Chapter 24
Institutional Structures and the Prevalence of Foreign Ownership of Firms:
Empirical Evidence From Africa

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ABSTRACT

This chapter examines how country-level institutional structures influence the prevalence of foreign ownership of firms in Africa. It reinforces the new institutional economics perspective by empirically highlighting that institutional structures influence the prevalence of foreign ownership of companies in an economy. Using archival data from 39 African economies, the authors found that there is a significant positive association between regulatory quality and foreign ownership prevalence. Also, foreign ownership is prevalent in African countries that are politically stable and embrace rule of law. However, the authors found that countries with high voice and accountability structures are associated with low foreign ownership prevalence.

INTRODUCTION

At the onset of developing, it is anticipated that the prevalence of foreign ownership of companies would become one of the significant sources of growth and development in developing economies. Firms with a higher share of foreign ownership should be more efficient than companies with no or small foreign stake (Blomstrom & Sjoholm, 1999). Foreign investments are anticipated to take the shape of transfer of new technologies and ideas, which eventually can be emulated by local corporate organisations (Naciri, 2008; Yudaeva et al., 2003). An opportunity to emulate Western style of managerialism is also a major reason for luring foreign investors into developing countries and economies in transition (Yudaeva et al., 2003). The prevalence of foreign ownership could possibly renew shareholders' meetings, which will eventually bring about a change in attitudes of management toward shareholders (Bien et al., 2008).

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However, in an incrementally globalised economy, competition is fierce and country-level institutional structures can make an unambiguous difference, by influencing the way and manner in which domestic corporate organisations are perceived by foreign investors (Naciri, 2008; Jalilian et al., 2003; Rodrik, 2000; Campos et al., 1999). National institutions, which include governance structures and practices based on international norms and standards would enable economies particularly, developing economies to post-modernize their corporate sector, which could possibly increase the prevalence of foreign ownership in their economies (Altomonte, 2000; Morisset, 2000; North, 1991).

A plethora of studies have examined the preferences of institutional investors and how economic factors tend to influence these preferences (Uhlenbruck et al., 2006; Kirkpatrick et al., 2006; Habib & Zurawicki, 2002). However, foreigners tend to invest less money in corporate organisations that reside in economies that are characterised by weak institutional structures, weak investor protection and flawed accountability system (Kirkpatrick et al., 2006). This implies that foreign investors invest in companies that are resided in economies, characterised by strong institutional structures, which can help ensure transparency, accountability, information symmetries, among others. Foreign investors shy away from firms located in economies with unsound institutional structures, in that they are more likely to incur huge costs in relation to their information and monitoring costs (Wei, 2000; Shleifer & Vishny, 1993).

This chapter is concerned with how country-level institutional structures influence the prevalence of foreign ownership instead of examining how economic factors influence the prevalence of foreign ownership, given that disparities across economies in economic circumstances offer only a fractional explanation of the locational choices of foreign investors and that the effectiveness and efficiency of an economy's institutional structures could have a considerable influence on their choices (see Uhlenbruck et al., 2006: Kirkpatrick et al., 2006; Habib & Zurawicki, 2002). Without a doubt, this chapter offers insight into how institutional structures influence the holdings of foreign investors in African countries. The objective therefore, of this paper, is to examine how country-level institutional structures influence the prevalence of foreign ownership in African economies.

BACKGROUND

A considerable number of works have been conducted on the determinants of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) inflows to developing countries in particular, African economies. However, the focus on the rationale behind the decision of foreign investors to own shares in companies situated in African economies has been given little attention. Even the inconsiderable number of studies on the determinants of foreign ownership in African economies have focused essentially on economic factors that induce foreign investors to invest in these economies. This implies that a repertoire of factors can in principle explain foreign ownership trends. The possible determining factors include macroeconomic variables, tax variables, indices of market access for foreign investors and proxies for financial market development. The hypothesis that connects foreign ownership to these variables is, in some instances, rather immediate. In other cases, the possible association between foreign ownership and possible explanatory variables is not a clear-cut (Huizinga & Denis, 2003). This is the case of the quality of governance and other institutional structures (among these are indicators of control of corruption, political stability, voice and accountability, rule of law, regulatory quality, government effectiveness, shareholder safeguard, and the quality of accounting and auditing standards), which are always given