FOREIGN DIRECT INVESTMENT AND FINANCIAL PERFORMANCE: A CASE OF NSE LISTED INSURANCE COMPANIES WITH FOREIGN OWNERSHIP

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ABSTRACT

Foreign Direct Investment (FDI) not only provides the African countries with much needed capital for domestic investment, but also creates employment opportunities, helps transfer of managerial skills and technology, all of which contribute to economic development. The objective of this study was to assess the effect of Foreign Direct Investment on performance of Listed Insurance Companies in Kenya with specific focus on tax regime. The study used a longitudinal research design covering a 6 year period between 2013 and 2018. The target population of the study was six NSE listed insurance companies with foreign ownership. The study undertook a census involving all the six companies therefore no sampling was done. Using STATA version 12, descriptive and panel regression analysis was used to determine the relationship between the independent and dependent variables. Data was interpreted and presented in form of tables. Three panel regression models, that is, pooled OLS model, the fixed effects model and the random effects models were subjected to diagnostic tests. Fixed model was selected as the most appropriate model and was used to interpret the findings. The findings of the study revealed that tax regime had a negative and significant effect on performance with a p value of 0.004. The study concluded that an increase in tax caused a decline in performance of listed insurance companies. The study therefore recommended that policy makers should direct effort towards improving these factors so as to attract more foreign direct investment to the insurance sector given that they affect performance.

Key Words: *tax regime, foreign direct investment, STATA, performance*

INTRODUCTION

Foreign Direct Investment (FDI) refers to an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Foreign investment is a major source of external capital and also serves as a major contributor to the economic growth and development of most countries. FDI is a major force shaping globalization as it offers the possibility for channeling resources to developing countries. Foreign investment in Kenya remains relatively weak considering the size of its economy and its level of development. This can be explained by a number of hindrances to investment, notably the country's poor-quality infrastructure, lack of security due to terrorism and an unfavorable business climate (Nangpiire, Rodrigues, & Adam, 2018).

PROBLEM STATEMENT

Recognizing that FDI can contribute a lot to economic development, all governments of Africa including that of Kenya want to attract it. The world market for such investment is highly competitive, and Kenya in particular, seeks such investment to accelerate its development

efforts. The World Bank's Doing Business reports are today pivotal in guiding investors into investor friendly and high return on investment regions through a comprehensive analysis on the business environment of different markets across the globe (Nangpiire, Rodrigues, & Adam, 2018). According to a report by United Nations Centre for Trade and Development (UNICTAD) for the last 5 years leading to 2016, Kenya has experiences a persistent fall in investment inflows hitting a six-year low of Sh40.7 billion (36% drop) in 2016 (UNICTAD, 2017). Kenya's attractiveness to foreign direct investment continued to slump as its East African neighbors increased their appeal to foreign capital. However, in 2017, Kenya saw FDI increase to $672 million, up 71 per cent defying a trend in East Africa that received $7.6 billion in FDI in 2017, a 3 per cent decline from 2016. This sudden shift in Kenya's attractiveness to foreign investment can be attributed to buoyant domestic demand and additional tax incentives to foreign investors by the Kenyan Government (UNICTAD, 2018). In the 2018 Ease of Doing Business Survey by the World Bank, Kenya ranked 61, 19 places up from position 80 in the previous year's survey (World Bank, 2018). Is there a link between these two variables, ease of doing business and foreign direct investment in Kenya? Many researchers have attempted to link ease of doing business, foreign direct investment and performance of domestic companies. Corcoran and Gillanders (2012) examined the relationship between a the regulatory environment of a country and the level foreign direct investment inflow into the country using the World Bank's Ease of Doing Business to identify and measure variable. The findings of the research revealed that there exists no significant association between business regulation and FDI inflow of a country. Previous studies are giving contradicting results as to the relationship between ease of doing business and foreign direct investment. This study therefore sought to examine the influence of determinants Foreign Direct Investment on performance of NSE listed insurance companies in Kenya.

RESEARCH OBJECTIVE

The general objective of this study was to examine the influence of determinants Foreign Direct Investment on performance of NSE listed insurance companies in Kenya. The specific Objectives objective of this study was to assess the effect of tax regime on performance of NSE listed insurance companies in Kenya.

LITERATURE REVIEW

Imperfect Market Theory

The imperfect market theory was first developed by Hymer (1976) with the aim to explain the behavior of firms in non-perfect competitive environments, that is, oligopolistic or monopolistic environment. For firms to undertake FDI they need some unique advantage such as technology to compete abroad with local firms who already have locations specific advantages. Considering the market disequilibrium hypotheses, FDI will be transitory as it acts as an equilibrating force

among segmented markets, which will be eliminated through the re-establishing of equilibrium (Socrates, 2012).

The disequilibrium is usually found in factor markets, that is; labor markets, access to capital, tax regimes where FDI flows from high labor cost, low capital access and stringent tax regime countries to low labor cost countries, favorable credit terms and cheap and efficient tax systems. Market Imperfection Theory therefore favors the foreign investors as they are able to obtain cheap labor, cheap credit and favorable tax (Cai, Kim, & Gan, 2012).

For an individual, organization or country looking to leverage from a foreign country's comparative advantage whether resources, human capital, incentives, technological advances or favorable trade arrangements, they enter the foreign market through foreign direct investment. This theory therefore is relevant to this study as it justifies the need for foreign direct investment.

Tax Regime and FDI

In the current business environment, majority of the countries have been force to increase their efforts to attract investment through foreign companies setting up in the host countries. Among the leading strategies adopted by these countries is tax reforms to make the process less tedious and efficient and make the cost of taxation cheaper for corporate companies. However, different researchers hold different views as far as effect of tax on investment is concerned. While some argue that high tax rates increase tax revenues to the host countries, others insist that this revenue can be recovered through other means including creation of employment and increase in GDP (Ocheni, 2018).

Fahmi (2012) conducted a research in Indonesia with the aim to investigate the influence of tax incentives in form of tax holidays on foreign direct investment (FDI). The research covered the period 1981 to 2010 and analysis was done through Ordinary Least Square regression. FDI was the dependent variable while tax was the independent variable. The researcher also included intervening variables including inflation, gross fixed capital formation, gross domestic product growth and tax rate. The results revealed that there was a significant association between gross fixed capital formation, inflation, openness, tax rate; and FDI. Tax holiday on the other hand showed no significant effect on FDI inflow in Indonesia. This can be attributed to the fact that tax holiday on its own without other factors such as proper infrastructure, security and investor friendly business regulation will not be sufficient to attract investors.

Ocheni (2018) sought to analyze the influence of marginal tax rate on foreign direct investment of a number of selected countries in Africa. The research data was extracted from a previous survey that was conducted whereby respondents were interviewed to establish investors' perspective on effect of tax rate on degree of investment in Africa for a three year period, that is, 2013, 2014, and 2015. The survey arrived at a conclusion that tax incentive significantly influences FDI inflow into African Countries. The survey further revealed that efficient Tax incentives determinants have a significant relationship with returns on investment.

Gumo (2013) conducted a research on the effect of tax incentives on foreign direct investments in Kenya. The study adopted a descriptive research and data was collected from secondary data sources. Descriptive statistics, correlation and multiple linear regression models were used in data analysis. The study established that Kenya has various tax incentives. The study concluded that tax incentive would have a positive resultant effect on FDI and recommends that Government need to evaluate its tax incentives policy, and weigh against the benefits that accrue with the intention of spurring investment including introducing evidence based tax incentives that would minimize tax evasion.

Someah-Addae (2015) utilized a multiple linear regression analysis to explain the association between tax, grant, inflation and GDP on FDI. The results of this research indicated that there exists a positive association between GDP and Foreign Direct Investment (FDI). On, the other hand, Grants and Inflation had no measurable influence on FDI while charges, had a positive effect on FDI and duties were identified as the main critical indicator of FDI.

Saidu (2015) examined the relationship between corporate taxation and foreign direct investment in Nigeria from 1970-1980. The annual reports were sourced from the CBN statistical bulletin, NBS and World Bank which were analyzed using Descriptive Statistic, correlation and regression. The independent variable corporate taxation was measured using corporate tax rate (CTR) whilst dependent variable foreign direct investment was measured using FDI net inflow (% of GDP). GDP, exchange rate and inflation rate were used as control variables. The result showed negative relationship between CTR and FDI whilst exchange rate and FDI indicated negative insignificant relationship. However, GDP was positively insignificantly related with FDI whilst inflation had positive relationship with FDI. Based on the findings, the study recommended that there is need for the government to reduce corporate tax rate in order to attract FDI into the country.

FDI and Performance

Gurbuz and Aybars (2010) sought to explore how the financial performance of the companies listed on the Istanbul Stock Exchange (ISE) is affected by foreign ownership. The study employed panel data analysis on a sample of 205 non-financial listed companies covering the 3 year time period from 2005-2007. The results indicated that minority foreign-owned companies (MIN) perform better than domestic ones (DOM) in terms of operating profitability. When return on assets is employed as a performance measure, it is observed that MIN perform better than both DOM and majority foreign-owned companies (MAJ). It is also found that MAJ perform worse than DOM. The results of further analyzed, which employ yearly dummies for different ownership structures, are also provided. The overall results of this study indicated that foreign ownership improves firm financial performance in Turkey up to a certain level, beyond which additional ownership by the foreigners does not add to firm profitability.

Gatsi, Gadzo and Kportorgbi (2013) examined whether foreign investment has an effect on Sharia-compliant companies. Sixty-four Sharia-compliant companies in Malaysia and 30 Sharia-compliant companies in Indonesia were selected as samples. Descriptive analysis was conducted to look at the frequency of the variables. *T*-test analysis was run to compare the performance between Malaysia and Indonesia's Sharia-compliant companies. It was followed by checking the assumption and looking at the correlation before the regression analysis was conducted. Based on the *t*-test analysis, there is a significant difference between the performance of Sharia-compliant companies in Malaysia and Indonesia. All measures indicate that the value of mean for Indonesia is higher compared to Malaysia. One of the factors is the different in the currency rate between these two countries, where Malaysia uses Ringgit Malaysia and Indonesia Rupiah as their currency.

Palade (2016) examined whether the firm accounting and financial performance ratios are reflected in the level of the Foreign Direct Investment and which one plays the most important role in attracting the foreign investors. The sample was made of 25 randomly extracted firms listed on Bucharest Stock Exchange, for the fiscal year 2014. The authors found a positive effect of the financial ratios such as the net turnover to networking capital, equity multiplier, and net profitability ratio on the level of Foreign Direct Investment. The results of the research show that to enhance Foreign Direct Investment, corporations must improve their accounting and financial performance.

Omodero, Alpheaus and Ihendinihu (2016) sought to determine whether foreign ownership in a developing economy is beneficial in terms of national competiveness; reducing the income gaps; improving employment opportunities; improving the financial performance of an acquired local firm and if the foreign parent introduces new technologies into the economy. The results indicate significant benefits for the host economy in attracting FDI into the country. The benefits seemingly outweigh the costs and the presence of Multinational Corporations (MNCs) in South Africa will help it in elevating some of the socio-economic challengers like high unemployment rate and the shortage of skills through resource sharing with the MNCs.

Onyinyechi and Ekwe (2017) examined the impact of Foreign Direct Investment (FDI) on the stock market performances in Nigeria, from 1985 – 2014. Multiple regression of least square estimation was the tool used to analyze the data in this study. In the model, the FDI was regressed on RGDP, Consumer Price Index, Real effective exchange rate, Money supply (M2), Share price index, Treasury bill, Nigerian stock exchange transactions. The study revealed that FDI has an insignificant and negative impact on the economy and the macroeconomic variables that determine the performances of the Nigerian stock market.

Apostolov (2017) examined how foreign direct investments influence the performance and entrepreneurship of domestic firms. The intent is to investigate the way foreign direct investments shape the capabilities of domestic firms. The study found find that foreign ownership has helped restructure and enhance the productivity of domestic firms, FDI has

positive influence in reinforcing the creation of new firms, and a foreign investment is likely to influence the job seeker to get employed rather to start their own business. Overall, the results confirm the influence of foreign firms in assisting entrepreneurial activity. The impact of foreign investment is, in general, positive and tends to influence the restructuring process of domestic enterprises.

RESEARCH METHODOLOGY

Research Design

This study adopted a longitudinal design with specific interest in NSE listed insurance companies with foreign ownership. This design involved observing of the same target population over a period of time. For this study, data was collected for period between 2013- 2018. This study targeted NSE listed insurance companies with foreign owned shares. Since this was a longitudinal study covering 6 years period, only insurance companies that have been listed in the NSE for 6 years or more and have foreign ownership were considered for the study. According to the Capital Markets Authority (CMA) (2018), there are six listed insurance companies with foreign owned shares.

Sample Size and Sampling Technique

For this study, the sampling frame for the target population was all the listed insurance companies in Kenya as at 31st December, 2018 as they appear in the database of NSE. The NSE handbook and the insurance regulatory authority also provide the list, physical address and contact details of the listed insurance companies in Kenya. The research carried out a census of all the six listed insurance companies with foreign ownership.

Data Collection Procedures

Data on the dependent and independent variables was collected by use of secondary data. Listed insurance companies are mandated by the regulators to publish their financial information annually. Thus the researcher extracted quantitative data from the financial statements of individual insurance company under study. The researcher opted to use secondary data because they have a higher efficiency and accuracy rates than primary data rate. The data collection covered six (6) year period from 2013 to 2018.

Data Processing and Analysis

The study collected quantitative data from audited financial statements of the listed insurance firms and the websites of regulatory bodies. The panel data collected was analyzed using inferential statistics which included; panel multiple regression, correlation and analysis of variance using Stata 12.0. The regression model was used to make the conclusions and recommendations for the study. The results of the data analysis were presented using tables,

charts and graphs for easy understanding. The regression model used expressed financial performance of the listed insurance companies as a function of tax regime and was expressed as follow:

$$Y_{it} = \beta 0 + \beta_1 TR_{it} + \epsilon_{it} \dotfill \text{Model 1}$$

Where: Y_{it} – Performance; $\beta 0$ – Constant; TR = Tax Regime; β_1 = Regression coefficients; i= number of firms; t= time period; ϵ_{it}= Error term

RESEARCH RESULTS

Tax Regime on Performance

This variable measures the taxes and mandatory contributions that companies must pay in a given year as a percentage of gross profit.

Table 1: Total tax payable as a share of gross profit

Variable		Mean	Std. Dev.	Min	Max	Observations	
Tax payable	Overall	39.56667	3.325057	37.1	44.2	N =	36
	between		0	39.56667	39.56667	n =	6
	Within		3.325057	37.1	44.2	T =	6

The total taxes payable as a portion of the gross profit indicates the percentage of taxes paid by companies in relation to the gross profit, and include corporate income tax, social contributions, labour taxes paid by employer, property and property transfer taxes, dividend, capital gains, financial transactions taxes and other taxes. The findings from table 4.1 above indicate that total number of observation for tax regime is 36. The tax payable as a percentage of the gross profit margin profit margin had an overall mean of 39.567 and a standard deviation of 3.325. This means that the variations in the tax payable of insurance companies listed at the NSE between 2013 and 2018 have been high. The standard deviation within panels was found to be 3.25057. The standard deviation between the panels is 0 because all the listed insurance companies pay the same types of taxes therefore; there are no variations between individual insurance firms. The maximum tax payables was 44.2 while the minimum tax payable is 37.1.

Return on Equity

Financial performance of the listed insurance companies was considered as the dependent variable. The study used the return on equity (ROE) as the indicator for financial performance of the listed insurance companies in Kenya.

Table 2: Return on Equity

Variable		Mean	Std. Dev.	Min	Max	Observations	
	overall	12.01778	7.309865	-5.7	21.5	N =	36
ROE (%)	between		3.536634	6.575	15.47333	n =	6
	within		6.535532	-4.148889	25.94278	T =	6

Return on equity (ROE) measures the profitability of an organization by examining the amount of profit the company is generating from capital shareholders have invested in the company. ROE is calculated by dividing the net profit after tax by the total equity. The findings from table 4.5 above indicate that that total number of observation is 36. The overall mean for all the listed insurance companies for all the years combined was found to be 12.012%. The overall standard deviation of ROE was found to be 7.309, indicating that there was a high variation in the ROE across the study period 2013-2018. The variation in ROE is larger within the panels (6.536) than between the panels (3.537). This means that insurance companies are competing among themselves for making profit. However, their standard deviations are evidence that their profit making capacity is divergent from each other, this may be as a result of the different levels of financial models and practices that vary from one firm to another. The maximum ROE was found to be -5.7% while the minimum ROE was found to be 21.5%.

Diagnostic Tests

The researcher performed a panel regression using three models; the pooled OLS model, the fixed effects model and random effect model. To select between the pooled effect and the random effect model for the study, a Breusch-Pagan Lagrange multiplier (LM) test was conducted while the Hausman test was used to choose the preferred model for the study between the fixed effect model and the random effect model. The results of the diagnostic tests are presented below.

In order to choose between pooled OLS model and random effects model for ROE, a Breusch-Pagan Lagrange multiplier (LM) test was used.

Table 3: Lagrange Multiplier Test - (Breusch-Pagan) test

Test Statistic chibar2 (01)	P value
5.37	0.0102

Based on the Breusch Pagan LM test, the pooled effect model was not suitable for the study, hence the study will either use random effects model or the fixed effects model.

In order to choose between fixed and random effects model for model ROE, Hausman test was used. The results of the Hausman test are presented in Table 4 below.

Table 4: Hausman Test

Test Statistic chi2(2)	P value
4.84	0.01764

From the results of the Hausman test in table 4.7 above, the Chi square has a value of 4.84 and a p vale of 0.01794 which is lower than the threshold of 0.05. This means that 5 percent level, the chi-square value obtained was statistically significant. Therefore, the null hypothesis that random effects model was preferred to fixed effect model for ROE model was rejected and the fixed effects model was deemed appropriate for the study.

Panel Regression Analysis

The study conducted a panel regression analysis using the three models; pooled regression model, fixed effect model and random effect model.

In this model ROE is presented as a function of tax regime. The findings of the random effect regression model are presented in Table 5 below

Table 5: Random Effect Model

ROE	Coefficient	Std. Err.	t	P>t	[95% Conf. Interval]	
Tax regime	-.5832	0.1397	-1.58	0.046*	-3.89751	.45377
Constant	.1896	2.3974	1.65	0.180	-2.87526	0.09681

Using the random effect regression model above, the regression equation becomes;

$$Y_{it} = 0.1896 - 0.5832 TR_{it} + \varepsilon t_{it}$$

The results of the random effect regression model indicate that tax regime has a coefficient of -0.5832 with a p value of 0.046 respectively. The findings indicate that tax has a significant negative effects on the ROE of the listed insurance firms in Kenya since the p value is less than 0.05. This means that when other variables are held constant, a unit increase in tax regime will reduce the ROE of the listed insurance firms in Kenya by a factor of 0.5832.

DISCUSSION

Taxes are essential for economic growth. However, the magnitude of the tax rates should be set wisely and unnecessarily complicated tax rules avoided. Most companies consider both tax rates and tax administration as obstacles to performance of their business. The first specific objective of the research was to investigate the effects of tax regime on the performance of listed insurance companies in Kenya. The results from the fixed effect regression model analysis indicated that tax regime significantly reduces the financial performance of listed insurance companies in Kenya. The findings are in line with Gatsi, Gadzo and Kportorgbi (2013) who examined the

effects of corporate income tax on the performance of ten listed manufacturing firms in Ghana using panel data methodology covering seven year period. The results of the study showed that corporate income tax and the financial performance of the manufacturing firms have a negative associate that is significant. An increase in the corporate income taxation reduced the performance of the manufacturing firms in terms of return on assets (ROA).

Neghina (2012) investigated the influence of tax on the financial performance of companies listed on the Bucharest Stock Exchange. The study conducted a regression analysis using data collected from 25 listed companies from 200 to 2011. The findings revealed that tax rate and interest rate have negative significant negative correlations with the performance of the listed companies. The study therefore confirms the findings of the current study that tax regime and performance of listed insurance companies in Kenya have is negative and significant.

Lazăr, and Istrate, (2018) used a fixed effect model to examine how the overall firm-specific tax-mix influence the performance of listed companies in Romania during the 2000–2011 period. The findings from the study revealed that firm-specific tax rate significantly reduced the financial performance of the listed companies in terms of return on assets. A decrease in the overall firm-specific tax rate by one percentage point led to an increase in the performance the listed companies by a 0.15 percentage point.

The Canadian Manufacturers and Exporters (2015) and Pitulice et al., (2016) examined how tax affects the performance of firms. The Canadian Manufacturers and Exporters (2015) analyzed the impact of tax on performance of listed companies in Canada and concluded that high corporate income tax rates reduces the return on invested capital, thus positioning Canada as a less attractive destination for capital investment. Pitulice et al., (2016) evaluated the impact of corporate tax on financial performance of firms. The study eliminated independent variables that did not show any significant impact on performance and then found that corporate tax and the effective tax rate had negative significant impact on the financial performance of firms.

Taxes harm the financial performance of companies. This may be partly explained by the fact that as the corporate tax rate increase, businesses will be required to cut more of their revenues to pay for the taxes, a process which significantly reduces their profitability. The high income tax rates reduce the earnings of the company in terms of capital invested of assets and deter foreign direct investment to the insurance industry sector. Taxes also reduce investment in insurance companies by increasing the cost of capital. In some countries, the governments have put in place measures to reduce the tax burden on listed companies such as allowing for more deductions and exemptions, reducing the number of taxes, lowering the tax rate, which has resulted in increased profitability of businesses.

Nekasa, Namusouge and Makokha, (2017) investigated the impact of corporate tax on financial performance of companies listed on the Nairobi Securities Exchange (NSE) in Kenya using a mixed research design. The study conducted a regression analysis which showed that corporate

income tax has significant positive influence on financial performance of companies listed on the NSE in Kenya. Ezeugwu and Akubo (2014) also conducted an empirical study on the influence of high corporate tax rate on the profitability of corporate organizations in Nigeria. The findings revealed that corporate tax have a positive relationship with the profitability of the. The two studied revealed that an increase in corporate tax can increase the performance of companies which contradicts the findings from the current study which revealed that an increase in taxes reduces the performance of listed insurance companies. However, the studies by Nekasa, Namusouge and Makokha, (2017) and Ezeugwu and Akubo (2014) did not focus on the insurance companies.

RECOMMENDATIONS

The study revealed that the effect of tax regime on the performance of listed insurance companies is negative and significant; therefore, the study recommends that the government should incorporate tax reforms that will provide tax incentives, reliefs and tax rebates that will reduce the tax burden on the insurance companies and attract more investors in the insurance industry. The study also recommends that listed insurance firms should seek the services of tax experts to help them to properly plan their taxes in ways that can reduce the tax burden and increase financial performance.

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