



FSDT FOCUS NOTE

BUSINESS FORMALISATION IN TANZANIA

**Building a stronger small business sector
through formalisation**

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ABBREVIATIONS & IMPORTANT TERMS

BRELA

Business Registrations and Licensing Agency

Business Licence

A license to establish or run a business which is usually renewed annually

Certificate of Registration

Businesses are required to register their names with BRELA

ESAURP

Eastern and Southern African Universities Research Programme

SIDO

Small Industries Development Organisation

TBS

Tanzania Bureau of Standards, established under the Ministry of Industry and Trade to support industry and commerce

TFDA

Tanzania Food and Drugs Authority which is mandated to regulate the quality, safety and efficacy of food, medicines, cosmetics and medical devices

TIN

Tax Identification Number for both individuals and businesses. Applicants are required to visit offices as part of the application process to present photos, finger prints and signatures.

TRA

Tanzania Revenue Authority

VETA

Vocational Educational and Training Authority



Financial Sector Deepening Trust (FSDT)'S Goal

All Tanzanians to derive value from regular use of financial services which are delivered with dignity and fairness.

A financial sector in which stakeholders implement policies, regulations and solutions which are innovative and responsive to the needs of MSMEs, individuals and smallholder farmers.

FSDT Purpose



Executive Summary

The small business sector has the potential to make a significant contribution to the economy of Tanzania. It has the capacity to provide employment, particularly in rural areas which lack economic opportunity as well as reducing the gender gap, alleviating poverty and generating government revenue through taxation and business license fees.

However, despite ongoing national reform programmes, there remain considerable challenges for Micro, Small and Medium Enterprises (MSMEs). The unreviewed SME policy and inadequate SME Development Coordination framework placed under the Ministry of Industry, Trade and Investment imply that the value of entrepreneurial initiatives in improving the lives of the people is yet to be recognized. Other factors include complex, bureaucratic and costly legal, regulatory and administrative environment where SMEs are at a greater disadvantage than their counterparts that are larger in size¹

Due to the unfavourable environment and costly, complex compliancy procedures, of the 3 million MSMEs, over 95% of micro businesses and 85% of small businesses operate informally. Many owners of informal businesses lack understanding and are distrustful of regulatory authorities and are therefore unaware of and unable to benefit from access to services which could improve their growth and sustainability.

The government's Vision 2025 aims to build a strong sustainable economy built from individual initiative and entrepreneurship with a strong private sector generating sustainable tax revenue.

Through initiatives from many of the organisations that support small businesses, there have been significant successes with positive impacts on businesses. Key actions have been business education and training, working together with other businesses and accessing capital and new markets.

To increase the opportunities for small businesses to grow and contribute to the national economy, there are further challenges to overcome. These challenges include continued improvement to the business environment and infrastructure, particularly the regulatory requirements, business support infrastructure and registration and regulatory processes. In addition, as business knowledge remains limited, there is a need for accessible business support services on a national basis to help build the capacities and knowledge of business owners.

Definition of Formal Businesses

Businesses that hold any long-term license. Such licenses include operating and market licenses by municipalities, but exclude daily trading licenses. A tax identification number (even if solely used for business) held by a small business owner is not regarded as a long-term license.

Micro, Small and Medium Enterprises National Baseline Survey Report, FSDT and Ministry of Industry and Trade, 2012

1 Small and Medium Enterprise Development Policy, Ministry of Industry and Trade, 2003

Business Regulatory Environment in Tanzania

With a history of a strong public sector economy, the regulatory framework and the public sector service industry delivery mechanisms are not designed for micro, small, and medium enterprises, and therefore, do not work for a majority of informal businesses².

In Tanzania, all businesses, including individual businesses, partnerships and corporations are required to be compliant with a number of agencies, regardless of size. All business activities that are not registered with the Business Registration and Licensing Agency (BRELA) are regarded as informal business.

The World Bank's Doing Business project, which measures and compares regulations relevant to small businesses, outlines the process and costs required to formalise a business in 190 countries. Tanzania is ranked as being 135 out of 190 countries.

PROCESS	AUTHORITY	TIME TO PROCESS	COST
Apply for clearance for proposed registered name	Business Registration and Licensing Agency (BRELA)	1 day	No charge
Obtain notarised declaration of compliancy	Notary	1 day	10,000 – 50,000 TSH
Apply for company incorporation and obtain certificate of incorporation	Registrar of companies	4 days	337, 200 TSH
Apply for taxpayer identification number (TIN)	Tanzania Revenue Authority (TRA)	1 day	No charge
Obtain taxpayer identification number (TIN)	Tanzania Revenue Authority (TRA)	1 day	No charge
Apply for business license	Ministry of Industry and Trade (MIT) or Local Government Authorities (LGAs)	6 days	1,000 TSH
Apply for VAT certificate	Tanzania Revenue Authority (TRA)	4 days	No charge
Register for workmen's compensation insurance	Workers Compensation Fund (WCF) and Tanzanian Insurance Regulatory Authority (TIRA)	1 day	No charge
Obtain Social Security registration number	Social Security Regulatory Authority (SSRA)	7 days	No charge
TOTAL		26 days	348, 200TSH (minimum) \$155 (at June 2017 rates)

The costs and regulations are for a business with 10-50 employees and a capital of 10 times the per-capita gross national income.

Depending on the nature of the business, once a business is launched, it is then exposed to further regulatory requirements which include those for consumer protection, quality standards of products and services, health and safety, good business practice and ethical business behaviour. Informal businesses run the risk of operating below these standards and can therefore be seen as inferior to formal businesses by customers, financial service providers and investors.

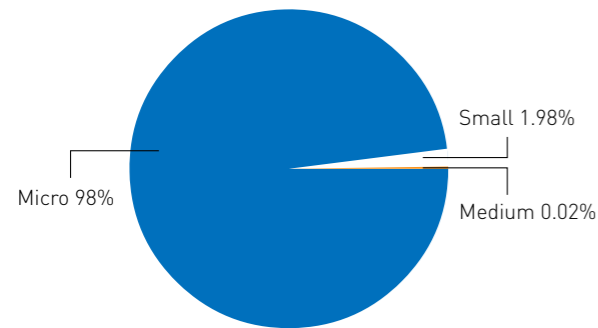
2 Towards Inclusive Business Formalisation: A New Paradigm in Handling Business Informality? D R Olomi, presented at Repoa's annual research workshop, Dar es Salaam, 2016

Informal Business Environment

NUMBER OF FORMAL AND INFORMAL BUSINESSES

Micro, Small and Medium Enterprises National Baseline Study Report, FSDT & MIT, 2012

Number of MSMEs in Tanzania by size (%) based on 2.75 million business owners in Tanzania

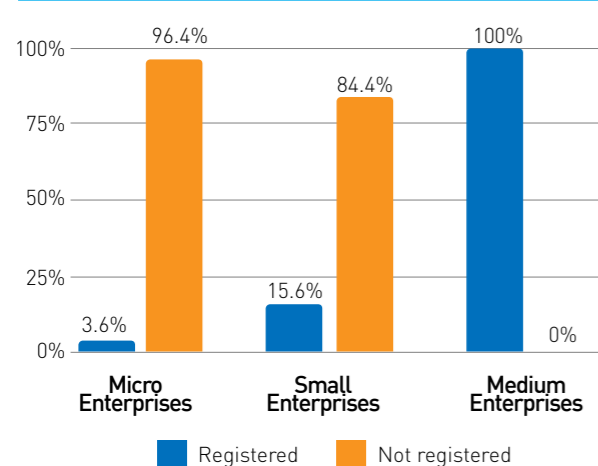


Definition of MSMEs

Micro, Small and Medium Enterprises National Baseline Study Report, FSDT & MIT, 2012

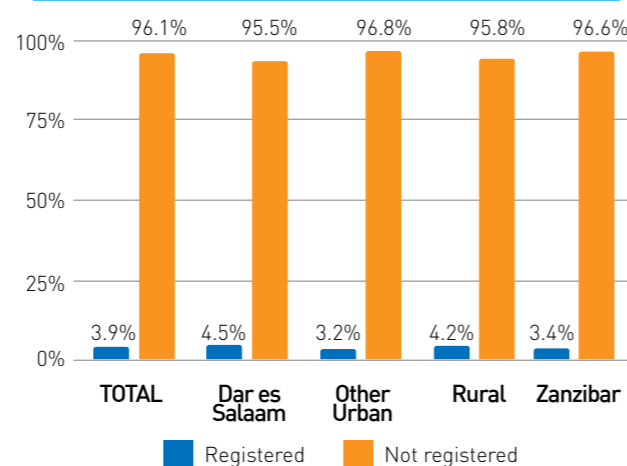
Category	Employees	Capital Investment (TSH)
Micro	1-4	Up to 5 million
Small	5-49	5 - 200 million
Medium	50-99	200 - 800 million
Large	100+	800+ million

Registration under BRELA by size (%)



While less than 4% of micro enterprises were registered, it is noteworthy that only 16% of small enterprises were registered.

Registration under BRELA by area (%)



Only 3.9% of small businesses were registered under BRELA. The low registration was consistent across all regions.

CHARACTERISTICS OF MSMEs

FSDT's Micro, Small and Medium Enterprises National Baseline Study Report of 2012

- Over 95% of small businesses were formally owned by sole proprietors across all regions
- Businesses in Zanzibar held higher numbers of trade licenses [28%] against an average of 6% across the country
- Less than 15% of businesses held professional registration, local authority, daily and other licenses
- 18% businesses in Zanzibar have a tax identification number (TIN) against an average of 6% across the country.
- Around 5% make utility payments and pay property tax and VAT
- About 81% of all small businesses had a business name
- Over 80% businesses do not hold title deeds or have rent agreements

Although most businesses are not registered, there is a small number that hold other licenses which suggests a move towards formalisation.

Challenges Facing Informal Business Sector

Capacity of regulatory bodies

With limited resources and large geographical spread across the country, most regulatory authorities' offices are based in Dar es Salaam or Arusha which present challenges for businesses owners elsewhere to spare the time and expense to travel long distances to complete formalisation procedures.

FSDT made a case study in November 2016 in Mbeya (Southern Highlands Zone), Dodoma (Central zone), Arusha (Northern zone), and Kagera (Lake Zone), interviewing small business owners and representatives from the Tanzania Revenue Authority (TRA), Small Industries Development Organisation (SIDO) as well as regional and municipal Business Development services and authorities.

In the study, regulatory officials talked of lack of resources to provide adequate services to businesses. Examples were given of 1 mobile computer to serve a whole district in Mbeya region to register businesses, operate financial record keeping and make tax payments and the case of 11 business officers to serve 36 wards, some of whom had to work in the central office as they lacked the required working tools.

Regulatory infrastructure

Some of the regulatory policies and practices have been in existence since 1980 resulting in formal business categories which are no longer relevant. Many authorities also lack market information which would support their work to increase the capacity of MSMEs.

Both regulatory officials and small business owners agree that the mechanisms to register or obtain licenses are multiple, complex, bureaucratic and lengthy and business owners are required to visit a number of offices to become compliant. There are also instances of lack of harmony and duplication of regulations, for example quality testing of milk by both the Tanzania Food and Drugs Administration (TFDA) and the Government Chemistry Laboratory Agency (GCLA).



53%

of business owners referred to access and cost of required finance as significant problems preventing them from starting a business.

Business support services

Due to limited resources and complex procedures, regulatory officials are unable to support enterprises through regular consultations, coaching and guidance on how to comply with requirements.

In the Kagera region, SIDO officials stated that there are not enough resources to run its operations and conduct business training as their funding merely covers their salaries. With 1 car and 5 staff, they are able to reach only 3 of the 8 districts due to long distances.

Cost-benefits of formalising a business

For many business owners, the perceived advantages of remaining informal outweigh those of formalising. In FSDT's 2012 MSME National Baseline Study Report, 53% of business owners referred to access and cost of required finance as significant problems preventing them from starting a business.

Other reports have also shown that the costs to formalise a business can equal 90% of the average start-up capital. This capital is needed for investment in the business for economic stability and to provide more jobs³. Business owners face both direct costs, which include registration fees, license fees and taxation and also indirect costs, which include personal and managerial time required to fulfil compliance requirements.

Enterprise competitiveness

With the additional direct and indirect costs, formal businesses usually pass compliancy costs onto customers, which raises selling prices and reduces competitiveness against informal businesses.

Business owners' capacity

For most business owners, they are reliant on entrepreneurship rather than sound education and training and, as a result, lack understanding of the benefits of formalising their business and trust in regulatory authorities. In fact, 88% of small business owners have completed primary school education and no further⁴.

In interviews, business trainers stated that the majority of training participants, particularly hawkers and food vendors, had no prior knowledge of business formalisation and its benefits, no awareness of the increased ability to secure loans from financial service providers once formalised and no relationship with financial institutions. In addition, some of them had little or no knowledge on how to differentiate business and family financial management, as well as the process to acquire a Tax Identification Number (TIN). For some participants, it was difficult to spare time away from their business to attend training, as they are living hand to mouth.

Financial inclusion of MSMEs

As the majority of micro and small businesses operate informally, over 70% are excluded from financial services and are unable to benefit from many business services, including access to formal markets, state protection and cooperation with others⁵. For many, there is the perception that traditional, kinship, neighbourhood, occupational and family ties will remain effective and durable in providing mechanisms and networks of financial services, marketing, training schemes, welfare schemes and social security nets.

Financial inclusion of MSMEs (%)

	Formal	Semi-formal	Informal	Excluded
Formal enterprises	41.3	10.6	6.7	41.4
Informal enterprises	6.5	10.9	12.8	69.8

Employment

There are an estimated 1 million people working in informal businesses in Tanzania, as paid workers, friends or relatives or apprentices. The most vulnerable are women and young people. Although 46% of MSME business people are male, there are over 1 million micro businesses of 1 female owner/employee⁶.

Currently, 900,000 young people enter the job market each year, but only 60,000 formal sector jobs are available. In a World Bank study in 2017, "informal has become normal", as it was reported that 75% young people earn their main income through the informal sector⁷.

The majority of employees in the informal sector are working "in unrecorded and legally unrecognized and unprotected economic activities, with poor access to business services"⁸.

3 Shayo-Temu, S Business Formalization Procedures and the Growth of Micro and Small Enterprises: Case of Dar es Salaam City in Tanzania, Business Management Review Journal Vol. 8 (1), p.37-p.32
 4 Micro, Small and Medium Enterprises National Baseline Study Report, FSDT & MIT, 2012
 5 Formalization Barriers and Benefits, Mutakyahwa, R in Maliyamkono, T. L et al (Eds) (2012) Transforming the Informal Sector: How to Overcome the Challenges, TEMA Publishers Company Ltd, Dar es Salaam
 6 Micro, Small and Medium Enterprises National Baseline Study Report, FSDT & MIT, 2012
 7 Youth Employment in Sub-Saharan Africa, World Bank, 2014
 8 D R Olomi, 2016

Success Stories

BUSINESS SUPPORT AND TRAINING

The larger regulatory authorities, including the TRA and regional and municipal authorities, see the need to provide education and training for business owners. For many decades, the government has supported small business training, and in 1973, created the Small Industries Development Organisation (SIDO) to support small businesses through a wide range of functions from policy formulation, training, technological support, marketing and international information sharing.

To improve vocational skills, the government formed the Vocational Educational Training Authority (VETA) in 1994 to promote and provide vocational education and training.

1. SIDO, Dodoma Region - Regional Manager, **Abel Mapunda**

After training on how to further their enterprises and knowledge to formalise their businesses, some of the SMEs who attended training have formed and registered a small group. They have since been allocated a business site and are waiting to start building an office.

2. Tanzania Revenue Authority (TRA), Mbeya Region - Director of Tax Payer Services, **Serapio Francis Luanda**

The TRA's main objective since its foundation, among many others, is to provide education to tax payers on different laws, regulations and directives that must be followed. They also have the responsibility of providing services and programmes which include direct education to business owners, visiting crowded places such as market places and big shops and using radio programmes. They have established a system of paying tax in installments over 6 months which can demonstrate the value of formalisation, through increased business from increased access to business support.

"Once you visit a TRA office, you will be given education by an officer at the reception or directed to my office or to any other officer in respective departments, to be given detailed education on different regulations and laws that one is required to abide by to fulfil a tax payer's responsibility, which is to pay tax," says Luanda.

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Prior to a training session in late 2016, most of the participants at the training had **no knowledge of business formalisation and its benefits**, and no relationship with financial institutions.



3. Central Zone Sunflower Oil Processors Association (CEZOSPA), Dodoma Region - Trainer / mentor & Chairperson, **Iringo Charles**

Prior to a training session in late 2016, most of the participants at the training had no knowledge of business formalisation and its benefits, and no relationship with financial institutions. The challenges facing participants were:

- low understanding of business and regulatory requirements, particularly among hawkers and food vendors
- Inability to attend the training fully as they rely on hand to mouth small businesses
- no designated business areas making it difficult to formalise their operations despite having acquired the knowledge
- failure to formalise their operations after training because of bureaucratic processes and costly charges

After the training, at least 150 SMEs grouped themselves and formed an organisation called *Umoja wa Wajasiriamali Asili Dodoma* (UWAADO) which has now been registered and acquired a tax identification number (TIN) and is waiting to be allocated a business site by the Capital Development Authority (CDA).

Several of those who attended the training have acquired loans from banks and other financial institutions to expand their businesses and five people have been voted to the District Business Council as representatives of SMEs, following their hard work and application during the training.

4. TRA, Dodoma Region - Regional Senior Taxpayer Service and Education Office, **Barnabas Masika**

Most entrepreneurs, especially those who are just getting into business, do not have sufficient knowledge and education on how to formalise their activities. One of the main challenges they face when registering, is that they do not have business premises, one of the main requisites for business formalisation process. It would be prudent if businesses work collectively to acquire TINs and other certificates to improve ease and reduce costs to formalise.

BUSINESS CLUSTERS

Working together in industry clusters brings many benefits to MSMEs, with the potential to improve value chains, improve collaboration and coordination, encourage policy reforms, develop supportive infrastructures and economic strategies, establish relevant setting and monitoring of industry standards and improve engagement with supporting industries, universities and institutions.

1. SIDO, Mbeya Region - Deputy Manager, **Moses Kalongole**

SIDO in collaboration with Mbeya Municipality and the Regional Authority, has allocated areas in Mbeya Region for business creation leading to increased employment and economic growth. The project is being implemented through business clusters to ensure businesses are sustainable. The benefits of clusters are that businesses form associations which can work together to apply for licenses and loans collectively, buy machinery, market collectively, receive training, encourage the improvement of the local infrastructure and secure investment more easily. Further potential benefits are that banks and tax collection offices could be encouraged to set up offices closer to associations.

“Our aim is to make sure that there is at least a single cluster in every district, and right now we have about five of them which operate in two districts,” Kalongole says.

In 2016, there were three clusters in Mbeya Urban district, which are Wheat, Sunflower, and Animal Feeds; the Rice Cluster has 28 operating businesses and expectations are for 48 after the installation of machinery; the Sunflower Cluster has 25 business and expectations are to rise to 41; the Animal Feed Cluster has 2 businesses.

ACCESS TO CAPITAL

1. Municipal Social Development Officer, Mbeya Region - **Beatha Mtani**

As well as providing business advice and connecting businesses to regulatory authorities and business services, municipal authorities in Mbeya have allocated 10% revenue for a fund to provide loans for women and young people. In addition, Economic Empowerment committees have been formed at regional, municipal and ward levels to collaborate with stakeholders, which include financial service providers.

2. Carpenter, Kagera Region - Mwabage Malisawa

Following training, he has increased his capital and has made products to take to market rather than waiting for customer orders. As he has started keeping records, he now knows how many tables he has built per month, profit gained and balance saved.

After formalising his activities, he is no longer worried about avoiding authorities and can focus on his work and now saves his money in a bank which prevents him from spending in an unplanned way. He is currently concentrating on the challenge of competition from cheaper products from China.

3. Grape and vegetable farmer, Dodoma Region - Eunice Kenyunko

Although she had a TIN before the training, she lacked skills in book keeping. Following the training, she has been able to set up and maintain financial records and has got a loan from a bank.

ACCESS TO NEW MARKETS

1. Entrepreneur and welder, Kagera Region - Dioniz Evarist

As a member of a newly formed collective business, Dioniz has seen increased customer trust as a result of obtaining a TIN and business license. In addition, because they registered collectively, the members of the collective group are now able to get contracts from organisations and members and can process payments and secure loans from the group.

They still face many issues including competition from other businesses with larger capital, lack of training on technological innovation and access to loans.

Insights for the Future of Small Businesses

Continued government support

In its SME Development Policy, the Government of Tanzania takes into account the particular constraints and opportunities of the small business sector and focusses on three main areas, namely,

- creation of an enabling business environment
- development of financial and non-financial services
- establishing a supportive institutional infrastructure.

Regulatory authorities should be supported to work to realistic objectives with adequate funding to make visible positive change in the small business sector. There have been many lessons learned across regulatory authorities which could be gathered and shared to inform future policies.

As the responsibility for informal sector development is with the Ministry of Labour, whilst the Ministry of Industry and Trade is responsible for small business development, it is recommended that the entire small business sector should be under the Ministry of Industry, Trade and Investment (MITI)?

Increase business owners' capacity

To improve the understanding and overall capacity of business owners, areas of weakness in knowledge need to be identified and addressed through a holistic approach, which could include:

- education frameworks for informal businesses to share the benefits of formalising, including modules aimed at hawkers and food vendors
- mentor schemes using small business owners who have successfully formalised their business who could act as role models and pass on relevant insights to business owners working in the same field
- sustained support to work closely with training participants after the training sessions
- funding opportunities with community funding schemes (eg Village Community Banks (VICOBA) and Savings and Credit Cooperative Organisations (SACCOs)
- connecting people to financial services and providing training on financial literacy and business management



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