Policy brief
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The presence of foreign firms in Ghana

The role of physical, financial, and governance infrastructure

In brief

- The presence of foreign firms in developing countries can help improve the operation and productivity of local firms. However, the volume and flow of foreign direct investment (FDI) into Ghana currently compares unfavourably with similar developing countries which has hampered growth.
- This study addresses the factors that determine the attractiveness of Ghana as a destination for foreign investments by using data on 720 firms to examine how the micro and macro environment affects the inflow of foreign firms into Ghana.
- The researchers find that financial constraints are the most binding of the three areas examined, particularly that of the environment to facilitate the efficient business operations in terms of purchases, payments, borrowing, and investment,
- Providing a suitable business environment is key to attracting foreign firms and deepening joint partnerships between foreign and domestic firms. The researchers suggest that policymakers: maintain a stable rate of interest and inflation to support investments, reduce physical constraints to business in regards to electricity and land restrictions, and invoke measures to reduce corruption at large local firms

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Motivation

Foreign firm presence in developing countries can positively impact development levels. They introduce sophistication and advancement which can positively change the operation and productivity of local firms. In addition, foreign firm spillovers can alter the general business environment, including the managerial, financing, marketing, and production philosophy. For Ghana, attracting more foreign firms in the manufacturing and services industries can potentially improve the growth of domestic firms with the added benefits of higher employment, revenues, and investment. To date, the volume and flow of foreign direct investment (FDI) into Ghana compare unfavourably with similar developing countries.

Research methods

This study explores the factors that determine the attractiveness of Ghana as a destination for foreign investments. Using a new wave of firm level data on 720 firms from the World Bank's Enterprise Survey, this study examines how the micro and macro environment affects the inflow of foreign firms into Ghana. Three avenues of research are pursued in this study:

- First, we examine the financial, institutional, and physical infrastructure constraints to doing business in Ghana. As an innovation, the effects of industry and firm specific determinants are also considered.

- Second, while subjective related variables capture firms' perceptions of business constraints, objective indicators help identify actual issues pertaining to the investment climate that potentially affect foreign firms. The latter also help alleviate the two problems of endogeneity bias.

- Finally, this study provides a breakdown of the effects of the various constraints by ownership, firm's size, industry, and region.

Policy Implications

Financial constraints

The outcome of the study indicates that financial constraints are the most binding of all three constraints examined. This confirms that the financial environment is key to attracting foreign firms and deepening joint partnerships between foreign and domestic firms. The subjective variable analysis provides an indication of the severity of financial constraints. Foreign firms require a fully functional financial environment to facilitate the efficient operation of a business in terms of purchases, payments, borrowing, and investment. The Bank of Ghana must endeavour to maintain a stable rate of interest and inflation to aid the planning activities and investment decisions of business.

Policymakers must improve accessibility to the financial environment particularly for small firms that are heavily constrained financially. From a regional perspective, even though all four regions analysed are found to be negatively impacted by financial constraints, Takoradi is worst affected, suggesting the importance of government policy focusing on this region with respect to improving financial accessibility.

Financial management

Using the objective variables, the results provide additional policy direction. Financial management represented by external auditing is significant in deterring foreign investments. Therefore, government should provide financial education to support firms in improving the management of their financial practices. For example, government can introduce and enforce laws concerning the prudent financial management of businesses. Good financial practices exercised by domestic firms can stimulate joint partnerships between foreign and local firms.

Infrastructure constraints

In the case of physical constraints, the results call for policymakers to provide sustainable sources of energy to guarantee continuity of production and sales. At the industry 3 level, the results indicate energy is a major constraint to both manufacturing and services sectors. Therefore, government should explore alternative sources to ensure the availability of power supply which affects all firms, irrespective of the industry. At the regional level, energy is found to be a binding constraint for the northern part of Ghana.

Elsewhere, a different source of physical constraints – access to land – was more problematic. The regions Accra, Tema, and Takoradi require policy intervention in this area to address land availability and to streamline the process of acquiring land. The Land and Registry Commission should be empowered to provide the necessary assistance required for land acquisition and registry. Furthermore, documentation on land availability can be made more accessible for foreign firms looking to set up business in Ghana. Alternatively, if government can improve the power supply in the North, foreign firms can be redirected to this region where access to the land is not a binding constraint. The Ministry of Trade and Industry can then advertise this superior advantage in their bid to attract foreign firms northwards.

Institutional constraints

Regarding institutional constraints, government must target policy at large firms and the services industry where rampant corruption activities significantly deter foreign firms from investing in Ghana. Clear and punitive measures must be applied to government offices and firms found guilty of bribery. This would discourage such practices and more importantly, would display government commitment to dealing with such institutional problems and hence send a good signal to prospective foreign investors.

For regionally targeted policy, government should focus on Accra where this institutional issue is a binding constraint. As Accra is host to most foreign-owned offices from the set up phase to the day-to-day running of business, a greater monitoring process must be initiated by government in this region to ensure that these offices do not burden the investment process.

In addition, business-related judicial issues must be expedited through the fast-track court system to reduce any contract enforcement delays. Policymakers must ensure government offices deliver a quick turnaround for permits requested by investors without unnecessary incentive payments by investors.