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# The Association between ease of doing business attributes and net foreign direct investment flows into Kenya's manufacturing sector

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**THE ASSOCIATION BETWEEN EASE OF DOING BUSINESS ATTRIBUTES  
AND NET FOREIGN DIRECT INVESTMENT FLOWS INTO KENYA'S  
MANUFACTURING SECTOR**



**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE  
REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF  
SCIENCE IN DEVELOPMENT FINANCE  
STRATHMORE BUSINESS SCHOOL**

**JULY 2021**

## DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, this research project contains no material previously published or written by another person except where due reference is made in the research project itself.

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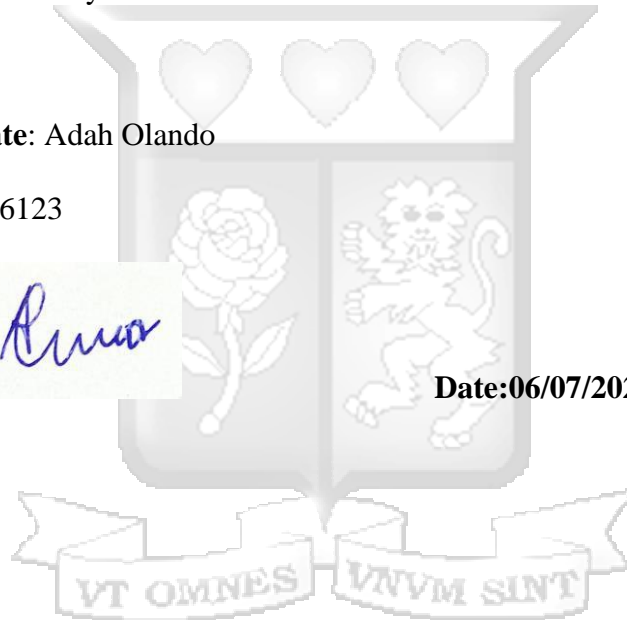
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## ACKNOWLEDGEMENTS

My sincere gratitude goes to Strathmore Business School, my supervisor, Dr. Mathuva, my family and friends for their unwavering support throughout this study.



## DEDICATION

This dissertation is dedicated to my family, my constant inspiration.



## ABSTRACT

The manufacturing sector plays an important part in the economic development of Kenya and forms a critical pillar in the achievement of the government's Big Four agenda. Attracting Foreign Direct Investment (FDI) into the manufacturing sector has been listed as one of the objectives of the government with the aim of revitalizing the performance of the sector in the future. One of the critical factors identified in attracting FDI into a country are the Ease of Doing Business (EDB) attributes. The purpose of the study was therefore to examine the association between EDB attributes and net FDI flows into Kenya's manufacturing sector. In doing so, the study was guided by four specific objectives which aimed at analysing the association between specific EDB attributes and net FDI flows into Kenya's manufacturing sector. The EDB attributes that were assessed relate to bureaucracy, access to credit, political risk and trade liberalization. The Ownership – Location – Internalization (OLI) Theory was the theoretical foundation of this study. A positivist research philosophy was adopted, and a descriptive correlational research design was applied to data from the year 2012 – 2019. The correlation analysis revealed that there was a significant positive association between access to credit and net inflow of FDI into Kenya's manufacturing sector. On the other hand, political risk, trade liberalization and bureaucracy all had significant negative associations with net inflow of FDI into Kenya's manufacturing sector. The study therefore recommends that the Government of Kenya continue with its efforts in reducing bureaucratic processes and procedures as well as curbing political risk and perceptions thereof. The study further proposes that the Government of Kenya consider providing competitive funding to firms that aim to internationalize their manufacturing operations in Kenya while creating a conducive environment for international firms to operate from Kenya by offering competitive terms in comparison to other members of the East African Community (EAC) who attract manufacturing firms into their economies.

**Keywords:** *Foreign direct investment, manufacturing foreign direct investment, ease of doing business, business regulation, trade costs, regulations*

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## ABBREVIATIONS AND ACRONYMS

<b>ASEAN</b>	Association of South East Asian Nations
<b>AU</b>	African Union
<b>EAC</b>	East African Community
<b>EDB</b>	Ease of Doing Business
<b>FDI</b>	Foreign Direct Investments
<b>MNC</b>	Multinational Companies
<b>MNE</b>	Multinational Enterprises
<b>MTP</b>	Medium Term Plan
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>OLI</b>	Ownership Location Internalization
<b>VIF</b>	Variance Inflation Factor
<b>WBG</b>	World Bank Group



# CHAPTER ONE: INTRODUCTION

This chapter presents the background of the study. It provides an overview of previous studies that have been conducted and identifies research gaps that this study aims to fill. The chapter summarizes the research problem, identifies the research objectives and questions, and concludes by looking at the scope and significance of the study.

## 1.1 Background of the Study

Foreign Direct Investment (FDI) influences the growth of technology which is crucial for supporting economic growth (Alfaro, Chanda, Kalemli-Ozcan, & Sayek, 2010), however, the flow of FDI and particularly FDI into the manufacturing sectors of developing economies has been constrained despite the efforts of various governments to reduce the barriers and costs of foreign investments into their respective countries.

Foreign Direct Investment refers to investments made across a border by a resident or firm of one nation's economy into another (Organization for Economic Cooperation and Development, 2008). A number of studies have found positive relationships between FDI flows and economic growth and development owing to the positive spillovers in productivity and wage associated with FDI flows (Gorg and Strobl, 2001; Tambunan, 2005).

Notwithstanding these positive findings, there are also arguments that the domination of FDI can have a negative impact on the development of local entrepreneurship (Abala, 2014). Abala (2014) also found that the contribution of FDI to a nation's revenue via corporate taxes can be significantly low in comparison to the liberal tax concessions and allowances granted to Multinational Companies by the host nation.

Nevertheless, it has been found that the negative consequences of Foreign Direct Investments can be controlled by having suitable labour and business regulations and it is widely accepted that FDI results in positive net advantages to nations' receiving it (Mwega & Ngugi, 2007).

In view of the demonstrated positive association between FDI and economic growth and development, many nations have attempted to relax their restrictions to FDI flows, improved macroeconomic stability and have instituted local policy and financial reforms aimed at attracting more FDI flows (Asiedu, 2003). One set of indicators used to measure the suitability of business conditions in a particular jurisdiction are the Ease of Doing Business (EDB) indicators and rankings published by the World Bank.

### **1.1.1 Ease of Doing Business (EDB) Indicators**

The EDB indicators are a measure of business regulatory quality and efficiency specific to a particular jurisdiction. The World Bank Group (WBG) has published data from 2004 on EDB parameters in approximately 190 nations (Jayasuriya, 2011).

The World Bank measures ten EDB indicators which are metrics that deal with: time it takes to start a business, dealing with construction permits, access to electricity, property registration, access to credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. For purposes of this study, these EDB metrics were classified under 4 broad categories to facilitate the analysis of the association of these indicators on the net inflow of FDI into Kenya's manufacturing sector.

The EDB metrics that pertain to the time it takes to start a business, dealing with construction permits, access to electricity and property registration are factors that are grouped under the bureaucracy factor. The EDB metrics that pertain to protecting minority investors, paying taxes, enforcing contracts, and resolving insolvency are factors that are encapsulated under the political risk factor. The EDB factor pertaining to trade across borders is a standalone factor, termed as trade liberalization in the study and access to credit is also a standalone factor. Together, the 10 EDB indicators were therefore categorized into four factors pertaining to bureaucracy, political risk, trade liberalization and access to credit for the purposes of this study (World Bank, 2019).

It is important to note however, that the World Bank's EDB attributes indicate the ease of doing business from the perspective of a typical local firm and does not consider the views of Multinational Corporations (MNCs). That said, the ease of doing business variables provide critical information around the business environment and practices of a particular country which are equally important to MNCs' (Vogiatzoglou, 2016). This point was substantiated by a study that was conducted by Shahadan (2014) who found that ease of doing business indicators and rankings were significant in explaining FDI flows into countries such as Afghanistan, Bangladesh, Iran, India, Sri Lanka, and Pakistan.

### **1.1.2 FDI and Ease of Doing Business**

In addition to the above studies, the World Bank (2009) carried out a study which found that empirical evidence suggests that due consideration is needed from policy makers to maximize benefits of FDI which are known to result in skills and technology transfer as well as foster overall spillover effects to the domestic economy. These propositions are supported by the practical experiences of the East Asian Tigers where contribution from FDI resulted in the diversification and upgrading of its industrial infrastructure (World Bank, 2009). In China, a variety of policies were adopted with the aim of increasing trade openness and maintaining stability in the macroeconomic environment which led to the increase of FDI flows particularly into China's manufacturing sector.

Closer to home, Kenya's Ease of Doing Business ranking has averaged 98 out of 190 countries from 2008 until 2019, reaching an all-time low of 129 out of 190 in 2013. Kenya's ranking has however improved to 56 in 2019 up from 61 in 2018 (Doing Business, 2019). However, despite the fact that Kenya's ease of doing business ranking increased by 75% between 2008 and 2019, FDI flows into Kenya only increased by 8% over the same period with most FDI flows going towards financial and insurance activities which accounted for approximately 40% of net FDI flows into Kenya compared to the 19% going towards the manufacturing sector in 2017 (Financial Investment Survey, 2018). These statistics pale in comparison to China whose FDI flows have increased by an estimated 55% against an improvement in its ease of doing business score by 22% between 2015 and 2019 (World Bank, 2019). As at 2019, China was ranked 46 out of 190 on the ease of doing business and had manufacturing contributing towards 30% of GDP while Kenya had its manufacturing sector contributing only 9.2% to the country's GDP (World Bank, 2018).

Research conducted by the Chen et al. in 2015 found that Africa as a whole has lagged behind in industrialization and the absence of development in the manufacturing industry can be partly associated with the constraints of attracting adequate FDI. Statistics from 2013 indicate that the average share of manufacturing value added in GDP for Sub – Saharan Africa (SSA) had remained at 11 % since the eighties. During the same period, FDI flows into SSA were also found to be quite low relative to net FDI flows into Asian economies (UNCTAD, 2019).

In the context of FDI flows into manufacturing sectors, empirical evidence from Rwanda and Ethiopia has shown that the regulatory business climate is critical to the attraction of FDI into countries' respective manufacturing sectors (Chen et al., 2015). The same was found in a study conducted by Vogiatzoglou (2016) on the Association of Southeast Asian Nations (ASEAN) which highlighted the importance of business regulatory reforms in the establishment of an entrepreneur – friendly environment and its importance in further attracting FDI flows into manufacturing sectors with the objective bringing about industrialization.

The significant function of industrialization in the growth of an economy and the structural transformation has been documented extensively in empirical literature (Chen et al., 2015; Takechi, 2011). In view of the critical role of industrialization in developing economies, all members of the African Union (AU) in 2008 adopted the Action Plan for the Accelerated Industrial Development of Africa that emphasized the importance of manufacturing development and the need for Foreign Direct Investments for the acceleration of Africa's industrialization.

A World Bank (2016) study revealed that FDI flows into manufacturing sectors create more job opportunities than FDI flows into any other industry. According to the World Bank's FDI data (2013/14), the manufacturing sector in Tanzania represented 43% of jobs created which is three times more than the job opportunities created from the flow of FDI into Tanzania's agricultural sector. In addition to the above, FDI flows into Uganda's manufacturing sector resulted in the growth of employment in the country which accounted for 30% of all FDI – created occupations in Uganda. Similar patterns have been found in Ethiopia, more so as relates to permanent job creation.

In view of the demonstrated critical role that industrialization plays in bringing about economic growth and development, the Government of Kenya through the adoption and implementation of the Big Four Agenda identified manufacturing and industrialization as critical pillars for actualizing Kenya's Vision 2030 developmental goals. In as far as manufacturing and industrialization goes, in its third Medium Term Plan (MTP) (2018 – 2022), the Government of Kenya aims at accelerating the expansion of the manufacturing sector to increase its contribution to GDP from 9.2% in 2017 to 15% by 2022 despite the fact that the contribution of the manufacturing sector to GDP declined from 10.7% in 2013 to 9.2% in 2017 (Financial Investment Survey, 2018).

Kenya's MTP III plan attributes the drop in contribution from the manufacturing sector to the high cost of doing business and stiff competition from imports. The high cost of doing business tends to dissuade foreign investments into the country. The highlighted decline in the contribution of the manufacturing sector to GDP in Kenya is also in part a function of the depressed growth in FDI flows into the country's manufacturing sector which has

increased by only 8% between 2008 and 2019 which runs counter to the country's improvements in its ease of doing business rankings which improved by 75% between the same period (Financial Investment Survey, 2019).

## **1.2 Problem Statement**

FDI flows into the manufacturing sectors of both developed and developing economies have been demonstrated to have positive developmental and productivity spillovers through spurring industrialization and resulting in economic growth and development as provided above. Empirically it has been established that improving the ease of doing business for a nation should result in an increase in net FDI flows into the manufacturing sectors of different jurisdictions (Corcoran & Gillanders, 2015) thereby resulting in industrialization, economic growth, and development.

In Kenya however, despite the improvement in ease of doing business indicators, net FDI flows into Kenya's manufacturing sector have lagged behind. While Kenya's EDB ranking has improved by 75% between 2008 and 2019, FDI flows have only increase by 8% over the same period (Financial Investment Survey, 2019). The study therefore seeks to assess the association between ease of doing attributes and net FDI flows with a view to provide insights to Kenyan government officials on how to improve net FDI flows into Kenya's manufacturing sector in order to bring about industrialization, economic growth and development pursuant to the Government's Big Four agenda.

By the 1960s, Vernon had identified the significance of nation-specific geographical factors in the determination of FDI flows into the United States of America (USA). The locational determinants ranging from costs of entry and regulatory reforms related to

entry liberalization are important in attraction of FDI indicating that high entry costs into an economy are a barrier to FDI flows (Klapper, Laeven, & Rajan, 2006; Barseghyan, 2008). These findings speak to the proposition of Dunning's (1980) Eclectic theory which posits that locational factors are critical in attracting FDI flows into a nation.

In Africa, however, research that has explored the association between ease of doing business parameters and FDI are scarce with only a few empirical studies on the subject (Mwega & Ngugi, 2007; Abala, 2014). Moreover, the findings from the aforementioned studies are based either on the determination of the relationship between FDI and economic growth or the general assessment of determinants of FDI flows into a country.

Consequently, despite the fact that the emphasized studies have provided useful insights, few local and regional studies have considered the association between ease of doing business attributes as measured by the World Bank on sectoral FDI flows and particularly FDI flows into the manufacturing sectors of developing countries such as Kenya. The study therefore analysed the association between the ease of doing business attributes and net FDI flows into Kenya's manufacturing sector.

### 1.3 Purpose of the Study

The aim of this study was to evaluate the association between the ease of doing business attributes and net FDI flows into Kenya's manufacturing sector.

### 1.4 Research Objectives

The objectives of the study were to:

- i. Determine the association between bureaucracy and the attraction of net FDI flows into Kenya's manufacturing sector
- ii. Evaluate the association between access to credit and net FDI flows into Kenya's manufacturing sector
- iii. Assess the association between political risk and net FDI flows into Kenya's manufacturing sector
- iv. Analyse the association between trade liberalization and net FDI flows into Kenya's manufacturing sector

In view of the research objectives stated above, the research questions for the study were:

- i. Is there an association between bureaucracy and the attraction of net FDI flows into Kenya's manufacturing sector?
- ii. Is there an association between access to credit and net FDI flows into Kenya's manufacturing sector?
- iii. Is there an association between political risk and net FDI flows into Kenya's manufacturing sector?
- iv. Is there an association between trade liberalization and net FDI flows into Kenya's manufacturing sector?

## 1.5 Scope of the Study

Data from Kenya was used for this assessment particularly due to the Government's focus on manufacturing and industrialization as encapsulated in the Country's Big Four Agenda. The study therefore considered the available published secondary data on the net FDI flows into Kenya's manufacturing sector that had been made available from 2012 to 2019 by Kenya's National Bureau of Statistics (KNBS) as well as various ease of doing business publications over the same reporting period that have been made available by the World Bank Group. The study period was determined based on the availability of disaggregated sectoral FDI flows from 2012 and also managed to avoid the effects of the 2008 Financial Crisis which was found to have impacted FDI flows into both developed and developing economies between 2008 and 2011 (UNCTAD, 2012).

## 1.6 Significance of the study

This study aimed at providing new information around the ease of doing business and FDI nexus in comparison to past studies. In assessing the above associations, the study aimed to provide insights to the identified groups of people below:

**To policy Makers:** The study offers some policy insights that could be valuable to policy makers not only in Kenya but in other developing contexts. A better understanding of the relationship between the ease of doing business attributes and FDI flows into Kenya's manufacturing sector could help in the formulation of appropriate policies aimed at increasing FDI flows into Kenya's manufacturing sector.

**To development partners and institutions such as the World Bank:** The study provides insights on the relevance of the Ease of Doing Business indicators and their

association with FDI flows into Kenya's manufacturing sector. In addition, the study highlights areas of potential support that could be extended to developing countries with a view to increasing FDI flows in order to bring about economic growth and development through industrialization.

**To researchers and academicians:** The study tested the relevance of the Eclectic or Ownership – Location - Internalization theory of Foreign Direct Investments which argued that investments are normally attracted by “location advantages” as may be encapsulated in various ease of doing business and macroeconomic indicators. These insights could be useful to researchers and academicians in testing and contributing to the existing body of research in determining the relevance of such economic theories in the 21<sup>st</sup> century.

These findings will be disseminated through publication in the Strathmore repository and will also be provided to the World Bank who are leading efforts relating to Ease of Doing Business quantification and ranking. A copy of this publication will also be provided to Ministry of Trade and Industrialization who deal with matters relating to Foreign Direct Investments into the country.

Chapter two considers the theoretical and empirical literature on the ease of doing business and FDI nexus. Chapter 3 presents the research methodology, while chapters 4 and 5 present the analysis of the data and the conclusions determined from the study respectively.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter presents theoretical literature on FDI and provides a critical review of various empirical studies on FDI. The chapter then provides a summary of the knowledge gaps from the empirical literature and concludes by providing a conceptual framework showing the association between the study variables presented in chapter one.

### **2.2 Theoretical Literature Review**

#### **2.2.1 The Ownership – Location – Internalization (OLI) Theory**

To the extent that a nation's regulations of FDI matter, a host nation's business regulatory framework is a location – specific quality. This is associated with the locational advantages expounded upon in the Ownership – Location – Internalization (OLI) framework (Dunning, 1980). The OLI theory is an eclectic paradigm first presented by Dunning (1980) which aims to explain the rationale applied by firms in making a determination on whether to set up subsidiaries in foreign jurisdictions instead of servicing the same markets through exports especially in view of the fact that Multinational Corporations (MNCs) are likely to experience additional costs, potential language and cultural barriers, political risks along with the risk of expropriation in foreign jurisdictions (Muli & Aduda, 2017).

In a situation where the advantages of OLI are greater than the mentioned costs, foreign investments flow into the host nation. The ownership advantage consists of firm specific operational models, services, or products that other organizations do not have access to due to the possession of some intellectual property rights that are owned by foreign investors that they can leverage in different jurisdictions.

The locational advantage arises directly from a foreign host or FDI – recipient country and includes factors such as competitive production costs, market access and regional trade linkages which make FDI a more commercially viable option than exporting. Finally, the internalization advantage is a concept that explains why licensing might not be practiced owing to the preference of a firm or enterprise to protect its intellectual property rights (Muli & Aduda, 2017).

Seeking locational advantages as given in the Eclectic theory resonates with the objectives of the study. The OLI paradigm has evolved over time in that more recently the location advantage covers the regulatory and institutional features of different countries. The variations in business costs and regulations are associated to changes in locational advantages and hence affect the MNCs' investment decisions in terms of selecting a suitable investment location from a range of likely host nations. All other things being equal, a friendly and efficient regulatory business setting can lead to an increase in FDI flows including FDI flows into the manufacturing sector of a specific host nation. Linking the OLI theory to the study, it is therefore the expectation that the identified EDB attributes which pertain to bureaucracy, political risk, trade liberalization and access to credit are a country's location specific attributes which are likely to impact FDI flows into Kenya's manufacturing sector.

Furthermore, it is worth noting that newer theories, explaining various forms of FDI and strategies of MNEs, consider and control for host country location factors, therefore, institutional quality and regulatory considerations cannot be ignored in the consideration of FDI flows. This theory has been demonstrated in a number of empirical studies such as the one conducted by Peng et al. in 2008 and more recently by Vogtsozoglou (2016) who

found that FDI flows are significantly impacted by locational factors as postulated in Dunning's OLI theory.

### **2.3 Empirical Literature Review**

The World Bank's Ease of Doing Business indicators contributed to the emergence of studies that aimed to understand and analyse the effects of the ease of doing business indices and their contribution to FDI attraction. In this section, studies that have explored the connection between ease of doing business and FDI are reviewed. It should be noted however that few studies have considered sectoral FDI flows.

Vogiatzoglou (2016) conducted a panel study among the Association of Southeast Asian Nations (ASEAN) countries and the outcomes of the study showed the effects and significance of ease of doing parameters on attracting FDI. The study showed that regulatory and business efficiency was connected with nation – specific attributes reflecting efficiency, sophistication, and quality. This is contrary to the findings of Jayasuriya's (2011) study which revealed that among a small sample of developing nations from 2006-2009, the improvement in ease of doing business ranking had on average and insignificant effect on FDI. The latter analysis, however, should be considered with caution given that it refers to a restricted 4 – year time period. A more comprehensive analysis that considers a longer time frame might provide a more reliable assessment of the relationship between FDI and the ease of doing business.

In a study that considered a longer study period (2004-2013), Shahadan (2014) evaluated the connection between FDI flow and ease of doing business among Six Asian nations – Sri Lanka, Afghanistan, Pakistan, Bangladesh, India, and Iran using regression estimation techniques. The study found that majority of the ease of doing business parameters had an inverse effect on FDI flows excluding access to credit, property registration, and trade across border. Moreover, the study found that all components of the doing business data are likely to influence FDI inflows across borders excluding the doing business components relating to tax payment and the resolution of insolvency. Taking into consideration the research questions and research hypotheses for the study, the next section considers empirical evidence on specific ease of doing business indicators on FDI flows including FDI flows into manufacturing sectors.

### **2.3.1 Bureaucracy and FDI**

The number of studies that have explored the nexus between ease of doing business and FDI in Africa is not significant. In the context of Ethiopia, Ebero and Begum (2016) conducted a time series analysis on the relationship between doing business indicators and FDI between 2010 and 2014. The data was assessed using graphic comparisons, analyses of variance and correlation tests. The correlation tests demonstrated that the cost of doing business as reflected in the costs of setting up a business, cost to access to power, cost of property registration and the cost of construction permits which all are all reflective of bureaucratic costs had a significant negative relationship with FDI (Maingi, 2017).

Further afield, similar findings were found by Bitzenis et al. (2009) who carried out a microeconomic assessment on MNCs in Greece between 1995 and 2003 and found that bureaucracy and administrative costs in the form of taxation negatively affected the flow of FDI flows into Greece. A Similar finding was found by Lawless (2012) who found that complicated tax systems were a barrier to FDI attraction and went on further to find reducing tax complexity by 10% resulted to a reduction of 1% in actual corporate tax rates.

### **2.3.2 Access to Credit and FDI**

In considering issues pertaining to the relationship between access to credit and FDI, a study on Japanese FDI flows carried out in 2002 found that while firms may be constrained by their balance sheet positions, they may also be constrained by a reduction in the willingness of lenders to provide credit, in particular, by an inward shift in loan supply. In the said study, a metric referred to as Relative Access to Credit (RAC) measured by the number of troubled banks in a particular jurisdiction was found to have a negative impact on FDI flows especially for bank – dependent firms and MNCs (Klein et al., 2002). The same was also found to be true with respect to an MNC's access to credit from their own home country. A study that was carried out on 317 Japanese MNCs that were active in the United States of America found that banking problems in Japan negatively affected their access to credit which then affected outward FDI flows from Japan to USA. While this last study considers MNCs' homeland locational conditions, the impact of access to credit on FDI remains (Alba et al., 2007).

The findings above however are contrary to the 2003 findings of Donald Lien who took an alternative look at access to credit in terms of capital controls such as restrictions to the expatriations of proceeds from an FDI – recipient jurisdiction and found that capital controls in the 1990s did not have an effect of FDI flows into Sub – Saharan Africa and the Middle East but found a negative and significant relationship between capital controls and FDI flows into jurisdictions such as East Asia and Latin America (Asiedu, 2003).

A more recent 2010 study however corroborated the findings of Klein et al. (2010) and found that access to credit has a positive effect in attracting FDI flows into Jamaica's bauxite industry (Lou, 2010). The same was found to be true in a 2011 analysis that was conducted on heterogeneous firms where it was determined that financial factors matter for firms' internationalization and that more capital endowment or less credit constraints have a positive impact on FDI activities (Li et al., 2011).

### **2.3.3 Political Risk and FDI**

There has been a growing body of empirical evidence that has explored the influence of regulatory environment, institutions, and governance quality on attracting FDI. This evidence supports that corruption and weak quality institutions have a negative association with all types FDI flows including manufacturing FDI (Bussea & Hefeker, 2007).

Amal, Tomio, and Raboch's (2010) panel – data study among 8 Latin nations from 1996 – 2008 established that FDI had a positive correlation with a good political and institutional environment. This was supported by a World Bank (2015) study that found that constraints to FDI flows to the manufacturing sectors of East African countries were linked to corruption, of slow progress in execution of structural changes, and the presence

of weak-quality institutions. However, the study did not find causal relationship between political risk and FDI flows (Muli & Aduda, 2017).

In addition, to the studies above, an empirical analysis that utilized data from the World Economic Forum (WEF) alongside various corruption indices as a proxy for political risk found that corruption in judicial decisions are strong deterrents against FDI (Teksoz, 2007) while in study among SSA nations found that the corruption and perception of poor judicial systems were the main constraints to SSAs FDI inflows (Abdulai, 2007).

Estrin and Uvalic (2014) assessed the variations in FDI inflows among Central East and Southeast European nations using a gravity model to using data from 1990 – 2011 and establishing that (Southeast European nations were recipients of less FDI, and this was associated to the political risks of these nations due to unsettled political matters that had a negative impact on FDI flows. The study however did not consider important ease of doing business indices such as trade openness and did not conduct cointegration and stationarity tests in analyzing the time series data.

### **2.1 Trade Liberalization and FDI**

In their assessment of the connection between economic integration, FDI and ease of doing business, Muli and Aduda (2017) adopted a utility regression model and found that trade openness and regional integration as proxied by ease of doing business indices were significant in FDI flows attraction to the East African Community thereby motivating the importance of trade openness in explaining FDI flows including FDI flows into manufacturing sectors, in line with the customs union theory. The customs union theory as expounded by Kindleberger (1966) hypothesized that integration of economies results in flows of FDI into member countries.

The vast literature on FDI identifies 3 main reasons for firms engaging in FDI transactions (Basu & Srinivasan, 2002). The 3 main reasons revolve around natural – resource – seeking investments, market – seeking and efficiency- seeking FDI flows. Natural – resource – seeking investments aim to exploit the natural resource endowments of countries as has been seen in countries such as Nigeria and Ghana where oil and gold has led to the attraction of FDI flows. On the other hand, market – seeking investments aim to access new markets (where market size is often represented by GDP and GDP growth rates) that are attractive as a result of their market size and growth potential while efficiency – seeking investments aim to take advantage of quality human capital and the accessibility to quality infrastructure (Mwega & Ngugi, 2007). Manufacturing FDI in Sub – Saharan Africa (SSA) is primarily market – seeking therefore making factors such as – trade openness critical in the determination of manufacturing FDI flows (World Bank, 2015).

## **2.5 Summary of Knowledge Gaps**

In conclusion, scholarly investigation on FDI over the last two decades can be categorized into assessments of: One, the relationship between FDI and economic outcomes such as economic growth and development (Basu & Guariglia, 2005; Sumner, 2005). Second, the relationship between FDI, Trade liberalization and regional development (Bode & Nunnenkamp, 2011; Muli & Aduda, 2017). Third, the effectiveness of fiscal incentives in attracting FDI flows (Emmanuel Cleeve, 2008) and fourth, the Motivations and Determinants of FDI flows (Hejazi & Pauly, 2003; Wilson & Baack, 2012).

More recent work has begun to explore specifically the impact of the ease of doing business on FDI (Corcoran & Gillanders, 2015; Jayasuriya, 2011) and though insightful, these recent efforts have shown mixed results and have either focused on a composite Doing Business ranking and/or have typically applied a cross – sectional model of analysis which makes it difficult to appreciate the progress made on regulatory reforms over time and its progressive impact on general FDI flows. A notable exception in this stream of literature is a study that was conducted by Vogiatzoglou (2016) who conducted a comprehensive and detailed analysis on a panel data set with respect to the role of various business regulations in attracting FDI.

Overall, Vogiatzoglou's (2016) study highlighted the important role that business regulatory reforms play in establishing an entrepreneurship – friendly environment and inducing FDI inflows into South East Asian Nations. This sort of analysis has however not been applied across to the assessment of FDI flows into particular sectors such as manufacturing sectors particularly in the developing country context where most studies are impact studies that have considered issues such as the impact of FDI flows into manufacturing and agricultural sectors on economic growth and development (Iram & Nishat, 2010).

**Table 2.1: Literature Gaps**

<b>Studies reviewed</b>	<b>Main findings</b>	<b>Gaps established</b>	<b>Study filling gap</b>
Vogiatzoglou (2016a). Ease of Doing Business and FDI Inflows in ASEAN.	Business and regulatory efficiency was interrelated with other country – specific attributes reflecting efficiency, sophistication, and quality	The sample of the study was nations in a regional trade agreement	The study focuses on assessing the association between ease of doing business and FDI inflow into Kenya’s manufacturing sector.
Jayasuriya (2011). Improvements in the World Bank’s Ease of Doing Business Rankings: Do they translate into Greater Foreign Direct Investment Inflows?	The results suggest an improved ranking has, on average, an insignificant (albeit positive) influence on foreign direct investment inflows	The sample of the study was inclusive of developed and developing nations which possess different ranking in the ease of doing business	The study focuses on a developing nation context and limits its assessment to Kenya’s manufacturing sector.
Shahadan, Sarmidi, & Faizi (2014). Relationships between doing business indexes and FDI net inflows: empirical evidence from six Asian countries (Afghanistan, Bangladesh, India, Iran, Pakistan and Sri Lanka).	The ease of doing business parameters have an inverse relationship with FDI flows except the indices relating to the registration of properties, access to credit and trade across borders	The sample consisted of six Asian countries – Afghanistan, Bangladesh, Iran, India, Sri Lanka and Pakistan.	The study focuses on a developing nation context and limits its assessment to Kenya’s manufacturing sector.
Maingi (2017). Economic Integration, Ease of	The study found that a conducive environment	The study examined the influence of ease of doing business in	The study focuses on a developing nation context and

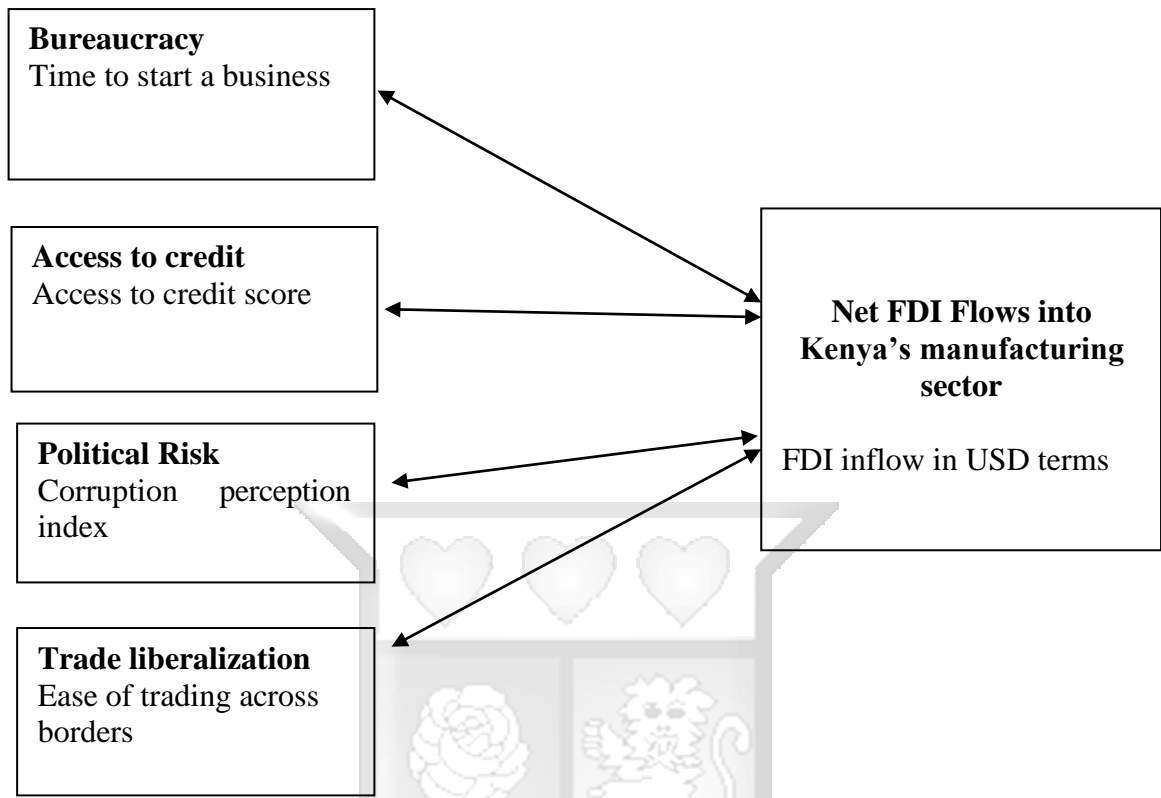
<b>Studies reviewed</b>	<b>Main findings</b>	<b>Gaps established</b>	<b>Study filling gap</b>
Doing Business, Economic Growth and Foreign Direct Investment in the East African Community	resulted in an increase in FDI in the EAC trade bloc	among regional trade agreement nations	limits its assessment to Kenya's manufacturing sector.
Bitzenis, Tsitouras, & Vlachos (2009). Decisive FDI obstacles as an explanatory reason for limited FDI inflows in an EMU member state: The case of Greece.	Bureaucracy and administrative costs in the form of taxation negatively affected the flow of FDI flows into Greece.	The study was limited to a sample of multinational corporations that operated in Greece	The study focuses on a developing nation context and limits its assessment to Kenya's manufacturing sector.
Lawless (2012). Do Complicated Tax Systems Prevent Foreign Direct Investment?	Measures of tax complexity have a significant inhibiting effect on the existence of FDI for a nation.	The study was limited to the relationship between Complicated Tax Systems and Foreign Direct Investment	The study focuses on a developing nation context and limits its assessment to Kenya's manufacturing sector.
Klein, Joe, & Eric, (2002). Troubled Banks, Impaired Foreign Direct Investment: The Role of Relative Access to Credit.	Access to credit had a negative impact on FDI flows especially for bank – dependent firms and MNCs	The study was limited to the access to credit as a variable for measuring ease of doing business	This study includes other ease of doing business parameters in its model.
Alba, Wang, & Ho, (2007). Relative Access to Credit, Relative Wealth and FDI Firm—Level Evidence from Japanese FDI into the United States.	The research found that banking problems in Japan negatively affected their access to credit which then affected outward FDI flows from Japan to USA	The study was limited to the access to credit as a variable for measuring ease of doing business	This study includes other ease of doing business parameters in its model.
Asiedu (2003). On the Determinants of Foreign Direct Investment to Developing	The capital controls in 1990s did not have an effect of FDI flows into Sub – Saharan Africa and	The study used the World Bank's World Business Environment Survey conducted in	This study uses recent ease of doing business ranking data as parameters for the independent

<b>Studies reviewed</b>	<b>Main findings</b>	<b>Gaps established</b>	<b>Study filling gap</b>
Countries: Is Africa Different?	the Middle East but found a negative and significant relationship between capital controls and FDI flows into jurisdictions such as East Asia and Latin America	1999/2000	variable
Li, Hou, & Zhang (2011). Capital Endowment, Credit Constraint and FDI: Analysis Based on Heterogeneous Firms.	The results indicated that more capital endowment or less credit constraints have a positive impact on FDI activities	The study examined the impact of capital endowment and credit constraint on firms' FDI decisions	The study focuses on the ease of doing business and FDI inflow into Kenya's manufacturing sector
Muli, & Aduda (2017). The Mediating Effect of Ease of Doing Business on the Relationship between Economic Integration and Foreign Direct Investment in the East African Community	The study established that economic growth enhances the capacity of economic integration to attract FDI into a region	The Moderating Effect of Economic Growth on the Relationship between Economic Integration and Foreign Direct Investment in the East African Community	The study focuses on the ease of doing business and FDI inflow into Kenya's manufacturing sector
Teksoz (2007). Corruption and Foreign Direct Investment: An Empirical Analysis	The results indicated that various corruption indices as a proxy for political risk found that corruption in judicial decisions are strong deterrents against FDI	The study used data from the World Bank's World Economic Forum	This study uses the ease of doing business ranking as parameters for the independent variable
Abdulai (2007). Attracting Foreign Direct Investment for Growth and Development in sub-Saharan Africa:	The research determined that the perception of weak judicial systems and corruption are among the major	The study adopted a literature review approach and did not use any primary data to establish relationships	This study uses the world banks ease of doing business data and FDI data to establish the association

<b>Studies reviewed</b>	<b>Main findings</b>	<b>Gaps established</b>	<b>Study filling gap</b>
Policy Options and Strategic Alternatives	hindrances to FDI flows into Sub-Saharan Africa	between variables	between these variables in the context of Kenya's manufacturing sector
Estrin & Uvalic (2014) FDI into transition economies: Are the Balkans different?	The results showed that unsettled political issues in the Western Balkan region that still seem to have a negative impact on the flows of FDI into the region	The study adopted a gravity model for all transition economies during 1990–2011 is then estimated to assess whether the factors driving FDI to the Western Balkans are different.	The study uses correlation assessment to analyse the relationship between Ease of doing business parameters and FDI inflow into Kenya's manufacturing sector

## 2.6 Conceptual Framework

In this study, net FDI flows into Kenya's manufacturing sector (measured in US Dollars) are published by the Government of Kenya between 2012 and 2019 while the ease of doing business indicators are published by the World Bank and Transparency International. The associations between the variables is illustrated in Figure 2.1.



**Figure 2.1: Conceptual Framework**

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter presents the research philosophy, design, population and sampling procedures as well as the data collection methods that were utilized. This chapter concludes with the empirical methodology that was applied in the analysis and addresses matters pertaining to the validity, reliability and objectivity of the research along with various ethical considerations that were considered in carrying out the study.

### **3.2 The Research Philosophy**

A research philosophy is a perspective around the method in which information about a particular study ought to be gathered, assessed and utilized. This study lends itself to the positivism philosophy which is a pure scientific approach which is designed to provide pure facts and data which cannot be manipulated by human bias and interpretation.

This philosophy is adopted due to the fact that the study aims to formulate hypotheses based on past studies and existing theories as well as an objective testing of hypotheses (Muli & Aduda, 2017). In determining that this study lends itself to the positivism philosophy, various alternative research philosophies were considered. Table 3.1 presents the different research philosophies with justification around why positivism was selected.

**Table 3.1: Analysis of Research Philosophies**

<b>Research Paradigm</b>	<b>Nature of Reality</b>	<b>Types of knowledge sought</b>	<b>Role of the Researcher</b>	<b>Implications of findings</b>
Positivism	There is only one, universal reality that researchers seek to gauge in an objective manner	The aim is to get theories that are universal in their use. Normally uses a quantitative approach to show relationship between variables.	Unbiased individual with commanding voice in his/her writing.	Data is meant to achieve universal theories and estimation of variables; information can be used in practice.
Post Positivism	In some circumstances there may be one outer truth	One cannot verify that a theory is completely true and hence the conclusions can be tentative.	The researcher cannot be unbiased	Data analysis enhances an appreciation of political, social and cultural processes; may be the basis of a recommended action.
Interpretivism	Interpretations and insights are multiple; the interpretations are subjective.	The aim is to detail events, processes or culture from the point of view of the participants. Many versions of the truth are possible.	An open minded observer who appreciates other people's views; less authoritative in his/her work	Research aims to appreciate gender – based differences usually with the objective of reducing gender-based disparities.
Feminism	Reality is evaluated from gender perspective, in ways that highlight gender dominance.	The focus is on how gender dimensions influence social behaviors.	A compassionate listener or observer who is sensitive towards those being studied.	

**Source: Coolican (2004)**

### **3.3 Research Design**

The research applied a descriptive correlational research design with the objective of examining the association between the ease of doing business attributes and FDI flows into Kenya's manufacturing sector. According to Waters (2005), a descriptive correlation study is a study in which the research is mainly concerned in telling associations amongst variables. The choice of the descriptive correlational research methodology was justifiable because the study aimed to use a correlation analysis in determining the correlation between ease of doing business indicators and FDI flows into Kenya's manufacturing sector.

### **3.4 Population and Sampling**

The study utilized Kenyan data for this assessment particularly due to the Government's focus on manufacturing and industrialization as encapsulated in the Country's Big Four Agenda. Published FDI data that was disaggregated into sectoral flows was made available from 2012 to 2019 and all data pertaining to the ease of doing business and macroeconomic metrics was also available over the research period. The study period had been determined based on the availability of disaggregated sectoral FDI flows from 2012 and also managed to avoid the effects of the 2008 Financial Crisis which had been found to have impacted FDI flows into both developed and developing economies between 2008 and 2011 (UNCTAD, 2012).

### **3.5 Data**

The study was dependent on readily available and published secondary data for the study period spanning 2012 to 2019. Provided in the table below are the data sources that were used in the correlation analysis.

**Table 3.2: Source of Data**

Variable	Data Source	Variable Metric	Published by
1. Net FDI flows into Kenya's manufacturing sector	<ul style="list-style-type: none"> <li>▪ Kenya's Foreign Investment Survey</li> </ul>	<ul style="list-style-type: none"> <li>▪ USD</li> </ul>	<ul style="list-style-type: none"> <li>▪ <a href="#">Kenya National Bureau of statistics (KNBS)</a></li> </ul>
2. EDB indicators	<ul style="list-style-type: none"> <li>▪ Bureaucracy</li> <li>▪ Access to Credit Trade Liberalization</li> <li>▪ Political Risk</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bureaucracy index</li> <li>▪ Access to credit score</li> <li>▪ Ease of trading across borders index</li> <li>▪ Corruption Perception Index</li> </ul>	<ul style="list-style-type: none"> <li>▪ <a href="#">World Bank</a></li> <li>▪ <a href="#">World Bank</a></li> <li>▪ <a href="#">Transparency International</a></li> </ul>

### 3.6 Operationalization of the Variables

Foreign Direct Investments flow into Kenya's Manufacturing sector refers to the net capital FDI flows into Kenya's manufacturing sector. Therefore, FDI into Kenya's manufacturing sector was represented as net FDI flows into Kenya's manufacturing sector in US dollar terms.

The Ease of Doing Business was decomposed into factors relating to bureaucracy, access to credit, political risk and trade Liberalization. Bureaucracy consists of the entire state institutions involved in implementing and formulating policy and regulating service delivery. The bureaucracy index focusses on how much money and time was spent by businesses to conform to business regulations. A positive bureaucracy position is anticipated to attract FDI flows (World Bank, 2009).

The Transparency International Corruption Perception Index shows the extent of

informality in an economy and integrated a number of indices that estimate the degree to which the power of the public is abused for private gain and is expected to discourage FDI flows into a country's manufacturing sector. Lower levels of corruption are anticipated to result in higher FDI, and thus negative coefficient is expected.

The variables relating to access to credit and trade openness were sourced from the World Bank's Doing Business assessments and it was anticipated that improvements in both access to credit and trade openness would result in higher FDI flows into Kenya's manufacturing sector.

### **3.7 Data Analysis**

The data was analysed using descriptive and inferential statistics using the Statistical Package for the Social Sciences (SPSS). The descriptive statistics were conducted first where mean, median score, and standard deviation of the study variables were presented in the descriptive summaries. The second step of analysis consisted of conducting diagnostic statistics which were done before the correlation analysis, where the Spearman ( $r$ ) correlation coefficient was used to determine associations between the variables. The findings were presented in tables and graphs and supported by interpretation by the researcher.

### **3.8 Research Quality – Validity and Reliability**

In order to ensure that the research results in a valid, reliable and objective assessment, a number of diagnostic tests on the variables of interest were conducted. Some of the tests that were conducted included tests for normality, tests for multicollinearity, heteroscedasticity as well as autocorrelation tests (Verbeek, 2008). Normality tests were conducted with the objective of determining whether the data set follows a normal

distribution. To test for normality, the Shapiro Wilk test was conducted for all dependent and independent variables (Verbeek, 2008).

Autocorrelation test was conducted to determine if the residuals are correlated over time. In order to test for correlation, the Durbin – Watson test was conducted. The Durbin-Watson tests leads to a test statistic that ranges from 0 to 4. A value closer to 2 is indicative of less autocorrelation and values closer to 4 or 0 are indicative of large negative or positive autocorrelation respectively (Verbeek, 2008).

A test for heteroscedasticity was also conducted. In order to test for heteroscedasticity, a scatter plot was used (Verbeek, 2008). Heteroscedasticity occurs when the standard errors of variable vary widely. A scatter Plot was used to display the data values of the variables. Normal distribution of the variables shows a cone shaped scatter plot, otherwise, data is concentrated on one side of the plot. Dataset distributed on the extreme left or extreme of the scatter plot shows heteroscedasticity.

Tests for multicollinearity were also conducted. Multicollinearity is the existence of correlation among the independent variables. In the study, multicollinearity was determined using Variance Inflation Factor (VIF).

### **3.9 Ethical Considerations**

In view of the fact that publicly available secondary data was used in the study, only verified sources of data from renowned organizations such as the World Bank, Transparency International and Kenya’s National Bureau of Statistics was used in the data analysis section. In addition to the above, majority of the published information from these institutions is generally audited and are therefore considered to be ethical and reliable sources of data.

## **CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF RESEARCH**

### **FINDINGS**

#### **4.1 Introduction**

This chapter presents the data analysis that was done using different levels and forms of statistical procedures. A trend analysis was conducted for each of the study variables followed by a descriptive statistics summary. Diagnostic tests were then conducted between the variables before conducting the inferential statistics which consisted of Pearson correlation and correlation analyses.

#### **4.2 Descriptive Statistics**

Descriptive statistics are exploited for data summary in a planned manner by telling the connection amongst variables in a population (Yellapu, 2018). The descriptive statistics of the data is presented in Table 4.1. The independent variable of the study was net inflow of FDI into Kenya's manufacturing sector which shows that the mean FDI inflow to Kenya's manufacturing sector was USD 11,637.46 million with a standard deviation of USD 7,029.02 million over the study period with the highest net inflow of FDI to Kenya's manufacturing sector being USD 24,141.84 million in comparison to USD 1,085.34 million which was the smallest inflow of FDI into Kenya's manufacturing sector recorded in the study period.

Political risk was measured by a proxy of the Corruption Perception Index (CPI) as published by Transparency International which showed that the mean CPI over the study period was 26.63 with a standard deviation of 1.19 which is indicative of a small variation of the CPI over the 2012 – 2019 period. The minimum CPI was 25.0 and the maximum

score of the CPI was 26.6 during the study period. Higher CPI values are indicative of higher levels of Political Risk in a country. The bureaucracy variable was measured by the number of days it took to start a business in Kenya as published by the World Bank Group. The mean score was 27.8 which mean that on average it took approximately 28 days to start a business during the study period with the least number of days for starting a business being 22 days and 33 days being the maximum number of days to start a business during the 2012 – 2019 study period.

In terms of the ease of trading across borders which is a measure of the degree of trade liberalization of a country as published by the World Bank Group, the mean score for this indicator was 60.3 and the highest score for trade liberalization was 68.1, with the lowest score being 52.0. The standard deviation for this indicator was 7.51 which indicates a moderate variance in the liberalization of trade in Kenya from 2012 – 2019.

The mean score for access to credit during the study period was 62.5 with the highest score for access to credit being 90.0 and the lowest score for this indicator being 35.0 with a standard deviation of 15.5 suggesting a moderate change in access to credit scores from 2012-2019. With regards to the ease of doing business score, the results show that the least score for doing business in Kenya from 2012- 2019 was 56.0 and the highest score for ease of doing business was 70.8 with a standard deviation that was relatively large at 12.49.

**Table 4.1: Descriptive Statistics**

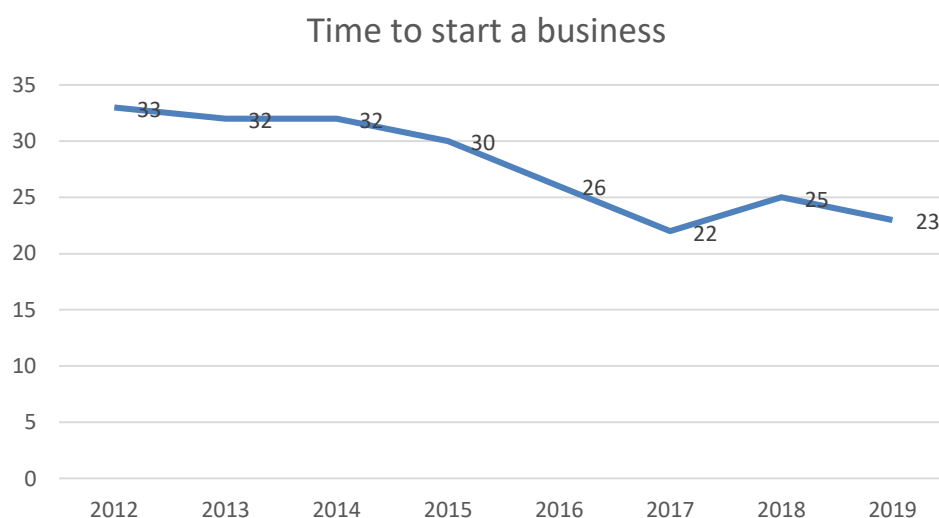
<b>Variables</b>	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
Time to start a business	8	22.00	33.00	27.88	4.39
Access to credit	8	35.00	90.00	62.50	19.04
Corruption Index	8	25.00	28.00	26.63	1.19
Ease of trading	8	52.00	68.10	60.03	7.51
Net inflow FDI in Manufacturing	8	1,085.34	2,4141.84	11,637.4	7,029.02
Ease of doing business Index	8	56.0	83.2	70.78	12.49

## 4.2 Trend Analysis

Trend analysis is a statistical technique that tries to determine future movements of a given variable by analyzing historical trends. It is commonly used in situations where data has been collected over time or at different levels of a variable, especially where a single independent variable, or factor, has been manipulated to observe its effects on a dependent variable, or response variable (Roller & Lavrakas, 2008). A trend analysis was conducted for each of the study variables.

### 4.2.1 Bureaucracy

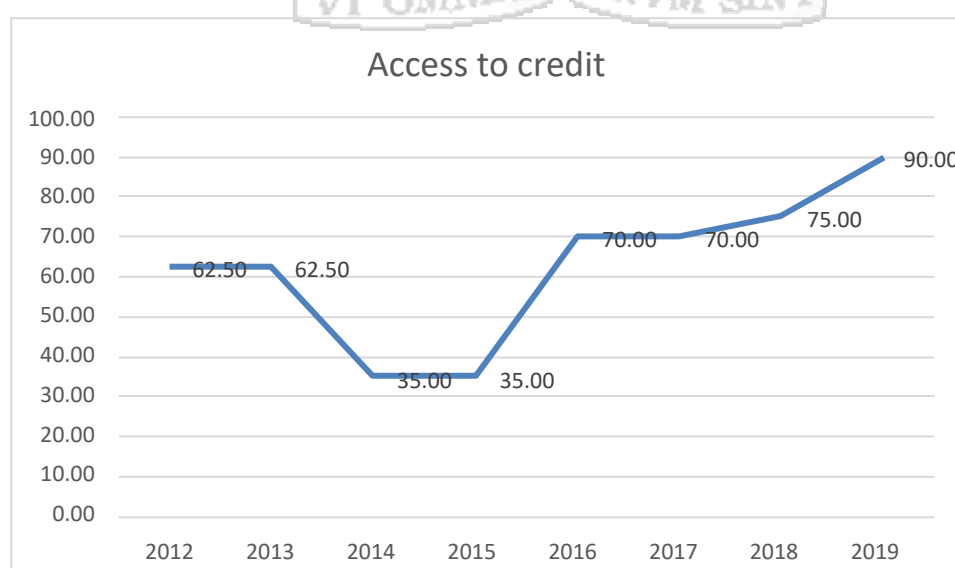
The bureaucracy variable was measured by time of days it took to start a business in Kenya and figure 4.1 shows that there was a steady decline of the time it took to start a business from 2012 to 2017 from 33 days to a low of 22 days in 2017 which rose again to 25 days in 2018 and falling to 23 days in 2019. The decline in the bureaucracy value is indicative of the fact that the Government is putting in measures to make investing in the country more efficient and effective which could potentially result in an increase in FDI flows.



**Figure 4.1: Kenya time to start a business 2012-2019**

#### 4.2.2 Access to credit

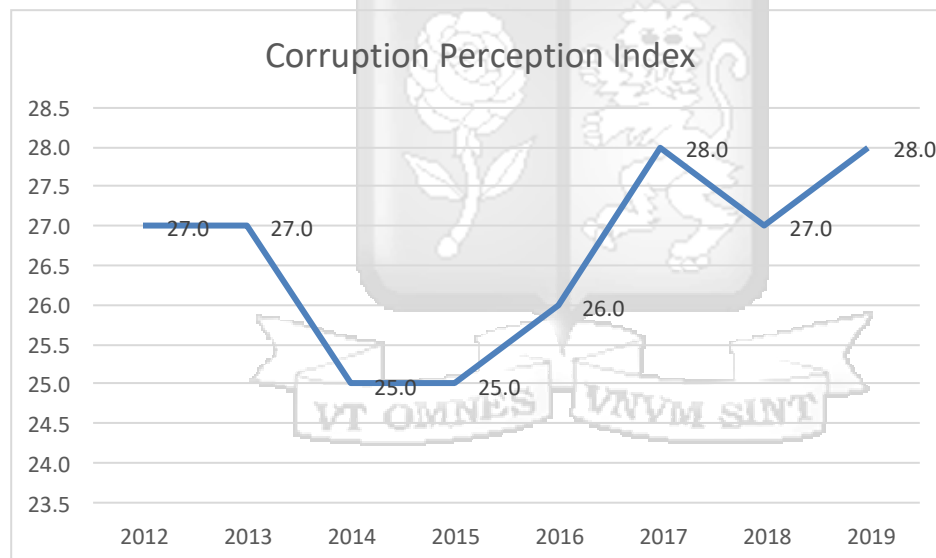
The results show that the access to credit score for Kenya from 2012 to 2019 stood at 62.5 to 2013 and later dropped to 35.0 in the period from 2014-2015. The access to credit score then rose to 70.0 from 2016 – 2017 rising to 75.0 in 2018 and reaching a high of 90.0 in 2019 as seen in Figure 4.2. This shows that over time there was an improvement in access to credit which could potentially result in an improvement in FDI flows.



**Figure 4.2: Kenya access to credit 2012-2019**

### 4.2.3 Political Risk

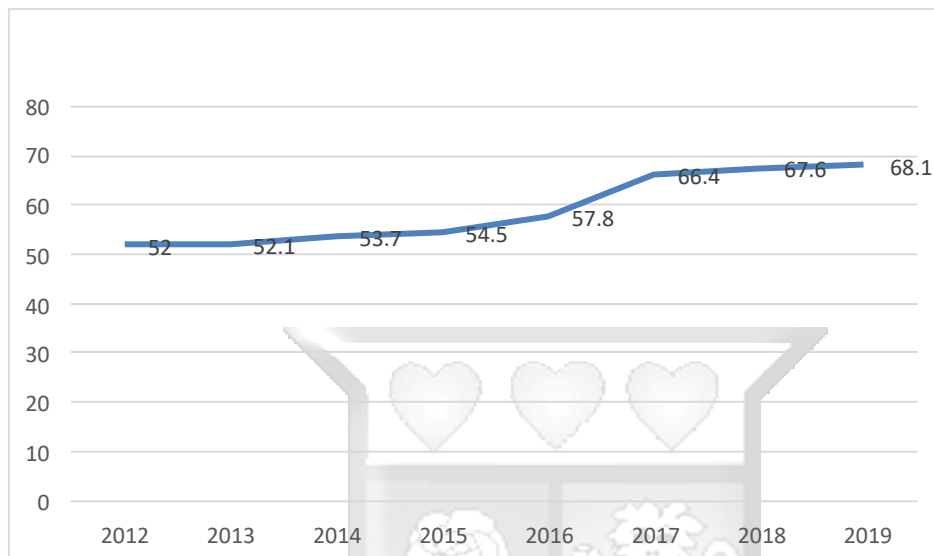
The political risk variable was measured by the corruption perception index (CPI) which stood at 27.0 in the 2012 and 2013 and this later went down to 25.0 from 2014 to 2015 which steadily rose to 26.0 in 2016 and 28.0 in 2017. The CPI dropped to 27.0 in 2018 and later rose to 28.0 in 2019 as illustrated in Figure 4.3. Higher CPI values are indicative of higher levels of Political Risk in a country. In general, Kenya's CPI rating did not change significantly over the study period but can be considered to have risen moderately from 2012. The rise in the CPI rating would likely result in a decline in FDI flows into Kenya's manufacturing sector.



### 4.2.4 Trade Liberalization

The ease of trading score was used to measure the trade liberalization variable from 2012 to 2019 which was 52.0 in 2012 and rose slightly to 52.1 in 2013 to 53.7 in 2014. This rise continued well into 2015 reaching a high of 54.5 and rising to 57.8 in 2016. In 2017, the ease of trading score was 66.4 and later increased to 67.6 in 2018 and reaching an all-

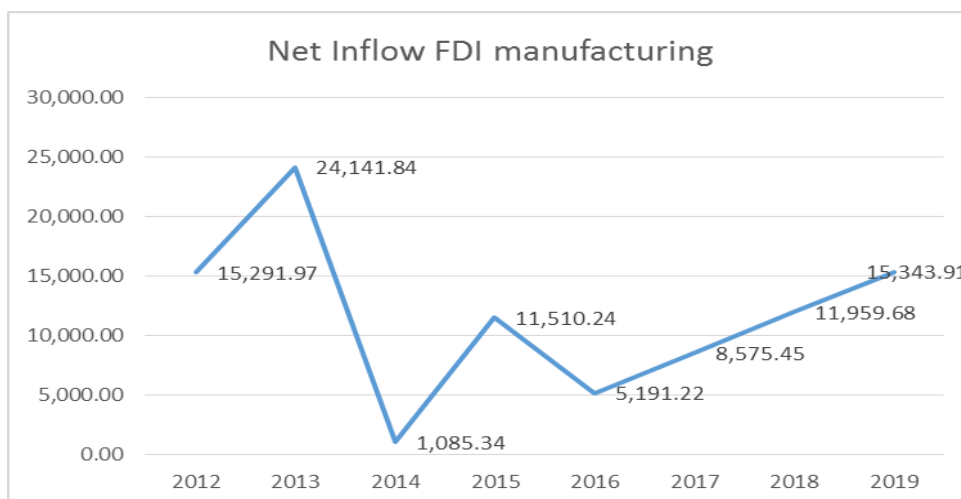
time high of 68.1 in 2019 as seen in Figure 4.4. This shows that the ease of trading improved over the 2012 - 2019 study period which should result in an overall increase in FDI flows.



**Figure 4.4: Trade Liberalization**

#### **4.2.5 Net inflow of FDI in Manufacturing**

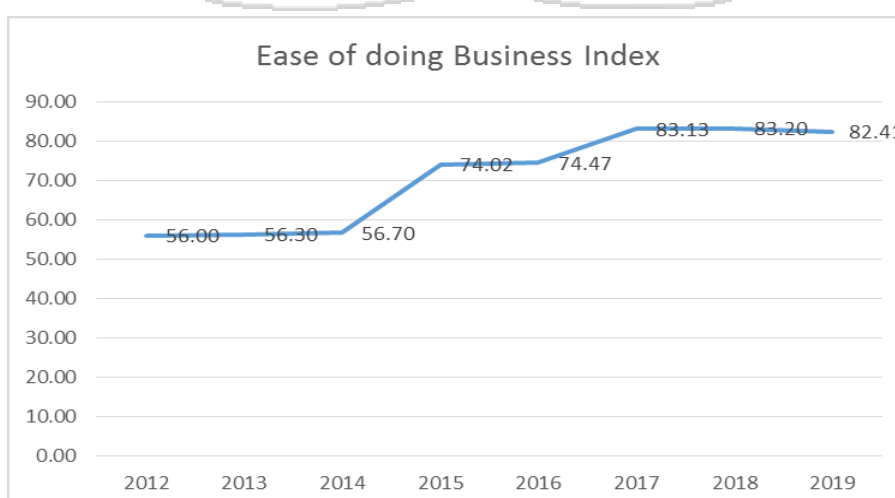
Figure 4.5 shows the net inflow FDI in Kenya's manufacturing sector from 2012 to 2019 which was 15,291.97 USD in 2012 and rose to its highest level in 2013 at 24,141.84 USD. In 2014, the net inflow FDI in the sector experienced its lowest at 1,085.34 USD and later rising to 11,510.24 USD in 2015 and then falling to 5,191.22 USD in 2016 and from then later rising consistently from 8,575.45 USD, 11,959.68 USD, and 15,343.91 USD in 2017 to 2019.



**Figure 4.5: Kenya's FDI in Kenya's manufacturing sector 2012 - 2019**

#### 4.2.6 Ease of doing business

Kenya's Ease of Doing Business Index score over the study period as presented in figure 4.7 below shows that the ease of doing business in Kenya as measured by the World Bank's Ease of Doing Business Index has consistently risen from 2012 with a score of 56 up to a score of 74 in 2015 and ultimately 82 in 2019. The ease of doing business index is the composite index which encapsulates all 4 EDB attribute categories. The upward trend in the EDB index should result in an increase in FDI flows taking into account the OLI theory.



**Figure 4.7: Kenya's ease of doing business score 2012 -2019**

### 4.3 Diagnostic Tests

Several diagnostic tests were conducted before beginning the analysis to measure the interaction between independent and dependent variables. These included the statistical tests for normality, multicollinearity, autocorrelation, and heteroscedasticity.

#### 4.3.1 Normality

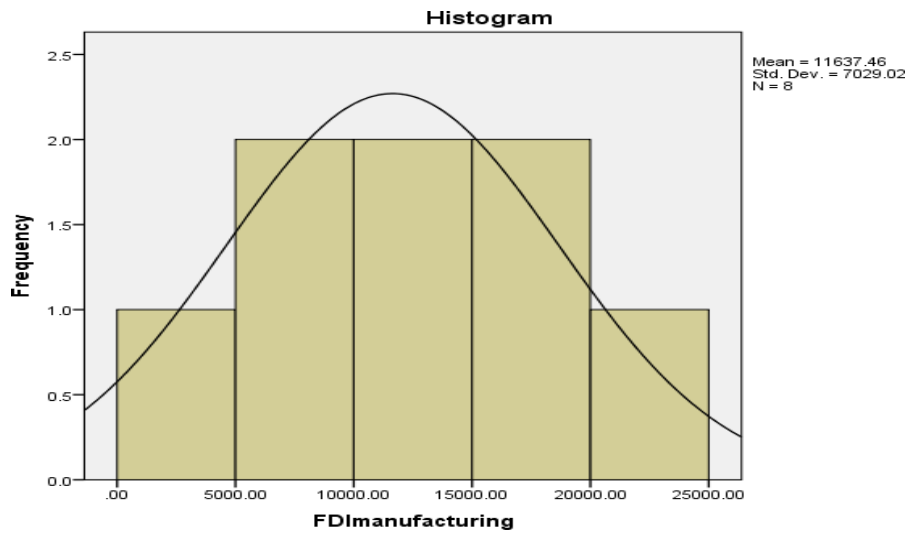
The null hypothesis for this test is that the data are normally distributed. The Prob < W value listed in the output is the p-value. If the chosen alpha level is 0.05 and the p-value is less than 0.05, then the null hypothesis that the data are normally distributed is rejected for both the Kolmogorov – Smirnov and Shapiro – Wilk tests. If the p-value is greater than 0.05, then the null hypothesis is not rejected. Table 4.2 shows that significance values for both tests of normality are above 0.05 which leads us to accept the null hypothesis and indicate that the dataset meets the threshold for normality.

**Table 4.2: Tests of Normality**

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Net Inflow FDI manufacturing	.174	8	.200*	.975	8	.934

\*. This is a lower bound of the true significance.

Figure 4.1 is a graphical presentation of the normality check which was conducted by running a plot against the distribution of the dependent variable. The results show that there is a normal distribution in the data which satisfies the requirement to conduct an inferential analysis.



**Figure 4.1: Normality plot for net inflow of FDI in manufacturing sector**

#### 4.3.2 Multicollinearity

The rule of thumb in checking for multicollinearity in data is that if the Variance Inflation Factor (VIF) value is greater than 10, or the Tolerance is less than 0.1, then you have concerns over multicollinearity. The tests to see if the data met the assumption of collinearity indicated that multicollinearity was not a concern as all tolerance values were above 0.1 and VIF values were less than 10 as shown in Table 4.3.

**Table 4.3: Collinearity Statistics**

Variables	Tolerance	VIF
Bureaucracy	.150	6.662
Access to credit	.245	4.084
Political Risk	.352	2.844
Trade Liberalization	.298	3.350
Ease of doing business	.177	5.658

#### 4.4.3 Heteroscedasticity

A Breusch-pagan test was conducted to check for Heteroscedasticity in the data. The rule of thumb in interpreting the Breusch-pagan test is if the test statistic has a  $p$ -value below an appropriate threshold (in this case,  $p < 0.05$ ) then the null hypothesis of

homoscedasticity is rejected, and heteroscedasticity assumed. The findings in Table 4.4 show that the  $p$ -values are greater than 0.05 which means that there exists no heteroscedasticity in the data.

**Table 4.4: Breusch-pagan and Koenker test statistic and sig-values**

	LM	Sig.
<b>BP</b>	1.563	0.815
<b>Koenker</b>	6.644	0.156

Null hypothesis: heteroscedasticity not present (homoscedasticity).

If sig-value less than 0.05, reject the null hypothesis

#### 4.4 Correlation Analysis

Table 4.6 shows the correlation between the variables where the results indicated that there was positive and significant association between access to credit ( $r = 0.350$ ,  $p < 0.05$ ) and net inflow of FDI to manufacturing sector. However, there was a negative and significant association between time to start a business ( $r = -0.174$ ,  $p < 0.05$ ), political risk ( $r = -0.487$ ,  $p < 0.05$ ), ease of trading ( $r = -0.096$ ,  $p < 0.05$ ) and net inflow of FDI into the manufacturing sector.

The positive association between access to credit and FDI flows into Kenya's manufacturing sector could be indicative of the fact that access to credit results in increased FDI flows or an increased in FDI flows could result in an increase in access to credit. Similarly, the negative associations between bureaucracy and net FDI flows, political risk and net FDI flows as well as trade liberalization and net FDI flows into Kenya's manufacturing sector is indicative of the fact that while there is a negative correlation the direction of causality cannot be clarified given the correlation assessment that has been conducted.

**Table 4.6: Results of the Correlation Coefficients**

		<b>Time to start a business</b>	<b>Access to credit</b>	<b>Corruption index</b>	<b>Ease of trading</b>
Time to start a business	Pearson	1			
	Correlation Sig. (2-tailed)				
Access to credit	Pearson	-.684	1		
	Correlation Sig. (2-tailed)	.062			
Corruption index	Pearson	-.586	.869**	1	
	Correlation Sig. (2-tailed)	.127	.005		
Ease of trading	Pearson	-.938**	.707*	.629	1
	Correlation Sig. (2-tailed)	.001	.050	.095	
Net inflow of FDI to manufacturing sector	Pearson	-.174	.350	-.487	-.096
	Correlation Sig. (2-tailed)	.005	.013	.024	.003

Despite the above, the findings from this study can be somewhat corroborated by studies that were presented in the literature review section which is presented in chapter 5 below.

## **CHAPTER 5: DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

A discussion of the study findings based on comparison with the existing literature review is presented below. The conclusions of the study based on the study objectives are also provided in this chapter along with the practical and political recommendations, and suggestions for areas of future research.

### **5.2 Discussion of the Findings**

#### **5.2.1 Association between bureaucracy and net FDI flows into Kenya's manufacturing sector**

The first aim of the study was to determine the association between bureaucracy and net FDI flows into Kenya's manufacturing sector. The variable of bureaucracy was measured by the number of days it takes to start a business. The findings showed that the average number of days to start a business in Kenya from 2012 - 2019 was 28 days. The correlation coefficient indicated that time to start a business and FDI inflow into manufacturing sector had a negative correlation with FDI flows into Kenya's manufacturing sector.

The findings support earlier studies that found that increase in bureaucratic processes had a negative association on FDI inflow into these economies. This includes Bitzenis et al. (2009) microeconomic assessment on MNCs in Greece between 1995 and 2003 which found that bureaucracy and administrative costs in the form of taxation negatively affected the flow of FDI flows into Greece. Similarly, the findings corroborate those of Ebero and Begum (2016) study in Ethiopia in which found correlations between property

registration, power connection costs, construction permit costs, and cost of setting a business which all are all reflective of bureaucratic costs had a significant negative association with FDI flows into Kenya's manufacturing sector.

### **5.2.2 Association between access to credit and net FDI flows into Kenya's manufacturing sector**

Analysing the association between access to credit and net FDI flows into Kenya's manufacturing sector was the second aim of the study. The access to credit variable was measured by credit scores from the World Bank's ease of doing business reports in which a higher score indicates an increase in the accessibility to credit. The descriptive statistics showed the average score for access to credit was 63.0 (2012 – 2019). The results from the analysis show that there existed a positive and significant association between access to credit and FDI inflow into the manufacturing sector.

The findings agree with those of Lou (2010) who conducted a study in Jamaica which found that access to credit had a positive effect in attracting FDI flows into Jamaica's bauxite industry. Klein et al (2002) finding also corroborates this finding as they established that although organizations were limited by the position of their balance sheets, they were also limited by the lessening in the readiness of lenders to give credit. The findings were similar in a study conducted in China, Li et al. (2011) study on capital endowment, FDI, and credit constraint on a sample of heterogeneous firms which found that financial factors mattered for internationalization of firms and that less credit and more capital endowment constraints have a positive impact on FDI activities. The results disagree with earlier studies such as that of Lien (2003) which found that capital controls in the 1990s did not have an effect of FDI flows into Sub – Saharan Africa.

### **5.2.3 Association between political risk and net FDI flows into Kenya's manufacturing sector**

The third aim of the study was to analyse the association between political risk measured by the Corruption Perception Index and net FDI flows into Kenya's manufacturing sector. The average CPI score for Kenya during the study period (2012 - 2019) was 27. The findings from the correlation analysis indicated that there was a negative and significant association between corruption perception index and FDI inflow.

The findings agree with those of Muli and Aduda (2017) study which found a negative association between political risk and FDI flows. The findings of this study are further corroborated by the study conducted by Zhang (2014) who found that corruption and poor – quality institutions were negatively related with all types FDI flows including manufacturing FDI.

### **5.2.4 Association between trade liberalization and net FDI flows into Kenya's manufacturing sector**

The study aimed to establish the association between trade liberalization and net FDI flows into Kenya's manufacturing sector. This variable was measured by the ease of trade in the World Banks' ease of doing business reports and the findings indicated that an increase in the ease of trade score would result to a decrease in net FDI flows into Kenya's manufacturing sector. This finding from the correlation indicated that there was negative and significant association between ease of trading and FDI inflows into Kenya's manufacturing sector.

This finding supports those of Muli and Aduda (2017) which found that regional integration and trade openness as enshrined in various ease of doing business indicators

were critical to attracting FDI flows to the East African Community thereby motivating the importance of trade openness in explaining FDI flows including FDI flows into manufacturing sectors, in line with the Customs Union theory.

### **5.3 Conclusions**

The study aimed to examine the association between the ease of doing business attributes and net foreign direct investment (FDI) flows into Kenya's manufacturing sector. The ease of doing business was measured by bureaucracy, political risk, trade liberalization, and access to credit. The findings from the correlation indicated that there was positive and significant association between access to credit and FDI inflows. However, the study further finds that there is a negative and significant association between bureaucracy, trade liberalization, political risks and net FDI inflow into the manufacturing sector. These associations corroborate the findings of the OLI theory which states that locational factors such as the one represented by the EDB attributes are still critical in determining net FDI flows into a host country.

### **5.4 Recommendations**

#### **5.4.1 Recommendations for Policy and Regulation**

The findings revealed that the number of days in starting a business were an important factor for net FDI flows into Kenya's manufacturing sector. The study recommends that the Ministry of Trade and Industrialization should continue with its efforts of harmonizing the procedures and processes of business registration so as to reduce the time taken to start a business. This can potentially be achieved by the automation of the

different requirements for starting a business to enable fast transaction for investors to establish their business.

#### **5.4.2 Recommendations for Practice**

The findings show that access to credit opportunities resulted to an increase to net FDI flows into Kenya's manufacturing sector. The study therefore recommends that the financial industry offers credit facilities for firms that aim to internationalize their manufacturing operations into Kenya. These credit facilities should also be competitive enough compared to those offered by transnational institutions which may lure these firms to other economies in the region.

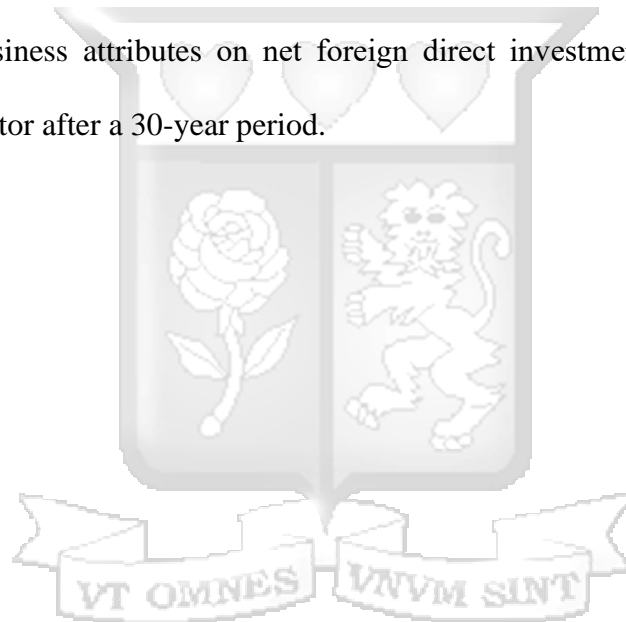
The results show that ease of trade resulted to a decrease in net FDI flows into Kenya's manufacturing sector. The study recommends that Kenyan authorities focus on creating a conducive environment for international firms to operate from Kenya by offering competitive terms in comparison to other members of the East African Community (EAC) who attract manufacturing firms into their economies. This can be done by increasing access to markets through the construction of transport and energy infrastructure which is an important input for performance of the manufacturing sector.

#### **5.5 Areas for further Research**

The study recommends research on the causality between ease of doing business attributes and FDI flows into Kenya's Manufacturing sector. The also recommends the assessment of the influence of ease of doing business on FDI inflows in other sectors such as mining and agriculture which are important industries for the economic development of Kenya.

## 5.6 Limitations of the Study

The study focused on investigating the correlation between the ease of doing business attributes and net foreign direct investment flows into Kenya's manufacturing sector. The study was limited to the study period from 2012 – 2019 in which data on net inflow of FDI into Kenya had been published. The limitation to this period meant that the study could not use regression analysis to determine the size and effect of the ease of doing business variables on FDI inflow to the manufacturing sector. The study recommends for future studies to focus on using OLS regression to determine the relationship between ease of doing business attributes on net foreign direct investment flows into Kenya's manufacturing sector after a 30-year period.



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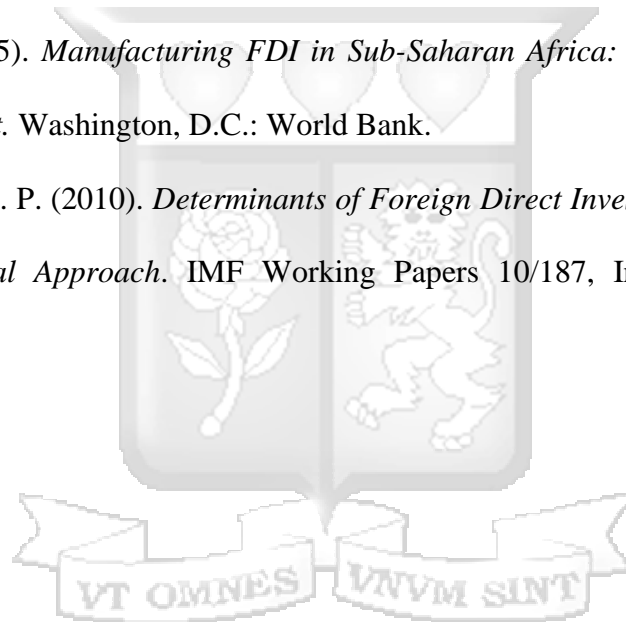
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# APPENDICES

## APPENDIX 1: RESEARCH PERMIT

 <b>REPUBLIC OF KENYA</b>	 <b>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY &amp; INNOVATION</b>
Ref No: <b>286696</b>	Date of Issue: <b>08/July/2020</b>
<b>RESEARCH LICENSE</b>	
	
<b>This is to Certify that Miss.. Adah Sylvia Olando of Strathmore University, has been licensed to conduct research in Nairobi on the topic: THE EFFECT OF EASE OF DOING BUSINESS ON NET FOREIGN DIRECT INVESTMENT (FDI) FLOWS INTO KENYA'S MANUFACTURING SECTOR for the period ending : 08/July/2021.</b>	
License No: <b>NACOSTI/P/20/5642</b>	
<b>286696</b> Applicant Identification Number	 Director General <b>NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY &amp; INNOVATION</b>
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## APPENDIX 2: ETHICAL APPROVAL



**Strathmore**  
UNIVERSITY

17<sup>th</sup> September 2020

Ms Orlando, Adah  
adah.olando@strathmore.edu

Dear Ms Orlando,

**RE: The Effect of the Ease of Doing Business on Net Foreign Direct Investment Flows into the Manufacturing Sector in Kenya**


This is to inform you that SU-IERC has reviewed and **approved** your above research proposal. Your application approval number is **SU-IERC0861/20**. The approval period is **17<sup>th</sup> September 2020 to 16<sup>th</sup> September 2021**.

This approval is subject to compliance with the following requirements:

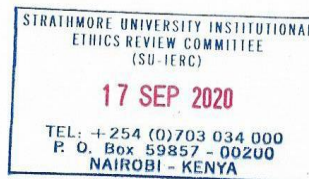
- i. Only approved documents including (informed consents, study instruments, MTA) will be used
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC.
- iii. Death and life threatening problems and serious adverse events or unexpected adverse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

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

Yours sincerely,

  
Dr Virginia Gichuru,  
Secretary; SU-IERC

Cc: Prof Fred Were,  
Chairperson; SU-IERC



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## **APPENDIX 2: DATA COLLECTION PROCESS**

**Research Topic:** The Effect of the Ease of Doing Business on Net Foreign Direct Investment (FDI) Flows into the Manufacturing Sector in Kenya

**Researcher:** Adah Olando - MDF/106123/17

### **NET FOREIGN DIRECT INVESTMENT AND EASE OF DOING BUSINESS DATA REVIEW PROCESS**

**Step 1:** Review the requisite Foreign Direct Investment and Ease of Doing Business data for the proposed research period

**Step 2:** Disaggregate FDI data into sectoral flows with the objective of isolating FDI flows into Kenya's manufacturing sector

#### **Step 3: Data Collection**

- a. Collect full data set constituting FDI flows as published by the Government of Kenya
- b. Collect full data set constituting all the relevant ease of doing business indicators as published in the World Bank data base. Consult any other data bases that could supplement the Ease of doing business indicators as published by the World Bank
- c. Collect the relevant macroeconomic factor data as published by the World Bank

#### **Step 4: Define what should be assessed**

- a. Coverage: All information will relate to Kenya over the proposed study period 2010 - 2020
- b. Proxies: Where data particularly relating to the Ease of Doing Business indicators is missing, proxy data as published by other Development Financial Institutions will also be considered.

#### **Step 5: Collate and Analyse**