

**MACROECONOMIC ENVIRONMENT AND FINANCIAL PERFORMANCE OF  
SMALL AND MEDIUM ENTERPRISES IN NAIROBI CITY COUNTY, KENYA**

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**A PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS, ECONOMICS AND  
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UNIVERSITY**

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**DECLARATION**

This thesis represents my own new effort and is yet to be submitted for a degree at any other university.

Signature: .....  ..... Date: .....12/04/2023.....

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## **DEDICATION**

I devote this thesis to my deceased parents, my spouse, and close associates in appreciation of how they were supportive and encouraging of my continued education.

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## **ABBREVIATIONS AND ACRONYMS**

<b>GoK</b>	Government of Kenya
<b>IMF</b>	International Monetary Fund
<b>MSEs</b>	Micro and Small Enterprises
<b>NACOSTI</b>	National Commission for Science, Technology and Innovation
<b>NIM</b>	Net Interest Margin
<b>ROA</b>	Return on Assets
<b>ROCE</b>	Return on Capital Employed
<b>ROE</b>	Return on Equity
<b>ROI</b>	Return on Investment
<b>SMEs</b>	Small and Medium Enterprises
<b>SPSS</b>	Statistical Package for the Social Sciences
<b>UK</b>	United Kingdom
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>USA</b>	United States of America

## OPERATIONAL DEFINITION OF TERMS

### **Economic Environment Factors**

deals with conditions that are present throughout the economy as opposed to just one specific industry or area. It was measured in the study in terms of taxation, inflation, government laws and policies and government activity.

### **Financial Performance**

Refers to a monetary indicator of a firm's performance relative to its objectives, plans, and all associated activities. It was proxied by effective marketing strategies, employee training and development and others.

### **Government Activity**

Refers to actions performed by government agencies with the intention of benefiting the public and as required or permitted by law. It was measured in the study by training, government support and incentive structure.

### **Government Laws and Policies**

Refers to strategic initiatives and guidelines memos, which is communicated and implemented by means of laws and policies, guides, inquiries for recommendations, agreements on contracts, and legal actions. It was measured in the study by

policies on SMEs, technology upgrade and business registration.

**Inflation**

Described as a continual surge in the general price scales of an economic system. It was measured in the study in terms of increases in prices; increased operational costs and demand-pull inflation.

**Taxation**

can be described as a mandatory fee that the nation levies on its people, companies, and other entities as earnings that enable the government to link its costs, as opposed to a fine for a violation or an instantaneous exchange of products. It was measured in the study in terms of levies, deductions and total income.

## ABSTRACT

Kenya's small and medium-sized businesses are vital to the country's growth and development economically. Nevertheless, the majority of Kenyan SMEs are not doing well financially; in the last five years, 2.2 million SMEs have closed, and 46.3% of SMEs have closed before their first year of operation has ended. Therefore, this research aims at investigating the effect of economic environment factors on the performance of Nairobi County's small and medium enterprises in Kenya. Particularly, taxation, inflation, government laws and policies and government activity effect was assessed on Nairobi County small and medium enterprises performance. Open system theory, balanced scorecard theory, Gibbs theory, and institutional theory served as the study's foundations. Descriptive design was used. Targeted population constituted five hundred and thirty-two (532) of these businesses in Nairobi County, Kenya. A sample size of one hundred and fifty (150) firms was chosen utilizing stratified simple random sampling techniques, with the owners or managers acting as the participants in the survey. Information from primary and secondary sources was used. Structured, closed-ended surveys were the main tool used to gather data; a document review guide was utilized to get secondary information from these businesses' financial records between 2018 and 2023. The study instrument's validity and dependability was examined. To examine the data, both descriptive and inferential statistics was utilized. The researcher utilized a panel regression analysis. Autocorrelation, heteroscedasticity, multicollinearity and normality assessment were performed as tests for diagnostic. All ethical considerations were duly followed. Finding demonstrated that taxation possess an inverse and insignificant effect on the enterprises financial performance; inflation revealed a significantly positive effect on the enterprises financial performance; government laws and policy demonstrated also significant positive effect on the enterprises financial performance; Furthermore, government activity disclosed an insignificant but positive effect on the financial performance of these enterprises. The government should consider revising tax policies to create a more favorable environment for these enterprises. Specifically, the government should explore reducing tax rates and simplifying tax compliance processes to alleviate the financial burden on SMEs, enabling them to allocate more resources towards growth and innovation. Additionally, implementing targeted tax incentives and support programs could encourage formalization and compliance among SMEs, ultimately fostering a more robust business ecosystem that contributes to economic development and job creation in the region.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Study Background

Any nation's revenue growth is dependent on four nationwide economy sectors: transportation, amenities, farming, as well as manufacturing (Dobes, Virglerova & Kramolis, 2019). Organizations of various dimensions as well as beliefs exist in all areas of the economy as a whole and make contributions to generally economic expansion (Dvorsky *et al.*, 2020). The economy of any country stands to benefit greatly from Small and medium-sized enterprises (SMEs), especially when it comes to employment; emergence, inventiveness, productivity, along with expansion of the economy (Cepel, 2019). The emergence and expansion of businesses of all sizes are dependent on an ideal business atmosphere (Meyer & Meyer, 2016). The enterprise setting, encompassing the framework according to which organizations work as well as their strategic plan, is extremely dependent on company operations (Rozsa, Formanek & Manak, 2019). The organization setting has an important effect on advancement, productivity, and possibilities for company expansion (Kolkova, 2020).

In Europe, they are categorized as business with 250 employees then a optimum number of 500 employees in the United States (Larios-Francia & Ferasso, 2023). SMEs comprise 65% of the US GDP, 67% of the private sector labor force, and a sizable portion of 99.7% of US employment categories. SMEs make up 99% of businesses in China, and they provide 60% of the country's economic growth. SMEs in China are financed by a variety of sources, including personal savings, bank loans, and family funds (Dini, Stumpo & Eueopea, 2020). In Japan, SMEs account for 60% of GDP, 70% of employment, and greatly contribute to the country's

economy. Nevertheless, they only provide 50% of the nation's value, despite their success in the economy (Khan, 2019). The Czech Republic and Slovakia render substantial attempts to encourage enterprises of all sizes (via financing, modifications to legislation, and so on) (Belas *et al.*, 2018).

Remarkably similar are the industry-specific traits of SMEs in Central European nations. SMEs primarily function in commerce, manufacturing, as well as various other industries that do not fall into a single of the tracked groupings. The Slovak Business Agency (2018) study establishes the key components of an excellent company atmosphere by comparing the business circumstances for SMEs in Central European nations. All of these variables are classified into four categories: institutionalized as well as regulatory structures, accessibility to markets, availability of resources, as well as a culture of entrepreneurship. The regulation constitutes one of the most important domains can significantly impact the firm's setting both now and in the future (Lyakina *et al.*, 2019).

In Africa, Gross Domestic Product (GDP) and employment production contributions of SMEs are similar. In Sub-Saharan Africa, almost 95% of businesses are owned by SMEs. 70% of manufacturing jobs in Ghana are held by SMEs, which generate over 50% of the GDP of the nation (Kaberia & Muathe, 2021). Unfortunately, as a result of challenges such industry competitiveness, government laws, and a lack of managerial expertise, the efficacy of SMEs has decreased over time in South Africa and other African countries (Sobende, Herbst, Twum-Darko, & Noruwana, 2021). The effectiveness of SMEs in Ghana has been found to be threatened by problems like the use of outdated materials and improper human resource technology (Donkor *et al.*, 2020). SME's are Nigeria's engine and the foundation of the nation's economic structure. In Nigeria, the number of entrepreneurs has increased, employment have

been generated, poverty has decreased, and SMEs have been successful in connecting growth for big industries and they make up 50% of the GDP and 97% of all enterprises (Tahir *et al.*, 2021).

In Kenya, SMEs have proven to be relevant to the economy through the opportunities it provides for employment to a noteworthy percentage of the nation's populace, more so than any other industry (Gathungu & Bairu, 2019). Comparatively speaking, in the official sector in 2015, there were 120,000 new employments (14%) but in the unregulated SME sector, 720,000 new jobs (86%) were created (Kenya National Bureau of Statistics, 2020). According to Krishnan *et al.* (2019), they employ over above 76% of the workforce with the number standing at around 14.9 million people and with 7.4 million SMEs, accounting for almost 80% of all businesses in Kenya, and generate just under a quarter of the nation's GDP. However, over the course of the preceding five years, 2.2 million SMEs in Kenya were shut down; on average, businesses closed after 3.8 years. Notwithstanding their importance, SMEs face a myriad of challenges that have an impact on their performance (Shumba, 2021). For example, SMEs have been having trouble satisfying client demands as a result of delayed product delivery. Customer discontent and poor business performance follow as a result (Mutunga & Makhamara, 2020).

Most improving countries' financial affairs are challenged by a plethora of prompts that influence the way they perform internally or externally. Many firms have failed as a result of high borrowing rates, price increases, numerous taxes, and insecurity these firms have staggered, collapsed, to the point some have moved within or outside the nation's geographical area because of the negative atmosphere brought on by social and economic problems. The Nigerian the economic climate consists of three components: internalized, profitable, and outside forces. According to Olabisi and Gbadamosi (2016), the Nigerian business atmosphere, both internally and externally, includes the structure, promotional activities, monetary, employees, and

operational aspects of the companies all of and this can be managed easily by the corporation. Vendors, competition, buyers, labor, as well as goods are the situations of competition in which firms in the industry must contend for gaining a competitive advantage. The economy's growth, technological advancements, and legislative, ideological, and social developments are the most important external variables. All of the aforementioned environmental elements are involved in business operations and can occasionally be advantageous to the company. These components include operations and transactions including employment, consumers, shareholders, super, buyers, competitors, and so on (Ibrahim & Abu, 2017).

Kenya's marketplaces effectiveness is heavily reliant on the character of the economic factors, as it constitutes one of Africa's newly industrialized nations. According to Kirui *et al.* (2016) these parameters have been suggested to be contributing factors to current business fluctuation as well as could result in a sales problem. Based to the International Finance Corporation (IFC), all developing-country sectors are classified as developing. The Kenyan business therefore constitutes one among the worldwide markets in development. Low product quality, a low rate of turnover, not many progressing businesses, and inadequate dissemination of knowledge constitute the industry. Kenyan policy on SMEs clearly indicates that the industry is not merely a provider of products and amenities, but additionally an engine of teamwork, creativity, and fostering an entrepreneurial culture, all of which are critical for entrepreneurial growth and industrial development. This industry should primarily address the issues of beginning beneficial and practical job prospects, encouraging growth in the economy, and eradicating impoverishment in the entire nation (Mohammed, 2019).

### **1.1.1 Economic Environment Factors**

The economic environment is part of the corporate setting which has to do with an assortment of drivers or variables within as well as outside the boundaries of an organization that are likely to be affecting its operations. These environmental factors evolve over duration and can present both a possibility and a risk to the business. The economic environment is determined by the overall economic indicators of the nation or geographical area whereby the enterprise structures operate. Because the businesses of today operate in an international framework, their financial aspect has become extremely complex, causing additional ambiguity and difficulty for businesses and executives (Richard, 2013). When choosing and identifying a company's opportunities, the status of the economy is crucial. This is because a growing market offers a functional dimension for both newly established businesses and those who are just starting out (Ogundele, 2015).

The economic setting involves the rate of exchange, unemployed people, supply/demand trends, expansion of the economy, financing rates, the inflation rate and these all influence how SMEs operate. These elements have significant effects on how enterprises function and how they make choices. Loans rates, for instance influence the expense of firms' financing equally as a result, the degree to which an organization expands and develops. In a market, rates of exchange influence the expenses of goods being exported as well as the availability and cost of items that are imported (Liman, Burah & Jibir, 2021). Companies operate in an economic setting that influences and is impacted by their operations, as well as parameters that are changing, engaging, alongside unreliable which in turn are influenced partly by governance policies pertaining to the economy (Ojimba *et al.*, 2023).

Taxation refers to the legislative and administrative procedures by which a nation or government imposes fees that are mandatory on citizens and businesses in order to fund public infrastructure and facilities (Aringo, 2023). These taxes can be applied on a number of revenue streams, such as capital gains, income, real estate, products and services, and other similar financial opportunities. Regardless of regional, local, or federal, taxes are the main source of income for public expenditures in governments centers (Orwa, 2019). Furthermore, taxes serve a number of purposes, such as regulating and impacting behavior and economic activity, defending homegrown startups, and encouraging social justice among a country's citizens (Gravelle, 2023). The authorities use the revenue collected through taxation to cover its financial obligations and to connect the basic requirements of the general population (Aringo, 2023). To produce goods, the governing body levies different taxes (Wadesango *et al.*, 2021). Taxation has grown to be the primary driver of SMEs' poor success. It was measured in the study in terms of levies, and deductions.

Inflation is a general rise in the consumer price index, which measures changes in prices for various goods and services using a weighted average (Walde, 2022). Inflation increases output when the economy is running at maximum capacity (Maimunah & Patmawati, 2019). The main cause of this is pay growth that isn't keeping up with the expansion in the amount of things produced or services rendered (Nwachukwu, Ezu & Amakor, 2023). Due to increased competition for a limited number of commodities, higher total costs are predicted, which would result in a significant decline in income and a loss in the purchasing power of low-income earners (Walde, 2022). Inflation can be described as a sustained rise in an economic system's overall price scales. Inflation successfully decreases a nation's currency's value for purchasing. Small or moderate degrees of inflation in a nation can be beneficial to the private sector by

acting as a reason to produce (Maimunah & Patmawati, 2019). Significant amounts of inflation, on the other hand, may negatively impact the profitability of an organization by increasing the price of components and decreasing the market demand for its final product (Wanjiku, Bosire & Matanda, 2021). Inflation is the propensity for prices of products and services to rise at a specific point in period of time. Inflation may reduce people's ability to buy things. As a result, a favorable connection among business price increases and turmoil may exist (Kristanti, Rahayu & Isyuardhana, 2019). Consumer price index is an apt measure for measuring inflation hence, was adopted in this study.

Government laws and policies refer to strategic initiatives, guidelines, and memos which is communicated and implemented by means of guides, inquiries for recommendations, agreements on contracts, and legal actions (Ifekwem, 2019). SMEs that lack governing laws usually limit their ability to improve their profitability and growth. Government agencies certainly have an impact on the growth rate of business ownership (Musabayana, Mutambara & Ngwenya, 2020). Policy decisions can essentially find the nations or region's business owners interactions by enacting particular rules that encourage entrepreneurial activity and also by establishing an overarching regulatory framework which is advantageous to business (Ifekwem, 2019). It involves an assertion about the political actions, goals, and plans of the government for a specific cause (Anjaneyulu, 2024). Federal backing policies for SMEs are strategies or programs used by the governing body to impact and decide how decisions are made that promote economic development by making certain the setting is sufficiently safeguarded for companies to operate (Musabayana, Mutambara & Ngwenya, 2020). It was ascertained in terms of policies on SMEs, technology upgrade and business registration.

Government activity refers to actions performed by government agencies with the intention of benefiting the public and as required or permitted by law (Kristanti, Rahayu & Isywardhana, 2019). Government activity in enterprises is developing an advantageous atmosphere, high-quality facilities and proprietary rights, as well as providing a means of obtaining cost-effective and necessary financing for national growth and development sectors. According to Bubou, Siyanbola, Ekperiware, and Gumus (2019), government support is critical for SMEs to accomplish favorable long-term outcomes. Tax breaks, funding, development, as well as market links are some of the unique activities used by government entities to foster SMEs. Tax structures, in along with encouraging expansion, capital investment, as well as inventiveness, enhance commerce worldwide as well as flexibility (Geleta, 2019). The most significant concerns for SMEs are reducing the administrative cost and preserving adherence, and ensuring that their informal operation considers incentives as well as the implications of their activities (Bubou, Siyanbola, Ekperiware, & Gumus, 2019). It was considered in terms of training, government support and incentive structure.

### **1.1.2 Financial Performance**

A firm's financial performance reveals how effectively it manages its resources, income, and earnings (Matar & Eneizan, 2020). The ability of a firm to maximize the investments made by its shareholders can be used to explain its financial performance. Financial performance is a metric utilized to evaluate how well a corporation is doing in respect to its goals, plans, and results (Agola, 2019). An important component of every business is its financial performance, which may be evaluated according to many criteria such as the company's competitiveness, potential, financial stability of the management, and the reliability of both present and future contracts (Dufera, 2020). A company's financial performance is frequently a reflection of its ability to

effectively manage its revenues, financial gain, as well as resources (Matar & Eneizan, 2020). Assessing it enables managers and researchers to assess specific businesses by executives and firms (Nzyoka, 2022).

A company's ability to maximize the investments made by its owners can be used to explain its financial performance (Bosire & Muturi, 2020). The comparison of a company's actual results to its predetermined goals, strategies, and objectives determines its financial performance (Nzyoka, 2022). It can be understood as a company's financial standing relative to other businesses in the same industry (Agola, 2019). An important component of every business is its financial performance, which may be evaluated according to a number of criteria such as the company's competitiveness, potential, financial stability of the management, and the reliability of both present and future contracts (Dufera, 2020). Financial performance indicators are chosen in accordance with the setting of the entity(s) that are being tracked as a result of specific opinions regarding results (Bosire & Muturi, 2020). The metrics chosen indicate the outcomes obtained, whether either favorable or adverse.

Metrics used to ascertain a firm's success include financial performance indicators including gross and net margins, returns on equity, economic value added, return on equity less cost of equity, and returns on capital utilized (Memba, 2018). Other performance metrics include cash flow measurements like free cash flow over sales and growth indicators like historical revenue growth. It is best to use metrics like projected profitability, cash flow, and growth to assess a company's success (Kiriianki, 2021). Often used performance metrics include net interest margin (NIM), earnings per share (EPS), and the price-to-earnings (P/E) ratio. Net interest income is divided by total assets to get the NIM variable. Promise, Achoronye, Ekeamadi, and Odukwu

(2024) use the ratio of before-tax profit to total assets and net interest margin to evaluate finance performances.

Financial performance seeks to explain why there is a slow adoption of small-to-medium business expansion and contributions to the manufacturing industries as a critical method for improving expansion rates, generating enough employment possibilities, as well as accomplishing a sustained economic expansion (Nzyoka, 2022). Return on Assets (ROA) is one of the most often used profitability assessment metrics. It is employed to evaluate the profitability of an industry based on the revenue produced by all of its assets (Al-Qudah, 2018). According to Hanafi (2018), a high return on assets (ROA) indicates how well a business can manage its resources. ROA is a commonly utilized metric for evaluating managerial effectiveness. It is a short-term indicator used to evaluate the financial achievements of businesses. A company's profitability is evaluated based on how its shareholders' money generates revenue (Al- Qudah, 2018). This performance was ascertained via ROA which was evaluated by dividing net income of an enterprise by the sum of all its assets.

### **1.1.3 Small and Medium Enterprises in Kenya**

In Kenya, a small business is classified as a SME if its annual sales are less than one million Kenyan Shillings. Micro firms employ less than ten individuals, whereas small businesses employ between ten and forty-nine persons. On the other hand, 50–99 individuals work for a medium-sized company. In Kenya, these various types of SMEs are known as micro, small, and medium enterprises (MSMEs), which are businesses with one to 99 workers with an annual revenue of fifty million Kenyan shillings (Cheruiyot, 2023).

The amount of an enterprise's yearly turnover is another way to categorize businesses in Kenya. As per the World Bank (2010), businesses are categorized based on their yearly revenue, while

those with a revenue under Ksh. 500,000 are called micro enterprises. Small businesses are those generating turnover per annum ranging from Ksh. 500,000 and Ksh. 5 million, whereas medium-sized enterprises are characterized by a turnover ranging from Ksh. 5 million to Ksh. 800 million (Ndolo, 2021). In Kenya, the SME sector accounts for over 70% of all employment. For young Kenyans who are considered unemployed otherwise, it is their primary source of employment. Nonetheless, the industry has encountered a wide range of difficulties, including exposure, low funding, unfavorable laws, and rivalry from more established businesses (MSME, 2015).

SMEs are active in the manufacturing, trade, as well as services divisions of economic activity. In Kenya, about one-third of SMEs are found in urban regions, while nearly two-thirds are situated in rural areas. Because it is essential to the creation of jobs and revenue, the goods supply and amenities, and the encouragement of competitors, industrial development, as well as inventiveness, the sector is seen as an economic engine. It makes up over 75% of all firms, 4.6 million individuals (30%), 87% of all new employment, as well as 18.4% of the GDP are employed by it (Isaboke, 2018).

#### **1.1.4 Small and Medium Enterprises in Nairobi City County**

A nation's SMEs are its main drivers of economic growth and development (Gherghina *et al.*, 2021). SMEs, as opposed to large corporations are confronted with difficulties such as resource inadequacy and vulnerability to market disruptions. While there is empirical data regarding the strategic orientation effect on business performance, most of it relates to large corporations in developed nations rather than SMEs in developing nations like Kenya. The lack of empirical literature may be attributed to the unique business environment in which SMEs in developing countries operate.

Nairobi City County constitutes one of the country's 47 counties. The Nairobi City County was founded in 2010 by the Kenyan Constitution to take over the abandoned Nairobi City Council. It is governed by several Acts, including the Devolved Governments Act and the Cities and Urban Areas Act. The largest and fastest-growing city in Africa is Nairobi. It is also the first territorial, economic, and institutional center of Kenya. As to the findings of the nationwide comparison survey, around 17% of all small and mid-sized businesses in Kenya receive funding from Nairobi (World Bank, 2014). In accordance to the Nairobi County Licensing Office (2015), the Nairobi County Government has 30252 enrolled businesses that are small or medium-sized.

Businesses were also gaining popularity within numerous prospective entrepreneurs due to the restricted resources required to start. Nonetheless, SMEs possess a substantial level of shifts, which limits one's ability to establish more extended periods of productive income while also potentially controlling the highest quantity of prosperity and losing employment. This happens since the SMEs' section is infamously unpredictable and encounters a high rate of a business conclusion and diminution, and as a result of this, the public sector is presently diligently attempting activities aimed at helping with the advancement of the Enterprise segments. SMEs are crucial to the growth of the economy and the generation of jobs (Nguyen, Le, & Do, 2022).

## **1.2 Statement of the Problem**

Given that other areas of revenue generation have surpassed SMEs' contributions to GDP, concerns have been raised about both the efficacy and financial benefits of SMEs (World Bank, 2020). Most SMEs in Kenya have not performed at their best financially. According to the KNBS (2021) study, SMEs' sales turnover has been steadily declining. 2.2 million SMEs have wind up in Kenya in the last five years, despite their significance (KNBS, 2020). This analysis indicates that the majority of shuttered enterprises were largely in the wholesale and retail

sectors trade, which made up 73% of the shutdown overall. 46.3% of SMEs shut down before their first year of business concluded (2020 Economic Survey Report). Three out of every five small and medium enterprises tend to collapse shortly after their establishment, highlighting ongoing concerns about their financial performance, as many of these businesses struggle to achieve consistent improvement (Mwende, Muturi & Njeru, 2019).

400,000 MSEs die annually, based on a survey done by the Kenya National Bureau of Statistics (KNBS, 2020). In the preceding five years, 2.2 million small businesses have closed. According to Chege and Wang (2020), the majority of Nairobi County SMEs usually close due to a lack of innovation, growing operating costs, declining revenue, and losses to the company. Macroeconomic environment factors are critical among the key factors in the company's success, deserving constant attention. In business today, which is fraught with frequent changes, understanding what elements would result in improved performance and the methods by which it can be determined is critical to the sustainability of all organizations, regardless of size (Okeke, *etal.*, 2023). The investigation evaluated the effect of macroeconomic environment on Kenya's SMEs in the County of Nairobi's financial performance.

Studies have been carried out on economic environment factors and performance. Ojimba, Okafor, Okeke and Mbah (2023) investigated the economic setting and performance of organizations in Anambra State pharmaceutical businesses. Xu, Li, Liang, and Rahman (2019) conducted research to assess the probability distribution of the cost of taxes for micro and small-sized businesses in Taizhou. (China). Atugeba (2021) examines how the rate of inflation affects the profitability of chosen (SMEs) in Ghana's Upper East region. These studies were carried out outside Kenya, as economic environment differs from that of Kenya, thereby providing a

contextual gap. Ogbonna, Onuoha, Chukwu and Ojeaburu (2020) investigated the connection among taxation and the financial outcomes of listed SMEs using secondary data collection.

Musabayana, Mutambra and Ngwenya (2022) determined the magnitude whereby government policies influenced the success of SMEs using mixed method technique. Mwangemi, Wilson, and Mung'atu (2017) investigated the impact of finance access and policies from the government on the success of Kenyan SMEs using Chi-square to analyze data, these studies provided methodological gaps. In evaluating government involvement effect on the level of innovation in small manufacturing businesses in Tigray, Ethiopia, Hayleslasie (2023) primarily examined government activities without considering other elements of the economic environment, creating a conceptual gap. Therefore, to bridge this gap, the Study considered economic environment factors effect on financial performance of SMEs in Kenya.

### **1.3 Study Objectives**

#### **1.3.1 Objective**

The investigation assessed macroeconomic environment influence on financial performance of Nairobi City County's SMEs in Kenya.

#### **1.3.2 Precise Objectives**

- i. To assess taxation effect on SMEs in Nairobi City County's financial performance of SMEs in Kenya
- ii. To establish the effect of inflation on Nairobi City County's SMEs financial performance in Kenya
- iii. To examine government laws and policies effect on SMEs in the City of Nairobi County's financial performance in Kenya.

- iv. To determine government activity influence on the SMEs financial performance in Kenya's Nairobi City County.

#### **1.4 Hypotheses**

- H<sub>01</sub> Taxation has non-significant influence on the SMEs in Nairobi City County's financial performance in Kenya.
- H<sub>02</sub> Inflation has insignificant effect on the Nairobi City County's SMEs financial performance in Kenya.
- H<sub>03</sub> Government laws and policies have no significant effect on the financial performance of SMEs in Nairobi City County, Kenya.
- H<sub>04</sub> Government activity has no significant effect on the financial performance of SMEs in Nairobi City County, Kenya.

#### **1.5 Study Significance**

In this investigation, governmental agencies would learn about the current obstacles existing in SMEs and devise solutions for tackling them. As a result, it acts as an example to identify services that are still not properly utilized. The research serves as a wake-up call to business owners and others in the community about the economic environment factors that exist. Furthermore, the research investigated whether or not economic environment factors contributes either advantageously or adversely to the performance of SMEs. This research enables business owners to enhance their abilities and raise their living standards by advancing them from their present situation to a higher commercial developmental stage where they can contend for goods of superior quality. The study can be helpful as an outline for academics, scholars, and investigators conducting research on macroeconomic environment factors and performance in different industries. It also contributes to improving our comprehension of economic

environment factors and the effect they have on the efficiency of SMEs in Nairobi County, Kenya.

### **1.6 Study Scope**

The investigation's purpose was to establish how elements of the economic environment affect SMEs' financial performance. Nairobi City County's SMEs were the investigation focus. Taxation, inflation, government policies and laws, and government activity was among the studied factors. Nairobi SMEs was the context with the study utilizing the time period from 2018-2023. The survey deployed primary and secondary information. Already existing information secondarily was obtained through a review guide document analyzing the chosen SMEs financial records, while new information from respondents primarily was gathered via a questionnaire structured with question that are closed-ended. Both descriptive and inferential statistics were applied, and panel regression analysis was conducted for the factors effect.

### **1.7 Study Limitations**

Some of the interviewees who were consulted felt hesitant to provide details out of worry that it might be utilized to harass these individuals or printing an adverse impression regarding them or their business. A few could possibly refuse completing out surveys. An introductory letter obtained from the university was attached, guaranteeing participants that the data they submit was kept confidential and used only for educational purposes.

The investigation could experience difficulties in gathering details from participants because the details necessary was dependent on subject matter feelings, thoughts, views, and opinions that are not easily quantified and/or independently confirmed. Because the investigation tools were lacking in their names, the investigator would inspire participants to take part despite withholding any details.

## **1.8 Study Organization**

Chapters in 5 separately constituted the investigation. One contains the investigation's introduction, the issue's statement, the investigation's goal, its research questions, the significance of the findings, its constraints, its assumptions, and its organizational structure. The literature is examined in the second chapter, which also looks at the conceptual framework, research gaps, and theoretical and empirical reviews. The study's design, the population it is intended to serve, the sampling strategy, the rationale behind the sample selection, information gathering tools, survey forms, research tools reliability and validity, information evaluation, and considerations of ethics are contained chapter three research methodology discussion. Chapter four encompassed of the analysis of data and discussion and overview of the finding summary, conclusion and recommendations detailed in fifth chapter.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

An overview of academic research on economic environment factors and their effects on SMEs' performance financially is included in the section that follows. It draws attention to the conclusions reached by other researchers who have studied a related field of study. This chapter presents the research gaps, conceptual framework, theoretical evaluation, empirical assessment, and summary.

#### **2.2 Theoretical Review**

##### **2.2.1 Open System Theory**

Bertalanffy (1956) propounded the Theory of Open Systems which states that the organization's social and structural elements are perfectly coordinated, integrated, and consistent with its ideational and symbolic nature. According to Bertalanffy (1956), businesses and societies influence and transform their surroundings, which in turn has an impact on their operations. The theory recognizes the difficulties encountered by each organization. The concept basically indicates a line of thinking which believes that the success of a business is heavily contingent on the circumstances in which it functions (Shala, Prebreza, & Ramosaj, 2021). The global business climate is turbulent, and companies find one another putting in a variety of requirements that are economic, partisan, authorized, technical, or societal in the environment. This environment provides companies with the capacity to acquire the needed assets and plans to ensure that they survive while enhancing their efficiency, leading to transformation.

It assists in recognizing the institutions that are frequently impacted by the actions of the people of a country. When marketplaces move in a particular direction, it impacts interest and how well

products perform. As the global community grows more conscious of environmental issues and changing climates, communities, countries, and businesses implement pollution-control regulations, such as Kenya's plastic ban, that influenced the packing of materials or products that were imported and exported. According to Scott (2002), companies and communities carry out business in a manner that frequently affect the firm, in order to change their economical surroundings, whereas they are impacted by the aforementioned external alterations in their collaborative settings both locally and globally. This type of two-way significant substitution was known to induce adaptation.

Businesses and communities are thus clearly considered to be open systems that are continually changing and influencing one another. Someone also changes and impact their surroundings by enacting regulations and establishing appropriate norms. The Kenyan trade business can thus be regarded as an open system, owing to the reality that business success was heavily influenced by environmental elements, whether monetary or social. This theory therefore supports inflation.

### **2.2.2 Balanced Scorecard Theory**

The postulation first was developed by Kaplan and Norton (1991). According to the notion, the Balanced Scorecard should be used to transmit the company's strategy and assist in coordinating internal departmental, organizational, and individual actions toward achieving shared objectives rather than being a control tool for assessing previous performance. Furthermore, according to Kaplan and Norton (1996), the Balanced Scorecard should be utilized as a tool for information sharing, learning, and communication rather than as a means of control. The theory evaluates a company's effectiveness, productivity, and sustainability, which can be determined using a variety of indicators. Because intangible resources were essential to developing revenue for the companies examined, the framework was based on them (Nolan Norton Institute, 1991). These

scholars believed that the company was required to advance the handling of their immaterial resources; they required integrating the practice of immaterial asset evaluation through their organizational mechanisms. The concept of a balanced scorecard readily recognizes the practical factors that contribute to the accomplishments of a company. Customer satisfaction along with retention rates, internally business components, acquiring knowledge, and creativity, for instance, all of which are encompassed in the system's suggested performance evaluation. The balanced scorecard altered the opinions of others of indicators of success for every aspect of their daily lives (Isorite, 2008). This concept has been created by Kaplan and Norton (1992) as companies changed one another to compete in the informational age, and their ability to use intangible resources proved to be far more significant than controlling tangible resources.

Businesses could use the scorecard to track their economic results and advancement when acquiring the abilities needed for potential expansion. Executives can employ the scorecard to develop 4 fresh processes that help enterprises connect. The authors devised a new evaluation of performance approach known as a "balanced scorecard," that supplies management with an immediate other than comprehensive assessment of their business's efficiency (Nisha, 2017). The balanced scorecard's economic metrics indicate the impact of previous decisions. These economic metrics are backed up by three functioning components: client happiness, internal procedures, as well as the business's capacity to acquire knowledge and create businesses that are crucial to its subsequent economic prosperity. Executives can create a balanced scorecard by transforming a company's mission and method into particular targets and measurements (Isorite, 2008). Because the efficiency of SMEs is influenced by environmental and financial variables, the balanced scorecard concepts create reasonable sense. This theory therefore supports government activity.

### **2.2.3 Gibbs Theory**

Gibbs supposition was postulated by Gibbs (1988). The postulation held that, as opposed to reflection as a process within general learning, critical processes exist within reflection itself. Gibbs theory's foundation is predicated on recurring experiencing situations. Gibb's (1988) theory demonstrates the several restrictions that need to be considered when developing programs for SMEs. The framework is adaptable in the sense that it takes into account changes in the needs of SMEs, organizations, and supporting elements for the business sector development. The components of supporting service initiatives are determined by the specifications of small and medium-sized. This approach provides four types of support bundles for SMEs. The first is the structure of policies, which measures the effects of laws on SMEs in multiple manners, as well as the following is the supporting structure, which can be separated into two categories: hardware and software facilitate: software support encompasses coaching, counseling, advisory services, transportation, and further services, while hardware backing encompasses financing services, infrastructures and products. Third, Gibb (1988) states that prerequisites can be regarded from the standpoint of the entire country as an entire entity, the magnitude of the engagement of the local community, and the organizations requirements and people interested in starting new businesses.

Finally, there is the framework of institutions, which is made up of different elements related to organizational ability aimed at promoting SMEs. According to Gibb (1988), entrepreneurs who were starting an enterprise for the initial time required non-financial support bundles more than those who had prior experience in trade. As it relates to this study, Gibb's model could potentially be used to clarify on how the industrial worldwide of SMEs is plagued with multiple challenges, particularly for executives. Insufficient rates of taxation along with straightforward

operations registration and authorization necessities help managers and owners enhance their innovative capacity and the general development of their SMEs for revenue generation, creating employment, as well as lowering poverty rates. Therefore, this theory supports government laws and policies and taxation.

#### **2.2.4 Institutional Theory**

Meyer and Rowan (1977) introduced this theory initially. The theory states that market demands and the organizational working environment can have a significant impact on how organizational formal structures emerge. This approach gives organizational transition and its effects on formal structures more weight. It is related to the way in which organizations legitimize innovations, regardless of whether they improve efficiency. It is seen irrational for these companies to refuse to welcome the innovation because they are forced to do so. Resistance can manifest itself in both an individual and an organization (Modum & Ugwoke, 2013). Institutions only adopt myths about themselves in order to be accepted by other organizations. Organizations decided to control their market by utilizing the "vocabulary of structures". The acceptance and unique presentation of these acknowledged credentials serve to protect the organization's reputation (Amenta, 2005).

Credibility is beneficial to an organization's ability to endure in an institutional framework. However, in the technical environment, the company's competitive position and efficiency could be weakened or hindered; to avoid these negative outcomes, the company uses a number of tactics (Pierson, 2000). Organizational structures in an institutional framework succeed and remain consistent because of institutional pressures. Companies would adopt comparable structures owing to three factors: coercive pressures, mimetic pressures, and normative pressures (Amenta, 2005). The theory relies on cooperation and interaction among its members to boost

production and profitability (Clemens & Cook, 1999). The theory is applicable because it clarifies the connection between profitability and a dynamic work environment. The theory therefore supports financial performance which is the dependent variable.

## **2.3 Empirical Review**

### **2.3.1 Taxation and Financial Performance of SMEs**

Wadesango, Muzenda, Satande and Malatji (2021) examined the obstacles encountered by SMEs when newly enacted taxation regulations were implemented, as well as the economic success of SMEs. The link among the point of transaction transactions tax, wireless payment duties, as well as profitability was studied using a model involving multiple regression. To evaluate the research information and determine the descriptive features of the dependent as well as independent parameters, as well as the findings from the tests, SPSS and EXCEL were utilized. The outcomes designated that SMEs' profitability is significantly impacted by intermediate cash tax transmission. The analysis also showed that bank transfer taxes and wireless cash taxes have a negative impact on SMEs' ability to obtain financing. Furthermore, given that all SMEs in the distribution network agree that wireless digital tax transfer raises transaction costs and lowers the volume of transactions, it was found that there is a negative association between them. The investigation mainly centered on taxation regulations, this inquiry focused on economic environment factors where taxation, government activity, government laws and inflation are parameters of the study.

From 2013 to 2017, Ogbonna, Onuoha, Chukwu and Ojeaburu (2020) investigated the connection that exists amongst taxation along with the fiscal performance of Nigerian listed SMEs. Investment return, ROA, and current ratio were examples of financial performance proxies, whereas company taxation of earnings and training tax were examples of replacement

taxes. The investigators employed an ex post facto investigative design. The study utilized secondary data obtainable from the websites of the ten listed SMEs whose shares are traded on the alternatives security market (ASeM) of the Nigerian Stock Exchange. Deploying multiple regression, correlation, and basic description, the outputs displayed that, during the course of the study, there was little to no association between business income tax and education taxes and return on investment, return on assets, and present ratios pertaining to SMEs in Nigeria. Consequently, it was unveiled that during the study period, taxes in Nigeria had no meaningful relationship to the financial success of SMEs. The inquiry used secondary data; this study sued primary data collection procedure.

Xu, Li, Liang, and Rahman (2019) conducted research to assess the probability distribution of the cost of taxes for micro and small-sized businesses in Taizhou. (China). The investigation determined the tax risk distribution of 3552 micro- and small-scale businesses in the loan insurance financed from January 2016 to August 2018 employing an intermittently adaptable non parameterized comparisons as well as route approach. The study was carried out using an eliminating approach with a nonparametric. The study discovered that, since compared with the standard framework employed to represent governmental taxes as well as lending policies, the effects of small and micro businesses' benefits for the economy offers an analysis of situations that improves the unusual viewpoint of taxes. The investigation was carried out with a nonparametric technique; this inquiry used parametric approach.

### **2.3.2 Inflation and Financial Performance SMEs**

Ojimba, Okafor, Okeke and Mbah (2023) investigated the economic setting and performance of organizations in Anambra State pharmaceutical businesses. The survey's layout was used in this research, enabling for gathering, analyzing, and interpreting of initial responses from the

participants. There were 2495 participants in the study, or 2,495 people in all. The Borg and Gall formula was used to get the collection size of 479. A questionnaire served as the major method of data collection, with supplementary ways being used to address the research's questions. The surveys have been validated by sending forty copies to a pharmaceutical company in Enugu. Output of regression analysis approaches concluded that the rate of inflation has a negative and significant effect on pharmaceutical companies' organizational effectiveness. The Nigerian state of Anambra hosted the investigation. The study was performed in Kenya's Nairobi County.

Atugeba (2021) examines how the rate of inflation affects the profitability of selected Upper East region SMEs in Ghana. ROA was utilized as a financial performance measure. The 36 SMEs on the customer record supplied were included in the investigation. Data spanning from 2013 to 2017 were included in the evaluation. A regression approach known as ordinary least squares (OLS) was exploited to determine the determinants that affect business success. According to the findings, the inflation rate is a not significant predictor of SMEs' success. Data was collected using secondary data instruments for collection; primary information was utilized.

Okeke, Anetoh, Obiezekwem, Anetoh, Okafor, Monday and Kobimdi (2020) studied how small and medium-sized enterprises' earnings were affected by inflation. The inquiry employed a cross-sectional approach. 1560 people were included in the study, and 296 people made up the sample. Applying multiple regression analysis, findings disclosed that South-East Nigerian SMEs' performance is significantly harmed by inflation. The study concludes that in order to promote economic growth, effective inflation rate management is required. The study used cross-sectional research layout; this investigation applied descriptive design.

### **2.3.3 Government Laws and Policies and Financial Performance of SMEs**

Musabayana, Mutambra and Ngwenya (2022) assessed the extent to which government policies affected Zimbabwe's small and medium-sized enterprise (SME) success. The successive exploratory technique was employed in the study's mixed-methods technique. According to the outcomes of this research, the governing body was able to educate the influential category, its representatives who have experience in SME regulations, and the goals of the government were clearly conveyed to all professionals in the SME industry, but the details did not filter through to the SME executors. The results would help authorities reconsider and create an updated plan of action that would include all SME sector stakeholders. The results indicated that the government's inability to communicate its goals to those who carried them out is mostly to blame for the poor Zimbabwean SMEs performance, which had a negative effect on the country's economy overall. A mixed method technique was applied, this study used stratified technique.

Nwalusiuka (2021) looked into how government regulations affected startup concerns. Over the period of three (3) years, the inquiry utilized questionnaires to gather thoughts of Anambra State new firms. 400 new firms in Anambra State were chosen at random by the study using a snowball method. At a significance level of 5%, the different hypotheses were tested utilizing the Chi-square test of independence. The study region encompassed the adjacent areas of Onitsha, Awka, and Nnewi. The results demonstrate that government regulations significantly affect new enterprises' ability to obtain financing. Furthermore, the findings indicate an important connection among government policies and the long-term viability of start-ups. Findings showed the occurrence of a substantial connection among government policies on enterprise encouragement and growth; the ongoing existence of new businesses in the inquiry location. As a result, the investigation ends that favorable policies of government play a significant role

towards solving business startup problems within the study area. Chi-square analyzed the study objective. This investigation utilized regression technique of analysis.

Mwangemi, Wilson, and Mung'atu (2017) investigated the impact of finance access and policies from the government on the success of Kenyan SMEs. The survey focused on Nairobi City's SMEs that operate in four economic sectors: logistics and storage, housing and offerings, communication and data processing, monetary and coverage operations, and competent to scientific, and technical pursuits. A total of 395 SMEs were collected employing a stratified technique, with an 88.1% response rate recorded. The investigator gathered primary data by means of structured conversations and surveys given to entrepreneurs and executives. At a significance level of 5%, the Chi-square test of association was utilized with the concluding that finance accessibility is a crucial factor in the establishment, growth, and eventual expansion of the SME sector. Kenya still has a lot of large corporations, despite having a more developed economy than others. Government policies were shown to have little effect on the expansion of businesses, even in spite of the emphasis placed on creating policies for SMEs. The study goal was to look into how government policies affect Kenyan SMEs' ability to succeed. This looked at how SMEs' success is influenced by elements in the economic environment.

#### **2.3.4 Government Activity and Financial Performance of SMEs**

Hayleslasie (2023) evaluated the impact of government involvement on the level of creativity in Tigray, Ethiopia's small manufacturing businesses. For this objective, an investigation of 464 owners of small manufacturing businesses in the textile and apparel, metal and wood works, construction input, chemical products, jewelry, and agro-processing sectors was carried out. Logistic regression, propensity score matching, chi-square testing, and descriptive statistics were all presented using Stata version 12. The PSM estimate states that using technology

advancements and transfer requires government action. Likewise, using a binary logistic regression, the research uncovered that program intervention positively affects the innovation process in terms of scale. This inquiry was performed in Kenya; the last investigation was done in Ethiopia.

Ye, Yi, Fangjang, and Yuzhu (2022) examined data from 2008 to 2018 on A-share listed companies in the stock exchanges of Shenzhen and Shanghai using the fixed-effect model. The outcomes showed that enterprise investment in resources for technological innovation is severely hindered by government involvement, whereas enterprise innovation investment can be enhanced by reduced government intervention. Internal control intervention exacerbates the detrimental effects of government interference on technological company advances, rather than offering institutional benefits. The study used fixed effect model; this study used multiple regression model.

Alkahtani, Nordin, and Khan (2020) investigated how government support via network structure affects long-term competitive performance in Pakistani SMEs. Small firms therefore contribute significantly to value creation, employment, and economic growth. Consequently, we created hypotheses on government financial support and network structure based on prior research, and we gathered information from SMEs' senior management using structured questionnaires. The results indicate that whereas centrality has no influence on SCP, density positively and considerably impact on long-term competitive performance. Furthermore, there is substantial financial support from the government for the interaction between SCP and networking structure in Pakistan. This investigation was done in Kenya; the previous survey was performed in Pakistan.

## 2.4 Literature Review Summary and Gaps in Research

**Table 2.1: Literature Review Summary and Gaps in Research**

Authors	Key Objective	Key Findings	Research Gap	Study bridging of Gap
Mwangemi, Wilson, and Mung'atu (2017)	Investigated the impact of access to finance and policies from the government on the success of Kenyan SMEs	It was discovered that government policies possessed a minimal impact upon business growth.	The study primary objective is to investigate the effect of government policies on success of Kenyan SMEs	This study primary goal is to investigate the effect of economic environment factors on performance of SMEs
Xu, Li, Liang, and Rahman (2019))	Conducted research to assess the probability distribution of the cost of taxes for micro and small-sized businesses in Taizhou. (China	The study discovered that, since compared with the standard framework employed to represent governmental	The study was carried out using a nonparametric approach	this study used a parametric approach

		<p>taxes as well as lending policies, the effects of small and micro businesses' benefits for the economy offers an analysis of situations that improves the unusual viewpoint of taxes</p>		
Ogbonna et al. (2020)	Investigated the connection among taxation and the financial outcomes of listed SMEs in Nigeria	Discovered that taxation had no substantial connection with the financial achievements of SMEs in Nigeria during the study period of time.	The study used secondary data	this study used primary data collection procedure
Okeke et al, (2020)	investigated how inflation affected	The study found that the	The study used cross-sectional	This study used

	small and medium-sized enterprises' profits.	performance of SMEs in South East Nigeria is significantly impacted negatively by inflation.	research layout.	descriptive research design
Alkahtani, Nordin, and Khan (2020)	Investigated how government support via network structure affects long-term competitive performance in Pakistani SMEs.	The results demonstrate that density significantly and favorably affects long-term competitive performance.	The study was carried out in Pakistan,	this study was carried out in Kenya
Wadesango et al. (2021).	Examined the obstacles encountered by SMEs when newly enacted taxation regulations were implemented, as well as the	According to the study's outcomes, intermediate cash tax transmit has a major effect on the profitability of SMEs. The investigation also	The study mainly focused on taxation regulations	This study focused on economic environment factors where taxation, government activity,

	economic success of SMEs	revealed that wireless cash tax transmit as well as banking transfer tax have an adverse effect on the finance effectiveness of SMEs		government laws and inflation are parameters of the study
Atugeba (2021).	Investigates the impact of the inflation rate on the business's success of chosen (SMEs) in Ghana's Upper East region	According to the findings, the inflation rate is a not significant predictor of SMEs' success.	Data was collected using secondary data collection instruments	This study utilized primary data
Nwalusiuka (2021).	investigated the impact of government policies on startup issues	The findings show that government policies have a significant impact on the access to	Chi-square was used to analyze the objective of the Study,.	this study used descriptive and inferential analysis to

		<p>finance for new businesses.</p> <p>Furthermore, the findings indicate an important connection among government policies and the long-term viability of start-ups in the research region.</p>		<p>estimate objectives</p>
<p>Musabayana et al., (2022)</p>	<p>Determined the magnitude whereby government policies influenced the success of SMEs in Zimbabwe</p>	<p>According to the study's findings, the poor performance of Zimbabwean SMEs is primarily the result of the government's failure to interact its objectives to those who</p>	<p>A mixed method technique was used in the study</p>	<p>This study used stratified technique</p>

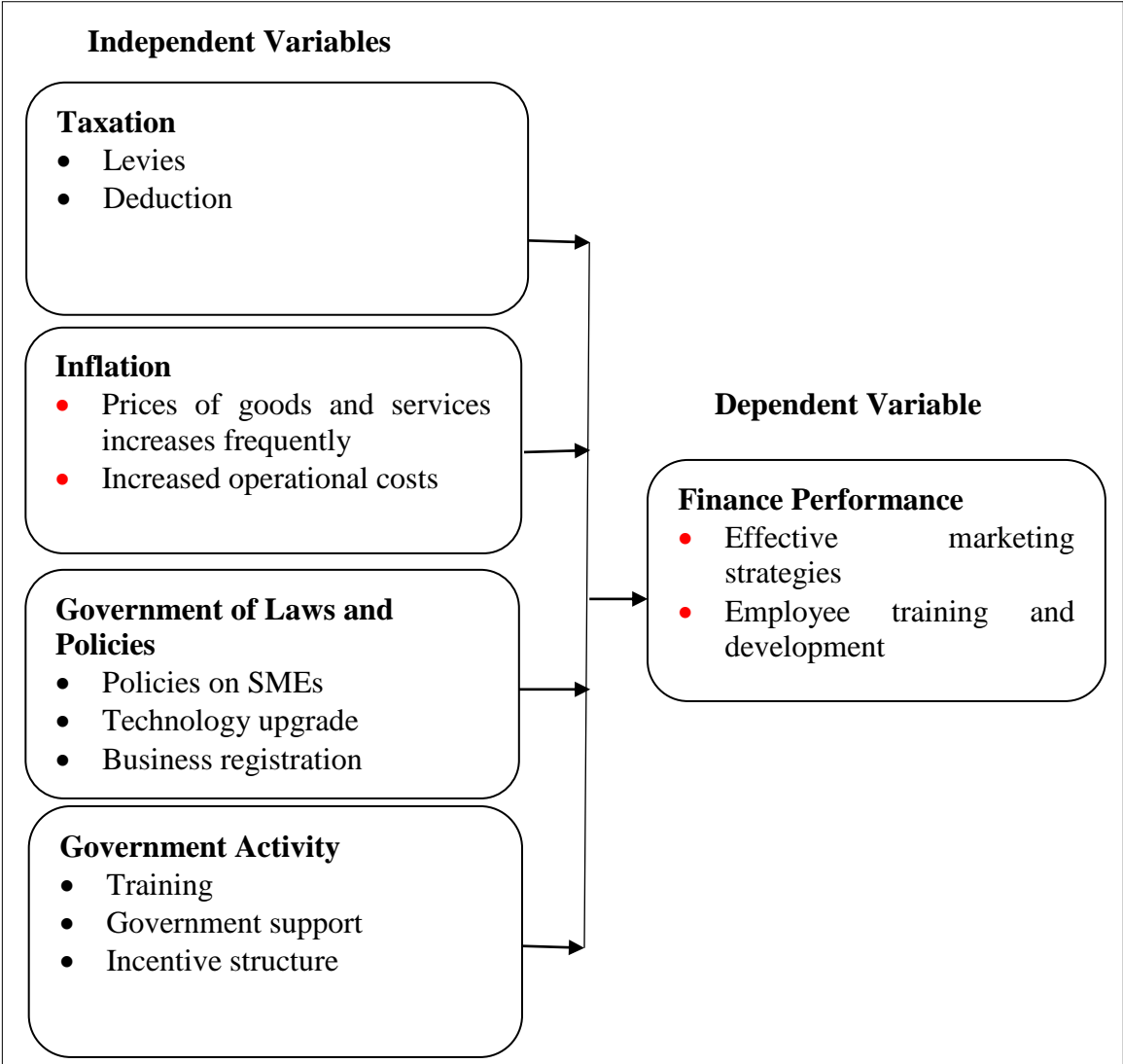
		implemented them, which had an adverse impact on the economy as a whole of Zimbabwe.		
Ye et al., (2022)	used the fixed-effect model to analyze data of A-share listed companies in Shanghai and Shenzhen	Internal control intervention does not provide institutional benefits; rather, it exacerbates the negative impact of government intervention on business breakthroughs in technology	The study used fixed effect model	this study used multiple regression model
Ojimba (2023).	Investigated the economic setting and performance of organizations in Anambra State	According to the findings of the research, the rate of inflation has an adverse and	The study was carried out in Anambra state, Nigeria	This study took place in Nairobi County, Kenya

	pharmaceutical businesses	substantial impact on the performance of organizations in pharmaceutical firms.		
Hayleslasie (2023).	Assessed the effects of government intervention on the degree of inventiveness in small manufacturing enterprises in Tigray, Ethiopia	According to the PSM estimate, government intervention is important in employing technological advances and transfer. Likewise, using a binary logistic regression, the research found that program intervention positively affects the innovation	Study was carried out in Ethiopia	this study was carried out in Kenya

		process in terms of scale.		
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Source: Researcher (2024)

2.5 Conceptual Framework



Source: Researcher (2024)

Figure 2.1 Conceptual Framework

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Introduction

The following section explains the survey approaches used in the investigation, including the data evaluation layout, study population, collection approaches, collecting data process, data evaluation, methods for investigating validity and trustworthiness, and data assessment approaches.

#### 3.2 Research Design

As per Kothari (2009), a design of investigation is a framework that facilitates the easy progression of diverse investigative procedures, with the aim of enhancing research precision. As defined by Bryman and Bell (2011), a research design is a framework for collecting and analyzing data aimed at answering the study's research questions. A descriptive research design looks at how study variables relate to one another without changing the research environment (Mugenda & Mugenda, 2003). The design for the research was descriptive. This particular study method was applied because it entails gathering information that describes occurrences, followed by organizing, tabulating, organizing, and interpreting the data.

#### 3.3 Empirical Model

The model was provided by panel regression framework and direct effect model which matches the section-specific objectives and study hypotheses.

$$FP = \beta_0 + \beta_1 TX + \beta_2 IF + \beta_3 GP + \beta_4 GA + \varepsilon$$

Where:

FP = Financial Performance

TX = Taxation

IF = Inflation

GP = Government Laws and Policies

GA = Government Activity

$\beta_1 - \beta_4$  = Coefficients

$\varepsilon$  = Error term

### 3.4 Operationalization and Variables Measurement

**Table 3.1: Operationalization and Variables Measurement**

<b>Variable</b>	<b>Type</b>	<b>Operationalization</b>	<b>Measurement</b>	<b>Hypothesis Direction</b>
Financial Performance	Explained Factor	Net Income/ Total Assets	Return on Assets (ROA)	Positive/Negative
Taxation	Independent Variable	Levies Deduction Total Income	Nominal	Positive/Negative
Inflation	Independent Variable	Increase in Prices Consumer Price Index	Nominal	Positive/Negative

		Demand Pull Inflation		
Government Laws and Policies	Independent Variable	Policies on SMEs Technology Upgrade Business Registration	Nominal	Positive/Negative
Government Activity	Independent Variable	Training Government Support Incentive Structure	Nominal	Positive/Negative

**Source: Researcher (2024)**

**3.5 Target Population**

Target population includes people or organizations with attributes that correspond to the study targets (Mugenda & Mugenda, 2013). The SMEs in Nairobi City County was the investigation’s target population. Firms in Kenya are classified primarily according to the number of workers they have. The report’s intended audience was 532 SMEs in Nairobi County from ICT, construction and engineering, health, manufacturing, retailing, hospitality and hotel, energy, financial, and automobile and logistics industries represented in Nairobi City County. Owners and managers of SMEs participated in the survey. The proprietors of the business that possess a strong and consistent understanding of SMEs operations were chosen for the inquiry.

**Table 3.2: Target Population**

<b>SMEs</b>	<b>Target population</b>
<b>Financial</b>	39
<b>Automobile and Logistics</b>	64
<b>Hospitality and Hotel Services</b>	87
<b>Retailing</b>	103
<b>Energy</b>	41
<b>Manufacturing</b>	19
<b>Construction and Engineering</b>	59
<b>ICT</b>	37
<b>Health</b>	84
<b>Total</b>	532

**Source: Researcher (2024)**

### **3.6 Sampling Technique and Sample Size**

According to Mugenda (2008), sampling design refers to the process used to determine survey sample sizes. As per Bolarinwa (2015), a sample is a crucial part of the target audience for the research endeavor. The sample design for this investigation was based on the stratified sampling technique. This inquiry employed a stratified random sample technique, which necessitates the researcher to pick participants based on preset criteria and is appropriate for target groups greater than thirty (Mugenda & Mugenda, 2003). Stratified sampling technique was employed by grouping the SMEs into stratas which comprised of ICT, construction and engineering, health, manufacturing, retailing, hospitality and hotel, energy, financial, and automobile and logistics

industries. A sample of 30% is sufficient to portray a demographic, following Mugenda and Mugenda (2003). After that, a 30% of intended population was chosen by the research using a straightforward technique of sampling that is random to create a 150 SMEs size of sample, with the owners and managers acting as responders.

**Table 3.3: Sample Size**

<b>SMEs</b>	<b>Target population</b>	<b>Ratio</b>	<b>Sample Size</b>
<b>Financial</b>	39	0.3	18
<b>Automobile and Logistics</b>	64	0.3	19
<b>Hospitality and Hotel Services</b>	87	0.3	22
<b>Retailing</b>	103	0.3	31
<b>Energy</b>	41	0.3	13
<b>Manufacturing</b>	19	0.3	6
<b>Construction and Engineering</b>	59	0.3	18
<b>ICT</b>	37	0.3	11
<b>Health</b>	84	0.3	24
<b>Total</b>	<b>532</b>		<b>150</b>

**Source: Researcher (2024)**

### **3.7 Data Collection Instruments**

To conduct the investigation, both secondary and primary information was applied. Because of its distinct descriptive characteristics and low cost, a structured survey was used. Information primarily was obtained with structured close-ended questionnaires. The questionnaire was broken up into two sections: the first had questions about the participants' basic information, and the second portion had questions concerning the goals of the exam. The questions had a 5-point

scale of Likert and be closed-ended. Information on the independent variables was gathered via questionnaire. Using a review document guide, secondary information was obtained from the SMEs' financial performance records between 2018 and 2023.

### **3.8 Pilot Test**

A pilot test is typically used to eliminate doubts about the veracity as well as accuracy of the survey. The outcomes and comments from a pilot test are used to make changes to the questionnaire. A test of pilot was performed on 10% portion of respondents to the survey to assess the genuineness of the survey queries in order to decide the legitimacy of the survey instrument (Kabir, 2016). Thus, in this study, the pilot assessment was done by collecting information from 10 respondents who were removed from the conclusion of the information gathering phase.

#### **3.8.1 Validity of Research Instrument**

Validity is defined as the significance and correctness of conclusions reached from study findings (Mugenda & Mugenda, 2013). It speaks to the degree to which the phenomenon being studied is accurately depicted by the data analysis findings. Determining one's own level of accountability for another person's behavior is referred to as "responsibility." To ensure content validity, the researcher collaborated closely with his supervisor, who is well-versed in research, to create a reliable and efficient questionnaire that measures the dependent variable. Pilot research guaranteed the content validity of the questionnaire and aid in its improvement.

#### **3.8.2 Reliability of Instrument**

Reliability, as per Shenton (2004), is the magnitude that the findings hold true over time and fairly represent the whole research population. According to Shenton, a research tool is considered credible if the findings of a study assessment are reliable and consistent. It denotes

how constantly a measure produces the similar outcomes across multiple experiments. The dependability of research tools is applied to evaluate the consistency of survey responses over time. There are several ways to assess the dependability of the necessary components, Cronbach's alpha internal consistency of 0.7 was used to assess tool reliability in various studies. In view of this, the Cronbach Alpha coefficient revealed that taxation has a coefficient of 0.890, inflation had 0.901, government laws and policy had 0.734, government activities had 0.762 while financial performance had 0.925 respectively.

### **3.9 Analysis of Data and Presentation**

To get outcomes, data must be gathered, then processed and analyzed. To answer research questions, estimate the population's unknown parameters, and draw inferences from survey or experiment data. Descriptive analysis and inferential analysis are the two main categories of analysis. While descriptive analysis focuses on generating specific indices from raw data, inferential statistics is more concerned with generalization. Inferential analytic methods including regression and correlation, tables, charts, and measures of central tendency and dispersion was utilized in addition to descriptive statistics like percentage and frequency. The statistical significance of the correlations between the research factors was examined utilizing panel regression analysis.

### **3.10 Diagnostic Tests**

The study variables were subjected to the following tests: normality tests, multicollinearity tests, autocorrelation tests and heteroscedasticity tests.

#### **3.10.1 Autocorrelation Test**

The degree of correlation between the studied variables is often ascertained using the autocorrelation test. The Breusch-Godfrey Serials Correlations Lagrange Multipliers test was

used in this investigation. The study variables are not associated with one another if the p-value for the null hypothesis is less than 5%; if it is larger than 5%, the variables are correlated but unsuitable for analysis.

### **3.10.2 Heteroskedasticity Test**

To ascertain whether there is any variance in the study variables that could lead to mistakes in the analysis, the heteroskedasticity test was utilized. The null hypothesis's p value at test completion was ascertained using the Breusch-Pagan Test; a value of less than 5% indicates that residual variation in the research variables is nonexistent, and a value of more than 5% shows the presence of residual variance.

### **3.10.3 Multicollinearity Test**

Prior to regression analysis, the multicollinearity test is typically done to ascertain whether the study variables have a linear association with one another. The multicollinearity of the study factors were ascertained via the Variance Inflation Factors (VIF) assessment with a verge of 5. A VIF score between one and ten indicates the degree of linear connection amongst the factors; a value of one or less indicates no linear connection.

### **3.10.4 Normality Test**

Prior to performing regression analysis, a normality test is typically performed to ascertain if the factors are distributed normally. The Shapiro-Wilk normality test was deployed to establish the status of the study variables with respect to normal distribution. It can be inferred that the research variables are not being administered normally if the computation value is less than 5%, and that the research variables are distributed normally if the computation value is larger than 5%.

### **3.11 Ethical Considerations**

The investigator began the collection of data after receiving letters of authorization from NACOSTI and Kenyatta University. The permission of potential respondents was sought in advance, along with an explanation of the survey's purposes. The researcher took great care to ensure that the answers are used in complete confidentiality and solely for educational purposes.

**CHAPTER FOUR**  
**RESEARCH FINDINGS AND DISCUSSION**

**4.1 Introduction**

The chapter outlines the survey outputs and establishes a framework for discussion by comparing these findings with those documented in previous research. It offers a summary of the responses from participants, juxtaposed with discoveries from those who opted not to complete the questionnaire, which formed the foundation for the survey analysis. Within this framework, the survey utilized descriptive and inferential techniques to interpret the information, and these results were evaluated against the conclusions drawn from relevant academic literature reviewed throughout the chapter.

**4.1.1 Response Rate**

This section of the survey showcases the responses gathered from participants, emphasizing the number of individuals who completed the questionnaire and contributed their views on the research topic. These responses are contrasted with the questionnaires that were not retrieved by the researcher. The findings from this analysis are comprehensively detailed in Table 4.1.

**Table 4.1: Response Rate**

Response	Frequency	Percent
Retrieved	118	78.7
Unretrieved	32	21.3
Total	150	100

Source: Field Data (2024)

Table 4.1 indicated a rate of response of 78.7% for the retrieved questionnaires, reflecting a strong level of engagement from participants in the survey. This high response rate suggests that

the research topic resonated well with the target audience, leading to a substantial number of individuals willing to share their perspectives. In contrast, the 21.3% of unretrieved questionnaires may point to potential barriers such as lack of interest, accessibility issues, or time constraints faced by some individuals. The significant proportion of retrieved responses enhances the reliability of the findings, providing a solid foundation for analysis and interpretation while also highlighting areas for improvement in future data collection efforts to minimize non-responses.

## **4.2 Descriptive Analysis**

The survey considered the socio-demographic respondents features to provide comprehensive discoveries into the diversity and composition of the participant pool. Key factors analyzed included sex, age, educational background, years of experience, and the specific sectors in which the participants are involved. The results enrich our understanding of the personal attributes of those who took part in the survey, emphasizing the diverse backgrounds and qualifications that influence their perspectives and experiences. Additionally, the findings related to the survey variables are presented with detailed discussions of percentages, means, and standard deviations.

### **4.2.1. Respondents Gender**

Analyzing the sex composition of interviewees is vital for examining the dynamics of entrepreneurship within the SME sector, as it provides understanding into the participation rates of men and women in business activities. This survey classified respondents according to their sex, facilitating an investigation into the disparities. The results of this analysis are obtainable in Table 4.2.

**Table 4.2: Sex of the Respondents**

	Frequency	Percent
Male	77	65.3
Female	41	34.7
Total	118	100.0

Source: Field Data (2024)

Table 4.2 indicated that 77 (65.3%) of the respondents are identified as male, while 41 (34.7%) identified as female. This gender distribution revealed a notable disparity, with males comprising a significantly larger portion of the participant pool compared to females. Such an imbalance may reflect broader societal trends within the SME sector in Nairobi City County, where male entrepreneurs often dominate business ownership and leadership roles. This predominance can impact the macroeconomic environment, as it may limit the diversity of perspectives and approaches to business management, potentially affecting overall financial performance. Furthermore, the lower representation of female respondents could suggest barriers that women face in accessing resources, funding, and support networks necessary for entrepreneurial success. Addressing these gender disparities is crucial for fostering a more inclusive economic landscape that promotes equal opportunities for all entrepreneurs.

#### **4.2.2 Age of the Participants**

Acknowledging the age demographics of participants is crucial, as it offers insightful perspectives on the entrepreneurial landscape and the diverse levels of experience and viewpoints among SME owners and employees. This survey segmented participants into specific age groups, facilitating an analysis of how age affects the SMEs financial performance within the macroeconomic environment. The responses of this examination are detailed in Table 4.3.

**Table 4.3: Respondents' age distribution**

	Frequency	Percent
Below 25 years	16	13.6
25-50 years	57	48.3
Above 50 years	45	38.1
Total	118	100.0

Source: Field Data (2024)

Table 4.3 revealed the interviewees age, displaying that 16 participants (13.6%) are below 25 years, 57 participants (48.3%) fall within the 25-50 year range, and 45 participants (38.1%) are above 50 years. This distribution signifies that nearly half of the participants are in the 25-50 age brackets, suggesting a dominant presence of relatively young to middle-aged individuals in the SME sector. The smaller representation of those below 25 years may reflect barriers faced by younger entrepreneurs, such as limited access to capital and experience. Conversely, the substantial proportion of respondents over 50 years highlights the involvement of seasoned entrepreneurs who likely bring valuable experience to their businesses. In relation to the macroeconomic environment and financial performance of SMEs in Nairobi City County, this age distribution may influence how different age groups perceive and respond to economic challenges, access financial services, and adopt innovative practices.

#### **4.2.3 Educational Qualification**

Considering the educational qualifications of SME owners and employees is essential, as these qualifications greatly affect their capacity to effectively manipulate the macroeconomic environment to their advantage. The categorization of the respondents in view of their educational attainment is reported in Table 4.4.

**Table 4.4: Educational Qualification of the Respondents**

	Frequency	Percent
Diploma	25	21.2
Bachelor's Degree	83	70.3
PhD	2	1.7
Others	8	6.8
Total	118	100.0

Source: Field Data (2024)

Table 4.4 illustrated the educational qualifications of the participants, revealing that 25 participants (21.2%) hold a diploma, while the majority, 83 participants (70.3%), possesses a bachelor's degree. Additionally, only 2 respondents (1.7%) have attained a PhD, and 8 participants (6.8%) fall into the "others" category, which may include various certifications or qualifications not specified. This distribution indicates a well-educated participant pool, with a significant emphasis on bachelor's degree holders, suggesting that many SME owners and staff are trained with substantial skills and knowledge relevant to their businesses. In relation to the macroeconomic environment and SMEs financial performance in Nairobi City County, this educational background may enhance the ability of these individuals to effectively utilize financial technologies and engage with banking services. Higher levels of education are often correlated with improved financial literacy, which can lead to better decision-making and ultimately drive the financial success of SMEs.

#### **4.2.4: Years of Business Experience**

Considering the business experience is vital in providing valuation information as it relates to the expertise and operational knowledge of the respondents within the SME sector. By categorizing participants based on their years of experience, this analysis exposed how varying levels of

experience influences business practices, decision-making, and overall financial performance. The outcome obtained is provided in Table 4.5.

**Table 4.5: Respondents’ years of business experience**

	Frequency	Percent
Below 5 years	71	60.2
6-15 years	21	17.8
Above 15 years	26	22.0
Total	118	100.0

Source: Field Data (2024)

Table 4.5 detailed the years of business experience among subjects, indicating that 71 participants (60.2%) have less than 5 years of experience, while 21 participants (17.8%) have between 6 and 15 years, and 26 participants (22.0%) possess more than 15 years of experience. This distribution suggests that a significant majority of respondents are relatively new to the business landscape, which may influence their adaptability and willingness to embrace innovative practices. The substantial proportion of respondents with less than 5 years of experience could indicate a dynamic influx of new entrepreneurs into the SME sector in Nairobi City County, reflecting both opportunities and challenges associated with limited experience. Conversely, the presence of seasoned entrepreneurs with over 15 years of experience may provide valuable insights and mentorship opportunities for newer entrants. In relation to the macroeconomic environment and Nairobi City County’s SMEs financial performance, this mix of experience levels could impact overall business resilience and growth strategies. Newer SMEs might struggle with navigating regulatory frameworks and accessing financial resources, while more experienced businesses could leverage their knowledge to enhance performance and stability.

#### 4.2.5 Ownership or Management

Understanding who owns or manages these enterprises provide depth into decision-making processes, resource allocation, and strategic direction, which are indispensable for navigating the challenges of the macroeconomic environment. The nature of ownership—whether sole proprietorship, partnership, or corporate structure—can significantly affect the SMEs financial performance. The outputs are reported in Table 4.6.

**Table 4.6: Respondents Ownership or Management**

	Frequency	Percent
Owner	87	73.4
Manager	31	26.6
Total	118	100.0

Source: Field Data (2024)

Table 4.6 revealed that out of a totality of 118 contributors, 73.4% identified themselves as owners, while 26.6% were classified as managers. This distribution indicates a significant prevalence of owner-operated businesses, suggesting that many SMEs are directly managed by their proprietors rather than hired managers. The dominance of owners in management roles may reflect both a lack of resources to hire managerial staff and a desire for direct control over business operations. The findings are consistent with broader trends in SMEs, where owners often play multiple roles due to financial constraints and operational demands. In relation to the macroeconomic environment, this ownership structure may impact financial performance, as owner-managers are typically more invested in their businesses' success. The high percentage of owners could lead to more agile decision-making but may also limit the professional management practices that can enhance growth and sustainability.

#### 4.2.6 Taxation

Taxation significantly influences the SMEs financial performance, as they grapple with various tax obligations, including income tax, VAT, and excise duties. The complexity of the tax system often poses challenges for SMEs, leading to high compliance costs and potential penalties for non-compliance, which can adversely affect their profitability and sustainability. The outcomes regarding the responses of the respondents are contained in Table 4.7.

**Table 4.7: Descriptive Result for Taxation**

Statement	Percentage					Mean	Std. Deviation
	SD	D	N	A	SA		
Business pays certain levies both for the county and national level	6.8	4.2	5.1	56.8	27.1	3.9322	1.05189
Government has reduced tax rates on profits of SMEs to encourage better operation	7.6	17.8	22.9	41.5	10.2	3.2881	1.11018
levies paid from the business affects the growth of the business	11.9	16.1	22.9	34.7	14.4	3.2373	1.23120
SMEs enjoy some form of tax holidays granted by the government	7.6	28.8	34.7	23.7	5.1	2.8983	1.01602
The government need to reduce the levies charged on small business owners	1.7	10.2	13.6	55.9	18.6	3.7966	.92042
Deductions reduces performance	7.6	3.4	31.4	45.8	11.9	3.5085	1.01059
<b>Average Score</b>						<b>3.4435</b>	<b>1.05671</b>

Source: Field Data (2024)

Table 4.7 discusses the respondents' perceptions regarding taxation, specifically focusing on the statement that business pays certain levies both for the county and national level. Findings

revealed that 6.8% of interviewees strongly disagreed with the declaration, while 4.2% disagreed. A neutral stance was taken by 5.1% of the participants, while a significant majority, 56.8%, agreed with the statement, and 27.1% strongly agreed. The mean for this proclamation is 3.9322 and standard deviation of 1.05189, indicating a general tendency towards agreement among respondents regarding the payment of levies at both levels of government. The mean value reflects a strong recognition among SMEs in Nairobi City County of their responsibility to pay various levies, highlighting the importance of taxation in their financial environment. Regarding the statement that government has reduced tax rates on profits of SMEs to encourage better operation, 7.6% of respondents strongly disagreed with the declaration, while 17.8% expressed disagreement. 22.9% of participants took a neutral position suggesting uncertainty regarding the government's actions on tax rates. In contrast, a majority of 41.5% agreed with the statement, and 10.2% strongly agreed, indicating a positive perception among a significant portion of respondents about the government's efforts to lower tax rates for SMEs. The score mean of 3.2881 and deviation of standard 1.11018 connotes a general tendency towards agreement. Therefore, there is a notable acknowledgment among SMEs regarding the reduction of tax rates aimed at fostering better operational conditions.

Regarding the statement that levies paid from the business affect the growth of the business, 11.9% of participants disagreed strongly with the proclamation, while 16.1% expressed disagreement as 22.9% of participants remained uncertain about the impact of levies on business growth. On the contrary, 34.7% of the interviewees agreed with the declaration, and 14.4% agreed strongly, suggesting that a significant portion of interviewees recognizes the influence of levies on their business expansion. The score of 3.2373 mean and deviation of 1.23120 standards indicates a slight tendency towards agreement with the assertion that levies have an effect on

growth. There is a general acknowledgment among SMEs that levies can impact their growth. As regards SMEs enjoy some form of tax holidays granted by the government, 7.6% of participants disagreed strongly with the proclamation, while 28.8% disagreed, suggesting a significant portion of the population does not believe that tax holidays are effectively utilized by SMEs with 34.7% of respondents being indifferent on this issue. Conversely, 23.7% agreed with the statement, and a small minority of 5.1% strongly agreed, reflecting recognition among some respondents that tax holidays may indeed be beneficial. The average of 2.8983 score and deviations of 1.01602 standards designates a tendency towards disagreement with the notion that SMEs benefit from tax holidays. Therefore, the overall sentiment leans towards disbelief regarding their effectiveness in practice.

Concerning the government needs to reduce the levies charged on small business owners" reveal a clear sentiment among respondents, 1.7% of participants disagreed strongly with the declaration, while 10.2% disagreed, indicating a minority who do not see the need for a reduction in levies as 13.6%, remained neutral, suggesting uncertainty on the issue. However, 55.9% of the participants agreed that the government should reduce these levies, and 18.6% strongly agreed, reflecting a strong consensus among respondents about the financial burden imposed by levies on small businesses. The 3.7966 mean and divergence of 0.92042 standards signifies a general tendency towards conformity with the need for reduced levies. The results regarding the statement that deductions reduce performance indicated that 7.6% of participants disagreed strongly with the assertion, while 3.4% disagreed, suggesting that a small portion believes deductions do not negatively affect performance. A more substantial 31.4% remained neutral, indicating uncertainty. Conversely, 45.8% of the participants agreed with the proclamation, and 11.9% agreed strongly, reflecting a strong consensus that deductions indeed have a detrimental

effect on business performance. The score of 3.5085 mean and standard of 1.01059 deviations suggests a general tendency towards agreement. The majority opinion suggests that many business owners perceive deductions as a hindrance to their operational success.

The average mean of the responses regarding various statements related to taxation and its impact on SMEs revealed significant outcomes into the perceptions of business owners. The mean scores for the different statements indicate a general tendency towards agreement on key issues, particularly concerning the need for reduced levies and the negative impact of deductions on performance. The average mean score of 3.4435 reflect a clear consensus among SMEs that current taxation policies, particularly levies and deductions, are perceived as burdensome and detrimental to their financial performance. The results line up with those of Wadesango, Muzenda, Satande, and Malatji (2021), which indicated that bank transfer taxes and mobile cash taxes negatively affect SMEs' access to financing. Additionally, Ogbonna, Onuoha, Chukwu, and Ojeaburu (2020) found that during their study period, taxes in Nigeria did not significantly correlate with the financial success of SMEs

#### **4.2.7 Inflation**

Inflation poses significant challenges for SMEs, as rising prices of goods and services directly increase operational costs. As inflation escalates, SMEs are often compelled to absorb these higher input costs without fully passing them on to consumers, leading to squeezed profit margins and potential layoffs. The views of the respondents on this are reported in Table 4.8.

**Table 4.8: Descriptive Result for Inflation**

Statement	Percentage					Mean	Std. Deviation
	SD	D	N	A	SA		
Inflation rate affects my business	3.4	2.5	4.2	60.2	29.7	4.1017	.86122
Prices of goods and services increases frequently	1.7	0.8	3.4	67.8	26.3	4.1610	.67899
inflation rate increase reduces the performance of SMEs	1.7	3.4	0.8	61.9	32.2	4.1949	.76525
Government increase in spending has benefited SMEs	1.7	1.7	2.5	66.1	28.0	4.1695	.70777
Inflation has been both a blessing and a curse for SMEs performance	2.5	4.2	9.3	58.5	25.4	4.0000	.86726
Inflation has led to increased operational costs for my SME	2.5	2.5	12.7	62.7	19.5	3.9407	.80906
<b>Average Score</b>						<b>4.0946</b>	<b>0.78159</b>

Source: Field Data (2024)

Table 4.8 illustrated the respondents' perceptions regarding the statement that inflation rate affects my business which revealed that 3.4% of participants strongly disagreed with the statement, even as 2.5% disagreed with 4.2% being remained neutral. 60.2% of the interviewees agreed that inflation rates do indeed affect their business operations, and 29.7% strongly agreed. The score of 4.1017 mean and standard of 0.86122 deviations indicates agreement among respondents. The findings underline the belief among SMEs that inflation rates significantly influence their business performance. Regarding the statement that prices of goods and services increase frequently, 1.7% of participants disagreed strongly with the statement, while 0.8% disagreed as 3.4% remained neutral. Also, 67.8% of the participants agreed that prices frequently

rise, and 26.3% strongly agreed. The score mean of 4.1610 and deviation of 0.67899 standards indicates agreement reflecting confidence in the observation of rising prices.

Results regarding the statement that increase in inflation rate reduces the performance of SMEs noted that 1.7% of participants disagreed strongly with the proclamation, whereas 3.4% disagreed. A small portion 0.8% remained neutral. Conversely, 61.9% of the respondents agreed that rising inflation adversely affects their performance, and 32.2% strongly agreed. The score mean of 4.1949 and deviation of 0.76525 standards indicates a widespread belief among SMEs that increasing inflation rates significantly hinder their operational performance. Regarding the statement that government increase in spending has benefited SMEs, 1.7% of participants disagreed strongly with the assertion, despite the fact that 1.7% disagreed as 2.5% remained unbiased. Findings also noted that 66.1% of the respondents agreed that government spending positively impacts their businesses, and 28.0% strongly agreed. The score mean of 4.1695 and standard of 0.70777 deviation indicating the belief among SMEs that increased government spending contributes positively to their growth and sustainability.

Findings concerning inflation have been both a blessing and a curse for SMEs performance revealed that 2.5% of participants strongly disagreed with the statement, as 4.2% disagreed with 9.3% remaining indifferent regarding this issue. In disparity, 58.5% of the respondents agreed that inflation has mixed effects on their performance, and 25.4% strongly agreed. The score mean of 4.0000 and deviation of 0.86726 standard highlight a prevalent belief among SMEs that inflation presents both challenges and opportunities for their performance. The survey results regarding the statement that inflation has led to increased operational costs for my SME indicated that 2.5% of participants strongly disagreed with the statement, even as another 2.5% disagreed with 12.7% being neutral. Also, 62.7% of the interviewees agreed that inflation has

indeed increased their operational costs, and 19.5% strongly agreed. The 3.9407 score and the departure of 0.80906 standard highlight a widespread belief among SMEs that inflation significantly raises their operational costs, impacting profitability and sustainability.

The mean average score across these statements stands at 4.0946, indicating a generally positive perception among SMEs regarding the effects of inflation on their operations and performance. This high average suggests that respondents largely believe inflation significantly influences their business dynamics, highlighting the need for effective strategies to navigate these economic challenges. The outcomes align with broader discussions on how inflation impacts SMEs by increasing operational costs while also emphasizing the importance of government support in mitigating these effects. The results are in line with those of Ojimba, Okafor, Okeke, and Mbah (2023), who found that inflation rates significantly impact the organizational effectiveness of pharmaceutical companies. Additionally, Okeke et al. (2020) revealed that inflation adversely affects the performance of SMEs in South-East Nigeria.

#### **4.2.8 Government Laws and Policies**

Government laws and policies play a crucial role in shaping the macroeconomic environment for SMEs. The recent implementation of the Unified Business Permit streamlines licensing processes, reducing bureaucratic hurdles for SMEs and potentially enhancing their financial performance by lowering compliance costs. Findings relating to this are noted in Table 4.9.

**Table 4.9: Descriptive Results for Government Laws and Policies**

Statement	Percentage					Mean	Std. Deviation
	SD	D	N	A	SA		
Government has created policies that benefits SMEs	1.7	1.7	0.8	61.9	33.9	4.2458	.71536
Strategic law initiatives have been put in places by government to increase SMEs s sustainability	1.7	3.4	3.4	55.1	36.4	4.2119	.80439
Business registration with the government comes with benefit for SMEs performance	1.7	0.8	0.8	59.3	37.3	4.2966	.69564
Technology upgrade has been put in place for easy access to various business in Nairobi county	1.7	1.7	3.4	66.1	27.1	4.1525	.71165
Government policies and laws for SMEs provides opportunity through which the evolution can be realized	2.5	2.5	2.5	55.9	36.4	4.2119	.82536
Technology upgrade is beneficial to the performance of SMEs	18.6	13.6	5.9	49.2	12.7	3.2373	1.35671
<b>Average Score</b>						<b>4.0593</b>	<b>0.85152</b>

Source: Field Data (2024)

Table 4.9 demonstrated that 1.7% of participants disagreed strongly with the assertion that government has created policies that benefit SMEs and another 1.7% disagreed, indicating the level of dissent regarding the effectiveness of government policies for SMEs as 0.8% of respondents remained neutral. 61.9% of the respondents agreed that government policies are beneficial to SMEs, while 33.9% strongly agreed, reflecting widespread support for the government's efforts in this area. The score of 4.2458 mean and deviation of 0.71536 standards

signifies a strong overall agreement among respondents regarding the positive impact of government policies on SMEs. The high mean score reinforces the belief that such policies play a central task in fostering a conducive environment for SMEs. Analysis of respondents' views on the statement that strategic law initiatives have been put in place by the government to increase SMEs' sustainability showed that 1.7% of participants disagreed strongly with the statement, while 3.4% disagreed, indicating a small level of skepticism regarding the effectiveness of these initiatives as 3.4% of respondents were indifferent. Outcomes unveiled that 55.1% of the respondents agreed that strategic law initiatives support the sustainability of SMEs, and 36.4% strongly agreed, reflecting strong overall support for government efforts in this area. The score of 4.2119 mean and deviation of 0.80439 standards indicates a general tendency towards agreement. The findings reveal a positive perception among SMEs regarding government strategic law initiatives aimed at enhancing sustainability.

Business registration with the government comes with benefits for SMEs' performance indicated that 1.7% of participants strongly disagreed with the statement, while 0.8% disagreed, showing least opposition to the idea that registration offers advantages as 0.8% remained neutral. The outcome noted that 59.3% of the respondent agreed that business registration positively impacts performance, and 37.3% strongly agreed, highlighting widespread recognition of the advantages that come with formalizing a business. The mean score of 4.2966 and standard deviation of 0.69564 suggests a strong overall agreement among respondents regarding the benefits of business registration. The high mean score reflects a strong consensus on the perceived advantages of formal registration, which may include improved access to financing, better market opportunities, and enhanced credibility with customers and suppliers. As regards technology upgrade has been put in place for easy access to various businesses in Nairobi

County, 1.7% of participants strongly disagreed with the statement, while another 1.7% disagreed, indicating minimal opposition to the notion that technology upgrades facilitate business access as 3.4%, remained neutral on this issue. In opposition, 66.1% of the respondents agreed that technology upgrades enhance accessibility for businesses, and 27.1% strongly agreed, highlighting strong support for the government's initiatives in this area. The score mean of 4.1525 and deviation of 0.71165 standard indicates a robust overall agreement regarding the positive impact of technology upgrades. The findings underscore a widespread belief among SMEs that recent technology upgrades have significantly improved access to various business opportunities in Nairobi County.

The statement concerning government policies and laws for SMEs provide opportunities through which evolution can be realized, had 2.5% of participants who strongly disagreed with the statement, while another 2.5% disagreed, suggesting minimal opposition to the idea that government policies facilitate opportunities for growth. A small percentage, also 2.5%, remained neutral. The findings noted that 55.9% of the respondents agreed that government initiatives create beneficial opportunities for SMEs, and 36.4% strongly agreed, reflecting strong support for the role of government in fostering an environment conducive to business evolution. The score mean of 4.2119 and standard of 0.82536 deviations indicates a general tendency towards agreement. The findings highlight a robust belief among SMEs that government policies and laws play a crucial role in providing opportunities for their growth and development. Findings regarding technology upgrade is beneficial to the performance of SMEs demonstrated that 18.6% of participants strongly disagreed with the statement, while 13.6% disagreed, indicating a notable level of disbelief about the benefits of technology upgrades as 5.9%, remained neutral. Distinctively, 49.2% of the respondents agreed that technology upgrades positively impact

performance, and 12.7% strongly agreed, reflecting a positive sentiment towards the role of technology in enhancing business operations. The score mean of 3.2373 and deviation of 1.35671 standard indicates a general tendency towards agreement. These findings highlight a substantial belief among SMEs that technology upgrades can enhance their performance.

The average mean across these statements stands at 4.0593, indicating a generally positive perception of government initiatives aimed at supporting SMEs. This high average suggests that respondents largely believe in the effectiveness of government policies and laws in fostering conducive environment for these SMEs growth and sustainability. Such sentiments highlight the importance of continued government engagement and policy refinement to further enhance the operational landscape for SMEs in the region. The results align with those of Nwalusiuka (2021), who revealed that supportive government policies significantly contribute to addressing business startup challenges in the study area. However, these findings contrast with those of Mwangemi, Wilson, and Mung'atu (2017), who observed that government policies had minimal impact on business expansion, despite a focus on developing policies for small and medium-sized enterprises. Additionally, Musabayana, Mutambra, and Ngwenya (2022) indicated that the government's failure to effectively communicate its objectives to implementers largely accounts for the poor performance of SMEs in Zimbabwe, negatively affecting the overall economy. The discrepancies in these findings may stem from differences in research methodologies and conceptual frameworks used in the studies.

#### **4.2.9 Government Activity**

Government activity significantly impacts the macroeconomic environment and financial performance of SMEs, through various initiatives aimed at supporting this sector. The Kenya Industry and Entrepreneurship Project (KIEP), for instance, targets over 250 SMEs to enhance

their productivity and innovation by creating linkages with larger corporations, thereby, improving their access to markets and resources. Result of the respondents' views is narrated in Table 4.10.

**Table 4.10: Descriptive Results for Government Activity**

Statement	Percentage					Mean	Std. Deviation
	SD	D	N	A	SA		
Government offers training on skill development, funding and monitor business to ensure business remain sustainable	1.7	0	1.7	66.1	30.5	4.2373	.64950
Government train SMEs on market competition and provide an environment to sustain the competition	3.4	5.1	8.5	64.4	18.6	3.8983	.88085
Government provides high advantageous environment necessary for development of SMEs	4.2	3.4	5.9	55.9	30.5	4.0508	.94143
The government support with tax incentives, socializing, and strategies for SMEs	11.0	28.8	18.6	33.9	7.6	2.9831	1.17657
Incentive structures are put in place to unlock opportunities for success of business	1.7	0	0.8	58.5	39.0	4.3305	.66737
Government activity is effective and increases performance	2.5	3.4	6.8	68.6	18.6	3.9746	.78948
<b>Average Score</b>						<b>3.9124</b>	<b>0.85087</b>

Source: Field Data (2024)

Results in Table 4.10 noted that 1.7% of participants disagreed strongly with the declaration while no respondents disagreed, suggesting broad acceptance of the government's role in supporting businesses as 1.7%, remained neutral reflecting some uncertainty about the effectiveness of these initiatives. In contrast, 66.1% of the participants agreed that government efforts in training and funding contribute positively to business sustainability, and 30.5% strongly agreed, highlighting strong support for these activities. The score mean of 4.2373 and deviation of 0.64950 standard demonstrate agreement among respondents regarding the government's initiatives aimed at enhancing business sustainability. The high mean score reflects confidence in the effectiveness of these initiatives, emphasizing the importance of continued government involvement in skill development and funding to promote the growth and resilience of SMEs. Government trains SMEs on market competition and provides an environment to sustain the competition had 3.4% of participants who disagreed strongly with the declaration, while 5.1% disagreed as 8.5%, remained unbiased. However, 64.4% of the interviewees approved that initiatives of government effectively train SMEs for market competition, and 18.6% strongly agreed, demonstrating strong support for these activities. The score mean of 3.8983 and deviation of 0.88085 standard signifies a general tendency towards agreement, The findings highlight a positive perception among SMEs regarding government training programs aimed at enhancing their competitiveness.

Regarding government provides a highly advantageous environment necessary for the development of SMEs, 4.2% of participants disagreed strongly with the proclamation, while 3.4% disagreed as only 5.9% of the participants remained impartial. In opposition, 55.9% of the respondents established that the government fosters an advantageous environment for SMEs, and 30.5% strongly agreed indicating strong support for government efforts in this area. The score of

4.0508 mean and deviation of 0.94143 standard reflects a general tendency towards agreement. The findings underline a positive perception among SMEs regarding the government's ability to create an environment conducive to their development. Concerning the statement that the government supports SMEs with tax incentives, socializing, and strategies, 11.0% of participants disagreed strongly with the statement, while 28.8% disagreed with 18.6% of the respondents being nonaligned. Conversely, 33.9% of the interviewees agreed that government initiatives are beneficial, and 7.6% strongly agreed, suggesting some recognition of the positive impact of these measures. The score mean of 2.9831 and deviation of 1.17657 standard designate a general tendency towards disagreement with the statement. The mean score indicates that many respondents do not perceive government initiatives as sufficiently beneficial for their businesses.

Incentive structures are put in place to unlock opportunities for the success of business indicated that 1.7% of participants disagreed strongly with the declaration, while none disagreed as 0.8% remained neutral. Furthermore, 58.5% of the participants agreed that incentive structures positively influence business success, and 39.0% strongly agreed, reflecting strong support for the role of incentives in fostering business growth. The score of 4.3305 mean and deviation of 0.66737 standard suggests a general tendency towards agreement. The high mean score underscores the perception that incentives are crucial for motivating performance and driving growth. Concerning the declaration that government activity is effective and increases performance, 2.5% of participants strongly disagreed with the statement, while 3.4% disagreed indicating a small level of disbelief regarding the effectiveness of government activities as 6.8% remained neutral. However, 68.6% of the participants agreed that government activities contribute positively to performance, and 18.6% strongly agreed, demonstrating strong overall support for these initiatives. The score mean of 3.9746 and deviation of 0.78948 standard

suggests a general tendency towards agreement. The mean score reflects confidence in the effectiveness of government initiatives aimed at supporting SMEs.

The average score across these statements stands at 3.9124, indicating a generally positive perception of government initiatives aimed at supporting SMEs. This high average suggests that respondents largely believe in the effectiveness of government activities in fostering SMEs conducive environment for expansion. Such sentiments highlight the importance of continued government engagement and policy refinement to further enhance the operational landscape for SMEs in the region. The results align with those of Hayleslasie (2023), who found that program interventions positively influence the innovation process at scale. Additionally, Alkahtani, Nordin, and Khan (2020) highlighted significant financial support from the government for the interaction between supply chain performance (SCP) and networking structures in Pakistan. However, these findings contrast with those of Ye, Yi, Fangjang, and Yuzhu (2022), who indicated that government involvement severely restricts enterprise investment in resources for technological innovation, whereas reduced government intervention can enhance such investments. The differences in findings may be attributed to the specific contexts of the studies, which feature unique government intervention programs that may not be universally applicable.

#### **4.2.10 Financial Performance**

Financial performance is influenced by various macroeconomic factors, including access to credit and effective management practices. Studies indicate that SMEs utilizing microfinance services experience improved financial outcomes, with significant increases in profit margins and sales attributed to these financial supports, as evidenced by high mean scores in respondent surveys. The views of the respondents are demonstrated in Table 4.11.

**Table 4.11: Descriptive for Financial Performance**

Statement	Percentage					Mean	Std. Deviation
	SD	D	N	A	SA		
My SME has consistently achieved its financial targets over the past year	4.2	6.8	6.8	50.8	31.4	3.9831	1.02100
The financial performance of my SME is primarily influenced by effective marketing strategies	1.7	5.1	11.0	54.2	28.0	4.0169	.86709
I believe that employee training and development have a positive effect on the SMEs performance financially	1.7	10.2	8.5	56.8	22.9	3.8898	.93172
External economic factors (e.g., inflation, interest rates) significantly affect the profitability of my SME	4.2	4.2	5.1	49.2	37.3	4.1102	.98522
My SME effectively manages its cash flow to ensure financial stability	3.4	5.1	6.8	50.8	33.9	4.0678	.95835
Access to government support programs has improved the financial performance of my SME	3.4	2.5	8.5	56.8	28.8	4.0508	.88528
<b>Average Score</b>						<b>4.0198</b>	<b>0.94144</b>

Source: Field Data (2024)

Table 4.11 presented an analysis of respondents' perceptions regarding the statement that my SME has consistently achieved its financial targets over the past year where 4.2% of participants strongly disagreed with the statement, while 6.8% disagreed and similar 6.8% remained neutral. In contrast, 50.8% of the interviewees agreed that their SMEs met financial targets, and 31.4% strongly agreed, demonstrating strong confidence in their financial achievements. The score

mean of 3.9831 and deviation of 1.02100 standard demonstrates a general tendency towards agreement among respondents. The findings underscore a positive perception among SMEs regarding their ability to achieve financial targets. The performance of my SME financially is primarily influenced by effective marketing strategies had 1.7% of participants who disagreed strongly with the statement, while 5.1% disagreed as 11.0% of the respondents remained nonaligned. In dissimilarity, 54.2% of the participants agreed that effective marketing strategies positively affect their financial performance, and 28.0% strongly agreed demonstrating support for this perspective. The score of 4.0169 mean and deviation of 0.86709 standard signifies a general tendency towards agreement. The mean score reflects confidence in the impact of marketing efforts on achieving financial goals.

Regarding the statement that I believe that employee training and development positively impact the financial performance of my SME, 1.7% of participants disagreed strongly with the proclamation, while 10.2% disagreed as 8.5% of the respondents were indifferent. The findings noted that 56.8% of the respondents agreed that employee training and development positively affects their financial performance, and 22.9% strongly agreed. The score mean of 3.8898 and deviation of 0.93172 standard specifies a general tendency towards agreement. The mean score reflects confidence in the positive impact of such initiatives. The survey results regarding the statement that external economic factors (e.g., inflation, interest rates) significantly affect the profitability of my SME indicate that 4.2% of participants strongly disagreed with the statement, while another 4.2% disagreed as 5.1% remained impartial. 49.2% of the participants agreed that external economic factors positively affect their profitability, and 37.3% strongly agreed. The score of 4.1102 mean and deviation of 0.98522 standards points to a general tendency towards

agreement reflecting confidence in the impact of external conditions such as inflation and interest rates on financial outcomes.

Regarding the statement that my SME effectively manages its cash flow to ensure financial stability, 3.4% of participants disagreed strongly with the declaration, whereas 5.1% disagreed with 6.8% being not taking sides. Contrary, 50.8% of the interviewees agreed that they effectively manage their cash flow, and 33.9% strongly agreed. The score of 4.0678 mean and deviation of 0.95835 standards indicates a general tendency towards agreement among interviewees noting confidence in their ability to manage cash flows effectively. The survey results regarding the statement that access to government support programs has improved the financial performance of my SME revealed that 3.4% of participants disagreed strongly with the declaration, whilst 2.5% disagreed as 8.5% remained neutral. In comparison 56.8% of the interviewees affirmed that government support programs positively affect their performance, and 28.8% agreed strongly. The score of 4.0508 mean and deviation of 0.88528 standards reflects assurance in the effectiveness of these programs.

The average score across these statements stands at 4.0198, indicating a generally positive perception of the factors influencing financial performance among Nairobi City County's SMEs. This high average suggests that respondents largely believe in the effectiveness of marketing strategies, employee development, cash flow management, and government support in enhancing their financial outcomes. These findings underscore the importance of continued investment in these areas to foster growth and sustainability within the SME sector in the region.

### **4.3. Correlation Analysis**

Correlational analysis performs a pivotal role in understanding the link among macroeconomic environment and the financial performance of SMEs. By examining variables such as taxation,

inflation, government policies, and economic activities, the study identified how these macroeconomic factors influence the operational success and profitability of SMEs. The conclusions reached from the examination are documented in Table 4.12.

**Table 4.12: Correlation Analysis Results**

		Financial Performance	Taxation	Inflation	Government laws and policy	Government Activity
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
Taxation	Pearson Correlation	.031	1			
	Sig. (2-tailed)	.735				
Inflation	Pearson Correlation	.764**	.135	1		
	Sig. (2-tailed)	.000	.144			
Government laws and policy	Pearson Correlation	.685**	.142	.756**	1	
	Sig. (2-tailed)	.000	.124	.000		
Government Activity	Pearson Correlation	.576**	.109	.718**	.632**	1
	Sig. (2-tailed)	.000	.242	.000	.000	

Source: Field Survey (2024)

Table 4.12 demonstrated the interplay between financial performance and various macroeconomic factors where it was revealed that the association among financial performance and inflation is notably strong at  $r=0.764$ , with a significance level of  $p<0.001$ , suggesting that

inflation has a substantial positive connection with the financial performance of SMEs. This implies that as inflation rises, it may lead to increased prices for goods and services, potentially enhancing revenue for SMEs that can pass on these costs to consumers. The results are in line with those of Ojimba, Okafor, Okeke, and Mbah (2023) and Okeke *et al* (2020), who found that inflation rates significantly impact the organizational effectiveness of companies. In contrast, the correlation between financial performance and taxation is weak ( $r=0.031$ ,  $p=0.735$ ), indicating that taxation does not significantly affect the profitability of SMEs, possibly due to the relatively low tax burden on smaller enterprises or effective tax management strategies employed by them. The results align with those of Wadesango, Muzenda, Satande, and Malatji (2021) and Ogbonna, Onuoha, Chukwu, and Ojeaburu (2020) found that during their study period, taxes in Nigeria did not significantly correlate with the financial success of SMEs.

Furthermore, government laws and policies show a strong positive correlation with financial performance ( $r=0.685$ ,  $p<0.001$ ), highlighting the importance of a supportive regulatory environment for enhancing SME profitability. This relationship suggests that favorable government policies creates an enabling environment for SMEs to thrive, possibly through incentives or reduced compliance costs. The results align with those of Nwalusiuka (2021), who revealed that supportive government policies significantly contribute to addressing business startup challenges in the study area. Additionally, government activity, which includes interventions and support programs, also correlates positively with performance financially ( $r=0.576$ ,  $p<0.001$ ), reinforcing the idea that proactive government involvement can significantly enhance the operational success of SMEs by providing necessary resources and support. The results align with those of Alkahtani, Nordin, and Khan (2020) who highlighted significant

financial support from the government for the interaction between supply chain performance (SCP) and networking structures in Pakistan.

#### 4.4 Tests for Diagnostic

The survey included tests for diagnostic to confirm that none of the axioms associated with the least squares regression method were breached. This step was essential to uphold the reliability and validity of the survey's findings. As noted by Williams, Grajales and Kurkiewicz (2019), violations of any fundamental assumptions underlying classical linear regression can lead to doubts regarding the credibility of the conclusions drawn. In this research, a range of diagnostic techniques was utilized to assess critical factors, including normality, multicollinearity, heteroscedasticity, and serial correlation.

##### 4.4.1 Autocorrelation Test

To examine the presence of autocorrelation within the model, the survey utilized the Breusch test with precision. The null posited that there is no autocorrelation present. A significance level of 0.05 was established as the threshold for determining statistical significance. The findings from this analysis detailed and presented in Table 4.13, provided a clear overview of the outcomes obtained from the test.

**Table 4.13 Autocorrelation Results**

<b>Breusch-Godfrey Serial Correlation LM Test:</b>			
F-statistic	0.671922	Prob. F(2,111)	0.5128
Obs*R-squared	1.411503	Prob. Chi-Square(2)	0.4937

**Source: Field Survey (2024)**

Table 4.13 demonstrated an F-statistic of 0.671922 with a corresponding p-value of 0.5128, and an Obs\*R-squared value of 1.411503 with a p-value of 0.4937. These statistics indicated that there is no significant autocorrelation present in the residuals of the model used to analyze the performance of SMEs, suggesting that past values do not influence current observations in a statistically significant manner. The absence of autocorrelation indicates that SMEs can rely on their financial models for decision-making without concern for underlying systematic errors that could distort performance assessments.

#### **4.4.2 Heteroscedasticity Test**

To ensure the reliability of the model, an examination of heteroscedasticity was conducted. This assessment sought to identify any potential relationships between the error terms across different observations. The core assumption declared homoscedastic of the residuals, which would indicate a constant variance among them. A value of p exceeding 0.05 suggested the presence of variance constancy, indicating that the model's residuals displayed a stable pattern. The findings from the test are carefully in depth in Table 4.14.

#### **Table 4.14 Heteroscedasticity Test Results**

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##### **Breusch-Pagan / Cook-Weisberg test for heteroskedasticity**

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Ho: Constant variance

Variables: fitted values of Financial Performance

chi2(1) = 1.43

Prob > chi2 = 0.2324

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**Source: Field Survey (2024)**

Table 4.14 disclosed that with a chi-square statistic of 1.43 and a p-value of 0.2324, the findings suggest that there is no significant evidence of heteroscedasticity in the model used to analyze

the financial performance of SMEs. This outcome implies that the residuals from the regression analysis exhibit a consistent variance across different levels of fitted values, supporting the assumption of homoscedasticity. Consequently, the reliability of the regression estimates is enhanced, allowing for more valid inferences.

#### 4.4.3 Multicollinearity Test

To assess the extent of correlation regarding the model’s factor explanatorily, an assessment of multicollinearity was conducted utilizing the variance inflation factor (VIF) method. A threshold of 5 was set to identify potential multicollinearity issues. Specifically, VIF values exceeding 5 indicated the presence of collinearity, whereas values below 5 suggested that significant collinearity was not an issue. The outcome is obtainable in Table 4.15.

**Table 4.15 Variance Inflation Factors Results**

Variable	VIF	1/VIF
Taxation	1.02	0.977985
Inflation	3.01	0.332661
Government Laws and Policy	2.43	0.412347
Government Activity	2.15	0.465273
Mean VIF	2.15	

**Source: Field Data (2024)**

Outputs in Table 4.15 displayed that taxation showed a VIF of 1.02, indicating minimal multicollinearity, while inflation has a VIF of 3.01, suggesting moderate correlation with other factors. Government laws and policy and government activity presented VIFs of 2.43 and 2.15, respectively, indicating some interrelatedness. The overall mean VIF of 2.15 suggests that while multicollinearity exists, it is not severe enough to compromise the analysis. The low VIF values

suggest that collinearity has a minimal effect on the model, ensuring that the estimated parameters remain reliable and accurate.

#### 4.4.4: Normality Test

Table 4.16 presented the outcomes of the Shapiro-Wilk test, which evaluates the normality of the model. The analysis of the study's data demonstrated whether the data exhibited conventional normality, as evidenced by their non-significant probability values. According to Table 4.16, a value of p above 0.05 signifies normality; conversely, a p-value below this threshold indicates a lack of normality.

**Table 4.16 Test Results for Normality**

Variable	Obs	W	V	z	Prob>z
Financial Performance	118	0.85602	13.659	5.852	0.00000
Taxation	118	0.94474	5.242	3.708	0.00010
Inflation	118	0.79069	19.858	6.690	0.00000
Government Laws and policy	118	0.82654	16.456	6.269	0.00000
Government Activities	118	0.88748	10.675	5.300	0.00000

**Source: Field Survey (2024)**

Table 4.16 explained that financial performance data and other variables analyzed—taxation, inflation, government laws and policy, and government activities—do not follow a normal distribution as evidenced in the values of p lower in view of 0.05. The substantial observations size supports the conclusion that the residuals in the factors survey conform to a normal distribution. The large sample size employed in this study lends empirical credibility to the assumption of a standard distribution for the residuals across the variables analyzed. As highlighted by McEwan (2020), the central limit theorem asserts that with an increasing sample

size, the probabilistic properties of sample averages tend to resemble a normal distribution, irrespective of the original distribution of the population. The researcher underscores that this crucial statistical principle mitigates concerns regarding non-normality in the data, as the significant number of the observations exceeding 30 produces normally distributed residual means according to probabilistic theory.

#### 4.5 Regression Results

Regression analysis served as a vital statistical instrument for exploring the effect of macroeconomic factors on the SMEs financial performance. By employing regression techniques, the study quantifies how variables such as taxation, inflation, and government policies affect the profitability and operational success of SMEs. The outputs are compiled and offered in Table 4.17.

**Table 4.17: Results of Regression**

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	-.308	.404		-.762	.448
	Taxation	-.079	.056	-.084	-1.428	.156
	Inflation	.718	.126	.573	5.684	.000
	Government	.393	.139	.257	2.830	.006
	Laws and Policy					
	Government	.016	.117	.012	.135	.893
	Activity					
	R	.786 <sup>a</sup>				
	R Square	.618				
	F	45.709				
	Sig.	.000 <sup>b</sup>				

Source: Field Survey (2024)

Table 4.17 uncovered that the constant term in the regression model is -0.308, which indicates the expected value of the dependent variable (financial performance of SMEs) when all independent variables are set to zero. A negative constant suggests that without the influence of

taxation, inflation, government laws and policies, and government activity, the baseline financial performance may be below zero. The correlation coefficient  $R$  is 0.786, suggesting a robust positive association among the explanatory factors and the explained factor. This suggests that as macroeconomic factors change, there exist a substantial connection with changes in performance among SMEs financially. The  $R^2$  value of 0.618 implies that 61.8% of the variation in financial performance is explained by the model's explanatory factors. This is a substantial proportion, indicating that the selected macroeconomic factors are relevant predictors of SME performance. The  $F$ -value is 45.709 with a significance level (Sig.) of 0.000 demonstrates that the model is significant statistically. This means that at least one of the independent variables has a non-zero coefficient, suggesting that these macroeconomic factors collectively have a considerable influence on SME financial performance.

Table 4.17 further noted that the coefficient for taxation is -0.079 with a significance level of 0.156. This designates a negative link between taxation and SME financial performance; however, it is not statistically significant at conventional levels ( $p < 0.05$ ). The outcome suggests that an increase in the SMEs that performed financially by 0.079% is as a result of 1 percent reduction in taxation. The outcome implies that the null hypothesis is not rejection noting that taxation does not perform a decisive task in enhancing the SMEs financial performance. The findings could be accredited to the various factors, such as the possibility that SMEs have developed strategies to mitigate tax burdens or those other macroeconomic variables may exert a more dominant influence on their financial outcomes, thereby masking the true impact of taxation in this specific context. The outcomes are in conformity with Wadesango, Muzenda, Satande and Malatji (2021) that showed that bank transfer taxes and wireless cash taxes have a negative impact on SMEs' ability to obtain financing. Ogbonna, Onuoha, Chukwu and Ojeaburu

(2020) found that during the study period, taxes in Nigeria had no meaningful relationship to the financial success of SMEs.

Inflation has a coefficient of 0.718 and is highly significant ( $p = 0.000$ ). This positive relationship suggests that inflation positively impacts SME financial performance. The outcome implies that a surge in inflation by a proportion leads in enhancement of 0.718 percent in the SMEs financial performance. The outcome indicated that the p-value of less than 0.05 thus leading to the rejection of the null hypothesis thus concluding that inflation play a crucial role in proving the SMEs financial performance. The outcome could be attributed to the ability of SMEs to adjust their pricing strategies in response to rising costs, allowing them to maintain or even enhance their revenue streams during inflationary periods, thereby benefiting from increased consumer spending power and demand for goods and services. The findings are consistent with those of Ojimba, Okafor, Okeke and Mbah (2023) who uncovered that rate of inflation has a significant effect on pharmaceutical companies' organizational effectiveness. Okeke *et al* (2020) disclosed that South-East Nigerian SMEs' performance is significantly harmed by inflation. Conflictingly, Atugeba (2021) observed that the inflation rate is a not a significant predictor of SMEs' success. The conflicting outcomes could be connected to the distinctiveness of the background frame which the studies were performed.

The coefficient for government laws and policy is 0.393 with a significance level of 0.006, demonstrating a positive and statistically significant relationship with SME performance. This suggests that favorable government regulations and policies contribute positively to the financial outcomes for SMEs, highlighting the importance of a supportive regulatory environment. This means that an improvement in government laws and policy by a percentage would amount in the enhancement of the SMEs financial performance by 0.393 percent. The result displayed a p-

value that is less compared to the 0.05 level thus noting that changes in government laws and policy significantly influence the SMEs performance financially. This may be linked to the supportive regulatory frameworks and favorable policies enacted by the government that could have enhanced the operational environment for SMEs, facilitating access to resources, reducing bureaucratic hurdles, and ultimately contributing to improved financial performance. The outcomes corroborates with those from Nwalusiuka (2021) who unraveled that favorable government policies play a significant role towards solving business startup problems within the study area. However, the outcome is inconsistent with those from Mwangemi, Wilson, and Mung'atu (2017) who noted that government policies were shown to have little effect on the expansion of businesses, even in spite of the emphasis placed on creating policies for small and medium-sized businesses. Musabayana, Mutambra and Ngwenya (2022) who unfolded that indicate that the government's inability to communicate its goals to those who carried them out is mostly to blame for the poor SMEs performance, that had a negative influence on the country's economy overall. The inconsistency in the findings could be as a result of the methodological variation in the studies as well as the conceptualization of the studies.

The coefficient for government activity is 0.016 with a significance level of 0.893, indicating no significant connection concerning government activity and SME financial performance. This implies that variations in government activity do not have a measurable impact on the financial outcomes for SMEs in this context. The findings imply that improvement in government activity by a percentage would results to enhancement in the financial performance of SMEs by 0.016 percent. Due to this result which disclosed a significance value above the 0.05 level, the hypothesis of government activity not having significant effect on financial performance is upheld leading to the conclusion that alteration in government activity do not significant enhance

the financial performance of these SMEs. This may suggest that the specific forms of government engagement or initiatives in place do not directly influence the financial outcomes of SMEs, possibly due to ineffective implementation, lack of alignment with SME needs, or the overshadowing impact of other more critical macroeconomic factors. The findings are consistent with the outcomes of Hayleslasie (2023) who discovered that program intervention positively affects the innovation process in terms of scale. The findings are at variance with those from Ye, Yi, Fangjang, and Yuzhu (2022) who showed that enterprise investment in resources for technological innovation is severely hindered by government involvement, whereas enterprise innovation investment can be enhanced by reduced government intervention. Alkahtani, Nordin, and Khan (2020) there is substantial and substantial financial support from the government for the interaction between SCP and networking structure in Pakistan. The disparity in the findings could be attributed to the study contexts which has unique government intervention programmes that cannot be generally applied to all environments.

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter offered a concise overview of the main outcomes, complemented by an analysis, actionable recommendations, and suggestion for future research. The summary is structured around the study's objectives, providing a clear framework of the research. The conclusions and recommendations are directly informed by the study's discoveries. Additionally, this chapter explores how the research enhances the overall understanding of the topic, adding valuable context and depth to the ongoing discussion.

#### 5.2 Findings Summary

Primarily, the investigation evaluated macroeconomic environment effect on City of Nairobi County's performance financially in Kenya. Uniquely, the influence of taxation, inflation, government laws and policy and government activity on these SMEs financial performance was uncovered. The theoretical postulation guiding the study were the open system theory, balanced score card theory, gibbs theory and institutional theory thus enabling the application and relevance of these theoretical framework within the study. Having considered this, the investigation went ahead to empirically evaluate the data within the framework of the regression and correlation approach with the outcome concisely noted therein.

In view of the effect of taxation on the SMEs financial performance, correlation outcome displayed that taxation has a weak positive not significantly connection with SMEs performance financially. Regressionally, the outcome demonstrated that taxation inversely and insignificant affect the SMEs financial performance. This implies that while there may be a tendency for

higher taxes to correlate with lower financial performance, this relationship is not strong enough to be statistically significant.

The investigation also analyzed the effect of inflation on the SMEs financial performance. The correlation analytical framework demonstrated that the nexus between financial performance and inflation is notably strong and significant. Furthermore, the significant effect was revealed by the regression outcome as it indicated positive and significant effect of inflation on the SMEs financial performance. This implies that in the context of Nairobi City County, SMEs may effectively leverage inflationary conditions to enhance their revenue, possibly by adjusting prices in line with rising costs or benefiting from increased consumer spending.

The effect of government laws and policy was examined on the SMEs financial performance. The correlation output noted there exist a positively strong connection among government laws and policy with performance financially. Similarly, the regression output unfolded that government laws and policy significantly and positively affects these SMEs financial performance. This implies that supportive regulatory frameworks and effective policy measures enhance the operational environment for these enterprises, facilitating access to resources, reducing operational challenges, and ultimately leading to improved financial outcomes.

Government activity effect on these SMEs financial performance was analyzed. The outcome unveiled that government activity had a significant connection with financial performance of the SMEs as evidenced by the correlation outcome. Furthermore, regarding the effect, the outcome unraveled an insignificant positive effect of government activity on the SMEs financial performance. This imply that the specific forms of government activity or support provided may not be effectively aligned with the needs of SMEs, or that other external factors are

overshadowing any potential positive impact, leading to a scenario where the overall influence of government activity on SME performance remains minimal and inconclusive.

### **5.3 Conclusions**

The investigation sought to unravel the effect of taxation these small and medium-sized enterprises (SMEs) financial performance. The outcome unveiled that taxation has an inverse and insignificant effect on these SMEs financial performance. The study concludes that while higher tax burdens may be associated with reduced financial outcomes for these enterprises, the lack of statistical significance indicates that this relationship is not robust enough to draw definitive conclusions. This result implies that other factors may play a more critical role in influencing SME performance, and it highlights the need for a better understanding of how taxation interacts with various operational challenges faced by SMEs. Consequently, policymakers should consider exploring alternative strategies to support SMEs, such as simplifying tax regulations or providing targeted incentives, to foster a more conducive environment for their growth and sustainability.

Effect of inflation was evaluated on the financial performance of the SMEs with the resulting noting that inflation significantly in a positive way affects these SMEs performance financially. In view of this, the conclusion is that these enterprises are able to capitalize on inflationary conditions to enhance their profitability. This suggests that SMEs may successfully adjust their pricing strategies in response to rising costs, potentially benefiting from increased consumer demand as purchasing power shifts. The finding highlights the resilience and adaptability of SMEs in navigating economic fluctuations, emphasizing the importance of understanding inflation not merely as a challenge but also as an opportunity for growth within the sector.

The analysis of government laws and policy influence on SMEs performance was performed. Give this, the findings demonstrated that government laws and policy significantly and positively affect the SMEs performance financially. Considering this outcome, the investigation concludes by underscoring the critical role that effective regulatory frameworks and supportive policies play in fostering a conducive business environment. This result indicates that when the government implements favorable laws and policies, such as incentives, access to financing, and streamlined regulations, SMEs are better equipped to thrive, innovate, and enhance their financial outcomes. This underlines the necessity for continued government engagement and reform aimed at strengthening the operational landscape for SMEs, which are vital for economic growth and job creation in the region.

The investigation investigated government activity effect on the SMEs performance financially. The outcome linked to this noted that government activity disclosed that significantly affect the SMEs performance financially in a positive manner. Concerning this, the study concludes that while there may be a slight beneficial influence from government initiatives, this impact is not strong enough to be statistically meaningful. This indicates that the specific forms of government engagement or support may not effectively address the needs of SMEs or may lack sufficient implementation to drive significant improvements in their financial outcomes. As such, it highlights the necessity for a more targeted and impactful approach to government activity, ensuring that policies and initiatives are better aligned with the operational realities of SMEs to foster substantial growth and enhance their financial performance.

#### **5.4 Recommendations**

Having considered the outcomes of the investigation, the recommendations are put forward. The government should consider revising tax policies to create a more favorable environment for

these enterprises. Specifically, the government should explore reducing tax rates and simplifying tax compliance processes to alleviate the financial burden on SMEs, enabling them to allocate more resources towards growth and innovation. Additionally, implementing targeted tax incentives and support programs could encourage formalization and compliance among SMEs, ultimately fostering a more robust business ecosystem that contributes to economic development and job creation in the region.

The government should leverage on the macroeconomic dynamic by developing strategies that support SMEs in capitalizing on inflationary trends. This could include providing training and resources to help SMEs effectively adjust their pricing strategies and manage costs in response to inflation, as well as facilitating access to financing that allows them to invest in growth opportunities during inflationary periods. Additionally, the government should consider implementing policies that stabilize the macroeconomic environment, ensuring that inflation remains at manageable levels while enabling SMEs to thrive. By fostering an environment where SMEs can adapt and benefit from inflation, the government can enhance their contributions to economic growth and employment generation in the region.

The government should continue to enhance and streamline regulatory frameworks that support SME growth. This could involve simplifying compliance processes, reducing bureaucratic hurdles, and implementing targeted incentives that empower SMEs to thrive. Additionally, fostering a collaborative dialogue between government officials and SME stakeholders can ensure that policies are responsive to the actual needs of businesses, thereby maximizing their effectiveness. By prioritizing supportive laws and policies, the government can create an enabling environment that not only boosts the financial performance of SMEs but also contributes to broader economic development in the region.

The government should reassess and enhance the effectiveness of government initiatives aimed at supporting these enterprises. This could involve conducting thorough evaluations of existing programs to identify gaps and areas for improvement, ensuring that government activities are better aligned with the specific needs and challenges faced by SMEs. Additionally, increasing engagement with SME stakeholders through consultations and feedback mechanisms can help tailor government support to be more impactful. By focusing on practical and relevant actions that directly address the operational realities of SMEs, the government can strengthen its role in fostering a more vibrant and financially successful SME sector.

### **5.5 Contribution to Knowledge**

The investigation add to policy information by highlighting the need for a reassessment of taxation policies affecting SMEs in Nairobi City County, given that taxation was found to have an insignificant effect on their financial performance. This suggests that policymakers should consider implementing more favorable tax regimes or incentives specifically designed for SMEs, which could alleviate financial burdens and encourage growth. Additionally, the significant positive impact of government laws and policies on SME performance indicates that ongoing reforms aimed at enhancing regulatory frameworks can further support the sector, thereby informing future policy development focused on fostering a conducive business environment for SMEs.

The study underscores the importance of adaptive business strategies for SMEs in response to inflation, which was shown to have a significant positive effect on financial performance. This finding encourages SME owners to develop robust pricing strategies and cost management practices that can leverage inflationary periods for growth. Furthermore, the results emphasize the need for SMEs to engage actively with government initiatives and policies that are beneficial,

suggesting that businesses should seek to understand and utilize available resources and support systems effectively, thereby enhancing their operational practices in alignment with favorable government regulations.

The theoretical contribution of this study lies in its exploration of the complex relationships between macroeconomic variables and SME financial performance within a specific context. By establishing that inflation and government laws and policy significantly influence financial outcomes while taxation and government activity do not, the study challenges existing economic theories that may overemphasize the negative impacts of taxation on business performance. This understanding enriches the theoretical discourse on SME economics by suggesting that external economic factors can have varying degrees of influence, thus calling for a more differentiated approach in future research that considers contextual variables when analyzing SME performance dynamics.

### **5.6 Suggestion for Further Research**

Future research should explore the dynamics between macroeconomic factors and the financial performance of SMEs in Nairobi City County by incorporating a broader range of variables, such as access to finance, market competition, and technological adoption. Additionally, longitudinal studies could provide depth into how these relationships evolve over time, particularly in response to changing economic conditions and government policies. It would also be beneficial to conduct comparative studies across different regions or sectors to identify best practices and contextual factors that influence SME performance. Furthermore, qualitative research involving interviews or focus groups with SME owners could uncover the underlying reasons behind their responses to taxation, inflation, and government initiatives, thereby enriching the understanding of how these enterprises navigate their operational environments.

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## **APPENDICES**

### **Appendix I: Letter of Introduction**

ABUSWALEH GUYO

School of Business, Economics and Tourism

Kenyatta University,

Nairobi, Kenya.

#### **RE: Request that the Questionnaire survey be completed**

As a graduate student at Kenyatta University, I am studying the influence of Economic Environment Factors on The Performance of SMEs In Nairobi City County. This completes a prerequisite for Kenyatta University's Master of Business Administration program. Out of a wide group of participants, you were selected at random to participate in this study. It should only take you fewer than twenty (20) minutes to complete the questioner. Kindly provide an unbiased and truthful feedback. Your assistance was greatly valued and is essential to the success of this study. I promise to handle whatever information you submit with the utmost confidentiality and to use it only for educational purposes.

Confidentiality is rigorously guaranteed because this is an academic study; nowhere in the report would your name appear. Please allot some time to finish the survey that is attached.

Thank you very much.

Yours Faithfully

**ABUSWALEH GUYO**

**Appendix II: Questionnaires**

**Section A**

I am a Kenyatta University student pursuing an MBA. I am conducting a study on “Economic Environment Factors and financial performance of SMEs in Nairobi City County, Kenya” as part of my academic requirements. Please help me fill out this questionnaire so that I can finish writing this research. Thank you very much.

Kindly respond to all questions by inputting a TICK where applicable.

**Sex:** Male ( ) Female ( )

**Age:** Below 25 ( ) 25 – 50 years ( ) Above 50 ( )

**Educational Qualification:** Diploma ( ) Bachelor’s Degree ( ) Masters ( ) PhD. ( ) others ( )

**Years of Business experience:** Below 5 years ( ), 6 – 15 years ( ) above 15 years ( )

**Indicate business owner or manager**.....

**SECTION B**

Please tick your preferred answer in line with the following parameters: Strongly Agree, Agree, Indifferent, Disagree and Strongly Disagree.

**TAXATION**

No	Statement	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree
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1	Business pays certain levies both for the county and national level					
2	Government has reduced tax rates on profits of SMEs to encourage better operation					
3	levies paid from the business affects the growth of the business					
4	SMEs enjoy some form of tax holidays granted by the government					
5	The government need to reduce the levies charged on small business owners					
6	deductions reduces performance					

## INFLATION

No	Statement	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree
1	Inflation rate affects my business					
2	Prices of goods and services increases frequently					
3	Increase in inflation rate reduces the performance of SMEs					
4	Government increase in					

	spending has benefited SMEs					
5	Inflation has been both a blessing and a curse for SMEs performance					
6	Inflation has led to increased operational costs for my SME					

### GOVERNMENT LAWS AND POLICIES

No	Statement	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree
1	Government has created policies that benefits SMEs					
2	Strategic law initiatives have been put in places by government to increase SMEs s sustainability					
3	Business registration with the government comes with benefit for SMEs performance					
4	Technology upgrade has been put in place for easy access to various business in Nairobi county					
5	Government policies and laws for SMEs provides opportunity through which the evolution can					

	be realized					
6	Technology upgrade is beneficial to the performance of SMEs					

### GOVERNMENT ACTIVITY

No	Statement	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree
1	Government offerstraining on skill development, funding and monitor business to ensure business remain sustainable					
2	Government trainSMEs on market competition and provide an environment to sustain the competition					
3	Government provides high advantageous environment necessary for development of SMEs					
4	The government support with tax incentives, socializing, and strategies for SMEs					

5	Incentive structures are put in place to unlock opportunities for success of business					
6	Government activity is effective and increases performance					

### FINANCIAL PERFORMANCE

No	Statement	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree
1	My SME has consistently achieved its financial targets over the past year					
2	The financial performance of my SME is primarily influenced by effective marketing strategies					
3	I believe that employee training and development have a positive impact on the financial performance of my SME					
4	External economic factors (e.g., inflation, interest rates) significantly affect the profitability of my SME					
5	My SME effectively manages its cash flow to ensure financial stability					

6	Access to government support programs has improved the financial performance of my SME					
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