

Final report

From the bottom-up: Firm capabilities and the “in- between” sector in Tanzania

Hazel Gray
Margaret McMillan

July 2016

When citing this paper,
please use the title and the
following reference number:
F-40302-TZA-1

IGC

International
Growth Centre



DIRECTED BY



FUNDED BY



From the Bottom Up: Firm Capabilities and the 'In Between' Sector in Tanzania

Final Report

Research Process

Research involved both quantitative and qualitative analysis to enhance our understanding of the MSME sector in Tanzania. The first part of the research project involved using existing (new) data including (i) the Central Registry of Establishments (CRE); (ii) Population Census Data; (iii) Labor Force Surveys; (iv) National Panel Surveys; (v) the Micro Small and Medium Sized Enterprise Survey; (vi) the World Bank Enterprise Surveys and; (vii) the Annual Survey of Industrial Production (ASIP). Research involved using state of the art econometric techniques to explore data from the FSDT. Following data analysis the results were used to strengthen the conceptual framework used to examine the relationship between SMEs, economic growth and job creation

The second part of the project involved qualitative interviews with policy stakeholders and larger and small manufacturers in the metals sector in Tanzania. Interview were held with 5 out of the 11 large metal and fabricated metals producers. We also undertook in-depth case study interviews with 6 small informal businesses in the metal sector and 1 medium sized metal fabrication enterprise. We had hoped to use the new Industrial Census data to provide the latest data on growth in the metals sector but this was not made available to us during the course of the research. The rich material from the interviews was written up and some of the interview material was included in the first academic paper. The interview data has been analyzed using a political economy analytical framework and will be used in writing up a further academic paper as explained in the section on academic outputs and next steps.

Key Results

At roughly 4% per annum, labor productivity in Tanzania has grown more rapidly over the past 14 years than at any other time in recent history. Employment growth has also been strong keeping up with population growth at roughly 2.2 percent per annum. However, the bulk of the employment growth – 88.6% - has been in the non-agricultural and largely informal private sector. Using Tanzania's first nationally representative survey of micro, small and medium sized enterprises

- we show that these informal firms made a substantial contribution to annual labor productivity growth through structural change. However, most of this labor productivity growth came from a relatively small subset of these firms where annual average labor productivity is significantly higher than average labor productivity in the rest of the economy. The owners of these firms share the following characteristics: (i) they wouldn't leave their business for a full time salaried position and; (ii) they keep written accounts. Accelerating employment growth in this group of firms has the potential to contribute 1.2 percentage points to annual labor productivity growth; to put this in perspective the formal modern sector contributed 1.58 percentage points to annual labor productivity growth over the past decade. Actualizing this potential will require financial products and business services targeted at this group of firms.

In order to get further insights into the relationship between SMEs, employment and economic growth, the second part of the research project involved a political economy analysis of firm linkages and policy support to the metals sector in Tanzania. The production of iron, steel and non-ferrous metal has increased dramatically in Tanzania over the past 10 years and following a steep decline in the 1990s there has been a revival of fabrication of metal products. Small and micro firms play a central role in many types of manufacturing related to metals and fabrication in Tanzania. Across all manufacturing new employment has mainly been generated by the large firms and the output and employment of large firms in metals has expanded quite dramatically in recent years. SME activities within metals are also expanding rapidly but we know little about the quality and dynamics of this growth.

The expansion of metal manufacturing activities is of particular policy relevance in Tanzania because of the desire to increase the local content within supply chains to the rapidly growing mining sector. Tanzania on the cusp of a new phase of economic transformation with the impending start of major gas production by a number of large foreign firms. Enhancing the local content of this production is seen to be a major way of boosting the transformative impact of a rising mining economy on local firm capabilities. How local content links to economic transformation depends on linkages and the type of local content in question. In order to enhance local content, a new Local Content Policy was drafted by the government of the United Republic of Tanzania in 2014.

One of the core objectives of the new local content initiatives is to promote all metal related works as a way of enhancing the manufacturing local content base. Objective 3.4 of the Local Content Policy of Tanzania for Oil and Gas Industry is to ‘To maximize in-country fabrication, welding, assembling, manufacturing and repairing works’ and on page 3 the draft policy explains that “sufficient thrust need to be given in promoting all metal related works including in-country manufacturing, fabrication, welding and assembling”.

Local sourcing of manufactured inputs is at a very early stage in Tanzania and so far, efforts to promote local content linkages have had only limited success (Kalinsky and Masuma; 2014). An important question is how local content policy targeted towards increasing metal related activities will involve MSMEs. According to the Annual Survey of Industrial Production and Performance of 2012 there were 5 large firms in the manufacture of basic metals, and 13 SMEs while in the manufacture of fabricated metal products (not including machinery) there were 6 large firms and 17 SMEs however there are many more informal small and micro firms engaged in assembly and simple manufacturing of metal products that are not captured in that previous survey.

One of the challenges to ensuring widespread benefits from the expansion of mining is that most linkages mainly benefit a number of large firms in Tanzania who are able to meet the regulatory requirements to provide inputs into the capital intensive gas and mining production. However, our interviews showed that there were very few linkages between the large metal firms and the mining and gas sector as yet. Linkages between the large firms and the natural resource sectors included in the provision of metal wire and in metal roofing materials for housing workers in Mtwara. The new industrial strategy envisages a rapid growth in SME metal manufacturing in Mtwara

Nevertheless, the benefits of these linkages may well go beyond these large firms through the impact of secondary linkages from these large companies. In this way, the gas and mining economy has the potential to impact on SMEs through their linkages to large firms that are in a position to provide inputs into the mining and gas industry. An important route for firm level capability development through linkages will be through changing demand for specific products by foreign firms in mining and gas who seek local content into their production process. This leads to product innovation in the large firm with direct supply linkages to foreign firms but also potentially in the SMEs with

linkages to larger domestic firms. The way that changing product demand will shape firm capabilities in SMEs will depend also on the collaboration intensity within linkages.

While there are studies of firm linkages in Tanzania there are no studies that examine this issue from the perspective of local content impact on SMEs via large firm linkages. Interviews with large firms indicated that there were very limited backward linkages between SMEs and large firms in the sector.

Nevertheless, the metals sector in Tanzania is highly heterogeneous with six different areas of activity:

- (1) Makers of steel and/or aluminium products from scrap.
- (2) Steel and aluminium fabricators and body builders.
- (3) Firms making drawn wire and related products.
- (4) Vehicle body builders.
- (5) Firms involved in the manufacture of large-scale steel and aluminium structures for the construction industry.
- (6) Firms involved in steel or aluminium building projects.

Metals fall into both the medium tech manufactures (iron and pipes) as well as the low tech manufacturing (e.g. simple metal parts or structures). The capabilities within different vertical segments are highly heterogeneous. This would suggest that the scope for linkages between firms of different sizes may be limited. However the expansion of large firms within the sector may have had numerous indirect impacts on smaller firms in different segments of metal production.

There have been a number of industrial policy initiatives to support large firms within the sector. For example, the government imposed a ban on the export of scrap metal to ensure adequate supplies within the local market for domestic metal fabrication. Similarly, high duties have been imposed on the import of metal bars used in the construction industry. These policies have been a factor in protecting large domestic manufacturers from competition with Chinese imports of steel bars. Protection of the large metal producers resulted from the successful establishment of a Steel Manufacturers Association in Tanzania that coordinated the large manufacturers and lobbied for protection.

Despite formal commitment to support SMEs in the metals sector, the actual implementation of policies to support these firms has been much less extensive and successful. In early 2000s efforts were made under guidance of UNIDO in collaboration with TCCIA to establish industrial clusters at the regional level. One successful cluster was established in Morogoro for metal fabrication and engineering. The Morogoro Engineering Cluster started in 2005 with 9 workshops and 20 non-registered working groups have developed to-date with 60 registered metal companies. An earlier cluster that was established in the 1970s in Gerezani Dar es Salaam has also been successful at supporting SME metal fabrication activities but SME metal fabrication is also under pressure from imports of cheaper metal products. The new industrial strategy envisages extensive support to the creation of new metal fabrication manufacturing activities in Mtwara. Industrial policy includes establishing an SEZ for heavy industries in Mtwara, in particular chemical and iron industries but these are not expected to target SMEs. Currently SMEs are excluded from EPZA EPZ initiatives as they do not have the minimum capital requirement to acquire an EPZ license. The reality is that most industrial policy initiatives have been introduced to support production within large firms in metals rather than the SME sector however these policies may have led to temporary or accidental rents to some of the other producers within the sector. This will be examined in the next stages of the research project.

Research Outputs

This project resulted in the following academic paper: “Economic Transformation from the Bottom Up: Macro and Micro Evidence from Tanzania.” The paper was accepted for presentation at the STARRS conference in Addis Ababa hosted by the African Development Bank and Cornell. At the request of the conference organizers, we submitted the paper for publication in a special issue of World Development. The paper was presented at RePOA’s annual research conference in Dar es Salaam. The paper was accepted for presentation at the Annual Bank Conference on Development Economics hosted by the World Bank in Washington D.C. on June 20 and 21 of 2016. The selection process for this conference was competitive as more than 1,000 papers were submitted and only around 60 were chosen. A short version of the paper is under consideration for publication in the World Bank Economic Review. Finally, the paper is scheduled to be presented at a conference being

organized by the Financial Sector Deepening Trust (FSDT) in Dar es Salaam in late August or early September.

A paper entitled 'Size matters? The Political Economy of Small Firm Promotion in Tanzania' was also accepted for presentation at the Africa Studies Association UK in Cambridge and at the Development Studies Association UK in Oxford both in September 2016.

Stakeholder Engagement

Throughout the course of the project, we worked closely with stakeholders in Tanzania. Government stakeholders include: Dr. Ishebabi the Director of SMEs at the Ministry of Industry and Trade, Eng. Omar Bakari at the Small Industries Development Organization, Dr X at the National Bureau of Statistics and Peter Kingu, the head of SME finance at the Financial Sector Deepening Trust (FSDT). FSDT is the organization that funded the MSME survey. FSDT was impressed by the quality of the academic paper we produced and has asked us to help them design the follow up survey.

In addition to government stakeholders, we also consulted with MSME owners, bankers, business development service providers and other researchers. Dialogue with MSME owners and business development service providers was particularly helpful as it gave us more confidence in our results regarding firm productivity and potential. For example, through discussions with one of the managing partners of MatchMaker Group (MMG), we learned about their investments in MSMEs in a variety of agri-business activities. The MSMEs funded by the MatchMaker Fund borrow not less than 100,000 USD and according to MMG have significant potential for growth.

We also consulted with the Association of Tanzanian Steel Manufactures and the CEO of the Confederation of Tanzanian Industries. We consulted with the Tanzania Private Sector Foundation and they supported us in identifying two associations of SMEs in the metals sector that we interviewed.

We consulted with the Executive Director of the National Economic Empowerment Council who was keen to explore ways to use the research to strengthen their efforts to create a multi-sector empowerment strategy to promote local content.

We worked closely with the Economic and Social Research Foundation in Tanzania and worked with a researcher within the organization to undertake interviews, thus helping to build local research capacity.

Potential for Policy Impact

At the risk of sounding overly confident, we think that there is a significant potential for policy impact based on the work that we have done. Both the government and the private sector have shown an interest in exploring financial products targeted at MSMEs with significant potential for productivity and employment growth. There is also strong interest in organizing a one to two day workshop that brings together MSME stakeholders. However, it is also clear that such a workshop will only be useful if it focuses on implementation and new products. Stakeholders do not want to be told one more time about the issues facing MSMEs. Instead, it will be important to showcase successes and (dispel) the enthusiasm that we heard from so many of MSME owners and bankers.

Next Steps

We are working on a second academic paper based on the interviews in the metals sector. When the industrial census becomes available this will be used to examine metals firm linkages through further quantitative analysis to support the qualitative research undertaken during this project.

A meeting of stakeholders will be organized for 2017 to disseminate the findings of the research project.

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about our work on our website
www.theigc.org

For media or communications enquiries, please contact
mail@theigc.org

Subscribe to our newsletter and topic updates
www.theigc.org/newsletter

Follow us on Twitter
[@the_igc](https://twitter.com/the_igc)

Contact us
International Growth Centre,
London School of Economic and Political Science,
Houghton Street,
London WC2A 2AE

IGC

**International
Growth Centre**

DIRECTED BY



FUNDED BY



Designed by soapbox.co.uk