ST MARY'S UNIVERSITY

SCHOOL OF POSTGRADUATE STUDIES

THE PRACTICAL UTILIZATION OF INVESTMENT PROMOTION INCENTIVES:

THE CASE OF WALIA STEEL INDUSTRY, SOF UMER INDUSTRY AND ASTCO FOOD COMPLEX.

BY:HANAN BEYAN

JUNE, 2016

ADDIS ABABA

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The practical utilization of Investment promotion incentives:

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By

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A THESIS SUBMITD TO ST MARY'S UNIVERSITY SCHOOL OF POSTGRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTERS OF BUSINESS ADMINISTRATION (MBA) IN GENERAL MANAGEMENT

JUNE,2016

ADDIS ABABA

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ACKNOWLEDGEMENTS

Above all, I would like to thank the Almighty God, whose strength and guidance enabled me to accomplishment this study. Then, I wish to express my deepest thanks to my advisor, Elias Nour(PhD), who dedicated much of his time in advising and encouraging me during the preparation of this study.

I would like to Thank to all the Management team of Walia steel industry, Sof Umer Terrazzo and Marble manufacturing and Astco Food Complex Factory S.C. for taking their time to respond to my questionnaires.

Finally, I take this opportunity to express the profound gratitude from my deep heart to my beloved parents, friends and siblings for their love and continuous support – Both spiritually and mentally. I also would like to thank those who have been with me and supported me on this journey.

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Lists of Acronyms

CEO	Chief Executive Officer
CTI	Corporate Tax Incentives
EPZs	Export Processing Zones
ERP	Economic Reform program
FDRE)	The Federal Democratic Republic of Ethiopia
GDP	Gross Domestic Product
IMF	International Monetary Fund
MOFED	Ministry of Finance and Economic Development
NPV	Net present Value
PLC	Private Limited Company
R&D	Research and Development
S.C.	Share Company
TGE	Transitional Government of Ethiopia
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WTO	World Trade organization

Abstract

This study examines the business environment and the practicality on the utilization of investment incentive. The purpose of this research is to examine the effectiveness of investment incentive. The study adopts a mixed methods research where primary data is collected using semi structured questionnaire from the management of three companies namely Walia steel industry, Sof UmerTerrazzo and Marble manufacturing , Astco Food Complex Factory S.C, and in addition to this secondary data was collected from various sources such, Ethiopian Investment Agency and Economic Development (MOFED). The sampling technique used was convenient (non-probability sampling).The study found that, Tax incentives cannot be an effective response to the economic or political problems that may exist in a country. Hence, the investment climate, which has a hampering effect in investment of the country, need to be checked and improved. The survey indicates that thetax system lacks simplicity and transparency in its administration. That overshadows the good range of incentives available to investors. The researcher also recommended that the existing tax incentives are worthy of attracting investment in the country. But these incentives alone cannot be as attractive as expected because of the very great influence of the business environment. Hence, improving administration of incentives and the tax system should be one area of focus.

CHAPTER ONE
INTRODUCTION

1.1. Background of the Study

In today's globalized economy, few countries can remain competitive without foreign direct investment (FDI). With the potential benefits including technology transfer, employment gains, skills upgrading, and growth, it is not surprising that many governments offer investment incentives. Governments may see such incentives as a necessary measure to compete with other host countries, and to signal government commitment to an open investment environment (Moran, 1998). Support for incentives could also arise from agency problems and the comparative ease with which incentives can be enacted (Aliber, 2001; Wells & Allen, 2001).

In terms of overall subsidies, the World Trade Organization (WTO) (2012a) reports, "available information indicates that 21 developed countries spent nearly US$ 250 billion in 2003 on subsidies. The total for the world was more than US$ 300 billion in that year."This would indicate that state and local incentives in the United States, US$ 50 billion, are almost as large as total subsidies in developing countries. In most instances, the efficacies of incentive measures are overestimated while the costs remain hidden. Overestimation of benefits is understandable. Numerous factors are behind a firm's decision to invest abroad with investment incentives playing a nuanced role, as noted by James (2009).

With this regard, Ethiopian investment law envisages the promotion of domestic and foreign investment towards the law which provides various incentives. The incentives include income tax exemption for five years, land allocation at modest leasehold rates, exemption of import duties for equipment and supplies, bank loan facilities for a significant amount of the investment cost (which may reach 70% of the investment cost) and others. Various assumptions underlie these incentives. Primarily the incentives envisage the realization of the promises embodied in investment project documents. Secondly, the incentives are meant to attract investment and in effect facilitate the attainment of the objectives embodied in Ethiopia's investment law. (Elias,2012:1)

This study analyzes the practice of investment incentive promotion and the role the business environment plays by employing primary and secondary data sources and document reviews.

The research has taken three companies from different industries namely walia steel industry, Sof UmerTerrazzo and Marble manufacturing, Astco Food Complex Factory S.C,walia steel Industry is a private limited company which was established in 2006 in the town of Alemgena with a total capital of Birr 334,510,000 with the objective of manufacturing and marketing of steel products and the industry is acquired additional 100000 square meters of land for expansion. Walia steel industry began its operating in the production of steel reinforcement bars and in the years to follow expands its operation by investing in steel pipe making technologies and start producing rectangular, square and circular hollow sections. LTZ profiles and sheet metals of various sizes and thickness. The other company is Sof Umer Terrazzo and Marble manufacturing, the company's headquarter in Addis Ababa serves expanding business opportunities and higher supply across the country. Caring two huge production sites in the city, the company registered 50 Million Birr net capital in the last year's budget year. With this asset, SofUmers accompany 50 permanent based and 105 temporary employees and from them 22 of them are women. The company has been operating for 27 years.

The third company is Astco Food complex Factory S.C which is located in south of Addis Ababa Administrative region at Debrezit Road.**:** It was established in August 20,1997 GC. With an initial Capital of birr 50 million by two brother hood shareholders(owners)& started operation on April 2004 G.C as a P.L.C.The total area of land occupied by the company is 12,000 square meters. In April 2015, a London based foreign company called KEVU Invest Ltd. Has invested in ASTCO and took 50.1% share ownership, including the previous owners with minority shares. This changed its legal status from PLC to S.C.

1.2. Statement of the Problem

Investment incentives have been around for over 100 years. In 19th century America, cities offered money to railroads in order to have the railway pass through them (Sbragia, 1996). But it was only in the late 20th century that governments around the world began offering direct grants, tax breaks, training funds, free infrastructure and other inducements to attract corporate investment. While often thought of as a competition to attract foreign direct investment, competition is equally strong for domestic firms. The most intense competition and the largest subsidies are given to well-known multinational companies who make large investments.

The widespread use of investment incentives is not a new phenomenon. In 1995, UNCTAD's World Investment Report presented a comprehensive survey of 103 countries' practices relating to their use of those tools. The survey found that incentives were generally offered both to foreign and domestic firms, were pervasively used in a range of countries and regions, and favored a variety of industries, with activities involving high-value added and technology appearing to be a growing.(UNITED ,2002:58)

Despite their prevalence and costs, the effectiveness of incentives is open to question, Ethiopian Government has been providing a wide range of incentives in order to attract both domestic and foreign direct investment. However, there are debates regarding the effectiveness of the practicality or the result. Despite the aforementioned debate, developing countries, particularly Ethiopia has continued giving incentives. This paper is aimed at contributing to existing literature/ debate by analyzing the practicality of these incentives by taking the case of walia steel industry, Sof Umer Terrazzo and Marble manufacturing, Astco Food Complex Factory s.c.

Consequently the study has focused on the practical utilization of investment incentives promotion by taking the companies mentioned and the conductivity of the business environment.

1.3. Research Questions

- How does the business environment influence the incentive packages?
- What are the different investment incentives given(provided)to investors?
- What are the practical challenges that are being observed with regard to investment incentive?
- What is the role of Ethiopian legal framework (regime)with regard to investment incentive?

1.4. Objective of the study

1.4.1 General objective

The general objective of this paper was to asses and describe the role of business environment in the practical utilization of investment incentive promotion. Hence, the aim was to see the practicality of investment incentive.

1.4.2 Specific Objective

- To identify how the business environment influence investment incentive package.
- To examine the different investment incentives that exists for investors.
- To investigate practical challenges and distribution of investment incentive.
- To examine the investment practice in Ethiopian legal context.

1.5. Significance of the study

The study intends to provide significant information to government bodies i.e. Investment Agency, policy makers, tax invectives, and its administration and also for the comments which will be forwarded at the concerned bodies ,will take constrictive comments to improve their system.

The study will shed light for future studies which will be conducted in similar topic area in the future and also it will increases the knowledge and ability of the researcher in conducting similar studies in future endeavors.

1.6. Scope/Delimitation of the Study

Study delimitation: -Even if the study area of investment is vast the paper is delimited to the practical utilization of investment incentive promotion.

Area delimitation: -The study was focused on Three manufacturing companies which are found in the region of Addis and in the town of Alemgena.

1.7. Definition of Key Terms

Foreign Direct investment (FDI):An investment that is made to acquire a lasting interest in a enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise (IMF)

Incentive: Any measurable advantage accorded to specific enterprises or categories of enterprises by (or at the direction of) government (UNCTAD)

Domestic Investor: An Ethiopian or a foreign national permanently residing in Ethiopia or foreign national but Ethiopian by birth and desiring to be considered as a foreign as a domestic investor (Federal Investment Bureau of Ethiopia)

1.8. Organization of the study

The paper is organized in five chapters .The first chapter provides an introduction to the study. It contains background of the study, statement of the problem, objectives, research questions, significance and limitation of the study.

The second chapter is Literature Review of the Study. In this part literatures related to the topic was reviewed. It includes review of different books for identifying the main theoretical perspectives. In addition prior studies have been reviewed.

The third chapter is about methods of the study. In this chapter the type and design of the study, the subjects and sampling of the study, sources and tools of data collection, procedure of data collection and the data analysis techniques is discussed.

The fourth chapter is about the results and discussion of the results of the study. The findings are presented in this part of the study. The analyses of the collected data are summarized, and then findings are discussed and interpreted.

The fifth chapter includes the summery, conclusions and recommendations of the study based on the findings.

CHAPTER TWO
LITERATURE REVIEW

2.1. Incentives and their Rationale

2.1.1. Theories of incentives

UNCTAD (2003) defines an incentive as ‘any measurable advantage accorded to specific enterprises or categories of enterprises by (or at the direction of) government’. Using this definition, an across-the-board reduction in corporate taxation is not an incentive scheme even though it may lead to increased corporate investment. Chua (1995) argues that an across-the-board reduction in corporate income tax is the best ‘incentive’ for investment, as it does not distort the price signals faced by firms and lowers administrative costs. Broadway and Shah (1995) in contrast see corporate income tax reductions as an expensive way to stimulate new additional investment, compared with tax credits, though much depends on the concurrent economic environment.

Lowering corporate taxes to firms locating in a specific region, or producing certain goods or services, is an incentive scheme. By definition, if preferential tax treatment is applied to foreign direct investment (FDI) over local investments then this is an incentive scheme to attract FDI. Incentives can be fiscal or non-fiscal, direct or indirect. Fiscal incentives include direct ‘cash’ grants or tax breaks. Non-fiscal incentives may include fast-track approval processes or exemptions from certain regulations. Investment incentives can be categorized in a number of different ways. The following is one taxonomy.

Direct incentives

• Cash payments

• Payments-in-kind (such as the provision of land or infrastructure to specific firms

Indirect (tax) incentives

• Reductions in the rate of direct taxation, either permanent or temporary. These can be in the form of tax holidays with reduced Corporate Income Tax (CIT) rates, accelerated depreciation allowances, investment tax credits, investment tax allowances or deductions of qualifying expenses.

• Reductions in indirect taxation either permanently or temporarily (e.g. reduced import tariffs or VAT on inputs or capital equipment). These can either be upfront reductions in import duties, or administered via duty drawbacks.

• Protection against competition from rival firms through tariff increases.

Other, non-fiscal, incentives include:

• Special deals on input prices from parastatals (e.g. electricity, oil).

• Streamlined administrative procedures or exemptions from certain pieces of legislation.

• Export Processing Zones (EPZs) which offer a combination of fiscal and non-fiscal incentives within a particular geographical area, normally near a port.

• Legislation and/or policies that promote investment into certain sectors, or by certain investors.

• Subsidized financing through parastatal lending or equity.

From the standpoint of both the government and the beneficiary, there are arguments in favor of both tax incentives and up-front grants (Kaplan, 2001). Grants have the significant advantage of being ‘on-budget’, thus allowing for better oversight and monitoring, whereas indirect (tax) incentives hide the level of revenues forgone unless the ‘tax expenditure’ is calculated ex post. Even though they are less transparent, tax incentives are popular, as they involve no up-front financing cost. Grants are easier to target at specific categories of industry but tend also to be administratively expensive for both governments and businesses. Companies like tax incentives because they are less discretionary and more automatic. They are also less susceptible to budget reductions.

2.1.2 Why offer investment incentives?

Governments pursue investment incentives as a means to an end. Policy-makers attribute poor economic performance to a lack of investment. Incentives are used as a tool to boost investment and growth, even if the causal links between each of these stages is far from proven. Incentives work by changing the parameters of an investment project. Companies choose to make investments when the Net Present Value (NPV) of a project's cash flows (suitably discounted) is greater than zero. In a world where companies face no rationing of capital at its going user cost, companies undertake every project with a NPV greater than zero. In a world where companies face capital rationing, they choose the mix of projects with the greatest Internal Rate of Return. Incentives bias investors' decision-making positively in favour of investments in certain sectors or regions. By reducing the tax burden or providing cash incentives, there is increased expected profitability of projects in those sectors or regions. Where companies have good access to finance, the introduction of special incentives to certain sectors or regions should in theory lead to an overall increase in investment.

The tax code can also influence how an investment is financed. For example, in most countries' tax systems interest payments on debt qualify as a tax-deductible expense, whereas returns to equity do not. This creates an incentive in favor of debt financing. Incentives can also affect the quality of investment (i.e. its performance as well as its quantity). Neo-classical economic theory argues that providing tax incentives to one group of investors rather than another violates one of the principal tenets of a 'good tax system' – that of horizontal equity. This inequality distorts the price signals faced by potential investors and leads to an inefficient allocation of capital. The justification most often given for special incentives is that there are market failures surrounding the decision to invest in certain sectors and/or locations, which justify government intervention. Although different tax rates based upon the elasticity of demand for each sector do raise a given level of revenue with a minimum dead weight loss (Stiglitz ,1986).

Incentives need to be carefully designed to achieve a specific policy goal. Poorly targeted tax incentives prove ineffective and expensive. Tax holidays, while being easy to administer, are a good example of a poorly targeted incentive. Moderate tax incentives that are targeted to new investment in machinery, equipment and R&D, and that provide up-front incentives, are more likely to be cost effective in stimulating desired investment. These can have powerful signaling effects without significant loss of revenue. Investment tax credits and allowances provide specific and targeted policy tools to achieve this.

Boadway and Shah (1995); Furthermore, applying uniform tax rates to different sectors of the economy results in very different marginal effective tax rates because of differences in capital intensity, financing structure, etc. (Bolnick, 2004). Market failures result in either too much or too little investment in certain sectors or locations. The key market failures most often cited (but hotly debated) are the following:

Externalities: Positive externalities (not internalized in the project's rate of return) are higher in certain sectors than in others. A classic example is Research and Development (R&D), where investment yields a higher social than private rate of return (because not all the technological knowledge can be effectively patented) and as such there exists an ex ante justification for subsidizing R&D investment (Kaplan, 2001). Without subsidy, the level of R&D investment would be below the optimum. A similar argument can be made for the reverse - that investment in sectors with significant negative externalities (such as pollution) should face a higher tax burden.

Infant industry: Markets often fail to correct for the gains that can accrue over time from declining unit costs and learning by doing. Capital markets are often very risk-averse and therefore avoid financing start-up companies, and equity markets are weak in developing countries. Hence, one argument for incentives is to support the establishment of businesses in the first few years. Subsidies to help potential investor\s overcome entry barriers in monopolized sectors, bringing about competition and lower prices, can be justified in a similar manner.

Information asymmetries and uncertainty: Both providers and users of capital suffer from less than perfect information. As a result, some investment opportunities may not be financed or undertaken, even though they are NPV-positive. Financiers face imperfect information about the level of risk in certain sectors of the economy because they lack experience in those sectors. Similarly, there is often a 'first mover disadvantage' for investors in new sectors, as they assume more risk than those that follow. Successful investments in new sectors or geographic areas have an ‘agglomeration effect’ as they provide information on the level of risk involved. For these reasons, it can be argued that incentives are required to counteract these inherent uncertainties and trigger a positive cycle of investment. Roberts (2004) goes so far as to argue that such market failures in the financial sector are ‘intrinsic’. In addition to market failures, other arguments for investment incentives are the following:

Equity: Whilst an allocation of capital directed by unfettered market prices might lead to an efficient outcome, it may not lead to an equitable one. For example, economically depressed remote areas are at a competitive disadvantage because it is harder to attract labour and costlier to transport inputs and outputs. The failure of depressed areas to attract investment is sometimes also categorised as a market failure because of the vicious circle created by a lack of investment feeding off and reinforcing itself.

Political economy: Opponents of investment incentives argue that many of them exist to support special (politically connected) interest groups. Politicians representing one region or province might argue for incentives in the region they represent without any economic justification for doing so.

There are other purported benefits of incentives, such as symbolic ‘signalling’ effects and the need to compensate for inadequacies in the investment regime elsewhere.Blolnick(2004) .

2.1.3 Rationale for the continued use of investment incentives

Despite the lack of evidence to support the efficacy or efficiency of fiscal incentives, governments continue to offer them. There has, however, been a global trend toward incentives which are better targeted and better designed to fit local circumstances (UNCTAD, 2000).Why is this? Wells (2001) argue that tax incentives offer an easy way to compensate for other government-created obstacles in the business environment. In other words, fiscal incentives respond to government failure as much as market failure. It is far harder, and takes far longer, to tackle the investment impediments themselves (low skills base, regulatory compliance costs, etc.) than to put in place a grant or tax regime to help counterbalance these impediments. Although it is a second-best solution to provide a subsidy to counteract an existing distortion, this is what often happens in practice. Agency problems also exist between government agencies responsible for attracting investment and those responsible for the more generic business environment. Whilst investment-promotion agencies can play an important role in coordinating government activity to attract investment, they also often argue for incentives without taking account of the costs borne by the economy as a whole. Costs (as opposed to benefits) are often not correctly accounted for, because they are especially hard to calculate (Bolnick, 2004).Wells (2001) point to 'stories' of potential investors locating elsewhere because of better incentive schemes, 'stories' that seldom stand up to rigorous analysis. For example, in 2001 a Malaysian textile company seeking an investment location in southern Africa from which to benefit from the United States' Africa Growth and Opportunity Act , chose Namibia. The story is often cited as an example of South Africa not offering sufficiently attractive investment incentives. The facts point to a far more complicated situation (see James, 2009).

2.2 Characteristics of effective investment incentives

Every incentive has advantages and disadvantages, and it is thus extremely difficult to determine one set of 'incentives which work' for very different economies with different challenges and circumstances. Much of determining 'what works' will depend on the circumstances of the economy, the competence of the tax administration, the type of investment being courted and the budgetary constraints of the government. Having said this, a careful reading of the evidence does provide a set of 'best practice guidelines' for policy-makers. The key lessons are necessarily broad and focus on the process and procedures surrounding incentive policy rather than a set of policy prescriptions. An effective and efficient incentive has different character , it Stimulates investment in the desired sector or location, with minimal revenue leakage, and provides minimal opportunities for tax planning, is transparent and easy to understand, has specific policy goals and is expressed precisely in legislation ,plus to this it is not frequently changed, and provides investors with certainty over its application and longevity, Avoids trying to target cyclical depressions due to the lag effects of intervention, furthermore it is developed, implemented, administered and monitored by a single agency, Has low administrative costs for both governments and firms, Co-ordinates national, regional and local governments effectively, Includes follow-up and monitoring, both to ensure that the incentive criteria are being met and also to provide a monitoring and evaluation feedback loop, last but not least it is non-discretionary and applied consistently against an open set of transparent criteria. (shah,1995 and Bolnick 2004)

This last point is debatable. Any benefit (such as an incentive) allocated by public servants or politicians is potentially open to abuse and corruption. There is therefore a strong argument that incentives should be automatically available to all investors who meet a set of open and transparent criteria. However, an alternative argument is that firms should receive just enough incentive to induce them to invest, and no more. Each potential investment therefore needs to receive an incentive specific to its particular situation. Clearly, which of these two alternatives the government chooses depends on the strength of governance within the appropriate institutions. If public servants and politicians retain decision-making power over the allocation of incentives, then the processes and outcomes need to be as transparent as possible.

If these guidelines are followed, governments are less likely to enter into some of the more egregious incentive schemes, which have proved so expensive and ineffectual in the past (Boadway and Shah, 1995).

2.3 Overview of incentives under Ethiopian law

Ethiopia has implemented Economic Reform Program (ERP) and has been modernizing tax and custom administration by overhauling the legislations and improving administration since 1992/93 with the aim of encouraging trade, investment and hence development. Given the important role of FDI in the development process of developing countries, Ethiopian tax policy is geared towards promoting investment, supporting industrial development and broadening the tax base and decreasing the tax rate in the view of financing the need of government expenditure. With the view of creating investment friendly environment and attract foreign direct investment, Ethiopian government have been providing a wide range of fiscal incentives. (Ethiopian Customs and Revenue Authority, 2011)

Transitional Government of Ethiopia (TGE) issued the first investment code (Proclamation No. 15/1992) on May, 25 1992 with the aim of encouraging private investment under this code areas eligible for investment incentives were limited to manufacturing and Agriculture sectors. The incentives provided were 100% exemption from custom duty on importation of capital goods and income tax exemption (tax holiday) ranging from 1-8 years depending on type and location of the investment. This proclamation had been in force for four years and replaced by Proclamation No. 37/1996 in June 1996.The revised Investment Code of 1996 extended areas eligible to incentives to Education, health, tourism and construction sectors. Capital entry requirements for joint ventures reduced from US$500,000 to US$300,000 and for technical consultancy services reduced to US$100,000. This code was opened the real estate sector and Electricity and water supply to foreign investors, extended the losses carried forward provision, and cut the capital gains tax from 40% to 10%.

Furthermore Proclamation No. 37/1996 improved and replaced by proclamation No.116/1998 in June 1998. The major changes introduced in this proclamation were Defense and telecommunication sectors allowed to private sectors to invest jointly with government which was reserved for government only in the earlier codes. The investment code was also amended in July 2002 (Proclamation No. 280/2002) and in September 2012 (Proclamation No. 769/2012) and further liberalized the investment regime and removed most of the remaining restrictions. In general all areas of investments are open for foreign investors except Banking, insurance and microcredit and saving services; forwarding and shipping agency services; broadcasting services; and air transport services using aircraft with a seating capacity of up to 20 passengers which are reserved for government, domestic investors and Ethiopian nationals.

Investment incentives provided in the investment codes are free repatriation of capitals; Duty free importation of goods and vehicles related to the investment; Tax holidays up to eight years; Opening and operating foreign currency accounts; owning immovable property for the purpose of the investment, Loss carry forward, duty drawback scheme and voucher scheme.

Well-designed but poorly implemented tax incentives are equally ineffective. Clear and transparent application and screening procedures, and an effective tax administration regime with 'bite', are crucially important to the ultimate credibility and success of a tax incentive programme. Governments need to bear in mind the capacity of their tax administration when considering whether to implement incentives, and if so which. Incentives play only a marginal role in the investment decision for businesses. Growth in demand, economic and political stability, the state of the infrastructure, the rule of law, and a skilled labour force are more important in determining investment decisions.

Among the fiscal incentives given the most popularly used are custom duty exemption and income tax exemption (tax holiday).

2.3.1 Tax holiday (exemption from income tax)

Any investors who invest to establish a new enterprise in manufacturing, agro-processing, production of agricultural products and information and communication technology development are entitled to income tax exemptions. Any income tax derived from approved new investment shall be exempted for periods of 1 to 8 years, depending upon the priority area of investment activities and the geographical location of the investment. Conditions for income tax exemption eligibility are:-

- If at least 50% of its production is to be exported; Profit Tax Exemption Years is 5 Years, if the Investment is made in relatively under-developed regions, the exemption period is 6 years.
- If at least 75% of its production will be an input for the production of export items; Profit Tax Exemption Years is 5 Years, if the Investment is made in relatively under-developed regions, the exemption period is 6 years.
- If the project is evaluated under a special circumstance by the BOI; Profit Tax Exemption Years is no longer than 7 Profit Tax Exemption Years. If the Investment is made in relatively under-developed regions the exemption is No longer than 8 years. However, the granting of income tax exemption for a period longer than 7 years requires the decision of the Council of Ministers.
- If less than 50% of the production is to be exported; Profit Tax Exemption Years is 2 Years, if the Investment is made in relatively under-developed regions the exemption shall be 3 years.
- If the production is for the local market; Profit Tax Exemption Years is 2 Years, if the Investment is made in relatively under-developed regions it will be 3 years.

In addition investors that establish new enterprise in the regions of Gambella, Benshangul, Afar, Somali, Guji and Borena and South Omo Zone are entitled to an income tax deduction of 30% for three consecutive years after the expiry of income tax exemption for expansion or upgrading of enterprises that increases the excise.

2.3.2 Custom Duty exemption

For expansion or upgrading of enterprises that increases the existing production by 25% in value and 50% of the production is to be exported; the Profit Tax Exemption granted is 2 years. Notwithstanding the information given above, directives issued by the Board may prohibit exemption from income tax with respect to an investor who supplies his products only to the domestic market. Moreover, an investor who exports hides and skins after processing up to crust level is not entitled for income tax holiday. The period of exemption of profit tax begins from the date of commencement of production or provision of services, as the case may be.

To encourage private investment and to promote the inflows of foreign capital the government of Ethiopia provide an incentive of custom duty exemption for investors engaged in eligible new enterprise or expansion project. The eligible sectors are Agriculture, manufacturing, construction, education, health, electricity and water supply and hotel and tourism. These incentives include the following:-

- 100% exemption from the payments of custom duties and other taxes levied on imports granted to all capital goods, such as plant, machinery and equipment and construction material.
- Spare parts worth up to 15% of the total value of the imported investment capital good, provided that the goods are also exempt from the payments of custom duties.
- An investor granted a custom duty exemption will be allowed to import spare parts duty free within five years from the date of commissioning of a project.
- With the exception of few products (e.g. semi-processed hide and skins-150%) no export tax is levied on export products of Ethiopia.
- Any investors who export or supplies to an exporter as a production or service input, at least 60% of his product or service shall be entitled to income tax exemption for 2 years in addition to the exemption period provided.

- Duty paid at the port of entry or locally, on raw materials used in the production of commodities is refunded, 100%, upon exportation of the commodity processed.
- In addition three duty incentive schemes are available for exporters. They are Duty Draw-Back Scheme, Voucher Scheme and Bonded Warehouse.
- Scheme Taxes and duties paid on raw materials are drawn back at the time of export of finished products. The duty draw back scheme applies to all taxes at the time of importation, and those paid on local purchases.

2.3.4 Other Incentives

In addition to the above stated the most popular incentives the following incentives are also given to investors in order to promote private investment. Business enterprises encountering losses during the tax holiday period can carry forward such losses following the expiry of the exemption period for 3 to 5 years free repatriation of profits and dividends Expenditures for training and research are tax deductible.

2.4 Business Environment

Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place. Because, the environmental factors influence almost every aspect of business, be it its nature, its location, the prices of products, the distribution system, or the personnel policies. Hence it is important to learn about the various components of the business environment, which consists of the economic aspect, the socio-cultural aspects, the political framework, the legal aspects and the technological aspects etc. In this chapter, we shall learn about the concept of business environment, its nature and significance and the various components of the environment. In addition, we shall also acquaint ourselves with the concept of social responsibility of business and business ethics. the success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government policies, the business has to make the necessary changes to adapt itself to the new policies. Similarly, A change in the technology may render the existing products obsolete, as we have seen that the introduction of computer has replaced the typewriters; the colour television has made the black and white television out of fashion. Again a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these changes in order to survive and succeed in business. Hence, it is very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of a business enterprise. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors etc. While some of these factors or forces may have direct influence over the business firm, others may operate indirectly. Thus, business environment may be defined as the total surroundings, which have a direct or indirect bearing on the functioning of business. It may also be defined as the set of external factors, such as economic factors, social factors, political and legal factors, demographic factors, technical factors etc.,which are uncontrollable in nature and affects the business decisions of a firm.

Geography

Geographically, Ethiopia is a country of immense contrasts. High mountains, which in the Semen (in the north) and Bale Mountain Ranges (in the south east) tower over 4,000 meters (13,120 feet) above sea level, give way to flat lowlands, 180 meters below sea level in the Dankal Depression, the lowest depression in the world. The Great Rift Valley divides the country into western and eastern highlands and is a further fascinating geographical feature of the country.

Government

The Federal Democratic Republic of Ethiopia (FDRE) was established under a new Constitution as of 21st of August 1995. The Constitution provides for a federal State system, which is structurally based on the Federal Government, nine autonomous States and two chartered cities (Addis Ababaand Dire Dawa). The States and chartered cities are vested with powers of self-administration. They also have legislative, executive and judicial powers, regarding all matters that fall under their respective jurisdictions, except for those exclusively given by the

Constitution to the Federal Government, such as national defence, foreign affairs, macroeconomic policy and the printing of currency.

Economy

The Ethiopian economy is predominantly of agricultural nature and the production in such a sector constitutes a major part of the country's economy, contributing about 45 % to the country's gross domestic product (GDP) and about 62 % to total exports. It accounts for 85 % of total employment. Coffee, a major cash crop, is of high quality and contributes about 62 % of total agricultural exports. So, it is a major source of foreign currency earnings. Manufacturing, mining, trade, tourism, construction, services, etc., which make up the remaining 55 % of GDP, all supplement the agricultural sector. Industrial activities contribute only 11 % to GDP and 16 % to total exports.

Manufacturing is now at an early stage of development and currently accounts for about seven % of GDP and 5.3 % of employment. It covers about 145 state-owned and 643 private manufacturing industries of all sizes. These industries are mainly engaged in the production of food products and beverages, tobacco products, textiles, wearing apparel, tanning and leather dressing footwear, luggage and handbags, manufacturing of wood and its products, manufacturing of rubber and plastic products, manufacturing of chemicals and chemical products, manufacturing of other non-metallic mineral products, manufacturing of basic iron and steel, manufacturing of fabricated metal products, assembling of motor vehicles, trailers and semi trailers. As part of the Government's effort to re-invigorates and revitalise the manufacturing sector, a new Industrialization Development Strategy has been recently adopted. The strategy clearly identifies the priority areas of the manufacturing sub-sectors and puts strategies in place that insure the development of vibrant industries in the country. (Ethiopian investment guide page, 24

2.5. Empirical evidence

Empirical literatures on the effectiveness of the promotion of investment incentive . Earlier studies have pointed out that incentive as a determinant of FDI flows was very insignificant. The dynamics of incentive seem to be related more with economic fundamentals by then. Many other studies also tried to see how effective incentive schemes were by comparing the costs and benefits.

Among the studies that found insignificant impact of incentives are a broad cross country analysis in ECCU member countries by Chai and Goyal (2008). The study used primary surveys that involved the investors themselves that have already received some sort of incentive packages. They have found that the benefit of tax concessions in terms of attracting FDI is very limited compared to its cost in terms of foregone revenue, by using cross country analysis. The study used firm level investor survey and regression analysis, both methods showed that lower statutory tax rates, the absence of FDI restrictions, and better institutional and infrastructural quality are the most important factors that affect FDI rather than tax incentives. And they finally recommend the need for re-evaluation of the strategy using tax incentives as to promote FDI by many developing countries. However, their study may have suffered from bias because of the difference among the cross sections. Given the differences in economic fundamentals among countries it is apparent that their responsiveness to incentives will also be different. In addition, the impact of incentives on different sectors could also be different.

A joint study by justice network Africa and Action Aid international on tax competition in east Africa has indicated Kenya, Uganda, Tanzania and Rwanda are losing up to USD 2.8 billion a year because of the tax incentives they offer to FDI companies. Hence, they suggest these kinds of incentives should stop because they are costly and inefficient. In addition, their analysis showed the incentives have not been helpful in attracting the FDI either; Uganda was able to attract higher level of FDI in the region though Kenya has been more generous in the incentive schemes. This study, however, used simple descriptive analysis that it is difficult to separate the impact of incentives from other factors when it comes to attracting FDI. Similarly, there are arguments forwarded against tax incentives, as a means of attracting FDI, in IMF reports stating these incentives have many related costs like loss of current and future revenue, creating distortion between activities subsidised and those that are not, require large administrative costs that outweigh the benefit. Rather than tax incentives, other factors like good quality of infrastructure, political stability, predictable macroeconomic policy, and low administrative costs of setting up play an important role in attracting FDI. (Tax Justice Network, 2005).

A study by Wells and Allen (2001) presents another case against incentives, consistent result with the above findings. The study is based on Indonesian experience where tax holiday were offered for foreign investors and then dropped. In this paper it is found that foreign investment continued to grow even after the tax holiday is dropped proving the negligible role of tax incentives in attracting foreign direct investment. This could be a strong case against incentive schemes as it has showed an actual natural experiment outcome.

A study by Tuomi (2009) that focused on middle income country, particularly on South Africa, looked at the topic from microeconomic perspectives by using firm level data. He found that investment climate is more important than incentives. According to this study, incentives play a negligible role in attracting foreign firms and countries economic, social and institutional fundamentals are more important. The study also argues there are cases in which incentives may play a positive role. This could be related to Forsyth's (1972) argument that once the decision to set up in a broad area is made inducements and incentives may affect the decision regarding the more precise location as referred in Morisset and Pirnia (2000).

On the other hand, most of the studies conducted in the past decade have shown positive impact of incentives on FDI inflow. Supporters of tax incentives argue that fiscal incentives are needed to increase investment which in turn generates economic and social benefit through its spill over effect on local firms, nurturing domestic production and building local capabilities. It is also believed, Productivity of local firms also increases as a result of forward and backward leakage with foreign firms. (Madiès and Dethier, 2010) Some of the researchers tried to identify which type of incentives work best instead of generalizing. Emmanuel Cleeve (2008) in his study on the effectiveness of fiscal incentives to attract FDI in 16 Sub-Sahara African countries, for the period 1990-2000 using pooled data, found that among fiscal incentives tax holidays were the most effective and while the other concessions seem to cause an ad-verse effect specially in countries that offered too many concessions. According to this study all fiscal incentives may not benefit the economy through attracting FDI, because some fiscal incentives may result in economic distortions. The study recommended that countries should be selective in their fiscal incentives.

Blomstrom and Kokko (2003) also argue that under a certain condition tax incentives increase investment; create job opportunity and leads to overall growth. According to them incentives should be given for foreign firms that are engaged in activities that have strong potential for spill over, activities that create linkage between local and foreign firms, education, training and R & D. They are also of the view that it is necessary to build the absorbing capacity of the local firms at the same time. It is under these conditions that tax incentives will have a significant impact on increasing investment.

Mudambi (1995), unlike the other studies in the 1990s, in his study found that corporate tax rate has a significant effect in attracting foreign direct investment suggesting low tax rate have a persistent effect on MNE location decision. His finding also shows that labour cost is an important determinant of MNE investment, which is in line with the other studies that identified re-source and other economic fundamentals as the main factors attracting FDI. On the other hand infrastructural factor found ineffective in MNE investment decision.

A study by Simmons even though it did not directly address the impact of incentives, it has tried to capture the general sensitiveness of FDI to corporate tax system measured by an index. The study constructed an index based on the evaluation obtained from investors and tax expert on different attributes of tax system of selected countries and prior research. The result showed a significant positive relationship between corporate tax attractiveness indices and inflows of FDI supporting the idea that host countries tax system is an important determinant of FDI. (Simmons, 2003)

Another strong support comes from Margalioth (2003) who argued that tax incentives are good and appropriate policies to attract FDI to developing countries. He justified the effectiveness of incentives by addressing the main arguments forwarded by the opponents of tax incentives. These arguments are: incentives distort behaviour, they are harmful and ineffective and incentive may also divert focus from other important determinants of FDI. But according to Margalioth as far as incentives attract FDI that would not come otherwise, it is not inefficient even if it create distortion. His arguments have the notion that the effectiveness of the incentive schemes should only be evaluated against its primary goal of attracting FDI. Furthermore, tax incentives become ineffective only if it is given to FDI that would have come even without the incentives. So it is not the incentives that are ineffective rather it is the administration and the implementation of the incentives that are no effective. In addition he argues that incentives are not given as compensation to other determinants of FDI rather it is an addition to the other policy efforts.

Tung and Cho (2000) also provided evidence on the effectiveness of tax incentives in attracting FDI in China. According to them the increased flows of FDI to the country were attributed to the incentives and concessionary taxes offered, controlling other factors. Before 1991 concessions and tax incentives were given to joint venture only and the values of this form of FDI were increased faster than other forms of FDI. After 1991 when incentives introduced to all forms of FDI, all forms had similar patterns of growth. In general this study supports the notion that tax incentives are effective in attracting foreign direct investment.

On the other hand, Tanzi and Shome cited in Zee (2002) witnessed a mixed result, Countries' experience showed a success and failure story of using tax incentives as a means to attract foreign direct investment. In East Asian countries (Taiwan, Korea and Singapore) tax incentives were found successful. In these countries tax incentives encouraged rapid industrialization through attracting FDI. In addition there also countries cited such as Ireland and Mauritius where tax incentives are effective. In contrast in Malaysia, Indonesia, Thailand and Philippines tax incentives appeared ineffective in achieving its goal. This finding strongly supports that view that the effectiveness of the incentives depends on the economic fundamentals and specific situations of eve-ry country.

The arguments presented so far have ignored the fact that companies (investors) may not respond the same way to incentives. Morisset and Pirnia (2000) presented a rather balanced view after a thorough review of literatures; it could not be said incentives failed in general, they do affect the decisions of some investors some of the time. They also pointed out that it is reasonable to believe that impact of tax incentives differs greatly depending on the characteristics of the multinational company. It is noted that the impact of tax rates on investment decisions tend to be higher on export oriented companies than on those that look for domestic market or location specific advantages. Export oriented industries are more sensitive to taxes because they operate in a highly competitive environment with very small profit margins, moreover, those firms are highly mobile and they are likely to compare taxes across different locations that it can be an important part of their cost structure. In a similar way the responsiveness of the companies may also differ based on the nature of the incentive scheme, whether the companies are new or existing and the size of the company. According to Rolfe et.al (1993) and Coyne (1994) as referred by Morisset and Pirnia, new companies prefer incentives that reduce their initial expenses while expanding companies prefer incentives that target profit; regarding size it is suggested that small companies are more responsive to tax incentives than the large ones. (Morisset and Pirnia, 2000) These arguments make sense as they do not suggest uniform aggregate treatment of FDI, studies should rather treat the investors in terms of their market orientation, size and time in business.

Another related argument forwarded by Cleeve is that the sources of FDI may also determine the effectiveness of fiscal incentives. If the investments are from USA, UK…etc. incentives will have a little effect on their location decision because these countries provide foreign tax credit. (Emmanuel Cleeve, 2008). Furthermore the impact of tax incentives on FDI may also differ among regions. Klemm and Parys, among other questions tried to answer how effective incentives were in attracting investment by employing panel data analysis technique on Latin America and the Caribbean and African countries. Their result showed that lower tax rates and longer tax holidays were effective in attracting FDI in Latin America and the Caribbean but not in Africa. (Klemm and Parys, 2012) However, the study still did not address heterogeneity of countries, in terms of the incentives they give and their economic fundamentals, as it was conducted in aggregate (regional) level.

It has also been argued that incentives are needed to remain in competition for FDI among regions. This is supportive of the view that, once the basic factors like market size, resource, political stability and others are fulfilled tax incentives could be the only factors that make difference between countries. There is also a case in which high technology industries found sensitive to tax incentive policies in Philippines. (Chalk, 2001)

In general from this wide range of debate in literatures it is clear that the effectiveness of fiscal incentives in attracting FDI still remain inconclusive. Roughly speaking the literatures in the past decade seem to agree on the positive impact, though some of them showed exceptions in terms of geographical areas and countries. In the earlier times, incentives were only important after factors like resource availability, market size, and macroeconomic and political stability. Most of the researches done until around 1990 have the same spirit; impact of tax incentives on FDI were negligible if any. However, studies since the 1990s were encouraging to policy makers, as some positive results were observed. Moreover, the increased globalization and regionalization of the international economy and scarcity of public funds in developing countries case have left with limited policy choices that they turned to tax incentives.

Another factor adding to the debate in the area is the fact that policy makers and investors have different views on the effectiveness of incentives. Surveys done by different researchers confirmed this. Survey studies by Barlow and Wender in 1955 have revealed that only 10% of the surveyed companies mentioned foreign tax policies as important factor in their decisions. In a similar way, a study by Robinson in 1961 and Aharoni in 1966 have shown that companies regard tax incentives as a weak stimulant or never consider it. On the other hand, the surveys uncovered that government officials think tax ex-emption is a very powerful determinant of FDI inflows. (Cited in Morisset and Pirnia, 2000)

Even though the debate is still there, those studies came up with different important conclusions. It is noted that economic fundamentals and stability still play a major role in attracting FDI; companies respond differently based on their size, years of operation, their market orientation, the type of resource they use and regional differences; the globalization of the world economy has limited the ability of governments to use exchange rate and other trade policy instruments; and some type of incentives are more effective than others. Methodologically, most of the studies employed a cross sectional analysis, time series analysis for specific countries and surveys on investors and government officials. However, none of them analysed the impact of tax incentives on different sectors; this study is believed to fill this gap by taking sectors as cross sectional units and applying panel data analysis technique, and focusing on one country, Ethiopia.

CHAPTER THREE
Research Design and Methodology

3.1. Introduction

The focus of this chapter is research design and methodology , a description of the methods is used in carrying out the study, the research design as well as their suitability for the topic. The chapter presents the population used, as well as the sampling technique that was engaged, data collection procedures, analysis and the instruments used in the study. The purpose for conducting this research was to establish the utilization of investment incentives promotion and the business environment.

3.2. Research Design

To accomplish the objective mentioned on chapter I and to seek answer to the research question the researcher used descriptive research methods. As calmorin (2007) states, descriptive researches are valuable in providing facts on which scientific judgments may be based, providing essential knowledge about the nature of the subject matter, for closer observation into the practice, behavior, methods and procedures, playing a large part in the development of instruments for the measurement of many things, formulating of policies in the local, national or international level. The researcher also applied both the quantitative and qualitative measurement .The qualitative measurement helps to interpret ideas which were gathered through open ended questions while the quantitative measurement method helped to interpret ideas which were gathered through close ended question. It emphasis is on assessing and describing a situation or a problem in order to explain the relationship between variables in this study which was used to explain Effectiveness of incentives in promoting investment .

3.3. Population Sample and Sampling Technique

The primary data was collected from the Management level of the three companies ; form CEOs, General managers, finance department manager, Marketing and sales department heads ,Procurement and supply department head, Human Recourse development & Administration department Manager, Production and Technical department Manager ,Quality Control Head, of Walia steel industry, Sof Umer Terrazzo and Marble manufacturing, Astco Food Complex Factory S.C. Secondary data is used from the Ethiopian Investment Agency and Economic Development (MOFED) is used for analysis, the qualitative part of this study is basically dependent up on key informants. The sampling technique which the researcher applied was convenient (non-probability sampling).

3.4. Source and Tools of Date Collection

Both primary and secondary data was employed for data collection. Primary data was collected form employees in management position of different departments as mentioned above. Secondary data was collected from Ethiopian investment Agency, investment laws, regulations and policies, magazines, and Articles.

The questionnaire had four sections .The first section was on the background of the respondents, which request information on the age, sex, work experience, educational qualification. The second section is about the investment incentive .the third section is about the investment Trend.

3.5. Procedures and Data Collection

The construction of a research instrument or tool for data collection is the most important aspect of a research project as the findings or conclusion is based upon the type of information collected and the data collected is entirely dependent up on the questions answered by the respondents.

The form of questionnaires which was used for the study is semi structured .The questionnaire was distributed to the top managing department heads. In the closed form of questionnaires the respondents has chosen one of the alternatives as possible answers. Thus, the filled questionnaires w collected from the respondents on the time line provided for the data collection.

3.6. Method of Data Analysis

Analysis of data means studying the tabulated material in order to determine inherent facts or meanings. It involves breaking down existing complex factors in to simpler parts and putting the parts together in new arrangements for the purpose of interpretation.

Quantitative data generated was analyzed through thematic content, by describing, narrating and interpreting the situation deeply so that the real picture of investment incentive, the role of the business environment and the practical utilization of incentives is seen in detail. In addition to this, the descriptive statistics such as frequencies, mean, percentages analysis was used in reporting the result.

3.7. Validity and reliability of Data

Maximum effort was exerted to minimize biases and to maintain the quality of the data collected. The quantitative data was cleaned and entered to SPSS and analysis was made using this software. All possible errors on the data (outliers, inconsistent values, etc) were checked and corrected in SPSS before making any data analysis .The findings are presented as they are without being distorted sot that it can show the real picture of the practical utilization of investment promotion incentive.

3.8. Ethical Considerations

The study was primarily focused on gathering primary and secondary data to analyze investment promotion incentive. The study neither involves any experiment on human subjects nor conducted without the consent of the study participants. Above all, the issue is not sensitive and secret and we did not ask the study participants to engage in to risks as a result of participating in this study . Besides ,formal and written consent was obtained from the respondents during data collection. The respondents were given the right to refuse to take part in the study as well as to withdraw any time during the interview.

CHAPTER FOUR
Data Presentation, Analysis and Interpretation

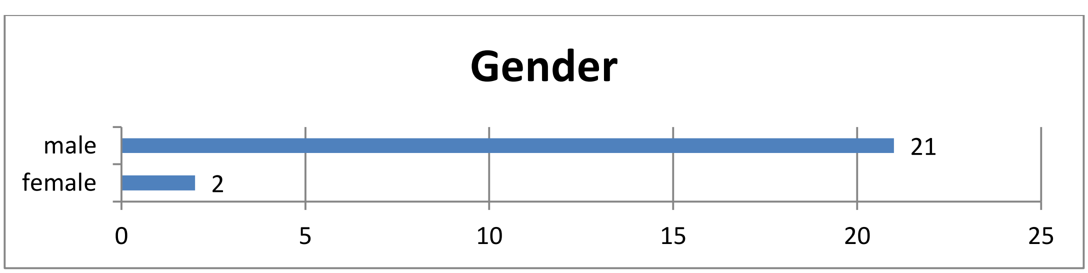
In this chapter an attempt was made to data presentation, analysis and interpretation. The information available for this purpose was collected using questionnaires. Following the data presentation in tabular form, discussions, analysis and interpretations is made based on the responses of CEOs and division managers from three manufacturing companies.

In this study the researcher selected 23 respondents for questionnaires out of which 8 respondents are from Sof-umer Terrazzo and Marble Manufacturing , 8 from Astco Food complex, and 7 from Walia Steel Industry .The data collected using the survey questionnaire from respondents of the three manufacturing companies is summarized and presented. Tables and charts are used to illustrate responses along with brief description of the finding.

4.1. Demographic Characteristics of Respondents

The socio-demographic characteristics of the respondents have distinction among the respondents. As shown in the following chart, most of the respondents 21(91.3%) of the respondents are male while the remaining 2(8.7%) are female.

Graph 1: Demographic/Gender/



Source : own survey 2016

The following table depicts other demographic characteristics of respondents. The age group of respondents touches all age categories. Where 11 (47.8%) are in the age range of 26-30. Five (21.1%) and six (26.1%) of the respondents fall in the age groups 31-40 and above 40, respectively. Having respondents from all these age categories would help to encompass ideas that may be accumulated through ages.

Table 1: Demographic /Age/

Respondents' Background	Demographic characteristics	No	%
Age Group	20-25	1	4.3
	26-30	11	47.8
	31-40	5	21.7
	above 40	6	26.1
	Total	23	100
Educational Level	Bachelor Degree	17	73.9
	Level IV Diploma	1	4.3
	Masters Degree	5	21.7
Years of Service	11-15 years	4	17.4
	2-5 years	7	30.4
	6-10 years	4	17.4
	less than 2 years	8	34.8

Source :Own survey 2016

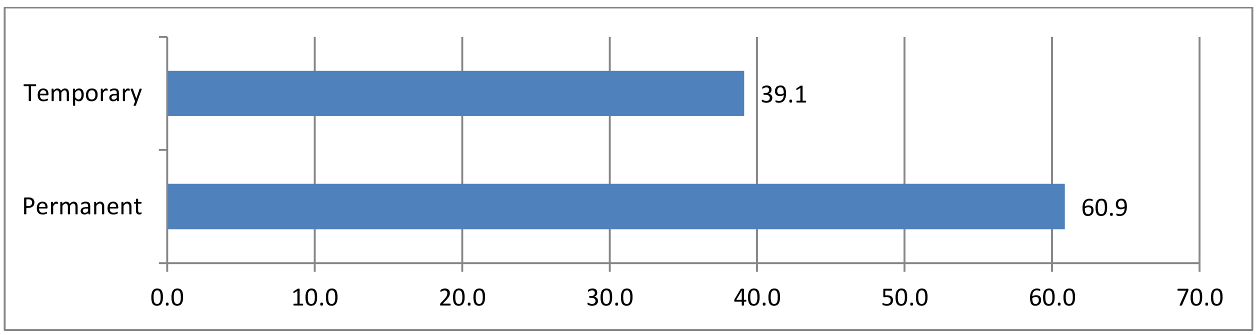
The educational level of 17 (73.5%) of respondents is Bachelor degree, where 6 (21.7%) of the respondents possessed masters degree. Such educational level has much help to gather expertise/intellectuals ideas that contributes to the research. The respondents are qualified and experienced and hence the information provided by them is reliable.

The work experiences of the respondents are presented in table above. As shown in the table 17.4% of the respondents have 11-15 years of experience, 30.4% of the respondents have 2-5 years of experience and 34.8% of the respondents have at most 2 years of experience.

4.2. Availability and Usage of Incentives

The organizations are beneficiary from either fiscal or non fiscal incentives. The major form of benefits being fiscal incentive according to 95.7% of the responses. A considerable number of respondents 13(56.5%) also acknowledge benefits from non fiscal incentives. Mostly, according to 52.2% of respondents, organizations receive both fiscal and non fiscal forms of incentives. As to tax incentives made to their organization, 14(60.9%) of the respondents acknowledged to have received permanent tax incentive. Whereas, 9 (39.1%) have said to have benefited from temporary tax incentive.

Graph 2: Incentives used



Source: Own survey 201

Responding the extent of investment incentive being received in their respective manufacturing companies, only one of the respondents rated in the rage 75-100 percent. Mostly, the percentage of incentives used by companies is contained within the range of 0-25 percent as indicated by 9(39.1%) and in the range of 25-50 percent according to 8(34.8%) of the responses.

Table 2: percentage of incentives used

percentage of the investment incentive you believe is being used by your specific organization	No	%
0-25	9	39.1
25-50	8	34.8

50-75	5	21.7
75-100	1	4.3
Total	23	100.0

Source: Own survey 2016

In the following table, respondents gave responses to those benefits obtained from different forms of tax incentives. Tax holiday is said to be one form of incentive according to 69.6% of the responses. Of these responses, 34.8% of respondents received the incentive in the past, and 26.1% of responses have enjoyed this benefit recently.

Investment allowance of credits is used as one form of tax incentive to manufacturing companies according to 39.1% of the respondents. This form of tax incentive is mainly used recently according to 5(21.7%) of respondents.

VAT exemption/reduction is also a tax incentive as 34.8% of the respondents believed that their organization has benefited from it. The benefits are being used recently (21.7%) and in the current time (13.0%).

Table 3: Tax incentives

	[Tax holiday		[Reduced tax rates		[Investment allowances or credits		[VAT exemptions/reductions		[Research and development tax incentives		[Special economic zones		[Payroll tax holidays]	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Currently used	2	8.7			2	8.7	3	13.0			2	8.7	1	4.3
Recently used	6	26.1	2	8.7	5	21.7	5	21.7			2	8.7	2	8.7
Used in the past	8	34.8	1	4.3	2	8.7			1	4.3	1	4.3	1	4.3
Total	16	69.6	3	13.0	9	39.1	8	34.8	1	4.3	5	21.7	4	17.4
Not used	7	30.4	20	87.0	14	60.9	15	65.2	22	95.7	18	78.3	19	82.6
Total	23	100.0	23	100.0	23	100.0	23	100.0	23	100.0	23	100.0	23	100.0

Source :Own Survey 2016

Respondents did not receive Research and development tax incentives according to 95.7% of respondents. Reduced tax rates and payroll tax holidays are not used as tax incentives according to 87% and 83% of respondents. Special economic zone is not the practice as indicated by 78% of the responses. Organizations are not beneficiary from Vat exemption/reduction and investment allowances/credits according to 65% and 61%, respectively, of the respondents.

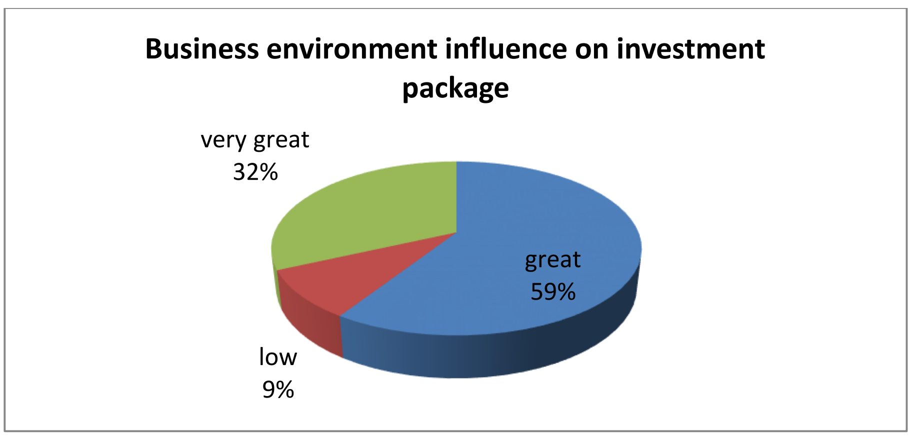
Tax holiday is relatively better form of tax incentive where 69.6% of the respondents believed that their organization has benefited from. But mostly this form of tax incentives were mainly used in the past according to 34.8% of the responses.

Almost 22(95.6%) of the responses believed that investment incentives have visible impact on promoting/attracting investment in the country.

4.4. Effects of Business Environment on Manufacturing

The business environment is considered to have very great impact in influencing the incentive package by 7(30.4%) of the respondents where the majority 13(6 6.5%) believed to have great impact. Only 8.7% of the respondents said to have low-level impact posed by the business environment on incentive package.

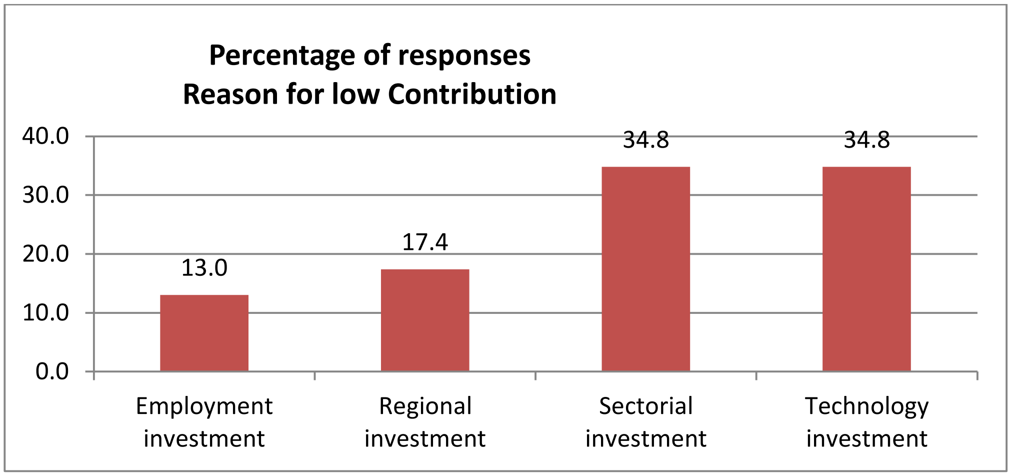
Chart 1: Business environment influence



Source :Own Survey 2016

The low level of contribution of business environment on the incentive package is mainly attributed to sectorial 8(34.8%) and technology 8(34.8%). Employment investment and regional investment are identified by 3(13.0%) and 4 (17.4%) of respondents, respectively, are considered the reasons for low level impact by business environment.

Graph 3: Major objective of incentive in Ethiopia

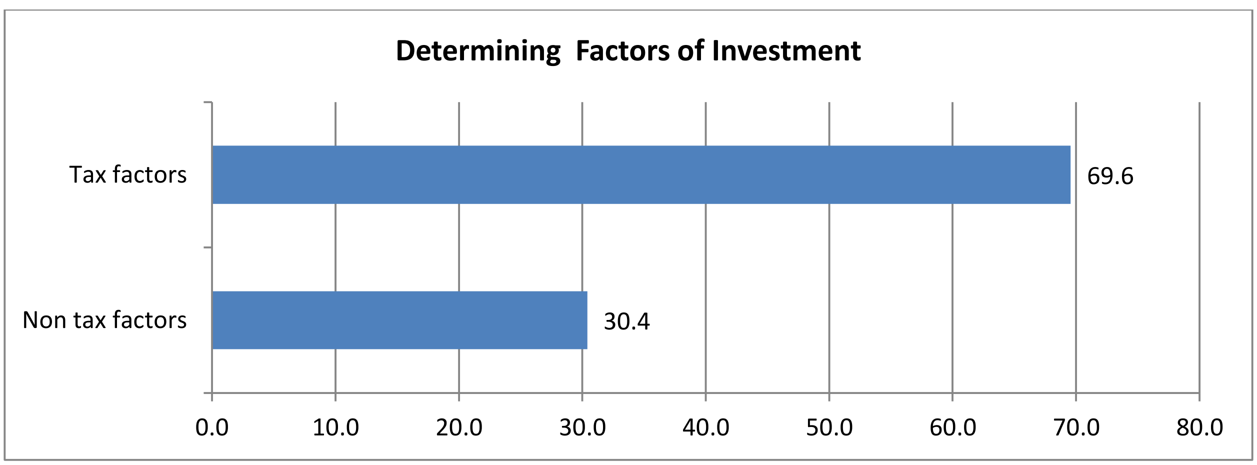


Source: Own Survey 2016

4.5. Factors Influencing Investment

Comparing tax and non tax factors, about 70% of the respondents believed that tax factors are considered to be the major determinant factor to invest in Ethiopia. Only few 7(30%) consider non-tax related issues being the major determinant factor.

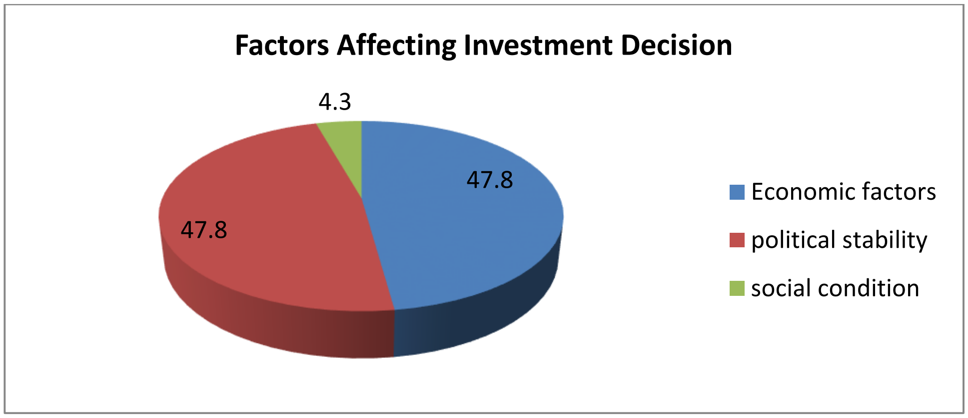
Graph 4: determining Factors of investment



Source : Own Survey 2016

Considering economic aspect, political stability and social condition of the country; investors consider societal condition has very little impact in making investment decision in Ethiopia. While both political and economic conditions are claimed to be major factors in making investment decision; which are considered by 11(47.8%) of the respondents.

Chart 2: Factors Affecting investment decision

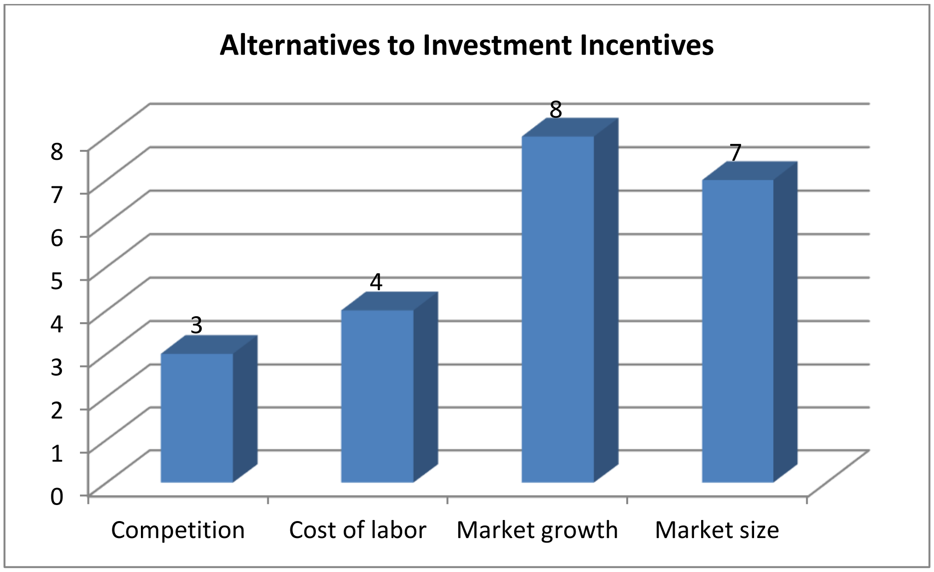


Source :Own survey 2016

Regarding the statement that *investment climate* can be supported by investment incentives, relatively majority (57.8%) of the respondents agreed the support; where a considerable number of responses (39.1%) disagree to the statement.

Respondents also consider other factor as alternative to investment incentives. Even in the absence of investment incentives, investors consider market growth (34.8%) and market size (30.4%) as factors that are relevant for them to consider investing in the country. Competition and cost of labor together are considered as basis for investment according to 7(30.4%) of the respondents. Moreover, country of origin is believed to have direct significant impact according to 18 (78.3%) of the respondents.

Source: Own Survey 2016



Graph 5: Alternatives to investment incentive

4.6. Effectiveness of Incentives

Rating the investment incentive administration, being simple and transparent, 7(30.4%) of the respondents have agreed. The same number of respondents also disagrees to the statement. Most of the responses, 9(39.1%) have moderate agreement (neutral) considering and transparency of the investment incentive administration. Further, respondents indicate the reasons that hinder incentive administration to be simple and transparent. The reasons being:

- There is no fair administration, high corruption in each section of the government office, government bureaucracy and subjectivity of incentive proclamation; and sometimes it has discrimination with regards to race, nationality
- The sector's offices staffs may have lack of awareness towards the investors, hence miss use of incentives.
- Absence of detail knowledge on effect of incentive on investment
- Has to ensure accountability ,transparency ,participation and inclusion .lack of good governance, lack of clear rules and regulations
- May be the process of institution especially problem and the knowhow problem.
- Unable to understand the advantages of investment thinking more for local activities (business) partner than investments.

Respondents were also asked for their agreement as to whether incentives have been communicated/promoted well enough to attract investors. Most of the respondents 13 (56.5%) agreed to the statement. Only 6(26.0%) of the respondents believed that there is no effective incentive promotions to attract investors.

Respondents, most of them 13(56.5%), believe that Ethiopia do not have a simple and transparent tax system that encourages investment. Nine of the responses (39.1%), however, consider the tax system in Ethiopia is simple and transparent.

4.7.Practical Challenges Being Exhibited in relation to the Investment Incentives.

The major obstacles for investment in Ethiopia is cited mainly due to infrastructure by 6(26.1%) and investment climate by 9(39.1%) of the responses. Tax issue is considered to hamper investment in Ethiopia according to 5(21.7%) of the respondents.

Respondents also mentioned the advantages and disadvantages of incentives implemented in Ethiopia. The advantages being:

- It encourages investor to invest more , promote FDI in collaboration with local investment.
- Incentives can help the investors to cop up establishment cost, and custom duty free commodity and machinery reduce operational cost
- Tax free machinery importation, Forex availability for manufacturing, low interest rate on loan.
- Tax holiday increase revenue, and establish good working capital.
- Technology transfer, employment advantage.
- getting land free or for reasonable price is encouraging

The disadvantages reported by the respondents are:

- Dependency syndrome, selfish behavior development
- Lack of clarity of the law, subjectivity of investment law, Government interaction
- Unnecessary holding of government money
- Improper uses of incentive may affect the country over all
- There must be foreign related investors to be supported or to inclusive in the incentive process.
- Subjective incentive systems
- There is no clear and consistent incentive so it will discourage the investors

The major obstacles your organization faces in executing incentives to action:

- Every now and then change at government regulation and directives, bureaucratic problem to implement the incentive to action, problem related to foreign currency
- Long process in government office to get decision -sometimes conflict with community that is related with the allowed investment land.
- VAT issues due to the unfair competition. Bureaucratic way of doing (implementing) the incentives.
- Conflicts related with land, shortage of foreign currency
- Electric power
- Infrastructure problem form raw material area
- Lack of enough foreign currency, shortage of row material.
- There is lack of working capital and also the place of expansion area.

4.8. Lack of Infrastructure as Challenges Impeding Incentive Packages

According to the survey , lack of infrastructures is one of the obstacles to the effectiveness of investment incentive .This is also supported by the information provided by the respondents .In promoting investment, infrastructure development and investment incentives are considered as factors according to 43.5% and 56.5% of the respondents respectively. And, large number of respondents, 19(82.6%), believed that there are alternatives to tax incentives to encourage investment in Ethiopia. The alternatives are:

- Backward and forward linkage of market
- levies of restriction foreign commodity that come from high labor productive county

- Political stability of the country
- Fair administration and social behavior
- Attractive rules and regulations, fast and good treatment
- Infrastructure facilities
- Utility (water ,electricity and internet)
- Low tariff
- Labor market monitoring separate
- Controlling tax evasion and creating equal ground for all players (market).
- Settlement of bank loan, settlement of investment place, settlement of resources.

CHAPTER FIVE
Summary, Conclusions and Recommendations

The purpose of this chapter is to review the whole research and indicate future research directions. Accordingly major findings, conclusions and recommendations made by the researcher for all concerned bodies are addressed. This study was conducted to asses and describe factor which contribute as the role for practical utilization of investment in the manufacturing sector.

5.1. Summary of major findings

- The business environments have very great impact according to the majority (59%) of the responses.
- The contribution of the business environment on investment package is relatively low on Sectorial and Technology related investments according to 70% of the responses.
- According to 56.55 %of the responses shows the tax system in Ethiopia lacks simplicity and transparency, and hence doesn't encourage investment. This tax system hampers investment according to 21.7% of the responses. A considerable number of responses, 48.5%, had experienced tax evasion.
- The majority 95.6% believe that incentives have visible impact in attracting investment. Whereas, 56.5% of the responses indicates that incentives are well communicated and promoted, and hence effective in attracting investors.
- About 70% of the responses indicated that the investment incentives being used by the companies are not more than 50%.
- About 52% of the responses indicate that both fiscal and non-fiscal forms of incentives are available; where mostly, according to 95% of the responses, have received fiscal incentive as the major form of beneficiary.
- About 61% of the responses indicate that manufacturers have received permanent form of tax incentives.
- One barrier to encourage investment in Ethiopia is limitations in infrastructure, according to 26.1% of the responses.

- About 70% of the responses reveal that investing in Ethiopia is mainly attributed to tax related factors.
- Political situation and economic condition of the country are considered to be major factors in making investment decisions.
- The investment climate is one that could hinder investment according to 39% of the responses. But the investment climate can be supplemented using investment incentives (according to 57.8% of the responses).
- Market size and market growth together are investment decision factors as alternatives of incentives.
- Infrastructure development is considered the major factor (above the incentive package) according to 43.5% of the responses.

5.2. Conclusions

Ethiopian Government has been providing a wide range of incentives in order to attract both domestic and foreign direct investment. However, there are debates regarding the effectiveness of the practicality or the result. From the survey result there is high level of influence of the business environment on investment undertaking; where political situation and economic conditions are the main determinants for investment decisions. Therefore, it is crucial that the country continuously improve and offer an investment-friendly environment that will encourage more investment.

Tax incentives cannot be an effective response to the economic or political problems that may exist in a country. Hence, the investment climate, which has a hampering effect in investment of the country, need to be checked and improved. The effectiveness of incentives is directly related to the investment climate in a particular country.

While tax incentives can make investing in a particular country more attractive, they cannot compensate for deficiencies in the design of the tax system or inadequate infrastructure physical, financial, legal or institutional. The survey indicates that the tax system lacks simplicity and transparency in its administration. That overshadows the good range of incentives available to investors.

5.3. Recommendation

Ethiopia has tremendous economic potentials for investments in all sectors of the economy, but this calls for bringing about a change in the image of the country and the people which has so far been depicted as war-torn, socialist-oriented and which discourages private investment. By concentrating on the 'credits' of the country, image-building and investment-promotion campaigns should be mounted as soon as possible. The economic policy and the instruments of its implementation, i.e., the investment legislations should see to it that linkage effects and consistency must be observed. Development is multifaceted and all efforts and incentives must be streamlined to bring about an integrated development.

The existing tax incentives are worthy of attracting investment in the country. But these incentives alone cannot be as attractive as expected because of the very great influence of the business environment. Hence, improving administration of incentives and the tax system should be one area of focus.

The investment climate along with the political and economic aspect of the country has great potential in investment decisions, and hence needs to be preserved and promoted.

Provision of basic infrastructures, which includes sustained supply of electricity, has to be given due attention.

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APPENDICE I – Questionnaire

ST MARY'S UNIVERSITY SCHOOL OF GRADUATES BUSINESS ADMINISTRATION MASTERS PROGRAM QUESTIONNAIRE

Dear sir/Madam, this is a research work on the practical utilization of incentive in promoting investment in Ethiopia .your application is very important part of this questionnaire. I would like to thank you in advance for your cooperation.

The primary purpose this study is for the fulfillment Masters Degree in Business Administration. Thereby the research intends to identify the effectiveness of incentive in promoting investment.

The expected length of filling the questionnaire will be approximately 15 minutes.Your participation in the study is invaluable, but you may withdraw at any time If youfeel the need to withdraw, all material and information you have provided will bedestroyed or returned to you.

All information supplied by you will be treated in the strictest confidence.

The research will be conducted by HananBeyan.

Thank you for your support,

Hanan

Confidentiality

The information you will provide for the study will be confidential. The findings of the study will be general for the study community and will not reflect anything particular of individual person. The questionnaire will be coded to exclude showing name no reference will be made in and will refer reports that link participants of the study.

Thank you

HananBeyan

Section I – background information

Please indicate your choice by putting a thick mark (✓) among the given alternatives

1. Please mention your age
   20-25 ☐ 26-30 ☐ 31-40 ☐ above 40 ☐

2. Sex
   Male ☐ Female ☐

3. How many years of experience do you have in your current organization?

   Less than 2 years ☐ 2-5 years ☐ 6-10 years ☐

   11-15 years ☐ more than 15 years ☐

4. What is your educational qualification?

   Below level IV Diploma ☐ Level IV Diploma ☐ Masters Degree ☐

   Bachelor Degree ☐ Above masters Degree ☐

Section II. Investment incentive

5. To what extent do you think the business environment influence the incentive package.

A. very great B. Great C. low

6. if your answer for question number is law what could be the reason for low contribution .

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______

7. What is the major objective of incentive in Ethiopia?
   A. Sectorial investment
   B. Regional investment
   C. Technology investment
   D. Employment investment

8. The investment incentive administration is simple &transparent.

   A. strongly agree B. Agree C. Neutral D. Disagree E. strongly Disagree

9. What are the reasons that hinder incentive administration to be simple & transparent?
   ____
   ____
   ____
   ____

10. What percentage of the investment incentive you believe is being used by your specific organization?
    A. 0-25
    B. 26-50
    C. 51-75
    D. 76-100

11. What type of investment package is (was)your organization beneficiary from

    A. fiscal incentive B. non fiscal incentive C. both D. neither

12. What types of tax incentives is your organization beneficiary from ?

Type of tax incentive	currently used	Used in the past
Tax holiday's	☐	☐
Reduced tax rates	☐	☐
Investment allowances or credits	☐	☐
VAT exemptions/reductions	☐	☐
Research and development tax incentives	☐	☐
Special economic zones	☐	☐
Payroll tax holidays	☐	☐

13. incentive have been communicated/promoted well enough to attract investors?

A. strongly agree B. Agree C. Neutral D. Disagree E. Strongly disagree

14. Which one of the following way granting tax incentive that boosts investment?
    Temporary ☐ Permanent ☐

15. Do you believe Ethiopia has a simple & transparent tax system that encouragers investment ?
    A. Yes ☐ B. No ☐

16. Can you mention advantage or disadvantage of incentives implemented in Ethiopia in your sector?

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Section III: Investment Trend

17. Which one of the following did you see as a major obstacle for investment?
    A. Investment climate (political) stability, economical, legal
    B. Tax issue
    C. Infrastructure

18. Which one of the following factors are major determinant of investment in Ethiopia?
    A. Tax factors
    B. Non tax factors

19. Which of the following factor considered as significant in investment decision?
    A. Political stability
    B. Social condition
    C. Economic factors

20. Do you think weak investment climate can be supported by investment incentives?

    A. strongly agree B. Agree C. Neutral D. Disagree E. Strongly disagree

21. Which factors do you think that will drive investors to invest even without incentives?
    A. Market size
    B. Cost of labor
    C. Market growth
    D. Competition

22. Did the area of origin (countries that investors originated) have impact/relation with investment volume?
    A. Significant impact
    B. Does have impact/relationship
    C. Little relationship

23. To what extent Do you think investment incentives have visible impact on investment.

Promotion ?

A. very great B. Great C. low

24. If your answer to question 23 is low what could be the reason for low contribution.

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25. Have you experienced a major tax envisions related to carrying out of tax incentives?
    A. yes ☐ B. No ☐
26. Which one of the following factors contributes lot in promoting investment?
    A. investment incentive
    B. Infrastructure development
27. Do you think there are alternatives to tax incentive that can encourage investment?
    A. Yes ☐ B. No ☐
28. Mention other alternatives that encourage investment other than tax incentives?

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29. Is there any other major activities performed to enhance investment in your office?

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30. What are the major obstacles your organization facein executing incentives to action?

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DECLARATION

I, the undersigned, declare that this thesis is my own original work and prepared under the guidance of Elias Nour(PhD).All material source used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Name	Signature
St. Mary's University, Addis Ababa	JUNE 2016

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Postgraduate studies for examination with my approval as a University advisor.

____

Advisor name Signature

St. Mary's University, Addis Ababa JUNE 2016