

**Determinants of Business Formalization in Singida Municipal Council,  
Tanzania**

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***Abstract***

*While Small and Medium Enterprises (SMEs) are recognized to be the engine of growth of the economy, most businesses continue to operate informally. There are competing arguments on prospects of business formalization. This study analysed the attitudes of business owners towards business formalization and determinants of such formalization among SMEs in Singida Municipality. The study adopted a cross-sectional research design, and a mixed-methods approach whereby both quantitative and qualitative data were collected. A sample of 200 SMEs owners were selected using Fisher's formula. Qualitative data were analysed using thematic content analysis with a constant comparison. Quantitative data were analysed with the aid of the Statistical Package for Social Sciences (SPSS) software whereby descriptive statistics were computed to obtain frequencies and percentage distributions of the responses. A five-point Likert scale was used to establish the level of attitude towards business formalization. Binary logistic regression was used to determine effects of predictors on chances of business formalization. It was found that education, age, sex, firm location, firm size, employment and access to credit were important predictors of business formalization ( $p < 0.005$ ). Many respondents (56.6%) had positive attitude on business formalization. Insufficient capital (30.1%) and high tax charges (21.7%) were the most frequently cited factors hindering business formalization. Prospects and factors enhancing business formalization in the area include: compliance with government directive which avoids disturbances from government law enforcers, growth of business, and easy access to credits which were mentioned by 27.7%, 16.9% and 15.7% respectively of the respondents as the most important factors enhancing business formalization. The study concludes that ability of business owners' to formalize their businesses is*

*influenced by their socio-economic characteristics as well as firm size and its location. It is, therefore, recommended that SMEs owners should be given more education on the prospects of business formalization and their obligatory need to pay taxes and other government levies. On the other hand, law enforcers on the compliance with tax payment should devise a friendly environment and encourage business operators to pay taxes in ways which do not harm or threaten their business growth and encourage informal business operations.*

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### **1.0 Introduction**

Business formalization is an important step towards the realization of sustainable development goal (SDG) number 8 that aims at achieving decent work and economic growth (Karst, 2004). Due to the fact that an informal economy has multiple forms of negative economic effects at both micro- and macro-levels; such as atrocious labour conditions, a poor tax basis, unsatisfactory social protection as well as hindering macro-economic growth as pointed out by (Brueck et al., 2006); governments across the world struggle to reduce the size of informal sector using various policy measures. Despite such efforts, evidence supports that many SMEs continue to operate informally, and therefore many policies and programmes around the world focused on reducing the size of the informal economy.

There are many efforts, policies and programmes to stimulate the formalization of informal enterprises. According to Schneider (2010), at the end of the first decade of the 21<sup>st</sup> Century, the size of the informal economy had shown a negative trend although it remained with an unweighted average value of 33% of official GDP. In recent years, in sub-Saharan Africa, many African countries have experienced economic growth restoration, but this has not necessarily generated decent jobs (AU, 2008). Unemployment remains high among youth and the adult African population. While many efforts have been made to ensure strengthening the informal sector's role in enhancing growth and job creation, less effort has been made on business formalization. It is a well-known fact that 55 per cent of Sub-Saharan Africa's GDP and 80 per cent of labour force are within the informal sector. Out of ten urban and rural workers in Africa, seven have informal jobs, most of them being youth and women. The importance of the informal sector in most African economies lies in the opportunities it gives to the most vulnerable populations, especially the poorest (Atchoarena and Paul, 2012).

Despite the fact that the informal sector enables many poor people to generate reasonable incomes, most of the workers in the sector remain without employment benefits, social protection and secure incomes. This explains why informality goes with poverty. For example, countries whose informality has been decreasing have witnessed a decrease in a number of working poor and vice versa. Governments across sub-Saharan Africa try to reduce the size of informal sector by designing and implementing various strategies regarding the formalization of informal enterprises (Atchoarena and Paul, 2012). It is widely accepted that a change from a large informal economy to a relatively large formal economy has numerous positive effects. Evidence shows that formalized enterprises perform better than informal ones, as they contribute to increase in GDP levels and growth rates (World Bank, 2017). Such a transition will lead to higher labour productivity and hence benefit a good number of employees in terms of higher wages and better working conditions. There will be a rise in a country's tax incomes which can be utilized in funding numerous public programmes. The general attitude towards government will be improved as a result of transition from an informal to a formal economy and hence improve the intention to comply with formalization regulations (Almeida and Carneiro, 2015).

In the Tanzanian context, formalization of business is increasingly becoming a significant requirement in seeking to improve economies and livelihood on a meaningful inclusive sustainable basis. Tanzania struggles to implement socio-economic development strategies intended to make her a semi-industrialized, middle income economy in line with the National Development Vision (TDV) 2025 (URT, 2007). The SME sector is growing as it possesses the highest employment potential in Tanzania; the sector is largely informal and in need of considerable assistance to overcome the entrenched disadvantages and barriers to be a formal economy (Claussen et al., 2018). Lack of suitable wage jobs and poor social security systems leads many people to starting a small, informal enterprise as the main means of survival and not because they want to become entrepreneurs. In Tanzania, all businesses are regarded as informal as far as they are not registered with Business Registration and Licensing Agency (BRELA). Not only that, but also every business, regardless of its size and ownership, is required to comply with a number of agencies (Gardner, 2014). Major efforts to reduce business informality has been placed on business education and training, sharing of knowledge and experience among businesses, increasing capital availability as well as access to new markets so as to enhance growth of small businesses and increase in their contribution to the national economy (World Bank, 2016).

Empirically, determinants of business formalization are controversial (Cling et al., 2012; William and Shahid (2014). Studies by Williams and Shahid (2014) indicated a positive relationship between business experience and formalization while studies by Cling et al. (2014) in Vietnam indicated no relationship between business experiences and its formalization. Likewise, studies in Pakistan by Cling et al. (2012) indicated a positive relationship between being male business owner and possibility of formalization of the business as well as owners' motivation, while studies conducted by Williams and Shahid (2014) in Pakistan indicated no relationship between sex and motivation of the business owner on business formalization. Based on the contending observations, it can be surmised that the contradicting results are due to contextual differences due to traditions and culture, values, business undertaking and levels of institutional development that provide incentives for formalization (Nelson, 2005).

Most of the research on which the above empirical literature was based was conducted in Asian countries which differ from African countries in terms of firm development and cultural backgrounds. Related studies which were conducted in African countries, including South Africa and Tanzania, include studies by Nelson and De Bruijn (2005) and Charman et al. (2013). These studies' findings cannot be generalized or guide interventions on business formalization in Africa, particularly in Tanzania, because they were based on a few business owners' attributes and were mainly qualitative in nature. Based on the foregoing introduction and background, it is clear that the determinants of business formalization are complex, diverse and context-specific. The analysis of business formalization in developing countries must take into account this diversity, and contexts in which businesses operate. Therefore, context-specific studies are necessary to contribute to the debate and enhance our understanding of the determinants of business formalization. This is critical when designing policy interventions to formalize businesses. Such divergent views call for more empirical evidence from as many locations as possible.

This study adopted the action research approach to examine determinants of SMEs formalization. The study was guided by the rational choice model which explains that all social and economic activities, including business formalization, are rationally motivated, and hence that people calculate the likely costs and benefits of any action before deciding what to do. Proponents of the theory posit that socio-economic interaction takes the form of exchange system that explores the social behaviour on how two parties that implement a cost-benefit analysis to decide risks and benefits interacts (Scott, 2000). Therefore, as per the rational choice theory, it was expected that formalization would be an exchange

transaction between the government and business operators, in the sense that the government offers informal operators rights and protection gained by registering or licensing lawful activities, as well as investment in infrastructure that facilitates business success and growth whose benefits the Government would in turn reap through more tax collection. The informal operators in the exchange agree to comply with state regulations and laws when running enterprises, including payment of taxes (Nelson, 2003). The theory is relevant to this study because it helps in explaining socio-economic determinants such as age, sex, owners' experiences, education, firm size and motivation to establish factors which influence business owners' ability to formalize their businesses. To contribute to the existing body of knowledge, this paper therefore assesses the determinants of business formalization in Singida Municipality.

## 2.0 Methodology

The study was conducted in Singida Municipal Council in Singida Region. The region was selected because it is one among the municipal councils which have, in recent years, developed from being dormant to being vibrant metropolitan towns with many businesses the majority of which operate informally. The study adopted a cross-sectional research design, which, according to Creswell (2014), allows data to be collected from multiple cases at one point in time and enables comparison of variables. Furthermore, the study adopted action research which involves SMEs owners and practitioners. The study also applied a mixed-methods approach in data collection utilizing both qualitative and quantitative data. This approach provided robust evidence to substantiate the conclusions and recommendations for the objectives of the study.

The sample size for the study was 200 business owners. The choice of this figure was based on the simple formula of selecting sample sizes according to Fisher et al. (1991) for a population which exceeds 10,000 as detailed below.

The simple formula used:

$$n = \frac{Z^2 pq}{d^2}$$

Where: n = sample size when the population is greater than 10,000; Z = Standard normal deviate, set at 1.96 (or simply 2.0) corresponding to 95% confidence level; p = proportion in the target population estimate to have a particular characteristic (if not known use 50%); q = 1.0 – P; and d = degree of accuracy desired, set at 0.05 or 0.02.

Therefore, the sample size was:

$$n = \frac{Z^2 pq}{d^2} = \frac{(2)^2 (0.50 \times 0.50)}{(0.05)^2} = \frac{4 \times 0.25}{0.0025} = \frac{1}{0.0025} = 200 \text{ respondents.}$$

Due to non-responses and incompleteness of some questionnaire copies, the study ended up with 166 SMEs owners who were randomly selected from 18 wards of Singida Municipality. Moreover, 18 Ward Executive Officers and four market leaders were selected for interview.

Primary data were collected through key informant interviews, Focus Group Discussions (FGD) and administration of a questionnaire. Secondary data were obtained from published and unpublished documents including those from Singida Municipal Council business department offices. Qualitative data were analysed by using thematic analysis with a constant comparison; data were coded, and conclusions were drawn based on themes of the study. A total of Five FGDs with a total of 30 (17 Male and 13 Female) participants were conducted. Participants ranged from six to eight individuals per FGD. The selection of FGD participants was based on gender and age representation to capture age and gender specific views. Ten KIIs were involved including District Business Officer, three Ward Executive Officers (WEOs), and four Village Executive Officers (VEOs), two from businessmen associations.

Quantitative data were analysed with the aid of the Statistical Package for Social Sciences (SPSS) software whereby descriptive statistics were computed to obtain frequencies and percentage distributions of the responses. Binary Logistic Regression was used to analyse effects of determinants of business formalization on chances of business formalisation. The explanatory variables which were entered in the model were those informed by empirical literature review and theoretical review. The model used was:

$$\text{Logit}(p_i) = \log(p_i/1-p_i) = b_0 + b_1X_1 + b_2X_2 + \dots + b_{12}X_{12} + \mu_i \text{ (Agresti and Finlay, 2009)}$$

Where:

Logit (pi) = ln (odds (event), that is the natural log of the odds of an event occurring

pi = prob (event), that is the probability that business owners will formalize business

1-pi = prob (non-event), that is the probability that the respondent will not formalize business

$b_0$  = constant of the equation,

$b_1$  to  $b_{11}$  = coefficients of the independent (predictor, response) variables

$k$  = number of independent variables

$x_1$  to  $x_{12}$  = independent variables entered in the model

$X_1$  = Age (measured in years)

$X_2$  = Household headship (1 if male headed household, 0 if otherwise)

$X_3$  = Years of schooling (measured in years)

$X_4$  = Access to credit (1=access and 0 =no access)

$X_5$  = Marital status (1 if married, 0 if otherwise)

$X_6$  = Firm Size (measured in number of employees)

$X_7$  = Firm location ( 1 if located in commercial area, 0 if otherwise)

$X_8$  = Firm age (measured in years since establishment) and

$X_9$  = Motivation to establish business (1 if capital , 0 if otherwise)

$X_{10}$  = Employment (1 if self-employed, 0 if otherwise)

A Summated Index Scale was used to measure attitudes of SMEs to engage in formal business using a five-point. Responses to the items that comprised the scale ranged from 1 to 5 scores such that: Strongly disagreed (1), Disagreed (2), Neutral (3), Agree (4) or Strongly agree (5). Medians and standard deviation were used to establish the cut-off points and categorization into low, medium and high attitude towards business formalization. Inferential statistics involved an ordinal logistic regression model to predict chances of business formalisation. The model was used because the outcome variable was a dummy.

### **3.0 Results and Discussion**

#### **3.1 Socio-Demographic Characteristics of the Business Owners**

Socio-demographic characteristics are known to affect one's business decisions. It was therefore necessary to investigate social and demographic characteristics of the respondents so as to link them with the respondents' awareness and readiness to formalize their businesses. The findings, as presented in Table 1, show that very few respondents (1.8%) were aged below 20 years 10.8% were 46 years old and above, while the rest of the respondents were aged between 21 years and 45 years. Moreover, 38.6% of the respondents were female while 61.4 % were male. Half of all the respondents (50%) were single; 44.6% were married; and 3.0% were widows/ widowers whereas 2.4% were divorced. In terms of educational attainment, 39% of respondents had primary school education; 34.1% had secondary education; 14.6 % had vocational training; 9.1% had university level education; and 3.0% had no formal education.

In terms of occupation, 81.9% of the respondents were business men and women; 3.6% of the respondents, despite having small businesses, were agro pastoralism; 6.0% of the respondents had farming as their major occupation; 5.4% were employed; and 3.0% were engaged in other occupations such as fishing, hair plaiting, and being brokers. Another socio-demographic aspect was household size; it was found that 39.9% of the respondents had a family size of 1 to 3 people; 47.5% of the respondents had a family size of 4 to 7 people; 11.4 % of the respondents had a family size of 8 to 11 people; and 1.3 % of respondents had a family size of 12 and above members.

**Table 1: Socio-demographic variables (n = 166)**

<b>Variables</b>	<b>Frequency</b>	<b>Percent</b>
<b>Age (years)</b>		
<20	3	1.8
21-25	43	25.9
26-30	53	31.9
31-35	26	15.7
35-40	17	10.2
41-45	6	3.6
>46	18	10.8
<b>Sex</b>		
Female	64	38.6
Male	102	61.4
<b>Marital status</b>		
Single	83	50.0
Married	74	44.6
Widow/widower	5	3.0
Divorced	4	2.4
<b>Level of education</b>		
Primary	64	39.0
Secondary	56	34.1
Vocational Training	24	14.6
University level	15	9.1
Uneducated	5	3.0
<b>Occupation</b>		
Business	136	81.9
Pastoralist	6	3.6
Farmer	10	6.0
Employed	9	5.4
Other (specify)	5	3.0
<b>Household Size</b>		
1-3	63	39.9
4-7	75	47.5
8-11	18	11.4
12+	2	1.3

### 3.2 Respondents' Perception on Business Formalization

It was found that more than half of the respondents (56.6%) had a positive perception on business formalization (Table 2). The findings compare well with ones reported by Ndili (2020) who found positive attitude towards business formalization and that formalization has a significant impact on profitability thereby leading to increase in access to credits from formal institutions and hence increase in customer retention.

**Table 2: Attitude Categorized (n=166)**

Level/perception of attitude	Frequency	Per cent
Negative	46	27.7
Neutral	26	15.7
Positive	94	56.6
Total	166	100.0

Whereas 15.7% of the respondents had a neutral attitude towards business formalization, 27.7 % of the respondents had a negative attitude towards the same undertaking. This compares with findings reported by Rand and Torm (2010) and Mwaipopo (2020) who found that SMEs formalization is a conscious choice among SMEs owners due to unsupportive formal environment, characterized by high tax burdens, social security contributions, and unclear regulations in the process of registration.

**Table 3 Attitude towards business formalization (n=166)**

Attitudinal statement	Disagree	Undecided	Agree
Formal business is as profitable as informal business	51.2	26.5	22.3
It is possible for SMEs' to stabilize through formal business	21.1	26.5	52.4
Available regulation for SMEs' participation in formal business are well known	25.9	39.8	34.3
Informal business is among the top sectors which the SMEs' would choose to engage in.	44.0	25.9	30.1
Transition from informal to formal economy could improve the general attitude towards government regulations	11.5	23.0	65.5

### 3.3 Factors Hindering Business Formalization

The factors perceived to hinder business formalization are presented in Table 4. The most common ones mentioned by the respondents were lack of insufficient capital (30.1%) and high tax charges (21.7%). The least popular factors mentioned in the study were fund transfers, price fluctuation and issues related

to provision of business identity cards (0.6%) The findings of the study on this aspect compare well with those reported by Ndili (2020) who found that SMEs owners do not register their businesses due to limited affordability caused by high costs involved in the formalization process.

**Table 4 Factors Hindering business formalization (n=166)**

<b>Factor</b>	<b>Frequency</b>	<b>Percent</b>
Insufficient capital and small scale business	50	30.1
High tax charges	36	21.7
Lack of education and awareness on benefits of business formalization	18	10.8
Low incomes	12	7.2
Unfriendly business environment (absence of permanent markets)	11	6.6
Tax evasion	10	6.0
Poor business performance in the market	8	4.8
Time consuming business formalization procedures	7	4.2
Unfavourable tax policies	4	2.4
Small size of a business	2	1.2
Little incomes	2	1.2
Negligence	2	1.2
It limits ability to transfer a business to another location	1	0.6
changes in tax payment systems	1	0.6
Price fluctuations	1	0.6
Delay in provision of entrepreneurs identity cards	1	0.6
<b>Total</b>	<b>166</b>	<b>100.0</b>

Slightly more than one-fifth (21.7%) of the respondents perceived high tax charges as a hindering factor for business formalization, while 10.8% of the respondents perceived lack of education and awareness on benefits of business formalization as factors hindering business formalization. These findings support findings by Ndili (2020) that SMEs formalization is constrained by barriers such as high registration costs, long distances covered to access the services, complex formalization procedures, and long time taken to formalize a business. A similar observation was made during an FGD when the participants at Ubungo centre made the following statement:

“Our effort to formalize our businesses is hindered by high taxes, little profit, small sizes of our businesses, lack of permanent area to locate our businesses and unclear business formalization procedures. Hence, we feel that we are not valued by our government as the government would have supported us to formalize our businesses” (Male FGD participants, Ubungo centre, 6<sup>th</sup> July 2022).

This means that insufficient capital and higher tax charges are the main factors hindering business formalization by business owners.

### 3.4 Factors Enhancing Business Formalization

The factors perceived to enhance business formalization are presented in Table 5, where compliance with the government directive to avoid disturbances from government law enforcers, growth of business, and easy access to credits were the most important factors which were mentioned by 27.7%, 16.9% and 15.7% respectively of the respondents. Similar findings have also been reported by Ishengoma (2018). Business formalization offers freedom from embarrassment and corruption, and instead increases access to business development services. The study also found that 16.9% of the respondents perceived that business formalization leads to satisfying growth of a business.

**Table 5: Factors enhancing business formalization (n = 166)**

Factor	Frequency	Percent
To avoid disturbances from government authorities	46	27.7
Satisfying growth of a business	28	16.9
To easy access to credits	26	15.7
To earn recognition and have permanent area for business	13	7.8
Efforts that have been made to educate entrepreneurs on the importance of business formalization.	11	6.6
To enhance business growth	9	5.4
Supportive business related policies	8	4.8
A formalized business is perceived as ethical/ legal business	6	3.6
Awareness on the importance of business formalization.	5	3.0
To adhere to government directives.	6	3.6
Tax payments	3	1.8
Favourable tax policies	2	1.2
To ensure security to a business	2	1.2
Provision of identity cards to small entrepreneurs	1	0.6
<b>Total</b>	<b>166</b>	<b>100.0</b>

The study also found that 15.7% of the respondents perceived that business formalization leads to easy access to credits. This supports Rand et al. (2020) who established that formalization creates property rights to the business owners that is useful in accessing credits from formal financial institutions which in turn leads to more investments to expand the business, resulting in better business performance. 7.8% of respondents perceived that business formalization helps to earn recognition and have permanent area for business. Formalized business easily accesses business development services including finance (loans, grants, and subsidies), opportunities in public procurement, management support and freedom to cooperate with other business partners and earns state protection.

### 3.5 Prospects of Business Formalization among SMEs

The findings on the prospects of the business formalization are presented in Table 6 where it is reported that the three most important advantages of formalizing business were: avoiding disturbances from government officials (32.7 %), recognition by government officials (19.4%) and higher chances of business performance (18.8%). The findings reported in this study are similar to what has been reported by Ishengoma (2018). The author further reported that business formalization offers freedom from embarrassment and corruption, and instead increases access to business development services.

**Table 6 Prospects of business formalization among SMEs (n=166)**

Factor	Frequency	Percent
Avoids disturbances from government authorities and increases entrepreneurs' comfort	54	32.7
To earn recognition from government and other stakeholders	32	19.4
Leads to good performance of a particular business.	31	18.8
Increase in government revenues	22	13.3
Ensure business security	7	4.2
Having a permanent area allocated by government for business	6	3.6
easy access to credits	6	3.6
No benefit due to high taxes	3	1.8
Helps an entrepreneur to reach his/her goals	2	1.2
helps to conduct business legally	2	1.2
<b>Total</b>	<b>166</b>	<b>100.0</b>

The least common advantages of business formalization mentioned by the respondents include: easy access to credit, enabling one to reach higher level goals, and helping one in conducting business in free environment. Findings reported from FGDs were similar to those reported in individual interviews on prospects of business formalization; FGD participants at Namfua business area said:

“Business formalization allows business owners to avoid disturbance from government officials, ensure business security, increases comfort of doing business and helps business owners to access credits from financial institutions. However, many business owners do not see the prospects of formalizing their businesses” (Male FGD participants, Namfua business area, July, 2022).

This quotation implies that, despite prospects for business formalization, business owners are still reluctant to formalize their businesses.

### 3.6 Determinants/Predictors of Business Formalization

Binary logistic regression was used to model the selected variables and business formalization, and the results are resented in Table 7. The results show that, among the ten (10) variables, seven (age of the business owner, firm owner’s education, business owner’s sex, firm access to credit, firm location, firm owner’s employment, and firm size) were more important predictors of chances of business formalization  $p < 0.05$ ). The strongest predictor was business owner employment ( $p = 0.000$ ). The findings in Table 7 indicate that the Hosmer and Lemeshow test showed a Chi-square statistics of 3.235 ( $p = 0.598$ ). This means that the overall model predicted the outcome well because the Hosmer and Lemeshow test Chi-square was not significant (Field, 2013). The findings show further that Nagelkerke pseudo  $R^2$  statistics which represents the adjusted Cox and Snell Pseudo  $R^2$  statistics was 0.596, which implies that 59.6% of the variance in business formalization was explained by the independent variables that were entered in the model. Because the Omnibus Chi-square was significant ( $p = 0.001$ ), the overall model predicted the outcome well (Field, 2013). Wald coefficients associated with individual independent variables help us realize the relative importance of each independent variable. A greater Wald statistic implies that the independent variable associated with it has a higher contribution to the happening of the dependent variable. In Table 7, the Wald statistic value of firm location which was  $Wald = 29.167$  was the maximum and statistically significant at  $p \leq 0.000$ . Also, Firm- owner’s education that had a Wald statistic value of 22.071 was the second highest and statistically significant at  $p \leq 0.000$ . The implication of this finding is that the Firm owner’s education increases the likelihood of business formalization .

**Table 7: Determinants of business formalization (n=166)**

Variables	Coefficient (B)	S.E.	Wald	Sig.	Exp (B)
Age of the business owner	0.063*	0.015	18.425	0.000	0.930
Business owner marital status	-0.880	0.525	2.810	0.094	0.415
Firm size	0.039	0.070	0.316	0.574	1.040
Firm owner’s education	1.979*	0.421	22.071	0.000	7.362
Business owner’s sex	1.370**	0.429	10.214	0.001	3.493
Firm access to credit	1.744*	0.492	12.534	0.000	0.157
Firm owner Motivation	0.034	0.127	0.071	0.790	1.034
Firm location	0.145*	0.027	29.167	0.000	0.856
Firm owner’s employment	-0.000**	0.000	5.797	0.016	1.000
Firm size	0.232	0.067	11.823	0.001	0.739

Omnibus Tests of Model Coefficients (Chi-square = 171.128, Sig. = 0.000); Cox & Snell R Square = 0.366, Hosmer and Lemeshow Test (Chi-square = 3.235, Sig. = 0.598); Nagelkerke R Square = 0.596; \*and \*\* indicate levels of significance at 0.1%, 1% and 5% respectively

The relationship of age of the business owner and business formalization in Table 7 was found to be statistically significant ( $p = 0.000$ ) implying that the age of the business owner was a significant predictor of the owner formalization of the business. The finding also indicates that if the age of the business owner increased by one unit, chances of business formalization increased by 0.930 units as indicated by the odds ratio which was 0.930. This implies that business owners with more age (one year older) were 0.930 more likely to formalize their business. This result affirms the contention that business owners may start running their business informally to test the business acceptance before making decision to formalize them (Nelson & De Bruijn, 2005; Williams & Nadin, 2013; Williams & Shahid, 2014). This result supports previous findings by Williams and Shahid (2014) and Ishengoma (2018) who reported that, as the number of years of business operations increase, the change of business formalization increase also.

Sex of the business owner significantly influenced household chances of formalizing business. The findings indicate further that if male had to formalize their business the odds ratio was to be 3.934 times, implying that the business owned by male had 3.493 times chances as those female owned businesses. This finding implies that male business owners are more likely than female to formalize their businesses. The findings correspond with those in a study by Cling et al. (2012) but contradict previous findings by Williams and Shahid (2014).

Firm owners' years of schooling was found to have a positive significant influence on the likelihood of a firm owner to formalize their businesses. The findings indicate that the odds ratio for years of schooling was 7.362, implying that more educated firm owners' were 7.362 times more likely to formalize their business. This implies that more educated business owners are more likely to understand and follow business formalization procedures and requirements than those with no formal education. More educated business owners are expected to be more aware of business operation techniques as well as cash flow management which eventually improve business performance. The findings of this study compare well with other scholars' findings in small and medium enterprises studies. For example, World Bank study (2016) reported that key actions for business performance have been business education and training, working

together with other businesses and accessing capital and new markets so as to increase the opportunities for small businesses to grow and contribute to the national economy. During an interview with a trader officer, he claimed that businesses which were performing well were those owned by individuals who had been attending trainings. The key informant reported the following:

“I have seen differences between when there was no education to business owners and when there is good education. When the traders attend training sessions, business will improve than previously when there was no such education” Female Key informant, Gineri centre, 18<sup>th</sup> June 2022).

FGD Participants also confirmed that lack of education on business formalization was hindering their effort to improve performance of their business.

“We are unable to improve our businesses as we have not yet formalized them. The reasons for that is that we lack education on business formalization procedures which could help us to formalize our businesses and hence improve performance of our businesses. ” Female FGD Participants, Gineri centre, 25<sup>th</sup> June 2022).

This quotation implies that education is very important in improving business performance. Similar findings were reported in other studies by Cling et al. (2012); Williams and Shahid (2014) and Ishengoma (2018) who established that business owners’ education positively affects business formalization.

The results revealed further that access to credit exerted a positive and statistically significant effect on chances of business owners to formalize their businesses. The findings indicated further that the odds ratio for access to credit were 0.157, implying that business owners with access to credit were 0.157 less likely to formalize their business. This might suggest that business owners with more credits tend to reduce time and cost of formalization process.

A similar observation was made in focus group discussions and FGD participants agreed as follows:

“Formalization of business makes their owners avoid disturbances from government officials and penalties. It also helps business owners to access credit as well as ensuring business security and enhance access to permanent areas for doing business” (Female FGD Participants, Bus stand business centre, 11<sup>th</sup> July 2022).

These findings concur with those reported by Guma (2015).

Firm location showed a positive and statistically significant influence on the possibilities of business formalization. The findings revealed further that when location is at a commercial area, the odds ratio became 0.856, implying that businesses located at a commercial area are 0.856 times less likely to be formalized. Locating business in commercial area means the business owners will be required to follow business procedures as stipulated by government authorities; similar results were also reported by Williams and Nadin (2013) and Ishengoma (2018). The land size owned significantly influenced household participation in the out-grower scheme. The findings revealed that when the firm size increased by one unit, the odds ratio increased by 0.739, implying that households with large land sizes were 0.739 times more likely to formalize their businesses. A possible explanation to this could be that firm with large size have the opportunity of growing large. Large firm size also implies that the firm owner can diversify into other business opportunities and reduce the inherent risk in running one kind of business. As reported by Ishengoma (2018), the larger the firm size, the higher the possibility of business formalization.

Likewise, firm owner's employment had significant negative effect on business formalization. The odds ratio for asset ownership was 1.000, suggesting that for every unit increase in the firm owner being self-employed, there would be no change on the business owner's likelihood to formalize their businesses. It was anticipated that, since business ownership is one of income generating activities, firm owners who are self-employed could have higher chances of formalizing their businesses. The results also suggest that business owners employed on a permanent basis increased their chances of formalizing their businesses. Similar findings were reported by Ishengoma (2018). Also, studies by Ishengoma (2004), Imai et al. (2010), Cling et al. (2012), and Rooyen et al. (2012) reported that self-employed business owners may determine chances of business formalization. Therefore, it can be suggested that self-employed firm owners are less likely to formalize their business.

#### **4.0 Conclusion and recommendations**

Based on the study findings, it is concluded that ability to formalize businesses is influenced by firm characteristics and business owners' socio-economic characteristics. The majority of respondents had a positive attitude toward business formalization. The process of business formalization is still faced by many challenges, including bureaucratic procedures and relatively low level of knowledge and practices from SMEs and MSMEs practitioners. There is a common perception among business operators that formalizing their SMEs exposes their small capitals to unavoidable high tax charges which limit growth

of their businesses. It is, therefore, recommended that SMEs owners should be given more education on the prospects of business formalization and their obligatory need to pay taxes and other government levies. On the other hand, law enforcers on the compliance for tax payment should devise a friendly environment and encourage business operators to pay taxes in a way that does not harm or threaten their business growth and encourage informal business operations.

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