THE INFLUENCE OF THE GLOBAL CREDIT CRUNCH ON FOREIGN DIRECT INVESTMENT (FDI) INFLOWS IN KENYA

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A Management Research Project Submitted In Partial Fulfillment of the Requirements of the Degree of Master of Business Administration, School of Business, University of Nairobi

October 2009
DECLARATION

This Research Project is my original work and has not been submitted for a degree course in this or any other University

Signed………………………………………………Date……………………………….

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

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Dr. Martin Ogutu
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DEDICATION

I wish to dedicate my achievements to my wife, Amina, son, Master Adam and daughter, Edita for their understanding, encouragement and sacrifice.
ACKNOWLEDGEMENT

I acknowledge the contributions made by several individuals and institutions towards the completion of this work. The individuals included my Supervisor, Dr. Martin Ogutu, for his guidance and valuable advice, Dr. Samwel Werema for his valuable advice in data analysis, staff members of African Institute for Capacity Development for their understanding, Mr. Martin Mutuku for his patience and all others. The list could be longer than this.

The institutions included African Institute for Capacity Development for giving me time to undertake this programme, Kenya National Bureau Of statistics for allowing me to access some manuals and Kenya Investment Authority for allowing me to have access to some of their officials.
The world had experienced three global economic problems in the same span of time of 2007-2009, namely, the global financial crisis resulting into the global credit crunch, oil crisis and food crisis. One of the global problems had been the global financial crisis that resulted into the global credit crunch thereby influencing the level of FDI inflows in several countries. The purpose of this study was to look into the case of Kenya with reference to the influence of the global credit crunch on foreign direct investment (FDI) inflows in Kenya.

The methodology used was to collect primary data from Kenya Investment Authority through the interview process and corroborate that data with secondary data from published reports so as to establish the challenges that faced FDI inflows in Kenya. Secondary data was also collected to determine the influence of the global credit crunch on FDI inflows in Kenya. The data was subjected to data analysis whereby conclusions were drawn from the analysis.

The research findings indicated that there were a myriad of challenges that faced FDI inflows in Kenya. These included lack of good governance, political instability, lack of consistent structural reforms, poor growth performance, corruption, crime, post-election violence, deteriorating infrastructure, small market size and high cost of doing business. These challenges were noted during the interview with a senior official of Kenya Investment Authority and corroborated with every literature that was reviewed. According to the qualitative data analysis presented in Chapter 4 in Table 1, these challenges appeared to be common, revolving and recurring over a number of years.

Also, on the influence of the global credit crunch on FDI inflows in Kenya the research findings suggested that the global credit squeeze influenced the low levels of FDI inflows in Kenya as depicted in depressed levels of real gross domestic product (GDP) and decreased GDP growth rates analyzed in Table 2 and Table 3.
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CHAPTER ONE: INTRODUCTION

1.1 Background

In international business, capital flows between two or more countries were specifically termed as foreign direct investment (FDI). According to Hill and Jain (2006), foreign direct investment occurred when a firm invested resources in business activities outside its home country. FDI flows from a foreign country to a host country were termed as FDI outflows and FDI inflows respectively. Depending on the direction of the FDI flows, there were several factors that influenced them. In this respect, the ensuing discussion focused on the influence of global credit crunch on FDI inflows into host countries with specific reference to Kenya.

The factors that affected FDI inflows to a host country like Kenya were external and/or internal. The external factors comprised of the growth and financial market conditions obtaining in foreign countries. For example, the current financial crisis in the world resulting in the global credit crunch had far reaching effects on FDI inflows in Kenya. Since most FDI depended on the availability of financial credit, the consequence of the global credit crunch had far reaching effects on the quantum of FDI inflows to Kenya and such other countries. On the other hand, internal factors that influenced the quantum of FDI inflows comprised of a range of host country policies, regulations and other characteristics. For example, regulatory frameworks (registration, licensing, tax levels, etc), incentives, political stability, infrastructure, location, access to markets, raw materials and such other internal factors determined the level of FDI inflows in a country. Accordingly, Ajayi (2006) noted that a number of studies examined the determinants of capital flow to developing countries.

With the formation of Kenya Investment Authority (KIA), tasked with creating conducive investment environment to boost FDI inflows in the country, the current phenomenon was seen as a looming drawback. However it was difficult to determine with certainty the influence of the global credit crunch on FDI inflows unless a study was done over a longer
period. Therefore this study sought to establish whether global financial crisis leading to the global credit crunch in international business influenced the decline of FDI inflows in Kenya and therefore negate KIA efforts in investment promotion.

1.1.1 Global Credit Crunch: Historical and Conceptual Perspectives

According to the online dictionary, a credit crunch had been defined as an economic condition in which investment capital was difficult to obtain (www.investopedia.com). It was a reduction in the availability of credit (loans) or a sudden tightening of the conditions required to obtain a loan from banks. In this respect, banks or finance houses and investors became cautious of lending funds to companies, thereby driving up the price of debts (interest rates) to borrowers.

Few people had heard of the term credit crunch before 2007, but since then, the phrase had been an everyday menu. The current discussion on global credit crunch came about when adverse news from a French investment bank, BNP Paribas, triggered sharp rise in the cost of credit, and made the financial world realise the seriousness of the situation. As a severe shortage of money or credit, the start of the phenomenon had been pinpointed on 9 August 2007 when adverse news from a French investment bank, BNP Paribas, triggered sharp rise in the cost of credit.

The global credit crisis had been linked to the sub-prime mortgage business, in which US banks gave high-risk loans to people with poor credit histories. These and other loans, bonds or assets were bundled into portfolios - or Collateralized Debt Obligations (CDOs) - and sold on to investors globally. Collateralized Debt Obligations (CDOs) was defined by the dictionary of Investopedia.com as an investment-grade security backed by a pool of bonds, loans and other assets. CDOs did not specialize in one type of debt but were often non-mortgage loans or bonds.

According to the global credit crunch timeline, the problems, however, started much earlier (http://news.bbc.co.uk/2/hi/business/7521250.stm). Between 2004 and 2006, US
interest rates rose from 1% to 5.35%. It was at this point that the US housing market began to suffer, with prices of houses falling and a rise in homeowners defaulting on their mortgages. Default rates on sub-prime loans with high-risk loans to clients with poor or no credit histories rose to record levels. According to UNCTAD (April, 2009), the year 2008 marked the end of a growth cycle in international investment that started in 2004 and saw world foreign direct investment (FDI) inflows reach a historic record of US $ 1.9 trillion in 2007. Henceforth, due to the impact of the global financial and economic crisis, FDI flows declined.

The concept of a credit crunch could be understood better by explaining the way in which it occurred. Ideally, absence or non-availability of funds in the credit market resulted in borrowers finding it difficult in accessing credit. The banks having limited funds for lending or additional lending was considered imprudent brought this about. Also, the banks increased the cost of borrowing such that the cost-benefit analysis by borrowers would post adverse results prompting borrowers to bail out from taking such credits. The genesis of a credit crunch started when banks had previously suffered significant losses prompting them to be wary of making further lending to avoid depleting their capital base below the minimum levels of liquidity. In this case the lenders suffered losses due to disposing of properties pledged as collateral for credit for lesser values than the outstanding loan balances. Since the losses were significant, they depleted the capital base below the minimum capital liquidity thereby reducing the amount that the banks could legally lend out. Effectively this led to a credit crunch.

Another scenario where credit crunch could occur was when regulatory authorities, especially Central Banks, increased minimum capital requirements for commercial or investment banks. Since banks were required to maintain a certain amount of liquidity in their capital base, this requirement prompted the banks to reduce lending immediately thereby causing a credit crunch. Also in cases where the banks foresaw a higher risk in the market, to offset such risks they raised the lending rates thereby effectively increasing the cost of borrowing to the extent that the borrowers found the loans being expensive and therefore difficult to access credit. Hence a credit crunch occurred in these circumstances. Since many companies borrowed in order to expand their level of operations, a credit
crunch could negatively affect companies’ operations thereby slowing down economic growth of countries through decreased capital liquidity and therefore reduction in borrowing. In the absence of credit access, expansion of businesses was rendered impossible. Therefore the general economy could be negatively affected due to a crunch in credit facilities.

1.1.2 Foreign Direct Investment (FDI) Inflows

Foreign Direct Investment (FDI) was investments between countries. These investments could either be inward (inflows) or outward (outflows) depending on the context in which the discussion was leading. While FDI inflows were investments from foreign countries to host countries, outflows were investments from home countries to foreign countries. In this paper the discussion would be on FDI inflows, i.e. investments from foreign countries to host countries with specific reference to FDI inflows to Kenya from foreign countries. According to Hill and Jain (2006), foreign direct investment occurred when a firm invested resources in business activities outside its home country.

Foreign direct investments were facilitated by companies with extensive operations in several parts of the world. These companies were termed as multi-national companies/corporations (MNCs). They had operations in different countries of the world. When they wanted to establish businesses or penetrate overseas markets in host countries they used FDI as a means of entry in a particular country or market. Therefore FDIs were a popular mode of entry in host countries. While FDI was a popular mode of entry in host countries like Kenya, there were mainly two main forms of FDI. The first was green-field investment, which involved the establishment of a wholly new operation in a foreign country (Hill and Jain, 2006). The second form involved acquiring or merging with an existing firm in the foreign country otherwise termed as grey-field investment.

The above two main forms of FDI might give rise to entry strategies that might be used to enter into foreign countries/markets. Entry strategies in foreign markets might vary according to the conditions obtaining in such particular countries. Ideally there were
several modes of entry into foreign markets depending on the firms’ expansionist objectives and specific foreign country analysis. Therefore when a firm decided to enter a foreign market, it selected an entry mode that was appropriate in its circumstances. The available basic entry strategies in foreign markets were exporting, turnkey projects, licensing, franchising, joint ventures and wholly owned subsidiaries.

There were several determinants of FDI. These were categorized into driving forces and restraining forces. Driving forces comprised of conducive environment such as market access, access to cheap and abundant inputs, peace and security tranquility, cheap labour, good infrastructure and commercial services. Restraining forces comprised of stiff competition, war, political unrest, low growth of gross domestic product (GDP), and negative balance of payment, extreme nationalism and such other negative forces.

1.1.3 Kenyan Experience

There were many multi-national companies (MNCs) that operated in Kenya. According to Yabs (2007), MNCs operating in Kenya came as early as 1945, immediately after WW II. The first ones included Dalgetti, Dunlop, CMC, Ford Motor Company, Singer Sewing Machines and others (Yabs, 2007). At the time these companies were coming, they were driven by cheap labour, abundant inputs and market access of new markets. The form of entry of FDI had been green-field operations. According to UNCTAD Report (2005) on Investment Policy Review of Kenya, although the level of FDI had been low both in absolute and in relative terms over the past decades, its impact on the economy could not be underestimated. The report (UNCTAD, 2005) continued to state that foreign investors in Kenya had indeed tended to make relatively small investments, but they were numerous and established across a wide variety of sectors. Foreign investors had also contributed significantly to some of the more dynamic sectors in the economy, including horticulture, and to export diversification. As was mentioned previously as well, significant weaknesses in data collection could have likely underestimated the actual flows of FDI (UNCTAD, 2005).
Kenya’s economic leadership in East Africa had been undermined by two decades of poor economic policies, low domestic and foreign investment and slow growth. While expectations for the future could have been high, however, as it engaged in a process of significant transformation (UNCTAD, 2005), the current global financial crisis might stand on the way of those expectations. Therefore the influence of the global credit crunch to developing economies with specific reference to Kenya could not have been clear as of now. However with a longer timeframe, the same could not be ruled out.

1.2 The Research Problem

There were a number of factors that might affect foreign direct investment (FDI) inflows. The factors could be external and/or internal. With specific reference to this study, the external factors might comprise the growth and financial market conditions obtaining in foreign countries. For example, the current financial crisis in the world resulting in the global credit crunch might have far reaching effects on FDI inflows in Kenya. Since most FDI depended on the availability of financial credit, the consequence of the global credit crunch might have far reaching effects on the quantum of FDI inflows in Kenya. It was anticipated that the quantum of FDI inflows in Kenya would be influenced by the global credit crunch. Therefore the relationships that might exist between the global credit crunch (GCC) and FDI inflows in Kenya were such that the former might influence the quantum of the latter.

On the other hand, internal factors that might influence the quantum of FDI inflows might comprise of a range of host country policies, regulations and other characteristics. For example, regulatory frameworks (registration, licensing, tax levels, etc), incentives, political stability, infrastructure, location, access to markets, raw materials and such other internal factors might determine the level of FDI inflows in a country.

Although many aggregate econometric studies had been conducted on FDI, a broad consensus on the major determinants of FDI had been elusive (Asiedu, 2002, as cited in Obwona and Egesa, 2006). This had been attributable to the lack of reliable and accurate
data on FDI flows and its potential determinants, particularly at the sectoral level, and the fact that most empirical work had analyzed FDI determinants by pooling a group of countries that might be structurally diverse (Obwona and Egesa, 2006). The lack of consensus on the major determinants of FDI inflows called for a continuing study of FDI flows. It should be noted that in many instances, internal factors had been cited as determinants of FDI inflows rather than external factors. Regulatory frameworks (registration, licensing, tax levels, etc), incentives, political stability, infrastructure, location, access to markets, raw materials and such other internal factors had been cited as determining the quantum of FDI inflows into a country like Kenya. For example, the high cost of doing business in a country like Kenya had been cited as a drawback by many foreign investors to invest in Kenya and such other developing countries in Africa. Also, incentives given by host countries had been cited as a driving force for FDI inflows. All these were internal factors. It was in light of this that a study on external factors with specific reference to the global credit crunch would be done. Therefore the study would seek to answer the following questions: -

i. What challenges faced FDI inflows in Kenya?
ii. What was the influence of the global credit crunch on FDI inflows in Kenya?

1.3 The Research Objectives

The general main objective or the problem was to study the influence of the global credit crunch on foreign direct investment (FDI) inflows in Kenya. With that main objective, the specific research objectives of the study were: -

i. To establish the challenges that faced FDI inflows in Kenya
ii. To determine the influence of the global credit crunch on FDI inflows in Kenya

1.4 Importance of the Study

In understanding the determinants of FDI inflows, it was important that the factors affecting the quantum of FDI inflows were clearly stated. A review of the literature had indicated that internal factors otherwise termed as pull-factors were cited as the major
factors. There had been a passing and little mention of external factors. However, the current global financial crisis had stimulated the discussion in the influence of global financial crisis on FDI inflows such that, now, external factors, otherwise known as push-factors with specific reference to the global credit crunch needed to be considered when the discussion of FDI inflows was done.

Therefore the findings of this study would add to the current body of knowledge regarding the determinants of FDI inflows and hence assist investors and policy makers to review their investment decisions in light of the current global financial crisis with specific reference to the global credit crunch.
CHAPTER TWO: LITERATURE REVIEW

2.1 Global Economic Problems

According to Khan (2008), with the global economy facing the very real possibility of recession and inflation – especially food inflation skyrocketing, the world’s most important and most traded resource reached unprecedented levels. The most traded resource that was referred was crude oil. In January 2008 the price of oil passed the US $100 mark per barrel when a single trader in search of market fame pushed through a small trade (Khan, 2008). By May 2008 the price of oil reached an unprecedented US $135 a barrel. In the final analysis, oil had risen by 25% since January 2008 and by nearly 400% since the beginning of the 21st century (Khan, 2008). The argument was that the sudden rise in global commodity prices (food and oil) occurred at the same time as the global credit crunch crisis. Therefore the world has experienced three global economic problems in the same span of time of 2007-2009 namely, the global financial crisis resulting into the global credit crunch, oil crisis and food crisis.

The global financial crisis that resulted into the global credit crunch came about through the housing bubble in the United State of America (USA). This was precipitated by the sub-prime mortgage business in which USA banks gave high-risk loans to people with poor credit histories. These and other loans, bonds or assets were bundled into portfolios – or Collateralized Debt Obligations (CDOs) – and sold on to investors globally. Collateralized Debt Obligations (CDOs) was defined by the dictionary of Investopedia.com as an investment-grade security backed by a pool of bonds, loans and other assets. CDOs did not specialize in one type of debt but were often non-mortgage loans or bonds. In the process, many borrowers defaulted in repayments necessitating wholesale foreclosures of mortgaged properties that eventually fetched lesser values than the loaned amounts thereby making losses to the lending banks. In this way, banks and financial institutions could not continue to lend in the normal way as their capital bases had been eroded below the minimum levels of liquidity. Hence credits squeezed leading to a credit crunch. Since the inter-bank lending and borrowing had been done on international markets, the effect had been felt globally. Therefore the global credit crunch
crisis had engulfed the whole world. It was a reduction in the availability of credit (loans) or a sudden tightening of the conditions required to obtain loans between banks for on-lending to final borrowers. This had now become one of the major economic crises in the world.

Another global economic crisis was the oil crisis (Khan, 2008). In January 2008 the price of oil passed the US $ 100 mark per barrel in the world market. By May 2008 the price of oil reached an unprecedented US $ 135 a barrel. In the final analysis, oil had risen by 25% since January 2008 and by nearly 400% since the beginning of the 21st century (Khan, 2008). The explanation that was given for this upward surge of oil price was speculation by oil traders in the futures markets. However, the slowing of global growth which preceded the financial crisis by several months, prompted commodity prices to start falling in mid- 2008 (IBRD/World Bank, 2009). By December 2008, crude oil prices had dropped to US $ 41 a barrel. The sharp decline of crude oil from more than US $ 140 a barrel in July 2008 to firm at about US $ 58 a barrel in May 2009 had been attributed to weaker global demand and relaxation of some refining capacity constraints that had contributed to high prices in the first half of the year (IBRD/World Bank, 2009). Oil price recovery was attributed to a slower recovery in global economic growth. Notwithstanding oil prices recovery, the price of crude oil in the world market was expected to rise, though at a moderate pace. However, according to Khan (2008), speculation through the futures markets could be contributing to these wide oil price swings.

Yet, another global economic problem facing the world was the food crisis. According to World Bank (2008), food prices had been driven by a combination of rising fuel costs, bio-fuels production, and unfavourable weather conditions, with trade restrictions boosting upward price pressures. Therefore as the global financial crisis leading to global credit crunch matured the soaring cost of food on the international market raised the spectre of inflation (Khan, 2008). According to Khan (2008), the price of wheat alone had increased an astonishing 120% since August 2007 with the price of rice increasing by 75% since February 2008. This price surge in commodity prices in the international market had the effect of feeding into domestic prices thereby raising the inflation in many countries.
2.2 Global Credit Crunch

Before 2007, few people had heard of the term credit crunch, but since then, the phrase had been an everyday menu. According to Tong and Wei (2009), the 2007-2009 crises started off in August 2007 in the United States as a subprime mortgage crisis but quickly morphed into a global financial crisis where financial institutions teetered on the edge of bankruptcy in many countries. The current discussion on the global credit crunch came about when adverse news from a French investment bank, BNP Paribas, triggered sharp rise in the cost of credit, and made the financial world realize the seriousness of the situation. As a severe shortage of money or credit, the start of the phenomenon had been pinpointed on 9 August 2007 when adverse news from a French investment bank, BNP Paribas, triggered sharp rise in the cost of credit.

According to Tong and Wei (2009), international capital flows, while potentially beneficial, were said to increase a country’s vulnerability to crisis, especially if it was skewed to non-FDI types. In this respect, the study by Tong and Wei (2009) was to determine whether the volume and composition of capital flows would affect the country’s degree of credit crunch faced by its manufacturing firms during the 2008-2009 crises. While the volume of capital flows would have no significant effect on the severity of credit crunch, however, the composition of capital flows mattered to a greater extent. Tong and Wei (2009) noted that the pre-crisis exposure to non-FDI capital inflows worsened the credit crunch, while the exposure to FDI alleviated liquidity constraint. These arguments tried to show that the composition of the capital flows would determine the severity of the credit crunch to a greater extent.

It should be noted that foreign capital flows comprised of FDI, foreign portfolio investment flows and foreign loans. Therefore, if one wished to understand the connection between the credit crunch and capital flows, care should have been taken not to lump together all capital flows but to isolate them between FDI and non-FDI inflows. While global credit crunch might not have significant influence on foreign direct investment (FDI), other capital flows such as foreign portfolio investment flows and foreign loans did have (Tong and Wei, 2009). Therefore the possibility that one of the capital flows could be
affected more by the global credit crunch than the other could not have been ruled out. However a careful study needed to be undertaken to determine the extent of the influence of the global credit crunch on FDI so that any doubts on the compositional effects on the severity of the credit crunch could be discounted or accepted. Otherwise the global financial crisis brought to an abrupt end the surge in private capital flows to developing countries that had occurred during 2003 to 2007 period (IBRD/World Bank, 2009).

According to McKinnon (2009), the global credit crunch that began in 2007 but became acute in 2008, originated from the collapse in the bubble in US house prices, and to a lesser extent, in European situation. McKinnon (2009) noted that, during the housing bubble, big US investment banks securitized home mortgages into complex risk tranches and then sold them to other banks and financial institutions mainly in the US and Europe. The collapse in home prices impaired the values of these mortgage-backed securities in the portfolios of banks everywhere (McKinnon, 2009). When foreclosures ensued, the mortgage-backed securities were sold at values below outstanding debts culminating into huge losses suffered by investment banks and other financial institutions. This situation would set the pace for the credit squeeze globally.

2.3 Foreign Direct Investment (FDI) Inflows

By definition, foreign direct investment (FDI) comprised equity investment, reinvested earnings (earnings not distributed as dividends and earnings of branches not remitted to the direct investor), and intra-company debt transactions (OECD, 2008, as cited in IBRD/World Bank, 2009). The global financial crisis brought to an abrupt end the surge in private capital flows to developing countries that had occurred during 2003-07 (IBRD/World Bank, 2009). According to Ajayi (2006), a number of studies examined the determinants of capital flows to developing countries (host/recipient countries). These studies tended to look first at capital flows generally and then specifically on foreign direct investment. In general, the factors influencing capital flows into developing countries comprised of the push and pull factors (Ajayi, 2006). The push factors which were external to developing countries focus on growth and financial market conditions in
industrial countries while on the other hand the pull factors comprised of a number of factors, namely, macroeconomic policy and performance, tax levels and existence of incentives to encourage capital flows, measures of the quality of legal and other institutions, political regime, conflict measures, size of domestic markets and natural resource base (Ajayi, 2006). This is simply to state that FDI inflows were determined by external and internal factors in the form of push and pull factors respectively as mentioned above. Moreover, while the push factors determined the pool of funds available to developing countries, the pull factors determined their allocation among developing countries (Collins, 2003, as cited in Ajayi, 2006). Therefore, availability of funds for foreign direct investment to developing countries (host/recipient countries) was determined by the push factors obtaining in the home countries whereas their allocation among developing countries (host/recipient countries) was determined by the pull factors obtaining in respective host countries. Hence availability of funds was determined by external factors obtaining in home countries whereas their allocation was determined by internal factors obtaining in host countries.

The motives behind foreign investors in undertaking investments projects in host countries were varied. According to Campos and Kinoshita (2006), three types of FDI were recognized, namely, market-seeking FDI, whose purpose was to serve local and regional markets, resource-or asset seeking FDI, whose purpose was to acquire resources that were not available in the home country and efficiency-seeking FDI, whose purpose was to gain from the common governance of geographically dispersed activities in the presence of economies of scale and scope. This was to say that FDI were not made indiscriminately. There wee always certain motives in favour of locating foreign direct investment in certain locations.

The motives behind locating foreign direct investments in certain locations was further corroborated by Ajayi (2006) who noted that in the literature on FDI, there were four motives for seeking to invest abroad. These are broadly described as resource seeking, market seeking, strategic asset seeking and efficiency seeking. His writings elaborated that in the case of resource seeking, investors located abroad in order to secure cheaper supplies of raw materials or inputs that were not available at home. Such resources might
be natural resources like oil and gas or low-cost input such as labour. The basic reasons were to lower production costs and enhance competitiveness in both local and foreign markets (Ajayi, 2006). He continued to argue that market-seeking FDI opens up new markets in the host or neighbouring countries to bring about a reduction in the cost of supplying a market. On the other hand he argued that efficiency-seeking FDI attempted to produce in as few countries as possible, with each one having advantage in terms of location, endowment and government incentives. He further noted that strategic-seeking FDI on the other hand, located in a place in order to take advantage of what was available in terms of research and development and other benefits.

The foregoing paragraphs had demonstrated that the determinants of FDI and the motives behind location of FDI were varied and complex such that each case had to be analyzed on its own merit. It was from this realization that, Africa was shown to be different from the rest of the world in terms of factors affecting foreign direct investments (Ajayi, 2006). The implications of such finding were that in the first instance, whatever fundamentals that were present in the various economies, Africa was unlikely to attract significant FDI. Accordingly, policies that have been successful in other regions might not be equally successful in Africa (Asiedu, 2002, as cited in Ajayi, 2006). Also Asiedu argued that economic policy did not matter for FDI. However this argument was at variance with other studies that found policy did matter very much in attracting or discouraging FDI in Africa. This showed that the findings of various studies on the determinants of FDI in Africa had been contradictory in many cases (Ajayi, 2006). At any rate, the studies by Campos and Kinoshita (2006) and Ajayi (2006) did provide the basic fundamentals on the determinants of foreign direct investments.

2.4 Global Credit Crunch and Foreign Direct Investment (FDI) Inflows

The global credit crisis had been linked to the sub-prime mortgage business, in which US banks gave high-risk loans to people with poor credit histories. These and other loans, bonds or assets were bundled into portfolios – or Collateralized Debt Obligations (CDOs) – and sold on to investors globally. This process created the conditions necessary for the
The emergence of the global credit crunch in that the borrowers started to default on repayments forcing the banks and other financial institutions to pounce on mortgaged assets whose values had fallen. This state of affairs led lenders to incur losses as a result of disposing of assets at values lower than the outstanding debts. Since the losses were significant, they depleted the capital base below the minimum capital liquidity thereby reducing the amount that the banks could legally lend out. Effectively this led to a credit crunch because the lenders’ ability to lend was diminished due to reduced liquidity. Hence funds for foreign direct investment (FDI) were hard to come by.

Therefore the business of selling CDOs to investors created the conditions necessary for the emergence of the global credit crunch. Due to high default rates on sub-prime mortgage business, the lenders could not find investors willing to buy their asset-backed commercial papers or term asset-backed securities at reasonable rates thereby reducing their willingness to lend in the future (Anderson, 2007). According to Anderson (2007), in this way, the credit crunch arrived and the economy moved into recession. Therefore credit crunches were considered as extensions of recessions. At a global level, credit crunches affected the availability of credit funds for foreign direct investment. In this way, the global credit crunch might affect the foreign direct investment inflows to certain developing countries like Kenya. It was a fact that many developing countries like Kenya, depend on foreign direct investment for its economic development. Therefore the consequences of the global credit crunch might have an influence on the quantum of foreign direct investment inflows to developing countries like Kenya. At any rate, note should be taken that the global credit crunch was an external factor determining the FDI level in a developing country like Kenya.

However it was not uncommon for developing countries, Kenya included, the discussions on what attracted foreign direct investment inflows to these countries revolved around internal factors. According to UNCTAD Report (2005), the poor growth performance, lack of consistent structural reforms and deteriorating infrastructure over the past couple of decades had actively discouraged FDI and led some large transnational corporations (TNCs) to reduce their operations in Kenya. In this case, the global credit crunch was not mentioned as one of the causes of the declining levels of FDI. You may note that the
reasons for declining levels of FDI were consistently related to internal factors. In this respect, given the global obtaining situation, there was a need to establish if the current global credit crunch, as an external factor, could influence the levels or quantum of FDI in developing countries like Kenya. Accordingly, IBRD/World Bank Report (2009) reported that the global financial crisis that followed the September 2008 collapse of several major financial institutions, including Lehman Brothers, severely constrained developing countries’ access to international financial markets, as investors deserted developing-country markets for what they perceived to be safer securities. The Report noted further that foreign direct investment (FDI) inflows, the largest component of international capital flows to the developing world, were also projected to decline by 30 percent to $385 billion in 2009. These were the initial indications that external factors contributing to the decline in FDI inflows were now being considered. In view of that realization, the need to study the influence of the global credit crunch on foreign direct investment (FDI) inflows was considered appropriate at this point in time.

However, according to Obwona and Egesa (2006), although many aggregate econometric studies had been conducted, a broad consensus on the major determinants of FDI had been elusive (Asiedu, 2002, as cited in Obwona and Egesa, 2006). The lack in consensus could be partially attributed to the lack of reliable and accurate data on FDI flows and its potential determinants, particularly at the sectoral level, and the fact that most empirical work had analyzed FDI determinants by pooling a group of countries that might be structurally diverse (Obwona and Egesa, 2006). It is worth to note that the impact of the financial crisis leading to the global credit crunch on foreign direct investment (FDI) inflows differed, depending on region and sector (UNCTAD, 2009). Further, the report by UNCTAD noted that the impact of the crisis on FDI to developing countries was expected to be much more dramatic in 2009. An outright decline in FDI inflows to those countries was likely to take place due to a pull-back both in efficiency- and resource- seeking FDI aimed at exporting to advanced economies that were currently depressed, and in market-seeking FDI aimed at servicing local markets where growth prospects – though still positive – are receding. Therefore this called for specific country analysis instead of lumping all countries together when analyzing particular fundamentals of determinants of foreign direct investment (FDI) flows.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This study was going to be an exploratory research using the case study research design. According to Becker, Dawson, Devine, Hannum, Hill, Leydens, Matuskevich, Traver, and Palmquist (2005), a case study referred to the collection and presentation of detailed information about a particular participant or small group, frequently including the accounts of subjects themselves. They argued that, as a form of qualitative descriptive research, the case study looked intensely at an individual or small participant pool, drawing conclusions only about that participant or group and only in that specific context. For that matter, researchers did not focus on the discovery of a universal, generalizable truth, nor did they typically look for cause-effect relationships; instead, emphasis was placed on exploration and description (Becker et al, 2005).

In the literature review it had been observed that although many aggregate econometric studies had been conducted on FDI, a broad consensus on the major determinants of FDI had been elusive (Asiedu, 2002, as cited in Obwona and Egesa, 2006). This had been attributable to the lack of reliable and accurate data on FDI flows and its potential determinants, particularly at the sectoral level, and the fact that most empirical work had analyzed FDI determinants by pooling a group of countries that might be structurally diverse (Obwona and Egesa, 2006). In view of that, it was justifiable that, the case study research design had been chosen because of the time and research constraints mentioned above. Therefore in this particular case, Kenya would be used as a country case study. Hence this research would be about a study of the influence of the global credit crunch on foreign direct investment (FDI) inflows in Kenya.

3.2 Data Collection

The research used both primary and secondary data. While the data was sourced from Kenya Investment Authority (KIA) and Kenya National Bureau of Statistics, however,
other sources like published reports from UNCTAD, World Bank, Central Bank of Kenya and the like were used where appropriate. Primary data information was collected by personal interview with one senior official of the Kenya Investment Authority (KIA) and secondary data information was collected from published information in order to establish challenges that face FDI inflows in Kenya. In this respect I interviewed one senior official (General Manager – Research, Policy Advocacy and Planning) The General Manager was the right person to interview because he was presumed to have appropriate information on investment information. Given his senior position and knowledge of the subject matter, the results of the interview were consistent with the information collected from secondary data information. Therefore an interview guide that was prepared was used to guide the interviewing process.

Secondary data was collected from published information to determine the influence of the global credit crunch on FDI inflows in Kenya. The secondary data came from published reports obtained or retrieved from KIA, Central Bank of Kenya, Kenya National Bureau of Statistics, World Bank, International Monetary Fund (IMF) and United Nations Conference on Trade and Development (UNCTAD).

3.3 Data Analysis

The data analysis included both qualitative and quantititative techniques. The primary and secondary data on the challenges that faced FDI inflows in Kenya was be analyzed by observing the frequency of reported challenges whereas the secondary data information for the influence of the global credit crunch on FDI inflows in Kenya was analyzed by using an excel package to generate $t$ – statistics and $p$ – values to assist the researcher in summarizing and commenting on the results thereon. Essentially primary data information was analyzed based on the interview guide responses and corroborated with the secondary data information that was analyzed based on the published reports in order to establish the challenges that face FDI inflows in Kenya. Therefore the magnitude of the challenges was established by analyzing the primary data and secondary data. The secondary data for the
influence of the global credit crunch on FDI inflows in Kenya was analyzed using an excel package to generate $t$ – statistics and $p$ – value.
CHAPTER FOUR: FINDINGS AND DISCUSSION

4.1 Introduction

In this chapter, Section 4.2 will focus on research findings and the discussion on the challenges that faced foreign direct investment (FDI) inflows in Kenya whereas in Section 4.3, the research findings and the discussion will focus on the influence of the global credit crunch on FDI inflows in Kenya. Therefore in each section the discussion will be on how the data was collected and analyzed. On the basis of the summary output results, after data analysis, an interpretation will be made with the ensuing discussion of the research findings.

4.2 Challenges That Faced Foreign Direct Investment (FDI) Inflows in Kenya

One of the research objectives was to establish the challenges that faced FDI inflows in Kenya. In this respect, the plan was to have interview sessions with some senior officials of the Kenya Investment Authority so as to get their insights on the challenges that faced FDI inflows in Kenya. After an interview with one senior official, it was apparent that an interview with any more officials would not elicit any new challenges other than those pointed in the previous interview. In view of that, I corroborated the results of the interview with secondary data information of particular aspects of challenges that faced FDI inflows in Kenya. Therefore data collection was done through an interview with one senior official of Kenya Investment Authority and in-depth reviews of secondary data information in the form of academic articles, grey material, press coverage and outputs from other research processes, UNCTAD, World Bank and Kenya National Bureau of Statistics or government statistics.

Data analysis from reviews of secondary data information provided a challenge for the researcher. All secondary data information was retrieved from online sources such that extensive reading was done to summarize the challenges from diverse sources with
different writing styles. At this point it should be appreciated that, according to Kabelwa (2006), economic effects of FDI contribution were difficult to measure such that two general approaches would normally be used to analyze the effects of FDI contribution, firstly, econometric analysis of the relationships between inward FDI and various measures of economic performance and secondly, a qualitative analysis of particular aspects of FDI contribution. In view of that observation, this study used the second approach for the purpose of data analysis. Therefore qualitative data analysis was done so as to establish the challenges that faced FDI inflows in Kenya. This was done in a form of summary listings that tied up challenges obtained from the results of the interview and from one secondary data information source to another. The results were provided in Table 1.

**Table 1: Challenges that Face FDI Inflows in Kenya**

<table>
<thead>
<tr>
<th>PRIMARY DATA FROM INTERVIEW</th>
<th>SECONDARY DATA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of good governance</td>
<td>Lack of good governance</td>
</tr>
<tr>
<td>Political instability</td>
<td>Political instability</td>
</tr>
<tr>
<td>Policy uncertainties</td>
<td>Lack of consistent structural reforms</td>
</tr>
<tr>
<td>Macroeconomic instability</td>
<td>Poor growth performance</td>
</tr>
<tr>
<td>Corruption</td>
<td>Corruption</td>
</tr>
<tr>
<td>Crime, theft and disorder</td>
<td>Crime, post-election violence</td>
</tr>
<tr>
<td>Bad infrastructure</td>
<td>Deteriorating infrastructure</td>
</tr>
<tr>
<td>Small market size</td>
<td>Small market size</td>
</tr>
<tr>
<td>High cost of doing business</td>
<td>High cost of doing business</td>
</tr>
</tbody>
</table>

**Source: Researcher’s summary**

The interpretation that was derived from the qualitative data analysis in Table 1 indicated that the challenges that faced FDI inflows in Kenya were common, revolving and
recurring over the years. While no one challenge could be said with certainty to be more critical than the other due to the subjective nature of the qualitative data analysis, however, one challenge that seemed to be broader than the others was lack of good governance. Therefore a challenge that was deemed to be broader in nature was more critical than others in that order. The challenges were listed and summarized as provided in Table 1.

The summary in Table 1 listed the challenges that faced FDI inflows in Kenya. The challenges that faced FDI inflows in Kenya were lack of good governance, political instability, lack of consistent structural reforms, poor growth performance, corruption, crime, post-election violence, deteriorating infrastructure, small market size and high cost of doing business. From Table 1, it could be deduced that challenges that faced FDI inflows in Kenya were common, revolving and recurring over the years. These challenges were noted during the interview with a senior official of Kenya Investment Authority and corroborated with every literature that was reviewed. In that case, unless deliberate efforts were made to address the issues raised, the future FDI inflows in Kenya would be faced by the same or more challenges.

On the first specific research objective that focused on establishing the challenges that faced FDI inflows in Kenya, the research findings indicated that there were a myriad of challenges that faced FDI inflows in Kenya. These included lack of good governance, political instability, lack of consistent structural reforms, poor growth performance, corruption, crime, post-election violence, deteriorating infrastructure, small market size and high cost of doing business. According to the qualitative data analysis presented in Chapter 4 in Table 1, these challenges appeared to be common, revolving and recurring over a number of years.

For example in previous research on lack of good governance, the research finding was supported by a report by UNCTAD (2005), that argued that Africa’s low level of FDI was explained by various governance failures that had closed the region off to a new growth dynamic built around participation in international production networks and more efficient service activities. This problem was not an exception to Kenya. Problems of policy credibility had been identified as likely deterrents to potential foreign investors, with trade
policies singled out for particular attention in cross-country regression studies. For example, low levels of FDI to Africa had been explained by the ad hoc and reversible nature of liberalization efforts and the abuse of trade policies for wider economic and social goals (Asiedu, 2002, as cited in UNCTAD, 2005).

It should be noted that the issue of good governance was broader as it encompassed public governance in public institutions as well as corporate governance. The challenge on lack of good governance included requirements to reduce corruption, increase transparency and accountability (EABC, 2008). Therefore the issue of good governance was so broader such that it covered almost all challenges that faced FDI inflows in a country. It was natural that, lack of good governance would discourage FDI inflows in a particular country. Therefore it would be up to the Government of Kenya in this respect to create favourable investment environment in order to attract foreign investors.

Political instability was cited as another challenge that faced FDI inflows in Kenya. According to Chigunta (2006), political stability was a fundamental aspect of the investment decision in that, investors simply would not risk their capital in an environment that was perceived as unstable, because the risk of losing their investment would be perceived as too high. In Kenya, the post-election violence that was witnessed in 2008 contributed to a greater extent to the drastic decline in FDI inflows in Kenya as observed in the secondary data in Table 2. No rational investors would risk investing in such kind of an environment. This challenge came at the same time as the global credit crunch thereby aggravating the situation. As a result of political instability, other societal vices would normally creep in. As noted in the research findings these would include crime, theft and other public disorders that were witnessed during the year 2008 and thereafter such that rational investors would normally shy away from such locations.

According to research findings, corruption had been cited as another variable that challenged FDI inflows. Corruption in the public sector and judiciary systems in most Sub-Saharan Africa countries had always been cited as one of the reasons that deterred investors from the region (Bhattacharya, Montiel, Sharma, 1997 as cited in Abdulai, 2007). In this respect Kenya has had its share of this vice such that it had kind of
contributed towards the increasing of the cost of doing business in Kenya. The investors would always factor the cost paid in corruption deals such the cost-benefit analysis would show negative or insignificant profitability leading to declining of any investment proposal. This would definitely discourage FDI inflows into the country.

In another research finding, it was indicated that deteriorating infrastructure was also one of the factors challenging FDI inflows in the country. Although this aspect of the challenge was being addressed, however, it might take some time to clear this restraining force. Previous research showed that infrastructure and skills were important determinants of FDI (Wheeler and Mody, 1992, and Noorbaksch, 2001, as cited in Kabelwa, 2006). Therefore the findings of this study were consistent with other previous studies. It should be noted that in a country where the means of communication were not available, the pace of development would be very slow if not stagnant. Therefore this would be a big challenge that would face FDI inflows in a country. For example events that were witnessed during the post-election violence in 2008 when the railway line was uprooted in order do disrupt movement of goods and people showed how important was the infrastructure to the development of a country. Effectively no investor would venture into such kind of location to do business. Moreover, if there were no proper infrastructure, investors would have to build their own infrastructure in order to produce, transport, sell or export their products. This would increase the cost of production considerably thereby decreasing profitability in turn making investments in such locations being un-attractive as they were un-economical.

Another research finding indicated that small market size was a challenge that faced FDI inflows in a country. This finding was consistent with an observation made by Abdulai (2007), who noted that market size had been one of the factors hindering the flow of FDI into the region. Therefore unless the current market size was increased by expanding to other neighboring countries the challenge will still hold for some time. It should be noted that Kenya had been strategically located in the region. Therefore it could cooperate with her neighbors to expand the market base in order to attract FDI inflows to the region. Therefore Kenya should develop effective methods to create large markets to make the region attractive for more FDI inflows.
In this respect the study sought to answer the question about what challenges faced FDI inflows in Kenya. The discussions that followed above tried to point out those challenges that the research findings found to be significant. In view of the research findings the challenges that faced FDI inflows in Kenya would affect the level of the FDI inflows in Kenya unless positive steps were taken to address them. Therefore in conclusion the government should address those challenges with a view of eliminating their severity if not eradicate them completely.

4.3 The Influence of the Global Credit Crunch on FDI Inflows in Kenya

Another specific objective of the research project was to determine the influence of the global credit crunch on FDI Inflows in Kenya. In this respect data collection was done through in-depth reviews of secondary data information obtained from UNCTAD reports, Kenya National Bureau of Statistics, International Monetary Fund (IMF) and World Bank reports on economic indicators for Kenya. Therefore the data that was collected on economic indicators was on the real gross domestic product (GDP), cumulative FDI inflows, annual FDI inflows and the GDP growth rates over a number of years for Kenya as indicated in Table 2.
Table 2: Economic Indicators

<table>
<thead>
<tr>
<th>YEARS</th>
<th>GDP</th>
<th>CUMMULATIVE FDI INFLOWS</th>
<th>ANNUAL FDI INFLOWS</th>
<th>GDP GROWTH RATE %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>US $ (IN MILLIONS)</td>
<td>US $ (IN MILLIONS)</td>
<td>US $ (IN MILLIONS)</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>11,701</td>
<td>732</td>
<td>33</td>
<td>4.4</td>
</tr>
<tr>
<td>1996</td>
<td>11,973</td>
<td>743</td>
<td>11</td>
<td>4.1</td>
</tr>
<tr>
<td>1997</td>
<td>13,034</td>
<td>796</td>
<td>53</td>
<td>0.3</td>
</tr>
<tr>
<td>1998</td>
<td>14,016</td>
<td>807</td>
<td>11</td>
<td>3.4</td>
</tr>
<tr>
<td>1999</td>
<td>12,799</td>
<td>820</td>
<td>14</td>
<td>2.1</td>
</tr>
<tr>
<td>2000</td>
<td>12,604</td>
<td>931</td>
<td>111</td>
<td>0.5</td>
</tr>
<tr>
<td>2001</td>
<td>12,983</td>
<td>937</td>
<td>5</td>
<td>0.5</td>
</tr>
<tr>
<td>2002</td>
<td>13,151</td>
<td>964</td>
<td>28</td>
<td>4.5</td>
</tr>
<tr>
<td>2003</td>
<td>14,986</td>
<td>1,046</td>
<td>82</td>
<td>0.6</td>
</tr>
<tr>
<td>2004</td>
<td>16,199</td>
<td>1,092</td>
<td>46</td>
<td>3.0</td>
</tr>
<tr>
<td>2005</td>
<td>18,730</td>
<td>1,113</td>
<td>21</td>
<td>4.9</td>
</tr>
<tr>
<td>2006</td>
<td>23,753</td>
<td>1,164</td>
<td>51</td>
<td>5.4</td>
</tr>
<tr>
<td><strong>2007</strong></td>
<td><strong>30,512</strong></td>
<td><strong>1,892</strong></td>
<td><strong>728</strong></td>
<td><strong>7.1</strong></td>
</tr>
<tr>
<td><strong>2008</strong></td>
<td><strong>30,236</strong></td>
<td><strong>1,988</strong></td>
<td><strong>96</strong></td>
<td><strong>1.7</strong></td>
</tr>
<tr>
<td>2009*</td>
<td>31,022</td>
<td>2,058</td>
<td>70</td>
<td>2.6</td>
</tr>
<tr>
<td>2010*</td>
<td>32,077</td>
<td>2,133</td>
<td>75</td>
<td>3.4</td>
</tr>
<tr>
<td>2011*</td>
<td>33,649</td>
<td>2,213</td>
<td>80</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Source: Extracts from UNCTAD data base/IMF/World Bank/2009

Key
* Estimates

All secondary data information was retrieved from online sources on UNCTAD, International Monetary Fund (IMF) and World Bank websites such that extensive reading and summaries were made. As pointed in the previous section, economic effects of FDI contribution were difficult to measure such that two general approaches would normally be used to analyze the effects of FDI contribution, firstly, econometric analysis of the relationships between inward FDI and various measures of economic performance, for example real GDP and GDP growth rates and secondly, a qualitative analysis of particular aspects of FDI contribution (Kabelwa, 2006). In view of that observation, the first approach was used for the purpose of data analysis. Therefore quantitative data analysis was done by processing the secondary data information in Table 2 using an excel package to get summary output results provided in Table 3 for t - statistics on cumulative FDI inflows and gross domestic product (GDP) for Kenya in order to determine the influence
of the global credit crunch on FDI Inflows in Kenya as per available economic indicators. Hence an excel package was used to run the secondary data for data analysis. The output results are provided in Table 3.

The data would be tested at the 95% confidence level and interpretation made on the output results. If the output level of significance were less than 5%, then the relationship would be considered stronger and significant. That meant the lower the level of significance the stronger the relationship between the cumulative FDI inflows and real GDP. The general summary output results of the secondary data information were provided in Table 3 below.

**Table 3: Output Results**

**SUMMARY OUTPUT**

<table>
<thead>
<tr>
<th>Regression Statistics</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple R</td>
<td>0.977</td>
<td>0.954</td>
<td>0.951</td>
<td>1857.6</td>
<td></td>
</tr>
<tr>
<td>R Square</td>
<td>0.977</td>
<td>0.954</td>
<td>0.951</td>
<td>1857.6</td>
<td></td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.977</td>
<td>0.954</td>
<td>0.951</td>
<td>1857.6</td>
<td></td>
</tr>
<tr>
<td>Standard Error</td>
<td>0.977</td>
<td>0.954</td>
<td>0.951</td>
<td>1857.6</td>
<td></td>
</tr>
<tr>
<td>Observations</td>
<td>17</td>
<td>17</td>
<td>17</td>
<td>17</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ANOVA</th>
<th>df</th>
<th>SS</th>
<th>MS</th>
<th>F</th>
<th>Significance F</th>
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<tbody>
<tr>
<td>Regression</td>
<td>1</td>
<td>1090230749</td>
<td>1090230749</td>
<td>315.9156233</td>
<td>1.73115E-11</td>
</tr>
<tr>
<td>Residual</td>
<td>15</td>
<td>51765281.72</td>
<td>3451018.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>16</td>
<td>1141996031</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Coefficients</th>
<th>Standard Error</th>
<th>t Stat</th>
<th>P-value</th>
<th>Lower 95%</th>
<th>Upper 95%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>619.4190169</td>
<td>1159.727381</td>
<td>0.53410744</td>
<td>-1852.481371</td>
<td>3091.319405</td>
</tr>
<tr>
<td>X Variable 1</td>
<td>15.06812622</td>
<td>0.847761515</td>
<td>17.7740154</td>
<td>1.73115E-11</td>
<td>13.26116533</td>
</tr>
</tbody>
</table>

**Source: Excel package summary output**

From Table 3 it could be interpreted that change in the GDP after controlling for cumulative FDI inflows was positive but insignificant at the conventional level of significance. However, the summary output results showed that there was a strong positive relationship (see positive coefficients in Table 3) between the GDP and cumulative FDI inflows over the observation period at the 1% level of significance (see P-value in Table
3). This suggested that cumulative FDI inflows contributed to the quantum of the country’s real GDP with associated GDP growth rate at a particular point in time. In this respect I could safely conclude that decreased FDI inflows as influenced by the global credit crunch would effectively reduce the country’s GDP growth rate as noted in Table 2 and confirmed in the summary output with reference to t- statistics and p- values in Table 3. Therefore, though the change in GDP after controlling for cumulative FDI inflows was insignificant but the relationship between country’s real GDP and cumulative FDI inflows was strongly positive at the 1% significance level. This finding suggested that FDI inflows contributed to the country’s levels of GDP and GDP growth rate.

The research finding implied that in times of the global credit crunch, the levels of FDI inflows in a country tended to decline due to global credit squeeze. The impact of this phenomenon would be felt in the decreased GDP growth rate. In the case of Kenya the decreased FDI inflows in Kenya as a result of global credit crunch resulted in the decreased GDP growth rate as exemplified in Table 2. For example, the growth rate of GDP in Kenya in 2007 at the time of the onset of the global financial crisis was 7.1% whereas the GDP growth rate in the thick of the global credit crunch in 2008 plummeted to 1.7%. This drastic fall in the GDP growth rate was attributed to decreased levels of FDI inflows in the country as influenced by the non-availability of global finance to finance production operations in the economy. While in the following years from 2009 to 2011 the GDP growth rates were projected at 2.6%, 3.4% and 4.9% respectively, however, the recovery would take some time to reach the all high of 7.1% GDP growth rate experienced in 2007.

On the second research objective, the purpose of the study focused on determining the influence of the global credit crunch on FDI inflows in Kenya. The research findings indicated that change in the real GDP after controlling for cumulative FDI inflows was positive but insignificant at the conventional level of significance. While the change in GDP was insignificant at the conventional level of significance, however, the findings suggested that cumulative FDI inflows contributed to the country’s levels of GDP and GDP growth rate. Hence the interpretation was that there was a strong positive relationship between the GDP and cumulative FDI inflows over the observation period at
the 1% level of significance. This suggested that cumulative FDI inflows contributed to the quantum of the country’s real GDP with associated GDP growth rate at a particular point in time. Therefore if the level of FDI inflows were to be decreased as a result of the global credit crunch, then the real GDP and associated GDP growth rates would be affected adversely. In this respect I could safely argue that decreased FDI inflows as influenced by the global credit crunch would effectively affect the country’s real GDP and therefore depress GDP growth rate as observed and noted in Table 2.

The above assertions were supported by previous research made on the subject. For example, according to UNCTAD (2005), the cumulative FDI inflows and real GDP in Africa were regressed and found to have positive signs in its coefficient signs indicating that positive relationship between the levels of FDI inflows and the real GDP existed with variation in significance. Those results were consistent with the results obtained from the findings of this study. The research findings in this study indicated positive signs of the coefficients as shown in Table 3. Hence the relationship existed between the levels of FDI inflows and the real GDP I a country. Therefore the global credit crunch would influence the levels of FDI inflows downwards and in turn that would affect the quantum of real GDP and depress the GDP growth rates. Since that was the quantitative data analysis no further explanation could be made but summary output results would explain that relationship.

Other research findings stated that the global credit crunch affected the levels of FDI inflows. Therefore they were consistent with the research findings of this study. For example, Mwega (2009) noted in his study that the anticipated decline in FDI as a result of the financial crisis would adversely affect the country’s performance. Hence economic performance as depicted in the economic indicators, namely, FDI inflows, real GDP and GDP growth rates would be affected as a result of the global financial crisis in the form of the global credit crunch. In this respect, non-availability of credit or credit squeeze would decrease the FDI inflows in a country and therefore depress real GDP and reduce the GDP growth. The finding was consistent with the research finding that there was a positive relationship between FDI inflows and real GDP and the GDP growth rates in that
decreased FDI inflows as a result of global credit crunch would affect the real GDP and therefore depress the GDP growth rates.

In another study done by Murinde (2009), it was indicated that in the short term, FDI into Africa would be expected to fall during 2009 and early 2010, which would further increase Africa’s financial marginalization and undermine growth in foreign capital dependent sectors such as natural resources. This observation tried to emphasize the effects of the global credit crunch on the FDI inflows. Therefore the influence of the global credit crunch on the FDI inflows in a country could felt on the impact it would have on the economic performance of the country as depicted in the real GDP and GDP growth rates over a number of years that the credit squeeze would prevail.
5.1 Introduction

In this chapter, Section 5.2 focuses on the summary of findings and answers to the research questions. Section 5.3 focuses on conclusions on the challenges that faced foreign direct investment (FDI) inflows in Kenya and the influence of the global credit crunch on FDI inflows in Kenya. Section 5.4 focuses on the limitations of the study whereby brief comments will be made on the limitations encountered in the research project. Section 5.5 contains the suggestions for further study. Section 5.6 focuses on the recommendations for policy and practice.

5.2 Summary

The general objective or the problem was to study the influence of the global credit crunch on foreign direct investment (FDI) inflows in Kenya. A case study approach was used to undertake the research with Kenya as a case for reference in relation to her FDI inflows, real GDP and the GDP growth rates. Therefore primary data was collected from the interview with one senior official of Kenya Investment Authority. Secondary data was collected from published reports of several agencies. Essentially there were two specific research objectives that directed the study. The first specific research objective was to establish the challenges that faced FDI inflows in Kenya and the second specific objective was to determine the influence of the global credit crunch on FDI inflows in Kenya.

On the first specific research objective that focused on establishing the challenges that faced FDI inflows in Kenya, the research findings indicated that there were a myriad of challenges that faced FDI inflows in Kenya. These included lack of good governance, political instability, lack of consistent structural reforms, poor growth performance, corruption, crime, post-election violence, deteriorating infrastructure, small market size and high cost of doing business. These challenges were noted during the interview with a senior official of Kenya Investment Authority and corroborated with every literature that
was reviewed. According to the qualitative data analysis presented in Chapter 4 in Table 1, these challenges appeared to be common, revolving and recurring over a number of years.

On the second research objective, the purpose of the study focused on determining the influence of the global credit crunch on FDI inflows in Kenya. The research findings indicated that change in the real GDP after controlling for cumulative FDI inflows was positive but insignificant at the conventional level of significance. While the change in GDP was insignificant at the conventional level of significance, however, the findings suggested that cumulative FDI inflows contributed to the country’s levels of GDP and GDP growth rate. Hence the interpretation was that there was a strong positive relationship between the GDP and cumulative FDI inflows over the observation period at the 1% level of significance. This suggested that cumulative FDI inflows contributed to the quantum of the country’s real GDP with associated GDP growth rate at a particular point in time. Therefore if the level of FDI inflows were to be decreased as a result of the global credit crunch, then the real GDP and associated GDP growth rates would be affected adversely. In this respect I could safely argue that decreased FDI inflows as influenced by the global credit crunch would effectively affect the country’s real GDP and therefore depress GDP growth rate as observed and noted in Table 2.

5.3 Conclusions

In conclusion, the challenges that faced FDI inflows in Kenya were varied and required different approaches in addressing them. These challenges as discussed in Chapter Four were the restraining forces behind low levels of FDI inflows in the country resulting into depressed levels of real GDP and decreased GDP growth rates. With the global credit crunch as an external factor that influenced the FDI inflows in the country, these challenges formed the internal factors that determined FDI inflows in the country. Therefore the government should take up necessary step to alleviate the impact of these and other challenges.
Also, regarding the influence of the global credit crunch on FDI inflows in Kenya, it was apparent that the global credit crunch had visited the country as depicted in the results of the relationship observed in the data analysis summary output results. The global credit crunch that occurred after the year 2007 as an external factor that determined the levels of FDI inflows influenced the levels of FDI inflows in Kenya as depicted in depressed levels of real GDP and decreased GDP growth rates. Therefore in conclusion the global credit squeeze would influence the levels of FDI inflows in a country like Kenya. The results of the data analysis in Table 2 and Table 3 supported these conclusions in that as a result of the global credit crunch after the year 2007 the levels of FDI inflows in the country went down significantly. This suggested that there was a relationship between global credit squeeze and low levels of FDI inflows resulting into depressed real GDP and decreased GDP growth rates.

5.4 Limitations of the Study

As in any research of this nature, there were limitations that were encountered in the course of data collection that might affect the results of the research findings. Ideally, a research of this nature would require an actual survey of a large number of companies and institutions in order to capture the actual reality regarding the management problem under study. Instead, the study relied on primary data from an interview with one senior official from an investment authority to corroborate evidence obtained from secondary data information from published reports. Another limitation was on the sample size used to do the regression of the collected secondary data. The sample size was not adequate, though the summary output results were consistent with the findings with other studies made on the subject. Also there were time constraints with respect to data collection. This kind of study would require an extended time frame to collect data and subject it to data analysis as appropriate. Notwithstanding these limitations, however, the methodology used was consistent with any research study that would be carried out on a management problem.
5.5 Suggestions for Further Research

According to research findings, FDI inflows of the country would contribute towards the economic performance of the country such that any imbalance in the levels of FDI inflows as a result of the global financial conditions would effectively affect the levels of country’s real GDP and related GDP growth rates. This assertion should be qualified in the sense that FDI inflows might not be the only variable that would affect the level of the country’s GDP. There could be other variables that might contribute to the levels of GDP. For example other capital inflows like portfolio investments, long-term loans and other investments could have contributed to the level of the country’s GDP. Therefore further study should be done on the influence of global credit crunch on non-FDI capita inflows in a country in relation to their contribution in the economic performance of the country.

Also there should be further research on qualitative factors affecting FDI inflows in the country. These might include levels of education of the labour force, population, HIV/AIDS prevalence, democratic freedom and such other variables. Therefore further research should be done on any of these variables. However it should be noted that all of these variables would present a bigger challenge during the data collection exercise and data analysis due to the nature of the variables. It would be a challenge to assign values for data analysis. However it would be a worthy study that would contribute towards a knowledge bank on FDI flows in general.

5.6 Recommendations for Policy and Practice

On the challenges that faced FDI inflows in Kenya, the research findings indicated that there were a myriad of challenges that faced the FDI inflows in Kenya. These included lack of good governance, political instability, lack of consistent structural reforms, poor growth performance, corruption, crime, post-election violence, deteriorating infrastructure, small market size and high cost of doing business. On the influence of the global credit crunch on the FDI in Kenya, the research findings suggested that FDI inflows contributed
to the country’s levels of GDP and GDP growth rate. Hence there was a positive relationship between the FDI inflows and country’s real GDP and GDP growth rates.

On the challenges that faced FDI inflows in Kenya, in case of good governance, the country should have properly functioning institutions in the public sector and the private sector. A proper code of conduct should be drawn that would bind all people in these institutions in order to make service delivery a reality. In case of political instability, there should be a proper constitution that addresses all issues related to human rights and other constitutional matters. Democracy and freedom of speech should be allowed in order for people to air their grievances and in the process diffuse any pressure that will culminate into chaotic scenes.

Also in case of lack of consistent structural reforms, there should be clear guidelines on how business could be conducted. In that respect, the policies that were made on structural reforms should be consistent and applied across the country without fear or favor. Also the government should ensure that the infrastructure is put in good shape. This will be done by building more accessible roads and maintain them accordingly. Also the info-structure should be affordable to enable people communicate with ease. Poor growth performance should be reversed by stimulating the economy by government intervention through subsidized inputs to the farmers to increase the production of their produce.

In case of the small size of the market, the country should have good relations with her neighbouring countries so as to expand the market of the goods and services. In his respect regional cooperation should be encouraged between countries and regional economic blocks. This will ensure that the market is expanded to encompass a wider geographical area. Regional economic blocks like COMESA, EAC, IGAD and SADCC should be consolidated to have one big market for good and services. In the case of the high cost of doing business, deliberate efforts should be made to reduce the number of licenses in order to reduce cost of production and other cumbersome procedures. Also the country should adopt bailout plans and rescue packages for industries that are affected by the financial crisis, especially the tourism industry.
Corruption is another area where improvement can be made. The Kenya Anti-Corruption Commission should be strengthened and given powers to prosecute to a long and winding judicial process in prosecution and recovery of ill-gotten assets. Also the Judiciary should be improved. These qualitative factors will go a greater length in attracting FDI inflows in the country. Also macroeconomic instability could be addressed by having a controlled interest rate regime and foreign exchange review periodically. These recommendations are not exhaustive. Hence continuing review should be made from time to time.
REFERENCES


APPENDICES

Appendix I: Introduction Letter

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

Re: MBA Research Proposal

I am an MBA student at the University of Nairobi. I am carrying a research study as a partial fulfillment for the award of the Master of Business Administration degree.

I am carrying out a research about the influence of the global credit crunch on foreign direct investment (FDI) inflows in Kenya. I hope that the results of the study will contribute in the body of knowledge on FDI inflows and therefore elicit further study on the influence of financial or economic turns in a country’s economy.

In order to gather some information for the research study, I am conducting interviews with some officials of your organization. Please be kind enough to assist in this.

Yours faithfully

…………………………

Allen P. M. Chombo

STUDENT
Appendix II: Interview Guide

Below are some questions that will guide me in completing the research assignment. The topic in question being: *The Influence of the Global Credit Crunch on Foreign Direct Investment (FDI) Inflows in Kenya*

- *Please spare a few minutes to complete the questionnaire below*
- *Kindly tick or answer the questions correctly, or to the best of your knowledge*
- *Do not write your name. All the information you give will be held in confidence*

Thank you for agreeing to be part of this study

**PART I: DEMOGRAPHICS**

1. Gender: Male [ ] Female [ ]
2. Age: Years

   Under 25 [ ]
   26 to 35 [ ]
   36 to 45 [ ]
   46 to 55 [ ]
   Over 56 [ ]

3. Highest Level of Education

________________________________________________________________________________________

4. Current Position

________________________________________________________________________________________
5. How long have you worked in the above position

Less than 5 years [ ]
6 to 10 years [ ]
11 to 15 years [ ]
More than 15 years [ ]

PART II: THE CHALLENGES THAT FACE FDI INFLOWS IN KENYA

1. What challenges does Kenya have in FDI Inflows? Explain the nature of the challenges and why you think Kenya faces them.

i. ______________________________________________________________________
   ______________________________________________________________________
   ______________________________________________________________________
   ______________________________________________________________________

ii. ______________________________________________________________________
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iii. _____________________________________________________________________
    ______________________________________________________________________
    ______________________________________________________________________
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iv. _____________________________________________________________________
    ______________________________________________________________________
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2. What are the general motives of investors for FDI Inflows in Kenya?

i

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iii

iv
3. Which motives of investors would you consider as the most important or prominent and why?

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PART III: THE INFLUENCE OF THE GLOBAL CREDIT CRUNCH ON FDI INFLOWS IN KENYA

1. Is the threat of the global credit crunch on FDI Inflows real for Kenya? Explain

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2. Is Kenya a favourite investment destination now than before 2008? Explain

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3. How is the global credit crunch affecting Kenya’s FDI inflows? Explain

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4. Which sector(s) of the economy do you consider as most affected? Explain

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45
PART III: ANY OTHER PERTINENT DISCUSSIONS/POINTS DURING THE INTERVIEW PROCESS

Thank you for your patience and understanding