

EXPLORING THE NETWORK PHENOMENON AMONG SMALL EXPORTING FIRMS.

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Abstract

The paper attempts to explore the role of networks in small firms internationalization in Tanzania. It notes that while firm internationalization has been studied extensively, inquiry into how small firms enter foreign markets and the strategies they use has not received much attention. The study is further motivated by the fact that export performance of Developing countries is alarmingly low, and hence there is need for African Governments to create an environment that will stimulate small firms competitiveness in the current globalized export markets. One such approach is to promote partnering and networks. The Tanzanian exploratory study has revealed that networks eliminate small firms ownership disadvantages and their perceived psychic distance thereby facilitating their entry into foreign markets.

1. INTRODUCTION

The literature on internationalization has revealed a number of barriers small businesses face in their attempt to enter foreign markets. These include both endogenous and exogenous factors. By the very nature of their size, resource constraint, both tangible and intangible, has often been cited as one amongst the endogenous factors inhibiting small firm internationalization. In his attempt to explain the existence of large multinational companies, Dunning (1981, 1997) cites ownership advantages as one among the facilitating factors. Such advantage is lacking in small firms. Past research has shown that small firms lack financial resources, management and marketing skills, previous export experience and export knowledge, as well as knowledge of foreign market information. They also lack command of

foreign language, and the relevant cultural experience; and they often fear foreign market risks (psychic distance). Exogenous inhibitors include; financing problems, technical barriers, and cumbersome export procedures (Moini, 1997). According to Penrose(1995), larger firms tend to have many competitive advantages over smaller firms, because of the resources and experience they command. There is now a growing literature suggesting that small firms may have to rely on networks and relationships to overcome their size disadvantages as they internationalize (Madhok, 1997). Small firms may also have to rely on networks to overcome their isolation in the current globalized market.

Networks could be seen as providing a competitive advantage to small firms, because of possibility of resource sharing and learning among network members that could enable them to minimize the disadvantages mentioned above. This may prove to be an excellent way for SMEs in developing countries to develop their business skills in exporting.

The internationalization of firms has been studied extensively. However the internationalization of small firms, especially from a developing country perspective, has received little attention in academic inquiry. The critical question that comes to mind in our Tanzanian study is: How do Tanzanian small firms participate and facilitate entry into export markets? Our current study attempts to explore this question using the network perspective. The policy implications of this kind of study are unquestionable, for African Governments need to create an environment that will end the isolation of small firms and put them on the road to increased partnering hence their export skills upgrading and competitiveness. The remaining part of the paper is divided into 4 parts. The next section reviews internationalization theories in order to enhance our understanding on why and how firms internationalize. Section three describes the methodology used in the exploratory study of small firms' internationalization in Tanzania. The findings are presented in section four, and we finally we conclude our paper in section five.

2. INTERNATIONALIZATION THEORIES AND THE NETWORK APPROACH.

A number of theories have attempted to explain *why, when, where, and how firms* engage themselves in international business. They range from economic to behavioral theories. Economic theories that have been used range from those that explain why trade takes place between nations to theories of the firm that explain the economic logic of going international. On the other hand behavioral theories have their roots in business administration, and they

focus on the managerial decisions of the individual firm or the owner manager. It is not the intention of this paper to review all of them here. Below we present a review of a few major traditional and recent theories that have gained currency in the internationalization literature.

The theory of growth draws heavily from industrial economics, and international economics. Luostarinen (1979), and Rugman (1980) use basic constituents of Penrose (1959) and her perspective on growth to explain internationalization of the firm. Economic fundamentals in a way dictate that one of the ways firms seek growth is through internationalization. It seems plausible therefore that growth is a significant driving force in corporate internationalization. Another economic theory that has been used to explain firm internationalization is Vernon's (1979) product life cycle (PLC) approach, although the original theory focused on trade between nations. The basic assumption of the PLC model is that location of new products usually starts in some developed countries such as the U.S.A to take advantage of high domestic demand, before investments can start in other moderate-income countries such as Europe. The U.S.A will therefore be the first to export to potential markets in Europe, at this early introduction stage of the PLC. During growth stage, investment may start in Europe (could be through FDI) and if labor costs differentials are large enough to offset transportation costs, U.S.A may import from Europe. At a later stage when the product is standardized, the less developed countries may offer competitive advantages as a product location (could be through FDI also). The theory has been cited for not taking into consideration products that have been traded without going through all the stages of the PLC due to technological changes and deregulation of markets. The model is therefore firm specific and product-specific.

Among the behavioral models are the transaction cost economics (TCE) approach, the Uppsala process model of internationalization, the innovation-diffusion model, the eclectic model, the resource-based perspective, and more recently the born global and the network perspectives. Some of these models are competing with each other, while others are complementing the existing theories. The TCE, the Uppsala model and the diffusion model are among the traditional internationalization theories. Researchers such as Madhoc (1997), and Wilkinson (2002) have used Williamson's (1975, 1985) TCE approach, which considers cost minimization, to determine a governance mode/market entry mode in foreign markets. Considering the uncertainties and risks associated with distant markets or culturally different markets (psychic distance), firms will tend to internalize exporting activities or transactions

with foreign markets. This theory explains the behavior of multinational enterprises, and their preference for hierarchical to market exchange transactions. Williamson identified three key conditions of transactions that affect choice of governance mode: asset specificity, frequency and size of transaction, and uncertainty. The assumption is that where the market is large and transactions are frequent, and also where assets owned by a company have limited other use, firms will favor internalization in order to minimize, among other problems, opportunisms and hence transaction costs. From the foreign market entry point of view firms will favor internalization (hierarchically integrated) of foreign market transactions

The Uppsala process model or the stage model on the other hand, describes firms' internationalization as an incremental, step-by-step process. That a firm will start as a low commitment exporter to committed exporter as it gains international marketing knowledge and experience and overcomes the psychic distance phenomenon. Hence an exporting firm will to start with have irregular export activities. In the next stage the firm will export via independent representatives or agents (indirect exporting). When it has gained experience the exporting firm will establish an overseas sales subsidiary (direct exporting) and finally undertake overseas production/manufacturing (Johanson & Wiedersheim-Paul 1975, Johanson & Vahlne 1977, 1990). Similarly, according to the Finnish variant of the stage model, at the beginning, firms will export to geographically close markets before venturing into distant and culturally different markets. This is supported by Luostarinen's (1979) large survey of Finnish firms in the 1960s and 1970s and beyond. His study also supported the Uppsala process model. The major factor influencing an incremental or a gradual process of foreign market entry is uncertainty with distant or culturally different markets, and the fear to invest resources where market knowledge is limited. Psychic distance appears to be the major hindrance, and is minimized through experiential learning and market commitment in foreign markets. These models have been criticized for being very deterministic (Johanson & vahlne 1993), for lacking explanation on behavior of firms that leapfrog or are born-global (Fletcher, 2001), for putting emphasis on psychic distance (Melin 1992), and for not emphasizing the role of networks (Holmlund & Kock, 1998).

On the other hand, the assumptions of the innovation-diffusion model by Roger (1962) have been borrowed by some researchers such as Bilkey & Tesar (1977), Cavusgil (1980), Czinkota (1982), and Reid (1981) (just to mention a few) to explain internationalization behavior of firms. Exporting is in this case taken as an innovation and internationalization is

assumed to take a stepwise process. This model appears to be closely related to the assumptions of the Uppsala model. The stages of innovation-diffusion are used to explain how firms start from non-exporting to committed exporters. Inexperience of foreign markets and psychic distance are minimized slowly through a stepwise and gradual commitment to more foreign involvement and experiential learning.

The resource-based perspective more or less complements the other perspectives. Ownership advantages in terms of organizational capability and capability of the entrepreneur, availability of a change agent, export marketing knowledge and experience, market information, business and social networks etc are all important drivers of internationalization. The arguments of most researchers in this area are rooted in Penrose's (1959) resource based perspective.

Among the most recent theories of internationalization are the eclectic perspective, the network perspective and the born global perspective. We will take a look at these perspectives in the ensuing paragraph.

The eclectic approach owes a lot to the work by Dunning (1981, 1996) in his attempt to explain the existence of multinational corporations (MNC), and what drives their expansion and growth. Dunning's model is based on three propositions related to location specific advantage, ownership advantage and internalization advantages. He posits that MNC have these three types of advantages because of their multinational nature of their activities; they boast a number of asset ownership: both tangible and intangible assets (technical as well as market and marketing assets), they have location advantages and can internalize activities with efficiency. Choice of foreign market entry mode will therefore be influenced by these three variables. The relevance of this model to small firm internationalization can be said to be limited.

The above theories have been criticized for providing little guidance in explaining firms that leapfrog or firms, which right from the beginning, go global (Fletcher 2001, Törnroos 2002). Advancement in information and communication technology (ICT), transportation and other infrastructure has made it possible for some businesses to go global without following the processes and stages of internationalization advanced by the traditional theories. This trend has also eliminated assumptions of the psychic distance advanced in the traditional theories

of internationalization. The born-global perspective has recently started to feature in the internationalization literature, and is already attracting some scholarly attention (it does not apply to our current study though).

As already observed earlier in this paper, the traditional theories of internationalization have also been criticized for not emphasizing the role of networks in firm internationalization. Perhaps among all the theories and perspectives of internationalization, the network perspective appears to be the most relevant from the point of view of small business internationalization. The network perspective on internationalization provides an interesting opportunity in understanding entry into foreign markets by young and/or resource-constrained small businesses. The network perspective posits that internationalization is a process that takes place through networks of relationships (Johanson & Mattsson 1988). Social capital, trust and human variables play an important role in binding individual firms or entrepreneurs into value adding relationships, which enable them to minimize or overcome their disadvantages of smallness and isolation, as well as overcome the problems associated with unknown markets and psychic distance. This way, small firms will minimize transaction costs hence overriding the assumptions of other cost minimization models such as the TCE. It is however noted that where networks have been studied it has in most cases been networks of the vertical type (relations between sellers and suppliers). Horizontal and social networks have not received adequate attention.

This study explored use of a wide range of networks, including horizontal and social networks, in small firm internationalization among small handicraft exporters in Tanzania. Recent small body of literature on business networks and clusters in Africa (e.g. Pedersen et al, 1994, McCommick, 1996) has helped to minimize the pessimism on potential of small firms in developing countries. It has been shown that clusters of small and medium-sized enterprises facilitate entry into foreign markets. It is quite understandable that few African firms can compete on their own in an age of liberalization and globalization.

Time is ripe for African businesses to realize that as barriers to globalization continue to fade, while powerful internationalization of production and marketing continue to thrive all over the globe, competing globally is not an option, but an economic imperative. This trend is deemed to create an extra-ordinary competitive environment for developing countries, as they do not appear to be ready to face the challenges and opportunities that globalization currently

present. The danger of economic and social marginalization is therefore obvious. This is clearly manifested in the poor export performance of most African Countries, which includes Tanzania. For despite almost two decades of structural adjustment and economic liberalization, Tanzania's trade deficit has been widening (see appendix-Table 1), reflecting an absence of a serious export- oriented economy. In the past decade, the share of manufacturing exports to total exports has been low (between 5% and 20%) and has decreased to as low as 5% in the year 2000, reflecting a structure of exports dominated by low value adding activities mainly of the extraction type and commodity products. The privatization programme, an important part of the economic liberalization, is yet to show some significant results. It is now well acknowledged that one possible approach to promoting an export-oriented manufacturing is developing the export activities of small and medium enterprises (SMEs). On the other hand, the current privatization programme has testified Tanzania's commitment to developing the private sector in which small enterprises play an important part. Small enterprises have often been described as seedbed to economic development in developing countries. At this juncture, it would therefore be interesting to examine the role small enterprises play in internationalization, and the strategies they use to enter foreign markets. This study is therefore very timely and should guide policy intervention in this area. Below we present the methodology and findings of the study.

3. METHODOLOGY

The fieldwork was carried out in the year 2002, in the Dar es Salaam Region, the commercial heart of the Tanzania. Specifically the study focused on one of the districts, Kinondoni municipality, where most handicrafts businesses are located. The study was mainly exploratory given that internationalization at the small business level has not been studied in the country, and given that a study on networks is a completely new area of research in Tanzania. Both survey and case study methods were employed. The case study approach was employed in order to provide in-depth findings on the network phenomenon and its role in foreign market entry especially for owner managers who have been in the handicraft business for a longer period.

3.1 The Sample

The research involved a survey of owner-managers of handicraft exporting enterprises. Handicraft enterprises were considered for the study because of the export-orientated nature

of the industry. The sample included 40 firms in the survey approach, and 4 case studies. Out of the forty companies selected for the study, 15 exporting firms were purposively picked from a list of Handicraft Marketing Mission obtained from the Board of External Trade (BET). 25 other firms were randomly selected at the time of the data collection from the famous handicraft business cluster located at the Mwenge Art and Craft Center in Kinondoni Municipality. Randomly selected firms were younger and were at their early stage of internationalization (between 2 and 8 years of export experience). The case studies involved firms with 10 to 15 years of export experience.

3.2 Data Collection

Personal interviews were held with Owner-managers using structured and semi-structured questionnaires. Identities of the owner-managers were disguised even in the case studies. Information sought included export marketing activities, years of export experience, business ownership and control, personal export experiences, international market entry strategies, network relationships at home and in foreign countries, etc. The questionnaires were personally administered, and hence 100% response rate was attained.

4. FINDINGS

4.1 Survey Results

The survey results revealed that a large number (72.5%) of the firms had less than 10 years of export experience. The remaining firms (27.5%) had been in the business for more than 10 years. Regarding their participation in networks and linkages, the findings showed that many owner managers belonged to at least more than one network relationship. 87.5 percent of the total respondents were found to belong to a cluster of handicraft sellers, 77.5 percent had linkages with customers, friends and relatives in foreign countries, 65 percent were linked to export houses, and foreign independent distributors, while 27.5 percent were found to maintain links with producer networks. With an exception of linkages with producers and export houses, most other networks were of informal character. Foreign market entry modes included indirect exporting (piggybacking) (12.5%), direct exporting through friends, relatives, and other customers (15%), direct exporting to independent distributors (12.5%), and direct exporting to customers (72.5%), singly or jointly with other cluster members. Again some owner managers had more than one export channel. Those with long export experience were found to maintain long-term relations with foreign independent distributors,

a strategy which helped to boost their sales. It is therefore clear from the results that handicraft exporters were exporting either indirectly or directly.

4.2 The Case Studies

Case I:

Tunu is an owner manager of a company that makes and sells garments made from exclusively designed and unique materials called *batik* and *tie-and-dye*. She first went into business in 1983, at a time when the Tanzanian economy was in a serious crisis, although the business was only officially registered in 1990. Tunu sells her products both locally and in foreign markets. She admits that the company has a bigger local market for its products, but she likes to sell internationally for more profit. The company is a member of a number of networks that include international artisans groups like Artisan Enterprises Network (AEN), Aid to Artisans (ATA) and Trade-Craft UK. Locally, the business is a member of an exporter of small firms' handicraft products located in Dar es Salaam called AMKA (A Swahili name that means awareness), a Non Governmental Organization. These networks, she claims, have enabled her to enter and increase her export sales. Her entry into the foreign market is through piggybacking. By 1996, Tunu had expanded her business to create other four departments like embroidery, fashion designing, curio making, and training of interested individuals and groups. The company's labor force has grown from 3 in 1990 to 15 workers in 2002.

Case II:

Danny, who is a primary school leaver, owns a family business dealing with the famous *Makonde (art)* woodcarvings and curio. Married with three children, Danny is a second-generation entrepreneur, who established the business in 1972. Located at the city center of Dar es Salaam, the business was able to generate a lot of profit from visiting tourists, who were the major target market. There were very few handicraft shops in Dar es Salaam then.

The business entered the export market for the first time in 1977 through a Japanese businessman who was a regular customer at Danny's shop, who took a few samples to Japan and Italy. The long-term business friend introduced the products to the Japanese market, after which Danny started received orders and invitations to attend trade fairs and exhibitions in Japan and other countries.

Danny and his wife have joined a number of networks, both local and international. They are a member of a Network of other Tanzanian craftsmen called the Union of Tanzanian Art and Craft Artisans (UTACA), and a couple international groups such as the Artisans Enterprises Network, and Fair Trade Federation. The owner-managers have also long term business and personal relationships with many of their foreign customers, friends and relatives living abroad, which are mainly informal in nature (based on trust and loyalty), and it is through these relationships the couple is able to connect their business to foreign buyers. The business sells directly to foreign buyers through these networks.

Over the years the business has grown from a single craft shop to other businesses. They now own a restaurant, a ceremony hall for leasing, and a gallery of collection of ancient art. This gallery is strategically used to attract more foreign customers wishing to see the artwork of famous Tanzanian artists.

Case III:

Anna and her husband Merinyo established their business informally in 1986, and were only able to register it in 1993. The business was first founded by Anna. A graduate in professional designing from a U.K based university (1982), she started her working life as an employee of the YWCA until 1986 when she abandoned her job to start her own business in traditional fashion and designing. She started making *batik* clothes by operating from her house and selling to individual customers and friends. As the market expanded, she established a shop at one of the tourist hotels in Dar es Salaam. In 1990, Merinyo joined her. The owner-managers maintains long-term relationships with suppliers and domestic exporters. Long-term relationships with suppliers enable them to secure production inputs on credit, while networks with other sellers facilitate joint marketing of their products abroad.

Due to business growth the company's labor force has increased from zero in 1990 to three in 1992, and to 5 in 1994. This growth also necessitated acquisition of a second production premise in 1992.

Case IV:

Married with five children, Gisela is a businesswoman selling handicraft products like woodcarvings and curio items. She went into business in 1985 at the time she was still

employed as a primary school teacher. She left her teaching job after four years to concentrate on her business. Gisela is a member of the Chamber of Commerce since 1988. She started exporting in 1989 after she received an order from France through the Chamber of Commerce. She has also attended many International Trade Fairs through the BET and her personal friends living outside the country. Through this exposure she has been able to establish long-term relationships with some customers and agencies abroad. This has enabled her to expand her business. In 1995 she purchased two shops at Mwenge Art and Craft Center (the handicraft cluster) where she can now display her items to take advantage of visiting tourists. She also maintains informal long-term relationships with suppliers, to ensure that she has constant supply for export. In 1997 she stopped selling locally and started concentrating on the export markets only. She attributes her success to the networks of customers and friends she has created abroad. She exports directly to these foreign customers.

5. CONCLUSIONS AND IMPLICATIONS

Results of the study have shown four typologies of networks commonly used by small handicraft exporting firms in Tanzania: a) networks with friends, customers and close family ties, b) networks with independent distributors in foreign markets, c) networks with cluster members, local and foreign associations like AMKA, AEN, Chamber of Commerce, and d) networks with local producers. Results of the exploratory study, especially the case studies, have further shown that networks have value adding benefits to small businesses. It is clear especially from the four case studies that networks of the owner-managers initially facilitated entry into foreign markets. The network benefits from the point of view of the owner-managers included access to foreign market information (demand, designs, prices, delivery schedules, channels etc), access to foreign markets, access to information about foreign trade fairs, and training opportunities, and access to supplier credit, just to mention a few. Most owner-managers were mainly using personal networks because, they claimed, Tanzanian embassies abroad were not helpful. Similarly, only a few were found to have knowledge on information and communication technology (ICT). Participation in both local and foreign international trade fairs was inaccessible to many of the owner-managers, given the high costs involved. In a few instances, however, foreign Trade Associations supported participation in trade fairs. Access to credit from formal financial institutions was a serious problem to many owner-managers. To many owner-managers, long-term relationships with handicraft producers/suppliers were a great relief, because they were able to get goods on

credit (on consignment basis). Asked why many of their networks were informal, inefficient judicial systems was often cited as a major constraint.

Regarding export market entry, all the owner-managers started selling their products domestically and eventually entered foreign markets through contacts with customers, friends, relatives, NGOs, cluster members, associations etc. Networks therefore facilitated internationalization of small handicraft firms. Indirect and direct exporting was found to be the only market entry mode. These results appear to support the Uppsala Stage Model of internationalization.

To conclude, it is quite clear from the findings of this study that partnering through networks and clusters is an alternative way for many resource-constraint developing country small enterprises to end their isolation in the current liberalized and globalized world and to become competitive in foreign markets. In the same vein, business growth in the current competitive environment will greatly depend on the ability of the owner-manager to establish networks. This argument advocates the need for networks capital and human capital to co-exist for successful internationalization. Developing Countries Governments should therefore address small business problems through creating a conducive environment for linkages and networks to thrive. Apart from creating macro-economic stability, developing countries Governments should strengthen capacity for small business development through education and training through building their technological and business capabilities.

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APPENDIX

TABLE I: TANZANIA'S TRADE BALANCE.

Millions of TZS

Period	Domestic Exports	Re-exports	Total Exports	Total Imports (f.o.b)	Trade Balance
1990	66,560.5	0.0	66,560.5	231,282.5	-164,722.0
1993	181,147.6	0.0	181,147.6	531,741.8	-350,594.2
1994	265,913.0	0.0	265,913.0	670,371.1	-404,458.1
1995	394,944.0	0.0	394,944.0	775,246.0	-380,302.0
1996	443,374.2	0.0	443,374.2	703,951.6	-260,577.4
1997	459,549.0	0.0	459,549.0	703,106.2	-243,557.2
1998	391,804.6	0.0	391,804.6	907,494.6	-515,690.0
1999	412,261.9	0.0	412,261.9	1,025,863.1	-613,601.2
2000-1 st Q	137,061.8	0.0	137,061.8	248,997.8	-111,936.0
2 nd Q	103,019.8	0.0	103,019.8	273,471.8	-170,451.9

Source: Bank of Tanzania

TABLE 2: TANZANIA EXPORTS BY TYPE OF COMMODITY (IN USD) MILLIONS OF USD

January- June

Commodity	1992	1993	1994	1995	1996	1997	1998	1999	2000*
Traditional Exports	145.28	144.90	174.35	198.85	210.44	184.14	148.60	100.16	132.28
Non traditional:									
Petroleum products	4.00	0.80	3.90	7.02	8.04	5.78	0.07	0.11	0.04
Minerals	20.50	45.20	10.80	29.58	26.45	28.57	13.66	20.23	80.39
Manufactured goods	27.60	25.70	50.10	41.57	32.14	87.31	17.71	14.65	16.59
Other exports	19.60	13.50	32.00	67.73	76.26	77.33	63.15	60.06	73.52
Sub Total non-Traditional	71.70	85.20	96.80	145.90	142.89	198.99	94.60	95.05	170.55
Grand Total									
Grand Total	216.98	230.10	271.15	344.74	353.33	383.13	243.20	195.21	302.83

Note: Volume in '000' Tons; Value in Millions of USD; Unit Price in USD/Ton

Source: Bank of Tanzania, International Economics Department.