

**Mzumbe University (former IDM) - Agder University  
College Collaboration**

**RESEARCH REPORT**

**ENTREPRENEURSHIP AND SMALL BUSINESS DEVELOPMENT  
RESEARCH PROGRAMME**

**ENTREPRENEURIAL RESPONSE TO THE REFORM OF  
INSTITUTIONAL FRAMEWORK**

**THE CASE OF SMALL-SCALE ENTERPRISES IN TANZANIA**

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## RESEARCH REPORT

**Title:** Entrepreneurial Response to the reform of institutional framework:  
the case of small-scale enterprises in Tanzania

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**Abstract:** The study analyses the role of institutional arrangements in entrepreneurial endeavour. An entrepreneur identifies a market opportunity and transforms it into a profitable economic value. Institutions are the humanly devised constraints that shape human interaction to determine transaction and transformation costs. Behavior of an entrepreneur depends heavily on the reward structure given by an institutional framework. Qualitative case study methodology was adopted and fifteen cases of small business enterprises were studied in Tanzania. The pattern of evidence from the case studies was matched with propositions developed from the theoretical framework. The study found out that entrepreneurial endeavour in small enterprises in Tanzania was taking place in the context of a mismatch between a slowly changing institutional framework and fast moving economic policy reforms. This mismatch constrains entrepreneurial endeavour and raises transaction costs. A favourable institutional framework is characterised by clear property rights and low transaction costs.

<b>Key Terms:</b>	<b>1</b>	Rule and norm structure	<b>3</b>	Transaction costs
	<b>2</b>	Entrepreneurial endeavour	<b>4</b>	Policy reforms

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## LIST OF ABBREVIATIONS

ACC	Arusha Cutlery Company
BOP	Balance of Payments
IDM	Institute of Development Management
MEDA	Mennonite Economic Development Associates
NORPACK	Northern Packages Ltd
REG	Regulation
SEs	Small Enterprises
SMEs	Small and Medium enterprises
SIDO	Small Industries Development Organization
SIMEX	Samky Import and Export
SIDA	Swedish International Development Agency
SOEs	State-Owned Enterprises
TAMECO	Tanzania Association of Mechanical Engineers Cooperative Society
TANESCO	Tanzania Electric Supply Company
TRA	Tanzania Revenue Authority
USAID	United States Agency for International Development
VAT	Value Added Tax
VETA	Vocational Education and Training Authority

## CHAPTER ONE

### INTRODUCTION

#### **1.1 Background to the study**

The report presents findings and analysis of a study undertaken in four urban areas of Tanzania (Dar-es-Salaam City, Mbeya, Moshi and Arusha Municipalities). The purpose of the study was to understand the set of institutional arrangements that account for successful entrepreneurial events in the Tanzanian small business sector. In particular, the study sought to understand the role of institutional arrangements in the observed increase of entrepreneurial activities and events in small enterprises in Tanzania after economic liberalization. The ultimate goal of the study was to understand the nature and characteristics of economic institutions that create a conducive environment for the growth of small enterprises in the process of economic growth.

Wide ranging economic policy reforms have been undertaken in Tanzania since 1986 as a response to the economic crisis of the early 1980s. The essence of the reforms constitute a shift from the state-centred to market-centred economic development in which the private sector is expected to take a leading role in the direct productive activities. The reforms are predicated on the belief that free market allocates resources more efficiently and hence enhances economic growth. Against the background of the low level of indigenous entrepreneurial activity, a concern has been raised as to how best to promote the private sector entrepreneurial activities. Small enterprise sector, in particular, is viewed as important because the sector is within the reach of potential indigenous entrepreneurs in terms of the requisite size of initial capital, technology, and skills.

A central issue in the current economic reforms has, therefore, been how to create an enabling business environment in which the private sector expands to take up the entrepreneurial space created, not only by the divestiture of the state-owned enterprises, but also by opportunities

created by a free market economy. The business environment being sought is one in which more potential indigenous entrepreneurs are enabled to take up the available business opportunities. Several approaches to meet this challenge have been suggested and implemented. They include enhancing entrepreneurial capacity through training, logistical support, financial support, and networking (Kuzilwa, 1997). One overlooked area, however, which requires more knowledge, is the role of institutional framework or “rules and norm structure” in this process. Little has been done in Tanzania in the way of understanding how potential and existing entrepreneurs respond to incentives and constraints created by institutional arrangements. The study contributes to the current endeavour to understand the role of institutional arrangements in the development of entrepreneurship in small enterprises.

The report is structured into four chapters. This introductory chapter presents background to the study, including the state of small enterprises in Tanzania, research problem, study objectives, rationale and scope. Chapter two reviews selective theories of entrepreneurship and institutional economics, which provide a framework of analysis linking institutional framework with small-scale entrepreneurial endeavour. Chapter three presents research design and methodology while chapter four discusses research findings, analysis and policy implications of the study. The findings emanate from cross-case analysis of the fifteen empirical cases of selected small-scale entrepreneurs in Dar-es-salaam, Mbeya, Moshi and Arusha. Transcriptions of the fifteen case studies are given as appendix of the report.

## **1.2 Small enterprises in Tanzania**

The study focuses on small enterprises employing up to about fifty persons. The category “small”, however, should not be strictly associated with number of employees because what matters more in this type of analysis are the qualitative characteristics of small enterprises in countries like Tanzania, and not necessarily quantitative categorization. Qualitative characteristics of small enterprises include their capacity to create more jobs at lower costs than the large enterprises, low capital to labour ratio, and the possibility of meeting local demand of



appropriate goods at affordable prices. Furthermore, the requisite managerial skills for small enterprises are less sophisticated and hence commensurate with limited managerial capacity. Yet another qualitative characteristic is the widespread ownership of small businesses, which provides for more equitable distribution of income. Small enterprises are also relatively less destructive to the environment (Engelmann, 1994:73; Fafchamps, 1994:1).

Definition and categorization of “small” enterprises vary also depending on the focus of analysis, degree of formality in operations, access to formal financing, organizational characteristics, and level of development of a particular economy. The Lome Convention<sup>1</sup>, for example, distinguishes between three types of small enterprises: Small and Medium Enterprises (SMEs), craft activities, and micro-enterprises. According to the Lome Convention, SMEs employ more than ten persons and operate mainly in the formal sector. Craft activities are found mainly in the semi-formal sector carrying out simple transformations of primary products and they have limited access to formal financing institutions and use rudimentary technologies. Micro-enterprises are normally family businesses operating mainly in the informal sector with as many as ten workers although the usual number is one or two, with or without some part-time assistance (Ritto, 1997:35). In general, however, small enterprises are mainly found in the realm of the private sector.

The increasing percentage share of the private sector in total monetary fixed capital formation can illustrate the growing importance of private entrepreneurship (which is characteristically small) in the Tanzanian economy after economic liberalization. Share of the private sector increased from 23.9% in 1971 to 67.3% in 1991 and reached about 79.6 in 1996.

Correspondingly, the share of the public sector decreased from 76.1% in 1971 to 32.7% in 1991 reaching about 18.8% in 1996. Likewise, the share of private sector employment in the formal sector increased from 23% in 1984 to 38% in 1988 and reached about 65% in 1994 (Tanzania, 1991, 1992 and 1996).

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<sup>1</sup> Economic and trade cooperation agreement between The European Economic Community and The African, Caribbean and Pacific countries (ACP).

According to Meir cited in Engelmann (1994) small enterprises, “constitute an important if not dominant portion of the private sector of most African countries in terms of employment and value added. Developing small businesses does thus make an important contribution to strengthening the private sector.” (p73). In the case of Tanzania the following illustrative statistics attest to this assertion. A 1989 industrial census carried out in the Dar-es-Salaam City, the major commercial and industrial centre in Tanzania, indicates that, of the 3,831 enterprises located there, 88% fall under the small-scale category (employing up to 10 persons) and 9% under a medium scale category (employing between 10 and 100 persons). Further, in a sample of 131 enterprises picked randomly from the above industrial survey, 43% of the firms are owned by non-indigenous entrepreneurs who constitute only about 1.3% of the total Tanzanian population (World Bank, 1994:193). A 1989 survey by the Tanzanian Bureau of Statistics estimated that the number of small-scale enterprises had grown to at least three times the level of mid 1980s (Msambichaka, 1995).

### **1.3 Research problem**

The link between private entrepreneurial activity and economic development is not controversial particularly for countries where development paths are a legacy of failed state entrepreneurship through state-owned enterprises. While it is interesting to know why entrepreneurial events in small private enterprise sector have increased in Tanzania after economic liberalization initiated in 1986, it is even more interesting to understand, in particular, how the reform of institutional framework has accounted for that increase.

The purpose of the study was to answer the following main question: what set of institutional arrangements account for successful entrepreneurial events in the Tanzanian small business sector? More specifically, it is important to investigate why and how do potential and existing small scale entrepreneurs respond to changes in institutional arrangements defined as a set of formal and informal constraints on behavior in form of rules, property rights and norms. In

particular, what has been the role of these institutional arrangements or “rules of the game” in the observed increase in Tanzania of entrepreneurial activities and events in small enterprises after economic liberalization in Tanzania?

The ultimate research objective was to understand the nature and characteristics of economic institutions that create a business environment conducive to growth of output and development in general. In other words; under what institutional conditions would potential entrepreneurs engage in formal small-scale growth-enhancing entrepreneurial activities? Policy implications of the findings have been drawn in terms of outlining the institutional conditions under which potential and existing entrepreneurs would intensify their entrepreneurial activities in small enterprises.

The study sought therefore to answer the following specific research questions:

- What is the nature and characteristics of the evolving institutional arrangements that affect the Small Scale Enterprise sector in the context of the ongoing economic reforms?
- Why and how have the entrepreneurs responded to the reform of institutional arrangements? What are the characteristics of incentives, constraints and transaction costs inherent in the changing institutional framework?

#### **1.4 Research Objectives**

The ultimate goal of the study was to understand the nature and characteristics of institutional arrangements that create conducive environment for the growth of small enterprises in the process of economic growth and development. This required understanding the nature and character of institutional changes taking place under the economic policy reforms in Tanzania. Specific research objectives were:

- To identify and characterize institutional arrangements (rule and norm structure) that have affected development of entrepreneurial events in the small enterprise sector in Tanzania

during the economic policy reforms initiated towards the end of 1980s. The characterization is in terms of incentives, constraints and transaction costs.

- To characterize the response of the successful small entrepreneurs to incentives, constraints and transaction costs inherent in the ongoing reform of institutional arrangements.
- To draw policy implications of the findings.

## **1.5 Rationale of the study**

A central issue in the current economic reforms has been how to create an enabling business environment in which the private sector expands to cover the entrepreneurial space created, not only by the divestiture of the state-owned enterprises, but also by opportunities created by a more liberal economy. The business environment being sought in Tanzania is one in which more potential indigenous entrepreneurs are enabled to take up the available business opportunities. Several approaches to meet this challenge have been suggested and implemented. They include enhancing entrepreneurial capacity through training, logistical support, financial support, and networking. One overlooked area in Tanzania, however, which requires more knowledge is the role of institutional framework or “rules of the game” (not organizations) in this process. Little has been done in the way of understanding how potential and existing entrepreneurs respond to incentives and constraints created by institutional arrangements. The study seeks to make a contribution in this dimension. Findings of this study will provide contextual knowledge that could be useful in policy making in the area of institutional reforms.

## **1.6 Scope of the study**

In terms of scope delimitation the study did not deal primarily with the mechanisms of institutional change (from pre-reform to post-reform) or the influence of “normative behavioral codes” (customs, traditions, and codes of conduct in entrepreneur’s social setting). The study also did not address the “constitutional order” as primary object of investigation (Feder and Feeny, 1991). The focus was on formal institutional arrangements (formal rules, regulations and

laws). Normative behavioral codes are, however, referred to in regard to their interface with formal institutional arrangements. The long run potency of the informal social-cultural constraints was not underestimated, however, particularly given that they are more “impervious” to deliberate policies.

The following chapter reviews briefly some theoretical aspects of entrepreneurship before linking it with the theory of institutional economics to provide a framework of analysing the empirical case studies of small enterprises in Tanzania.

## CHAPTER TWO

### SELECTIVE LITERATURE REVIEW AND ANALYTICAL FRAMEWORK

#### **2.1 The theory of entrepreneurship**

According to the Schumpeterian tradition, an entrepreneur is a person who identifies a market opportunity and transforms it into a profitable economic value. Entrepreneurship is the quality of the person, which includes both attitude (disposition to take responsibility for risk and outcomes) and behavior (set of actions necessary to implement a venture). According to Morris and Lewis, entrepreneurship requires both an entrepreneurial event (conceptualization and implementation of a new venture) and an entrepreneurial agent (individual or group that assumes personal responsibility for bringing the event to fruition). Behavioral ingredients of entrepreneurship include innovation, risk-taking and pro-activeness, which determine the degree (high or low) of entrepreneurship (Morris and Lewis, 1995:33).

This study adopts the economic approach in analyzing entrepreneurship. According to Schumpeter, entrepreneurship involves an innovative activity which leads to any of the following five outcomes: (i) the introduction of a new good, or a new quality of a good, (ii) the introduction of a new method of production, (iii) the opening of a new market, (iv) the conquest of a new source of supply of raw materials or components, or (v) the reorganization of any industry (Bull and Willard, 1995:3).

McCormick (1996), for analytical purposes, distinguishes the entrepreneur (the person) and entrepreneurship (abstract quality) from the entrepreneurial event (the outcome), and argues that, “what is important is that something has happened (an event) that has changed the future course of the economy” (p67). While the distinction and argument is useful in particular analytical settings, it is important, however, to understand also the genesis or process that leads to a particular entrepreneurial event. The process approach is necessary because

entrepreneurial events are problematic and have to be explained. Understanding the agent of change (the entrepreneur), its qualities (entrepreneurship) and the intervening process (entrepreneurial activity) is therefore important. The present analysis views institutional arrangements as affecting all the three elements although the measurement of outcome relies on the entrepreneurial event.

There are two approaches to understanding what motivates entrepreneurs; the supply and demand approaches. The supply approach focuses on individual interests, personality traits, cultural values, and perceptions. Among the factors that have been analyzed in theory or empirically and found to influence the supply of entrepreneurs (cited in Alange, 1987:75) are: profit (Leibenstein, 1957), need for achievement (McClelland, 1961), independence (Marris and Somerset, 1971; Kilby, 1969; Hart, 1972; Onyemelukwe, 1973), money and status (Harris and Rowe, 1966; Kilby, 1969).

The analysis in this study adopts the demand side approach, which focuses on contextual and situational factors, including institutional framework. Situational factors may constrain or enhance availability of opportunities for entrepreneurship. The demand side analysis focuses on how the institutional factors facilitate or constrain the availability of entrepreneurial opportunities. In terms of the baseline model of entrepreneurship endeavour and success, these factors are categorised as “bureaucratic maze” (constraints) and “navigational aid” (supporting facilities) (Kristiansen, 1999). Consequently, the demand approach assumes that the supply of entrepreneurs is elastic and the problem is lack of a conducive institutional framework for enhancing opportunities for entrepreneurship (Peterson, 1981).

In an attempt to develop a theory of entrepreneurship, Bull and Willard (1995) discussed four conditions under which entrepreneurship will occur. The conditions are: (i) task-related motivation, (ii) expertise (present know-how plus confidence to be able to obtain know-how needed), (iii) expectation of gain for self (economic and/or psychic benefits), and (iv) a supportive environment including institutional framework. This study focuses on the last

condition; a supportive environment, which is discussed in the following section which reviews the theory of institutional framework in relation to entrepreneurial endeavour.

## **2.2 Institutional framework: theory and practice**

According to Douglas North (1990: 3&6);

*Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. ... Together with technology employed, they determine the transaction and transformation (production) costs that make up total costs. The major role of institutions in society is to reduce uncertainty by establishing a stable [not necessarily efficient] structure to human interaction.*

Institutions provide an environment within which entrepreneurs emerge and operate. They structure incentives in human exchange in social, economic and political arenas. According to Bull and Willard (1995), behavior of an entrepreneur depends heavily on the reward structure in the economy as given by an institutional framework which is characterized by a particular “rule and norm structure”. Changing the rule and norm structure or institutional arrangements can modify the behavior of entrepreneurs, composition of the entrepreneurial class and the number of entrepreneurs. They further argue that, “rules of the game that produce gain for the entrepreneur are therefore hypothesized to be an important variable in explaining variations in entrepreneurship” (Bull and Willard, 1995:9).

An institutional framework is comprised of both formal rules and informal constraints. Formal rules or institutional arrangements include political and judicial rules, economic rules, and contracts. Political rules define the hierarchical structure of the polity and its basic decision structure (see also Feder and Feeny, 1991). Economic rules define property rights while contracts contain the provisions specific to a particular agreement in exchange (North, 1990:47).



Informal constraints, which coordinate repeated human interaction, are an extension, elaboration and modifications of formal rules. There are three forms of informal constraints: the unwritten constraints that have evolved from formal rules in the context of repeated interactions (exchange) among players; socially sanctioned norms of behavior, and internally (individual) enforced standards of conduct (e.g. giving up wealth maximization due to integrity, honesty, reputation). Informal constraints, which often lead to conventions, emerge from the coordination and cooperation problems of human interaction. Although informal constraints are not directly observable, the contracts that are written provide for indirect evidence of changes in informal constraints (North, 1990:40&43).

According to Lin and Nugent (cited in Aredo, 1997) the most basic function of institutions is to economize. The general demand side argument in the New Institutional Economics is that institutions are “transaction cost-minimizing arrangements, which may change and evolve with changes in the nature and sources of transaction costs and the means for minimizing them.” (Aredo, 1997:60).

North’s theoretical framework of institutions is constructed from a combination of the theory of human behavior, theory of transaction costs and theory of production. The theory seeks to explain the role of institutions in economic performance. The basic premise of North’s institutional theory is the ever-increasing complexity of transactions arising from division of labor and specialization. North (1990) departs from the rational choice model, which underpins the neo-classical economic theory of individual utility maximization and qualifies it by introducing the complexity of human motivation (that wealth maximization is not the only motive) and the individual’s problem of deciphering the environment (Hubert Simon’s “bounded rationality”). North links this behavioral model with the theory of transaction costs of exchange.

Cost of transacting consists of three elements: cost of measuring the valuable attributes of the object of exchange arising from information asymmetry between exchanging individuals; cost of monitoring and protecting property rights; and cost of enforcing agreements. Property rights are

the rights individuals appropriate over their own labor and goods they possess; the rights of ownership, use, sale, and access to property. Appropriation is a function of institutional framework in terms of legal rules, organizational forms, enforcement and norms of behavior. The costs of measurement and enforcement are the sources of social, political and economic institutions. The magnitude of measurement and enforcement costs can be figured in institutional arrangements such as warranties, guarantees, trademarks, bonding of agents, arbitration, mediation and judicial system. Enforcement can come from second party retaliation, internally enforced codes of conduct, societal sanctions, or a coercive third party (the state) (North, 1990:31-33).

The link between institutions and transaction costs reflects, therefore, the overall complex economic institutions (formal and informal) that make up an economy. Institutional structures in countries like Tanzania lack an effective formal institutional structure and enforcement, which are important for markets to be efficient and, above all, for creating an enabling environment for entrepreneurs. Consequently, transaction cost per exchange in such economies is higher than in developed economies. In the case of Tanzania the institutional framework before economic reforms initiated in 1986 was not conducive to formal small businesses. This led to development of lucrative informal sector or underground economy. The rationale for the current policy reforms is, inter alia, to rectify this perverse institutional landscape.

Douglas North summarizes below the consequence of perverse institutional frameworks in many Third World Countries, which matches the pre-reform situation in Tanzania:

*Firms come into existence to take advantage of profitable opportunities, which will be defined by the existing set of constraints. With insecure property rights, poorly enforced laws, barriers to entry, and monopolistic restrictions, the profit maximizing firms will tend to have short time horizons and little fixed capital, and will tend to be small scale. The most profitable businesses may be in trade, redistributive activities, or the black market. Large firms with substantial fixed capital will exist only under the umbrella of government protection with subsidies, tariff protections, and payoffs to the polity - a mixture hardly conducive to productive efficiency (North, 1990:67).*

In this study the entrepreneurial process experienced by the entrepreneurs is analysed in conjunction with the formal institutional arrangements that affected them. Small-scale entrepreneurs may have shifted or started new ventures because of a change in opportunity set created by economic and institutional reforms. That response may fit loosely into the McCormick's effect of "directional factors" in which it is argued that an institutional framework "exercises directional influence on entrepreneurship by allowing some ideas to be implemented easily while others are blocked by excessive regulation" (McCormick, 1996:72).

In the case of Tanzania, however, the institutional framework during the pre-reform period (before 1986) did not merely "influence the entrepreneur to undertake one activity rather than another" as McCormick would argue. Rather, it may have blocked altogether the generation of several entrepreneurial ideas and in some cases it redirected the entrepreneurial effort to illegal and unproductive activities. Institutional reform in Tanzania, therefore, may have affected positively the "total supply" of entrepreneurial opportunities and events and not only the "proportion" of total supply.

While the fervently challenged McClelland's (1961) psychology-based "need for achievement" argument is basic for a theory of entrepreneurship, the view taken in this study is that, need for achievement is necessary but not sufficient condition for entrepreneurial event to be realized in specific contexts. Incentives and constraints created by institutional arrangements are also important and may increase or decrease the need for achievement. As Peterson (1981:71) argues, "all studies agree that the significant blocks to the expression of entrepreneurship are legal, administrative, political, economic and social, rather than characterological." Engelmann (1994), after a study of entrepreneurship in Africa, found out also that, "the regulatory framework in which small businessmen operate might need revision ... in laws and regulations; relaxing licensing regulations ... reviewing municipality by-laws and building codes; and reviewing of labour and employment Acts with a view to adapting them to the needs of small businesses" (p76).

Institutional arrangements have proved to be important in determining not only the responses to economic opportunities but also the changes in the opportunities themselves. Institutional reforms have, therefore, to move in tandem with market reforms so as to ensure proper entrepreneurial response. After about fifteen years of economic policy reforms in Tanzania many of the laws and regulations governing economic agents are remnants, not only of the socialist model of development adopted after independence, but also of the pre-independence regime. The Companies Ordinance, for example, was enacted in 1923 while twelve labour laws, according to the Labour Advisory Board (LAB), were enacted during the colonial era or under the auspices of the Arusha Declaration.<sup>2</sup>

In addition to the out-of-date and incompatible "rules of the game", a duplication and plethora of rules and laws add to the institutional problem. Citing a 1991 study of constraints to private sector development, USAID/Tanzania found out that business activity in the city of Dar es salaam alone is governed by six statutes, 12 bylaws, 15 regulations, 11 ordinances, seven notices, and one rule, and this situation remains unchanged to this date (USAID/Tanzania, 1996:83).

This institutional scenario suggests that unless economic reforms are accompanied by changes in institutional framework, expected reform outcomes and goals may not be realized or may be realized at a slow pace and partially, leading to high transaction costs for economic agents. Laws and regulations should also be credible and enforceable. Enforcement of laws and regulations is a critical link between institutional development and entrepreneurial endeavour. Enforcement reduces opportunities for the abuse of power, raises the cost of corruption and

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<sup>2</sup> They include: Employment Ordinance No. 366 of 1956; Master and (Native) Servant Ordinance of 1923; Security of Employment Act No. 574 of 1964; Severance Allowance Act No. 487 of 1962; Compensation Ordinance No. 263 of 1957, Occupational Accidents and Diseases (Information) Act No.330 of 1953; Trade Union Act No. 20 of 1991; Wage and Professional Conduct Act no. 300 of 1951; Industrial Court Act No. 41 of 1967; Factories Ordinance No. 267 of 1950; Human Resources Development Act No. 6 of 1983; Disabled Persons (Employment) Act. No. 2 of 1982; and Employment Services Act No. 12 of 1969. (The Guardian, August 6<sup>th</sup>, 1996).

lowers transaction costs. All these tend to encourage entrepreneurs across all economic activities.

The following section links the theory of entrepreneurship with the theory of institutional framework to produce a framework for analysing barriers to entrepreneurial endeavour and response to a particular institutional framework.

### **2.3 Institutional framework and entrepreneurial endeavour: A linking framework of analysis**

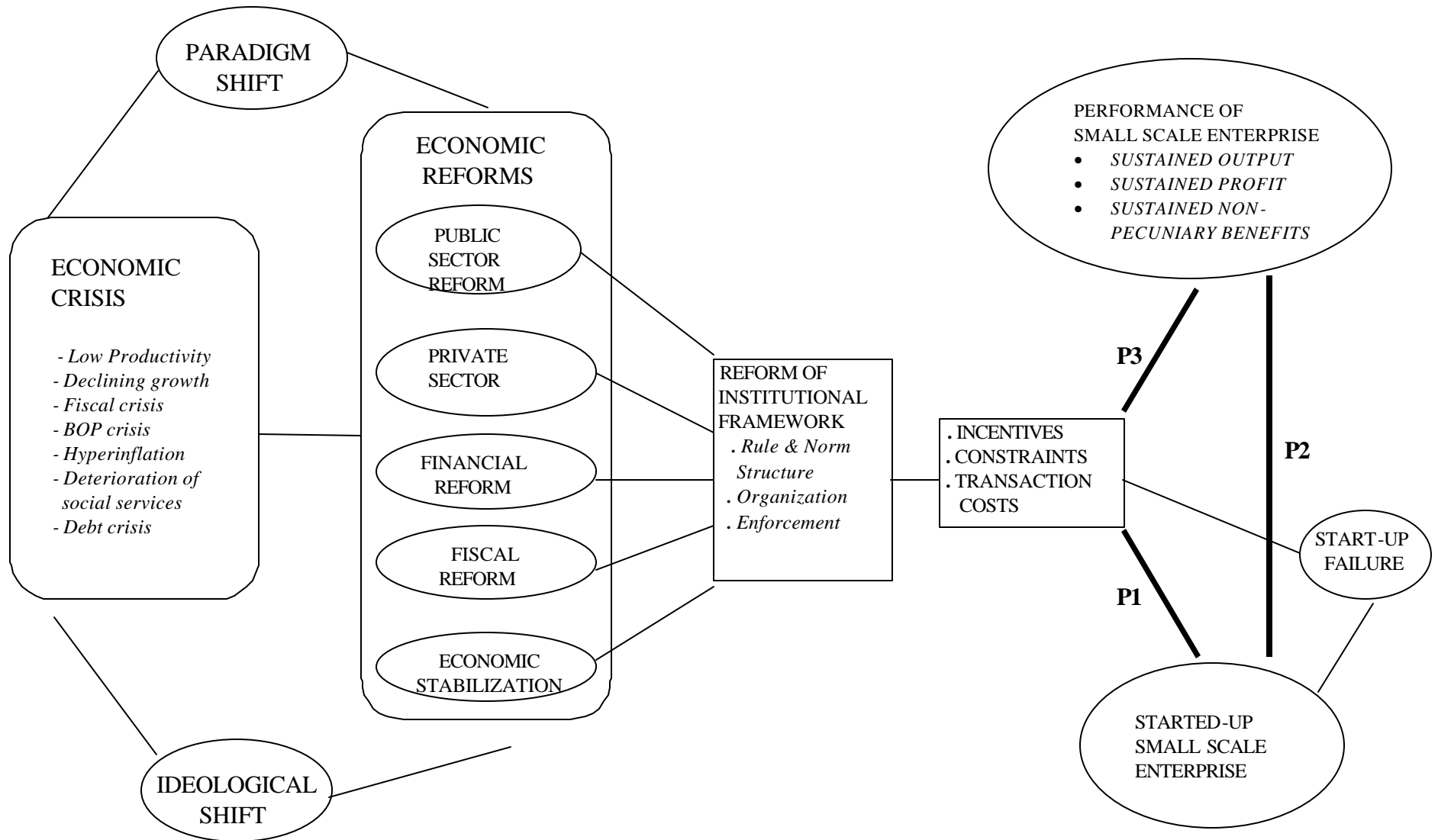
In analysing entrepreneurial activities in small enterprises in Tanzania, the study links the theory of entrepreneurship with the theory of institutions and economic performance as developed by Douglas North (1984 and 1990). The link between private entrepreneurial activity and economic development is not controversial particularly for countries where development paths are a legacy of failed state entrepreneurship through state-owned enterprises. While it is important to know why entrepreneurial events in small private enterprise sector have increased in Tanzania after economic liberalization initiated in 1986, it is even more interesting to understand, in particular, how the reform of institutional framework has accounted for that increase.

Entrepreneurial events are an outcome of entrepreneurial activities and an analytical framework should seek to understand how institutional arrangements influence entrepreneurial activities in a small business sector. There is a need therefore to link entrepreneurship and institutional arrangements in an analytical framework to guide the development of plausible claims or propositions for validation by empirical evidence. The interest in this study is to understand how institutional arrangements influence the disposition, decision to act, activities and realization of the entrepreneurial event; that is, establishment of a successful small enterprise. What incentives and constraints are created by institutional arrangements in that entrepreneurial process?

In understanding entrepreneurial process the analytical perspective adopted here is the “policy-institutional development” approach, which recognizes the importance of an enabling business environment for the development of entrepreneurship in a specific context. This does not, however, underestimate the importance of other two approaches; the “resource-input” and “entrepreneurial capacity-development” approaches (Engelmann, 1994). It rather emphasizes the increasing recognition and significance of institutional framework in shaping the evolution of the business task environment, often taken for granted in neo-classical economics.

The analytical model developed in figure 1 below suggests that economic crisis triggers economic reforms directly and indirectly through paradigm and ideological shifts. The various economic reform programmes (public, private, financial, fiscal and macroeconomic stabilization) cause reforms in the institutional framework (rule and norm structure, organization and enforcement). Institutional framework determines incentives, constraints and transaction costs that influence entrepreneurial activities and events including start-up and sustainability of small-scale enterprises. It is argued that an institutional framework that motivates partners, reduces constraints and lowers transaction costs, is characterised by the following elements: clear assignment of property rights and their allocation; clear rules governing the relationship between participants in economic process (such as contract laws); and clear rules and conventions controlling participation in the economic process (such as competition laws, fair business practices, brand names, trade marks and mutual trust). Such an institutional framework leads to intensified start-up and sustainable performance of small-scale enterprises. The clarity of such a “rule and norm structure” should also facilitate effective enforcement. Institutional reform is geared to providing such an “enabling” institutional environment.

**Fig.1: FRAMEWORK OF ANALYSIS FOR INSTITUTIONAL FRAMEWORK AND ENTREPRENEURSHIP**



*Source: Adapted from Nkya, E.J. (1995), p68 (bis)*



The three propositions indicated in figure 1 above are described below and verified by the fifteen empirical cases studied in Dar-es-Salaam, Mbeya, Moshi and Arusha. Some of the prominent variables could later be tested by a wider survey and quantitative analysis.

*Proposition one (P1)* posits that incentives, constraints and transaction costs inherent in an institutional framework influence start-up of a small-scale enterprise. Positive incentives (raised benefit stakes) and reduced start-up constraints and hustle, lower transaction costs, hence providing for an enabling entrepreneurial environment in which a small entrepreneur can be innovative, assume business risk and organize resources effectively. Conversely, negative incentives (lowered benefits) and increased start-up constraints and hustle may lead to enterprise start-up failure.

*Proposition two (P2)* suggests that incentives, constraints and transaction costs inherent in an institutional framework influence performance of a started-up small scale enterprise which is struggling to attain a sustainable level of performance. Positive incentives (raised benefit stakes) and reduced operational constraints and hustle, lower transaction costs hence providing for an enabling entrepreneurial environment in which a small entrepreneur can struggle to attain a sustainable enterprise performance through innovations, business risk management, effective allocation and organization of resources. Conversely, negative incentives (lowered benefits) and increased operational constraints and hustle may lead to enterprise failure before it attains a sustainable performance in terms of output, profits and other non-pecuniary benefits.

*Proposition three (P3)* claims that incentives, constraints and transaction costs inherent in an institutional framework influence performance of an ongoing small scale enterprise in terms of levels of sustainable output, profits and non-pecuniary benefits. Positive incentives (raised benefit stakes) and reduced operational constraints and hustle, lower transaction costs hence providing for an enabling entrepreneurial environment in which an entrepreneur can enhance sustainability of the enterprise through innovations, business risk management, effective allocation and organization of resources. Conversely, negative incentives (lowered benefit

stakes), increased operational constraints and hustle may lead to marginal and unsustainable enterprise performance.

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### **3.1 Research design: a multiple-case study**

The in-depth and dense nature of the research questions (how and why) point to the need and advantage of using qualitative research methodology in which descriptive case study design is employed to achieve the research objectives. A case study as a research strategy is defined by Yin (1989) as an empirical inquiry that “investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.”(p23). The boundary between institutional arrangements and other social structures in Tanzania is highly blurred given the interdisciplinary nature of institutional arrangements, the process through which they are established, and nature of previous development policy framework in Tanzania (Nkya, 1997). A particular strength of case study method is the possibility of combining a variety of evidence including documents, artifacts, interviews, and observations to conduct in-depth inquiry into a social phenomenon in which research interest involves a large number of variables and limited number of cases. The limitations of case study method which include a possibility of biased views and difficulties of broad generalization (external validity), have been foreseen and an attempt to reduce them made in this study. Multiple-Case study design is used in this study in which six cases were studied as *units of analysis*.

#### **3.2 Case selection and data collection**

Given the large number of small enterprises, a non-probability purposive sampling based on informed judgement was used to select fifteen cases of small enterprises. The following criteria were used to select the cases:

- The enterprise must have operated for at least five years before reforms and was still an ongoing enterprise.
- The enterprise must at the time of the study be employing not more than a hundred people.
- The enterprise management was willing to provide the necessary information required by the study.
- In the municipalities where more than the required number of enterprises were identified (in the sampling frame), a lottery method of simple random sampling was employed.

Case selection focused on four urban areas of Dar-es-Salaam, Mbeya Arusha and Moshi. At least three cases were selected from each of the four areas on the basis of the above criteria. Selection of these municipalities was based on controlling proximity to industrial activities and availability of formal small enterprises. The urban nature of this purposive sample of urban geographical locations is given by the fact that majority of formal small enterprises (apart from peasant-type enterprises) are located in urban areas.

Three main methods were used for data collection: direct interviews with owners of SEs, documents from the small enterprises, and archival records of various laws and regulations. The use of multiple sources of evidence was intended to increase "construct validity" of the case study design in terms of seeking convergent lines of inquiry (Yin,1984:41) or what Patton (1987:60) calls "methodological triangulation". Interviews were guided by unstructured open-ended lead questions to invoke a conversational interview.

The interview structure of each case was guided by the following elements:

- Background and description of the small enterprise (entrepreneurial event).
- Profile of the entrepreneur/s and source of the entrepreneurial idea.
- Characterization of specific law/s, rules, regulations, procedures, norms or contracts that affect/affected establishment, development and performance of the small enterprises.

- How specific rules and regulations affected performance of the small enterprises in terms of time used, incentives provided, constraints encountered, pecuniary costs, litigations, and any other effects.
- How the small enterprises responded to changes (reform) in the above rules and regulations.

The main concern in data collection was how to ensure reliability of the methods employed; that is to ensure that if another investigator followed the same procedures to conduct the same study was bound to obtain similar findings. The objective was to minimize bias. The use of multiple methods for data collection (interviews, documentary and archival evidence) was aimed at dealing with this problem. To this end, case study data base (case notes, documents and interviews) have been maintained for review and reference for tracing the chain of evidence.

### **3.3 Cross-case analysis**

Systematic case documentation and content analysis of documents was carried out and guided by research questions and objectives. They involved event description, summary of critical incidents, reflexive (before and after) comparison of institutional arrangements in terms of inherent incentives, constraints and transaction costs. Key opinion and perception statements were directly quoted in accordance with the normal research ethics in regard to protecting personal identity for sensitive opinions.

Another tool employed for cross-case analysis and synthesis of findings was descriptive matrix of "rule/effect" relationship categorized under the salient pieces of institutional arrangements for both periods (before and after reforms) indicating each major law, regulation and resources used to establish a small enterprises and their effect on entrepreneurial activities .

The pattern of evidence from the case study was contrasted with the institutionalist theoretical claim or proposition advanced under the analytical framework, using the "pattern-matching" technique (Yin, 1984:109-113). This is a method of analyzing and synthesizing evidence called

"analytical generalization" which utilizes a previously developed theoretical argument as a template with which to compare the empirical results from the studied cases of small enterprises in Dar-es-Salaam, Arusha, Moshi and Mbeya. Results are considered stronger if the empirical evidence from the case study supports the theoretical claim or proposition that was initially posed. The aim is to be able to draw-up policy relevant conclusions that provide discriminating explanations to fit the specific Tanzanian policy setting and not necessarily to generalize to other contexts or cases. The issue of threats to "external validity" (Cook and Campbell, 1979:ch2) is not therefore pertinent in this study because generalization beyond the context of the cases was not being sought.

Threats to "internal validity" are relevant, however, because the study seeks to show that the changing institutional setting in Tanzania is influencing entrepreneurial behavior in small enterprises. The relevant internal validity question in this study is therefore the extent to which the studied entrepreneurial events could be relied upon to support the claim that the changing institutional framework has influenced the intensification of entrepreneurial activity in small businesses in Dar-es-Salaam, Arusha and Mbeya. Measures taken in this study to reduce this threat to internal validity include the use of "cross-validation" of evidence through the use of multiple sources of evidence (interviews, documentary and archival evidence) and also the "pattern matching" mode of analysis (Yin, 1984:43).

### **3.4 Limitations of the study**

Study limitations are inherent in both the nature of the research subject matter and methodology employed. First, institutional economics as a unified body of knowledge in its own right is still developing and hence very eclectic in substance. Using institutional models for research requires pulling together elements from diverse disciplines in which a researcher may not be well versed. Second, results of case study design are not amenable to broad generalization. Findings are limited to "analytical generalization" in which they are compared to a theoretical claim or proposition based on a tested theoretical framework. Finally, experience indicates that

studying small business activities in countries like Tanzania often makes small businessmen apprehensive of likely tax payment implications of their revelations. Transparency in regard to research objectives and methods is therefore necessary.

The case study research design does not usually lead to a generalization outside a particular case situation because it provides a unique rich information specific to a particular situation or phenomenon. Case study design is a qualitative research approach in which a multitude of variables are studied in one or very few cases. In a quantitative research design, on the other hand, few variables are studied across a large number of cases. It is designed to produce accurate and reliable measurements that permit statistical analysis and generalization about the general population through inference from a sample (Denzin and Lincoln, 1994).

In this study, however, the design could be extended to undertake a quantitative survey of general characteristics of a few selected prominent variables to allow for generalization. The “rich” information obtained through the in-depth case studies undertaken in this project would be used to get an insight and interpret findings of the quantitative survey aimed at understanding how particular aspects of institutional framework affect small-scale entrepreneurs in Tanzanian.

## CHAPTER FOUR

### ANALYSIS OF FINDINGS AND POLICY IMPLICATIONS

#### **4.1 Institutional barriers to small-business development**

This final chapter is structured into two main sections. The first section presents findings from the case studies through a cross-case analysis and the second section presents policy implications of the analysis of findings. This first section is further subdivided into two subsections. The first subsection provides a cross-case identification of the various rules, regulations and administrative practices that were cited by respondents in the fifteen case studies. The second subsection provides a synthesis of the findings against which policy implications are drawn.

##### ***4.1.1 Identification of rules, regulations and administrative practices***

The findings from the fifteen cases were documented and *cross-case analysis* undertaken to identify “institutional arrangements” (rules, regulations, administrative practices, procedures and laws) that are affecting small-scale entrepreneurs as tabulated in Table 1 below. Twenty two various types of institutional arrangements (rules, regulations, laws and administrative practices) were identified as affecting adversely the small-scale entrepreneurs that own and manage the studied enterprises. Table 1 indicates the cases in which constraints inherent in the various regulations and rules were cited, and the frequency of citation for each regulation. The table is followed by a summary discussion of the regulatory constraints and administrative practices which were cited more frequently by the respondents as to have affected them and hence require more intensified institutional reforms. Given the views of the respondents it is plausible to assert that those regulatory constraints cited less frequently signalled a positive effect of institutional reforms.



**TABLE 1:**

**CROSS-CASE ANALYSIS**  
Constraints inherent in the rule structure (institutional arrangements)

<b>CASE →</b> <b>REG ↓</b>	C1	C2	C3	C4	C5	C6	C7	C8	C9	C10	C11	C12	C13	C14	C15	<b>SCORE</b> (nr. of cases citing)	<b>RANK</b> (frequency. of citing)
(i) Multiple Taxes, duties and fees					•	•	•	•	•	•	•	•	•	•	•	11/15	1
(ii) Unlevelled competition ground	•			•	•	•	•	•		•	•	•				9/15	2
(iii) Incompatible laws/regulations	•						•	•	•	•	•	•	•			8/15	3
(iv) Stringent credit terms & conditions	•			•				•			•		•			5/15	4
(v) Hustling health & safety inspection		•	•	•			•								•	5/15	4
(vi) Environmental protection		•			•								•	•	•	5/15	4
(vii) Bureaucratic licensing	•		•		•	•	•	•						•	•	8/15	3
(viii) Hustling Tax process	•		•	•	•			•	•			•			•	8/15	3
(ix) High regulated power tariff		•		•				•							•	4/15	5
(x) Societal norms/practices	•												•		•	3/15	6
(xi) Litigation process								•		•						2/15	7
(xii) Arbitrary compulsory contributions		•											•	•	•	4/15	5

(xiii) Informal contracting	•		•										•	•		4/15	5
(xiv) Corruptive enforcement	•			•											•	3/15	6
(xv) Non-enforced rules & regulations							•					•	•			3/15	6 (cont...)

<b>CASE →</b> <b>REG ↓</b>	C1	C2	C3	C4	C5	C6	C7	C8	C9	C10	C11	C12	C13	C14	C15	SCORE (nr. of cases citing)	RANK (freq. of citing)
(xvi) Unfair business practices					•		•					•				3/15	6
(xvii) Lack of information				•							•					2/15	7
(xviii) Red-tape trademarking							•	•								2/15	7
(xix) Low trust in business	•		•													2/15	7
(xx) High regltd water tariff		•														1/15	8
(xxi) Land titling process						•										1/15	8
(xxii) Labour laws (minimum wage)												•				1/15	8

**KEY:**

*C1 = SIMEX – Mbeya;*

*C2 = Mbeya Plastics; Mbeya*

*C3 = Safari Furniture Group, Mbeya;*

*C4 = DANCO Oil Plant, Mbeya;*

*C5 = TAMECO Ltd, DSM;*

*C6 = Buguruni Carpenters Coop Society, DSM;*

*C7 = Arusha Galvanizing Co. Ltd;*

*C8 = Arusha Cutlery Co.Ltd;*

*C9 = Sheriff Dewji & Co. Ltd, Arusha;*

*C10 = Tanzania Eyelets Co. Ltd., Moshi;*

*C11 = Northern Packages Ltd., Arusha;*

*C12 = Tommy Spades Manufacturing Co. Ltd, DSM;*

*C13 = Mbeya Woods and Joinery Works;*

*C14 = MOLEX, Mbeya;*

*C15 = Nkwenzulu Motel Ltd., Mbeya;*

*(See list of the relevant abbreviations on page 25)*



Below is a summary discussion of the regulatory constraints and administrative practices cited either more frequently or more intensively in the case studies as to have affected the entrepreneurs. Closely related constraints in terms of their effect on the operations of the entrepreneurs are discussed together under a major category and thus reducing the 22 constraints in table 1 into ten major groups of constraints. The institutional constraints (laws, rules, regulations and administrative practices) are discussed in reference to the three propositions developed in the framework of analysis in figure 1.

*(a) Multiple taxes, duties, fees, and a 'hustling' tax payment process*

Multiplicity of taxes, duties and fees were cited as a problem in eleven out of the fifteen cases. It was claimed that the taxes are too many and also too high and that there is yet no significant change when compared with the pre-reform period. The following 19 types of taxes, duties, fees and compulsory contributions were being paid to various organs by the enterprises studied:

- i. Value Added Tax (VAT) (20% of the sales price). The introduction of VAT has increased prices of goods produced by the enterprises and hence failing to compete with imported goods. For example, after VAT, knives produced by TAMECO must have sold at TShs. 738 (about US\$1 then) while the retail price of a Taiwanese knife was sold at Tshs 400 (about US\$ 0.55)
- ii. Pay Roll Levy (2.5% of total wage bill);
- iii. Withholding Tax (2% of total income);
- iv. Property Tax;
- v. Pay As You Earn (PAYE) for individual entrepreneurs;
- vi. Development Levy;
- vii. Income Tax (25% of profit);
- viii. Road licence fee;
- ix. Plying fees;
- x. Vocational education and training levy;

- xi. Wood tax;
- xii. Stamp duty;
- xiii. Land fees;
- xiv. Industrial cess;
- xv. Service tax;
- xvi. Import taxes;
- xvii. Sales tax;
- xviii. Education levy;
- xix. Arbitrary compulsory contributions (tied up with legal payments) for special events such as clean-up operations, political celebrations and social activities.

Complex taxation policies, several tax collection points (organs) and cumbersome tax administration procedures (including complex tax return forms), have also led to a tedious taxation process which was considered as a “hustling tax process” leading to high transaction costs. This was further claimed as to have led to marginal and unsustainable enterprise performance (converse of Proposition P3). It was also claimed that economic policy reforms have not improved the taxation situation and that some of the enterprises are forced to evade taxes or operate at the margins.

*(b) Unlevelled competition ground*

In most of the cases (nine out of fifteen) the entrepreneurs observed that economic reforms and the inherent institutional changes engender market liberalization and hence fierce business competition on “unlevelled playing field” in the input and output markets. Cheaper untaxed imported goods were cited as to have intensified the unfair competition. This situation presented a big challenge to small entrepreneurs who are failing to cope or compete effectively in the free market situation and thus threatening their survival. Unfair business practices, including tax evasion, were cited as to have contributed to the situation.

The market competition faced by TAMECO case (producers of knives), for example, forced them to diversify their activities. They have rented their offices to TANESCO and they were establishing a technical school, which will operate on VETA principles. Intensification of market competition seems to be threatening sustainability of TAMECO and they needed to improve quality of their products and reduce costs of production. The entrepreneurs have dubbed the influx of goods in the market a “production crisis”.

Owners of Case number nine (Sheriff Dewji and Sons in Moshi, the processors of bone meal) lamented about increasing costs of production and shrinking market for their products due to reforms and intensified competition. They have, however, responded by intensifying product innovations and hence enhancing entrepreneurial endeavour.

*(c) Regulations, laws and administrative practices that are incompatible with economic policy reforms*

In the majority of cases (eight out of fifteen) it was strongly expressed that several existing laws and regulations are incompatible with the requirements of the economic policy reforms, in particular market liberalization, and that situation tended to constrain small enterprises and raised the transaction costs of getting proper and complete information (clarification of regulations). For example, a wood processing small enterprise in Mbeya (Case nr.13) cited the 1952 colonial law which promulgated that all furniture should be made of hardwood. This law is yet to be repealed and as such, the attitudes of several consumers of wood products were still influenced by the belief that it is only hard wood that is good for furniture. The entrepreneur said that this attitude affects adversely performance of the wood industry. This finding addresses all three propositions and suggests that the converse of the propositions still hold even after about ten years of reforms.

*(d) Stringent credit terms and conditions*

Respondents in five out of the fifteen cases expressed deep concern about the difficult terms and stringent credit conditions of formal credits of both the banking and non-banking institutions. They were, in particular, constrained by high interest rates, prohibitive requirements of collateral, requirement of sophisticated project write-ups, short or zero grace periods and short repayment periods. Such conditions do not augur well with the small-scale enterprises; they are technical disincentives and tend to raise transaction and production costs of small-scale enterprises (converse of Proposition P2). Respondents' explanations indicated that institutional reforms seem to lag behind the economic policy reforms and various credit regulations are incompatible with the liberalized financial market.

*(e) Hustling health and safety inspection regulations coupled with corruptive enforcement*

These are 'non-tax' measures which, as claimed, discourage 'silently' (without much noticing) the small-scale entrepreneurs to the extent that, to others it amounted to harassment. The hustle is characterised by frequent and impromptu call by Municipal health and industrial inspectors to check on the health and safety status of an enterprise. It was claimed that the officers had no scheduled visits in terms of known frequency or period of visits. In all the eight cases in which this regulatory practice was cited, it was also claimed that, often the visits had an ulterior motive linked to corruptive enforcement and hence tended to raise transaction costs by constraining smooth operations (converse of Proposition P3). In most cases the visits did not accomplish the intended objectives of maintaining cleanness and safety in the small enterprises and instead they turned into technical disincentives.

*(f) Environmental protection regulations*

The constraining and prohibitive effect of environmental regulations was cited in five cases. The regulations were characterised as to have prevented the small entrepreneurs from locating in certain areas, which, although of productive and commercial use, are identified and reserved for



environmental conservation. These include preservation of natural forests (affecting small enterprises utilising wood), green belts (affecting dairy related and farming enterprises), polluting water masses and streams (affecting processing enterprises). Such protective regulations have tended to threaten survival of some small enterprises that depend on such resources for their raw materials (such as Mbeya Woods and Joinery Works, and Safari Furniture Group, Mbeya). For example, MOLEX Mbeya, dealing in motor spare parts are required to pay TShs. 10,000 monthly under an environmental by-law (converse of Proposition P1 leading to start-up failure).

*(g) Bureaucratic administrative formalities and practices*

The entrepreneurs said that, compared with the pre-reform period, reforms have simplified formalities for registering enterprises and that they are now able to operate freely in the liberalized market for inputs and outputs. In regard to land leasing and titling process, no case cited any complaints and the one case (Buguruni Carpenters Cooperative Society) which cited land matters, said that they got land within one year after formal request. This is different from the period before reforms when land lease process was taking much longer. These views support propositions P1 and P2. The entrepreneurs, however, still experience unnecessary delays due to requirements to pass through different offices to get endorsements for various annual renewals of business operations. For example, the Arusha Galvanizing Company (ACG) (Case nr.7) had to follow the following formalities, which were still applicable at the time of this study:

- i. Industrial licence obtained from the Ministry of Trade;
- ii. Export licence obtained from Bank of Tanzania;
- iii. Business licence obtained from the Arusha Municipal council;
- iv. Registration in the Labour Office;
- v. Inspection of premises and machines by the Labour Office to ensure employees' safety;
- vi. Registration of employees with the National Provident Fund (NPF).

According to the ACG entrepreneur, annual formalities are also still tedious because they have to ‘knock on the doors of several offices’ to process business licensing requirements. Unlike in the past (before reforms), however, when the process was longer, it now takes about one month to get the tax clearance if all documents are in order. After tax clearance the next stage is to meet the local government requirements including payment of a number of fees such as cleaning fee, plying fee and several other local fees.

*(h) High regulated tariff for utilities (power and water)*

Five cases cited high tariffs for utilities as to have increased not only their costs of production, but also transaction costs due to poor record keeping and the hustle of paying cumulated expenses to utilities organizations (TANESCO and Water Authorities). Power rationing was also mentioned as a cost constraint arising from the TANESCO monopoly of electrical power business, which is still allowed by law. The monopoly is viewed as raising transaction and production costs for the small enterprises (converse of Proposition P3). Market liberalization is still incomplete and huge utility monopolies like TANESCO are an anomaly in the context of the ongoing reforms.

*(i) Societal norms, practices and low trust: beyond formal rule structure*

Societal norms and practices in regard to trust in business operations were cited only in three cases. In one case (SIMEX, Mbeya), for example, the owner-operator said that, there was a low level of trust between small-scale entrepreneurs and clients in Mbeya, which reduced volume of transactions. As put by the owner-operator, ‘kauli’ (a word to be believed) is not a valued social norm and practice with most of his customers. He said, however, that trust is a function of the size of capital deployed by an entrepreneur. Larger investors seemed to be more trusted and were also more willing to trust customers. Suppliers of inputs such as sardines (dagaa) for the entrepreneur’s chicken feed processing were, however, more trusted and ready

to trust. But the suppliers operated from Dar-es-Salaam and they usually dealt with him on the basis of a “gentleman’s agreement” and not a formal legal contract.

It was also cited in Mbeya that, social norms and practices requiring support of extended family members was a costly burden for small entrepreneurs who would have liked to expand their operations. Two cases (Mbeya Wood and Joinery Works, and Nkwenzulu Motel) viewed the support of extended family as some sort of taxation that raised the cost of operations.

*(j) Long litigation process and stringent labour laws*

Long delays of civil court cases were cited as constraints to some of the small enterprises studied. For example, it was cited in case number eight (Arusha Cutlery Company) that they faced a litigation case in which retrenched employees demanded their final benefits. The case took almost six months in the court of law and at the end the company had to sell some machines to pay the workers and legal fees. Another example was cited in case number ten (Tanzania Eyelets Company of Moshi) where the company had a case with the Tanzania Revenue Authority (TRA) since 1993 on the withholding tax of Tshs 20 million. The case was still with the High Court and costing the company in terms of time and financial resources. Delayed resolution of cases, therefore, lead to high prohibitive transaction costs that pose a threat to viability and sustainability of small enterprises (converse of Proposition P3).

***4.1.2 Institutional framework and economic reforms: a debilitating mismatch***

This subsection synthesises the findings from the case studies. Entrepreneurial endeavour in small-scale enterprises in Tanzania is taking place in the context of a changing institutional framework, which is part and parcel of the ongoing economic policy reforms. Any attempt to study the dynamics of entrepreneurial endeavour in the context of institutional framework should be cautious of making conclusive statements. A synthesis attempted here is, therefore, cognisant of the futility of making definitive conclusions about the themes of this paper. It is

even more so when the synthesis is based on only fifteen case studies. The synthesis is based on the discussions (analysis) written for each case.

On the basis of the fifteen case studies, a preliminary observation is that entrepreneurial endeavour in small enterprises in Tanzania is taking place in the context of a mismatch between a changing institutional framework and economic policy reforms. Economic policy reforms are moving faster than the required reform of the institutional framework and thus constraining entrepreneurial endeavour. This mismatch tends to raise transaction costs and constrains opportunity capturing by small entrepreneurs.

The cases indicate that multiple taxes and credit regulations are the major constraints and disincentives to most small-scale entrepreneurs. The main problem is the manner in which taxes are collected which was characterised by some of the respondents as ‘terrorizing’. Cost of credit (25-28% annual rate of interest) is also too high for small-scale entrepreneurs. Enforcement of other laws and regulations seems also unnecessarily restrictive, disruptive and corruptive for small enterprises. This implies higher transaction costs and more constraints for the small-scale entrepreneur.

There seems to be a ‘mixed feeling’ about the effect of reforms in general and institutional reforms in particular. Some of the entrepreneurs agree that reforms have posed a ‘positive challenge’ leading to a need to diversify business activities and to be innovative in order to ensure survival. Others tend to indicate that the ‘rules of the game’ have not changed significantly as to benefit entrepreneurs or provide a clear direction. Yet others expressed concern about fierce competition that has led to slow moving of their products. This variation of respondents’ perception and assessment reflects the different types of small enterprises studied and the mismatch between institutional and economic reforms.

Some of the institutional problems faced by the entrepreneurs arise also from the legacy of the “paternalistic” state-centred development pursued by Tanzania in the 1970s. During that

period, the low level indigenous entrepreneurial endeavour was substantially ‘supported’ by the huge public sector, which provided ready and easily accessible market for the private sector. After market liberalization this ‘public sector market’ evaporated slowly and, while new entrepreneurial endeavour secured opportunity space for growth, the pre-reform entrepreneurs found their going difficult because they had groomed themselves for a ‘state market’ which by large was accessed corruptively. They now find it difficult to operate in a competitive free market-based institutional framework.

Some of the cases studied in Arusha (such as NORPACK and Arusha Cutlery Company-ACC) had been substantially dependent on ‘soft’ financial assistance from the Swedish International Development Agency (SIDA) through SIDO’s ‘Sister Industries Programme’. After withdrawal of the SIDA assistance, the enterprises found it difficult to operate profitably in a market-based institutional framework. For example, the ACC (case number eight) depended on ‘assisted’ cheap supply of inputs through SIDA/SIDO Sister Industry Programme and also depended on the ‘corrupted demand’ of the SOEs and government agencies (state market).

As pointed out by the entrepreneurs, there is a change in entrepreneurial behaviour whereby entrepreneurs are learning the hard way from the impact of trade liberalization. They are, for example, learning that quality of products and cost control are perhaps more critical for business sustainability than the rules and regulations affecting an enterprise. The pre-reform institutional framework provided perverse incentives to entrepreneurial effort, which led to unsustainable entrepreneurial events. The protected ‘state market’ drove policies, laws, rules, regulations and procedures.

In general, however, reforms have brought some positive changes such as reduced red tape and hassle. The time it took to get a business licence has been reduced, though not to the needed level, and corruption is still a problem. It was also observed that, after relaxation of various regulations including foreign exchange market, it is now easier to get raw materials. Changes in

laws, regulations and procedures have also changed the entrepreneurial behaviour; making the entrepreneur more aggressive and innovative.

The following final section draws policy implications from the specific findings and the above synthesis and concludes the paper.

## **4.2 Policy implications: the enabling role of the State**

Institutional arrangements as “rules of the game” are an important factor in the development of entrepreneurship in small enterprises. The ‘new’ role of state is to develop an institutional framework to which entrepreneurs respond positively to create economic value and enhance economic growth. An enabling institutional framework is one, which does not constrain entrepreneurial endeavour, reduces transaction costs and creates incentives for the development and sustainability of entrepreneurial events. Entrepreneurs in small business require an enabling institutional environment, which provides them with incentives to be innovative and aggressive.

The cases in this study indicate that institutional framework should be developed in tandem with the reform effort so as to avoid problems of mismatch between the two. Reform of the institutional framework should not lag behind the economic policy reforms. When there is a mismatch between economic policy reforms and reform of the institutional framework, the transition from state-centred to market-centred development may provide serious disincentives and constraints to small-scale entrepreneurs.

The establishment of a ‘one stop’ small business registration could facilitate entrepreneurial endeavour. Technical backstopping support centre like the one already created for large scale and foreign investors could also support entrepreneurial endeavour. Such a centre could be established in each regional or local government headquarter.

Systemic support for entrepreneurial endeavours is also required in the area of credit terms and conditions. Unlike large-scale entrepreneurs, the small-scale entrepreneurs need more simplified financing terms and conditions. They need facilitation for networking, resource pooling, longer grace periods, lower rates of interest, proxies for collateral, and availability of information.

Finally, there is a need to encourage and support group risk sharing in ‘cooperative entrepreneurship’ as is the case with the Tanzania Mechanical Engineers Cooperative Society (TAMECO) and Buguruni Carpenters Cooperative Society in Dar-es-Salaam (cases number five and six respectively). Specific provisions of the cooperative laws could enable entrepreneurs to surmount some of the institutional constraints in other pieces of legislations such as company law, credit terms and conditions, land leasing regulations and tax regulations.

#### **4.3 Conclusion**

With the help of in-depth case studies it has been demonstrated that institutional framework matters in entrepreneurial endeavour in small enterprises. If the institutional barriers identified are brought down in the ongoing economic reforms, entrepreneurial endeavour of the small-scale entrepreneurs will further be enhanced. The study findings indicate also that economic policy reforms undertaken since 1986 in Tanzania have significantly contributed to the growth of the small-scale enterprises in urban areas.

The study suggests that an enabling institutional framework is one that provides the following rule and norm structure: clear assignment of property rights and their allocation; clear and enforceable rules governing the relationship between participants in economic process (such as contract laws); and effective rules and conventions controlling participation in the economic process (such as competition laws, fair business practices, brand names, trade marks and mutual trust). Such institutional arrangements motivate potential entrepreneurs and lead to intensified start-up and sustainable performance of small-scale enterprises. Institutional reform in

the context of economic policy reforms is geared to providing such an “enabling” institutional environment.

Further research is required to study in more depth the various variables identified in these case studies. It is interesting to understand the nature and characteristics of a set of institutional arrangements that account for successful entrepreneurial events in the Tanzanian small business sector. More specifically, there is a need to investigate how do potential and existing small-scale entrepreneurs in various economic sectors respond to changes in institutional arrangements in order to identify inter-sectoral variations. In particular, it is interesting to find out what has been the specific role of these institutional arrangements in the observed increase of entrepreneurial activities and events in different types of small enterprises after economic liberalization in Tanzania.

Another area for further research is the need to study entrepreneurial “striving” and risk sharing in a “cooperative entrepreneurship”. Is there a “unique or lead entrepreneur” in a cooperative small enterprise? Under what institutional conditions will a ‘cooperative’ entrepreneurial endeavour succeed?

Finally, research is needed to investigate rigorously the extent to which formal and informal institutional frameworks explain variations in entrepreneurial endeavour in small enterprises. It would be interesting to find out the nature of transaction costs produced by each of the two institutional sets (formal and informal). The ultimate objective is to understand the institutional conditions under which potential entrepreneurs would engage in formal small-scale growth-enhancing entrepreneurial activities.



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## APPENDIX

### CASE STUDIES

#### **CASE # 1: SAMKY IMPORT-EXPORT (SIMEX) - MBEYA**

##### ***Case Background***

SIMEX stands for ‘Samky Import and Export’ a SSE dealing in making and distributing animal feeds and related products in Mbeya Municipality. The annual volume of business as estimated by the owner was between Tsh 25-30 mln (1999). SIMEX is owned and managed by Mr Africanus Samky who is thirty nine years old and hails from Moshi. He completed secondary education after which he was employed by the Tanzania Revenue Authority (TRA) from 1986 to 1989. After leaving TRA he started a small retail shop in 1989 and also practised dairy farming in Mbeya.

Mr Samky went to Mbeya because he was pushed by the scarcity of land in his home area (Moshi) and sought for an area like Mbeya, which resembles Moshi business environment, but less competitive. He secured land in Mbeya after making some savings from his salary while working with the TRA. He resigned from TRA in 1989 because the salary was inadequate and also because he needed more time for his then upcoming dairy project. He observed, however, that he learned record keeping from TRA, which is helping him in his entrepreneurial activities. He started with 300 broiler chicks, 10 piglets and 3 cows. This dairy activity still continues under the supervision of his wife.

##### ***Operations and Performance***

SIMEX was started in 1994 with a shop to sell animal feed which later developed into animal feed processing. It is managed by the owner, Mr Samky, and assisted by a shopkeeper who is also his village mate in Moshi. The idea for the business originated from the problems he experienced in getting supplies for his retail animal feed shop. He used to get the supplies from very far and other dealers who could not reach the source, used to ask for part of his supplies. This led the entrepreneur to identify an opportunity for establishing the animal feed processing.

The process of making animal feeds entails procurement of inputs, which include: maize, sunflower, fish meal, cotton cake, premixes (vitamin), rice polish, limestone and bone meal. The sources of inputs are mainly from Dar-es-Salaam by bus. Suppliers of the inputs such as sardines (dagaa) are his regular partners and, according to him (the entrepreneur), delivery of supplies is based on *trust* through a “*gentleman’s agreement*”. There has not been a need for a formal legal contract.

SIMPEX has its 'factory' for mixing the ingredients at Isanga, which is two kilometres from the outlet. Three (3) people are employed at the factory for mixing/processing the feeds. All the inputs are mixed using particular formulae to arrive at various types of animal feeds. The knowledge and skills for processing animal feeds were acquired by the entrepreneur through his own initiative and costs, from regional agricultural experts and Sokoine University of Agriculture who advised on the contents of the ingredients and the mixing ratios.

The marketing and selling activities of SIMEX involve advertising on notice boards in local offices and business areas, placement of orders by clients, delivery at clients' premises and regular retail selling at their outlet (shop) on Iringa Road, a major business area in Mbeya. The entrepreneur is aware of three other producers of animal feeds in Mbeya who compete with him. He says, however, that he makes some informal consultations with them.

The owner-manager himself makes business decisions of SIMEX. The four employees (three at the factory and one at the outlet) provide some advice casually when required or when a need arises. There are no 'committee' decisions. Sometimes Mr. Samky makes some visits to his clients in order to know their views on his products. His wife usually takes over the running of the business when he is on safari.

### ***Business Financing***

Mr. Samky has so far received loans from two organizations; Small Scale Industries Organization (SIDO) and MEDA's Mbeya Credit Facility (MCF). Mr Samky received a loan from SIDO in 1994 amounting to Tshs 400,000, which was 25% of the initial capital required to start the business (SIMPEX). Terms and conditions included monthly repayment for eight months and 28% interest. Mr. Samky repaid the loan in full.

SIMPEX received three loans from MEDA. The first loan was of Tshs 1 mln in 1996, which was repaid in eight months at a rate of Tshs 87,000 per month. The second loan of Tshs 2.5 mln was received in 1998 and repaid in eight months at a rate of Tshs 387,000 per month. The third loan also of Tshs 2.5 mln was received in 1999 and repaid in eight months at a rate of Tshs 387,000 with an interest rate of 26%. The entrepreneur has applied for a fourth loan from MEDA, which was under consideration. Credit standing of SIMPEX is very high ("A" rating) in MEDA's loan portfolio.

### ***Mr Samky's Future Plans and Vision***

The entrepreneur intends to acquire a milling/mixing machine. He said that he does not intend to secure bank loans because they take a long time (3 months) and require collateral. With MEDA a loan takes only three weeks to process because the process is simple, non-bureaucratic and no collateral is required. In lieu of collateral an applicant has to sign up three guarantors from civil society (e.g. a Pastor, village leader, village executive secretary).

In regard to future investment he said he wants first to assure himself of basic needs which include good education and health for his family, expand his business and repatriate some funds back home in Moshi to invest in his small farm there.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- Laws and regulations:
  - ⇒ Taxes are very high and the payment process is very rigid. He said, for example, payment by instalment is not allowed.
  - ⇒ Business licensing process takes about 2 months, which he says for a small entrepreneur, can be too long.
  - ⇒ Multiple business regulations with difficult conditions (or intentionally made so) that may require use of corruptive practices to go round them. The regulations include: inspection of business premises, health inspections, number of approval 'signatures' and hidden fees/conditions. The procedures, although simplified by political and policy pronouncements, are still made cumbersome by officials who want to prey on public positions.
  - ⇒ Credit regulations in the formal banks, as mentioned earlier, are prohibitive for the Samky's size of ventures. Recall the problem of collateral requirement and long procedures.
- Social norms in Mbeya:
  - ⇒ Low level of trust reduces volume of transactions. As put by Mr. Samky, 'kauli' (a word to be believed) is not there with most of his clients.
  - ⇒ He said, however that, trust is a function of the size of capital. Larger investors seem to be more trusted and are also more willing to trust customers.
  - ⇒ Suppliers of the inputs such as sardines (dagaa) are, however, more trusted and ready to trust. They are mainly in Dar-es-Salaam and they usually operate on the basis of a "gentleman's agreement" and not a formal legal contract.

### ***Discussion***

Mr. Samky is a small-scale entrepreneur and SIMEX is his entrepreneurial event with various entrepreneurial activities in processing and selling animal feeds which were earlier (before economic reforms) done by a State-Owned Enterprise. While economic liberalization has created business space and opportunities for Mr. Samky, the mismatch between institutional arrangements (the rule and regulation structure) and the pace of reforms are constraining his entrepreneurial efforts to capture the created opportunities. It was observed that Mr Samky was not using formal legal contracts to do business with his suppliers or clients. It is still an interesting issue for further study whether, with a better institutional arrangement, Mr Samky would have done better than the current situation. In other words, is institutional framework a

significant factor in entrepreneurial striving? More case studies and a survey are required to answer this question.

## **CASE # 2: MBEYA PLASTICS - MBEYA**

### ***Case Background***

Mbeya Plastics is a small enterprise established in 1981 within Mbeya SIDO facility (Industrial Area) with SIDO support to produce plastic toys. The entrepreneur, Ms Agnes Mwaisumbe, is a widow aged 50 years with three children. She was born in Mbeya and schooled up to standard four (primary education). Her parents are peasant farmers. The business idea was conceived within SIDOs strategy to develop SSE in Mbeya Region. Agnes responded to a SIDO advertisement in the region for people to take advantage of SIDO's facility and technical advice on establishing SSEs. She contributed Tshs 600,000 to finance 5 youths to visit Sweden to study production of plastic toys. Apparently these came back to be shareholders of the enterprise. At the time of this study only two shareholders had remained. The partnership was informal in the sense that it was not based on a formal contract. She obtained the seed money from her earlier business of selling cows and other merchandise.

The entrepreneur and her partners had employed a manager up to 1990 when she took over the management herself. The number of employees had over the years been about 34 but currently the enterprise employs only 8 people. The manager passed away but before that he had swindled the enterprise a substantial amount of money.

### ***Operations and Performance***

The technology used by the enterprise is not sophisticated. The raw material (rubber rejects) is mixed with fine grey plastic and processed into a thick grey heavy stiff liquid used for moulding the different types of truck toys. Raw materials are reject plastic materials obtained from Simba Plastics of Dar-es-Salaam. The entrepreneur signed for the supply of Raw materials with Simba Plastics in in which terms of payment were cash.

The estimated annual sales revenue is about Tshs 4 Mln. Main customers are in Dar-es-Salaam. Others are in Mbeya, Kigoma and Mwanza. The entrepreneur makes about two sales trips to Dar-es-Salaam every month.

At the time of this study the enterprise was in a dire situation and could hardly pay rent for SIDO premises and government taxes due to a low level of production. They could also not pay the employees regularly. The enterprise had also failed to service a Shs 10 mln loan secured from the National Bank of Commerce. The lead entrepreneur was thinking of inviting shares in the company so as to rehabilitate machinery, revive and expand production. She needed, however, to consult the other partners.



### ***Aspects and Constraints Related to Institutional Framework***

Comparing the regulatory situation now with the pre-reform period, the entrepreneur admitted that procedures of processing business licences had improved and less cumbersome now. The following regulations, rules and laws were, however, characterised as still constraining performance of the enterprise:

- Annual contribution for the National Uhuru Torch race;
- Environmental cleanliness (pays Tshs 6,000 monthly);
- Safety regulation fees (pays Tshs 5,000 monthly);
- Income tax (pays TSHs 200,000 per annum) and VAT (20% of sales);
- High cost of power (pays about TSHs 700,000 per month);
- High cost of water.

### ***Discussion***

The entrepreneur is mostly constrained by financial rules, particularly taxes and other charges. The issue is whether these financial/credit regulations are ‘*real*’ constraints to all enterprises or are merely ‘*relative*’ constraints specific to this particular enterprise because of its poor financial and operational state. Preliminary observation of data from other cases and documented complaints by large enterprises indicate that financial regulations are real constraints to most firms in Tanzania.

After several years of operating without a formal contract with partners, suppliers and customers, the entrepreneur admitted, however, that the contract is increasingly becoming crucial in her operations.

### **CASE # 3: SAFARI FURNITURE GROUP - Mbeya**

#### ***Case Background***

The Safari Furniture Group is owned and managed by 32 year old Mr Issa Maulidi who hails from Kondo District. He belongs to Iraqi ethnic group and he is a Roman Catholic. The enterprise makes and sells all types of furniture. Mr Maulidi moved from Kondo to Mbeya in 1989 and started the enterprise in 1994. Before that he was a hawker. The entrepreneur attained primary education and his parents are farmers. He says he got training on woodworking mainly from primary school.

He started the business in 1994 from his own savings after hawking for six months. He started by buying a welding machine. In 1995 the entrepreneur secured a Tsh 500,000 loan from SIDO and another loan from the Roman Catholic Mission, which together enabled him to make an investment of Tshs 3 million. He bought second-hand woodworking machines - a planer, a saw, a spindle machine and a wood lathing machine. He also employed 6 persons including two brothers. He is still repaying the loans.

#### ***Operations and Performance***

The main inputs are labour and wood. Woodworking process involves wood planing, cutting, sizing, joining and polishing. As an innovative endeavour, the entrepreneur made his own wood lathe machine which is working very well. He gets supplies of wood from Tukuyu, about 60 km, which is within the Mbeya Region. He owns a seven ton lorry for supply purposes. He had developed a long-term trust with one specific supplier and hence did not need a formal legal contract to secure supplies.

The entrepreneur's sales revenue ranges between Tshs two and three million per annum. The sales are mainly based on orders from customers and sometimes provides trade credit to reliable customers.

Constraints faced by the entrepreneur include high costs of renting business premises, lack of timber treating machine and a T&G machine. He said that he had no market limitations. The main limitation was capital.

Entrepreneur's ambitions include building his own living house and develop his children to take up the business. His priorities are to repay loans and expand his business.

#### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- It took the entrepreneur 3 months to secure a business licence. This was mainly due to various pre-licensing requirements;
- Inspectorate requirements for industrial safety and health which included placement of fire extinguishers, insurance, workers gear and provision of lavatories on the premises;
- “Terrorizing” income tax payment procedures including impromptu on the spot checks on business activities;
- Sales operations such as trade credit have to depend on personal trust based on knowing the customer;
- The entrepreneur depends on newspapers and his employees for business information such as availability of tender opportunities.

### ***Discussion***

The role of formal legal contract is not significant in this case. The main problem is the manner in which taxes were being collected which was characterised as “terrorizing”. It was also observed that the immediate driving entrepreneurial motive was to raise the standard of living of his family.

## **CASE # 4: DANCO INTERNATIONAL OIL PLANT - MBEYA**

### ***Case Background***

The enterprise was started in 1997 by the 35 years old Stephen Kibona together with another partner. Stephen hails from Ileje in Mbeya Region. He holds a degree in computer engineering from China and before starting the enterprise he worked with the Chinese Trading Company in Nairobi. He came from China with some machines for oil processing and after securing a loan of Tshs 3 mln from SIDO he acquired and installed an oil press filter. The idea for the business was hatched from his contacts with Sun Traders of Dar-es-Salaam which had links with oil machine makers of China.

### ***Operations and Performance***

The enterprise employs 7 persons including a workshop manager. Usually clients have to bring in their own seeds for processing into oil and they take away their oil for selling. The enterprise provides the processing services only and remains with the seed cake which is sold to animal feed processors. About 3-4 tons of cotton or sunflower seeds can be extracted daily.

The entrepreneur has acquired two more machines (for rice milling and oil extractor), has ordered a lorry and built his own living house. His major problem is adequate capital for expansion.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- Inaccurate assessment of taxes by tax authorities. They estimated that the enterprise generated Tshs 100,000 every six months, an estimate which was not based on actual income over that particular period. An order to stop operations was issued after failing to comply with this stringent tax estimate;
- Monthly health inspections were viewed as a bother to the entrepreneur because of the corruptive manner in which they are conducted;
- Requirement by industrial inspectors for workers to wear blue uniforms was complied with but was viewed as unnecessarily costly by the entrepreneur;
- Cheap imports due to low import duty of cooking oils which makes it difficult for the enterprise to compete in a liberalized market.
- High cost of electricity (Tshs 120,000 per month was expensive);
- Terms and conditions of bank loans are expensive and restrictive for such small enterprises (e.g. the need for collateral and high interest rates).
- Market information reaches potential clients through house to house visits by an employee who introduces the services of the enterprise. This seems to be an expensive way of advertising.

### ***Discussion***

The various regulations and laws are not resisted as such by the entrepreneur. What the entrepreneur complains about is the manner in which enforcement is carried out - unnecessarily restrictive, disruptive and corruptive for such small enterprises. This implies higher transaction costs for the small-scale entrepreneur.

## **CASE # 5: TANZANIA MECHANICAL ENGINEERS COOPERATIVE SOCIETY LTD (TAMECO) – DAR-ES-SALAAM**

### ***Case Background***

TAMECO employs about 40 people and was established in 1972 as a cooperative under the Cooperative Ordinance No.10 of 1968. It is situated at Keko Toroli in Temeke in Dar es Salaam Region. It produces multipurpose knives for kitchen and sisal cutting. The respondent, Mr Mlingili Massoud Shabani, is the Deputy Chairman of the cooperative and one of the founders of TAMECO. He is 53 years old. He has primary education and before establishing TAMECO he was a blacksmith making knives, buckets, local cookers and hoes in Mbagala. As a founder he became the foreman of the workshop section, rising to the positions of production manager, personnel manager and finally now marketing manager. He has attended various short and long courses within and outside Tanzania in German (3 months), Poland (2 months), Italy (1 month) and Russia (one year).

Formalities followed in establishing TAMECO were as follows:

- ⇒ In 1972 Mr Mbawala (the chairman) sold the idea of establishing an industrial cooperative society to several blacksmiths (Mafundi Uhunzi);
- ⇒ Consultation of cooperative experts;
- ⇒ Request for registration after satisfying the following conditions:
  - i. Listing of members;
  - ii. Minutes of members general meeting;
  - iii. Availability of land and office;
  - iv. Specification of technology to be used.
- ⇒ Probationary registration as an industrial cooperative granted in 1973;
- ⇒ Full registration obtained in August 1981 (Nr. DCC 59).

It was reported that availability of land at that time was not a problem because they requested for the land in 1972 from the City Council and obtained it the same year.

### **Operations and Performance**

TAMECO was formally dealing with vehicle repairs (1972-1975) and later started to produce knives using simple tools made locally. In 1988, sophisticated machines were acquired through a SIDO loan, which has already been paid.

Raw materials used are iron bars and plastics, all used to be provided free of charge until 1995 by the Netherlands Government. After the withdrawal of the Netherlands assistance TAMECO performance was severely adversely affected as shown in the table below (years 1995-97). TAMECO made alternative arrangements with local sources to supply the materials. They were

also trying to identify sources in South Africa, China and Belgium. Labour is obtained mainly from members' friends and relatives.

The technology used by TAMECO is claimed to be old to the extent that spare parts are not readily available anywhere. In order to obtain spare parts they have to send the sample to Holland and then be custom-made there. Also in case of machine breakdown an expert has to come all the way from Holland to make repairs.

Advertisement of TAMECO products is done through radio (15 minutes TAMECO programme), magazines and invitation of top government officials. Accessibility to government policies and regulations is not a problem to them because Mr. Mbawalla (the Chairman) holds leadership position as Deputy National Cooperative Chairman.

Performance of TAMECO during 1978-97 period is as given below (in TShs):

YEAR	INCOME	EXPENDITURE	PROFIT(LOSS)
1997	1,070,592	73,147,501	(72,076,909)
1996	8,060,328	59,797,916	(51,737,588)
1995	4,595,837	67,504,631	(62,908,794)
1994	65,561,558	68,660,617	(3,099,059)
1993	45,432,072	48,495,480	(3,063,408)
1992	35,785,249	48,930,313	(13,145,064)
1991	45,097,205	9,240,071	5,857,134
1990	38,023,025	28,760,224	9,262,801
1989	17,976,376	20,666,635	(2,690,259)
1988	10,041,214	7,845,256	2,195,958
1987	2,698,117	4,409,983	(1,711,866)
1986	4,517,182	3,346,183	1,170,999
1985	2,903,475	1,902,216	1,001,259
1984	2,056,995	1,841,102	215,893
1983	1,653,636	1,510,185	143,451
1982	1,681,904	1,017,544	664,360
1981	1,008,342	1,067,208	(58,866)
1980	834,904	955,706	(120,802)
1979	568,532	199,985	368,547
1978	312,615	577,540	(264,925)

*NB: Take note of the years after the withdrawal of Netherlands assistance (1995-97).*

Other achievements realised by TAMECO members include provision of employment to their relatives and acquisition of farming land at Mbande Village.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. Cooperative law, which in the past required that 10 or more people could establish a cooperative. Currently only 2 or more are allowed to do so, and therefore less stringent rule;
- ii. Environmental policies which regulate pollution now did not exist or were not rigorously enforced before the reforms;
- iii. Cumbersome taxation policies and procedures. It was claimed that, currently these taxes are too many and too high as compared with pre-reform period. Types of taxes paid by TAMECO currently include:
  - ⇒ VAT (20% of the sales price). The introduction of VAT has increased prices for TAMECO's knives. For example, if you add 20% VAT to the normal price of a knife produced by TAMECO (Tshs 615) the price goes up to Tshs 738 while the retail price of a Taiwanese knife is about Tshs 400.
  - ⇒ Pay Roll Levy (2.5% of total wage bill)
  - ⇒ Withholding Tax (2% of total income)
  - ⇒ Property Tax
  - ⇒ Pay As You Earn (PAYE) for individual members
  - ⇒ Development Levy for individual members
  - ⇒ Income Tax (25% of profit)
  - ⇒ road licence.
- iv. They claimed that trade liberalization policy has adversely affected the small-scale enterprises because they cannot compete with imports from large international companies. In some sort of a mixed feeling, however, the entrepreneur described the effect of privatisation as follows:

In order to raise funds TAMECO has rented some of their offices to TANESCO. They also established TAMECO Vocational Training School, which will start effectively this year. All these are due to trade liberalization. TAMECO has also retrenched some of their employees in order to reduce expenses. Further more, almost all members of TAMECO have 'shambas' (small peasant farms) in Mbande Village where they cultivate rice, cassava, and other food crops. Otherwise life would have been difficult at this time of "production crisis" (to them competition is a crisis).
- v. It was reported that a requirement to show previous three years sales receipts as condition for granting licences is unnecessary hassle to the company.

### ***Discussion***



The market competition faced by TAMECO has forced them to diversify their activities. They have rented offices to TANESCO and they are now establishing a technical school, which will operate on VETA principles. Market forces are making their way into the TAMECO operations and ultimately to their sustainability. The constraints related to institutional arrangements are viewed comparatively in this case because TAMECO has operated through the two phases of policy development - the pre and post reform. TAMECO seems to have a 'mixed feeling' about the effect of institutional reform arising from the policy reforms. In some areas of their business the changes have posed a positive challenge (i.e. the need to diversify their activities for survival). In other areas, however, they tend to indicate that the "rules of the game" have not changed significantly as to benefit them or to give the entrepreneurs a clear direction. A major complaint is the persistence of multiple taxes and fees, which they claim, have resulted from the reforms.

This is an interesting case because, unlike the others, we attempt to understand a "cooperative" or "collective" entrepreneurial striving. It is observed that in this case, survival strategies include both individual actions under the auspices of TAMECO (e.g. Mbande farms) and collective actions (the Chairman holding positions in umbrella or government supported organizations).

But it is still interesting to know how could TAMECO survive huge losses such as those of 1995 to 1997 when the Netherlands assistance was terminated. It is even more interesting to understand how is it that TAMECO have survived even when in most of its life span it has made losses. Note, for example, that in the 20 years of operations of which data was provided, TAMECO made marginal profits in only 9 years. Indeed when corroborated with other pieces of data and evidence, the pre-reform institutional framework and its current legacy based on socialist approach to development (subsidising non-performing entities) contributed significantly in sustaining TAMECO, perhaps for ideological and political symbolism.

## **CASE # 6: BUGURUNI CARPENTERS COOPERATIVE SOCIETY LTD - DSM**

### ***Case Background***

The Buguruni Carpenters Cooperative Society (BCCS) Ltd is located at Buguruni in Ilala Municipality of Dar es Salaam. The society was established in 1984 by 15 members. It employs the 15 members and other 18 people. The cooperative society deals in furniture making and selling of timber. The respondent, Mr Juma Sultani Mpangile (46) is the Chairman of the society. He completed primary school education in 1968. While in the society he has attended one training seminar on workers management sponsored by ILO in 1996.

Three basic reasons were cited as motivation for establishing the society. First was to implement the “Nguvukazi” policy of the early 1980s championed by the former Prime Minister Late Hon. Edward Moringe Sokoine which required every able bodied person to engage in a meaningful and gainful activity. This group of carpenters were mobilized to join hands in a cooperative society (collective entrepreneurship). The second motivation was the need for higher income and third was a belief of members in cooperative work.

### ***Operations and Performance***

With the assistance of SIDO the society acquired new technology (wood lathe machines) for processing timber. This technology enhanced performance substantially.

Raw materials include timber, glue, sand paper and fittings which are obtained from Dar es Salaam timber and hardware dealers. The society has a permit to purchase timber directly from timber production factories (saw mills) but due to inadequate working capital they have to purchase from retailers in Dar es Salaam.

Land was secured through their Ward Councillor but they are yet to get a title deed due to bureaucracy. The title deed was applied in 1994. This is a major regulatory constraint because without a title deed they cannot secure a substantial loan amount. Credit arrangements are therefore done on individual basis. They prefer to purchase raw materials on the basis of orders placed by customers. In times of financial crisis they are forced to enter into informal credit arrangements with timber dealers. They said labour is not a problem because they employ their own children and relatives.

In regard to performance it was said that the society used to get low revenue before reforms. However, after initiation of the current reforms the revenue increased substantially but profit per annum has dropped due to increased competition and increase in the production costs. The respondent admitted that whatever balance sheet they have would be misleading because of the incentive to avoid high taxes. Other objectives achieved include provision of employment to relatives.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, rules, regulations and procedures affecting the Buguruni society include Cooperative Ordinance No.10 of 1968, various taxes, accounting procedures (e.g. requirement of audited reports) and licensing process.

Formalities through which the society was established were as follows:

- A request for land was forwarded to the Ward Councillor in 1983 and was obtained in the same year.
- Request for registration was lodged to the cooperative officer in the Ministry responsible for cooperatives in Dar es Salaam.
- Application for business licence at the Dar es Salaam City Council which took about three weeks.
- The society was registered in 1984 (No. DSR. 287).

The process of establishing the Buguruni Cooperative Society took almost two years. The society has not entered in any contract with anybody. They also don't have any trade marks for their products.

Taxes and fees paid by the society are:

- Business licence (Tshs 30,000);
- Sales tax (an average of Tshs 120,000 per annum);
- Stamp duty (an average of Tshs 10,000 per month);
- Audit fees (Tshs 100,000 per annum);
- Water and electricity charges (Tshs 250,000 per annum);
- Land fees (Tshs 35,000 per annum).

The entrepreneur said that the above taxes and fees were moderate.

Information about the availability of timber is obtained from the retail timber sellers. The market for their products is secured through the following ways:

- Pedestrians window shoppers;
- Goodwill;
- Promotion through individual efforts.

They don't have funds allocated to promote society products through media.

The society gets information about related government policies and regulations through papers, radio, TV and public notice boards. Sometimes they had to go to the City Commission or Tanzania Revenue Authority to request for information about tax procedures. This was mentioned as the main constraint in regards to information.

### ***Discussion***

The entrepreneurs complained that competition has led to slow moving of their products. This has led to high costs of holding inventories. Sometimes they have to stop production to wait to clear ready-made furniture. But they also admit that competition has increased innovation in terms of thinking of new designs of furniture in order to win markets. In regard to rules and regulations the entrepreneurs claimed that red tape and hassle have increased especially in the renewal of licences and payment of taxes. Their accounts were also to be audited by the Cooperative Audit and Supervision Corporation that led to high transaction costs.

## **CASE # 7: ARUSHA GALVANISING COMPANY LTD - Arusha**

### ***Case Background***

The Arusha Galvanising Company (AGC) Ltd was established in 1981 by 3 entrepreneurs whose objective was working independently through self-management. They started with the assumption that privately owned business creates more money although they now admit that the assumption may no longer be tenable in such a fierce competition. AGC is located in Arusha SIDO industrial area within Arusha Municipality. It provides hot deep galvanising services and surface treatment of metals to prevent them from rusting. Currently the company employs 16 persons. The respondent Mr A.M. Mamuya (48) who is one of the three owners of the company is a graduate Mechanical Engineer of the University of Dar es Salaam. The other two are also university graduates in chemical engineering and accountancy. They all hail from Moshi.

### ***Operations and Performance***

The major inputs used by the company are iron steel for fabrication and galvanising chemicals. Before the current policy reforms it was difficult to get these raw materials from both local and external sources due to lack of foreign exchange. Currently, however, some inputs are obtained locally though at a higher prices while importation is no longer problem provided one has the foreign exchange. Up to the late 1980s SIDA used to provide the AGC with soft loans to purchase raw materials and other inputs. There is no problem of obtaining labour.

The technology used by AGC was provided by SIDA through SIDO under the Sister Industries Programme. The technology obtained was also in use in Sweden and hence some employees and the entrepreneur had to visit the sister company in Sweden to learn how to operate the technology.

The entrepreneur was reluctant to provide information on revenue, expenditure and profits of the company but said that production has deteriorated drastically due to competition from imports.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. High and cumbersome taxes that include corporate and income tax, director fees, VAT and import duty. The entrepreneur remarked that before reforms manufacturing industries prospered and could easily pay taxes because they enjoyed monopoly.
- ii. Formalities followed in registering AGC include:
  - a. Industrial licence obtained from the Ministry of Trade;
  - b. Export licence obtained from Bank of Tanzania;

- c. Business licence obtained from the Arusha Municipal council;
- d. Registration in the Labour Office;
- e. Inspection of premises and machines by the Labour Office to ensure employees' safety;
- f. Registration of employees with NPF.

*According to the entrepreneur, annual formalities are also still tedious because they have to “knock on the doors of several offices” to process business operation requirements. Unlike in the past (before reforms) when the process was longer, it now takes about one month to get the tax clearance if all documents are in order. But then after the tax clearance the next stage is to meet the local government requirements including payment of a number of fees such as cleaning fee, plying fee and several other local fees. Having obtained the clearance then the next stage was to deal with the council where a number of fees had to be paid including cleaning fee, industrial cess and licence fee. The process in the Municipal Council starts in April and ends in June.*

iii. Access to information:

*Information about inputs are obtained through correspondence. Markets on the other hand are obtained through individual initiative such as conducting marketing research, advertising, publication and attending exhibitions. The company is well attached to some hardware factories and outlets.*

In regard to the reforms in general the entrepreneur made the following remark (translated from Swahili):

*Trade liberalization has created a competitive environment which has affected many small scale enterprises. There is unfair treatment in the competition because poor technology (local) is competing with modern technology (multi-national) which uses more sophisticated technology. Therefore Local producers cannot produce the type of quality and standards required internationally. Entrepreneurs are more exposed to 'rules of the game' than before i.e. they are trying to know what sorts of products are coming to the market and their prices.*

The entrepreneur further remarked that, before reforms the entrepreneurs were more innovative, more enterprising and more hardworking than now. Before the reforms entrepreneurs had a sense of "we can make it ourselves" while currently most of the things are imported. Financial institutions used also to charge lower interest rates than now. The real meaning of this rather 'unconventional' remark is that with reforms these SSEs are no longer protected by a state-centred industrial policy.

## **Discussion**

The entrepreneur holds a view contrary to other entrepreneurs interviewed in regard to the impact of reforms and institutional changes taking place. He does not see any significant changes in the 'rule structure' and, in his case, the reforms have made matters worse in terms of performance. While the other entrepreneurs have accepted the realities of market forces as a given particular institutional frame (the market institution) and tried to adjust accordingly to take advantage of inherent market opportunities, the AGC entrepreneur seems to have seen a different light - unbeatable competition. This may be indicative of the strong legacy of "paternalistic" protection enjoyed by SSEs that were promoted by SIDO as a state organ. They are finding it difficult to shake off the legacy of state protection and go out there in the market to compete on the basis of cost, price and quality.

## **CASE # 8: ARUSHA CUTLERY COMPANY LTD - ARUSHA**

### ***Case Background***

The entrepreneur, Mr H.J. Ngowi who is the Managing Director and hails from Moshi, established the Arusha Cutlery Company (ACC) Ltd in 1978. The ACC was established under the auspices of the SIDA/SIDO Sister Industries Programme. The ACC produces spoons and forks and employs 50 persons. The company is located in SIDO industrial area in Arusha Municipality.

The entrepreneur has the following background:

- Completed 2 years technical mechanical course at the Dar es Salaam Technical College;
- Worked with the Williamson Diamond as a motor vehicle technician (1964- 1969);
- Attended a 2 years apprenticeship course in motor vehicles in London (1969-1970);
- worked with General Tyres Arusha as technical sales representative (1971 - 1978);
- Joined SIDO in 1978 and was sent to Sweden for a cutlery making course (1978-80);
- Established the Arusha Cutlery Company in 1978.

The purpose of establishing the company was to promote self-reliance spirit as stipulated in the Arusha Declaration of 1967.

### **Operations and Performance**

*Access to Inputs:* Stanley steel sheets are 100% imported from Sweden. Before the current reforms SIDO used to import the materials through SIDA and the company used to pay locally in Tshillings. They stopped producing spoons and forks immediately after that arrangement ceased. At the moment the ACC undertakes some small welding services to customers so that they can pay for utility bills such as electricity, rent and water.

*Access to Technology:* The technology was obtained from Sweden through SIDO under the Sister Industries Programme. Spare parts were also imported from Sweden.

*Access to Information:* Information on the inputs was been obtained through communication with the sister industry in Sweden (by fax, telephone and mail). Information about markets was obtained through the marketing manager who used to contact clients like HOSCO, government stores, schools, hotels, wholesalers, retailers and Regional Trading Companies (RTCs). The entrepreneur said that there was a problem in exporting due to high cost of domestic production.

*Performance:* During 1978-1988 period performance was good. From 1989 to 1995 the company experienced poor performance because of two major factors: pullout of SIDA assistance and intensified competition after trade liberalization. Consequently the company failed



to operate since 1995. This necessitated retrenchment of all employees in 1996 except two who continued with the welding services.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- *Banking Laws:* The company could not get loans from the Banks simply because the company does not own land for collateral. The land on which the premises are built belongs to SIDO;
- *Import Duty:* Because raw materials could not be obtained locally, the company had to import raw materials from Sweden at very higher prices compared to other countries. This was due to the Sister Industry Programme arrangements that existed. Hence import duty was also very high.
- *Electricity Rationing:* which lasted for two years contributed to poor performance of the company due to shortage of power.
- *Export Permits:* Long process taken to get permission to export. Before reforms export permission had to be obtained from the Ministry of Trade and the Bank of Tanzania. According to the entrepreneur, this was a very long process.
- *Trade Mark:* had to be approved by the Ministry of Trade and took a long time to be approved.
- *Taxes and Fees:* According to the entrepreneur the taxes and fees are too many and too high. He mentioned them as sales tax, import duty, income tax, stamp duty and Licence fees. He said that about 75% of the company's income went to the government coffers in the form of taxes and fees. This makes it difficult for the company to pay for other financial obligations such as salaries and utilities.
- *Bureaucracy/red-tape:* After reforms it takes much shorter time to get a licence or raw materials. The only problem now is liquidity. People are also more innovative now.
- *Litigations:* The Company faced litigation case in which the retrenchees demanded their final benefits. The company had to sale some machines to pay the workers. The case took about six months.

### ***Discussion***

This is a case of non-sustainability of a SSE arising from an institutional framework based on “paternalistic” state-driven development. In particular, ACC operated through “import dependency” based on “assisted” supply of inputs through SIDA/SIDO and dependency on the “state market” as primary outlet for its products (the ACC depended on the demand of SOEs and government agencies). They received preferential treatment in selling their product. Product quality was not a hurdle in selling. In the wake of the free market institutional framework, based on market forces and competition, the ACC apparent muscle crumbled.

While the other rules and regulations have been a constraint as it is the case with all other SSEs, in this case (and all State/SIDO/SIDA assisted SSEs) the critical institutional problem is that of “perverse institutional dependency” or an institutional arrangement that is not sustainable.

As pointed out by the entrepreneur, there is a change in entrepreneurial behaviour in which entrepreneurs are learning the hard way from the impact of trade liberalization. They are, for example, learning that quality of products and cost control may be more critical business sustainability factors than the rules and regulations affecting an enterprise. Institutional arrangements should be of a nature that they provide incentives to entrepreneurs to make business decisions that can sustain an enterprise in a competitive market. In the past, institutional arrangements (rules of the game) provided perverse incentives to entrepreneurs that led to unsustainable entrepreneurial behaviour and events. Policies, rules, regulations and procedures were driven by the “protected state market”.

## **CASE # 9: SHERIFF DEWJI & SONS LTD. - ARUSHA**

### ***Case Background***

Sheriff Dewji and Sons (SDS) Ltd is situated in plot No.14 Goliondoi Road in Arusha Municipality. It was established in May 1963. The respondent, Mr Tahseel Sheriff (43) is the Managing Director and founder of the company. He declined to provide information on his entrepreneurship background and the motivation for starting the business. He holds a BSc degree in Agricultural Science. The SDS deals in the export of coffee and manufacturing of bone meal. The company employs 22 people.

### ***Operations and Performance***

*Inputs/raw materials and Technology:* Coffee for export is obtained from local auctions conducted by the Tanzania Coffee Board. Bones for making bone meal are obtained locally. The ones are purchased, boiled, crushed and packed. Coffee is purchased, processed, parked and exported. Modern technology is used for both products but did not describe the type of technology and where obtained.

*Access to information:* Information about coffee and its markets are obtained from the Tanzania Coffee Association and through individual initiative. Information on bone meal is obtained through various Government Offices, Newspapers, and government gazettes. The entrepreneur declined to provide information on performance of the company.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. Taxation and licensing policies, local government laws such as environmental cleanliness, and local fees were cited as ‘bothering’;
- ii. Normal formalities were followed in the registration of the company;
- iii. Taxes charged after initiation of reforms are too many compared to the pre-reform phase.

The entrepreneur lamented that due to increased costs of production and the shrinking of markets resulting from reforms and intensified competition, his company is always challenged to think about how to increase sales. The reforms have also challenged him to be “innovative”.

### ***Discussion***

The entrepreneur is of the Asian origin and seemed uncomfortable and reluctant to freely provide the necessary information. This is not uncommon for the members of the Asian Community to think twice before giving business information. The legacy of the Arusha

Declaration and subsequent policies make the community somehow sceptical about motives of any business inquiry. The entrepreneur, however, has joined all the other entrepreneurs to voice the problem of too many taxes with cumbersome collection procedures.

## **CASE # 10: TANZANIA EYELETS COMPANY LTD - MOSHI**

### ***Case Background***

The Tanzania Eyelets Company (TEC) Ltd was established in 1981 by four entrepreneurs namely E. Ngowi, E. Kimambo, R. Mamseri and M.D. Mambo. Among these Mr. M.D. Mambo was available for the in-depth interview. Mr. Mambo is an engineer by profession. After graduating in India he was sent to Sweden for one year for an industrial manufacturing orientation course and later became the Managing Director of the company. Currently TEC employs 12 people. In the late 1980s the number of employees increased up to 40. The company could employ up to 100 people at 50% capacity utilization. Products produced by TEC included battery caps Bottom plates mosquito coil holders, standard eyelets washers, and buttons. Production started with 8 types of products at the inception year to 30 types of products in 1998.

The company is located in SIDO industrial complex in Moshi Municipality. Reasons given for establishing the company are:

- i. impressed by Chinese industrial development;
- ii. had acquired training in eyelets technology ;
- iii. to provide in-house training for young people/relatives;
- iv. to generate income.

### ***Operations and Performance***

Before economic reforms inputs and raw materials for TEC were imported through assistance of SIDA and SIDO from Europe and Far East. Formalities involved to secure import licence used to take about 2 months. Securing foreign exchange was also very difficult. SIDO used to purchase raw materials with foreign exchange provided by SIDA and TEC paid SIDO in local currency. Land and premises were provided by SIDO. Labour was obtained through advertisement and through owners contacts.

Technology was obtained from Sweden under the Sister Industries Programme of SIDO/SIDA. Before acquisition of the technology, the entrepreneur was sent to Sweden to familiarise himself with the technology. Spare parts had to be imported from Sweden. There was no problem in obtaining the technology and spare parts at that time because of government support through SIDO.

Information about markets was obtained through participation in trade exhibitions, magazines, newspapers, radio and international papers. National policies, laws, regulation are obtained from SIDO regional office, Moshi Municipal Council and government departments. The problem is that government took for granted that the entrepreneurs knows policies, laws, regulation and practices.

Turnover rose from Tshs 1.1 mln in 1983 to Tshs 200 mln in 1990. After 1990 the trend was irregular as follows:

- 1992 – 75 million
- 1993 – 190 million
- 1995 – 151 million
- 1996 – 204 million
- 1997 – 112 million

In 1998 production was stopped due to fierce competition arising from trade liberalization.

The entrepreneur was proud to have established a factory that could export to other African countries (Zambia, Zimbabwe and Kenya). The entrepreneur was satisfied also that he could provide employment to relatives.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. Registration of the company took six months. After reforms, the process takes less than a month.
- ii. Trading licence and inherent fees were paid to the Municipal Council. It took another five months to get the licence. After reforms, the process takes less than a month.
- iii. Multiple taxation policy continues even after reforms. Taxes included trading licence (TSHS 600,000), PAYE, development levy, refuse collection charges, fumigation charges, water and electricity charges. Other taxes include education levy, VAT, Stamp duty, Pay Roll levy, Property tax and import duty. Tax payment formalities were cumbersome and time consuming.
- iv. The company entered into formal legal contracts with some clients to supply products. However, such contracts ended after trade liberalization which led to a perception that imported goods are more superior the locally produced goods. Owing to trade liberalization, production of most products formally produced by small-scale industries has stopped and hence unsustainability of SSEs.
- v. Lengthy litigation process is another problem faced by the enterprise. The main litigation cases arising from reforms are labour appeals in 1997 against retrenchment which took two months to resolve. The company has also a case with TRA since 1993 on the withholding tax of Tshs 20 million. The case is still with the High Court, costing the enterprise both time and money.

### ***Discussion***

The entrepreneur is positive about the impact of reforms although his enterprise has been forced out of the market by competitions. According to the entrepreneur reforms have demotivated the

small scale industries. The reforms have, however, brought some positive changes such as reduced red tape and hassle. The time spent on getting the licence has been reduced but not to the required level. Corruption is still rampant. It is also easy now to get raw materials after relaxation or liberalization of various regulations including foreign exchange market. Tax levels have gone down but not to a level that encourages the SSEs.

This is a case of entrepreneurial striving that was substantially assisted and sustained by a “paternalistic” institutional arrangements before the initiation of reforms but after reforms, finding itself in a difficult situation of fitting (rather a misfit) in a market-based institutional framework. The problem is not, however, solely of its own making; the pace of the institutional reforms has not matched the exigencies of the liberalized market leading to “institutional incompatibility” arising from the legacy of “state-driven” development.

## **CASE # 11: NORTHERN PACKAGES (NORPACK) LTD - ARUSHA**

### ***Case Background***

The Northern Packages (NORPACK) Ltd company was established in May 1982 by Mr Fredrick Monyo, currently the managing director and the respondent in this case. Mr Monyo was trained as an aircraft maintenance engineer under the East African Airways Corporation (EAAC). After the collapse of the EAAC he joined Air Tanzania Corporation (ATC) in 1978 and later joined SIDA as an entrepreneur. The motivations for starting the business included an attractive SIDA package (land, premise, training abroad and technology), lack of security at ATC coupled with a low pay. NORPACK is located in Moshi SIDA industrial estate. It was established under the auspices of the SIDA/SIDO Sister Industry Programme. It employs 12 people and produces printing and packing materials.

### ***Operations and Performance***

During the SIDA/SIDO Sister Industry Programme raw materials (including hard paper) were imported from Sweden, after which the materials were obtained locally from the Mufindi Southern Paper Mill and Tanzania Karatasi Ltd in Dar es Salaam. Technology was obtained through SIDA/SIDO Sister Industry Programme. Spare parts were imported and sometimes modifications were made locally. The NORPACK technology is currently, however, facing stiff competition from computer-based printing technologies.

NORPACK performance continues to deteriorate particularly after the initiation of reforms and the termination of SIDA/SIDO assistance.

### ***Aspects and Constraints Related to Institutional Framework***

The following policies, laws, regulations and practices have affected the entrepreneur:

- i. Trade liberalization and depreciation of the Shilling. Before devaluation 1 Swedish Kronar was equivalent to TShs 2 (1985). According to the entrepreneur, in this case TShs 200,000 could buy 50 tons of raw materials which could last for 1 year. After devaluation the same money could purchase only 10 tons.
- ii. Likewise trade liberalization has reduced activities of some local industries such as cosmetic and shoe industries which were the main customers of NORPACK for packaging materials.
- iii. Taxation policy does not help the small entrepreneurs. For example, licence fee structure does not differentiate between large and small scale industries.
- iv. It was pointed out that before reforms there were only two major taxes paid (corporation tax and sales tax). But after reforms the number and type of taxes have increased. The entrepreneur mentioned some of them as:
  - ⇒ withholding tax (4% of income);
  - ⇒ payroll levy (4% of wage bill);



- ⇒ Corporation tax (30% of gross income);
- ⇒ VAT (20% of sales);
- ⇒ Municipal Council taxes (development levy, refuse collection fees, fumigation fee, liquid waste fee, etc). The entrepreneur complained that some fees were charged but no services are provided.
- v. Most tax assessments are done in the government offices without taking into consideration the actual performance of the company.
- vi. Income tax is paid a year before but if the turnover happened to be below the estimated rate no refund is made.
- vii. Bank loans carry high interest rates (30%) that prohibit SSEs.
- viii. In regard to information it was pointed out that most local by-laws are not communicated by authorities to entrepreneurs and other interested stakeholders. As a result people are sanctioned for not following regulations they are not aware of.
- ix. Information about the markets is obtained through business contacts and visits to clients.

### ***Discussion***

This is another case that has been adversely affected the economic liberalization policies. NORPCK was substantially dependent on “soft” and “paternalistic” assistance of SIDA and SIDO. It now finds it difficult to operate profitably in a market-based institutional framework i.e. “institutional incompatibility”. The problem was also the pace of the institutional reforms that did not match the exigencies of the liberalized market. Multiplicity of taxes and their cumbersome administration are viewed as other major constraints in the operation of NORPACK. The institutional framework does not provide adequate information support for SSEs like NORPACK and hence their transaction costs are higher than necessary.

## **CASE # 12: TOMMY SPADES MANUFACTURING COMPANY LTD - DSM**

### ***Case Background***

Tommy Spades Manufacturing Company (TSMC) LTD is located at Kimara area in the City of Dar es Salaam. Mr Thomas Lyimo established the company in 1982. The respondent was the company's Chief Accountant. TSMC employs 45 people and it deals with metal fabrication for fuel truck bodies. The entrepreneur owns also a dairy farm with 500 dairy cows that produce about 3000 litres of milk per day. The company was established for the purpose of generating wealth (money).

### ***Operations and Performance***

The major inputs/raw materials are iron bars, electricity and welding materials. The iron bars are purchased from the National Steel Corporation on cash payment basis. There are no credit arrangements. The land was obtained from the city council using normal procedures. Labour is obtained locally without major problems.

Up to 1992 the company was making fuel truck bodies manually after which they acquired modern machines from through SIDO on a loan basis. The loan was repaid fully last year (1999). Importation of better technology was not difficult because of the liberalization of foreign exchange market.

The respondent was not willing to provide detailed information on performance but he said that in general the company performance improved spectacularly from 1992 because of the following reasons:

- ⇒ Mushrooming of fuel companies which created the need for fuel trucks;
- ⇒ Increase of transporters resulting from trade liberalization;
- ⇒ Supply "loophole" in which fuel was transported tax free through Tanzania to Rwanda and Burundi.

It was noted that performance before 1991 was poor because of too much state control. Volume of profit was reported to have improved because of reforms.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. Taxation policy was claimed to be unfair because the tax rates were too high and too many taxes. For example, the local government charges plying fees and central government charges TLB fees, which are both charged for the purpose of maintaining roads.
- ii. Liberalization policy provides a big challenge to local entrepreneurs who have to compete with foreign investors with worldwide contacts.

- iii. Formalities for registering a business are not as cumbersome as they used to be before reforms however. Currently “transparency” is increasingly noted in enforcing rules and regulations.
- iv. Employment policy requires that a person employed over three months is automatically a permanent pensionable employee. In order to avoid this the company employs mainly on temporary basis for a period not exceeding three months. This denies the company a long-term view in productivity improvement.

### ***Discussion***

The report on this case is scanty because the actual entrepreneur was not available for interview. In regard to the effect of reforms to the company, the respondent noted that, after reforms, the government has been aggressive in tax collection. This has forced the company to pay taxes promptly. The entrepreneur admitted, however, that it takes a shorter time to process a business licence now when compared with the pre-reform period.

## **CASE # 13: MBEYA WOOD AND JOINERY WORKS - Mbeya**

### ***Case Background and Operations***

Mbeya Wood and Joinery Works was established in September 1984 by Mr Sikale (owner-manager) in collaboration with five other people. Mr Sikale completed secondary school and pursued an accounting study programme leading an award of a diploma in accountancy. They obtained initial loan and machinery from Sweden through SIDO. It is located in Mbeya SIDO Industrial Estate and it employs 15 persons.

The motives for establishment of the enterprise were to generate income through commercial utilization of wood and to reduce the use of hard wood by using softwood.

The main business of the enterprise is furniture making using mainly soft wood as raw material. Other inputs include spare parts, wood working machines and wood glue. Comparing access to inputs before and after the reforms, the entrepreneur observed that the situation is now better although prices are on the high side.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. The 1952 colonial law which promulgated that all furniture should be made by hardwood is yet to be repealed and as such the attitude of several consumers of wood products is still influenced by the belief that it is only hard wood that is good for furniture. The entrepreneur observed that this attitude affected adversely the enterprise performance.
- ii. Environmental protection restrictions on the harvesting of trees restrict availability of raw material (trees) for the enterprise.
- iii. Licensing formalities took about one month that entailed application for business permit and meeting health inspector's requirements.
- iv. A contractual agreement with TWICO to supply the entrepreneur with wood worth Tshs 1,000,000 monthly had several hitches due to poor performance of TWICO. TWICO is now out of business.
- v. Several types of taxes have to be paid. They are:
- vi. Sales Tax of 20% of Gross Sales Revenue. This is too high compared with a similar tax in Uganda and Kenya where the rate is 5% and 10% respectively;
- vii. Income tax at a rate of 35% of the gross profit;
- viii. VETA levy ;
- ix. Wood tax of 10% of total wood purchases;
- x. Withholding tax of 2% of the Gross Sales.
- xi. There are also "disguised taxes" in the form of fees, compulsory contributions and complementary gifts.

- xii. Societal norms and practices of supporting big extended families are also viewed as “tax” obligations involving substantial expenditures.
- xiii. Harsh credit terms and conditions have also constrained the entrepreneur. For example, the entrepreneur failed to secure a CRDB credit because of very restrictive conditions. Another example is FEDA credit that carries an interest of 30% per annum and has to be repaid within 2 years without grace period. A comprehensive write-up is also a requirement.
- xiv. The enterprise uses semi-legal contract for the supplies of wood inputs. It is semi-legal in the sense that the entrepreneur does not involve a lawyer in drawing out the contract. Involvement of lawyers is expensive for the entrepreneur.

### ***Discussion***

The entrepreneur has a relatively higher level of education. That could be the rationale for the entrepreneur to use semi-formal contracts with his inputs suppliers. He complained about too many taxes entailing cumbersome payment procedures. The changes in laws and regulations have, however, made the entrepreneur more aggressive in securing market opportunities.

## **CASE # 14: MOLEX - MBEYA**

### ***Case Background***

Molex is an enterprise located on Mbarizi Road, Mbeya, dealing in the sale of motor spare parts. MOLEX was established in 1996 by Ms Rehema Alex (owner-manager) who employs three persons. Ms Rehema Alex has a secondary education and a business certificate of the Dar-es-Salaam School of Accountancy. Four reasons for establishing the enterprise were lack of employment, spouse influence and confidence from educational background.

### ***Operations and Performance***

The entrepreneur used informal arrangements to raise start-up capital of Tshs 100,000. She started by selling used car parts before expanding to sell new parts. The enterprise has grown rapidly as indicated by the trend of investment growth given below:

1996	Tshs 600,000
1997	Tshs 2,000,000
1998	Tshs 3,000,000
1999	Tshs 6,000,000

The entrepreneur counted her achievements in terms of the following:

- i. built a residential house;
- ii. enrolled her kids in good schools;
- iii. enhanced capacity to support parents and other relatives.

### ***Aspects and Constraints Related to Institutional Framework***

Policies, laws, regulations and practices that have affected the entrepreneurial endeavour include:

- i. Environmental cleanliness by-laws which require the enterprise to contribute Tshs 10,000 monthly;
- ii. Uhuru Torch contribution of TShs 5,000 every year;
- iii. Tedious business licensing formalities. It took two months to acquire a business licence. The entrepreneur had to go through various stages to obtain a licence, such as:
  - a. Endorsement of the Village Secretariat;
  - b. Endorsement of the hygiene committee;
  - c. Municipal trade office procedures;
  - d. Revenue office procedures;
- iv. **Non-written contract was entered into with suppliers of spare parts in Dar es Salaam and Mbeya. Agreements were based on trust;**
- v. Multiple taxes such as income tax (Tshs 600,000 annually), license fee (Tshs. 300,000 annually) and VAT (20% of the total annual sales).

### ***Discussion***

Changes in laws, regulations and procedures have changed behaviour of the entrepreneur in the sense that she has become more aggressive. She has, for example, designed stickers to advertise her enterprise. The relatively higher level of education and training seems to have influenced her entrepreneurial endeavour.

## **CASE # 15: NKWENZULU MOTEL LTD - MBEYA**

### ***Case Background and Operations***

Nkwenzulu Motel Ltd is located on Mbalizi Road and was established in 1976 by Mr D.M. Tweve, the owner-manager. Mr Tweve completed secondary school education. The motel employs 14 people and all of them are family members. The motel provides accommodation, restaurant and bar services. Reasons given for starting the business were self-employment and income generation. The enterprise has survived both phases of policy changes; the pre-reform and reform phases.

Achievements registered by the entrepreneur include sending his children to good schools, expanded and diversified business, and capacity to support parents and other relatives.

### ***Aspects and Constraints Related to Institutional Framework***

In terms of regulations and procedures, the entrepreneur had the view that pre-reform situation was better than the current situation. However, the following policies, laws, regulations and practices have affected the entrepreneurial endeavour:

- i. Tedious and corruptive health regulations enforced at the whims of health inspectors;
- ii. Costly monthly contributions for environmental services;
- iii. Environment cleanness By-Law requiring cumbersome inspection procedures;
- iv. Annual contribution for the “Uhuru Torch”;
- v. Pre-reform formalities for establishing the Nkwenzulu Motel were tedious. They included several endorsements from the village or ward level up to the district or regional levels;
- vi. High annual licensing fees as follows:
  - Guesthouse (TShs 100,000);
  - Hotel (TShs 90,000);
  - Bar (TShs 40,000).
- vii. Multiple taxes;
- viii. Compulsory contributions to political causes amounting to Tshs 2,000 for every licence;
- ix. Tribal norms of helping each other generously are very costly;
- x. Inconsistent tax administration procedures.

### ***Discussion***

This case brings out the important issue and problem of arbitrary enforcement of rules, regulations and procedures characteristic of the pre-reform phase, which tended to increase transaction costs. This is characterised in this case as “*tedious and corruptive health regulations enforced at the whims of health inspectors*”. The problem of non-statutory or “unauthorised” contributions emerges also. Forced contributions to “Uhuru Torch” and to



political parties as conditions for obtaining a licence are examples of such non-statutory “taxes”. With the current policy reforms these non-statutory taxes “taxes” have *de jure* been abolished but there are complaints that they are still being solicited albeit in a subtle manner.