

CONTRACTORS REGISTRATION BOARD



CRB CONSULTATIVE MEETING ON CONTRACTORS' FINANCIAL MANAGEMENT ASPECTS

2008

PROCEEDINGS

*Seeking Collaborative Solutions to Contractors'
Financial Challenges*

*Karimjee Hall
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CONTENTS

	Page
Preface.....	ii
Contractors Financial Challenges & Solution - <i>CATA</i>	1
Financial Management Skills Challenges Facing Local Contractors and the Way Forward - <i>Oswald Urassa</i>	10
Financing Solutions to Contracting Industry Challenges - <i>Felix Kibodya - Tanzania Bankers Association</i>	25
SME Credit Guarantee Scheme And its Potential to the Contracting Industry - <i>Bank of Tanzania</i>	32
Finance Leasing: A Tool for Financing and Developing the Tanzanian Private Enterprise - <i>Moyo Violet Ndonde - IFC/SECO</i>	45
Salient Features of the Proposed Financing Leasing Law for Tanzania - <i>Moyo Violet Ndonde - IFC/SECO</i>	62
Tax Regime for the Construction Industry - <i>Protas H. Mmanda - Tanzania Revenue Authority</i>	73
East African Development Bank - <i>EADB</i>	82

PREFACE

It is said that 'To be a success in business, be daring, be first, be different'. It is with the spirit of ensuring the success of the contractors it regulates, that the Contractors Registration Board has found it necessary to be daring and the first to organize such a collaborating consultative meeting between financial institutions and contracting industry stakeholders.

Access to Finance is one of the Challenges that have continued to stifle the growth of contractors. This is despite the strategic role being played by Contractors. In turning around this predicament, the Board has adopted to seek a strategic and holistic approach in addressing the issue with an objective of seeking sustainable solutions through the collaborative efforts of the various stakeholders.

The objective of this forum is not just to deliberate but also to come up with practical and sustainable solutions for the financial predicament facing contractors. It is based upon this that the theme of this meeting has been appropriately named "Seeking Collaborative Solutions to Contractors' Financial Challenges". In this, we expect you our stakeholders to deliberate and provide the necessary input.

The Proceedings, have included a few, but focused papers on topical issues from a spectrum of the stakeholders from both the contracting and financial sector. Let me extend our appreciation to the paper authors, for devoting their time and resources, so as to serve the industry, in this noble way. It is our hope that these proceedings will stimulate discussions that will go some way in achieving the intended objectives of enabling financial institutions recognize the contracting industry as a potential partner to do business through a win-win relationship and provision of innovative, accessible and tailored products that meet the contractors needs. We also expect contractors to narrow the gap that they face with financial institutions, by being aware of what they need to do so as to keep their house in order. We expect employers to be flexible and allow equitable risks through allowing products such as insurance guarantees which are much more affordable and for which insurance companies can honour.

We do hope that in line with the theme we will all strive towards seeking collaborative solutions in addressing the contractors' financial challenges. I wish you a successful meeting. May Almighty God continue to guide us all, in our noble objective of Empowering the Contractor.



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Contractors Financial Challenges & Solution

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1.0. INTRODUCTION

The contracting industry in Tanzania is characterised by small and medium size contractors, even the so called large contractors when compared with other countries (developed and some developing) they are still small contractors. In Tanzania contractors are classified according to the Contractors Registration Act NO. 17 of 1997 into 7 classes that is Class I - VII, Class I being the highest. To-date the number of registered contractors is 4332. Class VII - V with the limit to undertake a project whose value does not exceed TZS 450million (approximately \$375,000) for a single project. In 2007 the market share by value for local contractors was 30%, while the foreign contractors enjoying 70%. However the local contractors accounts for about 94% of the total contractors registered in the country. This trend does not create a conducive environment for the development of local contractors and contracting capacity.

Then the current characteristic of the construction industry in the country look like "Inverted Pyramid" The challenge is how to create a sustainable national contracting capacity for such a large number of small contractors realizing small share in terms of monetary value, while few but 'large' foreign contractors dominate the industry in terms monetary value.

The importance of the construction industry to the national economy is well recognized in so many relevant policy documents e.g. Tanzania Vision 2025, MKUKUTA 2005-2010, Construction Industry Policy 2003,etc.

To date the construction industry contribute substantially to the national economy through contractors , it is growing at the rate 11% (average) for the last five years, with a contribution of about 5.8 % (2006) to the GDP) and 55-65% of the capital formation, employ about 9% of the workforce in Tanzania. The industry therefore has a strong operational base and business presence in the local economy.

Additional benefits contribute by the construction sector in Tanzania and worldwide include:

- Creates employment (directly or indirectly by a "multiplier effect")
- Protects the environment in its day to day activities
- Improves infrastructure which leads to growth of economy and reduction of poverty
- Improves living conditions of all citizens in Tanzania

- Contributes to the training and education of workers

To enhance the contribution of the sector to social economic development of the nation, deliberate efforts to develop the local contractors and contracting industry capacity have to be made by all the construction industry stakeholders.

These include finding solution to the challenges of emerging construction enterprises such as inadequate of finance and access to financial support.

2.0. PROBLEMS AND CHALLENGES TO CONSTRUCTION INDUSTRY

Challenges faced by local contractors in Tanzania are similar to those faced by most of the small and medium enterprises (SME's) in the country, however there few differences arising depending on the sector preference the major ones includes:

- Inadequate of finance and financial support to contractors
- unavailability of adequate plant and equipment
- Weak and non – facilitative legal and regulatory framework

2.1. Need for Assistance with Finance and financial support

Contractually contractor must typically pre-finance projects and receive periodic (interim) payments from clients. Thus they require substantial working capital.

In Tanzania, contractors especially small and medium, but also including large local contractors have limited financial resources, and encounter difficulties in obtaining financial assistance from the banks. They also face delay in payments from clients and unfavourable terms of trade from their suppliers. However the procurement provides an example of actions which can be taken .It has rationalised its construction procurements arrangements, provision on payments in the standard form of contract and the contract administration procedures (such as certification) to reduce delays in payments to contractors , and reduce the levels of risk of the contractors . The practice yet indicates that very few contractors receive their payments in time. Therefore delays in payments tend to affects their financial projections and work progress.

As to date no specific bank in the country which provides finance assistance, specifically targeting to the construction industry demand to provide product such as Bid Security, advance payments bond, performance bond, Insurance, hire-purchase and loans at either negotiable or considerable rate. In most case local contractors face a lot of problems in securing guarantee/security, working capital and asset financing to run and investing in their businesses.

At the moment the financial policy in the country does not provide preference for the benefit of local capacity building in the industry. So as to provide opportunities to increases the capacity utilization and development of local contractors in the industry.

In some countries like South Korea where government and industry established a bank to provide loans, performance bonds, insurance and hire- purchase assistance to

contractors both the bank and contractors are doing well. The bank together with other commercial banks have helped the construction capacity building such that today, Southern Korea is among the strong and reliable construction services exporters.

For instance in Ghana, Social Security Bank had a successful contractor pre-finance scheme to assist contractor. Experience has shown from these countries that contractors require a range of support schemes. Thus; the financial institutions should be part of a wider network of support institutions which, together, address the needs of the contractors.

However in Tanzania, the conservative attitudes of the commercial and financial institutions arising from the existing financial policies and their **antipathy** to assist contractors has led to initiatives to set up trust funds, guarantee funds, and so on, to address the needs of contractors. However these funds have not yet assist the contractors as expected during the set up. Despite of the increase in lending to the construction sector as shown in Table I below, yet the impact it is still minimal and has not made significant growth in the industry. Therefore the problem of poor access to finance has remained unresolved.

	Sector	2004/05	2005/06
1	Public Sector	0.9%	1.2%
2	Agricultural Production	13.3%	12.4%
3	Mining	1.0%	1.8%
4	Manufacturing	22.40%	20.50%
5	Building & Construction	4.1%	4.6%
6	Transportation	8.3%	7.8%
7	Tourism	2.7%	2.5%
8	Trade	23.8%	23.7%
9	Financial Institutional	4.6%	6.5%

Table 1: Distribution of Private Credit to Economic Activities 2004/05 & 2005/06; source BOT Annual Report 2005/06

3.0. CONTRACTORS OVERVIEW TO THE FINANCIAL INSTITUTIONS

Since trade liberalization in the late 80's and on going reform in the financial sector, a number of banks have grown tremendously. Today in the country there are about 30 banks registered to operate in Tanzania to offer banking services.

3.1. Specific Contractors Requirements from Banks

It is true that due the nature of the construction business the works are capital intensive and sometimes require contractor to have a huge working capital at initial stage and the entire period of project execution. In this case there is no way a contractor can turn away from approaching a bank for financial assistance. So that to enable him to pre-finance the projects prior for receiving interim payments, but also require investing in the company resources such as purchase of equipments and tools.

The major requirements for contractors from the banks includes

- Security Instruments (bid, advance payment , performance and payment bonds)
- Working capital

- Asset financing

Despite of the increase in number of banks in the country, yet the availability and access of finance and financial support to contractors still is a problem, which continues to affect contractors performance in the industry.

4.0. CONTRACTORS EXPERIENCE TO FINANCIAL INSTITUTIONS

4.1. Inadequate skills to evaluate and manage construction projects

Most of the banks do not have adequate understanding of business in the construction industry. The nature of the industry performance is not similar to other industries such as manufacturing or trades; their returns are subject and are affected with delays in payments either caused by the consultants' certifications or employer honouring the payments in time. For this reason it is likely for contractor not to realize income for a number of months, but yet continue to work on site as the contract require. This is unlike for the manufacturing industry the business trend is quite differently once the production begins the two can be realized either cash or goods, which make them to meet the monthly projection in servicing the bank loan. In this case contractors are not perceived as a good customer and become unattractive to the bank which further creates another barrier to fellow contractors in accessing bank loans.

4.2. Underprovided Amount v/s Loans Requested

It has been common practice that it is difficult to receive the amount requested for the loan, usually contractors receives fewer amounts than the actual requested loan value. The consequences to contractors have been that brings difficulties in project performance and does not bring the intended results due to project under financing. At the initial stage most of the contractors tend to accept it perhaps with the view that the balance may be obtained, elsewhere from other sources. Eventually the situation becomes worse and contractors start to experience difficulties in repayment of the total loan in time.

4.3. Excessive focus on security/ collateral

There is a view that banks still focus excessively on the available collateral as a determinant of credit the practice continue to weaken the financial status of the local contractors because this becomes a burden to contractors to meet these huge conditions.

For instance a contract value of shillings one billion, a contractor is required to pay 10% for performance bond and 15% of the contract price which amount to 25% (i.e. equivalent TSH 250mil). It is difficult for local contractors to raise such amount or to own a property which should be mortgaged as collateral.

This has led contractors to shy away from projects whose conditions require them to produce such security, before implementing the project, which it deny their capacity building opportunities

4.4. Long standing perceptions (non- compliance and defaults, etc)

History of non- compliance and defaults in the local market is still a factor in the resistance to new approaches to credit assessment and decision making “ Guilty until proven innocent” .

Unlike other business contractors business is broad open and is clear, because information on individual firm can be accessed and gathered easily from the clients, contractors register at Contractors Registration Board as well as from the Associations. Therefore is matter of close cooperation to monitor contractors integrity and performance which we believe can save time and reduce credit assessment period.

4.5. High lending Interest rates

The prevailing lending rates for most of the banks are too high and in fact increase a barrier to local contractor’s especially small, medium and even large local contractors to seek for bank loans. This is because their business or contracts are not much profitable to services for bank loan repayments as well as to remain with reasonable profit margin for office and business operation. The current practice and the trend in the business indicates that there is a stiff competition in the market which attracts most of the contractors to offer competitive or a bit low profit margin so as to win the tender, otherwise becomes difficult to remain in the business.

Therefore the lending rate discourages and does not motivate contractors to opt for the loans easily and therefore reduces the ability of contractors to invest through bank loans.

4.6. Delays in Loan Processing

In most cases the contractors seek loans when has a project in hand, the problem encountered here is that loan processing cycle take longer period even when all the documents required by the bank has been submitted and approved. The practice discourages contractors because sometimes either receives the loans at very late time, when project is stand still or closely to completion. Contracts on Construction projects have timeframe and contractual liability in which case require contractors to complete the projects in specified period. Otherwise he has to pay for liquidated damages for the delays caused to the project in hand.

4.7. Financial Policy

The current financial policy in the country does not provide relief to the industry either in terms of preference scheme or negotiation at a considerate rate on securities and

loans. The financial policy demands for full coverage for each product or services to be provided.

Other regulatory such as PPRA and CRB provides preference to local contractors capacity building, the idea here is to develop and increase the utilization of the local contractor in support the growth of the national economy, for instance

A lower class contractor can be permitted to execute projects above the ceiling value whereby a CRB has provided a dispensation to contractor to perform such project. But requires contractor to certify to the board its capability and performance. This has assisted many contractors to upgrade for higher class and have the opportunities to bid for sizeable projects.

Similarly, the public procurements act has clauses which spell out preference to projects set only for local contractors, however it has ceiling value. Currently project value up to shillings one billion is set only to local contractors, but also does not attract the provision of bid security as previous demanded in place contractor is required to submit tender securing declaration.

These efforts are made purposely to make sure that there is deliberately way for assisting to develop the capacity building to our local contractors.

However such preference is not there for local contractors when need to obtain financial services or products from the banks. It is therefore considered that the financial policy shall include such preference to take care for capacity building to local contractors.

Say instead of the contractors incurring full coverage on guarantee for bid security, advance payments and performance bonds the following can be considered and adopted as the best alternative in the practice,

- Bid security a contractor can provide a guarantee to cover only 25% to 50% of the total amount.
- Advance payments bond a contractors may enter a TRIPARTITE agreement which shall include the bank, client and contractor or alternatively can cover only 25% to 50% of the required guarantee.
- Performance bond contractor may cover say 25% to 75% of the total guarantee required.

5.0. CURRENT INITIATIVES

4.7. Contractors Assistance Fund (CAF)

The fund was established by the Contractors Registration Board in 2002 with objective of provision of bid bonds and advance payment guarantees to small contractors in class four to seven. The fund is small and capital deployed cannot cater for the entire contractors in the selected group. Due to these limitations the funds does not cover the

provision of guaranteeing performance bonds which is also a need area in the industry.

However at the current environment it is wise for the fund to extend its services to cover for the entire contractors and provide further services such as performance bond and bid security to large contractors so that to enhance the performance of the industry in the country.

5.2. Construction Industry Development Fund (CIDF)

The CIDF was established in 2002 and the National Construction Council was appointed as the Secretariat to the Fund .Objectives of the fund includes:

- To provide short-term working capital to contractors, consultants and materials manufacturer.
- To provide loans for equipment and tools.
- To guarantee loans secured through commercial banks and other institutions.
- To manage a construction warranty scheme.

Source of funding for CIDF are mainly from share/equity contribution from its members and membership fees. The fund today is not operational because the intended seed capital has not been contributed from the members and fund stakeholders.

5.3. Contractors Association of Tanzania (CATA)

Contractors Voluntary 0.1% Project Value Contribution to CAF

In 2004 Contractors Association of Tanzania initiated the idea for restructuring of the existing Contractors Assistance Fund (CAF) to become compulsory, requiring all contractors to contribute to the fund at a rate of 0.1% of each contract awarded. CATA idea came out after observations made from members' contribution that the existing fund is small, is not growing enough to cater even for intended members in the selected class, and does not provide more products such as performance bond which is the main need to contractors and currently the fund exclude large contractors.

This initiative was made to create sustainable fund which can serve a large number of contractors .But also extend its services to include more products such as bid security, advance payments, performance bond and loans to small and large contractors which keep on growing in the industry. The formalization has not yet completed and the Association is still working on it.

Finally, the current initiatives in the construction industry were taken as part of the role from the stakeholders and contractors efforts to increase the availability and

access to finance and do not mean that contractors finance requirements from the financial institutions are currently not needed.

6.0. THE WAY FORWARD

6.1. Intervention by the Government

Inadequate of finance and financial Support

Review financial and banks lending policies and statutes with the view of enabling contractors, the majority of whom are SMEs to access loans, collateral and security from banks.

Set up a preference scheme to financial institutions to take care for construction industry demand such as bid security, advance payments and performance bond which shall reduce the burden to local contractors by categorising them into two bands one of zero rate (to small works contracts) and 25% - 50% to medium and large works contracts in place for full coverage.

Sanction the application of the TRIPARTITE agreement between the contractor, client and bank in place of the collateral to become operational to financial institutions, on the condition that the client shall pay contractors money through customer account in the bank.

Remove the policy to the financial institutions so as to set a balance between the actual valuations of the property used for mortgage to attract the same value of the loan requested.

6.2. Intervention by Financial Institutions

Inadequate of Finance and Financial Support

Involve training expertise with appropriate skills in the construction industry for proper credit assessment to contractors' loan application.

Open doors and utilize the current available opportunities in the construction industry such as **Performance Based Management and Maintenance of Roads (PMMR)** construction projects whereby require a joint venture among the contractors, consultants and financiers (banks) to bid and eventually execute roads projects jointly.

6.3. Intervention by Contractors Association of Tanzania (CATA)

Inadequate of finance and Financial Support

The Association should continue to negotiate with banks for easing of conditions in extending loans, collateral and security and financial instruments to contractors. Contractors at the same time should improve their financial management so as to become attractive to banks.

CATA in collaboration with Tanzania Bank Associations to develop a training program for SMEs targeting to improve the business skills to contractors

CATA and Tanzania Bankers Association to draw up a memorandum of understanding for future collaboration in areas which focus to members' interest

7.0. CONCLUDING REMARKS

Construction sector contribution to the national economy has significant impact to the social economic development and therefore the development of local contractors needs deliberately efforts from, government, financial institutions and other stakeholders. The aim is to make the industry more vibrant and continue to assist the local contractors to have medium and long term solutions on availability and easy access to finance. The move shall enable the contracting industry to build its capacity and expand locally, in so doing can export its services in other countries.

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Financial Management Skills Challenges Facing Local Contractors and the Way Forward

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Abstract

The construction industry contributes about 9.5% of Tanzanian Gross Domestic Product (GDP). It is regulated by Contractors Registration Board (CRB) which is a Government agency established in 1997 to perform among other functions the supervision of activities in the industry. CRB has been in existence for ten years and has done a lot for the industry. Through consultative meetings, it has been identified that members of the industry face several challenges for them to be able to effectively contribute to the industry and GDP of the country. Some of the challenges are as follows; contractors lack equipment, they face unfair bidding competition arising from lack of skills in procurement procedures and deliberate decisions to under price contracts. They also lack financial management skills to keep and report on their financial records as required by various laws which include Companies Act as well as Auditors and Accountants (Registration) Act. Contractors also lack capital and have poor banking facilities to assist them in obtaining working capital. Financial record keeping is another shortcoming. Lack of financial records will not assist contractors in securing finance, be it from banks, investors or capital markets. It is therefore important to have adequate records for assessing the performance as well as assisting in securing needed capital. Changing the existing corporate set up is the only way forward for contractors to survive in the future.

1.0 INTRODUCTION

Construction industry in Tanzania is one of the sectors whose contribution to GDP is increasing significantly. In Tanzania, the industry is regulated by Contractors Registration Board (CRB) which is a public institution established under the Act of Parliament in 1997. The following are the mandates of the CRB:

- 1.1 To enter and inspect any site for Construction, installation, erection or alteration works for the purpose of verifying and ensuring that the works are being undertaken by registered contractors, and that the works comply with the Contractors Registration Act and its related by-laws.
- 1.2 To identify and compile information to facilitate institution of legal action against unregistered Contractors who undertake Construction, erection or alteration works.
- 1.3 To ensure that all construction sites are boarded and labour laws, Occupational health and safety regulations in the construction industry are adhered to.

- 1.4 To investigate cases of misconduct reported against unregistered contractors. Maintain updated records on trend of defaulters, safety compliance and occurrence of accidents.
- 1.5 To advise management on improvements in carrying out enforcement and regulation activities.
- 1.6 Inspection of offices and equipments for registration.

2.0 REQUIREMENTS OF THE INDUSTRY

Construction industry is one of the sectors which are handling huge financial resources in any country Tanzania inclusive. The amounts of money involved in the industry are significant. Due to the volume and value involved, it follows that there is a need to have adequate financial skills for the sector to contribute effectively in the GDP of the country. As mentioned, construction industry contributes 9.5% of the GDP in Tanzania.

The industry also requires equipment for the sector to perform its role. The construction equipment are very expensive and will require the contractor to have adequate capital to be able to acquire them. Appendix 1 itemises some of the important construction equipment needed and their respective prices. The conclusion arising from the list is that contractors must have adequate capital to have most of the equipment needed in the industry. Alternatively, a different means of obtaining the equipment, either buying or through hire must be in place for the sector to have its contribution felt in the society. This conference will have an opportunity to know something about leasing as a means of acquiring such equipment. In addition to the equipment requirements, the industry requires the financial management skills to manage the huge financial resources handled by the sector. Section 30 (1) of the Accountants and Auditors (Registration) Act which established the National Board of Accountants and Auditors (NBAA) stipulates that any organisation which has assets in Tanzania the value of which exceeds TZS 100 million or an annual turnover in Tanzania exceeding TZS 50 million shall employ at least one Certified Public Accountant. Section 31(1) further provides that no person shall submit his income tax returns to the Tanzania Revenue Authority (TRA) unless such returns are prepared by a Certified Public Accountant. The amount mentioned is insignificant as far as construction industry is concerned. One contract may cost as much as TZS 2 billion.

3.0 FINANCIAL SKILLS NEEDED IN THE CONSTRUCTION INDUSTRY

Financial skills needed in the construction industry include financial accounting, cost accounting, budgeting and budget control, procurement and taxation matters.

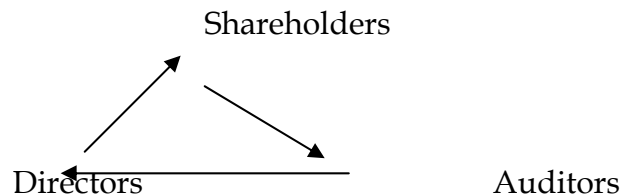
3.1 Financial accounting

All contractors are companies registered under the Companies Act of 2002. The Act defines a company to be an institution with owners (shareholders) who have given the directors capital to run the company and they (shareholders)

expect the directors to report back to them on the results of the operations. The manner in which they report is through the preparation of financial statements. Section 151(1) of the Companies Act requires every company to keep in English or Swahili language proper books of account which are sufficient to show and explain the company's transactions. Sections 152 through 163 elaborate more on the financial records needed, the role of auditors and directors of the company as well as the approval of accounts. Companies registered under CAP 212 will therefore need to observe these sections. The outcomes of accounting records kept in the books of accounts are the financial statements, namely the balance sheet, income statement and cashflow statement. The above statements are prepared using International Financial Reporting Standards (IFRS)¹. Also the statement of changes in equity has to be prepared to accompany these statements.

Shareholders rely on the above statements to evaluate the performance of the company. In order to have more credibility, shareholders appoint auditors to review the financial statements prepared by directors and report back to them (shareholders) whether the financial statements present a true and fair view of the state of affairs of the company. The financial reporting triangle may be seen as in figure 1 below.

Figure 1: Financial reporting triangle



To arrive at the above financial statements requires the company to keep financial records which are eventually summarised into the above statements. Companies with annual turnover amounting to TZS 100 million and assets amounting to TZS 50 million in Tanzania are required under the Accountants and Auditors (Registration) Act to employ qualified accountants.² The Act does not mention whether the firm must employ the CPA or use their services. The fact that most companies have capital limitations means they are unable to employ CPAs. Instead, these companies may use the services of CPA on a retainer basis to assist them in preparing financial statements as well as assisting the contractors on all taxation matters.

¹ Tanzania adopted IFRS from July 2004. Every company must prepare financial statements using IFRS. Company auditors are required to comment whether the company has adopted the IFRS and if not qualify the accounts.

² The Act defines a qualified Accountant as a person who has qualified as Certified Public Accountant (CPA).

3.2 Cost accounting

Cost accounting provides data for three major purposes:

- 3.2.1 Planning and controlling routine operations
- 3.2.2 Non-routine decision making
- 3.2.3 Inventory valuation and income determination.

Planning is a delineation of goals, prediction of potential results under various ways of achieving goals and decision on how to attain these goals. Controls are actions which implements the planning decision and performance evaluation that provides feedback of the results. Budgeting and performance reports are two major accounting tools that help managers to run the company effectively.

Cost accounting assists managers to identify cost behaviour. The knowledge of cost behaviour will assist in the decision making process. Some of the costs are fixed, meaning they are not affected by the decision made and others are variable, meaning they change with the volume of work. A clear knowledge of these costs will assist managers in the decision making process.

Cost accounting provides the costs for inventory valuation purposes. Quite often, companies acquire materials for their day to day operations. During the course of its operations, some materials may remain unutilised at the end of year. These materials will be used in the following financial year. As such, they are part of the inventory (stock). For the purposes of preparing financial statements, these materials will need to be valued. Cost accounting provides the means of establishing the value which will be used for balance sheet purposes.

3.3 Procurement system

Most of the contractors' assignments involve huge sums of money. This calls for procurement entities to plan for the procurement of goods and services in line with the requirement of procurement laws. Specifically, section 45 of Public Procurement Act, 2004, Regulation 40, 46 and 47 as well as 25 and 25 provides the following:

A procuring entity shall plan its procurement in a rational manner and in particular shall:

- 3.3.1 Avoid emergency procurement wherever possible
- 3.3.2 Aggregate its requirements wherever possible both within the procuring entity and between procuring entities, to obtain value for money and reduce procurement costs;
- 3.3.3 Make use of framework contacts wherever appropriate to provide an efficient, cost effective and flexible means to procure works, services or supplies that are required continuously or repeatedly over a set period of time;
- 3.3.4 Avoid splitting of procurement to defeat the use of appropriate procurement methods unless such splitting is to enable wider participation of local consultants, suppliers of contractors in which case the Authority shall determine such an undertaking; and
- 3.3.5 Integrate its procurement budget with its expenditure programme.

The purpose of the Act is to ensure that procurement processes achieve value for money from goods and services procured which can be achieved through equity, accountability and transparency and open and effective competition³. Since the assignments involve competitive bidding, contractors need to have adequate skills to cost the assignment and yet provide the room for negotiation. The procurement system and law is expected to have the qualities of a good procurement system. These qualities are:

- Equity
- Ethics and fair dealing
- Accountability and transparency
- Open and effective competition
- Value for money

3.4 Corporate governance

The good governance is critical for the survival and success of companies. Most contractors are family owned which makes them unsustainable. For contractors run as family to survive, they need to build up a corporate management structure that embraces good corporate governance principles. Different organisations have developed principles of good corporate governance⁴. These are summarised below:

3.4.1 Principle 1: Authority and Duties of Members [Shareholders]

Members or shareholders [as owners] of the corporation shall jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation to:

- Ensure that only competent and reliable persons, who can add value, are elected or appointed to the Board of Directors;
- Ensure that the Board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability.
- Change the composition of a Board that does not perform to expectation or in accordance with the mandate of the corporation.

3.4.2 Principle 2: Leadership

The Corporation shall be headed by an effective Board that exercises leadership, enterprise, integrity and judgment in directing the Corporation so as to achieve continuing prosperity and to act in the best interest of the Corporation in a manner based on transparency, accountability and responsibility.

³ External auditors are required to review whether procuring entities complied with the PPRA Act in the course of their audit.

⁴ Adopted from Principles for Corporate Governance of Kenya.

3.4.3 Principle 3: Appointments to the Board

Appointments to the Board shall, through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision-making process.

3.4.4 Principle 4: Strategy and Values

The Board shall determine the purpose and values of the corporation, determine the strategy to achieve that purpose and implement its values in order to ensure that the corporation survives and thrives and that procedures and values that protect the assets and reputation of the corporation are put in place.

3.4.5 Principle 5: Structure and Organization

The Board shall ensure that a proper management structure [organization, systems and people] is in place and make sure that the structure functions to maintain corporate integrity, reputation and responsibility.

3.4.6 Principle 6: Corporate Performance, Viability and Financial Sustainability

The Board shall monitor and evaluate the implementation of strategies, policies and management performance criteria and the plans of the corporation. In addition, the Board shall constantly review the viability and financial sustainability of the Corporation and must do so at least once every year.

3.4.7 Principle 7: Corporate Compliance

The Board shall ensure that the Corporation complies with all relevant laws, regulations, governance practices, accounting and auditing standards.

3.4.8 Principle 8: Corporate Communication

The Board shall ensure that the corporation communicates with all its stakeholders effectively.

3.4.9 Principle 9: Accountability to Members

The Board shall serve the legitimate interests of all members and account to them fully.

3.4.10 Principle 10: Responsibility to Stakeholders

The Board shall identify the corporation's internal and external stakeholders; agree on a policy or policies determining how the corporation should relate to, and with them, in creating wealth, jobs and the sustainability of a financially sound corporation while ensuring that

the rights of stakeholders [whether established by law or custom] are respected, recognized and protected.

3.4.11 Principle 11: Balance of Powers

The Board shall ensure that no one person or group of persons has unfettered power and that there is an appropriate balance of power on the Board so that it can exercise objective and independent judgment.

3.4.12 Principle 12: Internal Control Procedures

The Board shall regularly review systems, processes and procedures to ensure the effectiveness of its internal systems of control so that its decision-making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times.

3.4.13 Principle 13: Assessment of Performance of the Board

The Board shall regularly assess its performance and effectiveness as a whole and that of individual members, including the Chief Executive Officer. A summary of the major findings together with a statement confirming that the Board has carried out a self-assessment exercise should be made to the annual general meeting.

3.4.14 Principle 14: Induction, Development and Strengthening of Skills of Board Members

The Board recognizes the need for new members to be inducted into their roles and for all directors to develop and strengthen their governance skills in light of technological developments, changing corporate environment and other variables. The Board shall accordingly organize for the systematic induction and continuous development of its members.

3.4.15 Principle 15: Appointment and Development of Executive Management

The Board shall appoint the Chief Executive Officer and participate in the appointment of all senior management, ensure motivation and protection of intellectual capital crucial to the corporation, ensure that there is appropriate and adequate training for management and other employees and put in place a succession plan for senior management.

3.4.16 Principle 16: Adoption of Technology and Skills

The Board recognizes that to survive and thrive it has to ensure that the technology, skills and systems used in the corporation are adequate to run the corporation and that the corporation constantly reviews and adopts the same in order to remain competitive.

3.4.17 Principle 17: Management of Corporate Risk

The Board shall identify key risk areas and key performance indicators of the corporation's business and constantly monitor these factors.

3.4.18 Principle 18: Corporate Culture

The Board shall define, promote and protect the corporate ethos, ethics and beliefs on which the corporation premises its policies, actions and behaviour in its relationships with all who deal with it.

3.4.19 Principle 19: Social and Environmental Responsibility

The Board shall recognize that it is in the enlightened self-interest of the corporation to operate within the mandate entrusted to it by society and shoulder its social responsibility. For this reason, the Corporation will not fulfill its social responsibility by short-changing beneficiaries or customers, exploiting its labour, polluting the environment, failing to conserve resources, neglecting the needs of the local community, evading taxation or engaging in other anti-social practices.

3.4.20 Principle 20: Recognition and Utilization of Professional Skills and Competencies

The Board shall recognize and encourage professional development and, both collectively and individually, have the right to consult the corporation's professional advisers and, where necessary, seek independent professional advice at the corporation's expense in the furtherance of their duties as directors. [This is in addition to and not a substitute to directors' personal duty to acquire competence, training and information that would help them make informed, independent and astute decisions on issues relevant to the corporation.]

3.4.21 Principle 21: Recognition and Protection of Members' Rights and Obligations

Members of the Corporation have a right to receive any information that would materially affect their membership, to participate in any meeting of members and to participate in the election of directors and be facilitated to fully participate in all other resolutions of interest to them as members.

4.0 CHALLENGES FACING THE CONSTRUCTION SECTOR IN TANZANIA

The construction sector in Tanzania has significant challenges as highlighted below:

- 4.1 Lack of equipment – most companies do not have adequate equipment for the purposes of performing their construction works.
- 4.2 Lack of capital – for contractors to be able to undertake most construction works, they need equipment and capital. Most of them lack capital to acquire the needed equipment which are very expensive.
- 4.3 Poor and lack of appreciation of financial record keeping – most of the companies in the construction industry have poor financial management and record keeping of their financial records.

- 4.4 Reluctance to use professional accountants in managing the companies – very few construction companies use the services of accountants and financial experts in their day to day operations.
- 4.5 Limited access to banking sector to access working capital – most construction companies do not have access to banking services for their working capital requirements.
- 4.6 Rigorous procurement procedures – almost all construction works involve tendering. Since most companies do not have competences in tendering, they end up under-pricing their quotations and sometimes operate at loss or they are forced to compromise quality.

5.0 MANAGING THE ABOVE CHALLENGES

In order to minimize the effects of the above shortcomings, the government and financial community has developed various means of addressing the construction industry challenges. These include:

- 5.1 Leasing – this is specifically to avail the opportunity to the construction industry the ability to acquire heavy duty construction equipment to the sector which will minimise financial requirements for construction companies needed to acquire the assets. More discussion on Leasing will be made by the International Finance Corporation (IFC).
- 5.2 Additional means of enhancing capital – most of the construction companies are registered as private companies. Their shareholding structure involved mainly two to three shareholders who are also the executive directors of these companies. The limitation of the shareholding prohibits the capital expansion initiatives which may be needed as the business grows. The limitations arise from the following facts:
 - 5.2.1 The numbers of shareholders owning these companies have limited capital to invest additional funds in the company. If external shareholding was to be allowed, additional capital could have been raised relatively easily. New shareholders will also bring new ideas in the company and enhance the modernisation of the company and they will facilitate opening up of the company to even more shareholders through public ownership. The stock exchanges will therefore be an opportunity for these companies to raise additional capital if they meet the listing requirements attached as Appendix 2. Contractors will have the possibility of using either shares or bonds to raise the needed capital.
 - 5.2.2 Lack of good corporate governance structure – investors will only commit their funds in companies whose governance structures are well defined and they are working. Improving the manner in which these companies are run will provide an avenue for investors to join the company. This is more so in case the company wants to invite a foreign investor. The challenges can be met by

adopting the formal organisation structures which include a proper separation between shareholders, the board and management of these companies.

- 5.3 Meeting the challenge of financial reporting – contractors will be forced to appoint financial experts to assist them in the management of their companies. This can be either on full time basis (for those companies with high turnover (estimated at TZS 5 bn and above per annum⁵) or retain them to assist in financial record keeping, preparation of financial statements and compilation of tax matters. There are simple accounting packages which can assist contractors in their financial record keeping problems at reasonable costs.
- 5.4 Meeting the procurement hurdles – procurement has become more complex as the value of the assignments increase. It is also more complex as a result of increased competition, the amount of money involved in the sector and the need to obtain value for money in all construction activities. Contractors will be required to maintain standards in their work. This calls for proper costing of the assignments during procurement stage as well as continuous review of costs in order to operate at a profit. Contractors who will survive in the future will be those who are aware of the demands of the procurement laws and they can price their services appropriately. This is even more so as the procuring entities face the challenges posed by the five pillars of good procurement system. Procuring entities are expected to adhere to procurement laws. Competitive bidding places more demands to contractors in executing their assignments to give value for money to their clients. The process also has a lot of procedures and documentations needed to be filled as well as rigorous evaluation process. Contractors with the requisite skills are the ones who will survive the competition without compromising the quality of the assignment as well as not being involved in corrupt practices.
- 5.5 Establishing a good banking relationship – this is meant to support contractors with working capital requirements as well and bid performance bonds which most of the assignment requires the contractor to put in place before the contract is awarded. This is one of the constraints faced by many contractors, especially those in lower grades (class 4 and above). The practice is to have performance bond equivalent of 10% of the value of the contract. This amount will be significant as the value of the contract increases. Good banking relationship will also assist in the provision of working capital and bridging the finance gap existing in the course of the execution of contracts by contractors.

⁵ These are the views of the author.

6.0 ROLE OF DIFFERENT PLAYERS

As mentioned earlier, the construction industry plays a key role in the economy. Its contribution to GDP is 9.5%⁶. The number and value of registered projects with CRB for 2007 amounted to 2,084 and TZS 572.49 billion respectively. This is by all standards huge resources which went to the construction industry. Given the significant amount involved. This calls for the attention of all players to ensure that the sector contributes further to the economic growth of the country. Each player has to contribute to the success of the sector as follows:

6.1 The Government – the Government through CRB plays a role of facilitating contractors through research, development of industry standards and regulation of conduct by members. A gathering such as this one is one such initiatives by the Government to ensure high standards in the industry and effective contribution to the economy. The decision by CRB to establish Contractors Assistance Fund (CAF) and other initiatives to assist local contractors are the roles played by the Government to facilitate increased contribution by local contractors to the national development. The CAF started with TZS 300 million and it is currently valued at TZS 1.3 billion. The Government has also facilitated the passing of Financial Leasing Act, 2008 which will contribute to the reduction of equipment shortages experienced by contractors in Tanzania.

6.2 Contractors – these are the key players in the industry. Their role is to address the shortcomings addressed in section 4 above for them to have an effective contribution to the economy. Contractors should think out of the box to exploit all the avenues needed to face the above challenges. They need to improve their governance structures, enhance accountability and transparency as well as financial management skills for them to win the confidence of providers of capital. Contractors should also honour their obligations as far as CAF is concerned.

6.3 Financial institutions – these institutions may play a role of promoting the industry once challenges identified above are addressed by contractors. Financial institutions use depositors' funds to do their business. The existence of an environment which will enhance the assurance that the funds advanced will be repaid will provide the room for financial institutions to support the industry. Financial institutions will also provide working capital requirements to meet emergency expenditure such as bid security, and performance bond needed for contracts undertaken by contractors.

⁶ Tanzania experienced modest economic growth during the year. GDP grew by 6.7% in September 2007 – 6.7%, and an average of 7% since 2001. Main contributors to this growth include Telecommunications (19.2%); Mining (15.6%); Financial Intermediation (11.4%); Trade (9.5%); Construction (9.5%) and Manufacturing (8.5%).

7.0 CONCLUSION

Contractors play a key role in the national development. Enhancing their capacity is of paramount importance for their contribution to the national development to be seen. There is a need to forge a partnership among all stakeholders to achieve the desired results. These include the role played by the Government, financial institutions, clients as well as contractors themselves. Each has a role to play. More radical changes are needed in the ownership structure of these companies to put them in an environment which facilitates maximum contribution to GDP. Only will other investors and banks see the changes in the governance structure and financial reporting that they will be willing to invest in your companies.

References

1. Tanzania Procurement Journal Vol. 1. No 3 March 2008
2. The Contractor
3. www.usedequipment.com
4. International Financial Reporting Standards (IFRS)
5. Horngreen T, Cost Accounting
6. DSE Rules book
7. Auditors and Accountants (Registration) Act
8. Public Procurement Act, 2004 and its Regulations, 2005
9. Principles of Corporate Governance for Kenya

Appendix 1: Selected Construction equipment costs

1. Cat D9R	US\$ 327,000*
2. Volvo L70C	US\$ 39,000*
3. Excavator	US\$ 31,500*
4. Caterpillar	US\$ 75,000*
5. Link belt equipment	US\$ 79,000*
6. Grove equipment	US\$ 22,500*
7. Extec equipment	US\$ 62,500*

* price for used equipment

Appendix 2: Summarised listing requirements

S/N O.	CRITERIA	MAIN INVESTMENT MARKET SEGMENT	ENTERPRISE GROWTH MARKET SEGMENT
1.	Track record of existence	At least three years	None. But if the applicant has no track record, has to show that funds are required to support a project which has been fully researched and costed.
2.	Profitability Track record	Profits after tax attributable to shareholders in at least two of the last three financial years.	None
3.	Issued and paid-up capital	At least TZS 500 million	TZS 200 million
4.	Incorporation Status	Issuers must be incorporated in Tanzania as public companies or else where the companies law is in conformity with the law of Tanzania for cross-listing companies.	Issuers must be incorporated in Tanzania as public companies or else where the Companies law is in conformity with the law of Tanzania (for cross-listing companies).
5.	Net Tangible Assets	At least TZS 500 million.	The company shall have at least 50% of its net assets situated within Tanzania.
6.	Issuer Type	All companies from different economic sectors.	Growth companies of all sizes.
7.	Method of offering new issue of shares	Public offering, underwriting or combination of both.	Public offering, underwriting, private placement or combination of all.
8.	Business Operations	The applicant seeking listing should have at least one identifiable core business which is controlled by the listing company.	Detailed profile of planned operations including the following: 5 years business plan and independent technical feasibility report for companies with less than 12 months of operating history.
9.	Public shareholding spread	At least 25% of the listed shares. In this case public shareholders will own not more than 1% for individuals and not more than 5% for institutions.	At least 20% of its shares must be held by public.
10.	Minimum number of shareholders upon listing	Not less than 1000 shareholders excluding employees of the Issuer.	At least 100 shareholders
11.	Period moratorium	Not necessary.	If the Issuer has less than three years track record, promoters to be locked-in for up to 3 years.
12.	Utilization process of proceeds	Disclose the estimated amount of the proceeds from the offer (net of the expenses of the offer) broken down into each principal intended use. If the anticipated proceeds will not be sufficient to fund all of the intended uses, disclose the amount and sources of other funds needed. Where specific uses are not known for any portion of the proceeds, disclose the general uses for which the proceeds are proposed to be applied. State the minimum amount which, in the reasonable opinion of the directors of the relevant corporation, must be raised by the offer.	Disclose the estimated amount of the proceeds from the offer (net of the expenses of the offer) broken down into each principal intended use. If the anticipated proceeds will not be sufficient to fund all of the intended uses, disclose the amount and sources of other funds needed. Where specific uses are not known for any portion of the proceeds, disclose the general uses for which the proceeds are proposed to be applied. State the minimum amount which, in the reasonable opinion of the directors of the relevant corporation, must be raised by the offer.
13.	Nominated Advisors	Not necessary/required.	Must have a Nominated Advisor at all time of listing.
14.	Directors and Management	Disclosure of age, qualification and relevant experiences for the preceding five years.	Suitable senior management with relevant experience of one year prior to listing.
15.	Financial Statements	Must be IFRS compliant and must have been audited by authorized auditor.	Must be IFRS compliant and must have been audited by authorized auditor.
16.	Auditors	Registered by NBAA and approved by CMSA.	Registered by NBAA and approved by CMSA
17.	Same Management	At least 2 years before listing.	No need. Emphasis should be on competence of the Management team.
18.	Audit Committees	Issuers must have audit committee as per CMSA guidelines on Corporate Governance.	Issuers must have audit Committee as per CMSA guidelines on Corporate Governance

S/N O.	CRITERIA	MAIN INVESTMENT MARKET SEGMENT	ENTERPRISE GROWTH MARKET SEGMENT
19.	Working capital adequacy	Directors of the Issuer to give opinion on adequacy of working capital for at least 12 months.	Directors of the Issuer to give opinion on adequacy of working capital for at least 12 months.
20.	Certificate of comfort from relevant regulators	Issuers to obtain comfort letter from relevant regulators supervising their day to day activities.	Issuers to obtain comfort letters from institutions regulating their operations.
21.	Articles and Memorandum of Association	They must provide for public issuance of securities as well protection of minority shareholders, transferability of shares, borrowing powers of directors, corporate governance principles.	They must provide for public issuance of securities as well as protection of minority shareholders, transferability of shares, borrowing powers of directors, corporate governance principles.
22.	Composition of board of Directors	The Issuer must have at least one third of the Board members as non executive directors.	At least one third of the board members must be non executive directors.
23.	Prospectus approved by a regulator	Prospectus to be approved by the Authority.	Prospectus to be approved by the Authority
24.	Compliance to other Corporate Governance Issues	All applicants to undertake to comply with other corporate governance principle as per CMSA guidance as improved from time to time.	All applicants to undertake to comply with other corporate governance principle as per CMSA guidelines for corporate governance as improved from time to time.
25.	Clear dividend policy	The Issuer to disclose clear dividend policy.	Issuer to disclose clear dividend policy.
26.	Publication in the Press	Applicants to prepare abridged Prospectuses.	Applicants to prepare Abridged Prospectuses.

Source: DSE Handbook

Financing Solutions to Contracting Industry Challenges

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1.0 Background:

The primary function of banks the world over is to play an intermediation role i.e., to collect funds (through borrowing) from surplus households and invest the funds (through lending among others) to deficit units. In this way, banks are considered the harbinger or buttress of economic development of any country.

Tanzania embarked on fundamental transformation of its economy almost two decades ago. Not surprising, top on the agenda in the economic reforms was the need to overhaul the financial system. In view of pivotal role it plays in the country's economy, the banking sector was the first to undergo reforms. Implementation of the reforms followed recommendations of the Presidential Commission on the need to modernize the banking sector dubbed the "Nzirabu Commission". The Commission recommended *inter alia* enactment of modern legislation to regulate banking business in a liberalized market. Consequently, the Banking and Financial Institutions Act, 1991 was enacted. In 1995 the bank of Tanzania Act was enacted to replace a previous legislation that was enacted in 1965. After almost 15 years of experimenting, the two legislations were repealed and replaced in 2006.

The two laws referred to above are supplemented by a number of regulations the most important ones in this context are the Concentration of Credit and Other Exposure Limits as well as the Management of Risk Assets. On this score, all banks are duty bound to comply with the dictates of the two laws and regulations as well as directives given by the Bank of Tanzania – the regulator. Failure to comply attracts penalty such as fine, disqualification of directors and officers involved and in extreme situation, withdrawal of the banking license.

Following the liberalization of the banking sector in 1991, the country has witnessed a number of both local and foreign banks being established in the country. To-date, there are 33 banks operating in the country. This figure does not compare favourably with neighbouring countries such as Kenya (78) and Uganda (46). On the upside, Tanzania has the lowest incidences of bank failure in the region (only three) since 1991 which implies that the banking sector in Tanzania has matured and is resilient to shocks.

2.0 Access to Finance:

One of the challenges facing the Tanzania banking sector is the perennial complaint about the inaccessibility of financial products to the productive sector. Recent statistics released by a credible institution indicate that only 6% of Tanzanians (both retail and corporate) have bank accounts. On the other hand credit is available to only 3% of the population! As a result of this financing gap, businesses including contractors have resorted to other but expensive financing sources.

3.0 Relationship between Banks and Contractors:

Contractors play crucial role in the economic development of a country. In order for a contractor to successfully perform this role, he needs to create, nurture and maintain close relationship with his banker. It is very unfortunate that this is not always the case with developing economies like Tanzania.

It is the objective of this presentation to identify (from the bankers' perspective) some of the challenges facing contractors in accessing finance. It is our view that after identifying the challenges we will then attempt to reflect on appropriate financial solutions.

As mentioned earlier, we are all in agreement as to the importance of contractors in the economic development of a country. For instance, the construction boom we are currently witnessing is clear indication of the emergence of a middle class in our society. This class has both the appetite for and propensity to invest for the future. In GDP terms this group has significant contribution. Moreover, the mini-revolution that is happening in the industrial sector is another clear indication of the evolution of the contractors' business.

4.0 Current Products offered by Banks:

At the moment, banks in Tanzania offer very limited range of financial products to contractors. The following are some of the vanilla type of products:

- Bid bond
- Performance Guarantee
- Advance payment guarantee
- Over draft facility
- Term loan

Bid bond usually is applied by a contractor during the process of submitting bid documents. One of the common experiences in the banking industry is that such request is brought "under a certificate of emergency" i.e., at the

latest hour. This problem is prevalent in all classes of contractors and bankers are yet to discover the reason!

Performance bond is a bank guarantee given to a third party (employer of the contractor) that the contractor (customer of the bank) will complete a specified contract and will fulfil its terms.

Advance payment bond refers to a guarantee given by a bank to a third party securing advance payment made by the said third party (contractor and customer of the bank).

Over draft facility refers to credit facility granted to a contractor (customer of the bank) through a cheque account in which the account is allowed to go into debit to a specified limit (over draft limit). Interest is charged daily on the debit amount. This facility is suitable for short-term or working capital requirement. It is cheaper than term-loan because in the latter, interest accrues on the entire loan amount.

Term Loan is credit granted to a customer on condition that it is repaid in instalments or all at once on a given date at an agreed rate of interest. Term loans are used to finance capital investment or item of a long-term nature.

As it can be noted from the definition of the typical financial products available to contractors, relationship is key. Bank-customer contract is founded on a *relationship* which in turn creates "track record". In sum, a banker needs both comfort and audit trail of its customer's performance and such comfort is reflected in the customer's account turnover. The turn over is evidenced by bank statements. It is for this reason banker's are hesitant to advance credit or any form of accommodation to a customer without or with very little account history with that bank.

In the same token, bank-customer relationship referred to above will be harmed if a customer decides to maintain relationship with more than one bank. "Split banking" is preferred by customers who desire to "hide" their financial requirements. As a result, the primary bank ends up not having a complete picture of the financial performance of its customer. Disclosure of financial requirement is advantageous to the customer in that it enables the bank to leverage its costs by taking into account additional services it will give to a customer such as LC fees, guarantee charges etc. On the other hand, by preferring only one bank, the bank acting as financial adviser to the customer is in a better position to determine both the type and quantum of financial requirement of its customer. For instance, a customer who seeks to acquire plant and machinery may be advised to do a finance lease or term loan and not an over draft. Like wise, a customer may be either under or over funded or worse still wrongly funded (e.g., by a loan instead of equity).

One area is still wanting in Tanzania is property finance through mortgage facility. The Land Act was amended in 2004 as a result of outcry from the banking industry that the law was an impediment to instead of creating an enabling environment in facilitating property development especially home ownership. Notably, contractors in their capacity as property developers did

very little to voice their concern. Perhaps the silence is attributed to the fact that contractors were not seen as crucial stakeholders in property development in Tanzania.

In a developed economy, property developers maintain very close business tie with banks. Banks play dual roles i.e., front office marketing/sales point and financier. Property developer (who in some cases is the contractor) holds ownership of the property. This synergy is yet to be developed in Tanzania due to a number of reasons including poor land delivery mechanism, inadequate legal system and lack of suitable funding base (long-term finance).

5.0 Contractors' Precarious Position:

Most contractors who approach banks for financing suffer from two strategic weaknesses. The first one is their inability to properly evaluate both the financial and management capacity of the employer. On the other hand, banks are renowned for the "thorough" or stringent procedure they use in evaluating a loan applicant. The same is not the case with contractors when applying for a job. As a result, once the contractor had secured a given project say with a local authority, he approaches a bank for financing. Inevitably, the bank will request for "financials" of the employer say, of the past three years. The second strategic weakness flows from the first. The contractor finds himself running from one financier to another ostensibly to attract financing within limited time oblivious of the banking requirements for important information. As a result of this rush, the contractor ends up missing the financing or accessing it very late thereby making him vulnerable to penalties.

Associated to the rushing for time is the problem of contractors submitting inadequate and sometime misleading information to his bankers. For, we should remember that despite the urgency in sourcing finance, banks as risk managers must make an informed credit decision. They cannot make that decision if information sought is not forthcoming or misleading information is given. Lack of proper information has resulted into delays by banks in arriving at a proper credit decision. As a result, banks are blamed for delaying granting credit without examining the reasons causing the delay.

6.0 Lack of Capacity:

A quick survey of significant projects executed by contractors in Tanzania shows that major projects are awarded to foreign contractors. We are aware of the outcry by local contractors that they are not accorded with adequate attention by empowering them through "constructive preference". It must be said that big contractors have easy access to finance due to a number of factors such as management competence, adequate capital goods which act as security and favourable bank track record. For instance, a commercial bank (whose funding is mainly short term) is likely to favourably consider a

financing request by a contractor Class 1 of a reputable international brand instead of a request by a contractor of similar class but who lack the three ingredients mentioned above.

The inherent weak position of local contractors is aggravated by competition (including undercutting) among themselves. Internal competition works to the benefit of giant contractors and who are foreign owned entities. It is our view that small and medium size contractors should always consider either merging or forming consortium that is capable of competing with the giant. The CRB should consider this aspect as one of critical importance if intends to lift the small contractor from the precarious position referred to above.

Lack of capacity should also be viewed in terms of the equity of the company. Construction companies the world over are funded both by shareholders funds and loan capital. As such, the company whose funding is predominantly bank finance is likely to become financially stressed because loan finance is costly compared to equity. The challenge under these circumstances is how a company can attract equity instead of bank finance? This is a one million dollar question with no easy answers. However suffice to say that there are known methods of raising equity through both private and public means.

7.0 Management Quality:

Management is the lifeline of any business. Experience in the banking industry shows that businesses managed by professionals of the industry involved are prone to troubles including inability to grow. For instance, not all engineers are good in human resources or financial management. Yet small and medium size contractors are managed either as family business or as one-man show. When a company managed in this form approaches a bank for financing, the first question to be asked is the organisation structure of the company together with succession plan. The rationale behind this request by banks is for the purpose of determining the extent to which the company has underwritten the risk of management incompetence and those associated with one man's show such as sickness, death or intense family squabbles. It is important therefore that construction companies adhere to sound management principles and practices.

8.0 Security:

As was mentioned at the beginning, banking business is governed by the Banking and Financial Institutions Act, 2006, Bank of Tanzania Act, 2006 and regulations made thereunder. One of the regulatory requirements is that banks must demand security to cover for their advances or commitments (e.g., guarantees). The prudential threshold is that security must have value that cover 125% of the exposure. The 25% is intended to cater for interest that will accrue and legal costs. The regulations further provide for clean lending

(up to 5% of the core capital) and partially secured lending (up to 10% of the core capital). There is also an aggregate ceiling to unsecured and partially secured facilities. Security is required as part of risk management. In other words, banks do not lend against security but on the soundness of the business to repay the loan i.e., cash flow lending. Security/collateral merely is a fall back position. Again, realization of security being a costly legal process is not favoured by bankers.

A number of contractors seeking financial accommodation from banks find themselves disqualified due to lack of or inadequate collateral. As a result, collateral requirement has now become one of the complaints levelled against banks. The typical security offered by contractors is landed property and plant and machinery. Landed property is charged through the creation of a mortgage whilst plant and machinery is charged by a debenture or chattel mortgage.

Demand for security to the small and medium size contractors is more pronounced than say to a first class international contractor. Whether a company should be granted unsecured or partially secured loan (even the type of collateral to be accepted) will depend of the financial and reputation standing of the company. For instance, a first class international contractor would view reputation damage as a very serious matter. Here it is relevant to mention that there are a number of cases where banks found themselves holding forged/duplicate registration cards of trucks and earth moving machinery owned by local contractors. Typically, it is common to find that the equipment involved has been offered as security to more than one bank. The underlying point here is that reputation damage is not held in high esteem by certain local contractors.

Integrity is the hallmark of trust bankers have to their borrowing clients. Unfortunately, once clouds of shadow start gathering, distasteful behaviour of some contractors has, more or less, pushed the cost of credit to the roof leaving behind a feeling that bankers are administering "collective punishment". For it must be remembered that access to finance is dependent on two drivers namely; cost of funds and risk premium. The risk attached to the collateral play a very important factor in restricting credit facility to contractors. The risk is further aggravated by costly and inefficient court system.

9.0 Finance Leasing:

Absence of finance leasing arrangement /product is one of the severe limitations for the acquisition of capital assets by contractors. The recently passed finance leasing bill to be accompanied by appropriate tax breaks will no doubt alleviate the problem of contractors being poorly equipped. In the absence of finance lease, contractors have resorted to expensive term finance and which had the effect of overloading company's balance sheets whilst

creating a strain in their cash flows. This however is a subject that is being dealt with by another speaker to this conference.

10.0 What are the appropriate financing solutions?

The answer is not straightforward. Financial solutions vary from one person to another depending on financial requirement of each person. In general however, contractors require a combination of financial products. For instance, overdraft is imperative when working capital is required. On the other hand, finance leasing, equity or term loan or a combination of the two appears to be the most suitable financial product where acquisition of capital goods is required.

The most important factor to be borne in mind is the need by the contractor to fulfill all the conditions that would enable him to access the financing. Conversely, the contractor should be able to determine the type of finance that his business requires at a particular time and this demands him to establish a candid relationship with his banker in order to enable the later to arrive at an informed credit decision. Contractors should consider banks as their right hand men and not impediment to the success of their business.

Finally, contractors should recognize that they are now operating in a very different environment – a competitive environment where no body owes anybody a living. To survive in a competitive market, contractors must properly equip themselves financially, organization-wise and in capacity terms so that they can deliver to the satisfaction of the client. A contractor who is always in default in his projects is likely to default in the obligations to his banker so is the contractor who is always applying for extension of time or one who is changing his banker the way we change our clothes.

SME Credit Guarantee Scheme and its Potential to the Contracting Industry

Bank of Tanzania

E-mail: cgs@bot-tz.org

CREDIT GUARANTEE SCHEME



Small and Medium Enterprise Credit Guarantee Scheme (SME – CGS)

**SME CREDIT GUARANTEE SCHEME AND ITS POTENTIAL
TO THE CONTRACTING INDUSTRY**

Bank of Tanzania



FINANCIAL SECTOR REFORMS

- The government is implementing financial sector reforms which aim at to optimizing financial sector contribution to investment and growth of the economy
 - 1st Generation Reforms – 1993
 - 2nd Generation Reforms - 2005

 - OUTCOMES
 - Enactment of the Banking and Financial Institutions Act of 1991.
 - Liberalization of the banking sector from 2 commercial banks to 36 in 2008
 - Rapid growth in lending to the private sector from TZS 24 billion for the year 1990 to TZS 1,656.8 billion in 2005/06

 - Amendments of BOT Act 1995 and 2006 which had objective to strengthening the monetary policy and banking supervision roles of BOT .

 - The enactment of the Foreign Exchange Act of 1992 that allowed individuals and companies to hold foreign currency.

 - Liberalisation of the insurance sector which led to a surge in the number of operating insurance companies from 2 state owned companies to 11 private owned by June 2007.

 - Enactment of the Capital Markets and Securities Act of 1994. led to the establishment of the Dar es Salaam Stock Exchange – Currently there are 10 listed companies
-

REFORMS Contd.....

- Introduction of the Tanzania Interbank Settlement System (TISS) that modernize the payment system and facilitating final and timely transfer and settlement of inter-bank Settlement funds.

 - Reviewed Land Act, No 4/1999 as well as Village Act No.5 of 1999 which encourage the increase property based lending by banks and financial institutions. (Mortgage Lending)
-

Review of the Financial Sector

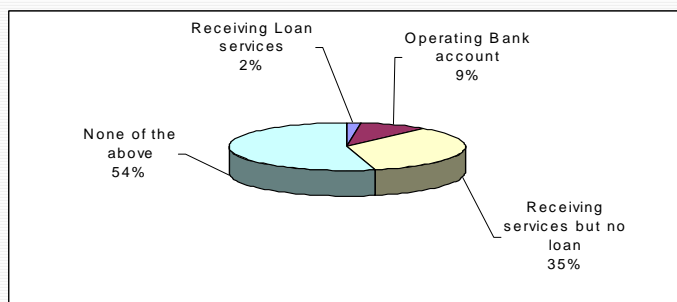
- During 2003/04 a review observed that, the Tanzania financial system plays a limited role in the economy and its current depth and efficiency falls short of what is needed to support economic growth: The following gaps were identified;
 - Lack of Long Term Development Finance (LTDF).
 - The two major sectors; Agriculture and SME are still lagging.
 - Legal and judicial reforms to remove the main obstacles to lending.
 - Enhancing access to financial services
 - Practice to open special windows for SMEs.
 - Credit Reference Bureau
-

Other Structural challenges

- Nascent capital market
 - Lending rates that allow SME borrowing
 - Poor outreach to rural areas
 - Judicial reforms lagging behind financial reforms
 - Strong partnership between banks and second tier financial intermediaries lacking.
-

Review of the reforms gaps contd...

Access to finance by categories



FINNSCOPE SURVEY 2007

Second Generation Financial Sector Reforms

- 2nd Generation Financial Sector Reforms (SGFSR) launched in 2004 identified some areas that need further reforms while consolidating the gains made during the first generation reforms.
- SGRS consist of the following components;
 - Legal and Judicial reforms,
 - Monetary Policy,
 - Banking Sector,
 - Financial Markets,
 - Pension Sector,
 - Insurance Sector,
 - Micro and rural financing,
 - Land and Employment.

2nd Generation Contd.....

- The 2nd Generation reforms put a special emphasis on LTDF as it is instrumental in facilitating the investment process and in accelerating economic growth. The delivery mechanism being contemplated under the reforms include;
 - Mortgage financing by
 - Improving legal framework through amendments of the Land Act and
 - Introduction of the Condominium Law
 - Enactment of Leasing Law
 - Strengthening of the existing Credit Guarantee Schemes
 - Export Credit Guarantee Scheme (ECGS) and
 - SME- credit Guarantee Scheme (SME-CGS).
 - Establishing the Development Finance Guarantee Facility (DFGF)
 - Establishment of the Long Term Finance Facility
 - Transformation of TIB into Development Financial Institutions
-

CREDIT GUARANTEE SCHEME



- Global view ;
 - Government direct /directed lending programmes are in eclipse
 - It is clear that, market failure exists for SME lending
 - There are 2000 schemes in more than 100 countries (almost all OECD countries
 - Almost all offer partial credit guarantee with risk sharing ranging from 50% to 80%
 - A well designed and well targeted policy intervention might improve welfare
-

CGS OPERATIONS

1	Funding	Govt/Donor/ Private
2	Management	Govt/Private
3	Credit Assessment	Private
4	Recovery	Govt/Private

Types of Guarantee Schemes

- Public Guarantee Schemes
- Private Operated Schemes
- Mutual Guarantee Institutions (MGI)
 - Independent organisations of small entrepreneurs willing to share their debt risk by granting collective guarantees to loans issued to their members.
 - Guarantee is usually backed by money deposit with lending bank as a general pledge/collateral against guaranteed loans

OBJECTIVES OF THE GUARANTEE SCHEME



- Additionality in bank lending and fostering economic growth through increased access to credit
- Additionality means extra or additional loan that could be made because of guarantee. Apart from extra loans additionality can take a variety of forms; getting loans at better interest rates, longer terms or by getting larger loans than they would otherwise have obtained

Government Strategies



- The government in its efforts to create a conducive environment for SMEs to access finance has established Export Credit Guarantee Scheme ECGS (2002), SME-CGS (2005) and DFGF (During 2008/09)
- Managed by BOT under Agency Agreement on transitory arrangement pending establishment of an independent institution
- The Scheme issues credit guarantees to financial institutions for on lending to SMEs.
- The objective is to cover shortfalls in the collateral thereby facilitating granting of credits to SMEs.

Eligibility Requirement under SME-CGS

- ❑ The Scheme will offer guarantee coverage only for loans with durations between 1 to 5 years.
 - ❑ The maximum guarantee amount is TZS 250,000,000 being 50% of the maximum amount of eligible loan of TZS 500,000,000.
 - ❑ The Scheme will guarantee both investment and working capital loans. However the guarantee for working capital covers productive sector such as agriculture, manufacturing, construction and mining but excludes retailers and traders
-

Eligibility under SME-CGS



- ❑ Be a formally registered business and majority owned by Tanzanian(s)
 - ❑ Be ready to offer any enforceable collateral including personal guarantee.
 - ❑ The Scheme shall not prescribe methodology to evaluate the credit worthiness of the borrower and/or the project and the lending decision will remain with PFI.
-

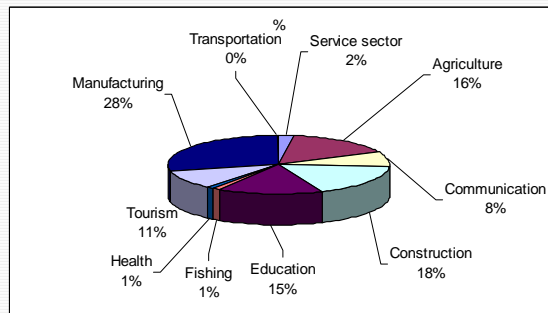
SME-CGS Performance

Description	Small and Medium Enterprises-Credit Guarantee Scheme (SME-CGS)
Objective	To promote SME by facilitating access to finance through credit guarantee
Commencement Date	September 2005
Capital	TZS 2.0 billion of which TZS 500 million has been paid up
Maximum Guarantee Cover	50%
Value of guaranteed loans	TZS 6,280,920,000.00
Value of guarantee issued	TZS 2,998,163,876.00
Extent of Guarantee (Average)	49.1%

GUARANTEE ISSUED

PFI	No of loans	Guarantee Issued (50% of approved loan (TZS millions))	Percentage
TIB	4	574,459,876.00	19.16
TWIGA	8	510,480,000.00	17.03
AZANIA	5	445,000,000.00	14.84
FBME	13	434,250,000.00	14.48
CRDB	2	350,000,000.00	11.67
BOA BANK	5	289,250,000.00	9.65
EXIM	3	192,254,000	6.41
NBC	3	128,970,000	4.3
CF UNION	2	32,500,000.00	1.08
STANCHART	1	32,000,000.00	1.07
TPB	1	9,000,000.00	0.30
TOTAL	48	2,998,163,876.00	100

Sector Distribution of the Guarantee issued



SME-CGS Performance contd....

Guaranteed Loan Category	No of Applications	Amount in TZS (millions)	Percentage
TZS (MILLIONS)			
5 - 100	27	1,615,990,000	25.73
101 - 200	14	2,129,500,000	33.90
201 - 500	7	2,535,430,000	40.37
TOTAL	48	6,280,920,000	100
Guaranteed Loan Maturity			
1 year	9	1,157,258,000	18.42
2 year	11	879,000,000	13.04
3 year	16	1,301,690,000	20.72
4 year	2	355,000,000	5.16
5 year	10	2,647,972,000	42.16
TOTAL	48	6,280,920,000	100



Constraints facing SME-CGS

- Low capital base
 - SME Entrepreneurship
 - Bankable Proposals
 - PFI preparedness
 - Product awareness/appreciation
 - Product specification/differentiation
 - Collateral
 - Capacity building
 - SME financial literacy
 - PFIs Credit officers
 - Business Development Services
-



Constraints facing Construction industry

- Lack of a designed product that cater to the needs of PFI and Guarantor
 - Nascent leasing finance market
 - Reliance by commercial banks on traditional collaterals. (contractors contracts could also be used as collaterals)
 - Bank lending strategies which do not meet SME requirements.
 - Size of contracts relatively higher than SME-CGS capacity. (Max loan TZS 500 million)
-

How to overcome constraints faced by Construction Industry



- Develop a Mutual Guarantee Fund to facilitate capital formation and loan access .
 - Act as a facilitator in the bank-borrower relationship
 - Negotiate interest rate reduction
 - Value of MGF derives;
 - Access to inside information of its member
 - Close monitoring of the firm's business conditions after the loan disbursement.
 - Mutual responsibility of all member firms
 - Design a product which will be accepted by both PFIs and the Guarantor.
-

Recommendations

1. The industry to initiate the establishment of mutual guarantee fund.
2. To design a product that will cater various need in the construction industry and also accepted by both PFIs and guarantor.



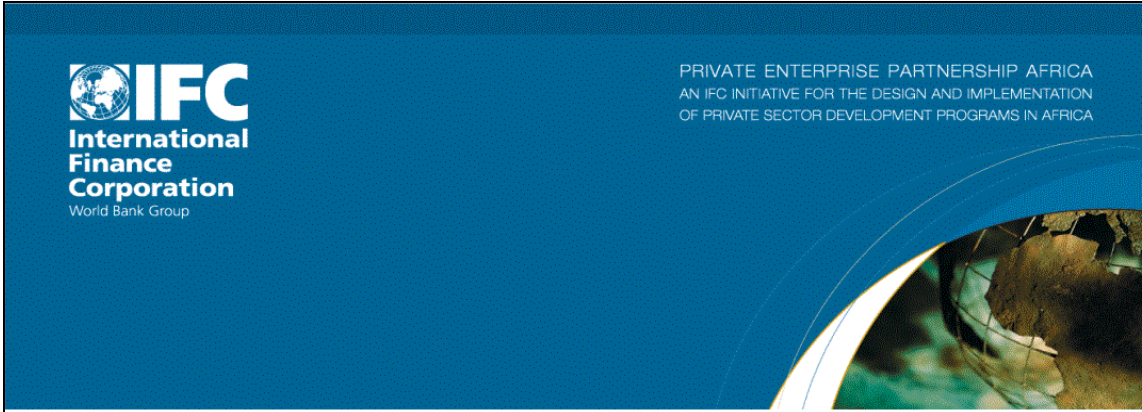
ASANTENI

Finance Leasing: A Tool for Financing and Developing the Tanzanian Private Enterprise

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PRIVATE ENTERPRISE PARTNERSHIP AFRICA
AN IFC INITIATIVE FOR THE DESIGN AND IMPLEMENTATION
OF PRIVATE SECTOR DEVELOPMENT PROGRAMS IN AFRICA

**Financial Leasing:
A Tool for Financing and Developing the Tanzanian Private
Enterprise**

By Moyo Violet Ndonde, Operations Officer, SECO - IFC Leasing
Program

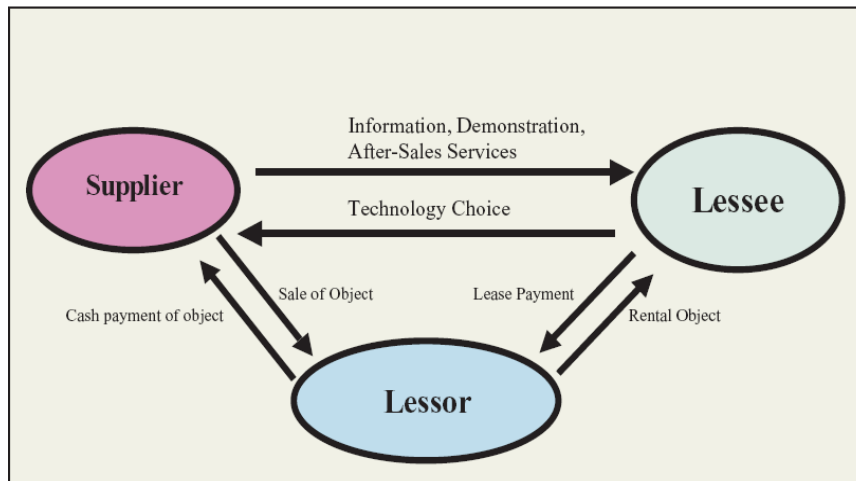
Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Federal Department of Economic Affairs FDFA
State Secretariat for Economic Affairs SECO

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The Leasing Process

Diagram 1- The three party arrangement in Finance Leasing

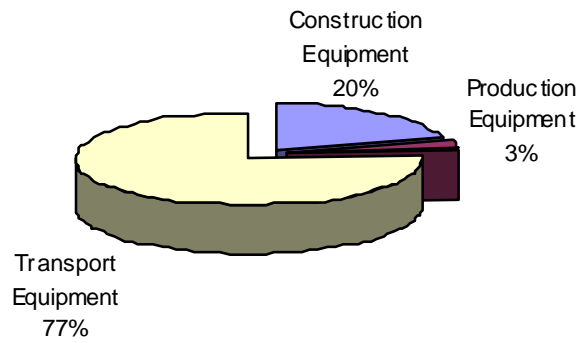


Definition

- Financing of all types of equipment.
- In Tanzania the legal framework for leasing is governed by English common law, contract and other written law affecting the lease transaction.
- IFC has proposed a law on financial leasing.

Financial Leasing Penetration in Tanzania

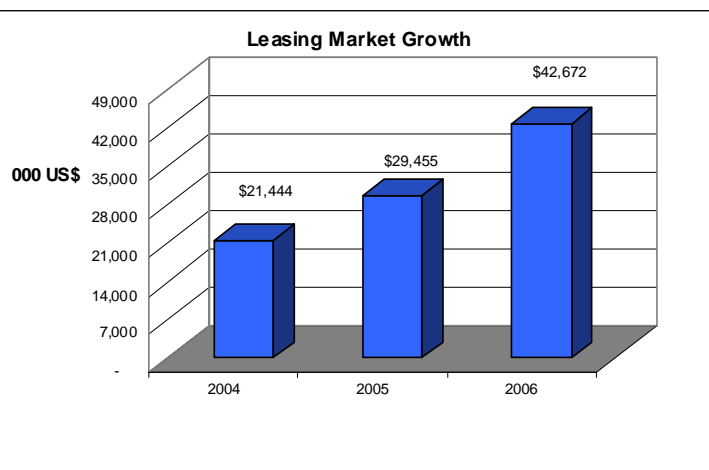
Leased Equipment under Finance lease 2005-06



4

Financial Leasing Market Growth

Leasing Market Growth



5

Principles of A Financial Leasing Agreement

- It is a rental contract, in which the customer chooses the equipment it wishes to purchase and the related supplier of the equipment. The leasing company purchases the equipment on behalf of the customer (lessee) and puts it at his disposal under an irrevocable contract for lease whereby the rent and period of lease is set in advance.
- The leasing company commits to lease the equipment to the customer under the terms of such rental period for an amount that is agreed in advance (taking into account the residual value of the equipment) **(and usually there is a unilateral commitment to sell the equipment) if the customer/lessee wishes to purchase the equipment.**
- Such sale takes place only in case the customer would have accomplished all his obligations deriving from the contract (reimbursement payments **(rents i.e., amortization)** in observance of the of lease payment dates.

6

What Type of Equipment?

- Transportation equipment : pick up, Car, Tractor truck
- Equipment for Buildings and Public Works : Loader, Grader, Tracked excavator, Crane....
- Industrial Equipment : Production machine (plant and machinery), equipment ...
- Medical equipment :Scanner, Ultrasound scanner..
- Computer and Office Automation Equipment : PC, server, offices...

7

Who are the target customers for leasing companies?

- SMEs
- Professional people
- Industrialists
- Traders

Such customers have to be already working.

Renting period

- Transportation equipment: 36 months (3 years)
- Equipment for Buildings and Public Works : 36 - 48 months (3 - 4 years)
- Industrial Equipment : 36- 60 months (3-5 years)
- Medical Equipment : 36-48 months (3-4 years)
- Computer and Office Automation Equipment :
12 to 24 months.

Key steps of a Financial Leasing operation

- The Lessee chooses the equipment he needs and negotiates the price and purchase modalities with his Supplier as well as the delivery modalities and the required warranties.
- The lessor studies the request made by the customer/Lessee. The customer/Lessee should submit an exhaustive file in accordance with the needs expressed by the Lessor e.g. current cashflows indicating credit worthiness etc.
- In case of approval by the Lessor, a leasing contract is submitted to the client for signing, following which the purchase order is handed to the supplier for invoicing, payment, and delivery of the equipment.

Key Steps of a Leasing Operation

- The Lessor raises an invoice for the rents that are agreed in the financial leasing agreement. The lessee is called upon to pay the invoiced rent on a monthly basis incorporating all taxes payable for the equipment and insurance charges.
- Upon expiry of the total period of the leasing agreement (i.e., repayment schedule of the credit), the customer becomes the owner of the equipment if he wishes. That is after amortizaion - payment of the residual value. Thus he moves from a Lessee status to an owner status.

Let's Recap

- **What ?**
- **Who ?**
- **How ?**
- **How much ?**

What?

Financing for:

- Equipment for Buildings and Public Works : Loader, Grader, Tracked excavator, Crane
- Industrial Equipment : Production machine, equipment ...
- Medical equipment: Scanner, Ultrasound scanner..
- Transportation equipment: Pick up, Road tractor truck, Crew cab.....
- Computer and IT Equipment :
PC, server, offices

Who?

- SMEs.
- Professionals.
- Industrialists.
- Traders.

How?

- The Customer chooses the equipment from the Supplier.
- The leasing company finances the purchase by paying the Supplier
- The supplier delivers the equipment to the lessee.
- The customer pays rents and becomes owner at the end of the period if he wishes (repayment installment plan).

How Much?

The cost depends on

✓ The rental period:

- 12 months
- 24 months
- 36 months
- 48 months

Or more

✓ And the participation of the customer in financing: First high rent (down payment).

How Much?

- The financed amount,
- The financed equipment
- The residual value.
- Example :
- Amount : 118,000 shillings
- Period : 36 months
- Linear rents
- 36 rents : 4,046 shillings
- RV : 1%

Why opt for Financial Leasing?

- Rapidity :
 - Decision
 - Setting up of the Credit
 - Payment Of Supplier
- Flexibility :
 - Simplicity -
 - No particular guarantee/security/collateral
 - Recovery of VAT on rents through capitalization of VAT in the rentals.
- Depreciation per the Tax policy for the equipment.

Presentation of a financing case:

- Our friend Jonass is an SME who wants to purchase a new loader. He goes and meets his Supplier i.e. Mantrac Tanzania Ltd., and wants to know whether the latter can grant him credit or whether Jonass has to see his bank or, better, he adopts this new formula: leasing
- By opting for this new financing alternative:
- Jonass is going to get new equipment every 3 or 4 years. This reduces the number of days for maintenance and repair, which allows him to improve his turnover and to better respond to the needs of his customers.

Financing case Cont/d

- **Jonass** :
- has thus a new loader.
- PAYS for his pick up over 3/4 years and depreciates it over the depreciation period per Tax depreciation policy.
- Once he becomes the owner, he may sell his equipment, which brings him an amount, from which he may make an important down payment for his next pick up, which allows him to reduce the rent charge as he wishes, and to improve his working capital by means of the balance.

Financing case

- **Jonass** no longer needs to wait until he has saved the whole amount to purchase his equipment.
- **Jonass** will be able to increase his equipment and obtain more contracts.
- Whereas His **Supplier** :
- is going to be paid cash.
- will be able to sell in minimum one equipment every 3 - 4 years.
- will be able to win the loyalty of the customer (Jonass).
- Will no longer wait until his customer has saved the amount to purchase an equipment but may, at the price of one loader, sell him three ones (down payment + leasing).

Who & What Can Be Financed?

- Who :

Any working company or person who has a registered trade (Tax identification number etc).

- What:

Truck, Pick-up, loader, cranes

Facility Equipment, Computer Equipment...

How & Who Can be Financed?

How?

- Simplicity/ less documentation.
- No specific guarantee.

Who?

- Customer with a good reputation
- Justified need.
- No start ups.
- He already has other vehicles or equipment

How Much?

➤ How much

This depends on:

- The down payment.
- The value of the asset.
- The leasing period.

Frequently Asked Questions in Financial Leasing

- What is the Rate?
- There is no rate; it is a profit margin
- What is the minimum down payment?

this depends on the customer's payment capacity (cash flow) which determines the rent that the customer/Lessee can pay and thus the down payment provided.

- What is the maximum period?

The lease period depends on the equipment financed, its age and, last, on the real monthly cash flow of the customer. It is a period that may be negotiated between the lessor and the lessee.

Frequently Asked Questions

Leasing is a financial product which managed to develop everywhere in the world, and I think that Tanzania may only draw advantage from such experiences. Indeed, it is one of the financing means that contributed most, in developing countries, to the development and growth of the private sector and especially of SMEs.



26



Other Financial Lease Structures for Contractors

▪ Back to Back Lease

One contractor company takes a financial lease/s from a bank/leasing company and provides the equipment on hire (operational lease) to a pool of contractors. In doing so, he collects rental from the pool of contractors and repays the bank/leasing company. The amortization of the cost of equipment should match or exceed the rentals he collects from the pool of contractors.

▪ Sale and Lease Back

A Contractor that already possesses equipment sells his equipment to a leasing company and leases the equipment from the Lessor (leasing company). This may solve his working capital needs.

27



Other Structures for Leasing Companies

- **Contractors form their own leasing company!**

The leasing company may have to be capitalized through owners equity (CRB members) or from loan capital from banks/financial institutions. The Contractors leasing company may obtain guarantees from Government or other International Financial institutions.

28

Risks, Hazards, & Issues for the Financial System:

- **Funding sources for banks & leasing companies** – Construction equipment is expensive! Banks are public deposit taking institutions and need to match their assets and liabilities maturities.
- **Banks and leasing companies may lack appropriate personnel** – human resources and asset management capabilities are required to run a leasing business. Our leasing program teaches banks how to do so!
- **How do leasing companies originate leasing deals?** By forming alliances with vendors, and clients of vendors.

29

Risks, Hazards & Issues for the Financial System

- **Banks & leasing companies need adequate Credit Acceptance criteria:** Criteria used to approve lease applications by leasing companies – e.g. 3 C's – Character, Capacity & Collateral.

Pricing & structuring of lease deals: Banks and leasing companies need to use innovative lease structures to suit lessee's cash flow needs and requirements. E.g. rental payments in arrears, in advance.

Documentation: Leasing companies need appropriate documentation to support the lease transaction.

30

Risks, Hazards & Issues for the Financial System

- **Appropriate legal framework, regulation, and environment** ('external risks' for leasing companies): legal environment/ framework may pose financial risks & hazards, depreciating nature of assets etc – **solution may be a leasing law to allocate financial risks!**
- **Foreign currency risks:** Leasing companies may be borrowing in foreign currency, deals are priced in local currency – **solution may be local currency lending for banks and leasing companies!**
- **Interest rate risks:** If leasing companies are exposed to change of their cost of funds without possibility of adjustment of their receivables, they must hedge their exposure to higher interest rates, or have a reserve for the potential loss.

31

Risks, Hazards & Issues (perceived or real).

- Government does not pay contractors on time!
- Contractors don't deliver on time!
- Contractors should not get special treatment (guarantees)!

32

innovation
partnership
growth

Thank you

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33

Salient Features of the Proposed Financing Leasing Law for Tanzania

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Salient Features of The Proposed Financial Leasing Law For Tanzania

Consultative Meeting on Contractors Financial Management

8 – 9 May 2008

By Moyo Violet Ndonde, Operations Officer, SECO – IFC Leasing Program,

 Schweizerische Eidgenossenschaft
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Confederazione Svizzera
Confederaziun svizra

Federal Department of Economic Affairs FDEA
State Secretariat for Economic Affairs SECO

 **International
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Objectives Of the Proposed Financial Leasing Law

A substantive law on financial leasing that aims to:

- Stimulate capital investment and hence economic growth.
- Provide certainty for financial lease providers and for domestic and international investment in leasing companies/banks.
- Clarify inconsistencies in the existing legal framework for financial leasing.

Process of the Financial Leasing Law

- **IFC provides Technical Assistance to the Government of Tanzania** under the framework of FSAP (2nd Generation of Financial Sector Reform), and based on IFC's experience in developing financial leasing legislation around the world – including the Ghana Finance Lease Law, for Central Asia Republics (Uzbekistan, Kazakhstan etc), Ukraine, Rwanda, and elsewhere.
- **The Process involved an initial study of the leasing market as of July 2005**, which included a review of the legislative, regulatory and taxation framework for financial leasing and leasing market statistics. Financial sector discussions of the findings of the '05 study were conducted at roundtables, followed by a leasing conference in 2005, and extensive consultation with various stakeholders (i.e., leading commercial banks in leasing). The draft law was circulated by Bank Of Tanzania to stakeholders in February, 2006.
- **IFC draft proposals were presented to the Tanzania Bankers Association's Technical Team.** The engagement of TBA was pursued through presentations, articles and discussions.

Process of the Financial Leasing Law

- Comments were received from stakeholders (commercial banks) and responded to by IFC.
- Proposals (both taxation and legal) were submitted, tabled, championed and discussed with the Technical Team for Long Term Development Finance Team (LTDF), charged with supervisory powers for leasing reform.
- The draft law was discussed with private sector representatives in September, 2006.
- Additional comments were received from leading commercial banks later in the process, and were discussed with relevant stakeholders. These proposals were later incorporated in IFC proposals but **not so as to change the substantive proposals of IFC's work.**

Substantive Provisions:

Part 1 – Preliminary Provisions: Short Title & Interpretation

- Applies to **finance leasing transactions** and variations thereof – sale and lease back, back to back lease, secondary leases, and sub-leasing.
- Provides definition sections that define key and essential terms – “asset” “assignment” “sublease” “secondary lease” “sale and lease back” “hire purchase” etc.

Note that the issue of whether an “asset” should include “immovable property/ assets” and the logic and rationale therefor were also discussed.

Substantive Provisions

Part II - Formation of Financial Lease agreement

- **Characteristics of A Financial Lease Agreement for legal purposes:**

The Asset is acquired from a third party (Supplier/vendor). 'Third party' means a different legal entity from the lessor even where they are related.

The option to purchase may or may not be there – but in practice a financial lease will seek to amortize the cost of the asset.

The Lessee specifies the asset without relying on the skill of the Lessor.

The Supplier shall know why the Lessor is acquiring the asset i.e., in consequence of a financial lease with a Lessee.

The dual nature of the financing of, and investment in, an asset is recognized in the law.

That a Financial lease is both a credit agreement and a rental agreement is recognized.

Substantive Provisions

Part II Cont/d

- **Formalities of Agreement** – capacity to contract, offer and acceptance etc in a financial lease agreement shall be in accordance with usual principles of contract law.
- **Pre –leasing formalities** may or may not be utilized. The parties may make a statement prior to the leasing contract being finally made – option of parties.
- **The Subject matter of a financial lease agreement** may be existing assets or assets to be acquired (if the assets are to be acquired then pre – leasing formalities may be required).

Substantive Provisions

Part II – Formation of Lease Agreement Cont/d

- **Calculation of Lease rentals**

To take into account amortization of all or substantially the whole cost of the asset.

The rentals should also take into account the Lessor's interest or profit.

- **Irrevocability of Lease contract** – Once the lease and supply agreement are created, they become irrevocable.

Substantive Provisions

Part III – Parties and Obligations of parties to Financial Lease Transaction

- **Defines Parties:** (a) Lessor, (b) Lessee and (c')Supplier are parties to the “**transaction**” and (a) Lessor and (b) Lessee, are parties to the “**financial lease agreement**”.
- **Defines rights & obligations of parties.** *Examples:*

Lessor obligations: - To grant quiet possession of the asset; and to be diligent in obtaining good title. However there is no Lessor liability for defects or fitness of the asset for the lessees purposes.

Circumstances for Lessor's liability are provided for (e.g. to pay supplier on time, for willful infringement of the Lessee's peaceful enjoyment of the asset).

Substantive Provisions

Part III – Parties, and rights and obligations of the parties Cont/d

No Liability on the Lessor for third party injury and death arising from the lessees' use of asset.

Duties of Supplier: For quality and fitness of assets. The supplier shall owe the Lessee the same duties as he owes the Lessor regarding the assets (merchantability). The Supplier **shall not** liable for the same damage to both the lessor and lessee regarding defect in the asset. The Lessee can take action against the supplier, even in the absence of privity of contract (i.e., direct "legal" relationship with the supplier).

Lessees: Utmost obligation is to pay the lessor for his investment in the asset. The Lessor intends to recover its full investment and profit. Lessor shall require the lessee to take insurance cover, inform him (the lessor) of any damage to the asset, and to maintain the asset in good condition, fair wear and tear excepted.

Substantive Provisions

Part III Cont/d – Repossession

- **The right of the lessor to recover rentals is paramount.** Where there is breach of the agreement the lessor has the right to repossess the asset.
- If the financial lease agreement does not state a period for remedy by the Lessee of a breach of the agreement in order for the Lessor to initiate repossession, the statutory period for the remedy shall be 30 days.
- The right to repossession, and repossession itself does not prevent the lessor from taking other remedial steps, e.g. for recovery of the full investment amount. In addition, the lessor can sue the lessee for damages.

Substantive Provisions

Repossession –Cont/d

For shortfall.

Where repossession occurs, immediate payment of future rentals for the remaining term of the lease is required. But this amount can be decreased by the fair value of the asset repossessed.

Substantive Provisions

Part IV – Third Party Claims & Interests in Financial Leases

- Provides for assignment of lease receivables and of the lease contract by the Lessor, as well as the conditions for the assignment. This is in order to promote growth of financial leasing and the market so that Lessors can obtain new credit lines.
- Assignment of the financial lease agreement is the Lessors' right, but such assignment should not interfere with the Lessee's quiet enjoyment of the asset. Assignment of lease receivables by the Lessor to a third party is absolute.
- The Lessee may sublease the asset only upon the consent of the Lessor.

Substantive Provisions

PART IV – Third Party Claims And Interest in Financial Leases (Sections 14- 20)

- The Lessee should not create encumbrances over the leased asset in favour of third party creditors i.e.,– should not mortgage the leased asset to a creditor. If a mortgage is created during the currency of lease, **it shall be void.**
- The Lessee shall be responsible for third party damage/s to the asset during the lease period, and shall have the right to take legal action against third parties to recover damages.
- Where assets subject to financial lease become attached to land e.g., “plant and machinery”, the asset shall not become part of the land (compare with English common law). Where the lessee has creditors, the asset shall not form part of his (the Lessee’s) property and the creditor cannot attach the property during a liquidation/bankruptcy of the Lessee’s estate).



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14



Substantive Provisions Cont/d

Part V – Registration of Interests (Section 20)

- An existing registry shall be designated for registration of “assets” that are under financial lease. **Registration is of the asset or of the interest in the asset and not the financial lease agreement.**
- Assets/interests in assets that are registered with the registry – serve as notice to third party purchasers or creditors etc, even if such parties have not actually checked the registry (English common law principle).

BUT

- This should be compared with the requirements of an existing Chattels Transfer Act, 1931 where under this Act, registration of the asset is not mandatory if the assets are marked e.g. “Mercedes Benz”, “Scania” etc.



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15



Substantive Provisions

Part VI - Supplementary Provisions

- **Lessor may require information** as to where the leased asset is kept.
- The Parties (Lessor & Lessee) may agree on other matters not in the law. – Provided that these are not in breach of the **mandatory provisions of the law**. Matters that can be varied include – events of default, rights, liabilities and duties of the parties.
- **Recovery of damages** – the principle is for recovery of damages that will put a party in the position it would have been had the agreement been performed, but not to constitute a penalty (English/ Common Law).
- **Application of the Financial Leasing Law** – (a) If the asset is within Tanzania, or (b) the lessee's centre of interests is in Tanzania, or (c') if the leasing agreement provides that Tanzania law should apply.



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16



Other Laws for Amendment and/ or Harmonization

Hire Purchase Act – To avoid confusion between a Financial Lease and a Hire – Purchase.

Both financing mechanisms should be available for financiers should they wish to use either. Our experience is that H-P is not preferred or is mainly used for small and consumer type assets.

Sale of Goods Act - To harmonize the duties of a supplier/vendor in a financial leasing transaction with provisions of suppliers/ sellers obligations under the Sale of goods law.

Chattels Transfer Act – To provide clearer provisions regarding registration of interests in leased assets.

Companies Act - To provide that leased assets shall not become the property of the lessee, and the lessee cannot charge the asset under lease to creditors.

Tanzania Investment Act – To provide that leasing is an investment activity, or that certain types of equipment leasing are investment activities e.g. agriculture, construction or transportation depending on the sector contribution to GDP. To clarify in the law matters of financial leasing for holders of a Certificate of Incentives issued by the TIC.



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17



Other Laws for Amendment

Business Registrations Act - To spell out licensing procedures for non – bank financial leasing companies.

Bankruptcy Act - To provide that assets under finance lease do not belong to the lessee, and cannot be attached by the lessees' creditors when undergoing bankruptcy proceedings.

Civil Procedure Code Act – To provide for a summary procedure (expedited process) for recovery of debts that arise from financial lease contracts, and for repossession of moveable assets under financial lease.

Road Traffic Act – To provide clearly that the users (Lessees) shall be liable for use of the leased assets and damages that may occur, and not the Lessors.

Banking and Financial Institutions Act – Review prudential guidelines for leasing, if appropriate. E.g. ratios for investment in moveable property for bank lessors.

Land Act – To provide for financial leasing of immovable property (if preferred) and that leased assets that become attached to the land shall not form part of the land.

Concerns Raised by Stakeholders

- **The law should state expressly that amortization will include return of capital and an element of profit or interest for the Lessors** – *This was done.*
- **The Lessor should not be liable for his negligence to obtain good title to the leased asset** - *This was not accepted by stakeholders, meaning that the Lessor should exercise diligence in obtaining good title to the assets he leases.*
- **Notice for Repossession should be 30 days** – *A compromise solution was found as stated in the section on repossession.*
- **General credit law as opposed to “ financial lease” law is good for the country** – *Though this may be the ideal situation, the IFC mandate was for financial leasing. In any event, a credit law in IFC’s experience would be for consumer protection, whereby a financial leasing law is in order to promote capital investment.*

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partnership
growth

Thank you

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Tax Regime for the Construction Industry

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1.0 INTRODUCTION

This presentation is based on the taxation regime as it relates to the construction industry in Tanzania together with the other players in the industry. Our focus is on the main types of taxes administered by Tanzania Revenue Authority (TRA) as they impact on the construction sector. The presentation touches on the tax incentives available to contractors and other players as provided under the tax laws such as Income Tax Act, Value Added Tax and Customs Tariff Act. The main purpose of the incentives is to encourage investment in the country.

We shall also discuss briefly some of the problems faced by the construction industry and the impact of the problems to the government revenue collection and the associated problems of taxing the industry. We shall briefly look at some challenges and tax implications on the industry and finally we shall conclude our discussion by proposing some recommendations which may minimize the problems and difficulties which the industry is facing.

2.0 ABSTRACT

The aim of this paper is to discuss the structure of the construction industry in Tanzania and how it operates. The impact of the rapid advancement in technology to the construction industry, the operating systems and procedures have direct link with the taxation system. This paper also considers the impact of the sub-sectors in the industry on their contribution to the Gross National Product (GDP) where the construction industry contributes 9% of employment in the economy. The sector has posed tax administrative problems not only in Tanzania but in many other countries of the world due its many stakeholders with their numerous transactions. Identification of areas of revenue risks associated with the tax exemptions under the current taxation laws such as Income tax; Value added Tax and Customs and Excise are important in improving the taxation and investment policy of the country.

Construction industry is one of the industries which need heavy capital investment in terms of plant and machinery. This equipment requires substantial amounts of financial resources to acquire them and thus pose a big challenge to small contractors. The industry also faces a technology challenge that will enable it meet the international standards in order to effectively participate in the perfect competitive global market. Considering these

challenges, the taxation regime in Tanzania introduces tax concessions through exemptions, capital allowances as replacement costs as well as tax relief's as a way of encouraging growth of the sector which has been growing steadily during the past ten years contributing 5% to the GDP. It is now second fastest growing sector after mining.

3.0 MEANING AND TAXATION REQUIREMENTS

Tax is a compulsory contribution in monetary terms made to the government by individual persons, natural and artificial, resident persons and non residents in the course of conducting business, investment and employment according to their level of earning ability. In return, the government ploughs back the taxes to people by providing services such as health, infrastructure, and provision of services to its people in terms of education, and maintenance of law and order to the citizen. Therefore it is imperative for every person in the society to discharge his/her obligation of contributing equitably to the government coffers in terms of tax.

4.0 TAX REGIME AND CONTRACTORS

Construction industry is a fundamental economic sector which is characterized with backward and forward linkages with other sectors through physical structures which are necessary for social and economic development. The industry has been growing steadily during the past decade as supported by the number of the new structures being developed in our urban areas.

The industry employs human labour thus creating employment where the government collects tax from the employment income (PAYE). On the other hand the projects generate profits where corporation tax is collected. In addition, the industry creates a number of secondary activities which also generate tax revenue to the government.

Considering the significance of the industry in the economic development, the government has put in place a tax regime which encourages investment in this capital intensive sector by providing a number of tax incentives in terms of capital allowances and deductions on plant and machinery as well as tax exemptions and tax relief on construction materials and equipment.

4.1 Local investors and Tax incentives

The government through its investment and taxation policies has been reviewing its policies by providing a number of tax incentives with a view to creating a conducive environment for encouraging local and foreign investors to invest in the country. These incentives are given through Income Tax, Value Added Tax (VAT) and the Customs and Excise. Whoever meets the requirements stipulated in the respective laws will get the incentives. However beneficiaries of tax exemptions in the construction industry under

the present tax regime are the clients or owners of the construction projects. Contractors are not beneficiaries of the incentive unless they are investors in the priority sector.

4.2 Incentives under the Income Tax Act

The Income Tax Act provides for income based tax incentives which are in the form of Wear and Tear allowances on the assets employed in construction. These allowances are grouped or pooled in eight classes of assets which eligible persons including contractors can enjoy. Under the present investment policy, tax incentives have been targeted to particular sectors of the economy which include the infrastructure. E.g. road construction, bridges, railways etc.

Holders of certificate of incentive including those in the construction industry are entitled to the incentives in this sector.

4.3 Determination of Taxable Income.

In determining the amount of tax payable by a construction project, the tax amount is based on the percentage of job completed and this is arrived at by comparing the total expenditure allocated to the contract and actual amount incurred before the end of the year of income with the estimated total contract expenditure as determined at the time of commencement of the contract.

The determination is authenticated by the certificate of completion which is issued periodically by the consultant.

4.4 Points of taxation on construction projects

Construction projects like other businesses pay income tax on their profits. Taxation of short term projects do not pose tax administrative problems compared to long term contracts whose tax point may differ with the time when certificates of completion are issued. The certificate of completion is issued by the consultant at each completion stage as per the agreement clause. This is the authority to show that the job has been completed to the required level. Therefore income tax is payable as a percentage of the contract completed during each year of income.

A more or less similar collection problem is experienced with VAT. The problem is based on the time of supply of the goods or service and the time of paying VAT. According to the VAT law section 6 (1) the time of supply is based on either of the following events:-

- Goods are supplied to the customer
- Tax invoice is received for all or part of the supply
- Payment is received for all or part of the supply

- Service is rendered or performed whatever time shall be the earliest

In the construction industry, a certificate may be issued but a tax invoice may deliberately be delayed depending on the cash flow of the contractor as issuance of certificate attracts VAT payment immediately. In some contracts, payment is effected long after the certificate has been issued. Under this delay, TRA issues tax demand notice as soon as the certificate is issued before contractors have received payments to pay the demanded taxes.

Experience shows that, over inflating of quantities and value of materials, capital goods and equipment is common among dishonest clients and quantity surveyors/contractors. In this case, a huge amount of VAT is refunded to the contractors which is a loss of government revenue. The over valuation also has a negative impact of income tax due over valuation of the property thus attracting more wear and tear. Tax administration relies on the bills of quantity of building materials prepared by a registered quantity surveyor and certification made thereon. Some clients may apply for tax exempt quantities that exceed the actual requirements for an intended construction project and sell them in the ordinary market or use them on non-exempt projects.

4.5 Incentives under the Value Added Tax.

Construction industry enjoys VAT exemptions provided that the contractor or client is registered with VAT or is anticipating undertaking a project worth shs 40m and above per annum. Imported generic capital goods and construction equipment are exempted from VAT under the EACMA 2004.

Importation or supplies of goods or services to projects funded by the Government relating to infrastructure and utilities development are VAT relieved under the third schedule of VAT. Item 10 (1) of the schedule further grants VAT relief to registered religious, charitable community based or non profit driven organization for supply of goods or services for use of the organization or institution (commonly known as NGOs) for execution of its functions of its functions which include construction project in the area of health, education, water supply, infrastructure or any other project relating to advancement of the community. The construction industry is the beneficiary of these projects

4.6 Tax Incentives under the Customs tariffs Act

The government has granted lucrative tax incentives to both local and foreign investors through tariff reduction on imported capital goods including plant and machinery which are regarded as vital in revamping the economy. These generic goods which include construction equipments are normally assigned zero percent (0%) import duty and this incentive is available to all

stakeholders in the industry. Such capital goods are like caterpillars, bulldozers, excavators etc.

5.0 STRUCTURE OF THE CONSTRUCTION INDUSTRY

The industry brings in a number of players in a construction project. There are the project clients, contractors, consultants, quantity surveyors, architects sub-contractors and project Managers. All these players earn income from one project and as such they are supposed to pay relevant taxes. In order to collect taxes from them there is a need for maintaining proper records on all the transactions at all levels and the records must be maintained in a transparent manner. Collection of taxes from each of them has become a challenge to TRA as at some stage it is difficult to trace some them or their employees. For instance, casual labourers employed by a sub-contractor may escape tax due to inadequate record keeping by the sub-contractor. Once a labourer is paid it is difficult even to trace him later in order to recover tax from him. This is also a challenge not only to TRA but also to the sub-contractor.

6.0 TAX CONTRIBUTION BY CONSTRUCTION INDUSTRY

The contribution of the construction sector (by Large Taxpayers Department) to the government revenue has been increasing during the last six (6) years as shown on table 1 below. Corporation tax which is paid out of the profits earned has been leading followed by PAYE. VAT on the materials and services rendered was the third contributor in the sector and this can be explained by the fact that most of the big and high valued construction projects which belong to the government are financed by external financiers who are exempt from VAT payment on the materials purchased.

Table 1 Tax collection (Tshs in billions) by Large Taxpayers Department

Year	TAX COLLECTION BY LTD (2001/02-2006/07)						TOTAL TSHS
	VAT	COR. TAX	PAYE	SDL	W/TAX	S/DUTY	
20001/02	1,342,	665	1,189	112	25		3,335
2002/03	2,592	1,378	1,714	1,718	4		7,408
2003/04	3,737	1,559	2,037	492	1,111	2	8,939
2004/05	2,533,	6,402	4,256	1,027	1,085	4	15,309
2005/06	3,494	4,723	6,298	1,544	1,728,	13	17,802
2006/07	5,242	13,588	10,021	2,611	3,487	93	35,043

Source: TRA Research and Policy Department.

Table 2

Analysis of revenue collection from construction industry

Year	Construction(LTD)	Grand total
20001/02	3,335.00	976,608.00
2002/03	7,408.37	1,145,161.00
2003/04	8,939.73	1,319,306.00
2004/05	15,309.72	1,679,008.00
2005/06	17,802.73	2,040,393.00
2006/07	35,043.57	2,345,510.79

Source: TRA Research and Policy Department

Figure 1

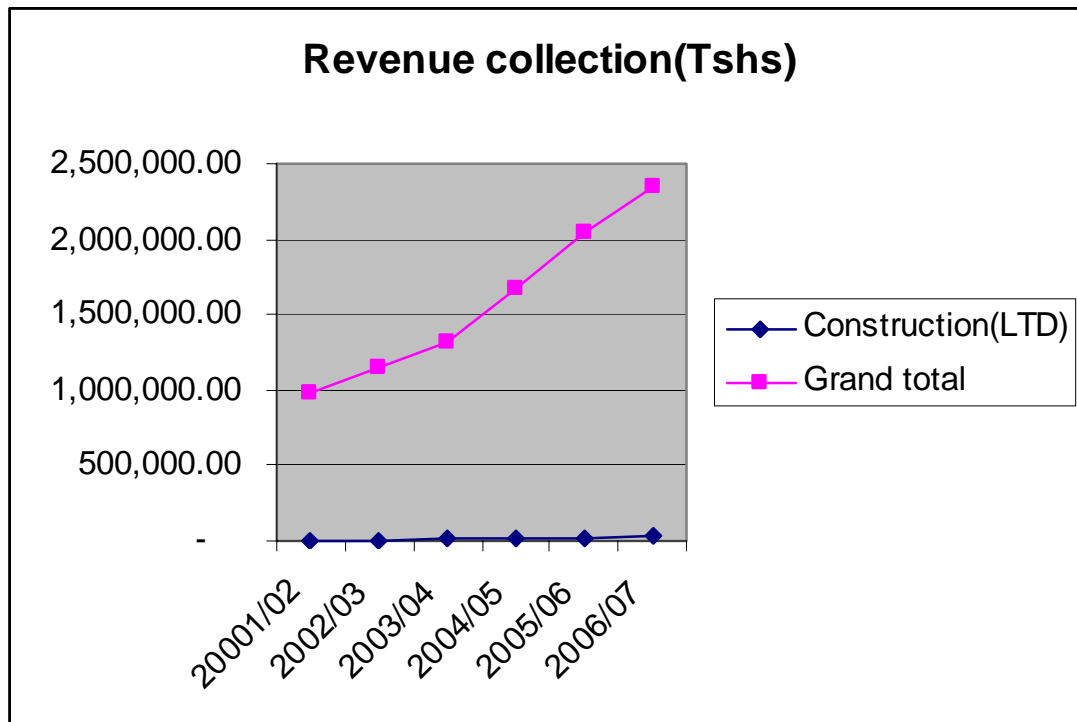
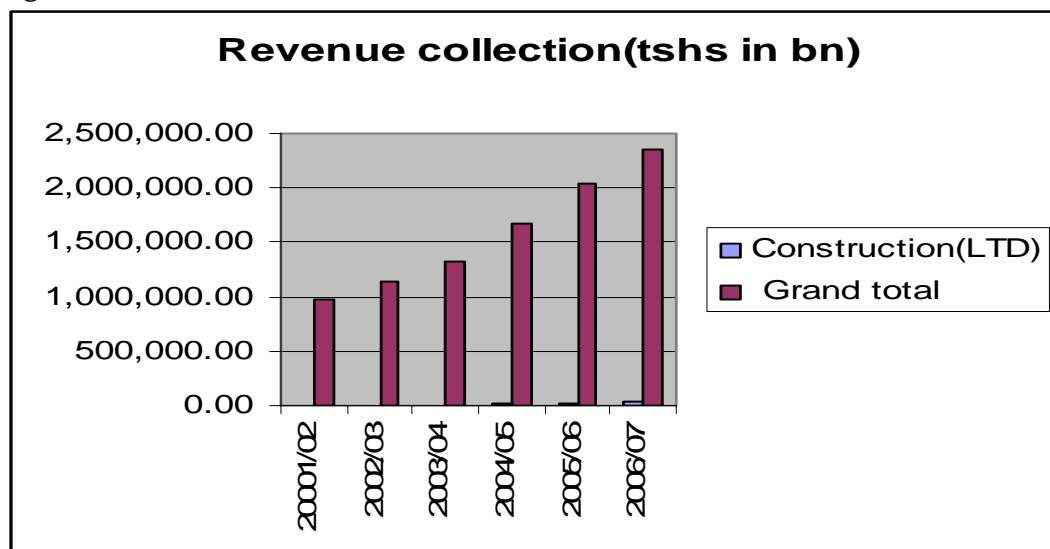


Figure 2



7.0 EQUIPMENT LEASING AND HIRING.

Leasing transactions have become an important means of financing the acquisition of capital assets. It involves rentals payable for the use of the leased asset by the lessee to the lessor. Leases are 'financing devices'. If a firm leases plant and machinery for the purpose of a construction business then the transactions in the lease agreements are subject to taxation. However some times it is difficult to get the agreement between the lessor and lessee for tax verification.

According to the Income Tax Act 2004 leases are taxable to the extent of the rentals receivable by the lessor. Leasing transactions are also taxable service under the VAT law.

Leases are classified as 'operating' or 'finance' leases. Where all the risks and benefits incidental to the ownership of the leased asset effectively remains with the lessor, the lease is an 'operating' one but when all the risks and benefits effectively pass to the lessee it is a finance lease.

With a finance lease the lessee pays rent to the lessor who does not deal with the management of the asset. Decision to lease plant and machinery must be evaluated carefully as there are financial risks associated with such a decision

Risks associated with leases according to Income Tax Act 2004

- Possibility of losses from idle capacity.
- Technological obsolescence.
- Variations in returns due to economic conditions
- Uninsured damage.

Finance or operating leases attract income tax on the rental received by the lessor of the asset. In calculating the taxable income lessors are free to deduct all the allowable expenditures in arriving at the chargeable income.

Deduction of depreciating allowance depends on who is the beneficial owners of the asset and not necessarily the legal owner.

Not all construction firms can own machinery as many of them have weak capital base. Recent statistics show that we have 4,432 construction firms and out of these only 21% of them are in class I & II. These large firms are financially strong and can manage to purchase the required plant and machinery compared to small and medium enterprises that constitute 79% of the industry. In order for these small firms to survive in the industry, they must hire equipment from large firms.

The leasing arrangement has helped small firms to grow and enable them to get high valued construction projects. On the other hand the equipment leasing charges tend to erode the profit element from the contracts receipts ending up into small profits or even losses hence depriving the government from getting the relevant tax revenue from the majority of small and medium contractors.

8.0 CHALLENGES AND TAX IMPLICATIONS FOR THE CONSTRUCTION INDUSTRY.

Taxation of the construction industry poses a number of challenges which affect the tax collection process.

- (i). There is a lack of transparency in the process of sub-contracting work.
 - Some agreements may not readily be available to verify the subcontracted work.
 - Sub-contracted work may be awarded to individuals or firms who are not registered with TRA.
 - There are no records of employees employed by sub-contracted firms leading to loss of PAYE.
- (ii). Sometimes the final retention money which is 2.5% can easily escape taxation especially when it is paid to small firms.
- (iii). In Tanzania most of the construction is undertaken informally by firms or individuals who are not registered with TRA. The industry is dominated by SMEs (79%) construction firms.
- (iv). Statistics show that 21% of the construction of firms are in Class I and II who command 80% of the monetary value of the works. These are mostly foreign firms which are awarded government contracts.
- (v). Use of cheap construction materials not only reduce the quality of the properties constructed but also VAT on the materials used and property tax from the buildings
- (vi). TRA relies on the Bills of Quantity prepared by Quantity Surveyors. The correctness of the bills of quantity have a tax implication.
- (vii) Abuse of the tax exemptions by dishonest contractors and clients.
- (viii) Fraudulent recovery of input VAT

9.0 RECOMMENDATIONS

- (i). Consideration should be given to the problem of '**tax point**' under Income Tax and '**Point of supply**' under VAT to be given a further analysis so as to sort out the tax payment problem by contractors.
- (ii). Construction Registration Board (CRB) and the related stakeholders in the construction industry to assist in ensuring that all informal contractors including individuals are registered with the relevant Boards thus facilitating TRA with data.
- (iii). All stakeholders in the industry to fully disclose all the payment made or received so as to assist TRA to collect the required taxes.

- (iv). Introduce a Contractors registration scheme that obliges main contractors to register their sub-contractors and submit such information to TRA periodically.
- (v). Establish equipment leasing firms that will lease plant and machinery to small construction firms so as to assist them to contribute to the labour market and taxes to the government.
- (vi) Contractors Registration Board to consider registering the informal operators in the industry in a special class of **Community Based Contractors** as these undertake most of the construction work in rural areas.

10.0 CONCLUSION

- i. Construction industry has grown steadily during the last decade contributing significantly to the GDP growth and therefore to employment creation.
- ii. Taxes from the sector also grew significantly but at a lower rate than the economic growth late in the industry. This is due to many firms being engaged in tax exempt government donor funded civil works.
- iii. There is a need for maintaining proper record of the entire stakeholder in the industry.
- iv. Consideration for establishing equipment leasing firms to assist local contractors.

East African Development Bank

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EAST AFRICAN DEVELOPMENT BANK



**A PRESENTATION AT THE CONSULTATIVE MEETING ON
CONTRACTORS' FINANCIAL MANAGEMENT ASPECTS.**

8TH – 9TH MAY 2008

DAR ES SALAAM, TANZANIA

EAST AFRICAN DEVELOPMENT BANK (EADB)

Background

- Established under the Treaty for East African Co-operation on 6th June 1967.
- A new Treaty amending and re-enacting the Charter was signed by the Member States and came into force on 23 July 1980
 - to confer legal force to the Charter independent of the Treaty for East African Co-operation
 - to amend the Charter to make possible a wider membership of the Bank as well emphasize its consulting and promotion functions.

Location

Head Office: *Kampala, Uganda*

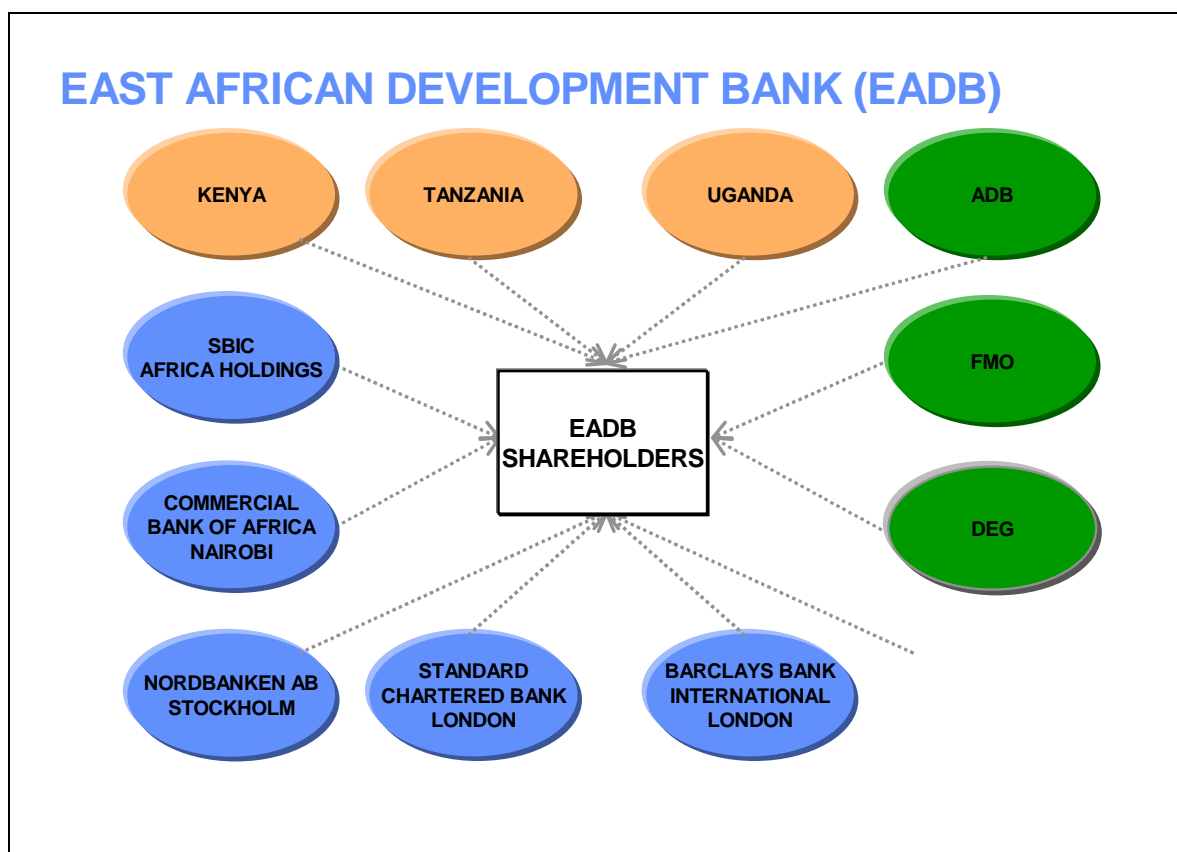
- Representative Offices: Nairobi, Kenya
Dar Es Salaam, Tanzania.

Rwanda & Burundi joining soon

EAST AFRICAN DEVELOPMENT BANK (EADB)

Objectives of EADB

- To provide financial assistance to all productive sectors of the economy in order to promote the development of the Member States;
- To supplement the activities of the national development agencies of the Member States by joint financing operations, technical assistance and the use of such agencies as channels for financing specific projects;
- To cooperate with other public, private, national or international institutions and organisations, which are interested in the development of EADB Member States;
- To promote the development of the region and undertake such other services as may advance the objectives of the Bank.
- To provide consulting, promotion, agency, and other similar services.



EAST AFRICAN DEVELOPMENT BANK (EADB)

OUR DIVERSE PRODUCTS AND SERVICE FOR SMEs

EADB has a wide range of financial products and services to suit a wide range of clients including SMEs. These include:

- **Medium and Long Term Loans:** The loans are offered in either foreign and/or local currency, depending on the client needs. Loans range from USD 50,000 to 15,000,000.

- **Short Terms Loans:** Offered for procurement of raw materials, spare parts and small auxiliary equipment from USD 50,000 to 400,000.

- **Equity Investments:** In the form of risk capital offered to selected enterprises for an agreed period after which the Bank divests. (USD 500,00 maximum per entity)

EAST AFRICAN DEVELOPMENT BANK

PRODUCTS/SERVICES continued

- **Asset Leasing:** The Bank offers asset lease finance for acquisition of equipment and machinery from USD 20,000 (to Maximum limit that depends on client needs)
- **Real Estate and Property Development:** The Bank finances commercial real estate and property development.
- **Agency for Donor Funds:** The Bank offers agency services whereby it collaborates with external donors to manage on their behalf funds channeled to projects in East Africa.
- **Loan Guarantees:** On a selective basis, the Bank provides guarantees in whole or in part in respect of loans made by other financial institutions for investments in the Members States.

EAST AFRICAN DEVELOPMENT BANK

More towards SMEs

- *Financing SMEs is EADB's primary function.*
- *Bank to support projects on both ends of the spectrum.*

Micro Projects USD 1,000 – 50,000

- **Bank has institutional limitation (No branch network)**
 - Working with smaller banks, MFI's etc by providing lines of credit
 - Already working with SIDO.

EAST AFRICAN DEVELOPMENT BANK

Areas of Finance

- Agriculture and Agro-processing;
- Hotel and Tourism;
- Manufacturing, Industry and Mining;
- Construction – USD 20M (10% of gross portfolio)
- Infrastructure (Energy, Information and Communication Technology, Transport and Commercial Real Estates); and
- Services (Education, Health and Finance).

WHY USE LEASE FINANCE?

- Accessibility especially for SMEs - cash flow based Vs Security based lending
- Minimum collateral requirement - leased assets are primary security.
- Duration - medium term up to 5 years
- Alternative source of finance - free other borrowings for working capital
- Minimum capital outlay required
- Easy cash flow budgeting- (Repayments suited to cash flows)
- Rentals can be tailored to meet the lessee's cash flow pattern
- Flexibility and shorter processing time
- Controlled funds usage - diversion is eliminated

POSSIBLE WAYS OF COLLABORATION

- Supply linkages with equipment vendors
- Backing/recommendation from CRB to improve risk grading of individual contractors.
- Repayment arrangements with contracting authority- TANROADS etc & the Banks.
- Honoring of obligations by contractors.

WHY EADB ?

- Industry Knowledge & expertise.
- Biggest regional out reach- For expansions & EAC formation
- Promotion of best practices- regional out reach
- Developmental orientation.
- Institutional approach

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