Government Taxation and Growth of Large Manufacturing Firms in Nairobi City County, Kenya Registered with Kenya Association of Manufacturers

Eunice Kagwiria Kalwigi[1], Dr Fredrick Warui[2], Dr Farida Abdul[3]
[1,2,3]Department of Accounting and Finance, Kenyatta University
Corresponding Email: kagwiria95@yahoo.com

Abstract

Purpose: This article explores the intricate relationship between government taxation and the growth of large manufacturing firms. Specific objectives of this study were to investigate effect of corporate income taxes, excise duty taxes and custom duty taxes on growth of large manufacturing firms. Finally, to examine moderating effect of firm size on the relationship between government taxations and growth of large manufacturing firms.

Methods: The research was guided descriptive research design with secondary data obtained from audited financial statements. The researcher employed stratified and systematic sampling to select 73 organizations from Nairobi City County's large manufacturing firms for the study. Panel data analysis was employed.

Results: The findings indicated that corporate income taxes had a negative and significant effect on growth of manufacturing firms (β=-0.002, p=0.045); excise duty taxes had a positive and significant effect on growth of manufacturing firms (β=0.004, p=0.000); and custom duty taxes had a positive and significant effect on growth of manufacturing firms (β=0.005, p=0.005). Further, the interaction between government taxations and firm size had a negative and significant effect on growth of large manufacturing firms in Kenya (β=-0.0028, p=0.000).

Conclusion: The study found that corporate taxes positively impact growth, as higher taxes correspond with increased income and tax contributions from rapidly growing firms. The relationship between excise duty and growth was positive but not statistically significant, suggesting little effect on large manufacturing firms. The study recommends maintaining current corporate tax rates for large manufacturers, as they do not impede growth. Policymakers should consider the minimal effects of these taxes when designing fiscal policies, and future research could investigate other tax-related factors. Additionally, firms are encouraged to expand their asset bases to enhance investment potential, improve funding security, and achieve economies of scale.

Keywords: *Government Taxation, Growth, Large Manufacturing Firms, Kenya Association of Manufacturers*

1. Introduction

Government taxation plays a pivotal role in shaping the business environment for large manufacturing firms. Taxes can influence operational costs, investment strategies, and ultimately, the growth trajectory of these firms. While taxation is essential for funding public services and infrastructure, excessive or poorly structured taxes can stifle growth, innovation, and competitiveness. It is a stylized truth that very few nations worldwide have achieved rapid economic growth and high-income levels without the manufacturing sector playing a crucial role (KAM, 2022). To improve the performance of large industrial enterprises, the government needs to reduce taxes, or even eliminate taxes, and zero-rate the outstanding balance. The national government of Kenya imposes taxes on all commodities produced or manufactured both domestically and abroad, increasing the cost of the final good and decreasing consumer demand. Nothing goes untaxed thanks to the support of various government organizations, including the Kenya Revenue Authority (Richard, 2023). This article aims to analyze the effects of different taxation types on large manufacturing firms, using empirical data and case studies to illustrate these dynamics. African nations are still facing challenges in their attempts to grow and close the gap with manufacturing companies in wealthy nations. Poor infrastructure, cutting-edge technology, unstable political environments, a contracting market, and numerous tariffs imposed on all produced items are some of these challenges (OECD, 2019). From 9.6% in 2018 to 8.3% in 2019, manufacturing companies' share of GDP in African countries decreased (Signe, 2018).

For instance, manufacturing production rose 5.5% in India, 12.7% in Turkey, and 7.6% in Vietnam; in contrast, it fell 1.5% in Indonesia. Considering industrialized economies outside of the European Union, output in the UK decreased by 1.6% in Q1 2021 after declining by 2.7% the previous quarter. The manufacturing and agricultural sectors saw notable declines in growth, going from 2.7% to 0.2% and 4.7% to 1.6%, respectively (World Bank, 2018).

Furthermore, over the past ten years, the manufacturing sector's relative contribution to GDP has decreased in all regions. The manufacturing value added (MVA) of Central, East, and West Africa is 9.2%, while that of Southern and North Africa is 12.7% and 15.9% of GDP, respectively. Manufacturing exports from African countries have increased at a rate of 9.5% annually on average (Signe 2018). Although employment and the value-added manufacturing sector's shares in Africa are growing, they are still quite low when compared to the rest of the globe (Zeufack, 2019).

Based on 2019 KNBS data, Kenya's manufacturing sector ranks third locally in terms of its contribution to the 7.5% annual GDP growth rate of the nation. Furthermore, the manufacturing sector's GDP contribution dropped in 2020, expanding by 7.6% as opposed to 7.9% in 2019, according to data from the KNBS (2021). Furthermore, from 9.3 percent in 2016 to 8.4 percent in 2018, the total GDP contribution decreased significantly. The manufacturing industry has recently had a declining trend. It grew by 3.6% in 2015, 3.1% in 2016, and 0.7% in 2017.

Other years saw additional declines to 3.1% and 0.7%, respectively. A minor recovery occurred in 2018 when the growth rate rose to 4.3%, but it again dropped to 3.2% in 2019 (KAM, 2021). The amount of food goods produced fell by 10.8% in 2017 as opposed to growing by 1.9% in 2016. This industry primarily services the East African market, although it also serves local and export markets. The manufacturing industry, according to (KAM, 2024) is split into twelve sub-sectors based on value addition and processing of the products they generate.

1.1 Problem Statement

The manufacturing sector's financial performance has varied over time. It made up 7.9% of the total in 2020, compared to 8.4% in 2019, 8.7% in 2018, and 9.3% in 2017. Over the last ten years, the manufacturing sector's average GDP contribution has been 11%, indicating a general stagnation in the industry.

Manufacturing businesses in Kenya have faced performance issues, which are shown in their reporting of year-end earnings and their reduction in GDP contributions. The manufacturing and related sector's declining GDP contribution which was 9.2% in 2016 and 8.4% in 2017 reveals that the nation underwent a premature deindustrialization. The previous fifteen years have seen significant challenges for the industry.

Key government development programs, such as Vision 2030, the Kenya Industrial Transformation Programme (KITP), and most recently, the Big 4 Agenda, are intended to help revive Kenya's manufacturing and allied sectors by 2022. Additionally, these programs seek to increase Kenya's GDP from 8.4% to 15% (KAM, 2022). Over the past three decades, the sector's contribution to GDP has not increased significantly; it averaged 10% from 1964 to 1973, increased somewhat to 13.6% from 1990 to 2007, and has subsequently averaged less than 10% (KAM, 2022).

For instance, Mumias Company's financial success as determined by ROA was 2.5% in 2014, 0.6% in 2015, and 0.02% in 2016. Furthermore, the East African Breweries (EAB) ROE-based financial performance was 0.6% in 2014, 0.5% in 2015, 0.7% in 2016, and 0.6% in 2017. From the greatest 9.4% in 2015 to the lowest 7.5% in 2019, the manufacturing sector's contribution to GDP has been declining during the past five years (KAM, 2021). There is evidence to suggest that Kenya is deindustrializing rather than industrializing. The accomplishment of the Big Four Agenda's 15% GDP target by 2022 is threatened by the manufacturing sector's ongoing reduction in GDP contribution (KAM, 2021).

1.2 Objectives of the study

i. To determine the effect of corporate income taxes on the growth of large manufacturing firms
ii. To determine the effect of excise duty taxes on growth of large manufacturing firms
iii. To determine the effect of custom duty taxes on the growth of large manufacturing firms
iv. To determine the moderating effect of firm size on the relationship between government taxation and the growth of large manufacturing firms

2. Literature Review

2.1 Theoretical Review

Optimal tax theory, as described by Mirrlees (1976), focuses on designing taxes that minimize distortion and inefficiency while generating predetermined revenues. A neutral tax is a theoretical concept that completely avoids these issues. When faced with two mutually exclusive economic projects of equal pre-tax risk, taxpayers will generally prefer the project with the lower tax burden or any available tax breaks.

The Savers-Spenders hypothesis, proposed by Mankiw (2000), explains fiscal policy's behavior in the economy based on several assumptions. It suggests that short-term tax adjustments can

significantly affect the market for goods and services. According to this theory, any increase in take-home pay for spenders would be offset by lower tax refunds or higher tax payments. As a result, consumers are expected to save the extra take-home pay to prepare for the increased tax bill, recognizing that their lifetime resources remain unchanged.

As to Chigbu, Eze, and Ebimobowei (2012), the tax that manufacturing firms submit to the tax authorities needs to correspond with their capacity to fulfill their financial responsibilities. This hypothesis was challenged because people would no longer have the incentive to earn more, which would mean that high wages would be penalized even though they may have been earned via resourcefulness and hard effort. Additionally, it discourages economic success since it burdens wealthier individuals with a disproportionate number of taxes.

Adam Smith laid the groundwork for the economies of scale hypothesis in his seminal work, Wealth of Nations (1976), where he argued that the division of labor can significantly enhance output capacity. This hypothesis describes the relationship between a company's output rate and the effective combination of productive services employed. It suggests that as a company grows in size, it can leverage these economies of scale to boost profitability.

2.2 Empirical Review

Numerous studies have examined the impact of taxation on the growth of large manufacturing firms. Eneisik (2023) conducted a study examining the impact of corporate income tax on the financial performance of listed manufacturing companies in Nigeria, using capital gains tax, tertiary education tax, and corporate income tax as proxies. The findings indicated that income taxes negatively affect the financial performance of these companies. Similarly, Oyinkansola and Omodero (2023) analyzed data from 2016 to 2021 and found that while corporate taxes have a minor negative impact on net asset bases, they positively influence profitability, particularly regarding statutory audits and corporate tax expenses. John (2021) explored the effects of corporate income tax on Ghanaian listed manufacturing firms over seven years using panel data methods, revealing a significant inverse relationship between business income tax and financial success while noting a strong positive correlation between a company's size, age, and growth with its financial performance. Research by Mwangi (2022) suggests that tax incentives targeted at specific sectors, including manufacturing, can lead to increased capital investment and job creation. Furthermore, custom duties often protect local industries but can also raise production costs, thereby affecting pricing and competitiveness (Smith & Johnson, 2022). According to Julius (2022), heavy tax burdens caused by excise taxes had a detrimental effect on petroleum fuel costs for manufacturing companies. Furthermore, there is a strong negative correlation between household welfare and tax costs. According to Abiahu (2020), corporation tax payments have no appreciable impact on a company's return on equity. Additional research showed that the corporate tax payment had a favorable and considerable impact on the listed companies' debt-to-equity ratio.

2.3 Conceptual Framework

In this research, the conceptual framework includes independent, dependent, and moderating variables, with government taxes as the independent variable and growth as the dependent variable measured by percentage change in net income. And the moderating variable firm size is measured by asset value. The study's conceptualization is illustrated in the accompanying figure.

Independent variable   **Dependent variable**
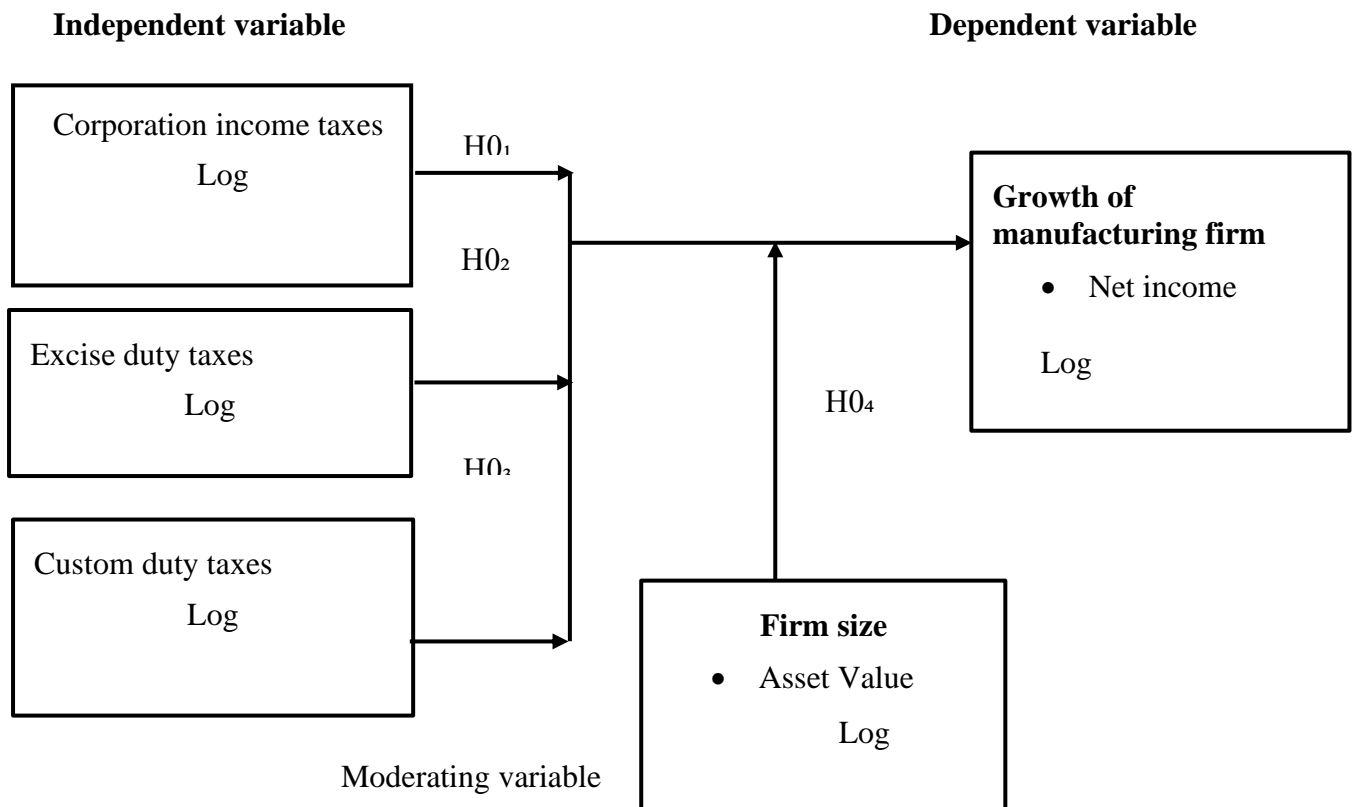
Figure 1: Conceptual Framework

3. Methodology

This study employed a descriptive research design to analyze financial data from large manufacturing firms within Nairobi city county. The researcher obtained secondary data from the selected large manufacturing firms and therefore, the researcher adopted a positivist paradigm in this study because it allowed the researcher to examine the relationship between government taxations and the growth large of manufacturing firms in Nairobi City County without manipulation or alteration of individual position. The sample included 73 firms operating in various manufacturing sectors, with data spanning six years (2018-2023). Key performance indicators such as revenue growth, profit margins, and investment levels were analyzed in relation to taxation levels. Panel data analysis was employed.

4. Results and Discussion

4.1 Descriptive Analysis

Table 1: Descriptive Statistics

Variable	observation	mean	minimum	maximum	std. dev
Growth (%)	365	0.068	0.029	0.090	0.014
Corporate Taxes	365	96.138	1.929	3901.227	216.336
Excise Duty Taxes	365	149.673	0.254	4228.649	378.319
Custom Duty Taxes	365	29.059	2.675	79.113	18.867
Asset Value	365	590.313	12.331	1394.335	214.922

The results indicated that the average growth of manufacturing firms in Kenya from 2019 to 2023 was 0.068, with a minimum growth rate of 0.029 and a maximum of 0.0897. The standard deviation was 0.0144769, suggesting that growth rates during this period ranged from 2.9% to 8.97%.

The study results also showed that the mean of corporate taxes of manufacturing firms in Kenya between 2019 and 2023 was KES 96.138 million. The minimum corporate taxes were ksh1.929 million while the maximum corporate taxes were KES 3901.227 million. The standard deviation was 216.336. This therefore meant that the corporate taxes of the manufacturing firms ranged between ksh1.929 million and KES 3901.227 million.

Further outcomes result also showed that the mean of excise duty taxes of manufacturing firms in Kenya between 2019 and 2023 was KES 149.673 million. The minimum excise duty taxes were KES 0.254 million while the maximum corporate taxes were KES 4228.649 million. The standard deviation was 378.319. This therefore meant that the corporate taxes of the manufacturing firms ranged between KES 0.254 million and KES 4228.649 million.

In addition, results showed that the mean of excise duty taxes of manufacturing firms in Kenya between 2019 and 2023 was KES 149.673 million. The minimum excise duty taxes were KES 0.254 million while the maximum corporate taxes were KES 4228.649 million. The standard deviation was 378.319. This therefore meant that the excise duty of the manufacturing firms ranged between KES 0.254 million and KES 4228.649 million.

Further outcomes showed that the mean of custom duty taxes of manufacturing firms in Kenya between 2019 and 2023 was KES 590.313 million. The minimum custom duty taxes were KES 12.331 million while the maximum custom duty taxes were KES 1394.335 million. The standard deviation was 214.922. This therefore meant that the custom duty taxes of the manufacturing firms ranged between KES 12.331 million and KES 1394.335 million.

4.2 Correlation Analysis

Table 2: Correlation Analysis

	Growth	Corporate taxes	Excise duty taxes	Customs duty taxes	Firm size
Growth	1				
Corporate taxes	-0.1834	1			
	0.0004				
Excise duty taxes	0.17	-0.082	1		
	0.0011	0.1179			
Customs duty taxes	0.5488	-0.2694	0.1294	1	
	0.000	0.0000	0.0133		
Firm size	0.7798	-0.0425	0.1598	0.059	1
	0.0000	0.4181	0.0022	0.2606	

The results indicated a significant negative relationship between corporate income taxes and the growth of large manufacturing firms in Kenya ($r = -0.1834$, $p = 0.004$). This suggests a weak negative correlation between corporate income taxes and growth. Further results showed that excise duty taxes had a positive and significant association with growth of the large manufacturing firms in Kenya ($r = 0.17$, $p=0.0011$). This infers that excise duty taxes had a weak and positive correlation with growth of the large manufacturing firms in Kenya.

In addition, results showed that custom duty taxes had a positive and significant association with growth of the large manufacturing firms in Kenya ($r= 0.5488$, $p=0.000$). This infers that custom duty taxes had a moderately strong and positive correlation with growth of the large manufacturing firms in Kenya. Further results showed that firm size had a positive and significant association with growth of the large manufacturing firms in Kenya ($r= 0.7798$, $p=0.0000$). This infers that firm size had a strong and positive correlation with growth of the large manufacturing firms in Kenya.

4.3 Diagnostic tests

Table 3: Normality Tests

Variable	Obs	W	V	z	Prob>z
Growth	365	0.893	27.242	7.830	0.090
corporate taxes	365	0.941	14.970	6.411	0.068
excise duty taxes	365	0.985	3.690	3.093	0.077
custom duty taxes	365	0.850	38.037	8.621	0.056
asset value	365	0.965	8.920	5.185	0.059

When the values of p are more than 0.05, the data are considered normal and the null hypothesis is true. When the p-value is higher than 0.05, the null proposition is not disproved. The fact that all of the variables' p-values were more than 0.05. This supposes that all the variables were normally distributed.

When there is a significant resemblance between two independent variables, multicollinearity exists. Multicollinearity was examined by use of Variance Inflation Factor. Table 4displays the findings. Table 4: Multicollinearity test.

Table 4: Multicollinearity

Variable	VIF	1/VIF
corporate taxes	1.09	0.915
excise duty taxes	1.08	0.925
custom duty taxes	1.04	0.958
asset value	1.03	0.973
Mean	**1.06**	

The outcomes in Table 4 show that multicollinearity was absent; all variables had VIFs of less than 10, and the mean was likewise less than 10 at 1.06. Similar to this, each of the variables under consideration had tolerance levels above 0.1, indicating that all the variables had no multicollinearity.

Table 5: Heteroskedasticity Test

Breusch Pagan test

Ho: Constant variance

Variable-fitted values	Growth
chi2 (01)	502.12
Prob > chi2	0.087

The results indicated a p-value of 0.087 which was more than 0.05. As a result, the study concludes that there was no heteroskedasticity in the data.

4.4 Hausmann Test for Model Specification

The determinant of the study's most appropriate model is by running panel data regression model through Hausman test. To achieve this, both the fixed and random effects models were run then Hausman test was conducted. Random effect model fits the null hypothesis; if p-value exceeds a critical value, random effect model is suitable, otherwise a fixed effects model is deployed. Results are shown in Table 6.

Ho: Accept the Random Effect Model

Ha: Accept the Fixed Effect Model

Table 6: Hausman Test

	(b)	(B)	(b-B)	sqrt(diag(V_b-V_B))	
	Fixed	random	Difference	S.E.	
corporate taxes	-0.0008	-0.0006	-0.0002	0.0002	0.2924
excise duty taxes	0.0011	0.0014	-0.0003	0.0090	7.9733
custom duty taxes	0.0022	-0.0010	0.0033	0.0003	0.1711
asset value	0.0081	0.0081	0.0000	0.0001	0.7208
chi2(5)	=	(b-B)'[(V_b-V_B) ^ (-1)] (b-B)			
	=	160.84			
Prob>chi2	=	**0.000**			

The fixed effects model was applied, according to the Hausman test. In response, the only findings given and covered in the next section were those of the fixed effects model. The Hausman test revealed a significance level of 0.000<0.05.

Thus, the null hypothesis of the researchers was disproved (H_0). This proves that the fixed effects panel data model, which was employed, provides the best fit for the data. Therefore, only the outcomes of the fixed effects panel regression were reflected in the subsequent sections.

4.5 Regression Analysis Before Moderation

Regression analysis was done to determine the relationship between the independent variables (government taxation) and dependent variable (growth of manufacturing firms).

Table 7: Fixed-effects Regression Model before moderation

Growth	Coef.	std. err	t	P>|t|	[95% conf. Interval	
Corporate taxes	-0.002	0.001	-1.990	0.045	-0.004	0.000
Excise duty taxes	0.004	0.001	3.750	0.000	0.002	0.007
Custom duty taxes	0.005	0.002	2.810	0.005	0.001	0.008
Cons	0.016	0.016	0.950	0.343	-0.017	0.048
r squared= 0.441						
F (3,289) =27.61						
Prob>F=0.0005						

The coefficient of determination (R squared) result of 0.441 shows that changes in government taxation accounted for 44.1% of variations in growth of manufacturing firms in Kenya. This was further supported by an F statistic of 27.61. The overall model was also significant (p=0.005) implying that government taxations have a significant effect on growth of the large manufacturing sector in Nairobi City County.

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4.6 Regression Analysis after Moderation

Regression analysis was done to determine whether moderating effect of firm size on the relationship between government taxation and growth of large manufacturing firms.

Table 8: Fixed-effects Regression Model after moderation

	Coef.	std. err	t	P>|t|	[95% conf. Interval	
Government taxation	-0.0017	0.0003	-6.1800	0.0000	-0.0012	0.0022
Firm size	0.0083	0.0002	45.6900	0.0000	0.0079	0.0086
X.M	-0.0028	0.0003	-8.6900	0.0000	-0.0034	0.0022
_cons	0.0620	0.0052	12.0300	0.0000	0.0519	0.0722
r squared= 0.5693						
F (3,289) =805.92						
Prob>F=0.000						

GT=0.0620 - 0.0017GT+ 0.0083FS -0.0028GT*FS

Where:

GT=Government taxations

FS=Firm size

Y=growth

The results showed that firm size had a positive and significant effect on the growth of large manufacturing firms in Kenya (β=0.0083, p=0.000). This implies that large firms had increased growth as compared to small firms. The study findings agreed with Ummy Kalsum (2022) who indicated that business size has a good and considerable impact on earning management.

In addition, results showed that the interaction between government taxation and firm size had a negative and significant effect on the growth of large manufacturing firms in Kenya (β=-0.0028, p=0.000). From the findings, the null hypothesis (**Ho4):** Firm size has no significant moderating effect on the relationship between government taxation and the growth of large manufacturing was rejected.

The coefficient of determination (R squared) was 0.5693. The F statistic was 805.92. The overall model was also significant (p=0.000) implying that firm size had a significant moderating effect on the relationship between government taxations and the growth of large manufacturing firms.

5. Conclusion

The study conclusions demonstrated that corporate taxes had a positive as well as significant effect on growth. This could be explained by the fact that high taxes imply high income and therefore firms that end up reporting higher growth have to pay more corporate taxes compared to firms that pay less corporate taxes. Moreover, the conclusions discovered corporate tax and customs duty have insignificant negative effects on the growth. This implies that firms' increase in corporate tax and customs duty does not result in growth change. Further, the study revealed that excise duty has a positive insignificant association with growth of large manufacturing

firms. This implies that an increase in excise duty could not significantly affect the growth of large manufacturing firms. Finally, the study revealed that firm size has a positive effect on growth. This might be described by the reality that manufacturing firms with more assets can take advantage of investment opportunities when they arise.

6. Recommendations

Based on the study's findings that corporate taxes significantly impact growth, it is recommended that the current corporate tax rates for large manufacturing firms be maintained, as they do not hinder growth. Further, it is recommended that policymakers consider the minimal impact of these taxes when designing fiscal policies. Additionally, future research could explore other factors or tax-related variables that might have a more pronounced effect on growth in this sector. Finally, the study recommends the need for manufacturing firms to grow their asset base as this will help them in taking advantage of investment opportunities when they arise and will also act as a security when negotiating for funds. Further, more assets enhance the economies of scale leading to increased output and reduced cost.

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