EFFECTS OF TAX INCENTIVES ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVE SOCIETIES IN NAIROBI COUNTY

BY

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DECLARATION

This research project has never been presented in any other University or institution for academic purposes.

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This research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

This research project is dedicated to my esteemed wife Joyce Nyambura and my two sons

Joel and Cyprian for their motivation, love and support during this study.

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ATR-	Asset Turnover Ratio
C.A.M.E.L-	Capital Assets Management Earnings Liquidity
CBD-	Central Business District
EPZ-	Export Processing Zone
EU-	European Union
FDI-	Foreign Direct Investment
FOSA-	Front Office Services Activity
FWD-	Farm Work Deduction
GDP-	Gross Domestic Product
IBD-	Industrial Building Deduction
ID-	Investment Deduction
KRA-	Kenya Revenue Authority
MUB-	Manufacturing Under Bond
NSE-	Nairobi Security Exchange
OPM-	Operating Profit Margin
R & D-	Research and Development
ROA-	Return on Asset
ROE-	Return on Equity
SACCOs-	Savings and Credit Cooperative Societies
SASRA-	Saccos Societies Regulatory Authority
TREO-	Tax Remissions and Exemptions Office
UNCTAD-	United Nations Conference on Trade and Development

ABSTRACT

The purpose of this study was to establish the effects of tax incentives on financial performance of SACCOs in Nairobi County. The study adopted a descriptive research design. The study population comprised of all the registered SACCOs in Nairobi County. A sample of 41 SACCOs was determined using 10- 30% of target population as representative rule and stratified random sampling technique. Secondary data from SASRA was collected and analyzed to establish the association between tax incentives and profitability of SACCOs. This study established that there is a weak positive relationship between capital allowance, accelerated depreciation and financial performance of SACCOs in Nairobi County. It further indicated a negative relationship between tax and financial performance. The study therefore recommended that the government should provide more and a diversity of tax incentives to the SACCOs, especially capital allowance and accelerated depreciation and tax exemptions, since an increase in each of them increases the profitability of SACCOs.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study.

SACCOs are regarded globally as key players in economic growth of a majority of countries. Vibrant and dynamic cooperative sectors contribute largely to the economic development of different countries. SACCOs in Kenya actively contribute to 30% of the economy, this is possible because they are well distributed all over (Karagu & Okibo, 2014). It is through SACCOs that many Kenyans save their funds for investment in businesses and home ownership further contributing to Kenya's Vision 2030 development agenda. In an attempt to stimulate growth and good financial performance of SACCOs, tax incentives are offered to motivate them to increase their investments (Mintz & Chen, 2011). In countries like Russia for example, tax incentives are a useful tool for increasing the profitability and improving the financial performance of businesses (Markov, 2016). Among the EU policy makers, tax incentives are a commonly used threshold to slightly reduce the tax liability of firms.

The study focused on corruption and influence, agglomeration economies and neo-classical theories. According to corruption and influence theory, countries with weak tax laws and firms involved in bribing government leaders enjoy illegal high levels of tax incentives. Agglomeration of economies theory which was developed by Garcia- Mila and McGuire explains that, firms which are located in the cities have got many skilled workers than their counterparts in rural areas and thus they receive high tax incentives. Neo- classical theory which was developed by Solow in 1956 indicates that there should

be no inequality in the distribution of tax incentives, all qualified firms should be provided with tax incentives.

In Kenya, tax incentives are categorized into export or investment promotion incentives. Export promotion incentives comprises of Export Processing Zone (EPZ), the Tax Remissions and Exemptions Office (TREO) and Manufacture Under Bond (MUB). The aim of EPZ is to Promote FDI, while TREO and MUB were meant to promote manufacture of goods in the country for export. Investment Promotion Incentives include Investment Deductions (ID) which is for processing machines, Industrial Building Deductions (IBD) which is granted on factory buildings and staff quarters, Mining Allowance which is granted on Mining and Farm Work Deductions (FWD) which is usually granted on capital expenditure incurred in farming (Githaiga, 2013). Despite the significance of stability of SACCOs, very scarce research on SACCOs and tax incentives is available.

1.1.1 Tax Incentive

According to James (2013) tax incentive is the process of reducing the tax liability which is available on various investments, through deviations from the unnecessary taxes levied in the system. It is provision for taxes that is made available for SACCOs to decrease the tax liability. Tax incentive is characterized by accelerated depreciation, tax credits and reductions in tax rates/exemptions and capital allowance.

Depreciation generally in finance and accounting, is all about assets losing their value over time or experiencing a reduction in their useful life. According to

Koowattanatianchai, Charles and Eddie (2009) accelerated depreciation incentive is the reduction in the useful life, or deterioration of a firm's asset cost in a faster manner in its beginning years than in years later. The advantage of this incentive is confined to deferral of tax. Since firms submit taxes on their surplus which are derived from deducting the expenses, accelerated depreciation being an expense, defers taxes of a firm especially in initial years of the life of an asset and boost them in future years. This incentive leads to more present value of the depreciation deductions and thereby increases the after-tax present value of the net returns. It is like a loan given to taxpayers that has no interest but a deferred tax payment.

Lower or reduced tax rates encourage and enable investors and firms to operate the businesses and open new ventures. Capital allowance is lowering a given investment percentage from the surplus which are taxable, it is usually granted to cater for the usage of assets in the business (Daniel & Faustin, 2019). It is normally granted on capital expenditures incurred in the business. Tax credits are reductions of tax burden and are traditional methods which stimulate investments and innovations, but in relation to small business they are specific depending on the country where they are applied.

1.1.2 Financial Performance

The general health of a company over a given time span is regarded as financial performance (Bhunia, Mukhuti & Roy, 2011). It is an analysis on the appraisal of growth of a firm. Most of the SACCOs rely on financial performance to evaluate the success and proper business governance. However, few existing indicators will be used by SACCOs. Some of the financial performance indicators used are tools that determine the revenue of

businesses and allow them to fulfill the given obligations. (Arcenildo Valderes Da Silva Nunes, 2012)

The trend analysis of various SACCOs in Kenya indicate that they had a good development in capital, loans, deposits and total assets. (Buluma, Kung'u, & Mungai, 2017). In this study financial performance was determined using ratios such as firm size, firm growth, liquidity and Capital Assets Management Earnings Liquidity (C.A.M.E.L) among others which were derived from the statements of businesses.

1.1.3 Relationship between Tax Incentive and Financial Performance

Countries have always been using tax incentives to benefit businesses and protect them from failure in order to influence their expansion and start-up. Zee, Stotsky and Ley (2002) argues tax incentive programs focus on creating employment and attract productive investment for the firms. However, a study by UNCTAD (2004) points out that, some countries provide conditions before granting tax incentives. For example, in the case of FDI, they demand the investors to create employment opportunities, to transfer a particular technology or to establish their firms in specific regions in the country. Daniel and Faustin (2019) indicates that governments create obstacles in the business environment and investment. Tax incentives are thus used to offer compensation for high tax rates through exemption and reduction in taxes.

In Kenya, newly listed companies enjoy reduced tax incentives of less than 30% corporate tax rate for the first few years of operation (Tirimba, Muturi, & Sifunjo, 2016). This is important to the firms, since their net revenue will increase leading to good

financial performance. Jun (2018) cautions that some countries have the habit of distorting resources allocated to businesses, enacting complex tax laws and providing opportunity for corruption thereby affecting the revenues of the firms.

1.1.4 SACCOs in Nairobi County

SACCOs are institutions or cooperatives registered under the cooperative societies Act which are mandated to collect deposits, savings and advancement of loans to members to promote their welfare (UN-Habitat, 2010). They are vital in supporting investors and those who require capital to establish businesses. In Kenya, SACCOs are found in almost all the counties and they provide access to funds, savings mobilization and wealth creation to citizens. SACCOs in Nairobi County are adopting new approaches and model therefore responding to different financial environment. (Buluma et al, 2017).

Most cooperative societies in Nairobi County are SACCOs. They provide services to members such as Front Office Services Activity (FOSA), emergency loans, special loans, development and college/school fees loans. According to Waswa (2013) SACCOs are legislated through a Societies Act of 2008 that provides licensing, regulations, supervision and promotion of SACCOs by a regulatory authority of SACCOs societies called SASRA. The Kenyan Government should look into incentivizing SACCOs growth especially in the county government of Nairobi. Furthermore, this will improve their financial performance and empower them to invest more.

1.2 Research Problem.

SACCOs in Kenya were performing poorly in the past few years leading to some of them collapsing with member's deposit, this was attributed to many difficulties like heavy

taxation, stiff competition, poor corporate governance and instability (Chahayo, Bureti, Juma, Maende & Aketch, 2013). This challenges made them to contribute negatively to the economy of the country. SACCOs worldwide are significant channels of economic prosperity, they play a vital role in granting finances to the needy (Karagu & Okibo, 2014). However, reports reveal that attaining proper utilization of tax incentives by many nations to support firms like SACCOs remain an unrealized dream (Feyitimi, Temitope, Akeem, & Samuel, 2016). Some governments are faced with fiscal indiscipline towards firms due to their inability to give tax incentives, charging multiple taxes, introducing new levies and difficulty in effectively implementing tax policies.

Research has been undertaken on tax incentives globally and locally. However, little research has been undertaken on tax incentives and its effects on SACCOs. A research was done on how policy makers from poor countries benefit from using tax incentives (Zee et al, 2002) the variables used were not exhaustive. Feyitimi et al, (2016) undertook a study in Nigeria about contribution of tax incentives from the government to growth of SME's, but the research was done in a different developing country. In Uganda Mayende (2013) analyzed how the performance of manufacturing industries is affected by tax incentives in regards to value added and gross sales. But he only considered the manufacturing firms.

Onyango (2015) conducted a study in Nairobi County on how performance of Five star hotels is affected by tax incentives, that research revealed conflicting findings as IBD and ID negatively affected financial performance whereas W&T had a positive effect on the

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hotels. Gumo (2013) sought to establish how FDI in Kenya is affected by tax incentives, though he didn't consider capital allowance which is an important part of tax incentives to be analyzed under the study. Murage (2012) investigated how the EPZ firms in Kenya are affected by tax incentives especially in Business Investment, the research however revealed that the impact on the dependent variable is not significant. Lack of inconsistency and adequate empirical literature in the results of the previous studies necessitates further research to be conducted. While the above researchers made great contributions, this study thus deliberate on establishing if actually the profitability of SACCOs is affected by tax incentives.

1.3 Research Objective

To determine effects of tax incentives on financial performance of savings and credit cooperative societies in Nairobi County.

1.4 Value of the Study

Through comprehending the need for receiving and giving tax incentives to SACCOs, the government which is usually interested in tax matters especially of various enterprises will benefit from this study. It is through this study that the government will know the response of the firms which enjoy tax incentives and the measures to take.

This research will be a stepping stone and a source of relevant information into the operations of SACCOs, as it will assist the scholars and researchers to analyze the literature that involves tax incentives and performance of a large number of SACCOs and therefore, adopt the outcome of these findings to do more research which will definitely benefit the SACCOs.

This study will also act as a guide to the policy makers and stakeholders. It will enable the management and administration of various SACCOs in implementing and executing the recommendations such as, appropriate tax incentive laws and regulations. This will promote and improve both the SACCOs' financial and economic growth in Kenya as decisions on tax incentives and investing in implementation of SACCOs will be fulfilled, guided and reviewed by the research findings (Karagu & Okibo, 2014)

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This part analyzes theoretical, empirical literature and conceptual framework of what other researchers have done.

2.2 Theoretical Literature

In this area, theories supporting the study are covered. They include corruption and influence theory, Agglomeration economies theory and Neo classical theory.

2.2.1 Corruption and Influence Theory

Corruption is misuse of public power by breaking down the set rules and regulations for self-interest (Jain, 2011). In this theory, tax incentive in most cases don't represent or indicate tax revenue maximization. Instead, it reflects the ability of the firms to bribe leaders in a given government. Pani and MPani (2009) points out that, corruption can be reduced by offering proper political and economic incentives which are appropriate to the firms.

The theory contributes to the occurrence of tax incentives, some firms get tax reductions and tax exemptions through bribing and coercing government and tax officials. The percentage of tax incentive given to most firms determined by their capability to bribe. Pellegrini and Gerlagh (2004) adds that if public institutions such as political parties, legal system, civic groups and the media become weak and ineffective they definitely cannot be able to expose the corrupt. Corruption and very high tax incentives leads to

negative net revenues of a country, poor allocation of resources, poor financial performance of firms and poor economic growth.

According to this theory, tax incentives are higher in countries which have a weaker rule of law. Furthermore, tax revenue collected is not properly used to serve the purpose of the firms. For instance in USA in the 19th and 20thcentury, various railroad companies were involved in bribing politicians in return for generous tax incentives (Glaeser, 2001). According to Imam and Jacobs (2007) complex tax laws and systems can contribute to corruption in a country. Moreover, tax officials should be well paid, well trained, well oriented, competent and above all have high integrity when operating or handling tax issues. This will help prevent corruption in distribution of tax incentives to SACCOs.

2.2.2 Agglomeration Economies Theory.

This theory is a representation of contribution of literature of Garcia- Mila and McGuire. They indicated that cities prefer to have many firms in a situation where agglomeration economies are present. These cities are mainly concerned in getting high spillovers from the firms and in return offer these firms high tax incentives. Nevertheless, the type and location of a firm determines a lot whether it will have a high spillover or not, cities which have got skilled workers and are located in marketable areas where they receive specialized services tend to get high spillovers (Agarwalla, 2011).

Agglomeration economies therefore suggests tax incentives will be most in firms that have a large number of skilled laborers. Glaeser (2001) argues that agglomeration of economies becomes more sensible in cities with many firms which are growing rapidly

than in those with just a few number of big firms, because, it becomes easy to rationalize tax incentives for small firms as opposed to big firms. Agglomeration tax incentives are also given to firms which are divers in terms of their operations leading to a liquidity increase.

According to this theory, a firm that is located in a good spot in the city and is able to attract other firms into that city, will definitely be rewarded with high tax incentives. However, the shortcoming of this theory is that firms located away from the city will be rewarded with little or no tax incentives. The location and performance of firms is indirectly affected by agglomeration economies which though do not contribute to their economic growth (Neumark, Junfu & Wall, 2006). Garcia-Mila and McGuire in this theory prove that, the net tax payments of the public services are likely to become negative due to high tax incentives.

2.2.3 Neo-classical Theory.

This theory dwells on labour, technology and capital. It was developed by Solow (1956) who articulates that the population growth rate and the technical progress plays a critical role in a government's long run growth rate. This theory mostly focuses on the human beings in an organization. Though taxation interferes with the incentive to invest in human or business capital.

This theory further posits that a good organization is that in which there is a combination of informal and formal sectors. It advocates for low tax rates, tax incentives and limited government spending for firms so that they may flourish and perform well financially. Colmar (2005) indicates that tax incentives offers many benefits like compensation for

losses in investments and symbolic signaling effects. Tax cut also causes a rise in labor supply as the workers will be able to increase their work efficiency, effectives and working hours. The government will be able to increase its tax revenue, because due to low tax rates the firms will submit their taxes effectively and thus tax evasion and tax avoidance will be a thing of the past.

In Neo-classical economic theory, a tax system of horizontal equity to the investors is a 'good tax system' and it prevents prejudice in the provision of tax incentives (Barbour, 2005). Furthermore, the presence of inequality in distribution of tax incentives in particular sectors will discourage investors, and lead to a drop in growth.

2.3 Determinants of Financial Performance of SACCOs

Every business aspires to improve its competitive position in the market through analyzing its financial position using certain determinants (Bhunia et al, 2011). Determinants of financial performance to be discussed in this section are; the size, growth, liquidity, Capital assets management earnings liquidity, ATR and OPM firms.

2.3.1 Size of the Firm

According to Serrasqueiro and Maçãs Nunes (2008) a firm size is considered to be the number of assets and employees it has and the total turnover available. Taxation is a major hindrance to growth of a firm, tax incentives therefore are important in improving a firm's output. Mayende (2013) conducted a study which suggested a strong correlation between large sized firms and revenue compared to small and medium sized ones. This is a clear indication that large and medium sized firms can maximize their profits due to their efficiency and effectiveness, therefore, increase their returns leading to a better

future profitability (Ondoro, 2015). Serrasqueiro and Maçãs Nunes (2008) concluded that despite the measure of the size used, performance and size of the firms are positively and significantly related. The fact that large firms have more qualified laborers and can easily access credit for investment, makes them perform financially better than small firms.

2.3.2 Age of the Firm

Age and size are important factors for the growth of young SACCOs. An increase in age of a firm doesn't affect the relations between its size in the past and growth in the present period (Voulgaris, Asteriou, & Agiomirgianakis, 2003). Young SACCOs will tend to uplift their growth rate in order to reach a particular size and secure their survival, but once they attain survival their rate of growth reduces. While age and size of firms contribute to a declining growth in young SACCOs, labour and high production positively influences the growth of young firms. Both young and old firms experience the diminished growth caused by the intensity of R&D.

2.3.3 Liquidity of the Firm

The effectiveness and ability in the transfer of a firm's assets into cash is the liquidity of a firm, it determines a firm's strength in meeting the short term liabilities such as financial and operating expenses occurring in a firm in a short span (Durrah, Rahman, Jamil & Ghafeer, 2016). Liquidity ratios are characterized by cash ratio, current ratio and return on assets ratio which are mainly used by companies to manage and improve their financial performance.

ROA determines how the firm uses its assets to generate profits, and ROE is a liquidity ratio that indicates the return for every one shilling of equity capital contributed by shareholders of a firm. ROE is derived from net profit after tax or net income against the

shareholder's total equity. Ryan, Robinson and Grigg (2000) revealed that current ratio is the best known determinant of liquidity as it is obtained from current assets against current liabilities.

2.3.4 Capital Assets Management Earnings Liquidity (C.A.M.E.L)

According to Derviz and Podpiera (2008) CAMEL is a supervisory system of rating and analyzing the overall condition of firms, it is a generally accepted measure of the safety of firms which is applied to credit institutions. Individual results from financial reports of various companies is often compared to CAMEL in order to identify or determine any arising crisis. Capital adequacy is important in determining how strong firms can withstand poor financial statements. Asset quality analyzes the strength of firm in comparison to the depreciation of the assets. Management is all about compliance with the set rules and regulations, leadership and administrative ability. Strong earnings of firms indicate the ability to support operations of a firm.

2.3.5 Operating Profit Margin (OPM) & Asset Turnover Ratio (ATR)

It is derived from the output, in the available resources of a firm, OPM and ATR are the main indicators of income that have an influence on firms. An increase in either or both of them will result to an improved financial performance. The ROA of firms can also be derived from the product of OPM by ATR. Businesses which experience poor operating profit margin, can improve their financial performance by implementing cost controls of their operations.

2.4 Empirical Studies

Research both at local and international level has been done to investigate the impacts tax incentives have on performance indicators. Therefore, this section reveals a literature study from different researchers.

2.4.1 International Studies

Klemm and Parys (2009) researched on effects of tax incentives in encouraging investments as well as a tool of tax competition. The study was done between 1985 and 2004 in more than 40 Caribbean and Latin American countries. The study found that tax holidays had strategic interactions, however, no evidence was found for competition over tax credits. The research also concluded that FDI is attracted by longer tax holiday. A study was done on why tax incentives are important to policy makers. It was ascertained that they should only be for correcting firms which experience market failures and that, investments can only be recovered faster through implementing the preferred form of tax incentives (Zee et al, 2002)

In a targeted population represented by a sample of 100 businesses in Osun State Industrial area in Nigeria, Feyitimi et al, (2016) assessed the role various governmental tax incentives play in contributing to the growth of SMEs. Primary data was retrieved through interviews, observations and questionnaires. The research design used was descriptive. The study revealed a correlation of taxation and SME's growth.

In Uganda a study was done to analyze what effects tax incentives had on the profitability of manufacturing industries. Panel data technique was used in the research. The results

were that tax incentives triggers industries to perform well in sales (Mayende, 2013). The study recommended the government to implement policies such as, technical skills in development for proper utilization of available tax incentives for better performance of firms.

2.4.2 Local studies

A research on Five-star hotels' performance in relation to tax incentives was done in Nairobi County, the hotels represented the target population. Questionnaires were used to conduct a censor survey. The research concluded that IBD and ID negatively affected financial performance whereas W&T had a positive effect. Therefore the study recommends that W&T tax incentives should be encouraged by the government because they are beneficial in improving the performance of hotels. (Onyango, 2015).

A survey on how FDI is affected by tax incentives was done in Kenya where-by Gumo (2013) collected secondary data from KRA, KNBS and the treasury and used a research design that was descriptive. The study found that on investment incentives, both mining operation deduction and investment deduction positively affect FDI, while industrial allowance negatively affect FDI. The study therefore concludes that, FDI is positively affected by tax incentives.

Ngure (2018) studied how firms in the manufacturing sector in Kenya are affected by tax incentives. The target population was 725 firms. The sample size was made up of 90 firms. Secondary data obtained was from 2011 to 2016. It was established that excise,

custom duty and capital allowance incentives positively affected performance of companies. The study findings recommended the need and expansion of tax incentives.

Murage (2012) investigated how EPZ firms are affected by tax incentives especially in Business Investment in Kenya, 104 EPZ firms in Kenya made up the target population, where the researcher selected 65 firms located in Nairobi Metropolitan. It was discovered that an increase in profits, sales and tax incentives is likely due to an increase in investment in EPZ firms.

2.5 Conceptual Framework.

A manifestation of association between all variables is referred to as a conceptual framework (Mugenda & Mugenda, 2003). In this research, independent variables are the various tax incentives like accelerated depreciation and reductions in tax rates among others. Whereas the dependent variable is financial performance.

Figure 2.1 Conceptual Framework

Independent Variables

Tax Incentives

Accelerated Depreciation

Dependent Variable

Financial Performance

Tax rates

Financial performance of firms determined by ROA

Capital Allowance

Size of the firm

Control Variable
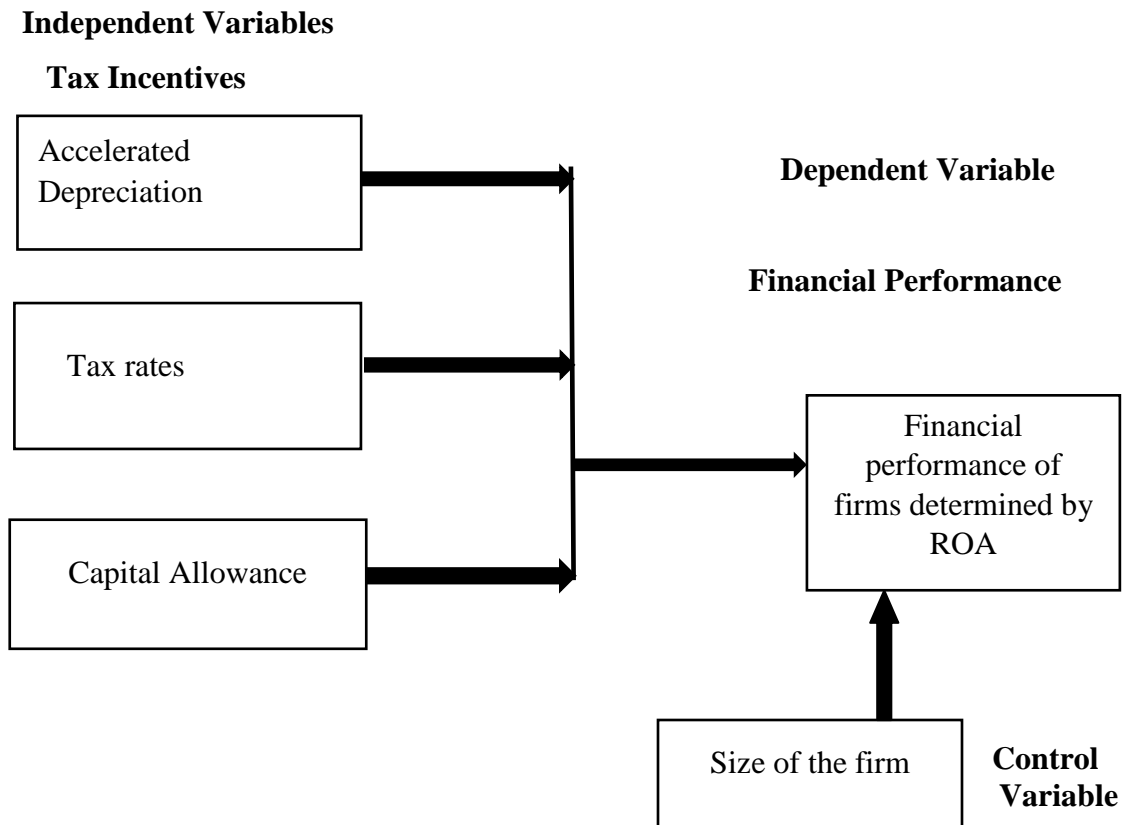
Source: Author (2019)

Based on Figure 2.1. Further capital allowance as an independent variable is considered as the amount of money which can be deducted from the firm's profits. While performance is considered on the effectiveness of the SACCOs' operations leading to their proper growth.

2.6 Summary of the Literature Review

Theoretical review dwelled on theories such as corruption and influence theory, agglomeration economies theory and Neo- classical theory. All this theories propagate that tax incentives are essential to firms. In the empirical review findings above, the

results of various studies have clearly indicated how positively the profitability of firms is affected by tax incentives.

Research has been conducted internationally and locally to analyze the impacts of tax incentives on certain dependent variables such as FDI, investments and performance of firms in different industries as indicated above, global studies in both developed and developing economies have also been done in this area by others like Klemm and Parys (2009) and Zee et al (2002) in developed economies. Feyitimi et al (2016) and Mayende (2013) in regional developing economies and in the local developing setting Murage (2012), Gumo (2013), Onyango (2015) and Ngure (2018) among others. However, of all these studies, none has studied tax incentives and their effects on profitability of SACCOs. This study thus investigate the effects of tax incentives on financial performance of SACCOs.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

A research methodology is a detailed procedure that describes systematically how a research problem will be solved.

3.2 Research Design

A research design is a set-up of requirements for obtaining data and analyzing it such that the purpose of research is relevant to existing economy (Kothari, 2004). The research was conducted through a descriptive research design which is suitable because it uses smaller samples for an in-depth analysis of the larger population that was studied. Furthermore, a descriptive design is better as it describes and explain a phenomenon rather than predict it. It gives a holistic explanation of the way variables relate in the study.

3.3 Target Population

Alvi (2016) indicates that all members who qualify and meet a given criteria that is specified and necessary for research investigation as the target population. There are 175 SACCOs licensed by SASRA to operate in Kenya. The population target comprised of 41 licensed SACCOs in Nairobi County.

3.4 Sample Size and Sampling Techniques

A sample is a section of entities which is part of population that determines and approximates the features of the population. (Crammer & Howitt, 2004). This study employed a stratified random sampling technique, which identify sub-groups in the population that have got same features and form a sample from these sub-groups. A total

of 41 SACCOs was identified and chosen from the target population. Mugenda and Mugenda (2003) propose for 10-30% of target population as representative. The researcher chose to study all the 41 SACCOs based in Nairobi County, representing 23.43% of the entire target population.

3.5 Data Collection

Gall, Gall and Borg (2007) describes data collection as the process or procedure of collecting and gathering raw information that is unprocessed but which can be processed into vital information, after being scientifically analyzed. Secondary data was collected and utilized in this research. Data was retrieved from the annual audited financial accounts and published financial SASRA reports of the SACCOs. The data was for a span of five years, ranging from 2014 to 2018.

3.6 Data Analysis

Data analysis is a strategy of decreasing and arranging data to give results which will be properly interpreted by the one performing the research (Burns & Grove, 2003). Stata software was used to analyze and interpret the data. Correlation Analyses helped to examine the difference between variables, while multiple regression analysis examined the significance of existing relationship between them. The results were interpreted in tables.

The regression model applied for data analysis was:

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

Where;

Y = Financial Performance (Measured by ROA)

X_1 = Accelerated Depreciation (Annual depreciation on total assets)

X_2 = Tax rates (Tax on total revenue)

X_3 = Capital Allowance (Capital allowance against the total assets)

β_0 = Constant term

β_1 to β_3 = Beta coefficients

ε = Error term

3.7 Test of Significance/ Diagnostic Tests

The research was carried out on the 41 registered SACCOs whereby normality, autocorrelation, heteroscedasticity and multicollinearity tests were carried out.

3.7.1 Normality Test

The normality of the variables was determined using Shapiro Wilk W test. The data is declared as normally distributed if the P-test of the variables becomes more than the significant level of 5% or 0.05,

3.7.2 Autocorrelation Test

To test for Autocorrelation, Durbin-Watson d stastic (dwatson- time series only) test was used. The rule of thumb is if it is near or equal to 2, then the data has autocorrelation. Incorrect estimates and biased errors exist if the researcher fails to recognize them.

3.7.3 Heteroscedasticity Test

It was done using Breusch-Pagan/Godfrey. The rule is that if the P-test is more than 5% or 0.05 confidence level it becomes insignificant, meaning that there will be homoscedasticity thus no heteroscedasticity.

3.7.4 Multicollinearity Test

In the event where more than two variables are highly correlated, multicollinearity is bound to occur. The presence of multicollinearity for each independent variable was tested through Variance Inflation Factor (VIF). To determine severe multicollinearity, VIF should be equal to or greater than 5. If it is less than 5 then it implies that all the variables indicated absence of multicollinearity (Hair et al, 2010).

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

Research findings were presented in this chapter. The study period was 5 years, secondary data for years 2014 to 2018 was obtained. Analysis was done on the data and results were presented in tables.

4.2 Diagnostic Tests

4.2.1 Normality Test

Table 4.1: Shapiro Wilk W Test for Normal Data

Shapiro-Wilk W test for normal data					
Variable	Obs	W	V	z	Prob>z
ROA	41	0.51845	19.400	6.250	0.00000
CapitalAll~e	41	0.85978	5.649	3.649	0.00013
Tax	40	0.71703	11.185	5.081	0.00000
Accelerate~n	41	0.42042	23.350	6.640	0.00000

Source: Research Findings

Ho: The data is normally distributed.

In table 4.1 above, Shapiro Wilk W Test was done, the P-test of ROA is 0.00000; that of Capital allowance is 0.00013; that of Tax is 0.00000 while that of Accelerated depreciation is 0.00000, they are all less than the significant level of 5% or 0.05, since they are all significant, you reject the null hypothesis. Thus the data of all the variables is not distributed normally.

4.2.2 Heteroskedasticity Test

Table 4.2: Heteroskedasticity Test

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of ROA
chi2(1)   =   6.78
Prob > chi2 =   0.092

Source: Research Findings

Using Breusch –Pagan test, table 4.2 indicates the results. The H0 indicates that there is constant variance. Therefore, our H0 is that there is no heteroskedasticity due to the constant variance, but the P-test is 0.092 which is more than 5% or 0.05 confidence level, it is insignificant, therefore you do not reject the H0, thus there is no heteroskedasticity.

4.2.3 Multicollinearity Test

Table 4.3: Variance Inflation Factor

Variable	VIF	1/VIF
Accelerate~n	1.04	0.961618
Tax	1.04	0.963156
CapitalAll~e	1.03	0.972200
Mean VIF	1.04	

Source: Research Findings

The rule of thumb to determine severe multicollinearity is that; VIF should be equal to or greater than 5. In the table 4.3 above, our VIF test shows a mean VIF of 1.04 which is less than 5, again all the variables presented a VIF test of less than 5. This implies that all the variables depicted absence of multicollinearity.

4.2.4 Autocorrelation Test

Table 4.4: Autocorrelation Test

Number of gaps in sample: 1
Durbin-Watson d-statistic(4,   40)   =   1.835491

Source: Research Findings

To test for autocorrelation, we used Durbin-Watson d statistic (dwatson- time series only). The results are as shown in table 4.4 above. The rule is, if the test is near or equal to 2, reject the null hypothesis. Our test is 1.835491 which is near to 2. It therefore means that our model has no autocorrelation.

4.3 Descriptive Statistics

Findings in table 4.5 showed the descriptive statistics on ROA, Capital allowance, Tax and Accelerated depreciation incentives of SACCOs.

Table 4.5: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	41	.3526341	.6474611	.016	3.031
CapitalAll~e	41	.0324878	.0293523	.001	.099
Tax	40	.796975	.8522681	.008	3.714
Accelerate~n	41	.0644146	.1420359	.002	.739

Source: Research Findings

In table 4.5 above the mean for ROA was 0.3526341, capital allowance had a mean of 0.0324878, tax and accelerated depreciation had a mean of 0.796975 and 0.0644146 respectively. ROA had a standard deviation of 0.6474611, capital allowance had a standard deviation of 0.0293523, tax and accelerated depreciation had a standard deviation of 0.8522681 and 0.1420359 respectively

4.4 Correlation Analysis.

Table 4.6: Correlation Matrix

	ROA	Capita~e	Tax	Accele~n
ROA	1.0000			
CapitalAll~e	0.1578	1.0000		
Tax	-0.0860	-0.1052	1.0000	
Accelerate~n	0.2448	-0.1124	-0.1477	1.0000

Source: Research Findings

From table 4.6 there's a weak positive correlation between capital allowance and ROA as indicated by the coefficient factor of 0.1578. The results also revealed a negatively weak correlation between tax paid and ROA as depicted by a factor of -0.0860. Lastly the results showed a weak positive correlation between accelerated depreciation and ROA as indicated by a factor of 0.2448. This clearly indicates a negative relationship between tax paid and profitability of SACCOs and a positive relationship between capital allowance and accelerated depreciation on financial performance of SACCOs in Nairobi County.

4.5 Regression Analysis

Multiple regression analysis was done using Stata.

Table 4.7: Regression Analysis

R	=	0.3004
R-squared	=	0.505
Adj R-squared	=	0.201
Root MSE	=	.6482

Source: Research Findings

The results in table 4.7 above show R squared is 0.505 which means 50.5% of variation of financial performance are explained by tax incentives. The correlation coefficient R

depicts what relationship exist between the research variables. The results above show a

positive relationship existing among the variables as outlined by a figure of 0.3004.

Table 4.8: Analysis of Variance

Analysis of Variance					
Source	SS	df	MS	F	Prob > F
Between groups	16.0745398	31	.518533543	6.73	0.0025
Within groups	.693693667	9	.077077074		
Total	16.7682335	40	.419205838		

Source: Research Findings

In table 4.8 above, the sum of square for regression or variables between groups was

16.0745398; f statistics value was 6.73. The probability significance was 0.0025 which is

below the significance level of 0.05 and which shows tax incentives influence

performance.

Table 4.9: Regression Model Coefficients

ROA	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
CapitalAllowance	4.190404	3.655661	1.15	0.259	3.223621	11.60443
Tax	-.0214859	.1240941	-0.17	0.864	.2731603	.2301886
AcceleratedDepreciation	1.190199	.736046	1.62	0.115	.3025713	2.68297
_cons	.1663761	.203633	0.82	0.419	.2466108	.579363

Source: Research Findings

According to table 4.9 above, the established regression model was;

Y= 0.1663761 + 4.190404X$_1$- 0.0214859 X$_2$ +1.190199X$_3$

With the independent variables at a constant, the model above shows a unit increase in

capital allowance and accelerated depreciation would lead to an increase in performance

by 4.190404 units and 1.190199 units respectively. Whereas a unit increase in tax would

lead to a decrease in performance by 0.0214859 units.

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4.6 Discussion of Findings

The test for normality on all the variables, gave a P-test for each of them which was less than the significant level of 5% or 0.05 an indication the data is not distributed normally. On testing heteroscedasticity, the P-test was more than 5% or 0.05 confidence level, which means there was no heteroskedasticity. From Multicollinearity test, the VIF test showed a mean VIF which was less than 5. This revealed that all the variables depicted absence of multicollinearity.

From the study on correlation analysis, the results showed capital allowance and accelerated depreciation positively influenced the profitability of SACCOs. This means when capital allowance and accelerated depreciation increases so does the profitability of SACCOs. This findings are in agreement with the research findings of Ngure (2018) which found that capital allowance positively influence the financial performance of manufacturing firms in Kenya. However, the research results showed that tax negatively affected the performance of SACCOs. An increase in tax charged on SACCOs would lead to a decline in their profitability, this results are similar to those of Kinyua (2015) who studied the effects of turnover tax on financial performance of SMEs in Nairobi County and found that, performance of SMEs reduced due to high taxes.

On regression analysis, R-Squared was 0.505 which is a variation of 50.5% of financial performance explained by tax incentives and which depicts a positive relationship of financial performance and the independent variables. The analysis of variance showed that tax incentives positively impacted on the performance of SACCOs

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The findings, conclusion and recommendations of the analyzed data were discussed in this chapter. These findings were pivoted on the purpose of research.

5.2 Summary of Findings

The objective of the research was to establish the effects of tax incentives on financial performance of SACCOs in Nairobi County. The population study was all the 41 licensed SACCOs. Descriptive statistics and data analysis were done on the secondary data collected from SASRA using Stata. The normality test depicted that the variables were not distributed normally, there was no heteroscedasticity and it showed absence of multicollinearity on all the variables.

From correlation analysis, the findings revealed that capital allowance and accelerated depreciation positively influenced ROA, while tax impacted negatively on ROA. R squared was 0.505 which means 50.5% of variation of financial performance were explained by tax incentives. From the analysis of variance, the probability significance was 0.0025 which is below the significance level of 95% or 0.05, indicating the impact on performance due to tax incentives.

The established regression equation for the study was;

$$Y= 0.1663761 + 4.190404X_1 - 0.0214859 X_2 + 1.190199X_3$$

With the independent variables at a constant, from the above equation a unit increase in capital allowance and in accelerated depreciation leads to an increase in financial

performance by 4.190404 units and 1.190199 units respectively. A rise in tax leads to a decline in performance by 0.0214859 units.

5.3 Conclusion
From the analysis the research concluded that tax had a negative effect on financial performance of SACCOs whereas both capital allowance and accelerated depreciation had a positive significant effect. Therefore, SACCOs should strive to ensure that they get capital allowance and accelerated depreciation incentives from the government to enable them make more profits in subsequent years. The government therefore should offer continuous tax incentives to SACCOs.

5.4 Recommendations
Currently the government does not levy tax on income interest which is the main source of income for SACCOs, but tax is charged on all the other sources of income of SACCOs, therefore, as far as the research findings and conclusion of this study are concerned, the government should provide more tax incentives to the SACCOs especially capital allowance and accelerated depreciation and tax exemptions, since an increase in all of them increases the profitability of SACCOs. The government should also provide a wide range of tax incentives which will encourage the establishment and continuous growth of SACCOs. SACCOs should on the other hand be able to identify the various tax incentives being offered by the government and work towards achieving them.

5.5 Limitations of the Study
This study used secondary data obtained from the audited financial reports of SACCOs from SASRA from year 2014 to 2018 using a data collection sheet. The study faced various limitations some of which include limited time to get the secondary data to be

used to accomplish the research. Firstly the researcher had to meet conditions such as applying for a research permit, getting an authorization letter from the county government in order to collect secondary data from SASRA. This was a challenge on the side of the researcher as it required time to get those documents therefore, contributing to collection of data within a short time. The other challenge is that while the researcher thought that he will easily get the secondary data electronically, that was however not the case, the researcher had to spend more time in manually collecting the data from financial statement of various SACCOs, this proved tiresome and time consuming. Nairobi County has more than 41 SACCOs, the researcher could not be able to get data for all the SACCOs, because some of them were unlicensed by the government for failing to meet certain given conditions. The secondary data is bound to be biased since it is submitted to SASRA from different SACCOs who might not be accurate in reporting their financial statements, this might compromise the research data for the study.

5.6 Suggestions for Further Research

The study sought to analyze the effects of tax incentives on financial performance of SACCOs in Nairobi County. The researcher advocates for similar studies to be conducted in other Counties apart from Nairobi County. The researcher also recommends studies to be done on tax incentives and real estate firms in Kenya. The study further recommends that research on tax incentives and performance of non-listed companies in NSE should be carried out.

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APPENDICES

Appendix I: Data collection sheet

Name of Sacco					
Year/ Tax Incentive	Accelerated Depreciation Incentives	Tax Rates Incentives	Capital Allowance Incentives	Total Assets	Net Profits
2014					
2015					
2016					
2017					
2018					

Source: Research Findings

Appendix II: List of Registered SACCOs

No.	NAME OF SAVINGS AND CREDIT COOPERATIVE SOCIETY
1	AFYA
2	AIRPORTS
3	ASILI
4	CHAI
5	CHUNA
6	COMOCO
7	ELIMU
8	FUNDILIMA
9	HARAMBEE
10	HAZINA
11	JAMII
12	KENPIPE
13	KENVERSITY
14	KENYA BANKERS
15	KENYA POLICE
16	KINGDOM
17	MAGEREZA
18	MAISHA BORA
19	MWALIMU NATIONAL
20	MWITO
21	NACICO
22	NAFAKA
23	NAKU
24	NASSEFU
25	NATION
26	NYATI
27	SAFARICOM
28	SHERIA
29	SHIRIKA
30	SHOPPERS
31	STIMA
32	TAQWA
33	TEMBO
34	UFANISI
35	UKRISTO NA UFANISI WA ANGALICANA
36	UKULIMA
37	UNAITAS

38	UNITED NATIONS	
39	WANAANGA	
40	WANANDEGE	
41	WAUMINI	

Source: Sasra

Appendix III: Research Data

SACCOS	ROA	Capital Allowance	Tax	Accelerated Depreciation
1	2.087	0.030	0.850	0.577
2	0.109	0.008	0.058	0.008
3	0.121	0.024	0.772	0.010
4	0.057	0.013	3.303	0.025
5	0.080	0.006	0.305	0.017
6	0.026	0.009	0.889	0.012
7	0.038	0.018	1.491	0.015
8	0.027	0.010	0.008	0.739
9	0.016	0.073	2.270	0.009
10	2.197	0.052	0.163	0.016
11	0.112	0.018	0.551	0.029
12	0.154	0.006	0.418	0.087
13	0.092	0.002	0.624	0.046
14	0.018	0.003	3.714	0.024
15	0.148	0.022	0.199	0.011
16	0.032	0.004	0.507	0.027
17	0.169	0.081	2.096	0.019
18	3.031	0.025	1.170	0.070
19	0.950	0.031	0.562	0.122
20	0.287	0.006	0.417	0.171
21	0.210	0.015	0.606	0.019
22	0.101	0.019	0.202	0.010
23	0.017	0.022	1.038	0.065
24	0.826	0.064	0.181	0.101
25	0.314	0.087	0.460	0.023
26	1.082	0.099	0.405	0.008
27	0.163	0.013	0.669	0.025
28	0.215	0.055	0.340	0.005
29	0.103	0.041	0.309	0.007
30	0.079	0.072	0.278	0.004
31	0.133	0.070	0.311	0.021
32	0.089	0.016	0.570	0.006
33	0.097	0.053	0.791	0.002
34	0.132	0.004	0.773	0.020
35	0.141	0.021	0.690	0.021
36	0.170	0.013	0.239	0.008
37	0.153	0.008	2.615	0.006
38	0.026	0.096	0.361	0.082
39	0.141	0.078	-	0.043
40	0.296	0.001	0.380	0.074
41	0.219	0.042	0.294	0.057

Source: Sasra

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P.O. Box 30197
Nairobi, KENYA

27 September 2019

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

INTRODUCTORY LETTER FOR RESEARCH
BONIFACE KNYUA REGISTRATION NO. D63/5939/2017

This is to confirm that the above named is a bona fide student in the Master of Science in Finance (MSc. Finance) option degree program in this University. He is conducting research on *'Effects of tax incentives on financial performance of savings and credit co-operative societies in Nairobi County.'*
The purpose of this letter is to kindly request you to assist and facilitate the student with necessary data which forms an integral part of the Project. The information and data required is needed for academic purposes only and will be treated in **Strict-Confidence**.

Your assistance will be highly appreciated.

Thank you.

Jane Muturi
For: Msc Finance co-ordinator

WN/jkm

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RESEARCH LICENSE

This is to Certify that Mr.. BONIFACE KINYUA of University of Nairobi, has been licensed to conduct research in Nairobi on the topic: Effects of tax incentives on financial performance of savings and credit cooperative societies in Nairobi county for the period ending : 08/October/2020.

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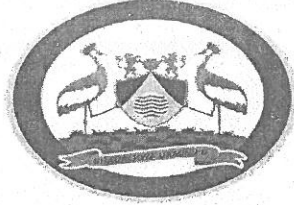
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14th October, 2019

Boniface Kinyua
University of Nairobi
College of Humanities & Social Sciences
P.O. Box 30197
NAIROBI

RE: RESEARCH AUTHORIZATION

Following your application to carry out Research and Subsequent approval by National Commission for Science, Technology and Innovation vide letter Ref: **NACOSTI/P/19/2024** dated **8th October, 2019.**

I am pleased to inform you that authority has been grant to you to carry out research on *"Effects of tax incentives on financial performance of savings and credit co-operative societies" in Nairobi County.*

On conclusion of the study, you are expected to submit a copy of the research findings to the undersigned:

Raphael Kinyungu
For: Chief Advisor to Schools.

Copy to: Chief Officer – Education, Social Services & Gender
              Director City Education

"The City of Choice to Invest, Work and Live in"

Boniface Kinyua,
P.O Box 51665- 00200,
Nairobi, Kenya.
0720583166
3bkinyua4@gmail.com

12th October, 2019.

The Chief Executive Officer,
Sacco Societies Regulatory Authority (SASRA)
P.O. Box 25089-00100,
Nairobi, Kenya.

Dear Sir/Madam,

RE: REQUEST FOR RESEARCH DATA

I am a postgraduate student at the University of Nairobi pursuing Masters of Science in Finance. I am conducting a study on **EFFECTS OF TAX INCENTIVES ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT CO-OPERATIVE SOCIETIES IN NAIROBI COUNTY.** To achieve this, i kindly request you to assist in the collection of secondary data from your organization which will enable me to accomplish the study. The data collected will be treated confidentially and used purely for academic purposes only. The findings of the study shall be availed to you upon request.

Your assistance and cooperation will be highly appreciated.

Thank you.

Yours Sincerely,

Boniface Kinyua