

# How does macroeconomics factors affect smes in tanzania



Essay one talked about how macroeconomics factors such as inflation, monetary policy, taxation and international trade affect the economy of Tanzania as a whole. As stated in essay one, this essay will discuss about how these microeconomics factors affect the small and medium enterprises (SMEs) or occasionally known as micro, small and medium enterprises (MSMEs) in Tanzania.

In Tanzania (SME Development Policy, 2002), it is at present increasingly recognized that SMEs play an important job in employment contribution, income generation and stimulation of growth in both rural and urban sectors. SMEs can easily be set up given that their requirements in terms of capital, technology, management, etc. are not as demanding compared to large enterprises.

SME Development Policy (2002) wrote different countries use different measures of size according to their development level. In the perspective of Tanzania, micro enterprises are those employing up to 4 employees or utilizing capital amounting up to Tshs. 5 million. Small enterprises are those that are employing between 5 and 49 employees or with capital investment amounting from Tshs. 5 million to Tshs. 200 million. Medium enterprises are those employing between 50 and 99 employees or utilize capital investment amounting from Tshs. 200 million to Tshs. 800 million. The above information can be summarized using the table below:

In 2002, the Government of Tanzania (quoted by Aikaeli, 2007) stated that it is estimated that about a third of the GDP originates from the SME sector

and employs approximately 20% of the Tanzanian work force. This data shows that SME sector plays a significant role in the economy.

According to Morwa (2006), following the privatization drive and the civil and public service reforms which began to take place in the early 1990s in Tanzania, the country observed a considerable increase in the number of SMEs over the last one decade. SME Development Policy (2002) argued that due to the existence of a number of restrictions hindering the development of Tanzania SME sector such as unfavorable legal and regulatory framework, undeveloped infrastructure, poor business development services, limited access of SMEs to finance, ineffective and poorly coordinated institutional support framework etc., the full potential of this sector has yet to be tapped. The anticipated result is to have a considerably increased contribution of the SME sector to economic development of Tanzania.

### **Monetary policy and its contribution to the SMEs in Tanzania:**

As described in essay one, the Bank of Tanzania is the central bank of Tanzania and in 1995, according to Wikipedia (2010) the bank had one single main objective, which was monetary policy.

One of the problems that SMEs in Tanzania face is limited access to finance. The government decided to set up the following schemes to tackle with this problem:

Small and Medium Enterprise Credit Guarantee Scheme (SME-CGS):

According to BOT (2010), this scheme was set up by the government during the financial year 2004/5. It is executed by the Bank of Tanzania (BOT) in alliance with Financial Institutions. SME-CGS is devised to promote and support SMEs by building up an enabling environment for expansion and making possible access to financial resources, thus speeding up economic growth and job creation.

Economic Empowerment Programme (J. K. Fund):

In the financial year 2006/7, the government kept aside about Tshs. 21 billion. Mkukuta (2008) stated that the motive of the fund is to offer special consideration loans through normal banking practices to empower SMEs, and especially those that are in the rural and urban areas. The execution of the programme is categorized into two phases.

The first phase was assigned Tshs. 10. 5 billion, which were issued under Credit Guarantee Scheme. The CRDB and NMB banks were selected to partake in the first phase.

The second phase was also assigned with Tshs. 10. 5 billion, which were issued to banks and non-bank financial institutions to offer loans mostly to districts that CRDB and NMB banks were not able to cover during the first phase.

According to Mkukuta (2008), as of 30th September 2008, loans worth of Tshs. 39 billion were issued from the first phase allocation, whereby the CRDB bank issued about Tshs. 22. 8 billion and 26, 384 entrepreneurs profited from this. NMB bank issued about Tshs. 16. 2 billion and 21, 955

entrepreneurs profited from this. In total, the number of entrepreneurs that profited was 48, 370.

#### Mwananchi Empowerment Fund:

This scheme was commenced in January 2008. According to Mkukuta (2008), since it was launched with limited capital resources of about Tshs. 400 million, the government decided to launch the scheme in five regions in the first phase and carry on with other regions subject to the availability of funds. The first phase regions included Lindi, Mtwara, Manyara, Singida and Rukwa. A Memorandum of Understanding (MOU) has been signed between the CRDB Bank and the National Economic Empowerment Council (NEEC), whereby NEEC had agreed to deposit about Tshs. 400 million to the CRDB Bank as cash guarantee.

The scheme seeks to empower Tanzania citizens to access capital and loans and take part in the economic activities of the country. The following are the objectives of the Fund as given by Mkukuta (2008):

Widen investment knowledge among Tanzanians

Enhance employment opportunities

Offer a connection among institutions, companies and corporations that are registered under the Economic Empowerment Act by bringing coordination in their activities, counseling and developing them

Offer loans to private individuals, corporations and institutions under credit guarantee scheme or non-guarantee scheme.

Mkukuta (2008) concluded that until 30th September 2008, a total loan worth Tshs. 143, 770, 000 has been issued to two of the first phase regions; Lindi and Mtwara.

## **CRDB BANK LTD – TANZANIA:**

Masuke (2010) stated in his presentation that CRDB Bank is a private commercial bank that was set up in July 1996. CRDB Bank is one of the banks in Tanzania that cannot escape doing and expanding business with the SMEs sector. This is because of the intense competition for the small corporate market. Because of this predicament, CRDB Bank has been compelled to adjust their traditional banking philosophy and practice and seek out methodologies of dealing with the crisis built-in in financing of SMEs in Tanzania.

According to CRDB Bank (Masuke, 2010), SMEs are those with:

Number of staff between 1 and 100 in the midst of them are relatives of the entrepreneur

Capital investment of between Tshs. 5 million to Tshs. 800 million

Requirement of businesses loan amounting Tshs. 1 million to Tshs. 100 million

Annual sales turnover of Tshs. 20 million to Tshs. 500 million

One of the problems faced by SMEs is getting finance from banks. CRDB Bank carried out a survey to uncover what was hampering SMEs from accessing finance. Masuke (2010) wrote that the following were the results:

<https://assignbuster.com/how-does-macroeconomics-factors-affect-smes-in-tanzania/>

SMEs sector is viewed as a high risk and costly to finance

SMEs have poor auditing and accounting framework

Lack of enough guarantee schemes to back-up financing SMEs

Inadequate knowledge of business operations

Failure of borrowers to organize and present applications/business plan that meets the banks requirements.

Failure of SMEs to fulfill collateral requirements.

According to Masuke (2010), the following are the initiatives that CRDB Bank took to support SMEs:

Devise modified products for SMEs:

The bank developed two credit products for SMEs: working capital loan and investment loan. The repayment style developed is by installments. In working capital loan, the minimum repayment period was developed to be 3months and the maximum 12months while in investment loan, the minimum repayment period is 12months and the maximum 60months.

Capacity building for CRDB staff and SME customers:

In building capacity for CRDB staff, the bank had to hire new staffs who specially deal with SMEs. Furthermore, all employed staffs had to go through an intensive training.

In building capacity for SMEs, the bank offers free business and loan management training to SMEs. In addition, after training the trainees are provided with booklet called SME Toolkit, which can be used as a reference.

Increase the range of collaterals accepted by the bank:

Before CRDB Bank implemented the SMEs concept, it used to call for just traditional collateral. But now, the bank has broadened the range of acceptable collaterals to include non-traditional collaterals e. g. Residential License, properties with offer letters, used motor vehicles and machines etc.

Introduction of customer relationship concept at branch level:

The bank extended the relationship concept to branch level, which can allow the bank to build a strong relationship with its SMEs.

The SME concept was executed as a project in 2005. Since then, the project has been a hit with remarkable growth in terms of portfolio and number of customers.

### **International trade and SMEs:**

Tanzania's ability to face global economic challenges depends on the stage of development of its SMEs. According to OECD Bologna conference (2000), there are four requirements for development of competitive SMEs that meet the criteria to get involved in cross-border business:

Provision of effective business support services

Availability of long-term finance



Availability of a good state of information and communication technology infrastructure

Existence of appropriate social capital

The following are the strategies that SMEs can adopt when involving in international activities (Young, 1987):

Exporting

Foreign direct investments (FDI)

Strategic alliance

Joint ventures

Licensing, etc.

According to Saiguran (2007), some of the problems that SMEs in Tanzania face include:

Lack of appropriate information, knowledge and skills

Challenge of small and competitive domestic market

Inadequate and inefficient infrastructural facilities

Multiplicity of taxes

The following are some of the initiatives that were set up in order to promote international trade in Tanzania:

The Board of External Trade (BET): This scheme was set up in 1978. The scheme is responsible for:

International markets searching

Synchronizing foreign businesses requiring to trade in Tanzania

Sorting out and helping out involvement in overseas trade fairs, exhibitions, and missions

Carrying out Research and Development on external trade

According to BET (2007), since the time the scheme was set up, it has been synchronizing and carrying out training programmes in all areas of international trade, holding specialized exhibitions and carrying out market research.

Mini-Tiger Plan 2020: this scheme is fed into the National Strategy for Growth and Reduction of Poverty (NSGRP). According to Aikaeli (2007), this scheme is responsible for:

Promote competitiveness of Tanzanian products on the global markets

Promote exports

Create special economic zones. The zones that were created included:

Tanzania Export Processing Zones, which was set up by the parliament Act of 2002 and Zanzibar Free Trade Economic Zones Authority (ZFTEZA), which was created in 1992

SMEs' Export Credit Guarantee Scheme: this scheme was set up in 2003 by the government of Tanzania through the central bank. The aim of the scheme is to facilitate export trade. According to BOT (2006), the scheme is geared to support SMEs in line with the National SMEs Development Policy.

In order to assist the mentioned above scheme in minimizing problems that are affect by SMEs in relation to international trade, the government in collaboration with private non-governmental organization (NGOs) organizes workshops and seminars to sensitize and educate people on how to cope with the existing global challenges. For example, SMEs Competitive Facility (SCF) of Tanzania organized a course with jingle " Track IT, Trace IT Tanzania: Competitiveness for Tanzania". According to SCF (2006), SCF grants opportunity for businesses that desire to build up or add to their ability to trade and export.

Regardless of all the problems that SMEs face in Tanzania in relation to international trade (Aikaeli, 2007), SMEs still have the potential to effectively compete and gain the benefits of the rapid expending international trade.

## **AMKA: DAR-ES-SALAAM, TANZANIA**

Tomesen and Gibson (1998) stated that AMKA is a Swahili word meaning awareness or awaken. It is an NGO in Tanzania which specializes in export and marketing-oriented business development services (BDS) to Tanzania SMEs. AMKA was founded in 1994. Its main goal is to:

Increase the incomes and numbers of Tanzanians (employees and/or producers) involved in exports... [And] increase the value of agricultural output in Tanzania via exports....

<https://assignbuster.com/how-does-macroeconomics-factors-affect-smes-in-tanzania/>

(Tomesen and Gibson, 1998)

In other words, Tomesen and Gibson (1998) wrote AMKA's export/market-focuses technique is to improve business performance by increasing efficiency and turnover through improved access to new markets (domestic and foreign). In quest of the goal, AMKA carries out a variety of activities that target the SME sector. These create a balancing market/export-focused portfolio of services and can basically be categorized into two groups:

Training and advisory services – providing training in small business development skills and business planning for export.

Trade promotion and intermediary services – AMKA acts as an agent between producers and customers. It offers market information on export, assist producers who need export facilities and eases the connection between the producers and alternative trade organizations, which are the customers. AMKA also helps producers and intermediary organizations to take part in trade fairs and offer ethical and quality standard audits of producers for external customers and carries out market research

AMKA's key income source is the Department for International Development (DFID). In 1994, it endorsed a 4 year funding of \$557, 053, which was to assist in forming the organization (AMKA). Nevertheless, the awareness strategy of lessening reliance on one donor has been successful. Reliance on DFID funding has lessened from 94% in 1994/5 to 40% IN 1997/8. Important funds from other donors began to enter into the organization. The percentage of internally generated funds has risen from 5% in 1994/95 to 41% in 1997/98.

<https://assignbuster.com/how-does-macroeconomics-factors-affect-smes-in-tanzania/>

According to Tomesen and Gibson (1998), AMKA successfully serves two groups of customers:

SMEs in Tanzania

Overseas customers

These customers are mainly in two sectors: food-processing and handicraft production. The customer base is extremely different in terms of the organization structure, the number of employees, their activities and main products. The customer enterprises size ranges from 4 to 446 employees. Customer enterprises have a range of structures of ownership, which include: producer groups (groups of self-employed people), co-operative societies, privately limited companies, parastatals, and associations.

Originally, AMKA's focus was to develop intermediaries (co-operatives and associations) who could, in turn, deliver services to producers. Nevertheless, AMKA has shifted deliberately towards to offering more services to producers itself directly mainly because of the weakness of these intermediaries and the complexity in increasing their ability.

In general, Tomesen and Gibson (1998) concluded that it is obvious that AMKA has had a positive impact on the economy of Tanzania in general and on producers, SMEs in particular. Because of AMKA, some businesses were rescued; others, for the first time, were introduced to exports, or had export sales increased.

## **Effects of Inflation on SMEs in Tanzania:**

As described in the first essay, Thompson and Vane (1979) argued that inflation can be caused by a simultaneous fall in the value of money. Inflation had continuously pressure Bank of Tanzania in the year 2009-10 due to its double digit and is expected to remain the same due to government expenditure ahead of October elections, the anticipated dry weather and the deteriorating of the shilling.

The rate of inflation affects SMEs' access to finance. As described in essay one, a high rate of inflation restricts SMEs from access to finance from the banks and other financial institutions while a low rate of inflation widens the SMEs' chances of accessing funds. Because of this, inflation is considered as one of the factors that get in the way of the growth of SMEs in Tanzania, in a way that it puts off investors. Investors prefer to invest in countries where currencies are stable and rates of inflation are low.

In order to help the SMEs sector, the central bank of Tanzania has set up a chain of strict fiscal measures to control inflation.

Professor Benno Ndulu, the governor of the Bank of Tanzania (cited by Emerging Markets Business News, 2010), in an exclusive interview in Dar es Salaam said his institution was acting quickly and resolutely to turn around the rising rate of inflation. He said the bank would remain alert against the risk of higher food and fuel prices firing up the inflation's upward spiral. He continued to say that increasing inflation was a worldwide happening and that the Bank was working round the clock to have power over money liquidity in the economy as one of the measures to deal with the problem. As

an economics expert, Prof. Ndulu suggested that Tanzania as a nation requires to produce more food for its rapidly increasing population to trim down reliance on costly imported food products, which add up to inflationary pressures. He challenged regulators such as the Energy and Water Utilities Regulatory Authority (EWURA) and others to make certain that when prices of fuel at the global market drop, such positive changes should be experienced by Tanzania too.

The Bank of Tanzania also controls the growth of money in order to control inflation. According to Ballali (2004), controlling the growth of money enables the bank to have influence over the rates of inflation. In controlling the growth of money, the bank targets broad money, M2, which is currency in circulation outside banks, and total deposits detained by commercial banks, not including foreign currency deposits.

### **BANK OF TANZANIA (BOT):**

The Bank of Tanzania is responsible for controlling the rate of inflation. Ballali (2004) wrote the objective of monetary policy is to attain a low and stable rate of inflation, which has a link with the key objective of the Bank of Tanzania, which is price stability. Therefore, the bank has an obligation of making sure that it sets up monetary conditions that are in agreement with low and stable inflation.

According to Ballali (2004), the focus of the Bank of Tanzania is on the Consumer Price Index (CPI), which it uses to determine inflation. The rate of change in the overall CPI is known as the headline inflation rate. The inflation rate, not including food prices is regularly known as the non-food inflation

rate. Non-food inflation rate is used to calculate price movements, which are mostly influenced by policy factors, but can also be often affected by external factors. The Bank of Tanzania also keeps an eye on food prices and their index. This is for the reason that food prices are occasionally influenced by non-monetary factors like drought and floods, which can have an effect on inflation significantly in spite of the attitude of monetary policy. The rate of change in food price index is known as the food inflation rate.

Ballali (2004) stated that by controlling the growth of money supply, Central Banks have influence over inflation. The Bank of Tanzania targets broad money, M2, which is described as currency in circulation outside banks, and total deposits detained by commercial banks, not including foreign currency deposits. M2 is selected for the reason that it is the monetary aggregate that is estimated to have closest relationship with the rate of inflation.

Central Banks usually have influence over reserve money (base money, or central bank money), as stated by Ballali (2004) which is directly connected to money supply in order to control the growth of M2. Reserve money is described as the liabilities of a Central Bank, which consist of currency detained outside banks and banks' reserves detained by the Central Bank.

### **Taxation and its effect on SMEs:**

According to Mittah (2009), there are two classifications of SMEs:

SMEs formal – these are potential taxpayers who comply with the tax laws, are well structured and keeps records



SMEs informal – these are not well structured and have complexities in keeping records. Most of the micro taxpayers fall under informal sector

There are advantages in grouping taxpayers, which according to Kimungu and Kileva (2007) include:

Simple to manage.

Simple to recognize.

Simple to educate or counsel on taxation issues.

Risk minimization.

Higher compliance.

The tax system is unfavorable for SMEs development. According to SME Development Policy (2002), the business community has the following perception about Tanzania's taxes:

The rates of taxes are higher in relation to neighboring countries in the region

Taxes are many and collected by a variety of authorities including: the Tanzania Revenue Authority (TRA), some Central Government Ministries (e. g. Lands, Natural Resources Environment Tourism Energy and Minerals etc.) and Local government Authorities.

These are some of the reasons why entrepreneurs are ignorant of tax matters and the cost of acting in agreement with tax regulations is regarded

as high. While taxation of businesses is a requirement for national economic development, the current tax system inflicts a major weight on SMEs.

The following are the strategies that are set up in order to promote compliances in paying tax by the SMEs:

**Simplify tax systems:** for SMEs the tax system is considered to be complicated. Simplifying the tax system can promote voluntary compliance in paying tax. Mittah (2009) stated that Tanzania has opted for the introduction of presumptive tax system to reinstate income tax, VAT and stamp duties. Presumptive tax system was set up in July 2004 with the intention of minimizing the problems that are faced by SMEs taxpayers in abiding by with the laws of tax.

**Introduce tax incentives to foster SMEs:** tax incentives like low tax rate to those who comply with the tax laws can encourage SMEs to comply and abide by with the tax laws.

The Sustainable Industrial Development Policy – SIDP (1996 – 2020):

SME Development Policy (2002) reported that this scheme was set up in order to place specific stress on encouragement of small and medium industries through the following measures:

Supporting current and new promotion institutions

Simplification of taxation

Licensing and registration of SMEs

Progress access to financial services.

Persuades informal sector businesses to grow and be formalized.

## **TANZANIA REVENUE AUTHORITY (TRA): TANZANIA**

TRA is one of the government companies that are responsible for the application of the Value Added Tax (VAT) to SMEs in Tanzania. VAT was set up in Tanzania on 1st July 1998. Formerly, VAT was known as Sales Tax, but it was replaced because it was unable to create adequate revenue as it was narrow-based. According to TRA (2010) in Tanzania, there are two valid rates of VAT:

Standard rate, which is 20%

Zero rate, which is 0%. This is generally valid to exports.

TRA (2010) gave the following main reasons for setting up VAT:

Widen the tax base

Achieve economic neutrality

Encourage exports

Achieve its administrative advantages

According to TRA (2010), small businesses are those with yearly taxable turnover of not more than Tshs. 40 million. By 31st December 2004, Tanzania had about 355, 750 businesses that were registered as small size businesses. This group contributes about 0. 44% to the TRA domestic

revenue collections. Medium size businesses are those with the yearly taxable turnover exceeding Tshs. 40 million, but whose yearly total domestic tax payments to TRA do not go beyond Tshs. 400 million. By 31st December 2004, the businesses that were registered as medium size businesses for VAT were about 6, 815. This group contributes about 13. 2% to TRA total domestic revenue collection. Businesses whose yearly aggregate tax payments to TRA exceed Tshs. 400 million are categorized as large taxpayers. TRA has registered about 200 businesses as large taxpayers, including non VAT registered traders such as banks and insurance companies, which entirely deliver free from VAT services. This group contributes about 18% of TRA total domestic revenue collections.

From July to December 2004, about Tshs. 2, 015. 2 million of presumptive tax was accumulated from small businesses. TRA's target was to accumulated tax amounting to Tshs. 2, 887. 3 million, leading to a performance rate of 70%. The key reason for not accomplishing their target was caused by the administrative complicatedness of monitoring the businesses under the informal sector, who do not keep records. About Tshs. 60, 084. 8 million was accumulated from medium size businesses during the first half of Tanzania's financial year 2004/5. TRA's target was to accumulated tax amounting to Tshs. 59, 212 million, leading to a performance rate of 101%.

TRA (2010) stated the following were the reasons for good performance from the medium size businesses:

There was close follow-up of monthly tax collections in which the estimated collections are verified by 15th of every month.

Recovery of outstanding amount of tax

Effective audits

Close monitoring of those businesses who do not keep records

Tight controls over special free of VAT and VAT repayments

Staff training

Carrying out of the Departmental Actions Plans

The challenges facing Tanzania with respect to taxation of SMEs are in particular to those in the formal sector. Kimungu and Kileva (2007) listed the challenges as:

Identification

Registration

Non compliance

Poor of non record keeping

Kimungu and Kileva (2007) stated in order to tax SMEs, the TRA has engaged in various activities:

Taxpayer education and sensitization

Block management system – door to door survey

Presumptive approach to taxation

Assessment procedures

Collection formalities and procedures.

## **Conclusion:**

An assessment of every feature involved in macro-economy i. e. inflation affects, implications of taxation, role of monetary policy and role of international trade suggest variable results.

Research has revealed that the SME sector plays a significant role in the economy of Tanzania. The results showed that a third of the GDP originates from the SME sector and employs approximately 20% of the Tanzanian work force.

Research has also shown that SME sector has many challenges, which need to be addressed effectively. Given the significance of the sector and the need to transform it to a vibrant and dynamic one, it is essential to put in place strategies that will ease the elimination of those challenges so that it can achieve the desired results.

One of the problems that SMEs in Tanzania face, in relation to monetary policy is limited access to finance. This problem exists because the SME sector is viewed as a high risk and costly to finance sector. In order to try eliminating this challenge, the government in collaboration with other financial institutions developed schemes such as SME-CGS, J. K. Fund, etc.

<https://assignbuster.com/how-does-macroeconomics-factors-affect-smes-in-tanzania/>

which were set up with a main objective of helping the SME sector to have access finance.

SMEs also face challenges with international trade. The challenge is caused by SMEs' lack of knowledge, information and skills needed to effectively compete in a global environment. Apart from setting up different schemes that tackle this challenge, the government in collaboration with private non-governmental organization (NGOs) also organizes workshops and seminars to sensitize and educate people on how to cope with the existing global challenges.

Inflation is considered as one of the factors that get in the way of the growth of SMEs in Tanzania, in a way that it puts off investors. Investors prefer to invest in countries where currencies are stable and rates of inflation are low. The rate of inflation also affects SMEs' access to finance. A high rate of inflation restricts SMEs from access to finance while a low rate of inflation widens the SMEs' chances of accessing funds. In order to help the SMEs sector, the central bank of Tanzania has set up a chain of strict fiscal measures to control inflation.

The tax system is considered as being unfavorable for SMEs development. Business community perceive the rates of Tanzania taxes as being high, complicated and that taxes are many and collected by a variety of authorities. In order to tackle this problem, the tax system need to be simplified so that the SME sector can understand how the whole system works and introduction of tax incentives to foster the SME sector to comply to tax laws.