

**ECONOMIC FACTORS INFLUENCING GROWTH OF SMALL AND  
MEDIUM ENTERPRISES IN MOMBASA COUNTY, KENYA**

**BY**

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**A FINAL RESEARCH THESIS SUBMITTED TO THE SCHOOL OF  
BUSINESS AND ECONOMICS IN PARTIAL FULFILLMENT OF THE  
REQUIREMENTS FOR THE AWARD OF MASTERS OF  
ARTS DEGREE IN ECONOMICS**

**MOI UNIVERSITY**

**2025**

## DECLARATION

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## **DEDICATION**

This final research thesis is dedicated towards my loving wife Gladys A. Babu and my beloved handsome young men sons, Stanley M. Mwakio, Shamir Maghanga B, St. Alfred Maghanga Jr., thank you both for always supporting me in my every step along this journey. As the saying goes 'charity begins at home' and family is the major step that without their love and support this project would not have been made possible.

## **ACKNOWLEDGEMENT**

My heartfelt appreciation goes to my family for their continued support, prayers and encouraging kind words during my studies. Family Love, career progression, change, ambitious future was key to my researching level of my studies. Above all, am grateful to the Almighty God for the gift of life and His wisdom to inspire and strengthening me to successful complete this study. I will remain indebted to my supervisor's Dr Patrick Onsando and Dr Stanley Kavale from Moi University whose assistance, stimulating suggestions and guidance helped me during the entire period of this research. Lastly, the academic establishment of Moi University, Coast Campus personnel for their guidance and key relevant stakeholders that enabled finalize this enriched research thesis.

## ABSTRACT

Small and Medium Enterprises (SMEs) contribute over 70% of jobs, contribute to GDP, aid industrial development, satisfy local demand for services, innovate and support large firms with inputs and services. However, the SMEs in Mombasa County are constantly faced with the threat of failure where three out five fails at infancy. The study investigated the influence of economic factors (taxation, finance access and wages and unemployment) on growth of SMEs in Kenya, in Mombasa County. The specific objectives of the study were; to explore the effect of taxation on growth of SMEs, to find out the effect of Financial Access on growth of SMEs, to determine the effect of wages on growth of SMEs operating, and to evaluate the effect of general unemployment on growth of SMEs operating in Mombasa County. This study employed the institutional theory of growth, the Schumpeter theory of growth and the Endogenous growth theory anchored the study. An explanatory research design was used so as to meet the research objectives. The target population was 54,245 registered SMEs and a sample size of 246 was derived using the Cochran, statistical formula. The list of registered SMEs in Mombasa formed the study population. A Systematic Random Sampling was used from a sample of 246 SMEs was drawn. Data was collected using a structured questionnaire. Multiple linear regression Analysis technique was the main technique to find the effect of social economic factors on SMEs growth. to analyze the data using the Statistical Package for Social Sciences with a significance level set at 0.05. Findings showed that SE conditions are just modest level. Correlation results showed that Taxation conditions ( $r=.344$ ,  $p=.000$ ), Financial Access ( $r=.430$ ,  $p=.000$ ), Wages affordability ( $r=.241$ ,  $p=.000$ ) are positively and significantly correlated with SMEs growth. Multiple Linear Regression results showed that Economic factors; Taxation conditions ( $\beta=.268$ ,  $p=.000$ ), Financial Access ( $\beta=.383$ ,  $p=.000$ ), Wages ( $\beta=.182$ ,  $p=.015$ ) and Unemployment ( $\beta=-.170$ ,  $p=.045$ ) has significance effect on SMEs growth. Conclusions; Economic factors can reverse the current trend of high SMEs failure rate. Economic factors can buck the present trend of a high failure rate among SMEs. The study recommended that the county and national governments should implement measures enhancing tax benefits for SMEs such as utilizing the taxes prudently. Additionally, the SMEs should adopt strategies that enhance internal financial capabilities so as to incase their revenue streams. Moreover, it is recommended the SMEs to have a working and sustainable wage policy that is able to attracts and keeps talented workforce and therefore ensure continued business growth. By using a multi-sectoral approach, both local and national governments should prioritize and focus on short- and long-term policies that lower the rising rates of unemployment.

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**ACRONYM AND ABBREVIATIONS OF TERMS**

ANOVA	Analysis of Variance
CAIPs	County Aggregation and Industrial Parks
EGT	Endogenous Growth Theory
ESP	Economic Stimulus Package
FA	Factor Analysis
GDP	Gross Domestic Product
ICRMS	Integrated County Revenue Management System
IOM	International Organization for Migration
KNBS	Kenya National Bureau of Statistics
MEDA	Mennonite Economic Development Associates
OLS	Ordinary Least Squares
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for the Social Sciences
STG	Schumpeter Theory of Growth
UKAID	United Kingdom Agency for International Development
UN Habitat	United Nations Human Settlements Programme
USAID	United States Agency for International Development

## DEFINITION OF KEY TERMS

Economic factors	refer to conditions affecting the performance and growth of businesses, including inflation, interest rates, taxation, and access to finance (Samuelson & Nordhaus, 2019). These factors influence business operations, resource allocation, and overall economic stability.
Financial Access	refers to the ability of businesses to obtain funding, credit, and capital to support their operations and growth. It is a key determinant of SME sustainability, as limited financial access constrains business expansion and innovation (Beck & Demirgüç-Kunt, 2008).
Growth of SMEs	the growth of SMEs is assessed based on indicators such as an increase in gross profit, revenue, and the number of employees. It reflects the overall business performance and sustainability over time (Storey, 1994).
SMEs	In Kenya, SMEs are categorized as enterprises with 10 to 100 employees and annual revenue ranging from Ksh 5 million to Ksh 800 million (Kenya National Bureau of Statistics, 2020).
SMEs Growth	SMEs growth refers to the expansion of small and medium-sized enterprises in terms of revenue, profitability, market share, employee base, and operational capabilities. Growth can be measured through financial performance, employment levels, and market penetration (Davidsson & Delmar, 2016).
Taxation Conditions	refer to the level of tax burden, incentives, and policies imposed on businesses, which can influence their financial performance

and investment decisions. Favorable tax policies can enhance business growth by reducing operational costs, while excessive taxation can stifle expansion (Holtz-Eakin, 1995).

Unemployment Levels indicates the proportion of the labor force that is jobless but actively seeking employment. High unemployment rates can negatively impact SMEs by reducing consumer purchasing power and demand for goods and services (Mosikari, 2013)

Wage Affordability is the ability of SMEs to meet employee wage obligations while maintaining profitability and operational efficiency. Competitive wages help attract skilled labor, which enhances productivity and business growth (Dewalheyns et al., 2021).

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.0 Overview**

This is an introductory chapter that aims to lay the foundation of the study. It covers the background of the study, the Problem Statement, the objectives, hypothesis and the significance of the study.

The scope of the study is covered at the end of the chapter.

#### **1.1 Background of the Study**

Small and medium enterprise, or SMEs, are recognized globally as the catalysts for both equitable development and economic growth. They can help generate the majority of the one billion new jobs that the world will require by the end of this century because they are capital efficient, laborintensive, and labor-intensive (Korunka & Kubicek, 2017). They are also seen as essential to generating jobs, reducing poverty, and fostering economic growth. Their importance especially in developing economies cannot be emphasized. Even the legitimacy of governments today is increasing assessed by the perceived success governments to provide an enabling business environment for the formal and informal sector (Page & Shimeles, 2015). Because of the diversities in development and business environment across the world economies, the growth of SMEs is diverse as well (Belyaeva, 2018). Data shows that developed countries on average have consistently recorded a vibrant SMEs sector compared with the less developed economies. This difference in SMEs vibrancy creates uneven distribution of job opportunities across the globe with less developed economies being more disadvantaged. And this is paradoxical because it is the less developed economies that are relatively in greater need for the job opportunities that SMEs sector provides

(Marmot, 2015). Moreover, a good number of the countries with poor record of SMEs growth are in Africa (Quartey, Turkson, Abor & Iddrisu, (2017). The growth of SMEs is a means to economic growth by contributing towards gross domestic product, creating jobs, reduction in poverty, generate income and facilitate nation's wealth thus resulting in national development of a country (Zafar, & Mustafa, S. (2017). The ongoing battle for market dominance in businesses creates a situation where suppliers and customers benefit, boosting overall productivity and the efficiency of the entire economy. Though many SMEs fail before they reach the five-year mark, which causes higher rate of unemployment, new entrepreneurs often bring innovations, ideas, and skills to the table. Depending on the number of employees, yearly turnover, asset value, small businesses are defined and classified differently in each country. European Union comprises of 28 member states that offers the most frequently cited definition. Various definitions are applied in Africa to classify businesses. In Ghana, a small business is defined as one that employs five to fifty people, has less than \$30,000 in annual revenue, and has assets of less than \$30,000. In order to mitigate the high perceived risk of SMEs, more instruments are frequently needed to generate a larger pool of capital. Here's where the promises come in handy. Guarantees are agreements whereby development actors assume responsibility for possible future liabilities that would have otherwise been incurred by commercial lenders, as opposed to directly providing capital to SMEs. These assurances aid in the stimulation of private capital flows by modifying the risk-return calculation. Between 2012 and 2018, guarantees were the blended finance instrument that mobilized the greatest amount of private capital in developing nations. One of the most popular types of guarantees, first-loss coverage binds development finance organizations to reimburse private lenders in the event that an SMEs fails to make loan payments. Many SMEs can get by with very little assistance

before they are prepared to accept outside investment. Their dilemma stems from the fact that they are too big to be eligible for microloans and too little to be attractive to banks. Development actors bridge this gap by offering front-end grant funding, which provides SMEs with the initial working capital they require to grow successfully until traditional debt becomes a feasible source of financing. Some SMEs need more than just financial support; they also need deeper knowledge. This is where having technical support can be helpful. In the context of development, "technical assistance" (also known as "technical cooperation") generally refers to support for a particular project or national program, including research and data sharing, technical advice, and skills training.

### **1.1.1 SMEs in Africa**

In Africa, Small, Medium and enterprise are estimated to be 17.4M accounting for 50% of industrial jobs and about 90% of manufacturing sector. But they face a number of growth challenges including unfriendly business environment (Ojong-Ejoh, et al 2021). Sub-Saharan Africa, SSA, is ranked as the region in the world where it is most difficult to do business. Though Africa is endowed with many resources, analysis reports show Sub-Saharan African countries as being most over-represented in the low end of the growth scale. Actually, countries such as The Democratic Republic of Congo, Chad and Burundi are at the bottom of the scale. The consequences of this unfavorable business environment are that growth of the SMEs in terms of numbers and size is significantly hampered (Quartey, et al.2017). A number of external factors like low access to finance, poor supply of production resources and vibrant business environment keep dominating the list of reasons for vibrant business environment and business growth (Quartey, et al. 2017). In South Africa SMEs are major sources of employment with around 68% of the population working in them. They are also a major source of income generation and

poverty alleviation (Kallier, 2017). Asah et al., 2015). However, many SMEs do not achieve their full potential; with some failing to grow while others fail completely. The failure rate is estimated to be between 70% and 80% with a 70% failure rate within the first year of operation (Neneh, & Van, 2017). SMEs make up 70% of the workforce in Ghana, Rwanda, Nigeria, Cameroon, Uganda, and Tanzania. However, these enterprises face numerous challenges, including low survival rates and limited access to finance. SMEs continue to struggle in Rwanda due to a wide range of challenges, and survival rate is disconcertingly low with SMEs account for 98% of all enterprises and employ nearly half of private sector workers. In Nigeria, SMEs contribute 46% of GDP and 25% of employment. In Cameroon, SMEs account for 22% of GDP but have a low survival rate. Within East Africa region, In Uganda experiences an alarming failure rate where 75% of SMEs fail before the third year (Nkwabi, & Mboya, 2019). In Africa, discrimination and barriers based on a woman's gender still affect her earnings, her ability to engage with the community, and her capacity to run a successful business. Legal discrimination, social norms, the possibility of gender-based violence, gaps in education and skill sets, risk aversion and confidence, information and network access, the distribution of productive resources within the household, time restraints, and childcare are a few of these. Due to these challenges, the average monthly income of women-owned businesses in Africa is 34% lower than that of men-owned businesses. Only 10% of SMEs owned by women have access to the necessary funding. Private lenders view women as even more risky due to their lack of credit histories and limited access to land for collateral. The majority of African economies are built on SMEs. They make up the majority of businesses in Sub-Saharan Africa, making up 60% of all enterprises (Nuwagaba, 2012) and contributing 41% of the region's economic growth (Tumwine et al., 2015). The informal and formal sectors make up the two parts

of African economies. Businesses in the unofficial sector typically function without a business registration or license. SMEs make up over 90% of formal businesses, are present in almost all industrial sectors of the economy, and account for over 50% of GDP and employment (Akinboade, 2015). Approximately 68% of the workforce in South Africa works for SMEs, making them a significant source of employment (Rabie et al) SMEs employ a sizable fraction of the labor force in Cameroon and are estimated to contribute 22% of the nation's GDP (Akinboade, 2015). In Uganda, small and medium-sized enterprises (SMEs) not only contribute to GDP but also generate jobs for skilled, semi-skilled, and unskilled workers. They also provide a more equitable distribution of national income, which promotes economic growth and development (Kakwa, 2008). In Ghana, micro, small, and medium-sized businesses employ about 70% of the labor force (Chu et al., 2007). These companies operate in a variety of industries, such as manufacturing, services, and agriculture, and they are essential to the nation's economic development and job creation.

### **1.1.2 SMEs in Kenya**

Since Kenya's independence, the country has made significant strides in combating poverty, ignorance, and diseases by focusing on job creation and fostering a vibrant informal sector. However, recent years have seen a low survival rate and unimpressive growth performance in employment generation, leading to research interests on the socioeconomic ecosystem of small and medium-sized enterprises (SMEs). As of 2021, there are 7.41 million SMEs in Kenya, with only 1.56 million licensed and 5.85 million unlicensed. These SMEs account for 98% of the business population and employ 14.9 million people. The value of SMEs output is estimated at Ksh 3,369.1 billion, contributing 4.0% to GDP in 2021. In terms of gross value added, SMEs contribute 1,613.0 billion compared to Ksh 5,668.2 billion for the entire economy. The SMEs

sector is crucial for achieving national goals such as employment creation, poverty alleviation, and balanced development across sectors and sub-sectors. It is central to national strategies for stimulating economic activity, reducing unemployment, and poverty reduction. However, despite their transformative power, the national government launched an economic model the (BETA) bottom-up economic transformative agenda designed to economical empower and turn around and inclusive enable growth through value chain approach on the small and medium enterprise to assist pump life to the sector, still the SMEs face growth challenges, particularly in size and number. Out of the 5.6 million SMEs businesses, only 9% employ more than 10 employees, and 47% employ less than 3 employees (KNBS 2020). This suggests significant growth bottlenecks exist in Kenya's business environment, necessitating further assessment of SMEs sector to unlock their full potential that will enable growth.

Kenya faces a number of challenges. The number of entrepreneurs who launch businesses in the formal sector, creating jobs and increasing government revenue, is influenced by the ease of registration, according to the 2017 Doing Business in Kenya report. In Kenya, the average cost of starting a business is 21.1% of a person's income, takes 22 days, and requires seven steps for both men and women. There are concerns about how simple it is for SMEs to start a business, despite Kenya's overall improvements in this area. According to the Deloitte Kenya Economic Outlook 2016, poor infrastructure, low capital, restricted market access, a lack of knowledge and skills, and the quick advancement of technology are all obstacles facing Kenyan SMEs. Other difficulties include corruption and an unfavorable regulatory environment. The government has established "Buy Kenya, Build Kenya" policies in public procurement, enforced laws requiring local content for public projects, supported research and development, and increased contributions to funds like the Uwezo in an effort to

address these issues. The Uwezo fund seeks to support women, youth, and people with disabilities while also increasing financial access. In addition, the Kenyan government intends to create SMEs parks and is supporting small and medium-sized manufacturing companies. A study discovered in 2016 that banks were not adequately supporting SMEs by another FSD project aimed at increasing capacity within Kenya's financial services sector. A few ways to improve financing would be to use more effective procedures for registering collateral, which would lower the high cost of SMEs credit, and to adopt new finance products like factoring and leasing. Since agriculture is the foundation of the economy, more funding access is needed. Despite the fact that the agriculture sector employs and sustains the majority of Kenyans—making up 80% of the country's employment and 30% of the GDP—its share of financing for SMEs is relatively low. In general, legislation, fiscal policies, financial institution strategy, and SMEs financing management all need to be changed. In its Vision 2030 plan, the Kenyan government has made SMEs a top priority. This is so because one of the nation's main four agendas—creating jobs—is something that these businesses accomplish. SMEs require sufficient funding sources in order to function (Kira, 2013). For small and medium-sized businesses (SMEs) to be able to launch and finance investments for expansion, bank lending is crucial. Since the 2008 financial crisis, there has been much discussion about the ongoing challenges SMEs see in securing bank financing (Armstrong, 2013). About 5.1 million people in Kenya are employed by SMEs, which accounts for 74% of all national employment. SMEs also create about 88% of all jobs at any given time, and they also boost the country's GDP. According to Chu et al. (2007), micro and small enterprises (MSEs) in Kenya boost the country's economy by lowering unemployment and generating jobs. 75% of all formal enterprises are MSEs, with over 41,000 of them being officially recognized (Kenya National Bureau of Statistics (KNBS), 2013). Of

Kenyan workers, 42% are employed by these formal MSEs. However, the majority of MSEs are part of the jua-kali, or informal sector, and employ 11.1 million people, according to KNBS (2013). 17 million SMEs are registered in Kenya, according to KNBS, and 98% of them employ 50% of the labor force and contribute 25% of the nation's GDP. The growth and success of MSEs and SMEs is critical to the Kenyan economy, as it is to other African economies.

### **1.1.3 SMEs in Mombasa County**

Kenya's capital city of Nairobi and its second-largest city of Mombasa are home to 16% of the country's SMEs, according to a survey. Buying and selling of goods and commodities makes up the majority of these SMEs (70%) in the trade sector. A further 15% of SMEs are in the service sector, and 13% are in the manufacturing sub-sector. Within Kenya, SMEs in the construction sector accounted for less than 2% of all SMEs, while the collective group representing other service providers, such as restaurants and hotels, made up only 6% of SMEs overall (KNBS, 2019). Local Authority Integrated Financial Operation Management Systems (LAIFOM) indicates that Mombasa County has over 54,245 registered SMEs providing a range of goods and services to the general public. One characteristic of SMEs is their ability to be started with little in the way of startup capital, registration fees, or managerial expertise. This puts them in a favorable position to create jobs and foster local entrepreneurship. The interesting part of the estimated failure rate of between 70% and 80% is that the SMEs can only create the necessary jobs if they manage to survive. Research has repeatedly demonstrated how crucial a supportive business environment is to the growth and overall success of SMEs (Matsongoni, & Mutambara, 2018). Financial and economic factors (limited liability and increased capital mobility, low taxes and tax incentives, free trade, good banking with credit availability, lower labor costs) are among them. Another key capacity gaps

for SMEs knowledge and skills on how to exploit different sectors within the small and medium enterprises lead by low literacy levels among business owners and managers, inadequate information from the county department of Trade on branding, trade development consolidated fund to facilitate loans to the SMEs. Sociocultural elements (families' and society's support, social standing, social integration, and social security). SMEs face a number of challenges that do not only affect SMEs in Mombasa. Local governments encourage corruption, which poses a serious threat to businesses in African nations by compelling small and medium-sized enterprises (SMEs) to redirect their resources toward non-financial endeavors. Government representatives anticipate this practice, which may result in higher costs and lower revenue. Legal authorities often harass and intimidate business owners, confiscating merchandise for unpaid licenses and penalties. This practice undermines African governments' efforts to promote SMEs and contributes to poverty reduction and economic growth. Some of the most corrupt countries in the world are in Africa. Government support is essential, globally, the government's role in assisting and promoting SMEs is still vital. The environment that is favorable or unfavorable for the expansion of businesses is created by the government. When SMEs receive little attention from the government sector, therefore, the sector is vulnerable to harm, making it impossible for many businesses to thrive. In addition to harming the industry, a government that fails to assist SMEs causes the sector's economic development to worsen. The infrastructure, taxation, licensing, opportunities, wage structure, and technological support and infrastructure that the government establishes determine whether SMEs succeed or fail. The government's regulatory frameworks have the power to either support or undermine the small business economy (Kamunge et al., 2014).

Africa's SMEs also struggle with a lack of sufficient business information from service providers and governments. The primary cause of the problem is inadequate business support systems and poor information environments brought on by underdeveloped communication and technology infrastructures (Oshikoya & Hussain, 2007). If African governments and other organizations want to help SMEs, they need to be aware of this. It is easier for businesses to be efficient and effective when appropriate technology and related support systems, like hardware and software, are available. This lowers the costs of production and operations. SMEs must fulfill their vital role in development (Benzing & Chu, 2012). Unfavorable opinions held by prospective clients present SMEs with additional difficulties. Compared to large businesses, the perception is that smaller businesses cannot deliver the necessary quality products and services (Amyx, 2005). It's noteworthy that SMEs have a lot of market recognition and frequently lose out to competitors with well-known brands (Bowen et al., 2009). SMEs must put forth great effort to excel in the quality of their services and products in order to alter the unfavorable perception. Additionally, they need to have well-thought-out strategies in place to withstand the pressure of current rivals and win over devoted clients. One of the biggest issues that many SMEs have is a deficiency in managerial competency. This indicates the expertise, experience, and knowledge of company owners and managers. According to Murithi (2015), competency is derived from a manager's capacity to integrate both material and immaterial resources to create capabilities, which when successful, lead to competencies. Beyond managerial proficiency. SMEs with workforces that are educated and have the necessary skills operate effectively. Lee (2001), who noted that the most successful companies have highly developed human resource capacities, lends additional support to the argument. Having knowledgeable and motivated employees also contributes to the positive growth of these businesses,

as high productivity ultimately ensures the long-term viability and sustainability of sustainable business. SMEs' power supply is essential to their ability to operate profitably. If the power supply is insufficient, businesses cannot function to their maximum potential (Fjose et al., 2010; Hatega, 2007). The inadequate of electricity is the largest challenge facing African SMEs, followed by the difficulty in obtaining capital, according to a 2010 World Bank Enterprise Survey study. Only on the African continent does the absence of electricity continue to be a major obstacle to business growth (Fjose et al., 2010).

## **1.2 Statement of the Problem**

The role of SMEs in Kenya's economic growth is crucial, contributing to employment, tax revenue, and GDP. However, SMEs face significant challenges, with only 20% surviving their first three years, a smaller proportion enduring beyond the sixth year, and only 5-10% reaching maturity (Anguiza, 2021). This high failure rate hinders employment creation and economic progress. Previous studies in various economies have explored the impact of economic factors on SMEs growth, yielding mixed results across different methodologies. Previous studies in both developed countries, such as the UK (Harrison & Baldock, 2015; Fogel & Zapalska, 2001), and developing countries, like Pakistan (Zafar & Mustafa, 2017), may not be applicable to the Kenyan context, particularly Mombasa, due to differences in economic structures. No study has yet specifically examined the relationship between economic factors and SMEs growth in Mombasa County. Mombasa, with its strategic location as a gateway to East and Central Africa, a bustling port, popular tourist destinations, and a population of 1.208 million (KDHS, 2019), faces unique demographic challenges, including a high youth unemployment rate (44%, KNBS, 2020). This situation highlights the need for research on how the Kenyan Coast community can leverage its potential to drive economic

transformation. Therefore, this study investigated the influence of economic factors on SMEs growth in Mombasa.

### **1.3 Objectives of the Study**

#### **1.3.1 General Objective**

The main objective of this study was to investigate the effect of economic factored on growth of SMEs in Mombasa County.

#### **1.3.2 Specific Objectives**

1. To explore the effect of tax conditions on growth of SMEs operating in Mombasa County.
2. To find out the effect of financial Access on growth of SMEs operating in Mombasa County.
3. To determine the effect of wage affordability on growth of SMEs operating in Mombasa County.
4. To evaluate the effect of general unemployment on growth of SMEs operating in Mombasa County.

### **1.4 Hypothesis**

1. **H<sub>01</sub>**: Tax conditions have no significant effect on growth of SMEs operating in Mombasa County
2. **H<sub>02</sub>**: Financial access has no significant effect on growth of SMEs operating in Mombasa County
3. **H<sub>03</sub>**: Wage affordability have no significant effect on growth of SMEs operating in Mombasa County
4. **H<sub>04</sub>**: General unemployment level has no significant effect on growth of SMEs operating in Mombasa County

### **1.5 Significance of the Study**

Findings of this study will provide important information on how each Economic factors influence growth of SMEs owners. The findings will help the growing SMEs owner/management to even solidify their growth course. For the owners of struggling SMEs, and the potential entrepreneurs, the knowledge derived from this study will help them be cognizant of each of the economic factors in their quest to revive their struggling business and return the business towards growth. At a time when a significant number of the struggling SMEs realize this turn around, donor funds, then Mombasa County will benefit in terms of fully utilization of the revolving fund they offer, job creation and therefore increase standards of living for its residents. In the future studies information on SMEs growth found from the current study will contribute invaluable baseline for scholars. The knowledge derived from this study will provide the county government department of Trade, Finance department and lending institutions in the county the required information necessary to engage and support the SMEs. For the county and national government, the information will help them identify the enablers of growth and therefore enablers of county revenue in terms of sustainable revenue stream for economic development. To explore the effect of Tax conditions, find out effects of Financial Access, determine effects of Wage conditions and evaluate effects of General Unemployment of SMEs growth operating within Mombasa County. In order to achieve both the Sustainable Development Goals (SDGs) and the Millennium Development Goals (MDGs), growth of SMEs is essential and empirical contribution from studies of this kind, are essential if Kenya is to achieve these goals. The goal include; Employment and Economic Growth: SMEs play a major role in both job creation and economic growth. They make up a sizable portion of the private sector workforce in many developing nations, which lowers poverty and raises living

standards. Poverty Reduction: SMEs directly contribute to the reduction of poverty by creating jobs, particularly for the impoverished and vulnerable groups (MDG 1). This has an especially big effect in underserved and rural areas<sup>1</sup>. Gender Equality: SMEs frequently give women job opportunities, advancing gender equality and giving women more power (MDG 3). Better household incomes and investments in the health and education of children may result from this (Clark, undated).

### **1.6 Scope of the Study**

This study examined the economic factors influencing the growth of small and medium enterprises (SMEs) in Mombasa County, Kenya. The theoretical scope was anchored on the Institutional Theory of Growth, Schumpeterian Growth Theory, and Endogenous Growth Theory, which provided a framework for understanding the economic determinants of SME growth. The study focused on four key economic variables: taxation conditions, financial access, wage affordability, and unemployment levels, assessing their impact on SME growth. The geographical scope of the study was Mombasa County, Kenya. Mombasa County is a key economic hub, hosting a significant number of SMEs across various sectors, including trade, services, and manufacturing. The study targeted 54,245 registered SMEs in Mombasa County, as documented by the County Government of Mombasa, the Local Authority Integrated Financial Operations Management System (LAIFOM), and other relevant regulatory authorities.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter provides a comprehensive review of economic factors affecting SMEs growth. The chapter will also look into relevant concepts, theories, related empirical studies on past studies, literature and conceptual framework.

#### **2.1 Overview**

This chapter focus on the review of relevant literature related to the SMEs and Economic factors. The chapter first discusses on the concepts of SE factors and theoretical aspects of SMEs growth. The second part focus on the empirical review so as to establish what together studies have established. The final part presents the conceptual framework of the study and hypothesis development.

##### **2.2.1 The Concept of SMEs Growth**

Small and Medium Enterprises (SMEs) play a crucial role in economic development by creating employment, fostering innovation, and contributing to GDP. SMES growth can be defined as the expansion of business activities, market reach, and financial performance over time (Storey, 1994). This growth can occur in various forms, including increased revenue, workforce expansion, geographical market penetration, and product diversification (Davidsson & Delmar, 2016). Several factors influence SMES growth, including access to finance, entrepreneurial capabilities, market conditions, and government policies (Beck & Demirgüç-Kunt, 2016). Financial constraints are often a major barrier, as SMEs may struggle to secure funding due to a lack of collateral and credit history (Berger & Udell, 2018). Additionally, managerial skills and strategic decision-making play a critical role in determining whether an

SMES can successfully scale its operations. Growth strategies for SMEs may include organic expansion, strategic partnerships, and technological adoption. Innovation and digitalization have become key drivers of SMES competitiveness, enabling businesses to optimize operations and reach new markets (OECD, 2017). However, SMEs also face challenges such as regulatory burdens, competition, and market volatility, which can hinder sustainable growth (Ayyagari, Demirgüç-Kunt, & Maksimovic, 2011). Thus, fostering SMEs growth requires a supportive business environment, access to capital, and capacity-building initiatives to enhance entrepreneurial skills and innovation.

A business organization can use both non-financial and financial metrics to evaluate its performance (ElDeeb & Kamel, (2021). Non-financial metrics include things like employee turnover, delivery speed, waiting times, customer satisfaction, and customer referral rates. Financial metrics, on the other hand, include profit before taxes and revenue. Acknowledging the drawbacks of depending solely on either financial or non-financial metrics, modern SMEs owners managers have adopted a combined approach using both types of metrics. These metrics act as indicators guiding future actions. A significant portion of contemporary research investigates how large corporations evaluate their performance, highlighting a considerable gap in understanding the same processes in SMEs (Malesios, et al. 2021). This discrepancy is largely attributed to the complicated nature of business structures and the willingness of owner managers to engage in investigative activities. This study presents results from in-depth semi structured interviews with owner-managers of five SMEs regarding their performance assessment methods. Five individuals were chosen, three from the service industry and two from manufacturing, to provide perspectives from two different business sectors. The interviews followed the core principles of grounded theory, providing insights into the functioning of specific processes while maintaining their natural context. The

findings indicate that, in addition to a hybrid method, participants use a time-axis approach for performance evaluation. This method measures performance and returns over a specified timeframe, aligned with the organization's short-term and long-term objectives (Malesios, et al. 2021). These findings enhance the understanding of variations in measurement practices and the practical application of the time-axis method. The time-axis approach demonstrates to be an effective metric for all business entities, regardless of size, structure, or activity type.

The goal-oriented approach to SMEs measures financial metrics like profits, revenues, and ROI, but these are often inaccessible and prone to manipulation. Non-financial metrics like employee numbers and revenue growth can provide a broader view. SMEs grow through stages like Existence, Survival, Success, Take-off, and Maturity, with entrepreneurs focusing on market validation. In summary, while SMEs are integral to Kenya's economic growth, addressing the challenges they face through supportive policies, capacity building, and technological integration is vital for their sustained development.

### **2.2.2 The Concept of Tax Conditions in Business**

Tax conditions are essential for managing businesses, as they reduce profits, which are the primary source of financing for small businesses (Challoumis, 023). Profit levels are not always consistent or predictable, and owners rely on strong profits to support times of profit declines. The pandemic has further impacted small businesses, as profits should be used for expansion, negatively impacting growth. Most SMEs lack the capacity to deal with government tax requirements, leading to high compliance costs and negatively impacting sector growth. Income, received from work or investment, influences spending, and an increase in consumer incomes can help businesses expand,

lower unemployment, and improve the economy. Falling consumer incomes may lead to decreased spending, negatively impacting businesses. High-income individuals tend to have higher growth, and SMEs managed by higher-income managers tend to experience higher growth compared to those managed by low-income individuals' sales tax, corporation tax, excise tax, custom duty, fees, prices, fines, special assessments, and VAT are just a few of the taxes that are covered by Salemi (2010). The government imposes taxes for a number of reasons, including revenue generation, economic stability, unemployment issues, protection policies, social welfare, and equitable resource distribution through efficient resource allocation, which raises the rate of economic growth.

However, for a tax to meet its objectives, it must satisfy certain conditions and challenges such as equality, certainty, convenience, economic productivity, elasticity, flexibility, simplicity, and durability. Additionally, a significant challenge in taxation is the evasion or avoidance of taxes. In promoting the growth of SMES sectors, the taxation level must be set in a way that is business friendly and does not hinder business operations. Holtz-Eakin (1995) examines the economic justification for preferential tax treatment of SMEs. First, smaller businesses frequently do not fully realize the benefits that they provide to the economy—especially if they are highly innovative—but larger businesses, with their market power, end up with the majority of the benefits when they acquire small businesses for less than their true value. This is one of the arguments in favor of tax concessions for SMEs. Second, tax benefits based on equity considerations are required for small businesses. Thirdly, it is crucial that the tax system does not hinder the expansion of SMEs. Offering tax incentives to small businesses is necessary for ensuring equity. Additionally, it is important that the tax framework does not impede the development of SMEs adversely. In particular, efforts should be concentrated on

enhancing three traits of a robust and high-functioning SMEs ecosystem: increasing SMEs' business confidence, fostering SMEs growth—including for top performers—and boosting SMEs competitiveness. Building these traits necessitates a segmented approach to execution. Consequently, it is crucial for government agencies to formulate their service offerings only after recognizing the specific subsegments present in their country and their varied needs. We have pinpointed ten strategies employed globally to address these needs.

### **2.2.3 The Concept of Financial Access for Business**

Funds are the driving force of an enterprise. However, 51% of these crucial companies need more funding than they can get right now. For SMEs, credit restrictions pose a significant problem. Lack of consistent sources of working capital causes SMEs stagnation results from their inability to make the necessary investments for expansion. Due to the significance of SMEs as a source of employment, obstacles to financing become impediments to economic growth and the fight against poverty. Mixed finance can assist businesses in bridging this crucial gap. SMEs expansion is made possible by concessional debt and equity, which prevents individual company bankruptcy. Because working capital is not readily available, businesses that would otherwise be forced to remain in the pilot stage are instead able to grow. Grants for technical assistance enable businesses to grow and perform better. Therefore, it is anticipated that having access to financing will accelerate the growth of SMEs, with the result that SMEs with easy access to financing will typically grow faster than those with limited access. The phrase "access to finance" refers to institutional or government subsidized loans that companies need to run. The purpose of financial services, which include credit, deposit, payment, insurance, and other risk management services, is to support and stimulate economic growth by financing businesses where the market is unable to do so

(Forkuoh, AffumOsei, & Quaye, 2015). This ability is available to both individuals and businesses. Acquiring the funds required to establish and grow small and medium-sized businesses has always been difficult for the industry. Aspiring entrepreneurs face major obstacles in securing sufficient financing, and Quadrey, Turkson, Abor, and Iddrisu (2017) report that there is still a massive global financing gap for small and medium-sized enterprises. All kinds and sizes of businesses require access to a range of financial services, such as those that enables deposits and withdrawals as well as credit, equity, and importantly guarantee access. It is demonstrated in this discussion that in order for businesses to sustain and expand, they must have access to financial services.

Organization prefers to fund entities that have a potential to grow characterized by entrepreneurial workforce. Individuals with varying levels of motivation, education, and managerial expertise are the driving forces behind the expansion of businesses. It's critical to comprehend the traits of prosperous businesspeople as well as the impacts of social media and education. The gender issue has also drawn more attention, with studies going beyond straightforward gender comparisons to examine the various socioeconomic and psychological traits—such as risk aversion—that distinguish male and female entrepreneurs and how these traits affect their ability to obtain and utilize financial services as well as their performance as business owners. Behavioral economics is a significant field related to entrepreneurship as well. The study of experimental economics can provide significant understanding of topics like network development and entrepreneur collaboration. Financial institutions would prefer to fund entities that gives them financial hope of not losing their cash. The growth of SMEs in Africa requires adequate financial capital, but lack of finance is a major hindrance to their survival and growth. The most significant obstacle impeding the operations and expansion of SMEs worldwide, according to a survey conducted by The Enterprise

Surveys of the World Bank, is access to finance. This is a problem that is widely acknowledged to affect SMEs. Africa has expensive, narrow, and small financial systems that only serve a small portion of the continent's population. Due to this, a large number of SMEs are forced to either finance themselves or rely on friends and unofficial networks. Because financial institutions require collateral, loan guarantees, and high comparative interest rates, it is challenging for SMEs to obtain financing. In addition, banks point out that it is difficult to give small loans to SMEs because doing so only lowers their profits. There are insufficient laws in many nations to enforce financial defaulters' repayment of loans. Insufficient financial resources are linked to unsound financial markets or unsuitable loan terms, which can impede numerous African enterprises from capitalizing and propelling their expansion. There is a direct relationship between GDP per capita and financial access, as evidenced by a World Bank report from 2006. Higher GDP levels are associated with better access to financial capital.

#### **2.2.4 The Concept of Unemployment**

The word "unemployment" describes those who are actively looking for work and are employable but are having difficulty finding it. People in the workforce who are employed but do not have a suitable employment are included in this group. Unemployment is one of the key indicators of a nation's economic health. It is typically calculated by dividing the number of jobless persons by the total number of workers. Kenya's labor market is characterized by a high rate of unemployment, particularly among young people. It is made up of a sizable informal sector in addition to a minor formal industry. The ADEA Kenya Report states that more than 30% of workers are casual workers. Teenagers with only a primary education are employed in the formal sector (4%), in the informal sector (54%), as students (14%), and unemployed (14%).

The following groups comprise those with a secondary education: students (26%), workers informally (40%), the unemployed (15%), and formal employment (12%). In contrast, 31% of those with postsecondary education are employed in formal settings, 9% work in informal settings, and 8% are unemployed. According to Vivier et al. (2001), unemployment affects the growth process of SMEs. In areas with high unemployment, many people are forced to become entrepreneurs in order to survive (Wickham, 2017; Dollinger, 2017); at the same time, markets are inherently constrained due to high unemployment and low earnings (Ligthelm & Cant, 2019). When assessing an economy's population's standard of living, purchasing power is a crucial concept. One can purchase more goods and services with their income if they have a higher purchasing power. The cost of living, inflation, and exchange rates all influence it. For instance, a nation's currency has a higher purchasing power if its exchange rate is high. This implies that the income of the people living there can be used to purchase more goods and services.

Conversely, a nation's citizens may have little purchasing power if their cost of living is high. The purchasing power and unemployment rate have a complicated relationship. High unemployment rates reduce people's disposable income, which could lead to a drop in consumer spending. Businesses and the economy as a whole may suffer as a result. Conversely, low unemployment rates increase people's disposable income, which boosts consumer spending and boosts the economy. However, low unemployment rates can also lead to inflation, which reduces the purchasing power of people's incomes and impedes the expansion of SMEs. Thus, maintaining a healthy economy necessitates finding a middle ground between these two viewpoints.

## **2.3 Theoretical Review**

This section discusses selected theories that underpin the study variables. The Theories discussed include the Institutional theory of growth, Endogenous theory and Schumpeter theory of growth on SMEs.

### **2.3.1 Institutional Theory of Growth**

John Meyer and Brian Rowan developed institutional theory in the late 1970s to investigate how organizations interact with, are influenced by, and were formed by their local, regional, national, and international contexts. Desha, Caldera, and Dawes, (2019). The Institutional Theory of Growth emphasizes the role of formal and informal institutions in shaping economic activities and business growth. When applied to the study of economic determinants of SMEs growth, it provides a framework for understanding how institutions influence the business environment, regulatory policies, and market dynamics. These institutions create an enabling or constraining environment for SMEs. The theory suggests that SMEs growth is influenced by the quality, efficiency, and stability of institutions in an economy. The way that organizations or businesses try to maintain some level of uniformity in adhering to the general guidelines and standards of the business/institution environment is explained by institutional theory. Understanding the forces that push institutions to become more alike, thereby reducing institutional diversity, is made easier with the help of institutional theory. Organizations strive to adhere to readily identifiable and widely accepted norms within their respective fields, which contributes to the development of their legitimacy.

Entrepreneurs are overcoming institutional limitations by utilizing creative business plans, fortitude, bravery, membership in associations, community service, and

cooperation with government agencies. Institutional theory explains that organizations adhere to accepted standards to maintain legitimacy and survival. Deviating from these standards can lead to community perception and reduced resources. Small and medium-sized enterprises (SMEs) operate within a specific environment set by external stakeholders, restricting managers' discretionary choices and influencing their behavior. Institutional theory helps analyze how societal or business boundaries impact SMEs' routes to sustainable growth, emphasizing that sustainable endeavors are not purely voluntary acts. By incorporating **Institutional Theory**, the study gains depth in understanding how economic determinants interact with the institutional framework to shape SMEs growth.

### **2.3.2 Endogenous Growth Theory**

The Endogenous Growth Theory (EGT) provides a strong theoretical framework for studying the effects of tax conditions, wage conditions, general unemployment, and financial access on SMEs growth. Unlike traditional growth theories that emphasize external factors (exogenous shocks), EGT highlights the role of internal mechanisms—such as human capital, innovation, and policy incentives—in driving long-term economic growth. Endogenous growth theory, originating in the 1980s, posits that economic growth is generated internally within the economy through endogenous forces, rather than exogenous factors. According to this theory, higher investments in human capital and quicker innovation are related to gains in productivity. It promotes the development of innovation projects and the provision of creative incentives by government and private sector organizations, such as funding for research and development and intellectual property rights. According to the theory, entrepreneurship should be encouraged by the government in order to promote capital investment, innovation, and the creation of jobs. It is relevant theory in this study. EGT emphasizes

human capital as a key driver of sustained economic growth. Wage conditions affect the ability of SMEs to attract and retain skilled labor. Higher wages can increase worker productivity and innovation but may also raise operational costs for SMEs, potentially limiting their growth. Policies that balance fair wages with productivity incentives (e.g., training programs, subsidies) align with EGT by enhancing human capital development and long-term SMEs growth.

EGT suggests that economic growth is driven by knowledge diffusion and skill accumulation. High unemployment can hinder this by reducing labor market participation and weakening innovation. SMEs can play a role in reducing unemployment by absorbing labor, but unfavorable macroeconomic conditions (e.g., recessions, lack of demand) may limit their hiring capacity. Policies that encourage SMEs employment creation (e.g., job training, wage subsidies) align with EGT's argument that productive labor utilization fosters long-term growth. The theory has been criticized, nevertheless, for neglecting to take into consideration the political aspect of innovation, relying too heavily on potentially false premises, and downplaying the role that organizations play in economic growth. Furthermore, it solely views human capital as a critical component of growth, which may not be as important in actual circumstances. The endogenous growth model is criticized for its lack of empirical evidence and assumptions, which may not be accurate in real-world scenarios.

### **2.3.3 Schumpeter Theory of Growth**

Schumpeterian growth theory suggests that innovation leads to new technology replacing outdated ones, boosting economic growth and productivity. This theory is influenced by laws on intellectual property rights, competition, economic openness,

business barriers, research education, and democracy. Small and medium-sized enterprises (SMEs) are essential for economic growth as they lower poverty, increase GDP, and create jobs. Schumpeter's theory emphasizes innovation, entrepreneurship, and creative destruction as key drivers of economic growth. The theory fits well with studies examining the impact of tax conditions, wage conditions, unemployment, and financial access on SMEs growth. High taxes may discourage innovation and investment, while tax incentives can promote entrepreneurship. Wage conditions and labor costs also play a role in SMEs growth, with higher wages potentially reducing innovation capacity but also fostering a skilled workforce.

Moreover, according to Schumpeter, economic downturns and unemployment spur innovation by encouraging individuals to start new businesses as an alternative to formal employment. The STG points that if unemployment is high, some individuals may turn to self-employment and SMEs, leading to potential entrepreneurial growth. Overall, The STG is critical in explaining the

Creative Destruction and SMEs Dynamics. Schumpeter's concept of creative destruction suggests that outdated businesses will be replaced by innovative SMEs. However, if taxes, wages, and financial barriers are too restrictive, they may hinder the natural cycle of creative destruction, reducing SMEs growth. The Schumpeterian Theory of Growth aligns well with the study of SMEs growth under different economic conditions. Favorable tax policies, manageable wages, lower unemployment, and financial accessibility can enable SMEs to innovate and expand. Conversely, restrictive conditions may limit their ability to contribute to economic growth.

## **2.4 Empirical Review Literature**

This section synthesizes existing research on economic factors affecting SMEs growth. It reviewed the independent variables; Tax conditions, financial access, wage affordability, unemployment and dependent variable; SMEs growth.

### **2.4.1 Effect of Tax conditions on SMEs Growth**

According to a 2011 study by Chittithaworn, Islam, Keawchana, and Yusuf, the characteristics, market and customer base, business practices, taxation, financial availability, and business methods of SMEs in Thailand have the greatest effects on their ability to succeed as a company. Govori (2013) discovered that expanding SMEs' access to capital is crucial to their growth, but he also pointed out that these businesses frequently encounter financial obstacles in developing nations. Hove and Tarisai (2013) discovered that, in addition to a strong business plan, marketing strategy, mission/vision, and SWOT analysis, one of the internal elements boosting SMEs' growth is access to financing. Tax conditions have a substantial impact on the performance of SMEs, according to Onyango (2015). Similarly, Feyitimi, Temitope, Akeem, and Samuel, (2016) studied the effect of tax incentives and the growth of small and medium scale enterprises in developing economy –the Nigerian experience. They used a sample of 100 respondents selected through Stratified and Simple Random Sampling techniques. Their study found a significant correlation between Tax conditions and SMEs' growth. But, Tee, Boadi and Opoku, (2016) indicate that majority of the respondents perceive the adverse impact of existing tax policies. The study recommended reforming the tax policies effect of tax incentives on the growth of small and medium-sized enterprises (SMEs) in Rwanda. Douglas, Douglas Muturi and Ochieng (2017) in their study found that the main barriers to success were identified as high taxes, too much government regulation and corruption in municipal government.

Olayemi and Folajimi. (2021) studies in Nigeria indicate that growth of SMEs was hindered by challenges ranging from the lack of financial resources to expand, inadequate infrastructural facilities, lack of support from the government, harsh business environment, and above all, unpleasant Tax conditions policy of the government. Benedict Gitonga, Agyeman, and Kyei (2021) simultaneously examined the impact of financial factors on the performance of SMEs using data from the Kenyan leather sector. A random selection of 300 respondents from SMEs in the Kenyan leather industry served as the sample size. According to the study, three statistically significant financial factors that impact the performance of SMEs are tax, loan availability, and financial literacy. Consequently, the report suggests that the government should step up its efforts to support SMEs by providing tax breaks and favorable rates to SMEs, particularly those operating in Kenya's leather industry. Additionally, in order to improve their access to finance, SMEs should increase their level of financial literacy.

Considering these past studies linking prevailing tax conditions and SMEs growth in the recent past, it is clear that a significant association between tax conditions and SMEs Growth exists over the years. An indication that tax conditions or tax incentives is a critical component of the SMEs growth. The studies have shown the positive relation of low tax pressure on growth. Thus, indicating that countries should move towards being low tax rate countries that would favor business growth. However, even though some nations have lower overall tax rates than others, their tax systems can nevertheless be complicated and onerous for particular taxpayer groups. On the other hand, nations with higher tax rates might offer superior public services and more extensive social welfare programs, which could make up for the higher tax burden. Therefore, when evaluating tax pressure in various nations, it's critical to take into account both tax rates

and the caliber of public services. The implication of these findings is that the balance between low tax rates and complexity to comply is critical factor.

#### **2.4.2 Effect of Financial Access conditions on SMEs Growth**

A number of studies have been undertaken in the recent past on financial access conditions and its effect on SMEs performance. Ngeek (2014) sought to determine high quality SMEs that significantly contribute to SMEs growth: regional evidence from South Africa, the results showed that human capital, growth ambition, innovativeness, motivation, and market orientation and financial power define a high-quality SMEs in South Africa that contributes significantly to SMEs growth (employment growth, sales growth and asset growth) but, Makina, et al. (2015) studied financial access and SMEs size in South Africa. Their aim was to develop an econometric model to estimate the effect of access to credit on firm size access to formal credit. The study found that access to finance in sole proprietorship has a positive relationship with firm size as measured by the number of employees. Inoue and Hamori (2016) use panel data on SMEs from 37 countries between 2004 and 2012 to study the relationship between economic development and financial access in Sub-Saharan Africa. The empirical findings unequivocally show that improving financial access has a substantial and statistically significant impact on boosting economic growth in Sub-Saharan Africa. In their article "Financing the expansion of SMEs in Africa: What are the limits to SMEs financing within ECOWAS?" Quartey, Turkson, Abor, and Iddrisu (2017) They discovered that, at the sub-regional level, variables including business size, ownership, the strength of legal rights, and the depth of credit information and access all significantly influence access to financing.

They did this using data from the World Bank's Enterprise Survey data collection and structural equation modeling (SEM) analysis.

Etemesi (2017) conducted research on the expansion of SMEs in Nairobi's central business area and credit access from commercial banks. There was an 838-sample size and an explanatory design. The findings indicated that SMEs' growth is positively impacted by financial availability. Mwangemi, Wilson, and Mung'atu (2017) investigated the impact of government policies and financing availability on the expansion of small and medium-sized businesses in Kenya within the same time frame. According to the report, one of the most important aspects of the establishment is having access to financing. In the context of Ghana, Thompson Agyapong, Mmieh, and Mordi (2018) investigated the variables influencing the expansion of small and medium-sized companies (SMEs). A sample size of 75 drawn from agriculture, manufacturing, and services was used. Findings show that several factors, including level of education, poor energy supply, access to external finance, competition, inflation and government policies influence the growth of SMEs in Ghana. Adegboye and Iweriebor (2018) conducted research in Nigeria over the same time period and asked if access to financing increased SMEs productivity and innovation in the country. Evidence from the World Bank Enterprise Survey: Using the logit model estimation approach on the World Bank Enterprise Survey (ES) data set, the study determines that the most powerful factor encouraging all forms of innovation among SMEs in Nigeria is the ease with which bank financing can be accessed and that development and innovation have a good relationship. Bakhtiari, Breunig Magnani, and Zhang (2020) looked at the relationship between small and medium-sized businesses and financial restraints. They found that restrictive budgets have a negative effect on both employment growth and business sales growth using a large sample size of 10,000

SMEs in 28 Eastern European and Central Asian nations. Brixiová, Kangoye, and Yogo (2020). Funding accessibility for small and medium-sized enterprises and creation of jobs in Africa. SMEs with formal funding sources generate more employment than businesses without, with employment in businesses with access to bigger and more affordable loans expanding at the quickest rate. These conclusions were drawn from firm level data from 42 African nations using an impact evaluation based methodology. In conclusion, research on financial access and SMEs growth, both historical and contemporary, consistently points to a favorable relationship between financial access and SMEs growth. On this basis it is expected that good Financial Access has a significant effect on a number of SMEs performance. Financial access has been studied extensively and is critical for the growth of small and medium-size enterprises (SMEs). It allows entrepreneurs to innovate, improve efficiency, expand to new markets, and provide millions of jobs. Yet, in developing countries, the majority of SMEs are unable to acquire the financing they need to reach their potential (Makina, et al., 2015).

It is clear that access to finance is a critical driver of SMEs growth, as evidenced by multiple studies across different regions. Research consistently shows that financial availability positively impacts firm size, employment generation, sales growth, and innovation. SMEs with access to formal credit tend to expand more rapidly, improve productivity, and contribute significantly to economic development. However, constraints such as restrictive budgets, weak legal frameworks, and inadequate credit information hinder SMEs financing, particularly in developing countries. Addressing these barriers through improved financial access mechanisms can unlock the growth potential of SMEs and drive broader economic progress.

### 2.4.3 Effect of Wages on SMEs Growth

The documented studies on effect of wages and firm performance in the recent past are few but informative. Example, Kersten, Harms Liket and Maas (2017) in his study ‘Small Firms, large Impact? A systematic review of the SMEs Finance Literature’ found that wages and costs business have no significant effect on SMEs growth on their investigation of salaries and the failure of SMEs, Dewaelheyns, Van Hulle, Van Landuyt, and Verreydt (2021), they used a sample of 29,596 Belgian SMEs to investigate the impact of salaries on the chance of failure between 2012 and 2019. They discovered that paying lower salaries is a strong predictor of SMEs failure using discrete temporal hazard regression models. Higher salaries hence encourage rapid growth. Additionally, Pratomo, Ade, and Setyadharma, Andryan (2020) looked into how the number of industries, wages, and economic growth affected unemployment. For this investigation, a panel regression with data from 2013 to 2015 was employed. The findings demonstrated that the minimum wage had a favorable and noteworthy impact on the expansion of SMEs. One of the strengths of this study is the embedded in its methodological approach of utilizing the panel framework. Yaffee (2003) conducted considerable research and found that panel data can assess and identify statistical impacts that cross-sectional or pure time series data cannot. Panel data, once again, provides more variable information, reduced collinearity across the variables, and the ability to prevent bias from missing variables. Azizah and Rachmawati (2022) looked at how Tulungagung, Indonesia's economic growth was affected by SMEs and minimum salaries between 2011 and 2021. Multiple linear regression analysis was performed using secondary data to examine the association between these components. The minimum wage has no discernible impact on Tulungagung's economic growth, according to the results, but the number of SMEs does. Although the study provided

the detailed model diagnosis using Jacque Bella test for normality, the Klein approach for multicollinearity test and the Breusch-Godfrey test for auto correlation. The source of the data is not clear indicating a data gap.

The literature on the effects of wages on SMEs growth presents mixed findings. While some studies, like Kersten et al. (2017), suggest that wages have no significant impact, others, such as Dewaelheyns et al. (2021), highlight that lower wages increase the likelihood of SMEs failure, implying that higher wages may foster growth. Similarly, Pratomo et al. (2020) found that minimum wages positively influence SMEs expansion using a panel regression approach. However, Azizah and Rachmawati (2022) observed no direct impact of minimum wages on economic growth in Tulungagung, Indonesia, though SMEs themselves contributed significantly. Methodological rigor varies across studies, with some leveraging panel data for stronger insights, while data gaps remain in certain cases

#### **2.4.4 Unemployment and SMEs Growth**

The percentage of the labor force that is jobless but looking for work is referred to as unemployment. Kenya's unemployment rate stood at 2.64% in 2018, down 0.05% from 2017, and 2.98% in 2020, up 0.38% from 2019. Because it indicates a worker's ability—or lack thereof—to find profitable employment and contribute to the economy's productive output, unemployment is a crucial economic indicator. More unemployed workers mean less total economic production. Using secondary data, Kuso and Gachunga's (2019) study looked at how unemployment affected Kenya's economic development. They examined the long-run, short-run, and direction of causation using Granger causality, Johansen Co-integration, and error correction mechanism (ECM). The findings demonstrated a long-term correlation between economic growth and

unemployment, with unemployment having a favorable effect on growth in the short and long terms. The report also emphasized how unemployment and the expansion of small and medium-sized businesses are related. The youthful population's explosive expansion has resulted in a labor excess, which is driving up unemployment, especially for young people living in cities. According to the skill mismatch theory, businesses undervalue the skills that are provided by the educational system, which makes them hesitant to accept applicants who are already unemployed and encourages jobless people to fill positions. Using Johansson's Co-integration test, Mosikari (2013) investigated the effect of unemployment on South Africa's GDP, a stand-in for the growth of SMEs. Granger causality, on the other hand, rules out a causal relationship between unemployment and economic growth. Oguze and Odim (2015) and Ditimi and Ifeakachukwu (2013) studied how unemployment affected the economic growth of small and medium-sized enterprises in Nigeria. The money supply, investment imports, real GDP unemployment interest rates, and time series data from 1970 to 2010 were utilized in Oguze and Odim's analysis. According to Least Squares Analysis,

Nigeria's SMEs growth was adversely affected by unemployment. In their analysis, Ditimi and Ifeakachukwu focused on unemployment and productivity development using time series data from 1986 to 2010. Both studies discovered that unemployment had a favorable effect on economic growth.

The literature presents mixed findings on the relationship between unemployment and SMEs growth. While studies in Kenya and Nigeria indicate that unemployment can have both positive and negative effects on economic growth, the mechanisms driving these outcomes vary. Kuso and Gachunga (2019) found a long-term positive correlation between unemployment and growth, suggesting that labor surplus may stimulate SMEs

expansion. However, studies in Nigeria by Oguze and Odim (2015) highlight an adverse impact, implying that high unemployment constrains SMEs growth due to reduced consumer demand and investment. Contrarily, Mosikari (2013) found no causal relationship in South Africa, emphasizing regional and contextual differences in how unemployment influences SMEs development.

## **2.5 Critique of Reviewed Literature**

Examining the research conducted over the past ten years on the economic factors influencing the growth of SMEs was the aim of this empirical review. This is crucial for demonstrating the advancements made in the expansion of SMEs. The reviewed papers make it evident that several economic factors were found to be important drivers of the expansion of SMEs. The review also makes it evident that there is a great deal of variation in these factors influencing the growth of SMEs. In SMEs growth studies, this lack of agreement on the factors influencing SMEs growth is still very important. Important findings about IVs like unemployment and economic growth as measured by growth proxies like GDP were found in the review. The studies used diverse methodological approaches including the co-integration in time series framework (Ditimi and Ifeakachukwu (2013) and panel data analysis. These panel data approach has a capability to control for individual-specific effects, provides precise estimates and increased statistical power and can accommodate heterogeneity, which is often a challenge in other research designs. However, some of these studies don't specifically state which SMEs growth indicators were employed, despite the fact that growth may be measured using a variety of non-financial and financial metrics. The term analytical levels, problems with nomenclature, and conceptual evaluation grounds have prevented the consensus on a single definition. All concur, that success expectations are often correlated "performance" has several facets, and researchers have tried to define it

accurately. However, different with performance. Moreover, few studies show that unemployment affects the expansion of Small and Medium Enterprises. There are even fewer of these studies in the Kenyan context, and since they are not recorded, it is challenging to pinpoint the beginnings of the current investigation. All things considered; this review provides useful information to support the conceptual framework of the research.

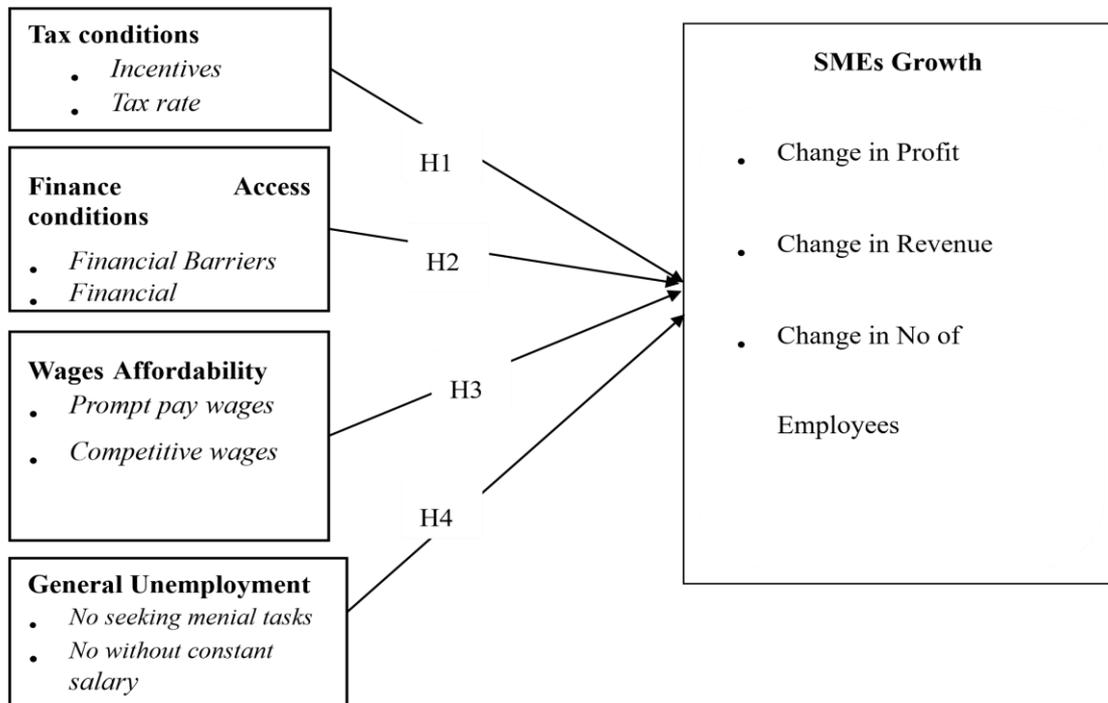
## **2.6 Chapter Summary**

In this chapter, the SMEs growth, the social factors and economic factors are conceptualized. Institutional growth theory of planned behaviors, endogenous growth theory anchored the study. The empirical review of related studies showed mixed results of the economic factors on SMEs growth across the globe. Based on the reviewed theoretical and empirical literature, a conceptual framework depicting the hypothesized relations between the Independent Variables and Growth of SMEs was presented. The research methodology is presented in the next chapter.

## **2.7 Conceptual Framework**

This study conceptualizes social and the economic characteristics as the predictors of SMEs growth. The change in sales and profits are used as measures of SMEs growth, because this form of growth measurement is mostly used by SMEs owner/managers themselves (Nunes, Gonçalves, & Serrasqueiro, 2013).

Figure 2.1 depicts the diagram explaining the conceptual framework



**Figure 2. 1 Conceptual Framework**

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

This chapter describes the methodology the study used in order to meet the research objective. First, the research design of the study was described. Then the study population, the sample size and sample size determination are also described. Data collection instrument and procedure to build the research model and data analysis procedure was also described.

#### **3.1 Research Design**

The research employed an explanatory research design, which is a perfect method for examining the reasons behind events in situations where data is scarce. This method aids in topic understanding, phenomena comprehension, and future event prediction. As a "cause and effect" model, explanatory research focuses on patterns and trends in data that have not been found before. Because it seeks to correctly represent a population, circumstance, or phenomena as it is, it is sometimes seen as a causal research method. This study's design was especially well-suited since it made it possible to use a variety of research techniques to look at one or more variables, leading to a thorough understanding of how economic factors affect the expansion of SMEs.

#### **3.2 Study Area**

The study focused on SMEs in Kenya's Mombasa County. Kenya's second-largest city and the country's main seaport, Mombasa Town, is part of Mombasa County, which is situated on the country's coast. According to KNBS (2018), Mombasa County is divided into six zones: Mvita, Likoni, Changamwe, Jomvu, Nyali, and Kisauni. As per the Business activity code summary 2018 of the Local Authority Integrated Financial Operation Management Systems (LAIFOM), Mombasa County has 54,245 Small and

Medium Enterprises registered with in the system. Mombasa County is home to SMEs in every industry, including retail, transportation, hospitality, catering, entertainment, technology, real estate, pharmaceuticals and health services, and clearing and forwarding. Compared to other counties, Mombasa County is a special place.

Mombasa is a vibrant are for doing business because it is an urban town whose business environment is quite dynamic, with several key factors influencing its business landscape. It includes good infrastructure: Mombasa has a mix of well-developed and underdeveloped infrastructure. While access to worksites is relatively high, challenges include insufficient public facilities, high utility costs, and frequent power outages.

Market Environment: The market environment is characterized by limited access to physical markets and government procurement opportunities. Fair competition is also a concern due to issues like counterfeiting and unfair trade practices, multiple taxes, corruption, insecurity and exploitative tendencies within the workforce (KIPPRA report No. 28/2019-2020, 2020). The country has great market with a total population, 1,208,333; Female, 49.5% • Contribution to total GDP: Average 4.7% for the period 2013-2017 • Contribution to Gross Value Added stood at 4.4% in 2017. Again, the SMEs sector driving growth in economic activity is in manufacturing (14%); Agriculture (0.4%); and Services (70%) The reforms in the county put in place by the current administration in the 2022 were meant to mitigate the challenges to make Mombasa a truly competitive business hub. The reforms have focused on working together with pertinent training organizations, such as the National Industrial Training Authority and the Kenya Institute of Business Training, to map knowledge and skills in order to offer MSEs technical training, certification, and apprenticeship programs in addition to pertinent entrepreneurial training. Also, work together with players in the financial sector, including banks, SACCOs, and microfinance organizations, to target

MSEs with financial innovations that present a chance to expand and penetrate the financial services market. Mombasa has a mix of formal and informal businesses, ranging from small retail shops and food vendors to established enterprises.

The interaction between these sectors makes it an interesting case for studying SMEs growth.

### **3.3 Target Population**

The study targeted SMEs operating within Mombasa County. This is one of the urban counties in Kenya and most populous in the coast region being the gateway and major port entry that connects inland Africa with global sea borne trade making it a trade hub center for a millennium. Mombasa as a region is disproportional suffered by the level of unemployed people compared to other part of the nation average that has a rate of 44% and if the informal unemployment people is to be added without decent livelihood or work conditions the rate adds up to 66% and many SMEs businesses. Mombasa county highly depends on Small and Medium-sized Enterprises (SMEs) as a key player in it's economy. Due to its strategic position for export business by both, air, road, rail and sea, and growing population that presents an expanding market for SMEs, Moreover, the county government of Mombasa has been promoting Special Economic Zones (SEZs), reprieves and licensing waivers for small and medium enterprises, policy advocacy, providing ease of doing business by digitalization of all its services to attract SMEs, offering incentives for businesses to set up operations in these zones. These efforts indicate a supportive ecosystem for SMEs in Mombasa, aiming to foster growth and innovation within the sector. The inclusion criteria are that an SMEs fulfil the definition as outlined. That is, an SMEs is included if and only if it has at least 10 and at most 50 employees. An enterprise/SMEs with less than 10 employees, or more

than 50 employees are excluded. Also, the enterprise should be registered. Therefore, the target population is 54,245 registered SMEs business in the County of Mombasa. LAIFOM (Local Authority Integrated Financial Operation Management Systems Business activity code summary 2018) the SMEs owner/ manager provided the data for the research.

### **3.4 Sampling Frame**

Identifying a sampling frame is part of the wider sampling design process. A sampling frame is a list of the elements or entities from which a study element is selected. It is the source material from within a population who can be sampled, and may include individuals, households or institutions.

The SMEs in Mombasa County formed the sampling frame of this study.

### **3.5 Sample Size and Sampling Design**

Sample size and sampling design are important considerations in research and data collection. The below will highlight the sample used and sampled design that enabled the research.

#### **3.5.1 Sample Size**

In research, it is frequently more practicable and important to employ a sample rather than a population. Cooper and Schindler (2014) define a sample size as a smaller subset of the broader population. Since it is unknown how many SMEs there are in Mombasa County, the sample size for this study was determined using the Cochran, (1977) statistical technique. This method was used to calculate the representative sample size from the owners and managers of SMEs operating in Mombasa County. It is advised for continuous dependent variables, such as growth.

The formula is based on the Z value, which is related to the confidence level, the population proportion, which is the estimated proportion (p) of the population with the desired attribute, and the margin of error, which is the maximum difference between the sample proportion and the population proportion. The formula also includes a population correction for small populations with known sizes (e).

$$n = \frac{z^2 p(1-p)}{e^2}$$

Where; n = required sample size, z=1.96, p is the estimated proportion of the population that register growth estimated at 0.2 and e = 0.05 at 95% confidence interval

$$n = \frac{1.96^2(0.2)(0.8)}{0.05^2} = 245.9 \cong 246$$

A sample of 246 was the minimum sample size required to estimate the effect of economic factors on growth of SMEs at 95% confidence interval with a margin of error of 0.05.

### 3.5.2 Sample Size Distribution.

**Table 3.1 Target Population**

SMEs Classification	Target Population	Sample Size
General Trade	24 649	112
Transport and Communications	3 137	14
Agriculture	2 115	10
Hospitality	13 057	59
Professional and Technical	4172	19
Education and Entertainment	4074	18
Manufacturing	3041	14
Total	54245	246

Source: Mombasa County Council, 2018

### **3.5.3 Sampling Method**

A key component of research methodology is sampling, which is the process of choosing a subset of people to represent the entire population from a larger one. As a result, without having to survey the entire population, researchers can draw conclusions about it. Probability sampling and nonprobability sampling are the two primary categories of sampling techniques. Simple Random Sampling method is one of the probabilistic sampling approaches and was used to identify the actual respondents for the survey from whom data was collected using a questionnaire. (Martinez, Fuensanta, and Rodríguez, 2013; Akinboade, 2015) also used simple SRS method in their study of the effect of SE on SMEs performance.

### **3.6 Data Collection Instruments and Procedures**

Primary data sources means first-hand information collected by an investigator. It is collected for the first time therefore it is original and more reliable. This study utilized structured questionnaires as the primary data collection instrument, designed based on best practices for survey research (Dillman et al., 2014). The questionnaires were pre-tested in a pilot study before being administered to SMEs in Mombasa County through research assistants. Data collection was conducted over a four-week period, with follow-ups via phone calls to enhance response rates.

#### **3.6.1 Data Collection Instruments**

The data collection instrument used was a questionnaire. This quantitative research used a questionnaire to collect data from of SMEs operating within Mombasa County. The main questionnaire items on economic and SMEs growth of the SMEs are derived from previous studies on the same topic. The questionnaire is organized in sections. The first section constitutes the background characteristics of the SMEs important in

better understanding the background of the studied firms. They include questions on the structure of the business owner, location and the business structure such as longevity of business and the current number of employees. In the second section of the questionnaire on economic factors, the items for each sub variables are designed to measure the economic environment or setup SMEs operate that shapes their activities.

They include items on Tax environment to assess level tax compliance and utilization. Examples of tax items include; Tax level in this business is favorable/reasonable, and Taxes we pay are well utilized to further develop business infrastructure like market, roads good for business. finally, on Financial Access sub variable, the items used are designed in such way to measure the level Financial Access of SMEs example of the indicators used to measure Financial Access include; This business has good income base from owner, we have a good credit rating and Credit prices are affordable. The wages were measured using items such as business gives best employee wages compared to similar businesses. And the wages reflect the economic realities, individual qualities like age, experience and education and personal needs.

### **3.6.2 Data Collection Procedures**

The process of obtaining and assessing data on specific variables in a pre-existing system allows one to assess results and respond to pertinent inquiries. In all study fields, including the humanities, business, social and physical sciences, and data collection, research is a necessary component. Although techniques differ depending on the discipline, making sure that the collection is honest and accurate always comes first. All data collection aims to gather evidence that will enable data analysis to produce believable responses to the questions that have been put forth. Data was collected from respondents using a structured questionnaire. The researcher recruited and trained two

research assistants to assist in administering the questionnaires to the respondents of the selected SMEs. The questionnaire contained both closed and open-ended questions, designed based on best practices for survey research (Dillman et al., 2014). Research assistants distributed and collected the questionnaires over a four-week period, ensuring confidentiality and anonymity in data collection.

### **3.7 Pilot Study**

For the purposes of the pilot study, a random sample of 10% of the SMEs in Mombasa was used. The aim of a pilot study was mainly to identify the problems in the questionnaire and the procedures in data collection. Some of the problems in a questionnaire includes ambiguities and difficulties of questions. If these ambiguities were not removed the results would be inaccurate responses in the final survey. Some of the procedural issues the pilot study assesses was the duration and flow of questions. These two issues were assessed in the pilot study using a 35-item questionnaire. The results of the pilot test showed that respondents took, on average, five to ten minutes to complete the survey. The pilot responses brought up several important points about the process of carrying out a large-scale final data collection. The problems included how to send out the questionnaire, how to get assistance contact with respondents, and how to include research to get information from the respondents. The lessons learned from the pilot study proved critical in coming up with optimal data collection procedures under the combined pressure of time and ethical considerations. The final questionnaire had 28 items of which four are items on background information (Appendix III).

### **3.7.1 Validity**

Validity is the extent to which a research instrument measures what it is intended to measure (Field, 2005). It ensures that the data collected accurately represents the concept being studied (Ghauri and Gronhaug, 2005). The instrument's validity was tested by having academic economists review it to ensure it measured the relevant variables accurately. This expert review process helped refine the instrument to improve its effectiveness. The results confirmed that the instrument effectively measured the intended constructs, ensuring the accuracy and reliability of the study findings.

### **3.7.2 Reliability**

In research, reliability is the overall consistency of a measure (Vaske, Beaman, and Sponarski, 2017). A measure is said to have high reliability if it produces similar results under consistent conditions. The reliability of the questionnaire was assessed using the Cronbach's Alpha test, which measures internal consistency. This test evaluates whether a set of survey items consistently measures the same characteristic. To ensure reliability, a pilot study was conducted using 10% of SMEs from the sample size before the main data collection. The reliability of the research instrument was assessed using Cronbach's Alpha, where a value greater than 0.7 is considered acceptable for internal consistency. Results showed that all constructs had acceptable reliability (greater than 0.7), confirming the instrument's reliability

## **3.8 Data Processing Analysis and Presentation**

This section outlines the procedures followed in data processing, analyzing, and presenting data collected from SMEs.

### **3.8.1 Data Processing**

The process of data processing is a crucial step in data mining, involving cleaning, transforming, and integrating data to prepare it for analysis. The objective is to enhance data quality and suitability for the specific data mining task. Data collected from the field was subjected to a rigorous cleaning process to identify and correct any inconsistencies or missing values (Saunders et al., 2019). The cleaned data was then coded and entered into SPSS for statistical analysis. Descriptive and inferential statistics were generated to facilitate hypothesis testing and result interpretation. In this study the involved checking for completeness, involved manual inspection of the questionnaire to find out the preliminary issues such as completeness of information. The data was then coded and entered into SPSS version 25 for the further.

### **3.8.2 Data Analysis**

In this study, various data analysis techniques were applied to ensure comprehensive interpretation and validation of results. Descriptive statistics were used to summarize key features of the collected data, including mean, standard deviation, skewness, and kurtosis, which helped in understanding data distribution, central tendency, and variability critical aspects in evaluating the economic factors influencing SME growth. Correlation analysis measured the strength and direction of relationships between independent variables such as tax conditions, wage affordability, financial access, and unemployment, and the dependent variable, SME growth, with Pearson's correlation coefficient establishing statistical significance. The model summary provided key indicators, including R-squared and adjusted R-squared values, explaining the proportion of variation in SME growth accounted for by the independent variables, where a higher R-squared value signified a stronger explanatory model. ANOVA was used to test the overall significance of the regression model, determining whether the

independent variables collectively had a significant impact on SME growth, with a statistically significant F-value ( $p < 0.05$ ) confirming at least one variable's effect. Multiple linear regression analysis assessed the individual effect of each independent variable on SME growth while controlling for other factors, with regression coefficients indicating the magnitude and direction of each variable's influence. Finally, hypothesis testing was conducted using p-values, where a p-value below 0.05 led to the rejection of the null hypothesis, confirming the statistical significance of the variable in influencing SME growth and validating the study's assumptions.

### 3.8.3 Data Presentation

The results of the data analysis were presented using tables, charts and graphs to facilitate easy interpretation. The study also provided narrative explanations alongside statistical outputs to enhance clarity.

### 3.8.4 Multiple Linear Regression Analysis

Multiple Linear Regression Analysis was used in hypothesis testing. Multiple regression is a technique of studying the effect of more than one predictor on the response variable. It fits a model by estimating the regression coefficients of each predictor variable in a model of the form

$$GROWTH = \beta + \beta_1 TAXCOND + \beta_2 FINANCIALaccess + \beta_3 WAGES + \beta_4 UNEMPLOYMENT$$

Where the regression parameters;  $\beta$ ,  $\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$  are regression coefficients estimated by Ordinary Least Squares (OLS) estimation. In a linear regression model, OLS selects the unknown parameters by minimizing the sum of squares of the variations between the dependent variable's observed and predicted values. In estimation theory, OLS has an advantage in producing the least biased estimates. In regression, the magnitude of the regression coefficient of an IV shows the impact of

the change of the independent variable on the DV; the higher the magnitude, the higher the impact. Just to illustrate this point. In order to reject or fail to reject  $H_0$ , the associated probability value corresponding to each of the four of the regression coefficients is compared to a threshold value, in this study, the common threshold value of 0.05 was used. If the p value obtained is less than 0.05, the corresponding null hypothesis is rejected.

Otherwise, the study fails to reject the null hypothesis. Standard and unstandardized regression are generated in SPSS for interpretation to reject or fail to reject the null hypotheses. Standardized coefficients hold the other variables constant and show the change in the predicted variable for a one-unit change in the predictor variable. For instance, given a coefficient of -333 for coefficient of car cost, then assuming all other variables stay the same, a house's price will drop by 333 units for every year that an owner ages. However, for standardized coefficients, when the predictor variable changes by one standard deviation, they show the change in the response variable in terms of standard deviations.

### **3.8.5 Multiple Linear Regression Model Assumption Diagnostics**

In fitting the multiple linear regression analysis, Ordinary Least Squares estimator was utilized to minimize the square of the distance between the predicted values of SMEs growth and the actual values. It is crucial to assess the classical assumptions to ensure the validity of the model. The linearity, normality, no multicollinearity and no heteroscedasticity form a set of baseline assumptions that are tested and verified prior to adopting the regression results (Thu, 2019). These assumptions were checked using both statistical and graphical visualization to support evidence of no violation. The linearity assumption is the belief that the expected value of a dependent variable change

at a constant rate across values of independent variables. The linearity is checked by evaluating a plot of Residuals (y-axis) vs. Fitted (x-axis). The linearity assumption is met when the scatter points are evenly scatter around the  $y=0$  horizontal line without any pattern emerging. If the linearity assumption is met, it is recommended to carry out a linear transform of the nonlinear relation. The no multicollinearity assumption states that no independent variables are strongly correlated ( $>0.7$ ). The presence of this issue reduces the model's estimated coefficient precision, resulting in higher standard errors and lower test statistic values, reducing the test's statistical power (Gwelo 2019). In practice, the assumption is determined using a variety of methods, including the correlation matrix, which is supplemented by the Variance Inflation Factor (VIF) test proposed by regression researchers (Gwelo, 2019). Multicollinearity is not an issue if the VIF is less than five. The commonly used VIF approach was utilized in this study. The normality assumption makes one of the classical OLS assumptions. This study investigated whether residuals are normally distributed. A histogram of residuals with a fitted normal curve is used to visually evaluate this assumption. Outliers were checked as one of the preliminary phases to clean data for further analysis. After the assumptions are assessed and appropriate remedies sought met the assumption, the model regression parameters are generated using the OLS estimation which minimizes the regression residuals. The goodness of the model is evaluated using R squared and ANOVA statistics. The R square estimates the proportion of variance explained by the model predictor variables. A significant F ( $P<.05$ ) indicates the model is adequate for prediction. Hypothesis testing is based on the regression coefficient results, with all statistical tests set to a significance level of 0.05.

**Table 3.2 Measurement of variables**

Variable	Measurement and indicator	Scale (1-5)
Tax conditions	Perceived tax inducements and level of tax conditions level they favor carrying out business measured at ordinal level from 1= less favorable 5= highly favorable	1 = Less favorable 5 = Highly favorable
Financial Access conditions	Ease of access of business income measured at ordinal level. ordinal level from 1= low Access to 5= high access	1 = Low access 5 = High access
Wages affordability	The ease of meeting the wage obligations by the SMEs business to its employees/workers. It is measured at ordinal level from 1= unfavorable wages to 5= favorable wages	1= Unfavorable wages 5 = Favorable wages
Unemployment	Number of SMEs customers not in formal employment. ordinal level from 1= high unemployment to 5= low Unemployment	1 = High unemployment 5 = Low unemployment
Growth	Growth indicators (Growth in Gross Profit, and Revenue, Employees). Measured at ordinal level from 1= low growth to 5= high growth	1 = Low growth 5 = High growth

### 3.9 Ethical Considerations

Ethical considerations in research are crucial for maintaining scientific integrity, respecting human rights and dignity, and fostering collaboration between science and society. This study adhered to ethical codes of research because ethical issues can influence research outcomes significantly in different ways (Locke, Alcorn, & O'Neill; 2013). Additionally, it strengthens the reliability and integrity of study findings and fosters the researcher's ability to disseminate the results. The study adhered to the principles of impartiality, confidentiality, and honesty that are essential to a trustworthy and legitimate research project. by keeping an eye on the following qualities. Participation of choice, informed consent, anonymity, secrecy, and open dissemination of results.

Furthermore, following a series of proposal defenses, authorization to carry out the primary research was requested from Moi University's School of Economic Studies. The National Commission for Science, Technology, and Innovation (NACOSTI), Kenya's research authorizing agency, requires a permission to be given.

## CHAPTER FOUR

### DATA PRESENTATION AND ANALYSIS

#### 4.0 Introduction

This chapter presents the results of the analysis and interpretation of the findings. It is partitioned into three broad sections. The first section presents the preliminary background information so as to provide an understanding of the characteristics of the SMEs that took part in the study. The next second section is dedicated to processing phase to assess data quality collected in and constructing measurement scale of the latent variables. This involves Factor Analysis (FA). The third section comprises of carrying out of explanatory statistics so as to describe the socioeconomic characteristics and performance of SMEs in the county. The fourth section is the core section of this study involving relationship through correlational and regression analysis.

#### 4.1 Response Rate

Out of the 246 targeted respondents for data collection, data was collected from 185 for analysis representing 75.2% response rate. In social sciences, a response rate of more than 60% is considered adequate (Stedman, et al.2019). Therefore, current response rate is considered adequate to provide the intended information on SMEs growth in Mombasa County.

#### 4.2 Background Information

The male gender dominated the sampled SMEs ownership in Mombasa County. The majority of the SMEs sampled are owned by 25 to 35-year-old owners (42.2%). However, those SMEs owners aged over 45 years were few at only 13% of SMEs owners. Moreover, most of the sampled businesses were aged less than five years (51.9%). see Table 4.1

**Table 4.1 Demographic Results**

		n	%
Gender	Male	134	72.4
	Female	51	27.6
Age of proprietor	Below 25 years	35	18.9
	25 to 35 years	78	42.2
	35 to 45 years	48	25.9
	More than 45 years	24	13.0
Age business	Less than 5 years	73	39.5
	5 to 10 years	62	33.5
	More than 10 years	50	30.8
Number of employees	Less than 10 employees	96	51.9
	10 to 20 employees	63	34.1
	Over 20 employees	26	14.0

### 4.3 Factor Analysis Results

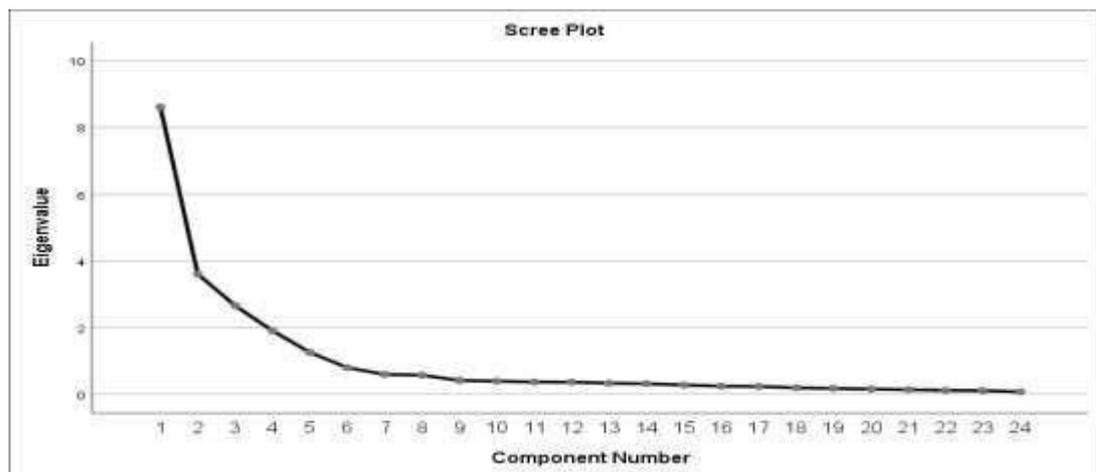
Factor Analysis marks the start of the long but important data step before subjecting the data for test of significance. A detailed procedure discussed in the previous chapter is adopted in this section to carry out a Factor analysis which aims at refining the data collected. The first step is assessing the suitability of FA on the data using the KMO and Bartlett's test statistic presented in Table 4.2. The observed KMO statistic is 0.761 is within recommended value of greater than 0.7 and the Bartlett test results is significant (Chi-square;1479.372, degree of freedom; 326 and p; .000). it is therefore indicative that the data is suitable for FA.

**Table 4. 2 KMO and Bartlett's Test Results**

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.761
Bartlett's Test of Sphericity	Approx. Chi-Square	1479.372
	df	326
	Sig.	.000

The second step after testing for the suitability of data for FA, is to select the extraction method to use from the two available methods; namely, the Eigenvalue criteria and fixed factor criteria.

In FA, a scree plot result is one the approaches to identify the ideal number of factors to extract.



**Figure 3.1 Scree plot to estimate the ideal number of factors to extract**

The scree plot in figure 3.1 has an 'elbow' at component five suggested a five Factor structure has the ideal number of factors to extract. This number is consistent with the number of components, factors of the study. In executing the Eigenvalue criteria, only components with at least an eigenvalue of 1 are extracted leaving the number of factors free. But in executing the fixed factor extraction method, the number of factors to extract are fixed at 5 factors as predicted by the scree plot. Following these two procedures, both methods resulted to identical final structure/results (Table 4.3 and Table 4.4) this indication that the final structure is stable across the two extraction methods. The first component in Table 4.3 recorded the highest variance of 37.568% of the original data. However, component five, recorded the least variance of 6.165 % of the original data. Collectively the five components explain 77.933% variance of the original data which is considered sufficient information of the original data.

**Table 4.3 Total Variance Explained**

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total % of Variance	Cumulative %	Total % of Variance	Cumulative %	Total % of Variance	Cumulative %
1	7.514	37.568	7.514	37.568	7.514	37.568
2	2.913	14.565	2.913	14.565	2.913	14.565
3	2.341	11.706	2.341	11.706	2.341	11.706
4	1.478	7.390	1.478	7.390	1.478	7.390
5	1.233	6.165	1.233	6.165	1.233	6.165
6	.641	3.204				
7	.598	2.991				
8	.429	2.143				
9	.388	1.941				
10	.375	1.876				
11	.341	1.706				
12	.306	1.531				
13	.294	1.470				
14	.257	1.287				
15	.226	1.130				
16	.170	.852				
17	.158	.791				
18	.127	.637				
19	.123	.613				
20	.087	.436				

Extraction Method: Principal Component Analysis.

**Table 4.4** results is the rotated component results; it shows the items that load to each component. The results show that the all four items of growth strongly loaded to component one. Their loading ranged from 0.876 to 0.812. Similarly, the indicators of Tax conditions all loaded to component two, wage Affordability indicator items loaded to component three, employment indicators loaded to component four and, Financial Access indicators loaded to component five. Overall, these results are an indication that the 24 indicators represent/support a distinct five factor structure. It is also an indication that indicators meant to measure a given construct actually measured that construct important in scale construction. The clear structure is an indication of construct reliability.

**Table 4. 4; Rotated Component Matrix**

	Component				
	1	2	3	4	5
Growth_4	.876				
Growth_3	.871				
Growth_1	.828				
Growth_2	.812				
Tax conditions_3		.898			
Tax conditions_4		.886			
Tax conditions_2		.870			
Tax conditions_1		.849			
Wages_2			.911		
Wages_4			.860		
Wages_3			.846		
Wages_1			.763		
Unemployment_1				.776	
Unemployment_4				.752	
Unemployment_3				.721	
Unemployment_2				.708	
Financial Access_2					.865
Financial Access_3					.817
Financial Access_4					.716
Financial Access_1					.650

The next important step in Factor Analysis procedures is scale construction using the refined construct structure. In this task, indicators in each component are combined by averaging them to make the construct they represent. For instance, the four growth indicators in component one was averaged to form SMEs growth Variable; the dependent Variable. The other four Independent Variables of Tax conditions, Wage

Affordability, Unemployment and Financial Access are similarly constructed from their remaining indicators. It is important at this stage to test the reliability of the constructs which is a measure of level of internal consistency of an instrument. The common Cronbach's alpha method was used for this purpose and the results is presented in Table 4.5. It is observed that the alpha score is all within recommended range of greater than 0.7. thus, the instrument demonstrates adequate reliability indicating the instrument had adequate internal consistency.

**Table 4.5 Reliability Test Results**

Variable/Construct	Number of items	Cronbach's alpha
Tax conditions	4	.852
Wage Affordability	4	.789
Unemployment	4	.849
Financial Access	4	.880
SMEs Growth	4	.779

In summary, the aim of this section was to refine the measurement instrument. The initial analysis has shown that the research data fitted a FA and that the refined indicators supported a five Factor structure. A major proportion of the data (77.393%) is explained by the refined structure as shown in which is sufficient representation of the variance in the original data. Only items meant to measure a particular variable coalesced in one construct thus demonstrating Construct Validity.

The Cronbach's alpha results of the extracted constructs demonstrated adequate Reliability. The next section presents the descriptive analysis of these study refined variables in the context of the SMEs in Mombasa County.

#### 4.4 Descriptive Statistic Results

According to Table 4.5's results, tax conditions are generally rated as moderate (mean = 3.47, SD = 1.041). This indicates that small and medium-sized business owners believe that the current tax incentives and conditions are only moderate, indicating that much work needs to be done. SMEs owners still lack the necessary level of proficiency.

**Table 4.6 Descriptive Statistics Results**

	Mean	Stdv	skewness	S.E	Kurtosis	S.E
Tax conditions	3.47	1.041	.068	.146	-1.201	.291
Wage Affordability	3.44	.908	.254	.146	-.777	.291
Financial Access	3.41	.914	-.046	.146	-.848	.291
Unemployment	2.34	.908	.154	.146	-.767	.291
Growth	3.35	.878	.237	.148	-.607	.295

Stdv: standard Deviation, S.E; standard error

The descriptive statistics presented in Table 4.6 above provide insights into how economic factors influence the growth of SMEs in Mombasa County. The mean values indicate the respondent's overall agreement on the extent to which each factor affects SME growth, while skewness and kurtosis help assess the distribution of responses. The interpretation of each independent variable (IV) and its impact on SME growth (DV); Tax Conditions (Mean = 3.47, Rounded to 4) The respondents, to a large extent, agreed that tax conditions affect the growth of SMEs in Mombasa County. This implies that if tax policies, incentives, and compliance procedures are favorable, SMEs are more likely to experience growth. A favorable tax environment reduces financial burdens on SMEs, enabling them to reinvest profits and expand operations. Wage Affordability (Mean = 3.44, Rounded to 3) The respondents moderately agreed that wage affordability influences the growth of SMEs. This suggests that SMEs that can afford to pay competitive wages are better positioned to attract and retain skilled

employees, leading to increased productivity and business expansion. However, excessively high wages may strain financial resources, limiting growth potential. Financial Access (Mean = 3.41, Rounded to 3) The respondents moderately agreed that financial access affects SME growth. This means that the ability to access credit, business loans, and capital influences business sustainability and expansion. Limited financial access restricts SMEs from investing in new technologies, increasing inventory, and scaling operations, thereby slowing growth. Unemployment (Mean = 2.34, Rounded to 2) The respondents indicated, to a small extent, that unemployment levels influence SME growth. This suggests that while unemployment may provide a larger pool of potential workers, high unemployment levels may reduce consumer purchasing power, negatively affecting SMEs' sales and profitability. A high unemployment rate can lead to reduced demand for goods and services, thereby limiting the growth of SMEs.

#### 4.5 Correlation Analysis Results

**Table 4.7: Correlation Results between study variables**

		Correlations				
		Tax conditions	Wages	Financial Access	Unemployment	Growth
Tax conditions	Pearson Correlation	1	.261**	.214**	.249**	.344
	Sig. (2-tailed)		.000	.000	.000	.000
Wages	Pearson Correlation	.261**	1	.171**	.240**	.241
	Sig. (2-tailed)	.000		.004	.000	.000
Financial Access	Pearson Correlation	.214**	.171**	1	.243**	.430
	Sig. (2-tailed)	.000	.004		.000	.100
Unemployment	Pearson Correlation	.249***	.240**	.243**	1	-.333*
	Sig. (2-tailed)	.000	.000	.000		.000
Growth	Pearson Correlation	.344	.241	.430	-.333**	1
	Sig. (2-tailed)	.000	.000	.000	.000	

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

The study investigated the association between the study variables using Pearson correlation statistics. As presented in Table 4.7, each of the four independent variables is significantly correlated with SME growth, although the direction of the relationships varies. On tax conditions and SME Growth ( $r = 0.344$ ,  $p < .001$ ) the correlation between tax conditions and SME growth is positive and significant, indicating that favorable tax conditions enhance SME growth. Conversely, unfavorable tax conditions—such as high tax burdens or inefficient tax utilization—can stifle growth. Favorable tax conditions include reasonable tax rates, effective utilization of tax revenue for infrastructure development (e.g., roads and markets), and a tax regime that does not impose excessive financial pressure on SMEs. As shown the wage Affordability and SME Growth ( $r = 0.241$ ,  $p < .001$ ) wage affordability is positively and significantly correlated with SME growth. This suggests that SMEs that can offer competitive wages and meet their wage obligations promptly are more likely to grow.

Favorable wage conditions enable SMEs to attract and retain skilled labor, leading to increased productivity and expansion. In contrast, SMEs that struggle to afford competitive wages may experience higher employee turnover and operational inefficiencies. The financial access and SME Growth ( $r = 0.430$ ,  $p < .001$ ) as shown on the table has the strongest positive correlation with SME growth among the independent variables. This implies that SMEs with easier access to financing tend to grow more than those facing financial constraints. Favorable financial access includes a strong revenue base, ease of obtaining business loans, and availability of investment capital. Limited access to credit restricts SMEs' ability to expand operations, acquire inventory, or invest in technology, which in turn hampers growth. Finally, unemployment and SME Growth ( $r = -0.333$ ,  $p < .001$ ) unlike the other variables, unemployment has a significant negative correlation with SME growth. This means

that SMEs operating in areas with high unemployment tend to experience slower growth compared to those in areas with lower unemployment rates. High unemployment reduces consumer purchasing power, leading to lower demand for goods and services. It also limits the availability of skilled employees, as individuals may lack experience or training necessary to contribute effectively to SME growth. In conclusion the correlation analysis confirms that economic factors are significantly associated with SME growth. While tax conditions, wage affordability, and financial access positively contribute to growth, high unemployment has an adverse impact. These findings set the stage for the next section, which presents the multiple linear regression analysis results to predict the effect of the independent variables on SME growth and test the study hypotheses.

#### **4.6 Multiple Linear Regression Analysis Results**

Multiple linear regression analysis was carried out so as to comprehend how, value of the dependent variable changes when any one of the independent variables is varied. First the model assumptions were checked before fitting the model.

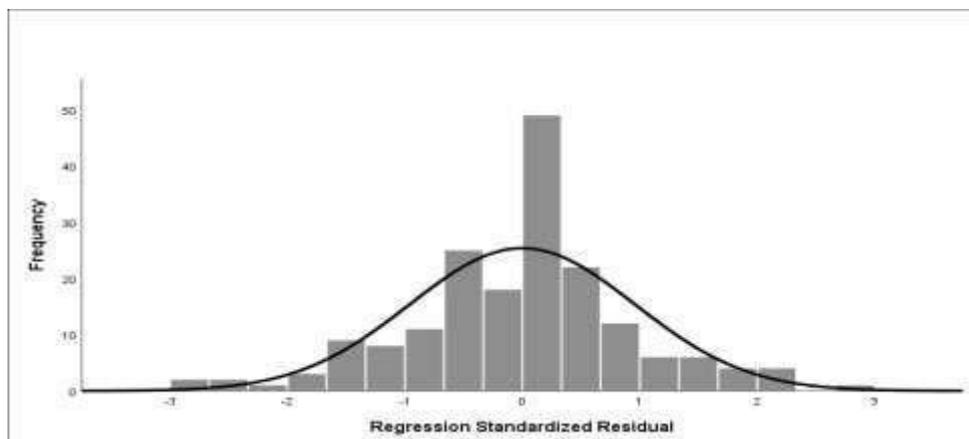
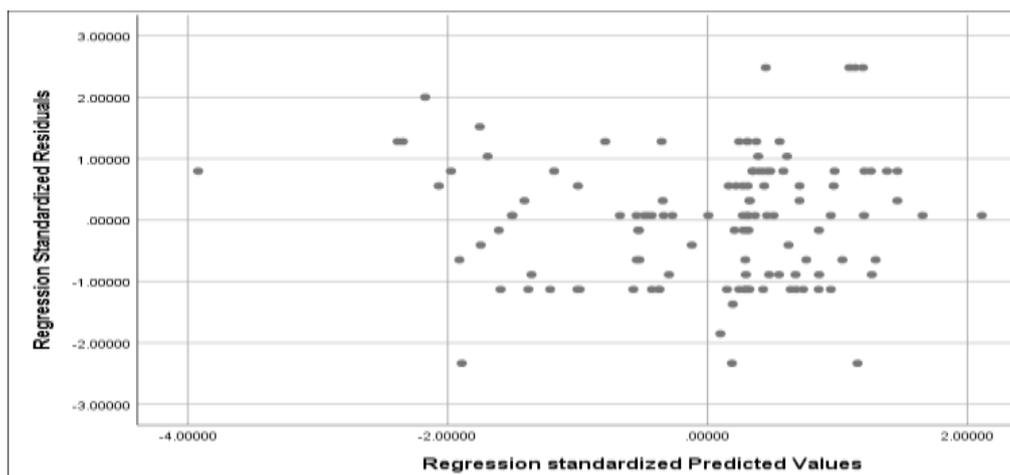
##### **4.6.1 Model Assumptions**

The model assumptions are tested using the procedure outlined in the previous chapter section 3.9. One of the assumptions of the OLS is that no multicollinearity is present among the IVs. The VIF values should be less than 10 to demonstrate the assumption is met. From the VIF results in Table 4.8 the assumption is met; all the VIF values are less than 10 as required.

**Table 4. 8: Variance Inflation Factor for multicollinearity test**

	Tolerance	Variance Inflation Factor
Tax conditions	.353	2.831
Financial Access	.249	4.018
Wage Affordability	.306	3.273
Unemployment	.328	3.044

The other assumption is that the residual is normally distributed. The histogram of standardized residuals shows that the residuals is typical normal distribution shape. The assumption is also met.

**Figure 4.1 Histogram of residual to assess Normality Assumption****Figure 4.2 Scatter plot of residuals versus predicted values for assessing heteroskedasticity**

The assumption of no heteroskedasticity states that the variance or the errors are constant across all the values of the Dependent Variable (Rosopa, et al 2013). A plot of

regression residuals against the predicted values is one of the visual inspections for the assumption. The errors should not show any pattern of fanning out for the assumption to be met. The results in figure 5.1 shows no apparent pattern emerge, an indication that the assumption is also met. Finally, the linearity assumptions states that the independent variables have a linear relation with the dependent variable. Data that satisfy the Normality Assumption and constant variance assumptions also satisfy the Linearity Assumption as well (Schmidt & Finan, 2018). Thus, the linearity assumption is met since the model met the two assumptions therefore fitted linear model is appropriate for the data. In conclusion, the Regression Assumptions are all met thus vindicating the SMEs growth model. In multiple linear regression analysis entails finding the effect of an IV on DV and three outputs are important for the interpretation of results (Schmidt & Finan, 2018). The first one is the model summary that asses the goodness of model. The ANOVA assesses the overall model and the regression coefficient to assess the fitness of each IV in the model.

#### 4.6.2 Model Summary

These model summary results are presented in Table 4.9, the ANOVA results in Table 4.12 and Regression Coefficient results in table 4.13. the results are discussed in detail from hereon.

**Table 4.9 Effect of economic factors on growth of SMEs Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.778 <sup>a</sup>	.606	.597	.595

The critical statistics in model summary output is the R square and adjusted R square that shows the predictive power of the DV by the set of IVs in the model. The results in Table 4.9 shows that the adjusted R square value is .597 suggesting that the four IVs

in the model account for 59.7% of growth variance among SMEs in Mombasa. Given that growth of an SMEs is influenced by multifaceted factors, the socioeconomic factors are critical as they explain more half of the variance in growth. The remaining 40.3% is explained by other factors not in the model. It's worthy to note that the standard error of the regression is the average distance that the observed values fall from the regression line. Smaller the value, the better the fit. In this regression example, the observed values fall an average of 0.595 units from the regression line. It further shows the fitness of the data.

#### 4.6.3 Analysis of Variance Results

On the other hand, the Analysis of Variance, ANOVA output, shows the fitness of the overall regression model in predicting the outcome variable. The ANOVA results in Table 4.10 shows that the model is significant ( $F_{(4,180)} = 69.071$ ,  $p < .001$ ) implying that the model is appropriate in predicting SMEs growth from known values of SE factors of the SMEs. This results further underscore the importance of SE factors in the growth of SMEs sector and spur the needed employment generation for the Mombasa County.

**Table 4.10 ANOVA; Effect of economic factors on growth of SMEs**

	Sum of Squares	df	Mean Square	F	Sig.
Regression	97.942	4	24.485	69.071	.000 <sup>b</sup>
Residual	63.810	180	.354		
Total	161.751	184			

#### 4.6.4 Multiple Linear Regression Coefficient Results

The Regression Coefficients results are key in evaluating the significance of each IV on the DV of the model. These are key results critical for hypothesis testing. The results show that favorable Tax conditions have a significant positive effect on Growth of

SMEs ( $\beta_1=.268$ ,  $p<.001$ ) and therefore the hypothesis H01 is rejected at 0.05 level of significance. When the SMEs owner meet their tax obligation adequately and the feel that the taxes are well utilized, the SMEs have positive growth.

The results also show that favorable Financial Access has positive effect on SMEs growth ( $\beta_2=.383$ ,  $p<.001$ ); the hypothesis H02 is thus rejected at 0.05 significance level. Furthermore, the results show that wage Affordability have a significance effect positive effect on SMEs growth ( $\beta_3=.182$ ,  $p=.015$ ), thus the hypothesis H03 is also rejected at 0.05 level of significance. Finally, the level of unemployment in the community has a significance negative effect on Growth of SMEs ( $\beta_4 = -.170$ ,  $P<.001$ ) meaning that the hypothesis H04 is rejected as well. Overall, the null hypotheses are refuted by these regression results, demonstrating the strong impact that SE has on the growth of SMEs. Then, by SE interventions targeting improving the SE conditions, the present issue facing SMEs—of which more than 70% shut down during their first three years of operation—can be solved.

**Table 4.11 Multiple Linear Regression Coefficients Results**

	Unstandardized Coef.		Standardized Coef.	
	$\beta_1$	Std. Error	$\beta_1$ ,eta	t Sig.
(Constant)	.367	.130		2.822 .005
Taxation conditions	.268	.075	.280	3.559 .000
Financial Access conditions	.383	.089	.363	4.286 .000
Wage Affordability	.182	.074	.173	2.448 .015
Unemployment status	-.170	.084	-.165	2.021 .045

One of the indirect objectives of a regression modelling is in model development that link the IVs and the DV. The derived mathematical model based on the regression coefficient results

$$GROWTH = .367 + .268TAX + .383FINANCIAL\_ACCESS + .182WAGES - .170UNEMPLOYMENT$$

from the fitted model, Financial Access has greatest influence on SMEs growth because it has the greatest coefficient of 0.383 an indication that, when an SMEs improves its financial access by one unit, the growth of an SMEs improves by 0.383 units, ceteris paribus. On the other hand, the results show that level of unemployment in the community recorded the least effect on SMEs Growth of -0.170. A unit decrease in unemployment level in community, the SMEs Growth by only 0.170 units; Ceteris Paribus. One of the fundamental implications of these results is that directing resources to improve one SE factor impacts differently on growth of SMEs. As long as resources remain scarce, prioritization of competing resources using this model is important for the SMEs in Mombasa County.

#### **4.6.5 Hypothesis Testing**

The hypothesis testing results confirmed the study's theoretical framework, demonstrating that tax conditions, wage affordability, financial access, and unemployment significantly influence the growth of SMEs in Mombasa County. Multiple regression analysis was employed to evaluate the relationship between these economic factors and SME growth. The results led to the rejection of all null hypotheses. The first hypothesis (H01), which stated that tax conditions have no significant effect on SME growth, was rejected as the analysis showed a significant relationship, indicated by a p-value of less than 0.05. Similarly, the second hypothesis (H02), asserting that financial access has no significant effect on SME growth, was also rejected, as the findings demonstrated a significant positive influence, supported by a p-value below 0.05. The third hypothesis (H03), which proposed that wage affordability has no significant effect on SME growth, was rejected after the regression analysis

confirmed a significant relationship, as indicated by a p-value of less than 0.05. Finally, the fourth hypothesis (H04), suggesting that general unemployment has no significant effect on SME growth, was also rejected, as the statistical analysis revealed a significant impact, with a p-value below 0.05. The findings indicate that financial access has the greatest influence on SME growth, with a coefficient of 0.383, meaning that an improvement in financial access by one-unit results in an increase in SME growth by 0.383 units, *ceteris paribus*. Conversely, unemployment had the least impact, with a coefficient of -0.170, meaning that a decrease in unemployment by one unit leads to an increase in SME growth by 0.170 units.

#### **4.7 Discussions of Key Findings**

The first objective investigated the effect of Tax Conditions on growth of SMEs. The aim was to find out the effect of perceived tax compliance by the SMEs and utilization by the government on growth of SMEs. Findings have shown that Tax incentives/conditions have a positive effect on growth of the SMEs. The SMEs that are able to comply and the tax is well utilized they realize growth than SMEs that do not comply and are in place tax is not well utilized. When SMEs in the region meet their tax obligation, they enable the county government of Mombasa provide services like security lights, garbage collection and infrastructure necessary for doing business. Tax compliance means availing financial resources by an individual entity for further development for business infrastructure for the benefit of the larger community (Slattery & Zidar (2020), Domazet, & Marjanović, 2017). Better utilization on the other hand is essential in the setting up business infrastructure necessary for business to thrive. When both tax compliance and utilization is optimal the likelihood of business environment is conducive and favor growth direction (Bushe et al. 2019). The observed positive effect of Tax conditions on growth is therefore theoretically supported. In this

regard, the positive perception on Tax Conditions is eventually achieved in SMEs sector when the taxes do not constitute largest cost of business. Moreover, when the SMEs comfortably comply and the collected taxes are well utilized in ways the SMEs owners appreciate enhances the positive view of Tax conditions. The second objective investigated the effect of Financial Access on Growth. It aimed to find out the effect of ease of acquisition of finances both internal or external sources. External sources include the loans from financial institutions and individuals. The amount of financing a business from external source awarded is a function of its credit worthiness and evidence to service the loan if awarded. It is expected that, an SMEs with a strong credit worthy and evidence to service its loans has greater Financial Access and therefore strong financial ability necessary for growth. The positive effect of Financial Access on Growth of SMEs is thus expected. SMEs have favorable financial access when they have good income base from owner, and are able to acquire cheaper business loans. According to the Schumpeter Theory of Growth, it requires SMEs and governments to be innovative to create a sustainable revenue stream.

In the third objective, the effect of wage conditions on growth of SMEs was investigated. The key concern on wages was whether perceived level of employee wages and if the wage package an SMEs pays out attracts best skills from other competitor businesses and is affordable. Good or favorable wage conditions is achieved when the employees are able to pay above average employee wages compared to similar businesses, the business are also able to promptly meet their wage obligations, and the wage package attracts best skills from other businesses. Such SMEs are therefore able to retain best skills necessary for innovation, growth and economic development. The study findings showed that favorable wage conditions have a significant positive effect on growth of SMEs. These results are expected because

wages enable high skill retention which in turn minimizes hiring and training costs for the management. Giving acceptable wages is consistent with the Institutional Theory which is of the view that legitimate institutions give expected pay to its workers important for skill retention. According to Endogenous Growth Theory, skill retention improves internal strengths critical for innovation and competitive advantage necessary for growth. Endogenous growth economists believe that improvements in productivity and growth are about faster innovation and more investments in human capital. Kersten, Harms and Maas (2017) and Pratomo, Ade & Setyadharma, Andryan. (2020) also found that favorable wage has positive and significant effects on SMEs growth.

The effect of unemployment on growth of SMEs was also a subject of investigation. The aim was to find out whether the unemployment level around an SMEs locality have a significant effect on its growth. It is based on the believe that level of an unemployment represents the level of cash flow between the community and the business. Low unemployment level represents fast cash flow and large volumes in business revenue and goods purchased. On the other hand, high proportion of unemployed population is characterized by among other things low purchasing power, small quantities purchases, generally high indebtedness and mostly low quantity purchases of only essential (non luxuries) goods or services. All these characteristics are not supportive of positive growth direction. Findings of this subject indicates that unemployment level in the neighborhood of SMEs showed significant negative contribution to growth of SMEs. This means that it inhibits growth as results of low rate of cash flow and low volumes of goods purchases. The negative growth is thus expected because SMEs that have low volumes of goods sold within a given period have low revenues and low profit margins and higher likelihood of loses. Again, as most of the SMEs such neighborhood is compelled to deal with only essential goods at

highly bargained prices, the profit margin is further narrow. These findings of the negative effect of unemployment on growth is consistent to theory. However, a study by Kuso, Yasin & Gachunga, Muhia John (2019) found positive long run positive association between unemployment and economic growth. The SMEs therefore can survive if they are innovative in ways that use their internal strengths to align their business model to take advantage of low purchasing power and debt purchase characteristics of their customer. This option of inattentiveness among the SMEs is important to mitigate the negative effect of unemployment. It is the option they need to take because unemployment and its negative effect is present will not disappear overnight but its negative effect can be progressively being reduced over time. SMEs play a crucial role in employment and economic growth, contributing to poverty reduction and improving living standards. They make up a significant portion of the private sector workforce in developing nations, lowering poverty and enhancing living standards. SMEs also contribute to gender equality by providing women with job opportunities, advancing gender equality and giving them more power. This can lead to better household incomes and investments in children's health and education. Empirical contributions from studies of this kind are essential for Kenya to achieve its goals.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.0 Introduction

The chapter presents the summary of the study, the conclusion drawn and the recommendations. Areas for further studies are suggested at the end of the chapter.

#### 5.1 Summary

This part presents a concise summary of the study, highlighting the key areas covered. The research focused on economic factors influencing the growth of SMEs in Mombasa County. Specifically, the study explored tax conditions, financial access, wage affordability, and unemployment as critical determinants of SME growth. The study examined how tax policies and government regulations shape SME performance and expansion. It also analyzed the role of financial access, emphasizing the importance of credit facilities and funding sources in supporting business sustainability. Wage affordability was considered in relation to labor retention and operational efficiency. Lastly, the study assessed the impact of unemployment on market demand and business stability. The subsequent sections elaborate on the specific effects of these economic factors, providing insights into their implications for SME growth.

##### 5.1.1 Effect of Tax Conditions on Growth of SMEs

The key findings are that Tax conditions are positively associated with growth and had positive effect on growth of SMEs ( $\beta_1=.268$ ,  $p<.001$ ). The Endogenous Theory of Growth postulate that conducive Tax conditions policies provide the government with necessary resources to provide incentives and subsidies for businesses in the private sector. It motivates businesses to invest in research. Also, these findings are consistent with the Institutional Theory of Growth, the theory postulate that institutions including

SMEs respond to institutional constraints and norms such as paying taxes to conforming to business requirements and societal expectations. This reduces legal costs and gives a business legitimacy to operate important for growth.

### **5.1.2 Effect of Financial Access on Growth of SMEs**

Another key finding is that Financial Access recorded a positive association with SMEs Growth and that Financial access has positive effect on Growth of SMEs ( $\beta=.383$ ,  $p<.001$ ); the. These findings are consistent with the Endogenous Theory of growth of a firm which is of the view that economic growth is generated internally through endogenous forces. Access to Finance provides capital investment which is an internal force for R&D, and innovation necessary to avail the factors of production.

### **5.1.3 Effect of Wage Affordability on Growth of SMEs**

Wages are costs to a business but they are measures of quality of the human skills. The findings showed that favorable SMEs Wages was also positively associated with growth and had a significant positive effect on growth of SMEs ( $\beta=.182$ ,  $p=.015$ ), Wages provides the employees with the means to meet their daily financial obligation and impetus to continues being productive. Favorable wages means that the proprietors of the SMEs are able to remunerate and compensate their workforce with minimal strain on their finances. Giving employee best wages compared to similar businesses, meeting wage obligations promptly and ensuring that the wages reflect the economic realities, and individual qualities like age, and experience and education is critical for growth.

### **5.1.4 Effect of Unemployment on Growth of SMEs**

Finally, the study found that Unemployment in the community was moderate but with a significant negative effect on SMEs growth ( $B=-.170$ ,  $P<.001$ ). One of the

implications of these results is on the need of policy shift to address the high unemployment rate in Kenya which stands at 5.6% in 2023. Governments to provide a supportive climate and flexible labor laws that draw in a significant number of small enterprises and the private sector, fusing old and new entrepreneurial spirit to increase job opportunities for entrepreneurs and absorb a big portion of the unemployed population.

## **5.2 Conclusions**

Tax conditions that are favorable is one of the ways the SMEs in Mombasa can survive beyond their infancy and create the much-sort job creation for economic development. Complying with the management on its tax obligation is important in the long run of a business. On the other hand, the government policies that support availability of friendly tax conditions is important. Apart from Tax conditions, improving Financial Access is one other way the SMEs in Mombasa can mitigate their survival challenges. The SMEs management with good credit rating and stable internal business financial sources have guaranteed sustainable Financial Access necessary for growth. The affordable wages are an important aspect to motivate employees so as to sustainably meet their employees' wage demands. Local and national government economic policies that enables the SMEs provide sustainable reasonable wages is important for growth of SMEs, finally on regarding the effect of unemployment level in the SMEs neighborhood, it is concluded that unemployment level significantly impedes SMEs growth. The government and the SMEs sector that are able to create an environment that spur growth are therefore critical to create more jobs and thus reduce unemployment in the neighborhood. The study explored the economic factors influencing the growth of small and medium enterprises in Mombasa County. It revealed that favorable tax laws, financial accessibility, wage affordability, and

unemployment rates significantly impact SMEs' expansion. Addressing challenges through prudent tax compliance, a thriving business environment, and wage policies can help support the economy and create employment, meeting the economic pillars in Vision 2030.

### **5.3 Recommendations**

These findings suggest that policymakers should focus on improving tax incentives, enhancing financial accessibility, and addressing wage affordability and unemployment challenges to foster the growth of SMEs in Mombasa County.

Owners of SMEs should work with them to develop a thriving financial system that offers favorable credit terms and takes loan rates for funding small and medium-sized enterprises. The Schumpeterian Theory of destructive innovation emphasizes the importance of financial power.

The SMEs owners should strive to provide affordable wages. This will help retain the best skills necessary for innovation, growth and economic development as suggested in the endogenous theory of growth. According to the theory, endogenous forces as opposed to exogenous ones are what drive economic growth from within the economy.

On the other hand, the government should create an enabling environment that stir the SMEs sector to create more sustainable job opportunities for the communities the SMEs operate. An employed community member has consistent income that increases purchasing power thus raising the SMEs revenues necessary for growth and development.

#### **5.4 Suggestions for Future Studies**

The current study used primary data alone in studying effect of SE factors on SMEs growth. Future studies should use both primary and secondary data to triangulate the data sources. Moreover, future research should use qualitative and quantitative methods to investigate in-depth the effect of SE on growth and also find out why these factors have effect or have no effect on growth. Future research should be carried out to investigate on the SE specific industries such as manufacturing or agriculture to investigate the differential effect of the SE across industries. This will be an important information in SMEs growth studies.

The relationship between economic variables can actually be complex, mediated and/or modified by a number of factors. Despite this, the current study employed a straightforward model to link SE characteristics to SMEs growth. Thus, the mediating and/or moderating variables in the SE-growth model must be taken into account in future research.

The prospects and difficulties that SMEs confront must be carefully considered in order to achieve economic growth and development. The case study of Mombasa that is being examined here demonstrates how SMEs have the power to revolutionize the economy and increase national productivity. But if the problems SMEs face—access to favorable financing being one of the most important—are not resolved, growth will be impacted, and Africa's ambition of using entrepreneurs to spur future growth will be hampered.

#### **5.5 Contribution of the study**

By focusing on Mombasa, the study contributes specific insights into the regional challenges and opportunities for SMEs, distinguishing it from broader national or

international studies. This could help policymakers design localized solutions for enhancing SMEs growth in Mombasa

This study's findings contribute to our understanding of SMEs growth by providing empirical evidence on the economic factors that affect SMEs in Mombasa. It aligns with Endogenous Growth Theory by highlighting the importance of finance and human capital in fostering longterm growth and innovation

The findings could serve as a baseline for future research on SMEs growth in Mombasa or other similar regions. Other scholars could build upon the study's conclusions to deepen understanding of SMEs challenges and success factors in developing economies.

This research provides valuable insights for policymakers, entrepreneurs, and financial institutions to develop targeted strategies to address these economic determinants and create an enabling environment for SMEs growth in Mombasa.

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**APPENDICES****Appendix I: Letter to NACOSTI****SCHOOL OF BUSINESS AND ECONOMICS**

DEAN'S OFFICE

P.O. Box 3900

ELDORET

Tel./Fax 254-053-43153/43620  
Ext.43422<sup>nd</sup>, February 2024**Attn; NACOSTI**PO Box  
Nairobi

Dear Sir/Madam,

**RE: ALFRED MAGHANGA MWAKIO - PGE/3009/16**

This is to confirm that the above-named person is a postgraduate student in the School of Business & Economics where he is pursuing a Masters of Arts in Economics. He is expected to collect research data in Mombasa, Kenya. His research thesis is titled: **“ECONOMIC FACTORS INFLUENCING THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN MOMBASA, KENYA”**.

Any assistance accorded to her especially on the issuance of research permit is highly appreciated.

Yours faithfully,

Dr. Stanley Kavale, POST GRADUATES COORDINATOR/ SBE COAST CAMPUS

**Appendix II: Introduction Letter**

Alfred Maghanga Mwakio

P.O Box 104202-80100

Cell 0780 009009,

22<sup>nd</sup> February, 2024

Mombasa- Kenya.

To Respondent SME owner/ Manager

Dear Sir/Madam,

**RE: REQUEST FOR PERMISSION TO CARRY OUT (DATA COLLECTION ON GROWTH OF SMEs)**

I am a student at Moi University Coast Campus, School of Business and Economics pursuing a Degree Master of Arts. Pursuant to the per-requisite course work, I would like to conduct a research study on “ECONOMIC FACTORS INFLUENCING THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN MOMBASA, KENYA”.

Kindly complete the attached questionnaire. Data collected shall be treated with utmost confidentiality and strictly was used for academic purposes only.

Thanking you in advance as I look forward for your cooperation.

Yours faithfully,



Alfred Maghanga Mwakio,  
**STUDENT, SCHOOL OF BUSINESS AND ECONOMICS.**

### Appendix III: Questionnaire

You are kindly requested to answer this questionnaire on economic factors and performance of this business. Kindly answer them as honestly as possible by selecting the best choice from the given set of choices in each question

1. Kindly select your gender MALE [ ] FEMALE [ ]

2. Your age

Below 25 years

25 years and below 35 years

35 years and below 45 years

Over 45 year

3. Age business

Less than 5 years

5 to 10 years

More than 10 years

4. Number of employees;

Less than 10 employees

10 to 20 employees Over 20 employees The statements below regard the owner

of this business. Kindly select by ✓ one of the options that best describes the

extent the following statements are true regarding your organization where

NE = No Extent,

SE = Small extent

ME = Moderate extent

LE = Large extent

Very large extent

<b>TAX conditions H1</b>	<b>Choice</b>				
	NE	SE	ME	LE	VLE
1. Tax level in this business is favorable/reasonable					
2. Taxes constitute the among the largest cost of my business					
3. Taxes we pay are well utilized to further develop business infrastructure like market, roads good for business					
4. We are able to meet our tax obligation promptly as required by law					
5. This business has good income base from owner					
6. lending conditions are conducive					
7. We have a good credit rating					
8. Credit prices from institutions and individuals are affordable in this business.					
9. This business gives best employee wages compared to similar businesses					
10. The business meets its wage obligations promptly					
11. Business wages are readily paid					
12. The wages reflect the economic realities, and individual qualities like age, and experience and education and personal needs					
<b>UNEMPLOYMENT H4</b>					
13. Most community members have a high purchasing power					
14. Most customers purchase items in large quantities					
15. Most customers have steady formal income from employment					
16. There is a large pool of applicants for job in this business Growth.					

17. In the past five years, on average, the business has remained profitable					
19. The business has recorded increasing Number of employees in last 5 years					
20. The business recorded increasing Number of branches in last than 5 years					
21. The production/ stock level has been generally increased in last 5 years					

Thank you very much.

Appendix IV: Map of Mombasa County

Mombasa County

