

The Informal SME Perspective Of Government Policies On SMEs' Business Environment In Lesotho

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Abstract

Informal SMEs in Lesotho constitute the majority, employing 80% of the workforce and contributing 30.9% to the economy. This study examines the perspective of informal SMEs in Maseru, Berea, Mafeteng, and Leribe districts about the impact of government policies on the business environment. This qualitative research employed a phenomenological approach. Data from semi-structured interviews and document analysis were thematically analysed using Atlas.ti. The findings revealed that many SMEs operate informally due to high formalisation costs, complicated procedures, and limited finance. It concluded that complex regulations create SMEs' registration barriers. The study highlights barriers preventing SMEs from joining the formal economy.

Keywords: support, incentives, policies, challenges, compliance

1. INTRODUCTION

While their importance differs from country to country, the research literature agrees that the SME sector plays a crucial role in any country's economic development. Specifically, this sector is recognised for its significant contribution to generating employment opportunities, economic growth, and development (United Nations Capital Development Fund, 2021:33). It accounts for the largest portion, 76%, of the private sector's economic activities in Lesotho. There are around 138,723 SMEs in Lesotho, of which 76% operate informally (FINMARK, 2025:10-15). In Lesotho, informal businesses not only form the majority SME sector but also employ the largest portion, 60%, of the labour force. The highest number of informal SMEs signifies the existence of several obstacles to meaningful development in the SME sector in Lesotho (United Nations Capital Development Fund, 2021:6-33).

In countries with slow economic growth rates, as evidenced by high unemployment rates, the unwieldy and time-consuming procedures for formalising businesses (United Nations Capital Development Fund, 2021:27-33) could lead to a growing number of informal businesses. Although many previous studies, such as Hansen-Addy *et al* (2025), explored SMEs' business environment, not much is known about how informal SMEs perceive the impact of government policies on SMEs' business environment.

The business practices of the informal sector ranked top three of the business environment obstacles in Lesotho, thus indicating a need to explore the motivational factors (World Bank, 2023:10). Existing literature on the influence of government policies on the business environment often concentrates on institutional standpoints (Dai, 2024; Makara *et al.*, 2023:47-50), ignoring how informal businesses interpret and react to the systems in place. This study investigates the perspectives of informal SMEs on government policies and regulations on SMEs' business environment in Lesotho.

Understanding the viewpoint of informal SMEs is crucial for gaining a deep insight into the problems for the economy of the businesses that are not formally registered, which can help foster a more conducive business environment. The study discovered that it costs about M700 in compliance expenses to start an SME, and roughly between M20,000 and M35,000 in continuing compliance costs. These expenses include yearly filing returns, professional fees, tax compliance, and license renewals, among others.

2. BACKGROUND

There are approximately 82,315 informal SMEs, which constitute 76% of the SME sector's economy and account for 30.9% of economic activity, employing 80% of the population in Lesotho (FINMARK, 2025:15; Stiftung, 2024:18). The economy of Lesotho is characterised by modest Gross Domestic Product (GDP) growth, a persistent trade deficit, and significant dependence on South Africa. Following a severe economic downturn of -8.16% in 2020 due to the COVID-19 pandemic, Lesotho's economic growth rate improved to 2.27% in 2021

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and further increased to 2.39% in 2022. However, it decreased to 1.8% in 2023. It is projected to rise again to 2.3% in 2024 and 3% in 2025, before declining to 2.0% in 2026 (Central Bank of Lesotho, 2024; Macrotrends, 2025b:2-8). This trend contrasts with the steady population growth rate, which rose from 2,261,524 in 2021 to 2,286,110 in 2022. The population further increased to 2,311,472 in 2023, 2,356,083 in 2024, and 2,381,381 in 2025 (Macrotrends, 2025a).

Despite the expected economic growth, Lesotho faces several challenges, including poverty, trade imbalance, and a high unemployment rate (Stiftung, 2024:23-27). In Lesotho, the unemployment rate decreased to 16.5% in 2024 from 16.46% in 2023, following a decline from 18.23% in 2021 and 16.69% in 2022, as indicated in Figure 1 below (Macrotrends, 2024).

The country is vulnerable to external shocks due to its reliance on South Africa for over 80% of imports. Additionally, Lesotho's currency is pegged to the South African rand at 1:1 (International Monetary Fund, 2022:58-85; Ojo & Adelakun, 2025:2). By March 2025, Lesotho recorded a trade deficit of M1.155 billion, driven by M2.05 billion in imports from South Africa compared to M500 million in exports (Observatory of Economic Complexity, 2025). Both exports and private investment are expected to remain low, leading to insufficient employment growth that can reduce the poverty rate, which is projected to stay high at 36% (World Bank, 2025:1).

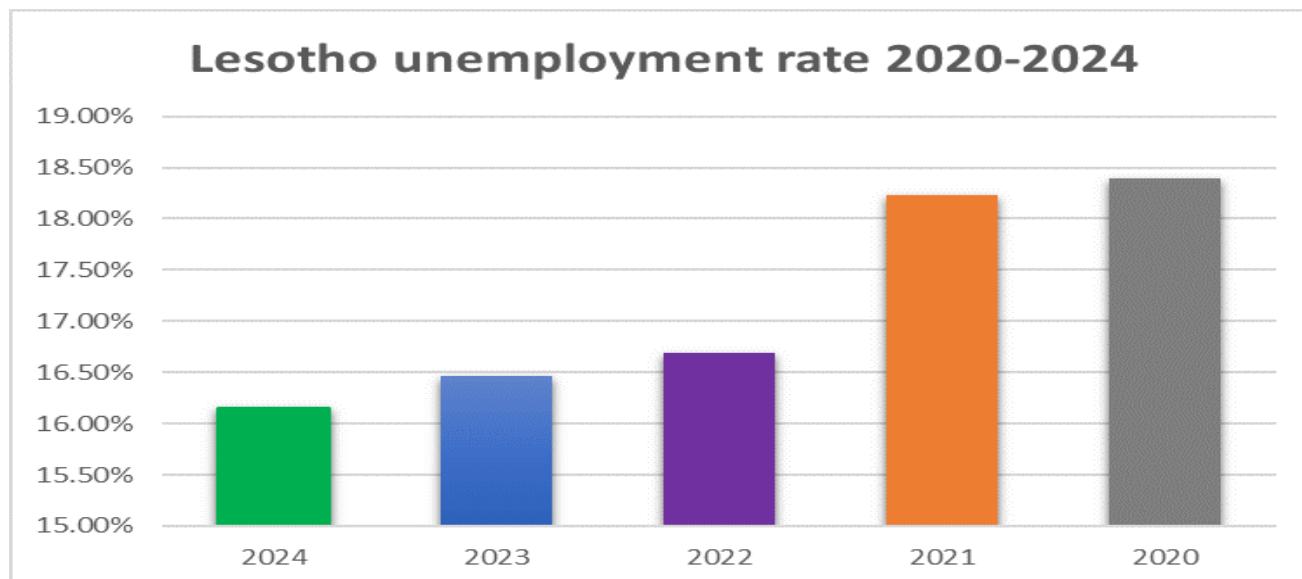


Figure 1: Lesotho unemployment rate 202-2024 (Source: Macrotrends 2024)

During the bilateral discussions between Lesotho and South Africa on 3 June 2025, the governments highlighted the need to improve the cross-border efficiency and cooperation standards and focus on the implementation of the African Continental Free Trade Area (AfCFTA). This collaboration is anticipated to reduce import costs and stabilise pricing in the future (Department of Trade Industry and Competition (dtic) Republic of South Africa, 2025).

Informal SMEs play a significant role in promoting economic development, particularly in developing countries (Sultana *et al.*, 2022:13). These businesses are usually owned by households or individuals and are not independent of the owners because they are not separately constituted. As such, they do not have financial statements that comply with the separate business entity concept, that is, those that reflect the business as a separate entity from the owner. The informal SMEs employ around two billion employees worldwide, especially in developing countries (Damane & Mochebelele, 2024:29), thus signifying their importance and the need for consideration.

Previous literature has highlighted the significance of informal SMEs in developing countries. In Lesotho, the sector contributes approximately M212 million and employs over 60% of the labour force (FINMARK, 2025:13; United Nations Capital Development Fund, 2021:6-33). Nonetheless, they normally fail during their earlier development stages, with roughly 10% surviving due to several business environment challenges (Amadasun & Mutezo, 2023:1; Richard Denanyoh & Owusu, 2025:138). The high number of informal businesses can correlate with an increase in unofficial government culture, including the inability to develop formal rules and corruption (Zylfijaj *et al.*, 2020:514).

Businesses remain informal as a strategy to avoid regulatory consequences, such as paying taxes. However, the growing informal sector presents threats like increased competition for formal businesses. A conducive business

environment is characterised by sound economic governance in areas such as taxation, regulations, and business licensing (World Bank, 2023:8). The aim of this research is therefore to investigate how informal SMEs perceive the influence of government policies and regulations on the SME business environment in Lesotho. By listening to the voices of informal SMEs, the study intends to provide deep insights into how government policies and regulations shape the business environment in Lesotho.

Problem statement

Some countries are making significant efforts to improve the business environment through strategies such as adopting customised private sector policies, improved communication, policy reforms in the areas of taxation, fiscal, and financial systems, and improved foreign investment attraction policies (Qiang, 2024:6). However, out of the 190 countries that were evaluated in terms of progress made toward business environment as measured by ease of doing business, Lesotho ranked 122 (World Bank, 2020:3-6), as shown in Figure 2.

The business environment in Lesotho is uncompetitive and characterised by high political instability, lengthy and complex business formalisation processes, corruption, inadequate access to essential resources, and a lack of a simplified tax system (United Nations Capital Development Fund, 2021:33-35; World Bank, 2023:9-10; World Bank Group, 2022:9). These factors impose significant challenges to SMEs, especially informal SMEs, as they jeopardise their growth and sustainability.

Lack of financial access, opportunities for partial inclusion, and limited support are amongst their main obstacles, thereby contributing to the reduced level of economic contributions and sense of isolation (Damane & Mochebelele, 2024:38-39; United Nations Capital Development Fund, 2021:35; World Bank Group, 2022:16-23). Additionally, SMEs in Lesotho struggle to formalise their operations due to high business registration costs and a lack of information (FINMARK, 2025:46).

This could negatively affect their perceptions of government policies that shape a conducive business environment and promote formal participation. It is essential to understand their perceptions and how these views might impact their productivity, sustainability, and economic contribution. The government should enhance communication channels and strategies to increase awareness of the benefits of business registration among informal SMEs and also lower the related costs (Moges, 2024:480-499).

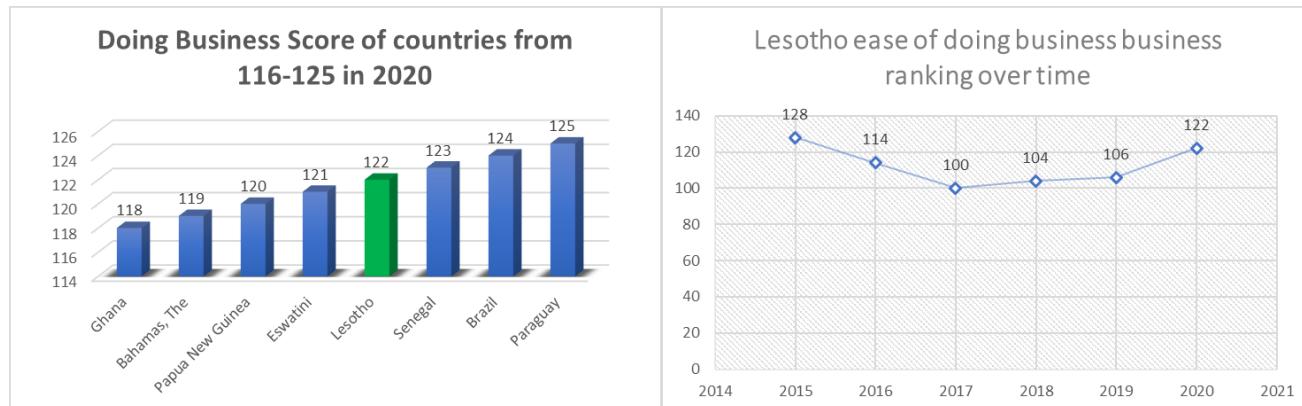


Figure 2: Lesotho ease of doing business ranking over time and its position compared to other Countries ranked 116-125 (Source: World Bank, 2020c:3-6)

3. Research questions

1. What challenges do informal SMEs face in the business environment that affect their formalisation or participation in Lesotho?
2. How do informal SMEs perceive the impact of current government policies and regulations on SMEs in Lesotho?
3. How do informal SMEs perceive the business environment compared to their needs or expectations in Lesotho?
4. What obstacles do informal SMEs encounter within the business environment of Lesotho?

4. Purpose of the study

The study sought to provide an understanding of how informal SMEs perceive the government policies and regulations' impact on the SME sector business environment in Lesotho. An analysis of the perspectives of informal SMEs enabled the formulation of policy recommendations for the formalisation of businesses in Lesotho.

5. Research objective

The main objective of this study is to examine informal SMEs' perception of the government policies and regulations' impact on the business environment in Lesotho.

6. Scope of the study

The study covers informal SMEs located in four districts of Lesotho with the highest SME population, namely Maseru, Berea, Mafeteng, and Leribe. It focuses on how informal SMEs observe the impact of government policies and regulations in shaping the SME sector business environment. These perceptions are gathered through qualitative approaches. Figure 3 shows the Lesotho map with districts of interest marked in red.

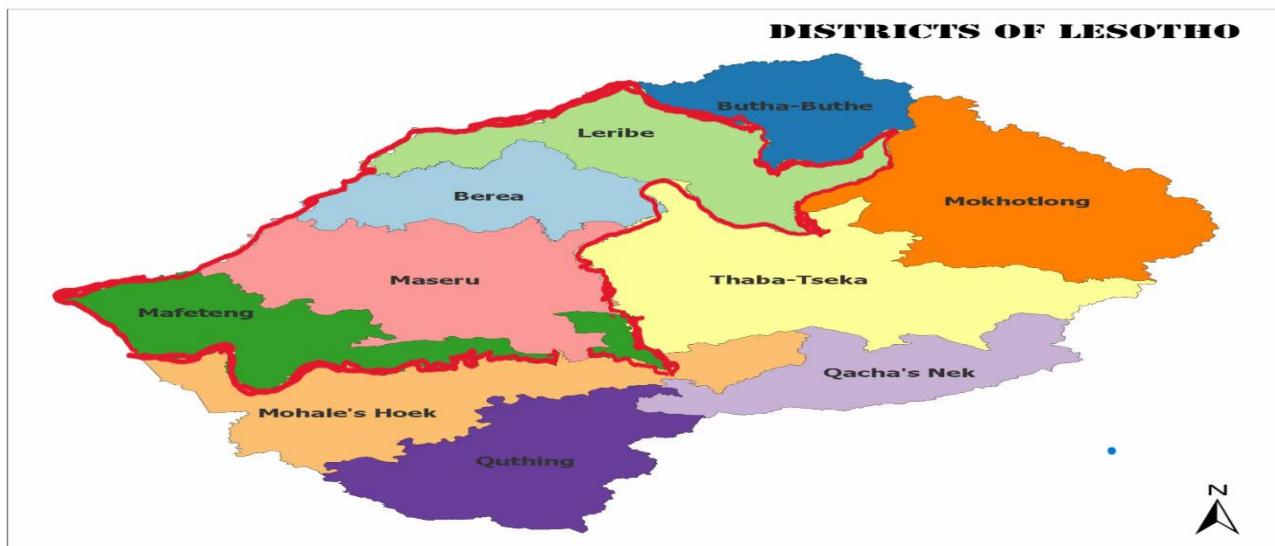


Figure 3: Scope of study (Source: Mappr, 2025)

7. LITERATURE REVIEW

The issue of regulation and SMEs has drawn attention in the past years, focusing on investigating the effects of regulation on SMEs. However, the larger portion of the literature concentrated on formal SMEs, thereby overlooking the exceptional experiences of the informal SMEs. Particularly the above-average number of informal sector activities in Lesotho. The literature review in this study investigates the bigger picture of regulations in inclusive environments, while identifying the gaps in how informal SMEs perceive the influence of the regulatory system on the current SME business environment in Lesotho. The study is primarily based on the theories of informality.

7.1. Informality theories

The exclusion view theory (Dell'Anno, 2022:1623), a perspective within the structuralist framework, argues that businesses do not choose to be informal, but are forced into informality owing to structural limitations like high compliance costs, training, inadequate infrastructure, limited access to finance, and support. (Moyo, 2022:487-491; Nuni & Feika, 2023:102). Structural theory (Martínez & Short, 2022:3), advocates for the robust link between the formal and informal sectors but marginalises the informal sector in the global economy. It

emphasises that the informal sector plays a marginal role because of the unequal distribution of international trade and economic globalization (Martínez & Short, 2022:3).

These constraints compel businesses into informality as a means to survive, not an intended business model (ILO, 2025a:17). This is consistent with the International Classification of Status in Employment (ICSE-18), which captures new types of precarious, semi-formal labour arrangements by distinguishing between formal and informal employment to include categories like employees and dependent contractors (ILO, 2025b:12).

In the context of specific regulation, formality and informality should be viewed in direct relation to economic activity. Kanbur (2009) presented fourfold conceptual categories to assist businesses' reactions to regulations or shape the analysis: (1) regulation applicable and compliant, (2) regulation applicable and non-compliant, (3) regulation non-applicable after adjustment of activity, and (4) regulation non-applicable to the activity (Kanbur, 2009:12).

On the contrary, exit view theory (Dell'Anno, 2022:1617) suggests that businesses voluntarily choose to operate informally based on their formalisation cost-benefit analysis assessment (Dell'Anno, 2022:1617-1626; Nuni & Feika, 2023:102). The third view is the dualist view (Dell'Anno, 2022:1618-1619), which regards the informal sector as marginal and distinct from the formal sector, and the high unemployment rate in the formal sector necessitates the informal sector (Nuni & Feika, 2023:102).

The complexity of formalising a business, high registration costs, high unemployment rate, and poverty in Lesotho (Malephane, 2024:2-9; World Bank Group, 2020:8) are closely aligned with the dualist view theory of informality. This suggests that informal businesses are excluded from the informal sector due to the high entry barriers rather than voluntarily opting to remain informal.

7.2. The Informality Concept in Small and Medium Businesses (SMEs)

Business literature has extensively recognised the expansion of SMEs in many developing countries. However, the emphasis is that the growth of the majority of SMEs is hampered by the high degree of informality, which seriously impairs SMEs' long-term sustainability and performance (Rutendo Taruvinga & Sakarombe, 2024:165). The informal sector refers to the part of the economy operating outside the regulatory frameworks. Although their operations are legit, informal businesses are not regulated by the societal institution (Nuni & Feika, 2023:103).

There is a need to implement effective strategies to simplify the business formalisation to help them improve their performance, reduce crime and vulnerable employment, inequality, and poverty. Providing informal SMEs with a decent business environment, as shown in Table 1 in Chapter 1, can potentially reduce political and social turmoil. Specific assistance may include protection from criminal activities, provision of land space, and access to formal finance to boost their performance (Moyo, 2022:480-491). The government should have in place policies that differentiate informal activities from criminal activities to fully appreciate their significance (Lah, 2024:ii).

7.3. Business environment and formalisation

The business environment is important to the formalisation and growth of SMEs. Consequently, excessive regulation resulting from a burdensome process and high registration fees is bad for SMEs. A conducive business environment, as evidenced by low compliance costs for SMEs and a level playing field, is created by a well-functioning regulatory system. This is because SMEs can find it challenging to navigate the legal system and adhere to regulations (Trnka *et al.*, 2022:8).

Mostly, SMEs' regulatory frameworks pose challenges because they usually struggle to cope with new regulations. Some SMEs may incur compliance costs but fail to enjoy the related long-term benefits. This suggests the need to allow SMEs, particularly start-ups, a free trial period like a tax holiday while still finding their feet (Trnka *et al.*, 2022:5-12). The complexity of the registration process, geographical location, and information irregularities influence an SME's decision to register. Also, the size of the business, market access, state of infrastructure, and having a business plan can motivate SMEs to formalise their operations (Nohoua, 2021:11).

These factors can be benchmarked against Kanbur's (2009) model of responses to regulation for a better understanding of their impact on formalisation decisions. For example, the complexity of registration procedures and information irregularities can push SMEs into categories 3 and 4, adjusting their operations to move out of the ambit and operating entirely outside the ambit. Quality infrastructure and market access can encourage businesses towards category 1, stay within the ambit of regulation, and comply.

7.4. Effects of regulatory frameworks on SMEs' growth

Regulations help determine the future of businesses' growth and survival by providing a direction to carry out their operation. Businesses invest a significant amount of time and money to comply with government regulations, some of which are ineffective and unnecessary for economic efficiency, profit-making, and job creation (Nuni & Feika, 2023:104). Literature revealed that SMEs' growth is positively influenced by simplified

registration processes, favourable tax policies, easy access to finance, and flexible labour market regulations. Moreover, it appeared that compliance with strict environmental regulations can stimulate SMEs' innovation (Usmany, 2024:1614-1619) by encouraging the creation of new business models, processes, and technology to comply with such regulations and gain a competitive advantage.

Regulatory frameworks connect SMEs to growth prospects by combining the benefits associated with business registration. However, informal SMEs face several challenges that hinder their growth, including corruption in the public sector, complex business registration processes, a lack of support and advice on formalisation procedures, and a lack of incentives that motivate formalisation (Nuni & Feika, 2023:109-110). Government policies and regulations that provide customised SME support through monetary initiatives, fiscal measures, and modernised regulatory frameworks provide SMEs with opportunities and resources that improve their growth (Abdulrahman Shehu Ahmadu *et al.*, 2025:36).

8. RESEARCH METHODOLOGY

8.1. Research strategy and method

The article adopted a qualitative approach with a mix of hermeneutic and phenomenology strategies to understand in-depth the reality of the examined context (Ñañez-Silva *et al.*, 2024:3). Additionally, an interpretive approach was adopted to gather accurate and comprehensive data about individuals' experiences with government policies and regulations on the SME business environment in Lesotho. The interpretive approach refers to the process of comprehending and making sense of the phenomena based on the meaning attached by the involved people (Pervin & Mokhtar, 2022:424).

A cross-sectional design was employed and deemed appropriate because the informal SME perspective of government policies and regulations in supporting SMEs' business environment in Lesotho was only measured and quantified over a predetermined period. The phenomenology strategy enabled in-depth comprehension of the interviewed informal SMEs' opinions, experiences, and feelings regarding the informal SME perspective of government policies and regulations in supporting the SMEs' business environment.

The data was collected through semi-structured interviews and document analysis. Interviews enabled interpretations of the social realities, customs, values, worldviews, and ideologies derived from a subjective perspective (Ñañez-Silva *et al.*, 2024:3). Document analysis complemented interviews for data triangulation, and reducing the inherent qualitative research obstacles, thereby increasing data richness (Morgan, 2022:66-69). Depending on participants' preferences, interviews were conducted either virtually or face-to-face within 40 to 60 minutes. Confidentiality, anonymity, and voluntary participation were upheld during the study.

8.2. Participants, data collection, and sample characteristics

Data was collected using purposive and snowball sampling methods from owners or informal SMEs from the Basotho Enterprise Development Corporation (BEDCO) database. The study focused on informal SMEs located in the four districts of Lesotho: Maseru, Mafeteng, Berea, and Leribe. A total of 16 informal SMEs participated in this study, and the saturation determined the final sample size. In a qualitative study, the sample size is deemed adequate until saturation is reached (Mwita, 2022:417).

8.3. Data analysis

An ATLAS. ti was used for efficient organisation and thematic analysis of the data. This software also facilitated data coding, identification of patterns and themes relevant to the research question, and constructing code networks to visualise the relationship. The Glaser and Strauss's coding process (Akkaya, 2023:89), including Open, Axial, and Selective Coding (Akkaya, 2023:92; Estaji & Azizbeigi, 2025:40), was adopted to identify themes. While data was originally collected from several participant groups, this study considered only data from informal SMEs, and any other data was irrelevant and excluded to ensure the research focus. Voice recordings and handwritten memos were transcribed and uploaded with secondary documents into Altas.ti for coding and analysis.

The responses were grouped based on similarities in content. Throughout the coding process, the codes were repeatedly refined to establish a more suitable label. Finally, the responses were categorised under wider themes that replicated informal SME perspectives and experiences.

The study followed a six-step thematic analysis procedure: data familiarisation, initial coding, categorising codes into subthemes, reviewing themes, defining themes and naming the themes, and producing research reporting (Dawadi, 2021:64-70) as depicted in Figure 4.

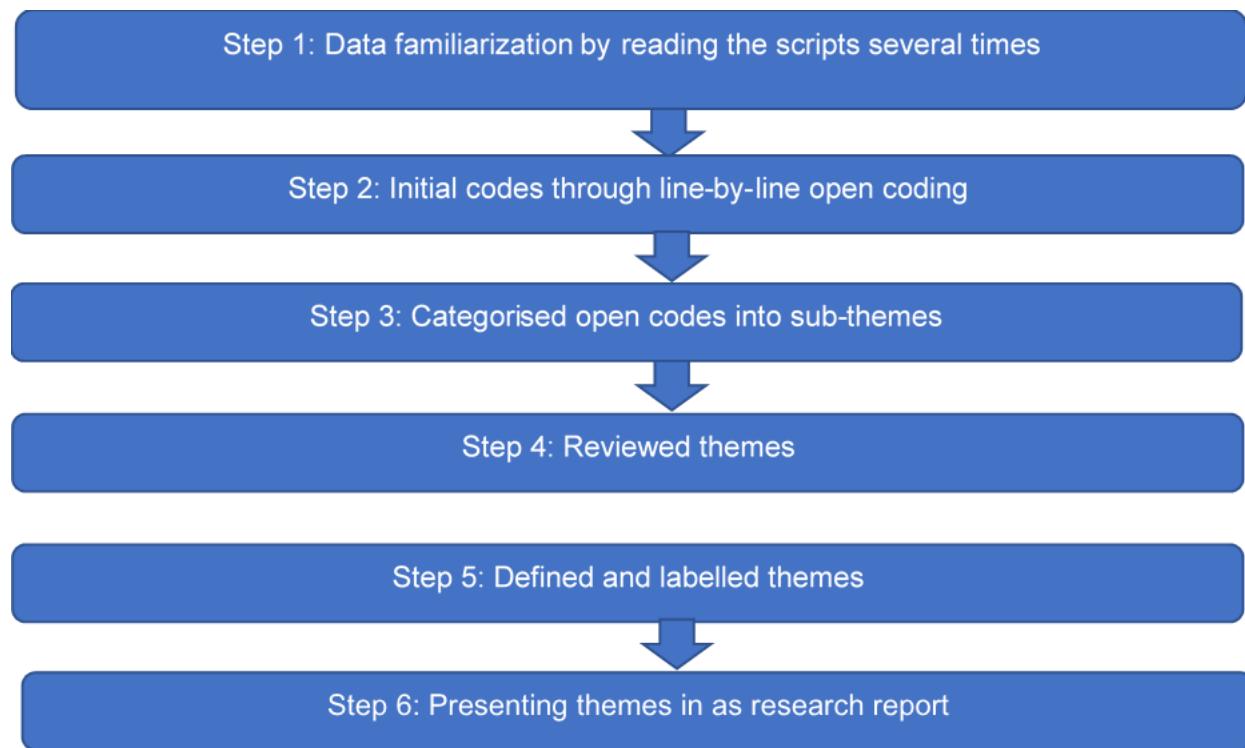


Figure 4: Thematic analysis process (Source: Own Compilation)

Following repeated reading of the data, initial codes were generated as key details from the scripts (Sharma, 2024:124). Similarities and patterns were recoded into memos as they emerged and resulted in the grouping of

related codes to form subthemes. Themes evolved following the memoing of broader patterns that resulted from reviewing and refining subthemes.

The code book was exported from ATLAS.ti into an Excel document, for simplifying the identification of commonalities in the codes and categorising them into groups, subthemes. The three identified themes were presented in the results section, and compelling quotes from the gathered data were used to bolster them. ATLAS.ti simplified data management through its special features that enabled uploading of documents, creating codes, and grouping them to develop themes with an emphasis on exploration of data (Ñañez-Silva *et al.*, 2024:129).

9. Ethical considerations

The study obtained ethical clearance (N W U - 0 0 6 8 3 - 2 4 - A 4) from the North-West University School of Business and Governance. Each participant provided informed consent before the interview started. Each participant was allocated a unique ID to safeguard their identity and confidentiality. All collected data was stored in lockable drawers and password-protected devices, accessible by the researcher only.

10. RESULTS

The findings were organised into four themes and thoroughly discussed within each to provide essential understanding. This structure enabled focused and cohesive data presentation that aligned with the research objectives.

Figure 5 shows a word cloud of the initial keywords that were prominent in the data and used to develop themes (Ronella Jansen van Rensburg, 2023:1-3). It indicates that words like “business, SMEs, government, registration, compliance, policies, support, challenges, incentives, regulations, costs” appeared frequently in responses. Their frequency is reflected by their size in the cloud, highlighting the significance of a conducive business environment for SMEs. By emphasising these recurring words, the word cloud helped guide the initial coding process.



Figure 5: Word cloud showing words frequently used in the data (Source: Own compilation)

Table 1 below depicts that 282 quotations were connected to 15 codes that were grouped into 7 categories to form 4 themes, namely: Government regulations and business environment, insufficient government assistance, informal SMEs challenges, and benefits of formalisation. The insufficient government assistance is supported by the largest percentage of code applications (47%), highlighting that it is a leading concern. Contrarily, government regulations and business environment, and benefits of formalisation themes accounted for 13% and 15% of the entire coding, respectively. Nonetheless, their inclusion in the analysis provided a more comprehensive picture of the difficulties faced by SMEs in the Lesotho business environment.

Table 1. Development of the themes process (Source: Own Compilation)

Codes (Frequency of codes)	Sub-themes	Theme	Frequency percentage (%)
1. Registration costs (9) 2. Centralised registration services (12)	Registration obstacles	Government regulations and business environment	37 (13%)
3. Knowledge of policies affecting SMEs (8) 4. Lack of knowledge of policies affecting SMEs (8)	Regulatory awareness		
5. Lack of incentives for formalisation (42) 6. Insufficient government support (19) 7. Complex and demanding registration process (23)	Discouragement for formalisation	Insufficient government assistance	132 (47%)
8. Inefficient engagement (26) 9. Poor communication (22)	Lack of stakeholder engagement		
10. Trading freedom restricted by registration (3) 11. Discrimination (5)	Operating difficulties	Informal SMEs challenges	70 (25%)
12. Informal businesses do not have access to formal business (30) 13. Limited capital (32)	Financial constraints		
14. Better market share for formal businesses (22) 15. Formal businesses have access to finance opportunities (20)	Motivational factors	Benefits of formalisation	42 (15%)

Table 2 below shows code document analysis, presenting the frequency and distribution of codes applied across all documents. The frequency at which each code appeared in an individual script assisted in recognising how particular respondents emphasised the codes. The distribution of codes, like limited capital, informal SMEs lack access to formal finance, a lack of incentives for formalisation, and inefficient SME engagement across several documents, demonstrates their universal significance.

For instance, limited capital appeared in all 16 scripts, signifying its supremacy in Lesotho SMEs. Conversely, codes like trading freedom are restricted by registration, appearing in fewer scripts, implying context-specific themes. This table indicates issues that were generally shared and those that were more individualised.

Table 2: Code document analysis (Source: Own Compilation)

	A001 IN Gr=4	A002 IN Gr=40	C001 IN Gr=40	C002 IN Gr=39	C003 IN Gr=44	D002 IN Gr=37	E001 IN Gr=17	A003 IN Gr=40	A004 IN Gr=34	C005 IN Gr=41	E002 IN Gr=29	E003 IN Gr=33	E004 IN Gr=32	E005 IN Gr=33	E006 IN Gr=18	C004 IN Gr=42	Totals
● RQ 1: SMEs growth constraints: Insufficient government support Gr=19	0	1	0	1	1	0	0	1	0	0	0	0	0	0	0	0	4
● RQ 2: Business environment policy constraints: Inefficient SME engagement Gr=26	0	0	1	0	2	0	0	1	1	1	1	0	1	1	1	2	12
● RQ 4: Regulatory impact on formal SMEs vs informal SMEs: Better market share for formal businesses Gr=22	1	0	0	0	1	0	0	0	0	1	1	0	0	0	0	0	4
● RQ 4: Regulatory impact on formal SMEs vs informal SMEs: Discrimination Gr=5	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	1	3
● RQ 4: Regulatory impact on formal SMEs vs informal SMEs: Formal businesses have access to finance opportunities Gr=20	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	3
● RQ 4: Regulatory impact on formal SMEs vs informal SMEs: Informal businesses do not have access to formal finance Gr=30	1	1	1	0	1	0	0	1	1	1	2	2	1	1	0	2	15
● RQ 4: Regulatory impact on formal SMEs vs informal SMEs: Trading freedom restricted by registration Gr=3	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	1
● RQ 5: Regulatory influences on formalization: Centralized business registration services Gr=12	1	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0	3
● RQ 5: Regulatory influences on formalization: Complex and demanding registration process Gr=23	0	0	0	0	0	0	0	0	0	1	0	0	1	0	0	0	2
○ RQ 5: Regulatory influences on formalization: Knowledge of policies affecting SME Gr=8	1	1	1	0	0	0	0	1	1	1	0	0	1	0	0	1	8
● RQ 5: Regulatory influences on formalization: Lack of incentives for formalisation Gr=37	0	0	0	1	1	0	1	1	1	1	1	1	1	1	1	0	11
● RQ 5: Regulatory influences on formalization: Lack of knowledge of policies affecting SMEs Gr=8	0	0	0	1	1	1	1	0	0	0	1	1	0	1	1	0	8
● RQ 5: Regulatory influences on formalization: Poor communication Gr=22	0	0	1	1	1	1	2	0	0	0	0	0	0	0	0	0	6
● RQ 5: Regulatory influences on formalization: Registration costs Gr=9	1	0	1	0	0	0	0	0	0	0	0	0	1	1	0	1	5
● RQ 6: Financing and cost issues: Limited capital Gr=32	1	1	1	2	1	1	1	1	1	1	1	1	1	1	1	1	17
Totals	7	6	8	6	10	4	5	6	5	7	7	5	8	6	4	8	102

The network image showing the connection between codes and themes is illustrated in Figure 6. It visualises the hierarchical structure of the data analysis in this study. Although codes did not directly co-occur, similar codes were grouped under related themes. Among the four themes, insufficient government assistance, government regulations and the business environment, and informal SMEs challenges emerged as dominant aspects of informal SMEs' experiences, as they are supported by a greater number of codes and subthemes. Their richness highlights their significance in what informal SMEs perceive as the impact of government policies on the SME business environment in Lesotho. While the benefits of formalisation were not widely discussed, its presence across a few codes provides significant insights that cannot be overlooked.

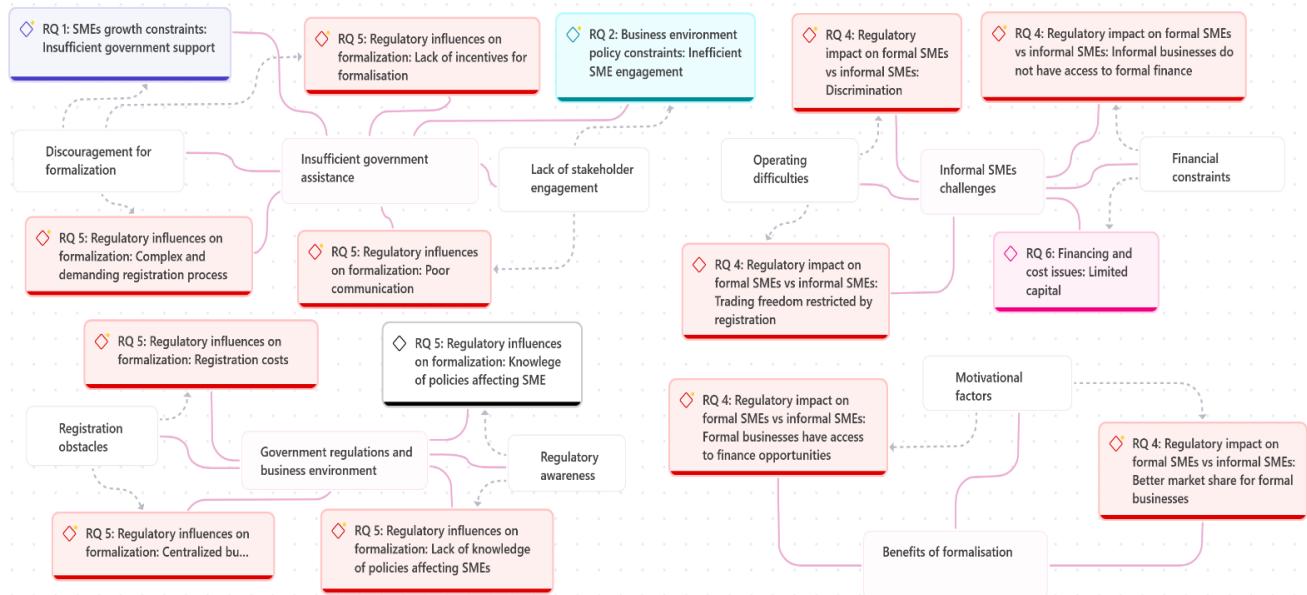


Figure 6: Network view of the informal SME perception of government regulations and policies on the SME business environment (Source: Own Compilation)

Theme 1: Government regulations and business environment

The analysis reflected that government policies significantly contribute to a large pool of informal SMEs in Lesotho. The interviewees appreciated the positive impact of regulations on the business environment in Lesotho by promoting more sustainable business practices, fair competition, and establishing consumer confidence, among others. However, regulations appeared to be creating more constraints on formalisation. The majority of interviewees stated that registration and tax services are centralised and not easily accessible. One interviewee mentioned, *“Business registration services are found in towns, and a stop business facilitation center is only in Maseru, and the process is not completed in one day”* (E004 IN, 2025).

It was revealed that this one-size-fits-all method does not accommodate the specific needs of different businesses in various parts of the country. 56% of the interviewees alluded that informal SMEs generally make small profit margins; therefore, even small registration costs can hinder their entry into the formal sector. Some of the interviewees stated that online business registration is not inclusive due to a lack of internet access in some parts of Lesotho, thus suggesting the use of a hybrid registration procedure.

When asked about specific government policies and regulations affecting SMEs, 50% of the interviewees mentioned regulations like the Business Licensing and Registration Regulations, Tax Regulations, Labour Act, and Environmental Regulations. The other 50% was not informed about these regulations. When probed about what could be effective ways to communicate government policies and regulations, most interviewees suggested the use of targeted multi-channels. *“Public gatherings are still effective communication channels in rural areas in Lesotho, so we would appreciate regulators considering them to raise awareness,”* (C001 IN, 2025) stated.

Theme 2: Insufficient government assistance

The lack of government assistance can potentially reduce SMEs' profitability, thereby negatively affecting their sustainability (Frederick O. Eze *et al.*, 2022:1-2). The code document table above shows that 25% of the interviewees highlighted that the government provides insufficient support to informal SMEs. It was clear that informal SMEs only benefit from the training provided by the Basotho Enterprise Development Corporation (BEDCO), which sometimes becomes a waste because some SMEs fail to implement the acquired knowledge due to financial difficulties.

Likewise, 69% of the interviewees reported that there are no regulatory incentives that could motivate them to formalise their operations. They specified that most people start businesses to make a living and close the income gap due to the high unemployment rate in Lesotho. So, the formalisation of their businesses with no incentives would burden their limited profit margins.

Additionally, 13% of the interviewees aware that all businesses must register before operating in Lesotho, but the registration process is complex and demanding, thus superseding the perceived benefits. Also, over 50% of the interviewees mentioned a lack of tax breaks, SME subsidies, and government grants intended to assist SMEs' growth. *“I started this business a long time ago and closed down during the COVID-19 era. In 2023, I used my savings to restart it, but decided not to register it because no benefit was obtained from the earlier registration status; instead, I suffered from frustrations and compliance costs. For example, even if a business makes a loss, it still has to file tax returns, thus attracting professional fees”* (A003 IN, 2025), stated.

Two more issues – poor communication and inefficient stakeholder engagement were raised. 63% of the interviewees highlighted that poor communication hampers the effectiveness of available government assistance. Some of these interviewees stated that only a few and the same SMEs benefit from government assistance programmes because of a communication breakdown. *“My neighbor received a greenhouse and a mill from the government development assistance programmes; however, I still don't know how to access such assistance because he cannot even share the information”* (D002 IN, 2025), noted. The other 38% of interviewees stated that inefficient SME engagement negatively affects government support because the government offers what it believes SMEs need, which might lead to resistance due to a mismatch with their needs.

Theme 3: Informal SMEs challenges

An emphasis was made that many informal SMEs face several challenges in Lesotho emerging from the regulatory system. It was evident from the interviews that informal SMEs specifically experience operating difficulties and are financially excluded. One interviewee noted that they do not operate freely. When probed to share the insights about how their informal status affects their legal protection as members of the community. *“We are afraid to report as we will be exposed, thereby making us victims of a high crime rate,”* (E004 IN, 2025) responded.

Additionally, 12% of the interviewees highlighted that the government regulations promote discrimination amongst businesses through high business registration fees, the same compliance requirements for all types of businesses, such as tax rates. It became clear during the interviews that these substantial registration fees, coupled

with complicated administration processes, require specific expertise and substantial resources. This can be a burden to SMEs, which find it difficult to comply and progress, thereby worsening the already-existing inequalities. *“The main beneficiaries of government assistance, like partial credit schemes, are formal large businesses because attached conditions make it disproportionately difficult for SMEs, especially informal. For example, only businesses with bank accounts can qualify for such schemes”* (A002 IN, 2025), noted.

Additionally, the majority of interviewees stated that financial difficulties are a key obstacle to their development and sustainability. All respondents cited that their informal status hinders their economic progression and sustainability because they are unbanked and have minimal capital sourced from personal savings and loans.

Theme 4: Benefits of formalisation

It was highlighted that SMEs can benefit from formalisation by having better market share and access to formal finance. For example, the availability of export markets through relationships such as the African Continental Free Trade Area (AfCFTA). However, it was discovered that complex regulations, high and all-encompassing registration costs, tax rates, and the absence of incentives can significantly deter the transition from informal to formal sector by the majority of SMEs.

On the issue of access to formal finance, 25% of the interviewees expressed that while formal SMEs still face challenges like high interest rates and inability to provide the required collateral due to strict regulatory requirements, they are better than informal SMEs. Most of these interviewees articulated that the majority of their profits are used toward their livelihood, as influenced by limited access to formal employment in Lesotho, thereby sustaining an informality loop. An interviewee, C001IN (2025), *“I believe that the majority of our businesses fail to meet registration requirements and forfeit the perceived advantages, because our profit retention ratios are less than 50%, which are used to finance daily business expenses”*.

11. DISCUSSION OF RESULTS

As shown in Table 1 above, most participants agree that insufficient government support harms the business environment for SMEs in Lesotho. This was further supported by the fact that all interviewees noted that SMEs have limited capital, as shown in Table 2. Therefore, this creates a significant barrier for some SMEs, which make low profits that only cover the income gap, preventing them from registering their businesses due to fears of high compliance costs.

Additionally, significant terms such as “government, businesses, funding, challenges, compliance, regulations, incentives, SMEs, and support,” as shown in the word cloud in Figure 5 above, support the identification of the themes. The repetitive mentioning of these issues signifies the ongoing experience of informal SMEs regarding the government policies’ influence on the business environment in Lesotho.

The finding that business registration is centralised, with certain services only available in Maseru, implies that it is very expensive and inconvenient to register a business in Lesotho, particularly for those located in rural parts of other districts. Travelling costs between two districts for more than one day to complete the process are likely to exceed the actual business registration fee, which might not be economically effective for SMEs, as illustrated by the high ratio of cost to value. These findings align with the theory that SMEs incur relatively high registration costs (Bobic *et al.*, 2023:9). Additionally, the noted limited internet access suggests that inequality exists in formalisation and business prospects for informal SMEs.

Although informal SMEs seem less advantaged than formal SMEs, some institutions advocate for their interests. Business associations and organisations like the Lesotho Chamber of Commerce and Industry serve as the voice for this group. However, the effectiveness of advocacy is limited by insufficient resources, low informal SME membership, and limited engagement with the government. This highlights the need for policy frameworks that support and address the needs of this group.

The indication that 50% of interviewees are aware of the policies and regulations affecting SMEs may suggest that they deliberately took advantage of loopholes in the regulatory system, such as inefficiency in law enforcement, or possibly because of a mismatch between SME situations and regulatory designs. This could be supported by the inefficiency of stakeholder engagement in the policies and regulations development process. Similarly, the lack of knowledge of these regulations by the other half signifies a communication gap.

These issues indicate the importance of clear and inclusive communication and effective engagement of SMEs in policies and regulations relevant to their operations to enable buy-in, relevance, and ownership. Prior studies suggested that effective stakeholder engagement enhances ownership, promotes trust, and relationships (Haile & Mekonnen, 2024:2-4). Likewise, literature demonstrates that inadequate communication hinders project success (Malik *et al.*, 2023:2).

Additionally, the finding that there is a lack of incentives for formalisation indicates that informal SMEs are not motivated and believe that the costs of formalisation outweigh the associated benefits. Most SMEs in Lesotho fail within five years of their existence (Amadasun & Mutezo, 2025:2). The three-year tax holiday, free registration, subsidies, and simplified regime can promote long-term capital investment (Digil *et al.*, 2024:172-174; Obafemi *et al.*, 2021:12-14). Tax holidays can influence business growth, as all profits can be reinvested and more jobs created. Previous studies noted that the government may need to provide tax breaks only to businesses that could expand the future tax base, such as those investing in research and development, since the government recognises the benefits over a longer period (Chijikwa & Mulenga, 2022:228).

Figure 7 below indicates that most participants (34%) consider insufficient government support as a significant obstacle to a conducive business environment. Likewise, only a small number (17%) believe that there are specific benefits attributable to the formalisation of SMEs in Lesotho.

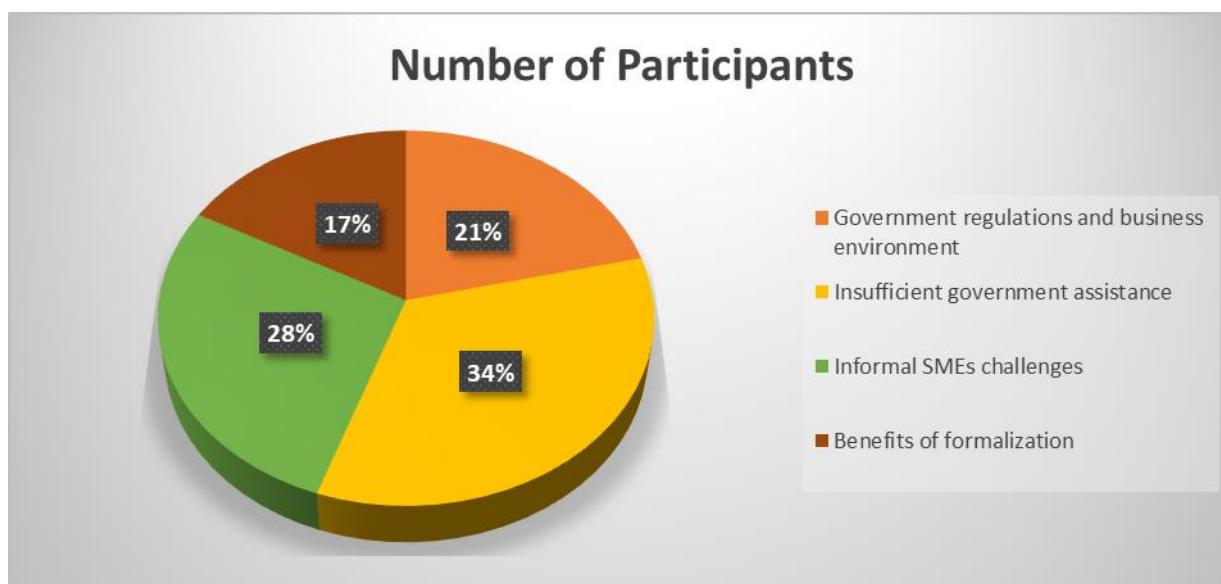


Figure 7: Contribution from participants by theme (Source: Own Compilation)

The perceived lack of protection suggests that not only are informal SMEs vulnerable, but also the individuals or communities that depend on them. Crime incidents not reported may increase to a point where they are not controlled and erode all profits, leaving many people jobless. Eventually, they will extend to formal businesses and increase poverty levels.

The findings of this study contribute to the existing literature on the effectiveness of government policies and regulations in shaping the business environment by gathering insights into the opinions and experiences of the informal SMEs. The study established that informal SMEs make the largest portion of the SME sector in Lesotho, 76% (FINMARK, 2025:15), thus signifying the importance of their perception and experiences.

The greater number of informal SMEs in Lesotho results from a combination of several factors, including the absence of comprehensive government assistance, a challenging business environment, limited access to funding, a complex regulatory environment, and high operational costs (Amadasun & Mutezo, 2022:3; Damane & Mochebelele, 2024:29).

In comparison with other African countries, Lesotho has a smaller informal economy (Alize le Roux, 2024:14). This justifies challenges in business formalisation, possibly due to limited finance and market, and reduced productivity and growth potential. This hurts formal SMEs in that, as the number of informal SMEs increases, formal SMEs face high competition on prices. The tax base remains small with a high tax burden on formal SMEs. They are also likely to lose skilled labour to informal practices, which may offer relatively good remuneration packages, as influenced by better profit margins.

Figure 8 below compares the ease of business formalisation between Lesotho, its neighboring country, South Africa, and the world's top performer, New Zealand. Lesotho's business formalisation process is relatively quick compared to South Africa. However, the business environment is generally burdened by high costs, cumbersome processes, and time delays. It takes 15 days to complete a business registration in Lesotho, compared to less than a day in New Zealand. The cost of business registration is around 6.1% of income per capita, which is much higher than in South Africa and New Zealand, at 0.2%. Additionally, the cost of property registration as a

percentage of the property's value is higher than in both New Zealand and South Africa.

Additionally, the time burden does not end with business registration. It takes an average of 43 calendar days to register a property in Lesotho, longer than the 23 days in South Africa and 3.5 days in New Zealand. Furthermore, it takes an average of 327 hours annually to pay taxes in Lesotho, compared to 210 hours in South Africa and 140 hours in New Zealand. Figure 8 shows that cost, administrative friction, and time-consuming processes are major challenges in Lesotho's business environment. This is despite Lesotho having fewer procedures and taking less time for business registration than South Africa; it still lags significantly behind the world's leading country, New Zealand.

The conduciveness of the Lesotho business environment for SMEs can also be assessed by comparing the number of informal businesses in Lesotho with those in South Africa. Nearly 76% of SMEs operate informally in Lesotho, compared to 56% in South Africa (FINMARK, 2024:17; 2025:15). This analysis highlights that the Lesotho business environment is not conducive to the formalisation of SMEs.

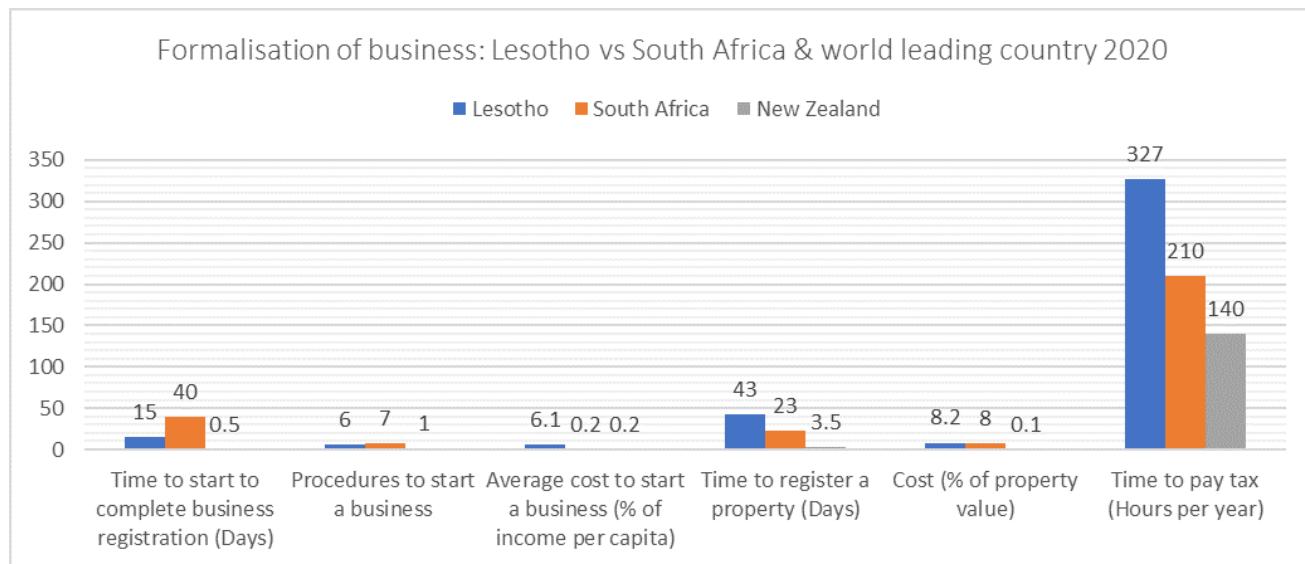


Figure 8: Comparison of formalisation of business: Lesotho vs South Africa & world-leading country 2020. (Source: World Bank, 2020)

The difficulties faced by informal SMEs in Lesotho are not exclusive. Several small open economies face substantial hurdles, including burdensome regulations, high levels of informality, and limited support (Omowole

et al., 2024:1128-1130). However, many countries implemented policy reforms that provide useful benchmarks for Lesotho. Some of the reforms implemented in the two small economies, Rwanda and Mauritius, are discussed below and presented in Table 3.

Rwanda is emerging as a leader in ease of doing business in Africa and among low-income economies, particularly for simplifying the formalisation of SMEs (World Bank Group, 2024:18-108). Rwanda's regulatory reforms continue to boost its international competitiveness. They include free online business registration, a one-stop shop for business services and licenses, and automated tax filing (Rwanda Development Board, 2024a). The free online registration has resulted in a 40% reduction in registration fees (Rwanda Development Board, 2024b:19). Mauritius has implemented a comprehensive set of policies to support SME development, including the SME equity fund and tax incentives for exports. Mauritius also streamlined the construction permit process, improved the quality of its land administration system, and enhanced the ability of debtors to continue their businesses during insolvency proceedings (World Bank, 2020:110-111). Additionally, Mauritius provides strong support to help SMEs formalise their operations, through free registration for government tenders, 10% of contracts reserved for SMEs, and a 10% price preference over competitors in government contract bidding (Tabti, 2025:8).

Table 3: Benchmarking SME support initiatives in other open economy countries (Source: Rwanda Development Board, 2024:9; Tabti, 2025:8).

Country	Important reforms	Lesotho's lessons
Rwanda	<ul style="list-style-type: none"> - Free online business registration (40% cost reduction. - Fully digitalized and online integrated one-stop centre for business services and licensing. 	<ul style="list-style-type: none"> - Simplify online business registration and eliminate registration costs. - Digitize one-stop facility service and fully integrate with all relevant agencies, such as immigration and tax departments.
Mauritius	<ul style="list-style-type: none"> - SMEs have free registration for government tenders. - Tax incentives for exports - 10% of government tenders guaranteed for SMEs. 	<ul style="list-style-type: none"> - Remove the government tenders registration fee for SMEs. - Implement tax incentives for exporting SMEs. - Reserve 10% - 15% of government tenders for SMEs.

This study provides new insights into the practical limitations of regulatory frameworks by investigating informal SMEs lived experiences. It expands the discussion on business formalisation, highlighting the challenges faced by SMEs operating outside the formal regulatory system due to systemic constraints. The study concludes that many SMEs in Lesotho face exclusion that surpasses simple administrative supervision, resulting in a lack of inclusion, which impacts their security and involvement in economic activities. These findings underscore the importance of policymakers considering inclusive strategies that support and recognise all SMEs, regardless of their legal status.

12. Limitations of the study and future research

While this study offers insights into the informal SMEs' perspective, it is acknowledged that it has limitations. Firstly, the study used a purposive, small sample of informal SMEs from certain districts of Lesotho, thus limiting the generalisation of the findings to the wider context of the informal sector. Moreover, semi-structured interviews were used to gather data, which involves the use of personal descriptions by the researchers, which could have incorporated bias through interpretations and phrasing of questions. Notwithstanding these study limitations, the study provides insightful perceptions that can influence future research and practices. Future research activities should focus on the perspectives of informal SMEs in the remaining six districts of

Lesotho to provide a more holistic viewpoint. Additionally, future research should investigate strategies that can simplify the formalisation, considering the realities of informal SMEs in Lesotho. Moreover, future longitudinal research could investigate the perspective of informal SMEs on government policies on the SME sector business environment in Lesotho over time because this study adopted cross cross-sectional design. Future studies may also adopt a mixed-methods improve the generalisation and triangulate findings.

Lastly, future studies should evaluate the effectiveness and long-term viability of the remedies suggested by participants in this study. These include free SME business registration, offering incentives for the formalisation, and tax holidays.

13. CONCLUSION

This research highlights perspectives of often overlooked, informal SMEs on how government policies influence the SME business environment, based on new qualitative findings and existing literature. Theories of informality, the concept of informality within the SME sector, and the impact of the regulatory framework on SME growth were discussed in the literature review. The BEDCO database was used to access the purposively selected participants. The study found that informal SMEs are discouraged from registering due to insufficient government support, complicated compliance processes, and a lack of incentives for formalisation. 50% of the participants were aware of related policies and regulations, but they are still unregistered.

Time-consuming processes, administration burdens, and formalisation costs stand out as the major obstacles for SMEs to formalise their operations. Despite the existence of well-documented recent Business Licensing and Registration Regulations of 2020, the number of informal SMEs increased from 61,800 to 82,315 between 2016 and 2023. This supports the findings that some SMEs are unaware of these regulations and that government

policies are not effectively communicated to those affected. These regulations negatively impact the business environment for SMEs as they incur relatively high registration costs and often fail to comply with many requirements.

Simplifying the compliance process, providing adequate government support, and offering incentives to formal SMEs can enhance the importance of formalising businesses, thereby reducing the number of informal SMEs. While informal SMEs create economic opportunities, such as providing employment that could lower crime rates in certain contexts, they can also contribute to increased crime due to economic instability and loopholes in the regulatory system (Lah, 2024:5). A high crime rate discourages new investments, which limit economic growth.

14. Practical implications

A conducive business environment is vital for SMEs for various reasons, including transformation, economic growth, formalisation, job quality, and entrepreneurship. A supportive business environment helps SMEs' sustainability and growth. From a management standpoint, informal SMEs encounter numerous challenges; this study provides a valuable framework highlighting different types of managerial struggles and the benefits of addressing them with inclusive and comprehensive policy measures.

The researcher identifies, maps, and combines several obstacles facing SMEs in the business environment as perceived by the informal SMEs through a qualitative study of 16 informal SMEs in Lesotho. Four main themes are suggested: government regulations and the business environment, insufficient government assistance, and the challenges and benefits of formalisation for informal SMEs. Each of these themes comprises various subcategories and unique challenges, indicating that informal SMEs aiming for formalisation, growth, and sustainability should recognise and consider these themes as equally important. Besides offering insights into these themes and their potential impacts on SMEs, this research also provides a comprehensive view of the difficulties faced by informal SMEs.

15. Recommendations

This section presents the recommendations based on the insights, findings, and conclusions of this study. These suggestions aim to address the identified challenges and leverage opportunities. They are intended to help policymakers develop inclusive policies that support SMEs in thriving within Lesotho's business environment.

1. **Reduce formalisation barriers and utilise open communication:** The government of Lesotho should lessen the formalisation barriers and create open communication platforms between the government departments and SMEs. The government needs to consider the interests of people who rely on informal SMEs for a living, thus aligning with the findings that advocate for the enhancement of the protection of the informal sector employees (Miti *et al.*, 2021:390-391).

2. **Reform:** Lesotho should concentrate on streamlining the processes and hybrid business registration services to reduce delays and improve the ease of doing business.

3. **Reinforces policy implementation strategies:** To improve the efficiency of SME support programs and agencies like BEDCO, the government ought to simplify the implementation of policies by ensuring an effortless process in accessing opportunities and benefits. This could be achieved through clear guidelines, set timelines, and established feedback mechanisms to enhance accountability and transparency (Abdulrahman Shehu Ahmadu *et al.*, 2025).

4. **Provide formalisation incentives:** Offering incentives like tax holidays for startups, innovation grants, tax credits, and simplified compliance processes could lower formalisation costs and encourage SMEs to register, helping them achieve better profit margins.

5. **Increase Access to Affordable Financing:** The government should develop tailored and easily accessible SME financing schemes, like SME grants and low-interest loans, in cooperation with financial institutions.

6. **Provide affordable, continuous advisory services:** These services can address the SMEs' business management knowledge and regulatory compliance gap. They can help SMEs enhance operational efficiency, strategic planning, and overall performance. Ongoing financial literacy advice can help with effective financial management, leading to the sustainability of SMEs' funding schemes.

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