

EFFECT OF TAXATION ON PERFORMANCE OF MEDIUM-SIZED ENTERPRISES IN KAJIADO COUNTY, A CASE STUDY IN KITENGELA TOWN, KAJIADO EAST WARD

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ABSTRACT

This study is to examine the effect of taxation on the performance of medium-sized enterprises in Kitengela Town, Kajiado County. The study sought to address the following specific objectives; to determine the effect of Value Added Tax on the performance of medium-sized enterprises in Kajiado County, to evaluate the effect of Income Tax on the performance of medium-sized enterprises in Kajiado County and to assess the effect of Excise tax on the performance of medium-sized enterprises in Kajiado County. The study was anchored on three theories; Ability-To-Pay theory; Benefit Theory of Taxation and Kaleckies Theory of Taxation. The research adopted cross-sectional research design. The target population of this study comprised of 1,229 MEs. Simple random sampling was used to select the sample size of 302 from the different business/activity sectors. This study used questionnaires with fixed choice formats, as well as interviews as the main data collection instruments. A pilot study was undertaken on 30 of the respondents to test the reliability and validity of the questionnaire. Quantitative data were analyzed using SPSS version 25 where relationships between the variables were assessed using correlation and regression analysis. Quantitative data were analyzed using SPSS version 25 where relationships between the variables were assessed using correlation and regression analysis. The study found out that there was a positive and significant relationship between Value Added Tax and performance of MEs. Further, the results revealed that there was a positive and significant relationship between Income Tax

and performance of MEs. Lastly, there was a positive and significant relationship between Excise Tax and performance of MEs. Based on the findings, the study concluded that Value Added Tax, Income Tax and Excise Tax have a positive and significant effect on performance of MEs. The study recommends that as a broad-based tax on final consumption, VAT regimes must determine whether, or the extent to which, the purchase should be treated as acquired for business purposes or for private consumption. To eliminate the tax burden among MEs brought about by income tax, policy makers should extend exemption to transactions necessitated by regulatory changes, compulsory government acquisitions and internal restructures considering that such transactions are rarely undertaken for a commercial gain. Excise tax should be developed in such a way that it would stimulate rather than stop the development of entrepreneurship.

Keywords: Gross Domestic Product, Tax, Medium enterprises.

INTRODUCTION

Medium Enterprises are an essential element in the economic growth and development of every nation (Atawodi & Ojeka, 2015). The macro enterprises contribute significantly to the creation of employment opportunities and growth of the economy. A 2005 World Development Report stated that creation of jobs that are sustainable coupled with opportunities is integral to poverty eradication (Herath & Mahmood, 2015). MEs are private enterprises and

are faced with a myriad of challenges when dealing with government tax administration especially in the developing countries. The performance of MEs is considered a significant element of the economy since such entities are the backbone of the economy (Al Asheq & Hossain, 2019).

Entrepreneurship that thrives in the MEs is the main engine of economic growth in Europe. Good performance of MEs in 2015 within Europe led to 3.9 trillion Euros being generated by only 23 million enterprises (European Commission, 2017). Moreover, the MEs in Romania generated 50% of the value added to the economy in the year 2015. MEs play a key role in the reduction of unemployment within Europe and other decentralized economies globally. The MEs performance in Europe and the Americas was robust and quick to recover following the 2008 financial crisis that shook the global economy (Jerkovic, 2017). The versatility and ability to adapt to challenges within the MEs ensures that such entities are strong in the long-term and able to overcome the challenges of a financial meltdown. The actions and policies undertaken by government in terms of business development are crucial to performance of the MEs in Malaysia and Asia-Pacific region (Isaga, 2018).

The tax regime is cited as a significant factor that determines the financial performance of the ME entities that thrive in Malaysia. Similarly, Isaga (2018) asserts that the innovation policy within the United Kingdom has a significant impact of the performance of MEs within the manufacturer ovation drives productivity and resilience of MEs. Moreover, organization performance correlates with the SME performance within the nation and the network the entrepreneur has in the industry (Mohammed & Hicham, 2018). Subsequently, the performance of the SMEs relies heavily on multiple variables both externally and internally. The entrepreneur can work towards improving the internal factors such innovation capability and the marketing aspects but external factors such as taxation and government policy are beyond the scope of the en-

trepreneur. Consequently, there is a consistent pattern of MEs performance depending on the government policies and regulations.

Muturi (2016) asserts that MEs performance in Kenya is affected by the capital held by entrepreneur and the resources available to the business. MEs in Kenya rely on banks for capital financing or some use retained earnings from previous profits made by the business. Unfortunately, the performance of MEs lags behind the multinationals and big corporations that can pool resources easily under short timelines (Erard, 2017). Developing nations such as Kenya have clear understanding on the importance of MEs performance in fueling the growth of the economy. MEs contribute at least 98% of the national GDP and 50% of the workforce (Dinis et.al., 2017). Subsequently, the profitability of such enterprises is significant to the government and the tax administrators since they rely on positive performance and cash flow availability in the MEs in Kenya.

Statement of the Problem

Medium-sized enterprises are unable or they find it hard to expand their business operations due to high taxation by the government, many MEs hence resort to tax evasion and many other non-compliance methods in order to maintain their business operations. This can be evidenced by Ndemo (2015) who found that; the majority of businesses particularly small and medium-sized enterprises are not registered and carry out business without both county and national government licenses. Using data posted by KRA (2015), most medium-sized enterprises have evaded tax between 35% and 33.1 in 2012 and 2011 respectively. Furthermore, various studies (Shalfman et al., 2019; Mohammed & Hicham, 2018) have established that the taxation environment surrounding MEs is a vital element of the economy and requires close monitoring to ensure vibrancy. According to Shlafman (2019) MEs are vital stakeholders in the economy and government agencies must create a favorable environment for the good performance of such entities through appropriate taxation. Moreover, MEs contribute

70% of all jobs in the economy and 35-55% of GDP in developing and developed nations respectively.

The research undertaken in regards to taxation and compliance has mostly focused on large corporations and there is no particular focus on MEs. There have not been any empirical studies on the effect of taxation on the performance of medium-sized enterprises in Kajiado County. Limited research in the field contributes to the need for more studies on the topic. Some of the studies have focused on taxation (Newman et al., 2018; Ndemo, 2015; Zafiris, 2016; Mohammed & Hicham, 2018; Muturi, 2016; Ngek, 2018) and have investigated the association between taxation compliance among MEs, and taxation environment. There is limited research on the effect of taxation on the performance of the MEs in Kitengela Town, Kajiado County. Consequently, this study sought to investigate the effect of taxation on the performance of medium-sized enterprises in Kitengela Town, Kajiado County.

Specific Objectives

The specific objectives are:

- a) To determine the effect of Value Added Tax on performance of medium-sized enterprises in Kajiado County
- b) To examine the effect of Income Tax on performance of medium-sized enterprises in Kajiado County.
- c) To assess the effect of Excise tax on performance of medium-sized enterprises in Kajiado County.

LITERATURE REVIEW

Ability-To-Pay Taxation Theory

The theory on Ability-to-pay is a progressive principle that guides taxation administration in different jurisdictions. According to the principle, taxes payable by an entity should be premised on the amount of money that people and businesses earn from their operations. Subsequently, people who earn more money should and are expected to pay more money through higher rates of taxation. Higher taxation rates imply that a significant portion of the income

of the business ends up as taxation (Downer, 2016). The ability-to-pay theory does not consider the amount of services that the taxpayers use. The taxation model can be described as a form of progressive taxation that holds that taxes should always be levied based on the taxpayer's capability to pay.

Benefit Theory of Taxation

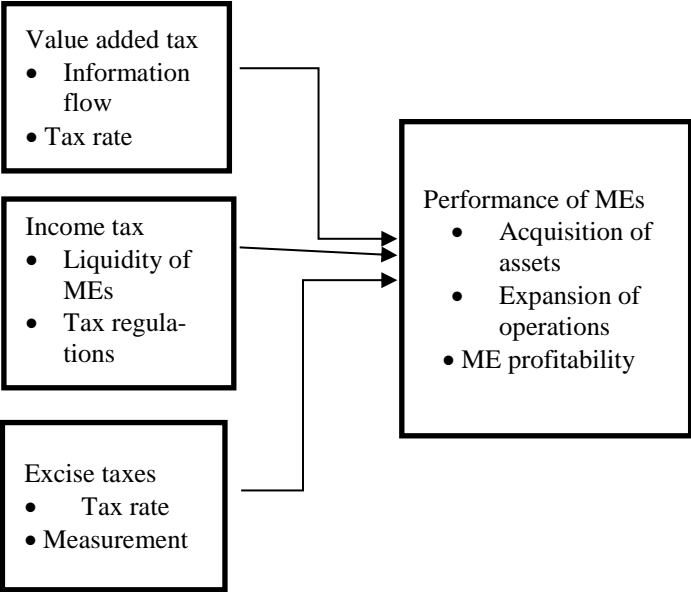
The benefit theory of taxation states that taxes should be levied on individuals based on the benefit conferred to the same people or businesses. Subsequently, the more benefits an entity or taxpayer derives from state activities then the more taxes they should pay. The benefit theory bases taxes for payment on public-goods expenditure on politically-revealed willingness to compensate for the benefits provided (Meier & Wrede, 2016). Under the benefit of taxation theory one likens the duty of prices in the allocation of private goods or items. The benefit principle assesses the prevailing efficiency of the taxes charged and appraisal of the nation's fiscal policy. Subsequently, the benefit theory considers a market-fashioned approach to the issue of taxation. The main goal is the accurate determination of the optimal revenue amount that requires to be spent on the public goods. Benefit theory is more equitable to the taxpayers including the MEs since they pay for what they get from the government. Under the benefit theory of taxation, taxes are similar to the prices that businesses and individuals pay for the services they receive from the government. Subsequently, the benefit theory advocates for specific charges to the taxpayers which are more direct where the preference of the businesses is the first consideration.

Kaleckies Theory of Taxation

Kaleckies, M (1971) as cited by Kent (2019) undertook an essential research to determine the effect of three different taxes. The taxes included tax on wage goods, capital tax and taxation on capitalist income. Subsequently, making an assumption that the proceeds of the taxation process were used on behalf of unemployed individuals. The research established that taxation imposed on the wage goods

had no particular effect. On the other hand, the demand on dole receipts provided a boost on spending on its entirety but the products had a higher price by a figure similar to the taxation and without the fear that market share would be lost. Taxation was deemed ad valorem for all wage goods (Kent, 2019).

The Conceptual Framework



METHODOLOGY

Research Design: The current research utilizes the cross-sectional research design which follows observational design where the investigator is able to measure the outcome and arising exposure among the participants (Gupta et al., 2016). The participants in the cross-sectional research design are selected through the inclusion and exclusion chosen by the researcher during the study. The research will embrace a cross-sectional approach that will rely on the use of descriptive and quantitative designs.

Target Population: The target population is 209 comprising of MEs drawn from General trade, wholesalers, retailers, workshops and industry plants.

Sampling Frame: Sampling frame provides a physical representation of the target population and

comprises different units that serve as potential members of a sample. The study will use random sampling of 21 MEs.

RESULTS AND DISCUSSION

Reliability Analysis

The reliability of the questionnaire was tested using the Cronbach’s Alpha correlation coefficient. Okelo (2015) postulates that Cronbach Alpha value greater than 0.6 is regarded as satisfactory for reliability assessment. As shown in table 4.1 Cronbach alpha values for all the variables; Value Added Tax, Income Tax, Excise tax and performance of MEs were greater than 0.6. From these findings it can be concluded that the constructs measured had the adequate reliability for the subsequent stages of analysis since all the Cronbach Alpha values were greater than 0.6. This has it that the questionnaire was not biased.

Table 4.1: Reliability Test

Scale	Cronbach’s Alpha	Number of Items	Remarks
Value Added Tax	.704	4	Valid
Income Tax	.691	4	Valid
Excise Tax	.710	4	Valid
Performance of SMEs	.733	4	Valid

Value Added Tax

The study sought to determine the effect of Value Added Tax on the performance of Small and medium-sized enterprises in Kitengela Town, kajiado east sub-county. Table 4.2 summarizes respondents’ level of agreement on the effect of Value Added Tax on the performance of medium-sized enterprises.

Table 4.2: Value Added Tax

	F	X	Mean	Stan. Deviation
The effects of value added tax on the rising and growth of medium enterprises.	15	17	4.11	1.637

Income Tax

Table 4.3 summarizes respondents' level of agreement on the effect of Income Tax on the performance of medium sized enterprises in the area. These study findings are supported by Dinis et al., (2017) who argues that the income tax regime helps develop a clear view of financial consequences of the taxation in businesses. Tax burdens charged on businesses influence the management decisions since income tax targets the income of the ME rather than consumption in the economy.

Table 4.3: Income Tax.

	F	X	Mean	Stan. Deviation.
The effects of income tax on the rising and growth of medium enterprises.	14	17	3.84	1.671

Excise Tax: Table 4.4 summarizes respondents' level of agreement on the effect of Excise Tax on the performance of medium sized enterprises in Kitembela town, Kajiado County

Table 4.4: Excise Tax

	F	X	Mean	Stan. Deviation
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The effects of export tax on the rising and growth of medium enterprises	16	17	4.39	1.601
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Coefficient of Correlation

From table 4.5, the results generally indicate that independent variables (Value Added Tax, Income Tax and Excise Tax) were found to have positive significant correlations on performance of MEs in Kajiado east sub-county at 5% level of significance. The results imply that independent variables; Value Added Tax, Income Tax and Excise Tax significantly influenced performance of MEs in Kajiado east sub-county. This is supported by Bunyasi et al., (2015) where they showed that taxation has a positive influence on the growth of businesses.

Table 4.5: Pearson Correlations

	Value Added Tax	Income Tax	Excise Tax	Performance of MEs
Value Added Tax	Pearson Correlation 1			
	Sig. (2-tailed)			
	N	62		
Income Tax	Pearson Correlation .818**	1		
	Sig. (2-tailed)	.000		
	N	62	62	
Excise Tax	Pearson Correlation .710**	.749**	1	
	Sig. (2-tailed)	.000	.000	
	N	62	62	62
Performance of MEs	Pearson Correlation .714**	.701**	.640**	1

of MEs	Sig. (2-tailed)	.000	.000	.000	
N		62	62	62	62

** . Correlation is significant at the 0.01 level (2-tailed).

CONCLUSION AND RECOMMENDATIONS

Discussion of the Key Findings

Pearson Bivariate correlation was used to compute the correlation between Value Added Tax and performance of MEs in kajiado east sub-county. There was a strong positive and highly significant correlation between Value Added Tax and performance of MEs ($r = 0.704$, $P < 0.05$). This finding agrees with Zafirir (2016) who posit that VAT is a progressive consumption tax that affects uniformity of the factor incomes that are produced within the enterprise.

Pearson Bivariate correlation was used to compute the correlation between Income Tax and performance of MEs in kajiado east sub-county. There was a strong positive and highly significant correlation between Income Tax and performance of MEs ($r = 0.691$, $P < 0.05$). These study findings are supported by Dinis et al., (2017) who argues that the income tax regime helps develop a clear view of financial consequences of the taxation in businesses. Tax burdens charged on businesses influence the management decisions since income tax targets the income of the ME rather than consumption in the economy. On the other hand, the findings by Dinis et al., (2017) indicate that a reduction in the rate of income tax does not lead to a concomitant reduction in tax burden. According to Brian (2018), the reduction in the rate of income tax among MEs encourages the different taxpayers to heighten their level of tax payment. In addition, taxing the income of the corporate and MEs discourages the level of productivity and should focus on the consumption side of the economy.

Pearson Bivariate correlation was used to compute the correlation between Excise Tax and performance of MEs in Kitengela Town. There was a

strong positive and highly significant correlation between Excise Tax and performance of MEs ($r = 0.710$, $P < 0.05$).

Conclusion

Based on the findings, the study concluded that Value Added Tax has a positive and significant effect on performance of MEs. Value added tax is a broad-based consumption taxation that has a direct impact on the operations of businesses and taxpayers. The use of a consumption tax such as VAT affects other aspects of the MEs and the economic environment including tax evasion, labor supply and the portfolio choice. It was observed that tax base under the use of VAT is easier to manage. VAT is a progressive consumption tax that affects uniformity of the factor incomes that are produced within the enterprise.

Based on the findings, the study concluded that Income Tax has a positive and significant effect on performance of MEs. Tax burdens charged on businesses influence the management decisions since income tax targets the income of the ME rather than consumption in the economy. The reduction in the rate of income tax among MEs encourages the different taxpayers to heighten their level of tax payment. Income taxation of enterprises constrains the growth potential of the taxpayers and hinders economic development in the future. It was also observed that the Income Tax Act does contain a number of benefits for a taxpayer that is classified as a small business corporation, for example, special wear and tear rates.

Based on the findings, the study concluded that Excise Tax has a positive and significant effect on performance of MEs. The industries that suffer the most when there is increases in excise duty include tobacco, alcoholic and non-alcoholic beverages, low value second-hand motor vehicles dealers, and motorcycles dealers. This tends to have a negative spiral effect on MEs that rely on these industries across the production and distribution chain. Some traders will be forced to shoulder a portion of the

excise duty to protect their sales resulting in lower margins.

Recommendations

As a broad-based tax on final consumption, which is understood to mean final consumption by households, it necessarily follows that the burden of the VAT should not rest on businesses. In practice, if a business acquires goods, services or intangibles that are used in whole or in part for the private consumption of the business owners, VAT regimes must determine whether, or the extent to which, the purchase should be treated as acquired for business purposes or for private consumption.

To eliminate the tax burden among MEs brought about by income tax, policy makers should extend exemption to transactions necessitated by regulatory changes, compulsory government acquisitions and internal restructures considering that such transactions are rarely undertaken for a commercial gain. This will eliminate the tax burden that would otherwise have arisen on transactions that were not undertaken for a commercial motive.

Cases when it is impossible to use lump-sum taxes excise taxes should be used, their tax base should be simple, rates and the general number of taxes should not be large or taxes should be equal. As a result of such a policy, distortions in the economy due to taxation would be minimized, as well as administrative and compliance costs should be held at the lowest level. Thus, MEs welfare would be maximized. Moreover, the excise tax should be developed in such a way that it would stimulate rather than stop the development of enterprises.

Further Research Recommendations

Further studies could consider other counties for purpose of making a comparison of the findings with those of the current study. The study used only three variables that affect performance of MEs. This is supported by coefficient of determination of 56.4%. This means that Value Added Tax, Income Tax and Excise Tax explain 56.4% of the variations in the dependent variable which is performance of

MEs. Future studies can incorporate other variables which are not captured by this study.

DECLARATION

We (Wesley & Paul) confirm that this is my sole research and hasn't been submitted for any examination. We did self-funding and data collected are available.

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