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## Effects of Government Taxation Policy on Operational Cost Level of SMEs in Uasin Gishu County, Kenya

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### **Abstract:**

*The objective of the study was to assess the effects of the government taxation on the operational cost level of SME of Uasin Gishu County. The study was interested in this research because every business, no matter what its size, has operational costs and the taxes paid by a business are considered as one of these operational costs. The researcher employed explanatory research design. The target population of this study comprised of 1785 SMEs operators mainly drawn from services (685) and manufacturing (1100) and 2 officials from the Ministry of trade and Uasin Gishu County. The researcher made use of stratified random and simple random sampling. Primary data were obtained using questionnaires, personal interviews and document analysis. Secondary sources include: internet, textbooks, government publications, journals, libraries, archives and government offices. The study conducted both quantitative and qualitative data. The study used the triangulation method of data collection. SPSS version 18 software and Microsoft Excel were used for all the data analysis and interpretation. The data were analyzed statistically using correlation analysis, descriptive and percentage analysis methods. The Kaiser-Meyer- Olkin was used to measure sampling adequacy while Bartlettstest test the suitability of the data for exploratory factor analysis. Correlation analysis was used to test hypotheses and showed the relationship between taxation policies with the levels of the relationship between the predictor variables of taxation policy, operational cost level. The strength of the linear relationship among variables was assessed using Pearson product moment correlation. The Durban-Watson statistic was used to examine if the prediction of dependence errors were correlated. Descriptive analysis, as an alternative to a test of hypothesis through logistic regression model was used to provide evidence of the impacts of selected variables on profitability and the growth of SMEs. Multiple regression as a statistical technique was used to examine the way a number of independent variables relate to one dependent variable. The Multiple Regressions Analysis was used to determine the relationship between independent and dependent variables. The coefficient of multiple correlations is symbolized by the correlation R which indicates the strength of the correlation between the combination of the predictor variables and criterion variables. The analytical model was developed and justified in the literature review, was used to provide the structure for the empirical analysis. Statistical method of the Shapiro- Wilk test was used to examine the normality distribution of the independent and dependent variables using SPSS. The findings of the study established that, government taxation policy variables, the R2 of operational costs increased to 0.183 indicating that the dimension of government taxation policy contributed an additional 17.3% of the variance in operational costs. The study concluded that, the government taxation policy had a significant impact on profitability and growth of SMEs through positive and negative effects on profit and growth dimension of operational costs.*

**Keywords:** Government taxation policy, operational cost level, SME

## 1. Introduction

### 1.1. Background Information

Taxation policy towards SME is an important issue because SME are a significant segment of the economy, despite being individually smaller in size than larger firms. When considered cumulatively, SME exceed the cumulative statistics of larger firms in terms of turnover, customer base, geographical market access and gross profit. SME are also a major source of employment, especially in areas that are underserved by state or commercial networks. SME also make notable contributions towards competitiveness, economic dynamism, and innovation through stimulating entrepreneurship and the diffusion of skills. SME also improve income distribution due to their geographical distribution patterns. SME play a commendable role in capital formation at local levels. In addition, they improve the standard of living of a majority of the population. Therefore, revenue authorities have to take all of the above features into account when establishing the components of taxation policy that are associated with SME.

Despite the vibrancy of SME, they have a major negative characteristic: they often have an extremely short life span. Some of the factors that lead to the winding down of SME soon after their inception are tax related, including multiple taxation and enormous tax burdens. Due to the lack of an officially recognized definition of SME, government policies ignore their unique characteristics, and thus they are usually viewed and treated in the same light as large corporations. Therefore, in making tax policy for SME, their unique qualities need to be taken into account. In levying taxes on SME, tax policies should be designed to bolster SME growth. Operational cost is one aspect of SME that is crucial to their profitability and growth. Therefore, any proposed taxation policy should consider its effects on the operational costs of SME.

### *1.2. Statement of the Problem*

The roles of both SME and taxation in any economy cannot be gainsaid. SME form the bulk of the economy, and so they require policies that will ensure their continued profitability, which will have positive effects on the rest of the economy. Taxation is the lifeblood of government, as it provides the revenues which go towards ensuring that government is able to fulfill its role of maintaining law and order and facilitating trade and industry, among other duties. SME and taxation are not mutually exclusive by any means. Yet it has been noted, in previous studies (such as Tomlin, 2008) that SME sacrifice funds to pay taxes, which could otherwise be invested in business growth. On the other hand, if all businesses applied similar reasoning, it would be impossible for businesses to grow at all, as the state would collapse through lack of revenue, and it would be unable to provide the business environment that firms need in order to thrive. This dilemma is at the crux of the issue under investigation in this study, which is: how can government taxation policy be designed to ensure that revenue is collected from SME without taxing them so heavily that they are unable to grow? Due to the lack of a separate tax regime for SME, their operational costs are inflated by high compliance costs. Many smaller SME do not keep proper records, they do not maintain up to date licensing documentation, and they cannot afford qualified accountancy services.

### *1.3. Objective of the Study*

To assess the effects of government taxation policy on the operational cost level of SME

## **2. Literature Review**

### *2.1. Effects of Tax Policy on Operational Cost Level of SME*

Every business, no matter what its size, has operational costs (also referred to as running costs). The taxes paid by a business are considered as one of these operational costs. However, an unfavourable tax policy may introduce a wedge between the gross and net income of a firm, which can have a negative incentive effect on SME creation, output, and labour intensity. Alternatively, a SME may decide to minimize operational costs by evading tax, in which event its growth and performance may be unaffected, while the tax authorities lose revenue. However, it is not quite accurate to suggest that SME always minimize their operational costs by evading tax. As many SME are in the informal “shadow” economy, they are particularly vulnerable to corruption. It is possible for corrupt individuals within the tax and regulatory authorities to capitalize on the informality of such firms by threatening to report them or have them shut down. The firms usually respond to such threats by bribing officials not to do so. Therefore, these bribes are considered as an “operational cost” by SME, even though they are never remitted to the relevant authorities. Therefore, from an operational cost perspective, tax policy can succeed in getting such SME into the tax bracket by convincing them that it is cheaper in the long term to pay tax, as there is no fixed rate for bribery, and furthermore, taxes are justified by service provision, while bribes are not.

Indeed, taxation is not the only operational cost that affects SME. Investors (both local and foreign) have noted that although Kenya is a favourable investment destination, there is an urgent need to improve the business environment for existing and potential investors. The key aspect of the business environment identified by these investors was the cost of doing business (Republic of Kenya, 2006). Some of the main constraints faced by businesses, including SME, in both formal and informal sectors include corruption (explained above), poor infrastructure, high and numerous taxes and tax administration, crime and insecurity and access to finance (Republic of Kenya, 2006). It follows that if taxes levied are high (as is the case in Kenya), then the level of service provision should be of an equally high standard. Unfortunately, as attested by the businesses above, this is not the case. Poor service provision is particularly acute for SME, as they may not have the resources which larger firms have, in terms of providing their own security and infrastructure (such as providing generators during power outages). Therefore, in order to justify the operational cost burden that many SME enjoy in terms of tax, the current study advocates either an increase in the quality of service provision, or alternatively a review of the tax policy relating to SME, to reduce their operational cost burden and to make it commensurate with the services they receive.

Furthermore, the level of taxation that SME currently experience is an administrative cost barrier, which will discourage SME from formalizing themselves and registering as taxpayers. It is also possible that SME development is being hampered by lack of transparency, clarity and consistency in administrative procedures, which creates space for discretion and further encourages corruption. A case in point is the lack of a formal, legal definition of SME in Kenya, which implies the absence of a specific taxation policy for this segment of the economy. This has to be addressed if SME are to play a significant role in the diversification and growth of the economy (Republic of Kenya, 2006).

There are authors who consider the informal sector, including SME, as a group of enterprises that take the voluntary option to operate within the informal economy as a rational choice (Orlando, 2001). As rational business people, SME evaluate the costs and benefits of formalizing in view of their institutional and resource configuration (Loayza, 1997). The costs of formality consist of taxes, registry

and licence payments, waiting time, higher labour costs and urban planning regulations, property rights, environmental protection regulations, consumer protection and quality control, workers' welfare, and so on. As all of these factors impinge in one way or another on a firm's operational costs, and because they are all consequences of a business joining the formal sector, according to the view of SME as rational, they will probably prefer to remain within the informal economy, where they can minimize their operational costs by not paying taxes and administrative fees. Because of the radical measures that many SME will take to evade and avoid tax, revenue authorities should be similarly innovative in seeking means to encourage, and if need be, compel SME to pay tax. There are simple and cost-effective techniques that can be used to record domestic transactions and sources of income that frequently escape taxation, such as lump-sum levies on small-scale business activities (standard assessments); the assessment of taxes through indicators or proxies that help estimate a taxpayer's income (estimated assessments); and the collection of minimum taxes irrespective of a taxpayer's actual level of business activity (presumptive minimum taxes) (Waweru, 2007). While the first two methods suggested may be difficult to implement, the third measure may work with SME, who are used to paying annual and monthly fixed costs, and who may view a lump sum tax as just another business expense. A further benefit of this approach is that it eliminates the need for a lengthy filing process, saving time and labour for SME and the revenue authority alike.

Due to the lack of a separate tax regime for SME, their operational costs are inflated by high compliance costs. Many smaller SME do not keep proper records, they do not maintain up to date licensing documentation, and they cannot afford qualified accountancy services. Therefore, they face difficulties in complying with the administrative requirements of the standard tax regime. Furthermore, as cited above, SME also has to contend with added costs from the risk of severe penalties for tax evasion, or illicit payments to tax officers (bribes) if businesses fail to keep proper accounts (King and Fullerton, 1984). This call for a tax rate that takes into account the peculiar characteristics of SME, as placing them in a similar tax bracket to larger firms is detrimental to their performance and growth.

### 3. Methodology

#### 3.1. Research Design

While carrying out the study, the researcher employed explanatory research design. Explanatory study is referred to as studies that establish a causal relationship between variables. Explanatory research most often preceded by explanatory and descriptive research and the emphasis is basically on studying a situation or a problem in order to explain the relationships between the variables. (Saunders, Lewis, Thornhill, 2007). Explanatory or a causal study is aimed at ascertaining the causal relationship between variables, i.e. the relationship between government tax policy, growth and the profitability of SMEs. Since the study involves collecting the opinions of the respondents concerning a particular issue, given the above stated attributes, explanatory research design was adopted in this study in order to establish relationship between government tax policy, growth and the profitability of SMEs between 2009 and 2011.

#### 3.2. Target Population

A population consists of all elements-individuals, items, or object-whose characteristics are being studied. The population that is being studied is also called the target population. The population refers to the group of people or study subjects who are similar in one or more ways and which forms the subject of the study in a particular survey (Kerlinger, 2003). The target population in this research covers all SME in Uasin Gishu County. Of all Kenya biggest cities in terms of numbers of SMEs, labour force, industrial outputs, trading and service volumes (Central Bureau of Statistics, 2010). In general, SMEs in the County may be viewed as representative of SMEs in the country. Therefore, the target population of this study comprises of 1785 SMEs operators mainly drawn from services (685) and manufacturing (1100) and 2 officials from the Ministry of trade and Uasin Gishu County. This is shown in the table 1 below.

Strata	Target population
SMEs (manufacturing)	1100
SMEs (services)	685
Officials from the Ministry of trade and Uasin Gishu County	2
TOTAL	1787

Table 1: Target population  
Source: Uasin Gishu County in 2012

#### 3.3. Sampling Size and Techniques

Sampling is a procedure of selecting a part of the population on which research can be conducted, which ensures that conclusions from the study can be generalized to the entire population. The sampling criteria for this study includes the following: the SMEs is either a service or production enterprise; the operations should involve the employment of a minimum of 20 workers; the SMEs operations must be using power and equipment in its operation and the company must be located in Uasin Gishu County and the SMEs must be using locally sourced raw materials as its major input. The sample size was determined using tables for determining sample size from a given population by Krejcie and Morgan (1970). The researcher made use of stratified random and simple random sampling. Stratified random sampling is the process of selecting a sample in such a way that identified subgroups in the population are

represented in the sample in the same proportion as they exist in the population (Frankel, et al, 2000), while a simple random sample is one in which each and every member of the population has an equal and independent chance of being selected as a respondent (Frankel, et al, 2000). From the 1885 SMEs, a sample size of 188 respondents was chosen from each of the strata whereby the target population was divided into strata, and samples of 10% of each stratum were selected. This ensured that all the strata within the study area were included in the study and thus taking into consideration the socioeconomic dynamics of the area by spreading the sample in the whole Uasin Gishu County. Therefore, in order to arrive at a statistically valid conclusion, the researcher administered at least 180 questionnaires.

Strata	Target population	Ratio %	Sample Size
SMEs (manufacturing)	1100	10 /100	110
SMEs (services)	685	10 /100	68
Officials from ministry of trade and Uasin Gishu County	2		2
TOTAL	1787		180

Table 2: Sample size of respondents  
Source: Uasin Gishu County in 2012

### 3.4. Data Collection Instrument

The study data for the study were generated from both primary and secondary sources. Primary data were obtained using questionnaires, personal interviews and document analysis. Secondary sources include: internet, textbooks, government publications, journals, libraries, archives and government offices among others. The study is both quantitative (Questionnaire and qualitative (interview schedule and document analysis) data. The study used the triangulation method of data collection, which usually involves the use of two or more research instruments to collect the necessary data. This is because no single method of data collection is perfect in itself (Okuni and Tembe, 1997).

### 3.5. Data Collection Methods

Data collection was conducted using questionnaires, personal interviews and document analysis as the main data collection tool. The questions were subdivided into sections to capture the response and details that were required. The researcher collected data from the selected respondents after receiving permission from the Washington International University authority and government of Kenya to carry out research in the identified area of study. The researcher before collecting data from the participant informed the Director of each SME in advance and sought for an appointment to enable data collection. After familiarization, data was then collected from the respondents using the three mentioned instruments. The service of research assistant was sought to assist in the collection of the questionnaires from the respondents, while the researcher personally distributed the questionnaire. The completed instruments were verified and collected from the respondents within a period of fifteen days from the day of distribution.

### 3.6. Validity and Reliability of the Instruments

In different areas of social science research, the accurate measurement of variables poses a challenge. In social sciences, undependable measurements of people's beliefs evidently hinder efforts to predict their behaviour. The issue of accurate measurement also comes up in applied research, whenever variables are difficult to examine. Based on this background, reliability of research instruments were used to construct reliable measurement scales, to improve existing scales, and to appraise the reliability of scales already in use. In particular, reliability aided in the design and assessment of sum scales, that is, scales that are made up of multiple individual measurements. The assessment of scale reliability was based on the correlations between the measurements that make up the scale, relative to the variety of the items. In this context the definition of reliability is straightforward: a measurement is reliable if it reflects mostly true score, relative to the error. In this study, the items were considered reliable when they yielded a reliability coefficient of 0.50 and above. This figure is usually considered respectable and desirable for consistency levels (Koul, 2002). However, the Cronbach's coefficient the research instruments are not reliable and the researcher should make necessary corrections before using the instruments to collect data. In addition, the reliability was established through the pilot-test whereby some items were either added or dropped to enable modification of the instrument. The interview schedules were pilot tested by using two directors of the SME within Uasin Gishu County. This was intended to establish the construct validity of the schedules.

Validity refers to the level at which a test measures what the instruments actually wish to measure. The question on how government taxation policy affecting the profitability and growth of small and medium enterprises in Uasin Gishu County,

Kenya was validated by adopting Yin's (2003) solution for validity. This included the use of multiple sources of information, to establish a chain of evidence, and to have key informants review the report. Also, multiple sources of information were used in the form of three kinds of sources: literature review on previous empirical research, primary data in the form of interviews with SME within Uasin Gishu County, Kenya and researcher direct observation. In order to perform this technique several respondents were asked to comment on some of the conclusions.

### 3.7. Data Analysis

The data collected for the purpose of the study were adopted and coded for completeness and accuracy. SPSS version 18 software and Microsoft Excel were used for all the data analysis and interpretation. The data were analyzed statistically using correlation analysis, descriptive and percentage analysis methods. The analysis was undertaken to establish the degree of relationships between some pertinent factors and issues as well as to show the relative size or significance of each factor relative to the others. Specifically, correlation analysis was used to test hypothesis and showed the relationship between operational cost levels. However, descriptive analysis, as an alternative to a test of hypothesis through logistic regression model was used to provide evidence of the impacts of selected variables on profitability and the growth of SMEs. Multiple regression as a statistical technique was used to examine the way a number of independent variables relate to one dependent variable. The Multiple Regressions Analysis was used to determine the relationship between independent and dependent variables.

The coefficient of multiple correlations is symbolized by the correlation R which indicates the strength of the correlation between the combination of the predictor variables and criteria variables. The analytical model for this research was developed and justified in the literature review and used to provide the structure to the empirical analysis. This analytical schema represented the model of the relationship between government tax policy, profitability and the growth of SMEs. The model demonstrated how SME profitability and the growth are expected to be influenced by government taxation policy. The following regression model was expressed in mathematical notation as follows:

$$GTP = \alpha + \beta_1 OCL + \beta_2 SR + \beta_3 ROC + \beta_4 LCA + e$$

Where GTP = Government taxation policy OCL= Operational cost level of SME SR= Sales revenue of SME

ROC= Returns of capital of SME

LCA= Levels of asset accumulation by SME

e=error term

$\alpha$  = alpha  $\beta$ = Beta.

The required assumptions of this multiple regression model are that (1) the error variable ( $\epsilon$ ) is normally distributed, zero, (3) (2) the variance of the error variable is a fixed but unknown value, (4) the values of the error variable are independent of one another, and (5) relationship between profitability and the growth of SMEs and variables of government taxation policy is linear.

## 4. Findings and Discussions

### 4.1. Operational Costs

A total of five items were proposed to measure the taxation effect on the operational cost level of SMEs. The principal component extracted only 1 factor which explained 72.82% of the total variable in operational costs. As shown in Table 4.4 all the item loadings were above 0.8. The Kaiser-Meyer- Olkin (0.808) value and the significance ( $p < 0.001$ ) of the Barlett's test of sphericity implied that data were adequate for factor analysis. The condensed scale had 4 items measuring the effect of taxation on operational costs of SMEs. The Cronbach's reliability coefficient of the four extracted items was 0.909 indicating that the condensed scale was reliable in measuring the effects of taxation on operational costs.

Constructs and scales	Loading	Eigen values	Cum. Variance Explained
Effect of Taxation on Operational Costs	.909*	3.641	72.823
Factor 1			
The policy on costing of raw materials and other prime costs do not at times consider the taxation aspect	.930		
Taxation policy leads to the increased operational costs of SMEs	.936		
Taxation policy does not take into account the cost of debts, hence increased operational costs for SMEs	.825		
The taxation policy does not take into account capital structure of SMEs hence, assuming the related costs	.872		
Kaiser-Meyer-Olkin MSA:	.808		
Bartlett's test of Sp	.000		

Table 3: Exploratory Factor Analysis Results for effect of Taxation Policy on Operational Cost

\* Reliability coefficient (Cronbach's Alpha)

### 4.1.2. Normality of the Study Variables

Statistical methods were used to examine the normality distribution of the independent and dependent variables using SPSS. The statistical method used was the Shapiro- Wilk test. It was used because of its versatility for small samples as well as samples sizes as

large as 2000. Consequently, the test was used to identify variables that significantly deviate from a normal distribution. As suggested by Hair et al (2006), Significant values of the Shapiro –Wilk test greater than 0.05 indicated that the data was normally distributed. As shown in Table 4, all the variables were normally distributed since the significant values were all above 0.05.

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Operational Cost Level	.141	165	.062	.888	165	.065

Table 4: Tests of Normality  
a. Lilliefors Significance Correction

#### 4.2. Descriptive Statistics of the Study Variables

Means and standard deviation of the independent variable was obtained. The purpose was to gauge respondents' compliance with government taxation policy as well as to obtain a general picture of the prevailing status of SMEs in terms of operational costs.

##### 4.2.1. Compliance with Income Tax Policy

Respondents appeared to be complying with income taxation policy basing on their mean response to most items as well as the smaller values in variations. In particular, respondents tended to agree that SMEs have information on how much tax, where to pay and mode of payment (M=4.29, SD=0.527); that tax payable is economical to SMEs. They however tended to disagree that SMEs pay tax when it is convenient for them to pay (M=1.81, SD=0.975).

##### 4.2.2. Compliance with Presumptive Tax Policy

On presumptive tax, respondents were particularly keen to comply with its policy. This is because as presented in Table 5, most respondents found the mode of taxation under presumptive taxation quite favourable to them.

In particular, respondents strongly agreed that non requirement of returns filing under presumptive tax was an incentive to them (M=4.59, SD=0.560); they agreed that elaborate business records are not necessary (M=4.10, SD=0.886); that payments of levies is straight forward hence the business does not hire professional consultancy services. Hence allows for momentary closures of business (M= 4.10, SD= 0.947). The means and standard deviations of the independent variables of SMEs compliance with government taxation policy in terms of operational costs was presented in Table 5 below.

	Mean	Std. Deviation
<b>Income Tax Policy</b>		
SMEs have information on how much tax, when to pay tax, where to pay and mode of tax payment	4.29	.527
SMEs pay tax when it is convenient for them to pay	1.81	.975
The tax payable is economical to SMEs	4.33	.942
The government either increases or decreases tax rate at its own discretion	4.44	.623
There are diverse taxes imposed on SMEs	4.01	.725
<b>VAT Policy</b>		
The business usually charges, VAT on all goods and services to the purchaser	4.23	.920
We normally charge VAT whenever we issue a certificate in respect of services	4.33	.733
VAT is usually levied on part or full payment of our supplies	4.14	.790
The business has a VAT compliance certificate	3.72	1.083
The business has never been penalized for failure to submit VAT returns	4.03	.930
The business has complied with VAT requirements by installing an ETR machine	4.08	.798
The business maintains up-to-date business records at all times	4.30	.891
<b>Presumptive Tax Policy</b>		
Non requirement of returns filing is an incentive	4.59	.560
Elaborate business records are not necessary	4.10	.886
Payment of levies is straight forward, hence the business does not hire professional consultancy services	4.21	.677
Levies are only charged when the business is operating. Hence allows for momentary closures of business	4.10	.947

Table 5: Perceived Compliance with Government Taxation Policy

##### 4.2.3. Perceived Effect of Taxation on Profitability and Growth of SMEs

Profitability and Growth of SMEs was measured using operational costs.

#### 4.2.4. Perceived Effects of Government Taxation Policy on Operational Costs

Effects of taxation on operational costs were measured using a condensed scale of four items. The responses to the items were elicited using a 5 point Likert scale (5 strongly agree, 1 strongly disagree). Results presented in Table 4.15 indicate that respondents tended to agree with all the items. In particular, respondents agreed that the policy on costing of raw materials and other prime costs do not at times consider the taxation aspect ( $M=4.28$ ,  $SD=0.854$ ); that taxation policy leads to the increased operational costs of SMEs ( $M=4.36$ ,  $SD=0.656$ ); that taxation policy does not take into account the cost of debt thereby increasing operational costs ( $M=4.16$ ,  $SD=0.739$ ); and that the taxation policy does not take into account capital structure of SMEs hence ignoring related costs ( $M=3.74$ ,  $SD=1.051$ ).

	Mean	Std. Deviation
The policy on costing of raw materials and other prime costs do not at times consider the taxation aspect	4.28	.854
Taxation policy leads to the increased operational costs of SMEs	4.36	.656
Taxation policy does not take into account the cost of debts hence increased operational costs for SMEs	4.16	.739
The taxation policy does not take into account capital structure of SMEs hence assuming the related costs	3.74	1.051

Table 6: Perceived Effect of Government Taxation Policy on SME Operational Costs

These results show that most of the SMEs perceive taxation as leading to increased costs of operation. Indeed most of the standard deviation values were small showing that respondents were consistent in their perceptions.

#### 4.3. Assumptions of linearity

The strength of the linear relationship among variables was assessed using Pearson product moment correlation. Correlation was used since being a measure of the degree of association; it was likely to identify independent variable dimensions that provide best predictions.

As shown in Table 7, correlation among the three government taxation policy dimensions (Income tax, VAT, presumptive tax) were significant and ranged from  $r=0.271$  ( $p<0.01$ ) to  $r=0.378$  ( $p<0.001$ ). Correlation in the profitability and growth operational cost was significant and was found to range from  $r=0.205$  ( $p<0.01$ ) to  $r=-0.384$  ( $p<0.01$ ). Correlation between operational costs and government taxation policy variables were significant and ranged from  $r=0.238$  ( $p<0.01$ ) to  $r=0.375$  ( $p<0.01$ ). Thus, linearity assumptions were satisfied.

	Income Tax Policy	VAT Policy	Presumptive Tax Policy	Operational Cost Level
Income Tax Policy	1			
VAT Policy	.271**	1		
Presumptive Tax Policy	.378**	.280**	1	
Operational Cost Level	.259**	.375**	.238**	1

Table 7: Intercorrelation Matrix

\*\* Correlation is significant at the 0.01 level (2-tailed). \* Correlation is significant at the 0.05 level (2-tailed).

#### 4.3.1. Assumptions of Independence of Errors

The Durban-Watson statistic was used to examine if prediction of dependence errors were correlated. As presented in Table 8, The Durban –Watson statistics for the regressions of operational costs (2.487) was within the 1.50 and 2.50 interval suggested by Tabachunck and Fidell (2001), the error was adjusted to be uncorrelated. The assumption of independence of errors was therefore met.

#### 4.3.2. Testing the Effect of Government Taxation Policy on Profitability and Growth of SMEs

The study sought to establish the effect of government taxation policy on profitability and growth of SMEs. It was therefore postulated that there was no significant statistical relationship between government taxation policy (income tax, VAT and presumptive tax) and profitability and growth of SME operational costs. Results of the hierarchical regression analysis are presented in Table 8.

Profitability and Growth of SME		
Operational costs		
Predictors		
	Model1	Model2
	Std.	Std.
Step1:		
<b>Controls</b>		
Management	.042	.044
Employment	.084	.078
Step2:		
<b>Tax. Policy</b>		
Income		.129
VAT		.309**
Presumptive		-.206*
R <sup>2</sup>	.010	.183
Adjusted R <sup>2</sup>	.002	.158
R <sup>2</sup>	.010	.173
F-value	0.828	11.669**
Durbin-Watson		2.487
**p<0.01, *p<0.05		

Table 8: Results of regression analysis: Effect of Government Taxation Policy on Profitability and Growth of SMEs

From table 8, it is seen that both management of the business and number of the employees had no significant effect on operational costs ( $R^2$  value = 0.013). On adding the government taxation policy variables, the  $R^2$  value = 0.013). On adding the government taxation policy variables, the  $R^2$  of operational costs increased to 0.183 indicating that the three dimensions of government taxation policy contributed an additional 17.3% to the variance in operational costs. Similarly, the  $R^2$  of sales.

Government taxation policy dimension, income tax policy was found that it had no significant relationship with operational and significantly related to on capital ( $\beta = 0.156$ , significantly  $p < 0.05$ ). Presumptive tax policy had a negative relationship with operational costs ( $\beta = -0.206$ ,  $p < 0.05$ ). The researcher (Table 8) concluded therefore that government taxation policy had a significant impact on profitability and growth of SMEs through positive and negative effects on profit and growth dimension operational costs.

#### 4.3.3. Summary of Hypothesis Testing Results

Results of the hypothesis testing are presented in Table 9. The results indicated that the hypothesis was statistically significant.

	Hypothesis	$\beta$ -value	Result
Ho1	Level of operational cost is independent of government taxation policy: Income tax	0.129	<b>Supported</b>
	policy	0.309**	<b>Not supported</b>
	VAT policy	-0.206*	<b>Not supported</b>
	Presumptive tax policy		

Table 9: Summary of Hypotheses Testing

\*\*p<0.01, \*p<0.05

- Hypothesis 1 Operational cost of SME is independent of Government taxation policy

Hypothesis 1 tested the relationship between the three dimensions of government taxation policy and operational costs of SMEs. The standardized coefficients of 0.309 for VAT and -0.206 for presumptive tax were significant. The hypothesis was therefore not supported with regards to VAT and presumptive tax policies. The positive coefficient of 0.309 for VAT implies that an increase of 1% in VAT policy is likely to lead to a 0.309% increase in operational costs. However the negative value of 0.206 for presumptive tax implies that a 1% increase in presumptive tax policy is likely to reduce operational costs by 0.206%. The standardized coefficient of 0.129 for income tax policy was not significant indicating that income tax policy has no significant impact on operational costs.



## 5. Conclusions

The findings of the study concluded that, the government taxation policy variables, the R<sup>2</sup> of operational costs increased to 0.183 indicating that the dimension of government taxation policy contributed an additional 17.3% to the variance in operational costs. Through the hierarchical regression analysis, both management of the business and number of the employees had no significant effect on operational costs (R<sup>2</sup> value = 0.013). Income tax policy had no significant relationship with operational and significantly related to operational costs ( $\beta = 0.309$ ,  $p < 0.01$ ) and return on capital ( $\beta = 0.156$ ,  $p < 0.05$ ). Results of the study found statistically significant relationship between the dimension of government taxation policy and the dimension of profitability and growth. The researcher concluded therefore that, government taxation policy had a significant impact on profitability and growth of SMEs through positive and negative effects on profit and growth dimension of operational costs.

## 6. References

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