

Chapter 21

Investment Climate Factors with Reference to Firm Performance in Bangladesh: A Prospective Cohort Study

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ABSTRACT

A productive investment climate is key to the growth of any developing country. Given the limited literature and importance of economic zone in attracting FDI, this paper conducts a study on the Export Processing Zone to provide an insight into the investment climate factors and its association with firms' performance. A total of 30 firms were chosen from the garment industry, in particular from the EPZ of Bangladesh. Findings reveal that all six factors were considered as important indicators affecting investment climate of EPZ firms. Moreover, five factors were found to be significantly associated with the firm performance. An important implication of the findings is that government and garment associations can get an important insights into the factors that are critical to the investment climate and accordingly take necessary steps to arrange better utilities provide sound governance, improve credit facilities, ensure a favorable trade union together with other infrastructural facilities that require for creating better investment climate for both the EPZ and non-EPZ firms.

INTRODUCTION

While developing countries as a group have certain similarities in terms of living standards, level of labour productivity, rate of population growth, and the degree of market failure and economic power, they vary in terms of political conditions, infrastructural development, and other development indicators such as imports and export growth (Mersha, 1997). Due to these differences, the investment climate¹

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also differs between the developing countries. While a suitable investment environment is especially important to attract investors, the EPZs² in developing country like Bangladesh have been successful in attracting Foreign Direct Investment (FDI)³ primarily in ready-made garments. EPZs are essential part of Bangladesh economy (Bhuiya et al., 2014). A review of literature indicates that the companies operating in the EPZs' in Bangladesh are achieving several benefits over the companies out of the EPZ (Ferdousi, 2009) because of its internationally competitive duty-free environment for export production at low cost. The especial support from the government in terms of modern infrastructure, utilities, tax facilities enable them to perform better and attract more investors than the non-EPZ firms. However, while EPZs of Bangladesh are performing well compared to some developing countries, they are lagging behind in respect to the investment growth and other performance indicators of the EPZ's of some other developing countries (Abdin, 2014).

This situation therefore, raises a fundamental question as to what factors influencing the investment climate of EPZ firms in Bangladesh. In line with this, previous studies have focused on the investment climate factors from both country level and firm level perspectives (Kinda et al., 2011; Aterido et al., 2010; Kee, 2005; World Bank and BEI, 2003; Dollar et al., 2003). There is only a limited study that have focused on this issue in respect to firms operating in EPZ, particularly in garment industry (Aggarwal, 2005). While some case studies (Watson 2001; Subramanian & Roy 2001; Madani 1999; Hinkle et al. 2003; Ferrerosa 2003; OTA 2003) conducted in EPZ in respect to the success and failure of this zone, there are only a limited empirical study (Aggarwal, 2005) focused on EPZ in respect to investment climate. Given the limited study, this study therefore, aims to empirically examine the factors that influence the investment climate and its association with performance in respect to the garment firms operating in eight EPZs of Bangladesh.

A growing number of research have examined the factors that affect investment climate (Kinda et al., 2011; Aterido et al., 2010; Kee, 2005; World Bank and BEI, 2003; Dollar et al. 2003), mainly focused on factors such as taxes & regulations, financing, policy instability, inflation, exchange rate, corruption, street crime, anti-competitive practice, organized crime, infrastructure, judicial system and service climate (Sangaiah et al. 2015; Sangaiah and Thangavelu, 2014; Kinda et al., 2011; Kee, 2005; World Bank and BEI, 2003, Dollar et al. 2003; World Bank Report, 2004; World Bank, 2001). This study examining six factors affecting investment climate including human resource, access to finance, infrastructure, power and energy, governance and trade union in the context of EPZ firms. These factors do not represent a comprehensive list of factors affecting the investment climate, but were chosen because they have been suggested in different studies.

While the researches that have examined the association of investment climate factors with organizational performance, such studies have generally measured performance in terms of sales growth, profitability growth, productivity improvement, investment growth (Kinda et al., 2011; Pernia & Salas, 2006; World Bank and BEI, 2003). For instance, Becket al. (2005) and Galindo and Micco (2005) have examined the critical role of access to finance on the growth of firm. Similarly, Djankov et al (2003) and Klapper et al. (2004) investigate the effect of entry regulations of firms on firm performance. In order to further contribute to the literature, this study has chosen three constructs to measure performance including increase in profit, sales growth and investment growth. Therefore, this study further contributes to the literature theorizing how each of the investment climate factors contribute in achieving firms' performance in the context of EPZs' in Bangladesh.

In a summary, the following research objectives are developed:

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