**Political Risk and Foreign Direct Investment in Africa: The Case of the Nigerian Telecommunications Industry**

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**Executive Summary**

Foreign direct investment (FDI) flows are expected to be influenced by political risk factors. However, studies that evaluate the relationship between political risk and FDI flows in Sub-Saharan Africa (SSA) are scarce. This study examines the impact of political risk on FDI flows in a SSA context using the 12 political risk components published as the International Country Risk Guide (ICRG) by the Political Risk Services Group (PRS) with the Nigerian telecommunications sector as a case study. The study finds that political risk has a significant influence on the inflow of FDI into developing economies in SSA such as Nigeria and that the 12 components affect FDI in different ways. Irrespective of the political risk rating, a consistent improvement in composite political risk enhances FDI inflow. Among the 12 components, corruption, law and order, democratic accountability and investment profile were found to have significant influences on FDI inflow into the Nigerian telecommunications sector. Corruption, in particular, explains nearly two-thirds of the FDI inflow.

Key Words: FDI, political risk, telecommunications, developing economies, Africa, Nigeria.

**Introduction**

Foreign direct investment (FDI) has been identified as a major contributing factor to the economic growth of developing nations (Osabutey & Debrah, 2012; Vijayakuma, Sridharan & Rao, 2009). Consequently, governments of developing nations such as those in Sub-Saharan Africa (SSA) continue to employ various policies and strategies aimed at attracting FDI into their economies (Mmieh & Owusu-Frimpong, 2004). The recent global economic downturn resulted in fierce competition among these nations to attract much needed FDI (Baek & Qian, 2011). The concept of FDI is underlined by Multinational Enterprises’ (MNEs) quest to improve their fortunes through the exploitation of opportunities abroad. They achieve this by establishing lasting business interest in the chosen host country (Dunning, 1979). These MNEs consider various variables before choosing investment location(s). These factors include economic, political, social, technological and legal variables. Strategic resources and capabilities of MNEs influence how they are influenced by political events (Frynas and Mellali, 2003). One of the key considerations of MNEs prior to embarking on FDI is the expected impact of current and projected political situations in the prospective host nation(s) on business operations and performance, and the consequent effect on profitability of investments.

A review of existing literature on political risk and FDI revealed that although there is an evident focus on developing economies there is paucity of existing published empirical work on countries in Sub-Saharan Africa (SSA). Quantitative studies that focus on specific SSA countries or sectors are scarce as most of the existing empirical works are multi-country studies. Cleeve (2012), for example, studied political and institutional impediments to FDI inflows to SSA and used cross-sectional time series data to study 40 SSA countries. In a conceptual paper, Alon, Gurumoorthy, Mitchell and Steen (2006) emphasised the need for a framework for examining sector-specific micro-political risk. This clearly shows that there is a gap in the literature on how political risk influence sector-specific FDI inflow. Krifa-Schneider and Matei (2010) also studied political risk and FDI in developing economies using panel data from 33 developing and transition economies. Baek and Qian (2011) used the ICRG twelve political risk indicators to compare the impact of political risk on FDI between developing and developed countries using 116 samples drawn from both markets. Unfortunately, none of these studies covered in-depth analysis that focuses on a particular country and/or specific sector such as the telecommunications sector considered in this study.

Other noticeable gaps in the existing literature on the subject are the absence of studies that comprehensively covered the whole range of political risk components. Most studies looked at a few of the components with the most commonly studied components being democracy and corruption. Some of these works include Okafor, Ujah, Elkassabgi and Ajalie (2011) who studied democracy and FDI inflow in SSA. Asiedu (2006) also looked at the role of three political components – government policy, institutions and political instability on FDI in Africa. This research paper studies, in considerable depth, a particular SSA country, Nigeria, and also uses all the 12-category political risk indicators compiled by the Political Risk Service Group (PRS) with the aim of identifying how each of the indicators could influence FDI inflow into a specific sector – the telecommunication industry.

UNCTAD (2013) reported that although Africa had a 5% increase in FDI inflows in 2012, Nigeria witnessed decreasing inflows within the same period noting that Nigeria’s FDI inflows fell from $8.9B in 2011 to $7.0B in 2012 as a result of political insecurity and the weak global economy. Political insecurity, a political risk, which has been prevalent in Nigeria, warrants attention in the international business literature. This downward trend affected the Nigerian telecommunications industry and data from the World Bank (2013) shows a declining FDI inflow since 2009, with 2011 alone witnessing a huge (51 per cent) drop in net FDI inflows into the sector from $3.03Billion in 2010 to $1.48Billion in 2011. This means that it is important and strategic to consider how much impact political risk influenced the FDI flows in the Nigerian telecommunications industry. This study focuses on the immediate post liberalization years as the literature has shown that FDI inflows into the industry stabilized in 2002 after the Nigerian Global System for Mobile (GSM) auction of 2001. This study will not include the year 2001 as the extraordinary one-off net inflow from the auction proceeds in that year could bias the entire data.

Preliminary research has identified a number of indicators by which political risk is measured. Some of these indicators are: corruption, political stability, internal and external conflicts, ethnic and religious issues, socio-economic conditions, government policy and type of government (Aguiar, Auira-Conraria, Gulamhussen & Magalhaes, 2012; PRS, 2014). We investigate the relationship between these political risk components and FDI. The main objective of the study, therefore, will be to investigate the influence of political risk on FDI inflow to SSA using the case of the Nigerian telecommunications industry. This study seeks to use political risk components and net FDI inflow data to provide answers to the following research questions:

* What is the impact of political risk on FDI inflow to developing economies?
* Which political risk components influence sector-specific FDI inflow into Africa?
* How do individual political risk components impact on the FDI inflow into the Nigerian telecommunications industry?

The rest of the paper is organised as follows. First, we review the theoretical and empirical literature on political risk and FDI. Second, we develop a contextual framework by giving insights into FDI inflow into the Nigerian telecommunications industry. Third, we discuss the adopted methodology and sources of data for this study. Fourth, we present and analyse the findings. Fifth, we conclude and discuss the implications of our findings and then set an agenda for future research.

**Theoretical and Empirical Literature Review**

Political risks are influenced by institutional factors. Home country institutions, which facilitate or constrain firm performance, establish the basis for economic activities of firms (North, 1990). Institutions govern societal transactions in the areas of politics (e.g. corruption, transparency), law (e.g. regulatory regime) and society (e.g. ethical norms) (Peng, Wang, and Jiang, 2008). Peng et al. (2008) further note that institutional arrangements in developing countries differ significantly from developed countries. Political risks are institutional in nature; institutional weaknesses are prevalent in developing countries such as those in SSA. Freckleton, Wright and Craigwell (2012) find that lower levels of corruption (an institutional phenomenon) in developing countries augment the impact that FDI has on economic growth. Kwok and Tadesse (2006) also noted FDI’s potential of influence on corruption in host countries indicating that foreign firms could either enhance transparency or contribute to increased corruption. Several surveys on Africa related to the perception of investors conducted by organisations such as the World Bank, highlight corruption and political risk as major constraining factors to SSA’s FDI inflow. Barta, Kaufmann, and Stone (2003) offer a detailed explanation of the World Business Environment Survey (WBE), they suggest that corruption is the highest ranking constraint to FDI in SSA. UNCTAD (2000) also assert that corruption and political outlook significantly restrain FDI inflows. Although Asiedu (2006) found a negative relationship between FDI and corruption she points out that corruption leads to weak enforcement of the law and was indeed a barrier to the conduct of effective business. Also, contrary to expectations, Cleeve (2012) found that the relationship between FDI inflows and corruption was not significant in explaining the SSA’s FDI inflow.

The findings from existing literature on the influence of political risk on FDI inflow are mixed. Some studies found that political risk discourages FDI (Dunning, 1998; Asiedu, 2006; Baek & Qian, 2011; Hayakawa, Kimura & Lee, 2011). Whilst others indicate that high political risk environments attract FDI (Janeba 2002; Dar-Hsin, Feng-Shun, & Chun-Da, 2005; Okafor et al., 2011). A third group found an insignificant relationship between political risk and FDI flow (Jadhav 2012; Wei, 2000). Additionally, others also argue that MNE home country political risk influence FDI location decisions (Sauvant, Maschek & McAllister, 2009 and Aguiar et al., 2012).

*Negative Effect of Political Risk on FDI Inflow*

Most studies on the causal relationship between political risk and FDI arrived at the conclusion that high political risk discourages FDI in developing countries. Some of these studies are Asiedu (2006), Bussman (2010), and Amal, Tomio and Raboch (2010). Amal et al. (2010), for example, found that in Latin America, a country’s political risk significantly affects its attractiveness to foreign investors. They argued that the reduced political risk in Latin America in the last two decades is responsible for the higher levels of FDI inflows. Baek and Qian (2011) studied 94 developing and 22 developed economies and discovered that host economies with high political risks discourage FDI inflow. This is because high political volatility results increased risk and therefore lower profits for foreign investors. Using the ICRG 12-component political risk index, they conclude that different political risk components affect FDI inflow to developing economies in different ways and that a stable political and policy environment encourages FDI inflows. Therefore, governments can attract FDI by promoting and maintaining a stable polity. Furthermore, and unsurprisingly, Asiedu’s (2006) study on the determinants of FDI inflow to Africa also arrived at the conclusion that an environment of high political risk is a deterrent to inflows. Utilising panel data, from 1984 to 2002, for 22 countries in SSA, her study concluded that reduced corruption and political instability will enhance the flow of FDI into SSA. Asiedu (2006) observed that FDI to the region is driven by natural resources and suggested that smaller SSA countries with limited natural resources needed to improve their political and institutional infrastructure to attract much needed FDI.

*Positive Effect of Political Risk on FDI Inflow*

Some studies observed that conditions of high political risk in developing countries attract MNEs. Dar-Hsin, Feng-Shun, and Chun-Da (2005), Janeba (2002) and Asiedu and Lien (2011) suggest that there is a positive relationship between political instability and FDI inflow. Dar-Hsin et al. argued that some high political risks cause host country assets to be under-valued excessively to make them increasingly attractive to foreign investors. Janeba (2002) discovered that most high political risk environments become attractive FDI destinations because of low factor costs which serve as an acceptable risk trade off. This implies that foreign firms would be able to handle their operations in a cost effective manner, thereby reducing the cost of doing business and increasing profitability. MNEs may focus their FDI on high political risk markets to avoid competition from most other MNEs, who may be cautious about investing in such risky markets.

Okafor et al. (2011), and Li and Resnick (2003), in separate studies focusing on the impact of the democratic component of political risk on the inflow of FDI, arrived at the same conclusion; that observance of democratic principles by developing countries discourages MNEs from investing in the countries. Okafor et al.’s (2011) study which focused on SSA discovered that the volume of FDI inflow to SSA declines as these countries progress to stronger and more proficient democracies. Arguably, these results could have been influenced by the dominance of investments from emerging markets who exploit the absence of democratic principles. It is not surprising, therefore, that Li and Resnick (2003) also observed that MNEs prefer to invest in developing countries with autocratic or totalitarian governments. Noting that, unlike democratic governments, autocratic governments are not answerable to their people and so can offer better incentives and protection from labour unions to the MNEs.

*Insignificant Relationship between Political Risk and FDI Inflow*

As indicated earlier, some other findings such as Asiedu (2002) and Noorbakhsh, Polani, and Youssef (2001) indicate an insignificant relationship between political risk and FDI inflow. Both strands of research appear to argue that political risk does not necessarily or significantly influence MNEs FDI location decisions. A report by the Economic Intelligence Unit, EIU (2007) observed that high political risk does not deter FDI. The report stated that, contrary to popular thinking, foreign investors’ location decisions focus on macro-conditions rather than political risk. This suggests that it is the overall business environment in a country that primarily influences MNEs location decisions. The EIU (2007) noted that MNEs now mitigate political risk through sophisticated strategies and insurance schemes, thereby reducing the contribution of political risk factors to their location decision making process. MNEs use the political risk forecasts to buy insurance to moderate the potential political risk deciding where to invest.

*Telecommunication FDI in Sub-Saharan Africa (SSA)*

Madichie (2011) observed that the telecommunications industry in SSA is experiencing tremendous growth, driven by FDI originating mostly from the Middle East and South Africa. He identified the key drivers of this growth as Kuwaiti based Zain (formerly Celtel), Etisalat of United Arab Emirates and MTN of South Africa. Madichie (2011) noted that Africa currently has the highest annual growth rate in mobile telephone subscription across the world. In their study on the developmental impact of FDI on SSA, Ndikumana and Verick (2008) attributed MNEs interests in the SSA’s telecommunications industry to the fact that the industry is underdeveloped in the region and therefore presents investors with huge markets and profit opportunities. In addition, Djiofack-Zebaze and Keck (2009), in their study using a sample of 45 SSA countries, found that foreign participation in various sectors is increasing because most SSA countries were opening up their economies through liberalization.

**FDI in the Nigerian Telecommunication Industry**

The Nigerian telecommunications industry started attracting significant MNE interests when it was liberalized in 2001. This industry is of interest because of the high volume of FDI it is currently attracting. The telecommunications industry is currently Nigeria’s second most important beneficiary of FDI after the extractive oil industry (Nigeria Bureau of Statistics, 2013). Another interesting statistic of the Nigerian telecoms industry is the origin of the FDI in the industry. According to the National Communications Commission (NCC, 2013), over 90 per cent of the FDI stocks in the industry originate from other developing economies. This implies that whilst MNEs from developed economies may appear to be reluctant to invest in the sector, MNEs from developing countries seize the opportunity. This is leading to the increasing trend of some emerging economies becoming major FDI players in other developing countries.

This study will focus on the ten year period between 2002 and 2011. The base year 2002 is chosen because of the significance of the year in the history of FDI in the Nigerian telecommunications industry and year 2011 chosen as the end year as the latest available data on the FDI flows in both World Bank and Nigeria Bureau of Statistics databases was that of 2011. Year 2002 is the year immediately after the liberalization of the telecommunications industry in Nigeria. Following the re-introduction of civilian democratic rule in Nigeria in 1999, the new civilian administration decided to liberalize the government controlled telecommunications industry. This led to the auctioning of Global System for Mobile (GSM) licences in 2001. Two of the three licenses were won by multinational telecommunications companies – South African based MTN and Econet Wireless of Zimbabwe. Payment for the licenses, which cost $285 million each, ushered in a new phase of foreign investments into the Nigerian telecommunications industry. Prior to the auction, over 85 per cent of the industry was controlled by the government owned Nigerian Telecommunications Limited (Nitel) (NCC, 2013). The auction year (2001) witnessed an unprecedented net FDI inflow totalling $970 million and representing 1181.37 per cent increase over the previous year (2000) net inflows of $75.7 million (Nigeria Bureau of Statistics, 2013).

Nigerian Telecommunications Ltd (Nitel) monopoly was broken up in 2001 when the Nigerian government liberalized the telecommunications industry by the introduction of GSM technology through the offering of three licenses by competitive bidding. According to the NCC (2013), the Nigerian telecommunications sphere is dominated by mobile telecommunications technology. Mobile telecommunications currently account for 99.67 per cent of all telephone facilities in the country with GSM technology dominating with over 97 per cent. The share of fixed (wired/wireless) is a negligible 0.33 per cent as shown in Table 1.

**TABLE 1: Nigerian Market Share by Telecommunications Technology (June 2013)**

|  |  |
| --- | --- |
| Telecommunications Technology | Percentage Market Share |
| Mobile (GSM) | 97.47% |
| Mobile (CDMA) | 2.20% |
| Fixed (Wired/Wireless) | 0.33% |

Source: NCC (2013)

**TABLE 2: Nigerian Mobile Telecommunications Market Share by Operators (June 2013)**

|  |  |  |
| --- | --- | --- |
| **Operator**  | **Number of Subscribers** | **Percentage Market Share** |
| MTN | 55,238,430 | 47.05% |
| Globacom | 25,019,862 | 21.31% |
| Airtel | 21,591,904 | 18.39% |
| Etisalat | 15,303,647 | 13.04% |
| MTel | 258,520 | 0.002% |
| TOTAL | 117,412,363 |  |

Source: NCC (2013)

Table 2 indicates that the highly competitive Nigerian mobile telecommunication market is currently dominated by four firms – South Africa based MTN, Globacom Ltd (Nigeria), Bharti Airtel of India and Etisalat owned by Emerging Market Telecom Services (EMTS) of UAE; together they account for around 99 per cent of the Nigerian mobile market. This demonstrates the prevalence of FDI in the Nigerian mobile telecommunications, as three of the four dominant firms are foreign MNEs. Madichie (2011) discovered that the major determinants of FDI inflow into the Nigerian telecommunications sector are the huge market opportunities for investment and the high-entry and product-research costs which is a major hindrance to domestic players. Madichie’s (2011) assessment of Middle Eastern firms’ telecommunications investments in SSA relied on qualitative case studies of three emerging market telecom operators in Nigeria: Zain (Middle East), Etisalat (Middle East) and MTN (South Africa). Oji-Okoro (2011) observed that telecommunications FDI have completely transformed the industry and has contributed to Nigeria having the highest tele-density in Africa. This trend has also driven prices below those in comparator countries. This high impact, since liberalization in 2001, could be ascribed to the large market size of the country (NCC, 2013).

It is also worth noting that the sources of FDI flow into the Nigerian telecommunications industry indicate that the ‘psychic distance’ postulation of Johansson and Vahlne’s (1977) Uppsala Model of internationalization remains relevant today. All key FDI players in the industry are MNEs from other developing countries – MTN from South Africa, Airtel from India and Etisalat from the United Arab Emirates, together they control 79 per cent of the Nigerian telecommunications market (see Table 2). These developing countries share similar political and institutional structures with Nigeria and thus lesser ‘psychic distance’. Previous studies affirm that developing countries generally pose higher levels of political risks than developed countries (Jensen, 2008; UNCTAD, 2013) and that these developing countries view political risk in much the same way (Sauvant et al., 2009 and Aguiar et al., 2012).

**Methodology and Sources of Data**

As a result of the longitudinal nature of this research paper, time series data from 2002 to 2011 was used. FDI inflow data was sourced from the World Bank’s World Development Indicator and the Nigerian Bureau of Statistics websites. Political risk data was sourced from the International Country Risk Guide (ICRG) published by the Political Risk Service (PRS) Group. The ICRG uses 12 risk components to measure political risk of a country or region. These components, as shown in Table 3, are Government Stability, Socioeconomic Conditions, Investment Profile, Internal Conflict, External Conflict, Corruption, Military in Politics, Religious Tensions, Law and Order, Ethnic Tensions, Democratic Accountability, and Bureaucracy Quality. The ICRG also makes available political information on which the ratings are based. This allows users to interrogate the data to assess their ratings against other rating systems for validity and authenticity. Baek and Qian (2011) referred to the ICRG 12-category political risk index as the most comprehensive measure of political risk and noted that it has the advantage of being directly relevant for foreign investors. The ICRG index has been used to measure political risk in both developed and developing economies by studies such as Asiedu (2006), Howell (2007), Busse and Hefeker (2007) and Hayakawa et al. (2011). The ICRG ratings are also generally used by MNEs, importers and exporters, institutional investors and foreign exchange traders (Hayakawa et al., 2011).

**TABLE 3 ICRG Political Risk Components and Weight**

 **Component** **Maximum Points/Weight**

1 Government Stability 12

2 Socioeconomic Conditions 12

3 Investment Profile 12

4 Internal Conflict 12

5 External Conflict 12

6 Corruption 6

7 Military in Politics 6

8 Religious Tensions 6

9 Law and Order 6

10 Ethnic Tensions 6

11 Democratic Accountability 6

12 Bureaucracy Quality 4

TOTAL 100

Source: PRS (2014)

The ICRG model was created in 1980 by the editors of International Reports, an international newsletter. In 1992, the ICRG became part of the PRS Group when its editors and analysts moved from International Reports to The PRS Group. To arrive at the ICRG political risk index, political information based on the evaluation and subjective analysis of consistent patterns are converted into risk points for individual risk components. Individual components are often drawn from an aggregate of subcomponents. Components are assigned numerical values (risk points). The minimum number of points that can be assigned to each component is zero while the maximum point awarded to any particular risk component is pre-set (see Table 3) and depends on the relevance of that component to the overall risk of a country. To ensure consistency, both between countries and over time, the ICRG editors assign these points on the basis of a series of pre-set questions for each risk component (PRS, 2014).

The ICRG provides monthly and annual political risk index for 166 countries by assigning risk points to each of the twelve components. High total risk points indicate lower risk, while low risk points signify higher risk. Composite political risk for each country is classified into the distinct bands below to indicate level of risk:

* Band one: Very-Low Risk (80% – 100%)
* Band two: Low-Risk (70% – 79.9%)
* Band three: Moderate Risk (60%– 69.9%)
* Band Four: High Risk (50% – 59.9%)
* Band Five: Very-High Risk (0.0% – 49.9%)

Quantitative data on FDI inflow into the Nigerian telecommunication industry, from 2002 to 2011, were used to generate tables and graphs as used in Howell (2007) to help establish trends analysed alongside quantified ICRG political risk data over the same period. The analysis was in two parts: First, composite political risk data (independent variables) involving the 12 components are presented alongside Nigeria’s FDI net inflow figures (dependent variable) for the study period to determine the overall effect of political risk on FDI. To evaluate trends further, annual political risk percentage changes are calculated and compared to annual net FDI inflow percentage changes for each year over the study period. Second, correlations between all variables are generated. Particular emphasis is given to the relationship between the dependent and independent variables and these are ranked accordingly. Political risk components that correlated significantly with Net Telecoms FDI inflow were then analysed, via multiple backward regression to evaluate the extent to which significant variables can explain net FDI inflow. In line with the ICRG data, this analysis takes into consideration the fact that increases in the risk component points over a period signify the lowering of political risk.

**Data Presentation and Discussion of Findings**

From Table 4, the composite political risk rating for Nigeria during the period 2002 to 2011 ranged from 38.79 to 46. This means that the most favourable risk rating Nigeria achieved within the period is 46 per cent, recorded in 2006 and 2011. This risk level falls within the very high risk ranking of the ICRG. However, there is notable and sustained improvement as most of the years witnessed positive percentage changes. Arguably, the improvement could have resulted from the introduction and sustainability of multi-party democracy; Nigeria is enjoying its longest uninterrupted period of multi-party democracy since independence in 1960. The highest decline (-4.72) occurred in 2007; an election year in Nigeria. Election years in most of SSA can often be characterised by increased political risks which create uncertainties for investors because changes in governments results in policy changes which can subsequently affect investment contracts. From Table 5, FDI net inflow ranged from $848 Million in year 2002 to $1,483Million in year 2011. FDI grew to its highest level of $3,057million in year 2009, but reduced in the two succeeding years. Year 2002 to 2003 witnessed an improvement in the political risk rating from 38.79 to 41.54, representing a 7.09 per cent positive movement while FDI net inflows for the same period grew by 97.40 per cent. This is depicted in Figures 1 and 2.

The net percentage change in the political risk rating over the period 2002 to 2011 was 17.75 per cent meaning a reduction in the risk level in the country by that margin whilst FDI grew by 154.70 per cent, within the same period. This may be interpreted to mean that lower levels of political risk encouraged the inflow of FDI into the Nigerian telecommunication sector. This effect is considered significant as only 17.75 per cent change in political risk index led to 154.70 per cent change in FDI net inflows. This result is consistent with the findings of Asiedu (2002), Busse and Hefeker (2007), Baek and Qian (2011), Bussman (2010) and Hayakawa et al. (2011). Even though Nigeria’s political risk rating is considered high the observed improvements warranted an increase in FDI inflow. Irrespective of political risk rating, even below 50% (considered high risk), consistent improvements are favourable signals to foreign investors.

General overview of the data indicates that some variables either remain constant or experience minimal change over the period. These include socio-economic conditions, corruption, military in politics, law and order, ethnic tensions and bureaucracy quality. Bureaucracy quality, for example, seemingly, remained the same throughout the study period; indicating that, in some cases, the individual variations may not adequately explain FDI inflow.

**Table 4 ICRG Political Risk Components Dataset for Nigeria (2002 – 2011)**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  Political Risk Components | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Government Stability | 6.88 | 7.63 | 7.79 | 7.92 | 7.92 | 7.00 | 7.17 | 7.96 | 7.54 | 8.00 |
| Socio-economic Conditions | 1.67 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.54 | 2.00 | 2.00 | 2.00 |
| Investment Profile | 4.54 | 4.04 | 4.50 | 4.88 | 6.13 | 6.00 | 6.04 | 6.50 | 6.50 | 6.50 |
| Internal Conflict | 4.58 | 6.13 | 7.42 | 6.50 | 6.17 | 5.67 | 5.58 | 6.17 | 6.58 | 6.50 |
| External Conflict | 11.08 | 10.58 | 10.00 | 10.00 | 10.00 | 9.67 | 9.21 | 9.50 | 9.50 | 9.50 |
| Corruption | 1.00 | 1.00 | 1.00 | 1.33 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| Military in Politics | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 1.67 | 2.00 |
| Religion in Politics | 0.50 | 1.42 | 2.00 | 2.00 | 2.00 | 2.00 | 1.96 | 1.50 | 1.50 | 1.50 |
| Law and Order | 1.50 | 1.50 | 1.50 | 1.67 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| Ethnic Tensions | 1.00 | 1.58 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| Democratic Accountability | 3.04 | 3.17 | 3.00 | 3.42 | 3.79 | 3.50 | 3.50 | 3.50 | 3.50 | 3.50 |
| Bureaucracy Quality | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Total | **38.79** | **41.54** | **43.71** | **44.21** | **46.00** | **43.83** | **43.50** | **45.63** | **45.29** | **46.00** |
| Annual Percentage Change | **0.00** | **7.09** | **5.22** | **1.14** | **4.05** | **-4.72** | **-0.75** | **4.9** | **-0.75** | **1.57** |

Source: Extracted from PRS International Country Risk Guide (ICRG) Researchers’ Dataset (2013)

**Table 5 FDI net inflows into the Nigeria Telecommunications Industry (2002 – 2011)**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Indicator Name | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Nigeria Telecomm FDI net inflows (US $M) | 848 | 1,674 | 1,070 | 2,312 | 2,535 | 2,761 | 2,995 | 3,057 | 3,036 | 1,483 |
| Annual % Change | 0.00 | 97.40 | -36.08 | 116.07 | 9.65 | 8.91 | 8.49 | 2.07 | -0.69 | -51.12 |

Sources: World Bank (2013) and Nigeria Bureau of Statistics

**Figure 1** **Percentage Change in Political Components and FDI (2002 to 2011)**

**Figure 2 Percentage Change in Political Components and FDI (2002 to 2011)**

*FDI Inflow and Individual Political Risk Components*

To evaluate the relationships further we generate correlation and regression results with the aim of ordering the importance of the variables. Table 6 depicts the relationship between all variables with particular focus on the relationship between net telecommunications FDI inflow (dependent variable) and the political risk component variables (independent variables). The relationships between all the variables, including composite political risk have also been shown in Table 6.

**Table 6 Correlation Matrix Net FDI Flow and Political Risk Components**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Variable** | **Mean** | **SD** | **1** | **2** | **3** | **4** | **5** | **6** | **7** | **8**  | **9** | **10** | **11** | **12** | **13** | **14** |
| 1. Government Stability | 7.58 | 0.421 | 1 |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 2. Socio-economic Conditions | 1.67 | 0.233 | 0.275 | 1 |  |  |  |  |  |  |  |  |  |  |  |  |
| 3. Investment Profile | 5.56 | 0.962 | 0.176 | 0.620 | 1 |  |  |  |  |  |  |  |  |  |  |  |
| 4. Internal Conflict | 6.13 | 0.750 | 0.753\* | 0.092 | 0.050 | 1 |  |  |  |  |  |  |  |  |  |  |
| 5. External Conflict | 9.90 | 0.567 | -0.275 | -0.365 | -0.797\*\* | -0.397 | 1 |  |  |  |  |  |  |  |  |  |
| 6. Corruption | 1.33 | 0.236 | 0.184 | 0.406 | 0.941\*\* | 0.042 | -0.823\*\* | 1 |  |  |  |  |  |  |  |  |
| 7. Military in Politics | 1.97 | 0.104 | 0.034 | -0.496 | -0.342 | -0.211 | 0.250 | -0.249 | 1 |  |  |  |  |  |  |  |
| 8. Religion in Politics | 1.64 | 0.475 | 0.368 | -0.390 | 0.242 | 0.598 | -0.628 | 0.432 | 0.102 | 1 |  |  |  |  |  |  |
| 9. Law and Order | 1.82 | 0.241 | 0.120 | .451 | 0.971\*\* | 0.005 | -0.817\*\* | 0.978\*\* | -0.266 | 0.366 | 1 |  |  |  |  |  |
| 10. Ethnic Tensions | 1.86 | 0.329 | 0.546 | 0.106 | 0.583 | 0.698\* | -0.869\*\* | 0.677\* | -0.152 | 0.875\*\* | 0.630 | 1 |  |  |  |  |
| 11. Democratic Accountability | 3.39 | 0.246 | 0.294 | 0.206 | 0.808\*\* | 0.030 | -0.630 | 0.916\*\* | -0.154 | 0.467 | 0.886\*\* | 0.611 | 1 |  |  |  |
| 12.Bureaucracy Quality | 1.00 | 0.000 | b | b | b | b | b | b | b | b | b | b | b | b |  |  |
| 13. Composite Political Risk | 43.85 | 2.253 | 0.694\* | 0.383 | 0.752\* | 0.631 | -0.801\*\* | 0.773\*\* | -0.225 | 0.650\* | 0.743\* | 0.904\*\* | 0.752\* | b | 1 |  |
| 14. Net Telecoms FDI Inflow (Nigeria) | 2177.10 | 842.96 | .055 | 0.186 | **0.690\*** | .025 | **-0.718\*** | **0.809\*\*** | -0.358 | 0.481 | **0.779\*\*** | .617 | **0.763\*** | b | 0.578 | 1 |
| Correlation Rank |  |  | 10 | 9 | **5** | 11 | **4** | **1** | 8 | 7 | **2** | 6 | **3** |  |  |  |

**\***p<0.05; **\*\***p<0.01(2-tailed);

b Cannot be computed because at least one of the variables is constant

**Table 7 Political Risk Component and FDI Flow: Backward Multiple Regression of Significant Variables**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Variable | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 |
| Corruption  | 0.774 | 0.760 | 0.880 | 1.391 | 0.809\*\* |
| Investment Profile | -1.069 | -1.060 | -1.027 | -0.618 |  |
| Law and Order | 0.909 | 0.900 | 0.916 |  |  |
| External Conflict | -0.198 | -0.202 |  |  |  |
| Democratic Accountability | -0.012 |  |  |  |  |
|  |  |  |  |  |  |
| *R2* | 0.729 | 0.729 | 0.716 | 0.699 | 0.655 |
| Adjusted *R2* | 0.391 | 0.512 | 0.574 | 0.612 | 0.611 |

The entries for the variables are the standardised Beta Coefficients

**\*\***p<0.01(2-tailed)

The variable Bureaucracy Quality as shown in Table 6 could not be computed because the variable remained constant over the study period. Net telecommunications FDI inflow correlates positively with Government Stability, Socioeconomic Conditions, Investment Profile, Internal Conflict, Corruption, Religion in Politics, Law and Order, Ethnic Tensions, and Democratic Accountability. However, the relationship between FDI inflow and External Conflict and Military in Politics is negative. Table 6 also ranks all the variables and indicates significance with the aim of ordering the importance of each political risk component to explaining FDI inflow. The variables with significant results are ranked as follows: (1) Corruption (0.809), (2) Law and Order (0.779), (3) Democratic Accountability (0.763), (4) External Conflict (-0.718), and (5) Investment Profile (0.690). This could be interpreted that, separately, with the exception of the external conflict variable, when all the significant variables increase (risk reduces) FDI inflow could also increase.

Contrary to expectation, when the external conflict variable reduces (risk increases) FDI inflow increases. Although the evident trend of reduction in the score of the external conflict variable over the period is small it does appear to influence FDI inflow positively. On one hand, this trend could have resulted from a relative increase in one of the subcomponents (war, cross-border conflict, foreign pressures). According to the PRS group’s evaluation, the external conflict variable assesses the risk to the incumbent government from foreign action, ranging from non-violent to violent external pressure. Perhaps this change in the variable could have resulted from external diplomatic pressures or sanctions rather than cross-border conflicts or war. It could also be argued that, in the telecommunications sector, non-violent external pressures do not significantly influence the expansion of operations. Also, in the event of cross-border conflicts, planned expansion into neighbouring countries are postponed, thereby prompting further expansion in the existing market. Although further research is required to strengthen this argument, it is plausible, in the Nigerian case, because of the relative large market size compared to neighbouring countries. In this regard, external pressures or conflicts were likely to benefit the larger economy. As expected, variable increase (risk reduction) for corruption, law and order, democratic accountability and investment profile increase FDI inflow. Reduced corruption gives an extra incentive to foreign firms to invest more because of the likelihood of improved returns on investment.

Backward multiple regressions of the variables with significant results from the correlation matrix in Table 6 together revealed that only corruption generated a significant result as shown in Table 7. The R Square value of 0.655 is also an important result because it means that over 65% of FDI inflow into the Nigerian telecommunications sector is explained by corruption alone. This confirms that by reducing corruption alone, this would increase Nigeria’s telecommunications FDI inflow tremendously.

**Conclusion and Implications**

This study investigated the influence of political risk on the attraction of FDI into developing economies in Africa with Nigeria telecommunications industry as the case study. We identified the various components of political risk and explored their aggregate and individual impacts on the inflow of FDI into Nigeria’s telecommunications industry between 2002 and 2011. Our findings show that, in general, reducing the level of political risk (independent variable) resulted in increased FDI net inflows (dependent variable) into the Nigerian telecommunications industry. The study also observed that Nigeria’s political risk rating improved over the study period from 38.79 per cent in 2002 to 46 per cent in 2011 resulting in growth in net FDI inflow. This implies that political risk had a significant impact on the flow of FDI into the industry. Although Nigeria remained a country with a very high political risk rating (highest rating of 46%) over the period, the improvements were enough to attract huge net telecommunications FDI inflows.

Our study also indicates that the various political risk components affect FDI in different ways. It was found that reducing the risk with respect to corruption, law and order, democratic accountability and investment profile were important in influencing FDI inflow. Our findings emphasise the importance of reducing corruption to enhance foreign investment. This means that SSA countries, such as Nigeria, need to appreciate the importance of tackling the canker of corruption to improve FDI inflow which is intrinsically linked to economic growth. Considering the important role FDI plays in the economic growth of developing nations (World Bank, 2013), and the fact that most economic determinants of FDI such as the availability of natural resources and large domestic markets are not within the control of governments (Baek and Qian, 2011), this paper recommends that for developing countries to be globally competitive for scarce FDI, their governments should endeavour to promote favourable business environments to attract MNEs. Based on our findings, the pertinent issues that need immediate attention must encompass tackling corruption in unison with improving law and order, democratic accountability, and investment profile. With regards to corruption, there is an urgent need for the provision of strong and independent anti-corruption institutions that can foster an improvement in transparency within both the public and private sectors. It is important that these processes can also ensure full independence and efficiency of the judiciary which will give added confidence to foreign investors that redress can be objectively sought in the law courts. Particularly, the PRS Group emphasise the need to control excessive patronage, nepotism, job reservation, exchange of favours, secret funding of political parties, and questionable close ties between business and politics. These tendencies would not only contribute to potential instability but have the tendency to increase long-term perceived host country political risk which is detrimental to FDI inflow.

Law and order, according to the PRS group, relates to the strength and impartiality of the legal system which must be supported by a general observance of the law. Democratic accountability, related to how responsive governments are to their people, is also crucial. SSA governments need to be accountable to their electorates to enhance their attractiveness to foreign investors. With investment profile, in line with the subcomponents, it is important that governments in SSA need to avoid payment delays, improve contract viability, eliminate expropriation tendencies, as well as allow profit repatriation, to reduce general political risk and therefore improve FDI attraction. Arguably, good governance and institutional arrangements are key to enhancing FDI inflow to Africa; there is an absolute need to continuously work towards improving these.

Our contribution highlights that, irrespective of the political risk rating, consistent improvement in the rating serves as a good signal to foreign investor location decision making. We also contribute further to the international business literature by ranking the potential risk components to stress their respective importance in explaining FDI inflow. Out study, for example, shows that corruption explains over 65% of FDI inflow into the Nigerian telecommunications industry. This study is also exemplified by attempting to suggest that the impact of political risk components vary from sector to sector as some components react to FDI inflow in different ways.

Despite our contributions, this study acknowledges the limitations of our approach. Firstly, our study focused on only one sector, in one country, in SSA. Further studies covering a wider range of sectors and countries in SSA, collectively or comparatively, could enrich our understanding of the influence of political risk components on FDI inflow. Secondly, a study that is able to explore subcomponents would be needed to explain their influences on FDI inflow independently. Such an approach could help to explain each subcomponent’s contribution to FDI inflow, positively or negatively, more clearly than the main component.

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