

Value Added Tax and The Financial Viability of Supermarkets in Laikipia County

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Abstract

Purpose: Value added Tax imposes financial burdens on retail businesses such as supermarkets forcing some of these supermarkets to fail in complying with the tax regulations and some even shutting down. The study looked at the effect of value added tax on the financial viability of supermarkets in Laikipia county.

Methodology: The study adopted a descriptive research design. Questionnaires were used to collect data from the respondents. The data was analysed and presented in frequency tables. To analyse the relationship between financial viability of supermarkets and value added tax, correlation and regression analysis were used.

Findings: The study concluded that there exists a strong relationship between Value Added Tax and the financial viability of supermarkets in Laikipia County.

Keywords: Value Added Tax, Financial Viability, Taxation

1. Introduction

VAT is an indirect tax that is paid by the person who consumes taxable goods and taxable services supplied in Kenya and/or imported into Kenya (KRA 2019). Value Added tax is an important component of the Kenyan taxation system. Persons supplying or who expects to supply taxable goods and taxable services with a value of Kshs 5 million or more in a year is required to register for VAT (KRA 2022). The determination of VAT rates, VAT credits and tax bases plays a critical role in shaping the company's cost structure, associated with VAT (Aringo, C. E., 2023). As intermediaries in the retail sector, supermarkets are majorly impacted by VAT because of their function in bridging the gap between manufacturers and final consumers.

Gale (2020) on raising revenue with a progressive value added tax showed that increasing VAT rates increased the US GDP by 1 percent however it made most small businesses vulnerable. Converting business tax to value added tax in China influenced the pricing strategies thus affecting the overall profitability of businesses in China (Chang, G. H., et.al, 2024). Value Added Tax in India plays a significant role in the fiscal health of the government as it provides a key source of revenue (Shah, V. 2024). A study by Ironkwe, (2015), showed that value added tax negatively impacted the financial performance of agribusinesses in Nigeria bringing about cases of non-compliance of these businesses. Mohammed, (2020), showed that taxation had a great influence on the economic development in Ghana however higher tax rates crippled most businesses.

General VAT rate in Kenya is at 16 percent and applies to all taxable goods and services other than zero-rated supplies (KRA 2022). Kenya has a tax to GDP ratio of 20 percent making it a high tax-yield country. These taxes however have a negative effect on the viability of retail businesses particularly supermarkets. Wangeci and Kaplelach, (2018), in their study showed that value added tax had a significant impact on the financial viability of SMEs in Voi town. High tax rates reduce the profit margins of businesses making it hard for them to grow and expand to new markets (Wangeci, M. M., & Kaplelach, S. 2018).

1.1 Problem Statement

The current value added tax framework in Kenya, often imposes heavy financial burdens on supermarkets in Laikipia County. Taxation provides government with funds necessary to run public services and invest in infrastructure, however it has a negative effect on these businesses (Aringo, C. E., 2023). Supermarkets are major players in the local economy as they provide consumers with access to a wide range of products as well as creating employment for residents. VAT increases the cost of goods which in return reduces consumption of these goods thus challenging the financial viability of supermarkets. 1,309 businesses were profiled by KRA for being involved in tax evasion schemes, with an estimated tax loss of approximately Kshs. 259 billion (KRA 2022). Such cases deprive the government from potential revenue and thus disrupting its processes. Despite the important role that supermarkets play in the local economy, limited research has been conducted on the effects of VAT on the financial viability of supermarkets in Laikipia County. This study therefore aims to fill this gap by providing insights on the effects of value added tax on the financial viability of supermarkets in Laikipia County.

1.2 Research Objective

The objective of this study is to investigate the effect of Value Added Tax on the financial viability of supermarkets in Laikipia County

2. Literature Review

2.1 Theoretical Review

Mirrlees proposed the theory of optimal taxation in the 1970s. This theory addresses how to design a tax system that maximizes social welfare while minimizing the economic distortions and inefficiencies that taxes can create (Mirrlees, J. A. 1986). This theory assumes that the social welfare is based on the utilities of individuals in the society (Fleurbaey, M., & Maniquet, F., 2018). Organizations should therefore be taxed in a way that will not 'harm' the operations of the organization. This can be achieved by balancing the tax rates and bases to avoid creating loopholes for tax evasion.

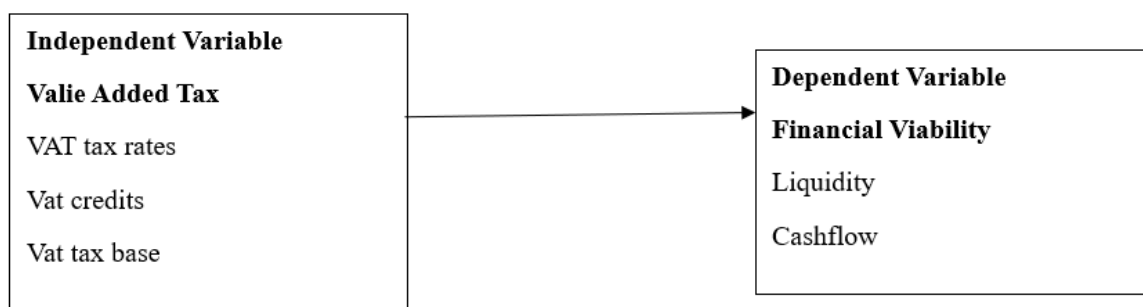
The defining feature of an optimal tax system is that there exists no reform of the marginal tax rates in any income range such that social welfare in the population improves after the reform (Ngali, J. I. (2020)). This theory seeks to ensure that there is an efficient resource allocation where the taxes imposed have minimal distortions on the economic decisions of the business. It also assumes that the government cannot perfectly observe individuals' income or ability to pay, leading to potential trade-offs between efficiency and equity (Blunden, C. 2022). It emphasizes on designing tax policies that reduce the negative effects of this asymmetry while promoting the economic well-being.

This theory is relevant to this study where it looks at the challenges faced by supermarkets such as higher tax burdens when compared to larger firms and financial resources. VAT (Value-Added Tax) will be discussed within this framework because they are consumption taxes that can be structured to minimize economic inefficiencies. Applying this theory will help in designing taxation systems that will reduce alleviate these pressures thus creating a tax environment that fosters business growth and viability.

2.2 Empirical review

A study by Omar, M. A. (2020), examined the impact of Value Added Tax on the financial performance of Small and Medium Enterprises in Mombasa County, the study concluded that VAT has a significant effect on the financial performance of SMEs hence increase in VAT rates led to a decline in the financial performance of these business. Shakkour, A., et.al (2021), did a study that investigated on the factors influencing Value Added Tax compliance among small and medium enterprises (SMEs) in Jordan. The study concluded that there is a positive relationship between personal characteristics and tax compliance. The study emphasized on the importance of VAT practices within SMEs. A study by Oduori, (2024) showed that value added tax had a positive and a statistically significant on the financial viability of export processing zone agro-processing zones in Nairobi County. Erick (2024), showed that the performance of SMEs in Tanzania was greatly hindered by the value added tax administration and tax rates. A study by Chang, (2024), concluded that the multiple-tier VAT rate system in China affected most businesses. Judith, N. I., et. al, (2022) did a study on the effect of taxation on the growth of Small and Medium-sized Enterprises. It looked at how VAT affected the profitability and cash flows of SMEs, it concluded that high VAT derailed the growth of SMEs. A study by Wedasango and Chirebvu on the impact of VAT on SMEs in a developing country concluded that high VAT rates affected tax compliance among these SMEs.

2.3 Conceptual Framework



3. Research Methodology

To provide insights into the research problem and explain the relationship between the variables of interest, this study used a descriptive research design. Laikipia county offers a unique setting as most of the residents deeply rely on entrepreneurship as a source of income. The target population was 30 supermarkets in Laikipia County that have been in operation for the past 3 years. The respondents were the financial managers in these supermarkets. Primary data was used, where questionnaires were administered to the respondents.

To analyse the data, descriptive statistics was used. Data was edited, coded, classified and summarized into sets. A multiple linear regression model was used to define the relationship between financial viability and value added tax, The multiple regression formula was presented as shown below:

$$Y = \beta_0 + \beta_1 XV + e$$

Where;

Y – Financial Viability

β_0 – Constant Term

β_1 – Correlation Coefficients

XV – Value Added Tax

e – Error term

3.1 Data Analysis and Findings

The objective of this study was to investigate the effect of value added tax on the financial viability of supermarkets in Laikipia County. To assess the agreement level of the respondents, the study used a five-point Likert scale questionnaire, with 1 representing the lowest score and 5 representing the highest score.

The descriptive statistics in table 1 showed the statement the current VAT rate is favourable to my business had a mean of 2.07 indicating that majority of the respondents disagreed with this statement. When asked whether the VAT taxation does not affect my business operations, the average response was 2.11 indicating that VAT affected most of the respondent's business operations. The respondents were also asked if the VAT filing process is simple and user friendly the average response was 2.00 showing that most respondents disagreed with this statement and that the tax filing process is not easy or user friendly. The participants were further asked if the KRA officers have provided adequate information regarding VAT processing and filing, the average response was 2.21 indicating disagreement with this statement. Finally, the respondents were asked if the size of an enterprise little direct impact on its ability to administer and manage the VAT function internally, the average response was 2.34. These findings are supported by Wadesango and Chirebvu (2020), who concluded that high VAT rates specifically and directly affect the cost structure, production capacity and growth prospects of the SMEs which also stimulated unethical business practices such as tax evasion. Schoeman, (2021) research concluded that high VAT rates affected how small businesses operate in South Africa where the high rates of VAT lead to an increase of non-compliance among the businesses.

Table 1. Mean and Standard deviation for value added tax

No.	Statement	Mean	Std. Dev
1.	The current VAT rate is favourable to my business	2.07	0.95
2.	VAT taxation does not affect my business operations	2.11	0.99
3.	The VAT filing process is simple and user friendly	2.00	1.01
4.	KRA officers have provided adequate information regarding VAT processing and filing	2.21	1.12
5.	The size of an enterprise has little impact on its ability to administer and manage the VAT function internally	2.34	1.07

3.2 Inferential Statistics

The study conducted both simple and multiple linear regression model analysis to determine the influence between the independent and dependent variables.

3.2.1 Model Summary

The study established that value added tax has a positive correlation on the financial viability of supermarkets, the above can be shown by Pearson correlation coefficient ($R = 0.668$). The study concluded that value added tax represented 35.8 percent ($R = 0.358$) of the factors affecting financial viability of supermarkets. This analysis means that there are other factors affecting the financial viability of supermarkets that the study did not consider and contributes to 64.2 percent.

Model Summary for value added tax.

Table 2 Model Summary

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate
1	.668 ^a	.446	.358	.42655

3.2.2 Analysis of Variance

The ANOVA analysis showed that value added tax had a positive link on Financial Viability ($P = 0.004$). The critical F was less than the F ($F = 5.037$) meaning that there is a positive significance. Therefore, with a P value of 0.004 and a F value of 5.037, the null hypothesis, that there is no correlation between value added tax and the financial viability of supermarkets, was rejected.

Table 3 ANOVA for value added tax

ANOVA for value added tax						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	3.666	4	.917	5.037	<.004 ^b
	Residual	4.549	35	.182		
	Total	8.215	29			
a. Dependent Variable: Financial Viability						
b. Predictors: (Constant), value added tax.						

3.2.3 Regression Coefficients

The study conducted a multiple linear regression analysis to explain the effect of value added tax on financial viability of supermarkets. The equation $\text{Financial Viability} = 0.523v + 4100$ was generated. With a coefficient of .480 Value Added Tax (VAT) it implies that by holding other factors constant, a unit change in VAT increases the financial viability of Supermarkets by .480. VAT is therefore statistically significant on the financial viability of supermarkets in Laikipia County (t value = 2.504; p value = 0.004). This was in support of Oscar, (2020), who showed that there exists a positive relationship between Value Added Tax and the performance of SMES in Mombasa County.

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.155	.818		7.582	<.001
	VAT	.523	.209	.415	2.504	.004

Table 4. Coefficients for Financial Viability

4. Conclusions

The study concluded that there is a positive link between value added tax and financial viability. The study additionally concluded that VAT tax rates, VAT tax base and VAT credits have a significant effect on the financial viability of supermarkets.

4.1 Recommendations

Based on the findings of this study, the following recommendations have been made:

- I. Supermarkets should prioritize cashflow management to ensure they can meet VAT obligations on time without straining operational finances.
- II. The policymakers should prioritize the provision of VAT education services to business owners, particularly supermarkets as education can have an impact on their performance.
- III. The study recommends that the government and KRA should consider revising the VAT rates and introducing VAT incentives to increase level of compliance and reduce the burden on supermarkets.
- IV. KRA should simplify the VAT filing process, making the e-filing platform more user friendly and ensure that it is easily accessible

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