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Abstract

Small and Medium-sized Enterprises (SMEs) are pivotal to Kenya's economic landscape, providing self-employment opportunities to numerous households. However, a significant proportion of these enterprises face sustainability challenges, with many collapsing within the first three years of operation, and 70% of the survivors failing to surpass the five-year mark. This high attrition rate is predominantly attributed to low profitability levels, leading to financial distress. A critical factor contributing to this phenomenon is the skills gap among proprietors, particularly in areas such as debt management, bookkeeping, tax management, and cash flow management, which culminates in operational inefficiencies and diminished business returns. A study was conducted to assess the effects of tax management skills on the financial performance of SMEs in Mombasa County, with net profit margin serving as the key performance indicator. The research was anchored on decision usefulness theory, which emphasizes the importance of financial information for effective decision-making, including tax planning and compliance. Employing a descriptive research design, the study targeted a population of 54,245 registered SMEs in Mombasa County, focusing on proprietors and managers. A sample size of 132 SMEs was selected through stratified random sampling, and primary data were collected using structured questionnaires tailored to address the study's objective. Data analysis was performed using SPSS software, employing both descriptive and inferential statistics. The results indicated that tax management skills had a significant positive effect on the financial performance of SMEs in Mombasa County, with a correlation coefficient of 0.509 ($p=0.000$) and accounting for 26.2% of the variance in net profit margin. The regression results demonstrated that for every unit increase in tax management skills, net profit margin increased by 0.414 units. The study concludes that tax management skills have a significant positive effect on the financial performance of SMEs in Mombasa County. The study recommends that SME owners and managers in Mombasa County should undergo comprehensive financial literacy training specifically focused on tax management skills, including tax planning, understanding of regulations, and strategic settlement of tax obligations. The County Government of Mombasa, in collaboration with the Kenya Revenue Authority, should establish accessible tax advisory services tailored specifically for SMEs to provide simplified guidance on compliance procedures and available incentives. Local universities and training institutions should partner with county authorities to offer regular workshops on tax management tailored to the needs of SME owner/managers, ensuring practical application of tax knowledge in business operations.

Keywords: Tax management skills, financial performance, SMEs, Mombasa County, Kenya

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1.0 Background of the Study

The financial performance of Small and Medium Enterprises (SMEs) has emerged as a critical focus area for economists and policymakers worldwide, given their pivotal role in driving economic growth, creating employment, and reducing poverty. Financial literacy, particularly tax management skills, stands among the most important capabilities that small businesses must develop to navigate complex business environments successfully. As Lusardi (2019) emphasizes, while various factors contribute to SME closures, financial literacy remains one of the most crucial competencies for building business resilience in dynamic economic conditions. The World Bank's 2019 report highlights how financial literacy has gained immeasurable attention due to its role in influencing SME performance. This growing interest stems from recognition that proper financial management capabilities are essential for poverty reduction at both national and global levels. Sound financial literacy empowers business owners to plan for long-term financial goals while maintaining operational stability. In developed countries, various approaches to improving financial literacy among SME proprietors have yielded significant performance improvements through effective management of liquidity and debt, enhancing business profitability through informed decision-making processes (North & Varvakis, 2016).

In Kenya, SMEs constitute a significant economic driver, with the USAID report (2023) estimating that the country has 7.4 million SMEs, collectively generating 40 percent of GDP and providing substantial non-agricultural employment. The Kenyan government has implemented initiatives through the Financial Sector Deepening (FSD) trust to disseminate financial knowledge to SMEs, while the Central Bank oversees financial literacy through its supervisory role over commercial banks (Aduol & Mwangi, 2018). Despite these efforts, many SMEs continue to struggle with financial management, including tax compliance. Tax management skills represent a critical component of financial literacy that directly impacts business sustainability. As noted by Minjo (2018), effective bookkeeping practices facilitate tax management through proper monitoring of enterprise profits. Corporate taxes are computed on operating profits, while Value Added Tax (VAT) requires careful tracking of sales and purchases. The preparation of accurate quarterly management accounts enables businesses to estimate correct installment taxes periodically within a financial year (Ochola, 2017).

The significance of tax management lies in its dual role of ensuring compliance while optimizing financial performance. Lusardi (2019) asserts that an effective financial plan requires a strategic approach to tax management that minimizes tax liabilities through leveraging various laws and regulations. Businesses should prioritize expenditures that qualify for tax allowances, such as investments in plant and machinery, to maximize tax benefits while maintaining compliance. Failure to implement proper tax planning and compliance measures can have devastating consequences for SMEs. Tax non-compliance often leads to litigation, hefty penalties, and reputational damage, resulting in diminished revenues and lost business opportunities. Tax planning ensures that the financial burden of compliance is distributed throughout the year, helping businesses manage liquidity effectively and avoid financial crises that could threaten their survival.

In Mombasa County specifically, despite the economic advantages offered by proximity to Kenya's largest port, which provides SMEs with comparatively cheaper access to supplies, many businesses continue to struggle with survival. Mohammed and Rugami (2019) found that despite this conducive business environment, the survival rate of SMEs in Mombasa County remains low due to poor financial performance resulting from ineffective business management, highlighting

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the urgent need for enhanced financial literacy, including tax management skills. The Mombasa County business landscape comprises 54,245 registered SMEs across various sectors, including transport, hospitality, wholesale and retail, healthcare, technology, and real estate (Mombasa County Licensing Records, 2023). Many of these businesses operate with limited financial management capabilities, making them vulnerable to tax-related challenges that undermine their sustainability and growth potential. This situation underscores the importance of investigating how tax management skills influence the financial performance of SMEs in Mombasa County, with the aim of identifying strategies to enhance business sustainability through improved financial literacy. Hence, the study examined the effects of tax management skills on financial performance of SMEs in Mombasa County.

1.1 Problem Statement

SMEs are vital drivers of inclusive economic growth in Kenya, operating across diverse sectors with lower startup costs and greater flexibility compared to large enterprises (Joseph & Moses, 2019). Despite their economic significance, evidence indicates that a majority of small businesses in developing countries perform poorly. Studies consistently show that financially literate SMEs outperform their counterparts that lack financial literacy. The 2017 KNBS survey revealed alarming trends: most SMEs operate informally without permanent worksites, fail to maintain proper financial records, and struggle with financial information evaluation due to poor technological integration. This widespread failure can be attributed to several factors, including non-compliance with tax authorities, which contributes to low profitability levels and business sustainability challenges (Hussain et al., 2018). The contribution of SMEs to the global economy is indisputable, as they create employment, promote balanced development, alleviate poverty, and strengthen the microeconomic sector (Ngeki, 2016). However, many SME proprietors in Mombasa County struggle to understand fundamental business concepts such as profitability, cash flow management, and return on investment. This knowledge gap contributes significantly to business failures and negatively impacts the investment landscape. Tax management skills are particularly important, as they enable business owners to optimize their tax positions legally while ensuring compliance with regulatory requirements, directly influencing financial performance and business sustainability (Nyamboga et al., 2014).

Lusardi's (2019) study confirmed that basic financial and business knowledge significantly improves sales and productivity levels of companies. Proper bookkeeping practices ensure that sales, variable costs, and fixed cost data are captured appropriately, which guides businesses in determining optimal production and sales levels to achieve profitability targets. Additionally, effective tax planning is essential for business sustainability, as noted by Storey (2017), who emphasized that proper cash flow management enables businesses to ensure tax compliance even during periods of unfavorable profitability. Without adequate tax management skills, SMEs risk substantial penalties, legal complications, and reputational damage that can threaten their survival. Despite several policies addressing micro and small enterprises in Kenya, the sector fails to realize its full potential due to inappropriate design and implementation (KIPPRA, 2019). With most SMEs operating in the informal sector, government initiatives for training and sensitization face significant challenges in reaching these businesses. The Kenya Industrial Training Institute (KITI) represents a pivotal initiative for disseminating knowledge on technical and entrepreneurship skills, but it needs to place greater emphasis on financial management skills, including tax

management, to ensure holistic business development (Obuya, 2017). The gap in tax management capabilities remains a major impediment to SME survival and growth in Mombasa County.

Ombongi and Long (2018) highlighted the precarious financial position of most SMEs in Kenya, which operate at an average net profit margin of 7% annually—just slightly above the average inflation rate of 6%. This razor-thin real return of 1% exposes these businesses to significant financial risk and potential closure due to financial distress. Financial literacy, particularly in tax management, would enable business proprietors to address revenue gaps proactively while maintaining expenses at sustainable levels. Unfortunately, as Earnst (2018) observed, most SME stakeholders focus primarily on general training rather than comprehensive financial literacy education. This study therefore aims to address this critical gap by examining how tax management skills specifically affect the financial performance of SMEs in Mombasa County.

1.2 Research Objective

To evaluate the effects of tax management skills on financial performance of SMEs in Mombasa County, Kenya

1.3 Research Hypothesis

H₀: Tax management skills have no significant effects on the financial performance of SMEs in Mombasa County, Kenya

2.0 Literature Review

2.1 Theoretical Framework

The study was anchored on decision usefulness theory. The theory, developed by George J. Staubus in 1958, posits that the primary purpose of financial reporting is to provide information that guides organizational decision-making. As explained by Wachter and Kahana (2024), this theory emphasizes that financial information must demonstrate reliability, relevance, consistency, comparability, and understandability to meet the needs of various stakeholders including investors, creditors, and tax authorities. The theory advocates for proper accounting practices, including the preparation of comprehensive financial statements such as income statements that clearly delineate profit before taxes and consider tax allowable expenses to avoid over-taxation. Keasey and Watson (2019) further highlight that financial projections derived from current financial statements are essential business strategy tools for forecasting future trends, while financial statements themselves should be prepared periodically as critical performance metrics.

The relevance of theory to this study on tax management skills and financial performance of SMEs in Mombasa County is significant, particularly in the context of developing economies. SMEs in Kenya typically operate in environments characterized by asymmetric information problems, with businesses commonly controlled by owner-managers who may not possess the financial literacy assumed by conventional theories. These SME owners require practical, decision-useful financial information to effectively manage their tax obligations and improve financial performance. The theory's normative, deductive approach—directing the economic decision-making process through information to achieve resource allocation efficiency—provides a framework for understanding how improved tax management skills can directly enhance business outcomes. As Wachter and Kahana (2024) assert, information is power, making it imperative for SMEs to equip themselves

with proper financial knowledge, particularly in tax management, to guide appropriate business decisions and ultimately improve their financial performance.

2.2 Empirical Review

Ochola (2017) conducted a study in Migori County with 104 SMEs and discovered that tax compliance significantly contributes to financial performance by maintaining a positive business image and ensuring long-term viability. The research emphasized that while taxation may appear as an organizational expense, non-compliance leads to severe consequences including business closure and litigation that threatens survival. Notably, the study highlighted that income tax is only levied on profits, providing relief to loss-making enterprises. However, Ochola's research primarily focused on general tax compliance without adequately addressing tax management skills, which involve proactive tax planning and strategic settlement of tax obligations through installments and prepayments during favorable business cycles.

Otwani, Simiyu, and Makokha (2017) examined the effects of corporate income tax on financial performance among firms listed on the Nairobi Securities Exchange. Using primary data collected through interviews and questionnaires from 59 senior executives, their study concluded that corporate income tax significantly influences financial performance. However, this research was limited to large listed companies and did not explore how tax management affects SMEs specifically. Similarly, Kabajulizi (2019) investigated taxation policies' impact on SME financial performance in Uganda's Hoima district, employing a descriptive survey design with 360 SMEs. The findings indicated that favorable tax administration improves taxpayer convenience, while taxation serves as a fiscal tool that can either positively or negatively influence businesses depending on their activities. Nevertheless, this study's geographical specificity to Uganda leaves room for research in other jurisdictions.

Tax management skills have been identified as crucial for financial performance by several researchers. Ngeek (2016) asserts that entrepreneurs' knowledge of tax laws, customs procedures, and grant application provisions are important determinants of financial performance. Effective tax planning enables businesses to select appropriate tax instruments for investment, leading to improved financial performance. A comprehensive understanding of refund procedures and minimizing compliance costs contributes to good financial performance, while failure to satisfy tax obligations increases risks and can lead to financial deterioration. These findings align with Mariam et al. (2023), who emphasized the vital role SMEs play in national development through job creation and economic growth.

Nyamboga et al. (2014) established that SME performance correlates with financial capital availability variables, with tax management skills triggered by financial literacy serving as a moderating factor between financial literacy and performance. Brownhilder Ngeek (2016) further noted that access to finance remains a critical issue for SMEs worldwide, attracting significant attention from policymakers. Financial literacy fundamentally determines SMEs' capacity to access finance, commence operations, and achieve success. The research indicates a concerning trend of deterioration in SME percentages over three-year periods, with dramatic declines noted in 2012-2013, partially attributed to governmental changes and stricter tax compliance measures. These findings collectively emphasize that tax management skills constitute an essential component of financial literacy that directly impacts SMEs' financial performance and sustainability.

2.3 Conceptual Framework

Figure 1 presents the conceptual framework.

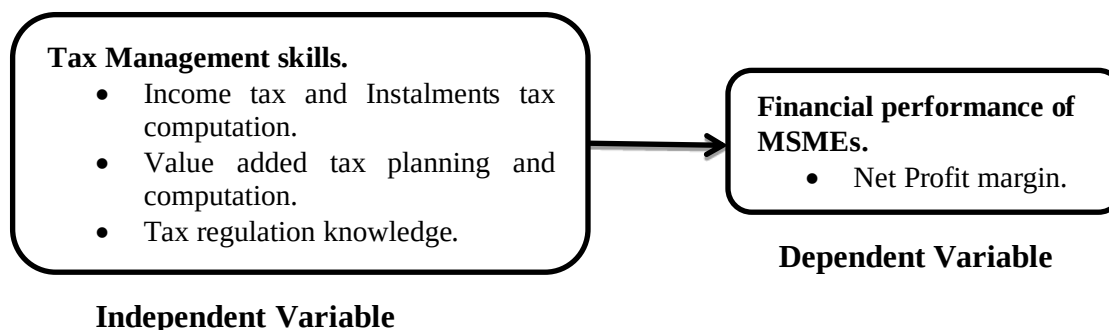


Figure 1: Conceptual Framework

Source Author (2024)

3.0 Research Methodology

The study employed a descriptive research design to investigate the relationship between tax management skills and financial performance of SMEs in Mombasa County. As noted by Kothari (2013), this research design is appropriate for utilizing both quantitative and qualitative data to make accurate predictions about the research objectives. The design was particularly suitable due to its effectiveness in obtaining facts through surveys from numerous participants, which aligned with the study's aim to gather data from a large number of SMEs. The target population comprised 54,245 registered SMEs in Mombasa County (Mombasa County Licensing Records, 2023), spread across six sub-counties: Changamwe, Likoni, Kisauni, Nyali, Mvita, and Jomvu. Proprietors and supervisors of these SMEs were the main focus as they possessed first-hand information about the enterprises. The study adopted stratified random sampling to ensure proper representation of all important sub-groups within the population. Using Wang's (2015) formula with a 75% confidence level and 5% margin of error, a sample size of 132 SMEs was determined and proportionally distributed across the six categories of businesses: Wholesale and Retail (66), Transport and Logistics (17), Tourism and Hospitality (14), Manufacturing (10), Professional and Technical Services (13), and Information Technology (12). Data collection was conducted using structured questionnaires that measured various demographic variables, financial concepts, and economic facts, with numeric scores assigned to capture statistical significance. The questionnaires were administered by hand with the assistance of a research assistant, and collected after two weeks. Data analysis employed both descriptive and inferential statistics, including means, standard deviations, and correlation analysis to establish relationships between tax management skills and financial performance. Throughout the research process, ethical considerations were upheld, including voluntary participation, informed consent, and the freedom for participants to withdraw from the study without facing any consequences.

4.0 Results and Analysis

This chapter presents the data collected and analysed to answer the main research questions, and most importantly to test hypotheses. Both descriptive and inferential statistics are used in this study.

4.1 Response Rate

The researcher sent out 163 questionnaires, 132 were fully completed and returned in time, with all participants meeting the inclusion criteria. This represents an 80% response rate.

4.2 Descriptive Statistics

Table 1 presents the descriptive statistics

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Tax Management Skills	132	2.0	5.0	4.003	.6525
Net Profit Margin	132	2.0	5.0	3.989	.6254

The study found that tax management skills had a mean score of 4.003 on a 5-point scale, with a standard deviation of 0.6525 among the 132 SMEs surveyed. This high mean value indicates that most participants demonstrated strong agreement with statements related to tax management skills, suggesting widespread recognition of its importance among SME owners in Mombasa County. The relatively small standard deviation reflects consistency in responses, with minimal variability among participants. Similarly, the Net Profit Margin variable showed a comparable mean score of 3.989 with a standard deviation of 0.6254, indicating generally positive financial performance among the surveyed businesses. Both variables had identical minimum and maximum values (2.0 and 5.0 respectively), showing that while some businesses reported lower levels of tax management skills and financial performance, many achieved high ratings in both areas. These descriptive statistics provide foundational evidence of the potential relationship between tax management skills and financial performance, suggesting practical implications for SME training programs that could focus on developing tax planning capabilities, understanding tax regulations, and implementing effective tax compliance strategies to enhance profitability.

4.3 Correlation Analysis

Table 2 presents the results of the correlation analysis conducted to assess the strength and direction of the linear relationship between the study variables. The analysis provides preliminary insights into how the independent variables are associated with the dependent variable before conducting regression analysis.

Table 2: Correlations

		Tax Management Skills	Net Profit Margin
Tax Management Skills	Pearson Correlation	1.000	.509**
	Sig. (2-tailed)		.000
	N	132	132
Net Profit Margin	Pearson Correlation	.509**	1.000
	Sig. (2-tailed)	.000	
	N	132	132

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

The study found a significant positive correlation between tax management skills and net profit margin among SMEs in Mombasa County. The Pearson correlation coefficient of 0.509 indicates a moderate to strong positive relationship between these variables, which was statistically significant at the 0.01 level ($p=0.000$). This finding suggests that as tax management skills increase among SME owners and managers, their businesses' net profit margins also tend to increase proportionally. With a sample size of 132 SMEs, this correlation provides robust evidence that tax management capabilities play an important role in determining financial performance outcomes. The results indicate that SMEs with stronger tax planning abilities, better understanding of tax regulations, and more effective tax compliance strategies are likely to achieve higher profitability levels. This finding has important implications for business support programs, financial literacy training, and policy interventions aimed at improving SME performance, suggesting that specific emphasis on developing tax management skills could yield tangible benefits for small business financial outcomes in Mombasa County.

4.4 Test of Hypothesis

This section uses regression analysis to test the hypothesis, where the analysis will determine whether or not different variables can predict financial performance. Table 3 presents the model summary.

Table 3: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.511 ^a	.262	.256	.5395

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a. Predictors: (Constant), Tax Management Skills

The model summary table provides valuable information about the predictive power of tax management skills on SME financial performance. The R-squared value of 0.262 indicates that tax management skills account for 26.2% of the variation in net profit margin among the surveyed SMEs in Mombasa County. This finding suggests that while tax management skills are an important factor in determining financial performance, approximately 73.8% of the variation in net profit margin is explained by other factors not included in this model. The adjusted R-squared value of 0.256 is slightly lower than the R-squared value, which is expected when adjusting for the number of predictors in the model. The standard error of the estimate (0.5395) represents the average distance that the observed values fall from the regression line, indicating moderate precision in the model's predictions. Table 4 presents the ANOVA results.

Table 4: ANOVA

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	13.398	1	13.398	46.037	.000 ^b
	Residual	37.835	130	.291		
	Total	51.233	131			

a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Tax Management Skills

The ANOVA table confirms the statistical significance of the regression model in predicting financial performance outcomes. With an F-statistic of 46.037 (df = 1, 131) and a p-value less than 0.05 ($p = 0.000$), the model demonstrates a significant relationship between tax management skills and net profit margin. This statistical significance indicates that the observed relationship between the independent variable (tax management skills) and the dependent variable (net profit margin) is unlikely to have occurred by chance. The sum of squares regression (13.398) compared to the total sum of squares (51.233) further supports the R-squared value, showing that while tax management skills explain an important portion of the variance in financial performance, other factors also contribute substantially to SME profitability in Mombasa County. Table 5 presents the coefficients.

Table 5: Coefficients

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	2.027	.293		6.920	.000
	Tax Management Skills	.414	.072	.511	6.785	.000

a. Dependent Variable: Net Profit Margin

The regression equation is therefore as follows:

$$\text{Net Profit Margin} = 2.027 + 0.414 (\text{Tax management skills}) + \text{error}$$

The coefficients table provides specific information about the mathematical relationship between tax management skills and net profit margin. The unstandardized coefficient ($B = 0.414$) indicates that for every one-unit increase in tax management skills, net profit margin increases by 0.414 units, holding all else constant. The constant value of 2.027 represents the predicted net profit margin when tax management skills are zero, though this has limited practical interpretation given the scale used. The standardized coefficient ($\text{Beta} = 0.511$) confirms the relatively strong positive relationship between the variables, while the t-statistic (6.785) and corresponding p-value (0.000) demonstrate statistical significance at the 0.01 level. Based on these results, the null hypothesis stating that "tax management skills have no significant effects on the financial performance of SMEs in Mombasa County" is rejected, confirming that tax management skills do indeed have a significant positive effect on the financial performance of SMEs in the region.

5.0 Conclusion

The study concludes that tax management skills have a significant positive effect on the financial performance of SMEs in Mombasa County. The statistical analysis revealed a moderate to strong correlation ($r=0.509$) between tax management skills and net profit margin, with the regression model confirming that tax management skills account for 26.2% of the variation in financial performance. This relationship was statistically significant ($p<0.05$), leading to the rejection of the null hypothesis that posited no relationship between these variables. Besides, it is concluded that successful tax management requires comprehensive planning, implementation of good internal control systems, and engagement of knowledgeable staff regarding tax matters. However, most SMEs in Mombasa County face capacity constraints in dealing with tax obligations, which they perceive as more demanding compared to larger companies. This skills gap contributes to compliance challenges, inefficient utilization of available tax incentives, and ultimately affects their financial performance and sustainability. Tax management primarily involves determining an organization's tax liabilities and ensuring proper implementation of tax policies that support government revenue generation. Proper tax management practices among SMEs contribute not only to individual business performance but also to the broader economic development through equitable utilization of taxpayers' money. Despite the demonstrated importance of tax management skills, many SME owners in Mombasa County lack formal financial training, which hampers their ability to implement effective tax planning strategies necessary for optimizing their financial performance.

6.0 Recommendations

The study recommends that SME owners and managers in Mombasa County should undergo comprehensive financial literacy training programs specifically focused on tax management skills. These programs should cover tax planning, understanding of tax regulations, preparation of quarterly management accounts, and strategic settlement of tax obligations through instalments and prepayments. Such training would equip business proprietors with the necessary competencies to optimize their tax positions legally while ensuring compliance with regulatory requirements. Moreover, the study recommends that the County Government of Mombasa, in collaboration with the Kenya Revenue Authority, should establish accessible tax advisory services tailored specifically for SMEs. These services should provide simplified guidance on tax compliance

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procedures, available tax incentives, and proper documentation requirements. Additionally, financial institutions and business support organizations should incorporate tax management components in their SME development programs to enhance the overall financial literacy levels among small business owners in the region. In addition, the study recommends that local universities and training institutions should collaborate with Mombasa County's authority in charge of SMEs to offer regular workshops on tax management, tailored specifically to the needs of SME owner/managers. Furthermore, a community-driven platform should be developed to support the establishment of a financial literacy network for SMEs in Mombasa County, where best practices in tax management can be shared among business owners. The Kenya School of Monetary Studies, in collaboration with the Central Bank of Kenya, should expand their financial literacy programs to include specialized tax management training for small businesses operating in various sectors of the economy.

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