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Investment Incentives and Performance: Review Study

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Abstract: This study aims to review the theoretical and empirical studies related to the literature on investment incentives. Most studies explored in this paper conclude that, despite being important in attracting FDI, tax incentives are more effective when combined with other financial incentives. There is an argument regarding investment incentives. While some studies promote using these incentives with few restrictions on their positive role regarding investment growth and economic development, others claim that this contribution is only a burden on the state budget due to the high applicable cost. Despite that , both recommend regular inspection and evaluation of these incentives to ensure their sustainable relevance and effectiveness.

Keywords: Foreign Direct Investment, Investment incentives, Performance, Theoretical Argument.

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Introduction: Some studies have concentrated on the concept of investment incentives, specifically exploring their various types, methods of measurement and evaluation, as well as their effectiveness in different contexts. These studies can be categorized based on their purpose, with some focusing exclusively on specific types of incentives, such as tax and fiscal incentives. Others have examined how these incentives impact corporate growth, investment rates, and financial performance. In general, some literature has compared various investment incentives in developing countries, analyzing their impact on investment and growth rates. Additionally, other studies have evaluated performance and explored the extent to which it is influenced by foreign investments in corporations. Furthermore, other research has focused on the relationship between investment incentives and corporate performance. A comprehensive review of the relevant literature will be presented in the subsequent section.

1. Theoretical arguments for investment incentives and performance

(Hussen,2022) aimed to study the impact of government financial incentives on the performance of Turkish companies. It was found that companies that receive financial incentives are more productive and export five times more than those that do not receive them. Therefore, it is necessary to support companies to improve performance, and regarding future incentives, they must be granted more to small and large-sized companies.

(Hintosova et al., 2021**)** investigated the impact of investment incentives (financial and fiscal) and the business environment on foreign direct investment flows (direct effect) in Slovakia from 2002 to 2019. On the other hand, the study examined the impact of investment incentives on macroeconomic variables (indirect effect) in Slovakia. The Slovak government changed incentives in the period from 2002 to 2019, and the study showed a significant impact of financial incentives on foreign direct investment flows and vice versa with fiscal incentives. The results showed that financial incentives until 2007 attracted particularly large foreign investments, and after a change in legislation and regulations, the government of Slovakia prefers fiscal incentives. However, most investors are provided with a full package of incentives, consisting of financial and fiscal incentives.

(Tulu,2021) studied the relationship between incentives and FDI inflows in developing countries and Ethiopia. The case study and comparative study were used in an attempt to trace the conceptual, legal analyzes and interpretations. The study presented a model of investment incentives in low-income countries and developing countries, namely tax exemption and its effectiveness. It also highlighted several different concepts of investment incentives under Ethiopian investment laws, the specific factors that drive and influence FDI inflows in developing countries and Ethiopia. In attracting foreign direct investment, the study also presented the results of many researchers concerning the relationship between tax incentives, income, and foreign direct investment flows. It was critically analyzed with various laws, especially Ethiopian investment laws. The study concluded that the tax incentives used to attract foreign direct investment in developing countries are not in a position to meet the comprehensive driving factors of foreign direct investment and the interests of investors.

(Lv et al., 2020) sought to understand how financial incentives provided to local governments in China affected investment rates in the period from 2004 to 2013. They built a model of financial competition to link local financial incentives, spending policy, and thus the movement of capital. The model's main prediction is to increase participation in the income tax on local businesses, which replaces fiscal incentives given to local governments, and also encourages local governments to compete for capital investment through increased public spending. The results revealed that local tax incentives significantly represent policy

choices and local economic performance. In addition to exploring financial incentives presented for local governments.

(Trung and Tan,2020) evaluated the impact of tax incentive policy on company performance after privatization for 260 companies in Vietnam. The study focused on whether tax incentive policies could improve company performance after privatization. It was found that privatized companies with tax incentives improved profitability, operating efficiency, and reduced financial leverage after privatization. Likewise, it was not found that there was a decrease in the number of employees and improved production after privatization. Besides, there is no statistical evidence proving that privatized companies have experienced significant changes in corporate performance in Vietnam. The results also showed that the tax incentive policy significantly helps state-owned companies improve the performance of post-privatization companies. Given the significant improvements in profitability and operating efficiency of companies after privatization; The government should accelerate the privatization program because privatized companies have the opportunity to participate in the market mechanism after privatization, which is no longer subject to state control, so that the company's performance will be greatly improved in the long term.

(Mauda and Saidu,2019) examined the impact of tax incentives on the financial performance of listed consumer goods companies in Nigeria. The study covered only (7) companies listed in Nigeria in 2000- 2017. The study revealed that capital allowances and carrying loss had a significant positive impact on the company performance along with the investment allowance and had a positive but insignificant impact on financial performance. It recommended that companies benefit more from the tax incentives available to them, especially incentives related to investments that would help improve corporate productivity, so the tax authorities should consider ways to provide more incentives for investors in vital sectors such as consumer goods.

(Siregar and Patunru,2019) analyzed the impact of tax incentives on foreign direct investment (FDI) in Indonesia in order to determine the direction and importance of tax incentives in their relationship to foreign direct investment with other determinants of foreign direct investment. The study was applied to 22 countries from 1999 to 2018. The results concluded that with increased tax incentives, the flow of foreign direct investment decreases significantly. However, the lower the corporate income tax (CIT) rate used as a proxy for the cost of investment, the greater the inflow of FDI.

(Napa et al., 2018) compared investment incentives offered by Southeast Asian member states (Philippines - Brunei - Indonesia - Malaysia - Singapore - Thailand - Vietnam) and proposed a vision to help formulate tax reform. It was applied from 2005 to 2016. The study examined several types of incentives, including tax exemption, preferential tax on total earned income, corporate income tax, customs exemption tax on imported capital

equipment, and accelerated depreciation. The study revealed that tax incentives still constitute an essential part of Southeast Asian member states' investment incentive strategies. This competition led to increased incentives, granting excess incentives, expansion of tax incentives, different tax incentive systems, etc., while these tax incentives have contributed to creating a strong investment climate in the Philippines. The study also indicated that there are other factors that affect the decision of a potential investor, such as infrastructure, low tax rates, economic growth rate, political stability, wage rates, availability of skilled workers, entry into free trade zones, and ease of doing business.

(Kinyua, 2017) investigated the impact of tax incentives on financial performance in Nairobi. The study used a descriptive research design and concluded that there is a weak positive relationship between capital allowances, accelerated depreciation, and financial performance. It also indicated a negative relationship between tax and financial performance. As a result, the study recommended that the government should provide more diversity of tax incentives especially capital allowances, accelerated depreciation, and tax exemptions, since an increase in each of them increases performance.

(Kuria, et al., 2017) studied the impact of tax incentives on the performance of companies in export zones in Kenya. It was applied in 86 companies. Primary data was obtained using a questionnaire, and secondary data was collected from the companies. It was revealed that tax incentives had a positive and significant relationship with the performance of export processing zone companies at a 5% significance level measured using ROA. The results also indicated that corporate income tax incentives have a positive and significant impact on the number of jobs and company age at a 5% significance level. The study concluded that increasing corporate income incentives led to an increase in return on assets, number of jobs, and company life. It was recommended that tax policy stakeholders should reconsider the economic value of corporate tax incentives.

(Mulyonoa and Mustikasari,2017) evaluated investment incentives policies in Indonesia from 2006 to 2011, which is represented in the form of tax exemption facilities granted by the Indonesian government to foreign investors. It aims to support the government in reducing the unemployment rate the slowdown of the economic sector, and the impact of global trade competition. This has led to a decrease in foreign investors' confidence in investing in Indonesia. A case study approach was used, and the data collection technique used was preliminary surveys, direct interviews, and direct observation with political parties. The results showed that the Indonesia tax investment policy in the form of tax exemptions indicates that it has little effect on increasing economic growth. The study also concluded that evaluating investment incentive policies and using them to describe developments in management will clearly lead to increased investment and enhanced development, infrastructure, and Indonesian economic growth.

(Tirimba,et al.,2016) determined the relationship between tax incentives and corporate performance. it was applied to companies listed on the NSE, and a stratified random sample of 30. The results concluded that tax incentives have an impact on performance. Therefore, it recommended that governments should establish clear tax laws and predictable tax administration that would provide favorable market opportunities to investors instead of granting investment incentives.

(Mayende,2013) analyzed the effects of tax incentives on the performance of Ugandan manufacturing companies from 2000 until 2002. The results concluded that the performance of companies with tax incentives is better in terms of total sales and value-added than their counterparts. The educational level of corporate managers, company size, and company age also positively affect company performance. It also indicated that the government needs to simplify the provision of tax incentives to improve company performance. Access to quality, technical education, and skills development are necessary in order to have qualified managers with a high level of management skills taking advantage of available tax incentives to improve company performance. It was also found that tax incentives had a positive impact on the company's performance in terms of total sales and value-added. The study proved that the age and size of the company have a positive impact on the company's performance. The performance of large and medium companies is better than small companies.

(Cedidlova,2013) tested whether investment incentives in the Czech Republic were effective not only for companies but also for the government. A case study was conducted of 30 companies that were granted investment incentives in the Czech Republic from 1998 until 2011. The Czech Republic has tried to attract foreign investors in order to become more competitive. An investment incentive system has been established and the results have indicated that it is basically effective for providing investment incentives; however, it is better to create any methodology or tool to analyze its effectiveness directly from its provider - the Ministry of Industry and Development - and monitor its contribution regularly.

(Kransdorff, 2010) assessed the impact of tax incentives on attracting FDI to South Africa. It comes to the conclusion that taxation is critical to attracting efficiency-seeking FDI. The analysis assumed that, given the efficiency of taxing in attracting FDI, South Africa's low FDI flows are the result of a bad tax incentive system. The research therefore proposes that South Africa's tax incentive framework be reformatted if the country is to attract meaningful FDI. However, the study is qualitative, with no quantitative evidence to substantiate the arguments.

(Wentzel,2010) investigated the determinants of the investment decision, and the mechanisms for incentivizing investment, as well as identifying additional incentives that are applied to the manufacturing sector in South Africa, Malaysia, and Singapore. This study answered the question "Can the government encourage foreign investors to choose South

Africa to invest in?".To do that a detailed comparison to the manufacturing sector was then conducted between these incentives for the three countries in order to identify similarities and differences. Based on the results of this comparison, the study concluded that comparing incentives with those in other countries may enhance South Africa's competitive advantage and influence the foreign investor's decision when choosing it as a country to invest in.

(Klemm and Van Parys, 2009) investigated whether tax incentives are used to compete for FDI and how effective they are in attracting FDI. They used tax incentive data from 40 Latin American, Caribbean, and African countries from 1985 to 2004. They used panel econometric methodologies to reach the conclusion that lower tax rates are significant in attracting FDI. Their second conclusion, that tax holidays and lower corporation taxes are used in tax competition for FDI, was supported by their use of spatial panel econometrics.

(Barbour,2005) analyzed whether the tax incentives available to the South African manufacturing sector work effectively to improve investment incentives, both domestic and foreign. This can be implemented by comparing the investment incentive system in South Africa with international best practices. The study was applied from 1999 until 2003 and came up with some recommendations for reforming the investment incentive system in South Africa. First, the government can do more to rationalize the incentives and policies it offers. Second, many incentives remain complex to implement. So, there is a company that helps others deal with complex applications and approval processes, highlighting the administrative costs for both the government and companies. Finally, the study recommended that governments should pay more attention to removing factors discouraging investment, rather than focusing only on incentives to attract investment.

2. The effectiveness of fiscal (tax) incentives debate

(Zee et al., 2002) This study is primarily intended for policymakers in developing countries. It examines the objectives, effectiveness, and execution of tax incentives, evaluates the relative benefits of different types of incentives, and presents an empirical literature analysis. The main conclusions emphasize that tax incentives should be focused on correcting market failures and that the most preferable types of incentives are those that enable faster recovery of investment costs.

According to (Zee et al., 2002) there is limited evidence available to support the effectiveness of tax incentives in foreign direct investment (FDI) attraction, particularly in developing countries. They questioned the utility of tax incentives in comparison to non-tax factors that enhance an economy's attractiveness to FDI. Similarly, (Beyer ,2002) found no relationship between tax incentives and FDI attraction. On the other hand, some studies, such as (Klemm and Van Parys ,2012) and (Van Parys and James,2010), have found tax incentives to be critical in attracting FDI to low-income countries, with tax exemptions being particularly beneficial in the Caribbean.

Despite the widespread use of tax incentives in developing countries to offset the impact of weak macroeconomics, poor infrastructure, and ineffective institutions, which increase the cost of doing business, By offering reduced tax rates, these incentives aim to compensate for investor losses. However, studies such as (Sudsawasd ,2008) suggest that non-tax factors are more effective in attracting FDI than tax incentives. On the other hand, (Hassett and Hubbard ,2002,Sato,2012) view fiscal incentives as essential for attracting FDI.

According to James (2010), policymakers utilize both tax and non-tax incentives to lure investments across borders. Tax incentives, as defined by James (2010), involve tax exemptions granted to foreign investments rather than domestic investments to encourage FDI. Tax incentives improve the after-tax earnings on investments, and generally, an investor will choose a location with a lower tax liability if the resources are equal (Owens, 2004). As a result, tax competitiveness has been the driving force behind the use of tax incentives, with neighboring countries vying to attract FDI by reducing tax rates.

3. Pros and cons of tax incentives

Tax incentives, according to (Esson and Zolt ,2002) are undesirable because they affect investment decisions. In practice, tax incentives are considered ineffective and prone to corruption, leading to the conclusion that they are bad (Easson & Zolt, 2002). However, almost all countries continue to use them for a number of reasons; therefore, this section of the study examines the positive and negative aspects of tax relief. (Bird ,1993), on the other hand, argues that "tax incentives improve economic performance only if government officials are better equipped than private investors decide the best types and means of production for an economy." This means that in the study, the advantages and disadvantages of tax relief should be examined to determine whether government employees are better qualified than private investors to make such decisions.

Taxation is used by governments to correct market failure. For example, tax incentives are utilized to address the private sector's underproduction of investment activities, resulting in beneficial impacts (Easson and Zolt, 2002). Governments will use tax incentives to correct private-sector investment decisions and to attract investment that would not have occurred otherwise. This is because governments want the economy to benefit from the benefits of foreign capital, such as technological transfer, skill transfer, job creation, and economic growth and development.

(Easson and Zolt,2002) highlight two causes of revenue loss as a result of tax incentives. First of all, tax incentives discourage alternative investments in favor of incentive-receiving businesses, resulting in revenue losses from omitted initiatives. Second, revenue is lost when corporations improperly claim incentives and, in some cases, move income from taxable operations to those that qualify for tax exemptions, thus avoiding taxes.

The success of tax incentive policies implies that investment will increase in regions and nations with successful incentive structures while decreasing investment in those without (Bird, 1993). This increase in investment related to tax incentives will address market failures in some cases, but in most cases, it will result in too much investment in activities with incentives and too little investment in activities without incentives, resulting in resource misallocation.

Based on the preceding, we can conclude that tax incentives may not be the best option for investment incentive policymakers, and it is preferable to provide other options for investors in order to increase investment opportunities.

4. Analysis of Investment incentives applicable in literature

Research both at local and international levels has been done to investigate the impact investment incentives have on performance, so this section reveals the analysis of investment incentives according to their scope, methodology, and type of incentives included.

Summary of Analysis for investment incentives literature

Study	Incentives	Scope	Methodology
(Hussen,2022)	Financial	Local	Empirical
(Hintosova et al., 2021)	Financial and fiscal	Local	Empirical
(Tulu,2021)	Fiscal	International	Comparison and case study
(Lv et al., 2020)	Fiscal	Local	Empirical
(Trung and Tan,2020)	Fiscal	Local	Content analysis
(Mauda and Saidu,2019)	Fiscal	Local	Empirical
(Siregar and Patunru,2019)	Fiscal	International	Empirical
(Napa et al., 2018)	Fiscal	International	Comparative study
(Kinyua,2017)	Fiscal	Local	Qualitative
(Kuria et al.,2017)	Fiscal	Local	Qualitative
(Mulyonoa and Mustikasari,2017)	Fiscal	Local	Case study – qualitative
(Tirimba et al.,2016)	Fiscal	Local	Qualitative
(Mayende, 2013)	Fiscal	Local	Empirical
(Cedidlova,2013)	Fiscal	Local	Case study
(Kransdorff, 2010)	Fiscal	Local	Qualitative

(Wentzel ,2010)	**Fiscal ,financial and others**	**International**	**Comparative study**
(Klemm and Van Parys, 2009)	**Fiscal**	**International**	**Empirical**
(Barbour,2005)	**Fiscal**	**International**	**Content analysis-comparative study Quantitative**

5. Discussion and Conclusion:

According to the findings, there is a scarcity of literature on measuring performance and its relevance to investment incentive programs. Some research used comparative and case studies, while others used quantitative methods. The results, on the other hand, differ; some investment incentives will lead directly or indirectly to attracting investment, particularly after changing all necessary regulations and legislation, whereas others concluded that incentives alone have limited effects on investments. As a result, countries should improve their investment environment, accelerate investment decisions, and encourage competition among investors.

Many studies has concluded that (fiscal) tax incentives are a fundamental type of investment incentive since countries compete to provide the best incentives in exchange for investment, but this does not indicate that other factors do not affect them. This implies a lack of studies referring to other incentives, such as financing incentives, and a focus only on tax incentives.

Most literature was limited to investigating or studying investment incentives without focusing on efficiency and effectiveness and how to manage them, then identifying and eliminating the defects. There are incentives, but they are not managed well. So, by focusing on the short- and long-term effects of investments on corporate performance, the literature has discovered that corporations with larger investments have weaker performance. At the same time, there was a significant reduction in company performance as a result of the Corona epidemic. Still, it was expected that the consequences would be less in countries that have better health care systems and more advanced financial systems.

According to several studies, incentives cannot address for deficiencies in the investment environment and are not equivalent to the external factors available in the investment environment. As a result, there is debate about investment incentives. While some studies propose the unrestricted use of these incentives, emphasizing their positive role in promoting investment growth, economic and social development, others argue that because of the high applicable cost, this contribution is merely a burden on the state budget.

Finally, it has been recommended that the reform choices be focused on removing government red tape and regulations, decreasing restrictions on foreign investment, and

providing growth opportunities. Some argue that the association between infrastructure and growth is stronger in low-income countries with poor infrastructure than in developed countries. As a result, rather than focusing just on the incentives and attractiveness factors, governments should concentrate on the elements that discourage investment.

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