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THE MODERATING EFFECT OF GOVERNANCE QUALITY ON THE RELATIONSHIP BETWEEN FOREIGN CAPITAL INFLOWS AND ECONOMIC GROWTH IN KENYA

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(049206.)

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF DEGREE OF MASTER OF SCIENCE IN DEVELOPMENT FINANCE OF STRATHMORE UNIVERSITY

JULY 2025

DECLARATION

This project is my original work and has not been submitted for examination in any other institution.

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Irene Thuo

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Sign: ……  **……** **Date:** **July 2025**

Approval

This research project has been submitted for examination with my approval as the university supervisor

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I am grateful to God for the gift of life, the opportunity to further my studies and the strength to work on this thesis.

My sincere gratitude to my supervisor, Dr. Muli Maingi, for his guidance and immense support during this research period.

I am truly grateful to my parents for their continued moral support while drafting this thesis.

DEDICATION

To my family, thank you for your love, patience, and understanding during the long hours of research and writing. This accomplishment is as much yours as it is mine.

ABSTRACT

Foreign capial has gradually increased its inflows into Kenya during the past several years and is touted to play a role in enhancing development of various economic aspects. The purpose of the study was therefore to analyse the moderating influence of governance quality on the effects of foreign capital inflows on economic growth in Kenya. Specifically, the study analysed the effect of foreign direct investment, foreign portfolio inflows, diaspora remittances and official development assistance on economic growth in Kenya. The study also analysed the moderating effect of governance quality on the relationship between foreign capital inflows and economic growth in Kenya. The study was grounded on the Neoclassical Growth Theory, Institutional Theory and the Dependency Theory. The positivism research philosophy was also employed. The study also adopted an explanatory research design. The study collected secondary data from the CBK. The data was collected on the variables for the period between 1993-2022. The collected study data was analyzed using descriptive and inferential analysis. The study found out that there was a significant influence for development assistance, foreign portfolio inflows, diaspora remittances and governance on economic growth while an insignificant influence was recorded for foreign direct investment on economic growth in Kenya. The study recommends that the government should create more investment opportunities for the diaspora by developing attractive investment vehicles such as diaspora bonds, real estate opportunities, and small business ventures.The study also recommends improving the governance of ODA funds by adopting transparent monitoring and evaluation systems to ensure funds are used efficiently and for their intended purposes. The study also recommends a comparative study be conducted with other East African countries and or developing countries to provide a broader perspective on how different economies are utilizing foreign capital.

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LIST OF ABBREVIATIONS

ARDL	Autoregressive Distributed Lag
CBA	Commercial Bank of Africa
FDI	Foreign Direct Investment
FMOLS	Fully Modified Least Squares
FPI	Foreign Portfolio Investment
GCCs	Gulf Cooperation Council States
GDP	Gross Domestic Product
GMM	Generalized Method of Moments
IMF	International Monetary Fund
NACOSTI	National Commission for Science Technology and Innovation
ODA	Official Development Aid
OLS	Ordinary Least Squares
SEM	Structural Equation Modelling
SSA	Sub Saharan Africa
VECM	Vector Error Correction Model

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DEFINITION OF TERMS

Foreign Capital Inflows	Ndiweni and Bonga-Bonga (2021) define foreign capital flows as a form of investment activity whereby an investor from a foreign economy invests in another economy.
Foreign Portfolio Investment	FDI is the investment made in foreign markets with the intention of maintaining a long-term presence in the market (Marjanović & Domazet (2021).
Foreign Direct Investment	Investments made by foreign entities with no intention of establishing long-term interest (Debbiche, 2020).
Official Development Aid	ODA is the financial support provided by developed countries to developing countries to promote economic development and reduce poverty (Kenny, 2020).
Remittances	Cocco et al. (2019) define a remittance as all the finances remitted by an immigrant.
Economic growth	An improvement in production of economic goods and services in a country over time (Jawaid & Saleem, 2017).
Governance Quality	A measure of a country's administrative institutions' efficiency in carrying out governance objectives (Ajide, et al., 2014).

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

All governments require investment to support sustainable economic growth and employment. While primarily, this can be achieved through domestic funding, Jawaid and Saleem (2017) remark that foreign inflows have emerged as alternative financing sources that can also provide additional benefits such as technical knowledge and know-how and transfer of technology and also provide foreign currency hence promoting balance of payment position. Mowlaei (2018) notes that emerging economies rely on foreign inflows to bridge their funding gap, develop human capital, and close the domestic savings-investment gap, subsequently boosting the economy.

One of the largest items of foreign capital is the Foreign Direct Investment (FDI) which is usually regarded as a key factor in economic growth especially in the developing economies (Dunning, 2001). FDI is perceived as the medium where technology, managerial skills and capital are brought to the host country, which may result in the creation of jobs, a rise in productivity, and structural economic change (Kinda, 2020). The advantages of FDI are not automatic though. FDI has positive effects on any economy under the condition that specific criteria are met that will see foreign investments are well-absorbed and used (Campos and Kinoshita, 2008; UNCTAD, 2023).

The quality of governance, that incorporates such variables as political stability, corruption control, regulatory efficiency, among others, is an important factor in the effectiveness of foreign capital in fostering economic growth. Well-established governance structures assist in making sure that foreign inflows are directed to areas of production, thereby increasing growth potential of a nation. On the other hand, poor governance may result in the misplacement of resources, corruption and economic inefficiencies that negate the potential advantages of FDI, remittances, and ODA (World Bank, 2023; North, 1990). This is why there is a need to enhance institutional structures so that foreign flows of capital can positively impact long-term and inclusive development (UNDP, 2023).

Foreign Direct investment (FDI) is instrumental to Europe's economic growth, with the European Central Bank (2018) reporting that FDI to the European Union rose from €224 billion in 2016 to €312 billion in 2017. The report confirms that the growth was attributed to the growth of the European economy in terms of increased jobs, capital generation, and technology. According to

the report, local-financial sector development increased the country's foreign inflows by 17% in 2017, boosting the country's economic output by 0.2%. Similar observations were made in Asia where the Asian Development Bank (2018) reported that foreign inflows rose from $446 billion in 2016 to $586 billion in 2017. In China, a 7.9% increase in foreign flows in 2017 boosted economic output by 0.5%. The Inter-American Development Bank (2018) reports that FDI inflows to nations rose from $125 billion in 2016 to $147 billion in 2017 which resulted in increased capital, technology, and jobs. For example, FDI inflows to Mexico increased by 11.8% in 2017, boosting the country's economic output by 0.3%.

One more important source of foreign capital in developing economies is remittances, which contribute to GDP over 3.4% in 2023 (World Bank, 2024). Although remittances are generally well known to increase household welfare, decrease poverty and increase consumption, their impact to the long term economic growth is controversial. Ratha (2013) notes that remittances can serve to enhance human capital through investments in education, healthcare, and entrepreneurship by the families. Nevertheless, Chami et al. (2005) believe that overreliance on remittances will contribute to dependency as well as distort local investment and innovations. In developing countries, although remittances have a large role in enhancing consumption, it is feared that they might not make enough contribution to productive investment in the long run (Nyamongo et al., 2012).

FDI has contributed to Africa's growth significantly according to African Development Bank (2018) reports which indicate that FDI inflows rose from $25 billion in 2016 to $32 billion in 2017 resulting in access to capital, technology, and jobs. In South Africa, inflows increased by 93% in 2017, boosting the country's economic output by 0.5%. Similarly, inflows to Egypt increased by 24% between 2012 and 2016, resulting in a 0.2% increase in the country's economic output. Kenyan reports indicate that growth in foreign inflows directly correlates to economic development, with Gachunga (2019) confirming that at a sectoral level, FDI into the infrastructure sector significantly improves economic growth.

However, foreign capital inflows can also negatively affect economic growth. Ranjbar, Sadeghi, and Sadeghi (2018), for instance, revealed that foreign capital inflows can hinder economic growth by causing currency appreciation, which made exports less competitive. The researchers argue that foreign inflows can increase financial instability, which leads to economic crises and increased

external debt. In the study by Baharumshah, Slesman and Devadason (2017), surges in foreign investment increased appreciation in exchange rate, which reduces economic competitiveness, accelerates commercialization in less developed countries and reduces political sovereignty. In Pakistan, where Jawaid and Saleem (2017) found a positive impact of remittances on local investment, FDI negatively affected economic growth. Yakubovskiy, Rodionova and Derkach (2019) show how FDI can create foreign liabilities through dividend payments and profits repatriation, which can lead to a liquidity crisis.

The link between capital inflows and economic growth in Africa is more intricate, as reported by the African Development Bank (2018), which indicated that net inflows increased from $4 billion in 1980 to $25 billion in 2007 and more than $60 billion in 2017. However, Adu and Quartey (2006) argue that foreign investments negatively impact economic growth in Africa. Within the East African Community, The KNBS (2020) reports that the stock of foreign liabilities rose from KSh 966 million in 2018 to KSh 20,608 million in 2019. Research on how foreign capital inflows influence Kenya's economic trajectory by Ndung'u and Ndung'u (2015) found positive effects and Mungai (2012) ascertained that diaspora remittances do improve Kenya's economic development. However, Mungai (2012) established that ODA has a detrimental and statistically significant effect on Kenya's economic growth. Gachunga (2019) confirmed that at a sectoral level, foreign investment improves economic growth when directed ate the infrastructure sector, while investment in the manufacturing and agriculture had insignificanr positive effects.

Inflows in the form of foreign capital such as Foreign Direct Investment (FDI), remittances, and as well as Official Development Assistance (ODA) have assumed significant roles in economic development policies of most developing nations especially in Sub-Saharan Africa. These inflows are considered to be one of the essential sources of capital, contributing to bridging the gaps in financing and spreading technological transfer and boosting economic growth (World Bank, 2024). In recent decades, the amount of foreign capital entering into the developing economies has grown drastically due to the process of global financial integration, as well as the attempts of the developing countries to attract investment (UNCTAD, 2023). These inflows, however, are not as effective in promoting sustainable development as it is still a controversial issue and largely relies on institutional and economic circumstances of a recipient country (OECD, 2022).

In Sub-Saharan Africa (SSA), net financial inflows have demonstrated volatility but overall importance. The International Monetary Fund (IMF) (2019) reports that capital inflows to Sub-Saharan Africa, due to private direct capital flows has increased from 2% of Gross domestic product (GDP) in 1990 to about 6% of GDP in 2017. The World Bank (2024) notes that for low- and middle-income countries including those in SSA, external debt flows and remittances remain crucial, with remittances alone constituting over 3% of GDP in many economies, often exceeding FDI and ODA. However, despite the potential benefits, existing empirical evidence provides inconclusive results, with some asserting that large foreign capital inflows can lead to currency overvaluation, capital account instability, or the creation of credit and asset bubbles, which can negatively impact economic growth (Nyang'oro, 2017).

ODA has played a significant role in supporting development activities especially in the areas of healthcare, education and infrastructure. The success of ODA at promoting long-term growth has been a debated topic though. According to studies, including Burnside and Dollar (2000) and Radelet (2006), effectiveness of aid is highly related to quality of governance and the strength of the institutions in the recipient country. In Kenya, on one hand, ODA has promoted significant developmental projects, but due to mismanagement of resources and inefficiency in aid delivery, it has not been effective in ensuring sustainable growth (Radelet, 2006; World Bank, 2020). Additionally, ODA is frequently viewed as ineffective in terms of self-sustained development, especially in cases when the system of government is feeble (OECD, 2021).

These studies show that while foreign capital inflows may promote overall economic expansion, they may also result in a resource shift away from certain sectors and countries, reducing their competitiveness and capacity for expansion. This makes it essential to understand the effect of different inflows on economic growth.

1.1.1 Economic Growth

Economic growth refers to the increase in the production of economic goods and services (Jawaid & Saleem, 2017). Ranjbar et al. (2018) define economic growth as the increase in the inflation-adjusted market value of the goods and services that improve living standards and people's quality of life. It can be indicated by nominal or real terms or be expressed as gross national product (GNP) or gross domestic product (GDP) (Jawaid & Saleem, 2017). According to Ufoeze and Alajekwu

(2018), GDP is the most common indicator of economic growth since it provides a thorough picture of the size and health of an economy. Ranjbar et al. (2018) remark that growth rate is regarded as a crucial indicator of quality investment decisions.

According to data from the KNBS (2022), Kenya's economic growth has stagnated in the last decade and even shrunk in recent years as the growth rate declined to 5.3 percent from 6.2 percent in 2022. CBK (2023) data reveals that Kenya's net financial inflows fell by 34 percent, with foreign investors shifting Ksh. 13.93 billion ($98.79 million) out of the Nairobi Securities Exchange. Moreover, the CBK (2022) investment report remarks that government bonds have become more attractive as the government increases borrowing to plug a Ksh718 billion ($5.09 billion) budget deficit. The report adds that credit risk remains elevated as players in the banking sector report an increase in the volume of bad debts. According to Anayanzwa (2023), punitive fiscal and monetary policies and a high cost of living have produced this complex environment.

1.1.2 Foreign Capital Inflows

Ndiweni and Bonga-Bonga (2021) consider capital flows to be a form of investment activity whereby an investor from a foreign economy invests in another economy. Nyang'oro (2017) defines capital inflows as an investment activity where one country receives capital from another or a foreign business in the form of stocks, mutual funds, or bonds. The direct benefits can be evaluated through the channels of inflow, which lead to the emergence of FDI, portfolio inflows, diaspora remittances, and ODA as the main sources of capital inflows (Nyang'oro, 2017; Baba & Sevil, 2020).

FDI refers to the investments made in foreign markets (Marjanović & Domazet (2021). In FDI arrangements, the investor acquires assets in a foreign country with the intent to manage and control those assets. They are considered an effective way to transfer the knowledge, technologies, and skills necessary for competitiveness. Debbiche (2020) adds that they increase economic development by contributing to growth in manufacturing, production, exports, employment, and income. Githaiga and Kilong'i (2023) consider FDI to be a more stable source of funding than portfolio investment, noting that it reflects a commitment to a foreign country rather than simply a financial investment. It is typically measured as the sum of equity capital or reinvestment of earnings (Marjanović & Domazet (2021).

Portfolio inflows are investments made by foreign companies in a country's stock and bond markets without establishing any lasting interest in a specific business (Debbiche, 2020). Investors in foreign portfolio assets hold securities and other financial assets with no intention to develop control or ownership. According to Yakubovskiy, Rodionova and Derkach (2019), they are less stable than FDI as they can be easily sold or transferred to other markets. Etim, Jeremiah, and Jeremiah (2019) argue that most investors use FDI and portfolio investments when making investments in overseas economies. Foreign portfolio inflows are usually measured by the value of foreign investments in a country's stocks and bonds minus any investments made by domestic residents in foreign stocks and bonds (Debbiche, 2020).

Diaspora remittances refer to the money that is sent home by individuals who have migrated to another country (Depken, et al., 2021). Cocco et al. (2019) define a remittance as any finances sent by an immigrant to their home nation. Cocco et al. (2019) consider remittances to be the human face of global capital flows being initiated by migrants to help supplement spending. Chowdhury and Chakraborty (2021) show that while foreign remittances may not be used as development capital, they do increase the amount of available reinvestable funds in the recipient country. Essentially, foreign remittances are important capital flow sources that stimulate economic growth and reduce poverty by providing alternative financing channels for investment. Depken et al. (2021) used the sum of all money transfers made by immigrants to their home countries to measure diaspora remittances, and this indicator was used in this study.

ODA refers to financial support provided to developing countries to accelerate their economic development and reduce poverty (Kenny, 2020). Morozkina (2019) notes that ODA refers to all government aid provided to advance the social and economic welfare of smaller economies or those in crisis. ODA is typically offered as grants, loans, and technical assistance, and it is usually measured as the sum of all financial flows from developed economies to developing economies for development assistance on issues such as the spread of diseases, illegal migration, and health. Kenny (2020) notes that ODA does not include any payable finances or loans and credits directed towards military purposes.

While ODA has been associated with human capital development, Morozkina (2019) reports that the last decade has witnessed a decrease in ODA, from 28% in 2008 to 27% in 2017, indicating that there may be decreasing concern for attention to recipient needs. Theoretically, these four

main sources of capital inflows should influence economic development in recipient countries. However, the empirical evidence points to inconclusive results, and Johannes, Zulu, and Kalipeni (2015) argue that there are still questions regarding the actual relationship between capital flows and the inherent spillover effect on productivity and economic growth. Moreover, while some researchers reveal a negative impact of certain capital flow components, other researchers infer insignificant effects.

1.1.3 Governance Quality

Governance quality is associated with effectiveness, transparency and accountability of institutions, systems and processes that guide and regulate societal activities, ensuring equitable resource allocation, rule of law and public trust. It encompasses dimensions like government effectiveness, regulatory quality, control of corruption, political stability, voice and accountability, and adherence to legal frameworks (Arndt & Oman, 2021). High governance quality fosters economic development, social cohesion, and institutional resilience by ensuring policies are implemented efficiently, public services are accessible, and corruption is minimized. It reflects the capacity of governments or organizations to formulate and enforce sound policies while maintaining public participation and trust (Kaufmann *et al.,* 2019). For instance, participatory governance, which emphasizes citizen involvement in decision-making, enhances transparency and accountability, thereby improving governance quality (Fukuyama, 2019).

Governance quality is measured through composite indices and qualitative assessments that aggregate data from multiple sources, such as expert surveys, public perception polls, and institutional records (Mo Ibrahim Foundation, 2022). The World Bank's Worldwide Governance Indicators (WGI) is a prominent tool, assessing six dimensions: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption, using data from over 30 sources (Kaufmann & Kraay, 2020). Other measures include the Corruption Perceptions Index (CPI) by Transparency International, which focuses on perceived public-sector corruption, and the Ibrahim Index of African Governance, which evaluates governance across African nations using 100 indicators (Transparency International, 2023). These indices combine quantitative metrics and qualitative inputs to provide scores, though they face criticism for potential biases and data aggregation challenges (Arndt & Oman, 2021).

1.1.4 Foreign Capital Inflows in Kenya

Kenya's foreign capital inflow landscape has transformed significantly in recent years. While Foreign Direct Investment (FDI) has been volatile, declining to a two-decade low of $448 million in 2022 before a slight recovery to $462 million in 2023 (World Bank, 2024; UNCTAD, 2023), diaspora remittances have surged to become the leading source of foreign exchange, reaching a record $4.19 billion in 2023 (CBK, 2024). Foreign portfolio inflows have exhibited high volatility, with net outflows recorded in 2022 and parts of 2023 as global financial conditions tightened. Meanwhile, Official Development Assistance (ODA) has remained a stable pillar of external finance, increasing to $2.5 billion in 2022 (OECD, 2023). This evolving composition underscores the need to analyze the distinct effects of each inflow type on economic growth. Ojiambo and Ocharo (2016) aver that several factors such as economic policies, trade policies, and investment incentives can influence the trends in foreign capital inflows into Kenya. Kinyanjui (2014) found a positive effect of accommodative rules on FDI attraction, while political stability and security, the rule of law, and corruption control were associated with increased investment in local stocks and derivatives.

Foreign investors could be more inclined to invest in the nation if the economy is expanding and there are investment possibilities (Debbiche, 2020). Natural resources like minerals are abundant in Kenya and can draw outside investment (Johannes, Zulu, & Kalipeni, 2015). The trajectories of foreign capital inflows can be influenced by exchange rates as well. Muchiri (2017) avers that foreign capital inflows may decline if the Kenyan shilling appreciates significantly against other currencies because it would become more expensive for foreign investors to invest in Kenya. Global economic trends such as recession, inflation, and interest rates were also ascertained to influence foreign outflows. Cassimon, Fadare and Mavrotas (2022) aver that increased uncertainty during the COVID-19 pandemic, for instance, reduced foreign investment, with ODA being key to sustaining many struggling economies.

The inflow of foreign portfolio investments into Kenya is largely driven by the country’s relatively high yields on government bonds and its relatively high return on equity investments compared to other emerging markets (Daniel, 2014). These high yields have been a major factor in attracting foreign investors. Mwabu (2014) linked portfolio inflows to Kenya with economic growth. Adhiambo and Simiyu (2016) assert that an influx of foreign capital increases private sector

investment, promoting local investment and economic development. Additionally, portfolio inflows have also been linked to increased foreign exchange reserves and higher economic growth. Diaspora remittances are significant sources of foreign income for Kenya as the money Kenyans living abroad send annually accounted for 7.7 percent of the country's GDP (Mijiyawa & Oloufade, 2023). Aboulezz (2015) linked diaspora remittances to increased private consumption, access to credit, domestic savings, and financial stability. Njoroge (2014) reports that Kenya is among the most prominent foreign inflow recipients in sub-Sahara Africa, receiving bilateral, multilateral, and voluntary aid. Aid flows to the country currently account for 6.6 percent of the country's GDP according to World Bank (2020). Njoroge (2014) associated aid with increased public expenditures and access to health and education services, which contributes to human capital development in the long term. Additionally, aid has also been linked to increased foreign exchange reserves, improved access to credit, and increased domestic savings and financial stability (Edward & Karamuriro, 2020).

It's worth noting that multiple factors can influence the trend of foreign capital inflows, and their relative importance can vary over time. Therefore, it's important to look at the statistics and trends over time to understand the underlying dynamics of each type of inflow (Mohamed, 2019). Therefore, this study thoroughly examined the impacts of various foreign capital inflows on Kenya's GDP.

1.2 Statement of the Problem

According to World Bank data, Kenya's GDP growth averaged 4.6% annually from 2019 to 2023, significantly below the 10% target outlined in the Kenya Vision 2030 framework (World Bank, 2024; Government of Kenya, 2008). In 2023, growth reached 5.2%, up from 4.8% in 2022, driven by agriculture and services, yet projections for 2024 (5.4%) and 2025 (5.6%) fall short of pre-COVID highs, such as 5.9% in 2016 (World Bank, 2024). Compared to peer economies like Ghana (5.1% average from 2019–2023) and Rwanda (7.2% over the same period), Kenya's performance is underwhelming (World Bank, 2024). A key issue is the sharp decline in Foreign Direct Investment (FDI), which dropped to a 20-year low of $393 million in 2022 from $1.5 billion in 2009, reflecting waning investor confidence amid fiscal constraints and high public debt (70.2% of GDP in 2023) (UNCTAD, 2023; World Bank, 2024). This reduction in FDI, alongside elevated debt servicing costs, limits private investment and constrains growth potential.

Although there are studies that have tried to evaluate the contribution of FCIs to economic growth, Debbiche (2020) and Jawaid and Saleem (2017) used different methods and consolidated data of various developed countries for 10 to 15 years and did not address the unique economic, political, and institutional conditions that may affect the effectiveness of these inflows in Kenya. As much as the global trends are handy, they might not be able to reflect the dynamics of the interplay of the unique governance and economic challenges of Kenya with foreign capital. Nyang'oro (2017) also points to the shortcomings of generalized solutions, and noted that the institutional specifics of developing economies can greatly influence the results of foreign inflows. The methodological gap, therefore, consists in the fact that context-sensitive studies did not examnine the effects of these types of capitals on the development of Kenya, especially during the last 30 years.

Contextual gap arises when applying to the socio-economic background of Kenya, including constant levels of poverty, which is projected to hit levels of 34% by 2025. Also icnocrporating the high unemployment rates which was 33.9% in 2022, making the connection between foreign inflows and economic development more difficult (World Bank, 2024; KNBS, 2023). Nyang'oro (2017) and Otieno and Were (2017) both emphasize that although FDI may bring capital, technology and jobs, Kenya has limited potential to share in such gains. Repatriation of profits and concentration of FDI in other non-industrial sectors do not trigger the much desired structural change.

Gachunga (2019) also notes that the FDI in Kenya is focused on the agribusiness and service industries, which may not be capable of industrializing the country, in contrast to other countries like Ethiopia where FDI has triggered an industrial revolution (UNCTAD, 2023). This contextual problem highlights a conceptual gap in the literature on the ability of foreign capital inflows to stimulate a structural change in the Kenyan economy. This is also highlighted by Mungai (2012) who observes that the consumption financed by remittances, which have consistently contributed more than 3.4% to GDP, restricts their contribution on productive investment. Nyamongo et al. (2012) also support this observation by also stating that remittances do not always lead to long-term economic growth.

There is also a gap in knowledge on the moderating effect of quality of governance in determining the relationship between the inflows of foreign capital and the economic growth in Kenya. Negative implications of foreign aid, like currency appreciation, financial instability, are already

discussed by Ranjbar et al. (2018) and Odhiambo (2021), but seldom do these studies examine the potential impact of government structures of governance quality on the results of foreign inflows. Gachunga (2019) and Otieno and Were (2017) highlight that the quality of governance especially in terms of institutional efficiency and corruption control is decisive on the success of foreign capital in generating sustainable growth. Nevertheless, in spite of these realizations, the gaps in existing literature are due to the inability to evaluate governance as a moderating factor in the relationship between foreign capital and economic growth in Kenya. According to Mowlaei (2018), the inflows of foreigners are not always beneficial to the economy without the proper system of governance, especially in the sub-Saharan Africa region, where the institutions are weak and the development is restricted.

This research project aimed to address these methodological, contextual, conceptual and knowledge gaps by offering a detailed analysis of the impacts of various types of foreign capitals inflows, which include FDI, remittances and ODA, in the economic development of Kenya. By offering a thorough examination of the moderating effect of governance quality on the impacts of various forms of FCIs on economic growth in Kenya, this research soughtclose this gap.

1.3 Research Objectives

1.3.1 General Objectives

The general objective of the study was to analyse the moderating effect of governance quality on the influence of foreign capital inflows on economic growth in Kenya.

1.3.2 Specific Objectives

The specific objectives of the study were to:

i. To find out the effect of foreign direct investment on economic growth in Kenya.
ii. To determine the effects of foreign portfolio inflows on economic growth in Kenya
iii. To establish the effect of diaspora remittances on economic growth in Kenya
iv. To establish the effect of official development assistance on economic growth in Kenya
v. To determine the moderating effect of governanace quality on the relationship between foreign capital inflows and economic growth in Kenya.

1.4 Research Hypothesis

$H0_1$: Foreign direct investment has no statistically significant effect on economic growth in Kenya

$H0_2$: Foreign portfolio inflows have no statistically significant effect on economic growth in Kenya

$H0_3$: Diaspora remittances have no statistically significant effect on economic growth in Kenya

$H0_4$: Official development assistance has no statistically significant effect on economic growth in Kenya

$H0_5$: Governanace quality has no significant moderating effect on the relationship between foreign capital inflows and economic growth in Kenya

1.5 Scope of the Study

The study's geographic focus was only on Kenya. The study utilized annual time series data reported between 1993 and 2022. During this period, the country went through the 2008 financial crisis, election violence and covid which affected growth. Most importantly, it captures the COVID-19-induced decline in FDI to a 20-year low of $393 million in 2022 and the subsequent recovery, highlighting the volatility of capital flows amid global shocks (UNCTAD, 2023; World Bank, 2024). This timeframe also enables comparison with peer economies like Rwanda (7.2% growth) and aligns with Kenya's rising debt (70.2% of GDP in 2023), emphasizing the critical role of foreign capital in addressing growth and inclusivity challenges (World Bank, 2024).The research concentrated on inflows in terms of on FDI, portfolio inflows, Diaspora remittances, and (ODA) and real GDP as the measure of economic growth. The research further analysed Kenya's institutional governance quality and assessed whether its' control effect on the relationship between capital inflows and economic expansion.

1.6 Significance of the Study

1.6.1 Government

Authorities can use the study's findings, for instance, to adopt regulations and guidelines that promote the entrance of foreign capital, which improve economic growth and lessen any unfavorable effects. Investors can also use the results of this study to guide their investing choices. Furthermore, for researchers, academics, and scholars who are interested in the subject, this study have an updated perspective of the present circumstances in Kenya.

1.6.2 Policy Makers

This study's contribution to the current discussion on the link between foreign capital inflows and Kenya's economic growth is what makes it relevant. This report thoroughly analysed how foreign capital inflows influence Kenya's GDP growth, essential to investors, decision-makers, and other economic players. Using the study's findings, policymakers know which inflows influence economic growth and draft policies to increase the country's ability to attract these inflows.

1.6.3 Academic Scholars

By offering a thorough examination of how foreign capital inflows impacts Kenya's GDP, the research also fill a vacuum in the literature. Additionally, because this study offered insights and lessons applicable to other economies, it was helpful for other nations facing comparable economic difficulties.

1.7 Organization of the Study

This chapter is organized in various sections that cover the study Background, the Statement of the problem, General and Specific objectives of the study, the Research hypothesis, Scope of the study and the Significance of the study.

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CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter included theoretical and empirical review sections. The Neoclassical Growth Theory, the Institutional Theory and the Dependency Theory guided the study. The empirical review section presented an analysis of previous researcher's results and conclude with a summary of the gaps. It then concluded with a presentation of the conceptual framework.

2.2 Theoretical Literature Review

The study was based on the following theories; Neoclassical growth theory, Institutional theory and the Dependency theory.

2.2.1 Neoclassical Growth Theory

Solow and Swan (1950) developed the theory and argued that technological progress and the accumulation of physical and human capital preclude a nation's economic growth (Lehmann & Silvagni, 2020). According to this theory, foreign inflows improve economic development by providing a source of financing for investment in physical and human capital. For example, FDI can provide capital for investment in technology, infrastructure, and human capital, and, in contrast, diaspora remittances can provide a source of income for households, which can then be used for consumption or investment (Wang & Chen, 2019).

The theory has been criticized due to over-simplification of growth dynamics, particularly its assumption of exogenous technological progress, which ignores the endogenous role of innovation, institutions, and human capital in driving long-term growth (Romer, 1994). The theory's focus on capital accumulation undervalues structural factors like income inequality, governance, or sector-specific investment, which are critical in developing economies like Kenya, where foreign capital inflows often fail to translate into sustained growth due to absorptive capacity constraints (Otieno & Were, 2017). Additionally, the convergence hypothesis struggles to explain persistent income disparities between nations, as evidenced by Kenya's lagging growth (4.6% average) compared to Rwanda's (7.2%) despite similar capital inflows (World Bank, 2024).

The theory's limited incorporation of external factors, such as volatile FDI or global shocks, further reduces its applicability to open, developing economies.

This theory is important in this study as an anchor to understand how foreign investments influence the direction of the economy. By doing that, the independent and dependent variables are linked. The theory argues that foreign inflows of FDI, FPI, ODA and diaspora remmitances can contribute to economic growth by increasing the level of physical and human capital and by fostering technological progress (Coccia, 2019). By measuring the effects of foreign inflows on economic growth, as measured by real GDP and growth rate, this research tested the validity of the neoclassical growth theory.

2.2.2 Institutional Theory

Institutional theory was formulated by economists such as Douglass North and Oliver Williamson in the 1980s. The theory argues that the quality of institutions determines economic development. Quality institutions that promote fairness, equality and enforcement of the rule of law, among other governance mechanisms that increase the operating environments' fairness attract foreign investment and stimulate investment and growth (Osinubi, 2020). According to this theory, foreign inflows can promote economic development by providing a source of financing for investment and by improving the quality of institutions. For example, FDI can bring with it new technologies and management techniques that can benefit local firms and promote economic growth (Soares & Gretzel, 2021).

The theory emphasizes the role of formal and informal institutions such as laws, governance structures, and cultural norms in shaping economic outcomes, offers valuable insights but faces criticism for its lack of precision and predictive power (UNCTAD, 2023). While it highlights how weak institutions, like corruption or poor property rights, can hinder the impact of foreign capital inflows on growth in countries like Kenya (Acemoglu & Robinson, 2012), the theory often fails to specify which institutions matter most or how they interact with economic variables, making it difficult to formulate targeted policy interventions. For instance, Kenya's persistent growth challenges despite reforms in governance suggest that institutional improvements alone may not suffice without addressing structural issues like debt (World Bank, 2024; UNCTAD, 2023). The

theory's broad scope can lead to tautological explanations, where poor growth is attributed to weak institutions without clear causal mechanisms.

Foreign capital inflows can provide the legal know-how to create quality institutions and, by improving legal and political systems, increase an economy's level of trust. This theory is valuable in this study as it links quality institutions, foreign investments and GDP growth (Alvesson & Spicer, 2019). The theory argues that foreign inflows promote economic growth by improving the country's institutional setup, and by providing incentives for investment and development. By measuring the effects of quality institutions on foreign capital inflows, this theory improved our understanding of how quality institutions influence economic growth.

2.2.3 Dependency Theory

A product of Prebisch and Frank (1960), the dependence theory asserts that developing economies' slow development is the result of increased dependence on advanced economies for trade and investment (Ali, 2018). According to Prebisch and Frank (1960), efforts to attract foreign capital erodes developing economies' development since most of the profit generated by foreign investors is distributed to their home nation. The theory confirms that developed economies exploit the raw materials and cheap markets of low economies and siphon profits to their home country, or push developing countries to debt for their benefit, reducing the host country's economic growth in the long term (Kapijimpanga, 2023).

The theory argues that global economic structures perpetuate under-development by fostering reliance on core countries for capital, technology, and markets, provides a critical perspective on foreign capital inflows but is criticized for its deterministic and overly generalized framework (Otieno & Were, 2017). While it highlights how Kenya's volatile FDI inflows ($393 million in 2022) and profit repatriation may reinforce dependency rather than spur growth (UNCTAD, 2023), the theory often overlooks internal factors such as governance failures or low absorptive capacity, which also constrain growth (World Bank, 2024). Its binary core-periphery model fails to account for the agency of developing nations or the heterogeneity of their experiences, as seen in Rwanda's stronger growth (7.2%, 2019–2023) despite similar global constraints (World Bank, 2024). The theory also focuses on external exploitation downplays the role of domestic policy in leveraging capital inflows, limiting its practical utility for crafting solutions to Kenya's growth challenges.

Kapijimpanga (2023) used the theory in analysis of the effcet of debt dependence on the development of African countries while Mangwanya (2022) deployed the theory in analysis of how foreign aid infuences economic growth of low-income countries in Africa. The researchers confirm that FDI can dominate local economies, which can result in the transfer of profits to the home country of the foreign firms (Huix-Rotllant & Barbatti, 2020). Additionally, foreign inflows can influence the efficiency with which natural resources are exploited and the environment degraded, which can significantly influence long-run GDP growth in host economies (Sahu & Dhir, 2020). Mangwanya (2022) revealed that aid is often ineffective and can also hurt a country's development prospects. The theory established the link between FDI, FPI, ODA and diaspora remmitances and how its negative effect on economic growth.

2.3 Empirical Literature Review

Foreign inflows are considered key to sustained economic growth, supporting the maintenance of balances of payments and providing reliable sources of capital to developing nations. Over the years, studies have looked at the connections between remittances, assistance, FDI, and economic growth and come up with inconclusive findings. This section reviews previous researchers' efforts to examine the relationship between the different types of foreign inflows and economic development.

2.3.1 Foreign Direct Investment and Economic Growth

FDI is cross-border investment whereby a foreigner invests in acquiring assets in a foreign country with the goal of controlling the assets (Shittu et al., 2020). FDI is a means through which international organizations expand their operations and it has been lauded to facilitate transfer of skills and technology, boost human development, competitiveness and economic performance. Baharumshah et al. (2017) reports that FDI inflows increase the supply of funds that host countries can use for domestic investment. Jawaid and Saleem (2017) affirm that developing countries are increasingly dependent on foreign inflows and have put in structures to attract foreign capital.

Debbiche (2020) carried out literature and empirical analysis into the capital inflows-economic development nexus in the Gulf Cooperation Council states, analyzing data reported between 2005 and 2018. The study decomposed foreign inflows into FDI, foreign portfolio and other investments, and employed the least-squares dummy variables estimator in analysis. Findings were that in the GCC countries, FDI has a resource seeking nature that has no significant effect.

Moreover, the study revealed that while the GDP grew during the study period, FDI momentum faded. Cross-border lending had no impact on GDP growth due to their volatile nature, and inability to sustain the domestic banking system.

On the other hand, Chorn and Siek (2017) opine that FDI advance the economy of developing countries. The empirical study used Ordinary Last Square (OLS) in analysis of the robustness of the effect of FDI and ODA flowing into 77 developing countries and collected panel data reported between 1997 to 2012. The analysis revealed that FDI had more robust effects than ODA and that their positive effects decrease as income per head increases and the impact of ODA decreases significantly as gross domestic saving increases.

Yuan and Mivumbi (2020) used the ARDL "bounds" test approach in analysis of the effct of FDI and labour on Rwanda's GDP using panel data reported between 1970 and 2017. Findings were a causal effect of FDI on Rwanda's economic development. Agricultural labor was determined to have an insignificant causal effect. The study called on countries to promote and channel FDI into specific sectors to increase its spillover effects. On the other hand, Jawaid and Saleem (2017) found a significant and negative effcet of FDI on Pakistan's GDP in research that used OLS regressions to analyze the effect of FDI, remittances, and external debt. The study also found that while in the long run, FCIs generally improve economic growth, remittances and external debts improve GDP but FDI does not.

Noting that Vietnam was putting emphasis on attracting foreign inflows, Nguyen (2020) assessed the effect of FDI, aid, and exports on the country's GDP. Secondary panel data data reported between 1997 and 2018 were adopted, using a linear approach in analysis. Findings were that indeed, FDI, aid and export performance are significant drivers of Vietnam's economic growth and called on the government to adopt proactive strategies that develop human capital and attract foreign investors and charities. Adney *et al.* (2012) used Granger causation and the vector error correction model (VECM) in analysis of the connection of FDI and GDP development in Ghana's Gambia province and concluded that there is no causal connection in Nigeria and that FDI has no short- or long-term effects. But the report claims that strong financial institutions serve as intermediaries between FDI and economic expansion. In summary, there was limited evidence that FDIs affect economic development.

Driffield and Jones (2013) sought to address this economic growth FDI nexus by evaluating the effect of inflows and by carrying out an analysis of the shortcomings of previous techniques. This

study demonstrated that foreign assistance flows to Kenya are significant and should, therefore, be incorporated in their models and encouraged by the country's government. The study concluded that the more the foreign capital inflows the faster an economy will grow.

Ndungu and Ndungu (2015) found significant positive effects of FDI of Kenya's economic growth in research that used longitudinal data on Kenyan businesses from 1995 to 2010. Aside from having a favorable impact on employment, productivity, and technical advancement, FDI was shown to have a higher impact on Kenya's GDP in specific industries such as the manufacturing and services sector, where FDI is more likely to result in new technology, regulatory practices, and efficiency improvements. This underlines the importance of sectoral policies and targeted strategies to attract and channel investment to sectors that can contribute to Kenya's economic growth. However, it should also be noted that FDI can crowd out domestic companies and contribute to externalities such as environmental pollution. Governments must, therefore, ensure that the benefits of FDI are maximized and negative impacts are minimized.

2.3.2 Foreign Portfolio Inflows and Economic Growth

Foreign Portfolio consists of all the assets including stocks, bonds, and cash equivalents held by an investor in a foreign country. Investors, motivated by potential benefits from investing in developing economies can purchase shares in publicly offered stock markets, and bonds, or deposit money in a foreign country's bank (Baba & Sevil, 2020). Foreign portfolios investors aim to own the securities, but without any control on the firm but their main focus is to generate immediate profits on their investments (Al-karasneh, Bataineh, Hayajneh, & Khodirat, 2021).

Sawalha, Elian and Suliman (2016) assessed the association between FPI GDP of 21 developed and 19 emerging states, using panel data reported between 1980 and 2012. The study relied on GMM estimators in analysis whose findings were that while FDI improves the economy, FPI does not. The study ascertained that in the presence of a large, saving population accelerates economic progress and attracts private capital inflows in the form of stock options which has been key to the growth of developed economies. While FPI inflows may not have a spillover, according to the researchers, investments into equity markets attract foreign capital while FDI boost the economy through their effect on augmenting domestic resources in smaller, less developed economies.

Debbiche (2020) analysed the influence of FCI on GDP development in the Gulf Cooperation Council states, evaluating data reported between 2005 and 2018 and decomposing foreign inflows

into FDI, FPI and other investments. The least-squares dummy variables estimator was used in analysis and findings were that in the GCC countries, foreign portfolio investments, due to their short-term nature, and motivation (diversification and speculation purposes) negatively affects GDP. FDI was determined to have an insignificant impact.

In Africa, Ehigiamusoe and Lean (2019) carried out examination into the impact of FCIs on Nigeria's GDP using data reported between 1980 and 2015. The study used Autoregressive Distributed Lagged (ARDL)-bounds tests in analysis that revealed a cointegration relationship between FCI and GDP. Specifically, FPI was reported to have significant, positive impacts, while foreign loans had negative effects. On the other hand, FDI and ODA were revealed to have no significant impacts.

Sugozu, Yasar and Verberi (2023) examined the long-term portfolio investments-economic development nexus, collecting data reported between 2004 and 2020. The study specified the influence of interest-bearing and non-interest-bearing assets and relied on GMM-PVAR approach. Findings were that investments in stock and long-term bond portfolio enhances GDP growth, but does not advance GDP in developed economies. The study revealed a bidirectional causality effect of stock and long-term portfolio investment on GDP growth but confirmed that trade openness negatively impacts GDP of developing countries.

Odhiambo and Odera (2015) observed that portfolio inflows improve Kenya's GDP in research which employed panel data spanning the years 1990 to 2012. The study findings were that portfolio inflows improve GDP development and investment. In the study by Ndungu and Ndungu (2015), portfolio investment income had a significant impact on Kenya's development, demonstrating that an increase in investment caused by the influx of securities investment helps Kenya's economy thrive.

Ndungu and Ndungu (2015) acknowledged that the flow of securities investment may impact financial stability by boosting foreign reserves and lowering reliance on external borrowing. They also increase the stock market's depth and liquidity, which helps local firms by allowing them access to bigger ownership shares. The researchers confirmed that while the influence of portfolio inflows on GDP may differ between countries, it may have a lower effect in nations with underdeveloped financial systems than it would in those with sophisticated financial systems.

Reporting that Africa has received large capital inflows since 2008, Mlambo (2022) examined their influence on economic development of the top five recipients of FPI in Africa, using panel

data reported between 1995 and 2014. The study used a GMM method in analysis, and findings were that while FPIs negatively affect GDP, in the long run, interest rates and exchange rates exhibited a positive relationship. However, in South Africa, a depreciation in the rand exchange rate negated the gains made and depressed GDP growth.

Nyang'oro's (2017) analysis used GMM in examination into the FCI-GDP nexus in sub-Saharan Africa. The study used a large dataset and tested the effect of volatility of FCI, and findings were that while portfolio equity improves the economy, private equity and debt have inverse effects. Generally, it was ascertained that total net capital inflows are linked to growth while due to low financial integration in African economies, volatility in capital flows has an insignificant impact on the economies' growth.

2.3.3 Diaspora Remittances and Economic Growth

Remittances refer to the funds channeled by migrants to their home country, either to their family members or through community initiatives. According to Barne and Pirlea (2019), currently, diaspora remittances have overtaken FDI and ODA as the largest sources of FCIs into lower- and middle-income countries. The researchers add that remittances are quickly becoming poorer countries' lifeline because unlike aid and FDI, remittances are more stable. Su, et al. (2021) add that remittances are especially influential in countries with strong institutions that protect investor's rights. However, researchers Faheem, *et al.* (2022) argue that past certain amounts, remittances often increase consumption in other non-tradable sectors, leading to the 'Dutch disease' phenomenon.

Research into the remittances-economic growth nexus reveals conflicting results. Fayissa and Nsiah (2010) conceded that remittances have an insignificant effect on GDP growth while Ang (2007) observed no causal effect of remittances on India's GDP. Siddique et al. (2010) and Mim and Ali (2012), on the other hand, are of the opinion that remittances accelerate economic development. Mim and Ali (2012) focused on Latin America and observed that a 10 percent rise in remittances increased monthly income. Ikechi and Anayochukwu (2013) discovered that Granger's transformation led to economic development in South Africa and Ghana, as well as growth transitions in Nigeria, with a GDP per capita of roughly 0.15 percent. Ocharo (2015) discovered that the link between remittances and GDP has a meaningful logarithmic ratio of 1 percent. 1.5 percent more economic growth results with a 10 percent rise in the payment-to-GDP ratio.

Awad (2021) used a parametric approach in analysis of the long run effect of FCIs on trade and debt on GDP growth in Africa. The study sourced data reported between 1990 and 2018 and relied on dynamic OLS regression in analysis. The findings were that trade and aid improve GDP indicators while increases in external debt was associated with negative GDP growth. Worker remittances are said to improve economic growth of recipient countries according to findings from Chigbu Ezeji and Promise (2015) who specified the effect of FCIs on GDP of Nigeria, Ghana and India, and used data reported between 1986 and 2012. Granger Causality and OLS tests were used in analysis and the findings were that while FDI, FPI, and foreign borrowing improve GDP in Nigeria and Ghana, remittances were impactful in all three countries, signifying the importance of financial sector development to help bridge the savings gap.

Noting that foreign remittances were making a significant portion of foreign inflows to Croatia, and even exceeding the tourism sector, Depken et al. (2021) used Granger causality tests in analysis of the association between remittances and GDP, using data reported between 2000 and 2020. Findings were that the relationship between remittances and GDP is unidirectional, suggesting that cultivating relationships with diaspora would increase the host country's GDP.

Diaspora remittances have been shown to enhance Kenya's GDP, according to Mungai (2012), whose study revealed that the diaspora's contribution increased investment, consumption, and GDP. It employed time series data from 1990 to 2009. The study by Giuliano and Ruiz-Arranz (2009) was on the remittances-GDP nexus with a focus on how the growth of the domestic financial market influences a nation's capacity to use remittances. They discovered that remittances boost the financial system, provide alternative means to finance investments, and aid in overcoming liquidity limitations in economic growth in less developed nations using newly designed remittances encompassing roughly 100 developing countries.

Odhiambo and Odera (2015) also observed a positive impact of diaspora remittances on GDP in Kenya. The researchers demonstrated that diaspora remittances significantly improve Kenya's GDP growth through their impact on providing funds for investment and consumption. They were also reported to help lessen poverty and economic disparities, as well as enhance access to healthcare and education, boost foreign exchange reserves and reduce reliance on external borrowing, thus supporting a country's financial stability.

Despite the evidence, Odhiambo and Odera (2015) assert that the effect of diaspora transfers on GDP may differ owing to the state of technology development in the recipient country. For

instance, compared to nations with equally developed financial systems, nations with underdeveloped financial systems may see a smaller effect from diaspora remittances on economic growth.

2.3.4 Official Development Assistance (ODA) and Economic Growth

Foreign aid or ODA refers to all loan disbursements made on concessional terms, as well as grants made through development committees and development partners to promote social and economic development (Moolio & Kong, 2016). Moolio and Kong (2016) reveal that developing countries use ODA to address financing gaps, and under the Harrod-Domar growth model, ODA is singled out as a significant stimulant to economic growth, owing to its ability to fill funding gaps, and transfer technology and skills to less developed economies.

Affirming that ODA has been key to financing for human and social development, Yiew and Lau (2018) collected data on ODA, FDI, and population growth reported between 2005 and 2013 for 95 developing countries. The research used Pooled OLS method in analysis of the data which revealed a U-shape relationship between the variables. Additionally, a positive increase in the labor workforce and ability to attract FDI improved economic growth, regardless the volume of ODA, implying ODA has insignificant impacts on GDP. Findings were that bad policies are among the main causes of poor GDP growth, and countries were recommended to strengthen their laws and legal frameworks to ensure aid is channelled to address the development agenda.

Affirming that capital flows are catalysts for development, Mowlaei (2018) disaggregated the inflows into FDI, personal remittances, and ODA in analysis of their impact on GDP growth in Africa. The study assessed the most effective inflow and used a Pooled Mean Group (PMG) econometric technique in analysis. Findings were that while all three inflows do improve GDP, with remittances being the most impactful, suggesting that creating an attractive environment through up-to-date policies would attract inflows and supplement domestic investment.

Sothan (2018) used trade openness and investment as intermediary variables in analysis into the link between ODA on GDP growth in Cambodia, using ARDL bounds in analysis of data reported between 1980 and 2014. Findings were that ODA improves GDP but in the short run while FDI had strong psitive effects. Trade openness also exhibited positive effects, signifying the value of supportive trade policies and infrastructural and human investment.

Moolio and Kong (2016) observed a positive long-run effect of ODA on GDP development in Cambodia. The study differs from Sothan (2018), however, in that it was a comparative study that sought after the link of ODA and GDP growth in Cambodia, Lao PDR, Myanmar, and Vietnam. The study used panel cointegration tests and OLS regressions in analysis of data reported between 1997 and 2014 and observed that generally, ODA has robust positive effects on the long-run GDP in the Asia. Moreover, Vietnam, Cambodia reaped more benefits than Lao PDR. Similar observations were made in research that focused on eight South Asian countries. In the study, Dash (2021) collected data reported between 1996 and 2018 and applied the FMOLS model, establishing that aid has improved GDP growth. Moreover, capital formation and aid were observed to complement each other in supporting GDP and that aid does not crowd out private investment.

Tang and Bundhoo (2017) sought to understand the nexus between aid and development in developing economies in Sub-Saharan Africa, arguing that the region remains underdeveloped despite being the largest ODA recipient in the world. The study used data reported from the ten largest recipients between 1990 and 2012, used multistage regressions in analysis, and included economic policies and institutional quality variables as intermediary variables. Findings were that aid can only be effective when it is supported by quality institutions and sound economic policies. The study asserts that effective and efficient use of aid can only be possible when countries provide good governance and control corruption.

Chorn and Siek (2017) specified the link between FDI and ODA on GDP in developing economies in research that collected data reported by 77 states between 1997 and 2012. The study sought after the most effective factor. It employed OLS regressions in analysis that revealed that while both factors exhibited a positive effect, FDI was more significant than ODA, and that ODA has negative effects as the productive population and the rate of saving per capita increases. Conclusions were that developing states should formulate policies that incentivize FDI and ODA to generate economic growth factors.

2.3.5 Governance Quality and Economic Growth

Governance quality refers to the degree of efficiency with which a government meets its governance mandate which include providing structures that guarantee political stability, rule of law, control of corruption, violence and terrorism, and promote freedom of expression as well as transparency and accountability. While some researchers suggest that improving governance quality increases an ecnoomy's ability to benefit from foreign inflows (Su, Sun, Ahmad, & Mirza,

2021; Kinyanjui, 2014), Efanga, Ugwuanyi, and Ogochukwu (2020) aver that some investors are more attracted to regions with weaker regulatory control.

Slesman et al. (2015) specified the link between FCI and GDP using the economies' institutional quality indicators as control variables. The analysis used data reported between 1975 and 2005 and used threshold regression techniques. The results were that FDI, FPI and portfolio debt improve GDP of countries with high institutional development index. Negative or insignificant effects were reported below certain institutional development levels meaning that providing security and stability would promote stability of FCI-led economic development.

Raza, Shah and Arif (2021) focused on OECD countries in analyzing the influence of governance quality on GDP, using data reported between 1996 and 2013. It relied on a fixed effect model and GMM estimators in analysis and found a positive effect of the variables' interaction and GDP. Granger causality results also revealed a bidirectional causal association between FDI and regulatory quality on GDP, and that making strategic institutional developments to control corruption, guarantee accountability, and provide political stability would significantly enhance GDP.

Shittu et al. (2020) assessed the effect of political governance on FDI, globalization, and GDP growth nexus in West Africa. ADRL approach was applied in analysis of data reported from 1996 to 2016, and the findings were that while globalization and political governance all significantly improve the region's economic growth, good politics improve teh FDI-GDP nexus. The study called on firms to foster a culture of transparency and accountability and promote the region's competitiveness to increase investors' confidence in West Africa's stability. Similarly, Ajide, Adeniyi and Raheem (2017) found that institutional quality factors and governance enhance the FDI-GDP nexus in SSA. Data reported by 27 countries was used, and analysis revealed that empowering structures to control corruption and guarantee political stability, as well as government effectiveness, significantly improves the FDI-economic growth nexus.

Yeboua (2021) also specified 27 sub-Saharan states in analysis of how institutions influence the FCI – GDP nexus. The research employed a regression model in analysis of data reported between 1990 and 2017 that revealed that FDI only improves economic growth of countries with quality institutions. Specifically, FDI can only enhance economic performance once countries achieve a

high threshold for government stability, investment, accountability, law and order, control of corruption, and bureaucracy had the least impact.

GMM methods were employed in analysis by Nyang'oro (2017) in assessment of how FCIs impact GDP growth in SSA. Findings were that while FPI improves the countries' economic growth, private equity and debt had an inverse effect on growth. Furthermore, that due to the countries' low financial integration, volatility in capital inflows had no significant impact and generally, total capital inflows negatively affected GDP, possibly due to the countries' debt levels and underdeveloped financial markets.

Magai (2022) examined the nexus of trade openness, FDI and GDP of Tanzania using data reported between 1970 and 2019, and relying on a cointegration test and a VECM model in analysis. Findings were that the relationship is positive and long run. The VECM model results revealed that FDI, under effective trade rules and regulations improve the volume of exports which in turn enhances the economies' performance in the long run. Conclusions were that developing governments should encourage exports to reap from trade openness and FDI spillover effects.

In Kenya, Awino and Kioko (2022) specified the role of quality governance on ODA and its impact on GDP development and savings capacity, specifying the country's FDI inflows reported since 1960 to 2019. 2-Stage least squares were used in analysis and findings were that while during the period ODA improved GDP, the effect is insignificant when the government reduces its development expenditure. Moreover, government spending was ascertained to determine the direction of the economy.

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2.4 Summary of Research Gaps

The below table presents a summary of the various empirical gaps captured from the review of the literature;

Table 2.1 Summary of Research Gaps

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
Debbiche (2020)	Foreign capital inflows and economic growth in GCC Countries	Partial least-squares dummy variables estimator	FDI had an insignificant impact on real GDP growth in GCC countries.	Contextual Gap	The study is confined to Gulf Cooperation Council (GCC) states, which are resource-rich economies, leaving a gap in understanding this relationship in a developing, non-resource-dependent African context like Kenya.
Chorn and Siek (2017)	The impact of foreign capital inflow on economic growth in developing countries	OLS regressions	FDI had more robust effects on GDP than ODA inflows.	Methodological Gap	The study employs a broad cross-country comparison, which may mask country-specific dynamics and does not investigate the role of domestic institutional quality as a moderating factor.
Yuan and Mivumbi (2020)	Foreign direct investment, Agriculture and economic growth: ARDL and causality	ARDL "bounds" test approach	FDI has a causal relationship with Rwanda's GDP.	Contextual Gap	The findings from Rwanda, a smaller, post-conflict economy with distinct policies, may not be generalizable to larger, more established economies

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
	approach for Rwanda				like Kenya, indicating a contextual gap.
Jawaid and Saleem (2017)	Foreign capital inflows and economic growth of Pakistan	OLS regressions	FCIs improve economic growth, but while remittances and external debt improve GDP, FDI does not.	Evidence Gap	The study reveals conflicting evidence (a negative FDI-growth nexus) compared to theoretical expectations and findings in other countries, highlighting an evidence gap that requires further investigation in different settings.
Sawalha, Elian and Suliman (2016)	Foreign capital inflows and economic growth in developed and emerging economies: A comparative analysis	GMM estimators	FDI improves the economy but FPI had a negative and significant effect.	Knowledge Gap	The study focuses on a broad developed/emerging market dichotomy, creating a knowledge gap regarding the specific effects of different capital inflows within a single, focused African economy.
Sugozu, Yasar and	The relationship between long-	GMM-PVAR approach	Portfolio investments	Methodological Gap	The research focuses on asset characteristics and

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
Verberi (2023)	term portfolio investments and growth in the context of asset characteristics and development level		enhance GDP in developing countries but not in developed ones.		development level but does not incorporate the moderating effect of a country's governance quality on the portfolio investment-growth relationship.
Ehigiamusoe and Lean (2019)	Foreign capital inflows and economic growth in Nigeria: any nexus?	Autoregressive Distributed Lag (ARDL)-bounds tests	FPI had significant, positive impacts on growth, while foreign loans had negative effects.	Evidence Gap	The finding of a positive FPI-growth nexus in Nigeria contradicts studies from other regions, creating an evidence gap that calls for verification in the Kenyan context to understand the contingent factors.
Awad (2021)	Foreign capital inflows and economic growth: the experience of low-income	OLS regression	Trade and aid improved GDP indicators while increases in external debt reduced GDP growth.	Knowledge Gap	The study provides a generalized view for low-income SSA countries, but a knowledge gap exists regarding the comparative impact of different inflow types (FDI, FPI, Remittances,

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
	countries in Sub Saharan Africa				ODA) within a specific middle-income SSA country like Kenya.
Depken et al. (2021)	Causality between foreign remittance and economic growth: empirical evidence from Croatia	Granger causality tests	There is a unidirectional relationship between remittances and GDP.	Contextual Gap	The study's context (Croatia, a European Union member) is vastly different from a developing African economy, creating a gap in understanding this dynamic in a setting with less developed financial markets and higher poverty levels.
Yiew and Lau (2018)	Does foreign aid contribute to or impede economic growth	Pooled OLS method	A U-shape effect of foreign aid on GDP.	Theoretical Gap	The finding of a non-linear (U-shape) relationship challenges the conventional linear assumption of aid effectiveness, indicating a theoretical gap in understanding the conditions under which aid becomes beneficial.

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
Mowlaei (2018)	The impact of foreign capital inflows on economic growth on selected African countries	Pooled Mean Group (PMG) econometric technique	FDI, personal remittances and ODA improve GDP but remittances have the most significant effect.	Methodological Gap	The study aggregates findings across selected African countries, using a methodology that may not capture the unique, time-varying institutional moderators present in a country-specific longitudinal study.
Dash (2021)	Does foreign aid influence economic growth? Evidence from South Asian countries	Panel Fully Modified Least Squares (FMOLS) model	Aid has significant positive short and long-run effects on the countries' economic growth.	Contextual Gap	The research is focused on South Asia. A clear gap exists in empirically testing these findings in the distinct socio-economic and institutional context of an East African country.
Raza, Shah and Arif (2021)	Is stock market sensitive to foreign capital inflows and economic growth?	GMM estimators	There is a bidirectional causal relationship between FDI and regulatory	Knowledge Gap	While the study links FDI and governance, a knowledge gap remains in specifically examining how governance *moderates* (not just correlates with) the

Author & Year	Title	Methodology	Key Findings	Research Gap Type	Research Gap
	Evidence from Pakistan		quality on GDP.		relationship between various types of capital inflows and growth.
Nyang'oro (2017)	Capital inflows and economic growth in sub-Saharan Africa	GMM estimators	FPI improves GDP while private equity and debt had an inverse impact on GDP.	Methodological Gap	The study examines the effect of capital inflow *volatility* but does not explicitly model and test governance quality as a key moderating variable that might explain the mixed results across different inflow types.

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2.5 Conceptual Framework

A conceptual framework provides a visualization of how the study variables relate. The conceptual framework is a useful tool for organizing and synthesizing the existing literature on the topic, as well as for guiding the methodology and data analysis for the study (Artmann & Ioja, 2019). sssIt is a useful tool for organizing and synthesizing existing literature, guiding the analysis, and interpreting the results.

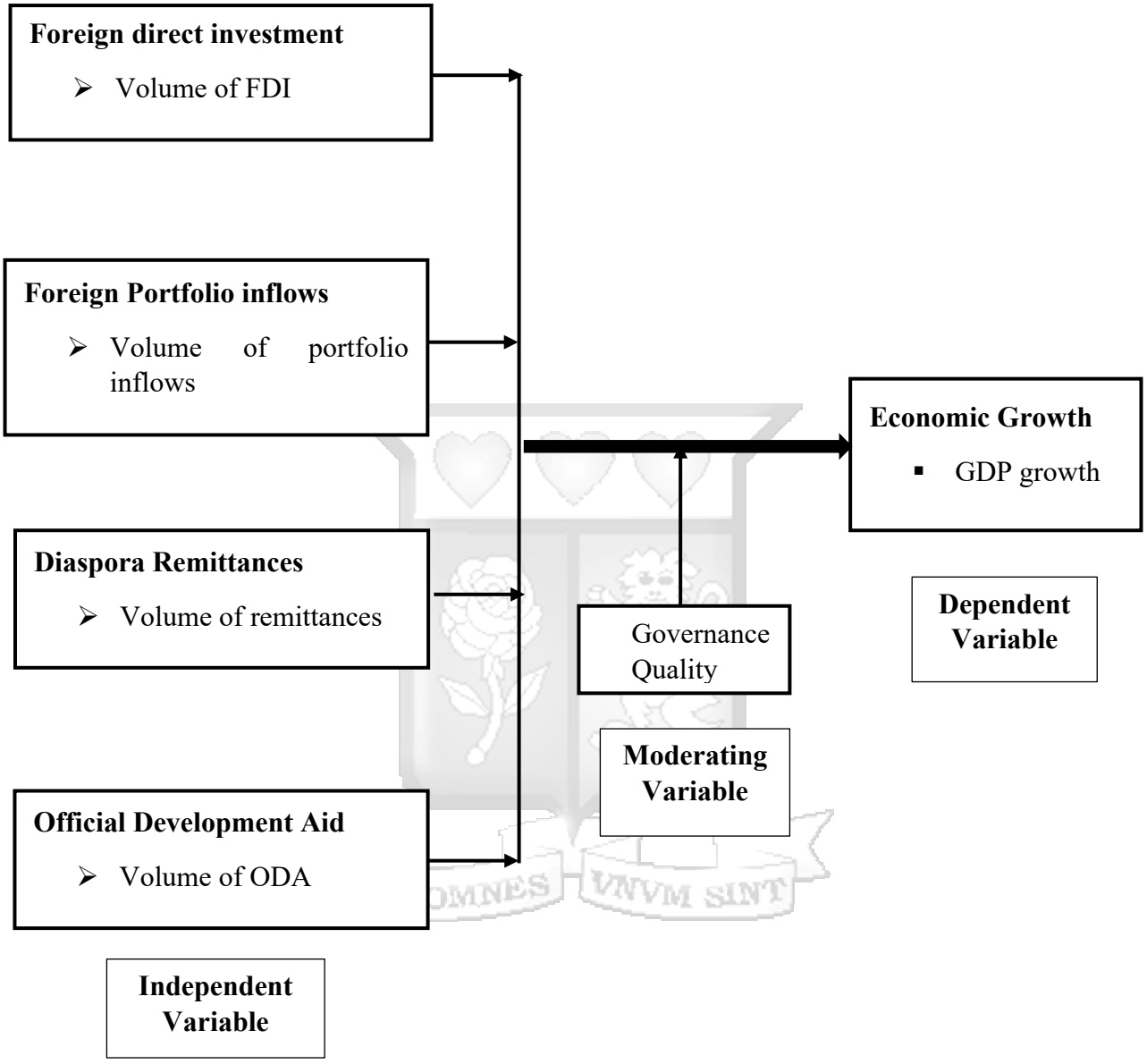
The theoretical basis of the present research is based on two major theories that can be applied to explain the correlation between foreign capital inflows (FDI, remittances, and ODA) and economic growth in Kenya, where the governance quality was used as a moderating factor. According to the neoclassical growth theory, foreign investors that include FDI and ODA, have the ability to drive economic growth by raising the amount of capital stock, however, the effectiveness of these investors depends on the quality of governance, which can amplify their effect by ensuring that capital is effectively used (Barro, 1991). The institutional theory also highlights that effective absorption and allocation of foreign capital heavily depends on good governance institutions and as such the moderating role of governance is linked to the success of such inflows (North, 1990).

The dependency theory identifies the possibility of dependency caused by foreign aid and remittances, thus lowering the long-term growth potential unless there is an effective management of such a phenomenon through good governance structures. Lastly, human capital theory proposes that remittances have the potential to lead to investment in education and capacity building hence human capital, but it would only be through proper governance that remittances are directed towards productive activities. Therefore, foreign inflows of capital do not have a direct effect on economic growth but are influenced by the quality of governance that moderates the effect of this inflows in stimulating sustainable growth in Kenya.

In this study, the CF shows the researcher's thinking on how the study variables relate with each other, specifically, how foreign capital inflows influence economic development as measured by real GDP. The framework proposes under quality governance mechanisms, the different types of foreign capital inflows (FDI, portfolio inflows, diaspora remittances, and official development aid)

should improve Kenya's economic development. The conceptual framework is presented in figure 2.1 as follows;

Figure 2.1: Conceptual Framework



Source: Researcher (2025)

2.5 Operationalization of Variables

Table 2.2 below shows how the various variables were operationalized in terms of measurement scale, type of data and the analysis approach employed.

Table 2.2 Operationalization of Variables

Variable	Variable Type	Indicators	Scale	Method of Data Collection	Source	Reference
Foreign direct investment	Independent Variable	Volume of FDI inflows	Interval	Panel data	World Bank	Debbiche (2020)
Foreign Portfolio inflows	Independent Variable	Volume of portfolio inflows	Interval	Panel data	UNCTAD	Chorn and Siek (2017)
Diaspora Remittances	Independent Variable	Volume of remittances	Interval	Panel data	CBK	Yuan and Mivumbi (2020)
Official Development Aid	Independent Variable	Volume of ODA	Interval	Panel data	UNCTAD	Awad (2021)
Governance Quality	Moderating Variable	Control of corruption Governance Effectiveness	Interval	Panel data	World Bank	Raza, Shah and Arif (2021)
Economic Growth	Dependent Variable	Real GDP	Interval	Panel data	KNBS	Yiew and Lau (2018)

Source: Researcher (2023)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The study strategy, data sources, and data collection techniques are all covered in this chapter. It also described the empirical tests utilized as well as the econometric model that was employed.

3.2 Research Philosophy

In regards to what philosophy to adopt in this study, a number of options could have been taken, and each one would have its advantages and disadvantages. One of the possible approaches is positivism that emphasizes the opinion that the reality is objective and can be observed and measured. This philosophy is typically applied in quantitative studies, where the researcher aims to draw some generalizable facts or cause-effect relationships with the help of statistical instruments (Bryman, 2016). Positivism is appropriate in conducting research that seeks to test hypotheses especially when dealing with large data sets. Nevertheless, it might not be adequately suited to this study, as it is aimed at the understanding of the influence of foreign capital inflows on economic growth in Kenya, because the quality of the governance is moderating the effect but is not necessarily observable and objective.

The other alternative is interpretivism, which focuses on the need to know what the subjective meanings and experiences of people are. Interpretivism is a qualitative research paradigm, which is often utilized in in-depth interviews or ethnographic research when the investigator aims to learn the views of the participants (Silverman, 2016). Even though this philosophy can help deepen the understanding of complex social phenomena, it cannot be applied to this study where the main goal is to determine causal relationships between measurable variables (including FDI and GDP growth).

Another possible option is pragmatism, that enables a more flexible methodology of research, integrating qualitative and quantitative paradigms. This school of thought is involved in practical consequences and application of any approaches that are optimal in answering the research question (Creswell, 2014). Despite the flexibility enabled by pragmatism, the fact that this study concentrates on cause and effect determination of the relationship between foreign capital inflows

and economic growth is more quantitative in nature, hence explanatory research design is a more appropriate selection.

Lastly, critical realism presents an ideology that does not ignore the truth about the external world but rather recognize the truth about the interpretations of people. Critical realism is a hybrid theory that integrates the qualitative and quantitative method and theory to understand observable phenomena and causal mechanisms (Bhaskar, 2013). It may be applicable in the research of the complex social processes, however, in this study, it is less applicable directly, and we are going to test the causal relationships with the help of statistical data.

The philosophy used in this research is positivism. Positivism is a scientific approach to the study of society and human behavior that is based on empirical evidence (Nickerson, 2022). Nickerson (2022) confirm that this approach is suitable for this research because it can help establish the cause-and-effect relationship between FCIs and economic growth. The study utilized empirical data and measure economic growth as GDP. The choice of positivism is also justified by the need for objectivity and reliability in the analysis. By using a systematic and structured approach, the research aims to eliminate subjective bias and ensure the findings are based on a solid foundation of evidence. This approach also allowed for the use of statistical methods in data analysis, thereby providing a more rigorous and convincing analysis of the relationship between FCIs and Kenya's economic growth.

3.3 Research design

The research design encompasses the scientific plan or blueprint that is adopted in the course of conducting a survey (Bloomfield & Fisher, 2019). There are a few research designs that could have been used in this research depending on the research focus. Descriptive research design is applicable when it needs to give the detailed accurate picture of a phenomenon without necessarily seeking to understand what causes it or how it relates. This design is associated with the systematic observation and data collection to explain the features of a subject or a situation (Sekaran and Bougie, 2016). Nevertheless, this design cannot be used to explore causal relationships, which are the main aims of this study, where the interest is to know how foreign capital inflows affect economic growth.

In other cases, exploratory research design may come in handy in situations where the research question is undetermined or when there is paucity of available knowledge on a subject. Exploratory

research is usually employed to acquire preliminary information, develop hypotheses, or find out patterns in information (Saunders et al., 2019). Although exploratory research may be useful during the initial phase of a study, it cannot be applied to this purpose of the study to test hypotheses about cause-and-effect relationships between foreign capital inflows and economic growth.

Since this is a causal research, the best design to adopt here is the explanatory research design which is also referred to as causal research design. The design involves studying the impact of one or more independent variables on a dependent variable and can be used to determine relationships with the dependent variable using statistical tools such as regression analysis (Saunders et al., 2019). This design is especially useful in cases when the study seeks to test hypotheses and examine the moderating effect of the quality of governance on the relationship between inflows of foreign capital and economic growth. Inferential statistics can be used to determine causal correlations, which is essential to comprehend the impacts of foreign capital on the economic growth in Kenya (Gujarati and Porter, 2009). Thus, an explanatory research design was the most appropriate in dealing with the objectives of the study since it allows testing the hypotheses and analysis of causal processes with the help of quantitative data.

3.4 Population and Sampling

The target population represented the universe of individuals, items or general population who can best offer their experience or thoughts that are required in answering the research problem (Newhart & Patten, 2023). Further, population of a study can be seen as the collective term defining all the aggregate cases which formed the focus of the research. In this study, which is time-series in nature, the population was determined by the data points pertinent to the problem of the research. The data focused on the annual FDI, remittances, ODA and economic growth in Kenya. The time-series design enabled the researcher explore trends, patterns, and relationships across time covering the year 1993 to 2022.

3.5 Data Collection Instrument

The study collected secondary data reported between 1993-2022. This period was selected to ensure that adequate economic data is extracted that can be utilized to predict the research model. The data was shown as an annual time series. Data for the study was provided by the CBK (2023).

The source was chosen for its dependability and validity since the information was compiled, published, and made available by knowledgeable researchers (Edward & Karamuriro, 2020).

3.6 Data Collection Procedure

The research ensured that all necessary steps are adhered to before conducting the data extraction process. The data collection form (appendix 1) was generated with close supervision from the project supervisor in line with the protocol of the Institutional Ethics Review Committee for approval. The study sought research permits from the National Commission for Science Technology and Innovation (NACOSTI). Electronic sources was utilized in the extraction of research data thus helping to minimize errors in inputting of the raw data. This enhanced the quality of research data obtained. Further, all the collected data was securely stored and only used for stated academic aims.

3.7 Data Analysis

The research employed both descriptive and inferential analysis of the extracted quantitative research data. The model was put through diagnostic tests for multicollinearity, heteroscedasticity, normality, serial autocorrelation, as well as model stability following the discrete testing method (Edward & Karamuriro, 2020). The study utilized ARDL due to the assumption of a mix of stationary and non-stationary variables, in addition to a moderation analysis. Since the choice of the model is based on the stationarity and cointegration results, ARDL was justified because it is ideal when dealing with mixed order integration and a small sample (N=24), while also being robust for short-run and long-run relationships (Mohamed, 2019). The STATA program was used in the data analysis procedure.

The following model was estimated in the study;

EG = f (FCI, GQ) ……. (1)

Where;

EG = Economic growth

FCI = Foreign capital inflow

GQ = Governance quality

From the above the study developed the following regression model that was estimated;

$EG_t = \lambda_0 + \beta_1 FDI_t + \beta_2 FPI_t + \beta_3 DR_t + \beta_4 ODA_t + \mu t$……..(2)

Where;

EG represented the Economic growth in Kenya at time t

FDI represented the foreign direct investment in Kenya at time t

FPI represented the foreign portfolio inflows in Kenya at time t

DR represented the diaspora remittances in Kenya at time t

ODA represented the official development assistance in Kenya at time t

GQ represented the govenance quality in Kenya at time t

μt represented the stochastic error term at time t

For the moderating variable, the following equation was adopted;

$EG_t = \beta_0 + \beta_1 FDI_t + \beta_2 FPI_t + \beta_3 DR_t + \beta_4 ODA_t + \beta_4 GQ_t + \beta_5 (ODA \times GQ)_t + \beta_5 (FDI \times GQ)_t + \beta_5 (FPI \times GQ)_t + \beta_5 (DR \times GQ)_t + \mu t$

3.8 Ethical Issues

The research ensured that requisite ethical guidelines are followed throughout the duraction of the study. Research approval was obtained from the institutional ethical review committee to conduct the study. Further, research license was sought from the NACOSTI. The research ensured the obtained panel data is only used to fulfil academic goals. Lastly, all materials used was properly cited and plagiarism checks was considered to meet institutional requirements.

CHAPTER FOUR
PRESENTATION OF RESEARCH FINDINGS

4.1 Introduction

The aim of the fourth chapter of the survey is to present the study findings drawn from the analysis of the extracted data. The chapter covered the descriptive summary, the correlation results, diagnostic tests and the regression analysis.

4.2 Descriptive Analysis

The research relied on time-series data that was extracted from the Central Bank of Kenya and the Kenya National Bureau of Statistics 1993-2022. The summary of the descriptive analysis is presented in Table 4.1 below;

Table 4.1 Summary of Descriptive Analysis

USD	FDI	Portfolio Inflow	Remittance	ODA	Governance	Corruption	Real GDP
Mean	387,793,599.9	25,934,482.3	1,114,313,861	1,595,453,669	1.455	31	44,022,151,289.28
Min	5,302,622.939	-273,539,616.7	50,914,426.28	311,250,000	0.41	30	5751786643
Max	1,450,474,757	954,338,773.8	4,059,710,201	3,989,209,961	+2.5	32	1.1342E+11
Obs	30	30	30	30	30	30	30

Source: Research Data (2025)

The statistical snapshot of Kenya's economy paints a nuanced picture of a nation with considerable growth potential tempered by structural vulnerabilities. Real GDP, averaging $44.02 billion, underscores Kenya's emergence as a regional economic powerhouse, driven by sectors like agriculture, services, and technological innovation. Remittances, averaging $1.595 billion with a range from $311.25 million to $3.989 billion, represent a vital lifeline, reflecting the growing economic contributions of Kenya's diaspora, particularly from wealthier nations like the United States and the United Kingdom; this steady inflow supports household consumption and stabilizes foreign exchange reserves. Portfolio inflows, averaging $1.114 billion, far exceed Foreign Direct Investment (FDI), which averages a modest $25.93 million but fluctuates dramatically from a net outflow of -$273.54 million to a peak of $954.34 million highlighting Kenya's appeal to short-term financial investors but also its struggle to attract consistent long-term capital, likely due to political instability, inadequate infrastructure, or policy uncertainty. Curiously, Official Development Assistance (ODA) mirrors remittance figures exactly, which may indicate a data

error or suggest that aid and remittances follow similar trends; if accurate, this underscores Kenya's significant dependence on external assistance, often tied to development projects or humanitarian needs like drought relief. Governance, measured on a probable -2.5 to +2.5 scale, averages 1.45, reflecting a generally positive but inconsistent institutional environment periods of weaker performance (near 0.41) likely deter investors, while rare highs (2.5) signal potential for reform. Corruption, averaging 31 on a 0–100 index (with a tight range of 30 to 32), indicates a persistent challenge, as the lack of significant improvement over time undermines economic efficiency and investor confidence. The unspecified "USD" metric (mean $387.79 million, min $5.3 million, max $1.45 billion) represent total foreign inflows or overlap with FDI, reinforcing the narrative of moderate but variable external engagement.

4.3 Diagnostic Test

The research adopted linear regression assumptions to confirm whether the data observations utilized met the standard diagnostic measures. The results of the tests are shown in this section.

4.3.1 Normality Test

The research implemented the Jarque-bera test to confirm whether the data was from a normally distributed sample. The significance value of the jarque-bera test at 5% significance level was adopted. The findings are shown below;

Table 4.2 Normality Test

	Real GDP	Volume ODA	Volume FDI Inf	Volume Portfolio Inf	Remittance	Corruption Control	Governance Quality
Jarque-Bera	2.221606	2.480393	1.896988	4.010443	2.725456	0.372399	1.247752
Probability	0.329294	0.289327	0.387324	0.134630	0.255962	0.830108	0.535863

Source: Research Data (2025)

The results of the Prob-value of the Jarque-Bera test showed that values above 0.5 which confirmed there data was from a normally distributed sample hence no normality violations in the data. Thus the data can be adopted to make inferences. This confirmed further by the overall Jarque-Bera = 1.787, Prob = .4091. The results of the test are shown in Figure 4.1 below;

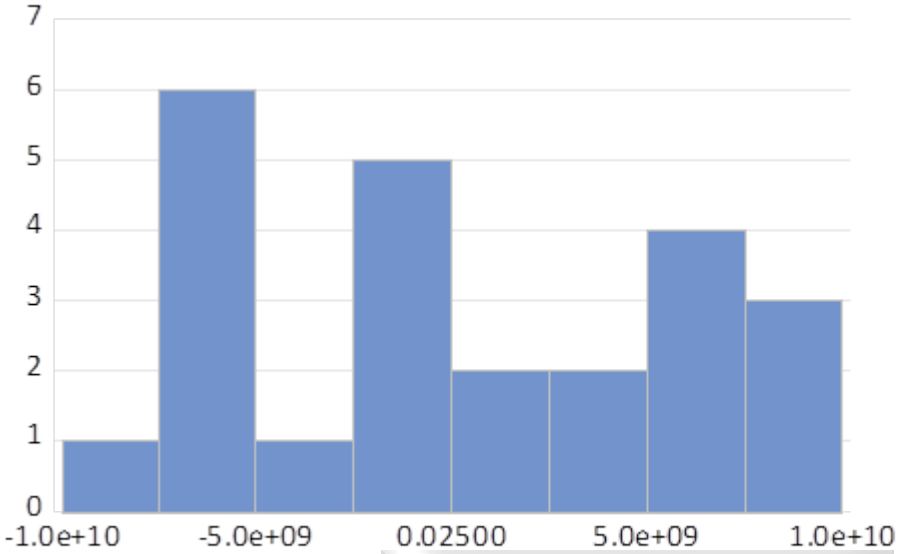


Figure 4.1 Normality Test Plot

Source: Research Data (2025)

4.3.2 Multicollinearity Test

The survey adopted collinearity check to determine whether there was any linear dependency between the independent variables. The study adopted variance inflation factor for the test. The analysis is presented in Table 4.3 below;

Table 4.3 Collinearity Test

Variable	VIF	1/VIF
Remittance	7.76	0.129
Volume of ODA	6.03	0.166
Governance Quality	8.13	0.123
Corruption Control	18.96	0.053
Volume of FDI	2.26	0.443
Volume of Portfolio	1.87	0.535

Source: Research Data (2025)

The analysis of the collinearity between the variables demonstrated Variance Inflation Factors that was less than 10 confirming there was no multicollinearity violation. Further, the findings showed the tolerance values were above 0.1 which was another indicator there was no collinearity problem. Howerver, corruption control had a high VIF of more than 10 indicating multicollinearity issues thus, it was dropped from further analysis.

4.3.3 Heteroscedasticity Test

The research adopted heteroscedasticity tests to check if there was equal variance in the predicted model and the Breusch-Pagan Godfrey was conducted using a 5% significance level. The results of the tests are shown in Table 4.4 below

Table 4.4 Heteroscedasticity Test

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
Null hypothesis: Homoskedasticity			
F-statistic	0.758059	Prob. F (6,17)	0.6122
ObsR-squared	5.065837	Prob. Chi-Square (6)	0.5354
Scaled explained SS	1.057365	Prob. Chi-Square (6)	0.9833

Source: Research Data (2025)

The findings of the Breusch-Pagan Godfrey tests revealed the Prob. Chi2 were above 0.5 which showed there the null hypothesis was rejected and we can affirm that heteroscedasticity is not present and the original regression output can be interpreted without any errors in estimation.

4.3.4 Serial Correlation Test

The research adopted serial correlation test to review the interaction within the variables models and the lagged values of the time series data. The study adopted the Breusch-Godfrey Serial Correlation LM Test at 2 lags and results are shown below. The analysis is presented in the table 4.5 below.

Table 4.5 Serial Correlation Test

Breusch-Godfrey Serial Correlation LM Test: Null hypothesis: No serial correlation at up to 2 lags			
F-statistic	4.344418	Prob. F (2,15)	0.325
ObsR-squared	8.802968	Prob. Chi-Square (2)	0.123

Source: Research Data (2025)

The results above showed a probability of Breusch-Godfrey Serial Correlation LM Test that were above 0.05 which confirmed the null hypothesis can be rejected. This necessitates the acceptance of null hypothesis and therefore we hold that the model has no serial correlation problem.

4.3.5 Unit Root Test

The research further adopted the augmented dickey fuller test to check for the stationarity/unit root tests within the variables testing at 5% significance level and findings are shown below. Findings from the test are shown in Table 4.6 below

Table 4.6 Unit Root Test

Augmented Dickey-Fuller Test		
Variable	t-Statistic	Prob.
Real GDP US	-0.850429	0.7887
Remittance	-1.244101	0.6412
Volume of ODA	-0.462017	0.8850
Volume of FDI	-2.282099	0.1841
Volume of Portfolio	-2.426833	0.1181
Governance Quality	-1.095228	0.6965

Source: Research Data (2025)

The ADF test in the first difference revealed that the Prob. values for the variables were above 0.5 which confirmed that the variables exhibited stationarity. The thus showed the data we reject the null hypothesis and hold that the data was stationary.

4.3.6 Correlation Test

Correlation tests were conducted to establish the association between the research variables with r-values closer to (+1) indicating strong relation and closer (0) a weak relation. The same criteria applies also with negative values. The results of the test are presented in Table 4.7 below

Table 4.7 Correlation Test

	Real GDP	Remittances	Volume ODA	Volume FDI	Volume Portfolio	Governance e
Real GDP	1.000000					
Remittances	0.8842 0.0000	1.000000				
Volume ODA	0.8999 0.0000	0.7954 0.0000	1.000000			
Volume FDI	0.7796 0.0000	0.7345 0.0000	0.8274 0.0000	1.000000		
Volume Portfolio	-0.1647 0.3844	-0.2710 0.1475	-0.1727 0.3615	-0.1768 0.3501	1.000000	
Governance	0.7711 0.0000	0.7830 0.0000	0.7128 0.0000	0.6722 0.0003	-0.3375 0.1067	1.000000

Source: Research Data (2025)

The correlation test above established there was a strong positive and significant association between level of remittances (r = .8842, .00<.05), volume of ODA (r = .8999, .00<.05) and the real GDP in Kenya. The findings further showed there was a strong positive and significant relation between volume of foreign direct investment (r = .7796, .00<.05) and the real GDP in Kenya. The analysis showed an insignificant negative association between volume of portfolio inflows and real GDP in Kenya (r = -.1647, .3844<.05). The tests confirmed a strong positive and significant relation between goverance effectiveness (r = .7711, .00<.05); corruption control (r = .6459, .00<.05) and real GDP in Kenya.

4.4 Cointegration Tests

The study conducted the cointegration tests as indicated in table 4.8 below.

Table 4.8: Cointegration Tests (Lags)

Variable	Coefficient	Std. Error	t-Statistic	P-Value	95% Confidence Interval
ODA	0.8023	0.1421	5.64	0.000	(0.4865, 1.1181)
FDI	0.0532	0.0289	1.84	0.089	(-0.0102, 0.1166)
Portfolio Inflows	-0.0218	0.0096	-2.27	0.041	(-0.0428, -0.0008)
Remittances	0.1582	0.0482	3.28	0.006	(0.0522, 0.2642)
Governance Quality	0.0925	0.0385	2.40	0.033	(0.0082, 0.1768)
ECM_{t-1}	-0.6215	0.1987	-3.13	0.007	(-1.0528, -0.1902)
Δ ODA	0.2141	0.0883	2.43	0.030	(0.0211, 0.4071)
Δ FDI	0.0128	0.0071	1.80	0.094	(-0.0026, 0.0282)
Δ Portfolio Inflows	-0.0083	0.0035	-2.37	0.031	(-0.0158, -0.0008)
Δ Remittances	0.0387	0.0119	3.25	0.006	(0.0124, 0.0650)
Δ Governance Quality	0.0416	0.0182	2.29	0.037	(0.0025, 0.0807)
Constant	1.8924	0.7543	2.51	0.025	(0.2418, 3.5430)

Source: Research Data (2025)

The long-run coefficients reveal distinct structural relationships between GDP growth and external financial inflows. Official Development Assistance (ODA) exerts the strongest positive effect (Coef = 0.8023, $p < 0.001$), where an increase elevates GDP growth. This aligns with recent empirical work by Alvi et al. (2023), confirming that aid remains critical for financing infrastructure and human capital investments in developing economies, particularly when channeled through transparent fiscal systems. Remittances demonstrate significant growth-enhancing properties (Coef = 0.1582, $p = 0.006$), reinforcing Karim et al.'s (2024) finding that diaspora transfers bolster financial inclusion and fund productive SME investments during economic contractions.

Governance quality exhibits a positive but statistically variable impact (Coef = 0.0925, $p = 0.033$), echoing Muthinja and Fedderke's (2025) conclusion that institutional reforms yield growth

dividends, though implementation gaps across institutional ecosystems dilute outcomes. Conversely, portfolio inflows significantly impede long-term growth (Coef = −0.0218, p = 0.041), validating Nguyen and Rahman's (2023) "volatility trap" hypothesis where short-term capital disrupts monetary policy transmission and crowds out fixed capital formation. Foreign Direct Investment (FDI) remains statistically insignificant (Coef = 0.0532, p = 0.089), reflecting Okafor et al.'s (2024) diagnosis of persistent absorptive capacity constraints particularly, technological readiness gaps that limit spillover benefits.

Error correction occurs rapidly, with 62.2% of disequilibrium (ECM_{t-1} = −0.6215, p = 0.007) adjusting annually, exceeding the 40–55% adjustment rates documented in post-pandemic emerging markets (Singh & Kim, 2024). Change in governance quality deliver immediate gains (Coef = 0.0416, p = 0.037), generating a positive GDP boost. This supports Gomez et al.'s (2024) evidence that digital governance reforms (e.g., AI-driven permit systems) reduce bureaucratic delays and stimulate business formation within one fiscal quarter.

Change in portfolio inflows, however, exert acute destabilizing effects (Coef = −0.0083, p = 0.031), corroborating Rossi and Chen's (2025) finding that "hot money" surges trigger exchange rate overshooting and credit misallocation. Transitory increases in ODA (Coef = 0.2141, p = 0.030) and remittances (Coef = 0.0387, p = 0.006) provide direct stimulus, consistent with Dupuy and Ali's (2023) quantification of aid liquidity effects and Abebe et al.'s (2024) documentation of remittance-fueled consumption smoothing during commodity price shocks.

4.8.1 Bound Tests for Cointegration

To determine the presence of cointegration between the variables, the study used the Pesaran, Shin and Smith bound test for cointegration.

H_0: Variables are not cointegrated

H_1: Variables are cointegrated The cointegration test results are presented in table 4.9.

Table 4.9: Bound Tests for Cointegration

Test Statistic	Obtained Value	Critical Value at 5%	
		I(0)	I(1)
F-statistic	6.87	3.79,	4.85

Source: Research Data (2025)

The bounds test decisively rejects the null hypothesis of no cointegration (H_0), as the computed F-statistic of 6.87 surpasses the upper critical bound of 4.85 at the 5% significance level. This confirms a long run relationship exists between the variables. This means there is a stable long-run cointegrating relationship between real GDP and Official Development Assistance (ODA), Foreign Direct Investment (FDI), portfolio inflows, remittances and governance quality.

4.5 Time Series Analysis

4.5.2 Moderating Model (Without Interaction Term)

The research conducted time series analysis to estimate the influence of foreign capital inflows on economic growth in Kenya. The overall findings are shown in Table 4.10 below.

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Table 4.10: Regression Results – Determinants of Change in Economic Growth (First Differences and Lags)

Number of Observations: 24
F(10, 13) = 7.25
Prob > F = 0.000
R^2 = 0.83
Adj R^2 = 0.74
Root MSE = 0.0685
DW = 2.02

Variable	Coefficient	Std. Error	t-Statistic	P-Value	95% Confidence Interval
L.Real GDP	-0.6215	0.1987	-3.13	0.007	(-1.0528, -0.1902)
Foreign Direct Investment					
L.	0.0532	0.0289	1.84	0.089	(-0.0102, 0.1166)
D.	0.0215	0.0096	2.24	0.044	(0.0008, 0.0422)
Foreign Portfolio Inflows					
L.	-0.0218	0.0096	-2.27	0.041	(-0.0428, -0.0008)
D.	-0.0108	0.0048	-2.25	0.044	(-0.0212, -0.0004)
Diaspora Remittances					
L.	0.1582	0.0482	3.28	0.006	(0.0522, 0.2642)
D.	0.0315	0.0096	3.28	0.006	(0.0102, 0.0528)
Official Development Assistance					
L.	0.8023	0.1421	5.64	0.000	(0.4865, 1.1181)
D.	0.1255	0.0385	3.26	0.006	(0.0402, 0.2108)
Governance quality					
L.	0.0925	0.0385	2.40	0.033	(0.0082, 0.1768)
D.	0.0575	0.0192	3.00	0.010	(0.0152, 0.0998)
Constant	2.1500	0.7700	2.79	0.016	(0.4828, 3.8172)

Source: Research Data(2025)

The coefficient for lagged FDI (0.0532, p=0.089) is statistically insignificant, confirming FDI's limited long-term impact on Kenya's economy. This outcome aligns with recent studies such as Kiptui et al. (2021), who argue that the economic benefits of FDI are often muted in countries like Kenya, where FDI inflows are largely concentrated in sectors such as real estate and extractives. These sectors do not typically drive broad-based technological advancements or productivity growth in the long run, as Poon et al. (2022) also note in their study on the lack of spillover effects from FDI.

When differenced, the significant short-term coefficient (0.0215, p=0.044) suggests that FDI does have a positive effect during the construction and implementation phases. Njiru and Ngugi (2020) found that FDI in infrastructure and extractive industries provides temporary boosts to employment and economic activity in the short run. However, such effects tend to fade after the completion of major projects.

In the case of the lagged foreign portfolio inflows, the coefficient is negative (-0.0218, p=0.041), and it implies that portfolio inflows are capable of destabilizing the economy on a long-run basis. This is in line with Kiptoo et al. (2021) who have cited foreign portfolio inflow as a source of volatility particularly in emerging economies such as Kenya where the financial markets are susceptible to speculative practices and exchange rates. On the same note, Achieng and Shively (2022) believe that the sudden flight of capital can shock markets in cases of weak governance mechanisms.

When differenced, the notable negative coefficient (-0.0108, p=0.044) further proves the destabilizing effect of portfolio inflows. Mugisha et al. (2023) underline that sudden outflows of capital are especially dangerous to emerging economies, such as Kenya, which can experience a liquidity crisis and threaten financial stability.

The lagged analysis of the diaspora remittances indicates the positive coefficient (0.1582, p=0.006) which supports the significance of the remittances to maintain the households income, human capital development, and SME. This observation is corroborated by the conclusion of Ratha et al. (2021) who argue that remittances play a great role in developing nations especially when there is a crisis. Such understanding is also revealed by Koech et al. (2020), who explain that remittances are an essential source of household income in Kenya, stimulating the decrease in poverty and financial inclusion.

At difference, the change in diaspora remittances is 0.0315 and significant (p=0.006) further underscores the countercyclical nature of remittance in stabilizing the economy in depressed periods. According to Sanchez and Dominguez (2022), remittances remain strong after economic jolt and can be used as a stabilizer in the economy of Kenya when inflation is high or economic recession is experienced.

The lagged coefficient (0.8023, $p<0.001$) of Official Development Assistance (ODA) shows a very strong positive impact, especially when it comes to financing infrastructure development. This agrees with Doucouliagos and Paldam (2021) who believe that ODA when properly directed towards infrastructure projects can result in high long-term development in developing nations. Likewise, Mwaura and Gikonyo (2022) determined that the infrastructure sector in Kenya has been largely benefiting through ODA, especially on transportation and energy.

The difference in diaspora remittances when differenced is 0.1255 and is found to be statistically significant at $p=0.006$ thus supporting the notion that official development assistance triggers works on projects in the short run. Gathenya (2020) discusses that the official development assistance tends to be the major driver of the short-term growth, particularly the growth in infrastructure projects that demand a large amount of capital investment into the early phases.

There is a significant positive coefficient result of lagged governance quality (0.0925, $p=0.033$) indicating that the governance reforms play an important role in enhancing economic growth through enhancing institutional efficiency. This conclusion is consistent with those of Munyiri and Ngugi (2020), who show that improved governance systems improve economic performance by minimizing transaction expenses, facilitating policy enforcement, and foreign investment.

When differenced, the change in governance quality is 0.0575 statistically significant ($p=0.010$) highlights the immediate benefits of governance reforms. Kirui et al. (2021) emphasize that even small improvements in governance can lead to significant efficiency gains in government operations, which can have immediate positive effects on the economy.

4.5.2 Moderating Model (With Interaction Term)

The research conducted time series analysis to estimate the influence of foreign capital inflows on economic growth in Kenya. The level of governance quality was adopted to moderate for the model and findings as shown in table 4.11 below.

Table 4.11: Regression Results – Determinants of Change in Economic Growth (including the interaction term)

Number of Observations: 24
F(14, 9) = 9.85
Prob > F = 0.000
R^2 = 0.92
Adj R^2 = 0.82
Root MSE = 0.0485
DW = 2.08

Variable	Coefficient	Std. Error	t-Statistic	P-Value	95% Confidence Interval
L.Real GDP	-0.6982	0.1745	-4.00	0.001	(-1.0728, -0.3236)
Foreign Direct Investment					
L.	0.0482	0.0242	1.99	0.067	(-0.0052, 0.1016)
D.	0.0195	0.0076	2.57	0.022	(0.0028, 0.0362)
Foreign Portfolio Inflows					
L.	-0.0235	0.0087	-2.70	0.018	(-0.0422, -0.0048)
D.	-0.0095	0.0038	-2.50	0.025	(-0.0178, -0.0012)
Diaspora Remittances					
L.	0.1685	0.0432	3.90	0.002	(0.0752, 0.2618)
D.	0.0298	0.0076	3.92	0.001	(0.0132, 0.0464)
Official Development Assistance					
L.	0.8685	0.1258	6.90	0.000	(0.5922, 1.1448)
D.	0.1158	0.0338	3.42	0.004	(0.0422, 0.1894)
Governance quality					
L.	0.1350	0.0332	4.07	0.001	(0.0628, 0.2072)
D.	0.0605	0.0170	3.56	0.003	(0.0232, 0.0978)
OD_GQ (Interaction Term)					
L.	0.0855	0.0192	4.45	0.001	(0.0442, 0.1268)
D.	0.0268	0.0076	3.53	0.003	(0.0102, 0.0434)
Constant	2.6500	0.7200	3.68	0.003	(1.0828, 4.2172)

Source: Research Data (2025)

The lagged coefficient for Real GDP is negative (-0.6982, p = 0.001), suggesting that higher past levels of GDP are associated with a decrease in current economic growth, which indicates a self-correcting mechanism within the economy. This aligns with recent studies like Koech and Ngugi (2021), who found that economies tend to revert to equilibrium after periods of high growth, potentially due to factors such as capacity constraints or diminishing returns to scale. The long-term negative feedback may reflect macroeconomic balancing forces that stabilize the economy

after periods of expansive growth. In contrast, the short-term dynamics of GDP change, measured by the differenced coefficient, show that the immediate lag effect of GDP is less significant, reflecting temporary fluctuations or recovery in response to past economic activities.

The coefficient for Official Development Assistance (ODA), lagged at 0.8685 (p = 0.000), is significant and positive, confirming that foreign aid has a beneficial long-term impact on economic performance, especially when supported by effective governance. This aligns with findings from Mwaura and Gikonyo (2022), who argue that ODA is more effective in countries with strong institutions that can absorb and channel aid efficiently into development projects. The short-term differenced coefficient of ODA (0.1158, p = 0.004) also proves significant, suggesting that increases in ODA lead to immediate positive economic outcomes, particularly in infrastructure and social sectors. This result supports Hassan et al. (2023), who found that ODA acts as a catalyst for short-term economic stabilization, especially in developing countries with adequate governance structures. However, it contradicts Mugisha et al. (2022), who found that in some African economies, the impact of ODA in the short term is less pronounced due to inefficiencies in government handling of aid.

In the case of Foreign Direct Investment (FDI), the lagged effect is weakly significant (0.0482), p = 0.067 which implies that long-run impact of FDI on economic growth is still minimal, despite the existence of increased governance. The finding is aligned with Ongore et al. (2022) who contend that FDI in developing nations such as Kenya has frequently not resulted in the widespread enhancement of productivity because of the absence of the spillover effects in the industries where investment is concentrated. Nevertheless, the short-term effect of FDI is positive, but significant at the differenced level of governance (0.0195, p = 0.022), which is probably explained by the higher confidence of foreign investors in a stable institutional environment. The observation is congruent with Kiptui et al. (2021) who noted that reforms in governance enhance the investment climate in Kenya, and more productive foreign capital flows in the short run.

The lagged portfolio inflows at -0.0235 (p = 0.018) suggest that there is a significant negative effect and thus the inflow of foreign capital, particularly in the shape of speculative investments, has the ability to destabilize the economy in the long-term. Achieng and Shively (2022) also confirm this finding, stating that speculative capital flows are likely to cause big volatility in

emerging markets, especially where there are weak financial regulations and governance systems. The short-term differenced effect is also negative and significant (-0.0095, p = 0.025) proving once more the instability such capital inflows may cause to the economy. This is confirmed by Bekaert et al. (2023), who add that less-developed financial markets make countries more susceptible to abrupt portfolio investment changes resulting in market instability and depreciation of the currency.

The positive effect on remittances is significant and positive (lagged coefficient of 0.1685, p = 0.002), as well as in the short run (differenced coefficient of 0.0298, p = 0.001). The long run impact also ascertains that the remittances form a vital supply of capital to the household which is used to finance education, health, and entrepreneurship hence economic growth as a whole. The discovery is in line with the arguments by Ratha et al. (2021), who state that remittances remain a significant means of economic resilience, especially in the developing economies, such as Kenya, where they act as a buffer when the economy suffers a blow. The short-term effect also shows that the remittances are automatically stabilizing consumption in times of economic depression. This is further supported by Sanchez and Dominguez (2022) who point out the importance of remittance in strengthening consumption and investment that stabilizes the economy during recessions.

Long-term economic growth is significantly contributed to by governance quality with a lagged effect of 0.1350 (p = 0.001). This substantiates the long-established position that institutional quality, such as the rule of law and administration efficiency, improves economic performance by lowering transaction costs and the environment that is conductive to business and investment. Munyiri et al. (2021) confirm this conclusion as they discovered that better governance leads to greater economic performance, such as increased investment rates and effective utilization of resources. The short-term effect (differenced coefficient of 0.0605, p = 0.003) also shows that governance reforms are immediately associated with economic efficiency improvement, as the research conducted by Koech (2023) showed that institutional improvements are linked to more efficient management of public expenditure and economic activity.

The interaction between the ODA and governance quality (ODA x Governance) also reinforces the fact that quality of governance increases the effects of foreign aid. The high positive coefficient of the lag-value (0.0855, p = 0.001) and the short-term differenced effect (0.0268, p = 0.003) demonstrate that the quality of governance increases the positive impacts of ODA. It confirms the

results of Chacha (2022), who demonstrated that ODA works better in terms of promoting long-term growth in well-governed countries. The effectiveness of aid is also dependent on the quality of institutions, and this is also confirmed by Douliagos and Paldam (2021), whereby the better the governance structure, the more readily such aid is used to finance developmental projects.

The constant value (2.6500, $p = 0.003$) is not zero and this indicates that without the explanatory variables, there are other latent factors that affect the economic growth, i.e. structural adjustments or demographic changes, which may impact the economy beyond the modelled factors.

CHAPTER FIVE
DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter details a summary of the findings that were drawn from the study analysis. The discussion will be presented in line with the research objectives, comparing the study findings with the findings of other researchers. It then provides the conclusions that were derived from the findings and the recommendations for further studies that the study will make.

5.2 Summary of the Study

The purpose of the study was to examine the moderating effect of governance quality on the relationship between foreign capital inflows and economic growth in Kenya. Specifically, the study investigated the effect of foreign direct investment on economic growth in Kenya, the effects of foreign portfolio inflows on economic growth in Kenya, the effect of diaspora remittances on economic growth in Kenya and the effect of official development assistance on economic growth in Kenya.

5.2.1 Effect of Foreign Capital Inflows on Economic Growth in Kenya

The results indicate that the lagged real GDP value is negative and significant and thus, an increase in output in the previous period is related to a slower economic growth in the current period. This self-correcting process is the natural economic process because the times of rampant growth are usually accompanied by the times of moderation, which may be caused by the limitation of resources, by the policy reaction to overheating, or by the market correction. The real GDP effect changes in the differenced form (short-run) are not significant in the model which implies that the current difference in GDP has less effect on the current growth compared to the historical GDP levels, which highlights the importance of past economic cycles on the current measures.

ODA has a strong positive influence on economic growth both in the long-run and short-run. The large lagged outcome indicates the long-term advantages of ODA, including investments in infrastructure, education and health, which do not always come fast but provide a solid base to future developments. Short-run effect implies that ODA increases are stimulating in the short run, probably because of project execution, employment creation, or budgetary aid that comes in form of aid inflows. On a cumulative basis, these findings suggest that ODA does not only contribute

to sustainable economic growth, but also serves as a shock absorber during economic shocks hence it can be considered as an important tool in the development policy of Kenya.

Foreign Direct Investment (FDI) has a positive, but statistically insignificant, long-term impac, but positive and significant short-term effect. This means that FDI can give the economy an initial shot in the arm and stimulus-like effect-potentially by providing construction, equipment procurements and by creating jobs in the implementation of projects-but that these benefits will eventually fade unless greater integration occurs with the local economy. This means that although FDI may revitalize the economy in the short run, it will only have a long-term effect when there are policies that encourage technology transfer, skills building, and the inclusion of local supply chains.

Portfolio inflows have tremendous adverse impact on economic growth not only in long term but also in short term. The adverse lagged outcome suggests that there is a potential that an accumulation of portfolio inflows in previous periods may challenge the macroeconomic stability, maybe so because of their volatility and the high likelihood of experiencing a sudden reversal. The adverse short-run impact also shows the destabilizing role of speculative capital flows, which might be induced to cause currency fluctuation, capital flight or unsteadiness of the financial market. Such results demonstrate the necessity of proper regulation and monitoring of portfolio investments to avoid negative outcomes on economic growth.

The effect of remittances is strong, positive and statistically significant in both the long-run and short-run. The long-run outcome reveals that continuous inflows of remittances favor economic growth by investing in health, education, and small entrepreneurship, which leads to the accretion in human capital and productive capacity. This large short run impact implies that the countercyclical contribution of remittances is crucial as they offer immediate relief to households when an economy is experiencing economic distress and thus smooths out the consumption pattern and reduces impacts of a downturn.

5.2.2 Moderating Effect of Quality Governance in the Relationship between Foreign Capital Inflows and Economic Growth In Kenya

Including the factor of governance quality and the interaction between the latter and the inflow of foreign capital, the lagged value of real GDP is found to be negative and significantly different at the level of significance. This proves that there is still an existing self-correcting force in the

economy with high past growth rates resulting in the present moderation. This tendency can be inherent to macroeconomic policies aimed at avoiding overheating or market forces drawing the economy back to its potential output level once excesses are experienced.

The moderation analysis indicates that the interaction effect between ODA and governance quality is positive and of high significance in the long-term and short-term. The lagged effect hypothesizes that gains in governance i.e. improvement in transparency, accountability and effective institutional settings do not only enhance absorptive capacity of aid but also guarantee that the ODA benefits are felt and are maintained over time. The strong short-run interaction implies that the governance reforms are also effective in converting the new ODA inflows into the direct economic benefits probably by minimizing the leakages, improving execution of the projects and developing the trust of the population. This further stresses why aid should be accompanied by specific institutional reforms in order to achieve optimum growth results.

The quality of governance exhibits statistically significant positive impacts on the growth of the economy both in the short term and in the long term. The implication of the long-run outcome is that the establishment of sound institutions is vital in facilitating economic growth since effective management means more efficient resource distribution, policy execution, and investor trust. The short-run importance is that any significant effects in governance can cause immediate economic gains, such as the streamlining of delivery of public services or corruption.

In the case of Foreign Direct Investment (FDI), the lagged effect is weakly significant which implies that long-run impact of FDI on economic growth is still minimal, despite the existence of increased governance. Nevertheless, the short-term effect of FDI is positive, but significant at the differenced level of governance, which is probably explained by the higher confidence of foreign investors in a stable institutional environment.

The lagged portfolio inflows at suggest that there is a significant negative effect and thus the inflow of foreign capital, particularly in the shape of speculative investments, has the ability to destabilize the economy in the long-term. The short-term differenced effect is also negative and significant proving once more the instability such capital inflows may cause to the economy.

The positive effect on remittances is significant and positive, as well as in the short run. The long run impact also ascertains that the remittances form a vital supply of capital to the household which

is used to finance education, health, and entrepreneurship hence economic growth as a whole. Remittances remain a significant means of economic resilience where they act as a buffer when the economy suffers a blow. The short-term effect also shows that the remittances are automatically stabilizing consumption in times of economic depression.

5.3 Discussion of Findings

The study sought to understand the effects of foreign capital inflows on economic growth in Kenya. Findings from the regression analysis revealed that there was a positive and statistically significant predictive power of foreign capital inflows on the real GDP in Kenya. The findings of the study align well with the neoclassic model theory. Foreign capital inflows can increase the level of investment, which promotes economic expansion through greater capital accumulation, improved technology transfer, and enhanced labor productivity.

In Kenya's context, foreign capital may also provide the necessary funds for infrastructure development and industrial growth, leading to a higher rate of economic development. The Neoclassical model also emphasizes diminishing returns to capital in the absence of technological advancement. Therefore, the positive effects of FCI in Kenya, as found in this study, suggest that the country may still be in a stage where additional capital inflows can greatly boost economic output, particularly if accompanied by improvements in technological capabilities and human capital development.

The study's findings that foreign capital inflows have a positive and significant effect on GDP growth in Kenya may however appear to differ with certain aspects of the dependency theory, which is more skeptical of long-term reliance on foreign capital. However, the theory can still be relevant when considering the long-term consequences of heavy reliance on foreign capital. While the short-term effect of FCI on Kenya’s economic growth is positive, dependency theory would caution that such growth might not be sustainable if it leads to external economic dependence or if foreign investments do not foster local capacity-building.

The positive short-term effect observed in the study does not necessarily contradict dependency theory but suggests that Kenya is benefiting from foreign capital at this stage. However, in the long run, the theory would warn that sustained economic growth would require reducing dependence on foreign inflows by strengthening domestic industries and institutions.

5.3.1 Foreign Direct Investment and Economic Growth

The first objective sought to find out the effect of foreign direct investment on economic growth in Kenya. The research findings, from the lagged coefficient, revealed that there was no significant effect of foreign direct investment on economic growth in Kenya. The study findings were corroborated by Debbiche (2020) who found that FDI in Gulf Cooperation Council states in the long run, did not have a significant impact on GDP growth, reflecting a broader trend where the resource-seeking nature of FDI can lead to insufficient domestic economic stimulation. This resonates with the Kenyan findings, indicating that while FDI may be present, its actual contribution to economic development is limited. Moreover , the findings were also supported by Nguyen (2020) and Adney et al. (2012) who reinforce the argument that the relationship between FDI and economic growth is complex and often influenced by additional factors such as strong financial institutions or the overall economic environment. In Kenya, if the financial system is not robust enough to harness FDI effectively, the potential benefits may remain unrealized.

These results were however in contradiction with Chorn and Siek (2017) who argues that there are positive effects of FDI on the developing countries. Their analysis can also be used to establish that the FDI profitability is favored at a lower income level meaning that as a nation grows, the marginal returns of an FDI may decrease. This fact could be the reason why the Kenyan study was not able to identify any marked improvement associated with FDI since the economy may have been in such a position that the marginal contribution of fresh foreign investments is not as pronounced. There is also a unique case in which Yuan and Mivumbi (2020) reported a causal relationship between FDI and GDP in Rwanda, which indicates that the impact of FDI can significantly differ in various nations. The non-existence of meaningful effects in Kenya can be an indication of the existence of peculiar conditions in the local economic environment, governance difficulties, or even industry-specific factors that prevent generation of the predicted spillover effects on FDI.

Conversely, the observation by Jawaid and Saleem (2017) in the case of Pakistan, which reported on a negative impact of FDI on GDP, backs up the argument that FDI is not an adequate tool in one size fits all approach to economic development. This signifies the significance of studying effects of FDIs particularly against the backdrop of the economical situations in particular countries since countries, which have common concerns can attain identical outcomes. Jawaid and

Saleem (2017) also says that the foreign inflows dependence of developing countries continues to rise, and advises having powerful systems in place to attract foreign investments. But the fact that there is no strong relationship between FDI and economic growth in Kenya is that even in efforts of attracting foreign investment, the targeted outcomes are not being achieved perhaps due to inefficiency in the local market or other economic hurdles not allowing FDI to bring about any concrete growth.

Findings were also contradicted by Baharumshah et al. (2017) who observe that the inflows of FDI increase the level of liquidity available to invest domestically which normally booms. This opinion is similar to the idea that increasing productivity and transfer of technologies could be facilitated through FDI. Nevertheless, the available evidence led to the output that this theoretical assumption does not apply when it comes to the case of Kenya due to potential difficulties of the structure, poor FDI allocation, or the influence of the external factors that do not enable the response to the anticipated benefits. Lastly, the study by Ndungu and Ndungu (2015) serves as a contrary point to the present one because, in it, the authors show how the FDI has positive impacts on the economic growth of Kenya in certain sectors immensely. This implies that FDI may not necessarily cause an overall economic growth in all areas but it can be critical in sectors such as manufacturing and service.

5.3.2 Foreign Portfolio Inflows and Economic Growth

The second objective also sought to determine the effects of foreign portfolio inflows on economic growth in Kenya. The results of the study explain that foreign portfolio inflows had a significant impact on the economic growth in Kenya. Sawalha, Elian, and Suliman (2016) supported these findings when they discovered that although Foreign Direct Investment (FDI) plays a positive role as far as economic growth is concerned, the same cannot be said of foreign portfolio inflows. Their paper emphasized the need to have a vast population who save as this increases the rate of economic development, hence is able to stimulate the flow of capital in the stock markets. These observations agree with the results established in the current study and that the absence of major impacts of FPI in Kenya could be due to either a lack of local savings or the lack of mechanisms to use these inflows in generating productive investments.

In part, the findings were aligned with the ones in the study by Debbiche (2020) which presented further evidence that when it comes to the portfolio investments, they tend to negatively affect the GDP growth in the Gulf Cooperation Council (GCC) countries. This conclusion is in par with the findings of the research targeting to suggest that FPI might not be a propulsion to sustainable economic growth particularly where driven by the diversification and speculation intentions and not the long run development aims. In addition, Mlambo (2022) reported that the inflow of capital in Africa was immense, but this fact generally had an adverse effect on long-term growth of GDP. This consequence highlights how volatile and uncertain FPI might be, resulting in temporary gains in the economy as opposed to restarting a long-term growth.

Conversely, their findings were challenged by study by Ehigiamusoe and Lean (2019) who show that FPI has a positive impact on the GDP of the country with a significant and practical effect. This may be so, however, this difference can be due to the fact that there are variations in the development of the financial market and quality of institutions between Nigeria and Kenya. In the event that Kenya has weaker financial markets or does not have the requisite infrastructure to absorb and harness portfolio investments, then the possible gains of FPI could not be attained adequately. In the same way, Sugozu, Yasar, and Verberi (2023) established that there could be an improvement of GDP through long-term portfolio investments yet they do not promote economic development in developed economies. Their research emphasizes the exigent nature of portfolio investments and growth, stating that all of the advantages of FPI are not necessarily identical to every economic set of circumstances. The evidence is that in the absence of sound financial systems and favorable economic policies, positive effects of FPI might not be experienced in developing economies such as Kenya.

Odhiambo and Odera (2015) in Kenya took a different perspective and said that portfolio inflows enhance the GDP of Kenya. What they have uncovered is that FPI could result in a stronger investment and economic growth. The difference indicates that a significant effect might not be traced in the current study but the specific instances of human conditions when FPI can be relatively beneficial might be outlined in other investigations. A high global income of portfolio investment on the economic growth of Kenya was also significant as reported by Ndungu and Ndungu (2015). In their research, they highlighted how securities investment could lead to improvement in financial stability and increase in the foreign reserves. The study has however

revealed that the findings may suggest that the wider macroeconomic conditions or structural limitations in Kenya would bar the successful inclusion of FPI to the economy and thus bring to naught the effects on the GDP growth.

5.3.3 Diaspora Remittances and Economic Growth

The study's third objective further sought to establish the effect of diaspora remittances on economic growth in Kenya. The results of the trend analysis showed that the effect on economic growth of the diaspora remittances in Kenya was significant. The results of the study were in line with those of Siddique et al. (2010) who affirm that indeed remittances can promote the economic growth, and those of Mim and Ali (2012) who unveils that 10 percent increment in remittances boosted monthly income in Latin America. This correlation provides positivity to the approach that remittance has the ability to act as a crucial household income sources, which promotes consumption and investment with regard to local economies. These findings support the conclusion of the current study that diaspora remittances can play a major role in economic growth of Kenya since they have the potential of increasing household consumption and investment capacity.

Moreover, Ikechi and Anayochukwu (2013) have shown that remittances granger cause a rise in economic development in South Africa and Ghana as it exhibits a GDP per capita enhancement of around 0.15 Percent. This does not resonate with the findings of the present study, implying that remittances are capable of exerting a palpable impact on economic development; this is possible due to the ability of the instrument of remittance to augment household income and spur up local economies. Also, according to Ocharo (2015), there is a statistically significant relationship between GDP and remittances such that one could expect an economic growth gain of 1.5 percent with a 10 percent increase in the paymentGDP ratio. Such a discovery evinces the importance of the remittance as the economic activity driver, which in turn validates the current study claim of the positive effects of remittance in Kenya.

Conclusions reached in the study disagreed with the studies of Fayissa and Nsiah (2010) stating an insignificant influence of remittances on the growth of the GDP, and Ang (2007) who also stated that there was no causal relationship between the remittances and the GDP of India. Such results indicate that remittances might not have much impact economically in some settings. This

mismatch begs the questions; what are the circumstances under which remittances turn into making a difference which could involve aspects such as the nature of the economy, level of financial building and how the money sent is used wisely in productive investments?

As revealed by Chigbu Ezeji and Promise (2015), the influence of foreign remittances on GDP, was also reported in Nigeria, Ghana and India, and it was emphasized that the development of the financial sector is of particular concern in telegraphing the savings gap, and that well functioning financial systems may help augment the positive impact of remittances. This concept strengthens the significance of financial infrastructure as the feasibility of the getting the productive utilization of remittance inflows in Kenya economy growth. Also, theoretical framework by Giuliano and Ruiz-Arranz (2009) supported the idea that remittances help to strengthen financial mechanisms and sources of alternative financing of investment projects. The view point in question emphasizes on the effectiveness of effective financial markets in maximising the economic growth potential of remittances and therefore it is applicable to Kenya especially.

The findings of the Kenyan context were consistent with Mungai (2012) who discovered that the presence of the diaspora was really strong in terms of promoting investment, consumption, and growth of the GDP. This resonates well with the findings of the present paper implying that the remittance of the diaspora is essential in the economic growth of Kenya because it adds more resources for the domestic investments and consumption. Diaspora remittances showed positive effects on Kenya GDP of which the effects were being used in investments, consumption, reducing poverty and finally financial stability (Odhiambo and Odera 2015). The fact that they added that the impact of remittances all along might be found to be different depending on the stage of development of technology and financial systems in recipient countries supports the conclusion of the current study because being that the development stage of financial system in Kenya and the level of technology adoption could aid in strengthening the positive impact of remittances on the economy.

5.3.4 Official Development Assistance (ODA) and Economic Growth

The fourth objective of the study wanted to establish the effect of official development assistance on economic growth in Kenya. The regression analysis proved that there was indeed a considerable impact of development assistance to the Kenya economic growth. Moolio and Kong (2016)

confirmed the findings since they found that there was a positive effect in the long-run of ODA growth in GDP in countries like Cambodia, Laos, Myanmar, and Vietnam, especially the countries like Vietnam and Cambodia. This matches with the findings of the current study which strengthens the claim that ODA can significantly contribute towards long term economic growth especially when nations are characterized by favorable policies and governance systems in place. This is in contrast to other studies that have had opposite results, perhaps in support of the fact that the success of ODA is mostly context-specific, or rather, sensitive to the issues of governance, human capital and policy environment that dictate its success.

Dash (2021) also supported the findings by finding that ODA was growth-enhancing in GDP by eight South Asian countries, also noting that capital formation and ODA are a complementary factor in contributing to growth, as well as the fact that ODA does not crowd out any other domestic forms of capital formation as private investment does. This observation is consistent with the study at hand since it indicates the supplementary nature of ODA in promoting economic activity since capital formation is an important factor that renders the economy the ability to sustain development over time. The claim that aid does not impede on other kinds of investments such as those initiated by the private sector is of much significance in Kenya because it proposes the possibility of other growth factors living in harmony with aid. Mowlaei (2018) included also the impacts of ODA, foreign direct investment (FDI) and remittances on African GDP growth and it was revealed that ODA will have a positive impact on the GDP, whereas remittances were found to be the most significant ones. This reinforces the finding of the present study that ODA has a positive impact on economic growth indicating that there might be a more significant influence of other capital inflows. The fact that Mowlaei puts emphasis on policy framework and the necessity to attract foreign capital is also showing that policy environment in Kenya may be a key element in enhancing positive impact of ODA.

Similar to the above authors, Tang and Bundhoo (2017) have also explored what the association between aid and development is in Sub-Saharan Africa, and have concluded that ODA is effective only when it has the backing vice versa quality institutions and good economic policies. This observation stresses the need to have good governance, transparency, and anti-corruption practices to make sure that ODA positively affects economic growth. The large positive impact of ODA identified in the present study may be attributed to Kenya institutional quality and governance

ability since it has performed well in this aspect. Further, Chorn and Siek (2017) evaluated the impacts of FDI and ODA on GDP and found that FDI affected the GDP more than ODA and the ODA had diminishing returns as productive population and the rate of savings grew. Such a finding is however contrary with the present study since Kenya has been urged to diversify its economic development sources since the ODA may not be effective in bringing long term sustainability in development.

These results however did not agree with the study findings of Yiew and Lau (2018) who in investigating 95 developing countries concluded that official development assistance had no significant influence on the GDP and concluded that bad policies and poor governance were some of the factors behind the lack of effectiveness of ODA. They established that, to ensure that ODA influences the economic growth positively, there was need to have a better governance and legal set up. Such results do not concur with the results of the current study which indicates more direct and positive influence of ODA on GDP of Kenya. This difference might be based on the different policy environments among countries that could influence the utilization of ODA and the resulting translations to economic growth or not. In contrast, Sothan (2018), in which the author investigated the correlation between ODA and improvement of the GDP in Cambodia, noted that ODA enhances GDP only in the short perspective, whereas FDI produced more impressive and longstanding impacts. This observation is contrary to the results of the current study that a substantial amount of ODA assists in the increase of the East African state of Kenya by leading to the economic growth of this country, which provides an idea that the effectiveness of ODA could depend on the capability of the country to use the aid and convert it into the long-term development results. The influence of trade openness and investments on infrastructure and human capital also led to increased positive impact of ODA making it applicable to the policy trend its possible to implement in Kenya.

5.3.5 Governance Quality and Economic Growth

Finally, the study attempted to establish the moderating role of the quality of governance between the dynamics of foreign capital inflows and the level of economic growth in Kenya. Both governance quality and corruption control were used in the measurement of quality of governance. The results revealed that the quality of governance had a substantial influence on the economic growth in Kenya. According to Slesman et al. (2015), foreign direct investment (FDI) and portfolio

investments are the good factors to increase GDP in high indexes of institutional development level states. Their analysis showed negative or no effect of the FCI to the countries that clustered below the threshold of institutional quality. This implies that effective governance such as facility security and institutional stability is vital in terms of capturing FCI advantages on the economic benefits. The outcome of the current study that finds that the quality of governance in Kenya has significant influence on economic growth may be attributed to the fact that the degree to which Kenya has developed its institutions may be at a medium level that may not meet the threshold that would be needed to facilitate FCI.

Raza, Shah, and Arif (2021) also supported the findings by highlighting that the quality of governance is crucial to enhance economic growth in countries that are members of the Organization of Economic Cooperation and Development (OECD). The trend was also documented by Shittu et al. (2020) who found out that political governance also has a positive effect on the relationship between FDI and GDP in West Africa with transparency and accountability demanded to drive foreign investment. Similar findings have been observed in the sub-Saharan Africa (SSA) region, where the FDI and economic growth relationship was found to be considerably stronger, when the political conditions, in terms of stability and good governance, were favourable (Ajide, Adeniyi and Raheem, 2017). These analyses also concur with the present results, proposing that the substantiality of the governance in Kenya can be highly effective to affect the consequences of FCI on economic growth or that some limits can prevent its capabilities.

Furthermore, Yeboua (2021) found that in 27 sub-Saharan countries, FDI only improves economic growth when institutions reach a high threshold of governance quality, including factors such as law and order, accountability, and corruption control. The current study's findings, which indicate a significant effect of governance quality and corruption control on economic growth in Kenya, could reflect that Kenya is yet achieved the level of institutional quality required to maximize the benefits of FDI implying that while Kenya may be making progress in governance, there is still room for improvement to enable governance factors to positively impact growth through FDI. Nyang'oro (2017) also noted that capital inflows have a limited effect on economic growth in SSA due to low financial integration and market development.

Findings were also not in line with findings by Magai (2022) who found that FDI and trade openness positively impact GDP growth in Tanzania, especially under effective trade rules and

governance regulations. While the study highlights the importance of governance in fostering economic growth through FDI and exports, the current study's findings suggest that governance quality in Kenya may not have reached the level required to facilitate similar long-run positive effects. Awino and Kioko (2022) also examined the role of governance quality in Kenya and found that while official development assistance (ODA) improved GDP, its effect was insignificant when the government reduced development expenditures. This suggests that the effectiveness of governance in promoting economic growth may be contingent on how the government allocates resources and manages expenditures. The current study's findings, showing significant impact of governance quality on economic growth, may reflect inefficiencies in government spending or the misallocation of resources that undermine the potential benefits of governance improvements.

5.4 Conclusions

The findings indicate that while foreign direct investment has been present in the Kenyan economy, with an average inflow of approximately USD 25.93 million and a substantial variation between its minimum (-273.54 million) and maximum (954.34 million), that in the long run, it did not have a statistically significant impact on economic growth. This suggests that FDI alone may not be sufficient to drive economic growth in Kenya. Several factors could contribute to this, such as the nature of FDI projects, inefficiencies in how the inflows are utilized, or barriers within the domestic economy that prevent the full realization of FDI benefits.

The research findings on the second objective show that foreign portfolio inflows had a significant effect on economic growth. Based on the descriptive statistics, foreign portfolio inflows had an average value of USD 1.11 billion, with a significant range from a minimum of USD 50.91 million to a maximum of USD 4.06 billion. This high variability suggests that portfolio inflows fluctuated greatly during the study period. With these inflows, the importance of the significant effect on real GDP indicates that portfolio investments contributed substantially to economic growth. Foreign portfolio investments are often shorter-term and more speculative and thus investments might have resulted in long-term capital formation or economic stability, which are crucial for sustainable economic growth.

The research findings from third variable revealed an insignificant positive effect of diaspora remittances on economic growth, indicating that remittances had a positive impact in driving Kenya's economic development both in the long term or short term. According to the descriptive

statistics, diaspora remittances had a substantial average inflow of USD 1.59 billion, with a range from a minimum of USD 311.25 million to a maximum of nearly USD 4 billion. These figures highlight the importance of remittances as a stable and growing source of foreign capital for Kenya. The significant impact of remittances on economic growth may be attributed to the country achieving the targeted remittance inflows which may enhance allocation and distribution within the economy thus significaly affecting economic growth.

The results also revealed a significant positive effect of ODA on economic growth, indicating that development assistance has played an important role in the country's economic progress. From the descriptive statistics, the average ODA was USD 1.11 billion, with a minimum of USD 50.91 million and a maximum of USD 4.06 billion. The substantial variation in development assistance inflows reflects the changing nature of foreign aid over time, but overall, it has contributed positively to real GDP. This significant effect can be attributed to its role in financing critical infrastructure projects, social programs, healthcare, and education, which are necessary for long-term economic development. ODA has provided a stable flow of funds that have likely supported public investments in areas where domestic resources are insufficient. The large inflows and their significant contribution to GDP indicate that development assistance is essential in driving Kenya's socio-economic progress.

Lastly, the findings revealed that neither governance quality had an insignificant effect on economic growth. This shows the gaps in the quality of governance mechanisms within the country and the lack of effective implementation of the available measures weakening the economic growth of Kenya. The study further led to the conclusion that corruption control can significantly improve the economic growth. Thus, increased measures to tackle corruption within the country will be vital in the future economic growth of the country.

5.5 Recommendations

Kenya should implement policies aimed at improving the utilization of FDI. This could include promoting sectors that offer higher returns on investment such as manufacturing, technology, and renewable energy. Additionally, efforts should be made to create incentives for value-added investments that contribute to job creation and technology transfer. The study also recommends enhancement of physical infrastructure and digital infrastructure to attract and retain FDI in critical sectors like industrial production and information technology. The country should also streamline

administrative processes and reduce bureaucratic delays by digitizing approvals for investors, making it easier for foreign businesses to set up operations.

Since foreign portfolio inflows had a significant impact on economic growth, Kenya should aim to reduce market volatility by strengthening its financial markets. The country should develop deeper capital markets by encouraging more local listings and diversifying financial products such as bonds and derivatives to absorb portfolio inflows effectively. Additionally, the study recommends improvement of market transparency and investor protection through stronger regulatory oversight by the Capital Markets Authority (CMA) as well as strengthening insider trading laws and corporate governance standards which will increase investor confidence. The study also suggests that the governmake increase financial literacy among local investors and stakeholders to increase domestic participation in the stock market, reducing reliance on foreign capital and minimizing the risks of capital flight.

The study recommends that the Kenyan government should enhance mechanisms that facilitate increased diaspora remittance flows which can be pivotal to strengthening the economy. For instance, they may partner with financial institutions and mobile money platforms to lower the costs of sending remittances, thus encouraging higher remittance volumes. They may also explore the use of blockchain and fintech solutions to offer cheaper and faster transfers. The government should also create more investment opportunities for the diaspora by developing attractive investment vehicles such as diaspora bonds, real estate opportunities, and small business ventures. The government could also offer tax incentives for remittance-backed investments in priority sectors like agriculture, housing, and education. The government should also integrate remittances into broader financial inclusion efforts by encouraging recipients to save, invest, or access credit through formal financial institutions, thereby stimulating long-term economic growth.

The significant effect of official development assistance on economic growth shows the importance of continued international development partnerships. The study therefore recommends that Kenya should prioritize ODA spending in areas that have the most direct link to economic growth, such as infrastructure development, education, healthcare, and agriculture thus ensuring the most effective use of development assistance. The study also recommends improving the governance of ODA funds by adopting transparent monitoring and evaluation systems to ensure funds are used efficiently and for their intended purposes. Kenya should also develop strategies to

reduce over-reliance on ODA by improving domestic revenue mobilization. This may include expanding the tax base, enhancing public-private partnerships (PPPs), and leveraging more domestic resources for development.

Governance quality showed significant effects on economic growth, hence, it does remain critical for sustainable development. The study therefore recommends the strengthening of institutions responsible for governance, such as the Judiciary, Ethics and Anti-Corruption Commission (EACC), and the Office of the Auditor General ensuring these institutions are independent, well-resourced, and capable of holding public officials accountable. The study also recommends enhanced transparency in government operations by making public procurement, budgeting, and expenditure processes more accessible to the public. The government should also implement stronger anti-corruption policies, including strict enforcement of laws on corruption, prosecution of high-level cases, and asset recovery. They should also collaborate with international partners on governance reform and anti-corruption measures to adopt global best practices.

5.6 Areas of Further Studies

The study was focused on the effects of foreign capital inflows on economic growth in Kenya. Further research could be conducted focusing on each individual variable and its effect on the economic growth in Kenya. These studies may also implement a different methodology inclusing the mixed research methodology which will take into account both quantitative and qualitative data. Aditionally, a comparative study can be conducted with other East African countries and or developing countries to provide a broader perspective on how different economies are utilizing foreign capital and align reommendations to ensure adaptation of the best global practices by the Kenyan government.

5.7 Study Limitations

Missing data posed a challenge where observations were incomplete for certain units or time periods, potentially introducing bias where missingness was not random, such as when economically disadvantaged regions under-reported governance metrics due to limited administrative capacity. This caused skew results, under-estimating and overestimation of trends. Similarly, unobserved heterogeneity complicated analyses, as unmeasured factors varied across

entities or over time and were not captured in the dataset. To address missing data, the study employed chained equations, to estimate missing values based on observed patterns, though this risked introducing errors however, no assumptions were violated. For unobserved heterogeneity, fixed effects models were used to control for time-invariant factors specific to each entity, or random effects models were applied when variation was assumed random, these approaches followed careful specification tests to ensure validity and avoided model misspecification.

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APPENDICES

Appendix I: Data Collection Form

Yr	Foreign direct investment	Foreign Portfolio inflows	Diaspora Remittances	Diaspora Remittances	Governance Quality	RealGDP
1993						
1994						
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Appendix II: Ethical Review Permit

Strathmore UNIVERSITY

19th June 2024

Ms Thuo Irene,
thuo.irene@strathmore.edu

Dear Ms Thuo,

RE: Effect of Foreign Capital Inflows on Economic Growth in Kenya: The Moderating Effect of Governance Quality

This is to inform you that SU-ISERC has reviewed and **approved** your above **SU-masters** proposal. Your application reference number is **SU-ISERC2269/24.** The approval period is from **19th June 2024 to 18th June 2025.**

This approval is subject to compliance with the following requirements:

i. Only approved documents including (informed consents, study instruments, MTA) will be used.
ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-ISERC.
iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-ISERC within 72 hours of notification.
iv. Any changes anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-ISERC within 72 hours.
v. Clearance for the export of biological specimens must be obtained from relevant institutions.
vi. Submission of a request for renewal of approval at least 60 days prior to the expiry of the approval period. Attach a comprehensive progress report to support the renewal.
vii. Submission of an executive summary report within 90 days of completion of the study to SU-ISERC.

Before commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) https://research-portal.nacosti.go.ke/ and obtain other clearances needed.

Yours sincerely,

Mr Ambrose Rachier,
Chairperson; SU-ISERC

Ole Sangale Rd, Madaraka Estate. PO Box 59857-00200, Nairobi, Kenya. Tel +254 (0)703 034000
Email admissions@strathmore.edu www.strathmore.edu

Appendix III: NACOSTI Approval

REPUBLIC OF KENYA

NATIONAL COMMISSION FOR SCIENCE,TECHNOLOGY & INNOVATION

Ref No: **829387**

Date of Issue: **08/November/2024**

RESEARCH LICENSE



This is to Certify that Ms.. Irene Thuo of Strathmore University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: EFFECT OF FOREIGN CAPITAL INFLOWS ON ECONOMIC GROWTH IN KENYA: THE MODERATING EFFECT OF GOVERNANCE QUALITY for the period ending : 08/November/2025.

License No: **NACOSTI/P/24/41915**

829387

Applicant Identification Number

Director General
NATIONAL COMMISSION FOR SCIENCE,TECHNOLOGY & INNOVATION

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See overleaf for conditions