

EXPORT PROMOTION FOR SMALL AND MEDIUM SIZED
ENTERPRISES IN ERITREA WITH FOCUS ON INFORMATION
PROVISION, FINANCING AND NETWORK OF MAIN ACTORS.

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**Submitted in partial fulfilment of the requirements for the degree
of**

MASTER OF BUSINESS ADMINISTRATION

**The Graduate School of Business
Faculty of Management
University of KwaZulu Natal, Durban**

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February 2005

DECLARATION

I hereby declare that the work presented in this study is original and it has not been previously accepted for any degree or is not being currently submitted in candidature for any degree. Where material from different sources has been used due acknowledgement is made.

Biniam Teclezion

ACKNOWLEDGEMENT

A word of thanks to all the following people and others who made it possible for me to write this study paper is necessary.

I'm very grateful to Prof. Elza Thomson my supervisor for her extensive comments, overall guidance, patience, and interest with which she helped me throughout. She made it possible for me to continue my dissertation through online contact.

I would like to thank Mr. Bill Harrison Head of the Graduate School of Business (GSB) and all the staff members of GSB for their prompt assistance throughout the two years of my MBA study.

I'm indebted to the Human Resource Development and Management (HRD&M) of the University of Asmara of the State of Eritrea and Mrs. Lula Ghebreyesus from AIPA for their great effort in processing and financing every needs of my scholarship.

I would also like to thank Mr. Solomon Tesfamariam, Mr. Abdullah, Eng. Abraham Kubrom, Mr. Michael and Mr. Berhane Araya for providing me the necessary information needed for the research. Mr. Solomon helped me in facilitating this work and providing comments and suggestions throughout.

The following people also deserve recognition for their support and encouragement in my study. My brother Kubrom from WFP, Mr. Yemane, Mr. Michael, Mrs. Birikti, Mr. Tadesse, Mr. Ashebir, Mr. Berhane, and others all from the Ministry of Trade and Industry.

ABSTRACT

The aim of this study was to evaluate the export promotion services of Eritrea according to the theories presented in chapter two and come up with recommendation suitable to the Eritrean case. It was found that national export promotion policies would not provide any benefits or lead to increased exports if they are not supported by export promotion policies and programmes at the industrial and enterprise level. Although the Eritrea's national economic policy states 'it is aimed for export-oriented growth', nothing has been done to upgrade the competitiveness of SMEs or increase their exports. The main reason is the unavailability of the export promotion programmes and policies at the industrial and enterprise level.

The elements of export promotion services include information provision and export finance assistance. Export information is crucial to the growth of exports of SMEs. Export finance is aimed at providing the financial and insurance needs of exporting firms. The main goals of Export Promotion are to contribute to overall economic improvement of a country, and the subsequent increase for the standard of living of the population. This is achieved through increased export of the country's products.

SMEs in Eritrea are facing many interrelated problems. Given their great contribution to the economy and the opportunities available in the world market, motivating them through export promotion and other services could be the best way to make them competitive. In this regard the following three points are recommended as the best ways of enhancing the competitiveness of SMEs.

First the Ministry of Trade and Industry (MTI) should have to have a general policy framework as well as programs specifically designed for SMEs development, which could serve as a general framework and a reference for policies and development efforts targeting SMEs. Second the MTI should establish and implement a strategy for SMEs export promotion aimed at increasing the SMEs export through the provision of necessary services. Finally firms themselves should also develop more responsive and proactive management, skilled labour, advanced equipment, and efficient production and marketing plans in order to withstand competition at home and abroad.

LIST OF ACRONYMS

- AGOA: Africa Growth and Opportunity Act
COMESA: Common Market for Eastern and Southern Africa
DOI: Department of Industry
DOT: Department of Trade
ECA: Export Credit Agency
ECG: Export Credit Guarantee
ECIC: Export Credit Insurance Corporation
EDIB: Eritrea Development and Investment Bank
EEDPC: Eritrea Export Promotion and Development Centre
EPO: Export Promotion Organisation
EPP: Export Promotion Programs
ETIMEX: Ethiopian Import Export Corporation
EXIM: Export Import Bank
GOE: Government of Eritrea
ITC: International Trade Center
MNC: Multi National Companies
MSME: Micro, Small and Medium Enterprises
MTI: Ministry of Trade and Industry
PEST: Political, Economic, Socio-cultural, and Technological analysis
PTA: Preferential Trade Association
SME: Small and Medium Enterprises
TPO: Trade Promotion Organisation
TSI: Trade Support Institution
UNIDO: United Nations Industrial Development organisation
VSE: Very Small Enterprises

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CHAPTER ONE: INTRODUCTION

1.1. Introduction

Today, globalisation and the acceleration of technological change and innovation are creating opportunities for Small and Medium sized Enterprises (SMEs) to enter foreign markets and to reduce business costs. But there are also transition costs, new competitive challenges and risks affecting these SMEs. These threats coupled with the inherent problems of small firms are becoming a challenge to today's SMEs.

The export potential of SMEs has also been a growing subject of interest. Hence, Governments export promotion programs have changed their focus on SMEs rather than on large enterprises. This is mainly because of the increasing role those SMEs are playing in the economy. Studies on the link between export promotion and economic growth show that export-promoting policies can lead to an increase in both welfare and growth rates.

This study focuses on the creation and improvement of Export Promotion Policies for SMEs in Eritrea. The key elements of the Export Promotion Program such as export financing, information provision, and networking constitute the body of the study, as their absence are the stumbling blocks for export oriented SMEs. This research proposal has identified the background information and statement of the research problem. Due to lack of previous empirical research in Eritrea, relevant information on the present situation of Eritrean SMEs is not available. Thus, the research will employ the case study method in answering the research questions and in providing conclusion and recommendation on how Eritrean export promotion program could be initiated and improved so that exports could be boosted. Although more weight is given to qualitative methods, quantitative research will also be used in order to increase the credibility of the findings that will be driven from the research.

With all its limitations it is expected that the research will assist the Ministry of Trade & Industry (MTI) and other public and private organisations to clearly understand the situation of SMEs and come up with better policy for SME support in the field of exporting.

1.2. Background Information

Globalisation and the impact of rapid advances in technologies are presenting new opportunities and new challenges to all countries, regions, societies, citizens and their business enterprises. Subject to this globalisation effects are small and medium sized enterprises (SMEs) whose contributions to economic growth in different countries is not on comparable parameters. There is a growing worldwide recognition that SMEs have an important role to play in the present context given their greater resource use efficiency, capacity for employment generation, technological innovation, promoting inter sectoral linkages, raising exports and developing entrepreneurial skills. However, the needs of small and medium enterprises (SMEs) are more severe, their problems in many ways are complex and their potential contribution to the economic development is far more substantial. The future of SMEs therefore is a major policy concern given their strategic importance in shaping the industrial sector.

As Wright and Rick (1994) have discussed in their international business studies, the trend toward economic globalisation offers exporting opportunities not only to large multinational firms but also to the thousands of small companies that continue to focus primarily on the domestic market. However, the export process of internationalisation of SMEs involves several steps that require different degrees of commitment of resources, which small firms by their nature cannot afford to possess.

Many business researches and government export studies explain that there are several barriers and difficulties for SMEs in the process of internationalisation. The internal barriers in small firms such as limited resources, difficulty in acquiring information, lack of managerial experience with exporting, and weak formal planning systems restrict their interest in and frustrate their efforts at internationalising (Karagozoglu and Lindell, 1998). Moreover, small firms that lack the depth of resources and experience available to large multinational corporations see exporting as risky (Burpitt and Rondinelli, 2000). In addition, tariff and non-tariff barriers are also some of the external barriers hampering the exports of SMEs. Furthermore, these barriers and difficulties increase as several other requirements arise in the export process. For instance, technical requirements such as customs paperwork, contractual agreements with potential counterparts, etc. will confront the venturing companies.

These and other issues are certainly challenging SMEs in competing globally. Therefore, either they should adjust and respond to external competitive threats and opportunities or conduct business as usual in their domestic market and face the inevitability of diminishing sales and profits.

It is important to mention that the SMEs are a major feature of the economic landscape of all developing countries today. Many third world countries have recognized the contribution of these enterprises to the creation of jobs and to the alleviation of poverty. If these enterprises are left to compete without any support, in this era of fast technological development and globalisation period, the comprehensive situation of the country could be jeopardized. Besides, it is clear that without any governmental support these SMEs will not be able to take advantage of emerging international commercial opportunities and their general performance will certainly deteriorate.

As a result, most governments in developing countries recognise the role of SMEs to their economy and are providing different types of assistance and incentives to SMEs not only for their local but also international development attempts. Thus, many authors argue that SMEs through their national governments should find an answer for their internationalisation attempts. This is done in the form of Export Promotion and Development Programs.

From the above analysis it is evident that there is a need for the provision of business support services with a special focus on the internationalisation of SMEs. In addition, it is noteworthy that any type of support must always match with the reality and needs of SMEs. Thus, the need of coherent and comprehensive support is required. For that reason, the question of how to create the support for export promotion and how to improve it arises. This research will therefore focus on providing and improving export promotion policies for small and medium sized enterprises (SMEs) in Eritrea, the young African nation. In light of the above discussion the following section will discuss briefly the situation of SMEs in Eritrea and their contribution to the economy.

1.2.1. SMEs in Eritrea

The industrial sector of Eritrea has passed many stages during the last hundred years. Modern industrial enterprises in Eritrea flourished during the Italian colonization period in the forties and fifties. During this period there was considerable investment that boosted the manufacturing, mining, and agricultural industries, which made the country industrious at that time. With the advent of the British colonization in the aftermath of Second World War Eritrea was a major exporter to the east African region.

However, since its annexation by Ethiopia in 1962, the productivity in agriculture, manufacturing and mining industries declined because of disinvestments, and nationalization. This was aggravated by the war for independence, recurrent droughts and famine, negligence of the Ethiopian government's on Eritrean industries, and lack of foreign exchange to pay for the import of production equipment. As a result the country lost its export markets and foreign investment disappeared.

After the country's total independence in 1991, small to medium sized manufacturing plants mostly in the capital city Asmara and its surroundings began to thrive producing beverages, processed foods, leather goods, textiles, construction materials, wood and metal furniture, salt, paper, and matches. The domestic market is relatively small to justify the growth of many of the SMEs. Some of the sectors have export opportunities in the regional and global markets. Hence, as the global competition is increasing rapidly with fast technological changes these firms should be able to take advantage of emerging international commercial opportunities in order to survive and prepare for future development.

Studies on the Eritrean firms show that SMEs are constrained by many internal and external factors. A survey of national firms (Tesfayohannes, 1995) revealed that micro small and medium enterprises (MSMEs) in general are faced with financial, marketing, transportation, personal and other constraints in their order of importance. A similar study by Hyde (2001) also identifies problems of lack of a vibrant market, followed by inadequate transportation to maintain a flow of imports and exports, limited access to appropriate workspaces and/or sites, and insufficient equipment. Moreover, Eritrean entrepreneurs do not have long-standing business experience, and most lack

management skills and accounting discipline (Internet 1). Another big problem facing the Eritrean SMEs is the lack of cohesion between the various sectors and sub-sectors. The connection between agriculture and industry is weak, just as connections between sub-sectors within industry.

As a result of the above-mentioned problems industrial exports at present are limited to fish and its products, leather products, textiles and salt. The expectation of the government and the general public is that the manufacturing industry will exploit the country's valuable human and natural resources and contribute dynamically to Eritrea's economic developments by strengthening its backward and forward linkages with the agricultural and the construction sectors as well as diversifying exports and increasing the country's export earnings. Given current low labour costs and domestic production of raw materials, light manufacturing of finished leather goods, cotton clothing and others have the potential to become a significant sector of the export economy.

In the past Eritrea used to export finished goods to Ethiopia, Sudan, Italy, and Saudi Arabia and others. Future growth depends on investment to increase volume and quality maintenance thus ensuring penetration of larger first world markets. Thus export promotion could be one of the ways to boost exports and raise the awareness level of entrepreneurs for competing in the global marketplace.

The economy of Eritrea is relatively diversified compared with other developing countries. In 1992, industrial production accounted for more than 25% of GNP and the service sector 40%. A study of employment creation of national firms (Yacob, 1996) showed that SMEs contribute about 45% of the total employment of the private sector industries. Although 80% of the population lives on cultivation, animal husbandry and fishing, agricultural production accounted for less than 25% of GNP in 1992.

The world bank in 1999 reported that because of the small size of the Eritrean economy, significant economic growth and transformation can only take place if Eritrea exploits all opportunities for export of goods and services, both traditional and new, and is open to foreign investment. In this effort, Eritrea can take advantage of its strategic location in the North-Eastern part of Africa, a long history of sea-trade through the two ports of Massawa and Assab, a past industrial tradition, and the skill, knowledge and wealth of

its expatriate community (Internet 2). Accordingly, the need for export promotion programmes becomes very understood if Eritrea is to achieve its economic development.

1.3. Literature Review

This section discusses the contribution of SMEs to the economy and their barriers in entering foreign markets. Although SMEs have a great contribution to the economy of the country they are considered as weak and unable to compete international markets. As a result many barriers in their internationalisation process hinder them.

1.3.1. SMEs and the Economy

There is no standard agreement on what constitutes a small or medium sized firm. Researches conducted in to such firms also display a variety of standards for defining these firms. Hence, country definitions have come to be useful for any national support programmes and study purposes (McAuley, 2001, PP.103). These definitions are based mostly on the number of employees, initial capital outlay and annual gross turnover of the firm.

Although the contribution of SMEs to the overall economy is an invaluable, it is often overlooked for so many reasons. The popular myth is that it is difficult for SMEs to become involved in exporting or international marketing. This usually stems from many interrelated reasons. First, smaller firms are assumed of having less awareness and knowledge of foreign markets and so their confidence, competence and ambitions are limited. The second myth dictates that SMEs can't achieve the same economies of scale as larger firms in relation to production, international marketing or administration. Thirdly, it is thought that SMEs lack the necessary financial and managerial resources (McAuley, 2001, PP.107). Some of these understandings and the terms 'small' and 'medium' connotations have profound implications to the firm's activity in international market.

Against this backdrop SMEs are now competing in the global market place more efficiently than before. Many SMEs in the South-east Asia, such as South Korea, are

contributing for a significant and growing share of export activity. In addition, SMEs are the source of employment and daily income in Africa and other third world countries. Most SMEs are labour intensive and capable of creating many new jobs at low costs.

Among the important contributions of SMEs to the economy discussed by Thuss (2003) are the following:

- SMEs increase the competitiveness of a national economy.
- SMEs are a source of innovation on the basis that they are more flexible, more dynamic and more sensitive to shifts in demand than larger firms.
- SMEs produce the largest part of any GDP. It is also important to mention that the extra growth over the past several years throughout the industrialised countries was a result of the growth of SMEs.
- SMEs contribute as "Seed-Beds" from which large companies can grow.
- SMEs as suppliers to larger companies contribute to the competitiveness of these firms as well.
- SMEs also make a positive contribution towards social inclusion.

Throughout the world, one finds the SMEs to be the employee, the customer and the supplier providing goods and services to the local market. They also provide the majority of entrepreneurship in any economy. On the other hand, Alfred (2001) argues that the cumulative contribution of SMEs to pollution on global environmental concerns can be as significant as those of multinational corporations. It is even suggested that SMEs cause relatively more pollution than larger companies operating in the same sector because of their production techniques.

1.3.2. SMEs Barriers to Internationalisation

Efforts to promote the exports of SMEs often involve helping their entrepreneurs to solve the problems that hinder them from competing in the global market. The most problems that prevent the growth of SMEs in developing countries lie on three main areas: markets for the products they produce; access to inputs required by these products; and finance. SMEs face a number of barriers or obstacles in 'going global'. These include psychological barriers (Burpitt and Rondinelli, 2000) – the view that exporting

is too costly, risky and unprofitable for SMEs; lack of trained personnel; lack of export incentives and coordinated assistance; lack of competitive products; language problems; (Barker and Kaynack, 1992).

Other problems include operational barriers relating to export paperwork, documentation, delays in receiving payment, import/export legislation, exchange rate risk, logistics, etc. There are also organisational barriers including limited resources, lack of 'global vision' and previous international marketing experience and problems in finding suitable overseas partners (agents/distributors); and product/market barriers relating to the suitability of the company's product or service for internationalisation and choosing the most attractive overseas markets (Internet 3). Thus if SMEs are to be able to compete in international market these problems should be avoided. This could only be done through government's concerted effort in the export promotion and development programs.

1.4. Value of the Proposed Study

In its simplest form it is hoped that this research will assist the Ministry of Trade & Industry (MTI) and Chamber of Commerce to understand better the situation of SMEs and come up with better policy for SME support in the field of exporting. Furthermore it will help the MTI and the export oriented firms to better understand the forces and sources of competitiveness in the international marketing area.

In addition, SMEs will benefit from the improved export promotion program if the recommendation is implemented.

1.5. Motivation For Research

The researcher has gained much information about this particular topic, export promotion, while working in the Ministry of Trade Industry (MTI) of Eritrea, Department of Industry (DOI). The researcher has been following documents of the United Nations Industrial Development Organisation (UNIDO), had many contacts with SME managers in various occasions, participated in information gathering for SMEs business data used for research purposes. From the experience in the department of

Industry, it was realized that SMEs in Eritrea have many problems. Primarily they have no international experience in relation to exporting. They were mainly depending on the neighboring Ethiopian market because of proximity and cultural similarities. With the start of the border conflict in 1998, all the companies lost their export market and were claiming about excess capacity.

It is the expectation of the researcher that in order to answer those questions and the crucial problems mentioned above, it would be necessary to study the need for the creation and improvement of Export Promotion Programs (EPPs) with focus on financing, information provision and creation of network of main actors that could be applicable to the needs of SMEs in Eritrea.

1.6. Statement of the Research Problem

The main problems to the growth and internationalisation of SMEs are the lack of information with regard to the markets and finance to support working capital needs throughout the process. The following sections discuss the problem of the research in detail.

1.6.1. Problem Analysis & Definition

While the call for globalisation is compelling given the increasing volume of world trade, SMEs in developing countries are having difficulties competing in the global arena and are also finding it to be overpowering activity. Hence, as mentioned earlier, exporting provides a viable way for SMEs to participate in the global business arena as it enables entry quickly, with relatively little risk, and at lower cost than the other alternatives, which have higher risk and cost. However, there are several steps involved in the export activity and SMEs require most of the time various types of assistance as they lack key resources and capabilities. These problems and other changes in the world economy have forced many countries to take steps to encourage SMEs, as their growth is crucial to economic development. Therefore, the provision of Export Promotion Program has become very important policy of many countries.

The absence of enabling environment, access to trade finance, lack of information and marketing are the most formidable obstacles in developing countries in export success. Hence, a country's export promotion strategy should define how best it could help SMEs to exploit opportunities and overcome major obstacles. One of the basic assistance given to SMEs is in the form of information and advice better called the Information Provision Service. Initially this information service raises awareness levels and decreases risk and uncertainty associated with the export process. As the firm proceeds through the stages it assists exporters with strategic problems including what market expansion strategy to adopt, where to introduce new products and how to evaluate the overall export performance.

Small and Medium-sized enterprises (SMEs) starting to enter the international market are most of the time hindered by financial problems. Access to finance is still very difficult for SMEs in most countries and particularly in developing countries. A report by international trade centre revealed that banks refuse credit to SMEs because they are perceived as risky and unprofitable. However, experience in the field shows that SME lending can be profitable and does not necessarily involve more risk for the bank than lending to large enterprises or the public sector (ITC issue 4/2002: 16). These problems make the need for export financing more important.

On the other hand, it is worth highlighting that any type of support and assistance is initiated, processed and provided by an arrangement or network of different export actors, public and private, which must be aligned in the best possible way. Therefore, as important as for SMEs to obtain the best possible financing services, information and advice is the creation and shaping of a competitive network of main actors, which will canalise this and other types of export services. Considering all the above points, the main problem of this study will be discussed in the next section.

1.6.2. Research Problem

The problem of the study focuses on the analysis of the various available services of finance and information provided through the arrangement of the network of main actors that will give us a crucial and beneficial insights on how the nations export promotion program should be improved so that Eritrean SMEs can be in a better position to export

and contribute their role to the economic growth. For that purpose, the main problem of the research is the following.

How can the management of the Ministry of Trade and Industry create and improve Export Promotion services towards SMEs in Eritrea, with focus on financing, Information provision and Network of main actors?

1.6.3. Objective of the Study

The general purpose of the study, as mentioned earlier is to identify whether there are any possibilities to create and to improve the export promotion towards the SMEs in Eritrea by identifying the existing theoretical background, analysing the opportunities and threats that SMEs in Eritrea are facing in the global market, and evaluating the current export incentive policies in Eritrea. Currently there is no formal export promotion program in Eritrea. However, there are informal export incentives that emanate from the nation's macro-economic policy, which is oriented at creating growth through boosting export of primary and manufactured products. Hence the basic need for export promotion program will be given more emphasis with the following main objectives.

1. To identify the factors contributing for declining export growth and the challenges and opportunities of SMEs in Eritrea.
2. To evaluate the export incentives that are being provided and look whether there is a gap between the needs of SMEs and those services.
3. To recommend on how the network of main actors and export promotion programs for Eritrea could be initiated and organized.

1.7. Research Design and Methodology

Having identified the research problems and objectives this section discusses the methods and processes to be used in conducting the research. For that purpose, it is divided in to two parts: research design, data collection.

1.7.1. Research Design

A research design is a master plan specifying the methods and procedures for collecting and analysing the needed information (Zikmund, 2000: 59). As explained by Yin, (1994: 18) it links the data to be collected to the initial question of the study defined during the early stages of the research process. This research employed the *case study* method in answering the research questions and in providing conclusion and recommendation on how Eritrean exports could be boosted by the formalizing and improving the export promotion program. Although more weight is given to qualitative methods, quantitative research will also be used in order to increase the credibility of the findings that will be driven from the research. This type of research, which includes both qualitative and quantitative methods, is referred to as the triangulation method.

The methodology will follow the four stages of case study research recommended by Yin (1994).

1. Design the case study,
2. Conduct the case study,
3. Analyse the case study evidence, and
4. Develop the conclusions, recommendations and implications.

1.7.2. Data Collection Methods

In order to completely achieve the desired results of the research the following three methods of data collection were used: Documentation, Interviews, and Focus group interviews.

1.7.2.1. Documentation: - The case study information about the Eritrean SMEs were collected from previous documents of the Ministry of Trade and Information (MTI) and Chamber of Commerce. Other sources of information include banks, SMEs and relevant previous researches, Journals articles, Books, Internet search engines, and others for collecting secondary and tertiary data.

1.7.2.2. Interviews: - Interviews were also conducted with respective authorities for gathering the data needed for the analysis of the challenges and opportunities of SMEs

and the export incentives available in Eritrea. With the purpose of enhancing the reliability of the data a follow up interview was done on particular issues as needed.

1.7.2.3. Focus Group: - obtaining information from the direct beneficiaries of export promotion policies i.e., SMEs was very important for the validity of the research. However, the focus group interview that was planned to be conducted with selected SME entrepreneurs from different sectors of the industry was not done due to certain problems and the unavailability of these entrepreneurs.

1.8. Internal and External Validity

The four tests of a case study research defined by Yin (1994:32-6) include: Construct validity, internal validity, external validity and reliability. As mentioned earlier data for the constructs is gathered from the different stakeholders in the Export Promotion Program (EPP) and other secondary and tertiary sources. This will enhance the construct validity of the research. The internal validity of the study was achieved by comparing the information gathered from the different sources. External validity was enhanced by evaluating the existing export promotion programmes in Eritrea with the available theories developed in the literature review of the study.

1.9. Limitations of the Study

As Eritrea is a young nation devastated by long time war for independence, there are limited researches conducted with regard to the development and promotion of small businesses. Hence there is a lack of relevant information. It is very difficult to get documented information. Besides this research is limited on export promotion policies only. Other elements such as export development and other services are not included because of time and budget constraints. However the situation of SMEs may determine the type of services they need. Hence, the service of export information provision, export finance support for SMEs, and the networking between and among the government bodies, the firms and other private organizations needed to facilitate SME exports will be the discussion of the paper.

1.10. Structure of the Study

This study is categorized in to five chapters. Chapter one has already established the research proposal of the study, which included the background information of the study, problem statement of the research, and its objectives.

Chapter Two of the project discusses the theoretical framework. It is divided in to four sections. Firstly, the internationalisation process of SMES will be discussed. The second section examines the information of export oriented SMEs and how these services should be provided. Similarly, section three focuses on the export finance needs of SMEs. The final section divulges the means of providing these services mainly through the organisation of export promotion and networking systems.

The discussion of Chapter Three focuses on the detailed review of SMEs export promotion policies in Eritrea. For this reason, the chapter starts with a presentation and description of SMEs, and the challenges that Eritrean SMEs are facing in the international marketing area. It then reviews the incentives and support services provided, specifically with regard to information and financing, for exporting SMEs in Eritrea. How these services are provided, how is the network of main actors working etc. will be the main part of this chapter.

In Chapter Four the export promotion policy of Eritrea will be evaluated against the theory set in chapter two of the study. Are SMEs in Eritrea able enough to capitalize on the opportunities in the world market? Is the ministry of Trade and Industry and also the chambers of commerce providing what the SMEs need in the exporting activities? Are the banks in a position to help SMEs export financing needs?

Chapter Five will then present the conclusions and recommendations to the reader from all the analytical and theoretical chapters. Thus, this chapter will provide crucial conclusions from the identified specific needs as well as best features directly addressed by the analytical parts of the thesis. On the other hand, as part of the recommendations, insights will also be offered directly addressing to the research problem mentioned above. Furthermore, these recommendations should take in consideration the empirical as well as theoretical findings.

1.11. Summary

The aim of the proposal was to discuss the need for the creation of export promotion programs in Eritrea. It has been discussed that SMEs in Eritrea are facing many interrelated problems. Given their great contribution to the economy and the opportunities available in the world market, export promotion could be the best way to support them in their internationalisation process. The main goals of Export Promotion are to contribute to overall economic improvement of a country, and the subsequent increase for the standard of living of the population. Hence, this study will evaluate and recommend on how the export promotion program for SMEs in Eritrea could be initiated and improved for the better future of SMEs, which are the backbone of the economy.

The research will employ the case study method of research design as it involves a holistic approach to the evaluation of a given case. Data will be gathered from previous documents, interviews, and focus group interviews. The study and its recommendation will help the Ministry of Trade & Industry (MTI) and other public and private organisations to come up with better support policy for SMEs in the field of exporting. Having discussed the research problem and its methodologies, the next chapter of the study deals with the relevant literature on export promotion and related materials.

CHAPTER TWO: STRATEGY IN CONTEXT

THE THEORY OF EXPORT PROMOTION PROGRAM AND ITS ELEMENTS

2.1. Introduction

In this chapter, the theories and concepts used throughout the study are presented in an orderly manner. Firstly the internationalization process of small and medium sized firms (SMEs) will be discussed as a starting point. The next part discusses the information needs of SMEs, which is presented with two frameworks for the collection of strategic information. One of the models deals with the strategic management of the export decision process and the other one describes the Institutional Network Theory for analyzing foreign markets and their constituents. What follows then is the export finance needs of SMEs. The concepts of export promotion policy and the characteristics of network of main actors will be presented as a final part of this chapter.

2.2. The Internationalisation Process of (SMEs) Small and Medium Enterprises

How do firms start exporting and internationalising their operations? What are the main stimuli or motivators? What are the resources supporting this process? What, in fact, is the process of internationalisation and how can it be understood? These are the main questions asked in the internationalisation process of firms. In order to have a clear idea of these questions the motivations and constraints for internationalisations will first be discussed and then the process of internationalisation will be followed thereafter. Before that some of the studies on the factors for internationalisation of small firms are discussed.

2.2.1. Motivation, Constraints & Opportunities for Internationalisation

There are many factors that motivate SMEs to go for international markets. These could be internal to the firms or external from the environment. Similarly as there are motivators there are also constraints. The following sections discuss these two factors.

2.2.1.1. Motivations to the Internationalisation of SMEs

Many variables are associated with a firm's decision to start exporting and with its subsequent evaluations of success. Researches on the exporting experience of small companies have explored a wide range of relevant issues. Ali and Swiercz (1991) (Mittelstaedt, Harben and Ward, 2003) recognize that firm size to be the important factor influencing the export performance. Other studies have also shown that the strongest motivations for small firms to explore international markets to be economic benefits. Furthermore, the decision to continue exporting can be influenced by a number of factors beyond the promise of immediate economic returns. The chance to acquire new knowledge and new skills and the chance to broaden organizational capabilities were felt to be important factors in evaluating the success of exporting and in decisions to continue exporting in the future (Burpitt & Rondinelli, 2000). The presence of strategic opportunities abroad, inquiries from foreign buyers, flat domestic sales, international moves by competitors were also identified as the factors associated with the initial decision to internationalise (Karagozoglu and Lindell 1998).

As many studies have come up with different reasons for the internationalisation of a firm there is no classification that can be regarded as inclusive of all possible reasons; instead they act as a shorthand guide to be adapted to all sorts of situations. According to Czinkota and Ronkainen (2001 pp. 267) the major motivators of small and medium enterprises (SMEs) internationalisation can be classified in to the following reactive and proactive factors.

- ***Proactive motivators:*** - proactive motivators represent stimuli to attempt strategic and entrepreneurial change. The manager believes that going international as one of the growth strategies of the firm and sees it as a natural and organic process. Some of the main proactive motivators for the internationalisation of the firm include profit advantage, having unique products, exclusive information, managerial urge, tax benefits and economies of scale.

Table 2.1: Proactive and Reactive Triggers for Internationalisation

	Internal Triggers	External Triggers
Proactive	<ul style="list-style-type: none"> • Visionary leadership • Saleable idea • Distinctive product, brand, service • Extend sources of supply • Extend sources of knowledge, • Extend sources of capital, technology • Extend product range, life cycle or seasonality • Search for market power, increase market share • New product development, • Innovation • Diversification (related and unrelated) • Increase brand identity • To move nearer to important markets • To better serve the customer 	<ul style="list-style-type: none"> • Removal of barriers to trade • Strategic presence vis-à-vis competitors • Increasing concentration (through mergers) • Improvements in I.T., mass communications • Physical infrastructure (channel tunnel etc.)
Reactive	<ul style="list-style-type: none"> • Improve levels of business performance • Have excess capacity • An order arrives 	<ul style="list-style-type: none"> • Decline, saturation of local/national market • Intensity of competition • Entry by cross-border rivals • Service existing customers who have gone international • To get around protection barriers

Source: - *Turku School of Economics and Business administration* available online at <http://www.tukkk.fi/intercrafts/1sisaltomoduuli.htm>

- **Reactive motivators:** - proactive firms go international because they want to while reactive ones go international because they have to. The reactive

motivators influence firms to respond to changes and pressures in the business environment rather than attempt to blaze trails. Such motivators include competitive pressures, overproduction. Declining domestic sales, excess capacity and proximity to customers and ports.

As discussed earlier many of the SMEs in Eritrea were exporting to Ethiopia because of the cultural and language similarities. The concept of psychic or psychological distance applies to the Eritrean firms exporting to Ethiopia. There are two important things to remember here. First of, some of the distance seen by firms is based on perception rather than similarities. At the same time, the fact is that closer psychological proximity does make it easier for firms to enter markets. Besides, the two countries were using the same currency until 1997. When the Eritrean government came up with its new currency, Nakfa, a problem arose in trading between the two countries. Soon trade between the countries started to deteriorate.

So it can be seen that there's a lot of reasons to go international, some of them are proactive and some are reactive. At the same time all the motivators can be described as internal and external triggers or change agents of the internationalisations process of a firm. Table 2.1 from the Turku School of Economics and Business Administration explains the internal and external triggers of internationalisation. On both approaches there's at least one common factor, internationalisation is never easy, but if well planned it can increase profitability for every kind of firm.

2.2.1.2. Constraints to the Internationalisation of SMEs

Many companies with the export potential never become involved in international marketing, and a series of government export studies have found that it is often a great deal easier to encourage existing exporters to increase their involvement in international markets than to encourage those who are not exporting to begin the process (Doole and Lowe, 2001, pp.178). It is understood that not all companies are in a position to take advantage of all opportunities, which may present themselves (McAuley, 2001, pp.87-88). There are many barriers such as limited resources, difficulty in acquiring information, lack of managerial experience with exporting, weak formal planning systems (Karagozolu and Lindell, 1998), transportation difficulties, lack of trained personnel, lack of export incentives and coordinated assistance, slow payment or

payment defaults by buyers, lack of competitive products, language problems (Barker and Kaynack, 1992) which restrict the need and ability of SMEs to involve in international marketing activities.

On the other hand, it is worth remembering that not all companies wish to become internationally active (McAuley, 2001, pp.87-88). The reasons given by companies for not exporting are numerous. Some of the factors are associated with the personal characteristics of the entrepreneur. Firms see exporting as risky and costly venture because they lack the necessary resources and experience (Burpitt and Rondinelli, 2000) while others are busy competing in the domestic market and do not think of the opportunities available in international markets. In addition, tariff and non-tariff barriers are also some of the external barriers hampering the exports of SMEs. Furthermore, these barriers and difficulties increase as several other requirements arise in the export process. For instance, technical requirements such as customs paperwork, contractual agreements with potential counterparts, etc. will confront the venturing companies.

Thus if SMEs are to be able to compete in international market, they need to be supported. They need appropriate assistance because of their nature and, beyond this, we need to recognise that an SME orientated business community has to develop appropriate support structures. In other words appropriate information and financial services should be available to SMEs not because they are ineffective entities, but rather because they are the norm in an increasingly networked economy where “small is normal” and a much greater proportion of services normally done within a firm will be out-sourced. This could only be done through government’s concerted effort in the export promotion and development programs. Export promotion refers to “the collective programs a nation has to help companies sell products abroad. These programs may include business counseling, training, and representational assistance, as well as providing market research information, trade fair opportunities, and export financing assistance” (Internet 4).

2.2.2. The Stages of Internationalisation

The internationalisation efforts of a firm, that is servicing a market across national boundaries, can be described as a gradual process moving over different stages of

development. Most firms begin their operations in the domestic market. Overtime they gradually expand from their home locations and some of them become interested in the international market. Numerous studies have been carried out into the internationalisation process of SMEs with differing perspectives and viewpoints. The model developed by Czinkota and Johnston (1981) regarded, as being effective in enabling distinguishing between firms engaged in exporting comprises six stages. In each of these steps, firms are measurably different in their capabilities, problems, and needs. In most instances firms that enter international markets are faced with a host of new problems.

Stage 1 The Unwilling / Completely Uninterested Firm

At this stage the firm doesn't export and doesn't plan to do so in the near future. Management is not interested in exploring the possibility of exporting and beliefs that there is no benefit from exporting.

Firms at this stage need a help that raises their awareness levels of exporting. Communicating the tangible benefits of exporting through trade associations and mini-conferences and using successful small exporters, as role models could be some of the ways of raising the awareness levels. Further, increased information dissemination showing the size and profitability of foreign markets, export activity figures by industry, export profitability statistics, and data about the impact of specific export activities on the balance of trade are another implementations strategies for raising the awareness levels.

Stage 2 The Partially Interested Firm

As unsolicited orders and other international marketing stimuli continue overtime, the firm becomes gradually a partially interested exporter. Management then starts to fill the unsolicited export orders, which are mostly directed to a psychologically close country. Management, mostly motivated by its unique products and profit advantage, tends to belief that exporting may be desirable activity and undertakes some exploration of export possibilities. The problem areas of the exporting firm are financing, information on business practices, communication, the provision of technical advice, and sales effort.

The partially interested firm's assistance needs include raising the awareness levels of export benefits, provision of information about the mechanics of exporting. Increasing communications to make firms more aware of the existing services, providing financing services like more active small volume export financing, and training employees to handle the routine documentation problems and to have a general knowledge of the mechanics of international transfer of funds are the most important support services that should be given. These assistances should be provided in an accurate, timely and rapid fashion.

Stage 3 The Interested /Exploring Firm

As the management's awareness level increases, the firm gradually starts to explore international markets and the management becomes willing to consider the feasibility of exporting. The potential contribution of exporting to the firm's growth and profits is acknowledged, but past export profits have not met expectations. Having a unique product and obtaining a profit advantage are principal motivating factors for exporting. The major problem areas of the exploring firm are that of communication, sales effort, marketing information gathering, information on business practices, and obtaining financial information. At this stage the exploring firm sees outside assistance as valuable on all the problem areas. The provision of general information and practical assistance will be important in solving the problems of the exploring firm. Further, government export financing services, risk and profit sharing agreements for a specified amount of initial exports could be more helpful. In addition, providing information on current general marketing data and their wide distribution is essential in satisfying the general information needs of the exploring SMEs.

Stage 4 The Experimental Exporter

After the exploratory stage the firm becomes an experimental exporter, usually to psychologically close countries. However, the management is still far from being committed to international marketing activities. Decisions are at the hands of the president and exporting is seen favourably but little active exploration of export possibilities takes place. The principal motivating factors for exporting are a unique product, technological advantage, and profit advantage.

Important export problems are seen in the areas of sales effort, obtaining financial information, physical product adaptation, marketing information gathering, and information on business practices. The firm is positive to outside assistance at this stage. The help needed by the experimental exporter include general assistance and product adaptation. Trade fair and exhibition participation are very important in searching potential orders and adapting products to foreign market needs. At the same time government support in searching for and carrying out contacts on behalf of these firms is helpful as these firms are not very committed to exploring markets and lack of information on business practices.

Stage 5 The Experienced Small Exporter

At this stage the firm evaluates the impact that exporting has had on its general activities. There is a positive attitude toward exporting. Here of course the possibility exists that a firm will be disappointed with its international market performance and will withdraw from these activities. On the other hand, frequently, it will continue to exist as an experienced small exporter. The input of the marketing managers is highly valued in the decisions related to international marketing activities. Additional export motivating factors include managerial urge and technological advantage.

The experienced small exporter encounters problems in the areas of communication, sales effort, marketing information gathering, obtaining financial information, and handling documentation. As a result greater size financial and general assistance are the most required assistance. An increase in the cooperation between government and the banking sector will help facilitate the financing needs of SMEs at this stage. Besides training seminars on export financing would be of value to those firms. The request for financial information needs to be addressed rapidly and accurately.

Stage 6 The Experienced Large Exporter

The final stage of internationalisation process is that of export adaptation. Here the firm is an experienced exporter to a particular country and adjusts its activities to changing exchange rates, tariffs, and other variables. Management is ready to explore the feasibility of exporting to additional countries that are psychologically farther away and plans to be continuously active exporter in the future. The main motivating factors for

exporting are profit advantage, technological advantage, competitive forces, tax benefits, a unique product, and managerial urge.

Important problem areas where external assistance is needed include communication skills, sales efforts, marketing information gathering, the provision of repair service, transfer of funds, information on business practices, and mostly the facilitation of customer service. To facilitate the customer services abroad, companies should be encouraged to train foreign personnel, enabling them to provide such services abroad. Government assistance to such firms should be reconsidered because they are already satisfied with the profitability of exporting efforts and sufficiently committed to the continuation of international activities even without public sector support.

2.3. The Information Needs of the Small and Medium Sized Export Oriented Enterprises

The main elements of export promotion services include the provision of information on the markets the firm is to be in and export-financing assistance required to help the firm reduce its risks & conduct its business smoothly. This section discusses the export information needs of SMEs. The next section will discuss the export finance needs.

2.3.1. The Importance of Export Information

Most organizations, whether large or small, are facing dramatic changes in their socio-economic landscape and operating environment. These changes are far-reaching and global. Managers are being challenged by questions such as how to track and make sense of the changes in order to survive and compete in such turbulence markets, how to manage the transformation required, and how to grow the organisation and ensure its long-term sustainability (Internet 5).

Organisations that want to succeed in this ever-changing business environment need to adopt suitable management tools that can identify emerging issues that may have the capacity to impact on their business. Environmental scanning is such a technique, often used within a suite of tools as part of a strategic planning process (Harris & Martin 2002). As defined by Ansoff in 1975 “the notion of environmental scanning is meant to

help managers in their decision making processes to reduce uncertainty, while at the same time allowing them to pick-up *weak signals* coming from the environment and increases the firm's ability to respond proactively. The concept of *weak signals*, as defined by Ansoff in 1975 and elaborated by Lesca (1986), designates the anticipatory signs of an event which, yet, has not been totally actualised”(Chapus, Lesca & et. al., 1999, at Internet 6). Environmental scanning has a more particular objective in attempting to identify broad trends in the political, legal, and economic environment that companies find themselves operating in.

Environmental scanning is a technique used by larger corporations to identify emerging issues within the broader economic and political environment. Although it is also necessary for the survival and growth of domestic or export oriented SMEs the important management processes that it involves require expensive resources that are beyond the means of small and medium sized companies, as research by Mohan-Neill (1995) confirms. Small and medium companies cannot match the resources of larger companies to undertake such structured and detailed data collection and analysis.

It has been explained that one of the crucial elements pertaining to export success is the export information behaviour of the exporting SMEs. Exporting requires new knowledge and information, new ways of advertising and selling, and familiarity with foreign cultures and ways of doing business (Burpitt and Rondinelli, 2000). In light of the unfamiliarity of the foreign environments, which, exporting firms face use of export information can be seen as a critical determinant to export performance (McAuley, 1993). Indeed, it has been found that the limited ability of SMEs to acquire information and knowledge about foreign markets and to manage foreign activities is largely responsible for their relatively low level of exporting commitment and poor performance.

Export information plays a critical role in fostering company internationalisation, because lack of information is a major barrier to both export initiation and export expansion (Katsikeas 1994). As a result government policies promoting SMEs and their exports are focusing on the provision of information, advisory and training services, which is part of the export promotion policy. In most developing countries there is a need to create an environment as favourable as possible to business, especially for

foreign trade oriented SMEs, as they are the main source of foreign currency. For that purpose the establishment of an information and services infrastructure that complements the international competencies of SMEs is one of the main support services that SMEs are currently in need. This is done in the form of export information and advisory services to exporting SMEs.

“The objective of export information and advisory services is to bring SMEs and Very Small Enterprises (VSEs) to the better use of economic intelligence in order to become more efficient, hence making businesses more profitable and competitive. The results of better management of economic intelligence would possibly lead to better designs, better manufacturing processes, a better approaches to regulations, better production and administration, better logistics and a better capacity to anticipate for the participating businesses, hence developing a competitive advantage” (Internet 7).

2.3.2. Export Information Behaviour of SMEs

This section discusses the export information use, information types needed and sources consulted by exporting SMEs, and factors affecting the need and ability to gather information which all describe the export information behaviour of SMEs.

A study of export market information behaviour of SMEs (Voerman, Wedel, and Zwart, 1998) identified that “firm size, the branch of industry and the national culture of the firm all significantly influence the amount of information gathered, the type of information source consulted, and the relationship between the quantity of export market information collected and the export sales (as an indicator for export performance). The study also warns Governments should not only consider the general situation in a country and offer general information, but also acknowledge that firms within different sectors and/or size classes display deviating information acquisition behaviour, when developing public promotion programs.” Therefore “information, which is of value to SMEs, has to be focused and precise, concentrated on what they need to know. Sub-sectoral analysis can be a useful tool in developing the detailed knowledge required to develop information products, which SMEs may want. If information is needs based, its potential benefits should be transparent to SMEs” (Internet 8).

The information needs of SMEs differ according to the stages of internationalisation they are in. During the pre-export or preparation phase, managers look for information that helps them to assess the attractiveness of foreign markets and decide whether or not to engage in exporting activity (Wiedersheim-Paul, Oslon et al. 1978). Once a firm has decided to start exporting, information is required not only about overseas markets but also about the logistics of exporting & potential complications and the promotional issues i.e., information on how to enter overseas markets and what marketing mix elements to use (Welch and Wiedersheim-Paul 1980). As a firm proceeds through the export stages, information is necessary to tackle strategic issues, such as: what market expansion strategy to adopt; where to introduce new products; and, how to appraise corporate export performance (Cavusgil, 1985).

In such cases the basic information can be provided by the government's export information and advisory service of the export promotion organisation (EPO) at a free or low cost whereas the more in-depth information through export development and consultancy or market research organisations.

According to Leonidas & Athena SME export managers give more weight to information gathered through the firm's own efforts or through their connections with other firms and individuals as opposed to information provided by external private organisations and government agencies. This implies that Government policy makers should upgrade their information sources such as government offices and ministries, export promotion organisations (EPO's), embassies and diplomatic sources, and the institution of trade fairs/exhibitions & trade missions.

Furthermore, it was revealed that the most influential information *types* that exporters need were information about overseas customers, product information, market preferences and pricing issues indicating that exporters seek to satisfy customers needs with the best product and affordable price.

Table 2.2 Types and Sources of Export Information

TYPES AND SOURCES OF EXPORT INFORMATION	
TYPES OF INFORMATION	SOURCES OF INFORMATION
<i>Macro environment</i>	<i>Company efforts</i>
Physical, Demographic, Economic, Political-legal, Technological,	Internal company records, Personal contacts, Foreign market visits, Sales people/office, Company's market research
<i>Microenvironment</i>	<i>Other firms/ individuals</i>
Company, Suppliers, Marketing intermediaries, Competitors, Customers, Publics	Suppliers, Other firms in the industry, Customers, Overseas agents/ distributors/ reps, Commercial associations, Chambers of commerce, Trade/industry associations, Exporter's union
<i>Market characteristics</i>	<i>Service organisations</i>
Size/growth, Structure, Entry conditions, Preferences, Potential, Position/share	Brokers/freight forwarders, Commercial banks, Consultancy / research agencies, International agencies
<i>Marketing mix</i>	<i>Information providers</i>
Product Pricing, Distribution Logistics, Promotion	Mass media, Trade journals/publications, Computerised databases/direct, Public/commercial libraries
<i>Miscellaneous</i>	<i>Government outlets</i>
	Government offices/ministries, Export promotion organisations, Embassies/diplomatic services, Trade fairs/exhibitions, Trade missions
	<i>Miscellaneous</i>

Source: Leonidas & Athena 1998-99

Correspondingly, foreign customers, personal contacts, managerial visits abroad, trade fairs/exhibitions and trade missions abroad were among the most popular information

sources that exporters consult for gathering information (Leonidas & Athena, 1998-99). This implies that Export Promotion Organisations need to strive on providing the right information that exporters need crucially. At the same time trade promotion institutions has to maintain trade their efforts in increasing the number of SME participants in trade fair/exhibitions and trade missions. The types and sources of export information are described in table 2.2.

There are three major modes of information acquisition in an export context: export marketing research, export assistance, and export market intelligence (Souchon & Diamantopoulos 1996 p. 51-53,). The first category, *export marketing research*, encompasses “research activities of firms carried out either in the home or foreign market for the purpose of reducing uncertainty surrounding international marketing decisions” (Cavusgil 1984a p. 262 in Souchon & Diamantopoulos, 1996). Export marketing research can be carried out internally (through in-house unit/department) and/or externally through a specialised market research agency or consultants [such as export consultancy service] (Ibid).

According to Seringhaus (1985, in Souchon & Diamantopoulos 1998 p. 146) the second mode of information acquisition, *export assistance*, encompasses “first standardised and customised market information and guidance on exporting and export marketing and second more comprehensive programs ranging from helping firms research specific foreign markets, market visits-individual or with trade missions- trade fairs to actual market entry.” It is aimed typically at small and medium sized firms and seeks to provide knowledge useful at different stages of the internationalisation process. Government institutions or banks provide export assistance (Souchon & Diamantopoulos 1998 p. 146).

The third information acquisition mode, *export market intelligence*, includes informal way of approaching potential customers, distributors and competitors through attendance at international trade fairs and shows, or more directly through foreign visits (Dennis and Depelteau, 1985). However, “a mere acquisition of information is not, in itself, sufficient to ensure that effective decisions will be made. One reason for this is that decision makers may possess but not use information” (Souchon & Diamantopoulos et al., 2003). Indeed it has been suggested that, "essentially the same information is

available to competing firms at about the same time. As a consequence, competitive advantage is to be found increasingly in what is done with information, that is, how it is used or employed rather than in who does or does not have it" (Zaltman and Moorman 1988). Therefore export information organisations have to deal with raising the awareness of SME managers on the importance of using strategic information before making a decision.

From the above analysis one can see that successful development of SMEs export activities requires a structured approach for collecting and providing information. Thus the government's export promotion organisation (EPO) information collection plan has to have a clear and definite process, which could fulfill the objectives of providing economic intelligence for the enhancement of the competitiveness of SMEs as well as reducing the uncertainties in the international markets. Hence, information collection process has to be systematically structured so that it works well at all the stages of the firm's internationalisation. The following section will discuss with the strategic information collection process.

2.3.3. Strategic Information Collection Framework for Export Promotion Organisations

As discussed earlier the problems precluding SMEs from going international or participating in export activities are of the motivational, informational, and operational or resource based barriers. In addition it was said that the role of export information is to help SME managers to make a better-informed decision while reducing uncertainty thereby to develop into more efficient, profitable and competitive in the international markets.

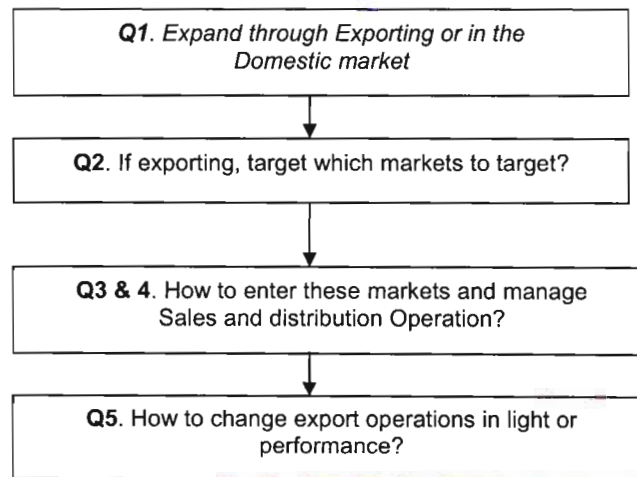
The above-mentioned barriers and the resulting export promotion programmes, [particularly the export information provision and advisory service], can be usefully thought of in the context of decisions that companies make about exporting (Seringhaus and Rosson 1991, PP. 17). It follows that the export information and advisory service should be provided in such a way that it complies with the SMEs strategic decision process. Hence the framework should encompass the export decision process and the

strategic management process in SMEs, which will help to provide a context for the strategic information collection framework.

There are a number of clearly demarcated steps of decisions that companies normally make in the export process i.e., in deciding and starting to export to a foreign market. The export decision model developed by Rosson and Reid consists of five questions the answers of which, it is postulated, result in the decisions that shape the export behaviour of any particular firm. These decision questions are depicted in the figure 2.1.

The dynamic SME strategic management process model consists of four stages by which SMEs determine their purposes, objectives and desired level of attainment; decide upon actions for achieving those objectives in an appropriate time scale and frequently in a changing environment; implement the actions and asses the progress made by evaluating the result. The four stages include: awareness, strategy formulation, strategy implementation and strategy control & development (Analoui and Karami, 2003, PP.58-59).

Figure 2.1. The export decision process

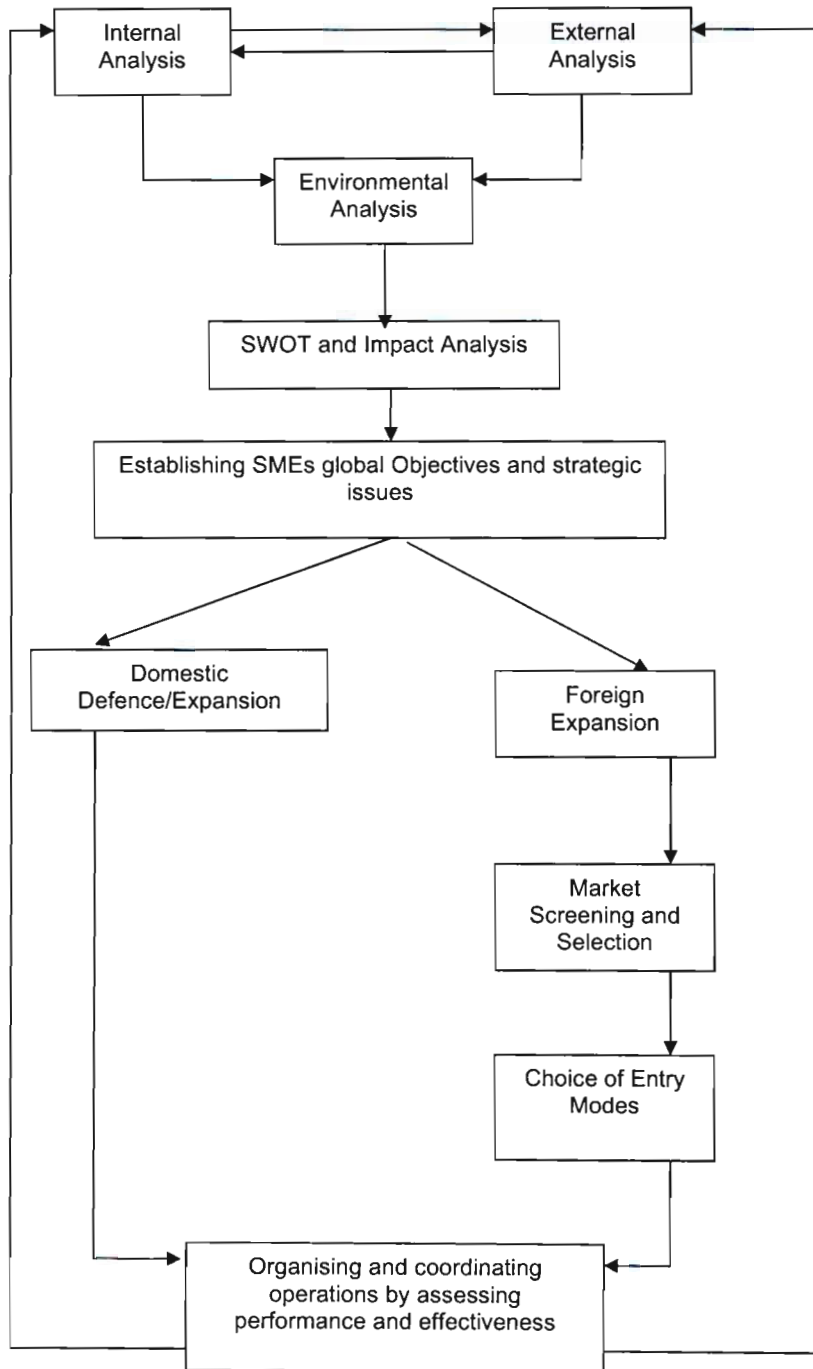


Source: Reid & Rosson 1987, in Seringhaus & Rosson, 1990, PP. 18

The model that is used for the collection of strategic information combines the export decision process and the dynamic SME strategic management process discussed in figure 2.2. The dynamic SME strategic management model is originally intended to depict strategic management process of formulating a competitive strategic plan for the

growth of the firm. Nevertheless, its theoretical frameworks can also be applied in the collection of information, as they encompass the companies' needs because they direct the firm's strategy to opportunities created in the external environment.

Figure 2.2. SME Strategic Information Collection Framework



Source: Adapted from Analoui Farhad and Karami Azhadar, 2003, P.137

The strategic information collection framework highlights the strategic decisions that export promotion organizations have to take in assisting SMEs in their internationalisation process. It also presents different techniques to be used for collecting information and advice that satisfy the needs of SMEs in the different stages of their internationalisation. Some of those techniques included within this strategic framework are: PEST analysis, the Networks Institutional Approach, the Five-Force Model, the Industry Dynamics Analysis, the Value Chain Analysis, SWOT and Impact Analysis, and the Market Assessment and Selection.

One important point that should be emphasized is the framework is developed from the information provision service point of view. Hence, it presents the decisions these actors, Export Promotion Organisations; need to make to realize the mentioned support and assistance.

2.3.3.1. Analysing the Environment

The first part of the strategic information collection process for SMEs starts with analysis of the environment. In our case environmental analysis can be defined as the process of studying external and internal environment in which SMEs operate. The external environment of the firm encompasses the more distant or remote environmental factors and immediate or industry dynamics factors which affect the firm's strategy. Thus distant environmental analysis is aimed towards the provision of general information involving economical, socio-cultural, political and technological factors while the industry analysis provides information related to the existing markets, the nature of competition and other factors affecting all firms in the industry

Information collected from analysing the environment provides SMEs with both of a general nature and a very specific one. For example, it will answer to questions such as what are key opportunities and threats in the environment, the key success factors in the market, the firm's ability to capitalize on these opportunities and minimize weaknesses, the attractiveness and profitability of the industry, the driving forces as well as government's policy towards trade, imports, and foreign firms etc.

Several techniques are available for analysing the external environment and collecting the required information our SMEs need. These include PEST analysis and Porter's Five

Forces analysis. In order to provide much in-depth information about the foreign markets the SMEs compete additional model for analysing the environment will be discussed. The Institutional Network Approach developed by Jansson (1994 & 2000) discusses the different constituents in the environment and their influence to the firm's strategic decisions.

- **The PEST Analysis**

A PEST analysis (also sometimes called STEP, STEEP or PESTLE analysis) looks at the external business environmental factors affecting the business. The analysis examines the impact of political, economic, socio-cultural, technological and other factors (and their interplay with each other) on the business. The results can then be used to take advantage of opportunities and to make contingency plans for threats when preparing business and strategic plans.

- **The Institutional Network Theory**

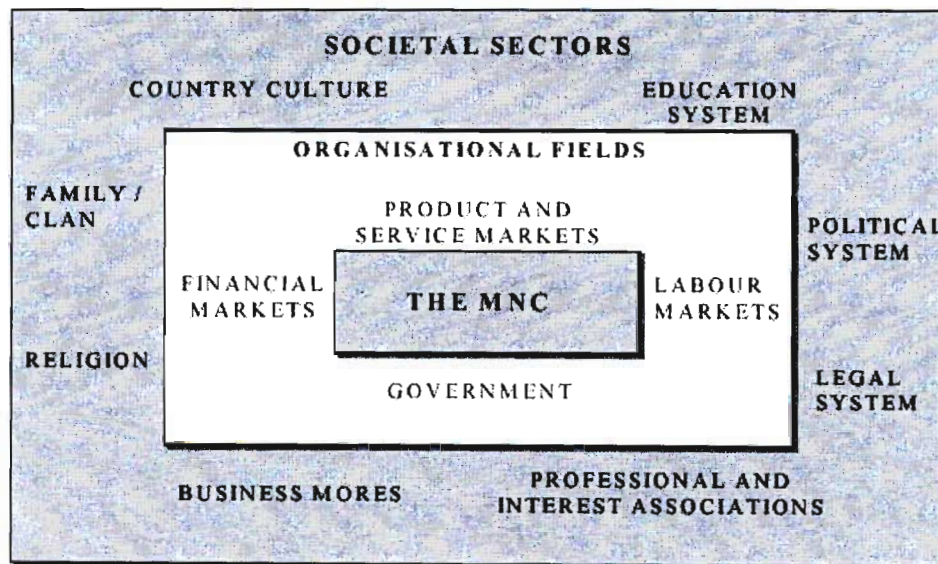
The "Institutional Network Theory" is developed by Jansson (2002) in order to analyse different countries' environments and to relate them to the international strategies of a company. Originally the theory was constructed for multinational companies (MNCs) operating on emerging markets, but the theoretical framework can be modified and thereby be used as a means of strategic information collection for the export information and advisory services of the export promotion programmes. The main advantage of using an institutional approach, compared to environmental analysis is the *greater possibility to penetrate the environment in depth and gain knowledge of how it influences the company* (Jansson, 1999, PP.1-4 in Emilson and Holmberg, 2000. PP. 17)

Jansson explains the external environment of a company, active on an international scale, consists of a multitude of economic and non-economic actors and factors, which are referred to as institutions (Jansson, 1999, PP. 7). All institutions together constitute the external institutional set-up of a company and how successful a company will be in its operations in a given country will be a function of how well it adapts to the characteristics of the business environment (Ibid PP. 8)

In other words the Institutional Network approach identifies and describes institutions that exist in a country, which set the rules and framework for how to conduct business. By identifying and describing the involved institutions, information of different dimensions such as norms, values, and standards, thought styles and enforcement mechanisms can be collected which help exporting SMEs on how to conduct businesses in the given country. Figure 2.3 shows Jansson's example of institutions that could be included in an environmental analysis.

According to Jansson the external set-up of institutions is separated into two fields, *societal sector* and *organisational fields*. The company participates directly in the organisational fields and the interaction between the institutions is a two-way one. This means that the institutions in the organisational field have direct impact on companies such as SMEs and includes institutions such as government, financial market, labour market, and product/service markets. Moreover under certain circumstances companies, especially MNCs can influence these institutions.

Figure 2.3. The Networks Institutions Model



Source: Jansson, 1999, PP. 10 in Emilson and Holmberg, 2000, PP. 18

In the societal sector, the company does not participate directly and the influence is one-way, from the institutions to the company (Jansson, 1999, PP. 8). Since the influence is one way there is no manner to adapt or change them rather than just to take them.

Institutions included in the societal sector can be country culture, family clan, education/training system, legal system, political system, business mores etc.

In the centre of the model is the network between the company and some of its major external parties on the product and service market. The company and its network actors on the market are influenced by institutional structures (“macro rules”) in the societal sector. The institutional context of a market facilitates or hinders the implementation of a certain strategy (Jansson, 1999, PP. 10).

However, the network approach will in this thesis focus on how the various institutions within a country influence the SME, and put in a perspective of identifying the most crucial factors for a company planning to enter a specific market in the country.

Industry Analysis

Industry analysis is important way of gathering necessary information to better understand the industry context in which the firm competes. According to Jansson, product and service markets part of the Institutional Model can be analysed by using a number of various tools. One of the techniques used for analysing the product service market or industry factors is the Five Forces model developed by Porter. *Porter's model is based on the insight that a firm's strategy should meet the opportunities and threats in the organizations external environment.* Especially, competitive strategy of the SME should base on the understanding of industry structures and the way they change. The concepts within the model are shown in figure 2.4.

The first step is to look at the industry competitors i.e., to see the extent of *competitive rivalry* that exists. Competitors usually struggle for position by using such tactics as price competition, advertising battles, product introduction, and increased customary service or warranties (Kotler, 1992, pp279-80). The next thing to look at is the *power of buyers* in the marketplace, which affect the business. This is important as buyer arrangements can mean hindrances for certain markets. Similar to buyers, *suppliers* can exert power over a business by threatening to raise prices or reducing the quality of goods and services they provide (Kotler, 1992, pp280).

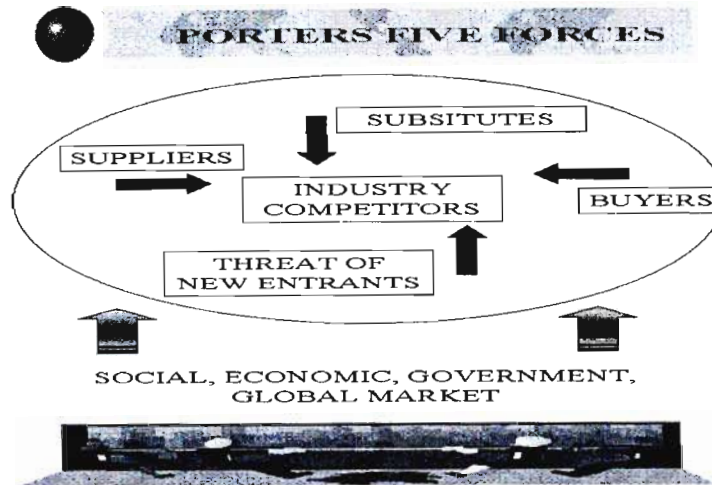


Figure 2.4. The Porter's Five Forces Model

Source: - <http://www.ecommerce-now.com/images/ecommerce-now/porters5force.htm>

The next step of the analysis is to look at the threat of *substitute* products in the market place, what products are in the marketplace, which do the same thing as our products but are not quite the same? Substitute products or services serve similar consumer needs in the industry. The final step is to look at the state of the marketplace and see what the potential *new entrants* may be. Where are the new products coming from? The extent to which new competitors can enter to the industry depends on economies of scale, capital requirements, switching costs, access to existing distribution channels and most importantly product differentiation and brand loyalty.

Although the Porter Five Forces model may at first appear rather simple, once the information is assembled, it will provide valuable information. In a static analysis the Five Forces analysis allows determining the attractiveness and/or profitability of an industry. Thus, it supports decisions of SMEs about entry to or exit from an industry or a market segment.

However, it is worthwhile to remember that the Porter's Five Forces model works on the assumption of stable environment or static market structures, which is hardly the case in today's dynamic markets.

Internal Analysis

The second step of the information collection framework deals with analysing the SME's current position and comparing it with other competing firms. As this type of information is to be gathered from and supplied to the SME itself it takes a very different focus than the previous step of analysing the external environment. In understanding the background of SMEs we can use the value chain analysis (VCA). VCA describes the activities that take place in the business and relates them with the analysis of competitive strength of the business. Thus in collecting information through the value chain analysis managers should look at the primary and supporting activities of the business. Analysing the primary activities involves evaluating those activities, which are concerned at creating value or delivering the product. These include inbound logistics, operations, outbound logistics, marketing, sales and services. Correspondingly analysing the supporting activities focuses on those activities, which increase the efficiency and effectiveness of the primary activities. Supporting activities include human resource, finance, research and development and others.

Analysing the core and supporting activities can help identify the crucial resources for the firm's competitive advantage. Thus value chain analysis highlights differences across firms, including specific differences in cost, differentiation or focus advantages between competing firms and the willingness of customers' to pay. This enables managers to know the firm's position in the market and its ability to capitalize on the opportunities and minimize the weaknesses that exist in the environment.

As the internal analysis deals with a single firm who is inquiring the information, in most cases, the collection and provision of this information is handled by the export consultancy and development services or market research organizations. However, the export information provision service should, to a certain extent, also cover this type of information, as it will establish the strategic opportunities to the firm's internationalisation process.

2.3.3.2. Establishing Global Objectives

Having explored the main issues in the environment surrounding the business, it is now time to define the global goals and objectives that the SME has to have to compete in the foreign market. At this stage there is no information to be collected but analysis of the

information, which is gathered from the external and internal environments, will be made so as to define the basic strategic issues of the SME. Therefore, this analysis helps the SME decide whether to defend its domestic market or expand in to foreign markets. The techniques available for developing global objectives include SWOT Analysis, Impact Analysis, and Grand Strategy Development Matrix.

Government export development and consultancy services or international marketing research firms provide this type of information. However, it should be recognized that this information is critically important to the internationalisation process of the firm. With out clear and definite goals and objectives it will not be easy to tackle the difficulties that arise in managing exports to foreign markets.

2.3.3.3. Market Screening and Selection

What comes after developing global objectives is screening and selecting the markets to in which the SME is to compete. This is a crucial step in the SME's a global expansion strategy as it entails assessing foreign markets in order to discern the most desirable from the less attractive ones.

The screening process uses five filtering information sources gathered from secondary data. The first four steps help identify the most attractive markets while the final step involves selecting from among those groups based on the company's objectives. The initial list of target countries decreases as we go down through the steps. In selecting the target market we can use the market attractiveness/competitive strength matrix as well as country attractiveness/competitive strength matrix. The screening steps determine the information to be collected by the export information and advisory services as well as by the export development and consultancy services (Internet 37):

- i. Identifying the targeted countries
- ii. Use of macro economic: - variables such economic, social, political, geographic and regional market agreements
- iii. Potential market size: - factors such as product acceptance, cultural consideration, tax duties, infrastructure, etc.
- iv. Micro factors: - such as competition, ease of and cost of entry, profit potential, use of customs brokers, and the focus of the firm.

- v. Evaluating remaining countries according to the firm's objectives and attractiveness index.

As the steps clearly show, the information to be collected differs at each step. However, part of the information is already covered in the previous steps of environmental analysis. By and large, the process provides decision makers with the potential risks and benefits of entering a foreign market.

2.3.3.4. Foreign Market Entry Modes

The next step of strategic information collection for supporting export-oriented SMEs involves gathering information on foreign market entry modes. A firm may enter new markets in a number of ways. Although various terms are used, the basic choices are categorized into exporting, intermediate, and hierarchical modes. Each of these modes of entry encompasses a number of alternative entry strategies, which offer particular advantages and disadvantages (Hollensen, 2001, pp. 241).

The collection of information at this stage involves identifying the internal and external factors that influence the firm's foreign market entry mode decision. The provision of this type of information is crucial to future growth and development of the SME. Therefore, it can be handled by the export development and consultancy services and to some extent by the export information provision services of the export promotion organisation (EPO) of the country. However, the export information provision service doesn't fully satisfy the needs of SMEs with regard to this issue but can provide complementary information to the export development and consultancy services.

2.4. The Export Finance Needs of SMEs

In the preceding section, the export information assistance of SMEs was discussed. In this section, the export finance needs of SMEs, which is the second element of export promotion services, will be discussed in detail.

2.4.1. The Importance of Export Finance

"A major issue for existing and would-be SME exporters is the question of financing deals and obtaining related services such as credit insurance. Other preoccupations of

SME exporters include having sufficient working capital and being able to operate without too much reliance on receivables” (Internet 9). This is mainly because SMEs cannot always get advance payment from customers on export sales. Unless they get pre-shipment financing, the strains on their working capital [and the risks of non-payment] are often more than they can manage (Internet 10). This makes “financing more often essential in international trade than in purely domestic transactions because the gap between production and payment is likely to be far greater, due to the longer distances involved in shipping goods and moving payments through financial channels (Internet 11).”

Several studies have confirmed this importance of export finance services or resource availability to the performance of the firms’ exports. A study of 350 SMEs in the Mercosur region indicated that greater access to bank finance has a positive effect on exports. Also shown to have a positive impact on export performance is the strength of the bank-business relationship. This finding suggests that it is important for small firms to establish a trusting relationship with a bank. The benefits may include improved access to credit or greater choices in financing--both critical ingredients for export success (Miller, Margaret, and Gerard Caprio, 1997) Internet 12).

Likewise another empirical study (Ling-yee & Ogunmokun, 2001) identified that export financing resources and export supply-chain management skills as significant contributors to both low-cost and high-differentiation export competitive advantages.

However, this being the case for a successful export many SMEs face interrelated problems in financing their international transaction. First SMEs lack the required working capital in producing export products and mostly depend on financial institutions. But “financial institutions assess SMEs as being inherently high-risk borrowers owing to their low capitalization and limited assets, vulnerability to market fluctuations and high mortality rates. Besides the significant administrative and transaction costs associated with lending or investing small amounts do not make SME financing a profitable business for private commercial banks” (Internet 13).

Furthermore financial institutions usually do not possess better information about the expected profits of established SMEs than the entrepreneurs or managers connected with

those enterprises. This lack of information (information asymmetry) leads to higher market rates to compensate for higher cost of information collection, the smaller volume of external financing and the greater risk of failure (Internet 14).

Finally lending to SMEs is more likely to be backed by collateral than lending to larger firms so as to reduce moral hazard and adverse selection. This may lead to situations in which the decision to extend loans is based not on expected returns but rather on access to the necessary collateral. Many SMEs lacking access to "good collateral" suffer from credit rationing (Internet 15). As a result institutional lenders become unwilling to provide short-term, pre-shipment, working capital for export contracts and to take into account an SME's foreign accounts receivable in calculating their line of credit.

2.4.2. Payment Systems and Risks in International Trade (Exporting)

In conducting international trade there are two important things that the firm needs to consider. The first is that the choice of method of payment. The second one deals with the risks involved in the each of the methods of payment.

2.4.2.1. Payment Systems

There are four common ways for customers to pay an invoice in international trade. These include paying cash in advance, opening an account, letters of credit, and using documentary collections. Except the advance cash payment system all these transactions involve risk to the exporter. However, only few foreign buyers are willing to pay *cash in advance*, with the exception of custom orders (Internet 16).

Selling on "*open account*" which is the norm in the domestic business may seem safe, especially when dealing with major industrialized trading partners. But it carries very high risk to the exporter. The seller ships the goods and relies on the buyer to pay the agreed price at the agreed time. This method is used when the buyer and seller have an established relationship. After cash, a *letter of credit (L/C)* is the safest bet for an exporter. To close a deal, a foreign buyer gets its own bank to essentially guarantee payment with a letter of credit. In turn, the exporter can have his local bank "confirm" the letter, which essentially guarantees that the exporter gets paid regardless of the actions of the foreign bank.

A fourth payment option costing less than an L/C is a "*documentary collection*." This includes a bill of exchange — an unconditional request from the exporter for payment on demand or at a specified future time — as well as other documents transferring ownership. The seller ships the goods before receiving payment. The seller will use a bank in the country of import (usually the importer's bank) and exchange the export documents for payment. The importer's signature only establishes the obligation to pay, not the ability to pay. The exporter may be in the position of losing control of the documents, and therefore the goods.

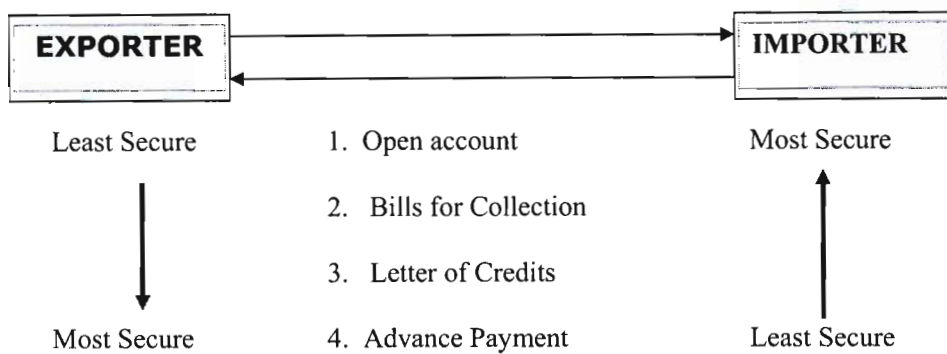


Figure 2.5. Export Payment Systems and Their Risks

Source: HSBC Bank <http://www.ukbusiness.hsbc.com/hsbc/ib/exporting/terms-of-trade>

Figure 2.5 summarises the four ways of payment methods for international trade according to their order of suitability to the exporter and importer respectively. For an Exporter, 'Advance Payment' is the most secure method of receiving payment, followed by Documentary or letter of Credits, then 'Bills for Collection' and 'Open Account', which is the least secure. It is the reverse for an Importer, 'Open account' is the most secure method of payment, followed by 'Bills for Collection', then 'Documentary Credits', and 'Advance Payment' which is the least secure (Internet 17). It has to be recalled that most of the foreign customers want an open account when ordering goods or services from the exporter. What comes after discussing the different types of payment in international trade (Exporting) is analysing the risks involved in.

2.4.2.2. Exporting Risks

Trading overseas inevitably exposes a business to certain risks. As an exporter the fundamental risk is non-payment by the customer (Buyer). The common risks in exporting that result in non-payment are commercial and political (Dunn A, & Knight M, 1982, PP.15): *Commercial loss* arises through the inability of the buyer to meet his obligations vis-à-vis the exporter, because of his insolvency or bankruptcy or other severe deterioration in his financial position. *Political loss* arises through the occurrence of some event in the buyer's country, which hinders or prevents him from meeting his obligations towards the supplier. Political events can cover the whole spectrum from war or civil war to an inability to pay caused by the non-availability of foreign exchange. Other risks added to these are the standard *credit risks* where the buyer will not pay; refusal of goods; and unfair contract termination.

As financing is increasingly becoming a key to winning export sales customers now demand that exporters arrange financing for sales. However, in many emerging markets, where the greatest export growth opportunities now exist, commercial banks are often unwilling to provide financing, even for credit-worthy customers (Internet 18). The absence of these credit and finance facilities to exporting firms and the increasing commercial and political risks of exporting are undoubtedly reducing the competitiveness and export activity of SMEs in international markets. Therefore, as Dunn Knight (1982, PP. 10,) suggest, an insurance or rather risk mitigation facility supported by the Government of the exporting country (either to the exporter or to the exporter's bank) could provide the necessary protection to enable exports to take place and would be acceptable to banks providing associated financing; to protect and promote exports.

For that purpose government export credit agencies have stepped in to finance the sales, either through direct loans to the customer, or through guarantees and insurance that a commercial lender will be repaid by the customer. With guarantees/insurance commercial banks are willing to provide financing (Internet 19). The following section will discuss the common export credit and finance services that are provided to exporting firms.

2.4.3. Export Credit and Finance Schemes

According to Dunn & Knight (1982, PP. 7) the expressions export credit and export finance mean the set of facilities available to an exporter in any country to help him cover the risks of non-repayment in his export business. All major exporting countries have arrangements to protect exporters, and the banks that provide them with funding support, from the risks of exporting. Dunn and Knight explain these arrangements are based upon insurance concepts and they also provide a bridge between the buyers and suppliers of internationally traded goods and services, and the banking systems, which provide the funding necessary to support such trade. In all cases, governments have inescapably become intimately involved in a number of areas.

Most countries argue that the availability of export credit and finance services is crucial to the country's economic growth. At the national level, these services can assist in increasing the country's international competitiveness by diversifying exports geographically, developing new markets and facilitating investment by its companies abroad. At the firm level, they enable exporters and investors to better manage risks in increasingly competitive international markets. The following paragraphs describe the different facilities, which are generally available in most of the countries export credit and finance services.

2.4.3.1. Export Credit Insurance Policies

As discussed in the preceding topics many exporters sale on credit in which the risk of non-payment becomes a question to be solved. In such cases they require an insurance that protects them from the risk of non-payment. Hence, Government *export credit insurance* policies become necessary to protect exporter against the commercial, political and other risks that cause non-payment (Figure 2.6).

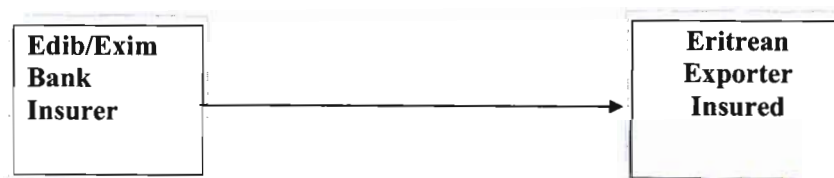


Figure 2.6. Export Credit Insurance Program adapted from Belay, 2000, PP. 270-7)

In most countries there is an official Export Credit Agency (ECA) or Export Credit Insurance Corporation (ECIC) that protects part of the losses arising from non-payment relating to commercial and political risks.

2.4.3.2. Export Credit Support (Financing an Export)

Export Finance involves the provision of financing by a bank or financial institution in support of an export of capital goods equipment and services or of a turnkey project to a buyer, often located in a developing country. A financing will normally be backed by a guarantee or insurance policy issued by the official Export Credit Agency (ECA) of the country from which the equipment is sourced (Internet 20).

There are instances where the exporter cannot cope with the cash flow difficulties or the risks of extending long-term credit for the export contracts. Things become worse as overseas buyers don't want to pay in cash for major projects or imports of high value capital goods and services. In such cases there are two alternative ways of financing for the exporter: Buyer Credit and Suppliers Credit (Internet 21).

In the case of *Buyer Credit Financing* the exporter looks for ways of financing the buyer from local banks. However, banks may only be willing to lend such large amounts to the buyer provided that they are guaranteed for full repayment. The credit guarantee that is given to the exporting firm is known as *Export Credit Guarantee*. The following discussion will explain how export credit guarantee works.

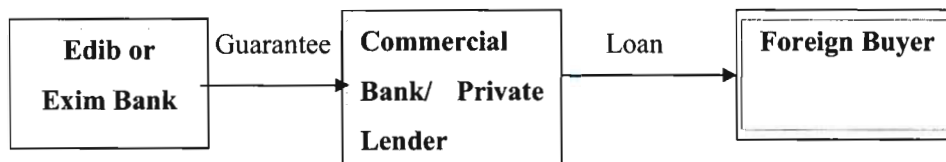
2.4.3.3. Export Credit Guarantee

Export credit guarantee-Buyer Credit benefits all the parties (the exporter, buyer, and the bank) involved. The exporter is paid as he has a cash contract with his buyer. The buyer is given the chance to borrow from the exporter's bank at favourable fixed or floating rates and a period of time to pay. The lending bank will also benefit as it is guaranteed for both the full repayment of the loan and a reasonable return on its funds (Internet 22).

Under the *Supplier Credit Financing* arrangement, a supplier agrees to allow deferred payment by his customer of the financed amount of the contract. The supplier in order to get his receivables as soon as he can after the performance of the work uses supplier credit mechanism. At the same time, the buyer in fulfilling his obligation to make

extended payment to the supplier issues a stream of promissory notes or accepts the stream of bills of exchange, which may be interest bearing. Once the bills or notes have been received by the supplier, an arrangement can be made between the exporter and his bank under which the bank buys or discounts them, thus effectively providing credit through the supplier to the buyer (Dunn & Knight, 1982, PP. 8-10,) Similar to the case of Buyer Credit Financing, the bank will only buy or discount the bills or notes provided that there is a credit guarantee for the risk of default. Figure 2.7 explains the buyer financed export credit programme.

Figure 2.7. Export Credit Guarantee Program adapted from Belay, 2000 PP. 270-7



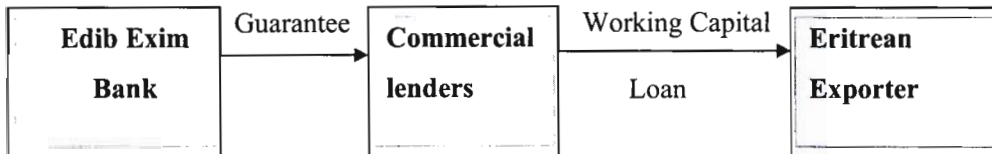
The benefits of Supplier Credit Finance are clear. One benefit of this scheme to the exporter is that finance can be made available in many cases without recourse. If the buyer defaults on the credit, the risk lies with the bank, and ultimately with that provides the bank with guarantee of payment i.e. the Export Credit Guarantee Department.

Continuing with the discussion of export finance there are some other situations where the SME needs direct finance to fulfill foreign trade obligations. It is clear that one of the preoccupations of exporting SMEs in addition to covering the risks involved is having sufficient working capital and being able to operate without too much reliance on receivables. The solutions available to such problem include providing loan from the export import bank (*Exim Bank*) if available or issuing a *loan guarantee* that enable SMEs to have access to finance from other banks (Figure 2.8). The Eritrean Development and Investment Bank (Edib) is used as the provider of the finance here.

For example, in providing trade finance facilities, the Eastern and South African Trade and Development Bank (PTA Bank) provides a *pre-shipment loan* to exporters to help them with working capital for purchase of raw materials and processing and packaging

of the exportable commodities. In providing pre-shipment finance, the bank uses the firm's exportable commodities as the primary security (Internet 23).

Figure 2.8. Export Working capital guarantee Program adapted from Belay, 2000, PP. 270-7



In addition the PTA bank offers exporters with a *post-shipment loan* that assists them to bridge their liquidity needs where exports are made under deferred payment basis. A typical mode of post-shipment financing is bills discounting, which serves to provide liquidity to an exporter by advancing him/her a portion of the face value of a trade bill drawn by the exporter, accepted by the buyer and endorsed to the PTA Bank.

Moreover, the bank provides both *issuance and confirmation of L/Cs*. It issues import L/Cs in favour of suppliers within or outside the COMESA for account of its customers having good track records. The Bank also adds its confirmation to Letters of Credit opened by buyers through their banks where the exporter is unwilling to take a risk on the buyer's bank, the issuing bank. Other services provided by the PTA bank that help to boost trade and finance include loan syndications, contingent liability based business, structured finance, hedging facilities, and securities backed finance (Internet 24).

2.5. Formulation and Implementation of Export Promotion Policies and Programs

This section aims to introduce the concept of export promotion policies and networking strategies between the different organisations in the export promotion and tries to explain how responsibilities are distributed among these various organizations and agencies to formulate, approve, and implement policies that promote and develop exports of small and medium sized enterprises (SMEs).

2.5.1. Government Economic Policies and Export Promotion Policies

The inability of developing countries to significantly increase their export volume on their own is greatly influenced by their level of national economic development. This in turn affects their level of poverty, unemployment and economic growth. Hence, most developing countries make export promotion and development a priority in order to achieve economic development goals. The expectation of these Governments is that sustained export promotion and development efforts will help earn additional foreign exchange needed to cover the cost of imports, solve balance of payments problems, help reduce the burden of increased foreign indebtedness and create additional employment for people (Internet 25).

Export promotion refers to “the collective programs a nation has to help companies sell products abroad. These programs may include business counseling, training, and representational assistance, as well as providing market research information, trade fair opportunities, and export financing assistance” (Internet 26). As explained in the above discussion export promotion programs emanate from the governments specific national objectives and strategic policies, which when implemented constitute a program towards promoting exports. Indeed as Hibbert explains it “national export objectives and policies guide the creation and performance of national export promotion programs that will provide support to manufacturers [exporters] for the achievement of specific export targets” (Hibbert, 1990, PP. 80).

In most countries, export promotion efforts are done under the auspices of the country’s Trade Promotion Organisations. Thus trade promotion organisations (TPOs) concentrate most of their efforts on export promotion; that is, a set of actions aimed at promoting export of the country's existing production. The trade promotion policy of a country is comprised of programs and measures that promote and develop trade with other countries. They are part of the overall foreign trade policy and cannot be considered alone. The country’s foreign trade policy must make it possible to achieve trade promotion policy objectives (Internet 27).

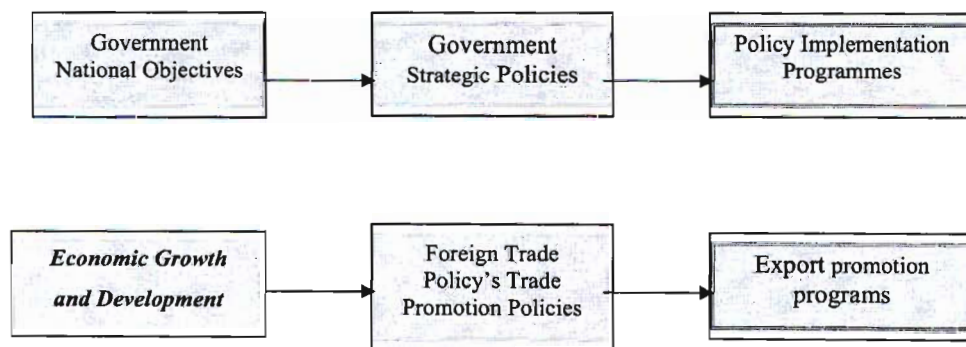
Figure 2.9 describes the relationship between government national objectives, specific strategic policies and strategy implementation programmes with regard to export

promotion policy and programs. The figure explains, “a national export strategy must be comprehensively integrated into the overall economic planning framework” (Internet 28). It can also be seen that Export Promotion Programs are part of the implementation programmes of the government’s strategic policies. Thus, “export promotion programs (EPPs) are the guiding lines laid down by export promotion policies, which decide how export activities should be performed, who should perform it, and how it relates in function and in time to other export promotion activities” (Hibbert, 1990, PP.80).

The basic objective of export promotion activities is to encourage increased sales of products that are currently available for export. All promotional efforts are aimed at increasing the value of foreign sales of the existing production by a given target, thereby leading to increased foreign trade of the country.

It is worthwhile to mention that the political, economical, technological, social and behavioural features of the nation and its people will affect its national export promotion strategy. Therefore, for any country’s export promotion policy and programs to be effective, there must be macro economic order including a stable exchange policy, and clear and strong [environmental] and investment rules to guarantee export activities, accompanied by a continuous modernization of the state apparatus (Hibbert, 1990, pp. 76). This is the basic policy source for export promotion programs outlined by the government’s economic development policy.

Figure 2.9. The Relationship Between Government National Objectives and Export Promotion Programs



The export promotion strategies of a nation should focus on enterprise, industry, and national levels (Internet 29). *Enterprise level* export promotion is provided because

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part of the business community is unable to significantly involve in export activity on its own. Some of the reasons for enterprise level export promotion could be the limited number of commodities available for export, lack of downstream activities which limits industrial production of exportable goods, enterprises dependence of on one or two key export markets, and enterprises lack of export readiness.

Industrial level export promotion focuses on increasing the export of existing products initially and secondly developing new exportable products. The initial export strategy devotes on enhancing and consolidating the volume of export in to existing markets as well as diversifying to other export markets while the second dimension involves making an assessment of what new products could be developed for export markets, i.e., exporting through industrial cluster planning.

AT the *national level* of export promotion the government sets the overall economic direction and trade development strategy. Establishing the export dimension of this strategy in terms of appropriate economic instruments and export promotion measures is critical to national export performance. Therefore, the design of relevant trade policies is the key to a successful national export promotion programme (Internet 30).

Finally for a successful export promotion programs effective trade support networks at the national and regional level must be put in place. Since most Governments have many institutions responsible for various foreign trade activities and an assortment of policies, procedures and practices that affect foreign trade performance, it is important to have effective mechanisms to co-ordinate among trade-related institutions and organizations (Internet 31). The next section will be on the structure and characteristics of networking between the different trade support institutions themselves and enterprise managers.

2.5.2. The Network of Main Actors in Export Promotion Program

As the ITC's Trade Support Institution's (TSI's) reference manual states, it does not necessarily follow that the export performance will improve just because a national export strategy has been designed. A structure encompassing both institutions and inter-institutional linkages (e.g. shared directorships, committees) is required for successful leadership and concerted action (Internet 32).

Such a network is needed to formulate policies and programs through which the export goals are established in the national plan fitting with the other national plans. In addition this network should exist in order to oversee the implementation of the created programs and to ensure an effective feedback form experience, which would improve the formulation of future plans for the export sector (Hibbert, 1990).

The objective of the trade support network is to deliver the needs of the group of exporting SMEs at low cost. In addition the network has to address the longer-term issues of national competitiveness i.e., promoting new entrants into the export community, stimulating international entrepreneurship, developing new export industries and increasing national “value-addition” (Internet 33).

2.5.3. Characteristics of Trade Support Networks

The network approach implies that several, perhaps even numerous, specialized organizations are engaged in providing competitiveness enhancement and trade support services. It also implies that each of these organizations has its specific mandate and role – that it addresses specific needs – and that effective working relationships exist between and among all network members (Internet 34). How well the links or relationships across these actors are structured and managed can determine how well any small, young or tentative exporter grows. Therefore, due to the nature of modern and diverse economies, where businesses face many choices for development, is such that formal structures will ensure more consistent results. But, the networks must be built with flexibility in mind to adapt to today’s rapidly changing environment (MacLean Internet 35).

Although there is no single model that will suit all countries at all time there are some common and crucial characteristics for a network of main actors. First, there should be a structure encompassing both institutions and institutional & functional linkages at the three stages of the export strategy process to provide leadership and concerted action. These sets of strategic linkages are: planning and consensus-building linkages, implementation and efficiency-building linkages, and performance monitoring and assessment linkages (Internet 36).

Second the structure of the network should create formal and informal linkages between the three principal stakeholders in the national export development effort: government, the private sector and labour. Formal linkages are needed among the most senior decision-makers in major sectoral ministries and private-sector organizations while informal linkages are required among all key institutions.

Effective trade promotion strategies are based on a continuous process of design, implementation, monitoring and evaluation, feedback and refinement. This activity does not end with the design of the strategy. Therefore the trade support network should work ensure the commitments of both the national government and the private sectors in all phases of the strategic planning cycle.

As it was said earlier no single networking model has universal application. However, the following checklist from International Trade Centre provides the basic characteristics for an effective trade support network.

1. The network should operate within the framework of an export development strategy that specifies priorities and targets.
2. The network should include decision-makers from public sector organizations concerned with key determinants of international competitiveness.
3. The network should be sufficiently flexible to provide different types and combinations of trade support services to its various client categories.
4. The network should have an effective referral system.
5. The network should cater to the trade support needs of the potential exporter of services.
6. The network should aim to simplify the supply chains of local exporters and to raise their position in the value chains of international buyers.
7. The network should give top priority to standards and quality management issues
8. The network should address the issue of competency development.
9. The network should give precedence to “border-in” capacity development issues.
10. The network’s border-in services should include investment promotion.
11. The network should be run like a business.
12. The network should be effectively coordinated.

13. The network should be subject to performance assessment.

Having mentioned the characteristics for the Network of main actors, table 2.3 presents a summary of the most relevant activities of the main actors (institutions) which Hibbert presents them as having impact on the national export strategy of the country (Hibbert, 1991, PP. 122). Most of these institutions are involved in the planning and execution of the national export strategy of the country.

	CM	PO	FTC	CB	MF	MT	MFA	EPO	SIS	BS	TS
Functions Related to Foreign Trade:											
Policy Recommendation		(X)	X	X	X	X	X	(X)	X		X
Policy Making	X	X	(X)	X	X	X	X	X			
Control Functions	X	X	(X)	X	X	X	X	X	(X)		
<i>Export Promotion:</i>											
Domestic Promotion Activities				X	X	(X)		(X)	X	X	
Advisory Services to Exporters						X		(X)	(X)	X	X
Commercial Representation Abroad							X	(X)			
Trade Fairs and Missions						X	X	(X)	X		
Incentives: Establishment	X	X	(X)	X	X	X		X			
Granting			(X)	(X)			X				
Export Credit			X				X		(X)		
Export Credit Insurance			X	X			X	(X)			
New Export Development	X	X	X		X		(X)		(X)	X	
Training							X	(X)		X	

Table 2.3. Institutions Concerned with Export Promotion and their Functions

Source: - Edgar P. Hibbert, 1990, PP. 122-23

Keys to the table: CM= council of ministers and/or monetary council, PO= planning organization board/ ministry, FTC= foreign trade council or equivalent, CB= central bank, MF= ministry of finance, MT= ministry of trade/ commerce, MFA= ministry of foreign affairs, EPO= export promotion organizations, SI= specialised institution such as foreign trade institute, export credit insurance company, packaging institute, standards institute etc., BS= banking and financial system, TS= trade sector.

SUMMARY

Strategically thinking export promotion programs are the result of a country's export objectives and policies. A country's strategic economic policy leads to the development of trade promotion policies that are concerned with improving trade with foreign countries. Export strategy is seen as a means of implementing the trade promotion policies.

The basic objective of export promotion activities is to encourage increased sales of products that are currently available for export. All promotional efforts are aimed at increasing the value of foreign sales of the existing production by a given target, thereby leading to increased foreign trade of the country.

The main elements of export promotion services are information provision and export finance assistance. Export information is crucial to the growth of exports of SMEs. This information should be collected following the strategic management process and the export decision process of SMEs. Export finance is aimed at providing the financial and insurance needs of exporting firms. Financial needs arise in producing exportable products and fulfilling the working capital shortages whereas insurance services are needed to avoid the risks involved in exporting products to a foreign buyer. The successful provision of export promotion however depends on the organisation and networking of the activities and responsibilities involved.

CHAPTER THREE

THE CASE OF SMES AND EXPORT PROMOTION POLICIES IN ERITREA

3.1. Introduction

Eritrea is a small country on the northeast coast of Africa. Its area is approximately 121,320 sq. km with a population of 4 million. Eritrea is bounded in the northeast by the Red Sea, Saudi Arabia and Yemen, southeast by Djibouti, South by Ethiopia and west by Sudan. Some 300 islands from the Dahlak Archipelago are mostly uninhabited. Eritrea holds a strategic geo-political position along the busiest shipping ports Massawa and Assab.

3.2. History of Business and Industrial Development in Eritrea

Given its strategic location and easy access to the markets of the Middle East, Africa and Europe, Eritrea has a long history of trade, industry and manufacturing. The earliest records of trade are those of the Egyptian Pharaohs, who conducted numerous commercial expeditions down the Red Sea. The most important of the areas they visited was what they termed the Land of Punt, which modern scholars equate with the coast of what are now Eritrea and the northern part of Ethiopia. Such expeditions came to the Eritrean region largely in quest of myrrh and other incense, gold, and ebony, or other valuable wood (Internet 38).

In the past 100 years passed through many phases of colonization and industrial developments. The Italian colonization (1890-1941) brought both modernization and exploitation in to Eritrea. In the years between 1887-1930 trade and business started to grow significantly with the advent of modern industries and commercial farming agricultures that appeared due to the large Italian investment (MTI). This investment was aimed at producing agricultural produce for Italy. Numerous food processing and building material enterprises were established in this period, and mineral exploration was started (Internet 39). With the advent of these industries there was also a development in country's infrastructure.

By the early 1930s Eritrea was one of the most highly industrialised colonies with advanced infrastructural facilities in Africa (Internet 40). During this period there were over fifty industrial enterprises in Eritrea including five flourmills, two pasta factories, three bakeries, a canned meat factory, two tanneries, a vegetable fibre plant, a button factory, a cement factory, two salt works, a soap factory, an edible oil factory and a liquor factory (Internet 41). The number of industrial enterprises and commercial firms grew to over 700 and 2,000 respectively by the end of the 1930s. This made Eritrea a major exporter in this period (Internet 42). In the 1940s Eritrea's export base was relatively diversified earning – by 1970s – approximately *USD 100 million* worth of foreign exchange per year. During that period a variety of its industrial products used to be exported to Djibouti, Cyprus, Egypt, Ethiopia, Iran, Palestine, Sudan, Yemen and other neighboring countries (Makki, 1996).

During the Second World War when European exports to East Africa were cut, Eritrea supplied these markets (Internet 43). In connection with the war effort, Great Britain and the USA invested heavily in infrastructural facilities and a number of import substitution industries such as food processing, textiles, leather and leather goods industries flourished during this time. As a result a continuous mushrooming of new manufacturing establishments was witnessed between 1941-1943 (MTI).

Although this investment made Eritrea one of the most advanced country in Africa at that time it also resulted a phase of long-term economic decline. There was a market for Eritrean goods in the Middle East, which was cut off from Europe by the war, thus creating a scarcity of trade. As this war was short lived and peace returned to the world, Eritrean products could not compete with goods from Europe (Internet 44). This may be because of late mover disadvantage that European suppliers were already engaged the Middle East market. Thus, factories closed because machines could not function due to the lack of repair and spare parts, and thousands of Eritreans were unemployed.

This was also aggravated by the British policy to dismantle the economy of Eritrea. They removed or sold an estimated £86 million worth of industrial plant and equipment, including port facilities at Massawa and Assab, factories producing cement, potash, and salt, and railway equipment to other countries such as Sudan, Malta, Saudi Arabia, Egypt, Yemen and others (Internet 45).

After the British Administration left in 1952, Ethiopia enacted its own policy, weakening the Eritrean economy as part of the annexation process. Eritrean enterprises were asked to relocate to Ethiopia. Several key industries were closed and moved to Addis Ababa, the capital of Ethiopia. Their foreign owners were instructed to make the move or have their property confiscated. Moreover, foreign investment in Eritrea was discouraged. Besides, enterprises that continued to operate in Eritrea stagnated due to lack of basic supplies and infrastructure, such as electricity. These economic policies not only forced many foreign businesses to immigrate to other countries, but also left thousands of people unemployed and caused others to emigrate. *In 1958 these policies resulted in the largest workers' strike in the history of Eritrea in which about five hundred workers were killed or wounded.* These policies continued increasingly after the full annexation in 1962 resulting in decline of Eritrean manufacturing industry in particular and the whole economy in general.

In 1974, the Socialist Mengistu regime introduced a planned economy, which entailed nationalisation of the most profitable enterprises in the private sector. The socialist regime neglected the Eritrean industries. Hence there was no investment made either on the existing or new firms. In addition a number of profitable Eritrean industries were also transferred to Ethiopia. Furthermore the export potential of the remaining enterprises was deteriorating as all exports were channeled and marketed by the parastatal, Ethiopian 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 (G. Tsegay 2001). As a result the firms were left with outmoded technology, low product quality, low capitalization, and were also alienated from competing in the international markets because of underdeveloped marketing and business management skills. This resulted in a loss of the already existing export infrastructure and long accumulated experience thereby leading to weak marketing knowledge and poor financial capacity of the entrepreneurs.

With independence from Ethiopia on 24 May 1993, Eritrea faced the economic problems of a small, desperately poor country. The industrial sector, which once was the most advanced industry in Africa, is suffering from war damage, years of neglect, and deterioration, as well as outmoded capital equipment. It remained with light industries

such as, *beverages, processed foods, leather goods, textiles, construction materials, wood and metal furniture, salt works, paper products, and matches*. The agricultural sector is devastated from a lack of modern techniques and inputs; deforestation; and an outdated land tenure system.

As a result of this situation, the Ministry of Trade and Industry took the following measures to tackle the challenges facing the industrial sector of the country. These measures were by no means strategically important to stimulate the highly weakened industrial sector.

- Manufacturing establishments from the armed struggle were installed within their associated manufacturing establishments and independently.
- Many establishments, which were closed until independence, were rehabilitated, reactivated and resumed production.
- By setting priorities, the foreign currency required for purchasing raw material was fulfilled through RRPE programme.
- Efforts were made to replace the out gone Ethiopian managers and other qualified personnel from local people.
- Autonomous status was given to public manufacturing establishment establishments with regard to production, selling, purchasing and distribution activities in order to facilitate their privatizations. Then an extensive study was made on their privatization for commercialisation
- Manufacturing firms were helped to get access to financial facilities and international markets and support facilities.

In addition to that the current Government of Eritrea has stated from the outset that it is committed to a market economy and privatisation, and it has made development and economic recovery its priorities. The new Government has activated the state-owned industrial sector inherited at independence on a commercial basis and progressively began to privatise them. As a result of this privatisation policy most of the large public enterprises had been sold off to private owners. By the year 2002 only nine manufacturing enterprises remained under public ownership.

3.3. Economic, Investment, Trade and Industry Policies

It was discussed in the preceding chapter that export promotion policies are the result of the government's strategic economic policies. Bearing this in mind the following section discusses some of the economic policies and performances of the Eritrean economy.

3.3.1. Economy

The current Eritrea's economy is largely based on subsistence agriculture, with 80% of the population involved in farming, herding and fishing. However the share of agriculture to GDP is lower than that of manufacturing and mining industries together, which makes the economy more diversified. This small economy had a GDP of \$800 million in 2001. In this period, industry as a whole accounted for 22.3 percent of which the manufacturing accounted for about 7.8 percent. Services industry contributed 59 percent (18 percent of which is public administration), and agriculture 18.7 percent. As domestic sales and exports were increasing steadily from 1992-1996 the GDP was also increasing at a satisfactory level. However the GDP started to decline after the 1998 period as the border conflict forced exports to decline.

The Eritrea's macro economic policy issued in 1994 states creating a modern, technologically advanced and internationally competitive economy within the next two decades. This clearly shows the commitment of the government to promote the country's economic growth. The main objective of the policy focuses on developing an efficient, outward-looking, private sector-led market economy and a modern, irrigation based commercial agricultural sector, an outward oriented, strong manufacturing sector and a highly efficient, multifaceted service sectors.

In order to establish a strong agriculture base capable of providing abundant raw materials to industrial units and exporting primary agricultural products to foreign markets Eritrea needs to develop and implement strategic rural development plans. In addition Business development and support programs should also be devised to strengthen the competitiveness of the impoverished manufacturing industry sector. However, to achieve all these objectives effective trade promotion and industry development policies should be implemented to support agricultural and industrial

exports. One of these policies could be the export promotion and development programs aimed at enhancing the export performance of small and medium enterprises through different incentive schemes and support services. The improvement of the service sector also depends on enhancing the infrastructural facilities of the country.

To this end the government has recognized economic diversification; especially export diversification, as a key requirement for achieving sustainable, broad-based growth in the new century. The loss of the Ethiopian market and rising debt means that increasing exports is very important. Therefore, considerable attention should be given to increasing comparative advantage in labor-intensive manufacturing for export because of the potential for dramatic growth based on experience in other developing countries.

3.3.2. Investment Policy

Eritrea's investment policy, promulgated in 1994, offers significant incentives to foreign investors, including elimination of the requirement for joint ventures, reduction of the tax on profits, the right to remit profits in hard currency, judicial protection from nationalisation and significant reductions of customs duties on imported items.

The Investment Code was reformulated and the Eritrean Investment Centre was established. Between 1992 and 1997, 500 new companies were licensed, although it is not known how many materialized. The Business Licensing Office (BLO) was designed to be a one-stop shop. Industrial estates were established on the outskirts of Asmara, Dekamhare and Dubarwa.

Table 3.1 shows the number of investment proposals of the manufacturing industry presented to the investment office with their initial capital outlays and employment opportunities from the year 1992 –2001. The sources of these investments were from Eritreans residing abroad, Italian, Egyptian, Jordan, Korean, USA, and Chinese investors. Most of these projects are implemented and are operating and few of them are involved in exporting at a small-scale level. However the rest are import substitution oriented businesses. It is expected that these projects will bring a new skill and knowledge base to the existing Eritrean firms.

Table 3.1 Investment Projects Approved By Eritrea's Investment Centre From 1992-2001

Year	No. Of Projects	Initial Capital in Nakfa	No. Of Employment
1992	07	41757479	381
1993	15	66288055	786
1994	24	137711176	588
1995	50	301391944	1106
1996	76	362023301	1789
1997	61	431137109	1787
1998	68	217195852	1130
1999	54	218075016	978
2000	21	158981550	567
2001	33	103910388	1227

Companies learn a lot from their competitors and counterparts. It can be seen from the table that the number of incoming projects was declining as of 1999 when the border war erupted with Ethiopia.

3.3.3. Trade Policy

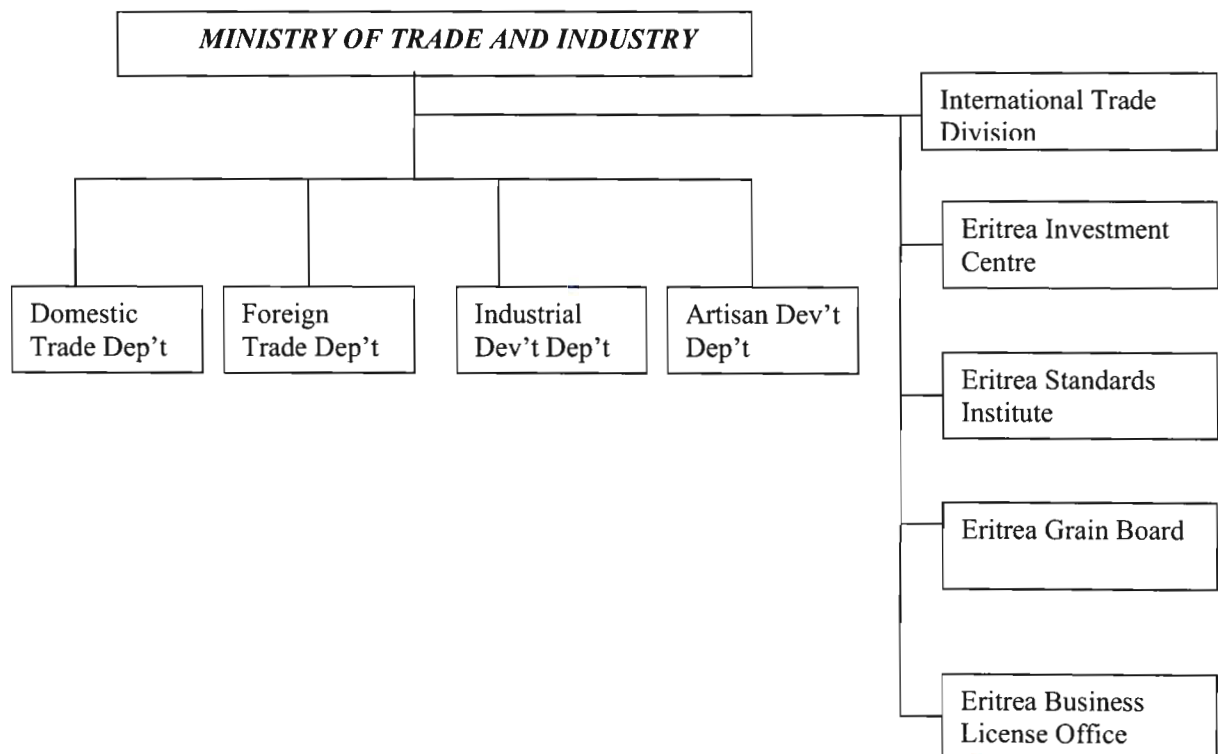
The government of Eritrea has decided to give the expansion of trade prominence in the development effort in order to remove constraints that might otherwise be imposed by the limitations of the domestic market. Expecting that Eritrea's unutilised resources in agriculture, fisheries, and mines will be able to support expansion in external trade, the government has enacted a series of policy measures designed to accomplish the following.

To promote foreign trade the Government is concentrating on industries in which there is already a significant level of skills in the country and which require relatively low levels of capital such as garments, knitwear and shoe uppers. In addition, the Government hopes to take advantage of the fact that the Cotonou Agreement gives Eritrea preferential access to the European Market, the free trade agreement of the COMESA region, and the United States Africa Growth and Opportunity Act (AGOA) gives Eritrea duty and quota-free access for garments for the next 8 years.

3.3.4. Industrial Policy

Initially, the industrial policy of the government was based on the principle that manufacturing firms should operate on a commercial basis, without reliance on any form of protection or subsidy. There were no specific incentives for manufacturing firms: government policies (including fiscal incentives) were sector-neutral. The declared economic role of the government would be in those areas in which the private sector is not interested to invest (GOE, 1994). This policy has resulted in poor performance of the public and private enterprises as they were mainly focused to the small domestic market not export oriented.

Figure 3.1. Organisational Chart of the Ministry of Trade and Industry



However, the National Economic Policy Framework and Program for 1998-2000 underpinned that "Eritrea's industrial strategy should aim at creating an environment that would facilitate the efficient expansion of manufacturing output in industries where Eritrea has comparative advantages. These industries include textiles and garments, leather products, general agro-processing, metal fabrication, plastic processing

conversion, construction materials, and other resource based industries". The National Economic Policy Framework and Program also indicated that the Government will, in collaboration with the private sector, take measures to encourage the development of small and medium-scale enterprises through, inter alia, providing industrial support services, including adequately serviced industrial estates, business incubators, and other support measures, such as ensuring access to credit and training.

Given the above policy framework, concrete measures should have been taken by the various implementing agents to achieve the desired objectives. However, it appears that the general policy guidelines outlined in the National Economic Policy have not taken in to consideration the assignment of specific roles for the implementing bodies in the public and private sectors. Looking at the institutional structure of the Ministry of Trade and Industry (MTI) critical institutions like trade promotion organizations (TPO's), export promotion and development organization and business promotion and development centers are lacking (Figure 3.1).

In the old structure of the MTI the department of trade (DOT) was responsible for the promotion of trade internally and externally with foreign markets. It was the foreign trade division of the department of trade that opposed the existence of the export promotion and development center saying that the center creates a redundancy of activities. The new chart gives more emphasis to the trade promotion or export development, as there are two agents responsible for foreign trade. These two units include the foreign trade department and international trade division. If these two areas are working in cooperation the result will be fruitful. As it is known the resource to be deployed by the foreign trade department and the international trade division is very limited. Therefore care must be taken these units will not create redundancy but work in cooperation with each other. In addition it should be understood from the beginning that the needs of those clients be the basis of the services to be provided by these areas. Potential exporters who need trade support services should be identified and there should be a network of the main actors in the trade promotion programmes. In order the network to be effective the network should operate within the framework of the trade promotion programmes or the export promotion and development policies specifying priorities and targets.

3.4. Overview of the Industry and Situation of SMEs in Eritrea

The industrial development policy of Eritrea endorses the development and Promotion of light consumer goods industries and other industries based on the country's agricultural resources initially and thereafter, competitive high-tech industries and export oriented industries. Industries so established should be designed to exploit the specific factor endowments of the country. The Macro-Policy also envisages the provision of knowledge and skills to improve the productivity of indigenous handicrafts and cottage industries.

The Ministry of Trade and Industry defines firms in to Micro, Small, medium or large enterprises based on the number of employees the firm accommodates. This means initial capital, total business area or other additional factors are not taken in to consideration when classifying firms, which is not the case in many other countries.

The 1996 survey of small and informal businesses identified about 8000 small-scale firms employing 3-9 persons and 420 medium scale Employing 10-25 persons each. The number of large-scale enterprises was only 105 employing above 25 persons each firm. This clearly shows that the classification of firms in Eritrea follows the current business and economic development in the country. The largest company with the highest number of employment was Asmara Textile Factory that employed about 2119 people in 1997. Most of the other large enterprises don't even reach the 1000 employees range. In fact, according to the MTI almost half of the large-scale enterprises have labour force less than 50 people. Furthermore, over 80% of the MSMEs employ only 1 or 2 people. This indicates that Eritrean enterprises are capital intensive.

The industrial sector in Eritrea is still relatively small employing some 25,000 employees. The main industrial sub-sectors are the food processing industrial sub-sector, textiles, leather and footwear, metalworking and metal, as well as the non-metallic industrial sub-sectors. A limited range of intermediate goods has been introduced. However, small and medium enterprises continue to account for well over 45% of total industrial output.

According to the result of an industrial census conducted by the Ministry of Trade and Industry in 1998, there were 223 medium-large scale manufacturing establishments, with 10 or more employees, and 1,707 small-scale manufacturing establishments, unevenly distributed throughout the six regions of the country (Table 3.2). However, the bulks of enterprises were (and still are) in the Asmara area. According to that census, 40% of the existing entrepreneurs were small-scale enterprises (with 5-10 employees); 40% were medium-scale enterprises (with 20-99 employees) and 20% were large enterprises (with 100 or more employees). The total working force of the industries surveyed was 15,000 of which 89% were Eritrean and 11% foreigners. The gender composition of the labour force was significant in that there were approximately 8,037 Eritrean males and 5,591 Eritrean females fully employed in the industrial sector. The same gender distribution was prevalent among the foreign workers; 987 males and 438 females. Women represented some 40% of the employees in the industrial sector.

Table 3.2. Composition and Distribution of Manufacturing Enterprises

No	Industrial sub sector	ISIC Code	Maekel		Debub		Anseba		G. Barka		S.K.B.		D.K.B.		Total	
			L	S	L	S	L	S	L	S	L	S	L	S	L	S
1	Food, Beverage & Tobacco	1511-1560	46	140	10	174	6	146	2	188	1	66	2	9	67	723
2	Textile & Clothing	1712-1810	18	44	1	14									19	58
3	Leather & Leather products	1911-1922	22	42	1										23	42
4	Paper printing & publishing	2101-2221	9	13									1		10	13
5	Chemicals and allied products	2411-2520	14	11	2					4	2	1			21	13
6	Pottery, Bricks, Glass & cement	2610-2696	34	58	3	47	4	9		24	5	8		1	46	147
7	Metal Mfg & Metal products	2710-2919	9	10		1		4							9	15
8	Accumulators and batteries	3140	1	1											1	1
9	Medical goods & drugs	3311-3312	2					1							3	-
10	Mfg of Motor Vehicle, bodies & parts	3420-3430	2	-	-	-	-	-	-	-	-	-	-	-	2	-
11	Furniture	3610	19	292	1	96				28	1	25	-	3	21	444
12	Gold and silver works	3691	-	84	-	18	-	59	-	13	-	15	-	2	-	191
13	Others		-	44	-	-	-	16	-	-	-	-	-	-	-	60
	TOTAL		176	730	18	350	11	234	2	253	12	116	4	15	223	1707

Source: - Ministry of Trade and Industry Records 1998

Table 3.2 illustrates the composition and regional distribution of industrial/manufacturing enterprises in Eritrea. The food processing, beverage and tobacco industries account for some 790 enterprises – that is about 41% of the total number of enterprises. The furniture industry accounts for about 408 establishments (24%) while the pottery, bricks, glass & cement 193 establishments. Of the large enterprises, 30% are in food and beverage, 20.6% in pottery, bricks, glass and cement, 10.8% in leather and leather products, 9.4% in furniture, 8.5% in textile and clothing. The majority of large enterprises and a significant percentage of small enterprises are in the Maekel region.

3.4.1. Challenges to the Growth of Firms in Eritrea

After the total independence of the country it was expected that manufacturing firms would grow instantly and help boost the economy of the country by generating employment and providing foreign currency and income to the GDP. However the growth of these firms has been hampered by the inherent problems of the sector in particular and the country's economic condition in general.

With regard to internationalising and managerial initiatives firms in Eritrea are more reactive than being proactive. They are unfamiliar to foreign environments and their markets. In addition their ability to acquire information and market knowledge is very limited. More over, their entrepreneurs don't take managerial initiative in marketing and investment opportunities. Their awareness level with respect to the reward of marketing and investment expenditure is very low. The reason could be their satisfaction with the status of their living standard. Besides internal triggers such as visionary leadership, saleable idea, distinctive products & branding, extended source of supply & knowledge and others doesn't exist with Eritrean entrepreneurs.

In addition these firms are not active in analysing the profit opportunities presented in export markets. They were forced to look for export markets when competitive pressure from outside was increasing and the Ethiopian market was closed as the border war erupted. As a result of this they were facing excess capacity, declining domestic sales, and overproduction. To make things worse the local market was not able to absorb the excess production that was being channeled to Ethiopia previously. As they lack the

necessary information and financial instruments it was not easy for them to compete in the international markets.

Firms in Eritrea are also more capital intensive than many other Sub-Saharan African countries. The median amount of capital per worker in Eritrea is just over \$21,000, a very high amount given the size of the country and its private sector. As a result of this the ratio of value added to capital (value added per unit of capital), which is used as an approximate measure of the productivity of capital is extremely high. This makes the returns to capital of firms in Eritrea very low and hence very low capital productivity. In fact it has been found that capital productivity in Eritrea is significantly lower than that of other countries in sub-Saharan Africa and beyond; it's almost to the point of zero return.

The question that arises is how can the capital productivity of these firms be improved. It is clear that the local market is very small to support those firms working under low capacity level. Applying market penetration strategies that lead to increased consumption of the existing customers may not be enough. Moreover government tax policies on import duty are not supporting as the import tax levied on imported goods similar to those locally produced are very low thereby making the foreign products more competitive and cheaper than local ones. As the returns become lower funds will not be available for promotional activities while importers are more active than local manufacturers with regard to marketing and promotional strategies because they do have enough funds and are able to get returns in a short time than manufacturers.

One may ask that they can borrow money from local banks and then invest it in market research and promotional activities. It is clear that a large proportion of firms in the private sector do have access to the formal financial sector, primarily through the use of overdrafts. However, most of the finance is clearly being used to meet working capital needs. Investment is very low in Eritrea, even when compared to the rest of Africa. The existing low returns and the high & inflexible interest rates are prohibiting firms to take a long-term loan that can be used for investment and other necessary strategic activities. The government should encourage credit flows to the private sector in order to put the country on a higher growth trajectory.

Although Eritrean labour force is more skilled comparatively to the Sub-Saharan region there is still a scarcity of skilled personnel at the higher management level. As we mentioned earlier reviving the export infrastructure of the manufacturing sector requires highly qualified people. It is also clear that as the demand for qualified labour increases the wages will immediately increase which may lead to a loss of competitiveness in the foreign markets.

The other problems of the manufacturing sectors include lack of infrastructural facilities, economic slow down, and others. With regard to infrastructural facilities shortage of electricity is becoming the main problem. First it takes about three months to get electrical connection. In addition to that some of the industrial districts were outside the electric line services and they were not able to get the connection at the required time. Second the electric supply encounters interruption at unknown time, which may lead a loss of sales to some firms and forces firms to own generators to obtain electricity to overcome the interruptions. Thus, the uncertain supply of electricity imposes higher business costs, both to acquire a generator and to operate it when the public grid is not supplying electricity. Telephone and Internet services are also other infrastructural problems that are hindering the growth of manufacturing sectors. The low availability of Internet in Eritrea means that it takes many days even months to communicate with a profitable customer with trust and confidence. We know nowadays that the globalisation of communication technology is affecting the nature of businesses and the time required to complete their contractual agreements.

The last five years the economy of Eritrea has been under fluctuation as the border war was continuing. This created a negative perception for potential investments and trading within foreign partners resulting in a decreased performance. It is within these years that exports showed a decline, which led to a lack of foreign exchange. However many development programmes are being implemented under the Warsay-Yikealo development campaign. Housing, road and electric infrastructures, and water and soil conservation are the main elements of the campaign.

What can be concluded about the present situation of Eritrean manufacturing sector is that they are very capital intensive, capital productivity is quite low, and there is a shortage of skilled labour, causing wages to rise. Firms do have access to the formal

financial sector to some extent, primarily through the use of overdrafts. However most of the finance is clearly being used to meet working capital needs and investment is very low. With regard to exporting they do have exportable products although they are not putting a desired level of effort for competing in the international markets. Government efforts to boost exports have done nothing because they were not oriented on the need basis of the exporters. The export promotion unit was established lately in 1999 and was not able to continue due to many unexplainable reasons. The next section will discuss about the export promotion and development of Eritrea and its efforts and impediments in boosting the required level of exports.

3.4.2. Export Opportunities for the Manufacturing Firms

The government has not been sleeping aside with all these problems. It has been working at its most effort to improve the situation of the manufacturing sectors in general and increase the export base of these firms in particular. To attract foreign investment it has modernized its business licensing office (BLO) to provide efficient services. Now it takes only a few days to get a new license which were not the case before. The government has also opened an export-processing zone (EPZ) in the port city of Massawa in order to increase exports and attract export-oriented investment in the country. The purpose of the EPZ is to alleviate the problems that are inhibiting exporting and foreign investment. Such problems include operating procedures, bureaucracy or complex customs procedures and lack of infrastructure in the country. The EPZ is expected to streamline the customs or other export procedures and may provide some promotion or marketing appeal to potential investors. With the advent of foreign investors local firms may learn a lot from them. The port city of Massawa is situated along the busiest Red Sea coastline, which is close to the major international trade routes. This makes it suitable for direct export to foreign markets. Other complementary actions are also underway to rehabilitate, upgrade, and expand transport, communications, power, and water supplies, which may have a positive effect to exporters and potential investors. In addition Eritrea doesn't have an oppressive or corrupt bureaucracy and the government has shown its commitment to this plan.

The national policy framework and programme for 1998/2000, published by the government of the state of Eritrea in March 1998 stated, “ to encourage trade expansion,

the customs administration has been streamlined and simplified, and a sound exchange rate is being maintained". It is clear that a competitive exchange rate is critical to an export development programme. However the trade imbalance is affecting many of the business activities in Eritrea. As imports are much higher than exports the demand for foreign exchange is increasing from time to time. This makes exporting firms unable to access input materials they need from foreign markets because they will be uncompetitive. In addition the local market is becoming stiff as imported products are taking the share of these local products.

Regional market opportunities for Eritrean enterprises exist in the COMESA market. The COMESA Free Trade Area was launched with the objective of achieving zero tariffs for all tradable goods by the end of 2000. The COMESA members have also agreed to adopt a customs union by the year 2004. The trade and transport facilitation measures that are allowed by the COMESA members written in chapter nine are aimed increasing the trade between the member states at the lowest cost possible. Some of the trade facilitation measures include reducing the cost of documents and paper works required in respect of trade among the members states, adopting common standards of trade procedures within the common market where international requirements do not suit the conditions prevailing among the member states, ensuring that the nature and volume of information required of trade with the common market does not adversely affect the economic development of trade among the member states. In addition the transport facilitation measures are aimed at creating harmonized road transit charges, COMESA Carrier's License, COMESA Yellow card Scheme for insurance. COMESA FTA opens access to an enlarged market for producers and manufacturers a wide range of exportable products already produced by both major enterprises and SMEs. However this depends on efforts of the enterprises and support provided by the responsible government agents.

In addition to the COMESA free market opportunities the Cotonou Agreement gives Eritrea preferential access to the European Market, and the United States Africa Growth and Opportunity Act (AGOA) gives Eritrea duty and quota-free access for garments for 8 years starting from 2000-2008. Exports to the COMESA free market are showing progress although they come infrequently. These exports are mainly composed of

footwear and textile products. The current exports to Americas, Europe, and the Arabs and the Middle East involve mainly of the fish and its products.

3.5. Eritrea's Export Promotion and Development Centre

The economic policy of Eritrea focuses on developing an efficient export oriented private sector. To support this policy creating export promotion and development center was one of the strategic issues. Recognizing the importance of this issue Eritrea opened an autonomous export promotion and development organisation in 1999. The organisation was expected to be a sole agent for the promotion and development of export in Eritrea and also to work in cooperation and coordination with other institutions in the public and private sector, which are involved in export and related support activities.

3.5.1. Mission

The mission of the export promotion and development center stated that all actions which include all those activities that aim at creating the condition required to succeed in dynamic export promotion and development plans are under the responsibility of export promotion and development organisation. Some of the elements of the missions were: to identify selected tradable goods from the existing firms and export them efficiently and effectively to selected world wide markets, to identify the different bottlenecks in the marketing process of exportable goods from the initial source to the final point of delivery and through time eliminate them appropriately, and finally to maintain detailed information about targeted products and identified markets and make available such information to all clients and users (MTI). In most of the developing countries the activities EPO's are almost similar to that of Eritrea. This mission also seems to be relevant with the industrial development level of Eritrea. Although there are many enterprises in all sectors of the industry, currently only few of them have the capability or competitive advantage to involve in the export activity. Starting with these enterprises will create awareness in other firms in the industry and lead to export initiation of these new firms. In addition the new export promotion and development organisation will only be able to serve few firms in its initial stage and through time as its human and financial capacity grows more new firms could be accommodated.

3.5.2. Strategy

As the organisation was very young its strategy was mainly focusing on developing its institutional capacity such as strengthening its capacity and technical know how in order to provide efficient and relevant services to its clients. This was a good way of developing the institution to make it efficient and effective service provider. However, the center was working with many constraints, which hindered it to provide all the necessary services to its clients. As a result its activities were merely limited to collecting export information on all aspects of export activity, and identifying constraints to export performance.

Some of the constraints of the center were limited manpower and financial resources. For example, the activities listed in the strategy include such as product and market identification, export information services, specialized support services, and promotional activities abroad. It is clear that these activities could not be performed with two personnel alone. These activities also require financial resources, which was not available to the center as the country was on border war with neighboring Ethiopia. This doesn't mean that there were no other development efforts by the government during this time. Moreover, there was no clear organizational structure with the required authority and responsibility to perform the functions. As a result the organisation was not recognized as a legal entity.

With regard to export information the center was not able to provide a full range of services as expected because of the staff shortage and low experience of the center. It was only supporting firms with export documentation and facilitation of communication with the foreign buyer. From the above analysis we can see that the organisation was in its initial stage of growth and recognition and its activities were limited although the mission was encompassing a set of activities that a normal EPO provides. However creating an EPO was a good for Eritrea.

3.5.3. Reasons for Closing the Export Promotion and Development Centre

When the export promotion centre was established there were a belief that more people would be assigned to strengthen the performance of the centre and its structure would be

addressed as required so that its services will be broad and all encompassing. Unfortunately the centre remained with the two staff and other staffs were not assigned as planned. The first idea of establishing the centre was made by the micro policy office and four ministers were supposed to create the council's export promotion. They created and announced the essentials of the export promotion centre and chose the Minister of industry as a chairperson to look after the day-to-day activity of the centre. The minister trade and industry (MTI) couldn't handle the situation and had delegated the director general of the department of industry. This situation has created a lot of problems:

1. The delegated director general was not well informed on the export promotion centre activity and was unable to proceed on giving guidance to the centre.
2. The export promotion centre was denied a legal entity and couldn't perform its activity as required.
3. A strong opposition was coming from the trade department and other on its existence. Most were protesting that there is no need for having a separate entity on export promotion activity. The idea was that there is a redundancy of activity between these offices. It was believed that the trade promotion department handles the activities of the export promotion centre and hence we don't need having a separate office of export promotion.

As a result these problems the export promotion centre was closed in 2001 by the new minister assigned to the ministry of trade and industry.

3.5.4. Export Crash Programme

With the closure of the export promotion centre the government attempted to undertake a needs assessments study for those sub sectors, which had failed to penetrate the export market. This study gave priority the shoe sub sector, which was highly affected by the loss of Ethiopian market. Other sectors were the textile and salt industries. The manufacturers of footwear were advised to prepare a business plan individually and later their plan was compiled by other external consultant's so as it will have the required information and a standard format for banks.

Experts made their own study by visiting the plants and various recommendations were given on how to handle the situation. The study also revealed that almost all plants prepared an ambitious loan proposal for the purchase of sophisticated machines without having the proper know-how on how to handle them.

Experts from abroad proposed the need for selecting few plants based on the potential they have to penetrate the international market and be able to implement the proposed recommendation for upgrading the plants products to meet the export market demand. Five shoe factories were selected and were helped to make a business tour and attend an international fair twice in Europe. However, this move was not accepted by most of the footwear manufacturers and had created a split among the manufacturers.

It should be known that the successful implementation of the Crash Program and, for that matter, the promotion of a competitive industrial sector depends not only on the availability of critical skills but also on the continuous training and upgrading of skills, the existence of a safe working environment, harmonious working relations, work ethics and job satisfaction. If all these are not fulfilled the program will not work as expected.

3.6. Export Challenges of the Eritrea's Manufacturing Industry

Since independence exporting has not been easy to firms in Eritrea 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 (MTI, 1998). Next to the market problem, lack of modern machinery and equipment and lack of good quality raw material were mentioned as serious problems. Another base line study (G. Tsegay 1999) on the export marketing problems of the footwear and textile-manufacturing firms showed similar results. According to this survey the main constraints to the internationalization of these firms were lack of market knowledge and information, limited financial resources to finance exports & to conduct market research, and lack of experienced personnel in international marketing.

The Eritrean firms were very reactive type rather than proactive. They were heavily dependent on the Ethiopian market until mid 1998. About 80% of the textile and 70% of footwear production was being exported to Ethiopia. In the mid of 1998 the closure of Ethiopian market forced the Eritrean footwear and textile manufacturers to assess new opportunities. They 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.

3.6.1. Constraints in Export Growth and Development

During its course of work the export promotion and development center has identified the following constraints to the growth and development of exports at the national, industrial and enterprise level. These factors were the main constraints to the internationalization of Eritrean firms.

- *Lack of Market Research:* - Only few firms conduct market research to assess their products and new markets. Most of them feel that they don't have enough funds to do so or they don't see the importance of it. As a result there is no product improvement or addition of new products from the firms. In addition the export promotion and development center which was supposed to help alleviate firms information needs was not able to conduct on behalf of firms because of the limited number of personnel, shortage of finance and inadequate experience. Firms can't compete with out having the right market information about required quality & type of product, packaging, price, and its customers.

- *Shortage of Export Commodities:* - Currently only a limited number of industrial sectors have the competitive advantage or exportable products at the national level. These include the textile, leather and its products, salt, and the fishing industry. The export growth of these sectors is not satisfactory as it is expected. As the export performance table shows only the fish industry is showing growth while the others are either stagnant or declining.
- *Low Quality Products:* - One big problem hampering Eritrean exports is that the low quality of the existing products. In today's growing globalization and high competition improving your products according the needs of customers faster than competitors is the best way of survival and growth. Firms that don't follow consumers will surely go out of the market. This is what is happening to Eritrean firms. Tomorrow the nature of competition might change which will become difficult for our firms to cope up.
- *Poor Presentation or Packaging:* - Having a good quality product is not enough in getting export market. In addition to the low product quality failure to ensure the packaging or labeling of product in conformity with legal and market standards of the export market is the key weaknesses of these firms in attracting foreign consumers. We have to know that our consumers want to know about the product they are buying. As we know international marketing is different and difficult than domestic marketing. Therefore our product packaging should be in line with the needs of those markets we want to be in.
- *Lack of Training to Improve the Quality and Productivity:* - With the existing problems it is evident that government training programmes could have done a lot at improving the quality of exportable products, raising the awareness level of firm managers at the importance of exporting and alleviating other export related problems. However firms in Eritrea are unlucky. There is no training programmes provided by the government institutions such as the Ministry of Trade and Industry, chamber of commerce and others.

- *Outdated Machinery and Technology:* - we can see that the problems hampering the growth of manufacturing firms in Eritrea are many and interrelated. As it was discussed earlier most of the firms in Eritrea are very old working with outdated machinery and technology. This was mainly due to the lack of investment during the successive colonial periods. The little investment made during the eleven years of independence was not enough to boost the existing technological competitiveness of the firms. This lack of modern technology is the main cause for the low quality of products and their presentation.
- *Lack of Resources:* - The important resources required for the production and presentation of exportable products such as raw materials, finance, skilled manpower, machinery and spare parts are not sufficiently available in Eritrean firms. There is a shortage of foreign currency required for importing such materials.
- *Limited Knowledge and Experience in International Marketing:* - According to the Ministry of Trade and Industry about 70 percent of the Eritrean exports were being channeled to Ethiopia till 1996. This was mainly due to the cultural and language proximity and the good political and economic relationships that we had with Ethiopian government. Although this was good to the small economy of Eritrea it has resulted in a lack of international marketing experience for the export-oriented firms, which are in need of it right now after the closure of the big Ethiopian market.
- *Lack of Export Credit Facilities:* - Export credit and finance facilities are the main elements of export promotion and development programmes. The Eritrean export promotion and development center was in its initial stage and hence was not able to provide such services. It had also very limited personnel and their experience with regard to such services was inadequate. However the expectation was that the existing banks would handle these services. But as it was known from the banks later on there are no such services to be provided to exporters particularly. First banks don't give a discounted interest rate borrowing to exporters. The interest rate for borrowing is too high given the savings interest rate is low and unattractive for saving. Besides to get a loan borrowings from

banks there is a collateral requirement which most of the firms do not have it. In addition these banks do use the letter of credit in settling payments to foreign sellers, which means that providing guarantee services to importers or foreign exporters to Eritrea. The question comes why can't such services be given to exporters also if they are believed to be the source of foreign currency and employment.

- *Lack of Cooperation Among Small Manufacturing Enterprises:* - It has been said that Eritrean firms are very weak in working on cooperation basis with each other. Cooperation could range between firms in the same or in different industry. Using cooperation strategies competing firms can source their raw material needs on group basis and can get a big discount which one firm alone may not get it. Firms in the same industry can also conduct their market research needs by one company as a group basis and share the costs instead of bearing it alone or not doing it. As we said earlier the lack of market research is among one of the main problems of Eritrean firms. In addition contractual agreements with a foreign buyer can be done on a group basis, which will help them to share the benefits.

Other problems include:

- Failure to conduct an information search on regulation on export market
- Failure to modify products to meet foreign requirements
- Failure to ensure that packaging or labeling of product is in conformity with legal standards in export market.
- Lack of trade partners
- Inadequate infrastructure road, telephone, fax etc.

3.6.2. The Sources of Information

Export information plays a crucial role in identifying potential foreign markets, entering the markets and reacting to competitor actions etc. Many different factors affect the firm's ability to gather, and continuously use information. Eritrean firms do not have the tradition of gathering information about the environment they are in or to be in, about

customers, potential markets, products, and competitors. One of the main reasons is the low level of awareness of owner managers on the importance of information processing. On top of that the unavailability of finance and reluctance of firm owners to invest in market research and related activities are also other prohibiting factors for the gathering and use of information. This shows that company efforts are very low. It has been explained that gathering information is not enough for the success of a firm. Information gathered in a right way if used incorrectly may lead to a wrong decision and failure. Thus the awareness of Eritrean firms with regard to the importance of information gathering and use is very low.

There are also other firms or individuals, which can provide export information to potential or interested firms. These include overseas agents, commercial associations, chambers of commerce, union of exporters and trade and industry association. There is one chamber of commerce in Eritrea formed by the association of the firms. In addition there are industrial association of some of the sectors. For example the association of footwear manufacturers works on finding export markets for its products and acquiring raw materials from abroad. However its success and growth depends on the commitment and funding of its founding members. From past experience it was not able to perform its duties as expected because of financial problems.

Service organizations such as commercial banks, consultancy and research agencies, brokers and freight forwarders do exist but firms only use banks as a source of information and export/import payment settlement services. Exporting firms does not use the other organisations. Government export information outlets are a good source of information to exporters. Although at low-level Eritrean firms do participate in trade mission and trade fairs or exhibitions thorough coordination by the chamber of commerce. Other government information outlets available for Eritrean firms include the foreign trade division department, the department of industry and the international trade unit of the ministry of trade and industry. Eritrean embassies abroad do not have commercial attaché and hence are not able to provide trade related information to exporters.

One interesting thing is that the Department of industry has been working rigorously on studying the industrial opportunities of the different sectors. The leather, textile,

building, salt, and ceramics industrial sectors have been studied by internationally recognized consultants and export and investment opportunities were identified accordingly. This database of information is highly valuable for exporters and investors. However, the records of the department of industry show that only investors from abroad use this information. Local business owners especially exporters don't use this information. They either do not know its existence or do not see the value of it. Sectoral and Sub-sectoral analysis can be a useful tool in developing the detailed knowledge required to develop information products, which SMEs may want. This has to be a continuous effort of the department of industry because the current information will depreciate through time. In addition the information should be needs based in order its potential benefits to be transparent to SMEs. This may lead increased use of government information services.

3.6.3. Stages of Internationalisation of Eritrean Firms

The stage of the firm in internationalisation process is one of the factors that could shape the type of information and other support services to be provided. With regard to the internationalisation process, Eritrean firms can be categorised between the uninterested/unwilling and the partially interested firms. Some of the firms are not interested to go for international markets and they don't have any plan to do so in the near future. They are satisfied with the local market benefits. The problem with this is that one day a competitor either from local or foreign might come or take a share of the market thereby leading to a loss of profits and customers. This will then motivate them to react i.e. look for other foreign markets if they are to survive.

Most of the other firms are interested in international markets but they don't act to do so. Although they know benefits of exporting to foreign markets they don't have the managerial and financial ability to do so. As a result they only respond to unsolicited orders or other international stimuli that comes over time. The leather & footwear and the textile enterprises can be the best example of these firms. The main reasons for not acting to conduct market research and looking for other markets are the financial and managerial problems they have. The shoe and textile manufacturers were mostly directing their products to the psychologically close country, Ethiopia. Management of these firms were mostly motivated by their unique products, excess capacity and profit

advantage. After 1998 when the Ethiopian market was closed problems started to arise as the unutilised capacity and stock of unsold production was increasing. The result of this is that the money was held both in machinery, building, and unsold product thus blocking other investment opportunities.

Table 3.3 Structures of Eritrean Exports Between 1995-1999

Products	In 000 Nakfa				
	1995	1996	1997	1998	1999
Salt	112,825	90,002	94,048	37,749	33,448
Footwear	40,834	73,683	50,432	10,233	5,522
Leather processed hides and skins	17,899	25,611	23,489	13,409	14,854
Garment Knitted or crouched	5,924	7,249	4,027	4,98	802
Fish fresh of chilled	478	3,022	4,407	7,906	11,845
Fish alive	417	992	471	333	30,104
Sheep and Goat live	27,842	17,171	6,671	1,233	34,106
Total	206,219	217,730	183,545	71,361	130,681

Table 3.3 shows the structure of Eritrean export from 1995-1999. The destinations for these exports were as follows: Sudan, Tanzania, Uganda, Kenya, Australia, Yemen, Saudi Arabia and USA for the footwear products. Italy, USA, Germany, Denmark, Netherlands, Srilanka, UAE for the food sectors particularly the fish exports. Ethiopia was mainly taking Eritrean products before 1997.

3.7. Trade Promotion Organisation

Under the department of Trade there was a trade promotion unit, which looks after the export activity of the country. The unit used to represent Eritrean manufacturers in all international trade fairs. Later the chamber of commerce after the adjustment of its restructure claimed to handle the case. The ministry agreed and the trade promotion was moved to chamber of commerce with the experts it had.

3.8. The Chamber of Commerce of Asmara

The chamber of commerce used to be a semi-autonomous organisation run by the help of the government's budget but later it was made fully autonomous and is led by a board of directors selected from the private sector. The new structure become fully private and began to be run by its own budget. It has a secretariat who runs the chamber and accountable to the board of directors. So far it had chosen to secretary to lead the chamber and its members are growing fast. There are a number of business associations that joined the chamber.

The Chamber of Commerce facilitates the participation Eritrean firms in regional and international trade fairs, exhibitions, and forums. It is known that trade fairs and forms are among the sources of export information and provide firms an opportunity in finding potential trading partners. The problem comes on the number of firms participating in the trade fair or forum, the financial resources required, and the results gained from the participation. Only a few numbers of firms have participated up to now. Unless and otherwise covered by the inviting country or organisation the financial expenditure for a trade fair or forum is covered by the participating firm itself. The participation becomes fruitless if there is no new trade partner gained.

Another problem with the Chamber of Commerce is that other activities of trade promotion are not being performed currently due to the lack of finance and qualified personnel. As we know trade promotion activities are not limited to organising or supporting firms to participate in trade fairs only.

SUMMARY

This chapter has examined the situation of SMEs and the export promotion services in Eritrea. It was found that Eritrean SMEs were highly developed during the initial stages of colonisation periods. Later on they were deteriorated during the successive Ethiopian regimes as a result of bad policy and continuous war.

The new government of Eritrea had initiated serious efforts to strengthen the competitiveness of these SMEs. However, there still remains more for these firms to be

part of the international market competition. Although the economic and industrial policies have clear objectives for the development of the industrial manufacturing sector there are no clear policies and implementation strategies at the lower level. Recently the export promotion and development center was initiated in 1999 with its limited services to support exporting firms but it was then closed in 2001. The reasons given were unjustifiable as there were no other support services to business enterprises.

At present the existing SMEs in Eritrea are at their initial stages of internationalisation process and have many constraints to be addressed either by them or the government organisations such as the Ministry of Trade and Industry (MTI). Some of the constraints include lack of market research, shortage of exportable products, lack of quality, poor presentation or marketing skills, lack of training in improving quality productivity and marketing skills, outdated machinery and equipment, lack of export credit facilities, and lack of cooperation between firms. These problems will only be solved by the government's concerted effort in export promotion and export development programs. Although success depends on the firms overall efforts these services will definitely have a great impact on the firms performance.

CHAPTER FOUR

FINDINGS AND CONCLUSIONS

4.1 Introduction

The last 100 years has shown both the growth and decline of the Eritrean industry. In the beginning of the 1920's and 1903's there has been an emergence of light small-scale industries operated mainly by the Italian colonizers. With the advent of the British rule the growth of industries continued and the economy was booming. However the Ethiopian colonisers stagnated the economy in general and the growth of industries in particular. The few light industries that continued to operate in the country during the Ethiopian colonisation period had not been maintained for about 30 years and thus, operated at a very low capacity and were lagging behind the competitive managerial and technological development of the global markets. As a result their export capacity and export infrastructure was deteriorating from time to time. In addition to that the generation-long war for independence has left the Eritrean economy, infrastructure, and human resources in a state of ruin. Consequently, the growth of industrial firms was hampered which made Eritrea one of the poorest countries of the world. Since the country was forced to start building its economy from scratch, it is currently in the midst of national reconstruction.

Following independence, may 1991, the industrial sector was given a priority and the ministry of trade and industry has taken many strategic measures to improve the competitive performance of the state enterprises and later privatised them to encourage private investment. The Government's macro economic policy states creating a modern, technologically advanced and internationally competitive economy within the next two decades. To achieve this the industrial strategy aimed at creating an environment that would facilitate the efficient expansion of manufacturing output in industries where Eritrea has comparative advantages. This clearly shows the commitment of the government to promote the country's economic growth.

However, the main obstacles to the growth and development of the industrial sector as well as the reconstruction process were the lack of capital, technology, and skilled manpower. The capital that existed was outdated and there was no investment made on

them. Along with these problems, the country inherited obsolete institutions and weak instruments geared to a command economy. Effective trade and industrial promotion organisations were lacking. As a result of this exports were only oriented to the market which Eritrea were part of it i.e. Ethiopia. This was mainly because of the physiological distance and cultural similarity between the two countries. Other markets were not looked either because the managers were not interested to go beyond Ethiopian market, or they had no additional capacity to satisfy other markets. The ministry of trade and industry also had done nothing to inform the business community to search markets outside Ethiopia. The sectoral studies were aimed for identifying export opportunities in the different industrial sectors available in the country. In fact one of the international consultants who studied the textile sector had warned the ministry in its report that depending on one market is not good for the country and its businessmen. However the problem was vividly seen after the closure of the Ethiopian market as the border conflict between the two countries erupted in May 1998.

4.2. Findings

With regard to the export promotion and development centre and the present situation of SMEs and their export the following findings can be discussed.

The export promotion and development centre was created later in 1999 with the objective of increasing the countries exports. It has come up with a good objectives and activities to perform. Initially the centre was working on building its institutional capacity and identifying the export constraints of the enterprises. However it was not able to perform the activities it planned due to many reasons. The centre was working with only two persons hence it was lacking qualified personnel. It can easily be seen that an export promotion centre working with only two personnel and not able to meet the needs of its clients.

For that reason the export information service of the centre was only limited to providing export documentation services only. Other services such as market research, identifying and entering target markets, developing foreign market entry strategies, product improvement, raising awareness level, creating contacts and others were not being given to the clients. In addition there was no a structured way of gathering

information on sectoral basis. As we discussed it in chapter two-export information plays a crucial role in promoting exports. However this seems to be neglected in the Eritrean case. The main problem here is that there is little enterprise level export promotion provided in the Eritrean case as the services that are provided sporadically are aimed at industry level. For example the export crush programme was targeting the leather and footwear manufacturing enterprises only not specific enterprises from the sector.

The enterprises in Eritrea are unfamiliar to foreign environments and their markets. In addition their ability to acquire information and market knowledge is very limited. The export promotion centre was not following the structured way of gathering and disseminating export information that would have helped it to provide information on a country, markets, and products basis according the needs of its clients. This could be used in selecting the most appropriate and profitable markets for the enterprise to be in. It must be clear that all these information and advisory services should complement the international competencies of the enterprises.

The stage of the firm in internationalisation process is one of the factors that could shape the type of information services to be provided. Those firms in the uninterested or unwilling stage would require export assistance ranging from raising their awareness levels of exporting by communicating the tangible benefits of exporting. For those firms who are interested and already know the importance of exporting, the export information assistance services may include provision of information about the mechanics of exporting and communicating the availability of the existing services. This is what Eritrea's export promotion and development centre's or the concerned party like Foreign Trade Department's main activity should have been with regard to information provision and advisory services. It is to be recalled that Eritrean firms are categorised between the uninterested/ unwilling and the partially interested firms in their internationalisation stages.

The second main part of export promotion is the provision of export finance services. Export finance is aimed at providing the financial and insurance needs of exporting firms. Financial needs arise in producing exportable products and fulfilling the working capital shortages whereas insurance services are needed to avoid the risks involved in

selling your products to a foreign buyer whom you don't have any information about his financial credibility. Although the importance of these services on boosting export performance is highly recognised it is not yet available in Eritrea. Credit facilities are available at a high interest rate and also backed by a collateral. However, the different services of export finance services such as export credit insurance, export credit support, and export credit guarantee are not provided. Export credit insurance is given to protect the exporter from the risk of non-payment by the foreign buyer. Export credit support involves providing short-term, pre-shipment, working capital credit to the exporter. It may also involve providing credit facilities to the foreign buyer, which will then be backed up by an export credit guarantee in order to avoid the risk of non-payment. It is clear that these services are critically important to firms in the developing country like Eritrea if they are to have a good business relationship with their foreign buyer. As one of the studies has identified firms were not able to contract with a foreign buyer because of their shortage of working capital and capacity. Such problems could have been solved easily through the export finance services. The Eritrean Investment and Development Bank can perform such activities for the time being until a new export promotion unit is created. The Ministry of Trade and Industry should have also worked on the opportunity of making available the Export finance services of the COMESA's PTA bank.

Finally what is missing in the Eritrean firms is lack of cooperation and networking. Firstly, cooperation becomes necessary in sourcing inputs from foreign suppliers and fulfilling contracts with foreign buyers. If one firm is not able to provide the needs of a foreign buyer alone why can't a group of firms do it cooperatively? The chamber of commerce performs the trade promotion activities. However it is limited to participation in trade fair or exhibitions.

Networking is essential for the success of export promotion efforts. As the ITC's trade institution support reports it does not necessarily follow that the export performance will improve just because a national export strategy has been designed. A structure encompassing both institutions and inter- institutional linkages is required for successful leadership and concerted action. This means that for a successful export promotion programs effective trade support networks at the national and regional level must be put in place. As there are no export strategy and objectives in Eritrea these networks also do not exist.

The overall cause for the above problems is the lack of policy framework at enhancing the competitiveness of SMEs. Although the economic policy clearly states that the aim is to create a technologically advanced, highly competitive and export oriented private economy there are no business development and support policies outlined to help the competitiveness of the existing enterprises. If it is expected that the existing enterprises should be competitive enough in the international markets they need to be supported at the enterprise and industrial level. It is true that strengthened SMEs will be able to break into international markets, compete more effectively in the domestic marketplace, and take the lead in redressing the balance of trade.

To conclude the following findings can be outlined with regard the situation of SMEs and the support services in Eritrea.

1. *Currently there is no export promotion services provided either at industrial or enterprises level in Eritrea.* The one that was opened in 1999 was closed after a few years of operation for unjustifiable reasons. It has been explained that export promotion programs are part of the implementation programs of the government's national development objectives. Therefore it is critical to have export promotional policies and programs if the government expects to achieve the objective of having highly competitive and export oriented industrial sector.
2. *The SMEs in Eritrea are facing many constraints in their export efforts.* Management wise they do lack international marketing skills and don't see the importance of market research or any other means of information search for the success of exports. The products are low in quality due to the outdated machinery and technology they use. In addition the products posses poor presentation and marketing strategies. These firm specific problems coupled with the lack of Government support services are dragging down the country's exports.
3. *National export promotion policies would not provide any benefits or lead to increased exports if they are not supported by export promotion policies and programmes at the industrial and enterprise level.* This could be used as a general finding applicable to other researches or further studies.

CHAPTER FIVE

RECOMMENDATIONS

5.1. Introduction

Given its small market, Exports and small and medium enterprises (SMEs) are fundamental to the development and modernization of the small Eritrean economy – indeed, one might also describe them as the twin pillars for the country’s development. Recognising the contribution of SMEs in the generation of employment, income and innovation supporting them in order to compete efficiently in the international markets has become a natural phenomenon in the world.

Exports, too, are critical to the welfare of Eritrean society as a whole. The small and sluggish domestic market is not enough to support the growth of SMEs in particular and the whole economy in general. The private sector – which consists largely of SMEs – shoulders the bulk of the burden in this area. For that purpose the question that the Ministry of Trade and Industry needs to answer is:

How to increase the exports of SMEs and/or how to improve the export promotion services to SMEs in Eritrea?

It has been discussed that SMEs are constrained by many firm specific, industrial and national problems to compete in the international markets. Despite various efforts to upgrade them, their capacity remains limited. To withstand competition at home and abroad, they (SMEs) must develop more responsive and proactive management, skilled labour, advanced equipment, and efficient production and marketing plans. In addition, SMEs need access to inputs at affordable prices, finance for investment at affordable rates; other banking services such as export finance, and information about international & domestic markets (for instance, with regard to quality specifications, product packaging, and competitive pricing). Moreover, there is a need for a favourable business environment and supportive infrastructure.

Overcoming such obstacles is necessary not only for these enterprises to survive and flourish, but indeed for the Eritrean economy as a whole to expand. In this respect, the following measures are paramount:

1. Developing a general policy framework as well as programs specifically designed for SMEs. A National Policy Framework for SME Development should be formulated which will serve as a general framework and a reference for policies and development efforts targeting SMEs.

2. Establishing and implementing a strategy for SMEs export promotion: The objective is that to increase the SMEs export quota through the provision of necessary services. The most important elements in this strategy are:

- i. Enabling SME representatives and other concerned parties to participate in the country's foreign trade affairs and take part in decisions related to exports. Increased interaction between SMEs and the decision makers should be done to arrive at appropriate solutions for the problems facing this sector as quickly as possible.
- ii. Identifying the sectors where these enterprises exist and enhancing their export efficiency.
- iii. Introducing a consortium quality control system and a consortium marketing and branding system to be implemented locally and internationally.
- iv. Introducing export promotion services: providing export information and export finance supports to the targeted SMEs according to their needs.

The development of export promotion policy and implementation of the program should be elaborated within a consultative framework and various stakeholders should be involved to provide their feedback. Then the information should be collated and analysed through workshops, questionnaires, and other tools for refining and finalising.

3. Improving coordination among the various bodies involved with this sector. A structure encompassing both institutions and inter- institutional linkages is required for successful leadership and concerted action. This means that for the success of the export promotion program effective trade support networks at the national and regional level

must be put in place. For that purpose it is important to have different institutions responsible for various foreign trade activities and an assortment of policies, procedures and practices that affect foreign trade performance and it is also important to have effective mechanisms to co-ordinate among trade-related institutions and organizations. Such institutions may include export promotion organisations, chambers of commerce, SME development centers, export finance and insurance services organisations and others.

In addition the Foreign Trade Department in cooperation with SME owners/managers should focus on developing a network for useful personal contacts and cooperation efforts — at trade shows, exhibitions, during contractual agreements with foreign buyer or suppliers, through agents and other companies. These personal contacts or networks can be used to gather information about developing and adapting appropriate marketing activities for exporting and to overcome any perceived difficulties and barriers to exporting.

4. Finally the Eritrean economy's institutional capacity has to be enhanced in order to assist SMEs effectively.

5.2. Organisational Structure

The implementation of the above-discussed recommendation requires creating two important institutions/organisations for the purpose of SMEs development and enhancing their capacity to compete in the international markets. First we need to have an Export Promotion and Development Centre (EPDC), which works on increasing the country's export through the provision of necessary services such as export information dissemination, training programs on export management and related skills, and export finance services in cooperation with other institutions. The reason for including both export promotion and export development together is mainly because the existing export constraints of SMEs can't be solved by the export promotion strategies alone.

The second institution to be formed is the SMEs Development unit (SMEDU), which assists in policy analysis and formulation related to SMEs. This unit should work on developing a general framework and a reference for policies and development efforts

targeting SMEs. It doesn't seem necessary to have export development bank as there is bank working on providing financial services for investment and business development. The Eritrean Development and Investment Bank (EDIB) can handle the export financing needs of SMEs.

With regard to the structure of these units they should be organized under the Ministry of Trade and Industry (MTI). The SME Development Unit should be under the department of the Industrial Development where as the Export Promotion and Development Centre can be under the Foreign Trade Department of the MTI.

5.3. Implementation Issues and Phases

The proper implementation of these recommendations and the continuation of the export promotion services to other enterprises will definitely lead to increased exports of the country. This is the main performance measure of the recommended policies. As a result of increased exports the country's balance of trade deficit will be reduced and the gross domestic product (GDP) will increase if exports continue to grow. In this regard Eritrea will also be able to bear the benefits of competitive SMEs such as employment and income generation, foreign currency creation, innovativeness and others. Through time the country's export infrastructure and know how will be enhanced which could be the basis for attracting new business enterprises. However, it has to be mentioned that having a good policies and strategies alone doesn't lead to the achievement of the above-mentioned benefits. Implementation procedures have a great impact on the success of the policies and strategies. The following discussion deals on the issues and phases on implementation.

In order to achieve the desired level of result from the two units and their strategies it is better for the SME development and export promotion policies to be consistent with the state's general economic policy framework. Otherwise, this sector and the support policies will tend to drag the economy down, or the sector will prove unresponsive to measures aimed at improving it. The concerned department i.e. the Foreign Trade Department and the Industrial Development Department of the Ministry of Trade and Industry (MTI) therefore should coordinate the SME development strategies with state's policy in promoting exports and enhancing competitiveness. Large investments and

heavy administrative burdens are superfluous sometimes. Therefore comparison analysis should be made between providing direct assistance or using intermediary organisations. International experience in supporting and developing SMEs has shown that intermediary organizations are particularly successful in assisting this sector, especially when compared to direct assistance, which is costly, inefficient as well as impractical. Whether this works with the Eritrean case or not should be the job of the Foreign Trade Department and the MTI.

It should be known that the successful implementation of these strategies for that matter, the promotion of a competitive industrial sector depends on the continuous training and upgrading of skills, the existence of a safe working environment, harmonious working relations, work ethics and job satisfaction. If all these are not fulfilled the program will not be fruitful as expected.

Finally the discussion of the paper will be closed by presenting the implementation phase for Export Promotion and Development Strategy for SMEs, which will serve as a basis for developing the Export Promotion and Development Center of Eritrea. It is assumed that the MTI has to initiate the export promotion and development strategy for SMEs. The strategy will be implemented in three phases:

Phase I. The strategy's main framework: Work at this level includes pinpointing priority sectors and targeting those SMEs most in need of export assistance, as well as identifying the factors that have prevented them from developing products for export, regardless of what sector they belong to. In this phase, it will be important to concentrate on the following courses of action:

- 1- Emphasizing that the foreign trade services provided by the Foreign Trade Department units and its affiliates are available to SMEs.
- 2- Increasing the participation of small investors in the elaboration of foreign trade policies: through increased participation in specialized policy meeting related to the services provided, management, production, exports & others and joint administrative committees that bring private sector representatives together with actors from foreign trade institutions.

3- Integrating new concepts and methods through which to support SME exports, such as consortia marketing, branding and quality control systems; introducing trading houses as well as many other innovative processes.

4- Enhancing the ability of SMEs to obtain export financing through the Eritrean Development and Investment Bank (EDIB) export finance services.

5- Determining the needs of each sector and intervening to fulfil such needs of SMEs.

Phase II. The second phase, building on the achievements of the first, will entail a comprehensive investigation and evaluation of SMEs' export capabilities according to the sectors defined in the first phase as priority recipients of export assistance. This research will result in the elaboration of SME export promotion and development policies for each sector.

Phase III. The third phase includes the implementation of assistance policies for SMEs within the defined sectors. The necessary financing could be raised to provide such support in cooperation with other relevant institutions and development programs. We have to see this effort as one of the development programs of the country and provide the required finance needs to see its fruitful results.

Conclusion

Looking at the current situation of SMEs in Eritrea and the existing support services, the following recommendation can be concluded. First the Ministry of Trade and Industry (MTI) should have to have a general policy framework as well as programs specifically designed for SMEs development, which could serve as a general framework and a reference for policies and development efforts targeting SMEs. Second the MTI should establish and implement a strategy for SMEs export promotion aimed at increasing the SMEs export through the provision of necessary services. These efforts if not supported by the firms will not lead to fruitful results. Therefore, firms themselves should also develop more responsive and proactive management, skilled labour, advanced equipment, and efficient production and marketing plans in order to withstand competition at home and abroad.

Given the devastated economy of the country, the proper implementation of these recommendations will definitely lead to increased exports of the country. As a result of increased exports the country's economic well-being will be enhanced and balance of trade deficit will be reduced. In addition Eritrea will also be able to bear the benefits of competitive SMEs such as employment and income generation, foreign currency creation, innovativeness and others. Through time the country's export infrastructure and know how will be enhanced which could be the basis for attracting new business enterprises. However, it has to be mentioned that having a good policies and strategies alone doesn't lead to the achievement of the above-mentioned benefits. Implementation procedures have a great impact on the success of the policies and strategies. Therefore care must be taken when implementing these policies and a proper procedure should be followed.

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