EFFECT OF ECONOMIC GROWTH ON FOREIGN DIRECT INVESTMENT IN KENYA

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF THE MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2015
DECLARATION

This Research project is my own original work and has not been presented in any other University or college for examination purpose.

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This Research project has been submitted for examination with my approval as University Supervisor

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ACKNOWLEDGMENTS

First and foremost, I would like to thank God for the gift of life, health, strength and knowledge that he bestowed upon me and for enabling me complete this research study. My sincere gratitude to my Supervisors, Mr. Dan Chirchir and Dr. Cyrus Iraya, for the continuous support I received from them during the study. I would also like to thank all the MBA Lecturers for building my knowledge during the study.

I would like to thank my MBA colleagues, friends and my loving family for all the guidance, motivation and support in all stages of this project.

I would like to appreciate all those who made this research project a success. God bless you all.
DEDICATION

I dedicate this project to my family, my wife, my children, my mum, my siblings, my in-laws, my late dad (May His Soul Rest in Peace) and all my friends.
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<tr>
<td>ADF</td>
<td>Augmented Dickey-Fuller</td>
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<td>ANOVA</td>
<td>Analysis of Variance</td>
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<td>ARDL</td>
<td>Autoregressive Distributive Lag</td>
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<tr>
<td>BRICS</td>
<td>Brazil, Russia, India and China</td>
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<td>ECM</td>
<td>Error Correction Model</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFCF</td>
<td>Gross Fixed Capital Formation</td>
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<td>GNP</td>
<td>Gross national product</td>
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<tr>
<td>MNCs</td>
<td>Multi-National Corporations</td>
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<td>OLS</td>
<td>ordinary least squares analysis</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>SBC</td>
<td>Schwarz Bayesian Criterion</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<td>USD</td>
<td>United States Dollars</td>
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ABSTRACT

The growing competition for FDI is certain to have an impact on the course of economic development of economies and encourage the pursuit of continued reforms to improve the investment climate and attract greater foreign investment. Many countries especially among developing countries are in need of FDI. In order to attract FDI in their economies, countries have ensured there exist appropriate structural development record to assure the foreign investors of business success. The objective of this study was to establish the effect of economic growth on foreign direct investment in Kenya. This study adopted a descriptive research design which generally describes the characteristics of a particular situation, event or case. The study used secondary data. The population of this study included all sectors of the Kenyan economy, for data relating to economic growth and foreign direct investment (FDI) inflows. The two main variables of this study are economic growth and FDI. The study conducted a multiple regression analysis and used analysis of variance (ANOVA) in the analysis of experimental data to test the variables for statistical significance. The study established that a relationship exists between economic growth and foreign direct investments. A positive relationship exists between the GDP growth, exchange rates with the foreign direct investments. Therefore, increments of these macroeconomic variables boost foreign direct investments in the country. The study recommended that policymakers should formulate policies and strategies that are geared towards achieving better economic growth in Kenya. Small and emerging sectors such as jua kali and other small and medium enterprises should be accorded the necessary support since they employ a majority of the Kenyan population thus making important contributions towards GDP growth. The government ought to readily support informal sectors since these sectors are key to economic growth that has an impact on foreign direct investment. The study recommends that the Kenyan legal system should be strengthened in order to protect investors thus creating a conducive business environment for foreign investments. The interference by government agencies in judicial operations undermines fair rulings thus causing multinational investors to go to countries with high judicial credibility.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

To overcome the high poverty levels and improve the standard of living in developing countries there is need for a substantial inflow of external resources in order to fill the savings and foreign exchange gaps. This will increase the rate of capital accumulation and growth in an economy (UNCTAD, 2005). Foreign Direct Investment (FDI) has been identified to contribute significantly to the economic growth of countries. Governments of many host countries (recipients of FDI) are using financial incentives such as tax allowances and grants in aid among other policies to attract FDI into their economies due to the perceived benefits associated with FDI inflows. Foreign Direct Investment not only provides the African countries with much needed capital for domestic investment, but also creates employment opportunities, helps transfer of managerial skills and technology, all of which contribute to economic development. Recognizing that FDI can contribute a lot to economic development, all governments of Africa including that of Kenya want to attract it (Bengosand Sanchez-Robles, 2003).

The growing competition for FDI is certain to have an impact on the course of economic development of economies and encourage the pursuit of continued reforms to improve the investment climate and attract greater foreign investment. Many countries especially among developing countries are in need of FDI (UNCTAD, 2005). In order to attract FDI in their economies, countries have ensured there exist appropriate structural development record to assure the foreign investors of business success (Ostadi and Ashja, 2014).
Countries are ensuring that the combination of such factors as the presence of strategic resources, highly educated populations, highly skilled workers available at low cost, comparatively well-developed infrastructure and social-welfare sectors undoubtedly confers advantages on most of the economies in attracting FDIs. Like any other investors, foreign investors review a number of factors when deciding where to take their investment in the form foreign direct investment.

1.1.1 Economic Growth

Economic growth is defined as the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is normally measured as the percent rate of increase in real GDP (Ostadi and Ashja, 2014). It is normally important to understand the growth of the ratio of GDP to population growth (GDP per capita or per capita income). A rise in growth which is as a result of more efficient use of inputs such as physical capital, population, or territory is known as intensive growth. GDP growth resulting from an increase in amount of inputs is known as extensive growth.

Economic growth or economic growth theory refers to growth in potential output i.e. production at full employment and this deals primarily with how countries can advance their economies. Growth is usually calculated in real terms i.e. inflation-adjusted terms, to eliminate the distorting effect of inflation on the prices of goods and services produced. Measurement of economic growth uses national income accounting (Bjork, 1999).
Economic growth is defined as 'a rise in the total output (goods or services) produced by a country'. It is an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. It occurs whenever people take resources and rearrange them in ways that are more valuable. It can be measured in nominal terms, which include inflation, or in real terms, which are adjusted for inflation like by the percent rate of increase in the GDP (Chaudhry, Mehmood and Mehmood, 2013).

Economic growth can be either positive or negative. Negative growth can be referred to by saying that the economy is shrinking. Negative growth is associated with economic recession and economic depression. GNP is sometimes used as an alternative measure to gross domestic product. In order to compare multiple countries, the statistics may be quoted in a single currency, based on either prevailing exchange rates or purchasing power parity (Ostadi and Ashja, 2014). Then, in order to compare countries of different population sizes, the per capita figure is quoted. To compensate for changes in the value of money (inflation or deflation) the GDP or GNP is usually given in "real" or inflation adjusted, terms rather than the actual money figure compiled in a given year, which is called the nominal or current figure (Oslon, 2008).

1.1.2 Foreign Direct Investment

FDI is a kind of investment in which the investor country directly invests on the assets and resources of the host country (Ostadi and Ashja, 2014). FDI not only provides the African countries with much needed capital for domestic investment, but also creates employment opportunities, helps transfer of managerial skills and technology, all of
which contribute to economic development. FDI is important to the future development of every country especially African nations, as it is a means of increasing the capital available for investment and the economic growth needed to reduce poverty and raise living standards in any given country (UNCTAD, 2008).

FDI plays a vital role in the upgradation of technology, skills and managerial capabilities in various sectors of the economy that would be difficult to generate through domestic savings, and even if it were not, it would still be difficult to import the necessary technology from abroad, since the transfer of technology to firms with no previous experience of using it is difficult, risky, and expensive (Oslon, 2008). FDI creates many externalities in the form of benefits available to the whole economy which the host countries cannot appropriate as part of their own income. FDI in Kenya is defined as investment in foreign assets, such as foreign currency, credits, rights, benefits or property, undertaken by a foreign national (a non-Kenyan citizen) for the purposes of production of goods and services which are to be sold either domestically or exported overseas (Investment Promotion Centre Act, Chapter 518). FDI is important for developing countries as it makes available the resources that could bring about an optimal level of economic development (Ismaila and Imoghelle, 2010). This is because their economies are plagued with problems associated with low domestic savings, low tax revenue, low productivity and limited foreign exchange earnings.

1.1.3 The relationship between Economic Growth and Foreign Direct Investment

The nature of the interaction of FDI with human capital is such that for countries with very low levels of human capital, the direct effect of FDI is negative (Nair, 2010). There
exist a direct relationship between economic growth and FDI such that the growth of economic growth may be boosted by a growing FDI. Wan (2010) argues that foreign direct investment could stimulate technological change through the adoption of foreign technology and know-how and technological spillovers, thus boosting host country economies.

Many policy makers and academicians contend that FDI can have important positive effects on a host country’s development efforts, plans and policies. In addition to the direct capital financing it supplies to the economy, FDI many a time is also a source of valuable and critical technology and know-how while nurturing linkages with local firms, which can help jumpstart an economy (Chaudhry et al., 2013). Based on these factors, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies. In the light of this however many investors look at the various factors which makes investing more attractive which include the factors which have an impact of economic growth (Mwega and Ngugi, 2004). It therefore tends to rationalize that investment inflows are low when these factors are not favorable and high when they are more favorable. Investors look at factors like exchange rates depicting the strength of the currency which is an indicator of how well an economy is doing, the infrastructural development which also indicate the strength of an economy and also skilled labor and taxes which play out on the interest of the economy to attract investment (Wan, 2010). When these conditions are favorable, indicating a healthy economic growth, investment is encouraged and investors are comfortable and ready to do business (Nair, 2010).
Chakraborty (2012) findings show that while the long-run co-integrating relationship between FDI, GFCF and GDP in India is confirmed by the empirical analysis, the findings that there is a unidirectional causality from India’s economic growth to FDI and from FDI to domestic investment raises important policy implications. According to Blomström (2002) the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view, is not a recommended strategy.

1.1.4 Economic Growth and FDI in Kenya

The level of FDI in Kenya has been low and stagnant over the past couple of years and well below Kenya's potential. There has also been a worrying trend of foreign investors moving out of Kenya and gravitating to other countries. Ocharo, Wawire, Ng’ang’a and Kosimbei (2014) found that there was a unidirectional causality from foreign direct investment to economic growth and from economic growth to cross-border interbank borrowing. The coefficient of foreign direct investment as a ratio of gross domestic product was positive and statistically significant, and the coefficients of portfolio investment as a ratio of gross domestic product and cross-border interbank borrowing as a ratio of domestic product were positive and statistically insignificant (George, 2014).

In 2008, Kenya launched vision 2030 with the objective of among other things to achieve global competitiveness for FDI and gain economic prosperity. Kenya has had inconsistent trends of FDI inflows starting with the 1970-1980 period. The then relatively high level of development, good infrastructure, market size, growth and openness to FDI at a time when other countries in the region had relatively closed regimes all contributed to the
multinational companies (MNCs) choosing Kenya as their regional hub. Net FDI were highly volatile and generally declining in the 1980s and 1990s despite the economic reforms and the progress made in the business environment (Mwega and Ngugi, 2004). By the year 2010, the level of FDI hit a high of USD 700 million. At this period, Kenya’s GDP was slightly below 5%.

The Kenyan Government, over the years, has put great efforts to boost the levels of FDI to spur economic growth by offering various investment incentive packages example establishment of the Export Promotional Zones (EPZs) which offer incentives such as ten-year tax holiday followed by a 25% tax rate for the next ten years, exemption from import duties, value added tax and stamp duty and repatriation of profits is unrestricted. Despite the Kenyan government effort to attract FDI, it has been volatile. The main sources of FDI in Kenya are India, China, UK and Germany (Otieno, 2013). The government implemented reforms in the legal framework for FDI in order to encourage investment.

Among the key factors to growth are, human resources and international transportation infrastructure, of which are two key aspects of Kenya’s attractive investment environment. Kenya boasts of the highest literacy rates resulting in a high level of qualified upper level staff and skilled labour. This large supply of labour also contributes to fairly low wage levels. Flexible employment regulations make workforce management comparatively easy for companies in Kenya (Ocharo et al., 2014). Kenyan firms also benefit from access to well developed sea shipping and air freight services. Investors reported some of low prices in official rentals, and utility costs are at a competitive level.
Kenya’s EPZ’s also strengthen the operating environment for zone based industries, as these areas have comparatively good electrical, water and telecommunications and connections; conducive environments for foreign direct investment.

1.2 Research Problem

Global competition for FDI has given the bargaining power to Multi-National Corporations (MNCs) and their allies in the evaluation of countries in which to invest (Borsos-Torstila, 1999). For instance, the competition has forced some countries to lower their entry regulations, taxes, environmental clearances, and stipulations on working conditions for attracting FDIs. These countries have recognized the importance of FDI inflows for their economic growth, poverty alleviation and development in general. FDIs are widely acknowledged to be crucial engines of growth especially in the developing countries (Jordaan, 2004). Foreign investors have an interest in improved regional integration, since this promotes more efficient production and offers greater opportunities for sales. Some countries do not receive large amounts of foreign investment because their markets are small or because they lack such natural resources as petroleum and natural gas which are attractive to investors, or because foreign investors have little confidence in their investment opportunities, have much to gain by becoming parts of regional markets. Therefore, in order to attract FDI required in an economy, the countries have to align their economic growth variables to show greater investment opportunities for the foreign investors.

Kenya has faced high fluctuations in FDI and economic growth. The fluctuations in FDI may be accounted for by a number of reasons. First, the recurrent tribal clashes every
time Kenya was approaching the election period (Mwega and Ngugi, 2004). For example the 1992, 1997 and 2007 tribal clashes in the Rift Valley, Nairobi and Coast Provinces had led Nairobi to be rated as one of the most dangerous cities in the world by the United Nations’ International Civil Service Commission and downgraded to class C from class B station. There was a sharp rise of FDI in 2000 due to new investment in the mobile telephone sector and the accelerated borrowing by the private sector to finance electricity generation because of the drought at the time (Ngugi and Nyang’oro, 2005). The change in trade policy from that of import substitution (IS) to export promotion (EP) which led to the establishment of the Export Processing Zone (EPZ) in 1990, led to increased FDI directed to specific industries like the garment industry to take advantage of the African Growth Opportunity Act (AGOA) initiative (IMF, 2012).

Several studies have been done on economic growth and FDI. For instance, Vijayakumar, Sridharan and Rao (2010) conducted a panel analysis of the determinants of FDI in Brazil, Russia, India and China (BRICS) Countries. The findings show that economic stability and growth prospects (measured by inflation rate and industrial production respectively), trade openness (measured by the ratio of total trade to GDP) are insignificant determinant of FDI inflows of the BRICS countries. Sharma, Jadhav, Singh, & Mahapatra (2012) conducted an analysis of economic, institutional and political factor determinants of FDI in BRICS economies. Findings indicate that economics factors are more significant than institutional and political Factors in BRICS economies. The results indicate that market size measured by real GDP is a significant determinates of FDI which implies that most of the investment in BRICS is motivated by market-seeking purpose.
Locally, Njeru (2013) examined the impact of foreign direct investment on economic growth in Kenya using FDI and GDP inflow data series from 1982 to 2012. This study used economic growth as dependent variable as opposed to independent variable. Wanjiru (2013) examined the impact of inflation volatility and economic growth on foreign direct investment in Kenya. This study though used economic growth and FDI, it insisted more on the intervening effect of the inflation on the relationship as opposed to the effects of economic growth of FDI. Maingi (2014) examined the effect of foreign direct investments on economic growth in Kenya. This study applied the economic growth as dependent variable as opposed to this study which uses it as independent variable. Abala (2014) conducted an empirical analysis of Kenya data on foreign direct investment and economic growth. The study findings show that FDIs in Kenya are mainly market-seeking and these require growing GDPs, political stability and good infrastructure, market size as well as reduction in corruption levels. Kariuki (2015) examined the determinants of foreign direct investment in the African Union and the results show that a high economic risk has a negative and significant effect on FDI flows into Africa; both political risk and financial risk have a negative but insignificant impact on FDI inflows; there is a positive and significant relationship between the commodity price index performance and FDI inflows; the good performance of stock markets in developed countries has a positive and significant impact on FDI inflows an increase in the infrastructure of a country has a positive and significant effect on FDI inflows; an increase in openness to trade has a positive and significant effect on FDI inflows; the amount of FDI received in the previous year by African countries is significant in influencing the FDI flows that come into the African continent in the current year.
The above studies though related to the variables of the study, they either looked at the intervening effect of inflation or treated the independent variable in this study as dependent variable. It is on the basis of this that this study seeks to establish the effect of economic growth on foreign direct investment. The study sought to answer one research question: What are the effects of economic growth on foreign direct investment in Kenya?

1.3 Research Objective

To establish the effect of economic growth on foreign direct investment in Kenya

1.4 Value of the Study

This study would be important to a number of stakeholders including government policy makers, foreign direct investors and future scholars and academicians. For the Government of Kenya, the findings of this study would be important in guiding their policy formulation and implementation in order to attract the right amount of FDI in Kenya. Since foreign direct investors review a number of factors which make up the economic development of a nation, the policy makers would utilize the findings of this study in putting the right framework for improvement of the various factors that influence the investor’s choice of a destination.

The findings of this study, foreign direct investors would assess the viability of investing in Kenya. It would help them in assessing the key areas of investment for optimal return on their investments. Through the findings of this study, foreign investors would learn how to use economic growth figure in determining viable investment destinations.
Through the findings of this study, future scholars and researchers would find literature to refer to when writing their future researches on either FDI or economic growth. Future scholars and researchers would also find the results of this study valuable as it would suggest areas for further research where they can extent knowledge on.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This section provides a review of the theories and empirical studies carried out on the subject of economic growth and foreign direct investment. The chapter focuses on studies done in the past by other scholars in the area so as to help bring out the gap that this study seeks to fill.

2.2 Theoretical Framework
This section presents the theories on which the study is grounded. In particular, the study is founded on three theories: the economic theory, Solow type growth theory and the neoclassical theory. These theories are well explained below:

2.2.1 The Economic Theory
The standard economic theory holds that foreign capital inflows into a recipient country increases its stock of capital and level of technology and lead to better economic performance. Theory provides conflicting predictions concerning the growth effects of FDI. FDI affects economic growth positively through improved technology, efficiency and increased productivity (Lim, 2001). However, the potential contribution of FDI to growth is strictly dependent on the circumstances in the recipient or host country.

Economists tend to favor the free flow of capital across national borders because it allows capital to seek out the highest rate of return. Unrestricted capital flows may also offer several other advantages (Barry and Collins, 1999). First, international flows of capital
reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions. Third, the global mobility of capital limits the ability of governments to pursue bad policies.

2.2.2 Solow Type Growth Theory

The role of foreign direct investment (FDI) in stimulating economic growth is one of the controversial issues in the development literature. In the standard Solow type growth model, FDI enables host countries to achieve investment that exceeds their own domestic saving and enhances capital formation (Mankiw, Reis & Wolfers, 2003). According to this theory, the potential beneficial impact of FDI on output growth is confined to the short run. In the long run, given the diminishing marginal returns to physical capital, the recipient economy could converge to the steady state growth rate as if FDI had never taken place leaving no permanent impact on the growth of the economy. Mankiw et al (2003) applying the Solow growth model argues that private businesses invest in traditional types of capital such as bulldozers and steel plants and newer types of capital such as computers and robots. On the other hand, government invests in various forms of public capital, called infrastructure, such as roads, bridges and sewer systems. Mankiw et al further argues that policy makers trying to stimulate growth must confront the issue of what kinds of capital the economy needs most. In other words, what kind of capital yields the highest marginal products?
2.2.3 Neoclassical Theory

According to neoclassical theory, FDI influences income growth by increasing the amount of capital per person (Nair, 2010). It spurs long-run growth through such variables as research and development (R&D) and human capital. Through technology transfer to their affiliates and technological spillovers to unaffiliated firms in the host economy, MNCs can speed up the development of new intermediate product varieties, raise product quality, facilitate international collaboration on R&D, and introduce new forms of human capital (Ikiara, 2003). Bajona and Kehoe (2010) discussed explanations of multinational production based on neoclassical theories of capital movement and trade within the Hecksher-Ohlin framework.

However, they criticize these theories on the basis that they were founded on the assumption of existence of perfect factor and goods markets and were therefore unable to provide satisfactory explanation of the nature and pattern of FDI. In the absence of market imperfections, these theories presumed that FDI would not take place (Bajona and Kehoe, 2010). Nevertheless, they argue that the presence of risks in investing abroad implies that there must be distinct advantages to locating in a particular host country.

2.3 Determinants of Foreign Direct Investment

This section describes the various determinants of FDI. The exact determinants discussed here include: openness, infrastructure, market size, labour costs and productivity, political risk, economic growth and taxation.
2.3.1 Openness

Charkrabarti (2001) states that since most investment projects are directed towards the tradable sector, a country’s degree of openness to international trade should be a relevant factor in the decision. Bakir & Alfawwaz (2009) claim that the impact of openness on FDI depends on the type of investment. When investments are market-seeking, trade restrictions (and therefore less openness) can have a positive impact on FDI. The reason stems from the “tariff jumping” hypothesis, which argues that foreign firms that seek to serve local markets may decide to set up subsidiaries in the host country if it is difficult to import their products to the country.

In contrast, multinational firms engaged in export-oriented investments may prefer to invest in a more open economy since increased imperfections that accompany trade protection generally imply higher transaction costs associated with exporting. Wheeler and Mody (1992) observe a strong positive support for the hypothesis in the manufacturing sector, but a weak negative link in the electronic sector. Kravis and Lipsey (1982), Culem (1988), Edwards (1990) find a strong positive effect of openness on FDI obtain a weak positive link.

2.3.2 Infrastructure

Infrastructure covers many dimensions ranging from roads, ports, railways and telecommunication systems to institutional development like accounting, legal services. According to ODI (1997), poor infrastructure can be seen, however, as both an obstacle and an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But foreign investors also point to the
potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector.

Jordaan (2004) claims that good quality and well-developed infrastructure increases the productivity potential of investments in a country and therefore stimulates FDI flows towards the country. According to Asiedu (2002) and Ancharaz (2003), the number of telephones per 1,000 inhabitants is a standard measurement in the literature for infrastructure development. However, according to Asiedu (2002), this measure falls short, because it only captures the availability and not the reliability of the infrastructure. Furthermore, it only includes fixed-line infrastructure and not cellular (mobile) telephones.

2.3.3 Market Size

According to Artige and Nicolini (2005) market size as measured by GDP or GDP per capita seems to be the most robust FDI determinant. This is the main determinant for horizontal FDI and it is irrelevant for vertical FDI. Bakir & Alfawwaz (2009) mention that FDI will move to countries with larger and expanding markets and greater purchasing power, where firms can potentially receive a higher return on their capital and by implication receive higher profit from their investments.

According to Charkrabarti (2001), the market-size hypothesis supports an idea that a large market is required for efficient utilization of resources and exploitation of economies of scale: as the market-size grows to some critical value, FDI will start to increase thereafter with its further expansion. This hypothesis has been quite popular and a variable representing the size of the host country market has come out as an explanatory
variable in nearly all empirical studies on the determinants of FDI. In ODI (1997), it is stated that econometric studies comparing a cross section of countries point to a well-established correlation between FDI and the size of the market, which is a proxy for the size of GDP, as well as some of its characteristics, such as average income levels and growth rates. Some studies found GDP growth rate to be a significant explanatory variable, whereas GDP was not, probably indicating that where the current size of national income is very small, increases may have less relevance to FDI decisions than growth performance, as an indicator of market potential.

2.3.4 Labour Costs and Productivity

Wage as an indicator of labour cost has been the most contentious of all the potential determinants of FDI. Theoretically, the importance of cheap labour in attracting multinationals is agreed upon by the proponents of the dependency hypothesis as well as those of the modernization hypothesis, though with very different implications (Charkrabarti, 2001). There is, however, no unanimity even among the comparatively small number of studies that have explored the role of wage in affecting FDI: results range from higher host country wages discouraging inbound FDI to having no significant effect or even a positive association.

There is no unanimity in the studies regarding the role of wages in attracting FDI. Shamsuddin (1994) demonstrate that higher wages discourage FDI. Tsai (1994) obtains strong support for the cheap-labour hypothesis over the period 1983 to 1986, but weak support from 1975 to 1978. In ODI (1997), it is stated that empirical research has also found relative labour costs to be statistically significant, particularly for foreign
investment in labour-intensive industries and for export-oriented subsidiaries. However, when the cost of labour is relatively insignificant (when wage rates vary little from country to country), the skills of the labour force are expected to have an impact on decisions about FDI location.

2.3.5 Political Risk

According to ODI (1997), where the host country owns rich natural resources, no further incentive may be required, as it is seen in politically unstable countries. In general, as long as the foreign company is confident of being able to operate profitably without excessive risk to its capital and personnel, it will continue to invest. For example, large mining companies overcome some of the political risks by investing in their own infrastructure maintenance and their own security forces. Moreover, these companies are limited neither by small local markets nor by exchange-rate risks since they tend to sell almost exclusively on the international market at hard currency prices. Specific proxy variables have proved significant in some studies; but these quantitative estimates can capture only some aspects of the qualitative nature of political risk.

Hausmann and Fernandez-Arias (2000) find no relationship between FDI flows and political risk while Schneider and Frey (1985) find an inverse relationship between the two variables. Using data on U.S. FDI for two time periods, Loree and Guisinger (1995) found that political risk had a negative impact on FDI in 1982 but no effect in 1977. Edwards (1990) uses two indices, namely political instability and political violence, to measure political risk. Political instability (which measures the probability of a change of government) was found to be significant, while political violence in terms of the
frequency of political assassinations, violent riots and politically motivated strikes was found to be insignificant.

2.3.6 Economic Growth

The role of growth in attracting FDI has also been the subject of controversy. Charkrabarti (2001) states that the growth hypothesis developed by Lim (2001) maintains that a rapidly growing economy provides relatively better opportunities for making profits than the ones growing slowly or not growing at all. Lunn (1980), Schneider and Frey (1985) and find a significantly positive effect of growth on FDI, while Culem (1988) obtains a strong support for the hypothesis over the period 1983 to 1986, but only a weak link from 1975 to 1978.

On the other hand, Nigh (1985) reports a weak positive correlation for the less developed economies and a weak negative correlation for the developed countries. Ancharaz (2003) finds a positive effect with lagged growth for the full sample and for the non-Sub-Saharan African countries, but an insignificant effect for the Sub-Saharan Africa sample. Gastanaga et al. (1998) and Schneider and Frey (1985) found positive significant effects of growth on FDI.

2.3.7 Taxation

The literature remains fairly indecisive regarding whether FDI may be sensitive to tax incentives. Some studies have shown that host country corporate taxes have a significant negative effect on FDI flows. Others have reported that taxes do not have a significant effect on FDI.
The direction of the effects of above mentioned determinants on FDI may be different. A variable may affect FDI both positively and negatively. For example, factors, such as labour costs, trade barriers, trade balance, exchange rate and tax have been found to have both negative and positive effects on FDI. In the empirical studies a various combination of these determinants as explanatory variables have been used. Ahmed (2012) states that due to the absence of a consensus on a theoretical framework to guide empirical work on FDI, there is no widely accepted set of explanatory variables that can be regarded as the “true” determinants of FDI.

2.4 Empirical Review

Several studies have been done on economic growth and foreign direct investment. These empirical studies are discussed in two categories including: international and local contexts. The exact studies are presented below:

2.4.1 International Empirical Studies

Nair (2010) studied the relationship between Foreign Direct Investment and Economic Growth using a case study of India from 1970 to 2007. The study applied regression analysis. The main regression results show that FDI has a positive and highly significant effect on overall growth for India. The stock of human capital is also significant in the growth process, and the magnitude of the effect of FDI does depend to some extent on the interaction between these two variables. The study further notes that the nature of the interaction of FDI with human capital is such that for countries with very low levels of human capital, the direct effect of FDI is negative. The large positive value of the dummy variable, and its high level of significance, reflect that the opening up of the Indian
economy in 1991 saw the effect of FDI on economic growth increase tremendously. Upon reintroducing the FDI and openness to trade variables into the regression model, the findings show that FDI variable again becomes negative and insignificant as does the variable for openness to trade.

Wan (2010) conducted a literature review on the relationship between foreign direct investment and economic growth. This study sums up the literature as well as empirical studies on the relationship between foreign direct investment and economic growth, trying to arrive at a meaning revelation eventually. Theories and existing literature provide conflicting results concerning this relationship. On one hand, some scholars argue that foreign direct investment could stimulate technological change through the adoption of foreign technology and know-how and technological spillovers, thus boosting host country economies. On the other hand, other pessimists believe that FDI may bring about crowding out effect on domestic investment, external vulnerability and dependence, destructive competition of foreign affiliates with domestic firms and “market-stealing effect” as a result of poor absorptive capacity.

Chakraborty (2012) sought to establish whether there was any relationship between foreign direct investment, domestic investment and economic growth in India using a time series analysis. The findings show that while the long-run co-integrating relationship between FDI, gross fixed capital formation (GFCF) and gross domestic product (GDP) in India is confirmed by the empirical analysis, the findings that there is a unidirectional causality from India’s economic growth to FDI and from FDI to domestic investment raises important policy implications. Higher FDI inflow in India could be argued to be
facilitated by the relatively stable GDP growth rate, which in turn acted as a major boost
towards a sustainable high domestic investment. The growth effects of the FDI on GDP
in the short run were, however, less pronounced.

Khaliq and Noy (2007) conducted empirical evidence from sectoral data in Indonesia
foreign direct investment and economic growth over the period 1997-2006. In the
aggregate level, FDI is observed to have a positive effect on economic growth. However,
when accounting for the different average growth performance across sectors, the
beneficial impact of FDI is no longer apparent. When examining different impacts across
sectors, estimation results show that the composition of FDI matters for its effect on
economic growth with very few sectors is showing positive impact of FDI and one sector
even showing a robust negative impact of FDI inflows (mining and quarrying). The
sectors examined included: farm food crops, livestock product, forestry, fishery, mining
and quarrying, non-oil and gas industry, electricity, gas and water, construction, retail and
wholesale trade, hotels and restaurant, transport and communications, and other private
and services sectors.

Alfaro (2003) sought to establish whether the sector for foreign direct investment and
Growth Matters. The study notes that although it may seem natural to argue that foreign
direct investment (FDI) can convey great advantages to host countries, the benefits of
FDI vary greatly across sectors. The study shows this by examining the effect of foreign
direct investment on growth in the primary, manufacturing, and services sectors. An
empirical analysis using cross-country data for the period 1981-1999 suggests that total
FDI exerts an ambiguous effect on growth. Foreign direct investments in the primary
sector, however, tend to have a negative effect on growth, while investment in manufacturing a positive one.

Chaudhry, Mehmood and Mehmood (2013) studied empirical relationship between foreign direct investment and economic growth using co-integration approach for China. This study used secondary data obtained from World Development Indicators over the period 1985-2009, whose viability had also been checked through the World Bank. An Augmented Dickey-Fuller (ADF) unit root test was used to estimate an autoregressive distributive lag (ARDL) approach to co-integration as the variables in the model were in \( I(1) \) and \( I(0) \) form and the Schwarz Bayesian Criterion (SBC) is used in this study to find out the estimated lags of the model, which were ultimately used to find out the short- and long-run relationship of the variables included in the model (American Library Association, 2000).

The error correction model (ECM) was also applied which basically provides information about the causal factors that may affect the variables included in the model. The results provide evidence that there is an empirical relationship among FDI and economic growth. The computed value of \( F \)-statistics is greater than the upper bond value described by Pesaran et al., which depicts evidence against the null hypothesis of no effect and hence long-run relationship among the variables is concluded at bottom line. Empirical evidence reveals that FDI has a positive effect on economic growth. An error correction model (ECM) is applied and the error correction term was negative and significant. This indicates that there exists a relationship between the variables.
Blomström (2002) studied the economics of international investment incentives and study notes that the attitude towards inward foreign direct investment (FDI) has changed considerably as most countries liberalized their policies to attract all kinds of investment from multinational corporations (MNCs). The findings show that the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view, is not a recommended strategy. The main reason being that the strongest theoretical motive for financial subsidies to inward FDI – spillovers of foreign technology and skills to local industry – is not an automatic consequence of foreign investment. The incentives should focus in particular on those activities that create the strongest potential for spillovers, including linkages between foreign and local firms, education, training, and research and development.

2.4.2 Local Empirical Studies

Njeru (2013) examined the impact of foreign direct investment on economic growth in Kenya using FDI and GDP inflow data series from 1982 to 2012. The findings show that FDI contributes to development in three major ways: capital inflows such as FDI enable countries to import more than they export, which enables them to invest more than they save and thus accumulate capital faster, boosting labor productivity and wages. FDI has the potential to absorb some of the surplus literate labor in the rural and urban informal sectors; and employment creation in industries with good productivity growth prospects is an important aspect of poverty alleviation strategies, which is good for local entrepreneurs.
Abala (2014) conducted an empirical analysis of Kenyan data on foreign direct investment and economic growth. The view suggests that FDI is important for economic growth as it provides much needed capital, increases competition in host countries and helps local firms to become more productive by adopting more efficient technology. The study findings show that FDIs in Kenya are mainly market-seeking and these require growing GDPs, political stability and good infrastructure, market size as well as reduction in corruption levels. The prevalence of crime and insecurity would be impediments to FDI inflow.

Wanjiru (2013) examined the impact of inflation volatility and economic growth on foreign direct investment in Kenya. FDI was taken as the dependent variable whereas GDP and inflation were taken as independent variables. A linear regression analysis was used on the data to determine the relationship between inflation, GDP and FDI flows. The results suggest that there is no relationship between foreign direct investment and inflation, whereas there is a negative relationship between foreign direct investment and gross domestic product. This study insisted on the intervening effect of inflation on the impact of economic growth on FDI. This therefore means that the effects of economic growth on FDI remain unstudied.

Maingi (2014) examined the effect of foreign direct investments on economic growth in Kenya. The Statistical Package for Social Sciences was used to analyze the data where descriptive analyses, frequencies and trend analysis, as well as inferential analyses involving Analysis of Variance (ANOVA) and Correlation analysis to establish relationships between the variables. Graphical trend analysis of FDI and GDP reveals a
direct positive relationship between the two variables. The Pearson correlation was computed for GDP and FDI inflow data series resulting in a correlation coefficient of 0.937 at the 0.01 (2 tailed) significance level which indicates a strong positive correlation between the variables; this in turn means that there is a significant direct proportional relationship between foreign direct investment and economic growth in Kenya.

2.5 Summary of Literature Review and Research Gaps

The empirical review above has shown the relationship between foreign direct investment and economic development of a country. However, the studies have not concentrated on the impact of economic growth on FDI or the intervening effects of inflation on the impact of economic growth on FDI with the exception of Chaudhry et al (2013) who established that FDI has a positive effect on economic growth. All the local studies have not considered the effect of economic growth on FDI mixing other macroeconomic variables except the inflation as done by Wanjiru (2013). This study therefore seeks to fill this research gap in literature where the only dependent variable being economic growth.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design, the population of the study, the sample, the procedures applied in data collection as well as the data analysis techniques applied.

3.2 Research Design

This study adopted a descriptive research design which generally describes the characteristics of a particular situation, event or case. As defined by Glass and Hopkins, (1984), descriptive research design involves gathering data that describes events and then organizes, tabulates, depicts, and describes the data collection and often uses visual aids such as graphs and charts to help the reader in understanding data distribution. Descriptive research answers the research questions who, what, where, when and how is the problem which would be fundamental in describing the data and characteristics about the population under study (Saunders, Lewis & Forsline, 2009).

Descriptive studies report summary data such as measures of central tendency including but not limited to the mean, median, mode, deviance from the mean, variation, percentage, and correlation between variables. Survey research commonly includes that type of measurement, but often goes beyond the descriptive statistics in order to draw inferences. Descriptive statistics utilize data collection and analysis techniques that yield reports concerning the measures of central tendency, variation, and correlation. The combination of its characteristic summary and correlation statistics, along with its focus
on specific types of research questions, methods, and outcomes is what distinguishes descriptive research from other research types (The Association for Educational Communications and Technology, 2001)

3.3 Data Collection

The study used secondary data as it saves time and it rules out the option of collecting biased data from primary sources. It also provides larger and higher quality databases that would be unfeasible for any individual researcher to collect on their own. Secondary data involved the collection and analysis of published material and information on the gross domestic product from sources such as the Kenya National Bureau of Statistics, this are statistical figures and conclusions that have been done by experienced researchers in Kenya. All the items under consideration in any field of inquiry constitute a ‘universe’ or ‘population’.

The population of this study included all sectors of the Kenyan economy, for data relating to economic growth and foreign direct investment (FDI) inflows. The two main variables of this study are economic growth and FDI. The real Gross Domestic Product (GDP) was used as the proxy for economic growth in Kenya and economic growth rate was represented using the constant value of Gross Domestic Product (GDP) measured in Kenyan shillings. The statistical abstracts for period 2009 to 2014 was collected from the Kenya National Bureau of Statistics. The study used quarterly data.
3.4 Data Analysis

Analysis of data entails a number of closely related operations such as establishment of categories, the application of these categories to raw data through coding, tabulation and then drawing statistical inferences. The study used the Statistical Package for Social Sciences (SPSS 21.0) to estimate the result of the regression between the variables. It was analyzed econometrically through regression analysis. In trying to understand the relationship between the dependent and the independent variables, regression analysis using ordinary least squares analysis (OLS) was done.

The exact data required and the sources was as shown in the table below:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Source of Data</th>
<th>Data Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Direct Investment inflow</td>
<td>KNBS</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Gross Domestic Product</td>
<td>KNBS</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Lending Rates</td>
<td>Central Bank of Kenya</td>
<td>Quarterly (Average)</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>KNBS</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Prevailing Exchange Rate in the economy against USD</td>
<td>Central Bank of Kenya</td>
<td>Quarterly</td>
</tr>
</tbody>
</table>

The data was tested for serial correlation, multicollinearity and heteroscedasticity.

Finally, the signs and the size of the parameters were evaluated.

3.4.1 Analytical Model

A linear log-log regression model was used to analyze the effect of economic growth on FDI. The literature reviewed has shown linearity between the dependent and independent variables therefore linear model was chosen. The regression model for analysis took the form:-

\[
\text{Log FDI} = \beta_0 + \beta_1 \text{Log GDP Growth} + \beta_2 \text{Int} + \beta_3 \text{Inf} + \beta_4 \text{Exch} + \varepsilon
\]
Where;

FDI = Foreign Direct Investment inflow in Kenya in a quarter (LN FDI)
GDP = Quarterly Gross Domestic Product in Kenya (GDP rate)
Int = Interest rates (Lending Rates)
Inf = Inflation rate (CPI index)
Exch = Prevailing Exchange Rate in the economy against USD (LN of exchange rate USD)
£ = Error Term
Bo = constant
β1, β2, β3, β4 = coefficients of independent variables.

The periodicity of the data was quarterly starting in the year 2005 to 2014.

3.4.2 Test of Significance

The test of significance to be used in the proposal is the R2 test. The coefficient of determination, denoted as $R^2$ was used to indicate how well data fit into the statistical model. F-statistics (also known as fixation indices) was used to test the expected level of heteroscedasticity in the target population. Analysis of variance (ANOVA) was used in the analysis of experimental data to test the variables for statistical significance.
CHAPTER FOUR
DATA ANALYSIS PRESENTATION AND FINDINGS

4.1 Introduction

The study explored the effects of inflation rates, interest rates, GDP growth and exchange rates on the foreign direct investment in the country for the study period. Data was collected and analyzed for the period 2009 to 2014. This chapter presents the research findings and the interpretations made there on.

4.2 Descriptive Analysis

The study sought to determine the effect of economic growth on foreign direct investment in Kenya. The references included websites, financial performance states, CBK survey on bank charges and lending interest rates and CBK supervisory annual reports. The collected data used in this study is presented in the appendices I, II and III.

The descriptive statistics of the data is presented below:

Table 4.1 Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>.47</td>
<td>.82</td>
<td>.6952</td>
<td>.10300</td>
</tr>
<tr>
<td>Inflation</td>
<td>3.33</td>
<td>16.87</td>
<td>7.7903</td>
<td>3.93793</td>
</tr>
<tr>
<td>Interest Rates</td>
<td>12.20</td>
<td>14.88</td>
<td>13.5342</td>
<td>.80421</td>
</tr>
<tr>
<td>Exchange Rates</td>
<td>4.32</td>
<td>4.55</td>
<td>4.4298</td>
<td>.05911</td>
</tr>
<tr>
<td>FDI</td>
<td>-89.93</td>
<td>2111.92</td>
<td>100.6923</td>
<td>433.55771</td>
</tr>
</tbody>
</table>

Source: Research Findings
Table 4.1 above presents results of the descriptive statistics of the overview of GDP in Kenya during the period of study (as shown in the appendix II). Minimum GDP during the study period was 0.47 while the maximum was 0.82. The mean was 0.6952 with a standard deviation of 0.10300. For the Inflation, the minimum value was 3.33% while the maximum value was 16.87%. The mean was 7.7903 with a standard deviation of 3.93793. The Interest rates had a minimum value of 12.20 and maximum of 14.88. The mean was 4.32 with a standard deviation of 0.80421. For exchange rates, the minimum value was 4.32 and maximum of 4.55. The mean was 4.4298 with a standard deviation of 0.05911.

4.3 Regression analysis

The researcher conducted a regression analysis whereby the foreign direct investment was regressed against the study independent variables. The research findings are presented in the subsequent sections of this chapter.

Table 4.2: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.7428</td>
<td>.5518</td>
<td>.5027</td>
<td>10.6714</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Exchange rates, Inflation, GDP growth, Interest rates

Source: Research Findings

The model summary results in Table 4.2 show that the value of R was 0.7428, whereas the value of R square was 0.5518. The adjusted R square was 0.5027 and the standard error of the estimate was 12.6714. These results imply that 50.27% of the changes in FDI in the study period were attributed to the independent variables in the study. However, other factors not included in this study contributed the remaining 49.73% of the changes in the dependent variable.
Table 4.3: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>128.748</td>
<td>4</td>
<td>32.187</td>
<td>10.476</td>
<td>.012</td>
</tr>
<tr>
<td>Residual</td>
<td>58.374</td>
<td>19</td>
<td>3.0723</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>187.122</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: FDI
b. Predictors: (Constant), Exchange rates, Inflation, GDP, Interest rates.

Source: Research Findings

The ANOVA results in Table 4.3 indicate that the value of F calculated was 10.476 and the significance was 0.012. The tabulated f value at 4 numerator degrees of freedom and 19 denominator degrees of freedom was 2.90. Since the value of calculated f was greater than the f critical (10.476 > 2.90), the regression model was thus significant.

Table 4.4: Coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>25.2981</td>
<td>3.148</td>
<td>11.748</td>
<td>8.036</td>
</tr>
<tr>
<td>GDP</td>
<td>.8790</td>
<td>.1499</td>
<td>.4081</td>
<td>5.864</td>
</tr>
<tr>
<td>Inflation</td>
<td>-5.0136</td>
<td>.7142</td>
<td>-4.350</td>
<td>-7.020</td>
</tr>
<tr>
<td>Interest rates</td>
<td>-8.738</td>
<td>1.5135</td>
<td>5.127</td>
<td>-5.773</td>
</tr>
<tr>
<td>Exchange rates</td>
<td>2.7411</td>
<td>.2781</td>
<td>3.131</td>
<td>9.857</td>
</tr>
</tbody>
</table>

a. Dependent Variable: FDI

Source: Research Findings

The co-efficient results indicate that holding the entire independent variables constant at zero, the foreign direct investment would increase by 25.2981. A unit increase in the GDP growth increased the foreign direct investments by 0.8790 while holding all other variables constant at zero, a unit increment in inflation rates while holding all other variables constant over the study period decreased foreign direct investments by 5.0136.
A unit increment in the interest rates also decreased the investments by 8.738 holding all other variables constant at zero and lastly a unit increment in exchange rates while holding all other variables constant increased the foreign direct investments by 2.7411. A positive relationship was noted between the GDP growth and exchange rates with the foreign direct investments. The exchange rates however had the greatest positive influence on FDI followed by GDP. The Inflation rates had the highest negative impact on FDI. However, a negative relationship was observed between the inflation rates and interest rates with the foreign investments. It is worth noting that all the independent variables in the study were significant since their significance values were less than the preset significance level of 0.05.

4.4 Discussion of the Findings

The research findings showed that a relationship exists between the independent variables (GDP growth, inflation rates, interest rates and the exchange rates) and the dependent variable (foreign direct investments). To be precise, 50.27% of the changes in foreign direct investments in the study period were attributed to changes in the independent variables in the study. The regression model was significant since the value of calculated $f$ was greater than the $f$ critical in showing the relationship between the dependent and the independent variables. The research findings showed that a positive relationship exists between the GDP growth and exchange rates with the foreign direct investments. Increment in GDP growth is an indication of economic growth in a country which boosts foreign direct investments. The research finding however contradicts Wanjiru (2013) who deduced that there is a negative relationship between foreign direct investment and gross
domestic product. The research findings agree with Maingi (2014) that a significant direct proportional relationship exists between foreign direct investment and economic growth in Kenya. Maingi (2014) indicated that indeed a significant direct proportional relationship exists between foreign direct investment and economic growth in Kenya. The findings however contradict Wanjiru (2013), that there is a negative relationship between foreign direct investment and gross domestic product in the country as it was indicated by the research findings. Chaudhry, Mehmood and Mehmood (2013) further provided evidence in their study that there is an empirical relationship between FDI and economic growth in a country. The study also established that exchange rates had the greatest positive influence on FDI followed by GDP. The Inflation rates however had the highest negative impact on FDI. Khaliq and Noy (2007) also observed a positive effect of economic growth on FDI. However, a negative relationship was observed between the inflation, interest rates with the foreign direct investments. This finding contradicts Wanjiru (2013) who concluded that there is no relationship between foreign direct investment and inflation rates.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter sought to present the summary of the research findings, conclusions recommendations, limitations and suggestions for further studies on the basis of the research findings.

5.2 Summary of findings
The research findings showed that a relationship exists between economic growth and foreign direct investments. Positive economic growths for instance the growth in gross domestic product is associated with increments in foreign direct investments. A positive relationship also exists between the exchange rates growth with the foreign direct investments. This implies that as the value of the domestic currency reduces, more investors are attracted to the country. Therefore, the increments of these macroeconomic variables that are used to assess economic growth boost the rate of foreign direct investments in the country. However, a negative relationship was observed between the inflation and interest rates with the foreign direct investments. These factors therefore adversely affect foreign direct investments. These increments are associated with increments in the cost of doing business thus low margins to investors. The exchange rates however had the greatest influence on FDI followed by GDP. The inflation rates had the highest negative impact on FDI.

The country should however incorporate even new and emerging sectors for instance the small and medium enterprises in the assessment of GDP growth. The government should
also support small and medium enterprises since they have potential for expansion which significantly boosts the economy. Economic growth fosters economic foreign direct investments in Kenya. Kenya is a developing nation which is experiencing economic growth thus improvements in FDI. The stimulation of economic growth and development would definitely increase foreign direct investments thus increasing job opportunities for Kenyans and consequently make the country more competitive in the world market.

5.3 Conclusions

The study concluded that economic growth has an influence on foreign direct investments. Policies which promote economic growth and development should be given sufficient attention in order to attract foreign direct investment. This is due to the fact that positive economic growth attracts FDI. It is important to note that Kenya has low levels of foreign direct investments hence it needs to develop its immediate business surroundings through improving on its administrative procedures and legal systems so as to improve economic growth. These factors would lead to higher levels of FDI being channeled into the country. Foreign direct investment ought to be channeled into profitable and self sustainable projects for which they are targeted.

Kenya has been faced with mismanagement of funds and in this regard, appropriate bodies and authorities should vigilantly perform their tasks and make follow ups on those who misappropriate project money. The study however noted that high interest and inflation rates negatively influence economic growth thus discouraging foreign direct investments. The central bank of Kenya should form and implement adequate policies to ensure that the local currency remains valuable despite the tough economic times. A
depreciating currency would lead to low returns on investments due to high production costs thus discouraging investments both local and international.

5.4 Recommendations for Policy and Research

5.4.1 Recommendations for Policy

Based on the research findings, the researcher made the following recommendations in regards to policy and practice in connection to economic growth and foreign direct investments.

The study recommended that policymakers should formulate policies and strategies that are geared towards achieving better economic growth in Kenya. Small and emerging sectors such as ‘jua kali’ and other small and medium enterprises should be accorded the necessary support since they employ a majority of the Kenyan population. They positively impact economic growth thus worthy of government support in terms of incentives. The government should readily support informal sectors since these sectors employ a majority of the Kenyan population. These establishments positively impact economic growth since they have potential for growth. By formulating policies that positively influence these businesses, the country at large would attract investments and consequently industrialize these sectors.

The study recommends that the Kenyan legal system should be strengthened in order to protect investors thus creating a conducive room for foreign investments. The interference by government agencies in judicial operations undermines fair ruling thus multinational investors would opt to go to countries with high judicial credibility. The
legal and business environment should be improved so as to make the country more conducive for business.

5.4.2 Contribution to Academia

The findings of this study are important to future scholars and researchers as they form the basis for future research. In addition, the study has expounded on application of the economic theory, Solow type growth theory and the Neo-classical theories and how they explain the relationship between economic growth and FDI in Kenya. The study has also extended the findings of past scholars like Wanjiru (2013) who deduced that there is a negative relationship between foreign direct investment and gross domestic product, and Maingi (2014) who indicated that indeed a significant direct proportional relationship exists between foreign direct investment and economic growth in Kenya.

5.5 Limitations of the Study

A limitation for the purpose of this study included any condition that was present and affected the attainment of study objectives. First, the data used in the study was secondary data meant for other purposes hence its determination may not have been accurate. This may have influenced the effects of independent variable on dependent variable.

In addition, the data was in the past and may not directly apply for the future because of the ever changing operating environment. The study aimed at collecting more secondary data but was limited on its availability especially on periodicity as used in the study. This makes its findings of little importance in predicting the future trends.
Thirdly, during the period of the study, there have been many changes affecting FDI and economic development. The policy framework has changed with changes in government which may have had a greater impact on both the FDI and economic growth. However, the study did not take all these changes into consideration as not all of them could be measured.

5.6 Suggestions for Further Research

The study period concentrated on the period between 2009 and 2014 thus further assessment ought to be done using a larger sample size in the near future. These findings would be imperative in knowing whether the above research findings in a short time span are comparable to results in the long run. The long behavior of changes in trend of FDI due to changes in the economic variables would be easily detected, this way visible patterns both seasonal and cyclical would be assessed. This study concentrated on the effects of four economic growth variables namely (exchange rates, inflation, GDP growth and interest rates). Additional assessment needs to be done so as to address the effects of the other economic growth variables on foreign direct investment. Future researchers can even address the effects of issues such as political stability on foreign direct investments.

Further studies ought to be done by looking at the effects of non-economic variables on foreign direct investments. Cultures and traditions ought to be investigated to determine if significant factors exist that hinders foreign direct investment in rural areas.
REFERENCES


APPENDICES

Appendix I: Monthly Inflation Rates

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Source: Central Bank of Kenya
## Appendix II: Monthly GDP

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## Appendix III: Monthly Exchange rates

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**Source:** KNBS, CBK, 2014
## Appendix IV: Monthly Interest rates

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*Source: KNBS, CBK, 2014*
Appendix V: Quarterly Natural log of FDI

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Source: KNBS, CBK, 2014