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Impact of Taxation on the Cost of Business Operations among Small and Medium Enterprises in Nairobi County, Kenya

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Abstract:

Small and Medium Enterprises (SME) make-up the largest proportion of businesses all over the world and play tremendous roles in employment generation, provision of goods and services, creating a better standard of living, as well as immensely contributing to the gross domestic products (GDPs). However, over the last few decades their growth has been stunted due to many factors, top of which is the challenge of multiple taxations that has crippled production capacity of the manufacturing sector. The current study examines the effect of multiple taxations on the growth of SMEs in Nairobi County, Kenya. This research followed both descriptive and exploration design with the target population being all the registered SMEs in Nairobi County. Both stratified and simple random sampling techniques were used to draw sample of 114 finance managers. Data collection was done by use of questionnaires and document analysis. Data was analysed by use of both descriptive and inferential statistics. The main test of importance here was to find out whether or not the dependent variable (response) is determined by any group of independent variables (predictors). ANOVA test was used with the assumption in mind that the four samples were randomly selected from the population and the populations being sampled have equal variances. Chi-square was used to test for significant associations between independent and dependent categorical variables. Multiple regressions were used to predict factors influencing the cost of operation and its effect on growth of SMES. Results suggest that the taxes charged for the small and medium enterprises differed proportionally except for corporate tax (2010) and advance tax (2009). The results showed significant variations concerning the effect of taxation on the growth of varying small and medium enterprises. It was concluded that growth of SMEs largely depends on the cost of operations (arising from high rates of taxation); nature of SMEs and how these SMEs respond to the adverse effects of such high taxes. The study concluded that when the taxes charged are high, cost of running those businesses are consequently high. The study recommends the use of enhanced tax planning measures (tax avoidance, tax compliance and seeking competent tax advices) to mitigate the harmful effects of taxation and reduce their heavy tax burden.

Keywords: Impact, taxation, cost, business operations, small, medium enterprises, SMEs, Nairobi, Kenya

1. Introduction

Small scale enterprises have so many definitions due to different criteria employed by different people and institutions in defining it. There is no single, uniformly accepted definition of a small firm (Batini et al. 2010). Firms differ in their levels of capitalization, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth, among others) when applied to one sector could lead to all-firm being classified as small, while the same size definition when applied to a different sector could lead to a different result.

Scholars, researchers and international bodies have always attempted to provide a standard definition of SMEs. No such definitions have been accepted universally. However, the following are some definitions of small and medium scale enterprises: the World Bank Document (Report No 71 14) of 1988, Nigeria, defines small and medium enterprises as one whose total fixed assets (excluding land) plus cost of investment do not exceed ten million naira in constant 1985 price. Ayyagari, Demirgüç-Kunt and Maksimovic (2014) see SMEs as firms with less than 50 employees and at least half the output is sold. The Bolton Committee (1971) defines small and medium scale enterprise as a firm that meets the following three criteria: it has a relatively small share of their market place; it is managed by owners in a personalized way, and not through the medium of a formalized management structure, and it is independent, in the sense of not forming part of a large enterprise.

There are various criteria of size that might be used to define an SME (turnover, number of employees, capital base, profits, extent of imports and exports), and various definitions have indeed been developed for application in a range of countries. The Centre for Industrial Research and Development (1990) defines small scale industries as one whose total assets in capital equipment, plant and working capital are less than two hundred and fifty thousand naira and employing fewer than fifty full-time workers. Onwe (2006) reports that the Central Bank of Nigeria defines SME as a firm with capital outlay of not more than N200 m. National Council of Industry (2003) defines small industry as a project with capital investment of over N1.5 million but not more than N50 million and/or work force of between 1 to 100 workers.

The definition of small and medium scale enterprise which has enjoyed wider acceptance is the one given by the United States Committee for Economic Development (2002). It defines small scale enterprise as any enterprise that is characterized by, at least, two of the following features: management is dependent – usually managers are also the owners; capital is supplied and ownership is held by an individual or small group; area is localized; while workers and the owners are of one home or community, market need not be local; and the size of the firm is small relative to the industry.

In fact, the concept 'small scale enterprise' often called small and 'medium-size' enterprise (SME) is relative and dynamic; hence there is no universal definition for small and medium scale enterprises. Researchers, because of this problem of definition, adopt definitions for small and medium-scale enterprises, which are more appropriate to their particular target group. To this end, small scale enterprise within the context of this paper is any business organization which has working capital between one hundred thousand naira and ten million naira excluding land and employs fewer than fifty full-time workers.

Sule (2002) observes that definitions of SMEs vary across countries and business environments as a result of differences in industrial organization at different level of economic development in parts of the same country. Characteristics of SMEs identified by Sule include the following distinguishing factors: tax payers tend to be few, owner of the business is also the manager, transactions are based on cash payments and hardly bank payments, the businesses normally have a dynamic lifespan, and the places of business for SMEs are normally fixed but volatile and react to changes/demands. On accounting standards, SMEs tend to have little accounts or records. They have focus on meeting local customers for their market reach and administratively, SMEs engage few or no professional unlike major companies run by professionals (Boune, 2007).

1.1. Relevance of SMES to the Development of National Economy

Small-scale enterprises are dominating other aspects of enterprises in the world economy and Kenya's in particular. According to According to Shehu *et al.*, (2013) it is estimated that probably up to 90 percent of all registered business organizations in Nigeria are in the category of small and medium scale enterprises. In the case of Ebonyi State, over 96 percent of the business organizations are small-scale businesses. The Kenyan scenario is not different either with hundreds of companies registered daily at the registrar of companies' house; records available at KRA (2010) show that there are over nine hundred SMEs that make tax returns.

The importance and contributions of small-scale enterprises to national economy's growth cannot be overemphasized. They play a crucial role in providing solid base for a country's social economic development. Small scale enterprises produce goods and services for both end and intermediate users and also utilize low capital cost for creating jobs especially in the fast-growing service sector of the economy. Russell Olukayode & Christopher Somoye, (2013) observe that small and medium scale enterprises provide productive employment and earning opportunities. The 2019 Small Business Profiles show that small businesses added 1.8 million net new jobs in the United States during the latest year studied. The United States has 30.7 million small businesses, and they employ 47.3 percent of the private workforce. SSES also play a vital role of introducing innovations. Records show that many scientific breakthroughs have originated with independent inventors and small organizations. Longnecker *et al.* (1997) suggest, on the basis of several studies by the US Department of Commerce, that 50 percent of all innovations since world war have come from new and smaller firms.

Ekhator (2001) has found out that most countries in the world that have attained advanced stage in industrial development started their industrial development with programmes in the small and medium scale enterprises. SMEs foster linkages within industries and between industries and other sectors of the economy (OECD, 2017). SMEs can also contribute to long run industrial growth by producing an increasing number of firms that grow up and out of small-scale sector. They accelerate rural development and promote the utilization of domestic resources by adapting to local markets and local sources of material.

Enudu (1999) avers those small-scale enterprises make use of waste material from big industries for further production. Small business can be an aid to personal and national self-reliance. Ukeje (2003) has noted that small-scale business enterprises contribute 70 percent of industrial employment in Kenyan economy though it accounts for only 10-15 percent of manufacturing output. In fact, there abound many economic-cum-social roles SMEs play in the development of the national economy. To this effect, policies that would facilitate their utilization should be adopted by concerned authorities.

In realization of the advantages of promoting SMEs, the Kenya government is at the forefront in promoting the growth of SMEs in all parts of the country in partnership with development partners, financial institutions and enterprise agencies. In Nigeria, the Federal Government of Nigeria has continued to play pioneering and active roles in stimulating SMEs (Johari, 2012). The government has established many institutions to facilitate the growth of SMEs. These institutions include the National Directorate of Employment (NDE), the Family Economic Advancement Programme (FEAP) among others. The government also provides technical assistance to SSEs through its various agencies such as the Industrial Development Centre (IDCs) centre for Industrial Research and Development (CIR), Project Development Centre (PRODA), Small and Medium Scale Enterprise Development Agency of Nigeria (SMEDAN), Small and Medium Scale Enterprise Investment Equity Scheme (SMEIES) among others specifically, the government has played lead role in.

Lee and Gordon (2005) make the following suggestions in their Background Paper for Tax Dialogue Conference: that for SMEs to fully develop and use their potential, they need specific policy measures to ensure that technology services and infrastructure are provided'. Further, research and development institutions that are publicly funded should be encouraged to target the technology needs of SMEs. Secondly, the problem of access to information may be attributed to the inadequacy of SME support institutions. The need for a supportive policy to encourage the establishment of

documentation centres and information networks to provide information to SMEs at an affordable price (Foluso, 2007). Thirdly, the government should come up with training for training managerial and technical courses for the small enterprise's entrepreneurs. Equally, there should be business information centres (Terkper, 2007). Fourthly, government should come up with proper regulatory policies that are small enterprises friendly since many of what we have in Kenya; frustrate every effort of a junior entrepreneur. The existing policies seem to cater for the well-established businesses. Since majority of small enterprises lack finance, government should establish friendly small loaning system. This would include low interests' rates to ensure the continuity of these businesses (Foluso, 2007).

1.2. Statement of the Problem

Taxation has been identified as a major threat to the growth of small and medium enterprises not only in highly industrialized countries such USA but also less industrialized countries; Kenya in particular (Burke &Jarratt, 2004). For instance, in Kenya, income tax is a direct tax charged on business income, employment income, rent income, pensions, and investment income. Current marginal tax rates mean that small businesses are faced with enormous burdens that are sapping capital resources and time which could otherwise be used for business expansion and growth. Irrespective of whether they pay taxes at the corporate or individual level, small businesses can face up to 35% federal tax rate. Further, small businesses spend three times more per employee on tax compliance than larger businesses do. There are many methods applied in the collection of income tax which include PAYE, withholding tax, instalment tax, advance tax, presumptive income tax and the direct payments to the Commissioner of Domestic Taxes for balance of tax and arrears. According to KRA (2009), PAYE is a method for collecting tax at source from individuals in gainful employment. Indirect taxation which is charged includes VAT (Value added tax), corporation tax, and instalment tax and excise duties. The stunted growth of the SMEs has often been blamed largely on the challenge of taxation (Gaskill*et al.*, 1993).

Taxation in general increases the costs of operation of running small and medium enterprises. To compensate for the increased costs of operation, prices on goods are raised thus causing the amounts of sales to go down. Moreover, the effects of reduced sales are reduced profits, reduced capital base and slow creation of employment resulting to slow growth (Thuronyi, 2009). The question that appears to generate surprisingly little debate in Kenya is the scope for legally mitigating taxes by individuals and SMEs.

Entrepreneurship is about change (Richard, as cited in Baer, 1993) and since entrepreneurs are innovators, they should devise ways and means of coping with the adverse and threatening effects of taxation in order to survive, grow and sustain their businesses. How then can Kenyan individuals and business enterprises arrange their affairs within the current legal environment so as to minimize their tax burden?

1.3. Research Objectives

The specific objectives of the study were to:

- To assess the intervening influence of taxation on the cost of operation and growth of small and medium enterprises
- To assess the intervening influence of taxation on the various categories of small and medium enterprises and their growth
- To assess the intervening influence of taxation on innovative tax security measures and growth of small and medium enterprises

1.4. Effect of Taxation on the Costs of Operation of SMEs

Arinaitwe (2006) says that the desired capital stock depends not only on output, but also on the costs associated with investments. In other words, an economy on a rapid growth path attracts a high rate of investment, while a stagnant or shrinking economy offers no inducement for net investment aimed at the market. From this basic condition one can readily incorporate tax considerations into the analysis. In particular, tax elements heavily influence costs of operation, which is the cost per yearof deploying capital in an investment project. From the point of view of the investor, the effective return on capital is diminished to the extent of tax due on company income.

However, the cost of paying company tax is offset by any benefit which may accrue to the investor from tax incentives such as tax holidays, preferential tax rates, investment credits, or capital allowances in excess of economic depreciation. These benefits arise at different points in time and vary year to year. To handle this complexity, the standard approach is to take the present discounted value of the tax benefits, per unit of the investment outlay. Borgarello*et al.* 2004) argue that investment can be financed by equity or debt.

Hence, the overall cost of funds depends on both the tax rate on debt financing and the risk adjusted real rate of return required by entrepreneurs who provide equity financing. In this framework, investment takes place as long as the gross return on additional investment exceeds the *tax-adjusted* cost of capital. In effect, the hurdle value of investment rises with the company tax rate and the tax on dividends, and falls with the value of the tax incentive package. A higher cost of capital reduces the set of viable investment projects. It also provides an incentive for companies to pursue more labor-intensive projects. Conversely, a lower cost expands the set of viable investment projects, and favors capital-intensive projects. The net impact of tax hence breaks on job creation. The theoretical effect of taxation on investment is mediated by three other considerations.

First, the gestation period for many investments may span several years, particularly for large projects. So, there can be substantial lags before tax policies to stimulate investment have an actual impact (still, policy changes that worsen profitability may provoke an immediate cessation of planned investments). Second, recent models that highlight the effect

of uncertainty show that investors may defer projects even if they are fundamentally viable. Faced with substantial uncertainty about economic stability or the sustainability of pro-investment policies, along with irreversible start-up costs, investors may choose to wait and see how events unfold before committing funds. Implicitly, they demand a higher hurdle rate consisting of the standard value. The result may be a very sluggish investment response. The antidote is to reduce uncertainty by establishing a track record of dependable policy management.

Third, liquidity constraints and imperfections in the financial markets can enhance the effectiveness of tax cuts. The neoclassical model assumes that investors have access to debt and equity financing at a market-determined cost of funds (adjusted for risk). This is a reasonable assumption for SMEs. But for many companies the main source of funds for investment is retained earnings. In this case, tax cuts can foster investment by augmenting the company's net cash flow, providing the means to take advantage of viable investment opportunities that otherwise would be missed for lack of finance.

1.5. Limitations of the Study

First, the empirical study was confined to SMEs in Nairobi County. This could limit the generalization of the findings to the SMEs in the whole of Kenya. Second, in executing the empirical study the questionnaire, was used. Although questionnaires are effective and efficient way of collecting data, it may not be free of respondents' bias. Second, the data were collected from finance managers and finance directors excluding other stakeholders such as accountants, proprietors and tax specialists. Collecting data from such stakeholders could have given a more holistic picture of the effects of taxation on the growth of SMEs. Lastly, some questions bordered on intrusive questions on taxation such as whether they evade tax, under taxation and the frequency of paying tax and tax compliance. The accuracy of such responses from such questions is in doubt.

2. Materials and Methods

This study was conducted in Nairobi County which comprises the administrative region of the capital city of Kenya. Nairobi County is thus synonymous with the city itself. According to the 2009 Population Census, Nairobi is the Kenya's largest urban centre with 3.1 million people (Kilele, 2010). Nairobi was selected as the location of the study first because, as the administrative and commercial capital of Kenya, the largest share (25 percent) of modern sector wage employment is found in Nairobi which is the greatest contributor of national gross domestic product (Economic Survey, 2006, p. 66) and furthermore it is the location where most of SMEs make tax returns to KRA.

The research followed a descriptive design to explore the effects of taxation on the growth small and medium enterprises. The target population comprised all the registered SMEs and which make tax returns to KRA. There are currently 574 SMEs which meet this condition in Nairobi. These differ by type and size. These are: services (airline, hotels, education, health, commercial, general services and clearing and forwarding), wholesalers and retailers, manufacturing and agriculture and financial services (construction, financial services Government, NGOs and real estates), (KRA, 2010). These SMEs are distributed across the administrative units. From these SMEs, all the finance managers and all the finance directors constituted the target population because they are directly in charge of tax management of these SMEs.

In order to ensure that these different categories were adequately represented in the sample, stratified sampling was used. Simple random sampling was used to draw the types of SMEs from each stratum. The author considered a sample size of 107 SMEs. Consequently, the sample size of 107 finance managers and 107 finance directors was satisfactory for the study, given cost and time constraints.

Data collection was conducted using questionnaires and document analysis. After the collection of raw data, coding was done using numeric codes. The coded data was captured through SPSS. Descriptive statistical tools such as frequency distributions tables, percentages, the measure of central tendency (mean and mode) and the measure of variability were also utilized to describe trends and the distribution of data on the effect of taxation on the costs of operation on SMEs.

2.1. Methods of Data Analysis for Each Objectives

2.1.1. The Intervening Influence of Taxation on the Types of Operational Costs on the Growth of Small and Medium Enterprises

After the collection of raw data, coding was done using numeric codes. This coding of data was useful in that it is quick for data entry and important in subsequent data re-entry in case a possible error has been spotted. The coded data was captured through SPSS. Descriptive statistical tools such as frequency distributions tables, percentages, the measure of central tendency (mean and mode) and the measure of variability were utilized. These statistical tools described trends and the distribution of data on the effect of taxation on the costs of operation on SMEs.

2.1.2. The Intervening Influence of Taxation on Innovative Tax Security Measures on the Growth of Small and Medium Enterprises

After the collection of raw data, listing of responses was done. Secondly, the listed responses were condensed and reduced to reduce the number of items coded. Coding was done using numeric codes. The coded data was captured through SPSS. Descriptive statistical tools such as frequency distributions tables, percentages and median were also utilized. The statistical tools used described trends and the distribution of data on business security measures onSMEs.

2.1.3. The Intervening Influence of Taxation on the Various Characteristics of Small and Medium Enterprises and Their Growth

In order to compare taxation effect on the growth of varying small and medium enterprises, a one-way ANOVA was applied. This involved examining the relationship among the different categories of SMEs when subjected to taxation. One-way analysis of variance was preferred because it is capable of comparing the means of three or more groups on a given attribute (Seward, 2007). ANOVA produces F statistics.

In interpreting the results, the researcher focused on the N, Mean, F ratio value and the Sig. level, and ignored the peripheral information such as standard deviation, standard error, and sum of squares between and within groups. The analysis of variance identified variations in the dependent and independent variables. If p value is less than 0.05 the null hypothesis was rejected. This meant that there was a statistically significant difference in the effect on the growth of varying small and medium enterprises as a result of taxation.

The major purpose of hypothesis testing is to choose between two competing hypotheses about the value of a population parameter (Piffer, 2011). Descriptive statistics used to analyze data were used to summarize finding and describe the population sample involved in hypotheses testing and making of inferences (Seward, 2007).

2.2. Statistical Measurement Models

The study applied three statistical measurement models.

2.2.1. Econometric Model of Growth

The multiple regression models assume the form:

Y= β_0 + $\beta_1 X_1$ + $\beta_2 X_2$ + $\beta_3 X_3$ + $\beta_4 X_4$ + ϵ Where;

Y= Growth of SMEs, β_0 = the intercept

 $\beta_1, \beta_2, \beta_3$ and β_4 = partial regression coefficients (shows the change in the expected value of Y for a unit change in X) X_1 = methods of tax coping mechanisms, X_2 = cost of operation, X_3 = data security, X_4 = nature of business

ε = random error

For every value of β (slope), a t-value and significance level for each t-value was determined.

An independent variable was considered a significant predictor of the dependent variable if the absolute t-value of the regression coefficient associated with the dependent variable is greater than the absolute critical t-value. The overall fit of multiple regressions was based on the F-test. The basis of F-test is based on ANOVA test. The common measure of overall fit used in the current study was the coefficient of determination or R^2 , which is based on ANOVA table's sum of squares. The coefficient of determination R^2 is used in the context of statistical models whose main purpose is the prediction of future outcomes on the basis of other related information. The level of significance used was 0.05. The obtained p value was to be smaller or equal to 0.05 in order to claim the relationship to be truly significant.

One-way analysis of variance was preferred because it is capable of comparing the means of three or more groups on a given attribute (Seward, 2007). The four predictors in the model were (a) methods of tax coping mechanisms, (b) cost of operation, (c) data security and (d) nature of business. ANOVA was most preferred in the study because it was used to examine differences among the means of several different groups at once. Since ANOVA is used to test independent variables, the researcher opted to use it.

The researcher's main test of importance here was to find out whether or not the dependent variable (response) is determined by any group of independent variables (predictors). F-test was used with the assumption in mind that the four samples were randomly selected from the population and the populations being sampled have equal variances. One of the assumptions of ANOVA is that the response variable was measured at interval or ratio scales.

2.2.2. Chi-Square Test of Independence

In the current study, Chi-square test of independence was used to test possible association between categorical variables (Orodho, 2005). According to Seward (2007), Chi-Square Test for Independence is appropriate when the sampling method is simple random sampling. The chi-square test procedure tabulates a variable into categories and computes a chi-square statistic (χ^2), degrees of freedom (df) and significant values (p). One of the assumptions of a chi-square is the use of data that is ordered or numeric categorical variables (ordinal or nominal levels). The P-value is the probability of observing a sample statistic as extreme as the test statistic. The rule of the thumb in is that when the p value is equal or less than .05, then the results is significant.

2.2.3. Analysis of Variance (ANOVA)

One-way analysis of variance was used to test the first hypothesis and this test was preferred because it is capable of comparing the means of three or more groups on a given attribute {(a) services, (b) wholesalers and retailers, (c) manufacturers and agriculture and (d) financial services}. ANOVA was most preferred in the first hypothesis because it can be used to examine differences among the means of several different groups at once. Since ANOVA is used to test independent variables, the researcher opted to use it.

Since F- distribution is the ratio of two variances, the ANOVA test statistic generated F test statistic. In interpreting the researcher focused on the N, Mean, F ratio value and the Sig. level, and ignore the peripheral information such as standard deviation, standard error, sum of squares between and within groups. The null hypothesis was rejected if the F test statistic (calculated value) exceeds the critical value. The null hypothesis is also rejected if p value is less than 0.05.

The researcher's main test of importance here was to find out whether or not taxation effects for the four categories of SMEs was equal or there was a difference. ANOVA test was used with the assumption in mind that the four samples were randomly selected from the population and the populations being sampled have equal variances. One of the assumptions of ANOVA is that the response variable was measured at interval or ratio scales. To test of hypotheses two and three ANOVA test was also applied.

3. Results and Discussion

3.1. Amount of Taxes for the Period 2007-2010 in '000'

Data on various types of taxes and their respective amounts were collected for the period ranging from years 2007-2010. Information on the means of various taxes was sourced from financial records of the SMEs and used for comparisons. These data were useful in comparing the same type of tax for different number of years in an attempt to bring out their effects on the cost of operation. Table 1 summarizes the findings.

| Types of Taxes | Mean (Ksh) | Std. Deviation | | |
|----------------------|------------|----------------|--|--|
| VAT tax 2007 | 26514.19 | 29596.26 | | |
| VAT tax 2008 | 37452.94 | 56833.42 | | |
| VAT tax 2009 | 43076.89 | 46966.60 | | |
| VAT tax 2010 | 48372.28 | 51697.08 | | |
| CORPORATE TAX 2007 | 10182.87 | 11624.76 | | |
| CORPORATE TAX 2008 | 13178.33 | 15583.08 | | |
| CORPORATE TAX 2009 | 17678.21 | 22105.92 | | |
| CORPORATE TAX 2010 | 19114.50 | 28156.39 | | |
| Excise duties 2007 | 42517.69 | 41103.10 | | |
| Excise duties 2008 | 45141.64 | 43553.94 | | |
| Excise duties 2009 | 70964.46 | 57791.99 | | |
| Excise duties 2010 | 88499.27 | 62598.97 | | |
| PAYE 2007 | 22254.36 | 16513.42 | | |
| PAYE 2008 | 19755.48 | 15839.48 | | |
| PAYE 2009 | 26904.66 | 21521.17 | | |
| PAYE 2010 | 28814.34 | 22994.40 | | |
| Withholding tax 2007 | 21088.89 | 18704.52 | | |
| Withholding tax 2008 | 42106.77 | 38320.63 | | |
| Withholding tax 2009 | 82500.58 | 58288.43 | | |
| Withholding tax 2010 | 96251.02 | 60947.34 | | |
| Advance tax 2007 | 2004.92 | 1055.41 | | |
| Advance tax 2008 | 3626.52 | 1809.06 | | |
| Advance tax 2009 | 4130.52 | 2171.07 | | |
| Advance tax 2010 | 4614.50 | 3695.60 | | |
| KEBs 2007 | 533.49 | 322.57 | | |
| KEBs 2008 | 708.46 | 579.17 | | |
| KEBs 2009 | 831.88 | 617.14 | | |
| KEBs 2010 | 941.21 | 663.06 | | |

Table 1: Amount of Taxes for the Period 2007-2010 in '000' Ksh

From Table 1, it was found out that the mean for all the taxes for each category increased substantially for the subsequent years except PAYE where a sharp decrease was recorded in the year 2008. This sharp decrease could partly be explained by the adverse effects of post-election violence that was experienced in the year 2008. Businesses that were affected by the violence may have advised their employees to take up temporary unpaid leaves as a measure to reduce costs.

Chi-square test of independence between the various taxes and the types of business indicated significant association at p=0.05 level (χ^2 =49.351, p= 0.001) for all the taxes except for corporate tax 2010 (χ^2 =15.82, p=0.199) and advance tax 2008 (χ^2 =7.201,p=0.206). The results suggest that the taxes charged for the small and medium enterprises differed proportionally except for corporate tax (2010) and advance tax (2009). A significant association was also noted between the forms of businesses and the various taxes at p=0.05 level (χ^2 =737.143, p=0.001). This meant that some forms of businesses were charged higher taxes than others at the time of research (2010). As depicted by the means of total taxes for the years 2007-2010, it is evident that taxes remained high in each successive year. Results indicates that the mean of taxes were highest in 2010 (Ksh157, 583,000). Table 2 shows the results.

| Total Tax Estimates | Mean | Std. Deviation | | |
|---------------------|-----------|----------------|--|--|
| Total tax 2007 | 109294.07 | 73084.20 | | |
| Total tax 2008 | 124685.11 | 96313.06 | | |
| Total tax 2009 | 150060.09 | 115352.32 | | |
| Total tax 2010 | 157583.15 | 121493.28 | | |
| | | | | |

Table 2: Total Tax Estimates for the Years 2007 to 2010 (Values in Ksh '000')

It is anticipated that high taxes raise the costs of operation of any form of business. The high tax recorded over the years especially in the year 2010 raises operating cost for the SMEs. This finding is consistent with the view of Arinaitwe (2006) that, the desired capital stock depends not only on output, but also on the costs associated with investments (taxation).

Chi-square test of independence between the total tax estimates and the forms of business shows a significant relation at p=0.05 level (χ^2 =622.741p= 0.001). The results suggest that some forms of businesses recorded higher tax totals than others. The research collected information from financial managers on whether there were taxes that were charged twice or more for a single product in the various forms of SMEs. Majority of the financial managers (n=67, 77.9%) felt to support the view that some goods and services were taxed more than once on a single product (Table 4.3).

| Responses | Frequency | Percent | | |
|-----------|-----------|---------|--|--|
| Yes | 67 | 77.9 | | |
| No | 19 | 22.1 | | |
| Total | 86 | 100.0 | | |

Table 3: Views of Financial Managers on Whether Taxes Are Charged Twice or More

Among the taxes identified by the respondents as to suffer from double entries were VAT and Corporation tax. VAT, which is an indirect tax, is charged at every stage of the production. Corporation tax is charged on company profits and the rate varies according to the size of the business. However, the data on the actual estimates of the taxes under consideration were scanty.

3.2. Impacts of Taxes on Cost of Operation

When asked to state whether or not taxes had an impact on the costs of operations, 74.4% (n=64) of financial managers indicated yes while 25.6 % (n=22) felt that it did not (Table 4).

| Responses | Impacts of taxes on cost of operation | | | | |
|-----------|---------------------------------------|-------------|-------------------|--------------|--|
| | Raises cost o | f operation | No impact on cost | of operation | |
| | F | % | F | % | |
| Yes | 64 | 74.4 | 12 | 14.0 | |
| No | 22 | 25.6 | 74 | 86.0 | |
| Total | 86 | 100.0 | 86 | 100.0 | |

Table 4: Impacts of Taxes on Cost of Operation

The financial managers who indicated that taxes had an impact on the costs of operation also felt that the higher the taxes, the greater are the costs of operations. The problem is further compounded if the taxes are charged twice or more for the same commodity or service. This concurs with the observation by Borgarello*et al.* (2004) that, in effect, the hurdle value of investment rises with the company taxes rate and the tax on dividends, and falls with the value of the tax incentive package. Chi-square test of independence between the impacts of taxes on cost of operation (taxes raises cost of operation) and the forms of businesses indicated significant results at p=0.05 level (χ^2 =78.496, p=0.001) suggesting that the impacts of taxes on cost of operation for various forms of business differed. It is likely the impact on the costs of operation of one business form may be higher than of the other.

3.3. Impacts of Taxes on the Growth of SMEs

The study explored the impacts of taxes on the growth of SMEs on four parameters. The respondents were asked whether or not taxes reduce profits, leads to laying off workers, reduce production and leads to business closure. Table 5 summarizes the findings.

| Responses | Impacts of Taxes on Growth of SMEs | | | | | | | |
|-----------|------------------------------------|-----------|----------------------------------|-------|----------------------|-------|-----------------------------|-------|
| | Reduce | e Profits | Lead to Laying Off of Workers | | Reduce Production | | Lead to Business Closure | |
| | F | % | F | % | F | % | f | % |
| Yes | 76 | 88.4 | 64 | 74.4 | 61 | 70.9 | 17 | 19.8 |
| No | 10 | 11.6 | 22 | 25.6 | 25 | 29.1 | 69 | 80.2 |
| Total | 86 | 100.0 | 86 | 100.0 | 86 | 100.0 | 86 | 100.0 |

Table 5: The Impacts of Taxes on the Growth of SMEs

Results presented in Table 5 show that majority of finance managers felt that taxes reduce profits (n=76, 88.4%), lead to laying off workers (n=64, 74.4%) and reduce production (n=61, 70.9%). However, taxes have minimal effects on the business closure (n=69, 80.2%). According to Karingi*et al.* (2005), there have been criticisms levelled against KRA resulting to the problem of ambitious and rapidly changing tax/GDP targets that are externally induced as well as the failure to reform local government taxation. One of the mistakes of the Kenyan tax reform as Karingi*et al.* (2005) indicated was poor sequencing, which results in policy reforms that hurts the growth of SMEs.

Chi-square tests of independence between taxes reduce profits and the various forms of business (χ^2 =50.651, p= 0.001), taxes lead to laying off of workers(χ^2 =20.512, p=0.001), taxes reduce production (χ^2 =15.070, p=0.001) and cost of taxation lead to business closure (χ^2 =31.442, p=0.001) showed a significant relation at p=0.05 levels suggesting effects of taxation are more likely to reduce profits and production as well as laying off workers than closing of businesses.

4. Main Findings

Results suggest that the taxes charged for the small and medium enterprises differed proportionally except for corporate tax (2010) and advance tax (2009). The results showed significant variations concerning the effect of taxation on the growth of varying small and medium enterprises. It was concluded that growth of SMEs largely depends on the cost of operations (arising from high rates of taxation); nature of SMEs and how these SMEs respond to the adverse effects of such high taxes. The study concluded that when the taxes charged are high, cost of running those businesses are consequently high. This adversely affects the performance of small and medium enterprises in manufacturing in Kenya.

4.1. Implications for Theory and Practice

4.1.1. Implications for Theory

This study leads to several theoretical implications for research on taxation. It highlights the reasons for considering major types of taxation a factor on performance of SMEs in manufacturing. This requires more differentiated approaches than usually used by previous scholars on this study area. Many studies in this field heavily relied secondary data for their analyses. However, these data sources can only give misleading results. This study heavily used primary data as an alternative source of data. In addition, regarding the theoretical framework of this study, it can be noted that theories applied in this study can be successfully applied to research in the field of taxation.

4.1.2. Implications for Practice

Several practical implications emerge from the results of the study. The study findings revealed that SMEs have been subjected to numerous taxes. In extreme cases SMEs were subjected to multiple taxations thus sharply raising the cost of operation. Consequently, the growth of SMEs as a result is slowed down. In response to this, the study advises SMEs make use of enhanced tax planning measures (tax avoidance, tax compliance and seeking competent tax advices) to mitigate the harmful effects of taxation and reduce their heavy tax burden. In addition, policy makers should review downwards the tax rates for SMEs. Lastly, the government offers are required to offer SMEs low tax incentives to encourage faster growth.

4.2. Originality/Value

This study has made a major contribution to the policy makers and in the field of academia. It's the first study to formulate a statistical model associating multiple taxation with performance of SMEs in the manufacturing sector in Kenya.

4.3. Recommendations of the Study

Based on the findings from this study, a number of recommendations for action were made. The study findings revealed that SMEs have been subjected to numerous taxes. In extreme cases SMEs were subjected to multiple taxations thus sharply raising the cost of operation. Consequently, the growth of SMEs as a result is slowed down. The study recommends the use of enhanced tax planning measures (tax avoidance, tax compliance and seeking competent tax advices) to mitigate the harmful effects of taxation and reduce their heavy tax burden. In addition, current taxation trends reveal an upward rise in tax rates to overcome inflation rates. Incidentally, such rise in taxation rates continues to slow the growth of SMEs. The policy makers should review downwards the tax rates for SMEs.

From time to time the government offers tax incentives to various economic sectors to encourage investment. A recent example was the incentive in 2007/2008 budget to low –income residential projects. However, the SMEs were excluded from such incentives. This study recommends that SMEs should be included for such tax incentives to encourage faster growth noting their overall importance in the Country's economy.

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