Effect of Tax Policy Reforms on Financial Performance of Food Manufacturing Companies in Industrial Area, Nairobi Kenya

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DOI: https://dx.doi.org/10.47772/IJRISS.2025.90400243

Received: 21 March 2025; Accepted: 25 March 2025; Published: 08 May 2025

ABSTRACT

Tax policy reforms impact food manufacturing companies by influencing financial performance through increased operational costs, compliance burdens, and investment uncertainties. Higher taxes and reduced incentives affect profit margins, while regulatory changes strain resources. This study examined the effects of tax digitalization and regulatory changes on food manufacturers in Nairobi's Industrial Area. It was guided by Public Choice Theory, Pecking Order Theory, and the Resource-Based View (RBV) Theory. The study adopted an explanatory research design and relied solely on primary data, utilizing a quantitative approach to analyze the relationship between tax policy reforms and financial performance. The target population comprised all registered food manufacturing companies in the Industrial Area, Nairobi City. The unit of observation consisted of all 200 owners/managers of the medium-sized food manufacturing firms targeted. Additionally, the study adopted a census method to sample all 200 owners/managers of the medium-sized food manufacturing firms. Primary data was gathered through the use of a structured questionnaire from the selected firms, while financial data provided additional information for financial performance measurement. The study's findings reveal that all four independent variables; tax digitalization and regulatory changes significantly impact the financial performance of food manufacturing companies in Nairobi's Industrial Area. The correlation results show a moderate to strong positive relationship between these variables and financial performance, with tax digitalization ($r = .583$) and regulatory changes ($r = .544$) exhibiting the strongest correlations. Regression analysis indicates that 33.2% of the variance in financial performance is explained by these factors, with regulatory changes having the most substantial impact ($\beta = .413$, $p < .001$). This study concludes that tax digitalization, along with new regulatory changes, is crucial for enhancing financial performance in the food manufacturing sector. Consequently, companies should invest in tax digitalization technologies and build robust compliance frameworks to optimize financial performance in an evolving regulatory environment. Future research could explore these dynamics in other sectors and consider additional variables influencing financial outcomes.

Key Words: Tax policy Reforms, financial performance, Food manufacturing companies

INTRODUCTION

Tax revenue mobilization remains a primary concern for policymakers in many developing nations. Governments prioritize modernizing tax administration and increasing tax revenue, which can significantly impact financial performance in various industries, including food manufacturing. Financial performance, as defined by Copisarow (2020), is a measure of how effectively a firm utilizes its assets to generate revenue. It also serves as a broader indicator of a firm's overall financial health, allowing for comparisons across similar firms and industries (Murira, 2014). Many firms struggle with financial performance due to bad debts, poor taxation structures, and management challenges, which ultimately lead to low revenues and hinder growth (Asantey & Tengey, 2018).

Financial performance is a crucial metric for evaluating a company's growth potential, earnings capacity, and overall financial strength (Richardson, 2012). It is commonly assessed using indicators such as Return on Assets (RoA) and Return on Equity (RoE) (World Bank, 2013). However, uncertainties in the economic and financial environment present complex challenges for businesses, particularly regarding taxation policies.

One of the key areas of tax policy reforms affecting financial performance is tax digitalization. The shift towards digital tax systems is aimed at improving compliance, reducing tax evasion, and enhancing efficiency in tax administration. According to Smith (2018), digital tax systems lower operational costs for tax authorities while ensuring more accurate and timely tax collections. However, for food manufacturing companies, tax digitalization can pose significant financial and operational challenges. The initial investment in digital tax compliance infrastructure, staff training, and system upgrades can be costly. Additionally, compliance with new digital tax systems requires continuous adaptation, which may disrupt business operations and impact financial performance (Jones, 2019).

In the United States, the adoption of digital tax filing and reporting systems under the Tax Cuts and Jobs Act of 2017 streamlined tax compliance, reducing administrative burdens on firms while increasing government revenue collection (Gravelle, 2018). In China, digital tax systems were introduced to enhance tax compliance, particularly among small and medium-sized enterprises (SMEs), contributing to improved financial health and competitiveness (Wang, Fan, & Liu, 2020). Similarly, in Kenya, the introduction of the iTax system aimed at automating tax filing and payments has had both positive and negative impacts on businesses. While it has improved efficiency in tax collection, some food manufacturing firms have faced difficulties adapting to the system due to high compliance costs and technical challenges.

Another major component of tax policy reforms affecting financial performance is regulatory changes. Governments frequently revise tax regulations to align with economic goals, address budget deficits, and promote business growth. However, frequent changes in tax policies create uncertainty for businesses, making long-term financial planning challenging. According to Perry (2018), regulatory changes in tax policies can lead to increased compliance costs, administrative burdens, and potential financial instability for businesses. In food manufacturing, regulatory tax changes often involve adjustments in Value Added Tax (VAT), corporate income tax rates, and industry-specific levies. These changes can significantly impact profit margins and investment decisions.

For example, in Latin America, tax regulatory changes have yielded mixed outcomes. Some reforms have increased tax compliance and revenue, while others have raised operational costs for firms, adversely affecting financial performance (Perry, 2018). In the United Kingdom, post-Brexit tax policy adjustments created uncertainty for multinational corporations, influencing decisions on corporate headquarters location and profit allocation across different jurisdictions (Devereux, Liu, & Loretz, 2019). In Kenya, frequent amendments to tax regulations, such as changes in VAT rates on food products and new tax obligations on manufacturing inputs, have created financial instability in the food manufacturing sector. Companies struggle to adjust to sudden tax hikes or reductions in incentives, leading to unpredictable cash flows and constrained investment capacity.

The implications of tax policy reforms on financial performance can also be analyzed through theoretical perspectives. The Pecking Order Theory (Myers & Majluf, 1984) suggests that firms prefer internal financing over external financing to minimize costs associated with information asymmetry. Changes in tax policies can influence a company's preference for internal or external financing, thereby affecting financial stability. Similarly, the Resource-Based View (RBV) theory posits that firms with superior resources can better adapt to tax policy changes, giving them a competitive advantage. Companies with well-established financial management systems may handle tax digitalization and regulatory changes more effectively than those with limited resources.

In addition to financial implications, regulatory tax changes also influence corporate investment decisions. According to Brown (2020), tax incentives for research and development encourage innovation, while reduced tax rates on capital gains can stimulate long-term investments. However, inconsistent regulatory changes may deter firms from committing to long-term investments due to uncertainty regarding future tax obligations. Weigel (2020) emphasizes that modifications in tax deductibility of interest payments influence corporate capital structures. If interest expenses become less tax-deductible, firms may shift toward equity financing, impacting their overall financial performance and cost of capital.

The impact of tax reforms on food manufacturing companies in Kenya underscores the need for a stable and predictable tax policy framework. Frequent and abrupt changes in tax regulations hinder financial planning and investment, creating an unfavorable business environment. Kenya's tax digitalization efforts, while intended to improve compliance, have introduced operational challenges that affect financial performance. Many food manufacturing firms incur high costs in adapting to digital tax systems, impacting their profitability. Additionally, regulatory tax changes, such as periodic VAT adjustments on essential food products, directly affect production costs and pricing strategies, influencing overall business sustainability.

Thus, effective tax policies impact cash flow, investment, and operational efficiency. Favorable policies enhance profitability, while excessive taxes hinder stability. Tax digitalization improves efficiency and reduces costs. Kenya has undergone tax reforms to enhance revenue collection and address fiscal challenges. However, there is limited research on the impact of tax policies on Kenya's food manufacturing sector. This study analyzes tax reforms' effects on financial performance, providing data-driven insights for stakeholders

By examining the effects of tax digitalization and regulatory changes on financial performance, this study provides valuable insights for policymakers and industry stakeholders. A balanced approach to tax policy reforms ensuring efficiency while minimizing compliance costs can enhance the financial performance of food manufacturing companies. Furthermore, stability in tax regulations will enable firms to plan their investments effectively, fostering sustainable growth in the sector. Policymakers should consider designing tax policies that promote economic development without imposing excessive financial burdens on businesses, ensuring a fair and competitive tax environment for all stakeholders.

Objectives

The objectives of this study were:

i. To establish the effect of digitalization on financial performance of food manufacturing companies in Industrial area, Nairobi-Kenya.

ii. To assess the effect of regulatory changes on financial performance of food manufacturing companies in Industrial area, Nairobi-Kenya.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Tax policy reforms and financial performance

The conceptual link between tax policy reforms and financial performance is rooted in the intricate relationship between regulatory frameworks and corporate economic outcomes. Heremans (2017) asserts that tax policy reforms play a pivotal role in shaping an organization's financial strategies within a given economic landscape. This perspective aligns with the findings of Bartelsman, Beetsma, and Ponds (2013), who emphasize that tax policies directly influence firms' investment decisions, thereby impacting their financial performance. The interaction between tax reforms and financial performance encompasses key financial metrics such as profitability, liquidity, and solvency, as highlighted by Brigham and Houston (2019). Ultimately, the underlying objective of tax policy adjustments is to align fiscal measures with broader economic goals, underscoring the importance of a comprehensive analysis to understand how such changes resonate across a firm's financial landscape and long-term viability.

Empirical studies examining the impact of tax policy reforms on financial performance present nuanced findings across different industries and economic settings. Gupta and Newberry (2017), for instance, analyzed tax reforms in Australia and found a positive correlation between reduced tax digitalization and enhanced financial performance among firms. Conversely, Altshuler and Goodspeed (2012) investigated tax policy changes in the United States, revealing mixed effects on corporate behavior, with varied implications for investment and financial outcomes. Bartelsman, Beetsma, and Ponds (2013) further explored tax reforms across European Union countries, demonstrating that such policies influence firm-level investment decisions, ultimately affecting financial performance.

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue IV April 2025

A sector-specific study by Felix and Hines (2019) focused on the manufacturing industry, concluding that tax incentives significantly boost investment, leading to improved financial performance. While these studies provide valuable insights, they also highlight the contextual variations in tax systems, economic structures, and industry-specific dynamics, which may contribute to differing outcomes. As a result, the empirical literature underscores the complexity and multifaceted nature of the relationship between tax policy reforms and financial performance, emphasizing the need to account for specific contextual factors when assessing their implications for businesses and industries.

Tax digitalization and financial performance

Tax digitalization, particularly through e-tax filing, digital invoicing, and real-time reporting, has been shown to significantly enhance financial performance. E-tax filing simplifies the tax submission process, reducing administrative burdens and increasing compliance rates. For instance, Alm and Soled (2020) found that the adoption of e-tax filing systems in several countries led to a substantial increase in timely and accurate tax filings, thereby boosting government revenues. Digital invoicing, which involves the electronic issuance and receipt of invoices, further supports financial performance by improving the traceability of transactions and reducing opportunities for fraud and tax evasion. According to a study by Ainsworth and Shact (2019), businesses that adopted digital invoicing reported a notable reduction in errors and processing times, which translated into cost savings and higher efficiency.

Real-time reporting provides tax authorities with immediate access to transaction data, enabling quicker identification of discrepancies and better enforcement of tax laws. DeStefano et al. (2020) demonstrated that real-time reporting systems implemented in several European countries enhanced the accuracy of tax collections and reduced the tax gap significantly. These systems facilitate a proactive approach to tax administration, allowing for real-time corrections and reducing the need for lengthy audits and investigations.

These digital initiatives not only streamline tax processes but also foster a transparent and efficient tax environment, ultimately leading to improved financial performance for both governments and businesses. The enhanced accuracy, reduced costs, and increased compliance resulting from e-tax filing, digital invoicing, and real-time reporting underscore the positive impact of tax digitalization on financial performance. Hence, hypothesis H_{01} below:

H_{01}*:* Tax digitalization has no significant effect on financial performance of food manufacturing companies in Industrial area.

Regulatory changes and financial performance

As emphasized by Knechel and Vanstraelen (2017), regulatory changes can significantly influence financial reporting practices and compliance costs, subsequently shaping a company's financial performance. This aligns with the findings of Ball and Shivakumar (2015), who highlight the association between accounting standards and financial reporting quality. The interplay involves considerations of adaptability, compliance efficiency, and the overall responsiveness of businesses to regulatory shifts, emphasizing the crucial role of regulatory changes in molding the financial landscape of corporations. Numerous studies have explored the impact of regulatory changes on the financial performance of companies.

Smith and Johnson (2018) conducted a comprehensive empirical review, examining the effects of regulatory shifts on various industries. Their findings suggest that regulatory changes significantly influence financial outcomes, with positive or negative consequences depending on the nature of the regulations and the adaptability of firms. Furthermore, Jones *et al.* (2020) reinforced these results in their longitudinal study, emphasizing the importance of firms' strategic responses to regulatory alterations. Conversely, a contrasting view is presented by Brown and Williams (2019), who argue that certain regulatory interventions may lead to short-term financial challenges but can foster long-term stability and sustainability. These divergent perspectives underscore the complexity of the relationship between regulatory changes and financial performance, urging policymakers and practitioners to consider multifaceted approaches when evaluating and implementing regulatory frameworks. Thus, the hypothesis H_{02} below:

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue IV April 2025

H_{02}: Regulatory changes have no significant effect on financial performance of food manufacturing companies in Industrial area.

Theoretical Review – Resource Based View (RBV) theory

The Resource-Based View (RBV) theory, developed by Jay B. Barney (1991), provides a valuable framework for examining the impact of tax reforms on financial performance. RBV emphasizes that a firm's ability to achieve and sustain competitive advantage depends on its unique internal resources and capabilities, which are valuable, rare, inimitable, and non-substitutable (VRIN). These resources may include financial expertise, tax planning strategies, compliance mechanisms, and adaptive financial management practices.

In the context of tax reforms, RBV suggests that firms with superior tax management capabilities and well-developed financial structures are better positioned to adapt to regulatory changes and mitigate risks associated with shifting tax policies. For instance, firms with robust tax planning strategies can optimize tax liabilities, ensuring compliance while maximizing profitability. Conversely, companies lacking such internal competencies may struggle to adjust, potentially facing higher costs, reduced cash flow, or regulatory penalties, which could negatively impact financial performance.

Applying the RBV theory to a study on tax reforms and financial performance in food manufacturing companies in Kenya enables an assessment of how firms leverage internal strengths to navigate tax policy changes. Firms that proactively develop tax-efficient financial strategies may enhance their operational efficiency, maintain profitability, and sustain competitive advantage despite external fiscal shifts. This perspective underscores the importance of internal capabilities in shaping financial resilience, offering insights into how firms can strategically position themselves to capitalize on or mitigate the effects of tax reforms.

By integrating RBV, the study can analyze the extent to which firm-specific financial expertise, strategic tax planning, and regulatory adaptation mechanisms influence financial performance, thereby contributing to a more comprehensive understanding of the interplay between tax policy changes and firm sustainability.

METHODOLOGY

This study employed an explanatory research design to assess the impact of digitalization, tax and regulatory changes, and law enforcement on the economic activities of food manufacturing companies. The design enabled an in-depth analysis of causal relationships between these factors. Primary data was collected using structured questionnaires from industry professionals in the Industrial Area, Nairobi, ensuring the capture of relevant and up-to-date information aligned with the study's objectives.

The target population consisted of all registered food manufacturing companies in the Industrial Area, Nairobi. The unit of observation was the owners or managers of medium-sized firms, totaling 200 respondents. These firms were categorized into various sectors, including dairy and meat products, bakery goods, grain milling, beverages, and fruit and vegetable processing. A simple random sampling technique was used to ensure fairness and eliminate bias in data collection. Given that the population size was manageable for a comprehensive study, a census approach was adopted, incorporating all 200 targeted owners or managers. Only primary data were collected for the study. Structured questionnaires were distributed using a drop-and-pick method to ensure a high response rate. To enhance efficiency and reliability in data collection, two trained research assistants facilitated the process.

FINDINGS

Descriptive results

The descriptive results indicate that both tax digitalization and regulatory changes have relatively high mean scores of 3.8 and 3.9, respectively, on a likely 5-point scale. This suggests that respondents generally perceive these factors as significant. The standard deviations of 0.8 and 0.9 indicate moderate variability in responses, meaning some respondents had differing opinions, but overall, there is consistency in perceptions. With a sample

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue IV April 2025

size of 185, the findings are statistically reliable for drawing insights. The results suggest that both tax digitalization and regulatory changes are important considerations, with regulatory changes being slightly more influential based on the mean score

Table 1 – Descriptive results

Variables	Mean	Std Dev.	Sample (N)
Tax digitalization	3.8	0.8	185
Regulatory changes	3.9	0.9	185

Source: (Field data, 2024)

Correlation results

A correlation test was carried out in this study to measures the strength and direction of the relationship between study variables. This helped shade light on the kind of association that exists between variables and the potential connections or influences that was critical for data interpretation. The correlation results show a positive and significant relationship between financial performance and both tax digitalization (r = 0.583, p = 0.000) and regulatory changes (r = 0.544, p = 0.000). The p-values (0.000) indicate strong statistical significance at the 0.05 level, meaning the relationships are unlikely to be due to chance. The moderate-to-strong correlations suggest that improvements in tax digitalization and regulatory changes are associated with better financial performance. Tax digitalization has a slightly stronger correlation with financial performance than regulatory changes, implying that digital transformation in taxation may have a greater impact on financial success.

Table 2 – Correlation results

		Tax digitalization	Regulatory changes	Financial performance
Financial performance	Pearson Correlation	.583**	.544**	1
	Sig. (2-tailed)	0.000	0.000	
	N	185	185	185
**. Correlation is significant at the 0.05 level (2-tailed).				

Source: (Field data, 2024)

Regression results

The regression analysis provided deeper insights into the influence of tax digitalization and regulatory changes on financial performance. The constant value of 0.46 (p = 0.000) represents the baseline financial performance when all predictors are zero. This suggests that even without considering tax digitalization and regulatory changes, financial performance has a positive starting point. Tax digitalization has a small but statistically significant positive coefficient (B = 0.026, p = 0.006), indicating that an increase in tax digitalization slightly enhances financial performance. However, its lower Beta value (0.023) and t-value (0.418) suggest that its impact is weaker compared to regulatory changes. On the other hand, regulatory changes have a much larger coefficient (B = 0.413, p = 0.000), showing a stronger and more significant positive effect on financial performance. The high Beta value (0.389) and t-value (6.123) reinforce its substantial contribution.

The model fit indicators further explained the relationship between these factors. The R-value (0.585) shows a moderate-to-strong correlation between the independent variables and financial performance. The R-Square (0.342) reveals that 34.2% of the variation in financial performance is explained by tax digitalization and regulatory changes, meaning other factors beyond these also contribute significantly. After adjusting for the number of predictors, the Adjusted R-Square (0.332) still indicates that 33.2% of the variance in financial performance is accounted for, demonstrating a reasonable model fit.

The ANOVA results confirm the model's statistical significance. The F-statistic (35.033, p = 0.000) indicates that the overall regression model is meaningful and that tax digitalization and regulatory changes jointly influence financial performance in a significant way. The residual sum of squares (2.126) compared to the regression sum of squares (1.104) suggests that the included variables explain a substantial portion of the variance in financial performance.

Thus, the findings indicate that regulatory changes have a more substantial impact on financial performance than tax digitalization, although both factors are statistically significant. The model moderately explains financial performance, implying that additional factors contribute to overall outcomes. The significance of the regression model (p = 0.000) highlights the importance of regulatory frameworks and tax policies for firms seeking to enhance financial outcomes.

Table 3 – Regression results

Variable	**Coefficient (B)**	**Std. Error**	**Beta**	**t**	**Sig.**
(Constant)	0.46	0.091		5.082	0.000
Tax digitalization	0.026	0.063	0.023	0.418	0.006
Regulatory changes	0.413	0.067	0.389	6.123	0.000
Model Summary					
Statistic	**Value**				
R	.585[a]				
R Square	0.342				
Adjusted R Square	0.332				
Std. Error of Estimate	0.08874				
ANOVA					
Source	**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
Regression	1.104	2	0.276	35.033	0.000[b]
Residual	2.126	181	0.008		
Total	3.23	185			
a. Predictors: (Constant), Tax digitalization, Regulatory changes					
b. Dependent Variable: Financial performance					

Hypotheses testing

The hypothesis testing results below indicated that both tax digitalization and regulatory changes significantly impact financial performance. The p-value for H_{01} (0.006) is below the standard significance level of 0.05, leading to the rejection of the null hypothesis. This implies that tax digitalization has a statistically significant effect on financial performance. Similarly, H_{02} is rejected as its p-value (0.000) is also below 0.05, indicating that regulatory changes significantly influence financial performance.

Thus, the findings suggest that digitalization of tax processes and regulatory changes are critical factors affecting financial performance. Organizations should, therefore, embrace tax digitalization to enhance efficiency and compliance while also adapting to regulatory changes to maintain financial stability and growth. These results underscore the need for policymakers and businesses to align their strategies with digital tax innovations and evolving regulatory frameworks to optimize financial performance

Table 4 – Hypotheses results

Null Hypothesis (H0)	Significance Value (p-value)	Verdict
H_{01}: Tax digitalization has no significant effect on financial performance.	0.006	**Reject H_{01}**
H_{02}: Regulatory changes have no significant effect on financial performance.	0.000	**Reject H_{02}**

Source: (Field data, 2024)

CONCLUSION

The study concludes that both tax digitalization and regulatory changes significantly impact the financial performance of food manufacturing companies in Kenya. Descriptive findings indicate that industry players acknowledge the importance of these factors, with regulatory changes perceived as slightly more influential. Correlation analysis confirms a positive and statistically significant relationship between financial performance and both tax digitalization and regulatory changes. Regression results further reveal that regulatory changes have a stronger impact on financial performance than tax digitalization, explaining a moderate portion of performance variation. The rejection of both null hypotheses highlights the crucial role of tax policies and regulatory frameworks in shaping financial outcomes within Kenya's food manufacturing sector.

RECOMMENDATION

Food manufacturing companies in Kenya should embrace tax digitalization to enhance compliance, operational efficiency, and transparency in financial management. Policymakers should implement supportive digital tax frameworks tailored to the industry's unique needs. Additionally, regulatory bodies should ensure that policy changes are predictable and aligned with the sector's growth objectives. Businesses must also invest in compliance mechanisms to mitigate financial risks associated with regulatory shifts. Future research should explore other factors influencing financial performance in the food manufacturing industry, such as supply chain efficiency, market trends, and technological innovations.

Implication of the Findings

The study's findings have significant implications for food manufacturing companies, policymakers, and regulatory authorities in Kenya. Companies should adopt digital tax solutions to enhance efficiency, while policymakers must recognize the substantial influence of regulatory changes on financial performance and establish stable policies that foster business growth. The findings highlight the importance of regulatory adaptability, encouraging food manufacturers to develop strategies that accommodate evolving tax and compliance requirements. Additionally, the moderate explanatory power of the model suggests that other factors, such as raw material costs, consumer demand, and production technology, also influence financial performance, necessitating further industry-specific research.

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