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**Review article**

## Analyzing the constraints to private investment in manufacturing industry

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### ABSTRACT

Production is the vital artery of society and country. If the growth path of production stop, society's life will fall in danger. Economic intellect and wisdom commands that before codify the policies related to producing. The target internal and external markets, their feasibility study, identification and networking should be analyzed and delete the barriers and constrains in the path of productive industries that one of their major problems is lack of asset. Persuasion of private part for investment in deprived areas like Kurdistan, persuasive policies of government , creation of security and suitable guaranties for private part's investors creation of self-sufficiency culture among people, encouragement of native investors by reward, reinforcement of productive companies and private organizations are the suitable strategies for development of investment.

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### 1. Introduction

A possible implication of financial constraints is that investment for constrained firms should be characterized with excess sensitivity to cash flow. However, a positive relationship between cash flow and investment has no clear interpretation. This is because cash flow not only measures liquidity, but also is a good proxy for the marginal product of capital, both in current and future periods.

The literature on the effects of commodity price variability on macroeconomic performance in developing countries has been concerned primarily with two aspects of variability, namely discrete ex post price shocks and uncertainty about future prices. There are strong reasons to suspect that both these manifestations of variability should have important implications for investment: The theory of temporary trade shocks shows that investment can be expected to respond strongly to discrete ex post commodity price shocks (Bevan, Collier and Gunning (1990a), Collier, Gunning and Associates (1999)). Similarly, recent theoretical developments support the view that investment decisions may be very sensitive to uncertainty about the future outcomes of key variables affecting investment decisions (Dixit and Pindyck (1994)).

This paper attempts to address these questions by examining the relationship between private investment in manufacturing industry which have been estimated using data on developing countries.

In most economies however, domestic private investment has proven to be insufficient in giving the economy the required boost to enable it meet its growth target because of the mismatch between their capital requirements and saving capacity. Foreign private investment, thus, augments domestic resources to enable the country carry out effectively her development programmes and raise the standard of living of her people.

Cleary (2006) finds that the financial constraints are presents in seven world largest economies: Australia, Canada, France, Germany, Japan, the United Kingdom and the United States. Kadapakkam et al. (1998) find that there is a significant relationship between investment and internal fund availability after testing for six OECD (Organization for Economic Cooperation and Development) countries comprising of the United States, Canada, Germany, United Kingdom, France and Japan. The results show that the cash flow variable contributes significantly to the explanatory power of the regression in all countries, except Japan.

Bond et al. (2003) constructed panel data sets of manufacturing firms in the United Kingdom, Belgium, France and Germany. The results show that the financial constraints are presents in all the countries but the constraints are relatively more severe in the United Kingdom. Bougheas et al. (2003) find that investment in R&D is financially constrained in the Republic of Ireland. This finding support previous studies of US firms for example Hall (1992), Hao and Jaffe (1993), and Himmelberg and Petersen (1994).

Therefore, this study is primarily aimed to examine the presence of financial constraints among firms in Malaysia. This study is crucial to investigate the presence of the financial constraints and their effects on firm's investment activities since the presence of financial constraints can cause the firms to be less accessible to external funds. The information on financial constraints and their effects on firm investment are also very useful for policy makers. Using this information they can ascertain appropriate monetary policies to release the effects of financial constraints on firms' investments and increase their accessibility to financing sources. This is important in order to achieve the ultimate goal of sustainable growth generated by private investment.

## **2. Shocks and investment**

The standard 'Dutch Disease' model has mainly focused on consumption and sectoral income distribution effects within a comparative static analytical framework suitable for evaluating long run effects ((Corden (1984), Neary (1985), Bruno (1982)). However, the premise of shock permanence, which underlies Dutch Disease models is unsuitable for developing countries for at least three reasons: First, the bulk of commodity shocks are arguably temporary rather than permanent (Deaton and Laroque (1992), Bevan, Collier and Gunning (1990)). Secondly, a dynamic modelling approach is more suitable for describing the effects of transitory shocks. Finally, as the analytical framework switches to a dynamic one, the variables of interest also change from consumption and income distribution towards investment.

## **3. Which types of firms are most affected by lack of access to finance?**

The types of firms most severely affected by lack of access to finance are:

- Start-ups and the newly established. They may lack assets to be used as collateral and the track record of performance that banks need to mitigate risk. And the rate of failure amongst new businesses is high the world over, making the banks risk averse in lending to them. Studies show that financial constraints are greater for start-ups and younger firms than for older firms.
- Small and medium firms (SMEs) face more financial constraints than large firms. The literature shows a huge gap in serving the needs of such businesses and there is evidence that financing

constraints have a greater impact on their growth than on that of large firms. Studies find that small firms consistently report more financial constraints than medium-sized firms, which in turn report more constraints than large firms. Such firms are more likely to be unable to have assets to pledge as collateral, face greater information failures and the profitability in lending to them is likely to be lower for the banks because of risk and transaction costs.

- Domestic firms. Firms that have access to foreign capital markets are less financially constrained than those that have to resort solely to domestic capital markets. And it is ownership (domestic versus foreign) that seems to determine if firms have access to outside markets. Foreign-owned firms report significantly lower financing obstacles than domestically-owned firms as they may choose to borrow on either the domestic or foreign market depending on where terms are most favourable.
- Sector of operation: Agribusiness firms are particularly capital constrained as lenders and equity investors tend to perceive this sector as high risk. There is a history of patronage and subsidy from the public sector in lending to farmers that makes them less willing to repay loans provided by a commercial bank. Where access to long term finance is limited, firms wishing to undertake long-gestation projects in agriculture, mining, manufacturing, infrastructure and housing may face acute problems in raising finance. There is some evidence also that, in some industries, firms need equity because they lack tangible assets to serve as security or cash flows are unpredictable (ICT, entertainment). Such firms are particularly constrained when equity markets are underdeveloped. There is also some evidence that lack of development of export credit and trade finance can hold back exporters and have a wider impact on small firms as trade finance may play an even more important role in helping them access bank finance because of its strength in addressing information problems.

Investment according to Theoretical Economics Investment means the production of capital goods - goods which are not consumed but instead used in future production.

Examples include

- Building
- A rail road
- A Factory clearing land
- Putting oneself through college

Investment according to Finance Term Investment means buying of Assets. For Examples

- Buying stocks and bonds
- Investing in real estate
- Mortgages

These investments may then provide a future income and increase in value (i.e., investing in real estate).

Investment according to Oxford Dictionary

Investment means the investing of money.

Investment from an Individual Point of View

Investment refers to a money commitment of some sort. For

example

I. A commitment of money to buy a new car is certainly an "investment".

**CHARACTERISTICS OF INVESTMENT**

Investment refers to invest money in Financial physical assets and Marketable assets. Major investments features such as risk, return, safety, liquidity, marketability concealability, capital growth, purchasing power, stability and the benefits.

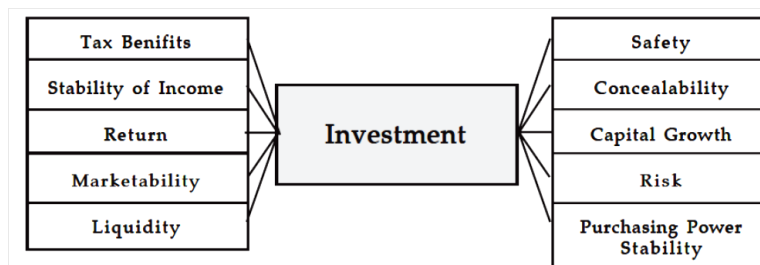


Fig. 1.1 Characteristics of Investment

Figure 1- indicates that an important characteristics of investments is outlined as:

- Risk
- Return
- Safety
- Liquidity
- Marketability
- Concealability
- Capital growth
- Purchasing power stability
- Stability of income
- Tax benefits.

Risk

Risk refers to the loss of principal amount of an investment. It is one of the major characteristics of an investment.

The risk depends on the following factors:

- The investment maturity period is longer, in this case, investor will take larger risk.
- Government or Semi Government bodies are issuing securities which have less risk.
- In the case of the debt instrument or fixed deposit, the risk of above investment is less due to their secured and fixed interest payable on them. For instance Debentures.
- In the case of ownership instrument like equity or preference shares, the risk is more due to their unsecured nature and variability of their return and ownership character.
- The risk of degree of variability of returns is more in the case of ownership capital compare to debt capital.
- The tax provisions would influence the return of risk.

Return

Return refers to expected rate of return from an investment

- Return is an important characteristics of investment. Return is the major factor which influences the pattern of investment that is made by the investor. Investor always prefers to high rate of return for his investment.

Safety

Safety refers to the protection of investor principal amount and expected rate of return.

- Safety is also one of the essential and crucial elements of investment. Investor prefers safety about his capital. Capital is the certainty of return without loss of money or it will take time to retain it. If investor prefers less risk securities, he chooses Government bonds. In the case, investor prefers high rate of return investor will choose private Securities and Safety of these securities is low.

Liquidity

Liquidity refers to an investment ready to convert into cash position. In other words, it is available immediately in cash form. Liquidity means that investment is easily realisable, saleable or marketable. When the liquidity is high, then the return may be low. For example, UTI units. An investor generally prefers liquidity for his investments, safety of funds through a minimum risk and maximisation of return from an investment.

Marketability

Marketability refers to buying and selling of Securities in market. Marketability means transferability or saleability of an asset. Securities are listed in a stock market which are more easily marketable than which are not listed. Public Limited Companies shares are more easily transferable than those of private limited companies.

#### Concealability

Concealability is another essential characteristic of the investment. Concealability means investment to be safe from social disorders, government confiscations or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes, because they combine high value with small bulk and

are readily transferable.

#### Capital Growth

Capital Growth refers to appreciation of investment. Capital growth has today become an important character of investment. It is recognising in connection between corporation and industry growth and very large capital growth. Investors and their advisers are constantly seeking 'growth stock' in the right industry and bought at the right time.

#### Purchasing Power Stability

It refers to the buying capacity of investment in market. Purchasing power stability has become one of the import traits of investment. Investment always involves the commitment of current funds with the objective of receiving greater amounts of future funds.

#### Stability of Income

It refers to constant return from an investment. Another major characteristic feature of the Investment is the stability of income. Stability of income must look for different path just as security of principal. Every investor always considers stability of monetary income and stability of purchasing power of income.

#### Tax Benefits

Tax benefits is the last characteristic feature of the investment. Tax benefits refer to plan an investment programme without regard to one's status may be costly to the investor. There are actually two problems:

- One concerned with the amount of income paid by the investment.
- Another is the burden of income tax upon that income.

## 4. Conclusion

A number of conclusions can be drawn from this body of empirical literature. On the one hand, there is evidence that internal funds are a crucial source of financing for innovation. How much a firm has to rely exclusively on internal funds because credit is constrained depends on firm and project characteristics.

Furthermore, this study is also helpful as the presence of financial constraints also determines the success of monetary policies to enhance economic growth as the constraints can magnify the shocks initiated by the policies specifically the unanticipated monetary policies (Kocherlakota 2000).

This calls for targeted policy support directed at the most constrained firms and those projects that are likely to face the largest gap between private and social returns. Several empirical studies have shown that for example public R&D subsidies may indeed work quite well as they do not crowd out private investment in R&D, but lead to additional investments and additional innovation outcome (e.g. David et al., 2000, Almus and Czarnitzki 2003, Aerts and Czarnitzki 2006, Czarnitzki and Hussinger 2004, Czarnitzki and Licht 2006, Czarnitzki et al. 2007, Hussinger 2008).

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