of the term (Welch and Luostarinen, 1988, p. 36). First, Penrose (1959) interprets it, paying attention to the firm's core competences and foreign market opportunities. Second, Calof and Beamish (1995, p. 116) argue that internationalization allows firms to adapt their operations (strategy, structure, resource, etc.) to international setting. Generally, internationalization may be defined as the growing tendency of firms to operate across national boundaries.

### 1.1.2 SMEs

Referred as the engine of the European economy, SMEs are defined by European Commission as «the category of micro, small and medium-sized enterprises (SMEs), which employ fewer than 250 persons and have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro» (Article 2 of the annex to Recommendation 2003/361/EC, p.3). However, not only the enterprise's number of employees, turnover and balance sheet total matter. In comparison with other companies, SMEs have to overcome a specific set of issues. Market failure in such areas as finance, research and innovation represent the most common challenges most SMEs face. Furthermore, lack of management and technical skills and a limited knowledge of opportunities for worldwide expansion can restrain SMEs from realizing their full potential. Thus, SMEs require support from their home governments. The initiatives of the Italian Ministry of Economic Development to improve the business environment for SMEs and promote their entrepreneurship will be discussed in Chapter 2.

### 1.1.3 Emerging markets

Scholars describe emerging markets as former developing economies that have attained substantial industrialization, modernization and rapid economic growth at the turn of the 21st century. These countries boast of rapidly improving living standards and flourishing middle class with growing economic aspirations (Cavusgil *et al.*, 2008). According to Amadeo (2016), the following 5 features characterize emerging markets. First, they have a lower-than-average per capita income (less than 4,025\$ as defined by World Bank). Low income leads to the second feature, rapid growth. In 2015, the economic growth rate of advanced economies (United States, Japan, Germany) was less than 3 percent, meanwhile China's and India's growth rate was around 7 percent. The third characteristic is high volatility, which may arise from domestic policy instability, external price shocks and natural disasters. The fourth feature is less mature capital markets compared to those in advanced economies, this implies higher risk. However, the rapid growth may result in higher-than-average returns for investors, which is the fifth characteristic of emerging markets. We will see detail in Chapter 2 how this definition applies to the CIS countries included in this study.

## 1.2. Internationalization process

### 1.2.1 The internationalization theories

As reported by Laghzaoui (2011), there are three approaches describing the process of internationalization:

#### **Economic approach**

First, the internationalization theory developed by Buckley and Casson (1995) states that international activities of a firm are extended within operations of vertical integration. Secondly, Williamson's transaction costs theory (1975) affirms that the choice made by a firm between the internalization and the externalization results in the internationalization of its activities. Thirdly, the eclectic paradigm, published by Dunning (1988), explains the process of internationalization by distinguishing three sources of advantage: ownership, location and internationalization. However, the economic approach devotes its attention mainly to large firms, underlying the fact that SMEs are limited by their lack of resources and skills necessary for international growth. It also ignores the importance of social relations in transactions.

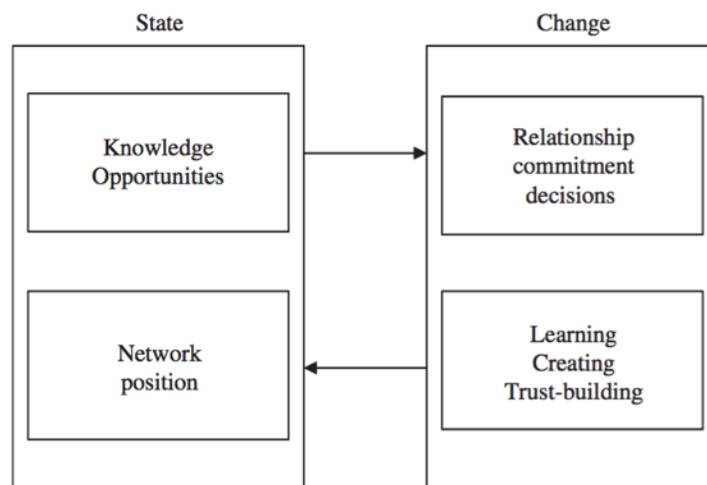
#### **Stages approach**

In this perspective, the process of internationalization happens as a linear and sequential process, as described by the Uppsala model developed by the Swedish school (Johanson & Vahlne, 1977), which will be discussed in detail in the next section, and the innovation-related internationalization models (also called I-models). There are numerous I-models (Bilkey & Tesar, 1977; Cavusgil, 1980; Reid, 1981) derived from Roger's stages of the adoption process (Rogers, 1962), where each stage is viewed as an innovation for the firm. These models vary in their stages, number and the initiating mechanism of internationalization. Despite the view of stage theory on learning as the only determinant of internationalization path followed by SMEs, there are other factors, specific to the firm and its environment, that take part in this process.

### *The Uppsala model*

One of the key concepts in the internationalization theory is known as Uppsala model. First introduced by Johanson & Vahlne (1977), this model explains the firm's behavioral approach to the internationalization process. According to Uppsala model, internationalization occurs as a sequential process: a firm enters a new market incrementally, resting on its market knowledge. Starting from sporadic export, the firm subsequently engages in low-commitment export modes, later establishing an overseas subsidiary (Hollensen, 2011). This stage model is applicable to both large companies and SMEs.

The Uppsala model was later revisited (Johanson & Vahlne, 1990; 2009) to acknowledge the role of networking and relationship building in the internationalization process. The authors state that a firm is affected by its existing business relationships both in the decision of entering a particular geographical market and in the choice of entry mode. Knowledge, trust and commitment allow the firm to develop new opportunities in the foreign markets.



*Fig. 1- The business network internationalization process model*

*(Source: Johansson & Vahlne, 2009, p. 1424)*

Fig. 1 illustrates the revisited Uppsala model. Two sets of variables, state and change, influence one another. State variables are related to the company's state and embody «knowledge and

opportunities» and «network position». As to the variables influencing changes in the company, also called change variables, they are represented by «relationship commitment decisions» and «learning, creating and trust-building». In the authors' view, the internationalization process predominantly depends on the link of relationship and network. Whereas, learning and knowledge build upon relationship and network, and vice versa. Thus, the internationalization process is pursued within a network.

The critics still argue that Uppsala model lacks understanding of factors starting the firm's internationalization process. Nevertheless, the model is unable to justify the behavior of large multinational companies, other researchers find it applicable to the behavior of SMEs in their internationalization (Kubíčková, 2013).

### **Networks approach**

Networks approach evolved from the revisited Uppsala model, when the importance of firm's position in its network was recognized. Johanson and Mattson (1988) define following stages of internationalization: prolongation, penetration and integration. The continuous establishment, development and maintenance of relations aims to reach firm's objectives, thus growing into a cumulative process of internationalization. The focus is put on the interactions inside the networks, through which the progressive learning and the acquisition of knowledge occur. As remarked by other scholars (Gemser *et al.* 2004; Coviello, Munro, 1997; Assens, Abittan, 2010), social relationships and networks of contacts can influence the firm's behavior, thus leading to its overseas expansion. Since SMEs are limited in their resources, the networks play an important role in their internationalization process.

#### **1.2.2 Motivations behind foreign market entry**

A firm may decide to expand its business activities abroad for a number of reasons. It's crucial to examine in deep the motivations in order to minimize possible risks and increase the probability of entrepreneurial success. As reported in a study by Westhead *et al.* (2002), the main rationale behind the exporting among small and medium size firms is based on one of the following:

- being contacted by foreign customers to place orders;
- one-off order (no continuous exporting);
- availability of foreign market information;
- part of firm's growth objective;
- export markets actively targeted by key founder/owner/manager.

Czinkota and Ronkainen (2007) differentiate between proactive and reactive reasons that push firms along internationalization path.

### Proactive motivations

Proactive motivations serve as catalyst to attempt strategic change. Among them are:

*Profit advantage.* Profitability is the strongest driver to expand internationally, especially for short-term oriented firms, willing to take advantage of higher profit margins.

*Unique products or technological advantage.* Uniqueness of products or their technological advances can provide an opportunity to expand firm's presence overseas. However, product or technological advantages may be threatened by competitor's breakthrough in technologies and imitation.

*Exclusive market information* comprises knowledge about foreign customers, marketplaces, or market situations that is not available to other firms as a result of firm's international research, special contacts and so on. Although exclusivity can act as an initial motivation to expand overseas, rivals will catch up with time.

*Economies of scale.* Since domestic market does not always provide sufficient sales, a firm may become involved in exporting activities to benefit from an increased market share. This results in increased production, which reduces the production costs and allows the firm to exploit economies of scale.

## Reactive motivations

Reactive motivations induce firms that are sensitive to environmental changes to modify their activities over time.

*Competitive pressures.* Since first movers are more likely to retain their market share, a firm may fear to lose domestic and foreign market share to its rivals. This is the case if the firm lacks an adequate preparation for internationalization process or there are economies of scale enjoyed by competing firms.

*Overproduction* represents one of the major reactive motivations. Whenever domestic market experiences a downturn, foreign markets become a temporary solution for the export of excess inventories.

*Excess capacity.* Likewise, expansion abroad allows to achieve distribution of fixed costs, if production equipment is underutilized. Some firms may use market-penetration strategy to enter foreign markets, based on variable cost, thus offering products at a lower cost than in domestic market. However, in the long run, fixed costs have to be recovered to ensure the replacement of production equipment.

*Declining domestic sales.* When a product becomes obsolete on the domestic market, a firm may decide to extend its product life cycle by expanding to a completely untapped market.

*Saturated domestic markets.* Similar to declining domestic sales, firms opt to enter foreign markets in order to prolong the product life cycle, as well as of their organization.

*Proximity to customers and ports.* A firm is encouraged to go abroad when foreign markets are physically and psychologically close. This holds particularly true in Europe, where firms trade with neighbouring countries thanks to their geographical proximity.

### 1.2.3. Foreign market selection

A firm, willing to enter a foreign market faces two decisions: which markets to enter and how the firm should enter the market chosen (Bradley, 2005). In this section, we are interested in analyzing which factors determine the firm's choice of overseas market. In the following part we will briefly present the different entry modes.

Koch (2001) in his work on the process of market selection distinguishes the factors, influencing the market selection process, in three categories: external, internal, and mixed. The complexity of the decision process is reflected in the possibility of inter- and cross-relations between factors. These factors are shown in Fig. 2 below.

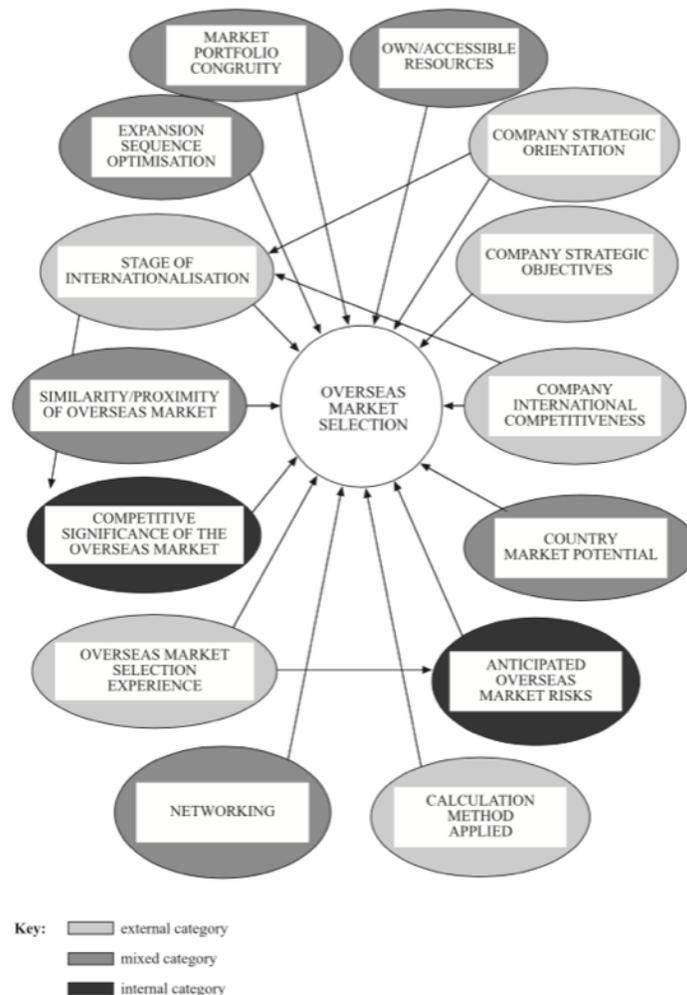


Fig. 2 – Factors, influencing market selection (Koch, 2001, p. 352)

## Internal factors

### *Company strategic orientation*

The strategic orientation of a company as an outcome of a multiple factors, incorporates individual and group experiences, values and attitudes of company's employees, its business environment and strategic objectives. It may affect the process of internationalization and the degree of company's willingness to cooperate with its competitors.

### *Stage of internationalization*

The stage of internationalization may relate to the export activity in particular, as well as international business activity in general. The firm's level of internationalization depends on two factors. Company's strategic orientation is directly correlated with its interest towards international involvement. Meanwhile, company's international competitiveness simply reflects the pace of internationalization.

### *Company strategic objectives*

A company may have a great variety of strategic objectives, defined by company's tradition, industry specificity, or personal preferences/interests of management. They encompass global/local market shares, growth of global/local market sales revenue, export/total sales revenue ratio or profit oriented objectives. In addition, the strategic planning horizon is a significant element to consider. If a country can boast of its stable conditions, a company with a long-term planning horizon will accept a chance to enlarge its potential by participating in global markets. In other circumstances, a company will adopt a short-term horizon.

### *Overseas market selection experience*

The previous experience in dealing with international markets majorly impacts company's strategic decision and direction in the process of internationalization. If positive, it reduces a sense of risk and uncertainty, thus contributing to efficiency and effectiveness of the learning process.

### *International competitiveness*

Specific capabilities and skills may impact the overall success of a firm in the global business environment. Thus, international competitiveness requires a deep analysis, not only of the information available on market shares, but also on how the firm will be able to obtain and develop the required competencies and capabilities.

### *Calculation methods applied*

The calculation methods should be distinguished between methods based on risk assessment against benefits and those methods, based on costs versus the degree of marketing control. The use of both methods depends on the availability of information and other data, and even individual preference.

### *Mixed factors*

#### *Own/accessible resources*

The availability of resources allows a firm under equal circumstances to have a greater freedom in the process of international market selection. A firm can obtain access to other firms' resources by forming a strategic alliance. Strategic alliances may enable SMEs to gain required resources to challenge in global competition.

#### *Networking*

Networking incorporates participation in international trade fairs, exhibitions and strategic alliances. Also, forming business relationships with suppliers, buyers plays a crucial role in developing firm's network. Through networking a firm can find new business opportunities.

#### *Similarity/proximity of overseas market*

The foreign market selection is influenced by perceived differences between a home country and a foreign country. The physic distance may play also a major role in the order in which markets get selected.

### *Market portfolio congruity*

During the course of its existence, the firm may change both its strategy and competitive position. The market environment changes over time as well. Market portfolio congruity represents the alignment of firm's current objectives with its external environment.

### *Expansion sequence optimization*

In order to identify the most suitable foreign market and appropriate entry sequence, the first step is to consider the available group of countries, based on their general socio-economic characteristics. Then a common framework is established by distinguishing among industries and creating some forecasts. In some cases, the process of international expansion happens either: by penetrating least demanding foreign markets, and then entering more challenging markets, as firm gains more experience; or by entering pioneer markets with established demand for new products, later moving to markets, trying to catch up. The decision of expansion sequence depends on the firm and its resources.

## External factors

### *Country market potential*

Market potential represents a common reference point in the process of market selection, nevertheless the role of judgement and the possible political contamination of statistics are underrated (Hodgson and Uytterhoeven, 1962; Johansson, 1997; Moyer, 1968; Root, 1994; Samli, 1997). Thus, Koch (2001) recommends that in order to estimate market potential the product market specific variables require further review, taking into account a wider range of industries.

### *Competitive significance of the market*

Leading markets are widely used to evaluate company's current performance and predict the future one. They are usually identified as large and strong markets, characterized by few government interventions. Thus, leading markets create an opportunity to test firm's abilities and reveal gaps between the firm and its competitors.

### *Anticipated overseas market risks*

Many banks and international enterprises are concerned about foreign market risk assessment.

Czinkota and Ronkainen (1996) distinguish the following categories of foreign market risks:

- Ownership risks (expropriation, confiscation and domestication);
- Operating risks (exchange risks, over investment and price controls related risks)
- Transfer risks.

Here, risk perception is of great significance too, particularly when recommended method for risk calculation is not applicable.

#### 1.2.4. Entry mode selection

An entry mode is described as the channel through which a firm gains entry to a new market. In Zekeri's view (2016), a firm's expansion strategy determines the choice of the most suitable entry mode for internationalization. Identification of international opportunities, availability of resources and capabilities, as well as the use of core competencies play an important role in the overall strategy implementation. *“What entry mode that a multinational company chooses has implications for how much resources the company must commit to its foreign operations, the risk that the company must bear, and the degree of control that the company can exercise over the operations on the new market.” (Charles Hill et al, 1990).*

As reported by Bradley (2005), perceived risk in a new venture affects the two factors a firm has to take into account, when determining the most suitable entry mode:

- the level of resource commitment that a firm is willing or able to achieve
- the level of control over the international operations a firm is willing to have

After the decision is made, the firm has to choose one of the following entry modes:

- Export entry modes
  - a) *Direct*
  - b) *Indirect*

- Contractual entry modes
  - a) *Licensing*
  - b) *Franchising*
  - c) *Subcontracting*
- Investment entry modes
  - a) *Joint venture*
  - b) *Mergers and acquisitions*
  - c) *Greenfield*

The European Commission (2015) states that most of European SMEs pursue internationalization through exports. Thus, the attention of our analysis dedicated to Italian SMEs, producing the «Made in Italy» furniture products and selling them overseas, will be put on only on the export entry modes.

According to Bradley (2005), exporting becomes a preferred market entry mode, when firm pursues market diversification strategy and the market complexity is low. This is the most appropriate mode of entry into foreign market whenever a market is uncertain or a firm lacks the required resources for other entry modes. In the case of exporting, firms face two options, which vary significantly with respect to benefits and costs. (Reynolds, 2003).

#### Indirect export entry mode

*“If the firm has little experience with and knowledge of international trade, it might first enter foreign markets in an indirect exporting mode.” (Reinert, 2012, p.143)*

Manufacturer does not directly trade and export its product to overseas buyers. Instead, intermediaries interfere and assume the role of exporter. They may work for producers, or buyers, or may themselves be principals to the transactions. There are 5 types of intermediaries: export trading companies, export management companies, export merchants, conforming houses, and nonconforming purchasing agents.

### *Export trading companies*

Export trading companies (ETCs) manage the entire export process for one or more suppliers. Here the term *supplier* may refer both to manufacturers and wholesalers. ETCs may provide the following support services: overseas trading partners location, product presentation, specific inquiry quotation, export order management, including the logistics. This option is advisable for less experienced suppliers, because it is often more efficient and cost-effective rather than establishing manufacturer's in-house export department. Rather than sales commissions, ETCs establish a markup between the prices charged to the final customer and those charged by supplier. To ensure a performing relationship, guaranteed minimum quantities are often negotiated.

### *Export management companies*

Export management companies (EMCs) come close to ETCs: they export on behalf of producers and wholesalers, locate foreign trading partners, may handle export shipping. However, unlike ETCs, EMCs specialize only in one product and rarely take on the export credit risk. In a way, EMCs act as supplier's export departments. Predetermined sales commissions are built into suppliers' export prices and are paid only after the suppliers receive payment. Working with EMCs is less attractive to suppliers, because producers lacking export experience are often reluctant extending credit to foreign buyers. On the other hand, since EMCs do not bear the export credit risk, they may charge lower profit margins.

### *Export merchants*

Export merchants are wholesale companies, which resell in foreign markets under their own trademarks the products acquired from suppliers. Thanks to high levels of brand awareness in their markets export merchants don't require promotional assistance. However, export merchant's activities affect negatively manufacturer's exporting efforts due to the presence of identical products, which may differ only in brand name or market pricing. Unfortunately, export merchants can switch easily manufacturers, thus putting manufacturers at a huge negotiating disadvantage if the latter rely heavily on export-merchant sales.

### *Conforming houses*

Conforming houses are purchasing agents represent the interests of an overseas buyer. They have following responsibilities: manage product sourcing, purchase negotiations, shipment arrangement, suppliers' payment. In this case, a likely possibility is that foreign principal may become a sales representative or importing distributor. Alternatively, the conforming house may take on the role of an ETC or EMC and offer the product overseas. However, suppliers have no control over conforming houses' activities, thus some forms of formal and legally binding agreements are required (e.g. contracts).

### *Nonconforming purchasing agents*

Nonconforming purchasing agents function similarly to conforming houses, with one exception: their payments arrangements are not managed by nonconforming agents and are worked out between the suppliers and the foreign buyers directly.

### *Direct export entry mode*

Direct export represents the most basic mode of foreign market entry. A firm exports its products or services either directly to end-user buyers or through intermediaries located in overseas markets. The firm takes on the research, marketing, finance and logistics, which incur extra costs. However, there is an offsetting advantage in managing own foreign market entry strategy.

### *Sales representatives*

Foreign manufacturers may be represented by sales representatives in their home markets in return for an established commission on sales. These trading partners provide local support services, such as sales presentations, advertising, legal requirements and customs clearance formalities. They work best for products that are make-to-order. However, the exclusivity may become an issue, therefore the most well-established representatives refuse to take on a new-to-market product line without some long-term protection. Local buyers are often tempted to go around sales representatives and deal directly with manufacturers, especially since buyers can often obtain detailed product-specific information from their websites. However, those buyers

that have cut local representatives out of deals may demand local services or warranty repairs that manufacturers won't be able provide.

### *Importing distributors*

The products are purchased by importing distributors in their own right to be resold in their home markets. Products that carried in inventory benefit most from sales representation. Importing distributors provide manufacturers with more benefits than representatives, such as:

- They reduce manufacturer's account-management burden, because they buy products in their own name.
- Their shipments have lower per-unit freight costs, because they order in larger quantities. So products are sold more competitively in their local market.
- Larger shipments often imply fewer shipments, thus reducing risks and transaction costs on both ends.
- They may boost favorable local familiarity to a product, if they dominate in their home market.

Like sales representatives, most importing distributors request agreements before accepting new-to-market products. They often demand to extend longer-than-normal terms of payment to be able to maintain sufficient inventories.

### 1.2.5 Drivers of SME internationalization

According to European Commission's report on Internationalization of European SMEs (2015):

- company's size is positively correlated with the level of internationalization regardless any single mode of internationalization: the larger the firm, the more it tends to expand overseas.
- the smaller the size of home country's population, the greater the level of its SME's level of international activity. However, the level of internationalization does not depend on the SME's proximity to a national border.

- the intensity of exporting activities increases by age of company.
- the majority of exporting SMEs serve other EU countries, while only 7% to 10% of SMEs export to emerging markets (BRIC).
- the level of internationalization is positively correlated with the involvement of SMEs in E-commerce, regardless the firm's size.

As to barriers for internationalization, SMEs distinguish between:

- *internal barriers* – own product/service price, high internationalization costs.
- *external barriers* – lack of capital, lack of adequate information, lack of adequate public support; high costs of proper transport documentation

The smaller the size of SME is, the higher the barriers associated with lack of capital and lack of public support. It is important to note that SMEs are generally unaware about public support initiatives, thus only few SMEs take advantage of public support programs.

As reported by European Commission (2015), the following are the effects of internationalization on business performance:

- SMEs that are internationally active have higher turnover growth.
- Being internationally active relates to higher employment growth.
- There is a positive correlation between internationalization and innovation.

Research by Daszkiewicz and Wach (2012) suggests the following four factors (Fig. 3) affect the SME's internationalization process. Entrepreneurial factor refers to the managerial orientation towards firm's growth as the most important motivation for internationalization. The shortage of opportunities on domestic market causes the firm to enter the foreign market, thus representing push factor. On the contrary, potential opportunities available in the foreign markets may attract the firm, thus becoming pull factor. Finally, chance factor relates to the availability of appropriate conditions in a foreign market.

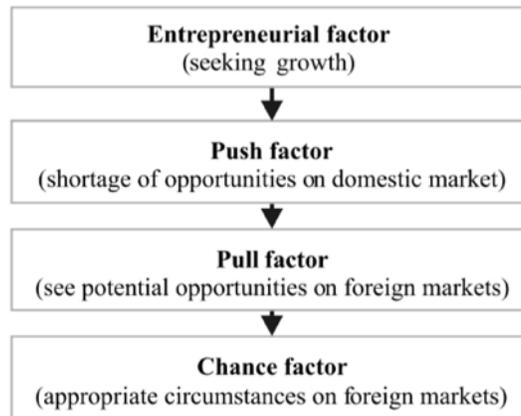


Fig. 3 – Internationalization factors (Daszkiewicz and Wach, 2012, p.15)

One of the peculiar characteristics of Italian economy is the presence of industrial districts described in detail in Chapter 2. Thus, it's crucial to recognize the «district effect» on the process of SMEs internationalization. In their paper Musso & Francioni (2012) examine the relationship between firm's belonging to industrial district and firm's behavior in entry mode selection. Their research findings show that firm's behavior during the process of internationalization is not affected by the «district effect». They also report that organizational culture has a strong effect on the entry decision, while previous internationalization experience doesn't affect it significantly.

With this in mind, we will further review the main drivers of SME's exporting activities. The latest work of Francioni *et al.* (2016) builds upon the study, previously developed by Leonidou *et al.* (2007), and aims to provide an updated classification of export drivers. Following Leonidou *et al.* (2007), the main drivers are distinguished as internal and external in Fig. 4.

**Internal drivers** are classified in terms of the firm's main business functions:

- *Human resources* – refer to the characteristics of human capital, such as specific competences, cognitive-related factors and socio-demographic-related factors, especially those belonging to entrepreneurs and managers. These internal factors affect whether SMEs intent to expand their business activities overseas.

- *R&D, innovation and productivity* – there is mixed evidence, supporting that proprietary knowledge and product innovation have influence on export performance. However, some studies confirm the positive relationship between firm productivity and internationalization.

Drivers	Traditional topics	Covered topics	
			New/emerging topics
<i>Internal drivers</i>			
Human resources	Competences/skills		Personality/subjective characteristics Socio-demographic factors (age, gender, nationality, family membership) HR management procedures
R&D, innovation and productivity	Possession of proprietary technical knowledge Product innovation		Process innovation
Marketing/sales Purchasing	Marketing capabilities		Internet/web marketing Purchasing experience
<i>External drivers</i>			
Home country	Saturation/shrinkage of domestic market Need to reduce dependence/risk of domestic market		
Host country	Export promotion programs Identification of better opportunities abroad Potential for extra growth Potential for extra sales/profits Close physical proximity to foreign markets		
Network			Personal networks Business networks (customers, intermediaries)

Fig. 4 – Drivers of internationalization (Source: Francioni et al., 2016, p. 204)

- *Marketing/sales* – the availability of marketing capabilities, including marketing differentiation, market orientation has a positive impact on international performance of the firm. In recent years, the greater attention is focused on the impact of internet on SMEs internationalization. ICT adoption enhances firm's competitiveness and export performance.
- *Purchasing* – viewed as another driver for export orientation, purchasing from abroad allows SMEs gain some experience in dealing with foreign markets.

**External drivers** are related to home and host country factors, with special attention given to network-related drivers:

- *Home country* – incorporates characteristics of domestic market and the policies of home government. It was revealed that saturation/shrinkage of the domestic market represents one of the main drivers of SME's internationalization. Specifically, the growth rate of domestic market is negatively correlated with the SME's exporting activity. Government-based support measures play a significant role in improving SME's export performance.
- *Host country* – refers to foreign-market-related factors, such as market growth potential, level of environmental hostility, geographical proximity between home and host countries. Nevertheless, there has been lack of attention given to the role of host government.
- *Network* – more attention is devoted to the role of networks in the process of SMEs' internationalization and to SME's orientation towards development of network competencies. Networks allow SMEs obtain necessary knowledge and help them to expand in new markets. Nevertheless, there is lack of attention on contribution of specific network actors, except for customers and distributors, the social ties established by the managers play a significant role in supporting SME's presence in overseas markets. The combined effect of internal and external networks defines the exporting behavior of SMEs. The decision taken by the entrepreneur is a result of his interaction with other actors involved in firm's internationalization process.

As highlighted by Francioni *et al.* (2016), governments can encourage SMEs' exporting activities by promoting policies aimed at enhancing both internal and external network: increasing the involvement of high-skilled workforce; endorsing initiatives, directed at innovating and upgrading export-related functions; providing financial and technical assistance in order to encourage cooperation among SMEs.

### 1.3. Impact of public incentives on firm's internationalization

European Commission (2015) states that «...more than 70% of the internationalization programs are still focusing on exports». Furthermore, OECD reports that most of its programs are directed towards assistance in the initial access to markets, while only 9% of the programs are aimed at eliminating trade barriers and creating business-friendly environment. Almost 72% of the EU government support programs are focused mainly on exporting activities, possibly explained by the positive impact on the national economies expected by policy makers. However, as indicated in the previous section, the majority of companies, engaged in international activities, neglect public support measures. In comparison with smaller firms, the larger ones are more informed about support programs and are more likely to use them. Nevertheless, public support is critical for the promotion of internationalization. It contributes to the elimination of such barriers as lack of foreign market information and access to financial support.

As reported by Freixanet (2012), different studies have evaluated the role of export promotion programs (EPPs). Some of them affirm that EPPs assist firms in overcoming internationalization barriers (Czinkota & Ricks, 1981; Seringhaus & Mayer, 1988); facilitate firms in acquiring the knowledge relevant for decision making (Brooks & Rosson, 1982; Lee & Brasch, 1978; Suntook, 1978); or reduce the time needed to locate sales leads (Seringhaus, 1984). Meanwhile, it is argued that according to manager's perceptions company needs and government assistance priorities are not consistent (Czinkota, 1982; Seringhaus & Botschen, 1991; Seringhaus & Rosson, 1990); that EPPs and export performance are not correlated (Cunningham & Spigel, 1971; Gronhaug & Lorentzen, 1983); or that companies do not use EPPs due to lack of awareness (Chokar & Kedia, 1986).

In addition, the results of the study undertaken by Freixanet (2012) suggest that the firms are more aware about and are more willing to participate in «classic» programs, such as trade shows and trade missions. On the contrary, the information programs are less utilized by the firms. The results obtained match the objectives of EPPS to assist the companies in the internationalization

process. However, other variables may affect whether the company is able to achieve a competitive position internationally. Companies require more support in the initial exporting stages, thus they should become a primary focus of EPPs. Regarding the type of program used, trade missions and trade shows allow the company to gain access to those markets, that require institutional assistance due to lack of information and local contacts. Meanwhile, direct promotion and information programs allow the firms to establish an international sales network, thus having positive impact on promotion activities.

The work of Leonidou *et al.* (2014) indicates the importance of government assistance as an «external resource» for international expansion of SMEs (Seringhaus 1986; Seringhaus and Rosson 1990). While reducing financial, informational, marketing, and other barriers, export promotion assistance may allow the firm to improve its organizational processes in order to succeed in the exporting activities. It also boosts the entrepreneurial spirit of a firm, which comprises risk tolerance, innovativeness, and proactiveness.

In order to improve the *risk tolerance* of SMEs the governments should adopt programs, related to information, education and training, and legal issues. Thus, the firm will be able both to take advantage of export opportunities and deal with unpredictable international business environment. Consequently, *innovativeness* has a decisive role in initial market entry and in achieving success in foreign markets. Governments may contribute to firm's innovativeness by providing appropriate education and training, financial support and assistance for each of the elements of the marketing mix. Finally, government assistance strengthens firm's *proactiveness* in export markets, thus enabling a firm in foreign market opportunities determination, planning and strategy implementation, and adaptation to changes in macro-environments abroad.

Among its recommendations for SME policy support, European Commission (2015) points out the importance of increasing the awareness of SMEs about the public support programmes. Only 10% of the SMEs already engaged in internationalization activities use the support instruments. Secondly, the access to support measures should be facilitated to micro firms, considering the

lack of capital and other constraints faced by them. Support programmes should specify the targets and objectives desired and include monitoring tools. Thirdly, the aim of policy support measures should be the promotion of both innovation and internationalization activities. Furthermore, policy makers should encourage firms to boost their competitiveness through e-commerce adoption, since the internet opens up the opportunities for market expansion. Finally, cooperation between EU Members States should be facilitated in order to improve knowledge transfer.



## **CHAPTER 2 - Outlook on Italian furniture industry and CIS countries.**

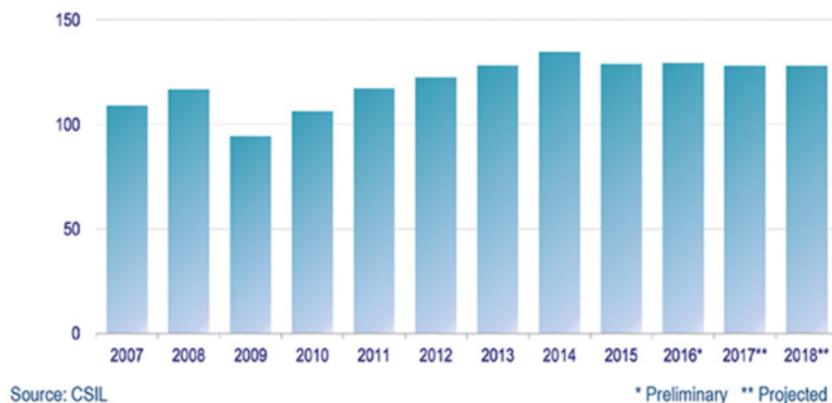
*In order to introduce the dissertation case study, the following chapter aims at providing an overview of Italian furniture industry and CIS countries as the destination of furniture exports, as well as the public incentives for internationalization promotion. The first part presents Italy in the world furniture industry and peculiar characteristics of internationalization of Italian furniture producers. In the next section the structural characteristics of CIS countries are discussed. We focus only on three CIS countries: Russia, Kazakhstan and Azerbaijan. A short country profile of their national economies is described. The final part presents the incentives provided by Italian government to promote the internationalization of Italian SMEs.*

## 2.1 Italian furniture industry

### 2.1.1 Italy in the global furniture market

Italy is the 6<sup>th</sup> leading manufacturing country (2013) after China, United States, Japan, Germany and South Korea. In 2015, it ranked 5<sup>th</sup> among G-20 countries, with manufacturing trade surplus of €57 billion. Despite rapid growth in emerging economies over the past decade, Italy confirms its position as the second most performing country in Europe after Germany. Italy's traditional sectors, also known as «4 Fs»: Fashion, Food, Furniture and Ferrari, represent the pillars of Italian economy.

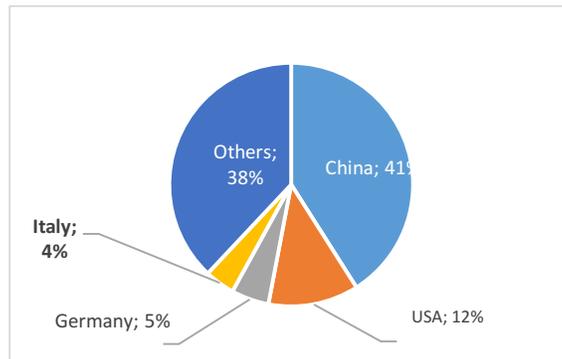
As reported by CSIL (2016), world trade of furniture was worth approximately US \$94 billion in 2009. There was a considerable decline by 19% compared to 2008. This amount rose to US \$135 billion in 2014. As a consequence of the depreciation of currencies of some major economies in relation to the US \$, there was a drop of 4% to US \$129 billion in 2015. The preliminary forecasts (Fig. 5) show no change for 2016-2018 due major uncertainties, such as the aftermath of Brexit and international trade policies of Trump administration.



*Fig. 5 – World trade of furniture. Current US\$ billion and annual percentage changes  
(Source: CSIL, «World Furniture Outlook 2017»)*

According to IMF and OECD forecasts (2016), world growth in GDP is projected to reach 3,6 % in 2017. Growth in advanced economies is expected to remain rather modest (1,8%), while that in emerging and developing markets will account for 4,8%. CSIL (2016) reports that the global furniture market has slowed its growth in 2016, compared to the positive results of the previous years. Still, there was an increase of 2,4% in the world consumption of furniture, which indicates further market expansion. However, forecasts across countries remain uneven and generally weaker than over the past two decades. The growth of 4% in furniture consumption is expected in Asia and Pacific region for 2017. Only 1% increase is estimated in Central and East Europe (also including former communist states and Russia), while no change in furniture consumption is foreseen for Kazakhstan. Though, another «pause» button is expected to be pushed in 2017 – with a slight increase of 3% in the world consumption of furniture – there is still a room for improvement for Italian furniture companies.

The world production of furniture amounted to US \$406 billion in 2015. Italy was ranked the 4<sup>th</sup> world producer of furniture, with around 4% of the global furniture production, after China (41%), USA (12%), and Germany (5%) as found in World Furniture Outlook 2017 (Fig. 6).



*Fig. 6 – Percentage breakdown of world furniture production  
(author's own elaboration, based on CSIL's «World Furniture Outlook 2017»)*

Tab. 1 below represents some data on Italy's furniture production and country rankings. As can be seen from the table, Italy's rankings remained unchanged except for exports. According to CSIL (2016), in 2016 the main furniture exporting countries were China, Germany, Italy, Poland and

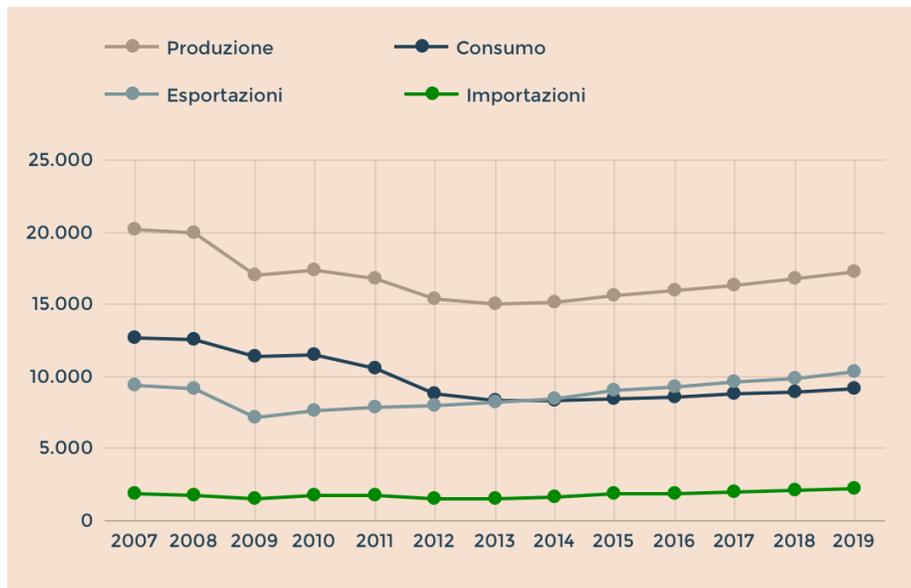
Vietnam. Current Italy's market share represents 7,3% of world exports, a further increase of 1,8% is expected for 2017.

<b>ITALY The furniture sector</b>	<b>2013 (\$mIn)</b>	<b>Ranking 2013 (among 70 countries)</b>	<b>2016 estimates (\$mIn)</b>	<b>Ranking 2016 (among 70 countries)</b>
Production	19,941	4	17,803	4
Exports	10,871	<b>2</b>	10,366	<b>3</b>
Imports	1,999	16	2,142	16
Consumption*	11,068	9	9,578	9

\*Apparent consumption = Production – Exports + Imports

*Tab. 1 – World furniture indicators: Italy*

*(author's own elaboration, source: CSIL, «World Furniture Outlook 2014», «World Furniture Outlook 2017»)*



*Fig. 7 – Italian furniture productions*

*(source: Il Sole 24 Ore, 2016; CSIL «Forecast report on the furniture sector in Italy in 2017-2019», «World Furniture Outlook 2017»)*

As stated by IFDM (2015), «Made in Italy» products are appreciated worldwide, especially in emerging countries such as the Emirates, Saudi Arabia and China. The following characteristics are often identified in Italian products: high quality, customization and prestige. As a worldwide trendsetter in furniture industry, Italy boasts a proud heritage of refined design and craftsmanship and still remains a key player in the furniture sector.

Italian SMEs are the driving force behind national exports. Work of CEPS *et al.* (2014) states that Italy has the largest number (over 19,000) of companies, operating in furniture industry among EU countries, with a workforce of 122,000. The average size of Italian companies is 6.5 employees per company, which is smaller than German firms (14.7 employees per company). Small company size and associated difficulties led to a concentration of firms. This presence of clusters is another peculiar characteristic of Italian furniture industry.

According to CEPS *et al.* (2014), clusters are responsible for around 70% of furniture production. The main furniture clusters are Brianza, Manzano, Alto Livenza and Quartiere del Piave, Bassa Veronese, Bassano, Forlì, Pesaro, Tuscany and Murge. They comprise around 80% of Italian furniture exports. It is worth mentioning that the share of exporting companies out of total companies is higher in clusters than in the sector as a whole. Over the last decade the performance among Italian furniture clusters has been heterogeneous due to diversity, arising from the differentiation of products and export markets. Some differences are also present in geographically close clusters or those with similar product specializations. So far, the best performing clusters seem to be characterized by efficient governance, a high level of autonomy of subcontractors, the presence of leaders that coordinate a network of companies and a high propensity to invest in innovation.

### 2.1.2 Internationalization process of Italian furniture SMEs

Over the last years, Italian furniture market, and that of Western Europe in general, encountered a series of obstacles, caused by financial crisis, then followed by the decrease of disposable income, slowdown of residential construction and economic uncertainty. Other reasons of the

decline of the furniture market in Europe were decreased volume of purchases, inflow of low cost furniture offered by large scale distributors (e.g. IKEA), growth of furniture e-commerce, fall in the average value of purchases, caused by price erosion and preference for cheaper options. Now the global furniture market is recovering thanks to market opportunities developing in emerging markets, where disposable income is growing fast.

According to SACE's report (2014), during the years of financial crisis Italian furniture industry has not only suffered from the burst of real estate bubbles in several key markets in 2007 and the sharp decline in domestic demand, but has also encountered major difficulties in the process of SMEs internationalization. Only 18% of firms exported steadily, while the rest were unable to build international commercial and distribution networks and to redirect exports towards more dynamic markets (mainly Russia, China and United Arab Emirates). Those, who targeted foreign markets, have exploited other strategies rather than pricing strategy alone, also taking advantage of contract furniture segment. Such factors as declining tariffs, partnerships between large-scale distributors and foreign suppliers, improvements in infrastructure and logistics have assisted in this process. Thus, Italian export share has risen by 12% during the period between 2007 and 2012.

As reported by CEPS *et al.* (2014), over 50,000 Italian furniture companies were exporting abroad in 2010, which is around a quarter of total number of Italian companies, operating in furniture industry. Within this group, around 200 of companies engaged in more complex entry modes, such as joint ventures, commercial partnerships and productive investments. This limited subgroup of companies, on average, showed better performance and were able to resist to the negative effects of the crisis.

In 2014, CSIL reported following countries (Tab. 2) as the main destinations of Italian furniture exports:

<b>Destinations of furniture exports</b>	
France	15,5%
Germany	11,4%
United Kingdom	8,6%
Russia	8,3%
United States	7,1%
Switzerland	5,6%
Spain	2,7%
Belgium	2,6%
China	2,0%
United Arab Emirates	1,8%

*Tab. 2 – Main furniture trading partners of Italy. Destination of furniture exports*

*(Source: CSIL, «World Furniture Outlook 2014»)*

CSIL divides Italian furniture companies in the following 4 sub-groups:

- ***opportunity driven*** – mainly domestic market-oriented companies with spot presence on foreign markets. This group was accounted for the majority, over one third of the total.
- ***entrants & established exporters*** – generally medium-sized companies with an established tradition of exporting, and a substantial share of turnover generated by exports, but with few other forms of internationalization activities.
- ***international players*** – export-oriented companies, the organizational structure of which is characterized by the presence of one of the following: equity agreements, commercial partnerships and foreign branches, sub-contracting, direct ownership of stores and greenfield investments

- **front runners** – usually medium-large companies with a structured internationalization activity, which takes form of foreign plants ownership and production of high quality and innovative products. This group was represented by very few companies.

Furthermore, CSIL reports that the internationalization behavior of Italian furniture companies is characterized by traditional approach to foreign markets. A limited number of companies carry out “light” internationalization strategies, such as sub-contracting and commercial agreements, together with exports. Moreover, very few companies engage in such “complex” strategies, as direct ownership of retailing channels or direct investments. Consequently, exports are the main route to internationalization for Italian furniture companies.

The work of Cioppi *et al.* (2014) pointed out the importance of development strategies and proactive behavior for SMEs in order to gain a competitive position, especially in periods of financial turbulence. Such factors, as lack of financial and professional resources, the limited size of the target markets and short-term strategy adoption are often associated with increasing vulnerability of SMEs to a crisis. Despite their small size, small firms can use this characteristic to their advantage. A small size allows more flexibility and agility to respond to rapid market changes. The manufacturing heritage and the attention for details are the peculiar traits of Italian SMEs, for which they are praised for all over the world.

In their analysis of 5 Italian SMEs, operating in the furniture industry in the aftermath of economic recession of 2008, Cioppi *et al.* (2014) revealed that international operations allowed Italian firms to overcome the poor demand of domestic market. The pursuit of market opportunities resulted in major focus on product innovation in order to satisfy the needs of new markets. The Italian SMEs have started the process of internationalization by entering in Russia, China and other emerging markets, which value the «Made in Italy» products, thus leveraging the impact of «Country Of Origin» (COO). Regarding marketing innovation, the results suggest that those firms, which recognized the importance of marketing activities, have increased their marketing budget and improved their marketing culture. Finally, some innovations in the management of

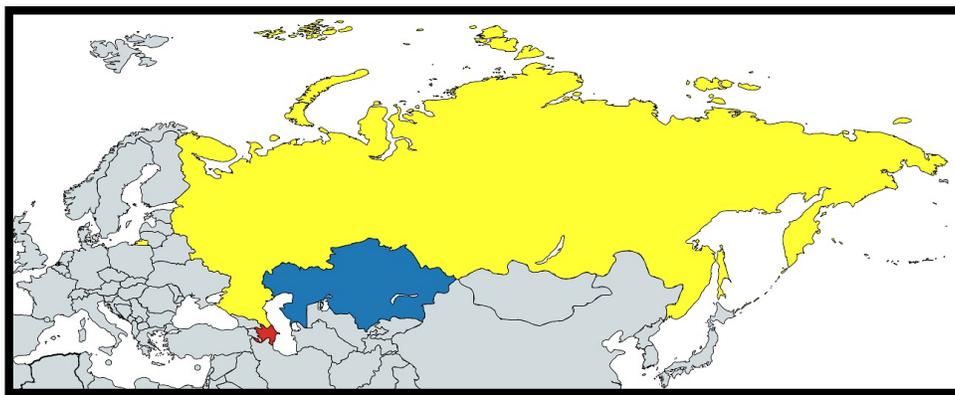
production and supply chain relationships were introduced in order improve the overall supply chain and reduce the delivery time to the market.

The evidence of Cioppi *et al.* (2014) seems to indicate that the following two conditions have determined the success of Italian furniture producers in the period from 2007 to 2012:

- *the capability to reinforce an entrepreneurial approach based on knowledge.* In other words, by investing in market-driven product innovations, SMEs increase the added value of their products and upgrade their human capital. Those firms that are able to exploit the «Made in Italy» brand, will successfully enter the international arena.
- *the adoption of decision making processes driven by strategic awareness.* By recognizing the importance of marketing activities, the firm will be able to keep up with the current trends in the furniture industry and take advantage of market opportunities as they arise. In the view of Cioppi *et al.* (2014), the marketing function plays a key role in the success of firms' strategies.

## 2.2 CIS countries as the destination of Italian furniture exports

Once part of USSR (United Soviet Socialist Republic), CIS region was disintegrated into several independent countries in 1991, which share common history and strong similarities in many fields of economy and society. Russia, one of the most important emerging economies, together with Azerbaijan, and Kazakhstan comprise approximately 181,5 mln people on the total territory of 20 mln km<sup>2</sup> (13.5% of the world's landmass). Kazakhstan is situated in Central Asia. Azerbaijan is located in Caucasus, while Russia occupies the eastern part of Europe and the northern part of Asia. Azerbaijan, Kazakhstan and Russia were listed among IMF's 48 resource-rich countries in the world.



*Fig. 8 – Map of following CIS countries: Azerbaijan (red), Kazakhstan (blue), Russia (yellow);  
(author's own elaboration)*

Over the past two decades, the CIS nations have been focusing on building trade relations with Italy. Russia, especially, was an important export market for Italy, but other CIS countries offered expansion possibilities to Italian exports as well. At present Russia constitutes around 8 % share in Italy's total furniture exports. The main reason for this can be attributed to the following factors: geographical distance, language barrier, inadequate transport facilities and lack of information about business opportunities. Though initially their focus on the CIS markets was limited, today many Italian companies have already established trade relations with these nations and are exporting their furniture products. The rise of the middle class in these nations has

emphasized the attractiveness of CIS markets, along with the boom in construction sector, one of the major drivers for furniture industry. Such factors as rapid economic growth, rising disposable income, consumer preferences for Western-style household goods have stimulated consumption in the furniture sector.

According to FederlegnoArredo (2014):

The area of the Russian Federation and CIS countries continues to be among the favourite outlets of Italian exporters for many reasons. It is a vast market, emerging, geographically close and not culturally distant, with noted sensitivity for cultural, historic and artistic topics that often refer to Italy, and it is particularly attracted by the Italian offer. There is a growing level of urbanization throughout the area, a process that becomes another strategic element and enables development in the medium term to be considered optimistically, both from the point of view of the consumer features and the ease of reaching the area. In addition to consumption and lifestyles often brought into line with those of advanced countries, businesses increasingly find the infrastructure necessary to enter the market (distribution channels and logistics services and better assistance with respect to the average in the country) in the main towns of the Russian Federation and the other CIS countries.

Finally, FederlegnoArredo (2014) finds Azerbaijan, Kazakhstan and Russia as the most attractive markets among CIS countries for the furniture industry. The reason is that these markets are open to top level furniture and are involved in major building projects.

### 2.2.1. CIS countries outline

#### Russia

The largest country in the world in terms of surface area, Russia is a federal republic with a semi-presidential form of government. It shares international borders with 14 countries. Russian Federation has rapidly gained importance within the global marketplace after the dissolution of the Soviet Union and served as a common example of emerging market economy. The total population in Russia was estimated at 142.3 million people in 2016, 77% of which is ethnically Russian. Moscow, its capital is not only the largest city in Russia (12 million residents), but also in Europe. Another important city is Saint Petersburg, with a population of over 5 million. Despite being a multi-national state with over 185 nationalities, the country's official language is Russian, which is the first most spoken language in Europe.

Since the 2000s, Russia's dominant political figure, Vladimir Putin promoted an assertive foreign policy, opposing to the West and establishing a strong position in former Soviet states. The global financial downturn affected Russia, however, the income from oil and gas helped overcome the economic crisis. But later, the oil price decline and Western sanctions of 2014 have hit hard Russia. Now Russia is slowly recovering from a two-year recession. The Economist forecasts a weak growth of 0.9% in 2017. GDP growth will stay below 2% due to structural weaknesses, low investment and fiscal tightening.

According to CSIL study on Russian furniture market (2013), Russia had a very large, fast growing and quite open furniture market. As shown in Tab. 3, Russia ranked 21<sup>th</sup> for furniture imports in 2016 CSIL ranking (compared to 15<sup>th</sup> position in 2002, and 9<sup>th</sup> in 2013 among 70 countries analyzed). Russian furniture production is mainly domestic market oriented, only 5% of which is exported abroad. Thus, the country is characterized by poor supply and high demand for furniture products.

<b>RUSSIA</b> <b>The furniture sector</b>	<b>2016</b> estimates (\$mln)	<b>Ranking 2016</b> (among 70 countries)
Production	2,941	19
Exports	213	44
Imports	1,434	<b>21</b>
Consumption*	4,162	14
*Apparent consumption = Production – Exports + Imports		

<b>Economic indicators</b>	<b>Value</b>	<b>Ranking</b>
Population	144 mln people	6
Area	17,098 km <sup>2</sup>	1
Total GNP	1,669 \$ bln	11
Per capita GNP	11,400 \$	13
<i>Data on Purchasing Power Parity (PPP)</i>		
Total GNP at PPP	3,482 \$ bln	6
Per capita GNP at PPP	23,790 \$	46

*Tab. 3 – World furniture indicators: Russia*  
(Source: CSIL, «World Furniture Outlook 2017»)

During the period between 2000 and 2012, there was a rapid growth in living standards thanks to Russia's energy exports. The furniture expense increased from 5% up to 20% in the period from 2000 to 2008, reaching 30% in 2012. However, the wealth is distributed unevenly in Russia. As reported by Credit Suisse (2016), Russia is the world's most unequal country, where over 74.5% of the nation's wealth is controlled by the richest 1% of people.

According to CSIL (2016), with a share of 24,6%, Italy is the main furniture trading partner of Russia (Tab. 4). Russian consumers appreciate following characteristics in Italian furniture products: functionality, exceptional design, comfort, quality and customization. Above all, Italian classic furniture is highly valued not only in Russia, but all CIS countries. This preference towards

imported products dates back to the communist era of the Soviet Union, when production volume was given more importance than quality and product diversity. Finally, «Made in Italy» products are generally perceived as exclusive and elegant. Thus, a successful penetration of Russian market is crucial to break ground to enter other fast-growing CIS countries.

<b>Origin of furniture imports</b>	
Italy	24,6%
China	19,1%
Belarus	9,7%
Germany	8,3%
Poland	6,6%
Ukraine	5,5%

*Tab. 4 – Origin of furniture imports in Russia.*

*(Source: CSIL, «World Furniture Outlook 2017»)*

Furthermore, CSIL (2016) finds Moscow and Saint Petersburg as the major trade partners for Italian companies thanks to the presence of the «new rich». These cities also represent the main hubs for imports to the far removed regions. As stated by IFDM (2015), «Made in Italy» furniture is displayed in numerous high end showrooms and monobrand stores.

With this in mind, as reported by IFDM (2016), the Russian economic crisis has effected the most the imports of furniture (-36,3% of the volume). In 2015, a drop of 24,6% in sales was registered in the Russian furniture market. Upholstered furniture has been affected the most, as well as home (-24,4,%) and office furniture (-22,5%). Meanwhile, the sales of inexpensive furniture have increased from 22% at the beginning of the 2015 to 39% by the end of the year, thus reflecting the effects of the crisis and the consumer behavior. According to the Economist (2016), the rouble against the dollar has lost over 25% of its value in the last two years, if adjusted for inflation. Nevertheless, the furniture market is expected to recover in 2017 thanks to 26 million of wealthy

Russian citizens and their demand for high quality, luxury goods. For this reason, IFDM (2016) points out that Italian furniture producers still consider Russia an attractive destination.

The Russia's entry into World Trade Organization (WTO) in 2012 was expected to reduce the barriers, but with the deepening of the Eurasian Economic Union (EEU) between Russia, Kazakhstan and Belarus, the country was unable to fulfill its WTO commitments. Moreover, as IFDM (2015) reports, the new regulation TR 025/2012 on furniture safety, adopted by the EEU, contains a number of controversial points. The complex paperwork, along with customs regulations, burdens Italian exports to Russia.

## Kazakhstan

With over 2,7 million km<sup>2</sup>, Kazakhstan is the 9th largest country in the world by area. Located in the center of the Eurasian continent, it shares land borders with fast-growing economies of Russia and China, and also other developing Central Asian countries: Kyrgyzstan, Uzbekistan and Turkmenistan. It is the second largest country among CIS nations. According to CIA World Factbook, Kazakhstan has a current population of 18,3 million people (2016 est.). Despite being a multiethnic country, two dominant ethnic groups are Kazakh and Russian (63.1% and 23.7% respectively, according to 2009 est.).

From a political point of view, the Republic of Kazakhstan is a unitary state with the presidential form of government, dominated by its President Nursultan Nazarbayev for more than 25 years. The capital and political center of Kazakhstan is Astana, which is rapidly expanding and is set to become the main center of the country. Another city of the significant importance is Almaty, financial and cultural center of Kazakhstan, with a population over 1.7 million people, often referred as “Southern capital”. It is also bigger in terms of investment, population and economy than any other region in Kazakhstan. Other economically strong and fast developing cities are Aktau, Atyrau, Karaganda and Shymkent. Even though Kazakh is the official language of Kazakhstan, Russian language plays a dominant role, being used in everyday business by an overwhelming majority of the population. The national currency of Kazakhstan is tenge (exchange rate on 02.02.2017 1 USD= 324 KZT; 1EUR= 349 KZT).

According to Stronski (2016), the country is now at political and economic crossroads. Despite a remarkable growth in the period between 2000 and 2015 due to high oil prices, Kazakhstan's economy remained dependent on extracting and exporting raw materials. The situation has started to worsen in 2014, when oil prices dropped sharply and Russia, China and the EU had to face major economic difficulties. The national currency lost around 20% of its value in February 2014, later followed by another 50% drop in 2015. The retail sector was strongly affected by the currency's devaluation. Thus, Kazakhstan's GDP grew only by 1% in 2016 as a consequence of low

oil prices and currency depreciation. Economist Intelligence Unit forecasts a gradual recovery (an average growth of 2,3%), starting from 2017, with ineffective attempts of the government to diversify the economy. It should be pointed out that many aspects of Kazakhstan's economy are intertwined with that of Russia, its closest ally. Thus, Kazakhstan's stability depends on the effects of Russia's actions.

In 2015, the current CEO of SACE, Alessandro Castellano has pointed out Kazakhstan as one of the most promising Euroasian markets for Italian exports. In his view, the establishment of EEU between Russia, Kazakhstan and Belarus and Kazakhstan's accession to WTO, have enforcing its strategic role as a connection point between East and West. ICE reports (InforMercatiEsteri, 2016), that the export of Italian products to Kazakhstan has registered an increase of 65,8% over the first half of the year, from € 365 million to €606 million. Also, as reported by InfoMercatiEsteri (2016), since the high-quality manufacturing is not present in Kazakhstan, this gap offers to Italian exporters a market opportunity for exporting products with high added value, such as furniture products, by targeting a medium-high income consumers.

In 2015, there was a growth of 4,4% (€11.6 bln) in Kazakhstan's construction, as reported by PMR's press release on "Construction sector in Kazakhstan 2016. Development forecasts for 2016-2021" (EuropaProperty, 2016). This positive performance is a result of an increase by 8,5% in the new construction projects. Meanwhile, the extensive renovation and repair initiatives have decreased considerably (-24% and -9,4% respectively). Nevertheless, the market share of Kazakh private companies corresponds to 76,1% of all construction output, in 2015 the growth in construction was driven by foreign contractors. There was an increase of 63,5% in the total value of new construction output generated by foreign contractors in 2015. Despite the economic contraction affecting the country, the residential construction continued to grow thanks to World's Fair EXPO-2017 to be held in Astana.

The furniture market in Kazakhstan is still undersized in terms of turnover. Local furniture producers only partially satisfy domestic demand, which has increased significantly over the last

decade. According to CSIL (2016), Kazakhstan has a negative balance in international trade in furniture, i.e. imports higher than exports. However, comparing the data reported by CSIL for 2013 and 2016, total imports of furniture have decreased by half. In terms of ranking, presented in Tab. 5 below, Kazakhstan has lost 14 positions, from 39<sup>th</sup> to 53<sup>rd</sup>.

<b>KAZAKHSTAN The furniture sector</b>	<b>2013 (\$mln)</b>	<b>Ranking 2013 (among 70 countries)</b>	<b>2016 estimates (\$mln)</b>	<b>Ranking 2016 (among 70 countries)</b>
Production	178	64	75	64
Exports	2	67	2	65
Imports	488	<b>39</b>	232	<b>53</b>
Consumption*	664	51	305	58
*Apparent consumption = Production – Exports + Imports				

<b>Economic indicators</b>	<b>Value</b>	<b>Ranking</b>
Population	18 mln people	35
Area	2,725 km <sup>2</sup>	9
Total GNP	203 \$ bln	45
Per capita GNP	15,580 \$	58

	<b>Value 2013</b>	<b>Ranking</b>	<b>Value 2016</b>	<b>Ranking</b>
Household consumption expense	105 \$ bln	47	112 \$ bln	45
<i>Data on Purchasing Power Parity (PPP)</i>				
Total GNP at PPP	350 \$ bln	42	426 \$ bln	36
Per capita GNP at PPP	20,570 \$	47	15,580 \$	48

*Tab. 5 – World furniture indicators: Kazakhstan*

*(Source: CSIL, «World Furniture Outlook 2014-2015»; «World Furniture Outlook 2017»)*

Kazakhstan is the main destination for Italian furniture exports in CIS countries, after Russia. Furniture of Italian origin represents a share of 8,6% of total furniture imports in Kazakh market (Tab. 6). As stated in CSIL study (2011), Kazakhstan is small, but open market. Over the past years, Italian firms found Kazakh furniture market attractive thanks to its growing residential construction and improving living standards.

<b>Origin of furniture imports</b>	
Russia	27,5%
China	19,1%
Ukraine	11,6%
Belarus	10 %
Italy	8,6 %

*Tab. 6 – Origin of furniture imports in Kazakhstan.*

*(Source: CSIL, «World Furniture Outlook 2017»)*

The import of furniture to Kazakhstan is done mainly by local distributors, who have experience in dealing with local government officials. Some of these companies have specialized in selling «Made in Italy» furniture products: these multi-brand dealers reserve part of their store floors for products of those Italian firms, with whom they are willing to develop long-term distribution partnerships. Most of these companies are high-end and only service a very limited share of the local population. The creation of a collaborative partnership with these intermediate partners is essential to obtain strategic market information. Since, there is absence of brand awareness in the Kazakh market, Italian brands do not have any different positioning or even awareness, except for “Made in Italy” or European sounding names. Few potential buyers tend to take considerable time learning the current furniture marketplace, taking into account style tendencies and fashion designs. Nevertheless, “Made in Italy” products are strongly valued by their high quality and unique design. Italian firms continue to search opportunities to enter the Kazakh market, and hopefully their presence will continue to grow.

## Azerbaijan

In recent years, Azerbaijan has been one of the strongest performing economies in the post-Soviet space. The country with an area of 86,600 km<sup>2</sup> is located on the shore of the Caspian Sea. Its neighboring countries are Russia, Georgia, Iran, Turkey and Armenia. As reported in CIA World Factbook, Azerbaijan has a population of 9.8 million people (2016 est.) and consists mainly of Azerbaijanis. The official language is Azerbaijani. As stated by Huseynov (2016), once the most commonly spoken language after the official one, Russian is losing its significance, while English and Turkish languages emerge ahead of it. However, Russian is still used by older generation.

Azerbaijan is a presidential republic, with the President Ilham Aliyev as the head of state. Its capital and the largest city is Baku, with a population of over 2 million. Already during the Soviet period, Azerbaijan's economy had been more industrially developed, compared to neighboring Armenia and Georgia. Following the collapse of the USSR, Azerbaijan went through the lengthy process of transformation from a command economy to a modern market economy.

Thanks to its large oil and gas endowments, Azerbaijan became a leading exporter of these natural resources. According to the Economist (2017), oil brought about 80% of the country's export revenues in 2015. However, the current global economic slowdown presents new challenges for the economy of Azerbaijan as world energy prices have fallen down in 2015 and put pressure on the country's currency. Earlier, in order to decrease its dependency on oil revenues, the government tried to diversify its economy through the FDI spillovers in other sectors, mainly trade, construction and services. IMF (2016) forecasts a growth of 1,7% in Azerbaijan's GDP for 2017. In the Sabatini's article (2015), Azerbaijan was listed along with Iran, Myanmar, Ghana and Colombia as countries, where to invest in 2016. Despite the economic slowdown, Azerbaijan is considered to be an attractive market for Italian SMEs thanks to its strategic position and the appeal of the "Made in Italy" to Azeri consumers.

As reported in Today.Az (2017), the general director of the Italian Chamber of Commerce in Azerbaijan, Luigi D'Aprèa has stated that there are extensive opportunities for the trade development between Italy and Azerbaijan. Despite current decrease in the bilateral trade, Italy is still one of the major trade partners of Azerbaijan. As he pointed out, "Made in Italy" products are highly appreciated in Azerbaijan for their quality and prestige.

PwC (2014) reports that the booming construction market, driven by oil revenues and the increased demand for new homes, has transformed Baku's skyline, now dominated by skyscrapers. Since the building materials are in high demand, the high quality ones are imported from the Western countries. As it was mentioned earlier, the growth in the construction sector represents one of the drivers for furniture industry. Following a boom in construction, many interior design and architecture firms emerged on the Azerbaijan's arena. Despite its small market, Azerbaijan provided significant opportunities for Italian firms, especially in contract furniture sector thanks to the ambitious construction projects, such as "Baku White City" and the "Khazar Islands". After a decade of growth, the construction industry has declined in 2016, however AECOM expects it to recover thanks to new infrastructure projects in Azerbaijan (The WorldBuild, 2016).

According to Turan Agency (2015), the imports of furniture have accounted for \$ 43 mln in the beginning of 2015, 75% more than in the same period of 2014, as reported by the State Customs Committee of Azerbaijan. Meanwhile, the State Statistics Committee have observed the average increase of 1,5% of retail furniture prices. The official data also estimates the volume of the furniture market in Azerbaijan around \$ 150 mln per year. Approximately 75% of the Azerbaijan furniture market belongs to producers from Turkey, China, Italy and other countries. There is no data available from CSIL reports so far on Azeri market, but hopefully it will be included among the countries covered in the World Furniture Outlook due to its increasing importance for Italian furniture consumption.

### 2.3. Internationalization support provided by Italian government

According to OECD (2013), the internationalization of Western SMEs towards emerging markets is considered to be a way to overcome the difficulties of their home economies. Thus, SMEs target BRIC and other high-growth markets, characterized by geographical, cultural and institutional proximity. However, these markets are perceived to have high entry barriers by both SMEs and policy makers. A major issue is the lack of relevant business information on emerging markets, which can be a valuable resource for SMEs.

Specifically, OECD (2014) reports the limited economic growth of Italy, huge financial costs, lack of access to credit, limited access to market knowledge, imperfect language skills, lack of expertise and technical communication problems as the main challenges, faced by Italian SMEs in their process of internationalization. Thus, public policy should address these issues in order to encourage the exporting activities of Italian firms.

One of the most important public agencies involved in the process of internationalization of Italian SMEs is Italian Trade Agency (ITA), also referred as the Istituto Commercio Estero (ICE). It aims to facilitate, develop and promote economic and trade relations of Italy with foreign countries, with particular attention devoted to the needs of SMEs. Its services include foreign market guidelines, market surveys, matchmaking with foreign companies, promotional events' organization and training. As OECD (2014) reports, ICE co-ordinates the adoption of the national guidelines for business internationalization together with the National Control Room for Enterprise Internationalization (Cabina di regia per l'internalizzazione).

The Italian Ministry of Economic Development (Ministero dello Sviluppo Economico = MISE) recognizes the importance of incentives to encourage growth of Italian economy and promote Italian companies abroad. Among its export promotion tools there is the provision of grants to those SMEs that form "internationalization consortia" or the ones with network contracts. The "internationalization consortia" refers to the voluntary alliances of firms with a common objective

of improving their export performance. As OECD (2014) points out, the grants, worth nearly € 2-3 mln per annum, are assigned to over 1600 firms in 110 consortia to finance promotional expenses (workshops, visits abroad and advertising). The reason why the grants are received by consortia is to distribute the benefits of financing over a network of firms and to encourage the inter-firm cooperation. However, this initiative is still small in size.

There are other two actors involved in SME's export support: Servizi Assicurativi del Commercio Estero (SACE) and the Società Italiana per le Imprese all'Estero (SIMEST), both owned by the Cassa Depositi e Prestiti (CDP). The former provides export-related insurance and financial services against a wide range of risks, while the latter supports the international development of Italian firms by providing soft loans for internationalization, export credit support and equity investments.

Finally, OECD (2014) reports that the Italian Chambers of Commerce (Camere di Commercio Italiane all'Estero – CCIEs) is another important player in supporting SME exporting activities. It follows an annual plan approved by the Ministry of Economic Development. In collaboration with Italian Embassies, CCIEs organize export support initiatives, such as business missions and B2B meetings. Another tool provided by CCIEs is "World Pass" network, which provides information required to assess foreign market opportunities.

In February 2015, MISE introduced the «Plan for Extraordinary Promotion of "Made in Italy" and Investment Attraction in Italy», which unlocks €260 million of public funding resources. The plan aims to boost Italian exports by offering a range of incentives and services to encourage business growth. It also includes projects designed to attract foreign investments. As it was pointed out in the plan, there are several elements that should be taken advantage of: the exponential growth of the middle class in emerging markets, attracted by "Italian way of living" and the prestige of "Made in Italy" products, the gap reduction between the production costs in advanced and emerging economies, the numerous free trade agreements negotiated between the EU and the

world's most important markets. Thus, the primary goal of government policies is to increase Italy's trade surplus and to penetrate new markets.

Among "MISE Incentives for companies" there are:

- Foreign market expansion program
- Export credit support
- Feasibility studies and technical support
- Venture capital fund
- Investment in company equity
- Capitalization of SMEs
- Trade shows participation in non-EU markets

However, as pointed out earlier, the major difficulty Italian SMEs encounter during their internationalization process is the lack of relevant information on the market opportunities. One of the tools, created by the Italian government, is a platform "InfoMercatiEsteri". It aims to provide information on markets of potential interest for Italian SMEs and the opportunities available. Some issues, arising with the use of this platform, will be discussed in Chapter 3.



### CHAPTER 3 – Decision making in the market selection process

*In this chapter our goal is to investigate the application of Multi Criteria Decision Analysis (MCDA) techniques to the market selection process in order to provide better decision aiding for firms and public actors. First, we introduce the two methods: Analytic Hierarchy Process (AHP) and Smart Multi Attribute Rating Technique (SMART). Then, AHP is applied to the case study of an Italian furniture firm deciding to enter one of the following CIS markets: Azerbaijan, Kazakhstan and Russia. SMART is used to present an updated version of a tool, used by the Italian government to assist the Italian firms in the process of potential market identification. Each MCDA application is followed by the sensitivity analysis, and finally the results of both methods are compared.*

### 3.1. Multi-Criteria Decision Analysis (MCDA) techniques

Multi-Criteria Decision Analysis (MCDA) is an important branch of Operational Research. As Ferreira et al. (2011) points out, MCDA deals with complex problems. It enables a decision maker (DM) to make a decision in the presence of multiple conflicting criteria, both quantitative and qualitative. According to the European school (Roy, 1990), the main objective of MCDA is to create a decision making model, that not necessarily has been established before. MCDA recognizes subjectivity and aims to integrate together objective and subjective elements in order to explain the behavior of the DM. In order to construct out market selection model we will apply following MCDA techniques: Analytic Hierarchy Process (AHP) and Simple Multi Attribute Technique (SMART). A brief description of both methodologies is presented below.

#### 3.1.1 Analytic Hierarchy Process (AHP)

Developed by Thomas L.Saaty in 1976, the Analytic Hierarchy Process (AHP) is one of the most widely applied MCDA techniques. AHP enables a DM to represent a complex issue in a hierarchical structure and find the decision that best suits his/her goal. The elements of the hierarchy can be tangible and intangible, accurately measured or estimated and the DM can use his/her judgments about the relative meaning and importance of each element. A number of factors and sub-factors, effecting the final decision, are taken into account and compared by constructing pairwise comparison matrices for each hierarchy level. According to Saaty (1990), the three basic principles of AHP are hierarchic structuring, priority setting and logical consistency.

The AHP decision process consists of following steps (Saaty, 1990):

- The problem is defined and the desired result is determined.
- The hierarchy is designed from the top to the lowest level, taking into account the target, alternatives, criteria and sub-criteria, if any.
- A set of pairwise comparison matrices is constructed, comparing pairs of elements with respect to a criterion in the upper level.

- Using the priorities obtained from the comparisons, the priorities are weighted in the immediately below level for every element.
- Finally, for each element in the level below its weighed values are added in order to obtain its overall or global priority. The weighting and adding process is continued until the final priorities of the alternatives in the bottom level are obtained.

<i>Intensity of Importance</i>	<i>Definition</i>	<i>Explanation</i>
1	Equal Importance	Two activities contribute equally to the objective
2	Weak or slight	
3	Moderate importance	Experience and judgement slightly favour one activity over another
4	Moderate plus	
5	Strong importance	Experience and judgement strongly favour one activity over another
6	Strong plus	
7	Very strong or demonstrated importance	An activity is favoured very strongly over another; its dominance demonstrated in practice
8	Very, very strong	
9	Extreme importance	The evidence favouring one activity over another is of the highest possible order of affirmation
Reciprocals of above	If activity <i>i</i> has one of the above non-zero numbers assigned to it when compared with activity <i>j</i> , then <i>j</i> has the reciprocal value when compared with <i>i</i>	A reasonable assumption
1.1–1.9	If the activities are very close	May be difficult to assign the best value but when compared with other contrasting activities the size of the small numbers would not be too noticeable, yet they can still indicate the relative importance of the activities.

*Fig. 9 – The fundamental scale of absolute numbers*

*(Source: Saaty (2008), p. 86)*

The following scale (Fig. 9) is used to evaluate alternatives on a pairwise basis. The values 1 to 9 express the intensity of importance between the elements and are assigned to judgements to compare pairs of elements in each level with respect to a criterion in the next higher level.

In the AHP, Saaty (1990) observes that decisions should be based on judgements with a certain degree of consistency in order to get valid results. When comparing alternatives, the DM's judgements should be as consistent as possible in order to satisfy the transitivity property of all pairwise comparisons. However, AHP does not require perfect consistency, but provides some measures to calculate the consistency of the judgements: *Consistency Index (CI)* and *Consistency Ratio (CR)*. Thus, to check if our opinions are consistent in our scoring, we obtain lambda estimates and then calculate *CI*, using the formula  $CI = (\lambda - n)/(n-1)$ , where  $n$  is the number of elements. Then *CR* is used in order to measure the overall consistency of DM's judgements. In order to obtain *CR*, we divide *CI* by *Random Consistency Index (RCI)*, which is an estimation of the average *CI* obtained from a large set of randomly generated matrices of size  $n$  (Fig. 10).

n. of alt.	Inconsistency index
2	0.00
3	0.58
4	0.90
5	1.12
6	1.24
7	1.32

*Fig. 10 – Average consistencies for random matrices*

*(Source: Saaty (1990), p. 84)*

The value of *CR* should be less than 10 percent. If the value is more than 10 percent, it means that the judgements of our DM were random and should be revised. We will see the application of AHP in detail in the next section.

According to Kendrick *et al.* (2007), there are several advantages of using AHP. First, it is easier to determine high level strategic objectives and specific metrics thanks to its hierarchical structure. Second, AHP allows for flexibility, thus combines judgement and personal values in the process of making decision in a logical way, when comparing different elements. Finally, a sensitivity analysis can be used in order to determine whether and how changes in one variable can impact the outcome.

### 3.1.2. Simple Multi Attribute Rating Technique (SMART)

Developed by Edwards (1971), Smart Multi Attribute Rating Technique (SMART) is a MCDA method, based on the direct ranking of the finite number of alternatives under a finite number of criteria. Alternatives are scored depending on their overall performance for each criterion in order to create a ranking. According to Lootsma (1999), the liner scale is used (percentage scale from 0 to 100) to convert the different scales of criteria into one scale.

In order to apply SMART, the following steps are taken:

- The objective of decision process and the decision-maker(s) are identified.
- The alternatives and criteria relevant to take a decision are determined.
- Values are assigned to each criterion and their weights are determined.
- A weighted average of the values assigned to each criterion is calculated in order to normalize the weights.
- A final decision is made. Also, a sensitivity analysis is applied as well.

The main advantage of using SMART is the independence of its alternatives. Since the ratings of the alternatives are not relative, thus adding or eliminating alternatives doesn't affect the decision scores of already existing alternatives.

## 3.2 Application of AHP to the market selection process

### 3.2.1 Case study profile

The case study involves an Italian company, operating in furniture sector and based in Altamura, the core of the Murge sofa cluster. Founded in 1955, the company is specialized in the production of high-quality upholstered furniture. In 1993, the second generation took over the family business and started to pursue internationalization strategy. First expanded in European markets, later the firm has penetrated the United States, Asian and CIS countries. Currently, the firm employs 65 workers and makes 50% of its turnover through exports. The core business of the company is mass production sofa brand with an extensive product portfolio. Moreover, 4 years ago the company has established a high-end sofa brand in order to meet the sophisticated demand of emerging markets. Both brands are exported abroad.

As reported by CEO of the company, exporting offers the opportunity for the company growth. Italy's domestic market is weak and unable to provide an adequate demand, thus exporting is the only way for market expansion and diversification. Europe remains the main market for exports, in terms of volume, then followed by Far East countries (Korea, Hong Kong and Singapore) and the United States. In order to grow the firm is looking for those markets, that are stable and have a high demand for "Made in Italy" products. The company is long-term orientated and focused on building a strong and continuous relationships with its clients, rather than spot trading.

The CEO of the company has expressed his concern about public support measures. Hit by the economic crisis, Italian government is experiencing difficulties in providing sufficient support to Italian SMEs. This lack of the government support measures leaves firms by themselves in the international arena. Fortunately, the company was able to participate in "Salone Internazionale del Mobile" – one of the most important international exhibition dedicated to furniture industry, held in Milan every year. The participation in this exhibition enables the company to develop a network to grow its business. However, the participation requires substantial financial resources.

The aim of the DM is to identify which CIS market has a greater potential for upholstery furniture exports. During the interview, the CEO and export manager of the company have underlined the fact that the company lacks Marketing department due to its small size. Thus, all critical decisions are taken by CEO and export manager after consulting the reports of private marketing research agencies, (e.g. "CSIL" = Centro Studi Industria Leggera) and public entities (e.g. "SACE" = Servizi Assicurativi del Commercio Estero). In our analysis of market selection decision making we will take into account only external factors, affecting market selection, reported by Koch (2001): country market potential, competitive significance of the market and anticipated overseas market risks.

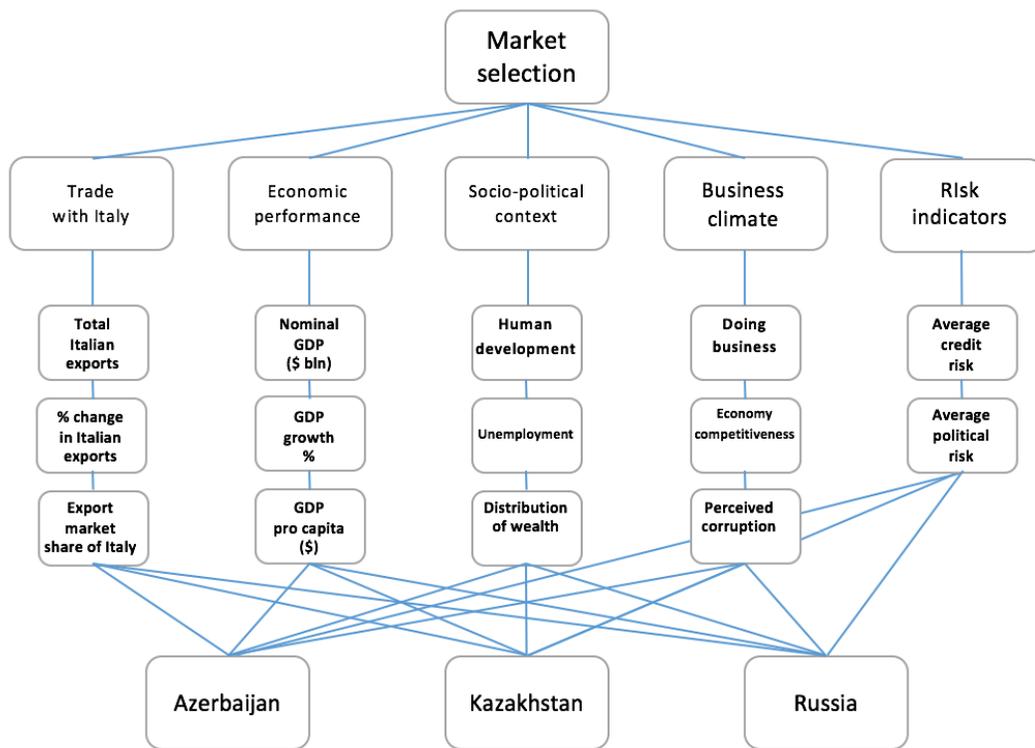
### 3.2.2 Application of AHP to the case study

In this case study, decision problem of a DM was solved using AHP method. The present simulation of a market selection refers to a project already accomplished by the company. Following the recommendation of FederLegnoArredo, it is assumed that the firm is interested in penetrating one of the CIS markets (Azerbaijan, Kazakhstan or Russia) with a new high-end brand of upholstered furniture. Taking into consideration the external factors of market selection reported in the Chapter 1 and data available from SACE country reports for 2015, the following criteria were determined (Tab. 8):

<b>Main criteria</b>	<b>Sub-criteria</b>	<b>Value</b>
<b>Trade with Italy</b>	Total Italian exports	€ mln
	Change in exports	%
	Export market share of Italy	%
<b>Economic performance</b>	Nominal GDP	\$ bln
	GDP growth	%
	GDP pro capita	\$
<b>Socio-political context</b>	Human development	out of 188 countries
	Unemployment	as % of workforce
	Distribution of wealth	held by the richest 10%
<b>Business climate</b>	Doing business	out of 190 countries
	Economy competitiveness	out of 138 countries
	Perceived corruption	out of 175 countries
<b>Risk indicators</b>	Average political risk	on scale 100
	Average credit risk	on scale 100

*Tab. 8 – Main criteria and sub-criteria  
(author's elaboration; Source: SACE country reports)*

At the second stage, the proposed hierarchic model was set up as represented in Fig. 11. It is structured into four levels of hierarchy consisting of goal, criteria, sub-criteria and alternatives. The first level of goal represents “Market Selection” as the aim of this study. The second level of criteria consists of five items, affecting the company’s choice in the process of market selection: “Trade with Italy”, “Economic performance”, “Socio-political context”, “Business climate” and “Risk indicators”. Subsequently, the sub-criteria level consists of fourteen additional criteria, grouped by each main criterion previously. In the last layer, three alternatives are given: Azerbaijan, Kazakhstan and Russia.



*Fig. 11 – Main criteria and sub-criteria  
(author’s elaboration; Source: SACE country reports)*

### Main criteria ranking

Using the Saaty’s 1-9 scale, the criteria were ranked and compared according to their importance in market selection decision-making based on the DM understanding. From Tab. 9, it can be seen that criterion “Trade with Italy” is weakly more important than criteria “Economic performance” and “Business climate”, and is slightly more important than “Socio-political context” and “Risk

indicators”. Similarly, criterion “Economic performance” is slightly more important than “Business climate” and “Risk indicators”. Criterion “Business climate” is more important than “Risk indicators” and moderately more important than “Socio-political context”. And finally, “Risk indicators” is slightly favored important than “Socio-political context”.

	Trade with Italy	Economic performance	Socio-political context	Business climate	Risk indicators
Trade with Italy	1	2	3	2	3
Economic performance	0,5	1	4	3	3
Socio-political context	0,33	0,25	1	0,25	0,33
Business climate	0,5	0,33	4	1	3
Risk indicators	0,33	0,33	3	0,33	1

*Tab. 9 – Main criteria matrix (author’s elaboration)*

Afterwards, we calculate geometric means along the columns in order to represent a measure of the goodness of each alternative (in absolute terms). To normalize the results, we divide them by the sum of the means (**5,99**). Thus, we obtain the following ranking of main criteria, as seen in Tab. 9a:

	Geometric means	Ranking
Trade with Italy	2,05	0,34
Economic performance	1,78	0,3
Socio-political context	0,37	0,06
Business climate	1,15	0,19
Risk indicators	0,64	0,1

**5,99**

*Tab. 9a – Main criteria ranking (author’s elaboration)*

Now we have to check if the DM judgements are consistent, we obtain lambda estimates and then calculate *CI*. Then we check if the value of *CR* is less than 10 percent. Since the Main criteria matrix has five elements, *Random Consistency Index* for  $n = 5$  is **1,12**. By comparing *Consistency*

Index of **0,09** and Random Consistency Index of **1,12**, we obtain Consistency Ratio of **8%** (Tab. 9b). Given the ratio less than 10%, we conclude that the Main criteria matrix is consistent enough:

lambda estimates	
1,83	5,35
1,61	5,42
0,33	5,4
1,03	5,38
0,57	5,3

Lambda	
5,37	

Consistency Index	
0,09	<b>8%</b>

OK

Tab. 9b – Main criteria ranking. (author’s elaboration)

#### Inconsistency matrix

Assume our DM has expressed the following judgements on main criteria, shown in Tab. 10a. Thus, we obtain the following matrix. Now, the criteria “Trade with Italy” has an importance level at “moderate level” compared to “Risk indicators” and “Economic performance”, and at “strong level” compared to “Business climate” and “Socio-political context”. “Economic performance” is strongly more important than “Socio-political context” and moderately important, compared to “Risk indicators” and “Business climate”. Next, “Business climate” is strongly more important than “Socio-political context”, while “Risk indicators” is moderately more important, compared to “Economic performance”. Finally, DM slightly favours “Risk indicators” to “Socio-political context”.

	Trade with Italy	Economic performance	Socio-political context	Business climate	Risk indicators
Trade with Italy	1	3	5	4	2
Economic performance	0,33	1	4	3	2
Socio-political context	0,2	0,25	1	0,2	0,33
Business climate	0,25	0,33	5	1	3
Risk indicators	0,5	0,5	3	0,33	1

Tab. 10a – Main criteria matrix (author’s elaboration)

Now we calculate geometric means, normalize the results to obtain the ranking of main criteria. Then, we check the consistency of our DM's judgements (Tab. 10b):

	Geometric means	Ranking	lambda estimates		Lambda	Consistency Index	
Trade with Italy	2,6	0,42	2,31	5,55	5,5	0,13	11% NOT OK
Economic performance	1,52	0,24	1,33	5,49			
Socio-political context	0,32	0,05	0,27	5,26			
Business climate	1,05	0,17	0,97	5,8			
Risk indicators	0,76	0,12	0,66	5,44			

**6,24**

Tab. 10b – Main criteria ranking (author's elaboration)

As shown in Tab. 10b, the CR is equal to **11%**, which is greater than the threshold value of 10%. Hence, the judgements of our DM are not consistent. In order to obtain the consistent matrix, we run "What if" analysis in Excel. We find, that the value of "Trade with Italy" vs "Risk indicators", should be at least greater than **2,75** for the matrix to be consistent. Thus, we put the value of that element equal to 3, and we obtain (Tab. 11a):

	Trade with Italy	Economic performance	Socio-political context	Business climate	Risk indicators
Trade with Italy	1	3	5	4	3
Economic performance	0,33	1	4	3	2
Socio-political context	0,2	0,25	1	0,2	0,33
Business climate	0,25	0,33	5	1	3
Risk indicators	0,33	0,5	3	0,33	1

Tab. 11a – Main criteria matrix (author's elaboration)

With this value, the CR of our matrix equals to 10% (Tab. 11b):

	Geometric means	Ranking	lambda estimates		Lambda
Trade with Italy	2,83	0,44	2,38	5,4	5,44
Economic performance	1,52	0,24	1,29	5,47	
Socio-political context	0,32	0,05	0,27	5,34	
Business climate	1,05	0,16	0,93	5,69	
Risk indicators	0,70	0,1	0,58	5,3	
	<b>6,4</b>				

Consistency Index	
0,1	<b>10%</b> OK

Tab. 11b – Main criteria ranking (author’s elaboration)

### Sub-criteria ranking

The next step for the DM is to create the square pairwise comparison matrices of all sub-criteria. As shown in Tab. 12a for the “Trade with Italy” criteria matrix, the DM favors very strongly “Change in exports” over “Total Italian exports” due to the fact that the former reflects the relative change over time of Italian exports, while the latter simply states the total amount per year. “Change in exports” is also slightly favored by the DM to “Export market share of Italy”, which measures the degree of importance of Italy within the total exports to the country. Overall, the DM finds that “Change in exports” detects general pattern of Italian exports and project its future direction, thus making it the most important sub-criteria within “Trade with Italy” criterion. Finally, DM considers “Export market share of Italy” slightly more important than “Total Italian exports”.

<b>Trade with Italy</b>	Total Italian exports	Change in exports	Export market share of Italy
Total Italian exports	1	0,14	0,33
Change in exports	7	1	3
Export market share of Italy	3	0,33	1

*Tab. 12a – “Trade with Italy” criteria matrix. (author’s elaboration)*

Tab. 12b shows the matrix for “Economic performance” criteria. One of the primary indicators of a country’s economic performance, The Gross Domestic Product (GDP) measures the monetary value of final goods and services produced over a specific time period (Callen, 2012). Evaluated at current market prices, the nominal GDP includes the changes in market prices, while GDP growth signals whether the economy is in a recession. The GDP pro capita displays the relative performance of each country, thus it serves to compare one country to another. With this in mind, “GDP growth” criterion has an importance level at “strong level” compared to “Nominal GDP” and at “moderate level” compared to “GDP growth”. In the same fashion, DM strongly favors “GDP growth” to “Nominal GDP”.

<b>Economic performance</b>	Nominal GDP	GDP growth	GDP pro capita
Nominal GDP	1	0,2	0,14
GDP growth	5	1	0,33
GDP pro capita	7	3	1

*Tab. 12b – “Economic performance” criteria matrix. (author’s elaboration)*

According to United Nations, economic growth is not the only assessment of the country's development. Human Development index can be used to determine and compare the social and economic development levels of countries. It encompasses three key dimensions of human development: per capita wealth, education and life expectancy. Furthermore, Unemployment rate is an important measure of economic health. It is a number of unemployed people as a percentage of the labour force. In addition, distribution of wealth reflects how the ownership of assets is shared among various members in a society and assesses the economic gap within wealthiest and poorest chart the economic gap within a country's wealthiest and poorest citizens. Tab. 12c below presents the matrix for "Socio-political context" criterion. The DM finds both "Human development" and "Distribution of wealth" to be of "moderate importance", compared to "Unemployment". Meanwhile, "Human development" and "Distribution of wealth" are equally important.

<b>Socio-political context</b>	Human development	Unemployment	Distribution of wealth
Human development	1	3	1
Unemployment	0,33	1	0,33
Distribution of wealth	1	3	1

*Tab. 12c – "Socio-political context" criteria matrix. (author's elaboration)*

As Saleem (2009) points put, the business environment in which a firm operates imposes several constraints and affects its strategic direction. Thus, the success of a firm in a certain market depends on whether the firm is able to interact with its environment in an effective way. World Bank ranks the economies on their ease of doing business, which defines the regulatory and operational environment of a country selected. Moreover, Economy competitiveness index, published by the World Economic Forum, assess the ability of a country to set the sustainable levels of economic prosperity. Finally, Transparency International publishes the Corruption

Perceptions Index, which measures the perceived levels of public sector corruption worldwide. Given that, the DM finds both “Doing Business” and “Economy competitiveness” to be equally important, compared to one another, and slightly more important than “Perceived corruption”.

Tab. 12d shows the “Business climate” criteria matrix obtained:

<b>Business climate</b>	Doing business	Economy competitiveness	Perceived corruption
Doing business	1	1	3
Economy competitiveness	1	1	3
Perceived corruption	0,33	0,33	1

*Tab. 12d – “Business climate” criteria matrix. (author’s elaboration)*

Firms face many risks when they operate overseas. Political risk refers to the risk faced by an investor in case of political changes or instability in a country. Equally, the firm is affected by credit risk, which refers to buyer’s insolvency. During the interview, the DM stressed credit risk as a critical factor, influencing his decision in a market selection process. Tab. 12e shows the “Risk indicators” criteria matrix, where both “Average political risk” and “Average credit risk” equally important.

<b>Risk indicators</b>	Average political risk	Average credit risk
Average political risk	1	1
Average credit risk	1	1

*Tab. 12e – “Risk indicators” criteria matrix. (author’s elaboration)*

After obtaining all the paired comparison matrices, *CR* was checked for each matrix. For all sub-criteria matrices *Random Consistency Index (RCI)* with  $n = 3$  is equal to **0,58**, with exception of “Risk indicators” (*RCI* with  $n = 2$  is **0**). Tab. 13 below sums up the results of assessing consistency of sub-criteria matrices. As it can be seen, all matrices are consistent, since the *CR* is less than 10%. In addition, we can identify whether the result is consistent enough, by looking at lambda. The closer lambda is to the number of alternatives, more consistent is the result.

<b>Main criteria</b>	<b>Sub-criteria</b>	<b>Lambda</b>	<b>CI</b>	<b>CR</b>
<b>Trade with Italy</b>	<i>Total Italian exports</i>	3,04	0,02	<b>3%</b>
	<i>Change in exports</i>	3,03	0,02	<b>3%</b>
	<i>Export market share of Italy</i>	3,02	0,01	<b>3%</b>
<b>Economic performance</b>	<i>Nominal GDP</i>	3,06	0,03	<b>6%</b>
	<i>GDP growth</i>	3,09	0,05	<b>8%</b>
	<i>GDP pro capita</i>	3,02	0,01	<b>2%</b>
<b>Socio-political context</b>	<i>Human development</i>	3,02	0,01	<b>2%</b>
	<i>Unemployment</i>	3,05	0,03	<b>5%</b>
	<i>Distribution of wealth</i>	3,02	0,01	<b>2%</b>
<b>Business climate</b>	<i>Doing business</i>	3,04	0,02	<b>3%</b>
	<i>Economy competitiveness</i>	3,09	0,05	<b>8%</b>
	<i>Perceived corruption</i>	3	0	<b>0%</b>
<b>Risk indicators</b>	<i>Average political risk</i>	3	0	<b>0%</b>
	<i>Average credit risk</i>	3,02	0,01	<b>2%</b>

*Tab. 13 – Lambda, Consistency Index and Consistency Ratio of sub-criteria matrices  
(author’s elaboration)*

After calculating the ranking for sub-criteria, we combine the ranking of main criteria and sub-criteria in order to obtain the combined ranking (Tab. 14), which sum up to 1.

Main criteria	Sub-criteria	Weights		
		Sub	Main	Combined
Trade with italy	Total Italian exports	0,09	0,34	0,03
	Change in exports	0,67		0,23
	Export market share of Italy	0,24		0,08
Economic performance	Nominal GDP	0,07	0,3	0,02
	GDP growth	0,28		0,08
	GDP pro capita	0,65		0,19
Socio-political context	Human development	0,43	0,06	0,02
	Unemployment	0,14		0,008
	Distribution of wealth	0,43		0,02
Business climate	Doing business	0,43	0,19	0,08
	Economy competitiveness	0,43		0,08
	Perceived corruption	0,14		0,03
Risk indicators	Average political risk	0,5	0,1	0,05
	Average credit risk	0,5		0,05
				<b>1</b>

Tab. 14 – Combined ranking (author's elaboration)

## Alternatives ranking

Next step is to create pairwise comparisons for alternatives. Based on the data available from SACE's Country Reports for 2015, the DM ranks the alternatives according to their importance. Tab. 15a reports the data for each alternative for "Trade with Italy" criteria. The pairwise comparisons for Azerbaijan, Kazakhstan and Russia are shown in Tab. 15b below.

		Azerbaijan	Kazakhstan	Russia
<b>Trade with Italy</b>	Total Italian exports	659,3 mln	779,5 mln	<b>7,1 bln</b>
	Change in exports	10,80%	10,60%	-25,20%
	Export market share of Italy	3%	2,50%	4,40%

Tab. 15a – Trade with Italy (author's elaboration; source: SACE)

### TRADE WITH ITALY

Total Italian exports	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,5	0,11
Kazakhstan	2	1	0,125
Russia	9	8	1

Change in exports	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	2	7
Kazakhstan	0,5	1	6
Russia	0,14	0,16	1

Export market share of Italy	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	2	0,25
Kazakhstan	0,5	1	0,2
Russia	4	5	1

Tab. 15b – Sub-criteria matrices for "Trade with Italy" (author's elaboration)

In the same manner, the pairwise comparisons are made for other criteria as well:

		Azerbaijan	Kazakhstan	Russia
<b>Economic performance</b>	Nominal GDP (\$ bln)	169,8	458,2	3724,9
	GDP growth %	1,10%	1,20%	-3,80%
	GDP pro capita (\$)	18030	25911,7	25965,1

Tab. 16a – Economic performance (author’s elaboration; source: SACE)

#### **ECONOMIC PERFORMANCE**

<b>Nominal GDP</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,33	0,14
Kazakhstan	3	1	0,2
Russia	7	5	1

<b>GDP growth</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,5	5
Kazakhstan	2	1	4
Russia	0,2	0,25	1

<b>GDP pro capita</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,25	0,2
Kazakhstan	4	1	0,5
Russia	5	2	1

Tab. 16b – Sub-criteria matrices for “Economic performance” (author’s elaboration)

		Azerbaijan	Kazakhstan	Russia
<b>Socio-political context</b>	Human development	78	56	50
	Unemployment	5,20%	4,10%	5,10%
	Distribution of wealth	30,20%	36,40%	48,30%

Tab. 17a – Socio-political context (author’s elaboration; source: SACE)

### SOCIO-POLITICAL CONTEXT

<b>Human development</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,25	0,2
Kazakhstan	4	1	0,5
Russia	5	2	1

<b>Unemployment</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,33	2
Kazakhstan	3	1	3
Russia	0,5	0,33	1

<b>Distribution of wealth</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	2	4
Kazakhstan	0,5	1	3
Russia	0,25	0,33	1

Tab. 17b – Sub-criteria matrices for “Socio-political context” (author’s elaboration)

		Azerbaijan	Kazakhstan	Russia
<b>Business climate</b>	Doing business	65	56	40
	Economy competitiveness	37	53	43
	Perceived corruption	123	131	131

Tab. 18a – Business climate (author’s elaboration; source: SACE)

### BUSINESS CLIMATE

<b>Doing business</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,33	0,2
Kazakhstan	3	1	0,33
Russia	5	3	1

<b>Economy competitiveness</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	5	4
Kazakhstan	0,2	1	2
Russia	0,25	0,5	1

<b>Perceived corruption</b>	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	3	3
Kazakhstan	0,33	1	1
Russia	0,33	1	1

Tab. 18b – Sub-criteria matrices for “Business climate” (author’s elaboration)

		Azerbaijan	Kazakhstan	Russia
Risk indicators	Average political risk	59	51	59
	Average credit risk	73	69	68

Tab. 19a – Risk indicators (author’s elaboration; source: SACE)

**RISK INDICATORS**

Average political risk	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,2	1
Kazakhstan	5	1	5
Russia	1	0,2	1

Average credit risk	Azerbaijan	Kazakhstan	Russia
Azerbaijan	1	0,25	0,2
Kazakhstan	4	1	0,5
Russia	5	2	1

Tab. 19b – Sub-criteria matrices for “Risk indicators” (author’s elaboration)

Finally, we put together the rankings obtained for each country on each sub-criterion in order to calculate the final priority vector. By summing up the values obtained along the columns for Azerbaijan, Kazakhstan and Russia, we get the priority vector for each of the countries. As shown in Tab. 20, Russia is the preferred option with the highest priority vector value **0,36**. Taking into account our DM’s judgements, his preference will be towards the Russian market. However, the values aren’t very different, thus there is a little difference between the preferences of our DM.

	<b>Combined weights</b>	<b>Azerbaijan</b>	<b>Kazakhstan</b>	<b>Russia</b>
<b>Total Italian exports</b>	0,03	0,07	0,12	0,8
<b>Change in exports</b>	0,23	0,58	0,35	0,07
<b>Export market share of Italy</b>	0,08	0,2	0,12	0,68
<b>Nominal GDP</b>	0,02	0,08	0,19	0,73
<b>GDP growth</b>	0,08	0,36	0,54	0,1
<b>GDP pro capita</b>	0,19	0,1	0,33	0,57
<b>Human development</b>	0,026	0,1	0,33	0,57
<b>Unemployment</b>	0,008	0,25	0,59	0,16
<b>Distribution of wealth</b>	0,03	0,56	0,32	0,12
<b>Doing business</b>	0,08	0,1	0,26	0,64
<b>Economy competitiveness</b>	0,08	0,69	0,19	0,13
<b>Perceived corruption</b>	0,03	0,6	0,2	0,2
<b>Average political risk</b>	0,05	0,14	0,71	0,14
<b>Average credit risk</b>	0,05	0,1	0,33	0,57

<b>Priority vector</b>	<b>0,32</b>	<b>0,33</b>	<b>0,36</b>
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the best

*Tab. 20 – Sub-criteria ranking. (author's elaboration)*

### Sensitivity analysis

It is essential to run the sensitivity analysis in a decision making process in order to ensure the consistency of final decision. By running “what-if” scenarios, it is possible to observe how the change in DM’s judgements can affect the final ranking of alternatives. In this section, the sensitivity analysis will be used to determine whether the optimal solution will change if we change the DM’s judgements in our AHP model.

After running sensitivity analysis on the original matrix and its final ranking (Tab. 20), the rank order hasn’t changed. This reflects the fact that the final decision is consistent and reliable and that the ranking obtained is not very sensitive to the values’ variation. Now, let’s see whether the same holds true, if we use the matrix obtained in the “Inconsistency matrix” section (Tab. 21).

	Trade with Italy	Economic performance	Socio-political context	Business climate	Risk indicators
Trade with Italy	1	3	5	4	3
Economic performance	0,33	1	4	3	2
Socio-political context	0,2	0,25	1	0,2	0,33
Business climate	0,25	0,33	5	1	3
Risk indicators	0,33	0,5	3	0,33	1

*Tab.21 – Main criteria matrix (author’s elaboration)*

First, we repeat the AHP steps showed previously, in order to obtain the combined ranking (Tab. 22). Next, we calculate the final priority vector by summing up the values along the columns for each alternative (Tab. 23a). Again, the results obtained are quite similar and Russia is the preferred option for entry, with the priority vector equal to **0,34**.

Main criteria	Sub-criteria	Weights		
		Sub	Main	Combined
Trade with italy	Total Italian exports	9%	44%	0,039
	% change	67%		0,3
	Export market share of Italy	24%		0,11
Economic performance	Nominal GDP	7%	24%	0,02
	GDP growth	28%		0,07
	GDP pro capita	65%		0,15
Socio-political context	Human development	43%	5%	0,02
	Unemployment	14%		0,007
	Distribution of wealth	43%		0,02
Business climate	Doing business	43%	16%	0,07
	Economy competitiveness	43%		0,07
	Perceived corruption	14%		0,02
Risk indicators	Average political risk	50%	11%	0,05
	Average credit risk	50%		0,05
				1

*Tab. 22 – Combined ranking (author’s elaboration)*

Since the weight of some main criteria and sub-criteria are very small (Tab. 22), we can leave them out from further consideration, assuming that the values less than 0,01 can be negligible. Thus, we can ignore “Socio-political context” main criterion, “Total Italian exports” and “Nominal GDP” sub-criteria, since their weights are small (0,05 and 0,04 and 0,02 respectively). We also have to adjust the weights of other criteria, so that their sum is still 100% (Tab. 23b).

	<b>Combined weights</b>	<b>Azerbaijan</b>	<b>Kazakhstan</b>	<b>Russia</b>
<b>Total Italian exports</b>	0,04	0,07	0,12	0,80
<b>Change in exports</b>	0,30	0,58	0,35	0,07
<b>Export market share of Italy</b>	0,11	0,20	0,12	0,68
<b>Nominal GDP</b>	0,02	0,08	0,19	0,73
<b>GDP growth</b>	0,07	0,36	0,54	0,10
<b>GDP pro capita</b>	0,15	0,10	0,33	0,57
<b>Human development</b>	0,02	0,10	0,33	0,57
<b>Unemployment</b>	0,01	0,25	0,59	0,16
<b>Distribution of wealth</b>	0,02	0,56	0,32	0,12
<b>Doing business</b>	0,07	0,10	0,26	0,64
<b>Economy competitiveness</b>	0,07	0,69	0,19	0,13
<b>Perceived corruption</b>	0,02	0,60	0,20	0,20
<b>Average political risk</b>	0,05	0,14	0,71	0,14
<b>Average credit risk</b>	0,05	0,10	0,33	0,57

<b>Priority vector</b>	0,33	0,32	0,34
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*Tab. 23a – Sub-criteria ranking. (author’s elaboration)*

<i>Main criteria</i>	<i>Sub-criteria</i>	<i>Weights</i>		
		<i>Sub</i>	<i>Main</i>	<i>Combined</i>
<b>Trade with Italy</b>	Change in exports	0,73	0,46	0,34
	Export market share of Italy	0,27		0,12
<b>Economic performance</b>	GDP growth	0,30	0,25	0,07
	GDP pro capita	0,70		0,17
<b>Business climate</b>	Doing business	0,43	0,17	0,07
	Economy competitiveness	0,43		0,07
	Perceived corruption	0,14		0,02
<b>Risk indicators</b>	Average political risk	0,50	0,11	0,06
	Average credit risk	0,50		0,06

*Tab. 23b – Sub-criteria ranking. (author’s elaboration)*

<b>Sub-criteria</b>	<b>Weights</b>	<b>Azerbaijan</b>	<b>Kazakhstan</b>	<b>Russia</b>
Change in exports	0,34	0,58	0,35	0,07
Export market share of Italy	0,12	0,20	0,12	0,68
GDP growth	0,07	0,36	0,54	0,10
GDP pro capita	0,17	0,10	0,33	0,57
Doing business	0,07	0,10	0,26	0,64
Economy competitiveness	0,07	0,69	0,19	0,13
Perceived corruption	0,02	0,60	0,20	0,20
Average political risk	0,06	0,14	0,71	0,14
Average credit risk	0,06	0,10	0,33	0,57

Priority vector	35%	33%	32%
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*Tab.24 – Sub-criteria final ranking. (author’s elaboration)*

To conclude, we calculate the final priority vector for the weights obtained in the previous step. As it can be seen from Tab. 24, after leaving out some sub-criteria, the final ranking has changed. Now, the preferred option of our DM is Azerbaijan.

Another results would be obtained if the judgements of our DM on sub-criteria's pairwise comparison were different. Also, other countries of the same size can be included in the analysis.

### 3.3. Application of SMART to the market selection process

The Italian Ministry of Foreign Affairs and International Cooperation in the Government has created a platform “InfoMercatiEsteri” in order to provide information on foreign markets to Italian firms. This platform is free and is organized in collaboration with ITA, Agenzia Nazionale per il Turismo (ENIT) and ICCs. InfoMercatiEsteri presents data on each industry and provides following information on each country: economic and political outlook, market opportunities, upcoming promotional activities, barriers to trade, critical investment and possible risk, credit access framework of the bilateral relations and Italian presence. However, still underdeveloped, InformercatiEsteri requires more sophisticated tools to present the data available in a more effective way. In a section dedicated to furniture sector, the platform ranks countries, using simple algorithm. Unfortunately, the data hasn’t been updated since 2013. In today's world, markets change faster, the decisions makers can not base their decisions on the outdated data.

#### 3.3.1 SMART model for InfoMercatiEsteri

In order to run SMART analysis, we have to identify the DM, alternatives and criteria to take into consideration. Let’s assume that the CEO from the previous AHP analysis has already penetrated the Russian market. Now, he is interested in receiving the assistance from the public agents to identify which CIS markets is of a higher interest for Italian furniture producers. Thus, our DM for SMART analysis is The Italian Ministry of Foreign Affairs.

Differently from the previous analysis, for the SMART we will focus our attention to the following CIS countries: Azerbaijan, Kazakhstan, Kyrgyzstan and Ukraine. The real reason why Russia is excluded from our analysis is due to its high rankings and the large values for both imports and FDI, making it insignificant to compare it with other countries taken into consideration.

Based on the ranking model provided by InfoMercatiEsteri, we will construct our model, which will be limited in the number of criteria taking into consideration. This limitation is due to the unavailability of access to a certain data, present in the original InforMercatiEsteri. However,

differently from InfoMercatiEsteri, our model will be more up-to-date. The weights used in the model are those given in the original InfoMercatiEsteri model.

<b>Sub-criteria</b>	<b>Main criteria</b>	<b>Weights</b>	
<i>World imports</i> (WITS)	<b>Trade</b>	0,5	0,5
<i>Italian imports</i> (WITS)			0,5
<i>World FDI average of last two years</i> (WITS)	<b>Investments</b>	0,3	0,4
<i>Ease of doing business</i> (Doing Business)			0,6
<i>Market access</i> (Enabling Trade Report)	<b>Market characteristics</b>	0,2	0,25
<i>Infrastructure</i> (Global Competitiveness Report)			0,25
<i>Average credit risk</i> (SACE )			0,25
<i>Human Development Index</i> (UNDP)			0,25

*Tab.25 – SMART model*  
(author’s elaboration; Source: InfoMercatiEsteri)

The following criteria are taking into consideration: “Trade”, “Investment” and “Market characteristics”. Each of criterion is made up by sub-criteria, as shown above (Tab. 25). The data for “World imports”, “Italian imports” and “World FDI average of last two years” are taken for the period 2015-2016 from World Integrated Trade Solution (WITS), software developed by World Bank. Other sub-criteria are based on the following rankings for the same period:

- “Ease of doing business” – Doing Business report 2015
- “Market access” – Enabling Trade report 2016
- “Infrastructure” – Global Competitiveness report 2015-2016
- “Average credit risk” – SACE country reports 2015
- “Human Development Index” - Human Development Report 2015

Tab. 26 shows the data for each country.

	<i>World imports</i>	<i>Italian imports</i>	<i>World FDI</i>	<i>Ease of doing business</i>	<i>Market access</i>	<i>Infrastructure</i>	<i>Credit risk</i>	<i>Human Development Index</i>
<b>Azerbaijan</b>	9,2	0,59	4,24	64,08	4,3	4,1	73	0,751
<b>Kazakhstan</b>	30,6	1,17	6,84	64,59	4	4,2	69	0,788
<b>Kyrgyzstan</b>	4,068	0,02	0,75	60,74	3,8	2,8	84	0,655
<b>Ukraine</b>	37,5	0,97	1,95	61,52	4,1	4,1	85	0,747

*Tab. 26 – Data (author’s elaboration)*

*(Sources: WITS, World Bank, World Economic Forum, SACE, UNDP)*

### 3.3.2 Rescaling

We need to rescale the data to the values from 0 (to the worst) to 100 (to the best) in order to obtain indirect ranking. To do so we have to use the linear interpolation, following the equation  $y=100*(x - xWorst)/(xBest - xWorst)$ . Tab. 27 show this operation:

	World imports	
Azerbaijan	9,2	15,35
Kazakhstan	30,6	79,36
Kyrgyzstan	4,07	0
Ukraine	37,5	100
<b>xBest</b>	<b>37,5</b>	
<b>xWorst</b>	<b>4,07</b>	
<b>xBest-xWorst</b>	<b>33,43</b>	

Tab. 27 – Linear interpolation for World Imports (author’s elaboration)

	<i>World imports</i>	<i>Italian imports</i>	<i>World FDI</i>	<i>Ease of doing business</i>	<i>Market access</i>	<i>Infrastructure</i>	<i>Credit risk</i>	<i>Human Development Index</i>
<b>Azerbaijan</b>	15,35	49,57	57,31	86,75	100,00	92,86	75,00	72,18
<b>Kazakhstan</b>	79,36	100,00	100,00	100,00	40,00	100,00	100,00	100,00
<b>Kyrgyzstan</b>	0,00	0,00	0,00	0,00	0,00	0,00	6,25	0,00
<b>Ukraine</b>	100,00	82,61	19,70	20,26	60,00	92,86	0,00	69,17

Tab. 28 – Linear interpolation for all sub-criteria (author’s elaboration)

Tab. 28 above provides the rescaling of benefits. Now we focus our attention on those sub-criteria, associated with “Trade”: “World imports” and “Italian imports”. We calculate the aggregate of each sub-criterion by multiplying for each alternative the rankings with the related weights. The results, shown in the following Tab. 29a, make us understand that if we consider

only the one main criterion “Trade”, the preferred option would be Ukraine, since it is the alternative with the highest value.

	<b>World imports</b>	<b>Italian imports</b>	<b>Trade</b>
Azerbaijan	15,35	49,57	<b>32,46</b>
Kazakhstan	79,36	100,00	<b>89,68</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	100,00	82,61	<b>91,3</b>
<i>Weights</i>	<i>0,50</i>	<i>0,50</i>	

*Tab. 29a – “Trade” criterion (author’s elaboration)*

We do the same calculations for other main criteria as well. Tab. 29b shows Kazakhstan as the preferred option for “Investments” criterion, taken into consideration. Meanwhile, if we consider “Market characteristics” only, Azerbaijan ranks the best alternative (Tab. 29c)

	<b>World FDI</b>	<b>Doing business</b>	<b>Investments</b>
Azerbaijan	57,31	86,75	<b>74,97</b>
Kazakhstan	100,00	100,00	<b>100</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	19,70	20,26	<b>20,04</b>
<i>Weights</i>	<i>0,40</i>	<i>0,60</i>	

*Tab. 29b – “Investments” criterion (author’s elaboration)*

	<b>Market access</b>	<b>Infrastructure</b>	<b>SACE risk</b>	<b>HDI</b>	<b>Market characteristics</b>
Azerbaijan	100,00	65,00	68,75	67,13	<b>75,22</b>
Kazakhstan	40,00	70,00	93,75	93,01	<b>74,19</b>
Kyrgyzstan	0,00	0,00	0,00	0,00	<b>0</b>
Ukraine	40,00	65,00	0,00	64,34	<b>42,33</b>
<i>Weights</i>	<i>0,25</i>	<i>0,25</i>	<i>0,25</i>	<i>0,25</i>	

*Tab. 29c – “Market characteristics” criterion (author’s elaboration)*

Next step is to aggregate both “Investments” and “Market characteristics” together in “Market potential”. We apply the following weights: 0,6 for Investments and 0,4 for Market characteristics.

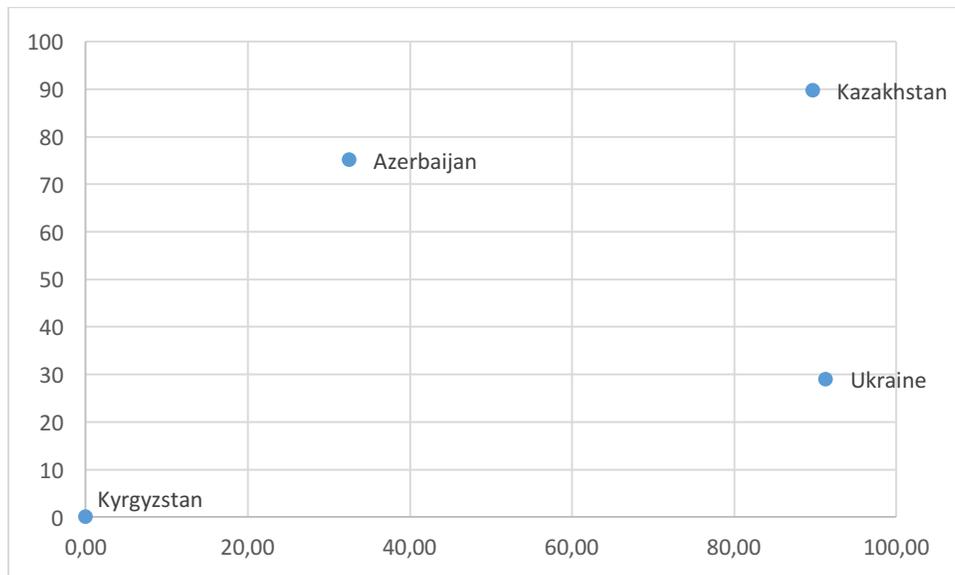
	<b>Investments</b>	<b>Market characteristics</b>	<b>Market potential</b>
Azerbaijan	74,97	75,22	<b>75,07</b>
Kazakhstan	100	74,19	<b>89,68</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	20,04	42,33	<b>28,96</b>
<i>Weights</i>	<i>0,6</i>	<i>0,4</i>	

*Tab. 30 – “Market potential” criterion (author’s elaboration)*

Finally, we compare “Trade” and “Market potential” (Tab. 30). This step is crucial to find the best alternative to be chosen.

	<b>Trade</b>	<b>Market potential</b>	
Azerbaijan	32,46	75,07	<b>53,77</b>
Kazakhstan	89,68	89,68	<b>89,68</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	91,3	28,96	<b>60,13</b>
<i>Weights</i>	<i>0,5</i>	<i>0,5</i>	

*Tab. 30 – Final ranking (author’s elaboration)*



*Fig. 12 – Final ranking (author’s elaboration)*

### 3.3.3 Sensitivity analysis

It is necessary to run the sensitivity analysis in SMART in order to check whether our decision is robust. We run “Goal seeking analysis” in order to find the threshold value, which makes our DM choose another alternative. First, we check the “Trade” criteria. As shown in Tab. 31a, with a weight of “World imports” reduced from **0,5** to **0,46**. This means that also Kazakhstan is a reasonable option, if our DM gives more importance to “Italian imports” criterion, rather than “World imports”.

	World imports	Italian imports	Trade
Azerbaijan	15,35	49,57	<b>32,46</b>
Kazakhstan	79,36	100,00	<b>89,68</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	100,00	82,61	<b>91,3</b>
<i>Weights</i>	<i>0,50</i>	<i>0,50</i>	

	World imports	Italian imports	Trade
Azerbaijan	15,35	49,57	<b>33,92</b>
Kazakhstan	79,36	100,00	<b>90,56</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	100,00	82,61	<b>90,56</b>
<i>Weights</i>	<i>0,46</i>	<i>0,54</i>	

*Tab. 31a – Sensitivity analysis for “Trade” criterion (author’s elaboration)*

Next, let’s try to run the same analysis for “Investments” criterion. We set the difference between “Kazakhstan” and “Azerbaijan” rankings equal to 0, and use the “Goal-seeking analysis” in Excel. However, the value of weights we obtain is unreasonable, meaning that with the ranking we have, no matter the weights, our DM will choose Kazakhstan as the best alternative, because it has the highest score for both criteria. (Tab. 31b).

	World FDI	Doing business	Investments
Azerbaijan	57,31	86,75	<b>74,97</b>
Kazakhstan	100,00	100,00	<b>100</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	19,70	20,26	<b>20,04</b>
<i>Weights</i>	<i>0,40</i>	<i>0,60</i>	

	World FDI	Doing business	Investments
Azerbaijan	57,31	86,75	<b>4315,13</b>
Kazakhstan	100,00	100,00	<b>100</b>
Kyrgyzstan	0,00	0,00	<b>0</b>
Ukraine	19,70	20,26	<b>100</b>
<i>Weights</i>	<i>-143,60</i>	<i>144,60</i>	

Tab. 31b – Sensitivity analysis for “Investments” criterion (author’s elaboration)

Furthermore, we perform “Goal-seeking analysis” for “Market potential”, which is an aggregate of “Investments” and “Market characteristics” criteria. The results obtained in Tab. 31c suggest that for DM to be indifferent between Azerbaijan and Kazakhstan, the weight put on “Investment” criterion should be that small (4%), which is almost irrelevant to take into consideration.

	Investments	Market characteristics	Market potential
Azerbaijan	74,97	75,22	<b>75,07</b>
Kazakhstan	100	74,19	<b>89,68</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	20,04	42,33	<b>6</b>
<i>Weights</i>	<i>0,6</i>	<i>0,4</i>	

	Investments	Market characteristics	Market potential
Azerbaijan	74,97	75,22	<b>75,21</b>
Kazakhstan	100	74,19	<b>75,21</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	20,04	42,33	<b>41,45</b>
<i>Weights</i>	<i>0,04</i>	<i>0,96</i>	

Tab. 31c – Sensitivity analysis for “Market potential” criterion (author’s elaboration)

Finally, let’s check the final ranking we obtained previously. As shown in Tab. 31d, the weights are completely unreasonable, meaning that our DM will stick with Kazakhstan as the best market among CIS countries analyzed. Thus, this is the robust decision and there is no acceptable weights change to alter the ranking.

	Trade	Market potential	
Azerbaijan	32,46	75,07	<b>53,77</b>
Kazakhstan	89,68	89,68	<b>89,68</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	91,3	28,96	<b>60,13</b>
<i>Weights</i>	<i>0,5</i>	<i>0,5</i>	

	Trade	Market potential	
Azerbaijan	32,46	75,07	<b>89,67</b>
Kazakhstan	89,68	89,68	<b>89,67</b>
Kyrgyzstan	0	0	<b>0</b>
Ukraine	91,30	28,96	<b>7,59</b>
<i>Weights</i>	<i>-0,34</i>	<i>1,34</i>	

Tab. 31d – Sensitivity analysis for “Trade” and “Market potential” criteria (author’s elaboration)

### 3.4. Results

The effectiveness of implementing the MCDA techniques to the market selection process was demonstrated in this chapter. Taking into account different criteria, it is possible to determine the attractiveness of CIS countries for international expansion of Italian furniture SMEs. Based on the judgements of a DM, we obtain the preference ranking of potential markets analyzed.

From firm's point of view, the criteria to be taken in consideration were identified based on the interview with the CEO and export manager of an Italian furniture firm. Russia was found to be the most attractive market for entry among three markets analyzed. After running sensitivity analysis, the final ranking based on DM's judgements was insensitive to the value variation, thus reflecting the robustness of the decision. However, the result was different when the final ranking was based on another DM's judgements on main criteria. Instead of Russia, Azerbaijan became the preferred option for market entry.

From government's point of view, we created a decision making model, which allows identifying the most attractive market for Italian SMEs, based on the official data available. The SMART rankings were sensitive to the change of value in sub-criteria's weights, however, the final ranking based on the aggregate of sub-criteria was robust. Overall, Kazakhstan became the preferred option for DM, once Russia was left out from the analysis.

The limitations of both models lie in the fact that they are based on the official rankings, taken from different reports, which can encompass same criteria, thus creating redundancy in the rankings. Another limitation is the difficulty in obtaining the access to more detailed data on the markets. Finally, in our analysis we focused only on external factors, affecting market selection problem. Thus, the models created only partially reflect the decision making process of a firm and the public agencies. It would be possible to have obtained different rankings, if a different set of criteria was used.



## CONCLUSION

Italian furniture SMEs, willing to export overseas, have to identify the potential markets for international expansion. Russia and CIS countries present an attractive destination for Italian furniture exports thanks to the great appreciation of “Made in Italy” by local consumers. For this reason, Italian firms continue to search opportunities to enter the CIS markets. However, market selection process is not an easy task. Especially, dealing with emerging markets, the limited access to the adequate market information presents a major difficulty in taking strategic decisions about market entry for SMEs.

In this dissertation, we aimed to analyze the decision making in the market selection process from two points of view: firm and government. Through the application of MCDA techniques, the model provides a useful framework for both firm and public actors. However, we take into consideration only external factors, affecting market selection process. One of the major difficulties encountered during this analysis was limited access to the furniture market-specific data. Thus, the analysis reflects only partially the true picture of market selection of Italian furniture SMEs.

Furthermore, the model shows the importance of DM’s judgements and how the change in DM’s judgements alter the ranking. It has to be emphasized that the results obtained strongly depend on the data and criteria we used. The decision-making process can be improved by encompassing more external and internal variables and more detailed data into analysis.

The recommendation for future work would be to apply the following analysis to the greater number of countries in order to identify the most promising markets. We hope that the Italian government will update the InfoMercatiEsteri tool, which can be of great use for Italian SMEs as a way to increase their awareness about the opportunities present abroad and facilitate the market selection process.

Finally, given personal work experience in the furniture sector, my opinion is that the applied methods can provide to Italian SMEs an easy tool to support their strategic decision making process. These methods don't require extensive knowledge on MCDA and use of a particular expensive software. Thus, SMEs bounded by budget constraints, personal limitations of their managers and lack of experience in the international arena, can easily implement these techniques. The most important aspect of the analysis is the DM's preferences and judgements. Thus, firms operating in mass market production and those involved in luxury segment can adjust the model, according to their preferences and objectives. Moreover, both AHP and SMART can be applied in the process of entry mode selection and other foreign market expansion decisions. Thus, the MCDA is a good tool for supporting strategic decision making for managers, dealing with multile aspects of unpredictable business environment.

## APPENDIX

In this appendix, questions asked during the interview with the CEO and the export manager of the company, operating in the furniture sector, are reported.

### **Firm's Background**

1. What is the name and title of the respondent?
2. When the firm was established and by whom?
3. How many employees are currently employed at the firm?
4. What is the firm's total turnover?
5. What is the core business of the firm?
6. What products does the firm offer?
7. How much of the total sales does the firm export (in percentage)?

### **Firm's Internationalization Experiences**

8. For how long has the firm been exporting?
9. Why did the firm begin to export?
10. How did the firm begin its exporting activities?
11. Which were the first countries where the firm exported?
12. To which countries does the firm export nowadays?
13. Does the firm aim to extend its exporting markets in the future?
14. Does the motives for exporting have changed over time and why?
15. Which motives are the most important ones in the process of selecting export markets and entry modes?

### **Firm's Internationalization**

16. Which external factors have influenced the export market selection?
17. Which internal factors have influenced the export market selection?
18. What type of entry mode has the firm utilized: Direct export vs Indirect export
19. Which external factors have influenced the firm's choice of entry modes and how?

20. Which internal factors have influenced the company's choice of entry modes and how?

21. What risks do the firm perceive as the largest in the process of the export market selection?

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