

# Possible Risks to Chinese Enterprises in Tanzania: The Construction Industry Experience

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## Abstract

This paper assesses the risks challenging Multinational Companies in Tanzania, focusing on the Chinese construction companies as an example. The paper incorporated a substantial literature review that determined a number of critical challenges that influence the company's ability to complete a project within time and under budget. The nature, strength and weakness, opportunities and risks within the Tanzania Construction industry were reviewed. The economy, the policies, business environment, resources and infrastructures of Tanzania were also assessed.

The main risks factors to Chinese International Construction companies identified in Tanzania including microeconomic and financial risks; fluctuating currency exchange rates, governance and administration, operational risks which include issues such as power supply problems, and corruption, strategic risks and cultural risks.

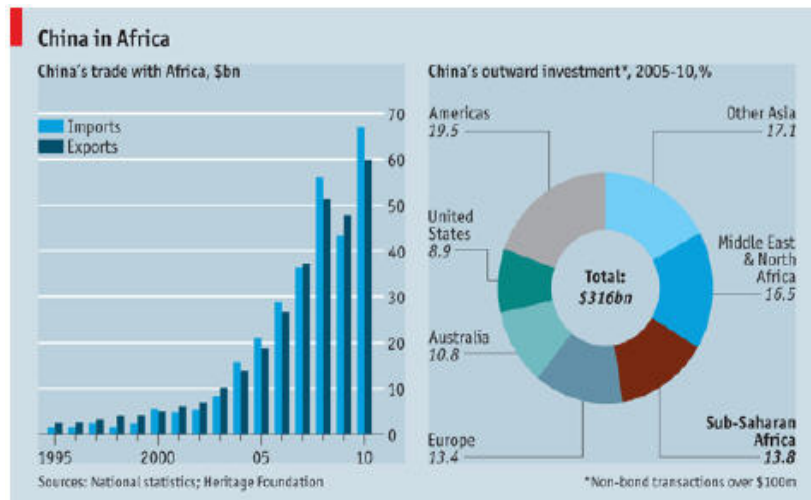
**Keywords:** Risk factors, Chinese Construction Companies, Tanzania

## 1. Introduction and background

In Africa market (Tanzania inclusive), the value of the global construction industry in 2011 was USD 5.8 trillion, in which took up 8.3% of the global GDP value (WB,2010). Asia and Australia, Europe and Middle-East countries are still the top three regions weighting 65.5% of the whole value of the international construction market; Asian and Australia comprises USD 112.19 billion, European countries 101.46 billion, and Middle East countries have the value of USD 83.07 billion. According to ENR, Latin America, Africa and Asia are certainly all regions where to see greater opportunities for the business growth in the future. Comparing with the total revenue in 2010, the growth rate of different regions were: 6.6 in Asia and Pacific; 6.4% in Latin America; 5.8 % East Europe; 4.7% in middle East; 4.7 in Africa; minus 0.4% in west Europe, and minus 3.3 in North America. And for the past decade, the total revenue of the ENR top 225 grew for 6 times (from USD 88 billion in 2001 to USD 606 billion in 2010). The revenue of African Market weighted 8.28% of the total top 225 revenue in 2001 and increased to 15.80% in 2010 (12.84% in 2011).

From given information above it can be seen that the African Market has been weighting a significant proportion in the total ENR international Contractors' Revenue. The market demand is increasing due to the needs to build and improve the infrastructures. Latest statistics shows that 49 Chinese companies were listed on the ENR's Top 225 International Contractors TIC 225 and in 2006 alone gained a total contracting revenue of \$16.289 billion from their overseas construction market.(ENR,2011)

Figure 1 China in African figures



Source: The economics (2011).

The global construction market in recent years has witnessed a fast expansion of Chinese creation under the umbrella of International Construction Companies CICC. China Report, (2007), shows that Construction companies have played a key role as omens of China's engagement with Africa. As noted earlier China has a long history of relations with Tanzania and the privatization and deregulation of China's construction industry has been accompanied by a steady increase in the number of Chinese construction firms entering the country. The infancy of the construction industries of Tanzania reveal interesting patterns in the participation of Chinese firms in the country's economy. Chinese contractors have made inroads to the Tanzanian construction market for years. Because of the foreign aid program towards Africa ever since China's establishment, the African (Tanzania) market has been a traditional territory for Chinese contractors (ERN, 2010).

## 2. Current Status and Scope

With a population of 46 million people characterized with peace and political stability, Tanzania has been perceived as relatively less corruption than many other African states. Tanzania's growth rate, averaging over 6 percent, the government's stance on corruption and its willingness to institute meaningful development policies have endeared Tanzania to the international trade. In 2008, Tanzania received the world's largest Millennium Challenge Compact grant, worth \$698 million. Tanzania's economy has been growing steadily for the past 10 years. In 2012, the economy expanded by 6.9 % (BOT, 2010), which is close to its more recent historical average.

The Tanzania construction sector continues to be among the most exciting and developing sector in the Tanzania economy. Moreover, Construction sector and Industry has contributed by 24% share to Gross Domestic Product. Currently the sector is experiencing a period of growth that primarily has been driven by the recent development in roadwork, housing and mining.

In Tanzania construction sector is dominated by foreign firms. There are currently more than 3,958 registered contractors in Tanzania. Only 5% percent are in class one and 60% percent of these are foreign companies.

The most iconic project of Chinese contactors in Tanzania include construction of the TAZARA railways linking Zambia's copper mines to ports on the Indian Ocean, government building and stadiums, financed by China. Initially the involvement was seen as largely political, with China acting as a partner and counterbalance to imperialism. According to World Bank, China involvement in Tanzania means two things. The first is strategy; to influence development and reform due to a lasting political will and a historical and undying friendship between the two countries. Second means an appreciation to opportunity (*a Special Economic Zone*) would create more potential and future collaboration in trade and investment.

The increase of current participation of construction firms from China, Western construction firms, in the markets of developing countries and the effects on local capacity has also not received adequate attention in the literature. China has improved its construction industry and its companies are involved in international.

Construction projects around the world, whereas most countries in sub-Saharan Africa are dependent on foreign construction firms. Currently in Tanzania, Chinese Construction Firms are winning pretty big projects contracts. However the industry is filled with such challenges as low capacity and capability of the local contractors and consultants due to weak resource-base and inexperience; Inadequate and erratic work opportunities, low public investment in infrastructure projects and over-dependence on donor funding; Inefficient and non-transparent procurement systems; Corruption and financial mismanagement in public/private sectors; Lack of supportive institutional mechanisms in terms of financial credit facilities, and equipment for hire and professional development

Baloi et al (2003) suggests that global risk factors pose more challenges to construction, contractors, who are less familiar with them. A number of authors have grouped risks associated with international construction companies according to their sources and similarities. Ling et al (2006) have identified several unique risks faced by foreign firms. The risks include; political and social risks; economic and financial risks; and cultural risks. PMI (2004) classified risks into four categories namely technical risks, organizational risks, project risks, and external risks (abbreviated TOPE risks). Zhi (1995) have categorized host country risk into three, namely internal risks (risks unique to overseas construction enterprise because of the nature of the projects, firm sizes, environmental information and overseas construction experience; project-specific risks (risks particular to the project itself-scope, complexity, budget, etc) and external risks (risks associated with the financial, social-cultural or political environment in which the company operates.

The objective of this study is to assess from the literature the possible risks to Chinese construction enterprises in Tanzania. The economy, policies, business environment, infrastructure, resources of Tanzania were assessed. The significance of this study lies in the fact that the success of the overseas construction projects depends on a thorough understanding of the nature of the internal and external risks posed by host country conditions and efficiently mitigating and managing these risks before and during the construction period. For Example, Corken, et al (2007) analyzed patterns of Chinese investment in Africa and found that out of 1000 companies only 400 were concerned about possible risk factors to business. This finding was based on the assumption that Chinese are concerned with tapping the market first before profit gain.

### **3. Risks to Chinese Construction Enterprises in Tanzania**

#### ***Economic/Financial Risk Factors***

These are the factors that ultimately affect the profitability of the CCE in the host country. An adverse trend in these factors can erode all returns on investment and cause failure of the construction enterprises.

#### ***Inflation/Exchange rate Fluctuation***

These are very two important financial indicators that have a significant bearing on the cost of delivering a project. Due to competitions to capture the market Chinese companies normally cut off their profit margin, while local and other foreign construction companies operate on the profit margin of 15-25%. In Tanzania Chinese SOE operates on profit margins as low as five percent (Corkin et al, 2007). Yet the incredibly small profit margins are obviously unsustainable, thereby exposing them to a range of risks including currency fluctuations and rising energy, transport and commodity prices.

This goes together as we consider the average inflation rate for five consecutive years, indicate that in 2006 was 6.7 per cent, 2007 was 6.4 per cent, 2008 was 13.5 per cent, 2009 was 12.1 per cent and 2010 was 5.5 per cent, (Bank of Tanzania BOT, 2010). Actually these values indicate the average change in base price of various commodities on the Tanzanian Market. High inflation will lead to rise of construction cost.

The implication of this goes directly to GDP that uncertainty will lead to recalculating the average growth. Thus it may not be good for ICCG to be overly optimistic of any significant changes in the economic performance of Tanzania in the near future.

Many Chinese firms face the risk of losing money on their projects because they tender in terms of market entry and do not make adequate provision for the costs and risks involved in the project themselves. The Chinese government-funded finance is the source of finance administered by the Ministry of Finance and Ministry of Commerce; it is however, not guarantee of commercial profit. The companies may lose money in these

government grants projects if not properly managed. They need to understand and assess the market carefully in order to control the money and succeed.(Aziz,1994)

***Client ability to meet financial requirements risk***

Tanzania like most Sub-Saharan African Countries is a low income developing country. According to BOT (2011), out of the total debt stock, external debt accounted for 80 per cent while domestic debt accounted for 19 per cent. The World Bank, the IMF, and bilateral donors have provided funds to rehabilitate Tanzania's aging economic infrastructure, including rail and port infrastructure that are important trade links for inland countries (CIA, 2010). One can only speculate what would happen if there is no more support from the multi-donor organizations and development partners. So this factor affects a lot of Chinese construction project to be completed on time due to the delay of payments and bureaucracy in procurement procedures.

***Administrative/Governance Factors risk***

Despite of the major efforts done by the Tanzanian Government to smoothen the procedures for starting business in Tanzania, yet there are a number of challenges which has been listed by (Uk Trade Investment, 2010) as unreliable high-cost power, undeveloped transport system, bureaucratic 'red tape' corruption particularly in customs and tax authorizes, limited availability of skilled labor and lack of information technology.

Table one below supports this phrase.

**Table 1: Doing Business in Tanzania (World Bank, 2012).**

Ease of....	2012 Rank	2011 Rank	Change in Rank
Starting a business	123	122	↓ -1
Dealing with Construction permit	176	177	↑ 1
Getting Electricity	78	80	↑ 2
Registering Property	158	155	↓ -3
Overall IFC doing Business rank of Tanzania	127	125	↓ -2

Source: World Bank Country Quarterly Report, 2012

The Tanzania Civil Engineering Contractors Association (TACECA) estimates that 90% of contractors pay between 10% to 15% of contract value in bribes. Moreover, in 2004, the Engineers Registration Board (ERB) and the Association of Consulting Engineers Tanzania (ACET) estimated that over 90% of construction contract awards and about 70% of consultancy assignments were secured through corruption.

***Competition on China-to-China risk***

The Chinese have little interest in joint ventures, although they regularly subcontract local companies and procure considerable quantities of local materials and labor. Once established, the only serious competition Chinese companies appear to face is from one another.(Burke, Corkin 2007). The literature has shown that this can be linked to strategic risk.

***Cultural Risk***

Language and cultural risks cause a lot of misunderstanding in labor relations because the middle management of the Chinese team on site is usually an individual technician with no or little English, and it is hard for such a person to communicate efficiently with local workers. The less the communication the more the risk and hence the misunderstanding arise between the local people and the Chinese. A case in pin point is local complaints about the labor practices of the Chinese firms, on the other hand, while on the other hand, the Chinese firms complain about the lack of understanding of their local staff and the latter low productivity output.

**Conclusion**

This theoretical research has investigated the possible risks to Chinese Enterprises in Tanzania's construction industry. With evidence from the literature the author has contributed to the knowledge of the potential risks

Chinese contractors are likely to face within the Tanzania's business environment. Although some risk factors may be more critical than the others, the project success will depend on management of all risks, response strategies used to minimize their effect and the organizational ability to control them. This research is limited by its theoretical nature. A future research based on empirical evidence is therefore proposed.

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