

**ASSESSING FACTORS CONTRIBUTING TO THE LOW LEVEL OF INVESTMENT
(IN CASE OF WOLKITE TOWN INVESTMENT)**



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ABSTRACT

Investment is very essential to mobilize human and natural resource to more productive efficient and effective utilization of available resource by allocating them in investment activity. So the government of Ethiopia has given much concern to this activity. However, this activity is in its low level in the country and in one of the urban center, wolkite town. For this reason, the purpose of this research paper is to assess the factors responsible for the low level of investment activity in the town. The source of data includes both primary and secondary method of data collection secondary data obtained by conductive structured questionnaire on private investment in the town and oral questions for the manager of service office of the town. The study used descriptive analysis in analyzing investment climate of the town and qualitative data of the survey made on investors in wolkite town administration. The questions include information about investment type in the town, promotional activities on investment opportunities and incentives given for investors by the governmental bodies, problems faced investors and possible solutions to alleviate problems in the future. The secondary data collected from written materials available in investment office The results showed that poor infrastructure, high level of tax and initial investment fee and corruption were the most serious problems hindering private investment in the town. For achieving improvement and progress, the city administration should tackle corruption, improve infrastructure and eliminate factors that diminish expectation of return of investors. Finally, the data obtained from primary and secondary source analyzed, through inferential methods

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CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Investment is a commitment of money or purchasing financial instrument or other in order to gain profitable return in the form of interest income or appreciation of value of instrument in the contemporary world, the main goal of every nation has become economic growth and development. And the route through which this objective can be realized is by making use of one's available resource and capacity to rewarding (productive) investment.(Lawrence J.gatman and Michael D.Joebonk) Thus, investment is a key to economic growth and development. Several studies such as Barro and Lic (1994) and Hernandez (2000) have established the critical linkage between investment and rate of growth based on the research they have conducted in Africa, Asia, and Latin America.

Investment has a very crucial role for accelerated and sustainable growth and development. As we know from aggregate expenditure function which includes consumption, private investment, government expenditure, and the net exports, investment is the second largest element of aggregate expenditure representing GDP (kuris, 2003).

Ethiopia, having recognized the immense contribution of investment in economic development and transformation of the country, has been exerting a big effort in promoting and accelerating investment. Following the adoption of investment proclamation number 14, 1992, the Ethiopian government offers a great political support for investors (Lensa, 2011).The role of investment to the development of a nation is very large. Investment increases the productive capacity of an economy. It is a very important to utilize untapped resource to create job opportunity for citizen, to increase foreign currency through import substitution and export promotion of a nation and facilitate the communication and cultural exchange of society. In our country there is huge amount of idle resource which is not mobilized to investment activity due to inefficient and infective utilization of resource which results in low level of income. (investment magazine,2002 EC),

Because of low level of income it is difficult for the people to allocate there in come for investment activity out of their consumption. To develop the investment activities in urban areas, facilitation of the infrastructure facilities, ownership right policy, identification of potential investment opportunities, access of information about investment activity, given incentives and promotion of investment opportunities for investment are very essential steps to be undertaken (Fantun Melles, January 2004).

1.2. STATEMENT OF THE PROBLEM

Investment is very essential to mobilize human and natural resource to more productive, efficient and effective utilization of available resource by allocating them in investment activity. It is also important to produce goods and services and create employment opportunities for the society. (Lensa Nigatu, 2011)As investment plays a great role in economic development, the government of Ethiopia has given emphasis concerning this activity. Its purpose was to develop the investment activity by giving major incentives for investors and promotion of investment opportunities both for domestic and foreign investor so as to increase the number of participants in this activity. ,(Befekadu Degefe and Berhanu Nega,1992) But due to social, political and economic constraints this activity has not show a remarkable development in wolkite town.(agriculture service office) Some research finding (Lensa nigatu, 2011Abebe, sobeka 2013) on promotion of private investment is concluded that, investment is constrained by the macro and micro economic determination, human capital base weaker and less diversified economies. But, this study cannot explain the inadequate and deteriorating infrastructure and poor institution. Additionally there is another problem come up and no solutions gained. All economic sectors and other related investment activity are not expanding as much as expected. This factor result to study the factor affecting investment expansion in the town and in order to identify the factor that affects investment activity in the town

To improve the living standard of the society, capital allocation on different sectors of economic activity is important to mobilize the available resources to more productive activity. For this purpose,wolkite town has good investment opportunity due to the availability of special agricultural product ginger, natural resource cool and its favorable strategic location owing to proximity and as a junction. But due to lack of significance study to identify this opportunity and to investigate its impact on economic development, the investment activity in the town is very limited.

Due to absence of significance efforts to enhance the investment activity, there are many developmental problems and promotional activities for investors, corruption and administrative influence; infrastructures problems like social service, and inadequate power supplies; and economic constraints like lack of loan service and high taxation. Identification of this cause for low level of investment is very important to develop this activity in the future.(agriculture service office)This study analyzed factors responsible for the low level of investment in wolkite town and indicated what should be done to enhance this activity.

Specific problem reported in wolkite town are Shortage of capital in the town, lack of skill man power to utilize resource effectively and Lack of government support to investment activity in the town.

1.3. RESEARCH QUESION

1.What are the factors for low level investment in the town?

Factors that affect investment activity in wolkite town are

✓ **institutional problem**

- problem of access to land
- lack of advisory and consultation service
- lack of promotional activities and incentives
- lack of major incentives for investors

✓ **Economic problems on investment activity**

- Lack of capital (loan service)
- High level of taxation

2.What is the role of government in achieving investment expansion in the town?

Role of government in achieving investments expansion are

- It gives access to land
- It provides promotional activities and incentives
- It provides loan service
- It reduces taxes
- It provides subsidy

3. What are the motives of investors in the town?

✓ **The motives of investors in the town are**

- Availability of natural resource
- Cheap semi-skilled and skilled labour
- Availability of high infrastructure
- Availability of creative assets

1.4. OBJECTIVES OF THE STUDY

1.4.1. GENERAL OBJECTIVE

the main objective this study was to It is to assess the factors which have contributes to the low level of investment in wolkite town

1.4.2. SPECIFIC OBJECTIVE

- Analyze factors responsible for the low level of investment in the town.
- To identify government role in achieving investment expansion in the town
- To evaluate how the investors are motivated to invest.

1.5. SIGNIFICANCE OF THE STUDY

The main relevance of this study lies on the fact that it would improve the economy of the study area in particular and that of Ethiopia in general by improving investment through understanding the investors' characteristics. Also, since the fight against poverty and the need of transformation cannot be realized by ignoring investment, the study would investigate factors that promote or hinder investment, for investors to participate investment alternative found in the town and its surroundings, Lastly, the study would be a stepping stone in the area and would be a good input for future researchers to study the topic by including wider geographical area as well wider concepts

1.6. SCOPE OF THE STUDY

This research was conduct in wolkite town to assess challenges and fertile condtion for private investment. In order to collect information by primary and secondary data, the study covered different populations. This population includes private owners in the town, governmental and nongovernmental organization. wolkite town service office is included in the study and supplementary information had been collected. It helps to know governmental supporting for investment activity in the town by giving major incentives and promotion of investment opportunities through different promotional methods.

CHAPTER TWO

LITERATURE REVIEW

2.1. THEORETICAL LITERATURE

The term investment refers to a sum of funds committed on the physical and human cavity by both profit and no profit oriented individuals and institutions. It is applied to production of goods not meant for immediate consumption but further production of goods such goods are called, investment goods. The investment of business firms usually comprises of capital goods and inventories (Baddeley 2005).

Many scholars defined investment in different way. Herfert (1997) has defined investment as a fixed and initial operating resource used for the production of goods, the provision of services and the development of science and technology capacity. Gitman (1997) defines it as a sizable outlays of funds that commit a firm to some course of operation, the firm lies on specific procedures to analyze and select those investments properly. In economics, investment can be defined as the purchase of plant, equipment or inventory. In lay terms investment is the acquisition of an asset such as a stock or a bond (Hprnet B.Mayo).

Once an individual receives income, there are two choices: to spend or to save it. Regardless of how you use your income, investment can be defined as post – pond consumption (R.stephen sears, 1993). Individuals may postpone their current consumption to accumulate for the sake of accumulating. For any or all of these reasons individuals save part of their income rather than spend all of their income.

The above analysis shows that investment has a strong relationship with saves in come. But the extent of investment also depends on the level of consumption. As mayradl observes “there is no other road of economic development than a compulsory rise in the share of the nations income which is withheld from consumption. In an economy where living standard of the masses is too low, to curb consumption, it is difficult to mobilize and allocate resource in to investment activity.

Harrod-Domar growth model can be used to predict the role of foreign capital inflows on growth. The model assumed that saving depends on income via the marginal propensity to save and that

investment is a constant ration of capital. The positive difference between investment and saving equals current account defecit. Harrod – Domar model predicts a positive relationship between the foreign aid and investment. That is to supplement the internal resources through foreign aid; investment should be increased to under developed economy.

As investment activity is affected by social, political and economic condition, there are some criteria have to be considered before starting investment activity. Shamunis (1998) said that before starting investment activity, one investor must know and analyze in what area he is going to invest, the available funds he/she has for investment, the economic and political situations and profitability. In addition, an investor should know the advantage for the society. That is the quality and quantity of goods and service to be produced, employment, export and utilization of natural resources.

2.2. THEORIES OF INVESTMENT

There are many theories of investment that discussed such as classical, keynessian, Neoclassical, Accelerate and other theories of investment.

2.2.1. CLASSICAL THEORIES OF INVESTMENT

The classical school argued that capitalist make investment because capitalist make profit in the future depends on what profit are now. For example, Adam smith in his book “ the wealth of nation “ elaborated this fact by arguing that, investment were made because the capital expected to earn profit on invested capital depending up on the present climate of investment as well as actual profit. However the rate of profit tends to full with economic progress, when the rate of which capital accumulated increase completion among capitalist, raise wages and tends to lower profit and hence investment (Jhingon, 1988).

2.2.2. NEOCLASSICAL THEORY OF INVESTMENT

For the neoclassical theories, the marginal benefit of investment can be represented as addition to future expected output that will be accured, with investment capital stock; the marginal cost can be represented by the cost associated with buying and renting an additional unit of capital. The desired level of capital is positively related to the rented cost of capital which is inturn depending on real interest rate. (Dornush, 1994).

2.2.3. KEYNESIAN THEORY OF INVESTMENT

The theory of investment behavior goes back to Keynesian (1936) General theory who first called attention to existence of an independent investment decision function in the economy. He observed that investment depends on the prospective marginal efficiency of capital relative to some interest rate that is reflective of the opportunity cost of investment fund. He further there pointed out that because the rational assessment is volatile. He described this volatility of expectation by saying that investment decision depends on the private investors or entrepreneurs optimism or pressurizing about the future, (serven L and Andres soliano, 1992).

2.2.4. ACCELERATE THEORY OF INVESTMENT

The accelerator theory postulated linear relationship between investment and output. According to this theory, given an investment requirement associated with a given target for output growth. That means a change in the rate of growth of income produced a magnified change in investment. As in come falls, investment falls quite significantly and arise in income result in arise an absolute level of investment (Dornbush and Fisher, 1994)

2.2.5. TOBIN'S "Q"THEORY

In the" theory of investments associated with Tobin (1969), the ratio of market value of an existing capital stock to its replacement cost (the 'Q' ratio) is the main force driving investment. Tobin argues that, delivery laps and increasing marginal cost of investment are the reason why Q would differ from unity.^a

^aAccordingly, the firm decides whether to invest or not depends on the values of Q. If the market value of capital is greater than its replacement cost i.e. when $Q > 1$, investors decides to invest and vice versa (Mankiw, 2003).

2.3. INVESTMENT AND ECONOMIC DEVELOPMENT

Investment activity is central to promotion of economic well being because it is one of the most important economic activities that consumers, producers and business can undertake. Investment also has an important influence an employment and today determines economic activites of tomorrow by building up resource of capital that will be used to produce goods and services (Mc Baddely, 2003)

2.3.1. DETERMINAT OF INVESTMENT

What determine the level of investment is highly continuous and emphasized topics in economics. Investment spending depends on the economic, social and political situation of a country that affect the return, but such a favorable condition is often lost for most developing countries in realizing this, there is growing interest in the countries on the factors that influence the pattern and level of the private investment activities and the same factors is identified.

According to Samuel son (1989), Investors invest more that will enable them to earn profit. According to him there are three (3) main determinants. These are revenue that is an investment will bring more product which leads to encourage investors less and other wise it discourage. The second one is cost which is interest rate and government taxes. As it is obvious investors invest by borrowing of funds and if the interest rate is higher it discourage investment. The third one is execrations were the investors predict about the future return of investment and if its prediction is positive this will encourage him or if its prediction is negative on its return this leads to discourage.

2.3.2. DEVALUATION

The principle component of **IMF-WB** package for poor nation's currency devaluation is criticized of ridiculing private investment. Real devaluation is an expenditure reducing and switching policy and thus affects investment through various channels. Real devaluation increase the level of foreign price measured in domestic currency and thus the price of traded goods relative to non-traded goods in the domestic economy depressing term of trade and investment (at least) in non-traded goods sector. Mlambo and Oshikoyo elaborated the above statement in 2001. (Alemayhu,eta'al,2004:92)

To reduce external inbalnce stractural adjustment program use acombination of expenditure reducing and expenditure swiching policies. Areal devaluation of acuntries currency (i.e a fixed exchange rate system) is usually included in switching policies. This generally had negative effect on investment in the short run.

Devalution may also reduce investment by depressing aggregate demand. More over it investment has asiginificant import contex. The expansion out put likely to be neccary conducts to expand investment (N.Gregory Mankiw 2007).

The important, concepts of investment are

Economic investment

Commitment investment

Financial investment

Economic investment : means that the net additional to the capital stock of the society which consists of goods and services that are used in production of other goods and services.

Commitment investment: refers to money commitment to satisfy person desire. Since no rate of return is expected.

Financial investment : involves the investment of funds in the various assets like stocks, bonds, real estate, mortgages (Brhanu 1999)

Elements of investment

Elements of investment are those which are common in investment activity. These are return, risk and time.

Return:- refers to reward from investment which includes current income, capital gain or losses and profits.

Risk:- is the change when the expected or prospective gain or profit is less than expected outcome. Or is the degree of happening of losses.

Time:- the important factor in which investment is the time which offers several different courses of action (Birhanu 1999).

kinds of investment

There are seven types of investment. There are:

Saving account: these types of investment take place by saving money in a saving at a financial institution such as banks, credit union or credit and saving associated in return of some percentage of deposit at a certain period of time usually a year.

Life insurance : it protect investors from financial disaster and for family member in case of the person dies.

Business investors engaged opration of business ventures for save of profit.

Real state : this includes investment on home land or rental propperty.

Bonds : it is debit security that allows investors to be paid periodically until the maturity date of the security.

Stock: it is a security that is accliam on the act of becoming the owner ship of the asset of the firm.

Mustal funds:- the purchase of mutal found shares which make profit to share holders(Teferl.2002)

2.4. EMPERICAL LITERATURE

There have been empirical studies by researchers to determine factors affecting investment behavior and volume of investment in Ethiopia and outside the country. The studies are based on time series data and cross sectional data. Studies on micro and macro perspectives with reference to developed and developing countries are also available.

2.4.1. STUDIES CONDUCTED IN ETHIOPIA

The World Bank (WB) and Ethiopian development research institute (EDRI)-(2004) on “determinants of private sector growth in Ethiopia’s urban industry: the role of investment climate” conducted a survey of 427 manufacturing business sampled from six regions of the country where there is a major concentration of manufacturing industries. They concluded that an empirical analysis of private sector based on firm level data, would be needed to inform a sound set of policies regarding investment climate and private sector development in Ethiopia.

Endale(2010) studied the Investment climate and manufacturing performance in Ethiopia. The data was gathered mainly from secondary source and were analyzed using descriptive and inferential statistics (OLS estimation). The research arrived at the cost and quality of infrastructure, limited financial access and poor institutional set ups are major restraints to firm performance and the econometrics result also concluded that poor infrastructural qualities, specially power interruption has a negative impact on manufacturing productivity. Finally, he

recommends that for the improvement of infrastructural services with a large emphasis to public power supply.

The research study which is prepared by Lemessa Tadese for the partial fulfillment of the requirement of BA degree in Economics program on the economic impact on one hand and social and political constraint of investment town in 2007 conclude that, activity in the town is rather small town that recently gained a higher administrative status. This low level of investment is due to absence of well qualified workers to study investment opportunities in the town and promote to investors who has a potential to investors who has a potential to invests, bureau critic system of land lease policy, high competition among investors.

Corruption can also deter investment and there by lower the economic development (Mauro, 1995). Corruption is a specific measure of illegal activities within the political system. The opportunity for corruption occurs when public officials are the gatekeeper of public goods and services.

Shaum's (1999) has set the process for evaluation and selecting long term investment in long term asset such as property, plant and equipment or resource commitments in the form of new product development, market research, refunding and replacement decisions such as replacement of existing facilities with new facilities.

Daniel (2004) has tried to model the determinant of investment in Ethiopia following the argument that investment is externally constrained in developing countries and it is affected by risk and un attained variables. The model tries to capture the effects of external financial constraints domestic and international risk variables, public investment of infrastructure and out on the private investment. In his thesis he concluded that private investment is determined by availability of finance, the real exchange rate, investment policy, debt service payment and the debt over hanging.

2.4.2. STUDIES CONDUCTED OUTSIDE ETHIOPIA

A study by harrunaissahaku (2011) on “determinants of saving and investment in deprived district capitals in Ghana: a case study of nadowli” is based on micro level approach of

estimating saving and investment in Ghana and utilized multiple regression and the data were collected using interview and questionnaire from 60 households.

The study found that value of asset of a household proportion of saving to an income has a positive impact on private investment. Thus, one Ghana cedes (birr in our case) increase in assets will lead to 0.614 increases in investment of the household. Similarly, an increase in saving of household (Ghanaian) by one cedes will increase the investment by 0.256 cedes, where both coefficients are significant in the model.

The study concluded the following points:

The factors that derive household investment are; occupation, expenditure, assets and saving.

Concluded finally, the intensification of education on family planning by the national commission for civic education and district assembly should translate into greater saving and investment.

CHAPER THREE

Methodology

3.1 INTRODATION

To achieve the general and specific objectives of the study, both primary and secondary data would be collected. Primary data would collect through structured questionnaire distributed to individuals engaged in investment activity in the town and interview questions for the manager of service office. The secondary data would obtain from written materials available in the service office of the town.

3.2. Research design

The study would focus on assessing factor contributing to low level of investment in case of wolkite town investment. The research would have used descriptive research design because descriptive study concerns with arranging summarizing and presenting numerical data in the form of table that the reader can understand easily.

3.3 Source of data

The relevant data and information's would be gathered from two main sources: Primary sources of data and secondary source of data the secondary source of data would be gathered in the form of questionnaires and interview (closed and open ended) for investors and for users of the investment as well as investment office of the town. Secondary data will be gathered from different written documents, journals, and brochures.

3.4 Data collection Tools

As data collections instrument the researcher intends to use both open ended and closed ended questions and structured interview. Structure interview. Interview give greater flexibility and opportunity to restructure questions more information in greater depth could be obtained. The questionnaire which is structured would be distributed to the target respondents.

3.5 DATA ANALYSIS AND INTERPRETATION

The study variables about investment activity that would be collect through the above methods of data collection are important to investigate their impact on investment level of the town. These include information about opportunities and types of investment, economic incentives given for investors (access of land to invest, exemption from taxes, advisory service, relatively low real

interest rate etc.), availability of finance and promotion of investment opportunities in the town for local and foreign investors through advertising, mass media, newspaper, magazine by governmental bodies to promote the investment activity in the town.

CHAPTER FOUR

4. Conclusion and Recommendation of Empirical Literature

4.1 Conclusion of Empirical Literature

The research finding from literature and empirical review show the following conclusion;

Allocation of capital on different sectors of economic activity is essential to move the available resources in to more productive. To increase the development, allocation of human and natural resources in effective and efficient manner on investment activity is very crucial aspect. Without investment it is impossible to have any development rather it remains in poverty. This is mainly seen in developing countries like Ethiopia. If there is unemployment, there will be low productivity which results in low level of income, there is poverty.

As noted by Keynesian multiplier, investment has the power to foster economic development through increased consumption and again further investment and so on.

The analysis shows that poor infrastructure, corruption and bureaucracy, high level of tax and initial investment fee are serious problems in the town were as lack of demand and market is found to be a moderate problem.

Low level of institutional capacity due to absence of well qualified workers to study investment opportunities in the town and to promote it to potential investors, to give advisory and incentives for private investors have its own limitation on this activity.

The town's low level of infrastructure facilities like, unbalance educational and health services with the town's population have also negative influence on investment activity.

In general, wolkite strategic location a proximity to the port with favorable climatic condition can be seen as an opportunity for development of new investment activity, But due to economical, infrastructures and political hindrances this activity in its low of stage in the town.

Finally, in spite of its crucial findings, this study has limitations. One among other is, this study didn't include all micro level determinants of investment in the study area due to absence of data and impossibility of being quantified. Having this limitation in consideration, the study can be used for any investment related policy of the study area.

4.2 Suggestion of Empirical Literature

- ✓ The main constraint for business activity in the town is the difficulty to easily obtain land for new investment. In this regard the land lease policy which is being used by the local authorities for implementation in the town better be handled in a manner that will contribute to the reification of local urban economy.
- ✓ To diversify the business activities, it is essential to provide sufficient information to private investors about alternative investment opportunities. And institution capacity of the town shall be strengthening to give advisory and consultation service for potential investors. In this regard it is better establish independent investment office which able to give the above service
- ✓ The role of financial sectors in private investment of the town is negligible. Financial sectors need collateral and only finance a huge investment most of the time. Here, in order to improve the investment in the town, firms should have enough and easy access to credit and to do so the policy of financial sector deepening and easing of access to credit is needed.
- ✓ As stated by several studies (Morrisset, 2000, mlambo. and oshikoya, 2001) and found by this study, infrastructure is a main determining factor for expanding private investment. Currently in the town there is a good start in provision of road, telecommunication and electricity services, but there is a great problem regarding the water supply So, the administration of the town in collaboration with concerned bodies shall urgently work in improving water supply. In this line, a study made by ErdalAtukeren (2010) shows a crowding – in effect of public investment (provision of infrastructure) on private investment and called for active work of the government body in provision of adequate infrastructure for the betterment of private investment performance
- ✓ Lastly, this research suggests that provision of investment service of the town to be out of corruption and bureaucratic red tape, since these problems will increase transactions costs and discourage individuals from investing. To do so, investment rule and procedure in the town should be revised and improved in such a way that officials could not exercise exclusive power.

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