

TAXATION OF THE INFORMAL SECTOR: OUTCOMES OF FORMALIZATION, TRANSPARENCY AND EFFICIENCY OF INFORMAL SMEs?

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Abstract

How to cite this paper: Mbama, P. C., & Mfelam, J. R. (2025). Taxation of the informal sector: Outcomes of formalization, transparency and efficiency of informal SMEs? *Business Performance Review*, 3(1), 17–26.
<https://doi.org/10.22495/bprv3i1p2>

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ISSN Online: 3005-6829

ISSN Print: 3005-6810

Received: 05.12.2024

Revised: 14.02.2025; 28.03.2025

Accepted: 11.04.2025

JEL Classification: D83, G24, H26

DOI: 10.22495/bprv3i1p2

The objective of this paper is to determine the impact of informal sector taxation on the formalization, transparency and performance of small and medium-sized enterprises (SMEs) operating informally in the Cameroonian context. The study examines in detail the various issues related to informal sector taxation. To achieve this objective, an inductive approach was adopted. Semi-structured interviews were conducted with the managers of 12 informal SMEs randomly selected in the cities of Yaoundé and Douala, Cameroon. The results revealed mixed impacts of informal sector taxation on the formalization, transparency and performance of the interviewed SMEs. Indeed, while some managers expressed strong concerns and even disbelief regarding the detrimental impact of informal sector taxation on the survival of their businesses (Zogning, 2023), others, on the other hand, tended to encourage it, indicating that it is a guarantee of formalization transparency and performance of their businesses (Okombi, 2023), but not without expressing a real need for support from government authorities. These findings therefore call on governments to seriously consider strengthening communication on taxation of informal SMEs and to take into account the country's socio-economic context when implementing this policy.

Keywords: Taxation, Formalization, Transparency, Informal SMEs, Performance

Authors' individual contribution: Conceptualization — P.C.M.; Methodology — J.R.M.; Software — J.R.M.; Validation — P.C.M. and J.R.M.; Formal Analysis — P.C.M. and J.R.M.; Investigation — J.R.M.; Resources — P.C.M. and J.R.M.; Data Curation — J.R.M.; Writing — Original Draft — P.C.M.; Writing — Review & Editing — P.C.M.; Visualization — P.C.M. and J.R.M.; Supervision — P.C.M.; Funding Acquisition — P.C.M. and J.R.M.

Declaration of conflicting interests: The Authors declare that there is no conflict of interest.

1. INTRODUCTION

Taxation of the informal sector is a subject of debate that remains relevant in developing countries such as Cameroon when it comes to finding solutions for the formalization, transparency and efficiency of informal small and medium-sized enterprises (SMEs). According to Omoloba and Bardot (2023),

the informal sector contributes significantly to the country's economy, but faces serious challenges in its efficient operation such as funding from financial institutions. Moreover, it is not properly accounted for in the tax system (Lopez-Castaño, 1987; Rubbers, 2007). In an attempt to find solutions for the formalization, transparency and performance of informal SMEs, the government has

implemented various policies, such as the taxation of the informal sector. However, the effectiveness of these policies remains a subject of debate.

It is important to note that informal SMEs are not subject to taxation, which limits the government's ability to maximize tax revenue collection (Lopez-Castaño, 1987; Rubbers, 2007). Although the informal sector can make a significant contribution to the country's economy since a significant proportion of the population is engaged in informal activities (Omoloba & Bardot, 2023), it is evident that its nature poses many challenges. SMEs in the informal sector have difficulty obtaining finance from banks due to their opacity (Si Lekhal, 2013). All this leads to small-scale production and consequently low wealth creation and low capacity to attract human resources, which can reduce unemployment. In light of the ideas developed, it is important to identify the contribution of informal sector taxation in the search for formalization and transparency productivity of informal SMEs.

According to Gautier et al. (2001), taxation of the informal sector involves integrating informal businesses into the formal economy by registering them with the government and taxing them. It involves registering them and collecting taxes from them. In this way, the government hopes to encourage informal businesses to formalize their activities and contribute to the country's tax revenues (Gautier et al., 2001). The idea behind taxation is to increase public revenue by broadening the tax base, while offering informal businesses access to formal financial services and the protection of the law.

Although taxation has the potential to increase government revenues and formalize informal SMEs, its implementation can also be problematic (Zerbo, 2001). Informal SMEs may resist formalization due to burdensome requirements and costs associated with registration and compliance (Zogning, 2023; Okombi, 2023). In addition, there may be a lack of trust between informal SME owners and the government, which may hinder the success of tax initiatives.

One of the challenges of taxing the informal sector is that many informal SMEs do not have the formal documents and structures needed to be registered for tax purposes (Zerbo, 2001). This makes it difficult for governments to identify and tax them. In addition, many informal SMEs operate in the informal sector because they cannot afford the costs of formalization, such as registration fees and taxes (Nohoua, 2016). Consequently, imposing taxes on them will not necessarily lead to formalization, but may rather force them to cease trading altogether.

Another challenge of taxing the informal sector is that it can increase the cost of doing business (Nyaga, 2020; Abate, 2021). This is because informal businesses can pass on the tax burden to their customers, resulting in higher prices. They will then find it difficult to compete with formal businesses that already have a customer base and already benefit from economies of scale.

The issue of taxation of the informal sector and the formalization of informal SMEs is of great concern in the context of Cameroon. The informal sector plays an important role in the country's economy, contributing a significant share to the country's gross domestic product (GDP). However, the sector remains largely unregulated and untaxed, resulting in a loss of potential revenue for the government. One of the main challenges of

the informal sector in Cameroon is the lack of formalization and transparency. Most informal businesses operate without any legal documents or registration, making it difficult for the government to monitor their activities or collect taxes (Nyaga, 2020; Kede Ndouna & Tsafack Nanfosso, 2023). This lack of formalization and transparency also makes it difficult for these businesses to access financial services and government support.

Although there has been previous research on corporate taxation and formalization in developing countries, few studies have specifically examined national contexts such as Cameroon, where informal SMEs constitute a significant share of the economy. There is also a gap in the analysis of the precise mechanisms through which taxation affects the transparency and accounting practices of informal enterprises. These elements are invaluable for understanding the tax policy levers that could foster lasting change in Cameroon's informal SME ecosystem.

In light of the above, the research question that structures our research problem is formulated as follows:

RQ: What is the effect of informal sector taxation on the formalization, transparency and performance of SMEs operating informally in the Cameroonian context?

The rest of the article is structured as follows. Section 2 reviews the literature, identifies the research gap, and develops the hypotheses. Section 3 presents the research methodology. Section 4 analyzes the results and Section 5 discusses them. Finally, Section 6 concludes the paper.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

According to Abate (2021), the informal sector is a strategic sector in developing economies because it creates wealth and reduces youth unemployment. However, it creates a shortfall in government tax revenues and opaque transaction information. There are mixed views on taxing this sector as a solution.

2.1. Taxation of the informal sector

Taxation is a solution proposed by the government to encourage informal SMEs to migrate to the formal economy. This policy has several benefits not only for informal SMEs, but also for various stakeholders.

2.1.1. The use of electronic payment systems by informal SMEs as a factor of transparency and financial responsibility

The promotion of electronic payment methods is becoming increasingly important in the formalization, transparency and productivity of informal SMEs. The use of electronic payment systems not only increases the transparency and accountability of financial transactions, but also offers informal SMEs a means of participating in the formal economy (Gradeva, 2009). Thus, the promotion of electronic payment methods can help reduce the prevalence of cash transactions, which are often associated with the informal economy (Lentz, 2010). According to Ngakosso (2015), this can lead to increased tax revenues for governments, as well as improved financial regulation and supervision.

In addition, technology can play a key role in promoting financial transparency and accountability. For example, the use of digital payment systems can reduce reliance on cash transactions by making financial transactions easier to track and monitor (Lentz, 2010). Digital payment systems can also facilitate SMEs' access to finance and credit, as they provide a digital footprint that can be used to assess creditworthiness (Guérineau & Jacolin, 2014; Zeamari, 2018).

Discouraging cash-based real estate transactions and formalizing informal SMEs are two essential steps towards achieving financial transparency and accountability in any economy. Cash transactions in real estate open the door to exploitation, money laundering and tax evasion. According to Paillaud et al. (1998), informal SMEs, which operate outside the legal framework, also evade taxation, resulting in lower tax revenues for governments.

Therefore, governments need to take measures to discourage cash transactions in real estate and encourage the formalization of informal SMEs. One way is to increase fines for cash real estate transactions and impose stricter regulations (Benazzou & Zoubair, 2020). Governments could also offer incentives for SMEs to formalize their activities, such as tax breaks and easier access to finance and credit (Song-Naba, 2023).

In short, discouraging cash transactions and formalizing informal SMEs are crucial steps towards achieving financial transparency and accountability. Governments must strive to create an enabling environment that encourages the use of digital payment systems and the formalization of SMEs. This will not only increase government tax revenues, but also promote economic growth and development. In light of the above, we formulate our first research hypothesis as follows:

H1: The use of electronic payment systems by informal SMEs leads to their transparency in financial transactions.

However, it is important to note that the promotion of electronic payment methods must be accompanied by efforts to improve the financial literacy and digital skills of informal SMEs (Akregbou, 2023; Berger-Douce, 2019). This can ensure that they can effectively use these systems and benefit from the advantages they offer.

2.1.2. The relationship between taxation and legal requirements as a factor in access to credit for informal SMEs

Taxation of the informal sector contains a number of requirements that informal SMEs must comply with in order to migrate into the formal economy. For example, the non-deductibility of expenses incurred by suppliers that are not included in the list of active taxpayers of the Directorate General of Taxes (DGT) is one of the measures aimed at increasing transparency and accountability in the tax system (Karimi, 2020).

By requiring SMEs to conduct transactions only with registered suppliers, the government can better control and regulate the flow of income and expenditure in the economy. This ensures that taxes are paid and necessary public services are provided to its citizens. In addition to this measure, it is also necessary to formalize SMEs that operate informally (Nohoua, 2016; Imad et al., 2022). Informal SMEs refer to businesses that are not registered with

the government and do not comply with legal tax and regulatory requirements. This informal sector poses a challenge to government efforts to collect taxes and regulate economic activities, as it operates outside the formal economy (Si Lekhal, 2013).

Overall, the non-deductibility of expenses for unregistered suppliers and the formalization of SMEs are important measures that can promote transparency, accountability and economic growth in the country (Barzi, 2011; Okombi, 2023). By encouraging businesses to comply with legal requirements and operate within the formal economy, the government can better regulate and monitor economic activities and provide essential public services to its citizens (Lefilleur, 2008). In addition to this non-deductibility of expenses for unregistered suppliers, we also have expenses related to invoices issued outside the electronic invoicing system of the DGT.

The non-deductibility of expenses based on invoices issued outside the DGT's e-invoicing system is a significant problem for many businesses (Gobert, 2001; Jay, 2015). This is because these expenses are not eligible for a tax deduction, leading to higher tax liabilities and lower profitability. However, the government is taking steps to address this problem by encouraging SMEs to adopt the e-invoicing system, which is a more efficient and transparent way of conducting business transactions (Gobert, 2001; Jay, 2015).

The government is also focusing on formalizing the informal sector, particularly SMEs (Henin & Doutriaux, 1993; Omoloba & Bardot, 2023). Many SMEs operate without proper registration or documentation, making it difficult for them to access credit, contracts, and other opportunities (Lefilleur, 2008). By formalizing this category of SMEs, the government aims not only to increase tax revenues (Okombi, 2023), but also to promote economic growth and development. The formalization process involves providing informal SMEs with access to tools and resources that can help them register their businesses and comply with legal and regulatory requirements (Jay, 2015). This includes training and capacity-building programmes, simplified registration procedures and access to credit and finance.

Compliance with legal requirements is not only a fundamental aspect of doing business, but also a key factor in informal SMEs' access to credit (Benjamin & Mbaye, 2012). Compliance with legal standards demonstrates a company's commitment to ethical business practices and ensures that it operates within the bounds of legality. This, in turn, strengthens the confidence of financial institutions and potential investors in the company's ability to repay loans and meet its obligations (El Manzani et al., 2018; Souleymanou et al., 2019).

In addition to complying with legal requirements, informal SMEs can also benefit from implementing sound financial management practices (Gagné, 2018). These include keeping accurate financial records, developing a budget and monitoring cash flow. Such practices not only help the business operate more efficiently, but also demonstrate to potential lenders that the business is financially responsible and able to manage its finances effectively (Souleymanou et al., 2019). Given all of the above, we formulate our second research hypothesis as follows:

H2: Informal SMEs that comply with legal tax requirements have easy access to bank financing.

For informal SMEs, complying with legal requirements and implementing sound financial management practices are crucial steps in accessing credit. By doing so, business can improve their financial position, gain the trust of financial institutions, and increase their chances of obtaining loans and investments.

2.2. Formalization, transparency and performance of informal SMEs through taxation of the informal sector

The informal sector has always been a major challenge for governments around the world. One of the biggest challenges is how to incorporate this sector into the formal economy and increase revenue through taxation, given the various obstacles to making the process of formalizing informal SMEs operational.

2.2.1. High cost of formalization as a possible reason for the cessation of informal SMEs

According to Nohoua (2016), one of the potential difficulties of taxing the informal sector is that it can increase the cost of doing business for informal SMEs. This may occur because these SMEs may not be able to comply with the regulatory requirements that accompany formalization (Kede Ndouna & Tsafack Nanfosso, 2023). The cost of registering a business, obtaining licences and paying taxes can be prohibitive for these businesses, leading to a decline in their activities or even closure.

Another challenge of implementing tax policies for the informal sector is the potential increase in business costs for SMEs operating in this sector (Nohoua, 2016). This is mainly due to the fact that these businesses may not have the necessary capacity to comply with the regulatory requirements that accompany formalization. The high costs associated with formalization can include expenses such as registration fees, taxes and other regulatory compliance costs (Nohoua, 2016; Abate, 2017; Okombi, 2023). SMEs operating in the informal sector may not be able to afford these costs, which could have negative consequences for their business activities (Paillaud et al., 1998; Amine & Falhaoui, 2014). This may involve a drop in profitability, a reduction in competitiveness, or even the risk of bankruptcy.

Another potential difficulty with taxing the informal sector is that it may lead to a reduction in the number of informal SMEs (Traore, 2021; Okombi, 2023). This may happen because some of these businesses do not have the capacity to compete with formal businesses in the formal economy. As a result, they may choose to remain informal or be forced to cease trading. This can have a significant impact on the economy as a whole, as the informal sector is a major contributor to job creation and income.

It is also important to note that taxing the informal sector can change the competitive landscape of the economy (Bellal, 2008). SMEs that previously operated informally may find it difficult to compete with formal firms that have access to better technology, finance and market networks. The result can be a situation where only larger, more established firms are able to survive and prosper in the formal economy, while smaller firms are forced to remain informal or close down (Mahamoud Houssein, 2008).

In view of all these limitations, it is important to note that the lack of formalization in the informal sector is often due to a number of factors, including limited access to finance (Kede Ndouna & Tsafack Nanfosso, 2023), weak institutional support (Mahamoud Houssein, 2008) and a lack of awareness of the benefits of formalization (Bony, 2021). It is therefore essential that regulators and policymakers take a holistic approach to solving these problems, which may involve providing targeted support to informal sector businesses to help them comply with the regulatory requirements of formalization. Given these insights, our third research hypothesis is as follows:

H3: Informal SMEs that incur high formalization costs are likely to cease trading.

While tax policies aimed at formalizing the informal sector are essential to promote economic growth and development, they must be implemented with care to ensure that they do not inadvertently increase the operating costs of SMEs operating in this sector. Policymakers need to work hand in hand with informal sector businesses to identify and address the challenges that may arise from formalization, while taking steps to provide the necessary support and incentives to promote compliance and ensure the success of these policies.

2.2.2. Difficulties in complying with government standards and requirements as a reason not encouraging SMEs to formalize

According to Sani (2009), one of the challenges of taxing the informal sector is that it can be difficult to accurately assess the tax liability of businesses that operate outside the formal framework. Informal SMEs may not keep detailed financial records or may under-report their income, making it difficult for tax authorities to determine the exact amount of tax due (Benjamin & Mbaye, 2012; Mas-Montserrat et al., 2023). This can lead to a situation where the tax burden falls disproportionately on businesses that already operate within the formal structure, further exacerbating existing inequalities in the economy.

Overall, while taxing the informal sector may have some advantages in terms of increasing tax revenues and formalizing the economy, it is important to carefully consider potential disadvantages and ensure that policies are designed in a way that does not disproportionately harm SMEs or exacerbate existing inequalities (Bellal, 2008). This requires a nuanced approach that takes into account the specific needs and challenges of informal enterprises, as well as the wider economic and social context in which they operate (Mahamoud Houssein, 2008).

In addition, the process of taxing the informal sector can lead to a change in the nature of informal businesses (Kane & Ndao, 2021). Some informal SMEs may choose to move to the formal sector, while others may choose to operate in the informal sector, but with a reduced scope (Abaté, 2018). This change may have consequences for the quality of the products and services provided by informal businesses, as well as for their ability to compete with formal businesses.

For Abaté (2021), the process of formalizing the informal sector can lead to a change in the nature of informal businesses. When the government starts imposing taxes and regulations on these businesses, some informally operating SMEs may choose to

move to the formal sector (Benjamin & Mbaye, 2012; Lemaître et al., 2016; Thiam, 2018). This may be due to the benefits of being a legal entity, such as access to credit and government support, or the desire to expand their business beyond the confines of the informal sector.

On the other hand, some informal businesses may choose to continue operating informally, but by reducing their scope (Abaté, 2018). This may mean reducing their activity or limiting their products or services in order to avoid the tax burden and regulatory requirements that accompany formalization. However, this change in the nature of informal businesses can have significant consequences for the quality of their products and services. As informal SMEs migrate to the formal sector, they may find it difficult to meet the standards and requirements set by the government and established businesses (Lelart, 2006; Mahamoud Houssein, 2008). This could lead to a decline in the quality of their products and services, as they find it difficult to adapt to new regulations and competition. Furthermore, informal businesses that choose to continue operating informally, but with a reduced scope of action may also find it difficult to maintain the same level of quality and competitiveness as before (Lelart, 2006). These ideas lead us to put forward the following hypothesis:

H4: Difficulties in complying with tax requirements are the reason why informal SMEs refuse to formalize.

The process of formalizing the informal sector can have negative effects on the nature of informal businesses. While some may benefit from the transition to the formal sector, others may struggle to maintain their quality and competitiveness. Therefore, policymakers need to carefully consider these implications and provide adequate support and incentives to facilitate a smooth transition to the formal sector.

3. RESEARCH METHODOLOGY

Our study is exploratory in nature and uses a qualitative approach. Due to the specific nature of the research question under consideration, we chose a case study approach (Hlady-Rispal, 2002). The cases that make up the unit of analysis are represented by 29 informal SMEs belonging to five sectors of activity: trade, agro-industry, crafts, catering and hairdressing. Eisenhardt (1989) and Yin (2003) recommend that in such a qualitative study the researcher can proceed with semi-structured interviews using flexible and thematic interview guides. Our epistemological position is based on the interpretivist paradigm (Allard-Poesi & Perret, 1999).

Overall, there were two key moments in our fieldwork: the selection of SMEs for the study and the in-depth interviews.

3.1. Selection of SMEs for the study

According to the statistical yearbook on SMEs, social economy organizations and craftsmen, unveiled in 2024 by the Ministry of Small and Medium-sized Enterprises, Social Economy and Handicrafts (MINPMEESA), Cameroon's economic fabric includes 393,166 SMEs, of which 19,651 were created in 2023 (Beloko, 2024). According to Law No. 2015/010 of July 16, 2015, amending and supplementing certain

provisions of Law No. 2010/001 of April 13, 2010, on the promotion of SMEs in Cameroon, there are three categories of SMEs, as also described by MINPMEESA (2022, p. 2):

1) Very small enterprise (VSE) is a company that employs a maximum of five people and whose annual turnover excluding taxes does not exceed 15 million CFA francs.

2) Small enterprise (SE) is a business that employs between six and 20 people and whose annual turnover excluding taxes is greater than 15 million CFA francs and does not exceed 250 million CFA francs.

3) Medium enterprise (ME) employs between 21 and 100 people and its annual turnover excluding taxes is greater than 250 million CFA francs and does not exceed three billion CFA francs.

Since the study focuses on the informal sector, based on the classification presented above, we randomly selected 29 informal SMEs in the cities of Yaoundé and Douala, the political and economic capitals of Cameroon, respectively, in January 2024 and March 2024, as shown in Table 1.

Table 1. SME distribution by category

Categories	Number of SMEs
Very small enterprise (VSE)	10
Small enterprises (SE)	10
Medium enterprise (ME)	09
Total	29

Source: Authors' elaboration.

Following this company identification phase, we conducted several open-ended interviews with selected SME managers on the issue of taxation of the informal sector and the formalization and increased transparency of informal SMEs. The interview guide is not stabilized at this level. The objective is to obtain a general understanding of the SME managers' perceptions of the research question and then finalize the interview guide for more in-depth surveys.

3.2. Time for in-depth interviews

Finally, semi-structured interviews were conducted with managers from 12 of the 29 selected companies. These were mainly managers who, during previous discussions, had shown a keen interest in repeating their experience with us as part of our continuing investigations. The main characteristics of the players interviewed are presented in the table below.

Table 2. Main characteristics of the interview participant

Players	Position held	Experience	Activity
R1	VSE manager	5 years	Trade
R2	VSE manager	6 years	Trade
R3	SE manager	5 years	Restaurant
R4	CEO ME	8 years	Restaurant
R5	VSE manager	4 years	Trade
R6	VSE manager	7 years	Car garage
R7	CEO ME	5 years	Agro-industry
R8	CEO ME	9 years	Restaurant
R9	SE manager	9 years	Agro-industry
R10	SE manager	11 years	Agro-industry
R11	SE manager	10 years	Trade
R12	VSE manager	8 years	Hairstyle

Note: CEO — chief executive officer.

Source: Authors' elaboration.

The interviews were conducted between September 2024 and October 2024. Discussions on the interview guide included the following main topics: 1) cost of formalization, 2) tax legal requirements, 3) use of electronic payment systems by SMEs in their transactions, and 4) tax requirements.

The interviews were conducted in January 2024 and March 2024, mainly in the cities of Yaoundé and Douala. Interviews lasted on average one hour per respondent and were conducted at a time convenient for the respondents. Data were collected by hand-writing and taking quick notes during the exchange, but also occasionally, with the prior permission of some respondents, by recording.

The data was processed using the technique of thematic content analysis (Miles & Huberman, 2003). The key ideas (recurring themes) of the interviewees were “abstracted”. In this way, we were able to identify words in each informal SME that were repeated in the interviewees’ discourse and provide information on themes. We also looked for meanings of words and ideas by extracting them from the verbatim.

4. RESEARCH RESULTS

Overall, comments from SME managers approached about the informal sector tax reform reflect different views on the issue of formalization, transparency and efficiency of SMEs. Indeed, while some managers expressed strong concerns and even mistrust of the reform, others were inclined to encourage it, not without expressing a real need for support from government authorities.

4.1. SME managers’ concerns about taxation

Most of the SME managers approached expressed concern about the negative impact that taxing the informal sector could have on the survival of their businesses. This perception is reflected in the following comments:

“Taxing the informal sector is seen as a threat to our survival. Taxes are already high, and profit margins in the informal sector are particularly low. If additional taxes are imposed on us, we risk closing our shops” (R2, personal communication, September 10, 2024).

“The survival of our SMEs is at stake. Taxing the informal sector could lead to unfair competition and increase the tax burden on our businesses, which are already under severe pressure” (R7, personal communication, October 8, 2024).

“Taxing the informal sector is a good idea in theory, but in practice, it is likely to lead to the closure of many SMEs, which will not be able to cope with the resulting unfair competition” (R8, personal communication, September 15, 2024).

This result is supported by the work of Schneider and Enste (2000), who showed that taxing the informal sector can lead to a reduction in the size of informal businesses and even to their closure. Similarly, a study by Djankov et al. (2002) found that informal SMEs are more likely to close when taxes are high.

4.2. Encouraging formalization

Some of the managers interviewed nevertheless acknowledged that taxing the informal sector could

be beneficial to them, but only under certain conditions, as the following extracts clearly illustrate:

“Taxation could be a good thing if it is accompanied by incentives such as tax reductions for businesses that formalize. This would encourage us to enter the formal sector while benefiting from certain legal protections” (R5, personal communication, October 25, 2024).

“Taxing the informal sector could strengthen the economy by enabling these businesses to contribute to tax revenues and access finance. However, this process must be accompanied by incentives, not just obligations” (R12, personal communication, October 14, 2024).

“Taxation is a good thing, but it needs to be gradual and accompanied by a simplification of administrative procedures. Many informal entrepreneurs don’t even know how to go about regularising their situation” (R8, personal communication, September 15, 2024).

This result is supported by the work of Zolt and Bird (2005), which showed that taxing the informal sector can increase tax revenue by 10% to 20%. Another study by Keen and Slemrod (2017) found that countries that have introduced policies to tax the informal sector have seen their tax revenue increase by 15% to 30%.

4.3. Formalizing the informal sector: A guarantee of greater business transparency

The formalization of the informal sector is seen by some SME managers as a guarantee of business transparency. Some managers put it this way:

“Formalizing the informal sector is crucial. It would increase transparency in our transactions, which is essential for attracting financial partners. As SMEs, we need to be able to prove that we comply with standards, and this is difficult without a common basis for transparency across the sector” (R4, personal communication, September 16, 2024).

“With the formalization of the informal sector, SMEs like ours could benefit from better visibility of financial flows. This would boost the confidence of investors and banks, who are sometimes reluctant to commit because of the lack of transparency in the informal sector” (R9, personal communication, October 19, 2024).

“With taxation, there would be more transparency in business. Today, many of us avoid keeping financial records for fear of attracting the attention of the tax authorities. If the taxation process is well structured, it could help us to organise our activities better” (R12, personal communication, October 14, 2024).

4.4. Distrust of tax authorities

The comments made by some of the SME managers we approached reveal a strong distrust of the tax authorities:

“The problem is precisely that we don’t trust the tax authorities. A lot of promoters’ fear that taxation will lead to more corruption and extortion on the part of civil servants, rather than actually improving transparency” (R7, personal communication, October 8, 2024).

“I’m afraid that tax officials are not at all objective and don’t treat us fairly” (R2, personal communication, September 10, 2024).

4.5. The need for support

Some of the players approached expressed the need for support from the tax authorities as a strong necessity if the reform is to be more effective. They expressed it in these terms:

“For taxation of the informal sector to work, we need support. Training in tax and accounting management is needed so that SMEs like ours can comply with the new requirements without too much difficulty” (R3, personal communication, September 13, 2024).

“We need support from the tax authorities on tax rules, bookkeeping and access to online tax services; this would give us a better understanding of what's at stake” (R6, personal communication, September 15, 2024).

A study by Loayza (1996) showed that 60% of informal SME managers needed assistance to access tax services. Similarly, another study by Mas-Montserrat et al. (2023) found that managers of informal SMEs need support to access online tax services.

Overall, the mixed findings on SME managers' perceptions of the effect of informal sector taxation on business formalization, transparency and performance in Cameroon differ from previous studies (Imad et al., 2022; Nohoua, 2016; Gradeva, 2009), which often find that taxation leads to increased formalization, transparency and better performance. Indeed, previous studies, especially in similar contexts, have often observed a positive correlation between taxation and formalization, highlighting that tax incentives encourage informal enterprises to formalize and adopt more transparent management practices. However, in the context of this study, the mixed result suggests that Cameroonian SME managers perceive taxation as an additional burden rather than a lever for development. This perception may stem from a number of factors specific to the Cameroonian context, such as concerns about red tape, the costs associated with tax compliance, as well as a lack of confidence in the efficiency of tax administration. This highlights the need to rethink tax and support policies to make taxation more attractive and truly beneficial for informal SMEs, particularly in developing countries.

5. DISCUSSION

The concerns expressed by SME managers who were approached about the negative impact of taxation of the informal sector on their businesses are supported by the study of Schneider and Enste (2000), who showed that taxation of the informal sector can lead to a reduction in the size of informal businesses and even contribute to their closure. In the same vein, the study by Djankov et al. (2002) found that informal SMEs are more likely to fail when taxes are high. Excessive and disproportionate regulation has also been implicated as a factor explaining firm-level informality (Dabla-Norris & Inchauste, 2008) and creating barriers to entry (Klapper et al., 2006; Djankov, 2009). The final impact of this regulation and the informality it generates will depend on the degree of institutional strength or weakness. In the context of weak institutions, particularly in Bolivia, informal enterprises tend to persist

because, as noted above, when performing cost-benefit analyses they eventually find that the costs of regulation outweigh the benefits (Sakho, 2009).

Second, the finding that some SME managers perceive benefits from formalization is supported by research by Nyaga (2020), which shows that formalization increases the likelihood of productivity improvements. Similarly, research by Zolt and Bird (2005) found that taxing the informal sector can increase tax revenues by 10-20%. Also, a study by Keen and Slemrod (2017) found that countries that implemented informal sector taxation policies in particular saw their tax revenues increase by 15-30%.

Furthermore, respondents' comments on the need for support are supported by the study by Loayza (1996), who found that 60% of informal SME managers needed assistance in accessing tax services. Similarly, a study by Mas-Montserrat et al. (2023) found that informal SME managers need support to access online tax services.

Finally, regarding the impact of informal sector formalization on the transparency and efficiency of informal SMEs, the findings support the study by La Porta and Shleifer (2008), who argue that business formalization through tax registration leads to greater financial transparency as SMEs are forced to comply with financial and tax reporting requirements.

6. CONCLUSION

The objective of this paper was to determine the impact of informal sector taxation on the formalization, transparency and performance of informally operating SMEs in the context of Cameroon. To achieve this objective, an inductive research approach based on a qualitative approach was adopted. Semi-directive interviews were conducted with managers of 12 informal SMEs, randomly selected in the cities of Yaoundé and Douala. The results obtained from the content analysis of the respondents' statements show an ambiguous impact of informal sector taxation on the formalization, transparency and performance of informal SMEs. Indeed, while some respondents expressed strong concerns and mistrust about the detrimental impact of informal sector taxation on the survival of their enterprises, others tended to encourage it, not only indicating that it was a guarantee of transparency for their businesses, but also emphasizing the need for support from government agencies. These results call on the authorities to seriously consider explaining the benefits of the reform to informal SMEs and to take into account the socio-economic context of the country when implementing this policy.

We recognize that this work has a number of limitations. The most serious limitation of the paper is inherent to any qualitative approach, i.e., the use of a modest sample size. Our case study-based research strategy is hampered by the lack of external generalizability, as it is limited to a few SMEs located in the cities of Yaoundé and Douala. This limitation, however, represents a potential research opportunity for adopting a quantitative approach aimed at increasing the size of the companies studied. In future studies, for our results to be generalizable, the study should be replicated on a larger sample, preferably including SMEs operating in several cities in Cameroon.

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