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Government Taxation Policy: A factor Affecting SMEs' Asset Accumulation in Uasin Gishu County, Kenya

Omare Abuga Dominic
Lecturer, Kisii University, Kenya
Erickson Gwaro Matundura
Lecturer, Moi University, Kenya

Abstract:
In Kenya, SME provide source of employment creation, innovation, competition, economic dynamism which eventually lead to poverty alleviation and national growth. Government taxation policy is one of the factors that constitute the SMEs" economic surroundings. This study sought to find out the effects of government taxation policy on asset accumulation of SME in Kenya and particularly Uasin Gishu County. In order to achieve the purpose of this study, the specific research objective was to find out the effects of government taxation policy on asset accumulation of SME. The data for this study was collected from primary and secondary sources. Research instruments were questionnaire and document analysis. The study population comprised of staff and management of SME within Uasin Gishu County, Kenya who formed the sample for the study. The explanatory research design was employed in the study. The samples for the study were selected using stratified random and simple random sampling methods. The data from the research instruments were coded and analyzed using the SPSS V 22. Descriptive statistics, frequency tables, percentages, mean and standard deviation were used to present the data, while Correlation was used to test the hypotheses. Results of the study found statistically significant relationships between the three dimensions of government taxation policy and SMEs asset accumulation. The researcher concluded therefore that government taxation policy had a significant impact on asset accumulation of SMEs.

Keywords: *Government taxation policy, asset accumulation*

1. Introduction

1.1. Background Information

The perception of SME by policy makers often fails to acknowledge their significance as a mechanism of economic growth and development. Regarding SME as insignificant enterprises that have no impact on the economy is an oversight that can no longer be justified. This is because SME merely require a favourable regulatory environment in which to conduct business, and they will demonstrate their potential for profitability and growth. Thus, they need to be granted a measure of flexibility in taxation which will allow them to maximize their potential.

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.

According to Holban (2007), taxation can contribute to development and to welfare through three sources; by generating sufficient funds for financing public services and social transfers at a high level of quality, by offering incentive for more employment and for an efficient and lasting use of natural resources, and by reallocation of income. However, this has to be balanced against the requirements of SME income and their need for survival. Without sufficient profitability, SME growth will be rendered impossible. Therefore, any prospective tax policy will have to evaluate the factors that encourage non-compliance with tax obligations by SME. This is because many SME opt to remain in the informal sector because the perceived benefits of compliance outweigh the perceived costs. Indeed, SME rarely see their tax contributions at work and the compliance costs are high. The government is also in a dilemma

because the cost of monitoring and collecting tax from SME may overwhelm the scarce resources of revenue authorities (Stern and Barbour 2005).

One of the major negative characteristic of SMEs is that they often have an extremely short life span, while the factors that lead to the SMEs winding down 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.

Although it has been acknowledged that taxation is a constraint on the productivity and growth of SME, this does not mean that SME should not pay tax. Without tax revenue, governments will be unable to facilitate the environment in which SME thrive, therefore it is in SME own best interest to pay taxes. The government has to collect revenue in order to finance its expenditure. Income obtained from taxation of individuals and businesses is used to run governments and to build and maintain infrastructure such as good roads, water supply, and electricity which are essential for the smooth running of businesses.

With the above in mind, the goal of the current study is to determine the importance of government taxation policy on profitability and growth of SME, and to find out its implications on the Kenyan economy, through a survey of SME in Uasin Gishu County.

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?

The answer to this question is pertinent, as SME, being a major economic segment, need to grow to maintain the broader health of the economy. At the same time, they are under an obligation to pay taxes. Thus this study seeks and suggests ways and means in which taxes can be levied on SME, without subjecting them to the tax rates of large corporations (which may diminish SME growth) and without allowing them the perpetual tax holiday that is enjoyed by the smallest of income earners. The resolution of this issue will go a long way towards ensuring the sustainable growth of not only the SME sector, but of revenue authorities as well.

1.3. Objective of the Study

- To establish the effects of taxation policy on levels of asset accumulation by SME

2. Literature Review

2.1. Effects of Tax Policy on Levels of Asset Accumulation by SME

Asset accumulation is a crucial component of SME performance and growth, particularly in the 21st century, as technological developments mean that any firm without the requisite technological equipment and know how is unlikely to succeed. Therefore, to boost the asset accumulation of SME, particularly in technological assets which will boost their performance and growth, the government, through the tax authority, should offer tax incentives for technology acquisition (Republic of Kenya, 2006). A step has already been made by the zero rating of computers and their accessories. This can be taken further by offering tax rebates to firms that make advances in technology, such as using environmentally friendly methods, or innovating in business processes to the extent that the sector as a whole benefits. This will encourage SME to innovate and invest in their capacity, which will enhance their rate of asset accumulation.

Studies have shown that the lower the amount of taxes paid by SME, the greater the growth related business project the profits are used for. These profits can be invested in the procurement of assets. These findings suggest that there may be other factors apart from tax that affect SMEs' ability to expand the current study. According to the International Tax Dialogue (ITD, 2007) a reduced tax rate will free more internal finance for SME, of which some will undoubtedly be reinvested. This supports the assertion of Horsepower (2001) which states that reduced tax rates improve internal financing which in turn enhance internal asset accumulation. Furthermore, Tadjibaeva and Komilova (2009) have found that tax rate is one of the factors that affect the prosperity of entrepreneurs, as determined by the amount of assets that they have accumulated. These findings from various sources show that by adjusting the tax rate in favour of SME will have long term benefits, as these SME will reinvest, accumulate assets and grow to the extent that they will eventually be able to enter a higher tax bracket.

SMEs in Kenya are disadvantaged in respect to asset accumulation attributed to a high percentage of sales revenue covering operational and other costs leaving them with insufficient funds to invest in assets. Therefore the tax structure affects SME efforts to accumulate assets as well. The often mentioned import substitution (IS) policy was actually intended as a means by which local firms

could acquire productive assets in order to minimize the importation of consumer goods. As these assets were not locally available, firms were encouraged to import them. Only the biggest firms were able to do so as this was costly. Furthermore, the high tariffs which were placed on exports, in order to encourage local sale of products, discouraged many erstwhile SME, as it meant that they could not boost their sales revenue (and their asset accumulation) through exports. The result was that SME largely abandoned the manufacturing sector, as they could not accumulate enough assets to put them on a level footing with large corporations, partly due to the tax regime, and partly due to their inability to access finance, which is a direct consequence of the lack of formalization, which in turn is influenced by taxation policy towards SME (Republic of Kenya, 2006).

2.2. Conceptual Framework

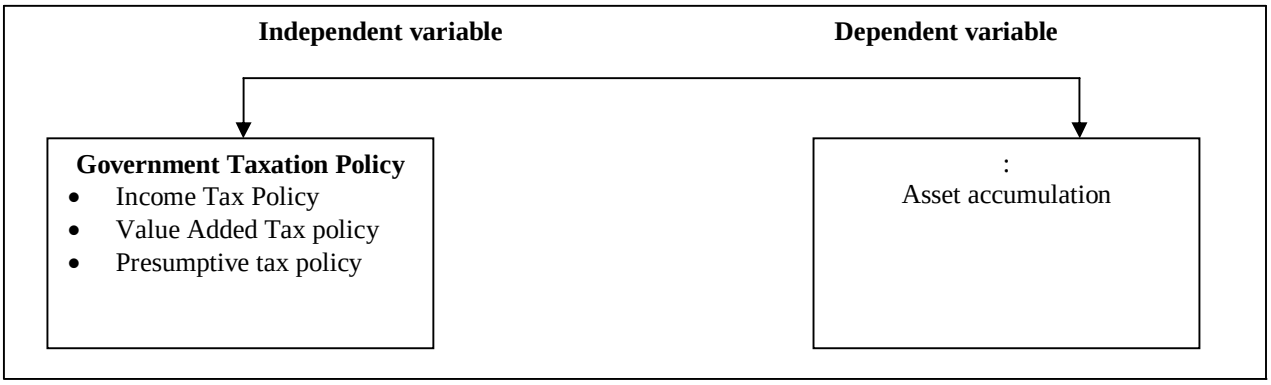

Figure 1: Hypothesised effect of government taxation policy on asset accumulation of medium sized enterprises
Source: Author Construct

This study put emphasis on the relationships between government taxation on asset accumulation of SMEs in Kenya.

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 casual 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, labor 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

Strata	Target population
Manufacturing industry	1100
Services industry	685
Officers from the Ministry of trade	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
Officers from ministry of trade	2		2
TOTAL	1787		180

Table 2: Sample size of respondents
Source: Uasin Gishu County in 2014

3.4. Data Collection Instrument

The 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 includes: 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 District Officer in Uasin Gishu County 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. Validity and Reliability of the Instruments: 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 Huruma Estate, Uasin Gishu County, Kenya will be validated by adopting (Yin, 2003) solution for validity. This includes 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 will be used in the form of three kinds of sources: literature review of 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 will be asked to comment on some of the conclusions.

4. Data Analysis

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 hypotheses and show the extent of the relationship between taxation policy and the sales revenue of SME; 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, which was developed and justified in the literature review, and which ultimately, provides structure to the empirical analysis. This analytical schema represented the model of the relationship between government tax policy and sales revenue of SMEs. The model demonstrated how SME sales revenue is expected to be influenced by government taxation policy. The following regression model was expressed in mathematical notation as follows:

$Y= \beta_{0+} \beta_1 X_{1+} \varepsilon$

Where Y = Government taxation policy X_1= Asset Accumulation of SME

β= Beta.

ε = Error term

5. Results and Discussion

5.1. Asset Accumulation

To measure the effect of taxation policy on levels of asset accumulation, seven items were proposed. The Kaiser-Meyer-Olkin (0.798) and Bartlett"s test of ($p<0.001$) indicated that data were adequate for factor analysis. All factor loadings were greater than 070 and loaded on only one factor (Table 4.0). The reliability of the six items extracted to explain effects of taxation policy on levels of asset accumulation was 0.871 and the variance explained was 57.70%.

Constructs and scales	Loading	Eigenvalues	Cum.
			Variance
			Explained
Effect of Taxation on Levels of Asset	.871*	4.039	57.704
accumulation			
Factor1			
Taxation policy is not very clear on asset	.765		
financing and tax deductable	.765		
Tax shields can be used with regards to depreciating assets Asset capital structure makes	.772		
government taxation policy irrelevant			
Assets financed through equity and debt is not	.775		
friendly to the government taxation policy			
Government taxation policy may not work well	.768		
within the assets which are used as collateral			
Levered SME may not fulfill the government	.828		
taxation policy on assets			
Kaiser-Meyer-Olkin MSA:	.798		
Bartlett's test of S	.000		

Table 3: Exploratory Factor Analysis Results for effect of Taxation Policy on Asset Accumulation

* *Reliability coefficient (Cronbach"s Alpha)*

5.1.1. 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 4.11, all the variables were normally distributed since the significant values were all above 0.05.

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Level of asset accumulation Compliance with government	.139	165	.101	.889	165	.102
Taxation Policy	.179	165	.072	.917	165	.081

Table 4: Tests of Normality
a. Lilliefors Significance Correction

5.2. Perceived Effects of Government Taxation Policy on Levels of Asset Accumulation
Six items were used to measure respondent's policy on levels of asset accumulation, the mean responses to the items ranged from 3.91 to 4.25 indicating agreement with the times. Besides, the largest variation was 0.990 while the smallest variation was 0.633 indicating that most of the responses were consistent with each other. (m=4.21, SD =0.633); that tax shields can be used with regards to depreciating assets (M=4.13, SD=0.876); that tax shields can be used with regards to depreciating assets 9M=4.13), SD=0.797); that asset capital structures make government taxation policy irrelevant (M=4.09, SD=0.7970; that assets financed through equity and debt is not friendly to the government taxation policy (M=4.13, SD=0.983);that government taxation policy may not work well within the assets which are used as collateral (M=3.91, SD=0.990); and that levered SMEs may not fulfill the government taxation policy on assets (M=4.25, SD=0.937).

		Std.
	Mean	**Deviation**
Taxation policy is not very clear on asset financing and tax deductable	4.21	.633
Tax shields can be used with regards to depreciating assets	4.13	.876
Asset capital structure makes government taxation policy irrelevant	4.09	.797
Assets financed through equity and debt is not friendly to the government taxation policy	4.13	.983
Government taxation policy may not work well within the assets which are used as collateral	3.91	.990
Levered SME may not fulfill the government taxation policyon assets	4.25	.937

Table 5: Perceived Effect of Government Taxation Policy on Levels of Asset Accumulation

5.3. Predictive Analysis
Hierarchical multiple regression analysis was conducted in order to test the effect of taxation policy on levels of asset accumulation by SMEs. The purpose was to examine the relationship between government taxation policy on SME asset accumulation levels while at the same time controlling the influence of the management of the business and the number of employees.

5.3.1. Testing the Effect of Taxation Policy on Levels of Asset Accumulation by SME
The study sought to establish the effect of taxation policy on levels of asset accumulation by SMEs. It was therefore postulated that there was no significant statistical relationship between government taxation policy (income tax, VAT and presumptive tax) and asset accumulation of SME (operational costs, sales revenue, asset accumulation and return on capital). Results of the hierarchical regression analysis are presented in Table 4.20.

Predictors	**Asset Accumulation**	
	Model1	**Model2**
	Std.	Std.
Step1:		
Controls		
Management	.026	.034
Employment	.096	.074
Step2:		
Tax. Policy		
Income		-.245**
VAT		.059
Presumptive		.311**
$_R2$	.011	.082
Adjusted R^2	-.001	.054
R^2	.011	.071
F-value	0.899	4.275**
Durbin-	2.120	
Watson		

Table 6: Results of regression analysis: Effect of Taxation Policy on Levels of Asset Accumulation by SMEs

The R^2 of asset accumulation increased to 0.082 meaning that government taxation policy contributed an additional 7.1% to the variance in asset accumulation..
The researcher (Table 4.20) concluded therefore that government taxation policy had a negative impact on the levels of asset accumulation by SMEs (operational costs, sales revenue, asset accumulation, return on capital).

5.3.2. Summary of Hypothesis Testing Results
There is no significant statistical relationship between government taxation policy and levels of asset accumulation
Hypothesis 3 tested the relationship between government taxation policy and levels of asset accumulation in SMEs. Results indicated that income tax policy (=-0.245, p<0.01) and presumptive tax policy (0.311, P=0.01) were significant predictors asset accumulation. However, VAT (0.059, p>0.05) was not a significant predictor of asset accumulation. The hypothesis was partially supported. Besides, the negative coefficient for income tax policy implies that an increase in 1% of income tax policy levels was likely to lead to a 0.245% decline in asset accumulation levels. Similarly, the positive coefficient for presumptive tax policy (0.311) implies that a 1% increase in presumptive tax was likely to boost asset accumulation levels by 0.311%.

	Hypothesis	β-value	Result
	between government taxation policy and asset	-0.245**	**Not supported**
	accumulation	0.059	**Supported**
	Income tax policy	0.311**	**Not supported**
	VAT policy		
	Presumptive tax policy		

Table 8: Summary of Hypotheses Testing
***p<0.01, *p<0.05*

6. Conclusion
The study sought to establish the relationship between government taxation policy and asset accumulation of SMEs in Uasin Gishu County, Kenya. From the findings of the study concluded through the hierarchical regression analysis it was concluded that R2 of asset accumulation increased to 0.082 meaning that government taxation policy contributed an additional 7.1% to the variance in asset accumulation of SMEs.

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