

Effect of Fines and Penalties on Legal Compliance of SMES in Tanzania: A Case of Business Registrations and Licensing Agency

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Abstract

This study sought to ascertain the effect of fines and penalties on the legal compliance of Small and medium Enterprises in Tanzania, particularly BRELA. Morale Theory was adopted in this study. The descriptive research design was adopted in this study, and both the quantitative approach to research and the qualitative approach were adopted to complement one another. The researcher selected 140 officials from BRELA, Dar es Salaam, and the researcher used simple random sampling to select a sample size. For data collection, the study relied on both primary and secondary sources. The data acquired in this investigation was quantitatively and qualitatively analyzed. To analyze quantitative data using descriptive and inferential statistics, the Statistical Package for Social Sciences (SPSS) version 26 was used as a data analysis tool. Also, qualitative data was analyzed using content analysis. Findings indicated that fines and penalties improve legal compliance among SMEs, while complexities in the existing fines and penalties strategy decrease legal compliance. This study concludes that fines and penalties have a positive and significant effect on legal compliance. The study recommends future research on the efficiency of BRELA's digital systems in enhancing company registration and licensing procedures as proposed.

Keywords: Fines, Penalties, Legal Compliance, SMEs, Business Sector

1. Introduction

In most nations throughout the world, Small and Medium Enterprises (SMEs) account for a sizable percentage of the national economy. SMEs have historically played an important role in creating jobs, stimulating innovation, and developing new goods in developed countries, contributing to economic vitality and growth (Collins 2018). Furthermore, SMEs have been the driving force behind the rapid rise of newly industrialized Asian countries. In South Korea, for example, SMEs account for 99% of all businesses and 88% of all employees. Some of the world's largest Korean corporations, such as Samsung and LG, began as modest businesses. From these instances, it is apparent that SMEs are crucial to the

development process and that African countries would benefit from promoting SMEs for future growth (Otero and Rhyne, 2019).

SMEs are seen as sources of job creation, economic growth, and social reform in African countries. Based on their size, location, ownership, status of formality, and economic activity, a significant proportion of SMEs are formal, while the majority are informal. Together, as major job providers, they produce a significant share of total value added and provide a large segment of the poor and middle-income populations with affordable goods and services (Mhandiki, 2017). For example, in Egypt, SMEs account for around 45% of total value added in manufacturing, 80% of industrial employment, approximately 25% of the labor force, and 90% of all enterprises (Mack, 2018). Over 52,000 SMEs in Malawi produce approximately 30% of overall tax income (Malawi revenue collection reports, 2011–2017).

Mwalyego (2019) observes that Small and Medium Enterprises (SMEs) play an important role in economic development since they are the primary source of job creation and production growth in Tanzania. She also claims that SMEs foster the growth of entrepreneurship, industry, and the rural economy. As a result, it is critical that they follow government policies. Tanzania is among the countries with the lowest levels of legal compliance as a result of ineffective administration (Malimo, 2020).

Individual competence and desire to comply with relevant rules and regulations are referred to as legal compliance (Mugube, 2019). This is also known as correct registration, licensing, income reporting, and cost reimbursement in line with applicable regulations (Kundy, 2020). Many governments throughout the world are concerned about legal business registration and licensing (Kapinga, 2017). One of the most significant issues that SMEs face is legal compliance. According to Ngungat (2019), government rules and regulations are a big source of anxiety for the global business sector. Regulatory constraints tend to fall disproportionately on SMEs, according to international experience.

Business registration and licensing are critical components in developing a successful business sector. It allows registered and licensed firms, particularly SMEs, to obtain access to capital and some legal protections. It also helps to formalize the economy since registered businesses pay taxes and provide other vital economic advantages such as employment creation (Kipilimba, 2019). Businesses in Tanzania, regardless of shape, size, or industry, are obliged by law to comply with all relevant regulations, including registration and licensing. The Business Registrations and Licensing Agency (BRELA) is an Executive Agency under the Ministry of Industry and Trade that is in charge of business administration and law enforcement, specifically company registration, business name registration, trade and service mark registration, patent granting, and industrial license issuance. It was created in accordance with the Government Executive Agencies Act No. 30 of 1997 and launched on December 3, 1999. (BRELA 2021). Nonetheless, despite the establishment of this Registration and Licensing Agency, SMEs' levels of legal compliance have remained relatively low. Against this background, the researcher sought to examine the factors affecting legal compliance by small and Medium enterprises in Tanzania using BRELA as a case study.

Small and Medium Enterprises (SMEs) are key factors in the growth of the Tanzanian industrial sector, but the majority of them have not been properly registered. The significance of SMEs in the economic growth of African countries in recent years cannot be overstated, particularly in terms of job creation,

innovation, raising people's living standards, and financial contribution to the increase of the country's Gross Domestic Product (DeAngelo 2019). However, according to Mollel (2020), most SMEs in Tanzania lack basic information and skills about formal business registration and licensing. As a result, despite several advocacy efforts for voluntary legal business compliance, Tanzania continues to be characterized by poor compliance levels (Fute 2021, Minja 2019). As a result, the government has adopted legal compliance administrative measures through the Business Registrations and Licensing Agency (BRELA) to ensure that SMEs in the country legally comply with the government rules and regulations of operating businesses (Eunice 2020), which have yet to provide significant yield. This is because the majority of SMEs in the nation are not registered by the government through the correct process and so go unnoticed and pay no tax, according to the NBS study (2019), which indicated that 51.5% were not registered while 48.5% were registered. It is therefore the intention of the researcher to examine factors particularly affecting legal compliance by small and Medium enterprises in Tanzania, particularly BRELA. The researcher sought to ascertain the effect of fines and penalties on the legal compliance of SMEs in Tanzania.

2. Literature Review

2.1. The Morale Theory

The Cologne School of Tax Psychology, founded by Gunter Schmolders, was the first to promote morale theory. Morale theory is the individual aspect that motivates a person to perform his or her commitments (Mocetti et al., 2018; Hamis, 2019; Amir et al., 2017). Individuals will be more likely to avoid their legal commitments as a result of the societies in which they live or work. Individuals are more likely to comply with their commitments if their families, friends, and acquaintances meet such obligations. Individuals may even avoid their commitments if they feel they will not immediately profit from them (Waweru, 2004). Individuals may feel morally justified in refusing their commitments in some situations if they perceive the quality and quantity of government services and products as inadequate. And the inverse is also true. The incidence of legal duty resistance is low in countries where the distribution of public goods and services is appropriate. Individuals are more likely to fulfill their commitments if they perceive their government as fair, democratic, and participative, and when fines and penalties are applied for noncompliance (Cummings, 2007). As a result, because the attitude, understanding, and availability of fines and penalties are major indicators of legal duty compliance, the study sought to ascertain the impact of user training, fines, and penalties on the legal compliance of SMEs in Tanzania. The weakness of this theory is that factors that motivate an individual can change during their lifetime. However, the strength of this theory is that it sees the establishment of individual aspects as a positive, reinforcing motivation to inspire legal compliance. This theory concentrates on the positive results of individual aspects, creating an environment that is upbeat and focused on legal compliance. Morale Theory guided the researcher in determining how user training, fines, and penalties influence the legal compliance of SMEs in Tanzania.

2.2. Empirical Literature Review

Nduati (2019) investigated the factors that influence business compliance in small and medium-sized enterprises in Embu County, Kenya. Using a stratified random sampling approach, the study sampled 185 businesses in Embu County. Fines and penalties, compliance costs, and knowledge and education all have a major impact on legal compliance among small and medium enterprises in Embu County, according to the research. Data was collected using self-administered questionnaires and an interview guide. The collected data was consequently analyzed using Statistical Package for Social Scientist

software, and the findings of the research were presented using tables. According to the report, the Kenya Revenue Authority should develop education and training programs to ensure that small and medium-sized firms adopt voluntary compliance with all legal requirements. The study focused on factors that influence business compliance in small and medium-sized enterprises; therefore, this study seeks to examine factors affecting legal compliance by small and Medium enterprises in Tanzania.

Nzioki (2019) wanted to identify the factors that influence legal compliance in the Real Estate business. The intended demographic of 841 real estate investors yielded a sample size of 271 people. Data was gathered via a structured questionnaire, coded, keyed, and statistically analyzed using descriptive and inferential statistics using SPSS version 24. According to the study's findings, compliance costs had a detrimental impact on the degree of legal compliance. Training, on the other hand, has a favorable influence on the degree of legal compliance among real estate investors. Fines and penalties, on the other hand, have a beneficial influence on the degree of legal compliance. The study presents early evidence that implementing fines and penalties and providing real estate investors with compliance information and education will promote legal compliance. The study is based on factors that influence legal compliance in the Real Estate business; therefore, this study seeks to examine factors affecting legal compliance by small and Medium enterprises in Tanzania.

Putri (2020) investigated the relationship between fines and taxpayer knowledge of corporate taxpayer compliance, as well as the function of compliant intent as a moderating variable. Multiple Linear Regression and Moderated Regression Analysis (MRA) are the analytical methods employed. This study's population is corporate taxpayers in the North Banjarmasin Tax Office in 2019, with a sample size of 142 corporate rate taxpayers. Convenience sampling was utilized as the sample method. The collected data was consequently analyzed using Statistical Package for Social Scientist software. The findings indicate that sanctions and taxpayer knowledge have a favorable impact on corporate taxpayer compliance. The study was based on the relationship between fines and taxpayer knowledge of corporate taxpayer compliance; therefore, this study seeks to examine factors affecting legal compliance by small and Medium enterprises in Tanzania.

Yunus (2017) explored the link between fines and the legal compliance behavior of SMEs, since they are more prone to non-compliance with legal concerns. For this study, the factors affecting penalties were rate and punishment, knowledge and education, and taxpayer psychological behavior. The purpose of this study is to examine the impact of fines on each factor of legal compliance behavior. This study used a quantitative research approach in which a survey was done on a selected sample of Malaysian Small and Medium Enterprises (SMEs). The findings indicate that sanctions increase SMEs' legal compliance behavior. According to the findings of the study, all parts of penalties, namely rate and punishment, education and awareness of penalties, and the psychological behavior of taxpayers with regard to legal compliance behavior, have a substantial association with legal compliance behavior. This study fails to outline factors affecting legal compliance by small and Medium enterprises; thus, the current study seeks to examine factors affecting legal compliance by small and Medium enterprises in Tanzania.

Keraro (2021) sought to determine the elements that impact legal compliance, with a particular emphasis on SME's operating in Nakuru CBD. A survey design technique was used in the investigation. A sample of 212 licensed SMEs operating inside the Nakuru CBD was chosen as a representation of the population of 3506 licensed SMEs. Structured questionnaires were self-administered as data-gathering

devices. The acquired data was analyzed using descriptive and inferential statistics in the SPSS software program. The study's findings demonstrated that training had no statistically meaningful influence on legal compliance in SMEs. Fines and penalties have been shown to have a statistically significant influence on legal compliance among SMEs. The study recommended that the Kenya Revenue Authority guarantee revenue streams are monitored by involving banking institutions, as well as increasing its workforce to assure monitoring and tracking of all revenues reported by SME operators. This study determines the elements that impact legal compliance in Kenya. However, the current study seeks to examine factors affecting legal compliance by small and Medium enterprises in Tanzania.

3. Methodology

The descriptive research design was adopted in this study. Data was collected from BRELA, Dar es Salaam. Workers in this organization explained the current scenario in depth and included opinions on factors affecting legal compliance by small and Medium enterprises in Tanzania. In this study, both the quantitative approach to research and the qualitative approach were adopted to complement one another.

The target population of this study is officials from BRELA-Dar es Salaam. The researcher selected 140 officials from BRELA-Dar es Salaam because he believed they had considerable knowledge of presenting a solution to the problem under consideration. The simple random sampling strategy was suited for this investigation because it provides advantages such as lowering bias in results and boosting the reliability and validity of data from population-representative respondents. Also, the study used purposive sampling in drawing heads of department and employees of the Business Registrations and Licensing Agency (BRELA) in Dar es Salaam, which assisted the researcher in obtaining important information in providing the solution to the problem under study. For the objectives of this study, a sample size of 104 officials was deemed adequate and cost-effective. Slovin's formula was used to calculate the sample size. The following formula was used:

$$n = \frac{N}{1 + N \cdot e^2}$$

$$n = \frac{140}{1 + 140 \times 0.05^2}$$

$$n = 104$$

For data collection, the study relied on both primary and secondary sources. Primary data was collected using a structured questionnaire and interview. The investigator used questionnaires to collect information from the officials from BRELA-Dar es Salaam in this study. In this study, a set of semi-structured interviews was conducted to collect data from heads of departments and employees of the Business Registrations and Licensing Agency (BRELA) in Dar es Salaam from various departments. Secondary data was acquired from a variety of sources, including newspapers, current case reports, administrative files, press announcements, financial surveys, and online multimedia resources. To analyze quantitative data using descriptive and inferential statistics, the Statistical Package for Social Sciences (SPSS) version 26 was used as a data analysis tool. Inferential statistics uses correlation and regression analysis to determine the degree of relationship between the dependent variable and the independent variables. Also, qualitative data was analyzed using content analysis. The multiple regression equation of this study was as follows:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$$

Where: Y = Legal Compliance

β_0 = constant; β_1 , β_2 , β_3 and β_4 = regression coefficients;

X_1 = User Training; X_2 = Fines and Penalties; X_3 = System Automation; ε = Error Term

4. Findings

The researcher provided surveys to 103 officials, 100 of whom completed and returned the questionnaires, yielding a 97.1% response rate. According to Khan (2015), a response rate of 50% is appropriate for analysis and reporting; a rate of 60% is good; and a rate of 70% or more is exceptional.

4.1. Effect of Fines and Penalties

The researcher intended to ascertain the effect of fines and penalties on the legal compliance of SMEs in Tanzania. The researcher utilized a five-point scale. The five-point scale ranges are as follows, based on the mean values: A mean score of less than 1.5 indicates Strongly Disagree; a mean score of 1.5 but less than 2.5 indicates Mean scores that differ by 2.5 but are less than 3.5 indicate disagreement. Mean scores of 3.5 but less than 4.5 indicate neutrality. Agreed; mean ratings ranging from 4.5 to 5 indicate strongly agreeing.

Table 4.1: Descriptive statistics for Effect of Fines and Penalties

	Mean	SD
Fines and penalties improve legal compliance of SMEs	3.7200	.45126
Complexities in existing in fines and penalties strategy decreases legal compliance	3.9100	.28762
Fines and penalties diminish clearness on legal compliance	3.7700	.42295
Presence of fines and penalties increase of awareness of legal compliance	3.8600	.34874
Higher fines and penalties imposed by BRELA increase resistance to legal obligations	3.8200	.38612
Higher fines and penalties imposed by BRELA maximize the burden of legal compliance	3.8400	.36845
Composite Mean	3.82	

Source: Field Data (2022)

The majority of the respondents agreed that fines and penalties improve legal compliance of SMEs (Mean = 3.7200, SD = .45126), while complexities in the existing fines and penalties strategy decrease legal compliance (Mean = 3.9100, SD = .28762). During the interview, respondents asserted that:

I can say fines and penalties are important because they make SMEs operators respect government requirements. Without fines and penalties, SMEs operators will never bother themselves to comply with the laws (BRELA: employee).

Fines and penalties are very important; they make SMEs operators behave according to government laws (BRELA: employee).

The findings further indicated that fines and penalties diminish clarity on legal compliance (Mean = 3.7700, SD = .42295), while the presence of fines and penalties increases awareness of legal compliance (Mean = 3.8600, SD = .34874). During the interview, respondents asserted that:

You know, SMEs comply with legal requirements because they fear fines and penalties. Our people are not in a position to comply with legal requirements without intimidation yet.

The fines and penalties posited by the government stimulate to a large extent SMEs attitudes toward legal compliance (BRELA, employee).

According to the respondents, higher fines and penalties imposed by BRELA increase resistance to legal obligation (Mean = 3.8200, SD = .38612), as well as maximize the burden of legal compliance (Mean = 3.8400, SD = .36845). The composite mean of 3.82 means that the respondents agreed with the statements concerning the effect of fines and penalties on the legal compliance of SMEs in Tanzania. It is critical that BRELA reconsider the fines and penalties now levied against SMEs and rectify any issues discovered with them. The considerable complexity connected with fines and penalties will be demystified, which will considerably increase SMEs' level of compliance.

4.2. Correlation Analysis

The table below shows the correlation analysis between independent variable and dependent variable.

Table 4.2: Correlation Analysis

		Fines and Penalties	Legal Compliance
Fines and Penalties	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	100	
Legal Compliance	Pearson Correlation	.690**	1
	Sig. (2-tailed)	.000	
	N	100	100

Source: Field Data (2022)

The findings showed that fines and penalties has a significant relationship with Legal Compliance with a coefficient of 0.690. The above results imply that all independent variable had a positive significant relationship with dependent variable Legal Compliance.

4.3. Regression Analysis

The fitness of the model was ascertained by the use of coefficient of determination. The coefficient of determination (R) from the model was 60.2% of the variations in legal compliance by small and Medium enterprises in Tanzania are explained by the Fines and Penalties. Hence, a fairly good model it was since $R > 50\%$.

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
.776 ^a	.602	.590	1.66846	.776 ^a

a. Predictors: (Constant), Fines and Penalties

Source: Field Data (2022)

Table 4.3 shows that the ANOVA test results revealed that $F(3, 96) = 48.481$, $p < 0.05$. This implies that the relationship between the dependent variables and the independent variable of the model fitted in the data collected is statistically significant. This outcome is also supplemented by the F- critical value associated with the degrees of freedom. This indicates that that Penalties have significant influence on legal compliance by small and Medium enterprises in Tanzania.

Table 4.4: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1957.313	3	652.438	48.481	.000 ^b
	Residual	1291.927	96	13.458		
	Total	3249.240	99			

a. Dependent Variable: Legal Compliance

b. Predictors: (Constant), Fines and Penalties

Source: Field Data (2022)

Table 4.4 explains the overall relationship between the independent variables and the dependent variable and the significance of each relationship. The table depicts fines and penalties are prominent in legal compliance

Table 4.5: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.536	2.103		4.536	.000
	Fines and Penalties	.250	.113	.233	2.202	.030

Source: Field Data (2022)

Using the results above, we have the regression equation as:

$$Y = 536 + 0.250X_1 + 2.103\alpha$$

Whereby Y = Legal Compliance; X₁ = Fines and Penalties

The regression model above gives that, a unit change Fines and Penalties while holding the other factors constant results to an increase in Legal Compliance by a value of 0.250. The predictor variables in this model were as indicated by p values which is 0.030 was less all than $\alpha = 0.05$. This supports conclusion using p value that all the independent variable was of significant.

4.4. Discussion of Findings

According to the Morale Theory, individuals prefer to fulfill their commitments if they feel their government is fair, democratic, and participatory, and when fines and penalties are levied for noncompliance. This postulation confirms the study's findings, which show that fines and penalties enhance SMEs' legal compliance, whereas complications in the present fines and penalties approach diminish legal compliance. The findings support Putri's (2020) finding that sanctions and taxpayer awareness have a favorable impact on corporate taxpayer compliance. The data also suggested that the existence of fines and penalties reduces clarity on legal compliance, whereas the absence of fines and penalties increases awareness of legal compliance. Nonetheless, Yunus (2017) asserted that sanctions promote SMEs' legal compliance behavior.

According to the findings of this study, greater BRELA fines and penalties enhance resistance to legal responsibility, whereas higher BRELA fines and penalties maximize the cost of legal compliance. This result is consistent with Nduati's (2019) findings that fines and penalties, compliance costs, and knowledge and education all have a major impact on legal compliance among small and medium-sized firms. However, rules must be developed to reduce fines and penalties experienced by small and medium-sized firms in order to prevent limiting their development potential and to encourage voluntary legal compliance.

Findings revealed that fines and penalties had a positive and substantial link with legal compliance, with a unit change in Fines and Penalties resulting in a 0.250 rise in Legal Compliance while maintaining the other components constant. These findings are consistent with Keraro's (2021) discovery that fines and penalties have a statistically significant influence on legal compliance among SMEs. Similarly, Nzioki (2019) found that fines and penalties had a favorable influence on the degree of legal compliance.

5. Conclusion and Recommendations

This study concludes that fines and penalties have a positive and significant effect on legal compliance. Fines and penalties have an impact on SMEs; hence, it is critical for BRELA to consider extending deadlines and informing them through various communication channels to increase compliance. BRELA should also teach SMEs on a regular basis so that they are up-to-date on the legislation and any other developments. BRELA personnel will be able to provide adequate and correct advice to SMEs during the business registration and licensing process in this manner. Consider changing the fines and penalties in order to improve legal compliance. Lowering fines and penalties, as opposed to high fines and penalties, makes it less appealing for SMEs to ignore legal responsibilities. BRELA should levy fines and penalties at the lowest possible level so as not to discourage small businesses. This study focused on the factors influencing legal compliance by Small and Medium Enterprises in Tanzania, with a particular emphasis on BRELA-Dar es Salaam. Aside from Tanzania, where this study was done, there is a need to conduct similar studies in other parts of the nation and in other countries in East Africa. Future research on the efficiency of BRELA's digital systems in enhancing company registration and licensing procedures is proposed. It is also critical to perform research on SMEs' perceptions of BRELA's digital systems.

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