

**Increasing Foreign Direct Investments to Kenya:
An Analysis of Underlying Factors**

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Master of Commerce (Finance)

2013

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**Submitted in partial fulfillment of the requirements for the Degree of
a Master of Commerce at Strathmore University**

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Nairobi, Kenya**

June, 2013

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ABSTRACT

This research studied a 14 year period of FDI inflows to Kenya (1998-2011) while especially focussing on the seven year period of increasing FDI inflows from 2005 to 2011. Prior to this period of growth, a trend of stagnating FDI inflows can be observed thus raising the question what factors exactly contributed to the rising FDI inflows. The study included two types of analyses: (1) an analysis of publicly available indices and (2) an analysis of primary data collected through questionnaires which intended to confirm or dismiss the findings of the secondary analysis. Through these analyses, the study revealed that the factors for the increasing FDI inflows were: Kenya's role as regional hub and the increasing regional cooperation and integration, increasing market size and level of education, innovation and technology embraced within the local market, the ease of doing business in Kenya and infrastructure development. Surprisingly, other factors such as political stability, inflation, rule of law and corruption levels even deteriorated during the period of growth. In general, this research was conducted to explain the reasons behind the increasing FDI inflows to Kenya and thus reveals important information for fellow researchers, policy makers and foreign companies. The implications of the study were for the government to strongly focus on increased regional cooperation and integration and to further improve the ease of doing business among others. This research contributes to existing knowledge by establishing factors for increasing FDI inflows to developing countries in general and Kenya in specific.

ACKNOWLEDGEMENT

I wish to thank God, my direct family, Teresa Kiboi, Luis Gil-Alana and three supervisors Freshia Mugo Waweru, David Wangombe and Frederick Ogola for their efforts.

Thank you!

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LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
DI	Direct Investment
EA	East Africa
FDI	Foreign Direct Investment(s)
GDP	Gross Domestic Product
KAM	Kenya Association of Manufacturers
KenInvest	Kenya Investment Authority
M&A	Mergers and Acquisitions
MNC	Multinational Company
NSE	National Securities Exchange
OECD	Organization for Economic Co-operation and Development
SME	Small and Medium Sized Enterprises
SSA	Sub-Saharan Africa
Std. Dev.	Standard Deviation
UNCTAD	United Nations Conference on Trade and Development
USD	US Dollar

OTHER TERMS USED AND THEIR EXPLANATIONS

Host country	This term is used to describe a country which is a host country to FDI inflows.
Period of Stagnation (Stagnation period)	The period of FDI inflows between 1998 and 2004 is termed period of stagnation
Period of Growth (Growth Period)	The period of FDI inflows between 2005 and 2011 is termed period of growth

Chapter 1 Introduction to the Study

1.1 Introduction

Foreign Direct Investments (FDI) became an important economic measure after the World War II (Dunning & Narula, 1995) and was commonly used among the industrialized countries. Nowadays, many Sub-Saharan Africa (SSA) countries recognize the importance of FDI after a long period of skepticism (Moss, Ramachandran, & Shah, 2004). A transition can be observed especially over the past decade in many SSA countries that are now actively searching for FDI to boost their economies. Countries are competing internationally over FDI since it is regarded as generating employment, higher productivity levels and competitiveness and technology spillovers (Oman, 2000). Especially in developing countries, FDI is associated as form of access to international markets and currencies, a possibility to increase exports and a means of financing as a substitute to bank loans (Denisia, 2010). But what is FDI? A number of slightly different definitions can be found in the literature. A common definition used by the Organization for Economic Co-operation and Development (OECD) indicates that FDI refers to the existence of a long-term relationship between a direct investor and the direct investment enterprise and a significant degree of influence (usually at least 10% ownership) on the management of the enterprise (OECD Publications, 1996).

The analysis of FDI in a country requires one to differentiate between FDI flows and stocks. Stocks refer to the total amount of FDI in a country held by multinational companies (MNC). In contrast, FDI flows are investments undertaken during a predefined time period. Furthermore, inward FDI describes the FDI inflows into a host country whereas outward FDI describes the investment assets of a country abroad. Over the past decades, several studies (Anyanwu, 2012; Asiedu, 2002; Hailu, 2010; Krugman, 1983; Schneider & Frey, 1985; Tsai, 1994) have been carried out to establish the reasons behind companies' foreign investment activities. Considerations for a company to engage in FDI may include government incentives (subsidies, regulations, tax), natural (mineral resources) or creative (human capital, purchasing power) gains. But not only can the foreign investor gain through FDI; the host

country can as well benefit in terms of employment, overall increase of its competitiveness or technology spillovers.

The necessity and importance of FDI especially to developing countries has not only been increasingly paid attention to but also has been widely been accepted. On the one hand, FDI to SSA for a long time have been viewed with a lot of doubt which originated mainly from historical and political reasons having been formed in light of colonialism and new independent states. On the other hand, these perceptions changed in many SSA countries over time leading to liberalized FDI policies in order to increase foreign investments thus improving economic development, income structures and employment. As a result, FDIs have seen a steady increase over the past 25 years¹. Despite the positive development, FDI to SSA never took a significant share compared to total FDI to other developing countries (Schwank, Arnim, & Sundaram, 2011). Actually, the FDI inflows to SSA never accounted for more than 10% (1989) of the global FDI inflows.

1.2 Background to the Study

1.2.1 Importance and Impact of Foreign Direct Investments

From a global perspective, FDI promotes the opening of global markets and liberalized trade regulations (Richards & Nwankwo, 2005). It should thus be of importance to every single country to position itself as an attractive investment destination so as to stay competitive with other countries. Attracting FDI is dependent on the ability to establish favorable conditions for FDI on a policy level as well as competitive factors of production (The World Bank Group, 2010). Even though the occurrence of FDI has been widely studied and positive as well as negative impacts of FDI have been acknowledged, a single theory explaining FDI cannot be identified (Calderón-Rossell, 1985). Common agreement in the literature is the fact that, as (Kindleberger, 1969) concludes FDI would not occur if markets were perfect. Thus, FDI flows are possible because of imperfect local and global markets. Market imperfections in foreign markets enable international companies bear the additional costs of market entry and still make profitable investments. Their

¹ Data has been obtained through (United Nations Conference on Trade and Development, 2012a)

perceived advantages such as technology, labor skills and knowledge make them believe to gain market share.

The positive impacts of FDI have been widely acknowledged (Bezuidenhout, 2009; Magnus Blomström, Globerman, & Kokko, 1999; Caves, 2007). Caves (2007) recognizes that FDI have positive effects on employment, income growth, generally economic development, productivity, managerial skills and access to international markets. For the case of Sub-Saharan Africa (SSA), Opolot, Mutenyo, & Kalio (2009) conclude that “FDI inevitably promotes growth and improves the integration of the region [SSA] into the global economy”. Therefore, many SSA countries undertook during the past years in-depths reforms to accelerate FDI inflows. However, it has to be noted that the impacts of FDI are not only positive. Research increasingly emphasizes on the negative impacts FDI can have on the local economy (Driffield & Love, 2007; Macrae, 1982; Smith, 2009; Zhou, Tse, & Li, 2002). Indeed, some researchers underline that the negative attributes of FDI outweigh the positive ones (OECD Publications, 2002). Regarding agriculture, (Hirschman, 1958) states that positive effects of foreign agriculture investments are limited. Further, Blomström (1991) points out that only emerging and developed countries are able to take advantage of technology spillovers. Developing countries are hardly able to absorb new high-tech innovations due to the lack of even basic facilities.

1.2.2 Foreign Direct Investments to Sub-Saharan Africa and Kenya

In order to understand investment characteristics and patterns to Kenya, it is important to take a closer look at the Sub-Saharan Africa FDI developments. In their study, Montiel, Bhattacharya, & Sharm (1997) establish that returns from FDI to Africa have been much higher than to other developing countries. However, African FDI inflows never exceeded 3% of the total global FDI inflows (UNCTAD, 2012a) even though the average annual growth rate between 1987 and 2011 stood at 14.29%². FDI inflows to SSA have been increasing from USD 1.5 billion in 1987 to almost USD 35 billion in 2011. There have only been few significant temporary decreases of which the most notable has been experienced in 2009 and 2010 as result of the global financial crisis and the resulting low liquidity levels in the market

² The calculations were done using the geometric mean of the annual growth rates between the given time periods.

(UNCTAD, 2012a). The SSA FDI inflow data can be split into three phases: The first phase includes the years from 1987 to 2000 (12.33% average annual growth rate). During this period the FDI inflows never exceeded USD 10 billion. The second phase can be characterized by FDI inflows standing at over USD 10 billion while in 2005 at first reaching over USD 15 billion (13.3% annual growth rate). The last phase from 2007-2011 impressed with average annual growth rates of 20.8%.

In comparison to the total Sub-Saharan Africa FDI development, Kenya's development of FDI inflows between 1987 and 2004 has been more or less stagnating, reaching its peak in 2000 with inflows of over 110 million USD. The year 2007 marked an extreme outlier, with FDIs amounting to over USD 700 million. During this year, two business transactions contributed significantly to this peak. Firstly, London based Helios Investment Partners bought a 24.99% stake in Equity Bank. The transaction volume stood at USD 178.7 million.³ Secondly, French company France Telecom bought 51% of the previously state-owned Telkom Kenya for USD 390 million in December 2007 (Information Gatekeepers Inc., 2010). The effect of these two transactions on the total FDI inflows in 2007 is immense. For the further analysis, these adjusted figures will be used whereas the overall FDI inflows in 2007 do not include the amounts of these investments thus amounting to USD 160.35 million. Therefore, increasing FDI inflows from USD 21.2 million to USD 335.2 million can be observed between 2005 and 2011. Previous research (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Ngugi & Nyang'oro, 2005) focused on determining the reasons for the stagnating or even decreasing FDI inflows to Kenya prior to 2007.

1.2.3 Perceptions on Sub-Saharan African Foreign Direct Investments

It is important to understand the perceptions different stakeholders have of Kenya as a country in general and an investment destination in specific. A closer analysis of the perceptions of entrepreneurs and managers of companies with foreign ownership, development and global financial institutions is inevitable. This will allow a better understanding of the underlying factors of willingness to invest. Perceptions are based on economical, political and social indicators such as GDP growth, political

³ Available through <http://www.heliosinvestment.com/representative-investments> (last accessed on 27.11.2012)

stability, availability of trained people and functional infrastructure and provide an explanation of the amount of FDIs.

A significant change in perceptions on businesses in Sub-Sahara Africa (SSA) can be identified during the past decade. The FDI data for the region supports this trend, having grown from USD 10.7 billion in 2002 to over USD 34.9 billion in 2011. This represents an increase of 226%. SSA is not anymore perceived as the region attracting adventurers and daredevils only. Indeed, an increasing number of international companies of literally all sectors and investors flock into the region (The World Bank Group, 2010). The region has been able to impress with constant and high growth rates, increased investments in its infrastructure, more favorable conditions for investors and positive forecasts.

1.3 Problem Definition

Prior research on Kenyan FDI inflows (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Mwega & Ngugi, 2006; Ngugi & Nyang'oro, 2005) focused on the stagnating FDI inflows to Kenya. These researchers not only tried to explain the reasons contributing to such stagnation but also worked out concrete recommendation for the Kenyan government to increase FDI inflows to the country. It was found that factors influencing FDI negatively were political instability, corruption, low levels of democracy and low rates of openness among others. The past seven years (2005-2011), however, indicated a reversing trend. Between 2005 and 2011, a stable annual increase can be observed with FDI inflows standing at USD 21.2 million in 2005 increasing to over USD 335.2 million in 2011 (Figure 2-6) which represents an increase of almost 1500%. The years between 1987 and 2011 never saw an increase of FDI inflows for more than four consecutive years. The average annual FDI inflows between 1987 and 2004 stood at USD 32.4 million only, whereas it increased to annually USD 136.7 million from 2005 to 2011.

The literature provides a set of factors leading to increasing FDI inflows to a country. Important factors are **market size** (Anyanwu, 2012; Krugell, 2005; Sawkut, Seetanah, & Wahid, 2009), **economic growth** (Addison & Heshmati, 2003; Asiedu, 2006; Nnadozie & Okonkwo, 2004), **political stability** (Busse & Hefeker, 2007; Dupasquier & Osakwe, 2005; Hailu, 2010) or **openness** (Agrawal & Ranjan, 2011;

Anyanwu, 2012; Asiedu & Lien, 2003) among many others. Most recent research revealed other interesting relationships between increasing FDI inflows and influencing factors. These include: no significant influence of corruption (Anyanwu, 2012; Khamfula, 2007) or a high significance of regional integration (Anyanwu, 2012; Campos & Kinoshita, 2003; Feils & Manzur, 2008) among others.

In light of 20 years of stagnating FDI levels to Kenya, the increasing FDI inflows to Kenya between 2005 and 2011 surprise and call for a further analysis of the underlying factors. It surprises especially considering the fact that during this period the whole world was struggling with the world financial crisis; that Kenya's elections in 2007 caused a serious domestic economic downturn; and Kenya's inflation rate stood on average during this period at annually 9.13%.

1.4 Research Objectives

Until 2005, Kenyan FDI inflows have shown a stagnating trend over a period of 20 years. This trend has since changed. As data of the UNCTAD (2012) suggests⁴, FDI inflows since 2005 are sustainably increasing. Sustainable in this context means that there has been a year by year increase of FDI without any temporary decreases. This implies an important development for the country since FDI create employment, stimulate economic growth, enable technology spillovers and, especially in developing countries, significantly contribute to economic growth.

To date, no research can be found focusing on the recent upwards trend of FDI to Kenya. Therefore, the main objective of this research is to provide an explanation for the observed increasing FDI inflows to Kenya over the past seven years from 2005 to 2011. Specific objectives include:

1. To establish that the real year of change from decreasing to increasing FDI inflows to Kenya has been in 2005 using a statistical model.
2. To establish the factors that contributed to the increasing FDI inflows to Kenya from 2005 to 2011 through an analysis of secondary data.

⁴ See Figures 1.3 and 1.4.

3. To compare the factors during the growth period of FDI inflows (2005 to 20011) with the factors of the period of stagnating FDI inflows between 1998 and 2004.

Research Questions

The following research questions will be answered by this study:

1. Can a statistical model be used to establish that the year 2005 has been the real year of change from decreasing to increasing FDI inflows to Kenya?
2. Which factors contributed the increasing FDI inflows to Kenya from 2005 to 2011?
3. What changed comparing the growth period of FDI inflows from 2005 to 2011 with the period of stagnating FDI inflows between 1998 and 2004?

1.5 Significance of the Study

This study is of importance to policy makers, MNCs operating in Kenya and other researchers. It adds to the existing knowledge in this field as it helps to understand the underlying factors of increasing FDI flows to Kenya, thus allowing conclusions to be drawn on how to sustain the current trend.

1.5.1 For Foreign Investors

Foreign companies in Kenya benefit from this research by getting insights of investment patterns in Kenya across industries. It is especially of importance for foreign companies who have not entered the Kenyan market yet to know the underlying reasons of other investors to invest in Kenya. This allows them to better understand the local markets and the countries potentials.

1.5.2 For policy makers

For policy decisions and the implementation of investment propelling measures, it is important to understand what drives the current positive trend. This understanding will allow policy makers to adjust, focus on or dismiss certain policies in order to sustain the increasing FDI inflows into the country. Increasing the country's

competitiveness thus implementing sustainable policies will be crucial to remain a leading country not only in the region but also in Africa.

1.5.3 For other Researchers

Other research benefit from this study because it comprehensively analyzes the reasons for the increasing FDI inflows to Kenya between 2005 and 2011. To date, no research has been undertaking examining the reasons for the constantly increasing FDI inflows to Kenya since 2005. Rather, previous studies focused on the reasons behind stagnating FDI inflows to Kenya. Therefore, this study adds to existing knowledge describing and analyzing underlying reasons for changing FDI patterns.

Chapter 2 Literature Review

2.1 Introduction

This chapter will provide the theoretical and conceptual framework, which is necessary in order to understand the background and role of FDI to an economy. Furthermore, the implications of FDI to the host country will be analyzed in order to draw conclusions in regard to Kenya. Chapter 2 elaborates the following topics: After a short introduction, the rationale of FDI is elaborated in Chapter 2.2. A discussion on definitions of FDI is provided in order to identify a common understanding of FDI. This forms the basis to introduce the theories supporting the existence of FDI (Chapter 2.3) after which a critical analysis of advantages and disadvantages of FDI is provided (Chapter 2.4). Chapters 2.5 and 2.6 focus on analyzing FDI inflow and importance to Sub-Saharan Africa and Kenya respectively. The main part of the literature review follows in Chapter 2.7 which entails the reasons and factors for FDI inflows to a host country. Chapter 2.8 summarizes the key findings and lists the relevant variables for the further analysis.

2.2 The Rationale for Foreign Direct Investments

Different institutions and general literature on the topic agreed that a stock of at least 10% in a foreign company defines an FDI (International Monetary Fund, 2010; OECD Publications, 1996). The OECD indicates that an FDI is the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence (usually at least 10% ownership) on the management of the enterprise (OECD Publications, 1996). A similar definition is provided by the International Monetary Fund (IMF, 2010): “A direct Investment is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy”. Besides the initial transaction, direct investment also comprises of all subsequent transactions between the investor and the investment entity. The IMF as well sticks to the 10% ownership rule to identify an FDI (IMF, 2010).

According to (UNCTAD, 2012), equity capital, intra-company loans as well as reinvested earnings are the three components of FDI. Equity capital relates hereby to shareholding in companies in countries foreign to that of the investor. Loans from the

parent company to affiliates in foreign countries are intra-company loans, whereas reinvested earnings comprise of those profits not distributed to the shareholders of a company.

2.2.1 Differentiating Foreign Direct Investments

A country can both be host and provider of FDI. The latter means that it engages in investment projects outside the country (outward FDI). Such investments are also termed investment assets. On the other hand, hosting FDI means that a country can be a host to foreign investment projects in its own country (inward FDI), thus the country holds investment liabilities. Further to this, FDI can be split into two types each impacting a company's business differently. Firstly, ownership of less than 10% in another company can be termed a portfolio investment. An investment above 10% interest in another company is, secondly, recorded as a lasting management interest. Whereas a portfolio investment does not require an FDI provider to get involved into day to day management issues, the second type of FDI requires some form of management participation in the acquired company.

(Caves, 1971) differentiates between three types of reasons to engage in outward FDI: vertical, horizontal and conglomerate FDI. Vertical FDI can occur in two forms, backward or forward. The latter implicates a firm's effort to invest into another company which occupies the next level in the value chain. The aim of such a strategy is to reduce the distance between the firm and its customers. If an investee seeks to control previous levels of the value chain relevant to the firm, a backward vertical integration is being undertaken. On the other hand, horizontal FDI, the most common type of FDI, implicate that the same product is being produced in the home country as well as the foreign country whereby knowledge, experience and resources are being shared. Mostly in the case of oligopolistic or monopolistic conditions this strategy will be very successful. Advantages could result from highly specialized products or patents hold by the firm. Lastly, conglomerate FDI indicate a firm desire to produce products in a foreign market which are not produced in the home country. Reasons for such a decision can be a firm's detection of a market niche in a foreign country, having managerial excess capacities and organizational skills or risk diversification.

Further to this classification, another differentiation can be made in regard to the strategies and goals of a company investing abroad. In his paper “Towards an Eclectic Theory of International Production: Some Empirical Tests”, (Dunning, 1980) develops four types of such strategies: (1) resource seeking FDI, (2) market seeking FDI, (3) efficiency-seeking FDI and (4) strategic asset seeking FDI. The following chapter provides further explanations about these strategies. In addition to this, FDI can be classification regarding its different forms which can be Greenfield FDI or mergers and acquisitions (M&A). From the host country perspective, FDI can be classified into three forms (1) import substituting, (2) export increasing and (3) government initiated FDI.

2.3 Theoretical Background of Foreign Direct Investments

But what drives a company to investment abroad? Obviously, it must possess a set of ownership advantages enabling it to outweigh the cost of servicing a foreign market and compete with local companies (Hirsch, 1976). In order to understand the existence of FDI, one has to know these advantages. This knowledge helps to analyze why companies engage in FDI rather than other options to grow, such as outsourcing, exporting, licensing or domestic production. It thus becomes crucial to recognize the theories underlying FDI which emerged over the past decades. The main research on FDI were developed by Dunning (1980), Hymer (1976) and Vernon (1966). In addition to their work, several other theories try to explain the phenomenon of FDI of which none can be termed as a generally accepted theory. Rather, the different theories should not be seen as mutually exclusive but complementary. Therefore, this chapter will focus on elaborating when and how FDI theories were developed. At the same time, emphasis will be put on understanding the motivations of a theory development. Again, theory trends are analyzed in order to establish the theoretical background of investment policy making in Kenya.

2.3.1 The Eclectic Paradigm of Dunning. The concept of the eclectic paradigm of international production was first put forward by Dunning in 1976 at a presentation to the Nobel Symposium in Stockholm on The International Allocation of Economic Activity (Dunning, 1988). Dunning’s theory is a composition of several other theories: the theory of the firm, location theory, trade theory and organizational theory. He tries to identify and evaluate the influencing factors for foreign production

using three general concepts: ownership-specific advantage, internalization advantage and location specific advantage (OLI framework). These concepts provide answers to why companies invest abroad, where the production takes place and how and why MNCs can still be more profitable than local competitors.

The initial version of the Eclectic Paradigm has been changed and edited by the author, incorporating several critics and comments of other researchers (Dunning, 1988, 2000). Dunning added asset-seeking FDI to the theory and pointed out as well that strategy cannot be predetermined but rather is a firm-specific and dynamic variable.

2.3.2 Production Cycle Theory of Vernon. Developed by Vernon in 1966, the production cycle theory tries to explain different FDI made throughout the four phases of the production cycle. Vernon in his study tests US companies investing in post war Europe. The production cycle comprises of four steps: innovation, growth, maturity and decline. Since demand for American products in Europe increased significantly after the Second World War, US companies' exports increased significantly due to their technological advantages. The demand increase was contributed to the fact that US companies developed new, innovative products which they exported after successfully selling them locally.

2.3.3 The Internalization Theory. Developed by Buckley & Casson (1976), the internalization theory tries to explain the growth of MNCs and their motivation for engaging in FDI. The theory emphasizes in the fact that MNCs try to develop company-specific advantages (i.e. knowledge, technologies). It is the aim of the MNC to retain monopolistic advantages. Through investments in multiple countries, the firm creates the needed market to meet its objectives. Thus, the MNC internalizes its global foreign operations through a common governance structure and ownership.

2.3.4 Additional Concepts. In addition to the above mentioned theories, numerous other theories have been developed trying to explain FDI. The Heckscher-Ohlin Model and the Neoclassical Trade Theory for example make the assumption that capital returns determine the allocation of capital globally (Markusen, 1984). Other theories, which are based on the internalization theory, are the horizontal (or Proximity-Concentration Hypothesis) (Ethier, 1986; Krugman, 1983) and vertical FDI model (or Factor-Proportions Hypothesis) (Dixit & Grossman, 1982). Both

models have proven to explain certain factors of FDI, e.g. the horizontal model explained FDI by market size, scale economies and transportation costs. The vertical model also found similar results such as market size, skilled labor and transportation costs. In addition to these models, a number of other theories exist which will not be further explained in this study.

2.4 Advantages and Disadvantages of FDI to a Host Country

A set of advantages can be identified promoting the benefits of FDI for countries. On the other hand, many studies have been conducted negating the positive impacts of FDI in general or under certain conditions while proving the negative effects of FDI. This sections aims at elaborating the advantages and disadvantages of FDI flows to a country as it provides recommendations to policy makers and other researchers.

Žilinskė (2010) concludes in his paper that the impact of FDI depends on the form it takes. Determinants of this are the type of FDI, location of business or the density of local firms in the sector. In addition, he finds that effects of Greenfield FDI are positive whereas mergers and acquisitions often have negative and only little positive impacts on the host country. In the same study, Žilinskė (2010) also emphasizes that FDI does not always have an advantage over other investment tools such as loans. This chapter provides an overview of both advantage and disadvantages of FDI. In most cases, there are studies emphasizing on a particular effect being an advantage while other studies point out the negative impacts of the same effect.

Economic Growth. The positive impacts of FDI on economic growth in the host country have been acknowledged by many authors. Borensztein, De Gregorio, & Lee (1998) conclude in their study that FDI have a positive effect on FDI, however, the level of those effects highly depend on the human capital level of the host country. This implicates that a country has to have achieved certain levels of education, infrastructure, financial markets and health to profit turn FDI into an economic growth factor. This finding is especially interesting in the case of Kenya and calls for further research.

Another study by Bengoa & Sanchez-Robles (2003) is in conformity with the findings of Borensztein, De Gregorio, & Lee (1998). They established that there is indeed a positive influence of FDI to economic growth; however, growth is only then

possible if governments manage to achieve a sound degree of political and economic stability.

Change of Competitive Structure and Impact on Local Companies. Some studies provide evidence to the idea that FDI leads to an increase in competition amongst local companies. Blomström, Globerman, & Kokko (1999) identify that former employees of MNCs migrating to local companies bring in their acquired knowledge about technologies of the MNC. Furthermore, former employees may decide to set up their own companies when leaving the MNC thus increasing competition as well as allowing for technology spillovers.

On the other hand, Borensztein et al. (1998) admit that firms investing in foreign countries most likely enjoy lower costs and higher productivity levels than its local counterparts. Especially, this is the case in developing countries where higher efficiency is a result of better access to modern technologies and advanced management skills. These findings can be seen as advantage (for the investing firm) as well as disadvantage (for local competitors).

Technology Spillovers. Research suggests that technology spillovers are, under certain conditions, possible. Kokko, (1994) and Kokko, Tansini, & Zejan (1996) conclude for Mexico and Uruguay respectively that technology spillovers highly depend on the productivity levels of local firms. Spillovers are more likely to take place in economies where productivity levels of MNCs and local companies are similar. The success of technology spillovers also depends on the form of the FDI. As Blomström & Zejan (1991) argue, MNCs entering a foreign country through a joint venture, do most likely not contribute much to technology spillovers due to the fear of technology theft by the partner company.

In general, the willingness of MNC to bring in technology to the host country is influenced by the countries' policies (Magnus Blomström, 1991). Research undertaken by Mansfield & Romeo (1980) indicates that a country's FDI attractiveness and the quality and quantity of technology transferred to a foreign country also depends on the grade of protection of intellectual property.

Training and Employment. It is obvious that technology spillovers can only be achieved through investments into the local human capital of the host country.

Due to cost efficiencies and competitive reasons, foreign companies will have to employ local staff. In order to allow for the successful implementation of new technologies, an investment destination country needs to have a certain level of human capital so as to attracting FDI.

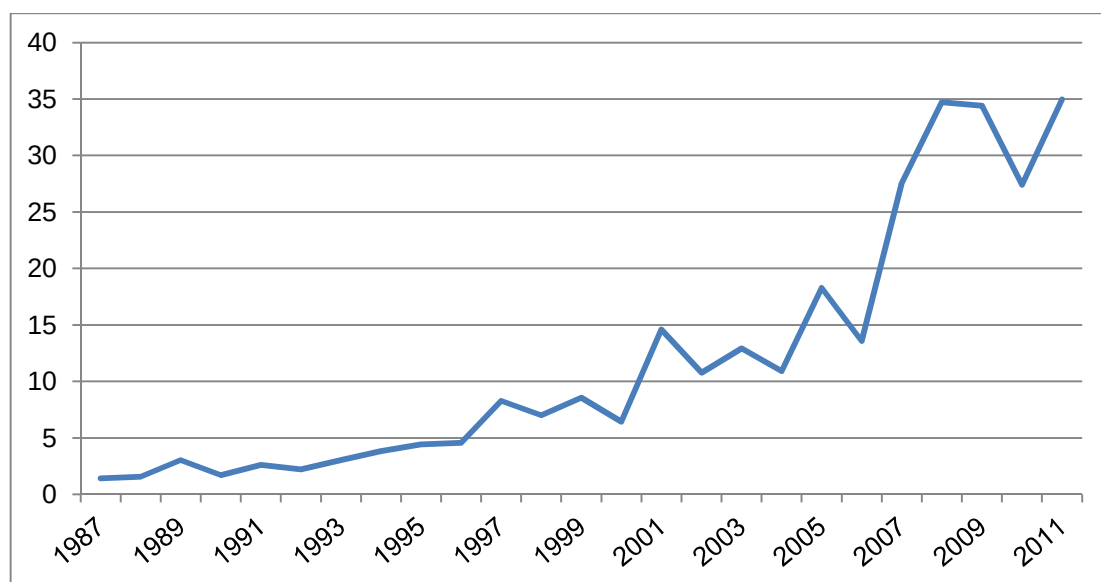
Scope of Realized Projects. Funding for huge investment projects in developing countries is often limited and requires external financing. MNC often have better financial resources than locals thus governments have the option to finance huge infrastructure projects through FDI.

Effect on Corruption. FDI indeed has an influence on corruption levels. Smith (2009) finds that FDI has a negative impact on local cultures and as well contributes to corruption.

2.5 Foreign Direct Investments to Sub-Saharan Africa

The SSA FDI inflow data can be split into three phases: The first phase includes the years from 1987 to 2000 (12.33% average annual growth rate). During this period the FDI inflows never exceeded USD 10 billion.

Figure 2-1: Sub-Saharan Africa FDI Inflows between 1987 and 2011



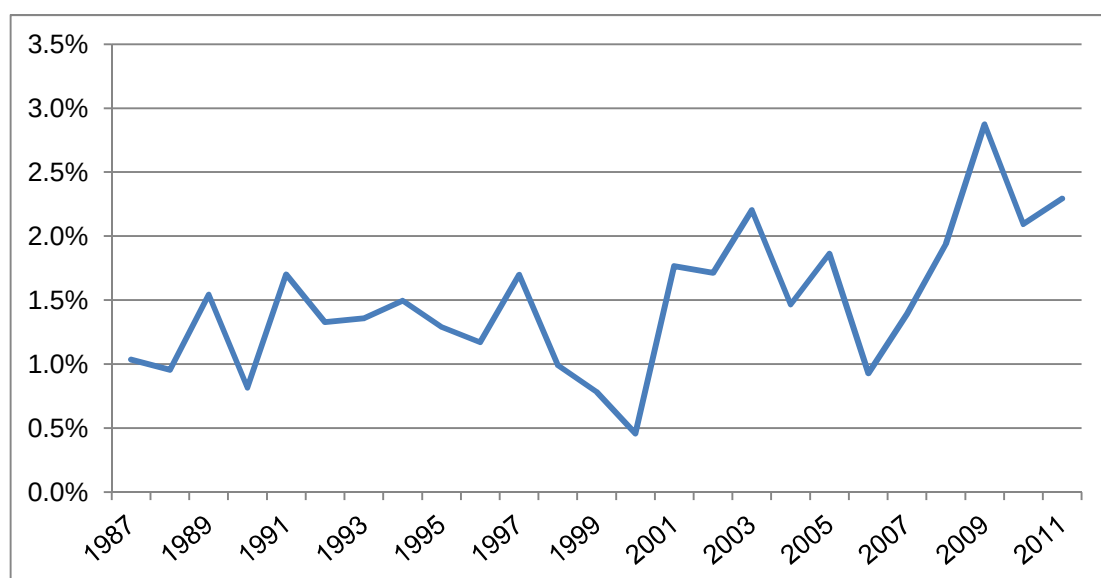
Inflows are in million USD. Data: UNCTAD. Figure: author.

The second phase can be characterized by FDI inflows standing at over USD 10 billion while in 2005 at first reaching over USD 15 billion (13.3% annual growth

rate). The last phase from 2007-2011 impressed with average annual growth rates of 20.8%.

It is important to compare FDI inflows to SSA to those globally. An analysis of the data of the UNCTAD (2012) is revealed in Figure 2-2. The data indicates that the Sub-Saharan Africa FDI share globally never even reached 3%. Even though a minimal upwards trend can be observed over the years, the annual SSA share of global FDI inflows has never reached a significant level (it has always been between below 0.5% and 2.9%). Figure 2-2 indicates that even though FDI inflows to SSA have been increasing significantly, the total share of global FDI has not moved at the same rate. This indicates that other regions and countries are much better in sourcing FDI than SSA thus outperforming SSA. (Anyanwu, 2012) also concludes that “Africa has never been a major recipient of FDI flows and so lags behind other regions of the world”. The largest recipients of FDI in Africa are traditionally its largest economies: Egypt, Angola, South Africa and Nigeria (Owusu-Antwi, 2012).

Figure 2-2: Annual SSA share (%) of global FDI inflows



Data: UNCTAD (2012). Figure: author.

The reasons for these countries to receive large amounts of FDI are multifaceted. Oil producing countries such as Nigeria and Angola have been recipients of FDI mainly contributed to the oil and gas industry. In 2002, more than half of the FDI inflows to the region went to the oil and gas industry in five countries namely Nigeria, Angola, Chad, Algeria and Tunisia (United Nations Conference on Trade and Development,

2003). For the case of South Africa, the reasons for its high FDI inflows can mainly be contributed to the continued privatization process and its large market (Owusu-Antwi, 2012).

In order to further understand FDI patterns in SSA countries, one has to look at several conditions including macroeconomic, political and social factors. More than in any other region in the world, wars are more likely to occur in Africa (Rogoff & Reinhart, 2003). The authors used susceptibility to war indices for the period of 1960 to 2001 and further found that there is a statistically significant negative correlation between FDI inflows and wars in the region. Macroeconomic instability is another factor influencing FDI inflows to SSA as has been elaborated earlier. In the past, SSA has been a location of events increasing the regions instability such as high budget deficits, crashes of financial markets and currencies or high inflation rates (Dupasquier & Osakwe, 2005; Onyeiwu & Shrestha, 2004). Other factors negatively influencing FDI inflows to the region were a poor infrastructure network in general, small market sizes of the individual economies and increased global competition for FDI. FDI inflows to Africa also have to be analyzed in light of colonialism which, after the independence of many African countries, resulted in economic nationalism, locking out foreign investors (Moss et al., 2004). Moss et al. (2004) conclude in their study in East African countries that part of the poor FDI performance are owed to deep-seated sentiments against foreign capital and ownership. Moss et al. (2004) also state that Africa is failing from fully benefitting through FDI which indeed contributes to economic development and integration with the global economy.

In the past, Africa attracted FDI as a result of her abundant natural resources and size of domestic market (Musila & Sigue, 2006). The authors, however, conclude that the natural resources as driver for increased FDI do not apply to most countries. On the one hand, countries must obtain the ability to establish sound political as well as economic conditions and introduce investment friendly policies. On the other hand, Musila & Sigue (2006) argue that this is not enough. Rather, countries have to identify and operate proactive marketing approaches to target selected FDI thus specializing in certain sectors.

Some studies (Asiedu, 2002, 2004; Musila & Sigue, 2006; Ngowi, 2001) established the factors influencing FDI to Sub-Saharan Africa. Ngowi (2001) identifies the

following factors: Favorable macroeconomic indicators (growth, stable inflation, low budget deficits), quality infrastructure, natural resources, political stability, Domestic market (size, openness, competitiveness), quality of human capital and cost, low transactions and business costs (rules of entry and exit, trade and labor laws, tax structures) and an efficient legal system. At the same time he recognizes the difficulty to identify the best mix of determinants of FDI needed to attract more FDI inflows. For Asiedu (2002, 2004) the following factors influence FDI inflows to Africa: return on investment, infrastructure development, openness of the economy, political risk, size of government consumption, economic stability and the growth rate of the domestic market. Bezuidenhout (2009), generally agrees with Musila & Sigie (2006) stating that it is foregone that FDI leads to increased growth in Africa. He agrees as well that countries have to focus on selected FDI. Other than Musila & Sigie (2006), he provides a concrete recommendation in regard to which type of FDI governments should focus on. He advises to put emphasis on attracting manufacturing Greenfield FDI with the main focus on training and Technological transfer. He further urges African governments to redesign their educational policies which should have the capability of absorbing FDI effects successfully.

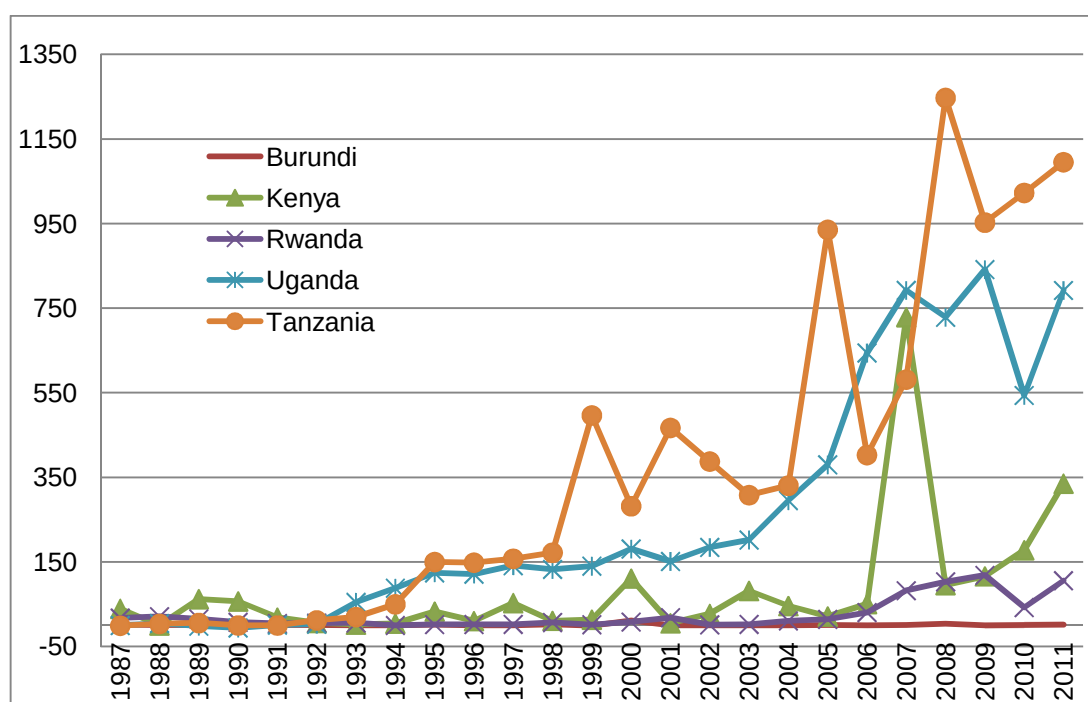
Another discussion which regularly appears in research is the debate on FDI versus aid (Bezuidenhout, 2009; Kosack & Tobin, 2006; Razin & Loungani, 2011). Africa in particular is often considered in this regard. Contrary to research promoting the argument of FDI having a positive effect on economic growth (Moss et al., 2004), Kosack & Tobin (2006) argue that FDI has, at best, no effect on economic growth and slows the rate of human development in developing countries. In contrast, they argue that aid is a great contributor to economic growth and human development.

2.5.1 Taking a Look at Eastern Africa

Due to country specific backgrounds and different historical and political developments of the individual Eastern Africa countries, varying FDI inflows can be assumed. And indeed, data shows (Figure 2-3) that FDI to East Africa varies greatly from country to country. The results are surprising. Kenya, often seen as the economic hot spot of East Africa, receives by far lower FDI than its neighboring countries Uganda and Tanzania. Until the beginning of the 90ies, FDI inflows to Tanzania, Uganda and Kenya had been on a similar level. However, during the late

90ies and the beginning of this century, the FDI inflows to Tanzania and Uganda increased strongly, while inflows to Kenya did not indicate any signs of growth. Having established the positive impacts of FDI and knowing about countries' global competition to attract FDI (Oman, 2000), it is important to highlight Kenya's position in a regional context. Even though Kenya's FDI levels have been low, they picked up during the last seven years (2005-2011), getting closer to the FDI levels of its neighboring countries: in 2011 Kenya's FDI inflows stood at USD335.25 million (Figure 2-3).

Figure 2-3: East African FDI inflows between 1987 and 2011



Data: UNCTAD. Figure: Author.

In their study, Musila & Sigie (2006) analyze different African countries in regard to their ability establishing a sound political, economic and policy environment conducive to investment. They conclude that Uganda and Tanzania among others are proving successful their ability to implement these factors. An East African survey by (Moss et al., 2004) on the impacts of FDI to Kenya, Tanzania and Uganda reveals that foreign companies bring in management skills, are more productive, invest more heavily in infrastructure and health of their workers as well as being better connected to international markets. Interestingly, the study also concludes that

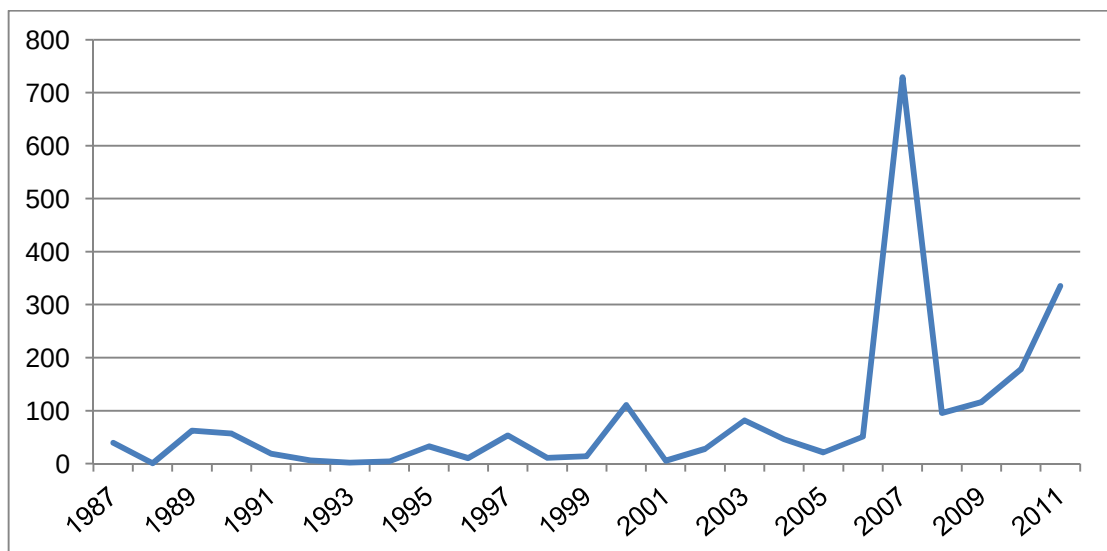
foreign companies are not, contrary to common perceptions, causing insolvencies of local companies and grabbing of market share.

2.6 Foreign Direct Investments to Kenya

For a better understanding of the investment climate and the occurrence of FDI inflows to Kenya, it is important to understand some basic economical, geographical and political data. Thus, before elaborating on FDIs to Kenya, this chapter provides an overview on the key information relevant to foreign investors.

Even though Kenya does not possess large deposits of natural resources in comparison to Uganda and especially Tanzania, Kenya has emerged as the economically leading country in East Africa. Bordering Tanzania, Uganda, Ethiopia, Southern Sudan and Somalia, approximately 43,013,341 people of over 40 indigenous groups live on 580,367 km² (Central Intelligence Agency, 2012). Its capital is Nairobi, which emerged being the central business hub for the wider East African region. Several international companies set up their regional or even continental headquarters in Nairobi, propelling its tremendous growth. Visualizing Kenya's geographical position is the key to understanding its role as economic leader in East Africa.

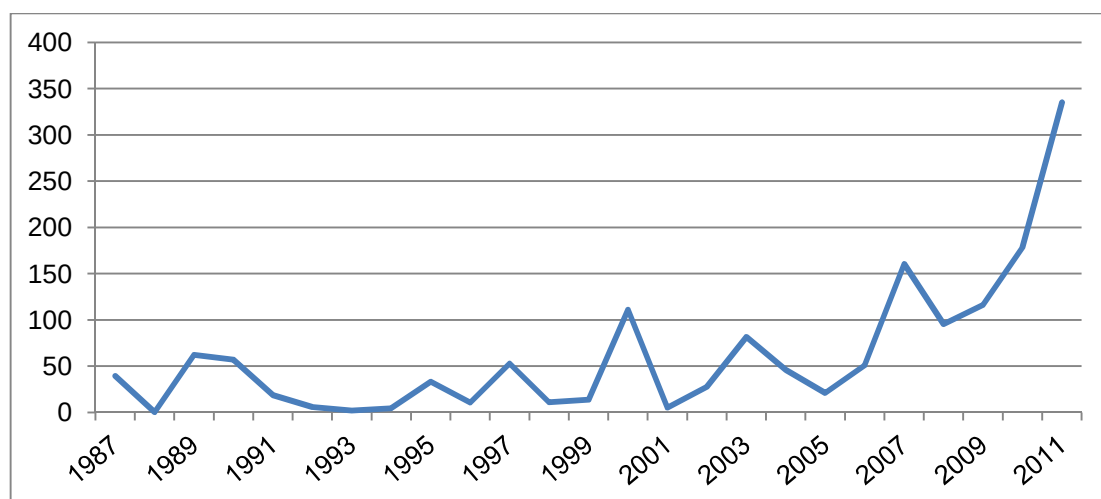
Figure 2-4: Kenyan FDI inflows between 1987 and 2011



Inflows are in million USD. Data: UNCTAD. Figure: author.

In comparison to the total Sub-Saharan Africa FDI development (Figure 2-1), Kenya's development of FDI inflows between 1987 and 2005 has been more or less stagnant, reaching its peak in 2000 with inflows of over 110 million USD (Figure 2-4). The year 2007 marked an extreme outlier, with FDIs amounting to over USD 700 million. During this year, two business transactions contributed significantly to this peak. Firstly, London based Helios Investment Partners bought a 24.99% stake in Equity Bank. The transaction volume stood at USD 178.7 million.⁵ Secondly, French company France Telecom bought 51% of the previously state-owned Telkom Kenya for USD 390 million in December 2007 (Information Gatekeepers Inc., 2010). The effect of these two transactions on the total FDI inflows in 2007 is immense. Figure 2-5 shows the FDI inflows without the acquisitions of Helios and France Telecom.

**Figure 2-5: Kenyan FDI inflows between 1987 and 2011
with adjusted FDI inflows in 2007**



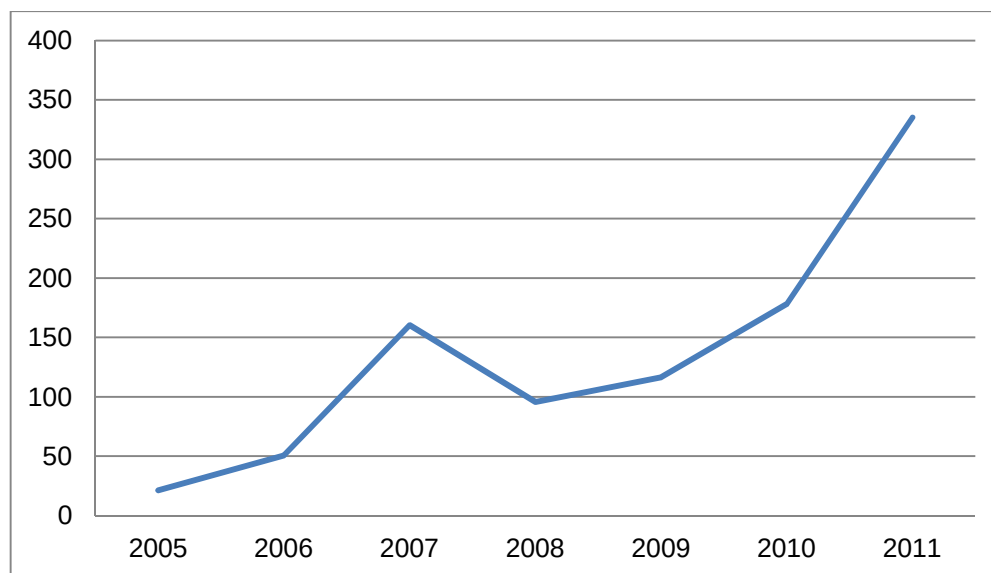
Inflows are in million USD. Data: UNCTAD. Figure: author.

For the further analysis, these adjusted figures will be used whereas the overall FDI inflows in 2007 do not include the amounts of these investments thus amounting to USD 160.35 million. Therefore, increasing FDI inflows from USD 21.2 million to USD 335.2 million can be observed between 2005 and 2011 (Figure 2-6). Previous research (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Ngugi &

⁵ Available through <http://www.heliosinvestment.com/representative-investments> (last accessed on 27.11.2012)

Nyang'oro, 2005) focused on determining the reasons for the stagnating or even decreasing FDI inflows to Kenya prior to 2007.

**Figure 2-6: FDI inflows between 2005 and 2011
with adjusted inflows in 2007**



Inflows are in million USD. Data: UNCTAD. Figure: author.

In the 70s Kenya was one of the most favorable FDI destinations in EA, however, FDI inflows have not only been highly volatile in the 80ies and 90ies but declined during this period (Mwega & Ngugi, 2006). This has mainly been contributed to political interventions in the local economy and the lack of reforms. However, Kenya maintained its stand as the strongest economy in Eastern Africa (Multilateral Investment Guarantee Agency, 2006). Today, Kenya is the most industrialized country in East Africa and one of the top performing countries in sub-Saharan Africa. The country thus provides an impressive array of reasons to invest in its industries. Through Kenya's port in Mombasa, Uganda, Rwanda, Burundi, Southern Sudan and Eastern Congo are supplied with imported goods. Furthermore, Kenya's road network is better developed than the ones' of its neighboring countries. In terms of regional networks, it has to be mentioned that Kenya is member of the East African Community and the Common Market for Eastern and Southern Africa. This opens a market of over 93 million and 385 million people respectively (Multilateral Investment Guarantee Agency, 2006).

As pointed out earlier, education plays a major role in investment decisions of foreign investors. In this regards, Kenya shows impressive numbers: it has the highest literacy rates in the region which results in a huge workforce of qualified upper level staff and skilled labor (Multilateral Investment Guarantee Agency, 2006). Again, high unemployment rates of over 40% (The World Bank Group (2012) lead to a large supply of qualified workers. Employer friendly labor laws in Kenya, make labor management easy. The government also tries to promote FDI into the country and, in this regard, set up Export Processing Zones (EPZ) across the country. Investors deciding to operate within such zones usually profit from better access to water, telecommunications and electricity.

Few studies (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Mwega & Ngugi, 2006; Ngugi & Nyang'oro, 2005) have been conducted on FDI inflows to Kenya of which most focus on the period of stagnation or decrease before 2007. Ngugi & Nyang'oro (2005) use FDI data and various institutional and macroeconomic factors from other developing countries and draw implications for Kenya. They conclude that the Kenyan government needs to improve on several issues such as price stability, openness and rule of law. They also find a positive relationship between FDI inflows and crime. Where law and order is observed, FDI inflows are higher. Other factors influencing FDI negatively were corruption, political instability and low levels of democracy. Kinuthia (2010) provides evidence on the determinants of FDI inflows to Kenya using foreign firm data (questionnaires) of 2007. His first finding is that most of the foreign investments are market seeking investments and come from the manufacturing and service sectors. The most important determinants are market size, political and economic stability, bilateral trade agreements and a favorable climate. Other to that, the three main impediments to FDI inflows are political instability, crime and insecurity, and institutional factors most notably corruption.

2.6.1 Investment Climate

Kenya's unique position and conditions within the East African region, has a direct impact on its status as investment destination. This chapter provides information on investment conditions in Kenya thus enabling to understand the developments FDI inflows. Between 2008 and 2011, a stable yearly increase of FDI inflows from USD

95.5 million in 2008 to USD 335.2 million in 2011 has been observed. Prior to 2008, such a continuous increase over four consecutive years cannot be observed. Mainly, the period prior to 2007 can be characterized by increases in one period followed by decreases in the next period.

Figure 2-7: Foreign equity ownership indexes and comparison of starting a foreign business

Foreign equity ownership indexes (100 = full foreign ownership allowed)	Country Score	IAB Regional Average*	IAB Global Average*
Mining, oil and gas	100	95.2	92
Agriculture and forestry	100	97.6	95.9
Light manufacturing	100	98.6	96.6
Telecommunications	70	84.1	88
Electricity	92.9	90.5	87.6
Banking	100	84.7	91
Insurance	66.7	87.3	91.2
Transportation	70	86.6	78.5
Media	75	69.9	68
Sector group 1 (tourism, construction, retail)	100	97.6	98.1
Sector group 2 (health care, waste management)	100	100	96.0

Starting a Foreign Business			
Time (days)	34	48	42
Procedures (number)	12	10	10
Ease of establishment index (0 = min, 100 = max)	57.9	51.5	64.5

Data: The World Bank Group (2010); Figure: Author. (* 21 African countries, ** 87 countries).

In 2010, the World Bank Group published its survey “Investing across borders”, analyzing the investment climate of 87 countries globally. 21 Sub-Saharan African countries⁶ were part of the assessment. The survey revealed valuable data about two main issues relevant to foreign investors: (1) A foreign equity ownership index was established, indicating to which percent companies in certain sectors can be owned

⁶ SSA countries analyzed in the survey: Angola, Burkina Faso, Cameroon, Cote d’Ivoire, Ethiopia, Ghana, Kenya, Liberia, Madagascar, Mali, Mauritius, Mozambique, Nigeria, Rwanda, Senegal, Sierra Leone, South Africa, Sudan, Tanzania, Uganda, Zambia.

by foreign entities. (2) The authors established the ease of starting a business in the sample countries (Figure 2-7). The survey revealed interesting information about Kenya's investment climate. Firstly, Kenya restricts foreign ownership in more sectors than most other economies. Especially the telecommunications, insurance and transportation sectors require significant foreign ownership. On the other hand, Kenya allows 100% foreign ownership in nine other sectors. In terms of starting a foreign business, Kenya ranks slightly above the regional average with 57.9 points (0 = min, 100 = max) and 51.5 points respectively. In terms of duration of setting up a business Kenya by far outpaces global as well as regional scores with 34, 42 and 48 days respectively. However, the number of procedures to set up a business stands at 12 compared to 10 as regional and global average.

In addition, foreign investors can obtain an Investment Certificate from the Kenya Investment Authority (for investments of \$100,000 and more) that helps speed up the administrative start-up procedures, including the provision of various work permits. During this period, the foreign investor is permitted to begin operations and apply for all the general and sector-specific licenses.

2.7 Determinants of Foreign Direct Investments

A set of factors determine the decision of a company to invest abroad. This section elaborates the important determinants influencing a firm's decision to or not to invest. After the introduction, eight hypotheses of the most important factors influencing investment decisions in foreign countries are developed.

One approach to categorize FDI determinants is to separate between firm and country specific determinants. While it is difficult to establish the exact quantity and quality of determinants needed to attract FDI, it is nevertheless clear that a critical minimum of these determinants must be present before FDI inflows begin to occur (Ngowi, 2001). The most obvious determinants can be derived from the OLI framework discussed before (Dunning, 1980). Firstly, a foreign company must possess some form of ownership advantages. These can for example be patents, technologies or management skills, size or reputation. Dunning (1980) concludes that ownership advantages, often also called competitive or monopolistic advantages, are firm specific, meaning that they depend on market position and company size. Once

ownership advantages have been established a company seeks to, secondly, internalize these advantages. Thirdly, after internalization has taken place, the company now has to see the possibility of exploiting location advantages. As pointed out earlier, literature generally emphasizes on four location advantages (Caves, 2007; Dunning, 1988). (1) Market seeking FDI seek to exploit fast growing or huge markets. (2) Companies seeking resources will choose markets close to the natural resources of interest. (3) Efficiency seeking FDI implicates the need to shift certain steps of the production cycle (goods or services) to foreign countries so as to reduce total costs of production and improve performance. (4) Lastly, strategic-asset-seeking FDI occurs when an investor wants to take advantages of what is available the specific market in terms of research and development and other benefits.

Several other factors influence a company's decision process on whether or not to invest in a foreign country. One finding is that natural resources have an influence on FDI levels in a country (Campos & Kinoshita, 2003; Jensen, 2003). Campos & Kinoshita (2003) conducted their study in some of the Eastern Europe and Commonwealth of Independent States countries. They further established that low labor costs as well as institutions and agglomeration economies influence the FDI decision making process. These findings partly conform with findings of other studies which found positive relationships between functioning institutions and limited policy risk and the level of FDI inflows (Click, 2005; Manzocchi, 2009). However, studies on the influence of labor costs reveal a mixed picture: Wheeler & Moody (1992) find that labor cost can have a positive effect on FDI, whereas a negative effects is established by (Kucera, 2002). In addition, and as established before, market size and economic growth matter (Flores & Aguilera, 2007; Jensen, 2003) as well as ease of starting a business or, as termed by some authors, a business friendly environment. In their study about FDI determinants of 68 developing countries, Mottaleb & Kalirajan (2010) establish that investors prefer, among other determinants, a business friendly environment (measured by the average duration to set up a business), large domestic markets and linkages to global markets. They conclude that developing countries worldwide are able to attract FDI by adopting more outward oriented trade policies and providing business friendly environments. One of the determinants considered in a long-term investment is the volatility of currency markets and foreign currency exposure. Currency volatilities have different

implications for different types of FDI. A company producing products in the host country but has substantial sales outside the country will greatly benefit from a depreciating currency. However, a depreciating currency is of disadvantage to an FDI having most of its sales within the domestic market. Especially for multinational companies, strategic pricing as an important determinant to investing in a foreign country (Musila & Sique, 2006). Strategic pricing is an important tactic to reduce the firm's overall tax obligations to a minimum. Especially MNCs who operate in several countries worldwide are able to shift, at least to some extent, profits from a high-tax country to a low-tax country (Musila & Sique, 2006). On the other hand, high-tax countries need to have other advantages offsetting the tax disadvantage.

It can be concluded that the relative importance and level of importance of some of the determinants varies between the different types of FDI i.e. resource-seeking, market-seeking, strategic-asset-seeking and efficiency seeking FDI. However, the most important factors can be identified from previous research regardless of the type of FDI. In the following, the eight most important factors as established in the literature (Asiedu, 2002; Campos & Kinoshita, 2003; Groh & Wieh, 2009; Hailu, 2010; Mottaleb & Kalirajan, 2010; Owusu-Antwi, 2012) are being elaborated and hypotheses for the further analysis established.

2.7.1 Market size

Many researchers found that one of the most robust determinants of FDI is market size (Artige & Nicolini, 2006; Billington, 1999; Kravis & Lipsey, 1982; Krugell, 2005; Sawkut et al., 2009; Wheeler & Moody, 1992). Market size is hereby often measured using total the GDP or GDP per capita. The argumentation behind market size influencing FDI inflows is that scale economies are created within a large domestic market thus bringing in higher returns. Therefore, an economy with a large market size receives higher FDI inflows than one with a small market size. However, there are also contrasting studies. For the case of Ghana, a study (Kyereboah-Coleman & Agyire-Tettey, 2008) find that market size is not a significant factor since investors mainly invest in sectors whose finished products are exported. A comprehensive research on several studies globally finding that market size indeed is a significant factor has been conducted by Chakrabarti (2001). In the case of South Asian countries a study (Sahoo, 2006) also finds that major determinants of FDI

inflows are market size, infrastructure development and openness. A key determinant of FDI inflows to Middle East and Northern Africa (MENA) countries was as well found to being the size of the host country (Mohamed & Sidiropoulos, 2010). In SSA countries, Adugna & Asefa (2003) and Asiedu (2002) conclude that large markets pull FDI inflows. In a study carried out in countries across Africa, this effect has been confirmed by Anyanwu (2012) and Sawkut et al. (2009). Anyanwu (2012), however, can only confirm this effect for the case those countries with a large urban population size. The hypothesis therefore developed is:

H1: A positive relationship exists between market size and FDI inflows.

2.7.2 Economic Growth

High market growth is a strong signal for the future potential of the market. As a result, countries with high constant growth rates attract more FDI inflows than economies with volatile growth rates. As will be shown, most researchers find economic growth a significant factor for increasing FDI inflows. However, few researchers find no significant relationship between FDI inflows and economic growth (Ancharaz, 2003 [only for African economies]; Nigh, 1985 [only for developed but not developing economies]). Nevertheless, most studies undertaken in this area attest a great positive effect of high and consistent growth rates to increasing FDI inflows to a country. Addison & Heshmati (2003) find a positive relationship between FDI inflows and economic growth in a study conducted in developing countries worldwide. Similarly, Nnadozie & Okonkwo (2004) also find that higher economic growth positively relates to higher FDI inflows into a host country. Another study (Agrawal & Ranjan, 2011) shows that foreign investors in the BRIC countries are highly sensitive to market growth. Gastanaga, Nugent, & Pashamova (1998), Schneider & Frey (1985), Asiedu (2006) and Sahoo (2006) also find in their research positive significant effects of economic growth and FDI inflows to a country. The hypothesis therefore developed is:

H2: A positive relationship exists between economic growth and FDI inflows.

2.7.3 Openness

Openness or “trade openness” is mostly interpreted as the ease and amount of trading (imports and exports) from and to a country. However, Hailu (2010) finds that openness can also be viewed from “economic treaties and integration between and among countries”. Following this concept of openness, (Neumayer & Spess, 2005) provide evidence that FDI inflows to a country are increasing, the higher the number of bilateral investment treaties. Similar findings have been made for the North American Free Trade Agreement region (Feils & Manzur, 2008) and between the European Union and Eastern European countries (Kersan-Škabić & Orlić, 2007). Trade openness as a factor influencing an investment decision of a company significantly depends on the form of FDI as discussed above. Companies seeking to export products from the host country will certainly be keen on measures related to openness. On the other hand, firms producing locally and seeking to penetrate the host country’s local market will not consider this factor as very significant. Therefore, research findings on this factor draw a mixed picture. Kravis & Lipsey (1982) and Culem (1988) (Culem for industrialized countries only) find that openness is inversely related with FDI. On the other hand, this determinant is found insignificant by Blomström et al. (1999), Campos & Kinoshita (2003) and Wheeler & Moody (1992) [only for the case of the electronic sector, however, a strong positive relationship for the manufacturing sector]) among others. In a previous study Magnus Blomström & Kokko (1997) find that the more open a country, the more international companies try to make use of location advantages in this economy. This as well has been found as a major factor by several researchers such as (Agrawal & Ranjan, 2011; Anyanwu, 2012; Asiedu & Lien, 2003; Asiedu, 2002; Hailu, 2010; Montiel et al., 1997). Two studies carried out by (Asiedu, 2002, 2006) find that FDI inflows to Sub-Saharan African countries can be increased by openness to trade. Pradhan & Saha (2011) find the same in a study conducted in 20 African countries. The hypothesis therefore developed is:

H3: A positive relationship exists between the level of openness of a country and FDI inflows.

2.7.4 Political Stability

Overall political stability is positively correlated with the levels of FDI inflows as a study by Harms & Ursprung (2002) reveals. In line with these findings are the results of Busse & Hefeker (2007) who use a sample of 87 developing countries over a 20 year period. Their study suggests that several factors of institutional quality, level of education and political risk are significant determinants of FDI inflows. Similar to these findings are several other studies: (Li, 2008) shows that military conflicts and FDI inflows are inversely correlated. Studies carried out in Africa prove that political stability is an important factor for foreign investors (Dupasquier & Osakwe, 2005; Hailu, 2010; Kyereboah-Coleman & Agyire-Tettey, 2008 [for the case of Ghana only]; Sawkut et al., 2009). Asiedu (2006) proves in a study conducted in 22 African countries that political stability indeed promotes increasing FDI inflows. In yet another study, researchers (Pradhan & Saha, 2011) found in 20 African countries that political instability hinders FDI inflows. The hypothesis therefore developed is:

H4: A positive relationship exists between the level of political stability in the host country and FDI inflows.

2.7.5 Corruption Level

Corruption levels are as well an important determinant of foreign investors in regard to choosing an investment destination. Wei (2000) finds that corruption has a negative impact on FDI. One of his major findings is that increasing the corruption level from that of Singapore to that of Mexico is equivalent to raising the tax rate by over twenty percentage points. Thus, corruption does directly influence the cost of production. According to several studies (Disdier & Mayer, 2004; Kersan-Škabić & Orlić, 2007; Kinda, 2010; Voyer & Beamish, 2004; Zhao, Kim, & Du, 2003), the existence of lack of transparency and corruption has been implicated as slowing down economic activity and development and thus negatively influencing FDI inflows. Al-Sadig (2009) conducted a study which measured the effect of corruption in 117 host countries worldwide. He finds that overall corruption hinders FDI inflows to host countries. However, he also finds that the variable corruption has less impact on the investment decision of foreign companies, if the quality of government institutions is high. A similar research (Khamfula, 2007) conducted in 17 countries

revealed that corruption is less damaging in export oriented economies than in import substitution markets. On the other hand, a very recent study (Anyanwu, 2012) shows that corruption and regulatory quality has no significant influence in FDI inflows to African countries. These findings comply with the results of a study (Haksoo, 2010) concluding that economies which are highly affected by corruption and low levels of democracy attract higher FDI inflows than those economies with low corruption levels. Due to the fact that the majority of the researchers in this area find a negative relationship between the existence of corruption and FDI inflows, the hypothesis developed is:

H5: A negative relationship exists between the existence of corruption in the host country and FDI inflows.

2.7.6 Rule of Law

Rule of Law is another important factor influencing FDI decisions. Functional legal systems provide the backbone of any country. In their study, Campos & Kinoshita (2003) measure rule of law by the strength and impartiality of the legal system and popular observance of the law. Their study concludes that rule of law is an important determinant of FDI inflows to a country. A similar finding is observed in a study by Anyanwu (2012) who finds that government quality is associated with higher FDI inflows to Africa. He concludes: “Therefore, FDI inflows to the continent correlate positively with the prevalence of the rule of law, meaning that the quality of government matters for making FDI inflows go where they do in Africa“. The hypothesis therefore developed is:

H6: A positive relationship exists between rule of law and FDI inflows.

2.7.7 Level of Education

The level of education in a host country plays an important role in determining a company’s investment decision. The education level indicates the existence and ease of finding qualified employees for a company’s foreign investment. This has been confirmed by Busse & Hefeker (2007) who use a sample of 87 developing countries over a 20 year period. In the case of the manufacturing sector, a study was conducted by Tsen (2005) in Malaysia. He found that besides market size and infrastructure,

education is indeed a major determinant for foreign investors. The hypothesis therefore developed is:

H7: A positive relationship exists between high levels of education and FDI inflows.

2.7.8 Inflation

Volatile and high inflation rates can be regarded as a proxy for an instable economy thus refraining potential investors to invest in such economies. In contrast to portfolio investors, FDI investors are much more exposed to inflation and volatile currency exchange rates. While portfolio investors can simply reduce their investments in volatile markets or hedge against certain risks, FDI investors are fully exposed to inflation and volatile markets. Therefore, FDI investments highly depend on stable markets. This phenomenon has been proven in some studies (Khair-Uz-Zaman & Awan, 2006; Nnadozie & Okonkwo, 2004). Razafimahefa & Hamori (2005) conclude that “the instability of the host country currency tends to reduce FDI inflow by discouraging the repatriation of investment returns”. They further continue that a positive relationship between FDI inflows and exchange rate volatility might be found if investment in the local market is used as a substitute to exporting. Hailu (2010) confirms these findings on the negative effect of high and volatile inflation rates on FDI inflows in his study on determinants of FDI inflows to African economies. He concludes that inflation has indeed a negative effect on attracting FDI even though it is statistically less robust. Similar results were found in a study on seven South Asian countries (Pradhan & Saha, 2011). The hypothesis therefore developed is:

H8: A negative relationship exists between high levels of inflation and FDI inflows.

2.8 Chapter Summary

The literature review clearly confirmed the mixed picture of determinants and impacts of FDI indicated by numerous researches worldwide. The determinants of FDI decisions seemed to be sector and country specific, resulting in positive or negative effects for the receiving country. The determinants identified ranged from

macroeconomic factors such as economic growth, market size, or inflation, to legal- and policy-related determinants (e.g. rule of law). Depending on the type of FDI, the importance of the different determinants varies from industry to industry. Research suggests positive (Borensztein, De Gregorio, & Lee, 1998; Bezuidenhout, 2009; Musila & Sigue, 2006; Kokko, 1994; and Kokko, Tansini, & Zejan, 1996) as well as negative (Smith, 2009; Michie, 2001; Blomström 1999) impacts of FDI to the host country. Determinants influencing FDI decisions are many, depending on the underlying motivations of the individual companies as well as country specific characteristics. The literature review gave as well an overview on FDI aspects across the region in general and Kenya in specific. This enabled to getting a better understanding of the market(s) and investment patterns. Previous studies focused on the stagnating or decreasing FDI inflows to Kenya (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Mwega & Ngugi, 2006; Ngugi & Nyang'oro, 2005). However, recently published data by the UNCTAD (Figure 1.2) suggested a change from stagnating to increasing FDI inflows.

Chapter 3 Research Methodology

3.1 Introduction

The purpose of this study was to establish the specific factors that have influenced development of the FDI inflows to Kenya from 1998 to 2004 and 2005 to 2011. In order to attain these objectives and answer the research questions, this chapter details the methodology as follows: the research design, population and sampling; data collection tools used as well as the statistical techniques applied in establishing the hypothesized relationships between variables. The last section entails how the data analysis was conducted and how variables were chosen.

3.2 Research Design

Different research designs were employed to fulfill the objectives stated earlier. This was achieved by employing quantitative and qualitative research methods. These methods allowed obtaining information regarding the influence of the underlying factors for FDI inflows to Kenya. The study involved two main sections to achieve these objectives: (1) an analysis of indices was undertaken to identify the relationship between FDI inflows to Kenya and influencing factors. Non-parametric analysis tools such as comparison of means and variances were used to analyze the data provided by the different indices. (2) After this, the answers of respondents from foreign owned companies in Kenya were analyzed and compared with the findings of the index analysis. Therefore, perceptions of managers and actual index data could be compared. In this case, valuable information was provided about the actual reasons to the increasing foreign investments in Kenya.

3.3 Population and Sampling

The United Nations Conference on Trade and Development (2012c) published “An Investment Guide to Kenya – Opportunities and Conditions 2012” in which 68 foreign companies are listed as a sample of Kenyan companies with at least 10% foreign ownership. These companies are operating in the following sectors (in brackets are the numbers of companies in each sector): agriculture and related (9), oil and gas (3), manufacturing (25), services (both financial and information communications & technology, 12), tourism and transport (6), business support (8)

and others (5). These sectors represent the most important sectors in Kenya⁷. A comprehensive data base of all companies in Kenya with foreign shareholding of at least 10% is not publicly available. The author established this by sending requests via e-mail and having follow-up meetings with different institutions such as the Central Bank of Kenya (CBK), the Kenya Investment Authority, the United Nations and the Kenya Revenue Authority (KRA). Thus, the total number of foreign companies in Kenya cannot be established⁸ and the author will use the sample list provided by the United Nations Conference on Trade and Development (2012c).

3.4 Data Collection Methods

In order to answer the research questions, different data was required. Firstly, index data was needed to test the importance of different factors influencing FDI inflows. This information was obtained using publicly available indices which are published by the World Bank and the United Nations. A comprehensive list of index sources used in this study is provided in later in this Chapter. In a second step, questionnaires⁹ were used to confirm or dismiss the findings of the index analyses. The questionnaires were made available through an online-version. The respondents targeted were CEOs since they generally are in the best position to provide the required data. However, if the CEO identified another employee she/he assumed as having enough expertise to answer the questionnaire, such a response was accepted as well. Through initial calls with the executive office, relevant contact details were acquired. The next step involved sending an e-mail with the link to the online-questionnaire. In case of a low response rate, follow-up calls and visits were considered as means of data collection. The described method of data collection allowed for comprehensive analyses to meet the study's objectives and provide profound answers to the research questions.

⁷ The Central Bank of Kenya uses a very similar categorization of relevant sectors in Kenya in its annual reports.

⁸ (Kinuthia, 2010) confirms this. The Kenya Association of Manufacturers (KAM) maintains a list of foreign manufacturing companies in Kenya which are in contact with KAM. Other foreign manufacturing companies which are not connected with KAM are not included in the list. A similar situation can be observed at the Kenya Investment Authority (KenInvest): it only maintains a data base of foreign companies which came to Kenya through KenInvest. All other companies are not listed. However, even this incomplete list of KenInvest could not be acquired because of "internal policies".

⁹ Draft questionnaire in Appendix A.

The data obtained for the index analysis was collected from publicly available data which and was thus aligned with the ethical standards of these organizations. When collecting the primary data, emphasis was put on keeping ethical standards such as ensuring anonymity of respondents' answers. Furthermore, it was clear to the respondents that this research was done as part of master studies at Strathmore University which ensured that in case of any abusive behavior of the researcher, the respondents were able to contact the university directly.

3.5 Data Analysis

3.5.1 Research Models

The research models employed in this study were structured as follows: **Firstly**, the selected periods of stagnating (1998-2004) and increasing (2005-2011) FDI inflows to Kenya were justified using a regression model. **Secondly**, the findings of the index analysis were presented and discussed. Two different analyses were carried out which represent the two periods of stagnation (1998-2004) and growth (2005-2011). **Thirdly**, the information about the increasing FDI inflows provided by managers through the questionnaires was analyzed. This last part was further split into two sections namely (1) the analysis of predetermined factors (the same as have been used in the index analysis) and (2) an analysis of individual factors which were provided and rated by the respondents themselves.

Firstly, the model¹⁰ provided a statistically valid justification of choosing the two periods of stagnating (1998-2004) and increasing (2005-2011) FDI inflows to Kenya. This was necessary to not only determine the two periods by eyeballing but actually through using statistically valid measures. To verify the selected periods, the following model was developed:

$$FDI_t = \alpha_1 I(t \leq T^*) + \alpha_2 I(t > T^*) + \beta_1 t I(t \leq T^*) + \beta_2 (t - T^*) I(t > T^*) + u_t$$

$$t = 1998, 1999, 2000, \dots, 2011$$

Function 1: Regression function

¹⁰ The model has solely been developed by the author of this thesis.

Whereby:

FDI_t: Dependent variable; Annual FDI inflow in USD to Kenya at time t.

α_1 : Coefficient corresponding to the intercept (or constant) prior to or at the time of the break

α_2 : Coefficient corresponding to the intercept (or constant) after the break

β_1 : Slope coefficient corresponding to the period before or just at the time of the break that we suppose it takes at time $t = T^*$

β_2 : Slope coefficient corresponding to the period after the break that we suppose it takes at time $t = T^*$

I(...): An indicator function that takes the value 1 if the criteria within each parentheses is satisfied and otherwise 0

T^* : Chosen year which marks the change from the period of stagnation to the period of growth

u_t : Error term

In other words, the above equation allows for a constant and a linear trend in the two subsamples (the periods of stagnation and growth). The model will be run for the following periods:

1. Period of stagnation 1998-2002 and period of growth 2003-2011
($T^* = 2003$)
2. Period of stagnation 1998-2003 and period of growth 2004-2011
($T^* = 2004$)
3. Period of stagnation 1998-2004 and period of growth 2005-2011
($T^* = 2005$)
4. Period of stagnation 1998-2005 and period of growth 2006-2011
($T^* = 2006$)
5. Period of stagnation 1998-2006 and period of growth 2007-2011
($T^* = 2007$)

The results of the models for all five periods indicated the best possible differentiations of the stagnation- and growth periods. Therefore, the model statistically proved where exactly the growth period begun.

The **second part** of the analysis was drawn from the discussions in the literature review where the variables to be used in the study were established. The research model applied in this section allowed a comparison of the annual FDI inflows to Kenya with the determinants developed in the literature review. The FDI inflows were measured as the net FDI inflows and outflows to Kenya in US Dollar. A comparison of the FDI inflows and the determinants was possible through the use of statistical tools such as means and variances measured over the period of stagnation in FDI inflows (1998-2004) and the growth period of FDI inflows (2005-2011). The explanatory variables are measured as follows:

Determinant	Abbr.	Measured by
Market Size	MSize	GDP per capita
Economic Growth	EcGrowth	GDP per capita growth
Openness	Openn	Eport to GDP ratio
Political Stability	PolStab	Government stability, internal conflicts, external conflicts and ethnics tensions.
Corruption Level	CorLev	Bribery, fraud and extortion
Rule of Law	RuleLaw	Strength and impartiality of the legal system and popular observance of the law
Level of Education	LevEdu	Education Index of the Human Development Index (UNDP)
Inflation	Infl	Annual inflation rate

Table 3-1: List of Determinants identified in literature, their abbreviations and form of measurement

Due to the nature of the given data and its few observations (2 x 7 years), it was not possible to conduct regression analysis (time series analysis). It was also not possible to increase the observations as neither quarterly nor monthly data was available for the variables chosen. Therefore, an analysis using descriptive statistical tools such as comparison of means and variances was chosen to analyze the change of the variables in the periods of stagnation (1998-2004) and growth (2005-2011) of FDI inflows to Kenya. Chosen tools stemmed from non-parametric statistics such as comparison of means and variances of the index values of the two periods.

Thirdly, the analysis of primary data aimed at increasing the explanatory power of the results found in the index analysis. Concerned managers know best the underlying reasons for or against investments in a country. As mentioned before, this section was split into **(1)** an analysis of predetermined factors (the same as have been used in the index analysis) and **(2)** an analysis of individual factors which were provided and rated by the respondents themselves. Chosen tools were similar to the ones used in the index analysis and stemmed from non-parametric statistics such as comparison of means and variances of the index values of the two periods.

3.5.2 Operationalization of Variables

3.5.2.1 Dependent and Independent Variables

The dependent variable was measured using the annual FDI inflows to Kenya between 1998 and 2011. The independent variables represent the factors which had a certain degree of influence on the FDI development.¹¹

3.5.2.2 Market Size (MSize)

The preferred measure for market size is a country's GDP per capita and its population size (Kucera, 2002). This double measure indeed includes two important factors: the size of a population gives a first overall picture on the number of potential customers in a country. Especially for mass consumption goods this is an important measure. In addition, the GDP per capita provides a valuable measure as to determining the spending power of a population. The determinant is thus measured by as GDP per capita. Time series data of the GDP per capita which measures the real or constant GDP per capita¹² is provided by the World Bank¹³.

3.5.2.3 Economic Growth (EcGrowth)

Following Kucera (2002), Tsai (1994) and Asiedu (2002), among others, the author uses the real GDP per capita growth rate to measure economic growth. It captures the rate (percentage) at which the GDP per capita in a specific country grows, thus

¹¹ Find a complete list including the eight factors for each year in Appendix B.

¹² Using the real (constant) GDP data indicates that the GDP is adjusted for changes in money value. Such changes occur as a direct result of inflation or deflation. Real GDP data allows for year-to-year analyzes.

¹³ Available through <http://data.worldbank.org/data-catalog> (last accessed on 08.01.2013)

indicating its potential. The data, which measures the real (or constant) GDP growth rate¹⁴, is retrieved from the World Bank¹⁵.

3.5.2.4 *Openness*

Depending on the type of the FDI, openness is an important determinant for foreign investors. Openness is commonly measured using the sum of imports and export to GDP (Agrawal & Ranjan, 2011; Anyanwu, 2012; Asiedu, 2002). The evidence of openness is mixed and largely depending on the type of the investment (e.g. efficiency-seeking, resource-seeking). Even though not a very strong determinant of FDI, there is a slightly positive effect of openness on FDI (Jaumotte, 2004). The data for this factor is provided by a World Bank data base (The World Bank Group, 2012).

3.5.2.5 *Political Stability (PolStab)*

This determinant includes government stability, internal conflicts, external conflicts and ethnics tensions. Time series data on this factor is provided through the Worldwide Governance Indicators published by the World Bank¹⁶.

3.5.2.6 *Corruption Level (CorLev)*

This study seeks at incorporating forms of corruption into the regression function that affect the costs of investment operations only. Corruption can take various forms such as fraud, bribery or extortion, therefore, several definitions exist. This study follows the definition of Macrae (1982) who defines corruption as an agreement involving “a private exchange between two parties (the ‘demander’ and the ‘supplier’), which (1) has an influence on the allocation of resources either immediately or in the future, and (2) involves the use or abuse of public or collective responsibility for private ends”. Corruption perceptions in this study are measured through the Corruption Perception Index provided by Transparency International¹⁷.

¹⁴ See footnote No. 7.

¹⁵ Available through <http://data.worldbank.org/data-catalog> (last accessed on 13.10.2012)

¹⁶ Available through <http://info.worldbank.org/governance/wgi/> (last accessed on 10.10.2012)

¹⁷ Available through <http://www.transparency.org/country> (last accessed on 10.10.2012)

3.5.2.7 *Rule of Law (RuleLaw)*

Rule of law is essential for any investor. Functional legal systems provide the backbone of any country and its operations. In their study, Campos & Kinoshita (2003) measure rule of law by the strength and impartiality of the legal system and popular observance of the law. They assess this determinant through a rating scale whereas a higher score implies better legal institutions. This study will use the publicly available Rule of Law Index provided by the World Justice Report¹⁸.

3.5.2.8 *Level of Education (LevEdu)*

Quality of labor can be seen as a result of the level of education (Campos & Kinoshita, 2003). It is thus not only important to analyze the labor costs but also establish the level of education which will help to predict the future development of a foreign entity. Campos & Kinoshita (2003) assess the level of education by using data on the secondary school enrollment rate. However, especially in the case of efficiency-seeking FDI, someone also has to have a look on the level of tertiary education in a country. Time series data on this factor is provided through the International Human Development Indicators published by the United Nations Development Program¹⁹.

3.5.2.9 *Inflation*

Depending on the type of FDI, inflation can play a major role in the FDI decision making process. Export oriented FDI is not as much exposed to inflation since such an FDI will realize most of its profits abroad. This implies sales in currencies other than the local currency which are not exposed to local inflation risks. However, inflation influences other FDI types much more. Market-seeking FDI, on the other hand, is much more exposed to inflation risks since it seeks to gain local market share. This determinant will require the respondents to rate the influence of local inflation in the recent FDI inflows development to Kenya. Time series data on this factor is provided by the International Monetary Fund²⁰.

¹⁸ Available through <http://worldjusticeproject.org/rule-of-law-index> (last accessed on 15.10.2012)

¹⁹ Available through <http://hdrstats.undp.org/en/indicators/103706.html> (last accessed on 18.11.2012)

²⁰ Available through <http://www.imf.org/external/data.htm> (last accessed on 20.10.2012)

3.6 Summary

This study aimed at capturing views and perceptions about the FDI increase over the past years and prospects to the development of FDI in Kenya. To achieve this, the data gathered was analyzed using the software EViews. The study employed descriptive as well as inferential statistics. Measures of central tendency, mode and mean, as well as a comparison of variances were used to describe the data. Furthermore, the results acquired through the sample were inferred to the population.

The analysis was split into three parts. First, a regression model was developed to statistically proof the change from the period of stagnation to the period of growth. Secondly, an analysis of indices representing the eight factors contributing to increasing FDI inflows was conducted. Chosen tools stem from non-parametric statistics such as comparison of means and variances of the index values of the two periods. Thirdly, the analysis of the questionnaires was carried out using descriptive non-parametric statistical tools as in the second part of the analysis.

Chapter 4 Presentation of Research Findings and Discussion

4.1 Introduction

The presentation of findings was structured as follows: Firstly, the selected periods of stagnating (1998-2004) and increasing (2005-2011) FDI inflows to Kenya were justified using a regression model. Secondly, the findings of the index analysis were presented and discussed. Two different analyses were carried out which represent the two periods of stagnation (1998-2004) and growth (2005-2011). Thirdly, information on the increasing FDI inflows from 2005 to 2011 provided by managers through the questionnaires was analyzed.

4.2 Justification of Chosen Periods of Stagnation and Increase of FDI Inflows

In order to verify the selected periods, the model developed earlier (Chapter 3) was run to provide a statistically valid justification of choosing the two periods of stagnating (1998-2004) and increasing (2005-2011) FDI inflows to Kenya. The regression function was as follows:

$$FDI_t = \alpha_1 I(t \leq T^*) + \alpha_2 I(t > T^*) + \beta_1 t I(t \leq T^*) + \beta_2 (t - T^*) I(t > T^*) + u_t$$

$$t = 1998, 1999, 2000, \dots, 2011$$

Function 1: Regression function

The model was run five times whereas the different values of T^* and the corresponding coefficients to the independent variables, i.e., α_1 , α_2 , β_1 and β_2 changed accordingly. In order to prove that the periods of growth and stagnation are indeed ranging from 1998-2004 and 2005-2011 respectively, different periods of stagnation and growth were assumed for each of the five regression analyses thus changing the values of the independent variables as shown in Table 4-1.

Name of regression	Period	Years	α_1	α_2	β_1	β_2
2003 (=T*)	Stagnation	1998-2002	1	0	1,...,5	0
	Growth	2003-2011	0	1	0	6,...,14
2004 (=T*)	Stagnation	1998-2003	1	0	1,...,6	0
	Growth	2004-2011	0	1	0	7,...,14
2005 (=T*)	Stagnation	1998-2004	1	0	1,...,7	0
	Growth	2005-2011	0	1	0	8,...,14
2006 (=T*)	Stagnation	1998-2005	1	0	1,...,8	0
	Growth	2006-2011	0	1	0	9,...,14
2007 (=T*)	Stagnation	1998-2006	1	0	1,...,9	0
	Growth	2007-2011	0	1	0	10,...,14

Table 4-1: Values of independent variables for each regression analysis

For a better understanding of the model, Table 4-2 below represents the complete list of data used for the regression analysis “2005”:

t	FDI	α_1	α_2	β_1	β_2
1998	11.00	1	0	1	0
1999	13.82	1	0	2	0
2000	110.90	1	0	3	0
2001	5.30	1	0	4	0
2002	27.62	1	0	5	0
2003	81.74	1	0	6	0
2004	46.06	1	0	7	0
2005	21.21	0	1	0	8
2006	50.67	0	1	0	9
2007	160.35	0	1	0	10
2008	95.58	0	1	0	11
2009	116.26	0	1	0	12
2010	178.06	0	1	0	13
2011	335.25	0	1	0	14

Table 4-2: Values of independent variables of the regression “2005”

The regression model (Function 1) has been applied for different periods as indicated in Table 4-1. The results of the five regression analyses are shown in Table 4-3 below. Besides the coefficients, standard errors, t-statistics and probabilities, the results include the R^2 and the R^2 adjusted.

		2003	2004	2005	2006	2007
Coefficient	Coefficient α_1	26.31	12.78	19.82	30.73	30.29
	Coefficient α_2	-153.60	-242.14	-316.12	-335.74	-341.63
	Coefficient β_1	2.47	8.27	5.63	1.99	2.13
	Coefficient β_2	27.42	35.01	41.17	42.76	43.23
Std. Error	Coefficient α_1	62.92	49.88	42.96	40.36	37.63
	Coefficient α_2	79.98	88.85	107.40	143.96	197.92
	Coefficient β_1	18.97	12.81	9.61	7.99	6.69
	Coefficient β_2	7.74	8.27	9.61	12.38	16.38
t-Statistic	Coefficient α_1	0.42	0.26	0.46	0.76	0.80
	Coefficient α_2	-1.92	-2.73	-2.94	-2.33	-1.73
	Coefficient β_1	0.13	0.65	0.59	0.25	0.32
	Coefficient β_2	3.54	4.23	4.29	3.45	2.64
Probability	Coefficient α_1	0.6846	0.8029	0.6545	0.4640	0.4396
	Coefficient α_2	0.0838	0.0214	0.0147	0.0419	0.1150
	Coefficient β_1	0.8989	0.5329	0.5706	0.8080	0.7570
	Coefficient β_2	0.0054	0.0017	0.0016	0.0062	0.0248
	R-squared	0.6586	0.7276	0.7548	0.7454	0.7454
	R-squared adjusted	0.5561	0.6459	0.6813	0.6690	0.6691

Table 4-3: Results of the five regression analyses

As expected, only the intercept is required during the stagnation period (first subsample) but both the intercept and the slope trend are required during the second subsample. The results in Table 4-3 indicate the best possible definition of the stagnation and growth periods. The model thus statistically proves where exactly the growth period begins. Table 4-3 illustrates the empirical results of the regression analysis. It indicates that the regression model with the dependent variable FDI fits well with the independent variables (α_1 , α_2 , β_1 , β_2) as the value of the adjusted R^2 is most significant (0.6813) when running the model assuming that the period of increasing FDI inflows begins in 2005. The R^2 and the adjusted R^2 both lead to the same result, supporting the view that $T^* = 2005$. The high value of R^2 (0.7548) also indicates that the explanatory variables included in the equation can explain most of the variation in the dependent variable. The p-values of the variables α_2 and β_2 are

the lowest in 2005 compared to the other years. This is a further indicator that the real change from stagnating to increasing FDI inflows has indeed been in 2005.

4.3 Index Analysis

To fulfill the first and third objective of the study, a descriptive analysis of the secondary data was conducted. This data comprised of the FDI inflows to Kenya over the past 14 years as well as eight other data sets reflecting the different factors influencing FDI inflows to a host country (Appendix B). These factors as elaborated through the literature reviews are: Market Size, Economic Growth, Openness, Political Stability, Corruption Level, Rule of Law, Education Index and Inflation. This analysis clearly indicated the movements of the index values during the two periods and allowed for a comparison of the values during both periods of stagnation and growth.

4.3.1 FDI Inflows

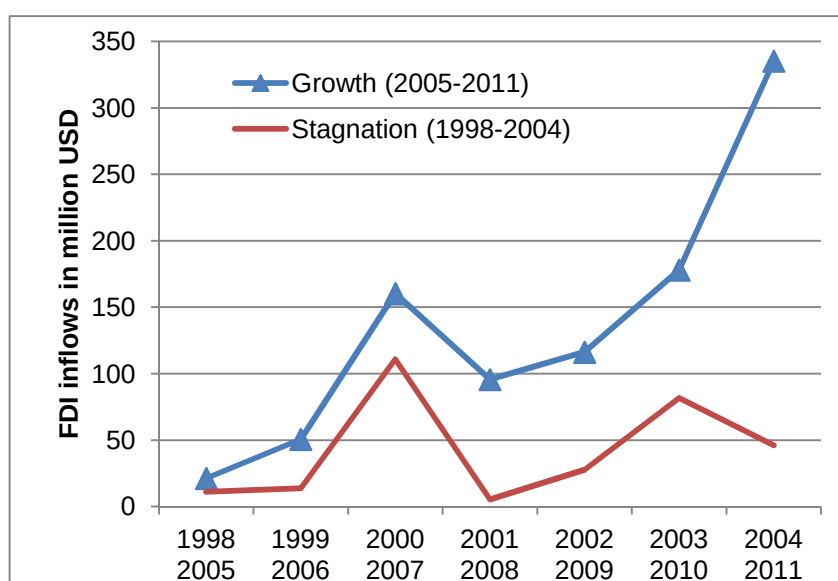
FDI inflows to Kenya are defined as the net FDI inflows between 1998 and 2011. As proven in the previous section, the period of stagnating FDI inflows has been between 1998 and 2004. During this period, the annual FDI inflows stood on average at USD 42.35 million per year with a standard deviation of USD 40.1 million (Table 4-4).

FDI Inflows to Kenya; In million USD	Mean	Median	Std. Dev.	% change of periods' means
1998 – 2004 „Stagnation“	42.4	27.6	40.1	
2005 – 2011 „Growth“	136.8	116.3	103.7	223.0%

Table 4-4: Key Statistical Data "FDI Inflows"

The high standard deviation is contributed to the fact that the annual FDI inflows highly fluctuated from as low as USD 5.3 million in 2001 to USD 110.9 million in 2000. On the other hand, the annual FDI inflows during the period of growth stood at USD 136.77 million, implying a periodical growth rate of over 223% as compared to the period of stagnation.

Figure 4-1: FDI inflows in growth and stagnation periods



The standard deviation stood at USD 103.71 million thus implying slightly more stable FDI inflows than in the previous period. Figure 4-1 illustrates the movements of FDI inflows to Kenya for both periods of stagnation and growth.

4.3.2 Market Size

The determinant market size as measured by real GDP per capita has been increasing during the period of growth as shown in Figure 4-2 and Table 4-5. While the GDP per capita stood at USD 426.5 in 2005, it grew over the next years to USD 478.2 in 2011.

Market size; Real GDP per capita (constant 2000 US\$)	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	409.6	411.1	5.3	
2005 - 2011	455.9	456.8	17.3	11.3%

Table 4-5: Key Statistical Data "Market Size"

The average annual growth of the GDP per capita therefore stood at 1.94% during the growth period whereas an average reduction of GDP per capita of -0.08% per year from 1998 to 2004 could be observed.

Figure 4-2: Market Size in stagnation and growth periods

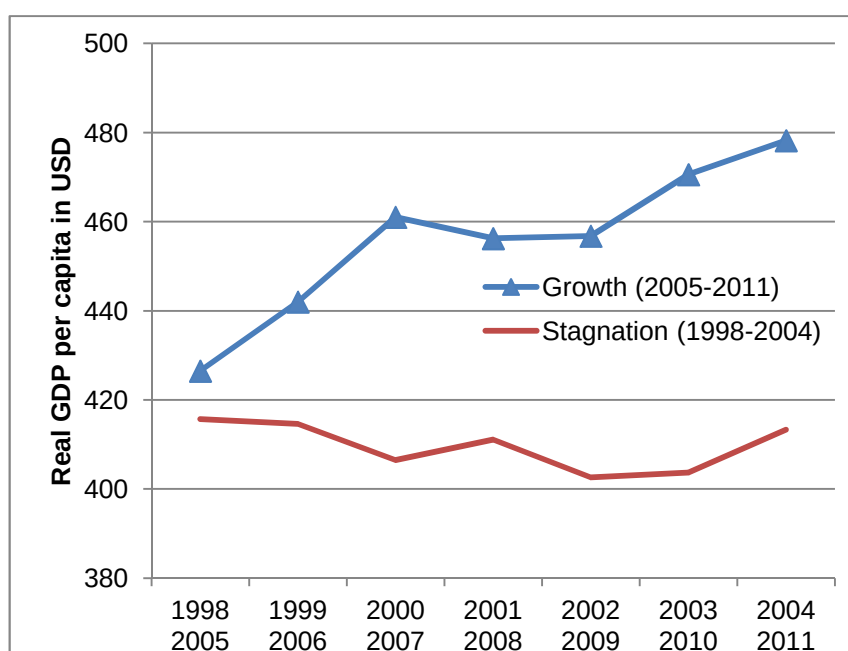


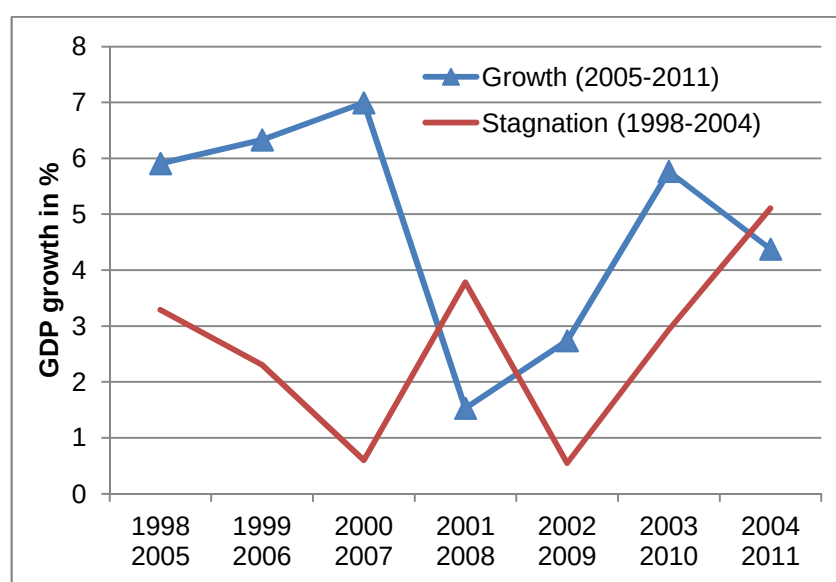
Table 4-5 presents mean, median, standard deviation and the percentage change of the means of both periods. As already shown in Figure 4-2, the mean of the variable stood at USD 409.6 per capita during the period of stagnation and at 455.9 per capita during the growth period. This difference is equivalent to an 11.3% increase of real GDP per capita in Kenya during the period of growth.

In summary, the real GDP per capita has been increasing during the period of growth of the FDI inflows to Kenya. On the contrary, the GDP per capita has been stagnating during the period of stagnation, similar to the FDI inflows. These findings are aligned with numerous research conducted to explain the reasons of increasing FDI inflows (Adugna & Asefa, 2003; Artige & Nicolini, 2006; Asiedu, 2002; Billington, 1999; Kravis & Lipsey, 1982; Krugell, 2005; Wheeler & Moody, 1992). These researchers find that the level of GDP per capita strongly influences FDI inflows to a country because it indicates that scale of economies can be created within large domestic markets. This in turn might lead to higher profits. **Therefore, the hypothesis that a positive relationship exists between market size and FDI inflows can be confirmed.**

4.3.3 Economic Growth

The determinant market size as measured by GDP growth (in %) has on average been higher during the period of growth than in the period of stagnation as shown in Table 4-6 and Figure 4-3. Between 1998 and 2004, the average annual growth rate was 2.65%. On the other hand, it increased during 2005 and 2011 to 4.8% per annum. This increase of the periodical annual growth rate represents an increase of 81.2% when comparing the mean growth rate in both periods. Furthermore, it can also be observed that the volatility of the GDP growth over the entire period (1998-2011) has been high (also compare Figure 4-3).

Figure 4-3: Economic Growth in growth and stagnation periods



During the stagnation period, the standard deviation stood at 1.66% with a mean annual growth rate of just 2.65% (Table 4-6). The standard deviation even further increased during the growth period to 2.02%.

Economic Growth; GDP growth (%)	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	2.65	2.93	1.66	
2005 - 2011	4.80	5.76	2.02	81.2%

Table 4-6: Key Statistical Data “Economic Growth”

The development of the annual GDP growth rates can be explained certain factors. During the period prior to the general elections 2002 in Kenya, the GDP growth rate did not hit the 4% mark. After a change of government in 2002, the GDP growth rate

increased significantly, reaching almost 7% in 2007. As a result of the post election violence in 2008, the growth rate dropped significantly to 1.53% after which it recovered in the years after reaching a high in 2010 of 5.8%.

The findings of this analysis are consistent with the literature. Previous research indicates that high market growth is a strong signal for the future potential of the market. As a result, countries with high growth rates attract more FDI than those countries with low growth rates. An important study of Addison & Heshmati (2003) concludes that a positive relationship between FDI inflows and economic growth in a study conducted in developing countries worldwide. Other researchers such as Nnadozie & Okonkwo (2004) or Agrawal & Ranjan (2011) confirm this finding also for African countries. **As a result, the hypothesis that a positive relationship exists between economic growth and FDI inflows can be confirmed.**

4.3.4 Openness

The variable Openness has been increasing over the years between 2005 and 2011.

Figure 4-4: Openness in growth and stagnation periods

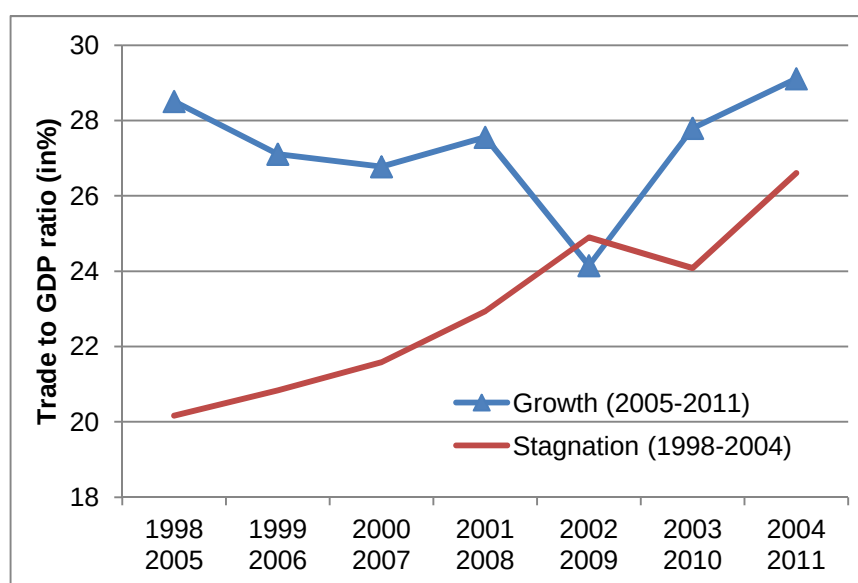


Table 4-7 shows that between 1998 and 2004, the trade to GDP ratio has been constantly increasing (except slight decrease in 2003) from 20.2% (1998) to 26.6% (2004). Even though the trade to GDP ratio was on average higher during the period of growth, it did not increase significantly (Figure 4-4). Standing at 28.5% in 2005, the trade to GDP ratio only rose marginally to 29.1% after decreasing significantly to

24.1% in 2002. On average, however, the GDP to trade ratio stood at 23% during the stagnation period and increased to 27.3% during the growth period (Table 4-7). This represents an increase of 18.6% of the mean values during both periods.

Openness; Trade to GDP ratio	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	23.0	22.9	2.3	
2005 - 2011	27.3	27.6	1.6	18.6%

Table 4-7: Key Statistical Data "Openness"

The standard deviations of the growth (1.6%) and stagnation (2.3%) periods reflect the constantly increasing GDP to trade ratio from 1998 to 2004 whereby the data points were spread over a larger range of values as compared to the period between 2005 and 2011 which saw the ratio increase only slightly without much dispersion from the mean value (27.3%).

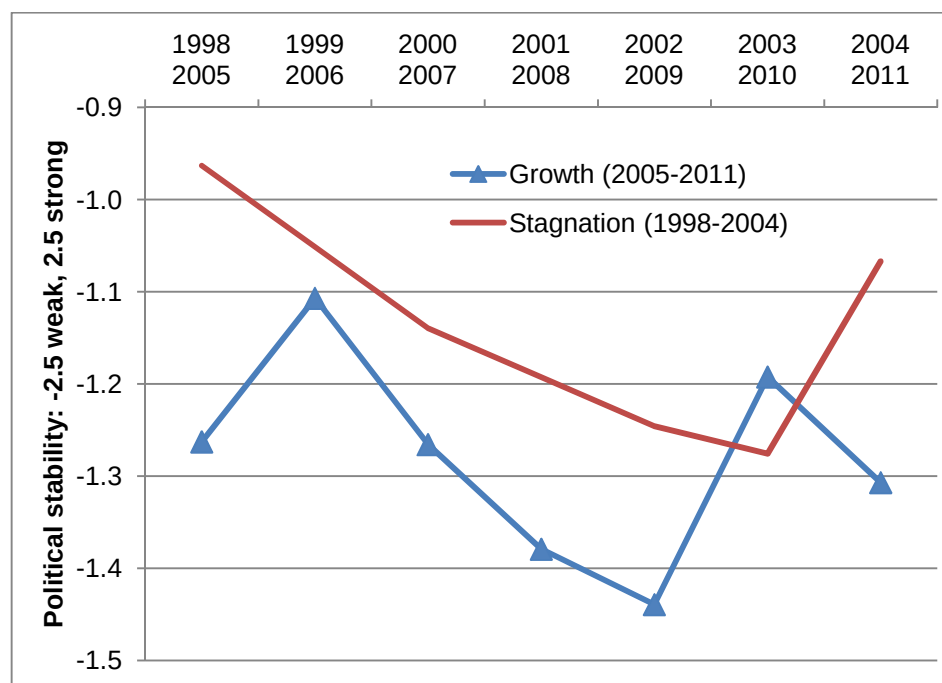
This finding of increasing openness during the period of growth is in line with the majority of research conducted in this area. Magnus Blomström & Kokko (1997), for example, find that the more open a country, the more international companies try to make use of location advantages in this economy. This finding has been confirmed by many other researchers such as Agrawal & Ranjan, 2011; Anyanwu, 2012; Asiedu & Lien, 2003; Asiedu, 2002; Hailu, 2010; Montiel et al., 1997. The study conducted by Asiedu (2002) finds that FDI inflows to Sub-Saharan African countries can be increased by openness to trade. In accordance with these findings is also a study by Culem (1988) who finds that the factor openness is inversely related to FDI inflows only to industrialized countries, however, positively related in developing countries. **Therefore, the hypothesis developed above that a positive relationship exists between the level of openness of a country and its FDI inflows can be confirmed.**

4.3.5 Political Stability

In contrast to Openness, Market Size and Economic Growth, the variable Political Stability has not improved during the period of growth (Figure 4-5). The opposite was rather the case with deteriorating index values during the growth period. The political stability index is measured on a scale ranging from 2.5 (high levels of

political stability) to -2.5 (low levels of political stability). The mean index value during the period of stagnation stood at -1.13 while during the period of growth dropped to -1.28.

Figure 4-5: Political Stability in stagnation and growth periods



This represents a decrease of -13.3% (Table 4-8) when comparing the two periods. As can be seen in Figure 4-5, the index dropped from 1998 to 2003 and slightly increased afterwards before dropping again significantly before and after the election period in 2007.

Political Stability; Worldwide Governance Indicators	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	-1.13	-1.14	0.11	
2005 - 2011	-1.28	-1.27	0.11	-13.3%

Table 4-8: Key Statistical Data "Political Stability"

The index slightly recovered in 2010 only to fall again in 2011 which might strongly be contributed to increasing terrorist attacks on Kenya.

These overall findings are contrary to the findings of other researchers. As has been found in several academic researches, overall political stability is positively correlated with the levels of FDI inflows to a country. A major study in this area includes Busse & Hefeker (2007) who use a sample of 87 developing countries over

a 20 year period and find that several factors of institutional quality, level of education and political risk are significant determinants of FDI inflows. Especially studies focusing on African countries (Dupasquier & Osakwe, 2005; Hailu, 2010; Kyereboah-Coleman & Agyire-Tettey, 2008) arrive at the same conclusion that political stability is indeed necessary to promote FDI inflows to a country. **Consequently, the hypothesis developed that a positive relationship exists between the level of political stability in the host country and FDI inflows cannot be confirmed for the case of Kenya during the period of growth between 2005 and 2011.**

4.3.6 Corruption Level

The variable Corruption Level is measured using the corruption index of the World Governance Indicators and ranges from 2.5 (high levels of Corruption) to -2.5 (low levels of Corruption). A comparison of the stagnation and growth periods reveals (Figure 4-6) that the corruption index has worsened between 2005 and 2011. While improving on an almost annual basis from 1998 (-1.02) to 2004 (-0.8), the index dropped again from 2005 to 2009 (-1.07, all time low). Only afterwards, it slightly improved reaching -0.91 in 2011 (Table 4-9).

Corruption Level; Worldwide Governance Indicators	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	-0.94	-0.97	0.08	
2005 - 2011	-0.96	-0.93	0.07	-2.3%

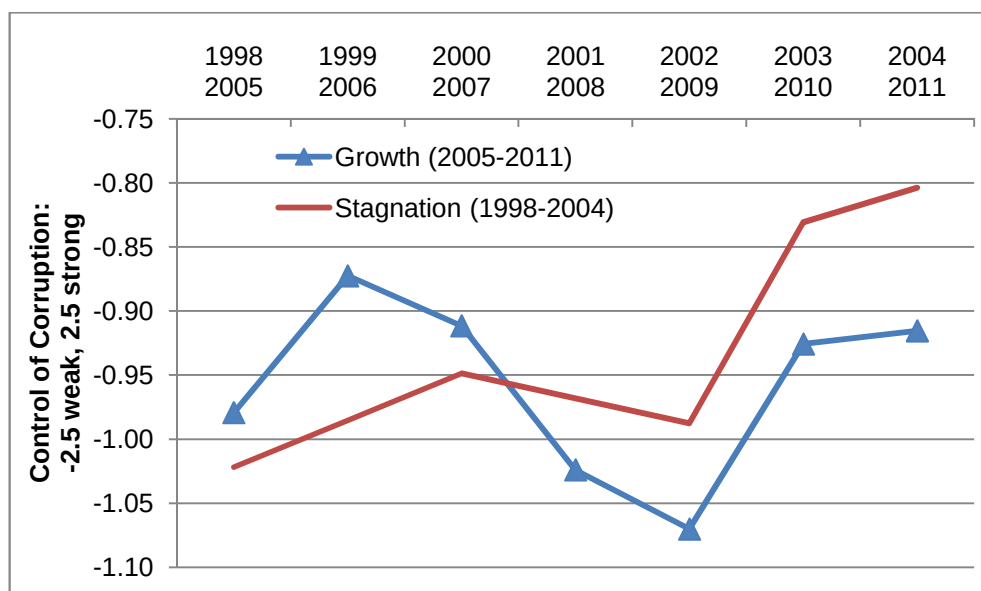
Table 4-9: Key Statistical Data "Corruption Level"

On average, the index mean value during the stagnation period stood at -0.94 but dropped to -0.98 during the period of growth. This decrease represents a percentage change of -2.3%.

The analysis of the variable Corruption Level is not consistent with findings from other research studied. The bulk of studies on this area conclude that high corruption levels hinder FDI inflows to host countries (Disdier & Mayer, 2004; Kersan-Škabić & Orlić, 2007; Kinda, 2010; Voyer & Beamish, 2004; Zhao et al., 2003). The existence of lack of transparency and corruption has been implicated as slowing down economic activity and development and thus negatively influencing FDI

inflows. However, it was also outlaid in the literature review that other studies find no or only insignificant relationships between high corruption levels and its impact on FDI inflows (Al-Sadig, 2009; Anyanwu, 2012; Haksoon, 2010; Khamfula, 2007).

Figure 4-6: Corruption Level in stagnation and growth periods



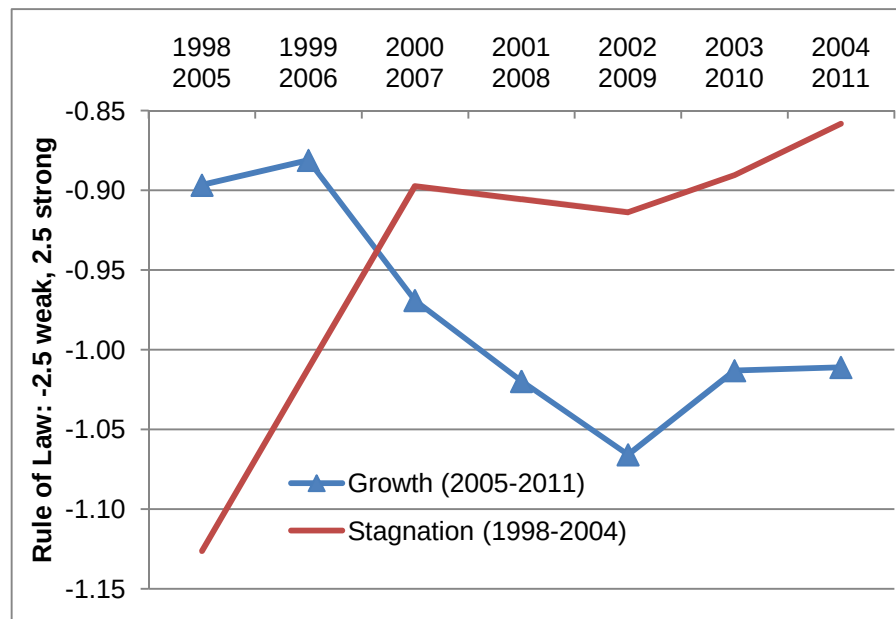
The majority of the studies found a negative relationship between FDI inflows and the existence of corruption while others, such as Anyanwu (2012) and Khamfula (2007), found corruption less influential on FDI inflows. **As a result, the hypothesis developed that a negative relationship exists between the existence of corruption in the host country and FDI inflows cannot be supported.**

4.3.7 Rule of Law

Similar as the corruption index and the political stability index, the Rule of Law index is measured on a scale ranging from 2.5 (high levels of Rule of Law) to -2.5 (low levels of Rule of Law). Comparing the factor Rule of Law during both periods, it is evident (Figure 4-7) that the variable has been lower during the period of growth.

In only two years (2005 and 2006) of the growth period, the variable was lower than during the period of stagnation. The mean values for the two periods were -0.94 (stagnation) and -0.98 (growth) while the standard deviations stood at 0.094 and 0.068 respectively Table 4-10.

Figure 4-7: Rule of Law in stagnation and growth period



Being on a high between 2000 and 2006, the index increased again significantly from 2007 to 2011 (Figure 4-7). This increase might be connected to the events following the elections in 2007. Comparing the means of both periods, the index dropped by 4.3% during the period of growth. In light of the massive increase of FDI inflows to Kenya, this decrease of the rule of law index can be termed marginal.

Rule of Law; Worldwide Governance Indicators	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	-0.94	-0.91	0.09	
2005 - 2011	-0.98	-1.01	0.07	-4.3%

Table 4-10: Key Statistical Data "Rule of Law"

The literature indicates that higher levels of rule of law promote increasing FDI inflows (Anyanwu, 2012; Campos & Kinoshita, 2003). In the case of Kenya, the opposite can be observed. While the mean FDI inflows during the period of growth increased by 223%, the variable rule of law decreased marginally by 4.3% when comparing the periods' means. **As a result, the hypothesis developed that a positive relationship exists between the levels of rule of law and FDI inflows cannot be supported.**

4.3.8 Level of Education

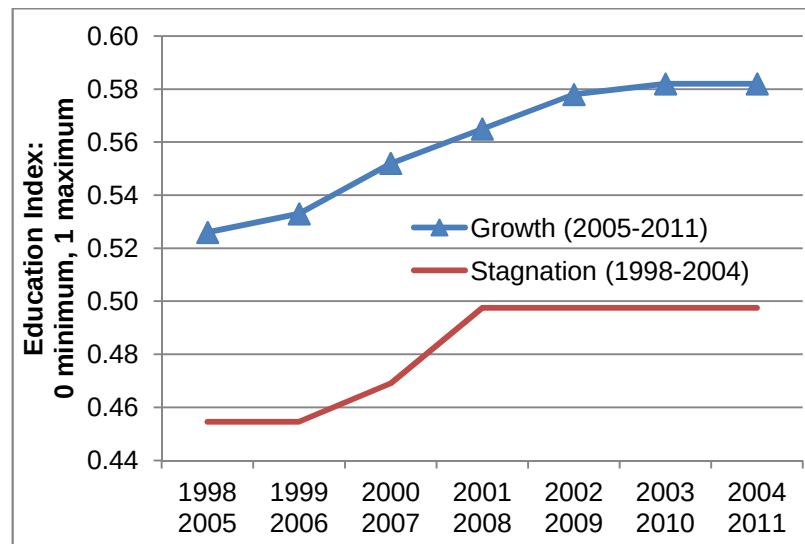
Figure 4-8 shows the development of the education index during both periods of stagnation and growth. It can be clearly seen that the Education index has been constantly increasing throughout both periods. The stagnation of the index between 2001 and 2004 is contributed to the fact that there was no annual data available for these years²¹. The average rating between 1998 and 2004 stood at 0.481 while the scale of the index ranged from 0 (lowest value) to 1 (highest possible value).

Education Index; Human Development Index (HDI)	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	0.481	0.498	0.021	16.3%
2005 - 2011	0.560	0.565	0.023	

Table 4-11: Key Statistical Data "Education Index"

The standard deviations for both periods have been as low as 0.021 and 0.023 for the periods of stagnation and growth respectively thus indicating that the data points are spread over a small range of values and are close to the mean.

Figure 4-8: Education Index during growth and stagnation periods



However, the rating increased during the growth period to an average rating of 0.559 thus representing a periodical increase of 16.3% (Table 4-11). The findings of the

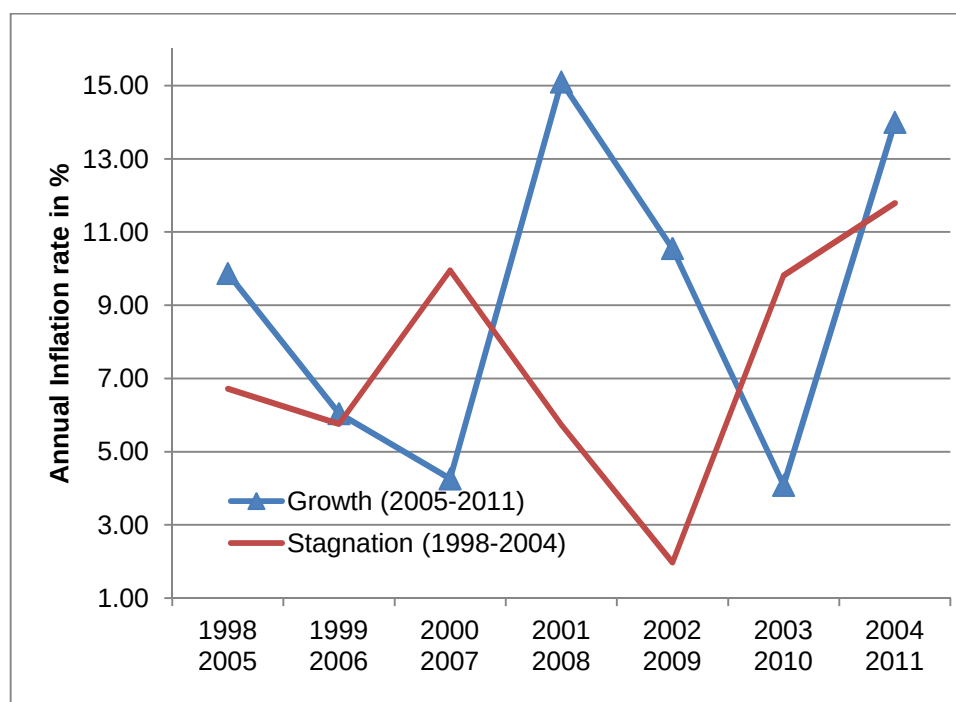
²¹ As a result of missing data, the author used the following formula to estimate the index values for the years 2001-2004: $Index\ value_t = \frac{(index\ value\ 2000 + index\ value\ 2005)}{2}$
 $t = 2001, 2002, 2003, 2004$

analysis of the variable Education Index consistent with the literature. The level of education in a host country plays an important role in determining a company's investment decision. The Busse & Hefeker (2007) investigated the role of education in attracting FDI inflows to a host country and found that it is highly relevant for foreign investors. The level of education in a host country indicates the existence and ease of finding qualified employees for a company's foreign investment. Similar results were found in a study conducted by Tsen (2005). **Hence, the hypothesis that a positive relationship exists between the level of education and FDI inflows can be supported.**

4.3.9 Inflation

The analysis of the inflation variable revealed that on average, the inflation rate of Kenya was lower during the period of stagnation than during the period of growth. As shown in Figure 4-9, the development of the inflation rate over the entire 14-year period was not characterized by any obvious pattern. Three major minimums (2002, 2007 and 2010) and three peaks (2000, 2004 and 2008) can be identified during both periods.

Figure 4-9: Inflation Rate in stagnation and growth periods



However, comparing the average inflation rates of the two periods shows, that the inflation rate increased by 23.6% (Table 4-12). Between 1998 and 2004, the average annual inflation rate stood at 7.39% while it increased to an average of 9.13% during 2005 and 2011.

Inflation; Annual inflation rate (%)	Mean	Median	Std. Dev.	% change of periods' means
1998 - 2004	7.39	6.72	3.34	
2005 - 2011	9.13	9.87	4.48	23.6%

Table 4-12: Key Statistical Data "Inflation"

Further to this and as discussed before, a huge distribution of the individual data points was identified. The variance of the inflation rate from 1998 to 2004 stood at 3.34% whereas it increased to 4.48% during the period of growth. Therefore, this data shows that it is almost impossible to predict the country's inflation annual rate or certain patterns.

These findings are not consistent with the literature. Most studies point out the negative effect of inflation on FDI inflows (Khair-Uz-Zaman & Awan, 2006; Nnadozie & Okonkwo, 2004; Pradhan & Saha, 2011 [for seven South Asian countries only]). In a very recent study, Hailu (2010) confirms these findings on the negative effect of high and volatile inflation rates on FDI inflows in his study on determinants of FDI inflows to African economies. He concludes that inflation has indeed a negative effect on attracting FDI even though it is statistically less robust. **Thus, the hypothesis developed that a negative relationship exists between high levels of inflation and FDI inflows cannot be supported for the case of increasing FDI inflows to Kenya between 2005 and 2011.**

4.3.10 Results of the Index Analysis

Different effects of the eight determinants chosen for the index analysis have been discussed in the literature. The results of this section revealed a mixed picture regarding the compliance of the effects of the factors as established in the literature. While the findings concerning Market Size, Economic Growth, Openness and Level of Education conformed to the findings of the literature review, the hypotheses developed for the factors Political Stability, Corruption Level, Rule of Law and

Inflation could not be confirmed. In contrast to findings of previous studies, the indices of these factors did not move in the expected directions. According to the literature and previous studies, Kenya, during the growth period, should have seen improving corruption levels, lower inflation rates, better rule of law and recovering political stability levels. However, the analysis showed that these factors deteriorated between 2005 and 2011.

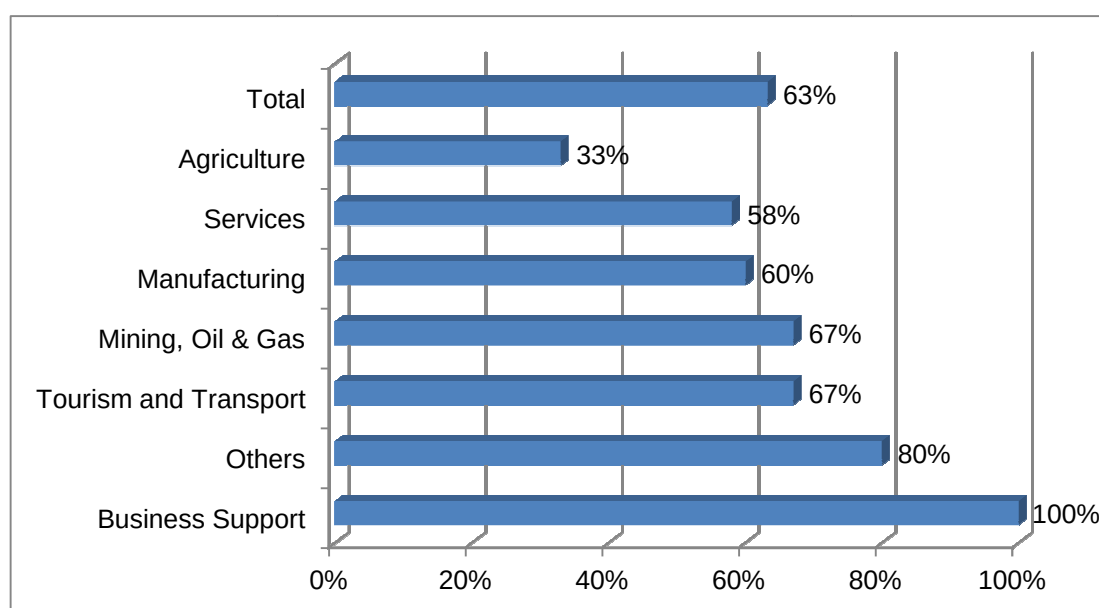
4.4 Analysis of Questionnaires

Further to this analysis of secondary data, questionnaires were sent to Kenyan based companies with at least 10% foreign ownership thus classifying for an FDI. This has been done in order to answer the second objective of the study. A list of companies was provided by the publication “An Investment Guide to Kenya – Opportunities and Conditions 2012” of UNCTAD (UNCTAD, 2012c). The list contains a total number of 68 companies in Kenya (Appendix C) from which the author aimed to get a response from at least 41 companies (60%). The given companies are operating in the following sectors (in brackets are the numbers of companies in each sector): agriculture and related (9), oil and gas (3), manufacturing (25), services (both financial and information communications & technology, 12), tourism and transport (6), business support (8) and others (5). For the further analysis it will be important to differentiate between the different sectors so as to try capturing sector specific views on the increasing FDI inflows to Kenya. The analysis of primary data aimed at increasing the explanatory power of the results found in the index analysis by conducting a study among concerned managers who know best the underlying reasons for or against investments in a country.

4.4.1 Response Rate

From the 68 companies contacted, 43 companies responded and completed the questionnaire. This results in a response rate of 63.23% (Figure 4-10). Two of the 68 companies no longer operated in Kenya and were closed down.

Figure 4-10: Response rates: Total and of each sector



The lowest response rate has been in the agricultural sector with 0.33% only whereas all companies in the Business Support sector completed the questionnaire. A response rate between 58% (Services) and 80% (Others) can be observed for the remaining five sectors. The low response rate for the agricultural sector does not surprise since companies in this sector mainly engage in business-to-business activities and do not have a strong customer focus. On the other hand, firms operating in the services, tourism or business support sectors are very consumer focused and thus have better structures in place to respond to research. In general, follow-up calls, company visits and additional mailings were undertaken for companies of all sectors in order to increase the response rate.

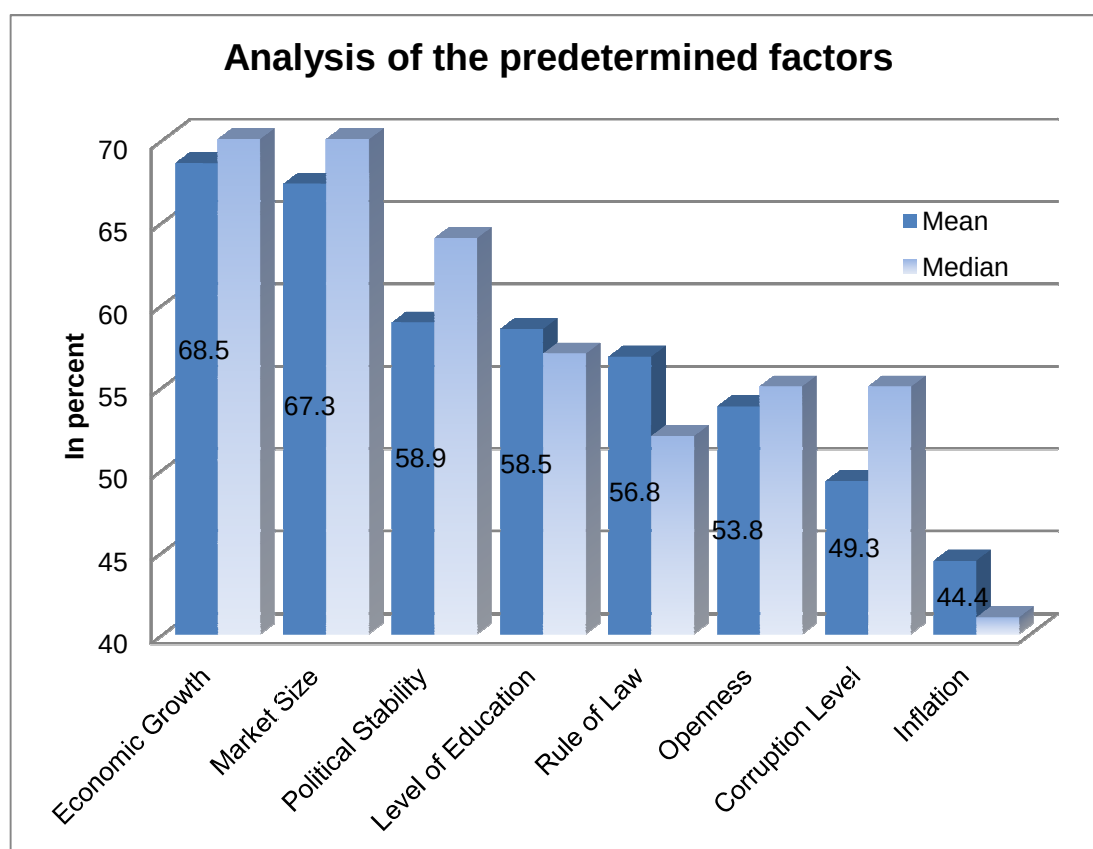
4.4.2 Company Profiling

Company profiling refers to a summary of the nature of companies that were used in the study. Two elements were used for the profiling: period of incorporation (before or after 01.01.2005) and the industry in which the company operates. 37 of the 43 companies completing the questionnaire have been operating in Kenya since before 2005, 6 firms (14%) were set up during or after 2005. Later in the analysis it will be interesting to analyze the different perspectives of companies which entered Kenya before the continuous increase of FDI to Kenya and those having set up their Kenyan entities during the period of increase (2005-2011). The business sectors of the companies have already been summarized in the previous section.

4.5 Analysis of Factors – Predetermined Factors and Comparison with Findings of the Index Analysis

As elaborated in the literature review, a set of eight factors was chosen as influencing foreign direct investments to Kenya. These factors were: Market Size, Economic Growth, Openness, Political Stability, Corruption Level, Rule of Law, Level of Education and Inflation. The respondents had to rate each of these factors on a scale from 0 (no influence on increasing FDI inflows over the past seven years) to 100 (very high influence on increasing FDI inflows). This had been done in order to compare the results of both the index analysis and perceptions from the respondents. The results allowed to be ordered in three categories: high influence (>60%), medium influence (50% - 60%) and low influence (<50%) (Table 4-13).

Figure 4-11: Results of the analysis of the predetermined factors (mean, median, standard deviation)



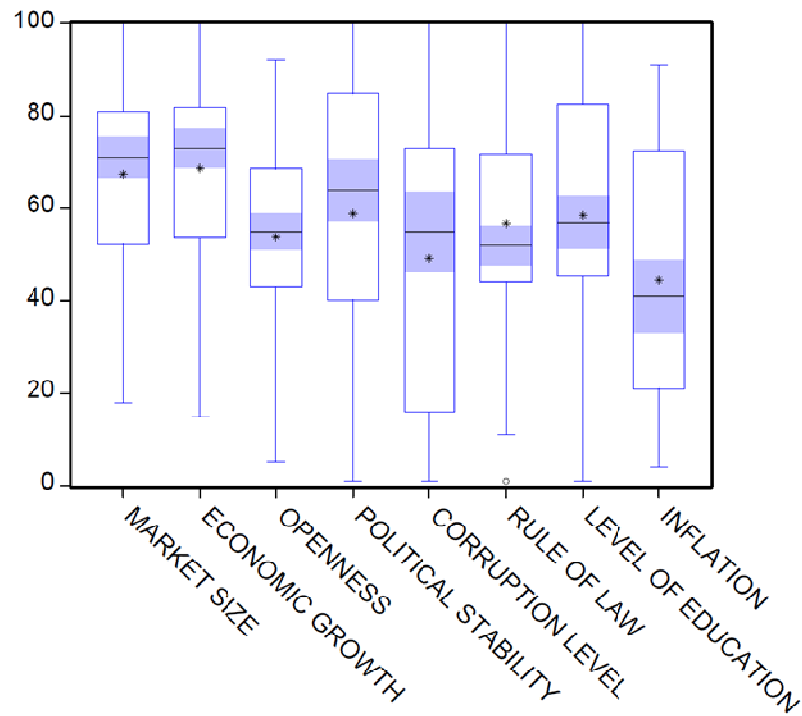
In addition to this analysis, this section also compares the findings of the predetermined factors with those of the index analysis.

	Economic Growth	Market Size	Political Stability	Level of Education	Rule of Law	Openness	Corruption Level	Inflation
Mean	68.5	67.3	58.9	58.5	56.8	53.8	49.3	44.4
Median	73	71	64	57	52	55	55	41
Std. Dev.	19.09	19.93	30.94	27.02	23.57	20.95	32.16	27.41
Skewness	-0.70	-0.65	-0.55	-0.41	-0.11	-0.57	-0.16	0.20

Table 4-13: Key Statistical Data of the Predetermined Factors' Rating

Before finally analyzing the different factors individually, the graphical expression of the five-number summaries (box plots) of all the eight factors is introduced (Figure 4-12).

Figure 4-12: Box plots of the predetermined factors



The box plots are a convenient tool of illustrating the ratings using (1) the smallest observation (sample minimum), (2) lower quartile (Q1), (3) median (Q2), (4) upper quartile (Q3), and (5) the largest observation (sample maximum). In addition to this, the mean value of each factor is indicated by a * in each box plot (Figure 4-12). The box plots also provide an indication of the degree of dispersion and skewness in the data.

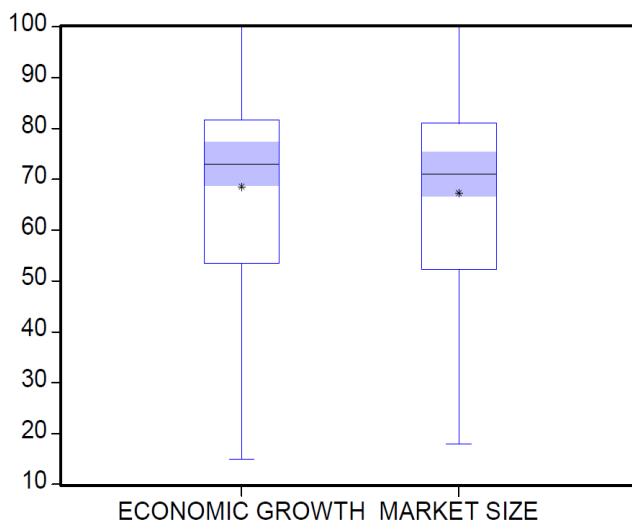


Figure 4-13: Box Plots, High influence factors

4.5.1 Factors of High Influence

Of high influence on the increasing FDI inflows to Kenya were the factors Economic Growth and Market Size each having an average rating of 68.5% and 67.3% respectively. Both factors also had the lowest standard deviation of all factors with 19.09% and 19.93%

respectively (Figure 4-13). The box plots of both variables (Figure 4-13) also indicate the low degree of dispersion and show that the data is negatively skewed. The box plots of both variables are more than double the size between Q1 and Q2 than between Q2 and Q3.

4.5.2 Factors of Medium Influence

Four factors were rated having a medium influence on the increasing FDI inflows. These factors were Political Stability, Level of Education, Rule of Law and Openness. **Political Stability** was rated as third highest predetermined factor at 58.9%. This indicates that the respondents appreciate the relative political stability of Kenya compared to other countries in the region. Furthermore and as directly indicated by some respondents, the rating of this variable shows that the respondents recognize the changing environment since the major change of government procedures and influence since 2002. However, one cannot ignore the high dispersion (standard deviation of 30.94%) of the ratings provided on this factor. The high standard deviation of Political Stability (second highest of all factors) indicates that the ratings are spread out over a large range of values. This fact allows drawing the conclusion that the respondents are strongly divided in their rating of the variable. A big part of the respondents thus perceive the political stability levels in Kenya as a strongly positively contributing factor to increasing FDI inflows. On the other hand, a similarly big proportion of the respondents rather rate the factor as not having a strong positive influence. This fact can also be seen in the size of the box

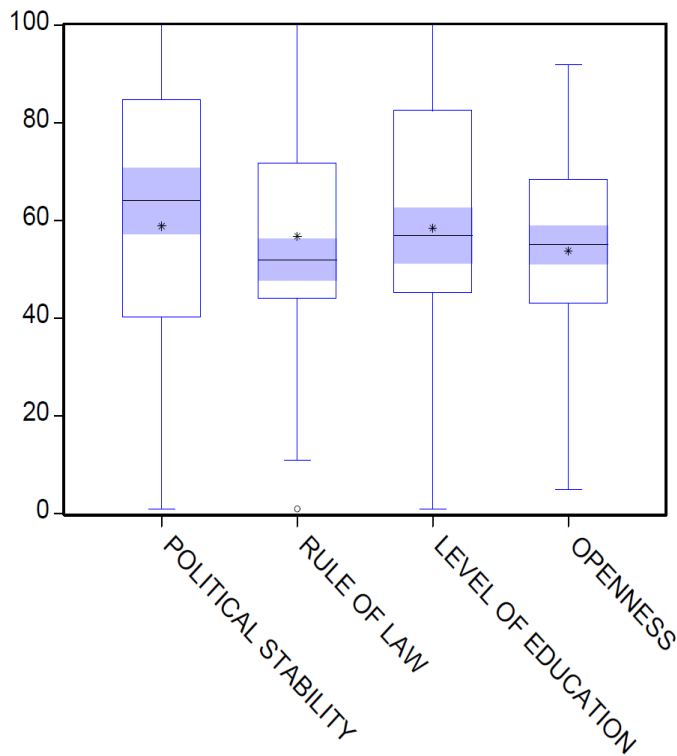


Figure 4-14: Box plots, Factors of medium influence

plot of this variable (**Error! Reference source not found.**) and its strongly negatively skewed data (0.55) indicating many extreme outliers to the left side.

The variable **Level of Education** was the fourth highest rated factor being rated at 58.5%. It also had a high standard deviation of 27.02%. The box plot (**Error! Reference source not found.**) and measure of skewness (Table 4-13) showed that the data was negatively skewed (-0.41). This means that most values are

concentrated on the right side of the mean with extreme outliers to the left side. The left skewed data indicates that even though the median was at 57%, many respondents opted to rate this factor much lower thus recognizing the factor Education Level as being less influential to the increasing FDI inflows.

With 56.8%, the variable **Rule of Law** was rated the fifth highest variable contributing to the increasing FDI inflows from 2005 to 2011. The standard deviation of 23.57% was as well one of the lowest of the predetermined variables. The data was slightly left skewed (-0.11, Table 4-13) with more extreme outliers to the left side.

The last of the factors of medium influence was **Openness** with an average rating of 53.8%. Also having a low standard deviation of 20.95%, the data was slightly right skewed when analyzing its box plot in Figure 4-13. Half of the respondents rated Openness using values within the “small” range Q1 and Q3. This is as well an indicator for the relatively small standard deviation.

4.5.3 Factors of Low Influence

Corruption Level (49.3%) and Inflation (44.4%) were the only two factors with a low influence on FDI inflows. Interestingly, the factor **Corruption Level** had the highest standard deviation of all factors (32.16%). This can also be observed when having a look at the variable's box plot (Figure 4-15). The distance between Q1 and Q3 of this variable was by far the highest of all eight factors studied. Nonetheless, the data was only slightly negatively skewed thus indicating that the respondents only to some extent rated this factor with more extreme outliers to the left.

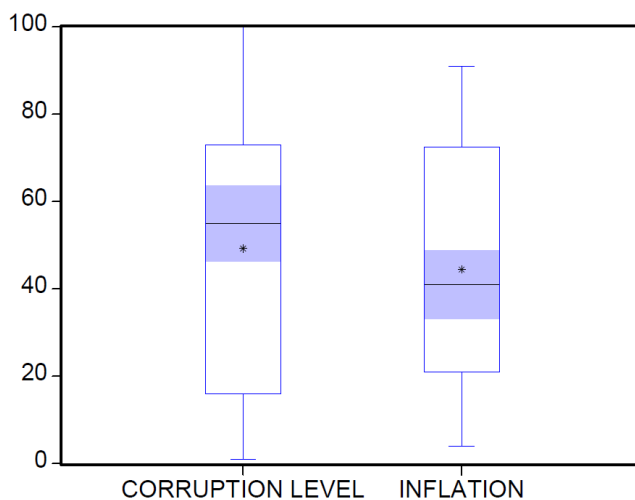


Figure 4-15: Box plots, Factors of low influence

The lowest rated factor was **Inflation** with an average rating of 44.4% and a relatively high standard deviation of 27.41%. As with Corruption Level, this high dispersion is also reflected in the distance between Q1 and Q3 of the box plot of this variable (Figure 4-15). The factor Inflation was the only variable with a positive skewness (0.2).

4.5.4 Comparison with Secondary Data Analysis

Market Size and **Economic Growth** proved to be important factors in both the analysis of primary (questionnaires) and secondary (publicly available) data. In addition, a positive relationship between increasing FDI inflows and economic growth and market size was found in other studies conducted worldwide (Artige & Nicolini, 2006; Billington, 1999; Kravis & Lipsey, 1982; Krugell, 2005; Wheeler & Moody, 1992) and in Africa in particular (Adugna & Asefa, 2003; Agrawal & Ranjan, 2011; Asiedu, 2002; Nnadozie & Okonkwo, 2004). When comparing their periodical mean growth, the variables market size and economic growth grew by 11.3% and 81.2% respectively. Again, the respondents rated both factors as the most important drivers for the increasing FDI inflows between 2005 and 2011.

Factors of low influence according to the primary data analysis were **Political Stability, Level of Education, Rule of Law** and **Openness**. The secondary data revealed that for the case of increasing FDI inflows to Kenya, several hypothesis about underlying factors which were strongly supported by other studies, had to be dismissed. For the case for Political Stability and Rule of Law, the common theory that FDI inflows increase when these two factors improve did not apply in Kenya between 2005 and 2011. However, the analysis results for Level of Education and Openness both complied with other research in this area. Compared with the results of the primary data analysis, these results agree to a certain extent in both types of analyses. Political Stability and Rule of Law were only rated as factors of medium influence to the increasing FDI inflows. Furthermore, Political Stability in the secondary data analysis proved to have the second largest standard deviation of all factors which also indicates the wide range of ratings provided by the respondents. It can also be noted that especially the factor Rule of Law only marginally decreased (-4.3%, Political Stability -13.3%) when comparing the means of both stagnation and growth period.

4.6 Analysis of Factors – Individual Factors

These eight predetermined factors were used because they are the most common mentioned in the relevant literature. However, companies base investment decisions considering a comprehensive set of determinants and not only eight factors. Therefore, the questionnaires gave the respondents the opportunity to name and rate up to eight more factors having influenced the continuous decrease of FDI inflows over the past years other than the predefined ones.

4.6.1 Section Completion Rate

More than 65% of the respondents (28) gave insights on additional factors (see Figure 4-16). In total, 102 individual factors were provided by all respondents. However, ten of the given factors indicated that the respondent did not understand the question correctly and were thus removed from the further analysis.²² Following

²² Appendix D shows the complete list of all answers given by the respondents. It also includes the answers assuming that the respondents did not understand the question correctly.

these adjustments, only 26 respondents (60.5%) provided valuable answers to this section of the questionnaire.

Figure 4-16: Response Rate Individual Factors

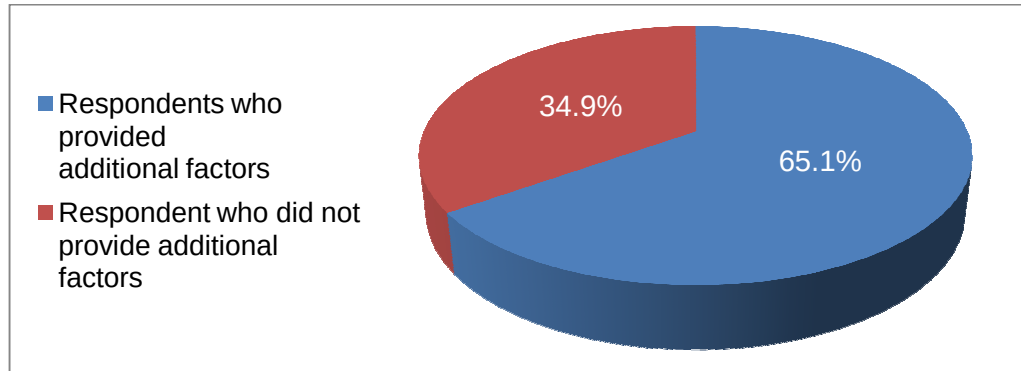
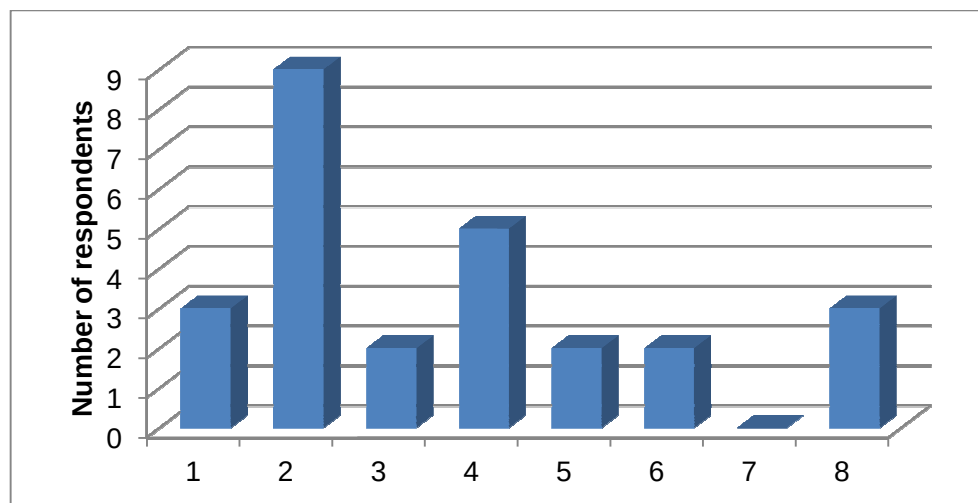


Figure 4-17 shows how many factors were provided by each respondent (in total 93). Thus on average, 3.3 additional factors were provided per respondent providing information in this section of the survey.

Figure 4-17: Number of additional factors provided by respondents

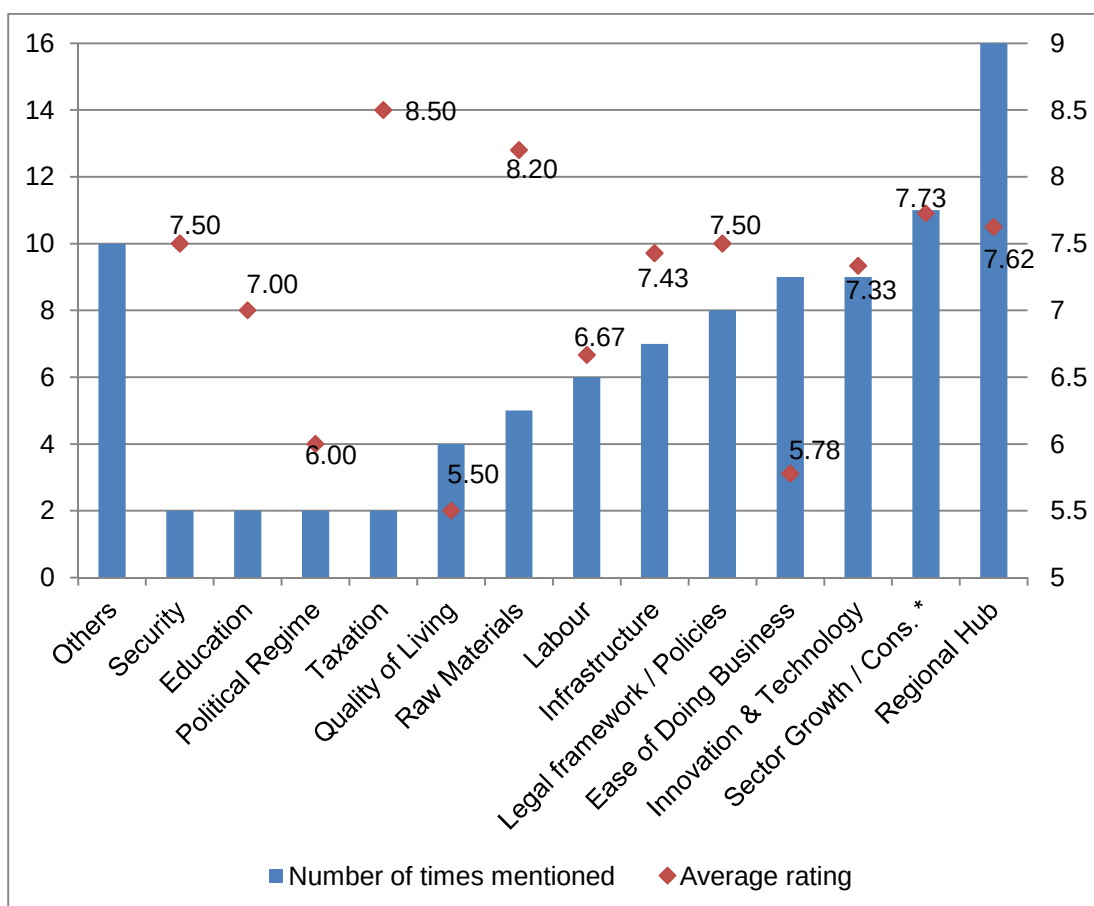


4.6.2 Clustering of Individual Answers

Clustering of the individual factors was necessary for further analysis. Grouping the factors required to develop a set of 14 different factors (plus “Others”; See Figure 4-18 and Appendix D). These determinants cover mainly issues which are not reflected in the previous analysis of the predetermined factors. However, one factor relates to a predetermined factor: Education. It was mentioned and rated two times when asked about the individual determinants. It could also be argued that the factor

Sector Growth / Increased Consumption relates to the predetermined factors Market Size and Economic Growth. Nevertheless, the factor is created because it includes more features than simply measure Market Size measured as GDP per capita or Economic Growth as GDP growth rate as indicated by the respondent's answers. Many respondents, for examples, mentioned the increasing middle class as a factor²³. It would be speculation to state that a direct relationship between increasing GDP per capita and a growing middle class exists because the index of GDP per capita does not entail information about the distribution of incomes within a country. Therefore, the variable Sector Related Growth / Increased Consumption is kept as individual variable.

Figure 4-18: Number of times an individual factor was provided by respondents and their average rating



* the complete name of this factor is Sector Related Growth / Increased Consumption

²³ These answers have also been included to the factor Sector Growth / Increased Consumption

A rating of individual factors was possible using a scale from 1 to 10 whereas 1 stood for a very low influence on increasing FDI inflows to Kenya between 2005 and 2011 and 10 for a very high influence on the increasing FDI inflows. As can be seen in Figure 4-18, most of the individual factors were rated higher than the predetermined factors. Only Political Regime, Quality of Living, Labor and Ease of Doing Business were rated lower than the highest rating given to a predetermined factor Economic Growth which was rated 68.5%. The following sections analyze each of the factors provided by the respondents.

4.6.3 Regional Hub

The factor Regional Hub was the most often mentioned individual factor (16 respondents or 17.2% of total) of the survey. On average it was rated at 7.63 and was thus among the highest rated individual factors (factors Raw Materials and Taxation were rated 8.2 and 8.5 respectively). Further to this, its variance of 1.41 was among the lowest variances measured for an individual factor.

The literature supports the importance of the factor Regional Hub. This factor entails different concepts such as the agglomeration effect. Agglomeration generally takes into account the importance of a country/city within its neighboring country as well as on a company level. Agglomeration effects describe the clustering of firms within a certain area. According to a research on FDI determinants (Artige & Nicolini, 2006), agglomeration effects signal high quality of infrastructure, human capital, specialization and higher competition which affect both horizontal and vertical FDI. Literature (Campos & Kinoshita, 2003) identifies three reasons for companies to locate close to each other. Firstly, foreign companies share technology spillovers such as knowledge about how to invest in the host country. Secondly, suppliers of production inputs and buyers of products produced by a company locate close to each other in order to reduce transaction costs. Lastly, companies can share among a pool of skilled labor and specialized production inputs when clustering near each other. Some respondents clearly indicate the ease of doing business within the region. Regional Hub thus also takes into consideration different factors related to openness when viewed from a perspective of economic treaties and integration between countries. In his study, Anyanwu (2012) concludes that enhanced regional cooperation and integration will increase FDI inflows to African countries. Given the

fact that many African domestic markets are small compared to most European and Asian countries, stronger regional integration will promote investments in African countries. Another study (Neumayer & Spess, 2005) found that the higher the number of bilateral investment treaties, the higher the increase of FDI flows.

Studies on the effect of agglomeration find similar results as provided by the respondents. Different researchers find agglomeration effects relevant and positively relating to FDI inflows. Studying FDI determinants of US based companies, Wheeler & Moody (1992) find agglomeration effects as being a highly significant factor in an investment decision abroad. For the case of Africa, a study (Anyanwu, 2012) finds agglomeration to have a strong impact on FDI inflows to Africa. Kyereboah-Coleman & Agyire-Tettey (2008) find that existing foreign investments in a country attract even more FDI to the same country. An extensive study conducted of 92 French departments reveals that the capital city Paris and regions close to the country's borders are main recipients of FDI to France. For the case of Hungary, a study (Boudier-Bensebaa, 2005) disclosed that FDI inflows are received within the region around the capital Budapest. For the case of America (Feils & Manzur, 2008) and Canada (Shapiro & Globerman, 1999), similar results have been obtained regarding the effect of trade agreements on FDI flows.

4.6.4 Sector Related Growth/Increased Consumption

Even though someone can argue that this determinant is closely linked with the predetermined variable market size, it is worth differentiating between the simple factor Market Size measured in GDP per capita, and actually sector related growth and increased consumption in certain sectors. In a recent study (Anyanwu, 2012), it was found that market size measured in terms of urban population share has a strongly significant relationship with FDI inflows to Africa. This indicates that certain consumption patterns of the urban population in Africa attract FDI. This finding can actually be confirmed by some of the answers provided by the respondents:

- “Increasing affluent middle-class market and consumerism among young upcoming professionals”,
- “Population increase in urban counties has driven real estate sector growth”,

- “Increasing urban population - market for manufactured goods and housing”,
or
- “Burgeoning middle class - increasing market for goods e.g. cars and other
leisure goods & services”.

Other answers simply relate to population growth in general or touch on certain sector related growth issues such as increased energy demand, housing, service industries or the horticultural sector.

4.6.5 Innovation & Technology

Nine respondents (9.7%) pointed out that an underlying factor for the increasing FDI inflows to Kenya was the openness and adaption of innovations and technologies in Kenya. The average rating of this variable was 7.33 out of ten. Respondents praised the technology savvy population and newly implemented IT solutions which radically ease business processes such as mobile payments. Furthermore, it was emphasized that the internet is affordable in Kenya and people learned how to create business with it.

4.6.6 Ease of Doing Business

The factor Ease of Doing Business was the fourth most often mentioned factor (9.7% of total answers provided). Interestingly, it was also the second lowest rated factor with an average rating of 5.78, slightly above Quality of Living (5.5). This shows that the ease doing business in Kenya was an important factor for the increasing FDI inflows to Kenya; however, the poor rating also reveals that there is room for improvement in this regard.

A study undertaken by the The World Bank Group (2010) compares the ease of doing business in countries worldwide. In this publication, Kenya ranks slightly above (57.9%) the regional average (51.5) in terms of starting a foreign business. The duration of setting up a business Kenya by far outpaces global as well as regional scores with 34, 42 and 48 days respectively. However, the number of procedures to set up a business stands at 12 compared to 10 as regional and global average. The fact that many respondents specified that Kenya is a favorable destination for doing business is supported by the World Bank report of 2010 in which Kenya proved to perform better in certain key areas than the regional average.

4.6.7 Legal Frameworks/Policies

Eight respondents found the legal framework and implemented policies in Kenya to be an influential factor to the increasing FDI inflows during 2005 and 2011. The average rating was at 7.5 out of ten.

The literature studied generally agrees with the positive effects of proper legal frameworks and policy implementation as a promoting factor to FDI inflows. The reasons for this are quite obvious: before investing in a foreign country, investors have to properly study and consider different dimensions of a country's legal system before engaging in business activities. Dupasquier & Osakwe (2005) find in their study that an inhospitable regulatory environment and poor governance prevent FDI. Additional factors suppressing FDI inflows to developing countries found in another study (Tarzi, 2005) include foreign ownership restrictions in specific sectors and capped repatriation of profits. However, one study undertaken by Kyereboah-Coleman & Agyire-Tettey (2008) concludes that the liberalization process in Ghana does not increase FDI inflows to the country. Similar results were established by Do Rouen & Biglaiser (2006) who conclude that FDI inflows are not assured even if new policies and improved legal systems were implemented. However, the evidence on reforms and legal systems positively influencing FDI inflows is overwhelming. In most recent studies (Hailu, 2010), the authors (Mohamed & Sidiropoulos, 2010 [for the case of 23 MENA countries]) call for increased government actions to increase trade, cede control over capital markets, strengthening government owned institutions and allow more foreign ownership.

4.6.8 Infrastructure

Seven respondents (7.5%) wrote that favorable infrastructure and increased investments in infrastructure projects have been a great factor to increasing FDI inflows to Kenya during the growth period (2005-2011). With an average rating of 7.43, the factor was as well highly rated.

This finding does not surprise and much research has been undertaken to explain the connection between increased investments in infrastructure and high FDI inflows. Different researchers find this factor being a key FDI promoter for the case of African countries (Ancharaz, 2003 [infrastructure measured in terms of number of

telephone lines only]; Anyanwu, 2012; Asiedu, 2006; Cotton & Ramachandran, 2001; Dupasquier & Osakwe, 2005; Hailu, 2010; Musila & Sique, 2006). They all show that infrastructure conditions of the host countries are positively related to FDI inflows and that FDI inflows even depend on the development of infrastructure. The same effect has been proven for other developing and emerging countries (Adams & Mengistu, 2007; Zhang, 2001 [for the case of China]) as well as developed countries (Botric & Skuflic, 2006; Kersan-Škabić & Orlić, 2007). For the case of Africa, only one study (Nnadozie & Okonkwo, 2004) was found which indicated a less robust evidence of the role of infrastructure on FDI inflows for the case of FDI from the United States of America.

4.6.9 Labor

Six respondents or 6.5% of the sample stated that favorable labor conditions in Kenya promoted FDI inflows to Kenya between 2005 and 2011. Gaining an average rating of 6.67, this factor, however, was one of the lowest rated variables. Respondents mainly mentioned available and affordable (some wrote “cheap”) labor under this category. One respondent highlighted the accountability and leadership skills of Kenyans as the reason for increasing FDI inflows during the period of growth. What became also clear is that the Kenyan job market offers a good basis of affordable skills.

Conditions related to the labor market of a host country have a strong influence on FDI flows. In their study, Agrawal & Ranjan (2011) find that if labor costs in one of the BRIC countries would decrease by 1%, FDI inflows will increase by 0.49%. This factor is also found to be highly significant to increasing FDI inflows in a study conducted in African markets (Hailu, 2010). High labor costs were found to hinder FDI inflows in a study conducted in 20 African countries (Pradhan & Saha, 2011) while the same study revealed that the level of stock of human capital has a positive effect on FDI.

4.6.10 Raw Materials

The availability and access to natural resources has been perceived as an influencing factor to increasing FDI inflows by five (5.4%) respondents. The average rating of this factor was the second highest of any factor with 8.20. Considering that only few

of the interviewed companies have a direct interest in the availability and access to natural resources, this factor can be considered as highly important to contributing positively to the period of growth.

The literature on this topic also provides a wide range of studies confirming the importance of this factor to FDI inflows. It is hereby not only important that a country is rich in raw materials but also allows foreign investors access to them. Several studies reveal the importance of natural resource endowment especially for FDI inflows to Africa (Asiedu, 2002; Dupasquier & Osakwe, 2005; Hailu, 2010; Pradhan & Saha, 2011). All these studies concluded that this factor is positively significant thus underscoring the fact that FDI inflows to Africa are mainly resource seeking. In yet another study in African countries (Anyanwu, 2012), the abundance of natural resources (oil in particular) proved to be a statistically highly significant determinant for four sub-regions (East, West, North and South) in Africa. This, the study continues, indicates that reforms being carried out by the individual economies in these regions are attracting foreign investors. An earlier study (Asiedu, 2006) carried out in 22 African countries establishes that those countries with available and accessible natural resources attracted higher FDI inflows in the period between 1994 and 2000. Similar results were also found in other regions across the world. A study (Eshghi, Deichmann, Haughton, Sayek, & Teebagy, 2003) conducted in Eurasian transition economies as well concurs with the importance of natural resources as a determining factor for FDI inflows to these countries. A key determinant of FDI inflows to Middle East and Northern Africa countries was as well found to being the abundance of natural resources (Mohamed & Sidiropoulos, 2010).

4.6.11 Quality of Living

Quality of Living in Kenya as whole and Nairobi in specific has been mentioned by four respondents (4.3%) as an important factor of increasing FDI inflows to Kenya over the past years. The average rating, however, has been the lowest (5.5) thus indicating that the quality of living is an important factor, however, that it is not a key decision making variable. In this section of the questionnaire, different answers were provided ranging from favorable climate conditions and tourism activities to general ease living for expatriates. And indeed, with its European summer-like temperatures, Nairobi in particular is a favorite place for European expatriates to

settle. In addition, with its regional hub for air transports and shopping malls offering “Western” products, Nairobi has become a preferred city in East Africa to attract foreign employees.

4.6.12 Taxation

Two respondents (2.5%) stated that Kenya was able to attract increasing FDI inflows during the growth period because of its favoring taxation regulations. The effect of taxation on FDI is a widely studied area in the literature and provides very mixed evidence. Even though this factor was not as important as others, the literature provides extensive research conducted globally on the determinant taxation. However, this factor also seems to be one of the most disputed determinants influencing FDI flows. In a recent study (Demirhan & Masca, 2008) it was found that the literature on this topic is not conclusive as both affirms and negates taxation as a relevant factor.

4.6.13 Political Regime

Two respondents (2.2%) as well pointed out that the current political regime as indeed being a determinant of their engagement in the region. Even though rated as a factor among the predetermined factors, these two respondents stated that the political regime is favorable for conducting their business.

4.6.14 Education

Even though respondents were asked to rate this factor as part of the predetermined factors, two respondents gave answers relating to education in this section as well. With a rating of 6.0 it was as well one of the lowest rated factors. The two respondents both highlighted the high skill level of Kenyans in general and appreciated the high literacy levels in Kenya. These findings have already been confirmed by previous research and conform with the analysis of the factor Education Level as stated above (Busse & Hefeker, 2007; Tsai, 1994).

4.6.15 Security

Another two responses (2.2%) were related to security issues. The respondents recognized the security measures provided in Kenya and implemented during the

period of growth. The two respondents pointed out the generally high security levels countrywide and in comparison to neighboring countries and Kenya's alliance with "Western" countries regarding terrorism.

Chapter 5 Conclusions, Recommendations and Limitations

5.1 Introduction

This chapter presents a summary of the study giving the implications of the findings based on the research objectives, conclusions and recommendations. It is organized as follows: first the summary of the study is presented followed by the research findings and implications; thirdly, recommendations for action and areas of further study are made and fourthly, limitations experienced during the study are presented. Section 5.2 provides a summary of the study while the following section (5.3) discusses the findings and conclusions. Implications and recommendations of the study follow in Section 5.4 while Chapter 5 concludes with the limitations of the study in Section 5.5.

5.2 Summary of the Study

This study aimed at establishing the reasons for the increasing FDI inflows from 2005 to 2011 to Kenya and compared these findings with the factors which, in previous periods, hindered higher FDI inflows. A trend of stagnating FDI inflows can be observed from the 1980ies until 2005 thus raising the question what factors exactly contributed to the rising FDI inflows. The study therefore established the reasons for the increasing FDI inflows using two analysis tools: (1) an analysis of publicly available indices and (2) an analysis of primary data acquired through questionnaires. The questionnaires were split into two sections, whereas in its first part the respondents had to rate the same factors as used in the index analysis (scale between 0 [no influence on FDI inflows between 2005 and 2011] and 100 [very high influence on FDI inflows between 2005 and 2011]). The second section asked the respondents to name and rate up to eight additional factors which in their own opinion contributed to the increasing FDI inflows during the period of growth. The findings of these analyses revealed interesting information about the motivations and reasons for increasing foreign investments into Kenya.

5.3 Findings and Conclusions

Sub-Saharan Africa as whole and Kenya in specific still have to improve the environment for foreign direct investments. The benefits of FDI for the recipient

countries are immense and, in light of high interest rates, increasing inflation and relatively small capital markets, have an important role to play in bringing fresh capital to the local markets. However, when comparing Africa with other regions in the world, the continent, especially Sub-Saharan Africa, only receives a small fraction of global FDI flows. Even though Kenya is among the better placed recipients of FDI in Africa, FDI inflows are still far behind other developing countries worldwide. Nonetheless, an encouraging trend of increasing FDI inflows to Kenya was observed in this study.

The following section is split into two subsections. Firstly, the results of the index analysis are presented. Afterwards, the findings from the questionnaires are introduced whereas the findings of the predetermined factors are separately looked at from the findings of the individual factors.

Table 5-1 below shows in summary which of the analyzed effects of the factors on FDI inflows (index analysis only) conform with the effects as discussed in the literature.

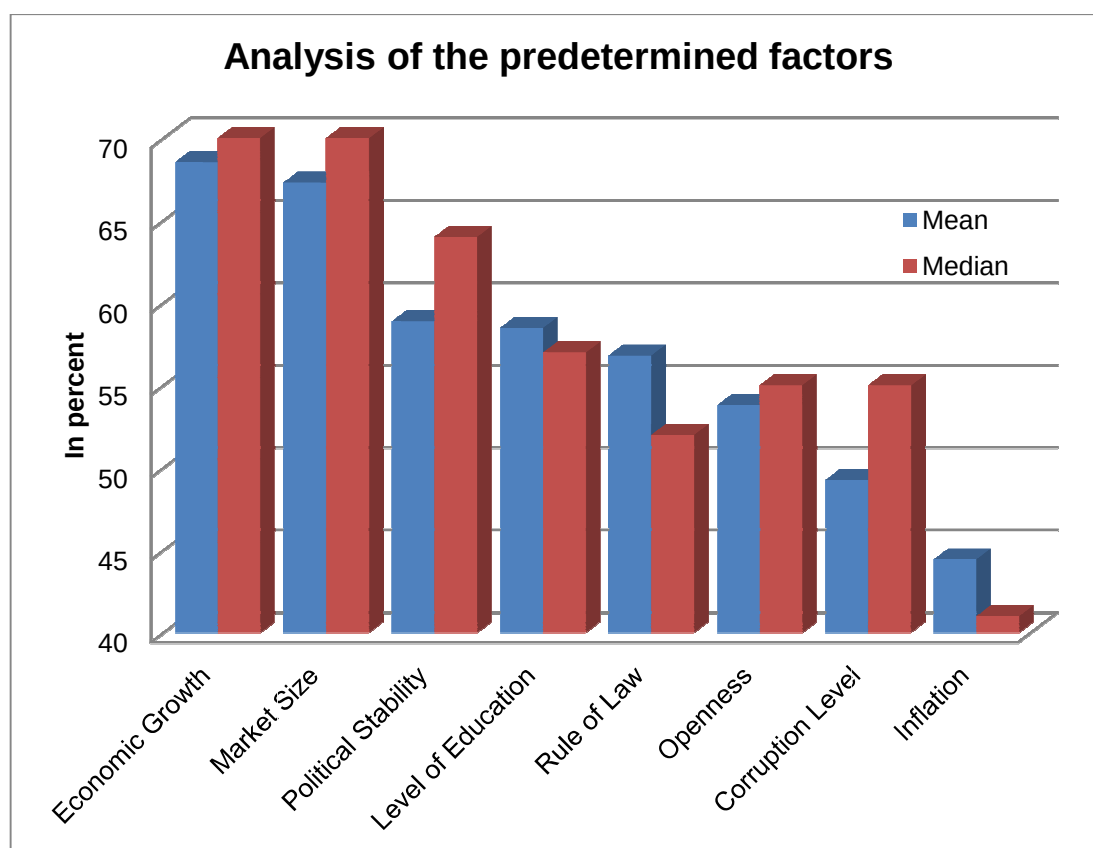
Effects of Determinants		
Determinant	Effect as per literature	Compliance of index analysis with literature?
Market Size	Positive	Yes
Economic Growth	Positive	Yes
Openness	Positive	Yes
Political Stability	Positive	No
Corruption Level	Negative	No
Rule of Law	Positive	No
Education Index	Positive	Yes
Inflation	Negative	No

Table 5-1: Summary of the effects of the factors; Index analysis

Interestingly, the summary shows that, according to the index analysis, pull factors for FDI inflows to Kenya were mainly related to business and macroeconomic indicators such as Market Size, Economic Growth and Openness. Education as well is crucial for businesses since it strongly touches on human resource issues. According to the literature and previous research, Kenya, during the growth period (2005-2011), should have seen improving corruption levels, lower inflation rates,

better rule of law and increasing political stability levels. However, the index analysis showed that these factors deteriorated between 2005 and 2011.

Figure 4-11: Results of the analysis of the predetermined factors (mean, median, standard deviation)



Secondly, the analysis of the predetermined factors (Figure 4-11) in the questionnaires showed that the respondents found the factors Economic Growth and Market Size highly influential towards the increasing FDI inflows during the period of growth. Interestingly, Political Stability was rated as the third most important factor even though the index analysis revealed that this factor deteriorated between 2005 and 2011.

This indicates that FDI investors perceive this factor differently than measured by the political stability index and do not recognize the levels of political stability in Kenya as a hindrance to FDI inflows. The ratings of the fourth highest factor, Level of Education, comply again with the findings of the index analysis. While Rule of Law and Openness were rated as factors with medium influence, the last two factors

Inflation and Corruption Level were factors of low influence thus also complying with the findings of the literature.

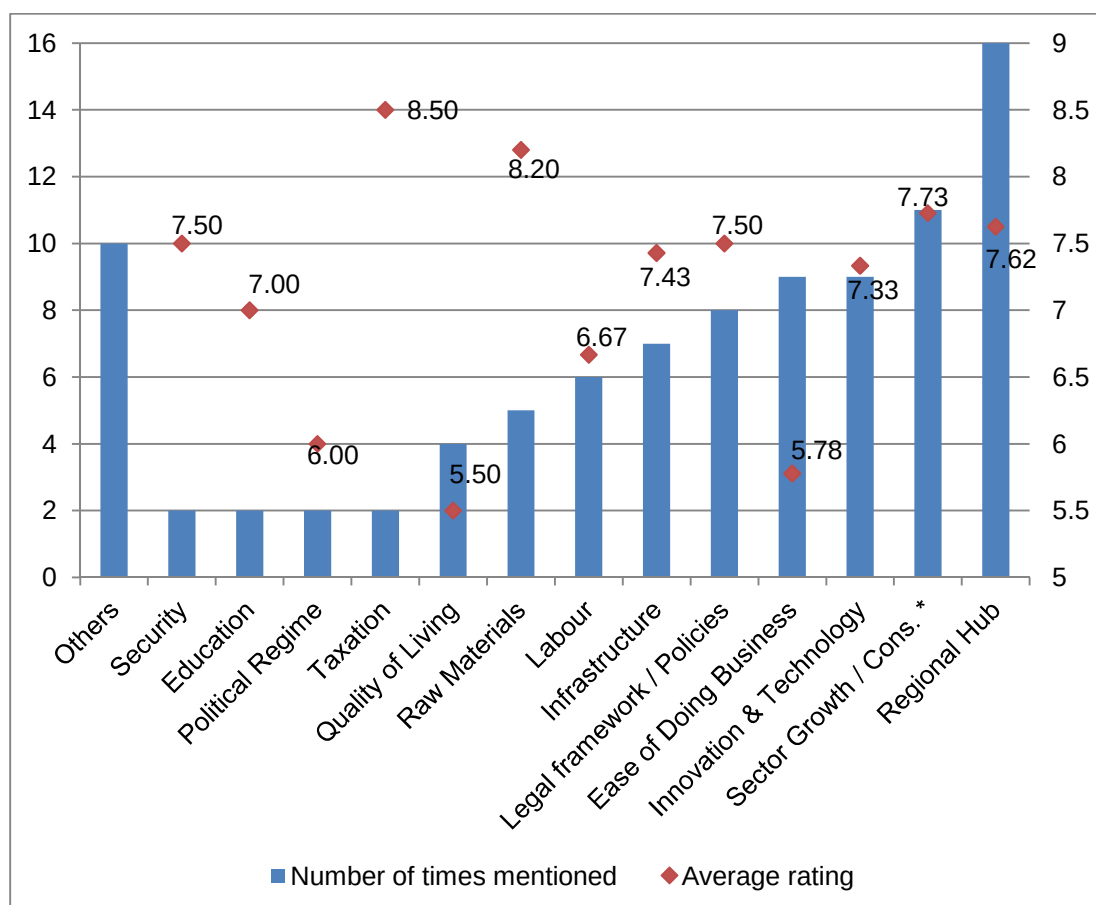
Thirdly, from the analysis of the individual factors it can be noted that reasons underlying FDI inflows to Kenya mainly result from

- (1) its position in the wider East African region,
- (2) increasing economic growth,
- (3) good education levels and qualified labor,
- (4) the innovation and technology drive of Kenyans and
- (5) the ease of doing business.

Factors such as Rule of Law, Corruption Level, Openness or Inflation were less important determinants to the increasing FDI inflows between 2005 and 2011 (Figure 4-18). Strengthening and enhancing regional integration and cooperation between East African countries was and will continue to play a major role in the investment decision of foreign companies. It will help to attract investors who may not see a potential for business in the individual East African countries but the region as whole. The benefits for Kenya would be immense since it is already the regional economic hub.

Furthermore, it seems that foreigners increasingly rethink their perceptions about Africa. Previous studies (e.g. Dupasquier & Osakwe, 2005) indicated the poor picture foreign investors had about Africa: high economic and political risks, poverty and diseases. Factors such as Political stability, Corruption Level or Rule of Law become less important determinants for foreign investors. Technology and innovations hereby support to reduce imperfect information and help to improve processes and accountability. Dupasquier & Osakwe (2005) further conclude that an “increase in political instability in one African country will diminish the probability of foreign direct investment flows to that country as well as to other countries in the region.” This study proves the opposite. While the political stability index decreased during the period of growth, the FDI inflows to Kenya increased massively. Apparently, other factors than political stability and rule of law became more important for foreign investors in Kenya.

Figure 4-18: Number of times an individual factor was provided by respondents and their average rating



Studies which had been conducted on FDI inflows to Kenya (Kenya National Bureau of Statistics, 2010; Kinuthia, 2010; Mwega & Ngugi, 2006; Ngugi & Nyang'oro, 2005) drew a mixed picture on the reasons for low FDI inflows. Ngugi & Nyang'oro (2005) used FDI data and various institutional and macroeconomic factors from other developing countries between 1990 and 2000 and draw implications for Kenya. They concluded that “to attain the best rating for Kenya, it means 200% improvement in law and order, 140% improvement in government stability, 100% improvement on socioeconomic status and 30% improvement on democratic status. This will allow FDI flow to increase by between 0.4% and 23%.” They furthermore continued that the “government should put a lot of resources to curb crime and restore law and order, embrace positive democratic practices, maintain its stability and embrace zero-tolerance on corruption more emphatically to gain substantially in investment growth and more so in FDI flows.”

In contrast to the outcomes of the study by Ngugi & Nyang'oro (2005) this study found different results. The indices for the factors Political Stability, Corruption Level, Rule of Law and Inflation deteriorated from 2005 to 2011. However, during the same period, the FDI inflows increased from USD 32.4 million average annual FDI inflows between 1987 and 2004 to annually USD 136.7 million from 2005 to 2011. The further results of this study also show that other factors such as education levels, technology and innovation, improved regional integration and cooperation, market size, infrastructure development and ease of doing business were much more important factors to increasing FDI inflows. Ngugi & Nyang'oro (2005) also called for improved openness. The factor openness increased during the period of growth thus showing that it was indeed a factor contributing to the increasing FDI inflows.

Kinuthia (2010) provides evidence on the determinants of FDI inflows to Kenya using foreign firm data (questionnaires) of 2007. His first findings were that the most important determinants were market size, political and economic stability, bilateral trade agreements and a favorable climate. Other to that, the three main impediments to FDI inflows are political instability, crime and insecurity, and institutional factors most notably corruption. In contrast, this study shows that even though the rule of law, inflation and political stability did not improve during the period of growth, FDI inflows increased. In addition, factors important for the companies asked related to Kenya's role as the regional economic hub, education levels, technology and innovation, market size, infrastructure development and ease of doing business.

5.4 Implications and Recommendation

The analysis revealed that most factors influencing FDI inflows to Kenya can be influenced by policy makers. These factors include: Regional Hub, Innovation and Technology, Ease of Doing Business, Infrastructure, Inflation, Quality of Living or Level of Education. Policy makers can influence these factors in various ways for example through increasing the regional integration, promoting education of Kenyans as to also keep levels of innovation and technology up to modern standard, reducing the days and procedures of setting up a business and improving the various infrastructure within the country.

This paper pointed out a number of factors why the FDI inflows to Kenya increased over the past few years. Most importantly, the results underline the importance of Kenya as the regional hub within the wider East Africa. An overwhelming majority of the respondents rated this factor as the most important reason of increasing FDI flows to Kenya. Foreign investors further value the improving regional integration thus enabling the access to a much larger market and new customers. Therefore, it is recommended to further extend the regional cooperation and integration between the member countries of the East African Community and neighboring countries. Especially Kenya will benefit enormously from improved regional integration measures since it is already named the regional hub.

The study also pointed out the good levels of doing business in Kenya, especially compared to other countries in SSA. However, this shall not prevent increased efforts to create an even better environment for setting up and doing business. Kenya cannot afford to rest on its good reputation especially when aiming at becoming an emerging country in the next decades and perusing ambitious aims through its Vision 2030. Wrong signals to foreign investors are also planned regulations such as the Merchant Shipping Bill which, when fully enacted in its current version, forces foreign shipping lines operating in Kenya to sell 51% of its shares to a Kenyan.

Infrastructure was also mentioned to having influenced the investment decisions of many companies during the growth period. The Kenyan government thus has the obligation to not only maintain but heavily invest in local infrastructure. This includes roads, ports and airports, electricity and water among others infrastructure investments. Improved infrastructure will not only benefit foreign investors but especially local investors who in turn will be enabled to grow and thus attract even more FDI.

The most recent oil findings in Kenya have the potential to substantially increase FDI inflows to Kenya during the next decades. In light of this, it is furthermore recommended to adopt proper policies and regulations to properly channel and control foreign investments in this sector in specific but also any other business regarding natural resources. The government should not concentrate on actively participating in investment activities but rather support and enable private sector investments as a facilitator.

Last but not least, the government should create an inviting, well regulated economy which attracts domestic as well as foreign investors in order to improve the country's wealth. Furthermore, the investment activities of the government should only be focused on areas which promote and attract increasing FDI inflows such as infrastructure development.

Further research should be conducted on the long term implications of decreasing measures for rule of law, corruption, inflation and political stability on the FDI inflows to a country. In addition, Continuous studies on the determinants influencing FDI inflows to Kenya have to be carried out to inform relevant stakeholders such as the government on underlying factors so as to being able to encourage and promote FDI inflows.

5.5 Limitations to the Study

The following limitations occurred in the course of the study. Firstly, Kenya does not maintain a comprehensive, single data base including all foreign companies registered in Kenya or those Kenyan companies with at least 10% foreign ownership. Several local associations and government authorities maintain incomplete lists of such companies. However, they only include those specific foreign companies which registered with the respective associations or authorities. This situation hinders proper research in the area of Kenyan FDI inflows tremendously and also posed difficulties to this study.

In addition, the measures for both inflation rate and GDP changed during the observed years (1998-2011). This change could have influenced the results obtained in this study. Again, economic data such as GDP growth or GDP per capita is only since few years being published quarterly. The same applies for numerous indices which are only published on an annual basis since not longer than 10 years. This results in difficulties if not the impossibility to use a number of statistical tools such as time series analyses to analyze the factors influencing FDI inflows to Kenya.

Regarding the model developed by the author to statistically prove that the year of change from stagnating to increasing FDI inflows is in 2005, it has to be noted that the model still has to undergo validation before applying it in different scenarios. The model does not influence the main research since it was only applied to provide a

different option to determining the year of change from the period of stagnation (1998-2004) to the period of increase (2005-2011) rather than just selecting the periods by eyeballing.

Furthermore, the available observation points for the dependent variables were not sufficient in number to carry out a multiple regression analysis (i.e. index data was mostly published annually). To solve this problem, a cross-country analysis could be conducted, adding to the observations and enriching scrutiny of independent variable effects.

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APPENDICES

Appendix A: Snapshot of the original online questionnaire

Questions marked with an * are required

Hello, Thank you for getting here. I am Paul.

5 MINUTES

On average, you will not spend more than 5 minutes completing this questionnaire.

This survey does **NOT REQUIRE CONFIDENTIAL** information about your company. It aims at determining the reasons for the continuously increasing Foreign Direct Investments (FDI) to Kenya since 2005.

ASANTE SANA!

When did your company commence operations in Kenya?

*

☐ During or after 2005

☐ Before 2005

In which sector does our company operate? *

☐ Agriculture and related

☐ Mining, Oil & Gas

☐ Manufacturing

☐ Financial services

☐ IT services

☐ Tourism

☐ Logistics & Transport

☐ Business Support

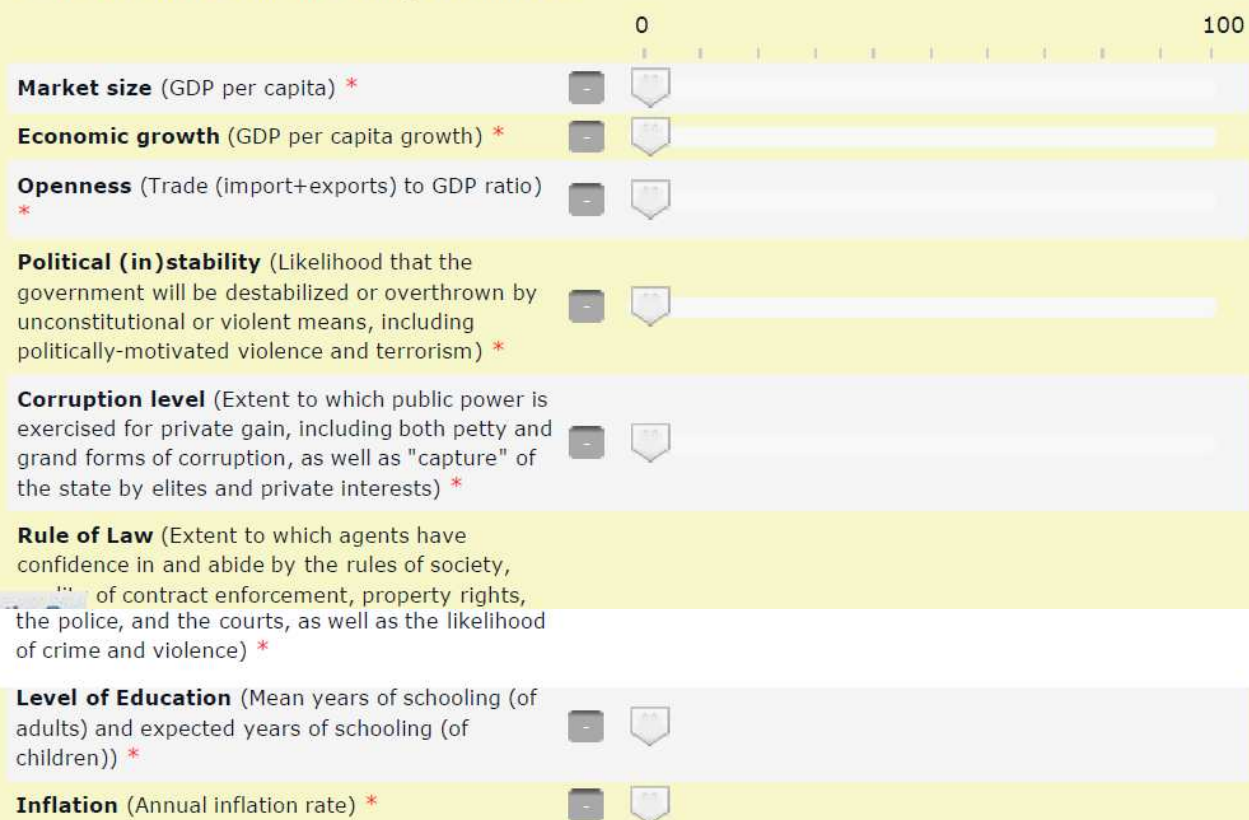
☐ Other (specify)

To which extent have the following factors contributed to the continuously increasing FDI inflows to Kenya since 2005?

(In brackets are the explanations on how the factors are measured)

100 - Very HIGH INFLUENCE on increasing FDI inflows

0 - NO INFLUENCE on increasing FDI inflows



This is my most important question to you!

Other than the factors influencing the FDI growth given in the last question, kindly enter now your own factors for the increasing FDI inflows and then rate them accordingly.

Please RATE A FACTOR FIRST, THEN a text box will appear for you to enter your factor.
You can later change the rating.

10 - VERY HIGH INFLUENCE on increasing FDI inflows

1 - VERY LOW INFLUENCE on increasing FDI inflows

	1	2	3	4	5	6	7	8	9	10
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Factor	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

I will highly appreciate if you provide me now with the name of your organization. The data will be kept strictly confidential. If you prefer not to provide your company name, please enter "anonymus".

Appendix B: List of Factors influencing FDI inflows to a host country²⁴

	FDI to Kenya	Market Size	Economic Growth	Openness	Political Stability	Corruption Level	Rule of Law	Education Index	Inflation
Year	Annual FDI Inflows (in million USD)	Real GDP per capita (constant 2000 US\$)	GDP growth (%)	Trade to GDP ratio	Worldwide Governance Indicators	Worldwide Governance Indicators	Worldwide Governance Indicators	Human Development Index (HDI)	Annual inflation rate (%)
1998	11.000000	415.70717	3.2902137	20.169261	-2.5717428	-1.021769	-1.126339	0.455	6.716
1999	13.821862	414.60006	2.3053886	20.832735	-2.5703068	-0.985246	-1.011896	0.455	5.753
2000	110.904611	406.52306	0.5996954	21.587571	-2.5688708	-0.948723	-0.897453	0.469	9.955
2001	5.302623	411.07133	3.7799065	22.931576	-2.3792466	-0.968117	-0.905694	0.498	5.730
2002	27.619363	402.62883	0.5468595	24.897973	-2.1896224	-0.987510	-0.913935	0.498	1.970
2003	81.740317	403.67889	2.9324755	24.086815	-2.2354953	-0.830638	-0.890637	0.498	9.810
2004	46.063942	413.31828	5.1042998	26.610259	-2.2933772	-0.803700	-0.858237	0.498	11.790
2005	21.211622	426.51749	5.9066661	28.509030	-2.0846112	-0.979308	-0.896734	0.526	9.870
2006	50.674663	442.02131	6.3306328	27.111758	-2.2330863	-0.872553	-0.881214	0.533	6.041
2007	160.351541	461.01937	6.9932852	26.778524	-2.4026171	-0.911561	-0.969048	0.552	4.265
2008	95.583250	456.25049	1.5269488	27.558424	-2.6910731	-1.023994	-1.019761	0.565	15.101
2009	116.260730	456.77154	2.7352125	24.152033	-2.6961783	-1.070131	-1.065776	0.578	10.552
2010	178.064498	470.57709	5.7649030	27.799461	-2.5493801	-0.925722	-1.013041	0.582	4.086
2011	335.249722	478.21949	4.3759336	29.111094	-2.5127382	-0.915390	-1.011057	0.582	13.998

²⁴ For nine data points, there was no actual data available. Therefore, the author calculated the mean value of the variables of the year before and after the missing variable.

Appendix C: List of Companies.

Listed companies in the publication “An Investment Guide to Kenya – Opportunities and Conditions 2012” by UNCTAD (2012c)

Company Name	Sector
Alltech Biotechnology E.A. Ltd	Agriculture
Aquarius Systems	Agriculture
BAT Industries	Agriculture
Delmonte Kenya Ltd (Del Monte Foods)	Agriculture
Williamson Tea Holdings plc	Agriculture
Goldsmith Seeds	Agriculture
Unilever Tea Kenya Ltd	Agriculture
James Finlay Ltd	Agriculture
Vitacress Kenya Ltd	Agriculture
BOC Kenya(Linde Group)	Mining, Oil and Gas
Caltex Oil (Kenya) Ltd(Chevron Corporation)	Mining, Oil and Gas
Vivo EnergyKenya Shell (The Royal Dutch/Shell Group)	Mining, Oil and Gas
Abbot Laboratories	Manufacturing
Atlas Copco Eastern Africa Ltd	Manufacturing
Bamburi Cement(Lafarge)	Manufacturing
Bata Shoe Company	Manufacturing
Bayer East Africa Ltd	Manufacturing
Beiersdorf East Africa Ltd	Manufacturing
Bestfoods Kenya Limited (Unilever plc)	Manufacturing
CarTrack Kenya Ltd (Lojak Corporation)	Manufacturing
Coca-Cola East and Central Africa Ltd	Manufacturing
Colgate Palmolive (EA) Ltd	Manufacturing
Corn Products Kenya Ltd (Corn Products International Inc.)	Manufacturing
De la Rue Currency & Security Print (K) Ltd	Manufacturing
Ecolab East Africa	Manufacturing
Eli Lilly (Suisse) SA (Eli Lilly and Company)	Manufacturing
Eveready East Africa Ltd	Manufacturing
General Motors EA Ltd	Manufacturing
Glaxosmithkline	Manufacturing
Henkel Kenya Ltd (Henkel AG & Co. KGaA)	Manufacturing
Jos. Hansen & Soehne EA Ltd	Manufacturing
Mitsubishi Corporation Nrb Liaison Office	Manufacturing
Nestlé Foods Kenya Ltd	Manufacturing
Procter and Gamble EA Ltd	Manufacturing
Siemens Limited	Manufacturing
Tetra Pak (Tetra Pak Beteiligungs GmbH)	Manufacturing
Wrigley Company (EA) Ltd (Wm. Wrigley Jr. Company)	Manufacturing
Acacia Financial Services Ltd (Acacia Life Insurance Company)	Services(Financial)
Chartis Kenya Insurance Company Ltd (American International Group Inc.)	Services(Financial)
AON Minet Kenya Insurance Brokers Ltd	Services(Financial)
Barclays Bank	Services(Financial)
British American Insurance Co (K) Ltd (British American Insurance Company Ltd)	Services(Financial)
Alexander Forbes Risk & Insurance Brokers Kenya Ltd	Services(Financial)
Citibank N.A.(Citigroup Inc)	Services(Financial)
Old Mutual Life Insurance	Services(Financial)

Standard Chartered Bank	Services(Financial)
CFC Stanbic Bank	Services(Financial)
AirTel Kenya (Bharti Airtel)	Services (ICT)
Safaricom Ltd (Partly Vodafone Group plc)	Services (ICT)
Abercrombie & Kent Ltd	Tourism & Transport
KLM Royal Dutch Airlines (Air France- KLM)	Tourism & Transport
Lonrho Hotels Kenya Ltd (Norfolk Hotel, et al.- John Holt Group Ltd)	Tourism & Transport
Pollman's Tours and Safaris Ltd (Partly TUI Group)	Tourism & Transport
Somak Tours and Travel (Somak Travel Ltd)	Tourism & Transport
Tourism Promotion Services Management Ltd (Serena Hotels- Aga Khan Group)	Tourism & Transport
AGS Frasers International Removals	Business Support
Ayton Young & Rubicam Ltd (Young & Rubicam (Y&R))	Business Support
Cargill Kenya Ltd (Cargill Inc.)	Business Support
Deloitte & Touche (Kenya) (Deloitte Touche Tohmatsu)	Business Support
DHL Worldwide Express Kenya Ltd (Deutsche Post AG)	Business Support
KPMG East Africa	Business Support
Maersk Sealand K Ltd (A.P. Moller-Maersk Group)	Business Support
United Parcel Service (UPS)	Business Support
Actis (Actis Capital plc)	Others
Oxford University Press EA Ltd	Others
Sera Software (EA) Ltd (Sera Europe B.V.)	Others
SGS Kenya Ltd	Others
Sumitomo Corporation	Others

Appendix D: Complete list of clustered factors.

It includes the respondents' individual ratings, number of observations and average rating of each factor.

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	No. of observations	% of total		Average	Std. Dev.
Others																	10	10.8%	100.0%		
Security	6	9															2	2.2%	89.2%	7.50	2.12
Education	8	6															2	2.2%	87.1%	7.00	1.41
Political Regime	4	8															2	2.2%	84.9%	6.00	2.83
Taxation	9	8															2	2.2%	82.8%	8.50	0.71
Quality of Living	5	3	8	6													4	4.3%	80.6%	5.50	2.08
Raw Materials	9	8	9	8	7												5	5.4%	76.3%	8.20	0.84
Labour	3	7	7	7	9	7											6	6.5%	71.0%	6.67	1.97
Infrastructure	9	6	8	7	8	6	8										7	7.5%	64.5%	7.43	1.13
Legal framework / Policies	6	10	8	7	8	8	6	7									8	8.6%	57.0%	7.50	1.31
Ease of Doing Business	7	1	7	7	6	5	7	8	4								9	9.7%	48.4%	5.78	2.17
Innovation & Technology	9	6	8	8	6	9	9	7	4								9	9.7%	38.7%	7.33	1.73
Sector Growth / Cons. *	7	7	9	8	6	8	8	10	9	9	4						11	11.8%	29.0%	7.73	1.68
Regional Hub	7	9	5	7	6	8	9	7	10	10	7	8	8	7	8	6	16	17.2%	17.2%	7.63	1.41
* Complete name is: Sector Related Growth / Increased Consumption																	93				