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Intra-Company Loans in Foreign Direct Investment and Performance of Real Estate Development Projects in Kenya

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Abstract: Foreign Direct Investment has over the years been a critical player in economic growth of mot countries across the globe. One of the key aspects that have defined the success of FDIs is the intra-company loans, which act as a source of affordable, effective and accessible funding to the FDI projects. In Kenya, FDIs have been instrument in economic growth and development, and one of the industries they have been centred on is the real estate development projects. However, very little is known empirically on how FDIs through intra-company loans have contributed to the success of the sector, hence the motivation of this paper. Descriptive research design was used while the target population was the real estate companies in Westlands, Nairobi County. There are forty-eighty registered real estate companies in this area. The units of observation were the directors, finance officers and investment managers from the forty-eight companies. This made a total of one hundred and forty-four respondents. Purposive sampling method was employed where the company directors, finance officers and investment managers were purposively picked. The data was collected using structured questionnaires and analyzed through descriptive and inferential statistical analysis techniques. The findings revealed that intra-company loans significantly and positively influenced the performance of real estate development projects in Westlands Sub-County. Government policy was also found to significantly moderate the relationship between intracompany loans and performance of the real estate development projects. The study concluded that through intra-company loans, the real estate development projects performed better. It is therefore recommended that the real estate development companies through their management embrace FDIs through intra-company loans so as to stir the performance of their development projects.

Keywords: Foreign Direct Investment, Intra-company Loans, Real Estate Development Projects

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1. Introduction

1.1. Background of the Study

Foreign Direct Investment (FDI) has been upheld by most countries across the World as a driver to economic prosperity and industrial revolution. The developing countries particularly those in Sub-Saharan Africa have also been keen on embracing FDI, to foster speedy development. The formation of the New Partnership for Africans Development (NEPAD) shows how African countries including Kenya have been steadfast in embracing FDI, which is anchored on the attraction of foreign investment to Africa as a major component. One of the key industries that FDIs have been focusing on is the real-estate sector. Owing to the growing demand and minimal risks in the sector, most FDI investors are findings it the safest way to invest, especially in low and middle-income countries like Kenya. This has seen the industry boom from a once stagnant industry, to one of the major contributors to economic growth and development. One of the aspects of FDIs is the ability to enhance the intra-company loans. These are short or long term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises ploughed into the new projects. In this study, the intra-company loans was measured by the long-term debts and the short-term debts.

Intercompany lending, is a constituent part of foreign direct investments (FDI) (IMF, 2009) that represents a controversial element, frequently underestimated because of its indebting nature and involvement in tax evasion strategies (Estrin and Uvalic, 2013). Intra-company loan is the debt financing in which a corporate invests part of the revenue to a business line or company owned or under the main company. Intra-company loans may be issued in short-term or log-term buts are directed towards steering the company's performance through putting into use idle funds or as an intervention measure to rescue the cash flows of the business. The intra-company finance is primarily concerned with the analysis of decisions that affect current assets and current liabilities from within the firm and how they can be used to keep the operations of other sister companies running (Bank, 2017). It involves multiple crucial decisions, which involve management of account payables and receivables, cash conversion cycle, preservation a definite level of stock and the investment of available cash (Fuest, Hebous, & Riedel, 2011). According to the matching principle of finance, intra-company loans from short-term assets should be financed with short-term liabilities and long-term assets should be financed with long-term liabilities (Guin, 2011).

Kenya's economy is plagued by inadequate resources for long term development, high poverty level, low capacity utilization, high level of unemployment and other sustainable development goals (SDGs) which have proven difficult to achieve by 2020, hence promotion and facilitation of technology transfer through FDI assumed a prominent place in the strategies of economic revival and growth being advocated by the policy makers at the county, national, regional and international levels because it is considered to be the key to bridging the technology and resource gap of under developed countries and avoiding further buildup of debt.

The role played by real estate sector in the economy has become critical especially in the emerging economies. Due to economic development and heavy investment in infrastructure in this region, demand for better quality housing and emergence of new cities has been on rise. Real estate can be defined as a property consisting of land and anything permanently fixed to it along with the natural resources such as crops, minerals or water (Polat, 2017). The sector is made up of three major segments namely, agency, investment and operations (Karadeniz et al., 2009). Real estate investment involves the purchase, ownership, management, renting of land or sale of real estate for profit. While real estate operations entail developing, renting, leasing, managing commercial and residential properties, consultation services, real estate appraisal service brokerage and agency services (Beule, & Van Den Bulcke, 2012). Kenyan real estate property covers all property category including single and multifamily residential dwellings, commercial and agricultural land, office space, go-downs and warehouses, retail outlets and shopping malls. Other aspects of real estate's include mortgage industry, real estate, investment trusts and other financial activities related to real estate sector (Pratheepkanth, 2011).

1.2. Statement of the Problem

Foreign Direct Investment has been an essential in economic growth and development, owing to its ability to stir long-term and high value investments. In Kenya, FDIs have been instrumental in reviving of sectors such as manufacturing, real estate, service and retail industry, among others. Their immense role particularly in the real estate sector has been visible, especially after the launch of the housing programme under the Big-four agenda by the government of Kenya (GOK, 2018). One of the main aspects of FDIs is intra-company loans, which have extensively enabled the investors acquire affordable financing to run their investments locally (Kioleoglou, 2015). Intra-company loans are the long-term or short-term loans that are transferred from one business unit of a company to another with the aim of enhancing the cash flows of the business unit in case of decline or investing corporate funds meant for investment. Intra-company loans help expand the FDI through provision of adequate funding to the struggling sister companies to undertake their construction projects thus strengthening their impact in the economy hence they are a key concern when it comes to the effect of FDI. Despite the need for intra-company loans in supporting the success of FDI-funded projects in the real estate sector, this has not been effectively achieved. Even with such concerted efforts by the scholars to understand the role of FDI, there remains a gap on whether the intra-company loans would enhance the effectiveness of FDIs towards enhancing project performance, hence the subject of this paper.

1.3. Objectives of the Study

i) To establish how intra company loans influences performance of real estate development projects in Kenya

ii) To assess how government policy moderates the relationship between intra company loans and performance of real estate development projects in Kenya.

2. Literature Review

2.1. Theoretical Framework

Trade-Off Theory

The trade-off theory was put forward by Kraus and Litzenberger (1973). The motive of the scholars was to introduce the interest tax shields associated with debt and financial distress into a state preference. As postulated by Myers (2001), the theory hypothesizes that firm managers seek to have an optimal financial structure by striking a balance (trade-off) between the benefits of debt financing (tax shields) and associated costs like financial distress costs and bankruptcy costs. According to this theory, every firm has an optimal debt-equity ratio that maximizes its value and minimizes the overall cost of capital. Firms set a target debt to value ratio and steadily adjust towards the target ratio to balance the trade-off between tax savings and bankruptcy costs. The major benefit of debt financing is that it provides a tax shield that increases the returns to be distributed to shareholders of equity.

The theory points out that firms that have an incentive to turn to debt as the generation of annual profits allows benefiting from the debt tax shields (Sheikh, & Wang, 2010). According to Voularis et al. (2010), non-debt tax shields, such as deductions allowed by depreciations and investment tax credit could substitute the role of tax savings permitted by debt. This implies that a firm with a high level of non-debt tax shields will probably have a lower level of debt than a firm with low non-debt tax shields. The theory emphasizes that a balance between tax saving arising from debt, decrease in agent cost and bankruptcy and financial distress costs (Oruç, 2009).

It assumed each source of money has its own cost and return and these are associates with the firm's earning capacity and its business and insolvency risks (Awan & Amin, 2014). Therefore, firm with more tax advantage will issue more debt to financed business operation and the cost of financial distress and benefit from tax shield are balanced (Mostafa & Boregowda, 2014).

2.2. Performance of Real Estate Development Projects

The real estate industry is an integrate part of the economic development of the country and essential economic changes have directly on the sectors pricing. The sector is vital to the economy for the part it plays in the country's not only for the physical structures but for the growth of the whole state and multiple economic (Zhang, Shen, Wu, & Qi, 2011). The properties pricing are vital as they are used to predict the economic growth of the nation (Khumpaisal, Ross & Abdulai, 2010). They are also vital to other sectors of the economy especially the financial markets which put their collateral on the advanced funds to its clients on them in cases of default. They take huge percentage of the commercial banks total current assets. Many investors who are interested in diversifying their investments give the properties market the first priority as the sector is not associated with frequent fluctuations (Masum, 2014).

A study by Ren (2016) analyzed the impact of property market investment on GDP and found that the study variables are directly correlated. Jackman (2010) carried out the analysis of the property market construction and GDP where he the results were ambiguous. Sorina (2014) posits that real estate market strongly influence the entire economy. According to Zighan, Bamford, and Reid (2018), the growth or decline of real estate sector considerably affects the general growth or decline of a country's economy.

In their study, Kong, Glascock and Lu-Andrews (2016) on their research on the impact of properties market on economic performance in Asian content where their study findings revealed an existence of a significant and direct correlation among the study variables. Kim (2020) examined association linking real estate investment on GDP among the Asian countries where the study results revealed a strong direct association among the study variables.

In Kenya, the real estate sector has continuously outdone other classes for the last five years, generating returns of between 25 percent and 30 percent hence making it the most lucrative business to venture in because of reduced losses. Residential units in Kenya generate an average rental yield of 5%, while commercial space generates an average yield of over 9% (NCC, 2017). A report by CAHF (2016) indicates that the total return, including rental yield and appreciation of housing businesses is about 28%. The real estate sector which has been previously dominated by individual developers now has an entry of more institutional developers such as Sacco's, private equity firms and foreign institutions in major towns around the country. Rapid population growth in Kenya of 2.4% per annum has created an increased demand for housing because of family growth and consumer needs which change to reflect improved standards of living. The demand has also been aided by the high urbanization rate of 4.4% per annum in the Nairobi area and the metropolis.

2.3. *Intra-Company Loans and Performance of Real Estate Development Projects*

The power of multinational companies (MNC) depends on their ability to make the most out of their global presence. Therefore, when deciding where to establish a new unit, they look for cost-cutting opportunities, such as tax reduction schemes (Devereux and Griffith, 1998; Barrios et al., 2009). Intercompany Lending (ICL) is a common part of these plans as it allows exploitation of the tax rate differentials to shift profit (Buettner and Wamser, 2007; Stewart, 1977) leaving both source and host countries with lower tax bases and tax revenues. However, ICL should not be observed only as a part of a tax evasion strategy but also as a part of a risk-management strategy that MNC employ to optimise resources and protect previously invested funds.

Since the outbreak of the financial crisis, risk aversion among investors has risen, leading to an increase in ICL (ECB, 2012). There are at least two reasons for this. First, affiliated companies located in emerging markets were faced with a tightening of credit conditions and were unable to obtain the necessary funds under conditions acceptable to them. Secondly, as EI represents pricier and riskier forms of capital, direct investors needed something that would allow them to finance their subsidiary while preserving flexibility. The solution was ICL since it provides a flow of funds for affiliates, and at the same time, creates enough pressure to make them step up and work better in the crisis period (Starnawska, 2015).

Studies have found that intercompany loans are the way to go for FDI. This dimension became noticeable only after the crisis when many posed the question regarding the sustainability of the benefits of FDI to emerging economies (Starnawska, 2015). Hebous and Weichenrieder (2010) noted that ICL amplified the stabilising role FDI had during the crisis.

Omran and Pointon (2015) conducted a study on the influence of intercompany long-term debts on firm characteristics and performance. The scholars did an empirical analysis from sugar firms in Egypt and aimed at establishing the effect of bonds and mortgages on the firm characteristics such as size of the firm, longevity of operations and diversity in shareholding as well as the overall performance of the firms. The study established that through effective management of long-term debts, the organizations were able to finance their investments and embrace effective shareholding through which they enhanced their performance. Omran and Pointon (2015) pointed out that the management of the sugar firms in Egypt had the full mandate of ensuring that the long-term debts are properly managed to steer organizational processes.

2.4. Government Policy and Performance of Real Estate Projects

The government policy stands to be the key determinant of how effective FDIs flow in the country and their overall contribution to the economy (World Bank, 2015). The major aspects of government policy attached to FDI include the restrictions, the openness of the boarders as well as internal policies aimed at providing guidelines on how FDI are carried out with limitations and benefits. The openness of a country to FDI is primarily assessed in terms of policies that create (or eliminate) border barriers for investors, measured by indicators of statutory restrictions to FDI and multilateral agreements that create areas of free trade and/or capital movements among signatory countries. However, tariff and non-tariff barriers to trade in goods and services are also considered, because they may affect the choice of MNEs between exporting and investing abroad as well as the choice between horizontal and vertical FDI.

Although formal international agreements on FDI have been far less extensive than on international trade, global negotiations and regional free-trade agreements often cover some aspects of international investment as well (for example capital-market liberalization within the European Union and provisions on commercial presence in the GATS), generally leading to lower barriers to FDI. Moreover, a number of bilateral investment treaties have been signed among OECD countries, aiming at curbing barriers to FDI. A new set of indicators of FDI restrictions was assembled by the OECD to summarize and quantify such barriers and their evolution over time. The indicators, which are described in detail in Golub (2003), cover mainly statutory barriers, ignoring most of the other direct or indirect obstacles impinging on FDI, such as those related to corporate governance mechanisms and/or hidden institutional or behavioral obstacles that discriminate against foreign firms.

Tariff barriers can also indirectly affect bilateral FDI relationships. Vertical FDI aimed at re-importing to the home country or exporting to third-party countries the final or intermediate goods produced by foreign affiliates can be depressed by high bilateral tariffs between the host and investor country or between the host and third-party countries. On the other hand, high bilateral tariffs can generate so-called "tariff-jumping" behaviour by MNEs (Sauve&Steinfatt, 2003).

2.5. Conceptual Framework

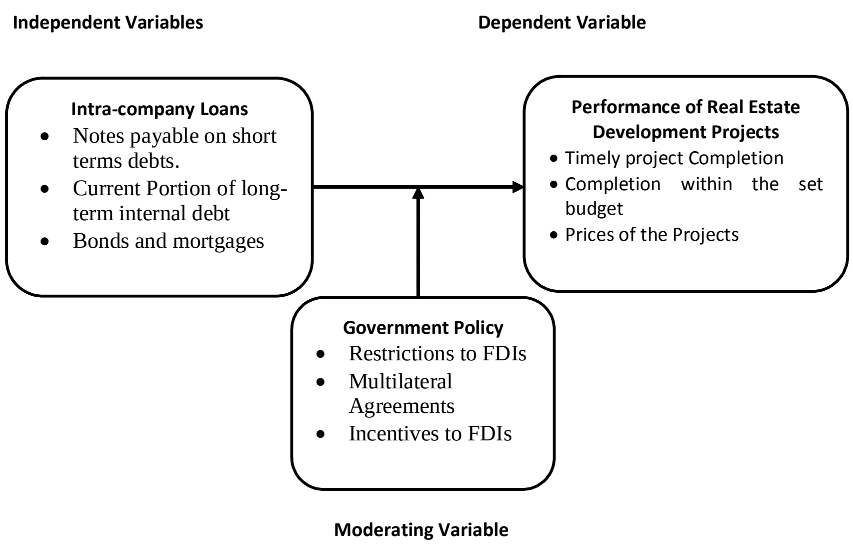

Figure 1: Conceptual Framework

Research Methodology

The study used a mixed method approach where both quantitative and qualitative methods were utilized. A descriptive survey research design was used to collect and analyse the data. The target population for this study was real estate companies in Westlands Sub-County, Nairobi County. According to the Nairobi City County and the real estate agents board, there are 48 real estate companies in the area. The study specifically targeted the company directors and finance/investment personnel in the 48 companies.

The sampling frame in the study comprised of the 48 registered real estate companies in Westlands Sub-county, Nairobi City County. The sample size for the study was specifically drawn from the directors and finance officers and investment managers. This totaled to a sample size of 144 respondents.

A purposive sampling was used to obtain the sample size where a director, a finance officer and an investment manager from each of the 48 companies were surveyed. This totaled to 148 respondents for the study.

This study employed primary data which was obtained using a self-administered questionnaire. The questionnaire was considered appropriate based on the ability to collect more data and with less time as well as avoiding biasness. Questionnaires were dropped at the respondent's working places through use of research assistants and the researcher who also picked the questionnaires at an agreed date. Based on the changes in technology some respondents may not be available physically at their designated working stations.

The study used both qualitative and quantitative data analysis techniques to analyse the collected data. Descriptive statistics were used to analyse the quantitative data. Under the descriptive statistics, mean, standard deviation, percentages and frequencies were used which were generated by use of Statistical Package for Social Scientists (SPSS). A regression model was used to test for the relationship between the variables.

4. Research Findings

4.1. Intra-company Loans and Performance of Real Estate Development Projects

The third objective of the study was to find out the influence of intra-company loans on the performance of real estate development projects in Nairobi County. The respondents were asked to indicate their level of agreement with specific statements on intra-company loans. The findings are as shown in Table 1. As the findings portray, majority of the respondents agreed that there were internal notes payable on short term in their respective companies. They further indicated that the internal notes payable were significant in running their companies' projects (Mean = 3.76; standard deviation = 1.12). The respondents indicated that their respective companies had no framework for providing shot-term loans to sister companies to develop their projects (Mean = 2.64; standard deviation = 1.97).

Majority of the respondents however agreed that their respective companies had existing long-term debts which were used to run the operations of the companies while disagreed that the available long-term internal debts were adequate in running the projects of the companies (Mean = 2.49; standard deviation = 1.92). Most of the companies had bonds and mortgages from internal investors to fund the companies' projects while there were customers who enrolled through mortgage plans to finance projects to be handed over to them upon completion. The findings compare with those by Starnawska (2015) who established that through intra-company loans, most of the FDIs were able to successfully establish themselves in foreign countries and deliver key projects.

Table 1: Intra-company Loans and Performance of Real Estate Development Projects

Statement	*Mean*	*Std. Dev.*
There are internal notes payable on short term in our company	3.75	1.12
The internal notes payable are significant in running the projects of our company into success	3.76	1.12
The company has a framework for providing short-term loans to the sister companies to develop their projects	2.64	1.97
Our company has existing internal long-term debts which have been used to run the operations of the company	3.45	1.19
The current portion of long-term internal debt is adequate for settling the needs of the company's projects	2.49	1.92
There are projects by our company that are financed by the long-term internal debt	3.51	1.22
We have bonds and mortgages from internal investors to fund the company's projects	3.71	1.16
The company has customers who enroll through mortgage plans to finance projects to be handed over to them upon completion	3.31	1.43
Through intra-company loans our company has been able to run its projects into success	3.58	1.23

4.2. *Government Policy and Performance of Real Estate Development Projects*

The fifth objective of the study was to establish the moderating effect of government policy on the relationship between intra-company loans and the performance of real estate development in Nairobi County. The findings are as shown in Table 2. The findings revealed that majority of the respondents felt that the minimization of the restrictions by the government on FDIs had enhanced the contribution and availability of foreign investors in the real estate sector and the most of the foreign investors had complied with the government regulations and policies.

The findings further revealed that the multilateral agreements between the government and other governments was friendly and led to increase in FDIs (Mean = 3.90; Standard Deviation = 0.98) and that the time taken to obtain building plan approvals from county governments affected the completion of the projects (Mean = 3.64; Standard Deviation = 1.05). Majority of the respondents indicated that the time taken to obtain completion and occupation certificates affected the success of the real estate projects as evidenced by a mean of 4.11 and a standard deviation of 0.82. According to Golub (2003), government policies influence the way of doing business such as the duration of approvals, easy of obtaining licenses and other operational requirements.

Table 2: Government Policy and Performance of Real Estate Development Projects

Statement	*Mean*	*Std. Dev.*
The restrictions by the government on FDIs have enhanced the contribution and availability of foreign investors in the real estate sector	3.94	0.94
There are fewer restrictions for new entrants into FDIs to encourage their investments	3.84	0.92
Most of the foreign investors in our company have complied with the government regulations and policies	3.42	0.98
The multilateral agreements between the government and other governments is friendly and has led to increase in FDIs	3.90	0.98
The foreign investors in our company are majorly as a results of multilateral agreement between the Kenyan government and their respective governments	3.80	0.73
The foreign investors in our company have received incentives from the government which have influenced their continued investment in real estate	4.07	0.82
The government policy has played a significant role in determining the extent of FDIs and their contribution to the real estate projects	3.68	1.03
The time taken to obtain building plan approvals from county governments affects the completion of the projects	3.64	1.05
Time taken to obtain completion and occupation certificates affects the success of the real estate projects	4.11	0.82

4.3. Performance of Real Estate Development Projects

The study sought to assess the performance of real estate development projects in Nairobi county. The respondents were asked to indicate their level of agreement on specific statements on project performance based on Likert's scale. Table 3 shows the findings. As the findings portray, majority of the respondents agreed that most of the projects in their respective companies had been completed within the set timelines. Most of the respondents further stated that the number of projects completed by their respective companies had increased over time. The respondents further stated that majority of the projects in their respective companies had been completed within the set budget and that the projects completed met the quality expectations of the customers.

Table 3: Descriptive Statistics on Performance of Real Estate Projects

Statement	*Mean*	*Std. Dev.*
Most of the real estate projects in our company have been completed within the set timelines	4.00	0.92
There has been an increase in the number of projects completed by our company over the last five years	3.94	0.90
The company has more recorded an increase in the sold units over the last five years	3.93	0.87
Majority of the real estate projects by our company have been completed with the set budget	4.11	1.03
The real estate projects completed by our company meets the quality expectations of our customers	4.23	0.89
There are more investors willing to enroll in our company due to the outstanding performance record	3.94	1.08

4.4. Regression Analysis

The regression coefficients of the model are as shown in Table 4. As the results portray, the Beta (â) coefficient for intra-company loans was 0.605. This is an indication that a unit change in the intra-company loans leads up to 60.5% increase in performance of real estate development projects. The P-value for the intra-company loans was 0.000 which confirms that indeed, intra-company loans significantly influence the performance of real estate development projects.

Table 4: Regression Coefficients

Model		*Unstandardized Coefficients*		*Standardized Coefficients*	*t*	*Sig.*
		B	*Std. Error*	*Beta*		
1	(Constant)	-2.064	2.574		-.802	.424
	Intracompany Loans	.605	.095	.523	6.403	.000

a. Dependent Variable: Performance of Real Estate Development Projects

The study sought to establish the influence of intra-company loans on the performance of real estate development projects in Nairobi County. The findings of the study revealed that the internal notes payable on short-term basis were available in most of the companies and that the internal notes payable were significant in running the completion of the projects by the respective companies. The findings revealed that the companies had existing internal long-term debts which played a key role in enhancing the success of the companies' projects. The respondents however disagreed that the available long-term debts used to run the operations of the projects was adequate but agreed that there were projects in their respective companies that were run by the long-term internal debts. The inferential analysis of the regression model for the study revealed that indeed intra-company loans had a significant and positive influence on the performance of real estate development projects in Nairobi County.

Conclusion and Recommendations

The study revealed that intra-company loans played a critical role in enhancing the performance or real estate development projects. These are the loans offered by the company to other sister companies or to other independent projects attached to the companies. Through the short-term notes payable and long-term internal debts, the companies are able to secure the financial needs of their projects thus enhancing their performance.

The management of the real estate companies can utilize intra-company loans to finance their construction projects. Instead of their sister companies seeking funding from other external sources, they can allocate them loans which could even be interest-free as a way of enhancing the success of the projects without involving external funding which is more costly.

The government ought to speed the process of licensing the real estate companies and offering compliance and completion certificates as a move towards enhancing the ability of these companies to implement their projects timely as well as enhancing the timely sales of the completed units. The government should be supportive to these companies since they also play a critical role in economic growth and development.

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