

# VU Research Portal

## Differences between Entrepreneurs in Tanzania's Informal and Formal Sectors

Abdallah, G.K.

2020

### **document version**

Publisher's PDF, also known as Version of record

[Link to publication in VU Research Portal](#)

### **citation for published version (APA)**

Abdallah, G. K. (2020). *Differences between Entrepreneurs in Tanzania's Informal and Formal Sectors: Opportunities, Growth and Competencies*.

### **General rights**

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal ?

### **Take down policy**

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

### **E-mail address:**

[vuresearchportal.ub@vu.nl](mailto:vuresearchportal.ub@vu.nl)

## **Abstract in English**

While small businesses may contribute towards reduction of poverty, studies in least developed countries (LDCs), particularly in Sub-Saharan Africa, have shown that small businesses often fail to contribute enough in this regard. One problem may be the informal nature of small businesses and entrepreneurship. The majority of the entrepreneurs in LDCs are characterized by features of tax avoidance, low levels of education and failure to keep accounting records. While entrepreneurs in the advanced economies participate in economic activities in terms of innovation and creative destruction (Kirzner, 1997; Schumpeter, 1934), entrepreneurs in LDCs such as Tanzania are mainly sellers of domestic goods, retailers of various goods, food processors and manufacturers, and tend to be less innovative (United Republic of Tanzania, 2014). This means that entrepreneurs from LDCs may differ from those in advanced economies in terms of: identification and exploitation of entrepreneurial opportunities; entrepreneurial competencies; and entrepreneurial motivation.

If this is the case then it may be helpful for policy makers to understand the extent to which entrepreneurs in small businesses in the formal sector are different from those in the informal sector in LDCs. This PhD thesis investigates this issue by studying entrepreneurs in Tanzania, an LDC, in areas of identification and exploitation of entrepreneurial opportunities, firm growth, competences development and entrepreneurial motivation.

A total of five empirical studies (herewith referred as chapters) comprised a sample of 180 small businesses in the formal sector and 397 small businesses in the informal sector that were surveyed; 60 experts were interviewed in the pre-studies; 40 entrepreneurs in the informal sector were surveyed in the pilot studies; and one focus group discussion with 6 experts was conducted. In total seven regions from Tanzania (viz. Arusha, Dar Es Salaam, Dodoma, Mbeya, Singida, Tanga and Mtwara) were surveyed during the four rounds of fieldwork that took place between 2012-2016.

In Chapter 2 it is investigated whether there is a difference between the entrepreneurs in the formal and informal sectors in identifying and exploiting entrepreneurial opportunities. Data were collected from a survey of 50 owner-managers in the formal sector and 61 owner-managers in the informal sector from the furniture industry in Tanzania. It is found that entrepreneurs in the formal

sector identify and exploit more entrepreneurial opportunities than the entrepreneurs in the informal sector. Herein, skills and knowledge is the most critical constraint.

In Chapter 3 it is investigated whether there is a significant difference in growth between firms in the formal and informal sectors in Tanzania. The chapter entailed 111 enterprises; 50 in the formal sector and 61 in the informal sector; they all operate in the furniture industry located in Dar Es Salaam (Tanzania). The collected data were evaluated using the Chi-Square Test and the Compounded Annual Growth Rate (CAGR). It is found that firms in the informal sector more often show employment growth than firms in the formal sector.

In Chapter 4 it is investigated what the differences between entrepreneurs in the formal and informal sectors are in developing entrepreneurial competencies in Tanzania. The data were collected from 80 entrepreneurs in the formal sector and 90 entrepreneurs in the informal sector in the construction industry and evaluated using the independent T-test. The results show that six entrepreneurial competencies out of ten indicate Cronbach's alpha values of 0.6 and above, five among them demonstrate significant differences between entrepreneurs in the formal and informal sectors. Therefore, the findings suggest that tolerance for ambiguity, goal setting, risk-taking propensity, self-efficacy and pro-activity competencies are more developed with owner-managers in the formal sector rather than with owner-managers in the informal sector.

In Chapter 5 it is investigated what the factors are that motivate entrepreneurs in the informal sector to move to the formal sector. The study surveyed 170 informal entrepreneurs from the tailoring industry in four regions of an LDC (Tanzania). The collected data were evaluated using the T-test and Principal Component Analysis (PCA). The results indicate that "access to finance" is the most important entrepreneurial motivation influencing entrepreneurs to formalize their business. The entrepreneurial motivations "financial success" and "freedom from government", were also highly ranked, as their scores differ significantly from "networking". The entrepreneurial motivation "innovation" hardly played a role of importance for the motivation of entrepreneurs to move from the informal sector to the formal sector. Further, the current chapter identified the motivational factors into two main clusters of business-related and person-related. More specifically the sum score across motivational factors contained in the business-related cluster is 2.663, and in the person-related cluster the sum score is 2.054.

In Chapter 6 it is investigated what the factors are that determine the entry and remain of entrepreneurs in the informal sector in Tanzania. Qualitative data analysis was performed using focus group discussion, expert interviews, and interviews with owner-managers in the informal sector. It is found that necessity-drivers are an important motivation for the entry and stay of owner-managers in the informal sector in an LDC (Tanzania). Additionally, two other salient aspects, viz. the degree of excessive regulations regarding taxes and the low level of education possessed by entrepreneurs in the informal sector, emerged as essential factors. The findings suggest that the majority of the owner-managers enter and remain in the informal because of necessity motivation, and that this motivation is enlarged by excessive regulations regarding taxes and low education levels.

It is interesting to see that in LDCs necessity motivations determine stay (and also entry) of owner-managers in the informal sector (Chapter 6) and that push factors motivate entrepreneurs in shifting from the informal sector to the formal sector (Chapter 5). This is a paradox, but it can be explained, namely from the rather hopeless situation in which many entrepreneurs and their families can be found: extreme poverty. The entry and stay of entrepreneurs in the informal sector is related with the low scores regarding gross national income per capita; social economic development; human development index including the enrolment in secondary school (United Nations, 2015). As a result, entrepreneurs from LDCs are exposed to less or at least different opportunities from technological innovations and environment change than entrepreneurs from the advanced economies. As a result, most of the informal entrepreneurs are exposed to local market opportunities through petty businesses that formal entrepreneurs cannot operate and in this way generate daily income for living (see Section 6.4.1). Concerning the wish to shift from the informal sector to the formal sector, necessity motivation exposes informal entrepreneurs to the push factors such as access to finance, financial success, freedom from government and networking (see Section 5.5). In this regard, necessity entrepreneurs weigh the cost of penalties from tax avoidance (informal sector) and the benefits of formalization (see Section 6.4.2).

Based on the findings from Chapters 2 to 6 of this PhD thesis the answer to the question to what extent do entrepreneurs in small businesses in the informal sector in an LDC differ from those in the formal sector is as follows. They are different in terms of two things. Those in the informal sector have less developed entrepreneurial competencies and seem less able to identify and exploit entrepreneurial opportunities than those in the formal sector. Nevertheless, the entrepreneurs of

small businesses in the informal sector are more successful than the entrepreneurs of small businesses in the formal sector, in the sense that their firms more often show employment growth than the firms of the entrepreneurs in the formal sector. It should be acknowledged however that this difference in employment growth between firms in the informal and formal sectors is strongly determined by the measurement approach that was used. Further, in the transition of entrepreneurs from the informal sector to become entrepreneurs in the formal sector, it appeared that push factors were the most important factors. However, the stay (and entry) of entrepreneurs in the informal sector is best explained by necessity motivation, mainly the fear for higher taxes that are applicable in the formal sector and the observation that the level of education of the entrepreneurs in the informal sector is too low to become successful in the formal sector. Based on the findings from Chapters 2 to 6, a number of theoretical contributions with regard to theory and practice were discussed. The limitations of the PhD thesis were also highlighted together with the recommendations for future research and implications for policy makers.