EFFECTS OF TAX INCENTIVES ON THE FINANCIAL PERFORMANCE OF EXPORT PROCESSING ZONES FIRMS IN MOMBASA

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A RESEARCH PROJECT SUBMITTED TO THE DEPARTMENT OF ECONOMICS, ACCOUNTING AND FINANCE IN THE SCHOOL OF BUSINESS IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF POSTGRADUATE DIPLOMA IN TAX ADMINISTRATION, THE JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

NOVEMBER, 2020

DECLARATION

This research project is my own work and has not been presented for examination in any other University.

Signature …… Date……..

VITALIS OTIEKO OCHIENG

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This research project has been submitted for examination with my approval as the university supervisor

Signature ……. Date ……

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DEDICATION

I dedicate this research project to my family for their love and support during this study.

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ACRONYMS AND ABREVIATIONS

EPZ - Export Processing Zone

FDI - Foreign Direct Investment

GDP - Gross Domestic Product

GRIPS - Graduate Institute for Policy Studies

IBD - Industrial Building Deduction

IEA - Institute of Economic Affairs

ITA - Income Tax Act

KRA - Kenya Revenue Authority

OECD - Organization for Economic Cooperation and Development

R&D - Research and Development

SEZs - Special Economic Zones

VAT - Value Added Tax

DEFINITION OF TERMS

Tax Incentives	Refers to any incentives that reduce the tax burden of any party in order to induce them to invest in particular projects or sectors. (Gruber, 2015).
Export Processing Zones (EPZs)	These are areas in developing countries that aim to spur economic growth through attraction of FDI for export oriented production by offering incentives (Mangieri, 2016)
Corporate Income Tax Incentives	This is a reduced corporate income tax rate on qualifying income to particular types of activity for instance manufacturing activity or locations. The rate reduction may be broad, may be applied to both foreign and domestic income or be applied to specific sources (Ohaka & Agundu, 2012)
Capital Allowances	This is the amount which a business can deduct from the overall corporate or income tax on its profits (Clark, Cebreiro, and Bohmer, 2017)
Value Added Tax	Is a tax on the amount by which the value of an article has been increased at each stage of its production or distribution. The VAT law is contained in the Value Added Act, Cap 476 Laws of Kenya (Ernst & Young, 2014).

ABSTRACT

Imports and exports remain a key segment of the Kenyan economy. Importation of goods has been and continues to be a problem faced by many countries in developing countries like Kenya, it was in the background of this problem that the researcher seeks to establish the effect of tax incentives on the financial performance of EPZ firms in Kenya. The specific objectives was to investigate the effect of corporate income tax incentive, capital allowance tax incentive and VAT incentive on the financial performance on EPZ firms in Kenya. The performance of EPZ firms was measured by profitability and gross margins. The study will be of great value to the government, KRA and financial managers of these firms. To underpin the study findings; agency theory tax incentives, normative theory and optimal theory of taxation was used. The study adopted a cross sectional research design. The study targeted 27 EPZ firms in the county, where 106 officials from these firms were used as the unit of analysis out of which Yamane's formulae was used to determine a sample of 84 officials. The study used a stratified sampling approach because the target population can be grouped into various categories. Structured questionnaires was used to collect data from the respondents. The study used both descriptive and inferential statistics to conduct data analysis through SPSS version 24. Descriptive statistics which included frequencies, percentages, mean and standard deviations while inferential statistics included correlations and regression analysis. The study relied on 54 (64.3%) returned questionnaires for data analysis, study findings and recommendation. The study determined that corporate income tax significantly and positively affects financial performance of EPZ firms. The study further established that an improvement in corporate income tax incentives would significantly contribute to improvement in financial performance. Further it was found that that capital allowance incentives significantly and positively affect financial performance of EPZ firms in Mombasa County. The study also showed that an improvement in capital allowances incentives would insignificantly lead to an improvement in financial performance of these firms. Finally, it was determined that VAT incentives significantly and positively affects financial performance of EPZ firms in Mombasa County. The analysis showed that an improvement in VAT incentives would significantly lead to an improvement in the financial performance of the firms. The study concluded that that corporate income tax incentives, VAT incentives and capital allowance significantly and positively affects financial performance of EPZ firms in Mombasa. The study further concludes that an improvement of these incentives would significantly contribute to an improvement of financial performance, excluding capital allowance incentives. The study recommended that stakeholders in tax policy should reconsider the economic value of corporate tax incentive. These incentives had the capacity to increase the ROA of EPZ firms as well as the number of jobs. In addition, the study recommended that the government should consider the economic value of capital allowance incentives. Lastly, the government should reconsider its VAT policy by encouraging more VAT rebates to firms in order to boost their productivity and increase the volume of exports.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Tax incentives are widespread around the globe and are always advancing. They are measures that accommodate a more encouraging duty treatment of specific exercises or segments contrasted with what is conceded to general industry, it comes in form of an offer to pay less tax. According to Institute of Economic Affairs (2012), tax incentive is an arrangement that concedes any individual or action great conditions that move away from the ordinary arrangements of the excise enactments. It is normally given to people who do something that the government is trying to encourage. A step that impacts the person in a constructive way, for that individual or action or any measure that accommodates a more good expense treatment of specific exercises or segments contrasted with what is accessible to the general business. It is an strategy means to enhance and expand flow of investments from abroad through lower taxation rates and to energize private division investment in monetary and social projects where government assumes a key part (Waris, 2018).

Governments all over the world use tax incentives to enhance economic activities and investments by firms, they use these forms of incentives to channel some special economic activities towards some important sectors of the economy where they are either not felt or not existing at all (Kaplan, 2011). Tax incentives are those special exclusions, exemptions, or deductions that provide special credits, preferential tax rates or deferral of tax liability. Tax incentives can take the form of tax holidays, investment allowances and tax credits, accelerated depreciation, special zones, investment subsidies, tax exemptions, reduction in tax rates and indirect tax incentives. Hence, tax incentives can be defined as fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country (Fletcher, 2013).

In the USA, Thomas (2017) argues that the government allowed accelerated depreciation that is taken into account as an associate incentive offered to draw in investments into the USA as compared to other countries where wide obtainable accelerated depreciation isn't the

norm. In the year 2014, accelerated depreciation for machinery and instrumentality was in the tune of US dollars 44.7 billion. Jensen and Malesky (2010) remarked that despite broad skepticism concerning the advantages of globalization, USA offered tax incentives to draw in investment. They indicate that the scale of those incentives was usually thought to be too large to be welfare enhancing although it drew skepticisms among various economists. However despite the mounting proof to the contrary, there has been an increase in the size, frequency and magnitude of the tax incentives offered by the US federal government which implies that the country considers foreign investment as well as extent of development more important.

In the case of Canada, tax incentives are more centralized than in the USA. For the case of USA, only the federal government is involved in setting up the tax incentives but in Canada, it‘s not only the federal government, but also the provincial governments who are involved (Thomas, 2017). In Caribbean countries, Van Parys & James (2010) argue that tax incentives have led to losses for instance a loss of 23.5% was recorded in Anguilla and a loss of 53.9% was recorded in Grenada. Furthermore, similar sentiments are echoed by Chai and Goyal (2018) who revealed that if not well planned, tax incentives can also lead to losses. The scholars argued that, tax incentives led to a loss of between 9% - 16%. This therefore reveals that, tax incentives are a double-edged sword with both benefits and severe repercussions.

In Asia, Malaysia for instance, over the years, these tax incentive programs have been amended several times including the 1986 amendment that extended the tax holiday period from 5-10 years for export based foreign investments christened “pioneer” status. Other tax incentives offered by the Malaysian government included direct grants for high-tech activities, reinvestment allowance, export allowance and investment tax allowance. The government further pursued programs aimed at maintaining both political and economic stability and improved infrastructure. These programs have been a success in Malaysia (Keen, 2015).

Coming to Africa, Tax incentives play a crucial role in the achievement of economies of scale by various countries when they open shop in foreign markets. One such success story is the case with Mauritius. The lenient tax regime in Mauritius is associated with the

ballooning of foreign firms relocating and opening branches in the Island. Tax incentives encourage business organizations to invest offshore due to the fact that they allow such firms improve their financial soundness (Nuţă & Nută, 2012).

Regionally, in 1987, the Ugandan Government embarked on reviving its economy by embracing fiscal and monetary reforms. The country's tax system transformed from a high tax regime to an economically sustainable and balanced system. Some of the major reforms undertaken since then included the creation of the Uganda Revenue Authority aimed at improving tax administration. The Uganda Investment Authority was also established around the same time to promote and facilitate doing business in the country. A number of incentives which were provided for in the investment code included; investors' exemption from sales taxes (VAT) and import duties, issuing of incentive certificates (tax credits), refund of sales tax on imported inputs used in the production of goods for export and credit accessibility locally by foreign investors among other incentives. Tax incentives were intended to encourage investment in capital intensive projects (Mayende, 2013). While, in Tanzania, tax incentives ranges from incentives on agricultural investors in the form of deferment of VAT payments on project capital goods as well as zero rated value added tax on agricultural exports (Network-Africa & Action Aid International, 2012).

On the local perspective, Kenyan government has continued to pursue a growth strategy centered on exports, a move, aimed at moving away from the previously favored import-substitution (Mangieri, 2016). That being the case, the government focused on improving exports by creation of EPZ which aimed to have tax incentives in order to spur exports. The overall aim of that was to have the Kenyan economy be more open and increase market access (Mangieri, 2016). Some of the tax incentives hence offered are the wear and tear allowance which is a deduction on the depreciation of assets as well as the investment deductions allowance (IDA) on the expenditure on machinery (Institute of Economic Affairs, 2012).

In Kenya companies including those operating at EPZ benefit from major tax incentives especially capital allowances such as Investment building deductions (IBD), Investment deduction (ID) and Wear &Tear allowances by claiming deductions from their corporate tax

liability. Incentives lowers the cost of the firm especially where the government offer subsidies and other forms of incentives to firms such as low interest rates, grants, lowering the cost of labor, and improving transportation networks to make transportation cost low, with reduced costs, the net profit posted by firms will be high and hence leads to high financial performance. Ohaka and Agundu (2012) argue that firms that are eligible for tax incentives normally have higher returns. Tax incentives also make investments more attractive and in turn enhance profitability of a firm. Tax incentive generate employment and encourage self-employed to incorporate into limited companies, this leads to improved financial performance of firms because limited companies perform better given the fact they can assess external sources of capital as compared to sole-traders (Philips, 2011). Incentives lowers the cost of the firm especially where the government offer subsidies and other forms of incentives to firms such as low interest rates, grants, lowering the cost of labor, and improving transportation networks to make transportation cost low, with reduced costs, the net profit posted by firms will be high and hence leads to high financial performance

Locally, for the Kenyan case, Tembur (2016) argues that tax incentives vary from tax holidays, allowances and subsidies on investments, special zones, accelerated depreciation, reduced tax rates as well exemptions on tax. Resident companies enjoy a corporate tax rate 30% while non-resident companies receive higher rate of 37.5%. EPZs are taxed at 25% for the 10 years succeeding the tax holiday. The Income Tax Act provides for various tax incentives through capital deductions. The government has allowed a claim of 150% for companies who invest outside the 3 cities and incur expenditures of more than 200 million. It has further been proposed in the Amendments to the Income Tax Act in the 2015/16 Budget statement 100% for ships from the initial allowance of 40% and capital deduction for buildings used for educational and training services to be increased from 50% to 100 % (ITA, 2010).

Kenya, like many other developing nations, has laid more emphasis on export promotion with a view to penetrating foreign markets and remain relevant in international trade (Tirimba, Muturi & Sifunjo, 2016). Taxation system in any country aims to finance government expenditure. Taxation system can help raise the democratic accountability

between the electorate and government. Of late, focus has been on national treasuries and revenue administration authorities as the key revenue collection centers that barely meet the budget requirements of their economies (Abiola & Asiweh, 2012).

1.2 Statement of the Problem

The scholars who propose tax incentives argue that it leads to higher rates of return on both equity and assets and that frees up some revenue to be reinvested in the business (Uwaume & Ordu, 2014). Imports and exports remain a key segment of the Kenyan economy. Importation of goods has been and continues to be a problem faced by many countries in developing countries like Kenya, a number of tax incentives have been provided in our tax laws. However, due to lack of understanding of such incentives or lack of expert advice on how to exploit such opportunities, some of these incentives remains unexploited by many players in the various industry. Various sectors in the Kenyan economy are under special economic zones (SEZs), which can enjoy the following tax incentives: 10% corporate tax rates, VAT zero rating of goods, lower withholding taxes and 100% to 150% investment deductions (Mutuku, 2018).

Most firms in the EPZ do not claim this deduction or do not follow the set requirements before claiming. This results in higher tax payments, risk of lose of the tax incentive opportunity or costly tax disputes. Further most firms involved the export and imports in Kenya have not applied for the gazettement as SEZs and the operations of these hotels are outside SEZs (Stratton Consulting, 2018). In addition, EPZ firms still experience poor financial performance. There has been a decreasing trend in the number of employees recruited by EPZ firms in Kenya. Also the number of jobs decreased significantly between 2017 and 2019 (EPZA, 2020). The expansion in the global trade and stiff beneficial competition has worsened the financial of situation of these firms. Economic competition from developed calls for the government finger on financial performance of EPZ firms (Uwaume & Ordu, 2014).

Thuita (2017), investigated the effect of tax incentives on the FDIs in Athi River, where it was established that retention and attraction of FDIs can be achieved through tax holidays. While Kuria (2018), investigated the effect of VAT incentives on the performance of EPZ

firms in Kenya, showed that VAT incentives have a significant and positive effect on the performance of these firms. Finally, Tembur (2016), examined the effect of tax incentives on the financial performance of EPZ firms in the country, found out that there was a weak positive relationship between tax incentives and financial performance of EPZ firms in Kenya. None of the studies have focused on the effect of capital allowance, income tax incentives and VAT incentives collectively, on the financial performance of EPZ firms. Therefore, this study seeks to bridge this research gap by investigating each of these components of tax incentives on the financial performance of EPZ firms in Mombasa County,

1.3 Objectives of the Study

1.3.1 General Objectives

The overall purpose of this study is to examine the effect of tax incentives on the financial performance of EPZ firms in Kenya.

1.3.2 Specific Objectives

The study will be guided by the following specific objectives.

i. To establish the effect of corporate income tax incentive on the financial performance of EPZ firms in Mombasa County.
ii. To establish the effect of capital allowances on the financial performance of EPZ firms in Mombasa County.
iii. To establish the effect of VAT Incentive on the financial performance of EPZ firms in Mombasa County.

1.4 Research Questions

The study answered the following research questions:

i. What is the effect of corporate income tax incentive on the financial performance of EPZ firms in Mombasa County?
ii. What is the effect of capital allowances on the financial performance of EPZ firms in Mombasa County?

iii. What is the effect of VAT Incentive on the financial performance of EPZ firms in Mombasa County?

1.5 Significance of the Study

The study will be of enormous importance to the government. It will enable the government to know the extent to which tax incentives influence the performance of firms. It will also enable government to know the extent firms have been responding to the available tax incentives. Government, through this research could evaluate the profitability of the tax incentives, that is whether the revenue forfeited by way of tax incentives are justifiable or not. On the other hand, it will enable government to know whether tax incentives can actually help to redirect investment pattern of individuals and corporate bodies towards the development of EPZs.

This study will also enable government to compare the effects of the different tax incentives in order to identify those that are more profitable to the economy. This study will go a long way to sensitize companies and individuals on the existing tax incentive available to the manufacturing firms and their possible effects. It will also enable individuals and companies to make qualitative investment and tax decisions. The study will also be instrumental for researchers and academicians who will want to get information relating to tax incentives and performance of firms. It will also be of great use for researchers and students who will want to review the literature on tax incentives and also on financial performance

1.6 Scope of the Research Study

This study focused on the effect of tax incentives on the financial performance of EPZ firms in Mombasa County. The study income tax incentives, VAT incentives and capital allowance constructs of tax incentives to provide the basis of the study objectives. The study targeted 29 EPZ firms, where 106 officials of these firms were used as the unit of analysis, from the following categories: service industry, manufacturing industry, property developers and commercials.

1.7 Limitations of the Study

The nature of the study called for an emphasis on confidential information related to the manufacturing firms. Disclosure of such confidential information may make the respondents feel intruded and hence they were assured of confidentiality and ethical handling of the information they provided. Time was also a limiting factor in this research; the researcher had little time to accomplish the research, being academic in nature it was subject to strict deadlines which had to be met by the researcher. This meant that some other variables which may affect the financial performance of EPZ firms were omitted.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents theoretical, empirical as well as conceptual frameworks. There is also critique of related literature which aides in development of research gaps which the study aimed to fill. Theories discussed in this section include the optimal tax theory, normative theory, and agency theory of tax incentives. The chapter is structured on the basis of the specific research objectives: corporate income tax, capital allowance and VAT incentives.

2.2 Theoretical Framework

This section discusses and articulates the relevant theories and concepts on how tax incentives affect financial performance of firms in EPZ. The theories help build a case to justify the study. These theories include Agency Theory of Tax Incentive, New Growth Theory and Cluster Approach.

2.2.1 Agency Theory of Tax Incentive

The government continues to provide fiscal incentives to companies and other businesses to boost their production. This is in spite there being very little evidence in way of the efficacy and efficiency of the fiscal policies. The government creates a significant number of business challenges that can be compensated by tax incentives according to (Wells *et al*. 2011). The fiscal incentives therefore address challenges in the market that are created by the government much in the same way as they address market failure and are therefore a suitable way of reducing market and government failures. There are several investment impediments that cannot be tackled easily through other means of incentives as they are either too costly or they take longer to be executed since there are barriers of regulatory as well as compliance costs and skills base that is not adequate. Setting up a grant or a tax regime will help to counter the effects of these impediments (Wells *et al*. 2011).

Provision of a subsidy in counteracting a prevalent distortion may well not be the best solution but it does provide a more practical way of reversing the trend. There is friction

between the government and the agencies that are responsible the business environment that is generic. In order to coordinate government activities and thereby create investment, agencies that promote investment often play a crucial role as they advocate for more government incentives to promote investment. However, they are oblivious of the costs of such incentives to the whole economy and therefore only enhance investment but not overall growth of the economy (Zee *et al.*, 2012). Zee *et al.*, (2012) further argues that such agencies basically lure the government into extending incentives that end up being tied up and are therefore not productive to the whole economy.

EPZ firms (agents) are monitored by the government (principle) as they provide tax incentives for their production activities which therefore explains the rationale behind incorporating this theory into this study. The legitimacy of government belief that horizontal equity in government taxation as well as expenditure is not justified since it may not fully address policy objectives even if they do address part of characteristic market failures in other sectors (Allen & Morisset 2011). The policy therefore advocates a number of issues that need to be addressed in order to justify any government incentives. For instance the government should focus its incentives to specific areas that are receiving less investment than they should as information asymmetry can alter economic fundamentals. Some of the studies that have used this theory in relation to tax incentives include: Nyberg, Fulmer, Gerhart and Carpenter (2010); Ballwieser, Bamberg, Beckmann, Bester, Blickle, Ewert and Gaynor (2012) and Baiman (2010).

2.2.2 Normative Theory

This theory is equally derived from practical approaches to tax administration but unlike other theories that have used the approach and found to have a number of significant shortcomings attributable to tax administration, it is less criticized when presented in textbooks and often forms the basis upon which policy makers are advised. According to this theory, government institutional structure development will lead to a number of incentives and also constraints that form the basis of the actions of the government and other actors. The incentives so developed will provide a breakthrough to development since it is common knowledge that different governments evolve with just a few operating efficiently

regarding tax. Therefore, the process of creating tax policies and tax admiration reforms may well lead to a link between tax policies and administrative reforms. The theory that will be developed here is the institutional theory which will provide a framework that can be generalized to better understand how tax policies as well as tax administration strategies are developed by examining different periods as well as cultures (Tresch, 2014). According to Tresch, (2014), the theory therefore provides a clearer model that guides description, explanation as well as prediction.

In relation to this study, based on the report by Chukwumerije and Akinyomi, (2011), provides useful signaling effects of this theory that will not witness any loss in revenue on the part of the government. Specific as well as target policy tools will be provided by both investment tax credits as well as allowances to achieve the aforementioned objective. An existing tax incentive will only be regarded as sound and ideal for the prevailing circumstances if it can significantly draw corporate tax to levels that can be compared with other countries that are operating in that region. Fletcher, (2013), further adds that tax incentive that brings about huge discrepancies in corporate tax between a country and its neighbors will directly affect its operations and therefore put it in a disadvantaged position relative to the trading partners in the region such as Tanzania and Uganda. This adjustment should however not fall way below the level that exists in capital exporting economies. For instance, if the corporate tax is below 20% when compared with the other exporting countries, then it may result to greater losses in revenue than the projected gains in investment. Past studies such as Chukwumerije and Akinyomi, (2011); Cochran (2019) and Hebermas (2016) have interlinked the signaling effect of this theory on tax incentives advanced by the government.

2.2.3 Optimal Tax Theory

The theory discusses a best way of raising set revenues, reducing inefficiency and distortion through distortionary taxation (Sørenson, 2010). A neutral tax is a theoretical tax which avoids distortion and inefficiency completely. Other things being equal, if a tax-payer must choose between two mutually exclusive economic projects (say investments) that face the

same pre-tax risk and returns, the one with the lower tax or with a tax break would be chosen by the rational actor.

With that insight, economists argue that generally taxes distort behavior. For example, since only economic actors who engage in market activity of "entering the labor market" get an income tax liability on their wages, people who are able to consume leisure or engage in household production outside the market by say providing housewife services in lieu of hiring a maid are not taxed or are taxed lightly. There is distortion attributable to the incidence of taxes that are levied on commodities a classic example being the tax on restaurant prepared food while the foods bought from supermarkets to then be prepared at home after they have been bought are usually not taxed. Thus it will be safely concluded that tax discriminations in favor of household work over the work that can be executed in the market places can lead to gross inefficiency in tax operations. According to a theory that was developed by Ramsey (2017) on optimal sales taxes levied on commodities, he posited that producer surplus as well as consumer surplus arises where a demand curve sloping downwards intersects with a supply curve that slopes upwards. As a result of imposing a sales tax, there is a considerable reduction in the output apart from imposing a deadweight loss. A single rate of tax that is applied uniformly, of course making the assumption of invariant demand and supply elasticities will bring about minimization of the sum area of DWL triangles that have developed. The general idea about the theory is that if an assumption is made regarding the elasticity of suppliers such that we now assume that they have a perfect elasticity regarding their responses to tax changes, it will be concluded that a smaller DWL distortion will be experienced on taxes levied on commodities that have a more inelastic response to consumer demand. Marginal deadweight loss is the main focus of the modern version of the optimal taxation theory according to (O'Brien, 2019). It is this modern theory upon which the objective of this study will be based.

There is a vivid justification why the theory of optimal tax is pertinent to this study as it provides crucial information on VAT Incentives as well as Excise Tax Incentives. According to Ohaka and Agundu (2012), eligibility of EPZs firms on VAT Incentives and also Excise Tax Incentives enables these firms to pay much more less tax which eventually gives them

a genuine upper hand to record increased return on assets as well as return on equity (ROE) both of which are arrived at from profit after tax. Tax incentives also make investments more attractive and in turn enhance profitability of a firm. Some of the studies which have used this theory include Dynarski and Scott-Clayton (2016), Kopczuk and Slemrod, (2016) and Saez and Stantcheva (2016).

2.3. Conceptual Framework

Conceptual framework is a diagrammatical representation of a relationship between variables. The variable that is manipulated to establish the effect it has on another variable is called the independent variable. Dependent variable is a variable that is affected by the independent variable. According to Mugenda and Mugenda (2013), a dependent variable is a function of an independent variable. Based on the research objectives, the dependent variable is financial performance of EPZ firms while the independent variables are represented by the corporate income tax incentive, capital allowance and VAT incentives. The measurement of financial performance was measured by ROA and ROE.

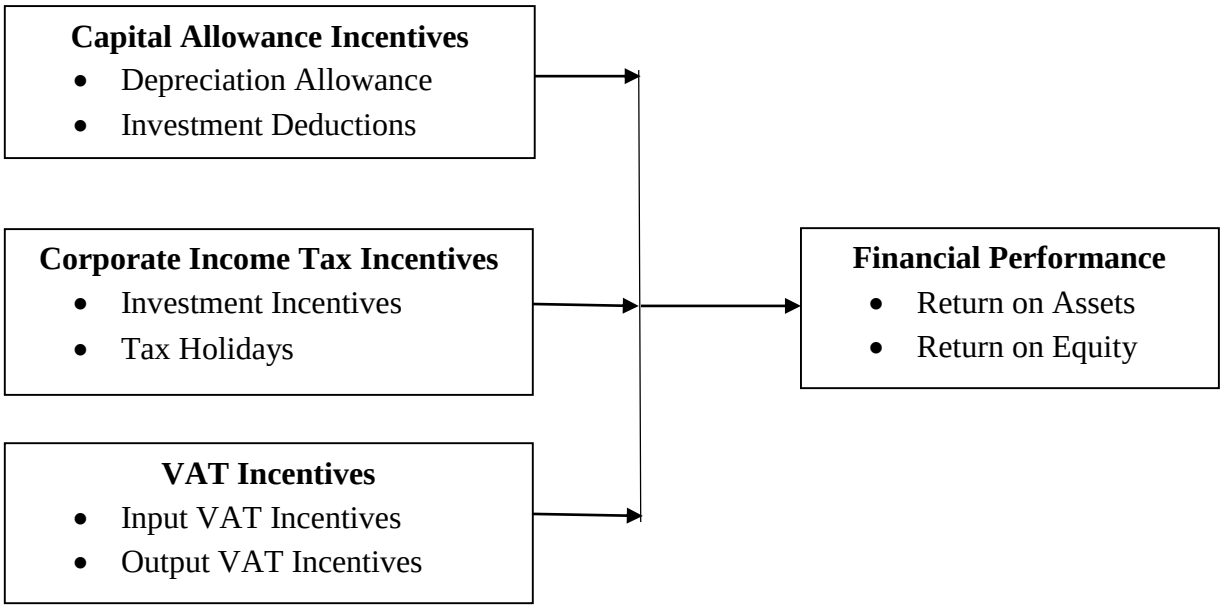

Figure 2. 1: Conceptual Framework

2.4 Review of Study Variables

2.4.1 Corporate Income Tax Incentives

This involves incentives levied on the net profits of EPZ firms, computed as the excess of receipts over allowable costs (Rohaya, Nor'Azem & Bardai, 2010). Olaleye, Riro, and Memba (2016) examined the effect of company income tax incentives on performance of listed Nigerian manufacturing companies. Descriptive research design was adopted in this particular study. The target population in the study was the one hundred and seventy four listed manufacturing companies. The number of employees in these companies was found to be in excess of 56000. The study made use of primary data that was collected using self-administered questionnaires. The questionnaires were administered by trained research assistants. Data was collected for a period of one month. The findings showed strong positive linear relationships between reduced company income tax incentives and foreign direct investment. The positive and statistically significant relationship between reduced company income tax incentives and foreign direct investment implied that foreign investors could maximize their investment by taking advantages of the available tax incentives allowed by the government to create an enabling investment environment. Reduced company income tax incentives laws had been used by governments as a policy tool for accelerating investment in specific economic sectors, shaping the investment environment of the country and eventually over coming some of the challenges posed by adverse investment conditions. The study recommended that there was need to conduct a cost benefit analysis for tax incentives available to various sectors of the economy. The benefits accrued in terms of increase in level of investments should exceed revenue forgone by the government through tax exemptions and allowance.

Pham (2015) investigated how temporary corporate income tax reduction can affect the performance of firms in the Vietnamese sector. The central focus of this particular study was on a temporary reduction by 30 percent of the corporate income tax in Vietnam specifically in small and medium sized businesses for the year 2009. Firms that had more than 300

employees who were working on a full time basis or those firms that didn‘t have more than 5000 dollars as their initial assets were considered eligible businesses to be included in the study. The approach that was adopted is a difference-in-differences with firm-level fixed effects to determine the eligibility of the firms regarding inclusion and where 300 employees cut considering the period up to and after implementation of the tax. The causal effects on capital investment, the profits that were reported as well as tax revenue generated were estimated by the study. Capital stock was increased by 11 to 13 percent by the tax cut as the point estimates indicated. The increase in the investment was explained by a relaxation of liquidity constraints. It was also established that this increase was not in any way explained by a drop in the UCC. The estimates also implied that large increases in before-tax reported profits in the tax cut year and even in the year after the tax cut ended. The tax revenue increased as a result of the increase in the reported profits. It was however established that the study failed to find any evidence that would lead to the conclusion that shift from non-tax year to tax cut years led to the increase in the profits that were generated. It was equally not attributable to changes recorded on capital or employment. A good part of the profits that were generated was found to come from foreign firms. This temporary reduction in the tax rate in Vietnam brought about an influx of multinational firms that leveraged on the reduced tax rate to carry out more profitable business activities than doing the same in other countries with significantly high and unaffordable tax rate. Of course the general conclusion is that this temporary reduction in the tax led to an increase in the tax revenue as these new firms still generated additional tax revenue despite the fact that there was a tax cut. It was therefore noted that capital stock increased as a result of the tax cut policy. Therefore as was anticipated, this turned out to be a low cost policy in way of reduced but temporary tax that formed part of a crucial economic stimulus in Vietnam.

Njeru and Ndimitu (2015) assessed the effect of tax incentives on performance among Export Processing Firms (EPZs) in Kenya. The study adopted a descriptive design. The findings from the study revealed that investments in EPZ firms increased with increase in sales, profit as well as tax incentives. However, the influence of tax incentives on investments in EPZ was insignificant. The study revealed that, the level to which EPZs have

benefited on the following tax incentives include grants or loan guarantees; corporate income tax incentives; tax holidays or reduced tax rates, investment allowances; exemption from import tariffs; exemption from sales, wage income or property taxes and subsidized financing. Positive impact of various attractive incentives extended to the EPZs include increased foreign exchange earnings for the state, tax breaks, increased gross exports that are used to boost business investments in the country, high quality manpower, good source of labor training and learning by doing and assisting countries in developing an industrial labor force as well as procedural incentives. Negative impacts, on the other hand include the administration is legally complicated and conflictive; unhealthy competitions in the manufacturing sector caused by the tax incentives to the EPZ.

Another study that was conducted by Devereux, Maffini and Xing (2015) focused on corporate tax incentives as well as firm performance. This study used data that was obtained from confidential tax return data that was combined with the data from financial statements for a panel of companies in the UK that were in operation between the fiscal years 2001/2002 - 2009/2010. The analysis of the study was based on the confidential tax return data in the UK at company-level. There were elaborate kinks in the corporate tax rate schedule that led to the variation in the company‘s marginal tax rates that therefore provided the leading identification strategy. A dynamic adjustment model that captured capital structure was used to arrive at a positive as well as substantial long run effect of tax on the competitive financial advantage of the companies. What this shows of course is that there were significant differences between the estimates of taxable profits as were captured in the tax returns data and the estimates of the financial statements. There was found to be a downward bias of the capital structure captured through financial statements as was influenced by the estimated tax. Variations in the marginal tax rate often necessitated an adjustment of capital structures as a gradual response to the change so as to match the demands of the new marginal tax rate. Additionally, there was a strong response to the corporate tax incentives that were extended to both the domestic stand-alone 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.

2.4.2 Capital Allowances

Capital allowances is the amount which EPZ firms can deduct from the overall corporate or income tax on its profits (Clark, Cebreiro, & Bohmer, 2017). The study by Maffini, Xing and Devereux (2016) on the influence of incentives in the form of depreciation allowances provided new evidence by employing confidential corporation tax returns in the UK. A difference-in-difference analysis was conducted by exploring an exogenous change in the qualifying threshold for the first year allowances (FYAs) that was recorded in the year 2004. The findings of the study depicted an increase in the investment rate during the period when the firms qualified for FYAs by a percentage increase of between 2.1-2.6 when compared to the firms that didn't qualify for the FYAs. There was thus a mean increase of about 11%. The study established that the large effect was not as a result of an increase in the available cash after exogenous variation in the timing of payments of tax had been exploited but rather it was a cost of capital effect. It was also found that firms showed a rapid response to the FYAs within the period 12-18 months. It was also found out in the study that the salience of the FYAs was enhanced due to the cost of the capital created by the qualifying thresholds being just below the notches. The main result was however not driven by this behavior.

Zwick and Mahon (2016) estimated the effect of temporary tax incentives on firm equipment performance. This study used two episodes of investment stimulus and a difference-in-differences methodology to study the effect of taxes on investment and how it varied across firms. The policy studied, ―bonus‖ depreciation, accelerated the schedule for when firms could deduct from taxable income the cost of investment purchases. Bonus altered the timing of deductions but not their amount, so the economic incentive created by bonus worked because future deductions were worth less than current deductions. Analyzing data for over 120,000 firms it was found that bonus depreciation had a substantial effect on investment. Across firms with differential exposure to bonus, we find a relative investment response of 10.4 percent on average between 2001 and 2004 and 16.9 percent between 2008 and 2010.

The study indicated methodological research gaps which suited the choice of the methodology in the current study. The study by Zwick and Mahon (2016) used a difference-in-differences methodology to achieve its objectives. The study also focused on temporary

tax incentives and the performance of equipment. The current study deviated from the choice of those variables and focused on a number of tax incentives versus performance of the firm. This was in an attempt to fill the existing conceptual knowledge gap from this study by Zwick and Mahon (2016).

A study by Rosenberg and Marron (2015) focused on startup as well as innovative businesses in order to examine the alterations by tax policies on investment incentives. The study concurred with other past studies and established that widely varying tax rates were imposed by existing policies on the investments that were carried out in different industries as well as different activities that favored debt over equity. It was equally noted that the existing policies also imposed the effective tax rates by favoring pass through entities over corporations. The cost of capital was well lowered by the targeted tax incentives for some specific businesses such as those that invested in intellectual property, startup businesses as well as small businesses. Two factors were found to weaken the advantages in some cases while in others the advantages were reversed. The first factor explained how firms that relied more on tangible investment were found not to rely heavily on higher-taxed equity in contrast to those firms that invested heavily in new materials. The second factor established that initial losses suffered by startups made them face limits that were confined to their ability to realize the full extent of the value of tax deductions as well as credits. The advantages that come as a result of tax incentives were therefore found to be offset by these limits. The effects of the tax reforms that would result to the achievement of more equal tax treatment across various business investment forms apart from enhancing a reduction in the corporate income rate of tax were also examined by the study.

Oghoghomeh (2014) while assessing agribusiness tax incentives in Nigeria came up with the recommendation that due to lack of enough funds brought about by lack of ability to borrow more funds from the capital markets, incentives should be aimed at small and growing agribusinesses. Therefore the required results may not be attained by reducing tax rates or even introducing tax holidays. More effective measures such as upfront funding from investment tax credits were therefore found to be more relevant to agribusiness in Nigeria. The study used primary data collected by use of questionnaires which were semi

structured in form. This collected both quantitative and qualitative data. The collected data was analyzed using descriptive methods which was a major method used. The study focused on small and medium enterprises operating in the agri-business sector. The fact that there is a contextual differences led to a need to focus on another sector, manufacturing sector to establish the effect of the same tax incentives on performance. More so, the study Oghoghomeh (2014) was conducted in Nigeria. The current study focused on four tax incentives and their effect on firms operating in the EPZ zone in Kenya so as to fill the conceptual and context knowledge gaps.

In Kenya, a similar study was conducted by Gumo (2013) to establish the effect of tax incentives on performance of manufacturing firms in Kenya. The study was descriptive and adopted a descriptive research design. There was the use of secondary sources such as Kenya revenue authority to collect secondary data on (tax incentives and Foreign Direct Investment). The data was also collected from the Kenya National Bureau of Statistics to enhance depth. The study further collected primary data through structured questionnaires to capture quantitative data. The study established that Kenya had various tax incentives including capital investment allowances offered to resident companies such as Industrial Building Allowance (IBA). Capital investment allowances were offered on the expenditure on capital which is incurred on an industrial building construction. The government of Kenya also has an allowance on investments made where by some deductions are made on each investment made and that was aimed to spur the growth of the manufacturing sector. There were other incentives levied on farm works in the tune of up to fifty percent per year for a duration spanning twenty four months. Other incentives involved were reductions on investment on shipping and that was charged at a tune of up to forty percent on the total expenditure on capital shipping. For those companies focusing on mining, there is an allowance called mining allowance if a company is involved in spending on capital to be used in mining related activities such as exploration, testing and gaining access to mineral deposits.

The study by Gumo (2013) focused on various tax incentives across the manufacturing sector in Kenya. The focus revealed conceptual differences in the studies and the current study

aimed to fill this knowledge gaps. The current study focused on the firms operating in the EPZ zones in Kenya. This was a contextual knowledge gap which this study aimed to fill.

Ramzani, Ismail, Kamarulzaman and Mohamed (2014) focused on using pro forma income statements in analyzing financial positions as well as evaluating the influence of government incentives on sustainability of aquaculture farms in Malaysia. The study was divide into two sections. The first part provided a discussion on financial analysis on freshwater as well as brackish water producers and also provided their finding and comparability. Financial viability criteria captured by net present value, the internal rate of return as well as the benefit cost ratio for base study was discussed in the first section. Four different phases provided the evaluation process. The first phase involved base study and government incentives simulations. The second phase tackled pioneer status (PS) while the third and fourth phases covered investment tax allowance (ITA) and accelerated capital allowance (ACA) respectively for determination of the effectiveness of government incentives as well as its roles in increasing profitability and production. There was a higher and positive value of the ACA ahead of NPV that preceded both individual PS as well as ITA that were recorded in the study for all brackish water farms. The influence of the incentives by the government on Penaeus vannmei as well as Grouper indicated that IRR and NPV on ACA (keeping PS as the base) was 2 percent and 9 percent respectively higher than that of ACA keeping ITA as the base. The study therefore made the conclusion that in order to maximize the profits then the aquaculture operators should pair PS with ACA adopted on Penaeus vannamei and Grouper. ACA based on ITA on Barramundi, Tilapia as well as Catfish should also be chosen by the aquaculture operators in order to maximize the profits.

2.4.3 VAT Incentives

Value added tax incentive is the tax exemption the value of a poduct that has been increased at each stage of its distribution or production (Earnst & Young, 2013). In their study, Harju, Matikka, and Rauhanen (2015) sought to find out the effects of the value-added tax (VAT) threshold on the performance of small businesses. It was reported in this study that in Finland, firms that earned below 8,500in annual sales Euros were not liable to pay VAT. A robust and clear evidence of behavioral effects of the threshold was obtained in the study by

applying the bunching method on detailed register data on the universe of businesses in Finland. The results of the study implied that small businesses were notably influenced by the VAT threshold. Notable efficiency implications were observed since the firms bunched actively 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 responses. The study found no evidence of tax avoidance or evasion, which suggested that firms responded by reducing output. Also, it was found that bunching behavior was relatively permanent, which implied that the threshold decreased the growth of small businesses.

The study played a significant role in adding to the existing literature on tax incentives and performance of firms. The study however opened avenue for the current study to fill the contextual and conceptual knowledge gaps it left. The study by Harju, Matikka, and Rauhanen (2015) focused on the performance of small businesses while the study focused on firms in export processing zones. It was forth comparing the findings to establish whether the situation with small firms is similar to that of large firms hence the importance of this study. Further, the situation in Finland (a developed economy) is different from the situation in Kenya (a developing economy). For that, there is a limitation in generalizing the findings of a study in developed economy to a developing economy. As such, the current study established whether there would be comparison in the findings between the two findings.

Ironkwe and Peter (2015) conducted a study aimed at investigating the impact of value-added tax incentive on corporate financial performance of quoted companies. Agribusinesses quoted in the Nigerian Stock Exchange Fact book of 2009 were considered as the population for this study. The population elements include the General Managers, Chief Accountants, Finance Managers, Chief Internal Auditors, External Auditors, and Tax Administrators of the selected companies. A total of forty (42) respondents were considered for this study. The study findings indicated that Value-Added Tax (VAT) impacted negatively on the financial performance of agribusinesses though the impact is of insignificant value. Based on the findings, the study recommended that agribusinesses should endeavour to keep appropriate source documents of all transactions for efficient VAT

operations and that the governments should ensure that proper tax incentive scheme was designed and fully implemented to promote the growth of agribusinesses, in Nigeria.

In comparison to the study by Harju, Matikka, and Rauhanen (2015), this study by Ironkwe and Peter (2015) also played a significant role in adding to the existing literature on tax incentives and performance of firms. More specifically, the study linked value added tax to performance. The study however opened avenue for the current study to fill the contextual and conceptual knowledge gaps it left. The study by Ironkwe and Peter (2015) focused on the performance of firms listed at Nigerian Stock Exchange while the study focused on firms in export processing zones. It was forth comparing the findings to establish whether the effect of tax incentives among listed firms in Nigeria is similar to that of firms operating in export processing zones in Kenya. Further, the economic situation in Nigeria is different from the situation in Kenya and due to that contextual difference; this study was timely in investigating the effect of VAT tax on performance with a context of Kenya.

In the Kenyan context, Mutwiri and Okello (2015) focused on how value added tax incentives affected the capital structure decisions involving the firms which are listed at the Nairobi Securities Exchange. The study adopted a descriptive research design which made it easy to achieve its objectives. The design majorly helped it to form a causal relationship between the study variables. The study also adopted the correlational research design which helped it to collect data at the same time over various companies. With data analysis, the study majorly relied on correlation and regression analysis with inclusion of descriptive results. The correlation findings revealed that value added tax incentives did not play a huge influence on the capital structure decisions of the firms listed at NSE. The nature of its effect was termed as weak due to a small value of Pearson correlation. It generally implied that the local tax incentives did not play a huge role in motivating investors to invest in the firms listed at Nairobi Securities. There was hence a need to review the value added tax incentives so as to see it play a significant role in attracting more investors, a fir which can spur growth through increased investments.

2.4.4 Financial Performance

According to Miller, Boehlje and Dobbins (2013) in their paper on key financial

performance measures discussed the below key financial performance measures; Capital employed must be used productively. Capital is mobile and if not used productively, will eventually move to where it can generate a competitive return. ROA provides a measure for assessing the overall efficiency with which the assets are used to produce net income from operations. It also is indicative of management's effectiveness in deploying capital, because it is certainly possible to be efficient and yet poorly positioned in terms of how capital is being utilized. Return on assets, is calculated by dividing profit after tax (PAT) and interest by total assets. This can be interpreted as a ratio of income to its total assets. Return on assets is probably the single best overall measure of operating performance. It ties together the results of operations with the resources used to produce those results. It is also relatively easy to interpret.

The rate of return on assets measure is itself the product of a measure of financial efficiency and a measure of profitability. The rate of return on assets may be calculated by multiplying the operating profit margin ratio (OPM) times the asset turnover ratio (ATR). The interrelatedness of these three performance measures emphasizes the fact that there are two primary ways to enhance the efficient use of resources to produce profit. One is to increase the profit per unit of output. Operating profit margin is a measure of profit per unit of product produced or output. A firm operation that has a high operating profit margin percentage is a low cost producer. Thus, the management may respond to a poor or small operating profit margin by instituting cost controls in order to increase profits per unit.

The other way to enhance performance is to increase the revenues generated per unit of an asset, as indicated by the asset turnover rate. For a given set of farm resources or size of farm, operating profit margin and asset turnover are the two key determinants of profit that the general manager must try to influence in order to improve financial performance. An increase in either or both will increase ROA and is generally indicative of improved financial performance.

Debt is an important component of the capital structure of a firm. Debt provides needed resources to take advantage of profit opportunities. When used productively, debt can leverage equity capital in a way that is very beneficial financially. But financial leverage is

impartial and unforgiving. Debt works just as well to the detriment of a business when it is used unproductively, as it works to benefit a farm that is managed wisely. A firm needs to know whether and to what extent financial leverage is working either for or against their farm business. The rate of return on equity (ROE) provides useful information about the performance of debt in the capital structure. ROE is calculated by dividing net income by shareholder's equity. ROE should exceed ROA for firms that borrow money. If ROE doesn't exceed ROA, it means that borrowed capital isn't earning enough to pay its cost. Alternatively, ROE may be way higher than ROA and may indicate potential to benefit from additional investments in the firm.

ROE is also a very useful measure of the performance of the firm owners' invested or equity capital. Investors generally have other alternatives to investing in the farm operation and need a basis for evaluating their investment alternatives. ROE is not a risk-adjusted return measure. So ROE should be adjusted for differences in the perceived riskiness of alternative investments when making head-to-head comparisons. ROE is related to and heavily influenced by ROA. Increasing ROA by taking management action that will either increase operating profit margin and/or asset turnover should have a favorable impact on ROE.

2.5 Empirical Review

Chukwumerije and Akinyomi (2016) examined the impact of the tax incentives on the overall performance of registered small scale industries in Rivers State, Nigeria. Eleven, out of the twenty two registered small scale food and beverages manufacturing industries in Rivers State were selected randomly for the study. Questionnaires were administered to 260 respondents in the selected. Frequency distribution and chi-square were used in the analysis of data and hypotheses testing respectively. The findings revealed that there are various tax incentives available to small scale industries and the operators in these industries are very familiar with them. It was also discovered that tax incentives do significantly affect the profitability, staff strength and the growth and development of small scale industries positively.

Musyoka (2017) studied the relationship between tax incentives and foreign direct investment in Kenya. To achieve this objective, the entire set of data for investment

incentives, trade related incentives, import duty exemptions and foreign direct investments inflows for ten most recent years was collected Basic analysis begun with the determination of various measures of central tendency; namely mean, minimum and maximum. The study found that there was no significance improvement in foreign direct investment as a result of implementing tax incentives in Kenya.

Ojochogwu and Ojeka (2017) studied the relationship between tax policy, growth of SMEs and the Nigerian economy. Using business sustenance and expansion as indices of growth, it analyzes responses obtained questionnaires distributed to SMEs in Zaria, North Central Nigeria. Sampling for the survey was done using the non-probability sampling method specifically by judgmental sampling. The hypothesis was tested using Spearman's Rank Correlation. Although there is a general perception that that tax is an important source of fund for development of the economy and provision of social services, the study revealed a significant negative relationship between taxes and the business' ability to sustain itself and to expand. In order to obtain a vibrant and flourishing SME sector, the tax policy needs to be appropriate such that it will not be an encumbrance to the growth of small and medium enterprises.

Kimeu (2018) investigated the effect of tax reforms on financial performance of real estate firms in Kenya. A descriptive survey was carried out in all the real estate firms within Nairobi County. Both primary and secondary data sources were used. Data was collected through a semi-structure questionnaire and analysis was done with the help of a regression model. The findings of this study depicted that a positive relationship with financial performance of the real estate firms in Kenya between years 2008–2011. The data was mainly from secondary sources, most attention being focused on annual reports and audited financial statements of the sampled firms. Correlation analysis was carried out on FDI inflows and tax incentives variables to establish whether there was any relationship. The results of the study revealed a strong relationship between wear and tear allowances and FDI inflows. Industrial Building Deductions and Investments Deductions had no significant relationship with FDI inflows.

Tembur (2016) examined the effect of tax incentives on the financial performance of EPZ

firms. This research embraced quantitative descriptive research design. The population of this study comprised all the firms registered and licensed by Export Processing Zone Authority as at 2016. Where it was established that that was a significant relationship between the efficiency of asset utilization and financial performance, as for the size of the firm, the study found a negative relationship with the financial performance and therefore recommended the firms to dispose off idle assets as it seemed to be incurring some cost to maintain them. The study therefore recommended the authorities concerned with tax incentives should make it easier for firms within and without EPZ to enjoy tax incentives.

2.5 Critique of Existing Literature

The chapter examined various literatures informing the study variables. The review of literature above pin pointed out various research gaps which the current study sought to fill. Uwaume and Ordu (2014) carried out a study to establish the impact of tax incentives on economic development in Nigeria. The study found that sufficient tax incentive enhances industrial growth and economy. The study relied on secondary data which was unreliable hence its findings could not be completely relied on. Tembur (2016) conducted a study on the Effect of Tax Incentives on Financial Performance of Export Processing Zone Firms in Kenya. The study used IBD, W&T and ID as independent variables (and size and asset utilization as independent variables) and thus an indication of conceptual gap on capital allowance incentive, VAT incentive and corporate income tax incentive. The current study used corporate income tax incentives, capital allowances, VAT Incentives Excise Tax Incentives, custom duty incentives as independent variables (and Firm size as a moderating variable).

Chukwumerije and Akinyomi (2011) studied the impact of the tax incentives on the overall performance of registered small scale industries in Rivers State, Nigeria. They concluded that there was significant positive relationship between tax incentives and profitability, staff strength and the growth and development of small scale industries. Gumo (2013) conducted a study on the effect of tax incentives on foreign direct investments (FDI) in Kenya but did not focus on financial performance, hence its study also creating a conceptual gap. His study established that investments deductions and mining operation deductions incentives policy

have a positive effect on FDI while industrial allowance has a negative influence. Therefore, this study sought to bridge the research gap by investigating on the effects of tax incentives available on the performance of EPZ firms in Kenya.

2.6 Research Gap

The literature review showed that a number of studies had been conducted to show the relationship between various tax incentives and performance for instance; Onyango (2015) carried out a research to establish the effect of tax incentives on financial performance of five-star hotels in Nairobi County. The population comprised of all the seven 5-star hotels in the city. Census approach was used and primary data collected using questionnaires. Data collected was then analyzed using regression model to establish the relationship between tax incentives and financial performance. The study found that there was strong relationship between ID and IBD incentives and financial performance of the five-Star hotel in Nairobi City County and recommended the government to review policies that guide the provision of ID and IBD.

Githaiga (2013) carried out a research to establish the impact of tax incentives on FDI inflows of firms listed at the NSE. His focus was on the impact of ID, IBD, and wear and tear towards attracting FDI inflows. The population included 60 firms listed at NSE while the sample included 10 firms selected using simple random method. The study adopted secondary data where data relating to FDI and incentives were collected from annual reports and audited financial statements covering a period of 2008-2011. For data analysis, Microsoft excel sheets was used to analyze quantitative data while SPSS was used to analyze qualitative data with an aid of a conceptual model. Correlation analysis carried out on FDI and tax incentives variables showed that tax incentives impacted on FDI inflows of firms listed at NSE. Wear and tear had a strong relationship with FDI.

Gumo (2013) carried out a study on the effect of tax incentives on FDI in Kenya with an aim of determining the effect of tax incentives on investments in Kenya. He adopted a descriptive research design where secondary data was collected from relevant authorities; EPZA, KRA and KNBS. For data analysis, descriptive statistic, correlation and multiple linear regression models were used. The study established that investment deductions and mining operation

deductions incentives policy had a positive effect of FDI while industrial allowance had a negative influence. Gumo concluded with a recommendation to the Kenyan government to evaluate tax incentive policy among other things, introduce evidence base tax incentives that minimize tax evasion and encourage positive FDI.

2.7 Summary of Literature Review

The above chapter reviewed the various theories that explained the independent and dependent variables. The reviewed theories are then critiqued for relevance to specific variables. Several studies have been done both locally and internationally to determine the effects of tax incentives on various dependent variables. From the empirical review above, both international and local scholars none of them has focused on the effects of tax incentives on financial performance of EPZ firms in Kenya. This study sought to bridge the research gap by investigating on the effects of tax incentives available on the performance of EPZ firms in Kenya. The chapter also explored the conceptualization of the independent and the dependent variables by analyzing the relationships between the two set of variables. The dependent variable is performance of EPZ firms while the independent variables are represented by the corporate income tax incentive, capital allowance, and VAT incentives

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research methodology that was adopted in the study. It explains the methodology that was used in selecting the population, sampling data, collecting data, and gathering, coding, classifying and analysing the data as well as reporting the results of the study. The researcher aimed at applying methods, tools and techniques that was relevant and reliable to ensure that the data obtained was relevant and accurate for the study.

3.2 Research Design

A research design is the outline of study that characterizes the study type (Kothari, 2014). Kothari (2014) further adds that a research design directs the researcher by offering him with guidelines on how to collect, analyze and interpret the data in a coherent manner. The researcher will employ cross-sectional research design. Sarma and Misar (2016) describes cross-sectional research design, as where the researchers observe a set of variables at a given point of time across space or other units of analysis. In cross-sectional data the data from multiple sources taken into account. In the analysis of data from different sources, the units of analysis were observed across different organisations. Cross-sectional research design takes into account differences on the respondents of the structured questionnaire. The design fitted the study which aimed at determining the relationships between variables that is tax incentives and financial performance of EPZ firms in Kenya.

3.3 Target Population

Mugenda and Mugenda (2013) highlights the target population as a number of individuals about which a researcher is interested in describing or making a statistical inference. This study targeted 27 EPZ firms in Mombasa County from different categories (manufacturing industry, property developers, service industry and commercial) according to Export Processing Zone Authority (EPZA), 2020. financial managers, chief accountants and

operational managers from these firms were used as the unit of analysis. This formed a total of 106 officers of EPZ firms from the county.

Table 3. 1: Target Population

Category	Population
Financial Managers	27
Chief Accountants	36
Operational Managers	43
Total	**106**

3.4 Sampling Frame

According to Thompson (2012), a sampling frame comprises of a list of people from which the researcher uses to obtain information about the study. Sampling frame in this study comprised of 29 firms from various categories (manufacturing industry, property developers, service industry and commercial) according to Export Processing Zone Authority (EPZA), 2020, where 106 officials comprising of financial managers, chief accountants and operational managers were used as the study respondents.

3.5 Sample and Sampling Technique

Sample size is the portion of the target populace (Kothari, 2014). Cramer and Howitt (2017) adds that a sample s a set of entities drawn from a population with the aim of estimating characteristics of the population. There are various formulas that have been proposed for sample size determinations. However, this study adopted the formula proposed by Yamane, (1967) since it is simple to use, scientific and can be used in cases of large populations. Thus, to calculate the sample size from 106 officials as per human resource departments of these firms, the study specifies a 5 percent error as shown in equation below.

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

Where; n is the sample size, N is the target population and e is the error term

$$n = \frac{106}{1+106(0.05^2)}$$

=84

A percentage of the sample (84 officials) out of a population of 106 officials was calculated which was 79 % to allow for sample size computation in all the four categories. It was more precise, for it ensured each category within the population received equal representation within the sample.

Table 3. 2: Sample Size

Category	**Population**	**Sample Proportion %**	**Sample Size**
Financial Managers	27	79	22
Chief Accountants	36	79	28
Operational Managers	43	79	34
Total	**106**	**79**	**84**

The study adopted a stratified random sampling technique to select a suitable sample size to ensure all units in the population had an equal chance of being selected, thereby allowing for the generalization of the finding, this is made possible by dividing the population into homogenous subgroups and then taking samples in each subgroup (category).

3.6 Data Collection Instruments

According to Daniel and Harland (2017), data collection instrument is a tool of gathering information from all the relevant sources by responding to the questions through interview, writing, content analysis or observations and presenting the answers to the research problem for outcome analysis. This study will rely on primary data which was gathered through structured questionnaires containing closed ended questions. Closed ended questions was used because it ensured that the respondents were restricted to certain categories in their responses. The main advantage of using the questionnaire is to uphold privacy promised to

the respondent so as to directly enhance and facilitate the sincerity of the information given out. The respondents indicated their extent of agreements to the given statements on a 5-Likert scale. The scale (1) strongly disagree: (2) disagree (3) neutral, (4) agree: (5) strongly agree.

3.7 Data Collection Procedure

The first step of data collection was to sought an authorization letter from the Kenya School of Revenue Administration, research office. The researcher then contacted human resource department and administration and the target respondents (financial managers, operational managers and chief accountants) of the respective firms to seek for permission to administer the questionnaire. The researcher adopted a drop and pick method, where questionnaires were left to the respondents to fill at their own free time and then they were collected after two to three days.

3.8 Pilot Study

Sidabi (2012) states that the purpose of piloting of instruments was to establish the clarity of meaning and the comprehensibility of each of the items in the research instrument. Hence this study conducted a pilot study of 8 officials (10% of the sample size) from 3 EPZ firms to determine validity and reliability of the research instrument. Creswell, (2013), pilot study ensures the success of the main study as it helps identify and shortcomings of the research tool and fix them in time.

3.8.1 Validity of the Research Instruments

Validity of the research instruments refers to the credibility of the research instruments in the achievement of the study objectives (Mugenda & Mugenda, 2013). In this study content validity was determined using KMO and Bartlett Test, where KMO value of above 0.5 was accepted and significance of Chi square was also accepted as recommended by Field (2015).

3.8.2 Reliability of the Research Instruments

Reliability of the research instrument is defined as the consistency when answering research questions (Jack & Clarke, 2018). In this study measure of internal consistency was used to

measure reliability of the research instrument through Cronbach' s Alpha, which has a scale of 0 to 1. This study will use a threshold of 0.7 as recommended by Hair *et al* (2010)

3.9 Data Analysis and Presentation

Data analysis is the process of reducing and organizing data to generate results which necessitate interpretations by the researcher (Sekaran, 2016). Data collected was simplified, organized and tabulated to make it easier to understand and be analysed. The data was then analysed using the Statistical package for social sciences (SPSS) Version 24.0. Measures of central tendencies, standard deviations and percentages was applied in analysing the data. Correlation analysis was used to show whether and how strongly tax incentives and financial performance are related while regression analysis will be used to measure the nature of relationship between Tax incentives and economic growth. The quantitative reports obtained from the analysis was presented using tables. The model that was applied in data analysis as given below.

Y is the dependent variable, X1 to X3 are the independent variables

Regression model: $Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + e$

Where Y = Financial Performance of EPZ firms

X1= Corporate Income Tax Incentives

X2 = Capital Allowance Tax Incentives

X3 = VAT incentives

e = The random error term

The F-Statistic for the multiple linear regression model was computed to determine the significance of the model that is, to what extent the variation in the independent variable explains the changes in the dependent variable.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter covered response rate, validity and reliability of the research instruments, frequency and percentages on general information, mean and standard deviation on study variables and inferential statistics (correlation coefficient, ANOVA, Coefficient of determination and regression coefficient).

4.2 Response Rate

This the percentage of returned questionnaires (Mugenda & Mugenda, 2013). Out of the 84 questionnaires distributed to the Operational Managers, Chief Accountants and Financial Managers of the 29 EPZ, only 54 questionnaires were returned and completely filled. This formed a response rate of 64.3% which the researcher relied on for data analysis. According to Mugenda and Mugenda (2013), a response rate of more than 50% is good, response rate of more than 60% is satisfactory and a response rate of more than 70% is excellent, hence a response rate of 64.3% was excellent for the study.

Table 4. 1: Response Rate

Response	**Frequency**	**Valid Percent**
Returned and Complete Questionnaires	54	64.3%
Incomplete and Unreturned Questionnaires	30	35.7%
Total	**84**	**100**

4.3 Pilot Study Results

4.3.1 Validity of the Research Instruments

Validity is the extent to which a test measures what it is supposed to measure. Validity is the degree to which the results obtained from the analysis of the data actually represents the phenomenon under study (Mugenda & Mugenda, 2013). Construct validity will be determined and highlight variability among observed variables and to also check for any

correlated variables in order to reduce redundancy in data. Mwiti (2018) suggested that variables with factor loadings greater than 0.5 were the ones that had the highest significance and influence.

Table 4. 2: Validity of the Research Instruments

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.797
Bartlett's Test of Sphericity	Approx. Chi-Square	784.44
	Df	465
	Sig	0.000

KMO measures on the study variables was 0.797 which represented great acceptability of the use of factor analysis and sufficient intercorrelations. Bartlett's test of Sphericity was significant (chi-square=784.44, $p<0.000$). Bartlett's test checks if the observed correlation matrix diverges significantly from the identity matrix.

4.3.2 Reliability of the Research Instruments

The measurement of the reliability and the validity of a data instrument helps the researcher to gauge the goodness of the variables of measurement (Sekaran & Bougie, 2010). Reliability was measured using Cronbach's Alpha coefficient which was used to measure the internal consistency of the variable measures.

Table 4. 3: Reliability of the Research Instruments

Variable	**Number of Items**	**Cronbach Alpha**
Corporate Income Tax	5	0.806
Capital Allowance Incentives	5	0.780
VAT Incentives	5	0.996
Financial Performance	5	0.855
Overall Alpha		**0.811**

The overall Cronbach's alpha coefficients for all the constructs in the study were 0.811. The study measures were found to be highly reliable in that they all had alpha coefficient greater

than the minimum accepted Cronbach's alpha coefficient of 0.70 (Hair *et al.,* 2010). Corporate income tax had an alpha of 0.806 while capital allowance incentives had an alpha of 0.780, VAT incentives had an alpha of 0.996 while financial performance had an apha of 0.855.

4.4 Demographic Analysis

In this section, the researcher sought to establish the gender, education level, age bracket of the respondents and number years worked in the hotel sector.

4.4.1 Gender of the Respondents

The respondents were asked to indicate the gender in which they belong and the findings were depicted on table 4.4.

Table 4. 4: Gender of the Respondents

Gender	Frequency	Valid Percent
Male	32	59.3
Female	22	40.7
Total	**54**	**100**

The analysis indicated that 59.3% (32) were males compared with 40.7% (22) who were females. This suggests a good representation of gender thereby the study collected views from both genders. Hence, these firms adheres to the two thirds gender rule according to the 2010 constitution.

4.4.2 Education Level

The respondents were also asked to indicate the level of education in which they had and the findings were depicted on table 4.5.

Table 4. 5: Education Level

Education Level	Frequency	Valid Percent
Bachelors' Degree	25	46.3
Masters	13	24.1
Post Graduate Diploma	16	29.6
Total	**54**	**100**

It was evident that 46.3% (25) had a bachelors' degree, compared with 29.6% (16) of the respondents had post graduate diploma and finally 24.1% (13) had a masters' degree. The analysis indicated that majority of the respondents were qualified to understand the basis of the study.

4.4.3 Age Bracket of the Respondents

The respondents were asked indicate the age bracket in which they belong and the findings were depicted in table 4.5.

Table 4. 6: Age Bracket of the Respondents

Age Bracket	Frequency	Valid Percent
20-29 Years	13	24.1
30-39 Years	33	61.1
40-49 Years	5	9.3
50 Years and Above	3	5.5
Total	**54**	**100**

From table 4.6, it was evident that 61.1% (33) of the respondents indicated that they were aged between 30 to 39 years, followed by 24.1% (13) of the respondents were aged between 20 to 29 years, followed by 9.3% (5) of the respondents who were aged between 40 to 49 years and finally 5.5% (3) of the respondents who aged above 50 years. The analysis indicated that majority of the officials of EPZ firms are youths

4.4.4 Length of Service

Finally, the respondents were asked to indicate the number of years they had served in the organisation.

Table 4. 7: Length of Service

Length of Service	Frequency	Valid Percent
Less than 1 year	5	9.3
Between 1 to 3 years	10	18.5
Between 3 to 5 years	16	29.6
More than 5 years	23	42.6
Total	**54**	**100**

From 4.7, 42.6% (23) indicated that they had worked in the industry for more than 5 years, followed by 29.6% (16) of the respondents indicated that they had worked in the sector for between 3 to 5 years, followed by 18.5% (10) of the respondents who indicated that they had worked in the sector for between 1 to 3 years and finally 9.3% (5) of the respondents indicated they had worked in the industry for less than 1. The study concluded that majority of the respondents were experienced with the effect of tax incentives on the financial performance of the EPZ firms.

4.5 Descriptive Analysis

This section presents the mean and standard deviation on the extent of agreement on the various statements on the study variables.

4.5.1 Corporate Tax Incentives

The respondents were asked to indicate the extent in which they agree with the various statements on corporate tax incentives The following scale was used: Strongly disagree (1), Disagree (2), Neutral (3), Agree (4) and Strongly Agree (5).

Table 4. 8: Corporate Tax Incentives

Opinion Statements	Mean	Std. Deviation
Investment incentive offered by the government encourages EPZ firms to expand in the Kenyan market	3.7692	1.06281
Investment incentives decreases financial risk on the EPZ operating environment	3.7949	1.39886
Investment incentive in form of grants compensates capital costs of EPZ firms	4.1538	.93298
Tax holidays that have failed to generate jobs and investment for Kenyans causes government to lose revenue	3.8718	1.00471
10-year Tax holiday advanced to EPZ firms insignificantly contributes to job creation compared to Kenyan public firms	4.3333	.52981
Valid N = 54 (listwise)		
Overall	**3.9846**	**.98583**

From the analysis it was evident that majority of the respondents strongly agreed that 10-year Tax holiday advanced to EPZ firms insignificantly contributes to job creation compared to Kenyan public firms with (M=4.3333; SD=0.52981) and they also strongly agreed that investment incentive in form of grants compensates capital costs of EPZ firms with (M=4.1538; SD=93298). The analysis further showed that the respondents agreed that tax holidays that have failed to generate jobs and investment for Kenyans causes government to lose revenue with (M=3.8718; SD=1.00471) and they agreed that investment incentives decreases financial risk on the EPZ operating environment with (M=3.7949; SD=1.39886). The respondents further agreed that investment incentive offered by the government encourages EPZ firms to expand in the Kenyan market with (M=3.7692; SD=1.06281). The overall mean of 3.9846 and standard deviation of 0.98583, implied that majority of the respondents agreed that corporate income tax incentives affects financial performance of EPZ firms and there was a low variation from the mean since standard deviation was greater than 1. This is in tandem with the findings of Devereux, Maffini and Xing (2015, who

established that corporate income tax incentives affected the external leverage of both domestic and multinational companies.

4.5.2 Capital Allowance Incentive

The respondents were asked to indicate the extent in which they agree with the various statements on capital allowance and financial performance. The following scale was used: Strongly disagree (1), Disagree (2), Neutral (3), Agree (4) and Strongly Agree (5).

Table 4. 9: Capital Allowance Incentive

Opinion Statements	Mean	Std. Deviation
Depreciation allowances allows the firms to ward off losses after the assets of the firm has stopped function	3.5897	1.40896
Depreciation allowances can be accumulated to finance the purchase of new assets	4.0000	.97333
Depreciation allowance allows EPZ firms to project their true finances	3.9231	1.22226
Investment deductions allows EPZ firms to claim capital expenditure on the industrial building	3.9231	1.17842
100% investment deductions advanced to EPZ firms is favourable	3.6154	1.28995
Valid N =54 (listwise)		
Overall	**3.02564**	**1.21458**

On the capital allowance incentives, the respondents strongly agreed that depreciation allowances can be accumulated to finance the purchase of new assets with (M=4.0000; SD=0.97333). The respondents agreed that depreciation allowance allows EPZ firms to project their true finances

with (M=3.9231, SD= 1.17842) and they agreed that the investment deductions allows EPZ firms to claim capital expenditure on the industrial building with (M=3.9231; SD=1.22226). The respondents further agreed that 100% investment deductions advanced to EPZ firms is favourable with (M=3.6154; SD=1.28995) and they agreed that depreciation allowances allows the firms to ward off losses after the assets of the firm has stopped function with

(M=3.5897; SD= 1.40896). The overall mean of 3.02564 and standard deviation of 1.21458, implied that majority of the respondents agreed that capital allowance deductions affects financial performance of EPZ firms and there was a strong deviation from the mean since standard deviation was greater than 1. This corroborates the findings by Zwick and Mahon (2016), who established that hat bonus depreciation and capital allowance had a substantial effect on investment hence affects financial performance. Kuria, Omboj and Achoki (2017),adds that capital allowance tax incentive had a positive and significant relationship with performance

4.5.3 VAT Incentives

On the last independent variable, the respondents were also asked to indicate the extent in which they agree with the various statements on VAT incentives and financial performance. The following scale was used: Strongly disagree (1), Disagree (2), Neutral (3), Agree (4) and Strongly Agree (5).

Table 4. 10: VAT Incentives

Opinion Statements	**Mean**	**Std. Deviation**
Output VAT incentives allows EPZ firms to sale their products at lower prices	3.7949	1.36072
Zero rating of VAT on EPZ firms improves financial performance of the firms	4.3590	1.03840
Perpetual exception of VAT provides multiple benefits to the firms	3.7179	1.33670
Input VAT incentives allows EPZ firms to purchase inventories and materials at lower prices	4.1538	1.13644
Government should consider more VAT rebates to improve productivity of EPZ firms	4.2821	.88700
Valid N =54 (listwise)		
Overall	**4.06154**	**1.151852**

The analysis showed that respondents strongly agreed that Zero rating of VAT on EPZ firms improves financial performance of the firms with (M=4.3590; SD=1.03840) and they also strongly agreed that government should consider more VAT rebates to improve productivity of EPZ firms with (M=4.2821; SD=0.88700). The respondents further strongly agreed that Input VAT incentives allows EPZ firms to purchase inventories and materials at lower prices with (M=4.1538; SD=1.13644). The respondents agreed that Perpetual exception of VAT provides multiple benefits to the firms with (M=3.7179; SD=1.33670) and they agreed that Output VAT incentives allows EPZ firms to sale their products at lower prices with (M=3.7949; SD=1.36072). The overall mean of 4.06154 and standard deviation of 1.15182, implied that the respondents strongly agreed that VAT incentives affects financial performance and there was a strong variation from the mean since standard deviation was greater than 1. This findings cognates with that of Ironkwe and Peter (2015), who opined that VAT affects financial performance of agribusinesses.

4.4.5 Financial Performance

On the dependent variable, the respondents were also asked to indicate the extent in which they agree with the various statements on financial performance. The following scale was used: Strongly disagree (1), Disagree (2), Neutral (3), Agree (4) and Strongly Agree (5).

Table 4. 11: Financial Performance

Opinion Statements	Mean	Std. Deviation
With implementation of tax incentives, capital employed is used productively	4.1282	1.00471
ROA improvement has been contributed by management effectiveness in handling tax issues	3.4359	1.27310
Registration on the VAT register has improved ROE of the firm	4.1538	1.06471
There is efficient use of assets by the organisation with the advancement of tax incentives.	3.6410	1.18070
The revenue collected by the firm has improved with the application on the EPZ	4.0513	.99865
Valid N =54 (listwise)		
Overall	3.88204	1.34051

On the dependent variable, the respondents strongly agreed that registration on the VAT register has improved ROE of the firm with (M=4.1538; SD=1.06471) and they also agreed that with implementation of tax incentives, capital employed is used productively with (M=4.1282; SD=1.00471). The respondents further strongly agreed that the revenue collected by the firm has improved with the application on the EPZ with (M=4.0513; SD=0.99865). The respondents further agreed that there is efficient use of assets by the organisation with the advancement of tax incentives with (M=3.6410; SD=1.18070) and they agreed that ROA improvement has been contributed by management effectiveness in handling tax issues with (M=3.4359; SD=1.27310). It was evident that tax incentives in the organisation contributes to financial performance of the with the overall mean of 3.88204 and standard deviation of 1.34051. This can be corroborated by the findings of Chukwumerije and Akinyomi (2011), who showed that tax incentives do significantly affect the profitability, staff strength and the growth and development of small-scale industries positively.

4.6 Inferential Statistics

Data was then subjected to inferential statistics to establish relationships between variables. Hypothesis was tested using the multiple regression model in order to link the relationships between tax incentives and financial performance (Kraus, Harms & Schwarz, 2016).

4.6.1 Correlation Coefficients

In order to establish the relationship among financial incentives and financial performance of the EPZ firms, correlation coefficient was used.

Table 4. 12: Correlation Coefficients

		X1	X2	X3	Y
Corporate Income Tax Incentive (X1)	Pearson Correlation	1			
	Sig (2-tailed)				
	N	54			
Capital Allowance Incentive (X2)	Pearson Correlation	.338**	1		
	Sig (2-tailed)	.000			
	N	54	54		
VAT Incentive (X3)	Pearson Correlation	.603**	.318**	1	
	Sig (2-tailed)	.000	.000		
	N	54	54	54	
Financial Performance (Y)	Pearson Correlation	.673**	.318**	.566**	1
	Sig (2-tailed)	.000	.001	.000	
	N	54	54	54	54

Correlation is Significant at p=0.01

The correlation analysis between corporate income tax incentive and financial performance showed (r=0.673; p=0.000), this implied that their existed above moderate positive correlation between the two variables and the relationship was statistically significant since the p-value <0.01, These findings support that the findings of Kuria (2018), but contradicts that of Musyoka (2017). Further the analysis showed a correlation between capital allowance

incentive and financial performance as (r=0.318; p = 0.001), which implied that there existed a weak positive relationship between the two variables and the relationship was statistically significant since p-value < 0.01, this supports the findings of Davies, Norback and Koru (2010). The analysis further showed a correlation between financial performance and VAT incentive as (r=0.566; p=0.000), which implied that there existed a moderate positive correlation between the two variables and the relationship was statistically significant since the p-value <0.01, which supported the findings of Kuria, Omboj and Achoki (2017).

4.6.2 Coefficient of Determination

To establish the suitability of the independent variables (corporate income tax incentives, capital allowance incentives and VAT incentive) in explaining financial performance of EPZ firms, coefficient of determination was done through liner regression.

Table 4. 13: Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std Error of Estimate
1	.625[a]	.390	.353	.74649

Predictors: (Constant), Corporate Income Tax Incentives, Capital Allowance Incentives, VAT Incentives

Table 4.13, showed that there existed a positive and above moderate correlation between the combined predictors on the financial performance (r=0.625). The adjusted R^2 indicated that corporate income tax incentives, capital allowance incentives and VAT incentive can only explain 35.3% (0.353) of the financial performance of the EPZ firms and there were other factors which could explain 64.7% of financial performance of EPZ firms, which were not incorporated in the study.

4.6.3 Analysis of Variance

To explain the suitability of the model in explaining financial performance of the EPZ firms in Mombasa County.

Table 4. 14: ANOVA

	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	13.979	3	4.6597	9.0112	0.000[b]
	Residual	25.855	50	0.5171		
	Total	39.564				

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Corporate Income Tax Incentives, Capital Allowance Incentives, VAT Incentives

On the model the ANOVA showed (F{3,50}= 9.0112; p=0.000), the analysis indicated that the model was statistically significant since p-value<0.05. Hence the corporate income tax incentives, capital allowance incentives and VAT incentive incorporated in this study significantly predicts financial performance of the EPZ firms.

4.6.4 Regression Coefficient

A regression analysis was carried out in order to explain the nature and relationship between independent variables and dependent variable.

Table 4. 15: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig
		B		Beta		
1	(Constant)	1.440	.370		3.679	.000
	Corporate Income Tax Incentives	.260	.119	.249	2.201	.032
	Capital Allowance Incentives	.108	.082	.210	1.317	.096
	VAT Incentives	.204	.071	.344	2.873	.006

Dependent Variable: Financial Performance

Based on table 4.15, the following regression equation can be obtained:

Y=1.440 + 0.260X1 + 0.108X2 + 0.104X3 + 0.74649

Where:

Y= Financial Performance

X1=Corporate Income Tax Incentive

X2= Capital Allowance Incentives

X3= VAT Incentives

The analysis indicated that a unit increase in corporate income tax incentives would lead to 26% (0.260) improvement in the financial performance of the EPZ firms and the association was statistically significant since p-value<0.05. The analysis further indicated a unit improvement in capital allowance incentives would result in 10.8% increase in financial performance of the EPZ firms but the association was statistically insignificant since the p-value>0.05. Finally, the analysis indicated a unit increase in VAT incentives would result in 20.4% (0.204) increase in the financial performance of the EPZ firms in Mombasa County and the association was statistically significance since the p-value < 0.05.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter presents summary, conclusion and recommendation on the effect of tax incentives on the financial performance of EPZ firms. The chapter further presented the suggestions of further studies in relation to financial incentives and financial performance.

5.2. Summary of Findings

5.2.1 Corporate Income Tax Incentives and Financial Performance

On the first objective it was determined that corporate income tax significantly and positively affects financial performance of EPZ firms. The study further established that an improvement in corporate income tax incentives would significantly contribute to improvement in financial performance. The study also showed that investment incentive offered by the government encourages EPZ firms to expand in the Kenyan market and investment incentives decreases financial risk on the EPZ operating environment. Further it was determined that investment incentive in form of grants compensates capital costs of EPZ firms and tax holidays that have failed to generate jobs and investment for Kenyans causes government to lose revenue. Finally, on this objective, it was determined that tax holidays that have failed to generate jobs and investment for Kenyans causes government to lose revenue.

5.2.2 Capital Allowance Incentive and Financial Performance

On the second objective, the study determined that capital allowance incentives significantly and positively affect financial performance of EPZ firms in Mombasa County. The study also showed that an improvement in capital allowances incentives would insignificantly lead to an improvement in financial performance of these firms. The study found out that depreciation allowances allows the firms to ward off losses after the assets of the firm has stopped function and it can be accumulated to finance the purchase of new assets. Further it was revealed that depreciation allowance allows EPZ firms to project their true finances and investment deductions allows EPZ firms to claim capital expenditure on the industrial

building. Finally, on this objective, it was showed that 100% investment deductions advanced to EPZ firms is favourable.

5.2.3 VAT Incentives and Financial Performance

On the third and final objective, it was determined that VAT incentives significantly and positively affects financial performance of EPZ firms in Mombasa County. The analysis showed that an improvement in VAT incentives would significantly lead to an improvement in the financial performance of the firms. The study further found out that output VAT incentives allows EPZ firms to sale their products at lower prices and zero rating of VAT on EPZ firms improves financial performance of the firms. The study showed that perpetual exception of VAT provides multiple benefits to the firms and input VAT incentives allows EPZ firms to purchase inventories and materials at lower prices. Finally, it was determined that government should consider more VAT rebates to improve productivity of EPZ firms.

5.3 Conclusion

Based on the analysis of the study and study findings, this research concluded that corporate income tax incentives, VAT incentives and capital allowance significantly and positively affects financial performance of EPZ firms in Mombasa. The study further concludes that an improvement of these incentives would significantly contribute to an improvement of financial performance, excluding capital allowance incentives, in addition, the study concluded that there are additional factors that contribute to the financial performance of the firms which were not captured in this study. The study further concluded that with implementation of tax incentives, capital employed is used productively and ROA improvement has been contributed by management effectiveness in handling tax issues. The study also concluded that registration on the VAT register has improved ROE of the firm and there is efficient use of assets by the organisation with the advancement of tax incentives. Finally, the study concludes that the revenue collected by the firm has improved with the application on the EPZ.

5.4 Recommendation of the Study

Based on the study analysis, study findings, conclusion and recommendations, this study recommends that:

1. This study recommends that stakeholders in tax policy should reconsider the economic value of corporate tax incentive. These incentives had the capacity to increase the profitability of EPZ firms as well as the number of jobs. Therefore, the government should offer more CIT holidays and reduced tax rates in order to increase the level of foreign investments and employment in the country. Companies located in an approved EPZ, principally to export goods, are taxed at a 0% CIT rate for ten years from its commencement and at a rate of 25% for the next ten years. A further reduction would benefit EPZ firms who had so far benefitted from tax holidays and reduced tax rates which acted as drivers for growth, productivity and increased investments by the firms. Such a measure increased investment through a decrease in the user cost of capital. This explained the positive productivity effects of reduced corporate income tax rates through new capital goods embodied technological change.
2. The government should consider the economic value of capital allowance incentives. The study recommended that the country could increase the level of capital inflow in to the country as well as the level of investment and growth in order to increase the level of employment and the level of industrialization in the country.
3. With regard to firms operating in the export processing zones in Kenya, in the light of the analytical revelations of the study, the study recommends that it is imperative for accounting and finance executives in manufacturing firms operating in the export processing zones in Kenya to professionally enumerate and profile their investments in qualifying industrial assets in accordance with extant tax guides in order to benefit from capital allowance grants.
4. Based on the study findings, it was recommended that the government should reconsider its VAT policy by encouraging more VAT rebates to firms in order to

boost their productivity and increase the volume of exports. Adjustments to the VAT rebates have positive and significant repercussions on the exported volume.

5. The study recommends that the government should introduce a strong monitoring unit to oversee the administration of VAT incentives. Government should equally pay attention to the issue of security and infrastructure which are basic in order to maximize the benefits of VAT incentives. Tax incentives don‘t necessarily play a huge role if the other factors that support financial performance of companies are not taken care of.

5.5 Suggestions for Further Studies

The study sought to establish the effects of tax incentives on financial performance of EPZ firms in Mombasa County. The study recommended that future studies should be done on the same topic in other counties where these firms are located to facilitate study comparisons. While this study was done, it recommends a study to be done on the impact of Tax incentive reforms on revenue collection by the Kenya Revenue Authority. Further it recommends a study to be done on the effects of tax incentives on financial performance of the selected sectors to allow, to facilitate specific recommendation on a specific sector. It also recommends a study on the effects of tax incentive reforms on compliance multinational organization’s.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

Kenya School of Revenue Administration

KENYA REVENUE AUTHORITY

ISO 9001:2015 CERTIFIED

KRA/KESRA/MSA/106 **5th November 2020**

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

RE: REQUEST TO COLLECT RESEARCH DATA

This is to certify that the following is bona fide student of the Kenya School of Revenue Administration Mombasa Campus undertaking Post Graduate Diploma in Customs Administration.

Name	Admission Number
VITALIS OTIEKO OCHIENG	HDB336- C006-5181/2016

The above mentioned student is in his final year of study at the school and currently conducting research on the **EFFECTS OF TAX INCENTIVES ON THE FINANCIAL PERFORMANCE OF EXPORT PROCESSING ZONES FIRMS IN MOMBASA.** The student is in the process of gathering data and thereafter, compile a report that will strictly be used for academic purposes only. The School would therefore like to seek your permission to allow him/her collect information that relates to his research from your organization.

Thank you in advance for your support and cooperation.

Yours sincerely,

Mumia B.J.
Associate Head of Research KESRA, Mombasa Campus

APPENDIX II: RESEARCH QUESTIONNAIRE

I am a student at Kenya School of Revenue Administration taking a course in Post Graduate Diploma on Tax Studies. As part of my academic requirements. Please assist in filling this questionnaire to enable me to complete writing this research. Thank you.

Instructions

Tick (√) or write where appropriate

Section I: Background Information

1. What is your gender?

   Female ( ) Male ( )

2. What is your educational level?

   Bachelor Degree ( ) Diploma ( ) Secondary Level ( ) Primary Level ( )

   Others (specify)…….

3. Which age bracket do you belong?

   20-29 Years ( ) 30-39 Years ( ) 40-49 Years ( ) 50 and above years ( )

4. Please indicate the number of years you have worked at the firm

   Less than 1 year ( ) between 1 to 3 years ( ) between 3 to 5 years ( )

   More than 5 years ( )

5. Please indicate the name of your organisation (optional).

……

.**Section II: Corporate Tax Incentive**

Kindly indicate the extent to which these statements apply to the firms on corporate tax incentive: Use a scale of 1-5 where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree and 5= strongly agree.

Opinion Statements	**1**	**2**	**3**	**4**	**5**
Investment incentive offered by the government encourages EPZ firms to expand in the Kenyan market					
Investment incentives decreases financial risk on the EPZ operating environment					
Investment incentive in form of grants compensates capital costs of EPZ firms					
Tax holidays that have failed to generate jobs and investment for Kenyans causes government to lose revenue					
10-year Tax holiday advanced to EPZ firms insignificantly contributes to job creation compared to Kenyan public firms					

Section III: Capital Allowance Incentive

Kindly indicate the extent to which these statements apply to the firms on capital allowance. Use a scale of 1-5 where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree and 5= strongly agree.

Opinion Statements	**1**	**2**	**3**	**4**	**5**
Depreciation allowances allows the firms to ward off losses after the assets of the firm has stopped function					
Depreciation allowances can be accumulated to finance the purchase of new assets					
Depreciation allowance allows EPZ firms to project their true finances					
Investment deductions allows EPZ firms to claim capital expenditure on the industrial building					
100% investment deductions advanced to EPZ firms is favourable					

Section IV: VAT Incentive

Kindly indicate the extent to which these statements apply to the firms on VAT incentive. Use a scale of 1-5 where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree and 5= strongly agree.

Opinion Statements	**1**	**2**	**3**	**4**	**5**
Output VAT incentives allows EPZ firms to sale their products at lower prices					
Zero rating of VAT on EPZ firms improves financial performance of the firms					
Perpetual exception of VAT provides multiple benefits to the firms					
Input VAT incentives allows EPZ firms to purchase inventories and materials at lower prices					
Government should consider more VAT rebates to improve productivity of EPZ firms					

Section V: Financial Performance

Kindly indicate the extent to which these statements apply to the firm's financial performance. Use a scale of 1-5 where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree and 5= strongly agree.

Opinion Statements	**1**	**2**	**3**	**4**	**5**
With implementation of tax incentives, capital employed is used productively					
ROA improvement has been contributed by management effectiveness in handling tax issues					
Registration on the VAT register has improved ROE of the firm					
There is efficient use of assets by the organisation with the advancement of tax incentives.					

The revenue collected by the firm has improved with the application on the EPZ					

APPENDIX III: LIST OF EPZ FIRMS

S/N	Firms
1	Achelis Material Handling Ltd
2	All Fruits EPZ Limited
3	Alpha Logistics Services (EPZ) Ltd
4	Amor Coco Kenya (EPZ) LTD
6	APT Commodities
7	Ashton Apparel (Epz) Ltd
8	Comarco Group
9	East African Tea Trade Association
10	Garsen Holding EPZ Ltd.
11	Global Foods (EPZ) Ltd.
12	Gold Crown Foods EPZ Ltd
13	Halai Brothers (EPZ) Ltd
14	Hantex Garment EPZ
15	Hui Commercial EPZ K. Ltd
16	Kapric Apparels EPZ Ltd.
17	Kutbi Creations
18	Longyun Garments Kenya EPZ Ltd
19	Mega Garments EPZ Ltd
20	Mombasa Apparel (EPZ) Ltd
21	Mugama Containers EPZ Ltd
22	Polucon
23	Pulsaris Design
24	Simba Apparel EPZ Ltd
25	Southern Engineering Co. Ltd (SECO)
26	Supply base (EPZ) Ltd
27	Talab EPZ Ltd

Source: Export Processing Zones Authority, 2020