Customs Incentives Strategy and Growth of Tanneries within the Leather industry in Kenya

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Abstract: Despite introduction of customs incentives in leather industry by Kenyan Government, Tanneries still experience challenges especially fierce competition with foreign leather industries. Therefore we may need to know how these measures that have been put in place by Kenyan government impact on the growth of tanneries within leather industry in Kenya. It is for this reason that the general objective of this study aimed at establishing the effectiveness of customs incentive strategy on the growth of tanneries within leather industry in Kenya. Specific objectives of this research project were geared towards examining the effect of duty drawback, duty remission schemes, manufacturing under bond, export processing zones and special economic zones on the growth of tanneries within leather industry in Kenya. The growth of tanneries in leather industry was measured by the Return on Assets (ROA). Profit maximization and Resource - based theory supported this study. Descriptive research design was adopted in this study. Census method of sampling was used to select all tanneries within Nairobi County and its environs to represent all the tanneries within leather industry in Kenya. Annual financial statements and disclosures from the individual tanneries formed the source of secondary data. Primary data was obtained from finance and operation directors in various departments of the tanneries within leather industry in Kenya. Further information was derived from research firms like the Kenya National Bureau of Statistics (KNBS). The data collected from yearly financial and general report of individual tanneries in leather industry was then coded into Microsoft excel and analysis done through SPSS version 20. Analysis of data adopted descriptive statistical and multiple regression methods. Results were used in developing a classical regression model to ascertain a causal relationship between dependent and independent variables. Analysis of Variance (ANOVA) was used to give an F test of significance. Relevant discussions and conclusions were arrived at and necessary recommendations made based on the Statistical results. This project will benefit both government and tanneries as it will explain how the various custom tax incentives impact on the growth of tanneries within leather industry in Kenya. It will also help in decision making on which strategies to give more weight to. Those who intend to further their studies in fields related to firms in leather industry and customs incentives will also have a base to start from.

Keywords: customs incentive strategy, duty drawback, duty remission schemes, export processing zones, Return on Assets (ROA)

1. Introduction

Kenya’s leather industry has been on a steady growth trajectory in recent decades. An abundance of livestock population in Kenya has created an industry for meat export as well as export of hides and skins for decades. Hides and skins have traditionally been perceived as by-products of the meat industry. Leather export predominantly took place in the form of raw hides and skins (Tradecraft, 2010). Today, Kenya’s leather industry comprises of suppliers of raw hides and skins from the abattoirs, tanneries and producers of finished leather product. Broadly, the sector is divided into the formal and informal sector (Mwinyithija, 2014).

Thomas (2007) argues that for the case of Canada, tax incentives programs are more integrated and centralized than in the case of United States of America. For instance in USA, only federal government is actively involved in putting up the tax incentives. This is a different case for Canada as it’s not only the federal government, but also the provincial governments which are both actively involved. For Caribbean countries, Van Parys & James (2010) argued that tax incentives led to losses. Specifically, a loss of 23.5% and 53.9% was recorded in Anguilla and Grenada respectively. Moreover, similar concerns were raised by Goyal and Chai (2008) whereby they revealed that if tax incentives are not well planned it could lead to huge losses and consequently loss of government revenue. They further noted a loss of between 9% and 16%. Therefore, this clearly depicts tax incentives are a double edged sword with both merits and demerits. The Institute of Economic Affairs (2012) report expressed concern that tax incentives are always increasing and hence an inevitable situations of shifting away from normal and usual provisions of the excise legislations.

In Kenya, Tembur (2016) observed that tax holidays and incentives varied from rebates, allowances, investment deductions, subsidies, accelerated depreciation, reduced tax rates and tax exemptions. Residential companies are taxed at 30% on qualifying income as opposed to non - residential companies that suffer higher rate of 37.5%. For the case of Export processing zones, first 10 years are exempted from tax while a subsidized rate of 25% is applicable for the next 10 years. It is observed that listed private firms in Nairobi Stock Exchange should benefit from reduced tax rates. Corporations with minimum listing of 20, 30 & 40 percent of the issued share capital pay tax rate of 27% for first three years, 25% for the next five years & 20% for 5years in that order (ITA, 2010).

In a way to diversify portfolio on spurred economic growth, the Kenyan government has put more emphasis on export promotion as opposed to traditional import - substitution arrangement. Therefore, it is against this backdrop that has led to the creation of EPZs ostensibly aimed at promoting exports, opening and increasing market access (Mangieri, 2006).

Tanneries within leather industry in Kenya are among firms that presumably benefit from customs incentives strategy...
like DD, DR, MUB, EPZ and SEZ. Corporates operating under the umbrella of EPZ majorly enjoy capital allowances like Investment Deduction (ID), Wear and tear allowances, Industrial Building Deductions (IBD), and other allowable expenses from their corporate tax liability.

Companies qualifying for tax holiday usually have higher returns owing the fact of reduced operational expenses and subsequently long term profits as a result of investment attractiveness and opportunities. (Okaka & Agundu, 2012). On Macroeconomic perspective, tax incentives creates employment and encourage conversion of sole proprietorships to Incorporated Companies limited by shares, hence improved financial performance of industries since limited companies performs better due to ease access of external financing as compared to sole proprietorships (Phils, 2011).

Under the East African customs management Act of 2004, various tax incentives were proposed and adopted by EAC partner states with a sole aim of promoting exports. This literally saw growth of firms within leather industry within EAC region. EPZs, Freeport encouraged removal of supplies or surplus for domestic use hence minimizing wastages. Secondly, MUB that entailed certification of bonded workshops, custom entry of buildings as bonded factories, entry of plant & machinery etcetera for exportation and manufacturer to provide facilities (EACCMA, 2004).

Thirdly, the duty drawback provided that certain goods be allowed drawback. Others included duty remission and SEZs. The formation of SEZ’s is key to the realization of vision 2030. SEZ authority is charged with the responsibility of designing, approving, establishing, developing, operating, promoting and regulating on Special Economic Zones. It is for the above reasons that this research study got to examine effectiveness of custom incentive strategy on the growth of tanneries within leather industry in Kenya. (EACCMA, 2004)

The aim of ‘BIG FOUR’ agenda is to make Kenya realize middle - income economy. The manufacturing pillar provides a good platform for industrialization Other than Apparel and textile Industry, there is need to improve performance of leather industry which has great potential to create more job opportunities and spur economic growth in the country (BPS, 2018). Lately, Kenya is on record to have produced an average of six (6) Million skins, 20, 000 (twenty thousand) Camel hides and 2.4 million hides. (Mbogo, 2010). Leather industry mainly depend on livestock supply from Semi - Arid and Arid Lands (ASALs) more so pastoralists regions with adequate slaughter stock therefore hides and skins considered as byproducts. In Kenyan economy, it’s estimated that Leather industry contributes approximately 4% to the country’s GDP. Revenues of local market dealers and sub dealers are valued at Kshs 1.8 Billion annually. Moreover, this country’s total earnings of about Kshs 4 billion are realized from exports of semi - processed and raw leather (KNBS, 2013) report.

The growth of tanneries within the leather industry in Kenya is dependent on value addition. There is notable increase in number of tanneries from nine (9) to eleven (11), with two (2) more being rehabilitated and under renovation therefore posing a positive indicator that the industry is on upward trajectory to a tune of 10.5%. Optimal realization of an industry’s capacity in any state is determined by the value addition, which is additionally hinged on skilled expertise, Build capacity, technical knowhow and skills, adequate funding and high quality control (Economic survey, 2018)

Lack of the key interventions mentioned above give rise to low quality leather leads to low profit and low demand of leather products in local and export markets. Evidently, Value addition in livestock sector has been negligible since in most cases, Majority of Kenya’s exports are in the form of non - processed skins and hides. Kenya is well capable of producing enough footwear for its local and domestic market thereby reducing overreliance of cheap imports and second hand footwear (Curtis, 2010).

Analysis of leading leather export would form a strong base and yardstick in formulation of strategy for Kenya’s leather processed and tanned wet blue. (KNBS, 2013) showed that total leather exports was valued at ($131 Million) in the year 2012 representing 89% of the value of existing leather products and markets. Raw hides and skins posted 27%mark of leather products highlighting highest percentage total export for latter only in 2007 pending the significant sections and inclinations of domestic government duties and taxes impositions and sanctions.

Opportunities that exist in tanneries within leather industry are not fully utilized. This is because, over 90% of produced skins and hides in Kenya are exported international markets as well as external markets while still in semi processed and raw form. About 80% of the exports are normally in wet blue form (Mwinyihija, 2010). According to (Mhono, 2012). Production in Kenya alone stands at an anticipated four million gadgets of leather - based products, which is way below expected demand of about 28 million units.

According to (Mwinyihija & Onyango, 2012; Kagunyu, 2013) argued that students have shown their concerns on leather producers failing to reap maximum benefits and opportunity which leather industry offers due to loss of fee addition Other studies within leather industry have looked on other features and only one or two captures value addition concept. Therefore, there is need to bridge gap within leather industry value chain through research in order to build Kenya firms within leather industry and final leather products hence attainment of competitive edge in the international market (Kiuului, 2008).

According to Kenya’s leather industries report which was on released October 2015, despite Africa possessing 20% of global livestock population, only 4% of the international leather production can be accounted while 3.3% is attributed to value addition. Kenya’s textile and apparel sector has the ability to grow and largely contributes to overall GDP. Moreover, it offers employment for the fast growing youthful population. There is need therefore to come up with more and advanced strategies to stimulate the growth of tanneries within Kenya leather industry.
The EAC Partner states have chosen to support five major export promotion schemes, namely DR, EPZs, MUB, SEZ and DD schemes. Manufactured goods for exports fairly decreased and stagnated for the past few years (1980 - 1990) and (1992 - 2005). Therefore, this called upon six partner states to embark on measures to promote growth within the region (EAC Protocol, 2005). Promotion of exports within EAC is critical (EACCU, 1999). Although, the rationale behind the formation of the current export promotion schemes is not clear, and it would be difficult to link export performance and growth of tanneries within leather industry.

Theoretically all these customs incentives are expected to lower the cost of production for goods manufactured for export as they encompass Exemptions, Refunds on duty paid on imported primary inputs, raw materials, assists or components used in the production of exported goods. As a result of this, it is expected that the exports of the EAC partner states should significantly increase, holding other factors constant.

Benefits of these schemes are not very clear on how they impact on exports and the manufacturing sectors within the partner states as per EAC protocol. It is worth to note that statistical evidence reveals a strong positive association between export promotion especially on manufacturing and increased growth in incomes and capacity which eventually lead to expanded external market (Helleiner & Gerald, 2002). It is against this backdrop that this study intends to study the performance of exports and the manufacturing sector of the EAC countries under the different export promotion schemes which are in place, and shed light on their impacts.

Despite the efforts made by the government to rehabilitate tanneries within leather industry in Kenya, with an aim of improving exports, there is no big impact realized in the net income from exportation. Moreover, with all customs incentives in place, tanneries post low production units, net losses and others or on the verge of closing operations. Government has spent huge resources in trying to revamp and improve the production among the existing tanneries in leather industry. This project was therefore meant to close the gap between the efforts made by the government to the growth of tanneries within leather industry in Kenya ((Mwinyihija, 2010). Guiding principle behind this study sought to question an implemented strategy against expected returns.

2. Literature Review

This research project was premised on the profit - maximization and competition theory and resource base theory. These are strategic management theories applied in the study of organization’s growth and management. Profit - Maximization and Competition Theory was based on the idea that business organization main objective is to maximize profit while at it minimizing operation costs thereby giving firms a competitive advantage against their internal and external rivals. The industrial - organization (I/O) perspective forms basis of this theory as it analyses firm’s external market positioning a major factor in attainment of sustained competitive advantage (Porter, 1981).

Application of this theory in this study was relevant in the sense that, Government extends Customs incentives mainly to support local manufacturing industries. Firms realize savings emanating from subsidized taxes and hence reduced operation costs, protection from cheap imported products by way of government overtaxing them, promotion of exports encouraging more produced units, tax exempts and waivers. This ultimately actualize profit maximization goal as desired by firms.

Penrose (1959) and later Wernerfelt (1984) propagated the Resource - based View Theory (RBV). It proposes that competitiveness can only be attained by innovatively giving high value to consumers. RBV refers to the contention that all organizations are a collection of unique capabilities and resources. The exclusivity of any organization capabilities and resources is the foundation of an organization’s strategy and its capability to get above average returns. Penrose (1959), offered durable principles governing the growth of firms and the rate at which firms can grow efficiently. Specifically, Penrose (1959) provided an explanatory logic to unravel causal links among resources, capabilities, and competitive advantage, which contributes to a resource - based theory of competitive advantage. Penrose (1959) provides at least three key arguments concerning linkages among firm’s resources, productive opportunities, and profitable firm growth. She maintained that firms could create economic value not due to mere possession of resources, but due to effective and innovative management of resources. The RBV theory advances that the resources must fulfill the criteria of being: An enabler of the 9 firm to employ a value - creating strategy, by either outperforming its competitors or reduce its own weaknesses. The resource must be rare by definition and this could be measured by the price of the resource, which will be a reflection of the expected discounted future above - average returns. The advantage of the resource is only sustainable if competitors are not able to duplicate it perfectly. The resource must be non - substitutable i. e. if competitors are able to counter the firm’s value - creating strategy with a substitute, prices are driven down to the point that the price equals the discounted future earnings resulting in zero economic profits.

According to Fiol (2001) specialized skills, resources and factor endowments of a firm must constantly change to avoid temporal advantage but a sustained competitive advantage. This suggests that it is the way resources are configured and not the capabilities as such that is the basis of competitive advantage. Resource base view of the firm forecasts that resources endowed by firms guarantees competitive advantage and eventually firm’s growth (Ainuddin et al, 2007).

The theory is pertinent to the study because it identifies economic resources that are likely to be important in margin analysis in value chains. Resource - based theory predicts resources availability and employment of these resources will be more important determinants of the performance than the sector effects by comparing outcomes across multiple levels of analysis.
3. Empirical Review

This study argued that custom incentives have an impact on the growth of tanneries within leather industry Kenya and also export volumes. It’s worth to note that this study doesn’t ignore the other drivers of exports in Kenya. Therefore, this paper reviews some empirical studies carried out on EPZ, SEZs, DD, DR and other exports determinants of a country and narrows to find the linkage between their explanations on performance of exports in countries. Much of the empirical literature on customs incentives has concentrated more on developing and developed countries. According to World Bank Study, 1980on existing Economic Partnership Agreements (EPAs), (Hogan, Keessing, & Singer, 1992) argued that EPAs contributed negatively on exports among developing nations. They further argued that EPAs failed to realize their goals for instance their negative impact were was rampant with an exception of nations like Korea, Singapore and Hong Kong. Some of weaknesses these nations experienced were understaffed agencies with inadequate requisite training skills and minimal linkages with private sector.

Customs agencies didn’t have more productive and attractive incentives facilitate high - quality services to exporters. (Hogan, 1991; dew Ulf, 2001) argument was that most of customs agencies suffered inadequate budgetary funding but echoed that bad policies on environment could be solved by adequately funded EPAs, like in China, Taiwan and Korea.

Togan (1993) researched on export led incentives configurations in Turkey between 1983 and 1990and came up with positive results. Among the incentives handled were export credits, tax rebate scheme, duty free imports of inputs and raw materials, exemption of VAT, foreign exchange allocations, corporate income exemptions and assorted subsidies. Research results highlighted that in 1980s, levels of the economy - wide subsidized rates and that of inter - industry dispersion of incentives had extensively been reduced. It was further noted that Turkish exports and imports competing firms gained more from the export led incentives compared to other sectors.

Invention of Duty Drawbacks schemes advocated for reduced cost of imported inputs hence profit increase and positioning in the exporting firms’ competition (Ianchovicchina, 2005). The DD also corrected and alleviated anti - trade tariff barriers. Contrary to this scenario of DD scheme; (Mah, 2007) in his study argued DD scheme in China, posed insignificant impact in export promotion. Exports promotion competitiveness of manufacturing firms within EAC study by (Niringiye, Luvanda, & Shitundu, 2010) unearthed that capacity building and training of employees, adequate capital funding were success factors that promote exports of the manufacturing firms ‘competitiveness. For Kenyan case, it was ascertained that capital, training of employees and proportion of unskilled workers contributes to lesser competitiveness. (Janniffer, 2013) in her study conducted in Uganda focused on establishment of foreign exchange controls, monetary strategy, institution and infrastructure as the main export promotion strategies. She argued that for export volume units to increase better infrastructures are inevitable. adequate government funding must also be considered and consequently foreign exchanges should be encouraged. Therefore these are important considerations describing export volumes though different from the customs export promotion schemes scenario.

Marianna & Michele, (2011), in their study concentrated on laid measures like National Development Plan (NDP), fiscal policy, procedures, practices, production controls, price controls and investment policies as the main export promotion led strategies. These strategies are important as well on promoting exports, but have discussed nothing on the set out EPZ in the protocol and inexistence. Sharma (2017) defines DR Scheme as export replacement or reduction of duty that is exclusion of taxes levied on inputs that are used in manufacture of export product. DR schemes consist of D. F. R. C (duty - free replenishment certificate) and D. E. P. B (duty entitlement passbook scheme). D. F. R. C allows duty - free replacement of primary inputs used production of export product.

According to (Mogendi, 2017) part X, sections 138 - 140 of EAC customs Management Act (EAC, 2004), provides for duty remission for industrial inputs imported for manufacture of goods in the EAC context it is carried out through EAC Customs management (duty remission) regulations which became effective from 1st may 2008. These schemes are mostly available on those imported products and assists, which will be later on be used for manufacturing of goods only meant for export. This promotes industrial growth and development hence foreign direct investment gains in long term.

According to (EACCMA, 2004) Export processing zones are allocated boundaries in a country with distinct and special economic policies different from other regions within a country. These policies are meant to promote foreign direct investments including tax incentives and reduced tariffs. EPZs in Kenya enjoy tax exemption for first 10 years and a subsequent reduced corporate tax rate of 20% for the next 10 years (ITA, 2010).

Tax exemptions have a number of disadvantages especially if not planned executed and controlled well. Tax exemptions encourage short term development in the sense that once this short tax holiday period is over these organizations cease their operations and shift to invest elsewhere (Blackwell, 2009). Tax holiday to some extent encourages tax avoidance by allowing firms to move from high tax rate areas to low taxed regions. While tax avoidance is not illegal per se, it’s clearly unjust because administration expenses to guarantee consistency with all laws and precise reporting might be high (Irish, 1978).

Evidently, some nations have a lot of issues with EPZs establishments. EPZs within Kenya are considered to be outside custom area hence construed not to be of Kenyan origin under COMESA. It is for this case that exports from EPZs are not dutiable when traded among COMESA’s member states (Glenday and Ndii, 1999). (EACCMA, 2004) explains SEZs as reserves found in both physical and administration, outside a country customs area. These fenced
zones are in regions situated almost like a port. Organizations operating under these SEZs generally have access to duty free capital and moderate imports. Moreover, they are given access to streamlined custom freedom strategies, harmonized procedures that remove tedious, bureaucratic, and repetitive custom systems at the port.

SEZs offer firms with great physical framework and infrastructures like roads, power, and telecommunications. Few countries offer extra incentives like tax relief on income or wage charges. Good example is the Dominican Republic where zone administrations offer extra services to organizations like recruitment of laborers and bookkeepers. Only few zones are publicly owned and controlled; others are privatized and work closely with the administration (Farole, 2011). SEZs have areas of concerns and impediments despite benefit facilities and utilities that enable exporters to worry not on issues to do infrastructure, bureaucratic procedures, and imposition high levies and tariffs. These zones are however accessed by only subset of exporters hence limited. Organizations that are found near fundamental provider of raw materials neither can exploit a zone, nor desirous to keep on selling a portion of their production on domestic markets. Segmented zones for public can be excessive to the legislature to make and maintain although this has been defeated due to upsurge of private owned SEZs (Farole, 2011)

This is an incentive to manufacturers permitting them to import hardware, property, plant & equipment and raw materials tax free, on condition that these items are used in production of goods that are meant for exclusive export. This incentive is geared towards empowering manufacturers locally and internationally with ultimate aim of promoting exports and hence growth of these producing firms. US, Canada, India, Bangladesh, Nepal and Tanzania are among nations that have exceeded in this incentive (EACCMA, 2004)

Manufacturers are expected to operate within a specific bonded factory or warehouse which must be licensed by Commissioner of Customs. Financial or bond security must be placed in order to cushion the government against loss of duty or tax emanating from imported primary materials (Economic Survey 2004, 2005)

MUB program in Kenya entails exception of import duties, VAT chargeable on raw and primary materials and capital allowances specifically 100% investment deduction allowance on property, plant & equipment and hardware. Under the circumstances that produced goods using those exempted raw materials and components remains unsold, the plan's player is liable to an additional charge tax at a rate of 2.5%. (Economic Survey 2017, 2018)

Unlike duty remission that allows duty exemption upon importation, Duty Drawback offers discount on duty already paid on importation of primary inputs that are used in manufacturing goods meant for export. This incentive reduces risk of tax evasion since the government will have already recovered duty payable upon importation and it’s upon the manufacturer to prove that the produced goods were exported in order to get a discount or refund of duty paid on imported primary inputs (EACCMA, 2004).

Immediate exporters as in the ones who undertakes export themselves guarantees duty drawback in several countries. However, few countries enable duty drawback to be guaranteed by an aberrant exporter that is individuals who supplies to an exporter. Like in the case of Korea, Chile and Colombia. Classification of products that will meet all requirements for drawback among few nations is normally done solely as a method of empowering the use of similar private produced goods. A good example is India which entails only those items incorporated into a thorough rundown and grants discount only for focal government duties as opposed to the state taxes and obligations collected on inputs (World Bank, 2005)

Duty drawback rely on computation of the measure of duty accumulated on imported sources of primary inputs that have been consolidated in one unit of yield. Consequently, the measure of the discount should tally with the results of foreign input estimates that are used as a part of delivering exports and the corresponding duty rate. Customs applies two strategies to determine import obligation substance for exports that is settled rates and individual rates. For the case of settled rates, discount will be considered alongside each export great encircled information table with yield coefficients (World Bank, 2013)

Korea and Taiwan were among first countries to adopt this “settled rates” concept. They changed their duty drawback plans at regular and gradual intervals. This framework has pros and con. Its application is difficult, requires no much investigation on a specific producer’s execution, approximation may include several coefficients which of course is time consuming and complicated. Moreover, trade imbalance may occur as it might fetch too low for a few exporters and too high for others (EC Synthesis Report, 2017)

“Individual rate” framework relies on the performance of individual producer as ascertained by a customs officer. This concept has a self - assessment part with the manufacturer in charge of setting up rates in respect to guarantee drawback and afterward customs undertaking post - exchange reviews its authenticity. Perception on this concept is that it’s fair and usually applicable than the settled rate concept since it demonstrates execution of individual industrialists as opposed to a normal transverse over industry. (EU Report 2014, 2020)

4. Research Methodology

This study adopted a descriptive design aimed at ascertaining effectiveness of custom incentives strategy and the growth of tanneries within leather industry in Kenya. Since the study sought to establish the relationship between two (2) variables the research employed a descriptive research design. Mugenda & Mugenda, (2003) argued descriptive design as a method enabling a researcher to organize and summarize data in a proper and efficient way.

The target population of this study comprised of all finance managers and Operations Directors in all the 23 registered tanneries within Nairobi County, Kenya. Therefore the study population was 46individuals. The study adopted a census
survey design. Census Survey was applied because population was small. Therefore, all the 46 individuals were considered in this study. In this research study, targeted population was all registered tanneries within leather industry in Kenya specifically those within Nairobi County. All tanneries were considered to form part of the study sample. To avoid mono - method bias in this research project, primary as well as secondary data was obtained. Semi structured questionnaires collected primary data obtained through a five point likert scale.

Research questionnaires were developed based on the study objectives and whose suitability was ascertained through pre - testing prior to the actual distribution. Questionnaires were administered to 5 respondents who were selected purposively for pre - testing. Caution was exercised to ensure that the 5 pre - tested respondents are not part of the study sample size. This facilitated the possibility of fine - tuning the efficiency and the objectivity of the questionnaire. Answering the questionnaire took approximately 15 Minutes.

The administration of questionnaires was done by one research assistant, equipped and tasked with the interviewing and communication skills on respondents with the help of a questionnaire instrument, refined questionnaire was also administered by the research assistant so as to aid the data entry. The financial managers of tanneries were taken through demonstrated answers to make sure that they had a solid and thoughtful insight of the questions for their timely and accurate responses. To enhance the response rate, questionnaires were dropped and picked later method of collection.

This study adopted descriptive statistical measures. Inferential statistics measures were also employed in hypothesis testing for this case; specific objectives. SPSS software was employed to analyze quantitative data. Multiple regression models were adopted expounding on correlation between dependent variables and the independent variables. Confidence level considered in this study was 95% meaning a significance level (p - value) of 5%. In other words, statistically significant correlations between variables were only those with p - value below 5%. Pearson’s correlation coefficient was measured the strength of associations between independent and dependent variables while F - test was employed to verify significance of this correlation coefficient. Research problem was conceptualized on direct dependent and independent variable associations. Model specification therefore assessed effectiveness of custom incentives strategy on the growth of tanneries within leather industry in Kenya.

From onset, test on effectiveness of predictor variables on the outcome.

\[ Y_{it}^t = \beta_0 + \beta_1 X_{it1} t_1 + \beta_2 X_{it2} t_2 + \beta_3 X_{it3} t_3 + \beta_4 X_{it4} t_4 + \beta_5 X_{it5} t_5 + \epsilon \]

\[ i \text{ is a firm } i = 1, \ldots 23 \]
\[ t \text{ is the time period } t = 2010, \ldots 2014 \]
\[ b \text{ are beta coefficients} \]
\[ x \text{ is predictor variable vector} \]

\[ Y_{it}^t = \text{Growth of tanneries within leather industry in Kenya that will be measured by the Net Income} \]
\[ X_{it1} = \text{DD} \]
\[ X_{it2} = \text{DR} \]
\[ X_{it3} = \text{MUB} \]
\[ X_{it4} = \text{EPZ} \]
\[ X_{it5} = \text{SEZs} \]
\[ \epsilon = \text{error term} \]

5. Results and Discussion

Response Rate

Target population involved all the 23 registered tanneries within leather industry, operational since 31st December, 2011 and licensed to carry out tanning activities in Kenya under the leather Act. A population census was applied in this study. However, firms in leather industry which were not in operation for the entire 5 - year period or under receivership were dropped due to incompleteness of the records or missing data.

Annual time series data from 2010 to 2014 has been used for the analysis. The data on all the variables was collected from secondary sources. Data an EPZ output and investment was sourced from EPZ authority database. Data on manufactured exports & domestic GDP was sourced from KNBS statistical abstracts & surveys. Data analysis method used was based on Pearson correlation analysis and a multiple regression model which took the form of:

<table>
<thead>
<tr>
<th>Table 4.1: Response rate</th>
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<tr>
<td>Respondent Category</td>
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<tr>
<td>Finance Directors</td>
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<tr>
<td>Operation Directors</td>
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<tr>
<td>Total</td>
</tr>
</tbody>
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Source: Field Data (2021)

Descriptive data analysis

Table 4.2 below summarized the descriptive statistics of the variables included in the regression models as presented. It represents the variables of 23 tanneries within leather industry operating in the Kenya whose financial results were available for the years 2010 - 2014.

<table>
<thead>
<tr>
<th>Table 4.2: Descriptive Statistics</th>
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<tbody>
<tr>
<td>Descriptive Statistics</td>
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<tr>
<td>Mean</td>
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<td>------</td>
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<tr>
<td>ROA</td>
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<td>MUB</td>
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<td>EPZ</td>
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<td>SEZ</td>
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This table summarized the descriptive statistics of custom incentives. The total number of observation N was 115.

The means of customs incentives are as shown in the table 4.3 below
Correlation analysis

Table above showed a positive correlation between Custom incentives and the growth of tanneries within leather industry in Kenya. Basing on the Pearson’s correlation coefficient, improving on customs incentives leads to an increase growth of Kenyan leather industries.

From the table duty drawback had the highest correlation followed by duty remission, EPZ, Manufacturing under bond then special economic zones respectively. The therefore means that duty remission affects the ROA the most while special economic zone the least.

Coefficient of Determination

Table above represents coefficient of determination (R Square) at 0.709 this means that 70.9% of the increase in growth of tanneries within leather industry for the period of this study was attributed to the custom incentives. The R value represents the simple correlation and is 0.529 it usually indicates positive degree of correlation among custom incentives and the growth of tanneries within leather industry in Kenya.

Analysis of Variance

Table above indicates significance of the correlation between Custom incentives strategy and the growth of tanneries within leather industry in Kenya at 0.000%, which is a value below the 5% level of significance. Therefore, their relationship among the five customs incentives strategy are statistically significant - statistic value is 8.452 greater than F - tabulated which is 4.32 at 40 degrees of freedom. Hence, we reject null hypothesis and accept the alternative hypothesis that custom incentives strategy has an impact on the growth of tanneries within leather industry in Kenya.

Significance and Regression Model

Table above is used to derive the Regression Equation below:

\[ Y = 0.333 + 0.743 X_1 + 0.547 X_2 + 0.366 X_3 + 0.237 X_4 + 0.004 X_5 \]

Where:

- \( Y \) = Growth of leather industries
- \( X_1 \) = Duty remission
- \( X_2 \) = Duty drawback
- \( X_3 \) = Export processing zones
- \( X_4 \) = Manufacturing under bond
- \( X_5 \) = Special economic zones

The regression equation above shows that with increase in Customs incentives strategies there is increase in the growth of tanneries within Leather industry in Kenya. Duty remission giving the highest contribution followed by duty drawback. Special economic zones being the least contributor.

Therefore, the government should work to increase more incentives.

Hypothesis

Duty remission has no effect on the growth of tanneries within leather industry in Kenya. From the study, it’s now evident that duty remission has a significant effect on the growth of tanneries within leather industry in Kenya. Therefore, we reject the null hypothesis and accept the alternative hypothesis which states that duty remission has an effect on the growth of tanneries within leather industry in Kenya. Duty drawback has no effect on the growth of tanneries within leather industry in Kenya. The study revealed that duty drawback is the second contributor in performance comparing the custom incentives strategies. Therefore, we reject the null hypothesis and accept the alternative hypothesis which states that duty drawback has an effect on the growth of tanneries within leather industry in Kenya. Export processing zones has no effect on the growth of tanneries within leather industry in Kenya. The analysis revealed that export processing zones and performance have a correlation. EPZ has a significant effect on the growth of Kenyan leather industries. We therefore reject the null hypothesis and accept the alternative hypothesis which states that EPZ has an impact on the growth of tanneries within leather industry in Kenya.
Manufacturing under bond has no impact on the growth of Kenyan leather industries. From the study, manufacturing under bond has a significant impact on the growth of tanneries within leather industry in Kenya. We therefore reject the null hypothesis and accept the alternative hypothesis that states that manufacturing under bond has an impact on the growth of tanneries within leather industry in Kenya. Special economic zones have no impact on the growth of Kenyan leather industries. Although the impact was as low as from the correlation analysis but it was positive. Special economic zones have a low impact on the growth of tanneries within leather industry in Kenya.

6. Discussion of Research Findings

From the study, it’s now evident that duty remission has a significant effect on the growth of tanneries within leather industry in Kenya. Duty remission had the highest contributing factor among the custom incentive strategies with a correlation coefficient of 0.737. A unit increase in duty remission impact to a 0.737 increase in the growth of tanneries within leather industry in Kenya. The study revealed that duty drawback is the second contributor in performance comparing the custom incentives strategies. Therefore, we reject the null hypothesis and accept the alternative hypothesis which states that duty drawback has an effect on the growth of tanneries within leather industry in Kenya. Duty drawback has a significant correlation coefficient of 0.547.

The analysis revealed that export processing zones and performance have a correlation. EPZ has a significant effect on the growth of Kenyan leather industries. We therefore reject the null hypothesis and accept the alternative hypothesis which states that EPZ has an impact on the Kenyan leather industries. EPZ has a significant correlation coefficient of 0.366. From the study, manufacturing under bond has a significant impact on the growth of tanneries within leather industry in Kenya. We therefore reject the null hypothesis and accept the alternative hypothesis that states that manufacturing under bond has an impact on the growth of Kenyan leather industries. Manufacturing under bond had a weak positive correlation of 0.237.

Although the impact was as low as from the correlation analysis but it was positive. Special economic zones have a low impact on the growth of tanneries within leather industry in Kenya. Special economic zones have a very weak impact on the growth of Kenyan leather firms. Giving a significant contribution of 0.004. Which is 0.4%

7. Conclusions and Recommendations

7.1 Conclusions

The study unearthed that customs incentive strategy had a strong impact on growth of tanneries within leather industry in Kenya. From the findings and conclusions, it was clear that adoption of custom incentives affect their performance. This study recommends that for tanneries to gain competitive advantage, modern technology needs to be employed for example working under specialised production areas such as EPZ. Technological innovations are key ingredients defining a society and civilization. Key role of custom incentives in the general expansion of companies and its impact to the economic growth of corporations has been widely been documented. The study concludes that Duty drawback, Duty remission, Manufacturing under bond, EPZ have a strong relationship with the growth of leather firms while Special economic zones have weak relationship with growth of leather firms in Kenya.

7.2 Recommendations

For Kenya as a nation to realize its economic targets envisaged under Vision 2030 it is expected of the government and firms to embrace custom incentive strategies in their commercial practices. The eventuality is that as unit costs for firms under EPZ decrease with enhanced output, nations ought to obtain comparative advantage in enlarging industry and export more, this is so because commodities requiring for their production abundant incentives and minimal factors are exported in exchange for goods and services hence calling for factors in the opposite amounts.

There is need to continuously benchmark exports & industrial zones models abroad with an aim of keeping Kenyan EPZs at par with international standards and emerging business trends, integrating industrial areas with commercial areas, service areas, residential areas and social amenity areas is proving to be the modern fashion for many export oriented economics. There is need to provide one - stop shop and comfortable living environment of the EPZ investors. Towards this end, fastening operationalization of Special Economic Zones (SEZ) may help address the above key issues, Kenyan external sector reforms need to be credible and sustained over time in order for the exporting leather firms to respond by increasing investment, production and exports.

8. Suggestions for Further study

Further research studies is such important mainly to emphasize on the determinants of financial performance of firms within leather industry in Kenya. There is need to address the contribution of EPZ and special economic zones on the country’s industrial growth.

References


