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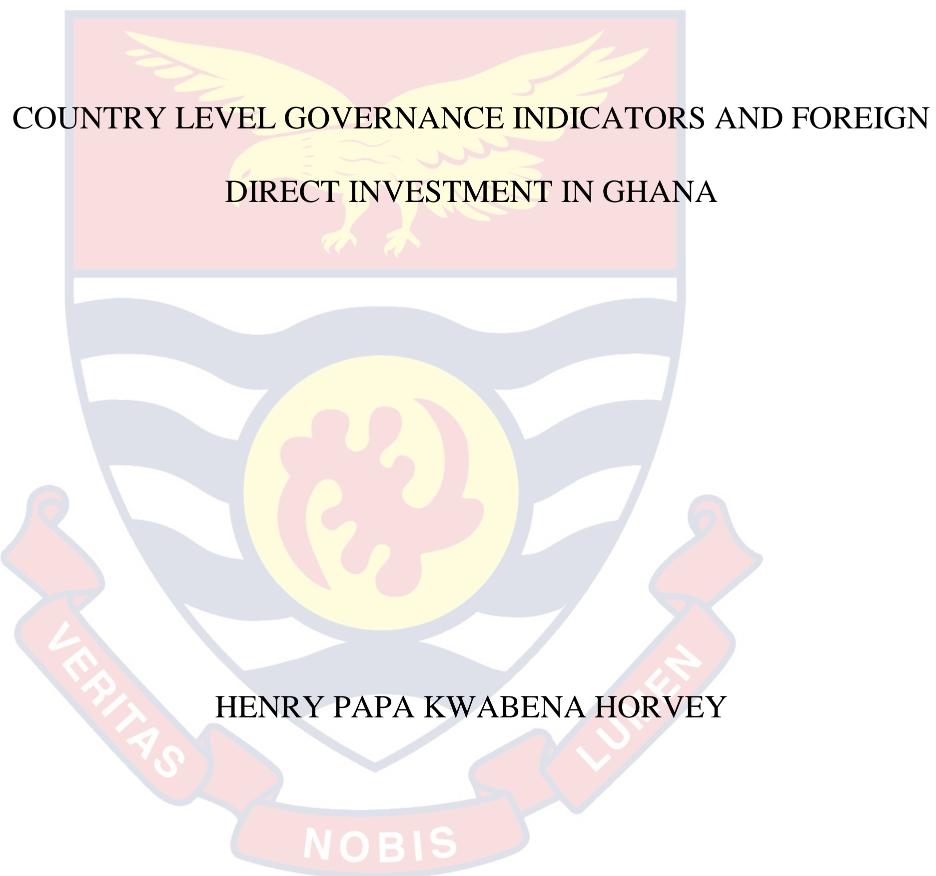

COUNTRY LEVEL GOVERNANCE INDICATORS AND FOREIGN DIRECT INVESTMENT IN GHANA

HENRY PAPA KWABENA HORVEY

2019

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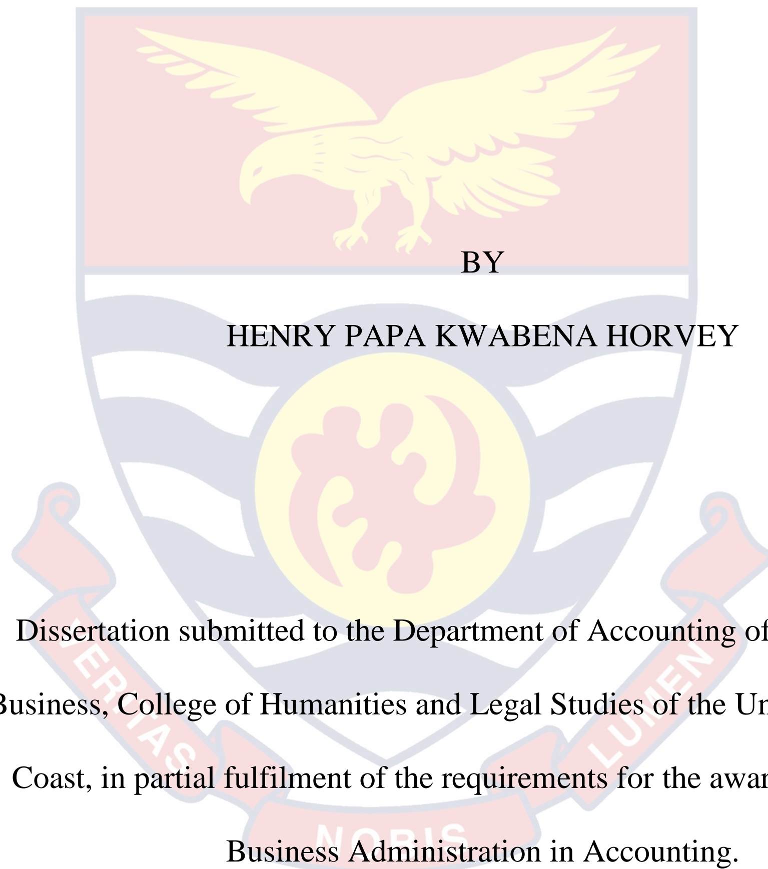

BY

HENRY PAPA KWABENA HORVEY

Dissertation submitted to the Department of Accounting of the School of Business, College of Humanities and Legal Studies of the University of Cape Coast, in partial fulfilment of the requirements for the award of Master of Business Administration in Accounting.

JULY 2019

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DECLARATION

Candidate's Declaration

I hereby declare that this dissertation is the result of my own original research and that no part of it has been presented for another degree in this university or elsewhere.

Candidate's Signature: .... Date: ………………………...

Name: Henry Papa Kwabena Horvey

Supervisor's Declaration

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision of dissertation laid down by the University of Cape Coast.

Supervisor's Signature: .... Date: ....

Name: Prof. John G. Gatsi

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ABSTRACT

Foreign Direct Investment plays a critical role in the developmental agenda of every country. In recent times, one question that has become even more topical is why some countries are able to attract so much foreign capital into their countries while others do not. The aim of this study thus is to go beyond the traditionally known macro-economic factors to examine the relationship between Ghana's country level governance indicators and foreign direct investment. The study used Two-stage Least Squares econometric techniques for a time series data from 1996 to 2016. Overall, the study found a significant positive relationship between all the six country level governance indicators and foreign direct investment. The implication is that governance indicators significantly increase foreign direct investment into Ghana. Based on the results, it is recommended that attention must be focused on control of corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability since these variables also create significant opportunities to enhance foreign direct investment into Ghana and boost Ghana's economic development.

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ACKNOWLEDGEMENTS

I am grateful to everyone who made this dissertation a success, especially, Prof. John Gartchie Gatsi who supervised the entire work and provided tremendous suggestions at every step till the completion of this write up. Without these important suggestions, this work could not have been successfully completed. I also owe a very big thank you to my course mates who, in diverse ways, shared with me their valuable pieces of advice.

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DEDICATION

To my family, especially my dear wife, Cynthia, and my lovely daughters, Benedicta and Benicia.

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TABLE OF CONTENTS

	Page
DECLARATION	ii
ABSTRACT	iii
ACKNOWLEDGEMENTS	iv
DEDICATION	v
TABLE OF CONTENTS	vi
LIST OF TABLES	ix
CHAPTER ONE: INTRODUCTION	
Background to the Study	1
Statement of the Problem	5
Research Objectives	6
Research Hypotheses	6
Scope of the Study	7
Significance of the Study	8
Organization of the Study	8
CHAPTER TWO: REVIEW OF RELATED LITERATURE	
Introduction	10
Theoretical Review	10
Movement of Capital Theory	10
The New Institutional Economics Theory	13
Conceptual Review	18
Empirical Review	22
Research Gap	32
Chapter Summary	33
CHAPTER THREE: RESEARCH METHODS	

Digitized by Sam Jonah Library

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Introduction 34

Research Design 34

Source of Data 35

Model Specification and Estimation 36

Justification for the selected variables 38

Foreign Direct Investment 38

Control of Corruption 39

Government effectiveness 40

Political stability 41

Rule of law 42

Regulatory quality 42

Voice and accountability 43

Control variables 44

Economic uncertainty 44

Market size 44

Trade openness 45

Chapter Summary 48

CHAPTER FOUR: RESULTS AND DISCUSSION

Introduction 49

Descriptive Statistics 49

Discussion of Empirical Results 50

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction 58

Summary 58

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Conclusion 59

Recommendations 60

Limitations and Suggestion for Future Research 60

REFERENCES 61

Digitized by Sam Jonah Library

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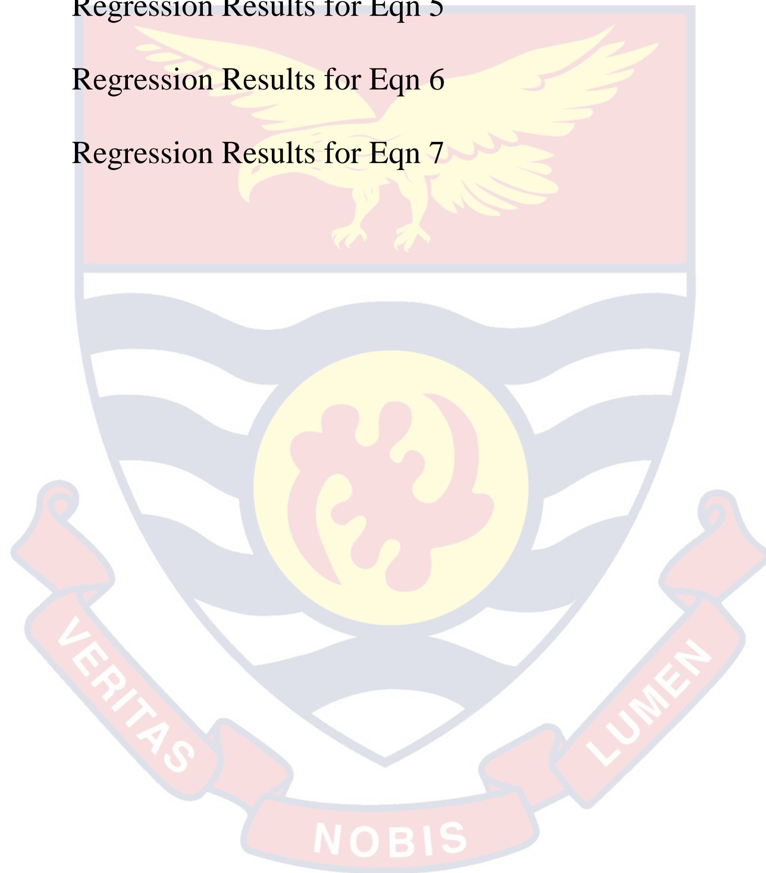
LIST OF TABLES

Page

1	Summary of Variables	47
2	Descriptive statistics	50
3	Regression Results for Eqn. 2	51
4	Regression Results for Eqn 3	52
5	Regression Results for Eqn 4	53
6	Regression Results for Eqn 5	54
7	Regression Results for Eqn 6	55
8	Regression Results for Eqn 7	57



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CHAPTER ONE

INTRODUCTION

Foreign direct investment (FDI) is a catalyst for economic growth and sustainable development within all countries but particularly so for developing countries and emerging market economies. The reality is that FDI is not the saviour of all development cures of the world and will in itself not alleviate poverty and socio-economic challenges faced by the developing world. However, FDI objectives which are well defined, outlined and formulated in a coherent manner will be able to address the development objectives of Sub-Saharan African (SSA) countries like Ghana and enable these countries to compete for capital intensive projects and be less reliant on the degree of local investment, trade flows and portfolio flows. According to Talamo (2011), the Washington consensus has actively promoted and hailed FDI as the panacea for economic stimulus and development. The increased FDI flows and market integration as a result of globalisation by both developed and less advanced industrial countries are largely associated with the introduction of structural adjustment programmes, which have resulted in trade liberalisation, privatisation, reduced state ownership, internationalisation of capital markets and more and better transparent institutional economic systems (OECD, 2002).

Background to the Study

For over two decades, many countries across the world have made significant attempt to direct foreign capital into their economies (Kurecic & Kokotovic, 2017). In particular, discussions have centred on how governments can attract foreign investments into their countries. Several governance and

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institutional reforms have been initiated to make investment environments conducive and sustainable to foreign inflows and growth (Nizam & Hassan, 2018), and further uplift these economies from their economic backwardness and reach their long term goals of development. The debate about governance and foreign direct investment has even become more critical in the wake of the recent crises as the world economy suffered the deepest financial and economic crisis, experiencing major declines in output, trade and investments (Zeneli, 2014).

As a sum of equity capital, re-investment of earnings, short and long-term capitals, foreign direct investment (FDI) is seen as one of the basic tools that could promote economic growth (Ray, 2012; Almfraji & Almsafir, 2014). Of great significance also is that attracting foreign capital into host countries for investment could generate domestic investment through matching of funds, facilitation of transfer of managerial skills and technological knowledge, increasing local market competition, creation of modern job opportunities and global market access for export commodities (Quazi, 2014). Likewise, foreign direct investment acts as a mechanism of technology transfer between two or more countries, especially, those in less developed and developing countries (Jensen, 2003).

Recognizing these critical roles that foreign direct investment play, foreign direct investment inflows have grown at an annual average of 14.7% in the 70's, 19.1% in the 80's, 20.8% in the 90's and ten times more currently than it was in 1990s (Castro & Nunes, 2013), following the removal of trade restrictions in host countries (Quazi, 2014). Even more spectacular is the real term outputs values which represent increase from US$296.28 billion to over

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US$8.48 trillion (UNCTAD, 2015). These recent developments have attracted researchers to find possible drivers, beyond the traditionally known theoretical argument adduced in favour of eclectic paradigm (Dunning, 1981) and other economic conditions of size, growth of markets, trade openness and economic uncertainty. In this regard, focus shifted to country level governance indicators which are widely composed of control of corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability, particularly, when the question of why some countries have become attractive to foreign investors and others are not has become topical and worthy of study (Buchanan, Le & Rishi, 2012).

According to Kaufmann, Kraay and Mastruzzi (2010), the governance indicators create better development outcomes such as inflows of foreign investment and provide healthy business environment for foreign capital inflows. As well, various dimensions of the governance indicators have global benefits, and therefore represent the most precise institutional prerequisite to attract foreign investors. Based on this, internationally recognized institutions such as the World Bank, currently places much emphasis on nations' ability to increase government effectiveness as a basis for providing foreign investments into such countries (Friedman, Cox & Tribunella, 2010). To this end, United States launched a major foreign investment initiative to direct grants to countries with good governance (Millennium Challenge Account, 2009).

Many developing country governments in Africa have also become more market-oriented and are striving to implement more investor-friendly policy regimes in order to attract foreign investors. This is because foreign investors pay a great deal of attention to the institutional framework of the

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countries in which they undertake an investment (Organization for Economic Co-operation and Development, 2012). In this light, increasing foreign direct inflows has become a high priority for African policy makers (UNCTAD, 2012). For instance, African leaders implemented New Partnership for Africa's Development initiative program to change investors' perception of Africa as a high-risk continent in terms of poor property rights, weak regulatory frameworks, insecurity and lack of transparency (UNCTAD, 2012). These efforts clearly indicate that foreign investor attraction and their protection depend on reforming governance systems and other trade policies in the region.

As Nondo, Kahsai and Hailu (2016) noted, African leaders are justified in implementing programs including institutional reforms, trade liberalizations, and others to attract more foreign direct investments and stimulate growth and development. Gatsi and Kyeraa (2016) supported these views after finding evidence that non-macroeconomic indicators such as regulatory quality, political stability, voice and accountability among others protect and create conducive climate for investors in African countries, and so needed to be effectively and transparently enforced to stimulate compliance in a specifically clear-cut manner. Given the roles of these governance indicators and foreign direct investment in promoting industrialization, development and growth, especially when the incentives for domestic investments are weak (Asiedu & Lien, 2011), it is of critical interest to examine these country level governance indicators in attracting foreign direct investment into Ghana.

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Statement of the Problem

Various studies focus on the economic determinants which influence FDI and governance, including country- specific institutional aspects of governance such as rule of law, democracy and corruption (Blonigen, 2005; Viyakumar, Sridharan & Rao, 2010; Balusubramanyam, 2001; Globerman & Shapiro, 2003; Busse, 2007; Wei & Schleifer, 2000). However, there are only a few studies which look at how macro-level corporate governance indicators as developed by Kaufmann (1999) at aggregate macro-level governance impact FDI inflows. Some studies, such as Adeoye (2009) and Ewestrand (2010), focused on middle income countries and used Kaufmann et al.'s (1999) governance indicators to determine the extent that this aggregate level of governance impacts FDI flows. The aim of this study was to evaluate aggregate macro-level corporate governance for SSA countries specifically, and to determine the impact of the aggregate level of governance on FDI inflows. The study focused on a period of ten years (2002–2011) to determine the effects of macro- level governance on FDI inflows.

The importance of the study is that many countries are perceived to have weak governance measures in place and that potential FDI decisions by investors and multinational corporations (MNCs) are negatively influenced by this lack of overall macro-governance stability. However, the link between FDI and macro-level corporate governance for Ghana requires more in detail research and would be useful for policymakers and governments. If a positive link is found, strategies and policies which will induce foreign investors to increase the level of FDI in Ghana should be encouraged. Past studies have only focused on selected aspects of macro-level governance, without

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evaluating all the governance indicators as developed by Kaufmann et al. (1999) and also not solely on Ghana.

Research Objectives

In this study, the main purpose is to find out how the country level governance indicators and foreign direct investment in Ghana are related. Specifically, the study is intended to:

a) examine the relationship between control of corruption and foreign direct investment.

b) determine the relationship between government effectiveness and foreign direct investment.

c) assess the relationship between political stability and foreign direct investment.

d) analyze the relationship between rule of law and foreign direct investment.

e) investigate the relationship between regulatory quality and foreign direct investment.

f) explore the relationship between voice and accountability and foreign direct investment.

VERITAS LUMEN NOBIS

Research Hypotheses

Based on the study objectives, the following hypotheses have been formulated and tested in their null and alternative form.

Null and Alternative Hypotheses

1) H_o: there is no significant relationship between control of corruption and foreign direct investment

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H_1: there is a significant relationship between control of corruption and foreign direct investment

2) H_o: there is no significant relationship between government effectiveness and foreign direct investment

   H_1: there is a significant relationship between government effectiveness and foreign direct investment

3) H_o: there is no significant relationship between political stability and foreign direct investment

   H_1: there is a significant relationship between political stability and foreign direct investment

4) H_o: there is no significant relationship between rule of law and foreign direct investment

   H_1: there is a significant relationship between rule of law and foreign direct investment

5) H_o: there is no significant relationship between regulatory quality and foreign direct investment

   H_1: there is a significant relationship between regulatory quality and foreign direct investment

6) H_o: there is no significant relationship between voice and accountability and foreign direct investment

   H_1: there is no significant relationship between voice and accountability and foreign direct investment

Scope of the Study

Basically, the study focuses on Ghana. This is motivated by the fact that Ghana has practiced a much more liberalized regime for foreign direct

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investment, addressing investor concerns, actively creating a good environment to boost investor confidence and expanding the scope for foreign direct investment by reducing the number of industries closed to foreign investors (Owusu-Antwi, Antwi & Poku, 2013). Similarly, Ghana outperforms most of the countries on the continent with regard to civil liberty, political rights and political stability (African Development Fund, 2012). In view of these developments, Ghana is considered appropriate for the current study.

Significance of the Study

According to the extant literature, country level governance indicators and foreign direct investments play crucial roles in the development of every economy. As the first empirical evidence on governance indicators and foreign direct investment and, in particular, the fact that Ghana has seen renewed and intense efforts in attracting foreign investors currently, evidence from this study would enhance strategic and critical policy framework which could in turn create that enabling environment conducive for foreign investors. Besides, the study will serve as a contribution to knowledge and increase effectiveness of theories, fill the gap in the literature and provide reference for other researchers who will want to further research on governance indicators and foreign direct investment.

Organization of the Study

Remainder of this study is organized as follows: chapter two reviews both the theoretical and empirical literature on the country level governance indicators and foreign direct investment with some perspectives on conceptual framework. Chapter three looks at the methodology employed in conducting the study. The study results are analyzed and discussed in chapter four. In

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Chapter five, the summary of the findings are presented, conclusion, policy implications and recommendations of the study as well as the limitation and suggestion for further research are also provided.

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CHAPTER TWO

REVIEW OF RELATED LITERATURE

Introduction

Every successful research work is underscored by an effective literature review. It is the foundation for knowledge development and a platform for unearthing areas where research is needed. According to Creswell (2014), literature review accomplishes the purpose of sharing the results of other studies that are closely related to the one being undertaken and shaping larger problems into narrower issues that leads directly into the methods of the study. In an earlier discussion, Marshall and Rossman (2011) noted that literature review relates the study to the larger ongoing discourse in the extant literature, filling gaps and extending past works. In this regard, and in order to appreciate the relevant issues on the country level governance indicators and foreign direct investment, this chapter reviews the relevant literature based on the following sub-themes: definitional construct of governance and foreign direct investment, theoretical framework and empirical reviews on the governance indicators and foreign direct investment.

Theoretical Review

Movement of Capital Theory

Critical look at the literature indicated that at the initial stages, cross-border movement of capital was viewed as a kind of portfolio investment and so the theory of capital movement and its related models were used as explanation for foreign direct investment (see, for example, Aliber, 1971). In the industrial organization cycle, Hymer's path breaking contributions on modes of transferring knowledge, intangible firm assets in organizing

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production abroad was also linked to FDI (Hymer, 1960). Quite different from the portfolio investment, the knowledge transfers in Hymer's case did not give up ownership and control of capital. Almost concurrently, Vernon (1966) also theorized using the product life cycle perspective that businesses established production facilities in other countries for products which were already standardized and matured in their home country's market. Both Hymer's (1960) and Vernon's (1966) positions became the two critical seminal research projects that led to several contributions, all of which were an attempt to explain FDI and transnational enterprises' undertakings from the perspective of different theoretical underpinnings.

In another development, Buckley and Hennart (1982) focused on internalization theory to explain the reasons for internalizing transactions within the context of transnational corporations but in an earlier discussions, Knickerbocker (1973) described these actions of transnational corporations to send their investment abroad as strategic response to oligopolistic competition, whilst in Johnson and Vahlne (1977) the internalization theory was captured within the upsaala model posited where it was argued that trananational corporations initially make small investments based on country proximity but as the transnational corporations grow in experience, investments are made in other countries that are farther away.

Additionally, Dunning (1981) further looked at why countries attract foreign direct investment in what was described as the eclectic paradigm. In particular, the eclectic paradigm considered how the changing configuration of ownership, location and internalisation (OLI) provide investment development path for countries to attract inward direct investment and how each is likely to

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affect different types of FDI activity. Other subsequent theoretical models offered to explain the dynamic changes in the ownership advantage and the way by which transnational corporations transfer this ownership advantage through the activity of FDI. These evolutionary theories included evolutionary perspective (Teece, Pisano & Shuen, 1997), organizational management (Prahalad & Doz, 1987)) and the resource based approach (Conner, 1991).

The importance of all these theories is that knowledge of a firm and skills form distinct ownership advantage that evolve over time, with the transnational corporation's resolve to manage these complicated organizational structures and leverage all the advantages using worldwide investments with clear sustainability motives. However, these theories only provide a generalized context for FDI without critically providing the specific country institutional variations. Similarly, Jensen (2003) noted that state credibility has a strong role to play in investment as international corporations gain confidence that host nations will not adopt policies that negatively affect their investments. Thus, any theory that seeks to provide explanation for FDI must take these characteristics in consideration. These views on the defect of the OLI framework were further echoed in Blanton and Blanton (2007).

According to Blanton and Blanton (2007), while the OLI framework serves as an important tool for understanding the motivations for investment decisions, greater insight is needed as to why some countries are more successful than others in attracting FDI. This implies that the OLI framework does not provide a comprehensive theoretical ground for assessing the foreign direct investment nexus. Consequently, the main theory upon which the

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current study focused on for an in-depth discussion on the foreign direct investment debate is the New Institutional Economics.

The New Institutional Economics Theory

New Institutional Economics theory indicated a shift from a long established and expansive research work on the determinants of FDI (Moran, 1999). The New Institutional Economics theory originated from economic perspective and explained how economic transactions are not simply as a the result of countries amassing economic resources which take the form of physical and human capital, but also involve the need for institution building to reduce information imperfections, transaction costs and maximize economic incentives to increase cross-country capital mobility and encourage exchanges (North, 1991). Strong institutions are viewed as bearers of good governance within which the necessary governance indicators emerge. Thus, according to North (1991), New Institutional Economics Theory defines a set of both informal and formal rules of the game that constraint political, economic and social interaction. North further noted that these institutions are devised by human beings to create order and reduce uncertainty in business transactions, so that together with the standard constraints of economics the institutions may provide the choice set of investment and the feasibility of engaging in economic activity in other countries.

From these perspectives, Kirkpatrick et al. (2006) added that it is now increasingly recognized that differences across a country's economic conditions merely provide a partial explanation of the location choices of transnational corporations, and that the quality of a country's institutional framework can have a significant impact on the perceived investment

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environment. Embedded in this whole institutional structure are the various laws, political and social norms and conventions that provide the foundation for successful market activity in terms of production and exchange. Consequently, the wider perspective of institutions has been included in empirical research studies of foreign direct investments using a broader range of indicators such as government effectiveness, rule of law, control of corruption among others found in the political environment (Morisset, 2000).

With few notable exceptions from pioneers of development economics including Biersteker (1978), Smith (1979) and Moran (1986), Dunning (2006) argued that the ideas and scholarship of economists in the 1970s and early 1980s paid relatively little attention to institutional mechanisms that could not be readily supplied by existing market. Dunning maintained that although careful appraisal of the role of foreign direct investment in development was undertaken by pioneering studies and gaps were identified, the actions and opinions which dominated mainstream scholarly thinking on transnational organizations in the 1970s and early 1980s paid relatively little attention to the extent and quality of institutional infrastructure, which is widely accepted today as one of the main determinants of the success by which resources could be created and effectively deployed in developing countries to gain access to markets which are critical for development.

Furthermore, in a complementary argument exploring how institutional economic theory affects management decisions for very critical outcomes such as those involving investment behaviour, efficient functioning of markets, and the generation of wealth, Witt and Redding (2013) believed that proper understanding of these institutional concepts could only occur using a

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simultaneous approach since institutions are complex and multifaceted. This is because as market exchanges become the focus of economic activity and are explicitly social, investors with competing interests transact with one another in a well structured institutionally friendly environment (Granovetter, 1985). Particularly, when institutions define what is acceptable and discipline behavior that is non-confirmatory, by allowing individuals investors to form expectations about the actions and commitments of exchange partners for equilibrium practices to occur (Greif, 1994). In this regard therefore, the presence of legitimate and recognized institutions in defining and overseeing investment exchanges is important if long-term wealth creation is to be realized (Kostova & Zaheer, 1999).

Within this same framework of institutional complexity, those identified as most likely to be important to governments in their investment attraction decision making are those that include regulatory, political, and economic institutions (Holmes, Miller, Hitt & Salmador, 2012). As these three institutional types embodied established order, Zucker (1987) in an earlier paper described them as state-linked because each is enacted primarily by governments as a result of the government's sovereign authority to devise legal and control systems that define rules and monitor adherence. In turn, the practice provides the means to engage in cross-country exchanges (Brodbeck, Frese, & Javidan, 2002), and shape both the demand for and the supply of capital and how this capital is managed.

Beck, Demirguc-Kunt, and Peria (2007) specifically noted, for example, that institutions established by governments influence capital investments through monetary mechanisms, fiscal mechanisms, or political

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mechanisms. In the monetary mechanisms, governments alter supply of money through the policies of central banks (Bernanke & Reinhart, 2004), whilst the fiscal mechanisms involve annual surpluses and deficits of government budgets (Fischer, 1993). Likewise, using the tools of political mechanisms, governments can influence electoral laws, judicial processes, rights and civil liberties and the extent to political violence is minimized (Matten & Crane, 2005). These developments, on the whole, indicate the extent to which institutions are useful for investment since FDI decisions reflect assessment of the opportunities available in a host country's markets and the critical support or limitations posed by the host country's institutional environment (Pajunen, 2008).

In contrast, though institutions play these critical roles to establish rules expected to reduce investment uncertainty linking the activities of foreign organizations through standardization, the scope and content of these institutional regulations vary (Scott, 2008). That is, the degree to which they are formalized and explicitly codified for foreign companies to make sense of them differ (Francis, Zheng & Mukherji, 2009). Often, institutions created by governments provide hostile environments that discourage foreign investments. In most cases, enacted government policies result in inefficiencies, particularly, in the use of financial resources that aim to satisfy special interests and distort private incentives for investments (Levine & Renelt, 1992). More so, institutional interference in the operations of foreign organizations, according to Guthrie (2006), introduces costs which can take the forms of direct compliance costs or indirect costs associated with distorted

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incentives; thus limiting managers from relocating certain activities into other countries (Hennart, 1989).

Likewise, since institutions maintain power even without the support of foreign managers, institutions tend to favour the interests of local companies at the expense of foreign company's interests (Boddewyn, 1988). In this sense, if institutional regulations are designed to provide governments with more discretionary controls, foreign organizations will become victims of advanced moral hazard by these institutions, particularly when the investments have already been undertaken by the foreign company (Teece, 1986). To the extent that countries impose specific regulations, foreign subsidiaries have little choice but to comply. In effect, these institution impositions change foreign direct investment incentives and reduce employer flexibility (Saint-Paul, 2002), and deprive foreign firms from the development and availability of human capital, and therefore reduce a country's attractiveness to foreign firms. This explains why most managers avoid large resource deployments when regulatory institutions are overly domineering and unfriendly (Delios & Beamish, 1999).

In short, Institutional theory acknowledged that foreign companies operate in uncertain, complex and sometimes conflicting environments and in order to make sense of their new external environment, foreign companies need the influence of various types of institutions to protect their capital and generate value for their investment through a common understanding of what is appropriate and fundamentally meaningful. Nonetheless, when institutions become unstable for foreign investors, the business environment is exacerbated by this uncertainty that the foreign investor must overcome

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(Henisz & Delios, 2001). In particular, the instability complicates the foreign investors efforts to leverage his or her assets (Teece, 1986), blocks learning opportunities (Newman, 2000), and hampers the degree to which economic forecasts can be made with reliability and consistency (Andersen, Bollerslev, Diebold, & Vega, 2003). Thus, whilst the presence of institutions can attract foreign investments (Busse & Hefeker, 2007) and contribute to economic boom (Temple, 1999), the potential instability associated with these institutions and the absence thereof may contribute to lower foreign investment (Chan & Makino, 2007; Delios & Henisz, 2003).

Conceptual Review

According to Gharaibeh (2015), the relationship between governance and foreign direct investment dates back around the mid of the last century, and the interest is not restricted to academics and scholars but policy makers as well (Milner & Mukherjee, 2009). Since both governance and FDI are key concepts, it is important to identify and analyze how both have been defined and applied by past researchers. On governance, the United Nations defined the concept as the support rendered by critical democratic political state institutions through a system of representation, strong electoral system, separation of powers with an effective check and balance mechanism, and monitoring of public and private engagements by a vibrant civil society (United Nations, 2007). Thus, through good governance, countries and their governments achieve democratic values, fundamental freedom, reduced violence and corruption, rule of law, accountability and pluralism (United Nations, 2016).

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Similarly, the European Commission defined governance with a focus on two essential attributes: democracy and human rights (European Commission, 2001). The work of Organization for Economic Cooperation and Development (2009) also noted that governance is based on accountability, transparency, efficiency and effectiveness, responsiveness, forward vision and rule of law. More so, British and Irish Ombudsman Association (2009) explained that six principles constituted governance for organizations and institutions to ensure effectiveness in achieving their objectives and these include Independence, Openness and transparency, Accountability, Integrity, and Clarity of purpose and Effectiveness.

Reviewing these definitions, Kaufmann et al. (2010) noted that there is as yet no strong consensus around a single definition of governance and identified three main characteristics about the definitions offered on foreign direct investment, including the fact that they are so broad that they cover almost everything, some are also very narrow and focused mainly on public sector management issues such as the manner in which power is exercised in the management of a country's economic and social resources for development, while again, others looked specifically at some areas of governance such rule of law and are considered to be thin versus thick, where thin focuses on whether existing rules and laws are enforced and thick emphasizes the justice of the content of the laws. Kaufmann et al. (2010) argued that a comprehensive definition was necessary and therefore defined governance as the traditions and institutions by which authority in a country is exercised, including a) the process by which governments are selected, monitored and replaced, b) the capacity of the government to effectively to

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formulate and implement sound policies, and c) the respect of citizens and the state for the institutions that govern economic and social interactions among them. Similar arguments were raised in the earlier version of Kaufmann et al. (1999).

According to Kirkpatrick, Parker and Zhang (2006), the Kaufmann indices describe various aspects of the governance structures, including measures of political instability, rule of law, graft, regulatory burden, voice and political freedom and government effectiveness, and therefore encompassed many of the individual institutional variables used in previous studies. However, according to the review of Nizam and Hassan (2018), whether the definitions of governance and the identification of the various elements are varied or not varied, they all aim at strengthening economies of all countries.

Much the same way as governance, foreign direct investment has also been defined differently by different authorities. Froot (1993) offered one of the simplest forms of definition of foreign direct investment as cross-border expenditures to acquire or expand corporate control of productive assets. UNCTAD (2007) also defined Foreign direct investment (FDI) as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investor. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated and may be undertaken by individuals as well as business entities (UNCTAD, 2007). UNCTAD further categorized FDI into

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three components: equity capital, reinvested earnings and intra-company loans. Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own. Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

A similar but rather tailored form of categorization was established in Sichei and Kinyondo (2012) for developing countries with specific focus on Africa. According to Sichei and Kinyondo (2012), a foreign direct investment can be market-seeking (where only local markets are served), asset or resource seeking (acquiring the resources in the host country which are not available in the home country) and efficiency seeking (where a company gains from economies of scope and scale). This line of reasoning led Blanton and Blanton (2007) to note that governance (whether good or repressive) affects all types of FDI by increasing audience costs for investors within the global marketplace. Therefore, countries with good governance structures potentially protect investors' interest (Gasti and Kyeraa, 2016), and effectively attract all the three categories of FDI (Nondo et al., 2016).

For the purposes of this study, the definition expounded by Kaufmann et al. (2010) was adopted for three main reasons. Firstly, it provides a quantitative means by which governance can be assessed. Secondly, it captures critical constructs about governance that this study seeks to examine. Thirdly, it is the most widely used definition in the extant literature. Likewise

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the UNCTAD (2007) definition of FDI was adopted in this study because it sets the boundary within which FDI can be examined.

Empirical Review

A significant number of researchers have explored how relevant the various constructs of the country level governance indicators are to attracting FDI, mostly, within the context of the New Institutional Theory. These studies cut across both developed and developing countries. There are also those that investigated governance using a multi-dimensional approach as against those that used only one dimension. The analyses here took all the categories into consideration, starting first from the context of both developed and developing countries' perspective and within the framework of multi-dimensional measure of governance. Then, at the latter end of the discussion, those that focused exclusively on only one dimension are presented to show how they have all helped to shape the governance-FDI relationship.

One of the studies that employed multi-dimensional measures to examine the effects of governance infrastructure on both foreign direct investment (FDI) inflows and outflows for a broad sample of developed and developing countries over time were Globerman and Shapiro (2002). Using a logistic transformation model, the results of the authors clearly showed that governance infrastructure is an important determinant of both FDI inflows and outflows. Thus, investments in governance infrastructure not only attract but also create the conditions under which domestic multinational corporations emerge and invest abroad. Globerman and Shapiro's (2002) paper is significant for several reasons. First, it touched on different dimensions of governance, and therefore signified a complete shift from a long term held

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view of using macro-economic data in testing FDI to using a non-macroeconomic data. Secondly, it provided a direct statistical prove for the newly developed index of Kaufmann et al. (1999). These notwithstanding, the paper failed to provide a single theory within which to situate the study.

Building on the same work, Globerman and Shapiro (2003) looked at how important governance infrastructures are in attracting US foreign direct invests. The econometric analysis employed was a two-stage estimation procedure. Two key findings were made. First of all, it was observed that countries that failed to achieve a minimum threshold of effective governance were countries that received no US FDI, that is, they were typically countries that did not promote free and transparent markets, effective governments, and that often have legal systems not rooted in English common law. Secondly, it was found that governance infrastructure, which includes the nature of legal systems, regulations and transparency of governments, is an important determinant of the amount of US FDI received.

Globerman and Shapiro (2003) used a large sample size with an estimation method that is capable of eliminating sample selection biases. All the variables used including the dependent, independent and control variables were all situated within the literature. In particular, the authors used, for example, FDI as dependent variable; rule of law, government effectiveness, voice and accountability, political stability and absence of violence as independent variables and market size, economic uncertainty (inflation) and quality of life as control variables. Though the paper expanded our scope of knowledge on the use of non-macroeconomic variables, it failed to link the

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work to any particular theory. More so, it only focused on developed countries.

Another study which also dealt with the governance indicators and FDI was Asiedu (2006). The study examined, among others, the impact of government policies, political instability and the quality of a country's institutions on FDI and the critical role the variables play in directing FDI flows. The result of the study indicated, among other important findings, that lower inflation, good infrastructure, openness to FDI, less corruption, political stability and a reliable legal system promote FDI. Based on the results, Asiedu (2006) noted that whether a country is small or lack natural resources, that country can still attract FDI by improving their institutions and policy environment. The paper used an elongated study period from 1984 to 2000. The fixed effect estimation technique was also robust in tackling correlation among the variables. The findings were also linked to previous empirical results. Even though these important findings were made, it is unclear how the findings can be tailored to the specific countries included in the study since all the data were combined. It is likely the case that if the countries were decomposed, differences in the result, particularly, the signs and the magnitude of their effects would have emerged since these countries operate under different governance mechanisms and are affected by different economic conditions.

In another related development, Gani (2007) presented a panel data estimates of the relationship between the various indicators of governance and foreign direct investment (FDI) using a sample of countries from Asia and Latin America. While controlling for standard FDI variables, the results

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provided a strong confirmation that rule of law; control of corruption; regulatory quality; government effectiveness and political stability are positively correlated with FDI. Similar to Gani (2007), Meon and Sekkat (2007) found that there is an association of larger FDI inflows in better-governed countries. Specifically, four indices out of the six turned out significant values in their regression results. Only quality of regulatory framework and the voice and accountability indices failed to show a significant coefficient. The other four all exhibit a positive and significant coefficient. Informatively, a comparison of the magnitude or impact of the dimensions of governance on FDI inflows indicated that probity exhibited the largest coefficient, and it was followed by rule of law, lack of political violence, and government effectiveness. However, one striking aspect of the work of Meon and Sakkat (2007) was that after correcting for endogeneity using a two staged least square, the relationship became weaker.

Likewise, Busse and Hefeker (2007) explored the linkages between political risk, institutions and foreign direct investment inflows. Using different econometric techniques for a data sample of 83 developing countries and the period 1984 to 2003, the paper was able to identify those indicators that matter most for the activities of multinational corporations from an overall of 12 different indicators for political risk and institutions. The results stated that government stability, the absence of corruption, ensuring law and order, democratic accountability of the government are highly significant determinants of foreign investment inflows. The authors conducted several sensitivity analyses to check the influence of serial correlation in order to make the result robust. Such sensitivity analyses included introduction of

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instrumental variables in the various model and also ensuring that the political risk and institutional measures used in the model were entered one by one. All the selected developing countries were indicated and the basis of their selection justified. On the whole, the paper was able to achieve its objective.

Additionally, Jadhav (2012) presented and brought together economic institutional and political determinants of FDI in a more generic and holistic manner with the aim of explaining the determinants of FDI in five BRICS economies. The results showed several generic propositions based on other past empirical research works and then verified these previous research works by statistically analyzing the determinants of FDI in the five BRICS economies over 10 years time frame from 2000-2009. The outcome of the study revealed, first of all, that traditional economic determinants are more important than institutional and political determinants of FDI. Secondly, most of the institutional and political determinants adopted in the study are not statistically significant and voice and accountability showed negative association with FDI. The author explained the negative results to mean that investors from countries with high corruption and the lack of enforcement of anticorruption laws select similar countries to invest in order to exploit the corrupt environments and also because such investors face lower costs of operating as opposed to other investors.

Jadhav (2012) brought several important aspects of the determinants of FDI to light. Especially, on the fact that in the BRICS countries, economic variables are more valued as determinants of FDI than institutional and political variables. More so, the various constituents of both economic and institutional variables which were used were identified. Also, the various

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theoretical frameworks were provided. The data were also screened using correlation matrix to identify if there was high correlation between the variables which could possibly lead to multicollinearity. Despite these efforts, there were problems with the methodology the author used. In the first place, Jadhav was misled by the unit root results to use the wrong estimating technique of Ordinary Least Squares since the unit root results showed stationarity at levels. Consequently, the OLS estimation technique resulted in bias estimated coefficients and serial correlation since the Durbin-Watson was 0.81, well below the close to 2 rule of thumb. A more robust method such as generalized method of moments (where there could be an introduction of the lagged dependent variable in the right side of the model), generalized least square in the form of fixed or random effects or two stage least squares would have been appropriate option to use in estimating the models.

In a similar manner, but this time, using a robust estimating technique of fixed effect, Saidi, Ochi and Ghadri (2013) examined the effect of governance on FDI attractiveness in 20 developed and developing countries. In all, mixed results were obtained. For the combined model examining the effect of six governance indicators on FDI in both developed and developing countries, it was noticed that political stability and regulatory requirement increase FDI attractiveness in both of these countries. On the other hand, the same combined model indicated that control of corruption, rule of law and government effectiveness do not really matter in attracting FDI since these variables have positive but insignificant probability values. On voice and accountability, it was evident that it decreases FDI attractiveness in both countries. Again, when the model was further broken down into developed

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and developing countries differences still emerged. This proved that previous studies which combined economies of both developed and developing countries to make their analysis could not be portraying a complete picture of the impact of governance on FDI attractiveness.

Shifting the focus to Arab countries, Bannaga, Gangi, Abdrazak and Al-Fakhry (2013) also investigated the effects of good governance on foreign direct investment inflows among some selected Arab countries. The sample size was 18 Arab countries from the period 1999 to 2009. Using an augmented gravity model with fixed and random effects estimation technique, Bannaga et al. (2013) found that there was a strong support for the significance of good governance to foreign direct investment inflows in the Selected Arab countries. The work is very intuitive because it was exclusively limited to Arab countries. In spite the intuitiveness, it appeared as though Bannaga et al (2013) reported the most interesting results just to suit their specific research aim that there is a strong support for the significance of good governance to foreign direct investment inflows. This is because a cursory look at the findings confirmed mixed results. . In particular, the governance indicators of voice and accountability, regulatory requirement and government effectiveness were all found to be highly negatively significant to the FDI inflows. This implied that they are deterrent rather than supportive to FDI inflows. This clearly shows that the conclusions arrived at by Bannaga et al. (2013) are inconsistent and misleading.

Zeneli (2014) analyzed the role of institutions and good governance for attracting foreign direct investments into eight selected South-Eastern European countries during the 1992-2010 timeframe. The author adopted

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Generalized Moment of Method (GMM) in estimating the econometric method. The empirical results provided evidence to support the importance of quality of institutions and governance in attracting FDI into the selected countries' economies. Also, the paper justified the reason for the selected countries by indicating that the FDI inflows into these countries were at minimal levels. More so, the study was linked to theory and previous empirical results. On the whole, the GMM technique also proved capable of tackling endogeneity, thus, giving robust estimates. The flaw associated with the paper is that the author failed to indicate how the institutions were measured even though it was mentioned that eight indices were used. Considering that there are different dimensions of institutions, it would have been appropriate to indicate the particular dimensions being employed in the study.

Furthermore, Yerrabati and Hawkes (2016) also explored the value of quality economic governance in attracting FDI in South and East Asia by meta-synthesizing 771 estimates from 48 empirical studies published between 1980 and 2012. The authors found evidence that countries with good quality regulations and low levels of corruption are able to attract more FDI. It was further foud that countries with stronger legal systems are better rewarded with higher levels of inward FDI. The authors therefore suggested that investing in quality economic governance is rewarding in the global economy through high levels of inward FDI.

From the point of view of East African countries, Karau and Mburu (2016) studied the institutional, governance and economic factors influencing FDI Inflows. Eight Eastern African Countries were involved in the study for

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the period 1996-2010. The one way fixed effects least squares model estimated found that control of corruption, political stability, rule of law, and infrastructure among others significantly influenced FDI inflows to East Africa. Karau and Mburu (2016) therefore suggested that East African governments needed to strengthen their institutional base and governance in order to attract more FDI. Though the paper provided an insightful perspective, it is not clear what the researchers meant by control of corruption, political stability, rule of law, and infrastructure among others significantly influenced FDI inflows. A significant influence can be positive or negative but this was not indicated. This means that the authors failed to report the results adequately. More so, Karau and Mburu failed to present the results for regulatory requirement and government effectiveness even though both were captured in the model and the descriptive statistics. The recommendation should also have been directed only to the selected East African countries and not generalized because it was not the whole of the East African countries that were studied.

In Peres, Ameer and Xu (2018), the analysis on the impact of institutional quality on foreign direct investment was broken into developed and developing countries. The developed countries were 41 while the developing countries were 69. The authors formulated separate models for the two analyses with 11-year time span from 2002 to 2012. The results showed that governance has a positive and significant impact on FDI for developed countries. Peres et al. (2018) interpreted this to mean governance stability in these economies. On the developing countries, it was noted that the governance indicators have insignificant impact on FDI inflows. This was

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attributed to the fact that institutions in developing countries are not strong enough to work effectively with other types of laws to attract FDI.

Following the patterns described above are other studies which provided evidence on the impact of governance on FDI attractiveness by focusing on only one aspect of governance or institution. Thus, though they also showed how governance affects FDI, their scope, in terms of governance indicators, is limited and skewed. For example, Baek and Quian (2011) sought to find out the manner in which political risks affect Foreign Direct Investment (FDI) in both developing and developed economies and whether the effect is similar. 12 categories of political risk were employed. Using a gravity model and a Feasible Generalized Least Square (FGLS) method, Baek and Quian (2011) found that political risk is a significant determinant of FDI in both industrialized and developing nations. However, not all aspects of political risk affect FDI stocks in industrialized and developing countries in the same way. Comparing the effects of different political risk components, the authors found that since the 9/11 attacks, political risks such as law and stable government have become more important and significant determinants of FDI flows, especially in industrialized nations.

Using another aspect of governance, Quazi (2014) analyzed the impact of corruption on FDI inflows in two regions which have benefited greatly from FDI inflows, that is, East Asia and South Asia. Using GLS methodology with data spanning from 1995-2011, the study found that the impact of corruption on FDI is significantly negative and robust. As noted by Quazi, the result validates the grabbing hand hypothesis of corruption. On this basis, it was suggested that strategies should be formulated and policies enforced to curb

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corruption, which will translate into a healthy economic environment not only capable of attracting more FDI inflows, but also preparing to nurture the economic factors required for economic development. The author controlled for very critical variables including market size and carried out diagnostic tests such as heteroscedasticity to make the outcomes of the study unbiased. The results were also linked to theory and other previous findings. All the selected countries were also mentioned and their reason of inclusion justified.

Building on institutional theory, Kunsch, Schnarr and Rowe (2014) examined the association between the relative rule of law of two countries and foreign direct investment (FDI). Using FDI data from Japanese firms in 114 countries and South Korean firms in 118 countries, Kunsch et al. (2014) found that rule of law is a predictor of FDI per capita. In particular, it was discovered that companies from a high rule of law country will seek out similar or higher rule of law environments for higher levels of FDI per capita investments while companies from a medium level rule of law country will seek a country with medium level of rule of law. The authors accounted for other possible influences government consumption, inflation rate, labour growth, cultural practices and values and industry as control variables.

Research Gap

This seeks to analyse the factors that influences Foreign Direct Investment in Ghana. Most of the work from researchers under the empirical review were conducted outside of West Africa and Ghana to be specific. This research therefore seeks to fill in gap.

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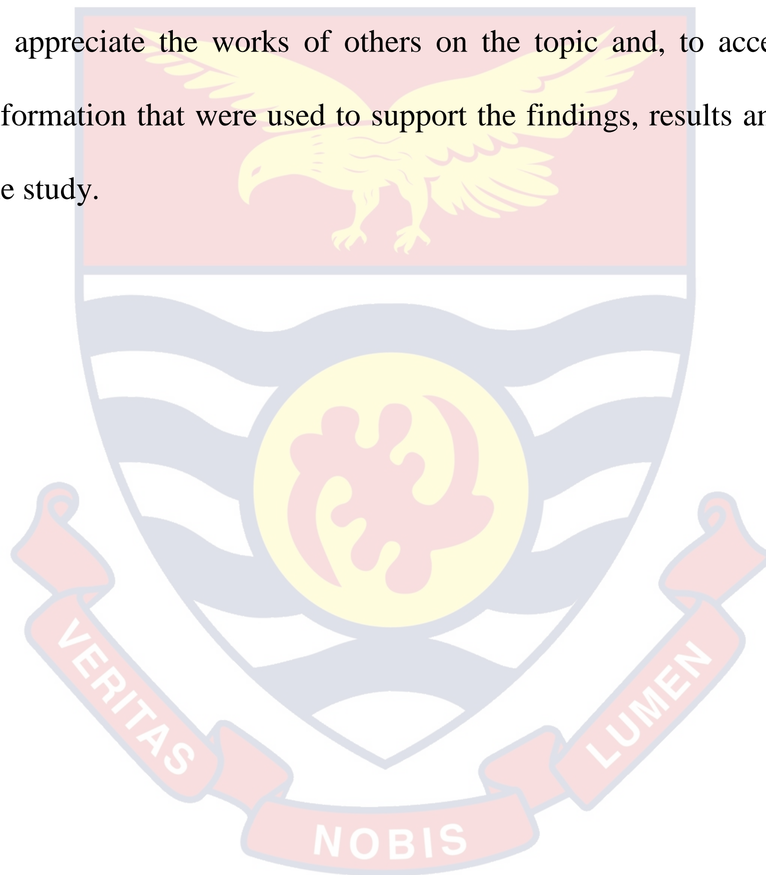
Chapter Summary

This reviewed the capital movement theory and the new institutional economics theory which provided a good foundation for the study. The theories guided the researcher to define the conceptual framework for the study. The conceptual framework in turn helped the researcher to state research problem, objectives of the study, research questions and, to structure data collection and analysis process. Empirical review on the topic was done to appreciate the works of others on the topic and, to access very relevant information that were used to support the findings, results and conclusions of the study.



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CHAPTER THREE

RESEARCH METHODS

Introduction

As an essential element in every research undertaking, this chapter focuses on all the various methods that are logically arranged to deliver outcomes that adequately reflect the research objectives. In this light, the current chapter looks at the study design and the source of data employed. It also covers the model specification and estimation technique. In particular, it discusses all the respective proxies used for the variables and the justification for their inclusion. In the last section of this chapter, the summary of the variables, their measurement and the priori expectations are provided.

Research Design

This study adopted the descriptive cross-sectional research design to examine the how the country level governance indicators affect foreign direct inflows into Ghana. The study was conducted within eight weeks. This duration of the study was affirmed by Cowell (2014), who postulated that cross-sectional research design is a method that is used to collect data over short and fixed period of time on a data. Sarantakos, (2005), also posits that cross-sectional research design enables researchers to collect a large amount of data from a large sources. This makes it useful for students who are yet to develop the skills or obtain the time and resources necessary to execute more sophisticated research designs. Cross-sectional research design can be cost-effective. The cross-sectional research design was chosen because the sampled variables that are being studied are simply being observed as they are without making any attempt to control or manipulate them. Despite the benefits cross-

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sectional research offers, it has some shortcomings. For instance, cross-sectional research designs do not allow researchers to assess facts about time in terms of exposure and effect (Manheim, 1977).

Source of Data

Basically, secondary quantitative data were used for the study. The data on foreign direct investment, economic uncertainty (also termed as inflation), market size and trade openness were sourced from the World Development Indicators for Ghana (World Bank, 2017). In order to determine how the country level governance indicators affect foreign direct inflows into Ghana, the study used the governance indicators from World Bank's Worldwide Governance Indicators developed by Kaufmann et al. (1999) and updated in Kaufmann et al.(2010). The indicators were constructed based on wide variety of cross country questionnaires and polls of experts and by using unobserved components. A scale of index values ranging from zero (0) to hundred (100) percent or -2.5 to +2.5 was used for the considered indicators (Kaufmann et al. (2010). This means that higher values of the index indicate a higher level of good governance, while lower levels indicate poor level of governance. These indicators covered six broad dimensions, each of which shows different aspect of good governance in Ghana.

All the six dimensions were considered and used in this study. These include control of corruption, government effectiveness, political stability, rule of law, regulatory quality and voice and accountability to provide an in-depth coverage. The choice for these particular indices is based on the argument of Meon and Sekkat (2007) that the indices are available for a very large sample of countries and provide a consistent assessment. Again, Thomas (2010) noted

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that because the indicators achieve maximum precision, they have become attractive to all. The study period spanned from 1996 to 2016. These periods were chosen in order to provide a longer timeframe larger enough to capture any variation that might occur in the data over time.

Model Specification and Estimation

Theoretically, it has been emphasized that governance could possibly be endogenous because of choice problems where respondents were self-selected into groups based on unobserved factors (Clougherty, Duso, & Muck, 2016). When endogeneity issues arise, doubt is cast on the unbiasness of the coefficient estimator of Ordinary Least Squares (OLS) (Antonakis, Bendahan, Jacquart, & Lalive, 2010). According to Semadeni, Withers and Certo (2014), even low levels of endogeneity can lead to bias and inconsistent results that increase the likeliness of making incorrect causal inferences and flawed managerial decisions. To check the issue of endogeneity as identified in prior studies and produce robust estimates, Bascle (2008) advocated the use of instrumental variables, since instrumental variables move round the endogenous independent variable and does not directly affect the dependent variable (Rossi, 2014).

In view of these lines of reasoning, the current study used instrumental variables. The use of instrumental variables technique requires appropriate estimator as well. One of the most commonly used instrumental variables estimators is Two Stage Least Squares (Zaefarian, Kadile, Henneberg & Leischnig, 2017). This is because it was observed in an earlier account that correcting for endogeneity using instrumental variables increases the likelihood of reporting coefficient estimates that are near their true values

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(Semadeni et al., 2014). Consequently, to maximize the predictive power of the current study and avoid the endogeneity issues that characterized the previous studies, Two-stage Least Squares approach was adopted and used to estimate the formulated hypotheses. The general model was thus specified following Angrist and Imbens (1995) as:

$$FDI_t = f(CLGI_t, Instrumental\ Variables_t) \quad ....\ equation\ 1$$

In equation 1,

$FDI = Foreign\ Direct\ Investment$,

$CLGI = Country\ Level\ Governance\ Indicators$ and the $t = Time\ Dimension$.

Equation 1 was re-parameterized into specific terms as:

$$LFDI_t = \alpha + \beta_1 LCC_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 2$$

$$LFDI_t = \alpha + \beta_1 LGE_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 3$$

$$LFDI_t = \alpha + \beta_1 LPS_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 4$$

$$LFDI_t = \alpha + \beta_1 LROL_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 5$$

$$LFDI_t = \alpha + \beta_1 LRQ_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 6$$

$$LFDI_t = \alpha + \beta_1 LVA_t + \beta_2 LEU_t + \beta_3 LMS_t + \beta_4 LTO_t + \mu_t \quad ....\ equation\ 7$$

Where

$\alpha = the\ intercept$

$\beta_{1-4} = the\ coefficients\ to\ be\ determined$

$L = Natural\ Logarithm$

$CC = Control\ of\ Corruption$

$GE = Government\ Effectiveness$

$PS = Political\ Stability$

$ROL = Rule\ of\ Law$

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$RQ = \text{Re}\, gulatory\, Quality$

$VA = Voice\ and\ Accountabi\, lity$

$EU = Economic\ \ uncerta\,\text{int}\ y$

$MS = Market\, size$

$TO = Tradeopenness$

$\mu = Random\, term$

All the other terms are as described in equation 1. Control of corruption, government effectiveness, political stability, rule of law, regulatory quality and voice and accountability were used as proxies for country level governance indicators. Economic uncertainty, market size and trade openness were proxies used for instrumental variables following the literature review (see for example Nondo, Kahsai & Hailu, 2016 and Sarmidi, Md-Nor & Ridzuan, 2015). By using the Two-stage Least Squares estimation technique, the potential correlation power of the random term is limited so endogeneity problems do not arise; and therefore, the true effect of each of the governance indicators on foreign direct investment into Ghana could be determined leading to making the right inferences and managerial decisions without biasness. The natural logarithm was taken of all the variables to ensure linearity and making the estimates easily interpretable as elasticities (Gelman & Hill, 2007).

Justification for the selected variables

Foreign Direct Investment

Foreign direct investment is widely used in the literature. First, as endogenous variable as in the case of Saidi, Ochi and Ghadri (2013), Castro and Nunes (2013) and Sarmidi, Md Nor and Ridzuan (2015). These previous

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researchers considered foreign direct investment to be influenced by complex set of factors including governance mechanisms (Zeneli, 2014) and hold a very strategic position in the developmental agenda of every country (Ray, 2012; Almfraji & Almsafir, 2014 and Quazi, 2014). To explore this variable further in the case of Ghana, foreign direct investment was used in this study as endogenous variable. The foreign direct investment variable was taken as a composite measure of all the three categories identified in Asiedu (2002) and Sichei and Kinyondo (2012); therefore, it represents the sum of all the new capital invested, profits re-invested, and inter-enterprises capital invested by foreign investment into Ghana. Again, following Adam and Filippaios (2007) and Kurul and Yalta (2017), the foreign direct investment was scaled by gross domestic product to allow for normalization and easy comparison with past research works.

Control of Corruption

One other critical concern of a foreign investor's decision making to invest in another country is corruption. Generally, the mainstream consideration is that corruption breeds inefficiencies and distortions, which harm a nation's economy. This means that Corruption becomes a grabbing hand and raises the costs of transaction to be incurred by foreign investors through several payments such as commissions to top officials/bureaucrats to win big contracts or bribing local officers to obtain permits, utilities connection, police protection, tax rebates among others which contribute to raising the overall cost of doing business (Bardhan, 1997), market distortions (Habib and Zurawicki, 2002) and loss of reputation and brand goodwill (Zhao, Kim & Du, 2003). However, other strand of views considered corruption as a

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helping hand. In this regard, corruption greases the wheels of commerce where weak legal and regulatory frameworks exist (Bardhan, 1997) and act as speed money that allows foreign investors to bypass bureaucratic systems (Huntington, 1968). On these contrasting views, Peres, Ameer and Xu (2018) argued that control of corruption attract more foreign direct investment in both developed and emerging economies, hence the motivation to include this variable. It is measured by the degree of actual or potential corruption within a political system ranging from nepotism, excessive patronage to bribery. The rating ranged from zero (0) to hundred (100) percent with lower score indicating poor control.

Government effectiveness

According to Rodrik (2008), government effectiveness contributes significantly to inflow of foreign investments by attracting foreign firms into host countries. More so, government effectiveness provides quality public services, effective bureaucracy, independence of civil service, ease of political pressure and winning the trust, credibility and commitment of the government in implementing sound policies (Oster, 2009) which eventually attract foreign investors. Similarly, Murphy, Andrei and Vishny (1991) noted that government effectiveness extends beyond attracting foreign investors to creating favourable conditions for domestic and foreign multinational corporations (MNCs) in small and developing nations. From these positions, Nizam and Hassan (2018) believed that government effectiveness is a relevant incentive to foreign investors. Thus, on foreign direct investment and trade, it would be expected that foreign businesses would prefer an effective host country's government. This study seeks to see if these agreements on

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government effectiveness are the case in an emerging economy such as Ghana. It is measured taking into account quality of public services, civil service, policy formulation and implementation, independence from political pressure and credibility of government's commitment to policies. The rating ranged from zero (0) to hundred (100) percent with lower score indicating government effectiveness is poor.

Political stability

Political stability was included in this study to measure the resilience of government to political shocks, terrorism and domestic violence which are likely to increase the risk of undertaking business and prevent investments. The rating ranged from zero (0) to hundred (100) percent with lower score indicating that political stability is poor. Conceivably, foreign investors would like to invest in countries which are politically stable so that there can be continuity of policies by government that may not affect investors. Research projects focusing on this measure of governance include Baek and Qian (2011), Busse, Nunnenkamp and Spatareanu (2011), Gordon, Loeb and Zhu (2012) and Jadhav (2012). In an environment of political uncertainty, public official and investors have myopic focus, and sacrifices legality and work for personal benefits (Shahbaz & Rahman, 2010). Therefore, political stability should increase the probability of a country being selected as an investment destination (Woodward & Rolfe, 1993). But Meon and Sekkat (2007) also argued that there are some multinational firms which invest in politically risky countries thus causing disconnect between foreign direct investment and political stability. This study tests these assumptions further using perspectives from Ghana.

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Rule of law

Rule of law affects investments inflows through various legal institutions and property rights protection mechanisms. It involves the quality of contract enforcement, the effectiveness of the police, the judiciary service and the likelihood of crime occurring (Zidi & Ali, 2016). In developed or developing countries, where existing legal institutions and property rights protection frameworks are weak and easily compromised, very few foreign investors would like to venture to invest in such countries since this would put their investments at risk. While Fan, Morck, Xu and Yeung (2009) and Jadhav (2012) argued that a more effective rule of law promotes higher foreign investments inflows, Gordon, Loeb and Zhu (2012) have reported mixed effects of this measure on foreign direct investment. This variable was added, particularly, because Te-Velde (2001) posited that it took about one to two years in Ghana to establish business but could improve when rule of law is enhanced. It is measured by the confidence of Ghanaian citizens in the social rules, effectiveness of the judiciary and compliance with contract enforcement, and the rating ranged from zero (0) to hundred (100) percent with lower score indicating rule of law is poor.

Regulatory quality

According to UNCTAD (1998), regulatory quality comprises non-discrimination between foreign and domestic private investors, allowing for profit repatriation by foreign investors, protection against expropriation, granting of incentives, strengthening of standards of treatment of foreign investors, and a shift away from targeting foreign investors. But as Asiedu (2004) noted, regulatory quality slowed in Sub-Sahara Africa compared to

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other developing countries. This implies that when regulatory quality weakens, extra weight is attached to worst-case scenario of total loss of investment, and therefore deterring foreign direct investment (Meon and Sekkat, 2007). In essence, regulatory quality leads to formulation of market-friendly policies and the ability of government to eliminate price controls and ensure adequate supervision which in turn eliminates intrusion of public power and excessive regulation on the market and unofficial activities thereby encouraging investors (Kurul & Yalta, 2017). Regulatory quality was measured by the ability of government to formulate and implement sound policies and regulations that permit and promote foreign investment inflows. The rating ranged from zero (0) to hundred (100) percent with lower score indicating poor regulatory quality.

Voice and accountability

Voice and accountability variable was measured by the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, of association, and of media. The measurement rating ranged from zero (0) to hundred (100) percent with lower score indicating voice and accountability is poor. Theoretically, literature suggested that a measure of greater pluralism as in the case of voice and accountability tend to lower a host country's foreign direct investment inflows. But previous studies including Davis (2011), Doces (2010) and Zheng (2011) all suggested that the effect of voice and accountability on foreign direct investment is mixed. This position aligned with Gani (2007) that voice and accountability might influence foreign direct investment through either inclusion or exclusion

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of public opinion on investments which can in turn allow or deter foreign investments.

Control variables

One major issue identified in both the theoretical and empirical literature on the link between governance indicators and foreign direct investment is endogeneity. As discussed earlier, three variables have been instrumented in this study to deal with the problem. These variables include economic uncertainty, market size and trade openness. These variables are considered next.

Economic uncertainty

Economic uncertainty in this study was measured by the annual rate of inflation. According to Saidi, Ochi and Ghadri (2013), it represents an inadequate form of macroeconomic policy when it is high and prudence economic policy when it is low. Both forms have influence on foreign direct investment. All else equal, Asiedu and Lien (2011) asserted that lower inflation should have a favourable effect on foreign direct investment and make a host country attractive to foreign investors. On the other hand, higher level acts as a barrier that inhibits inward foreign investment because investors would prefer to invest in economies that are relatively stable. In this regard, it is logical that allowing economic uncertainty in equations linking governance indices and foreign direct investment could possibly bias the association was instrumented for.

Market size

Market size was measured following the literature by gross domestic product per capita. The size of an economy can either be large or small. An

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increase in gross domestic product translates into larger gross domestic product per capita and this tends to attract foreign direct investment (Nondo et al. 2016) because of the large nature of such economy. However, a smaller economy is a disincentive to foregn investors. Again, foreign direct investment inflows also affect the size and growth of gross domestic product, as also in the case of exports (Sachs, 2003). This bi-directional causality can lead to endogeneity, therefore was checked.

Trade openness

Open economies facilitate trade with the rest of the world and favour investors seeking to export their products (Nisam & Hassan, 2018). Trade openness was measured as the ratio of total trade (sum of exports and imports) to gross domestic product. This variable was found to have a close relationship with corruption. This is because trade and investment may breed virtue among local politicians by putting them under the scrutiny of independent agents (Meon & Sekkat, 2007). As Rodrik (2002) noted over a decade ago, trade openness is an institutional reform, similar to the views of Treisman (2000) that those countries that are more opened to trade are significantly less corrupt. Though Asiedu (2002) observed that the impact of trade openness depends on the type of investment, allowing it as an exogenous variable in the estimation equation may lead to endogeneity, therefore, the trade openness variable was modeled as an **Instrumental variable.**

Following these discussions, a summary of all the variables used, how the variables were measured and the priori expectations have been given in Table 1. Since instrumental variables are completely checked, their values are

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not reported Two-Stage Least Squares. Therefore, their priori expectations are not shown in Table 1.

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Table 1: Summary of Variables

Category	Variables	Measurement	Priori expectation
Dependent variable	Foreign Direct Investment (FDI)	Sum of all new capital invested, profits re-invested, and inter-enterprises capital invested by foreign investors into Ghana scaled by gross domestic product.	+/-
Independent variable	Control of corruption (CC)	Degree of actual or potential corruption within a political system including nepotism, excessive patronage and bribery.	+/-
	Government effectiveness (GE)	Quality of public services, civil service, policy formulation and implementation, independence from political pressure and credibility of government's commitment to policies.	+/-
	Political Stability (PS)	Resilience of government to political shocks, terrorism and domestic violence.	+/-
	Rule of Law (ROL)	Ability of government to formulate and implement sound policies and regulations.	+/-
	Voice and Accountability (VA)	Extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, of association, and of media. .	+/-
		Annual rate of inflation.	
	Economic uncertainty (EU)	Gross domestic product per capita.	
	Market size (MS)	The ratio of total trade (sum of exports and imports) to gross domestic product.	
	Trade openness (TO)		

Source: Author's compilation

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Chapter Summary

The study used descriptive cross sectional research design to examine the factors that influence Foreign Direct Investment. Secondary data on foreign direct investment, economic uncertainty, market size and trade openness were sourced from the World Development Indicators was used for this study. The data was analysed using statistical package for social science (SPSS).

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CHAPTER FOUR

RESULTS AND DISCUSSION

Introduction

Chapter four presents the results of the study. In the first place, the main purpose of the study was to find out how the country level governance indicators and foreign direct investment in Ghana are related. Specifically, (a) examine the relationship between control of corruption and foreign direct investment, (b) determine the relationship between government effectiveness and foreign direct investment, (c) assess the relationship between political stability and foreign direct investment, (d) analyze the relationship between rule of law and foreign direct investment, (e) investigate the relationship between regulatory quality and foreign direct investment, (f) explore the relationship between voice and accountability and foreign direct investment. The study period was from 1996 to 2016.

Descriptive Statistics

Table II displays the descriptive statistics for both the dependent and independent variables used in this study. Table II also shows the mean, standard deviation, minimum and maximum values for all the variables. As can be seen, the mean value of foreign direct investment into Ghana during the periods under study is 0.487. This means that, on the average, the level of FDI inflows into Ghana was about 48.7%. Also, on the six country level governance indicators, it was revealed that control of corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability recorded 0.450, 0.449, 0.377, 0.461, 0.426, 0.496 respectively. This can be interpreted to mean that, on the average, control of

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corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability shown during the research period is about 45%, 44.9%, 37.7%, 46.1%, 42.6% and 49.6% respectively. Of all the country level governance indicators, voice and accountability showed the highest mean value followed by control of corruption. With respect to economic uncertainty, the mean figure is 0.026, which means that during the research time, the economic uncertainty was about 2.6%. Similarly, Ghana's market size and trade openness are 0.089 and 0.868 respectively. In this regard, Ghana's market size was about 8.9% while Ghana's trade openness was about 86.8%. From Table II, one quick observation to be made is that Ghana's economy was highly open to trade during the research period from 1996 to 2016.

Table 2: Descriptive statistics

	FDI	CC	GE	PS	ROL	RQ	VA	EU	MS	TO
Mean	0.487	0.450	0.449	0.377	0.461	0.426	0.496	0.026	0.089	0.868
St. Dev.	0.032	0.193	0.192	0.164	0.198	0.187	0.216	8.931	5.398	0.141
Min.	0.960	0.010	0.005	0.021	0.003	0.012	0.041	0.072	26.310	6.535
Max.	0.952	5.932	6.049	5.261	6.058	5.640	6.749	41.45	18.144	11.605

Source: Field Survey (Horvey, 2019)

Discussion of Empirical Results

Table 3 indicates the test results for hypothesis 1. Overall, the ANOVA statistics indicated that the model is significant at 5% significance level (sig. = 0.030). From the R square coefficient of determination, about 88.3% of the variation in the dependent variable (that is, FDI) is explained by the variations in the independent variable (CC) (Adj. R square = 87.7%). Additionally, after

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holding the instrumental variables (comprising economic uncertainty, market size, trade openness) constant, a significant positive relationship is found between control of corruption and foreign direct investment at a significance level of 5% (p-value = 0.030). The results mean that when control of corruption is increased by 1%, foreign direct investment also increases by 2.208%, all things being equal. Thus, control of corruption significantly increases foreign direct investment. Based on this finding, the null hypothesis (H_0) that there is no significant relationship between control of corruption and foreign direct investment is rejected. This finding is also consistent with the findings of Barassi and Zhou (2012) but contradicts the mixed findings of Asiedu and Lien (2011).

Table 3: Regression Results for Eqn. 2

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
LCC_t	2.208	0.940	1.978	0.030
Constant	5.520	1.411		0.001
R. Square	0.883			
Adj. R. Square	0.877			
ANOVA				
F. Stat.	5.518			
Sig.	0.030			

Source: Field Survey (Horvey, 2019)

Furthermore, the findings of hypothesis 2 are displayed in Table 4. Based on the outcome of the ANOVA statistics, the model is significant at 5% level of significance (0.000). The R square coefficient of determination showed that about 88% of the variation in the foreign direct investment is

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explained by the variations in government effectiveness (Adj. R square = 87.4%). More so, when the instrumental variables are held constant, a significant positive relationship is found between government effectiveness and foreign direct investment at a significance level of 5% (p-value = 0.000). This result means that when government effectiveness is increased by 1%, foreign direct investment also increases by 5.855%, holding all other things constant. Thus, government effectiveness increases foreign direct investment significantly. In view of this result, the null hypothesis (H_0) that there is no significant relationship between government effectiveness and foreign direct investment is rejected.

The results confirmed the earlier findings of Globerman and Shapiro (2002 and 2003). It however, failed to agree with Nondo et al (2016) which found no significant relationship.

Table 4: Regression Results for Eqn 3

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
LGE_t	5.855	0.484	1.058	0.000
Constant	5.175	1.784		0.009
R. Square	0.880			
Adj. R. Square	0.874			
ANOVA				
F. Stat.	6.531			
Sig.	0.000			

Source: Field Survey (Horvey, 2019)

In another development, the results of hypothesis 3 are given in Table 5. As evident from the ANOVA test results, the model used to analysize hypothesis 3 is generally significant at 5% significance level (0.030). Overall, the R square coefficient of determination showed that about 88.2% of the

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variation in the foreign direct investment is explained by the variations in political stability (Adj. R square = 87.6%). More so, when the instrumental variables of economic uncertainty, market size and trade openness are held constant, a significant positive relationship is found to exist between political stability and foreign direct investment at a significance level of 5% (p-value = 0.030). This result means that when political stability is increased by 1%, foreign direct investment also increases by 2.269%, holding all other things constant. In this regard, political stability increases foreign direct investment significantly. The results of the study mean that the null hypothesis (H_0) that there is no significant relationship between political stability and foreign direct investment is rejected.

The results aligned with the past research work of Baek and Quian (2011) and Quazi (2014). Both Baek and Quian (2011) and Quazi (2014) found that political stability or absence of political risk acts as a great motivator for directing foreign direct investment into host countries.

Table 5: Regression Results for Eqn 4

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
LPS_t	2.269	0.966	1.943	0.030
Constant	5.583	1.385		0.001
R. Square	0.882			
Adj. R. Square	0.876			
ANOVA				
F. Stat.	5.517			
Sig.	0.030			

Source: Field Survey (Horvey, 2019)

Additionally, Table 6 contained the outcomes for hypothesis 4. The model estimating this equation is significant at 5% significance level (sig.

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0.032). Overall, the R square coefficient of determination showed that about 88.2% of the variation in the foreign direct investment is explained by the variations in rule of law (Adj. R square = 87.7%). More so, a significant positive relationship is found between rule of law and foreign direct investment at a significance level of 5% (sig. 0.032) when instrumental variables such as economic uncertainty, market size and trade openness were held constant (p-value = 0.032). The implication of this result is that when rule of law is increased by 1%, foreign direct investment also increases by 2.208%, holding all other things constant. In this regard this study has found that rule of law increases foreign direct investment significantly. The results of the study mean that the null hypothesis (H_0) that there is no significant relationship between rule of law and foreign direct investment is rejected. Kunsch et al. (2014) and Peres et al. (2018) who examined similar relationship from different regions or countries also obtained a significant positive association between rule of law and foreign direct investment.

Table 6: Regression Results for Eqn 5

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
$LROL_t$	2.208	0.954	1.990	0.032
Constant	5.502	1.441		0.001
R. Square	0.882			
Adj. R. Square	0.877			
ANOVA				
F. Stat.	5.350			
Sig.	0.032			

Source: Field Survey (Horvey, 2019)

Table 7 provides the regression results for hypothesis 5. The results indicate that the estimated model for hypothesis 5, using the ANOVA

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statistics, is significant at 5% significance level (sig. 0.022). Table 7 showed that the R square coefficient of determination is 88.4%. This indicates that about 88.4% of the variations in the foreign direct investment variable is explained by regulatory requirement (Adj. R square = 87.8%). Furthermore, it is shown in Table 7 that a significant positive relationship exist between regulatory requirement and foreign direct investment at a significance level of 5% (sig. 0.022) when such instrumental variables as economic uncertainty, market size and trade openness were held constant (p-value = 0.022). When regulatory requirement is increased about 1%, foreign direct investment increases about 2.122%, all things being equal. The results of the study mean that the null hypothesis (H_0) of no significant relationship between regulatory requirement and foreign direct investment is rejected.

This significant positive relationship followed the findings of Globerman (2002 and 2003), Castro & Nunes, 2013) and Yerrabati and Hawkes (2016) but differs from Bellos and Subasat (2012) and Subasat and Bellos (2013).

Table 7: Regression Results for Eqn 6

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
LRQ_t	2.122	0.852	1.876	0.022
Constant	5.695	1.262		0.000
R. Square	0.884			
Adj. R. Square	0.878			
ANOVA				
F. Stat.	6.211			
Sig.	0.022			

Source: Field Survey (Horvey, 2019)

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Hypothesis 6 results are presented in Table 8. It shows all the relevant test statistics. In the first place, the ANOVA statistics confirmed that the model is significant at 5% significance level (sig. = 0.023). Moreover, from the R square coefficient of determination, it can be seen that about 88.4% of the variation in the foreign direct investment is explained by the variations in voice and accountability (Adj. R square = 87.8%). Additionally, holding the effects of instrumental variables such as economic uncertainty, market size and trade openness constant, a significant positive relationship is found to exist between voice and accountability and foreign direct investment at a significance level of 5% (p-value = 0.023). The results mean that when voice and accountability is increased by 1%, foreign direct investment also increases by 2.059%, all things being equal. Therefore, voice and accountability significantly increases foreign direct investment. Based on this finding, the null hypothesis (H_0) that there is no significant relationship between voice and accountability and foreign direct investment is rejected.

The findings in this study are in line with Blanton and Blanton (2007), Globerman and Shapiro (2002 and 2003) and Yerrabati and Hawkes (2016). On the other hand, it disconfirmed the results of Nondo et al (2016) and Subasat and Bellos (2013).

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Table 8: Regression Results for Eqn 7

Dependent variable: LFDIt

Variable	B Coefficient	St. error	Beta	P-Value
LVA_t	2.059	0.833	1.891	0.023
Constant	5.667	1.283		0.000
R. Square	0.884			
Adj. R. Square	0.878			
ANOVA				
F. Stat.	6.111			
Sig.	0.023			

Source: Field Survey (Horvey, 2019)

From theoretical point of view, the study is consistent with the positions of Institutional theory. In the context of this theory, improvements in the various governance indicators such as control of corruption, government effectiveness, rule of law, regulatory requirement, political stability and accountability enhance the business environment for foreign investors. Consequently, for the Institutional theorists, a country that puts in place good governance framework becomes a good destination for foreign direct investments. Corporations are not only concerned with improvement in macro-economic variables. A major complement in the quest to attract foreign capital comes with implementation of an effective institutional mechanism. Thus, to Institutional theorists such as Dunning (1981) and North (1990), a positive association is expected to exist between country level governance indicators (institutions) of various host nations and foreign direct investment. This position is largely confirmed in this study.

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CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter forms the concluding chapter of this study and it is divided into three sections. Section one deals with the summary including the motivation for the study, various approaches, data, tests and the major findings of the study. Second two and three focused on the conclusion drawn from the study and the recommendations made respectively.

Summary

As a summary, governance indicators and foreign direct investment play a significant role in the development of every country. To be able to attain the required level of economic development, issues about effective and efficient governance indicators and how these governance indicators impact foreign direct investment are critical. Knowledge about how the governance indicators impact foreign direct investment, particularly in the case of Ghana can enhance Ghana's economic management decision and constitute a specific strategy for improvement, particularly, when these governance indicators and foreign direct investments are generally thought to be closely related to economic development.

Based on these arguments, this study was conducted using a time series data to test how the various governance indicators affect foreign direct investment in Ghana. Overall, the study covered the periods 1996 to 2016. Secondary data on country level governance indicators and foreign direct investment were used, therefore, making the research method purely quantitative. A Two-stage Least Squares estimating technique was adopted.

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This technique is expected to completely tackle the problems of endogeneity which had characterized past results. Thus, the Two Stage Least Square estimates are efficient and unbiased. After instrumenting for important variables such as economic uncertainty, market size and trade openness, the empirical results from the Two-stage Least Squares showed that a significant positive relationship exists between the country level governance indicators and foreign direct investment. Importantly, all the six governance indicators showed a significant positive relationship with foreign direct investment. This indicates that there is significant evidence of benefits of the governance indicators on foreign direct investment for Ghana from 1996 to 2016 fiscal years. To this end, the more attention is directed towards improvement of the governance indicators, the more Ghana's foreign direct investment will increase, all things being equal.

Conclusion

The focus of this study was to examine the relationship between the country level governance indicators and foreign direct investment in Ghana covering the periods 1996 to 2016. Based on the outcomes, this study empirically documents that country level governance indicators significantly affects foreign direct investment in Ghana. To this end, as the various governance indicators including control of corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability increase, foreign direct investment in Ghana also increases. In a similar fashion, this study further concludes based on the empirical results that the position of Institutional theory is explicitly significant in determining foreign direct investment in Ghana.

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Recommendations

Based on the results of the study, it can be noticed that beyond the traditionally known macro-economic factors, the various country level governance indicators also need to be considered in any major economic strategy aimed at attracting foreign investors into Ghana. In particular, attention must be focused on control of corruption, government effectiveness, political stability, rule of law, regulatory requirement and voice and accountability since these variables also create opportunity to enhance foreign direct investment into Ghana and enhance Ghana's economic development. For instance, in the case of control of corruption, the legal systems and other institutions responsible for dealing with corruption have to be supported to function as appropriate. Also, in terms of government effectiveness, Ghana's public services must provide quality and effective services independent of political influences, while at the same time there must be commitment of government to formulate and implement sound policies.

Limitations and Suggestion for Future Research

The outcome and the empirical findings of this research work needs to be interpreted within the limitation that the study focused primarily on only one country, therefore, the degree to which the findings of the study can be generalized is limited. For future research studies on the topic, attention should be directed to how the governance indicators affect growth in foreign direct investment in order to enhance our understanding of the subject.

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