

The Effect of Taxation Awareness on Financial Performance of Small-Scale Enterprises in Kanungu District

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Abstract

The study investigated the effect of taxation awareness on the financial performance of small-scale enterprises (SSEs) in Kanungu District, Uganda. A cross-sectional survey design was employed with a sample size of 160 respondents selected through stratified random sampling. Data were collected using structured questionnaires and analyzed using descriptive statistics and Pearson correlation analysis. Results revealed that taxation awareness had a significant positive relationship with financial performance ($r = 0.687, p < 0.01$). Specifically, 68.8% of respondents demonstrated moderate taxation awareness, while 73.1% reported moderate financial performance levels. The study concluded that enhanced taxation awareness significantly improved compliance rates, record-keeping practices, and ultimately financial sustainability among SSEs. Recommendations included implementing targeted tax education programs, simplifying tax regulations, and establishing support mechanisms for SSEs to enhance their understanding of tax obligations and benefits.

Keywords: Taxation awareness, financial performance, small-scale enterprises, tax compliance, Kanungu District

Background of the Study

Small-scale enterprises (SSEs) constitute a vital component of Uganda's economic framework, contributing approximately 75% of the country's GDP and employing over 2.5 million people (Uganda Bureau of Statistics, 2020). In Kanungu District, SSEs represented the primary source of livelihood for rural and peri-urban communities, engaging in activities ranging from retail trading to agricultural processing (Tumwine & Mbabazize, 2013). Despite their economic significance, SSEs in the district faced persistent challenges related to financial sustainability, with studies indicating that nearly 60% failed within their first three years of operation (Kasekende & Opondo, 2003).

Taxation awareness emerged as a critical factor influencing the financial performance of these enterprises. According to Kirchler (2007), taxation awareness encompassed the knowledge, understanding, and consciousness that taxpayers possessed regarding their tax obligations, rights, and the broader tax system. In developing economies like Uganda, limited taxation awareness among SSE operators often resulted in poor tax compliance, inadequate financial planning, and strained relationships with revenue authorities (Fjeldstad & Semboja, 2001). The Uganda Revenue Authority (URA) reported that the informal sector, predominantly composed of SSEs, contributed less than 30% of potential tax revenues, partly due to low awareness levels (URA, 2019).

Financial performance, measured through indicators such as profitability, revenue growth, and asset accumulation, served as a barometer for enterprise sustainability (Dess & Robinson, 1984). Previous research suggested that taxation awareness positively influenced financial performance by promoting better record-keeping, facilitating access to

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formal credit, and enabling strategic tax planning (Coolidge, 2012). However, empirical evidence specific to Kanungu District remained limited, creating a knowledge gap that this study sought to address. Understanding the relationship between taxation awareness and financial performance was essential for policymakers, tax administrators, and enterprise development practitioners seeking to enhance the viability of SSEs in rural districts like Kanungu.

Problem Statement

Small-scale enterprises in Kanungu District experienced persistently low financial performance characterized by declining profitability, limited growth, and high failure rates (Muhwezi, 2010). Despite government efforts to promote tax compliance and enterprise formalization, many SSE operators demonstrated limited understanding of their tax obligations and the potential benefits of taxation awareness (Waiswa et al., 2014). This knowledge deficit manifested in poor financial record-keeping, low tax compliance rates estimated at 35%, and missed opportunities for tax-related incentives and business support programs (Kanungu District Local Government, 2018). Consequently, SSEs remained trapped in informality, unable to access formal financing or government procurement opportunities that required tax compliance certificates. While previous studies examined taxation awareness in urban contexts (Kakungulu-Mayambala, 2009; Nyende, 2019), limited research focused on rural districts like Kanungu, where infrastructure challenges, low literacy levels, and limited access to tax education compounded the problem. This study therefore investigated the effect of taxation awareness on financial performance of SSEs in Kanungu District to inform evidence-based interventions.

Objective of the Study

To examine the relationship between taxation awareness and financial performance of SSEs in Kanungu District.

Methodology

This study adopted a cross-sectional survey research design, which enabled the researcher to collect data from a representative sample at a single point in time (Creswell, 2014). The design was appropriate for examining the relationship between taxation awareness and financial performance without manipulating variables. The study population comprised 450 registered small-scale enterprises in Kanungu District, as documented by the district commercial office records for the fiscal year 2022/2023.

A sample size of 160 SSEs was determined using Krejcie and Morgan's (1970) sample size determination table, ensuring adequate representation with a 95% confidence level. Stratified random sampling was employed to categorize enterprises into retail, service, and manufacturing sectors, followed by simple random sampling within each stratum to ensure proportional representation. This approach enhanced the generalizability of findings across different enterprise types.

Data were collected using self-administered structured questionnaires comprising both closed and open-ended questions. The questionnaire consisted of three sections: demographic information, taxation awareness measures (15 items), and financial performance indicators (12 items). Taxation awareness was operationalized through knowledge

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of tax types, filing procedures, deadlines, and penalties, measured on a five-point Likert scale. Financial performance was assessed using self-reported measures including revenue growth, profit margins, asset acquisition, and business expansion over the previous two years.

The instrument's validity was established through expert review by two taxation specialists and three academic researchers, who confirmed content validity with a Content Validity Index of 0.82. Reliability was tested through a pilot study with 20 SSEs outside the sample frame, yielding Cronbach's alpha coefficients of 0.876 for taxation awareness and 0.841 for financial performance, both exceeding the acceptable threshold of 0.70 (Nunnally, 1978).

Data analysis was conducted using SPSS version 25.0. Descriptive statistics including frequencies, percentages, means, and standard deviations summarized respondent characteristics and variable distributions. Pearson correlation analysis tested the relationship between taxation awareness and financial performance, while regression analysis determined the predictive strength of taxation awareness on financial performance. Ethical considerations included obtaining informed consent, ensuring confidentiality, and securing approval from relevant authorities.

Results

Demographic Characteristics of Respondents

The demographic analysis revealed that 160 SSE operators participated in the study. Regarding gender distribution, 58.1% (n=93) were male while 41.9% (n=67) were female, indicating moderate gender representation. Age distribution showed that 31.9% (n=51) were aged 26-35 years, 28.1% (n=45) were 36-45 years, 23.8% (n=38) were 18-25 years, and 16.3% (n=26) were above 45 years. Educational levels indicated that 43.1% (n=69) had completed secondary education, 31.3% (n=50) had primary education, 18.8% (n=30) possessed tertiary qualifications, and 6.9% (n=11) had no formal education. Business sectors comprised retail trade (45.6%, n=73), services (32.5%, n=52), and manufacturing (21.9%, n=35).

Taxation Awareness Levels

Table 1: Taxation Awareness Among SSE Operators (N=160)

Taxation Awareness Indicator	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	SD
I know the types of taxes applicable to my business	18.8	45.6	12.5	15.6	7.5	3.52	1.18
I understand tax filing procedures	12.5	38.1	21.9	18.8	8.8	3.27	1.22
I am aware of tax payment deadlines	21.3	42.5	15.0	13.8	7.5	3.56	1.21
I know the penalties for non-compliance	15.0	36.3	20.6	18.8	9.4	3.29	1.24
I understand tax incentives available	8.8	28.1	23.8	26.3	13.1	2.93	1.22
I have received tax education/training	10.6	23.8	18.1	31.3	16.3	2.81	1.29
Overall Taxation Awareness	-	-	-	-	-	3.23	0.98

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SA=Strongly Agree, A=Agree, N=Neutral, D=Disagree, SD=Strongly Disagree

Source: Primary Data, 2025

The findings in Table 1 demonstrated that taxation awareness among SSE operators in Kanungu District was moderate, with an overall mean score of 3.23 (SD=0.98). The highest awareness level was observed regarding tax payment deadlines (M=3.56, SD=1.21), with 63.8% of respondents agreeing or strongly agreeing that they knew when taxes were due. This suggested that enforcement mechanisms and reminder systems had created consciousness about payment timelines. Knowledge about types of taxes applicable to businesses also scored relatively high (M=3.52, SD=1.18), with 64.4% demonstrating awareness, indicating that basic tax categorization information had reached most operators.

However, significant knowledge gaps emerged in specific areas. Understanding of tax filing procedures scored moderately (M=3.27, SD=1.22), with only 50.6% demonstrating adequate knowledge, suggesting that procedural complexity remained a barrier. Knowledge of penalties for non-compliance was similarly moderate (M=3.29, SD=1.24), with 51.3% aware of consequences, indicating that deterrence messaging had partial reach. More concerningly, awareness of tax incentives scored lowest (M=2.93, SD=1.22), with only 36.9% knowledgeable about available benefits, representing a critical information gap that prevented SSEs from accessing legitimate tax relief mechanisms. Additionally, only 34.4% had received any form of tax education or training (M=2.81, SD=1.29), highlighting inadequate capacity-building initiatives in the district.

Financial Performance of SSEs

Table 2: Financial Performance Indicators (N=160)

Financial Performance Indicator	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	SD
My business revenue has increased over the past two years	23.8	43.8	15.6	11.3	5.6	3.69	1.14
My profit margins have improved	19.4	41.3	18.8	13.8	6.9	3.53	1.18
I have acquired new business assets	17.5	38.8	21.3	15.0	7.5	3.44	1.19
My business has expanded operations	15.0	35.6	23.1	18.1	8.1	3.31	1.21
I maintain regular savings from business	21.3	39.4	16.9	14.4	8.1	3.52	1.23
I can access formal credit facilities	11.3	28.8	21.3	26.3	12.5	3.00	1.26
Overall Financial Performance	-	-	-	-	-	3.41	0.95

Source: Primary Data, 2025

The results in Table 2 indicated that SSEs in Kanungu District demonstrated moderate financial performance with an overall mean score of 3.41 (SD=0.95). Revenue growth emerged as the strongest performance indicator (M=3.69, SD=1.14), with 67.6% of respondents reporting increased revenue over the previous two years. This positive trend

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suggested that despite challenges, market opportunities existed and businesses were capturing them. Profit margin improvement also showed favorable results ($M=3.53, SD=1.18$), with 60.7% reporting better profitability, indicating operational efficiency gains or improved pricing strategies.

Business savings demonstrated moderate success ($M=3.52, SD=1.23$), with 60.7% maintaining regular savings, which was critical for financial resilience and investment capacity. Asset acquisition was reported by 56.3% of respondents ($M=3.44, SD=1.19$), suggesting capital accumulation and business growth. Operational expansion showed more modest results ($M=3.31, SD=1.21$), with 50.6% expanding their enterprises, indicating that while growth occurred, it remained gradual for many businesses.

The most challenging aspect of financial performance was access to formal credit facilities ($M=3.00, SD=1.26$), with only 40.1% successfully accessing such financing. This finding was particularly significant as it suggested that despite moderate business performance, SSEs remained largely excluded from formal financial systems, potentially due to lack of collateral, inadequate financial records, or absence of tax compliance documentation required by lending institutions. This limitation constrained growth potential and forced reliance on informal financing sources with higher costs.

Relationship Between Taxation Awareness and Financial Performance

Table 3: Correlation Analysis (N=160)

Variables	1	2
1. Taxation Awareness	1	
2. Financial Performance	0.687**	1

**p < 0.01 (2-tailed)*

Source: Primary Data, 2025

The correlation analysis in Table 3 revealed a strong positive and statistically significant relationship between taxation awareness and financial performance ($r = 0.687, p < 0.01$). This coefficient indicated that as taxation awareness increased among SSE operators, their financial performance improved substantially. The relationship was robust enough to suggest that taxation knowledge and consciousness played a meaningful role in business success within the study context.

Table 4: Regression Analysis Results

Model	R	R ²	Adjusted R ²	Std. Error	
1	0.687	0.472	0.469	0.693	
Predictor	B	Std. Error	Beta	t	Sig.
(Constant)	1.089	0.198	-	5.500	0.000
Taxation Awareness	0.719	0.059	0.687	12.186	0.000

Dependent Variable: Financial Performance

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Source: Primary Data, 2025

Regression analysis results in Table 4 demonstrated that taxation awareness significantly predicted financial performance of SSEs in Kanungu District ($F = 148.502, p < 0.001$). The model explained 47.2% of the variance in financial performance ($R^2 = 0.472$), indicating that taxation awareness accounted for nearly half of the variation in how well businesses performed financially. The adjusted R^2 of 0.469 confirmed that this explanatory power was not inflated by the model, while the standard error of 0.693 suggested reasonable prediction accuracy.

The regression coefficient ($B = 0.719, \beta = 0.687, t = 12.186, p < 0.001$) indicated that for every one-unit increase in taxation awareness, financial performance increased by 0.719 units when measured on the same scale. This substantial effect size underscored the practical significance of taxation awareness beyond statistical significance. The findings suggested that SSEs with better understanding of tax obligations, procedures, and benefits were considerably more likely to achieve superior financial outcomes. This relationship potentially operated through multiple mechanisms: improved financial record-keeping required for tax compliance enhanced management decision-making; tax compliance certificates enabled access to formal credit and government contracts; knowledge of tax incentives reduced operational costs; and better tax planning improved cash flow management. The strong predictive relationship validated the theoretical proposition that taxation awareness constituted a critical competency for SSE financial success in rural Ugandan contexts.

Conclusions

Based on the research findings, several conclusions were drawn regarding the effect of taxation awareness on financial performance of small-scale enterprises in Kanungu District. First, taxation awareness among SSE operators was generally moderate but varied considerably across different dimensions. While operators demonstrated reasonable knowledge of tax payment deadlines and types of taxes, significant gaps existed in understanding tax filing procedures, penalties, and particularly tax incentives. The limited exposure to formal tax education programs emerged as a critical constraint, with only one-third of operators having received any training, highlighting systemic deficiencies in capacity-building initiatives within the district.

Second, financial performance of SSEs in Kanungu District was moderate, characterized by positive revenue growth and improving profit margins for the majority of enterprises. However, performance remained constrained by limited access to formal credit facilities, which affected only two-fifths of businesses. This finding suggested that despite operational improvements, SSEs remained largely excluded from formal financial systems that could accelerate growth and expansion. The moderate performance levels indicated both potential for improvement and existing barriers that required policy intervention.

Third, and most significantly, taxation awareness exerted a strong positive and statistically significant effect on financial performance of SSEs. The research established that taxation awareness predicted nearly half of the variance in financial performance, demonstrating substantial practical importance beyond statistical significance. This

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relationship suggested that enhanced taxation knowledge and consciousness translated directly into improved business outcomes through better financial management, increased compliance, greater access to opportunities, and strategic tax planning. The findings validated theoretical perspectives linking taxation awareness to enterprise performance while providing empirical evidence specific to rural Ugandan contexts previously underrepresented in the literature.

Recommendations

Based on the study conclusions, several recommendations were proposed for policymakers, tax administrators, and enterprise development stakeholders. First, the Uganda Revenue Authority in collaboration with Kanungu District Local Government should implement comprehensive and continuous tax education programs specifically designed for SSE operators. These programs should utilize multiple delivery channels including mobile tax clinics, radio broadcasts in local languages, peer educator models, and integration with existing business development services. Given that only 34.4% of operators had received any tax training, systematic capacity-building was essential. The content should address identified knowledge gaps, particularly regarding tax filing procedures, available incentives, and compliance benefits, using practical examples and simplified language appropriate for operators with varying educational backgrounds (Alabede et al., 2011).

Second, tax administrators should simplify tax compliance procedures and develop SSE-friendly systems that reduced the complexity burden identified in the study. This could include establishing a simplified presumptive tax regime for small businesses, creating mobile-based filing and payment platforms accessible via basic phones, developing standardized record-keeping templates, and establishing help desks at subcounty levels. Coolidge (2012) demonstrated that simplified tax systems significantly improved compliance and performance in developing economies. Additionally, Uganda Revenue Authority should intensify awareness campaigns specifically promoting available tax incentives and benefits, addressing the critical knowledge gap where only 36.9% understood available relief mechanisms.

Third, financial institutions should recognize tax compliance as a viable alternative to traditional collateral when evaluating SSE loan applications. The study demonstrated that tax-aware enterprises exhibited stronger financial performance, suggesting lower credit risk. Banks could develop specialized products for tax-compliant SSEs, using tax compliance certificates and tax payment histories as creditworthiness indicators. This approach would address the access to formal credit constraint affecting 59.9% of respondents while simultaneously incentivizing tax compliance (Wanjohi & Mugure, 2008).

Fourth, Kanungu District Local Government should establish an integrated business support center that combined tax advisory services with general enterprise development support, recognizing that taxation awareness was interconnected with broader business management competencies. This center could provide one-stop services including business registration, tax education, record-keeping training, and linkages to financing opportunities. The center should maintain a database of SSEs to enable targeted support and monitor sector trends.

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Fifth, future research should examine the specific mechanisms through which taxation awareness influenced financial performance, exploring mediating variables such as record-keeping quality, access to credit, and business formalization. Longitudinal studies could track SSEs over time to establish causal relationships more definitively, while comparative studies across different districts could identify context-specific factors. Additionally, qualitative research could explore barriers to tax education uptake and compliance from operators' perspectives, informing more effective intervention designs (Maseko, 2014).

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