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ST. MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES

BARRIERS TO DOMESTIC INVESTMENT IN ADDIS ABABA

CITY ADMINISTRATION

BY

AHMED MOHAMMED

MARCH, 2022

ADDIS ABABA, ETHIOPIA

**BARRIERS TO DOMESTIC INVESTMENT IN ADDIS ABABA
CITY ADMINISTRATION**

**A THESIS SUBMITTED TO ST.MARY'S UNIVERSITY, SCHOOL OF
GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF MASTER OF ARTS DEGREE
IN DEVELOPMENT MANAGEMENT**

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As members of the examining board of the final M.Sc. thesis open defense, we certify that we have read and evaluated the thesis prepared by Ahmed Mohammed, entitled "BARRIERS TO DOMESTIC INVESTMENT IN ADDIS ABABA CITY ADMINISTRATION " and recommend that it to be accepted as fulfilling the thesis requirement for Master of Art degree in Development Management.

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I hereby declare that this thesis entitled “BARRIERS TO DOMESTIC INVESTMENT IN ADDIS ABABA CITY ADMINISTRATION” has been written by me and it is a record of my own research work. No part of this work has been presented in any previous application for another degree or diploma at any institution. All borrowed ideas have been duly acknowledged in the text and a list of references provided.

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ENDORSEMENT

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March, 2022

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ACRONYMS

CSA	Central Statistics Authority
EIA	Ethiopian Investment Agency
ETB	Ethiopian Birr
ES	Enterprises Survey
FDI	Foreign Direct Investment
FOB	Free On Bond
HDI	Human Development Index
GDP	Growth Domestic Products
GTP	Growth and Transformation
IDS	Industrial Development Strategy
LDCs	Least Developed Countries
LC	Letter of Credit
MoFED	Ministry of Finance and Economic Development
NGOs	Non-Governmental Organizations
SSA	Sub Saharan Africa
USD	United States Dollar
WB	World Bank
WDR	World Development Report

ACKNOWLEDGMENT

First of all words are not enough to express the gratitude to my families for their support. Next, I would like to extend my deep rooted gratitude from the bottom of my heart to my advisor Muluadam Alemu (PhD) for his guidance, suggestions and constructive comments without which this thesis would have not been in this form. Also I would like to extend my appreciation to all my friends those who helped me to achieve this milestone.

Finally, I would like to forward my special thanks to Mr. Wondimagegn Tadesse for his support and devotion of time in typing, correction and edition of this research.

ABSTRACT

It is commonly and widely thought that investment is the engine of economic growth. Following this view, a number of empirical studies have been made on domestic investments in Ethiopia. However these entire studies uses macroeconomic variable to identify the determinate of private investment at national level and the determinant of private investment at Addis Ababa city level was not separately identified and also the non-macroeconomic variables that hinder domestic investments were not addressed sufficiently. Furthermore the conversion rate of investment projects into operation in Addis Ababa city is the lower than the national average due to different barriers. Thus the main objective of this study is to examine the barriers to domestic investment and evaluate these barriers by investment sectors in Addis Ababa City Administration. Descriptive type of research design has been employed to address the research objective. Quantitative research analysis is used to provide numerical measurement and analysis of the magnitude. The study used secondary data that was the World Bank's Enterprise Survey (ES) data on Ethiopia. The data was collected by World Bank from June 2015 to February 2016 from 457 firms operating in Addis Ababa. Descriptive statistics such as frequency, percentage, mean, standard deviation was used to analyze the data. The findings indicated that electricity, access to land, tax rate, business licensing, political instability, corruption and custom and customs clearance and procedures related to export are the moderate barriers for domestic investors. Further, the major components of barriers to doing investment business in Addis Ababa city are access to finance, inadequately educated workforce, access to foreign exchange, customs clearance for imported materials, parts and equipment and Import Licensing and Other Non-Tariff Barriers. Hence, to promote of domestic investment in the city as well as to attract domestic investors, policy implications that give top priority to address the identified barriers specially policy implication that give due consideration to major barriers that hinder domestic investment is required

Keywords: *Domestic Investment, Investment Barriers, Addis Ababa City, Enterprises*

CHAPTER ONE

INTRODUCTION

1.1. Backgrounds of the Study

Globally, investment is widely considered as one of the main drivers of economic growth because it is a flow that increases the existence of capital in the economy, and high investment rates are widely considered to be an essential condition for attaining a high and sustainable growth rate (UNCTAD, 2008). Private investment plays an important role in the expansion of the economy's production capacity and long term economic growth. Private investment is a crucial pre requisite for economic growth because it allows entrepreneurs to set economic activity in motion by bringing resources together to produce goods and services (Frimpong & Marbuah, 2010).

Investment is, without doubt, one of the primary engines of growth in all economies (Khan, 2005). Investment, in general, is recognized as an integral component of economic development and a crucial element in the effort to lift countries out of poverty (Wolfenson, 2007). Private investment, in particular, is one aspect of investment and as such it contributes significantly to economic growth and the ability of a country to reduce or alleviate poverty and improve the lives of its citizens (Bayai & Nyangara, 2013).

Private investment is one of the most important macroeconomic variables. Importance of private investment stems from the fact that it has both short term and long term implications for any economy. In short term, private investment drives the direction of business cycle whereas in long

term it defines the path of economy by setting steady state growth rate. In short run, private investment is important because it is the most sensitive and volatile component of aggregate demand; which is chiefly responsible for business fluctuations. Long term significance of private investment comes from its role in physical and human capital formation which is the ultimate source of growth and productivity. Countries with high and stable investment paths are in general more prosperous than those countries that have low and volatile investment paths ([Atif and Nawaz, 2014](#))

It is argued that investment is the major foundation of enhancement in the level of literacy, improvement in technology and increase in the capital stock ([Hashmi et al 2012](#)). argued that investment in capital goods is the most robust and vital determinant of economic growth. Gross domestic investment boosts economic growth by increasing physical capital directly and indirectly through technological spillovers ([De Long & Summers, 2012](#)).

The investment sector has the significant contribution to the economic growth through creating an employment opportunities, enhancing technical progress and introducing new techniques of production. In the investigation of [Greene & Villanueva \(1991\)](#) in developing countries during the year 1980s, decline in economic progress of countries was directly linked with the decline in gross capital formation. As evidenced in many studies, it is rather private investment that plays greater role than public investment in determining growth in most developing ([Serven and Salimano ,1990](#) , [Khan and Reinhart 1990](#) & [Badawi , 2005](#)).

In the process of investigating the economic performance or growth of a country, one of the key determinants that need to be considered is investment ([Augustine, 2014](#)). Countries that are

developed are those that have invested much in their economies whereas countries that are investing slowly, are not only developing slowly but also still remaining poor (Solow, 1956).

Alemayehu & Befekadu (2005) have explored the role of investment as one of the long-run determinants of Ethiopia's growth rate. With regard to the relative contribution of public investment and private investment to economic growth, they confirmed that private investment is a greater contributor than public investment to the country's economic growth; a 10% increase in private investment leads to an approximately 1.5% increase in output, while a similar increase in government investment leads to a 0.95% increase. Recently, economists have developed a common opinion about the constructive effect of sustainable investment on economic growth. Moreover, the sustainability of investment depends on the investment sector (World Investment Report 2014).

A good investment climate provides opportunities and incentives for investors to invest profitably, create jobs, and expand national output thereby increasing private investment and economic growth (World Bank, 2004). There are dominant narratives about the Ethiopian economy that are often repeated, but infrequently assessed for accuracy. The Government of Ethiopia has long been promoting the “Ethiopia rising” image, academics have called it the “China of Africa” international agencies rank it as one of the fastest-growing economies in the world (World Bank 2018), and journalists have lauded its miraculous transformation (Kopf 2017). One challenge to these narratives is a line of questioning regarding the distribution of benefits of the growing economy—in other words, for which the economic growth benefits, and at whose expense (Haylemariam 2017). Effectively, this line of critique questions the accuracy of the data, as well as the relevance of the aggregate narratives to lived experiences of the

majority of Ethiopians. Aggregations have the potential to make invisible rising inequalities, chronic poverty, and new vulnerabilities resulting from economic change. These are important questions to ask, and critiques to make. With regard to inequalities, emerging research is highlighting the manifestations of, and challenges brought about by, rising inequality (e.g., [Cochrane & Rao 2018](#); [Rammelt et al. 2017](#); [UNDP 2015](#)).

Despite the fast growth record in recent years, Ethiopia in general and Addis Ababa in particular recorded a high urban unemployment rate. Youth unemployment is a major challenge; about 25% of young people (aged 15-29) in Addis Ababa were unemployed in 2020 ([CSA 2020](#)). There is also significant immigration to Addis Ababa, and most recent migrants endure economic hardship and a poor quality of life (World Bank 2010).

Ethiopia has now started implementing Ethiopia's Growth and Transformation Plan II (GTP II) which sets even more ambitious targets for industry and manufacturing to grow at an average rate of 19.8% and 23.9% per annum respectively, leading to a rise in its GDP share to 23% (and manufacturing to 18.8%) by the end of the GTPII period while that of agriculture and services decline to 36% and 41%, respectively (FDRE National Planning Commission 2016).

This industrial development vision and target hinges on attracting both domestic and FDI manufacturing firms. But especially Ethiopia's Industrial Development Strategy (IDS) puts the role of domestic investment or manufacturing sector in the industrial journey of Ethiopia as critical or irreplaceable. The reasons for this are firstly domestic investment is reliable and sustainable. For local investors, Ethiopia is their country with which they have significant ties; hence, they continue to create more wealth and employment unlike foreign firms who tend to migrate whenever better opportunities arise elsewhere. And the secondly the anticipated benefits

of FDI (technology transfer, job creation and market linkage) can only be realized if we have a dynamic domestic private sector. There is no such thing as technology transfer and market linkage unless you build a vibrant and dynamic domestic private sector.

Although the Ethiopia's Industrial Development Strategy (IDS) emphasizes domestic investment as key to sustainable industrial development and the investment promotion strategy started to attract domestic investors to the manufacturing sector, quite a few of them go beyond the licensing stage to start production as well as expansion of existing business [Gebrehiwot et al \(2014\)](#).

1.2. Statement of the Problem

Home to about 115 million people, Ethiopia is the second-most-populous nation in Africa and has one of the fastest-growing economies in the region. According to the [World Bank \(2020\)](#), Ethiopia's economy experienced strong, broad-based growth averaging 9.8% a year from 2008/2009 to 2018/2019, with the share of the population living below the national poverty line declining from 38% to 24% over the same period [World Bank \(2020\)](#), The [International Monetary Fund \(2020\)](#) notes that Ethiopia's per capita income has risen by about 200% since 1990 while life expectancy increased by about 10 years in a decade and infant mortality was reduced by half. Despite this impressive economic growth, Ethiopia remains one of the poorest countries in the world with a per capita annual income that the government estimates at \$883 ([MoFEC, 2019](#)). Thus the expansion of domestic investment should be encouraged to lift the country out of the list of poorer country in the world.

Ethiopia was ranked 159 out of 190 countries in the World Bank's Ease of Doing Business indicators of 2019 report, sliding two positions from the 2018 and down 55 positions from its

best-ever ranking back in 2011. Within East Africa, Ethiopia is the second worst overall standing in easy of doing business after Eritrea (World Bank 2019). Investment is one of the business sectors in Ethiopia challenged by easy of doing business. Beside this Ethiopian investors complain about poor infrastructure, particularly power shortages; poor transport; poor telecom connectivity of business locations and lack of efficient tax administration (Mima and David, 2012; World Bank, 2004). Ethiopia ranked 124th out of 148 countries in terms of the infrastructure in the 2013/14 global competitiveness report (WEF, 2013).

Several studies have been undertaken at country level to identify determinant and challenges of investment in Ethiopia. For instance [Abdushi\(2000\)](#) studied factors determining private investment in Ethiopia using time series data for the period between 1975 and 1998. In his study he showed that real gross domestic product and public expenditure are found to have statistically significant effect to promote private investment in Ethiopia, [Adugna \(2013\)](#) studied determinants of private investment using time series data over the period from 1981-2010 and his study showed there is a positive and statistically significant impact of public investment, economic growth and interest rate upon the performance of private investment in Ethiopia. [Hailu and Debele \(2015\)](#) studied the effects of monetary policy on the private investment on in the case of Ethiopia using the time series data from 1975-2011. The main findings of their study revealed that economic growth, exchange rate and public investment has significant long run impacts on the expansion of private investment in Ethiopia. These entire studies uses macroeconomic variable to identify the determinate of private investment at national level and the determinant of private investment at Addis Ababa city level was not separately identified and also the non-macroeconomic variables were not addressed. However according to [World Bank \(2014\)](#) report on the investment climate in Addis Ababa showed that only 5 percent of domestic firms

receiving an investment license are able to convert from the preoperational to the operational phase. This indicates that the conversion rate of investment projects into operation in the capital city, Addis Ababa, is even much lower than the national average (9.5%). whereas conversion rates for foreign investors in Addis Ababa are 60 percent [World Bank \(2014\)](#). Despite all of the above mentioned existing reports, the barriers to domestic investment in Addis Ababa city administration were not adequately addressed and it should be investigated for making a corrective measure by the concerned body. Thus, this paper is initiated to fill this gap by investigating barrier of domestic investment in Addis Ababa City Administration. Addis Ababa was selected for this study because it is the capital city, the largest and most economically significant city in the country.

1.3 Research Questions

The study aimed to answer the following core research questions:

- i. What are the major barriers for doing investment business in Addis Ababa?
- ii. How do the investment barriers affecting domestic investors investing in different sectors?

1.4 Objectives of the Study

General Objective

The general objective of this study is to examine the barriers to domestic investment and evaluate these barriers by investment sectors in Addis Ababa City Administration

The Specific Objectives of the study are to

- i. Identify the barriers to domestic investment in Addis Ababa
- ii. Evaluate the barriers of domestic investment by investment sectors in Addis Ababa

1.5 Significance of the Study

Identifying the barrier of domestic investment can be springboard information for government, decision-making stakeholders such as the Investment Agency and policy maker for expansion of domestic investment by resolving the barriers that discourage domestic investors. Apart from this, it will fill the gap of the existing literature as of challenged of domestic investment studies are minimal and even absent in the context of Ethiopia.

1.6 Scope of the Study

The study is delimited to explore the barriers to domestic private investment activities in Addis Ababa city Administration. The study area is selected based on the availability large number of domestic investor in different sectors. Therefore, the study is look to examine the major barriers to domestic investments in Addis Ababa level city.

1.7 Limitation of the study

This study is limited to investigate the barriers of domestic investment in Addis Ababa by taking secondary data from World Bank's Enterprise Survey (ES) for Ethiopia. Due to time constraints the study was not able to investigate the barriers of domestic investment at country level. Investigating the barriers to domestic investment at country level will help the policy maker, investors and other stakeholder to compare and contrast the barriers from one region to other region in Ethiopia. In addition to the above mentioned limitation, the researcher unable to extract the latest data because of the pandemic the 2020 Enterprise Survey (ES) for Ethiopia were not conducted by World Bank. Thus the researcher were forced to use recently available data which is 2015/2016 enterprises survey data.

1.8 Organization of the Paper

The rest of the paper is organized as follows. Chapter two contains both theoretical and empirical literature reviews. Chapter three describes the methodological issues of the study and the 4th chapter presents the result and discussion. Finally, Summary, conclusions and policy implication of the study are presented in chapter five.

CHAPTER TWO

LITERATURE REVIEW

The aim of this chapter is to briefly and critically review both theoretical and empirical literatures on investment and relevant studies were reviewed giving special focus on findings and methodological issue in developing countries.

2.1 Theoretical Literature Review

2.1.1. Concept and Definitions

UNCTAD (2014 and 2015a) defines investment as one of the key drivers of structural change and as a prerequisite for economic growth. Investment plays a strategic role for policymakers in the promotion of growth in developing countries, particularly of long-term growth, for instance, by boosting the level and rate of investment, improving its productivity and ensuring that the investment reaches the economy's strategic industries (UNCTAD, 2014 and 2015).

Major drivers of economic development and sustainable investment include good governance, transparency, stability, openness, quality regulation and respect for the rule of law and predictability as well as strong institutions (OECD, 2015, OSCE, 2006).

2.1.2 Investment and Its Growth Implications

Investment has been regarded as crucial for growth since the formal onset of economics by the optimistic classical economist Adam Smith (1776). The belief of economists including the views of classical optimists and pessimists, Thomas Malthus (1798), David Ricardo (1817), and Karl Marx (1847)), Keynesian, neoclassical and endogenous growth theorists has been consistently the same in that the level of income and living standard of nations is a function of investment and

capital accumulation. With the exception of neoclassical view, all the above blocks of thinking agree that economic growth depend on the rates of saving, investment and capital accumulation.

2.2.3 Investment and Employment Generation: Existence of Duality

Free market permits the move together of labor, capital and entrepreneurship to superior return areas. The Lewis Surplus labor theory states the dual existence of traditional labor and the modern labor. Surplus Labor means the existence of such a large population in the rural sector so that the marginal productivity of labor has fallen to zero. This condition is also called disguised unemployment. Thus for development, there could be transfer of labor from the agricultural sector to the modern surplus generating industrial sector and is pursued for capital accumulation (Todaro and Smith 2012). Though Lewis is criticized multidimensionality, it is possible to strengthen this theory in the context of Ethiopia. The average land holding per household in Ethiopia is not more than one hectare. Because of this, most of the family members are disguisedly unemployed which is also aggravated by the seasonality of agriculture in the country. In non-irrigated areas, the usual active farming period in the country ranges from May to December and in the remaining months, farmers are idle, usually in the north. From December to April these rural labor migrate for work to the nearby towns. For example, most of the physical manual works in Addis Ababa road, train and housing works are accomplished by these migrants. According to EIA (2013), during the last 21 years out of the total temporary employment created, the share of Addis Ababa is 38.3%. However, to find the actual figure needs further research that whether this temporary employment is made by the migrants or those original habitants of the town. In the same period, the share of Amhara, Oromiya, Tigray and Dire Dawa was respectively 12.7%, 24.7%, 4%, 2%.

2.2 Empirical Literature Review

The purpose of this section is to review empirical literature related studies in the rest of the world and in Ethiopia to have a deeper understanding of the factors contributing for private sector investment growth and their barriers.

A study by [Bakare \(2011\)](#) on the impact of corruption on investment showed that corruption was among the most significant barriers facing investment cited by Afghan business people. Others included access to land, anti-competitive behaviour and tax administration, all closely related to corruption. The World Bank's report on the investment climate in Afghanistan identifies the major barriers to investment as being electricity, access to land, corruption and access to finance.

[Badawi \(2004\)](#) investigated the impact of macroeconomic policies on private investment in Sudan employing annual data over the period 1969-1998. The results suggested the significant crowding-out effect of public investment on private investment in Sudan, devaluation policies also contributed to discouraging private sector capital expansion.

[Sakr et al \(1993\)](#) carried on studies on the private investment behavior in Kenya and found a positive influence of savings, GDP growth and public investment on the behavior of private investors. The study's findings also indicated that output growth did not affect private investment while monetary policy played a less significant role. Further, the paper found that credit provided to the private sector, public investment and GDP growth had a significant impact on private investment. Restrictions on investment financing are a problem broadly documented in the literature on the determinants of investment. [Loungani and Rush \(1995\)](#) suggested that some agents, typically small and medium enterprises (SMEs), are unable to get financing directly from open market debt. Hence, these agents are strongly dependent on bank credit, a market that is

usually characterized by imperfections due to asymmetric information between lenders and borrowers. In developing countries, this problem of access to credit is critical, due to the absence of markets and poor access to long-term financing. The evolution of the credit amounts destined for the private sector would be a good indicator of the restrictions operating in the domestic financing of investment. [Ronge and Kimuyu \(1997\)](#) examined the determinants of private sector investment for Kenya using data over the period 1964-1996. A double-logarithmic form of the investment equation was estimated using ordinary least squares (OLS). The results indicated that both the availability of credit and foreign exchange exerts significant positive effects on private investment confirming the results in most empirical studies. Private investment, however, was adversely affected by the stock of debt. Specifically, a one percent increase in the lagged debt to GDP ratio reduced private investment by 0.3 percent. The study also establishes a negative effect of exchange rate depreciation on investment while public investment crowded in private investment.

[Asante \(2000\)](#) investigated the determinants of private investment in Ghana using time series and cross-section data. The survey data comprised of 116 manufacturing firms in Ghana sought to capture the determinants of private investment that are not captured in time series analysis, for example, political instability and policy uncertainties. [Frimpong et al \(2010\)](#) carried out a study seeking to present an empirical assessment of factors that have either stimulated or dampened private sector investment in Ghana using ARDL framework covering the period 1970 to 2002. From the results it emerges that private investment is determined in the short-run by public investment, inflation, real interest rate, openness, real exchange rate and a regime of constitutional rule, while real GDP, inflation, external debt, real interest rate, real exchange rate and openness significantly influenced private investment response in the long-run. On the policy

front, the study indicates that improving the productivity of sectors such as agriculture and manufacturing by providing more efficient advanced technologies as input subsidies could go a long way to increasing private investment levels and growth in output. [Temitope W.Oshikoyo \(1994\)](#) made analysis of the determinants of domestic private investment in eight African countries in a period of 1970-1988. Results indicate that infrastructure had a positive impact while no infrastructural variables had negative impact on private investment. Also the likely impact of domestic inflation rate on private investment performance in middle income countries is positive and insignificant. [Bazoumana \(2004\)](#) studied factors that determine private investment in Senegal. On his study he found a significant relationship between private investment and its explanatory variables. Accordingly, public infrastructural investment had positively relation with private investment and GDP. He also found that credit to private sector and trade terms have a significant negative impact on private investment. [Weder \(1998\)](#) conducted a study on 21 Sub-Saharan African countries using data on institutional factors. The institutional factors which he employed were qualitative information on annual ratings of the following indicators: the rule of law, quality of bureaucracy, policy surprises, credibility of announcements, degree to which business can participate in making new rules, predictability of judiciary enforcement, security of property rights theft and crime, extent of availability of information on new rules, frequency of corruption; uncertainty of corruption, and corruption perceived as an barriers to domestic investment. He rated all indicators from 1 (worst) to 6 (best) and concluded that judiciary enforcement, theft and crime, security of property rights are significantly associated with domestic private investments.

[Erden and Hocokombe \(2005\)](#) have examined the impact of public investment on private investment. They applied several pooled specifications of a standard investment model to a panel

of developing economies from the period 1980 to 1997. Their study find out that public investment crowds in private investment i.e. an average, a 10% increase in public investment is associated with 2% increase in private investment. Moreover, the results also indicate that in developing economies availability of bank credit is the major constraint for private investment.

[Everhart and sumlisk \(2001\)](#) analyzed the quality of public investments its interactive with corruption and the resulting impact on private investment for 63 developing countries from 1970 to 2000. They found out that lagged private investment and the availability of credit to private sector are positive and significant. The external debt is also negative with expected negative sign implying that the presence of large external debt burden implies uncertainty.

[Bazoumana \(2004\)](#) analyzed the determinants of private investment in general. He found a significant relationship between private investment and its explanatory variables. Public infrastructure investment was found to be positively related with private investment GDP, credit to the private sectors and terms of trade has a significant negative impact in private investment.

The survey made by [Seruvatu and Jayaraman \(2001\)](#) on determinants of private investment in Fiji indicated that the principal factors hindering investment are largely policy-related issues. This suggested that while investment incentive schemes might go some way in promoting investment, the key to improving the investment climate is clear policy direction and simple bureaucracy and regulation. The top major barriers to investment were government policy uncertainty, bureaucratic red tape, government regulations, finding skilled labor, volatile political situations, land issues, law and order instability, a lack of infrastructure, and high utility costs like water and electricity. Consumer confidence, interest rates, shipping costs, profitability, bank fees and charges, price controls, tax rates, racial issues, medical/education facilities, finding suitable land/premises, availability of work/sales, lack of bank lending, wages, cash flow,

contract security, and exchange controls were relatively less important. Other impediments to investment include expatriate permits, a lack the Board of Directors' support and interest, lack of management focus and prioritizing, trade union issues, lack of local equity, labor rigidity, trade relations, lack of raw material, international tax treaties, and coups and crime.

[Ndikumana \(2014\)](#) domestic savings appear to be an important driver of domestic investment. Similarly, bank credit to the private sector has a positive and statistically significant effect on domestic investment. The effect is nonlinear, suggesting that beyond a certain threshold of the credit to GDP ratio, the relationship between credit and investment turns negative. However, in this particular sample, the threshold implied by the regression results is high, implying that there is plenty of room for credit to increase in the range where the relationship between domestic investment and credit to the private sector is positive. The effect of credit on investment is quantitatively much larger than that of domestic savings. The results suggest that improvements in access to investment capital from the banking sector are a more potent tool to stimulate domestic investment than domestic savings. In other words, while both bank credit and domestic savings constitute potential sources of investment financing, domestic savings that are intermediated through the banking sector ultimately alleviate the financing constraints more effectively. The two results taken together are consistent with prior studies in the literature that have documented a powerful role by financial intermediation for domestic investment in Africa. A study by [Admasu \(2002\)](#) on the macro and microeconomic determinants of private investment both at national and regional levels in Ethiopia showed that at the micro level the probability of individual's to invest is significantly and positively influenced by the level of education, access to land and investment incentives. The influence of bureaucratic red tape was also found to be

negative and significant. Moreover, [Deneke\(2001\)](#) concluded that unclear land policy, compounded by investors' fear of political instability, has impeded Private sector development.

[Ambachew,\(2010\)](#) study on the determinants of domestic private investment in Ethiopia identified that domestic credit given to the private sector reduces domestic private investment because the credit may be diverted to non-productive activities. The study further identifies that the appreciation of the real exchange rate discourages domestic private investment and vice versa. In short, the high value of local currency constrains domestic investment.

[Dawit\(2010\)](#) showed that the following are the success factors for private investment: the maintenance of good accounting records by firms, good managerial skill, experience, government support and training. The major problems are a lack of proper planning and feasibility studies, lack of skilled staff, delays in securing bank loans, a lack of market for products and service, infrastructure problems and inflation.

A study by [Workie \(1996\)](#) on constraints to entry, operation and expansion of private investment in Ethiopia using investor level information showed that bureaucratic procedures, a lack of infrastructure, power supply problems and access to finance were the leading constraints for operations. The other areas of the business environment (such as political/policy uncertainty and labour regulations) were relatively less important. The survey ultimately confirmed that the availability of finance rather than the interest rate is a crucial determinant of private investment in Ethiopia. Macroeconomic instability and political/policy uncertainty were not found to be significant determinants of private investment.

[Sisay\(2010\)](#) carried on the study of the determinants of private investment in Ethiopia over the period ranging from 1950-2003 motivated by modified flexible accelerator model by applying multivariate single equation ECM estimation methodology. According to his study private

investment in Ethiopia is influenced by the domestic market, infrastructural facilities and FDI and negatively by macroeconomic uncertainty.

[Esubalew \(2014\)](#) carried on studies on the macroeconomic determinants of private investment in east Africa region with panel data set from the period of 2000-2012. According to his studies macroeconomic factors such as variation in the output and real per capita growth fiscal and monetary policy as well as exchange rate are the most determinant factors for the variation of private investment in eastern African countries over the study period. His study confirmed that domestic private investment is positively influenced by real GDP growth, financial availability as measured by credit to the private sector as the percentage of GDP and the development of human capital as measured by school enrollment has significant positive influence on the private investment of the region. On the other hand variable such as unstable macroeconomic environment, as measured by the inflationary situation, high external debt, fluctuation in the terms of trade, real exchange movement, public investment and real interest rate are found to hinder private investment significantly in east Africa.

[Siraj \(2014\)](#) tried to evaluate the inter-relationship between private investment and economic growth both in the long and short run. He argued that there is evidence of unia-directional causality between economic growth and private investment. The findings showed that both private and public sector investment have a positive significant impact on real output/economic growth while in the short run public investment has a negative impact on growth and private investment has a positive impact on private investment.

[Gebrehiwot et al. \(2014\)](#) conducted a qualitative survey on a total of 42 firms (investors) in Addis Ababa mostly from manufacturing. The main finding of their study is that the key barriers to investment are related to lack of access to land, finance, regulatory and institutional

inefficiency, poor infrastructure particularly power and lack of skills. The study contains a detailed manifestation of each of these problems. The overall implication is that the poor business environment is not only undermining existing firms but also discouraging new investments and transition from project to operation.

A study conducted by in Ethiopia by [EDRI \(2017\)](#) found that access to commercial or industrial land was the main barriers to entry in the investment operation and operational firms were found to be similarly constrained by difficulty in accessing finance and land for expansion, while other important constraints for them included poor electricity, foreign currency, and skill shortages

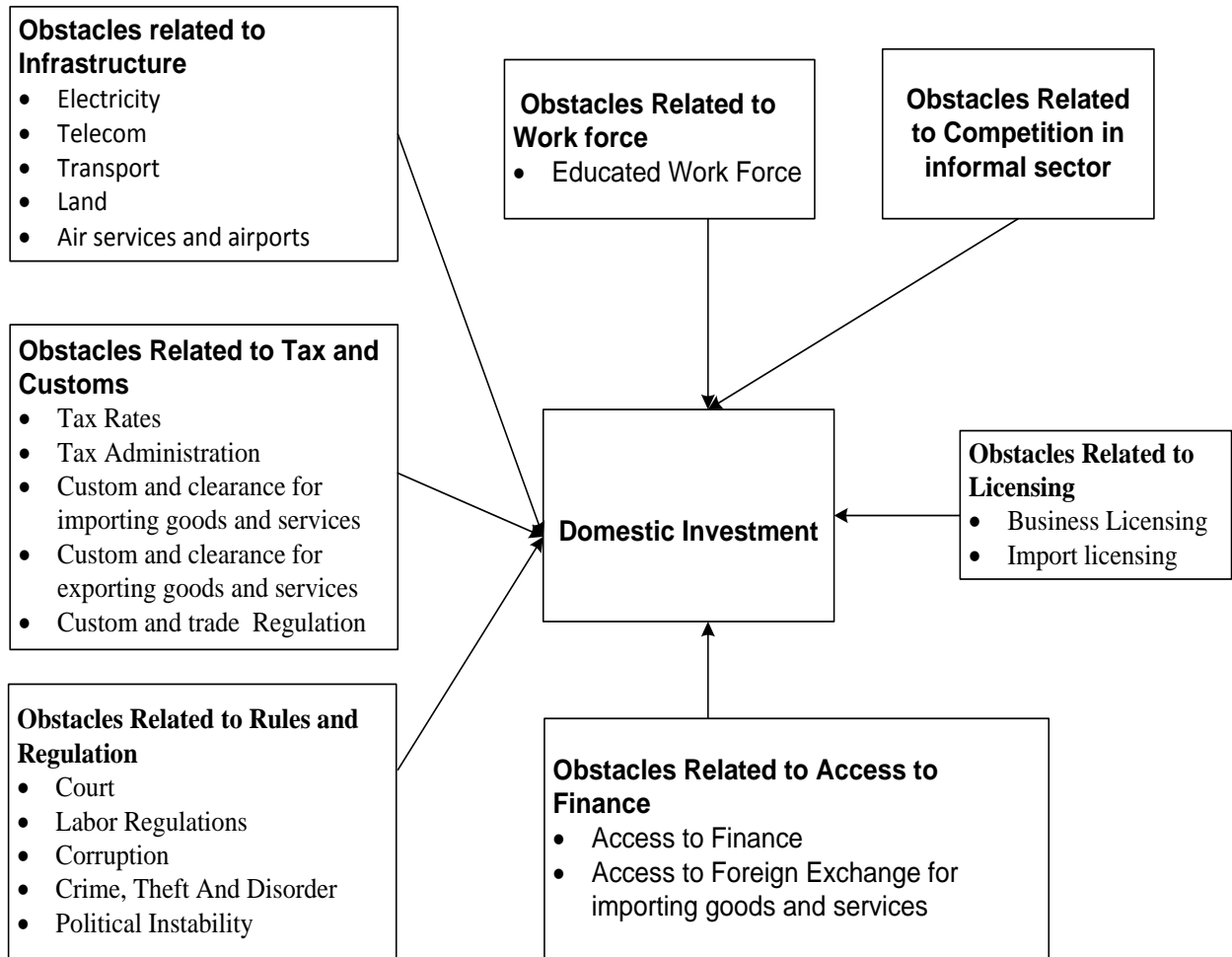
2.3. Knowledge gap

A number of studies on private investment especially in developing countries have been carried out. Nevertheless from the review of literatures and empirical studies cited above one can clearly see that even if the barriers related to domestic investment are tried to address by different researcher, the barriers for the domestic investment at Addis Ababa level have not been adequately addressed. Presently, Ethiopia has been implementing GTPII and the government hugely makes public investment and expanding different industry parks to attract both domestic and foreign investors. Thus, presence of little empirical analysis in this context makes this study vital to show the barriers of domestic investment in Addis Ababa to help design informed and prudent recommendation to promote domestic investment by circumventing its barriers

2.4 Conceptual framework of the study

Domestic investment in the study place is challenged by different barriers. The barriers are categorized into different categories such as barriers related to infrastructure, barriers related to rules and regulation , barriers related to tax and customs, barriers related to access to finance,

barriers related to licensing , barriers related to work force. The conceptual frame work of the study is presented as follow.



Source: Developed by the Researcher (2021)

Figure 3.1-Conceptual framework of different on barriers categories and domestic investment.

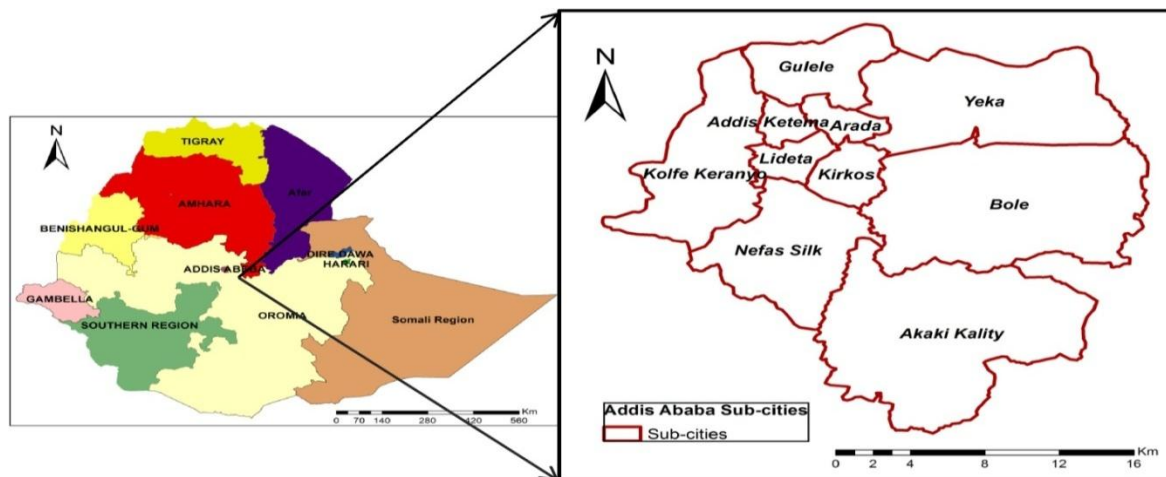
CHAPTER THREE

DATA AND METHODOLOGY

3.1 Description of the Study Area

Addis Ababa City is the political capital and the most important commercial and cultural centre of Ethiopia. It is located in the horn of Africa at geographic coordinate of 8°53'46.92" N Latitude and 38°55'52.22" E Longitude. The city has an area of 540 km² and its altitude range of 2200–3100 m above sea level, the city is located in the central highland with Afro-Alpine temperate and warm climate. Addis Ababa City Administration has a total population of 2,738,248 of which 1,433,730 (52%) is female population and the remaining 1,304,518 (48%) is male population and the sex ratio (number of males to number of female populations) is 0.91 in the census year CSA (2007),. Being among the ten largest cities in Sub-Saharan Africa with annual growth rate of 3.8%, the population growth in the city will have reached 8 million by 2020. The city divided into 10 sub-cities and 116 districts (woredas), which are the lowest administrative units

Figure 3.1 Map of Study Area



Source (Sisay and Till, 2021)

3.2 Study Design

The main purpose of this study was to examine the barrier of private domestic investment in Addis Ababa city administration. Therefore, this study utilized quantitative research approach to achieve the stated objectives.

3.3 Source of Data

The source of data for the study is the World Bank's Enterprise Survey (ES) data on Ethiopia for 2015/16 which was a sample survey conducted using stratified random sampling with industry, establishment size, and region representing the three levels of stratification used. The survey covered 848 firms including micro, small, medium, and large firms. The data from these 848 firms was collected from June 2015 to February 2016 in Ethiopia by the World Bank. In this study 457 firms operating in Addis Ababa only was used as the source of the data for the study

3.4 Sampling Techniques

The sample was selected using stratified random sampling by the World Bank's Enterprise Surveyor. Three levels of stratification were used in this country: industry, establishment size, and region. Industry stratification was designed in the way that follows: the universe was stratified into four manufacturing industries Food and Beverages, Textile and Garments including leather, Non-metallic mineral products, and other manufacturing. And three services sectors, Transportation, Retail and Other Services. Size stratification was defined as follows: small (5 to 19 employees), medium (20 to 99 employees), and large (more than 99 employees). Regional stratification for the 2015 Ethiopia ES was done across six geographic regions: Addis Ababa and Dire Dawa city administrations, and Amhara, Oromia, SNNPR and Tigray regional states (World Bank 2016)

3.5 Method of Data Collection

The data was collected by the World Bank for its Enterprise Survey (ES) project; during the data collection method questioner and checklist were used by the World Bank when they collected the data from 457 firms operating in Addis Ababa. For this study the researcher didn't collect primary level data from these 457 firms but used the already collected data to investigate the barriers of domestic investment in Addis Ababa City Administration.

3.6 Method of Data Analysis

In this study, the data were analyzed via measures of central tendency and measures of variation. These methods were applied for data summarization. To examine the barriers to domestic investment, a 5 point Likert scale which was categorized 0 for no barriers, 1 for minor barrier, 2 for moderate barriers, 3 for major barriers and 4 for very severe barriers. A Likert scale data can be analyzed as interval data, that means the mean and standard deviations are the best measure of central tendency and dispersions respectively (Kerlinger, 1986). The Statistical Package for the Social Science (SPSS 23.0) is used to precede the data analysis.

CHAPTER FOUR

RESULT AND DISCUSSION

In this chapter, the data gathered from the most recent Enterprise Survey data were presented, analyzed and interpreted accordingly.

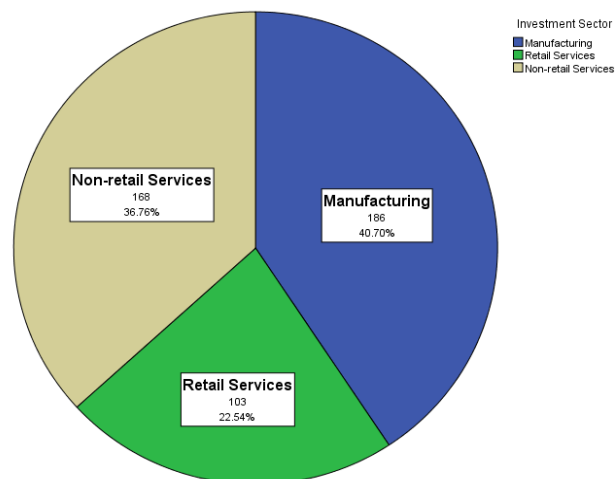
4.1 Descriptive Analysis

In this section, data obtained from 457 investors operation their investment business in Addis Ababa city is summarized.

4.1.1 Investment by Sectors

The researcher believes that summarizing investment by sector in essential in ordered to understand in which investment sector the participant of this study are investing their money. As shown in the figure 1, from the total investors 186(40.7%) of them are from manufacturing sector, 168(36.76%) of them are from non-retail services sector and the remaining 103(22.54%) of them are from the retail services sector. This indicated that majority of the respondents of this study are from manufacturing sector followed by non-retail services.

Figure 4.1 Investments by Sectors

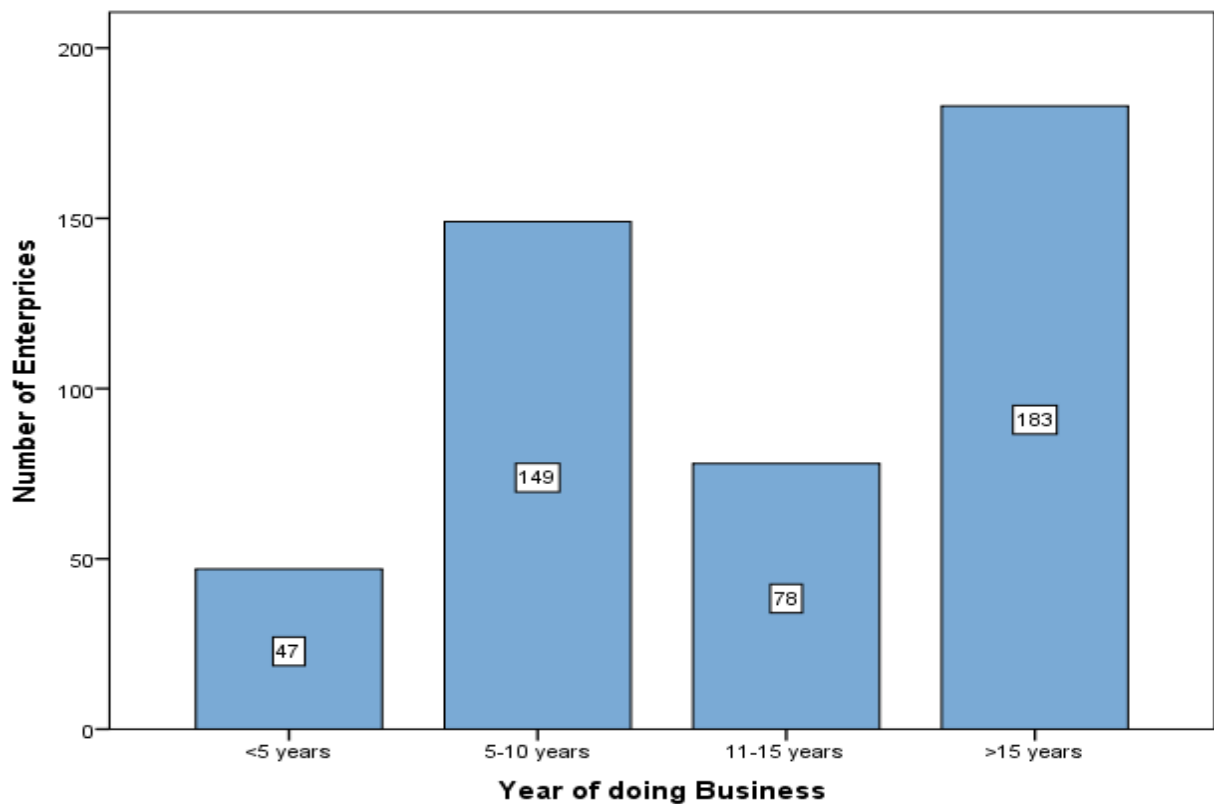


(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.1.2 Investment Experience of the Enterprises

The researcher believes that assessing the investment experience of the respondents is very important in order to understand the practice of domestic investment culture in the study place. Figure 4.1 indicates the year in which the respondents stayed in the investment activity. Of the total 457 respondents, 183(40%) of them are participated in domestic investments for more than 15 years, 78 (17.1%) of them are from 10 to 15 years, 149(32.6%) of them are from 5 to 10 years and the rest 47(10.3%) of them are in domestic investment activities for less than five years. This indicated that majority of the respondents are in domestic investment business for more than 15 years followed by 5 to 10 years in domestic business from 5 to 10 year. This implies the data for the study were taken from highly experienced investors.

Figure 4.1 Frequency of investment experience of respondents



Source: (Own computation 2021 based on World Bank's Enterprises Survey)

4.1.3 The Distribution of Investments per Sector

Table 4.1 Distribution of Investments per Sector

	Frequency	Percent	Valid Percent
Food	26	5.7	5.7
Tobacco	1	.2	.2
Textiles	7	1.5	1.5
Garments	18	3.9	3.9
Leather	16	3.5	3.5
Wood	5	1.1	1.1
Paper	2	.4	.4
Publishing, printing, and Recorded media	21	4.6	4.6
Chemicals	13	2.8	2.8
Plastics & rubber	17	3.7	3.7
Nonmetallic mineral products	23	5.0	5.0
Basic metals	5	1.1	1.1
Fabricated metal products	11	2.4	2.4
Machinery and equipment	2	.4	.4
Electronics	4	.9	.9
Precision instruments	1	.2	.2
Transport machines	2	.4	.4
Furniture	10	2.2	2.2
Construction Section	39	8.5	8.5
Services of motor vehicles	28	6.1	6.1
Wholesale	77	16.8	16.8
Retail	48	10.5	10.5
Hotel and restaurants	19	4.2	4.2
Transport Section	58	12.7	12.7
IT	4	.9	.9
Total	457	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

The distribution of investments per sector is depicted in Table 4.1 where wholesale business activity accounts for 16.8% the total investment in Addis Ababa followed by transport sector (12.7%) and retail business (10.5%). The lowest investment sector distribution is observed in tobacco (0.2%) and precision instruments (0.2%) business.

4.2 Analysis of Investment Barriers

Table 4.2 Investment barriers in Addis Ababa City Administration

no.	Barriers	No Barrier=0	Minor Barrier=1	Moderate Barrier=2	Major Barrier =3	Very Severe Barrier=4	Grouped Mean	S.D.
1	Electricity	44(9.6%)	95(20.8%)	112(24.5%)	131(28.7%)	75(16.4%)	2.2	1.2
2	Telecom	91(19.9%)	157(34.4)	107(23.4%)	65(14.2%)	37(8.1%)	1.5	1.2
3	Transport	189(41.4%)	110(24.1%)	111(24.3%)	28(6.1%)	19(4.2%)	1.0	1.1
4	Custom And Trade Regulation	116(25.4%)	113(24.7%)	73(16%)	81(17.7%)	81(17.7%)	1.7	1.4
5	Competition In Informal Sector	134(29.3%)	98(21.4%)	145(31.7%)	41(9.0%)	39(8.5%)	1.5	1.2
6	Access to Land	5(1.1%)	9(2.0%)	63(13.8%)	273(59.7%)	107(23.4%)	3.02	0.74
7	Crime, Theft and Disorder	317(69.4%)	74(16.2%)	50(10.9%)	8(1.8%)	8(1.8%)	0.5	0.9
8	Tax Rates	66(14.4%)	84(18.4%)	115(25.2%)	158(36.6%)	34(7.4%)	2.0	1.2
9	Tax Administration	226(49.5%)	101(22.1%)	64(14.0%)	35(7.7%)	31(6.8%)	1.0	1.3
10	Business Licensing	88(19.3%)	66(14.4%)	94(20.6%)	128(28.0%)	81(17.7%)	2.1	1.4
11	Political Instability	17(3.7%)	68(14.9%)	167(36.5%)	154(33.7%)	51(11.2%)	2.3	1.0
12	Corruption	94(20.6%)	78(17.1%)	97(21.2%)	103(22.5%)	85(18.6%)	2.0	1.4
13	Court	236(51.6%)	78(17.1%)	45(9.8%)	14(3.1%)	84(18.4%)	1.3	1.5
14	Access to Finance	2(0.4%)	7(1.5%)	55(12.0%)	281(61.5%)	112(24.5%)	3.2	0.7
15	Labor Regulations	190(41.6%)	176(38.5%)	35(7.7%)	12(2.6%)	44(9.6%)	1.0	1.2
16	Skilled labor	4(0.9%)	7(1.5%)	58(12.0%)	284(62.1%)	104(22.8%)	3.0	0.7
17	Access to Foreign Exchange	0(0.0%)	0(0.0%)	2(0.4%)	294(64.3%)	161(35.2%)	3.4	0.5
18	Custom and clearance for importing	0(0.0%)	4(0.9%)	6(1.3%)	317(69.4%)	130(28.4%)	3.3	0.5
19	Custom and clearance exporting	57(12.5%)	27(5.9%)	23(5.0%)	344(75.3%)	6(1.3%)	2.5	1.1
20	Air Services And Airports	145(31.7%)	272(59.5%)	23(5.0%)	13(2.8%)	4(0.9%)	0.8	0.7
21	Import Licensing	4(0.9%)	9(2.0%)	62(13.6%)	275(60.2%)	107(23.4%)	3.0	0.7

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

Minor Barriers to Domestic Investment in Addis Ababa

Table 4.2 above shows the grouped mean score and standard deviation values of Telecom ($\mu = 1.5, \sigma = 1.2$), Custom and Trade Regulation ($\mu = 1.7, \sigma = 1.4$), Transport ($\mu = 1.0, \sigma = 1.1$), Competition in Informal Sector ($\mu = 1.5, \sigma = 1.2$), Crime, Theft and Disorder ($\mu = 0.5, \sigma = 0.9$), Tax Administration ($\mu = 1.0, \sigma = 1.3$), Court ($\mu = 1.3, \sigma = 1.5$), Labor Regulation ($\mu = 1.0, \sigma = 1.2$) and Air Services and Airport ($\mu = 0.8, \sigma = 0.7$). The mean score value these variables are between 0.6 and 1.5. This indicates that they have minor barriers on the domestic private investment in Addis Ababa city.

Moderate Barriers to Domestic Investment in Addis Ababa

Table 4.2 above further shows that, Electricity ($\mu = 2.2, \sigma = 1.4$), Tax Rate ($\mu = 2.0, \sigma = 1.3$), Business Licensing ($\mu = 2.1, \sigma = 1.4$), Political Instability ($\mu = 2.3, \sigma = 1.0$), Corruption ($\mu = 2.0, \sigma = 1.4$) and Custom and Clearance Exported ($\mu = 2.5, \sigma = 1.0$). Since their mean score value fall on the moderate categories we can conclude that they have moderate barriers for domestic investors in Addis Ababa city.

Major Barriers to Domestic Investment in Addis Ababa

Finally, from Table 4.2 above we can see that Access to Land ($\mu = 3.02, \sigma = 0.742$), Access to Finance ($\mu = 3.2, \sigma = 0.7$), Educated Workforce ($\mu = 3.0, \sigma = 0.7$), Access to Foreign Exchange ($\mu = 3.4, \sigma = 0.5$), Custom and Clearance Imported ($\mu = 3.3, \sigma = 0.5$) and Importing licensing ($\mu = 3.0, \sigma = 0.7$) have the mean score values rounded to 3. And it falls in the major barriers categories. This indicates that they are major barriers for domestic investment

in the study places. Hence priority should be given to these obstacles in order to promote the expansion of domestic investments.

As compare to all the barriers, crime, theft and disorder have the lowest mean score value ($\mu = 0.5$) and access to foreign exchange have the highest mean score value ($\mu = 3.4$). This signifies that crime, theft and disorder are the lowest barriers for domestic investor whereas access to foreign exchange is the top major barriers for domestic investor in Addis Ababa city administration.

4.3 Analysis of Domestic Investment Barriers by Investment Sector

In this section both moderate and major investment barriers by different investment sector such as manufacturing, retail and non-retail service is analyzed. The variables that are identified as minor barriers were ignored from further analysis because they have almost no barriers for domestic investment.

4.3.1 Electricity

Access to Electric power supply is one of the main demand for investor to invest their money specially investors that are engaged in the manufacturing sector. Tables 4.3 provide comparisons of electricity barriers on the three investment sectors. From the result in Table 4.3 below it can be observed that from the sampled 186 manufactured, 26.3% , 32.8% and 26.3% of them reported that electricity is very severely , major and moderate barriers for their investment business respectively. Likewise about 5.8%, 28.2% and 30.1% of the retail service provider responded that electricity is very severely, major and moderate barriers for their investment business respectively. Finally of the total 168 non-retail service provider, 16.4% of them responded that electricity is very severely barriers, 28.7% of them are reported that electricity is a major barriers for their investment business and 19.0% responded that electricity is a moderate

barriers for their investment business. From this we can generalize that electricity is a very severe barriers for manufactures as compared to retail services and non-retail service providers. It is a minor for 28.0% and no barriers for 16.7% of the non-retail service provider which is a larger percentage as compared to manufacturing and retail services sector investors.

Table 4.3 How Much Of An Barriers: Electricity * Investment Sector Cross tabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Electricity To Operations Of This Establishment?	No Barriers	Count	3	13	28	44
		% Investment Sector	1.6	12.6	16.7	9.6
	Minor Barriers	Count	24	24	47	95
		% Investment Sector	12.9	23.3	28.0	20.8
	Moderate Barriers	Count	49	31	32	112
		% Investment Sector	26.3	30.1	19.0	24.5
	Major Barriers	Count	61	29	41	131
		% Investment Sector	32.8	28.2	24.4	28.7
	Very Severe Barriers	Count	49	6	20	75
		% Investment Sector	26.3	5.8	11.9	16.4
	Total	Count	186	103	168	457
		% Investment Sector	100.0%	100.0%	100.0%	100.0%

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.2 Tax Rate

From the result in Table 4.4 below it can be observed that from the sampled 186 manufactured, 4.3% , 37.1% and 28.0% of them are reported that tax rate is very severely , major and moderate barriers for their investment business respectively. Likewise about 9.7%, 29.1% and 24.3% of the retail service provider responded that tax rate is very severely, major and moderate barriers for their investment business respectively. Finally of the total 168 non-retail service

provider, 9.5% of them responded that tax rate is very severely barriers, 29.1% of them are responded that tax rate is a major barriers for their investment business and 24.3% responded that tax rate is a moderate barriers for their investment business. This reflect that tax rate is major barriers for all manufactures retail services and non-retail service investors

Table 4.4 How Much Of An Barriers: Tax Rates * Investment Sector Cross tabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Tax Rates	No Barriers	Count	23	14	29	66
		% Investment Sector	12.4	13.6	17.3	14.4
	Minor Barriers	Count	34	24	26	84
		% Investment Sector	18.3	23.3	15.5	18.4
	Moderate Barriers	Count	52	25	38	115
		% Investment Sector	28.0	24.3	22.6	25.2
	Major Barriers	Count	69	30	59	158
		% Investment Sector	37.1	29.1	35.1	34.6
	Very Severe Barriers	Count	8	10	16	34
		% Investment Sector	4.3	9.7	9.5	7.4
	Total	Count	186	103	168	457
		% Investment Sector	100.0%	100.0%	100.0%	100.0%

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.3 Business Licensing

As the below Table 4.5 shows that, from the total 186 manufacturer 16.7% them responded that business licensing and permits is a very severely barriers, 36.6% of them responded that access to land is a major barriers, 16.7% of them responded for moderate barriers for their investment expansion and the remaining 9.1% and 21.0 % of them responded that business licensing and permits is a minor and no barriers respectively. Regarding Retail service providers, 15.5%,

24.3% and 33.0% of the them responded that business licensing and permits is a very severely, major and moderate barriers for their investment and the rest 15.5% and 11.7% of them responded as minor and no barriers. And finally about 20.2%, 20.8% and 17.3% respondents replied that business licensing and permits is severely, major and moderate barriers for their investment respectively. And remaining 19.6 % and 22.0% of them considered access to business licensing and permits as minor and no barriers for their investment respectively. From this we can conclude that investors in the manufacturing sectors are affected majorly by business licensing and permit with the high percentage as compared to retail and non-retail services providers.

Table 4.5 How Much Of An Barriers: Business Licensing And Permits * Investment Sector Cross tabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Business Licensing And Permits	No Barriers	Count	39	12	37	88
		% Investment Sector	21.0	11.7	22.0	19.3
	Minor Barriers	Count	17	16	33	66
		% Investment Sector	9.1	15.5	19.6	14.4
	Moderate Barriers	Count	31	34	29	94
		% Investment Sector	16.7	33.0	17.3	20.6
	Major Barriers	Count	68	25	35	128
		% Investment Sector	36.6	24.3	20.8	28.0
	Very Severe Barriers	Count	31	16	34	81
		% Investment Sector	16.7	15.5	20.2	17.7
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.4 Political Instability

From the result in Table 4.6 below it can be observed that from the sampled 186 manufactured, 12.9% , 31.7% and 36.6% of them are reported that political instability is very severely , major and moderate barriers for their investment business respectively. Likewise about 11.7%, 36.9% and 31.1% of the retail service provider responded that political instability is very severely, major and moderate barriers for their investment business respectively. Finally of the total 168 non-retail service provider, 8.9% of them responded that political instability is very severely barriers, 33.9% of them are responded that political instability is a major barriers for their investment business and 39.9% responded that political instability is a moderate barriers for their investment business. This reflects that political instability is major barriers for retail services relative to manufacturing and non-retail service investors because it accounts the larger percentage.

Table 4.6 How Much Of An Barriers: Political Instability * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Political Instability	No Barriers	Count	10	5	2	17
		% Investment Sector	5.4	4.9	1.2	3.7
	Minor Barriers	Count	25	16	27	68
		% Investment Sector	13.4	15.5	16.1	14.9
	Moderate Barriers	Count	68	32	67	167
		% Investment Sector	36.6	31.1	39.9	36.5
	Major Barriers	Count	59	38	57	154
		% Investment Sector	31.7	36.9	33.9	33.7
	Very Severe Barriers	Count	24	12	15	51
		% Investment Sector	12.9	11.7	8.9	11.2
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.5 Corruption

As it is depicted in table 4.7 below from the total sampled manufactured, 16.7%, 27.4% and 22.6% of them are reported that corruption is very severely, major and moderate barriers for their investment business respectively. Similarly about 20.4%, 17.5% and 16.5% of the retail service provider responded that corruption is very severely, major and moderate barriers for their investment business respectively. Finally of the total 168 non-retail service provider, 19.6% of them responded that political instability is very severely barriers, 20.2% of them are responded that corruption is a major barriers for their investment business and 13.7% responded that corruption is a moderate barriers for their investment business. This reflects that corruption is major barriers for retail services relative to manufacturing and non-retail service investors because it accounts the larger percentage.

Table 4.7 How Much Of An Barriers: Corruption * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Corruption	No Barriers	Count	26	28	40	94
		% Investment Sector	14.0	27.2	23.8	20.6
	Minor Barriers	Count	36	19	23	78
		% Investment Sector	19.4	18.4	13.7	17.1
	Moderate Barriers	Count	42	17	38	97
		% Investment Sector	22.6	16.5	22.6	21.2
	Major Barriers	Count	51	18	34	103
		% Investment Sector	27.4	17.5	20.2	22.5
	Very Severe Barriers	Count	31	21	33	85
		% Investment Sector	16.7	20.4	19.6	18.6
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.6 Customs Clearance and Procedures Related To Export

The result in the Table 4.8 illustrates that customs clearance and procedures related to export is a major barriers for all the investment sectors. More specifically, about 74.2% of the from manufacturing sector, about 80.6% from retail services and about 73.3% from non-retail services responded that customs clearance and procedures related to export is a major challenge for their investment business.

Table 4.8 Customs clearance and procedures related to exports * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
Customs clearance and procedures related to exports	No barriers	Count	27	12	18	57
		% Investment Sector	14.5	11.7	10.7	12.5
	Minor barriers	Count	12	3	12	27
		% Investment Sector	6.5	2.9	7.1	5.9
	Moderate barriers	Count	7	3	13	23
		% Investment Sector	3.8	2.9	7.7	5.0
	Major barriers	Count	138	83	123	344
		% Investment Sector	74.2	80.6	73.2	75.3
	Very Severe barriers	Count	2	2	2	6
		% Investment Sector	1.1	1.9	1.2	1.3
	Total	Count	186	103	168	457
		% Investment Sector	100.0%	100.0%	100.0%	100.0%

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.7 Access to Land

Land is a key resource for investment. As the below Table 4.9 shows that, from the total 186 manufacturer 21.5% them responded that access to land is a very severely barriers, 61.3% of them responded that access to land is a major barriers ,12.5% of them responded for moderate barriers for their investment expansion. And the remaining 1.6% and 2.7 % responded that access to land is a minor and no barriers respectively. Regarding Retail service providers, 29.1%, 60.2% and 8.7% of the them responded that access to land is a very severely, major and moderate barriers for their investment and the rest 1.9% of them responded as minor barriers and non of the investor in the retail service sectors respond access to land is no barriers. And finally about 29.1%, 60.2% and 8.7% of investor in the non-retail investment them replied that access to land is a very severely, major and moderate barriers for their investment respectively. And remaining 2.4 % of them considered access to land as minor barriers and none of them responds replied as no barriers for their investment respectively. From this we can conclude that investors all three sectors are affected very severely by access to land as well as access to land was a major barriers for all the three investment sector with almost same high percentage.

The problem of access to affordable land in Addis Ababa emanates from two interrelated problems limited availability of land and the lack of capacity to provide serviced land (land that is equipped with utilities, access roads and transport links to markets). Access to affordable land is quite important for investment entry. If investors are to acquire land on their own from private sources (through purchasing or renting a working space), then their limited capital which would have been allocated to productive investment or used as working capital to expand their business would simply be eaten up unproductively since acquiring land through private means is too

expensive. Since industrial investments usually require a large tract of land, acquiring it through purchasing or renting from private sources is simply implausible. If a potential investor attempts to do that, he would simply reallocate his investment funds (i.e., fund which would have been used as start up or working capital) to buying land and this leaves him with no money to make new investment or expand existing investments. In other words, this is simply going to be speculative investment, which is usually classified as unproductive for there is no real production or value addition. And this retards economic growth, which in turn impedes job creation. So, what is the alternative for potential investors to acquire land affordably? A relatively better but still expensive alternative is to acquire land through lease-hold. The city government announces pockets/pieces of land for lease regularly around the city, where investors can freely bid. However, although somewhat better than acquiring land through private means, lease-hold is still quite expensive for potential investors. Consequently, most potential investors don't consider this option as viable because it would simply eat up their investment money and leaves them without finance to set up their factory. A cheaper alternative is to acquire land through public means – i.e., public allotment. The city government provides land to eligible industrial investors at very subsidized rates or even for free. Since this is the best alternative to acquire land, almost everyone opts for this option. However, the city administration has quite limited industrial investment land that it can allocate compared to the land demand (or requests).

Table 4.9 How Much Of An Barriers: Access To Land? * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers:	No Barriers	Count	5	0	0	5
		% within Investment	2.7	0.0	0.0	1.1
Access To Land?	Minor Barriers	Count	3	2	4	9
		% within Investment Se	1.6	1.9	2.4	2.0

	Moderate Barriers	Count	24	9	30	63
		% within Investment	12.9	8.7	17.9	13.8
	Major Barriers	Count	114	62	97	273
		% within Investment	61.3	60.2	57.7	59.7
	Very Severe Barriers	Count	40	30	37	107
		% within Investment	21.5	29.1	22.0	23.4
Total		Count	186	103	168	457
		% within Investment	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.8 Access to Finance

In relation to finance, the issues of finance range from access to finance in domestic market to access to foreign currency. Firms can secure finance for fixed investment and working capital for their projects through either own savings, traditional financial institutions and modern financial institutions. Own savings can take the form of profit/retained earnings from previous business or personal savings. The second option is approaching modern financial institutions for loan. In order to access foreign currency, the formal option is through banks. However, the informal foreign exchange market thrives because of the limited access in the formal market. More than twenty commercial banks are operating in Addis Ababa; in addition, there are also microfinance institutions. The commercial banks mostly cater to the demands of established businesses. These businesses usually have previous interaction with the bank and have fewer problems providing collateral for the requested fund. It is also usually not for long terms loans that can be used for investment financing as can be understood from the financial products advertised by the commercial banks.

For manufacturing investments, financial sources from private sources (including private and commercial banks) are quite limited. Private financial institutions (commercial banks and

microfinance institutions) focus on short-term loans, mainly for the trading sector. Long-term financing from private financial institutions is not only extremely limited but it is also extremely expensive. They charge prohibitively high interest rates and require significant collaterals.

So the cheaper alternative is to access finance from public sources, especially the Development Bank of Ethiopia (DBE). But the DBE has limited financial resources and thus prioritizes sectors. DBE is a policy lending institution, its lending criteria is in line with Ethiopia's industrial priorities, where the manufacturing, Agro-processing, large commercial farming and mining are the policy priorities. So an investor must be big enough and a priority sector to access DBE finance. Moreover, an investor has to provide equity of 25 percent to access the 75 percent from DBE. Since DBE's financing is project-based, no collateral is required and decision is based on cash flow of the project and feasibility of the project. Project loans are long term loans with a payback period of 5 to 15 years. The grace period can range from 1 to 5 years depending on the project. The loans can be used for construction, capital goods, and working capital. The interest rate ranges from 9 to 12 percent. Those exporting can enjoy 9% interest (if they export 80% of their product); 9.5% interest for import substitution; for others the interest rate is 12 percent. Since DBE does not require collaterals, it monitors and provides technical support to solve problems with the implementation.

For small businesses, DBE has just launched a new lease financing program. Once small businesses have the minimum capital, the DBE imports machinery and lease the machinery. For one enterprise up to 30 million birr is the maximum machinery cost allowed. The leasing period can go from 5 up to 10 years. The minimum requirements to get the lease financing are: having 20% of machinery cost in blocked account (The 20% will be released for working capital) and the secondly employing at least six people.

DBE's project finance has three phases. In the first phase, the DBE checks the customer's documents and appraises the customer in terms of risk, equity sources, business experience and credit history. If an applicant qualifies in the first phase, the second phase process begins. In the second phase, his project proposal is appraised. Appraisal of the project involves assessing the viability of the project. This includes appraising the loan amount and repayment schedule etc. DBE experts make recommendation/comments on the project appraisal. If the quality fulfills minimum standard DBE considers it. The last phase involves passing the final decision by the loan approval team. There are two independent teams at the head office: one approves 25 million to 150 million and the second one above 150 million. Branch offices can approve up to 25 million loan amount. And the decision is communicated back to the customer. DBE argues that if everything is done according to guidelines and regulations, the whole process takes about two months on average excluding waiting time for document for the customers. However, in practices it takes much longer – sometimes up to a year. However, for many domestic investors, meeting the two key requirements is a challenge raising the minimum equity 25 percent (a minimum of 7.5 million) is challenging. Although the 75 percent DBE loan is quite attractive, the 25 percent is too big for many domestic investors. Securing serviced industrial land or a 5-year contractual agreement of work premise is another challenge.

Findings of this study revealed that access to finance is a major and a very severe barriers for all the investment sectors. About 65.6% of the from manufacturing sector, about 60.2% from retail services and about 57.7% from non-retail services responded that access to finance is a major challenge for their investment. Furthermore 24.2% from manufacturing sector, 29.1% from retail services and 22.0% non-retail services replayed that access to finance is a severe barriers their investment growth (See Table 4.9).

Table 4.9 How Much Of An Barriers: Access To Finance * Investment Sector Cross tabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Access To Finance	No Barriers	Count	2	0	0	2
		% Investment Sector	1.1	0.0	0.0	0.4
	Minor Barriers	Count	1	2	4	7
		% Investment Sector	0.5	1.9	2.4	1.5
	Moderate Barriers	Count	16	9	30	55
		% Investment Sector	8.6	8.7	17.9	12.0
	Major Barriers	Count	122	62	97	281
		% Investment Sector	65.6	60.2	57.7	61.5
	Very Severe Barriers	Count	45	30	37	112
		% Investment Sector	24.2	29.1	22.0	24.5
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0%

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.8 Inadequately Skilled Labor

According to models of endogenous growth, the skill levels of the workforce are an important driver of economic development. Endogenous growth models emphasise that human capital is a key resources for growth (Romer, 1994). And Access to skilled labor is a key determinant of firm performance. In this regards investor in the three investment sectors were asked about the barriers related to inadequately educated work force. And the finding in presented in Table 4.10. Findings from Table 4.10 showed that Inadequately Educated Workforce is a major and a very severe barriers for all the investment sectors. About 52.7% of the from manufacturing sector, about 68.9% from retail services and about 68.5% from non-retail services responded that Inadequately Educated Workforce is a major challenge for their investment. Besides 26.3% from manufacturing sector, 21.4% from retail services and 19.6% non-retail services replayed that Inadequately Educated Workforce is a severe barriers their investment productivity.

Table 4.10 How Much Of An Barriers: Inadequately Educated Workforce? * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
How Much Of An Barriers: Inadequately Educated Workforce?	No Barriers	Count	3	0	1	4
		% within Investment Sector	1.6	0.0	0.6	0.9
	Minor Barriers	Count	6	0	1	7
		% Investment Sector	3.2	0.0	0.6	1.5
	Moderate Barriers	Count	30	10	18	58
		% Investment Sector	16.1	9.7	10.7	12.7
	Major Barriers	Count	98	71	115	284
		% Investment Sector	52.7	68.9	68.5	62.1
	Very Severe Barriers	Count	49	22	33	104
		% Investment Sector	26.3	21.4	19.6	22.8
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.9 Access to Foreign Exchange

In Ethiopia the foreign exchange Payments for imports can be made by Letter of Credit (LC), Cash Against Documents (CAD) and advanced payment (TT). Although the National Bank of Ethiopia is responsible for legal framework, commercial banks handle the foreign exchange demands requested by importers. Importers are required to provide import license, industry license/investment license accompanied by proforma invoice or contracts from suppliers stating the type of commodity, quantity of the good, unit price and FOB value. Importers can get the amount of foreign currency that they requested for their imports based on the foreign exchange allocation procedure. The Commercial Bank of Ethiopia has setup a committee to approve foreign exchange requests according to an expert in the bank. There is some element of

prioritizing inputs for the manufacturing sector, fuel and pharmaceutical products. Experts at the Commercial Bank of Ethiopia also stated that they serve client on first come, first-served basis. However, investors complain that there is lack of transparency in the foreign currency allocation process. It is not possible to know how long it will take (there is a queue). The process can take anywhere from three months to one year. As the investor is unsure about when her/his request will be approved she/he has always to be ready. This process ties up capital that would have been used for other purposes. The long waiting time means prices (including the exchange rate) will change increasing the cost of waiting.

Previously in order to get foreign currency, firms were supposed to save 50% of the total amount of money they acquire. Currently, it is made 100%, they have to deposit 100% of the cost to the bank. They deposit the whole money and wait minimum of three and maximum of one year. It is stated that they would have done other side business with the money until they got LC. The other issue was that, formerly firms used to submit their proposal/Performa in different private and government banks at the same time just to take advantage of getting earlier. But now it is made only to submit in one bank may be government or private. This reduces the chance of getting LC earlier.

This study also revealed that access to foreign exchange is a major and a very severe barriers for all the investment sectors. As it is shown in Table 4.11 below, about 56.5% of the from manufacturing sector, about 70.9% from retail services and about 69.0% from non-retail services responded that Access to Foreign exchange is a major challenge for their investment. Furthermore 43.0% from manufacturing sector, 28.2% from retail services and 31.0% non-retail services replayed that access to foreign exchange is a very severe barriers to their investment growth especially in manufacturing sector.

Table 4.11 To what degree is Access to Foreign exchange an barriers to the current operatio *
Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
To what degree is Access to Foreign exchange an barriers to the current operatio		Count	1	1	0	2
	Moderate barriers	% within Investment Sector	0.5	1.0	0.0	0.4
		Count	105	73	116	294
	Major Barriers	% within Investment Sector	56.5	70.9	69.0	64.3
		Count	80	29	52	161
	Very Severe Barriers	% within Investment Sector	43.0	28.2	31.0	35.2
		Count	186	103	168	457
	Total	% within Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.10 Customs Clearance for Imported Materials, Parts and Equipment

Customs plays a role in ensuring the business competitiveness of the country, contribute to revenue collection and provides social protection. It is also used to as a policy instrument to support the structural transformation agenda. Customs rate applicable to various imports range from 0 to 35 percent depending on the type and purpose of imports. In addition, there are various incentives that investors can enjoy when starting their businesses such as a full exemption of duties on capital goods such as machinery and equipment imports and spare parts worth 15% of the imported capital goods and income tax exemption ranging from one up to three years (Council of Ministry Regulation 84/2003). In addition, favorable duty rates are applicable on intermediate inputs compared the higher rate levied on final goods. However customs clearance

is still challenging. The challenge is mainly in the implementation of the aforementioned incentives in practice and a bureaucratic process.

The Findings of this study revealed that customs clearance for imported materials, parts and equipment is a major and a very severe barriers for all the investment sectors. Table 4.12 below showed that about 66.7% of the from manufacturing sector, about 71.8% from retail services and about 70.8% from non-retail services responded that customs clearance for imported materials, parts and equipment is a major challenge for their investment. Furthermore 43.0% from manufacturing sector, 28.2% from retail services and 31.0% non-retail services replayed that Customs clearance for imported materials, parts and equipment is a very severe barriers to their investment growth especially in manufacturing sector.

Table 4.12 Customs clearance for imported materials, parts and equipment * Investment Sector Crosstabulation

			Investment Sector			Total
			Manufacturin g	Retail Services	Non-retail Services	
Customs clearance for imported materials, parts and equipment	Minor barriers	Count	1	2	1	4
		% within Investment Sector	0.5	1.9	0.6	0.9
	Moderate barriers	Count	4	1	1	6
		% within Investment Sector	2.2	1.0	0.6	1.3
	Major barriers	Count	124	74	119	317
		% within Investment Sector	66.7	71.8	70.8	69.4
	Very Severe barriers	Count	57	26	47	130
		% within Investment Sector	30.6	25.2	28.0	28.4
	Total	Count	186	103	168	457
		% within Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

4.3.11 Import Licensing and Other Non-Tariff Barriers

Findings from Table 4.13 showed that customs clearance for import licensing and other non-tariff barriers is a major and a very severe barrier for all the investment sectors. About 62.4% of the from manufacturing sector, about 60.2% from retail services and about 57.7% from non-retail services responded that import licensing and other non-tariff barriers is a major challenge for their investment. Furthermore 21.5% from manufacturing sector, 29.1% from retail services and 22.0% non-retail services replayed that import licensing and other non-tariff barriers is a very severe barriers to their investment growth especially in retail services sector.

Table 4.13 Import licensing and other non-tariff barriers to imported inputs, parts and equ *
Investment Sector Cross tabulation

			Investment Sector			Total
			Manufacturing	Retail Services	Non-retail Services	
Import licensing and other non-tariff barriers to imported inputs, parts and equ	No barriers	Count	4	0	0	4
		% Investment Sector	2.2	0.0	0.0	0.9
	Minor barriers	Count	3	2	4	9
		% Investment Sector	1.6	1.9	2.4	2.0
	Moderate barriers	Count	23	9	30	62
		% Investment Sector	12.4	8.7	17.9	13.6
	Major barriers	Count	116	62	97	275
		% Investment Sector	62.4	60.2	57.7	60.2
	Very Severe barriers	Count	40	30	37	107
		% Investment Sector	21.5	29.1	22.0	23.4
	Total	Count	186	103	168	457
		% Investment Sector	100.0	100.0	100.0	100.0

(Source: Own computation 2021 based on World Bank's Enterprises Survey)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND POLICY IMPLICATION

In this chapter we discuss the summary of key findings, conclusion, as well as policy implication of the study are discussed under this chapter.

5.1 Summary

The objective of this study is to examine the barriers to domestic investment and evaluate these barriers by investment sectors in Addis Ababa City Administration. To achieve the objective of the study, the researcher has reviewed both theoretical explanations and empirical literatures regarding to the obstacles to domestic investment expansions as well as factors associated of private investment activities at a global and domestic level. A secondary level data that were collected from 457 investors by World Bank for its 2015/2016 Enterprise Survey project were used for the analysis of this study. From the total 457 investors included in the study, 40.7% of them were from manufacturing sector, 22.54% of them were from retail service sector and the rest 36.76% of them were from non-retail service sector. Regarding the experience of the investment, 47 of them are experienced up to 5 years, 149 of them are experienced from 5 to 10 years ,78 of them are experienced from 10 to 15 years and the rest 183 of them are experienced for more than 15 years. This reflect that majority of the investor participated in the study have more than 15 years in the investment business. The result showed that electricity, tax rate, business licensing, political instability, corruption, customs clearance and procedures related to export are the moderate barriers for domestic investors. Furthermore, the major barriers for doing investment business in Addis Ababa city are access to land, access to finance, inadequately educated workforce, access to foreign exchange, customs clearance for imported materials, parts

and equipment and import licensing and other non-tariff barriers. When we compare the proportion of very severe barriers response of investors in manufacturing sector, the large proportion of very severe barriers responses was recorded under the access to foreign exchange which is 43.3%. Indicating that access to foreign exchange is a very severe barrier for investor in the manufacturing sector. Likewise when we compare the proportion of major barriers response of investors in similar sector, we identify that customs clearance and procedures related to exports has the highest percentage (74.2%) followed by Customs clearance for imported materials, parts and equipment (66.7%) and Import licensing and other non-tariff barriers to imported inputs, parts and equipments (62.4%). Barriers related to corruption were identified as a larger proportion of 19.4% when we compare the response of no barriers among the investor in manufacturing sector. This implies that the weight for corruption as no barriers among the manufacturing sector is higher. Regarding the investment in retail sector, the large proportion of very severe barriers responses was recorded in access to land, access to finance and import licensing and other non-tariff barriers with 29.1% when we compare to severe of other barriers. And the large proportion of major barriers was found in customs clearance and procedures related to exports (80.6%) followed by Access to Foreign exchange 70.9% and customs clearance for imported materials, parts and equipment 71.9% categories when we compare the proportion of major barriers response of investors retail sectors. Barriers related to corruption were also identified as a larger proportion of 27.2% when we compare the response of no barriers among the investor in retail sector. This implies that the weight for corruption as no barriers among the retail sector is also higher.

Finally, comparing the proportion of very severe barriers response of investors in non-retail sector, the large proportion of very severe barriers responses was recorded under the access to

foreign exchange which is 31%. Indicating that access to foreign exchange is a very severe barrier for investor in the non-retail sector. Similarly when we compare the proportion of major barriers response of investors in same sector, we identify that customs clearance and procedures related to exports has the highest percentage (73.2%) followed by Customs clearance for imported materials, parts and equipment's (70.8%). Barriers related to corruption were identified as a larger proportion of 28.3% when we compare the response of no barriers among the investor in non-retail sector. This implies that the weight for corruption as no barriers among the non-retail sector is higher.

5.2 Conclusion

This paper attempted to examine the barriers of domestic investment in Addis Ababa city administration. The study used secondary data, sourced from World Bank Enterprises survey data. A descriptive research approach was employed in data analysis to help in addressing the objectives of the study. The study investigated the barriers of domestic investment in Addis Ababa, Ethiopia and the relevance of understanding the barriers of domestic investment lies in the fact that domestic investment has been one of the main engines of growth for countries over the decades. Based on the findings of the study the following conclusions are drawn

Lack of Infrastructure such as access to electricity, tax and customs such as tax rating system and bureaucratic process in customs clearance and procedures for exporting goods, absence of rule and regulation specifically political instability and corruption and getting business license are the moderated obstacles for domestic investment expansion in Addis Ababa. Furthermore

Furthermore, the major barriers for doing investment business in Addis Ababa city are access to land for establishing and expanding investment business, access to finance for expansion of

investment business, lack of skilled manpower in the labor market, access to foreign exchange for importing goods and services, bureaucratic process in customs clearance for imported materials, parts and equipment and getting license for importing good and services and other non-tariff barriers.

5.3 Policy Implication

Based on the analysis made, results obtained, and conclusions drawn, the following policy implications are forwarded to the policy makers, concerned government actors and other stakeholder.

- i. To minimize the investment barriers for domestic investors, policy action need be in place that prioritizes the major barriers such as access to land, access to finance, inadequately educated workforce, access to foreign exchange, customs clearance for imported materials, parts and equipment are the major. And moderate investment barriers such as electricity, tax rate, business licensing, political instability, corruption and custom and customs clearance and procedures related to export
- ii. To promote the domestic investors the concerned body should facilitate the access to financial for domestic investor as well as expand high quality education to fill the gap of skilled man power
- iii. Serious effort is needed to improve and shorten the chain and bureaucracy for the domestic investors to access the foreign exchanges as well as access to the import licensing and other non-tariff barriers. In addition customs clearance and procedures processes should be simplified to promote a dynamic and thriving domestic investment.

- iv. When formulating development strategies, the government, development agencies, and other interested parties should take into account the barriers of domestic investment when they formulated the development policies.
- v. Finally this study has used cross sectional data collected from 457 investors operating in Addis Ababa city administration and the outcomes may not be able to make generalization for city over a period of time. Therefore, the researcher recommends conducting further studies to explore dynamics of domestic investment barriers overtime

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