

**THE RELATIONSHIP BETWEEN TAX INCENTIVES AND FOREIGN DIRECT
INVESTMENT INFLOWS OF LISTED MULTINATIONAL CORPORATIONS
IN KENYA**

BY

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than the University of Nairobi for examination.

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DEDICATION

I dedicate this research project to the Gitonga family and my fiancée Miss Virginia Musimbi.

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LIST OF ACRONYMS AND ABBREVIATIONS

FDI	Foreign Direct Investment
IMF	International Monetary Fund
Kshs.	Kenya Shillings
MNCs	Multinational Corporations
MNEs	Multinational Enterprises
OECD	Organization of Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
US\$	United States Dollar
VAT	Value Added Tax

ABSTRACT

The objective of this study was to determine the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. The rationale behind granting of tax incentives is to exploit investments opportunities by attracting FDI inflows, where tax system is seen as an obstacle. Empirically, the same has been proved in developed countries although it's still at its formative stage. As such, this study focused on the impact of tax incentives towards attracting FDI inflows of listed multinational corporations in Kenya. The study collected secondary data. A time series data covering period of twenty years (1995-2015) was collected. The secondary data was collected from financial statements of listed MNCs, KNBS and KRA reports and previous studies both published and unpublished. The study further adopted a regression model to establish the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. The study results indicated that there is a positive relationship between Wear and tear allowances and FDI inflows. This is an indication that the period of study (1995-2015) FDI inflows of multinational corporations in Kenya was a result of attraction from wear and tear allowances; a correlation coefficient of 0.5465 confirmed this relationship. However, investment deductions and industrial building allowances had no any significant relationship on FDI inflows. Even though the research findings prove that Wear and tear allowances have an impact on FDI inflows of multinational corporations in Kenya, analysis of percentage change in FDI inflows between years 1995 – 2015 contradict the results.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The previous two decades have been characterized by massive efforts by many governments to market their countries as investment hubs. This move has been motivated by the need to get hold of the limited private capital together with relevant technologies and managerial approaches so as to accelerate the realization of their development agenda. As such, many countries have initiated programmes to enable them catch up with foreign direct investment (FDI). In this regard, various governments have embarked on liberalization of policies for the accommodation of foreign investment projects with emphasis on repatriation of investment profits. At the same time, proper systems have been established to allow for resolution of investment disputes. The investors are also set to enjoy tax incentives as yet another promotion strategy (Abdulla, Othman & Hongzhong, 2012).

Globally, the direct implications for increasing competition are being harnessed by the current interaction among different countries. Companies are being forced to be more competitive and innovative as they aim to pass the market due to the rising state of globalization. Major companies have managed to progress in terms of internationalization since new information and communication technologies continue to emerge and develop. In order to gain competitive advantages, companies are greatly involved in finding new strategies that will enable them create an open environment to access and harness trade as well as the need to reduce costs leading to a competitive pressure. Several reasons such as cheap labor, tax payment exemption, tax secrecy or other taxation benefits, even

geographical benefits are among driving reasons making investors to invest in other countries while they search for strategies in achieving the desired competitive advantage (UNCTAD, 2005).

Investment incentives are quantifiable economic benefits provided by governments to entrepreneurs aiming at directing investment towards specific sectors of the national economy. According to the United Nations (2010), these benefits are categorized as fiscal and non-fiscal. Fiscal benefits include tax concessions while non-fiscal benefits consist of grants and loans. While a number of studies have focused on the role of incentives in promoting FDI, information about their merits and demerits remains remote. Both successes and failures have been attributed to incentives as engines of FDI. Incentives are seen to play a marginal role compared to primary contributors such as market capacity, accessibility of raw materials and skilled labour. Two phases are undertaken by investors when assessing countries as investment destinations. First and foremost, they identify countries by their basic determinants and only those countries which qualify the set standard proceed to the next level of evaluation. In the next stage, tax rates, grants and other incentives become paramount. According to UNCTAD (2000), incentives are crucial in attracting FDI.

The number of countries working towards the realization of a suitable environment for FDI is on the rise. Measures such as minimizing barriers on the entry of FDI are being undertaken by many governments. Many governments are particularly embarking on liberalization policies to align them with FDI requirements. Whereas the effectiveness of incentives as contributors of a -conducive FDI environment remains questionable, the recent years have witnessed an upsurge of countries adopting such policies (Organization

of Economic Cooperation and Development (OECD), 2002). According to the FDI theory, decisions of Multinational Companies (MNCs) are influenced by the location advantages certain countries have for specific activities. Regions endowed with resources are attraction locations for MNCs whose operations rely on massive exploitation of such resources. It's generally assumed that specific location advantages have the same worth to all MCNs on the basis that firms value the resource potential on a similar level and that firms enjoy the same level of gains from them (Dunning, 2002).

1.1.1 Concept of Tax Incentives

Tax incentive can be defined as a deduction, exclusion or exemption from tax liability offered as an enticement to engage in a specified investment activity (Keen & Mansour, 2009). In Kenya, the most prevailing tax incentives include investment allowances, tax exemption or reduced tax rates, special economic zones and tax credit. On that note, tax incentives specifically take the form of capital market incentives, Capital allowances, EPZ benefits and tax remissions for exports.

Majority of third world countries prefer to use tax holidays as tax incentives. According to UNCTAD (2000), tax holidays is an incentive where paying of CIT by new foreign establishments is exempted for a specified period of time, likely five years in most cases. Still, other tax liabilities the firm faces may also apply from the provision of the tax holiday, for instance, import duties and VAT from raw materials. Tax holiday incentive is a temporary measure and in most cases the exemptions of administration tax on firms is rendered during holiday seasons (James, 2009). Although, partial holidays with reduced obligation can be issued by governments rather than full exemption if necessary.

Both tax and non-tax incentives have been extensively used as drivers of investment. Countries such as Ireland, Mauritius and Singapore have realized high levels of investment out of their adoption of fiscal incentives. Despite the success attributed to incentives in some countries, a number of others have not realized the anticipated investment outcomes (United Nations, 2010).

By granting tax incentives, the horizon of investment opportunities is expanded. At the same time, tax incentives promote the advancement of social welfare through incentives related to education and health care. Additionally, tax incentives help to reduce overreliance on agricultural production which is affected by market instabilities (Klemm & Parys, 2009). A number of studies have exposed achievements and failures of various tax incentives. Among the key contributors to the failure are prospects of various investors as well as tax competition (UNCTAD, 2000).

1.1.2 Foreign Direct Investments Inflows

Foreign Direct Investment (FDI) refers to the approach whereby citizens of the domestic country acquire ownership of assets with the aim of managing the production and distribution of a firm's activities in the host country (Pugel, 1999). The International Monetary Fund (IMF) looks at foreign direct investment (FDI) as a branch of international investment where an investor in one economy acquires a long-term interest in an enterprise resident in another economy (IMF, 1993). Development of many global economies is anchored on Foreign Direct Investment (FDI). According to UNCTAD (2000), Foreign Direct Investment not only brings capital but also accelerates the transfer of technology, organizational and managerial practices and skills as well as enhancing international market linkages (UNCTAD, 2000).

Foreign Direct Investment is divided into two branches: Vertical FDI and horizontal FDI. Under vertical FDI, MNCs divide processes into various geographical fragments. MNCs break up the production process by outsourcing some stages abroad. Vertical FDI operates under the underlying principle that if the cost of inputs in a certain stage of production is lower in a country away from the investor's country, it's more profitable to fragment the production process. Horizontal FDI, on the other hand, entails the production of ideally the same goods and services in the host country as produced by the MNCs in their home country. It is regarded as horizontal since it duplicates the production of goods and services in various countries. According to Asafo-Adjei, (2009), horizontal FDI is employed out of realization that it is cheaper to serve foreign markets by investments instead of exports which would otherwise attract high tariffs and high transport costs.

FDI is evaluated in terms of the amount of investment achieved in one year and the sum accrued at the end of the year. According to Banga (2003), FDI has for a long time been linked with the growth of international business and remains the basis of operation of MNCs. FDI's are in most cases created by MNCs and operate as a component of the parent corporation's attempt to defend its ability to gain profits from the control of intangible assets in line with emerging competitive forces domestically and abroad. According to Asafo-Adjei (2009), FDI is premised on gaining higher profits from control of business operations in foreign countries.

The rise of FDI is regarded as a positive aspect in both the organization, social and economic perspective. Tax incentives and tax reductions are used by countries as instruments to stimulate FDI inflow. For instance, China has effortlessly reduced their taxes from 30% to 15%-24% to steer investments endeavors in specific parts of the country.

Romania is another example whereby various companies have been exempted to pay custom duties and corporate duties to allow investments in the country. Such measures are directed to stimulate the countries' economies, and in the end through social contributions and the employee's personal income tax will increase in the state budget (Klemm& Parys, 2009).

In the Kenyan context, foreign investment is termed as investment in foreign assets, including foreign currency, credits, rights, benefits or property, basically undertaken by foreign nationals with the aim of production of goods and services for marketing locally or internationally (Investment Promotion Centre Act, Chapter 518). According to Githaiga (2013), incentives are granted to the resident companies involved in various key sectors of the Kenyan economy such as agriculture, tourism, energy and mining in line with vision 2030.

Various tax incentives are granted by the Kenyan government to foreign firms involved in local manufacturing of goods for export, a move aimed at attracting foreign investors. This includes a ten-year corporate income tax holiday and a ten- year withholding tax holiday on repatriated dividends among other incentives. In addition, foreign investors also enjoy exemption from payments of value added tax (VAT), import duty on inputs, as well as exemption from stamp duty granted on legal basis. According to the Kenya Investment Report (2015), foreign investors qualify for 100 per cent deduction on new capital investments. Recent reports such as Tax Justice Network-Africa and ActionAid International (2012) however indicate massive losses of revenue hence not necessarily relevant in attracting FDI.

1.1.3 Tax Incentives and Foreign Direct Investment

Generally, tax incentives greatly play a significant role in attracting FDI in developed countries. Conversely, it's not the same case in developing countries where major concern is attributed to loss of much needed revenue by the government (AAI & TJN-A, 2012). In Kenya, tax incentives role in attracting FDI inflows have not been clearly established. The key pillars of Kenyan economy as articulated under the in vision 2030 are guided by incentives offered to resident companies aiming agriculture, tourism, and mining sectors.

Globally, various types of tax incentives have been introduced and used by various governments to reduce the effective rates capable of determining business proposals by investors to attract investments (UNCTAD, 2000). These tax incentives should alleviate the tax burden which has a considerable bearing on corporate sector. Hence, the tax weighty measures can be relieved by host countries in different forms. For instance, the tax burden measures may include tax holidays; investment tax credits specific or general - Reduction in tax rates on dividends or interest; statutory tax rate reduction of corporate profits; wear and tear allowances; increase / accelerate depreciation of capital expenditures; industrial building allowances; mining allowances. These incentives instruments can be categorized in terms of means or channel where benefits or costs of additional investment are affected as follows: Incentives that reduce corporate costs after obtaining new capital tax (depreciation, tax credits); incentives that lessen costs after tax growth of capital to obtain funds for us; incentives that reduce tax rates on profits derived from corporate investments (Nuta & Nuta, 2012).

In previous surveys, a major problem in relation to the growth in FDIs even though FDIs are faced with many setbacks consistently appears to be lack of well-structured and attractive tax incentives. Globally, Tax incentives stipulate an important component of investment promotion strategies of the governments. Generally, various countries governments have greatly been engaged in dynamic processes intended to experiment range of tax incentives that will be capable of Foreign Direct Investment, boosting economic growth, production expansion and promoting technological transfer. Since taxes have a significant influence on the net return on capital it is then the mandate of governments to ascertain they influence the capital movements among other countries (Morisset & Pirna, 2001).

The existing studies have shown that effectiveness of various tax incentives is embedded to both success and failures. The subject of failure is pre-determined by issues unveiled by expectations of the investors and tax competition (UNCTAD, 2000). Tax competition is one of the key issues contributing to tax incentive failure. In order to attract and retain FDI, governments compete in aligning preeminent tax policies. The loss of tax can be experienced if tax competition is inefficiently put on check (Flechter, 2002). Tax rates inconsistencies in East African countries have contributed to trades marred with illegalities and complicated business deals (AAI & TJN-A, 2012). Nevertheless, from economic standpoint, tax competition is capable of increasing individual purchasing power and for that reason it should be encouraged (Clark, 2004). Clark, Cebreiro and Böhme (2007) on the other hand stipulate that this argument is still at formative stage and there is need of empirical research to make a distinction between good and bad tax competition. As such, it can be justified that the benefits resulting from any tax incentives are supposed to be significantly higher than the administering cost.

1.1.4 Listed Multinational Companies in Kenya

The role played by MNCs in fostering economic growth in various countries cannot be underestimated. According to the Kenyan Ministry of Finance (2010), MNCs contributes about 75 per cent of the total tax revenues. Whereas many MNCs initiated their activities in Kenya in the 1990s, others had begun investing in the country at onset of Kenya's independence.

Heavy presence of multinational companies is already realized in various sectors of the Kenyan economy. The role of MNCs in promoting the agricultural, transport and financial sector in Kenya is quite pronounced. In a departure from the traditional practice where MNCs operated in Kenya as fully-fledged investors, some have recently preferred to transfer their operations from Kenya. This move is aimed at lowering the risk profile, at a time when manufacturing functions are being centralized in several countries which comprise of Egypt, South Africa and the United Arab Emirates.

1.2 Research Problem

The policy by the government of Kenya to grant tax incentives so as to encourage foreign investment has of late been surrounded by controversy. The state is on the receiving end from critics who blame the government of addressing the demands of foreign firms to the detriment of the local enterprise. The critics' concerns are based on the fact that a number of multinational firms leave the country after enjoying sustained growth without equipping the local population with relevant skills, infrastructure, technologies as well as facilitating trade and access to exports market.

Previous studies on tax incentives and investments and their results have been different depending on the countries of origin where they have been carried out and empirical approach adopted. Klemm and Parys (2009) carried out a study to examine how effective tax incentives can attract investments. This research collected data from 1984-2004 from over 40 countries mainly from Africa, Latin America and Caribbean. The study used FDI and private gross fixed capital formation as the dependent variable whereas the tax as the independent variable. The study findings indicated that there was a direct correlation between tax incentives and FDI inflows.

Deng, Falvey and Blake (2010) conducted a study on tax incentives and foreign direct investment in China. The study revealed that tax incentives have been adopted worldwide as a means of encouraging foreign direct investment (FDI). The results suggested that doing away with differential tax policy leads to less FDI spillovers in the short duration. All the same, the changes improve the production entry capacity for international-based firms, and the existing domestic enterprises increase their productivity hence stand a better chance of dealing with productivity spillover.

Fahmi (2012) carried out research to analyze the correlation between tax holiday and foreign direct investment in Indonesia. This research aimed to examine historical tax holiday regulation in 1958-2010 and also analyze whether it affected the foreign direct investment trend during that study period. The results of the study revealed that during the Soekarno regime, inconsistency in the first implementation of tax holiday was experienced creating uncertainty among investors.

Musyoka (2012) carried out a study to establish the correlation between tax incentives and FDI. The study employed data from a period of ten years that included investments incentives, trade related incentives, import duty exemption as well as FDI inflows. The measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies were used to measure dispersion while relationship between the dependent variable against the independent variables was determined by the correlation and regression analysis. The study findings revealed that tax incentives lead to the losses of revenue by the government.

Gumo (2013) conducted a study to establish the effect of tax incentives on Foreign Direct Investments in Kenya. The study concluded that tax incentive would have a positive resultant effect on FDI and recommended 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.

Based on these previous studies, there is inadequate empirical literature in Kenya and the results of previous studies give mixed evidence on the relationship between tax incentives and FDI inflows necessitates further research to be carried out . Against this background, this research seeks to find the answer to the following question: Is there any relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya?

1.3 Objective of the Study

The objective of the study is to establish the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya.

1.4 Value of the Study

This investigation is set to make a significance contribution towards the expansion of Kenyan-based agencies such as KenInvest and Export Processing Zones Authority which have lengthily relied on tax incentives to attract foreign investors. The study will definitely empower these agencies with credible information on the bearing tax incentives have on FDIs in the country.

Additionally, the study will be of great value to the Kenya Revenue Authority and will create a reliable basis for policy reforms. The study will be instrumental in reviewing the current tax incentives after carrying out a credible cost-benefit analysis before adopting a new investment model.

Moreover, the study will expose potential investors to the existing tax incentives in Kenya, preparing them to undertake foreign direct investment in the country. This will eliminate concerns and uncertainties among foreign investors as they embark on investment of their capital in Kenya.

Furthermore, researchers will gain a lot of knowledge on tax incentives and direct investment inflows in Kenya. By aligning themselves with the wide range of facts from this study, future researchers will definitely undertake credible research in this field.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter covers the theoretical foundation of the investigation and empirical studies review. The theoretical foundation discusses the theories that guide the study while the empirical studies section presents a discussion of past studies on the research topic.

2.2 Theoretical Foundation

This section reviewed the theories that have been put forward by other authors/scholars and are relevant to the concepts under research. The theories discussed include: The eclectic theory, the Internalisation Theory/Transaction Cost Approach and Market Imperfections Theory.

2.2.1 The Eclectic Model

The eclectic theory, also known as the OLI paradigm, was developed by Dunning (1988). The theory stipulates that FDI is an outcome of an organization from a sending country having a competitive advantage on the basis of trademark, entrepreneurial skills and techniques and lays claims that the proposed investment location has the necessary requirements in form of raw materials, low wages as well as favorable tariffs.

The firm banks on these investment advantages without entering into joint ventures to maximize production in the host country. This model merges other FDI models in practice, particularly the monopolistic advantages model. The model blends together three different theories of $FDI = O + L + I$, where each part focuses on a different question. Based on this model, a firm commences its production abroad since three different requirements happen at once. These are Ownership advantages (O), Location advantages (L) and Internalization advantages (I).

The Ownership advantages (O) address the WHY question; that is ‘why go abroad?’ and also elaborates on the salient competencies that show competitive edge over firms already operating with foreign markets. The WHY question assumes that a multinational company has one or more firm-specific advantages (FSAs) which enable it to triumph over the costs of operating in a foreign country.

Location advantages, on the other hand, deal with the WHERE question; that is ‘locate where?’ as well as specific factors that are favourable for production abroad since firms use some production resources more efficiently compared to their home country. Moving from their home country is largely motivated by the need to exploit the firm-specific advantages in line with the factors in a foreign country. Factors such as land and labour enable the MNCs to make profits and generally benefit from its firm-specific advantages. The investment location is determined by a wide range of factors which encompass social, economic and political factors. The location advantages inherent in various countries are key determinants of the most conducive country to invest in. Internalization factors address the HOW question; that is ‘How go abroad?’ This is a result of internalization of foreign operations based on the control over market outlets. The multinational enterprise makes choices on the mode of entry, either the vertical to the horizontal mode. According to Dunning (1988), the multinational enterprise resorts to internalization in the cases where the market is non-existent or where transaction costs of the external route are too high to allow proper functioning.

Dunning (2000), explains that the capacity of a firm to successfully take part in transnational business activities lies in the satisfaction of all the criteria specified above. The internalization gain is determined by the first two advantages which Dunning (1982)

specifies when expressing the association of the advantages on the following basis: the more the ownership-related advantages owned by a firm, the greater the incentive to internalize them; and the larger the inducement of an international rather than the domestic-country entrepreneurial basis, the higher the possibility that a firm, granted the incentive (in relation to home country) to do so, will embark on foreign investment.

2.2.2 The Internalization Theory/Transaction Cost Approach

This theory explains the expansion of transnational companies as well as the drive towards achieving foreign direct investment. The theory was stated by Coase in 1937 in the national context. In the international context, the theory is associated with Hymer (1976), whereby he shows that FDI succeeds in an environment where the benefits of exploiting firm-specific advantages outweigh the relative costs of the operations abroad. As Hymer (1976) postulates, MNCs develop from market imperfections resulting to divergence from proper competition in the final product market. Additionally, Hymer (1976) describes the challenge cost of information for foreign firms relative to the cost in local firms as well as diverse government approaches and currency risk. This analysis arrives at a logical conclusion: transnational companies make a number of adjustments to costs in regard to foreign investments. Resultantly, Hymer establishes that FDI is a firm-level strategy decision and not necessarily a capital-market final decision.

Proponents of the Transaction Cost Approach downplay neoclassical economics which are attributed to lack of realization of the assumptions of perfect competition. The absence of the perfect market coupled with inconsistent signals from the price system leads to high transaction costs which include the information cost, bargaining cost as well as high cost of enforcement of agreements. Market forces may not ideally determine the prices existing

in foreign countries. The multinationals may face exploitation from its agents in foreign markets through generation of non-pecuniary externalities. Under such challenging circumstances, the company may be forced to adopt an organizational system which provides for proper coordination of different production units in hierarchical design.

The hierarchical system adopted by the multinationals helps in cutting down the general transaction costs. It is through the FDI that MNCs generate opportunities for interactions in the host country towards the realization of an ideal mode of production as well as appropriate distribution patterns. Subsequently, the interacting parties benefit from the gains from the trade as a result of the proper interactions.

2.2.3. Market Imperfections Theory

The emergence of MNCs left economists questioning how those enterprises could make profits in foreign companies while faced by higher costs of production compared to production costs at home. According to Denisia (2010), general uncertainties about the host country's environment makes it quite difficult for a firm to set up entrepreneurial operations there. This difficult question takes centre stage in the presence of imperfect markets in the foreign countries. From an argument regarding the market imperfection approach presented by Hymer (1979), the orthodox theories associated with international trade and capital movements did not adequately address the question of the involvement of MNCs in international business. Basically, they exist in foreign countries due to market imperfections.

The proponents of this approach believe that the prevailing market imperfections were monopolistic by design and developed due to development of advanced technologies, attainability of capital, getting hold of distribution channels, economies of scale, differentiated products as well as advanced management practices (Denisia, 2010). From this wide range of factors, foreign enterprises were able to counterbalance the demerits from their operations in foreign countries and the extra cost incurred there. The concern raised by Hymer (1979) was about the market power of MNCs which basically limited the chances of entry of other firms. The market power is derived from conspiracy with other players in the industry to limit completion. This strategy leads to accumulation of massive profits.

The firm's behaviour and the imperfect market structure are fundamentally interlinked in one way. The firm initially develops the market base in the home country. When the profit margin declines in the home country, the firm prefers to channel their investment in a foreign country where it uses its patent rights to extensively control the foreign markets.

2.3 Determinants of FDI

Foreign direct investment to a large extent accelerates economic growth in various countries. Governments of many host countries (recipients of FDI) are using monetary incentives such as tax allowances and grants in aid among other policies to attract FDI into their economies due to the perceived benefits associated with FDI inflows. Studies by Görg and Strobl (2001), UNCTAD (2005) suggested that foreign firms are able to positively affect the levels of productivity and growth rates in the industries they enter and to also promote skill upgrading, increase employment and increased innovation.

Fedderke and Romm (2006) opine that the related literature on determinants of FDI in developed countries identified that FDI is determined by both policy and non-policy factors. The policy factors include labour market, restrictions on direct FDI, openness, infrastructure, product market and trade barriers. On the other hand, the non-policy factors include economic and political stability, market size, transport costs, factor endowments as well as transport costs. For instance, accelerated depreciation is allowed by U.S. federal government as incentive to attract domestic investments in the country rather than other countries where they do not consider accelerated depreciation as a way out (Thomas, 2007). Foreign Direct Investment is categorized into two ways: (i) direct transfers from mother Company a foreign affiliate, this can be in form of equity or debt; and (ii) foreign affiliate reinvested earnings. It is estimated by OECD (2001) that more than sixty percent (60%) of all FDI in developed Countries is catered by mergers and acquisition. The increase of joint ventures and equity being the other components of FDI is comprised of financial capital investments. FDI is very essential as Auerbach and Hasset (1993) explain that different components may possibly respond differently to taxes.

It is a very complex decision for multinationals companies to engage in FDI because strategic measures are needed to oversee them. As abovementioned, the eclectic approach developed by Dunning (1981) is the widely accepted theory of FDI. The circumstances whereby a multinational is seeking to maximize the value of the firm, FDI will be attractive on condition that OLI (Ownership, Location and Internalization) is met. Primarily, ownership advantage for the multinational relative to ownership by local firms should exist. This satiate importance of technological or organizational knowledge of the multinational

but also the tax issue cannot be overlooked. Another reason is that it ought to be attractive for the multinational to produce abroad; comparative locational advantage should not be exempted since the multinational would have chosen to export rather than to invest. Lastly, it ought to be attractive to carry out activities within the multinational rather than buy or lease them from other firm.

Hence, all three OLI conditions are affected by taxes. For example, tax treatment of a foreign firm is affected comparatively to domestically owned firms. Also, the attractiveness of a location for undertaking investment is determined by tax rate factor even though there are other potential locational factors. Other determining factors include proximity to markets, or the proximity of other businesses elaborated by network and agglomeration, the availability of workers with good knowledge as well as a good infrastructure.

2.4 Empirical Studies and Research Gaps

Deng, Falvey and Blake (2010) conducted a study on tax incentives and foreign direct investment in china. The study revealed that tax incentives have been implemented globally to attract foreign direct investment (FDI). The results suggested that eliminating differential tax system leads to weaker FDI spillovers in the short term. On the other hand, the restructuring improves the productivity entry capacity for foreign firms, and the existing domestic enterprises become more productive hence better positioned to manage productivity spillover.

Mooij and Ederveen (2001) conducted an empirical literature review on impact of tax on FDI in European Union member countries. The study employed tax elasticity under uniform definition to approximately compare 25 empirical studies. The results indicated

that there was a mean tax elasticity of 3.3 % overall. Initially, 1% reduction in host country tax rate was recorded, which was significant to a 3.3% increase in FDI. Similar study by OECD (2001) had reported the same findings.

Grubert and Mutti (2000) carried out a research to examine the impact of effective tax rates on investment of multinationals corporations in US. The study employed 60 plant and equipment companies in various locations. The final research results reported that there was a significant negative elasticity. Similarly, a previous study had argued that FDI components need to be divided into various segments since they respond differently when tax rates are concerned (Auerbach&Hassett, 1993). The most appropriate measure of FDI inflows is well detailed by investments property plant and equipment data because it showcases a real investment venture. Swenson (2001) was able to distinguish 6 main components of FDI. The components included the joint ventures, mergers and acquisition, increase of equity, new plant, plant diversification and other FDI. The study results reported that there was positive tax elasticity for mergers and acquisition, and negative tax elasticity for new plants and plant diversification.

Fahmi (2012) carried out a study to analyze the relationship between tax holiday and foreign direct investment in Indonesia. This research aimed to examine historical tax holiday regulation in 1958-2010 and also analyze whether it affected the foreign direct investment trend during that study period. In order to have an all-inclusive understanding of their effectiveness and efficiency in regards to their capability to attract FDI, the study methodically analyzed the considerations and background of tax holiday regulations as well as their implementation. The results of the study revealed that during the Soekarno

regime, inconsistency in the first implementation of tax holiday was experienced creating uncertainty among investors. Furthermore, during the Suharto Regime, investors were skeptical in extending tax holiday facility since there were no comprehensible measures to select which investors were qualified to be given tax holiday. One of the main conclusions of the study was that tax holiday being the main objective of the study was credibly verified not significant as determinant of FDI inflow. Apparently, this is because Indonesian tax holiday incapable of counterbalancing economic, politic, government policy susceptibility as well as poor infrastructure like it once prevailed in this country. Also, where investors investment decision making is concerned, tax incentives and specifically tax holiday is not a major consideration. Nevertheless, tax holiday happens to be an extra advantage for investors in locating their firms if other main determinants of FDI are available.

Klemm and Parys (2009) carried out a study to examine how effective tax incentives can attract investments. This research collected data from 1984-2004 from over 40 countries mainly from Africa, Latin America and Caribbean. The study used FDI and private gross fixed capital formation as the dependent variable whereas the tax as the independent variable. The study findings indicated that there was a strong relationship between tax incentives and FDI inflows.

Research work conducted by Massoud (2003) on inflows of Egypt FDI concluded that the policies in the country should have mainly focused on obtaining macroeconomic related benefits from FDI rather than concentrating on the ones that attract FDI. The study further stated that the need to offer incentives did not show that it attracted more benefits as a result. But the need to improve the sufficient qualified labour while focusing sound institutions establishment as well as international trade introduction will enable potential

investors to find the country more favorable due to its locational characteristics. An empirical research by Thomas (2007) discovered that China was able to attract considerable investment due to its low labour costs and large number of skilled workers by providing a full five years with 50 percent tax liability and another one with five-year tax holiday.

Similarly, Munongo (2015) investigated the tax incentives effectiveness to attract foreign direct investment. This study involved a case study on Southern African Development Community (SADC). In respect to the research findings, tax incentives are significant in attraction FDI inflows in the SADC countries; as a result, in order to ensure sustainable FDI inflows into the region, tax mix which is effective will be capable of ensuring efficient use of tax incentives. Additionally, it was also important to articulate good governance to increase FDI inflows in the region. In that line, FDI inflows in the SADC is reduced by increasing rents from natural resources by the government. FDI inflows from the previous year were positively correlated to the inflows of the current year. As such, it is apparent that consistent SADC FDI attraction policies are significant. On the other hand, the study made some recommendations that SADC infrastructure needs consistence improvement to ensure foreign investment dynamic nature is sustained. Also, if they develop other financial markets they will be able to ensure that there is effective flow of capital and growth in economies by gaining more investment.

Previous research that examined effects of tax incentives on investments in OECD countries by analyzing existing literature and case studies concluded that tax incentives alone are unlikely to increase or attract investments (Sebastian, 2009). The study key findings indicated that both costs and benefits are derived from every tax incentive. The

increased investments determine the benefits whereas the revenue losses by the government determine the costs. Therefore, the study recommended that in order to monitor costs and benefits of tax incentives, government should always prepare expenditure statements.

Musyoka (2012) carried out an investigation to find out the relationship between tax incentives and FDI. The study employed data from a period of ten years that included investments incentives, trade related incentives, import duty exemption as well as FDI inflows. The measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies were used to measure dispersion while relationship between the dependent variable and the independent variables were determined by the correlation and regression analysis. The study findings revealed that tax incentives lead to the losses of revenue by the government.

Gumo (2013) conducted a study to establish the effect of tax incentives on Foreign Direct Investments in Kenya. The study concluded that tax incentive would have a positive resultant effect on FDI and recommended 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.

In relevance to the research findings, a positive correlation between wear and tear allowances and FDI inflows was revealed. On the other hand, both investments deductions and industrial building deductions had a negative relationship on FDI inflows. Further analysis on percentage change in FDI inflows in the course of the study period shows that the Impact of tax incentives on FDI inflows is insignificant regardless the fact that there is a positive relationship between Wear and tear allowances and FDI inflows.

Different but a similar study to review empirical findings aimed to satiate the impact of the corporate tax burden on foreign investment considerations was conducted by Clark (2000). The study highlighted the main category of tax incentives for corporations of several host countries. The key interaction analysis of tax systems of the host country level and at the home country in shaping the tax burden of the host country and behavioral implications for investment and financing alternatives in the context of tax credits is the center of focus. The issue to increase sensitivity over time of real or financial affairs of the host country taxation has been brought by recent works.

In other literature, Kose et al. (2003) suggest that international capital flows can be attracted by de-regulating activities domestic financial markets of the mother countries, and liberalizing their capital account transactions and equity markets. As such, by easing restrictions on foreign ownership limitations there is likelihood of an increase on FDI inflows just as the offshore borrowing de-regulation may attract more foreign private loan inflows when quantitative restrictions are removed on overseas borrowing and the tax incentives provision. Yet, there is high probability to attract more FDI inflows by countries which allow goods and services to freely cross their borders than countries employing restrictive and protective policies (Ang, 2008). Conversely, different views on whether liberalization can reduce market- to seek inward FDI due to altering trade costs and other factors is likewise logical.

2.5 Conceptual Framework

This study basically focused on the eclectic theory, the Internalisation theory/Transaction Cost Approach and Market Imperfections Theory as the theoretical framework through which the relationship between tax incentives and FDI inflow was examined. FDI facilitates infrastructure, technology diffusion, facilitation of trade and access to exports, and knowledge management that contribute to economic growth. Tax incentive was the dependent variable which was correlated to FDI inflows which was the independent variable.

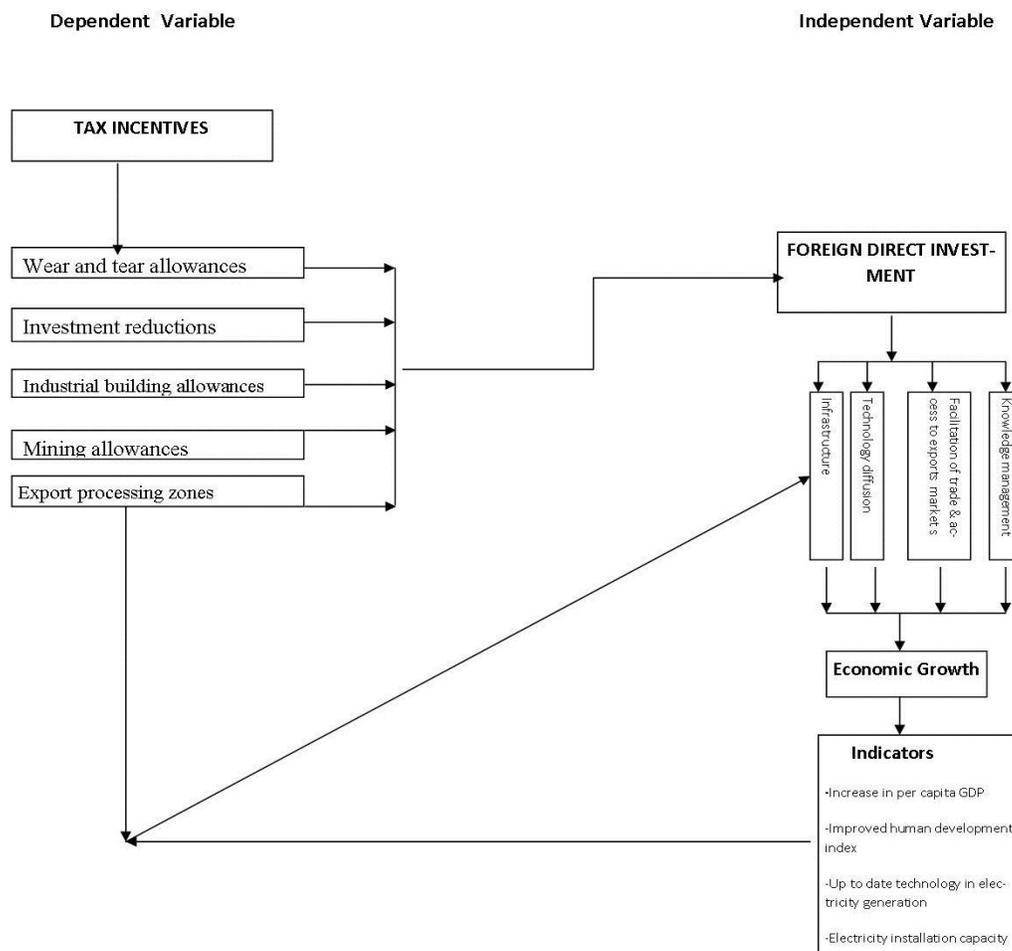


Figure 2.1: Conceptual Framework

2.6 Summary of the Literature

By reviewing the literature, it can be concluded that existing empirical works related to tax incentives and FDI inflow that in some circumstances tax incentives do not affect investments while considering it vital to investors. This is because tax incentives are found to be costly and are on odd occasions regarded as key investments determinant. Furthermore, the evident to show how tax incentives are better placed to promote investment than the simple moderate rates of taxation is scarce or biased.

Moreover, most of the studies which have investigated the impact or relationship of tax incentives on/and investment have not taken the empirical approach rather than they have widely a case study approach. Generally, tax incentives greatly play a significant role in attracting FDI in developed countries where most of the studies have been carried out. The study result shows that tax incentives attract growth in FDI's after using series analysis of FDI data and ROI as GDP percentage. Nevertheless, there is a research gap on the same in developing countries. By reviewing the literature, it is affirmed that tax incentives in developing countries have a stake in depriving their governments their needed revenue set for development.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter details the research methodology that was applied in the study to examine the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. It focused on the research design, population, data collection methods and data analysis.

3.2 Research Design

The study adopted a descriptive design. According to Robson (2002), descriptive study represents a perfect profile of persons, proceedings or situation. Descriptive study also describes the prevailing states and attitudes through observation and interpretation techniques. Descriptive research design is one of the best methods for conducting research in human contexts because of portraying accurate current facts through data collection for testing hypothesis or answering questions to conclude the study (Chandran, 2004).

Through use of descriptive and inferential statistics, thus this design deemed the best design to fulfill the objective of this study. Descriptive research design is more appropriate because the study sought to describe the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya.

3.3 Population

Statistically, population refers to the specific population from which the needed information is obtained. According to Ngechu (2004), a population comprises of a distinct set of people, services, elements, and events; alongside group of items or households that are being investigated. The study analysed 50 listed multinationals in Kenya. The selected companies were found to be comparatively uniform in regards to capital structure since a standard measure is adopted during listing by Capital Market Authority (CMA). As such, the study used simple random sampling to draw a representative sample of 10 out of the 50 listed multinational firms in Kenya. The study collected data relating to tax incentives and investments from years between 1995 and 2015.

3.4 Data Collection

The study collected secondary data. A time series data covering period of twenty years (1995-2015) was collected. This included percentage changes in FDI inflows; total revenue lost by the government through tax incentives during the sample period. A comprehensive data collection method was used to capture relevant information. The secondary data was obtained from financial statements of specific MNCs, KNBS and KRA reports and previous studies both published and unpublished

3.5 Data Analysis

The data collected was entered into Statistical Package for Social Sciences (SPSS) Version 22.0 which aided in the data analysis. Both descriptive and inferential statistics were adopted for the study. Descriptive statistics included frequency distribution tables and measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies. The relationship between the dependent variable and the independent variables were determined by the regression analysis. The analyzed data was presented using tables, charts and graphs.

3.5.1 Analytical Model

The study further adopted the following regression model to establish the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. The equation took the following form;

$$Y = \beta_0 + \beta_1 \chi_1 + \beta_2 \chi_2 + \beta_3 \chi_3 + \beta_4 \chi_4 + \beta_5 \chi_5 + \epsilon$$

Where Y represents percentage change in FDI inflows

χ represented percentage change in tax incentives.

χ_1 = Percentage Change in Wear and Tear Allowances

χ_2 = Percentage Change in Industrial Building Allowances

χ_3 = Percentage Change in Tax Exemptions

χ_4 = Percentage Change in Corporate Tax Rates

χ_5 = Percentage Change in Investment Deductions

β_0 = Constant

β_1 = Coefficient of X1

β_2 = Coefficient of X2

β_3 = Coefficient of X3

β_4 = Coefficient of X4

β_5 = Coefficient of X5

ϵ = Error or random term

The study used t-test to test the hypothesis that tax incentives are negatively related to FDI Inflows of listed multinational corporations in Kenya leading to revenue loss by the government. Furthermore, R square test and ANOVA test of hypothesis was also computed. The tests were conducted on tax incentives and FDI variables during the period

of 1995-2015. The Pearson Correlation explained whether the relationship between the dependent and the independent variable is high or low, positive or negative. This gave a statistical strength on the relationship between tax incentives and FDI inflows. This was revealed by the value of the 95% to reject or accept the null hypothesis. The t-test was computed to test hypothesis that tax incentives are negatively related to FDI Inflows.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the analysis of data findings on the relationship between tax incentives and Foreign Direct Investments (FDI) inflows. Hence, both the descriptive statistics and the inferential analysis are presented to establish the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. All of the data that will be presented in this chapter will be processed using Statistical Package for Social Sciences (SPSS).

4.2 Statistical Summary

The study sought to determine the relationship between tax incentives and foreign direct investments inflows of multinational corporations in Kenya. Thus, this section analyzes the summary of statistics used to make an inference on the relationship.

Table 4.1: Distribution by industry

Sector	Frequency (F)	Percentage (%)
Agricultural	1	10
Banking	1	10
Commercial & Services	1	10
Automobile & Accessories	1	10
Insurance	1	10
Investment	1	10
Manufacturing & Allied	4	40
Total	10	100

Judging from the table above, it is evident that data was collected from various sectors. Major consideration has been ascribed to the manufacturing and allied sector since this sector is biased in terms of major investment tax allowances. In order to give a comprehensible view, the same data is presented in figure 4.1 in form of a pie chart.

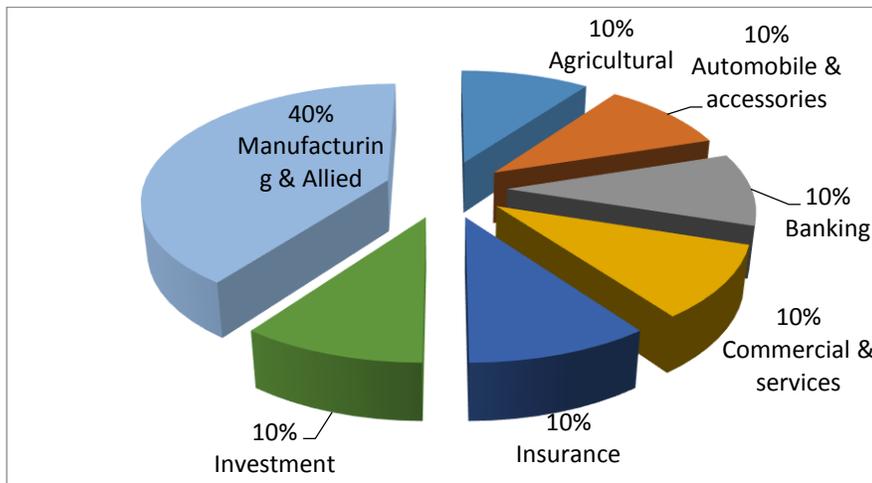


Figure 4.1: Distribution by industry

This study was set to find out the impact of tax incentives and Foreign Direct Investments (FDI) inflows of multinational corporations in Kenya. To have a deeper understanding of the study objective, the researcher sought to find out what tax incentives that are available for the organizations in Kenya.

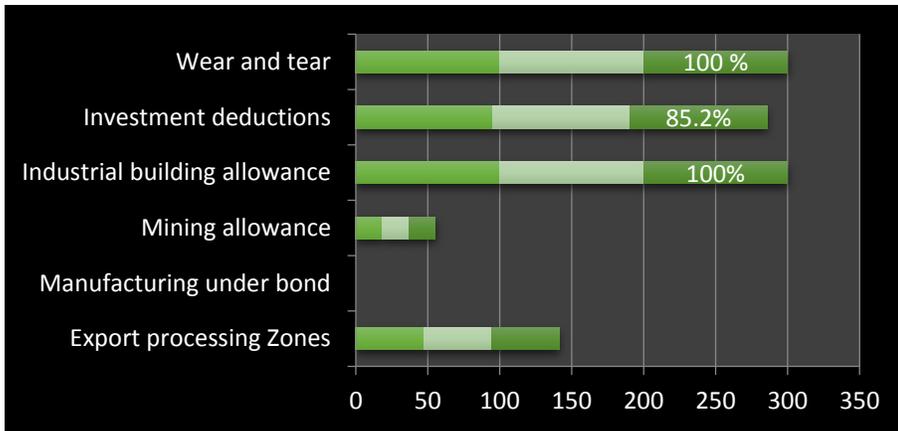


Figure 4.2: Tax incentives available for Multinational Corporations in Kenya

It is apparent from the figure above that an overwhelming majority of the companies studied (100%) claimed wear and tear and industrial building allowances as well as 85.2% of the companies claiming investment deduction. However, no observations were made on export processing zone, manufacturing under bond and mining allowance.

The researcher intended to find out further the level of FDI inflows for the organization during years 1995-2015. The figure below shows the change observed.

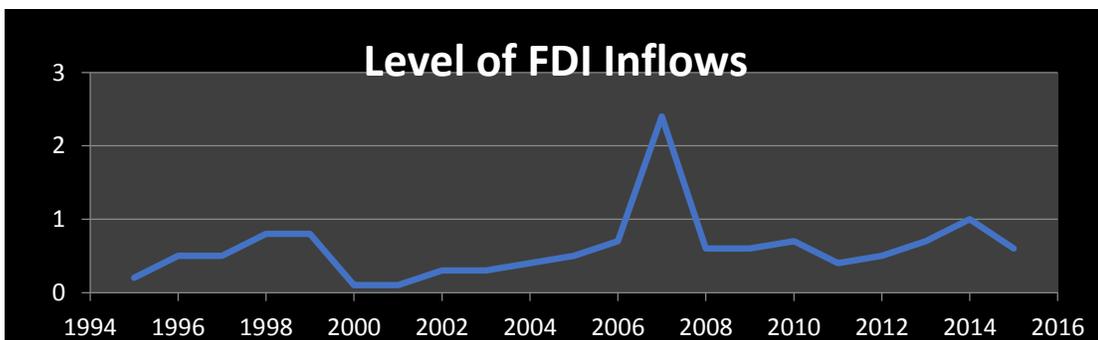


Figure 4.3: Percentage change in the level of FDI inflows

From the indications of the figure above, minor fluctuations on level of FDI inflows is observed but the trend has overall remained the same. However, there was a sharp increase in 2006 ranging from 2.4%, probably owing to Wear and Tear allowances and industrial

building allowances. From 2000, multinational companies in Kenya witnessed a small improvement in attracting FDI inflows. It is argued in the literature that tax incentives fail to counterbalance effectively due to unattractive investment climate conditions such as poor infrastructure, small markets, poor governance, security and rule of law as well as macroeconomic instability. In 2007, new reforms were enacted and Vision 2030 was founded and as a result, a special focus on attracting more FDI (such as improved infrastructure and incentives development) was reached by the government. On that note, the figure above shows a significant growth of FDI inflows from year 2007 onwards after implementation of reforms. Hence, the upsurge in FDI from 2000-2007 can be explained by privatization of companies or by emergence of new investments companies in mobile telephone during that time.

Furthermore, this study also sought to find out how much did the organizations claim for the following tax incentives, between years 1995-2015. The table below summarizes the findings.

Table 4.2: Percentage change in tax allowance claims

	Wear and tear	Investment deductions	Industrial building allowance	Mining allowance	Manufacturing under bond	Export processing zones
1995/96	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
1996/97	-0.02454	-0.0015	-0.0005	0.0000	0.0000	0.0000
1997/98	-0.2406	-0.2306	-0.7374	0.0000	0.0000	-0.0230
1998/99	3.0335	-1.4025	-1.0025	0.0000	0.0000	0.0000
1999/2000	3.4150	1.5850	-1.7750	0.0000	0.0000	0.0000
2000/01	-0.7546	-1.352	-1.6174	0.0000	0.0000	0.0000
2001/02	2.4115	-0.7401	-0.7892	0.0000	0.0000	0.0000
2002/03	2.0025	-2.0155	0.9025	0.0000	0.0000	0.0000
2003/04	-1.3110	-0.3150	-0.3150	0.0000	0.0000	0.0000
2004/05	4.7806	3.7806	3.7106	0.0000	0.0000	0.0000
2005/06	-1.0025	2.0015	1.0025	0.0000	0.0000	-0.0320
2006/07	4.3150	1.2250	-0.3150	0.0000	0.0000	0.0020
2007/08	-2.0216	-1.4632	-0.2015	0.0000	0.0000	0.0000
2008/09	-0.7806	-0.7806	-0.7806	0.0000	0.0000	0.0000
2009/10	1.0025	0.1025	-0.1125	0.0000	0.0000	0.0000
2010/11	0.1150	-0.1150	-0.3150	0.0000	0.0000	-0.3200
2011/12	-0.7806	-0.7806	-0.7806	0.0000	0.0000	0.0000
2012/13	2.0025	1.0025	-0.025	0.0000	0.0000	0.0000
2013/14	3.3150	3.3150	3.3150	0.0000	0.0000	0.0000
2014/15	2.4002	1.3632	1.6105	0.0000	0.0000	0.0000

The data from the above table shows that the most of the years 1995 to 2015 translated less than one percent average change in tax allowances. The occurrence is mainly attributed to a fix rate on capital allowances that are claimed during an asset life span. Hence, revenue losses due to investment deduction was highest in 2004/05, Wear and Tear was highest in 1998-2000, 2006/ 2007 and 2013/14 respectively. Whereas industrial building allowances was highest in 2013/2014. However, export processing zones; manufacture under bond and mining allowances did not show alluring changes throughout the study period. Afterwards the researcher needed to know the reported return on investment for the years 1995-2015.

Table 4.3: Average return on investment

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Mean	4.8656%	4.3999%	5.2204%	5.4641%	3.9256	4.3069%	5.6785%	6.0056%	5.3036%	5.011%
					%					
Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Mean	6.2251%	4.6785%	5.8856%	5.3069%	6.004%	5.4651%	6.6785%	5.1456%	6.3069%	6.8408%

The return on investment (ROI) is mainly the investor’s benefit or profit from an investment course or resource. There is clarity on the table above which depicts significant levels of investment between the years 1995-2015. An increase in total assets of firms studied would have been observed if there were good investments during this period of study. Hence, as a result of increase tax allowances, reduction in profit after tax would have been observed. On the other hand, the average return on investment rate across the period could have in turn been affected. Still, this observation could be affirmed irrelevant if there could be uniform additional investments across the organizations whereby such an occurrence translates a possibility of compensating error. The graphical trend of ROI is presented in the figure below; the range varies between 4% and 6.8% respectively.

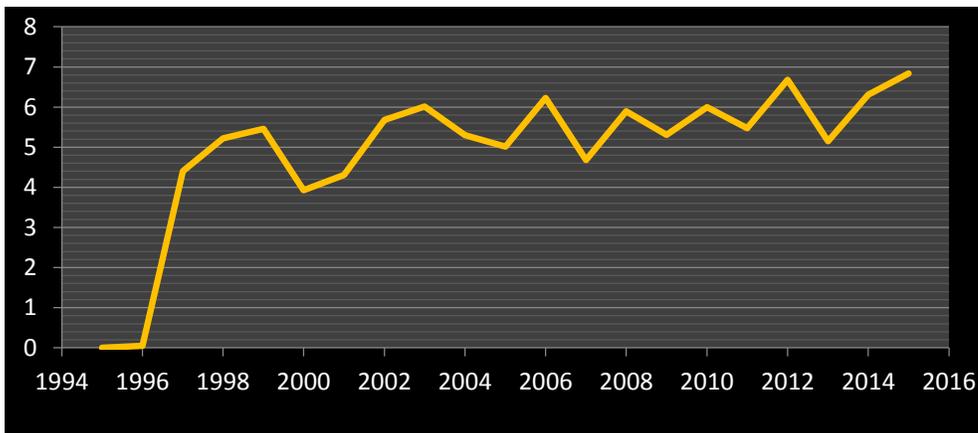


Figure 4.4: Average Return on Investment

Furthermore, it was important for the researcher based on preliminary analysis using available data to find out the extent which tax incentives has impacted on FDI inflows. The following were the indicators: Not at all, less extent, moderate extent, large extent and very large extent. The table below summarizes the findings.

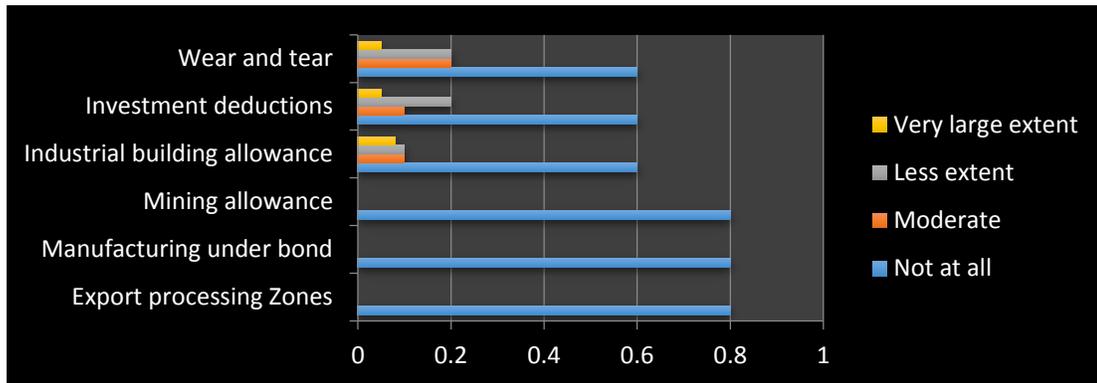


Figure 4.5: Extent of tax incentives contribution towards FDI inflows

From the findings on the extent which tax incentives has impacted on FDI inflows, the figure 4.5 above illustrate that FDI inflow facet was not triggered by mining allowances, manufacturing under bond and export processing zone. Whereas; wear and tear, investment deductions and industrial building allowance have all contributed to large extent or moderate extent towards FDI inflow during the study period. It is under-stable that tax incentives are likely costly and are rarely the key determinant to investment. Hence, judging from the figure above, tax incentives may have promoted the investment during the study period, however, there is no clear data to prove that discriminatory tax incentives are better placed to attract investment than a moderate taxation rate. The study results indicate that the latter is preferable and depreciation is likely to be more efficient if tax incentives are to be used.

4.3 Estimated Model for Impacts of Tax Incentives on FDI Inflows

Table 4.4: Descriptive statistics

Variable	Mean	Standard Deviation	N
FDI	4.8324	0.6621	20
Wear and tear allowances	0.7120	0.1990	20
Investment deductions	0.5167	0.0679	20
Industrial building allowances	0.8860	0.0541	20
Mining allowance	0.0000	0.0000	20
Manufacturing under bond	0.0000	0.0000	20
Export processing zones	0.02016	0.02010	20

Table 4.5: Pearson Correlation

Pearson Correlations	FDI	Wear and tear allowances	Industrial building allowance	Investment deductions
FDI	1.00000	0.54654	0.56632	0.476217
Wear and tear allowances	0.54654	1.00000	0.056321	-0.31200
Industrial building allowance	-0.56632	0.056321	1.00000	0.296142
Investment deductions	-0.476217	-0.31200	0.296142	1.00000

Table 4.6: t test value

Tax incentive	t	df	Sig. (2 tailed)	Mean difference	95 % confidence interval of the difference Lower	Upper
Wear and tear allowances	0.58200	3	0.9147	0.44562	-0.4820	2.9564
Industrial building allowance	-0.05810	3	0.4896	0.2551	-1.4820	2.1667
Investment deductions	-2.21420	3	0.29229	-0.0636	-1.3295	0.2410
FDI	3.44460	3	0.3856	0.6862	-0.5862	1.4124

Table 4.7: ANOVA table for testing hypothesis

Model	Sum of squares	df	Mean square	F	Sig
Regression	28.25800	2	14.12900	124.5211	0.4600
Residual	0.1420	1	0.0710		
Total	28.4000	3			

Table 4.8: R square table for testing hypothesis

Change statistics							
R	R square	Adjusted R square	Std Error of the estimate	R square change	F change	df	1
0.622	0.0622	0.07	0.05921	0.0622	124.521		2

4.4 Results Discussion

This section discusses the estimated model used to test the relationship of the variables. They include wear and tear, investment deductions, industrial building allowances, export processing zone, mining allowances and manufacturing under bond.

4.4.1 Wear and Tear Allowances

From the correlation model, there is a positive relationship between Wear and tear allowances and FDI inflows. This is an indication that the period of study (1995-2015) FDI inflows of multinational corporations in Kenya was a result of attraction from wear and tear allowances; a correlation coefficient of 0.54654 confirms this relationship. These results are supported by prior findings that revealed that 100% of the firms studied claims wear and tear allowances. On the other hand, a t value of 0.58200 which falls with the lower and upper limit at 95% confidence level is indicated by a test of hypothesis that wear and tear allowance has less impact on attracting FDI inflows. As such, it rejects the null hypothesis.

4.4.2 Investment deductions

From the correlation model, there is a negative relationship between investment deductions and FDI inflows. A correlation coefficient of -0.47621 confirms that the two variables doesn't have direct association. A t value of -2.2142 which falls outside the 95% confidence interval level is presented by investment deductions. Hence, it can be accepted -null hypothesis that an investment deduction has less impact on FDI inflows of multinational corporations in Kenya.

4.4.3 Industrial Building Allowances

From the correlation model, there is a negative relationship between investment deductions and FDI inflows. A correlation coefficient of -0.5663 confirms that the two variables doesn't have direct association. A t value of -0.0581 which falls outside the 95% confidence interval level is presented by investment deduction. as such, it reject the null hypothesis that that industrial building deduction has less impact on FDI inflows of multinational corporations in Kenya.

4.4.4 Other estimated Relationship Models

There was no significant information from the sample studied that could be used to Measure the impact of export processing zones and mining allowances on FDI inflows of multinational corporations in Kenya. This could be attributed to the reason that there are few firms operating at EPZ zones and there are few mining companies in Kenya respectively.

4.4.5 Foreign Direct Investment Inflows

A t value of 3.4446 which falls within the 95% confidence interval level is presented by FDI inflows. As such, these findings indicate that indeed tax incentives have an impact on FDI inflows of multinational corporations in Kenya. Thus, this rejects the null hypothesis that a tax incentive has less impact on FDI inflows. This observation is also tested and confirmed by the ANOVA test and R square.

CHAPTER FIVE

SUMMARY AND CONCLUSION

5.1 Introduction

This chapter presents the summary of the findings, conclusions, recommendations and suggestions of further research of this study on the relationship between tax incentives and Foreign Direct Investments of multinational corporations in Kenya.

5.2 Summary

The main objective of this study was to determine the relationship between tax incentives and Foreign Direct Investments multinational corporations in Kenya. The research design used in this study was a descriptive research design. The key data collection instrument that was used in this study was the questionnaire. The collected data was analyzed using both quantitative and qualitative data analysis approach.

From the analysis, the following key findings were made:

An overwhelming majority of the companies studied (100%) claimed wear and tear and industrial building allowances as well as 85.2% of the companies claiming investment deduction.

Minor fluctuations on level of FDI inflows are observed but the trend has overall remained the same. However, there was a sharp increase in 2006 ranging from 2.4%, probably owing to Wear and Tear allowances and industrial building allowances. From 2000, multinational companies in Kenya witnessed a small improvement in attracting FDI inflows. The years 1995 to 2015 translated less than one percent average change in tax allowances. The occurrence is mainly attributed to a fix rate on capital allowances that are claimed during an asset life span.

There is clarity on the table 4.3 which depicts significant levels of investment between the years 1995-2015.

Revenue losses due to investment deduction was highest in 2004/05, Wear and Tear was highest in 1998-2000, 2006/ 2007 and 2013/14 respectively. Whereas industrial building allowances was highest in 2013/2014.

From the correlation model, there is a positive relationship between Wear and tear allowances and FDI inflows. This is an indication that the period of study (1995-2015) FDI inflows of multinational corporations in Kenya was a result of attraction from wear and tear allowances; a correlation coefficient of 0.54654 confirms this relationship.

A t value of 3.4446 which falls within the 95% confidence interval level is presented by FDI inflows. As such, these findings indicate that in deed tax incentives has an impact of FDI inflows of multinational corporations in Kenya in overall.

5.3 Conclusions

The research findings outlined for investigation in this study has been adequately answered. It is evident that there is a positive relationship between tax incentives and FDI inflows of the multinational corporations in Kenya. Nevertheless, during the period of the study (1995-2015) various sectors were embedded to very low level of significance on average FDI inflows compared to tax allowances. As such, tax incentives cost benefit analysis available to various sectors of the economy should be conducted. The revenue forgone by the government through tax exemptions and allowances should be exceeded by the benefits accrued in terms of increase in level of investments.

It is a fact that Kenyan government to introduce tax incentives was largely aimed at attracting investment, Foreign Direct Investment as well creating employment. However, to ascertain the net benefit of such programs, no cost and benefit analysis study has ever been undertaken. According to World Bank Investment Climate Advisory Services (2009), many developing countries, tax incentives lacks to effectively offset unattractive investment climate conditions such as security and rule of law, weak governance, poor infrastructure, macroeconomic instability and small markets.

Even though the research findings has proofed that tax incentives have an impact of FDI inflows of multinational corporations in Kenya, analysis of percentage change in FDI inflows between years 1995 – 2015 contradict the results. An insignificant range - 0.01% to 0.58% was observed. This depicts that FDI inflows are affected by other factors apart from tax incentives. Probably, these could be social, security and political stability of the investment destination. Therefore, by ensuring security and political stability and also improving on infrastructure, it is a government responsibility to ensure that the investment environment is favorable.

5.4 Limitations of the Study

As suggested by the literature review, the impact of FDI inflows is sophisticated and relies on multiple complex situations. Thus, extensive empirical research is needed to quantify the impact of taxation policies alongside major scenarios determining location decisions of FDI. Even though the current study focused on quantifiable factors only, which included tax incentives ROI and FDI inflows trends between years 1995 -2015, it is evident from research findings that other unquantifiable factors that attract FDI inflows exist.

It's difficult to accurately estimate the response of the FDI to the host country's taxation levels, a scenario where tax and non-tax factors in different locations need to be collectively analyzed , considered, and the prospect that the FDI tax elasticity may vary considerably across business activities, host countries and time, therefore creating a deferment bridge for policy-makers and academic researchers alike.

5.5 Recommendation for Further Research

By undertaking another research to ascertain empirical outcomes of already existing incentives, the evidence based tax incentives given that tax incentives erode the tax base. This is because tax incentives in Kenya are introduced through lobbying and in an adhoc manner. Further research is ideal for reviewing and assessing whether they have accomplished the purpose for which they were introduced in order to ensure relevance and effectiveness.

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Appendix I :10 Multinational Corporations in Kenya

British American Tobacco

Coca-Cola Company

Sameer Group

Bayer East Africa

Total

Standard Chartered

Rockefeller Foundation

ICAO

Unilever

Trans-Century Ltd