Impact of Foreign Direct Investment on Business Growth in Nigeria

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Abstract

The Study sought to determine the relationship between foreign direct investment and business growth, as well as the limiting factors that affect foreign direct investment in Nigeria. It focused on the impact of Foreign Direct Investment on business growth in Nigeria. The study used primary and secondary data. It adopted a descriptive research design, mostly quantitative data. Regression model and Pearson correlation coefficient were used to test the hypotheses of the study. It was found out that there is a positive relationship between foreign direct investment and business growth in Nigeria. The study concluded that the government and the monetary authorities should design policies and programmes that will encourage investors to invest in Nigeria. Therefore, there is need to have a stable political and economic environment and improve the level of security at all levels in the country.

Key words: Foreign Direct Investment, Development, Business Growth, Investors, Trade

Introduction

Foreign Direct Investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Onu (2012) asserts that Foreign Direct Investment (FDI) has emerged as the most important source of external resource flows to developing countries over the years and has become a significant part of capital formation in these countries. He maintains that though the share of developing countries in the global distribution of FDI continue to remain small or is even declining, the role of FDI has been widely recognized as a growth-enhancing factor in the developing countries.

Falki (2009), writing on the effects and advantages of FDI to the host economy, notes that the effects of FDI on the host economy are normally believed to be increase in employment, augmenting the productivity, boost in exports and amplified pace of transfer of technology. Also, the potential advantages of the FDI to the host economy include the fact that - it facilitates the utilization and exploitation of local raw materials, introduces modern techniques of management and marketing and eases access to new technologies. Foreign inflows can be used for financing current account deficits, finance inflows from FDI do not generate repayment of principal or interests (as opposed to external debt) and increase the stock of human capital via on-the-job training. The realization of the importance of FDI had informed the radical and pragmatic economic reforms introduced since the mid-1980s by the Nigerian government. The reforms were designed to increase the attractiveness of Nigeria's investment opportunities and foster the growing confidence in the economy so as to encourage foreign investors to invest in the economy (Oyinlola, 1995).

Macaulay (2012) asserts that Nigeria's foreign investment can be traced back to the colonial era, when the colonial masters had the intention of exploiting our resources for the development of their economy. However, there was little investment by these colonial masters but successive administrations in Nigerian governments have recognized the importance of FDI in enhancing economic growth and development and have devised various strategies involving incentives, policies and regulatory measures to promote the inflow of FDI to the country. According to Lall, (2002), privatization was also adopted, among other measures, to encourage foreign investments in Nigeria. This involved transfer of state-owned enterprises (manufacturing, agricultural production, public utility services such as telecommunication, transportation, electricity and water supply), companies that are completely or partly owned by or managed by private individuals or companies. Therefore, this paper studies the Impact of Foreign Direct Investment on Business Growth in Nigeria

Statement of the Problem

In spite of the perceived and obvious need for foreign direct investment in the continent, efforts of most countries in Africa to attract foreign direct investment have been futile. The development is disturbing, indicating very little hope of economic development and growth for these countries. Further, the pattern of the foreign direct investment that exist is skewed towards the extractive industry, meaning that the differential rate of foreign direct investment inflow into sub-Saharan African countries have been adduced to natural resources although the size of the local market may also be a consideration. However, Nigeria as a country, given her natural resource base and large market size, qualifies to be a major recipient of foreign direct investment in Africa and indeed is one of the top leading African countries that has consistently attracted foreign direct investment in the last decade. However, the level of foreign direct investment attracted by Nigeria is minimal compared with the resource base and potential need. In spite of all the programmes and policies introduced in the country to promote foreign direct investment, the economy still faces macro-economic conditions that has led the country to recession. This has constituted serious problems to the nation and this study is aimed at unravelling some of the challenges that have bedeviled business growth in Nigeria. It is against this backdrop that this paper examines the impact of Foreign Direct Investment on business growth in Nigeria.

Objectives of the Study

The broad objective of this study is to examine the Impact of Foreign Direct Investment on Business Growth in Nigeria, while the specific objectives are to:

i. Determine the relationship between foreign direct investment and business growth in Nigeria.
ii. Determine the limiting factors that affect foreign direct investment in Nigeria.

Research Hypotheses

Ho_1: There is a significant relationship between foreign direct investment and business growth in Nigeria

Ho_2: Exchange rate, inflation and political instability are not the limiting factors that affect foreign direct investment in Nigeria.

Conceptual Review

Foreign Direct Investment

Renewed research interest in foreign direct investment stems from the change of perspective among policy makers from "hostility" to "conscious encouragement", especially among developing countries. Foreign direct investment had been seen as "parasitic" and as retarding the development of domestic industries for export promotion until recently. However, Bende-Nabende and Ford (1998) submit that the wide externalities in respect of technology transfer, the development of human capital and the opening up of the economy to international forces, among other factors, have served to change the former image. The rationale for increased efforts to attract more foreign direct investment stems from the belief that foreign direct investment has several positive effects. Among these are productivity gains, technology transfers, the introduction of new processes, managerial skills and know how in the domestic market, employee training, international production networks, and access to markets.

Foreign direct investment is an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment. Foreign direct investment increases the rate of technical progress in the host country through a "contagion" effect from the more advanced technology, management practices and so on, used by foreign firms. On the basis of these assertions, governments have often provided special incentives to foreign firms to set up companies in their countries. Nwankwo, and Ademola (2002) note that the economic rationale for offering special incentives to attract foreign direct investment frequently derives from the belief that foreign investments produce externalities in the form of technology transfers and spillover.

Curiously, the empirical evidence of these benefits both at the firm level and at the national level remains ambiguous. The debate on the importance of foreign direct investment, notes that foreign direct investment may allow a country to bring technologies and knowledge that are not readily available to domestic investors, and in this way increases productivity growth throughout the economy. A lot of research interests have been shown on the relationship between foreign direct investment and economic growth, although most of such work are not situated in Africa. The focus of the research work on foreign direct investment and economic growth can be broadly classified into two. First, foreign direct investment is considered to have direct impact on trade through which the growth process is assured. Second, foreign direct investment is assumed to augment domestic capital thereby stimulating the productivity of domestic investments (Obwana & Morios, 2001). These two arguments are in conformity with endogenous growth theories and cross country models on industrialization in which both the quantity and quality of factors of production as well as the transformation of the production processes are ingredients in developing a competitive advantage. Foreign direct investment has empirically been found to stimulate economic growth by a number of researchers, for example, foreign direct investment has been important in explaining China's economic growth, while Solomon and Eka (2013) present a positive correlation for selected Latin American countries. Inflows of foreign capital are assumed to boost investment levels.

Zhang (2001) reports that foreign direct investment exerts a positive effect on economic growth, but that there seems to be a threshold level of income above which foreign direct investment has positive effect on economic growth and below which it does not. The explanation was that only those countries that have reached a certain income level can absorb new technologies and benefit from technology diffusion, and thus reap the extra advantages that foreign direct investment can offer. Previous works suggest human capital as one of the reasons for the differential response to foreign direct investment at different levels of income. This is because it takes a well-educated population to understand and spread the benefits of new innovations to the whole economy. UNCTAD (1999) also found that the interaction of foreign direct investment and human capital had important effect on economic growth, and suggests that the differences in the technological absorptive ability may explain the variation in growth effects of foreign direct investment across countries. They suggest further that countries may need a minimum threshold stock of human capital in order to experience positive effects of foreign direct investments.

Foreign Direct Investment and Business Growth in Nigeria

The nexus between FDI and business growth has been widely debated in recent years. A fundamental challenge to the economy of Nigeria is how to achieve a sustainable increase in output overtime. Nigeria have been attracting FDI to bridge the gaps between the domestically available supplies of savings and investment demands, generating foreign exchange, transferring technology and enhancing job creation and human capital skills to achieve a sustainable FDI and business growth in the country. The consensus in the literature seems to be that foreign direct investment increases growth through productivity and efficiency gains. The empirical evidence is not unanimous, however, available evidence for developed countries seems to support the idea that the productivity of domestic firms is positively related to the presence of foreign firms. Still others find no evidence of positive short run spillover from foreign firms. Some of the reasons adduced for these mixed results are that the envisaged forward and backward linkages may not necessarily be there and that arguments of transnational companies encouraging increased productivity due to competition may not be true in practice. Other reasons include the fact that transnational companies tend to locate in high productivity industries and, therefore, could force less productive firms to exit (Olopoenia, 2002); the crowding out of domestic firms and possible contraction in the total industry and or employment. However, crowding out is a rarer event and the benefit of foreign direct investment in export promotion remains controversial and depends crucially on the motive for such investment (World Bank, 1998). The consensus in the literature appears to be that foreign direct investment spillovers depend on the host country's capacity to absorb the foreign technology and the type of investment climate.

The review shows that the debate on the impact of foreign direct investment on economic growth is far from being conclusive. The role of foreign direct investment seems to be country specific, and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the recipient countries.

Most studies on foreign direct investment and growth are cross country evidences, while the role of foreign direct investment in economic growth can be country specific. Further, only a few of the country specific studies actually took conscious note of the endogenous nature of the relationship between foreign direct investment and growth in their analysis, thereby raising some questions on the robustness of their findings. However, Adams (2009), enumerated the impact of FDI on business growth in Nigeria as follows:

1) creation of competitive market;

2) Improved capital flow;

3) Improved technology;

4) Increase in exports;
5) It boosts and stimulates economic growth and development.

Finally, the relationship between foreign direct investment and growth is conditional on the macro-economic dispensation the country in question is passing through. In fact, Zhang (2001) asserts that "the extent to which foreign direct investment contributes to growth depends on the economic and social condition or in short, the quality of the new environment of the recipient country". In essence, the impact foreign direct investment has on the growth of any economy may be country and period specific. And as such there is the need for country specific studies.

Empirical Literature
Otepola (2002) conducted a study on the importance of direct foreign investment in Nigeria. The study empirically examined the impact of FDI on growth. He concluded that FDI contributes significantly to growth especially through exports. Ricardo, Hwang and Rod rick (2005) argued that Foreign Direct Investment (FDI) provide a path for emerging nations to export the products developed economies usually sell, in effect increasing their export sophistication. Many developing countries pursue FDI as a tool for export promotion, rather than production for the domestic economy. Typically, foreign investors build plants in nations where they can produce goods for export at lower costs. Bende-Nabende (2002) also found that direct long term impact of Foreign Direct Investment (FDI) on output is significant and positive for comparatively economically less advanced Philippines and Thailand, but negative in the more economically advanced Japan and Taiwan. In the same line, Ariyo (1998) studied the investment trend and its impact on Nigeria's economic growth over the years. He found that only private domestic investment consistently contributed to raising GDP growth rates during the period considered (1970–1995).

Theoretical Review
Keynesian Theory of Investment

In Keynesian terminology, investment refers to real investment which adds to capital equipment. It leads to increase in level of income and production by increasing the production and purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like roads, dams, buildings, etc. By investment, is meant an addition to capital, such as occurs when a new house is being built or a new factory is built. Investment means making an addition to the stock of goods in existence (Keynes,1936). According to Blaug (1997), investment decisions are taken by comparing the management efficiency of capital (MEC) or the yield with the real rate of interest (r). So long as the MEC is greater than r, new investment in plant, equipment and machinery will take place.

Gould (1968), posits that investments are made until the present value of expected future revenue at the margin is equal to the opportunity cost of capital. This means that investments are made until the net present value is equal to zero. An investment is expected to generate a stream of future cash flows. Keynes (1936), observed that a lower level of inflation would induce employers to make capital investments and employ more people stimulating employment and restoring growth. He believed that the depth and persistence of the Great Depression however, severely tested this hypothesis.

According to Jorgenson (2010), the basic ideology of Keynesian theory of investment is that active fiscal and monetary policies are the primary tools recommended by the Keynesian Economists to manage the economy and fight unemployment. It focuses on using active government policies to manage aggregate demand in order to address or prevent economic recessions.

The adoption of this approach for this study is based on two (2) reasons:

1) It enhances optimal economic performance;
2) It prevents economic slumps by influencing aggregate demand through active stabilization and economic intervention policies by the government.

Evidence from many other studies give support to the application of this theory to the investment need of developing economy such as Nigeria. Although the Keynesian theory of investment has been criticized by some theorists, (Baddeley 2003, Lo 2004, Chiang 2000, Farmer and Geanakoplos 2008), the theory remains a model through which other theorists will evolve, develop and expand since it focuses on changes in the economy. It is also important because the theory advocated for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression.

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Methodology

The study used primary and secondary data from official Nigeria Statistical Bulletin and journals. The data was analyzed quantitatively using regression model and Pearson correlation coefficient to test the impact of FDI on Business Growth in Nigeria. The results were on tables.

Model Specifications

Regression Model, thus

FDI = (BG)……………………………………………………………(1)

FDI F (ER, IN, PS)……………………………………………(2)

Where: FDI = FOREIGN DIRECT INVESTMENT

ER= Exchange Rate

IN = Inflation

PS= Political Stability

Mathematically:

$FDI= a_0+a_1, ER+a_2IN+a_3PS+ a_4BG + e_t$

Where: $a_{0\,=}$ Constant

$a_{1\,=}$ Constant

$a_{1\text{-------}}\ a_{4\,=}$ Coefficient

$e_{t=}$error term

Ho_1: There is a significant relationship between foreign direct investment and business growth in Nigeria

Correlation coefficient model on foreign direct investment on business growth

Correlations

		FDI	**BG**
FDI	Pearson Correlation	1	.809**
	Sig. (2-tailed)		.004
BG	Pearson Correlation	.809**	1
	Sig. (2-tailed)	.004	

Source; Field Data, 2021

The table shows the relationship between foreign direct investment on business growth in Nigeria. The result rho showed that 80.9% significantly affects business growth in Nigeria with the p-value = .00 < 0.05% significance level, which therefore states that there is a positive relationship between foreign direct investment on business growth in Nigeria. This implies that a unit increase in foreign direct investment leads to a unit increase in business growth.

Ho_2: Exchange rate, inflation and political instability are not the limiting factors that affect foreign direct investment in Nigeria.

Regression, on Exchange rate, inflation and political instability on business growth

Variable	Parameters	Coefficient	Std error	t – value	Sig
Constant	β_0	0.017	0.028	0.607***	.002
ER (X_1)	β_1	0.042	0.068	0.618***	.000
IN (X_2)	β_2	0.035	0.012	2.917***	.012
PI (X_3)	β_3	0.010	0.011	0.909**	.004
R-Square		0.801			
Adjusted R – Square		0.711			
F – statistics		10.680***			

Source: Field Data, 2021

The table above showed the factors affecting exchange rate, inflation and political instability on business growth**.** The result of coefficient of multiple determination (R^2) was 0.801 which implies that 80.1% of the variations in dependents were explained by changes in the independent variables while 19.9% were unexplained by the stochastic variable indicating a goodness of fit of the regression model adopted in this study which is statistically significant at 1% probability level.

The coefficient of Exchange rate was statistically significant and positively related to affecting on business growth at 5 percent level (0.618***). With p-value= .000<.05% significance level. The coefficient of inflation was statistically significant and positively related to affecting business growth at 5 percent level (2.917***) with p-value=.012<.05% significance level. The coefficient of political instability was statistically significant and positively related to affecting business growth at 5 percent level (0.909***) with p-value=.004<.05% significance level.

The implication is that exchange rate, inflation and political instability are the limiting factors that affect foreign direct investment in Nigeria. This result agrees with Oyatoye *et al* (2011); Alejandro (2010); Lall (2002); Otepola, (2002) and Ariyo, (1998) that Direct Foreign Investment is inevitable in business growth of a nation.

Conclusion

The study analyzed the impact of foreign direct investment on business growth in Nigeria. The findings revealed that business growth is directly related to foreign direct investment and statistically significant at 5% level. This implies that a good performance of the economy is a positive increase on foreign direct investment. It can be concluded that foreign direct investment is an engine of business growth of a nation. The empirical results show that there is a positive relationship between foreign direct investment and business growth in Nigeria. The study concluded that exchange rate, inflation and political instability are the limiting factors that affect foreign direct investment in Nigeria and that it has a significant impact on business growth, which shows that a unit increase on these factors lead definitely to an increase on business growth of the nation.

Recommendations

i. It is important that the government concentrate on providing the basic infrastructures to support the locally organized private sector that are ready to invest domestic funds into the economy.

ii. The government and the monetary authorities should design policies and programmes that will encourage investors to invest in Nigeria. Therefore, there is need to have a stable political and economic environment and improve the level of security at all levels in the country.

iii. Furthermore, government needs to liberalize the foreign sector in Nigeria so that all barriers to trade such as arbitrary tariffs; import and export duties and other levies should be reduced so as to encourage investors.

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