

**THE RELATIONSHIP BETWEEN POLITICAL RISK AND INVESTMENTS IN  
KENYA**

**AZIZ SHABBIR MOHAMEDALI**

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## DECLARATION

I declare that this research project has not been submitted to any other university for an award of a degree and is my original work

Signed.....  .....Date... October 25, 2022

AZIZ SHABBIR MOHAMEDALI

D61/75999/2012

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

### Supervisor

Signed.....  .....Date... October 25, 2022

Dr. Herick Ondigo

Senior Lecturer,

Department of Finance and Accounting,

University of Nairobi

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## **ABBREVIATIONS AND ACRONYMS**

<b>BSC</b>	-	Balanced Score Card
<b>CAPM</b>	-	capital asset pricing model
<b>CEO</b>	-	Chief Executive Officer
<b>CMA</b>	-	Capital Markets Authority
<b>FDI</b>	-	Foreign Direct Investment
<b>GDP</b>	-	Gross Domestic Product
<b>ICRG</b>	-	International Country Risk Guide
<b>KNBS</b>		Kenya National Bureau of Statistics
<b>MNCs</b>	-	Multinational Corporations
<b>NSE</b>	-	Nairobi Securities Exchange
<b>PRS</b>	-	Political Risk Services
<b>UNCTAD</b>	-	United Nations Conference on Trade and Development
<b>USA</b>	-	United States of America

## ABSTRACT

Investments are determined by many factors. Many risks come into the mind of investors at the time of making investments. The bottom line of any investment is usually whether returns will be satisfactory or not. To earn these returns, underlying risks are usually assessed based on the premise whether the risks materialize or not so that the net gain should be more than the investment made. This study had the objective to establish whether there is a relationship between and political risk and investments in Kenya. Investment was measured using an investment rate, which was a percentile of gross capital formation (annual investments) and gross domestic product, and data was collected using secondary data from the World Bank data bank for the gross capital formation and from KNBS for the GDP. Political risks variables obtained from political risk service international website were political stability and absence of violence, government effectiveness, and regulatory quality, rule of law and control of corruption. Data was collected for thirty (30) years. Descriptive statistics, diagnostic tests and thereafter inferential statistics namely the correlation analysis and regression analysis were undertaken. According to the descriptive analysis, it was observed that during the election period in the 90's, investments were affected within the same year, while in the 2000's the investments were affected the year after the election (following year (post-effect)). During the promulgation (a major political breakthrough) in 2010 it was observed there was increase in investment in that year compared to 2009 and 2011. The findings of the inferential statistics was that there is a statistical significant relationship of 72.5% that existed between investments and political risk, meanwhile amongst the political risk variables, political stability, government effectiveness and regulatory quality were seen to be significant to the model while rule of law and control of corruption were insignificant. The government effectiveness variable of political risk had a positive coefficient hence supporting the general theory of investment, whilst the political stability and regulatory quality had a negative coefficient, hence, supporting the portfolio theory. The study recommends that though political risk influences investments in Kenya, other risks also need to be taken into considerations such as economic risks and financial risks. Conversely, the study also recommends that similar studies should be done separately for developed and developing countries. Finally, the study used investment as a percentile of GDP, hence, future studies should use absolute values and adjustments to real values in order to enhance comparability.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Political risk bears greatly on the performance of any country considering macroeconomic measures such as investment (Salahuddin, Islam & Salim, 2009). While some countries in the world experience relatively calm political environments, others are featured with tumultuous and erratic political environments. Given the risk averse nature of investors, they have to factor the political risk in a country they invest their funds in. This indicates, the responses of investors to a given level of political risk may vary with time and context. According to Restrepo, Correia & Poblacion (2012) political risk definitely has an effect on investment.

Political risk is difficult to accurately define since the concept is highly contextual and its meaning has been varying across time (Wafo, 1998). According to Agmon (1985), political risk is “the unanticipated changes in political factors that affect the relative prices of traded factors of production, goods and services caused by the actions and reactions of governments and other political groups within and between countries.” This meaning restricts itself to political risk basing on the position that it emanates from the activities of the state. Another definition was provided by Robock & Simmonds (1973) from an international business perspective as discontinuities that occur in the business environment resulting from difficulty in anticipation and resulting from political change.

Investment also is defined according to the context within which the definition has to be done. Levine & Renelt (1992) define investment as: first, the act of committing money or capital to an undertaking hoping to benefit by way of further profit or additional income; and secondly, it refers to the purchase of an asset with the hope of generating extra income or value in future; thirdly, the procurement of goods not for today’s consumption but for the creation of future wealth; and lastly, a monetary asset bought on the assumption of future value increase or future income generation on the premise that it will be disposed at a higher price. According to Keynes (1936) investment is “the current addition to the value of capital equipment which had resulted from the productive activity within the period.”

As per Keynes investments was viewed as that part of the income within the period that has not become consumption.

Investment is a very powerful variable used in the macroeconomic analysis of development. This importance of investment emanates from the Ricardian conception that raising the investment in an economy drives long run economic growth. It has been observed that countries having experienced long run sustained growth have had a correlation between capital accumulation and economic growth (Salahuddin, Islam & Salim, 2009). This makes mobilization of investment an essential ingredient of development. The United Nations (2002) posited that it had become clear that though public expenditure is important for development, the demand for finance overrides what can be provided by the public sector. The report recognized that a considerable increase in private investment was a minimum requirement for the achievement of countries internationally set development targets.

Despite investment gaining recognition as a channel through which economic development can be achieved, its success varies according to the political situation in the country the investment is carried out. Wafo (1998) argues that activity of the state within a country and when handling issues with other countries can lead to reactions that will lead to variations in investment with regard to the various sources of the investment.

This study is guided by General Theory of Investment, Portfolio Theory and Capital Asset Pricing Model. The General Theory of Investment explains future likely investments when the future risks seem low and vice-versa (Keynes, 1936). Modern Portfolio Theory explains that diversification of investments helps reduce the unsystematic risk but not the systematic risk. This basically means that if political risk (systematic risk) is high, then investments will increase in order to create a portfolio that will reduce the unsystematic risk and vice versa, since the systematic risk cannot be diversified (Markowitz, 1952). Finally, CAPM was posed by Sharpe in 1970 after critiquing Modern Portfolio Theory. He stated that even if trying to diversify risk, the systematic risk still remains, hence, he developed Beta factor which would measure the risk, and hence effect investment decision.

It is worth noting that firstly, most of these theories usually relate to stock markets, but would also apply in all spheres of investments, and secondly political risk would fall in the category of systematic and market risks

### **1.1.1 Investment**

According to Keynes (1936), investment is viewed as the current investment in an economy. He posited that current investment value is the value addition to the current capital tools due to production within the period. Hence, investment period's income that has not been added to consumption. Therefore, investment is the additions and replacements of fixed assets stocks. This comprises of structures, software, equipment, and account of investment. The rate of investment is expressed as a fraction of the Gross Domestic Product (GDP) in a specified period.

Financially, investment refers to the act of a person committing funds in for future benefits realized as income, dividend, pension, or capital appreciation (Levine & Renelt, 1992). In this study investment borrows the definition of Levin & Renelt (1992) but will include: the purchase of an asset with the hope of generating extra income or value in future; the purchase of goods not to be consumed today but used for future wealth creation; purchase of monetary assets with the hope that the asset will provide will appreciate in value or provide future income.

Investment can be looked at from different perspectives. Private investment is investment done by non-government entities in their own right while public investment refers to the provision of the necessary infrastructure for economic activity in a country (Artadi & Sala-i-Martin, 2003). Foreign investment is defined by (UNCTAD, 2002) as investments, which are long lasting in nature and directed towards businesses located outside the investor's country. Foreign investment includes subsidiaries, joint businesses and mergers & acquisitions. These are investments owned by foreigners. On the other hand, domestic (local) investment refers to investments attributable to Kenyans. In this study, investment will mean the totality of public, private, local and foreign investment. Hence, we will apply

in this study the definition of OECD which states investment is acquisition of assets less the disposals, which will be used in the production of goods and services for more than a year plus the net changes in inventories, which are goods held temporarily to make gains

### **1.1.2 Political Risk**

Political risk scholars argue that political risk is a highly contextual term making it difficult to define (Restrepo, Correia & Poblacion, 2012), but scholars such as Tomz & Wright (2010) indicate that political risk derives from the national, regional and local levels of government activity. Feils & Sabac (2000) view political risk with regard to political events that affect investment in a country. Jarvis & Griths (2007) argue that political risk is a function of international relations and closely associated to the state system sovereignty. Anna & Campbell (2002) explained political risk as a blend of undesirable costs of political activity. It is also the combined negative impact of government and society's actions on investors. These definitions of political risk support the first-generation schools of thought that were popular before 1960.

Other scholars found the definition of political risk based on government activities rather delimiting leading to the rise of the system–event school of thought. These scholars define political risk in terms of events and their effect on investment. For instance, Almond & Coleman (1960) stressed the identification of the events that had an effect on the stability of the regime and that deflates its governance capacity. It should also focus on factors that enable the occurrence of political events that shake the governance system's stability, political maturation and acceptability. This associates political risk with political occurrences like political and social unrests, labour unrests and currency control difficulties and import constraints.

The later generation of political risk employed the positivist outlook to political risk. Popular in the 1970s the positivist outlook to political risk was driven by the success of the sciences in analyzing political risk. They focused more on the importance of context at project-specific level analysis. The fourth generation of political risk outlook focused on the use of generated data to measure political risk. Many projects political risk triggers

such as food security, ethnic and religious tensions, civil conflict etc. (Jarvis & Griths, 2007).

### **1.1.3 Political Risk and Investments**

According to Wei (2000), there is an expected strong negative association between political risk and investment. This points to the fact that countries with high risk indicators experience dipping investment since investors avoid such countries. However, due to the variation in what constitutes political risk, variations arise. Busse & Hefeker (2005) conducted a study that broke down political risk into 12 variables and studied how they related with investment in 83 developing countries. The variables were: stability of government; pressures from socio-economic factors; investment portfolio and profiles; domestic conflict; external conflict; the level of corruption; the impact and the dominance of the military in politics; religious anxiety and tensions; law and order; the degree of ethnic and racial tensions; government accountability, level of democracy and the institutional strength. In this study, a higher indicator showed low risk while a lower indicator showed low risk. The results showed mixed relationships between each variable and investment

The negative relationship expected stems from the assumption that, in this study, a higher score on the measure of risk will indicate high rating therefore low risk while a lower score will mean low rating, therefore high level of risk. Secondly, basing on the capital asset pricing model (CAPM) investors, assumed to be risk averse, will avoid markets that are riskier give a certain rate of return. In effect, this means that investors will tend to avoid risky markets so that is inversely proportional to investment (Fama & French, 2004).

### **1.1.4 Political Environment in Kenya**

To-date, Kenya, like almost every other Africa country, is suffering the negative effects of historical injustices and oppressive colonial structures sustained by post-colonial leaders (Nyadera, Agwanda & Maulani, 2020). Most state institutions are weak, legislative structures are flawed and there are seemingly self-perpetuating political power struggles at the expense of citizens' well-being. The relationships with the international community are not stable and keep varying. More of the countries that relate with Kenya tend to address

more of their interest and benefit from the status quo than support the establishment of functioning systems (Ong'ayo, 2008).

Political instability in Kenya is majorly due to internal factors. A combination of such factors, for instance, unequal development of regions, disease and ailments, impoverishments, violence and the manipulative/devious tendencies and propensity of the local elite, political and economic instability keep putting Kenya on the edge as an investment destination for locals and foreigners. Despite the presence of institutions for delivering essential services to citizens, the institutions are weakened by elite politics through political manipulation and predation. These tendencies result in wars for resources, rivalry among ethnic groups and post-electoral violence (Oyugi, Wanyande & Mbai, 2004).

## **1.2 Research Problem**

Political risk is a prime consideration in the investment decisions made by any individual investors. Keynes' (1936) General Theory of Investment posited that investment depends highly on the business cycles in a country. This was after a long time study of how national investment varied as a result of capital stock growth and fluctuation in economic activity. Markowitz's (1952) portfolio theory, strongly related risk to expected return arguing that expected return depends on risk. This relationship affected investment decision of the risk-averse investor. In the position by Eaton, Gersovitz & Stiglitz's (1986) in the pure theory of country risk, political risk is directly connected to investment. The theory argues that political risk in a country causes variation in both local investment and FDI. The three theories, together, indicate a relationship between investment and risk.

The political environment in Kenya is highly variant (Oyugi, Wanyande & Mbai, 2004). The variance is driven by both internal and external factors. The effect of factors such as unequal interregional development, poverty, disease, political violence etc. keep putting Kenya on the edge as an investment destination for locals and foreigners. The effectiveness of institutions and framework to manage the variance causing factors is limited by the continual failing of these institutions, through political manipulation. This pushes more Kenyan investors to seek investment opportunities abroad and/or reducing their local

investment. Increasing numbers of foreign investors are only marginally considering Kenya as an investment destination.

A study by Jensen (2012) covered 153 countries in the world found that political risk hurt the interests of investors and more democracy in political institutions led to lower political risk. Another study by Khan & Akbar (2013) on 94 countries across the world covering a time span of 24 years from 1986 to 2009 found that political risk has impacts negatively on FDI. In Kenya, a study by Salesio (2006) covering all the 43 licensed insurers in Kenya found them to be highly exposed to legal risk and political risk. The study conducted by K'Obonyo, M'Nchebere & Mugambi (2012) on the 56 listed companies in Kenya's Nairobi Stock Exchange (NSE) covering five years from 2002 to 2006 found that political risk, corruption and economic factors were among factors that affected financial performance.

The theories and empirical studies cited above have not been able to address the question of the relationship and correlation between political risk and investment. Those that attempted to do this limited themselves on FDI leaving out domestic investment. This study is different from these earlier studies since it will address itself to addressing, first, the relationship between political risk and investments, and, second, including both local investment and FDI in the research. This increase or decrease in investment and inventories can be resolved by getting the gross capital formation annually, which is the net investment in a country, hence, incorporating both the local and FDI. Secondly as mentioned by Oyugi et al in 2004 that political environment in Kenya is vibrant, then this research should pose to resolve as to whether the political risk affects investments in Kenya, Therefore, this will be resolved by studying and answering the question as to what is the relationship between political risks and investments in Kenya?

### **1.3 Research Objective**

To establish the relationship between investments and political risks in Kenya.

### **1.4 Value of the Study**

This research will address the research gap about explaining the relationship between political risk and investments. Current and future scholars will, therefore, use the findings

of this study useful in contributing towards the scholarly discussion regarding how political risk influences investment. They may use the study as reference in future discussions on risk and investment.

The government of Kenyans will access a researched position regarding how political activities and policies contribute to investment in Kenya. This study will expose the Kenya-specific political factors that contribute to variability in investment. This will contribute to informing direction to the policy makers regarding the management of the political behaviour in the country to achieve desired investment behaviour.

The economic planners and policy makers will have researched information that directly relates political risk to investment in Kenya. This will make them come up will come up with more accurate investment policies tailored to Kenya's political environment.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The literature review includes theories on the connection between political risk and investments. The literature review also focuses on past studies on the connection between and political risk and investments. The theories reviewed include the General Theory of Investment, Portfolio Theory and the Capital Asset Pricing Model.

#### **2.2 Theoretical Literature Review**

This study is based upon the overview that political risk is a risk (categorized as a systematic and market risk) affects investments, hence anchored upon the general theory of investment (Keynes, 1936), portfolio theory (Markowitz, 1952) and Capital Asset Pricing Model (Sharpe, 1970). This subsection discusses the theories.

##### **2.2.1 General Theory of Investment**

The theory was brought forward by Keynes (1936) and relates to the variations in investment to business cycles in a country. In the simplest summary, when investors exude optimistic forecasts, then investments are likely to take place, in order to obtain high future returns, meanwhile when the risks tend to be high, like having a political coup, then there would be a lack of confidence, hence, no investment

This theory suggests that the financial environment within which investors operate will determine decisions concerning investment. According to Stiglitz & Weiss (1981), risk of any form becomes embodied into the cost of capital for investors. Consequently, unless matched with returns that sufficiently absorb the cost of capital, investors will be drawn away towards better businesses or towards countries that will have lower risk and better returns. This therefore, contributes to the variation of investment in a country.

Keynes theory has been criticized since it focused on the importance of investment resulting from its long run effect on capital stock growth and fluctuation in economic activity while ignoring technological condition. He stressed monetary factors, finance and uncertainty as fundamental determinants of investment. In the theory of investment, financial and monetary conditions affect a firm's capital spending and investments, conversely, this theory is relevant to the study as it states that managers exude confidence when the risks are low, and when that happens then investments take place heavily and vice versa.

### **2.2.2 Portfolio Theory**

The modern portfolio theory was laid down by the works of Markowitz (1952). It relates risk and return and suggests the mean-variance approach to mitigation of risk for the risk averse investor. According to this theory, it is not enough for an investor to look at the risk and the return of an asset considered for investment. Rather, the investor should look at the ways in which the asset can contribute to a portfolio that will not only reduce risk but also increase returns. This can be done by analysis of the correlations of the various returns of possible assets in order to come up with combinations that will optimize risk and return.

This theory emphasis that investors seek to look for a well diversified portfolio in order to reduce the overall portfolio risk. The portfolio comprises of both systematic and unsystematic risks. Systematic risks are market risks and comprise of political risks, market risks, purchasing power risk, exchange rate risk and others which cannot be diversified away, meanwhile, the unsystematic risk are specific to a company and can always be diversified away.

Though this theory has been criticized as to having shortcomings in the real world since it requires investors to rethink the notion of risk and to increase investments in order to reduce the overall risk, which would mean heavy investments. This would go against the normal economies where majority of commoners and citizens having very limited capital try to make such heavy investments to reduce risks. However, this theory is relevant to this study since it assumes that systematic risks like political risk cannot be diversified, hence, when

the systematic risks are high, investors invest highly in order to reduce the unsystematic risks in order to reduce the overall portfolio risk in order to maximize the expected return

### **2.2.3 Capital Asset Pricing Model**

CAPM developed by Sharpe, Treynor, Linter and Mossin in 1970 and is an evolution of Modern Portfolio Theory/ The states that all the investments in an economy are affected by the systematic risk only and not the specific risk (unsystematic risk) and all investments have at least a minimum rate of return which they referred to as the risk free rate. The unsystematic risk can be diversified away but the systematic risk cannot, hence, the return is based and correlated to the market return and risk thereupon

The greatest bond of contention from the portfolio theory was the systematic risk. Sharpe et al depicted a scenario that even if portfolios were highly diversified to eliminate the total risk, some level of risks would always exist, hence the systematic risk still exist as it can't be eliminated by diversification, and therefore, investors would develop a return that would offset that risk.

He conversed the whole theory to stipulate that it is the systematic risk mostly plagues investors, and developed the CAPM formula, which comprises of the equity market premium, which is multiplied by Beta. And according to Sharpe, Beta is the only relevant measure of stocks risk. Securities are held on to and investments are undertaken when beta is greater than one and market is rising or beta less than one and market is falling

This theory though highly used is also criticized due to its limitation in real world, since many investors do not diversify in a planned manner and secondly due to the basic assumption that risk free rate will remain constant over the discounted period and if it increases then usually the cost of capital used in investment also increases, and could make the stocks looked overvalued, however, this theory is relevant to the study as political risk

is a systematic risk, and CAPM has formulated a way to measure systematic risk, and how much risk the investment would add to the portfolio that will look like the market or deviate from it

### **2.3 Empirical Literature Review**

A study done by Jensen (2012) determined the impact of political risk and democratic institutions on FDI. The data used for the study covered 153 countries and was obtained from ONDD (Office National du Dueroire). This is the Belgian Export Credit Agency which was supplemented by qualitative data from interviews with people in multinationals to estimate the effect of democracy on political risk the study used Ordered Probit Models. The study found that political risk was detrimental to the interests of investors and more political institutions led to lower political risk.

In another study, Vadlamannati (2012) sought to determine the influence of political risk on FDI. The study was done with USA firm as the units of analysis. The data were on investment activities of American firms in 101 developing countries between 1997 and 2007. The findings revealed that during times of lower political risk the number of firms with equity stake of 51% and above increased. The low political risk also increased ROI. Further analysis revealed that the connection was also strong with regard to investments in assets and sales.

Agiuar, Conraria, Gulamhussen & Magalhase (2012) conducted a study in to the factors that drove FDI in Brazil categorized basing on country of origin. The study used 180 countries whether or not they had FDI in Brazil. The study singled out the impact of country political risk on outward FDI using multiple estimation methods. The study found that countries having lower political risk invested more in Brazil. This adverse relationship between risk and FDI resulted from the policy environment of home countries. The study also established that that the political/institutional environment was the most likely driver of the negative relation.

Khan & Akbar (2013) conducted a research to establish the connection between political risk and FDI among 94 countries across the world. The study covered a time span of 24 years from 1986 to 2009. The political components used for the study were: socioeconomic conditions; investment profiles; internal and external conflicts; military involvement in politics; corruptions; law and order; religion involvement politics; democratic accountability; ethnic tensions and bureaucratic quality. The study employed the Ordinary Least Squares (OLS) to analyze data in which each of the indicators of political risk was separately regressed against FDI. The study established that political risk had an adverse influence on FDI.

On the African scene, Kriel (2011) established the link between political risk and the financial performance through a study in five countries in Africa. The study employed financial ratios of 405 firms spread across the five countries. A variety of variables measuring political risk was used in the assessment. The analysis discovered a strong positive connection between political risk and return indicating that higher risk was associated with higher the return to firm as a result of hedging against risk.

Singhania and Saini (2017) also scrutinized the association between FDI flows and social inclusion or pro-social policies in the host countries. The study applied a dataset of 59 countries in Africa. The findings indicated that a strong link between FDI flows and pro-social policies. Further analysis revealed that the two pro-social policies impacted positively on a country's capacity to attract FDI.

A study was conducted by Salesio (2006) to identify the risks Kenyan insurers addressed, the strategies the insurance companies used, the techniques they adopted, and the experienced challenges when mitigating the risks. The study was exploratory and employed survey methodology. The study targeted all the 43 licensed insurance companies. Self-administered questionnaires were used to collect primary data. The study determined that the insurance industry was vulnerable to economic risks, legal risks, political risk and other types of risk they investigated.

K'Obonyo, M'Nchebere & Mugambi (2012) conducted a study whose objective to conclude the impact of contextual factors on corporate performance in Kenya. It employed Kaplan

and Norton's Balanced Score Card (BSC) to measure corporate performance. The study focused on all the 56 listed companies. It used both primary and secondary data in analysis. Data were collected from the CEOs of the listed companies. Secondary data were collected from Capital Markets Authority (CMA) and NSE (Nairobi Stock Exchange) and focused on financial variables. The data covered five years from 2002 to 2006. Exploratory principal component factor analysis extracted security, political risk, corruption and economic factors as factors that affected financial performance.

Odero (2015), in his study of the impediments affecting Turkana county observed that corruption which is a political risk created high uncertainties increased the risk in investments, hence, impeding investments. Furthermore he asserted it also increased the costs of doing business

Abala (2014) investigated main drivers of GDP growth and the drivers that drive the FDI in Kenya. The study used panel data collected from World Bank. From 1970 – 2010. He performed regression analysis and concluded FDI were market seeking which needed political stability, growing GDP's and good infrastructure

Gachunga (2019) considered the impact of FDI inflows in various sectors and its impact on economic growth in Kenya. Secondary data was collected from World Bank and KNBS from year 2007 to 2017 and Augmented Solow Model was used to determine growth within the country. The findings indicated that political risk affected FDI in various sectors of the country

## **2.4 Determinants of Investment**

Factors determining investment are many and both quantitative and qualitative. The factors that were stated as quantitative in nature include rates of interest, capital, profit, and market size (Suresh, 1997). According to Keynes (1936), increasing the rate of interest distorts investment activity while a reduction in interest rates encourages investment. Suresh

(1997) stresses the importance of profit as a determinant of investment and argues that increased profitability increases investment.

Institutional factors affecting investment include the presence of strong institutions that facilitate economic exchanges, efficient allocation of resources and enhancement of efficiency in economic activities. The role of strong institutions is putting in place constraints that enhance the level of freedom of investors without fear of unnecessary risk. When people have no fear with regard to expropriation and troubles in the market, investment tends to grow faster (North, 1991).

Investments are also driven by other financial and macroeconomic factors. These macroeconomic factors and variables include from domestic sources advocated (Feldstein & Horioka, 1980); growth (Loayza et al, 2000); policies in relation to trade (Rodriguez & Rodrik, 1999); inflation or macroeconomic stability (Fisher, 1993) and expenditure by the government or government spending (Barro, 1990). Funds are channelled from savers to investors, and this is the backbone of the financial system of an economy. A strong determinant of investment in an economy can be linked to the depth of financial development (Levine, 1997).

According to OECD investment is the acquisition of assets less the disposals, which will be used in the production of goods and services for more than a year and the net changes in inventories, which are goods held temporarily to make a gains. This is an indirect approach to know totally what is the local investment and the FDI into an economy. Here, the fixed assets are usually netted off against disposals, which include but not limited to purchase of plant and machinery, constructions of buildings etc., meanwhile the changes in inventories are goods held by firms that are expected to get fluctuations, hence, gain in the end of the process. Besides only the fixed assets and inventories, it also comprise of net acquisitions of valuables. This is the gross capital formation

## **2.5 Summary of the Literature Review and Research Gaps**

The literature review section assess the theoretical framework that will guide the study in analysis and relating findings of the study to these theories. The theories that the study found relevant were the General Theory of Investment and the Portfolio Theory. The General Theory states that low risk leads to higher investments due to high returns, meanwhile, the Portfolio theory contradicts that position and stipulates high systematic risk (political risk) lead to high investments since high returns would reduce the unsystematic risk of the portfolio. Therefore, this study tries to establish which theory would relate to Kenya

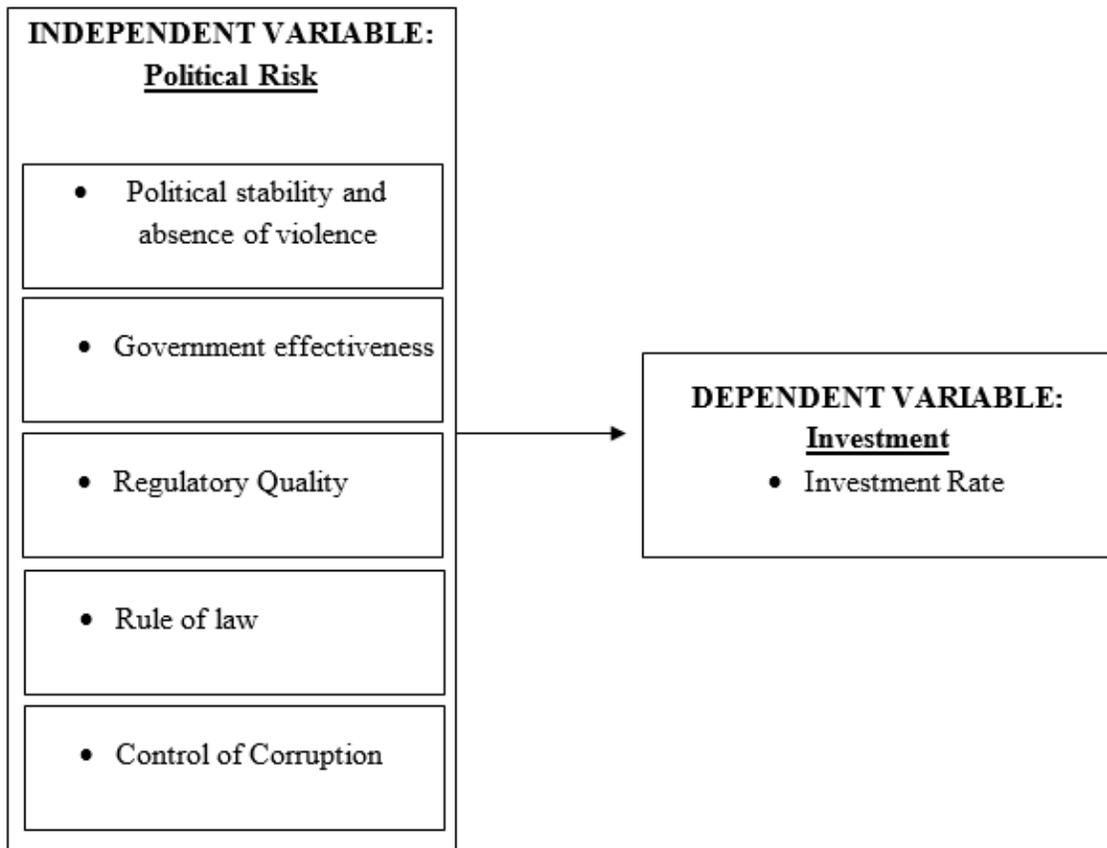
Similarly in the empirical studies, none of the studies have been able to describe the how investments are determined by political risks. Most of the studies have looked at how political risk affect foreign direct investment ignoring local investment not only in Kenya but also amongst all studied countries. The study will also ascertain how investments behave during election years and during the promulgation of the new constitution in 2010 which was a major political break through. Finally, the research will determine whether there is a relationship between political risk and investments in Kenya

## **2.6 Conceptual Framework and the Model**

Conceptual framework is an analytical tool used to structure a presentation and adopts standards taken from various fields of enquiry

Figure 2.1 below presents the conceptual framework of the variables in this study. The dependent variable will be the investment rate. The study will have five sub-variables of political risk as shown below. The sub-variables are political stability and the absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption.

**Figure 2.1 Conceptual Framework of the Variables**



**Source: Author**

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter describes the steps the researcher used in order to attain the stated objectives of the research. In describing, the methodology to be used in this study, this chapter focuses on the target population, the research design and how data was collected. The chapter also details the method that the data was analyzed and presented, inferences drawn which lead to conclusions and recommendations

#### **3.2 Research Design**

A research design is the outline, framework and guidance tool that the researcher uses to collect and analyse data. The research was a time series correlation study which relates the annual investments to political risks. Political risk was the independent variable meanwhile the investment was the dependent variable. As stated by Campbell, Webb, Schwartz & Sechrest (1966) time series studies are descriptive studies. This descriptive characteristic was vital for studying variables that extend over a considerable period of time. Secondly, this was the justification for the choice of the research design for this study since the key variables of the study were well defined and had a clearly outlined hypothesis. Further, such an approach was used by Khan & Akbar (2013) to study the connection between FDI and political risk among 94 countries across the world.

#### **3.3 Data Collection**

Data collected was secondary data which was; annual values and figures of investment as percentage of GDP of Kenya for the dependent variable; the annual values of absence of violence and political stability, government effectiveness, regulatory quality, rule of law and control of corruption indicators for each year was used as the independent variables. All the data was formulated to the target population of the study. The annual values of data used for the study was for a period of thirty years starting 1990 to 2020. The yearly values

for the 30 years were used because, firstly 30 years was sufficient time to draw the rightful insights and conclusions to the relationship between effect of investments and political risks, and secondly, during this period the country changed to a democratic political system which allowed elections every five years and a possibly change of presidency every five-year causing variations in the political landscape.

The data for the annual investments (gross capital formation) was be obtained from the World Bank Data Bank and from the Kenya National Bureau of Statistics for the GDP figures while for the political risk, data was obtained from Political Risk Services International (PRS) focusing on the thirty (30) years from 1990 to 2020. The data was collected electronically by downloading from the websites of the sources.

### **3.4 Diagnostic Tests**

The linear regression model is usually based on a couple of assumptions. The multicollinearity, heteroscedasticity, independence and normality tests were conducted on the data

#### **3.4.1 Multi-collinearity Test**

One of the assumptions of linear regression is that no predictor variable is a perfect liner function of another predictor or independent variable. When the independent or predictor variables are highly correlated, there would be very high standard errors in the individual coefficients in the regression model, making the model highly sensitive to small changes. The presence of multi-collinearity was assessed by use of VIF. In the event multi-collinearity is present, then the variable with multi-collinearity would be dropped from the model

#### **3.4.2 Heteroscedasticity Test**

Another assumption of linear regression is that the residuals/errors have the same but unknown variance. . The violation of this assumption is known as heteroscedasticity. This test was conducted by a scatter plot of the regressed predicted values and the regressed

standardized residues. This was crosschecked analytically by using of Breusch-Pagan test and comparing the p-value. If the even the test failed, then transformation of the dependent variable would be undertaken

### **3.4.3 Independence Test**

Linear regression assumes that between the variables there is no auto correlation, hence the test of independence determines whether the factors are independent or not. The Durbin Watson test was conducted for this test. The test shows values from 0-4, with values between 1.5-2.5 as the rule of thumb. In the event auto correlation was found to be present, then the structure of the data would be relooked at to ensure it is correctly ordered. And if incase there would have been a structure then an AR1 model could have been included in order to reduce the effect of correlation

### **3.4.4 Normality test**

The linear regression assumes that the data set should be normally distributed. Cramer-von Mises test was conducted in order to ascertain whether it meets the data met the assumptions of regression analysis. The P-Value that is greater than 0.5 will mean that the data is normally distributed. In the event it fails the test, then the variables would have been standardized using log transformations, and a non-parametric test would be adapted.

### **3.5 Test of Significance**

This study used  $t - tests$  at 95 % confidence level to assess the statistical significance of the coefficients,  $\beta_{i(i=0,1,2,3,4,5)}$ . The study applied the  $F - test$  to assess whether the regression is statistically significant at 95 % confidence level. Further, the study employed the coefficient of determination,  $R^2$ , and the Adjusted  $R^2$  to determine how much variation in investment rate was explained by political risk variables

### 3.6 Operationalization of Variables

Operationalization is a process of assigning numerals, numbers and other symbols to the study variable, which is the explicit specification of the variable to enable measurability. The two variables of the study were investments and political risk. The investment was measured using an investment rate that measured Kenya's annual investments per unit of GDP in the same year. The annual investments was the gross capital formation which according to OECD gross capital formation refers to investments leading to acquisition of assets less the disposals, which will be used in the production of goods and services for more than a year plus the net changes in inventories, which are goods held temporarily to make a gains

The political risk variables of this study are as defined and measured by Political Risk Service (PRS) which is an international organization tasked with assessment of risk in all countries in the world. The political risk comprise of sub-variables of Political Stability and Absence of Violence, government effectiveness, regulatory quality, rule of law and control of corruption which are assigned percentages from 0-1 with 0.8-1 rated as very low risk, 0 - 0.5 (50%) as very high risk meanwhile 0.5-0.8 as medium political risk.

### 3.7 Data Analysis

Data analysis is a process of collecting and changing data, in order to enable making of interpretation and make conclusive judgement and decisions. Descriptive statistics was firstly used so as to get the likely patterns and understanding of the movement of the data, thereafter, diagnostic tests were undertaken so as to meet the assumptions of regression and finally the correlation and regression analysis was undertaken.

The annual investment in a year is a percentile derivative as follows:

$$Investment\ Rate = \left( \frac{Annual\ Investment\ (Gross\ Capital\ Formation)}{Gross\ Domestic\ Product} \times 100 \right)$$

The values of the other variables will be obtained from Political Risk Services International (PRS). The relationship between investment and political risk variables was then analysed using the simple linear regression model below:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Where,

$Y$	=	Investment
$X_1$	=	Political stability and absence of violence
$X_2$	=	Government effectiveness
$X_3$	=	Regulatory quality
$X_4$	=	Rule of law
$X_5$	=	Control of corruption
$\beta_0$	=	The intercept term
$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$	=	The sensitivity of investment to each of the independent variables
$e$	=	The error term of the regression

The analysis software used was MS Excel due to its availability.

## **CHAPTER FOUR**

### **DATA ANALYSIS, RESULTS AND CONCLUSION**

#### **4.1 Introduction**

This chapter discusses the data collected for the variables from 1991 up to 2020 (equating to 30 years of observation). Descriptive statistics was determined and analysed. The chapter further discusses the various diagnostic tests undertaken, and finally the results of the regression analysis.

#### **4.2 Descriptive Statistics**

Descriptive statistics helps researchers visualise the pattern of how the data was showing over a duration of time. This enables better interpretation. This was complemented with a graphical representation over the 30 years of time, hence, to make a comparison between the various variables over time.

The descriptive statistics assisted to know the skewness so as to establish the symmetry, the mean which is a central tendency used and the most typical value, the maximum and minimum to know the highest and lowest investment rates

The results of the descriptive statistics were as follows;

**Table 4.1 Summary of Descriptive statistics for Investment Rate**

<i>Investment Rate</i>	
Mean	18.70882299
Standard Error	0.396857101
Median	18.86899765
Mode	#N/A
Standard Deviation	2.173675865
Sample Variance	4.724866766
Kurtosis	-0.415006943
Skewness	0.259936478
Range	8.496832912
Minimum	15.38790076
Maximum	23.88473367
Sum	561.2646897
Count	30
Confidence Level(95.0%)	0.811663907

Source: Research Findings

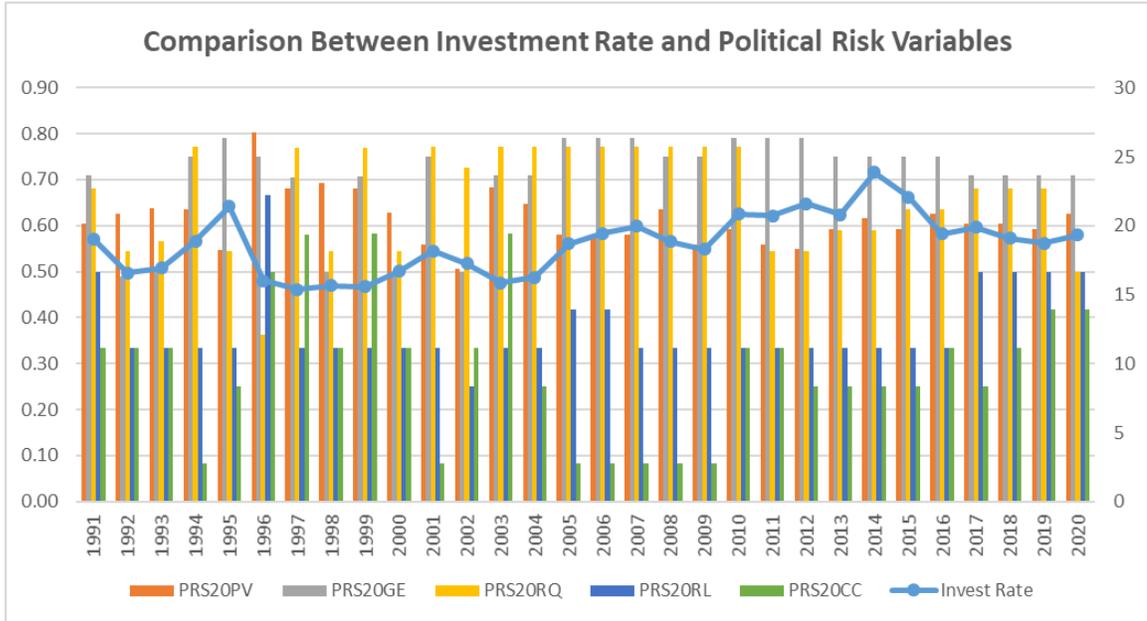
What can be deduced is that the mean and the median are quite close at around 18.86, which means that the graph is more or less well skewed, achieving the bell shaped curve.

The lowest Investment rate was 15.38, which was experienced in 1997, which is the year of election. Meanwhile, the highest was 23.88 experienced in the year 2014.

### **4.3 Graphical Representation**

In order to understand the relationship better, a combo chart of bars for the political risks and corresponding lines for the investment rate was undertaken.

**Figure 4.1 Trends of Investment Rate and Political Risk**



**KEY**

- PRS20PV** Political Stability and Absence of Violence
- PRS20GE** Government Effectiveness
- PRS20RQ** Regulatory Quality
- PRS20RL** Rule of Law
- PRS20CC** Control of Corruption

**Source: Research Findings**

In 1992, during election it can be seen the investment rate reduced from 1991, and immediately in 1993, it started to rise up again. The same was noticed in 1997. In 2002 (election year), there was a decline in the investment rate, but it further declined in 2003 (year after election), after which it began to rise consistently until 2007 (election year). In 2008 (year after election) a decline was experienced, and a further decline in 2009. It began to rise again in 2010 (promulgation of new constitution). There was a slight decline in 2013 (year after election), but peaked in 2014, It then declined downwards until 2016. In 2017

(year of election), it slightly climbed up but reduced in 2018 and 2019 and further rose in 2020.

Apparently, from this trend it can be deduced that during the election period of the 90's the election had a direct effect on the investment rate during the election year but in 2002 and 2007, the investment rate reduced in the following year after the election. Meanwhile in 2012 and 2017 it can be seen that during election the investment rate increased and then reduced immediately in the following year. Therefore, in 90's election affected investments in the year of the election, but in 2000's it affected a year after the election (post-effect)

#### **4.4 Diagnostic Tests of Statistical Assumptions**

A linear regression model is based on a number of assumptions, which are multicollinearity, homoscedasticity, independence and normality. It is necessary to undertake the tests in order to ensure data collected meets the requirements

##### **4.4.1 Multicollinearity Test**

Multicollinearity test helps to identify if there is a correlation between the independent variables. A strong correlation between the independent variables would mean that the estimated coefficient precision is reduced as the estimates become very sensitive to changes.

**Table 4.2 Results of the Multicollinearity Test**

---

	<i>VIF</i>
Intercept	
PRS20PV	1.6695
PRS20GE	1.3239
PRS20RQ	1.3473
PRS20RL	1.53
PRS20CC	1.5436

---

**KEY**

<b>PRS20PV</b>	Political Stability and Absence of Violence
<b>PRS20GE</b>	Government Effectiveness
<b>PRS20RQ</b>	Regulatory Quality
<b>PRS20RL</b>	Rule of Law
<b>PRS20CC</b>	Control of Corruption

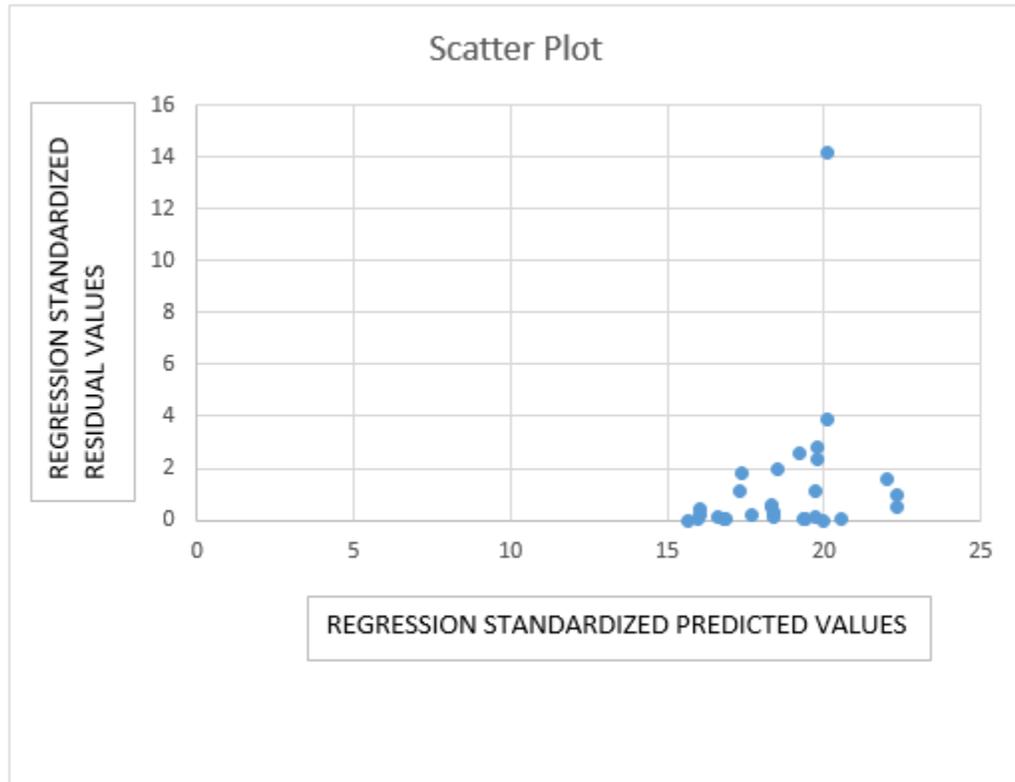
**Source: Research Findings**

The VIF threshold is usually  $0.1 < VIF < 10$ . In this case, none of the VIF had a score of more than 10, hence, meaning that the political risk variables do not have any correlation, hence, passing the multicollinearity test, hence, we can trust that our P-values showing the significance of the independent variables do be giving true position of significance

#### **4.4.2 Heteroscedasticity Test**

Heteroscedasticity tests whether there is a systematic change in the variance of residuals over a range of measured values. Such systematic changes indicates the data is heteroscedastic. This was tested using scatter plots on the regression predicted values and the regression standardized residuals and thereafter was supported with the Breusch-Pagan

**Figure 4.2 Scatter Plot for Heteroscedasticity Test**



**Source: Research Findings**

As shown above there is no tendency in the error term.

To support this the Breusch-Pagan test was used. The simple model of Breusch-Pagan is to regress the squared residuals to the independent variables and analyse the P value which should be higher than 0.05 since in the situation where P is less than 0.05 the null hypothesis is rejected and the alternative hypothesis of the error term would hold meaning that there would be heteroscedasticity. The following were the results

**Table 4.3 Result from Breusch-Pagan Test**

SUMMARY OUTPUT					
<i>Regression Statistics</i>					
Multiple R	0.335553				
R Square	0.112596				
Adjusted R Square	-0.07228				
Standard Error	2.734355				
Observations	30				
<i>ANOVA</i>					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	5	22.76789	4.553578	0.609036	0.693785623
Residual	24	179.4407	7.476697		
Total	29	202.2086			

Source: Research Findings

Since the P-value is more than 0.05, it means we will hold on to the null hypothesis and reject the alternative hypotheses, therefore, this signifies that there was no heteroscedasticity in the data

#### 4.4.3 Independence Test

Linear regressions require no or little auto correlation in the data. It measures the degree of correlation of the same variable between two successive time intervals; therefore, it indicates the lagging after the time interval and the difference from the original version. When the residuals are not independents from each other then we have the occurrence of Auto correlation.

The Durbin Watson test was conducted which detection auto correction in lag 1. It is calculated as the sum of squared differential residuals divided by sum of squared residuals which was as follows

**Table 4.4 Result from the Independence Test**

sum of squared difference residuals	350.6242	=	1.953983
sum of squared residuals	179.4407		

Source: Research Findings

The normal rule of thumb is that auto correlation does not exist when the value lies between 1.5 and 2.5. According to the table at K5, N30, the values d lower and d upper are 1.071 and 1.931. Whilst upon the calculation above, the d value is 1.953983, and when d is above the d upper, there is no significant auto correlation, hence the data was not distorted by auto correlation

#### 4.4.4 Normality Test

Normality test indicates whether the data forms a bell-curved distribution, which is called the normal curve. When the data is large enough, it forms a bell curve meaning that the data meets the assumptions, hence, can be regressed. The variables were tested for normality test using the Cramer-von Mises obtaining the following results

**Table 4.5 Results from Normality Test**

	Inv Rate	PRS20PV	PRS20GE	PRS20RQ	PRS20RL	PRS20CC
P-Value	0.0541	0.0854	0.6355	0.2646	0.10025	0.1947

**KEY**

- PRS20PV** Political Stability and Absence of Violence
- PRS20GE** Government Effectiveness
- PRS20RQ** Regulatory Quality
- PRS20RL** Rule of Law
- PRS20CC** Control of Corruption

Source: Research Findings

All the values were higher than 0.05, indicating data is normally distributed

## 4.5 Regression and Correlation Analysis

In order to determine the relationship between the independent and dependent variables, a regression analysis was performed.

The study was taken at a confidence level of 5%, hence the significance of the regression was obtained at  $\alpha = 0.05$ . This implies if the probability value was less than the  $\alpha$ , then the variable and/or equation is significant and vice versa.

### 4.5.1 Correlation Analysis

A correlation analysis is used to gauge the relationship between two variables, the dependent and the independent variables. It ranges from -1 to +1, with a +1 referring to a strong positive correlation and vice versa for -1.

**Table 4.6 Regression Statistics Results between Investment rate and Political Risks**

<i>Regression Statistics</i>	
Multiple R	0.851661
R Square	0.725327
Adjusted R Square	0.668104
Standard Error	1.252265
Observations	30

**Source: Research Findings**

The study revealed that there is a relationship between investment rate and political risk. This is usually shown by the coefficient of determination, which equates to 0.851 and coefficient of correlation at 0.725, meaning that 72.53% of the changes in investment rate can be explained by changes in the political risks

Meanwhile, the standard error is used to establish the precision level of the regression. Usually the rule of thumb is that 95% observation should fall within  $\pm 2 * \text{Standard error}$  of the regression from the regression line, which is also a quick approximate of the 95% prediction level. Therefore, to attain a narrow 95% prediction interval, standard error should be less or equal ( $\leq$ ) 2.5. The regression analysis of this model shows standard error of 1.25, which is less than 2.5, hence, the model is more precise

#### 4.5.2 Analysis of Variance

The Anova is also a test of linearity. It is used to test the significance of the relationship between the dependent and independent variable in this case being the political risk and investment.

**Table 4.7 Results from the Analysis of Variance (ANOVA)**

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	5	99.385138	19.87703	12.67533	4.31422E-06
Residual	24	37.635998	1.568167		
Total	29	137.02114			

**Source: Research Findings**

According to Anova, the F significance of 0.00000431 which implied that the value is lower than 0.05, hence the model is significant in predicting the relationship between the investment rate and political risk. Similarly, Using the F-table, the value of F at df 6 and 23 at  $\alpha$  of 0.05 gave a value of 2.53 which was less than F-critical of 12.67 (as table above), hence, indicating the model was significant

### 4.5.3 Coefficient Analysis

The coefficient analysis is used to determine how a change in one independent variable would affect the dependent variable.

	Coefficients	Standard		t Stat	P-value	Lower	Upper	Lower	Upper
		Error				95%	95%	95.0%	95.0%
Intercept	28.64609616	3.7262656	7.687615	6.34E-08	20.95546	36.33673	20.955462	36.33673	
PRS20PV	-18.5699924	5.2624184	-3.52879	0.001716	-29.43109	-7.70889	-29.4310902	-7.708895	
PRS20GE	13.02248562	2.7182152	4.790822	7.07E-05	7.412365	18.63261	7.4123651	18.632606	
PRS20RQ	-9.24749242	2.3925906	-3.86505	0.000741	-14.18556	-4.30943	-14.1855568	-4.309428	
PRS20RL	-2.73446769	3.3118179	-0.82567	0.417124	-9.569724	4.100788	-9.5697238	4.1007884	
PRS20CC	-1.93740889	1.9133031	-1.0126	0.321352	-5.886272	2.011455	-5.88627239	2.0114546	

**KEY**

- PRS20PV Political Stability and Absence of Violence
- PRS20GE Government Effectiveness
- PRS20RQ Regulatory Quality
- PRS20RL Rule of Law
- PRS20CC Control of Corruption

Source: Research Findings

The regression analysis can be explained with the following equation

$$Y = 28.64 - 18.5X_1 + 13.02X_2 - 9.24X_3 - 2.73X_4 - 1.937X_5 + e$$

Where

This means that holding all factors constant, the total investment rate would be 28.64. A unit increase in political stability, regulatory quality, rule of law and control of corruption would reduce the investment rate by 18.56, 9.24, 2.73 and 1.937 and vice versa for unit decrease

Meanwhile the contrary applies for Government Effectiveness implying that an increase in one unit would increase the investment rate by 13.02 and vice versa. In relation to the test of significance at a 95% confidence level implies that the coefficient having less than  $\alpha$  of 0.05 would be significant to the model. In this instance political stability, government effectiveness and regulatory quality had alfa of less than 0.05, hence were significant, while, rule of law and control of corruption were contrary due to having higher p-values of more than 0.05.

In the interpretation of these coefficients of the political variables, a low value means higher risk, meanwhile a higher value means a lower risk. Conversely in reference to the theoretical review, the government effectiveness variable (of political risk) shows that when the value is high (lower risk) the value of investment rate is higher. This seconds the general theory of investment by Keynes which states when risks are low there are higher investments and vice versa, but will negate the portfolio. This means that the other two negative significant variables would support the portfolio theory and negate the general theory, because the political risks namely political stability and regulatory quality, increases (means that the political risk is low {of the said variables}), the model would give a lower value the investment rate due to the negative coefficients, since, if the risk for the two variables is high, then investment rate would increase. The portfolio theory states that political risk is a systematic risk, and it cannot be eliminated, hence, when political risk is high, investors invest more in order to reduce the unsystematic risk on the ideology that the aggregate effect would reduce the overall risk, but not the political risk since it is a systematic risk

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Introduction**

This chapter gives conclusions, which are drawn from the previous chapters, and recommendations made to make any future further research or future policies and be referred to. The limitations are also highlighted that can assist future scholarly studies

#### **5.2 Summary**

The objective of the study was to establish as to whether there is a relationship between political risks and investments in Kenya. Secondary data was collected for a duration of 30 years. In the application of descriptive study, it was noted that in the year 1992 investment rate reduced in comparison to 1991, and immediately started to rise up again. The lowest investment rate was experienced in 1997 (Election year at 15.38%).

Consequently, in 2002 there was a decline in investment rate, but declined further in 2003 (year after election). It started to rise consistently until 2007 (election year) and declined in 2008 (year after election) and rose again in 2010 (promulgation on new constitution until 2012 (year of election) and declined immediately in 2013 (year after election) and peaked in 2014. It declined downwards until 2016 and climbed shortly in 2017 (year of election) and declined in 2018 and 2019 and finally rose in 2020.

The entire model depicted a positive correlation of 72.53%, meaning that 72.53% of changes in investment rate can be explained by the political risk. The Anova showed that the model was significant. Upon further analysis of the coefficients, it was noticed that three variables (of political risk) namely political stability, regulatory quality and government effectiveness were significant to the model, meanwhile, rule of law and control of corruption were not significant. Political stability and regulatory quality had negative coefficients, meanwhile government effectiveness had a positive coefficient.

This implied that for political stability and regulatory quality, an increase by one unit (means that the political risk is lowering {of the said variables}), the model would give a lower value of the investment rate due to the negative coefficients and vice versa. Simplistically put this deduces to low risk low return and vice versa

As for the variable of government effectiveness, which had a positive coefficient, an increase by one unit (means that the political risk is lowering {of the said variables}), the model, would give a higher value of the investment rate due to the positive coefficients and vice versa. Simplistically put this deduces to low risk high, return and vice versa

### **5.3 Conclusion**

The study concludes that in the 90's the election had a direct effect to the investment in the year (same year) of the election, since the investment reduced in both 1992 and 1997 (which is the lowest amongst all the years of the study). In the 2000's it can be noticed that in all the years after the election (following year), the investment variable reduces but does not affect the year during election (except in 2002, where a decline was experienced in 2002). This means that there was a post effect on the consecutive year after elections. In the year 2010 there was an increase in the investment rate, and might be since that was the year when the new constitution was promulgated.

According to the regression analysis, the correlation of 72.53% means that 72.53% of changes in investment rate can be explained by the political risk. Meanwhile in reference to the analysis of the coefficients of political risk the following can be deduced that the variables political stability and regulatory quality had negative coefficients, hence, an increase by one unit (means that the political risk is lowering {of the said variables}), the model would give a lower value of the investment rate due to the negative coefficients and vice versa. These two coefficients imply lower political risk, lower investment and vice versa (higher political risk, higher investment returns). Therefore, this means this would support the portfolio theory.

In contrary, the variable of Government effectiveness had a positive coefficient (denoted as  $X_2$ ) . As  $X_2$  increases, investment increases. An increase in  $X_2$  means reduction in political risk (variable). Hence, we can deduce that a reduction in political risk would increases investment from that coefficient and vice versa, which in turn would support general theory of investment which states low risk high investment and vice versa.

From the above study we can make a final conclusion that investments are affected by the political risk in Kenya.

## **5.4 Contributions of the Study**

The finding of the study makes contributions to theory of political risk and investments. Furthermore, it makes further contribution to practice referring to regulators and how political seasons affect investment in Kenya

### **5.4.1 Contribution to Knowledge and Theory**

The study was guided by the general theory of investment and the portfolio theory of investment. The general theory states that when the risks in an economy are high, the investments will be low and vice versa. It signifies investments being made in risk averse environments. The study supports the general theory of investment since the coefficient of government effectiveness ( $X_2$ ) depicted low return high investment and vice versa

To the contrary, the study also supports the portfolio theory which states that political risk is a systematic risk and it cannot be eliminated, hence, when political risk is high, investors invest more in order to reduce the unsystematic risk on the ideology that the aggregate effect would reduce the overall risk, but not the political risk since it is a systematic risk. This could be noticed through the political stability  $X_1$  and regulatory quality  $X_3$  coefficient, since by increasing by one unit (means that the political risk is lowering {of

the said variables}}, the model would give a lower value of the investment rate due to the negative coefficients and vice versa

#### **5.4.2 Contribution to Practice**

This study makes contributions to regulators and investors in general as it was noticed that during electioneering years and immediately the year that follows the election period, there is usually an impact in the rate of investments. It was also noticed that during the promulgation of the new constitution in 2010 and the year following (2011), there were major impacts in the investment rate. This means that regulators need to see how to formulate laws especially for the sake of election times such that politics and political seasons should not affect the investor confidence in the country

#### **5.5 Limitation of the Study**

The study used secondary data, which was in the public domain, unlike primary data. Hence, various assumptions and estimations in the collection of the secondary data would have cascaded into this research. Conversely, the researcher used Ms Excel for the purpose of analysis. That means a lot of time was used to do calculations on various tests performed since the software does not do auto calculations like for the diagnostic tests

Lastly, the research was undertaken during a very busy work schedule, hence, if time would have allowed the researcher would have spent more time on considering more variables and scenarios such as how how political risk affects investments in other developed countries visa viz developing countries, Nonetheless, the study was given maximum time and attention, hence, producing a top quality paper

#### **5.6 Suggestion for Further Studies**

This study recommends further study to be done on whether political risk really affects investments, and should give comparison with other developing and developed countries, so as to get a better over view. On the same note, the investment rate was a percentile of

annual investments over GDP. It would have been more appropriate to use values and adjust for inflation (real values) in order to get a more objective research.

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## APPENDICES

### APPENDIX 1 DATA USED

	Investment Rate	X1= Political Stability and Absence of Violence (PRS20PV)	X2= Government Effectiveness (PRS20GE)	X3= Regulatory Quality (PRS20RQ)	X4= Rule of Law (PRS20RL)	X5= Control of Corruption (PRS20CC)
2020	19.3412224	0.63	0.71	0.50	0.50	0.42
2019	18.7300049	0.59	0.71	0.68	0.50	0.42
2018	19.0979954	0.60	0.71	0.68	0.50	0.33
2017	19.8957222	0.60	0.71	0.68	0.50	0.25
2016	19.3917381	0.63	0.75	0.64	0.33	0.33
2015	22.0910368	0.59	0.75	0.64	0.33	0.25
2014	23.8847337	0.62	0.75	0.59	0.33	0.25
2013	20.7857855	0.59	0.75	0.59	0.33	0.25
2012	21.5850382	0.55	0.79	0.55	0.33	0.25
2011	20.7086391	0.56	0.79	0.55	0.33	0.33
2010	20.8470576	0.59	0.79	0.77	0.33	0.33
2009	18.2864916	0.56	0.75	0.77	0.33	0.08
2008	18.8649238	0.64	0.75	0.77	0.33	0.08
2007	19.9647291	0.58	0.79	0.77	0.33	0.08
2006	19.424438	0.58	0.79	0.77	0.42	0.08
2005	18.6991118	0.58	0.79	0.77	0.42	0.08
2004	16.2592235	0.65	0.71	0.77	0.33	0.25
2003	15.8382091	0.68	0.71	0.77	0.33	0.58
2002	17.2368798	0.51	0.50	0.73	0.25	0.33
2001	18.1515574	0.56	0.75	0.77	0.33	0.08
2000	16.7088065	0.63	0.50	0.55	0.33	0.33
1999	15.5914315	0.68	0.71	0.77	0.33	0.58
1998	15.6752133	0.69	0.50	0.55	0.33	0.33
1997	15.3879008	0.68	0.71	0.77	0.33	0.58
1996	16.0090582	0.80	0.75	0.36	0.67	0.50
1995	21.3855866	0.55	0.79	0.55	0.33	0.25
1994	18.8730715	0.64	0.75	0.77	0.33	0.08
1993	16.9376161	0.64	0.51	0.57	0.33	0.33
1992	16.5813701	0.63	0.49	0.55	0.33	0.33
1991	19.0300971	0.60	0.71	0.68	0.50	0.33