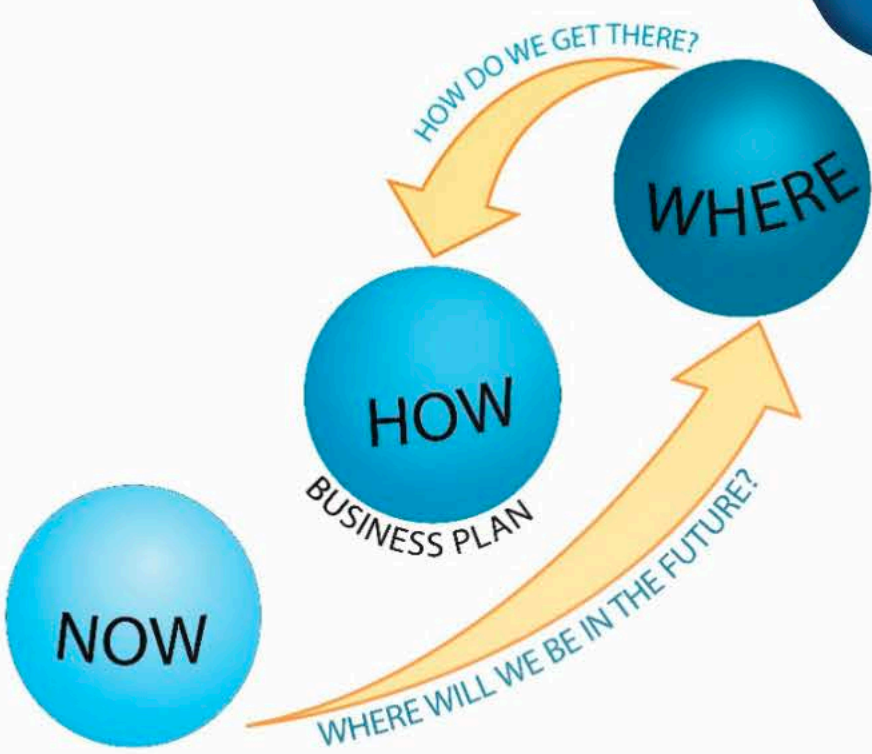
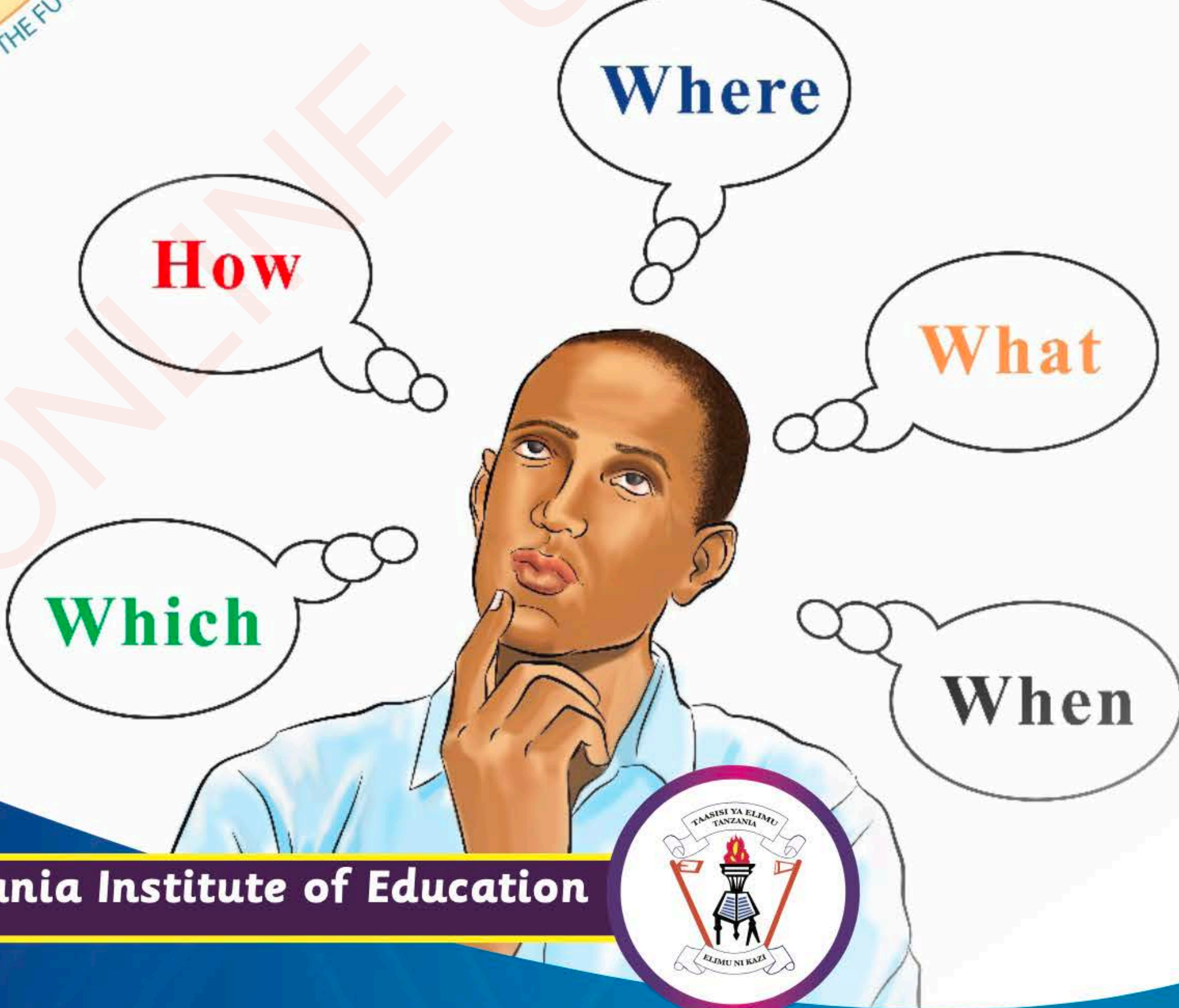
Commerce

for Secondary Schools Student's Book

Form Four





Tanzania Institute of Education

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Commerce

for Secondary Schools

Student's Book

Form Four

THE UNITED REPUBLIC OF TANZANIA
MINISTRY OF EDUCATION,
SCIENCE AND TECHNOLOGY

Certificate of Approval

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Dr Lyabwene M. Mtahabwa
Commissioner for Education

Tanzania Institute of Education

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Abbreviations and Acronyms

AMCOS	Agricultural Marketing Co-operative Society
ATCL	Air Tanzania Company Limited
BoT	Bank of Tanzania
BPRA	Zanzibar Business and Property Registration Agency
BRELA	Business Registration and Licensing Agency
CEO	Chief Executive Officer
CHF	Community Health Fund
CSR	Corporate Social Responsibility
DAWASA	Dar es Salaam Water Supply and Sanitation Authority
EWURA	Energy and Water Utilities Regulatory Authority
HR	Human Resource
HRM	Human Resource Management
IBM	International Business Machines
KFC	Kentucky Fried Chicken
Kg	Kilogram
LATRA	Land Transport Regulatory Authority
LGAs	Local Government Authorities
LLPs	Limited Liability Partnerships
Ltd	Limited
MPCL	Mwanakwetu Printing Company Limited
MSMEs	Micro, Small, and Medium Enterprises
MU	Mzumbe University

NBC	National Bank of Commerce
NHIF	National Health Insurance Fund
NIC	National Insurance Corporation
PAYE	Pay As You Earn
PBZ	People's Bank of Zanzibar
Plc	Public limited company
QCP	Quality Chicken Partnership
Qty	Quantity
R & D	Research and Development
SACCOS	Savings and Credit Co-operative Society
SADC	Southern African Development Community
SMEs	Small and Medium Enterprises
TANESCO	Tanzania Electric Supply Company Limited
TBS	Tanzania Bureau of Standards
TC	Teachers College
TCDC	Tanzania Co-operative Development Commission
TCRA	Tanzania Communications Regulatory Authority
TIC	Tanzania Investment Centre
TIE	Tanzania Institute of Education
TIN	Taxpayer Identification Number
TIRA	Tanzania Insurance Regulatory Authority
TMDA	Tanzania Medicines and Medical Devices Authority
TRA	Tanzania Revenue Authority

TRC	Tanzania Railways Corporation
TShs	Tanzanian Shillings
TTCL	Tanzania Telecommunications Corporation
TV	Television
UDART	UDA Rapid Transit Public Limited Company
UDOM	University of Dodoma
UDSM	University of Dar es Salaam
URT	United Republic of Tanzania
VAT	Value Added Tax
VRN	VAT Registration Number
ZBC	Zanzibar Broadcasting Corporation
ZBS	Zanzibar Bureau of Standards
ZECO	Zanzibar Electricity Corporation
ZFDA	Zanzibar Food and Drug Agency
ZIC	Zanzibar Insurance Corporation
ZIPA	Zanzibar Investment Promotion Authority
ZMA	Zanzibar Maritime Authority
ZRB	Zanzibar Revenue Board

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Acknowledgements

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Coordinator:	Mr Nehemia D. Kaaya

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Dr Aneth A. Komba
Director General
Tanzania Institute of Education

Preface

This book, *Commerce for Secondary Schools*, is written specifically for Form Four students in the United Republic of Tanzania. It is prepared according to the *2016 Commerce Syllabus for Ordinary Secondary Education Form I-IV*, issued by the Ministry of Education Science and Technology. The book consists of five chapters, namely Entrepreneurship, Business units, Business management, Taxation, and Insurance. Each chapter contains texts, illustrations, activities, and exercises. You are encouraged to do all the activities and attempt all the given exercises as well as other assignments provided by your teacher. Doing so will enable you to develop the intended competencies.

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Chapter One

Entrepreneurship

Introduction

The majority of innovative and successful businesses we see today started with good planning. Planning helps entrepreneurs to know well about the businesses they are going to start, the amount of capital they will need, the source of capital, how the businesses will be formalised, the key operations, and all other important aspects needed to make the businesses successful. In this chapter, you will learn about business planning, business start-up and preliminary activities as well as an overview of businesses in Tanzania. The competencies developed from this chapter will enable preparation and execution of a business plan.

Business planning

As individuals, we often make several decisions on the things we want to do and how we want them to be done; this is part of planning. Planning entails deciding ahead of time what needs to be done, when it should be done, how it should be done, and who should execute it. Similarly, business owners do the same in managing their businesses. Almost all successful businesses undergo planning continuously just like the way we plan for our things every day. The business planning process involves the logical putting together of an entrepreneur's thoughts in a manner that describes the business's current status, market situation, and precise activities which the business will undertake to achieve its goals. In general business planning starts with a business idea. Business idea is any concept that can be used for commercial purposes. Figure 1.1 presents a reflection on a business plan for moving from the current state to the desired state.

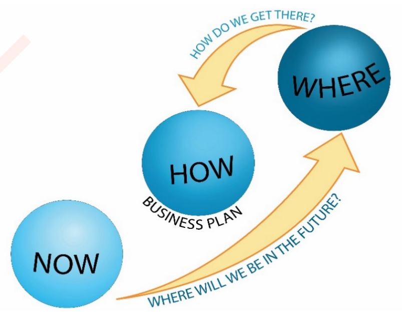


Figure 1. 1: *Reflection of a business planning process*

The reflection in Figure 1.1 indicates that before starting any business, you have to plan first. The planning process will help you identify an appropriate business that you can start, the amount of capital needed, the source of capital, how the business is going to be formalised, and the key operational processes. Without planning, it is difficult to start and operate any business smoothly.

A business plan is a document that provides a detailed analysis and description of all important aspects of the business over a given time frame. It serves as a roadmap to guide an entrepreneur in developing strategies and procedures necessary to convert an idea into a sustainable business. It is an important document because it spells out the business vision, mission, objectives, and goals. By uncovering all important aspects of the business, the business plan enhances the chances of succeeding in the business as it gives answers to questions about the business's operation before the business starts. Figure 1.2 shows an entrepreneur thinking about key issues of the business, such as what type of business to do, when to do that business, to which market the products will be sold, how much will be the price of the products, and what will be the name of the business. All these issues will be addressed by a well-prepared business plan.

Figure 1. 2: *An entrepreneur thinking about key issues of the business*

Significance of a business plan

A business plan serves as a guide to all categories of businesses seeking to expand and excel in their fields of specialisation. It effectively responds to essential issues about a business's everyday activities as well as long-term operations. Basically, the business plan has the following significance among others:

Helps in starting an enterprise: A business plan is considered as a roadmap of the business to be undertaken as it lays down the nature of the business, marketing, and operation strategies necessary for the survival of the business. The business plan shows the steps in starting a business and the resources which are needed.

Aid in decision making: Decision making is an important task for an entrepreneur. Some decisions like when to rent a new space or expand the business are not always easy to make. With a clear business plan in place, entrepreneurs can determine the specific times or goals they must meet to make these important decisions. A good business plan will help an entrepreneur to identify business critical priorities and milestones to focus on.

Helps in setting objectives and benchmarks: A detailed business plan helps in setting short-term and long-term objectives for the business. Specific objectives can be set and appropriate strategies can be built around within a limited time frame. Also, business plans set benchmarks from which performance can be measured.

Helps in securing finance: A business plan can also help an entrepreneur decide how much money is needed to start and operate a business. An entrepreneur may decide to take out a business loan or invite investors to be part of the business. New businesses often require funds and a business plan can help an entrepreneur to present business ideas to potential investors. If an entrepreneur applies for a business loan, he or she may need a thorough business plan to demonstrate the business idea to potential lenders such as banks and other financial institutions.

Helps in improving marketing: Once an entrepreneur has a business, he or she will need to reach customers through marketing. Marketing is an important aspect of a business plan as it helps to define the business's target markets, target customers, and the business to be contracted to promote and place its product or service in these markets.

Helps in managing the workforce: Business plan may provide details of the workforce needed by the business. With business plan, managers have the bonus to pre-determine the requirements of the organisations in terms of the total manpower required.

Helps in risk management: Businesses involve a lot of risks that may potentially affect the operations and the general existence of the business. A business plan can also help an entrepreneur to predict potential problems like low seasons or changing customer trends, taste or habits. An entrepreneur may be able to prepare and overcome these challenges ahead of time with a business plan.

For better understanding of business competition: By creating a business plan it forces entrepreneurs to analyse their competition. All businesses compete directly or indirectly; thus, it is critical to understand the competitive advantages of entrepreneurs' businesses. Small business owners and those aspiring to start a new business often believe that they do not need a business plan. They believe they are offering their products in a clear and simple manner; hence the insignificance of the business plan. However, if they take the time to design and develop a business plan, they are more likely to enjoy the returns from their businesses with relatively fewer disappointments.

Components of a business plan

In preparing a business plan, it is important to make sure that it is simple, clear, and precise to all users such as lenders and investors. It should be persuasive, and free from spelling and any grammatical or numerical errors. In all circumstances active rather than passive voice should be used in the document. There are different ways of preparing business plans depending on the intended users.

However, the following are the basic components of a business plan:

Executive summary: Executive summary gives us an overview of the business plan. It gives a snapshot of all the details of the business plan. The executive summary is meant to capture the reader's attention. It should, therefore, be written in a concise but comprehensive manner as some readers may not have time to read the whole document.

Business description: This part provides key information about the business. This information includes:

(a) Business name: This part informs about the identification of a business. An entrepreneur may choose any business name to be referred by clients. It is important to note that, one need to choose a good business name that will attract customers more than offend them. In Tanzania, to ensure the uniqueness of the business name it is important to consider registering the name with Business Registration and Licensing Agency (BRELA) or Zanzibar Business and Property Registration Agency (BPRA). Some examples of registered business names are Great 20 Company Limited, Azam, GSM, Mohammed Enterprises Tanzania Ltd, Azania Group, Apple, IBM, Google, and Microsoft.

(b) Legal status: Legal status explains the registration and/or nature of the business whether it is a sole proprietorship, partnership, or a company.

(c) Ownership structure: Ownership structure informs about how the business is owned in terms of the capital composition towards the establishment or growth of the business.

(d) Mission: Mission is a statement of purpose. It tells about the purpose of the business's existence. A good mission statement communicates to customers what the business serves them. Examples of mission statements can be:

"*To offer a quality education to students*".

"*To provide the customers with the most enjoyable shopping experience*".

(e) Vision: A vision is a statement outlining what the business wants to accomplish in the long run. It portrays a future state for the business and establishes a clear path for future planning. Examples of business visions are:

"*To become the leading secondary school that provides a quality education in Tanzania*".

"To be the national customer-focused business centre for customers to get their supplies".

Market assessment: Market assessment shows existing opportunities in the market that can be exploited. For a start-up, market assessment is important as it provides the basis for justifying the demand and supply, the sales projection, and the marketing plan. It also shows how the new business will fit into the market. The purpose of market assessment is to get more information about the customers of the business as well as existing or future competition. Alongside market assessment, the competitive analysis provides the business with clear information about the close competitors; hence it gives the business prior information about their strengths and weaknesses which will assist the business to set competitive strategies. Thus, among other things, information from the market assessment is used in writing a marketing plan.

Marketing plan: This entails the logical planning for all marketing issues by providing a thorough description of the product that the business will provide to its customers. The features of the product have to be well explained such as; size, packaging, and ingredients. The pricing processes and market entry price should be explained. Moreover, distribution processes to various categories of customers and associated costs should be described. Finally, promotion activities that will be used and their respective costs should be well explained. After that, sales estimates should be made for all the years that the plan covers as well as the marketing strategies needed to achieve them.

Operations plan: This part involves consideration of how production will be executed. It shows the key operational activities that have to be undertaken to produce the proposed goods or deliver the proposed services. Some of the operational activities include: the choice of an appropriate location for setting up the business, working premises and facilities, infrastructures needed, plant and machinery needed, as well as the various types of inputs. Others include, how to maintain quality standards and adherence to business regulations. Where appropriate, it is helpful to provide a detailed flow chart of how these processes sequentially build on each other, from the point where inputs are received to the point where final products are packaged and ready for marketing.

Management and organisation plan: This part outlines the way human resources in the business will be coordinated. It provides an introduction to management with a summary of their skills and their primary job responsibilities. Information mostly included in this section includes the organisation structure, top management, staffing requirements, and all matters related to employees' welfare.

Financial Plan: This part presents projections of the expected amount of money that the business will earn and the amount that will be spent for a specific period. It summarises the financial outcomes of activities carried out in the business for the whole period of the business plan. It logically presents the projected income statement covering all the years for which the business plan is concerned. Likewise, projected statements of cash flows and statements of financial position are made.

Appendices: The part of appendices presents all other attachments that add value to the reader of the business plan but could not fit in the above sections. For example, it may include pictures, the design of the product, proposed advertisements, and the curriculum vitae of personnel. Figure 1.3 presents a summary of a logical flow of components of a business plan.

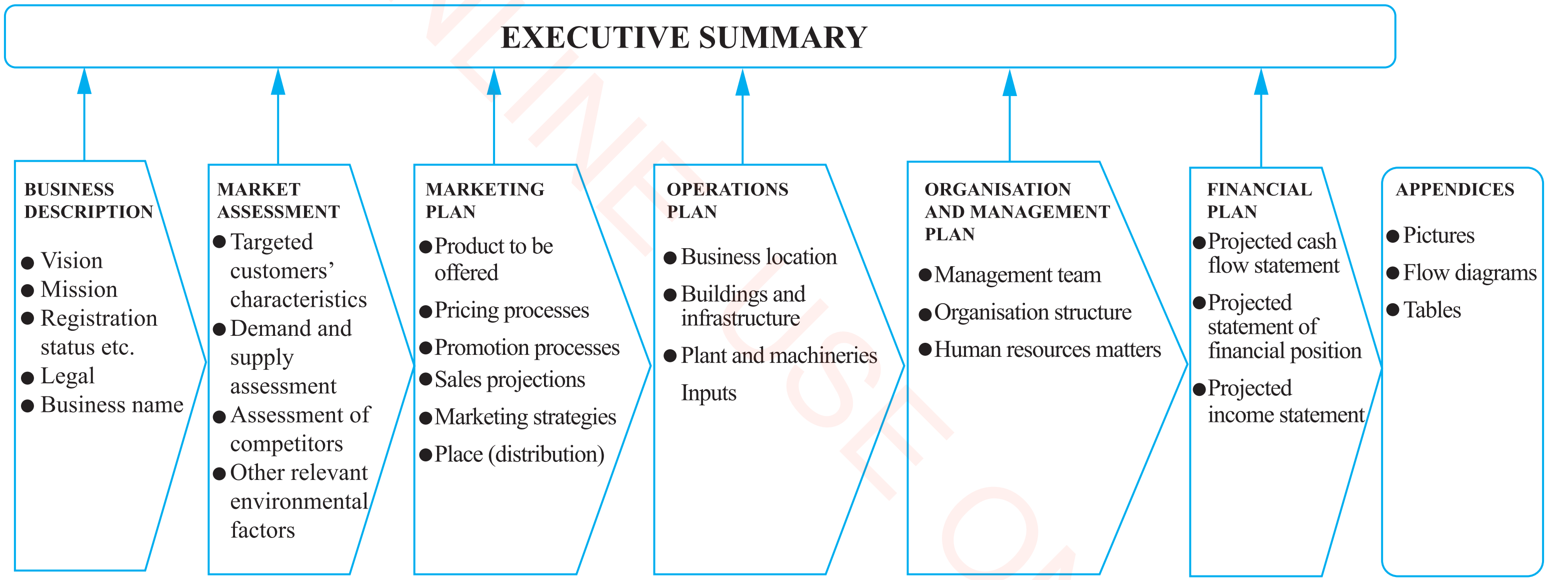


Figure 1. 3: *Summary of components of a business plan*

An example of a simple business plan

Mosi is a form four student at Mtakuja secondary school in Mtakuja Ward. Mosi is intending to start a business soon after completing form four. Upon exploring opportunities, Mosi discovered that there is a shortage in the supply of broiler chickens in their nearby community and that he can work in partnership with Mei who had the same observation. Mei had already started making preparations to start that business and she has some savings for that matter. However, she had no proper place to build a chicken coop. The cost of the building was also relatively high for her. On his side, Mosi was given two coops for free by his family which could be easily used for keeping broilers but had no start-up cash. The coops could accommodate up to 1,000 chickens at once. Thus, the two could work well in partnership whereas Mosi's capital contribution will be the coops and Mei's will be cash. The two have agreed to write a business plan to enhance the chances of their business success.

Business description

This business is about the rearing and selling of broiler chickens at Mtakuja ward following the shortage in supply of such products. The business is to be located in Mtakuja ward to serve the community around which the owners have identified an opportunity for running the business with a high probability of success.

Business name

The business will be called *"Quality Chicken Partnership"* abbreviated as QCP.

Legal status

For the purpose of sharing experience, physical resources, and finances, QCP will be run as a partnership. The business will strive to secure a business licence that permits its operations in the area.

Ownership structure

The ownership of the business is to be based on the value of capital contributed by each partner. Mosi will contribute the two coops which have a market value of 8 million Tanzanian shillings and Mei will bring 8 million Tanzanian shillings in cash. Therefore, QCP will be owned equally by both partners.

Operation status

The partners for QCP are Mei and Mosi whom will share profits and losses equally. Mei will be involved in the daily operations of the business and will be entitled with a monthly salary. Likewise, Mosi will not be involved in the daily operations of the business, thus will not be entitled with any salary.

Mission

"To offer high quality broiler chicken that meets customers' needs".

Vision

"To become the largest supplier of broiler chicken in Tanzania".

Market assessment

For the past few months, the Mtakuja area has been experiencing an increase in the number of food vendors who demand broiler chicken for their customers. Suppliers who are serving them however have been accused on their lateness and insufficient delivery. It is estimated that, the current demand for broiler chicken per month is over 1200 broiler chickens while the currently reliable supply is estimated to be less than 500 broiler chickens per month leading to a deficit of more than 700 broiler chickens per month in the market. QCP is intending to reduce this shortage by supplying at least 600 broiler chickens per month. This rate will be increased given the growth of the market. However, competition is also anticipated from Tona Enterprises Ltd., one of the largest suppliers of broiler chicken in the area. Nevertheless, QCP is anticipated to win the Mtakuja market over Tona Enterprises Ltd as QCP owners have personal connections with the majority of the food vendors.

Marketing plan

The main product of the business is broiler chicken. QCP will be buying chicks from prominent poultry farms and rear them for a maximum of six weeks before they are ready for sale to local food vendors. With proper feeding and good care, this ensures that the chicken to be sold attains at least 1.5Kgs which is the requirement of many customers in the market. In order to penetrate the market, QCP will be selling the chicken at 7,000 Tanzanian shillings during the first two years, which is relatively lower than the market price. However, from the third year, the price is expected to increase to 7,500 Tanzanian shillings. In terms of distribution arrangements, it is expected that customers will be coming to collect the chicken at the business premises. As a way of promoting its business, QCP will design simple fliers that will be distributed to potential customers. The sales projections for the first three years of the business's operations are as indicated in the table below.

QCP's sales projections for the first three years

Year 1			Year 2			Year 3		
Number of chickens	**Rate in TShs**	**Amount in TShs**	**Number of chickens**	**Rate in TShs**	**Amount in TShs**	**Number of chickens**	**Rate in TShs**	**Amount in TShs**
7,200	7,000	50,400,000	8,000	7,000	56,000,000	10,000	7,500	75,000,000

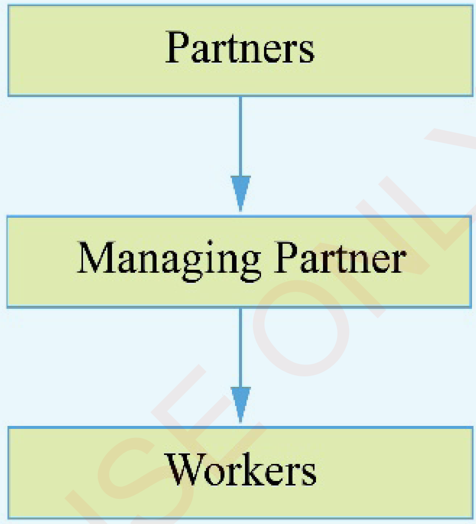
To achieve the sales projections presented in the table, the owners of QCP expect to use several marketing strategies including use of penetration pricing for the first two years and personally visiting and persuading the food vendors in the Mtakuja area to buy broiler chicken from QCP. Given the high quality of chicken and services provided by QCP, it is expected that customers trust will be built resulting to spreading of good message to other potential customers through the word-of-mouth promotion.

Operations plan

The business will be located in the Mtakuja area. The key activities which will be carried out is commercial rearing of the chickens in the coops which have been freely provided by the family of one of the partners. There are no initial investments needed in physical infrastructure as the coops are already in place. The benefits of locating the business in this area include proximity to many food vendors, and the area is mostly free from hazards such as burglary events and natural calamities such as floods.

Management and organisation plan

QCP will be managed by Mei and Mosi who are going to employ two people to support them in taking care of the chicken and distribution to customers. The two employees will be paid on monthly basis. As a way of providing incentives and motivating these employees, breakfast and lunch will be provided for them. Mei will also be working full time for the business and will also be entitled to a monthly salary. QCP's organisation structure is provided in the following figure.



Financial plan

Considering the sales projections as well as anticipated operational costs, the financial projections for the first three consecutive years of QCP show that the business will provide partners with good returns. The table provides a simplified projected income statement. The table shows that QCP estimates to make profits of TShs 1,302,000, TShs 2,449,000, and TShs 3,937,000 for three consecutive years respectively.

QCP

Projected Income Statement for Three Years

Items	Year 1				Year 2				Year 3			
	Qty/Year	Rate in TShs.	Amount in Tshs. "000"	Total in TShs. "000"	Qty/Year	Rate in TShs.	Amount in Tshs. "000"	Total in TShs. "000"	Qty/Year	Rate in TShs.	Amount in Tshs. "000"	Total in TShs. "000"
Sales	**7,200**	**7,000**	**50,400**	**50,400**	**8,000**	**7,000**	**56,000**	**56,000**	**10,000**	**7,500**	**75,000**	**75,000**
Less: Cost of Sales												
Purchase of chicks	7,200	2,000	14,400		8,000	2,000	16,000		10,000	1,900	19,000	
Purchase of chicken feeds	7,200	2,850	20,520		8,000	2,850	22,800		10,000	3,250	32,500	
Medication and vaccination	7,200	300	2,160		8,000	300	2,400		10,000	300	3,000	
Wages	12	200,000	2,400		12	200,000	2,400		12	300,000	3,600	
Total Cost of Sales				**(39,480)**				**(43,600)**				**(58,100)**
Gross Profit				**10,920**				**12,400**				**16,900**
Less: Expenses												
Salaries	12	400,000	4,800		12	400,000	4,800		12	500,000	6,000	
Other operating cost	12	370,000	4,440		12	370,000	4,440		12	485,000	5,820	
Total Expenses				**(9,240)**				**(9,240)**				**(11,820)**
Profit Before Interest and Tax (PBIT)				**1,680**				**3,160**				**5,080**
Interest on loan				0				0				0
Profit Before Tax				**1,680**				**3,160**				**5,080**
Tax				(378)				(711)				(1,143)
Profit After Tax				**1,302**				**2,449**				**3,937**

Appendices:

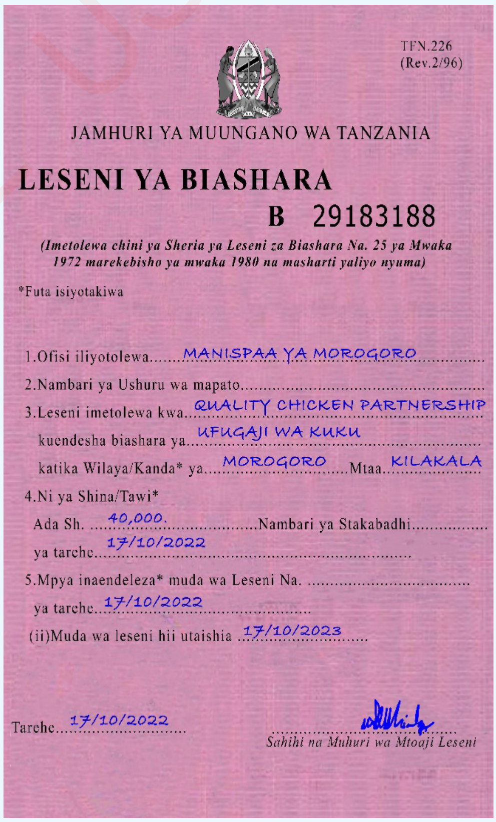
Appendix 1

Underlying assumptions are as follows:

1. The selling price of the broiler chicken will be TShs 7,000 for the first two years and TShs 10,000 in the third year;
2. In the first year of operation 7,200 chickens will be produced. In the second year of operation, the production level rises from 7,200 to 8,000 chickens as the business will be anticipating more customers. As more customers are coming in, the third year's production is expected to further rise to 10,000 chickens;
3. The business is expecting to buy chicks from supplier at a price of TShs 2000 per chick for the first two years. In the third year of operation, the business is anticipating to benefit from bulk purchases and enjoy a discount of TShs 100 per chick;
4. The average cost of feeding chick to a full-grown chicken is estimated to be TShs 2,850. Changes in market price are anticipated to increase chicken feed expenses on the third year to an average of TShs 3,250 per chick;
5. Wages to the two employees will stand at TShs 200,000 per month in the first two years and expect to rise to TShs 300,000 in the third year. Similarly, the salary to the managing partner will stand at TShs 400,000 in the first two years and rise to TShs 500,000 in the third year and other operating costs will stand at TShs 370,000 per month in the first two years and expected to rise to TShs 485,000 in the third year.
6. It is assumed that, for every batch of chicks purchased the supplier adds an additional of ten chicks. The same number of chicks are assumed to perish in the process and as a result, the same number of chickens are sold as the number of chicks bought.
7. Tax rate is 22.5 per cent charged to each partner allocations.

Appendix 2

A business license



TFN.226
(Rev.2/96)

JAMHURI YA MUUNGANO WA TANZANIA

LESENI YA BIASHARA

B 29183188

(Imetolewa chini ya Sheria ya Leseni za Biashara Na. 25 ya Mwaka 1972 marekebisho ya mwaka 1980 na masharti yaliyo nyuma)

*Futa isiyotakiwa

1.Ofisi iliyotolewa....MANISPAA YA MOROGORO....

2.Nambari ya Ushuru wa mapato........

3.Leseni imetolewa kwa....QUALITY CHICKEN PARTNERSHIP....

kuendesha biashara ya....UFUGAJI WA KUKU....

katika Wilaya/Kanda* ya....MOROGORO....Mtaa....KILAKALA....

4.Ni ya Shina/Tawi*

Ada Sh. ....40,000....Nambari ya Stakabadhi........

ya tarehe....17/10/2022....

5.Mpya inaendeleza* muda wa Leseni Na. ....

ya tarehe....17/10/2022....

(ii)Muda wa leseni hii utaishia ....17/10/2023....

Tarehe....17/10/2022....

Sahihi na Muhuri wa Mtoaji Leseni

Appendix 3

Picture of the coop

Appendix 4

Picture of the chickens in a coop

Appendix 5

Picture of a quality chicken that is ready for sale

Activity 1.1

Assuming your classmates are some potential investors:

(i) Identify one business idea.

(ii) Develop a business plan to be presented to your potential investors.

Exercise 1.1

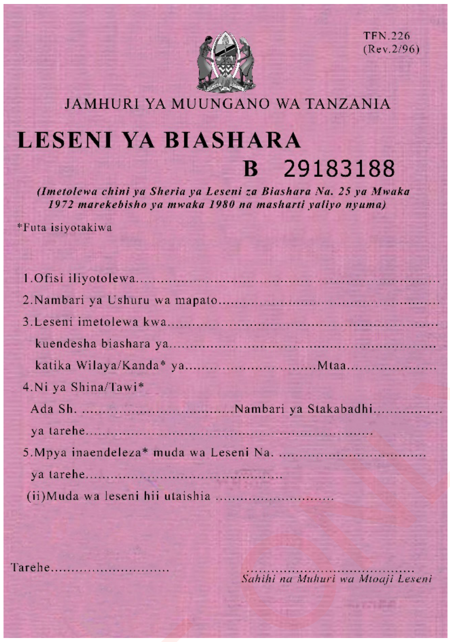
1. You have been invited by the chairman of business owners around your area to tell them why they should prepare a business plan before commencing their businesses. Taking into consideration what you have learnt, prepare a summary of what you will address them.
2. Assume you have a small business and you are intending to expand the business. In doing so, you have approached some investors and lenders around your area. One of their requirements is your business plan. You have decided to revisit your business plan for improvements. What information do you think will make the investors or lenders to be attracted to your business plan?

Business start-up and preliminary activities

A well-prepared business plan is one step ahead toward seeing a business idea turned into a profitable and sustainable business. However, there is a need for vigorous, patience, and a hard work to make one's dreams come true. Before start implementing the business plan, the following activities need to be undertaken with care:

Organise the resources: Get ready all the resources needed to run the business. The resources would include capital, workers, materials, opening a bank account, and insuring your business.

Secure the permits: A business is governed by local legislation as well as industry-specific laws and regulations. Look into the permits needed from the local government authorities and relevant government agencies which allow to run the business legally. Figure 1.4 shows an example of a business license for Tanzania mainland and Figure 1.5 shows an example of a business license for Zanzibar.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*Futa isiyotakiwa

1.Ofisi iliyotolewa.................................

2.Nambari ya Ushuru wa mapato.................................

3.Leseni imetolewa kwa.................................
kuendesha biashara ya.................................
katika Wilaya/Kanda* ya.................Mtaa.................

4.Ni ya Shina/Tawi*
Ada Sh. ....Nambari ya Stakabadhi.................
ya tarehe.................................

5.Mpya inaendeleza* muda wa Leseni Na. ....
ya tarehe.................................
(ii)Muda wa leseni hii utaishia ....

Tarehe.................   Sahihi na Muhuri wa Mtoaji Leseni

Figure 1. 4: *An example of a business license for Tanzania mainland*


SERIKALI YA MAPINDUZI ZANZIBAR

BARAZA LA MANISPAA MJINI

SHERIA YA MAMLAKA YA SERIKALI ZA MITAA

Kifungu Na. 21(4) Sheria Na 7 ya 2014

LESENI YA BIASHARA

A20

Leseni hii ni halali kwa

Kuendesha biashara halali ya

Katika eneo la

Shehia ya

Ambapo ndipo mahali pekee itakapotumika kama Makao Makuu/Tawi la Biashara

Leseni hii imetolewa na itatumika kuanzia tarehe

Leseni hii itamalizika muda wake tarehe

MKUU WA MAPATO   MKURUGENZI

Gharama ya leseni hii ni: Tsh.

Faini: Tshs. 0/=

Leseni hii haimruhusu mwenye biashara na mwenye kiwanda ambaye leseni au ruhusu nyingine inahitajika kwa mujibuwa kanuni nyingine kifungu Na. 10(5)

A2020

Figure 1. 5: *An example of a business license for Zanzibar*

Network: It has been said that business is all about who you know. In entrepreneurship, networking refers to establishing and maintaining social connections that can assist businesses in meeting their objectives. Strengthening business networks is one of the most crucial things that a business must consider. An entrepreneur needs to have a network of clients, business partners, and associates to draw energy from and keep the business going. Figure 1.6 shows an example of the business network of a business owner with other partners. Thus, the five biggest benefits of business networking include having easy access to opportunities, advice, new business, growing your profile, and friendship.

Figure 1. 6: *An example of business networking*

Market your product: Now that you have everything it takes to turn your idea into a business. Your product needs to be communicated and delivered to your potential customers. Given the level of satisfaction your customers are going to have, they will continuously go for your product.

Exercise 1.2

Assume your uncle is interested to open up a business for you after graduation. He has given you an assignment of elaborating to him the business startup activities before opening the business. Briefly elaborate the business startup activities that you will present to your uncle.

Overview of businesses in Tanzania

Many of the start-up businesses in Tanzania mainly fall under the category of Micro, Small, and Medium Enterprises (MSMEs). In the Tanzanian context, micro enterprises are those engaging up to 4 people and in most cases family members or with the capital amounting up to TShs 5,000,000. The majority of micro enterprises fall under the informal sector. Small enterprises are undertakings engaging between 5 and 49 employees or with capital investment above TShs 5,000,000 to TShs 200,000,000. Medium enterprises employ between 50 and 99 people or with a capital investment above TShs 200,000,000 to TShs 800,000,000. Large enterprises on the other hand employ 100 people and above or with capital investment above TShs 800 million. This classification is illustrated in Table 1.1. However, in situations where the numbers of people and capital investment do not correspond well, capital investment is used as the main factor in deciding the category of a business.

Table 1. 1: *Classification of businesses*

Business size	**Number of employees**	Capital investment in machinery (TSh)
Micro enterprise	1 to 4	Up to 5 million
Small enterprise	5 to 49	Above 5 to 200 million
Medium enterprise	50 to 99	Above 200 to 800 million
Large enterprise	100+	Above 800 million

Source: *URT (2012): Micro, Small, and Medium Enterprises in Tanzania: National Baseline Survey. Dar es Salaam*

Exercise 1.3

Suppose you are selected to team up in the panel of business experts to assess categories of businesses in one of the district business councils. How would you classify the following businesses into either micro, small, medium, or large enterprises and justify each case:

(a) Mr Ngolowi owns a business with a capital of TShs 3,500,000 and two employees.

(b) Ms Namia owns a business with a capital of TShs 12,000,000 and three employees.

(c) Mr and Mrs Suza own a business with a capital of TShs 198,000,000 with thirty employees.

(d) Mpendae Company Ltd. has a capital of TShs 950,000,000 with twenty five employees. Machomane Enterprises has a capital of TShs 257,000,000 with fifty five employees.

Chapter summary

1. A business plan is a written document that explains in detail how a business is going to achieve its stated goals over a given period of time.
2. Development of business ideas requires innovation and creativity to address a challenge in the community.
3. An outline of a business plan consists of the following: executive summary, business description, market analysis, marketing plan, operations plan, management and organisation plan, financial plan as well as appendices.
4. Business start-up preliminary activities are organising resources, securing the permits, networking, and marketing the product/service.
5. Business enterprises in Tanzania are categorised into micro, small, medium business, and large enterprises depending on the number of employees and capital investment.

Revision exercise

1. Business description is one of the components of the business plan. Explain what needs to be included in it.
2. Dabo argues that financial projection is an important component of a business plan. Do you agree? Why?
3. Is there any necessity for conducting marketing research before starting up a business? Give reasons for your answer.
4. Malipesa has told you to propose a name for her new business. What are the important things you will consider when choosing the business name?
5. On your way home from school you met some people arguing whether or not it is a must for street vendors to have a business license. Using the knowledge you have from commerce explain to them whether or not it is a must for street vendors to have a business license.
6. One of the significance of a business plan is used for better understanding of business competition. Briefly explain.
7. Choose the correct answer from the following questions:

i. Which of the following is considered as most essential to a business owner before starting any business?
   - A. Find enough capital.
   - B. Build business office.
   - C. Plan a business.
   - D. Purchase stocks.

ii. Which component of a business plan analyses the weaknesses of competitors?
   - A. Market plan.
   - B. Management and business organisation.
   - C. Competitive analysis.
   - D. Market assessment.

iii. The following are examples of business gaps from competitors **except** ________.
   - A. related business.
   - B. delay of supplies.
   - C. poor quality of goods.
   - D. poor customer services.

iv. The following are business ideas **except** ________.
   - A. human trafficking business.
   - B. opening a retail shop.
   - C. catering business.
   - D. tailoring business.

v. These are preliminary activities carried out by one who wishes to start a new business **except** ________.

A. organising resources.
B. writing a business plan.
C. securing the permits.
D. networking.

Chapter Two

Business units

Introduction

Businesses around us have different forms depending on ownership structures. While some businesses are owned by an individual, others are owned by groups of people. This ownership structure determines the form of a business unit. In this chapter, you will learn about the concept of the business unit, forms of business units as well as international business ventures. The competencies developed from this chapter will enable you to decide on the form of business units to operate.

The concept of business unit

A business unit is an organisation or a firm that deals with the production, exchange, and distribution of products usually to make profits. It may be set up by an individual or a group of individuals. The business unit which is also known as an enterprise, a firm or an organisation engages in activities such as production, distribution, and marketing. Business units are organised in different structures or forms depending on their formation, size, control, ownership, and operation. Regardless of their forms, Tanzania laws require every business undertaking to be licensed before its operation. While some business units need to be registered and secure licenses, some need only to secure a license. The laws and regulations guiding licensing of business operations provide specific institutions with powers to license and regulate businesses. Some of the institutions or agencies from which licenses may be sought of include Local Government Authorities (LGAs), Tanzania Revenue Authority (TRA), Zanzibar Revenue Board (ZRB), and Land Transport Regulatory Authority (LATRA).

Exercise 2.1

1. Provide five examples of business units operating in your area.
2. From the examples identified in question 1, explain how they differ in terms of their activities.

Forms of business units

Business units may be formed depending on whether it is publicly or privately owned or the owner is an individual or group of individuals. Figure 2.1 shows the summary of the forms of business units.

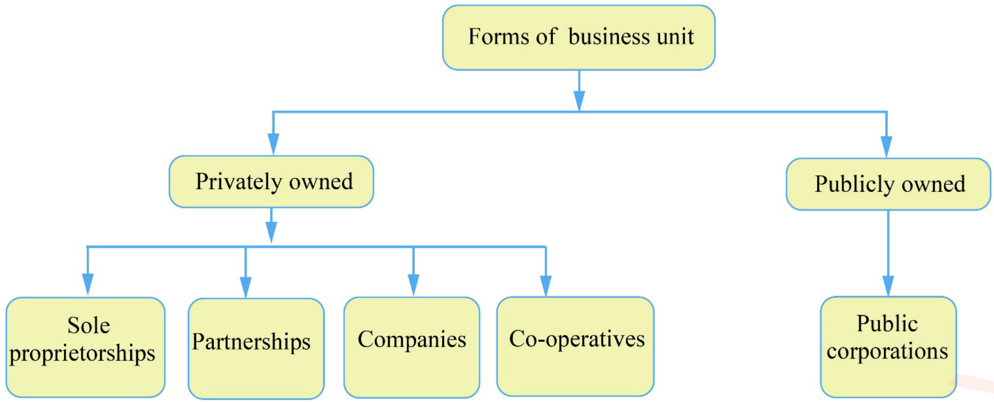

Figure 2. 1: *Business units summary*

Sole proprietorship

A proprietor means the owner of a business and sole means single. Therefore, sole proprietorship refers to an organised business which is owned, managed, and controlled by one person. Under sole proprietorship, the owner is the recipient of all the profit and bears all the risk of the business. It is the most popular, common, and oldest type of business unit. Examples of the common sole proprietorships are small shops, salons, butchers, hawkers, and food vendors.

Features of a sole proprietorship

The following are the features of the sole proprietorship:

Oldest and most common business: Sole proprietorship is the oldest and the most common business model that has been in existence for decades. Many individuals are engaged in this type of business due to its nature and size. Many mobile traders and fixed shops have been established in our communities.

Flexibility: Sole proprietorship business is the most flexible compared to other forms of business. A sole proprietor can easily change or shift from selling ice creams to selling vegetables, from butchery to salon, or from restaurant to stationery.

Single owner: Sole proprietorship business is owned and often operated by one person. In some cases, a sole proprietor may hire trusted employees or family members. However, the overall control and decision-making rest with the owner.

No profit and loss sharing: A sole proprietor takes all the benefits of the business and all the risks associated with the business. Nobody else shares the profit or loss of the sole proprietor. The whole profit arising from the sole proprietorship business remains with the sole proprietor. If there is any loss, it is also to be incurred by the sole proprietor alone.

Unlimited liability: There is no legal separation of entity between the owner and the business. Business assets and liabilities are considered to belong to the owner. In case of loss, the business wealth, along with the personal possessions of the sole proprietor, shall be used to settle the business liabilities.

Stability: Stability and continuity of the sole proprietorship significantly depend upon the capacity, competence, experience, and life span of the proprietor. If the sole proprietor is competent and committed enough to the business, the business will most likely expand and grow.

Advantages of a sole proprietorship

The following are the advantages of the sole proprietorship:

Easy to form and close down the business: It is relatively easy to form a sole proprietorship as it needs a small capital and few legal requirements. Just like formation, it is also very easy to close the business. It is within the discretion of the owner to form or close down the business.

Quick decision and prompt actions: A sole proprietor has the final say in all decisions to be made regarding the business operations. Having one person to make decisions removes unnecessary bureaucracies.

These decisions can be made anytime which means they can be made quickly as the sole proprietor only needs to consult very few people if at all.

Independence in decision making: The sole proprietor has the final say in all matters related to the business. The sole proprietor is free to make decisions independently without the interference of others. For example, a sole proprietor can make any legal transactions independently.

Easy to supervise: It is easy to supervise a sole proprietorship because owners have close and direct contact with employees, customers, and the business in general. A sole proprietor makes it easier to supervise and handle the business without much difficulty as the business is simple with relatively few transactions. Sole proprietors keep full control over their business for self-interest and easy supervision.

It needs a small start-up capital: Sole proprietorships need a small amount of capital to start. One can start the business with a meagre amount and grow over time. Under sole proprietorship, an individual can start the business even without having fixed premises. The size of capital encourages a big number of people to be attracted to start sole proprietorships.

Direct relations with customers: Sole proprietors have close contact with their customers. The close and direct relationships with the customers enable sole proprietors to serve and satisfy their customers' needs. Sole proprietors can receive orders from customers and can learn the taste and preferences of customers. Sole proprietors give personal attention and handle the complaints of their customers and thus can easily make efforts to retain them.

Keeps business secrets: Sole proprietor coordinates, and sustains a high standard of secrecy of the business such as a special method of production, and special prices for sales. For example, the goldsmith can keep their design secrets to themselves.

Disadvantages of a sole proprietorship

The following are the disadvantages of sole proprietorship:

Unlimited liabilities: The personal property of the sole proprietor can be sold to meet the liabilities of the business when it suffers losses. This situation may occur because every business involves risks. Moreover, the fear of losing personal assets increases precautionary measures by owners on their business undertakings. This may result in the rejection of some viable projects for fear of high risk. These rejections may significantly affect business operations, growth prospects, and even the business ability to keep up with the rate of development within the industry.

Limited skills: An individual owner may not possess all skills necessary for financing, marketing, purchasing, producing, and supervising the business operations. Owners tend to rely on their skills which limit their ability to perform all duties and functions efficiently.

Uncertainty in continuity: The life span of a sole proprietorship is uncertain and difficult to predict. The sole proprietorship may be liquidated, closed, and sold when the proprietor faces challenges that may stop active supervision of the business. Such challenges may be death, sickness, and imprisonment. In such cases, the business may easily come to an end.

Overworked: Sole proprietors often take care of all major concerns of their business with little or no support from their employees. They perform a wide range of activities and some of which they are not skilful enough to perform. In the due course, they end up spending long hours in the office, hence they are sometimes overworked.

Difficulty of getting credits: It is difficult to get financial support for this type of business. Banks or other financial institutions hesitate to advance loans because sole proprietors lack credit worthiness.

High cost of production: Being a small business with small scale production, the owner of the firm in sole proprietorship cannot reap the benefit of economies of large scale production. This results in a high cost of production and high prices.

Formation of a sole proprietorship

In setting up a sole proprietorship there are few and usually not complicated legal formalities to be adhered to. In many instances there is no so much legal consultation to be made. The only requirement to the sole proprietor is secure the relevant license and permit from the local council depending on the activities to be undertaken. Thus, the formation of a sole proprietorship is the simplest of all forms of business units.

Activity 2.1

Visit at least two business ventures which are most flexible around your community. Depending on the nature of the business, identify the startup procedures and present your observations in class.

Partnership

Two or more individuals or businesses may come into an agreement to run a business. The form of business run under this arrangement is termed as a partnership. Therefore, the partnership is the form of business that is owned by two or more people. Many laws across the world limit this association to a maximum of twenty people. Individuals who join efforts to form a partnership are called partners. The partners agree on a number of issues including capital to be contributed, profit and loss sharing ratio, and management of the business. The partners' agreement is called a partnership deed. The partnership deed is a legal agreement and it is used to govern the operations of the partnership and may as well be used to solve conflicts when they arise. Partnership agreements may be oral or written. The basic contents to put into partners' agreement are:

(a) Name of partnership business;
(b) A list of names and addresses of partners;
(c) The business purpose as well as a business location;
(d) Starting date of the partnership;
(e) Capital contribution by partners;
(f) Responsibilities of each partner to the business management;
(g) The salaries to be paid to partner;
(h) Profits or loss sharing ratio;
(i) Accounting procedures;
(j) The procedures for taking in new partners;
(k) Any special restrictions, rights, or duties of any partner; and
(l) Treatment for a retiring partner.

Types of partners in a partnership

Partners may be classified according to:

(a) The role played by them in the business: Partners may be active or dormant.
(b) The liability toward the firm's debts: Partners may be general or limited.
(c) The age of partners: Partners may be major or minor.
(d) The capital contributed by partners: Partners may be real, secret, nominal, quasi, partner by holding out or estoppel.
(e) The admission/ retirement of

partners: Partners may be incoming partners or outgoing partners.

Active partner: An active partner manages the day-to-day operations of the business on behalf of other partners. However, other partners are similarly accountable for the acts of the partnership just as the active partner. The active partner may be entitled to a salary depending on the agreements.

Dormant partner: A dormant partner do not participate in the management of the business. In most cases, their shares of profits are lower than those of other partners. However, the dormant partners are still liable to third parties in the same way as other partners. Other names of dormant partners are sleeping partners, silent partners or financing partners.

Minor partner: A minor partner is a person who is under eighteen years of age. The minor partner is admitted with the consent of entirely existing partners. The minor partner is not accountable for the debts of the partnership business. The minor partner is given an opportunity to decide whether to continue with the partnership or stop upon becoming a major partner. If the minor partner decides to continue as a partner, then the minor partner becomes liable for all debts of the business. If the minor partner decides to stop being a partner, then the capital of that minor partner will be refunded. This type of partnership however is not applicable in Tanzania since the law governing partnership disqualifies the minor partner from being a partner.

Major partner: The major partner is the member of the partnership who is over eighteen years of age. This partner is liable for all the debts of the business.

Secret partner: Secret partner is a partner whose association with the partnership is not disclosed to the member of the public. The partner always contribute toward the capital of the partnership and thus has a share of the profit of the partnership including the losses. A secret partner is always involved in the management of the partnership, and thus is aware of the partnership operations and decisions made.

Partner by holding out (estoppel): A partner by estoppel or quasi partner or nominal partner is not an actual partner in a partnership. The partner does not contribute anything toward the capital of partnership, and so, does not have a share of the profit or loss distribution. Partner by estoppel is a result of a personal initiative or conduct behaviours of an individual that give an impression to others including third parties that the individual is a partner. However, in an event of a crisis, a partner by estoppel becomes liable to the debt of the partnership, especially those debts whose key decisions were made with the belief that the partner by estoppel is a real partner.

Limited partner: A limited partner is a member of a partnership business whose liability towards the debts incurred by the business is limited to a stated sum, usually the capital contributed by the partner.

General partner: A general partner has unlimited liability and may be called upon to meet the debts of the business from personal resources when the business fails to settle them.

Outgoing partner: An outgoing partner is a partner who leaves the partnership. The capital contributed by an outgoing partner is adjusted with gains and losses before being refunded. If the partnership does not have enough cash to refund the outgoing partner, the amount will remain as a loan to the partnership.

Incoming partner: An incoming partner is a newly admitted partner to the partnership. The incoming partner starts to enjoy the benefits of the partnership from the date of joining the partnership. Table 2.1 summarises the types of partners, their capital contribution, participation in management, shares in profit and loss, and nature of liability.

Table 2. 1: *Summary of types of partners*

Type	Contributes capital to the partnership	Participates in the management of the business	Shares profit or losses	Have limited liability
Active	Yes	Yes	Yes	No
Sleeping/Dormant	Yes	No	Yes	No
Secret	Yes	Yes	Yes	No
Nominal/ Estoppel/ Holding out/Quasi	No	No	No	No
Incoming	Yes	Yes	Yes	No
Outgoing	Yes	Yes	Yes	No
General	Yes	Yes	Yes	No
Limited	Yes	No	Yes	Yes
Minor	Yes	Yes	Yes	Yes
Major	Yes	Yes	Yes	No

Forms of partnership

In this type of business organisation undertaken by two or more individuals, there are three main forms of partnership: general partnership, limited liability partnership, and limited partnership.

General partnership: In a general partnership, all parties in the business agree to share legal and financial liability of the partnership. The individual partners are personally responsible for the debts the partnership takes on. Similarly, the partnership profits are also shared among partners. The specifics of profit sharing will almost certainly be laid out in writing in a partnership agreement. When drafting a partnership agreement, an expulsion clause should be included, detailing what events are grounds for expelling a partner.

Limited liability partnership: Limited liability partnership is a common structure for professionals such as accountants, lawyers, and architects. This arrangement limits partners' liability; for example, if one partner is sued for misconduct, the assets of other partners are not at risk. Some law and accounting firms make a further distinction between equity partners and salaried partners. The salaried partners are more senior than associates but do not have an ownership stake. They are generally paid bonuses based on the firm's profits.

Limited partnership: Limited partnership is a hybrid of general partnership and limited liability partnership. At least one partner must be a general partner, with full personal liability for the partnership's debts. On the other hand, at least one other is a silent partner whose liability is limited to the amount invested. This silent partner generally does not participate in the management or day-to-day operation of the partnership.

Test of partnership

Many businesses exist and operate in ways convenient to owners. Some partnerships are formed without even awareness of the parties involved. To test the existence of a partnership, Figure 2.2 provides issues that must exist for an association to be a partnership.

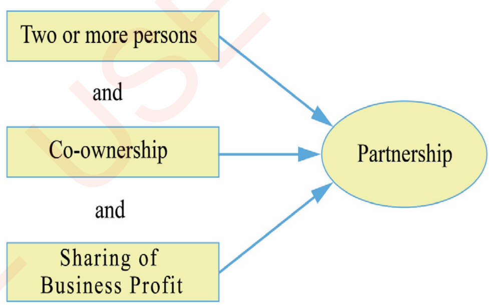

Figure 2. 2: *Test of partnership*

Thus, for a partnership business to exist there must be:

(a) an agreement between two or more but not exceeding twenty people or entities to run a business;
(b) owned business by all the people or entities agreed; and
(c) sharing of profit and loss among the people or entities agreed.

Features of partnership

The following are the features of partnership:

Existence of agreement: Partnership is the result of an agreement between two or more people to run a business. The agreement may be made orally or in written form. In most cases, the agreement is done legally. Every member must have a copy of the agreement if such an agreement is in written form. An oral contract is sufficient but it is always better to draft a deed of partnership specifying terms and conditions, the rights, duties, and obligations of each partner. In a valid contract, insolvents, lunatics and other incompetent people cannot get into a partnership agreement. The agreement has all conditions and terms to guide the partnership.

Sharing of profits or losses: Since the partners are the owners of the business, any profit or loss resulting from the operations of the business is shared among partners according to the agreement. In case there is no any agreement on the profit or loss sharing ratio, the partners will share profit or loss equally.

Capital contribution: The capital of the partnership is a result of the contribution from each partner. Every partner contributes either cash or asset towards the capital of the business.

Limited life: Partnership may be ended at any time by death, bankruptcy, or disagreement among members of the partnership. When such an event happens, the business must be dissolved.

Partner acts as an agent as well as principal: Each partner acts as an agent of the partnership with the authority to enter into contracts or purchase and sale of goods and services. The business may be carried on by all partners or one or more acting on behalf of other partners. In result, such a partner is both an agent and a principal. The partner acts as an agent for other partners and the principal for such a partnership. Every partner is the owner of the business and is respected by all members.

Nature of liability: In most cases the liability of partnership is unlimited. Each member is responsible for all the debts of the business. Therefore, the liability of partners is both individual and collective. The creditors have the right to recover the partnerships' debts from the private property of one or from all partners, where the assets of the business are inadequate.

The number of partners: In partnership, the number of partners ranges from two to twenty. Partners could be individuals or business units.

Restriction on the transfer of ownership: A partner is not allowed to sell or transfer ownership to somebody else to be in a partnership. This can however, be done with the consent of all other partners.

High level of faith (Utmost good faith): All partners should trust one another in the partnership. All partners act honestly and in the best interest of the business. All information is disclosed openly to one another.

No separate entity: A partnership is neither a legal entity nor a person with any separate right distinct from the partners establishing it.

Advantages of partnership

The following are the advantages of partnership:

Simplicity of formation: A partnership is simply formed when individuals get into agreements. There are no complex formalities to form a partnership.

More financial resources: Getting into a partnership allows the business to gather financial resources from partners and expand the capital of the business.

Collective management, skills and knowledge: It is much easier to manage the day-to-day business operations with carefully chosen partners. Partners choose themselves by knowing each other about ability, skills, behaviour, commitment and competence. Therefore, there is a combination of talents in doing the best for a business.

Easy to obtain loan: Partnerships enjoy the benefit of ease in securing loans as lenders feel more comfortable offering loans to groups than offering loans to individuals.

Free entry and exit of partners: It is free to join and leave the partnership. Any member who wishes to leave or join the partnership has to do so under a mutual agreement or consent from other partners as stated in the partnership agreement.

Ease of dissolution: Dissolution of partnership means the closure of the partnership. As the formation is based on the partners' agreement, the same goes for the dissolution. The partnership can be lawfully dissolved without much difficulty by mutual consent of the partners in accordance with an agreement among the partners.

Disadvantages of partnership

The following are the disadvantages of partnership:

Unlimited liabilities: All general partners are liable for the debts of the partnership irrespective of the person responsible for causing them. Like sole proprietors, general partners can lose their personal properties if the partnership loses a lawsuit or goes bankrupt.

Lack of unity of command: The unity of command requires every worker to receive orders from only one superior. In the event that partners' duties and responsibilities are not well defined, there is likelihood of partners' conflicts in management.

Possibility of misunderstandings: Since decisions of the business are made by more than one individuals, disagreements among partners may create serious misunderstandings. For example, who among the partners has authority over employees?

Bureaucracy in decision-making: Decision-making can be slower than running a business as a sole proprietor because partners need consultation from others in the partnership to reach an agreement. In the presence of disagreements, partners will need to spend time negotiating to reach a consensus. It is possible that opportunities will be missed as a result of this. This may irritate a partner who is accustomed to make all of the business decisions.

Disappointing the hard working partner: An enthusiastic or hard working partner may be discouraged if the profit arising out of the efforts of a hard worker is shared equally by all the partners.

Formation of partnership

The formation of a partnership requires a voluntary "association" of persons who "co-own" the business and intend to conduct the business for profit. Persons can form a partnership by written or oral agreement, and a partnership agreement often governs the partners' relations with each other and the partnership. The term *person* generally includes individuals, corporations, and other partnerships and business associations. Accordingly, some partnerships may contain individuals as well as large corporations. Family members may also form and operate a partnership, but courts generally look closely at the structure of a family business before recognising it as a partnership for the benefit of the firm's creditors. Accordingly, a partnership may come into existence through a course of dealings provided it is possible to identify an agreement between the parties on the essential elements of the contract. It may be possible to separate an agreement on essential terms from the conduct of the parties. Thus, a partnership may arise in two ways:

By express agreement: While the law does not require formality to establish a partnership, in practice it is usual to have a written agreement drawn up and executed by the partners, setting out the terms upon which the relationship subsists. It remains possible to have an expressive partnership agreement without committing the terms in written document, in which case the agreement may be proved by oral evidence.

By implied agreement: In the eyes of the law, a partnership exists when two or more persons carry on business in common with a view of making a profit. Persons in such a position are partners even if they are not aware of that fact. As with any other type of contract, it is possible to infer the contractual relationship from the conduct of the parties. Their conduct in the circumstances may go further and be evidence of an implied agreement of the terms of their relationship, For example, their right to a specified proportion of profits.

Thus, forming a partnership is all about getting into agreement whether by expression or by implication. Figure 2.3 shows some partners who have agreed to form a partnership.

Figure 2. 3: *Partners in a meeting*

Activity 2.2

Visit one business venture around your community owned by at least two people but not more than twenty.

(a) Identify the characteristics of that business

(b) Identify its startup procedures and present your observation in class.

Company

Company is a corporate association of persons formed to carry out specific functions with the aim of generating profit. It is a 'corporate body' created under the law and it has an existence of its own, quite separate from the members who comprise it. In the eyes of the law, a company is an artificial person that can enter into contracts, own properties, incur liabilities, sue others, be sued by others, and do anything for which it has been formed. Examples of companies in Tanzania are NMB Bank Plc (NMB), the People's Bank of Zanzibar Ltd (PBZ), CRDB Bank Plc (CRDB), the National Bank of Commerce Ltd (NBC), Tanzania Commercial Bank Plc, and Tanzania Telecommunications Corporation (TTCL).

Types of companies

Companies can be classified based on the nature of capital, ownership, control or holding, access to capital, and other basis.

Classification of companies based on the nature of capital

The following is the classification of companies based on the nature of capital:

Companies limited by shares: In companies limited by shares, the liabilities of members are limited to the extent of the number of fully paid-up shares. This means that in case of winding up, members will be liable only for the number of shares that have been fully paid for.

Companies limited by guarantee: Company limited by guarantee is a company without any shareholder but is owned by members called guarantors who agree to pay a nominal amount of debts or liabilities in the event of winding up. The profit earned by the company is re-invested in the company to be used for different purposes. For example, most not-for-profit companies operate as companies limited by guarantee.

Unlimited companies: Unlimited companies have no limits on their members' assets. These companies' shareholders become liable for all the debts of the company in case the company becomes insolvent. If the company will not have sufficient assets to pay all the liabilities during winding up, the personal belongings of shareholders will be used to compensate for the deficit.

Classification of companies based on ownership

The classification of companies based on ownership is as follows:

Private companies: Private companies are those companies whose Articles of Association restrict the free transferability of shares. In terms of members, private companies need to have a minimum of two and a maximum of fifty members.

Public limited companies: Public limited companies allow their members to freely transfer their shares to others. They need to have a minimum of seven members, but they have unlimited maximum number of members. Most large-scale industrial and commercial companies fall under this type of company.

Classification of companies on the basis of control or holding

The classification of companies on the basis of control or holding is as follows:

Holding and subsidiary /group companies: In some cases, the company's shares might be held fully or partly by another company. Here, the company owning these shares becomes the holding or parent company. Likewise, the company whose shares are owned by the parent company becomes a subsidiary company. Holding companies may exercise control over their subsidiaries. Thus, when company A holds more than 50 per cent shares of company B, then company A is the parenting or holding company and company B is a subsidiary company.

Associate companies: Associate companies are those in which other companies have significant influence. By significance influence it implies a control of at least 20 per cent and no more than 50 per cent of total share capital or of a business decision under agreement.

Classification of companies in terms of access to capital

The classification of companies in terms of access to capital is as follows:

Listed Companies: Listed companies have their securities listed on stock exchange markets. This means people can freely buy and sell their shares. In such markets, public companies are a common form of listed companies.

Unlisted companies: Unlisted companies, on the other hand, do not list their securities on stock exchange markets. Private companies can come under this category.

Other classifications of companies

The following are other types of companies:

Government companies: Government companies are those in which more than 50 per cent of share capital is held by either the central government, or by one or more state governments, or jointly by the central government and one or more state governments.

Foreign companies: Foreign companies are incorporated outside their domestic country. They also conduct business in the domestic country using a place of business either by themselves or with other companies.

Charitable companies under certain specific section: Certain companies have charitable purposes as their objectives. Charitable companies focus on the promotion of arts, science, culture, religion, education, sports, trade, and commerce as their objectives. Since they do not earn profits, they also do not pay any dividends to their members.

Dormant companies: These companies are generally formed for future projects. They do not have significant accounting transactions and do not have to carry out all compliances with regular companies.

Features of a company

The following are the features of a company:

Artificial person: A company has its legal existence separate from its owners. In the eyes of the law, a company is a legal person thus it can own assets, enter a contract, be sued, or sue.

Separate legal entity: There is a clear line of separation between the business and its owners. The assets of the business are separate from those of the owners.

Perpetual succession: Companies are established with a belief of operating indefinitely. Hence companies are designed in such a way that the death of a member will not significantly affect the continuity or going concern of the company.

Control: Companies are always managed by the board of directors who act on behalf of the owners. They are responsible to appoint top management to oversee the daily functioning of the company.

Liability: Owners of the company usually have limited liability. The liabilities of owners of the business are limited to the amount of capital they have agreed to contribute or an amount of capital guaranteed by owners in the event of a crisis.

Common seal: The owners of a company are many, as a result a common seal is prepared to identify the company as one. The common seal is required to appear in all dealings of the company to guarantee the involvement of the company. In the absence of such a seal, company participation is not guaranteed and hence exempted.

Low risk: The risk of the company is borne by every owner of the company and limited to the amount of capital they have agreed to contribute. As the amount is borne by many, the risk is spread out and thus reducing its impact on an individual investor.

Advantages of a company

Operating a business as a company has the following advantages:

Encourages business expansion: It is easy for a company to grow since a limited company's capital can be raised from different sources, therefore, expanding the business becomes easier. Companies can increase their capital by issuing more shares or debentures. Companies can also use their reserves to fund their expansion.

Allows transfer of ownership: If shareholders are dissatisfied with the company's performance, they can sell their shares at any moment in the stock market. This makes the company's ability to continue to operate throughout regardless of the transition in ownership.

Limited liability: Unless otherwise stated, the liability of shareholders is limited to the amount of capital they have agreed to contribute or the guarantee a shareholder provides. In the event that the company fails to meet its obligations, the personal property of shareholders will not be taken to pay the company's liabilities.

Presence of professional management: The management of a company is in the hands of the board of directors who are elected by the shareholders and have extensive expertise. Salaried professional managers are hired to oversee day-to-day operations of a company as a result, the company is provided with expert management.

Disadvantages of a company

The company has the following disadvantages:

Absence of direct control by shareholders: The owners (shareholders) do not have direct control over the running of the business. Only the expert directors have control of the business.

Lack of secrecy: Due to legal requirements, a public company must make numerous statements available to the Registrar of companies, financial institutions and the general public. Hence, commercial secrecy is compromised. It is further lowered when the company issues its annual report to shareholders, as competitors have access to all financial information.

Complex formalities: Companies operations are guided by regulations that must be adhered to. Adhering to such formalities may sometimes be costly.

Possibilities of misallocation of resources by management: Since companies are not operated by owners, those operating the company may abuse their powers and conduct fraudulent activities for their personal gains.

Lack of personal interest: Unlike proprietorship and partnership, salaried managers handle a company's day-to-day operations. They may have little personal interest and dedication to the business since they are only employees not owners.

Double taxation: After paying out all salaries, bonuses, overhead, and other expenses, the company also pays taxes on profits. Even though the company's profit is taxed as a corporate tax, still whenever shareholders are paid dividends are taxed a withholding tax, thus, leads to double taxation.

The formation of a company

A company is formed according to the laws of the country. In the beginning, persons known as 'Promoters' prepare the plan of the company. After preparing the plan, they submit an application to the Registrar of companies seeking permission to establish such a company along with the following two documents:

Memorandum of Association: The memorandum of association consists of the name, purpose, types of shares and amount of capital of the company.

Articles of Association: The articles of association consists of the details of by-laws of the share-holders meeting, timing of the meeting, and procedure of election of officers among share-holders. Minor details regarding the rules and procedures or by-laws of the company are also given in it.

These two documents are submitted to the Registrar of companies who grants permission or orders to form such a company if the prescribed conditions according to the law are fulfilled. These orders are known as the 'Certificate of Incorporation' and 'Certificate of Registration'. After obtaining these certificates, the company starts selling its shares and collects capital to establish the company.

Formation of a company in Tanzania mainland is subject to registration by the Registrar of companies. For this purpose, Business Registration and Licensing Agency (BRELA) is the sole agency responsible for this purpose. To form a company, one needs to prepare all necessary documents and lodge the application online. BRELA has stopped paper work registration since the year 2018. For Zanzibar, Zanzibar Business and Property Registration Agency (BPRA) is the sole agency responsible for registration of companies. The following are the procedures necessary for the registration of a company in Tanzania:

Determine company's business structure: The selected business structure forms the type of the company, such as a limited liability company, a public company, and its respective branches.

Registering a business/company name: Registering a business name is done online. Before applying for a business name, there is a need to search through the BRELA website or BPRA website to check if the name already exists or not. If the name you are proposing does not exist, then you can apply for registration of such a name.

Preparing company documents: The main documents to be prepared for registration of a company are the Articles of Association and Memorandum of Association. The Articles of Association serve as the constitution of the company. It specifies the procedures through which the internal affairs of the company will be handled. Table 2.2 shows the components of the Articles of Association.

Table 2. 2: *Information to be included in the Articles of Association*

1. Organisation structure.
2. Powers and rights of each shareholder including the founder or owners of the company, and the power of the board of directors.
3. Election of the management committee.
4. Organisation meetings.
5. Information on business financing sources.
6. Company accounts and records.
7. Management salary.
8. Information on borrowing, dividend and reserve policy.
9. Information on transferability of shares.
10. Information on book-keeping and auditing requirements.
11. Information on altering capital.
12. Information on the qualifications, duties and power of directors.

On the other hand, the Memorandum of Association explains the objectives of the company and the relationship between the company and shareholders. Table 2.3 shows the components of the Memorandum of Association. These two documents are usually prepared with the help of a lawyer. Copies of directors' identity cards and their Taxpayer Identification Number (TIN) are other documents that may be needed to be attached during the application.

Table 2. 3: *Information to be included in the Memorandum of Association*

1. Name clause: The name should be unique and must be differentiated from other existing registered business names. 2. Place of operation/ address/ situation/location clause: Information on the registered office where the books of accounts will be kept and physical address are also added under this clause. 3. Objective clause: The aims and objectives of the business are stated here. It includes both primary and secondary goals. 4. Capital clause: (a) Information on the authorised or registered capital of the business is provided. (b) Information on the amount of share capital, the unit into which share capital is divided and types of shares to be issued (common or preference share). Note: the capital clause can be altered only after the meeting of the shareholders and agreeing on the alterations by their majority (above fifty one per cent). 5. Liability clause: Information on the extent of liability to the owners is provided in this clause. 6. Declaration clause: Declaration of the promoter or owners of the business on their desires to establish the business.

Applying: When all necessary documents are in place, a business account is created and the lodgment of the application by filling out the forms and uploading all the required documents is done. Upon successful registration, the company will be issued with a certificate of registration and/or a certificate of incorporation. A certificate of registration entails the company has been registered and can start operations however, it is not a separate legal entity without a certificate of incorporation. Figure 2.4 shows the samples of certificate of incorporation and certificate of registration offered by BRELA after the registration process of a company in Tanzania mainland is complete as per the requirements.

C.1

TANZANIA

BRELA
BUSINESS REGISTRATIONS AND LICENSING AGENCY

Certificate of Incorporation of a Company

Section 15

No:

I HEREBY CERTIFY THAT

LIMITED

is this day incorporated under the Companies Act, 2002 and that the Company is Limited.

GIVEN under my hand at Dar es Salaam this 6th day of **NOVEMBER TWO THOUSAND AND EIGHTEEN.**

REGISTRAR OF COMPANIES * TANZANIA *

Princ.Asst.Registrar of Companies

Form 5

TANZANIA

BRELA
BUSINESS REGISTRATIONS AND LICENSING AGENCY

No. 445005

Certificate of Registration

The Business Names (Registration)Act(Cap 213)

I HEREBY CERTIFY THAT **ENTERPRISES** this day of **JUNE** year **2018** has been duly registered pursuant to and in accordance with the provisions of the Business Names (Registration) Act and the Rules made thereunder, and has been entered the Number in the Index of Registration.

GIVEN under my hand at Dar es salaam this **29th** day of **JUNE TWO THOUSAND AND EIGHTEEN.**

REGISTRAR OF BUSINESS NAMES * TANZANIA *

Deputy Registrar of Business Names

NOTE – This certificate must be kept in a conspicuous position at the principal place of business. Any change in the particulars originally registered must be notified to the Registrar within twenty eight days.

Figure 2. 4: *Certificate of incorporation and certificate of registration samples offered by BRELA*

Figure 2.5 shows a sample of certificate of incorporation offered by BPRA after registration of a company in Zanzibar is complete as per the requirements.

Zanzibar Government

Certificate of Incorporation

Business Entities Registration Act No. 12 of 2012

Registration Number: Z00000

The Registrar of Companies hereby certify that

Company

Limited

is on 7th day of January 2019 incorporated under the Companies Act, No. 15 of 2013 and that the company is Private company Limited by shares

Assistant Registrar of Companies

Figure 2. 5: *Certificate of incorporation sample offered by PBRA*

Register with the tax authority: The registered company needs to obtain a Taxpayer Identification Number (TIN). TIN is issued for free by the Tanzania Revenue Authority (TRA). Once TRA has issued a TIN, the company will be registered for tax purposes and will be required to fill out the tax return forms and pay tax each year.

Get a business license: After incorporation, the company needs to obtain a license to start operations. The type of business license will depend on the nature of the activities the business is involved in. A general business license can be obtained from the Ministry of Industry, Trade and Investment or the LGAs in the locality where the business is operating. Businesses in certain sectors like oil and gas, food and beverage, manufacturing, and consultancy are required to apply for special licenses or permits from regulators such as Energy and Water Utilities Regulatory Authority (EWURA), Tanzania Medicines and Medical Devices Authority (TMDA), Zanzibar Food and Drug Agency (ZFDA), Tanzania Bureau of Standards (TBS), Zanzibar Bureau of Standards (ZBS), Bank of Tanzania (BOT), and Land Transport Regulatory Authority (LATRA).

Start operating business: After fulfilling all the requirements, a company can start its operations officially.

Winding up of a company

A company as an artificial person can as well die just like a natural person. Winding up of a company means closing down of the business. That is, the life of the company comes to an end. As the birth of the company was made by law, the death will as well be affected by the law. Therefore, legal procedures must be followed during the winding up of the company. Example of circumstances under which the company may be wound up are conflicts between shareholders, poor management skills, and company becoming bankruptcy.

Activity 2.3

Visit one business venture around your community which was required to prepare Memorandum of Association and Articles of Association during its formation:

(i) Identify the characteristics of that business.

(ii) Comment on its startup procedures and present your observation in class.

Public corporations

Public corporations/enterprises are independent or semi-independent corporations or companies involved in industrial and commercial activity that are formed, owned, and controlled by the government. Public enterprises are meant to promote the welfare and economic activities of the country. Examples of public enterprises are Tanzania Railways Corporation (TRC), Tanzania Electric Supply Company Limited (TANESCO), Zanzibar Electricity Corporation (ZECO), Dar es Salaam Water and Sewerage Authority (DAWASA), Zanzibar Broadcasting Corporation (ZBC), Tanzania Telecommunications Corporation (TTCL), UDA Rapid Transit Public Limited Company (UDART), Zanzibar Insurance Corporation (ZIC), and Air Tanzania Company Limited (ATCL). These enterprises are operated by the government or any semi-government organisation and public or statutory corporations.

Features of public enterprises

The following are the features of public enterprises:

Government sponsored: Public enterprises are either fully owned by the government or have a government as the majority shareholding. Private investments are permitted in some ventures, although the government continues to play a major role.

Government administration and management: The government is in charge of public enterprises. On rare occasions, the government has launched businesses under the sponsorship of its ministries. In other circumstances, the government appoints people to run the businesses. Government departments have direct and indirect authority over these independent bodies.

Financial self-sufficiency: Despite the fact that the government makes investments in government enterprises, the public enterprises can become financially self-sufficient that are not reliant on the government to meet their basic requirements. Also, public enterprises can plan and handle their budgets, set their pricing strategies, take profit into account as well as support businesses in self-financing their expansion.

Government services: The basic goal of public enterprise is to serve society. These businesses are founded on the principle of providing services than doing business. A private entrepreneur will establish a business only if there is a chance of earning profit, but this is not the goal of public enterprises.

Supports government plans: The government's economic strategies and plans are carried out through public enterprises. For example, the reforestation policy of the country is carried-out by many public institutions such as schools, colleges and universities.

The formation of public enterprises

Formation of public enterprises in Tanzania is governed by different laws and regulations. They are established under Acts of the Parliament related to the sector they are going to serve.

Advantages of public enterprises

The following are the advantages of public enterprises:

(a) They are legal entities, which means they can sue and being sued;
(b) They have an infinite life span;
(c) They are answerable or accountable to the people at large;
(d) They aid in the government's revenue generation;
(e) They supply citizens with infrastructure services;
(f) They are monetarily sound and can obtain loans easily on large scale for the benefit of people at a fair interest rate than the private enterprises;
(g) Controlled democratically through the state and local authorities;
(h) Services are provided at fair prices since the interest of the public is the main consideration;
(i) They are appropriate for activities such as public utilities where competing firms would consider them as a waste and inefficient; and
(j) They can receive accountability that is beyond the normal aims of private enterprises, for example, sewerage and garbage collection, although these are slowly been privatised.

Disadvantages of public enterprises

Public enterprises have the following disadvantages:

They may provide poor services: Public enterprises serve a large population which may be difficult to meet individual needs. Moreover, the absence of competition in sectors in which these public enterprises operate may lead to poor quality products.

Uncertainty: Majority of the public enterprises are established by laws which also determine their functioning as well as continuity. Whenever laws are changed, the functioning and continuity of the enterprise may be affected.

Unfair terms and conditions: In competitions, both public and private enterprises compete; however, private businesses are sometimes subjected to unfair terms and conditions.

Co-operative organisations

Co-operative organisations also known as co-operative societies are voluntarily formed by individuals with common interests with the intention of pooling resources to promote their welfare. In Tanzania, co-operative organisations started during the colonial period. Co-operative organisations differ from other major forms of organisations since are set not for profit earning but to promote welfare of their members.

Co-operative organisations are characterised by "*Each for all and all for each*" philosophy meaning that, everybody benefits from acting collectively. Examples of co-operative organisations include: Savings and Credit Co-operative Societies (SACCOS), Kilimo Fursa Co-operative, and Agricultural Marketing Co-operative Society (AMCOS).

Characteristics of co-operative organisations

The following are the characteristics of co-operative organisations:

Voluntary membership: Co-operative organisations are formed by voluntary membership. A person who shares similar interests and is willing to follow society's norms has the right to join the society, and stay in it as long as the member wants.

Open membership: A co-operative organisation membership is open to all, regardless of race, colour, or gender, because it is voluntary. Membership can only be denied if it is considered to be harmful to society interests or existence. The managing committee of the co-operative organisation may also expel any member for identified reasons, and this will not be regarded as a violation of the open membership concept.

Finance: Co-operative organisation members contribute to the finances of a co-operative organisation by purchasing shares or periodic compulsory savings. The government also may provide financial assistance in the form of state and central co-operative bank loans.

Democratic control: Co-operative organisations are controlled democratically. The business of a co-operative organisation is generally managed by a committee elected by the members at an annual general meeting. Regardless of the number of shares, all members have the same voting right and power. "*One man one vote*" is the basic element of co-operative democracy.

Surplus distribution: Like profit-oriented businesses, a co-operative organisations' surplus is distributed to members in proportion to their capital contribution or an agreed ratio. At least twenty-five per cent of profit must be allocated to the general reserve according to the law. Similarly, a portion of the proceeds (not to exceed ten per cent) may be used for the general welfare of the community.

Service motive: A co-operative organisation is created with the primary goal of delivering beneficial services to its members and society, whether in the form of credit, consumption items, or input resources.

Education and training: A co-operative organisation may provide education and training to its members with the main reason of developing skills of its members for the growth of the co-operative organisation.

Solidarity: Co-operative organisations are formed by people with common interests. The members are united while taking any decision regarding their welfare.

Formation of co-operative organisations

Co-operative organisations are registered under the Co-operative Societies Act of the year 2013. The Tanzania Co-operative Development Commission (TCDC) is the registrar of all co-operative societies in Tanzania. Procedures to register a co-operative organisation are:

Make voluntary decisions: Individuals must voluntarily decide to form a co-operative society and inform the co-operative officer at their location about their aim. The officer will then guide them on how to register the co-operative organisation of their aim.

Holding a general establishment meeting: Individuals intending to start a co-operative organisation will hold a general meeting that will be chaired by the co-operative officer. The agenda for the meeting will among others include:

(a) The goal of starting the co-operative organisation.

(b) Appointment of members to form the founding board of the co-operative organisation.

(c) Appointing the board leaders.

(d) To inform members about procedures for the establishment of the co-operative organisation.

(e) Delegation of powers and responsibilities to the founding board until the co-operative organisation is registered.

(f) Proposing the name of the co-operative organisation, fees and shares.

Holding a general meeting to discuss the board's recommendations: The founding board is required to call a meeting with the founders to discuss and approve the constitution, budget, business plan and the will to start the co-operative organisation.

Apply for registration: The application will be sent to the assistant registrar of co-operatives at the regional level. Upon satisfaction, the registrar must issue a certificate of registration within sixty days.

Holding a general meeting after registration: The meeting must be held within two months for handling the registration certificate to members, dissolving the founding board and appointing the management board, receiving directives from the registrar of co-operatives as well as setting strategies to attain their objectives.

Advantages of co-operative organisations

Co-operative organisations have the following advantages:

Easy formation: The formation of a co-operative organisation is considered easy as there is always a co-operative officer in place to assist and provide guidelines.

Freedom of entry and exit: Everyone who is interested can join a co-operative organisation. A member can be anyone who shares a common interest. The membership price is maintained low so that everyone may participate in co-operative organisations and benefit from them. At the same time, any member of a co-operative organisation who wishes to leave is free to do so.

Promotes democracy: All members of co-operative organisations have equal rights and power regardless of their shares. Co-operative organisations allow anyone to join, leave, and choose a leader or chosen as a leader.

There is fair distribution of surplus: The surplus generated by co-operative organisations are dispersed among members fairly; as a result, everyone in the co-operative organisation benefits. Furthermore, co-operative organisations benefits since a portion of the surplus, not exceeding ten per cent can be used to improve the welfare of the community in which the co-operative organisation is based.

Limited liabilities: A co-operative organisation members' liability is restricted to the amount of share they have contributed. A co-operative organisation member cannot be held individually accountable for the organisation's liabilities.

Going concern: A co-operative organisation has its legal entity separate from its members. As a result, the death, insanity, or insolvency of its members has no bearing on its continuation. It continues to exist indefinitely.

Possess some distinct set of interests: Co-operative organisations operate in a small geographic area, and members have a stronger sense of shared interests. Members would communicate with one another; work together and handle organisation activities more effectively.

Attract government assistance: The government can provide full assistance to co-operative organisations to encourage their growth. It may offer low-interest loans, as well as subsidies and other benefits.

The elimination of middlemen: Co-operative organisations have direct contact with both producers and final consumers. As a result, they are not reliant on middlemen and may save the earnings that the middlemen enjoy.

Provide credit in rural areas: Villagers have been liberated from informal money lenders, thanks to co-operative groups. Informal money lenders used to charge large interest rates, and the villagers' income were utilised solely to pay the interest. Co-operative organisations have benefited the rural population by providing loans at lower interest rates. Rural people are able to break free from the control of the informal money lenders after the founding of co-operative organisations.

Contribution to agricultural development: The government efforts to enhance agricultural production have been helped by co-operative organisations. They have enhanced people lives in rural areas and they are always there to help.

Offer reasonable price and high-quality products: Co-operative organisations purchase and sell large quantities of goods directly from producers or customers. Fair prices and high-quality products offered by the co-operative organisations ensure market satisfaction.

Social benefit: Co-operative organisations have a significant influence in influencing societal norms and reducing wasteful spending. The co-operative organisation profits are utilised to improve the welfare of their members.

Disadvantages of co-operative organisations

Co-operative organisations have the following disadvantages:

Limited financial resources:
The co-operative organisations are always operating on limited financial resources resulting from low membership dues (fees). This leads to a low accumulation of financial resources which in turn results in a failure of the co-operative organisations to achieve intended goals and objectives.

An excessive reliance on government funds: As co-operative societies fail to raise funds on their own, they sometimes rely on government assistance. Heavy reliance on government assistance may result in the inability to properly plan their activities. This is because in most cases the government subsidies do not come on time as expected.

Lack of administrative skills:
Co-operative organisations are managed by the managing committee elected by their members. The members of the managing committee may not have the required qualification, skills, or experience. Since it has limited financial resources, its ability to compensate employees is limited. Therefore, it cannot employ the best talented personnel. Lack of managerial skills results in inefficient management, poor functioning and difficulty in achieving objectives.

Misuse of funds: If the members of the managing committee are corrupt, they might misuse the funds of the co-operative organisation. Many co-operative organisations have faced financial troubles and closed down because of corruption and misuse of funds.

Possibility of conflicts among members:
Co-operative organisations are based on the principles of co-operation and therefore harmony among members is important. But in practice, there might be internal politics, differences in opinions, and quarrels among members which may lead to disputes. Such disputes may affect the general functioning of co-operative organisations. Table 2.4 provides a comparative summary of different business units in Tanzania in terms of formation, number of members, capital contribution, liability, management, and continuity.

Table 2. 4: *A comparative summary of different forms of business units in Tanzania*

Basis	Sole Proprietorship	Partnership	Company	Co-operative organisation
Formation	Minimal legal requirements	Easy formation in the existence of partnership deed	Compulsory registration is expensive and consumes time	Registration is compulsory
Members	Only the owner of the business	Minimum of 2 and maximum of 20	• Public limited companies minimum of 7 people, the maximum number varies depending on the capital requirement • Private companies minimum of 2 people and maximum of 50 people	At least 10 adult people are needed
Capital Contribution	Comes from the owner alone	Comes from partners contribution	Comes from the purchase of shares	Comes from the purchase of shares
Liability	Unlimited	Unlimited	Limited	Limited
Management and Control	Owner make all business decisions	Partners make all business decision	Separation of power between owners and management	Elected management committee
Stability for continuity	Unstable	Unstable	Stable	Stable

Activity 2.4

Visit at least two business ventures around your community. Depending on the characteristics of the businesses, identify their forms and present your observations in class.

Exercise 2.2

1. Why public enterprises do not aim at making profit?
2. Your brother who has graduated from the University last year taking Bachelor of Sociology wishes to start a business. He is desperate whether to start a partnership with his fellow graduate or register a company. Using your knowledge from forms of business units explain to him any four differences between a partnership and a company.
3. Aba has been running a sole proprietor business for the past five years. This year he winded up the business due to several reasons. Analyse any possible causes for shutting down the business.
4. Pompi Company Limited has suffered some challenges which force it to wind up. Briefly explain the possible circumstances under which the Pompi Company can be winded up

International business ventures

The transaction of commodities, services, technology, capital, and information across national borders is referred to as an international business. It entails the exchange of commodities and services across national borders between two or more countries. Capital, skills, and people are all used in transactions of economic resources for the international production of physical goods and services. Services include finance, banking, insurance, and construction. There are different forms of international business ventures including joint venture, franchising, and strategic alliance.

Joint venture

A joint venture is a union between two or more companies or partners that pool their resources and expertise to pursue a common goal for a specific period where the enterprise's risks and rewards are also shared. Business expansion, product development, and product expansion into new markets, particularly internationally, are all motivations for forming a joint venture. A joint venture provides the company with the following benefits: more financial resources, more management capacity, more technical know-how, access to well-established markets, and means of distribution. Many firms enter foreign markets by engaging in a joint venture with a local company.

Features of joint ventures

The following are the features of joint ventures:

Agreement: Two or more firms come to an agreement, to undertake a business, for a definite purpose and are bound by it.

Joint Control: There exists a joint control of the co-ventures over business assets, operations, administration, and even the venture.

Pooling of resources and expertise: Firms pool their resources like capital, manpower, technical know-how and expertise, which helps in large-scale production.

Sharing of profit and loss: The co-ventures agree to share the profits and losses of the business in an agreed ratio. The computation of the profit and loss is usually done at the end of the business venture, however, when it continues for a long duration, the profit and loss are calculated annually.

Access to advanced technology: By entering into a joint ventures, firms get access to various techniques of production, marketing and doing business, which decreases the overall cost and also improves quality.

Dissolution: Once the term or purpose of the joint venture is complete, the agreement comes to an end, and the accounts of the co-ventures are settled as when it is dissolved.

Advantages of joint ventures

The following are the advantages of joint ventures:

Access to new markets: A joint venture agreement provides an opportunity to access new markets and distribution networks. This in turn enhances sales of the products or services rendered by the new joint venture firm.

Enhance business growth: Joint venture arrangement helps businesses to grow faster, increase productivity and generate greater profits.

Provide access to more resources: When two or more firms agree on a joint venture, it means they are pooling together the resources including technology and staff to an established venture. This is advantageous in combining the expertise, knowledge and technology in offering better services.

Flexibility: Being a temporary contract between participating companies, a joint venture can dissolve at any specific future date or when the project is completed.

No loss of identity: Each company is able to maintain its own identity and can easily return to normal business operations once the joint venture is complete.

Economies of scale: Joint venture helps organisations to scale up with their limited capacity. The strength of one organisation can be utilised by the other. This gives a competitive advantage to both the organisations to generate economies of scale.

Minimisation of risk: Joint venture tend to share risks between the firms involved in the agreement. This in turn helps to minimise the overall risk of the venture.

Disadvantages of the joint ventures

The following are the disadvantages of the joint ventures:

Taxation challenges: Creating a joint venture may result in more complex tax arrangements especially when the joint venture involves companies from different countries.

Political risk: Joint ventures formed by companies from different countries may involve higher political risks especially if the wrong partner is chosen.

Unequal involvement: Equal pay may be possible, but it is extremely unlikely for all the companies working together to share the same involvement and responsibilities.

Clash of cultures: Companies involved in the joint venture agreement may have different beliefs, tastes, and preferences which may lead to poor cooperation and integration. This may undermine their profitability.

Franchising

Franchising is a business system in a form of marketing and distribution in which the owner of a business system (the franchisor) grants an individual or group of individuals (the franchisee) the right to run a business using the franchisor's business system. Franchisees are also given permission to use the franchisor's branding, trademarks, and identification marks under specified guidelines. It is important for anyone deciding to start a business by becoming a franchisee to remember that in franchising, the franchisee is bound to a partnership agreement with the franchisor for a defined period. Some examples of the Franchise found in Tanzania include; Kentucky Fried Chicken (KFC) and Subway which are American fast-food chains that have been established in Dar es Salaam. Woolworth Holdings Limited is a South African multinational retailing company that has operations in Dar es Salaam and Arusha.

Advantages of franchising

The following are the advantages of franchising:

Business assistance: Depending on the terms of the franchise agreement and the structure of the business, the franchisee might receive significant assistance in business operations. They may be provided with the brand, the equipment, supplies, and the advertising plan needed to operate the business.

Profit: In general, franchises see higher profits than independently established businesses. Most franchises have recognisable brands that bring customers from different countries. This popularity results in higher profits.

Customer base: Franchises come with instant brand recognition and a loyal customer base. Even if the first branch of a franchise is opened in a small town, the likelihood is that potential customers are already familiar with the brand from exposure to television (TV) commercials or travel to other cities.

Easiness in securing finance: An already established brand in franchising makes it relatively easier to secure finance due to brand awareness.

Training offered to franchisee: Training provided by the franchisor compensates for the need for experience.

Disadvantages of franchising

The following are the disadvantages of franchising:

Little room for creativity: Franchisees are not entirely in control of their business, nor can they make decisions without taking into account the opinion of the franchisor.

Higher initial cost: Initial cost in most franchising agreements is very high. This may be a disadvantage for small businesses.

Potential for conflict: While one of the benefits of owning a franchise is the network of support received, it also has the potential for conflict. Any close business relationship, especially when there's an imbalance of power, comes with a risk that the parties will not get along.

Risk from other franchises: Failure of one franchise may cost other franchises.

Lack of financial privacy: The franchise agreement will likely stipulate that the franchisor can oversee the entire financial ecosystem of the franchise. This lack of financial privacy can be seen by the franchisee as a disadvantage of owning a franchise; however, it may be less of an issue if financial guidance is welcomed.

Strategic alliance

A strategic alliance is an agreement between two or more parties to undertake a mutually beneficial project while remaining independent of one another. Essentially, it allows the independent parties to work towards a common goal that will benefit the parties involved. An example of strategic alliance in Tanzania is an agreement between vehicle selling companies and banks to supply commercial vehicles to young entrepreneurs or between SMEs and banks by financing their business through credit facility of up to three years.

Advantages of strategic alliance

The following are the advantages of strategic alliance:

Sharing resources and expertise: A strategic alliance involves the combination of the resources and expertise of both companies involved. Such resources include: a deeper understanding of the product, sales, or marketing knowledge which are necessary for improving profitability.

Access to market: In some cases, a strategic alliance gives access to new markets with a solution that would not have been possible for either company on its own. For instance, companies going global often work with a trusted local partner to get an advantage in an emerging market.

Enhance production: Strategic alliances allow partners to increase their capabilities and scale quickly to meet demand.

Drive innovation: With the right alliance, partners can outpace the competition with new solutions that are complete package for their customers. These alliances are creative and revolutionary and change the market landscape in a dramatic way.

Disadvantages of strategic alliance

The following are the disadvantages of strategic alliance:

Loss of control: In an alliance, both organisations must give up some control over how their business is run and perceived.

Increased liability: Both partners involved in a strategic alliance are at risk of loss of reputation in case of a business failure.

Exercise 2.3

1. Mwanakwetu Printing Company Limited (MPCL) has been offered tender to print election ballots for 2025 presidential election. MPCL has entered into a union with Shawarma Printing Company Limited an international business venture. They have a specified agreement in terms of time and task.
   (a) Identify this type of international business venture.
   (b) Describe the possible features of this type of business.
2. Business A which is an international business has granted permission for Business B located in Tanzania to do business using business A's system. They have entered into an agreement specifying the right of each business. Identify this type of international business venture.
   (a) What is the technical name of Business A?
   (b) What is the technical name of Business B?
   (c) Describe the advantages and disadvantages of this type of international business venture.

General strengths of business units

Strengths of business units are the good traits of business that make a business prosper. The general strengths of business units are as follows:

Good management of business: If the business has good management, then the business has the wide chance of growing and expanding.

Potential location: If the business is potentially located, it impacts the prosperity of the business. For example, a retail shop located nearby three schools with a total of four thousand pupils will flourish more than any retail shop located far away from this area.

Reputation of the business: If the business demonstrates honesty and trust to the customers, it will lead to customers becoming loyal to the business, and hence the business will prosper. For example, a business with a good history of loyalty to customers may have many of its customers coming from different areas to get services.

Knowledgeable employees: If the employees are skilled, professional, committed and competent in their work, then the business will likely to prosper.

Training of workers: If the business trains and improves the knowledge and skills of its workers, the business may expand.

Fast making decisions: If the business can react fast to challenges and opportunities, then the business is likely to prosper.

Flexibility: If the business is advantageously flexible, the business may prosper. For example, a company may choose to alternate four products depending on the season.

Good innovative aspects: If the business is innovatively oriented to products, distribution, and process of production then the business will enjoy the opportunities it faces.

General challenges of business units

The general challenges of business units are difficulties faced by business units that may affect the business to prosper if no corrective actions are taken. General challenges of business units include:

Insufficient financial support: One of the problems facing the business units is insufficient financial support. In many events, financial institutions do not disburse effective loans to business enterprises which slow down their growth.

Poor infrastructures: Poor infrastructures is one of the challenges facing business in developing countries. Much of the infrastructures such as roads, railways, power, and water supply have a limited operation which hinders some of the business activities.

Raw materials accessibility: Access to raw materials requires the use of advanced technology. Lack of advanced technology particularly in developing countries leads to reduction in business operation, which affects profitability.

Corruption: Corruption is one of the challenges facing businesses in most developing economies. Many of the business resources may be concentrated to the eradication of the root causes of corruption rather than serving the interest of the business.

Embezzlement of business funds: Dishonest employees might misuse business resources into non-productive activities at the cost of the business.

Bureaucracy: The establishment of large businesses involves a lot of procedures before taking off and sometimes there is a lot of barriers in the procedures that the business needs to deal with.

Other challenges of business units include: lack of good research; less supply of goods to meet customer's demand; absence of brand name (popular name), high competition; cost related to change in technology, insufficient skilled labour; and products' market price fluctuations.

Exercise 2.4

1. Tanzania is one among many countries which are still developing. As one of the developing countries its businesses are faced with many challenges. What do you think are the challenges facing business units in Tanzania?

2. Assume you have been invited by business people around your area in their regular meeting. In the invitation letter they request you to address them on what makes business prosper as they find their businesses facing challenges. Prepare your presentation basing on what makes business prosper.

Institutions involved in business registration in Tanzania

There are various institutions involved in business registration in Tanzania depending on the type of business registered. These institutions include the following:

Local Government Authorities (LGAs)

These are government administrative organs that make decisions on behalf of the central government. In fulfilling the duties from which these LGAs were formed, they are the responsible organs for issuing business licenses as per the Business Licensing Act No. 25 of the year 1972 which requires all businesses to have a business license before starting up.

Conditions for getting a business license

Applicants for a business license have to fill out the application form and submit with the following:

(a) Taxpayer Identification Number (TIN);

(b) Certificate of registration (only if the business must be registered);

(c) Property lease contract (if the place of business is leased);

(d) Tax Clearance Certificate;

(e) Certificates from specific agencies if the applicant is applying for specialised services such as Zanzibar Food and Drug Agency (ZFDA) for regulating all matters relating to quality, safety of food, drugs, herbal drug, cosmetics, medical devices, and diagnostics, Zanzibar Maritime Authority (ZMA) for monitoring, regulating, and coordinating activities in the maritime industry in Zanzibar, Land Transport Regulatory Authority (LATRA) for regulating the land transport sectors, Tanzania Communications Regulatory Authority (TCRA) for regulating the electronic and postal communication sector, and Tanzania Medicines and Medical Devices Authority (TMDA) for regulating quality, safety, and effectiveness of medicines, medical devices, diagnostics, biocidal, and tobacco products ; and

(d) Professional certificates (if the applicant is applying for professional services such as engineering, accountancy, and auditing).

Benefits of a business license

Business license offers the following benefits:

(a) Legal recognition of the business;

(b) Used to open a business bank account;

(c) Used when applying for a business loan;

(d) Contribute to the national income; and

(e) Safety of the business by government authorities.

The business registrations agencies

The Business Registrations and Licensing Agency (BRELA) and Zanzibar Business and Property Registration Agency (BPRA) are executive agencies responsible for business administration and regulation of the laws; namely company registration, business names registration, trade and service mark registration, granting of patents and issuing of an industrial license.

Investment Centres

The Tanzania Investment Centre (TIC) and Zanzibar Investment Promotion Authority (ZIPA) are government agencies which promote and facilitate investments within and outside the country and ensure conducive business environment in Tanzania. These organs are responsible to advise the government on investment policy and related matters.

The revenue authorities

The Tanzania Revenue Authority (TRA) is a government agency responsible for administering fairly various taxes of the Central Government. The Zanzibar Revenue Board (ZRB) is the prime agency of the Government of Zanzibar for collection and administration of all taxes from the Inland Revenue sources other than customs, excise and income taxes that are administered by the Tanzania Revenue Authority (TRA).

It is important to note that small-scale businesses undergo the same procedures in registration as large and medium enterprises with the exception that they are not registered by TIC or ZIPA. In micro businesses, on the other hand, the same procedures as small-scale businesses are administered. This however is with an exception with those micro- businesses which do not have a permanent place. For example, in 2019 street vendors (hawkers) needed only to pay TShs 20,000 to acquire an identity card provided by the government to formalise their businesses. Figure 2.6 shows some institutions responsible for business registration in Tanzania.

Business Registrations and Licensing Agency (BRELA)/ Zanzibar Business and Property Registration Agency (PBRA)

↓

Tanzania Revenue Authority (TRA)/ Zanzibar Revenue Board (ZRB)

↓

Local Goverment Authority (LGA) and other licensing agencies or authorities

Figure 2. 6: *Some institutions responsible for business registration in Tanzania*

Importance of registering a business in Tanzania

The following are the importance of business registration in Tanzania:

Increase access to credit: Many of the financial institutions in the country offer loans to businesses that have formalised their operations. Businesses that have undergone the formalisation process can use this opportunity to secure funding from the financial institutions to expand their operations and thus boost economic developments.

Right to copyright: Business registration involves the process of securing the right to the trading name of the business. Similarly, companies can secure patent rights for their products from BRELA or BPRA during or after the registration process. Securing both copyright and patent right should help the business to secure its earnings in the long-run.

Improve tax administration: The sharing of information between BRELA or BPRA and TRA or ZRB ensures that all registered and operating businesses in the country pay tax. By formalising the business, the tax administration burden is significantly reduced as fewer resources are allocated in search of those businesses that are informally operating in the country.

Increase of tax base: Expanding the tax base is about creating more assets on the tax rolls to spread the cost of operations across more entities. As discussed above, every registered business at BRELA or BPRA, reflect the same increase in the number of tax payer in TRA or ZRB system. As more businesses formalise their operations, the same effect will have on the tax base.

Assist in the acquiring of property rights: Business formalisation allows for the acquisition of property rights to the business. Under the business name, an individual may be able to acquire large investments such as land or properties on behalf of a business something which can be limited in the case of individual activities.

Help in the planning process: Business formalisation can help the government and businesses during the planning process. In an environment of formal businesses, the government can estimate the amount of revenue to be collected including the cost of collection. Similarly, business owners can easily estimate the amount of tax liable each year and plan on payment.

Challenges of business registration in Tanzania

The following are the challenges of business registration in Tanzania:

(a) Shortage of communication facilities such as postal offices and internet facilities especially in rural areas;

(b) High costs of establishment makes it difficult for small businesses to access many of the required services. For example, transportation costs from rural areas to towns where the respective offices are located prohibits many people to establish small business;

(c) Legal costs are a bit high in most developing countries including Tanzania. These add to the total cost of establishment hence limiting large business formation;

(d) Inefficiency and poor-quality services from some of the staff in government institutions who are responsible for business formation.

(e) Many regulations set by the government may become barriers to those who want to register their businesses. For example, the requirement by the government to acquire all legal documents including payment of initial tax instalment before starting operating the business;

(f) The presence of bureaucracy in the registration process leads some government officials to be involved in corruption, especially from those business operators who want to register their business on time; and

(g) Low education on the importance of business registration, unawareness of the law related to business registration, and the use of the internet cause many business owners not to be interested in formalising their businesses.

Solutions to the challenges of business registration

The challenges of business registration in Tanzania may be resolved by:

(a) Increasing the number of service providers especially in rural areas to reduce some costs to potential businesses which may want to register their businesses;

(b) Reducing the bureaucracy in registration procedures;

(c) Establishing one stop centre for handling business registration. For example, the government may allocate all the offices involved in registration in one building such as BRELA, BPRA, ZRB, TRA, and TIC; and

(d) Fostering inter-collaboration between government specific departments to ease the process of registration.

Activity 2.5

Visit any institution or agency responsible for business registration and identify the procedures necessary for business registration. Present your findings to the class.

Exercise 2.5

1. Assume you have been invited by one of the radio stations in your area to address about business registration in Tanzania. Prepare your presentation taking into consideration:
   (a) The general registration processes.
   (b) The importance of registering businesses.
   (c) Challenges faced by business owners during business registration process.
   (d) Solution to the challenges of business registration.

Chapter summary

1. Business unit is an organisation or a firm that deals with the production, distribution, and exchange of products usually for the purpose of making profits.
2. Business units are organised in different structures depending on their formation, size, control, ownership and operation.
3. Common forms of business units in Tanzania are sole proprietorship, partnership, joint company, public enterprises and co-operative organisations.
4. Sole proprietorship refers to organised business which is owned by one person who is responsible for profits and losses.
5. Partnership is the form of business that is owned by two or more people with a common view of making profit.
6. Company is a corporate association of persons formed to carry out certain specific functions with the aim of getting profit.
7. Public enterprises are autonomous or semi-autonomous companies involved in industrial and commercial activities that are formed, owned, and controlled by the government.
8. Co-operatives are the organisations that are voluntary Co-operatives are the organisations that are voluntary combinations of individuals who run businesses to achieve common goals or for the common interests of their members.
9. International business ventures refer to the union of different businesses dealing with the exchange of commodities and services across international borders.

Revision exercise

1. Ame owns a business in which he does not share profit or loss incurred. What are the general features of the business owned by Ame?
2. Your mother is running her own business at Kiembesamaki. She has her longtime friend who wishes to do business with her. Your mother is not knowledgeable about the advantages and disadvantages of doing the business with her friend. Explain to her the advantages and disadvantages of doing the business with her friend.
3. Assume you and your three colleagues' wishes to start a partnership business after your graduation. In the process, you have agreed to prepare a document for the formation which include information on the operation of the business.
   (a) What is the name of the document as far as partnership business is concerned?
   (b) What kind of the information does the document contain?
4. Your father wants to establish a company. He was told that, the company will be having limited liabilities. He is not aware of the differences between limited and unlimited liabilities. Briefly explain to him the differences between limited and unlimited liabilities.
5. Mwanaheri wants to register her business as a company or partnership. She does not know the differences between the two.
   (a) Explain to her the difference between a company and a partnership.
   (b) Outline to her the advantages of establishing a company.
   (c) Outline to her the advantages of establishing a partnership.
6. Choose the best answer from the alternatives given in each of the following items and write the correct answer.
   i. Mpendamali has established a business with limited liability. Which type of business has Mpendamali established among the following?
      A. Joint venture.
      B. A company.
      C. Public enterprise.
      D. Co-operative.
   ii. Debora owns a soft-drinks supplying business. She is the only one owning this business. What form of business unit is this?
      A. A sole proprietorship.
      B. A company.
      C. A limited liability partnership.
      D. A general partnership.

iii. The following are the characteristics of sole proprietorship **except** ________.
   A. controlled by the owner.
   B. it has legal entity.
   C. owner takes all risks.
   D. owner business assets are legally separate from his or her assets.

iv. The following are features of general partnership **except** ________.
   A. the partnership is formed by incorporation.
   B. the partnership has unlimited liabilities.
   C. the partnership is formed by agreement.
   D. the partnership needs a minimum of two persons and maximum of fifty persons.

v. The following are attributes of the legal personality of a registered company **except** ________.
   A. it can contract with outside parties and with its own members.
   B. it is liable for its own obligations like any other person.
   C. its major shareholders and directors cannot be employees for it.
   D. it has perpetual succession.

7. Match the meaning of the terms used in business units in group A with the most appropriate terms in group B

GROUP A	GROUP B
(i) A business unit owned by a single person where the owner bears liabilities of the business during bankruptcy.	A. Business units
(ii) A partner with unlimited liabilities.	B. A company
(iii) Companies that allow members to freely transfer their shares to others.	C. Sole proprietorship
(iv) A partner with limited liabilities.	D. General partner
(v) Companies that restrict the transferability of shares by the members.	E. Partnerships
(vi) A union between two or more companies, partnerships, or individuals that pool their resources and expertise to pursue a common goal.	F. Silent partner
(vii) A form of marketing and distribution in which the owner of a business system grants an individual or group of individuals the right to run a business using the owner's business system.	G. Public limited companies
(viii) A business with legal existence which is separate from the members comprising it.	H. Limited partner
(ix) A voluntary combination of individuals who run a business to achieve a common goal for their own interest.	I. Private companies
(x) Business units owned by two or more people with the common goal of making a profit.	J. Joint venture
	K. A franchise
	L. Nominal partner
	M. Quasi partner

Chapter Three: Business management

Introduction

All businesses around us do not operate by themselves. There is always someone or a group of individuals who takes care of the businesses, that is management of the business. The success of such businesses depends to a large extent on how they are managed. Those which are well managed are expected to experience good performance while those which are not well managed experience poor performance and eventually die. In this chapter, you will learn about the concept of business management, organisational structure, and business ethics. The competencies developed from this chapter will enable management of businesses effectively.

The concept of business management

Business refers to an organised effort of individuals with the goal of providing products to consumers. It includes all activities leading to the creation of utility for both providers and users. Business is mostly the result of a number of individuals working together in an organised way. It can operate in different forms such as sole proprietorship, partnership, company, public enterprise, co-operative, and joint venture. It can be for profit or non-profit. The goal of the business is to serve the needs of its customers, satisfy social needs or make a profit. The business process involves activities of organising resources, creating and delivering value through offering goods or services. Management on the other hand is the coordination and administration of tasks to achieve a goal. Such administrative activities include setting the organisation's strategy and coordinating the efforts of staff to accomplish these objectives through the use of available resources. Management can also be referred to the seniority structure of staff members within an organisation. Traditionally, management was considered to be a process in which people were getting things done through other people. It involved the process of acquiring and combining human, financial and physical resources to ensure organisation goals are achieved. Ideally, the functions of management involved the process of planning, organising, staffing, directing and controlling. Management also involved the coordination of factors of production such as land, labour, capital, and entrepreneurship. The modern view on the other hand considers the concept of management to be a process of attempting to cope with the external and internal environment through realising the strengths and weaknesses of the organisation. Management process includes the process of coordinating factors of production and is considered to be universal as its basic principle is applicable in all organisations and at different levels all over the world.

Business management, therefore, is the process of applying the functions of management in business affairs. It includes all activities seeking to combine basic resources in the organisation to maximise the value of the business. It requires effective and efficient utilisation of the resources and ensuring business goals are achieved and it varies depending on the nature and size of the business.

Levels of management

In most organisations, there are three levels of management. These are; top-level management, middle-level management, and low-level management. Top-level management is responsible for controlling and overseeing the entire organisation. An example of top-level management are the general managers. Middle-level management is responsible for executing organisation plans which comply with the organisation's policies. Examples of middle-level management are departmental managers. Low-level management focuses on controlling and directing the employees to perform the assigned activities. Low-level management includes supervisors, section leaders, and foremen. Figure 3.1 shows the levels of management and their responsibilities.

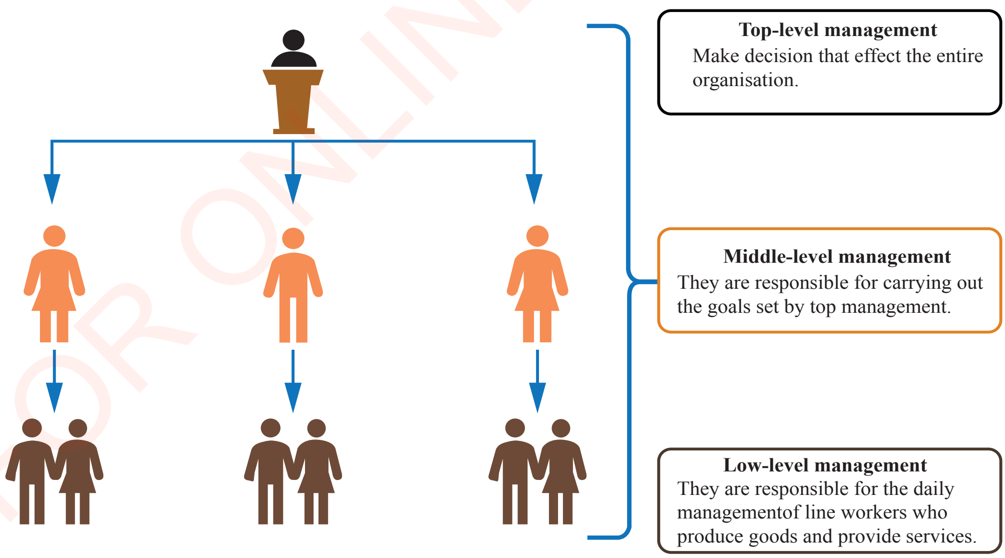

Figure 3. 1: *Levels of management and responsibilities*

Functions of business management

Management involves the processes of planning, organising, staffing, directing and controlling. These functions are carried out by managers at different levels within a business organisation. A business unit may be managed by different departmental managers with a general manager who oversees the overall management of the business. Figure 3.2 shows business managers in a meeting discussing matters about the business.

Figure 3. 2: *Business managers in a meeting*

The following are the functions of business management:

Planning: Planning involves the determination of the course of action to be taken by an organisation to achieve its goals. The major activity in planning involves thinking and forecasting all important processes before doing. It is a continuous process that takes place at all levels of management. If planning is properly done, it tends to reduce the time and effort to be exerted to achieve the predetermined goals.

Organising: Organising is a systematic process of coordinating, structuring, integrating goals and activities to ensure that organisation objectives are realised. It also involves the process of arranging, coordinating and controlling other factors of production. The following steps are involved in the organising process:

(a) Identification of the work needed to be performed;
(b) Classification of the work;
(c) Assigning work to the respective individuals;
(d) Delegation of authority for the identified responsibilities; and
(e) Coordinating resources in ensuring goals are achieved.

The process of organising requires a great amount of flexibility to ensure the work assigned leads to the achievement of stated objectives.

Staffing: Staffing is the process of finding the right people with the right qualifications for the right job. It is a human resource management function and involves the process of recruitment, selection, placement, training, and termination of personnel in the business organisation.

Directing: Directing involves the action of leading, influencing and motivating employees to work towards the predetermined objectives. The process of directing includes the creation of a business environment that encourages employees to do their best. The whole process is achieved in the presence of the right information and an understanding between subordinates and their supervisors. It also involves the act of praising employees for a job well-done and voicing criticisms in an event of the creation of a negative work environment around the assigned work.

Controlling: Controlling involves the process of monitoring, comparing and correcting the work performed. It further provides a link with the planning process given that it is the last stage of the management process. The controlling process involves the following steps:

(a) Establishment of a standard of performance measure within an ideal state of the functioning of the business organisation;

(b) Measuring the current performance in the prevailing environment of the organisation;

(c) Comparing the current performance with the established standard performance in determining the variations or variances; and

(d) Taking corrective actions against the variances, especially those resulting in unfavorable outcomes.

Without the controlling stage, it is difficult for an organisation to monitor and assess activities to achieve business goals. This makes the controlling stage to be one of the most important steps in the business management process. A summary of the business management functions is provided in Figure 3.3.

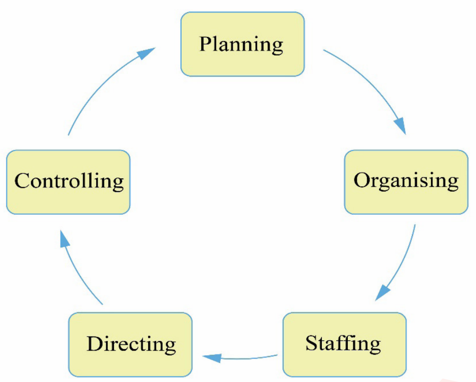

Figure 3. 3: *Summary of business management functions*

Management functions in small businesses

As explained above, the functions of management appear to be more relevant to large businesses which have formal structures and the capacity to dedicate specific personnel to each of the functions of management, starting from planning up to controlling. Nevertheless, these functions of management are equally important in the processes of managing small businesses. The main difference is largely based on the scale of operations because in the context of small businesses, one or few persons may be required to perform more than one function of the management. Thus, a person who intends to establish and successfully operate a small business is required to acquire some or all the competencies associated with the successful application of each of the functions of management.

Principles of business management

Principles of management were developed by Henri Fayol who is regarded as the father of modern management in his book of *Industrial and General Administration* published in the year 1916. He stipulated fourteen principles that are universally accepted guidelines on the responsibilities of managers. It is important to note that these principles establish the cause-effect relationship between the management and employees. The list on its own is not exhaustive but suggestive, hence the principles are not rigid as management principles tend to change according to the situation in the organisation. The discussion of principles are as follows:

Division of work: This principle calls for a full division of all works of an organisation among employees. The employees assigned such work or task should best suit the requirement of the assigned work and should work toward building up necessary skills and becoming more productive. The division of work leads to specialisation which increases efficiency and profitability of an organisation.

Authority and responsibility: Authority is concerned with the right to command others to perform an assignment while responsibilities are related to the accomplishment of the assigned work and being accountable for results. The right to give orders in an organisation should take into consideration the responsibilities given and must be adequate to that specific responsibility. As the manager is given power to give orders and directions, such a manager should as well be responsible for the outcome.

Discipline: The principle calls for the need of subordinates to obey orders and respect rules and regulations including respecting their superiors. Discipline may result from personal control (self-discipline) or enforced by commands (enforced discipline). In the process of discharging their responsibilities, employees are required to exhibit those two forms of discipline. Discipline in an organisation is further enhanced with the existence of good supervision, rules, and regulations to ensure there is impartiality.

Unity of command: According to Fayol, a subordinate should only receive orders from one supervisor at a time to avoid conflict in the execution of such orders. As subordinates (junior workers) they must as well report to only one superior. Failure to this would amount to discipline, order and stability failures.

Unity of direction: Unity of direction calls for the need of members within the organisation to be moving towards a common goal. Similarly, activities aiming at achieving the same goal must be set and led by one person and executed using a single plan.

Subordination of individual interest to general interest: The interest of the organisation should be significantly preferred over those of its employees. Likewise, group interest should be strictly preferred over individual interest. Even during the conflict, organisation or general interest should take precedence over the interest of the employee or individuals.

Remuneration: The satisfaction of employees depends on how fair they are paid/ remunerated. Employees must be compensated for the work performed. The remuneration awarded should be in the best interest of the organisation and that of the employee.

Centralisation: Centralisation refers to a situation in which core management functions are concentrated on specific leaders, while decentralisation is a situation in which the functions are spread throughout the organisation. The principle requires the centralisation of power in the organisation to be based on the capabilities of the person in charge. In an event of over assignment resulting in a person failing to discharge the assigned duties, decentralisation should be adopted. The decision on whether to use centralised or decentralised system is always at the discretion of the management.

Scalar chain (line of authority): Scalar chain is a chain of superiority in the organisation from the highest to the lowest rank. The chain represents the hierarchy of the flow of information in the organisation. The organisation structure of any organisation depicts this hierarchy of the organisation. The principle calls for instructions and orders to flow downwards while accountability to flow upwards.

Order: The principle requires the arrangement of things and people in the organisation. It emphasises the need for the right people with the right skills to be placed in the right place. Under this principle, there must be the orderly placement of all materials and human in the organisation. It emphasises on "a place for everything and everything in its place".

Equity: The requirement is on the observation of kindness and justice by all members of the organisation. Special attention is given to management and supervisors who are required to be kind and do justice to their subordinates.

Stability of tenure: During the appointment for employment, it is required that the appointment must base on stable employment. Frequent termination of employment should be discouraged. Employees should be given ample time to settle down, and learn their responsibilities including opportunities to receive formal training relating to the position.

Initiative: Significant initiatives should be taken during the planning and execution of the organisation's objectives. Similarly, management should work toward an environment that encourages its members to be more creative by allowing employees to show their initiatives which can be a source of strength to the organisation.

Team spirit (Esprit de Corps): The infusion of team spirit in an organisation should be one of the functions of management. The action includes increasing unity and cooperation among members of the organisation. The management should avoid as much as possible to divide the employees but create unity and cooperation among themselves.

Activity 3.1

Caroline manages a wholesale shop. The shop is in a good location and has many customers. However, the shop is experiencing pressure from its owners to improve profit. As a result, one third of the shop employees had to be reduced. Currently, there has been a constant reporting of complaints from the customers because of the delays in receiving services, and some customers reported to have been abused by the overworked employees. It has also come to the attention of Caroline that many of the employees are stressed out thus threatening the quality of service offered. Caroline has more customers than she is capable to manage at the moment. Following the disturbing incidences which have taken place two days ago, Caroline decides to conduct a meeting. In the past, such meeting had never produced any positive results but Caroline is looking for a way to change this fact. She is thinking of finding a way to solve the problem.

Required: With your fellow students discuss the following:

i. Kind of general principles to be adopted by Caroline to solve the problems.

ii. How can Caroline and her staff address productivity and quality of service problems in the shop?

Exercise 3.1

1. Planning is the only function of business management. Argue against this statement.
2. One among the principles of management is management should avoid dividing employees but create unity and cooperation among employees. Briefly explain any other five principles of management.

Business organisational structure

A business organisational structure is a graphical representation of a business that explains what people do, who they report to, and how decisions are made throughout the organisation. The organisational structure essentially establishes a company hierarchy to improve the efficiency and effectiveness of business operations. Organisational structures help businesses stay organised, communicate as well as collaborate more effectively. Choosing the right organisational structure for the business begins with identifying how you want the business to operate. The structure determines among others; the chain of command (short or long), the span of control (narrow or wide), and centralisation (centralised or decentralised).

Types of organisational structures

There are several organisational structures to choose from. Because businesses run in different ways, there is no one-size-fits-all organisational structure that all businesses should pick. However, you can figure out which of the most frequent used formats is best for the business out of the following:

Functional organisational structure: Functional organisational structure groups workers according to their specialisations and tasks performed within an organisation. The structure builds a hierarchy based on the job role of each employee. Figure 3.4 presents an example of a functional organisational structure.

Figure 3. 4: *Functional organisational structure*

Divisional organisational structure: Divisional organisational structure divides business activities into sections based on market, product, service, or client. The divisional structure's goal is to develop workgroups that can produce similar products that meet the needs of different groups. The geographic structure is a common kind of divisional organisation, in which regional divisions are created to deliver products to specific places. Figure 3.5 presents an example of a divisional organisational structure.

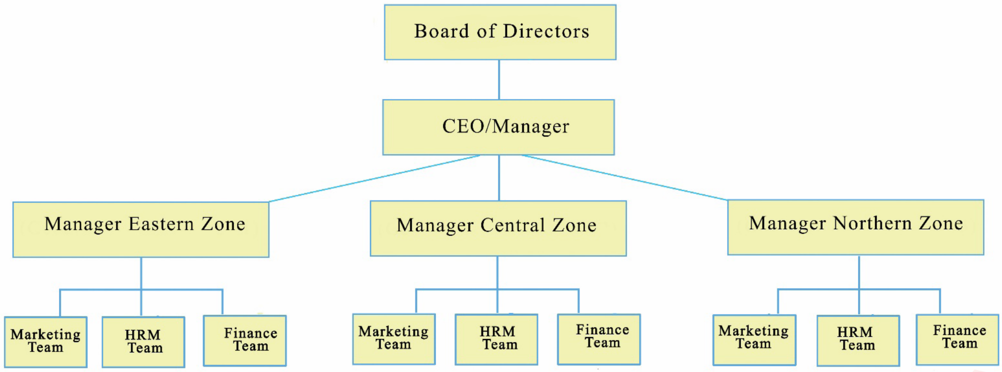

Figure 3. 5: *Divisional organisational structure*

Matrix organisational structure: Matrix organisational structure is made up of both functional and divisional components. Decentralised decision-making, increased autonomy, increased inter-departmental connections, and consequently increased productivity and innovation are all possible with this structure. Despite its benefits, this structure comes at a higher cost and may result in conflicts between vertical functions and horizontal product lines. It disobeys the principle of unity of command as the subordinates may receive orders from two supervisors. Figure 3.6 presents an example of a matrix organisational structure.

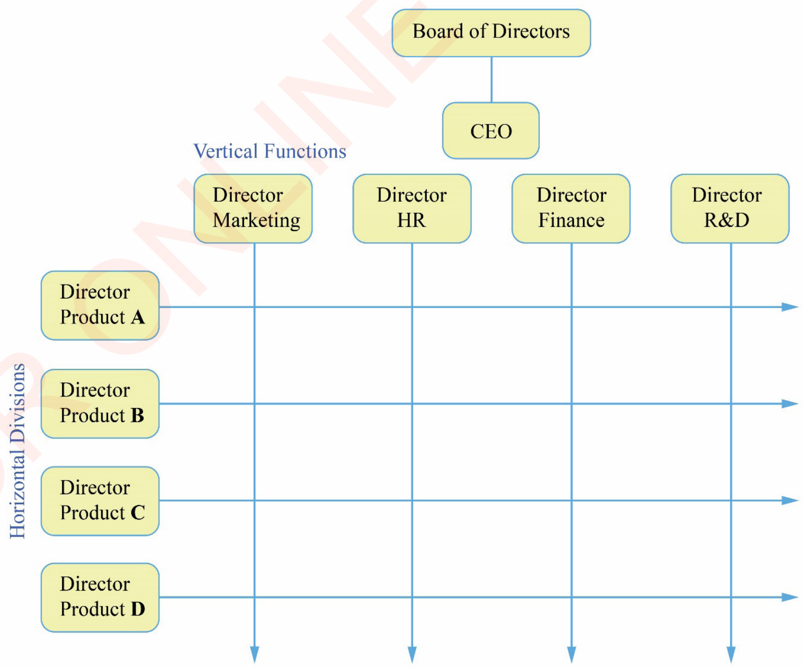

Figure 3. 6: *Matrix organisational structure*

Hybrid organisational structure: Hybrid organisational structure incorporates both functional and divisional elements. In contrast to matrix structures, the hybrid structure splits its activities into functional and divisional departments. This structure allows each function to make use of resources and knowledge while retaining product specialisation across divisions. Many large corporations are using this structure. Figure 3.7 presents an example of a hybrid organisational structure.

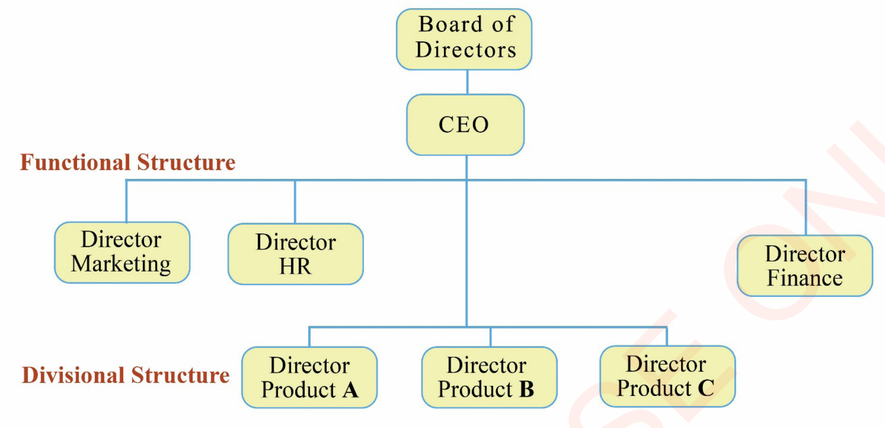

Figure 3. 7: *Hybrid organisational structure*

Activity 3.2

a. Consider the leadership at your school (From head boy or head girl to class monitors) and construct an organisational structure for that leadership.

b. Design the hybrid organisational structure of any company of your interest.

Exercise 3.2

1. It is argued that, organisational structure and principles of management are related. Do you agree or disagree with the argument? Briefly explain your answer.

2. As a knowledgeable person in business management, what kind of organisational structure would you recommend for a business selling its products in different markets with different requirements? Give reasons for your answer.

Business ethics

Business ethics are moral guidelines that govern good behaviours when conducting business. The term ethics refers to a guide to moral behaviour based on culturally embedded definitions of what is right and what is wrong. Consequently, behaving ethically in business is the act of doing what is morally right in order to protect the interest of all business stakeholders (investors, consumers, lenders, suppliers, government, competitors, employees, and the public). Ethical behaviour in business facilitates the achievement of the primary goal of the business and maximisation of shareholder's wealth. Business ethics revolves around the trust that society places in people who are in business and the obligations that those business people have towards society. Examples of good business ethics include:

(a) considering health, safety and environmental standards;
(b) avoiding child labour;
(c) avoiding forced labour;
(d) avoiding the violation of workers' basic rights; and
(e) avoiding tax evasion.

Generally, business ethics involve avoiding all activities that push towards the generation of profit and ignoring moral behaviours and the interest of other stakeholders.

Corporate social responsibility

Corporate social responsibility (CSR) refers to the business accountability towards the society around. CSR in the business is concerned with the welfare of the whole community not just for the owners of the business. It is a business commitment to contribute to social welfare, fairness, respect and honesty to its community. CSR includes the following activities:

(a) to ethically perform business by considering all stakeholders;
(b) to positively respond to community priorities;
(c) to willingly act in advance to the regulatory requirements;
(d) to balance between shareholder's interests and the community's interests; and
(e) to be a high-quality resident of the community.

Importance of corporate social responsibility

CSR involves the consideration of the interest of stakeholders by the business while taking business decisions and actions. This entails that businesses should perform their operations with consideration to the aspirations of the stakeholders. Businesses should also measure the consequences of their decisions and courses of action on society and ascertain that no undue harm is done to the interests of the stakeholders. CSR has the following significance:

Improves public image: A business that practices CSR is usually regarded as a better organisation by consumers. Something simple, like staff members of the business volunteering an hour a week at a charity, shows that the business is committed to helping others. As a result, it creates a good image in the community.

Increases brand awareness and recognition: If the business is committed to ethical practices and CSR, this news could spread. More people could therefore hear about the business brand, which creates increased brand awareness.

An advantage over competitors: By embracing CSR, the business stands out from competitors in the industry. It could establish itself as a company committed to go one step further by considering social and environmental factors.

Increased customer engagement: Businesses engaged in CSR usually show their efforts to local media outlets in hope of getting some coverage. Such an act is a simple means of advertising for attracting more customers.

Greater employee engagement: Similar to customer engagement, most businesses engaging in CSR ensure that their employees know about the CSR strategies. Employees tend to enjoy working for a company that has a good public image than one that does not. Furthermore, by showing that the business is committed to things like human rights, it is likely that it would attract and retain the top candidates.

Increase employees retention: There is also a range of benefits for a business that embraces CSR. The workplace could be a more positive and productive place to work, and promoting things like volunteering, it would encourage personal and professional growth.

Other significance may include easy access to financial support and the creation of affirmative public relations due to media interest in the ethical activities of businesses.

An example of a CSR in Tanzania includes, financial borrowing institutions in Tanzania suffered from an increase in non-performing loans. It was then observed that, many borrowers from these communities had little or no financial literacy. As such, the financial institutions introduced financial literacy trainings and seminars to their prospective customers before lending them money. The institutions then managed to avoid the challenge exerted by non-performing loans. Through this CSR initiative, the business contributed to the welfare of the community and not just the profit for the company.

Ethical principles and practices in business

Ethical principles are a set of standards and guidelines that encourage a person's ethical behaviour. Ethical principles should be followed by people in the businesses as a way of improving business ethics. Ethical principles among others include the following:

Honesty: Honesty involves being trustworthy, truthful, candid and forthright. Ethical organisations do not deliberately mislead or deceive others by misrepresentations, overstatements, partial truths, selective omissions, or any other means.

Promise-keeping: The principle of promise-keeping requires the business to keep promises and fulfil commitments. This means that people in business should not interpret agreements in an unreasonably technical or legalistic manner in order to rationalise non-compliance or create justifications for escaping their commitments.

Fairness: The principle of fairness requires a business to be just in all of their dealings. This means that people in business should neither exercise power arbitrarily nor use indecent means to gain or maintain any advantage or take undue advantage of another's mistakes or difficulties. They should manifest a commitment to justice, equal treatment of individuals, tolerance for and acceptance of diversity.

Respect for others: The principle of respect for others calls for the treatment of everyone the way you would like them to treat you. Ethical businesses should demonstrate respect for the human dignity, autonomy, privacy, rights, and interests of all those who have a stake in their decisions; they are courteous and treat all people with equal respect and dignity regardless of their sex, race, or nationality.

Law abiding: The law-abiding principle calls for obedience to the laws, rules and regulations relating to business activities. Countries have laws and regulations that govern business undertakings which may vary depending on the nature of the business. Under the law abiding principle, the premise is to work within the boundaries of the law.

Commitment to excellence: The commitment to excellence principle calls for businesses to strive to perform their best while executing their duties. Businesses should pursue excellence in performing all business duties and should constantly endeavour to increase proficiency in all areas of responsibility.

Accountability: The principle of accountability requires businesses to take responsibility of their actions and decisions. Businesses should acknowledge and accept being held accountable for the ethical quality of their decisions and omissions to themselves, their colleagues, and their communities.

Business ethics attitudes

Business ethics are normally put to the test during times of crises and confusion in the business and that calls for organisations to have employees that have ethical attitudes. Ethical attitudes involve questioning decisions, being respectful of the views of others, and doing no harm. Ethical attitudes follow principles that call for being honest in all communications and actions, maintaining personal integrity, fulfilment of commitments, being fair in all dealings, obedience to the law, being accountable, and respecting others.

Companies often voluntarily adopt those principles of business ethics and attitude, but sometimes those principles are imposed by legislation. A company's business ethics can shape the way it is seen by the world, its business partners and its customers. Organisations embracing ethical attitudes are in the following forms:

A moral organisation: A moral organisation allows actions that are in favour of the organisational plan without dishonesty; as there is neither written code nor set of values other than the business's self-commitment.

A legal organisation: A legal organisation complies with laws that ensure no damage happens to the business organisation. In an event of the occurrence of problems, they will be dealt with by using the formal code of ethics in place.

A responsive organisation: A responsive organisation agrees that ethical behaviours are valuable to an organisation. For example, consideration of staff welfare (allowances, training, and leave) indicates that formal code of ethics is applied by management of that organisation.

Components of business ethics

When discussing business or corporate ethics, there is a number of components that need to be addressed thoroughly in order to develop ethical corporate behaviour in the organisation. These components include:

Ethics training: Training on ethics can make a positive contribution toward ethical behaviours in an organisation. The basic objectives of ethical training include making employees aware of the organisational policy on ethical issues as well as training employees on how and where to apply ethical principles.

Codes of ethics: Codes of ethics provide a general idea about the ethical standards of an organisation. It reflects the organisation's core values, norms, beliefs and rules of operations. To make an ethical organisation, it is important to make sure that codes of ethics are planned, proposed, discussed and defined by top executives in the firm and then communicated to all employees.

Ethics committee: Ethics committee is a body responsible for ensuring that everyone within an organisation is behaving ethically under codes of conduct. Ethics committee can have functions such as:

(a) periodic assessment of ethical issues;
(b) meetings to discuss ethical issues;
(c) communicating the codes of ethics;
(d) enforcing the codes; and
(e) oversee the punishment and rewards system.

Integrating ethical concepts: Senior executives should incorporate and integrate ethical concepts into day-to-day actions. They must create a structure that encourages ethical behaviour, such as providing proper information to new employees about ethical standards, annual performance appraisals, ethical guidelines, and a critical internal whistle-blowing system that alerts higher management to violations promptly.

Whistleblowing: Whistleblowing occurs when an individual alerts/informs the authority about the occurrence of illegal misconduct. An individual who reports misconduct to the authorities is to be protected. The person reporting a violation of the law to respective authority is called a whistle blower. The two forms of whistleblowing are:

(a) *Internal whistleblowing:* this happens when an individual reports suspected/discovered misconduct in the chain of command at the workplace. In internal whistleblowing, someone notices misconduct in the workplace and decides to report it to a supervisor. The supervisor is required to follow business protocol in dealing with the suspected misconduct.

(b) *External whistleblowing:* this happens when individual reports suspected/discovered misconduct beyond the chain of command at the workplace. In external whistleblowing, someone notices misconduct in the workplace and decides to report it to the media or authorities outside the organisation.

Ways to improve ethical behaviours in businesses

The following are the ways to improve ethical behaviours in a business:

(a) Top management must openly accept and maintain the business code of ethics and conduct;

(b) Employees must understand that ethical behaviours start at the top and senior management must inform all employees to respect and comply with the business ethics;

(c) Management and other stakeholders must be educated to respect all the ethical issues in all business undertakings;

(d) An office responsible for overseeing ethical behaviours within the business must be located in an area whereby employees can talk in privacy. For example, whistle-blowers in the business must be protected from any form of hostile confrontation with the accused;

(e) Stakeholders such as suppliers, contractors, distributors, and customers who are outside the organisation must be informed about the business's code of ethics as most pressures on compliance to this code of conduct are coming from those outside the organisation; and

(f) The business code of conduct must be relevant at a given time. If any regulations are seen not to be working, a proper measure should be taken including finding a suitable regulation that will correspond with the business's culture. It is also a recommended approach to remind employees of the seriousness of the business code of ethics.

It is worthless to have a business code of ethics that cannot be implemented or integrated with the business culture. It is also important to have a business ethics officer who is responsible for ensuring the enforcement of the codes of conduct.

Importance of business ethics in the workplace

There are tangible and intangible benefits to maintaining ethical practices in the workplace. Some of the importance of maintaining business ethics in the workplace among others include:

Improved employee retention: Strong business ethics often encourage managers to show appreciation for an employee's hard work. As a result, team members may be more loyal to the organisation and strive to be more productive. It also means that employees at all levels are less likely to be fired for reasons related to unethical behaviour.

Stronger collaboration: Team members who practice business ethics have respect for one another and work well together. This solidarity not only fosters a pleasant working environment but also encourages team collaboration and productivity.

More effective leadership: When managers follow business ethics, they are more likely to treat employees well. As a result, teams are more motivated to follow their leader. This minimises indiscipline issues and encourage teams to trust managers and supervisors when tough decisions need to be made.

Increased professional value: When employees have a positive attitude toward the work and those they work with, can increase the quality of the work. It also increases their value to the team and the company as a whole.

Creates a positive image: Business ethics creates a good organisation image when both employees and employer follows ethical practices. The positive image may lead to improvement in profitability, attracting employees and customers.

Strengthens organisational relationships with customers: Ethical values improve relationships between an organisation and its customers. Ethical values strengthen the organisation by ensuring consistency in the standard and quality of the products.

Activity 3.3

With the help of newspapers, the annual report of any organisation, and different websites, identify different forms of corporate social responsibility activities carried out by organisations in Tanzania.

Exercise 3.3

1. It is important to maintain ethical practices in the work place. Why do you think it is important for every business undertaking to adopt business ethics?
2. A mining company in its operation is producing waste chemicals as byproducts. The chemicals were left to flow recklessly to the nearby water streams. The village chairman called a meeting between villagers and the mining company management. On the meeting the village chairman addressed the challenge they face from the chemicals as well as other social challenges. The management of the mining company agrees to construct a pond where they can channel and recycle the chemicals. But not only that, they agreed to construct a secondary school, dispensary, and main village road.
   (a) Identify the practice done by the mining company as far as business ethics is concerned.
   (b) Briefly explain the importance of the action done by the mining company.

Chapter summary

1. Business management is the process of applying management functions in business affairs.
2. Business ethics are moral guidelines that govern good behaviour when conducting business.
3. The three levels of management are top, middle and low management.
4. The five functions of management are planning, organising, staffing, directing and controlling.
5. The four common organisational structures are functional, divisional, matrix and hybrid structures.
6. Corporate social responsibility refers to accountability to all stake holders and not focusing on shareholders only.
7. The last step while adopting proper business ethics in an organisation is the consideration of enforcement of the business ethics codes of conduct.

Revision exercise

1. Assume your aunt wishes to establish her business after retirement. The business will be having branches in three regions managed by branch managers and other three employees (cashier, sales person, and marketing personnel). The headquarter of the business will be in Mbeya managed by Chief Executive Officer and other four departments

(Finance, Marketing, Human Resources, and Legal). She has managed to attend some entrepreneurship courses but has not acquired much skills on business management. She has approached you for clarification on business management issues. Please, assist her on the following:

(a) Elaborate to her the principles of business management as she will be one of the management team in the business.

(b) Propose an organisational structure for the business.

2. "Business ethics and corporate social responsibility can be used interchangeably". Argue for or against this statement.

3. Choose the best answer from the following items and write the letter of the correct answer.

i. What does the term team spirit mean in relation to business management? _______________
   A. Union is strength.
   B. Service is our motto.
   C. Buyer beware.
   D. Product is our strength.

ii. Aba is an employee in Tanzania Institute of Education who receives orders and accountable to only one supervisor. Which principle of business management is this?
   A. Unity of direction
   B. Unity of command
   C. Centralisation
   D. Scalar chain

iii. Asha is an employee at Mkunguni Enterprises. She heard Dodo discussing with Mwamba how they could steal the company laptop. Asha reported the issue to the General Manager. Asha is a__________.
   A. reporter.
   B. whistle blower.
   C. customers.
   D. governor.

iv. The chain of command from the highest authority to the lowest level in the organisation defines__________.
   A. unity of direction.
   B. unity of command.
   C. centralisation.
   D. scalar chain.

v. The following are the functions of management **except** __________.
   A. planning and organising.
   B. directing.
   C. controlling.
   D. centralising.

vi. At which level of management do managers apply management skills?
   A. Middle levels in an organisation.
   B. Top levels in an organisation.
   C. Executive levels in an organisation.
   D. All levels in an organisation.

vii. "Specialisation is the most efficient way to use human effort." Which principle of business management reflects this statement?
  A. Authority and responsibility.
  B. Division of work.
  C. Unity of command.
  D. Discipline.

viii. "A manager should have the right to punish a subordinate for willfully not obeying a legitimate order but only after sufficient opportunity has been given to the subordinate to present defense about the case" Which principle is being reflected?
  A. Authority and responsibility.
  B. Division of work.
  C. Unity of command.
  D. Discipline.

ix. "One head and one plan." This statement is related to which principle?
  A. Unity of direction.
  B. Scalar chain.
  C. Unity of command.
  D. Remuneration of employees.

x. The concentration of decision-making authority is referred to as __________.
  A. centralisation.
  B. decentralisation.
  C. span of management.
  D. span of control.

4. Match the items in group A with the most correct ones in group B

GROUP A	GROUP B
(i) It requires members of the organisation to treat each other with kindness and justice.	A. Profit or non-profit
(ii) A systematic process of coordinating, structuring, and integrating goals and activities to ensure the achievement of predetermined goals.	B. Division of work
(iii) The action of finding the right people with the right qualification for the right job.	C. Unity of command
(iv) It calls for the need for all employees to be based on a permanent position.	D. Planning
(v) Orders should only be given to subordinates from one supervisor.	E. Remuneration
(vi) It requires full division of all works of an organisation among all employees.	F. Stability of tenure
(vii) It requires employees' compensation to be in the best interest of the employees and the employer.	G. Management
(viii) Determination of the course of action to be taken.	H. Staffing
(ix) It refers to accountability towards stakeholders rather than focusing on the owners of the organisation.	I. Equity
(x) Moral guidelines governing good behaviours when conducting business.	J. Business ethics
(xi) They are guiding values in generating an environment that supports fairly sound behaviours and pressure for mutual accountability among workers.	K. Corporate social responsibility L. Initiative M. Centralisation

Chapter Four Taxation

Introduction

Every government mobilises, collects, and spends funds on behalf of its citizens with the goal of improving social and economic welfare. One of the ways in which the government collects funds is through taxation. Taxes are imposed with the purpose of achieving various social, economic, and political objectives. In this chapter, you will learn about the concept of tax and taxation, tax systems, tax systems in Tanzania, value added tax, practical issues in taxation, as well as effects of taxation. The competencies developed from this chapter will enable you to assess the amount of tax payable by a business and its remittance to the respective authorities.

The concept of tax and taxation

Taxation is the process of charging and collecting funds from responsible individuals and companies. Taxation is a subject matter of public finance that deals with the means by which the government raises revenue from the public by imposing and collecting taxes. Taxation aims at raising public revenue which in turn is used by the government to finance public expenditure which includes the provision of goods and services to its people. Therefore, tax is a compulsory payment made by individuals or companies to the government without receiving any corresponding entitlement to reflect the exact payment or direct benefit in return from the government.

Need for taxation

Taxation is important to the functioning of the country. Tax revenues pay for public goods including health care, education, and infrastructures. Some taxes are imposed for a specific objective or a number of objectives. The following are the justifications for the need of taxation:

Source of revenue: The basic and primary objective of a government to impose tax is to raise revenue. Public revenue is needed to cater for public expenditure, for example, the national defence, development of infrastructure, payment of civil servants, and social welfare.

Provision of a public goods: Taxation helps to raise revenue which is used to provide public goods to society. A pure public good is characterised by being non-rivalry and non-excludable. Non-rivalry means there is zero marginal cost of providing the good to an additional individual. In other words, the consumption of a public good by one person does not reduce the amount available for others. Non-excludable means individuals cannot be significantly excluded from consuming the goods once they are provided. Similarly, all individuals are always consuming the same amount of the product and no individual is entitled to receive less or more of it than the general public.

Regulate consumption: The government through taxation can discourage an excessive consumption of harmful products such as tobacco and alcohol while encouraging the consumption of merit goods such as education and health services. This is done by charging a high tax levy on the prohibitive products which could lead to price increase that could lower their demand.

Regulate production: The government may stimulate the production of some products, especially through tax exemption to new industries, reducing tax on capital goods, and raise tax on imported goods to encourage locally produced goods.

Regulating imports and exports: Importation of undesirable products can be restricted by the imposition of the prohibitive taxes such as high tariff rates. Exports can be encouraged by cutting duties and taxes on exports.

Fostering economic development: Through taxation, a country is able to secure the necessary income to support government expenditure and capital investment which are necessary for fostering economic growth and thus economic development. Economic development involves the improvement of the public sector, private sector, social, and economic well-being and the quality of life of a nation.

Enhancing capital formation: Capital formation is the creation of supportive mechanisms or infrastructures for advancement in production within the economy. Creation of the employment opportunities is one of the economic roles of capital formation in the country. Taxation plays a major role in savings by providing different kinds of exemptions from the contribution of tax on issues such as provident funds, insurance premiums, loans, and shares.

Increasing employment opportunities: The government may charge low taxes on job creation activities and also exemption may be given to activities that stimulate employment. For example, Small and Medium Enterprises (SMEs) usually have the potential for providing employment opportunities. Similarly, industrial parks, special economic zones, and export-oriented parks have high employment potential.

Reduce income inequalities arising from economic disparities: Income levels may differ across individuals in economies, leading to the creation of a wide gap between the rich and poor. If the gap continues to increase, it can lead to social and economic inequalities which can result in unrest. Taxation is a powerful tool to adjust the income disparities or gaps between rich and poor, by taxing more to the rich and less to the poor.

Reduction of regional imbalances: Countries can be formed by several states or regions. Some states or regions may become well developed as compared to others in a country due to opportunities allocated in the areas. Taxation can be used to create balances between regions through tax incentives or tax exemptions as a solution to the problem. Also, the government can pool the resources and allocate them to the disadvantageous regions on equity basis.

Principles of taxation

Principles of taxation are the guidelines that the governing organisation uses when devising the system of taxation. A set of such principles was first pointed out by Adam Smith in the year 1776, who termed them canons of taxation and later supported by other famous economists in the literature. The canons of taxation include important objectives connecting with the tax system. They aim at attaining intended objectives whereby an economy can improve its productive capacity to achieve a high rate of economic growth, creation of jobs, maintenance of economic stability, control for frequent prices increase (inflation), and improve community welfare. The aim of tax is to achieve various social, political and economic objectives. The government's objective may be for a specific objective but might serve other unintended objectives. To achieve these intended and unintended objectives, the tax system must obey various canons as prescribed by Adam Smith and other economists:

Canon of equality: This canon tries to observe the objective of economic justice that taxpayers should be taxed based on their ability to pay. This implies that rich individuals should pay more taxes than the poor. This canon therefore, examines the horizontal equity whereby individuals within the same income group pay the same tax rate. Similarly, it holds the requirement of vertical equity whereby different tax treatment is given to individuals at different income levels.

Canon of certainty: It requires that the time of payment, the manner of payment, and the amount to be paid should be simple and clear to the taxpayer and the general public. This canon is meant to provide confidence to taxpayers. The tax payers should not be subjected to any unpredictability or at the discretion of the tax laws and regulations, since these may lead to the emergence of a corrupt tax system.

Canon of convenience: Taxes should be levied and collected in such a manner that, it is convenient to tax payers and the government. This canon recommends that any unnecessary trouble to the taxpayers should be avoided; otherwise, various ill-effects such as tax evasion may result.

Canon of economy: This canon recommends that the cost of tax collection should be as minimum as possible in relation to the revenue collected. Tax bases that are too widespread and difficult to administer, create additional administration expenses to the tax collection authorities, for example, TRA for the case of Tanzania and ZRB for the case of Zanzibar. Covering this increase in the cost for tax collection, the authority, for example, TRA or ZRB could most likely increase the tax rate to be charged to cover these additional expenses. This in turn could lead to an increase in unnecessary burden on society.

Canon of productivity: The canon of productivity also referred to as a canon of fiscal adequacy requires that, the tax system should be able to yield enough revenue for the country's treasury. This will ensure that the government does not seek additional sources of funds to cover the budget deficit.

Canon of flexibility: The canon requires that the authorities without delay should be able and flexible to revise the tax structure both concerning to its coverage and rates to suit the changing requirements of the economy and the treasury. This means flexibility ensures that, whenever the government requires additional revenue, it can be generated without greater effort. Also, lowering taxes should not be a problem.

Canon of simplicity: The tax system should not be too complicated to administer and for the taxpayer to understand. In understanding tax rates, tax levels and tax collection presence of some difficulties raises problems of interpretation and at times leads to legal disputes.

Canon of diversity: It is risky for the government to depend upon a few taxes as a source of public revenue. Such a system is bound to create a lot of uncertainty for the treasury. It is also likely to be inequitable between different sections of society. On the other hand, if the tax revenue comes from diversified sources, then any reduction in tax revenue on account of any one is bound to be very small. However, too much multiplicity of taxes has to be avoided to evade unnecessary cost of collection that violates the canon of the economy.

Key attributes of tax

Taxes have their attributes which distinguish them from other charges. The following are the key attributes of tax:

It is a compulsory levy: Tax is normally imposed by the government and it is compulsory for all individuals qualifying to pay tax. Other institutions (church, schools, and clubs) do also have the power to levy certain charges which are similar to tax such as donations, gifts, levies, and fees, but have no power to levy taxes.

It is a charge imposed by the government or state: Only a state or government has the authority to impose taxes. Similarly, the rate payable by the taxpayers is also determined by the rule and regulations put in place by the government.

It is levied on both citizens and non-citizens: Tax is not imposed exclusively on the country's citizens; any person who happens to be within the country or who is generating income; consuming products from or within the respective country may be liable to pay tax depending on the prevailing legal provisions.

It is usually payable in monetary terms: Tax is normally payable in monetary terms either by the currency of the state collecting it or an equivalent currency from other countries but convertible to the collecting country's currency.

No direct benefit from the payments: The government needs not to offer or render equivalent direct compensatory service or goods in return to the taxpayer; also taxpayers cannot claim anything in return on the taxes paid to the government.

Exercise 4.1

1. You are a member of tax club in your school and you have been told to prepare a presentation about tax to address your fellow students. Using the knowledge obtained from taxation chapter, explain the meaning of taxation and its roles in the economy, principles of taxation, and the key attributes of tax.
2. Most of citizens in developing countries are lamenting taxes are high and argue as to why they pay tax. Using the knowledge obtained from taxation, tell them why they should pay taxes?
3. Some citizens are arguing that "tax is bad" and others are arguing "tax is good". Why do you think they have different opinion? What is your stand in this?

Practical issues in taxation

One of the most fundamental questions related to taxation is that of who bears the final burden of a tax. The basic issue is that tax induces changes in an individual and firm behaviour and the associated changes in commodity prices and factor returns are likely to imply that the final burden or "economic incidence" of a tax could be different from its "statutory incidence" that is, a tax may be partially or fully "shifted" from one set of economic agents to another. Ideally, we would want to know the effect of a tax change on utility levels of all agents in the economy but realistically, we usually look at the impacts of the tax on the prices or income, rather than utility. There are three concepts needed to be clarified here;

Impact of tax

The term impact of the tax is used to express the immediate result of or original imposition of the tax. The impact of a tax is on the person on whom it is imposed first.

Incidence of tax

The incidence of tax is the direct monetary burden of the tax. It means the final resting place of a tax. The incidence is on the person who ultimately bears the money burden of the tax.

Shifting of tax

Shifting of tax is the transfer of the burden of tax from the person who is legally imposed to another person. It is through this process of shifting that incidence of a tax comes finally to rest somewhere. The process of shifting may be slow or may be only partially effective so that the burden of a tax may not fall entirely on the person, who is intended to bear it. To what extent the burden of tax fall on the buyer and/or seller depends upon many factors such as the nature of the tax, the elasticity of demand, the elasticity of supply, nature of market, and cost conditions.

Shifting of tax depends upon the nature of tax; whether a tax is part of fixed cost or variable cost. If it is a part of fixed cost and is independent of the volume of production, such taxes are not shifted in a short period. In long run, the producer also can bear the burden of tax if he or she is not incurring losses. If the demand for the commodity is elastic, more burden will be borne by the producer, because commodity elastic demand will have low demand if the price increases.

The concepts of tax evasion and tax avoidance

While taxation has a lot of benefits to the economy, not all persons have a positive attitude towards paying taxes. They would wish to use any means either to reduce the tax burden or evade paying tax. This gives rise to two concepts namely; tax evasion and tax avoidance. Tax evasion and tax avoidance tend to minimise revenues available for the social and economic development of any country.

Tax evasion: Tax evasion is an illegal act of not paying taxes. This can be done by not reporting all of the taxable income from employment, investment, business, and other illegal practices that intentionally are aiming at reducing the amount of tax burden. Tax evasion consists of seeking to pay too little or no tax by deliberately misleading the revenue authority by either:

(a) Suppressing information to which they are entitled (failing to notify TRA or ZRB that you are liable to tax, understating income or gains or omitting to disclose a relevant fact); and

(b) Providing the authority with deliberately false information (deducting expenses that have not been incurred).

Tax avoidance: Tax avoidance, on the other hand, is an act of not paying tax by making use of the loopholes existing within the tax system. For example, the use of allowable deductions such as charitable deductions for personal gain. Even though the charitable deductions are not taxed, they should be used for the intended charitable activities rather than for personal use. It should be noted that, these actions of tax evasion and tax avoidance occur if the tax burden is high. If the tax burden is low, the challenges of tax avoidance and tax evasion could not persist. Tax avoidance is accomplished by claiming permissible deductions and credits. Under tax avoidance, a taxpayer analyses the existing legal framework to structure the business transactions to realize the maximum tax savings.

Exercise 4.2

1. Briefly construct one scenario for each of the following tax concepts:
   (a) tax evasion and
   (b) tax avoidance.
2. Tarishi has a baking bread company. On his financial projections he included the element of tax as he is supposed to pay tax according to the law. The calculation reveals that he is supposed to pay TShs 6 million to the tax authority. Upon setting the price, he included the element of tax payable by the company in the price of bread. The breads are sold in the market and bought by the final consumer paying the price with the tax element in it. Basing on the knowledge you have in taxation, from the story:
   (a) Identify the scenario which best describes impact of tax.
   (b) Identify the scenario which best describes incidence of tax.
   (c) Identify the scenario which best describes shifting of tax.

Tax system

The tax system can be defined as a set of taxes and fees that are charged in a state and the forms and methods of its organisation. Similarly, tax system is a set of taxes, duties, and fees that are charged in the territory of a state in accordance with the tax code, and also the set of rules and regulations that determine the powers and responsibilities of parties that participate in tax legal relations. When defining a tax system, one should take into account the tax base, tax structure and tax rates of the country and how these are administered.

Tax base

Tax base is the total amount of income, property, assets, consumption, transactions, or other economic activity subject to taxation by a tax authority. It serves as a total base on which the tax can be charged.

Tax rate

Tax rates are specific levels of tax collection based on given levels of income and expenditure. It is a per centage at which an individual or corporation is taxed. The tax rate is charged on the tax base to obtain the tax liability. For example, the Value Added Tax (VAT) is currently charged at 18 per cent tax rate in each stage that involves value addition.

Tax structure

The tax structure of an economy depends on its tax base, tax rate, and how the tax rate varies. The tax base is the amount to which a tax rate is applied. The tax rate is the per centage of the tax base that must be paid in taxes. To calculate most taxes, it is necessary to know the tax base and the tax rate.

Characteristics of a good tax system

Characteristics or features of a good tax system may be formulated from various objectives, principles or canons of a tax system. A good tax system should:

Maintain economic stability: Tax helps the government to finance economic fluctuations through subsidising some essential goods and services while increasing taxes on harmful goods or services. This improves community welfare and promotes social and economic development.

Fairly distribute income: Tax helps to distribute income among the community. For example, taxes charged on high income earners can be used to support community services such as the supply of medicine, and purchasing or improving teaching facilities in local schools which lead to the improvement of local community welfare.

Increase the rate of economic growth: Tax helps the government to raise fund to finance the infrastructure of the key sectors in the economy which boost the economic activities and facilitates the social and economic development of the country.

Fairly charged: The tax system has many dimensions ranging from its volume, composition, rates, coverage, timings of collection, and mode of collection to grasp its effect in their totality.

Efficient and honest: A tax system that does not have a high cost of collection in relation to the amount of tax collected and imposes a correct tax assessment is far more efficient, honest and highly preferred by taxpayers.

Equitable: A good tax system should not discriminate against its taxpayers since the burden of the tax is based on the ability to pay and thus create an equal attitude for all taxpayers. The government in turn, must equally prevent wars, maintain peace, and help in solving natural calamities such as floods, drought, or economic situations such as prosperity or depression.

Harmony with national objectives: A good tax system should be in harmony with important national objectives and should assist society in achieving them.

Accommodate the taxpayers' attitudes and problems: A tax system should accommodate the taxpayers' attitudes and problems (basic rights, no harassment), reflect the professional language, yield adequate revenue for the treasury, and be flexible enough to change with the requirements of the government and economy.

Solve economic discrepancies: A good tax system should help in counteracting the inflationary forces. A good tax system is designed to discourage unnecessary consumption and encourage production to the desired targets.

Classification of tax

Tax can be classified according to the system of paying and the person who bears the burden. According to the system of paying tax, there are three systems of taxation namely: progressive tax system, proportional tax system and regressive tax system. According to the person who bears the tax burden there are two types namely: direct tax and indirect tax.

According to the system of paying tax

Tax can be classified according to the system of paying tax as follows:

A progressive tax system

A progressive tax system is one where the per centage rate increases as the income increases. In other words, as the income of a person increases, the tax rate also increases gradually, and vice versa. Figure 4.1 shows a progressive tax system graph, which indicates that as the level of income increases, the per centage of income paid on tax also increases. For example, employees' income tax which is deducted from the monthly salary.

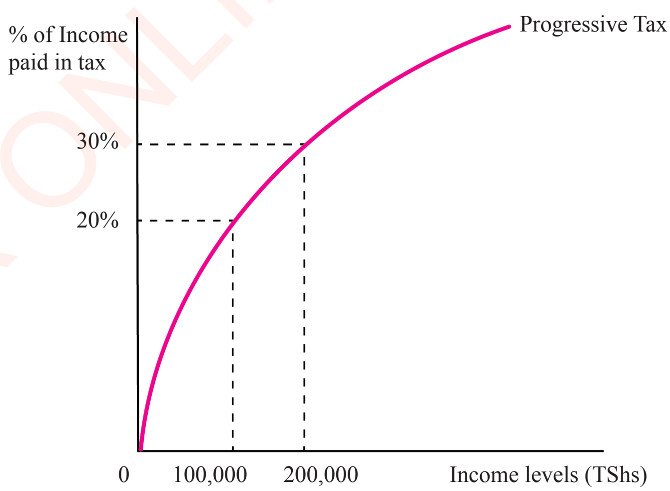

Figure 4. 1: *Progressive tax system graph*

Advantages of the progressive tax system

A progressive tax has the following advantages:

It is productive: Progressive tax system motivates people to work hard. It takes into consideration the ability to pay and thus enable governments to collect the sufficient amount from income earners.

Promotes social justice: Through progressive tax system, fairness is attained. Those who earn more pay more and those who earn less pay less.

Promotes income equality and economic stability: A progressive tax also requires those with the greatest amount of resources to fund a greater portion of the services that all citizens and businesses rely on such as road maintenance, public safety, and health.

Disadvantages of the progressive tax system

The main disadvantage of the progressive tax system is considered to be a disincentive to success. Since high income and middle-income earners are considered to be unfairly punished by being taxed higher. Therefore, this system may encourage tax evasion and tax avoidance practices.

A proportional tax system

A proportional tax system is one that the per centage rate remains the same at all income levels. In proportional tax, all tax payers, both rich and poor are made to pay the same per centage of their income tax. Figure 4.2 shows a proportional tax system graph, in which the same per centage of income is paid on tax as the level of income increases. Since the rate is constant, a tax payer will pay more tax as the taxpayer's income increases.

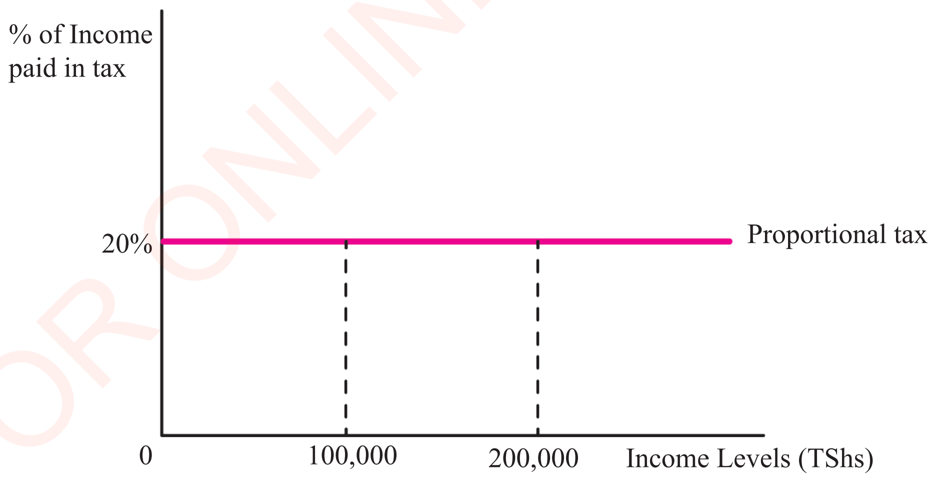

Figure 4. 2: *Proportional tax system graph*

Advantages of the proportional tax system

A proportional tax system has the following advantages:

Simplicity: There is no ambiguity to rate of taxation which in itself leads to clarity in the minds of taxpayers as well as tax collecting authorities.

Reduces chances of tax evasion from the high income earners section: When the tax rate is the same for all groups of tax payers (small, middle and high), high income earners find no motive for evasion.

Disadvantages of the proportional tax system

A proportional tax system has the following disadvantages:

It is less productive: Governments would have collected more revenue by charging higher rates to higher income earners. As for the same amount of tax charged from a small group of rich people, it will require the government to collect taxes from a large tax base using a proportion tax rate.

Increases inequalities: Proportional tax system leads to a huge gap between the rich and poor leading to anger, frustration and in the worst-case scenario may even lead to the revolt by the middle and poor classes against the ruling government.

A regressive tax system

A regressive tax system is one whose per centage rate decreases as the income increases. In other words, as income of a person increases, the tax rate decreases, that is higher income person pays less tax and vice versa. Figure 4.3 shows a regressive tax graph in which as the level of income increases, the per centage of income paid on tax decreases and vice versa.

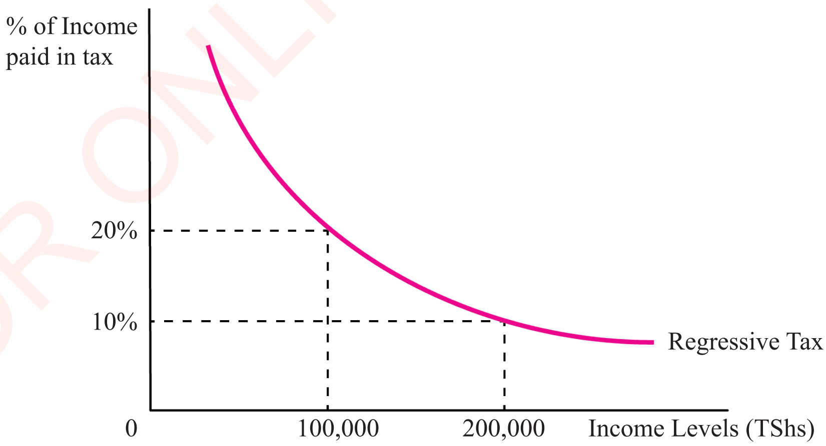

Figure 4. 3: *Regressive tax system graph*

Advantages of regressive tax system

The main advantages of regressive tax system are considered to be:

Incentive to success: The high-income and middle-income earners are taxed less. They remain with more money for saving and investment, therefore, are highly motivated to work hard.

Reduce evasion and avoidance practices: High income earners are normally involved in tax evasion and avoidance practices especially under the progressive tax system which is believed to be unfair. With a regressive tax system, high income earners comply easily since they pay less.

Disadvantages of regressive tax system

The regressive tax system has the following disadvantages:

It is unproductive: Regressive tax systems does not take into consideration the ability to pay principle and thus governments fail to collect a sufficient amount of tax from high income earners. Generally, the amount collected as tax revenue is usually low compared to other tax systems.

Fail to promote social justice: In regressive tax system, fairness is not attained since those who earn more pay less and those who earn less pay more.

Fail to promote income equality and economic stability: A regressive tax requires those with the minimal amount of resources to fund a greater portion of the services that all citizens and businesses rely on, such as road maintenance and public safety, health and leaves a lot of money in hands of high-income earners.

All three tax systems that are; a progressive tax, a proportional tax, and a regressive tax can be illustrated using the tax systems graph. See Figure 4.4

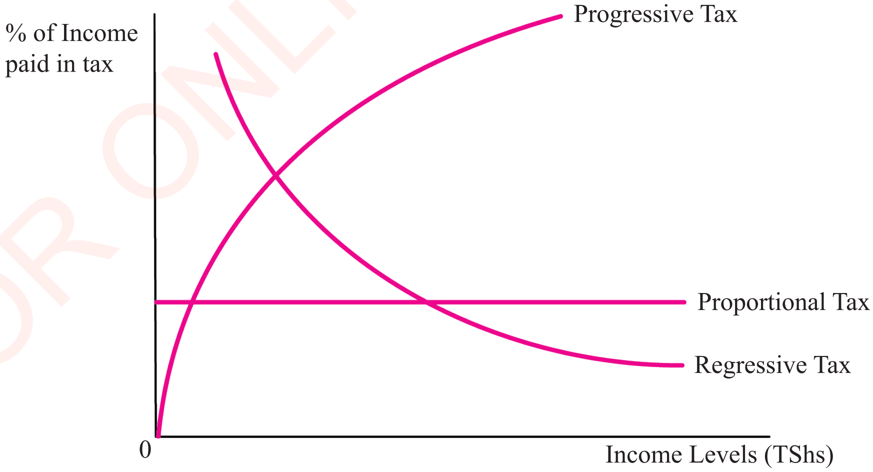

Figure 4. 4: *Tax systems graph*

According to the person who bears the tax burden

Tax can be classified according to the person who bears the tax burden as follows:

Direct tax

Direct tax is one whose impact and incidence are on the same person. It is a tax collected directly from the source of income, wealth, or spending power of individuals or companies whose incidence and the impact are on the individuals or companies that pay the tax to the government. The following are examples of a direct tax:

Employment income tax: Employment income tax is the tax charged on the income of the individual. It is termed as "Pay As You Earn" (PAYE)

Corporate tax: Corporate tax is a tax on the profits of the company.

Property tax: Property tax is tax on properties owned by an individual or a company such as tax on buildings.

Capital gain tax: Capital gain tax is a tax charged on the proceeding of the sale of an asset whose value has been appreciated. It includes a tax on interest.

Advantages of direct tax

Direct tax has the following advantages:

Equitable: Direct tax is based on the canon of equity. The burden of the direct tax is equally distributed as it is progressive in nature. With direct tax, a heavy tax burden falls on the high-income earners and it falls lower on the low-income earners.

Certainty: Direct tax satisfies the canon of certainty. The taxpayer is certain or aware of the time, the manner, and the amount to be paid in a direct tax. Similarly, the government is also certain about the amount of tax revenue that is going to be collected from this tax.

Economical: Direct tax satisfies the canon of economy, that is, the cost of collection of direct tax is smaller as compared to the revenue to be collected as it is charged from the source.

Elastic: Direct taxes are flexible and thus satisfy the canon of elasticity. The government can increase or decrease the rates of direct tax according to the economic requirements of the country.

Simple: Direct tax is simple to understand and administer.

Reduce inequalities: Direct tax helps to reduce income and wealth inequalities because it is progressive in nature.

Civic consciousness: Direct tax helps in calculating civic consciousness among the taxpayers. The taxpayers would like to know how their money is spent by the government and that, there is no wastage of public funds.

Disadvantages of direct tax

Direct tax has the following disadvantages:

Discourage saving and investment: Direct tax adversely affects savings and investment. When people know that they will be taxed more they will tend to reduce their will to work and invest.

Encourage tax evasion and avoidance: Since direct tax touches every taxpayer, some will try to evade or avoid it by filing out wrong returns and even taking the help of income tax experts. Direct taxes encourage dishonest behaviours resulting in a loss in revenue by the government.

Discourage production: Direct tax such as corporate tax may discourage those industries and firms which produce essential goods and services.

High rates act as a disincentive to effort or demoralising: Direct taxation may be a disincentive to hard workers. The most efficient people are discouraged to work hard since by working hard they are going to be taxed more.

High tax tends to discourage foreign capital: High direct tax may induce people to prefer to invest in companies operating in countries where there is a higher return to capital.

Indirect tax

Indirect tax is the one whose impact is on the person but paid partly or wholly by another person. It is a tax imposed on the value of goods and services produced and consumed within the country whose burden is shifted in part or in full to the final consumer. The following are examples of indirect taxes:

Custom duties: Custom duties are taxes levied on imported products. Customs duties are collected at the borders or harbour or airport of a given country.

Value Added Tax: A Value Added Tax (VAT) is a tax on goods and services charged at each stage of production, exchange and distribution.

Excise duty: Excise duty is a sales or purchases tax levied on domestically produced or imported goods.

Excise duty on age of the product: Excise duty on age of the product is the tax levied on vehicles older than ten years since their production that are imported into the country.

Advantages of indirect tax

Indirect tax has the following advantages:

Minimal chances of evasion: It is very difficult to evade an indirect tax because it is included in the price of products one purchases.

Convenient: An indirect tax is convenient as it is paid when we buy a product at any time when we can afford it. The taxpayer does not feel the burden of paying for such a product.

High revenue yield or wide coverage: Indirect taxes can be levied on a large number of products. It brings more people into the tax net leading to a high revenue yield for the government as the tax base becomes large.

Help in reducing consumption of harmful goods: The government can use indirect tax to discourage the consumption of harmful products such as tobacco that harm the health of the people.

Economical: Indirect tax is economical in the sense that it involves the little cost of the collection because the producers and sellers are responsible to collect the tax on behalf of the government.

Powerful tool of economic policies: Indirect tax can be used as a powerful tool for implementing economic policies by the government. If the government wants to protect domestic industries from foreign competition, it can impose heavy customs duties.

Disadvantages of indirect tax

Indirect tax has the following disadvantages:

Increases income inequality: Indirect tax does not satisfy the canon of equity. Both high and low-income earners pay the same amount of tax for every product they consume, this may lead to high income inequality.

Stimulates inflation: Indirect tax stimulates inflation. Imposition of indirect tax tends to raise the prices of the commodities which may lead to inflation.

Uncertainty: Indirect tax causes uncertainty on the part of the taxpayer who is not made aware of the amount to be paid. This increases the level of uncertainty for the government regarding the revenue to be collected.

Bad effects on production and employment: Sometimes, indirect tax adversely affect production of commodities and even employment. For example, when the price of a commodity rises with the levy of a tax, its demand falls. As a result, its production falls, and so does employment.

Lack of civic consciousness: People who buy a commodity does not know that they are paying tax to the government on the price of the commodity. As a result, such taxes do not instigate any civic consciousness among the majority of tax payers who are not aware of their contribution to the government.

Uneconomical: The cost of collection of certain indirect taxes is very high. For example, it may be more cost full in collecting custom duties, especially for the cost incurred related to the control of smuggling.

Exercise 4.3

During ministerial conference of Southern African Development Community (SADC) held in Harare - Zimbabwe, the minister of finance Zambia commented that Tanzanian tax system is a good tax system. In your context, what are the characteristics that makes this tax system to be termed a good tax system?

Tax system in Tanzania

The tax regime in Tanzania consists of a number of direct and indirect taxes including income tax, value added tax, import duty, excise duty, and stamp duty. There are also taxes levied at the local government level. All central government taxes are administered by the Tanzania Revenue Authority (TRA). The authority has three tax departments (Domestic Revenue, Customs and Excise, and Large Taxpayers (in respect of all taxes). TRA is headed by a Commissioner General in charge of tax collection and day to day administration. The Ministry of Finance oversees the tax policy. Generally, Tanzania uses the self-assessment approach with a requirement to file a tax return at the end of the year. Tax payment is on a quarterly basis. Withholding tax arrangement applies to individuals deriving income from employment (PAYE), rental charges, interest, dividend income, and also to non-resident taxpayers with Tanzania source of income. VAT is accounted for monthly. The following are some of the taxes administered under the taxation system in Tanzania:

Income tax: Income tax is a tax imposed on annual gains or profit earned by individuals, limited companies, businesses, and other organisations.

Value added tax (VAT): VAT is a tax imposed on the sale of commodities and services.

Excise duty: Excise duty is a tax imposed on commodities produced locally or imported. It targets specific commodities, for example, luxuries and commodities that are detrimental to health.

Customs duty: Customs duty is a tax imposed on the import or export of commodities.

Stamp duty: Stamp duty is a tax that is aimed at legitimising transactions. It is imposed on share capital, transfer of shares, mortgage charges, and the transfer of property among others.

Figure 4.5 shows the share of the Tanzanian government revenue by source. VAT (domestic and on imports) account for the most (14.8 per cent and 14.5 per cent respectively) of tax collected. 12.3 per cent and 12.1 per cent are from income tax mostly PAYE and corporate tax respectively. Other import charges and other income taxes account for 11.0 per cent and 9.5 per cent respectively, while excise duty on import and imports duty account for 8.2 per cent and 7.4 per cent respectively.

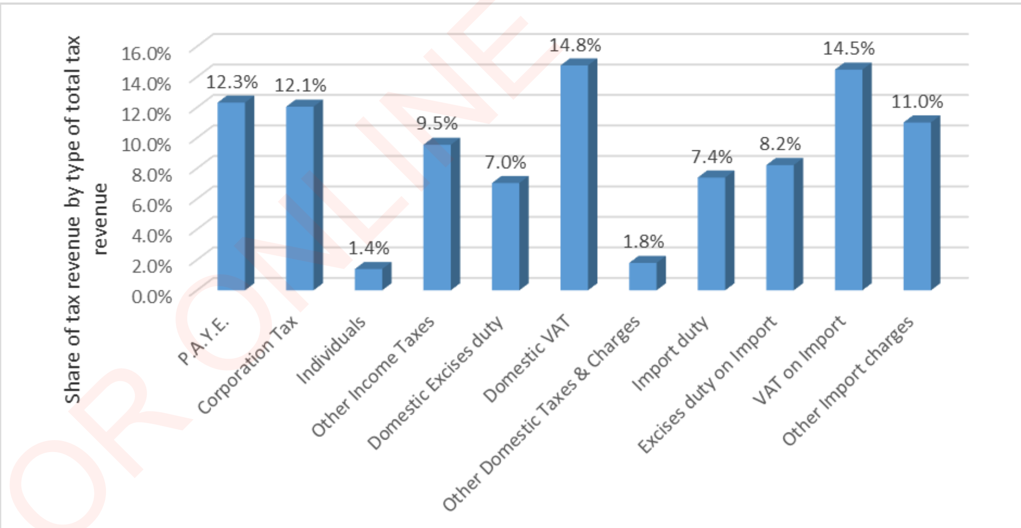

Figure 4. 5: *Share of tax revenue by type to total tax revenue in 2020/2021, (Tanzania mainland)*

Source: Tanzania Revenue Authority-2020/2021

Tariffs in Tanzania

A tariff is a tax on goods upon importation or exportation. Tariff is charged on both imported and exported goods. Imported goods may arrive in the country by; train, vehicles, ships or airplanes. Since the goods cannot be delivered until the tax liability is paid or certain conditions are met, it is one of the easiest type of tax to collect, and usually the cost of collection is generally low. It proves to be difficult when: the entry points are many, the level of corruption is high, and there are weak tax laws. Tariffs may be of the following forms:

An ad-valorem tariff: An *ad-valorem* tariff is set as a per centage of the value of the good that is being exported or imported. For imported products, if the international price of such a good falls, so does the tariff. This in turn increases competition for domestic industries. Conversely, when the price of a good rise in the international market so does the tariff. However, a country is often interested in protecting its citizens when the price is higher. An example of *ad-valorem* (by value) tax is Value Added Tax (VAT) which is levied as a per centage of the selling price of the commodity.

A specific tariff: Specific tariff is a tariff levied as a fixed charge per unit of import. It is a specific amount of money that does not vary with the price of the goods but is applicable to the quantity, weight, volume, or any other measures. In these types of tariffs, it may be harder to decide on the amount as they may need to be frequently updated due to changes in market conditions or inflation. It varies depending on the type of goods imported. For example, a country may decide to charge a specific amount of money for a single litre of petrol imported.

A protective tariff: A protective tariff is intended to artificially inflate the prices of imports and to protect domestic industries from foreign competition. For example, a 50 per cent tax on imported toys may increase the price from TShs 10,000 to TShs 15,000. Without a tariff, the suppliers could only charge TShs 10,000 for the same quantity of toys; but now, they need to charge TShs 15,000 to make the sale. *A prohibitive tariff*: A prohibitive tariff is one that prohibits the importation of any item that is prohibitive in a country.

Activity 4.1

Go and consult people around you and ask them if they have ever paid tax, if they say yes, list the types of taxes paid, if not, why? Bring your findings for class discussion.

Exercise 4.5

1. It has come to attention that most of the citizens do not know the tax system in Tanzania. You have been told by your teacher to present on the tax system in Tanzania to neighbor school. Prepare a brief explanation on tax system in Tanzania for presentation.
2. How protective tariff differ from a prohibitive tariff?

Value Added Tax

Value Added Tax (VAT) is a tax on the value added to goods and services by producers and traders at each stage in the production and distribution process. VAT is the indirect tax paid on consumption covering on a wide range of goods and services; VAT is levied also on the importation of goods and services. VAT is collected by VAT registered traders at various stages and remit it to the tax authority. For example, in Tanzania, we remit to Tanzania Revenue Authority (TRA). VAT is paid finally by the consumer. In Tanzania, VAT was established by the Value Added Tax Act of 1997 and approved to be the law. It started to operate in Tanzania Mainland on 1st July 1997. VAT rates can be charged in standard rated, zero rated, special relief and exempt whereby some goods and services are exempted. In 2009 the VAT standard rate was reduced from 20 per cent to 18 per cent. In 2014 VAT Act was improved whereby some implements, inputs and commodities of agriculture, dairy, education, fishery, medicine, and pharmaceutical goods were exempted from VAT. The VAT taxable person deducts tax that has been paid as VAT during the person's purchases of the VAT taxable supplies from VAT collected from the sales of taxable supplies. The VAT on purchases is input tax and the VAT on sales is output tax. The difference between the output tax and input tax is the amount payable to TRA or refundable to the taxpayer.

Value added tax = Output tax – Input tax

When the output tax is higher than input tax, the excess amount is the value of VAT payable to TRA. In an event where the output tax is lower than the input tax, the difference is refundable to the taxpayer by TRA. The VAT registered person needs to file VAT returns even when the difference between output and input tax is zero.

Registration for VAT

The registration for VAT involves a taxable person who deals with taxable supplies and holds a business license. The tax authority needs to know the person who is responsible to pay VAT and the person to consult or convict in the event of non-payment VAT. The person must apply for registration to the Commissioner General of TRA, who will assess the lodged application and grant approval or rejection. The approval will be based on good reasons including the protection of government revenue. Registration is statutory for all businesses which qualify for the conditions as stipulated in the regulations even if not applied for the VAT registration. The Commissioner General might register a person regardless of the turnover. The main purposes of a taxpayer to register for VAT are to:

(a) record the particulars of taxable person for control and collection of tax;

(b) enable them to enjoy the benefit of input tax on their purchases of taxable supplies; and

(c) allow them to charge output tax on their taxable supplies and to issue tax invoices.

Eligibility for registration of VAT

Before a person can be registered for VAT must satisfy the following conditions:

(a) The person must be making or intending to make taxable supplies of goods and/or services in excess of the turnover figures prescribed in the Value Added Tax (Registration) and Regulations; and

(b) The taxable supplies must be made or intended to be made in the course of, or furtherance of a business carried on by that person.

Types of VAT registration

The following are the types of VAT registration in Tanzania:

Normal registration: Normal registration is for traders whose registration for VAT is obligatory since their turnover is above the threshold to comply with the registration requirement.

Voluntary registration: Voluntary registration is a registration whereby an application to register may be received from a person who does not fulfil the registration requirements for example, their annual taxable turnover is below the required threshold. This type of application is not normally encouraged but the Commissioner has the power to register any person on the grounds of "National Economic Interest".

Intending trader registration: The regulations require any person who believes has qualifications for registration to apply for registration. Traders who intend to start a business fall into this category and may seek registration to recover any input tax incurred in setting up a business. Traders should provide full information about the nature, size of the business and business evidence of the stage reached in the development of the business such as contracts to supply, procurement of products and degree of financial commitment.

Branch registration: Many businesses operate from more than one set of premises. The trader needs to provide details of all branches operated by the trader. Normally all branches' activities are part of one legal entity and all figures (turnover, and VAT) are combined for the completion of a single VAT return. Some businesses may wish to have branches registered separately. The trader must apply in writing giving details and legal entity involved and the breakdown of branches. Some of the details to be included are location of the business, turnover, activities, and reasons for requiring separate registration.

Divisional registration: Limited liability companies may structure their organisation and create autonomous units within the same legal entity and describe them as divisions. These can be treated separately or in the same way as branches.

VAT certificate of registration

VAT certificate of registration is proof that a person has been registered. The information that must be contained in the VAT certificate is the person's Taxpayer Identification Number (TIN), VAT Registration Number (VRN), the effective date of registration, and place of business. In the case of different business locations, branch certificates will be issued, and VAT should be paid by headquarter but collected by branches. It is conditioned that the VAT Certificate must be displayed in an open place at a place of business.

Deregistration for VAT

If there is a need for business deregistration from VAT, The Commissioner General of the TRA has the power to do so. A business that is filing for deregistration should submit the following information to be checked; the name of the business, VAT registration number and tax identification number, address (present and/or future contact address), date of cessation of trading, and reasons for deregistration. If the business is sold (name, address of purchaser, period covered by the last VAT return submitted, estimated tax free stock and the valuable assets on hand and the amount of VAT).

Scope of chargeability and coverage of VAT

The VAT is chargeable on any supply of goods, services, immovable property or any economic activity made by taxable persons in the course of the economic activity carried by the person except where it is excluded under the law.

Types of supplies under VAT

The following are types of supplies under VAT:

Exempt supplies: These are supplies listed under the VAT Act of 2019, the supply of goods and services which are not taxable at any rate, they are free from the charge of VAT. Exempt supplies have the following characteristics:

(a) No tax is charged on exempt supplies;

(b) Traders supplying exempt goods and services do not charge VAT to their customers; and
(c) Input tax incurred or any cost needed to make the sales (transport, marketing) cannot be claimed.

Examples of exempt supplies include agricultural inputs such as fertilizers, pesticides, herbicides, rodenticides, and fungicides; fishery implements like fishing nets, fishing vessels, factory ships and other vessels for processing or preserving fishery products. Others include beekeeping implements such as beehives, honey strainers, and beehive smokers; dairy equipment such as milking machines, cream separators, and milking machines; and educational materials such as dictionaries, encyclopaedias, printed books, instructional chats, and diagrams.

Zero-rated supplies: Zero-rated supplies are VAT supplies that are charged at zero rates. The following are the features of zero-rated supplies:

(a) These are taxable supplies but chargeable at zero-rates;
(b) Trader supplying a zero-rated supply charge VAT, but at a rate of 0 per cent;
(c) Trader is entitled to receive a refund of input tax paid on purchases; and
(d) Provides complete relief.

Examples of zero-rated supplies include exports of goods, supplies of goods and supplies of immovable property to address outside Tanzania, and exports of taxable services to a person outside the United Republic of Tanzania who effectively enjoys the services outside the United Republic of Tanzania.

Standard rated supplies: These are goods and services whose output tax is levied at the standard rate of 18 per cent and the whole amount of their input tax incurred on the purchases of goods and service and in making such sales is deducted. They include goods like cooking oil, sugar and services such as mobile services, electricity, water, and other utilities available in the country.

Advantages of the VAT

The following are the advantages of the VAT:

Provision of revenue: VAT provides a more stable source of revenue to the government because it has a wide tax base and is charged at various stages of the supply chain where most goods and services are deemed to be taxable.

Revenue security: VAT represents an important protection instrument of revenue against tax evasion. If payment of tax is successfully avoided at one stage, nothing would be lost if it is collected at a previous stage(s). Even if it is not collected subsequently, the government will at least have collected VAT paid at stages previously to that at which tax was avoided. If tax evasion takes place at the final stage, the government would lose only tax on the value added at that point.

Claims of VAT from purchases: The general advantage of VAT is that the registered person is able to claim VAT from purchases. The registered person is exempted from payment of stamp duty on receipts, payment of entertainment tax and hotel levy.

Administrative advantages: The administrative advantages of VAT are as follows:

(a) Structure of VAT is simple to administer. Unlike other indirect consumption and turnover tax such as sales tax where due to the complex structure there is ample scope for tax evasion and corruption.

(b) VAT is self-pricing that cuts down tax avoidance and tax evasion. Conflict of interests exists between the buyer and the seller and therefore acts as an anti-evasion feature. For example, if the seller understates the sales and thus underpays tax then the seller reduces the amount of tax credit available to the buyer.

(c) Registered traders are required legally to issue and keep tax invoices, sales and purchases receipts and other books of accounts. This enables cross checking of the documents and matching invoices received by purchasers against those retained by sellers. These processes ease the tax audit activities.

(d) If a trader defaults on a VAT claims, then that will be the only portion of VAT that is lost and not the whole of the amount on the product.

Promotes exports: VAT promotes exports because exports are zero rated. That is no tax is charged, but a registered person can reclaim tax on their inputs.

Disadvantages of VAT

The following are the disadvantages of VAT:

Regressive in nature: VAT is regressive in nature, as its burden falls more heavily or disproportionally on low-income households since they are more likely to spend more of their income than relatively high-income households.

Encourage inflation: VAT system sets an environment in which the prices and wages would feed on each other and therefore encourage inflation. That is, if care is not taken, inflation is likely to occur as prices and wages will tend to rise. One of the measures to avoid inflation resulting from VAT is the implementation of prudent monetary and fiscal policies.

VAT computation

This part will demonstrate how VAT is charged at various stages of production and distribution of goods. Value addition is considered when advancement is added to the product or service by a business before the product or service is offered to the final consumer. For example, in the case of bee products beeswax, and honey can be considered as raw materials, and any enhancement can add value.

Example

A forester sells logs to a timber merchant (wholesaler) for TShs 1,000,000 plus 18 per cent VAT. The timber merchant processes (saws) the timber and sells it to a furniture manufacturer for TShs 1,400,000 (excluding VAT) and charges 18 per cent VAT. The furniture manufacturer then makes furniture and sells them to a retail furniture shop known as Deluxe Furniture Centre for TShs 2,000,000 (excluding VAT) and charges 18 per cent VAT. Deluxe Furniture Centre finally sells the furniture to a consumer for TShs 2,500,000 (excluding VAT) and charges 18 per cent VAT. Assume VAT is collected at each stage of production and distribution:

Required:

(a) Calculate the VAT collected at each stage of production and distribution, and

(b) Calculate the VAT borne by the final consumer.

Solution:

(a) Calculation of VAT collected at each stage of production and distribution:

Value added tax = Output tax – Input tax

Data

VAT= 18%

Solution (Approach 1)

Stage one: (forester)

Buying price: 0 (the forester has grown the trees)

Selling Price: TShs 1,000,000 + 18% (TShs 1,000,000) = TShs 1,180,000

Thus:

From

Value added tax = Output tax – Input tax

Input tax = 0

Output Tax = TShs 1,180,000 – TShs 1,000,000 = TShs 180,000

Therefore,

Value Added Tax = TShs 180,000 – TShs 0 = TShs 180,000

TShs 180,000 is the amount of VAT due at the first stage

Stage two: (timber merchant)

Buying price: TShs 1,180,000 (from forester)

Selling Price: TShs 1,400,000 + 18% (TShs 1,400,000) = TShs 1,652,000

Thus:

From

Value added tax = Output tax – Input tax

Input tax = TShs 1,180,000 – TShs 1,000,000 = TShs 180,000

Output Tax = TShs 1,652,000 – TShs 1,400,000 = TShs 252,000

Therefore,

Value Added Tax = TShs 252,000 – TShs 180,000 = TShs 72,000

TShs 72,000 is the amount of VAT due at the second stage

Stage three: (furniture manufacturer) Buying price: TShs 1,652,000 (from timber merchant)

Selling Price: TShs 2,000,000 + 18% (TShs 2,000,000) = TShs 2,360,000

Thus:

From

Value added tax = Output tax – Input tax

Input tax = TShs 1,652,000 – TShs 1,400,000 = TShs 252,000

Output Tax = TShs 2,360,000 – TShs 2,000,000 = TShs 360,000

Therefore,

Value Added Tax = TShs 360,000 – TShs 252, 000 = TShs 108,000

TShs 108,000 is the amount of VAT due at the third stage

Stage four: (Deluxe Furniture centre)

Buying price: TShs 2,360,000 (from furniture manufacturer)

Selling Price: TShs 2,500,000 + 18% (TShs 2,500,000) = TShs 2,950,000

Thus:

From

Value added tax = Output tax – Input tax

Input tax = TShs 2,360,000 – TShs 2,000,000 = TShs 360,000

Output Tax = TShs 2,950,000 – TShs 2,500,000 = TShs 450,000

Therefore,

Value Added Tax = TShs 450,000 – TShs 360,000= TShs 90,000

TShs 90,000 is the amount of VAT due at the fourth stage

(b) Tax collected at each stage and borne by the final consumer is:

VAT= VAT at stage one + VAT at stage two + VAT at stage three + VAT at stage four)

VAT= TShs 180,000 + TShs 72,000 + TShs 108,000 + TShs 90,000 = TShs 450,000

Solution (Approach 2)

The student may also choose to use the following approach in solving the question.

(a) Calculation of VAT collected at each stage of production and distribution:

Value added tax = Output tax – Input tax

Stages	Transaction	Input tax	Output tax	Amount paid to TRA
1.	Forester sells logs to timber merchant or wholesaler for TShs 1,000,000 + 18%VAT = TShs 1,180,000 (VAT content TShs 180,000	There is no value added to the production of the log. Moreover, VAT law exempt VAT from unprocessed agricultural products. The input tax is zero.	TShs 180,000	TShs 180,000

2.	Timber merchant/wholesaler buys logs for TSh 1,180,000 (1,000,000 + VAT 180,000) Merchant then saws and sells the timber to a furniture manufacturer for TSh 1,400,000 exclusive of input VAT and charges 18% VAT TShs 1,400,000 + 18% VAT = TShs 1,652,000 (VAT content TShs 252,000)	TShs 180,000	TShs 252,000	252,000 −180,000 72,000
3.	Manufacturer buys timber for TShs 1,400,000 (1,400,000 + VAT 252,000); Manufacturer then makes tables/chairs and sells to a Retail furniture shop for TShs 2,000,000 exclusive of input VAT and charges 18%; VAT; 2,000,000 + 18% VAT = TShs 2,360,000 (VAT Content TShs 360,000)	TShs 252,000	TShs 360,000	360,000 −252,000 108,000
4.	Retail furniture shop buys for TShs 2,360,000 (2,000,000 + VAT 360,000). The Retailer then sells to a final consumer (the customer) for TShs 2,500,000 exclusive of input VAT and; charges 18% VAT = TShs 2,500,000 + 18% VAT = TShs 2,950,000 (VAT Content TShs 450,000)	TShs 360,000	TShs 450,000	450,000 −360,000 90,000

(b) The tax is collected at each stage and borne by the final consumer is:
VAT = TShs 180,000 + TShs 72,000 + TShs 108,000 + TShs 90,000 = TShs 450,000

Activity 4.2

Think of any business that you can establish and prepare a report to address the following:

(a) How much do you anticipate earning from that business?

(b) What type of taxes will you be required to pay?

(c) How much tax will you be required to pay? Why?

Exercise 4.5

1. Value Added Tax (VAT) is disadvantageous to the economy and at the same time to the taxpayer. Briefly explain this statement.
2. Value Added Tax (VAT) provides a more stable source of revenue to the government. This is claimed to be the only advantage of VAT. Justify this claim.
3. Give examples of zero-rated and exempt supplies.

Limitations of taxation

The limitations of taxation are as follows:

Limitation on saving ability: Little saving indicates little investment. To an individual income earner, the amount to be saved will be reduced by heavy taxes, however, an increase in government investment can offset this.

Limitation on the desire to work: Many people would feel that it is not worthwhile to work overtime if taxation is heavy. Thus, the incentive to work is reduced.

Limitation on enterprise: Business undertaking depends on profit for their living. The heavy tax would discourage them from undertaking risky businesses if they are not sure of succeeding. Taxation only checks the earnings of the enterprises but does not consider business failures.

Limitation of inflation: In order to reduce inflation, the increased tax can be a tool but where indirect taxes are increased, the purchasing power of people would be reduced. This act would create a demand for increased wages which lead to an increase in consumption, thus increasing inflation.

Limitation on diversion of economic resources: Heavy tax will shift economic undertakings from heavily taxed ones to lightly taxed occupations, which in most cases will be less productive.

Exercise 4.6

Inflation is one of the limitations of taxation. Explain other limitations of taxation.

Chapter summary

1. Taxation is a compulsory levy charged by the government or state on her citizens and non-citizens which is payable in monetary terms directly or indirectly on a *non-quid pro quo* arrangement.

2. The success of taxation relies upon a good tax system which is a set of all taxes with a target to achieve certain objectives with stipulated principles termed as canons of taxation.
3. The main aim of tax is to achieve various social, political and economic objectives.
4. A tariff is a tax on goods upon importation, also referred to as import duty.
5. Tariffs can be categorised into protective or revenue tariffs.
6. Tax can be direct or indirect.
7. Tax has three systems namely: progressive, proportional, and regressive tax systems.
8. The impact of the tax is on the person who is first paying the tax, or where tax is legally charged.
9. Incidence of tax is on the person who finally bears the burden of paying the tax.
10. Taxation affects a taxpayer economically and socially.
11. The value added tax is a tax on the consumption of commodities charged or computed at each stage of production, and distribution.
12. The scope of VAT chargeability is based on the types of supplies such as standard rated supplies, zero rated supplies, and exempt supplies.

Revision exercise

1. Distinguish between progressive and regressive tax systems.
2. Explain the main advantages and disadvantages of deducting tax at the source?
3. A farmer sells wheat to a wholesale trader for TShs 250,000. The wholesale trader sells to a milling merchant who processes (grind) the wheat, and sells it to a bakery owner for TShs 400,000 (excluding VAT) and charges 18% VAT. The bakery owner then makes bread, and cakes and sells them to a pastry (retail outlet shop) known as Fresh Pastry for TShs 600,000 (excluding VAT) and charges 18% VAT. Fresh Pastry ultimately sells the bread, and cakes as bites to different consumers for TShs 700,000 (excluding VAT) and charges 18% VAT. You are required to calculate: the VAT collected at each stage and VAT borne by the final consumer.
4. Choose the best answer from the following questions and write the letter of the correct answer.
   i. The principle of taxation which is based on the ability of taxpayers to pay is referred to as___________.
      A. economy.
      B. equity.
      C. certainty.
      D. flexibility.

ii. Suppose the tax authority collects tax from citizens who do not know how much to pay, where to pay, and how to pay. Which principle of taxation is the authority violating?
   A. Convenience.
   B. Equity.
   C. Certainty.
   D. Flexibility.

iii. Suppose TRA has incurred TShs 1.2 billion per month to collect total revenue of TShs 1 billion per month. Identify the canon of taxation which is not obeyed by the authority from the given list.
   A. Convenience.
   B. Equity.
   C. Economy.
   D. Flexibility.

iv. Which principle of taxation states that a tax should be easy to understand, and households and firms should be able to calculate the amount of tax required to pay?
   A. Convenience.
   B. Equity.
   C. Certainty.
   D. Flexibility.

v. The following are the advantages of tax **except** __________________.
   A. discourage production and consumption of goods.
   B. fund government spending.
   C. relieve the country from financial difficulties.
   D. not creating a more socially acceptable or fair distribution of resources.

vi. Which of the following statements explain the meaning of tax?
   A. A compulsory payment made to the government by all people in an economy.
   B. A non-compulsory payment made to the government by all people in an economy.
   C. A compulsory payment made by the government to all people in an economy.
   D. A non-compulsory payment made by the government to all people in an economy.

vii. Which of the following is an example of a progressive tax?
   A. Custom duty
   B. Sale tax
   C. Income tax
   D. Excise duty

viii. The following are the advantages of progressive tax **except** ____________________.

A. cheap to collect.
B. certainty.
C. inflationary.
D. convenience.

ix. Which one of the following is not an indirect tax?

A. Import duties.
B. Value added tax.
C. Excise duties.
D. Pay As You Earn.

x. Why do governments impose tax?

A. To maintain general administration.
B. To maintain internal law and order.
C. To redistribute income.
D. To punish offenders.

Chapter Five Insurance

Introduction

As human beings, we are not certain about what will happen in the next few minutes, let alone what could happen tomorrow. The degree of uncertainty in our lives exposes us to some risks. Given past experiences, however, we can learn the behaviour of these risks and their possible outcomes, and make relevant plans on how to ease them. Moreover, we can choose to share these risks with others through insurance. In this chapter, you will learn about terms of insurance, the concept of insurance, principles of insurance, forms of insurance, insurance policies in Tanzania, the insurance industry in Tanzania, and the functions of insurance companies. The competence developed from this chapter will enable you to use the knowledge of insurance to reduce the risks associated with family, businesses, and assets.

Terms used in insurance business

The following terminologies are frequently used in the insurance business:

Uncertainty: Uncertainty is a state of limited knowledge where it is generally impossible to describe the existing condition or a future outcome. It is a consequence of lacking knowledge of an obtainable fact.

Loss: Loss is damage sustained by the insured as a result of the occurrence of unfavourable conditions. In many cases, it is not always possible to prevent unwanted events from occurring. The financial world however has developed products aiming at compensating the individual against losses. One element is the pooling of risk covered by the insurance contract.

Risk: Risk is a circumstance in which one is exposed to danger. It is considered as an outcome of a state of uncertainty in which the possible outcome has an undesired effect or results in a loss. Possibility of the outcome of an event will develop worse than planned. In many events, risks are associated with the occurrence of an unfavourable or undesirable event that results in financial loss. There are different forms of risks affecting our communities. These are:

(a) Pure risks, which are risks that cannot be controlled and the possibility of the outcome is loss or no loss. For example, fire, floods, and hurricanes;

(b) Speculative risks, which are risks whose outcome is either profit or loss. For example, exchange rates risks;

(c) Fundamental risks, which are risks that affects a large community within an economy. For example, inflation, unemployment, and natural disasters;

(d) Particular risks, which are risks that only affect an individual. For example, burglary, accident, and fire; and

(e) Enterprise risks, which are risks that affect business operations. For example, data breaches, system failure, and being sued.

Insured: Insured is an individual or company that represents one party of the insurance contract who seeks to obtain an insurance policy. An insured individual significantly transfers potential risks to the insurer and is expected to be protected by the insurance policy. With the exception of insurance policy such as motor vehicle (third party policy) and life assurance, in all other instances the insured is the principal beneficiary of the insurance contract.

Insurer: Insurer is second part of the insurance contract that shares risk with the insured for a price (insurance premium). The insurer is the insurance company granting assurance to the insured. The discretions as to whether or not to provide coverage to the insured lie with the insurer. This is based on the assessment of the risk the insurer is willing to take and the nature of the insurance coverage. The insurer will not wish to offer insurance to high-risk applicants and to those events that affect a large community such as earthquakes, floods, and lightning.

Insurance premiums: Insurance premiums are payments made by the insured to the insurer against the protection of an asset of interest. It can be a fixed amount payable as a single payment or may be paid periodically depending on the terms and conditions of the insurance contract. In some events, it is adjustable to reflect the special characteristics of the insurance policy.

Risk pooling: Risk pooling is a term used to describe the tendency in which insurance companies come together to provide insurance services against catastrophic risks such as floods, earthquakes, and death. In risk pooling, individuals exposed to a particular event that might result in losses come together and gather money (premium) against such an event. In the event a member of the pool suffers losses, the amount collected in the pool will be used to compensate such a member for the loss. However, for this idea to work, the risk of the member in the pool should be independent. It will exclude risks resulting from a natural disasters such as earthquakes and floods which significantly can impact a large number of individuals in the pool at the same time.

Peril: Peril is a term used to describe the cause of the risk. It includes factors such as fire, floods, burglary or theft, accident and natural disasters such as earthquakes, and volcanoes. It is the element that is insured against and has to occur for the insured to lodge a claim that can be compensated by the insurer.

Hazards: Hazards are conditions necessary to the occurrence of the loss. They are generally not the cause of the loss; however, their existence significantly contributes to the occurrence of loss. For example, settlements near river banks or low land areas are more vulnerable to flooding as compared to settlements in highlands.

Sum insured: Sum insured is the value of the asset as stated by the insured at the time of signing the insurance contract. The insured is not allowed to claim for losses above the stated value of the asset. Upon the filing of a claim for a loss suffered, the recoverable loss will be equivalent to the value of the asset or lower depending on the amount of actual loss incurred. If an insured over-valued the asset insured (over-insured) at the time of taking out the insurance, the insured would be required to pay a high premium; and in the event of incurring losses the insured would only be compensated to the extent of the correct value of the asset insured. Similarly, if an insured under values the asset insured (under-insured) to pay a low premium, at the time of the loss, the insured would only be compensated to the extent of the declared value of the asset insured.

Re-insurance: Re-insurance is a process by which the insurance companies with excess insured risks take a policy with another insurance company to cover the risk liability they are exposed to. It is the insurance for insurers where the insurer transfers the risks to another insurer. This allows the insurer to remain solvent.

Co-insurance: Co- insurance is an act of spreading risk among insurance companies. It occurs in an event where the value insured is too high. Here, a number of insurance companies will collaborate to insure the asset in question. The insurance company with the highest proportion of the risk will offer a single insurance contract. If the insured suffers losses, all the insurance companies which have co-insured will contribute to compensate the insured for such a loss.

Moral hazard: A moral hazard is a change of behaviour in which a party protected from risk in some ways will act negligently due to protection he or she has. We encounter moral hazards every day. For example, people with theft insurance such as motor bicycle insurance may become negligent about where they park, and salaried employees who take long breaks because of the guarantee of the salaries at the end of the month represent a moral hazard. The moral hazard insurance industry entails the situation in which insurance companies worry that by offering pay-outs to protect against losses from accidents, they may encourage risk-taking.

Adverse selection: In the insurance industry, adverse selection refers to situations in which an insurance company extends insurance coverage to an applicant whose actual risk is substantially higher than the risk known by the insurance company. The insurance company suffers adverse effects by offering coverage at a cost that does not accurately reflect its actual risk exposure. For example, a health insurance company may extend insurance coverage to a person who is already sick at a low premium then the company suffers consequences when the actual risk has to consume more cost than expected.

Actuaries: Actuaries are experts at assessing risks by analysing statistics and data. These experts set rates for insurance products.

Adjuster or claim examiner: Adjuster is someone who investigates a claim to determines if the loss is covered by the policy, estimate damages, and often write a check to the insured.

Deductible: Deductible is the amount of money the insured is required to pay before the insurance company pays the claim. For example, one may be having an insurance cover worth TShs 10,000,000 but also having deductibles amounting TShs 2,000,000 and is involved in an accident required to be paid total loss by the insurance company. The insurance company will pay TShs 8,000,000 and TShs 2,000,000 will be paid by the insured.

Claim: Claim refers to any request for payment within the bounds of an insurance policy. For example, if you have motor insurance and you got an accident you would file a claim requesting that your insurer investigate and issue a payment if needed.

Cover note or binder: Cover note is a temporary or preliminary agreement which provides coverage until an insurance policy can be written or delivered.

The concept of insurance

Insurance is an agreement between the insurer and the insured for a premium. The insurer agrees to pay the insured a defined amount of money against the occurrence of a specific loss. The amount to be compensated by the insurer can either be a fixed amount or a reimbursement for the whole loss or part of the loss. The premium paid by the insured is their share of the total premium in the risk pool. On the other hand, the insurer takes into consideration the number of losses to be expected from the insurance pool and its potential variations to determine the amount to be charged as a premium.

In general, an insurance contract involves the exchange of risks for a known payment (premium) by the insured. In insurance, the risk of anticipated losses is significantly transferred to the insurer who in turn is required to compensate the insured against an occurrence of such risk. The insurer is always granted the right to specify rules, regulations, and conditions to be met by the insured to participate in the insurance pool.

It is important to understand the difference between insurance and assurance. These two terms are commonly used interchangeably but they differ significantly. Insurance cover losses that may or may not occur while an assurance covers events that are bound to happen, and the only uncertainty is a time of occurrence of an event. For example, death. Insurance is for properties while assurance is for human life.

An insurance contract only exists in the presence of insurable risks. The risk become insurable when:

(a) The potential of loss is significant such that substituting insurance premium against the loss is desirable;
(b) The economic value of the loss is well-defined and the insured had worked towards the prevention of the occurrence of the insured loss; and
(c) At any given moment, the loss of one policyholder should not relate to the loss of another member in the pool that is, the loss of the insured must be independent of the losses of the members in the pool.

The major role of insurance contracts has always been in the spreading of financial losses; however, the importance of insurance goes above risk spreading. It includes a provision of security and a sense of safety to holders of the insurance policy that their losses will be covered in the event it occurs. This adds some peace of mind, especially to those managing many assets that are exposed to different forms of risks. Insurance also eliminates the dependency burden after death by those with a number of dependants. Similarly, a country benefits from the pool of insurance premiums (savings) managed by insurance companies through their involvement in productive activities and from international trade supported by insurance contracts. Figure 5.1 shows the insurance covers, that is properties and life.

Figure 5. 1: *Insurance coverage*

Need for insurance

People need insurance for the following reasons:

To provide security and safety: Insurance compensates the insured in the event of losses suffered by the insured. For example, properties insured against hazards are safe as they should be compensated in case of loss.

To provide peace of mind: The uncertainty due to fire, accident, death, illness, and disability in human life is beyond the control of human beings. By the way of insurance, people can be compensated financially. The financial compensation provides not only peace of mind but also motivates to work more and more.

To reduce dependency: In the case of the death of the breadwinner, the consequences to the household are significant. Similar to the destruction of property and goods, the family would suffer a lot. It could lead to a reduction in the standard of living or begging from relatives, friends, or neighbours. Insurance reduces economic independence of the family. Insurance is among the ways to assist and provide needs adequately at the time of suffering.

Leads to accumulation of savings: Insurance involves the collection of premiums from the insured to compensate them in the event of a loss. The premiums collected are invested and some amount is saved for compensation thus accumulating savings.

To reduce the business losses: Businesses invest a significant amounts in acquiring the properties such as buildings, plants, and machinery. These properties may be destroyed and cause losses that could adversely affect the business. Insurance reduces the uncertainty of business losses.

To improve the welfare of employees: The welfare of employees is the responsibility of the employer. The employer is supposed to look after the welfare of the employees. The provisions are being made for death, disability, and old age. Though these can be insured through individual life assurance but an individual may not be insurable due to illness and age. But the group policy should cover employee's insurance and the premium is very low in group insurance. The expenditure paid on account of premium should be allowable expenditure.

Principles of insurance

The insurance system is governed by the following principles:

Principle of utmost good faith (Uberrimae Fidei): Principle of utmost good faith requires good faith between parties involved in the insurance activities, especially during the contract signing. Here the insured is required to provide clear, correct and complete information to the insurer and the insurer is required to provide clear, correct and complete information on the terms and conditions of the insurance contract.

In the event the insured had either omitted, hidden, falsified or presented the wrong information to the insurer, the insured liability can be legally revoked or cancelled by the insurer.

Principle of insurable interest: An insured must have an insurable interest in the subject matter to be insured. An insurable interest exists when the insured obtain economic benefit on the existence while suffering an economic loss upon the non-existence or damage of the subject matter. For example, individuals have an insurable interest in their own life, health, house, and properties, but have no insurable interest in the life of their neighbours or their properties. As insurance contracts are based on the measurement of economic loss, the insured has to have provable causes relating to suffering an economic loss.

Principle of indemnity: The insurance contract provides a guarantee or assurance to the insured on the recovery of the prevailing conditions before the occurrence of the economic loss. The goal of insurance is not to benefit the insured rather is to recover their original state before the occurrence of loss. The amount to be compensated is limited between the total amount insured or assured and the actual loss incurred whichever is lower. It is important to note that the principle of indemnity is not applicable in life assurance, as the value of human life cannot be measured in monetary form.

Principle of loss minimisation: This principle emphasises that, the insured individual responsibilities in relation to their insured assets are not waivered by the purchase of the insurance policy. The insured still has the duty of taking relevant steps to protect the insured asset to minimise losses in an event of the occurrence of an unfavourable event. For example, an individual buying motor vehicle insurance is required to take necessary precautions while driving and in maintaining the vehicle. Similarly, an individual buying an insurance policy against fire, flood or burglary, should take all relevant measures to ensure flammable materials are kept far, the location of the house should be in areas less prone to floods and install all the necessary security systems to reduce burglary.

The doctrine of proximate cause (nearest cause): An insurance claim is honoured by the insurer in the event that there is a close relationship between the cause of the loss (peril) and the insurance coverage. In the event of the loss caused by more than one factor or in succession, the nearest or the closest cause should be determined to estimate the amount of liability liable to the insurer. For example, a property might be insured against some cause such as fire, theft, and flood but not against all peril. In an event of a loss, a proximate cause will be identified. If it is related to fire, flood, or theft, the insurer is bound to compensate the insured. However, if the proximate cause relates to a weak structure, the insurance company is not liable to pay such a claim. The principle emphasises that not all losses suffered by the insured will be compensated by the insurer. It is if and only if they are related to the peril insured.

Principle of subrogation: The principle of subrogation requires that in the event an insured person is compensated fully for the loss or damage incurred, the right to the insured asset is transferred to the insurer. Under this principle, the insurer has the right to claim compensation from the third party that caused the damage compensated. For example, Mwaka insured her property for TShs 1,500,000. The property was subsequently destroyed by Wiki. The insurance company shall indemnify Mwaka for TShs 1,500,000. After the insurance company has paid Mwaka, the compensation right of Mwaka to recover damages to Wiki gets transferred to the insurance company which can sue Wiki for rectifying the negligence which led to the loss.

Principle of contribution: If an insured takes up more than one insurance policy on the same asset, the insured person is only entitled to claim an amount to the extent of actual loss from either all insurers or only one insurer.

Activity 5.1

Read the following case study, then attempt the questions that follow:

After completion of form four secondary education, your classmates Juma and Anna decided to establish their own business. Anna chose to start her clothing business in Dar es Salaam. Her family provided her with a brand-new house and a car. Upon her arrival in Dar es Salaam, Anna observed that she is not an excellent driver thus prone to accidents. Moreover, after her stay in the new house, it has come to her knowledge that her surrounding areas are highly vulnerable to burglary incidents. To date, Anna has not added any form of security to improve this situation. As a starting business, Anna has no guarantee in the viability of her business.

Juma on the other hand started his trading business in Mbeya region. The trading business concentrated on buying and selling grain products (maize, wheat, and rice). Juma buys the products during the harvesting period as the price in the market tends to be relatively low and sells them during planting season as the price tends to be high. Considering the type of this business, Juma is aware of the need for the warehouse for storage as his responsibilities extend to the date products are sold. His responsibilities are further extended to overseeing the security and the state of the products in the warehouse. Under no given circumstance, Juma is allowed to sell products in any state that cannot be consumed by human beings.

It has come to the attention of both Juma and Anna on the concept of risk and its management and they have heard that their classmate (that is you) has learned this in school. They have approached you to help them on identifying the type of risks and how they can manage them using insurance. The following are the questions directed to you:

1. Identify the risks faced by Anna and Juma as far as this story is concerned.
2. On what subject matter do Anna and Juma have an insurable interest?
3. Based on the 'Principle of Utmost Good Faith', what information is needed to be disclosed by Anna and Juma before securing an insurance contract?

Exercise 5.1

Based on the definition of insurance, indicate whether the following guarantees can be considered to be an insurance contract or not:

(i) A warrant on the television set for one year.

(ii) A guarantor agrees to pay the loan balance of the original debtor defaults on the payments.

(iii) A large group of homeowners agrees to pay for losses to homes that are burnt during the year because of fire.

Forms of insurance

There are generally two forms of insurance contracts available in the insurance market. These include life insurance and general insurance.

Life insurance

Life insurance is an agreement between the insurer and the insured where upon the receipt of a premium from the insured, the insurer guarantees to pay a sum of money to the designated beneficiary upon the demise of the insured. The guarantee can also include coverage in an event where the insured suffers from a terminal illness or has a permanent disability. The amount is paid to assist in discharging their social responsibilities same as before the illness or accident.

General insurance

General insurance covers most of the non-life types of insurance including health insurance, motor insurance, liability insurance, personal accident insurance, and marine insurance.

Insurance policies in Tanzania

An insurance policy is a legal contract between the insurance company (the insurer) and the person or business or entity being insured (the insured). The insurance policy needs to be read and understood by the insured as it will help the insured to know their responsibilities and that of the insurer if any loss occurs.

Types of insurance policies in Tanzania

A number of policies are available depending on the form of insurance coverage available in any country. The following are the insurance policies available in Tanzania:

Life insurance policy

The main objective of taking a life insurance policy by the insured is to protect dependant livelihoods through replenishing loss income as a result of the death of the insured, covering children's education, paying off debts, and provide assistance income to the insured's legal spouse. The factors considered by insured before taking this policy include; the number and ages of the insured children, amount of debt, level of income, family requirements, and alternative income sources available to the insured dependants. There are two kinds of life insurance policies in Tanzania, these are:

Term life/endowment life insurance: Term life insurance is a contract between an insurance company (the insurer) and a policyholder (the insured) in which the insurer agrees to offer insurance coverage to the insured in exchange for regular payments (premium) for a set length of time and to pay a set amount in the case of the policyholder's death. The policy expires at the end of the term and has no residual value. This happens in an event where the premium is only paid once or for a specified period and the sum insured becomes payable the earlier between the expiration date and date of death. Term life insurance is meant to offer coverage for a specific period such as 10, 15, 20, or 30 years. The insurance will cover the death benefit if the insured person dies within the time frame stated in the policy. If this is not the case, no benefit or refund will be given. Term life insurance may be worthwhile for persons looking for coverage for particular needs that will come to an end at some point in the future.

Permanent life insurance/Life assurance: Life assurance is a contract between an insurance company (the insurer) and a policyholder (the insured) in which the insurer agrees to pay someone (the beneficiary) following the death of the person whose life is being insured in exchange for a payment (premium) from the policyholder (the life assured). Permanent life insurance is intended to safeguard the insured for the whole life. This type of policy allows the insured to spread out the rising expense of insurance over the course of the insured life. This policy is more expensive than an endowment-life assurance contract, thus the majority of life assurance seekers tend to opt for endowment-life assurance.

General insurance policy

General insurance policy also known as the non-life insurance policy is an insurance policy other than a life insurance policy. There are several kinds of general insurance policies as explained below:

Motor insurance: Motor insurance is also termed as automotive insurance. It includes both comprehensive and third-party policies. In Tanzania, third-party policies are a mandatory type of insurance for any person operating a motor vehicle. It is a guarantee for payment of compensation to a third party who has significantly suffered economic loss as a result of an accident caused by the insured motor vehicle. The compensation is on medical expenses for bodily injury and against damage to property. The comprehensive type of policy covers both liabilities to third parties and damages sustained by the insured motor vehicle after an accident. Figure 5.2 shows damaged cars during an accident which is subjected to compensation if insured.

Figure 5. 2: *Car accident*

Health insurance: This is a form of insurance that aims at protecting individuals against medical expenses resulting from illness. In Tanzania, there are several providers of health insurance services such as the National Health Insurance Fund (NHIF) and Community Health Fund (CHF). The dominant provider of health insurance in Tanzania is the NHIF. NHIF was established by the Act of Parliament number eight of 1999 and began its operation in June 2001 to provide health insurance to government employees. However, in recent years it expanded its bases to include other individuals in other sectors. The goal of health insurance is to reduce the out-of-pocket cost relating to hospitalisation, purchase of prescription medicine and doctor consultation. In the case of employees, the coverage includes the insured person, spouse, and four dependants. The premium is paid monthly from a deduction of the employee's salary and is honoured only when such deductible has been received by the insurer (NHIF).

Fire accident insurance: Fire accident insurance is property insurance that provides coverage against damages or losses related to fire. The coverage of fire insurance includes peril relating to fire, lightning, and explosion, or implosion.

Engineering insurance: Engineering insurance provides coverage against economic losses related to:

(a) ongoing construction projects;
(b) operation of machines and equipment; and
(c) installation projects.

It is commonly related to the risk of building to contractors and subcontractors, plant erectors and machinery operators. Thus, the most common customers for this type of insurance policy include among others the construction enterprises, real estates, production or manufacturing industry and electrical engineers.

Oil and gas: Businesses operating in the oil and gas industry are exposed to risks related to specialised property, inland marine and commercial general liability. Specialised property and inland marine relate to the damage of buildings, rigs, erecting equipment and ocean marine. On the other hand, commercial general liability relates to bodily injury to employees or third parties, damage to properties of third parties and environmental pollution. Businesses buy policies related to these risks to reduce the cost burden in an event of the occurrence of such loss. Designed to recover the loss from loss of oil, gas, and equipment.

Aviation insurance: The coverage is on risks related to aviation. It includes a physical damage insurance policy on the damage to the aircraft itself. It covers the cost of repair resulting from physical damages. It also includes accident policies (death or injury) for passengers, cabin crew, and third parties. It also includes damage to third-party properties including damage to airport facilities. Due to large exposures pertaining to aviation, a single insurance company cannot underwrite completely the risk, thus a number of insurance companies underwrite a small per centage of the total risk of a particular airline in ensure the maximum coverage is attained without jeopardising the minimum aviation risk requirement of the insurance company.

Marine insurance: Marine insurance compensates against losses related to the destruction of cargo, freight of commodities and means of transport (hull). The marine cargo insurance policy covers losses and damages on transit. The losses covered are related to voyage delays and accidents during transit, loading, and offloading. It also covers third-party liabilities on losses related to shipwrecking and accidents at the port or during transit. The policy's main coverage is on safeguarding the ship. Freight insurance policy, on the other hand, compensates the shipping company in the event one suffers losses during freight while the hull insurance policy is offered to the owner of the vessel to cover losses related to the vessels, fittings, and equipment on board the vessels.

Liability insurance: Liability insurance covers legal liability arising from third parties. This class of insurance provides cover for legal liability in respect of loss, damage to property, or injury to the third party arising from defects to insured asset or event.

Personal accident insurance: Personal accident insurance is an insurance contract that provides compensation to the insured in event of injuries, disabilities, or death resulting solely from violent accidents, or external and visible events.

Health and motor insurance

While health and motor insurance may seem to be different, they have so much in common. Both aim at reducing out-off pocket expenses related to medical expenses. While health insurance concentrates on protecting the health of an individual, motor insurance protects against human body injury. They are both required by an individual in possession of a car and need some medical attention. However, some differences can be spotted between the two. Table 5.1 provides the differences between health and motor insurance.

Table 5. 1: *Differences between health and motor insurance*

Parameter	Health insurance	Motor insurance
Definition	It is a type of insurance contract requiring the insurer to pay some or all of the insured's medical expenses in exchange for a premium	It is a type of insurance contract that provides financial coverage to the insured vehicle against losses resulting from accidents and other damages
Policy type	Health insurance policy	Comprehensive policy and Third-party policy
Scope	Covers a wide range of benefits to the insured person including routine check-ups	Does not compensate owners against routine expenses of the car or the injured person
Premium Payment	Monthly deductions or annually	Annually or in terms of instalments.
Premium Calculation	Varies depending on the size of the salary or based on the amount categorised by respective health insurance.	Comprehensive policy: depending on the value of the car. Third party policy, Constant or fixed amount to all motors.

Activity 5.2

Visit any hospital or healthcare centre and identify health insurance that is accepted by the hospital or healthcare centre. Ask about the benefits provided by each of the insurance companies to insured. Present the findings in your class.

Exercise 5.2

1. Distinguish between health and motor insurance.
2. Differentiate between life and general insurance.
3. Briefly explain the various kinds of general insurance.

Profit making in the insurance companies

Insurance companies make profits from the premium collected and from the investment of the premium collected. In the normal course of the insurance business, not all the premium collected in the pool is used to cover or compensate the insured against the loss (as not all insured incur a loss at the same time as the event tends to be independent). Some amount of the premium collected is invested in money-generating activities. The advantage here is in the insurer's right to select the risk to be insured, the person or individual to be insured and on the amount of premium to be charged. Moreover, the insurance company expenses are related to compensation against losses and administration expenses. As stated above, only few people in the pool incur losses, this type of expense tends to be low when the risk pool is significantly large. Thus, administration cost remains to be the only significant expense for the insurance company. Given the low number of claims filed, it can be expected that the cost of administration also to be low, thus the majority of the premium collected is largely invested to generate profit for the insurance company. The general business model of the insurance company aims at collecting more in the insurance premium and on the investment income than the amount paid out as losses while offering a competitive price of a premium that the customer will tend to accept. Thus, the profit model of an insurance company is given as:

$$Profit = Earned\ \ premium + Investment\ income - Incurred\ losses - Administration\ expenses$$

Example 5.1:

The following information relates to Panda insurance company for the financial year 2021/2022:

Items	**Amount in TSh**
Amount of premium collected	960,000,000.00
Investment income	480,000,000.00
Claim compensated	670,000,000.00
Administration expenses	150,000,000.00

Required:

Calculate the amount of profit or loss for Panda Company for the financial year 2021/2022

Solution:

All the amounts are in Tanzanian Shillings (TShs)

$$Profit = Earned\ \ premium + Investment\ income - Incurred\ losses - Administration\ expenses$$

Earned premium = 960,000,000

Investment income = 480,000,000

Incurred losses = 670,000,000

Administration expenses = 150,000,000

Profit = 960,000,000 + 480,000,000 − 670,000,000 − 150,000,000

Therefore, Profit = Tshs 620,000,000

Example 5.2:

In the year 2021, Akili Insurance Company collected a premium totalling to TShs 180 million. On February of the same year, TShs 80 million of the premium collected was invested as a fixed deposit in a bank offering an interest of 10% per annum. Claims totalling an amount of TShs 40 million were paid during the year while expenses amounting to TShs 20 million was also paid. Determine the amount of profit or loss earned by Akili Insurance Company for the year ending 31st December 2021.

Solution:

The investment income has to be calculated first as the company has invested the money into a fixed deposit account. The formula for calculating investment income is:

$$\text{Investment income} = \text{Principal} \times \left(1 + \frac{\text{interest}}{12}\right)^{t} - \text{Principal}$$

Where, t is the months for investment

In this case the company invested the money for 11 months i.e from February to December

Principal = Tshs 80,000,000

Interest =10%

$$\text{Investment income} = 80{,}000{,}000 \times \left(1 + \frac{10\%}{12}\right)^{11} - 80{,}000{,}000$$

$$\text{Investment income} = 80{,}000{,}000 \times \left(1 + \frac{0.1}{12}\right)^{11} - 80{,}000{,}000$$

$$\text{Investment income} = 80{,}000{,}000 \times (1 + 0.008333)^{11} - 80{,}000{,}000$$

$$\text{Investment income} = 80{,}000{,}000 \times (1.008333)^{11} - 80{,}000{,}000$$

$$\text{Investment income} = 80{,}000{,}000 \times (1.095579) - 80{,}000{,}000$$

$$\text{Investment income} = 87{,}646{,}320 - 80{,}000{,}000$$

$$\text{Investment income} = 7{,}646{,}320$$

Now, Profit = Earned premium + investment income — Incurred losses — Administration expenses

Earned premium = 180,000,000

Investment income = 7,646,320

Incurred losses = 40,000,000

Administration expenses = 20,000,000

Therefore, Profit = 180,000,000 + 7,646,320 – 40,000,000 – 20,000,000

Profit = Tshs 127,646,320

Activity 5.3

A form four student studying commerce owns a sports bicycle that she frequently rides to school. The current market value of a sport bicycle is TShs 3,000,000. As the school is a bit far from home, the student rented an apartment near the school. The current replacement value of student's clothes, television set, mobile phones and other apparel worth TShs 8,000,000. The street the student resides in, has a reputation of being extremely dangerous because of numerous breakings in resulting in the loss of personal property. The parent of the students in one way or another work to support the student. For each of the above risks or exposures faced by the student, discuss the most appropriate type of insurance policy that could be purchased by that student.

Exercise 5.3

1. How can insurance contract be classified?
2. Mabala Insurance Company offers three types of insurance policies: individual life assurance, health insurance and motor insurance. For individual life assurance policy, the company charges a fixed annual premium of TShs 360,000 for a single payment of TShs 20,000,000 upon the demise of the insured. The premium is due and payable at the beginning of each year. Under health insurance, the company covers all medical expenses of the insured upon receipt of a monthly premium of TShs 12,000. Two policies are available for motor insurance: a comprehensive policy requiring an annual pay of TShs 250,000 for full coverage of the value of the motor vehicle, a third-party policy that requires an annual pay of TShs 100,000 for medical expenses and damage liabilities to a maximum TShs 1,500,000. In the year 2021, the company

underwrite 960 people for individual-insurance policy, 48,000 people for health insurance, 1,300 motor vehicles for comprehensive policy and 570,000 motor vehicles for third-party policy. The company paid a total of 60 individual life assurance; TShs 53,000,000 for medical expenses; TShs 45,000,000 for motor insurance. Administration expenses amounted to TShs 46,500,000. It is the company policy to invest all the proceeds from the individual-life assurance and motor insurance in a fixed deposit. The interest on the fixed deposit is 9% per annum. The company makes such a deposit at the beginning of each year.

Calculate:

(a) The amount of income generated from each policy.
(b) The amount of income generated from the investment activities.
(c) The profit of Mabala Insurance Company for the year ending 2021.

Insurance industry in Tanzania

From 1967 to 1996, the insurance industry of Tanzania was served only by the state-owned insurance company called National Insurance Corporation (NIC). Thereafter, insurance companies from other countries were allowed to offer insurance services in Tanzania as a result of makert liberalisation. Liberalisation intended to turn the insurance industry into a competitive agency for national savings mobilisation, among other things. Liberalisation led entrepreneurs from other African nations with more developed insurance markets, such as South Africa, Kenya, and others entered the insurance market of Tanzania. Following the liberalisation and other financial reforms in Tanzania, NIC was no longer a monopoly when the number of insurers increased gradually over the years. The Tanzania Insurance Act No. 10 of 2009 defines the insurance business as the business of accepting an insurer's duty in any class of insurance, whether mentioned in the Act or not. The Act established the Tanzania Insurance Regulatory Authority (TIRA) with the responsibility of coordinating policy and other matters relating to insurance in the country. The core functions of the authority are:

(a) Registration of insurance agents;
(b) Registration of insurance assessors and loss surveyors;
(c) Registration of insurance brokers;
(d) Registration of insurance companies;
(e) Registration of Reinsurance companies;
(f) Inspection of all insurance players;
(g) Handling insurance complaints from the public; and
(h) Creation of insurance awareness to the Public.

Insurance firms, insurance companies, reinsurance companies, insurance brokers, insurance agents, the insuring public, and the government through TIRA are all players in the insurance industry.

Functions of insurance companies

Insurance companies serve to cater two categories of insurance functions. These are:

(a) Primary functions; and
(b) Secondary functions.

Primary functions of insurance companies

The following are the primary functions of insurance companies:

Providing safety and security: In business and everyday life, insurance provides financial support and lowers uncertainty. It ensures safety and security in the event of a specific incident. The basic function of insurance is to safeguard against future hazards, accidents, and vulnerabilities in this way. No insurance can prevent a risk from existing or prevent future catastrophes, but it can undoubtedly aid in providing coverage for hazards and misfortune.

Collective risks: A large number of people purchase insurance policies to protect themselves from disasters. However, not every one of them is subjected to bad luck regularly. Simply said, a large number of people contribute to insurance, and only a few people are required to share it. It is a method that has resulted in a pair of misfortunes to large number of people. Each member of the general public who receives protection pays an annual premium to the reserve. People who are victims of hazards are compensated according to the conditions of the insurance policy, which helps them meet their financial demands during a tough period.

Risk assessment: The numerous components that rise to give a chance of risks are surveyed by insurance companies to estimate the degree of hazards. By examining the circumstances, the insurers play a vital role in calculating the actual level of risk associated with the occurrence of a specific event. They carefully consider all factors of risk before making a decision. It assists them in determining the ultimate insurance amount as well as the premium that the insured must pay. The procedures for determining premium rates are also based on the policy's risks.

Certainty: One of the primary advantages of purchasing an insurance policy for the insured is on the certainty that they will be able to satisfy future losses after purchasing coverage for a specific risk. This provides assurance to the insured person which allow them to go about their everyday activities with much more confidence and less fear and doubt. In real life, we are confident in our capacity to meet future losses and withstand future challenges when we have coverage from the insurer. In any event, obtaining a security guarantee from the insurer transforms our vulnerability into confidence that we will be able to deal with any danger.

Secondary functions of insurance companies

The following are the secondary functions of insurance companies:

Prevention of losses: In the event of an unforeseen incident, an insurance policy can assist the insured in mitigating their losses by providing some form of security. It aids firms in developing a backup plan if things do not go as planned. Insurance is a critical tool for businesses because it allows them to cover their basis while operating in a high-risk environment where losses can lead to catastrophic outcomes if they do not play their cards correctly. It also enables them to cover these significant risks in their enterprises by paying a relatively cheap premium.

Covering bigger risks with smaller capital: Risks bear the potentials to adversely affect businesses and individuals. Insurance allows the insured to pool all their risks in one pool and share the loss from a small contribution paid by every insured. Since the loss is not anticipated to happen to all members of the pool, the contribution serves to compensate the insured for a significant loss.

Helps in the development of greater industry: There is a considerable deal of risk involved in establishing major industries. Large corporations have broad regions of operation where one sector may occasionally operate independently of another in the same industry. The activities of large corporations have become so pervasive that they have taken over and are attempting to cover any form of hazard. It does not come to support these large firms, especially in the face of a perceived threat, other than assisting in their development. This is understandable because insurance allows large firms with higher risks to grow.

General procedures for obtaining an insurance policy

The procedures for obtaining an insurance policy will depend on the type of an insurance policy to be obtained. There could be different procedures for obtaining an insurance policy but in this scenario the general procedures will be explained. Procedures for obtaining an insurance policy will include:

Search and identification of insurance companies: It is important for a person who wishes to insure the property to search for the best insurance company among many. This is done because some insurance companies may be having some challenges or may not be responsible when damage happens. A search might be done through internet, media, and asking friends or relatives. After the search is complete and clear analysis of the insurance company is done, then the identification of the insurance company from which the policy is to be purchased is done.

Filling a proposal form: When the insurance company has been identified the insurance proposer will visit the insurance company or the insurance broker for filling a proposal form. The proposer must disclose all relevant materials or facts concerning the property or life to be covered. The current market value of the property must be stated in the form as it will help when the property is damaged or lost. If the proposer understates the value of the property to be insured, then it will creates problems when damaged.

Determination of premium: The insurance proposer calculates the monthly or annual premiums taking into account the material facts disclosed in the proposal form. It is in this step where the proposer determines what to pay to cover the property basing on the value of the property filled in the proposal form.

Survey of property: After all the above steps, the insurance company or insurance broker will visit the property for evaluation purpose. This is done to make sure what is to be insured exists with conditions stated on the proposal form. The insurance company may hire experts to do the valuation if need arise.

Payment of first premium: Upon acceptance of the insurer to cover the risks, the insured is asked to pay the first premium. Mostly the premiums are paid annually as a lumpsum but the insured may request to pay for installments and finalise payment before the cover period ends.

Issuance of cover note: When the payment has been made then the proposer is qualified to insured. The insured has to be given a cover note which will serve as the evidence that the insured is covered.

Issuance of the policy: The last procedure is for the insurance company to issue an insurance policy to the insured. The insurance policy will be issued within a specific period of time as specified in the company policy or the body governing the insurance companies. The insurance policy will contain all the terms and conditions of the cover.

General procedures for insurance claim

The procedures for insurance claim will depend on the type of an insurance policy obtained. There could be different procedures for insurance claim but in this scenario the general procedures will be explained. Procedures for insurance claim will include:

Report to police: Once the property has been damaged, go to police post near the event and report. Police officer will take and write information of the event and document. If need arises the property may be carried to police post for further investigation.

Connect with insurance company or broker: Most often the insurance broker is the primary contact when it comes to insurance policy. In the event of damage, report to the insurance broker or insurance company. The situation should be explained in detail to the broker or insurance company. Once the insured explain in detail the damage or loss, providing photos or videos will help the broker explain the circumstances and assessor will follow up to continue the claim process. The insured will be required to fill the claim form from the insurer.

Claim investigation begins: After the claim has been reported, it will need to be investigated by an adjuster to determine the amount of loss or damages covered by the insurance policy. The adjuster will identify any liable parties, and the insured can help the process by providing any witness information or other parties contact information.

Policy review: Once the investigation is complete, the adjuster will go through the policy carefully to determine what is and is not covered under the policy and inform the insured of any applicable deductibles that may apply to the case.

Damage evaluation: The insurance company will assess the extent of the damage of the property. The insurance adjuster may hire assessors, appraisers, engineers, or contractors to lend their expert advice. Once the evaluation is complete, the adjuster will provide insured with information of what is to be done concerning the property.

Payments and repairs: After damage evaluation, the insurance company will contact the insured for payments or repair of the property. The amount of time it takes to receive payment will depend on the complexity and severity the situation.

Every claim is different. Some claims processes can vary slightly depending on the situation and the kind of insurance being motor, general, health, or life insurance.

Exercise 5.4

1. Briefly explain the insurance industry in Tanzania.
2. Explain the functions of insurance companies?
3. Suppose your mother has imported a car from Japan and she wants to buy an insurance policy for the car. Briefly explain to her the general procedures for obtaining insurance policy for the car.

Chapter summary

1. Insurance is a contract between the insurer and the insured for a stipulated premium, the insurer agrees to compensate the insured against the occurrence of a specific loss.
2. The concept of insurance is based on the idea of risk pooling which involves the process of grouping a large number of similar exposure units that allow for taccurate prediction of losses.

3. Insurance involves the sharing of losses by the member of the pooling group and loss prediction based on the size of the pool.
4. Uncertainties and risks exist in a situation where information is lacking thus increasing the possibility of occurrence of an economic loss.
5. An individual always strives to reduce economic losses through risk reduction and transferring processes.
6. Peril is the cause of risk while hazards are necessary conditions to the occurrence of a loss.
7. The contract of insurance requires utmost good faith between the insured and the insurer.
8. The insured is required to have insurable interest on the subject matter to be insured. In an event of loss, the insured will only be compensated to the extent of loss and has to try to minimise the amount of loss to be ascertained.
9. The insurer will compensate the insured only when the proximate cause of the loss relates to the insured event.
10. The right of the asset is transferred to the insurer after full- coverage of the loss.
11. In an event of the purchase of multiple insurance policies on the same asset, the maximum amount to be claimed by the insured is the amount of loss and should be covered in proportion by all insurers or as a whole by a single insurer.
12. There are two types of insurance policies in Tanzania, life and general insurance policies.
13. Insurance companies make a profit from the collection of premiums and the investment of the collected premium.

Revision exercise

1. Pasua wishes to insure her property and she was told that there will be an insurance contract between her and the insurance company. She does not know what the insurance contract is all about. Describe to her what an insurance contract is and the features of the same.
2. Provision of security and safety to insured is one of the importance of an insurance contract. Explain other importance of an insurance contract.
3. Can an individual take two insurance policies for the same property and claim from each insurer? How is it done?
4. In which circumstances the principle of indemnity is exempted?
5. Many of the general contracts work under the principle of simple good faith. Insurance contracts on the other hand work under the principle of ‘utmost good faith.

Explain this statement with relevant examples.

6. Angel needs to assure her life but she is not aware of the types of life assurance available. Assist her by explaining the types of life assurance so that she can make the right decision.
7. Mene insured her car worth TShs 20 million and paid the insurance company the premium less by TShs 200,000. The car got an accident and she was supposed to be paid TShs 17 million as cover for the loss incurred. Basing on the deductible principle, what is the actual amount that she will receive from the insurance company? Why did she receive that amount?
8. An insurance company has noticed that the insured risks are excess compared to their capacity. Advice the insurance company what to do.
9. Assume your mother's car has been stolen some spare parts in the parking area when she was attending a wedding ceremony at a reception. Your mother is not aware of the insurance claim procedures. Advise her on the procedures for insurance claim.
10. In the year 2019, Yetu insurance company received a premium totaling to TShs 196 million. During the same year, a total of one thousand four hundred claims were lodged with a total amount of TShs 40 million, of which only 65% of the claims were honoured and the remaining were rejected. The company incurred an additional cost of TShs 25 million relating to the underwriting and processing of insurance claims.

(a) Determine the amount of claims paid by Yetu Insurance Company for the year ended 2019.

(b) Calculate the amount of profit or loss earned by Yetu Insurance Company for the year ended 2019.

11. A2Z Company offers a number of insurance products to its customers. The following information is related to the company for the financial year 2021. Premium received during the year:

Insurance product	**Units**	**Rate per unit**
Health insurance	46,000 people	TShs 10,000 per person per month
Motor insurance	360,000 motor vehicles	TShs 106,000 per motor vehicle per year
Life assurance	10,000 people	TShs 300,000 per person per year

Claims received and paid during the year

Health Insurance	TShs 140,000,000
Motor vehicle	TShs 60,000,000
Life assurance	TShs 30,000,000

The company operating expenses for the year amounted to TShs 360 million.

Calculate the profit or loss made by A2Z Company for the year 2021.

12. Choose the best answer from the following questions and write the letter of the correct answer.

i. Juakali has taken insurance for her property against fire. Who is Juakali in insurance context?
   A. insured.
   B. assessor.
   C. agents.
   D. insurer.

ii. The term assurance is also referred to as ________________.
   A. life insurance.
   B. marine insurance.
   C. fire insurance.
   D. motor vehicle insurance.

iii. The risk which arise because of change in major economic, social, cultural and political factors are:
   A. Particular risk.
   B. Fundamental risk.
   C. Speculative risk.
   D. Dynamic risk.

iv. In which policy, the insurer agrees to pay the assured or beneficiaries a specified sum of money upon the death of the insured or on the maturity of the policy whichever is earlier?
   A. Long-term policy.
   B. Endowment policy.
   C. Annuity policy.
   D. Unit-linked insurance policy.

v. Mwanakwetu Insurance Company and Mpekazi Insurance Company enter into a contract to cover an insured whose property is very expensive. What is the best term describing this contract?
   A. Cover notes.
   B. Re-insurance.
   C. Co-insurance.
   D. Double insurance.

vi. Sasha's car worth TShs 8 million but the records in insurance shows that the value insured is TShs 10 million. Which of the following insurance terms is meant by the value insured?
   A. Double insurance.
   B. Over insurance.
   C. Re-insurance.
   D. Under insurance.

vii. The danger of loss from the unforeseen circumstance in future refers to ______________.

A. perils.
B. hazards.
C. risk.
D. damage.

viii. Any risk involving a situation where there is a possibility of gain or loss refers to ________________.

A. liability risk.
B. personal risk.
C. pure risk.
D. speculative risk.

ix. Mwinyiheri proposed for a property insurance from Mwanakwetu Insurance Company. On his proposal he falsified the value of the property. Which principle of insurance Mwinyiheri violated?

A. Principle of indemnity
B. Principle of adverse selection
C. Principle of utmost good faith
D. Principle of trueness

x. The principle of indemnity is applicable in all kinds of insurance **except** _________.

A. motor insurance.
B. marine insurance.
C. life insurance.
D. fire insurance.

xi. Kengele insured his house in two different insurance companies. The house unfortunately got burnt down and he was entitled with compensation for the loss. The loss was compensated by only one insurance company. Which principle of insurance was adhered?

A. Principle of utmost good faith
B. Principle of contribution
C. Principle of indemnity
D. Principle of subrogation

Glossary

Ad-valorem tariff	is a tax on the importation of products that can be charged in per centage from the value of the products
Articles of Association	is a written document that specifies the regulations for a company's operation and defines the company's purpose
Audited accounts	are company's financial records that have been officially examined to check that they are free from material misstatements
Beneficiary	is a person entitled to receive the proceeding of the life assurance policy upon the demise of the insured person
Capital formation	refers to the increase in the stock of real capital in an economy during an accounting period
Certificate of incorporation	is an official document that proves the company has been legally created and officially exists
Claim	is a statement of loss sent to the insurer by the insured to request compensation against the loss incurred
Competitors	are other businesses that offer the same or similar goods and services in the market.
Corporate tax	is a tax imposed on income from a business
Custom duty	is a kind of tax imposed on the import or export of products
Deferred tax	is the tax liability payable in the future
Discount price	is a price lower than the usual price
Economic development	refers to the process by which the economic well-being and quality of life of a nation, region, or local community is improved
Economies of scale	are the cost advantages that enterprises obtain due to their scale of operation, and are typically measured by the amount of output produced. A decrease in cost per unit of output enables an increase in scale
Elastic	means a small change in price causes a large change in quantity supplied or quantity demanded

Excise tax is a tax imposed on the production of commodities

Fraud is an intentionally deceptive action designed to provide the perpetrator with an unlawful gain or to deny a right to a victim

Imported goods are goods that are entered into the country from another country

Income tax is a tax imposed on the income from employment, business, and investment

Inelastic means a small change in price causes a small change in quantity supplied or quantity demanded

Lease agreement is an arrangement made between two parties that allows one of those parties to use an asset belonging to the other party for a price

License number is a local government business registration number that is given to a business after acquiring the tax identification number

Memorandum of Association is a legal document that specifies the scope of the business activities of the company and information about the shareholding of the company

Non-performing loans are loans whose borrowers have not made scheduled payment against interest and principal for over 90 days

Partnership deed is the written legal agreement between partners outlining the basis, terms and conditions on which the partnership will operate

Pay As You Earn is a tax that is charged on an individual's income from employment

Person for tax purposes can be defined as a natural person (individual), a company (corporation), a partnership or a trust

Products means goods and services

Proposer a person who wishes to insure the property

Public revenue is the fund received by the government from different sources both tax and non-tax revenue

Quid pro quo is a Latin word that refers to something given or taken equivalent to another (something for something).

Sales tax is a tax imposed on the sale of products

Shareholder	is an individual or legal entity who owns shares in a company and therefore gets part of the company profits and has the right to vote on how the company is controlled
Stakeholders	are the interested parties of the organisation such as customers, suppliers, employees, government and the wider community
Tax administration	is the verification of tax returns, refund, assessment, investigation, determination, litigation, collection, implementation, and control of tax collections
Tax credit	is a tax incentive that grants certain taxpayers to deduct the amount of the credit accrued from the total indebted to the state
Tax Identification Number	is a unique number generated by the tax authority which identifies individuals, co-operation and other business entities as taxpayer
Tax laws	are rules and regulations which give a mandate to the government to impose and collect taxes from the taxpayers
VAT Registration Number	a unique number that identifies a registered VAT's taxpayer
VAT taxable person	is a person registered to collect VAT
Whistle-blowers	are individuals who are inside an organisation and who report illegal or unethical behaviour of the organisation
Withholding tax	is the amount of tax retained by one person when making payment to another person with respect to products supplied rendered by the payee

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