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Foreign Direct Investment and Profitability of Real Estate Firms in Kenya

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Abstract

The purpose of this research paper was to determine the impact of foreign direct investment on the profitability of real estate firms in Kenya. The research utilized the descriptive research design. The target populace for the investigation encompassed 69 real estate firms that are registered with Kenya Property Developers Association (KPDA) in Kenya. Since the populace was small, all the 69 real estate firms were included in the study and thus no sampling was done. Secondary data was collected. The researcher used both descriptive and inferential statistics in the study. The study found that foreign direct investment positively influenced the real estate firm's profitability. Therefore, an increase in foreign direct investment would lead to an increase in the profitability of real estate firms in Kenya. The study concluded an increase in foreign direct investment would lead to an increase in the profitability of real estate firms in Kenya. The study recommends that the Kenyan government should set a conducive and proper environment for both local and foreign investors. In addition, incentives and tax holidays, and reliefs should be set for foreign investors. This will increase the level of foreign direct investment which will help to attract more investors to the real estate.

Keywords: *Foreign direct investment, Profitability, Real estate firms*

1.0 Introduction

The profitability of an organization refers to the level at which an organization can utilize its assets and its capital available to it to create benefits that surpass the expenses caused (Kinyua, 2020). It has likewise been viewed as the capacity to create gain from all the business exercises of an association, organization, firm, or enterprise. It estimates the board productivity in the utilization of authoritative assets in increasing the value of the business. As indicated by Nikitta (2017) profits are just made by business visionaries who can make the right gauge about the future or whose forecast validates. Then again, entrepreneurs who can't make right future appraisals or whose predictions, endure misfortunes over the long haul.

Real estate profitability level and its drivers are the main workings of the stability financial system stability of a country. If it is efficient enough then it should show profits and thus profitability of the firm is an efficiency indicator of an economy (Mangâ et al., 2018). Gwadiva (2017) proposed that an increased profitability level in a real estate sector may imply an increase in financial stability, hence the wellness of the real estate sector. If profits are not paid out as dividends but are retained in the firms as part of equity. The retained equity can be

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utilized for real estate sector growth. Therefore, the level of profitability is an important component of the health of the real estate sector.

Studies have such as Loyford and Moronge (2014) recognized Macroeconomic variables as the central point influencing real estate profitability with the impact of FDI being taken in terms of the economy in general. At the worldwide level, the FDI and real estate relationship has been seen in similar light for certain investigations investigating the impact of FDI in explicit areas of the economy and others looking at the impact of FDI on foreign real estate investment (Amondi, 2016). FDI has been defined as the phenomenon brought about by globalization through the incorporation of a neighborhood or homegrown business sectors with worldwide business sectors. It is essentially achieved through the formation of a helpful business climate for local people as well concerning the unfamiliar financial backers to upgrade fast monetary development. As the property market all over the planet is encountering an air pocket, improvements in FDI have therefore guaranteed the housing market has stayed solid with the interest for middle to high income staying consistent (Kariuki & Sang, 2018).

In Kenya, the economy has enjoyed significant development over time in terms of framework and policies as well as experts keen on extending tasks migrating into Kenya. Because of this turn of events, Kenya has drawn in foreign capitals and its land area has turned into an area important to outside economies (Kenya Economy Report, 2018). The development of expatriates into the nation and in the progression of business has prompted the expanded interest in private as well as business lodging. There is therefore a need to regulate the effect of foreign direct investment on real estate firms' profitability in Kenya.

1.1 Problem Statement

In Kenya, the real estate sector contributes roughly Ksh. 259.6 billion ($2.86b) or 8.8 percent of the country's GDP making the area one of the significant drivers of the economy (KNBS, 2016). Notwithstanding, the real estate sector faces genuine difficulties like insufficient financing, the significant expense of land for development, and the long administrative cycles associated with the acquisition of property. The sector has additionally remained generally immature notwithstanding the way that area players perceive the financial and social significance of the sector (Dolde, 2014). In addition, the profitability has been slowing down. In 2017, the profitability slowed down by 18.4% 2017 (Cytonn Investments, 2018). The decline in profitability has been associated with the slowdown of the Kenyan economy which has led to a decline in the GDP. This has therefore pushed away from the investors from investing in the country. Mwaita (2020) added that the huge decline in real estate profitability by 49.5% in 2020 was majorly due to the withdrawal of external investors in the country. The current investigation sought to examine the effect of foreign direct investment on the profitability of real estate firms in Kenya.

1.2 Research Hypothesis

$H_0 1$: Foreign direct investment does not have a significant effect on the profitability of real estate firms in Kenya.

2.0 Literature Review

2.1 Theoretical Framework

Marshall (1890) developed the profit maximization theory. The hypothesis depends on the contention that the critical objective of undertakings is the augmentation of profits. As indicated by the hypothesis each individual who is important to the association acts to his greatest advantage to create sure that the gains of the business are boosted. The hypothesis is normally utilized in the monetary viewpoint by which associations guarantee their profits are amplified by likening minimal income to minor expenses. As Day et al. (2013) call attention, a firm accomplishes its objectives when it gets sufficient benefits and that's just the beginning so when its assets are utilized to think of labor and products that can be offered to clients to get income. He adds that the endurance of any firm is reliant upon the profits got from its wellsprings of income. Today this hypothesis can be utilized in different associations, particularly in the real estate sector. One of the key suppositions will be that real estate firms look to boost their profits while offering services. The investors of the real estate expect profits and along these lines, real estate firms must choose the option to direct business in a manner that boosts their profits. This prompts an augmentation of their income and a minimization of cost (Wong, 2012).

The real estate market forces in the result and info market permit it to diminish or expand the costs of information and result separately. Purchase utilization of the perfect administration the firm can pick the best mix of results and sources of info that can expand benefits (Dasgupta, 2009). Players in the real estate business in Kenya have taken on different methodologies to work on their exhibition. One of these ways is the utilization of FDI. Creating and creating countries the same look for the unfamiliar venture as they have seen the significance of such interest in the financial development of their nations. Subsequently, FDI further develops the administration abilities, innovation, and information in the host countries while simultaneously it helps the nations as it sets out to work open doors and emphatically influences the balance of payment

Cockcroft and Riddell (1991) developed the Neoclassical Theory. The theory states that the inflow of interest into a nation is directed by the variables, for example, macroeconomic strategies, tax collection, and what they mean for a firm anticipated pace of return. The hypothesis contends that FDI by expanding the capital pay per individual impacts the development of pay. Further FDI builds development through innovative work, innovation moves, and the presentation of new types of human resources. Whenever a nation has set up reasonable arrangements, for example, charge motivations, simplicity of getting licenses and beginning organizations, and further developed framework, MNEs will be attracted to these nations prompting expanded venture and work in the host nation. At the point when the work paces of a nation increment, the pay per capita of the host country expands which implies that more individuals will put resources into the real estate sector (Bloomstrom & Kokko, 2003).

Taking the case of Kenya, through the declaration of corporate assessment derivation of 20% from the past 30% for the engineers who foster more than 1000 houses in a year, foreign real estate designers will be brought into the country in an endeavor to gain by the expense motivations and sector of real estate.

2.2 Empirical Review

In Italy, Borin and Mancini (2016) did a study on foreign direct investment and firm performance: an empirical analysis of Italian firms. The study adopted a desktop research design. Findings showed that firms' performance was greatly affected by FDI. In South Africa, Tshepo (2014) did a study on the impact of foreign direct investment on economic growth and employment in South Africa: A time series analysis. Unit root test was used. In the long run, FDI had an impact on economic growth. However, FDI had no impact on economic growth in the short run. In addition, FDI also enhances employment in South Africa.

In Tanzania, Taylor (2020) did a study on foreign direct investment and economic growth in Tanzania. Time series information from 1988 to 2017 and 1999 to 2017 was analyzed.

Estimated long-and momentary coefficients show that the impact of the FDI is positive and measurably huge at the 10% and 5% importance levels. Interestingly, that of the auxiliary and tertiary areas is immaterial. The coefficient of the overall unfamiliar direct speculation is viewed as genuinely immaterial. These outcomes affirm that the sort rather than the amount of unfamiliar direct speculation might be more significant in clarifying financial development. Other control factors display their normal signs except that of receptiveness to exchange.

In Kenya, Amondi (2016) focused on foreign direct investment and the performance of real estate firms. A descriptive research design was used in the investigation. Performance was found to be influenced by FDI. In addition, the influence of FDI on performance was positive. Kariuki and Sang (2018) did a study on foreign direct investment and bank performance in Kenya. This study used secondary cross-sectional time-series data. The outcomes show that FDI affected bank performance.

Wanjere et al. (2021) did a study on foreign direct investment and local firms' performance. The investigation was descriptive. Local firms' performance was found to affect the FDI. Therefore, the strength of FDI was found to determine the level of performance. This infers that to accomplish better firm execution, the public authority needs to concoct strategies outfitted to draw in more FDI into the vital areas of the economy.

In Kenya, Gwadiva (2017) focused on foreign direct investment real estate financial performance. The investigation used both descriptive and cross-sectional research. The investigation found a weak correlation between FDI and performance. However, inflation, exchange rates, and interest rates had no impact on performance. Janský and Palanský (2019) did a study on estimating the scale of profit shifting and tax revenue losses related to foreign direct investment. The investigation used cross-sectional research. The findings established that FDI affected the profitability of firms. Corporate duty income misfortunes, comparative with their GDP and expense incomes, of nation bunches arranged by pay per capita are no measurably huge contrasts across these gatherings.

Past studies have presented some gaps which include; methodological gaps, scope gaps, and conceptual gaps. Kariuki and Sang (2018) study adopted a secondary which was time-series in nature thus showing a methodological gap. The current study adopted panel data. Borin and Mancini (2016) adopted a desktop research design while the current study adopted a descriptive research design. In addition, most studies have focused on the effect of foreign direct investment and profitability in different sectors rather than real estate firms. Kariuki and Sang (2018) study was done in banks. Borin and Mancini (2016) focused on firms listed in Italy. These studies, therefore, presented scope gaps. Taylor (2020) and Tshepo (2014) studies focused on foreign direct investment and growth thus presenting a conceptual gap. Borin and Mancini (2016), Amondi (2016), and Kariuki and Sang (2018) focused on foreign direct investment and performance. The current study focused on foreign direct investment and profitability.

2.3 Conceptual Framework

Gerber et al. (2014) have depicted a conceptual framework as a conjectured illustration highlighting the concept being studied as well as the connection of the various variables. Figure 2.2 shows the theoretical framework linking the independent variable and dependent variable. The independent variable is a foreign domestic investment while the dependent variable is the profitability of real estate firms. The study adopts the following conceptual framework shown in Figure 1.

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Independent Variable | **Dependent Variable**

Foreign Domestic Investment

- FDI as a percentage of GDP

→

Performance of Real Esate Firms

- Profits after tax

Figure 1: Conceptual Framework

3.0 Methodology

The research utilized the descriptive research design. The target populace for the investigation encompassed 69 real estate firms that are listed with Kenya Property Developers Association (KPDA) in Kenya. Since the populace was small, all the 69 real estate firms were included in the study and thus no sampling was done. Secondary data was collected from the Kenyan website as well as from the Kenya Property Developers Association. Five-year data was collected (2016 – 2020). The researcher used both descriptive and inferential statistics in the study. The particular descriptive statistics were maximum, minimum, mean, and standard deviations. Inferential statistics comprised regression and correlations. A linear regressions model was used. Coding and analysis of data was done using Statistical Package for Social Sciences (SPSS 26.0).

4.0 Results and Discussion

4.1 Descriptive Results

Table 1: Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FDI	345	0.92	1.85	1.35	0.36
Profits after tax’ million	345	0.03	5276.89	538.11	821.08

Results showed that the mean of FDI from the year 2016 to 2020 was 1.35%. The minimum FDI was 0.92% while the maximum FDI was 1.85%. The standard deviation was 0.36.

Results also showed that mean profits after tax in the year 2016 to 2020 was Ksh 538.11 Million. The minimum profits after tax were Ksh 0.03 while the maximum profits after tax were Ksh 5276.89. The standard deviation was 821.08.

4.2 Trend Results

Figure 2 shows the trend results for FDI.

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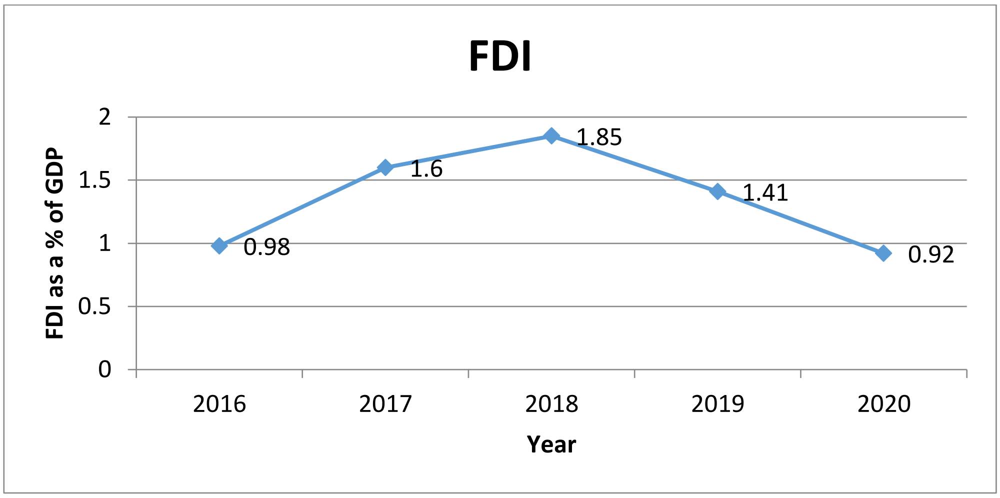

Figure 2: Trend Results for FDI

Results in Figure 2 showed that FDI in the year 2016 was 0.98. In the year 2017, FDI rose to 1.6 and further rose to 1.85 in the year 2018. However, FDI declined to 1.41 in 2019 and further declined to 0.92 in the year 2020. The decline in the year 2019 and 2020 was majorly due to disruptions by covid 19.

Figure 2 shows the trend results for Profit after Tax.

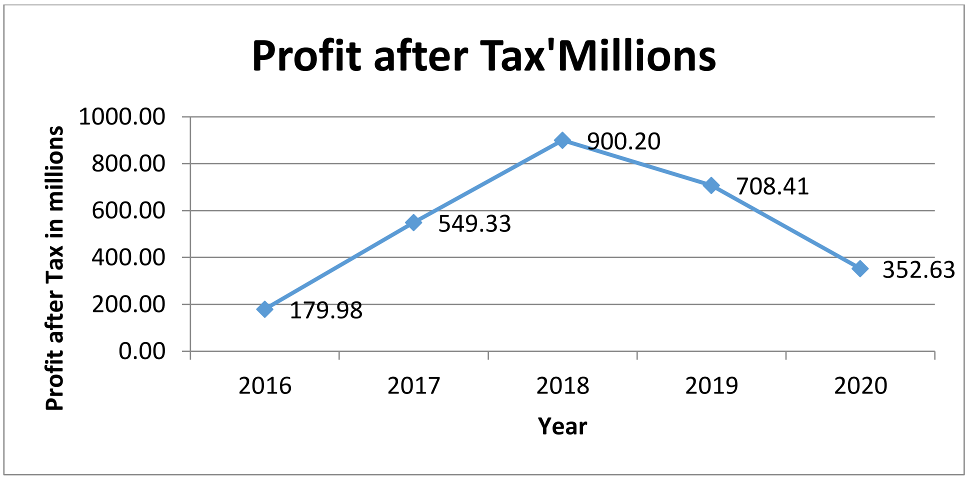

Figure 3: Trend Results for Profit after Tax

Results in Figure 3showed that profit after tax in the year 2016 was Ksh 179.98 million. In the year 2017, profit after tax rose to Ksh 549.33 million and further rose to Ksh 900.20 million in the year 2018. However, FDI declined to Ksh 708.41 million in 2019 and further declined to Ksh 352.63 million in the year 2020. The decline in profits in the year 2019 and 2020 was majorly due to disruptions by covid 19.

4.3 Correlation Results

Correlation results showed were presented in Table 2.

Table 2: Correlation results between FDI and Profits after tax

		FDI	Profits after tax
FDI	Pearson Correlation	1	
	Sig. (2-tailed)		
Profits after tax	Pearson Correlation	.247**	1
	Sig. (2-tailed)	0.000	

Results showed that foreign direct investment had a positive and positive correlation with real estate firms' profitability. This implied that an increase in FDI led to an upsurge in the profitability of real estate firms in Kenya.

4.4 Regression Results

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.796a	0.633	0.631	0.45489

The R^2 was 0.633. This means that the model fitness found that foreign direct investment explains 63.3% of the variations in the dependent variable which is the profitability of real estate firms in Kenya.

To determine the suitability of performance appraisal practices as a predictor for the profitability of real estate firms in Kenya the ANOVA was computed. Table 4 presents the results.

Table 4: ANOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
Regression	9.724	1	9.724	112.63	.000b
Residual	264.073	343	0.77		
Total	273.796	344			

Table 4 indicated that foreign direct investment was a good predictor of profitability of real estate firms in Kenya as represented by an F statistic of 112.63 and the reported p-value of 0.000, which was less than the conventional probability of 0.05 significance level. This implies that foreign direct investment has a statistically significant effect on the profitability of real estate firms in Kenya at a 95% confidence level. Based on these results the study rejected the $H_0 1$ hypothesis that stated that there is no statistically significant effect of foreign direct investment on the profitability of real estate firms in Kenya and concluded that there is a statistically significant effect of FDI on real estate firms' profitability.

The regression of the Coefficient significance of the foreign direct investment on profitability was presented in Table 5.

Table 5: Regression of Coefficient

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.559	0.165		9.476	0.000
FDI (%GDP)	0.441	0.124	0.188	3.554	0.000

Results showed that foreign direct investment had a positive and significant effect on the profitability of real estate firms in Kenya. This implied that an increase in FDI by one unit led to an increase in profitability of real estate firms in Kenya by 0.441 units.

5.0 Conclusion

The study concluded that foreign direct investment had a positive and significant effect on the profitability of real estate firms in Kenya. Therefore, an increase in foreign direct investment would lead to an increase in the profitability of real estate firms in Kenya.

6.0 Recommendations

The study recommends that the Kenyan government should set a conducive and proper environment for both local and foreign investors. In addition, incentives and tax holidays, and reliefs should be set for foreign investors. This will increase the level of foreign direct investment which will help to attract more investors to the real estate.

In addition, the Kenyan government should make an effort of marketing the country to foreign investors. This will grow the foreign direct investment in a positive way which will further enhance real estate profitability.

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