

EFFECT OF FOREIGN DIRECT INVESTMENTS ON THE PERFORMANCE OF THE RENEWABLE ENERGY SECTOR IN RWANDA: A CASE OF MOBISOL

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Abstract: Over the past two decades after the Genocide Rwandan economy has enjoyed several developments in terms of infrastructure and policies as well as experts relocating in Rwanda and corporations interested in expanding operations in Rwanda. Foreign Direct Investment has become an area of concern to many developing nations due to the economic benefits it presents to the host nation. The role played by real estate sector in the economy has become critical especially in emerging economies. As the property market around the world is experiencing a bubble, developments in FDI has ensured the real estate market has remained strong with the demand for middle to high income housing remaining steady. This study sought to establish the effect of FDI on the performance of the energy sector in Rwanda. A case of MOBISOL Rwanda Ltd. The specific objectives of the study were; to examine the extent to which corporate governance elements, political governance, trade openness, market size, exchange rate, and inflation determine performance in the energy sector in Rwanda. The study adopted a descriptive research design. The target population were 112 employees of MOBISOL which has with significant foreign ownership in Rwanda. A sample size of 88 respondents were obtained for study using stratified random sampling. The statistical tools of analysis that were used for descriptive data were the arithmetic mean and the standard deviation while the statistical tools of analysis used for inferential statistics were Pearson's product moment correlation and stepwise regression to find correlations among the explanatory variables. F-tests were used to test the hypotheses in the study. Tests of statistical assumptions was carried out before data analysis to avoid invalidation of statistical analysis. The Statistical Package for Social Sciences Version 21 software was used to facilitate data analysis. Descriptive statistics and inferential statistics were used in the analysis. Descriptive statistics was encompassing frequencies, percentages, means and standard deviations. Inferential statistics took the form of Spearman rank correlation coefficient and multiple regression. The results of the analyses were presented in tables. The findings indicated that FDI inflows amount to 0.979 units holding another factors constant. Subsequently, a unit increase in inflation rates decreases performance of renewable energy by 0.521 units. Furthermore, it was not significant at 5% level using the p-value. Equally, a unit increase in exchange rates increases FDI inflow by 0.30 units. A unit increase in corporate governance increases performance of renewable energy by 0.082 units as per expectation. Furthermore, it was significant as its p value was greater than 0.05. Political governance as similar to corporate governance increases performance of renewable energy by 0.137. This is also as per expectation. Additionally, it was significant as its p value was greater than 5%. Any unit increase in market size increases performance of renewable energy by 0.07 units and it was significant using the p value. Lastly, trade openness as expected increased performance of renewable energy by 0.071 units. It was also significant using the p value which is greater than 5%. It was also recommended that a combination of traditional determinants of FDI and Institutional determinants should be considered when formulating policies to appeal to investors to invest into the country. The energy industry and its stakeholders in Rwanda should ensure that they put in place good governance practices in place to appeal to foreign investment. Due to the difficulty of studying cognitive constructs the researcher recommends further research to be carried out on determinants of FDI's and verify if they actually started their own business or not.

Keywords: Corporate governance, Performance, Renewable energy, Rwanda.

1.1 Background

In the last two decades, FDI has been a major source of investment capital in developing countries and an important issue in international finance since the globalization of capital markets. FDI is defined as the net inflows of investment to acquire a lasting management interest taken as 10% or more of voting shares in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, long-term and short-term capital as shown in the balance of payments (World Bank, 2013).

Foreign Direct investment has become an area of concern to many developing nations due to the economic benefits it presents to the host nation. Following this developing nation are putting in place policies such as subsidies to foreign firms and import duties exemptions to encourage the inflow of Foreign Direct investment (Ezeanjeji & Ifebi 2016). Bjorvatvatn (2000) defines Foreign Direct investment as an investment made to acquire a long-term investment in a foreign enterprise with the view of having a voice in the enterprises management. Foreign Direct investment can take three forms Horizontal Foreign Direct investment which occurs when a company undertakes the same activities abroad as at home, Vertical Foreign Direct investment where different stages of activities are added abroad and Conglomerate where a company expands its operations abroad through either Greenfield or Acquisition (O'Connor, 2003). Foreign Direct investment also differs in their objective abroad; they can be resource seeking, efficiency seeking and market seeking. Resource seeking is concerned with moving their operations close to the resources, efficiency seeking is concerned with cutting costs and market seeking is concerned with the market for its products (Spatz & Nunnenkamp, 2004).

At the global level the effect of Foreign Direct Investment on the economy is not conclusive with some studies arguing that its dependent on the sector of the economy to which it's channeled and others associating it with the linkage that the sector has to the rest of the economy. Aykut & Sayek (2015) in his study in Latin America established that FDI in the manufacturing sector has a positive effect on the economy while Foreign Direct Investment in the primary or service sector has a negative impact on the economy. The study further indicated that Foreign Direct investment in the manufacturing sector in addition to using local resources brings in technology and know-how while Foreign Direct Investment in the primary sector uses less of local good and is export oriented.

Studies confirm that investors are mostly influenced in their decision by market factors, political factors and in some cases tax policy in FDI location decisions (Lim, 2011). Hines (2004) finds that on average 1%-point reduction in the effective tax rate would increase FDI by approximately 2%. Efficiency seeking FDI in the export-oriented manufacturing sector, is found more responsive to tax relief (Blomstrom & Kokko, 2003; Kransdorff, 2010).

Anop (2010) in his research on determinants of FREI established that GDP as a measure of market size, good infrastructure and human capital were responsible for attracting foreign capital in the real estate sector. Based on this argument, it can be said that in an attempt to increase inflow of Foreign Direct investment into a country, governments tend to invest heavily in infrastructure development and improvement by improving on transport networks and social amenities in its various towns. This move by the government will lead to growth in satellite towns prompting people to move to these regions and companies to move their operations in these regions. As companies move their operations to these emerging cities they are in need of commercial properties for their operations and residential properties for their staff. Through this increased demand for properties, an opportunity is presented to the real estate sector to capitalize on thereby contributing to increased investment in real estate sector and increase in housing prices (He & Zhu, 2010).

The literature on determinants of FDI does not say much about how institutional determinants like corporate governance might affect the FDI decision (Jackson, 2008; Piesse J. et al, 2008). In Sub-Saharan Africa, a large market has been seen as attracting FDI flows, while inflation has discouraged FDI flows (Obwona, 2001). Studies in other African countries show that trade openness play a positive role in attracting FDI (Aoki 2007; Busse, 2005). Recent studies have started to recognize the importance of non-traditional factors such as globalization and governance (Dikova, 2007) mainly because FDI in developing countries is shifting from market-seeking and resource-seeking which are horizontal to more vertical efficiency-seeking FDI (Campino, 2010). In all these studies, the role of governance elements still remains largely neglected mainly due to the lack of quality data on corporate governance measures and indicators. Analysis shows that corporate governance framework depends on the legal, tax, regulatory, and institutional environment in a country (IMF, 2011; UNCTAD, 2012).

In 2012, FDI flows to developing economies exceeded those to developed countries by \$ 142 billion amounting to \$703 billion in 2012 from \$ 735 billion in 2011 and representing 52 percent of global FDI inflows. Asia and Latin America

continued to be the best destination of FDI with \$ 407 billion and \$ 244 billion respectively, while FDI inflows to Africa slightly increased to \$ 50 billion in 2012 from \$ 48 billion in 2011 (National Bank of Rwanda, 2012).

Foreign Direct Investment flows to developing Asia decreased by 7 percent to \$ 407 billion in 2012. This decline was reflected across all sub regions but was most severe in South Asia, where FDI inflows fell by 24 percent. China and Hong Kong (China) were the second and third largest FDI recipients worldwide while Singapore, India and Indonesia were among the top 20. Driven by continued intraregional restructuring, lower-income countries such as Cambodia, Myanmar, the Philippines and Viet Nam were attractive as FDI locations for labor-intensive manufacturing.

In 2012, FDI inflows were driven partly by investments in the extractive sector in countries such as the Democratic Republic of the Congo, Mauritania, Mozambique and Uganda. At the same time, there was an increase in FDI in consumer-oriented manufacturing and services, reflecting demographic changes (National Bank of Rwanda, 2012).

The distribution of FDI by industry shows a concentration in the mining industry in terms of value and although the manufacturing sector accounted for 41 per cent of the total number of investment projects during the period 2003–2009, it was of low value (UNCTAD, 2010). This called for examination of the extent to which FDI determines FDI inflows in Rwanda as a different picture emerges, depending on whether the analysis is conducted with investment values versus investment cases (UNCTAD, 2010). The problem emanated from the fact that the literature available on the determinants of FDI had left gaps while addressing growth of FDI inflows in Rwanda and more so in the energy sector by leaning on traditional determinants in empirical analysis, this study will seek to fill this gap

1.2 Statement of the Problem

Rwanda has been the destination areas for multinationals and its real estate sector has attracted a lot of attention. This is attributable to its growing middle class, its highly educated population, its improved infrastructure, its strategic position as the head quarter of many MNC and organizations. Over the years, its real estate sector has been growing alongside Foreign Direct Investment in the country with housing projects coming up and more multinational corporations moving into the country, (World Bank Doing Business Report, 2015).

The Rwandan context was of particular interest for the development and testing of FDI theory due to its high level of governance risk, complex tax regime and the low levels of FDI attracted in the last ten years (UNCTAD, 2012). Evidence showed Rwanda is a poor performer and laggard in FDI growth in EAC despite the fact that it is the strongest and EAC's most diversified economy. Rwanda has not attracted much FDI (as a % of GDP) and has not outstripped both the developing-countries average and the sub-Saharan Africa average (Rwanda's average was 7.1%; developing countries average was 29.4%; Africa average was 32% in the period 2008-2013 (UNCTAD, 2013; World Bank, 2013).

It is believed that FDI has a positive impact on the economic development of country. The success of FDI depends on different factors including but not limited to the effectiveness of the government policies, competition and the volume of investment. FDI is most needed in developing sectors that demand hug capitals that other source of investment (Government and Local private investment) can't afford alone. Renewable energy sector is one example of such sectors.

The energy is one of the most powerful tools that can boost the economic development when it is well combined with other factors including but not limited to infrastructures, financial system and government policies. Due to the huge investment that is needed in this sector, the public budget and local private investment are not sufficient in order to achieve the set country's objectives in short and long term. That is why the foreign investment is needed to contribute to the achievement of these objectives.

Due to the fact that the renewable energy sector is still underexploited in Rwanda, many factors may justify this hypothesis including lack of enough capital; that is why a kind of analysis is needed to find out to what extent Rwanda is encouraging the foreign investor to invest in this sector and also to what extent these investors are motivated to respond to this call. The researcher thinks that there is a relationship between the effect of FDI and the performance of the renewable energy sector and this relationship will be measured by carrying out this research.

1.3 Objectives of the study

1.3.1 General objective

The general objective of this study was to determine the effect of foreign direct investment on the performance of the renewable energy sector in Rwanda.

1.3.2 Specific objectives

The specific objectives were:

1. To examine the effect of corporate governance on performance of the renewable energy sector in Rwanda.

2. CONCEPTUAL FRAMEWORK

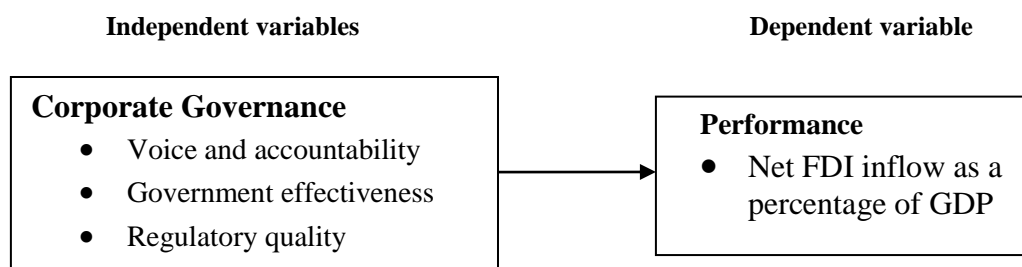


Figure 2.1 Conceptual framework

3. TARGET POPULATION

Target population in statistics is the specific population about which information is desired. According to Ngechu (2014), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous. And by population the researcher means the complete census of the sampling frames. According to Mugenda and Mugenda (2008), target population in statistics is the specific population about which information is desired. The target population describes subjects or individuals who share similar character traits. It is the population to which the study findings are generalized (Kombo & Tromp, 2010). The target population was 112 employees of MOBISOL which has with significant foreign ownership in Rwanda.

4. RESEARCH FINDINGS AND DISCUSSION

4.1 Corporate Governance on performance of the renewable energy sector

The first objective of the study was to effect of corporate governance on performance of the renewable energy sector in Rwanda.

Table 4.1: Corporate Governance

	SA	Disagree	Uncertain	Agree	SA
Good corporate governance can lead to growth of FDI inflows	0.00%	0.00%	0.00%	55.60%	44.40%
The rule of law in the Rwanda is fully developed	9.30%	31.50%	48.70%	18.50%	0.00%
There is generally good practice of corporate governance in the Rwanda	41.70%	33.30%	16.70%	6.20%	2.10%
The laws governing transfer pricing by foreign investors is not well laid down in Rwanda	2.10%	2.10%	55.60%	55.60%	55.60%
Governance and quality of institutions have a positive effect on FDI flows	0.00%	4.20%	14.60%	47.90%	33.30%
The corporate tax rate in Rwanda is high and can discourage investors	0.00%	0.00%	4.20%	60.40%	35.40%
Democracy as proxy of governance can foster development of stable ground rules for FDI inflows	2.10%	0.00%	0.00%	8.20%	89.60%

Table 4.1 shows that 100% of the respondents agreed that good corporate governance can lead to growth of FDI inflows. 40.8% disagreed that there are generally good practices of corporate governance in the Rwanda while 40% were

uncertain. Regarding the rule of law, 75% disagreed that rule of law in the Rwanda is fully developed. The respondents were asked whether the laws governing transfer pricing by foreign investors is not well laid down in Rwanda; 58.3% were uncertain while 37.5% agreed. 81.2% agreed that governance and quality of institutions have a positive effect on FDI flows. 95.8% agreed that democracy as proxy of governance can foster development of stable ground rules for FDI inflows while 77.1% also agreed that corporate tax rate in Rwanda is high and can discourage investors. When asked whether corruption in Rwanda hinders FDI growth, 97.9% agreed

5. CONCLUSIONS

Research objective one in this study was to examine the extent to which corporate governance performance of renewable energy in Rwanda. The indicators of corporate governance were voice and accountability, political stability & absence of violence, Government effectiveness, regulatory quality, and rule of law, control of corruption and level of taxation. The indicator for FDI growth was the net FDI inflow as a percentage of GDP. Corporate governance was found significant in determining growth of FDI in Rwanda; this was in agreement with other studies (Globerman & Shapiro, 2002; Mkenda & Mkenda, 2004; Talamo, 2011). The findings Mwega and Rose (2007) was that governance though not significant was positively related to FDI inflows.

5.1. Recommendations

It was also recommended that a combination of traditional determinants of FDI and Institutional determinants should be considered when formulating policies to appeal to investors to invest into the country. The energy industry and its stakeholders in Rwanda should ensure that they put in place good governance practices in place to appeal to foreign investment. This implies that in the selection of persons to serve in the governance structure, proper research should be undertaken in consultation with both local and foreign investors to ensure that the governance structure enhances and does not inhibit flow of FDI.

5.2. Areas for further research

Due to the difficulty of studying cognitive constructs the researcher recommends further research to be carried out on determinants of FDIs and verify if they actually started their own business or not. A study on factors that would hinder these employees from venturing into business could also be carried out. A lot of research is still needed to better comprehend which factors affect entrepreneurial intentions leading to business creation.

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