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THE ROLE OF FOREIGN DIRECT INVESTMENT FOR THE
EXPORT GROWTH OF LEATHER INDUSTRY
IN ETHIOPIA

by
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A Thesis Submitted to the Department of Public Administration
and Development Management for Partial Fulfillment of the
Requirements for the Degree of Master of Arts in Development
Management

Addis Ababa, Ethiopia

July, 2017

Declaration

This thesis is a presentation of my original research work. Wherever contributions of others are involved, every effort is made to indicate this clearly, with due reference to the literature, and acknowledgement of collaborative research and discussions. Furthermore, I took reasonable care to ensure that the work is original, and, to the best of my knowledge, does not breach copyright law, and has not been taken from other sources except where such work has been cited and acknowledged within the text.

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EXAMINERS' APPROVAL

As members of the Examiners of the final Master's degree open defense, we certify that we have read and evaluated the thesis prepared by Mr Tadesse Gurmu under the title The Role of Foreign Direct Investment for Export Growth Leather Industry in Ethiopian, and recommend that it be accepted as fulfilling the thesis requirement for the degree of Master's of Art in Public Administration and Development Management with Specialization in Development Management.

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ACKNOWLEDGEMENTS

It is difficult to thank all those people and institutions that have helped me in accomplishing my thesis research work, but the following deserve a special mention. First and foremost, I would like to thank my advisor Jemal Abagisa (PhD), in providing me the required materials, offering helpful and constructive comments, guiding and encouraging me in all moments since the research proposal preparation. His comments on the survey instruments greatly helped me to come up with good and comprehensive data set for the thesis. Without exaggeration, the finalization of this thesis report would have been hardly possible without his guidance and heart full support.

I sincerely acknowledge Tsion Getaneh and Wubdle Nigussie, the staff of LIDI, the government institutions Central Statistical Agency, Ethiopian Investment Commission, Footwear factories and Tanneries, Leather Industry Development Institute and Ministry of Industry with their staff for their kind cooperation during the data collection. I also want to thank Eyoal Tamrat, Aregawi Gebremedihin and Getnet Zenebe (MA) for their support by giving guidance during start-up of the research.

I would also like to thank my entire family for being a great source of encouragement, advice and help in proofreading and commenting on my work.

Above all, I extend my special thanks to the Almighty God for everything of merits is due to his benevolence.

TABLE OF CONTENTS

Contents	page
Declaration.....	i
EXAMINERS’ APPROVAL	ii
ACKNOWLEDGEMENTS	iii
TABLE OF CONTENTS	iv
List of Tables	vi
List of Figures.....	vi
ABBREVIATIONS	vii
ABSTRACT	viii
CHAPTER ONE.....	1
INTRODUCTION	1
1.1 Background of the study.....	1
1.2 Statement of the problem	3
1.3 Research questions	5
1.4 Objectives of the study	6
1.5 Significance of the study	6
1.6 Scope of the study.....	6
1.7 Challenges and limitations of the study	7
1.8 Organization of the study	7
CHAPTER 2:.....	8
REVIEW OF THEORETICAL AND EMPIRICAL LITERATURE.....	8
2.1 Introduction.....	8
2.2 Review of theoretical literatures	8
2.2.1 Definitions and Types of Foreign Direct Investment	8
2.2.2 Basic causes for Foreign Direct Investment.....	10
2.2.3 Impacts of Foreign Direct Investment	13
2.2.4 Driving force behind the internationalization process of FDI firm.....	15
2.3 Empirical Literature	16
2.4 Evaluation of the literatures in the context of the study	18
2.4.1 Foreign direct investment and export expansion in LDCs.....	18
2.4.2 FDI contribution in creating job opportunities.....	19
CHAPTER 3.....	21
RESEARCH DESIGN AND METHODOLOGY	21
3.1 Introduction.....	21
3.2 Research approach	21
3.3 Source and methods of data collection	21
3.4 Sampling.....	22
3.5 Methods of data analysis	23

CHAPTER 4.....	24
DATA PRESENTATION AND ANALYSIS.....	24
4.1 Introduction.....	24
4.2 Characteristics of the respondents and firms.....	24
4.3 Foreign Direct Investment Experience in Ethiopia	26
4.3.1 Patterns of FDI in Ethiopia.....	26
4.3.2 Policies on FDI in Ethiopia	27
4.3.3 FDI and Export performance in Ethiopia.....	27
4.4 Ethiopia's Trade and Export Structures.....	29
4.4.1 Trade Structure.....	29
4.4.2 Export Structure	30
4.5 Ethiopia's Leather Sector Overview and the FDI.....	32
4.5.1 Ethiopia’s Overall Investment Trends and Approved Projects.....	32
4.5.2 Leather sector investment overview	32
4.5.3 Analysis of FDI’s role on Export of Ethiopian leather industry	34
4.5.3.1 Export trend of leather and leather products, by Value.....	34
4.5.3.2 Export trend of leather and leather products, by Volume	35
4.5.3.3 Export trend of leather and leather products, in unit value	37
4.5.3.4 Leather sector Market Diversifications	37
4.6 Linkage effect of FDI in the leather sector of Ethiopia	38
CHAPTER 5.....	45
CONCLUSIONS AND POLICY IMPLICATION	45
5.1 CONCLUSIONS	45
5.2 POLICY IMPLICATIONS	46
REFERENCES	48
Annex 1: Questionnaire.....	52
Annex 2: Interview Questions	55

List of Tables

Table 1: FDI contribution in job creation	20
Table 2: Job Title and Educational levels of the respondents.....	24
Table 3: Sub-sector, legal status and ownership of firms	25
Table 4: Number, Capital (million ETB) and expected job creation of approved projects since 2010.....	32
Table 5: Percentage Share of FDI inflow in Leather sector from 2010 -2016 G.C.....	33
Table 6: Trend of leather and leather products, by Volume (Millions).....	35
Table 7: Unit Value of leather and leather products export.....	37
Table 8: Leather sector export destinations (2010-2016) (percentage)	38
Table 9: opportunities of foreign firms.....	39
Table 10: Challenges of FDI firms	39
Table 11: Reasons for sourcing from abroad by foreign firms (only non-leather inputs)	40
Table 12: Basic Requirements expected from domestic suppliers	41
Table 13: Ethiopian based FDI firm qualifications.....	42
Table 14: Effects of the entry and operation of FDI.....	43
Table 15: Importance of foreign firms to domestic firms in the leather industry.....	43

List of Figures

Figure 1: Manufacturing value added and GDP growth of Ethiopia (2001-2013).....	28
Figure 2: FDI inflow and manufactured export (2001-2014).....	29
Figure 3: Export performance of FDI firms (2010-2016).....	35
Figure 4: Trend of leather and leather products, FDI Share (per cent).....	36

ABBREVIATIONS

ABA	Everything But Arms
AGOA	African Growth and Opportunity Act
COMESA	Common Market for Eastern and Southern Africa
CSA	Central Statistics Agency
ERCA	Ethiopian Revenue and Customs Authority
FAO	Food and Agricultural Organization
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GTP	Growth and Transformation Plan
ITC	International Trade Center
LDCs	Least Developing Countries
LIDI	Leather Industry Development Institute
MoFED	Ministry of Finance and Economic Development
MoGCA	Ministry of Government Communication Affairs
MOI	Ministry of Industry
UK	United Kingdom
UNCTAD	United Nations Commission for Trade and Development
UNIDO	United Nations Industrial Development Organization
USA	United States of America
USD	United State Dollar
WIR	World Investment Report

ABSTRACT

Exports play a vital role in the economic growth of a country. This study tries to examines the role of FDI in export growth of leather industry in Ethiopia. A primary data collected from 15 FDI firms in the leather sector of Ethiopia through surveying and interviewing the General Managers, Marketing Managers, Finance Managers and Production Managers. In addition, secondary data also collected from different government institutions like LIDI, ERCA, FIC CSA and MOI to strengthen the research work. In analyzing the role of FDI in leather, sector export and basic determinants descriptive statistics utilized. The analysis shows the export share of FDI firms reaches 70 per cent of the total leather sector export values. This export volume is very high when compared with local firms, which have long-term involvement in the sector. The study also shows FDI's vital role in product diversification, value addition, skill transfer, opening new market route for local firms across value chain. Therefore, in order to increase and maintain the role of FDI for export growth of the leather sector strong institutional support needed from government and stakeholders. Capacity building for all actors in the chain, especially for domestic firms to enter international market competition were recommended.

Keywords: foreign direct investments, Ethiopia, leather sector exports.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Foreign Direct Investment (FDI) defined as a means for the transfer of tangible or intangible assets from one country into another, for the purpose of generating wealth (UNCTAD 1999 and Moosa 2002). The level of FDI has fluctuated over time, and was high in early 20th century, low in the middle part and growing and high towards the end. Recently there has been a growing trend in FDI to developing countries focusing on their economic wealth, human resource skills and technological competencies. In developing countries, the trend shows that there has been a shift towards liberalization of the FDI regime. It is believed that FDI is regarded as more asset creating and export increasing means for host countries than a couple of decades ago (UNCTAD 2004, Manuela and Toma 2011 and WIR 2012).

Great attentions have been made to improve both national and international investment policies over last two decades by developing countries mainly due to governments realization of crucial role of private investment, including FDI, in fueling economic growth and development. Developing countries, made great efforts in particular, often aided by the international development community through policy frameworks, model treaties, and technical assistance (WIR 2012).

(Manuela and Toma 2011) in their work emphasized that; unrestricted capital flows reduce the risk faced by owners of capital by allowing them to diversify their lending and investment, contribute for benchmarking in corporate governance, accounting rules, and legal traditions, and limits the governments to follow bad policies.

On the reports of strengthening the inflow of FDI in to developing countries different kinds of literature classified FDI according to their objective performance in the host country. The first, 'Horizontal' or market-seeking FDI, which aimed at building the same production lines in the host country for supplying local and/or regional markets focusing on market size, growth prospects, tariffs and transport costs. The second, 'Vertical' or asset-seeking FDI which is export-oriented and aimed relocating some parts of its facility to low-cost locations mainly focusing on available cheap labor force, natural resources or raw materials. The final, Efficiency-seeking FDI mainly arises when the investors benefit from the common governance of

geographically dispersed activities in the presence of economies of scale and scope.

As highlighted by (UNCTAD 2014 and WIR2014), to attract as much FDI as possible a proper investment climate like institutional support and conducive regulatory environment should be on place. According to the report, well-developed investment climate helps both local economy and foreign companies by generating income, creating job opportunity and improving people's life. The continuous inflow of FDI is an indicator of country's economic sustainability and its attractiveness. In this regard, developing countries are in competition to attract more investment by improving investment climates to the best world standard indexes.

Like other developing countries, to attract FDI the government of Ethiopia has taken different measures both in legislation and creation of the necessary support institutions that provide appropriate services and create a conducive environment for industrial development along with devising different incentive schemes. According to the strategic document of 2002, the strategy is centered on the creation of a conducive environment for the private sector as the driving force for economic development. The strategy includes the key role of private-public dialogue and of the continuous and proactive participation of the private sector in the implementation of the strategy. The sectoral focus of the strategy is agro-based industry and thus the interrelationship between agriculture and industry. Labor-intensive industry and technologies, micro and small enterprises and export orientation are core issues. The priority industrial sectors are garment and textiles, meat processing, agro-processing, and leather and leather products, construction industries, micro and small-scale industries and information technology (FDRE 2002, MoFED 2012, 2014).

Leather industry acknowledged as a priority sector among different manufacturing sector by government of Ethiopia, mainly due to the reason that leather industries are a non-capital intensive industry but also to create good employment opportunity since it is a labor intensive light industry. According to Kwabena (2009), most countries regarded this industry as a priority sector based on resource endowment as well as economies of scales.

Currently, China, Brazil, India, Italy, Pakistan, Turkey, and Vietnam are among the global industrial leaders in leather production which are stimulating their economic development and they have stability mainly due to enormous revenues from exportation of various forms of cured raw hides, skins, finished leather and leather products (UNIDO 2002, Taye 2012 and MOI 2014).

The leather industry of Ethiopia bases itself on the country's livestock resources. Indeed, Ethiopia possesses high livestock populations. According to FAO's (2013) report on livestock, Ethiopia is 6th for Cattle, 10th for Sheep and lambs and eighth for Goats. Tanneries process this huge potential livestock raw hides and skins into finished leather and leather products both for the domestic and export market. The export performance of Ethiopian leather industry is bigger compared with other Ethiopian manufacturing sector which followed by Textile and garment industry. With regard to, Export performance of major commodities of the country, the leather and leather products industry contributes and ranked 8th following Gold, Coffee, oil seeds and spices. The total share of the manufacturing sector contribution for export earnings is less than 7 percent out of which around 2.5 percent is a contribution of leather sector export earnings. The major export contributor of the manufacturing sector in Ethiopia is the leather and footwear industries, which contributed 51 percent of the sectoral export earnings for the year 2013/14. The total export of the leather sector reached 98.5 million USD in 2013 which is twice of export value comparing with 2009 which was 49.9 million USD (MoFED 2012, MoFED 2014 and ERCA 2015).

1.2 Statement of the problem

The composition of the Ethiopian economy has changed in favor of service sectors and to some extent the industry over the last decades, the process need to be accelerated to bring about a significant shift in the structure of the economy. Particularly, to set the economy on a rapid process of industrialization, the growth of manufacturing industry has to be accelerated to accommodate the ambitions set by the government in Industrial Development Strategy in 2002. This, in turn, entails promoting investment in the industrial sector, particularly in manufacturing, and enhancing productivity of agriculture to support the process of industrialization and export development (FDRE 2002 and MOI 2014).

The share of manufacturing industry in the economy has been remained the same 4.2 per cent in the past 10 years. Therefore, accelerating the production and productivity of manufacturing is essential to bring about industrialization and economic transformation. According to the Industrial Road Map of the country MOI (2014), in Ethiopia the manufacturing sector continues to be an important economic sector and it is targeted to grow at about 11.2 per cent per annum which is similar to GTP growth rate of base case scenario for next development period, and to contribute about 17 percent of GDP by 2025.

With regards to manufactured export MoFED (2014) reported that, the manufacturing share of total exports were 9.16per cent. This indicates the low contribution of manufacturing sector for the export earnings of the country. According to the report the main reasons for the weak performance of export earnings is generally attributed to inadequate supply of the required quantity, quality, and type of export products, lack of appropriate experts and market problems.

According to reports from government inadequate supply of export products is associated with low level of productivity and low level of investment in the manufacturing sector. Therefore, to fill these gaps, the attraction of FDI, especially export-oriented FDI has been one of the main economic policy goals for the government. The policy goals were backed by incentives for attracting this type of investment. The exports for developing countries like Ethiopia are a means that helps to generate the foreign exchange needed to finance the import of capital goods like machineries and services like experts (FDRE 2002, Zenegnaw 2010, Sharma & Khurana 2013, MoFED 2014 and MOI 2014).

The comparative advantage of most of developing countries still depends traditionally on primary commodities and unskilled labor-intensive manufactures. Transformation from primary and labor- intensive exports into higher value-added items requires greater inputs of skill and technology. The main way for developing countries like Ethiopia can attain by attracting FDI into export activities and upgrading these activities over time. The Government of Ethiopia since transition period of 1991 saw FDI as a potential source of finance, capital, technology, market access (foreign), employment, skills, and other benefits, which could solve the problems of the shortfall in national savings, investments, exports, and unemployment (FDRE 2002).

Zenegnaw (2010), argued that FDI would also help host countries in the expansion of production and trade and increase opportunities to enhance the benefits that could be drawn from greater integration with the international market. Taking this fact, the Industrial strategy of Ethiopia published in 2002 accepted FDI and export-oriented industrialization as an engine of growth (FDRE 2002).

Ana, Jana, Jasna (2013) strengthened these ideas indicating that FDI can promote exports of the host countries by enhancing the productivity and productive capacity by capital accumulation, technology transfer, managerial skill development, and marketing channel creation. They specifically stressed the importance of FDI for export development. According to different

literature, FDI firms have a comparative advantage in their knowledge of international markets, technology, market information, distribution channels, and changing pattern and dynamics of international markets than do local firms (FDRE 2002, Weishi 2008, Zenegnaw 2010 and Gaurav 2011 and).

As reviewed in the above paragraphs, FDI is a major channel by which developing countries can develop their international market by exporting manufactured product through FDI firms, creating a market linkage, strengthening backward and forward integration, and learn managerial and marketing skills of FDI by local firms. In this regards the role of FDI in leather sector in general and the role FDI played in export growth of leather and leather products in particular have not been explored, and published literatures on this topic, to date, is fragmented or not exist. However, there is no detail study on export marketing aspects of the role of FDI in the leather sector. Thus, it is important that the continuum of the role of FDI in export growth of leather sector be examined.

1.3 Research questions

The research questions that will be addressed by this study are:

1. To what extent FDI is more important in determining the exports performance of leather industry in Ethiopia?
2. What are the success factors and barriers influencing export growth in the leather industry?
3. What is the relationship between FDI and exports, and has it changed over time?
4. Why Ethiopian leather industry exports are growing in recent years since 2010?
5. Is there a linkage between and effects from foreign owned to domestic firms in the Ethiopian leather industry?

1.4 Objectives of the study

1.4.1 General objectives

To assess the role of FDI in export growth of leather sector and analyze constraints FDI face and opportunities came through FDI involvement in the study area.

1.4.2 Specific objectives

1. To assess the role of FDI firm's playing in export growth of leather industry in Ethiopia.
2. To analyze opportunities and barriers influencing export growth of the leather industry.
3. To analyze the linkage between and effects from foreign owned to domestic firms in the Ethiopian leather industry

1.5 Significance of the study

This study contributes to the academic as well as policy circles by adding value to the already existing stock of knowledge and will supplement the existing empirical literature on the relationship between export growth and FDI in Ethiopia. The anticipated result of this research is expected to be an input for policy makers, support institutions and core actors in the value chain to act on coordinated and cooperative manners.

Moreover, in the course of the research the researcher acquires a broader understanding and knowledge about the role of FDI in export growth of Ethiopian leather industry which may lead to new problems for further investigation in the future and also it could be a building block for future studies by different scholars.

1.6 Scope of the study

This study is concerned with the role of FDI in export growth of the leather industry of Ethiopia and its contribution for domestic firms. This study aims to further shed light on the influences of FDI industry in Ethiopia. The goals of this paper are to identify the factors, particularly those related to FDI, that determine export growth of leather industry, and to make policy recommendations with regard to facilitating FDI's export spillovers. In this thesis paper, I will conduct a literature survey and an empirical analysis of FDI and export spillovers in the leather industry in Ethiopia. I will use firm-level survey data since 2010.

Analyses will focus on the survey of firms in three categories of export-oriented firms which are leather articles and garment, footwear and tanning industries. The leather articles and garments with footwear industries are representative of a relatively labor-intensive, where there is low capital-labor (K/L) ratio when compared to other industries. Finally, the tanning industry is representative of a capital-intensive industry where there is high capital-labor ratio.

Since most of FDI firms are in Addis Ababa and surrounding towns, the survey focuses only in Addis Ababa city, Mojo town, Sululita town, Bishoftu town, and Dukum town the survey did not include other areas outside of these cities. Therefore, as the study was only conducted on medium and large scale leather industry, the findings may not be generalizable to the Micro and Small Scale firms if exist.

1.7 Challenges and limitations of the study

There were challenges and limitations to undertake this research. Some respondents not willing to fill the questionnaire, some of the firm were very late to return the questionnaire, due to this data collection process of the study takes longer period of time than expected.

Due to time and financial resource unavailability, the study is limited in its depth and coverage to fully address the domestic firm's opinion about importance and challenges of FDI in the leather sector of Ethiopia. Furthermore, Since the leather sector has different stakeholders, inability of collecting relevant information's from these stakeholders, the result of the study may have limitations to make generalizations and make them applicable to overall leather sectors.

1.8 Organization of the study

The rest of paper is organized as follow. Chapter two will give a review of the literature on the motives of FDI and its effects on the host economy with an emphasis on effects of FDI and export expansion. Second chapter's discussion will also encompass FDI in Ethiopia presenting the patterns of FDI in Ethiopia, government policies which have been implemented since the 1991, as well as the trend in policies and FDI in Ethiopia.

Chapter three will focus on the conceptual framework, which includes research design, methodology that followed in this research paper and the study area description are presented. Chapter four will focus on the empirical analysis of the research. The empirical results, implications, and discussions on collected data will be explained in this chapter. Finally, chapter five concludes the research project with the summary of the findings as well as the recommendations.

CHAPTER 2: REVIEW OF THEORETICAL AND EMPIRICAL LITERATURE

2.1 Introduction

This chapter provides a brief summary of existing theories and empirical evidences on foreign direct investment (FDI). Section 2.2 presents a review of theoretical literatures which includes a brief definition and an overview of the classifications of FDI. The motives of FDI to invest also will be presented in this section. The effects of FDI in host countries economy will also summarized in the theoretical review of the literature. 2.3 presents an empirical evidence of the literatures that experienced by different countries, regions and industries. As this research focuses on the case of Ethiopia, the discussions in empirical literatures gives an emphasis on FDI and export expansion of Ethiopia under different topics.

2.2 Review of theoretical literatures

2.2.1 Definitions and Types of Foreign Direct Investment

UNCTAD (1999 and 2014) defines FDI as, “an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor; the investor’s purpose being to have an effective voice in the management of the enterprise”. According to IMF (2007) definition, FDI occurs when a firm invests directly in production or other facilities, over which it has effective control, in a foreign country. It involves the direct control of the capital invested and, more importantly, a movement of factors of production other than capital such as skilled labor, technological knowledge, and management.

Moosa (2002) in his research work explained the distinguishing feature of FDI, comparing with other forms of international investment, according to him the element of control of policy and decision-making are a basic feature of FDI. The term ‘control’ in FDI, as Moosa (2002) defines it, implies that some degree of open decision-making by the investor exist in management policies and strategy. According to the above explanation, FDI differs from portfolio investment in the sense that portfolio investors have no direct control over their investments like FDI firms do. With regard to host country’s investment (domestic investment), FDI also differs that it faces environmental factors that are different from those that are operating in their own country.

Different kinds of literature on FDI discuss and classify in different forms. They classified from the host countries perspective, from the investor’s perspective, from the intention of the investing firm, and from the modes of operation (Caves 1971, Chen and Yang 1999 Chen and Ku 2000, Saggi 2000 and Moosa 2002).

The first perspectives are from the host country perspective that Moosa (2002) categorized FDI into three groups. The first group is that Moosa (2002) refers to as import-substituting FDI. This kind of FDI generally refers to situations in which an economy takes up the production of goods and services that were previously imported. In this case, researchers explained that imports by the host country and exports by the investing country will decline. This kind of investment is likely determined by the size of the host country's market, transportation costs, and trade barriers. The second group from host countries' perspectives are export-increasing FDI. In this group, the investment is motivated by the investing firms' desire to seek new sources of inputs and an intention of using the host country as a base to export their products to the host country's neighboring countries. The last group from host countries' perspectives according to Moosa (2002) is government-initiated FDI that is an investment triggered when a government offers incentives to foreign investors in an attempt to eliminate a balance of payments deficit.

The second perspectives are from the investors' perspective which Caves (1971) explained the types of FDI from an investor's perspective that he categorized into three groups. The first group is that Caves (1971) refers to as horizontal FDI in which the investment undertaken for the purpose of horizontal expansion to produce similar kinds of goods abroad as in the source country. They are motivated by the drive for expansion of the firm and/or is influenced by protective tariffs in foreign markets. This kind of investment is mainly done to exploit and to develop fully monopolistic or oligopolistic advantages. The second group according to Caves (1971) is vertical FDI. In this group, two sub-categories within vertical FDI are backward vertical FDI and forward vertical FDI. Backward vertical FDI is the case where investors try to invest and exploit raw materials. Forward vertical FDI, on the other hand, is undertaken by acquisition of distribution outlets so that the investors could be nearer to the consumers. The last group from an investor's perspective are conglomerating FDI that Caves (1971) involves both horizontal and vertical FDI. A conglomerate FDI is a diversified company whose plants' outputs have traits of both vertically and horizontally integrated investments.

The third perspectives of FDI classification are from an investor's intention which is explained in the works of (Chen and Yang 1999 and Chen, and Ku 2002) as expansionary and defensive FDI. The first group is expansionary FDI in which the FDI seeks to exploit an advantage like research and development (R&D) intensity, profitability, and technology acquisition. This FDI has the advantages of sales growth for home and abroad. The second group from an investor's intention

perspectives is defensive FDI that investors aimed at reducing cost of production by investing in cheap labor force areas.

The fourth classification of FDI based on mode of operation, mainly determined by the FDI's interest to protect their proprietary assets. In this case, factors of production and FDI's proprietary assets transferable and used in many locations at the same time (Markusen and Markus 1999 and Saggi 2000). According to Markusen and Markus (1999) from modes of operation, they categorized in to three groups. The first group is that Markusen and Markus (1999) refers to as licensing FDI. This investment conducted when there is an information asymmetry between the host country and source economy. This performs to reduce the risk of operation by licensing their business to local producers. Through licensing licensees benefit, advanced technology and knowledge from their foreign affiliates and licensees have an upper hand over local firms.

The second group is joint venture in that FDI starts investment to reduce the risks of information asymmetry of the host country, having to pay a higher fixed cost of operation and incorrectly predicting the host country's demand for its products. In this business, FDI firm benefits from the knowledge of the industry, the consumer network and distribution channels in the host market from their affiliates. According to Saggi (2000), domestic affiliates also benefit managerial skills and marketing techniques from FDI firms which make firms operation more efficient and giving an advantage over local firms in the same industry. The last group from investors mood of operation are wholly owned Subsidiary FDI in which an investment will be started when FDI firm fear that their proprietary assets might spillover and get adopted by their domestic affiliates in the foreign market. This is because the value of the FDI proprietary asset might depreciate if other firms adopt similar and/or the same assets.

2.2.2 Basic causes for Foreign Direct Investment

Motives for FDI were the central topic of discussion in much of trade literature in the late 20th century. Owing to the fact that investing firms which engage in FDI must face additional costs due to operating at a distance as well as costs of uncertainty as discussed earlier in the previous section 2.2. Many economists during the period were interested in questions about the main factors influencing decisions to invest in a foreign country.

Caves (1971) points out that the basic causes for an FDI to invest in other country or overseas differ based on forms of investments. According to him, horizontal FDI motivated to expand the firm whereas vertical FDI motivated by the desire for raw materials and control over input sources. According to different literatures, FDI will occur only if the investing firm has the following advantages: ownership advantage, internalization advantage, location advantage, income advantage, cost advantage, product innovation advantage, and growth advantage. Possession of these advantages will enable the foreign investing firm to out-compete other potential suppliers in the domestic market (Vernon 1966, Kindleberger 1970, Caves 1971, Hymer 1976, Melo & Sapir 1991 and Markusen 1995).

The first advantage for occurrence of FDI is ownership advantage. According to Hymer (1976) the basic motivating force to FDI occurrence were ownership advantage. In this case, the investing firm must have a comparative advantage over other firms when conducting FDI because it faced with competition from local producers who are more familiar with the market, the demand conditions, and the consumer group. Mainly due to ownership of proprietary assets rights to a particular technology, monopoly power and size, access to raw materials, and access to cheap financing FDI's have an advantage and operate more successfully than the host economy.

The second advantage that FDI seeks to work in different country are internalization advantage which Hymer (1976) explained that the foreign investing firm also has an internalization advantage that leads the FDI to buy or create a foreign subsidiary rather than license production and/or distribution of a product to a firm in the host country.

The third advantage that FDI look for working or investing in different country rather than in home country is location advantage. In this case the host country in which foreign investors are to engage in FDI must have a location advantage for production, such as low tariff or transport cost barriers to imports or low factor prices, which gives for the firm incentives than service via exports. In particular, FDI firms seek more profitability to use its ownership and internalization advantages (Kindleberger 1970 and Hymer 1976).

The fourth gains FDI seeks to invest in different parts of the world is income advantage in which Hymer (1976) recognize that operating in a foreign country entails additional costs due to operating at a distance as well as costs of uncertainty and misunderstanding. Therefore, for a firm to engage in FDI in a foreign country, it must possess some sort of advantages over existing or potential competitors in the host country. These advantages will allow the foreign investing firms to gain a higher stream of income from a given amount of capital when compared to that of the domestic firms'. This higher stream of income, which foreign direct investors receive, will compensate the investors for the additional costs.

The fifth advantages for the existence of FDI are in search for cost advantage. In this case, the advantages of FDI lie in the form of departures from perfect competition in goods and factor markets— including product differentiation, special marketing skills, superior technology, and economies of scale. Kindleberger (1970) explained that firms would be more likely to engage in FDI over exports if they are already operating at minimum costs at home — additional production for exports would move them into a segment of rising costs. Moreover, lower production costs abroad achieved because of the procurement of cheap raw materials, an efficient transportation network, superior managerial skills, non-marketable technology, and substantial investment in R & D in the host country.

The sixth motivating factor for the occurrence of FDI are product innovation advantage in which Vernon (1966) emphasized product innovation, and the demand conditions abroad, all of which lead to the setting up of the overseas producing capacity of FDI's. He explains that product innovations made in a country with high income and large domestic market. Once the product is developed and there is demand for the product in the overseas market, such demand will lead to export. Furthermore, if the product has a high-income elasticity of demand, the demand will expand rapidly in the growing overseas markets. Once the market expands, the source country's entrepreneurs will be more likely to take the risk of setting up a local producing facility in a foreign country if cost conditions are favorable.

The last causes for the existence of FDI are growth advantage that FDI seek. In this growth

advantage situation, an alternative explanation for the motivation of FDI is the general quest for the growth of the firm. De Melo and Sapir (1991) contends that the motives for FDI can be considered as part of the firm's market strategy in an attempt to improve or defend its position in both foreign and domestic markets. An oligopolistic firm will be motivated to invest in a foreign country if the effort of expansion in the domestic market tends to incite retaliation from other oligopolists. Despite all the additional costs the investing firm has to pay in order to conduct FDI, expansion into a foreign market may turn out to be a less costly means of satisfying the growth motive of the firm.

2.2.3 Impacts of Foreign Direct Investment

The impacts of FDI on both the source and the host countries were seen from different perspectives like socio-political impact and economic impact. The wide-ranging impacts that discussed from economic impact were on the industrial and trade structures, and export performances of the countries involved (UNCTAD 1999 & 2014 and Michael 2011). The discussion of economic impacts of FDI to the host country in this section pertains to the following topics. The first effect, is the impact on income and employment. In this situation, FDI helps to generate employment and income in the host economy. More investments lead to a higher demand for labor. In response to the higher demand for labor, wages will increase, which in turn leads to higher spending power. Increased spending is beneficial to the host economy in the sense that it stimulates other economic activities, and contributes to other economic linkages such as the production of raw materials, improved logistics (ILO 2008, Ali 2011 and Michael 2011).

The second impact is a capital accumulation effect. As literature, shows FDI inflows not only bring in foreign currencies, but also help the host economy accumulate physical capital from movement of factors of production such as capital, machinery, and (skilled) labor from the source country. This will contribute to the increase in the capital stock of the host economy (Ali 2011, Michael 2011 and UNCTAD 2014).

The third impact is on the efficient utilization of resource that host country endowed. With the FDIs' advanced technology and superior knowledge, the entrance of the firms to the host country could promote a more efficient utilization of resources. Furthermore, FDIs could bring about new goods and services, which could introduce new uses of the host country's

resources. More efficient resource extraction, lower levels of waste, and more ways to employ resources are amongst the benefits of FDI (Alper and Teoman 2009, Ali 2011 and Michael 2011).

The fourth impact is through technology and knowledge spillovers. Alper and Teoman (2009) in their work emphasized that despite the FDIs' reluctance to share their technologies and knowledge with their local affiliates, technology, and knowledge transfers could still take place when there is FDI. Technology and knowledge spillovers can take place through direct and indirect training as well as through other channels such as the demonstration effect, labor turnover, and backward linkages. In doing so, the FDIs have to help firms in the upstream and downstream industries generate quality inputs that result in technology and knowledge transfers (UNCTAD 1999 and 2014).

The fifth effect of FDI is on balance of trade and balance of payments effects. When FDIs set up plants in a host country and bring with them large amounts of capital, they have a positive effect on the host country's balance of payments. There are many other ways in which FDI can affect—both positively and negatively—the host country's balance of payments through the country's trade and service balance such as through imports, import-substitution, and exports (Arslan 2005, Alper and Teoman 2009, Michael 2011 and UNCTAD 2014).

The sixth Effects of FDI is on the industrial structure of the host country structure include the introduction of new goods and services, new industrial clusters, structural changes in production and exports, and effects on an industry's competitive edge. If the FDI possesses superior technology and managerial skills, the entrance of the foreign firm may force the local firm out of business (Alper and Teoman 2009 and Michael 2011) .

The seventh and last effects are on consumption pattern of the host country. With the FDIs' investments, more goods and services introduced to the host economy. Although this may provide consumers with more choices—better quality at cheaper prices, it can bring in inappropriate spending habits. For instance, the entrance of fast-food chains into the host country or the introduction of luxury goods to developing host countries may generate unsuitable dietary habits or overspending amongst the people (Arslan 2005, Alper and Teoman 2009 and Michael 2011).

2.2.4 Driving force behind the internationalization process of FDI firm

The internationalization process of FDI firm is a dichotomy between “internal” and “external” drivers. Internal drivers are found inside the company, e.g., in the form of a certain international mentality in the top management - a wish to “conquer the world”. External drivers may be opportunities spotted in foreign markets, e.g., an opportunity to serve new needs, or adverse developments in traditional marketplaces.

In explaining the growth of international production, several strands of economic and business theory assert that this is dependent on the investing firms possessing some kind of unique and sustainable competitive advantage (or set of advantages), relative to that (or those) possessed by their foreign competitors. According to Dunning (1995) foreign production undertaken by FDI is determined by the interaction of three sets of interdependent variables-which, themselves, comprise the components of three sub-paradigms. The first is the competitive advantages of the enterprises seeking to engage in FDI (or increase their existing FDI), which are specific to the ownership of the investing enterprises, i.e. their ownership (O) specific advantages. This sub-paradigm asserts that, *ceteris paribus*, the greater the competitive advantages of the investing firms, relative to those of other firms — and particularly those domiciled in the country in which they are seeking to make their investments- the more they are likely to be able to engage in, or increase, their foreign production. The second is the locational attractions (L) of alternative countries or regions, for undertaking the value adding activities of MNEs. This sub-paradigm avers that the more the immobile, natural or created endowments, which firms need to use jointly with their own competitive advantages, favor a presence in a foreign, rather than a domestic, location, the more firms will choose to augment or exploit their specific advantages by engaging in FDI.

The third sub-paradigm of the OLI tripod offers a framework for evaluating alternative ways in which firms may organize the creation and exploitation of their core competencies, given the locational attractions of different countries or regions. Such modalities range from buying and selling goods and services in the open market, through a variety of inter-firm non-equity agreements, to the integration of intermediate product markets, and an outright purchase of a foreign corporation.

2.3 Empirical Literature

Theoretically, FDI is supposed to foster exports since FDI are likely to be more export oriented than domestic firms. In addition to the spillover effects that arise from the export activities of MNCs, the sunk costs that are involved with the export activities of domestic firms are supposed to fall contributing to the improved export diversification of these firms. When it comes to the empirical evidence there is hardly any consensus. Jayaweera (2009) aims to investigate whether FDI helps low income nations diversify their export base. By constructing a rich panel data set of 29 countries from 1990-2006 and using an instrumental variable technique, the paper investigates the relationship between FDI and export diversification. In this paper diversification is measured by using a count variable for the number of new export lines in each panel, which is a measure of diversification at the extensive margin. The results suggest a positive correlation between FDI and export diversification. The draw-back of this paper is that it only focuses on diversification at the extensive margin. It doesn't address how FDI might bring a restructuring of already exported products, i.e. diversification at the intensive margin. This issue can be addressed by including Herfindahl index as an additional measure of diversification, which is what the present paper aims to do.

Bebczuk and Berrettoni (2006) try to investigate what determines export diversification. Using data for 56 countries ranging from 1962-2002, they employ panel fixed effects estimator and arrive at a conclusion that FDI has no significant impact on export diversification. The paper hypothesizes that the differences in sampling, reference period and econometric specifications might have something to do with it. But these are not the only reasons behind all the confusion, the paper states. They say that heterogeneity in the dependent variable series is not accounted for in the previous studies. Since the studies do not account for the different level of export diversification achieved by the countries in their samples, they do not account for a possible non-linear relationship between FDI and export diversification. To correct this, they utilize parametric (quantile) and semi-parametric econometric methods. The results indicate that an increase in the stock of FDI enhances the horizontal diversification of exports. The actual magnitude of the effects however, is different depending on the existing stock of FDI and stage of diversification achieved.

Ahmadet et al (2004) formulate a VAR system comprised of export, FDI, foreign income, exchange rate and domestic income, to study the effects of FDI on exports and domestic output in Pakistan. Although the study failed to find any evidence that FDI increased export performance, their findings do suggest the presence of an FDI-domestic output growth nexus. Aside from investigating the effects of FDI on export volumes, this paper doesn't look into how FDI affects diversification. Iwamoto and Nabeshima (2012) ask the question "Can FDI promote Export Diversification and

Sophistication of Host countries?” The paper utilizes a dynamic panel model to answer this question. The findings suggest that the five year lagged FDI inflow correlates positively with export diversification. But this result is true only for developing countries. The authors provide two explanations for this. The first one is that firms in developing countries possess capabilities that are less diversified than those of MNCs and hence are more affected by the spill-overs from the MNCs. The second one is that developing countries less diversified export baskets are more likely to be affected by the export activities of MNCs. Again this paper makes no reference of diversification at the extensive margin.

Kamuganga (2012) examines the different determinants of export diversification in Africa. Specifically, the author asks four major questions: How much of Africa’s trade growth can be attributed to export on the new-product new-market margin? What is the effect of intra-African regional trade cooperation? Do learning effects from exporting countries promote export diversification? And what are the other underlying factors that determine the probability that an African exporter will export a new product or export a product to a new market? Using a conditional logit technique and data for African countries from the period 1995-2009, they get three major findings; Intra-regional trade cooperation in Africa leads to diversification, export experience matters and policy and institutions can hinder export diversification. Moreover they find that FDI has a negative effect on export diversification. The different effects that FDI might have on export volume and diversification was studied by Banga (2006). This paper begins by admitting that FDI in India has had no effect on traditional export value. But by using a random effects model, it investigates the differential impact of FDI from the US and Japan on non-traditional exports and the effect of the said FDI sources on domestic firm capability to export. The distinction between US based and Japan Based FDI was necessary because of the differing mode of organization of international production that these two types of companies have. The author claims that US FDI has stronger linkages to domestic firms than Japan FDI which tends to be more vertically integrated with its parent companies. This difference means that the export spillover of FDI could be greater with US FDI than Japan FDI. And the empirical findings of this paper confirm this assertion. There is also evidence that both types of FDI have had no effect on traditional exports, but have had some effect on non-traditional exports, which means India has experienced export diversification with little increase in export value.

Gorg and Greenway (2003), attempt to explain the reason behind the proliferation of conflicting empirical evidence as to the effect of FDI on exports and productivity. They approach the problem from the point of view of spillovers. After reviewing the relevant literature, they advance three

possible reasons for the lack of consensus. First, they argue that MNCs might protect their technology and knowledge about international markets so that they don't spill over to domestic competitors. (I.e. MNCs are not simply going to hand over their competitive advantages). This might stand in the way of horizontal spillovers. Second, they argue that in some cases spillovers do exist but we don't have the technical capability to identify them. Third, they argue that spillovers are not necessarily positive. There could be negative spillovers to domestic firms and the economy in general. And at the aggregate level, these spillovers might cancel out each other and this characteristic may make them invisible. In the end they conclude 22 that the impact of FDI on domestic export diversification may depend on factors like the relative backwardness of the home country, contagion and the absorptive capacity of the home country.

When it comes to COMESA, Ndoricimpa (2009) examines what the effect of FDI is on exports and economic growth. Using a panel of 16 COMESA countries, the author utilizes residual-based panel cointegration tests and heterogeneous panel causality tests. The findings lend support to "FDI-led exports", "Export-led growth" and "FDI-led growth". Still the paper does not investigate the issue of structural diversification of exports. Reviewing these works, one cannot help but notice the limitation in most of them. The limitation is that most of them do not account for the two tier nature of export diversification. These studies either limit themselves to the extensive margin of export diversification or the intensive margin of it. It is the contention of this paper that these two margins should be examined at the same time for each sample. By so doing we can better understand how FDI promotes export diversification; it might be the case that FDI only leads to extensive diversification or only to intensive diversification.

2.4 Evaluation of the literatures in the context of the study

2.4.1 Foreign direct investment and export expansion in LDCs

There is a widely shared view that FDI promotes exports by augmenting domestic capital for exports, helping the transfer of technology and new products for exports, facilitating access to new and large foreign markets and providing training for the local workforce and upgrading technical and management skills. There are a shared view that FDI lower or replace domestic savings and investment, transfer in technologies which are low and/or inappropriate for the host countries. There are also a view of FDI target primarily the host country's domestic and in-fact does not increase exports, inhibit the expansion of indigenous firms that might become exporters; and not help develop the host country's

dynamic comparative advantages by focusing solely on local cheap labor and raw materials (Zhang 2006). Zhang (2006) further suggests that FDI helps exports by investing capital in the exploitation of the host country's comparative advantage. In the case of China, FDIs invest their capital in utilizing and improving the country's low-cost labor.

UNCTAD (2014), similarly, points out that theoretically, the stimulative effects of FDI on exports of the host country derive from the additional capital, technology, and managerial know-how which the FDIs bring with them, along with access to global, regional, and especially home-country markets. Such resources which FDI brings allow the host country to build new export activities as well as improve their performance on existing ones. In a similar way, Zhang and Song (2000) also explained that FDIs help developing country exporters to enter the world markets through special arrangements to provide links to final buyers.

2.4.2 FDI contribution in creating job opportunities

Manufactured exports create greater value addition than the primary products as they go through more stages of processing. The manufacturing sector has greater linkages with the rest of the economy and hence, the downstream effects on exports from these sectors are likely to be greater than primary exports. The commodities entering the trade could also be classified by various other criteria such as value added per unit of output, productivity of labour, capital intensity in production, the strength of backward and forward linkages, etc. The shifts in the commodity composition of trade in these categories would bring out the nature of structural changes concerning income generation, employment effect and overall industrialization through linkage effects, etc...(K.K Ghai 2015).

Job creation is arguably one of the main challenges for developing countries. Broad based improvement in human welfare is difficult to achieve without substantial increase in modern sector employment. Inflows of FDI might increase the competitiveness of the country by combining firm- and country-specific assets. This typically involves combining access to foreign markets and modern technology with a large supply of cheap labor. Such a combination of firm- and country-specific assets with product and labor market conditions in the host country has frequently improved and expanded existing industries, introduced

production in new industries, and changed the comparative advantage of the host country (Lipsey 2004 and 2006).

Table 1: FDI contribution in job creation

Description	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Total employment	7,137	8,412	11,403	11,591	13,070	17,764	18,357
FDI contribution	2,586	3,210	4,463	4,538	6,155	10,243	11,124
Share (per cent)	36	38	39	39	47	58	61

Source: LIDI (2017)

As we can see from Table 1 above, the total employment in leather industry grew in more than double since 2010. The table depicts, the workers in leather industry in 2010 were 7,137, the shares of FDI were 36 per cent of all job creation by leather industry. The amount of job created in the past 7 years were more than 11,220 this employment opportunity. As clearly shown in Table 9 FDI contribution grow from 36per cent in 2010 to 61per cent of employment creation in 2016. This clearly signify FDI's role in addition to introducing new industries and establishing new firms in the host country, inflows of FDI might increase employment through establishing linkages with domestic industries. Foreign firms may purchase inputs of goods and services from domestic firms. It is also possible that FDI can introduce new and better quality inputs to be used in the production of upstream domestic firms, making them more competitive and enable them to expand production and employment.

CHAPTER 3

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

In this chapter, I discuss the research design and methodology and elaborate on the research approach, methods of data collection, sampling, and analyses of FDI firms. The chapter is organized as follows: the research approach presented in section 3.2, which discusses the approaches that I follow in the analysis of the data. Source and methods of data collection described in section 3.3. In section 3.4 sampling that is sample frame, sampling technique and sample size are described. In the last section, section 3.5 methods of data analysis presented.

3.2 Research approach

To fulfill the objectives of the study, the researcher used qualitative methods. The research question that can be informed by qualitative approach develop rich insight in to various phenomena of interest that can be fully understood. The qualitative method helps the researcher to see the research area in depth from different angles. In this case, the study wishes to examine the role of FDI for export growth since 2010. Thus, using a qualitative approach offered an opportunity to look up every situation of FDI firms in exporting leather and leather products.

3.3 Source and methods of data collection

To analyze and investigate empirically the role of FDI on export growth of leather industry of Ethiopia, the study uses primary as well as secondary data sources. The data for this study is largely collected through the survey of FDI firms in the leather industry.

The instruments engaged in order to collect primary data is structured questionnaires and personal interviews. In addition, secondary data also was collected from profiles of the footwear industries, documents, existing literature derived from relevant books, articles and journals; reports and assessments of LIDI, FIC, MoI and Data from previously worked researches.

In order to assess the sample firms closed ended structured questionnaire was distributed to the respondents due to inexpensiveness' and easy administration. The way of presentation of the structured questionnaires will be using exactly the same wording and in the same order to ensure all respondents reply to the same set of questions. The type of questions either closed (choice) or open (inviting free response). There is also a room for the respondent's suggestion, comment and additional data, which will enrich the research.

a) Questionnaire

Questionnaires are the main tools in collecting data. The structured questionnaires are directed to General Manager, marketing and finance managers of the industries since they are the one who directly relate and have the knowledge about the role of FDI and its contribution in export business. That is, 60 questionnaires were distributed to the 15 firms.

b) Interview

The interview guide was designed to allow flexibility and to generate responses and issues for further probing and clarification. Conducting key informant interview is a loosely structured qualitative in-depth interview with people who was considered particularly knowledgeable about the topic of interest. In this research, key informants were selected from the factories and Leather Industry Development Institute (LIDI).

c) Secondary Data

The secondary sources of data that the researcher will use Journals, Articles, reports and assessments of LIDI, FIC and Data from previously worked researches. This can also help to interpret the primary data. For this purpose, journals, conference proceedings, government reports, and books will be tapped that are related to the nature of the problem. Due to this, the data set has been collected from the databank of World Bank, FIC, ITC, UNCTAD, MoFED, CSA, National Bank of Ethiopia, Ethiopian Leather Industry Development Institute and ERCA.

3.4 Sampling

The purpose of this study is to explore the role of FDI for export growth Ethiopian leather industry, a relatively a young research domain. The sample of leather industry enterprises includes those who have potential to receive technology and knowhow and give the same for the sector (above 2 years of operation in the sector). The study population includes all medium and large scale foreign owned enterprise that was involved specifically in leather industry.

In the literature, firms have been operating in the form of cottage industry, small scale industry, medium and large scale industry, either based on machine they use, sales turnover, capital outlay, or number of persons employed. In Africa, according to Oyeyinka (1997), firms employing less than 10 persons are considered to be micro enterprise, firms employing 10-49 persons are usually considered to be small scale, 50-199 persons' medium scale and firms employing 200 and more persons are considered to be large scale firms. According to CSA (2013) firms employing 10 persons and above and use machine driven operation as medium and large scale enterprises and

those who employ less than 10 as cottage or small scale industries but don not have restrictions on how much employee they employ if they do not use power driven machineries.

Due to this the researcher surveys all medium and large scale industries solely based on the definitions given by CSA. The survey for this study employs a census, mainly due to the firms located in surrounding area of Addis Ababa and the number is not more than 15 Firms. This gives a freedom to the researcher in terms of numbers of issues that could be investigated, like cases, which are different, extreme or unusual. This sampling helps to understand in-depth the topic under study instead of generalizing.

3.5 Methods of data analysis

After primary and secondary data are collected, they are analyzed in accordance with the objective of the research. To analyze the data collected using questionnaire from the companies, descriptive analysis which represent and interpret the Data using tables is also made in order to display the collected data in a concise and meaningful way, percentage to show the respondents position towards the role of FDI in export growth of Ethiopian leather sector.

This study tries to see the role of FDI on export growth of leather industry. This needs describing important success factors and barriers as well as investigation on the relationships of the FDI and export. Due to the above reasons the study will use descriptive approach. This will help to describe important demographic features, the benefits of the existence of FDI, and success factors and problems associated with FDI and will help to analyze using frequency, percentage, tabulation and graphs.

CHAPTER 4 DATA PRESENTATION AND ANALYSIS

4.1 Introduction

In this part of the thesis, the data collected from primary and secondary sources presented, analyzed and interpreted. The chapter is divided in to five main parts. The first part deals with the analysis of basic characteristics of respondents and firms. The second part deals with the analysis of FDI experience in Ethiopia. Third part deal with Ethiopia's Trade and Export Structures. The fourth part focuses on overview of Ethiopia's Leather Sector Finally, linkage effect of FDI firms are analyzed and interpreted. In order to analyze the role of FDI on the export growth of leather sector in Ethiopian, the researcher conducted descriptive analysis using tabulation and percentage.

4.2 Characteristics of the respondents and firms

The focus of this part is to present a background profile of the leather and footwear enterprises contacted during the data collection process. The type of ownership, legal status and sub-sectors approached also described. Moreover, the respondent's job title and educational background analyzed by using percentage and tables

4.2.1 Characteristics of the respondents

The questionnaire designed to fill by managers, marketing departments and finance departments of the firm that directly or indirectly participated in decision-making. The results as indicated in Table 1, most of the respondents were General Manager of the firm followed by Sales Managers of the firm, which were 40per cent and 34per cent, respectively.

Table 2: Job Title and Educational levels of the respondents

Characteristics of the respondent	No. of response	percent
Job title		
General Manager	19	40
Finance Manager	12	26
Marketing & Sales Manager	16	34
Total	47	100
Educational level		
Degree and above	32	68
Diploma and below	15	32
Total	47	100

Source: own survey (2017)

The researcher has tried to assess the educational background of the respondents. The data on Table 2 show that 68per cent of the respondents had first degree and above and the remaining 32per cent of the respondents were diploma holders and below that. This shows that most of the firms are managed by educated personnel and gives an appetite to decide on what technology to adopt, which market to enter, with which FDI firm work with and decide to export or not. This helps for export decision and educated managers may communicate with foreign customers and adapt easily FDI technologies than non-educated.

4.2.2 Characteristics of the firms

Three sub-sectors, which considered as more export-oriented industries, taken for investigation in this study as a sample; these sub-sectors of the leather sector were tanning sub-industries that are more capital and chemical intensive industry, footwear and leather articles which are a labor-intensive industry. The results of Table 3 indicate, 47per cent of the firms from tanning sub-sector, 40per cent of the firms were from footwear sub-sector and the rest 13per cent were leather articles. In all areas, FDI enters due to comparative advantages the country possesses.

Table 3: Sub-sector, legal status and ownership of firms

Characteristics of the firm	No. of firms	percent
Sub-sector		
Tanning sub-sector	7	47
Footwear manufacturing Sub-sector	6	40
Leather articles	2	13
Total	15	100
Firm type		
Sole proprietorship	-	-
Private limited Company	12	86
Share company	2	14
partnership	-	-
cooperative	-	-
others	-	-
Total	14	100
Country of origin		
China	5	33
India	3	20
Taiwan	1	7
Italy	1	7
Britain	3	20
Joint venture (China-Italy)	2	13
Total	15	100

Source: own survey (2017)

As Table 3 indicates, almost 86per cent of the firms were private limited company, and the remaining 14per cent of the firms were share companies. This indicates that. The legal establishments of the majority of the firm in this study were private limited company.

The type of ownership and country of origin plays an important role in influencing a firm's decision to participate in export market. As discussed in chapter 2, foreign affiliates have access to the source firms' global distribution networks as well as the advanced technology that the source firm possesses. Due to this fact, the researcher takes foreign firms for the study. The result on Table 2 indicates 37per cent of the firms were Chinese firms, Britain and Inia share 20per cent each and the remaining were come from Italy, Taiwan and joint venture of China and Italy. This signifies, FDI inflow comes from developed countries, it is more likely that it is regular FDI and seeks cheap labor in the host country with the objective of reducing the cost of production.

4.3 Foreign Direct Investment Experience in Ethiopia

4.3.1 Patterns of FDI in Ethiopia

The total net inflow of FDI was registered a total capital of 3.59 million USD in the past three years of GTP1 (MoFED 2014). On the other hand, according to FIC (2015) in the past three GTP1 years, 2,164 foreign investors with a total capital of birr 187.3 billion got investment license to invest across all regions of the country. Of these, 133 projects with total capital of birr 21.5 billion were under establishment while the remaining 637 projects with total capital of birr 28.3 billion have started operation. These projects reported to have created new job opportunities for 26 thousand permanent and 35 thousand temporary employees (FIC 2015 and MOI 2014).

Sectoral distribution of the licensed foreign direct investments indicates, 423 (19.5 percent) projects registered to engage in agriculture and related activities, while, 888 (41 percent) projects registered to produce manufacturing products and the remaining 855 (40 percent) projects licensed to engage in agriculture. The fact that 41 percent and 40 percent of foreign investors are registered to invest in manufacturing and service sectors respectively in stark contrast with the intentions of domestic investors where 76 percent of them are licensed to operate in the service sector (FIC 2015 and MOI 2014).

Investors from Peoples Republic of China constitute for the highest number of foreign investors investing on 322 projects followed by investors from Sudan and India who have acquired licenses to invest on 310 and 180 projects respectively. Turkey and Ethiopian Diaspora from USA took the 4th and 5th place through investing on 98 and 81 projects, respectively. However, with regard to the amount of capital invested in the economy, Turkey, India, Sudan, Peoples Republic of China, Saudi Arabia and Joint investment by

Ethiopian and Saudi Arabia constitute the top five investors in that order (MOI, 2014, MoFED 2014, FIC 2015).

4.3.2 Policies on FDI in Ethiopia

According to FDRE (2002), industrial development strategy should accept and put into practice the idea that the private capitalist should be the engine of industrial development. In this regard, it is possible to use the foreign capitalist as the engine or his domestic counterpart as the sole engine. It is also possible to combine the two development forces in various forms and at different levels. According to the industrial strategic document of Ethiopia, the strengths of the foreign capitalist include possession of high capital accumulation, worldwide marketing networks, advanced technology and modern management. All of these possessions are what absolutely the country lack and can be exploited to enhance industrial development.

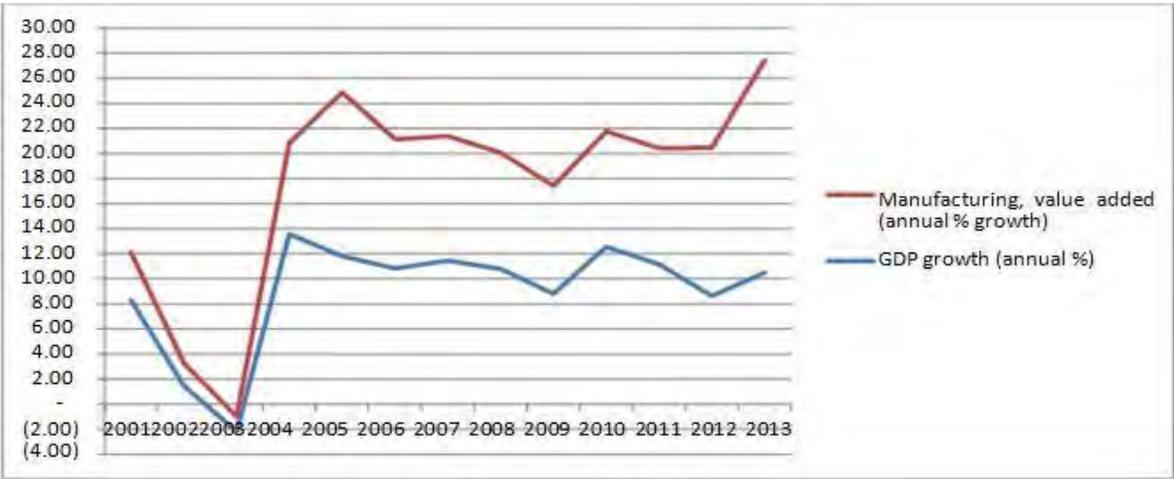
As pointed in different strategic documents and other literature a domestic capitalist has a high capital shortage, at least in the short-run. He has also difficulties in entering the foreign market since he lacks worldwide marketing networks. He faces problems in competing and increasing productivity since his management capability is limited (MOI 2014). According to different strategic documents and policies, although the domestic capitalist should be the main capitalist, this cannot insure rapid industrial development using only this resource. As a result, the policy must focus to attract as much foreign investment as possible that will contribute positively to the development. According to MOI (2014) to attract more FDI creating a conducive investment climate and investment guarantee are a major activity that expected from Ethiopian government. This is mainly due to the reason that FDI needs investment support to produce goods and services that fulfill international buyer's requirement with competitive prices. Literatures shows that the strategic focus of Ethiopian government on FDI are primarily to create a marketing network, transferring technical skill and upgrading management capacity of local firms through linkage effects (FDRE 2002, MoFED 2014, MOI 2014 and Arkebe 2015).

4.3.3 FDI and Export performance in Ethiopia

Foreign investment has considerable significance in financing development in Ethiopia, not only in the manufacturing but also in the primary and tertiary sectors. Before 1991 the few manufacturing industries established, were mainly for basic processing of agricultural exports

and the processing of food for the local market. After 1991 (post Derg), FDI within the manufacturing sector increased significantly partly due to a government policy, which restricted it from the traditional agricultural sector and service sector. The growth in FDI participation happened within an import substitution environment implemented since early 2000s. The government used a combination of tariffs and quotas supplemented by foreign allocation measures such as overvaluing exchange rates to maintain import costs low and favorable credit and interest rate policies intended to subsidize the manufacturing of consumer goods (FDRE 2002, MOI 2014 and MoFED 2014).

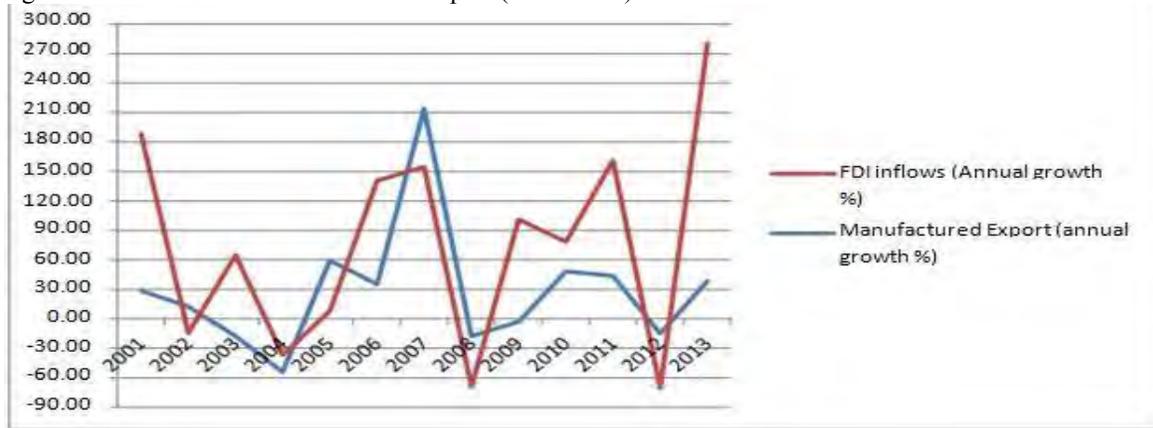
Figure 1: Manufacturing value added and GDP growth of Ethiopia (2001-2013)



Source: World Development Indicators (2014)

According to figure 1 above, the GDP growth shows stagnant growth trend from 2004-2014 which are around 10 per cent on average. As we can see from the figure 1 manufacturing value added grew on average by more than 15 percent per annum in the same period. The reasons for growing of manufactured value add related with an increase in inflow of FDI investments in different sectors of the economy. The main participant countries for investment in Ethiopia were China, India and Turkey (MOI 2014 and Arkebe 2015)

Figure 2: FDI inflow and manufactured export (2001-2014)



Source: World Development Indicators (2014)

According to figure 2, it is important to note that manufactured exports shows a fluctuating trends since 2001 with a sharp increase in 2007 registering more than 213per cent and later falling in 2008 less than -7per cent. This attributed to the effects of the global market fluctuation and global financial crisis. Foreign owned firms in Ethiopia since the 2000s have invested in a wide range of sectors. Most notably, they have played a major role in floriculture and horticulture, with close to 70 percent of flowers controlled by foreign affiliates (Arkebe 2015). In the manufacturing sector, FDI has concentrated on the textile, leather, metal and metal products, and Beverages industries. The reason for inflow of the FDI in Ethiopian leather industry was mainly to get access to US market through AGOA agreement provided to the African countries by US government (UNCTAD 2014, FIC 2015).

4.4 Ethiopia's Trade and Export Structures

4.4.1 Trade Structure

According to MoFED (2014) in the early 1990 to late 2000, agricultural products accounted for the bulk of Ethiopia's exports. Manufactured products in this period mostly directed to local consumers and exports from the manufacturing sector were modest. Most of the manufacturing products were semi-processed leather and textile products. Since the 2000s, however, the manufacturing sector in Ethiopia has pushed by the government to more export-oriented and has been contributing a little bit shares to the country's exports but the progress is better than previous semi-finished agricultural products. FDI's setting up of manufacturing plants brought technology and knowledge spillover, market linkage, and an increasing foreign currency through export of manufactured products particularly in leather and textile industries (MoFED 2014).

According to FIC (2015) the dominant FDI in leather and textile industry were from India, Turkey and China, which make up more than 80per cent of the total FDI in the manufacturing sector.

The Ethiopian manufacturing sector relies heavily on imported materials. Products serving the domestic and the exporting markets both have high import contents. Manufactured goods that produced to serve domestic market, which has high import contents, are oil, vegetable oil, pharmaceuticals, iron, steel, rubber, and metal products. Exporting goods that rely on imported raw materials are mainly chemicals and different accessories and components. The structure of Ethiopia's merchandise imports has also increased over the past decades. The share of manufacturing imports has increased contrary to the country's import-substitution policies together with intermediate and capital goods' shares of imports. Capital goods such as machinery and parts (electrical and non-electrical equipment) comprise a larger part of Ethiopia's merchandise imports. Consumer goods, on the same trend, have seen increasing import shares. Sources of Ethiopia's imports are Germany, Italy, Japan, USA, China, Turkey, India and the Middle East (MoFED 2014, ERCA 2014 and Arkebe 2015).

4.4.2 Export Structure

The main recipients of Ethiopia's export commodities were USA, Germany, Italy, Switzerland, India and China. In the late 1990s, exports from Ethiopia to these countries dominated by agricultural products and some mineral ores. It was also during that period that the government initiated import substituting industrialization policies (MoFED 2014).

The structure of Ethiopian exports is different for each region the country exports. Ethiopia's exports to the US dominated by manufactured products, like textile and leather. Ethiopia's exports to the EU a mix of labor-intensive and resource intensive products such as footwear, textile, flowers, precious stones and others. Ethiopia's exports to ASEAN countries are mainly semi-finished industrial products to use as a raw material for consumer goods like finished leather, precious stones, semi-finished textile products, and flower. The export trades to the Middle East and African countries are mainly agricultural products, precious stones and manufactured consumer goods (ERCA 2014).

In short, the 1990s export structure of the country dominated by agricultural goods. Later in the late 1990s to 2000s, the country's trade and export structures shifted from relying on resource-intensive products from the agricultural sector to manufactured goods that are intensive in both resource and labor. As Ethiopia's comparative advantage in cheap labor gets higher, its leading exports have changed the most manufactured products sourcing from local raw materials (MoFED 2000, 2008 & 2014 and MOI 2014).

The export market destinations are the country, to which goods are going in order to be consumed, further processed, or manufactured, as presumed by the shipper at the time of exportation. It is associated with understanding of the linkages among trade, regional comparative advantage and human capital accumulation. FDI is instrumental in bringing goods and services to the global marketplace, and the influx of foreign investment not only displays investor confidence in the business and the geopolitical climate of the host country, such capital links national economies. Exporting is expected to impact upon firm performance; it seems that many of these benefits are more likely for exports to large, highly developed destinations. First, the competitive disciplines imposed upon exporting firms are likely to be more severe when exporting to large, developed markets, as these markets can be expected to have a significant number of local suppliers already and may attract a broader range of suppliers from abroad. At the same time, consumers that are more sophisticated are likely to place greater demands on exporters in terms of product quality and timeliness. Second, opportunities to learn from offshore contacts will be more beneficial the greater the degree of sophistication of those contacts. Finally, in imperfectly competitive markets, firms may be able to charge higher prices to consumers in wealthy countries, leading to higher observed value-added with no change in the underlying efficiency of the firm.

When we see the case of Ethiopia in the market destinations, According to Business review (2014) only four out of the top ten markets for Ethiopia's exports were located in the conventional 'West' (Germany, Switzerland, Netherlands, and US) while the other five countries are in what might be termed as the 'South' (Somalia, China, India, Saudi Arabia, Israel and Japan). Turkey also joined the top ten lists for the first time in 2013 (<http://ethiopianbusinessreview.net>)

In what is probably the start of a longer-term trend, neighboring and regional countries are increasingly among the largest buyers of Ethiopian goods. Somalia and Sudan are both now

individually larger export markets for Ethiopia. It is also striking that countries with very low per capita incomes and highly unsettled domestic political environments (Sudan and Somalia) are now larger markets for Ethiopia's exports than world's richest and most stable countries.

4.5 Ethiopia's Leather Sector Overview and the FDI

4.5.1 Ethiopia's Overall Investment Trends and Approved Projects

Looking at the investment licensing profiles of the Ethiopian Investment commission and Regional Investment Offices, a total of 26,900 investment projects involving Birr 620.6 billion ETB in capital were licensed during 2009/10-2016. Of these projects, 3,850 (or 14 percent) were foreign firms. In terms of investment capital ETB 248.34 Billion was attributed to foreign investors.

Table 4: Number, Capital (million ETB) and expected job creation of approved projects since 2010

Year	FDI			Total investment			Percentage Share of FDI (per cent)		
	Quantity	Capital	Job creation	Quantity	Capital	Job creation	Quantity	Capital	Job creation
2009/10	1,413	55,169	247,855	6,496	96,415	712,963	22	57	35
2010/11	952	53,355	194,932	6,322	249,469	814,095	15	21	24
2011/12	604	83,975	163,475	5,649	146,168	523,057	11	57	31
2012/13	722	49,485	196,113	7,011	112,072	381,589	10	44	51
2013/14	34	2,508	2,372	163	5,636	10,361	21	45	23
2014/15	45	2,605	8,987	407	4,135	21,732	11	63	41
2015/16	80	1,245	10,572	852	6,709	25,434	9	19	42
Total	3,850	248,342	824,306	26,900	620,604	2,489,231	14	40	33

Source: Annual Report of National Bank of Ethiopia (2011-2017)

Investment has tended to fluctuate both in capital and quantities of approved projects. In 2009/10 alone, a total of 1,413 foreign investment projects involving capital outlay of ETB 55.2 billion were approved, the highest number in a single year in 7 consecutive years. Globalization opens up opportunities for the inflow of Foreign Direct Investment (FDI) and thus for employment opportunities domestically. In this regard, the foreign investment projects approved during the review fiscal year, when implemented, are expected to create job opportunities for 824,306 permanent and temporary workers.

4.5.2 Leather sector investment overview

The leather and leather products industries comprise both capital-intensive and labor-intensive sectors. This is because the two industries have high-technology components as well as a large degree of manual checks and machine operation. In this case, leather tanning is categorized as a capital-intensive and chemical intensive (more advanced technology component) while

leather products industry like footwear manufacturing is labor-intensive due to mainly manual checks and light machineries involvement (FDRE 2002, MOI 2014 and Arkebe 2015). The FDI involvement in the leather sector plays an important role in both labor-intensive and capital-intensive industries in the areas of technology transfer and human resource development.

Table 5: Percentage Share of FDI inflow in Leather sector from 2010 -2016 G.C

Description	from Manufacturing	from Total inflow	Manufacturing from total inflow	Total FDI inflow
Capital in (Million ETB)	1.81	1.45	80.36	248,342
Employment opportunity	18	11	61.38	824,306
Number of Projects	4.54	2.22	48.84	3,850

Source: Federal Investment Commission (2010-2016)

FDI has played an important role in the development of the leather industry in Ethiopia since the 2000s. Foreign firms provided capital, technology, and management. At the early stages of Ethiopia's export oriented era (late 1990s and early 2000s), many FDIs established their plants in the leather and leather products industries in Ethiopia. It was also during this period that Ethiopia saw its leather and leather products industries gain competitiveness and an expansion in exports (MOI 2014). The leather and leather products industries also saw a prolonged spell of growth in value addition. As we can see from the Table 4 above, the percentage share of leather sector FDI inflow both from manufacturing and total FDI inflow to the country were 4.54per cent and 2.22per cent respectively. With regard to employment creation, the leather sector has 18per cent and 11per cent from FDI inflows to the total manufacturing sector and all FDI inflows to the country respectively. The above analysis shows there is a job creation tendency in leather sector. Since the leather sector is categorized in the light industry category and labor intensive industry the employment creation opportunities is very high. As shown on the table, there existence of labor intensity in leather and leather products industries (MoFED 2014, Arkebe 2015 and FIC 2015).

4.5.3 Analysis of FDI's role on Export of Ethiopian leather industry

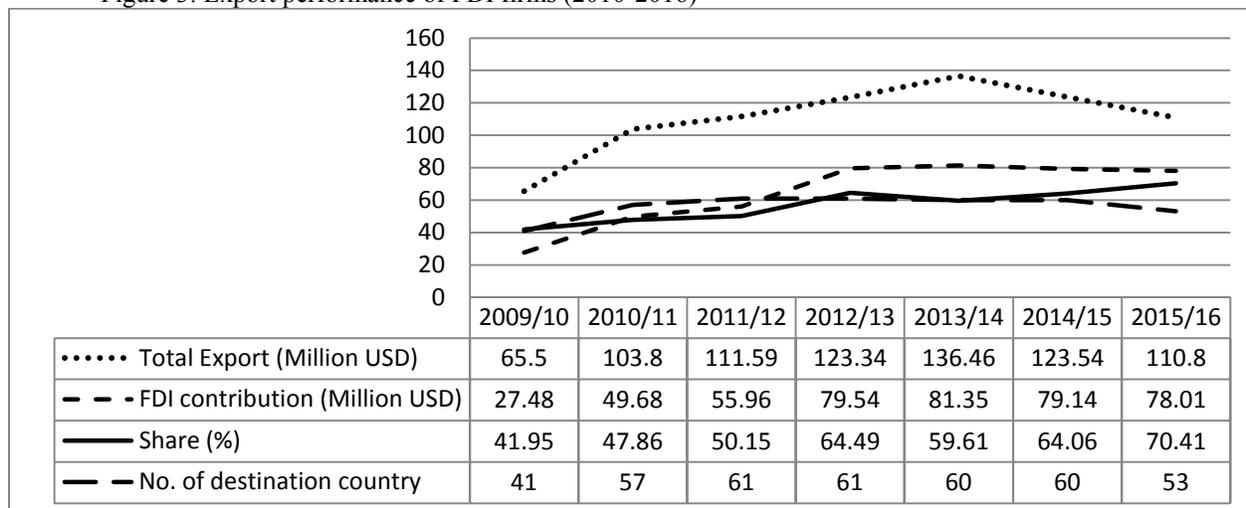
Ethiopia offers a wide range of processed and semi-processed hides and skins to the world market. Some of the products, such as Ethiopian highland sheepskin (which has gained international reputation for making gloves), are known for their quality and natural characteristics. The export of finished leather and leather products (such as leather garments, foot wear, gloves, bags and other leather articles) is also highly promising.

In this section, we discuss that large inflows of FDI into the Ethiopian leather industry in the 2000s resulted in strong productivity effects especially in value addition in hides and skins tanning, footwear production and leather articles. In the meantime, the government tried to benchmark and hired foreign expatriates in order to transform the leather sector towards export orientation but the result is not as expected (Arkebe 2015). In the process, the most capable domestic suppliers were taken-over by foreign firms as a management contract in order to grasp technology. At the same time, leather-supporting institutions established and staffed in plan for achieving new standards.

4.5.3.1 Export trend of leather and leather products, by Value

According to Industrial policy of Ethiopia, a well-planned export-led growth strategy can stimulate economic activities, induce more efficient resource allocation, generating income and employment, and thus better quality of life outcomes for the country (FDRE 2002). There is a strong and natural link between FDI and export-driven economic growth. FDI firms have a key role in channeling products from host countries to the international markets through their global distribution networks. FDI firms, therefore, are considered amongst the important ingredients in an economy's exporting success. The Ethiopian leather industry was among priority sectors of the government that believed to attract more FDI and contribute for export earning of the country through value addition, product diversification and market expansion.

Figure 3: Export performance of FDI firms (2010-2016)



Source: Own Survey (2017), and LIDI (2017)

As we observe from the above graph the share of FDI-invested firms in the total industrial output and exports have been increasing from 27.48 Million USD (42 per cent share) to 78.01 Million USD (70.4 per cent share) in the past 7 years, and this implies that domestic firms' shares were decreasing. So compared with domestic firms, FDI-invested firms have become more productive and export-oriented. This could happen if FDI-invested firms have technological superiority and more knowledge of export markets and have existing customers (buyers).

4.5.3.2 Export trend of leather and leather products, by Volume

Export volume in leather industry relates to the size of leather supply in quantity to the international market. The trends in the volume of export trade over time help to identify the basic forces that may be operating at different periods in the leather industry. The export growth of leather industry in both volume and value of exports in the world trade indicates the importance of the country as a nation in the world leather and leather product supplies. It reflects the market thrust that the country is able to realize in the presence of the various competitors in the world market.

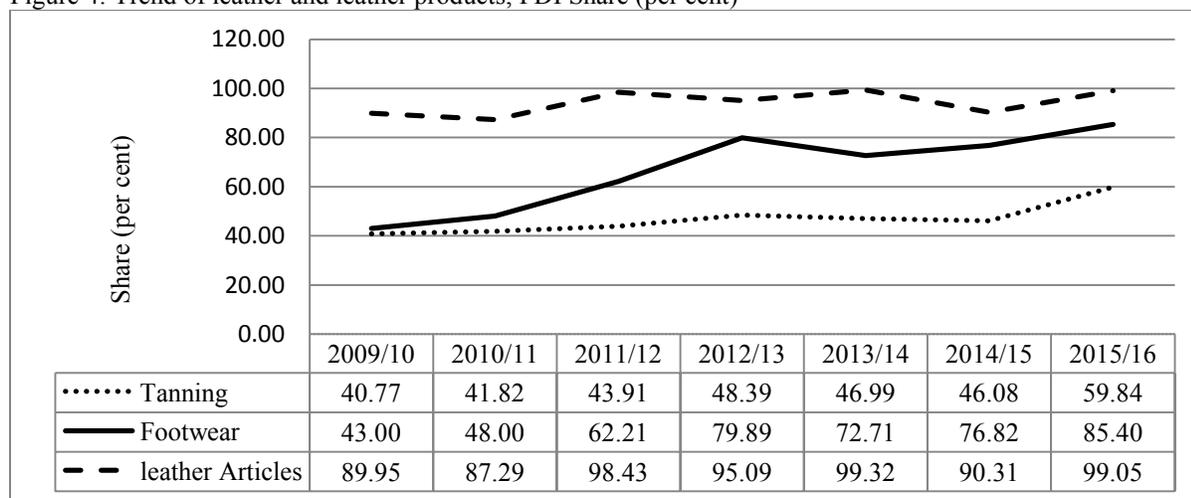
Table 6: Trend of leather and leather products, by Volume (Millions)

Industry	Description	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Tanning	Export volume (Sq.Ft)	67.15	67.24	68	61.75	67.87	66	62.82
	FDI contribution (Sq.Ft)	27.38	28.12	29.9	29.88	31.89	30.24	37.59
Footwear	Export volume (Pairs)	0.6	0.68	0.86	1.33	1.98	2.67	2.91
	FDI contribution (Pairs)	0.3	0.33	0.54	1.07	1.44	2.05	2.48
leather	Export volume (Kg)	0.14	0.22	0.47	0.56	0.17	0.12	1.41
Articles	FDI contribution (Kg)	0.13	0.19	0.46	0.54	0.16	0.11	1.38

Source: Own Survey (2017), LIDI (2017)

Data in Table 5 shows export volumes of each leather industry sub-sectors. It is indicative of the structure and level of development of leather industries. For instance, most of the developing countries depend for their export earnings on a few primary commodities. These countries export raw materials of for further processing thus, denying themselves the benefits of value added. According to the above table in 2009/110 alone Ethiopia exports 67.15 million Square Feet of finished leather which will be used for further processing or manufacturing of leather articles in the destination countries. The export trend in finished leather declining through time mainly due to more value addition in leather articles and product diversifications in to footwear, leather bags, luggage's, belts, garments, gloves, etc... This is mainly, as an industry develops, its trade gets diversified. It no more remains dependent on a few primary commodities for its export as it begins to export more of manufactured industrial goods like footwear and other leather articles importing industrial raw materials, capital equipment and technical knowledge.

Figure 4: Trend of leather and leather products, FDI Share (per cent)



Source: Own Survey (2017), and LIDI (2017)

The data on Figure 4, clearly depicts, the growth in value added product exports of footwear and leather articles, which mainly targeted for end users/not requires further processing/manufacturing. The export volume of footwear industry growth showed more than double in export volume since 2010. The role of FDI firms in this industry stronger comparing with the volume of exports, which was 43per cent of contribution in 2010 but currently it contributes more than 85per cent export volume of the total footwear industry export. Export of leather articles, mainly dominated by FDI firms and contributes more than 90per cent of export volume since 2010.

4.5.3.3 Export trend of leather and leather products, in unit value

The unit value of a commodity item is the average value obtained by dividing its total value by its corresponding quantity. Unit values are subject to the effect of changes over time in quality, product mix and markets or sources of supply for a commodity item in addition to pure price changes. The unit value provides information on the trends in export unit values that are weighted with quantities of the current reference period. The calculation of unit value indices of commodities in exports covers transactions reported by foreign firms in Ethiopian leather sector. The results are used to compile export unit value, which are a measure of changes in export prices of locally produced leather products.

Table 7: Unit Value of leather and leather products export

Description	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Overall industry							
Tanning (US\$/Sq.Ft)	1.35	1.42	1.48	1.71	1.58	1.40	1.16
Footwear (US\$/Prs)	11.49	11.29	11.50	12.65	12.48	11.13	10.42
Leather articles (US\$/Kg)	26.15	27.05	28.09	22.62	25.85	27.54	29.26
FDI Firms							
Tanning (US\$/Sq.Ft)	1.38	1.48	1.65	1.99	1.83	1.51	1.15
Footwear (US\$/Prs)	10.05	10.61	10.67	12.23	13.06	11.80	10.81
Leather articles (US\$/Kg)	26.28	28.21	28.09	21.21	25.41	29.00	28.04

Source: Own Survey (2017), and LIDI (2017)

As we can see from Table 7, the unit value of exported leather and leather products of Ethiopian leather industry shows a fluctuating trend over the past 7 years. Since FDI firms thought to carry advantages in entering world markets, such as established global marketing networks the unit value of export of FDI firms slightly better than overall leather sector export unit value. Except 2015/16, the export unit value of FDI firms in Tanning industry shows a better value than 2009/10.

4.5.3.4 Leather sector Market Diversifications

The direction of the trade is indicative of the structure and level of industrial development. As an industry develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of exports also widened. The country begins to trade with an increasingly large number of countries. Apart from all commodity exports, the country's leather industry has witnessed tremendous growth since 2010, which is mostly due to large-

scale private investment and FDI inflow. The country is exporting raw finished leather as well as luxury leather-made product to more than 61 countries in the past 7 years (2010-2016).

Table 8: Leather sector export destinations (2010-2016) (percentage)

Rank	Country	2010	Country	2012	Country	2014	Country	2016
1	China	31.35	China	45.76	China	41.06	China	46.11
2	UK	18.38	Italy	18.32	USA	17.61	USA	23.48
3	Italy	17.51	USA	9.48	Italy	14.39	Italy	4.85
4	India	15.71	Thailand	5.40	India	5.13	Kenya	4.61
5	Tunisia	6.46	India	3.65	Thailand	4.87	Thailand	3.95
6	Germany	2.73	Germany	3.32	Kenya	4.68	UK	3.57
7	Indonesia	1.64	Indonesia	2.74	UK	2.12	India	3.15
8	Thailand	0.67	UK	2.50	Viet Nam	1.37	Viet Nam	1.77
9	France	0.63	Hungary	1.39	Indonesia	1.20	Indonesia	1.52
10	Turkey	0.53	Turkey	0.95	Germany	1.04	Canada	1.45
	others	4.37	others	6.50	others	6.53	others	5.52
	Total	100.00	Total	100.00	Total	100.00	Total	100.00

Source: Ethiopian Revenue Customs Authority (2017)

As per the data from 2010- 2016 on Table 8, China is the prime export partner of Ethiopia in leather and leather products. It accounts for more than 31.35per cent-46.11per cent of the total export value in the stated period with growing trend. Other major partners like USA, India and Thailand shows a high growth trend in the past 7 years comparing with other export partners of the country. The share of Italy's imports value declining from year to year which means in 2010 it has 17.51per cent but end of 2010 the share from total leather sector import declined to 4.85per cent share.

The interviewed firms respond that the export items exported to China and USA were different within leather sector themselves. The dominant export items to USA market were footwear and leather articles that are mainly for consumer market. In opposite to US import the export to China market was finished leather that is for further production of leather articles and footwear products. According to interviewed respondent, the FDI firms that export to China and India plays as subsidiary supplier for sister company's operating in their home land with similar activities or make some value addition to the products exported from Ethiopia.

4.6 Linkage effect of FDI in the leather sector of Ethiopia

4.6.1 Opportunities and Challenges of FDI firms

Our analysis of Ethiopian leather industry based on detailed firm-level data collected through survey of foreign firms. The survey provided firm-level data about linkages between domestic and FDI firms. The survey from 15 firms, in which foreign firms targeted with same questions, collected with detailed information about linkages and are, therefore, the main source of data for our analysis presented here. A large number of surveyed firms at different positions of the leather value chain yielded a highly representative sample. Therefore, in addition to the

identification of different types of spillovers, our qualitative data allowed us to examine their consequences for technological, organizational and strategic competences of domestic firms and explain why only certain domestic firms have been able to benefit from linkages.

4.6.1.1 Opportunities of FDI firms

Table 9: opportunities of foreign firms

Reasons	No. of responses	(per cent)
Geographic proximity to the market	8	18
Flexibility in raw material sourcing	5	11
Raw material prices advantage	17	38
Transportation costs advantage	5	11
Raw material quality, know-how advantage	7	16
Geographic proximity to the market	3	7
Total	45	100

Source: own survey (2017)

According to survey result, the most important advantages of foreign firms include their raw materials price advantage (38per cent), geographic proximity (18per cent), Raw material quality, know-how advantage (16per cent), transportation cost (11per cent) and flexibility (11per cent).

4.6.1.2 Challenges of FDI firms

Table 10: Challenges of FDI firms

Reasons	No. of responses	(per cent)
Raw material quality problem	27	30
Reliability of material sourcing problem	7	8
Raw material prices disadvantage	5	6
Instability of the market	10	11
Managerial skills problem	17	19
Technology problem	3	3
Financial resources problem	3	3
Low Productivity of work force	17	19
Total	89	100

Source: own survey (2017)

At the same time, the lower quality of their products (16.92per cent), together with their technology (35.38per cent), lower managerial skill (13.85per cent) and less size (12.31per cent) compared to foreign firms considered their most important disadvantages to export. The weakness of domestic firms in product quality, technology usage and managerial skill strongly affect firm's competitiveness in international arena. The existence of those FDI firms helps to copy those technology and managerial skills to improve product quality problems.

4.6.2 Reasons for sourcing supplies from abroad by FDI

Technology transfer from foreign to domestic firms should potentially contribute to process and product upgrading of domestic firms that, over time, reflected in the gradually increasing quality and sophistication of supplied components by domestic firms. In this case, surveyed firms argued as shown on the table below.

Table 11: Reasons for sourcing from abroad by foreign firms (only non-leather inputs)

Reasons	N. of responses	Percent
Centralized sourcing	17	27
Unavailability in Ethiopia	32	50
Low quality in Ethiopia	15	23
Total	64	100

Source: own survey (2017)

According to surveyed firms, the two most important reasons for a low share of supplies sourced from domestic suppliers are the unavailability of particular parts, components and materials in Ethiopia with 54.24 per cent share and the centralized sourcing by foreign lead firms from their home country or sister company abroad. This means that foreign firms have no or very limited influence on where their most important supplies are sourced from. When they have a choice, they choose suppliers that meet their price, quality and quantity requirements. The majority of surveyed managers both from domestic and FDI firms reasoned that whether suppliers were foreign or domestic was not an important selection criterion. Foreign firms working mostly by centralized sourcing and, therefore, have the weakest linkages with domestic firms. In the backward linkage, the surveyed FDI except three, tanneries the government discourages to sell in local markets.

4.6.3 Requirements from domestic suppliers by FDI

Foreign firms typically have specific requirements on domestic suppliers in terms of the quality of supplied parts and components, such as technology audits and quality certificates, before they can start supplying foreign firms. For foreign firms, the basic reason for sourcing supplies from abroad in some context is mainly due to high requirements from international buyers, unavailability in local market and centralized sourcing from their mother company. FDI requirements on domestic suppliers were higher at the beginning of their supplier relationship with domestic firms, especially in terms of quality of supplied materials/inputs. Meeting these requirements increases the productivity and competitiveness of domestic firms, which can be achieved without the direct or indirect transfer of technological knowledge and know-how from foreign firms. Domestic firms thus become more efficient by imitating the process

technologies of foreign firms while, at the same time, lacking innovation capabilities to further exploit, advance or develop these technologies.

Table 12: Basic Requirements expected from domestic suppliers

Requirements	Yes		No		Total	
	No. of responses	percent	No. of responses	percent	No. of responses	percent
High requirements on domestic suppliers in terms of:						
• Quality of materials/components	28	67	14	33	42	100
• Production technology	23	74	8	26	31	100
• Timing of delivery	35	88	5	13	40	100
Domestic suppliers asked to meet specific requests before they could start supplying	26	72	10	28	36	100
Quality certificate	19	53	17	47	36	100
Technology audit	22	61	14	39	36	100
Increase in parts/components quality	17	77	5	23	22	100
New production technologies	10	37	17	63	27	100
New machinery	19	48	21	53	40	100

Source: own survey (2017)

According to Table 12, in 72 per cent of the cases, domestic firms were asked to meet certain requirements in the start-up of business relation with foreign firms, especially to undergo technology audits (61 per cent), new production technology (37 per cent), new machinery (48 per cent) and obtain quality certificates (53 per cent). The basic reasons for low share of domestic suppliers to foreign firms associated with low level of turnover, low value-added and other financial and technology problems in the leather industry. Through time the capacity of quantity supplied by domestic firms to FDI firms are growing mainly due to delay of imported inputs, foreign currency problem and delay in customs clearance. This opened a door for domestic firms indirectly to work with FDI, which in turn increase the chance for productivity improvement, and technology transfer. The requirements asked by FDI are mainly basic requirements of the international market. As the relationship increase with FDI, domestic firms gradually upgrade themselves to these basic requirements, which might help them to enter international market.

4.6.4 Ethiopian based FDI firm qualifications

Firm qualifications for export readiness also needs to fulfill and invest in research and development activities like availability of sample preparation facility and training center by individual firms. Barrios et al. (2003) suggest that research and development expenditure should be included into firms' export requirement. However, firms in developing countries' usually spent on making the production process more efficient rather than for innovation purposes. In other words, for developing countries, research and development expenditure will result in increased firm efficiency. Firms that conduct their own R&D, have sample preparation tools

and training center are better at using and imitating external knowledge than firms without their own R&D, including better abilities to imitate externally available process or product innovations generated by other firms which will help the domestic firms to adopt these practices.

Table 13: Ethiopian based FDI firm qualifications

Facilities/qualifications	No. of firms	percent
Availability of sample preparation facilities		
Yes	8	53
No	7	47
Total	15	100
Availability of R&D facilities (product development)		
Yes	5	36
No	9	64
Total	14	100
Availability of training center		
Yes	5	33
No	10	67
Total	15	100

Source: Own survey (2017)

According to Table 13, FDI firms qualified in terms product development, research and training facilities that would help the factory to produce good quality products which fulfill international buyers requirements. According to surveyed firms, 53per cent of the firms have sample preparation facilities in a separate place which didn't affect the main production line of the firms. The most important ingredient for producing quality product is investing in research and development activities. In this regard, 36per cent of the firms have a good product development center that converts ideas in to product. The majority or 64per cent of FDI firms don't have product development center in Ethiopia. This was directly attributed to the company's intention to invest in Ethiopia main reason could be the main product development center was in the investors home town or sister company abroad and sometimes buyers will bring products developed or existing to make a copy and produce the mass production. According to surveyed firms, 67per cent of firm's do not have a separate training center and facilities.

4.6.5 Effects of FDI entry and operation in the Ethiopian leather sector

According to UNCTAD (2001), generally, higher-tier suppliers are in a better position to advantage from linkages than lower-tier suppliers are and on parallel position, that produces the same products. In the next step, I have collected and analyzed surveys from 15 firms about their linkages with domestic firms.

Table 14: Effects of the entry and operation of FDI

Effects	Yes		No		Total	
	No. of response	percent	No. of response	percent	No. of response	percent
New customers among foreign firms	33	87	5	13	38	100
Bigger competition in the labor market	37	79	10	21	47	100
Increased direct raw materials competition	26	70	11	30	37	100
Declining local market share	5	14	31	86	36	100

Source: own survey (2017)

As illustrated in Table 14, most of surveyed firms reasoned that the entry and operation of FDI have positive effects in Ethiopian leather industry. Increased sales, because of new customers among foreign firms, was prominent positive effect of entry and operation of FDI which cited by 87per cent of firms. The increased competition for employee was treated as negative effect in the views of the firms which cited by 79per cent of surveyed firms. About 70per cent of firms believe that they disadvantaged by product competition.

4.6.6 Importance of FDI in Ethiopian leather sector

In our approach, I tried to investigate direct and indirect significance of FDI firms, which might help for firms for export decision. The fieldwork advocates that domestic suppliers are a highly differentiated group of firms with different competencies and absorptive capacity whose relationships with foreign firms vary as well as their abilities to benefit from potential transfers.

Table 15: Importance of foreign firms to domestic firms in the leather industry

Parameters	Indirect		Direct		Total	
	No. of response	percent	No. of response	percent	No. of response	percent
Learning about new technology	17	47	19	53	36	100
Learning about new quality management systems	26	72	10	28	36	100
Learning about new organizational and management methods	23	64	13	36	36	100
Access to new components/parts	9	82	2	18	11	100
Technology transfer through workers previously employed by foreign firms	7	19	29	81	36	100
Learning about new marketing methods	21	58	15	42	36	100

Source: own survey (2017)

Table 15, demonstrates FDI firms direct and indirect effects in the domestic firms in leather sector, suggesting overall the higher significance of direct effects on locally owned/domestic firms. Direct effects took place especially in those cases when foreign firms were interested in

sourcing components and parts from domestic firms and domestic firms need help to achieve the required quality and production capacity. These requirements significantly affect domestic firms to meet such specific requirements during start-up of the relationship with foreign firms.

The most important positive direct effects experienced by local/domestic firms related to Technology transfer through workers previously employed by foreign firms (81per cent). The other important direct effect was on learning about new technology (53per cent) to cope up and compete in international market. With regard to indirect effect, learning about new organizational and management methods (64per cent), Access to new components/parts (82per cent) acquired through indirect contact and Learning about new marketing methods (58per cent).

CHAPTER 5

CONCLUSIONS AND POLICY IMPLICATION

5.1 CONCLUSIONS

The involvement of FDI in Ethiopian leather industry directly linked with the government privatization of existing firms to foreign company. FDI firm's contribution for export growth of leather sector directly linked with government's intention to expand export market since FDI has an established market in the overseas or home country. The direct contribution of FDI in employment creation, value addition, export earnings and capital accumulation are very high when compared with local firms, which have long-term involvement in the sector. Since most of the FDI firms do not encouraged by the government to sale in the local market, most of their sales data shows export earnings they brought to the country.

The export volume of leather and leather products of the domestic owned firms shows a declining trend while FDI firm's show an increasing trend through time which reaches 70 Per cent share in 2015/16 fiscal year alone. In this export arena, the strength of FDI firms in product quality, technology usage, market linkage in international market and managerial skill positively affect firm's competitiveness in export market. The linkage between domestic firms and FDI are low mainly due to centralized sourcing from abroad by FDI, the unavailability of particular materials or parts in Ethiopia and often a low quality of supplies by domestic firms. The analysis shows higher improvement by domestic firms mainly because, in most cases, foreign firms imposed higher requirements on quality of inputs. The existence of FDI helps to improve domestic firms in product quality, import new technology, and improve their managerial skills to fulfill FDI firm's requirement, which help them to fulfill minimum international market standards.

This study has identified diverse effects of FDI through direct and indirect linkage effects. Direct effects, the most prominent positive direct effects experienced by domestic firms related to skill transfer through workers (81per cent) and learning about new technology (53per cent).

The domestic firms benefit from FDI indirectly especially from learning about new quality management systems (72per cent) and learning about new management system (64per cent) which will help the firms to increase access to both domestic and international markets to upgrade their products. Concerning indirect effect, especially in the form of increased competition and increased quality requirements were a key indirect effects witnessed in leather

industry. The most main indirect effects are learning about new quality management systems (72per cent) and organizational and management methods (64per cent) from FDI firms which strongly impact the status of domestic firms and stimulate them to start upgrading themselves in international market. In overall assessment, at least in terms of the extent of impact, in the form of increased product and labor market competition, quality requirements, demonstration effects and market access FDI played a more important role in the Ethiopian leather industry.

In one side, domestic firms established to take advantage of the increased demand for parts and components and new customer among foreign firms as a positive result that generated by the entry of foreign firms. In the other side, increased competition in the labor market and declined share of the domestic market as a negative, result that generated by entry of FDI firms. Our firm level data explain that, the increased competition for workers in the local labor market was the most important negative effect of foreign firms on domestic firms. Concerning domestic market competition there is no any negative effect that reduce local market share of domestic firms since FDI firms encouraged only to export 100per cent what they produce. The other beneficial effect of the existence of FDI is the new customers that come to buy from foreign firms have a chance to visit domestic firms.

5.2 POLICY IMPLICATIONS

In this paper, I have noted Ethiopia's long commitment to attracting foreign direct investment as shown through the pursuit of various policies and institutions. However, these efforts do not appear to have yielded much fruit because FDI in Ethiopian leather industry compared to other countries are very low except those from the newly industrialized countries like China and India. Due to this, first, in addition to great efforts aimed at increasing FDI inflows in the leather sector, there is a need to investigate the causes that affect domestic firms to supply inputs and copy technology and managerial skill to make leather sector internationally competitive. FDI in the leather industries should be encouraged because the results had revealed that their presences proved to be non-harmful to domestic firms.

The second, the leather industry has a distinctive technological and economic characteristic. It is light industry and labor intensive compared with other industries. The production process is product driven, and depends on labor skill and market order based. As discussed above, entry into international market, driven by fashion houses and global retail chain is very competitive for domestic firms. This has significant implication for government to support in technical

capacity building, credit facility for machineries purchase and human resource development in production, marketing and managerial skills since firms do not have this much resource to invest in human development.

Third, domestic firms have to increase product varieties in order to compete in international market. This requires the stakeholder's involvement and support for domestic owned firms in terms of skill development, acquisition of new technology, quality improvement and supply of inputs and international marketing skills.

Finally, this study has shown that the Ethiopian government has been working in attraction of FDI firms in the leather industry which lead to an increase in export of leather products. To continue the growth and benefit more from export of potential resources in leather sector, needs the government to look in to push FDI firms to work towards more value added products like leather articles and footwear sub-sectors.

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Annex 1: Questionnaire

Firm-specific general information

- 1) Name of firm: _____ Location: _____
Region _____
- 2) Year of Establishment: _____
- 3) Ownership type:
 - a) Local
 - b) Foreign Origin (country) _____
- 4) Legal status Sole proprietorship PLC Share Company
Partnership Cooperative Other
- 5) Capital and investment (Birr/USD/Euro)
 - a) Paid-up capital _____ in _____
 - b) Total investment (current asset) _____ in _____
- 6) Business background and experience
 - c) Management structure: Owner-manager ___ Employed manager ___ Partner-manager ___
 - d) Can your business be described as family business: Yes ___ No ___
 - e) Owner business background: Import/export/domestic trade ___ Manufacturing ___
Same industry ___ New entrant ___
 - f) Do you have same/related business in other countries: Yes ___ No ___
 - g) If yes, please list to five countries _____
- 7) Core business in Ethiopia (Since 2010)
 - a) Engagement in other businesses:
Transport Export Import Domestic trade Manufacturing
Mining Agriculture Construction Others: _____
- 8) Employees/workforce (Current June 30/2016)
 - a) Total number
 - b) Employment by sex: Female Male
 - c) Employment background

Character	2010	2011	2012	2013	2014	2015	2016
Employees-Total							
Permanent Employees							
Contract employees							
Casual (temporary)							
Professionals all (≥BA/BSc)							
Expatriates							
- 9) Which task is your top priority (put in order of weight) ?
 - a) Marketing _____
 - b) Production _____
 - c) Logistics _____
 - d) R& D (product dev.) _____

Part II: Firm competitiveness & capability

1) Reasons for investment in Ethiopia (please specify top 3 reasons, put 1, 2, 3 in order of priority)

- a) Cheap labour _____
- b) Cheap land _____
- c) Natural resources _____
- d) Growing domestic market _____
- e) Ease of access to European and US market (USA-AGOA, Europe) _____
- f) Availability of incentives (investment, export etc.) _____
- g) Locational advantage (geographic location) _____
- h) Political stability _____
- i) If other, please specify list:- _____

2) Market Destinations:

- a) China
- b) India
- c) Asia
- d) Middle East
- e) Europe (specify- Italy, Germany, Spain,) _____
- f) Americas
- g) Africa(specify) _____
- h) Other(specify):- _____

3) Sales and financial performance since 2010

	2010	2011	2012	2013	2014	2015	2016
a) Export- volume							
b) Export in USD							
c) Domestic sales- volume							
d) Domestic sales (in Birr)							
e) Total sales/ revenues							
f) Total raw materials cost							
g) Raw materials cost (import) (per cent F)							
h) Raw materials cost (local) (per cent F)							

4) What opportunities FDI firms get from Ethiopia

- a. Geographic proximity to the market
- b. Flexibility in raw material sourcing
- c. Raw material prices advantage
- d. Transportation costs advantage
- e. Raw material quality, know-how advantage
- f. Other opportunities _____

5) Challenges FDI firms face in Ethiopia

- a. Raw material quality problem
- b. Reliability of material sourcing problem
- c. Raw material prices disadvantage
- d. Instability of the market
- e. Managerial skills problem
- f. Technology problem
- g. Financial resources problem
- h. Low Productivity of work force
- i. other challenges _____

6) Reasons for sourcing from abroad by foreign firms

- a. Centralized sourcing
- b. Unavailability in Ethiopia
- c. Low quality in Ethiopia

7) Requirements on domestic suppliers by Ethiopian-based foreign firms

Requirements	Yes	No
Higher requirements on domestic suppliers in terms of:		
➤ Quality of materials/components		
➤ Production technology		
➤ Timing of delivery		
Domestic suppliers asked to meet specific requirements before they could start supplying		
Quality certificate		
Technology audit		
Increase in parts/components quality		
New production technologies		
New machinery		

8) General effects of the entry and operation of foreign firms

General FDI effects	Yes	No
New customers among foreign firms		
Increased competition in the labor market		
Increased direct (product) competition		
Decreased share of the domestic market		

9) Firm Qualifications

- a) Availability of sample preparation facility: Yes No Year _____
- b) Availability of R&D facility/core: Yes No Year _____
- c) Availability of a training centre: Yes No Year ____ Annual budget _____

10) Please state direct export spillover effect of foreign to domestic firms in the Ethiopian leather industry _____

11) Please state Indirect export spillover effect from foreign to domestic firms in the Ethiopian leather industry _____

12) Please propose measures to promote export in your sector _____

13) Other recommendations _____

Thank you

Annex 2: Interview Questions

1. What is its contribution of government in supporting the sector export growth?
2. What measures do you suggest to promote export of the leather industry in Ethiopia?
3. How do you view the role of FDI in the leather sector in export growth of the industry?
4. What are five key constraints/concerns on your sector with regard to export?
5. Please propose measures to improve supports by government institutions
6. How do you evaluate the existing export promotion policies of the country?