

## Effect of Peer Influence on Value Added Tax Compliance Among Manufacturing Firms in Embakasi North, Nairobi, Kenya

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### Abstract

Value-Added Tax (VAT) compliance and digitalization is significant, as digital tools and technologies play a crucial role in improving tax compliance, reducing errors, and enhancing efficiency in tax collection. Value Added Tax (VAT) compliance is a critical aspect of revenue collection for governments worldwide. However, it has encountered various challenges, the most prevalent being verifying input tax claimed by taxpayers when filing VAT returns. The study's general objective was to determine the effect of peer influence on value-added tax compliance among manufacturing firms in Embakasi North, Nairobi, Kenya. The study was guided by the Theory of Planned Behaviour. The research design was explanatory, with a target population of 426 manufacturing firms in Embakasi North, Nairobi, Kenya, and a sample of 206 respondents. Out of the 206 questionnaires issued, 196 were completed and submitted on time, resulting in a 95.1% response rate. The data was collected through a structured questionnaire. The research data were analyzed using descriptive statistics, measures of central tendency, and inferential statistics, including linear regression analysis. The study found that peer influence affects value-added tax compliance ( $\beta = 0.186$ ,  $p = 0.000$ ). Based on the findings, the study recommends that the government should foster peer influence by creating official digital forums or recognizing compliant firms, thereby harnessing social norms to encourage wider compliance. Future research should investigate the impact of tax audit on Value Added Tax Compliance.

**Keywords:** *Peer Influence, Value Added Tax Compliance, Manufacturing Firms, Embakasi North*

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### 1. Introduction

Tax, as defined by the OECD, is a compulsory, unrequited payment to the general government since the benefits provided by the government aren't normally proportional to the payment. (OECD, 2024). This implies that tax is a compulsory financial charge imposed by governments on individuals or entities to fund public expenditure. Tax revenue plays a crucial role in fostering economic growth globally. It serves as the primary source of income for central

governments, contributing to state-building efforts, reducing reliance on foreign aid over the long term, amplifying the fiscal impacts of trade liberalization, and facilitating the provision of essential public goods and services (World Bank, 2023).

Value-added tax (VAT) was introduced in Kenya in 1990 to replace sales tax. It was introduced as a measure to increase government revenue by expanding the tax base. The VAT Act, no 35 of 2013, of Kenyan laws governs the administration of Value Added Tax. The VAT framework taxes goods and services, except for exempt and zero-rated products, which include basic goods and exports. Value Added Tax was adopted with an ordinary rate of 17 percent but incorporated with other 14 rates, with the highest ever being 210 percent. A 210% rate made VAT look like a tax system targeting differentiated commodities.

In the year 2013, the current Value Added Tax Act was adopted and implemented. At this time, VAT policies faced several drawbacks for both business owners and the government. Since the VAT was introduced, the taxman has removed some provisions and added others to the Act. The most noteworthy changes comprise removing the Value Added Tax remission, exclusion of a lowered rate of twelve percent, combination of previous subordinate regulations and the main regulations, reduced scheduling of 8 to 2, as well as raising the rates of zero-rated tax charges and exempting basic supplies (Ernst & Young, 2016). VAT is collected at specified points by registered persons who remit it to the Commissioner. Since the tax is paid by the final consumer of products, registered persons serve solely as VAT agents in collecting and paying the tax.

Peer influence refers to the impact that individuals within a social group have on each other's attitudes, decisions, and behaviors through social interaction and shared norms. It occurs when people consciously or unconsciously adapt their actions to align with those of their peers, often due to the need for social acceptance, belonging, or conformity (Brown & Larson, 2020). In the context of decision-making, peer influence can play a powerful role in shaping values and behaviors, particularly among adolescents and young adults who are more susceptible to group pressure.

Peer influence is a social concept that spans various domains of human life, emphasizing how individuals adjust their behaviors, beliefs, and attitudes to align with their peers' expectations or practices. It can be either positive, encouraging, and constructive behavior, such as academic achievement and adherence to civic responsibility, or negative, leading to undesirable actions like misconduct or tax evasion (Due, 2023). Social learning theory explains peer influence by suggesting that individuals observe and model behaviors within their groups, reinforcing conformity through approval or disapproval (Bandura, 2020).

Embakasi North is a constituency in Kenya and one of the seventeen constituencies in Nairobi County. Embakasi North includes five electoral wards: Kariobangi North, Dandora Area I, Dandora Area II, Dandora Area III, and Dandora Area IV. The constituency has an area of 5.50 km<sup>2</sup> (2.1 sq mi). It was created prior to the 2013 general elections, when the boundaries of Kasarani and Embakasi Constituencies were revised. The constituency forms part of two sub-counties of Nairobi; Kariobangi North falls under Kasarani, while the Dandora area is in Njiru.

## 1.1 Problem Statement

Tax compliance has been a crucial subject for researchers in many countries around the globe. Like the other tax systems, the system of has been confronted with many challenges, both on the side of taxpayers and officials (Berhane & Yesuf, 2023). The Macroeconomic observed that non-compliance is a growing concern in the administration of VAT, partly because under a credit-invoice tax, the gross amount of taxes paid by firms plus refunds returned to firms is so large relative to the net taxes collected by the government (Carroll, 2020).

Despite a number of reform exercises the Kenya Revenue Authority (KRA) has undertaken towards improving its revenue compliance in recent years, it has failed to meet the targets set by the treasury. For instance, for the financial year 2022/2023, VAT collection stood at KShs. 272.452 billion (KRA 2023) against a target of KShs. 314.17 billion KRA (2023). In the 2023/2024 financial year, VAT collected amounted to KShs. 478.2 billion against a target of KShs. 484.2 billion missing targets by KShs. 6 billion (KRA, 2024). Additionally, in the year 2024/2025, VAT collected amounted to KShs. 481.3 billion against a target of KShs. 490.1 billion, KRA (2025), which shows a consistent trend of low VAT collection over the years. These revenue shortfalls have been blamed on tax evasion and other behaviors of tax non-compliance by taxpayers.

## 2. Literature Review

### 2.1 Theoretical Review

The Theory of Planned Behavior (TPB), developed by Ajzen (1991), explains how individual behavior is guided by three factors: attitudes toward the behavior, subjective norms, and perceived behavioral control. In the context of taxation, TPB has been widely applied to understand taxpayer compliance. Peer influence can be integrated into this framework as a key determinant shaping compliance behavior. Peer influence, on the other hand, aligns more closely with the subjective norms dimension of TPB, which refers to the perceived social pressure to perform or not perform a behavior. In the context of taxation, individuals often observe and imitate their peers' behavior, especially when compliance or noncompliance is socially reinforced within a group (Ali et al., 2020). When peers value compliance, taxpayers are more likely to experience normative pressure to meet their obligations, thereby strengthening their compliance intentions (Steinberg & Monahan, 2007). Conversely, if non-compliance is normalized within a social circle, it may weaken taxpayers' motivation to comply, despite personal attitudes or knowledge

### 2.2 Empirical review

#### 2.2.1 Peer Influence

According to Kelman (2021), the social influence theory postulates that surrounding environmental factors affect people's behaviour, either deliberately or non-deliberately. It focuses on how other people's beliefs, views, and behaviours affect an individual (Sussman & Gifford, 2019). The social influence theory is related to social learning theory, which is based on Bandura's (2023) idea that an individual's personal environment influences them. It also emphasizes the effects of peer opinions and the level of social influence on an individual's relationships during socialization, as essential for identifying tax evasion behavior (Sutinen & Kuperan, 2018).

Lu et al. (2022) found that the capital structure of Chinese enterprises is influenced by their peers' capital structure. Further, they found that the mechanism by which peer effects influence managers primarily involves managers' consideration of reputation. Adhikari and Agrawal (2023) found that companies' dividend and share-repurchase policies are significantly influenced by peer companies' policies. Grennan (2019) also confirmed that a company's dividend distribution policy has a significant peer effect. While there is substantial literature documenting peer effects in other settings, the study of peer effects in taxes is novel; little research has examined peer effects in corporate tax avoidance and their impact mechanisms. In this study, we investigate the role of peer effects in Value Added Tax compliance.

King'oina (2019) indicates that, despite administrative reforms, the compliance level for Value Added Tax has been low in Kenya due to factors such as poor understanding of VAT laws and negative perceptions and attitudes towards VAT payments. On average, about 30% of all taxpayers fail to submit their VAT returns, and many face prosecution each year for failing to file complete returns (Onditi, 2022).

### **2.2.2 Value Added Tax Compliance**

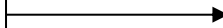
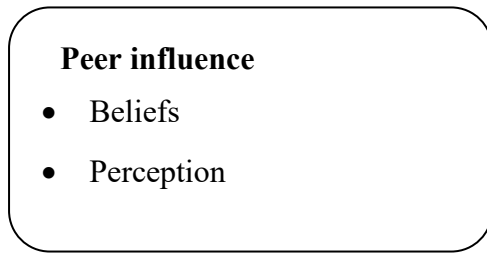
VAT is regarded as a form of indirect tax imposed on goods and services produced in a country (Schenk & Oldman, 2021). VAT was introduced in Kenya in 1990 as a means of increasing the government's tax collections by widening the tax base. It is collected by the Kenya Revenue Authority (KRA) in accordance with the provisions of the Value Added Tax Act 2013. VAT on goods and services supplied in Kenya is collected at each stage of the production process by VAT-registered persons who act as the agents of the government. VAT on imported goods and services is paid by the importer. Both developed and developing countries can change VAT policies over time in response to a number of factors, including political, economic, social, technological, and legal. VAT contributes about 36% of the total tax revenue collection by the government (KNBS 2019).

VAT tax compliance refers to the act of citizens registered for VAT documenting their VAT expense forms on time, declaring the correct self-evaluated tax, and making timely payments of sums due without the mediation of the expert (Palil, 2020). Value Added Tax compliance has become the key managerial approach to both individual and corporate duty assessment in developed nations. The world has been experiencing exceptional progress in data communication technology. These mechanical advancements are expected to profoundly affect assessment consistency, as they influence how tax assessment is controlled (Kamel, 2020).

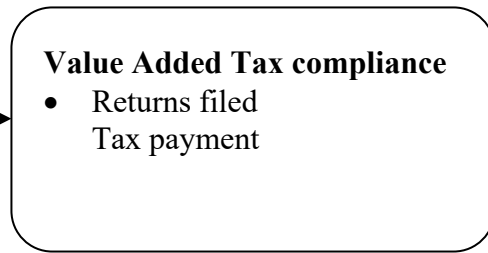
### **2.3 Conceptual Framework**

A conceptual framework is a hypothesized model that identifies the model under study and the relationships between the dependent and independent variables (Mugenda, 2008). Garg and Kothari (2014) define an independent variable, also known as the explanatory variable, as the presumed cause of the changes of the dependent variable, while a dependent variable refers to the variable that the researcher wishes to explain. In this study, the independent variable was peer influence, and the dependent variable was value-added tax compliance, as shown in Figure 1.

**Independent Variable**



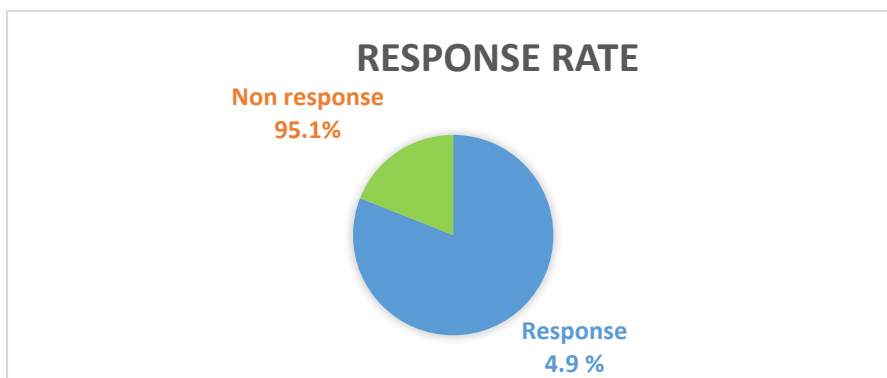
**Dependent Variable**



**Figure 1: Conceptual Framework**

**3. Methodology**

Research design describes the systematic, scientific procedures appropriate for a given study. It is a detailed plan that outlines the methods, structure, and approach of a study, with the goal of identifying solutions to research problems while minimizing variation (Kothari, 2004). This study adopted the explanatory research design, which explains the effect of one variable on another (Gray, 2013). A population is the entire gathering of elements about which extrapolations are made (Cooper Schindler, 2011) or is a group of the variables that are being studied (Chandan, Singh, and Khanna, 2010). For this study, the target population comprised 426 manufacturing firms in Embakasi North, Nairobi, Kenya (KRA, 2025). And a sample size of 206 respondents. The selection of Embakasi North as the study location was deliberate. This area is a recognized industrial hub within Nairobi, hosting a high concentration of diverse manufacturing and logistics firms (Nairobi City County, 2022). This study targeted 206 manufacturing firms in Embakasi North, Nairobi, Kenya, and therefore all of them were contacted for data collection. Of the 206 questionnaires issued, 196 were completed and submitted on time, resulting in a 95.1% response rate, as shown in Figure 1. Only 10 questionnaires were returned incomplete, accounting for a minimal non-response rate of 4.9%.



**Figure 2: Response Rate**

**Reliability analysis**

Sekaran (2003) stated that the reliability of a measure is an indication of the stability and consistency with which the instrument measures the concept and helps to assess the “goodness” of a measure. The reliability analysis was done using Cronbach’s Alpha, which is usually interpreted as the mean of all possible split-half coefficients. The Cronbach’s alpha coefficient of 0.7 was used as the benchmark for this study. Table 1 shows the pilot study reliability tests

for each variable, with value-added tax compliance showing a Cronbach's alpha of 0.927, which exceeds 0.7. peer influence, Cronbach's alpha value of 0.743>0.7.

**Table 1: Test of Reliability**

Factor	Number of Items	Cronbach's Alpha score	Conclusion
Value Added Tax Compliance	4	0.927	Acceptable
Peer influence	4	0.743	Acceptable

## 4. Results and Discussion

### 4.1 Descriptive Statistics

#### 4.1.1 Descriptive Statistics for Peer Influence

Table 2 showed that for the statement, "My friends, neighbors, and other business owners comply with tax matters," had a mean response of 3.98 and a standard deviation of 0.829. The mean, being just below the agreement, indicates that respondents generally concur with this perception of peer influence. For the item, "The government should reward those who are VAT compliant," the mean was 3.96 with a standard deviation of 0.831. This mean score reflects a strong tendency for respondents to agree with the notion of governmental rewards for VAT compliance. The standard deviation indicates a consistent, low level of variation in these affirmative responses. The statement, "There is a high degree of being detected for not complying," yielded a mean of 4.00 and a standard deviation of 0.823. This means a score showing moderate agreement. This demonstrates a consensus among respondents that the perceived risk of detection is high. The standard deviation confirms a low level of deviation from this consensus view. Finally, the item "Other business owners motivate me to comply with tax laws" had the highest mean on the construct at 4.07, with a standard deviation of 0.848. This mean indicates that respondents, on average, agreed most strongly with this statement, highlighting the motivational role of peers. In summary, with a collective mean of 4.00 across all statements, respondents consistently agreed with statements regarding peer influence on tax compliance, with distributions that were generally symmetrical and flatter than a normal curve, indicating a diverse yet consensus-driven response pattern.

**Table 2: Peer Influence**

	Mean	Std. Deviation
N= 196		
My friends, neighbors, and other business owners comply with tax matters	3.98	.829
The government should reward those who are VAT compliant	3.96	.831
There is a high degree of detection for not complying	4.00	.823
Other business owners motivate me to comply with tax laws	4.07	.848
Mean	4.00	

#### 4.1.2 Descriptive Statistics for Value Added Tax Compliance

Table 3 showed that the statement, "We submit our returns on time," yielded a mean response of 3.92 with a standard deviation of 0.849. This standard deviation indicates low dispersion among the responses, suggesting a general consensus around the mean. The mean score signifies that respondents predominantly agreed with this statement. For the item, "We have registered for VAT tax compliance obligation," the mean response was 3.99, and the standard deviation was 0.889. The standard deviation reflects a low to moderate variation in responses. Regarding the statement, "We mostly file our returns accurately," the analysis showed a mean of 4.04 and a standard deviation of 0.899. This standard deviation suggests a moderate level of variability from the mean response. Finally, the item stating, "The tax system in place motivates us to voluntarily comply with VAT tax obligation," recorded the highest mean of 4.08, with a standard deviation of 0.896. This standard deviation denotes a moderate level of disagreement or variability around the high mean. In summary, the overall mean of 4.01 across all four items confirms a consistent pattern where respondents generally agree with statements affirming their firm's VAT compliance and the motivating role of the tax system.

**Table 3: VAT compliance**

N= 196	Mean	Std. Deviation
We submit our returns on time	3.92	.849
We have registered for the VAT tax compliance obligation	3.99	.889
We mostly file our returns accurately	4.04	.899
The tax system in place motivates us to voluntarily comply with VAT tax obligation	4.08	.896
Mean	4.01	

#### 4.2 Correlation Analysis

A correlation analysis assesses the strength and direction of the relationship between Value Added Tax Compliance and peer influence, indicating the extent to which changes in one variable are associated with changes in the other (Akoglu, 2018). Peer influence showed a significant and positive correlation with Value Added Tax Compliance ( $r = 0.584$ ,  $p = 0.000$ ), supporting previous findings that taxpayers' understanding of fiscal regulations significantly influences compliance behavior (Kogler *et al.*, 2015).

**Table 4: Correlations Statistics**

	Value Added Tax Compliance	Peer influence
Value Added Tax Compliance	1	0.584**
Peer influence	0.584**	1
Sig.	0.000	

\*\* . Correlation is significant at the 0.05 level (2-tailed).

### 4.3 Regression Analysis

A model summary was conducted to determine the correlation R and the percentage variation explained by Value Added Tax Compliance (R-squared). Table 5. showed that Peer influence had a correlation at 58.4% ( $R = 0.584$ ) and accounted for 34.1% ( $R^2 = 0.341$ ) of the variance in Value Added Tax Compliance. The remaining 65.9% of the variation in Value Added Tax Compliance was caused by factors not included in the model.

**Table 5: Model Summary**

Model	R	R Square	Adjusted R-Square	Std. Error of the Estimate
1	.584 <sup>a</sup>	.0341	.337	.41457

a. Predictors: (Constant), Peer influence \_mean

Table 6 showed an F statistic of 262.794 and a p-value of  $0.000 < 0.05$ , indicating that the model was significant in explaining the variance attributable to Value Added Tax Compliance.

**Table 6: Analysis of Variance**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	134.025	1	134.025	262.794	0.000
	Residual	98.964	194	0.510		
	Total	232.989	195			

a. Dependent Variable: Value Added Tax Compliance

b. Predictors: (Constant), Peer influence

Table 7 shows that peer influence also had a significant positive effect on Value Added Tax Compliance, with a standardized beta coefficient of 0.186 ( $\beta = 0.186$ ,  $p = 0.000$ ). A unit change in Peer influence was associated with a 0.186 increase in Value Added Tax Compliance, indicating that improved Peer influence led to greater Value Added Tax Compliance.

**Table 7: Regression Coefficient analysis**

Variable	Standardized		Unstandardized		
	$\beta$	Std. Error	t-Statistic	$\beta$	Prob.
Constant	2.067	0.204	10.132		0.000
Peer influence	0.186	0.032	5.813	0.136	0.000

### 4.4 Discussion of the Findings

The study objective was to determine the effect of peer influence on value-added tax compliance among manufacturing firms in Embakasi North, Nairobi, Kenya. The results from the correlation matrix indicated a significant, positive correlation between peer influence and

VAT compliance ( $r = 0.584$ ,  $p = 0.000$ ), indicating that firms are more likely to comply when they perceive that their business peers are also adhering to tax regulations. The model further found that peer influence had a positive and significant effect on VAT compliance ( $\beta = 0.186$ ,  $p = 0.000$ ). This underscores the powerful role of social norms and network effects. This finding is consistent with Wanjiru and Maina's (2023) research on Nakuru industrial clusters, which found that "compliance is socially contagious; firms embedded in networks with high compliance rates were 2.3 times more likely to be fully compliant themselves, due to both peer learning and reputational concerns."

## 5. Conclusion

The study concludes that peer influence has a significant positive effect on VAT compliance, underscoring the powerful role of social norms and network behavior in shaping tax compliance. This finding contributes new knowledge by demonstrating that the social contagion of compliance behavior is accelerated and intensified in digital environments. It establishes that digital platforms do not replace social interactions but rather augment them, creating a "digital contagion effect" that strengthens normative pressures and observational learning within business networks.

## 6. Recommendations

Based on the findings, the study recommends that the government should foster peer influence by creating official digital forums or recognizing compliant firms, thereby harnessing social norms to encourage wider compliance. Future research should investigate the impact of tax audit on Value Added Tax Compliance.

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