

# Strategies to Attract Foreign Direct Investors Collaborating with Small and Medium Contractors in Tanzania Construction Sector

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## Abstract

Foreign Direct Investment (FDI) is an investment which is made to serve the business interest of the investor in a company, which is in a different nation distinct from the investor's country of the origin. The study objective is to assessing strategies to attract foreign investors to collaborate with Small and Medium Contractors (SMCs) in construction sector in Tanzania. The focus was mainly on the investment aspects and not in the issues such as gender equity, discrimination or the environmental consequences of foreign investments. Evidence shows that a number of countries have deepened the development impact of FDI through measures that stimulate large and small enterprises to work together (Lorraine Ruffing, 2006). Debra and Ofori(2006) observed that many construction firms in developing countries are small and medium sized organizations. The researcher believes that by knowing the strategies which attract FDI to collaborate with SMCs can bring about changes on SMC's perception about FDI's. And this kind of diversity can contribute to SMCs operational improvement both technical and managerial. The researcher also believes the factors which get positive opinions can be adopted by SMCs as strategies to attract foreign investors to collaborate with them. Data was collected from foreign investors who have offered subcontracts to SMCs, outsourcing some of their operations to them or partnering via strategic alliances or joint ventures. Response data was subjected to descriptive statistics and subsequently rates analysis were used to collect foreign investors' opinions. The results of data analysis indicated that foreign investors would prefer SMCs who work on certain standard, who have specialized skills and who lowered their prices during subcontracting bargaining in their operations and rated those factors as very important. In operation factors they as well rated best practices guideline, technology capability, managerial capability, market information skills and institutional capacity as important in SMCs. The main motivation factors for foreign investors to work with SMCs are resources, raw materials, appropriate delivery practices and culture of long term thinking rated as very important. And the factors which strongly agreed that attract foreign investors to continue collaborate with SMCs are political stability, mutual trust and integrity between them and SMCs, Productivity of Local Firms, Reliability and Price on SMCs services and Local Knowledge assessing.

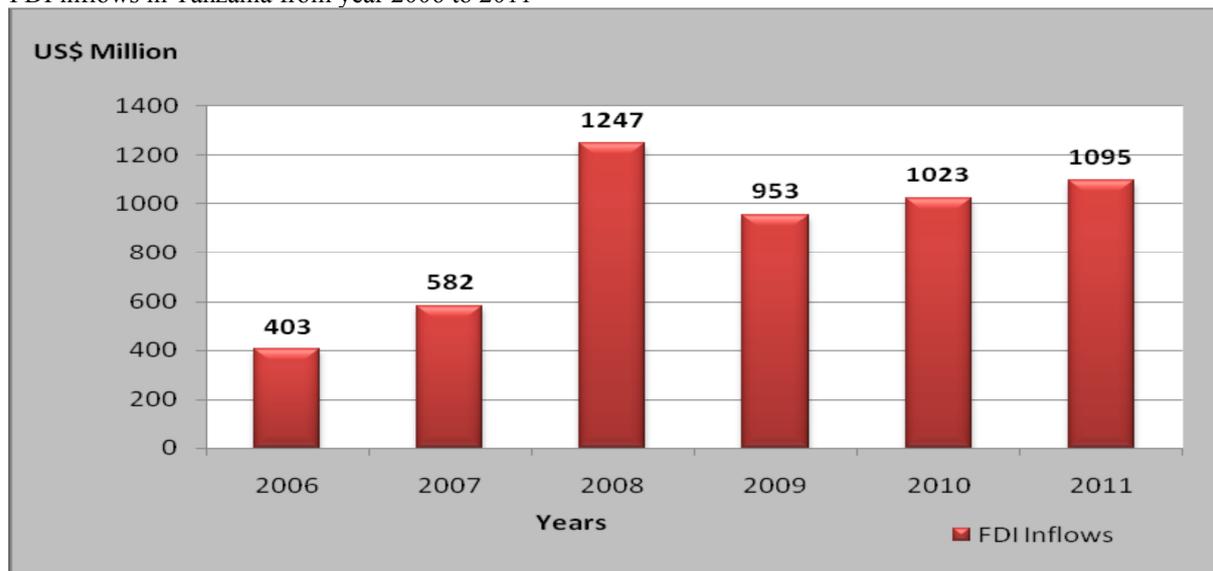
**Keywords;** Foreign Direct Investment, Small and Medium Contractors, Strategies

## 1. Background of the study

### 1.1 Status of FDI's Flow into Tanzania's Economy

It has been known that FDI bring economic transformation in developing countries from technological advancement to standard of living improvement. It's the source of investment policies improvement considering the needs of both local and foreign investors in Tanzania. Tanzania took the lead in attracting FDI in East African countries attracting the record of \$1.1billion equivalent to (Tshs 1.76 trillion), same report highlighted that between June 2011 and June 2012, Tanzania overtook Kenya-the region's biggest economy. Tanzania has attracted about 47% of all FDI flows in East African countries. (World Investment Report, 2012). Thus Tanzania took the lead in attracting FDI in East Africa region during the past two years. There have been different arguments in literatures that different types of FDI have different critical determinants. FDI has been criticized as footloose(Gong & Strobl,2003) and seeking locations with lowest labor costs regardless of the source of this advantage(Bellak et al, 2008) FDI may not embed itself within the local economies meaning that few local businesses benefit from supply contracts(Phelps et al 2003: Simmie & Martin, 2010).

FDI inflows in Tanzania from year 2006 to 2011



(Source: UNCTAD 2012 report)

The said reasons of why there is recently tremendous number of FDI in Tanzania are infrastructure improvement such as roads with average of 8.9km of roads per 100km square compared with 6.6km/100m square in East Africa, decrease in congestion at Dar-es-salaam airport, a functional railway systems, speed company registration and land acquisition has been simplified (Dr Adelhelm Meru, Director general of Export Processing zone, 2012).

In addition, favorable policy regarding foreign investment such as tax incentives which provide exemption of import duty to capital goods including establishment facilities for investment by 90% and reduced VAT on projects capital goods including deemed capital goods to 10%. Also assistance to obtain land for investment, automatic immigration quota of up to 5 expatriates at the initial stage of the project are the reasons that attract FDI's in the country (Tanzania Investment Centre, 2012).

Tanzania is a resource-rich nation but throughout the country history its natural resources wealth has not translated into economic well being for more than a small minority (The National Strategy for Growth and Poverty Reduction, 2009). Thus it's rich in agriculture, forestry, wildlife land and minerals such as gold, diamond, iron, coal, nickel, tanzanite, uranium and natural gas (Tanzania Government website 2014). The resources mentioned have been the main source of FDI inflows in Tanzania. Tanzania bordered by Kenya, Uganda, Burundi, Zambia Malawi and Rwanda.

### 1.2 Construction sector and Small and Medium Contractors in Tanzania

The construction sector/industry in Tanzania is a sector of the economy that transforms various resources into constructed physical economic and social infrastructure necessary for social-economic development. Statistics recently released by the Contractors Registration Board (CRB) have indicated that the construction sector which consumes 60% of the development budget grew by 11% in 2012 despite major challenges facing the industry (CRB, 2012). This is mainly due to major investment by government and aid agencies in infrastructure including roads, housing, government offices and tourism. The sector also employs about 9% of the workforce in Tanzania (UNESCO, 2012)

On average, CRB Tanzania has been registering over 560 contractors annually. By January 2007, 4432 contractors were on its register among which 94% are small contractors ranging from classes seven to four (Shi Xueyong, 2009). CRB is government autonomous regulatory board established by Act of Parliament No 17 of 1997 to register all types of contractors and regulate their conduct for the purpose of protecting consumers of construction services in Tanzania. Challenges faced by SMCs are financial weaknesses, stiff environment highlighted by undue competition within contractors, insufficient pool of skilled personnel at both technical and managerial level, inadequate access to credit, more risks in their operations and less profitability (Shi Xueyong 2009). CRB has reported to delete over 600 contractors on its register, which 598 are Building and civil workers and 22 are temporary foreign contractors (CRB, 2014). Other major regulatory boards in Construction sectors are the National Construction Council (NCC), Engineers Registration Board (ERB), Architect and Quantity Surveyors Registration Board (AQRB), Tanzania Building Agency (TBA), Tanzania Electrical Mechanical and Electronics Services Agency (TEMESA), Public Procurement Regulatory Authority (PPRA), and Procurement and Supplies Professionals and Technicians Board (PSPTB). The construction sector holds a very special place

in Tanzania's economy. This is crucial sector as it cuts across sectors and stimulates their growth. In addition to this, the sector is pivotal to the achievement of Tanzania's long term developmental strategy that seeks to attain sustainable human development and becoming a middle income economy by 2025(UNESCO, 2012).

Tanzania government by recognizing the importance of SMCs has been facilitating access to bank loans or line of credit to Small and Medium Enterprises to empower them financially. Moreover, it has adopted a new Construction Industry Policy followed by the creation of the construction Industry Development fund that was intended to finance local SMCs .One of the construction industry policy's directions is to promote meaningful joint ventures and other forms of strategic alliances with foreign partners to ensure effective participation of local players in construction projects (Construction Industry Policy, 2003).

Quick survey which was done by contractors in Tanzania shows that the major projects are awarded to foreign contractors. Recent in 2010s Tanzania Bankers Association reported that, big contractors have easy access to finance due to number of factors such as management competence, adequate capital goods which act as a security and favorable bank track record. 2013's CRB report suggested that SMCs should consider either merging with foreign investors or forming consortium that is capable competing with the giants. The government through CRB and other regulatory boards has implemented the system of training, mentorship and meeting to provide technical and managerial skills of local contractors to empower them with requisite knowledge. Some tenders and works are confined to local contractors only. This encouraged local contractors to participate actively in the bidding.

The figure below shows the SMCs' Number, classes and their capacity to projects

SMCs Class	No of SMCs	Class limit for any single contract(In million Tshs)	
		Civil	Building
4	162	1500	1200
5	495	750	600***
6	858	300	200**
7	1053	150	120*

CRB, 2014

### 3. Small and Medium Enterprises (SME) and FDI linkages from previous research

Few evidence in literatures show the FDI's benefits to local firms especially Small and Medium Enterprises such as SMCs in Tanzania. For FDI to stimulate technical efficiency, technology transfer, and change in local firms, suppliers and clients it needs strong linkages between FDI and local firms. This is in turn calls for competitive firms, suppliers and clients that can engage with these rather sophisticated MNEs that undertake FDIs. Local content demands are important but not adequate if these local firms, suppliers and clients are not competent. Capacity building therefore as in the case for technology transfer is extremely important. (Honest Prosper Ngowi, 2012)

A United Nation Conference on Trade and Development (UNCTAD) study conducted in five countries including Uganda and South Africa indicates that FDI with the few exceptions are reluctant to cooperate with SME sector because of shortcomings such as lack of quality, high production costs and poor reliability and preference of cash transactions because of limited access to credit (UNCTAD 2006). Few papers have written about the FDI and SME linkages in Tanzania, the paper available have tried to explain the SME's shortcomings only which leave the FDI-SME linkage to be interested area to investigate. There will be an increasing of employment and wealth creation by local firms(SMEs), acceleration of knowledge transfer and technology upgrading, enhanced skills, standards and capacity, access to new domestic and foreign markets, attraction of additional foreign direct investment in 'cluster's effects, more diversified clients and market structures, more stable relationships to buyer or producer organizations, risk sharing through joint funding and/or operations, facilitation of access to finance and opportunities to innovate, upgrade and increase competitiveness( Jenkins, Akhalkatsi, Gardiner, 2007). There is significant evidence that the productivity of domestic firms is positive correlated with the presence of FDIs through productivity spillovers (Jarovick and Spatareanu, 2005)

Different authors have mentioned different programs of linkages which could bring FDI and SME's working together. These programs if well implemented will bring benefits to Foreign Investors and SME and change the SME's and FDI perceptions. Mentioned programs such as Value chain SME development linkage program, where SME can be in FDI's value chain with activities including manufacturing, subcontracting, outsourcing non-core functions and services, distribution and retail, franchising and leasing. Key to these programs is developing the capacity of SMEs to meet the needs of the large firms such as Foreign Companies. Another mentioned program is beyond the FDIs' value chain SME Development and Linkage Programs, this can reduce the SME's level of dependency if the foreign company leaves.( Beth Jenkins, Anna Akhalkatsi, Brad Roberts, Amanda Gardiner, 2007). UN, 2009 has mentioned mechanisms through which FDI partner with each other or other stakeholders to support business linkages and SME's development, often with the explicit goal of

overcoming some of the obstacles faced by SMEs. These mechanisms are linkages along individual company value chains, groups of companies in the same industry sector or location working collectively together, traditional trade and industry associations enhancing their capacity to better serve SMEs, joint public-private financing mechanism, dedicated small enterprise support centers and multi stakeholders public policy structure.(UN,2009). SME need to be at a level of development where it is realistic for them to engage in business relationship with larger multinational companies (UNCTAD, 2011).

Types of linkage according to UNCTAD are Backward Linkages with suppliers; when a FDI obtains goods and/or services (e.g parts, raw materials components, other inputs) from a domestic firm. These may range from transactions to close inter-firm cooperation. Forward linkages with buyers; are present when FDIs outsource the distribution of their goods and/or services to domestic firms or when FDIs provide extensive after sale services. And Horizontal linkages; represent linkages with competing domestic firms. This paper has concentrated in Backward Linkages where foreign investors can partner or link with Small and Medium Contractors to perform construction projects.

## **2. Objective of the study**

**2.1 General Objective**  
To assess the strategies to attract Foreign Investors to collaborate with Small and Medium Contractors

### **2.2 Specific Objectives**

- i. To assess strategies by measuring factors which motivate foreign investors to link with SMCs
- ii. To assess strategies by measuring factors which SMCs can be qualified being in operation with foreign investors
- iii. Assessing strategies by measuring factors which attract foreign investors to retain its partnership with SMCs

## **2. Research Methodology**

This study concentrates with a relatively unexplored area: Assess the strategies to attract FDI to Collaborate with SME through business linkages in construction industry in Tanzania.

### *2.1 Research Design*

The research design provide a framework for the collection, measurement and analysis of data(Cooper & Schindler,2011) A research design is the plan and structure of investigating so concerned as to obtain data to research questions(Kothari,2004).Since the study is an unexplored area it was felt that a mixed method of inquiry was considered the most appropriate to undertake a detailed investigation of the research questions, as it provides flexibility in the exploration, description and analysis of issues. Exploratory design is important especially if an area of investigation is new or vague and by carrying out an exploratory study the researcher learns and is able to define variables thoroughly.

### *2.2 Research/Target Population*

Population targeted were Foreign Investors who are in construction industry and are registered in CRB. Key respondents were top executives of 55 visited organizations. Only experienced top executives respondents were involved. Data collected in Dar-es-salaam area where most companies have their head quarters. According to Chandler 2003, population is the total collection of elements about which inferences are made and refers to all possible cases which are of interest for a study.

### *2.3 Data Collection Instruments*

Questionnaire which contained open ended and closed questions were used up to collect data from foreign companies. In questionnaires they are useful if you are unsure of the response such as exploratory research, when you require the detailed answer or when you want to find out what is upper most in the respondents' mind. (Saunders,2009) Opinion variables were used to collect data. Opinion variables record how respondents feel about something or what they think or believe is true or false (Mark Saunders, 2009). To reduce non-respondent rate in the research, each respondent was well informed of the purpose of the study and if keen in the topic was asked to fill in the questionnaires to help accomplish the purpose.

### *2.4 Sampling Technique*

55 first class foreign construction firms were included in the sample. The basic idea of sampling is that by sampling, some elements of the population, conclusions can be drawn, The ultimate test of a sample design is how well it presents the characteristics of the population it purports(Kothari,2004).Only first class foreign companies where entitled.

### 2.5 Method of Data Analysis

Descriptive statistics such as percentage, frequency, charts, and graphs were used to process the data collected.

### 3. Data Analysis, Result and Discussion

Questionnaires came up with the answer from only 50 companies which was 90% of all questionnaires. This was due to self administering which was done by the researcher. Questionnaires must be introduced carefully to the respondents to ensure a high respond rate (Saunders, 2007).

Based to questionnaires administered to foreign investors 9 factors/indexes used to find out if SMCs can qualify being in an operation with foreign investors and named Operational factors. It rated by the respondents from a scale of 1 to 5 with 1-not very important, 2-not important, 3-moderate, 4-important and 5-very important. 9 factors or indexes for motivation were used and rated by them in order of satisfaction which 5 presented very important, 4 presented important, 3 presented moderate, 2 presented not important whereby 1 presented not very important. Lastly were factors/indexes that can attract foreign investors to continue collaborating with SMCs. These rated by the respondents from a Likert scale of 1 to 3 which 1 was disagree, 2 agree and 3 strong agree. Researcher based the study on backward linkage to suppliers which seems to be most applicable in construction industry. Investors in construction industry looking for materials and labor sources and therefore most arrangements for subcontracting based on input materials, machinery services, supporting services, skilled and unskilled labors from local suppliers.

#### 3.1 Operational Factors

Operational factors or indexes are factors which if SMCs possess can qualify being in an operation with foreign construction Investors. Features were Inventory Cost Efficiency (ICE), Access to Specialization Skills (AS), Managerial Capability (MC), Technological Capability (TC), Supply Chain Organization (SCO), Institutional Capacity(IC), Work Standardization (WS), Market Information Skills (MIS) and Best Practice Guidelines (BPG).

#### *How important are the following factors for SMCs to qualify working with you in your operation?*

The figure below (figure 1) shown the results of operational factors which are giving SMCs chances to qualify being in an operation with foreign investors. The factors which foreign investors highly rated as very important factors were Work standardization (WS) rated by 40(80%) companies, Access to Specialization Skills(AS) by 39(78%) companies and Inventory Cost Efficiency(ICE) by 37(74%) companies. Best Practices Guidelines (BPG) and Technology Capability (TC) were rated important by 32(64%) companies. Managerial Capability (MC) and Market Information Skills (MIS) were rated important by 30(60%) companies. Institution Capacity(IC) rated important by 25(50%) companies whereby Supply Chain Organization (SCO) rated moderate by 25(50%) companies.

However, the not important and not very important weren't rated by majority of companies. Thus depicts that all operation factors/ indexes were of importance by most companies by being in very important to moderate rate only. For that reason according to the results obtained, 8 factors were accepted by the majority which was 89% of all factors assessed. This made the operational factors to be the key of all factors assessed. Foreign investors suggested SMCs to attend professional training which remind of work standards for them to become competent. Specialization Skills are of importance due to the fact that most construction tasks have repetitive nature but important, and it was suggested that it's for the best for small contractors to specialize and never jump from one specialization to the other for example from electrical installation to welding etc. Foreign investors' suggestion advocated that, they have much concern on cost efficiency and they are satisfied with Small contractors which have their practice guidelines of their own which reveal their level of professionalism. Although most local contractors believe technology spillover transfers from FDI to local enterprises, but it acts different if its collaboration especially subcontracting. They have explained the reason behind this is most of big projects funded by banks, e.g World Bank, and Africa Development Bank (ADB) which follows Federation Internationale Des Ingenieurs Conseils (FIDIC) (in French) contracts guidelines. This translated as the International Federation of Consulting Engineers and it represents both globally and domestically. The projects defined as big are economy infrastructures such as roads, bridges and dams example Bus Rapid Transit infrastructure which awarded to Strabag International which worth Euro134.4m. The FIDIC contract guideline has strict procedures to follow, qualifications of subcontractors and penalties associated with negligence. The negligence done by subcontractors can affect the main contractor or the whole project life. All these facts which mentioned by Foreign investors have been the reasons of them being selective or end up implementing the whole projects by themselves. Managerial Capability(MC) and Institutional Capacity(IC) have mentioned of importance due to the reasons explained as to be sure of people they are working with and if they real available for the job. Some SMCs have presentable profile but during task execution most of people mentioned on their profile are not available on site. Investors have mentioned these and suggested these are among of reasons of low performance and work delay. To add weight on investors' concern in FIDIC conditions of contract for

construction 4.4 analyzed subcontractors condition that, the contractor shall be responsible for the acts or defaults of any subcontractors, his agents or employees as if they were the acts or default of the contractor.(FIDIC 2010). Therefore by this kind of FIDIC condition, precautions have been taken prior to the project commencement.

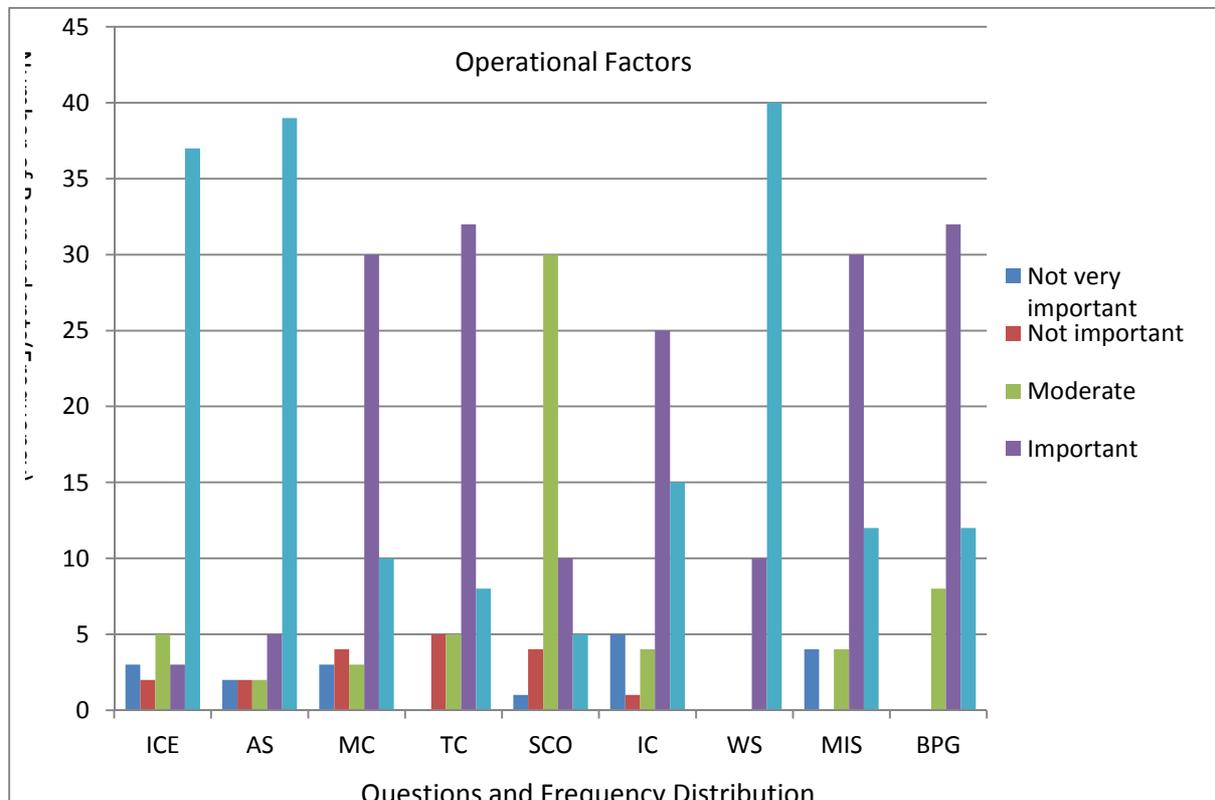


Figure 1

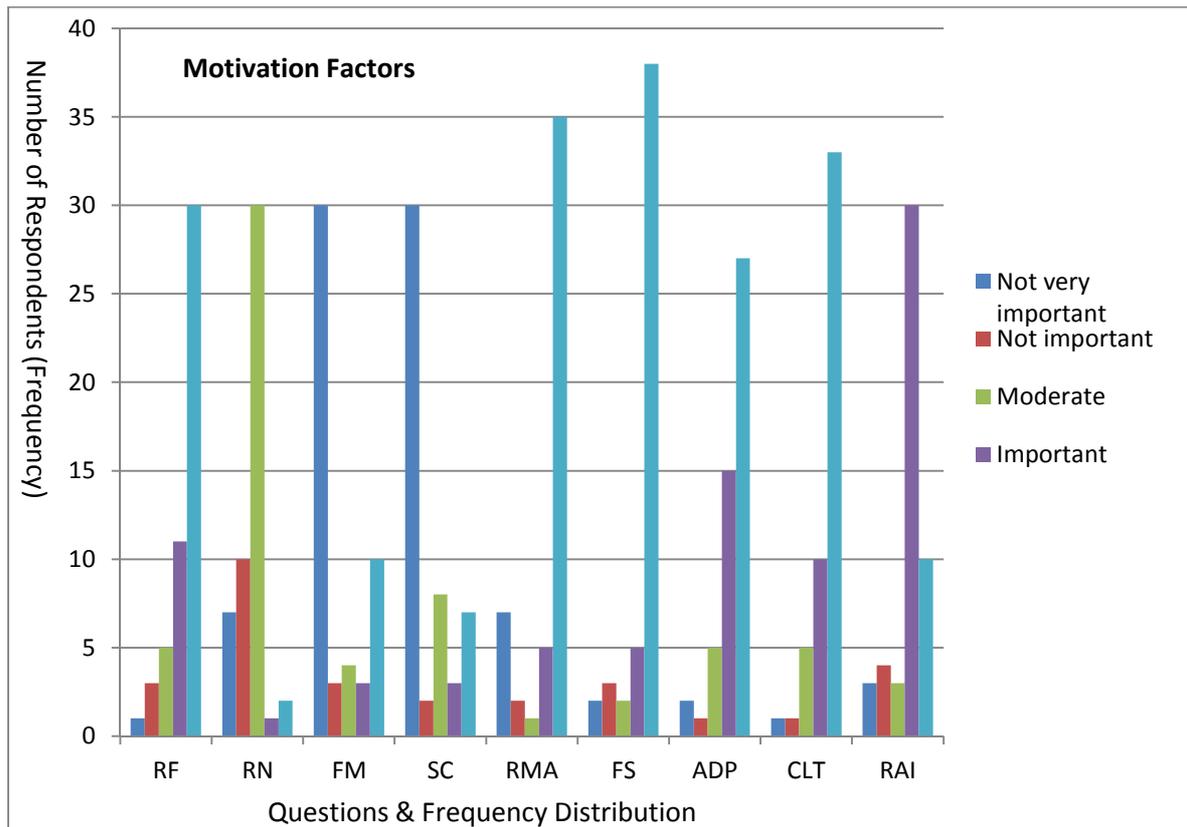
### 3.2 Motivation Factors

Motivation factors are factors which motivated foreign Construction companies to link with SMCs. Motivation features were Resource Foundation (RF), Relationship Network (RN), Following Markets (FM), Strategic Consideration (SC), Raw materials Accessibility (RMA), Financial Sound (FS), Appropriate Delivery Practices (ADP), Culture of Long Term Thinking (CLT) and Reliable and Actionable Informer (RAI).

#### How important are the following factors motivated you collaborate with SMCs?

The figure 3.2 depicts the indexes or factors of motivation and the role each Foreign Investors declared that through those higher rated factors if well implemented with SMCs will motivate and influence to collaborate with them. Out of 50 Foreign Construction Companies, the highest number rated Financial Sound (FS) factor or index as very crucial from 38(76%) respondents as the highest, thus the firm with unsound credit ability would be challenged and very difficult to win subcontract or partner on projects with them. Resources Foundation (RF), Raw Material Accessibility (RMA), Appropriate Delivery Practices (ADP) and Culture of Long term thinking (CLT) factors are also very important with higher rates from 30(60%), 35(70%), 27(54%), 33(66%) companies respectively. Moreover, Reliable and Actionable Informers (RAI) rated important with 30(60%) companies and Relationship Network (RN) rated by 30(60%) respondents as moderate.

Nevertheless, under the not very important option, Following Markets and Strategic Consideration received the highest of 30(60%) respondents each said not very important. Therefore, out of nine factors/indexes, six were important factors accepted by majority number of investors which are 67% of all motivation factors assessed. Investors addressed the requirements and needs during construction project period such as site materials which most of them dependent on competent suppliers in the country. That motivates them to collaborate with Small contractors who are financially stable and have professional arrangements of materials delivery which have to be in standard and on time. In additional to their motivation opinion they have agreed on the fact that local suppliers can be the good source of labors and materials and it motivates if these suppliers have culture of long term thinking and reliable.



**Figure 2 Motivation Factors**

### 3.3 Attractive Factors

These factors sat up to access which factors are attracted to foreign investors to continue its collaboration with SMCs. Likewise 9 factors were introduced for investors to rate according to their opinion. The feature for attractive factors are Access Local Knowledge(ALN), Special Investment Policy Treatment(SIP), Reliability and Price(RP), Political Stability(PS), Mutual Trust and Integrity(MTI), Information on Opportunities, Construction Industry Policy(CIP), Access Local Fund(ALF), and Productivity of Local Firms(PLF).

#### *Are the following factors attracted you to continue collaborate with SMCs?*

The figure 3 below shows the factors or indexes that can attract foreign investors to continue collaborate with SMCs in construction industry in Tanzania. The figure 3.3 below indicates that out of 50 respondents, 45(90%) strongly agreed on Political Stability (PS), 43(86%) strongly agreed on Mutual Trust and Integrity (MTI), 41(82%) strongly agreed on Productivity of Local Firms (PLF), 40(80%) strongly agreed on Reliability and Price (RP) and 39 strongly agreed on Access Local Knowledge (ALK). 30(60%) respondents just agreed on Information on Opportunities. However majority disagreed by Construction Industry Policy (CIP), Access Local Funds (ALF) and Special Investment Policy Treatment (SIP) by 46(92%), 45(90%), 30(60%) rate respectively. Therefore based on nine factor/indexes suggested, only five got strongly agreed by big number of investors which is 57% of all factors assessed. Political stability is every FDI determinant and it has given high rate (86%) due to its importance. Being attracted to remain in business with Small contractors was defined by investors as stable market maintenance. Investors admitted that it is not easy to establish a lasting business relationship and enjoy mutual interest with local contractors who lack trust and integrity. This has given high priority along with political stability, local firms' productivity reliability and price efficiency. They prefer and being attracted to continue working with Small contractors who meet their standards of quality and reliable. Investors strong disagree with the special investment policy treatment as the one influence them working with Small contractors as well as Construction industry policy. Investors showed their willingness to participate in linkage programmes with small and medium contractors with modern standard of operations, management and quality control as they insisted to be working under tough international contract agreement(FIDIC) in most of their projects.

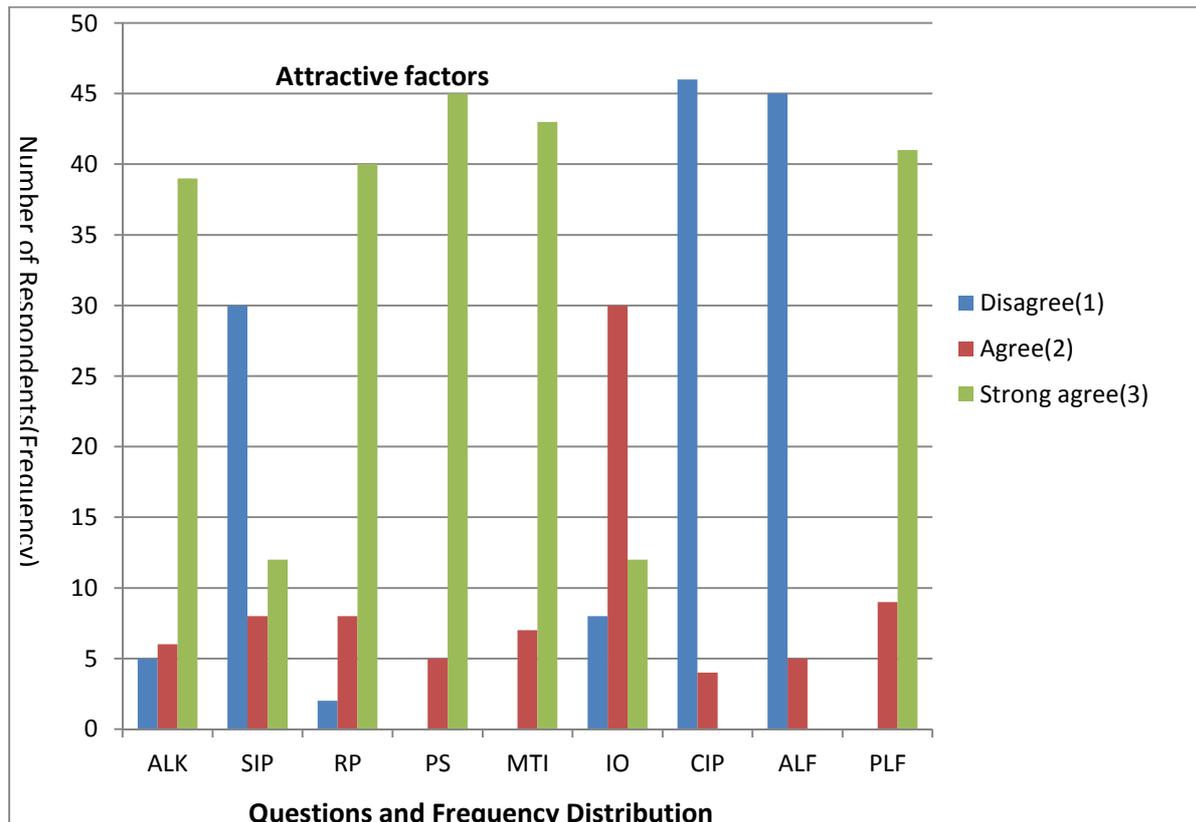


Fig 3

#### 4. Conclusions and Recommendations

Despite the constraints SME in general face, for them to qualify being in linkage with foreign investors need a lot of efforts. Most of them lack technical skills, specialization on the field, finance, managerial capability, institutional capacity and are technological lagging. These are disadvantage faced by these contractors due to the unfavorable business environment from procurement to fund sources. Most of foreign contractors are from China and it's now common for them to empower each other through partnering instead of dealing with locals. Despite the fact that there is foreign and local joint concern in construction policy but the result has concluded that Tanzania policies both investment policy and Construction policy have never be a key driver for their linkage in business.

By looking at SMC's classes which are class four to seven, the projects which they are capable and allowed to handle by them are of 1,500,000,000Tshs to 150,000,000Tshs value. It's a night mare to contractors who are just from college to handle the project of 150,000,000Tshs if there is not any source of fund which can trust and assist. Therefore subsidy in equipments should be provided to SMCs who most of them established their enterprises straight from university/colleges. These equipments will be their starting capitals which will help them to win tenders, enhance their profile through won tenders and become competent enough to work with foreign investors. Non Governmental Organizations (NGOs) which deal with economic development should be established which can assist SMCs as it has been done with other countries such as China.

Special zones should be created all over Tanzania which should be under local contractors who will make sure all projects which are in those zone are giving chance to SMCs too. The government should stand for its people by establishing investment policies special for promoting linkage. Government should create conducive business environment for both foreign and local investors. I could imagine if CRB, the National Construction Council (NCC), Engineers Registration Board (ERB), Architect and Quantity Surveyors Registration Board (AQRB), Tanzania Building Agency (TBA), Tanzania Electrical Mechanical and Electronics Services Agency (TEMESA), Public Procurement Regulatory Authority (PPRA), and Procurement and Supplies Professionals and Technicians Board (PSPTB) would come up with good and consistent policy which promote local and foreign construction company to work together. This will be of assistance for Tanzania government to take action considering the situation which SMCs facing.

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