Impact of taxation on financial performance of small scale business enterprises in Ugenya Sub-County, Siaya County, Kenya

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Abstract
The serious decline in financial performance of small business in recent years had led to a decrease in profit available for tax obligation to the government. The need for small business enterprises to generate more returns from its internal sources has therefore become a matter of extreme urgency which has been linked with taxation of small business, especially in developing countries. Failure of small business enterprise ha grow high, approximately by 80% of the business closed down before the 5th anniversary as a result of tax related issues, coming from multiple taxations to enormous tax burdens. The study aimed to assess the impact of taxation on financial performance of small business enterprises in Ugenya Sub –county, Siaya County in Kenya. To achieve the study aims, the following specific objective was used; To evaluate the impact of level of taxation awareness and knowledge on financial performance of SSEs in Ugenya sub-county. Descriptive survey design with both qualitative and quantitative technique was used for the study. The target population was 265 SSBs in Ugenya Sub County. The study used stratified sampling techniques. Data was analyzed using descriptive statistics, correlations, and linear regressions analysis. The findings were presented in tables showing frequencies, means, percentages and graphs. The primary data was collected using questionnaire and was analyzed. The study found that business entity is aware of the consequences of failing to pay tax obligations in time. The findings found also that taxpayers take low tax rates in Kenyan tax rates in relations to financial performance. It also indicated that tax is a tool for fiscal policy employed by the government to influence the business negatively or positively depending on the nature of business activities in a country. The study also recommended that Tax awareness/knowledge, should be widened in order to increase financial performance.

Keywords: *Financial Performance; Taxation; Awareness; Knowledge; Small Business, Ugenya Sub County*

1.0 Introduction

The serious decline in financial performance of small enterprises in recent years had led to a decrease in profit available for tax distribution to the government. The need for small enterprises to generate more business returns from its internal sources has therefore become a matter of extreme urgency and importance in taxation. This need for taxation has underscores financial performance on all parts of small enterprise and even in the government to look for new internal sources to get revenue. It has become more aggressive and innovative method of collecting tax revenue from existing enterprises without performance considerations (Dennis 2014).

According to Adams (2010) an American businessman, taxation is a burden in which citizens must bear to sustain their government since the government has certain activities for the benefits of those in it governs. Though taxation may not be most significant source of revenue to the government in terms of enterprise size, however, taxation is important raising government revenue from the point of view of business certainty but not consistency in performance. Despite the inherent power of government to impose taxes, identifying the means of taxations has been used to promote fiscal distributions of income, but not identify the problems that militate against the use of taxations as financial performance in small enterprise. It also challenges some selected government states in the country to identify the use of taxation to improve economic growth and development in business returns.

In recent time, the world economy has developed tremendously and this has been linked with taxation in Small and Medium Scale Enterprises (SMEs), especially in developing countries. Although smaller in size, SMEs are the most important enterprises in the economy due to the fact that when all the individual effects are aggregated, they surpass that of the larger companies. The social and economic advantages of small and medium scale enterprises cannot be overstated. Braithwaite, (2009). viewed SMEs as a source of employment, competition, economic dynamism, and innovation which stimulates the entrepreneurial spirit and the diffusion of skills. Since SMEs enjoy a wider geographical presence than big companies, SMEs also contribute to better income distribution. Small and medium scale enterprises have undoubtedly improved the standard of living of so many people especially those in the rural areas (Aguolu, 2014).

Despite the setting, the cumbersome effects of taxation has not been considered in other problems militating against financial performance in of small and medium enterprises in Kenya such as tax purpose, tax administrations, awareness and tax rates problems. Thus, the study sought to bridge the information gap on the tax-related issues by critically looking into impact of taxation on financial performance of small business in Ugenya sub-county, Siaya County in Kenya.

1.2 Statement of the Problem

Many small firms in Africa choose to remain in the informal sector because the perceived benefits outweigh the perceived costs. Tax is an important source of fund for development of the economy and provision of social services. Biber, (2010) asserted that taxation can contribute to development and to welfare through generating sufficient funds for financing public services, and social transfers at a high level of quality, offering incentive for more employment, and for an efficient, and lasting use of natural resources, and ability to reallocate income.

However, SMEs face problems of negative relationship between taxes and the SMEs' ability to sustain and expand. In addition, SMEs face operational challenges including inadequate capital, poor technical and managerial skills, environmental effects and the government regulations.

1.3 Purpose of the Study

The purpose of the study was to evaluate the impact of taxation on performance of small scale business enterprises in Ugenya Sub-County. Specifically: to evaluate the impact of level of taxation awareness and knowledge on financial performance of SSEs in Ugenya sub-county.

2.0 Literature review

2.1 The concept of Taxation and Financial Performance

Agoulu (2014) sees taxation as the compulsory levy by the government by its agencies on income, salaries, profits, dividend, discounts, interests and royalties. He adds that tax is levied against company's profits, capital gain, transfers while Ojo (2017) argued that taxation is a concept or science of imposing tax on citizens. According to him, tax is itself a compulsory levy imposed and requires to be paid every citizen. The imposition of tax is expected to generate income which shall be used in the provision of social amenities (Dennis 2014).

Adeyemi (2012) observes taxation as a burden in which every person must bear to sustain the government functions. Income tax can be considered as a tool for fiscal policy employed by the government in all business. The main goal of taxation is to develop countries economic development and increase rate of economic growth and thus per capita income leads to high standard of living. Taxation can be progressive tax rate employed to attain equitable distribution of resources. The government can increase tax rates, or decrease capital allowances rates given in lieu of depression to promote or discourage certain business or tax may give tax holidays to certain firms (Ali, 2015). The taxation in terms of income of tax can be employed as an agent of social change if used as creative force in the economic development.

Abertbach (2017) posited that there is an urgent need for the government to state clearly the basic objective of imposing tax system and the relationship between tax objectives. The can help to provide tax administrator a sense of making directions at when taxpayers can see clear reason for paying tax when is due. The tax collection approaches applied by tax authorities must be corruption free in embezzlement. These must be ensured for the government to be able to collect revenue or reach many taxpayers for the desired target. Taxation can be administered to have been utilized to encourage taxpayers to pay taxes through convenience assessment.

The concept of financial performance has been explained differently by different scholars. Micheni (2013) describes financial performance as the subjective measure of how well a firm can use its asset to generate revenue. He also adds that financial performance is a general measure of the firms's financial health over a given period. It is also used to compare related firms across the industry or compare the same industries across sectors.

The Adams (2010) identified three commonly employed measure of financial performance by Jensen measure. Jensen measure is the ratio of business portfolio' returns less expected return as determined by capital asset pricing model. According to Wanjiku (2014) financial performance is the single most important determinant in evaluating the growth potential, earning capacity and financial strength. The study has used financial performance in taxation of small and medium enterprise, since it serves as a measure of financial management to meet objective of the enterprise. It is also serves a mechanism for motivation and resource control in the organization. Different scholars have measured financial performance differently.

Muiru, (2012) posits that a business is set up to thrive on profits since profit is the only motivator for an entrepreneur. This points out that a business with no profits is not worth running. There is the desire and pursuit of higher revenue of any given business operation. Businesses operate with the primary mission to increase value of their capital and thus make profits (Goesel, 2010). This study sets to ascertain how taxation of small scale business enterprises impact on their financial performance in terms of profitability, liquidity, activity ratios and debt ratios.

2.2 The Tax Morale Theory

The tax morale theory was first advanced by German scholars centered around Gunter Schmolders known as Cologne school of tax psychology. Tax morale can be termed as the individual factor that motivates a person to comply with his or her tax obligations. As a determinant of tax behavior, tax morals aim to explain how and why a tax payer's morality influences his or her tax behavior. Many studies have found out that tax evasion can be attributed to the tax morale (Martinez-Vazquez, Goodspeed, 2011).

On the one hand, tax payers would be inclined to evade tax when the communities in which they live or operate disapprove of tax evasion and on the other hand, tax payers are more likely to comply with tax obligation if their friends, relatives and acquaintances comply with these obligations. Similarly, tax payers are likely to evade taxes if they feel that other people are getting away with tax evasion. In other words, if a society tolerates tax evasion, such a society would encourage tax evasion (Naibei, (2012).

Small scale businesses form the basis of entrepreneurship in any given economy. In fact, most large companies businesses have their roots in small and medium enterprises; an indication that the future large corporations are the SMEs of today and that they must be nurtured to ensure their growth. SMEs are generally perceived to be the seedbed for indigenous entrepreneurship and generate all the many small investments, which would otherwise not have taken place (Ary Okon, Eda (2017). Therefore, developing economies like Kenya needs to further the development of its private sector by creating an environment favorable to the growth of SMEs, strengthening the factors that lead to business success, and addressing the problems threatening the existence and advancement of small and medium enterprises, so they can adequately play the role expected of them in economic transformation.

2.3 Level of Tax Awareness/Knowledge

A number of studies have been conducted on the effect of awareness of taxation matters between taxpayers and how it affects business performance. While most of these studies were conducted in the developed countries, there is no broad conformity on whether the awareness of tax is significantly or insignificantly affects business performance. Aoki (2014) studied the relationship between tax awareness and business performance in Kisii County. The aim of the study was to examine the effect of awareness of taxpayers on business performance in the county. The findings from the study show that awareness of taxpayers of taxpayers' due to tax compliance is not significantly related to business performance. Further, budget of business performance tax collection efficiency, must be discussed with the help of compliance, poverty influences tax compliance in taxation.

With high rates of taxation, commercial banks like any other investors have saved more money to earn and vice versa due to high rate of borrowing. Commercial banks in its bonds have been increasing steadily. Armendariz (2015) studied the effect of taxpayer's awareness on tax compliance of banks in Philippines. The study aim was to establish the relationship between tax compliance and taxpayer's awareness in Development banks. The study used 76 firms in Massachusetts Asian in Manila. The study used a cross section survey study by correlations analysis. Data was collected by primary data. The study showed that there exist a relationship between tax compliance and taxpayer's awareness. The level of Tax Awareness/Knowledge, depends on the access to information, knowledge of taxation system and understanding of taxes

However, Aguolu, (2014) studied the influence of tax awareness on financial cycles. The objective of the study was to integrate tax compliance as determinant of taxpayer's awareness in India. The noted that there are no correlations of tax compliance cross movement of capital across company entrepreneurs. The study awareness of tax in the economy affects domestic savings in financial market. The study findings show that there are no statistical significant intervals between compliance and financial performance. According to market conditions of demand and supply are influenced by credit. Taxpayer's awareness enable the economy to withstand tax control due to inflexible policy, tax instability has no relationship between revenue collection and taxpayer's awareness of firms.

Baurer, (2005) examined the relationship between electronic tax register and taxpayer's awareness. The study aim was to examine the effect of tax valuation on taxpayer's awareness in East Asian countries. The objective of the study was to examine the influence of electronic tax register and taxpayer's awareness. The study used secondary data. The study used regression analysis and correlation analysis of asset tax prices and financial savings. The study found out that there was no physical tax relationship between electronic tax register on compliance. They also established that there was no optimistic growth of tax compliance all over the economy but heavily on compliance in resources deductions, inadequate corporate governance, and dependence on intermediation by under-regulated rates to rapid economic growth.. The main implication of compliance is to ensure revenue is collected with reducing cost.

2.1 Conceptual Framework

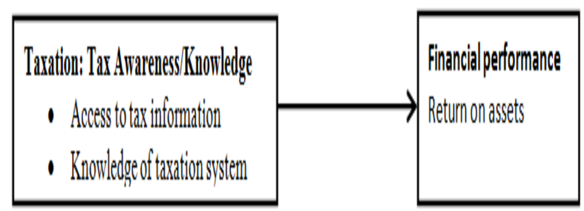

Figure 2.1: Conceptual framework

As conceptualized in Figure 2.1, taxation was the independent variable whose aspects of level of tax awareness or knowledge, impacted on financial performance of SSEs (the dependent variable) as evidenced in the level of return on asset of SSEs.

3.0 Methodology

The study utilized a descriptive survey design of all the SSBs in Ugenya, Siaya County. A survey focused on a set of firms thus the SSBs in Ugenya as per this study. The population of the study consisted of 265 SSBs within Ugenya. Purposive sampling was used to select the respondents to the questionnaires. Primary data was collected using questionnaires distributed to those targeted in the study. The data collected was analyzed using descriptive statistics, correlations, and linear regression analyses. Descriptive statistics were used to meaningfully describe measurement using statistics, the output were presented in form of tables and figures.

4.0 Findings

The researcher distributed 56 questionnaires to the respondents out of which only 35 questionnaires were filled and returned for data analysis. This indicated 63% response rate, which was justifiable for data analysis. The response rate was acceptable according to Kothari (2014) which states that a response rate of above 50% was good and concurred with Mugenda (2003) that response rate of above 60% percent as very adequate for analysis and presentations of the findings.

4.1 Tax awareness on financial performance

The study sought to examine the effect of tax awareness on financial performance. Table 4.1 presents the descriptive statistics in terms of the number of observations, mean and standard deviation. The study shows that as a business entity are you aware of the consequences of failing to meet your tax obligations in time had a mean of 3.5429 and standard deviation 1.17180, does lack of tax information affect your business' tax compliance had a mean of 3.2571 and standard deviation 1.42133, Is Information about taxes in Kenya readily available had a mean of 3.2000 and standard deviations of 1.27879, As a business entity, are you able to correctly calculate the tax amount payable based on available the information had a mean of 3.000 and standard deviation of 1.39326 and As a business entity, are you aware of your tax obligation had a mean of 2.800 with a standard deviation of 1.3016 as presented in table 1.

Table 4.1: Tax awareness on financial performance

	N	Mean	td. Deviation
Is Information about taxes in Kenya readily available	35	3.2000	1.27879
As a business entity, are you aware of your tax obligation	35	2.800	1.3016
does lack of tax information affect your business' tax compliance	35	3.2571	1.42133
As a business entity, are you able to correctly calculate the tax amount payable based on available the information	35	3.0000	1.39326
As a business entity, are you aware of the consequences of failing to meet your tax obligations in time	35	3.5429	1.17180
Valid N (list wise)	35		

Source: Field data (2018)

From the results it implied that the business entity is aware of the consequences in failing to meet tax obligations in their financial performance. However, awareness of tax obligation is not well known implying that there is need to make awareness.

4.2 Financial performance

The study sought to establish the impact of taxation on financial performance. Financial performance was measured in terms of return on investment, return on equity, and return on assets and market share aspects from empirical aspects. The results indicated that the ratio of business returns less expected return on tax is worth with a mean and standard of 4.0857 and 0.56211, maximize profits, sales, capture a particular market share, improve survival chances of the firm, and maximize wealth in a mean 3.4857 and standard of 1.09468. However, taxation impacts should be reflected on the business return on investment, return on equity, and level of liquidity.

The study sought to establish the relationship between taxation and financial performance. Table 4.14 Presents correlation analysis. The study showed that tax awareness is either negatively or positively correlated to financial performance. From the finding study found that has tax awareness has a positive correlation of 1; this implies that there was a strong statistical correlations from tax awareness on variations in financial performance. This implies that there is a significant relationship between taxation and financial performance. This can be supported by the study of Richard Bird (2014) who examined the impact of administrative dimension of tax reforms in Asian pacific tax bulletin.

5.0 Summary of the study findings

The first objective was sought to examine the impact of tax awareness on financial performance. The used descriptive statistics in terms of the number of observations made and analyzed by mean and standard deviation. The study shows that business entity is aware of the consequences of failing to pay tax obligations in time which indicated a high mean of 3.5429 with standard deviation 1.17180. This was followed by lack of tax information which affected business' from tax compliance which the second highest a mean of 3.2571 with standard deviation 1.42133. This study also adds that taxpayers have Information about taxes in Kenya since they are readily available with third highest mean of 3.2000 and standard deviations of 1.27879. Finally but not limited to a business entity able to correctly calculate the amount of tax payable based on the available information with a mean of 3.000 and standard deviation of 1.39326. The business entity aware of your tax obligation however, they should be able to correctly calculate the amount of tax payable based on the available information.

5.1 Conclusion of the Study Findings

Based on the first objective examined the impact of tax awareness on financial performance. The study concluded that business entity is aware of the consequences of failing to pay tax obligations in time, lack of tax information leads to non compliance to tax. Finally, the business entity is able to correctly calculate the amount of tax payable based on the available information. The taxpayers from business entity are aware of tax obligation or tax payable based on the available information.

5.2 Recommendation of the study

The first objective was sought to examine the impact of tax awareness on financial performance. From the finding it is indicated that lack of tax information affects businesses from tax compliance. This study recommended that taxpayers should have Information about to establish tax compliance not only awareness. Finally, the study also recommended business entity should have knowledge on how to calculate the amount of tax payable based on the available information. The business entity aware of your tax obligation, however, they should be able to correctly calculate the amount of tax payable based on the available information.

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