Original Article

Effect of Tax Incentives on Investment Drive-In Southwest Nigeria

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Abstract - This study examined the effect of tax incentives on an investment drive in Southwest Nigeria. Specifically, the study evaluates the effect of capital allowance, pioneer relief, rural investment allowance, and investment tax credit on an investment drive in selected manufacturing firms in Southwest Nigeria. The primary source of data collection was employed and sourced through a structured questionnaire administered to the staff (Senior and Middle) of selected manufacturing firms in Southwest Nigeria. Data were analyzed using both descriptive and inferential statistics. Descriptive analyses conducted in the study include frequency tables, and pie charts, while inferential analyses conducted include linear regression and ANOVA analysis. F.test was used to test the overall significance of the regression model. In contrast, the coefficient of determinant R^2 was used to determine how much variation the dependent variable (investment drive) was explained by the independent variable (capital allowance, pioneer relief, rural investment allowance, and investment tax credit). Results revealed that the coefficient of determination (r^2) of capital allowance, Pioneer relief, rural investment allowances, and Investment tax credit was 0.346, 0.167, 0.433, and 0.730, which implies that about 34.6%, 16.7%, 43.3%, and 73% variation in investment drive of the selected manufacturing firms can be explained by capital allowance, Pioneer relief, rural investment allowances and Investment tax credit in individual firms. The study found that capital allowance, rural investment allowances, and Investment tax credit indicated a positive and significant effect on an investment drive in Southwest Nigeria (0.325, p <0.05), (0.658, p<0.05), and (0.854, p< 0.05) respectively. In contrast, pioneer relief indicated a negative and insignificant effect on an investment drive in Southwest Nigeria (-.042, p >0.05). The study concluded that capital allowance, rural investment allowances, and Investment tax credit had increased Southwest Nigeria's investment drive, while pioneer relief had a negative effect.

Keywords - Tax Incentives, Investment Drive, Capital allowance, Pioneer relief, Rural investment allowances, Investment tax credit

I. INTRODUCTION

Governments need to perform various functions in political, social, and economic activities to maximize social and economic welfare. Governments require many resources called public revenues to perform these duties and functions. Public revenue consists of taxes and revenue from administrative activities like fines, fees, gifts, and grants. However, taxes are the first and foremost important sources of public revenue, which are central to the current economic growth and development plan. The importance of taxation as a veritable tool of economic growth and development depends on a proper tax system that can generate revenue through tax. While fulfilling the revenue function, taxes also have a pervasive influence on the economic decisions of individuals and businesses and social equity. (SADC, 2004). Likewise, there is a general agreement that the process of economic growth and investment\capital formation is closely interconnected. According to Walid (2010), GDP growth is higher for countries with relatively higher investment/GDP ratios. Virtually governments are keen to attract potential investors. Investment can generate new jobs, bring in new technologies, and, more generally, promote growth and employment. The resulting net increase in domestic income is shared with the government through taxation of wages and profits and possibly other taxes on business (OECD, 2002). Given the above-mentioned potential benefits, policymakers continually re-examine their tax rules to ensure they are attractive to investors. Investment is known to be the engine of sustainable growth (Ahn&Hemmings, 2000). However, in less developed countries (LDCs), the national level of savings is quite low (Javorcik, 2004). Consequently, there exists a huge gap between the required rate of investment and the existing rate of savings (Asiedu, 2006). The government has adopted more incentives to promote private investment (Babatunde&Adepeju, 2012). Most governments depend on investment promotion agencies, economic development boards, industrial development agencies, and other investment promotion commissions to compete globally for critical foreign investment and the development benefits (Ortega & Griffin, 2009). In 1995, the Nigerian Investment Promotion Commission (NIPC) was established to enhance investment inflow (Abubakar, Haruna& Ahmed, 2012). An alternative source of capital that can fill this gap and bring about sustainable development is Foreign Direct Investment (FDI). Previous studies carried out on tax incentives and investment have been inconclusive. Meron (2016) investigated the effect of tax incentives on domestic investment in Ethiopia, a case study in the manufacturing sectors, with a scope of (1992-to 2014). The study concluded that tax incentives and market openness have a significant positive long-run effect on private domestic manufacturing investment. George and Bariyima (2015) studied tax incentives and foreign direct investment in Nigeria (1980-2011). The study showed a negative significance; the increase in tax incentives does not bring about a corresponding increase in FDI. Ironkwe and

Promise (2016) examined the impact of tax incentives on economic development in Nigeria with a scope of (2004-to 2014). 30 companies in the south-south geo-political zone of Nigeria were sampled, and a questionnaire was used for data collection. The study concluded that sufficient tax incentives enhance industrial growth and development. Olaleye (2016) studied the effect of tax incentives on foreign direct investment in listed manufacturing companies (2005-2014). The study sampled 32 manufacturing companies out of 74 listed companies; the companies were selected across the six geo-political zones in Nigeria and concluded a strong positive linear relationship between tax incentives and FDI. Uwuigbe, Adeyemo, and Anowai (2016) investigated tax incentives and the growth of manufacturing firms in Nigeria. The study sampled 20 small and medium industries in Ogun state, and a questionnaire was used for data collection. It was concluded that tax incentives would significantly increase the number of manufacturing industries in Nigeria. Jiakponna (2012) conducted a study on the impact of tax incentives on the growth and development of small and medium scale industries in Nigeria and sampled 3 industries in Enugu. Even though similar studies have been done in Nigeria, the effects of tax incentives on investment drive-in listed manufacturing companies in Nigeria have received less attention. The manufacturing sector is very important for the growth of an economy. It is unclear whether tax incentives significantly affect investment dive in the Nigerian manufacturing sector listed. Oriakhi and Osemwengie (2013) examined tax incentives and revenue productivity of the Nigeria tax, within (1981-2009). Musyoka (2012) carried out a study to correlate tax incentives and foreign direct investments in Kenya. Sebastian (2009) analyzed how tax incentives may or may not be used to attract investments, especially in developing countries. The analysis was based on research using microeconomic data collected from Organization for Economic Cooperation and Development (OECD) countries. The analysis of most previous studies was conducted in developing counties (Kenya, Ethiopia, Ghana, South Africa, and Morocco) and in South-south and Southeast Nigeria. In contrast, Most of these works focused effect of Incentives on foreign direct investment, economic development, and the oil and gas sector. Few studies were also conducted on tax Incentives for foreign direct investment, which focused on manufacturing firms in developed and developing counties. Due to a lack of consensus among previous researchers and differences in geographical location and period, see (George et al., 2015; Olaleye, 2016; Jiakponna, 2012; Uwuigbe et al., 2016; Ironkwe, 2016; and Meron, 2016). Hence, this study will bridge the gap in the literature. In addition, this present study focused on the effect of tax Incentives on investment drives in Southwest Nigeria. With a specific emphasis on manufacturing firms in Southwest Nigeria. The broad objective of this study is to examine the effect of tax incentives on an investment drive in Southwest Nigeria, while the specific objectives are to examine the effect of capital allowance on an investment drive in selected manufacturing firms in Southwest Nigeria, examine the

effect of pioneer relief on an investment drive in selected manufacturing firms in Southwest Nigeria, examine the impact of rural investment allowance on an investment drive in selected manufacturing firms in Southwest Nigeria and evaluate the effect of the investment tax credit on an investment drive in selected manufacturing firms in Southwest Nigeria.

II. LITERATURE REVIEW

A. Tax Incentives

Tax incentive can be defined as a deduction, exclusion, or exemption from tax liability offered as an enticement to engage in specified investment activity. Ogbonna and Ebimobowei (2012) define tax incentives as any tax provision granted to a qualified investment project representing a favorable deviation from the general provisions applicable to investment projects. Tax incentives are designed to encourage investments in priority sectors of the economy. According to Somorin (2012), tax incentives in Nigeria include tax holidays, tax cuts, reliefs and allowances, credits, and exemptions. Tax incentives are directed at attracting an inflow of foreign earnings to complement domestic suppliers to grow the economy. Such sectors of the economy where incentives are normally granted are manufacturing, agriculture, solid minerals, and export promotion. Individuals also derive tax incentives from the government. Relevant incentives for industrial promotions include capital allowance, investment allowance, annual allowance, loss relief, pioneer company relief, export processing zone relief, and others. According to Uwaoma and Odu (2016), the incentives act as a catalyst to industrial development by reducing the import content of domestic production, thereby improving the balance of payment and enhancing the impact of industrialization on income and employment within the nation. For the case studies, an array of tax incentives granted to stimulate the industrial sectors abound, few of which are a result of this restated in this study. In Nigeria, virtually all the tax laws have provisions for tax incentives. Specifically, CITA grants various incentives to manufacturing companies.

B. Nature of Investment

The term investment can have more than one meaning. In economics, it is the purchase of a physical asset such as a firm's acquisition of a plant, equipment, inventory, or an individual's purchase of a new home. An *investment* is the purchase of goods that are not consumed today but used to create wealth in the future. In finance, an *investment* is a monetary asset purchased with the idea that the asset will provide income in the future or will be sold at a higher price for a profit. To the layperson, the word denotes buying stock or bonds [or maybe even a house], but it probably does not mean purchasing a plant, equipment, or inventory. Shah (2005) explains investment as the purchase of an asset to store value [and hopefully increase that value over time] if, in the aggregate, there is only a transfer of ownership from one seller to the other. Investment is a necessity for the development of a nation; Thuita (2017) continued that "in alluding to how necessary investment is, indicated that investments encourage development ."Investment, apart

from assisting in producing needs for man's survival, can also be used to transmit technical change and product innovation. They confirmed that it is equally important for policymakers in developing countries to assess how investment responds to changes in government policy, not only in designing long–term strategies but also in implementing short-term stabilization programs.

C. Empirical Review

Musyoka (2012) examined tax incentives and foreign direct investments in Kenya. Data for investment incentives, trade-related incentives, import duty exemption, and foreign direct investment inflows for the recent10 years was collected. Measures of central tendency were conducted to measure dispersion, while correlation and regression analysis was carried out to establish a relationship between the dependent and independent variables. The study revealed no significant improvement in FDI due to implementing tax incentives in Kenya.

Estian (2013) examined the impact of tax incentives to stimulate investment in South Africa. The study used relatively simple tools such as social accounting matrices and Leontief multipliers which can provide policymakers a means to evaluate the relative value of incentives concerning their output effects. With these models, the study provides preliminary evidence of the superior impact of a general tax incentive such as a reduced corporate tax rate on output.

Keakook (2014) examined the effects of the Korean tax incentives on investment during the past four decades (1953-1992). The impact of changes in the tax systems on the user costs of capital is quantified according to the neoclassical framework. The relationship between major economic variables, including the user costs of capital and investment, is examined using multiple regression analysis. The results show that economic and tax variables have different effects on the user costs of capital that would not affect investment behavior in Korea. The impact of the tax incentives for investment seemed to have been to reduce tax revenues rather than to influence the allocation of investment resources.

Uwaoma and Ordu (2016) studied the impact of tax incentives on economic development in Nigeria (Evidence Of 2004 – 2014). The survey method, including questionnaires and interviews, was adopted, while the correlation analysis method was adopted. Twenty-eight (28) Correctly responded copies of the questionnaire out of 30 administered were obtained for the analysis; Spearman's Rank Correlation Coefficient (rho) statistical tool was used in testing the hypothesis. The findings reveal that sufficient tax incentives enhance industrial growth and the economy.

Stausholm (2017) examined the rise of ineffective incentives: New empirical evidence on tax holidays in developing countries. Developing countries employ tax incentives in the hope of attracting investors. This study investigates tax rates and tax holidays regarding economic and social impacts in developing countries from 1985-to 2014. Panel data was employed. The study found out that tax holidays are negatively correlated with tax revenues, and as revenues decrease, the spending on education decreases. This has real effects, as evidenced by a significant negative correlation with enrollment in primary education. The analysis concludes that tax holidays overall have more negative than positive impacts on sustainable development.

Ezeudeka, and Amuka, (2017). Examined Tax Incentives and the Flow of Foreign Direct Investment to Non-Oil Sector: Empirical. The study adopted a multiple regression model, which was transformed into a log-log model in the analysis. The regime switch model helped us evaluate the effectiveness of the policy introduced in late 1999. Both company income tax and investment allowance appeared with the right sign. The result showed that the tax incentive policy changed the flow of foreign investment to the non-oil sector, showing that the country's tax incentives can help revive the ailing non-oil sector.

III. METHODOLOGY

Model Specification

To measure the effects of tax incentives on an investment drive in Nigeria, the model of this study is specified as follows;

$INVD = f(CA, PR, RIA, ITC)$…………………….. (3.2)

Where

INVD = Investment Drive
CA = Capital allowance
PR = Pioneer Relief
RIA = Rural investment allowance
ITC = Investment tax credit

Linear Form

$INVD = \beta_0 + \beta_1 CA + \beta_2 PR + \beta_3 RIA + \beta_4 ITC + \mu$ ....(3.3)

ANOVA Analysis

Relationship between Investment drive *and* capital allowance

$INVD = \beta_0 + \beta_1 CA + \mu$ ………………….…..(3.4)

Relationship between investment drive *and* Pioneer Relief

$INVD = \beta_0 + \beta_2 PR + \mu$ ……………………...(3.5)

Relationship between investment drive *and* rural investment allowance

$INVD = \beta_0 + \beta_3 RIA + \mu$ ……………………..(3.6)

Relationship between investment drive *and* Investment tax credit

$INVD = \beta_0 + \beta_4 ITC + \mu$ ……………………..(3.7)

Where

b_0 represents the intercepts or constants;

$b_1 - b_3$ indicates the coefficient of the independent variables

μ represents the disturbance term

3.1. Source(s) of Data and Method of Analysis

The study focused on ten manufacturing firms selected from three Southwest states in Nigeria, namely Lagos, Oyo, and the Ogun States. The selected manufacturing firms include Unilever Plc, Yale Food ltd, Lafarge plc, Nestle Nigeria Plc, Nigeria Breweries Plc, and Phamer-Deko Nig. PLC, May & Baker Nig. PLC, Fidson Nig. PLC, Cadbury Nig.PLC, and Glaxo-Smithkline PLC. The study relied heavily on the primary source of data. Primary data used in the study was sourced through the administered questionnaire to the selected States. Data collated were analyzed using analysis of variance (ANOVA). Taro

Yamane's model (1967) was used to calculate the sample size. The calculation is given below Sample size

$$n = \frac{N}{1 + N(e)2}$$

(Where, n = anticipated total sample size; N = population size; e = acceptable error term (0.05)).

n $\quad=\quad \dfrac{164}{1+164\,(0.05)^2}$

n $\quad=\quad \dfrac{164}{1+164\,(0.0025)}$

n $\quad=\quad \dfrac{164}{1.41}$

n $\quad=$ 116.

Regression Analysis

IV. DATA ANALYSIS AND FINDINGS

Statistical analysis was conducted. Consequently, the ANOVA test was applied to develop regression analysis. The ANOVA test result has been elucidated to determine the level of relationship between the capital allowance, pioneer relief, rural investment allowance, and investment tax crediton investment drive in selected manufacturing firms in Southwest Nigeria.

Table 1. Capital Allowance

Model	B	Std.Error	T	Sig.T	Beta	R	r^2	Adr^{-2}	F
Constant	1.371	0.244	5.614	0.000					
					0.325	.325ᵃ	.346	0.096	47.248
Capital Allowance	0.37	0.11	3.354	0.001					

Source: *Data Analysis, (2018)*

Table 2. Pioneer Relief

Model	B	Std. Error	T	Sig.T	Beta	R	r^2	Adr^{-2}	F
Constant	2.239	0.452	4.952	0.000					
					-.042	.042ᵃ	.167	-.009	11.169
Pioneer relief	-.107	0.259	-.411	0.682					

Source: Data Analysis, (2018).

Table 3. Rural investment allowance

Model	B	Std.Error	T	Sig.T	Beta	R	r^2	Adr^{-2}	F
Constant	2.149	.305	7.049	.000					
					.658	.658	.433	.426	61.846
Rural investment allowance	0.540	.069	7.864	.000					

Source: Data Analysis, (2018).

Table 4 : Investment tax credit

Model	B	Std.Error	T	Sig.T	Beta	R	r^2	Adr^{-2}	F
Constant	0.204	0.137	1.497	0.138					
					0.854	.854ᵃ	0.730	0.727	256.641
Investment tax credit	0.984	0.061	16.020	0.000					

Source: Data Analysis, (2018).

A. Result and Discussion

The analysis outcome in Tables 1, 2,3, and 4 shows that the relationship between accelerated capital allowance and the investment drive of selected manufacturing companies (p = 0.001) is strong, though positive, and statistically significant at a 5% level of significance. The R-value of 0.325 reveals the strength of the association, The coefficient of determination (r^2) in the table is 0.346 with an F-value of 47.248. The rural investment allowances and investment drive of selected manufacturing companies (p = 0.000) are strong, positive, and statistically significant at a 5% significance level. The R-value of 0.658 reveals the strength of the association. The table's coefficient of determination (r^2) is 0.433 with an F-value of 61.846.

The Pioneer relief and investment drive of selected manufacturing companies (p = 0.682) are weak, negative, and statistically insignificant at a 5% significance level. The coefficient of determination (r^2) in the table is 0.167. The coefficient of determination (r^2) in the table is 0.002. The variation due to the studied variables (16.7%) is weak and thus explains the ineffectiveness of Pioneer relief and the investment drive of selected manufacturing companies. And finally, the relationship between an accelerated investment tax credit and the investment drive of selected manufacturing companies (p = 0.000) is strong, positive, and statistically significant at a 5% significance level. The coefficient of determination (r^2) in the table is 0.73, strong and significant, with an F-value of 256.641. The study found that capital allowance, rural investment allowances, and Investment tax credit indicated a positive and

significant effect on an investment drive in Southwest Nigeria, (0.325, p <0.005), (0.658, p<0.005) and (0.854, p< 0.05) respectively, while pioneer relief indicated a negative and insignificant effect on an investment drive in Southwest Nigeria (-.042, p >0.05). The study revealed that capital allowances improve the chances of selected firms' investment drive making; rural investment allowances have significantly affected investment drive in Nigerian manufacturing firms. It was also revealed that investment tax credit significantly improves investment drives in selected manufacturing firms. The study further revealed that Pioneer relief has not contributed as expected to the rate of manufacturing firm's investment decisions. The findings correlate to Gale (1996)'s study that found that, although Incentives are provided to motivate investors, access to domestic markets, a good investment climate, security and stability, skilled labor, and other factors matter most.

This study was also inconsistent with the study by Meron (2016) that tax incentives have a significant positive long-run effect on private domestic manufacturing investment. Also, the study of Uwaoma and Ordu(2015) on the impact of tax incentives on economic development in Nigeria (Evidence Of 2004 – 2014) affirmed that sufficient tax incentives enhance industrial growth and economy. At the same time, the findings of this study were contrary to the findings of George and Bariyima (2015), which affirmed that the Investment response to tax incentives is negatively significant. An increase in tax incentives does not bring about a corresponding increase in investment. It was also discovered in the study of Musyoka (2012) that there was no significant improvement in FDI as a result of implementing tax incentives in Kenya. Also, in the study of James (2009), it was established that incentives have limited effects on investments.

V. CONCLUSION AND RECOMMENDATIONS

Based on the findings of this study, the study settled that manufacturing firms in Nigeria are privileged to enjoy certain tax incentives from the government, which gives them higher opportunities for financial performance and also the opportunity of financing other capital projects as a result of tax incentives. This invariably increases the firm's growth and positively impacts the nation's economy as well. Hence, following the outcome of the selected firms and the study output, the conclusion that tax incentives do necessarily increase the manufacturing firm's productivity may suffice. The findings show that capital allowance, rural investment allowances, and Investment tax credit have increased selected firms' investment drive. The study recommended that the government increase the number of capital allowances, especially the one meant for machinery, to boost their investment. There is a need for the government to enlighten the general public about the capital allowance given to investments and those extended to local firms. An incentive should be a short-term strategy designed for specific firms to attract investment. A long-term strategy should improve infrastructure and security and minimize strict policies and regulations. The public should know the comprehensive information on procedures

and criteria for obtaining tax incentives under each existing program to boost investment. Also, the methods of providing tax incentives should be clear without being biased about the firm's owner. Finally, the government should increase awareness of the tax incentives available to manufacturing firms so that companies can take full advantage of them. This would encourage investment in the economy and promote employment and development in the long run.

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