THE PROSPECT AND CHALLENGES OF FOREIGN DIRECT INVESTMENT ON GHANA’S CAPITAL MARKET

Author Details (optional)

Gladstone Stanley is currently Monitoring and Statistics Officer in Ghana Education Service, Ghana, PH - +233543029089. Email: gladstanley@gmail.com

Keywords
Capital Market, Economic Growth, Exchange Rate, Foreign Direct Investment, Ghana, Stock Market, Infrastructure Development

Abstract
This paper assesses the prospects and challenges and effect of Foreign Direct Investment on capital market in Ghana. In this regard, this paper seeks to authenticates literature evidence of foreign direct investment being a substitute or complement to capital market development and direction of causality.

Introduction
Even though foreign direct investment helped these countries, especially Ghana, there exist poverty, high debt to GDP, low and poor quality infrastructure development and bad exchange rate. Ghana’s debt to GDP stands at 68.1% with an unfavorable exchange rate of Ghc4.55 to US$1 according to Bank of Ghana, 2017 annual report. This is affecting even foreign direct investment in the country. Projects financed by the World Bank and the IMF stand still. There is loss of investor confidence.

2. Literature Review
2.1 Definition of Foreign Direct Investment
It is the sum of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Ownership of 10 percent or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship”. FDI as an individual or an organization with at least 10% ownership of a company’s capital is a direct investor.
2.2 Overview of Foreign Direct Investment

Studies have proved that foreign direct investment plays a major role in the socio-economic development in the Africa sub-region especially Ghana. It provides solutions to financial, technological and skills challenges in the region. It increases both capital and financial investment. It further adds to technology, skills and innovative capacity, organizational and managerial practices between the providing and receiving nations. Foreign direct investment further creates international marketing connections for the receiving countries. However, all these benefits that foreign direct investment brings to the receiving nation are not subject to the flexibility of the business and political environment of the receiving country and the characteristics of the foreign company. If the political, business and the legal regime of the receiving nation is friendly and accommodating, the size and quality of the foreign direct investment increases and vice versa. (Anokye, A. M. and Tweneboah, G., 2009)

Post-Independence era up to 1982

The aim of this regime was to deliver Ghana from the control and influence of the colonial masters and create an identity and self-reliance economy. The Dr. Kwame Nkrumah led government prepared the first Medium Term Development Plan, covering a period of 1957 – 1966, which aimed at economic transformation through industrialization and empowerment of citizens. The plan focused on promoting the production of imported substituted products; ensure active state participation and little open economy. The regime is best termed radical and overconfidence approach to development to the detriment of foreign direct investments.

Cocoa production was envisaged to be the major source of revenue the country needed to finance development and achieve economic transformation. However, low cocoa output and falling world prices of cocoa has negatively affected the effective implementation of the plan.

This caused the National Liberation Council (NLC) and Progress Party governments to appreciate the significance of foreign direct investment and quickly implemented reforms such as currency devaluation and trade liberalization aimed at making Ghana foreign investor friendly nation. This policy was supported by the International Monetary Fund (IMF).

The National Redemption Council (NRC)/Supreme Military Council (SMC) succeeded Progress Party and adopted command state economy, which aimed at giving citizen opportunity to produce goods and services and consume such without importation and the inflow of foreign direct investment. The era was unfriendly to foreign direct investment due to insecurity and political instability. (Acheampong, I. K. and Mensah, J. V., 2006)


The post-economic decline, increased impact of the 1980 debt crisis and facilitation of the attraction of value-added FDI inflows to Ghana had forced the Provisional National Defense Council to adopt a Structural Adjustment Program sponsored by the World Bank/International Monitoring Fund in 1983. The main purpose of this Economic Recovery Program (ERP) is to motive the producers, resuscitate both
infrastructure and industries, reduce and stabilize inflation and ensure sustainable economic growth in Ghana. This is boosting investor trust and confidence in the economy of Ghana.

In the 1988, the major disincentive to foreign direct investment – license for importers, was removed and incentives such tax holiday, accelerated depreciation allowances, arrangements for profit repatriation and property rights were allowed to motivate the foreign investors to invest in the country. (Acheampong, I. K. and Mensah, J. V., 2006)

**Democratic Dispensation (2001 and beyond)**

The New Patriotic Party government headed by John Agyekum Kuffour created conducive atmosphere for FDI through the agenda “Golden Age of Business” which resulted in 1,921 projects valued at $12,421.14 million in foreign and local investments between January 2001 and December 2009. (Ghana Investment Promotion Center Report, 2009).

**2.3 Trends of FDI in Ghana**

Tsikata et al (2000) has also adopted the three-way nexus of foreign direct investment such as economic growth, investment and political stability. This is based on the outcome of the coup d'etat in 1972. In that year, the foreign direct investment fell from $30.6 in 1971 to $11.5 million in 1972 with a growth rate of 2.3%. Besides, in 1979, the government of PNDC adopted an unfriendly business policy which had drastically reduced growth to negative 3.2% with an inflow of $2.8 million of foreign direct investment. The economy further deteriorated in from negative 3.5% in 1981 to negative 6.9% in 1982 but the foreign direct investment inflow remained constant %16.3 million. The dawn of the democracy in 1992 had reduced growth from 5.3% in 1991 to 3.9% in 1992. This is large due to deficit financing of democratic processes. But the foreign direct investment had increased from $20 million in 1991 to $22.5 million in 1992.

**2.4 Sectorial flow of FDI**

**Non Mining Sectors**

Foreign direct investment contributes significantly to other sectors such as services, tourism, manufacturing, real estate, export, agriculture and trade amounted to $412.8 million with an average yearly growth of $103.22 million between 2000 and 2003. The service Subsector received the major share of the foreign direct investment inflows representing 55%. This is due to the huge investment in telecommunication. Followed by manufacturing Subsector accounting for 19.03% in 1994-1999 and further reduced to 17.01% in 2001-2003. A total of 385 projects were implemented under the Subsector.

**The Mining Sector Inflows**

The Mining sector is the major recipient of the foreign direct investment inflows into Ghana. Because the sector is capital intensive and lucrative, it receives much attention from private foreign investors. The gold Subsector specifically receives the major inflows of the total foreign investment in the mining sector. The
investment into the sector began in 1980s during the implementation of the Structural Adjustment Program. The total investment to the till date is $5 billion with an average yearly inflow of $200 million while the non-mining had a net inflow of $1.6 billion in 2003. In addition, the foreign capital of the sector continues to increase over the years while the capital to the non-mining sector diminishes. The capital intensive nature of the sector made the sector to receive the huge financial resource in any little business expansion unlike the non-mining sector.

2.5 Stock Market Development in Emerging Markets

Apart from their role in domestic financial liberalization, the stock markets have also been very important in recent years as a major channel for foreign capital flows to emerging economies. Net equity flows to the emerging markets have grown to roughly $200 billion per year, providing an important source of capital for development. (IMF Working Paper, 2008).

Ghana through FDI has received a lot of revenue, technology transfer, employment opportunities and expertise through Foreign Direct Investments.

2.6 Foreign Direct Investment and Stock Markets

Studies have shown that there is a triangular relationship between FDI and Stock Market. These are; FDI stimulates economic growth (2) Economic growth exerts a positive impact on stock market development and (3) the implication is that FDI promotes stock market development (Adam and Anokye, 2008).

2.7 Ghana Stock Exchange

The Ghana Stock Exchange was first incorporated as a private company limited by guarantee in 1989. It was recognized as the only authority to trade on the floor of the exchange under the Stock Exchange Act of 1971 (act 384) in October, 1990 and first trading was done in November, 1990. In April 1994, it was converted into a public company limited by guarantee. The Exchange is governed by, a Council with representation from Licensed Dealing Members, Listed Companies, the banks, Insurance Companies, Money Market and the public. The Council is mandated to initiate policies of the Ghana Stock Exchange to regulate the industry to ensure the smooth running of the industry.

3. Data Analysis and Discussion of Results

3.1 Data Source

The paper adopted desktop study approach to achieve the objectives of this paper since the data needed is on the internet, books, newspapers and written articles and reports on the websites of the intended respondents.

In addition, the paper used a combination of quantitative and qualitative data collection modes, either to offset the weakness of a particular mode with the strengths of another. The data collection methods sought to make information gathering simplified to give a correct representation.
3.2 Data Analysis

Reasons for accepting Foreign Direct Investment

The research conducted by Boateng in 2013, companies list on the Ghana Stock Exchange to raise additional capital for expansion. CAL bank use these funds to expand its operations by opening other branches, providing more ATM (Automated Teller Machine) services, hiring more people to work in these new branches, introducing new services and products such as internet banking and also improving their customer related services. The main issue is, no matter how small the foreign direct investment is, it boasts the operations of companies and government at large. For instance, Aluworks Limited and HFC Bank with moderate foreign direct investments have also improved their productivity and service quality respectively.

How long does it take to receive the foreign direct investment after application?

It was identified that, most of the companies listed receive their foreign direct investment averagely one year after. This is due to investor confidence and economic viability of the companies. For instance, CAL bank in 2017 has increased its capital adequacy to 21.9%.

Impart of the FDI on companies and the employees

The companies open more outlets and diversified their operations. This has resulted in more profits, which translated into more rewards for employees and offer job opportunities for the new recruits. The large amount of FDI in Cal Bank shows the level of faith the investors have in these companies. The company also pays dividends to investors. The Net Interest Income grew by 39.7%, operating income increased 25.9%, Net impairment loss decreased by 72.4%, operating expenses decreased by 30.5% and profit after income tax increased by 1,397.8% by the end 2017 (CAL Bank Annual Report, 2017).

This has made the bank to rejuvenate business franchise and to reflect digital transformation strategy. The agreement with key partners has

The Status of the FDI

It was realized that the FDI received by the companies are not repayable. They are additional capital injected into the companies through the purchase of shares on the floor of Ghana Stock Exchange to hold a stake the company and the investor can withdraw his/her stake by selling the shares. At the time of withdrawal, the investor can sell it to either foreign investor or local investor.

However, in the case of government, FDI comes as loan and grant.

How long does the company plan to continue with FDI from these foreigners?
It was clear that, none of the companies want to delist from the exchange market and loss the foreign direct investment due to the paucity of additional fund receives and their effects on the operation of the companies are high. According to Boateng, “Cal Bank and HFC Bank put in an application for a renounceable rights issue for their shares in 2009 and in 2010 respectively. Aluworks has also put in an application for a renounceable rights issue for its share from March 15th to April 16th this year. These developments in the various companies are clear indications that the companies with FDIs do not have any intention of delisting from the exchange”.

**Performance of companies without FDI support**

From the research, Pioneer Kitchenware after listing its shares has not been performing well in 2006 and in 2007. The company recorded a huge amount of losses in these years. In 2006 the company recorded a loss of GH¢290,099 and in 2007 recorded another loss of GH¢263,542. SIC on the other hand, from 2002 to 2006 has been making profits from its operations. This shows that companies without FDI support may or may not perform better on their own.

**4. Finding, Recommendation and Conclusion**

**4.1 Discussionsofkeyfindings**

It was clear that FDI contributes immensely towards the success of listed companies. It enables listed companies to expand and diversified their operations, which resulted in increased profits.

FDI helped the companies to adopt policies that promote the welfare of the employees. Employees are involved in the decision making process. They were paid and this helped them to fend their dependents.

It was further realized that for a country to attract FDI, there must be both financial and political transformation and that the FDI only serve as a Sustainer of a stable economy.

It was also realized that FDI is a disincentive to state command economy.

Finally, the operations of these companies have also impacted positively on the economy of Ghana. Many jobs have been created as a result of the increase in their operations. Their operations again have contributed to the increased Gross Domestic Products of Ghana.

**4.2 Recommendations**

It is recommended that, FDI investment should be encouraged but provision should be made to encourage local content. This is to enable the country achieve good Gross National Product and Income. If Ghana balance FDI with local content, our current debt stock to GDP of 68.1% will be reduced.

It is also recommended that there should be a proper mix of FDI and good governance.
Since dividends are paid in foreign currency, it affects the exchange rates, which in turn increase cost of doing business in the recipient country. There should be government legislation preventing such occurrences.

4.3 Conclusion

The paper is concluded that foreign direct investment should be encouraged with local content and good governance to ensure mutual benefit.

Acknowledgement

The author is grateful to all the respondents to the questionnaires, the authors of secondary data and the Global Scientific Journal for accepting to add our work to their journal to showcase of findings to the world. This research was funded by the author.

References


