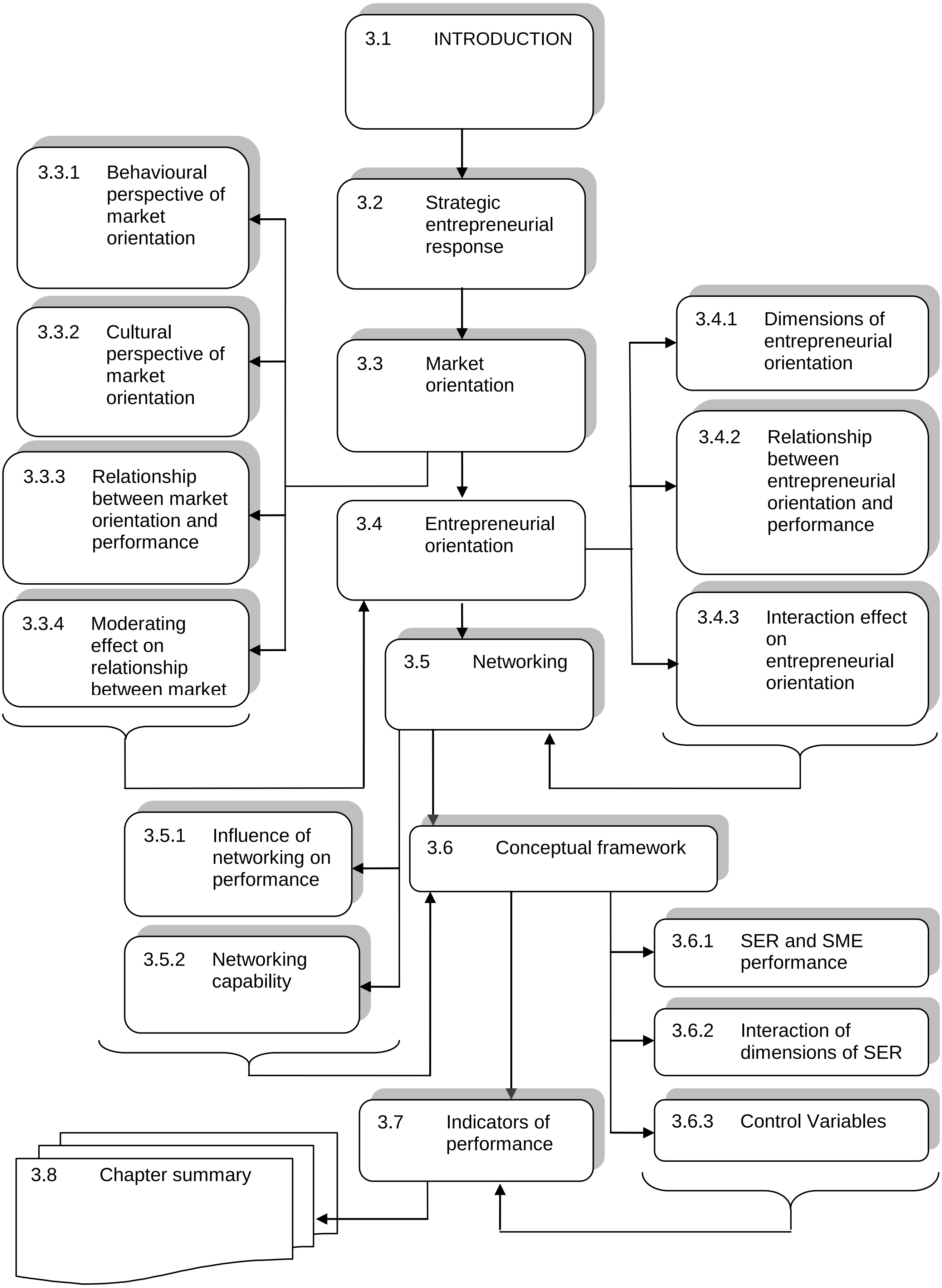
CHAPTER LAYOUT – CHAPTER THREE



CHAPTER THREE

3 STRATEGIC ENTREPRENEURIAL RESPONSE

3.1 INTRODUCTION

This chapter reviews relevant literature that seeks to examine the relationship between dimensions of strategic entrepreneurial response (SER) namely market orientation, entrepreneurial orientation, and networking capability on SME performance. It examines the possible influence of control variables in the relationship between dimensions of strategic entrepreneurial response and SME performance, presents the research conceptual framework and the possible contribution of the study in the entrepreneurship literature. The details of each construct, namely market orientation, entrepreneurial orientation, and networking capability and their relationship with SME performance are discussed.

3.2 STRATEGIC ENTREPRENEURIAL RESPONSE

The dynamic and competitive environment poses intense pressure on firms operating in this environment and firms have no choice but to face this reality. In the effort to address challenges of dynamic and competitive environment, strategic entrepreneurship emerged as an appropriate strategic orientation in which firms are required to acquire and practice simultaneously opportunity seeking behaviour and advantage seeking behaviour, in order to attain superior performance and wealth creation (Ireland *et al.,* 2003a:963; Ketchen *et al.,* 2007:371). According to Ireland (2007:9) and Ireland *et al.* (2003a:966) opportunity seeking behaviour is an entrepreneurial behaviour associated with identification and exploitation of the entrepreneurial opportunities, while advantage seeking behaviour is the component of strategic management intended to sustain competitive advantage. From this context, the intersection of entrepreneurship and strategic management result into strategic entrepreneurship that enable firms to respond to the current environmental changes and sustaining competitive advantage for the future (Ireland & Webb, 2007b:50).

Deriving from strategic entrepreneurship, the concept of strategic entrepreneurial response in this study is developed based on the interaction between SMEs and the environment in which they operate and the way SMEs respond through simultaneous opportunity-seeking and advantage-seeking behaviours to cope with the changes taking place (Ketchen *et al*., 2007:373; Ireland, 2007:9; Ireland *et al*., 2003a:966). Figure 3.1 presents a conceptual framework, which shows the interaction of SME's and environmental forces. In real life SMEs operate in an open environment whereby they are confronted by several environmental forces. These forces can be summarised into four main categories namely: customer behaviour, competitive actions, technological dynamics, and regulatory environment. In a competitive environment, as in the case of an open market economy, these forces are dynamic and keep changing at a fast pace (Kuratko & Audretsch, 2009:7), which create big pressures on SMEs. The survival of SMEs in such an environment depends on how they respond to these forces and to attain competitive advantage that leads to performance. In this view, firms need to have a system to monitor customer behaviour, competitor's actions, technological dynamics, regulatory environment, and adjust inter-functional operations to respond to these forces.

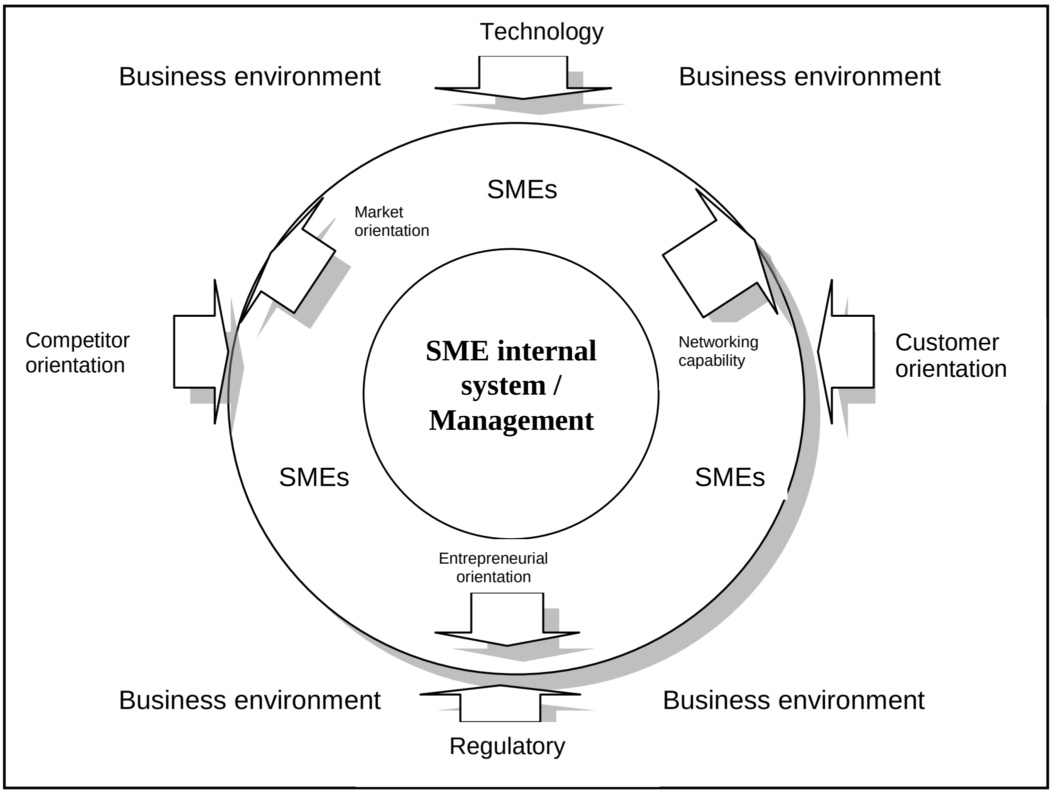


Figure 3.1: Interaction of SME and environmental forces

What can be derived from the above is that environmental forces trigger impulses to the internal system of the firms. These changes in the environment can be a result of changes in competitor's actions, customers and social behaviours, as well as changes in technology, and or legal, regulations and ethical standards (Morris *et al.,* 2008:4). Changes or disturbance of environmental forces are stimuli to a firm's internal system that respond through adopting new strategies or adjusting existing strategies in order to adapt new environments. The adopted or adjusted strategies aimed at giving firms competitive advantage over competitors that lead to a long term performance (Man, Lau & Chan, 2002:126). In this study, the tendencies of entrepreneurial firms to respond to changes in an external environment, in order to maintain or attain sustainable superior performance over competitors, are referred to as a strategic entrepreneurial response.

For the purpose of this study, the concept of strategic entrepreneurial response is defined as a set of actions, measures or posture taken by the entrepreneur through simultaneous opportunity seeking and advantage seeking behaviours to counteract the impact of changes in customer behavior, technological dynamics, competitor's actions, and changes in legal, regulatory, and ethical standards and be able to maintain or attain superior performance. In a competitive business environment, entrepreneur's survival depends mostly on how they respond to these forces. When confronted by the market competition that is explained by the environmental forces, entrepreneurs are likely to adopt entrepreneurial strategies such as entrepreneurial orientation, market orientation and/or networking with individuals or other firms. The response in most cases, will involve a combination of strategies, which are determined by circumstances such as availability and accessibility of resources, convenience of implementation and the capacity in terms of supporting infrastructure and human resources.

The market orientation fundamentally generate market intelligence that gives a firm ability to understand customer's preferences, competitor's actions, technology dynamics, focusses on long term benefits, survival and growth. It involves inter-functional coordination within the firm, which allows different department or individuals to share market information and take appropriate measures or actions (Narver & Slater, 1990:21; Walter *et al.*, 2006:547) as a response to face the environmental challenges. Through generated market information, entrepreneurial firms, through the use of an entrepreneurial mindset, are able to identify opportunities presented by discontinuities and the environmental dynamics (Kuratko & Audretsch, 2009:7; Schindehutte & Morris, 2009:246) and exploit them before competitors do so. This is possible if a firm has autonomy to make timely decisions, is willing to take calculated risks, proactive in service and product offering, continuous innovation to offer unique value added products to customers and competitive aggressiveness to face rivals regardless of what it takes to win (Lumpkin & Dess, 2001:431).

The literature shows that firms face challenges to integrate opportunity seeking behaviour and advantage seeking behaviour to sustain competitive advantage (Ireland & Webb, 2007b:51; Ketchen et al., 2007:374) necessary in a competitive environment. This study argues that integrating market orientation and entrepreneurial orientation in strategic entrepreneurship will sustain competitive advantage of the firm. Market orientation is necessary to continuously generate market intelligence and share the information within the firm which is a learning process that creates competitive capability (Song, Wang, & Parry, 2010:565). The generated market information also form a source of opportunity identification, which is necessary to build a strong entrepreneurial orientation as to identify and choose those opportunities that are mostly likely to be attractive and well received by customers (Baker & Sinkula, 2009:457; Gorry & Westbrook, 2011). In a dynamic and competitive environment that demand aggressive product development, and customer support systems and highly adaptable product processes, a strong entrepreneurial orientation (Baker & Sinkula, 2009:457) and market orientation may be essential to success.

Baker and Sinkula (2009:443) postulate that “market orientation and entrepreneurial orientation are correlated, but distinct constructs”. In strategic perspectives, market orientation reflects the degree to which firms are driven by customers and competitor’s intelligence and inter-functional coordination (Narver & Slater, 1990:21). This enables a firm to understand current, future and latent needs of the customers, and offer more value. It understands short and long term strategies of competitors, which enables the firm to come up with the different strategies that differentiate from competitors. The inter-functional coordination ensures sharing of the generated market intelligence among workers to contribute to a common goal (Kuratko & Audretsch, 2009:3). On the other hand, entrepreneurial orientation reflects the degree to which a firm's growth objectives are driven by the identification and exploitation of untapped market opportunities (Shane, 2003:4; Shane & Venkataraman, 2000:211), that can be identified through market intelligence. This implies that continuous generation of market intelligence creates a source of opportunities from which entrepreneurial orientation can identify and choose those opportunities which are related to a customer's needs.

A balance of entrepreneurial orientation and market orientation is essential for strategic entrepreneurial response. According to Baker and Sinkula (2009:457) firms with strong entrepreneurial orientation without a strong market orientation are likely to identify market opportunities, but not able to adequately prioritize such opportunities with the greatest value to customers. As a result, an entrepreneurial orientation not grounded in a strong market orientation may lead to innovations which may not catch the taste and preferences of customers. Consistently, a strong market orientation without a strong entrepreneurial orientation may facilitate a focus on customer leading to an over-emphasis on incremental innovations or copying of the successful product and customer services of others rather than exploring new differentiating initiatives (Baker & Sinkula, 2009:457). This implies that a balance between market orientation and entrepreneurial orientation is important for a firm to attain and sustain competitive advantage required for sustainable performance.

The implementation of the two strategies namely market orientation and entrepreneurial orientation, requires resources (Covin & Slevin, 1991:15). For SMEs, which are usually confronted by shortage of resources (Kropp & Zolin, 2005:1; Nieto & Santamaria, 2010:45; Verhees & Meulenberg, 2004:137), networking strategy is added in this study because it is considered appropriate for SMEs to enable them to complement resource requirement from other firms, which subsequently give SMEs competitive advantage over the rivals (George *et al*., 2001:269; Walter *et al*., 2006:548; Watson, 2007:854). Collectively, the three strategies namely market orientation; entrepreneurial orientation, and networking capability identified in this study are conceptualized as strategic entrepreneurial response over the rivals. This implies that entrepreneurial firms operating in a dynamic and competitive environment respond to environmental forces through market orientation, continuously generate market intelligence, share market information within the firm, and respond to the market intelligence through entrepreneurial orientation that aggressively pursue new market opportunities to satisfy current, future, and latent customer needs.

Since the implementation of market orientation and entrepreneurial orientation strategies require resources, which are scarce for most SMEs, the ability of SMEs to create effective networking considered appropriate to complement resource needs. It is from this background that the next sections presents a review of the dimensions of strategic entrepreneurial response namely market orientation, entrepreneurial orientation and networking capability.

3.3 MARKET ORIENTATION

Although business literature has long emphasized the significance of market orientation to the firms performance, Kohli and Jaworski (1990:2) and Narver and Slater (1990:21) were the first authors to operationalize the construct (Ngai & Ellis, 1998:119; Soehadi, Hart & Tagg, 2001:286; Verhees & Meulenberg, 2004:135;) and establish the empirical support for its relationship with performance (Jaworski & Kohli, 1993:63; Slater & Narver, 1994:52). The first authors Kohli & Jawoski (1990:2) and Narver and Slater (1990:21) conceptualised the two perspectives; the behavioural and cultural perspectives, respectively. The details of each perspective are given in the following sections.

3.3.1 Behavioural Perspective Of Market Orientation

According to Kohli and Jaworski (1990:6) the concept of market orientation refers to “the organization-wide generation of market intelligence pertaining to current and future needs of customers, dissemination of the intelligence across departments, and organization-wide responsiveness to the intelligence”. This definition presents behavioural perspective in market orientation. Consistently, Matsuno, Mentzer and Rentz (2005:2) emphasize that market orientation is a firm’s process that is engaged in generation of market intelligence and dissemination of market intelligence across departments. Baker & Sinkula, (2009:457) argued that market orientation is more than the scanning of external environment or sharing customer information, it is the commitment to respond to the customer's needs with the objective of maximizing customer satisfaction. The three processes namely generation, dissemination, and responsiveness to the market intelligence are very crucial in the market orientation process especially in dynamic and competitive environments where events are constantly changing and future is less predictable (Kuratko & Audretsch, 2009:7).

The generation and dissemination of the market intelligence provides a room for a firm to learn emerging or new customers and competitor's behaviour as time goes and through lessons gained, firms develop or renew strategies as a response to the existing environmental conditions. In view of the importance of these processes, namely generation, dissemination, and response to market intelligence in market orientation the next sections give a brief account of each step in the process of market orientation.

3.3.1.1 Generation of market intelligence

In dynamic and competitive environment, generation of market intelligence is focused on scanning the business environment, gather and analyse information pertaining to customer behaviours, external factors that influence customer needs, and competitor's actions (Wood, Bhuian & Kiecker, 2000:214). The customer behaviour changes frequently, especially in the open market economy where consumers are exposed to several brands that may influence changes of taste and preferences due to quality, price, and or brand reputation. Keh *et al*. (2007:607) emphasizes that a deep understanding of customers, such as their purchasing habits, psychological makeup and lifestyles can help SMEs to conduct better market segmentation and find new market niches. This implies that by having such information at hand, through creativity and innovation SMEs are in a position to offer more value to customers.

The process of market intelligence generation by the firm captures the external factors that may influence current and future needs of customers, manage investment risks, as well as challenge competitors to the market (Keh *et al.,* 2007:593). Such factors include technological change, competitive intensity, government regulations, demographic dynamics, and social economic factors (Ireland *et al*., 2009:28; Shane, 2003:3). Furthermore, to understand what and how competitors are doing is crucial to enable the firm to offer new and or different products or similar products in a different way to differentiate the firm from other players in the market. Keh *et al.* (2007:596) postulates that ”information is a powerful knowledge resource that can enhance competitive advantage”. In light of this, the acquisition and utilization of information regarding customers, competitors and other external factors improve market decisions that place a firm at a competitive market position over rivals. According to Song *et al.* (2010:565) the market information, if used properly, can reveal latent needs which exist and are not addressed or not known to competitors.

The generated market information is only useful if it is used properly. Keh *et al.* (2007:593) observed no evidence supporting the positive impact of information acquisition to firm performance; however, they reported positive relationship between information utilization to market decisions and subsequently firm performance. This implies that information generation should be accompanied by effective utilization to realize firm performance. Song *et al*. (2010:565) supports this argument by putting more emphasis on formal processes of information acquisition and utilisation that leads to good performance. The next section presents the dissemination of market intelligence, which is a step towards information utilisation.

3.3.1.2 Dissemination of market intelligence

Dissemination of market intelligence involves sharing of market information once generated (Matsuno *et al*., 2005:2). Dynamic and competitive environments require owners/managers to communicate effectively, share information, and generally keep the employees aware of what is going on in the business environment (Slater & Narver, 1995:69). This process engages all departments or all employees in the firm to ensure vertical and horizontal flows of information within and between departments (Kuratko & Audretsch, 2009:3; Kohli, Jaworski & Kumar, 1993:468). This stage is very important because it intends to share and internalise market information to all workers within the firm. It enables the firm to understand what and how competitors are operating, their key competitive strength and weakness. This information helps the firm to come up with the most competitive market strategy that offers value to customers and enables firms to win competitors (Gorry & Westbrook, 2011). Keh *et al.* (2007:607) also support this argument by pointing that with the valuable market information SMEs evaluate their options, identify the most feasible opportunities and thus reduce risks implied in the investment.

The strategic implication of dissemination of market information within the firm is a learning process among workers and adds a firm's knowledge, which forms the base for a competitive advantage. Slater and Narver (1995:71) echoed similar views by saying that because of its external focus, marketing is well positioned to appreciate the benefits of market driven learning and be lead advocate of the market oriented entrepreneurial values that constitute the culture of learning organization. Baker and Sinkula (1999:412) argue that learning orientation can facilitate both incremental and discontinuous innovation of which without a strong market orientation can lead an organization astray. With the appropriate information and effective sharing of the information SMEs can have a better understanding of their customers' changing needs and respond accordingly. With this background the next section presents how SMEs respond to the market intelligence.

3.3.1.3 Responsiveness to market intelligence

The responsiveness is the action taken in response to intelligence that is generated and disseminated (Kohli, Jaworski, and Kumar, 1993:468). It is engaged in building competitive advantage over rivals by altering tangible and intangible resources and creates a combination of resource base that is valuable, and imperfectly imitable by competitors to sustain a competitive advantage (Barney, 1991:105). It promotes, distributes, and price goods and services that respond to the current, future, and latent needs of customers by utilising market segmentation, product differentiation, cost leadership and other marketing strategies.

3.3.2 Cultural Perspective Of Market Orientation

Narver and Slater (1990:21) conceptualized the market orientation construct based on cultural perspective and defined it as “the organizational culture that most effectively and efficiently creates the necessary behaviours for the creation of superior value to customers and thus continuous superior performance for the business”. Slater and Narver (1995:67) emphasize that market orientation is the principal cultural foundation of learning organization, and provide strong evidence that a learning orientation is based on a market orientation. Consistently, Baker and Sinkula (1999) support this argument by pointing out that market orientation provides ground for learning orientation and a learning orientation has a positive impact on the performance of the firm. The premise that market orientation provides ground for learning is based on the fact that market orientation is engaged on the acquisition of the market information and dissemination of the market intelligence, which follows the same paten of learning.

Narver and Slater (1990:21) state that market orientation consists of three behavioural components namely; customer orientation, competitor’s orientation, and inter-functional coordination. This implies that the firm has to scan the external business environment and generate market information pertaining to customers and competitors’ behaviours and capitalise on effective inter-functional coordination of the market information. The subsequent sections present a review of the three cultural components of the market orientation and their influence on SME performance.

3.3.2.1 Customer orientation

Customer orientation is intended to generate information regarding the changes of customer behaviours in terms of taste and preferences (Gorry & Westbrook, 2011; Li *et al.* 2008:115). Li *et al.* (2006:107) argues that firms with high market orientation continuously generate market information and examine alternative sources of competitive advantage to determine how it can most effectively create superior value for its present and future target customers and enhance performance. The process involves generating information relating to other environmental factors that have influence on customer behaviours. Such factors include, but are not limited to, technological change and demographic dynamics, and government regulations (Morris *et al.,* 2008:4; Ireland *et al.,* 2009:28; Shane, 2003:3). The information enables the firm to capitalize its products and service strategies to offer more values to customers to satisfy their current, future, and latent needs. The literature provide evidence that firms which monitor customers' needs tend to improve product offering that target to fulfil the needs of customers and reduce the risks of developing products or services that have no appeal to customers (Keh *et al*., 2007:607). In this view, firms focussing on customer needs are likely to enhance the firm's performance because products and services developed are targeted to address the immediate needs of the customers.

3.3.2.2 Competitor orientation

The open market economy has intensified competition in the business environment and it has changed the way businesses are managed. Adoption of any business strategies such as differentiation, cost leadership, niche market and any other competitive strategies in the competitive business, requires to understand what and how competitors are doing so as to be able to offer different products or similar products in different ways (Porter, 1996:64) . As such, competitor orientation is the study of competitor behaviours to identify strengths and weaknesses in order to design a competitive strategy that capitalise on the competitor weaknesses and withstand competitor's strength. Lumpkin and Dess (2001:434) contend that "firms create, acquire, and leverage resources to achieve competitive advantage, which they tend to defend". In this regards, for new entrants must study thoroughly the environment they are to operate by critically examining competitors' behaviour, their strengths and weaknesses, to be able to identify the entry point that give competitive advantage over the rivals.

3.3.2.3 Inter-functional coordination

Inter-functional coordination is engaged in pulling together internal resources and match with the strategy and the problem at hand to respond to the current, future and latent needs of customers. Alvarez and Busenitz (2001:762) argue that unless it is coordinated, a firm's knowledge, or information/intelligence "is often dispersed, fragmented, and sometimes even contradictory". In this view, inter-functional coordination is responsive to create a bundle of resources within the firm by relying on locally available resources to create competitive advantages if it own or control resources which are rare, valuable, inimitable, and are not easily substitutable by competitors. This implies that resources have potential to add value to products and services intended to be offered, they are not easily available to competitors, the combination of such resources is not easily understood by competitors to allow copying/imitations or is restricted through property right. In such, this can be achieved through inter-functional coordination of the resources within the firm.

In this case, it is necessary to analyse, identify the most relevant resources, information and or knowledge the firm has and share it with the rest of the employees in the firm to develop a common understanding among workers, of which their efforts contribute to a common objective. The strategic implication of the inter-functional coordination is to build a result oriented climate throughout the firm (Thomson, 2003:9). This is consistent with a dynamic capabilities view of organisations in which the learning between and the coordination and reconfiguration of key organisational competencies leads to competitive advantage (Teece *et al.,* 1997:520). In this view, well-coordinated resources in the firm create competitive advantage of the firm over rivals.

3.3.3 Association Of Market Orientation And Performance

Previous studies using samples from United States of America (USA), supported positive relationship between market orientation and firm performance (Jaworski & Kohli, 1993:63; Narver & Slater, 1990:32; Slater & Narver, 1994:52). Subsequent work in this stream examined the relationship between market orientation and performance in non USA, but primarily Western contexts reported mixed findings. Studies conducted in Britain (Diamantopoulos & Hart, 1993:115; Greenley, 1995:8) for example, reported weak and in The Netherlands (Langerak, Hultink, & Robben, 2004:88) found no significant direct relationship between market orientation and firm performance. At the same time other scholars reported strong and positive results in several Western contexts such as Germany (Homburg & Pflesser, 2000:457), the

United Kingdom (Harris & Ogbonna, 2001:163; Verhees & Meulenberg, 2004:147) and Australia (Farrell 2000:215).

Other studies for non USA built on the early work on market orientation and performance conducted in Western context to examine the relationship between the variables, are those that used non-Western samples. The sample includes China (Li *et al*., 2008), Thailand (Powpaka, 1998), Hong Kong (Ngai & Ellis, 1998), Taiwan (Horng & Cheng-Hsui, 1998), Saudi Arabia (Bhuian, 1998), Indonesia (Soehadi *et al.,* 2001) and Ghana (Appiah-Adu & Singh, 1998). However, contrary to Jaworski and Kholi's (1996:131) observation that the effect of market orientation on business performance generalises across national cultures, this has not been the case, as other replicated studies done in other non US countries have failed to establish this linkage (Diamantopoulos & Hart, 1993:115; Greenley, 1995:8; Han, Kim & Srivastava, 1998:38; Harris, 2001:28; Langerak *et al*., 2004:88; Ngai & Ellis, 1998:121). The inconsistence of the result might have been contributed by several factors such as differences among countries in terms of entrepreneurial culture, social values, and political ideologies (i.e. communists versus capitalists), to mention but a few.

3.3.4 Moderating Effect On Relationship Between Market Orientation And Performance

Following the inconsistence of the findings, some authors have suggested that the relationship between market orientation and performance is moderated by additional variables such as market and technological turbulence (Greenley, 1995:9; Han *et al.,* 1998:35) and competitive intensity (Homburg & Pflesser, 2000:458). But again, these results are inconclusive with some scholars finding no significant moderating effects of market turbulence (Han *et al.,* 1998:39), competitive intensity, and technological turbulence in this relationship (Langerak, 2003:109; Jaworski & Kohli, 1993:64; Harris, 2001:33) and conclude that the association between market orientation and performance is robust, and is not affected by changes in environmental variables.

Other scholars studied the moderating effects of the three dimensions of the entrepreneurial orientation namely: innovativeness, pro-activeness, and risk taking on market orientation and performance relationship. Their findings revealed that the first two dimensions of the entrepreneurial orientation namely innovativeness and pro-activeness have a positive and statistical significant moderating effect in the relationship between market orientation and performance (Li *et al*., 2008:128). This implies that through market orientation firms are able to understand current, future, and latent needs of customers and studies the competitor's behaviours. As a response to the market intelligence, firms innovatively, develop unique products and services that offer more value to customers and proactively present these products and services to the market before competitors. Li *et al*. (2008:119) argues that pro-activeness enables market oriented small firms to gain first mover advantage and enhance its performance. These findings are in line with the results reported earlier that entrepreneurial orientation played an influential role on the acquisition and utilization of market information and also has a direct effect on performance (Keh *et al*., 2007:592).

Hamel and Prahalad (1994:126) argue that market oriented firms focused on articulated customer needs, may miss opportunities for developing new products that customers cannot articulate. Zahra (1993:9), supporting this argument suggest that firms to address unarticulated needs should adopt a proactive posture focused on innovations, which meet emerging and unarticulated customer needs. This may imply that the interaction of market orientation and entrepreneurial orientation is critical to the performance of the firm. While market orientation enhance firm performance by satisfying customer's articulated needs and by facilitating internal sharing of competitors information and cross-functional coordination (Narver & Slater, 1990:21) entrepreneurial orientation will increase information acquisition and utilization in innovative, proactive and risk taking ways to capture customers' unarticulated needs (Keh *et al.,* 2007:596).

3.3.5 Influence Of Environment

The influence of the environment in the relationship between market orientation and enterprise performance was studied and reported to be strongest and typically found in USA environments. This was based on the results, drawn from data collected in Hong Kong (Ngai & Ellis, 1998:122) and supported by other findings reported in Britain (Greenley, 1995:7), the Netherlands (Langerak *et al.,* 2004:88), and New Zealand (Gray, Matea, Boschoff & Matheson, 1998:893). However, this notion did not last long since other studies have reported strong and positive results in several non-US countries such as Germany (Homburg & Pflesser, 2000:457), Australia (Farrell, 2000:215), and China (Li *et al*., 2008:125). The inconsistence of the findings implies that there are other factors than those examined in the previous studies that influence the relationship. This prompts a need to study the relationship between market orientation and performance in specific contexts, such that one can state empirically the importance of this construct in competitive advantage and firm performance.

3.4 ENTREPRENEURIAL ORIENTATION

According to the entrepreneurship literature, the concept of entrepreneurial orientation originated from the work of Khandwalla (1977) and and Miller (1983:771). Firms with high entrepreneurial orientation tend to continuously scan and monitor the environment in which they operate in order to find new opportunities for exploitation and strengthening of the competitive positions. High entrepreneurial orientation is closely related to first mover advantage and tendency to take advantage of emerging opportunities, which ultimately has a positive influence on performance (Li *et al*., 2008:119). This implies that through proactive behaviour firms take risks by innovating products, services, and or administrative processes to address unarticulated need of the customers and gained competitive advantage. In this view, it is important to examine the dimensions of the entrepreneurial orientation and understand how they contribute to gain competitive advantage of a firm.

3.4.1 Dimensions Of Entrepreneurial Orientation

Miller’s (1983:771) conceptualization of entrepreneurial orientation identified three dimensions (i.e. innovation, risk taking, and pro-activeness) which define an entrepreneurial firm. Covin and Slevin (1991:8) referred to entrepreneurial orientation as a strategic posture reflecting how firms implicitly and explicitly choose to compete.

However, a popular model of entrepreneurial orientation suggests five dimensions of entrepreneurial orientation namely: autonomy in decision making and implementing business ideas, risk taking in business venture, innovativeness in developing products and services, proactive in pursuing opportunities, and competitive aggressiveness over rivals (Lumpkin & Dess, 1996:137; Lumpkin & Dess, 2001:431; Walter *et al.*, 2006:557). Based on this background, the subsequent sections briefly highlight the strategic implications of the individual dimension of the entrepreneurial orientation namely innovation, autonomy, risk taking, pro-activeness and competitive aggressiveness.

3.4.1.1 Innovation

In competitive market environments, creative and innovative firms always find ways to serve their customers as well as form new bases on which to differentiate their products and or services from those of competitors (Hooley, Greenley, Cadogan, & Fahhy, 2005:19). Introduction of innovative new products and services is critical and enables firms to increase market share, improve performance, and enhance survival (Tang & Murphy, 2012:41). In this view, innovation refers to a willingness to support creativity and experimentation in introducing new products/services and novelty, technological leadership, and R&D in developing new processes (Lumpkin *et al*., 2009:56; Lumpkin & Dess, 2001:431; Monsen & Boss, 2009:75). The intention of innovation is to offer more value to customers and build competitive advantage of the firm. The literature identifies two categories of innovation namely incremental and radical (Lumsdaine & Binks, 2009:179). The incremental innovation is built on existing technologies, products, services and processes with minor improvements while the radical innovation is associated with the break through or discontinuities.

According to Ireland *et al.* (2003a:981) incremental innovation result from learning how to better exploit existing capabilities that contribute to competitive advantages. On the other hand radical innovation is derived from identifying and exploiting entrepreneurial opportunities through new combination of resources to create new competitive capabilities that lead to competitive advantage. Lumpkin and Dess (1996:142) citing the concept of “creative destruction” introduced by Schumpeter (1942), pointed out that a firm create wealth when existing market structures are disrupted by the introduction of new goods or services that shift resources away from existing firms and cause new firms to grow. In this argument it implies that radical innovation renders existing technologies obsolete. Consequently, new entrants take advantage of new innovations to attain competitive advantage that leads to a firm's performance. This is consistent with previous studies that indicated positive relationship between innovation and firm performance. (Li *et al*., 2008:128).

3.4.1.2 Autonomy

Autonomy gives firm members the freedom and flexibility to develop and enact entrepreneurial initiatives with minimum or no interference (Lumpkin *et al*., 2009:47). This is crucial in dynamic and competitive environment where timely decisions are expected to deploy resources to allow process to identify and or discover and seize opportunities. Lumpkin and Dess (1996:140) and Lumpkin & Dess (2001:431) define autonomy as the "ability to work independently, make decisions, and take actions aimed at bringing forth a business concept or vision and carrying it through to completion". Based on this definition, Lumpkin *et al.* (2009:63) pointed out that autonomy in entrepreneurial orientation context is clearly a vital aspect of entrepreneurial value creation and central to the notion of strategic entrepreneurship.

In the context of strategic entrepreneurship, autonomy enhances both opportunity-seeking and advantage-seeking behaviours because both processes require a set of decision making. In this case, individual employees in the firm needs freedom to exercise decision making that leads to continuous identification and exploitation of opportunities. Previous studies in small firms, have examined the extent of autonomous behaviour by investigating how centralized the leadership is and how often managers delegate authority and rely on technical expertise (Lumpkin & Dess, 1996:141). Miller (1983:773) reported that in "small firms high level of entrepreneurial activities were associated with chief executives who maintain strong central authority and acted as the firm's knowledge leader and being aware of emerging technologies by being aware of emerging technologies and markets". Since small firm's decisions are centralized to the owners or managers it is crucial for timely decision that leads into competitive advantage of the firms.

3.4.1.3 Risk taking

Commitment of resources in the dynamic environment where factors are continuously changing, involves risk taking. Lumpkin *et al.* (2009:56) and Monsen and Boss (2009:75) describe risk taking as a tendency to take bold actions such as venturing into unknown, new markets, committing a large portion of resources to ventures with uncertain outcomes and or borrowing heavily. The literature differentiates between risk and uncertainty. According to Alverez and Barney (2007:14) a decision making context is risky if at the time of decision making, decision makers were exposed to a situation where there were adequate information to anticipate the possible outcome associated with that decision, and the probability of each of the possible outcomes. In contrast, a decision making context is uncertain, if at the time of decision making, decision makers are not exposed to adequate information to anticipate neither the possible outcome, nor the probability of those outcomes.

In this case, entrepreneurs are likely to operate in risky and not uncertain environments where there is a possibility of predicting the possible outcome of their investments (Wickham, 2006:10). It is from this context, entrepreneurs are reported to take calculated risks when they decide to invest. In the events of entrepreneurs to take calculated risks, they used to collect appropriate information. Keh *et al.* (2007:596) argues that information acquisition and utilization tend to be risk as they involves substantial effort and expenditures that the outcome of these activities not necessarily ensure realization of expected returns, due to several influencing factors. However, entrepreneurial orientation reported to increase information acquisition and utilization which implies that entrepreneurial oriented firms are likely to be leaders in information acquisition and utilization that subsequently enhance firm performance (Keh *et al.,* 2007:596).

3.4.1.4 Pro-activeness

Pro-activeness is an opportunity seeking behavior, forward looking perspective involving the introduction of new products or services ahead of the competitors and acting in anticipation of future demand to create change and shape the environment

(Lumpkin *et al.,* 2009:56; Monsen & Boss, 2009:75). While market orientation is associated with the incremental innovations to improve existing products and or services through a tendency of generating market intelligence focused on customers and competitors. Pro-activeness support disruptive innovation that focuses introducing new products or services in markets or creating new markets as a response to future needs and desires to shape the environment. In such, proactive behaviour is relevant in strategic entrepreneurship, since it keeps the firm in a position to lead competitors in the industry.

According to Lumpkin and Dess (2001:434) pro-activeness refers to "how firms relate to market opportunities by seizing initiative and leading in the market place, it does so by seizing initiatives and acting opportunistically in order to shape the environment that is to influence trends and perhaps even create demand. Chen and Hambrick (1995:457) pointed that a firm should be both proactive and responsive to its environment in terms of technology and innovation, competition, customer and other environmental forces that may impact performance of the firm. Chen and Hambrick (1995:457) further argue that pro-activeness involves taking the initiatives in effort to shape the environment to one's advantage; responsiveness involves being adaptive to competitors challenges (competitive aggressiveness). This implies that a firm must be both proactive in pursuit of opportunities and the will to respond aggressively to competitors.

3.4.1.5 Competitive aggressiveness

The competitive environment requires firms to be alert to the environmental dynamics and respond aggressively to rivals to maintain or attain competitive position. Competitive aggressiveness is a driver to face intense competition posed by rivals. Baker and Sinkula (2009:457) support the argument that dynamic market environment demand aggressive product development, customer support systems, and highly adaptable product process to win the market. Consistently, Miller (1983:771) emphasized that competitive aggressiveness implies "beating competitors to the punch". This implies that it is a competitive intensity that new entrants to the market often need to compete with existing rivals or the response competitive intensity the rivals poses to protect its competitive position against new entrants. In this view, competitive aggressiveness is the firm's response to competitors in the effort to protect competitive market position.

3.4.2 Association Of Entrepreneurial Orientation And Performance

In an attempt to examine the relationship between entrepreneurial orientations and firm performance several studies have reported mixed findings. While some have reported positive relationships (Keh *et al*., 2007:605; Kraus *et al*., 2005:335; Li *et al.*, 2008:128; Wiklund & Shepherd, 2005:85), others reported only a partial relationship (Walter *et al.,* 2006:557). The argument for a positive influence of entrepreneurial orientation on performance is based on the first-mover advantages and the tendency to take advantage of emerging opportunities implied by the entrepreneurial orientation (Li *et al*., 2008:119).

Walter *et al.* (2006:549) conclude that entrepreneurial oriented firms can target premium market segments and capture high profits ahead of rivals. These firms monitor market dynamics and respond quickly, thus proactively capitalize on emerging opportunities. Innovation keeps them ahead of their competitors, while gaining a competitive advantage that leads to improved financial results (Morris *et al*., 2008:57). Pro-activeness give firms the ability to predict future demands of customers and present new products/services to the market ahead of competitors, which also gives them a competitive advantage in the dynamic business environment (Li *et al.,* 2008:129; Walter *et al.,* 2006:549).

Empirically, research has found that the effects of entrepreneurial orientation on firm performance vary with the types of business industry and environments (Lumpkin & Dess, 2001:436; Walter *et al.,* 2006:557; Schindehutte, Morris, & Kocak, 2008:11). While previous studies have highlighted the importance of a two way interaction between entrepreneurial orientation and performance (Kraus *et al.*, 2005:318; Wiklund & Shepherd, 2005), greater insight into performance might be gained through use of moderating effect model, and interaction-effect model proposed by Lumpkin and Dess (1996:156) to investigate the impact of a third or fourth variable as a means of exploring contingency relationship. It is from this background that next section presents a review of previous studies on the interaction effects of other variables on the relationship between entrepreneurial orientation and firm performance.

3.4.3 Interaction Effect On Entrepreneurial Orientation

Previous studies have examined the interaction effects of different variables in the relationship between entrepreneurial orientation and firm performance. Wiklund (1998:334) examined the interaction effects of entrepreneurial orientation, and capital availability and their impact on firm performance reported no effect. In another study Keh *et al*. (2007:607) examined the moderating effects of acquisition and utilization of the market information in the relationship between entrepreneurial orientation and SME performance. The results show that there is a direct and indirect effect of entrepreneurial orientation on SME performance. On the indirect relationship, Keh *et al.* (2007:607) observed that acquisition of market information had non-significant relationship with SME performance but has significant relationship with the utilization of market information that subsequently has significant relationship with SME performance. These findings may imply that information acquisition has no value in SME performance unless it is utilized. Consistently, entrepreneurial orientation reported to play an influential role on the acquisition and utilization of market information that leads to SME performance (Keh *et al.*, 2007:606). These findings, again, imply that entrepreneurial oriented SMEs are likely to attain performance through acquisition and utilization of market information.

On the other hand, networking capability was reported to moderate the relationship between entrepreneurial orientation and firm performance but no direct relationship was observed between entrepreneurial orientation and performance measures such as sales growth, sales per employee, or profit attainment (Walter *et al.,* 2006:557). These findings indicate that entrepreneurial oriented SMEs could benefit more when they are engaged in networks than operating in isolation. This can be explained by the fact that networking allows firms to gain access to resources they need but do not own, learn new capabilities from partners and build reputation in the market (Ireland *et al*., 2001:55; Hitt *et al.,* 2007:239). In this view, these findings may imply that the existence of entrepreneurial orientation per se should not be regarded as a remedy for improving firm performance and long term survival of firms, unless other factors influencing the relationship are identified. The next section reviews the literature on networking and how a firm can use networks to attain performance.

3.5 NETWORKING

In the effort to study firm performance, networking has also been pointed out as a contributing factor (George *et al*., 2001:280). Networking has become an important factor particularly in SME's due to increasing competition in the business environment. Networking describes entrepreneurial behaviour in building relationships with the external environment to develop mutual trust and access to information, resources, market and technologies (Barringer, Jones & Neubaum, 2005:680;Hitt *et al.,* 2007:239 Moreno & Casillas, 2007:85; Soh, 2003:731; Semrau & Werner, 2012:159). Aldrich and Zimmer in George *et al*. (2001:271) define networking as a set of long-term contacts between people or organizations in order to get information and build resources. A network can be either formal or informal. The formal networking is guided by a set of formally specified rules and informal networking involves more discretionary patterns of interaction (Hitt *et al.,* 2001:482).

The network theory, usually conclude that membership of a business network will offer participants the opportunity to add greater unique value to their products and or services (Chaston, 2000:39; Moreno & Casillas, 2007:85). Barringer *et al.* (2005:680) define unique value to customers as helping customers maximize utility, reduce costs, and / or increase organizational effectiveness in a unique manner. The reason behind this is, networking with external environment is a mechanism by which entrepreneurs obtain potential information about untapped opportunities (George *et al*., 2001:270) and firms access scarce resources or discover new resources that are not known to existing firms (Hitt *et al.,* 2007). Creating and maintaining these linkages may be a firm's capability that creates competitive advantage for SMEs and chances of success (George *et al.,* 2001:280; Nieto & Santamaria, 2010:62; Watson, 2007:854). For example, Soh (2003:728) points out that those firms with a more effective networking strategy tend to acquire more competitive information earlier than other firms; and this information advantage in turn leads to better new product performance. Similarly, Nieto and Santamaria (2010:61) conclude that networking, if well utilised, narrows the innovation gap between small and large firms.

The competitive business environment requires SMEs to adopt new market strategies such as innovation, upgrading the quality of existing products/services, acquires timely marketing information, hire or employ qualified staff (Vusi & Kamilla, 2002:162). At the same time, many SMEs cannot afford all the technologies and human resources that they need due to resource constraints (Kropp & Zolin, 2005:1; Verhees & Meulenberg, 2004:137). In such environments, networking allows SMEs to forge a flexible relationship with other players such as suppliers, competing firms, customers, and public research institutions to fully capitalize on their core competencies (Verhees & Meulenberg, 2005:137; Walter *et al.,* 2006:557; Dickson & Weaver, 2011:126). The management of innovation literature indicates that firms seeking to survive in rapidly changing and/or highly competitive markets are being advised to consider participating in business networks (Charston, 2000:36). Through networking, firms are likely to attain superior performance over competitors, based on the value added products and services they offer (Barringer *et al*., 2005:680; George *et al.,* 2001:280).

Other scholars have argued that where the required market information is complex, expensive or difficult to obtain, firms choose to network with other firms or individuals as the most cost effective strategy for data acquisition (Walter *et al.,* 2006:548). The transaction cost theory supports the argument that networks are one of the affordable ways that some organisations use to gain access to resources or to receive new and more complex technologies (Dickson & Weaver, 2011:126). George *et al.* (2001:269) concludes that the interdependency over shared resources lowers transaction costs, thereby permitting network members to more rapidly respond to problems or adapt to changing market conditions. This is in line with the findings reported by Walter *et al.* (2006:550) that networking firms are better able to anticipate new preferences, are aware of competitors actions quickly, and can either develop new market offerings when competitors copying becomes apparent or imitate their innovations. In this regard, access to these resources enables SMEs to develop market competence through product or process improvement that leads to performance. The next section presents a review of the influence of networking on firm performance.

3.5.1 Influence Of Networking On Performance

Although the arguments in favor of networking appear compelling, and most of the existing literature is premised on the belief that networking is beneficial (George *et al*., 2001:280; Hoang & Antoncic, 2003:169; Watson, 2007:854). There have been little empirical evidence on the association between firm performance and the owner's use of networks (Havnes & Senneseth, 2001:299), particularly for established businesses like the ones under the study. Aldrich and Reese (1993:327) were unable to find any evidence linking an entrepreneur's use of networks to business performance and, similarly, Cooper *et al.* (1994:390) was unable to find a significant relationship between the use of professional advisors and firm performance. Examining the role of networks, it becomes clear that it involves sharing of resources among participating partners that may lead to a firm gaining competitive advantage over rivals (Dickson & Weaver, 2011:126; Nieto & Santamaria, 2010:62; Semrau & Werner, 2012:159). However, the benefits of networking may not be direct as many people tend to believe.

Walter *et al*. (2006:546) argued that value creating, organizational ties between organizations do not simply exist or emerge, the transfer of know how between network partners is fraught with ambiguity and interactions can rarely be pre-specified. This finding is consistent with the results reported earlier by other authors such as Gulati, Nohria and Zaheer (2000:210), that networks may have negative implications, locking into unproductive process where know-how and other resources are wasted. The inconsistence of the findings warrants further investigation for other factors influencing the relationship between networking and firm performance. It is from this context that this study considers networking capability to be more relevant to determine performance than just networking as a process.

Networking capability is considered appropriate in this study because it is an outcome oriented construct with the attributes that once the firm poses and execute, it is likely to realize the outcome of their relationship. Keh *et al.* (2007:375) supports this argument by emphasizing that firms choose to pursue networking as a strategy, must be able to develop the capabilities, structures and processes to support a collaborative approach. The next section presents a brief review of networking capability and how it can be used to build a competitive advantage of the firm to enhance performance.

3.5.2 Networking Capability

Networking capability refers to the abilities to initiate, maintain, and utilise inter-organisational relationships with various external partners (Walter *et al.,* 2006:541). In other words, networking capability emphasizes the ability to develop a robust and sustainable relationship with mutual benefits among collaborating firms. The aim of such a relationship is for the firms to access and complement resource requirement, which subsequently enhance competitive advantage. Networking capability is an outcome driven construct that thrive to realise the objective of the inter-firm relationship. According to Kale *et al*. (2000:221), networking capability has four dimensions namely coordination, relational skills, partner knowledge, and internal communication that the management of a firm needs to focus for a firm's good performance. The details of these components are elaborated below.

3.5.2.1 Coordination between collaborating firms

The coordination activities extend beyond firm's boundaries, connecting individual firms together with other firms and different individuals into a network of mutually supportive interaction. The networking literature suggests that firms participating in inter-organizational relationships to complement resource needs from networking partners, is a common way of firms to gain competitive advantage (Barringer *et al.,* 2005:680). This is especially important in today's business environment where market forces are changing continuously and the resource needs has grown enormously beyond the resource base of most firms. In this regard, the ability to develop effective coordination is important for a firm to benefit from resource sharing and efficient utilization of resources obtained from networking partners. Dickson and Weaver (2011:126) and Ireland *et al*. (2001:55) postulate similar views that "networks allow firms to gain access to resources they need, but do not poses and learn new capabilities from networking partners". This emphasis is particularly relevant to resource constrained firms if they are to complement resource requirements and build competitive advantage.

The literature indicates that knowledge and other resources necessary to build a firm's competitive advantage are in isolation, and fragmented, unless they are well coordinated and combined in a unique combination to realise their potential (Barney & Arika, 2005:174). Barney (1991:105), supporting this argument pointed out that the competitive advantage of a firm is attained when firms are able to coordinate the available resources in a way that leads to competitive advantage. This implies that for effective utilization of resources, coordination is engaged in pulling together resources from both sources within the firm and those shared by partners, allocate resources to the most feasible operations and monitor the process to ensure resources yield the most valuable return which imparts the competitive advantage of the firm. However, the effective coordination can be attained if a firm has good relational skills to build trust and confidence to networking partners so that they are willing to share core competitive resources, otherwise the relationship will be fraught and ambiguous with no benefits among networking partners. With the understanding of the importance of the relational skills in networking, the next section gives a brief account on how it supports firm performance.

3.5.2.2 Relational skills

The relational skills are important for a firm to create and sustain long term relationships with mutual benefits among participating firms. Kale *et al.* (2000:220) refers relational skills as a social competence, which are crucial for the management of relationships because relationships are very often inter-personal exchange situations. It is argued that interpersonal exchange situations rely on trust and confidence built by the partners of whom partners with good relational skills are well placed to impart both issues (trust and confidence), to the second party. Marshall, Goebel and Moncrief (2003:248) argues that relational skills include such aspects "as communication skills, problem solving skills, interpersonal skills, conflict management skills, empathy, emotional stability, self-reflection, sense of justice and cooperativeness". In this view, a firm with good relational skills is likely to develop effective and sustainable relationship that is mutually beneficial among networking partners, which in turn enhance competitive advantage that leads to performance. The relational skill on customers, suppliers and competitors is crucial in this regard.

With regard to customers, relational skills are important means of learning about customer needs in order to offer more value of products and or services (Walter *et al*., 2006:548). The implication of this is the attraction of new customers and retention of regular customers to continue buying products and services for the business. Barringer *et al.* (2005:680) define creating unique value as ”helping a customer maximize utility, reduce costs or increase firm effectiveness in a unique manner” compared to competitors. On the supplier side, relationships are crucial to ensure timely available supplies for continuous availability of products of notable value to customers. Due to the increasing complexity of technologies, capabilities needed and risks implied, firms increasingly opt for collaborative innovation (Nieto & Santamaria, 2010:61). The collaborative innovation has been associated with the sharing of resources and risk implied by the innovation in case the innovation does not make it in the market. Ketchen *et al*. (2008:371) postulated that collaborative innovation is the pursuit of innovations across firm boundaries through sharing of ideas, knowledge, expertise, and opportunities that allows partner firms to complement resource needs. The relational skill is important when associated with partner’s knowledge in order to identify the appropriate partners. In this regard the next section present the role of partner’s knowledge in identifying the right partner with relevant resources to complement the resource needs of the firm.

3.5.2.3 Partner’s knowledge

Partner’s knowledge is the organized and structured information about a firm’s partners such as suppliers, customers and competitors (Walter *et al.,* 2006:547). The information capitalises on the potential resources and constraints existing in each potential partner. Kale *et al.* (2000:221) argues that SME owners or managers with knowledge about their partners can structure appropriate exchange mechanisms and governance structures and these firms can avoid or handle instabilities in their partnerships to sustain their relationships. Partner’s knowledge allows firms to identify appropriate partners with relevant resources and capabilities to complement their resource and capability needs.

In the effort to connect its own resources to those of other firms by building relationships, a firm strive to understand about possible partners to network with. In the process, the owner/managers evaluate the possible options from a pool of potential partners and choose the best partner with relevant resources and capabilities to complement resource needs of the firm. It can be argued that for effective taping, the benefit from networking partners, the firm's owners or managers, must share the information to the rest of the workers on the potential resources and capabilities, existing to the partners, the main weaknesses of partners, and the core objective of their relationship. This creates an environment where each employee's effort is directed towards a common goal. The next section reviews the role of internal communication in enhancing competitive advantage.

3.5.2.4 Internal communication

Internal communication is a vital part of collaborative competence (Kale *et al.*, 2000:223). It encompasses assimilation and sharing of strategic information, resources, and agreements with all employees in the firm to improve the detection of synergies between partners and focus their efforts in areas which are more beneficial to their firm. It allows dissemination of knowledge and information regarding the strength and weakness of partner's firms and highlights areas of focus in their collaborative lifespan so they can tape the potential exist from collaborating firms. Song *et al*. (2010:565) emphasizes that regardless of market conditions, the competitive advantage associated with information depends on the formal processes of information acquisition and utilisation. In this regard, internal communication is one way of formal utilisation of strategic information aimed at creating a firm's competitive advantage.

To summarise, networking capability is a firm competence building construct that strategically identify the resource needs of the firm and use relational skills and partners knowledge to identify potential networking partners to complement resource needs. The networking capability enhance assimilation and sharing of strategic information pertaining to the relationship to direct the attention and efforts of employees to learn new capabilities and share resources which fill the resource and capability gap in their firm and build competitive advantage. For efficient and effective realisation of the benefits of networking, the process is well coordinated to ensure the expected benefits are gained from the relationship in case of disparity appropriate measures for remedy are taken. The next section presents conceptual framework and indicates the relationship of variables involved in this study.

3.6 CONCEPTUAL FRAMEWORK

The empirical research is proposed to examine the relationship between dimensions of strategic entrepreneurial response, such as market orientation (i.e. competitor orientation, customer orientation, and inter-functional coordination), entrepreneurial orientation (i.e. innovation, autonomy, proactive, risk taking, competitive aggressiveness) and networking capability (i.e. coordination, relational skills, partner’s knowledge, and internal coordination) with SME performance. Previous research studied the relationship between individual dimensions of strategic entrepreneurial response and performance has failed to give consistent results, possibly because it has been considering these variables in isolation, while in reality entrepreneurs use them in combination when responding to rivals. It follows from this regard; this study integrates these dimensions of strategic entrepreneurial response and examines their interaction and their effect on SME performance.

The intention of the study is to describe the relationship of the dimensions of strategic entrepreneurial response and SME performance. Regarding this explanation it is conceptualized that the SME’s performance increases with the dimensions of strategic entrepreneurial response, but faster in a situation where there is interaction of the dimensions of the strategic entrepreneurial response that enhance simultaneous opportunity seeking and advantage seeking.

3.6.1 Strategic Entrepreneurial Response And SME Performance

Figure 3.2 presents the proposed conceptual framework that shows the relationship of constructs and variables involved in this study. The broken lines represent direct relationship between dimensions of strategic entrepreneurial response (i.e., market orientation, entrepreneurial orientation, and networking) and SME performance, and the solid lines represent the interactions among dimensions of strategic entrepreneurial response and their relationship to SME performance.

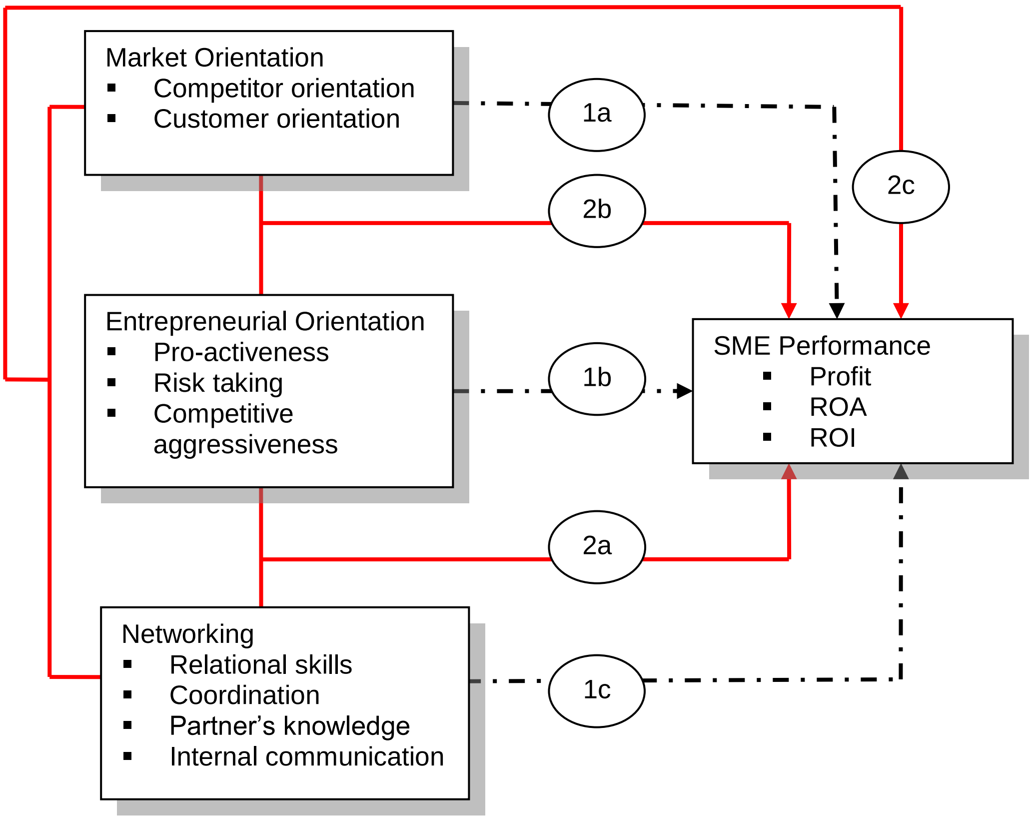


Figure 3.2: Relationship between dimensions of strategic entrepreneurial response and SME performance.

Source: Own formulation

3.6.1.1 Relationship between market orientation and performance

The positive relationship between market orientation and performance is based on the fact that trade liberalization has exposed customers to several brands and is able to compare quality of products and prices from various suppliers. In essence, this contributes to changes in customers' behaviour in terms of taste and preferences, which have an implication on decision to buy. In such a situation, market oriented firms have a system in place to monitor customer behaviour, competitors and internal coordination to respond to these changes so as to attain high performance. For example in China, Li *et al*. (2006:95) postulates that "small firms are increasingly concerned with consumer preferences by undertaking rapid internal adjustment to adopt new changes taking place in the environment to attain high performance". This finding is consistent with other studies that reported positive relationship between market orientation and performance (Kara *et al*., 2005;112; Langerak, 2003:104; Li *et al*., 2008:128; Li *et al*., 2006:106).

In view of the above, it implies that market oriented firms gather strategic information on customers and competitors, assimilate and utilize to attain competitive advantage, which subsequently leads to performance (Li *et al*., 2008:128). Inter-functional coordination ensures the available strategic resources are well managed to yield maximum potential of return. Gove, Simon, & Hitt, (2003) in Ireland *et al*. (2003a:973) argue that idiosyncratic resources are likely to produce sustainable competitive advantages only when they are managed strategically. In this view, inter-functional coordination is important for a firm to attain sustainable competitive advantage. While previous studies considered market orientation as a undimensional construct, this study consider multidimension where customer orientation, competitor orientation, and inter-functional coordination are considered as individual dimensions of the market orientation and varies independently and have different influence on performance, hence a need to study individual dimension of the market orientation.

3.6.1.2 Relationship between entrepreneurial orientation and performance

Entrepreneurial literature agrees that, opportunities are dynamic. In this case, it requires timely decision making, being flexible, and first to seize opportunities before rivals. Also in situation of trade liberalization where there is an intense competition to win market, firms are required to create unique value products/services to customers. In this view, these factors are implied in the entrepreneurial orientation that focuses on autonomy, risk taking, innovation, pro-activeness, and competitive aggressiveness. It can therefore be conceived that entrepreneurial oriented firms are likely to outer-perform firms which are none entrepreneurial oriented.

The literature offer evidence of positive relationship between entrepreneurial orientation and firm performance (Li *et al*., 2008:128; Keh *et al*., 2007:607; Kraus *et al.*, 2005:335; Wiklund & Shepherd, 2005:85). The argument for a positive relationship between entrepreneurial orientation and performance is associated with the first mover advantage implied by the entrepreneurial orientation (Li *et al*., 2008:119). Keh *et al.* (2007:593) observed that three core dimensions of entrepreneurial orientation: risk taking, acting proactively, and innovativeness, have position impact on performance. Other studies observed that the stage of industry life cycle development tended to favour one dimension of the entrepreneurial orientation over the other. For example, Lumpkin and Dess (2001:430) during the initial test showed that proactive was positively related to performance, but competitive aggressiveness was poorly associated with performance. Subsequent tests revealed that performance of firms in the early stages of industry development was stronger when strategy making was proactively oriented. In contrast, a competitive aggressive frame of mind was helpful to firms in more mature stages of industry development.

Furthermore, results indicated that in dynamic environments, characterised by rapid change and uncertainty (Teece, 2007:1319; Kuratko & Audretsch, 2009:1; Morris et al., 2008:7), proactive firms had higher performance relative to competitive aggressive firms (Lumpkin & Dess, 2001). In hostile environments where competition is tense and resources are constrained, competitive aggressive firms had stronger performance (Lumpkin & Dess, 2001). Contrary to the previous studies which considered entrepreneurial orientation as unidimensional construct, this study conceptualize entrepreneurial orientation as multi-dimensional in nature and it examines the relationship of individual dimension of entrepreneurial orientation on firm performance. Lumpkin and Dess (2001:430) emphasized a need to study entrepreneurial orientation as a multidimensional construct for the reasons that individual dimension varies with the context and stage of industry life cycle development. Based on the same argument this study tests the relationship between individual dimensions of entrepreneurial orientation and SME performance.

3.6.1.3 Relationship between networking capability and SME performance

Small businesses face steep competition in environment they operate. To face these challenges they need to be innovative to offer unique and value added products and services to customers. Innovation is a long process which starts from invention to commercialization of products/services. To complete this process requires SMEs to have adequate resources in terms of physicality and humanity. While this is the requirement, the majority of SMEs are constrained with resources (Kropp & Zolin, 2005:1; Nieto & Santamaria, 2010:45; Verhees & Meulenberg, 2004:137) and their survival is dictated by competitive forces which leave SMEs with little choice to avoid networking. George *et al.* (2001:270) and Nieto and Santamaria (2010:62) point out that firms use networking as a strategy to build relationships with other firms to gain access to scarce resources that may lead to a sustainable competitive advantage.

George *et al.* (2001:270) pointed out that a firm, which establishes and maintains networks has the likelihood to access to new information, ideas, and opportunities. Consistently, Soh (2003:728) argues that a firm with more efficient networking strategy tends to acquire more competitive information about other firms, earlier than other firms, and this information advantage in turn, leads to better new product performance over competitors. The study on effects of entrepreneurial orientation and marketing information on the performance of SMEs revealed that information utilization in market decision making has significant and positive impacts on performance (Keh *et al*., 2007:607). This implies that information utilization enables SMEs to gain competitive advantage and maintain a stronger position relative to competitors.

However, Walter *et al*. (2006:546) suggests that the transfer of know how between networking partners is not realised automatically, it needs proper management. This implies that networking partners need to have networking capacity to initiate and maintain relationship with mutual benefits among participating firms. According to Kale *et al*. (2000:221) a firm with networking capability should have relational skills, partner’s knowledge, ability to assimilate and disseminate information within the firm and coordination of networking operations beyond the firm’s boundaries. In this case, the networking capability is a competence enhancing organizational strategy that helps the firm to attain performance.

3.6.2 Interaction Of Dimensions Of Strategic Entrepreneurial Response

The inconsistencies of the results on the relationships between dimensions of the strategic entrepreneurial response (i.e., market orientation, entrepreneurial orientation, and networking) and performance has prompted researchers to investigate other dimensions contributing to performance. Lumpkin and Dess (1996:156) proposed earlier that greater insight of performance might be gained through studying moderating and interaction effect models to investigate the impact of the third or fourth variable as a means of exploring the contingence relationship.

While other studies have considered, in isolation, the dimensions of strategic entrepreneurial response such as market orientation, entrepreneurial orientation and networking in respect to their relationship with firm performance, this study considers these dimensions as strategic entrepreneurial response which implies that entrepreneurs use them in combination in real life and not in isolation when responding to rivals. When an entrepreneur is confronted by the rivals, it may decide to use these strategies in different combinations. In this case, there will be an interaction effect among variables and the implication is reflected on the firm's performance.

Zhou, Yim and Tse (2005:54) suggest the need to consider the interaction effect of the three strategic orientations namely: market orientation, entrepreneurial orientation and technological orientation and their impact on source of sustainable competitive advantage. Man *et al.* (2002:130) contends that the performance of a firm, be it a larger firm or SME, is based on a long term competitiveness. Recently, Schindehutte *et al.* (2008:12) argued that the relationship between strategic orientation (i.e., market orientation, entrepreneurial orientation and technological orientation), market driving behavior, and sustainable competitive advantage, that leads to firm performance, remain unclear and call for further study.

While previous studies insist on market orientation, entrepreneurial orientation, and technological orientation, in this study technological orientation is substituted by networking capability due to the relevance of the networking in SMEs to complement resource needs. Various studies indicate that SMEs select networking strategy to access technologies (Ireland *et al.,* 2001:55; Moreno & Casilla, 2007:85; Baringer *et al.,* 2005:680) among other things, because SMEs lack resources (Kropp & Zolin, 2005:1; Nieto & Santamaria, 2010:45; Verhees & Meulenberg, 2004:137) to acquire all technologies required in a competitive environment. This persistent call warrant further research to understand the interaction effects of the dimensions of strategic entrepreneurial response and their impact on performance.

3.6.2.1 Interaction of entrepreneurial orientation and networking capability

In response to that, several authors have investigated this relationship. For example, Walter *et al.* (2006:558) studied the relationship between entrepreneurial orientation and performance of university spin-offs and did not find any significant direct relationship between the two variables but reported moderating effects of networking capability in the relationship between entrepreneurial orientation and performance. This implies that networking capability strengthens the relationship between entrepreneurial orientation and performance. This finding is in line with previous reports, which show that entrepreneurial orientation and networking strategy are significant and positively related (George *et al*., 2001:281), which implies that more entrepreneurial firms follow proactively networking strategy to access resources, markets and technologies (Barringer *et al*., 2005:680; Moreno & Casillas, 2007:85; Semrau & Werner, 2012:159).

While networking strategy is one of the most effective strategies to access information and other resources, other scholars have showed that entrepreneurial orientation is a strong predictor of both information acquisition and utilization, which enhances a firm's performance (Keh *et al*., 2007:605). Furthermore, the finding shows that information utilization serves as a partial mediator in the relationship between entrepreneurial orientation and performance relationship (Keh *et al*., 2007:606). In light of this background, it implies that entrepreneurial orientation alone in a firm, is not adequate for a firm to compete in the dynamic market environment of contemporary times. In view of this argument, this study considered crucial to examine the relationship between SME performance and the interaction between networking capabilities and entrepreneurial orientation.

3.6.2.2 Interaction between market orientation and entrepreneurial orientation

According to Schindehutte *et al.* (2008:14) the primary source of sustainable competitive advantage is derived from either market orientation, entrepreneurial orientation or technological orientation. For example, the entrepreneurial literature indicate that firms with high levels of entrepreneurial orientation constantly search and exploit potential opportunities which strengthen their competitive positions (Keh *et al.,* 2007:593). On the other hand, market orientation is also focused on acquisition and utilization of market information focused on customers and competitors (Gorry & Westbrook, 2011). Kara *et al.* (2005:106) argue that continued collection of information on customer needs and competitor capabilities enhances consistently the offering of value added products and services to customers and to the sustainability of competitive position. This implies that market orientation provides information that aid for entrepreneurial oriented firms to choose the most appealing opportunities to customers and adopt competitive strategies to outperform competitors.

Delivering unique values to customers are centered on the innovation or doing things different from existing market players. This implies risk taking, because entrepreneurs operate in an uncertain environment, which does not ensure acceptability of products/services by end users. It also needs to be pro-active, which implies to be the first to offer these products/services to market, and competitive aggressiveness that indicate how entrepreneurs interact and respond to competitors and market demands (Lumpkin & Dess, 2001:434). Schindehutte *et al. (*2008:15) pointed out that performance is positively associated with the alignment between market orientation and entrepreneurial orientation. This background implies that entrepreneurial oriented firms are likely to follow market oriented strategies to attain performance over rivals. It is from this argument, this study is planned to examine the relationship between SME performance and the interaction of market orientation and entrepreneurial orientations.

3.6.2.3 Interaction of market orientation and networking capability

Networking strategy has long been identified as a mechanism for small firm's to access information, resources, technologies, and markets, which subsequently enhance competitive position (Barringer *et al*., 2005:680; Nieto & Santamaria, 2010:62; Semrau & Werner, 2012:159). Similarly, it is acknowledged that market oriented firms tend to link their firms with external environment that enable them to compete by anticipating market requirements ahead of competitors and creating sustainable relationships with customers and suppliers (Schindehutte *et al*., 2008:6). While market orientation is important for attaining competence, various studies have pointed out that small firms lack adequate resources to implement market oriented strategies (Li *et al*., 2008:127; Keh *et al*., 2007:593). In response to that, SMEs tend to establish networks with other firms in order to complement resource and capability needs from other firms which are not constrained with required resources. In light of this observation, this study intends to examine the relationship between SME performance and interaction of market orientation and networking capability.

3.6.3 Control Variables

The entrepreneurial literature has identified a number of situational variables that affect a firm's performance. These variables must be controlled, while analyzing the effect of dimensions of strategic entrepreneurial response on performance. The literature consistently reported that entrepreneurial orientation related phenomena are affected by firm size, age of the firm, type of industry, gender, age of owner/manager and level of education of owner/manager (Verhees & Meulenberg, 2004:137; Walter *et al.,* 2006:554; Tang & Murphy, 2012:49; Tang & Hull, 2012:142). Each of these variables can influence the firm's performance and therefore, need to be controlled for in examining the effect of dimensions of strategic entrepreneurial response on performance.

The literature indicates that larger firms have better technologies, human and financial resources to pursue market oriented strategies (Barringer *et al.*, 2005:671; Keh *et al*., 2007:593; Li *et al*., 2008:127; Verhees & Meulenberg, 2004:137; Walter *et* *al*., 2006:564). In addition, the size of a firm may determine the enterprise to go for the economies of scale in various activities, thereby positively affecting its performance (Barringer *et al.,* 2005:671). However, other scholars have reported controversial results on relationship between size and growth of the firm. For example, Moreno and Casilla (2007:82) report that a small firm grows faster than their counterpart's larger firms, which is contrary to the widely known Gibrat's Law, which suggests that all firms have the same likelihood of growth, regardless of their initial size. Tang and Hull (2012:142) argue that a firm's age has also been verified to be a significant factor in exploiting organizational strategic behavior. The older the firm, the more hierarchy and inertia it has, and the less it is motivated to change organizational directions by innovating new products or services.

The type of an industry affects the ability of a firm to obtain resources and hence, could be critical in determining the extent to which it can strategically respond to rivals actions (Barringer *et al.,* 2005:666). Morris and Kuratko (2002) argue that while each firm has a certain level of entrepreneurial orientation, norms for entrepreneurial orientation are expected to vary among industries. Contrary to this argument Schindehutte *et al*. (2008:11) assert that even within similar industry, there can be significant variation in the level of entrepreneurial orientation, which influences a firm's performance.

3.7 INDICATORS OF PERFORMANCE

There is a long debate, and yet no consensus reached with regard to the appropriate measures of SME performance. Man *et al.* (2002:130) argues that although previous studies have focused on factors contributing to performance rather than performance itself, it is clear that all studies put more emphasis on long term performance, success and or growth of firms. Man *et al.* (2002:130) further suggests that the performance resulting from SMEs competitiveness should be long term focused, rather than short term oriented. This implies that whatever the level of focus; competitiveness is ultimately concerned with the long term performance of the subject related to its competitors, which is a result of being competitive.

It is also argued that growth is the crucial performance measure in SMEs due to easy accessibility of its indicators than financial performance measures. Hence superior to indicators of financial performance, especially in cases where small business owners or managers tend to be reluctant to offer profit records for tax reasons or do not keep financial records (Kraus *et al.,* 2005:338). Consistently, Wolff and Pett (2006:274) point out that the “sensitivity of small and medium sized private enterprise to provide performance information makes it difficult to measure performance in SMEs”. While other studies argue that there is no unique method to measure a firm’s growth, there is still a debate going on about how to measure a firm’s growth objective versus subjective approaches; single versus multiple indicators through sales, assets, employment and so forth (Delmar, Davidsson & Gartner, 2003).

Walter *et al*. (2006:553) views performance as multidimensional in nature and suggest that it is advantageous to integrate different dimensions of performance in empirical studies. It is possible to regard financial performance and growth as different aspects of performance, each aspect representing important and unique information. A firm could, for example choose to trade off long–term growth for short-term profitability (Wolff & Pett, 2006:271). Taken together, growth and financial performance such as return on asset (ROA), and return on investment (ROI) (Meyer, 2009:345) gives a richer description of the actual performance of the firm than each does separately.

Walter *et al.* (2006:553) contends that sales growth is the best growth measure. It reflects both short- and long-term changes in the firm, and is easily obtainable. This argument is consistent with the remark posed by Barkham, Gudgin, Hart & Hankey (1996) that entrepreneurs consider sales growth to be the most common performance indicator. However, the growth process itself poses further arguments for advocating sales growth. The growth process is likely to be triggered by increased demand of the firm’s products or services, which is an indicator of market acceptance and success (Walter *et al*., 2006:553). From this background, sales growth allows for acquisition of additional resources such as employees, equipments and machineries. It seems unlikely that growth in other dimensions could take place without increasing sales. It is also possible to increase sales without acquiring additional resources or employing additional staff through outsourcing to increase business volumes. In this case, only sales would increase. Thus, sales growth has a high generality.

On the other hand, there is widespread interest in the creation of new employment. This makes employment growth and wage bill as other important aspects to capture. In a process of rationalization, it is possible to replace employees with capital investments. In other words, there is to some extent an inverse relationship between capital investment and employment growth. As a consequence, assets are another important aspect of growth. Weinzimmer, Nystrom and Freeman (1998:254) observed that ”measuring growth in terms of assets is often considered problematic in the service sector due to problems associated with accounting procedure”. According to the authors, assets may expand in a growing firm, but this is not normally reflected in the firm’s balance sheet. Thus, the problem of studying growing assets in service industries is related to the difficulty in the data collection, rather than in the lack of relevance.

When assessing performance, comparisons of competing firms in the market reveal important supplementary information (Birley & Westhead, 1990:553) and it has successfully been used in several studies (Wolff & Pett, 2006:275). Such measures give indication to whether firms are deviating substantially from growth pattern of their industrial counterparts. Based on previous research, this study suggests that performance measures should consider both growth and financial performance such as profit, return on asset (ROA), and return on investment (ROI). Moreover, performance should also be related to the performance of competitors. In studying growth, the expansion of sales, employment, wage bill, profit, and assets growth all provide important and complementary information. Therefore, in testing the hypotheses, this study used several indicators such as profit, ROA, and ROI to capture performance.

3.8 CHAPTER SUMMARY

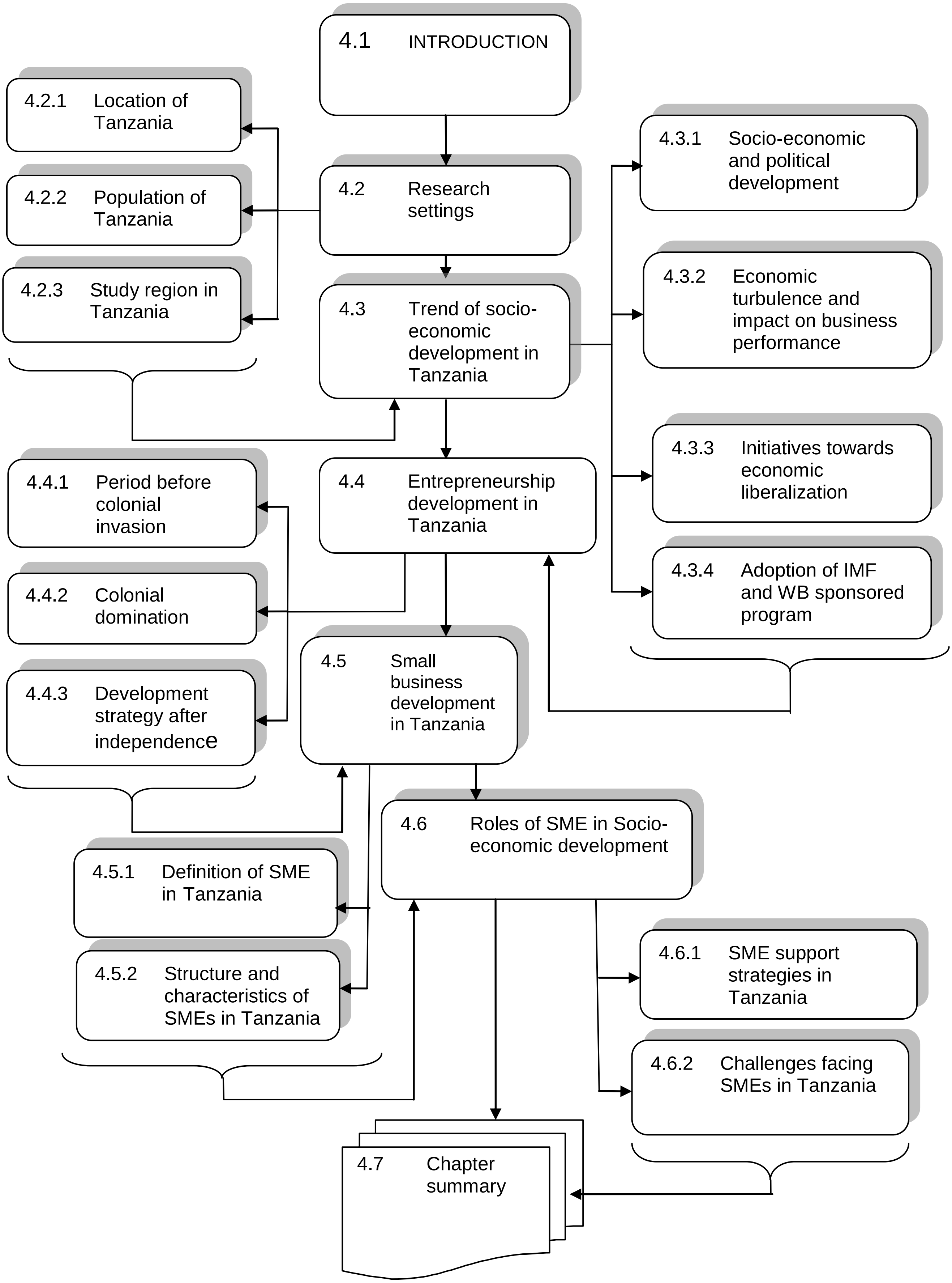
This chapter presented the concept of strategic entrepreneurial response in dynamic and competitive environment. The literature indicate that strategic entrepreneurship is appropriate for a firm to respond to the challenges posed by dynamic environment and to achieve this, it requires firms to simultaneously acquire and apply opportunity and advantage-seeking behaviours to attain and sustain competitive advantage. While this is what expected, firms face challenges to combine opportunity and advantage-seeking behaviours (Ireland & Webb, 2007b:51; Ketchen *et al.,* 2007:374). Among argument advanced for this, is that although opportunity-seeking (exploration) acknowledged contributing to strategic flexibility, the outcomes of investments made in the firm's opportunity-seeking is uncertain, due to their experimental nature and lack of certainty that positive outcomes will accrue from them (Ireland & Webb, 2007b:51).

In light of the above, Alvarez and Barney (2007:14) defined uncertain as, "a decision making context in which at the time decision is made, the decision makers are not exposed to adequate information needed to anticipate, neither the possible outcomes associated with a decision, nor the probability of those outcomes". McGrath and MacMillan, (2000:1) contend that uncertainty can be used to the firm's benefit if it creates and employ entrepreneurial mindsets as a way of thinking about a firm's business that captures the benefits of uncertainty. In this view, this study integrates market orientation and entrepreneurial orientation to address this puzzle. The market orientation is engaged in continuous scanning of external environment; generate adequate information regarding environmental dynamics. The collected information expose decision makers to adequate information to make informed strategic decisions and be able to anticipate possible outcomes associated with the decision, and enhance prediction of probability of each of those possible outcomes. In such environment, entrepreneurs are able to take calculated risks.

Market orientation grounded in entrepreneurial orientation enables firms to generate market intelligence focused on customer satisfaction and differentiate from rivals through aggressively pursuing new market opportunities that enhance sustainable competitive advantage. On the other hand, entrepreneurial orientation grounded in market orientation creates innovations with customer value, while sustaining competitive advantage over rivals. With the understanding that SME's face resource constrain, a firm's ability to form effective networking to complement resource and capability needs are considered appropriate to address this problem.

In light of the above, entrepreneurship development has long been associated with the entrepreneurial culture, socio economic status and political settings (Welter & Smallbone, 2011:120). In this regard, it is acknowledged that these factors contribute to the differential entrepreneurial activity from one country to another. It is from this context a need arose to review the context in which data were collected. The next chapter gives an account of socio economic setting of Tanzania, efforts made so far to support SME and entrepreneurship development and the challenges confronting entrepreneurship in the country.

CHAPTER LAYOUT - CHAPTER FOUR



CHAPTER FOUR

4 OVERVIEW OF SME AND ENTREPRENEURSHIP DEVELOPMENT IN TANZANIA

4.1 INTRODUCTION

This chapter provides an overview of SMEs and entrepreneurship development in Tanzania. It highlights various strategies employed to support entrepreneurship and SME sector, the trends of economic development and policy reforms before and after independence and their implication on the entrepreneurial culture and SME development. This chapter concludes by pointing out the main challenges facing entrepreneurs and SME in Tanzania in the era of globalization and trade liberalization.

4.2 RESEARCH SETTINGS

Before discussing SME and entrepreneurship development in Tanzania, this section gives an overview of the research context, highlighting the location of Tanzania, population and administrative regions in which data were collected. The United Republic of Tanzania (URT) is a product of the union of two sovereign states namely Tanganyika and Zanzibar. Tanganyika became a sovereign state on 9 December 1961 and became a republic one year later in 1962 (Mwakikangile, 2006:30). Zanzibar gained independence on 10 December 1963 and the People's Republic of Zanzibar was established after the revolution of 12 January 1964 (Mwakikangile, 2008:11). The Tanganyika is the mainland and Zanzibar is formed by the two isles; Unguja and Pemba, both located in the Indian Ocean. The two sovereign states the Tanganyika and Zanzibar united to form the United Republic of Tanzania (URT) on 26 April 1964 (Bekefi, 2006:10; Mwakikangile, 2010a:11; Mwakikangile, 2008:7; Mwakikangile, 2006:9).

4.2.1 Location Of Tanzania

Tanzania is located in East Africa between 29 degrees longtitude and 41 degrees East latitude, 1 degree North and 12 degrees South. Tanzania is bordered on the South by Mozambique, Malawi and Zambia; on the West by the Democratic Republic of Congo (DRC), Burundi and Rwanda; on the north by Uganda and Kenya; and on the East by the Indian Ocean (Figure 4.1).

Figure 4.1: Locational Map of Tanzania
(Source: World map, 2008)

Tanzania is among the five East African states forming the East African Community (EAC). Other EAC member states are Kenya, Uganda, Rwanda, and Burundi. The East African Community where Tanzania is the member state as indicated before was originally found in 1967. By then it had three member states: Tanzania, Kenya and Uganda. The community collapsed in 1977 and officially revived on 7 July 2000 of which later Rwanda and Burundi joined as new members. In 2008 after negotiations with the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMMESA), the EAC agreed to an expanded free trade area including all five member states. The EAC is one of the pillars of the African economic community. In 2010, the EAC launched its own common market for goods, labour, and capital within the region that allow the free movement of goods and services. In this view, it provides an opportunity for member states to explore entrepreneurial opportunities within the region.

4.2.2 Population Of Tanzania

The national housing and population census of 2002 is the recent population census in Tanzania. According to this census, Tanzania had a population of 34,569,232 people. Based on the national average annual population growth rate of 2.9 percent, it is estimated that in 2009 the population was around 41,915,799 people both in the mainland and Zanzibar (Ministry of Finance and Economic Affairs, 2010:100). The Tanzania mainland had an estimated population of 40.7 million people (East African Community, 2010:6; Ministry of Finance and Economic Affairs, 2010:100) and the Tanzania Zanzibar had an estimated population of 1.2 million people (Ministry of Finance and Economic Affairs, 2010:100). In view of the population figures, Tanzania herself forms the largest part of market among East African countries. With the East African common market protocol that allow free movement of goods, capital and services within the region, coupled with the combined population of East Africa that was estimated to reach 126.6 million people in 2008 (East African Community, 2010:6) it provides potential market opportunity for Tanzania entrepreneurs.

4.2.3 Study Regions In Tanzania

Although Tanzania is formed by the mainland and island, this study focuses on the mainland side, specifically three administrative regions namely; Morogoro, Dar es Salaam and Iringa. The selection of the three administrative regions was based on the relevance of the region to the theme of study, convenience, and accessibility. Morogoro region is one of the administrative regions that had several state owned enterprises which were later privatised during the structural adjustment, consequently laid off workers joined SMEs as an alternative way of earning a living. Dar es Salaam is the economic hub of Tanzania where several business activities are taking place and Iringa is one of the regions with several private processing enterprises, survived nationalisation during Arusha declaration. The details of each administrative region in this study are given in the subsequent sections.

4.2.3.1 Morogoro region

Morogoro region is located in the central Eastern part of Tanzania about 200 Kilometres west of Dar es Salaam. The region has six administrative districts namely Morogoro rural, Morogoro urban, Kilosa, Kilombero, Ulanga, and Mvomero (Figure 4.2). Before economic reforms, the Morogoro region had well developed industrial complex with various types of factories such as Morogoro Canvas Mill, Morogoro Shoes Ltd, Morogoro Ceramics, Morogoro Leather Goods, Morogoro Polyester Textile Mills Ltd, Morogoro Tobacco Processing Factory, Magunia Ltd, and Morogoro Vegetable Oil Mills. With the economic reforms of the mid 1980's all industries were closed down and privatised, but since then only few enterprises such as Morogoro tobacco processing factory, Morogoro leather goods, Morogoro polyester textile Ltd, Magunia Ltd, and Morogoro canvas Mills are operational, though below full capacity (Ministry of Finance and Economic Affairs, 2008a). Consequently, workers who used to work in these factories after closing down were absorbed by the SME sector (Olomi, 2009:14).

Figure 4.2: Locational map of Morogoro region
(Source: Own drawing)

4.2.3.2 Dar es salaam region

Dar es Salaam is the commercial city in Tanzania with the largest sea port and the gateway to East and Central Africa and the rest of the world through the Indian Ocean and Mwalimu Nyerere International Airport (Figure 4.3). According to confederation of Tanzania industries (CIT) in Bekefi (2006:12) about 70 percent of Tanzania industries are in and around Dar es Salaam. In this regards, most business activities are taking place in the region with a mixture of people from other regions in the country, neighbouring countries, and the rest of the world. In light of this, Dar es Salaam is regarded as the most active business region in Tanzania with a blend of entrepreneurial culture compared to other regions in the country.

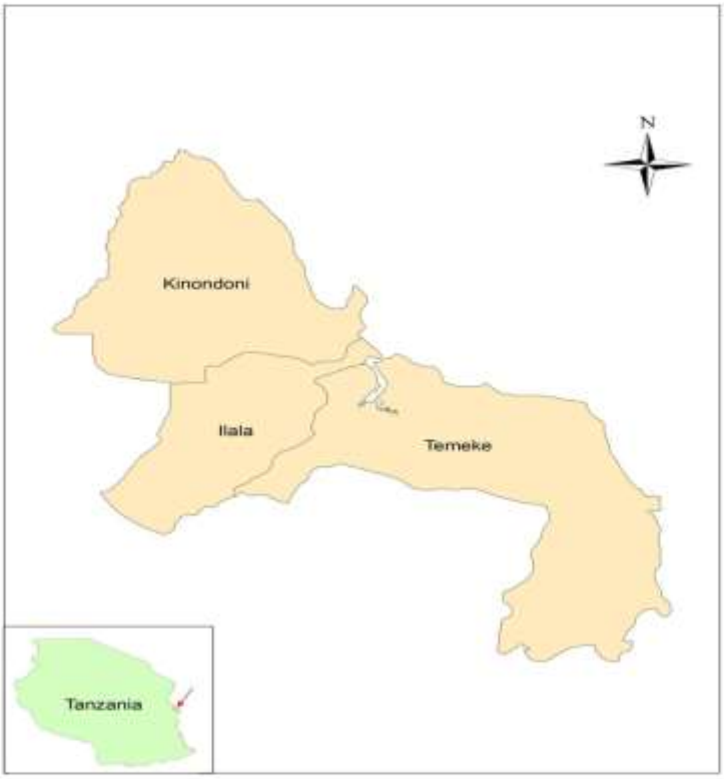


Figure 4.3: Locational map of Dar es Salaam region
(*Source: Own drwawing*)

4.2.3.3 Iringa region

Iringa region is located in the Southern highland of Tanzania, comprised of six administrative districts; Iringa Urban, Iringa Rural, Kilolo, Mafinga, Njombe, Ludewa, and Makete (Figure 4.4). The region is the home of famous private investments that survived nationalisation during Arusha declaration in 1967. Some of the private enterprises that survived nationalisation includes; Tanganyika Wattle Company Ltd, Mufindi Tea Company Ltd, and Brooke Bond Tea Company Ltd. In addition to these private companies, the government introduced several state owned enterprises which later closed down as a result of privatisation policy in the early 1990's (Ministry of Finance and Economic Affairs, 2008a:3; Temu and Due 2000; Kristiansen, 2004). Such public enterprises include Mgololo Paper Mills, Mufindi Pyrethrum Processing Company Ltd, National Milling Cooperation, and Sao Hill Company. However, all these processing enterprises were privatised and are no longer in the hands of the public.

Figure 4.4: Locational map of Iringa region

(*Source: Own drawing*)

4.3 TREND OF SOCIO-ECONOMIC DEVELOPMENT IN TANZANIA

The literature clearly indicates the influence of sociocultural, political, and economic factors in development of entrepreneurship. Welter and Smallbone (2011:107) emphasized a need to interpret entrepreneurial behaviour in the context of socio-economic, political, and cultural environment in which it occurs. The socio-economic cultural and political development influences the attitude of the people towards the entrepreneurship initiatives. Based on this arguments it was considered crucial to review the socio-economic and political development of the study area.

4.3.1 Socio-Economic And Political Development

Since existence, Tanganyika and then Tanzania, has gone through a number of social, political, and economic reforms in an effort to attain economic development. Such efforts include; Tanganyika's first five year development plan (1961-1966), foreseen to develop the economy by attracting foreign direct investment (FDI) (Mwakikagile, 2006:43), Arusha declaration in 1967 through which the Tanzania government adopted a radical transformation to a socialism development strategy through Arusha declaration aimed at abolishing exploitation of humankind and attain social economic empowerment among citizens (Bekefi, 2006:10; Ministry of Finance and Economic Affairs, 2010:2; Mwakikagile, 2006:38), the Structural adjustment that began in the mid-1980's as a consequence of economic crisis experienced since the mid-1970's intended to create enabling environment for private sector development (Kristiansen, 2004:376; Mwaigomole, 2008:96; Kapinga, 2008:92).

All these political, social, and economic changes had several impacts on the development of entrepreneurship and SME sector in Tanzania. Welter and Smallbone (2011:108) argued that the context has impact on the nature, pace of development, and extent of entrepreneurship as well as how entrepreneurs behave, since the socio-cultural and political institutions influence entrepreneurial attitudes and motives. Tanzania is one of the low income countries in the world with per capita income estimated at USD 524.8 in 2008 (East African Community, 2010:29), the economy is heavily depending on agriculture that accounted for about 24.6 percent of Gross Domestic Product (GDP) in 2009 (Ministry of Finance and Economic

Affairs, 2010:2), contributes 75 percent of merchandise exports; employs about 80 percent of the population and provide linkages with the none farm sector. According to the economic survey of 2009 the contribution of other economic sectors is such that the share of services economic activities to GDP recorded at a tune of 43.6 percent, followed by industrial and construction sector that contributes around 22.0 percent of the GDP. The trade sector accounts for around 16 percent of GDP and the manufacturing sector contributing 8.6 percent in 2009 slightly higher compared to 7.8 percent in 2008 (Ministry of Finance and Economic Affairs, 2010:2). However, the general trend of economy has gone through a number of crisises which are briefly presented in the next section.

4.3.2 Economic Turbulence And Impact On Business Performance

The Tanzania economy sustained growth between 1960's and early 1970's (Bekefi, 2006:10). However, the period between 1970 and 1980s experienced a series of economic recession that caused economic dilemma (Kristiansen, 2004:377; Kristiansen and Mbwambo, 2003:366). The external shocks that resulted into the economic crisis include; the oil shock in 1973 triggered by reduced supplies of crude oil in the world market by the Organization of Petroleum Exporting Countries (OPEC) resulted into higher oil prices, collapse of commodity prices in 1970's and 1980's (Bekefi, 2006:11) such that Tanzania dependence on export of agricultural raw material suffered more, consecutive drought in 1973/74 and 1981/82, break up of the East African Community in 1977, and the Tanzania–Uganda war in late 1978 to 1980 (Mbeki, 2005:3; Bekefi, 2006:11; Mwakikagile, 2010b:312). Other factors that pushed the economic crisis in the 1980's, include the weak agricultural policies, which favoured cash crops at the expense of food crops and poor performance of state owned enterprises (Temu and Due, 2000:685; Bekefi, 2006:10).

The economic catastrophe resulted into several social devastations to the Tanzania general public. Some of the impacts associated with the economic crisis include; the annual change in income per capita that declined from 2.5 percent during 1965-1970 to -1.6 percent during 1980–1985, rising inflation and poor performance of public enterprises (Kristiansen, 2004:377; Kristiansen and Mbwambo, 2003:366). Devaluation of Tanzania currency (TAS) coupled with the poor performance of state owned enterprises, drained government revenues that could otherwise be allocated to social services, which by then were offered freely by the government to her citizens, consequently, the deterioration of social services such as education and health. Other crises were severe shortage of basic consumer goods such as sugar, salt, edible oil, soaps, kerosene, cloth, batteries, corrugated iron sheets, beer, soft drinks and cigarettes (Sharpley, 1985:85).

It should be remembered that at this period the level of entrepreneurship in the country was very low since the private sector was almost none existing and all trade operations such as production, distribution and sales were in the hands of the state owned enterprises that proved to be inefficient (Temu & Due, 2000:684; Ministry of Finance & Economic Affairs, 2008a:3). This observation is shared by other scholars who noted that following independence up to the mid-1980's the macro policy environment in Tanzania discriminated the development of the private enterprises (Kristiansen, 2004:377; Kristiansen and Mbwambo, 2003:366; Mongula, 2004b:18) that could drive the entrepreneurship development in the country. Consequently, the prevailed policy environment stunted the entrepreneurship development by undermining the role of the private sector.

4.3.3 Initiatives Toward Economic Liberalisation

Failure of the public enterprises to render expected services in the early 1980's was the beginning of the government to redefine the direction of the economic management and consequently, pushed the government to negotiate with the International Monetary Fund (IMF) and the World Bank (WB), to address the economic crisis (Kristiansen and Mbwambo, 2003:367; Mwaigomole, 2008:95; Temu and Due, 2000:685). According to Mwaigomole (2008:96) the home grown reform effort was executed through the national economic survival programme (1981–1982) and the second attempt was through the Structural Adjustment Programmes (SAP's) from 1983 to 1986, both aimed at closing the fiscal gap and addressing macroeconomic stability. The initial reform effort was followed by a more bold generation of reforms which included, two Economic Recovery Programmes (ERP) from 1986 to 1989, followed by the Economic and Social Adjustment Programme (ESAP) in 1989 to 1992. In terms of the policy, the programmes sponsored by the

IMF and the WB resulted in a major change in Tanzania's policies for economic management, with the emphasis placed on trade and economic liberalisation of which all together was a new beginning for entrepreneurship development in the country.

The liberalisation of the Tanzania economy from state-led economy to a market-driven one redefined the role of the government to engage in business and remained with that of creating an enabling environment for the private sector to take lead in economic development (Kapinga, 2008:92; Mwaigomole, 2008:96). Since then, amongst others the government remained with the role of formulating policies, maintaining law and order, providing basic social and economic infrastructure, and facilitating economic growth (Kristiansen, 2004:376). Accordingly, public monopoly in the financial sector is no more, as most of the public enterprises in the industry, commerce and services have been privatised (Temu and Due, 2000). It was the first time in history that the government opened doors for entrepreneurs from private sector to take lead in economic growth, which implied a positive shift for entrepreneurship development in the country.

4.3.4 Adoption Of IMF And WB Sponsored Programs

The adoption of IMF and WB sponsored programmes in the mid-1980's shaped the economy and contributed enormously to improvements in the performance of the economy (Kristiansen, 2004:377; Mwaigomole, 2008:104). According to the economic survey of 2007; the economy grew by 7.1% in 2007, from 4 percent in 1999 and 4.7 percent in 2000 and 6.7 percent in 2006 (Ministry of Finance and Economic Affairs, 2008b:1). Similarly, the inflation rate declined continuously since 1994 from 35.5% (Ministry of Finance and Economic Affairs, 2005:3) to 4.2 percent in 2004, the lowest ever since 1973 according to the Bank of Tanzania (United Republic of Tanzania, 2005:1). However, the inflation increased continuously from 4.7 in 2005 to 12.1 percent in 2009 mainly triggered by severe drought in 2006/07, followed by the global financial crisis in 2008/09 (Ministry of Finance and Economic Affairs, 2010:5).

However, it is worth noting that the recorded economic growth was not reflected in the living standard of the ordinary Tanzanians. For example, the economic reforms of 1990's that involved privatisation of public enterprises was associated with a significant reduction in wage employment through retrenchment (Afican Forum and Network on Debt and Development, 2007:16). At the same time, as a result of the economic social adjustment programme, the cost of living rose due to the introduction of cost sharing in social services such as education, water, and health. In rural areas the situation was compounded by rising production costs due to the removal of subsidies in agricultural inputs that resulted in the diminishing output (Temu and Due, 2000:685; Kristiansen and Mbwambo, 2003:372), a situation that created both social and economic hardships amongst rural dwellers and prompted rural–urban migration. Given the shrinking of wage employment since the 1990's, the SME sector that is easier to set up in the Tanzania environment absorbed these new entrants in urban areas (Kristiansen and Mbwambo, 2003:372).

In light of the above, it is clear that the previous efforts of the government with the support from IMF and WB to create sustainable macroeconomic stability were successful. However, this success were not realised at the micro level that could benefit directly the citizens. In this regard, since 2004 the government took this as a challenge and embarked on the implementation of the national economic empowerment policy with the objective of promoting, amongst other things, a stable broad based economic growth that ensures the economic prosperity to all people (Ministry of Finance and Economic Affairs, 2008a:4). This view is shared by Mwaigomole (2008:97), who noted that while the economic recovery programmes succeeded in redressing the macroeconomic stability, they were not successful in cushioning vulnerable groups of the people from the effects of the structural adjustment. In this view, the national economic empowerment policy intended to address this challenge.

4.4 ENTREPRENEURSHIP DEVELOPMENT IN TANZANIA

The entrepreneurship development in any society is mainly influenced by the political, social, culture, and economic changes taking place in that particular society (Welter & Smallbone, 2011:107). In this view, this section presents trend of entrepreneurship development in Tanzania in the light of political, social, culture, and economic changes took shape before and after independence. In all these periods it presents, the major events took place and their implication on the entrepreneurship development.

4.4.1 Period Before Colonial Invasion

During this period, the indigenous people of Tanganyika, later named Tanzania, following the union between two sovereign states Tanganyika and Zanzibar, had a well established political system and local institutions to govern their socio-economic welfares. By then the dominant ruling systems were the state organization, kinship or clan organization, and social orders or age set organizations (Mwijage, 2004). The state organizations that existed in Tanganyika during the 15th century were; Gogo, Nyamwezi, Sukuma, Chagga, Hehe, and Ngoni of which all were headed by chiefs. The famous kinship or clan organization in Tanganyika includes the Makonde and Makua with the increase in population and economic strength these clans were subsequently transformed into large states. With regards to the age set organisations, the Maasai of Tanzania mainland offers the best example.

In all these social cultural and political organisations they had the ruling class and the ruled class, the forma was responsible for all economic and social decisions in the area of their jurisdiction. Although, there were some economic activities taking place in various social political organizations such as butter trade and cottage industries mainly blacksmithery, weaving, woodwork and tinsmithery, but still all decisions were made by chiefs or the ruling class and the ruled class had no opportunity to practice decision making (Mwijage, 2004). In view of this, it denied the ruled class the right to practice decision making that is crucial for entrepreneurship development. The dominant mode of production was communal; the relations of production were based on collective labour and common ownership of means of production that determined the collective appropriation of products.

Individuals who became socially and economically powerful and those who demonstrated ambition were perceived as a threat to the rulers and were eliminated (Olomi, 2009:11). This culture never cultivated the entrepreneurial spirit, but rather created dependence syndrome amongst community members that is a barrier to entrepreneurship development.

4.4.1.1 Integration of Tanganyika into the world economy

The integration of Tanganyika in the world economy was recorded since the beginning of contacts between Tanganyika and the outside world such as Asia and the Middle East (Mwakikagile, 2010a:12). The occupation of the islands and the coastal areas of Tanganyika by Asian societies resulted into inhuman slave trade. The slave trade shattered the spirit of technological innovation among Africans that is important for entrepreneurship development. During the slave trade regime the varsity majority of the African population were not settled to engage in technological advancement. Energetic, creative, and innovative people were the target of slave trade. The population left behind was weak and helpless for it rarely internalised the entrepreneurial skills and knowledge that existed and was not able to pass on to the next generations. In light of this, the slave trade destroyed the role models and limited the sustainability of the entrepreneurship development in the country.

The Portuguese also had early contacts with the coastal people in the 1500's but their impact was minimal compared to that of the Arabs whose culture became dominant especially after introduction of Islamic religious. The Oman Authority played a great role in the expulsion of the Portuguese from occupation of East Africa in the 17th Century. In the 19th Century the Oman administration was established in Zanzibar (Tanzania Island) for economic and political reasons (Mwakikagile, 2006:9). Some Arabs settled in the Tanganyika coast before colonization by Europeans to exploit trade in Tanganyika, where indigenous African's were used as middle men (Mwakikagile, 2010a:12). The major products involved in butter trade between Arabs and indigenous Africans were beads, polyssain, and spice that were brought by Arabs from the middle-East and Asia and were exchanged with slaves, copper and ivory. The Arabs rulers introduced clove economy in Zanzibar; hence slaves from the Tanganyika were the only solution to the labour problem. This later implanted racism, inequality, and tribalism which subsequently created both social and political tensions in both parts Tanganyika and isles (Zanzibar), a situation that frustrated the entrepreneurial development in the country.

4.4.2 Colonial Domination

The colonialism involved the acquisition of economic and political control in order to exploit raw materials, markets, cheap labour, and new areas for investments. Historically Tanzania fell under two different colonial masters originating from different countries in Europe i.e. the Germany and British. The domination of Germany in Tanzania is recorded since 1886, after the 1884 – 1885 Berlin Conference, which partitioned Africa (Mwijage, 2004). The British took over Tanganyika following Germany's defeat during World War I (Mwakikagile, 2006:16). The colonialism regime introduced a cash economy in which money became the medium of exchange in trade. This led to the development of infrastructures that aided transportation and hinterland resources to the coast ready for shipping to the colonial master's home countries (industrialised countries). This was followed by introduction of a series of taxes including the development levy that was paid by each adult individual.

During this period, cash crop economy, plantation agriculture, settler economy, and the mining of minerals deposits, developed rapidly. Thus commercialized farming was either introduced or strengthened where it existed in order to double the volume of exports (Mwaikagile, 2010). Since these activities are associated with the generation of wealth and development of economic infrastructure in one way or another have direct impact in the entrepreneurship development. In this regard, this section briefly examines the impact of colonial administration on entrepreneurial development in Tanganyika and then Tanzania. In this view, the negative and positive impacts of colonial regimes are presented.

4.4.2.1 Negative impacts of colonial regime on entrepreneurship development

After a protracted occupation by the unsuspecting traders, explorers and missionaries from Europe since the 15th century, Tanganyika found itself being subjected to a systematic colonial domination by Germany and Great Britain at different times before 1961 (Mongula, 2004b:18; Mpangala, 2004:2). The Great Berlin conference of 1884–1885 was the catalyst of all what had happened for conquering Tanganyika and Africa (Mwijage, 2004). During the domination of Tanganyika by Germany and British, the indigenous people were marginalised, lost their destiny and cultural identities, were economically exploited and their technology disrupted (Mwakikagile, 2010a:33). This did not only affect the social and cultural setting of indigenous people, but also frustrated the entrepreneurial initiatives among indigenous people.

Moreover, the colonial regime introduced laws, regulations and policies that consistently aimed at making the colony a producer of raw materials for use in industrialised countries, the potential market of finished goods from the colonial masters, source of cheap labour and new area of investment of accumulated capital (Mpangala, 2004:2; Mwijage, 2004:83). The adopted strategy was to introduce money as a medium of exchange coupled with a series of taxes, such as development levies that were mandatory and paid by each individual. These had two impacts, firstly it destroyed the butter system that was a dominant mode of exchange, and secondly it created a demand for money for people to be able to meet the cost of living, including servicing the taxes. The only source of money was to work in estate farms and mining industries, which were owned by settlers who dictated the terms of payment. In this case, payments made to labourers were a subsistence amount.

The introduction of cash crops provided base for the colonialists to consolidate power over the local population. State corporations favoured private monopolies from the colonial powers. Home country brought cash crops from the peasants. Either way, the farmers got the worse end of the bargain as they were paid at far below world market price (Mbeki, 2005:3). This practice had negative implication on entrepreneurship development because it limited the abilities of entrepreneurs to do meaningful savings that could be used to invest in new ventures. On the other hand, the import of finished goods from colonial masters frustrated the cottage industries developed during the pre-colonial era and this killed the spirit of creativity and innovation which are necessary for entrepreneurship development (Mwijage, 2004:77). In this way, the indigenous people became dependent on their colonial masters. Their entrepreneurial activities were mainly in the area of distributive trade that does not support rapid entrepreneurship development and economic growth as reversed to manufacturing (Mbeki, 2005).

The colonial policies also deliberately restricted participation of indigenous Africans in business activities except for very small forms of business (Ministry of Finance and Economic Affairs, 2008a:2). The indigenous people were regarded as cheap labour to work in industries or estate farms established to satisfy growing needs of the raw materials in industrialised countries. To a lesser extent policies relaxed to Tanzanian-Asians origin who participated in banking, insurance, manufacturing, import and export (Mongula, 2004b:18; Temu and Due, 2000:864). In financial sector for example, the commercial banks and other institutions were foreign owned and served a small segment of the economy and offered credit to Whites and Asians only. They could easily comply with the loan conditionality set by the banks. This practice denied an opportunity for indigenous people to access start-up capital to start and grow businesses.

In addition, the education offered during the colonial period was discriminatory in nature with three different curriculums. The first curricula was Whites, meant to prepare rulers and technocrats, the second curricula was Asians meant to prepare them for clerical jobs, the third curricula was indigenous Africans meant to make them understand to read and write in order for them to receive instructions and be able to communicate with the ruling class (Mwakikagile, 2010a:39). Mwijage (2004) contend that education is an endless socialisation process whereby the knowledge, values, and skills of the society are transmitted to the younger generation. In this view education package offered to indigenous as it can be learnt was not geared to prepare indigenous to acquire knowledge and skills that help them to be enterprise minded.

The colonial strategy to undermine Africans' socio-economy was a deliberate move to disempower the indigenous Africans and make them easy to rule (Mwijage, 2004). The colonial political system deprived the indigenous Africans the economic and political power,a situation that left them with no ability to do anything meaningful in the society (Mwakikagile, 2010:33). Such an environment had a negative impact on the development of entrepreneurial culture consequently discouraged creativity, innovation, proactiveness, aggressiveness and competence which are prominent entrepreneurial values necessary in competitive environment.

4.4.2.2 Positive impacts of colonial era

Although the colonial administration sighted to be responsible for drawback of entrepreneurship development in Tanzania, there are some positive aspects that contributed to enhance entrepreneurial culture in some parts of the country and deserve mention. For example, the European missionaries who settled in some parts of the country introduced Christianity, education, health facilities (hospitals), commercial crops, and farmer's cooperatives. The followers of Christianity were allowed to attend missionary schools, get health services from hospitals and grow commercial crops which were sold to cooperatives ready for export. Although some authors argue that Christianity was meant to prepare indigenous Africans to be obedient and accept colonial rulers and the education system was meant to prepare few individuals to work in clerical jobs, in reality the introduction of commercial crops was associated with construction of economic infrastructure such as railway lines, roads and telecommunication. All these together advantaged communities in such places and made fast progress in terms of economic development. Clear evidence is Kilimanjaro, Bukoba and Southern highlands regions of Tanzania. In these regions communities are by far enterprise minded compared to other regions in the country and they are quite ahead in terms of economic infrastructure development that foster entrepreneurship development.

Similarly, the indigenous social and political organisations (chiefdoms) engaged in trade with the foreign traders such as Europeans and Asians or Arabs, in particular acquired wealth and became strong kingdoms. According to Mwijage (2004) the Nyamwezi society which had several chiefdoms were involved in the long distance trade with coastal Arabs and Swahili traders. The Nyamwezi traded copper, ivory and slaves who were raided from neighbouring kingdoms, also taxed all foreign trading through their land as another source of revenue. The Nyamwezi gained a lot of wealth from this trade and their political leaders used this wealth to acquire firearms and ammunitions from coastal Arabs and Swahili traders. The growth of

Nyamwezi kingdom is a clear indication that is due to entrepreneurial culture development as a result of interaction with foreign traders.

Subsequent domination of Arabs and Europeans in Tanzania created social and political pressure among indigenous and triggered series of struggle movements for independence. Among others, “Maji Maji” uprising in 1905 to 1907 is a typical example of Ngoni in Southern Tanganyika resisting domination of Germans (Iliffe, 1967;497; Mwakikagile, 2006:18). The end of the Second World War in 1946 Tanganyika became a United Nation (UN) trusteeship territory and that was the beginning of the modern struggles for independence which were characterised by a series of political party movements (Mwakikagile, 2010:13). In Tanganyika, the strongest political party was the Tanganyika African National Union (TANU) that aimed at struggling for independence. It was under the same political party that Tanganyika declared independence in 1961 (Mwakikagile, 2006:19). Similarly, in Zanzibar, the Afro Shiraz Party (ASP) emerged late in the 1950’s and overthrew the Arab rule on the island in 1964 of which in the same year Tanganyika and Zanzibar united to form the United Republic of Tanzania. The independence of the two sovereign states changed the social economic and political landscape which eventually opened up a new environment for the entrepreneurship development in the country.

4.4.3 Development Strategy After Independence

Following independence the government aimed at changing the social economic and political environment that promotes equity among people of Tanzania. To attain this, the government developed a series of development strategies with the intention of attaining equity and sustainable development. Since these strategies intended to attain social and economic empowerment among the indigenous, in this view, they had direct impact on entrepreneurship development. For this reason the next section briefly review these strategies and gives an account of their impact on entrepreneurship development.

4.4.3.1 First five years development plan (1961–1966)

After independence the government of the then Tanganyika was ambitious to attain high economic growth and social development. The government development vision was to attain economic empowerment among citizens and fight three enemies; poverty, diseases and ignorance (Mwakikagile, 2006:42). To achieve this vision, the government developed a first five years development plan (1961 – 1967) envisaged developing the economy by attracting foreign direct investment (FDI). Throughout this period the government retained the economic system inherited from the colonial master (British) of which all the economy and major means of production were still in the hands of few individuals especially the foreign settlers and Asians who owned estate farms, commercial banks, insurance firms, hospitals, schools, large manufacturing, and transport (Temu & Due, 2000:684; Ministry of Finance and Economic Affairs, 2008a:2)..

Since before independence the distribution of wealth was skewed to few individuals especially settlers. The retention of the colonial economic system after independence did not help much to bring changes in terms of economic empowerment amongst the indigenous. Towards the end of the first five years development plan, the FDI was not flowing as expected and there were concern that not much had been achieved in terms of addressing the legacy of the marginal position of Africans in the economic sphere left by the colonial government. The leaders by then were in the opinion that the nation got political independence and not economic independence (Ministry of Finance and Economic Affairs, 2008a:2) necessary to determine the direction of economic growth and social development, hence a need to have an alternative development strategy. The leaders by then opted to nationalise the private investment as a means to attain equity among citizens.

4.4.3.2 Nationalisation of private enterprises

The failure of the first five year's development plan to address the legacy of the marginal position of Africans in the economic field, compelled leaders to identify socialism (*ujamaa*) as an appropriate development strategy characterised by policies based on extensive state control of the economy (Temu and Due, 2000:684). The Arusha declaration was aimed at economic empowerment of Tanzanians so that they could take command of the economy (Ministry of Finance and Economic Affairs, 2008a:2). The Arusha declaration was a radical change in the national economic sphere that involved nationalisation of major private economic activities owned by foreign investors (Ministry of Finance and Economic Affairs, 2008a:2; Temu and Due, 2000:684). The nationalised investments included banks, plantations, private companies, factories, manufacturing, transport, import-export, insurance firms, schools and hospitals (Mongula, 2004b:18; Temu and Due, 2000:684; Bekefi, 2006:10). The nationalised enterprises were transformed from private to state owned enterprises and were engaged in the production sector and provision of services (Ministry of Finance and Economic Affairs, 2008a:2). Mbeki (2005:3) pointed that all modern schools of political thought from Marx and Lenin to Hayek and Freedman despite of their ideological differences, at least agreed on one thing: the private sector is the driver of modern economic development. The nationalisation of private enterprises was the biggest set-back for entrepreneurship development in Tanzanian history, since it destroyed the role models that others could use as a learning ground when intending to start and grow businesses.

The government immediately after nationalisation through socialist policy discouraged private enterprises on the expense of public enterprises. According to Mongula (2004b:18) the private sector involvement was limited to retail business which was mainly operated by Tanzanians minority of Asians origin while indigenous Tanzanians were restricted to peasant farming or plantation labourers. Even at this level, the state owned Regional Trading Company's (RTC) posed severe competition against small scale private owned retail businesses because they enjoyed monopoly of macro-policy environment (Kristiansen, 2004:377; Temu & Due, 2000:684). The production by small farmers was strictly under the communal rural groupings called *"ujamaa"* villages. The marketing of produce was through state owned crop authorities or cooperatives that were amongst other duties responsible for setting purchasing price of farmer's produce. The farmers had no power to negotiate price for their crops. According to Temu & Due (2000:684) the earning received by farmers were the residual price, derived from the World market (for export) or retail price (for domestic food crops), less marketing costs, taxes and any other deduction deemed necessary by the government. As a result peasant received subsistence amounts that were only enough to serve a plate of a meal on a table and limited the ability of deriving meaningful savings that could allow them to grow their businesses. It is through this practice the government is blamed for frustrating the entrepreneurial initiatives in the country.

With regard to capital, credit was controlled in favour of co-operative farmers and state farms till the liberalization of policies of the mid 1980's. Since all financial institutions such as commercial banks were nationalised and owned by state (Mongula, 2004b:18). The government intervention to control capital and credit facilities in favour of the cooperatives and state owned enterprises deprived the right of the private sector entrepreneurs to source start up and expansion capital. Lack of accessibility to credit facilities among entrepreneurs in SMEs, is one of the major constraints that hindered the development of the sector in Tanzania.

The government also introduced a code of ethics that restricted the civil servants and other public officials to engage in any business activities. Any profit seeking venture performed by a civil servant lacked legal legitimacy and was considered economic saboteur (Temu & Due, 2000:684). By then few Africans were educated, for this reason educated Africans were civil servants, this imply that by restricting the civil servants to engage in business activities left Asians and Africans with no jobs, while the majority had no substantial education to engage in business activities. This strategy again was a snag for entrepreneurship development in the country. Education is important for entrepreneurship development for several reasons; through education people build networks which are important to share business information, physical resources and access to new markets. These all together are essential for entrepreneurship development. By restricting elite to participate in business undertakings was another drawback for Africans to take an active role in entrepreneurship development. It was from this period where the education system prepared to graduate to be job seekers and not job creators; whoever graduated at any level of education the first expectation was to be employed by the government and stay away from self-employment. This slowly killed the entrepreneurial spirit amongst elites; entrepreneurial venture was regarded as an activity for uneducated and people who do not have an option for survival.

The setup of socialism policy was centred on collectivism; people lived together, worked together, shared resources and made collective decisions on all issues that affected their daily life. Although theoretically people were supposed to make collective decisions where one would expect bottom up approach, in contrary the government practiced top down approach where people were instructed what to do and what they should not. For example the government instructed people to form community based investments; type of crops to grow in specific areas, regulated prices of various products even the salaries of civil servants (Temu &Due, 2000). In addition the government provided free social services such as education and health services for her citizens and free transport for civil servants and students. While this practice was good and enabled poor people who were in the majority, to access free health services, educate their children and address the problem of ignorance and poverty, on the other hand, created dependency syndrome and killed the spirit of creativity, innovation, drive towards need for achievement, willingness to take risk, proactiveness and aggressiveness towards opportunities which are key pillars of entrepreneurship.

Initially, the public enterprises after nationalisation performed well between 1967 and the early 1970's before the nation stumbled in a series of misfortune economic events. These events include the oil crisis of the early 1970's resulted from reduced supply of crude oil in the world market by the OPEC (Bekefi, 2006:11), collapse of the East African community in 1977 (East African Community, 2010), immediately followed by the war between Tanzania and Uganda in 1978–1979 (Mbeki, 2005:3; Bekefi, 2006:11). The oil crisis in 1973 pushed up oil price that was reflected on higher prices of consumer goods. The collapse of EAC in 1977 was another blow to Tanzania because most of the manufacturing industries during the EAC were located in Kenya and by this time diplomatic relationship between Tanzania and Kenya was not favourable a situation that lead into a closure of boarders between the two countries. Followed by the war between Tanzania and Uganda, it worsened the economic situation. These crises all together drained foreign currency reserve, impaired the purchasing power, shortened the supply of consumer goods, triggered inflation and continued to decline of the crop prices in the world market. A series of these events signalled a total failure of formal economy to serve the society and left an economic vacuum that needed to be filled in order to stabilize the economic system. This was the beginning of the emergence of the parallel or second economy to fill the gap left by the formal economy.

4.4.3.3 Emergence of second economy

In view of the above, wage earners and farmers were pushed to engage in petty business activities to supplement their income to be able to meet their basic needs. Since the ethics of conduct was restricting civil servants and public officials to engage in business activities and the policy environment was not in favour of the private sector, this forced operators to create a series of informal businesses such as backyard factories, smuggling goods from neighbouring countries and hoarding of little consumer products that was available from the local industries and selling the same at inflated prices. The emergence of the second economy was a result of the failure of the formal economy to fulfil the basic economic demand of the society. The rise of the entrepreneurs in the informal sector (second economy) was the evidence that Tanzania did not lack entrepreneurship talents but the problem was lack of supportive policy and regulatory framework (Kshetri, 2009:238). This view, shared by Mongula (2004b:18), pointed that private enterprises were suppressed during the years of socialism after the Arusha declaration in 1967 up to 1985 when the ideology of socialism was the foundation of public policies, thus limiting opportunities for entrepreneurship.

However, the second economy met strong resistance from the state which was regarded as being in conflict with the socialist (ujamaa) policy that aimed at attaining social equity and economic empowerment among citizens through state-owned enterprises and self-reliance. While in the second economy there were some good elements of entrepreneurship that could have contributed to the economic development, the state failed to do thorough analysis to identify good elements that required support and bad elements that were to be stopped. In the contrary the government labelled all players in the second economy as “economic saboteurs” (Temu & Due, 2000:684).

In 1983, the government implemented a ruthless campaign against “economic saboteurs” confiscated property and arresting business owners in the emerging sector. The state economic saboteurs campaign in 1983 created social stigma towards entrepreneurship and delayed the social and political legitimisation of entrepreneurial initiatives in Tanzania. Temu & Due (2000:684) shared similar views that there were severe suppression of the private sector, the government and specifically civil servants considered private entrepreneurs to be economic saboteurs; any element of business initiative and profit generating endeavours was labelled economic saboteurs. This is a clear indication that socialist policy in Tanzania stunted entrepreneurial culture required for entrepreneurship development.

4. 4.3.4 Economic and Policy Reforms

The background history indicates clearly that the decision makers failed to achieve self-sustained growth as the essential pre-condition for any pattern of economic development. In view of this, by the early 1980’s the magnitude of the structural weaknesses in it’s economic model had come to full light and had forced Tanzania to find an alternative model to invigorate her economy. Despite the socialism narration and nationalistic style, society reality continued to be shaped by capitalist `regulations and dependence. Coupled with the increasing criticism of inefficient and unproductive performance of public owned investments (Temu & Due, 2000:685), the government was viewed as hampering economic development by constraining market forces. It was at this stage in 1986, that the government was forced to adopt economic liberalisation and implemented the radical transformation programme spearheaded by the International Monetary Fund (IMF) and the World Bank (WB) (AFRODAD, 2007:11; Mongula, 2004a:239; Temu and Due, 2000:685).

The economic reform involved liberalization of all sectors of the economy, privatisation of public enterprises and rationalisation of employment in the public sector (Ministry of Finance and Economic Affairs, 2008a:3). The first ten years (1986–1996) were for structural adjustment that involved gradual changes in economic policies from public led economic growth to private led growth that promoted free market economy and local entrepreneurship. This was a turning point for the national development vision, shifting from state monopoly of economy that involves the private sector in the economic development. The role of the state was redefined to focus on creating a business enabling environment through design and implementation of proper macro-economic framework and eliminating obstacles to efficient functioning of markets (Mongula, 2004a:246).

Successful completion of the structural adjustment during the mid-1990's leads the government to embark on privatisation of public enterprises. The exercise was associated with the retrenchment of sizeable labour force, downsizing and re-engineering of large corporations that intended to improve production efficiency and secure market competitiveness (Cooper *et al*., 2000:122; Mongula, 2004a:243). Consequently, there was a dramatic change in employment set up in the country. For example, the public sector that initially used to absorb a large number of job seekers from different sources in the country did no longer exist due to privatisation of public enterprises. The private sector that was expected to replace the role of the public sector had not expanded enough to absorb the growing number of job seekers, hence increased pressure of unemployment in the country. Kristiansen and Mbwambo (2003:372) and Olomi (2009:14) conclude that most people who could not secure jobs and workers, who were under paid, started micro and informal businesses to enable them to earn a living.

A shift of policy from socialism to open market economy has encouraged entrepreneurship development in the private sector in the country. Since the mid-1990's entrepreneurship as a career has increasingly acquired legitimisation. The proportion of individuals consciously choosing self-employment, even among the highly educated, has increased. A clear evidence of policy shift amongst others is the review of the leadership code of ethics that, since independence, restricted public officials and civil servants to engage in business activities. The review of the leadership code of ethics is no long restricting public officials and civil servants to engage in any business activities, provided it is legal and does not have conflict of interest on their careers. Also the introduction of the SME policy in 2003 is a positive initiative of the government to legitimatise entrepreneurship in small business entities (Ngalinda & Mutagahwa, 2006:53).

4.5 SMALL BUSINESS DEVELOPMENT IN TANZANIA

There is no single definition of small businesses, as each country uses a different definition (Tusubira & Ndiwalana, 2006:57). However, a small business can be described as the one that is independently owned, managed by its owner or part owner, has relatively small market share, and does not engage in new market and innovative practices (Carland, Hoy, Boulton & Carland, 1984:358). According to Nieman and Nieuwenhuizen (2009:10) “small businesses in most cases are established to meet personal goals and ensuring security of owners and not necessarily interested in growth”. The literature supports this observation by pointing that entrepreneurial firms are driven by innovation as reversed to small businesses (Kartz & Green, 2008; Tang & Murphy, 2012:44). It is the innovation that fosters growth in the entrepreneurial firms.

In quantitative terms, small businesses are categorised, based on different criteria in different countries, even within the same country, definitions sometimes tend to differ from one sector of economy to another (Tusubira & Ndiwalana, 2006”57; Esselaar, 2006:49). Despite of all these variations there are mainly some common criteria used to define small businesses with some minor variation between countries on adopted criteria. These criteria are the total number of permanently full paid employees, volume of production or total turnover, total asset values, capital investment in machinery (Tusubira & Ndiwalana, 2006:57). Through these criteria, the small businesses are categorised into small, micro, and medium enterprises (SME’s).

While there is an agreement in terms of categories, there is no consensus in terms of cut off points of criteria used to arrive at these categories. For example, the upper cut off point of number of full paid employees in medium enterprises in USA and Canada is less than 500 employees, in the United Kingdom it is less than 250 employees, in South Africa it is 200 employees, in Malaysia for the manufacturing sector it is 150 employees and for agriculture and services it is 50 employees and for Brazil and Tanzania it is less than 100 employees. This implies a medium enterprise in one country not necessarily fall in the same category in another country. For example, a medium enterprise in South Africa will be a large enterprise in terms of number of permanently fully paid employees in Tanzania.

4.5.1 Definition Of SME In Tanzania

The literature of political and non-governmental institutions, provide a wide range of definitions of the term SME. The term SME stands for Small, Micro, and Medium enterprises (Ministry of Industry and Tande, 2003:3; Antonie, 2001:2; Department of Trade and Industry, 1995:4). Just the words “small, micro and medium” indicate that most definitions use the firm size to distinguish between SMEs and larger corporations. Amongst these quantitative elements that seem to be commonly used, are the number of employees, capital invested, share capital, number of shareholders, market share, annual turnover, total asset value, composition of management and degree of formalisation (Ministry of Industry and Trade, 2003:3; Hibbert, 2001:5).

According to the Ministry of Industry and Trade in Tanzania, SME is defined according to the number of employees and capital investment in machinery (Ministry of Industry and Trade, 2003:3; Ngalinda & Mutagahwa, 2006:54). Accordingly, the SME policy of 2003 gives official definition of SME and is defined as small, micro, and medium enterprises in non-farm activities, including manufacturing, mining, commerce and services. A micro-enterprise is one with fewer than five employees, a small enterprise with 5 to 49 employees, a medium enterprise with 50 to 99 employees and a large enterprise with more than 100 employees (Ministry of Industry and Trade, 2003:3). Capital investments in machinery range from less than Tshs 5 million for micro enterprises and up to Tshs 800 million for medium enterprises (Table 4.1). This definition does not differentiate the number of employees and their level of capital investment in machinery in different sectors of the economy. However, the policy states clearly in case an enterprise falls in two criteria stated above, the monetary criteria rules out (Ministry of Industry and Trade, 2003).

Table 4.1: Definition of SME in Tanzania

Category	Number of employees	Capital investment in machinery (Tsh)
Micro-enterprise	1-4 employees	Up to 5 million
Small enterprise	5-49 employees	5-200million
Medium enterprise	50-99 employees	200-800 million
Large enterprise	100+	Over 800 million

Source: SME Development Policy, April. 2003:5 *USD 1 = TAS 1600*

4.5.2 Structure And Characteristics Of SMEs In Tanzania

There is a shortage of comprehensive data on the state of the SME sector in Tanzania. Most reports on the sector rely on data from the 1991 National Informal Sector Survey (NISS) (Ministry of Industry and Trade, 2003; Ngalinda & Mutagahwa, 2006:54; Ministry of Finance and Economic Affairs, 2008a:19), which is out-dated. Although other studies have been done such as the 1992 Rural Informal Sector Survey (RISS) and the 1995 Dar es Salaam Informal Sector Survey, the NISS 1991 remains the only nationwide study of the informal sector. The structure of SME in Tanzania is considered in terms of categories in the SME development policy that include small, micro, and medium enterprises. The characteristics of each category are briefly discussed.

4.5.2.1 Characteristics of micro enterprises

The micro enterprises are the smallest unit in the business categorisation; most have one to four employees (Shreiner &Woller, 2003:1567). They tend to lack formality in terms of registration for tax purposes, labour legislation, business premises, and accounting procedures (Antonie, 2001:4), which is the case for Tanzania (Stevenson & St-Onge, 2005:7). They are found in both the formal and informal economies and have limited capacity to grow (Rogerson, 2004:770). According to Bekefi (2006:17), 70 percent of Tanzanians are engaged in informal production of goods and services. It is within this category that the survivalist businesses are found (Jeppsen, 2005:265).

The survivalist operates in the informal sector of the economy, mainly undertaken by people unable to secure regular wages employment or access to economic sector of their choice (Antonie, 20001:2; Rogerson & Rogerson, 1997:87). The income generation is below poverty line, which limits saving and growth. Their businesses provide minimum means to keep the unemployed and their families alive, with little capital investment requirement, less asset requirements, virtually no skills, training, and constrained opportunities for business growth (Antonie, 2001:2). Most entrepreneurs in this category involved in hawking, vending and subsistence farming (Rogerson, 1996:171). In Tanzania the survivalists are commonly known as *"machinga.*"

In Tanzania it is estimated that the SME sector form over 98% of all active enterprises in the country, of these micro-enterprises form over 92% of total SME in the country (Kozak, 2007). This implies that the dominant category in SME is the micro enterprises. Among several reasons, the complexity of the regulatory framework with unsupportive institutions mentioned to limit small businesses to formalise their undertakings (Ngalinda & Mutagahwa, 2006:53). As a result most businesses decide to remain micro or small and operate informally (Bekefi, 2006). Consequently, large proportions of businesses are unable to build a reputation and be able to assess and acquire expansion capital from financial institutions that could enable them to grow.

4.5.2.2 Characteristics of the small enterprises

The small enterprises are more established and complex businesses compared to the micro enterprises, varies in terms of number of employees and other monetary criteria from one country to another (Ayyagari *et al.,* 2005:4; Esselaar, 2006;49; Tusubira & Ndiwalana, 2006:57). For example, in the United States of America (USA), the small enterprise the most common upper cut off point is 100 employees, while in manufacturing it is fewer than 500 employees. This figure does not compare to countries like the United Kingdom and Tanzania where the upper cut off point is less than fifty employees. This difference is not limited to the United Kingdom (UK) and Tanzania alone; it is experienced in other countries as well.

According to Antonie (2001) entrepreneurs in the small business sector often have some form of collateral that would be acceptable by the formal financial institutions, but it is usually not sufficient to meet their requirements, hence the collateral remains a constraint to access finance. Kuzilwa (2004:125) shared similar views that lack of access to credit is among major constraints in small business in Tanzania and other developing countries. The commercial banks have traditionally concentrated on lending mainly large formal enterprises with collaterals and therefore thought to be less risky. According to a 1997 study on the supply and demand for financial services in Tanzania by K-Rep (1997), less than 5% of enterprises in urban and rural areas in Tanzania had access to credit from formal sources. This proportion of entrepreneurs accessing credit is very low to stimulate entrepreneurial initiatives in the country.

4.5.2.3 Characteristics of medium enterprises

The medium sized enterprises are enterprises with up to 200 paid employees. Although in the case of South Africa, the agriculture sector is up to 100 employees (Department of Industry and Trade, 2003). This is not the case for Tanzania, where according to the 2003 Tanzania national SME development policy, the limit is less than 100 employees (Ngalindwa & Mutagahwa, 2006:54). These enterprises generally have established relationships with bankers and lending to medium and small enterprises is profitable (Antonie, 2001). According to Rogerson (2004:770) this is the category that is regarded as dynamic and contributes significantly to employment as compared to other categories.

In Tanzania, this category constitutes the smallest segment in SME. According to Kozak (2007) the proportional composition of medium enterprise in SME is only 0.6%. Consistently, the Tanzania SME policy of 2003 recognizes this shortfall and clearly indicates that among limitations of the enterprise development in Tanzania, is the missing middle between the large and the small enterprises hence a need to build capacity to enable small business to grow and graduate from one category to another. The literature clearly indicates that the entrepreneurial culture in Tanzania is still underdeveloped and most entrepreneurs in businesses are ‘first generation’, and are still in the learning process (Nchimmbi, 2002; Ngalinda & Mutagahwa, 2006;

Olomi, 2009; Ministry of Industry and Trade, 2003). Although one can see businesses in every corner of town, most owners of these businesses do not have a growth vision or interest to systematically analyse their business constraints and innovatively respond to address the challenges confronting them.

4.6 Roles Of SME In Socio-Economic Development

The role SMEs play in socio-economic development is increasingly recognised. According to Nieto and Santamaria (2010:44) SMEs in the European Union make up to 99 percent of the industry and account for more than 70 percent of employment. In developing countries, in terms of economic and industrial development, the SMEs are reported to form over 90 percent of enterprises, and account for about 50–60 percent of employment (Befeki, 2006:9). Consistently, Ngalinda and Mutagahwa (2006:54) pointed out that in South East Asia, SMEs account up to 60 percent of GDP. In view of these statistics, no wonder most economies are currently largely composed of SMEs.

Tanzania suffers from reliable statistics on SME (Ngalinda & Mutagahwa, 2006:54). However, it is estimated that close to 80 percent of formal industries are SMEs, each employing between 5 and 99 employees (Bekefi, 2006:10). Similarly, Kozak (2007) pointed out that SMEs form the largest group within the private sector and are estimated to constitute about 98 percent of all active enterprises in the country. The SMEs account for about 34 percent of GDP and 20 percent of jobs in the private sector (Ministry of Industry and Trade, 2003:4). The importance of SME in the economic growth, employment, and income generation compelled the government to develop supporting strategies to enhance survival, growth and the success of the sector. The next section briefly covers the support strategies designed and executed by the government as a supporting mechanism to facilitate the growth of the sector.

4.6.1 SME Support Strategies In Tanzania

Business support services are activities aimed at supporting the creation, survival of businesses, increases business profitability and assist business development and growth. They incorporate information, advice, training and consultancy, financial services, incubators, networking, and regulatory environment." In Tanzania, as in other countries, business support is paramount to the survival and growth of SMEs. In event where business support services are underdeveloped or not well coordinated, they encourage unethical behaviours amongst entrepreneurs. For example Tang and Hull (2012:135) observed that entrepreneurs operating in a weak regulatory environment where laws and regulations are not recognizing or protecting them, they feel threatened and tend to engage in illegal operations such as violation of property rights or breaking contracts, as well as corruption with the government officials to find legitimacy of their undertakings. Consistently, Tang and Murphy (2012:41) pointed out that absence or inadequacy of business support services increases the risk for entrepreneurs and when feel threatened, they avoid undertaking innovation initiatives which are crucial to increase market share, market value, improve performance and enhance survival.

In Tanzania, several studies indicate that SME suffers from lack of business support services. Specifically, formal financial institutions such as banks, mentioned to be not supportive to small businesses, in most cases don't meet the collateral conditionality (Kuzilwa, 2004:125). Training institutions also have been challenged to offer none entrepreneurial oriented education that generate graduates who are not enterprise minded. These problems might have been contributed to by the background socio-cultural and political system adopted earlier that did not nurture the entrepreneurial culture in Tanzania. However, since the adoption of the open market driven policies, several efforts have been made in terms of restructuring of the regulatory environment to encourage private sector to take lead in economic growth. The next sections present various interventions taken by the government right after independence to date.

4.6.1.1 Establishment of national small industries corporation

An attempt to support SME in Tanzania can be traced back to 1966 when the National Small Industries Corporation (NSIC) was established under the National Development Corporation. The objective of the NSIC was to establish small industries clusters, essentially training production workshops intended to provide knowledge and skill to nascent entrepreneurs in order to develop a pool of entrepreneurs in the country. With all these efforts made by the government, the policy environment for small businesses, especially the private owned businesses, were still unfavourable (Kristiansen, 2004:377; Mongula, 2004b:18). For example, Kristiansen and Mbwambo (2003:366) contend that following independence, small enterprises in Tanzania were in many ways disadvantaged by large scale and state-owned companies. Consistently, Bagachwa (1993:103) indicates that up to the mid-1980's, before embarking on the structural adjustment, the macro-policy environment in Tanzania were not in favour of the small enterprises. All sorts of development strategies focused on large scale import, substituting and state-owned manufacturing industries. In this view, the NSIC could not easily achieve its objectives since most of the small business operators in the small business sector were not well supported by the existed policy environment.

4.6.1.2 Establishment of small industries development organisation

In 1973, the government took on another initiative to support the small businesses by establishing the Small Industries Development Organisation (SIDO) that replaced the National Small Industries Corporation (Kristiansen and Mbwambo, 2003:366). The establishment of SIDO was intended to expand the obligations of the NSIC by providing basic infrastructure facilities such as premises, water, electricity and training for entrepreneurs. To reach more entrepreneurs, SIDO offices were established in each administrative region of Tanzania and provided training and fabrication or processing facilities for entrepreneurs. Although this was another good initiative intended to support the development of small scale enterprises, the policy environment was not yet to legitimatise the private small scale enterprises. For example, the Government Acts, directives and regulations prohibited the development of private small scale enterprises. This view is shared by Helmsing and Kolstee (1993) that the Ujamaa Village Act of 1975 agrees that all village based enterprises should be communally owned. According to Temu and Due (2000:685) an individual's wealth accrual was not acceptable by the state and community at large and the civil service excessively regulated the private sector. All these together sent a negative signal to the business community and frustrated the entrepreneurship initiatives in the country.

In light of the above, SIDO was obliged to serve more of communal owned enterprises because they were much more favoured by the existed policy and the legal framework than the private businesses which were marginalised. Although this strategy thought to be appropriate, in reality was not helping to nurture the environment for entrepreneurship development. The literature acknowledges the role played by the private sector in economic development. For example Mbeki (2003:3) argued that the entrepreneurs in the quest for greater security and comfort seek to accumulate material wealth that compels them to produce more and exchange what they produce with other individuals who seek the same. For entrepreneurs to produce more, they must generate savings and plough back those savings into the production process in the form of innovation such as the new and improved techniques, processes and products. However, in communal based businesses, it may not have similar drive due to the nature of ownership, conflicts of interest among owners and the set-up of decision making that may not be flexible enough to cope with the pace of environmental change.

4.6.1.3 Financial services

With the approach that used to support communal owned businesses and state owned enterprises, until the 1980s the capital market was heavily subsidised by the financial institutions such as banks owned and sponsored by the government (Kristiansen and Mbwambo, 2003:366). In other words this practice distorted the market forces essential for the development of the robust financial sector. As a result, credit rationing diverted the bulk of funds to the large scale state owned enterprises while leaving a large proportion of small scale enterprises un-served. Bagachwa (1993) supported this argument by pointing that small scale enterprises received only 5.7 percent of funds allocated through the Co-operative and Rural Development Bank (CRDB) in the period 1976/7–1986/7 mainly due to uncompliance with the loan conditionality. This environment denied an opportunity for small scale enterprises to access start-up and expansion capital.

The foreign trade regime employed a rationing system for all essential imports and was characterised by overvalued national currency. This situation created an uneven environment for private small enterprises to compete with the state owned enterprises which were favoured in obtaining licences, currency exchange and import (Kristiansen and Mbwambo, 2003:366). During the late 1970s and early 1980s, Tanzania's economic performance weakened substantially. According to Kristiansen and Mbwambo (2003:366) the annual change in income per capital declined from 2.5 percent during 1965–70 to -1.6 percent during 1980–1985. The inflation escalated from an average of less than 10 percent per annum 1970–1976, to 31 percent in the years 1980–1986. It was at this time in history, the public enterprises performed poorly and drained government revenue through subsidies (Temu & Due, 2000:685). The domestic market fell short of basic commodities and citizens became accustomed to rationed basic commodities, partly as a strategy to contain social unrest.

In the environment of an open market economy, the government realised these weakness and transformed the financial sector to be able to serve the private sector specifically the SMEs (Temu & Due, 2000:684). Also several initiatives have been taken to easier accessibility of financial services for start-ups and expansion capital. Such initiatives includes establishment of the Credit Guarantee Scheme managed by the Bank of Tanzania with the intention to facilitate accessibility to loans, National Entrepreneurship Development Fund (NEDF) managed by SIDO, Mwanachi Empowerment Fund, Economic Empowerment Programme and Small Entrepreneurs Loan Facility (SELF) (Ministry of Finance and Economic Affairs, 2008a:9). In view of this, it is a clear indication that the government recognises the role of small businesses in economic development and several efforts have been made to support SME sector. However, coordination amongst these programs and policies is still lacking for effective service delivery; consequently SME's still face more or less similar situations as before.

4.6.1.4 Establishment of Tanzania national business council

The economic crisis, market shortages and failure of public enterprises to render goods and services experienced in the early 1980s, created new opportunities for the small enterprises. It was at this stage, entrepreneurs in the private small scale enterprises emerged to fill the gap left by public enterprises. This implies that entrepreneurs were present but suppressed by the existing policies and the regulatory framework. This argument is in line with the observation made by Kshetri (2009:237) that post socialist economies do not lack entrepreneurship talents. There has been a lack of institutional support needed to promote productive free market entrepreneurship. Since anti-business policies remain unchanged, the rise of the entrepreneurs in the private sector lacked legitimacy in the eyes of the community and the government. As a result, the entrepreneurs in the private sector operated by hiding transaction, none compliance to government regulations, evading tax, and bribing to get licences and permits became pre-conditions to do business (Temu and Due, 2000). Tang and Hull (2012:135) found that unlawful behaviours in businesses are accelerated when entrepreneurial firms do not perceive sufficient protection from regulatory environment and find ways of surviving. This argument reflects the real situation experienced in Tanzania. With respect to existed business environment by mid-1980s, Tanzania needed more than simply an adjustment, but rather a complete structural transformation to legitimatise the private-owned businesses and create an enabling environment for the take-off.

Since the mid-1980s the government embarked on formal economic reforms. This was a positive shift from state control of economy to private sector lead economic growth. Since then, several efforts have been made to promote the private sector. For example, in 2001, with the assistance from UNIDO the Tanzania president's office launched the Tanzania National Business Council (TNBC) to hold discussions with business leaders about economic development and the business climate in the country. According to Bekefi (2006:14) the TNBC addressed the country's legal and regulatory framework that helped to create a favourable business environment for the private sector to operate in.

4.6.1.5 Policy environment

The background information clearly indicates that for many years the policy environment in Tanzania has not been favourable to support SME development. The shift to the open market economy accompanied by the privatization of state owned enterprises created pressure in terms of employment opportunities and social hardships due to the layoff of a number of employees who previously worked in the state owned enterprises (Olomi, 2009:14). Consequently, people who lost jobs established SMEs as a way of earning a living (Kristiansen and Mbwambo, 2003:372). Despite of the significance of the SME in the socio-economic development, its growth was hampered by several factors including the policy environment that was not supportive. The government realised this short fall and focused to create a favourable policy environment in which the potential contribution of the SMEs can be fully exploited (Ngalinda & Mutagahwa, 2006:53).

In an effort to create a small business enabling environment, the government developed a small and medium enterprise policy that was launched in April 2003 and the Private Sector Development Strategy of 2003 as means to enable the private sector to participate fully in economic development and achieve ends. In 2004 the national economic empowerment policy was introduced after the government realised that most of local citizens did not benefit from privatisation of the state-owned enterprises because they could not afford to access credits from formal financial institutions due to lack of collaterals. The economic empowerment policy was meant to empower local entrepreneurs to participate in economic development.

Coupled with these policies, the government embarked on other initiatives such as developing and launching a Business Environment Strengthening for Tanzania (BEST) (Ministry of Finance and Economic Affairs, 2008a:9). These initiatives were geared to support SME development in terms of minimizing regulatory and administrative costs, risks and barriers to conduct business in Tanzania. Also they were intended to improve policy and regulatory decision-making and service delivery by government to promote a better environment for business and investment. There are still challenges in implementation to realise the expected results.

4.6.2 Challenges Facing SMEs In Tanzania

Despite efforts done by the government to support SME sector in the country, there are several challenges that need to be addressed if the sector is to contribute more in economic development. Below are some of the challenges confronting the SME sector in Tanzania.

- Inadequate entrepreneurial skills and knowledge such as creativity and innovation (low technological capability) among entrepreneurs in SMEs.

- Due to inadequate entrepreneurial knowledge and skills, entrepreneurs in SMEs are not competitive enough to face competition posed by rivals in the dynamic business environment we are today.

- Uncoordinated business support services and institutions responsible for SME support in the country.

- Lack of accessibility to credit among entrepreneurs in SMEs is a major constraint hindering the development of SMEs in Tanzania

- Much as it is acknowledged that the current regulatory environment is difficult for medium and large scale formal sector firms, it is largely inappropriate and irrelevant to micro and small scale businesses.

4.7 CHAPTER SUMMARY

This chapter presented the socio-political and economic changes that took place in Tanzania before and after independence and their implication in the development of SME and entrepreneurship. Drawing from the background information, it is clear that Tanzania has gone through a number of socio-political and economic transformations that have impacted entrepreneurship and small business development. The development presented in basically three major phases: pre-colonial regime, colonial regime, and after independence.

The pre-colonial regime represents a period before penetration of foreign nations to colonize Tanganyika. At this period, although there were entrepreneurial initiatives such as cottage industries and butter trade activities taking place in different socio-political settings, all the socio-political and economic decisions were done by the ruling class and the ruled class had no opportunity to practice decision-making which is crucial in entrepreneurship development. Also the dominant mode of production was communal that put emphasis on collective labour and common ownership of means of production that determine the collective appropriation of products. Individuals were not allowed to accumulate wealth and whoever was perceived becoming socially and economically powerful, was eliminated. This culture stunted the entrepreneurial spirit and created dependence syndrome amongst community members.

The colonial regime introduced laws, regulations and policies aimed at making the colony a producer of raw materials for use in the industrial countries and the potential market of finished goods from industrialised countries. The import of finished goods from industrialised countries frustrated the cottage industries developed during the pre-colonial era and this killed the spirit of creativity and innovation which are pillars of entrepreneurship development. They also introduced cash economy coupled with a series of taxes such as development levies paid by individuals and they introduced money as a dominant mode of exchange. The introduction of money as a medium of exchange destroyed the existed mode of exchange, namely the butter system, which involved the exchange of goods for goods. This was done purposely to create demands for money for people to be able to meet the cost of living as well as servicing taxes. The restriction of colonial policies for indigenous Africans to participate in business activities coupled with the discriminatory education system that prepared them to be able to receive instructions from the ruling class left indigenous Africans with no choice than seeking casual employment in estate farms and mining where they were engaged as cheap labourers. This strategy impacted entrepreneurship development in all aspects in terms of knowledge, legal and capacity to generate enough savings to accumulate wealth.

Since independence the government has taken several socio-political and economic transformations in the effort to empower the Tanzanian citizen. The initial period is between 1961 to the mid-1980's when the government followed the *"ujamaa"* policy or African socialism that focused on self-reliance, and fight against three enemies; poverty, diseases and ignorance. However, while fighting against poverty was the central agenda, the *"ujamaa"* policy failed to recognize the role of the private sector as an incubator of entrepreneurship and a driver of economic growth. In 1967, the government nationalised most of private businesses such as banks, insurance companies, plantations, manufacturing, transport, hospitals and schools. It was at this time the government discouraged the private businesses on expense of the state-owned enterprises and introduced a code of ethics for the public officials that restricted them to engage in any business or own/share in any company, this shuttered all possibilities for the entrepreneurship development.

Despite these initiatives taken by the government to establish NSIC in 1967 and then succeeded by SIDO in 1973, with the intention to establish small industries clusters, essentially for training, production, workshops were to provide knowledge and skills to nascent entrepreneurs. This stimulated entrepreneurship development because the private sector which could better utilise the entrepreneurial knowledge and skill, did not exist due to the existing policy environment. The nascent entrepreneurs were expected to apply knowledge and skills gained in communal-owned businesses and/or projects of which in most cases were not well developed due to lack of necessary business supports. However, during the period between the early 1970's and the early 1980's the government stumbled in a series of economic misfortune such as an oil crisis in 1973, consecutive droughts in 1974 and 1975, the collapse of East African Community in 1977, and the war between Uganda and Tanzania in 1978 to 1979. These events created saviour social and economic pressure that resulted into the emergence of the second economy to fill the gap left by the formal economy.

The second economy contravened the *"ujamaa"* policy that promoted equity amongst citizens. For this reason it received strong resistance from the state and the general community. While there were some good entrepreneurship elements in the second economy, the government failed to do thorough analysis and identify good elements that required support. On the contrary all participants were labelled "economic saboteurs". By the early 1980's, the economic crisis reached the highest stage and was reflected in every sector of the economy. There were saviour shortages of consumer goods, continuous increase of inflation and deterioration of the social services. It was during the mid-1980's the government adopted a structural adjustment guided by the IMF and WB that lead to the privatization of the state-owned enterprises (SOEs). For the first time in history, the government recognised the role of the sector as the driver of economic growth and remained creating an enabling environment.

The effective privatisation of state-owned enterprises began in 1996, after the completion of the structural adjustment. The period between 1992 and 2004 recorded positive economic growth, the GDP grew from 3.2% to 6.7% and the inflation declined from 35.5% to 4.2%. However, these changes in economic growth were accounted for by the large businesses and the role of SME was still marginalised. It was until 2003 when the government formulated the SME policy and in 2006 the government started implementing the broad based economic empowerment program preceded by the formulation of the National Economic Empowerment Policy, National Economic Empowerment Act No. 16 of 2004, and the establishment of the National Economic Empowerment Council. Despite of these efforts, there are still outcries of several challenges experienced before, which are still persisting. One of explanations of this might be the poor coordination of supporting institutions aimed to support SMEs in the country.

The next chapter presents the research methodology showing the research design and sampling procedure used to capture data and the statistical techniques used for data analysis.