

# WHY DO INFORMAL SMALL-SCALE ENTERPRISES STAY INFORMAL? ESTIMATING COST OF DOING BUSINESS IN TANZANIA

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## ABSTRACT

*The paper is based on a study that estimated comparatively the cost of doing business in sixteen food vending ventures in informal and formal sectors in Tanzania. It is argued that the high cost of doing formal business, which entails registration and sustaining formalization, encourages informality. Case study method allowed in-depth inquiry into actors' viewpoints on the cost of doing business. Systematic within and cross-case analysis provided range and mean values of resources deployed in starting and sustaining formalization of business in terms of time, effort and money. Wide variations in monetary cost and time spent by entrepreneurs were found. Cross-case analysis provided a range of between 3 weeks and 8 months for registration and 11 and 41 hours annually for the cost of sustaining formalization. Monetary cost of doing business ranged between US\$89 and \$562 annually. On the other hand, the time cost of doing informal business ranged between 192 and 360 hours per annum, while money cost ranged between US\$6 and \$282. Bureaucratic gridlock, "hidden" or "informal" costs of doing formal business embedded in societal norms, fear to expose wealth in community, and poor non-consequential enforcement, are the qualitative constraints that raised the cost of doing business in Tanzania.*

## Introduction

The purpose of this paper is to answer the captioned question through estimating and comparing 'broad' transaction costs (or cost of doing business) in informal and formal food vending enterprises in Tanzania. Specifically the paper examines the extent to which broad transaction costs may constrain growth of the small business sector. Frame of analysis is informed by the transaction cost theory within the 'new' institutional economics. Broad transaction costs or cost of doing business entails not only registration,

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but also the sustenance of formalized business, which includes renewal of licenses and permits, meeting health inspection and environmental requirements. Cost of doing business or broad transaction costs includes not only the money cost, but also time spent to comply with rules and regulations, which determine entrepreneurs' opportunity cost of doing business in small enterprises.

The paper is based on a study conducted between 2004 and 2005 under the auspices of the African Institute for Capacity Development (AICAD). The reference study focused on understanding the extent to which the cost of starting and doing business in formal and informal small-scale enterprises constrains growth of the private sector. The study sought to find out why do small-scale entrepreneurs in Tanzania choose to remain informal and, in particular, to what extent do the market transaction costs constrain formalization of the informal food vending enterprises. The in-depth exploratory nature of the research focus pointed to the need and advantage of using qualitative research methodology in which case study design was employed. According to Yin (1989:23) a case study as a research strategy is defined as an empirical inquiry that “investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident”. The case study methodology was adopted to capture the “actor’s viewpoint”, or societal contexts and dynamics in regard to nature and levels of transaction costs. A particular strength of case study method is the possibility of combining a variety of evidence from documents, artifacts, interviews, and observations in an in-depth inquiry into a social phenomenon where research interest involves a large number of variables and limited number of cases (Denzin and Lincoln, 1994).

Given the large number of small food preparation and vending enterprises, purposive sampling was used to select sixteen cases of small-scale food preparation and vending enterprises, from both the informal and formal (restaurants) sub-sectors in Morogoro and Ilala Municipalities. Systematic within and cross-case and content analysis was carried out, which involved event description, cross-case summary of common critical incidents, estimation of average values of resources deployed in operations (time, money and energy). Constraints to business start-up and operation were also examined.

Rationale of the reference study was underlined by the central issue in the current economic reforms, which is how to create an enabling business environment in which the private sector expands to cover the entrepreneurial space created by the privatization of the state-owned enterprises and market oriented policies. The ultimate policy goal of the study was to contribute to the ongoing Tanzanian government endeavour to tap the enormous potential of the informal sector for economic growth and poverty alleviation.

After this introduction, the paper is structured into six main sections. Section one presents a synopsis of the background of doing small business in Tanzania. The background is followed in section two by theoretical and analytical framework of the paper. Section three presents a profile of food vendors in Morogoro and Ilala Districts in Tanzania, while section four presents a comparison of the cost of doing formal and informal business. Perceptions of entrepreneurs and policy makers about the constraints of doing small business are discussed in section five. Section six discusses policy implications followed by a conclusion.

## **The Background of Doing Small Business in Tanzania**

A central strategic concern in Tanzania is the need to eradicate poverty through empowerment of people for self-development and the informal sector is an important part of the equation. Palmade (2005) defines informality more broadly to include output and workforce of non registered firms as well as the non reported activities and workforce of registered firms. Schneider (2005) estimated that the size of informality in Tanzania as percentage of GDP increased from 58.3% in 1999 to 60.2% in 2003. Excluding traditional (peasant) agriculture, the informal sector employs about 55% of the total labour force in Tanzania (URT, 2003). The small-scale enterprise sector is particularly important in urban areas where urbanization rate is about 8.5% per annum. It is also estimated that by year 2025, over 55% of the Tanzanian population will be urbanized (ILO, UNIDO and UNDP, 2002).

There are three categories of small businesses in Tanzania; formal, informal and semi-formal enterprises. Formal small-scale enterprises are those legally registered and licensed by either the central or local governments, and their workforce and output are accounted for in the national income. Informal enterprises are neither legally registered nor accounted for in the national income. The third category of enterprises, the semi-formal, is neither formal nor informal. Business permits for these enterprises are usually issued by local government authorities under the Human Resource Development Act of 1987. The Act provides for limited legal status for micro enterprises which are too small to warrant a normal business license issued by the Ministry of Industry and Trade. The semi-formal enterprises are locally known as 'nguvu kazi' (literally meaning work that requires physical sweating) and connote mainly use of human physical energy to do own

business involving menial activities. The semi-formal entrepreneurs are intermittently harassed by the very local government officials that issued them with licenses.

The Roadmap Study of the informal sector in the Mainland Tanzania analyses two categories of constraints hindering enterprise development in the informal sector; regulatory constraints and non-regulatory or operational constraints. Regulatory constraints include labour legislation, employee benefits and rights, and locational related factors including acquisition of land, site development, utility connections, and environmental laws. Other regulatory constraints are reporting requirements which include registration, licensing, taxes, duties and property rights. Non-regulatory or operational constraints include availability of public utilities and infrastructure (water and sanitation, telephone, roads and power); public information (rules and regulations) and private information (advice, investment opportunities, market situation for inputs and products); and financing (ILO, UNIDO and UNDP, 2002).

In order to remain legal the law requires all businesses to pay a variety of annual taxes and levies at national and local government levels. The Tanzania Revenue Authority (TRA) collects taxes and duties on behalf of central government, and the local government authorities (LGAs) collect local taxes, fees and dues for their operations. Local government taxes are fixed by the local authorities and cover various areas including property tax, environmental charges, premise levies and cleaning charges. Over time, however, measures have been introduced by the TRA to reduce the burden of taxation on the small tax payers who are mainly in the informal or semi-formal sub-sectors (ILO, UNIDO and UNDP, 2002).

The small tax payers or informal and semi-formal entrepreneurs are, however, required to pay taxes up-front in quarterly installments, amounts which for micro investors may just equal their capital. Typical taxes, fees and charges levied by local government authorities include garbage collection fees, property tax, sanitation fees and tree planting fees. Most of these charges are viewed as ‘nuisance’ taxes by the entrepreneurs.

Business locating constraints were also reported as ‘nuisance’ constraints in the informal sector Roadmap Study. Entrepreneurs experienced severe difficulties in securing physical space on which to do business. Since permanent premises are a requirement for business licensing, formalization is constrained and creates a ground for corrupt practices. The problem is most acute for sectors such as food processing and carpentry (ILO, UNIDO and UNDP, 2002).

Entrepreneurs have to go through three stages in formalizing a business; business name registration, business licensing, payment of taxes and fees. The Roadmap Study case studies of simulated attempts to register a business indicated a complex process requiring 25-27 steps through 5-7 agencies and offices. The Road Map Study found out also that costs of registration for entrepreneurs from regional headquarters were 6-7 times higher than in Dar es Salaam. The higher cost includes traveling and accommodation in the capital city where the national registration office (BRELA) is located. Plans are underway, however, to open BRELA zonal or regional offices.

According to the informal sector Roadmap Study, formalization of food vending business in Tanzania required the entrepreneur to go through 23 activities in various agencies and

offices. Information on the activities and the process flow is not usually known formally in advance by the food vendors. It is known only after completing each particular step. The Roadmap Study found out that the complexity of the procedures and the ignorance of the entrepreneurs creates conditions for rent-seeking and exploitation of the latter (ILO, UNIDO and UNDP, 2002:30).

### **Conceptual and Theoretical Framework**

Formal and informal Small-Scale Enterprises (SSEs) in countries like Tanzania are important because they create more jobs at lower costs than large enterprises and they meet local demand of appropriate goods at affordable prices. The requisite managerial skills are less sophisticated and hence commensurate with limited managerial capacity. Widespread ownership in small businesses entails more equitable distribution of income. Small-scale enterprises are also relatively less destructive to the environment (Engelmann, 1994:73).

Informal enterprises are units engaged in the production of goods and services, which are not constituted as separate legal entities independently of the individuals or households that own them. They do not have a complete set of accounts which would permit a clear distinction between the production activities of the enterprises and other activities of their owners (ILO, UNIDO and UNDP, 2002:16).

According to Douglas North (1990) institutions entail rule structure or “rules of the game” in society that are humanly devised to constrain and shape human interaction. Together with technology employed, institutions determine the transaction and

transformation (production) costs that make up total costs. The major role of institutions in society is to reduce uncertainty by establishing a stable structure to human interaction.

Transaction costs consist of three main elements: cost of measuring the valuable attributes of the object of exchange given information asymmetry between exchanging individuals; cost of monitoring and protecting property rights; cost of integrating dispersed knowledge; and cost of enforcing agreements (North, 2005). Enforcement could involve second party retaliation, internally enforced codes of conduct, societal sanctions, or a coercive third party such as the state (North, 1990:31).

The link between institutions and transaction costs reflects, therefore, the overall complex economic institutions (formal and informal) that make up an economy. Institutions in countries like Tanzania lack effective formal structures and enforcement mechanisms, which are important for markets to be efficient and, above all, for creating an enabling environment for entrepreneurs. Transaction cost per exchange in poor economies is higher than in developed economies. In the case of Tanzania the institutional framework prior to the economic reforms initiated in 1986 constrained development of formal small businesses. This led to the development of a lucrative informal sector or underground economy. The rationale for the current policy reforms is, inter alia, to rectify this institutional framework.

The link between the ongoing economic policy reforms, institutional reforms and transaction costs in Tanzania, as summarized in figure 1 below, was triggered by the economic crisis of the early 1980s. The crisis was characterized by low productivity and



declining growth that led to fiscal and balance of payments crises, hyperinflation, debt crisis and drastic deterioration of social services. The economic crisis unfolded within an international context characterized by shifts in development paradigm and ideology that necessitated economic policy reforms. The economic policy reforms entailed reforms in the public and private sectors, fiscal, financial and economic stabilization. Most of the reforms, however, needed institutional reform (regulations, norm structure, organization and enforcement) that in turn influenced transaction costs in terms of realigning incentives and constraints to doing small business. Distorted incentives and constraints led to varied outcomes including intensification of informal and formal small scale enterprises and hence determined performance of the enterprises, including start-up failure. The central argument in this paper is that distorted institutional incentives and constraints have motivated entrepreneurs' choice to remain informal. A different mix of incentives and constraints may be needed to motivate entrepreneurs towards formalization. In-depth understanding of entrepreneurs' viewpoints is therefore critical. Figure 1 below summarizes the described link between economic policy reforms, institutional reform and transaction costs.

*Source: Adapted from Nkya, E.J. (2003), p56*

## **Profile of Food Vending Enterprises and Entrepreneurs**

The first stage of analysis in the reference study provided profiles of food vending entrepreneurs and their enterprises. The first stage analysis was important for providing a context within which entrepreneurs' perceptions and factual data could be analyzed. The in-depth interview with entrepreneurs in sixteen case studies of both formal and informal food vending enterprises in Morogoro and Ilala (Dar-es-Salaam) municipalities in Tanzania provided the following main characteristics of the enterprises and their entrepreneurs:

i. *A wide range of monetary characteristics of the enterprises*

In the formal enterprises there was a wide range in the levels of operating capital (\$60 to \$1400), monthly revenue (\$216 to \$3600) and profit (\$36 to \$1000). In the informal enterprises the range was also wide for operating capital (\$10 to \$948), monthly revenue (\$50 to \$1200) and profits (\$6 to \$250). Operating capital was larger for Dar-es-salaam enterprises. Variations within these cases were, however, large for both small and large enterprises.

ii. *Predominance of men in formal enterprises and women in informal enterprise*

All but one of the entrepreneurs in the formal food vending enterprises were males while most of the entrepreneurs in the informal enterprises (6 out of 8) were females. Predominance of women in informal small scale enterprises could be attributed to gender related cultural stereotypes. Most of the entrepreneurs in both formal and informal enterprises were in their middle ages.

iii. *Levels of education*

Most of the entrepreneurs in the formal food vending enterprises (5 out of 8) had attained secondary school education, while primary education was the highest level for most entrepreneurs in the informal enterprises (5 out of 8). It was apparent that in a wider survey education could be hypothesized as a factor and motivation for formalization because some respondents intimated that formalization was an indication they had gone to school.

iv. *Prior unemployment status dominated informal entrepreneurs*

Most of the entrepreneurs in the informal food vending enterprises (6 out of 8) were unemployed prior to starting business, while most of those in the formal enterprises (7 out of 8) had been employed. Again in a wider survey past employment may come out as a factor and motivation for formalization because entrepreneurs would use previous connections to simplify registration and also bid for government tenders, which would tend to lower transaction costs.

Tables 1(a) and 1(b) below provides a summary of the characteristics described above.

*Table 1(a): Profile of Formal Enterprises and Entrepreneurs*

	FORMAL ENTERPRISES								
ITEM	MG1F	MG2F	MG3F	MG4F	DSM1F	DSM2F	DSM3F	DSM4F	Mean
Years in operation	3	7	5	6	10	3	4	9	5.9
Number of Employees	12	3	4	7	8	12	7	10	7.9
Operating Capital (\$)	250	60	1200	440	1000	1030	1500	1400	860
Monthly Rev (\$)	1500	216	1500	600	3600	1800	1800	2200	1652
Monthly Profit (\$)	300	36	600	300	300	270	1000	780	448
Entrepren Sex	M	M	M	F	M	M	M	M	NA
Entrepren Age	Middle Age	39	34	39	38	39	39	42	39
Entrepren Education	SEC	SEC	PRIM	SEC	SEC	UNIV	PRIM	SEC	NA
Previous Occupation	Trade	Unemp	Service	Trade	Transport	Service	Trade	Mfctg	NA

*Table 1(b): Profile of Informal Enterprises and Entrepreneurs*

	INFORMAL ENTERPRISES								
ITEM	MG5N	MG6N	MG7N	MG8N	DSM5N	DSM6N	DSM7N	DSM8N	Mean
Years in operation	5	7	9	1	1.5	2.5	7	5	48
Number of Employees	1	1	1	1	1	1	1	1	1
Operating Capital (\$)	10	15	50	250	948	344	300	350	283
Monthly Rev (\$)	150	170	50	450	637	801	950	1200	551
Monthly Profit (\$)	30	35	6	45	139	195	250	250	119
Entrepren Sex	M	F	F	F	F	M	F	F	NA
Entrepren Age	38	29	29	40	30	30	43	37	35
Entrepren Education	PRIM	PRIM	PRIM	SEC	SEC	SEC	PRIM	PRIM	NA
Previous Occupation	Mfctg	Unemp	Unemp	Unemp	Unemp	Trade	Unemp	Unemp	NA

Key: PRIM Primary education Unemp Unemployment  
SEC Secondary education Mfctg Manufacturing  
UNIV University education Entrepren Entrepreneur  
M Male NA Non Applicable  
F Female

MGF Morogoro 'Formal' Case Studies and Serial Numbers  
MGN Morogoro 'Informal' Case Studies and Serial Numbers  
DSMF DSM 'Formal' Case Studies and Serial Numbers  
DSMN DSM 'Informal' Case Studies and Serial Numbers

## Comparing Cost of Doing Formal and Informal Small Business

### *Cost of Doing Formal Business*

Cost of doing formal business entails registration and sustenance of formalization, which include renewals and meeting inspection requirements for cleanliness, health and environment. The reference study found out that entrepreneurs in formal food vending enterprises were required to move through at least three different offices for the registration process. For example, entrepreneurs in cases MG2F, MG4F and DSM2F had to go through five different offices for registration. This was reflected also in the wide range of registration duration (3 weeks to 8 months). After an in-depth discussion with entrepreneurs in formal (registered) food vending cases, the magnitudes of the cost of doing business in Table 2 below were indicated.

*Table 2: Cost of Doing Formal Business  
(Registration and sustenance of formalization)*

FORMAL CASE STUDIES	TIME COST (Hours)	REGISTRATION DURATION (M=Months, W=Weeks)	MONEY COST (US\$)
MG-1F	15	1M	384
MG-2F	13	4M	256
MG-3F	22	1M	173
MG-4F	17	3W	178
DSM-1F	17	8M	89
DSM-2F	11.5	2M	215
DSM-3F	41	4M	240
DSM-4F	26	4M	562
ALL FORMAL CASES	Time Range 11-41	Registration Duration Range 3W – 8M	Money Cost Range 89 – 562

Key: MG Morogoro Municipality Formal Case Studies and Serial Numbers  
DSM Ilala Municipality Formal Case Studies and Serial Numbers

Data from the above cases indicated a wide range of money cost of doing formal business (\$89 to \$562) and a wide range of the registration duration (3 weeks to 8 months). This is an indication of wide variations in the enforcement of similar regulations in food vending

enterprises, presumably due to corrupt practices and poor enforcement reported during the in-depth discussions with entrepreneurs. Given the limited number of cases, however, consideration of average values would not make sense here.

Reasons mentioned by entrepreneurs as to why they chose to formalize their enterprises (ranked in descending order of importance) were to:

- i. Avoid penalties
- ii. Obtain credit
- iii. Be able to advertise
- iv. Avoid paying bribes
- v. Be able to operate openly and avoid interruptions
- vi. Be able to use courts of law for contract enforcement
- vii. Gain access to new customers and suppliers.

The first three reasons were cited by at least 50% of the respondents.

### ***Cost of Doing Informal Business***

Cost of doing informal business entails sustenance of business through holding informal stakeholder meetings to organize for “self-regulation”, time spent on dodging, and money spent on bribing-off regulatory inspectors. Self-regulation would include activities such as setting norms to regulate behavior among the informal stakeholders. Informal regulations in this study included organizing for “self-help” cleaning around business premises, environmental requirements, agreeing on prices of meals, how to signal incoming inspectors, and organizing how to resist hustling by authorities. After in-depth discussions

with entrepreneurs in informal food vending cases, the magnitudes of the cost of doing informal business is presented in Table 3 below.

*Table 3: Cost of Doing Informal Business (Sustenance of informal business)*

INFORMAL CASE STUDIES	TIME COST (Hours per Annum)	MONEY COST (US\$ per Annum)
MG-5N	24x12m=288	0
MG-6N	16x12m=192	0
MG-7N	30x12m=360	3x12m=36
MG-8N	20x12m=240	23.5x12m=282
DSM-5N	0	.5x12m=6
DSM-6N	0	.5x12m=6
DSM-7N	0	12x12m=144
DSM-8N	0	14x12m=168
ALL INFORMAL CASES	Time Cost Range 0 – 360 Hours	Money Cost Range US\$ 0 – 282

Key: m = month

The data from the above limited number of cases indicate a smaller variation of money cost of doing informal business (\$0 - \$282) when compared with that of doing formal business (\$89 - \$562) in Table 2. Much of the money cost in informal cases entailed payment of bribes and arbitrary charges. However, the informal cases indicated a much wider range of time cost (0 - 360 hours) presumably because of time wasted in trying to dodge enforcement of regulations, frequent temporary closures due to harassment by regulators, and time needed by entrepreneurs to organize themselves for “self-help” activities such as cleanliness.

Reasons mentioned by respondents as to why they chose to remain informal (ranked in descending order of importance) were:

- i. Cumbersome, complex and bureaucratic procedures
- ii. Too costly to register
- iii. Business is too small



- iv. Takes too much time
- v. To avoid taxes, license fees and other charges
- vi. Others operate informally
- vii. Stringent registration conditions.

The first three reasons were cited by at least 50% of the respondents.

## Comparing Perceptions on Constraints

### *Perception on Constraints in Doing Formal Business*

The in-depth interview of entrepreneurs indicated that their formal food vending enterprises were “highly constrained” by the constraints listed in Table 4 below, which were cited in at least 50% of the cases.

*Table 4: Highly Constraining Regulations: Formal Enterprises*

NATURE OF CONSTRAINT	NUMBER OF CASES CITING	MUNICIPALITY CITED MOST
Minimum wage	5 out of 8	Morogoro
Electricity installation*	7 out of 8	Both (Morogoro and Ilala)
Water supply*	6 out of 8	Ilala
Health inspection	4 out of 8	Both (Morogoro and Ilala)
Business registration	4 out of 8	Morogoro
Business Licensing	4 out of 8	Morogoro
Tax collection	4 out of 8	Morogoro
Collateral conditions	4 out of 8	Morogoro
Cost of borrowing	4 out of 8	Morogoro

\* These were production costs unless adversely affected by hustle and bureaucracy in obtaining the service.

### *Perception on Constraints in Doing Informal Business*

The in-depth interview of entrepreneurs indicated that their informal food vending enterprises were “highly constrained” by the constraints listed in Table 5 below, which were cited in at least 50% of the cases.

*Table 5: Highly Constraining Regulations: Informal Enterprises*

NATURE OF CONSTRAINT	NUMBER OF CASES CITING	MUNICIPALITY CITED MOST
Minimum wage	6 out of 8	Morogoro
Minimum age	4 out of 8	All in Morogoro
Water supply*	4 out of 8	In both
Working environment	4 out of 8	In both
Permanent business premise	6 out of 8	Morogoro
Health inspection	6 out of 8	Morogoro
Credit arrangements	4 out of 8	Morogoro
Collateral conditions	6 out of 8	Morogoro
Cost of borrowing	6 out of 8	Morogoro

\* These were production costs unless adversely affected by hustle and bureaucracy in obtaining the service.

### ***Policy Makers Perceptions on Doing Small Business***

In-depth interviews with eight policy implementers as “key informants” were conducted in Morogoro and Ilala municipalities in order to augment, corroborate or verify perceptions of the food vending entrepreneurs. The key informants were informed by their experience in implementing and interacting with the small-scale entrepreneurs. The following insights were distilled from the in-depth discussions with policy makers:

- i. Non-consequential enforcement in informal enterprises may have encouraged informality in food vending activities.
- ii. Regulation enforcers changed their enforcement strategy from moving individually to moving in teams, presumably to curb corruptive practices. However, collusion to collect bribes could not be ruled out.
- iii. “Soft” enforcement (without sanctions) in the informal food vending enterprises was viewed as a problem that encouraged informality.
- iv. Most common factors that were mentioned by the key informants as contributing to informality and thus corroborating information from entrepreneurs were:

- a. Small size (capital) of informal enterprises.
- b. Need to capture “fleeting” opportunities, which if not captured when and where they occur, may never return to the entrepreneur.
- c. High cost of registration and cumbersome procedures.
- d. Need to avoid taxes and other charges.
- v. A new form of informality in food vending was identified where meals prepared in homes were sold in formal public offices.
- vi. Choice of business location by local governments for informal food vendors were found unsuitable by entrepreneurs because were not within entrepreneurs’ market proximity.
- vii. Conflicting regulations in a local government area and non-adherence to master plans.
- viii. Mobile nature of informal food vending enterprises provided effective ways of beating the regulatory system.
- ix. Effective enforcement was constrained by politics, which impaired authority of enforcement agents. For example, “hard” enforcement of regulations that led to evictions and harassment were viewed as “politically incorrect” if they adversely affected a major section of the electorate.

## **Conclusion**

The findings in the reference study were important because research effort focused on understanding and estimating all resource costs and constraints experienced, not only in starting a small business, but also sustaining it through renewals of licenses and other regulatory requirements. The reference study approach and research design were also

important because actors' viewpoints were critical in understanding public policy ramifications. The cost of business registration and sustenance of formalization was indicated in the study as an important factor constraining entrepreneurs' decisions to register their enterprises. On the other hand, deepening and widespread informality in food vending may also signal the need to nurture informality for purposes of alleviating poverty. What is not very clear for intervention, however, is the extent to which the increasing informality emanates either from reluctance to formalize or from the influx of new informal entrepreneurs from rural areas, given the intensifying rural-urban migration. This could be an interesting area of further study that could inform policy making at local level.

The sixteen in-depth case studies indicated that informality in food vending has had a positive effect in decreasing 'income poverty' in the localities studied. Growth of working capital, turnover and profit reported in all the case studies provided that indication. It is also plausible to argue that the positive change in income poverty is enabling the interviewed informal entrepreneurs improve their 'non-income poverty' through enhanced ability to reduce vulnerability to survival threats including access to education, health and nutrition. All that said then, *should informality in micro enterprises be discouraged?*

The cost of business registration and sustenance of formalization was found in this study to be an important factor constraining entrepreneurs' decisions to formalize their enterprises. The findings, therefore, answer the grand question titling this paper.

### **Policy Implications**

Cost of doing business in Tanzania has been changing continuously over the years due to the ongoing economic policy reforms. The status of data used in this study may not,

therefore, reflect the most current situation. In such a situation, policy implications of the results are at best tentative. It is also important to note that qualitative analysis is heavily laden with subjectivity, which could, however, be viewed as resulting from ‘inter-subjectivity’ analysis given that views of various respondents were taken into account. Further, the data obtained through in-depth discussions with respondents indicated that the cost of electricity and water should be considered cost of production rather than cost of doing business.

The following policy implications of findings in the reference study emerged from the in-depth discussions with entrepreneurs and policy implementers. Some of these implications could also be framed as hypotheses to be tested in a wider survey.

- i. Wide range or variations in the money cost and time needed for complying with similar regulations could be an indication of inconsistent enforcement of regulations by various local governments and offices. One of the contributing factors to the inconsistency could be corrupt practices of enforcement agents.
- ii. Higher money cost of doing and sustaining formal business as compared to that of doing informal business could have contributed to sustained informality in food vending enterprises. It is also likely that informality is increasing, not because of non-formalization, but due to the influx of entrepreneurs from rural areas who have to start informal businesses before they could understand advantages of operating formally.

- iii. Perceptions of entrepreneurs in the formal food vending enterprises indicated several “highly constraining” regulations, which seemed to have scared away the entrepreneurs that were considering formalization. The same constraints affected also, though selectively, entrepreneurs in the informal enterprises.
- iv. Contravention of minimum age and wage are more pronounced phenomenon in the informal food vending enterprises. It encouraged the entrepreneurs to stay informal so that they could continue to engage under-age persons and pay them lower than the minimum wage. This observation was made in all informal enterprises studied in Morogoro and Dar-es-Salaam.
- v. Poor or “soft” non-consequential enforcement of regulations in the informal food vending enterprises encouraged entrepreneurs to stay informal. Statements such as *“I remain informal because others are also informal”* pointed to non-consequential enforcement of formalization. Such attitudes tended to encourage a “culture of informality”.
- vi. Enforcement of regulations in the informal food vending enterprises has encouraged what may be termed “indirect formalization”, which has also led to the existence of “semi-formal” micro enterprises that were granted “temporary limited” legal status (“small license”) by local governments but still subject to discretionary harassment by officials. For example, in all informal case studies, instead of closing down the businesses the regulators required the entrepreneurs to adhere to some “selected” regulations related to health, building fees and

environment. The entrepreneurs were also encouraged to apply for micro-credits. Some key informants considered this stance as “acceptance of reality” by authorities, which encouraged informality.

- vii. Societal norms seemed to have resulted in “hidden” or “informal” costs of doing formal business. For example, it was implied in some of the cases that, there was fear to expose wealth in society because exposure attracted social responsibilities such as supporting extended family members. Such a stance could hinder formalization, which requires one to be transparent.
- viii. An interesting observation was what could be considered reversion to informality where formal enterprises (restaurants) prepared meals and sold them through the informal outlets. This implied that demand in the informal market is more vibrant and lucrative than in the formal market, and may have enticed reversion to informality by those already in the formal food vending enterprises.

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