KAMPALA INTERNATIONAL UNIVERSITY-UGANDA

FACULTY OF BUSINESS AND MANAGEMENT

AN ASSESSMENT OF THE IMPACT OF FISCAL POLICIES ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN TANZANIA

A CASE STUDY OF SME's IN MAZOMBE DIVISION-IRINGA REGION TANZANIA

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DECLARATION

I, WASIWASI KILAVE, declare to the Senate of Kampala International University that this research paper has not been submitted for any other award at any institution of higher learning for any purpose and that it is my own original work.

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STATEMENT OF APPROVAL

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DEDICATION

I dedicate this work to my lovely parents Mr. Sylon Kilave and Consolatha Kadilo.

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This research would not have been possible without the help of a number of persons;

My sponsors and all the IOP personnel clue; who have done a great part as far as my studies are concerned,

Anton Muganga Wannah, Bomma Obunga Rabbala, Frank Simon, Wesley Luyangi- my best friends and above all my parents; I love you people.

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LIST OF ABBREVIATIONS

BDS	Business Development Services
MDGs	Millennium Development Goals
NEDF	National Entrepreneurship Development Fund
NGO's	Non-Government Organizations
OICT	Opportunities Industrialization Center of Tanzania
SAP	Structural Adjustment Programs
SCF	SME Competitive Facility
SELF	Small Entrepreneurship Loan Fund
SIDO	Small Industrial Development Organization
SME's	Small and Medium Enterprise
SPSS	Statistical Package for Social Science
TIB	Tanzania Investment Bank
WEDF	Women Entrepreneurship Fund

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ABSTRACT

In many developing countries, there is growing recognition that SME's have a very vital role to play in economic development. SME's create employment, help achieve equitable income distribution, alleviate poverty, build up local technological base, promote participation of vulnerable groups particularly women in the development process, provide training ground for entrepreneurial and managerial skills and opportunities for use of own capital resources as well as act as ancillaries to large-scale enterprises. However, the development of SME's largely depends on the policies in place and in particular the tax structure of a given country. The aim of this study was to determine the impact of fiscal policy on the growth of SME's in Tanzania. The study was based in Mazombe Division and covered a sample size of 50 SME's. The methodology used to select the sample size was stratified random sampling. Primary data was collected using administered questionnaires. The data was analyzed using SPSS. The results from the study showed that fiscal policies were not in the least supportive to the growth of SME's. Further, the study also revealed that most SME owners did not register themselves as legal entities as a way of evading tax and other mandatory payments. In addition, the study showed that TRA officials who collected company tax from SME's where not honest enough and capitalized on the ignorance of SME's owners. The study concluded that in order for SME's to grow, there is need for various stakeholders to put up their efforts into bringing the wheels of SMEs into full stroke.

CHAPTER ONE

INTRODUCTION

1.0   BACKGROUND TO SME's IN TANZANIA

SME's are one of the principal driving forces in economic development. They stimulate private ownership and entrepreneurial skills, they are flexible and can adapt quickly to changing market demand and supply situations, they generate employment, help diversify economic activity and make a significant contribution to exports and trade. Despite the large proportion of local and regional business accounted for by SME's, most are not involved in international trade and investment. SME's are often at a disadvantage in terms of finance, technology, human resource development and networking.

SME's do not normally have adequate financial resources to take part properly in the establishment of standards, despite the fact that it is they who withstand the worst of multiple tests and certifications. The problem is intensifying by the influence of large private-sector enterprises, which lay down standards, adherence to which becomes more or less binding.

Economic Reform Program implemented by the Tanzania Government have been based on the philosophy that Tanzania is committed to a market economy whereby the private sector will take the lead in creating incomes, employment and growth. On the other hand the state will be a producer of public goods, play a regulatory role to level the playing field and create conducive environment for the private sector to take the lead in driving the economic growth. This philosophy is evident in almost all policy statements made since 1986 and in particular after

1996. The private sector has started playing an ever-increasing role in creating incomes and employment. SME's account for large share of the enterprises active in Tanzania. In fact SME's are the emerging private sector and do form the base private sector-led growth (SME's Development Policy).

Trade policy should aim to make it as easy for SME's to engage in international transactions as doing business domestically. Governments need to simplify their own regulations regarding importing/exporting and harmonize their trade procedures with international standards. Most West European countries have established national trade and transport facilitation committees, bringing together representatives of relevant public and private sector institutions, to reach this objective.

1.1   BACKGROUND OF THE PROBLEM

SME's are one of the principal driving forces in economic development. They stimulate private ownership and entrepreneurial skills, they are flexible and can adapt quickly to changing market demand and supply situations, they generate employment, help diversify economic activity and make a significant contribution to exports and trade.

SME's contribute to employment growth at a higher rate than larger firms (According to the informal sector survey of 1991, micro enterprises operating in the formal sector alone consisted of more than 1.7 million businesses engaging about 3 million persons, that was, about 20% of the Tanzanian labour force [SME's Development Policy]) and they may well, in the long term,

provide a very significant share of overall employment; SME's can help in the restructuring and streamlining of large state-owned enterprises by enabling them to abandon and/or sell off non-core production activities and by absorbing redundant employees; SME's provide economies with greater flexibility in the provision of services and the manufacture of a variety of consumer goods; SME's increase the competitiveness of the marketplace and curb the monopolistic positions of large enterprises; and SME's can act as the seed-bed for the development of entrepreneurial skills and innovation; they play an important part in the provision of services in the community; and they can make an important contribution to regional development programs.

In Tanzania, SME's can be easily established since their requirements in terms of capital, technology, management, and even utilities are not as demanding as it is the case for large enterprises. These enterprises can also be established in rural settings and thus add value to the agro products and at the same time facilitate dispersal of enterprises.

Tanzania Development Vision (2025) seeks to transform a low productivity agricultural economy to semi-industrialized one lead by modernized and highly productive agricultural activities, which are buttressed by supportive industrial and services activities through actively mobilization of people and other resources towards the achievement of shared goals.

There are a number of government policies already i n place facilitating the growth of the economy, which have a bearing on the development of SME's sector. The government has addressed the issue of access to finance including the establishment of SME Credit Guarantee, National Entrepreneurship Development Fund (NEDF), SME Competitive Facility (SCF), and

Women Entrepreneurship Fund (WEDF). Others are Small Entrepreneurship Loan Fund (SELF) and the so-called "Kikwete Funds" (21 billions). Central to all these policies is creation of enabling environment, building of robust private sector and articulation of strategy that will create a sustainable growth.

1.2   STATEMENT OF THE PROBLEM

The government has among its Millennium Development Goals (MDGs) objectives to improve the performance of SME's, which in turn would lead to poverty reduction. With this regard, the government has instituted a number of policies ranging from the establishment/support of micro financing to varying its tax structure. The keyword in all its operations or efforts towards propelling the growth of SME's has been to create an "enabling" environment for them.

However, in as much as the government has tried to create an enabling environment for the growth of SME's, it is questionable whether or not some fiscal policies that it has implemented work in contradiction as a result, committing the fallacy of ignoring secondary effects.

For instance, the issue of double taxation (direct and indirect taxes) erodes company profits, thus, minimizing re-investment, working capital and savings. In addition, taxation may prevent vertical expansion of SME's and their integration with the government to achieve certain objectives such as income distribution, employment creation, transfer of technology, and market expansion.

Similarly, policies like tax exceptions on imported inputs for foreign investors and tax holidays for foreign investors create stiff competition for locally produced inputs and locally owned firms.

Further still, the adaptation of Structural Adjustment Programs (SAP) has resulted in reduced public expenditure, which has affected SME's through the output market. Empirical evidence indicates that direct government purchases typically account for less than one percent of the total demand for SME's manufactured goods. A significant proportion of current expenditures are still on wages for public sector employees.

This research aimed to discuss the number of fiscal policy issues, which are aimed at enhancing the growth of SME's in Tanzania. It has identified the fiscal policies that Tanzania adopts in the pursuit of their economic development as well as analyzed how these policies influence the growth of SME's.

1.3   OBJECTIVE OF THE STUDY

The research had a number of objectives as here under listed

1.3.1   General Objective

The general objective of the study is to assess the impact of government fiscal policies on SME's growth in Tanzania in particular the Mazombe Division.

1.3.2   Specific Objectives

The specific objectives of the research were as follows:

i.   To identify the fiscal policies impacting on SME's in Tanzania.

ii.   To assess the impact of the company tax structure on the performance of SME's in Tanzania.

iii.   To assess the impact of various legal payments such as land rates and (National Social Security Fund) NSSF employee contributions on the performance of SME's in Tanzania.

iv.   To give policy implications from the findings of the impact of fiscal policies on SME's in Tanzania.

1.4   Research Questions

From the above research objectives, the researcher formulated the following research questions.

i.   Does the current company tax structure foster the growth of SME's development in Tanzania?

ii.   Does the current practice of employer contributions towards NSSF of 10% foster the growth of SME's development in Tanzania?

iii.   Does the current compulsory payment structure of annual license operating fees foster the growth of SME's development in Tanzania?

iv.   Does the current VAT structure foster the growth of SME's development in Tanzania?

1.5   Hypothesis

From the above research questions, the following research hypotheses were formulated.

H_1:   A high company tax structure does not have a negative impact on the growth of SME's in Tanzania.

H_2:   The compulsory contributions made to the government on the employees' behalf by SME's do not have a negative impact on the growth of SME's in Tanzania.

H_3:   The compulsory annual license operating fees do not have a negative impact on the growth of SME's in Tanzania.

H_4:   The current VAT structure does not have a negative impact on the growth of SME's in Tanzania.

1.6   Scope of the Study

The scope of the study was SME's based in Iringa Region, Kilolo District, Mazombe Division-Tanzania. The study gathered data from 50 SME owners on various aspects pertaining to mandatory government payments. Further, the study assessed the impact of these mandatory contributions on the growth of SME's in Iringa-Mazombe Division Tanzania. The findings of the study were generalized to the entire SME's population in Iringa region and Tanzania at large.

1.7   Limitations

The study had the following limitations.

i. The study was not adequately funded. Thus, the researcher was not able to conduct a comprehensive study as wished.

ii. The study concentrated in Mazombe ward-Iringa and hence, the results generated from the study may not be reflective of Tanzania as a whole.

1.8   Definition of terms

The following section provides the various definition of terms used in this study. The source of these definitions includes

Direct Tax: This is a tax that is collected directly by government from the entity on which it is levied. Examples of direct tax include income tax and company tax and transfer tax. In this study Pay-As-You-Earn (PAYE) and company tax are considered. The company tax payable by SME's in Tanzania is a flat rate and is determined by the Central Government.

Employee contributions:

This refers to the payment which employers are obliged by law to make on behalf on their employees. In this study these include NSSF contributions, which are 10% of an employees' gross pay.

Fiscal Policy: The use of government spending and taxation, as opposed to monetary policy (interest rates and money supply), to try to influence the level of economic activity. An expansionary fiscal policy means lower taxes and higher government spending. Conversely, a contractionary fiscal policy

means raising taxes and cutting spending. The term fiscal policy refers to the expenditure a government undertakes to provide goods and services and to the way in which the government finances these expenditures (**Heyne, P. T., Boettke, P. J., Prychitko, D. L. (2002):** *The Economic Way of thinking* **(10th Ed). Prentice Hall.**).

Growth: It reflects the increase in the production of goods and services over time and is often used as a measure of increased material well being generated through economic activity. Economic growth is an increase in activity in an economy. It is often measured as the rate of change of gross domestic product (GDP). Economic growth refers only to the quantity of goods and services produced; it says nothing about the way in which they are produced. Economic development, a related term, refers to change in the way goods and services are produced; positive economic development involves the introduction of more efficient or "productive" technologies or forms of social organization.

License renewals: This is a legal payment that is paid to the local council as permission to operate a business in a given locality. The license fee paid is determined by the nature of the business and thus, is not a flat rate.

SME's: Small and medium enterprises (**also** SMEs, small and medium businesses, SMBs, and variations thereof) are companies whose headcount or turnover

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falls below certain limits. **EU** Member States traditionally have their own definition of what constitutes an SME, for example the traditional definition in **Germany** had a limit of 250 employees, while, for example, in **Belgium** it could have been 100. But now the EU has started to standardize the concept. Its current definition categorizes companies with fewer than 10 employees as "micro", those with fewer than 50 employees as "small", and those with fewer than 250 as "medium". By contrast, in the **United States**, when small business is defined by the number of employees, it often refers to those with fewer than 100 employees, while medium-sized business often refers to those with fewer than 500 **employees.**Defined in terms of number of employees, Small enterprises are recognized as having fewer than 200 workers. In this study SME's refers to an organization with less than 50 workers.

CHAPTER TWO

LITERATURE REVIEW

2.1   INTRODUCTION

This chapter aims at defining the important terms related to the research topic. It consists of both theoretical and empirical literature review. In theoretical literature review, the researcher defines the concepts and terms according to how different authors have defined them; and the empirical literature review provides the findings of different researchers who did a similar study to the one done by the researcher.

2.2   Theoretical Literature Review

This section provides the various theories of fiscal policy and how they relate to developmental issues.

2.2.1 Fiscal Policy

McEachern (1988) defined fiscal policy as the use of government spending, taxes, and borrowing to influence aggregate economic activity. Fiscal policy can be used to close deflationary and inflationary gaps. To close a deflationary gap government spending can be increased or taxes reduced to increase aggregate demand. Since the aggregate supply curve is upward sloping, the increase in aggregate demand will raise both output and price level. Fiscal policy focuses on demand side, not supply side. Its focus intends to manipulate aggregate demand to stabilize employment and output over business cycles.

Fiscal policy describes two actions by the government as follows:

i. *Taxation*: by means of levying taxes the government receives revenue from the public. Taxes come in many varieties and serve different specific purposes, but the key concept is that taxation is a transfer of assets from the people to the government.

ii. *Government spending*: This may take the form of wages to government employees and social security benefits. When the government spends, it transfers assets from itself to the public (although in the case of weaponry, it is not always so obvious that the population holds the assets).

Since taxation and government spending represent reversed asset flows, they are usually considered as opposite policies.

2.2.2 Expansionary and Contractionary Fiscal Policy

The government has control over both taxes and government spending. When the government uses fiscal policy to increase the amount of money available to the general public, this is called expansionary fiscal policy. Examples of this include lowering taxes and rising government spending.

When the government uses fiscal policy to decrease the amount of money available to the populace, this is called contractionary fiscal policy. Examples of this include escalating taxes and lowering government spending.

There is another way to interpret the terms expansionary and contractionary when discussing fiscal policy. When examining the effects of fiscal policy on the economy as a whole, rather than

on the individual, what is observed is that expansionary fiscal policy increases the output, or national income; while contractionary fiscal policy decreases output or national income. Thus, there are two basic classes of effects of fiscal policy; those that deal with the individual and those that deal with the economy at large.

2.2.3 Taxes Vs the Growth of Companies

Some economists argue that taxes can have a significant effect on the intensity with which people work and their overall efficiency and productivity. However, there is little substantive empirical evidence to support this view. Many factors contribute to improving productivity – tax changes can play a role – but isolating the impact of tax cuts on productivity is extremely difficult.

Lower rates of corporation tax and other business taxes can stimulate an increase in business fixed capital investment spending. If planned investment increases, the nation's capital stock can rise and the capital stock per worker employed can rise.

The government might also use tax allowances to stimulate increases in research and development and encourage more business start-ups. A favorable tax regime could also be attractive to inflows of foreign direct investment – a stimulus to the economy that might benefit both aggregate demand and supply. The economy is often touted as an example of how substantial cuts in the rate of corporation tax can act as a magnet for large amounts of inward investment.

Capital investment should not be seen solely in terms of the purchase of new machines. Changes to the tax system and specific areas of government spending might also be used to stimulate investment in technology, innovation, the skills of the labour force and social infrastructure. A good example of this might be a substantial increase in real spending on the transport infrastructure. Improvements in our transport system would add directly to aggregate demand, but would also provide a boost to productivity and competitiveness. Similarly increases in capital spending in education would have feedback effects in the long term on the supply-side of the economy.

A tax cut, for example, leaves more disposable income in the hands of households. If the tax cut is viewed as temporary, though, it may have a much smaller effect on household spending than a permanent tax cut would. In contrast, some temporary tax changes can have larger effects on spending than permanent changes. For example, an investment tax credit that temporarily lowers the cost of investment projects can lead firms to schedule their spending to take advantage of the tax credit. Both current and future fiscal actions must be considered in assessing the impact of fiscal policy in the economy.

2.2.4 Fiscal Policy and Economic Growth

Growth is an investment that will provide capital appreciation over the long-term. It reflects the increase in the production of goods and services over time and is often used as a measure of increased material well being generated through economic activity. Economic growth is the increase in the value of goods and services produced by an economy. It is conventionally measured as the percent rate of increase in real gross domestic product (GDP). Growth is usually

calculated in real terms, that is, inflation-adjusted terms, in order to net out the effect of inflation on the price of the goods and services produced.

Economic growth is driven by greater use of inputs (labor, capital and natural resources) and/or growth in productivity. It is usually reported as a percentage increase in GDP for a country. Economic growth may also occur by having more people in an economy. If the economic growth occurs more slowly than the population growth, then there can be economic growth, but the average person is less well off.

2.2.5 The Definition of SME's

In Tanzania like elsewhere, there is no consensus on the definition of SME's both at institutional level and among researchers. Small Industry Development Organization (SIDO) classifies SME's into two classes, namely micro enterprises as those employing 10 people or less. Small scale industries as those projects, which employ people not exceeding 50. *National Accounts of Tanzania and the Bureau of Statistics* both define SME's as those firms employing up to 10 employees. *The national information sector survey of 1991 and 1995* defines SME's as those businesses with initial capital of up to 500,000Tshs and employing 5-50 employees.

In the SME Development Policy **(2002)**, the term SME's is used to mean micro, small and medium enterprises. Different countries use various measures of size depending on their level of development. The commonly used yardsticks are total number of employees, total investment and sales turnover. In the context of Tanzania, micro enterprises are those engaging up to 4 people, with capital among to Tshs 5,000,000/=(Tanzanian shillings five million). Small enterprises are mostly formalized undertakings engaging between 5-49 employees or with capital

investment from Tshs 5,000,000/=- 20,000,000/= (five million shillings to twenty million shillings). Medium enterprises employ between 50-99 employees or use capital investment from Tshs 200million to 800 million. This is illustrated in the table below:

Table 1:   CATEGORIES OF SME's IN TANZANIA

Categories	Employees	Capital Investment in Machinery (TShs.)
Micro enterprises:	1-4	Up to 5 million
Small enterprises:	5-49	Above 5 million - 200million
Medium enterprises:	50-99	Above 200million - 800 million
Large enterprises:	100+	Above 800 million

Source: Small and Medium Enterprises Development Policy (2007)

2.2.6   Characteristics of SME's

According to **Burns and Dew hurt (1996),** the major characteristic of SME's is that its firm's share of the market is not large enough to enable it influence the price of national quantities of goods sold to any extent. In addition, SME's have personalized management where the owner actively participates in all aspects of management of the business and in all major decision-making process. Thus there is little devolution of delegation of authority.

In third world countries, SME's are mostly trade – oriented with only a small proportion of them is involved in the production of commercial goods or services, thus requiring relatively higher skilled employees. However, the majority of SME's involved in trade are not familiar either

with foreign trade and customs procedures or with product liability, quality and consumer protection requirements. This can be attributed to two important factors: First, the fact that most developing countries are faced with an underdeveloped segment of small credit banks and credit guarantee institutions that can aid in the development and growth of SME's.

Second, the development of information services and networking that would provide information on products, markets, export requirements, customs regulations, partners (both domestic and foreign) are very poorly developed and when available are very expensive for SME's to afford.

In Tanzania, the characteristics of SME's are no different from that defined by Burns and Dewhurt (1996) above. *A national SME's Workshop conducted in 1999 by SIDO* revealed that most SME's in Tanzania are very small business engaged in survivalist activities (e.g. craft, food vending, fishermen, shops, food processing, textile (batik tie and die), and often involve the owner, some family members and one-paid employee. The owner of the business is usually the only and final decision maker and the controller of the business. These SME's are not engaged in many new innovative practices and rarely show signs of growth.

2.3 Empirical Literature Review

This section of the chapter presents the empirical literature review. It visits studies that have been conducted in the area.

Elhiraika and Ahmed (1998) conducted a research on "The effects of nation policy on the development of the SME's in Côte d'Ivoire". The study focused on the existing efforts in Côte d'Ivoire that were aimed at creating a technical-support infrastructure for the development of

SME's. Thus, the objectives of the study included the need to share know-how on developing and carrying out policies and programs for financing SME's, the need to stress the role of the public and private sectors in creating an environment to foster the emergence and flowering of small business and the need to help coordinate the implementation of action programs for small-enterprise development in several countries.

The justification for their study was that liberalization has created a free-market environment that was more favorable to the private sector and thus there were fears that without support and access to ample resources during the adjustment period, SME's would be unable to succeed. Further, the researchers argued that SME's be an important component of any growing economy and could not be ignored. In their own words, they argue that:

"...small enterprises have to be fostered because of their great potential and value in creating employment, achieving equitable income distribution, alleviating poverty, building up local technological base, promoting participation of vulnerable groups, particularly women, in the development process, providing training ground for entrepreneurial and managerial skills, providing opportunities for use of own capital resources, and acting as ancillaries to large-scale enterprises."

The finding of the study showed that the lack of an appropriate institutional framework and of adequate infrastructures, inadequate financing schemes and inefficient information systems were some of the important obstacles which still hampered the organized development of small enterprises in the region. The study's findings implied that in order to create a sound business

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climate, the government of Côte d'Ivoire had to set up industrial and handicraft zones for SME's and had to give them tax and customs privileges under the investment code. The government had also to take special steps to help the marketing efforts of small enterprises.

Atieno R (2001) on the formal and informal government lending policies of SME's in Kenya. This study assessed the role of formal and informal government lending policies and credit institutions in determining the access of small-scale enterprises in Kenya. The results of the study showed that the limited use of credit reflected the lack of supply, resulting from the rationing behavior of both formal and informal lending institutions.

In the study, Kenya's small-enterprise sector was defined as being all of those businesses that employed 1–50 people. It was estimated that 2.1 million of Kenya's workforce are employed in the sector's 912 000 enterprises. The sector was seen to be growing at an impressive rate. In 1993, for example, it grew 20%; the large-enterprise sector, on the other hand, recorded a 2.3% growth in the same year. The implication of these growth rates was that in the foreseeable future, small enterprises would employ three out of every four people looking for a job in the nonagricultural sector of the economy. In addition to its importance in job creation, the small-enterprise sector contributed 33% of the value added in manufacturing and the retail trade in Kenya. The study concluded that given the established network of formal credit institutions, improving lending terms and conditions in favor of small-scale enterprises would provide an important avenue for facilitating their access to credit.

2.4   Conclusion

Although SME's are an important component of any growing economy and should not be ignored, existing fiscal policies fail to support their sustained contribution towards economic development. Instead, many governments in African countries are seen to support large foreign companies by providing them with fiscal incentives such as tax holidays and lower taxes than SME's. In addition, there exist limited institutional frameworks and adequate infrastructures such as adequate financing schemes and inefficient information systems that would support the growth of SME's.

The empirical literature review supports the theories detailed above in that tax cuts leave more disposable income in the hands of not only households but also companies. A lower rate of corporate tax and other business taxes stimulates an increase in business fixed capital investment spending. If planned investment increases, the nation's capital stock can rise and the capital stock per worker employed can rise. In addition, an investment tax credit temporarily lowers the cost of investment projects causing firms to schedule their spending so as to take advantage of the tax credit

Although numerous studies have been conducted in various countries to determine the impact of taxes on the performance of corporations, very little work has been done in the area of SME's. Thus, one significant factor of this study is its contribution of knowledge in this area and in particular in Tanzania.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

This chapter presents the research methodology and procedures that were used in conducting the study. *Solomon et al (1997)* define research methodology as a "plan of attack" that best meets the needs of the defined problem.

3.1 LOCATION OF THE STUDY

The study was conducted in Mazombe Divis ion-Kilolo District Iringa Tanzania. This is because in Mazombe Division, there are large incoming number of SME's, due to the fact that the place is located in the Dar Es Salaam- Mbeya Highway and also easy of availability of the information to the researcher.

3.2 POPULATION SAMPLE AND SAMPLE SIZE

The study included 50 SME's, which were randomly selected in Mazombe Division. The researcher mapped the Division into in its various wards randomly and not in alphabetical order and randomly chose the all the wards and selecting the villages. This was done by selecting a village each ward. The outcome of this exercise gave the researcher the following villages namely: Imalutwa, Ilula Mwaya, Mazombe, Image, Ruaha Mbuyuni, Ilula Itunda, Irole, Uhambingeto, Ikuka, Muhiliwa, Lundamatwe, Lugalo and Mbigili.

The researcher chose three SME's from each village except from Ilula Mwaya and Ilula Itunda where the resecher took four SMEs due to the fact that the two villages have a bigger number of SMEs. This was done by using the method of availability of the owners of the business and the life time the SME has survived in the market. If the owners of a business were not available, the researcher moved on to another SME. This exercise was repeatedly done in all the villages until the researcher reached the required number of 3 SME's in a village. The exercise took the researcher a period of 16 days to gather data from SME's.

3.3   RESEARCH INSTRUMENT

The study used questionnaires to collect the primary data used in the research. The questionnaire included both open and closed ended questions. The researcher visited three (3) SME's in a day administering a questionnaire to the available owner. The respondent was required to fill the questionnaire in the presence of the researcher. All respondents were assured of confidentiality.

3.4 DATA ANALYSIS

A codebook was constructed from the questionnaire. The responses in the questionnaire were then extracted, coded and entered onto a coding sheet. This information was later fed into a computer and the data was analyzed using the Statistical Package for Social Scientists (SPSS).

The analysis involved descriptive statistics such as frequencies and percentages. Cross tabulations of the data were conducted and the hypotheses were tested using Pearson Correlation analysis and its level of significance.

3.5   SOURCE OF THE DATA

Secondary data was also used in this study. This data was collected from various sources such as Iringa University College (IUCO) library, Internet and the Tanzania local newspapers.

CHAPTER FOUR

PRESENTATION OF RESEARCH FINDINGS

4.1   INTRODUCTION

This chapter provides the research findings as collected from the field.   It begins by first presenting general information, followed by data collected in order to test the research hypothesis.   The discussions and conclusions drawn from the results are discussed in Chapter Five.

4.2   GENERAL INFORMATION

There was a 100% response rate and no questionnaire was returned unanswered.   Out of the total sample of 50 SME's operators, 58% indicated as being female and 42% as being male.   The data collected also showed that 40% of the respondents had a secondary education, 24% were diploma holders, 16% had a primary education, 12% had obtained a vocational training and only 8% were degree holders.   The average monthly earnings of the SME's including in the study were Tsh208, 000.   The type of SME's, included in the study ranged from food processing, textiles and garments, restaurant, handcraft, biogas technology, and carpentry.   This is shown in Table 2 below.

Table 2:   **Types of Business**

Types of Business	Number of responds	Percentage
Food Vending	28	56
Food Processing	10	20
Handcraft Business	6	12
Textiles and Garments	4	8
Others	2	4
Total	50	100

The mandatory types of payments that SME's are required to pay range from VAT, company tax, license fees, PAYE and NSSF as shown below.

Figure 1:   **Ranking of tax burden on the business**
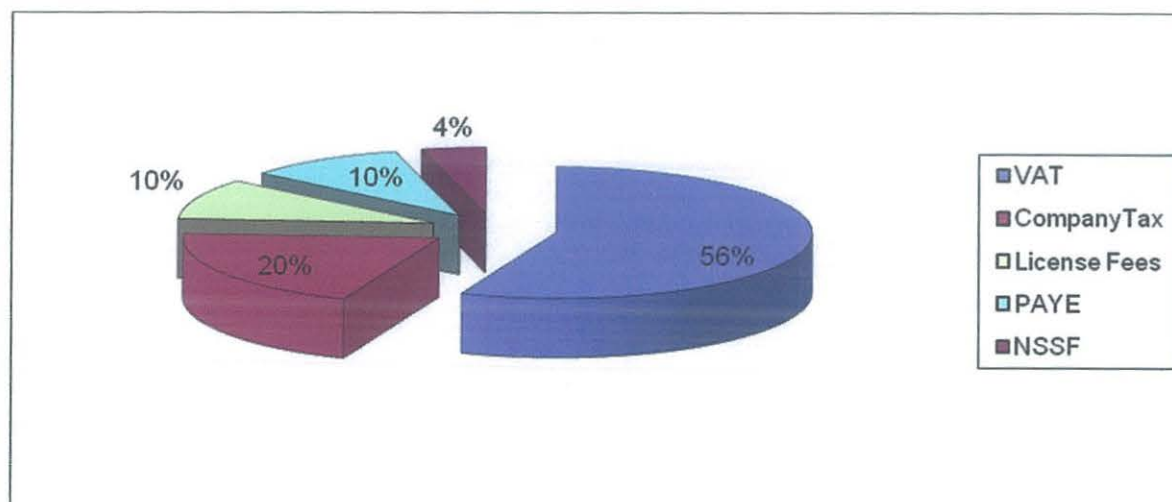
Approximately 56% of the respondents indicated that VAT was the most expensive form of payment that their businesses had to make. This was followed by company tax, license fees and

PAYE contributions. Four percent of the respondents indicated that NSSF was the least expensive mandatory payment their businesses made.

The results also revealed that 40% of the respondents started their businesses with capital from friends and family, 28% from Commercial Banks, 16% from Formal Micro-Financing Institutions, 8% from personal savings and another 8% from other sources such as informal Micro-Financing.

Approximately 47% of SME's owners interviewed indicted that they had experienced some form of growth in either increase in the number of laborers, increased stock and increased capital (capital was defined as the purchase of new equipment worth more than Tsh500,000) in the last 5 years.

4.3 Testing of the hypotheses

This section attempts to test the various hypotheses of the study. It uses primary data collected by the researcher.

4.3.1 A high company tax structure does not have a negative impact on the growth of SME's

Out of 50 respondents who were asked the question whether they considered the current level of company tax structure to be high and does not have a negative impact on the growth of their businesses, 94% responded that the current company tax structure is too high thus affecting the performance of their business. This is presented in the Table below.

Table 3:   High company tax structure

Taxes too high?	Number of respondents	Percentage
Yes	47	94
No	3	6
Total	**50**	**100**

Only 6% felt that the current tax structure was not too high and did not in any way affect the performance of their business.

To further test the first hypothesis, the researcher also asked the respondents to rank their perception of the degree of inconvenience of the current company tax structure on the daily performance of their businesses in terms of too high, fair or too low. Thus, in this case, if the respondent chose the option of too high, this indicated that the respondent viewed the current tax structure as being a major setback in the daily operations of their business. Similarly, the converse held true for too low, which indicated that the respondent felt that the current tax structure was not a major setback in the daily operations of their business. A response indicating fair indicated that the respondent sees no significant impact of the current tax structure on the daily performance of the business.

Figure 2:   **The degree of inconvenience of company taxes**
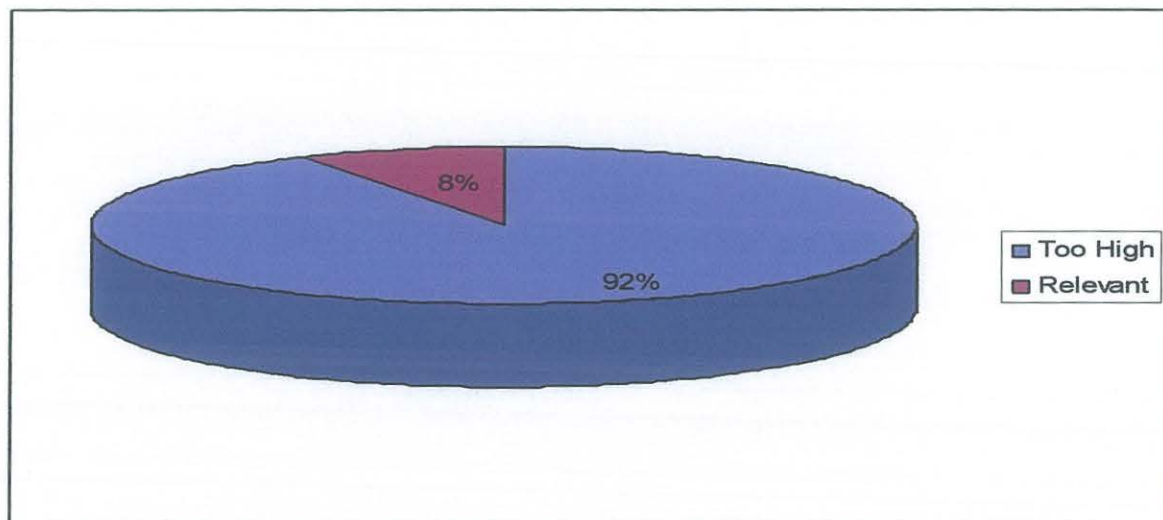
The results are presented in Figure 1 above. According to the results, 92% of the respondents indicated that the current company tax structure was too high and affected the daily operations of the business. Only 8% indicated that the current company tax structure was fair and the government was justified in setting the current company tax structure. There was no respondent who indicated that the current company tax structure is too low.

From the above findings, the researcher rejects the null hypothesis and accepts the alternative hypothesis that a high tax structure has a negative impact on the performance of SME's in Tanzania.

4.3.2 The compulsory contributions made to the government by the SME employers do not have a negative impact on the growth of SME's

In order to test the second hypothesis, the researcher posed the following question: Does the current employee contribution (NSSF of 10%) have a negative impact on the daily performance of your business? In response to this 72% indicated that the current NSSF contribution of 10% made on behalf of their employees was not too high and did not affect the daily operations of the business. The remaining 28% felt that the current NSSF contribution by employees was too high and affected the performance of the business.

Table 4:   High employee contributions

Contributions too high	Number of respondents	Percentage
Yes	14	28
No	36	72
Total	**50**	**100**

From these findings, the researcher accepts the null hypothesis that state compulsory contributions made to the government on the employees' behalf by SME's do not have a negative impact on the growth of SME's in Tanzania.

4.3.3 The compulsory license renewal fees for operating do not have a negative impact on the growth of SME's

In order to test this hypothesis, the researcher asked the respondents to whether the compulsory annual licence operating renewal fees had a negative impact on the growth of SME's. The results showed that 38% of the respondents agreed that the compulsory annual licence operating fees did have a negative impact on the growth of their business. 36% of the respondents said it does not apply. This means many of the SME's are not registered and therefore the compulsory licence renewal fee does not apply to their business operation. The remaining 26% indicated that the compulsory annual license fees did not have a negative impact of their growth of their business as indicated in Table below.

Table 5:   High renewal license fees

Response	Number of respondents	Percentage
Yes	19	38
No	13	26
Does not apply	18	36
Total	**50**	**100**

In order to further test this hypothesis, the researcher asked the respondents whether their businesses would perform well financially if the annual license-operating fees were cancelled. The results indicated that 100% of the respondents agreed that their businesses would perform well financially if the annual license-operating fees were cancelled.

From the research results, the researcher rejects the null hypothesis and accepts the alternative hypothesis that the compulsory annual license operating renewal fees have a negative impact on the growth of the SME's in Tanzania.

4.3.4 The current VAT structure does not have a negative impact on the growth of SME's

In order to test this hypothesis the researcher asked the respondents if the current VAT structure has a negative impact on the performance of the daily operations of the business. The response to the question showed that 80% of the respondents felt that the current VAT structure has a negative impact on the performance of the business. Only 20% of the respondents indicated that the current VAT structure does not have any negative impact on the daily performance of the business.

Table 6: **High VAT structure**

Response	Number of Respondents	Percentage
Yes	40	80
No	10	20
Total	**50**	**100**

From these results, the researcher ejects the null hypothesis and accepts the alternative hypothesis that the current VAT structure has a negative impact on the growth of SME's in Mazombe Divisison and Tanzania at large.

4.4 DISCUSSION OF THE FINDINGS

The researcher had some assumptions prior to undertaking the actual research. These assumptions were stated in terms of hypotheses. The findings, which have been obtained from the analysis of data collected, enabled the researcher to verify the assumptions made in the study. In this chapter, the researcher substantiates the hypothesis initially formulated with the respective findings.

Discussion of the findings of the hypotheses

This section provides a discussion on the findings of the results.

4.4.1 A high company tax structure does not have a negative impact on the growth of SME's

This study aimed at determining whether the current company tax structure does have a negative impact on the growth of SME's. The results showed that majority of the SME's have responded as paying a high direct company tax that has had a negative impact to their possible growth. From the general findings the research observed that the average monthly income of an SME in Mazombe Division was TShs 208,000. Thus, the average company tax at the flat rate of 20% that an SME would have to pay is approximately TShs 500,000 per annum.

This current tax structure of a flat rate of 20% levied onto SME's whether they realize a profit or not, adds on to the cost structure of SME's because they do not have the financial and human capacity to develop sophisticated tax avoidance strategies. As a result, many SME's do not

register themselves as established organizations. In this case, the possibilities of expanding and growing as a business entity are hindered.

The current tax structure in Tanzania favors large corporations. These corporations pay tax on the amount of profit made. In cases of a loss, they are liable to tax payments. This is unlike the tax structure of SME's. The researcher argues that if the current tax structure were to change and resemble that of large corporations, then perhaps more SME's may grow.

In addition to the unfavorable flat tax structure that SME's are faced with, the Tanzania Revenue Authorities (TRA) representatives who collect taxes are in more cases than not, not honest enough to tell the business owners the exactly amount owed to the government as tax. In many cases, TRA representatives have been found making extra earnings by over-charging SME owners. This argument can be validated by the fact that the study observed that most of the SME owners are females (58%) and hold only a secondary school education of Form 2. Generally it is argued that females are easily intimidated and thus it is assumed that TRA representatives may take advantage of them. Similarly, the poor educational background, of most SME owners entails that they are able to ask questions relating to tax payable. In addition, their average monthly income does not also allow them to hire experts to deal with the TRA officials.

4.4.2 The compulsory contributions made to the government on the employees' behalf by SME's do not have a negative impact on the growth of SME's

The hypothesis aimed at investigating the contributions to the government on employees' behalf made by SME's. The findings of the study showed that the current contribution made by SME's of 10% towards NSSF does not affect the daily operations of the business. According to the general findings of the study, a large number of SME's (56%) were into food vending famously known as "mama ntilie". In most cases, these SME's do not have formally registered employees who are liable for NSSF contributions. This is because most SME's in Tanzania are not formally registered with the appropriate authorities. Further still, the employees working in these SME's are not fully aware of their rights that their employer is mandated by law to contribute 10% of their gross earnings towards their pensionable pay.

4.4.3 The compulsory annual license operating renewal fees do not have a negative impact on the growth of SME's

The aim of this hypothesis was to evaluate the impact of the annual license operating renewal fees on the performance of SME's business. The results showed that the compulsory annual license operating renewal fees have a negative impact on the growth of the SME's. Majority of the respondents agreed that the compulsory annual license fees have negative impact to the growth of their business. The result signifies that SME's are paying high compulsory annual license operating renewal fees that erode their profit they make from the operation of their business. It is the roles of the government to look again on the payment SME's are required to

pay. The capital of SME's should be known that to enable the government to know how much to charge them.

This brings to the conclusion that the growth of SME's is greatly affected by the taxes charged on them. In order to move taxpayers from the shadow economy onto the tax role, or to bring registered but non-compliant taxpayers current in their tax obligations a tax amnesty program can be considered. Depending on the nature of the amnesty program, taxpayers may be forgiven for past non-filing or non-payment of taxes, have all penalties and/or interest waived, or be exempted from prosecution for past tax crimes. Experience has shown that amnesty programs are most effective if well revealed, not repeated, and followed by strict enforcement measures for taxpayers who don't take advantage of the program and remain noncompliant.

The researcher found that food vending and other micro-enterprises are very small businesses, often involving only the owner, some family member(s) and, at the most, one or two paid employees. For practical purposes, the SME fiscal policy makes the convention of establishing a limit of 5 employees for considering a firm as a "micro -enterprise". These firms usually lack "formality" in terms of business compulsory annual license operating renewal fees, formal business premises, operating permits and accounting procedures. Most of them have a limited capital base and only rudimentary technical or business skills among their operators. However, many food vending activities and other micro-enterprises advance into viable small businesses. Earning levels of micro-enterprises differ widely, depending on the particular sector, the growth phase of the business and access to relevant support.

4.4.4 The current VAT structure does not have a negative impact on the growth of SME's

Respondents were asked if the current VAT structure have a negative impact on the growth of their business. The researcher found that 80% of the respondents revealed that the current VAT structure does not have a negative impact on the growth of their business. From the general observation, majority of the SME's are female and their level of education is only secondary school. They are not registered and hence they don't get the benefit of VAT which is returned to the registered business.

This brings to the conclusion that exemption from VAT registration and filing based on threshold amounts proscribed by law. However, SME's with turnover under the threshold amount may be permitted to opt into VAT, which seems to be the burden to the growth of their business. The researcher found that it could be supportive to the growth of SME's if the government could take into consideration the presumptive from VAT based on the size, location, and type of business activity for small enterprises as the means to enable SME's grow and reduce the burden of paying VAT and also to educate the SME's the importance of VAT to the growth of their business.

Services provided by food venders are mainly directed at domestic consumption, but may also affect distribution of products within the country and if the current VAT structure may not be changed quickly. Possible distortion as regards food vending services is likely to be different in magnitude in the country and the degree of possible substitution of holiday destinations plays an important role. As far as the business consumption of these services is concerned, the rules on VAT deductibility may also impact on the functioning of the internal market.

From a purely technical point of view, it should be borne in mind that the level of a VAT rate – by its very mechanism – can only have an impact on purchases by final consumers. It will only indirectly affect the behavior of business, and other actors that dispose of the right to deduct VAT. Again it must be noted that most of these SME's are not registered and thus cannot claim for VAT exemption.

The government should use a "flat rate scheme". Within this scheme, SMEs will be able to calculate their VAT liabilities as a percentage of their turnover and avoid having to internally account for VAT on all of their purchases and sales. The scheme would be designed to generate broadly the same amount of VAT payable, but would be simpler to use.

4.5   VALIDATION OF THE HYPOTHESIS

SME's should be given special promotions to enable them expand. This can be done through the support of Business Development Services (BDS). The presence of BDS helps in lobbying against policies that are detrimental to the growth of SME's. In addition, BDS can provide support services such as micro-finance, access to markets, extension services, entrepreneurial skills (on good record keeping, risk and financial management), networking and aid in group formation of SME's facing similar challenges.

Special promotional measures should include:

i. Appropriateness of existing and proposed legislation and regulations in the fields of taxation, land use, tendering procedures, training requirements, health and occupational conditions and how they can be made more suitable for SME's.

ii. Simplification and standardization of documents, including business registration and licensing; loan applications; purchasing, sub-contracting and tender documents; export documentation and other commercial documents; registration of contracts; simplified tax return forms for SME's;

iii. Need for regulations to strengthen small enterprises in their access to raw materials and other inputs controlled by monopolistic suppliers.

iv. Steps taken by local authorities to reduce restrictive and up hazard regulatory policies.

v. Facilitation of feasible avenues of legal assistance that could help leveling the legal playing fields for SME's, with particular attention to women and young entrepreneurs.

vi. Support all steps aimed at improving the court system, with special consideration to the introduction of a small-claims-court system with outlets spread all over the country, even in small towns and villages.

CHAPTER FIVE

SUMMARY, RECOMMENDATIONS AND CONCLUSIONS

5.1 INTRODUCTION

This chapter gives a summary of the research; followed by the recommendations to what the researcher found it usefully to support the growth of SME's in Tanzania. Finally, gives the conclusion of the researcher and measures to be taken to support the growth of SME's in Tanzania.

5.2 SUMMARY

The aim of this study was to access the impact of fiscal policies on the growth of SME's in Tanzania. The study formulated four hypotheses and these hypotheses were tested using data collected from SME's based in Mazombe Division-Iringa. The data was collected from a sample size of 50 SME's using a researcher administered questionnaire. The sample size was selected using the method of stratified random sampling design. The data collected was edited and later coded and the analysis was done using SPSS.

The results of the study showed that:

i. The current company tax structure does not favor the growth of SME's in Tanzania.

ii. Employee contributions by SME's does not in any way affect the growth of SME's.

iii. The renewal fees for operating licenses affects the growth of SME's in a negative way. This is especially true for those SME's that have been legally registered.

iv. The current VAT structure does not support that growth of SME's in Tanzania. This is because a number of SME's are not legally registered and therefore, are not liable for VAT exemption.

From the above findings, the study recommended in Chapter Five that there should be active involvement of BDS, the government through TRA and other stakeholders in promoting the growth of SME's.

5.3 POLICY IMPLICATION

From the discussion in previous sections it can be realized that, the promotion of SME's for the future development is very important. The study has drawn the following policy measures that need to be addressed by the Government of Tanzania as well as TRA as a functional entity of the government and SME's.

First, the study suggests that the government should:

i. Be aware of the impact of taxes on the SME sector which depends largely on whether the taxes levied are direct or indirect. Direct taxes erode profit thus minimizing re-investment, working capital and savings. Also exceptions from duties on imported inputs for foreign

investors create stiff competition for locally produced inputs. Taxation may prevent vertical expansion of SME's and their integration with the larger corporations to achieve given objectives such as income distribution, employment creation, transfer of technology, and market expansion.

ii. Ensure the establishment of a legal and fiscal framework which will allow SME's to operate in a conducive environment that will foster growth and development. The Government must initiate the incentives and environment needed to stimulate SME development, and must set up appropriate policies (financial, fiscal), which are a basic factor in determining economically and financially sustained SME's.

iii. Be responsible for providing basic education and skills through training to guarantee an adequately trained and skilled labour force to meet the need of the various sectors of the economy. This could be done through the empowerment of BDS and Non Governmental Organizations (NGO's).

iv. Distribute information on programs and schemes for regional development, information on how to promote exports and transparently reveal to all SME's the incentives in place to support exports by SME's.

v. Help to forge links between enterprises and the research and technological development being undertaken in institutions of higher learning and public financed research centres.

vi. Carry out research to determine the impact of its fiscal policies on the growth of SME's and the findings should aim at formulating policies that reduce the tax burden on the affected. This may help reduce tax evasion.

vii. Through the local government re-think on lowering the compulsory licence renewal operating fees. Further, the bureaucracy for licensing procedures should be reduced and all activities and procedures to obtain a licence should be in one place.

viii. Create tax incentives to large firms and the banking sector to stimulate subcontracting and greater volumes of loans to small enterprises.

Second, the study suggests that TRA as a functional body of the government should:

i. Educate people on taxation regulations and procedures.

ii. Establish good relationships between tax collectors and taxpayers.

iii. Allow for a grace period for all business start-ups, which must be honored at all times.

iv. Officials of the TRA are focused solely on immediate revenue generation through taxation. They are interested in enforcement at all costs. TRA's intention is to have a system that is open, fair and transparent but the reality, from the perspective of the small business owners, is just the opposite.

v. Attempt to bridge the gulf of understanding between the administration of tax by the officials of the TRA and SME owners that pay the taxes. Currently, the officials of TRA and entrepreneurs live in two different worlds.

Third, the study suggests that SME's should:

i. Fully be educated on the SME's process of how taxes actually lead to the economic growth. This is because many SME's do not see any connection between the taxes they pay and the net benefits that accrue to their local communities.

ii. Know that the taxation process is not an arbitrary, open to negotiation, nor does it have any hidden or direct methods of coercion. Thus, TRA officials are entitled to solicit bribes.

iii. Be able to contest tax rulings through the office of the commissioner of income tax.

5.4 SUGGESSTED AREAS FOR FURTHER RESEARCH

The following areas have not been taken care of by the current study and are worthy of further research:

i. The role of BDS on the growth of SME's.

ii. The impact of tax incentives on lending institutions on the performance of SME's.

iii. The impact of government spending on the performance of SME's.

5.5 CONCLUSION

This study sought to assess the impacts of fiscal policy on the growth of SME's in Tanzania. Basing on the findings of the study, and analysis presented in Chapter Four it is clear that fiscal policies pursued by the government do not in the least support the expansion and growth of SME's in Tanzania.

The findings of the study imply that for as long as fiscal policies will be formulated in isolation of SME's

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QUESTIONNAIRE

1. Name...

2. Sex   Male ☐   Female ☐

3. How long have you worked for the organization?

       1-5 years   ☐

       6-10 years   ☐

       11-15   years ☐

4. Does the current company tax structure foster the growth of SME's development in Tanzania?..

....

5. Does the current practice of employer contributions towards NSSF of 10% foster the growth of SME's development in Tanzania?

....

....

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6. Does the current compulsory payment structure of annual license operating fees foster the growth of SME's development in Tanzania?

....

....

7. Does the current VAT structure foster the growth of SME's development in Tanzania?

....

....

8. Which fiscal policies have an impact on SME's in Tanzania?

....

....

9. What is the impact of the company tax structure on the performance of SME's in Tanzania?

....

....

10. What is the impact of various legal payments such as land rates and (National Social Security Fund) NSSF employee contributions on the performance of SME's in Tanzania?

....

....

11. What are the policy implications from the findings of the impact of fiscal policies on SME's in Tanzania?

....

TIME PLAN:

CTIVITY	JAN	FEB	MAR	APR	MAY	JUN	JULY	SEP	OCT	NOV	DEC
asibility udy	***	***									
oposal riting		***	***	***							
ibmission the oposal					***						
ata ollection						***	***				
ata nalysis							***	***			
Moderating f research roject									***	***	
ubmission f inal report											***

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BUDGET

The funds are provided for by the researcher with the help of the parents.

Item	Amount (Tshs)
Internet	20000
Transport	20000
Photocopying	5000
Binding	30000
Stationery	28000
Secretarial services	25000
Miscellaneous expenses	22000
Total	150000