EFFECTS OF TAX INCENTIVES ON PROFITABILITY OF MILLERS IN KENYA: A CASE STUDY OF UNGA GROUP LIMITED

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RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF ECONOMICS, ACCOUNTING AND FINANCE, SCHOOL OF BUSINESS IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF POST GRADUATE DIPLOMA ON CUSTOMS/TAX ADMINISTRATION AT JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY.

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DECLARATION

This research project is my undertaking and has not been submitted to any institution of higher learning for academic purposes.

Sign_____ **Date_____**

KOLO ABDULLAHI

HDB336-C016-4304/2016

Approval by Supervisor:

This research project has been presented for examination with my approval as the University supervisor.

Sign_____ **Date_____**

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DEDICATION

I dedicate this research project to my lovely family for all the moral efforts they have accorded to me throughout this research project process.

ACKNOWLEDGEMENT

I am grateful to Allah for endless kindness. I also acknowledge my supervisor Dr.Nekesa for her professional guidance and advice throughout the process of this research project. Staff of UGL also deserves appreciation for all the assistance accorded during data collection process.

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LIST OF ACRYNOMS

CBK- Central Bank of Kenya

CBS- Central Bureau of Statistics

COMESA- Common market for East and South Africa

EPZs- Export Processing Zones

FDI- Foreign Direct Investments

GDP- Gross Domestic Product

IBD- Industrial Building Deduction

ID- Investment Deduction

KAM- Kenya Association of Manufacturers

KRA- Kenya Revenue Authority

NSE- Nairobi Stock Exchange

UNCTAD- United Nations Conference on Trade and Development

USA- United States of America

VAT- Value Added Tax

W&T- Wear and Tear allowances

OPERATIONAL DEFINITION OF KEY TERMS

Custom & Excise Tax: Custom tax is levied on the goods that are imported basically for local consumption by importing country. Excise is a tax levied on the goods manufactured by a manufacturer that are sold in the hosting country. Custom & Excise are indirect taxes, meaning as they are passed on to the consumer by adding them in the costing (EAC, 2010)

Corporate Income Tax: This is a predetermined levy that is imposed on the net profits of corporations operating within a country hence it has direct impact on the profits which should be cultivated back (KRA, 2013)

Profitability: In reference to Olweny (2011), profitability is the total income generated by a manufacturing firm after deduction of all expenses.

Tax: Compulsory contribution of financial resources from any entity to the government levied on predetermined criteria and without reference to any specific benefits received by the tax payer (Ochieng & Opondo, 2012)

Tax incentives: Provision that grants any person or activity favourable conditions that deviate from the normal provisions of the tax legislation (KRA, 2013)

Value-Added Tax (VAT): is a consumption tax levied on the gross margin at each point in the manufacturing-distribution-sales process of an item (VAT Act, 2013)

ABSTRACT

Taxation rate and any existing incentives in a given country is a key determinant for economic development as any investor ought to know the viability of the investment prior to committing any resources to the endeavour. The purpose of the study was to determine the effect of tax incentives on profitability of Millers in Kenya. The study was guided by the following specific objectives; to determine the extent to which custom & excise tax incentives affects the profitability of firms, to establish the extent to which VAT incentives affects the profitability of firms and to determine the extent to which corporate income tax incentives affects the profitability of Kenyan Millers. The study utilized descriptive research design where the nature of the main data for the study was quantitative and was collected through questionnaire. The target population was Unga group limited and the sample size will be 20 respondents. Data was analyzed by use of SPSS-Version 20.0 and findings presented in the form of tables. From the findings it was revealed that custom & excise tax incentives, VAT incentives and corporate income tax incentives affected the Kenya Millers profitability significantly. Correspondingly, it was revealed that if there were no tax incentive for Kenya Millers, the firms will be operating at a loss. The finding further revealed that custom & excise tax incentives had negative effect on profitability while VAT incentives and corporate income tax incentives had positive effect on Millers profitability. The study recommends that the government should absorb the cost of electricity & fuel to the tune of the foregone duty on imports and VAT exemptions on imported raw materials in order to make the incentives of custom and excise duty as well as VAT more viable. The study further recommends that, Kenya manufacturing sector should adopt technology to improve the quality of their output to attain sustainable local and export market competitiveness and minimize dependency on government protection.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Taxation has been an important tool in the hands of governments globally to achieve some of its fiscal and economic goals. From the view of economists, a tax is a compulsory contribution of resources from the private to the public sector or government levied on a basis of predetermined criteria and without reference to any specific benefits received by the tax payer. In words of Easson (2013) tax incentives are those special exclusions, exemptions or deductions that provide special credits, preferential tax rates or deferral of tax liability. The Kenya Revenue Authority (KRA, 2013) defines tax incentives as a provision that grants any person or activity favourable conditions that deviate from the normal provisions of the tax legislation.

1.1.1 Global perspective of tax incentives

Governments in both developed and developing countries come up with laws and bills tailored towards attraction of investments and growth of industries in form of attractive incentives to individuals as well as corporate entities with ultimate goals of growth and development of economy (COMESA, 2012). In reference to Tuomi (2012) in developed nations, tax incentives frequently assume different forms including, credits for investors of assets, high rate of depreciation and exciting treatments for all expenditures incurred in research and developments.

Concurrently, developing nations have extraordinary centre ranges such as; to empower local manufacturing sector and residential enterprises that support development along specific regions of financial consideration and to draw in investments from abroad. In the USA, the government allows accelerated depreciation that takes into account as an associate incentive offered to draw in investments into the USA (Thomas, 2007). On the other hand, Malaysia and Ireland are able to attract manufacturing sector investments without giving tax breaks and instead focused on ensuring stable financial and political conditions.

1.1.2 Regional perspective of tax incentives

Africa banks on investment incentives, reinvestment incentives and tax holidays preference are tax holidays, promote investment in manufacturing (Zolit, 2013). On the other hand,

country like Botswana focuses on financial policy reviews and political stability to stabilize economic growth (Holban, 2015). A review from a study on association between corporate tax incentives and finance performance of listed companies in Nigeria noted a positive effect (Adejare, 2015). Contrary to these findings are a review from a study in Ghana on association corporate income tax and financial performance of listed manufacturing companies which noted a negative impact (Kufor, 2013).

In Kenya a study on the association between taxation and firms' performance noted difference in mode of influence where Value Added Taxes and income taxes favoured investment while custom and excise affected the performance negatively (Ombuki & Wawire, 2013). To this point it can be noted that indirect taxes are more convenient to investment as they are generalized in the f vinal prices of the goods meaning their increment does not necessitate decline on the demand of the products.

1.1.3 Tax incentives in Kenya Manufacturing Sector

In Kenya tax incentives are utilized to boost economic activities in specific area that the government perceives to be of importance for any economic development to be realized in the country (Kuria & Wambua, 2016). Kenya offer tax incentives through Tax Act Cap 470, The EPZs Act Cap 517 and the VAT Act Cap 475. The objective of granting tax relief and incentives to the manufacturing sector in Kenya is to enhance their growth and development, thus contributing to the overall economic development of the country (KRA, 2014). In reference to KRA (2014) incentives in Kenya can be fiscal or non-fiscal, direct or indirect. Fiscal incentives include grants or tax breaks while non-fiscal incentives may include fast-track approval processes or exemptions from certain regulations.

Incentives are often granted to offset actual or perceived differences in the cost of doing business in different political jurisdictions whether the cost differences arise from tax differences or from differences in transportations, labour or other costs (Ochieng and Opondo, 2012). Incentives raise the return to capital thereby making investment in a location more attractive. Several types of fiscal incentives exist, they include government provision of below market interest loans, tax relief through the use of credits, deductions or abatements, direct grants of land and facilities and taxpayer financed workforce training for targeted firms and industries (Kuria, 2016). It is arguable that in the absence of such incentives some industries that may yield substantial spill over benefits to the community might not be built. Indeed, strategically applied tax incentives can correct market failure by inducing

manufacturing investors to make the desired investment and allow an economy to attain its potential output.

1.1.4 Unga Group Limited Performance

There is no define incentives offered to Millers rather its incentives are categorized under Kenya manufacturing sector. Millers which falls in the category of manufacturing sector, can be defined as firms that buy certain product/ grains as inputs and process (transforms) these inputs to a value added final product for sale (Wambua, 2016). Based on data from Kenya Association of Manufacturers (KAM 2014), taxation regime uncertainty and volatility have adversely affected the profitability of Millers in Kenya.

According to Unga Group Limited (UGL) financial report (2016), Millers performance like the rest on manufacturing firms stagnated in the 2000s with low profitability of 2.96% in 2013 but has experienced a recovery in the last few years registering a profitability of 26% in 2014, 44% in 2015 and 31% in 2016. This impressive profitability in Millers is closed aligned to the overall manufacturing sector performance of 4.9% in 2014, 6.8% in 2015 and above 9% in 2016 thus creating some linkage on the impact of Millers to the overall manufacturing sector performance (Mokaya, 2017). KAM (2014) report, acknowledges that the profitability on Millers has been driven more by an increase in volumes supplied from emerging markets of Southern Sudan, COMESA, EAC, Brazil and Mexico than efficiency and productivity improvements.

Montiel and Serven (2014) posits that factors associated with firm-level profit variations are based on nature of product market compensation, economies of scale and outside competitive forces in the form of entry-exit barriers. According to UNCTAD (2012) report, increasing exchange rate and capital flow volatility were found to raise inflation uncertainty and encourage financial investments while discouraging fixed investments by manufacturing sector in Kenya. In addition, despite comprehensive tax reform programs persistent capital market imperfections and high real interest rates in developing countries continue to hurt manufacturing firms' profitability hence Millers are not an exception (Serve, 2014)

1.2 Statement of the Problem

The taxation level is a key determinant for an investment decision in Kenya manufacturing sector. However, studies conducted that are in line with this study have inconclusive and contradicting findings hence knowledge gaps exist in empirical literature that justify the need

for this study. For instance in global perspective study by European Union by Regional Plan Policy Research (2014) on effect of excise duty incentives and economic performance of European Countries noted negative effect. This present a knowledge gap on environmental settings as the study was undertaken on developed economies while Kenya is underdeveloped.

In Africa, a study carried out by Adejare (2014) on the effect of corporate tax on revenue profile of firms in Nigeria noted a positive significant effect, however a study by Kufor (2013) on the effects of corporate income tax on finance performance of listed manufacturing firms in Ghana revealed a negatively relationship. From these reviews it is evident that the findings are contradicting hence a knowledge gap existed. Locally studies undertaken had not addressed the aspect of manufacturing firms' profitability exhaustively and those dealing with this aspect had not addressed the specific objectives which this study seeks to investigate (Ombuki & Wawire, 2013). Moreover no studies have addressed Millers profitability specifically. Based on the above existing gaps this study investigated the effects of custom & excise tax incentives, VAT incentives and corporate income tax incentives on profitability of Millers in Kenya to narrow them.

1.3 Objectives of the study

The purpose of the study was to investigate the effect of tax incentives on profitability of Millers in Kenya.

1.3.1 Specific objectives

The study utilized the specific objectives stated below

i) To determine the effect of custom and excise tax incentives on the profitability of Millers in Kenya

ii) To establish the effect of VAT incentives on the profitability of Millers in Kenya

iii) To examine the effect of corporate income tax incentives on the profitability of Millers in Kenya

1.4 Research Questions

The following research questions were formulated.

i) To what extent does custom and excise tax incentives affects the profitability of Millers in Kenya?

ii) To what extent does VAT incentives affects the profitability of Millers in Kenya?
iii) To what extent does corporate income tax incentives affects the profitability of Millers in Kenya?

1.5 Significance of the study

The study will be of significance to the following;

1.5.1 Government

The study findings will be important to government by enabling it perceive Millers as important component of economic develop thereby incorporating tax incentives generously to enhance their performance.

1.5.2 Manufacturing sector

The study will be relevant to Millers as its findings will provide insights which when utilized will enable them to find ways to cope with tax related factors affecting the profitability of the firm.

1.5.3 Researchers

The study will expand existing empirical knowledge on Millers performance in Kenya in respect to prevailing taxation policy

1.6 Scope of the study

The study was undertaken at Unga Group Limited where it was confined on effect of tax incentives on profitability and not any other aspect. Staffs of Unga Group Limited were the target where the sample size was 20 respondents and structured questionnaire was the main data collection instrument. Data was analysed using SPSS version 20.0 and findings presented in tables.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter incorporate theoretical framework and conceptual frameworks to guide the study as well as empirical review to establish the existing knowledge gap

2.2 Theoretical Framework review

Normative Theory and Transaction Cost Theory were utilized for this study.

2.2.1 Normative Theory

According to this theory, every incentive has advantages and disadvantages and it is therefore extremely difficult to determine one set of incentives which work for every different economy with different challenges and circumstances. Much of determining what works depends on the circumstance of the economy, the competence of the tax administration, the type of investment being courted and the budgetary constraints of the government to stimulate investment in the desired sector or location with minimal revenue leakage and provides minimal opportunities for tax planning.

Boadway and Shah (1995) argue that any benefit such as an incentive allocated by public servants and politicians is potentially open to abuse and corruption. There is therefore a strong argument that incentives should be automatically available to all investors who meet a set of open and transparent criteria. However, an alternative argument is that firms should receive just enough incentive to induce them to invest and no more. Each potential investment therefore needs to receive an incentive specific to its particular situation. Clearly, either of these two alternatives the government choices depends on the strength of governance within the appropriate institutions. If public servants and politicians as in Kenya case retain decision-making power over allocation of incentives, then the processes and outcome need to be as transparent as possible.

Moderate tax incentives that are targeted to new investment in machinery, equipment and research and development, provide up-front incentive, that are more likely to be cost effective in stimulating desired investment. These can have powerful signalling effects without significant loss of revenue (Chukwumerije and Akinyomi, 2011). Investment tax credits and allowances provide specific and targeted policy tools to achieve this. For instance, reducing corporate tax to a level comparable with other countries in the region is a sound tax incentive.

However, reduction beyond the level found in capital exporting countries such as; 20-30% often bring about greater revenue losses than increases in investment (Fletcher, 2003). This theory therefore was important to the study as it will provided much insight on both the merits and demerits of taxation which may have direct impact on the profitability of Kenyan manufacturing sector.

2.2.2 Transaction Cost Theory

Transaction cost theory tries to explain why companies exist, and why companies expand or source out activities to the external environment. The transaction cost theory supposes that companies try to minimize the costs of exchanging resources with the environment, and that companies try to minimize the bureaucratic costs of exchanges within the company. Companies are therefore weighing the costs of exchanging resources with the environment, against the bureaucratic costs of performing activities in-house.

Following the transaction cost theory (Coase, 1937) companies evaluate the relative costs of alternative governance structures (spot market transactions, short term contracts, long-term contracts, vertical integration) for managing transactions. Transaction costs could be defined as the costs of acquiring and handling the information about the quality of inputs, the relevant prices, the supplier's reputation, and so on. The exchange relationship may be one-time, occasional or recurrent; a frequent transaction (especially in the presence of specific assets) is more likely to be internalized (Williamson, 1979), since expected damages from opportunistic behaviour are higher; As far as there is uncertainty, complete contracts cannot be foreseen and the firm making the specific investment is disadvantaged when future contingencies impose to re-negotiate the contract terms. The theory was significant since it captured variables related to cost of production and ultimate investment decisions of a firm in Kenya manufacturing sector.

2.3 Conceptual Framework

Conceptual framework is a graphical representation of the relationship between variables in a study. In this study the independent variables- custom & excise duty incentives, corporate income tax incentives and VAT incentives were conceptualized to affect the dependent variable – profitability of Millers in Kenya. The conceptualization is stipulated below in Fig2.1

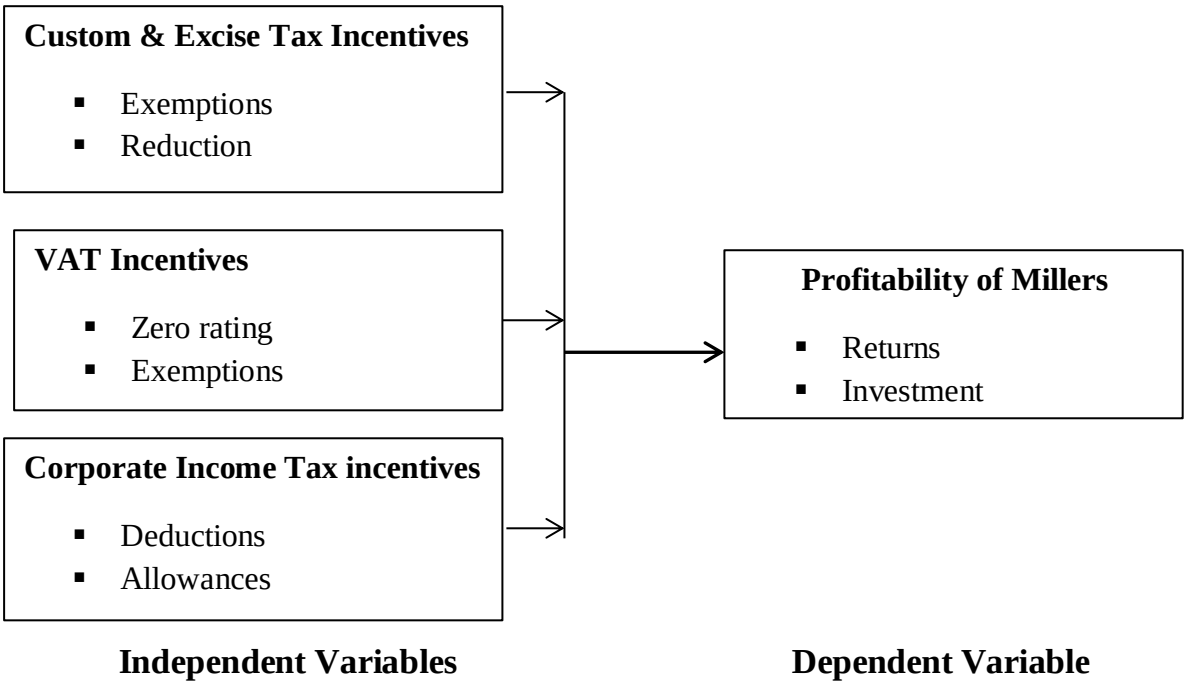

Fig2.1 Conceptual framework

2.3.1 Custom & Excise Tax Incentives and profitability

Custom & Excise incentives such as exemptions and reduction of import duty and local taxes reduces shortages of supplies as well as reduction in production cost hence more profit can be accrued.

2.3.2 VAT Incentives and profitability

VAT incentives in form of zero rating and exemptions leads to reduction in general cost of production in each value addition process which means the price of commodities will be less hence the firm can realize more sales translating to better returns

2.3.3 Corporate Income Tax Incentives and profitability

Corporate income tax incentives in form of deductions and allowances such as IBD, ID & W&T allowance lead to high net profit retention thus more for investment.

2.3.4 Profitability of Millers

Profitability generally reflects the degree of use of existing resources of success and is measured based on returns and the investment.

2.4 Empirical literature review

In its research on tax incentives for investments in Sub-Saharan African, the OECD (2011) noted that business environment and not tax incentives contributed to investment. Sifunjo, Muturi and Tirimba (2016) on their study on tax incentives and performance of stock market in Nairobi Securities Exchange, noted that tax incentives did not necessitate any significant impact on performance. However, the study recommended a review on existing laws and regulation in regard to taxation. Similarly a study carried out by Institute of Economic Affairs (2012) on impact of tax incentives on manufacturing firm in Kenya concluded that tax incentives were not appropriate for Kenya since they led to decrease in the tax collected by the regulator on the years under review. On local perspective, the study findings by Njeru and Ndimitu (2015) noted that tax incentives have negative impacts such as conflictive and unhealthy competitions on Kenya manufacturing sector.

2.4.1 Custom & Excise tax incentive and Profitability

In reference to East Africa Custom (EAC) excise is a tax levied on the goods manufactured by a manufacturer that are sold in the hosting country. According to KRA, excise duty constitutes the indirect tax levied on the sale of a commodity. Concurrently, Custom tax is levied on the goods that are imported basically for local consumption by importing country. Custom & Excise are indirect taxes, meaning as they are passed on to the consumer by adding them in the costing (EAC, 2010)

A review on study by Ohaka and Dagogo (2015) on association between custom duty tax incentives and manufacturing firms' performance in Nigeria noted significant impact. In Kenya a study on the association between taxation and firms' performance noted difference in mode of influence where Value Added Taxes and income taxes favoured investment while custom and excise affected the performance negatively (Ombuki & Wawire, 2013). Similarly, Musyoka (2012) focusing on effect of custom duty tax incentives on firm performance in Kenya noted insignificant influence.

In order for a country to stimulate its exports, custom duty incentives have to be applied in abundance to give the country a competitive edge. An increase in a country's export will in turn improve its trade balances that will eventually close any gaps that may work against its development goals. Some of the results of increasing customs duty incentives include balance of payments promotion, motivation on production as well as competition, increasing foreign direct investments, addressing regional inequalities and also stimulating technology diffusion.

An improvement in these aggregate variables will lead to economic development. A study conducted in the European Union by Regional Plan Policy Research (2014) seeking to link high excise duty incentives to economy of countries operating in the European Union, established negative effects of the excise duty on the economy of those countries. With an increase of the excise duties incentives, there was a decrease in the government revenue collected among the countries investigated. Consumers in those countries benefited from lower prices of goods.

2.4.2 VAT Tax incentives and Profitability

A value-added tax (VAT) is a consumption tax placed on a produce where value is added at each stage of the supply chain, from production to the point of sale. VAT is charged and collected irrespective of whether a company has profits or losses. In reference to Ochieng and Opondo (2012) the amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed. VAT is levied on the gross margin at each point in the manufacturing-distribution-sales process of an item. This means that where the government offers VAT incentives the final price of the product will be less that its normal prices thus the consumer will be able to buy more.

According to the study report by Ebrill et al.(2001), a higher level of income per capita in an economy will translate to an increase in the income that is generated from VAT in that particular economy. The other two measures whose respective decrease or improvement also directly elevates the revenue gains are the share of agriculture as well as the level of education literary. The VAT incentives have far reaching consequences on macroeconomic stability, mobilization of the fiscal tools as well as economic development. In terms of revenue collection, the VAT has proven to be the most efficient tool and therefore an improvement in VAT will mean overall increase in the level of revenue collected.

Ironkwe and Peterus (2015) conducted a study aimed at investigating the impact of VAT incentives on corporate finance performance of quoted companies in Nigeria. The findings revealed that VAT impacted negatively on the financial performance of agribusinesses though the impact was of insignificance value. Thus the governments should ensure that proper VAT incentive scheme is designed and fully implemented to promote the growth of agribusiness in Nigeria.

On studies carried out in Kenya, Kigera and Wahithe (2015) sought to find out the effects of the VAT threshold on the performance of small business in Nairobi County. The results of

the study implied that small businesses were notably influenced by the VAT threshold. Notable efficiency implications were observed since firms' bunched activity just below the threshold. It was found that changing tax incentives at the threshold did not have a significant effect on the extent of the response. This implied that compliance costs were important in explaining observed response. The study found no evidence of tax avoidance or evasion, which suggested that firms responded by reducing output. Also, it was found that bunching behaviour was relatively permanent, which means that the threshold decreased the growth of small businesses.

The nature of the VAT makes it easily the best alternative in revenue collection when compared with other alternatives that have more pronounced shortcoming. Firstly, the potential in revenue collection of the VAT stem from its broad-based nature through improvement in tax compliance as well as enforcement that are attained by several invoices. Secondly, VAT can easily remove the cascading problem that is a negative characteristic of the turnover tax. OECD countries have generally clearly defined and consistent trend where in sale tax collection, the VAT has been drafted in with great success (Heady 2002)

2.4.3 Corporate income Tax incentives and Profitability

Corporate income tax is a predetermined levy that is imposed on the net profits of corporations operating within a country hence it has direct impact on the profits which should be cultivated back (KRA, 2013). Based on this context, it is evident corporate tax impacts investors' decision on investment and continuity of manufacturing sector in a given country based on how profitable they perform. Thus the existence of corporate income tax incentives may boost the profitability of manufacturing sector as less will be levied on their profits

In a study conducted by Maffini and Xing (2015) focusing on corporate tax incentives as well as firm performance on UK companies that were in operation between the fiscal years 2001-2010 revealed a strong response to the corporate income tax incentives that were extended to both the domestic standalone companies as well as the multinational companies based on their external leverage. They found the evidence that corporate tax incentives affected the external leverage of both domestic and multinational companies. Another study conducted by Pham (2015) investigated how temporary corporate income tax reduction can affect the performance of firms in the Vietnamese sector. The central focus of the study was on a temporary reduction by 30% of the corporate income tax in Vietnam specifically in small and

medium sized business for the year 2009. The study revealed that temporary reduction in the tax enhanced revenue collected as tax reduction did not necessitate poor performance.

A review from a study on association between corporate tax incentives and finance performance of listed companies in Nigeria noted a positive effect (Adejare, 2014). Contrary to these findings are a review from a study in Ghana on association corporate income tax and financial performance of listed manufacturing companies which noted a negative impact (Kufor, 2013). Locally, a review on study conducted by by Njeru and Ndimitu (2015) on effect of tax incentives on performance of Export Processing Zones (EPZ) noted insignificant influence. The study however noted positive impact that can be realized if the incentives were to be reviewed based on the needs of the zones such as enhanced exports volume. Concurrently the study also noted negative impacts of tax incentives such as administration as is legally complicated and conflictive as well as unhealthy competitions in the manufacturing sector caused by the tax incentives to the EPZ.

2.5 Critiques of existing literature

Whether tax incentives are cost-effective in inducing the desired investment remain highly inconclusive, as it can be argued that tax incentives reduce the tax base and result in less revenue for government infrastructural development and other programs which in long run may impact the profitability of manufacturing sector by increasing the cost of production. Similarly, tax incentives given on a case-by-case basis can also unfairly favour some business over others in the same line of business which may distort healthy competition resulting to increment in counterfeit goods which will distort the profitability of the manufacturing sector in general. In the same note, where the government utilizes tax incentives as a means to attract foreign direct investment it is not clearly articulated why if the private investors are not willing to risk their own funds in manufacturing sector the government should opt to utilize public money to remove the risk and leave investors all the profits as investment basically involves taking calculated risk with the notion of realizing profit but not avoiding any risk at all. This preposition is in correspondence with Musyoka (2012) study finding on effect of custom duty tax incentives on firm performance in Kenya, where it was revealed that tax incentives did not have a significant improvement in the foreign direct investment.

On another perspective, Malaysia, Ireland and Botswana are able to attract manufacturing sector investments without giving tax breaks and instead focused on ensuring stable financial and political conditions which have spurred steady economic growth in those countries

(Holban, 2015). Based on this perspective, it is evident that there are other more viable means that does not entails government directly getting involved in investors' decision to invest which besides making the investors realize their profit the government similarly benefits from taxes accrued from such undertakings. This study argues that government should review its investment policy which is heavily grounded on tax incentives as the only mean and borrow leaf from aforementioned countries which have alternatives means of investment strategies. The resultant will be that the government will fully benefit from manufacturing and other sectors by levying taxes to fully fund its developmental programs internally for the benefit of its citizenry instead of benefiting individual investors at the expense of the rest of the population.

2.6 Summary of the literature review

In summation, the review of past studies have addressed tax and tax incentives in general thus providing an understanding to the concept of taxation which is relevant to this study. Based on the reviewed literature it is evident that tax policy actually does have a significant effect on profitability of manufacturing sector but existing reviews have not exhaustively address the objectives under the study hence a need for this study. By levying high taxes on exports and on the cost of locally procured capital equipment, local manufacturers such as Millers may be unable to generate enough profits to facilitate their growth leading to a slum in the manufacturing sector. This study notes that government should embrace Millers as a viable component of economic stability thus boost their performance through favourable tax incentives brackets away from general manufacturing sector bracket. The argument is based on the fact that if Miller underperform and are unable to contain the consumer food basket it will hurt the whole economy through inflation.

2.7 Research Gaps

From empirical review it is evident that studies conducted that are in line with this study have not exhaustively addressed the aspect of Millers profitability, more so in Kenya. For instance in global perspective study by European Union by Regional Plan Policy Research (2014) on effect of excise duty incentives and economic performance of European Countries noted negative effect. The above study have gaps based on macroeconomic settings hence a need for a study locally

Regionally, a review of study by Adejare (2014) on the effect of corporate tax on revenue profile of firms in Nigeria noted a positive significant effect. However in Ghana, a study by

Kufor (2013) on the effects of corporate income tax on finance performance of listed manufacturing firms in Ghana revealed a negatively relationship. Contrary to tax incentives, determinants such as company size and years of operation impacted financial performance greatly. Based on these reviews it is conclusive that findings are contradicting and it can be deduced that the concept of tax incentives and profitability in manufacturing sector cannot be equated in generalization rather each country may have other factors that may inhibit its effectiveness as noted in Ghana. This presents a knowledge deficit in that though Kenya is an African country the macro environment as well as other factors are not same as those in Ghana, thus there is need for the same research to be conducted in Kenya in order to provide a conclusive findings on whether tax incentives are effective in Kenya manufacturing sector or not.

In Kenya, most of the studies which have been conducted in regard to tax incentives have not specifically addressed the aspect of Kenya manufacturing sector profitability. For instance, a study conducted by Ombuki and Wawire (2013) on the link between taxation and the performance of firms in Kenya, revealed that some forms of taxes were found to negatively affect the investment while other favoured the same. This provides a knowledge gap since there are various form of taxes for different sectors thus the impact cannot be generalized. Generally the reviews have not addressed the aspect of manufacturing firms' profitability exhaustively and those dealing with this aspect have not addressed the specific objectives which this study sought to investigate. Moreover no studies had addressed Millers profitability specifically. Based on the above existing gaps this study investigated the effects of custom & excise tax incentives, VAT incentives and corporate income tax incentives on profitability of Millers in Kenya to narrow them.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter addresses the methodology that was used to conduct the study.

3.2 Research Design

Research design is the plan and structure of investigation so conceived as to obtain answers to research questions. The study adopted a descriptive research design. It is a method of collecting information by administering a questionnaire to a sample of individuals (Orodho, 2003). The relevance of descriptive design is that it provides a convenient platform for collecting quantitative data from the respondents that is necessary in answering research questions of the study.

3.3 Target Population

A population element is the subject such as a person, an organization, customer database, or the amount of quantitative data on which the measurement is being taken (Cooper and Schindler, 2013). The target population was staff of production, procurement, sales and finance departments of Unga Group Limited

Table 3.1 Target Population

Department	Target population (staffs)
Production	5
Procurement	5
Sales	5
Finance	5
TOTAL	**20**

3.4 Sampling Techniques and Sampling Size

Sampling is the process of selecting a number of individuals for a study in such a way that the individuals selected represent the large group from which they were selected (Mugenda and Mugenda 2003). Due to nature of the study, the study considered the managers, assistant managers, supervisor and two employees in specific department namely; production, procurement, sales and finance department. According to Cooper & Schindler (2010), when the population is small and variable, any sample we draw may not be representative of the population from which it is drawn; in this respect the whole population will be considered for

the study since it will be small and manageable. In this regard, sampling procedure was 100% of total population which translates to a sample size of 20 respondents. To validate that indeed the population was small and variable, the study utilize mathematic model by Taro Yamani (1964) formulae:-

$$n= \frac{N}{1+N\,(e)^2}$$

Where:

n = Sample size

N = the population of size/ target (20)

e = Level of significance (0.05)

t = constant

$$n= \frac{20}{1+20\,(0.05)^2} = \frac{20}{1.05} = 19.136 \text{ Samples}$$

Hence the total sample size of the study was 20 respondents representing the whole target population.

3.5 Data Collection Instruments

The main data collection instrument used was structured questionnaire based on research objectives. Questionnaire is an objective method because it has no bias resulting from the personal characteristics. Questionnaire is a research tool that gathers data over a large sample (Kombo 2012). The instrument had two sections where section one contained the demographic information of the respondents while section two contain the research question as per the objectives of the study. The questionnaire was preferred in this study because all the sampled respondents were literate and therefore capable of answering the items adequately.

3.5.1 Primary data

The nature of the data used in the study was primary data based on the study objectives and it will obtained by use of questionnaire

3.5.2 Secondary data

Secondary data was used to gather relevant information that relates to the study and it was obtained by use of journals, books and online materials. The nature of information involved reviewing of past studies on tax incentives and how they affected the profitability of manufacturing companies.

3.6 Data Collection Procedure

The researcher personally administered the research tool after a prior visit that assisted in refining timings of distribution of questionnaires as well as providing a rough picture of respondents' expectations. The researcher had agreed with the respondents when the research instrument was to be administered and specific dates of collecting them. Adequate time was granted to the respondents to respond to the questionnaires. The researcher later collected the instrument for data analysis

3.7 Pilot Study

Cooper and Schinder (2013), indicate that a pilot test is conducted to detect weakness in design and instrumentation and to provide proxy data for selection of probability sample. The rule of the thumb is that 1% of the sample should constitute the pilot test (Cooper and Schinder, 2013; Creswell, 2012). For this study, pilot testing was conducted in order to provide an opportunity to detect and remedy a wide range of potential problems with an instrument. By conducting a pilot testing there was an assurance that appropriate questions were asked, the right data collected and data collection methods were working.

3.8 Validity and Reliability of Research Instruments

How research instrument are reliable and valid is necessary as they will impact the final outcome of the findings. .

3.8.1 Reliability of research instrument

To affirm reliability the same instrument was administered twice to the same group who were not part of the final study with time interval of one week. The level of consistency was observed hence ascertaining the instrument as reliable.

3.8.2 Validity of research instrument

To affirm validity, the researcher used the expert judgment method to determine content validity by giving a copy of the questionnaire to the supervisor to check whether it represented all the objectives of the study thus validating it.

3.9 Data Analysis and Presentation

Data collected was checked for completeness of recording from the respondents and its accuracy. The researcher used both descriptive and statistical approaches in analyzing and processing the data. Data was analyzed by use of statistical package for social sciences (SPSS- Version 20.0) and findings presented in the form of tables.

The study utilized $Y=\alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3+\varepsilon$…… as regression equation to assess the relationship between tax incentives and profitability

Y = Profitability

α = Constant term

X_1= Custom & excise tax incentives

X_2 = VAT incentives

X_3 = Corporate income tax incentives

β_1 = Coefficient of Custom & excise

β_2 = Coefficient of VAT

β_3 = Coefficient of corporate income

ε = Error term

3.9 Measurement of variables

Variables	Indicators/Measure	Lickert Scale
Customs & Excise tax incentive	▪ Exemptions ▪ Reductions	5 points
VAT incentives	▪ Zero rating ▪ Exemptions	5 points
Corporate income tax incentive	▪ Deductions ▪ Allowances	5 points
Profitability	▪ Annual profits	

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter present data analysis, presentation and interpretation of findings of both demographic characteristics of the respondents and objectives of the study.

4.2 Demographic information

The respondent demographic characteristics were examined as it was essential to the study in question

4.2.3: Level of education

The respondents' education level was investigated.

Table 4.3 Level of Education

Level	Frequency	Percentage (%)
Diploma	-	0
Degree	11	50
Masters	8	43
Doctorate	1	7
TOTAL	**20**	**100**

The study findings revealed that most of the respondents as indicated (50%) had degree qualifications followed by Masters holders at (43%) while those who had furthered their education to Doctorate level were (7%). This implies that majority of respondents were well informed and capable of providing relevant information under the investigation.

4.2.4: Relevant work experience

The respondents' work experience was examined.

Table 4.4 Work experience

Category	Frequency	Percentage (%)
<1 year	1	7
2 -5 years	5	27
6-10 years	11	56
>10 years	3	10
Total	**20**	**100**

The study findings revealed that most of the respondents as indicated (56%) had worked between bracket 6-10 followed by those who had worked between 2-5years as indicated by (27%). The study findings show that the majority of the respondents had stayed for a relatively long in their respective field and therefore were conversant with the variables of the study.

4.2.5: Job designation

The respondents' job position was determined

Table 4.5 Job designation

Department	**Frequency**	**Percentage (%)**
Production	5	25
Procurement	5	25
Sales	5	25
Finance	5	25
Total	**20**	**100**

The findings revealed that the respondents were evenly distributed meaning all departments related to taxation and its incentives were well included

4.3 Study findings

4.3.1 How custom & excise tax incentives affect the profitability of Millers

Table 4.4 Effect of custom & excise tax incentives on profitability of Millers

S/N	Custom & excise tax incentives		Agree	Undecided	Disagree	Total
(a)	Local tax reductions reduces shortages of supplies locally	*Percentage*	54%	3%	43%	100%
		Frequency	*10*	*1*	*9*	*20*
(b)	Import duty exemptions leads to stiff competition reducing profit margin	*Percentage*	81%	3%	16%	100%
		Frequency	*16*	*1*	*3*	*20*
(c)	Import duty exemptions leads to high profits during drought due to shortage	*Percentage*	57%	28%	15%	100%
		Frequency	*11*	*6*	*3*	*20*
(d)	Import duty exemptions leads to counterfeits in market hence less sales	*Percentage*	77%	10%	13%	100%
		Frequency	*15*	*2*	*3*	*20*
	Total Mean	**Percentage**	**67%**	**11%**	**22%**	**100%**
		Frequency	**13**	**2**	**5**	**20**

On findings on Custom & excise tax incentives, the statement on whether local tax reduction reduced shortages of supplies locally or not, the variation on response was mild however majority (54%) of the respondents were in agreement. On the other hand, majority of the respondents (81%) agreed with the opinion that Import duty exemptions may lead to importation of surplus inputs by competitors leading to stiff competition hence Millers have to lower prices which halt their profitability. On the opinion, import duty exemptions may lead to high profits during drought due to shortage, the variation on preposition was mild where significance response was revealed as being neutral however majority (57%) were in agreement. Finally, it was revealed that majority of the respondents (77%) agreed that import duty exemptions may contribute to rise in counterfeit which are generally cheap hence making the genuine Millers products unaffordable. The mean indicated that the level of agreement was 67%, this affirms that almost a third of response was in disagreement hence it is evident that the contribution of custom & excise tax incentives on profitability of Millers is

minimal. The study findings are in correspondence with the data on Unga Group Limited annual reports on profits between 2008-2014. The study findings affirms Njeru and Ndimitu (2015) study which noted that tax incentives have negative impacts such as conflictive and unhealthy competitions on Kenya manufacturing sector. Also related to these findings are the findings from a study by Musyoka (2012) study which established that the custom duty tax incentives did not have a significant improvement in the FDI. The findings however are in agreement with Ohaka and Dagogo (2015) study that established custom duty incentives led to a positive improvement on the performance of the manufacturing firms listed at the Nigerian Stock Exchange

4.3.2 How VAT incentives affect the profitability of Millers

Table 4.5 Effects of VAT incentives on profitability of Millers

S/N	VAT incentives		Agree	Undecided	Disagree	Total
(a)	Exemptions contribute to economy of scale on importation	*Percentage*	61%	23%	16%	100%
		Frequency	*12*	*5*	*3*	*20*
(b)	Zero rating encourages product diversification	*Percentage*	64%	16%	20%	100%
		Frequency	*13*	*3*	*4*	*20*
(c)	Zero rating lowers prices hence higher consumption rate	*Percentage*	90%	7%	3%	100%
		Frequency	*18*	*1*	*1*	*20*
(d)	Exemptions & Zero rating lowers value addition costs	*Percentage*	84%	6%	10%	100%
		Frequency	*17*	*1*	*2*	*20*
	Total Mean	**Percentage**	**75%**	**13%**	**12%**	**100%**
		Frequency	**15**	**3**	**2**	**20**

From the study findings on VAT incentives it was found out that majority of the respondent (61%) agreed that exemptions contributed to economy of scale on importation which translates to more profit accumulations. On the other hand, most of the respondents (64%) agreed with the opinion that, zero rating encourages product diversification which creates more avenues for profit generation. It was further revealed that zero rating lowers prices of commodities leading to higher consumption rate hence high profits to manufacturers as it was

indicated by majority (90%). Finally, most of the respondents were in total agreement (84%) that exemptions & zero rating lowers value addition costs; that is, the general cost of processing raw material to final enriched product was minimal hence Millers spend less in processing. The total mean was 75% meaning the contribution of VAT incentives to overall profitability of Millers was relatively high. The study findings disagreed with the findings of Ironkwe and Peterus (2015) who noted that the effect of VAT incentives on financial performance of listed firms in Nigeria was negative.

4.3.3 How corporate income tax incentives affect the profitability of Millers

Table 4.6 Effects of corporate income tax incentives on profitability of Millers

S/N	Corporate income tax incentives		Agree	Undecided	Disagree	Total
(a)	ID allowance contribute to purchase of modern capital equipment	*Percentage*	80%	3%	17%	100%
		Frequency	16	1	4	20
(b)	IBD allowance facilitates expansion of modern storage facilities	*Percentage*	70%	17%	13%	100%
		Frequency	14	4	2	20
(c)	W&T allowance reduces replacement costs.	*Percentage*	67%	20%	13%	100%
		Frequency	18	1	1	20
(d)	Corporate incentives widens firm's market share	*Percentage*	93%	3%	3%	100%
		Frequency	12	4	2	20
	Total Mean	**Percentage**	**77%**	**10%**	**13%**	**100%**
		Frequency	**16**	**2**	**2**	**20**

The study revealed that there were various contributions of corporate income tax incentives that were directly related to profitability of a firm. This was based on the findings where most of the respondents (80%) agreed with the opinion that the ID allowance contributed to purchase of modern capital equipment which lowered the cost of operations. Majority of the respondents (70%) were in agreement that IBD allowance facilitated expansion of modern storage facilities hence Millers were well cautioned against shortages or surpluses. Another significance finding was in regard to W&T incentives, where majority (67%) acknowledged that it reduces replacement cost meaning much was utilized for investment. One notable

corporate income incentive merit was noted on it general impact where majority of the respondent (93%) argued that corporate income incentives in general meant less was levied on net profit which translated to improved values on shares as well as more to invest. The mean was 77% meaning the contribution of corporate income tax incentives to the profitability of Millers was great.

These findings echo preposition by Cheruiyot (2016) that major tax incentives in Kenya manufacturing sector such as IBD & ID enables the sector to report higher profit after tax leading to higher financial performance. The findings are in line with findings from a study conducted in UK by Maffini and Xing (2015) focusing on corporate tax incentives and performance on UK companies which revealed a strong and positive response between corporate income tax incentives and performance. However, the study contradicts findings from a study conducted on the same sector in Ghana by Kufor (2013) that revealed that corporate income tax impacted listed firms negatively.

4.3.4 Millers profitability

The study utilized secondary source of data for dependent variable analysis

Table 4.7 Source of Dependent Variable Data

Year	Dependent variable Profitability ('000')
2008	343,661
2009	185,192
2010	236,172
2011	441,043
2012	348,192
2013	338,196
2014	474,494

Annual reports (UGL, 2016)

Data from annual reports of Unga Group Limited noted a significant change in profit margin. Whereas some other incentives which could not be deduced outright may had an impact, it can be noted that the custom and excise tax incentives negatively affected profitability on the year 2009, this was in response by government to exempt duty for that year. Correspondingly, there was significant decline in profitability from 343,661 in 2008 units to 185,192 units in 2009 which further improved to 236,172 units in 2010 respectively when incentives were reversed.

4.4 Inferential Statistics

4.4.1 Correlation Analysis

Table 4.8 Correlation Analysis

The study sought to determine the direction and the strength of study variables.

		Profitability	Custom & Excise incentives	VAT incentives	Corporate Income incentives
Profitability	Pearson Correlation	1			
	Sig. (2-tailed)	0.01			
Custom & Excise incentives	Pearson Correlation	.771 (*)	1		
	Sig. (2-tailed)	0.01	0.002		
VAT incentives	Pearson Correlation	.815(*)	.862 (*)	1	
	Sig. (2-tailed)	0.03	0.02	.003	
Corporate Income incentives	Pearson Correlation	.849(*)	.873(*)	.825(*)	1
	Sig. (2-tailed)	0.01	0.001	0.002	0.03

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

From correlation analysis on table 4.8, the association between custom & excise incentive with profitability is 77% while the association between VAT incentives and profitability is 81%. Similarly, the association between corporate income tax incentives and profitability is 84%. Based on these revelations it is evident that the association between independent variables and dependent variable is strong and positive at 95% confidence level. In furtherance the correlation was statistically significance between all independent variables and dependent variable since all the p-values were less than 0.05.

4.4.2 Coefficient of determination

Table 4.9 Coefficient of determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.986[a]	.972	.970	.164

Adjusted R squared is the coefficient of determination which shows the variation in dependent variable as a result of changes in independent variables. From Table 4.9 above, adjusted R squared was 0.970, an indication that there was variation of 97% of profitability due to changes in Custom & excise, VAT and corporate income tax Incentives at 95% confidence interval. This shows that 97% changes in profitability could be accounted for by effects of tax incentives. The findings affirm that independent variables greatly influence dependent variable.

4.4.3 Analysis of Variance

Table 4.10 Analysis of variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	33.308	3	11.136	4.738	.000[b]
	Residual	.967	36	.027		
	Total	34.375	39			

Where the processed data has a significance level less than 0.05 the data is deemed ideal to make conclusion. From the ANOVA statistics in table 4.10 above, the significance value was 0.000 which is less than 0.05, indication that the model was statistically significance. On the other hand, the calculated value shows the level of relationship between the dependent and independent variables, where if the calculated value is greater than critical value (2.87), then the relationship is deemed significant. From the findings above the calculated value was greater than the critical value (2.87< 4.738) an indication that Custom & excise, VAT and Corporate income tax incentives significantly influenced the profitability of Millers.

4.4.4 Regression coefficients

Table 4.11 Regression coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.061	.061		-.995	.327
	Custom & excise_code	-.483	.184	-.463	-2.629	.013
	VAT_code	.994	.166	.971	5.980	.000
	Corporate income_code	.522	.089	.491	5.884	.000

From the findings in the table4.11 above, the established regression equation was

$Y= -0.61- 0.483X_1 +0.994X_2 +0.522X_3$

From the above regression equation it was revealed that holding profitability to a constant zero, its performance would be -0.61, that is, it will be underperforming. Further, a unit increase in custom & excise incentives would lead to a further a decrease in profitability by a factor of 0.483. Contrary, a unit increase in VAT incentives would lead to increase in profitability by a factor of 0.994. Similarly, a unit increase in corporate income incentives would lead to increase in profitability by a factor of 0.522. In furtherance, the influence of Custom & excise incentives, VAT incentives and corporate income tax incentives to profitability of manufacturing firm is statistically high as it is reflected by significance level less than 0.05 for each.

4.5 Discussion of the findings

In reference to correlation analysis the association between independent variables and dependent variable is strong and positive at 95% confidence level. In furtherance the correlation was statistically significance between all independent variables and dependent variable since all the p-values were less than 0.05.

In reference to coefficient of determination findings, the value of adjusted R squared was 0.972, an indication that there was variation of 97.2% on performance of profitability due to change in tax incentives at 95% confidence interval. Similarly, the correlation coefficient between the study variables as reflected by R was strong and positive shown by 0.986. From these findings it is eminent that the relationship between the study variables was strong, that is, the influence of independent variable to dependent was strong. From the analysis of variance findings, the significance value was 0.000 which is less than 0.05, indication that the model was statistically significance. This meant that the data was deemed ideal to derive conclusions from. Similarly, the calculated value was greater than critical values. This meant that the influence of independent variables over dependent variable indeed existed.

On reference on regression coefficients, the significance levels for the study variables were less that 0.05 at 95% confidence interval. This meant that the influence of independent variables to profitability of Millers was statistically high. On regression equation, it was noted that its performance would be -0.61 when the incentives were not under equation. That is, Millers will be making losses hence for them to make any profit there was need for various types of incentives. Concurrently, a unit increase in custom & excise incentives led to further reduction in profitability of Millers by a factor of 0.483. This can well be articulated based on the negative trends of importation of grains that emanate from government offering a window

period where import duty is free. For instance, such instances leads to importation of surplus inputs by competitors leading to stiff competition hence Millers have to lower prices. Also it contributes to importation of cheap substandard inputs by cartels that lead to cheap products locally than Millers' quality products. This leads to product unaffordability hence Millers suffer losses as they can't compromise their quality for short term gain.

On the other hand, a unit increase in VAT incentive would lead to increase in profitability by a factor of 0.994. It can be noted VAT incentives have positive effect on the performance of Millers which can be well urged to be enormous based on its overall contribution to product diversification, consumption rate as well as the reduction in the cost of processing goods. Similarly, a unit increase in corporate income incentives would lead to increase in profitability by a factor of 0.522. This finding can be inferred well since if Millers pay less tax more will be saved for ploughing back.

Generally based on the profitability from annual reports of Unga Group Limited it is evident that the contribution of tax incentives to the profitability of Millers is minimal. This means that unless other factors are to be incorporated to Millers productivity, incentives alone are of less significance. The argument is based on data from annual reports of Unga Group Limited that depicted variation on profit margin. Whereas some other incentives which could not be deduced outright may had an impact, it was be noted that the custom and excise tax incentives negatively affected profitability on the year 2009, this was in response by government to exempt duty for that year. Correspondingly, there was significant decline in profitability from 343,661 units on 2008 to 185,192 units on 2009 which further improved to 236,172 units on 2010 respectively when incentives were reversed.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter covers the summary of findings conclusions and recommendation.

5.2 Summary of the findings

The purpose of the study was to investigate the effect of various tax incentives on Millers profitability in Kenya where the regression analysis was utilized.

On correlation coefficient, the association between independent variables and dependent variable is strong and positive at 95% confidence level. Similarly, the correlation was statistically significance between all independent variables and dependent variable since all the p-values were less than 0.05. On coefficient of determination the value of adjusted R squared was 0.972 indicating a variation of 97.2% on general profitability of Millers due to change in tax incentives (custom & excise tax, VAT and corporate) meaning the influence of tax incentives over Kenyan Millers was high. From the analysis of variance findings, the significance value of processed data was 0.000 which is less than 0.05, indication that the model was statistically significance; the data was deemed ideal to base conclusions from.

On regression coefficient, the findings revealed that when Millers in Kenya is not a recipient of any tax incentives, its general performance was dismal resulting to loss in place of profit. The argument is based on the regression equation that was established; $Y= -0.61 -0.483X_1 +0.994X_2 +0.522X_3$. Where, 0.61 represents the profitability, $-0.483X_1$ custom and excise tax incentives, $0.994X_2$ VAT incentives and $0.522X_3$ corporate income tax incentives. A unit increase in custom & excise incentives would lead to a further decrease in profitability by a factor of 0.483., where a unit increase in VAT incentives would lead to increase in profitability by a factor of 0.994. Similarly, a unit increase in corporate income incentives would lead to increase in profitability by a factor of 0.522.

5.3 Conclusions

Based on the findings as per the regression analysis the study concludes that VAT incentives and corporate income tax incentives contributed significantly to positive performance of Millers in Kenya while custom and excise tax incentives affects its profitability negatively. The conclusion is based on the regression equation established. $Y= -0.61 -0.483X_1 +0.994X_2 +0.522X_3$. Further, the conclusion reflects secondary source of data which noted that the

custom and excise tax incentives negatively affected profitability of Miller on the year 2009, this was in response by government to exempt duty for that year. Correspondingly, there was significant decline in profitability from 343,661 units on 2008 to 185,192 units on 2009 which further improved to 236,172 units on 2010 respectively when incentives were reversed.

5.3.1 Custom & Excise Tax Incentives and Profitability

The regression equation established on association between profitability and custom & excise tax incentives was $Y= -0.61 -0.483X_1 +0.994X_2 +0.522X_3$. This meant a unit increase in custom & excise incentives would lead to decrease in profitability by a factor of 0.483. Based on the study findings on custom and excise tax incentives the study concludes that; import duty exemptions provides a lifeline for Millers during drought spell and since the supply is low and demand high, the prices of commodity skyrockets hence they accrue more profits. On the other hand local tax reductions reduces shortages of supplies locally as Millers buying price in fair which make suppliers not to withhold supplies thus ensuring steady source of profit. One notable demerit of import duty exemptions is related to stiff competition leading to lower prices as a result of over importation of goods. In furtherance, duty free period triggers importation of substandard inputs by cartels that lead to cheap prices of processed goods locally than Millers' quality products. This leads to product unaffordability that hurt the profitability of Millers negatively.

5.3.2 VAT Incentives and Profitability

The regression equation established on association between profitability and custom & excise tax incentives was $Y= -0.61 -0.483X_1 +0.994X_2 +0.522X_3$. This meant a unit increase in VAT incentives would lead to increase in profitability by a factor of 0.994. Based on the study findings on VAT incentives the study concludes that; zero rating leads to low prices of finished product hence the consumers can consume more leading to high profits to Millers. More significantly, exemptions & zero rating reduce the cost of product in each value addition process thus Millers saves more profits to cultivate back. Similarly, zero rating encourages diversification which translates to wider avenues for profits for Millers. Further, exemptions on VAT on various imported raw materials, machinery and other inputs promotes economy of scale as Millers have relief on general cost of imports.

5.3.3 Corporate Income Tax Incentives and Profitability

The regression equation established on association between profitability and custom & excise tax incentives was $Y= -0.61 -0.483X_1 +0.994X_2 +0.522X_3$. This meant that a unit increase in

corporate income incentives would lead to increase in profitability by a factor of 0.522. Based on the study findings on corporate income tax incentives the study concludes that; Wear and Tear allowances reduces the cost of replacement incurred by firm which ensures much of the returns are utilized for investment. Notably, Investment Deduction Allowance had enabled the Millers to invest on modern capital equipment thereby reducing cost of production hence more profit. Concurrently, Industrial Building Deductions allowance had enabled Millers to expand and install modern storage facilities to caution surplus and shortages hence steady flow of profits. Generally, corporate income incentives means less is levied on net profit which translate to improved chances of investment

5.4 Recommendations

From the study findings and conclusions, the study recommends that;

Based on the negative impact of custom and excise duty, the study notes that though imported raw materials constitute the biggest percentage of costs followed by labour, other costs include electricity & fuel that have to be factored by Millers. For instance, the cost of electricity & fuel in Kenya is higher compared to that in Uganda and Tanzania. Based on this perspective the study recommends that government should absorb the cost of electricity & fuel to the tune of the foregone duty on imports and VAT exemptions on imported raw materials in order to make the incentives of custom and excise duty as well as VAT more viable.

The study further recommends that Millers should capitalize on the investment incentives offered to them for capital equipment and refurbishment to adopt and embrace modern technology in manufacturing. This is in the view that incentives on corporate income tax will be more yielding since the cost of production will be reduced significantly. For instance, where capital equipment meets the threshold of modern technology the labour expenses will reduce drastically and also the duration of output production will be less thus overcoming financial damages associated with delays.

Generally, the study recommends that Kenya manufacturing sector should improve the quality of their output by incorporating latest manufacturing technology to attain sustainable local and export market competitiveness and minimize dependency on government protection. This can be done through investing in professionally trained staff and active targeted training as well as utilizing technology in its supply chain e.g e-procurement, e-supply, e-marketing etc.

5.5 Recommendation for Further Studies

Further studies should be carried out on the same to expand it further. Other researches should focus on;

i) Influence of tax regime on financial performance of Unga Group Limited

ii) What are the challenges facing firms in Kenyan manufacturing sector

iii) Impact of macroeconomic variables on the performance of manufacturing companies

iv) Determinant of firm's profitability on manufacturing sector in Kenya

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APPENDICES

Appendix I: Introductory letter

Dear Respondent,

RE: DATA COLLECTION

I am a student of Jomo Kenyatta University of Agriculture and Technology pursuing a Post Graduate Diploma on tax administration. I am collecting data how tax incentives on affect Millers profitability. Kindly answer all the questions comprehensively.

Thank you for your time.

KOLO ABDULLAHI

Appendix II: Questionnaire

EFFECT OF TAX INCENTIVES ON PROFITABILITY OF MILLERS IN KENYA

This questionnaire is meant to collection information on tax incentives on profitability of UNGA Group limited.

SECTION A: DEMOGRAPHIC INFORMATION OF THE RESPONDENTS

This section addresses demographic characteristics of the respondents. Kindly indicate your response in the space provided below by ticking appropriately in the space provided.

1) Education level

Diploma ( )

Bachelors ( )

Post graduates ( )

2) Work experience

<1 year ( )

2-5yrs ( )

6-10yrs ( )

Above 10yrs ( )

3) Department

Production ( )

Procurement ( )

Sales department ( )

Finance department ( )

SECTION B: SPECIFIC OBJECTIVES

This section addresses effects of custom & excise incentives, VAT incentives and corporate income tax incentives on profitability of UNGA Group limited.

Using a scale of 1 to 5 kindly, indicate your level of agreement in respect to the tax incentive highlighted.

(5-Strongly agree, 4 – Agree, 3-Neutral, 2-Disagree, 1-Strongly disagree).

4) To what extent does custom and excise tax incentives affects the profitability of Millers in Kenya?

No.	Excise & custom tax incentives	1	2	3	4	5
A.	Excise duty exemptions reduce shortages of supplies locally as Millers buying price in fair hence suppliers do not withhold supplies. This ensures steady source of profit.					
B.	Import duty exemptions may lead to importation of surplus inputs by competitors leading to stiff competition hence lower prices					
C.	Import duty reductions provides a lifeline for Millers during drought spell which could otherwise lead to shutdown due to low supplies hence the prices of commodity is skyrocket					
D.	Import duty exemptions may contribute to importation of substandard inputs by cartels that lead to cheap prices locally than Millers' quality products. This leads to product unaffordability					

5) To what extent does VAT incentives affects the profitability of Millers in Kenya?

No.	VAT incentives	1	2	3	4	5
A.	Exemptions on VAT on various imported raw materials, machinery and other inputs promotes economy of scale as Millers have relief on general cost of imports					
B.	Zero rating encourages diversification which translates to wider avenues for profits as Millers get VAT reimbursement from goods which would otherwise attract no refund					
C.	Zero rating leads to low prices of finished product hence the consumers can consume more leading to high profits to manufacturers					
D.	Exemptions & Zero rating reduces the cost of product in each value addition process thus the manufacturer saves more profits to cultivate back					

6) To what extent does corporate income tax incentives affects the profitability of Millers in Kenya?

No.	Corporate income tax incentives	1	2	3	4	5
A.	ID Allowance has enabled the Millers to invest on modern capital equipment thereby reducing cost of production					
B.	IBD allowance has enabled Millers to expand and install modern storage facilities to caution surplus and shortages hence steady flow of profits					
C.	W&T allowances reduces the cost of replacement incurred by firm which ensures much of the returns are utilized for investment					
D.	The corporate income incentives generally means less is levied on net profit which translate to improved chances of investment					

7) Do tax incentives contribution to profitability of Millers in Kenya?

Response	
Yes	
Not sure	
No	

----------END----------

THANK YOU FOR YOUR PARTICIPATION

Appendix III: Secondary Source of Data

Year	UGL Profitability ('000')
2008	343,661
2009	185,192
2010	236,172
2011	441,043
2012	348,192
2013	338,196
2014	474,494

Appendix IV: Work Plan

S/N		Jan.	Feb	March	May	June	June	July	July	July	
1.	Topic identification	*									
2.	Literature review		*								
3.	Methodology			*							
4.	Proposal defence				*						
5.	Data collection					*					
6.	Data analysis						*				
7.	Compiling final draft							*			
8.	Typing & editing								*		
9.	Project defence									*	
10.	Research submission										

Appendix V: Budget

	Quantity	**Unit cost Ksh.**	**Total Cost Ksh.**
Proposal writing			
Typing	35pgs	@50	1750
1st print out	35pgs	@10	350
2nd print out	38	@10	380
3rd print out	40	@10	400
4th print out	40x 5	@10	2,000
Binding	6books	@100	600
Sub-Total			***5,480***
Data collection			
Questionnaires	20x2 pages	@50	2,000
Data analysis			3,000
Report writing	20pages	@50	1,000
Print out	6 books	@600	3,600
Final research project	3 books	@500	1,500
Binding	6 books	@100	600
Final research project	3books (hardbound)	@800	2,400
Sub-Total			***14,100***
TOTAL			**19, 580**