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Research Paper

Foreign Direct Investments, Location, Lax Regulations in Sub-Saharan Africa

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Abstract
Multinationals are widely reputed to contribute to the economic performance of their host countries, yet it is not clear whether the location of these multinational corporations is associated with the wellbeing and stability of the host countries, or rather a function of lax and weak regulatory framework within these host countries. This study was an expost-facto research with the use of trend analysis. Findings revealed that countries in the sub-Saharan Africa have received lower net inflows of GDP when compared to other nations of the world, and that countries with higher FDI net inflows have regulations that are less strict than those with lower inflows. Host countries are advised to put good regulatory framework in place while protecting their economy from exploitation
Keywords: *Lax regulations, FDI, Location, Multinationals, Sub-Saharan Africa.*

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I. INTRODUCTION

On the broad concept of the geography of multinational corporations and economic performance, a probing and topical theme is whether the location of these multinational corporations is associated with the wellbeing and stability of the host countries, or rather a function of lax and weak regulatory framework within these host countries(Naudé & Krugell, 2007). The transactional nature of business operations could imply that like individuals, having protectionist inclinations, organizations are no different as they too are more interested in locating their firms in environments where they are certain of maximizing profits, even if situating their firms in these host countries do nothing to improve the stability or wellbeing of the countries. An intricate look at this scenario would mean that if host countries do not consciously deploy efforts to strengthen their economies and do their best in maximizing returns from these multinationals, these firms could just persist around, ripping the countries, while returning large profits to their parent countries and make sudden exit decisions whenever they see the host country as lacking in profitable opportunities(Mijiyawa, 2015).

Studies previously conducted around the geography and locational context of firms have shown that the spatial distribution of these firms that bring in Foreign Direct Investment (FDI) is not necessarily targeted at improving the economy of the countries wherein they choose, but rather predicated upon the ability of the multinationals to enrich themselves, even to the detriment of the host nation(Mhlanga *et al*., 2010; Naudé & Krugell, 2007). Ahmed *et al*., (2015) made a quite brilliant case as to how multinationals take advantage of democratic transitions to come into a host country. They showed that at the period when a country is either changing its political process from militaristic rule to democratic rule or from one political party to another; with a lot of uncertainties or soft instabilities, it is at such times that most multinationals see it fit to test the wit of the country; obviously knowing that these countries must be in a precarious condition. Supported by other older studies (Borensztein *et al*., 1998; Gastanaga *et al*., 1998; Ekpo, 1997), multinational corporations are being perceived as having to take undue advantage of their host countries, mostly to the detriment of the country(Sichei & Kinyondo, 2012).

In this paper, we would consider relevant case where multinationals decide to situate their operations in spite of instabilities, rather than improving the conditions within the country, they come in to simply exploit the lax regulations within these countries. This work would draw relevant information from the World Bank Development Indicators on FDI net inflows with a comparative emphasis on Fragile States, Sub-Saharan Africa

and the World Aggregate. Whereas data is available from 1970 till date, we make use of data from the turn of the century till 2019 (2000-2019).

Foreign direct investment

Foreign direct investments (FDIs) are investments made into a foreign country by individuals or companies that reside or are domiciled in another country(Yoon & Heshmati, 2020; Dupasquier & Osakwe, 2006). The generic meaning of FDI is that it involves the establishment of businesses or real structures in another country; or the acquisition of foreign based assets that were hitherto owned by a foreign company. It is important to note that FDIs thrive better in open economies than in closed economies. In other words, economies that are open to expatriate interventions are more likely to experience FDIs than those economies that are tightly regulated. The import of this is that in countries where FDIs thrive, there are opportunities for foreign business to succeed and the policies in such places are just enough for investments to yield substantial returns(Anyanwu & Erhijakpor, 2014; Gui-Diby, 2014). Beyond the capital investments made in FDIs, there are also situations where FDI is implemented through the provision of latest technology or managerial competencies. A very important characteristic of FDI is that it aims to establish total or partial control over the decision making processes of the foreign business. Hence, an individual or company may engage in FDI by outrightly buying a foreign company; partially buying the company by purchasing some of its shares; providing technological equipment for the running of the company; or sending its own people to manage the foreign company. FDIs can also be implemented through mergers or joint ventures with a foreign firm. Hence, it can be said that FDIs encompass long-term capital, equity capital, and even short term capital investments made by one company into another company. The Organization of Economic Co-operation and Development (OECD) stipulated that the limits that make for a company to be deemed to have made an FDI in another country is that the firm should have ten percent ownership stake or controlling interests in the foreign company. This definition is however amenable to situations where controlling interests are established with less than ten percent of the voting shares of the foreign company(Erol & Kamil, 2015; Sichei & Kinyondo, 2012).

Three main types of FDIs are found in literature. They are horizontal FDIs, vertical FDIs, and conglomerate FDIs(Kottaridi *et al*., 2019; Zhang & Fu, 2008). Horizontal FDI is the type of investment wherein the multinational establishes the same type of company it operates at its home country or headquarters in another country – with similar *modus operandi* as that of the home country. The establishment of Coca-Cola companies in different countries of the world with similar methods of operation as the ones found in its home country of the United States of America is an example. Firms that engage in horizontal FDI seek to circumvent barriers to trade, engender improved access to the local environment, or exploit the technical knowhow resident in the environment by establishing their company close to other already established firms in the same industry. Horizontal FDI can also occur in the form of investments made in a firm abroad which produces similar goods and services as the firm in the home country(Gui-Diby, 2014). A vertical FDI occurs when a multinational establishes or acquires another business in a foreign country that may be related to its operations but not exactly the same as the one in the home country. For instance, a manufacturing organization may acquire stakes or even totally buy out another firm that deals on the supplies for its production processes. In vertical FDI, multinationals move downstream or upstream with regard to different value-chains related to their operations. The intent of vertical FDI is for a company to invest in another that it intends to supply its products to or acquire supplies from. Conglomerate FDI is investments made into another firm in another country which is completely unrelated to the current business in the home country and in which the home country business has no previous experience. This kind of FDI usually assumes a joint ventures or merger structure wherein the partnering firms still exist independently but combine their resource capabilities for certain objectives and goals(Morrison, 2019; Mhlanga *et al*., 2010).

Lax regulations

As highlighted earlier, lax regulations can become the motivation for the influx of FDIs in countries and not necessarily the desire to develop those countries to become better places through the creation of employment opportunities and infrastructural development. Lax regulations refer to the weaknesses that can be found in the regulations and rules governing the set up and running of businesses in the countries of the world(Kottaridi *et al*., 2019). When a country's regulations are lax, it means they are not strict enough to curtail the exploitation of the market by capitalists; it means that the systems that should facilitate a free market economy and ensure the elimination of market imperfections do not exist, or at best are weak. In countries where lax regulations exist, companies contravene rules and regulations without fear of any repercussions or rebates. In other words, the regulations may exist, but the institutions that are supposed to enforce them may be weak and unable to punish offenders. Hence, in such climes, there is a flagrant abuse of the market by those who believe they have control over the means of production, distribution and exchange.

Regulatory institutions are charged with the responsibility of issuing permits, licenses, and permissions to individuals and companies; assessment of the marketers, producers, and distributors; the examination and

registration of products and services; quality control and monitoring; advertising and promotion of products and services; product vigilance and other support services (Moran *et al*., 2011). In sub-Saharan Africa, regulatory frameworks are weak, with issues such as corruption, lack of funding, incoherent regulations, humdrum and stultifying workforce, high environmental volatility, unskilled workers, ever changing rules and regulations, and so on; making it possible for individuals and multinationals who intend to invest in these economies to exploit the loopholes to achieve their capitalist tendencies but with a make-believe that they are developing the country. In such countries, the government and other regulatory agencies lack the impetus or amplitude to control the manufacturing, exportation, distribution, or use of the products and services of multinationals who exploit the human and material resources of the country. In this way, the health, safety, and economic prosperity of the people in those nations are jeopardized because those multinationals clamp on infant or home industries by bending the rules to their favor through bribery and corruption of regulatory agencies(Dean *et al*., 2009; Xing & Kolstad, 2002).

Apart from these predicates, other reasons for lax regulations in countries in sub-Saharan Africa abound. First, there is no way that regulations on the manufacturing, sale, distribution, and use of foreign products and services would be enforced without a strong legal framework – comprising a competent legislative apparatus to make the laws and an uncompromising judiciary to enforce the laws(Morris & Aziz, 2011). In such countries where these particular institutions are compromised, there is no impetus for punishing offenders and multinationals exploit the resources of these countries unabated. Countries in sub-Saharan Africa are characterized by fragmented legislative frameworks because of the continuous evolvement of the legal framework of these economies; leading to many provisions in the constitution which are confusing, contradictory, and often times irksome to execute(Roth *et al*., 2018). Fragmented legislative frameworks comprise those legislations that cut across various ministries and departments of the government, making it difficult to know which particular government institutions are responsible for their enforcement. Oftentimes, these institutions find it hard to cooperate with each other and such disagreements may cause the processes of registering businesses and FDIs to be turbulent, complex, and marred with inconsistencies(Dobbins *et al*., 2015).

Geography

Geography is described in this work as the physical location where foreign direct investments are made by multinational firms and the way their investments in the location may affect the participation or non-participation of local businesses, the state of the economy, and prosperity of the locals. People living within the same geographical space usually share the same identity, language, culture, and ethnicity(Agbola, 1994). In our study context, geography refers to those economies within sub-Saharan Africa that have experienced a prodigious influx of FDIs in the past three decades. Such countries are usually favorite destinations for the inflows of resources and investments from developed nations who contribute to the development of infrastructure, human capital, and improvement of the living standard of people in such areas by setting up businesses. While this may be the motive, evidence has shown that not many of these FDIs or net inflows have achieved this outcome(Gui-Diby, 2014; Naudé & Krugell, 2007; Seretis & Tsaliki, 2015).

Lax regulations and FDIs

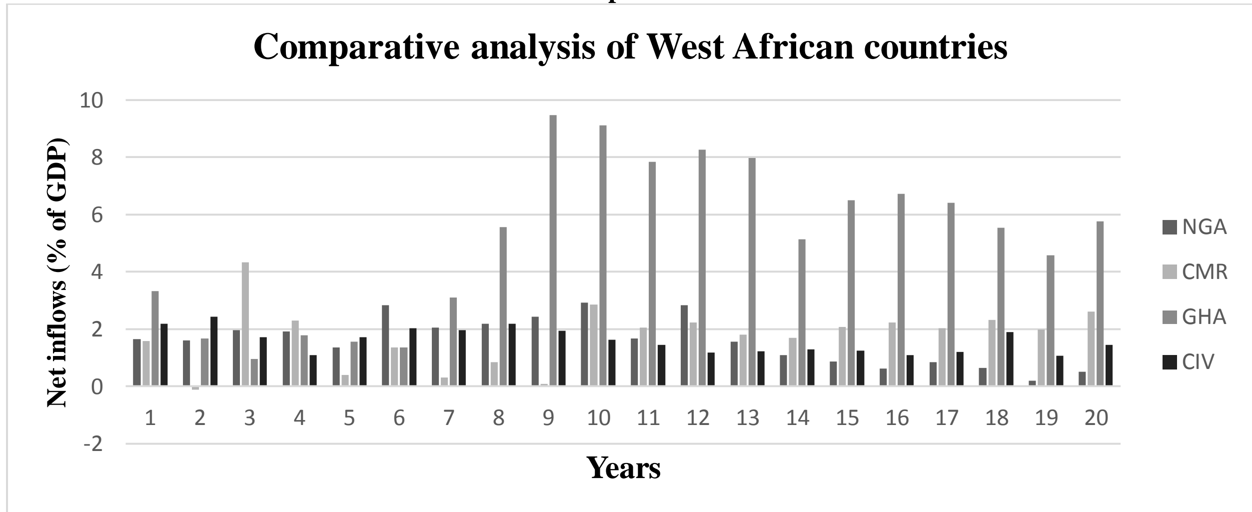
Extant literature is replete with studies that examined the extent to which weak regulatory frameworks in developing contexts have affected the level of FDIs in such nations and the characters of multinationals as they seek entry into those geographical environments. Kneller & Manderson(2009) suggested that FDIs that are pollution intensive may become outflows from economies with more strict regulatory frameworks, and inflows into those economies with weak regulatory systems. They conducted this study by integrating certain predictions set forth by the heterogeneous models of international trade into an empirical model of outward FDI by firms in the United Kingdom. An attempt was made by Yoon & Heshmati (2020)to corroborate the pollution haven hypothesis by investigating the effect of environmental regulations on foreign direct investment (FDI) in Korea using data from the manufacturing sector from 2009-2015. Haglund(2008) suggested that the atrocious standards of operation which are perpetuated by Chinese investors in sub-Saharan Africa may lead to the social problems linked with extractive industries and ultimately compromise the ability of the host countries to engender sustainable economic development in their geographical contexts. In other words, the weak regulatory framework of countries in sub-Saharan Africa may burgeon the atrocious tendencies of Chinese investors who have famously increased their economic engagements with African countries in the guise of enhancing economic growth, development and investment cooperation; but may be lacking in execution transparency. Like Xing & Kolstad(2002), Dean *et al*., (2009) also corroborated the pollution haven hypothesis, but also posited that although previous studies insist that foreign companies are attracted to developing economies characterized by lax regulations, but this is only for inward FDI into industrial economies. Thus, the authors identified the gap from previous studies in that the few studies that have examined the net inflows of FDIs into developing economies have been characterized by very weak measurement of environmental strictness and insufficient data to explain the variegations with regard to the company's responses to pollution. The work of Dean *et al*., (2009)

hypothesized that with regard to the pollution haven discussion, there could be determinants of location choice for equity choice ventures such as pollution taxes and profits, pollution intensity/tendencies of the investing company, and technology use, with the nation of China as the case country.

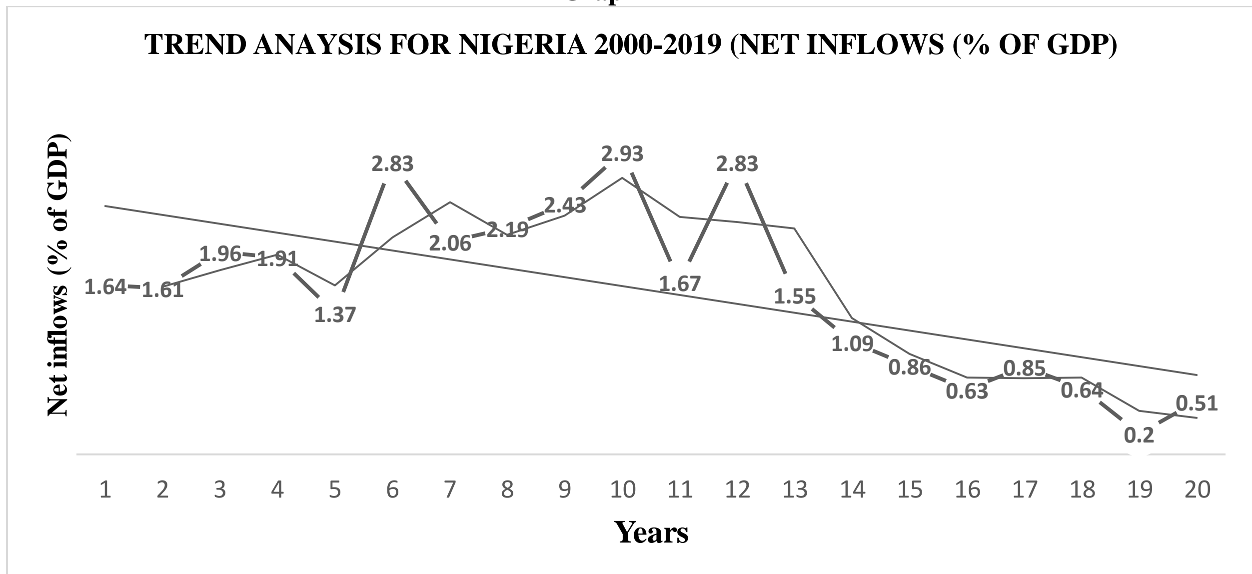
II. METHODOLOGY

This study made use of secondary data from the United Nations Conference on Trade and Development (UNCTAD) report on the net FDI inflows (% of GDP) for various countries of the world. The report is available from 1971 to 2019, but for the purpose of this research work, data of twenty (20) sub-Saharan countries from 2000 to 2019 was collected. Specifically, the aggregate data for countries in sub-Saharan Africa were also collected and analyzed.

Graph 1



Graph 2



		Foreign direct investment, net inflows (% of GDP)																			
		Years(2000-2019)																			
s/n	Coun.	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18	19
1	AGO	9.62	24.01	11.41	20.08	9.33	-3.53	-0.07	-1.37	1.90	3.14	-3.85	-2.70	-1.14	-5.21	2.51	8.63	-0.18	-6.06	-6.36	-4.58
2	BEN	-0.36	0.46	-0.46	0.20	-0.66	-0.13	-0.18	1.70	0.49	-0.19	0.56	1.51	2.53	2.88	3.05	1.31	1.11	1.58	1.36	1.52
3	BFA	0.78	0.20	0.41	0.61	0.26	0.85	1.28	0.28	0.35	0.60	0.38	1.90	2.62	3.64	2.56	1.20	3.04	0.02	1.67	1.02
4	BWA	0.99	0.56	7.50	5.57	4.36	4.24	4.80	4.52	4.76	2.03	1.71	1.91	1.02	0.45	3.17	2.63	0.91	1.50	1.53	1.42
5	CAR	0.10	0.56	0.57	0.99	1.19	0.76	2.37	3.34	5.90	2.05	2.87	1.51	2.79	0.11	0.18	0.18	0.40	0.33	0.81	1.53
6	CIV	2.18	2.43	1.71	1.08	1.71	2.04	1.97	2.18	1.93	1.63	1.44	1.19	1.23	1.30	1.24	1.08	1.20	1.89	1.07	1.45
7	CMR	1.58	-0.11	4.34	2.30	0.39	1.36	0.31	0.85	0.08	2.86	2.05	2.22	1.81	1.69	2.07	2.24	2.03	2.32	1.98	2.62
8	ETH	1.63	4.24	3.24	5.39	5.38	2.13	3.57	1.12	0.40	0.68	0.96	1.97	0.64	2.82	3.34	4.07	5.58	4.91	3.99	2.62
9	GHA	3.33	1.68	0.96	1.79	1.57	1.35	3.11	5.57	9.47	9.11	7.85	8.26	7.98	5.13	6.50	6.72	6.40	5.53	4.58	5.77
10	GIN	0.33	0.06	1.02	2.29	2.69	3.57	2.96	6.14	5.48	1.36	1.48	14.09	7.93	0.00	0.84	0.61	18.8	5.59	2.98	0.33
11	GMB	5.56	5.16	7.41	3.75	5.77	5.22	7.80	6.10	4.53	2.72	2.41	2.56	2.91	4.97	1.87	0.12	0.08	0.36	1.97	1.77
12	KEN	0.87	0.04	0.21	0.55	0.29	0.11	0.20	2.28	0.27	0.31	0.44	3.46	2.73	2.03	1.34	0.97	0.98	1.60	1.86	1.40
13	LBR	2.38	0.92	0.30	49.76	8.40	8.72	9.64	9.59	16.43	7.23	103.34	86.99	84.89	65.17	15.96	7.32	9.51	7.54	3.96	2.82
14	MLI	2.03	6.02	0.32	1.53	1.56	2.56	2.15	2.53	2.71	6.32	3.48	4.28	3.20	2.32	1.00	2.10	2.54	3.64	2.74	2.86
15	NER	0.70	0.92	0.28	0.55	0.65	1.14	0.85	1.73	3.88	8.62	10.15	12.16	8.92	7.04	7.58	5.47	2.91	3.03	3.63	5.55
16	NGA	1.64	1.61	1.96	1.91	1.37	2.83	2.06	2.19	2.43	2.93	1.67	2.83	1.55	1.09	0.86	0.63	0.85	0.64	0.20	0.51
17	SEN	1.35	0.69	1.78	0.98	1.35	1.52	2.47	2.51	2.70	2.05	1.69	1.90	1.56	1.65	2.04	2.30	2.48	2.80	3.67	4.22
18	ZAF	0.71	5.98	1.28	0.45	0.31	2.53	0.23	2.20	3.45	2.58	0.98	0.99	1.17	2.24	1.65	0.48	0.75	0.59	1.51	1.46
19	UGA	2.59	2.59	2.99	3.06	3.72	4.11	6.46	6.66	5.05	3.36	2.05	3.22	4.43	3.81	3.26	2.28	1.15	2.61	3.21	3.60
20	ZWE	0.35	0.06	0.41	0.07	0.15	1.79	0.73	1.30	1.17	1.09	1.02	2.44	2.04	1.95	2.43	2.00	1.67	1.30	3.81	1.65

Source: Adapted from United Nations Conference on Trade and Development (UNCTAD) report (Last updated on 21/07/2021)

III. RESULTS

The table below reveals that countries in sub-Saharan Africa have averagely performed abysmally in terms of net FDI inflows (% of GDP) from the year 2000 to 2019. Table 1 reveals that countries like Angola, Niger, Gambia, Uganda, and Liberia fared fairly but the worst countries include Benin Republic, Kenya, Cote d'Ivore, and Central Africa Republic. Comparative data of West African countries of Ghana, Nigeria, Cameroun and Cote d'Ivore reveal that Ghana and Cameroun received the highest net inflows, with Nigeria performing the least. A trend analysis of the performance of Nigeria from the year 2000 to 2019 revealed that Nigeria had the highest net inflows in the year 2009 and the lowest in the year 2018.

IV. DISCUSSION

The data obtained showed that countries in the sub-Saharan Africa have received lower net inflows of GDP when compared to other nations of the world. It is possible that countries with higher FDI net inflows may have regulations that are less strict than those with lower inflows. World Bank data further reveals that there was a decrease in the FDI inflows into sub-Saharan Africa by 12% to $30 billion; and in very few countries, investments grew by a very little margin. The receipts of FDI by Southern African countries went down by 16% to $4.3 billion whilein Angola, there was a slow pace of the repatriation of capital by multinational enterprises (MNEs). Most inflows recorded in Southern Africa was recorded by South Africa and Mozambique. Although there were minimal increases in the FDI inflows into Nigeria from $2.3 billion in 2019 to $2.4 billion, the investments into the West African regionin 2020 was decreased by 18% to $9.8 billion. One of the few economies on the continent that received increased inflows in 2020 was Senegal, recording a 39% increase to $1.5 billion; and this was because of the investments made by foreign multinationals and governments in energy.

These reports are empirically supported with previous studies showing that s host country regulatory characteristics, in combination with certain features of investors' corporate governance, that together herald a new set of challenges both for business regulation and the attraction of FDI into developing African countries

(Yoon &Heshmati, 2020; Dean *et al*., 2009; Haglund, 2008). In fact, empirical evidencehas shown that in any host country, the laxity of environmental regulations is a significant predicate of FDI from the United States of America; but this is especially true for heavily polluting industries, and is insignificant for less polluting industries (Xing &Kolstad, 2002). From the results of a GMM analysis, Gossel(2018)further found that corruption is an institutional weakness employed by FDI investors to surmount Africa's weak democratic institutional and regulatory status. Although the 'helping hand' – the ideology that multinationals are interested in helping develop low-income economies – is more prevalent, however, the results of the study further showed that as democratic capital in these developing economies accumulates, this relationship may outlive its importance and relevance and as a result, corruption becomes a 'grabbing hand' instead of a 'helping hand' in real time.Gui-Diby(2014)examined the impact of foreign direct investment (FDI) on economic growth in Africa and presented estimations based on panel data of 50 African countries during the period from 1980 to 2009, and found that FDI inflows had a significant impact on economic growth in the African region during the period of interest. He also found that while the low level of human resources did not limit the impact of FDI, the impact of FDI on economic growth was negative during the period from 1980 to 1994 and positive during the period from 1995 to 2009.

V. CONCLUSION

This study concludes that countries in sub-Saharan Africa should pay attention to the integration of their economies – which includes their local businesses – into the international economy so as to exploit already existing financial enforcement legislations in other countries while simultaneously developing, reconstructing and strengthening local constitutional anti-corruption laws, guidelines, and institutions. Although stringent economic and regulatory frameworks are necessary to avoid foreign exploitation of local resources and the clamp down on domestic businesses, yet it is important for government to ease out on the regulations so that multinational firms that have investments in the country can continue to provide goods and service, generate employment opportunities and also contribute to economic growth and development.

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