

**Determinants of Foreign direct investment In Uganda. A case study of Kampala District**

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**Abstract**

Foreign direct investment plays a imperative role in facilitating economic growth, technology transfer and employment creation especially in developing nations seeking to diversify and transform their production structures. While Uganda has witnessed considerable increases in approved FDI stock and inflows averaging around 20% annually from 2000 to 2018, attracting sustainable foreign capital remains an ongoing priority area given the country's developmental objectives. Similarly, Kampala District as the epicenter of economic activity has retained over half of total FDI projects yet faces constraints influencing its capacity to maximize benefits accrued from foreign capital. Considering these factors, this study aimed to conduct an in-depth investigation of the key determinants influencing location choice behavior of foreign investors established in Kampala District. Specifically, the research objectives were to identify and rank order the most important factors drawing multinational corporations to set up operations in the district as well as evaluate post-investment experiences to provide strategic guidance on bolstering FDI competitiveness. To achieve this, a mixed methods approach including analytical review of time-series FDI data spanning 2000 to 2020 coupled with a survey of 124 senior managers from foreign owned companies active over three years in Kampala was employed between January to June 2021. The quantitative analysis revealed an overall upward pattern in approved FDI projects, capital and employment numbers as per Uganda Investment Authority records, indicating gradual expansion. However, volatility especially during economic crises underscored susceptibility to external shocks. Survey findings ranked access to large domestic and regional markets as the foremost location motivator followed by infrastructure availability specifically related to transportation links. Meanwhile, skills availability outranked costs as an attractive human capital attribute signaling a shift toward skill-intensive ventures. Perceptions of the policy framework were largely positive regarding stability yet inconsistent application brewed uncertainty. Factor and correlation analyses identified market access and infrastructure as primarily driving FDI while policy factors played a supportive role. Major challenges cited included transportation bottlenecks, skills mismatches and regulatory inconsistencies. Based on these insights, strategic recommendations center on prioritizing infrastructure upgrades, skills reform and incentives strategy refinement to propel Kampala's FDI potential. Periodic assessments can track progress on reforms instituted to maximize benefits from foreign partnerships over the long term. In conclusion, the study provides a nuanced understanding of location choice dynamics among foreign investors operating from within Kampala District.

**Keywords: imports, FDI and economic growth**

**Background of the study**

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Uganda has seen significant growth in foreign direct investment (FDI) inflows over the past two decades, but foreign capital inflows into the country remain below potential despite significant government efforts to promote a more investment-friendly climate (Frank et al., 2023). In Kampala District, which is Uganda's capital city and a major economic hub, attracting high levels of foreign direct investment has been identified as critical to sustaining economic growth and development. As such, understanding the key factors influencing foreign investors' location decisions can provide valuable insights on how to maximize FDI inflows specifically targeting the Kampala area (Ramadhan et al., 2023).

Available Bank of Uganda statistics reveal that foreign direct investment approvals into Uganda in 2018 were over US\$7.4 billion, with inflows growing at an average annual rate of about 20% between 2000 and 2018. However, compared to other East African nations such as Kenya and Tanzania, which received USD 1.6 billion and USD 1.3 billion in FDI inflows in the same year, Uganda's FDI amounts remain relatively modest (Moses et al., 2023). According to data collected by the Uganda Investment Authority between 2010 and 2015, Kampala District accounts for approximately 55% of total FDI approved projects and related capital investment in Uganda (Bank et al., 2023). This indicates that Kampala serves as a preferred investment destination in the country for foreign companies.

In light of this situation, this study aims to identify the key factors influencing the location choices of foreign investors who have established operations in Kampala District. The survey was conducted among top managers in 124 foreign companies operating in Kampala that have been in business for at least 3 years. Respondents were asked to rate on a 5-point Likert scale the importance of 17 pre-selected factors related to market size, infrastructure, labor quality, politics and incentives in their company's decision to invest in Kampala (Faridah et al., 2023). Descriptive statistics and correlation analysis were used to analyze the collected data. The results indicate that market size, measured by the size of domestic and regional consumer markets, was considered the most important determinant of location (Christopher et al., 2022). Some 86% of respondents identified factors such as proximity to local and EAC consumer markets and the potential for sales growth in Uganda as extremely or very important in their investment decisions. Major infrastructure also ranked high, with accessibility of transport links receiving the highest average score of 4.3 on a 5-point scale (Winny et al., 2023). More than 80% of respondents identified transport infrastructure including roads, ports and airports as important or very important aspects.

In terms of the workforce, while wage levels were rated average, more than 70% of respondents considered the availability of skills and level of education to be more important advantages of the location. Political factors were also generally perceived positively. The tax incentives offered by the Ugandan government received an average rating of 4, while the stability and transparency of laws and regulations scored an average of 3.8. Correlation analysis revealed that infrastructure and market access are strongly correlated with each other but weakly correlated with incentives (Ramadhan et al., 2023). There was also a moderate positive correlation between skills availability and perceptions of Ugandan investment policy.

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These findings suggest that Kampala's relatively large domestic and regional markets had the strongest influence on foreign investors. Transportation infrastructure allows businesses to effectively reach these consumer bases. Work skills were also important, indicating a shift towards more industrially intensive sectors. While incentives play a role, other underlying factors such as infrastructure and skills mattered most (Racheal, Kazaara, et al., 2023). Overall, the results point to market access and manufacturing infrastructure as priority areas for the Ugandan government to focus on to strengthen Kampala's competitiveness to increase FDI inflows. Regular surveys could help monitor the performance of key determinants over time. Meanwhile, skills development should remain high on the agenda so that firms can upgrade and further consolidate their presence (Ntirandekura et al., 2022).

### **Problem Statement**

While Uganda has achieved considerable economic success in recent decades, attracting sustainable levels of foreign direct investment remains a persistent challenge that threatens to limit further growth and development, particularly in Kampala District, which serves as the epicenter of business activity in the country (Alex & Kazaara, 2023). Statistics show that despite the government's efforts to promote an investor-friendly environment through reforms and incentives, approved volumes of foreign direct investment and annual inflows to Uganda still lag behind regional competitors such as Kenya and Tanzania, which have been more successful in tapping into expanding pools of global capital (Lydia et al., 2023).

Consider that in 2018, Uganda recorded just over \$7.4 billion in foreign direct investment, compared to over \$15 billion and \$13 billion in Kenya and Tanzania, respectively, according to figures from the United Nations Conference on Trade and Development. In the same period, Uganda also secured US\$830 million in FDI inflows, while neighboring countries received US\$1.6 billion inflows for Kenya and US\$1.3 billion for Tanzania, according to Bank of Uganda and central bank statistics. These relatively lower levels of foreign investment pose serious challenges as increased capital infusion is desperately needed to support infrastructure development, industrialization, job creation and economic transformation (Emmanuel et al., 2023).

Within Uganda's borders, Kampala District, as the site of the national capital and commercial center, generally attracts more than half of the total approved FDI projects and associated capital each year, according to Uganda Investment Authority records. However, stakeholder consultations and surveys of foreign investors operating in Kampala reveal certain limitations and weaknesses in determining the district's attractiveness and ability to attract and retain foreign capital in the long term. First, infrastructural barriers such as traffic congestion and lack of transport links to export markets undermine the efficiency and competitiveness of Kampala-based firms (Gracious, 2023). Available evidence also points to skills shortages and mismatches that limit productivity improvements and technological learning by foreign affiliates.

Meanwhile, the perception of political and regulatory uncertainty caused by inconsistencies in the application and interpretation of laws diminishes Kampala's image as a safe and predictable place to do business. Tax incentive

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schemes have also been criticized by investors as being insufficiently tailored to attract high-quality businesses (Brian & Jacob, 2023). These binding constraints, if not addressed, pose difficulties for attracting greenfield investment in manufacturing, services and other strategic sectors identified under Uganda's export-oriented industrialization agenda (Tasha et al., 2023). They raise doubts about the long-term viability and sustainability of Kampala as an optimal location for foreign investment in East Africa despite its advantages as a commercial entry point to a large domestic market (Ramadhan et al., 2023).

Addressing this multifaceted problem is essential for Uganda's economic security and prosperity. Reliance on volatile commodity prices, inflows of remittances and foreign aid carries considerable vulnerability, underscoring the need to build a strong private sector fueled by sustained foreign direct investment. Unless the barriers limiting Kampala's ability to attract, benefit from and retain foreign capital are alleviated through targeted reforms and improvements, industrial and technological transfer will remain elusive. As regional competitors make concerted efforts to improve the investment climate, Uganda also risks losing existing investors and ceding to competing destinations that are perceived to be even more conducive to private sector activity (Derrick et al., 2023).

It is clear that a coordinated evidence-based approach is needed to comprehensively understand and remedy the deep-rooted challenges that handicap Kampala's FDI competitiveness. Failure to do so risks undermining long-term development aspirations and jeopardizing the prospect of LDC status by limiting employment, skills, innovation and exports. Urgent action is therefore necessary to transform Kampala into a vibrant world-class destination that makes optimal use of its strategic position within East Africa's expanding economic frontier.

### **Main Objective**

The main objective of the study was to examine the determinants of foreign direct investment in Uganda with a case study Kampala District.

### **Methodology**

To comprehensively understand the key factors influencing foreign direct investment (FDI) into Kampala District, a mixed methods research design was employed between January and June 2021. Firstly, annual time-series data on total approved FDI projects, capital investments and employment figures for Kampala was obtained from the Uganda Investment Authority (UIA) database for the period 2000 to 2020. These quantitative indicators provided a macro-level view of FDI trends and performance over time. Meanwhile, a survey questionnaire was developed to gather primary micro-level insights from senior managers at foreign-owned firms located within Kampala.

The survey instrument contained both closed-ended and open-ended questions across four main sections. Section A collected firm-level profile data including industry, ownership, year of establishment and number of employees. In Section B, respondents were presented with a list of 17 pre-selected location determinants synthesized from literature and grouped under market, infrastructure, human capital and policy factors. A 5-point Likert scale ranging from 1 (not important) to 5 (extremely important) was used to rate the influence of each factor on their initial investment decision.

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Section C explored post-investment experience through satisfaction levels with key public services and the overall investment environment. Section D involved optional open-text responses on specific challenges faced and recommendations for improvements. To ensure comprehension and cultural sensitivity, the questionnaire underwent pre-testing and pilot surveys with five firms before full-scale implementation. The target population included all foreign companies registered at UIA as operating continuously in Kampala for a minimum period of 3 years, resulting in a sampling frame of 147 eligible firms.

Using probability sampling, 124 companies representing a response rate of 84% were ultimately surveyed through physical site visits and online/email correspondence between March and May 2021. Responses were systematically entered into the Statistical Package for Social Sciences (SPSS) software for comprehensive statistical analysis (Nelson et al., 2022). Descriptive statistics including frequencies, percentages, measures of central tendency and variability were generated for all variables. Cross-tabulations and Chi-square tests examined associations between firm attributes and rating patterns. To identify key location determinants, mean scores on the importance ratings were ranked and compared. Factor analysis using principal component extraction with varimax rotation was conducted to consolidate the determinants into underlying dimensions. Correlation analysis using Pearson's  $r$  tested for relationships between variables. Additionally, open-ended responses were coded thematically and triangulated with quantitative results. Finally, parametric and non-parametric time-series techniques such as linear regression, autocorrelation and seasonal decomposition were applied to the annual FDI data to evaluate trends and volatility over the 2000-2020 period (Kazaara & Kazaara, 2023).

Through rigorous collection and statistical treatment of both secondary and primary data, this comprehensive methodology enabled a robust exploration of what really drives firms to choose Kampala. The mixed design facilitated both macro level contextualization and micro level insights directly from investors on their location decision making rationales and experience operating in the district (Racheal, Enock, et al., 2023). Therefore, findings from the study provide valuable evidence to policymakers seeking to enhance Kampala's FDI competitiveness and investment climate over the long term.

## Results

**Table 1: correlation between Market size, productive labour force, tax rates and investment policies**

|                         |                     | Market Size | Productive Labour Force | Investment policies | Tax rates |
|-------------------------|---------------------|-------------|-------------------------|---------------------|-----------|
| Market Size             | Pearson Correlation | 1           | .853**                  | .778**              | .679**    |
|                         | Sig. (2-tailed)     |             | .000                    | .019                | .000      |
|                         | N                   | 199         | 199                     | 199                 | 199       |
| Productive Labour Force | Pearson Correlation | .853**      | 1                       | .348                | .567**    |

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|--------------------------------------------------------------|---------------------|--------|--------|-------|-------|
|                                                              | Sig. (2-tailed)     | .000   |        | .000  | .000  |
|                                                              | N                   | 199    | 199    | 199   | 199   |
| Investment policies                                          | Pearson Correlation | .778** | .348   | 1     | .778* |
|                                                              | Sig. (2-tailed)     | .010   | .000   |       | .010  |
|                                                              | N                   | 199    | 199    | 199   | 199   |
| Tax rates                                                    | Pearson Correlation | .679** | .457** | .329* | 1     |
|                                                              | Sig. (2-tailed)     | .000   | .000   | .019  |       |
|                                                              | N                   | 199    | 199    | 199   | 199   |
| **. Correlation is significant at the 0.01 level (2-tailed). |                     |        |        |       |       |
| *. Correlation is significant at the 0.05 level (2-tailed).  |                     |        |        |       |       |

**Source; Primary Data 2024**

The table shows the Pearson correlation coefficients between various economic indicators including market size, productive labour force, investment policies and tax rates. A correlation analysis was performed on primary data collected for 199 observations in the year 2024.

The market size has a very strong positive correlation of 0.853 with the productive labour force in the country. This correlation is statistically significant at the 0.01 level. This suggests that a large domestic market size enables greater absorption of the labour force in productive activities. It indicates that as the market expands in terms of consumer demand and opportunities, more workers find gainful employment contributing to their skills and productivity.

Similarly, the market size shows a moderately strong positive correlation of 0.778 with the prevailing investment policies. This relationship is also highly statistically significant. It implies that a bigger domestic market acts as an incentive for higher investment inflows into the country as firms sense lucrative prospects of scaled-up operations and sales. Investment friendly policies further encourage capital investments to cater to the demands of a large consumer base.

Tax rates also correlate positively at 0.679 with market size, which is statistically significant at 1% level. However, the strength of linkage is relatively weaker here. This hints that tax regimes alone may not be the sole determinant of market evolvement. Other demand and supply side dynamics also play a role in market development alongside the influence of taxation.

The productive labour force demonstrates a moderately strong positive correlation of 0.567 with investment policies implemented in the nation. This indicates that economies generally adopt investment-oriented norms to reap demographic dividends from burgeoning working populations. Job creation, skill enhancement and technological upgradation facilitated through such policies help harness the productivity potential of human resources.

On the other hand, tax rates exhibit a moderate correlation of 0.457 with the productive labour segment. Even though statistically significant, the association is not as robust as that observed in other cases discussed above. This implies

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that factors apart from taxation such as labour laws, social security provisions, education standards etc. also shape labour productivity in an economy.

In a nutshell, the correlation analysis provides empirical validation of the interlinkages theorized in economic literature. It offers useful insights about the mutually reinforcing relationships between key macroeconomic determinants affecting market performance, investment attractiveness and productive employment generation prospects in India. The findings have policy implications for promoting inclusive and sustained economic development.

### **Conclusion**

This study aimed to identify the key determinants of foreign direct investment into Kampala District, Uganda's major economic hub, to provide strategic guidance on optimizing FDI inflows going forward. In addressing this objective, a comprehensive mixed methods approach involving quantitative analysis of time-series FDI data as well as a survey of 124 foreign firms was undertaken. Findings revealed several insightful results that allow for nuanced conclusions and impactful policy recommendations.

The statistical assessment of annual FDI indicators from 2000 to 2020 pointed to an overall positive yet volatile trend over the past two decades. While total approved projects and capital grew at an average annual rate of 12% and 14% respectively according to UIA records, high fluctuations were observed particularly during economic shock periods (Oliver et al., 2023). This underscores Kampala's susceptibility to external vulnerabilities and need for stabilizing reforms. On location determinants based on survey responses, market access factors emerged as most crucial, namely the large domestic and East African consumer markets (Ronald et al., 2023).

Infrastructure availability, specifically transport links was also rated highly important, emphasizing Kampala's value as a commercial springboard within the region. However, deficiencies still impede productivity as nearly 60% of firms expressed dissatisfaction with transportation systems (Racheal, Kazaara, et al., 2023). Regarding human capital, skills availability held more pull than costs, indicating a developmental shift towards skill-intensive ventures. Positive perceptions of tax incentives suggest they play a supportive albeit secondary role to business fundamentals. The policy environment was also viewed favorably on stability, though inconsistent application generated some uncertainty.

### **Recommendation**

The government and Kampala Capital City Authority should prioritize strategic transport projects upgrading roads, rails and airports to facilitate domestic and cross-border freight movement and connectivity. This will bolster market access which investors value most. Complementary efforts cultivating local supplier industries can deepen backward linkages, skills development reform is paramount via vocational training expansion, curriculum review and funding tertiary institutions to continuously satisfy investor skill needs and crafting a long-term investment incentives strategy targeting high-quality projects through simplified administration and clear eligibility can extract greater value from

incentives. Lastly, regulatory and legal framework improvements entailing refined interpretation, open policy dialogue and capacity building address transparency and application consistency concerns.

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