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## Export networking challenges and opportunities for manufacturing firms from developing countries

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PART I

INTRODUCTION



# Chapter 1

## Introduction and Problem Definition

### 1.1 Introduction

International trade is important for developing countries as it can create employment and provide foreign exchange for imports. While trade between nations has been an economic activity pursued in the world since ancient times, it experienced rapid global growth only after the end of the Second World War due to a number of factors. These factors are the establishment of the International Monetary Fund; the construction of the world trading system; the economic growth experienced by many countries; and the significant developments in transportation, communication, and information technology. More recently, the establishment of the World Trade Organisation has increasingly influenced international trade activities.

Economists explain the engagement of nations in international trade by several theories; the most frequently one cited being the theory of comparative advantage (Ricardo, 1817). According to this theory, a country exports those products that it can produce relatively inexpensively and imports those goods that it can produce only at a relatively higher expense. However, this theory, although important for economic policy purpose, does not explain why some individual firms are successful in exporting while others fail. Stiglitz (1991) stressed the importance of firm level studies and criticised economists for restricting their views to market mechanisms.

In the last decades, however, many scholars have adopted a company perspective of international trade by attempting to investigate the forces inhibiting the firms to initiate, develop or sustain export operations. A large number of empirical studies, investigating a variety of issues pertaining to export marketing activities, have been conducted with particular empirical attention being given to the problems that companies experience in their exporting activities (Burgess and Oldenboom, 1997; Moini, 1995; Kaleka and Katsikeas, 1995; Katsikeas and Morgan, 1994; and Ghauri and Herbern, 1994). The focus of these studies is not on macroeconomic policy but on barriers, real and perceived by the individual companies. Undoubtedly, the empirical findings of this kind are critical for decision-makers at the micro level, since they can provide strategic guidelines for the development of effective export plans. Furthermore, such findings constitute a source of valuable information for public policy makers in their attempt to design and implement optimal national export policies.

Micro level studies are important for developing countries in particular because most of the policies in these countries do not stem from the firm level export problems. Policy makers often lack the institutional environment in order to be able to assess the state of the art of manufacturing firms in their countries while firms have no organisation that may defend their interest. Consequently, many companies in developing countries still hesitate to enter foreign markets, and those already engaged in international activities face serious problems in their future progression along the internationalisation path. Currently footwear and textile manufacturing firms in Eritrea are facing this problem.

Eritrea<sup>1</sup> developed a good export capacity in the first half of the twentieth-century during the Italian colonisation. According to the records of the Ministry of Trade and Industry, Eritrea exported manufactured products such as textiles, footwear, as well as fish to the Middle East, Europe and Africa. Adequate communication facilities such as railway, air and road transport were available. Italian investors were the main players in the export business. With the coming of the Ethiopian administration and particularly under the socialist government of Ethiopia in the 1980s, a new export approach prevailed. All exports were channelled and marketed by the parastatal, Ethiopia Import Export Corporation (ETIMEX) responsible for negotiating export prices with foreign buyers. During this time manufacturing firms in Eritrea limited their activities only to production. Furthermore, in fear of the expropriation policy of the socialist government directed at those firms that generate foreign currency, privately owned manufacturing firms were forced to focus on the domestic market. The centralised system of export policy together with thirty years of war for independence alienated the footwear and textile-manufacturing firms in Eritrea from the international market. This resulted in a weak marketing knowledge and poor financial capacity of the entrepreneurs. The companies lost their export infrastructure and long accumulated experience.

Following the attainment of full independence on 24 May 1993, marketing of exports has been liberalised and manufacturing firms once again are developing strategies to sell their products in the international market. However, exporting has not been easy to them and only a limited number of the manufacturers managed to participate in the international market. The poor participation was reflected, in a problem assessment survey conducted in 1998 by the Ministry of Trade and Industry of Eritrea. Out of 242 respondents 96(39.7%) small and 112(46.3%) large enterprises reported that lack of adequate and reliable export markets was the major problem they encountered (MIT, 1998). Next to the market problem, lack of modern machinery and equipment and lack of good quality raw material were mentioned as serious problems. In order to get adequate first hand information on the export marketing problems of the footwear and textile-manufacturing firms in Eritrea, the researcher conducted a base line study in April and May 1999. During the interview the managers of these firms mentioned lack of market knowledge and information, limited financial resources to finance exports and to conduct market research, and lack of experienced personnel in international marketing as problems that constrain their entry to the international market.

Although most of the export problems of the footwear and textile-manufacturing firms in Eritrea are similar to the problems that other developing countries experience some of them are unique to Eritrea. Before the war between Ethiopia and Eritrea in 1998, the footwear and textile-manufacturing firms were selling about 70 percent of their production to Ethiopia. This market opportunity, however, has been lost and the firms have to find another market. Despite the fact that many of the footwear and textile-manufacturing firms in Eritrea have a long business experience only a few are successful in accessing new export markets. Barriers to export often provoke failures in foreign business operations. However, little has been done to investigate these export problems of individual firms in developing countries. In particular, studies that focus on the organisation of the export marketing channel are useful to the footwear and textile-manufacturing firms in Eritrea as they are looking for an economic export organisation that helps them to increase their export capability.

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<sup>1</sup> Eritrea is a country located in East Africa. It was an Italian colony (1885-1941) and under a British protectorate (1941-1952). Eritrea federated with Ethiopia (1952-1961). In 1961 the struggle for independence started. Ethiopia annexed Eritrea in 1962. In 1991 Eritrea gained independence, which was formalised through a referendum in 1993.

Exporting today is a highly skilled and professional operation. To be successful in this field requires an adequate and cost-effective marketing organisation. The type of export marketing organisation that firms choose to distribute their product to their customers has an impact on the final result of each transaction, not to mention the firms' overall survival. In view of this argument, it is the objective of this study to investigate the specific export problems associated with the footwear and textile-manufacturing firms in Eritrea, examine and understand the requirements of potential buyers in target export markets and design an export marketing network that increases their export capability.

## **1.2 The Research problem in perspective**

Export transactions could be organised through three types of governance structures. These are Markets, Networks and Hierarchies (Thorelli, 1986; Thomson et al., 1991). Market forms of transaction governance rely on prices, competition and contracts to keep all parties in an exchange informed of their rights and responsibilities (Williamson, 1975). In a pure market form of economic organisation, all activity is conducted as a set of discrete, market based transactions and virtually all-necessary information is contained in the price of the product that is exchanged. However, in real world practice, the price established in the competitive marketplace does not contain all the information necessary for both parties to conclude the exchange. Markets fail due to asymmetric information about product quality and problems arising from imperfect information. As a result, though they provide a useful starting point for theoretical analysis, pure market transactions are rare.

If the transaction takes place in a hierarchy, the firm is expected to organise the export operation (Williamson, 1985). Multiple layers of management, functional specialisation, integrated operations, and clear distinctions between line and staff functions characterise hierarchy (Webster and Frederic, 1992). The larger the firm, the more activities it could undertake by itself and the less it depend on contracting out. Governance through hierarchy is the result of high transaction cost involved in exchanges through markets.

In the international footwear and textile market to conduct a sound transaction, buyer and seller have to go through certain stages. These stages are identifying the fashion trend, producing a sample design, making the sample and finally exhibiting the sample to see how customers react to it. It is only after this long process that a market demand is identified and the wholesalers can put the order to the manufacturer. Each order is different and the footwear and textile produced is not standardised. This makes continuous flows of information between manufacturers and buyers critical. To expedite this process history of past business relationships and trust are essential. When these factors are absent information exchange precedes real business transaction. Thus, the international footwear and textile business takes place in a network setting where different business actors are linked to one other through direct and indirect business relationships deviating from the pure market transaction where price and quantity mediate buyer seller relations.

However, it is worthwhile noting that networks also have some characteristics of markets and hierarchies. While maintaining the benefits of hierarchy and market governance structures, networks also fail because of similar transaction hazards that lead to the failure of markets and hierarchies (Park, 1996).

Networks are regarded as an especially significant strategy for managing long-term exchange relationships between firms. They combine autonomy and flexibility with increasing control

and efficiency (Johanson and Mattsson, 1988; Lorange and Roos, 1992). Networks emphasise the importance of partnerships between firms and depend on relationship management instead of market transactions (Webster and Frederic, 1992). They depend on negotiation, rather than market based processes, as principal bases for conducting business and determining prices, though market forces almost always influence and shape negotiations. Chetty and Holm (2000) noted that managers should realise that establishing and maintaining relationships in business networks is an important part of their international strategy. Consistent with this argument Gray (1994) in his study of New Zealand firms concluded that one of the greatest perceived barriers to internationalisation is a lack of business networks.

Easton (1992) identifies three groups of network definitions. One set of definitions (e.g. Hakansson, 1989; Van de Ven and Ferry, 1980) describes a network as a total pattern of relationships within a group of organisations that recognise that the best way to achieve common goals is to co-ordinate the business system in an adaptive fashion. Ghauri and Prasad (1995) claimed that a network could simply be identified as a relationship created between two organisations. According to Ghauri and Prasad (1995) if firm A has a relationships with firm B, B with C, C with D and so on, there is a simple linear chain of connection. However, a complex network relationships can be found if firm C is linked to A, and firm D is linked to B and perhaps to A. The second set of definitions identified by Easton focuses on the bond or social relationships that link loosely connected organisations (Aldrich, 1979; Lundgren, 1995). The third definition focuses on the exchange dimensions in two or more connected organisations (Anderson et al. 1994; Cook and Emerson, 1978).

Each of these groups of definitions implies a different level of analysis. The first definition focuses on the overall relationships between business organisations. It includes both the exchange and social relationships dimensions in the inter-organizational relationships. Trotter (1999, p.1) defines a social network as “a specific type of relation linking a defined set of people, organisations or communities.” The second definition may include loose organisations such as social gatherings between employees of two organisations, not necessarily linked with business transactions in the two organisations. This can also include soft co-operation whereby groups of firms are involved in the exchange of ideas and the development of broad initiatives such as training programmes and capability brochures. In contrast the third definition focuses solely on the exchange relationships.

The first definition is relevant because in our study the term network refers to both the social and exchange relationships. We included the social aspect of the business relationships into our study because it is a key factor that facilitates the network formation among footwear manufacturers, textile manufacturers, leather and cotton suppliers and buyers. For our purpose, the term network is defined as:

*A total pattern of relationships among the footwear (textile) manufacturers, leather (cotton) suppliers in Eritrea, and agents and buyers in the international footwear (textile) export markets, who recognise that a network is the best way to solve common export problems, exploit export market opportunities and achieve common export objectives.*

Networks are characterised by vertical or horizontal patterns of exchange, interdependent flows of resources and reciprocal flows of information (Ibarra, 1992). Horizontal networks include organisations in the same industry. Their main purpose is to co-ordinate their skill, resources and functions that contribute to the production and marketing of a certain product. Horizontal networks can improve the collective bargaining power of manufacturers in relation

to their vertical partners (Cook and Emerson, 1984). Vertical networks include organisations at different levels of the marketing channel (Elg and Johansson, 1996). Vertical networks offer a new marketing opportunity by making alternative buyers accessible to the firm. The related firms need to coordinate their activities by exchanging information about the quantities and qualities of leather, cotton, footwear and textiles, the prices set, the nature and reliability of suppliers and buyers, and about the changes in such products as they undergo improvement and technical innovation. However, not all vertical networks foster economic growth (Lall, 1980). Some networks may well reflect the unequal market power of buyers vis-à-vis sellers; others may be the result of misguided government policy and socially detrimental (though privately profitable); yet others may embody collusive anti-competitive behaviour (Ibid). Thus, only an understanding of their causes and detailed case-by-case study analysis can show the net effect of networks in different circumstances.

The network approach has been adopted as export marketing strategy for gaining access to new markets (Christensen, 1991; Forsgren et al., 1992; Hakansson, 1989). Major concerns focus on overcoming entry barriers by forming groups of firms or getting access to new markets by establishing network relationships with actors in the marketing channel. Network programmes have been initiated to overcome the liabilities of being small by joining forces in constellations of firms as a point of departure for growth, product development and exporting (Gelsing and Knop, 1990). Most of the programmes were perceived as very positive because of the degree of market penetration they have achieved and the advanced learning opportunities that they provided. Visser (1996) showed that small textile firms in Peru were able to transform themselves into big exporting companies through networking. Scarce resources have been allocated efficiently to all members and this resulted in a competitive advantage to network members through reduced transaction costs and ultimately lower prices to the customer. Ceglie and Dini (1999) explained that footwear manufacturers in the Sinos Valley (Brazil) created horizontal and vertical business networks and managed to penetrate the US footwear market. Thus, the results from network experience of small firms in developing countries justify the move to consider networks as a mechanism to alleviate the export marketing problems of footwear and textile manufacturing firms in Eritrea.

The need for new markets encouraged the Eritrean footwear and textile manufacturers to assess new opportunities. Eritrean footwear and textile producers started to travel to the Great Lakes region (in Africa), South Africa and Europe to exhibit their products. However, individual efforts have not been successful. The reasons mentioned by manufacturers in Eritrea were: insufficient knowledge about the market, difficulty in finding reliable buyers on an ongoing basis, financial constraints to finance exports (only overdraft facilities are available) and operating space constraints hindering expansion. The poor marketing knowledge and limited financial capability of the footwear and textile-manufacturing firms do not allow them to contact, contract and control on an individual basis. The cost of travelling to foreign markets is high, their poor experience in export marketing may make them susceptible to the opportunistic behaviour of some importers, and they need partners to fulfil large orders.

The upshot of the above mentioned argument is that the Eritrean manufacturers need buyers that are committed to working with them to produce footwear and textiles suitable to the target export market and provide a reliable channel of distribution. Particularly they need market information related to product quality, design, and price. These factors are important to the manufacturers to evaluate their product standards and take the necessary corrective action to achieve the desired level. Business network relationship with a committed buyer can enable the footwear and textile-manufacturing firms to secure the distribution of their products to the target market, and



ultimately build their export capability. In general the problem is about organising a competitive and sustainable export-marketing network that delivers value to the customer.

It has been argued so far that neither pure market nor pure hierarchy exchange governance approaches are appropriate to footwear and textile manufacturing firms in Eritrea. When there are transaction costs a simple market mechanism is not appropriate to facilitate exchange. This makes a different transaction co-ordination mechanism necessary. It has been also said that vertical and horizontal business network relationships can open new market opportunities to the footwear and textile manufacturers in Eritrea and improve value to the customer through reduced transaction costs and improved product quality. The continuous flow of information in the networks facilitates the enforcement of contract and helps to curbe misunderstandings between the contracting parties. These are also the factors that influence the development of export capability and market representation of manufacturing firms in developing countries. Therefore the central theme of this study is:

*Horizontal and vertical business network relationships can alleviate export-marketing problems and increase the export capability of small and medium sized manufacturing firms in developing countries.*

The key issue is to identify what kind of vertical and horizontal business network relationships are appropriate for the Eritrean manufacturing firms. What types of network structures exist in the export markets and how they are managed. And finally it is also essential to make sure whether the conditions required for creating successful vertical network relationships among suppliers, manufacturers and customers and horizontal network relationships between manufacturers are fulfilled. If that is the case it is important to see the ways of organizing it. Different problems demand different networks: some problems require a relatively stable and closed network while others need a more open network with very flexible internal relations. In view of the above, the following central research problem emerges for investigation:

*How can footwear and textile manufacturing firms in Eritrea enter into horizontal and vertical business network relationships and increase their export capability?*

The argument behind the central research problem mentioned above is that the international footwear and textile market is full of network relationships. The network theory helps to design such relationships. However, the network research has its own pitfalls, as it has been mainly limited to analysing and understanding existing networks structures. Being empirically rich the network theory lacks the ability to provide normative implications for managerial actions (Belenker et al., 1997). Consequently, it lacks norms that predict network structures as optimal governance form for a specific exchange process. This research intends to contribute to the efforts that have been undertaken to fill this gap. Our line of reasoning is consistent with Salancik's (1995) argument that network research should propose how network structures of interaction enable the network's members to co-ordinate their actions to achieve collective and individual interests.

In our central research problem the term good export capability is defined as, access to updated market information; capacity to produce export standard product; good knowledge of export procedures; international business practices and government regulations; and access to export support services. The aforementioned factors must lead to fulfilling buyer requirements. The term manufacturing firms' refers to the footwear and textile-manufacturing

firms in Eritrea. By suppliers we mean the leather and cotton producers in Eritrea. The term buyer refers to footwear and textile buying organisations, wholesalers and retailers in Europe and the Great Lakes region. Buying organisations are co-operative marketing organisations that represent small textile and footwear retailers. They are often established as a share company or an association. Their purpose is to buy textiles and footwear for their members. Studying both footwear and textile buyers and manufacturers together will help us to have a good understanding about the networking opportunities from both buyer and seller perspective.

### **1.3 Research sub-questions**

The main research problem has been divided into five research sub-questions:

#### 1. What are the export problems of manufacturing firms in developing countries?

In chapter two a literature review will be made to make an inventory of the export problems of manufacturing firms in developing countries. The answer to this research sub-question is used to develop a classification of export marketing problems of manufacturing firms in developing countries. The export problems will be an input to develop a semi-structured questionnaire for the empirical study in Eritrea.

#### 2. How are networks used to alleviate the export problems of manufacturing firms in developing countries?

In chapter three we will conduct a literature review to make an inventory of the experiences of the manufacturing firms in developing countries with networks. The lessons from the business network relationships in developing countries are useful to frame the possible network solutions for the export problems of the footwear and textile-manufacturing firms in Eritrea.

#### 3. What are the specific export problems of the footwear and textile-manufacturing firms in Eritrea?

This research sub-question examines the export problems that are common to footwear and textile manufacturing firms in Eritrea. Knowledge of the export problems in Eritrea helps us to suggest relevant business network solutions. Extensive interviews of the manufacturing firms in Eritrea will provide the information.

#### 4. What are the prevailing network structures and requirements of the Netherlands' and Ugandan footwear and textile export markets?

Examination of the business network structures in the two potential export markets helps us to understand the requirements that the footwear and textile manufacturing firms in Eritrea have to fulfil to do business in the two export markets. Traders in both markets will be interviewed to collect the information.

#### 5. How can the footwear and textile-manufacturing firms in Eritrea enter into a vertical and horizontal business network relationships and increase their export capability?

The answers to the first four research sub-questions will show us how the footwear and textile-manufacturing firms in Eritrea can enter into a business network relationship and

increase their export capability. This information will be used to answer the central research question and results in a design of business network relationships.

Table 1.1 Sources to answer the research sub-questions

Research sub-question	Sources to answer the sub-questions	Relevant chapter
Sub-question no. 1	Literature review	Chapter 2
Sub-question no. 2	Literature review	Chapter 3
Sub-question no. 3	Empirical study	Chapter 6,7
Sub-question no. 4	Empirical study	Chapter 8, 9
Sub-question no. 5	Empirical study	Chapter 10,11

The aforementioned five research questions set the parameters of the research project and determine the methods to be used for data gathering and analysis. Table 1.1 shows the data sources to answer the five research sub-questions.

### ***Why footwear and textile manufacturing firms?***

Almost all manufacturing firms in Eritrea experience the export problems discussed above. However, only the footwear and textile-manufacturing firms are chosen for this study. The main reason is that there is potential to increase exports in the two industries because of the existing idle capacity and a potential to develop bovine hide and cotton production. Eritrea also has access to a potentially abundant pool of raw materials in the region, namely Uganda, Ethiopia and Sudan. The long experience in manufacturing footwear and textiles can be seen as an important resource for further development of the industry.

The footwear and textile-manufacturing firms in Eritrea are found in the capital, the city of Asmara. Although the importance of proximity is debatable in the era of globalisation, it is still important for networking since it reduces transaction and learning costs not only because of physical closeness, but also because of the homogeneity of the participants' social background, which facilitates trust. What lies behind this idea is the need to establish trust and penalise opportunism in a network of business relationships through a corresponding network of social relationships and geographical proximity. Geographical proximity between network members facilitates the personal contact between the parties in the relationships, which is critical to develop trust among them.

### ***Why the Ugandan and Netherlands footwear and textile export markets?***

During the baseline study conducted in April-May 1999, the researcher came to know that two principal export markets, Europe and Great Lakes region (Africa) were valued more by manufacturers. Furthermore, a London based consulting firm, Manderstam International Group Ltd. conducted a Techno-Economic Feasibility study of the leather industry in Eritrea in 1997 and has identified these two markets as alternative target export markets for the footwear manufacturers in Eritrea. Jabati (1996) also suggested that the Great Lakes region is a potential market for Eritrean footwear manufacturers. Eritrea has cultural and historical links with Italy, one of the leading footwear manufacturing firms in the world. It also has cultural and historical links with the UK again one of the leading footwear and textile markets. The central geographical location to Europe is another reason why Europe is important to Eritrea. Eritrea also has geographical and cultural proximity to the East African and Great Lakes market. However, as the European and the Great Lakes region footwear and textile export markets have different market structures, they require a radically different

marketing approach. The difference in market structures makes comparison between the two markets interesting.

## **1.4 Outline of this thesis**

This thesis has twelve chapters. The first chapter introduces the reader to the main research problem, and research sub-questions. Chapter two gives an overview of the current state of conceptual knowledge on export barriers to manufacturing firms from developing countries. This chapter concludes with a classification of the major export problems: barriers associated with the company, industry, market and macro environment. Chapter three reviews the current state of practical knowledge on measures undertaken by firms and governments in developing countries to encounter the export marketing problems of manufacturing firms. It compiles and synthesises the empirical results contained in the relevant studies, and draws lessons to the footwear-and textile-manufacturing firms in Eritrea. Chapter four reviews four theories of inter-organisational co-operation that are useful to conceptualise the experiences reviewed in chapter two and three and ultimately to construct a theoretical framework for the empirical research. Chapter five has two Sections: the first Section builds a research framework that represents the relationships between the concepts and theories reviewed in the previous chapters. It draws a schematic diagram of the research framework so that the reader can visualise the theorised relationships. Section two addresses the overall research strategy, data collection, and data analysis. It identifies the appropriate research strategy to answer our main research problem. It also describes how we select the site, cases, and the method of data collection. Eventually, we portray how we analyse the data.

In chapter six and chapter seven we identify the requirements that the footwear and textile manufacturers in Eritrea have to fulfil to do business with wholesalers, buying organisations and retailers in the Netherlands, and Uganda. In chapter eight we conduct a preliminary study to identify the export problems that are important and difficult to solve for the footwear and textile manufacturers in Eritrea.

Chapter nine conducts an in-depth study on selected cases to examine further the export problems that are regarded as important (see chapter eight). This chapter also verifies whether there are networking opportunities with footwear and textile buyers in the Netherlands and Uganda. Chapter ten conducts a comparative study between the Netherlands and the Ugandan footwear and textile export markets. It identifies the factors that influence the entry strategy to the two export markets. Chapter eleven, designs horizontal business network relationships among the footwear and textile manufacturers in Eritrea. Moreover, it portrays vertical business network relationships between the leather and cotton suppliers and footwear and textile manufacturers in Eritrea, and between footwear and textile manufacturers in Eritrea and footwear and textile buyers in the Netherlands and Uganda. Finally, in chapter twelve we draw our conclusions and forward relevant recommendations.

