

**AN ANALYSIS OF THE INFLUENCE OF TAXATION ON THE  
PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN  
MOGADISHU, SOMALIA**

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## DECLARATION AND APPROVAL

### Declaration

This thesis is my original work and has never been presented for any academic award in any institution.

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## **DEDICATION**

This thesis is dedicated to my supportive family, inspiring mentors at Mount Kenya University, and all who believe in the transformative power of education and knowledge.



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## ABSTRACT

Small and Medium Enterprises (SMEs) play a crucial role in driving economic growth and development in Mogadishu, Somalia, yet they face significant challenges related to taxation. This study investigates the impact of taxation on the performance of SMEs in Mogadishu, with a specific focus on tax rates, income tax, and excise tax. Utilizing a descriptive research design, the study integrates quantitative and qualitative data collection methods to explore the relationship between tax policies and SME performance metrics such as profitability, growth, and compliance. Primary data was gathered from SME owners and managers using structured questionnaires and interviews, with a sample size of 172 selected from a target population of 300 SMEs operating in Mogadishu. Secondary data from relevant government reports and policy documents was used to complement the analysis. Quantitative data was analyzed using SPSS for statistical insights, while qualitative data was subjected to thematic analysis to capture nuanced perspectives. The study is anchored in the Ability-to-Pay and Benefit Theories of Taxation, providing a theoretical framework to assess the fairness and effectiveness of tax policies. Preliminary findings highlight a complex interplay between taxation and SME performance. Excessive tax rates and administrative inefficiencies have been identified as significant barriers, leading to reduced profitability and limited business expansion. The study also reveals gaps in tax compliance, largely attributed to poor communication, limited awareness, and the absence of structured support mechanisms for SMEs. Moreover, the sociopolitical context of Mogadishu, characterized by instability and informal economic practices, adds to the challenges of tax administration and compliance. The study aims to contribute to the ongoing discourse on taxation and SME development by offering evidence-based recommendations for policymakers. These include optimizing tax rates, enhancing administrative efficiency, and fostering transparency and dialogue between tax authorities and SMEs. The findings of this research seek to empower SMEs, improve tax compliance, and support sustainable economic growth in Mogadishu. The study underscores the need for a collaborative approach involving government agencies, development partners, and local stakeholders to create a conducive environment for SME growth in Somalia.

**Keywords:** *Taxation, Small and Medium Enterprises (SMEs), Mogadishu, Tax Compliance, SME Performance*

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## LIST OF ABBREVIATIONS AND ACRONYMS

<b>DRC</b>	Democratic Republic of Congo
<b>EPZ</b>	Export Processing Zone
<b>EU</b>	European Union
<b>FGS</b>	Federal Government of Somalia
<b>GDP</b>	Gross Domestic Product
<b>IMF</b>	International Monetary Fund
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>SDGs</b>	Sustainable Development Goals
<b>SFMIS</b>	Somalia Financial Management Information System
<b>SMEs</b>	Small and medium enterprises
<b>SPSS</b>	Statistical Package for Social Sciences
<b>SR&amp;ED</b>	Scientific Research and Experimental Development
<b>VAT</b>	Value-added Tax



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# **CHAPTER ONE**

## **INTRODUCTION**

### **INTRODUCTION**

#### **1.1 Background of the Study**

Taxation plays a crucial role in shaping business behavior and economic outcomes, particularly for SMEs. Taxes imposed on SMEs can have far-reaching implications for their financial performance, investment decisions, employment levels, and overall business sustainability (Atawodi & Ojeka, 2015). SMEs, which form the backbone of many economies worldwide, are essential to a nation's economic development. They account for over 50% of the GDP in numerous emerging nations and employ the majority of workers (Al Asheq & Hossain, 2019).

The objective of this study is to examine the influence of taxation on the performance of SMEs in Mogadishu, examining various dimensions such as revenue generation, profitability, investment, employment, and innovation. SMEs are key drivers of economic growth and job creation in many countries (Amoah et al., 2022). However, the impact of taxation on SME performance has been a topic of significant interest among researchers, policymakers, and stakeholders.

Taxation directly impacts SMEs through various tax obligations, including corporate income tax, value-added tax (VAT), payroll taxes, and other levies (Chebii, 2020). The tax burden can be particularly challenging for SMEs due to their limited financial resources and operational scale (Farah & Ainebyona, 2019). Compliance costs, administrative burdens, and complexities associated with tax regulations further add to the challenges faced by SMEs (Favourate, 2021).

Tsuruta (2018) points out that there are measures put in place by different jurisdictions to ensure that the potential negative impact of taxation on the performance of SMEs is avoided. Ireland

offers a reduced corporate tax rate for SMEs, and that has been instrumental in encouraging the growth of entrepreneurship in the country (OECD, 2019). Countries like Brazil, India, and Pakistan have in place simplified filing systems that target SMEs with the purpose of encouraging tax compliance and reducing the negative impact of taxation on businesses (Dom et al., 2022). According to Braunerhjelm and Henrekson (2023), the United States has in place temporary tax exemptions meant to promote innovation, entrepreneurship, and reduce the negative impact of taxation on the performance of SMEs.

SMEs account for a significant proportion of employment in Africa with estimates indicating that it accounts for between 80% to 90% of employment (International Labour Organization, 2024). However, taxation policies that are in place in Africa, in most instances, are cited to act as barriers to the performance of SMEs by stifling their potential to fully contribute to the economic growth of the continent (Runde et al., 2021). The findings by Klaver (2015) in their study that focused on the Democratic Republic of Congo (DRC) hold that when taxes are imposed on SMEs on a territorial basis, the outcomes include a negative impact on performance. Akakpo (2024) explored the impact of corporate tax on the financial performance of businesses in Ghana. The findings suggest that there is a negative relationship between corporate income tax and the financial performance of businesses in Ghana. A study by Kariuki (2017) investigated the financial performance of companies that operate in Kenya. The results of the study indicate that corporate tax planning and liquidity had a positive impact on the performance of the companies.

Taxation policies and practices can have both direct and indirect effects on SMEs. For example, tax incentives can encourage entrepreneurship and innovation (Stolowy, 2015). On the other hand, high tax burdens can hinder profitability and investment (Abiahu & Nwaorgu, 2020). Contextual factors such as country-specific tax regimes, regulatory environments, and socioeconomic

conditions can influence the relationship between taxation and SME performance (Twesige & Gasheja, 2019). Therefore, it is crucial to conduct context-specific studies to gain a deeper understanding of the unique dynamics and challenges faced by SMEs in different regions.

By understanding the intricate relationship between taxation and SME performance, policymakers can design tax policies that foster a conducive business environment, promote entrepreneurship, and support SME growth. For example, simplifying tax systems or providing tax incentives can help reduce compliance costs and administrative burdens for SMEs (Twesige & Gasheja, 2019). Furthermore, promoting economic growth is one of the objectives of the Sustainable Development Goals (SDGs), and the private sector is viewed as a crucial contributor to this progress. Micro and small businesses can play a significant role in achieving these goals, especially with the support of favorable tax legislation (Ndlovu & Schutte, 2024).

Mogadishu, the capital city of Somalia, has experienced significant economic and political transformations in recent years. The government has been working towards improving tax administration and revenue collection to fund public services and infrastructure development. However, the impact of taxation policies and practices on SMEs remains relatively understudied. Thus, there is a need to examine how taxation affects the performance of SMEs in Mogadishu, specifically.

The taxation system in Somalia has been plagued by challenges, including low revenue-to GDP ratio, corruption, and lack of institutional capacity (Isak, 2018). The country's fragile state and history of conflict have also contributed to the limited capacity of the state to enforce taxes (Sahgal, 2023). Despite these challenges, the private sector has continued to grow and develop, particularly in the telecom sector (Sahgal, 2023). Mohamud and Isak (2019) highlight the importance of tax reform in Somalia. They found that the introduction of a simplified collection process and a shift

towards self-assessment have improved operational efficiency within the tax administration. Additionally, the automation of key operations through the Somalia Financial Management Information System (SFMIS) has facilitated better data collection and management.

Mohamed (2022) examines the impact of tax revenue on economic growth in Somalia. The author found that 49.3% of the variation in GDP is explained by income and corporate taxes, international trade taxes, and domestic indirect taxes. The findings also revealed that the coefficient of domestic indirect taxes was negative, indicating that it has a negative influence on economic growth in Somalia. Raballand (2020) suggests that addressing corruption, lack of capacity, and political instability is crucial for effective revenue mobilization. He emphasizes the need for a fiscal contract between government and citizenry to increase revenue mobilization. Abdi and Hersi (2023) investigate the influence of tax administration on revenue generation in Somalia. They found that the tax administration in Somalia is inefficient, which negatively impacts revenue generation.

Taxation in Somalia is complex and context-specific. Strengthening institutional capacity, improving fiscal federalism, encouraging formalization of the economy, and implementing effective tax administration systems are essential to increase revenue collection and improve economic stability. The unique context of Mogadishu, Somalia, with its emerging economy, political dynamics, and evolving tax landscape, necessitates a focused examination of the impact of taxation on SMEs. By conducting research in this area, policymakers can gain insights into the specific challenges faced by SMEs in Mogadishu related to taxation. Additionally, SME owners can better understand the implications of tax policies on their business operations and make informed decisions to navigate the tax environment more effectively.

## 1.2 Statement of the Problem

Taxation serves a crucial role in the sustainability and growth of SMEs, which are widely recognized as key drivers of economic development. Ndlovu and Schutte (2024) highlight that countries with robust SME sectors experience elevated economic growth rates, driven by job creation, productivity enhancement, and innovation. However, SMEs in Mogadishu face significant barriers to expansion primarily due to burdensome taxation policies. These challenges often lead to widespread tax evasion and non-compliance, as many SMEs operate without proper licensing from governmental authorities.

Despite the centrality of SMEs to job creation and GDP contributions, there is a notable deficiency in research that specifically addresses the taxation landscape within this sector, particularly in Mogadishu. Most existing studies tend to focus on taxation issues related to large corporations, leaving the unique challenges and opportunities faced by SMEs underexplored. This lack of empirical evidence creates a knowledge gap that hampers informed policymaking and effective tax administration.

There is a pressing need to thoroughly examine the impact of taxation on the performance of SMEs in Mogadishu. This research aims to clarify the complex relationship between the taxation environment and the operational success of SMEs, providing valuable insights for policymakers, tax authorities, and SME owners. By addressing this gap, the study seeks to promote the development of a more supportive taxation framework that fosters SME growth, ultimately contributing to broader socio-economic progress in the region.

### **1.3 Purpose of Study**

This study's main goal was to investigate how taxation affects the performance of SMEs in Mogadishu, Somalia.

#### **1.3.1 Specific Objectives**

1. To examine how tax rates influence the performance of SMEs in Mogadishu, Somalia.
2. To evaluate the influence of income tax on the performance of SMEs in Mogadishu, Somalia.
3. To analyze the influence of excise tax on the performance of SMEs in Mogadishu, Somalia.

#### **1.4 Research Questions**

1. How do tax rates influence the performance of SMEs in Mogadishu, Somalia?
2. How does income tax influence the performance of SMEs in Mogadishu, Somalia?
3. To what extent does excise tax influence the performance of SMEs in Mogadishu, Somalia?

#### **1.5 Significance of the Study**

This investigation into the impact of taxation on SMEs in Mogadishu is significant for various stakeholders and the region's socio-economic development:

Policymakers and tax authorities will gain insights into how taxation affects SMEs, guiding the creation of targeted tax policies that foster growth, competitiveness, and sustainability, ultimately attracting investments and stimulating entrepreneurship. SME owners and managers will understand the relationship between taxation and business performance, enabling informed decision-making regarding resource allocation, investment planning, and compliance strategies, enhancing their operations, and navigation of the tax landscape.

The research fills a gap in empirical studies on taxation's impact on SMEs in developing countries, providing a foundation for further research and academic discourse, and promoting a deeper understanding of taxation's effects on performance. International development organizations can leverage the findings to design targeted programs that support SME growth, aligning interventions with challenges and opportunities related to taxation to contribute to poverty reduction and sustainable economic development.

In summary, the research will provide valuable insights to tax administrators and help the government create a conducive environment for SME expansion. It will also guide the academic community and future scholars in related research (Goerke, 2015).

### **1.6 Scope of the Study**

This research conducted in Mogadishu, Somalia, focusing on the performance of SMEs as influenced by taxation. The study examined key performance indicators, including profitability, investment decisions, operational efficiency, competitiveness, and overall business growth. By analyzing both historical data and recent developments, the research aims to provide a comprehensive understanding of SME performance within a specified timeframe, from January 2023 to June 2024.

Data was collected through a cross-sectional survey design, targeting selected SMEs in Mogadishu. Insights will be gathered from a variety of stakeholders, including SME owners, managers, policymakers, and representatives from industry associations. This diverse input is intended to enrich the study's findings and ensure a holistic understanding of the taxation landscape's impact on SMEs.

The primary objective is to investigate the relationship between taxation and SME performance, centering on three key variables: income tax, tax rates, and excise tax. The findings and recommendations derived from this study are anticipated to provide valuable insights for policymakers, tax authorities, SMEs, and international development organizations. Ultimately, this information will assist in the formulation of effective tax policies and strategies that foster the growth and sustainability of SMEs in Mogadishu and potentially extend beyond.

### **1.7 Limitations of the Study**

Despite the significance and potential impact of this study, several limitations are anticipated that may affect the scope and generalizability of the findings:

First, the study focuses exclusively on SMEs within Mogadishu, Somalia. As such, the results may not be generalizable to other regions of Somalia or to SMEs operating in more stable or economically advanced countries. Different regulatory, political, and economic conditions elsewhere may yield different results.

Reliable data on SMEs in Somalia, especially in Mogadishu, can be difficult to obtain due to weak institutional frameworks, a large informal sector, and limited official business registries. There may also be inconsistencies or inaccuracies in financial reporting and tax compliance records among SMEs. The prevailing security risks and political instability in Mogadishu may limit the ability to access certain areas or conduct in-depth fieldwork. This might restrict the reach of data collection and reduce the representativeness of the sample.

SMEs owners may be hesitant to discuss sensitive information regarding their taxes, revenues, or compliance behavior due to fear of reprisal or mistrust of researchers. This could result in response bias or incomplete data. The study adopts a cross-sectional research design, which captures data

at a single point in time. This limits the ability to establish causality between taxation and SME performance. A longitudinal approach would be more effective in capturing changes over time but was beyond the scope of this study due to time and resource constraints. As a student-led academic study, the research is constrained by available funding and time. This may impact the sample size, breadth of coverage, and depth of analysis. Despite these limitations, the study is designed to ensure methodological rigor and generate relevant insights that can guide both policy and academic discourse.

### **1.8 Delimitations of the Study**

To ensure clarity and manageability, the study was intentionally delimited in the following ways. First, the study specifically targets Small and Medium Enterprises (SMEs) operating within Mogadishu. Large corporations and micro-enterprises are excluded from the study scope to maintain a clear focus on the unique challenges and opportunities faced by SMEs. Secondly, the research is limited to examining the effects of three specific tax variables, tax rates, income tax, and excise tax, on SME performance. Other forms of taxation such as value-added tax (VAT), customs duties, and payroll tax are excluded to ensure a manageable scope and more in-depth analysis of selected variables.

Thirdly, although SMEs exist throughout Somalia, the research is geographically confined to Mogadishu due to its economic centrality, relative accessibility, and concentration of formal SMEs. This also helps mitigate logistical and security challenges. Also, the study covers the period from January 2023 to June 2024. This timeframe was selected to reflect recent taxation policies and performance data and may not account for longer-term trends or historical factors influencing SME development.

The primary respondents are SME owners and managers, with supplementary insights from policymakers and representatives of industry associations. This choice was made to capture perspectives from both operational and regulatory standpoints. The study primarily adopts a quantitative approach using survey data. Although qualitative insights may enrich understanding, interviews or focus groups are not included in the data collection phase due to time constraints. These delimitations were necessary to focus the research on its core objectives and enhance the feasibility of execution within the available time and resources.

### **1.9 Operational Definitions**

**Tax:** Tax is a mandatory financial contribution imposed by a government with the purpose of generating revenue. It is typically assessed on the income or assets of individuals or organizations (Downer, 2016).

**Performance:** Performance refers to a business's capability to execute a strategy effectively in order to attain its organizational objectives. It serves as a critical tool for businesses to evaluate the efficiency of their management in accomplishing business goals.

**SMEs:** The number of employees a business has determines which category it falls into. Small businesses are usually those with less than 50 employees, while medium-sized businesses are those with less than 250 employees.

**Income Tax:** Income tax is a tax imposed on the earnings or income of individual taxpayers or corporations. It is typically charged annually and is determined based on a specified tax rate (Goerke, 2015).

**Excise Tax:** Excise taxes are levies applied to a range of goods, services, and activities, with the responsibility for paying these taxes falling on either the producer, retailer, or consumers, depending on the particular tax in question.

**Tax Rate:** A tax rate can be presented in a number of ways, including statutory, average, marginal, and effective. A tax rate is the ratio at which an individual or corporation is subject to taxation.



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter incorporates a comprehensive exploration of different literature concerning the impact of taxation on the performance of small and medium enterprises. It starts with an exploration of literature that analyzes the issue from a global perspective, which is then narrowed down to an African perspective and then concludes with the context of Somalia. The purpose of this chapter is to develop an understanding of the impact of taxation and identify existing gaps that prompted the need for the study to be completed. The identification of the research gap is important since it justifies the need for the study to be carried out.

#### **2.1 Taxation and its Role in the Economy**

Taxation involves the process that governments use to impose financial charges or levies on businesses, individuals, and other relevant entities with the purpose of generating revenue to facilitate public spending (Ongayi et al., 2021). The revenue collected through taxation is essential for funding different critical public services such as education, defense, welfare systems, and the development of infrastructure (Adefunke & Usiomon, 2022). Therefore, when the government does not have a sufficient tax revenue infrastructure in place, it is likely to face challenges in maintaining law and order, basic amenities, and fostering economic growth (Chude & Chude, 2015). Therefore, taxation is considered to be important for facilitating a functional economy, enabling countries to address social inequalities, causing market stability, and promoting equitable distribution of wealth (Ongayi et al., 2021).

The structure of taxation in different jurisdictions can be classified into two broad categories, namely direct and indirect taxes (Abiahu & Nwaorgu, 2020). Direct taxes include income tax, corporate tax, and capital gains tax, which focuses on the income, profits, or wealth of individuals and businesses. On the other hand, indirect taxes include value-added tax (VAT), excise duties, sales tax, and customs duties. Indirect taxes are levied on the cost of goods and services and are, in most instances, passed on to the final consumer (Balasoju et al., 2023). Important, Rahman (2023) explains that effective taxation systems should strike a balance between generating sufficient revenue for public expenditure and ensuring that the tax burden does not discourage economic activity or investment.

Mohammed and Tangl (2023) point out that taxation plays a vital role in fostering economic growth and development by ensuring there are funds available for infrastructure, social welfare programs, and other relevant government operations. For instance, revenue from taxes makes it possible for governments to invest in different projects, such as the development of physical infrastructure in the form of ports, roads, and power supplies, which are essential for facilitating the efficient operation of businesses (Balasoju et al., 2023). Similarly, revenues collected through taxation are used to finance social infrastructure in the form of healthcare systems and education, which improve the quality of the labour force and contribute to long-term economic development (Abiahu & Nwaorgu, 2020). Therefore, a well-structured tax system ensures that such kinds of public investments end up creating an environment that enables business activities, job creation, and business innovation (Kouam & Asongu, 2022).

Despite the positive associated with taxation, the concept can also pose significant challenges, especially in the context of small and medium enterprises (SMEs). According to Ndlovu and Schutte (2024), SMEs usually find themselves in situations where they are vulnerable to the

negative effects of taxation compared to large corporations. That is because SMEs have limited access to financial resources and expertise. Taxes are vital in facilitating funding of public services that end up benefiting SMEs; tax regimes can also act as financial and administrative burdens. Also, compliance with tax obligations in most instances involves significant costs from tax filing, record keeping, and consultation fees (Eichfelder & Hechtner, 2017). In the case of many SMEs operating in emerging economies, the burden associated with taxation can discourage formalization and stifle business growth. In addition, taxation policies that are poorly designed and implemented, such as excessively high tax rates or complex regulatory frameworks, have the potential to reduce the competitiveness of SMEs and discourage entrepreneurship (Kouam & Asongu, 2022).

The relationship between taxation and the economic performance of businesses is usually influenced by the utilization of tax revenues (Kouam & Asongu, 2022). In instances where governments use tax revenue effectively by investing in infrastructure, healthcare, public security, and education, then taxation is bound to have a positive effect on the economic growth and performance of SMEs (Okunogbe & Santoro, 2023). Conversely, having in place ineffective tax systems that are riddled with corruption and poorly administered the outcomes include undermining economic progress, reduced profitability of businesses, and increased incidents of tax evasion (Okunogbe & Santoro, 2023). In their study, Roman et al. (2023) found that taxation has a dual impact on the performance of SMEs, and effective management determines the impact realized. Taxation can contribute to the growth of SMEs, or it can hinder their growth and performance. Therefore, that makes it an important area of focus for policymakers motivated by the need to achieve sustainable economic growth.

The findings of the study by Roman et al. (2023) suggest that tax systems are expected to evolve to meet the changing demands of global economies. Contemporary economies are increasingly dependent on different forms of technology, such as digital platforms and crossborder trades, and they lead to new challenges in tax administration. Mohammed and Tangl (2023) argue that governments should implement tax policies that make it easy for people and businesses to comply, reduce tax administration burdens, and incentivize businesses such as SMEs to operate within the formal economy. For instance, many countries across the globe have introduced the concept of digital tax filing systems, tax incentives for SMEs, and progressive tax regimes meant to promote economic growth and minimize the negative impacts of taxation on SMEs (Roman et al., 2023).

## **2.2 Taxation Systems and Economic Growth**

Taxation systems are designed to help distribute the burden associated with funding public goods and services across businesses and individuals based on their potential to pay (Gale & Samwick, 2017). The main forms of taxation that impact businesses such as SMEs include income tax, value-added tax, sales tax, property taxes, and customs and excise duties. Income tax is levied on business earnings and falls under the category of direct taxes, and it varies based on the profits earned by businesses. Progressive tax systems are in place to ensure that businesses that have higher earnings contribute a larger share of tax revenue (OECD, 2016). In particular, corporate income tax is considered to be a significant source of revenue in many economies and has a direct effect on the profitability of businesses and reinvestment decisions (Okunogbe & Santoro, 2023).

Value-added tax and sales tax are indirect taxes that are levied on the consumption of goods and services. Value-added tax is applied at the different stages of consumption, and the distribution of goods and services is an important source of revenue in both developed and developing economies. It is important to note that while value-added tax generates substantial revenue for governments,

it also can impose a disproportionate burden on small and medium enterprises and low-income households (Warwick et al., 2022). On its part, property taxes are levied on things like buildings, land, and real estate. Property tax levied on businesses plays a vital role in financing local government services such as public safety, learning institutions, and infrastructure development (Cozmei & Onofrei, 2015).

Customs and excise duties are taxes that target imports, exports, and some specific goods such as tobacco, alcohol, and fuel. Customs and excise duties as forms of tax act as revenue-generating tools and policy instruments. As policy instruments, they are meant to regulate trade and consumption patterns within a particular jurisdiction (Van Oordt, 2023). Like the other forms of taxes, customs and excise duties can have a positive or negative impact on the performance of SMEs. They can spur performance or negatively impact the ability of a business to perform in its industry of operation (Munyoro et al., 2016).

Taxation influences economic growth and the performance of businesses through several channels. The channels include public spending, private investment, and consumption. According to Balasoiu et al. (2023), governments' decisions to fund education, infrastructure, and healthcare by using the taxes collected make it possible to create an environment that is conducive to economic activities. For instance, public investment in transportation networks that are in place has the potential to reduce logistical costs for businesses and improve access to diverse markets. That enables SMEs to expand their operations and enjoy improved performance (Macek, 2015). Similarly, tax revenue, when used to finance education and healthcare in a country, enhances human capital, which then increases productivity and innovation in the economy (Ho et al., 2023). According to Barrios (2020), the relationship between taxation, growth, and business performance is not straightforward. Excessive taxation, especially those that target enterprises and

entrepreneurs, is likely to have a negative effect on business performance and economic growth. Findings by Balasoiu et al. (2023) suggest that high tax rates may reduce incentives for businesses to invest, provide employment opportunities, or engage in innovation. Moreover, the costs associated with tax compliance and the time and resources needed to meet tax obligations can have a disproportionate effect on SMEs. Such compliance costs are often higher in developing economies where there is less efficiency in tax systems that are in place and high levels of bureaucracy (Balasoiu et al., 2023).

### **2.3 Taxation and SMEs**

Small and medium enterprises are vital for any economy in different countries across the globe. It is estimated that small businesses make up 99.9% of businesses in the United States since there are over 34.8 million small businesses compared to 19,688 large businesses in the country. Small businesses provide employment for over 59 million individuals, which is 45.9% of all employment in the private sector (USAFacts, 2023). Rowinski (2022) explains that small businesses account for 44% of the United States economic activities. According to the World Bank (2019), SMEs contribute up to 40% of the national income or gross domestic product in emerging economies. However, the numbers go up significantly when informal SMEs are also factored in.

Small and medium-sized enterprises are a driving force for economic development in the European Union (EU). SMEs create employment opportunities, products, and services and contribute to economic growth. SMEs are estimated to make up 99.8% of non-financial businesses in Europe and are the source of two-thirds of all employment opportunities (European Investment Bank, 2022). According to the European Parliament (2024), SMEs in the European Union provide employment for over 100 million individuals, and they are an essential source of entrepreneurship and innovation. Businesses are the backbone of Europe's economy since they create jobs and drive

innovation. SMEs mostly operate at a national level in Europe, and few of them engage in cross-border business within the European Union. However, SMEs are still impacted by European Union legislation in fields such as taxation (European Parliament, 2024).

SMEs are considered to be vital components of the global economy since they serve as engines of innovation, employment creation, and economic development. Gherghina et al. (2020) point out that since SMEs account for a significant proportion of global employment and gross domestic product, then their growth and sustainability are important for both developing and developed economies (Surya et al., 2021). However, despite the importance of SMEs, businesses usually face different challenges when it comes to taxation. Some of the challenges include high costs of compliance, limited access to tax incentives, and administrative burdens, which hinder the potential of such businesses (Amoah et al., 2022).

High compliance costs are one of the challenges that can limit the growth and sustainability of SMEs. According to Runde et al. (2021), SMEs face disproportionate taxation compliance burdens compared to larger corporations. Compliance costs include fees for hiring tax professionals, costs of preparing returns, managing audits, and understanding complex regulations. These costs divert resources from the business that could otherwise be invested in growth and innovation in the businesses (Musimenta, 2020). Amoah et al. (2022) explain that compliance costs as a share of revenue are significantly higher compared to those of larger corporations.

In many regions, high corporate tax rates that are in place discourage SMEs from formalizing their operations or realizing expansion. Pimhidazai and Fox (2012) state that it is because excessive tax burdens that come with high corporate tax rates erode profitability, which forces SMEs to opt for remaining in the informal sector as a way of avoiding taxation. Appiah et al. (2024), in their findings, hold that, in instances where SMEs have a limited understanding of tax systems, that

influences their performance in the market of operation. SMEs lack the financial literacy and expertise necessary to go through the complex and dynamic tax systems. The inadequate knowledge that is present can lead to errors in tax compliance, attract fines and penalties, or lead to missed opportunities to accessing tax incentives (Favourate, 2021).

Different jurisdictions have in place tax incentives that are meant to encourage individuals and businesses to formalize their operations and willingly pay taxes. Sun (2022) suggests that many tax incentives that are in place are designed to support the growth of businesses. Deyganto (2022) identified some relevant tax incentives including tax credits, reduced tax rates, and exemptions. However, there are instances where SMEs lack the necessary awareness or administrative capacity to be able to exploit the available tax incentives and opportunities (Ayem & Hijayanti, 2022).

The different challenges associated with taxation end up impacting the performance of SMEs in the different industries of operations. Chebii (2020) pointed out that the challenges emphasize the need for tax policies that are in place to be simplified and SME-friendly as a way of ensuring there are reduced compliance-associated costs and supporting the formalization of small businesses. According to Surya et al. (2021), recognizing the importance of SMEs to economic growth has prompted the need for governments in different parts of the world to implement tax policies that try to address the identified challenges and promote the development of SMEs.

Many countries have in place lower corporate tax rates for SMEs compared to large corporations. Tsuruta (2018) argues that the essence of that is to ensure that the potential negative impact of taxation on the performance of SMEs is avoided. For instance, Ireland offers a reduced corporate tax rate for SMEs, and that has been instrumental in encouraging the growth of entrepreneurship in the country (OECD, 2019). Simplified tax filing is another aspect of tax policies that have been introduced to mitigate the challenges that SMEs face when it comes to taxation. Simplified tax

regimes in the form of single tax returns or turnover tax have been vital in facilitating the reduction of tax compliance costs and associated administrative burdens. Countries like Brazil, India, and Pakistan have in place simplified filing systems that target SMEs with the purpose of encouraging tax compliance (Dom et al., 2022).

There are governments that opt for tax holidays and exemptions as a way of addressing the challenges of taxation on SMEs. The findings by Braunerhjelm and Henrekson (2023) suggest that temporary tax exemptions are offered by governments, such as the United States governments, with the aim of promoting innovation and entrepreneurship. Darnihamedani et al. (2018) explain that startups that operate in certain industries, such as agriculture, technology, and manufacturing, are offered tax exemptions to ensure that taxes do not negatively impact their performance. Therefore, it means that there is a relationship between increased tax burden and reduced performance and productivity by SMEs.

Value-added tax thresholds involve businesses that have not been able to earn certain amounts of profit being exempted from taxation. SMEs that have low turnover get relief since they are exempted from value-added tax and sales tax. Such a policy is introduced to reduce the indirect tax burden on SMEs since it goes beyond the direct tax burden. Also, the taxation processes are simplified, which is something that is positive for companies (Twesige & Gasheja, 2019). Engelschalk and Loeprick (2015) found that tax credits for investment and innovation are another approach used to influence the relationship between taxation and SMEs in contemporary society. Tax credits for research and development are important since they encourage SMEs to invest in innovation, which, in turn, enhances their competitiveness. For example, Canada has in place what is known as the Scientific Research and Experimental Development (SR&ED) program tasked with providing tax credits to SMEs that are identified to engage in research and development

activities (Jamie et al., 2019). These measures aim to balance revenue generation with fostering an environment conducive to SME growth, particularly in emerging markets where SMEs drive significant economic activity (Jamie et al., 2019).

## **2.4 The Impact of Taxation on SMEs in Africa**

As a continent, Africa is dynamic and experiencing rapid growth in the SME sector. The sector has ended up playing a central role in the economic development of the continent, being involved in poverty reduction and enhanced creation of employment opportunities (Aringo, 2023). According to the International Labour Organization (2024), in Africa, SMEs account for 80% of employment. Runde et al. (2021), in their report published by the Center of Strategic and International Studies, found that in the context of Africa, SMEs make up approximately 90% of the private sector. However, taxation policies that are in place in Africa, in most instances, are cited to act as barriers to the performance of SMEs by stifling their potential to fully contribute to the economic growth of the continent (Runde et al., 2021).

### **2.4.1 Taxation and Economic Growth in Africa**

The relationship between taxation and economic growth in the context of Africa is multifaceted. Onakoya et al. (2017) explain that tax revenue is vital for facilitating development, but excessive tax burdens, inefficient tax systems, and high levels of informality can act as challenges that must be addressed. Like in other parts of the world, African governments rely on taxation to mobilize resources to facilitate development projects. However, the difference is that there are instances where most governments rely heavily on taxation as a source of resources to finance development projects such as education, healthcare, and transportation (Kessy & Sukartini, 2023). Onakoya et al. (2017) suggest that tax revenue in Africa remains low compared to other regions because of

low compliance, ineffective tax administration systems, and the prevalence of informal economies in the continent.

A significant proportion of small and medium enterprises in Africa operate in the informal sector, which means that a majority of them do not comply with tax requirements. Findings by Matsongoni and Mutambara (2018) suggest that the informal economy associated with SMEs in Africa undermines the ability of governments to generate revenue and also their ability to support the development of business in different sectors. According to Quartey et al. (2017), informality is mainly caused by a high tax burden, complex tax regulations that are in place, and a lack of trust in government institutions. Therefore, SMEs opt to operate in the informal sector because it makes it possible for them to avoid complying with tax regulations.

Compliance costs are another aspect that is constant in studies exploring the relationship between taxation, economic growth, and SMEs in Africa. Junpath et al. (2016) state that SMEs in Africa face the challenge of high compliance costs associated with taxation because of the presence of bureaucratic tax systems, corruption, and limited digitization of tax administration processes. Djossa-Tchokoté et al. (2024) explain that the high costs of tax compliance end up consuming a significant portion of SME revenues, which then reduces their profitability and discourages businesses from pursuing the path of formalization. That means that SMEs are less likely to formalize and remain in the informal sector as a way of avoiding being taxed because of the negative impact taxation has on their ability to sustain their operations (Djossa-Tchokoté et al., 2024).

Tax incentives are identified as an important aspect when it comes to exploring the relationship between the taxation of SMEs and economic growth in Africa. According to Nkwe (2017), there are governments in Africa that have in place tax incentives that are meant to support SMEs

operating within their jurisdictions. Tax incentives include reduced tax rates, introduction of tax holidays, and simplifying the tax filing processes. However, there are still challenges with regard to tax incentives. They include the existence of uneven implementation of tax incentive policies and limited awareness among SMEs concerning tax incentives. The limitations often reduce the effectiveness of the tax incentive policies meant to promote the performance and sustainability of SMEs (Olawale & Garwe, 2010).

#### **2.4.2 Taxation and SME Growth in Africa**

In Nigeria, SMEs contribute an estimated 48% of the country's gross domestic product and are responsible for the creation of millions of employment opportunities (Ojelabi, 2023).

However, despite the positive contribution of SMEs to the country's economy, taxation has played an integral part in hindering their growth. The existence of high compliance costs, complex tax systems, and SMEs' lack of awareness concerning tax incentives are the main contributors to the hindered growth of SMEs in the country (Olawale & Garwe, 2010). That has prompted the need for the Nigerian government to introduce mitigative measures. The Nigerian government introduced policies that include reduced corporate tax rates for SMEs, which have positively impacted the performance of such businesses in the country (Adefunke & Usiomon, 2022).

South Africa has a tiered tax system in place that is meant to ensure that SMEs are supported and reduce the negative impact of taxation on small businesses. The country has a small business corporation tax regime in place that allows SMEs that qualify to benefit from several incentives (Ndlovu & Schutte, 2024). The incentives include reduced tax rates and tax holidays, which end up having a positive impact on the performance of the businesses. The SMEs are able to reinvest in their operations the funds that they would have otherwise paid as taxes, and that drives up economic growth in the country (Ndlovu & Schutte, 2024).

The findings by Klaver (2015) in their study that focused on the Democratic Republic of Congo (DRC) hold that when taxes are imposed on SMEs on a territorial basis, the outcomes include a negative impact on performance. Also, the study found that non-resident businesses, including SMEs that conduct their business within the Democratic Republic of Congo, are required to pay taxes on profits earned through fixed policies. Gatsi et al. (2017) in their study explored the impact of corporate tax on the financial performance of businesses in Ghana. The study focused on ten businesses in the country that operated between 2005 and 2012, and a descriptive causal research design was used. The findings suggest that there is a negative relationship between corporate income tax and the financial performance of businesses in Ghana. However, there are factors that influence the relationship, and they include the size of the business, the age of the business, and the growth that the business has achieved over the years (Gatsi et al., 2017).

In nearly all countries in Africa, the main objective of taxation is to generate income for governmental expenses and other additional functions (Ojede & Yamarik, 2016). In the case of Kenya, the country's total revenue generation is over 75%, which suggests the country's government's reliance on taxation as a source of income (Aringo, 2023). A study by Kariuki (2017) investigated the financial performance of companies that operate in Kenya. The study sample included 64 companies listed in Kenya. The results of the study indicate that corporate tax planning and liquidity had a positive impact on the performance of the companies. Also, the findings found that the financial performance of the companies was unfavourable in instances of high taxation.

Kuria et al. (2017) assessed the impact of tax incentives on the operation effectiveness of EPZ businesses in Kenya. The study involved the use of a bivariate regression model to help explore the relationship between corporate income tax incentives, capital allowance tax incentives, and VAT incentives on the performance of companies. The results suggest that a significant positive

correlation existed between the tax incentives and the performance of the companies. Njuru et al. (2015) examined the influence of taxation on private investment in Kenya by using the vector auto-regression model. The results of the study highlight the importance of having a well-designed tax system in place and the need for the implementation of progressive tax reforms to ensure the enhanced performance of businesses.

## **2.5 Taxation in Somalia**

### **2.5.1 History of Taxation in Somalia**

Taxation systems in Somalia before the arrival of colonial powers were informal and based on a culture that was present in the region, which was pastoralist and clan-based cultures. It involved people being prompted to make community contributions, often in the form of livestock, goods, or labour. The purpose of the contributions was to support local leaders, protect communities, and maintain mutual welfare. Clan elders were responsible for collecting resources based on mutual agreement. Therefore, the taxation system that was in place in the region was informed by reciprocity rather than coercion (Isak & Mohamud, 2022).

Trade was an important aspect of pre-colonial Somalia since it contributed to the development and sustenance of many coastal cities such as Mogadishu, Berbera, and Kismayo. Such cities were active centres of commerce in the region. Concerning taxation and trade, there were informal taxes in the form of levies placed on trade routes or market transactions. Such levies were imposed to sustain local economies and community leadership structures. The decentralized system that was in place in pre-colonial Somalia was a reflection of the absence of a unified state but worked effectively within clan-based governance (Isak & Mohamud, 2022).

### **2.5.2 Colonial Era and Taxation**

Somalia was colonized by the British and Italians in the late 19<sup>th</sup> and early 20<sup>th</sup> centuries. That saw the country be divided into British Somaliland in the north and Italian Somaliland in the south. The colonial powers needed to raise revenue, so they introduced what would be the country's first formal tax system, which was to extract revenue to support the costs of administration and finance economic interests (Isak, 2018). In the part of the country that was under the control of the British, the colonial administration that was in place imposed taxes on agricultural produce, livestock, and trade. In most instances, the pastoral community resented the taxes since they perceived them as being exploitative and not compatible with their nomadic way of life. Therefore, there was resistance to the taxation measures put in place, and many Somalis refused to comply or evaded payment of taxes (Isak & Mohamud, 2022). In the part of Somalia that was under the control of Italians, the colonial administration introduced a more centralized taxation system. The taxation system that was introduced involved levies being imposed on trade, agricultural products, and labour in different regions. Also, customs duties were imposed on imports and exports, which contributed to economic disparities and social grievances among Somali communities (Isak & Mohamud, 2022).

The colonial taxation systems that were present in Somalia were mainly extractive and designed to serve the interests of the colonial powers rather than supporting local development. It meant that despite the local communities contributing the revenues, the finances were not used mainly to improve their quality of life. Therefore, the outcome is the establishment of a lasting distrust towards formal taxation among Somali communities, and that is a sentiment that would define the ability of the country to successfully implement formal taxation systems in modern times (Raballand & Knebelmann, 2020).

### 2.5.3 Post-Independence Tax Policies

Somali gained independence in 1960, and the country faced challenges concerning taxation systems inherited from the British and Italian colonial administrations. It was prudent for the newly formed government to introduce formal taxation structures that included income tax, trade tariffs, and property tax. These taxes were levied on salaries, business profits, imports and exports, and land ownership. President Siad Barre (1969-1991) oversaw the country's adopting socialist economic policies, with emphasis being placed on state ownership of resources and the establishment of centralized taxation (Isak & Mohamud, 2022).

The government imposed heavy taxes on businesses, and that was justified that the government was meant to fund state-led development programs. However, weak enforcement, corruption, and inefficient tax administration played a significant role in undermining such efforts. Also, the lack of transparency concerning the use of tax revenues further eroded the trust that the public had in taxation as a concept (Raballand & Knebelmann, 2020). During this period, the economy of the country increasingly became fragile, and resistance to taxation increased, specifically in rural communities. The government was unable to effectively collect taxes effectively, which meant that the quality of public services was reduced significantly (Farah & Ainebyona, 2019).

Isak and Mohamud (2022) explain that the collapse of the central government in Somalia in 1991 led to widespread chaos and disintegration of the formal taxation systems. The country descended into civil war, which meant that the absence of a functioning government allowed for the emergence of alternative taxation systems. Militias, warlords, and clan leaders imposed informal taxes on households, traders, and businesses. That involved setting up roadblocks on major trade routes and forcing transporters to pay fees for goods they were ferrying. Also, traders in the different markets were required to pay what was known as protection money to local militias and

warlords (Isak & Mohamud, 2022). The informal taxation systems imposed heavy burdens on businesses, especially small businesses, and they ended up struggling to survive amid insecurity and economic instability. The lack of a centralized tax authority in the country during that period meant that revenue generation for public services was nonexistent.

Somalia was able to restore governance and taxation systems in the early 2000s with the assistance and support of international organizations such as the World Bank and the International Monetary Fund (IMF). That saw the establishment of the Federal Government of Somalia (FGS) in 2012, which marked a significant step toward rebuilding fiscal institutions in the country. The government that was established introduced various types of tax reforms meant to mobilize domestic revenue (Raballand & Knebelmann, 2020). Hassan (2022) explains that the taxes that were introduced include customs duties, sales tax, and income tax. However, despite the reforms, the taxation system that was present in Somalia remained weak.

Taxation systems in Somalia remained weak because of political instability, limited administrative capacity, and widespread informality. Also, tax compliance was significantly low with a significant portion of the country's economy operating outside the formal system (Hassan, 2022). However, Isak and Mohamud (2022) point out that the ongoing efforts that include modernizing tax collection by introducing the use of digital technologies indicates the country moving in the right direction when it comes to improving revenue generation in the future.

#### **2.5.4. SMEs and Taxation in Somalia**

Small and medium enterprises (SMEs) are considered to be the backbone of Somalia's economy. Businesses play an important role in facilitating the creation of employment opportunities, reducing poverty, and creating economic resilience (Hassan, 2022). According to the World Bank Group (2022), SMEs account for a significant share of employment and economic activity in

Somalia. The businesses make significant contributions in the different sectors that include agriculture and livestock, trade and commerce, and services. Small-scale farming and livestock trade remain key economic drivers, and SMEs are dominant in wholesale, retail, and cross-border trade. The fragile economy that is present in the country has seen SMEs become the main source of livelihood for millions of people and families (World Bank Group, 2022).

According to Isak and Mohamud (2022), SMEs in Somalia face numerous challenges related to taxation. Some of the challenges identified include high informality rates, limited awareness and capacity, lack of incentives, and high costs of compliance. A significant portion of SMEs operate informally to avoid taxation in Somalia. That is prompted by the absence of trust in government institutions and the lack of incentives to encourage formalization. Isak (2018) and Farah and Ainebyona (2019) found that many SMEs in Somalia lack the financial knowledge or administrative systems necessary to facilitate compliance with tax regulations. Therefore, SMEs prioritize survival over tax compliance due to limited resources. Compliance costs are a burden to SMEs since they spend a lot of time and money to file taxes. Policies that are present in the country are inconsistent and outdated, which creates uncertainty for SMEs.

## **2.6 Theoretical Framework**

Developing an understanding of the impact of taxation on the performance of SMEs prompts the need to engage a comprehensive theoretical foundation. The theories are important in helping to explore how fiscal policies around taxation influence the performance of enterprises. The theoretical framework developed in this instance includes three theories, namely fiscal exchange theory, pecking order theory, and institutional theory. The theories identified in this case provide enhanced insights into the different elements of taxation and their relationship to the performance of businesses.

Fiscal exchange theory is stated to have evolved from the economic deterrence and social psychology theories. The theory holds that the presence of government expenditures is likely to serve as a motivating factor to facilitate compliance among taxpayers, especially in instances where the taxpayers value the services they receive from the government (Saptono & Khozen, 2023). The theory posits that taxation is a form of exchange that happens between the government and those who are governed. Therefore, the theory suggests that people are willing to comply with taxation measures when they perceive that they will gain tangible benefits, such as infrastructure, public services, and security from the government (Nikiema & Zahonogo, 2017).

In the context of Mogadishu, Somalia, SMEs operate in a challenging business environment that is characterized by political instability, weak governance, and limited public services. Therefore, it means that in instances where SMEs perceive that the taxes they pay to the government are not reciprocated with adequate public goods and services, they are likely to engage in tax evasion or reduced investment, which then negatively impacts their performance. For instance, the lack of visible benefits from taxes can make taxation perceived as a cost in the books of the business rather than being an investment in infrastructures and services that will benefit the operations of the business (Isak & Mohamud, 2022). Also, SMEs in Somalia may struggle with compliance because of bureaucratic inefficiencies or corrupt practices. That makes the situation worse since it negatively impacts the operations of businesses. The theory highlights the importance of transparency and accountability in taxation. Governments that engage in prudent use of the revenues collected by reinvesting the tax revenues effectively can promote a more conducive environment for SMEs, improving their overall performance (Isak & Mohamud, 2022).

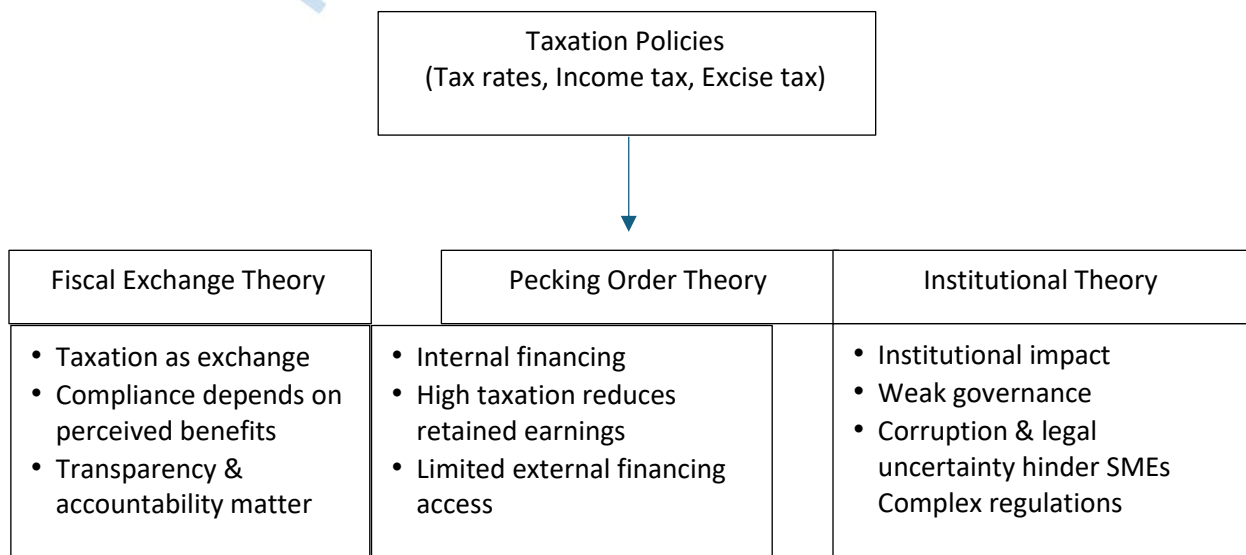
The pecking order theory is usually applied to corporate finance, but it can be applied to explore the relationship between taxation and the performance of SMEs. The theory can be used to explain

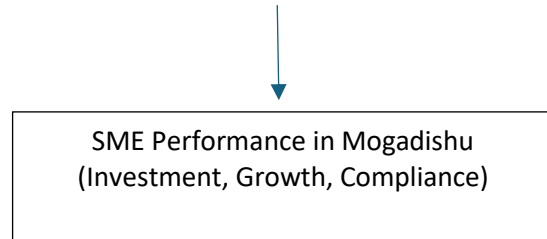
how businesses prioritize their financial strategies when they have to comply with taxation policies. The pecking order theory holds that organizations prefer to use internal finances first before pursuing debt and then lastly involve the use of equity to finance their operations or to achieve growth and expansion (Singh et al., 2021). In the context of SMEs operating in Mogadishu, the businesses have limited access to formal financing options, therefore, they are more reliant on retained earnings and finances from informal lending networks (Isak & Mohamud, 2022). Therefore, high taxation is likely to reduce the finances available to SMEs, which then constrains the ability of the businesses to reinvest in sustaining their operations and achieving growth.

The main implications include excessive taxation leading to the depletion of internal resources, which then forced SMEs to rely on debt, an option that is often expensive or inaccessible in Somalia. Also, SMEs might find themselves in a situation where they prioritize survival over growth when faced with high tax rates, which undermines their ability to expand or innovate effectively. Finally, unpredictable tax policies can make financial uncertainty worse, which then impacts the performance of SMEs. The pecking order theory highlights the need for tax policies to be implemented that take into consideration the financial vulnerabilities of SMEs (Isak & Mohamud, 2022; Isak, 2018).

The institutional theory explores how formal and informal institutional frameworks influence organizational behavior and performance (Madni et al., 2019). According to Horodnic (2018), institutional theory can explain tax incidence, tax non-compliance, and tax morale. The theory mainly explores how external pressures influence organizations' decisions to adopt organizational practice. The theory is relevant in Mogadishu since the institutional environment in the jurisdiction is characterized by weak legal enforcement, corruption, and an informal economy.

Institutional factors that affect taxation and SME performance include the existence of complex and opaque tax regulations which are likely to increase compliance costs and limit the growth of businesses. The widespread corruption present in a jurisdiction is likely to lead to SMEs deciding to operate informally so as to avoid taxation. That limits businesses' ability to gain access to formal markets and financing. Frequent changes in tax policies or enforcement can create uncertainty, which then discourages long-term investment (Madni et al., 2019).

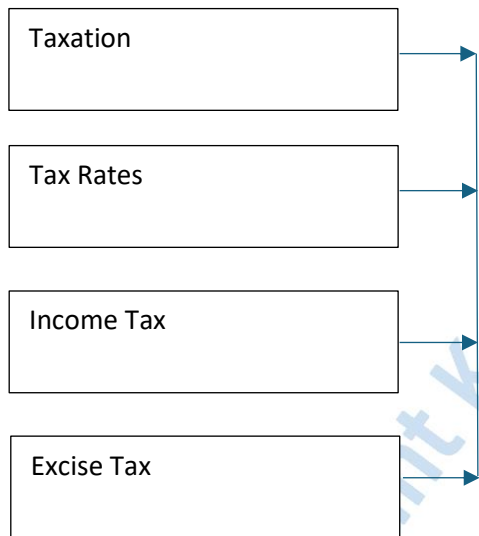




**Figure 2.1: Theoretical Framework**

### 2.7 Conceptual Framework

#### Independent Variable



#### Dependent Variable



**Figure 2.2: Conceptual Framework**

## 2.8. Conclusion

This chapter provides a comprehensive review of existing literature on the relationship between taxation and the performance of Small and Medium Enterprises (SMEs), structured across global, African, and Somali contexts. Globally, taxation is recognized as a crucial tool for financing public services and promoting economic growth. However, excessive tax burdens and complex tax systems can negatively impact SMEs by increasing operational costs and discouraging formalization and investment. Direct taxes like income tax and corporate tax, as well as indirect taxes such as VAT and excise duties, affect business profitability and competitiveness. Governments worldwide are increasingly implementing SME-friendly tax policies, including reduced tax rates, simplified filing systems, and digital platforms, to encourage compliance and support growth.

Across Africa, SMEs account for a large share of employment and economic activity, but taxation poses significant challenges. These include high compliance costs, limited access to incentives, and the prevalence of informal business practices due to burdensome tax regimes. Countries like Nigeria, South Africa, and Kenya have adopted tiered tax systems, tax holidays, and incentives to support SMEs. Nonetheless, many SMEs remain unaware of such benefits or lack the capacity to utilize them effectively.

In the Somali context, taxation has historically been informal, community-based, and rooted in clan structures. In recent years, Somalia has attempted to modernize its tax administration, especially in urban centers like Mogadishu, through reforms such as simplified collection systems and digital financial management platforms. However, the country still faces challenges

related to institutional capacity, corruption, and weak enforcement. These issues, coupled with high informality in the SME sector, limit the effectiveness of the current tax regime.

The literature identifies a dual role of taxation: while it enables infrastructure development and public services that benefit SMEs, it can also serve as a barrier to SME performance if poorly designed. The review concludes by highlighting gaps in the Somali context, especially the lack of empirical studies focusing on the taxation challenges and performance dynamics of SMEs in Mogadishu. These gaps justify the current study and its goal of informing policy for a more conducive tax environment



Mount Kenya University

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

This chapter outlines the methods and techniques that were used to carry out the investigation. That involves detailing the research design, target population, sample size, sampling technique, data collection methods, and data analysis approach that was used to conduct the research. The different elements explored are essential in facilitating the reliability, validity, and objectivity of the research, which focuses on the impact of taxation on the performance of small and medium enterprises (SMEs) in Mogadishu, Somalia. Therefore, a systemic methodology is effective in ensuring that accurate and generalizable findings are generated.

#### **3.1 Research Design**

The research employed the use of a cross-sectional research design, which is usually effective when it comes to assessing the relationship between variables at a specific point in time. According to Gupta et al. (2016), cross-sectional studies are considered effective since they allow researchers to explore the exposure and outcomes at the same time. That ensures that a snapshot of current conditions and interactions is presented. Cross-sectional research design is mainly relevant for exploring the impact of taxation on the performance of SMEs since it is able to capture real-time data representing the operational realities of SMEs in a particular jurisdiction.

The study involved the use of a combination of descriptive and quantitative methods to facilitate the process of data analysis. Descriptive methods are preferred in this instance since they allow for the summation of patterns and trends (Taherdoost, 2021). Quantitative approaches allow for the collection of statistical evidence concerning the relationship between taxation and the performance

of businesses (Ghanad, 2023). Karafiath (2014) emphasizes that cross-sectional studies are effective in the exploration of relationships, especially in settings where access to longitudinal data might be limited. Also, inclusion and exclusion criteria that was used in the study it to be established beforehand with the purpose of ensuring that participant selection is aligned with the objectives of the study with the purpose of improving data reliability, as explained by Patino and Ferreira (2018).

### **3.2 Target Population**

The target population for this research was made up of SMEs operating in Mogadishu, Somalia. SMEs are considered to be important contributors to the growth and stability of the economy in Somalia since they contribute to a significant portion of employment opportunities and economic activity in the country (Amoah et al., 2022). According to Hadhan (2017), a population is the entire set of components or a subset of variables that are being studied. In the context of this study, it is estimated that the target population made up of 300 SMEs, including those operating general trade, wholesale, and retail enterprises as well as workshops, will be the study's target population.

The focus on SMEs in Mogadishu is a reflection of the role of the city as the economic hub of Somalia. Businesses operating in the city face unique challenges in the form of informal practices, weak governance, and taxation policies that are inconsistent (Isak & Mohamud, 2022). Therefore, the context makes Mogadishu to be an ideal setting to explore the relationship between taxation and the performance of SMEs. The study aims to generate relevant findings that represent the broader business landscape in the country by exploring a diverse set of SMEs located in Mogadishu.

### 3.3 Sample Size and Sampling Technique

The sample size in this research was calculated using Solvent's formula, which is meant to ensure that the statistical significance is factored in by considering the maximum allowable margin error of 5% (Nduku et al., 2015). The decision to use Solvent's formula will see the study select a sample size of 172 respondents from the target population of 300 SMEs. The sample that was used was made up of representatives from different industries and sectors, such as wholesale, general trade, workshops, and retail, to ensure a balanced and accurate representation of SMEs in Mogadishu is achieved.

**Table 3.1: Sample Size**

Categories	Total Number of Participants
Wholesale	55
General trade	40
Workshops	35
Retail	42
<b>TOTAL</b>	<b>172</b>

The study involved the use of a stratified random sampling technique. The sampling technique was preferred because it involves dividing the target population into specific strata based on the different types of industries and sectors. Within each stratum, participants who were engaged in the study were selected randomly to ensure that there is a proportional representation of SMEs across the different industries. According to Makwana et al. (2023), stratified sampling is effective since it reduces selection bias and enhances the reliability of findings by ensuring that the sample reflects the diversity of the target population (Ahmed, 2024).

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

N stands for the population

n. stands the sample

a. stands acceptable error

$$n = \frac{300}{1 + 300(0.05)^2}$$

$$=172$$

### 3.4 Data Collection Instruments

In this research, questionnaires were used as the primary method for collecting data. Questionnaires are preferred because they are effective in gathering large volumes of data in a structured way and that facilitates the collection of quantitative and qualitative data (Haradhan, 2017). According to the definition provided by Haradhan (2017), the questionnaire is a tool consisting of a sequence of printed or typed questions on a form or multiple forms. The forms were then be distributed to individuals relevant to the study, accompanied by a request for them to respond to the questions and subsequently return the completed questionnaire.

The questionnaires that were used in the research are designed to align with the objectives of the study and ensure that each question addresses the different aspects concerning the impact of taxation on the performance of SMEs in Mogadishu. Questions were categorized into sections to incorporate the different variables, including tax compliance, financial performance, business growth, and operational challenges. The different sections are informed by existing literature, which is meant to ensure relevance and comprehensiveness (Saharan et al., 2024).

The need to simplify the process saw the research engage the use of a five-point Likert scale, which ranged from “Strongly Disagree” (1) to “Strongly Agree” (5). The Likert scale is universally recognized because of its ability to capture the intensity of the attitudes and perceptions of respondents in a structured way, which then enhances the interpretability of data (Tanujaya et al.,

2022). For instance, the respondents were asked to rate their agreement with statements such as “The current tax policies significantly hinder SME growth” and “Compliance with taxation regulations enhances business reputation.”

In instances where face-to-face administration of the questionnaires was not possible, the instruments were distributed via email to ensure that a broader reach is achieved. The emails that were sent out were accompanied by a detailed introduction letter that explained the objectives of the research and the importance of the participation of the respondents. Follow-up emails and calls were used to encourage timely response. The dual approach of questionnaire administration and distribution is focused on ensuring the response rate is maximized while non-response bias is minimized, as stated by Williamson (2016).

Some of the advantages associated with self-administered questionnaires include their ability to provide respondents with sufficient time to reflect on the responses they provide, which ensures thoughtful responses are provided (Williamson, 2016). Also, the method is preferred since it allows the researcher to have the opportunity to address errors, omissions, or misinterpretations during the process of data collection (Williamson, 2016). That significantly improved the quality and completeness of data collected. However, despite the benefits, there are challenges associated with the use of questionnaires. Some of the challenges include the reluctance of respondents to participate in the research because of concerns about confidentiality or time constraints (Kempf-Leonard, 2018). Such issues were addressed by reassuring respondents that the responses they provided were anonymous and confidential. That was accompanied by an emphasis that the data collected will be used solely for academic purposes.

### **3.5 Data Collection Procedure**

The data collection method was implemented systematically to ensure that the reliability and validity of findings are assured. Through the distribution of questionnaires, research staff assisted in the collection of data. Top management personnel from the SMEs based in Mogadishu, Somalia, was the target audience for these questions. These individuals were perceived to be the relevant respondents because of their direct involvement in decision-making processes, including aspects of compliance with taxation policies that are in place. An introduction letter approving the research was sent first to the identified SMEs. The letter outlined the objectives of the study and emphasize the importance of their perception. The purpose of the letter was to build trust and encourage respondents to provide accurate information.

The researcher followed up on the initial communications by scheduling meetings with business representatives who agreed to take part in the study by phone and in person. The method worked well for keeping the questions' comprehension constant, which encouraged a high response rate and reduce the possibility of erroneous or inconsistent answers. According to Jensen and Laurie (2016), uniformity in instructions provided to respondents minimizes variability in interpretations by respondents and reduces instances of errors in the responses provided.

### **3.6 Pilot Study**

A pilot test serves as a valuable procedure that assists researchers in identifying any deficiencies, limitations, or issues within their data collection instruments, allowing them to make necessary revisions and enhancements before proceeding with the actual study. In line with Singh's (2014) recommendation, a pilot study involves administering questionnaires to a subset of the target population to pre-test the survey questions. For this research, a pilot study was conducted with 17 SMEs to assess the reliability and validity of the questionnaire. The number selected for the pilot

study aligns with the standard guideline, suggesting that the pilot test should encompass 1 to 10 percent of the sample (Gupta et al., 2016).

### **3.6.1 Validity**

Validity refers to the degree to which the instruments or measurement scales used in research accurately measure the intended outcomes or variables. It assesses how well the research hypotheses align with the actual outcomes and helps answer questions regarding the correctness of the research methodology and the accuracy of the results. In essence, validity is a measure of the strength and appropriateness of the connection between the research instruments and the desired research outcomes (Sürücü & Maslakci, 2020). Validity primarily pertains to whether the measurement aligns correctly with the intended concept (Haradhan, 2017). It assesses how faithfully the collected data accurately reflects the study's variables, as suggested by Singh (2014). To evaluate this, the researcher used the widely recognized internal consistency measure, the KMO-Bartlett's test. This test typically yields a value ranging from 0 to 1, with a satisfactory value exceeding 0.6, indicating that the scale meets the criteria for validity.

### **3.6.2 Reliability**

Reliability pertains to the consistency and stability of a measurement scale or instrument. In other words, if a test is administered using a particular instrument for a specific subject, and the results consistently produce similar outcomes in every attempt, then the measurement is considered reliable (Gidron, 2020). Reliability focuses on the dependability and consistency of the test results, ensuring that they are not subject to significant fluctuations or variations (Haradhan, 2017). That was achieved by assessing the correlation between scores obtained from multiple administrations of the scale. If the correlation is strong, it indicates that the scale produces consistent and reliable

results. To measure the internal reliability of the questionnaire used in this study, Cronbach's alpha was used.

### **3.7 Data Analysis and Presentation**

The data analysis process involved descriptive and inferential statistical techniques which are purposed to ensure that a comprehensive and accurate interpretation of the collected data is achieved. The main statistical tool that was used to accomplish the process is the Statistical Package for Social Sciences (SPSS) version 25.0, which is popular for its robustness and versatility when it comes to handling complex datasets (Rahman & Muktadir, 2021). Descriptive statistics in the form of percentages, frequencies, standard deviations, and means will be used to summarize the data collected. The metrics were calculated since they were able provide a clear overview of the demographic profiles of the respondents and their perceptions of the impact of taxation on SMEs' performance.

Inferential statistics, in the form of regression analysis, was implemented to test the hypotheses of the study. According to Lee (2022), regression analysis is especially relevant in the examination of the relationship between independent variables and dependent variables. A 95% confidence interval and a p-value threshold of 0.05 was used to determine statistical significance. Correlation analysis was used to measure the strength and direction of the relationships between the different variables. The analysis involved the exploration of the correlation between tax compliance and financial performance, which provided valuable insights into the influence of taxation policies on the performance of businesses in the jurisdiction under exploration.

Factor analysis was used to identify the underlying patterns and themes that are present within the data that was collected. The technique is important since it helped in uncovering the main factors that influence SMEs and provide comprehensive understanding concerning challenges and

opportunities faced by SMEs when it comes to taxation policies. In the case of the open-ended questions that were used, thematic analysis was used to identify recurring themes and patterns. The approach is effective since it complemented quantitative findings, which, in turn, offered a holistic view of the research problem under exploration (Watkins, 2018).

### **3.8 Ethical Consideration**

Ethical considerations are important in research since they are meant to ensure the integrity of the study and respect for respondents is achieved (Onen & Oso, 2008). In this research, ethical approval was sought from the relevant authorities before the start of the study. The researcher is responsible for ensuring that all the participants who take part in a study are fully informed about the scope, purpose, and objectives of the research (Bos, 2020). That was achieved by incorporating a detailed letter, which was attached to the questionnaires distributed among participants.

Informed consent of participants was obtained to ensure that they have voluntarily agreed to be part of the research without being subjected to any form of coercion. It is important for confidentiality and anonymity of the participants to be maintained in the study (Bos, 2020).

That was achieved by assigning the unique codes to the questionnaires and ensuring that data that is collected is stored securely.

The researcher adhered to the principles of transparency and honesty in all the stages of the study, which include data collection, analysis, and reporting. According to Kang and Hwang (2023), researchers are required to protect the dignity and privacy of participants while also ensuring that the data collected is only used for the intended academic purposes. There was compliance with intellectual property rights by ensuring that all the references used are cited appropriately and plagiarism is avoided.

## **CHAPTER FOUR**

### **RESEARCH FINDINGS AND DISCUSSIONS**

#### **4.0 Introduction**

This study looked into Impact of taxation on the performance of small and medium enterprises in Mogadishu. demographic information, the presentation and analysis of data, key discoveries, and discussions. To fulfill the study's objectives, the researchers present and deliberate on the research findings, analyze the data, and provide interpretations. The data collected through a questionnaire were subjected to descriptive statistical analysis.

#### **4.1 Demographic Data**

The demographic features of the respondents. The study encompassed a sample size of 172 participants, consisting of managers and employees from a select group of manufacturing enterprises located in Mogadishu, Somalia. The demographic characteristics taken into account for the respondents included gender, age, level of education, years of experience, place of employment, and job position. Upon the collection and analysis of the distributed questionnaires, the researcher identified the following key demographic characteristics among the respondents. The background information of the respondents is presented in the tables below.

Table 4.1 illustrates that the demographic characteristics of the participants were considered as respondents in this study. The demographic traits of the respondents encompassed age, gender, marital status, educational attainment, work experience, the age of the business, position within the company, ownership status, and the size of the company. Regarding the age of the respondents,

approximately 19.8% fell within the age range of 18-24, while the majority, which accounted for 54.1%, were between 25 and 36 years old. About 22.1% of the respondents were aged between 37 and 43, and a smaller proportion, 4.1%, were 44 years old and above. In terms of gender distribution, the research found that 76.2% of the respondents were male, while the remaining 23.8% were female, indicating a predominance of male participants. The study inquired about the marital status of the respondents, revealing that a slight majority, or 51.2%, were married, while the remaining 48.8% were single. The respondents were queried about their educational backgrounds as part of the demographic information gathering process.

Therefore 22.7% of the respondent were master degrees, where 65.1% of the respondents had a bachelor, and the remaining 12.2% were diploma. Also, The respondent was asked their age of business experience in the involvement of work by The researcher, however, (17.4%) respondents were less than 1 year while (57.0%) respondents were 1 to 5 years and (21.5.2%) respondents were 5 to 10 years and the (4.1%) were 10 and above years, therefore, the researcher indicates that the most majority of the respondents 'experience were 1 to 5 years.

The position titles of the respondents were administrative and non-administrative. Therefore, the researcher found that (34.9%) of the respondents were administrative while the remaining (65.1%) were non-administrative, the majority of the cover were non- administrative, on the other hand, the respondents were asked if they were owners or not, but the researcher was found that 17.4% were owner while 82.6 were employees. The final demographic information that was asked to the respondents by the researcher was the size of their company, and the result found that was the majority of the respondents (54.7%) told their size of the company is medium while (45.3 %) told their size of the company is small.

**Table 4.1: Demographics Data**

<b>Age</b>	<b>frequency</b>	<b>Percent</b>	<b>valid percent</b>
18-24	34	19.8	19.8
25-36	93	54.1	54.1
37-43	38	22.1	22.1
44 and above	7	4.1	4.1
Total	172	100	100
<b>Gender</b>			
Male	131	76.2	76.2
Female	41	23.8	23.8
Total	172	100	100
<b>Marital status</b>			
Single	84	48.8	48.8
Married	88	51.2	51.2
Total	172	100	100

#### **4.2 Reliability and Validity of Data**

Validity is the ability of a data collection instrument or technique to measure what it was designed to measure. A number of approaches were utilized to prove the study's validity. First, a considerable amount of data was collected from a convenience and random sample,

<b>Educational level</b>			
Master degree	39	22.7	22.7
Bachelor	112	65.1	65.1
Diploma	21	12.2	12.2
Total	172	100	100
<b>Age of Business</b>			
Less than one year	30	17.4	17.4
1-5 years	98	57.0	57.0
5-10 years	37	21.5	21.5
More than 10 years	7	4.1	4.1
Total	172	100	100
<b>Position</b>			
Administrative	60	34.9	34.9
None administrative	112	65.1	65.1
Total	172	100	100

**Table 4.2: Reliability Statistics**

Cronbach's Alpha	N of Items
.757	20

**Source: Primary Data, 2021**

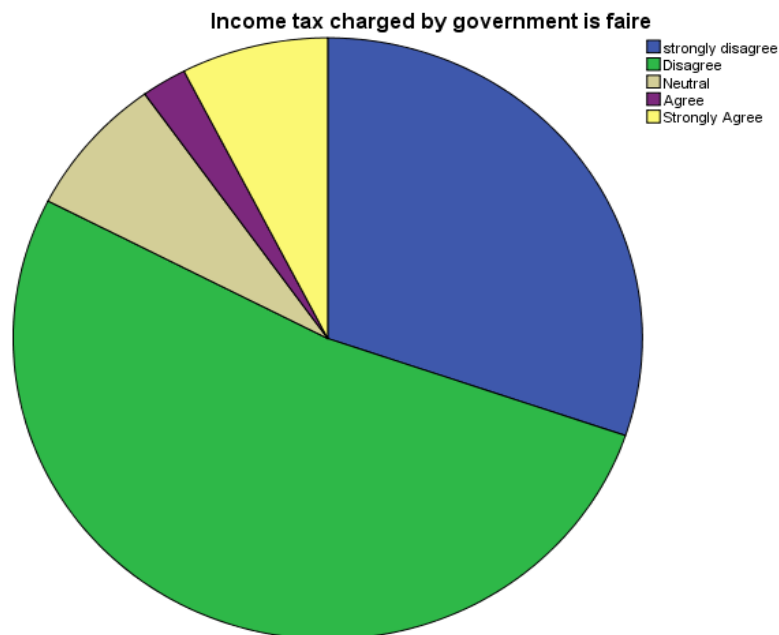
Dependability refers to the consistency of results over time and their accurate representation of the entire population. Researchers need to convince readers that the methods and outcomes are valid and trustworthy. The greater the consistency with which the results accurately represent the overall study population, the higher their scientific reliability. To assess reliability, Cronbach's alpha was computed using the Statistical Package for Social Sciences (SPSS). As shown in the table above, the alpha coefficient stands at 0.757, signifying that the study's reliability is relatively strong and falls within the acceptable range discussed in earlier chapters.

### 4.3 Data Presentation and Analysis

This section discusses how the data collected in questionnaires were analyzed concerning the research objectives. Respondents have answered questions about the study's aims, and their answers were examined and presented using descriptive statistics.

**Table 4.3: Income Tax Charged by Government is Fair**

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly disagree	52	30.2	30.2	30.2
Disagree	90	52.3	52.3	82.6
Neutral	13	7.6	7.6	90.1
Agree	4	2.3	2.3	92.4
Strongly Agree	13	7.6	7.6	100.0
Total	172	100.0	100.0	

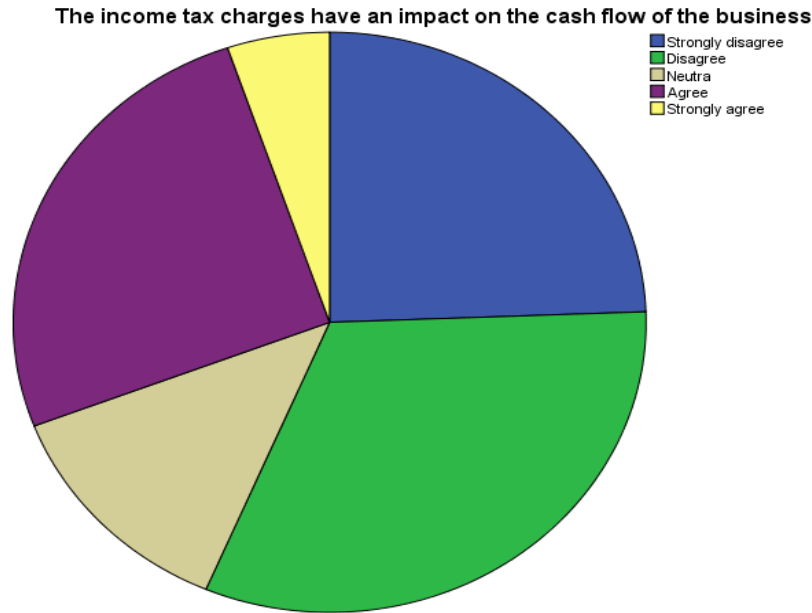


**Figure 4.1: Income Tax Charged by Government is Fair**

Table 4.3 and Figure 4.1 indicate that the majority of respondents, 52(30.2%) strongly disagreed that income tax imposed by the government is fair, 90 (52.3%) disagreed, 13 (7.6%) were neutral, 4 (2.3%) agreed, and 13 (7.6%) strongly agreed. Based on these findings, the majority of the sample population (82.5%) either disagreed or strongly disagreed that income tax charged by the government is fair. Only a small percentage of the sample (9.9%) either agreed or strongly agreed that income tax charged by the government is fair, while the remaining percentage were neutral (7.6%).

**Table 4.4: The Income Tax Charges have an Impact on the Cash Flow of the Business**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	42	24.4	24.4	24.4
Disagree	55	32.0	32.0	56.4
Neutral	22	12.8	12.8	69.2
Agree	44	25.6	25.6	94.8
Strongly agree	9	5.2	5.2	100.0
Total	172	100.0	100.0	

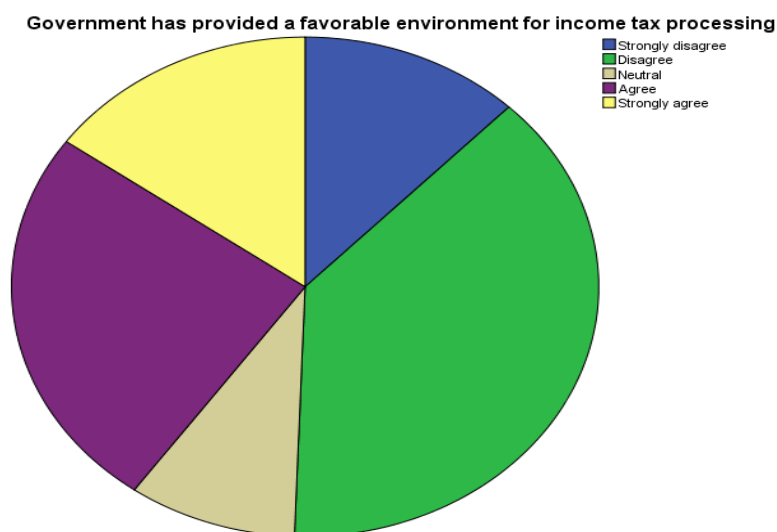


**Figure 4.2: The Income Tax Charges have an Impact on the Cash Flow of the Business**

Table 4.4 and Figure 4.2 display the distribution of responses to a statement about the impact of income tax charges on the cash flow of a business for the population, based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category. 42 participants strongly disagreed that income tax charges have an impact on the cash flow of the business, 55 disagreed, 22 individuals were neutral, 44 individuals agreed, and 9 individuals strongly agreed. Based on these findings, the majority of the sample population (57.2%) either disagreed or strongly disagreed that income tax charges have an impact on the cash flow of the business. A significant percentage of the sample (25.6%) agreed or strongly agreed that income tax charges have an impact on the cash flow of the business, while the remaining percentage were neutral (12.8%).

**Table 4.5: The Government has Created a Conducive Atmosphere for the Processing of Income Tax**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	21	12.2	12.2
	Disagree	66	38.4	50.6
	Neutral	16	9.3	59.9
	Agree	43	25.0	84.9
	Strongly agree	26	15.1	100.0
	Total	172	100.0	100.0



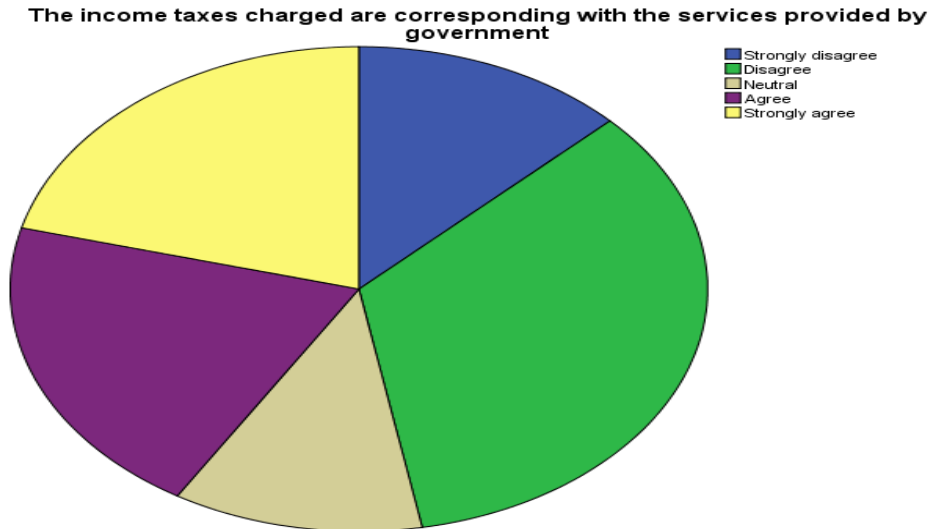
***Figure 4.3: The Government has Created a Conducive Atmosphere for the Processing of Income Tax***

Table 4.5 and Figure 4.3 present the distribution of responses to a statement about the government has established a conducive environment for the processing of income tax for the population, based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The representations show that an estimated 12.1% of the sample strongly disagreed that the government has provided a favorable environment for income tax processing, while 38.2% disagreed, 9.2% were neutral, 24.9% agreed, and 15.0% strongly agreed.

Based on these findings, the majority of the sample population (53.4%) either disagreed or strongly disagreed that the government has established a conducive environment for the processing of income tax. A significant percentage of the sample (40.1%) agreed or strongly agreed that the government has provided a favorable environment for income tax processing, while the remaining percentage were neutral (6.5%).

**Table 4.6: The Levied Income Taxes Align with the Services Offered by the Government**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	22	12.8	12.8	12.8
Disagree	59	34.3	34.3	47.1
Neutral	20	11.6	11.6	58.7
Agree	35	20.3	20.3	79.1
Strongly agree	36	20.9	20.9	100.0
Total	172	100.0	100.0	



**Figure 4.4: The Levied Income Taxes Align with the Services Offered by the Government**

Table 4.6 and Figure 4.4 show the distribution of responses to a statement about the correspondence between income taxes levied and the services provided by the government for the

population, based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree.

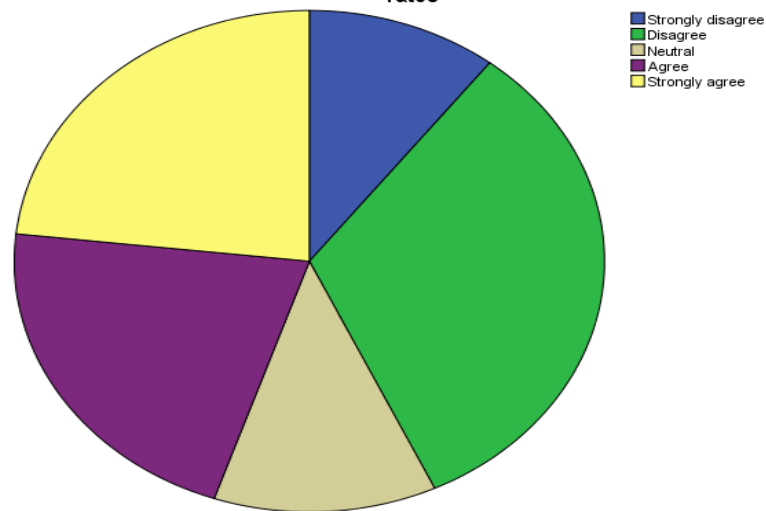
The frequency column indicates the number of individuals who selected each response category. It shows that an estimated 22 individuals strongly disagreed that income taxes charged correspond with the services provided by the government, 59 individuals disagree, 20 individuals were neutral, 35 individuals agreed, and 36 individuals strongly agreed. The percent column shows the percentage of individuals who selected each response category in the sample. An estimated 12.7% of the sample strongly disagreed that income taxes charged correspond with the services provided by the government, while 34.1% disagreed, 11.6% were neutral, 20.2% agreed, and 20.8% strongly agreed.

Based on these findings, the majority of the sample population (54.2%) either disagreed or strongly disagreed that income taxes charged correspond with the services provided by the government. A significant percentage of the sample (41.0%) agreed or strongly agreed that income taxes charged correspond with the services provided by the government, while the remaining percentage were neutral (4.8%).

**Table 4.7: Benefits for a Taxpayer that is Classified as a Small Business Corporation**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	18	10.5	10.5	10.5
Disagree	56	32.6	32.6	43.0
Neutral	21	12.2	12.2	55.2
Agree	37	21.5	21.5	76.7
Strongly agree	40	23.3	23.3	100.0
Total	172	100.0	100.0	

The Income Tax Procedure contain a number of benefits for a taxpayer that is classified as a small business corporation, for example, special wear and tear rates



**Figure 4.5: Benefits for a Taxpayer that is Classified as a Small Business Corporation**

Table 4.7 and Figure 4.5 present the distribution of responses to a statement about the benefits of the income tax procedure for a taxpayer classified as a small business corporation, based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category. 18 individuals strongly disagreed that the Income Tax Procedure contains benefits for an SME, 56 individuals disagreed, 21 individuals were neutral, 37 individuals agreed, and 40 individuals strongly agreed.

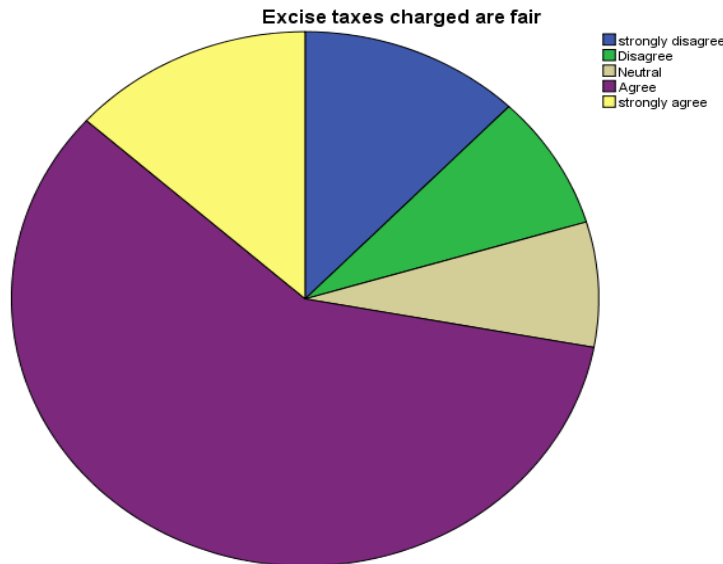
The percent column shows the percentage of individuals who selected each response category in the sample. An estimated 10.4% of the sample strongly disagreed that the Income Tax Procedure contains benefits for a small business corporation, while 32.4% disagreed, 12.1% were neutral, 21.4% agreed, and 23.1% strongly agreed. Based on these findings, the majority of the sample population (44.5%) either agreed or strongly agreed that the Income Tax Procedure contains

**Table 4.8: Excise Taxes Charged**

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly disagree	21	12.2	12.2	12.2
Disagree	14	8.1	8.1	20.3
Neutral	13	7.6	7.6	27.9
Agree	101	58.7	58.7	86.6
strongly agree	23	13.4	13.4	100.0
Total	172	100.0	100.0	

benefits for SMEs, while a significant percentage (42.8%) disagreed or

strongly disagreed. The remaining percentage were neutral (12.7%).



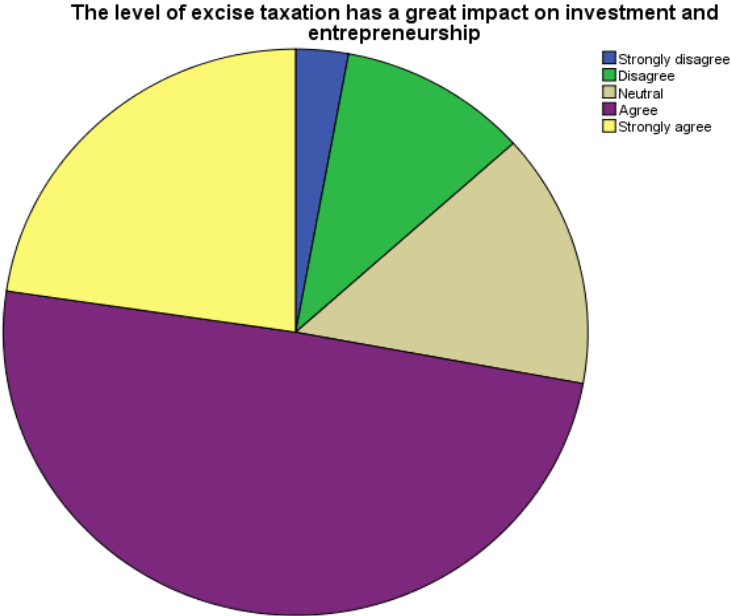
**Figure 4.6: Excise Taxes Charged**

Table 4.8 and Figure 4.6 show the distribution of responses to a statement about the fairness of excise taxes charged. Based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category. 21 individuals strongly disagreed that excise taxes charged are fair, 14 individuals disagreed, 13 individuals were neutral, 101 individuals agreed, and 23 individuals strongly agreed.

The percent column shows the percentage of individuals who selected each response category in the sample. An estimated 12.1% of the sample strongly disagreed that excise taxes charged are fair, while 8.1% disagreed, 7.5% were neutral, 58.4% agreed, and 13.3% strongly agreed. Based on these findings, the majority of the sample population (71.7%) agreed or strongly agreed that excise taxes charged are fair, while a smaller percentage (20.2%) disagreed or strongly disagreed. The remaining percentage were neutral (8.1%).

**Table 4.9: The Extent of Excise Taxation**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	5	2.9	2.9	2.9
Disagree	18	10.5	10.5	13.4
Neutral	25	14.5	14.5	27.9
Agree	85	49.4	49.4	77.3
Strongly agree	39	22.7	22.7	100.0
Total	172	100.0	100.0	



**Figure 4.7: The Extent of Excise Taxation**

Table 4.9 and Figure 4.7 present the distribution of responses to a statement about the impact of excise taxation on investment and entrepreneurship. Based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree.

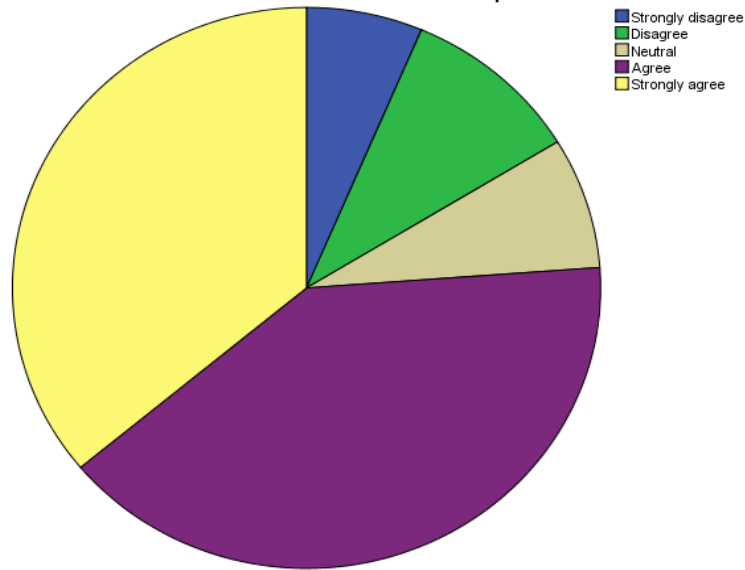
The frequency column indicates the number of individuals who selected each response category. 5 individuals strongly disagreed that the extent of excise taxation significantly influences investment and entrepreneurial activities, 18 individuals disagreed, 25 individuals were neutral, 85 individuals agreed, and 39 individuals strongly agreed. The percent column shows the percentage of individuals who selected each response category in the sample. For instance, 2.9% of the sample strongly disagreed that the extent of excise taxation significantly influences investment and entrepreneurial activities, 10.4% disagreed, 14.5% were neutral, 49.1% agreed, and 22.5% strongly agreed.

Based on these findings, the majority of the sample population (71.6%) agreed or strongly agreed that the extent of excise taxation significantly influences investment and entrepreneurial activities, while a smaller percentage (13.3%) disagreed or strongly disagreed. The remaining percentage were neutral (15.1%).

**Table 4.10: Tax Base and Excise Taxes**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	11	6.4	6.4	6.4
Disagree	17	9.9	9.9	16.3
Neutral	13	7.6	7.6	23.8
Agree	69	40.1	40.1	64.0
Strongly agree	62	36.0	36.0	100.0
Total	172	100.0	100.0	

**A simple tax base and a small number of excise taxes that is easily calculated can reduce administrative and compliance costs**



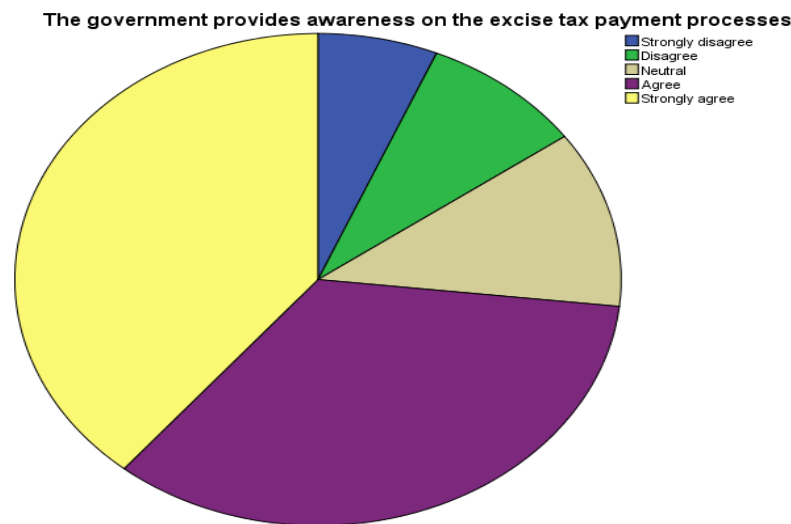
**Figure 4.8: Tax Base and Excise Taxes**

Table 4.10 and Figure 4.8 incorporate the distribution of responses to a statement about the benefits of a simple tax base and a small number of excise taxes. Based on a sample of 172 individuals. The response categories are Strongly disagreed, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category. The findings show that 11 individuals strongly disagreed that a simple tax base and a small number of excise taxes can reduce administrative and compliance costs, 17 individuals disagreed, 13 individuals were neutral, 69 individuals agreed, and 62 individuals strongly agreed. The percent column shows the percentage of individuals who selected each response category in the sample. Also, the findings show that 6.4% of the sample strongly disagreed that a simple tax base and a small number of excise taxes can reduce administrative and compliance costs, while 9.8% disagreed, 7.5% were neutral, 39.9% agreed, and 35.8% strongly agreed.

Based on these findings, the majority of the sample population (76.0%) agreed or strongly agreed that a simple tax base and a small number of excise taxes can reduce administrative and compliance costs, while a smaller percentage (16.2%) disagreed or strongly disagreed. The remaining percentage were neutral (7.8%).

**Table 4.11: Government Provision of Awareness on the Excise Tax Payment Processes**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	11	6.4	6.4	6.4
Disagree	15	8.7	8.7	15.1
Neutral	20	11.6	11.6	26.7
Agree	59	34.3	34.3	61.0
Strongly agree	67	39.0	39.0	100.0
Total	172	100.0	100.0	



**Figure 4.9: Government Provision of Awareness on the Excise Tax Payment Processes**

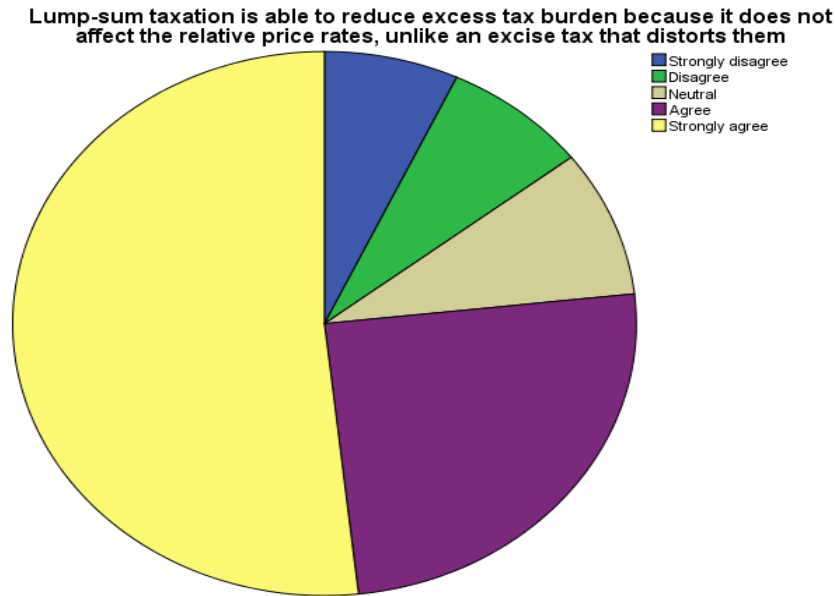
Table 4.11 and Figure 4.9 presents the distribution of responses to a statement about the government providing awareness on the excise tax payment processes. Based on a sample of 172

individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category. The findings show that 11 individuals strongly disagreed that the government provides awareness on the excise tax payment processes, 15 individuals disagreed, 20 individuals were neutral, 59 individuals agreed, and 67 individuals strongly agreed. The percent column shows the percentage of individuals who selected each response category in the sample. An estimated 6.4% of the sample strongly disagreed that the government provides awareness on the excise tax payment processes, while 8.7% disagreed, 11.6% were neutral, 34.1% agreed, and 38.7% strongly agreed.

Based on these findings, the majority of the sample population (77.7%) agreed or strongly agreed that the government provides awareness on the excise tax payment processes, while a smaller percentage (15.1%) disagreed or strongly disagreed. The remaining percentage were neutral (7.2%).

**Table 4.12: Lump-sum Taxation and Excess Tax Burden**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	12	7.0	7.0	7.0
Disagree	13	7.6	7.6	14.5
Neutral	15	8.7	8.7	23.3
Agree	43	25.0	25.0	48.3
Strongly agree	89	51.7	51.7	100.0
Total	172	100.0	100.0	



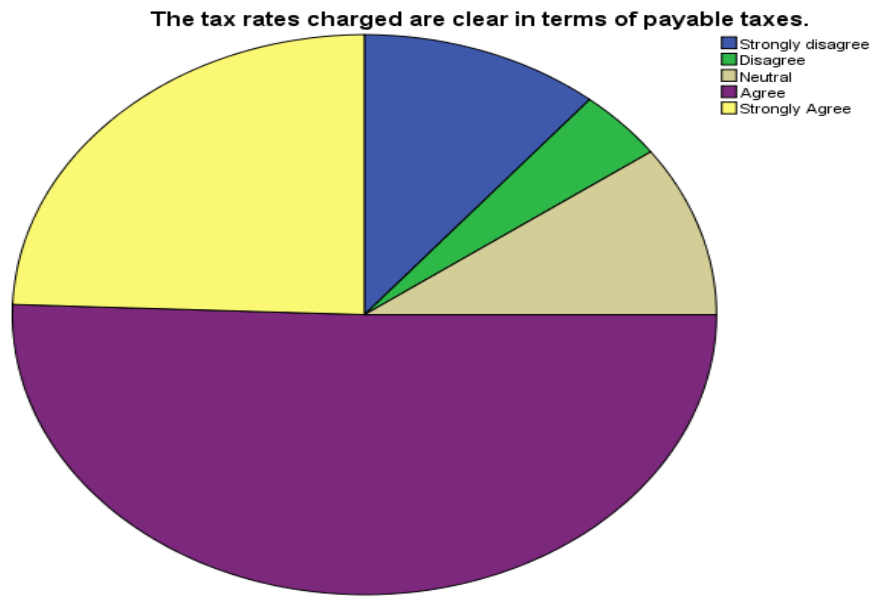
**Figure 4.10: Lump-sum Taxation and Excess Tax Burden**

Table 4.12 and Figure 4.10 presents the distribution of responses to a statement about the ability of lump-sum taxation to reduce excess tax burden, based on a sample of 172 individuals. The statement suggests that lump-sum taxation does not affect relative price rates, unlike an excise tax that distorts them. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The frequency column indicates the number of individuals who selected each response category.

The percent column shows the percentage of individuals who selected each response category in the sample. The findings suggest that 6.9% of the sample strongly disagreed that lump-sum taxation is able to reduce excess tax burden, while 7.5% disagreed, 9.2% were neutral, 24.9% agreed, and 51.4% strongly agreed. Based on these findings, the majority of the sample population (76.4%) agreed or strongly agreed that lump-sum taxation is able to reduce excess tax burden, while a smaller percentage (14.4%) disagreed or strongly disagreed. The remaining percentage were neutral (9.2%).

**Table 4.13: Clarity of The Tax Rates Charged**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	19	11.0	11.0	11.0
Disagree	7	4.1	4.1	15.1
Neutral	17	9.9	9.9	25.0
Agree	87	50.6	50.6	75.6
Strongly Agree	42	24.4	24.4	100.0
Total	172	100.0	100.0	



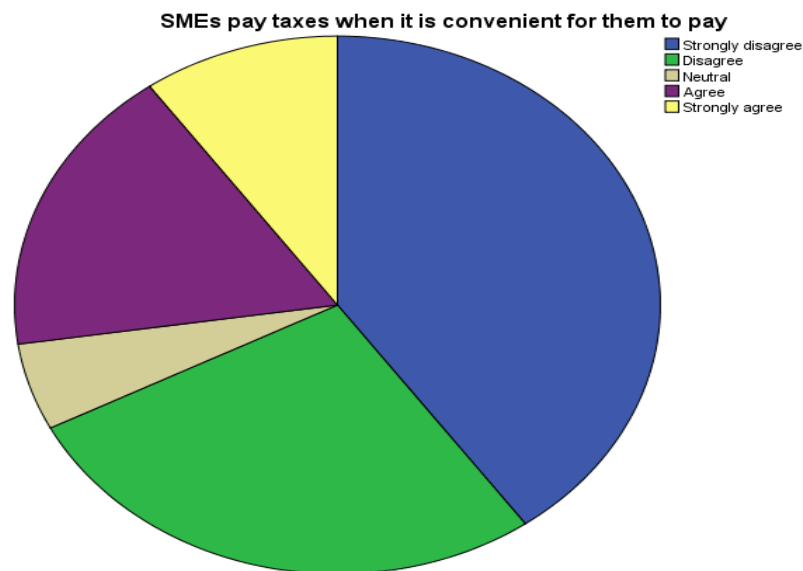
**Figure 4.11: Clarity of The Tax Rates Charged**

Table 4.13 and Figure 4.11 present the distribution of responses to a statement about the clarity of tax rates in terms of payable taxes, based on a sample of 172 individuals. The response categories are Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. The findings indicate that 19 individuals strongly disagreed that the tax rates imposed are transparent regarding the taxes that need to be paid, 7 individuals disagreed, 17 individuals were neutral, 87 individuals agreed, and 42 individuals strongly agreed. Also, 11.0% of the sample strongly disagreed that the tax rates

charged are clear in terms of payable taxes, while 4.0% disagreed, 9.8% were neutral, 50.3% agreed, and 24.3% strongly agreed. Based on these findings, the majority of the sample population (74.9%) agreed or strongly agreed that the tax rates imposed are transparent regarding the taxes that need to be paid, while a smaller percentage (15.0%) disagreed or strongly disagreed. The remaining percentage is neutral (10.1%).

**Table 4.14: Payment of Taxes by SMEs**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	69	40.1	40.1	40.1
Disagree	47	27.3	27.3	67.4
Neutral	9	5.2	5.2	72.7
Agree	30	17.4	17.4	90.1
Strongly agree	17	9.9	9.9	100.0
Total	172	100.0	100.0	



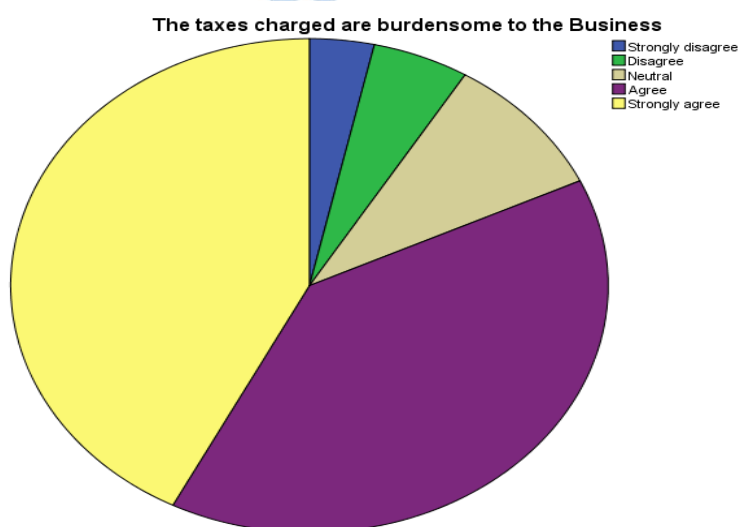
**Figure 4.12: Payment of Taxes by SMEs**

The findings in Table 4.14 and Figure 4.12 above focus on the distribution of responses to a statement about SMEs paying taxes when it is suitable for them to pay, based on a sample of 172

individuals. The findings show that an estimated 40.1% of the participants strongly disagreed that SMEs pay taxes when it is convenient for them to pay, while 27.3 % disagreed, 5.2 % were neutral, 17.4 % agreed, and 9.9 % strongly agreed. Based on these findings, the majority of the sample population, 67.4%, indicated that they strongly disagreed or disagreed that SMEs pay taxes at their convenience. Also, a smaller percentage, 27.3% agreed or strongly agreed. The remaining percentage were neutral (5.2%).

**Table 4.15: Burden of The Taxes Charged**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	6	3.5	3.5	3.5
Disagree	9	5.2	5.2	8.7
Neutral	16	9.3	9.3	18.0
Agree	68	39.5	39.5	57.6
Strongly agree	73	42.4	42.4	100.0
Total	172	100.0	100.0	

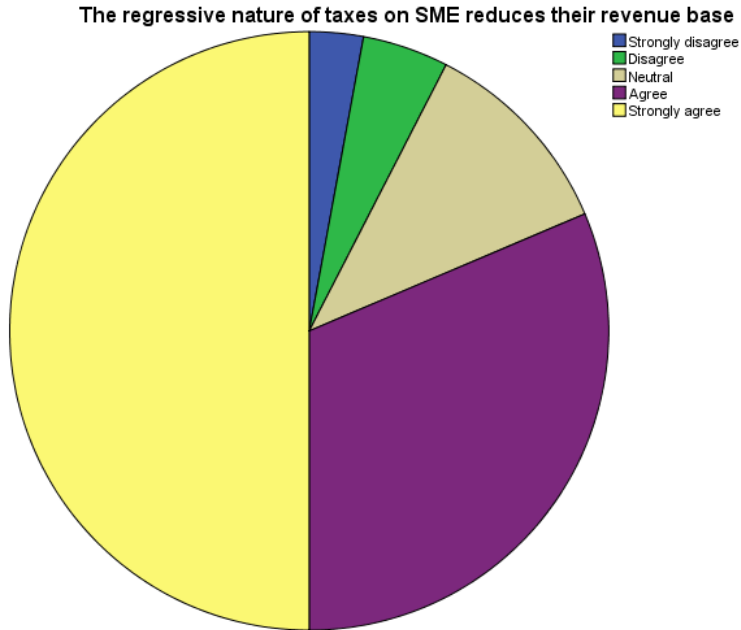


**Figure 4.13: Burden of The Taxes Charged**

Table 4.15 and Figure 4.13 focus on providing findings concerning the tax burdensome to the businesses, based on a sample of 172 individuals. The findings suggest that an estimated 3.5% of the participant indicated that they strongly disagreed with the statement that the taxes charged are burdensome to businesses, while 5.2% disagreed, 9.2% were neutral, 39.3% agreed, and 42.2% strongly agreed. Based on these findings, the majority of the sample population (81.5%) agreed or strongly agreed that the taxes levied are onerous for businesses, while a smaller percentage (8.7%) disagreed or strongly disagreed. The remaining percentage were neutral (9.8%).

**Table 4.16: The Regressive Nature of Taxes on SME Reduces their Revenue Base**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	5	2.9	2.9	2.9
Disagree	8	4.7	4.7	7.6
Neutral	19	11.0	11.0	18.6
Agree	54	31.4	31.4	50.0
Strongly agree	86	50.0	50.0	100.0
Total	172	100.0	100.0	



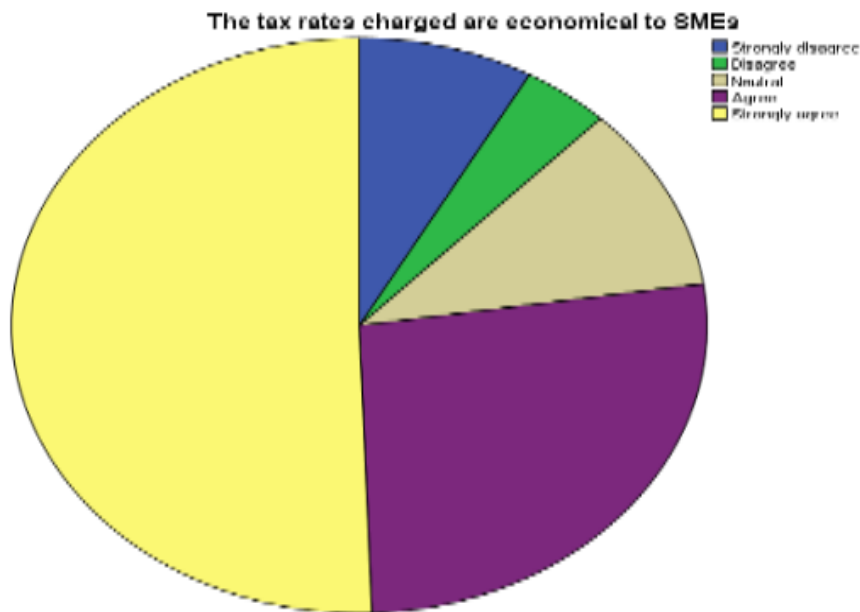
**Figure 4.14: The Regressive Nature of Taxes on SME Reduces their Revenue Base**

Table 4.16 and Figure 4.14 focuses on providing findings concerning the regressive nature of taxes on SMEs reducing their revenue base. The findings indicate that 2.9% of the participants strongly disagreed that the regressive nature of taxes on SMEs reduces their revenue base, while 4.6% disagreed. An estimated 11.0% were neutral, 31.2% agreed, and 49.7% strongly agreed. Based on these findings, the majority of the sample population (81.0%) agreed or strongly agreed that the regressive nature of taxes on SMEs reduces their revenue base, while a smaller percentage (7.5%) disagreed or strongly disagreed. The remaining percentage is neutral (11.5%).

**Table 4.17: The Tax Rates Charged are Economical to SMEs**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly disagree	14	8.1	8.1	8.1
Disagree	7	4.1	4.1	12.2
Valid Neutral	18	10.5	10.5	22.7
Agree	46	26.7	26.7	49.4
Strongly agree	87	50.6	50.6	100.0

Total	172	100.0	100.0
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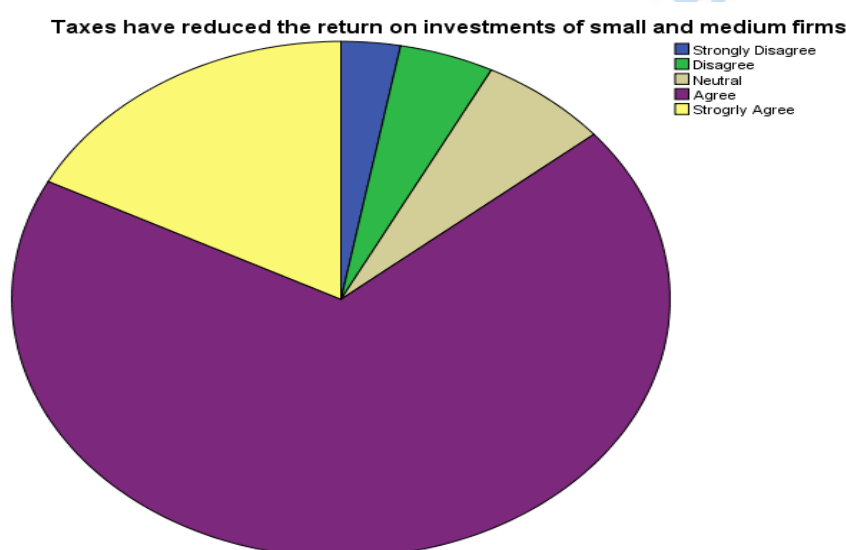


**Figure 4.15: The Tax Rates Charged are Economical to SMEs**

Table 4.17 and Figure 4.15 present findings concerning responses to a statement about the economic impact of tax rates on SMEs. The findings indicate that 14 participants strongly disagreed that the tax rates imposed are affordable for SMEs, 7 participants disagreed, 18 participants were neutral, 46 participants agreed, and 87 participants strongly agreed. The percent column shows the percentage of participants who selected each response category in the sample. An estimated 8.1% of the sample strongly disagreed that the tax rates charged are economical to SMEs, while 4.0% disagreed, 10.4% were neutral, 26.6% agreed, and 50.3% strongly agreed. Based on these findings, the majority of the sample population (76.9%) agreed or strongly agreed that tax rates imposed are affordable for SMEs, while a smaller percentage (12.1%) disagreed or strongly disagreed. The remaining percentage is neutral (11.0%).

**Table 4.17: Taxes have Reduced the Return on Investments of SMEs**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	5	2.9	2.9	2.9
Disagree	8	4.7	4.7	7.6
Neutral	11	6.4	6.4	14.0
Agree	118	68.6	68.6	82.6
Strongly Agree	30	17.4	17.4	100.0
Total	172	100.0	100.0	



**Figure 4.16: The Tax Rates Charged are Economical to SMEs**

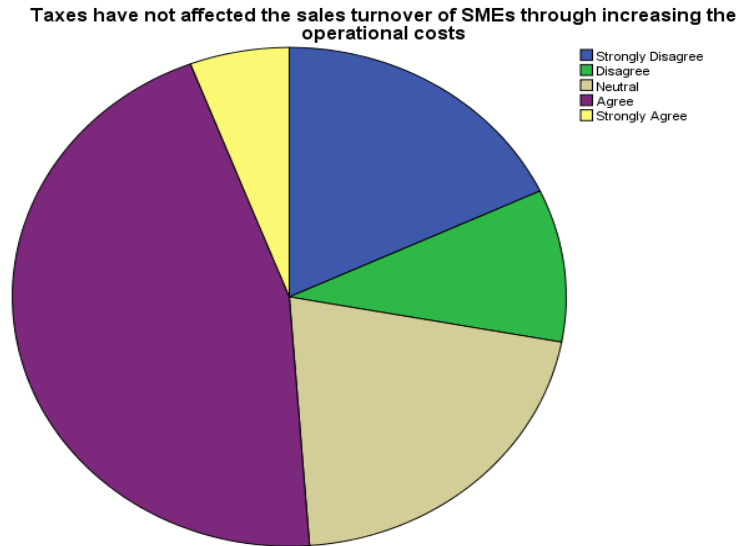
Table 4.18 and Figure 4.16 present findings based on the statement concerning the impact of taxes on the return on investments of SMEs. The findings indicate that 5 participants strongly disagreed that taxes have diminished the return on investments for SMEs. 8 participants disagreed with the statement, 11 participants were neutral, 118 agreed, and 30 individuals strongly agreed. The percent column shows the percentage of participants who selected each response category in the sample. An estimated 2.9% of the sample strongly disagreed that taxes have reduced the return on

investments of SMEs, while 4.6% disagreed, 6.4% were neutral, 68.2% agreed, and 17.3% strongly agreed.

Based on these findings, the majority of the sample population (85.9%) agreed or strongly agreed that taxes have diminished the return on investments for small and medium-sized enterprises. While a smaller percentage (7.5%) disagreed or strongly disagreed. The remaining percentage were neutral (6.6%).

**Table 4.19: Taxes have not Affected the Sales Turnover of SMEs through Increasing the Operational Costs**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	31	18.0	18.0	18.0
Disagree	17	9.9	9.9	27.9
Neutral	36	20.9	20.9	48.8
Agree	78	45.3	45.3	94.2
Strongly Agree	10	5.8	5.8	100.0
Total	172	100.0	100.0	



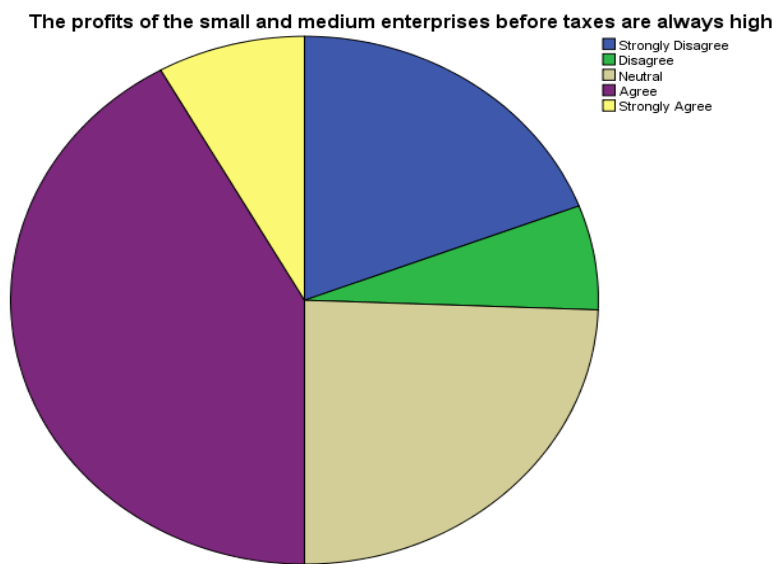
**Figure 4.17: Taxes have not Affected the Sales Turnover of SMEs through Increasing the Operational Costs**

Table 4.19 and Figure 4.17 present findings on responses concerning the statement about taxes not having an influence on the sales turnover of SMEs through raising the operational costs, based on a sample of 172 individuals. The findings indicate that 31 participants strongly disagreed with the statement that taxes do not influence the sales turnover of SMEs through raising the operational costs. 17 participants disagreed, 36 were neutral, 78 participants agreed and 10 participants strongly agreed. The percent column shows the percentage of participants who selected each response category in the sample. An estimated 18% of the sample are strongly disagreed, 9.9% disagreed, 20.9% were neutral, while 45.3% agreed, and 5.8% strongly agreed. Based on these findings, the majority of the sample population (51.1 %) agreed or strongly agreed that taxes do not affect the sales turnover of SMEs through increasing operational costs.

**Table 4.20: The Profits of the SMEs before Taxes are Always High**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Disagree	33	19.2	19.2	19.2

Disagree	11	6.4	6.4	25.6
Neutral	42	24.4	24.4	50.0
Agree	72	41.9	41.9	91.9
Strongly Agree	14	8.1	8.1	100.0
Total	172	100.0	100.0	



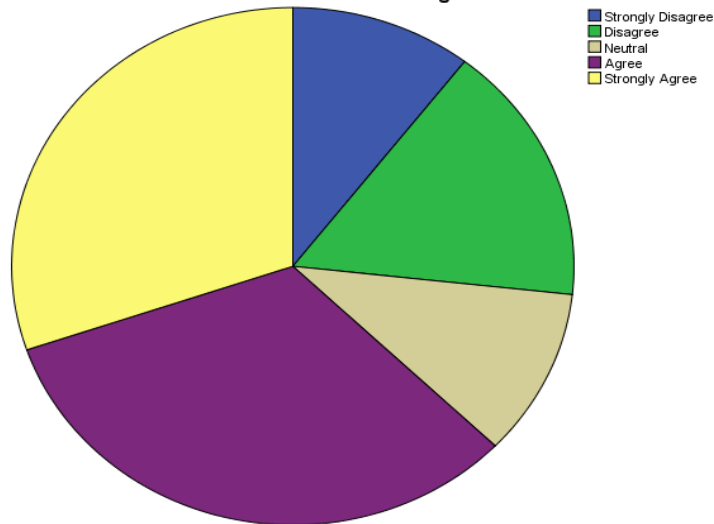
**Figure 4.18: The Profits of the SMEs before Taxes are Always High**

Table 4.20 and Figure 4.18 show the distribution of responses to a statement about the profits of SMEs before taxes are always high, based on a sample of 172 individuals. The findings indicate that an estimated 19.2% of the sample strongly disagreed that the profits of SMEs before taxes are always high, 6.4% disagreed, 24.4% were neutral, 41.9% agreed, while 8.1% strongly agreed. Based on these findings, the majority of the sample population (50%) agreed or strongly agreed that the profits of SMEs before taxes are always high, while a smaller percentage (25.6%) disagreed and 24.4% were neutral.

**Table 4.21: The Taxes Levied from SMEs have Made it Difficult for SMEs to achieve their Goals**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	18	10.5	10.5	10.5
Disagree	28	16.3	16.3	26.7
Neutral	18	10.5	10.5	37.2
Agree	56	32.6	32.6	69.8
Strongly Agree	52	30.2	30.2	100.0
Total	172	100.0	100.0	

**The taxes levied from SMEs have made it difficult for the small and medium firms to achieve their goals**



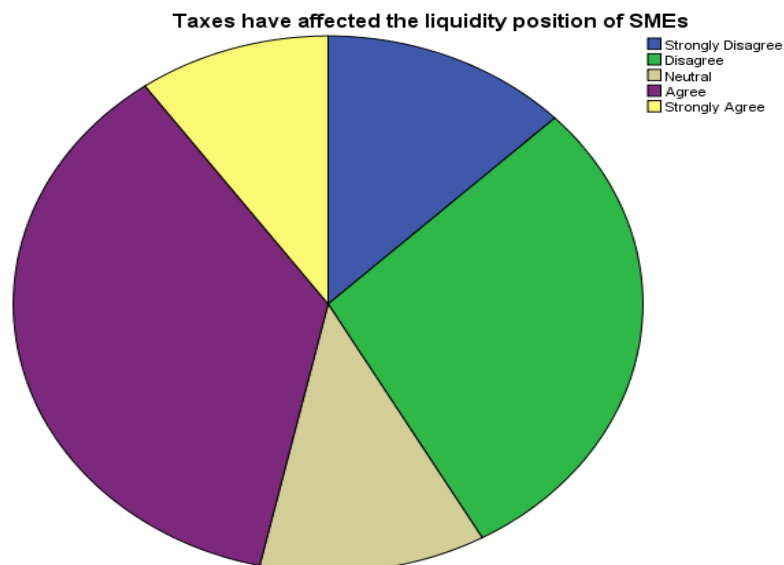
**Figure 4.19: The Taxes Levied from SMEs have Made it Difficult for SMEs to achieve their Goals**

Table 4.21 and Figure 4.19 provide findings of responses to a statement about the taxes imposed on SMEs have made it difficult for the firms to achieve their goals, based on a sample of 172

individuals. The responses indicate that 18 participants strongly disagreed that taxes imposed on SMEs has posed challenges for the businesses to achieving their objectives. 28 participants agreed, 18 were neutral, 56 agreed, and 52 strongly agreed. The percent column shows the percentage of individuals who selected each response category in the sample. An estimated 10.4% of the sample strongly disagreed that taxes levied from SMEs have made it difficult for the firms to achieve their goals, 16.2% disagreed, 10.4% were neutral, 32.4% agreed, and 30.1% strongly agreed. Based on these findings, the majority of the sample population (62.5%) agreed or strongly agreed that taxes levied from SMEs have made it difficult for the firms to achieve their goals.

**Table 4.22: Taxes Have Affected the Liquidity Position of SMEs**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	22	12.8	12.8	12.8
Disagree	50	29.1	29.1	41.9
Neutral	20	11.6	11.6	53.5
Agree	63	36.6	36.6	90.1
Strongly Agree	17	9.9	9.9	100.0
Total	172	100.0	100.0	



***Figure 4.20: Taxes Have Affected the Liquidity Position of SMEs***

Table 4.22 and Figure 4.20 offer insights into the distribution of responses to a statement that taxes have affected the liquidity position of SMEs. The findings indicate that 22 participants strongly disagreed with the statement, 50 disagreed, 20 were neutral, 63 agreed, and 17 individuals strongly agreed. An estimated 12.7% of the sample strongly disagreed with the statement that taxes have affected the liquidity position of SMEs, 28.9% disagree, 11.6% were neutral, 36.4% agreed, and 9.8% strongly agreed. Based on these findings, a majority of the sample population (41.6%) disagreed or strongly disagreed that taxes have affected the liquidity position of SMEs, while 46.2% agreed or strongly agreed. The remaining percentage were neutral (11.6%).



Mount Kenya

University

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.0 Introduction**

This chapter provides a comprehensive overview and interpretation of the findings from the study titled *"The Impact of Taxation on the Performance of Small and Medium Enterprises (SMEs) in Mogadishu, Somalia."* The chapter begins with a summary of the main findings and continues with a discussion that links these results to existing literature and theoretical frameworks. The chapter further presents the conclusions drawn from the study, policy and managerial recommendations, limitations encountered during the research process, and suggestions for future research.

#### **5.1 Summary of Main Findings**

This study set out to examine the relationship between taxation and the performance of small and medium-sized enterprises in Mogadishu, Somalia. Specifically, the study explored the influence of tax rates, income tax, and excise tax on SME performance. The major findings are summarized under the following sub-sections:

##### **5.1.1 Tax rates and the performance of SMEs**

The study found that prevailing tax rates are widely perceived by SME owners as excessive, unfair, and regressive. These tax structures significantly undermine the financial viability of SMEs by increasing their operational costs, eroding their capital base, and thereby reducing their capacity to grow and compete effectively.

Respondents indicated that existing tax policies do not differentiate between large corporations and SMEs, compelling small businesses to pay tax rates that are not proportionate to their revenue levels. This uniformity exacerbates financial pressure on SMEs, making it challenging for them to reinvest profits, retain employees, and expand their operations. These findings align with Masato (2009), who observed that SMEs often face a disproportionate tax burden compared to larger firms, resulting in structural inequality within tax systems.

Furthermore, the perception that tax policies are not SME-friendly has contributed to high levels of non-compliance, with many SMEs either underreporting their income or opting out of the formal economy altogether. Atawodi and Ojeka (2012) similarly stressed that tax systems should be adapted to accommodate the limited resources and capacity of SMEs through targeted incentives, tax reliefs, or holiday schemes.

The findings also support the argument that the regressive nature of taxation discourages entrepreneurship and innovation. High tax rates reduce available working capital and can lead to reduced profitability, making SMEs more susceptible to failure. The study observed that the lack of fairness and transparency in the application of tax rates contributes to a lack of trust in the taxation system, further complicating tax administration and enforcement efforts.

### **5.1.2 Income Tax and the performance of SMEs**

The study's second objective was to assess the effect of income tax on SME performance. While income tax is traditionally regarded as a key revenue-generating mechanism for governments, the results from this study indicate that income tax has a statistically significant negative impact on SME performance in Mogadishu.

SME owners reported that income tax obligations are excessively burdensome, especially given the unstable economic environment in Somalia, coupled with limited access to formal credit and financial services. Rather than reflecting the ability-to-pay principle, income taxes often disregard the seasonal or fluctuating nature of many SMEs' revenues, leading to liquidity problems.

The study established a negative correlation between income tax rates and SME performance, suggesting that increases in income tax are linked to declining profitability, reduced operational scale, and lower business sustainability. This finding is consistent with previous research, such as Wanjohi and Mugure (2008) which emphasized the need for tax policies to account for the fragile financial standing of SMEs.

Moreover, the research noted that the lack of structured tax exemptions or deductions for SMEs means that many businesses operate on thin profit margins after taxation. This undermines their competitiveness and creates an environment in which informal or underground businesses thrive, further eroding the tax base.

### **5.1.3 Excise Tax and the performance of SMEs**

The third objective focused on assessing the impact of excise tax on SME performance. Excise taxes, often levied on specific goods such as alcohol, tobacco, and luxury items, were found to have a significantly negative impact on SMEs in relevant sectors. The study observed that excise tax regulations impose considerable financial strain on businesses that deal in excisable goods. For SMEs involved in the sale of products such as khat or imported vehicles, excise taxes reduce their profit margins and may force some businesses to absorb part of the tax in order to remain competitive, which in turn decreases profitability.

A statistically significant negative relationship was observed between excise tax levels and business performance indicators such as revenue growth, employee retention, and customer base expansion. These findings are consistent with the research of Muriithi and Moyi (2016), who noted that excise duties tend to disproportionately affect small-scale traders due to their limited pricing flexibility and lower economies of scale. In Mogadishu, the excise tax regime was perceived as unclear and arbitrarily enforced, leading to uncertainty and unpredictability in business planning. SMEs highlighted issues such as inconsistent tax audits, arbitrary tax assessments, and lack of transparency in how excise taxes are calculated and applied.

This study affirms the growing concern that taxation systems in fragile and developing economies such as Somalia can hinder rather than facilitate SME growth when poorly designed or administered. SMEs play a critical role in economic development by creating jobs, generating income, and contributing to innovation. However, when faced with a tax system that is overly complex, punitive, and non-transparent, their potential contribution is stifled.

The evidence from this study supports theoretical perspectives such as the Theory of Optimal Taxation, which emphasizes the need for tax systems to be efficient, equitable, and minimally distortive. The findings reveal that Somalia's tax system, as applied to SMEs, falls short of these principles. Tax rates are not proportionally aligned with business capacity, tax collection methods lack transparency, and the fiscal environment discourages formalization and compliance.

Furthermore, the Cost of Compliance Theory also provides a useful lens through which to interpret the findings. SMEs in Mogadishu are not only taxed heavily but also bear a high cost of compliance due to the lack of digital systems, clear guidelines, and tax education. As such, many SMEs find compliance to be more burdensome than beneficial, reinforcing a cycle of evasion and informality.

The study also reflects broader socio-economic challenges, including weak governance, corruption, and poor infrastructure, which compound the negative effects of taxation. In the absence of public goods and services that taxes are meant to fund, taxpayers become skeptical and less willing to comply. Thus, improving governance and public accountability could play a critical role in improving tax compliance and SME performance.

## **5.2 Conclusions**

The study's results lead to the conclusion that Income Tax has a negative effect on the performance of small and medium-sized enterprises (SMEs). Tax obligations placed on businesses significantly affect how management makes decisions, as Income Tax primarily targets taxing the earnings of SMEs rather than the consumption aspect of the economy. Reducing Income Tax rates for SMEs has the potential to motivate taxpayers to improve their tax compliance. The taxation of business profits constrains taxpayers' growth prospects and impedes future economic progress. Additionally, it was observed that the government lacks a comprehensive income tax act that provides special benefits to taxpayers and encourages them to fulfill their tax obligations.

The study also concluded that Excise Tax negatively affects the performance of SMEs, particularly those in Mogadishu. SMEs that are most affected by increases in excise duty include luxury vehicle dealers and khat sellers. Certain traders might find it necessary to absorb a portion of the excise duty in order to safeguard their sales, potentially leading to reduced profit margins.

Additionally, based on the study's results, the researcher reached the conclusion that determining the appropriate tax rates, ensuring their transparency, and maintaining fairness in tax rates are critical for the growth and success of small and medium-sized enterprises (SMEs). This underscores the importance of developing an efficient tax system that involves lowering tax rates

and offering tax relief to SMEs. This would reduce the overall operational costs of these businesses, ultimately enhancing their performance in Mogadishu.

### **5.3 Recommendations**

1. To alleviate the tax challenges faced by SMEs due to income tax, policymakers should consider extending exemptions to transactions resulting from regulatory changes, mandatory government acquisitions, and internal restructuring. These types of transactions are relatively uncommon when it comes to seeking commercial gains. Implementing such a measure would assist in eradicating the tax load that could be placed on transactions not primarily motivated by commercial reasons.
2. Strengthen Governance and Institutional Capacity: Establishing a functional and transparent taxation system requires a stable and effective government. Strengthening governance institutions and building the capacity of tax administration agencies can help improve tax collection and enforcement.
3. Standardize Taxation Policies: Creating a unified and standardized tax policy across different regions of Somalia can help eliminate confusion and encourage compliance. This involves developing a clear set of tax laws, regulations, and guidelines that apply uniformly throughout the country.
4. Invest in Technology and Infrastructure: Modernizing tax collection systems through the use of technology can streamline processes, reduce administrative burdens, and improve data accuracy. This might involve implementing digital platforms for filing taxes and facilitating online payments
5. Promote Taxpayer Education and Awareness: Educating the public about the importance of taxes and how they contribute to public services can foster a culture of tax compliance.

This includes raising awareness about the benefits of paying taxes and clarifying how tax revenues are used for the betterment of society.

#### **5.4 Limitations of the Study**

The aim of this study was to investigate the influence of taxation on the performance of small and medium-sized enterprises (SMEs) in Mogadishu. The study suffers as a result of the questionnaire's flaws, which include incomplete responses, a low response rate, and a small number of responses. The most major obstacle to getting the most accurate answers to the questionnaire is the language barrier.

Another constraint was obtaining necessary data owing to Mogadishu's fierce competitiveness among local businesses. Because there are other relevant methods such as interviews and observation methods, the only research tool utilized in this study was a survey questionnaire. The study has some flaws that make it difficult to achieve its objectives. For starters, there is a scarcity of access previous studies in this subject. Finally, throughout the distribution of the questionnaire and its hasty completion, numerous respondents and management bodies demonstrated a lack of cooperation. In addition, the study only looked at three factors; additional factors could impact on SMEs performance in terms of taxation.

#### **5.5 Areas for Further Study**

Given the limitations of the current study, future research should consider:

1. Exploring the Impact of VAT and Corporate Income Tax on SMEs: These are significant revenue sources and likely affect SMEs in different ways. Understanding their impact could guide more comprehensive policy reform.

2. Examining Sector-Specific Tax Impacts: Different industries within the SME sector may experience unique challenges. Tailored studies could help develop targeted tax interventions.
3. Conducting Comparative Regional Studies: Comparing SME taxation across different regions in Somalia could reveal disparities and best practices.
4. Evaluating Informal Taxation and Unofficial Levies: Many SMEs face informal payments or bribes that effectively function as taxes. These need to be studied systematically to understand their real impact.
5. Longitudinal Studies on Tax Reform Impacts: Assessing SME performance over time following tax policy reforms would provide deeper insights into the effectiveness of those changes.

It is necessary to do more study to examine the impact of corporate income tax and value-added tax, where applicable, on the operations of small and medium-sized firms (SMEs) in Somalia. This is very important as SMEs are essential to Somalia's economy since they bring in money, create employment, and contribute in other ways.

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## APPENDICES

### I) Research tools

#### Consent Form

I humbly request your participation in my research proposal, " **AN ANALYSIS OF THE INFLUENCE OF TAXATION ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MOGADISHU, SOMALIA**

.” Kindly go through the following statements and sign below if you agree.

1. Participation is voluntary; you are free to decide whether to participate and walk out if you wish.
2. For any use of the obtained data other than academic purposes, as stated, you will be promptly informed, and your consent will be sought.
3. The gathered information will be kept confidential. Codes will be used in the reporting stage to avoid disclosing your details and responses.
4. Though some answers will be indicated on the question or cited in academic journals, thesis reports, or conferences, your identity will not be concealed.
5. When completed, this form will belong to Mount Kenya University. However, you can request it from the Directorate of Graduate Studies.
6. These are the researcher’s contact details in case you need more clarifications: **Mohamed Khalif Mohamud; Email: Mrqaliifaani@gmail.com**

I, \_\_\_\_\_, confirm I have read and comprehended the statements above and voluntarily agree to provide my answers without influence or any persuasion, hereby granting my consent freely.

Signature (participant): \_\_\_\_\_ Date: \_\_\_\_\_

Researchers Acknowledged the informed consent:

Signature: \_\_\_\_\_

Date: \_\_\_\_\_



## Questionnaire

DEAR RESPONDENTS

I am a graduate student pursuing a Master's degree in the MBA Department at Open University Malaysia. Currently, I am working on a research project to prepare my proposal, focusing on the impact of taxation on the performance of small and medium enterprises in Mogadishu, Somalia. I kindly request your participation in responding to the statements presented in the following questionnaire. Your input holds significant value as it constitutes a crucial component of this study. Please rest assured that your answers will be treated with strict confidentiality and solely utilized for research purposes.

Age: (a) 18 – 24  (b) 25-36  (c) 37-43  (D) 44 and above

Gender: (a) male  (b) female

Marital Status: (a) Single  (b) Married

### Educational level

(a) Master Degree  (b) Bachelor  (a) Diploma

### Work Experience

a) Less than one year  (b) 1-5 years  (c) 5-10 years

(D)more than

### Position:

(a) Administrative  (b) Non-administrative

## Part B: Company profile

### 1. Ownership

(a) Owner  (b) Employee

### 2. Age of the business

a) (1-5 Years )

(b) (5-10 Years )

(c) (More than 5 Years )

**Questionnaire:**

Please indicate your level of agreement or disagreement with the statements by placing a checkmark in the corresponding box that best reflects your position on the provided scale. The scale ranges from "Strongly Disagree (1)" to "Disagree (2)," "Neutral (3)," "Agree (4)," and "Strongly Agree (5)."

**Section A: Effect of Income Tax on the Performance of SMEs in Mogadishu Somalia**

#	Items	1	2	3	4	5
1	The tax rates charged are clear in terms of payable taxes.					
2	SMEs pay taxes when it is convenient for them to pay					
3	The taxes charged are burdensome to the Business					
4	The regressive nature of taxes on SME reduces their revenue base					
5	The tax rates charged are economical to SMEs					

### Section B: Effect of Excise Tax on the Performance of SMEs in Mogadishu Somalia

#	Items	1	2	3	4	5
1	Income tax Imposed by Government is fair					
2	The income tax charges have an impact on the cash flow of the business					
3	The government has created a conducive atmosphere for the processing of income tax					
4	The levied income taxes align with the services offered by the government					
5	The Income Tax Procedure contain a number of benefits for a taxpayer that is classified as a small business corporation, for example, special wear and tear rates					

#	Items	1	2	3	4	5
1	Excise taxes charged are fair					
2	The extent of excise taxation significantly influences investment and entrepreneurial activities.					
3	A straightforward tax base and a limited number of easily calculable excise taxes can decrease administrative and compliance expenses					
4	The government provides awareness on the excise tax payment processes					
5	Lump-sum taxation has the ability to alleviate an excess tax burden as it doesn't impact relative price rates, in contrast to an excise tax, which can distort them.					

### Section C: How Tax Rate effect on the Performance of SMEs in Mogadishu Somalia

### Section D: Performance of SMEs in Mogadishu Somalia

#	Items	1	2	3	4	5
1	Taxes have reduced the return on investments of small and medium firms					
2	Taxes have not affected the sales turnover of SMEs through increasing the operational costs					
3	The profits of the small and medium enterprises before taxes are always high					
4	The taxes levied from SMEs have made it difficult for the small and medium firms to achieve their goals					
5	Taxes have affected the liquidity position of SMEs					



## Work Plan

Activity	Nov 2024	Dec 2024	Jan 2025	Feb 2025	Mar 2025	Apr 2025	May 2025	Jun 2025
Proposal Development								
Presentation								
Pilot Testing								
Data Collection								
Data Coding & Editing								
Data Analysis								
Report Writing								
Submission								

## Budget

Activity	Item	Cost (\$)
Proposal Development	Proposal printing	30
	Proposal binding	15
	Photocopying	25
	Stationery	10
Data Collection	Piloting	50
	Travelling	100
	Telephone	18
	Research assistants	122
	Data cleaning and coding	70
	Field Activity	380
Data Analysis	Data Analysis training	65
	Project printing	30
Thesis Preparation	Project Photocopying	28
	Project binding	22
	Internet services	40
	Miscellaneous	200
<b>TOTAL BUDGET</b>		<b>1,205</b>

II) ERC certificate



# Mount Kenya University



REF: MKU/ISERC/4959  
TO: MOHAMED KHALIF MOHAMUD

REG: MBA/2023/44565

Dear Sir/Madam,

**RE: IMPACT OF TAXATION ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MOGADISHU**

This is to inform you that **Mount Kenya University** has reviewed and approved your above research proposal. Your application approval number is **3681**. The approval period is **29/04/2025 - 28/04/2026**.

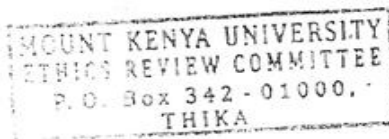
This approval is subject to compliance with the following requirements:

- i. Only approved documents including informed consents, study instruments, MTA will be used
- ii. All changes including amendments, deviations and violations are submitted for review and approval by **Mount Kenya University**
- iii. Death and life threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to **Mount Kenya University** within 72 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affect the safety or welfare of study participants and others or affect the integrity of the research must be reported to **Mount Kenya University** within 72 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal
- vii. Submission of an executive summary report within 90 days upon completion of the study to **Mount Kenya University**

Prior to commencing your study, you will be expected to comply with any additional requirements from the relevant authorities in the country where this study will be conducted

Yours sincerely,

**Dr. Alfred Owino, PhD**  
**Chairman, Mount Kenya University ISERC**



III) Introduction letter from MKU



**DIRECTORATE OF GRADUATE STUDIES**

MBA/2023/44565

30<sup>th</sup> April, 2025

*TO WHOM IT MAY CONCERN*

Dear Sir/Madam,


**RE: MOHAMED KHALIF MOHAMUD – REGISTRATION NO. MBA/2023/44565**

The purpose of this letter is to introduce the above-named student who is pursuing **Master of Business Administration** in the **Department of Accounting and Finance** in the **School of Business and Economics**.

The title of the research is **“Impact of Taxation on the Performance of Small and Medium Enterprises in Mogadishu.”** It has been cleared by the University’s Ethics Review Committee (Certificate attached) and now has to proceed to the field to collect data between **May, 2025 and July, 2025**.

Any assistance accorded to the student will be highly appreciated.

Thank you.

  
**Dr. Samuel M. Karenga, Ph.D**  
**Director, Graduate Studies**  
Enc.

Mount Kenya University  
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Chartered and ISO 9001 : 2015 Certified  
**Unlocking Infinite Possibilities**

IV) Turnitin report (First two (2) pages



# Mohamed khalif mohamud

## thesis final

by Mohamed Mohamud

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**Submission date:** 11-Jul-2025 10:54AM (UTC+0300)  
**Submission ID:** 2567667805  
**File name:** MOHAMED\_KHALIF\_MOHAMUD\_THESIS.Finaldocx.docx (715.6K)  
**Word count:** 23240  
**Character count:** 132750

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## Mohamed khalif mohamud thesis final

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## V) Research site map

### Research Site Map: Bakaro Market - SMEs Study

This site map illustrates the designated research zones within Bakaro Market, Mogadishu, Somalia, where data collection was conducted for the study on the impact of taxation on SMEs. Each zone represents a specific category of businesses: Electronics, Clothing, Food, and General Goods.

### Research Site Map: Bakaro Market - SMEs Study

