

**IMPACT OF TAX AWARENESS ON BUSINESS FINANCIAL PERFORMANCE OF
SMALL AND MEDIUM ENTERPRISES IN VIHIGA COUNTY, KENYA**

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MASTER OF SCIENCE IN COMMERCE (FINANCE)

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**A RESEARCH PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS IN
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UNIVERSITY**

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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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I do hereby confirm that I have examined the master's dissertation of

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And have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.



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ABSTRACT

Small and medium-sized enterprises (SMEs) play an important role in many countries' economic development, contributing significantly to job creation, revenue production, and innovation. According to Algan (2019), SMEs account for approximately 90% of businesses globally and provide more than 50% of employment opportunities worldwide. Tax is a compulsory financial charge imposed by the government on individuals or entities to yield public income. Taxation is a key function of the government, where it collects revenues from taxpayers, which are used to finance public services and benefits for society (Murphy, 2002). Tax awareness plays an important role in determining the financial well-being and capacity of growth for businesses and shouldn't be underestimated, particularly for small and medium enterprises. Kenya's SMEs have been of great importance to economic growth, employment generation, and innovation, with estimates of share contribution of about 80% of total employment opportunities and 30% of GDP Kenya National Bureau of Statistics (2022). The general objective of the study was to establish the impact of tax awareness on the business financial performance of small and medium enterprises (SMEs) in Vihiga County, Kenya. Specific Objectives were: To assess the effect of tax incentives and credits on financial performance of SMEs in Vihiga County, Kenya, to assess the effect of tax incentives and credits on financial performance of SMEs in Vihiga County, Kenya, to evaluate the effect of income tax awareness on financial performance of SMEs in Vihiga County, Kenya. The analysis of study variables shows varying effects of different tax components on the financial performance of SMEs in Vihiga County, Kenya. Tax deductions recorded a moderate influence, with the highest mean of 3.74 (SD = 0.970) indicating agreement that they help reduce taxable income, though gaps in government information were noted (Mean = 3.33, SD = 1.200). Tax exemptions had the strongest positive perception, with unanimous agreement on their benefits (Mean = 5.00, SD = 0.000), highlighting their effectiveness in reducing costs and supporting business growth. Tax incentives were moderately rated, with business growth linked to incentives (Mean = 3.91, SD = 0.870) but challenges in accessibility and understanding reflected in lower means of 3.24–3.25. Income tax rates were seen as burdensome, with high rates negatively affecting performance (Mean = 4.47, SD = 0.678) and changes significantly impacting operations (Mean = 4.08, SD = 0.793). Tax filing practices revealed high compliance (Mean = 4.97, SD = 0.828), though simplicity, efficiency, and support were rated moderately (Means 3.40–3.55). Timeliness of tax payments showed that flexibility would improve compliance (Mean = 4.23, SD = 0.715), while penalties for late payment were a major concern (Mean = 4.14, SD = 0.768). Finally, investment-related tax benefits were perceived as supportive but underutilized, with incentives making assets more affordable (Mean = 3.47, SD = 1.017) yet limited government information (Mean = 3.10, SD = 1.066) pointing to awareness gaps. Overall, the findings suggest that while SMEs recognize the value of tax-related measures in improving performance, issues of accessibility, awareness, and fairness limit their full effectiveness. The study recommends that the government and tax authorities, particularly the Kenya Revenue Authority (KRA), should strengthen tax awareness and education programs targeting SMEs in Vihiga County, Kenya by simplifying access to information, providing digital resources, organizing training sessions, and collaborating with local business associations. Tailor-made policies, sensitization forums, and easy-to-understand materials on income tax obligations, rates, and investment tax incentives should be introduced to enhance compliance, reduce penalties, and improve informed financial decision-making.

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DEDICATION

This project is dedicated to my family and in particular to my lovely parents Mr. and Mrs. Mutegi for their constant encouragement and praying for me all through. I appreciate their continued support and understanding throughout this period of writing my project. If it was not for them, I would not have reached this far.

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ACRONYMS AND ABBREVIATIONS

ETR Effective Tax Rate

GDP Gross Domestic Product

KNBS Kenya National Bureau of Statistics

KRA Kenya Revenue Authority

R&D Research and Development

RBV Resource-Based View

ROA Return on Assets

ROE Return on Equity

ROI Return on Investment

SMEs Small and Medium-Sized Enterprises

TPB Theory of Planned Behavior

TRA Theory of Reasoned Action

VAT Value Added Tax

TERMS AND DEFINITIONS

Awareness and utilization of tax incentives and credits- refers to the extent to which individuals or businesses are informed about available tax relief measures such as deductions, exemptions, and credits and how effectively they apply or benefit from them to reduce their tax liability.

Business Financial performance- refers to the measure of how well a business is achieving its financial goals and utilizing its resources to generate revenue, profit, and value over a specific period. It reflects the overall financial health, stability, and profitability of a business.

Financial performance-refers to the degree to which a business achieves its financial objectives, typically measured through indicators such as profitability, revenue growth, return on investment, liquidity, solvency, and overall efficiency in the use of resources.

Income tax awareness- refers to the level of knowledge and understanding that individuals or business owners possess regarding income tax laws, regulations, obligations, rates, and filing procedures.

Investment tax awareness- refers to the understanding and knowledge that individuals or business owners have regarding tax policies, incentives, reliefs, and obligations related to business investments.

Tax awareness on the business- refers to the extent to which business owners or managers understand the tax obligations, regulations, benefits, and procedures that apply to their business operations.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Small and medium-sized enterprises (SMEs) play an important role in many countries' economic development, contributing significantly to job creation, revenue production, and innovation. Algan (2019) stated that SMEs constitute nearly 90 percent of the businesses in the world and more than 50 percent of jobs in the world. Small and medium firms are mostly privately owned firms that although they are an essential part of the economy, they are commonly faced by several issues that hamper their survival and growth such as the tax regime in which they exist particularly in developing governments. Tax refers to an obligatory economic contribution by the state to an individual or corporation as a way of deriving national revenue. One major role of the government is taxation where the government collects the revenue generating tax on taxpayers to fund the services and benefits available to the society (Murphy, 2002).

Tax awareness means the level at which SME owners and managers know about tax regulations, requirements, tax filing and their rights under the tax regime. There is an increased relevance of tax knowledge on financial management in small and medium enterprises (SMEs), particularly in nations that are in the developing economy like Kenya. The role of SMEs in the economy of Kenya is critical since they contribute towards maintenance of employment, poverty reduction and improving countries economy. According to the Kenya National Bureau of Statistics (KNBS), the SMEs contribute approximately 30 per cent of the GDP value in the economy of the country and occupy more than 80 per cent of the work force. Nevertheless, despite such relevance, some SMEs in Kenya are facing issues concerning taxation and such issues encompass tax

liabilities, ways of complying with the particular tax liabilities and dealing with the complex tax system. Kenya has developed a tax system, which is under the management of Kenya Revenue Authority (KRA) yet the Kenyan Revenue Authority (KRA) collects not only the income tax, VAT, but also the excise taxes, it has clear information that many SMEs still are not in control of their business in paying their taxes because the tax regulations are quite complicated and other tax advisors are not available in large numbers. This is what normally fails due to ignorance on tax mechanism which in the long run impacts on their economic performance. Non compliances with the tax regulations can lead to fines and interest charged which is costly to the SMEs and this minimizes on profit making and the capability of the SMEs to stay in business in the long-term. Furthermore, lack of knowledge about the tax concessions alongside tax reliefs causes the SMEs lack utilization of the opportunities that exist in helping them reduce their tax burden which in its turn would help them to gain better profitability in case they make use of the tax concessions and tax reliefs. Tax education has become a matter of emphasis in the improvement of businesses in several studies. The level of tax awareness was rated among the greatest cause of high tax evasion in SMEs in Kenya.

Wanjohi and Mugure (2008) indicate that those SMEs that complied with taxes, regarding the measurement of SME tax knowledge of laws and regulations internationally, performed better. The reason is that the tax awareness makes the businesses evade fines and penalties, improves the cash flow planning and management of the business and even enables tax incentives and tax deductions that are available to boost the bottom line. There are other factors which may ensure or not ensure the relationship to exist between an awareness of taxes and financial performance, which are the level of education of SME owners/managers, the access to tax advisory services and complexity of tax policies. As Owners of the small and medium-sized enterprises (SMEs) learn

about tax, they are able to make better financial decisions, manage costs, and avoid unnecessary fines. This has the effect of making companies more profitable, because the companies have a chance to take advantage of allowable deductions and incentives to reduce their tax liabilities.

Moreover, a company, which is conscious of the taxation rules, is more likely to operate and act in a transparent manner and meet the requirements of the law, which increases its image and long-term sustainability. It follows that Atawodi and Ojeka (2012) argue that most SMEs in developing nations seem to find it difficult to comply with taxes because of a lack of resources especially when handling more resources are necessary to pay tax professionals or obtain trustworthy tax information. It is even more crucial to SMEs in Kenya since a good number of them are not formally educated on issues of tax and rely on the word-of-mouth or informal sources of information which can easily result into misinterpretation as far as the preparation of taxes is concerned. Problems associated with tax education in Kenya are further compounded by the fact that they operate numerous SMEs in the underground economy. The presence of these companies does not count in the official tax net and thus defined by depending ignorance or deliberate tax evasion, in most cases, they continue to be tax-free. As (Gichuki et al., 2014) stressed, the inability to associate formally with tax authorities exposes most of these businesses to legal implications indeed, payable fines and the omission of high revenue possibilities. They noted that they are less financially stable since they fail to declare and clear off their taxes thus they are not included in the finance programs of the governments that are given to the compliant firms.

There are various obstacles as there are issues with the current research on the direct correlation between the tax consciousness and broader application of the SMEs financial sector and financial performance of the SMEs (Ajzen, 2002). A growing body of evidence acknowledges that SMEs behavior may change because of the tax awareness, especially in terms of compliance.

The linkage between tax awareness and financial performance however has not been looked at thoroughly and in case of Kenya as well. There are multiple studies that are inclined to narrowly define tax compliance as the fulfilment of tax requirements such as registration, correct filing of tax, and payment of taxes on time but fail to elaborate the differences between tax compliance and tax awareness which forms a foundation of such actions (Aladejebi, 2018). Although tax compliance suggests behavior, tax awareness represents knowledge and comprehension that can have either an outcome or not depending on other affecting factors including capacity, fairness visions, or enforcement. In most of the studies, tax compliance is the primary focus of interest but they do not fully employ the impacts of tax knowledge on key financial performance measures of companies and entities like earnings, cash remuneration control, and cost control of operating the business in the Kenyan context. In addition, little is known about the role of implementing bodies like KRA with regard to creating awareness to the society about tax. Some of these studies can demonstrate that special tax education programs can bring about increased compliance and cause better financial results of small businesses, yet not a single one of them mentions KRA and the channels upon which they impact. The bigger rural county of Vihiga County offers a good case example as a study area in understanding the connection between tax awareness and the financial performance of the SME (Algan, 2019). The businesses in Vihiga are mainly informal which are small-scale and operated by individuals who are not well educated in the area of business and tax. The businesses operated by the companies are situated in regions that are non-infrastructure, poor access to capital coupled with lack of tax consciousness. All this is compounded by the fact that Kenya has a very high tax complexity index of The Tax Policy Handbook of 43 which is controlled and run by KRA. Majority of the business forms pay such taxes as income tax, value-added tax (VAT) and excise duties although the rates of compliance are very low as there are limited

knowledge on the responsibility of the taxation among the taxators and this is compounded by the belief that many of the SME owners in the Vihiga County do not understand what is expected of them and this leads to their making business in losses due to ignorance.

1.1.1 Tax Awareness

Tax awareness refers to the knowledge of a person or organization about paying taxes and the regulations and the tax system of the establishment where the person/ organization exists. This knowledge is critical to compliance, risk management and improved financial decisions. Tax awareness not only helps people and companies fulfill their legal and financial duties but also enables them to make best use of legitimate tax reliefs including deductions and credits that can minimize the amount of tax payable (Doran, 2009). Concerning corporate governance and financial planning, tax awareness is part and parcel of an organization. High tax-aware companies are more able to negotiate the peculiarities of the tax code to predict tax liabilities and consider taxes in the general strategic planning. This may result in reduced costs and improved financial management which is of great essence especially in a competitive market Hanlon and Heitzman (2010). Tax authorities and even governments have in the recent past been advocating tax education as a means of enhancing tax compliance. The more people know about taxes, the less tax evasions and the more general compliance will take place since citizens who realize the necessity of contributing to the taxes will also comply with their obligations Kirchler (2007). Tax awareness also implies more civic sense and more reasonable distribution of the state funds and good attitude between taxpayers and tax authorities (OECD, 2015). The ethical tax awareness influences taxpayers in regard to showing voluntary compliance in taxes as well as avoiding aggressive tax avoidance behaviour, depending on the knowledge of how taxes are used in the society Richardson (2006).

There are several types of tax awareness which are considered to be very important both in the cases of individuals and organizations. To begin with, there is the Tax incentives and credits awareness where small and medium-sized enterprises (SMEs) can often be entitled to a variety of incentives and credits that are intended to both develop the growth of small business, spur innovation, and lead to creation of jobs. As an example, research and development (R&D) activities in many countries receive tax credits in order to favor innovative practice. Being aware of them, SMEs will have time to trace the possible reduction of the tax expenses that could be then invested into the business growth and development (Czarnitzki et al., 2011). Tax credits toward renewable energy efforts, recruitment programs or even industry-specific incentives can provide formidable tax saving as well. They found out that SMEs who are well-informed about tax incentives and credits tend to engage in growth and innovation strategies and exploit the available resources to give them a competitive advantage (Chen et al., 2020). Another type of tax awareness needed by SMEs, is income tax awareness; this is needed by small and medium-sized enterprises (SMEs) so they may understand their responsibilities regarding income tax, both to meet those obligations as well as to be able to structure them as part of financial planning. It is important to be aware of income tax because this will entail knowing the applicable tax rates and deductions and credits that will reduce taxable income. In comparison with bigger companies, SMEs more often have to face more serious constraints on cash flows, and it is crucial to handle the issues of income taxes on the highest level. Many SMEs are able to claim the deductions on issues like wages, business expenses that can and will reduce the amount of taxes they have to pay. It has been found that the SMEs with greater comprehension ability of income tax policies usually experience higher financial performance and are more highly likely to pay their taxes (Marandu et al., (2015). Moreover, having an eye on taxes, their deadlines, and deadlines and filing

requirements allows SMEs to evade penalties and interests, thereby increasing the stability of their finances (OECD, 2021).

The awareness of Investment tax among the small and medium-sized enterprises (SMEs) is important especially to the enterprises to get the chance of expanding their businesses by investing, whether it is to acquire equipment or property development, or purchasing one kind of property. Comprehending the investment tax means getting an idea about capital gains taxes, depreciations regulations as well as a chance to defer certain taxation. Research has indicated that SMEs usually use capital allowances whereby part of the expenditure on capital goods is allowed as deduction over an adjusting period. This promotes reinvesting and growth. It is through being conversant with such provisions that the SMEs will be able to reduce the immediate tax burden associated with large investments Graham & Tucker (2006). Evidence shows that the encouraging Investment Taxation Policies positively influence the growth of SMEs. This is attributed to the fact that such businesses will likely to reinvest in case they are aware of how to take advantage of tax policies regarding capital purchases (De Mooij & Ederveen, 2003).

Additionally, business structure tax knowledge is also another major type of tax knowledge because the choice of business form can have a strong impact on the small and medium-sized enterprises (SMEs) regarding their tax burden, the rates they are required to pay, amount of paperwork to be submitted and the possibilities to access certain tax benefits. The appreciation of variances between sole proprietorship, partnerships, limited liability companies (LLCs) and corporations is crucial to strategic tax planning. As an example, an LLC can provide flexibility of its treatment of tax whereby it can be treated as a sole proprietorship or a partnership or even as a corporation, and each of these comes with its own tax benefits or tax problems Desai & Dharmapala (2006). In educating small businesses about the tax implications of different types of

businesses, they are more capable of making decisions according to their financial goals. The research study will concentrate more on the tax incentives and credits awareness, income tax awareness and investment tax awareness and their impact on business, financial performance of SMEs in Vihiga County, Kenya. Generally, personal and corporate financial literacy on tax concepts ensures financial stability, increased funding to public service and more strengthened socio-economic foundations of societies.

1.1.2 Business Financial Performance

Business financial performance suggests how well a company is performing and gives an idea regarding how healthy a company is financially based on essential indicators that include increase in revenue, profitability, liquidity and asset efficiency (Kanaan et al., 2023). The performance analysis provides a notion of how well a business is employing its resources so that it can rake in profit and retain a competitive edge in an industry. There are a couple of other important measures applied in the assessment of the financial performance of a business including profit margins (Net, gross, operating ones), returned on assets (ROA) and returns on equity (ROE). The relationships indicate the extent to which an organization can realize income on its property and equity support, providing implications into general efficiency and management performance (Damodaran, 2020). The high ratio of profitability means good earning performance and decrease in the ratio would mean having operating inefficiencies or increased costs. On the same note, the current ratio and quick ratio will be used as a measure of the capacity of a company to finance its short term obligations, which play important roles in determining its financial stability. Since companies capable of generating such liquidity can not only recover in the same condition after economic downturns but have also proved the capability of careful management of fiscal practice Ross et al. (2019).

Financial performance is not focused on internal indicators. Some of the market trends, industry competition and the economic conditions have a high impact on the financial performance of a given company. A proper financial performance appraisal therefore should not only focus on the internal financial capacity but also the external business environment since this would give a balanced picture of current performance of the operations and the future performances Kaplan and Norton (1992). Effective administration of financial performance helps companies raise funds, fund-growth and create value to the shareholders. By conducting constant checks on financial performance and improving it, companies will become more long-term survivable, and establish preconditions of an increase Penman (2013). Some of the measures to be used in this study would include: Effective Tax Rate (ETR): The ratio of the taxable earnings used up in paying taxes. The SMEs armed with the knowledge on tax benefits and rebates are often able to maintain their ETR at low levels through deductions, credits and tax saving strategies. When ETR is low, it is an indication of an effective tax planning. Tax Expense as a Percentage of Revenue: By understanding income tax and tax incentive programs, the SMEs are able to reduce the percentage proportion of their earnings paid as a taxes thereby increasing the number of monies they can re- invest or expand. Revenue Growth: Tax investment in R&D and capital investments Tax breaks regarding R&D and capital investment are often availed by the SMEs possessing knowledge of the tax treatment of investment and used to fund its growth. Being aware of these incentives enhances new project investments, which increases revenue. This can be particularly relevant in the sectors where R&D tax incentives are large. Increased Capital Expenditure (CapEx): The investment tax awareness allows firms (SMEs) increase on their capital expenditure on fixed assets by facilitating deductions and credits on investments of these assets. These resources stimulate productivity or workforce, and encourages the growth in the long term.

Also, we will apply Return on Investment (ROI), among SMEs that have the knowledge about the investment tax benefits, ROI becomes handy in comparing the performance of the tax favored investment against a typical one. The use of credits and deductions yields more net benefits to the investments, improving the ROI. Asset Turnover Ratio: The difference that an understanding of tax on investments makes is that the SMEs are in a position to control their assets better because they are sure they would be able to recover the cost of investment either through a tax deduction or credit. Such awareness assists in choosing of greater efficiency assets that result in increasing revenue compared to assets utilized.

1.1.3 Small and Medium Enterprises in Vihiga County, Kenya

Vihiga County, though one of the smallest in Kenya by land size, hosts a vibrant Small and Medium Enterprise (SME) sector that significantly contributes to its local economy and community livelihoods. The SMEs in the county are diverse, spanning across retail trade, agribusiness, transport, manufacturing, hospitality, and service-oriented ventures such as salons, cybercafés, and repair workshops. Due to limited formal employment opportunities, many residents turn to small-scale enterprises as their primary source of income, making SMEs the backbone of the county's economic activities. Agriculture remains the mainstay of Vihiga's economy, and a substantial number of SMEs are linked to agricultural value chains such as dairy farming, poultry, horticulture, and agro-processing. These enterprises not only create self-employment but also support rural households by providing access to markets and increasing household incomes. Additionally, the county's proximity to urban centers like Kisumu and Kakamega creates a favorable market for SME goods and services, enabling local entrepreneurs to expand beyond village-level operations.

The County Government of Vihiga has made deliberate efforts to support SMEs through initiatives such as capacity-building programs, promotion of savings and credit cooperatives (SACCOs), and improving access to devolved funds like the County Enterprise Development Fund. Nevertheless, SMEs in Vihiga face several challenges, including inadequate access to affordable credit, limited modern warehousing and storage facilities, poor infrastructure in rural areas, and stiff competition from larger firms. Despite these challenges, SMEs in Vihiga continue to play a vital role in reducing unemployment, fostering innovation, and stimulating grassroots development, thereby contributing to the county's overall socio-economic growth.

1.2 Statement of the Problem

Tax awareness plays a pivotal role in shaping the financial well-being of businesses, particularly small and medium enterprises (SMEs), by influencing their growth opportunities, compliance, and long-term sustainability. In Kenya, SMEs contribute approximately 80 per cent of employment and 30 per cent of the GDP (KNBS, 2022), yet many of these businesses continue to struggle with tax management due to limited knowledge and awareness. For SMEs, inadequate understanding of taxation leads to financial inefficiencies, compliance risks, and misclassification into tax brackets that deny them access to tax incentives and reliefs designed to promote business growth and profitability. This challenge is particularly pronounced in rural counties such as Vihiga, where access to tax education and awareness programs is limited, leaving many entrepreneurs ill-prepared to navigate the complex tax landscape (Kiring'ai et al., 2015). As a result, SMEs in such settings face constrained profitability and diminished competitiveness compared to their urban counterparts.

Although there is growing literature on the relationship between tax compliance and business performance in Kenya, much of it focuses on urban areas such as Nairobi, Mombasa, and Kisumu, while counties like Vihiga remain largely underexplored (Ngugi & Muturi, 2018). Rural SMEs face unique challenges, including low literacy levels, limited access to professional tax advisory services, weak infrastructure, and minimal exposure to sensitization initiatives, all of which intensify the knowledge gap in taxation. Unlike their urban peers who often benefit from targeted training programs and closer proximity to Kenya Revenue Authority (KRA) offices, rural SMEs remain vulnerable to misinformation, non-compliance penalties, and lost opportunities to leverage legitimate tax incentives. This gap in understanding limits their ability to optimize resource allocation, cut unnecessary costs, or expand their operations, thereby curtailing their overall financial performance.

This study, therefore, sought to bridge this gap by critically evaluating the impact of tax awareness on the financial performance of SMEs in Vihiga County, Kenya. By employing case studies, questionnaires, and secondary data analysis, the research will assess the depth of tax knowledge among SME owners, identify the correlation between awareness levels and profitability, and uncover the extent to which limited tax literacy undermines business sustainability in a rural context. Findings from this study are expected to provide valuable insights for policymakers, tax authorities, and business advocacy groups in designing targeted awareness campaigns and support structures that empower SMEs to comply effectively while enhancing their profitability. Ultimately, the study intends to provide empirical evidence on whether improved tax awareness directly translates into tangible financial performance gains, such as reduced operating costs, higher profit margins, and more efficient use of resources in SMEs operating in rural

counties like Vihiga. Most studies have focused on urban areas and tax compliance generally, while the “impact of tax awareness on financial performance” in rural contexts is underexplored.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of the study was to establish the impact of tax awareness on the business financial performance of small and medium enterprises (SMEs) in Vihiga County, Kenya.

1.3.2 Specific Objectives

I. To assess the effect of awareness and utilization of tax incentives and credits on the financial performance of SMEs in Vihiga County, Kenya.

II. To evaluate the effect of income tax awareness on business financial performance of SMEs in Vihiga County, Kenya.

III. To find out the effect of investment tax awareness on SMEs business financial performance in Vihiga County, Kenya.

1.4 Research Questions

I. How does the awareness and utilization of tax incentives and credits affect the business financial performance of small and medium enterprises in Vihiga County, Kenya?

II. How does income tax awareness affect the business financial performance of small and medium enterprises in Vihiga County, Kenya?

III. What is the effect of investment tax awareness on the business financial performance of small and medium enterprises in Vihiga County, Kenya?

1.5 Significance of the Study

The research will be of immense importance as it will establish the significant correlation between tax awareness and the financial performance of small and medium enterprises (SMEs) in Vihiga County, Kenya. Tax awareness, defined as the knowledge of taxation obligations, rights, and the broader tax environment, is essential for sound financial decision-making. SMEs with higher levels of tax knowledge tend to comply more effectively, avoid unnecessary penalties, and strategically position themselves to take advantage of available tax incentives, ultimately improving their financial performance. Conversely, inadequate tax awareness exposes SMEs to compliance risks, inefficiencies in resource allocation, and missed opportunities for tax breaks that could enhance profitability. This gap in awareness may contribute to underperformance, limited growth, and financial instability. By addressing this issue, the research will provide a strong foundation for practical recommendations aimed at strengthening both theoretical insights and actionable strategies in taxation and business management, ensuring SMEs in rural contexts can fully leverage taxation systems for growth and sustainability.

The findings of this study will also be of use to policymakers in strategic planning of Kenya in having useful and related educational programs and literature on the target of SMEs. After conducting an analysis of the existing situation Oseifuah (2010) points out that due to a lack of proper education on taxation levels have been unfavorable and negatively affect the economic development of the regions the government can, therefore, focus its efforts at improving the state of awareness/knowledge gaps and ultimate tax literacy. The resultant outcome of the study would be useful in drafting policies that reduce the burden of compliance and at the same time increase the overall development of SMEs in Vihiga County, Kenya.

It could also be a positive influence for the general improvement of the base of taxation in Vihiga County, Kenya by developing a culture of compliance with taxes. Promotion of tax awareness and compliance will be utilized by the research as a way of further creating a proactive approach among the owners of small businesses. There is a great need for the culture of compliance, which is an essential path toward the stability and growth of the economy, according to Bittencourt (2012). This would hopefully provide perspectives that could yield a change of heart for the SMEs, instill in them a sense of responsibility towards taxes, and contribute thereby to the economic well-being of the region. In essence, this research on the effect of tax awareness on the financial performance of SMEs in Vihiga County, Kenya is highly instrumental in developing knowledge, policy education, promoting SME development, compliance, and empowerment, thus acting as a starting point for further research. The results shall go a long way toward meaningfully influencing the discourse on taxation and its relationship to the financial performance of SMEs in Kenya.

1.6 Scope of the Study

This study examined how tax awareness affects the performance of small and medium-sized enterprises (SMEs) in Vihiga County, Kenya. The study covered a wide area of Vihiga County, including Mbale Town, Hamisi, Majengo, Cheptulu, Sabatia, Shamakhokho, and other small towns. It focused on many sectors of the SME environment to quantify the level of tax awareness among these firms and how this affected their profitability, revenue growth, and overall financial health (Kiarie, 2020). The study used questionnaires to provide information that could be used to inform tax education initiatives and improve SME performance in the area.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section examines both theoretical and empirical research, thoroughly delving into the research gaps outlined in the paper. It critically reviews key theories that underpin the study, highlighting how they explain the relationship between the variables under investigation.

2.2 Theoretical Review

The study was guided by three main theories that are discussed below.

2.2.1 Theory of Planned Behavior

Theory of Planned Behavior (TPB), postulated by AJZEN (1991) gives the entire model of the influences that drive people when making decisions, it is a development of the previous Theory of Reasoned Action (TRA) by Ajzen and Martin Fishbein. Although the TRA mainly focuses on the volitional behaviors, those behaviors under full control of the actor, the TPB extends the boundary by adding the non-volitional behaviors that are driven by external forces, and binding constraints. This theoretical framework has proved to be very useful regarding the determinants of human behavior whereby intention does not always guarantee that action is taken (Conner, M2020). The principle behind the TPB is that the closest predictor of behavior is the intention by an individual to act in a given way. On its own, intention is influenced by the three key constructs: attitude toward the behavior: This refers to the favorable/unfavorable evaluation of engaging in a particular activity. The attitudes are influenced by the beliefs about the consequences of the action and evaluation of the consequences. An example is that when one believes that engaging in a particular action would deliver positive outcomes, then they are likely to have a favorable attitude towards

it. Subjective norms refer to the presumed social compulsion to pursue or avoid the behavior. These norms are molded by normative beliefs or the perceptions of the person regarding whether the behavior has the approval or disapproval of significant people who act as important persons, such as the family, friends or peers (Bosnjak et al., 2020). The effects of such societal forces may vary depending on the individual due to his/her attitude toward social norms and tendencies to conformity. Finally, one classic feature of the TPB is that it includes the aspect of perceived behavioral control, which refers to the beliefs that a person has that he or she can do the behavior. This is influenced by control beliefs which are belief about the things that may either favor or impede the behavior. Perceived behavioral control influences not only intention but may also have a direct influence on behavior especially when an individual has reduced control over the behavior. The framework described by Ajzen (1985) points out that an interdependence between these constructs mediate on behavioral intention. Strong positive attitude, supportive subjective norms and higher perceived control would cause a higher intention to engage in the behavior. Conversely any barriers in these spheres can lessen intention, thus reducing the likelihood of performing the behavior (Ajzen & Schmidt 2020).

Despite the merits of the TPB, it has also faced different criticisms. One of the critical criticisms of it is the fact that it relies on the assumption of rationality in decision-making. The hypothesis assumes the consistent evaluation of the costs and benefits of the decisions made by people, which may not be true in situations that are habit-related, impulsive, or emotional-based (Ulker-Demirel, & Ciftci 2020). As an instance, the addictive behaviors often make use of logical reasoning null to effectively apply many times thus making the TPB less effective in such cases. People have another criticism about the method used to measure the perceived behavioral control. The concept may be theoretically robust but often, it is inconsistent during real life research. Self-

reported assessment methods are typically relied upon by the researchers, and the degree of such type of control may not be very accurate (Hagger, et al., 2022). This discrepancy can cause low validity of predictions. Structural and contextual influences at large have also been criticized as being overlooked by the TPB due to its tendency to focus on factors at individual levels. Environmental and social issues such as the culture, socioeconomic status and institutional barriers can significantly present a change in behavior but not directly included in the model. Besides, the theory has also been criticized as being too localized on time component of intention-behavior relationships. One can be having intentions that could have been changing with time due to changing circumstances, yet there is this dynamic aspect that the TPB does not look at (Ajzen, 1985).

This research is aimed at analyzing through TPB the impact of tax information on the tax compliance and subsequent performance of the SMEs. Personality, learning types and successful control of behavior. These are significant in terms of understanding why SME owners are interested in adhering to the tax structure and the influence of their knowledge on such a decision. The opinions of small business owners regarding tax compliance depend on their perception regarding taxes, and in particular, whether views of tax as a substantial burden placed upon people as individuals or random decrees of the government. Tough demeanor will suffice when taxpayers perceive that tax system is efficient and transparent. Conversely, a negative perception can be caused by the feeling that corruption, government business and excessive consumption are not being influenced seriously. Knowing about tax laws, the necessity to follow the tax laws, and the advantages of paying taxes on the state budget of taxes will assist the SME owners in making good bargains with the tax compliance. According to a study conducted by Saads (2014), individuals who possess a profound knowledge of the meaning of taxation to the country and the general well-

being of people are much ready to comply with the law without coercion. Thus, more efficient approval and degrees of compliance can be achieved with the help of the advertising campaign penalizing the SMEs about the effect of high taxes. These norms depend on what is expected of us by others including, co- workers, family members or influential individuals in the business world. The simple components of the SMEs might involve the opinions of other business proprietors or business coalition concerning the taxation regulations. When the business has an atmosphere of adherence to business standards, small business owners are ready to abide by the laid down rules. The creation of the perception of normal behavior through the tax awareness campaigns can be significant as it demonstrates businesses that play by the rules and how every person can gain when every person plays by the rules (La Barbera & Ajzen 2020).

According to Bobek and Hatfield (2003), strict regulations are capable of influencing the willingness of taxpayers to comply and this is the case particularly in any strict economic society. Studies have shown that standards are enhanced by good friends and development of culture of compliance in SMEs this way the compliance to the tax laws will definitely rise. Regarding their capability of carrying out a certain behavior. It contains internal and external components i.e. talents and skills and external components like resources and core processes. SME proprietors regard management behaviour as being associated with their conviction in ability to cover their taxes. Tax literacy will help the owners of SME businesses to become conscious of issues in regard to taxation and therefore have the capacity to deal with complexities in taxation processes. The business owners are more prone to realizing their plans when they feel capable of adhering to the demands. According to Ajzen (2002), in case the perception of a person is agreeable after the assessment of reality, the perceived control will influence observed behavior and the actual behavior. An easier management may be achieved by simplifying the tax process, offering tools

that are easy to use and offer some form of training so that the SMEs can satisfy their requirements with ease. This theory can be applied by legislators and taxing agencies to come up with intervention strategies to enhance tax knowledge, lift strictures of compliance, and assist SMEs to carry out their tasks. In the case of the SMEs, more information will assist them in meeting legislation requirements as well as financial stability and its growth; the significance of tax compliance and success in finances is inevitable (Soliman, 2021).

2.2.2 Resource-Based View Theory

The theory of Resource-Based View (also known as an RBV theory) which was original proposed by Wernerfelt in 1984 provides a conceptual model through which competitive advantage can be developed by applying the resources within a firm to gain long-term competitive advantage. The theory is a significant change over the older models where emphasis was laid on the external positioning in the market such as the Five Forces by Porter, focusing on the unique internal characteristics of an organization (Freeman et al., 2021). A resource-Based View of the Firm provides a unique perspective to understanding firms along with their resource-based capabilities. These resources can be tangible or intangible and must match a set of standards to aid a sustainable competitive advantage. The resources need, in particular, to be valuable, rare, nonimitable, and cannot be replaced, or VRIN framework in short. Natural resources allow the companies to exploit chances within their environment or guard against the effects of threats. Rare resources refer to resources which are not in possession of the competitors. Inimitability refers to that a resource is not easily copied, and is often due to unique historical conditions or uncertain reasons or more complicated social forces. Finally, non-substitutable resources are the resources where no strategically equivalent substitute can be found (Dasuki, 2021).

Barney (1991) further extended Wernerfelt original framework to clearly outline the VRIN criteria and examined further the impacts of such criteria on the strategic management. According to Barney, those companies that are able to acquire, develop, and employ such resources can be able to create a sustainable competitive advantage that can result into improved performance in the long-run. His works pointed out the importance of resource endowments coupled with managerial activities on its realization. Path dependency is also another feature of the RBV theory whereby the progression of the past accumulation of resources and capabilities influences the present and subsequent strategic decisions of a firm. An example is that such firms who have previously spent more in research and development are better suited to innovate and maintain their competitive edge. Also, based on the theory, dynamic capabilities have been noted to be important according to Teece et al., (1997). Such skills enable firms to change, mix and restructure resources in response to the changes in order to ensure the competitive advantage also stays relevant to the firm.

Although the Resource-Based View (RBV) of the firm is well known and fundamental in strategic management, its strategic management has also received a number of criticisms since its inception. Its theoretical underpinnings, practical applicability as well as its inability to deal with dynamic market environments have been questioned by scholars (Lubis, 2022). These are critic remarks which present a fair argumentative position, displaying shortcomings of the RBV as a holistic model to understand competitive advantages. The one of the most widely presented arguments against the RBV, with emphasis made by Priem and Butler (2001) is the alleged tautology. According to critics, the theory specifies that only resources bearing competitive advantages are resources; it subsequently makes use of a circular reasoning in trading off usefulness in foretelling allowance. Through this tautological reasoning, it has become difficult to

speculate in advance of what resources will aid us because these resources are usually found out long after their effectiveness in influencing performance is determined. Moreover, it has also been argued that the RBV is not operationalized and tested empirically (Nayak et al., 2023).

Newbert (2007) claims that the theory does not provide information in determining and identifying resources that can meet the VRIN (valuable, rare, inimitable, and non-substitutable) conditions. This uncertainty creates problems to the researchers and practitioners, who seek to apply the RBV in the real world. As an example, it is easy to categorize intangible resources such as financial capital or physical assets but it is much more subjective to determine the value and uniqueness of such factors as organizational culture or brand reputation. RBV has also been criticized as being non-dynamic and has a one-sided look at events as to the availability of resources instead of the economical ways through which corporations procure, develop and utilize resources. According to Eisenhardt and Martin (2000), at dynamic and fast changing environments, the ability to have the resources is not the only parameter to consider in order to have the competitive advantage. Rather, long-term success is made possible by power to always be changing and re-arranging resources, what they refer to as dynamic capabilities. It is within this argument that the suggestion is that there is need to a more dynamic approach which considers the evolutionary nature of the competitive advantage. Moreover, the RBV has been faulted in not considering the external forces. Scholars that are inclined towards this opinion include Foss and Knudsen (2003) because they opine that the theory emphasizes on internal resources to the exclusion of market factors, industry structure and competitive relationships. This means that in industries in which force are afloat, the RBV will not be an adequate source of explanation of company performance due to its extremely subjective nature (Kosiol et al., 2023).

In small and medium-sized enterprise (SMEs), the RBV has a prominent role in analyzing the effect of intangible assets, including tax information, on financial success and sustainability. Examples of tangible capital are physical assets and financial capital; intangible capital also consists of knowledge, skills and leadership (Putra *et al.*, 2021). The knowledge of tax is expert knowledge that is significant to SMEs in a tax environment whereby the performance of an enterprise relation directly to compliance with taxes and tax regulations. Tax compliance the better SMEs understand the tax laws, the export process and the potential rewards, the better they are able to minimize the cost of compliance, eliminate penalties and maximize on tax benefits.

According to this view, one of the greatest advantages of strategic planning is the knowledge of taxes. Knowledge of tax by the small and medium-sized enterprises (SMEs) may enhance profitability through the enhancement of the financial planning and allocation of resources. The problems that SMEs with no tax knowledge may experience include being inefficient financially, managing tax advantages and violations and, consequently, decline in competitiveness. Hence, RBV assists in the recognition of the tax knowledge as a means useful to distinguish between successful and unsuccessful SMEs. Such variation is also eminent in SMEs because of varying knowledge in tax issues (Vasudevan, 2021). Companies which take the matter of tax serious like hiring appropriate financial talents or employing experts to assist or even offer training to their employees would give superior results. Such investments hinge on the argument advanced by Penrose (1959) who has stated that the growth and profitability of a company rest on the successful management and utilization of resources. In the case of the SMEs, investment in tax knowledge has the ability to turn tax knowledge into a powerful tool that can be used to enhance the operational and financial performance. Penrose (1959) also said that there must be a strategic engagement of resources so as to make the value. Tax information by SMEs should not be viewed

as a necessity in order to stick to the rules, but as a professional competence that assists one in making decisions in the financial sector (McGahan, 2021). By combining tax data with general financial and work activities, small and medium enterprises (SMEs) can minimize their tax risks, re-manage the cash flow and maximize their advantages. The example demonstrates the argument by the RBV that good management of its resources is a priority in the performance of a company. Tax literacy enhances the financial performance of SMEs and the theoretical framework offers a wide framework to analyze the improvement of tax literacy in enhancing the financial performance of SMEs. In this research, SMEs are led by the RBV theory to unravel the significance of the tax information as a valuable entity capable of enhancing their competitiveness, performance and financial stability. The fact that most SMEs lack numerous resources makes it important to be in a position to design and use viable tax information to maximize the success of these firms in a stiff competitive environment (Shibin *et al.*, 2020).

2.2.3 Profit Maximization Theory

This concept is clearly stated in the study and can be traced back to classical economics (Barney, 1991). As Friedman says, the primary responsibility of a company is to maximize profit but still within the framework of the law and ethical rules. He considered that maximizing profits is the social responsibility of businesses functioning in a capitalistic society and it is not only an economic requirement. Friedman maintained that the managers of a company are in a fiduciary relationship to increase the wealth of the stockholders that the managers act as agents of the stockholders (Bijannia & Dekamini 2024). His point was that monies must be invested in practices that bring the best returns as long as they are moral and socially acceptable. Corporate resources were not believed to be properly used when they were used for other activities, such as social or environmental, unless the objectives would lead to higher profitability of the firm. This perception

dates back to the conventional economic theory that states that feasible resource distribution in competitive market places is inspired by maximization of profits. Friedman noted that profit seeking encourages innovation, creates wealth and creates jobs to a society as a whole. A company that is profit-oriented is indirectly contributing to the good health of the society because it is contributing to economic growth and providing the supplies of goods and services that meet the demands of the customers (Weersink & Fulton 2020).

Although the theory introduced by Friedman puts heavy emphasis on economic efficiency and maximization of shareholder wealth, it has been criticized because it only focuses on the monetary benefits, and disregards the more significant ethical, social and environmental responsibility. Existence of this theory presented by Friedman motivating short-termism can be considered one of the most frequent arguments against his theory. The critics argue that overemphasis on quarterly earnings might result in the companies prioritizing the short-term financial gains over sustainable survival. This perspective has been brought into the limelight by examinations which in fact establish a connection between short-term profit-maximization methods and such behaviors as cost-cutting activities that lend themselves to poor environmental stewardship, employee welfare and product quality Rappaport (2005). The opponents of shareholder value allege that companies can forego investments in personnel development, innovation and other programs that foster long term prosperity by focusing on shareholder returns. Another criticism relates to the insufficient consideration of the effects of externalities that the theory contains. Under the concept of Friedman, businesses employ good resource distribution to make the greatest rewards out of the indirect society. There are still, nevertheless, many critics who cite instances of how such profit maximizing behavior leads to significant negative externalities such as pollution, climatic change, and even exploitation of the workers. The accounts

that the companies, which are out to make maximum profits, use do not cost the expenses that such externalities are imposing on the society Freeman et al., (2010). Opponents argue that it is the ethical responsibility of the companies to make proactive efforts to reduce this impact despite their reduced profitability. The rejection of the efforts of corporate social responsibility (CSR) that are not aimed at being profitable have been criticized by Friedman as well. The advocates of the stakeholder's theory, led by authors like R. Edward Freeman, assert that the business organizations should take into account the interests of all stakeholders: the workers, clients, suppliers, and society on a fair basis. In this light, the focus on shareholders only could cause contradictions with other stakeholders and undermine trust and bonding. According to Freeman et al. (2010), long term success is based on the development of positive relationships with all stakeholders but not only shareholders. The other attack has been the reliance of Friedman on government regulation as the primary mechanism of addressing the social and environmental issues. Academics argue that this assumption is unrealistic in practice because governments are often faced with resources shortage, political gridlocks, and regulatory pressure of powerful corporate players. Lack of a proper regulation would set the movement of firms that are inclined on making the most profit to use the gaps in regulations that would be detrimental to society. The critics urge firms to carry out voluntary CSR-related actions to address social and environmental problems head-on (Elkington 1997).

The tax knowledge is linked with profit maximization in SME business. Businesses place significance on taxes and failure to understand taxes will deny the small and medium sized businesses an opportunity to cut taxes. According to Palil and Mustapha (2011), the knowledge in tax is considered a means of knowing the tax law, tax compliance and tax benefits or incentives. This information is critical to SMEs that may avoid unwarranted funding in form of penalty,

overspending or absence of time to allow deductions and exemptions. Co-ordinate their operations with tax. To cite an example, they can effectively carry out tax planning by organizing their businesses in such a manner that they enjoy tax savings besides remaining legal. Financial performance can be enhanced through tax planning such as debt and reinvestment of the resources. Karanja and Ngugi (2019) point out that tax literate small and medium-sized enterprises (SMEs) are more successful regarding finances in Kenya than those that are not tax literate. It has received commendation from researchers because it knows how to apply the methods that minimize the debt compliance of SMEs and enhance financial management. On the same note, Evans (2003) points out that the cost of tax compliance, especially the time and other resource used to perform back and adhere to the regulations, affects small and medium-sized enterprises (SMEs) a great deal. Nevertheless, these cost are manageable by enhancing knowledge about taxes, enabling businesses to concentrate in lucrative undertakings. It is based on this theory that research into the ways and means employed by SMEs to collate their resources and expenses (including taxes) to bring about the most optimal outcome can and should be carried out. This knowledge of taxes is vital since it empowers the SMEs with information that they require in raising their profits and exploiting the complex tax regime.

2.3 The Empirical Review

2.3.1 Tax Incentives and Financial Performance

Tax incentives have proved to be a necessary policy instrument among governments all over the world as a way of encouraging the development, profitability and sustainability of small and medium-sized enterprises (SMEs). These financial provisions are meant to reduce the burden of tax on the SMEs, promote entrepreneurship and contribute to success of the enterprises in the long term. Throughout much empirical research has been done to investigate a relationship between tax

incentives (dependent on capital deductions, exemptions and credits) and financial performance of SMEs and discovered both direct and indirect positive impacts. Mbroh and Attom (2020) conducted a comprehensive study of the reforms of tax policies and SMEs performance in Ghana. They found out that capital allowances, tax exemptions, and others play a key role in positively affecting the financial stability of SMEs. They suggested that such incentives boost their disposable income of SMEs, thus enabling to re-invest in key areas like acquisition of new capitals, expansion of workforce, as well as product innovations. Their findings support the notion that well-formulated tax incentives do not only improve the cash flow of businesses, but they also promote the greater flow of reinvestment within the economy, which assists the country to progress.

Kinyua and Nyambane (2018) analyzed the impacts of tax exemptions on SMEs in Kenya and found that the businesses who had acquired tax exemptions received an average rise in profits by 18 percent more than non-recipients. According to the research, the providers of these financial advantages associated them with reduced operational costs and improved financial margins among the firms thanks to the tax break. The authors found out that tax exemptions form good tools to increase the profitability and sustainability of SMEs particularly in a competitive market. Sanni (2019) also investigated the ability of tax holidays to support the thriftiness of new businesses in Nigeria. He also noted that temporary tax holidays allow the businesses who are first time entrepreneurs in the SME to operate without being burdened by the impending tax load, thereby increasing their chances of survival and solvency in the long term. In the study, the author describes how the initial financial assistance in the early business years is of great essence and how tax incentives at the outset can have tremendous influence on the survival of SMEs. Targeted tax credits on specific activity such as research and development (R&D) or environmental compliance

have been effective too. In one of the studies that centered on the U.S. SMEs operating in the tech-intensive economy, Laffer (2020) found out that a 3-year increase in revenue with regards to the firms receiving the R&D tax credits was 22%. This growth was related to the introduction of new products and services along with generation of jobs. As pointed out by Laffer, R&D tax assistance plays a significant role in fostering innovation and competitiveness especially in the high-growth industries.

Similarly, Nteere et al. (2021) threw some light on the influence of investment tax incentives on small and medium enterprises in South Africa. They have found out that SMEs that received such incentives experienced an average growth in their profits of 25 percent within four years. These incentives enabled SMEs to make investments in modern equipment and technologies hence productivity, efficiency of operation, and competitiveness in the market. This study proved the idea, that tax breaks do not only provide a short-term economic stimulus but also facilitate long-term strategic investment. In addition to direct financial outcomes, developmental effects have been linked to a larger extent with tax incentives. Recently, Musah and Akomea-Frimpong (2022) have studied the correlation between tax incentives and business formalization in SMEs of Ghana. They revealed that SMEs that enjoyed tax incentives were more prone to formalize their operations. In its turn, formalization allowed gaining access to credit opportunities and external financing, better enforcement of the rules, and ongoing expansion. Odhiambo et al. (2021) also researched the socioeconomic impact of tax incentives in Kenya concerning employment. They found that companies who were able to utilize a given set of tax incentives were able to add an average of 12 percent in number of employees annually. This growth did not only increase the efficiency of business operation, but also contributed to greater economy development through job creation and reduction of poverty.

Despite how many research efforts have been done to prove the benefits of incentives to the SMEs, a significant weakness is still present regarding the geographical orientation of the research. A large part of the existing studies, as it is noted by Musyoka (2019) and Ochieng (2020), has concentrated around large cities or highly developed countries, where the system of taxes, consulting services, and applicable regulations have been long established. These observations fail to capture the issues faced by the SMEs in the rural and semi-urban areas such as Vihiga County. As an example, access to tax education in the sector may be limited to rural small and medium enterprises as services are less institutional and there is limited knowledge of available incentives. Such situational differences are confined to limit the applicability of the urban-oriented findings in the rural setting. This research therefore addresses a significant research gap that investigates the effects of tax incentive on financial performance of SMEs in rural areas like Vihiga.

2.3.2 Income Tax Awareness Level and Financial Performance

The link between tax awareness and the financial prosperity of small and medium-sized enterprises (SMEs) has been thoroughly researched, highlighting the crucial importance of tax literacy in improving business results and maintaining compliance with tax regulations. Research consistently shows that SMEs possessing superior tax knowledge often demonstrate enhanced financial performance, which is linked to more effective tax planning and compliance approaches. Bala et al. (2022) showed that tax awareness in Indian micro, small, and medium enterprises (MSMEs) boosts productivity. Their research, utilizing Partial Least Squares Structural Equation Modeling (PLS-SEM), demonstrated that firms with sufficient tax awareness are more equipped to adhere to tax laws, decrease tax evasion, and lower penalties. Additionally, the research indicated that progress in tax technology has enhanced compliance and governance in small and medium-sized enterprises (SMEs). In the European context, Marcu et al. (2023) carried out a

longitudinal study emphasizing that although SMEs frequently view the tax burden as a problem, inadequate tax knowledge worsens its effects. The research indicated that companies deficient in tax understanding are more prone to miss essential tax details, resulting in financial instability. Likewise, studies in South Africa conducted by Maseko (2014) and Wadesango & Mhaka (2017) support these conclusions. Their research shows that SMEs possessing better tax awareness are more inclined to adhere to tax regulations, thus evading penalties and improving financial management. In contrast, SMEs lacking sufficient tax understanding frequently encounter tax penalties that adversely impact their profits. In addition to meeting regulations, understanding taxes aids in efficient financial planning.

As Loo et al. (2016) found out, companies that have a clear picture of what they should pay in taxes engage in more strategic financial planning, leading to more effective resources allocation and effectiveness; this is because they thoroughly comprehend the impact of setting aside funds needed in paying taxes. This is most evident in firms that use regulatory compliance technologies which streamline the activities related to tax, and make them efficient. In the Kenyan settings, many studies have investigated the impact of tax knowledge in the compliance of the SME. Kandagor et al. (2024) investigated the impact of taxpayer awareness to Turnover Tax compliance of SMEs at Kariokor Market in Nairobi. The study pointed out that there is a positive relationship between the taxpayer awareness and Turnover Tax compliance meaning that KRA should put some money in taxpayer awareness initiatives in the form of education to increase the knowledge and understanding regarding SMEs. In another study, Gitonga and Kilonzi (2022) examined how taxpayer education affected the SMEs tax compliance of Meru Town in Kenya. They found out that electronic taxpayer education, stakeholder awareness programs, and education through the print media had an indisputable impact on tax compliance among SMEs. The study discovered

that joint programs in these areas can increase tax compliance and proposed that KRA must improve these educative methods. The paper by Okoth et al. (2024) assessed the impact of tax knowledge on the compliance of consumption tax between retailers within the Starehe Sub-County of Nairobi. The study found out that tax literacy contributes significantly to the understanding of tax on consumption and suggested that KRA should conduct thorough tax literacy programs to enlighten retailers on tax regulations and benefits. Gichohi and Muchira (2023) examined the effects of the electronic taxpayer education on tax compliance among manufacturing small and medium enterprises in Nairobi City County. In their study, it was found that electronic taxpayer education positively affects tax compliance, which may indicate that policymakers ought to enhance the use of online means to educate taxpayers.

All these researches show how the issue of tax awareness and education play a significant role in enhancing tax compliance among SMEs. However, several studies have relied mostly on the secondary data which may not portray the intricate knowledge of tax compliance in the SMEs. As an example, Ochieng (2019) reviewed the information included in KRA reports that cannot reflect the detailed opinions of SMEs regarding tax compliance. On the other hand, this paper aims at overcoming this shortcoming by collecting primary information through questionnaires, thus allowing to reach the greater audience and more objective answers. The approach will help decrease potential biases and increase the validity of the findings, providing a more comprehensive idea of the correlation between the tax knowledge and financial performance of SMEs.

2.3.3 Investment Tax Awareness and Financial Performance

Much evidence points out the critical influence of tax awareness in regulating the financial performance and compliance behavior of small and medium-sized enterprises (SMEs). Tax literacy entails the understanding of tax payments, benefits, and incentives, which in sum affect

the strategic financial decisions of the SMEs. This synthesis investigates various researches to explain the impact of tax awareness on SMEs concentrating on tax knowledge related to investments. According to Astana and Merkusiwati (2017), the tax literacy influences directly the level of compliance and the investment plans of SMEs. According to their study, the level of awareness of tax systems by the SMEs will enable them more ready to use tax incentives, which will not only reduce debt but also lead to reinvestments in their businesses, improving their financial performance. Within the European context, Ravselj et al. et al. (2019) survey the amount of tax that SMEs in Slovenia face. They realize that despite the existence of tax burdens, the SMEs capable of effectively coping with the tax regimes and utilizing available financial resources can eliminate the problem, enhancing the cost recovery and other indicators of performance. Vincent (2021) develops a scale of tax compliance aimed at Nigerian SME, noting such metrics as the complexity of the tax regime, tax compliance expenses, and tax information. The study indicates that a good knowledge of taxes which includes alertness to the tax incentives is a major contributor to compliance and financial stability to SMEs. Wadsango et al. (2020), in Zimbabwe, assess the effectiveness of the tax amnesties program in affecting the compliance practices of SMEs. Their findings are that tax amnesties aim at improving compliance but can only be determined by how knowledgeable and understandable the policies are through SMEs. Enhanced tax knowledge is therefore a key to success of these initiatives.

Heimonen (2021) pays attention to the Finnish SME sector and notes that the data on taxation of investment-related expenses improves returns on investment (ROI) and the profitability of an enterprise in general. SMEs with knowledge in terms of tax deductions and credits are in a better position to direct their resources to innovation and growth hence enhance their financial performance. Examining Indonesian SMEs, Timothy and Abbas (2021) come to the conclusion

that the company with a high level of tax awareness combines business plans and the financial support system more effectively. This combination is beneficial in terms of revenue increase and financial stability, which confirms the importance of incorporating tax education in small and medium enterprises support programs. Tax education and awareness are some of the key issues highlighted in many studies in the context of Kenya. Kandagor et al. (2024) find that knowledge of taxation influences positively the compliance behaviour in the payment of the turnover tax by SMEs in Kariokor Market, Nairobi. Similarly, other studies carried out in Meru Town reveal that a combination of electronic taxpayer education, the creation of awareness to the stakeholders, and printed media education remarkably contributes to making tax compliance among SMEs (African Tax and Customs Review, 2023). Despite these results, other studies including Ochieng (2019) consider tax awareness as one concept, without giving particular attention to the characteristic impacts of various forms of taxes such as income tax, investment tax, and value-added tax (VAT). This general approach fails to consider the eventual influence of a specific repertoire of knowledge about investment tax on the financial outcome as it enriches choices of investments and capital allocation. This gap in the literature is what the current study sought to address as it conceptualized investment tax awareness as a unique element on the financial performance of SMEs.

2.4 Summary of the Literature and the Research gap

The issue of tax awareness has gained full momentum as an influence that impacts financial outcomes of small and medium enterprises (SMEs). This relationship is well researched particularly in the construction industry where SMEs are experiencing numerous financial and operational issues. Literature indicates that tax literacy which is an understanding of the tax laws, the necessity of paying taxes and the advantages thereof on the development and growth of the SMEs is relevant. This will be as a result of ignorance in the tax system. This is also further

compounded by the fact that taxes have been increased and the process of compliance is very complicated giving effect to the fact that people do not voluntarily comply (Mnewa and Maliti, 2008). In Kenya, SMEs comprise a major part of the economy and most of them work illegally or fail to operate legally because of their ignorance and the cost of adhering to the law. Ignorance does not only amplify the chances of non-compliance but it also exposes the businesses to the risk of penalties that can negatively affect their future financial performance and growth Muklis et al., (2015). Legal enforcement. In this research we can identify two significant elements of tax knowledge which are legal and procedural. Legal tax knowledge entails knowledge of the rates of taxes, exemptions and legal provisions of taxes, whilst the knowledge of tax process entails compliance with the requirement necessary like filing and payment of taxes Adebisi and Gbegi (2013).

Having improved knowledge on taxes, the SMEs will be in a better position to meet tax legislations since they will be in a better position to deal with complex tax protocols and incur unwarranted cost. This research will also give more knowledge on how the tax literacy indicators can be used in achieving some wider economic goals in addition to enhancing financial performance of the small and medium enterprises in Vihiga County, Kenya Muklis et al., (2015). Nevertheless, knowledge is not the only factor that influences SMEs tax knowledge. The level of tax compliance may depend on external influences which include corruption within the tax authorities, negative interest in the tax regime, and the overall business environment among others. To give just one such case study example when these perceptions were evaluated again in similar cases a relationship was found between the perceptions of corruption and a lack of accountability by the tax authorities as increasing the trust in the tax system hence influencing compliance Berhane (2011). These factors can influence the tax compliance of small and medium applicable

businesses in Vihiga County, Kenya. Despite the valuable information the available literature can tell about tax knowledge compliance, not much is known about its direct linkage to financial performance. The vast majority of researches only examine the main advantages of tax literacy and barely consider the positive effect of tax literacy on such economical outcomes as an economic growth, financial stability, and accessible credits (MDPI, 2020). More so, evidence on the role of digital infrastructure on enhancing tax knowledge and compliance in SMEs in low-income regions like Vihiga County through e-tax platforms is scarce. The second variability is associated with the context of the present study. Almost all the literature available talks about a more regional or national analysis and hardly anything is available about the issues and opportunities of SMEs in these regions. Economic status using agricultural and small business economy of the County of Vihiga requires a regional analysis of the influence of tax knowledge on financial returns of the SMEs. To overcome these problems, there should be deep researches to determine whether there is a correlation between the level of tax knowledge with financial performance and also the intervening variables that influence such a correlation Muklis et al., (2015).

2.5 Conceptual Framework

The conceptual framework demonstrates how different aspects of tax awareness are interconnected with the financial performance of small and medium-sized enterprises (SMEs). In this framework, tax incentives/credits, income tax, and investment tax are considered the independent variables, while the financial performance of SMEs is treated as the dependent variable. This framework operates under the assumption that enhanced tax awareness can impact financial outcomes by means of various tax-related practices and advantages.

Independent variables

Dependent variable

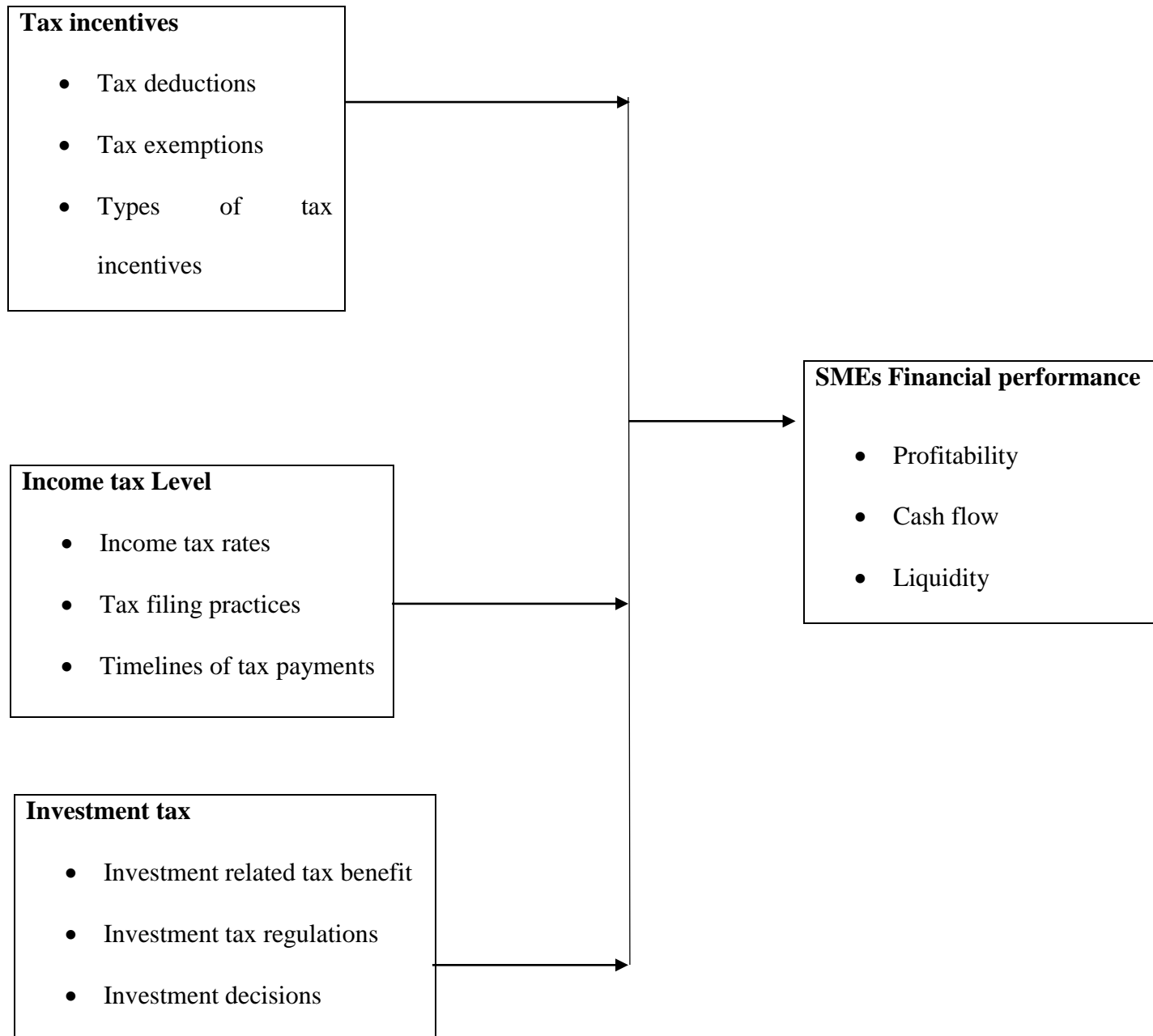


Figure 1 Conceptual Framework

2.6 Measurement and Operationalization of Variables

Table 1 Operationalization of the Study Variables

Variable	Type	Indicators	Measure	Question in questionnaire
Tax incentives	Independent variable	<ul style="list-style-type: none"> • Tax deductions • Tax exemptions • Type of tax incentives 	<ul style="list-style-type: none"> • Interval scale 	Section B
Income tax level	Independent variable	<ul style="list-style-type: none"> • Income tax rates • Tax filing practices • Timelines of tax payments 	<ul style="list-style-type: none"> • Interval scale 	Section C
Investment tax	Independent variable	<ul style="list-style-type: none"> • Investment related tax benefit • Investment tax regulation 	<ul style="list-style-type: none"> • Interval scale 	Section D

		<ul style="list-style-type: none"> • Investment decisions 		
SME financial performance	Dependent variable	<ul style="list-style-type: none"> • Profitability • Cash flow • Liquidity 	<ul style="list-style-type: none"> • Interval scale 	Section E

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the techniques employed to achieve the research objectives. It outlines the research structure, techniques for data collection, sampling approaches and procedures for data analysis. The approach ensures that the study is conducted systematically and ethically, providing reliable insights to address the research questions.

3.2 Research Design

Research design is defined as the inclusiveness methodology a researcher uses to come up with coherent and logical marriage of different aspects of research and ensure that the research problem is addressed. It entails the structure of collecting, measuring, and analyzing data Creswell (2014). The research was informed by a descriptive research design to find out the effects of tax awareness to the financial performance of the small and medium sized enterprise (SME). A descriptive research framework is the one that is generally constructed to define the nature of a population or phenomenon in a systematic and accurate fashion. According to Creswell (2014), descriptive research aims at establishing the facts about what exists on a certain phenomenon as opposed to examining the reasons as to why the phenomenon exists. On the same note, Babbie (2020) underlines that descriptive research presents a detailed snapshot of particular variables in a study and the researcher is in a position to see and comprehend patterns without adjusting the variables.

3.3 Population of the Study

The population of interest in the study refers to a total number of people or other beings which the researcher tries to study Mugenda & Mugenda (2003). In this or any other study, the target population can be constituted of 150 SMEs that had an annual turnover of one million and above. Such SMEs are: financial services, supermarkets and shops, boutiques, the hoteliers, general hand wares, transport services and information technology services, where the owners/ managers of these businesses will be well versed with regard to financial performance of their businesses and thus tax awareness.

3.4 Sample Size and Sampling Procedure

According to Cooper and Schindler (2001), a census refers to the strategy of collecting information on every rule of a target population, and hence the entire population is examined rather than a sample of the entire population. Using a census method eliminates sampling errors and provides details as well information that is comprehensive and accurate about the population under study. According to Kothari (2004), census ensures highest reliability and representativeness since all the factors in the population are represented in the study. This study employed census method, which covered SMEs of 150 in the target population. The SMEs were grouped at first into different levels based on their respective sectors. These industries were the Financial Services, Supermarkets and Shops, Boutiques, Hoteliers, General Hand Wares, Transport Services and Information Technology Services. All the levels had SMEs operating in the same sphere. With the introduction of stratification, the study made sure that the area on sectoral diversity was represented well hence the results were more profound and relevant. All SMEs within each stratum were used and all the data obtained allowed a good comprehension of the dynamics of the sector. Data collection was done using questionnaires.

Table 2 Summary of small and medium-sized enterprises (SMEs) per sector

Item	Categories	No. of listed firms	Percentage
1.	Financial services	25	16.67%
2.	Supermarkets and shops	30	20%
3.	Boutiques	14	9.33%
4.	Hoteliers	22	14.67%
5.	General hand wares	20	13.33%
6.	Transport services	19	12.67%
7	Information Technology services	20	13.33%
	Total	150	100%

3.5 Instrumentation

According to Cooper (2014), questionnaire is a sophisticated arrangement, whether in writing or printed that is composed of organized group of questions but in the form of question that is structured to gain information about one or more topics by one or a number of respondents. It was designed with the latest literature and opinion of specialists to ensure the questionnaire is relevant. The final questionnaire that would be given to the other person was posted online to increase the number of participants and to guarantee the accuracy of data. A structured questionnaire was used in collecting primary data among the participants in the research. The survey consisted of five parts. Personal information was obtained in section A by focusing on aspects such as age, gender, educational level, and business characteristics. Section B was focused on tax incentives and credits, Section C was on income tax, Section D was on investment tax, and the last section which was Section E was on financial performance. The survey was done with a variety of close ended

and a few open-ended items so that the respondents could be keenly honest. The majority of items were assessed on an interval scale through a 5-point Likert scale that ranged from “Strongly Disagree” being 1 to “Strongly Agree” being 5 to gauge respondents' perceptions and degrees of awareness.

3.5.1 Validity of Instrument

Professional analyses and pilot test were run to ensure proper testing and accuracy of the questionnaire before its application on a broader level. Tiny stratum of the target members was first of all selected. They were asked to complete the survey. After finishing the task, the researcher asked them to help out with the questions, whether they were understandable and straight forward. The researcher then studied the comments and established whether the responses were rational. In case there were questions that were not clear or not working as they supposed to, the researcher had to make corrections. This was accompanied by rephrasing questions or doing away with redundant questions. Finally, upon making any necessary adjustments, the researcher re-tested the revised instrument using a small sample and established that it was ready to be used in the entire study. This process helped establish the fact that the tool was valid and worked well as intended. In determining content validity of the questionnaire, the experts in field of taxation and finances were consulted in a bid to reassure that the questionnaire covered all crucial aspects of financial performance and tax awareness (Bryman, 2016). Construct validity was assessed by ensuring that the questions were in line with the purpose of the research. During the pilot-test any ambiguous or unspecified items were corrected to increase legibility and precision.

3.5.2 Reliability of Instrument

Reliability means how an experiment, a test, or any other type of measuring process provides the same outcome when it is repeated (Creswell, 2014). To ensure the reliability of the questionnaire, it was tested on stability and consistency of measuring the tax awareness and financial performance in the owners of SME. The reliability was gauged by use of test-retest process (Mugenda and Mugenda, 2003). To examine whether their answers are consistent, a test-retest strategy was applied when a small sample of the population was provided with the questionnaire twice within a specified period of time. All the necessary changes were made to enhance reliability of the instrument before the actual data collection process.

3.6 Data Collection Method

This research utilized questionnaires as the primary tool for data collection to gather insights on tax awareness and its effects on the SME financial performance. In this study, questionnaires were used as the main source of collecting data with the aim of obtaining the response on tax awareness and its effects on the SME financial performance. Cooper and Schindler (2014) state that a questionnaire constitutes one of the primary forms of data gathering wherein structured questions are asked to the participants and their answers duly noted down and analyzed. The researcher sent the questionnaires over the internet to the target population and this made data collection process more effective and timelier. The respondents were clearly told the purpose of the study before it was distributed to improve the purpose of the study among the respondents and make them participate. According to Mugenda and Mugenda (2013), elucidating about the objectives of the study and the character of the data collecting tools also promotes high response rates and validity of the instruments that are employed.

3.7 Data Analysis

Analysis of the data was conducted using correlation analysis, descriptive statistics, and multiple regression models, aided by the SPSS software. Descriptive statistics were used to profile and summarize the status of tax incentives/credits, income tax, investment tax, and the financial performance of small and medium-sized enterprises (SMEs). Correlation analysis was used to establish whether a relationship existed between the independent variables (tax incentives/credits, income tax, investment tax) and the dependent variable—financial performance of SMEs. Regression analysis was also conducted, and the results were used to test the hypotheses of the study. The following regression model was applied:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where:

Y = Financial Performance of SMEs

β_0 = constant (coefficient of intercept)

X1 = Tax incentives/credits, X2 = Income tax, X3 = investment tax

β_1 , β_2 , β_3 = regression coefficient of Tax incentives/credits, Income tax and = investment tax respectively.

ϵ = Error term

The error term indicates that there are other factors that affect financial performance of SMEs which cannot be accentuated in this study.

3.7.1 Diagnostic Test

Table 3 Summary of diagnostic test to be carried out

Diagnostic test	Specific test	conclusion
<p>Normality test</p> <p>This is a statistical test used to check if a set of data follows a normal distribution, which is a bell-shaped curve.</p>	Shapiro-Wilk test	If p value is > 0.05 , data is normally distributed, if not there is skewness.
<p>Heteroscedasticity test</p> <p>It is a statistical procedure used to determine whether the variance of the errors (residuals) in a regression model is constant across all levels of an independent variable.</p>	Breusch – Pagan test	If P value is $<$ than 0.05 reject the null hypothesis, if P value is $>$ than 0.05 accept
<p>Multicollinearity test</p> <p>Applied to detect the presence of high correlations among independent variables in a regression model.</p>	Value inflation factor (VIF)	If VIF is < 5 there is no significant multicollinearity, if VIF is between 5 to 10 there is moderate multicollinearity & if VIF is > 10 there is severe multicollinearity
<p>Autocorrelation test</p>	Breusch-Godfrey LM test	If P value is < 0.05 reject H_0 , If P value is > 0.05 accept the H_0 .

<p>A test that determines linearity between errors on a series of observations over time.</p>		
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3.8 Ethical Considerations

The researcher prioritized the privacy and confidentiality of the information provided by the respondents. She acquired ethical approval from the ethics committee of KCA University and applied for a research permit from the National Commission for Science, Technology and Innovation (NACOSTI) to carry out the study. An introductory letter was given to the respondents to clarify the study’s objectives. Before collecting data, the researcher obtained the respondents’ consent. While collecting data, the identities of the respondents were kept secret to maintain the confidentiality of their information. The collected data was used to gain knowledge about the tax awareness of SME owners in Vihiga County, Kenya and helped the community better understand why tax is important and the benefits of timely tax filing, among others, as discussed in the study. Data was stored electronically in Word/PDF documents, retained for a period of six months after the research, and was disposed of by securely deleting electronic files.

CHAPTER FOUR

FINDINGS AND DISCUSSION

4.1 Introduction

This chapter's primary subjects include the data analysis for the study and the presentation and explanation of the findings. The results are examined and shown in tables, each of which has a background explanation to help set the scene and improve comprehension.

4.2 Response Rate

As shown in Table 4, the researcher gave the sample population a set of 150 questionnaires.

Table 4 Response Rate

Category	Frequency	Percentage
Response	116	77
Non-Response	34	23
Total	150	100

Source (Author, 2025)

The study attained a noteworthy response rate of 77%, signifying a substantial degree of involvement from the respondents. A response rate of more than 23% is deemed extraordinary by Kombo and Tromp (2019) criteria, indicating strong questionnaire validity at the data processing stage.

4.3 Demographic Analysis

4.3.1 Gender of the Respondents

Table 5 Gender of the Respondents

Category	Frequency	Percentage
Male	51	44
Female	65	56
Total	116	100

Source (Author, 2025)

Table 5 presents the gender distribution of respondents who participated in the study on the impact of tax awareness on the business financial performance of Small and Medium Enterprises (SMEs) in Vihiga County, Kenya. Out of the 116 total respondents, 65 (56%) were female, while 51 (44%) were male. This indicates that the majority of SME operators engaged in the study were female. This gender distribution suggests an increasing trend of female participation in entrepreneurship and SME management within Vihiga County, Kenya. The active involvement of women in business may be attributed to empowerment programs, improved access to financial resources, and greater awareness of compliance obligations, including tax matters. Supporting literature affirms this trend. According to Kinyanjui (2010), women in Kenya are playing an increasingly vital role in the SME sector, driven by both necessity and opportunity entrepreneurship. Similarly, Mwobobia (2012) notes that female entrepreneurs are progressively becoming tax compliant due to growing awareness and education on financial and legal business practices.

4.3.2 Age Bracket of the Respondents

Table 6 Age bracket of the respondents

Category	Frequency	Percentage
18-25 years	20	17
26-35 years	71	61
36-45 years	18	16
46-55 years	5	4
Above 55 years	2	2
Total	116	100

Source (Author, 2025)

Table 6 presents the age distribution of respondents participating in the study. The majority of respondents, 61%, fall within the 26–35 years age bracket, indicating that most SME operators are young adults. This is followed by 17% in the 18–25 years category, suggesting a growing number of youths venturing into entrepreneurship. Respondents aged 36–45 years constituted 16%, while 4% were between 46–55 years, and only 2% were aged above 55 years. The results imply that SME ownership in Vihiga County, Kenya is largely driven by younger individuals, particularly those below 35 years of age. This trend may reflect the increasing involvement of youth in business as a means of self-employment amid limited formal job opportunities. According to Gachanja and Were (2021), the youth are becoming more proactive in entrepreneurship, particularly within Kenya’s devolved counties, due to access to digital tools and entrepreneurial training. Additionally, Ngugi et al. (2018) highlight that younger entrepreneurs are more receptive to financial education and tax compliance programs, making them a critical group for interventions aimed at improving SME tax awareness and financial performance.

4.3.3 Participants' level of education

Table 7 Highest level of education of the respondents

Category	Frequency	Percentage
No formal education	1	1
Primary	0	0
Secondary	9	8
Diploma	20	17
Degree	69	59
Postgraduate	17	15
Total	116	100

Source (Author, 2025)

Table 7 presents the highest level of education attained by respondents in the study. The majority of the respondents, 59%, hold a diploma, followed by 17% who have attained a secondary education level. Additionally, 15% of the respondents possess postgraduate qualifications, while 8% have a degree, and only 1% reported having no formal education, with 0% indicating primary education. These findings suggest that most SME owners in the county are fairly well-educated, with a significant number having post-secondary qualifications. According to Atkinson and Messy (2012), education plays a crucial role in enhancing financial literacy, including tax awareness, thereby improving financial decision-making and compliance. Furthermore, Wanjohi and Mugure (2017) observed that educated entrepreneurs are more likely to understand tax obligations and engage with digital tax platforms effectively, contributing positively to business performance.

4.3.4 Number of Years in Business

Table 8 Number of Years in Business

Category	Frequency	Percentage
Less than 1 year	19	16
1-2 years	44	38
4-6 years	25	22
7-10 years	12	10
Above 10 years	16	14
Total	116	100

Source (Author, 2025)

Table 8 presents the number of years respondents have been in business. The largest proportion of respondents, 38%, have operated their businesses for 1–2 years, followed by 22% with 4–6 years of experience. 16% have been in business for less than 1 year, while 14% have operated for more than 10 years, and only 10% fall within the 7–10 years category. These figures indicate that a significant number of SME owners are still in the early stages of their business ventures, which may affect their level of tax knowledge and compliance. According to Kiriri (2019), newer businesses often face challenges in navigating tax systems due to limited experience and exposure, which can affect their financial performance. Similarly, Olawale and Garwe (2010) argue that business longevity enhances operational stability and increases the likelihood of engaging in formal financial and tax systems.

4.3.5 Nature of Business

Table 9 Nature of Business

Category	Frequency	Percentage
Retail	78	67
Wholesale	13	11
Others	25	22
Total	116	100

Source (Author, 2025)

Table 9 presents the nature of businesses operated by the respondents in the study. The majority, 67%, of the respondents are engaged in retail businesses, followed by 22% in other types of businesses, and 11% in wholesale operations. These results suggest that retail enterprises dominate the SME landscape in the county, which is consistent with national trends where small-scale retail is a common entrepreneurial entry point due to lower capital requirements and broader customer reach. According to Mutua (2017), retail SMEs often have direct interactions with consumers and are highly susceptible to tax policy changes, making tax awareness critical for sustaining their financial performance. Furthermore, Ngugi and Bwisa (2013) highlight that the nature of business significantly influences record-keeping practices and tax compliance, especially among retailers who handle daily cash transactions.

4.3.6 Business Registration Status

Table 10 Business Registration Status

Category	Frequency	Percentage
Registered	61	55
Not Registered	53	47
Total	116	100

Source (Author, 2025)

Table 10 presents the business registration status of the respondents involved in the study. The findings show that 55% of the businesses are registered, while 47% are not registered. This indicates that nearly half of the SMEs operate informally, which may have implications on their tax compliance and access to financial or government support. These findings align with KIPPRA (2021), which noted that a significant portion of SMEs in Kenya remains unregistered, contributing to low tax compliance levels. Furthermore, Mungai and Bwisa (2019) argue that unregistered businesses often lack the necessary awareness of tax obligations and the benefits of compliance, thereby limiting their potential for sustainable growth and financial stability.

4.3.7 SMEs Sector

Table 11 SMEs Sector

Category	Frequency	Percentage
Transport	15	13
Financial	17	15
General	10	8
Information	14	12
Boutique	21	18
Supermarket	31	27
Hotelier	8	7
Total	116	100

Source (Author, 2025)

Table 11 presents the distribution of SMEs across various sectors in Vihiga County, Kenya. The findings indicate that the majority of SMEs fall within the supermarket sector (27%), followed by boutique (18%), financial services (15%), transport (13%), information (12%), general services (8%) and hotelier (7%). This sectoral spread demonstrates the diversity of the SME environment in the region, with a strong presence in retail-related and service-oriented businesses. The dominance of supermarket and boutique businesses suggests that retail trade remains a primary source of livelihood for many entrepreneurs in the county. These findings are supported by KNBS (2022), which notes that most SMEs in Kenya are concentrated in the retail and service sectors, which often face challenges in tax compliance due to informal operations and limited tax knowledge. As such, sector-specific tax awareness initiatives could enhance compliance and financial performance among these enterprises.

4.4 Pilot Test Results

Table 12 Pilot Test Results

Items	N of Items	Cronbach's Alpha	Remarks
Tax incentives	4	0.70	Reliable
Income tax awareness	4	0.72	Reliable
Investment tax awareness	4	0.73	Reliable
Business financial performance	4	0.73	Reliable

Source (Author, 2025)

Table 12 presents the results of the pilot test assessing the reliability of the research instrument using Cronbach's Alpha. The results show that all constructs recorded acceptable reliability scores: Tax incentives ($\alpha = 0.70$), Income tax awareness ($\alpha = 0.72$), Investment tax awareness ($\alpha = 0.73$), and Business financial performance ($\alpha = 0.73$). According to Mugenda and Mugenda (2003), a Cronbach's Alpha value of 0.70 and above is considered acceptable for determining internal consistency of a measurement scale. Therefore, all the items used in the study demonstrated adequate reliability, indicating that the questionnaire is consistent in measuring the intended variables and is suitable for full-scale data collection.

4.5 Analysis of Study Variables

4.5.1 Tax deductions and the financial performance of SMEs in Vihiga County, Kenya

Table 13 Tax deductions and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	Tax deductions help reduce my business's taxable income	3.74	.970
2	I have utilized tax deductions to improve my business's financial performance	3.47	.909
3	The government provides adequate information on tax deductions available for SMEs	3.33	1.200
4	My business actively takes advantage of available tax deductions	3.45	.954

Table 13 presents the descriptive statistics on the relationship between tax incentives and credits and the financial performance of SMEs in Vihiga County, Kenya. The statement "Tax deductions help reduce my business's taxable income" recorded the highest mean score of 3.74 with a standard deviation of 0.970, indicating a general agreement among respondents that tax deductions are beneficial in lowering taxable income. The lowest mean score was 3.33 (SD = 1.200) for the statement "The government provides adequate information on tax deductions available for SMEs," suggesting moderate awareness and possible gaps in information dissemination. The statements "I have utilized tax deductions to improve my business's financial performance" and "My business actively takes advantage of available tax deductions" had mean scores of 3.47 and 3.45 respectively, showing that many SMEs are moderately responsive to tax incentives. These findings

are supported by Siololo (2022) who emphasized that tax incentives, when well understood and effectively utilized, can significantly enhance the financial outcomes of small enterprises by reducing operational costs and improving compliance levels.

4.5.2 Tax Exemptions and the financial performance of SMEs in Vihiga County, Kenya

Table 14 Tax Exemptions and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	Tax exemptions help my business reduce operational costs	4.50	.707
2	I am aware of the tax exemptions available for SMEs	4.00	1.414
3	My business benefits from tax exemptions provided by the government	5.00	.000
4	The process of applying for tax exemptions is simple and clear	5.00	.000

Table 14 presents the descriptive statistics on the relationship between tax exemptions and the financial performance of SMEs in Vihiga County, Kenya. The statements "My business benefits from tax exemptions provided by the government" and "The process of applying for tax exemptions is simple and clear" both recorded the highest possible mean score of 5.00 with a standard deviation of .000, indicating unanimous strong agreement among all respondents. This suggests that tax exemptions are not only accessible but also greatly beneficial to SME operations. The statement "Tax exemptions help my business reduce operational costs" also received a high mean of 4.50 (SD = .707), reinforcing the perception that tax exemptions contribute significantly

to cost reduction. Additionally, the mean score of 4.00 (SD = 1.414) for the statement "I am aware of the tax exemptions available for SMEs" indicates that a majority of respondents are well-informed about the available exemptions. These findings align with Adegbe and Akinyemi (2020), who noted that tax exemptions enhance SME sustainability by lowering financial burdens and increasing available capital for reinvestment, thereby boosting financial performance.

4.5.3 Tax Incentives and the financial performance of SMEs in Vihiga County, Kenya

Table 15 Tax Incentives and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	The government provides a variety of tax incentives for SMEs	3.47	1.034
2	Tax incentives encourage business growth and expansion	3.91	.870
3	My business has benefited from tax incentives offered by the government	3.25	1.054
4	I find it easy to understand and apply for tax incentives relevant to my business	3.24	1.124

Table 15 presents the descriptive statistics on tax incentives and their effect on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 3.91 (SD = .870) was recorded for the statement "Tax incentives encourage business growth and expansion," indicating that a majority of respondents agree that incentives positively influence business development. The statement "The government provides a variety of tax incentives for SMEs" had a mean of 3.47

(SD = 1.034), suggesting moderate agreement, while "My business has benefited from tax incentives offered by the government" recorded a slightly lower mean of 3.25 (SD = 1.054), implying that fewer SMEs are experiencing direct benefits. Furthermore, the lowest mean of 3.24 (SD = 1.124) was recorded for the ease of understanding and applying for tax incentives, pointing to challenges in accessibility and clarity of the process. These findings are consistent with Mukiri (2022), who noted that although tax incentives are available, many SMEs face barriers in accessing them due to limited awareness and bureaucratic application procedures, which ultimately limit their impact on financial performance.

4.5.4 Income Tax Rates and the financial performance of SMEs in Vihiga County, Kenya

Table 16 Income Tax Rates and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	The current income tax rates are fair and reasonable for my business	3.43	1.271
2	High income tax rates negatively impact my business's financial performance	4.47	.678
3	I clearly understand how income tax rates are determined for my business	3.44	1.098
4	Changes in income tax rates affect my business operations significantly	4.08	.793

Table 16 presents the descriptive statistics on income tax rates and their influence on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 4.47 (SD = .678) was

observed for the statement "High income tax rates negatively impact my business's financial performance," indicating strong agreement among respondents that elevated tax burdens hinder profitability. This is followed by a mean of 4.08 (SD = .793) for "Changes in income tax rates affect my business operations significantly," showing that most SMEs are sensitive to fluctuations in tax policy. Meanwhile, the statements "The current income tax rates are fair and reasonable" and "I clearly understand how income tax rates are determined" recorded moderate mean scores of 3.43 and 3.44 respectively, highlighting a perceived imbalance between fairness and comprehension of the tax system. These results align with Kiarie (2020), who found that while tax is essential for national revenue, its structure and implementation often place a disproportionate strain on small businesses, thereby affecting their financial sustainability.

4.5.5 Tax Filing Practices and the financial performance of SMEs in Vihiga County, Kenya

Table 17 Tax Filing Practices and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	I find the income tax filing process simple and easy to follow	3.55	1.082
2	My business files income tax returns accurately and on time	4.97	.828
3	The tax filing system is efficient and user-friendly for SMEs	3.45	1.007
4	I receive adequate support and guidance from tax authorities regarding tax filing	3.40	1.102

Table 17 presents the descriptive statistics on tax filing practices and their impact on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 4.97 (SD = .828) was recorded for the statement “My business files income tax returns accurately and on time,” indicating a high level of compliance among SMEs with regard to timely and accurate tax return submissions. The statement “I find the income tax filing process simple and easy to follow” had a moderate mean of 3.55 (SD = 1.082), suggesting that while the process is manageable for many, complexities still exist for some. Similarly, “The tax filing system is efficient and user-friendly for SMEs” (Mean = 3.45, SD = 1.007) and “I receive adequate support and guidance from tax authorities” (Mean = 3.40, SD = 1.102) reflect moderate satisfaction, pointing to areas needing

improvement in user experience and institutional support. These findings are in line with Mukiri (2022), who emphasized that while digital filing platforms like iTax have improved compliance rates in Kenya, many SMEs still encounter usability and support challenges that can impact their tax-related efficiency and overall financial performance.

4.5.5 Timeliness of Tax Payments and the financial performance of SMEs in Vihiga County, Kenya

Table 18 Timeliness of Tax Payments and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	My business meets all income tax payment deadlines without difficulty	3.53	1.025
2	Late tax payments result in significant penalties that affect my business	4.14	.768
3	The government provides clear deadlines for income tax payments	3.86	.941
4	Flexible tax payment timelines would improve tax compliance among SMEs	4.23	.715

Table 18 presents the descriptive statistics on the timeliness of tax payments and their influence on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 4.23 (SD = .715) was reported for the statement “Flexible tax payment timelines would improve tax compliance among SMEs,” suggesting that a majority of respondents believe that greater

flexibility in payment schedules would enhance compliance. This is followed by the statement “Late tax payments result in significant penalties that affect my business” (Mean = 4.14, SD = .768), indicating that penalties are a real concern and have a negative impact on business performance. The statement “The government provides clear deadlines for income tax payments” had a moderately high mean of 3.86 (SD = .941), reflecting that most SMEs are aware of the payment deadlines. Lastly, “My business meets all income tax payment deadlines without difficulty” had a lower mean of 3.53 (SD = 1.025), indicating that some SMEs still struggle to meet deadlines. These findings align with Adegbe and Akinyemi (2020), who noted that rigid payment structures and penalty systems without corresponding flexibility often hinder SMEs’ ability to comply effectively, thereby affecting their financial sustainability.

4.5.6 Investment Related Tax Benefit and the financial performance of SMEs in Vihiga County, Kenya

Table 19 Investment Related Tax Benefit and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	The current investment tax benefit rates encourage business expansion	3.41	.995
2	My business has benefited from tax reliefs on investments	3.35	1.090
3	The available tax incentives make investing in business assets more affordable	3.47	1.017
4	The government provides sufficient information on investment tax benefits	3.10	1.066

Table 19 presents the descriptive statistics on investment-related tax benefits and their influence on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 3.47 (SD = 1.017) was recorded for the statement “The available tax incentives make investing in business assets more affordable,” suggesting that most respondents perceive tax incentives as supportive of capital investments. This is closely followed by the perception that “The current investment tax benefit rates encourage business expansion” (Mean = 3.41, SD = .995), reflecting moderate agreement among SMEs that tax benefits positively influence growth. The statement “My business has benefited from tax reliefs on investments” had a mean of 3.35 (SD = 1.090),

showing that while some SMEs have gained from investment tax reliefs, a considerable number may not be fully utilizing these benefits. The lowest mean score of 3.10 (SD = 1.066) for “The government provides sufficient information on investment tax benefits” indicates a communication gap that may hinder full utilization of these incentives. These findings are consistent with Mukiri (2022), who emphasized that limited awareness and poor dissemination of tax benefit information often reduce the effectiveness of investment-related tax policies in promoting SME development.

4.5.6 Investment Tax Regulations and the financial performance of SMEs in Vihiga County, Kenya

Table 20 Investment Tax Regulations and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	The existing investment tax regulations are clear and easy to understand	3.11	1.053
2	Frequent changes in investment tax policies affect my business planning	3.99	.775
3	Compliance with investment tax regulations is simple for SMEs	3.19	1.046
4	The government provides adequate support to businesses regarding investment tax compliance	3.14	1.046

Table 20 presents the descriptive statistics on investment tax regulations and their impact on the financial performance of SMEs in Vihiga County, Kenya. The highest mean of 3.99 (SD = .775) was reported for the statement “Frequent changes in investment tax policies affect my business planning,” indicating that many SMEs perceive policy volatility as a major barrier to long-term investment decisions. The other statements received more neutral responses, with “Compliance with investment tax regulations is simple for SMEs” scoring a mean of 3.19 (SD = 1.046), “The government provides adequate support to businesses regarding investment tax compliance” at 3.14 (SD = 1.046), and “The existing investment tax regulations are clear and easy to understand” at 3.11 (SD = 1.053). These results suggest a general perception that current investment tax

regulations lack clarity and sufficient support for SME compliance. This aligns with Adegbe and Akinyemi (2020), who found that complex tax regulations and frequent policy shifts can hinder SMEs' ability to plan, comply, and invest effectively, ultimately impacting their financial performance.

4.5.7 Investment Decisions and the financial performance of SMEs in Vihiga County, Kenya

Table 21 Investment Decisions and the financial performance of SMEs in Vihiga County, Kenya

S/N	Statement	Mean	SD
1	Tax incentives play a significant role in my business investment decisions	3.75	.912
2	My business considers tax benefits before making investment decisions	3.70	.935
3	The availability of investment tax incentives influences long-term business strategies	3.80	.867
4	I would invest more in my business if there were better tax incentives	4.30	.749

Table 21 presents the descriptive statistics on investment decisions and their influence on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score of 4.30 (SD = .749) was recorded for the statement “I would invest more in my business if there were better tax incentives,” suggesting that most SME owners strongly believe that improved tax incentives would

significantly boost their investment levels. Other notable responses included “The availability of investment tax incentives influences long-term business strategies” (mean = 3.80, SD = .867), “Tax incentives play a significant role in my business investment decisions” (mean = 3.75, SD = .912), and “My business considers tax benefits before making investment decisions” (mean = 3.70, SD = .935). These findings indicate a generally positive perception of the importance of tax incentives in shaping business investment behavior. This aligns with the findings of Mukiri (2022) and Mukuwa & Phiri (2020), who noted that favorable tax policies significantly impact SMEs' investment patterns by reducing financial burdens and enabling long-term strategic planning.

4.5.8 SMEs financial performance

Table 22 SMEs financial performance

S/N	Statement	Mean	SD
1	Awareness of tax obligations has improved the business's profitability	3.63	.947
2	Proper tax planning has reduced the business's tax burden, enhancing profitability	3.83	.783
3	Understanding tax incentives has helped the business reduce operational costs	3.72	.902
4	Awareness of tax payment schedules has helped in better cash flow management	3.81	.864
5	Tax compliance has reduced unexpected penalties, improving cash flow	4.00	.791

S/N	Statement	Mean	SD
	Delays in tax payments have negatively impacted business cash flow	3.90	.908
6	Tax obligations are well planned to prevent liquidity challenges	3.75	.853
	Tax compliance has reduced the risk of financial distress	3.85	.877
7	The business maintains adequate liquidity even after meeting tax obligations	3.45	.945

Table 22 presents the descriptive statistics on the financial performance of SMEs in Vihiga County, Kenya. The highest mean score was 4.00 (SD = .791) for the statement “Tax compliance has reduced unexpected penalties, improving cash flow,” followed closely by “Delays in tax payments have negatively impacted business cash flow” with a mean of 3.90 (SD = .908), and “Tax compliance has reduced the risk of financial distress” at 3.85 (SD = .877). Other high scores included “Proper tax planning has reduced the business's tax burden, enhancing profitability” (mean = 3.83, SD = .783) and “Awareness of tax payment schedules has helped in better cash flow management” (mean = 3.81, SD = .864). These results indicate that SMEs recognize the significant role of tax awareness and compliance in reducing financial risks, improving liquidity, and enhancing profitability. This is supported by Mukiri (2022) and Siololo (2022), who observed that

enhanced tax knowledge and strategic compliance contribute positively to SME financial health by minimizing tax-related penalties and improving cash flow predictability.

4.6 Diagnostic Tests

A multi-collinearity test was performed to assess the presence of strong correlation among two or more predictor variables in the regression model. The Variance credit provision was used to assess the presence of multi-collinearity, with VIF values below 10 indicating acceptable levels. Variables with a credit provision over 10 were considered to have a significant degree of collinearity.

Table 23 Multi-collinearity Test Using Tolerance and VIF

	Collinearity Statistics	
	Tolerance	VIF
Tax incentives	0.608	1.646
Income tax awareness	0.486	2.056
Investment tax awareness	0.586	1.705

a. Dependent Variable: performance

Table 23 presents the results of the multicollinearity test using Tolerance and Variance Inflation Factor (VIF) to evaluate the degree of correlation among the independent variables—tax incentives, income tax awareness, and investment tax awareness. The Tolerance values of 0.608, 0.486, and 0.586 are all above the recommended minimum threshold of 0.1, indicating that each variable provides sufficient unique contribution to the model. Similarly, the VIF values of 1.646 for tax incentives, 2.056 for income tax awareness, and 1.705 for investment tax awareness are well below the conventional cut-off point of 5, further confirming the absence of problematic multicollinearity. Gujarati and Porter (2009) note that multicollinearity is unlikely to be a concern

when VIF values remain below 10 and Tolerance values exceed 0.1. Based on these results, it can be concluded that the independent variables do not exhibit excessive overlap in explaining the dependent variable, financial performance, thereby ensuring the robustness and reliability of the multiple regression analysis.

4.6.2 Test for Heteroscedasticity

The study involved transforming raw data into meaningful information by simplifying large volumes of responses into a form that could be effectively used for decision-making. Data analysis was carried out using the Statistical Package for the Social Sciences (SPSS) version 25 and Microsoft Excel. SPSS version 25 was selected because it provides a comprehensive range of statistical tools, is widely recognized for its accuracy, and is user-friendly in handling both descriptive and inferential analyses. Prior to analysis, data encoding was conducted, where raw responses were systematically converted into numerical codes. This process ensured consistency, facilitated easier interpretation, and enhanced the reliability of the results. The theory proposed was that;

H1: The data is Homoscedastic.

If the p-value is less than 0.05, the hypothesis is rejected.

The Breusch-Pagan results are presented in Table 24.

Table 24 Heteroscedasticity Results

chi2(1)	72.14
Prob > chi2	0.061

Source: Field Survey Data (2025)

The findings presented in Table 4.21 indicate that the p-value is greater than the 5% significance level. Specifically, the Chi² (1) statistic was 72.14 with a corresponding p-value of 0.061, which exceeds the critical threshold of 0.05. Therefore, the null hypothesis was not rejected, implying that the model does not suffer from heteroscedasticity.

4.6.3 Normality Test

The normality test was conducted to determine the extent to which the data conformed to a normal distribution, which is a key assumption in regression analysis. The Shapiro–Wilk test was applied because it is widely regarded as having superior statistical power compared to other normality tests. The hypothesis was evaluated at a 5% significance level, following the convention that the null hypothesis (H₀) of normality is rejected if the p-value is less than 0.05 and retained otherwise. For the multiple regression model to be valid, it is essential that the dependent variable approximates a normal distribution, as emphasized by Knief and Forstmeier (2021). The results of the normality test are summarized in Table 25.

Table 25 Normality Outputs

	Statistic	Shapiro-Wilk	
		Df	Sig.
Tax incentives	0.698	150	0.658
Income tax awareness	0.909	150	0.072
Investment tax awareness	0.803	150	0.054

Source: Field Survey Data (2025)

Table 4.22 presents the results of the Shapiro–Wilk normality test for the variables tax incentives, income tax awareness, and investment tax awareness. The corresponding significance values (p-values) are 0.658, 0.072, and 0.054, respectively—all of which exceed the conventional threshold of 0.05. This indicates that the null hypothesis of normal distribution cannot be rejected, suggesting that the data for these variables are approximately normally distributed. Normality is a fundamental assumption in regression analysis and other inferential statistical techniques. As noted by Ghasemi and Zahediasl (2012), when the p-value is greater than 0.05, the sample distribution does not significantly deviate from normality, thereby satisfying the assumption.

4.7 Correlation Analysis

4.7.1 Correlation Analysis

This study aimed to explore the relationships between awareness and utilization of tax incentives and credits, income tax awareness, investment tax awareness and SMEs business financial performance in Vihiga County, Kenya. A correlation analysis revealed positive correlations between each of the independent variables and SMEs business financial performance in Vihiga County, Kenya.

Table 26 Correlations

	tax awareness	SMEs business financial performance in Vihiga County, Kenya
tax awareness	Pearson Correlation Sig. (2-tailed) N	1 .772** .000 150
SMEs business financial performance in Vihiga County, Kenya	Pearson Correlation Sig. (2-tailed) N	.772** 1 .000 150

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

Table 26 presents the results of the correlation analysis between tax awareness and SMEs’ business financial performance in Vihiga County, Kenya. The Pearson correlation coefficient is 0.772, indicating a strong positive relationship between tax awareness and business financial performance. The significance value ($p = 0.000$) confirms that this relationship is statistically significant at the 0.01 level (2-tailed), meaning the observed correlation is unlikely due to chance. This implies that higher awareness of tax-related matters such as incentives, income tax, and investment tax is associated with improved financial performance among SMEs in the county.

These findings align with the observations by Mukuwa and Phiri (2020), who noted that tax awareness enhances compliance and contributes to more effective financial planning and profitability among SMEs. Therefore, promoting tax education and awareness can be seen as a vital strategy for strengthening financial outcomes for small businesses in Kenya.

4.8 Regression Analysis

This study explored the effect of awareness and utilization of tax incentives and credits, income tax awareness, investment tax awareness and SMEs business financial performance in Vihiga County, Kenya. Regression analysis was done, and Table 27 presents the findings. This table illustrates the interrelation between these factors and the extent to which the independent variables, represented in a regression equation, can effectively elucidate the dependent variable, SMEs business financial performance in Vihiga County, Kenya.

Table 27 Regression Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.775 ^a	.601	.591	.36702

Source: Research data 2025

Table 27 presents the regression model summary, which assesses the collective influence of tax incentives and credits awareness, income tax awareness, and investment tax awareness on the financial performance of SMEs in Vihiga County, Kenya. The model yields an R value of 0.775, indicating a strong positive correlation between the independent variables and SME financial performance. The R Square value of 0.601 suggests that approximately 60.1% of the variance in financial performance among SMEs can be explained by the combined influence of the three predictors. The Adjusted R Square of 0.591 accounts for the number of predictors in the model

and confirms the robustness of the relationship. The standard error of 0.36702 reflects a moderate level of dispersion of observed values from the regression line. These findings are supported by Mukiri (2022) and Tarus & Koori (2024), who noted that improved tax awareness significantly influences profitability, compliance, and strategic investment decisions among SMEs. This underscores the importance of tax education and structured fiscal policy in enhancing SME sustainability and growth.

4.8.1 Analysis of Variance

Table 28 Analysis of Variance (f-test)

Model	Sum Squares	Df	Mean Square	F	Sg
Regression	22.759	3	7.586	56.319	0.000 ^b
Residual	15.086	112	.135		
Total	37.845	115			

a. Dependent Variable: performance

b. Predictors: (Constant), investment tax, tax incentives, income tax

Table 28 presents the Analysis of Variance (ANOVA) results, which assess the overall significance of the regression model examining the effect of tax incentives, income tax awareness, and investment tax awareness on SMEs' financial performance in Vihiga County, Kenya. The F-statistic value of 56.319 with a significance level (Sig.) of 0.000 indicates that the model is statistically significant at the 0.01 level. This means that the combined independent variables have a meaningful impact on the dependent variable—financial performance. The regression sum of squares (22.759) compared to the residual sum of squares (15.086) further supports the strength of

the model in explaining variation in SME performance. These findings align with Adegbe and Akinyemi (2020) and Mukiri (2022) who emphasize that tax awareness, when supported by clear tax incentives and structured investment policies, plays a critical role in enhancing the financial health and operational efficiency of SMEs.

4.8.2 Coefficient of Correlation

Table 29 Coefficient of Correlation

	Unstandardized coefficients				
	B	Std. Error	Beta	t	Sig.
(Constant)	.582	.269		2.160	.033
Tax incentives	-.088	.072	-.095	- 1.235	.219
Income tax awareness	.309	.095	.278	3.253	.002
Investment tax awareness	.659	.083	.623	7.990	.00

Table 29 presents the coefficients of correlation from the multiple regression analysis, showing the individual contributions of tax incentives, income tax awareness, and investment tax awareness to the financial performance of SMEs in Vihiga County, Kenya. The results reveal that investment tax awareness had the strongest positive and statistically significant effect on financial performance, with a Beta of 0.623, t-value of 7.990, and significance level of 0.000, indicating a substantial influence. Income tax awareness also showed a positive and significant relationship, with a Beta of 0.278, t-value of 3.253, and p-value of 0.002, suggesting that increased understanding of income tax obligations contributes meaningfully to better financial outcomes.

However, tax incentives demonstrated a negative but statistically insignificant effect (Beta = -0.095, $t = -1.235$, $p = 0.219$), implying that despite their availability, tax incentives may not be effectively utilized or understood by SMEs. These findings are consistent with Mukiri (2022) and Tarus & Koori (2024), who observed a disconnect between policy design and SME-level awareness and access, particularly in tax incentive schemes.

4.9 Research Hypotheses Tests

4.9.1 Awareness and utilization of tax incentives and the financial performance of SMEs in Vihiga County, Kenya

H₀₁: Awareness and utilization of tax incentives has no significant effect on the SMEs business financial performance in Vihiga County, Kenya.

The hypothesis H₀₁, which stated that *awareness and utilization of tax incentives and credits has no significant effect on the SMEs business financial performance in Vihiga County, Kenya*, was tested using multiple regression analysis. The results, as shown in Table 4.26, revealed a negative but statistically insignificant relationship between tax incentives and financial performance ($\beta = -0.088$, $p = 0.219$). This indicates that, although tax incentives are available, their impact on SMEs' financial performance in Vihiga County, Kenya is minimal and not statistically meaningful. The lack of significance may be attributed to limited awareness, complicated application processes, or inadequate access to these incentives among SMEs. Therefore, H₀₁ is not rejected, supporting the conclusion that awareness and utilization of tax incentives and credits does not have a statistically significant influence on SMEs' financial performance in the study area. These findings align with prior literature, such as Mukiri (2022), which highlighted that many SMEs lack sufficient knowledge or capacity to fully benefit from government-offered tax incentives.

4.9.2 Income tax awareness level and the financial performance of SMEs in Vihiga County, Kenya

H₀₂: Income tax awareness has no significant effect on the SMEs business financial performance in Vihiga County, Kenya

The hypothesis H₀₂, which posited that *income tax awareness has no significant effect on the SMEs business financial performance in Vihiga County, Kenya*, was tested through multiple regression analysis. The results in Table 4.26 show a positive and statistically significant relationship between income tax awareness and financial performance ($\beta = 0.309$, $p = 0.002$). This finding implies that SMEs with a clearer understanding of income tax obligations, rates, and compliance procedures tend to exhibit better financial performance. The positive effect is likely due to improved tax planning, reduced penalties, and better cash flow management resulting from enhanced awareness. Consequently, H₀₂ is rejected, confirming that income tax awareness has a significant influence on the financial performance of SMEs in Vihiga County, Kenya. This aligns with the findings of Tarus & Koori (2024), who noted that well-informed SMEs are better positioned to comply with tax regulations and manage their finances efficiently.

4.9.3 Investment tax awareness and the financial performance of SMEs in Vihiga County, Kenya

H₀₃: Investment tax awareness has no significant effect on the SMEs business financial performance in Vihiga County, Kenya

The hypothesis H₀₃, which stated that *investment tax awareness has no significant effect on the SMEs business financial performance in Vihiga County, Kenya*, was examined using multiple regression analysis. The results in Table 4.26 show a strong positive and significant relationship

between investment tax awareness and financial performance ($\beta = 0.659$, $p = 0.000$). This indicates that SMEs informed about tax benefits such as capital allowances and deductions make better investment decisions, lower costs, and improve financial outcomes. With investment tax awareness emerging as the most influential variable, H03 is rejected, confirming its significant effect on SME performance in Vihiga County, Kenya. These findings align with Mukiri (2022), who noted that tax awareness enhances long-term planning and business growth.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of the Findings

5.1.1 Discussion on Awareness and Utilization of Tax Incentives on the Financial Performance

The study sought to determine the effect of awareness and utilization of tax incentives on the financial performance of SMEs in Vihiga County, Kenya. The study found that awareness and utilization of tax incentives and credits have a positive but statistically insignificant effect on the financial performance of SMEs in Vihiga County, Kenya. SMEs confirmed that tax incentives of deductions and exemptions are good in taxing the amount of income and operations of businesses and it is instrumental in minimizing the taxable income. Regression analysis findings indicated that the variable was not statistically significant ($\beta = -0.088$, $p > 0.05$). This indicates that business owners only understand the theoretical importance of using tax incentives without realizing its full potential whereas others do not make full use of it perhaps due to lack of information, complicated applications processes and lack of government guidance. Such evidence suggests an awareness-practice disconnect that shows the importance of increasing tax training and making it easier to get cash out of available incentives that would work on the ground to get real financial advantages to the SMEs.

5.1.2 Discussion on Income Tax Awareness Level and Business Financial Performance

The study sought to determine effect of income tax awareness on business financial performance of SMEs in Vihiga County, Kenya. The findings of the study indicate that income tax awareness has a significant positive effect on the financial performance of SMEs in Vihiga County, Kenya.

Regressions also indicated that the effect of income tax awareness was significant (beta = 0.309, $p = 0.002$), that is, by increasing their awareness of tax rates, policies and methods of filing income tax, SMEs are more likely to improve their financial performance. Those respondents with more significant levels of awareness indicated increased profitability and more effective cash flow management and fewer penalties, since compliance was achieved in time. These findings indicate that proper awareness of SMEs on the issue of income tax obligation increases the chances of proper planning by SMEs, preventing SMEs entanglement in financial shortage and ultimately resource allocation in an efficient manner-hence having a positive influence on the financial performance of SMEs. The results confirm the significance of highly specific tax education initiatives and clear communication between tax authorities and individuals to enhance business compliance to achieve the growth of SMEs.

5.1.3 Discussion on Investment Tax Awareness Level on SMEs Business Financial Performance.

The study sought to determine the effect of investment tax awareness on SMEs business financial performance in Vihiga County, Kenya. The findings revealed that investment tax awareness has a significant and strong positive effect on the financial performance of SMEs in Vihiga County, Kenya. The regression analysis showed that investment tax awareness was significant ($B = 0.659$, $p = 0.000$) where it is evident that where SMEs have a high level of familiarity with the issue of investment taxations and regulations, they record better financial performances. Respondents who had an idea about how to use tax incentives on investing said that it became more affordable to purchase property, financially plan better on the long-term scale, and expand the business. This implies that tax knowledge on the aspects of investment will help the SMEs to direct their investments more strategically and financially. The researchers affirm that tax agencies

should improve the levels of information release about investment tax incentives to enable SMEs grow and have sustained financial development.

5.2 Conclusion

The study concludes that awareness and utilization of tax incentives have a positive but statistically insignificant effect on the financial performance of SMEs in Vihiga County, Kenya. In spite of the fact that tax deductions, incentives are taken into consideration by many respondents, the results showed that a considerable proportion of the SMEs do not actively utilize these benefits, though they are abundant simply because of little awareness, complexity of application procedures, and poor responses of the taxing authorities. Consequently, the benefits of taxes incentives to boost profitability, cut the cost of operation and help in growth of the business have not been fully exploited. Which implies that even such theoretical value of tax incentives to the SMEs is limited in practice by different barriers to access and use.

The study concludes that income tax awareness level has a positive and statistically significant effect on the financial performance of SMEs in Vihiga County, Kenya. The results reveal that SMEs who clearly understand the rates of the income tax, how to file the taxes and the payment calendar are likely to obey the taxes and evade penalties and they can also succeed in managing their cash flows. Awareness would lead to proper tax planning, as well as minimized taxation that would enhance profitability and financial stability. The sensitivity of this underlines the value of focused education in tax and simplified communication by tax authorities to have a more educated and compliant start-up business sector.

The study concludes that investment tax awareness has a strong and statistically significant effect on the financial performance of SMEs in Vihiga County, Kenya. The findings indicate that

once the owners of SMEs understand the tax benefits associated with investments including reliefs and incentives, an SME owner can easily make strategic investment decisions that can boost business growth and expansion, asset purchases as well as profitability in a long-term manner. Understanding these benefits helps the businesses to cut operational costs and strategize according to provisions that are available to the companies thus advance the financial wellbeing of the business. It shows the necessity to enhance further spread of information and capacity building in investment taxes policies to facilitate development and sustenance of SMEs.

5.3 Recommendations

The study recommends that the government and tax authorities, particularly the Kenya Revenue Authority (KRA), should enhance awareness campaigns and training programs targeting SMEs to improve understanding and utilization of available tax incentives and credits. The routes of applying should be simplified, and more access to the area of the relevant information should be provided by digital sources, local business associations, and periodic workshops. Moreover, the policies ought to be customized in such a way that the incentives ought to be feasible and in line with the demands of the small businesses. Through awareness creation and simplification of access, larger numbers of the SMEs in Vihiga County, Kenya can enjoy these incentives and thus make their performance in terms of finances to be better and thereby help the economy grow.

The study also suggests that the Kenya Revenue Authority (KRA) and other concerned parties should design appropriate income tax education and sensitization programmes in order to create awareness on income tax among the SMEs in Vihiga County, Kenya. These programs are supposed to aim at making comprehension easier regarding the tax obligations, tax rate structure and requirements. It can be done by using training sessions, online resources, and collaborating

with local business associations in order to cover a broader audience. The tax education will enable SMEs to be more aware of any tax law thus helping them to adhere to the tax regulations to minimize penalty and contribute towards the informed financial decision. This will boost the overall financial performance of the business.

The research suggests that the government through Kenya Revenue Authority (KRA) together with other coordinating agencies should embark in enlightening the SMEs in Vihiga County, Kenya more on investment tax waivers and mechanisms they can use to invest through them and access them. This would be done by the introduction of tailor-made training sessions, easy to read information bulletins and frequent stakeholder thematic forums that speak on the practical dimensions of investment tax incentives. Also, the tax authorities are to make the dispersion of policy changes simpler and should make regulations on taxation of investments clear concise and available to the proprietors of little businesses. Creating better awareness and knowledge with regard to these provisions will promote more informed decision making in investing activities which will eventually promote improved financial performance and growth of SMEs in the region.

5.4 Research Limitation

One of the main limitations of this study was its geographical scope, which was restricted to SMEs operating within Vihiga County, Kenya. While this provided a focused understanding of the local context, the findings may not be generalizable to SMEs in other counties or regions with different economic, infrastructural, or regulatory environments. As a result, caution should be exercised when attempting to apply the conclusions of this research to a broader national or international context.

Another limitation was the reliance on self-reported data collected through questionnaires. Although efforts were made to ensure the clarity and neutrality of the questions, the responses may have been affected by social desirability bias or the respondents' limited understanding of some tax-related concepts. This could lead to over- or under-reporting of tax awareness and financial performance, thereby impacting the accuracy of the findings. Furthermore, some respondents may have lacked the time or motivation to provide comprehensive responses.

5.5 Areas of Further Studies

Future research should consider expanding the geographical scope beyond Vihiga County to include multiple counties or a nationwide sample. This would allow for comparative analysis across different regions in Kenya, revealing how variations in infrastructure, access to information, and tax administration practices influence the relationship between tax awareness and SMEs' financial performance.

Additionally, further studies could explore the role of digital literacy and technological adoption in enhancing tax awareness and compliance among SMEs. Investigating how mobile tax platforms, e-filing systems, and other digital tools affect tax behavior and business outcomes would provide valuable insights into the modernization of tax administration and its practical implications for small enterprises.

Lastly, subsequent research could examine the mediating or moderating effects of variables such as access to financial advisory services, the business owner's level of financial education, or regulatory support. This would deepen the understanding of the mechanisms through which tax awareness impacts financial performance and help design more targeted interventions to improve SME sustainability and compliance.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION



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BOARD OF POSTGRADUATE STUDIES

KCAUBPS/2025

Date: Friday, May 16, 2025

**NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION (NACOSTI)
P.O BOX 30623-00100
NAIROBI**

Dear Sir/Madam,

RE: MUTEGI CATHERINE KAGWIRA - REG NO. 2307455

It is my distinct pleasure to introduce Mutegi Catherine Kagwira, a student at our institution pursuing a Master of Science in Commerce- Finance degree within the School of Business.

Mutegi is conducting research on the topic: *"Impact of tax awareness on business financial performance of small and medium enterprises in Vihiga County."* Her study has been reviewed and approved by the University's Ethics Review Committee Approval No. KCAUSERCSOB043. The approval period is from March 20, 2025 to March 20, 2026. 1 9 8 9 -

Any assistance accorded to her is highly appreciated.

Yours faithfully,

**DR. JACKSON NDOLO
DIRECTOR, BOARD OF POST GRADUATE STUDIES**

APPENDIX II: RESEARCH QUESTIONNAIRE

This questionnaire aims at collecting data on Impact of Tax Awareness on Business Financial Performance of SMEs in Vihiga County, Kenya. Please complete this questionnaire as instructed.

SECTION A: Background Information

Instructions:

Select your choice by Ticking (✓) in the brackets ()

1. Gender:

Male Female

2. Age Bracket:

18–25 26–35 36–45 46–55 Above 55

3. Level of Education:

No formal education Primary Secondary Diploma Degree Postgraduate

5. Number of Years in Business:

Less than 1 year 1–3 years 4–6 years 7–10 years Above 10 years

6. Nature of Business:

Retail Wholesale Other (Specify)

7. Business Registration Status:

Registered Not Registered

8. Kindly indicate your SME sector _____

SECTION B: Tax Incentives

1. To what extent do you agree with the following statements regarding to tax incentives and tax credits in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
Tax deductions help reduce my business's taxable income.					
I have utilized tax deductions to improve my business's financial performance.					
The government provides adequate information on tax deductions available for SMEs.					
My business actively takes advantage of available tax deductions.					

2. To what extent do you agree with the following statements regarding to tax Exemptions in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
Tax exemptions help my business reduce operational costs.					
I am aware of the tax exemptions available for SMEs.					
My business benefits from tax exemptions provided by the government.					
The process of applying for tax exemptions is simple and clear.					

- To what extent do you agree with the following statements regarding to type of tax incentives in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
The government provides a variety of tax incentives for SMEs.					
Tax incentives encourage business growth and expansion					
My business has benefited from tax incentives offered by the government.					

I find it easy to understand and apply for tax incentives relevant to my business.					
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SECTION C: Income Tax Level;

3. To what extent do you agree with the following statements regarding to income tax rates in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
The current income tax rates are fair and reasonable for my business					
High income tax rates negatively impact my business's financial performance.					
I clearly understand how income tax rates are determined for my business.					
Changes in income tax rates affect my business operations significantly.					

4. To what extent do you agree with the following statements regarding to Tax filing practices in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
I find the income tax filing process simple and easy to follow.					
My business files income tax returns accurately and on time.					
The tax filing system is efficient and user-friendly for SMEs					
I receive adequate support and guidance from tax authorities regarding tax filing.					

5. To what extent do you agree with the following statements regarding to timelines of tax payments in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
My business meets all income tax payment deadlines without difficulty.					
Late tax payments result in significant penalties that affect my business.					
The government provides clear deadlines for income tax payments.					

Flexible tax payment timelines would improve tax compliance among SMEs.					
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SECTION D: Investment Tax

6. To what extent do you agree with the following statements regarding to investment related tax benefit in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
The current investment tax benefit rates encourage business expansion.					
My business has benefited from tax reliefs on investments.					
The available tax incentives make investing in business assets more affordable.					
The government provides sufficient information on investment tax benefits.					

7. To what extent do you agree with the following statements regarding to investment tax regulations in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
The existing investment tax regulations are clear and easy to understand.					
Frequent changes in investment tax policies affect my business planning.					
Compliance with investment tax regulations is simple for SMEs.					
The government provides adequate support to businesses regarding investment tax compliance.					

8. To what extent do you agree with the following statements regarding to investment decisions in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
Tax incentives play a significant role in my business investment decisions.					
My business considers tax benefits before making investment decisions.					

The availability of investment tax incentives influences long-term business strategies.					
I would invest more in my business if there were better tax incentives.					

SECTION E: SMEs Financial Performance

9. To what extent do you agree with the following statements regarding to SMEs financial performance in your business? Use a scale of 1 – 5 where 1 is strongly disagree and 5 is strongly agree.

	SD	D	N	A	SA
	1	2	3	4	5
Awareness of tax obligations has improved the business’s profitability.					
Proper tax planning has reduced the business's tax burden, enhancing profitability.					
Understanding tax incentives has helped the business reduce operational costs.					
Awareness of tax payment schedules has helped in better cash flow management.					

Tax compliance has reduced unexpected penalties, improving cash flow.					
Delays in tax payments have negatively impacted business cash flow.					
Tax obligations are well planned to prevent liquidity challenges.					
Tax compliance has reduced the risk of financial distress.					
The business maintains adequate liquidity even after meeting tax obligations.					

APPENDIX III: RESEARCH PERMIT-NACOSTI



REPUBLIC OF KENYA

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RESEARCH LICENSE



This is to Certify that Miss. CATHERINE KAGWERA MUTEGI of KCA University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Village on the topic: **IMPACT OF TAX-AWARENESS ON BUSINESS FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN VIHIGA COUNTY for the period ending : 07/June/2024.**

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Applicant Identification Number

[Signature]

Deputy Director

NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION



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