UNIVERSITY OF NAIROBI

INSTITUTE OF DIPLOMACY AND INTERNATIONAL STUDIES

AN EVALUATION OF FACTORS AFFECTING FOREIGN DIRECT INVESTMENT INFLOWS IN AFRICA; A CASE STUDY OF KENYA 1990-2011

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A Research Project submitted in partial fulfillment of the Degree of Masters of Arts in International Studies

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DECLARATION

I declare that this research proposal is my original work and has not been presented for a degree in any other university.

Sign: ……………………………… Date: ………………………

ANTONY MUKUI WANJIKU

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

SUPERVISOR:

Sign: ………………………… Date: …………………………

G.K.IKIARA

DEDICATION

I would like to dedicate this research to my family my brother Andrew Chege my mother Salome Chege and Maria Goretti my sister for all their direction and sacrifices. May God bless them abundantly.

ACKNOWLEDGEMENT

This work would not have been complete without the tireless effort of my supervisor, Mr. G.K Ikiara whose critical input, patience and constant advice shaped the end product.

I also appreciate the good work done by all my lecturers at the Institute of Diplomacy and International Studies for laying the groundwork for this scholarly work, and my classmates for their encouragement and solidarity in the coursework.

God bless you all

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LIST OF ABBREVIATIONS

IMF:	International Monetary Fund
FDI:	Foreign Direct Investments
GDP:	Gross Domestic Product
UNCTAD:	United Nations Conference on Trade and Development
TNC:	Transnational Corporations
MNCs:	Multinational Corporations
WIPS:	World Investment Prospects Survey
IPAs:	Investment Promotion Agencies
BITs:	Bilateral Investment Treaties
DTTs:	Double Taxation Treaties
ASEAN:	Association of Southeast Asian Nations
OECD:	Organization for Economic Co-operation and Development
WTO:	World Trade Organization
TRIMs:	Trade Related Investment Measures
GATS:	General Agreement of Trade in Service

ABSTRACT

Foreign Direct Investment (FDI) is among the most dynamic international resource flows to developing countries. FDI's is usually a mix of investments in both tangible and intangible assets and firms that deploy such assets are often important players in the global economy.

Many argue that FDI can be expected to facilitate the transfer of new technology, help improve workers' skills and welfare in recipient countries. Others argue that FDI focuses primarily on resource extraction and may have little broad contribution to recipient economy.

But what are the determinants of FDI? What is the role of infrastructure, political stability and sustained economic growth or decline? This paper attempts to answer these questions for the economies of Africa using Kenya as a case study for the period 1990-2011.

Using panel data methods, this study finds that infrastructural development has a positive role in FDI inflows in a country, political instability this study finds has a negative effect on FDI inflows.

Lastly, the paper finds that sustained economic growth or decline has no real impact on FDI inflows in Kenya,

CHAPTER ONE

INTRODUCTION

1.0 Background to the Study

It is the stated goal of any state to provide the good life for its citizens. This can only be achieved when the economy of that state can grow effectively and trickle down to the people so that there is economic development[1]. Economic growth measured in terms of the GDP of a country is affected by many factors. One of these factors is foreign direct investment, defined as an investment made by a firm based in a foreign country, into a firm based in another country that is not its own.[2]

Foreign direct investments tend to be typically different from indirect investments such as portfolio flows, in which foreign institutions invest in stocks and equities listed on the stock exchange of a country. Entities making direct investments will typically wield a significant degree of influence and control over the company into which the investment is made.

The investing firm may make its overseas investment in a number of ways either by starting a new subsidiary or associate company in the foreign country, by investing in shares or through a merger or joint partnership with local firms. Africa's experience with foreign direct investment varies from country to country. Despite the different arguments for or against FDI most African countries have come to the

[1] North D (1992). Institutions, Institutional Change and Economic

[2] Alazzawi, S. (2004), "Foreign Direct Investment and Knowledge Flows: Evidence from Patent Citation", mimeo, University of California, Davis.

general realization that indeed foreign direct investment is an important tool to spur economic growth and development.

Consequently since the 1990s there has been a greater push by African countries to attract foreign investors. Some countries have succeeded in attracting foreign direct investment while others have failed.

What then are the factors and conditions that attract foreign investors to certain African countries and not others? It is this factors that this research investigates and analyzes using Kenya as a case study.

1.1 Statement of the Problem

Despite the attainment of independence about 50 years ago Africa is still faced with a majority of the same problems that we had during independence that is disease, hunger and illiteracy. Despite the promise that independence came with most African countries continue to struggle with these problems. One of the major issues that African countries face is unemployment especially among population the youth.

This has led to a need to encourage investment for economic growth. The question that then arises is whether foreign investment should be encouraged on the African continent to encourage faster growth of the African economies. This is because of the experience that African countries have had with multinational corporations that have been accused of benefiting their home countries at the expense of the host countries.

On the other hand local investors most of the times do not have the funds required to set up large scale firms which would create the amount of jobs that the country may need to offset the deficit needed in terms of job creation. In the recent past most African countries have gone on overdrive in a bid to attract more FDI in their individual countries.

Some research has been done on foreign direct investment inflows in Africa for example by UNTAD, the World Bank, Asiedu (2002, 2006), Majocchi and Strange (2007), and Lemi and Asefa, (2003). Despite these attempts by these scholars most the research conducted on foreign direct investment in Africa has been on the role of multinational corporations on the African continent.

Most has focused on the negative role of MNCS on the continent. Therefore there is a gap that needs to be filled by more research on the subject of the factors that affect foreign direct investment inflows in the African continent.

Very little research for example has been done on the role of infrastructural development, political instability and the role of sustained economic growth as a factor for FDI inflows on the African continent and by extension in Kenya.

1.2 Objectives of the Study

The main objective of this research is to examine the factors that affect foreign direct investment inflows in Africa with a case study of Kenya. The specific objectives that guide the study are:

i. To examine to what extend sustained economic growth affects foreign direct investment inflows in a country.

ii. To understand the role of political stability in fostering foreign direct investment.

iii. To analyze the role played by infrastructural development in attracting Foreign Direct Investment.

1.3 Hypothesis

This study was guided by following hypotheses:

$H_{1:}$ The sustained economic growth did not affect foreign direct investment inflows in Kenya.

$H_{1:}$ Political stability extensively affects foreign direct investment inflows in Kenya.

$H_{1:}$ The rate of infrastructural development has not played an important role in attracting Foreign Direct Investment in Kenya.

1.4 Justification of Study

The global economy is by nature competitive. Countries are constantly trying to outdo each other in terms of getting the best markets their goods and their companies.

Government's therefore needed to develop policies that promote investment within their borders. The findings of this research may be used as invaluable information for government agencies and other agencies in formulation of FDI related.

This research also provides a good based that can be used to help in the development of new legislation for regulation and promotion of FDI.

Finally, it will help to gauge the technology and skills transfer and how they can be retained for growth of economy. This research project hence contributes to knowledge on trade, Foreign Direct Investment and Aid with keen interest on the African continent.

1.5 Scope of the Study

The study was restricted to the period between 1990 and 2011 looking at the economic growth figures, infrastructural development and political stability during this period with specific reference to their relation to the foreign investment inflows into the country during the time with the aim of coming up with conclusions as to the relationship between foreign direct investment and this factors.

1.6 Limitation of the Research

One of the limitations that this research faced was be in collection of data especially due to the nature of the data that was required for the study and the vastness of the data needed.

1.7 Literature Review

1.7.1 Concept of Foreign Direct Investment

According to the World trade organization 1996 report on trade and foreign direct investment, foreign direct investment (FDI) is when an investor based in one country obtains an asset in another country with the purpose of managing that asset. The management dimension the report argues is what distinguishes FDI from portfolio investment in stocks, bonds and other foreign based financial transactions. In majority of the cases, both the investing firm and the acquisitions it manages abroad are business firms. In such cases, the investor is commonly referred to as the parent firm and the acquisition as the subsidiary.

The report further distinguishes three broad categories of FDI that is Equity capital which is the value of a firm's investment in shares of an enterprise in a foreign country. An injection of a firms total equity stake of 10% or shares or voting power in a foreign enterprise that is listed in the stock market, or its equal in a firm not listed is normally considered to be the threshold for the control of assets in the firm. Profits that are reinvested constitute an enterprises' share of the affiliate's earnings that are not paid out as dividends or remitted to the firm. Such retained profits by affiliates are assumed to be reinvested in the affiliate.

The IMF defines FDI in more or less the same way as the world trade organization its definition gives less attention management as it argues that FDI occurs when one individual or business owns ten percent or more of a company's capital that is not in its home country.

Every financial transaction afterwards is considered by the IMF a form of additional direct investment. In the case where an controls less than ten percent it is considered as nothing more than an addition to his/her stock or equity. This is because 10% of the company, guarantee's the investor a significant influence on how the company is run in terms of management, operations and policy direction.[3] For this reason, most regulatory agencies will try to keep a close eye on who is investing in their country's businesses.

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[3] Blomström, M. (1990), "Competitiveness of Firms and Countries" in J. Dunning, B. Kogut, and M. Blomström, Globalization of Firms and the Competitiveness of Nations, Lund University Press, Lund.

The IMF therefore does not envision a situation where the investor is necessarily involved in the daily management of the acquisition although it does argue that the firm must have some control over the decisions made by the management

UNCTAD, (2002) on the other hand views Foreign Direct Investment (FDI) as long term investments and which are directed towards businesses located outside the economy or country of the investor. Foreign Direct Investment according to the organization will usually include investment types as wholly owned, joint partnerships and mergers.

It is therefore clear that in FDI, the investor has the intention to exercise control over the enterprise although he may not be engaged in the day to day running of the organization. Dunning (2001) further expanded this definition when he argued that on top of financial and monetary assets, FDI also refers to intellectual capital and transferred technology. This definition therefore included technological knowledge, human and physical capital and monetary assets, which are moved from one country to another in form of investments.

1.7.2 Why Foreign Investment?

According to Asiedu, (2006) although overseas operations put additional financial burdens on firms, for example through information gathering about native firms and legal frameworks, labor relations, costs of travel, and cultural integration issues that certainly emerge in these operations. Firms choose to invest abroad because of the comparative advantages that they gain from doing so.

She argues that for firms operating in the service industry, the reason is usually because for them to have a completive edge in the global market; they must have a physical presence markets that they wish to invest.

Wells and Adler (1972) argue that a majority of cross-border trade in the service industry are by and large FDI driven. In non-service industries such as manufacturing, FDI often follows trade in services although it is sometimes the other way round.[4]

According to Midgley, (1981) there are two main reasons why firms choose to invest overseas. Firstly, some champion vertical Foreign Direct investment; this is where firms locate different stages of the production cycle in different countries. These ventures often come about due to differences across countries in terms of costs of production. For example labor costs or the availability of skilled laborers if the good require such labor.[5]

Secondly there is the argument for the advantages brought by horizontal Foreign Direct Investment if similar activities in the chain of production are undertaken in various countries. The proponents of this type of FDI argue that, it reduces transport costs for goods which is likely to have a high value and the firm benefits

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[4] Alazzawi, S. (2004), "Foreign Direct Investment and Knowledge Flows: Evidence from Patent Citation", mimeo, University of California, Davis.

[5] Midgley, D. & Australian Graduate School of Management (1981) *toward a theory of the product life cycle: Explaining diversity*. Kensington, N.S.W.: Australian Graduate School of Management, University of New South Wales.

from local production and thus rendering the operation more profitable; products will also be produced in close proximity to customers as the case may be; local production also makes it easier for the firm to adjust to the standards required locally; and finally local production better information about competitors. Foreign direct investment may also be driven by the need to avoid trade barriers.

1.7.2 The Relationship between FDI and Economic Growth

Obadan (1992) in his study conducted in Nigeria discovered a positive and statistically significant relationship between economic growth and FDI inflows. The study covered the period 1973-1990, when the economy grew at an average rate of 1.85% per annum, of which the contribution from the index of foreign capital was 54 %.[6]

In another study on Nigeria, Ayanwale and Bamire (2004) assessed the influence of FDI on firm level productivity in Nigeria and reported a positive effect of foreign firms on domestic productivity in terms of GDP growth and eventual development.[7]

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[6] Obadan, M. I., National Centre for Economic Management and Administration (Nigeria), & United Nations Development Programme. (1992). *Analysis and evaluation of development projects in Nigeria*. S.l.: The Centre.

[7] Campos, N. F., Kinoshita, Y., IMF Institute., & International Monetary Fund. (2003). *Why does FDI go where it goes? New evidence from the transition economies*. Washington, D.C: International Monetary Fund.

A causality study conducted by Eke (2003) to analyse the impact of FDI on economic growth in Nigeria tested whether foreign private investment caused an increase in the GDP. The findings showed that causality runs in both directions, that is FDI caused GDP growth and GDP growth led to an increase in foreign investment. He concluded that FDI had a positive effect on economic growth in Nigeria, however, foreign capital inflow is growth-path dependent.

Campos and Kinoshita (2003) conducted a study examining the effects of FDI on growth for twenty five Central and Eastern Europe and former Soviet Union transition economies for the years 1990-1998. In these countries, FDI was mostly through technology transfer. Their observations indicated that FDI had a significant and positive effect on the economic growth of each of the studied countries.

The studies show that there is a strong and significant relationship between FDI and GDP growth. This indicates that an increase in FDI combined with other factors can stimulate economic growth.

1.7.3 The Relationship between FDI and Openness

In his study examining the relation between a developing country's trade openness and the stock of its FDI liabilities using panel data for the period 1970-97 Ghosh (2007) found that trade openness was positively correlated with foreign direct investment liabilities, using country fixed assets or without using them in the analysis. Moreover, this correlation remained robust to the inclusion of additional variables such as economic growth measured as the GDP per capita, inflationary fluctuations, institutional quality, macroeconomic stability and the measures of capital controls. The study also showed that the source of the correlation was causality from FDI to trade openness, and not the other way around.

In their study Liargovas and Skandalis (2011) examined the importance of trade openness in attracting Foreign Direct Investment inflows, using a sample of thirty six developing economies for the period 1990–2008. The study provided a direct test for the causal relationship between FDI inflows, trade openness and other key variables in the developing world: Latin America, Asia, Africa, and Eastern Europe. The findings of the panel regression analysis confirmed that in the long run, trade openness had a positive impact on the inflow of FDI in developing economies.

Majocchi and Strange (2007) conducted a study to determine the relation between market, financial and trade liberalization and FDI location decisions. They used a sample of Italian firms that had invested in seven Central and East European countries such as Poland, Bulgaria, Hungary, Romania, Slovakia, Czech Republic and Slovenia. The results confirmed that the choice of FDI location is positively affected by liberal market policies, but negatively related to the openness to foreign banks.[8]

1.8: Factors Affecting FDI Inflows in Africa.

There are several general factors that affect foreign direct investment inflows in on the African continent. These factors tend to be by and large country specific but

[8] Majocchi, A., & Strange, R. (January 01, 2007). The FDI location decision: does liberalization matter?. *Transnational Corporations, 16*, 2, 1-40.

some factors tend to be override over the whole continent. Some of these factors include trade openness, political, stability, macroeconomic stability, infrastructural development, and return on investment.

1.8.1 Trade Openness

The effect of trade openness on FDI inflows depends on the type of FDI. When a country receives market seeking FDI, that is foreign firms aimed at serving the already existing market locally, trade openness may reduce FDI inflows. The reason is the theory referred to as the tariff jumping theory , which postulates that foreign firms that seek to serve local markets may decide to set up subsidiaries in the host country when it is difficult to import their products in that country. In contrast, multinational firms that are engaged in export oriented activities may prefer to locate in a more an economy that is more open, since protectionism in trade may increase costs for transaction; thereby reducing economic competitiveness and exports. Thus, the effect of trade openness on FDI inflows is not very clear .several authors have However found that countries that are more engaged in international trade receive more FDI for example Asiedu, (2002) argues that the level of openness in an economy is directly propositional to the amount of FDI that it receives.

1.8.2 Infrastructural Development

Willoughby (2003) argues that beyond its direct effect on economic growth, good infrastructure may also affect economic growth by increasing the productivity in investment and thus investors will be enticed to invest in the economy, either foreign or domestic. [9]Infrastructure here implies

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[9] Agu, C., & Onodugo, V. (January 01, 2009). Capacity, Proximity and the Limitations of Infrastructure Services Decentralization for Poverty Reduction. *Journal of Infrastructure Development, 1,* 2, 153-178.

the in broad terms the range of physical systems that a nation or business possesses. Examples of infrastructure systems may include electric, sewage, Transportation, water and communication systems. These systems are usually very costly in setting them up; however, their importance to a country's economic growth and development cannot be understated. Infrastructure projects are usually financed publicly or privately or through as partnership of both that is through public private partnerships[10]. Empirically, Wheeler and Mody (1992) find that countries in the developing world with a good infrastructural base tend to attract more FDI from the United States and other more developed economies.

In a cross-sectional study, Loree and Guisinger (1995) found that countries with developed infrastructure receive more FDI from the United States and other western countries than countries with less developed infrastructure. Others such as Ngowi, (2001); and Jenkins and Thomas, (2002) have also found a positive effect of infrastructure on FDI.

1.8.3 Macroeconomic Stability

Macroeconomic stability is generally cited as one of the factors that MNCs consider when deciding whether to locate an enterprise in developing countries. For example, Asiedu (2006) looks at the findings of four surveys on business environment and finds that macroeconomic instability is cited as one of the deterrents to FDI in Africa. Barro, (1976 and 1980) argues that High inflation rate for example is a sign

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[10] Agénor, P.-R., Nabli, M. K., & Yousef, T. (2005). *Public infrastructure and private investment in the Middle East and North Africa.* Washington, D.C.: World Bank, Middle East and North Africa Region, Social and Economic Development Group, and Social Development Group.

of macroeconomic instability and a source of uncertainty in the economy. High inflation rate often creates uncertainty in the economic environment and making it difficult for economic agents to extract the correct signals from relative prices.

By creating an uncertain economic environment, high inflation rate usually reduces the expected return to investment and so the volume of investment. Asiedu (2006) argues that African countries with high inflation rate attract significantly less FDI. Based on case studies relating to seven African countries that had attracted significant amounts of FDI, Basu and Srinivasan (2002) concluded that macroeconomic stability was one of the factors that rendered these countries more attractive to FDI.

1.8.4 Political Stability

Political instability can be harmful for investment and for a country's general economic performance. this is not surprising since a country's level of political stability is one the factors that firms' executive directors generally consider when making decision on the location and indeed the amount of investment that they will make in a particular foreign firm[11] (Asiedu, 2006). A few studies have found that FDI in developing countries and by extension Africa is affected negatively by unstable politics (Lemi and Asefa, 2003). Political instability here includes many kinds of events for example antigovernment demos, political assassinations, changes in government, changes in constitutions, purges, coups, revolutions, and

[11] Asiedu, E. (January 01, 2006). Foreign direct investment in Africa: The role of natural resources, market size, government policy, institutions and political instability. *World Economy, 291,* 2006, 63-77.

riots. It leads to a decrease in FDI because it increases the uncertainty about the cost and profitability of investment. [12]

In a survey of foreign owned firms in Africa, Sachs and Sievers (1998) found that the greatest concern for firm owners was stability. In an empirical analysis of the social and political development of foreign investment in Africa, Kolstad and Tondel (2002) found that countries that are less risky attract more foreign direct investment, risk here implying how stable or unstable they are.

Jespersen et al (2000) and Asiedu (2002) have argued that being an African country is indeed a significantly negative determinant of FDI, because of the kind of perceptions of Africa that investors have. That is it is inherently risky. According to the findings of Collier and Pattillo (2000), commercial risk rating agencies rate African countries as riskier than other regions have justified this by the investment conditions in Africa.

Martin and Rose-Innes (2003) On the other hand, in a study on private capital flows in low-income countries reveals that investors no longer fully share the continuing negative perception of much of Africa as a “basket case” region with high risk and low return, which influences the perceptions of many multinational firms, the international media and rating agencies. In a study of regional susceptibility to war, Rogoff and Reinhart (2003) found that wars are more likely to occur in Africa than in other regions and there is a negative correlation between FDI and conflict in Africa.

[12] Kolstad, I., Tøndel, L., & Chr. Michelsens institute. (2002). *Social development and foreign direct investments in developing countries*. Bergen: Chr. Michelsen Institute, Development Studies and Human Rights.

1.8.5 The Availability of Natural Resources

This has been for a long time a critical factor in attracting FDI in Africa because of the need of industrializing nations of Europe and North America to secure an economic and reliable source of minerals and primary products (Dunning, 1993). Though declining relatively in importance, natural resource availability is still of particular importance for inward investment in resource-abundant countries, even though comparative advantage in natural resources by itself is no longer a sufficient factor for attracting FDI (UNCTAD, 1998).

The availability of natural resources has a positive relationship to FDI flows in to Africa (Onyeiwu and Shrestha, 2004). Kolstad and Tondel (2002) argue that those countries rich in oil and other natural resources, for example Libya, and Nigeria, are able to attract heavy FDI inflows. Indeed, it is in the sector of mining of high-value minerals and petroleum where Africa is particularly prominent as a host to Foreign Investors and where the greatest potential for future FDI exists (Basu 2002).

1.8.6 Market Size and Growth

The rate of a country's economic growth and the size of the market have proved to be one of the most important determinants of FDI according to Krugell (2005). The most common argument in support of the relevance of market size and growth in attracting FDI is that a large domestic market size will generate economies of scale, growing markets improve the prospects of market potential (Tsai, 1994).

Thus, an economy with a large market size should attract more FDI and countries that have high and sustained growth rates should receive more FDI flows than volatile economies.

Onyeiwu and Shrestha (2004) argue that there is evidence that economic growth is an important factor in attracting FDI flows to Africa. For example Elbadawi and Mwega (1999) argue that countries in the SADC region receive more FDI than other countries in Africa because of the relative high market sizes in the region more so in South Africa. Some investors, notably those from Asia, have for example invested in Botswana in order to produce for the South African market. [13]

1.9 Theoretical Frame Work

A theory may be defined as a set of assertions, propositions, or accepted facts that attempts to postulate plausible or rational relationships about phenomenon in society. Theory therefore provides what one would call a guideline to understanding phenomena without a theory one would not be able to perform effective analysis of phenomena[14]. In order to answer the controversy does foreign direct investment lead to economic growth and development and what makes a country attractive to foreign direct investment. The research utilized several theories including;

[13] [13] Collier, P., Elbadawi, I. A., & Oyejide, T. A. (1999). *Regional integration and trade liberalization in Sub-Saharan Africa: Vol. 4*. Basingstoke, Hampshire [u.a.: Macmillan [u)

[14] Chapuisat, X., Papoušek, D., & Schneider, H. (1977). *Theory*. Berlin: Springer-Verlag

1.9.1 The Internalizations Theory

This theory attempts to explain the growth and expansion of transnational companies and their motivations for foreign direct investment. The theory was proposed by Buckley and Casson, in 1976 and Hennart, in 1982 and Casson in 1983.

The theory was first proposed by Coase in 1937 in a national context and Hymer in 1976 in an international perspective. In his Doctoral Dissertation, he identified two major determinants of FDI that is the removal or reduction of competition and the competitive advantage of some firms in particular activities (Hymer, 1976).

Buckley and Casson, who founded the theory demonstrate that transnational companies that organize their internal activities so as to develop specific advantages, that they can then exploit.

Hymer, the author of the concept of firm-specific advantages argues that FDI takes place only if the benefits of exploiting firm-specific advantages outweigh the relative costs of the operations abroad. According to Hymer (1976) the MNE appears due to the market imperfections that lead to a divergence from perfect competition in the final product market.

He discusses the problem of information costs for foreign firms compared to local firms, different treatment of governments, currency risk (Eden and Miller, 2004). The result was the same conclusion: transnational companies face some adjustment costs when the investments are made abroad. He therefore concluded that FDI is a firm-level strategy decision rather than a capital-market financial decision.

1.9.2 The Eclectic Paradigm of Dunning

The eclectic theory developed by professor Dunning is a mix of three different theories of foreign direct investments (O-L-I):

1.9.2.1 "O" from Ownership advantages:

These advantages generally denote intangible assets that are, at least for a while exclusive possess of the company and may be transferred within transnational companies at low costs, leading either to higher incomes or reduced costs.

TNC investments in different countries face some additional operational costs. Consequently to successfully invest in a foreign market, a firm must possess particular qualities that would triumph over the additional operating costs in an overseas market. These qualities are the property competences or the specific benefits of the company. The firm has complete control over its own specific advantages and utilizing them abroad results in higher marginal profitability or lower marginal cost than other competitors. (Dunning, 1973, 1980)

Three specific advantages can be observed here:

a) Monopoly advantages that are as a consequence of privileged access to markets from the ownership of natural limited resources, patents, trademarks;

b) Technology, knowledge broadly defined so as to contain all forms of innovation activities

c) Economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital;

1.9.1.2 “L” from Location:

When the first condition has been accomplished, it is more advantageous for the firm that owns them to utilize them itself as opposed to selling or renting out to foreign firms. The qualities found in a country that make it an ideal location constitute the key factors that influencing transnational corporations on where to invest. These country specific advantages can be divided into three categories:

a) The economic benefits constituting the quantitative and qualitative factors of production, for example transport costs, telecommunications infrastructure, the size of the market etc.

b) Political advantages such as consistent and predictable government policies that affect FDI flows

c) Social advantages: including distance from the location and home countries in the case of expatriates, cultural diversity, attitude towards strangers etc.

1.9.2.3 “I” from Internalizations:

Even when the first two conditions are met, a profitable benefit must be present for the firm to use them, in combination with some advantages derived from the country of origin. The third and final characteristic in the eclectic paradigm OLI gives framework for assessing the different ways through which the company exploits its advantages from the sale of goods and services to various agreements that might be signed between the companies. As the advantages of overseas market Internalizations become more evident the firm will want to be involved in foreign production rather than giving up this right through license, or franchise.

Eclectic paradigm shows that OLI parameters are different from company to company and depend on context and reflect the economic, political, social characteristics of the host country. Therefore the objectives and strategies of the firms, the magnitude and pattern of production will depend on the challenges and opportunities offered by different types of countries.

1.9.3: The Oligopolistic Reaction Theory

An oligopolistic reaction is an economic concept developed by Frederick T. Knickerbocker in 1973 in an attempt to understand why firms follow rivals into markets. He argued in favorable conditions of growth in an economy, firms are likely match the investments of competitors into an economy. This model is also known as the follow-the-leader model.

This theory may be used to understand the global flows of foreign direct investments (FDI) and consequently the structure of the world economy. Oligopoly in this case describes a market form in which there are very few sellers or suppliers who tend to control the market for example the mobile telecommunications market in Kenya is controlled by four major companies that is Safaricom, Airtel, Yu mobile and orange telecom. A four-firm concentration ratio is usually utilized quantitative description of oligopoly.

This method shows the share of the market that the four largest firms in an industry control in percentage terms. This enables one to recognize whether the industry is an oligopoly. For example, as of the last quarter of 2008, 89% of the mobile phone market in the United States was controlled by just a few companies that are Verizon, AT&T, Sprint Nextel and T-Mobile. Oligopolistic markets may lead to a wide range of different outcomes. For instance the firms may use restrictive trade practices for example market sharing and collusion to raise prices and restrict production in much the same way as in monopolies.[15]

This theory postulates that the decision of one firm to invest overseas raises competing firms' incentives to invest in the same country .Knickerbockers introduced "oligopolistic reaction" to explain why firms follow rivals into foreign markets.

He argued that the more concentrated industries were, the more likely they were to exhibit oligopolistic reactions. He further argued that another motivation in the location choice of firms was generally to try and match another competing firm's move. He argued that firms in industries characterized by oligopoly would tend to follow each other's location in to locations. Since they don't want to be out competed out of business they follow their rival into the new location.

This supports his position that firms get greater benefits through clustering than dispersing when there are positive spillovers. For example when several companies set up base in a country the effects that arise from this clustering will be mutually beneficial to all of the firms. For instance in the case of cars auto spare companies will also set up base in the area, there is also some level of technology sharing among them and also customers are able to easily access any of them.

Therefore, Knickerbockers' oligopolistic reaction hypothesis can be simplified in terms of FDI decisions being strategic complements He argues that firms want to minimize their risk by matching the Foreign Investments of rival that is risk aversion. Oligopoly, uncertainty, and risk

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[15] Himmelsbach, Hans-Joachim. (2010). *Foreign investment decisions of European companies : a test of the oligopolistic competition model*.

aversion are therefore the principal elements of Knickerbockers' theory, and combined they generate the follow-the leader investment behavior.

Knickerbockers examined the FDI behavior of187 major US manufacturing firms using the Harvard Business School Multinational Enterprise data base, over 20 years, so as to assess the level to which they clustered the investments of their subsidiaries together in twenty three countries (fifteen developed countries, eight developing countries).

He utilized a sample involving 54 industries, including food, paper, chemicals, petroleum, primary metals, fabricated metal products, and others. Knickerbockers found that, in almost two thousand foreign subsidiaries established, nearly half were set up in three-year clusters, while three-fourths were established within a seven year period.

This observed clustering was also seen to be independent of other events and there was also a marked difference with the general trend of US investment abroad. Knickerbocker found that what he called the band wagon effect was by and large, more common in firms involved in high seller concentration markets than in low seller concentration.

This theory can be applied for Kenya in terms of attracting and retaining foreign direct investment in that if Kenya was to maintain a stable economic environment that will attract the large firms in this oligopolistic markets then the rival firms will also set up base in the country for example Pepsi has followed Coca-Cola in setting up base and also most global market leaders in the motor vehicle industry such general motors' Toyota and Nissan all have subsidiaries in Kenya which is seen as a gate way to the East African region.

1.10 Research Methodology

This study drew its data from secondary sources of information. The Secondary data was sourced from a collection and review of published and unpublished material, journals, academic papers and periodicals. These study equally also made use of World Bank and IMF reports as well as those by the Kenya national bureau of statistics and UNCTAD. These were taken through intensive and critical analysis.

1.10.1 Data Analysis

Data analysis is a body of methods that help to describe facts, detect patterns, and develop explanations. The researcher analyzed the collected data and drew comparisons and conclusions from both quantitative and qualitative data through application of relevant statistical methods in order to establish patterns and relationships between the different variables.

1.11 Chapter Outline

Chapter One: Introduction and General Orientation

Chapter one comprises of introduction/ background of study, statement of the problem, a review of existing literature, objectives of study, hypothesis, scope, of the study,.

Chapter Two: global trends in foreign direct investment

This chapter will embark on analyses of the global trends of foreign direct investment that have emerged over time to date. It will focus on the contribution of

Foreign direct investment to the global economy, it will also analyze the efforts taken by countries to attract foreign direct investment.

Chapter Three: foreign direct investment in Africa.

This chapter will attempt to analyze the foreign direct investment trends in the African continent narrowing to the foreign direct investment in Kenya. This chapter will also analyze the factors that influence foreign direct investment inflows in Africa.

Chapter Four: Data Analysis

This chapter analyzed the data collected in the previous chapters by comparing and contrasting with the hypothesis and the theoretical framework this was be used to guide the study to see if the research had met its objective and either confirm or nullify the hypothesis of the research.

Chapter Five: Conclusions and Recommendations

This is the final chapter of research in which the researcher will provides conclusions and recommendations of the study.

CHAPTER TWO

GLOBAL TRENDS IN FOREIGN DIRECT INVESTMENT

2.0 Introduction

A substantial body of literature has grown around the question of how inward foreign direct investment (FDI) affects host countries. There is however a growing consensus among policy-makers that inward FDI is indeed valuable for their countries.

2.1 Global Trends in FDI

Global foreign direct investment inflows have been growing for the two decades although there have been times there have been drops in global FDI inflows. Despite this the general trend has been one of an increasingly growing importance of FDI as an investment model for firms. The global economic meltdown in 2009 saw however reduction in the world foreign direct investment inflows by 36.5%. However there was a marked increase of 14.7% showing a positive trend for the global economy.

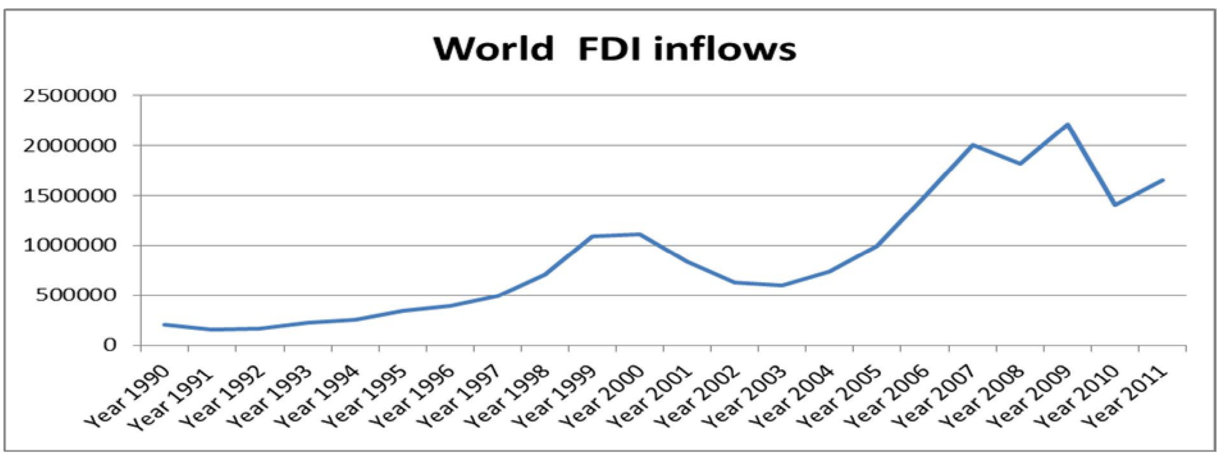
Table 2.1: World FDI inflows 1990-2011

year	**World FDI inflows**
Year 1990	207632.3
Year 1991	153794.6
Year 1992	166027.9
Year 1993	223356.2
Year 1994	255980.3
Year 1995	343544.1
Year 1996	391439.4
Year 1997	488160.3

Year 1998	705938.8
Year 1999	1091490.7
Year 2000	1,113,169.3
Year 2001	836,012.2
Year 2002	626081.3
Year 2003	601246.3
Year 2004	734,148.4
Year 2005	989617.7
Year 2006	1,480,586
Year 2007	2,002,694.1
Year 2008	1,816,398.0
Year 2009	2,216,474.7
Year 2010	1,408,536.9
Year 2011	1,651,510.0

Source UNCTAD world investment report 2013

Figure 2.1: World FDI inflows 1990-2011



Source UNCTAD world investment report 2013

To analyze the global trends in foreign direct investment this study analyzed the findings of two key reports that is the world investment report of 2003 and the world investment report of 2010.

2.1.1 The United Nations Conference on Trade and Development world investment report of 2003

The United Nations Conference on Trade and Development publishes annual data on the changes in national regulations of FDI and finds in its 2003 report that from 1991 through to 2002, over 1,500 changes making regulations more favorable and fewer than 100 making regulations less favorable to FDI were made globally demonstrating a positive preference for FDI in most countries (UNCTAD 2003).[16]

Table 2.2: Change in FDI regulations 1990-2002

ITEM	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Number of countries that introduced changes into their investment regime	35	43	57	49	64	65	76	60	63	69	71	70
Number of regulatory changes	82	79	102	110	112	114	151	145	140	150	208	248
changes More favorable to FDI	80	79	101	108	106	98	135	136	131	147	194	236
changes Less favorable to FDI	2	-	1	2	6	6	16	9	9	3	14	12

Source: UNCTAD world investment report 2003.

[16] UNCTAD., & UN. Department of Economic and Social Affairs. (2003). World *economic situation and prospects 2003*. New York: UN.

The UNTCTAD 2003 world investment report also argued that the use of incentives to attract FDI had considerably expanded in frequency and value (UNCTAD, 2003). The report further stated that some of the possible effects of foreign direct investment inflows on a host country include technological transfer because investing firms more often than not have superior to that of host country firms, higher-quality goods and services could be produced at either lower prices or in greater volume than previously available, resulting in higher consumer welfare for the citizens of the host country among other benefits[17]

The rise of FDI as a tool for economic growth and the continued presence of foreign firms in countries, had led countries to increasingly look at the impacts of FDI, rather than assume that all a country had to do was attract FDI in a country. Three main policy inventions were observed they include, creating a liberal trade regime, creating a competitive environment building up adequate human resources and infrastructural development[18]

The report further found that host economies benefit more from the presence of foreign firms if there are linkages between local firms and foreign firms for example as suppliers which encourages not only technological and knowledge transfer but also financial gain is made possible.

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[17] Blomström, M., S. Globerman, and A. Kokko (2001), "The Determinants of Host Country Spillovers from Foreign Direct Investment: A Review and Synthesis of the Literature", in N. Pain, ed., Inward Investment, Technological Change, and Growth: The Impact of Multinational Corporations on the UK Economy, Palgrave, Basingstoke. 32

[18] Frank, R.H. and R.T. Freeman (1978), Distributional Consequences of Direct Foreign Investment, Academic Press, New York

These benefits are however dependent on how appropriate local capabilities prove to be. Improving local capabilities is not the responsibility of the market alone; the government must also be willing to step in and help develop this capacity through appropriate policies and specific interventions.[19]

From this policies to provide linkages between foreign and local firms have become more prominent over time as well as policies that are more coherent across the areas of investment, innovation, education, and enterprise development.[20]

2.1 The World Investment Report 2010.

The report found that the global economic crisis did not halt the increasing internationalization of production despite its impact on FDI flows. The decrease in profits and in the value-added to overseas affiliates of multinational corporations (TNCs) in 2008 and 2009 the report observed was less than the contraction of the world economy. As a result, the share by this foreign affiliates' in the global gross domestic product (GDP) reached an historic high of 11 per cent. \

The UNCTAD 2010 world investment report predicted that Global inflows were expected to pick up to over $1.2 trillion in 2010, and rise further to $1.3–1.5 trillion in 2011, and then move towards $1.6 to 2 trillion in 2012. [21]

[19] Fors,G. and A. Kokko (2001), "Home Country Effects of FDI: Foreign Production and Structural Change in Home Country Operations", in M. Blomström and L. Goldberg, eds., Topics in Empirical International Economics: A Festschrift in Honor of Bob Lipsey, University of Chicago Press; Chicago.
[20] UNCTAD(2001). *E-commerce and development report 2001: Prepared by the UNCTAD secretariat*. New York: United Nations
[21] UNCTAD (Geneva). (2010). *Trade and development report, 2010: Employment, globalization and development*. Geneva [etc.: United nations conference on trade and development (UNCTAD.

The report also observed that the level foreign employment for transnational corporations increased slightly in 2009, to 80 million workers globally. The rise of developing and transition economies had an apparent impact on international production patterns.

These economies now host the majority of foreign affiliate's labour force. In addition, they accounted for 28 per cent of the 82,000 TNCs worldwide in 2008, two percentage points higher than in 2006. This compares to a share of less than 10 per cent in 1992, and reflects their growing importance as home countries for these firms as well.

The assets of foreign affiliates' grew by 7.5 per cent in 2009, thanks largely to the 15 per cent rise in inward FDI stock to $18 trillion. The increase in FDI stock was due to a significant rebound of global stock markets as well as continued investment inflows of FDI, which remained positive but expanded at a much reduced pace than before Global foreign direct investment (FDI) flows began to bottom out in the latter half of 2009. This was followed by a modest recovery in the first half of 2010, sparking some cautious optimism for FDI prospects in the short term.

The report predicted that the major changes in global FDI patterns that had preceded the global crisis and would likely gain momentum in the short and medium term. Firstly, that the relative weight of developing and transition economies as both destinations and sources of global FDI were expected to continue on an upward trajectory.

The developing and transition economies absorbed almost half of FDI inflows in 2009, and were said to be leading the charge for global FDI recovery and Secondly, the report further observed a decline in manufacturing FDI, relative to that in the services and primary sectors, a trend that was unlikely to be reversed.

2.1.1 Flows to Developing and Transition Economies

FDI inflows to developing and transition economies declined by 27 per cent to $548 billion in 2009, following six years of uninterrupted growth. While their FDI contracted, this grouping appeared more resilient to the global economic crisis than developed countries, as their decline was smaller than that for developed countries which declined by 44%.

Table 2.3: FDI inflows in developing and transitional economies 1990-2011 in millions of US dollars.

year	Developing	Transitional
Year 1990	34477.0	70.9
Year 1991	39577.3	138.6
Year 1992	53272.3	16664.1
Year 1993	76789.6	3143.1
Year 1994	103.357	2045.3
Year 1995	116975.3	4106.7
Year 1996	149537.3	5871.1
Year 1997	192429.0	10349.3
Year 1998	189076.1	8121.70
Year 1999	231065.6	8607.30
Year 2000	264 544.6	7038.4

Year 2001	224071.2	9462.2
Year 2002	193750.7	11273.0
Year 2003	280262.0	19994.8
Year 2004	334526.2	30232.7
Year 2005	432113.4	33611.6
Year 2006	589430.5	62584.9
Year 2007	668438.8	93371.1
Year 2008	530288.8	121428.7
Year 2009	637663.0	72749.9
Year 2010	735212.2	75056.1
Year 2011	702825.6	96290.2

Source UNCTAD world investment report of 2013

Table 2.4: Average inflows to developing regions, 1970s-2000s as a percentage of global inflows

Period	**Africa**	**Latin America and Caribbean**	**Asia**
1970s	5.2	11.7	7.7
1980s	2.6	8.4	14.2
1990s	1.9	9.7	19.1
2000s*	3.0	8.6	17.8

Source: *UNCTAD Investment Reports*

Their share of global FDI inflows kept rising: for the first time ever, developing and transition economies are now absorbing half of global FDI inflows. Following a five-year upward trend, FDI outflows from developing and transition economies contracted by 21 per cent in 2009. However, with the rise of TNCs from those economies, the FDI contraction was also more muted than in developed countries, where FDI outflows shrank by 48 per cent.

FDI is also rebounding faster in the developing world. The share of their outward investment remains much smaller, but it is accelerating and reaching a quarter of global outflows. Among the largest FDI recipients, China rose to second place after the United States in 2009. Half of the six top destinations for FDI flows are now developing or transition economies. Over two thirds of cross-border M&A transactions still involve developed countries, but the share of developing and transition economies as hosts to those transactions has risen from 26 per cent in 2007 to 31 per cent in 2009. In addition, this grouping attracted more than 50 per cent of Greenfield projects in 2009.

2.1.2 Performance of FDI across Regions

2.1.2.1: Africa

Following almost a decade of uninterrupted growth, FDI flows to Africa fell to $59 billion – a 19 per cent decline compared to 2008 mainly due to contraction in global demand and falling commodity prices. Commodities producers in West and East Africa were affected. Flows to North Africa also declined despite its more diversified FDI and sustained privatization programs.

Contraction of investment in the services sector in Africa was less pronounced than in other sectors. Sustained by expanded activity, the telecommunications industry became the largest recipient of FDI inflows. Recovering commodity prices and continued interest from emerging Asian economies are expected to feed a slow upturn in FDI flows to Africa in 2010.

TNCs from developing and transition economies have increasingly been investing in Africa over the past few years. They accounted for 21 per cent of flows to the region over the 2005–2008 periods, compared to 18 per cent in 1995–1999. Investors from China, Malaysia, India and the Gulf Cooperation Council (GCC) are among the most active although Africa still makes up only a fraction of their FDI. Investors from Southern Africa and North Africa have also raised their profile in the region. These new sources of investment not only provide additional development opportunities, but are also expected to be more resilient than traditional ones, providing a potential buffer against crises.

Outward investment from Africa as a whole contracted by half, to $5 billion. Outflows from Southern Africa, however, expanded to $1.6 billion in 2009, boosted by South African investment, mainly in the rest of Africa. Nevertheless, North Africa remained the largest source of regional outflows, accounting for over 50 per cent of the total.

2.1.2.2: South, East and South-East Asia

FDI flows to South, East and South-East Asia have experienced their largest decline since 2001, but they are the first to bottom out from the current downturn. Inflows to the region dropped by 17 per cent in 2009, to $233 billion, mainly reflecting a decline in cross-border M&As, which was particularly severe in services (-51 per cent). As investment from developed countries plummeted, intraregional FDI gained ground and now accounts for as much as half of the region's inward FDI stock. Total outflows from the region declined by 8 per cent to $153 billion, with cross-border M&A purchases dropping by 44 per cent.

FDI in South, East and South-East Asia has already started rebounding, and is likely to pick up speed as the region plays a leading role in the global economic recovery. In particular, inflows to China and India started picking up as early as mid-2009, and their sustained FDI outflows are expected to drive the region's outward investment back to growth in 2010.

Recovery of FDI in and from the four newly industrializing economies (Hong Kong (China), Republic of Korea, Singapore and Taiwan Province of China), however, is likely to be slow and modest. Growing intraregional investment in Asia has served as a vehicle for technology diffusion, "recycling" of comparative advantages and competitiveness enhancement. It has been instrumental in the sequential upgrading of industries across countries at various stages of development. Regional integration and China's take-off are now accelerating this process, creating development opportunities for a wider range of countries, including LDCs such as Cambodia, the Lao People's Democratic Republic and Myanmar. In addition, this process of sequential upgrading has expanded beyond industries such as electronics, and more high-tech products have been involved.

The tightening of international credit markets and the decline of international trade impacted FDI flows to West Asia, which contracted by 24 per cent to $68 billion in 2009. Except in the case of Kuwait, Lebanon and Qatar, inward FDI declined across the region. The contraction hit Turkey and the United Arab Emirates the hardest. In Turkey, cross-border M&As plummeted, and export-oriented industries suffered from the impact of the global crisis. FDI outflows from the region, 87 per cent of which are generated from the countries of the GCC, declined by 39 per cent to $23 billion. Rising outward investment from Saudi Arabia was not enough to compensate for the negative impact of the Dubai World crisis. Provided that this crisis

abates and international credit markets stabilize, West Asian Governments' sustained commitment to ambitious infrastructure plans is expected to support a recovery in FDI inflows in 2010. Outward investment, on the other hand, will remain subdued in the short term. State-owned entities – the region's main investors – have refocused their attention on their domestic economies, and the Dubai World crisis will continue to weigh on the outward FDI of the United Arab Emirates.

2.1.2.3 Latin America and the Caribbean

The impact of the global economic and financial turmoil drove FDI to Latin America and the Caribbean down to $117 billion – a 36 per cent decline from the 2008 level. Although Brazil, with a 42 per cent contraction in inward investment, was more affected than the region as a whole, it remained the largest FDI recipient. Cross-border M&As in the region collapsed, turning negative in 2009 due to sales of foreign affiliates to domestic companies, particularly in Brazil. FDI inflows are expected to recover in 2010 and to continue growing in the medium term, as Brazil and Mexico remain popular investment destinations, according to investor surveys.

Brazil's outward FDI swung to a negative $10 billion, due to a surge in intra-company loans from Brazilian affiliates abroad to their parent companies.

This resulted in a 42 per cent decline in the region's outward investment. Nevertheless, cross-border M&A purchases by TNCs from the region, directed mainly at developed countries, rose by 52 per cent to $3.7 billion. The continued emergence of the region's TNCs, which began in 2003, will drive outward FDI in the medium term.

FDI outflows from Latin America and the Caribbean leaped from an average of $15 billion a year in 1991–2000 to $48 billion annually in 2003–2009. An increasing number of Latin American companies – mostly Brazilian and Mexican – have been expanding outside the region, primarily into developed economies. Besides favorable economic conditions in the region since 2003, government policies also contributed to the consolidation of domestic firms at home and their further outward expansion.

The region's main foreign investors today are often the largest and oldest business groups that prospered during the import substitution era. Moreover, privatization policies in countries such as Brazil and Mexico have resulted in the creation of national champions. More recently, government incentives in Brazil, including targeted credit lines, have supported companies' outward expansion. Limited access to domestic financing, coupled with the current tight international financial markets, could hinder further expansion, however. These TNCs will continue to benefit from their low debt-to-earnings ratio, limited exposure to the industry's most affected by the crisis, and the relative resilience of the region's economy.

2.1.2.3 South-East Europe and the Commonwealth of Independent States (CIS)

After an eight-year upward trend, FDI inflows to South-East Europe and the Commonwealth of Independent States (CIS**)** shrank to $69.9 billion, a 43 per cent decline from 2008. FDI inflows to both sub regions dropped in 2009, although flows to South-East Europe were less affected than those to the CIS. FDI flows to the Russian Federation almost halved, due to sluggish local demand, declining expected returns in projects related to natural resources, and the drying-up of round-tripping FDI.

Nevertheless, the Russian Federation ranked sixth in the global ranking of top locations in 2009. Cross-border M&As collapsed due to sluggish acquisitions by firms from the EU, the largest investors in the region. Investments from developing countries, China in particular, were on the rise, though. The contraction of FDI outflows from the region (-16 per cent) was not as severe as the decline in inflows. In 2009, the Russian Federation – by far the largest source of outward FDI from the region – became a net outward investor. Stronger commodity prices, a new round of privatization, and economic recovery in large commodity-exporting countries (Kazakhstan, the Russian Federation and Ukraine) should support a modest recovery in FDI in the region in 2010.

FDI in South-East Europe's banking industry has been on the rise since the early years of the new millennium, fuelled by substantial restructuring and privatization.

As a result, 90 per cent of banking assets were owned by foreign entities at the end of 2008. Foreign banks have played a positive role in he region during the global financial crisis. The recent sovereign debt crisis in Greece, however, is reviving concerns that the large presence of foreign banks could channel systemic risks to the region.

2.1.2.4 FDI Inflows to Developed Countries

FDI flows to developed countries suffered the worst decline of all regions, contracting by 44 per cent to $566 billion. However, this setback was not as pronounced as during the previous economic downturn of 2000–2003, even though the current economic and financial turmoil is far more severe. North America was the worst affected, while the 27 member countries of the EU weathered the blow better with Germany, for example, recording a 46 per cent increase, mainly due to an upswing in intra-company loans.

On the other hand, FDI flows to the United Kingdom, another major host country in the region, shrank by 50 per cent compared to the previous year. Cross-border M&As dropped by two thirds in developed countries, with transactions in the manufacturing sector contracting by about 80 per cent.

A modest economic recovery stabilized inward investment in the first half of 2010 and is expected to push FDI inflows to developed countries to above their 2009 levels. Ongoing liberalization in areas such as electricity, further regional integration, and continued interest from TNCs based in developing and transition economies should all contribute to better FDI prospects for the developed countries in the medium term. Outward FDI, after falling 48 per cent in 2009, is also expected to recover in 2010 and pick up pace in the medium term, supported by the improving global economic prospects, in particular in the developing world.

However, the perception of increased risk of sovereign debt default in certain European countries and its possible further spread in the euro zone could easily disrupt this upward trend. The economic downturn has revived long-standing concerns in developed countries over the impact of the growing internationalization of production on home country employment. Rapid growth of outward FDI over the past decade has resulted in a growing share of developed-country TNCs' employment moving abroad. And yet, FDI can save or expand domestic employment if it results in exports for the home country or improved competitiveness for investing firms. Research has produced mixed evidence on the impact of outward FDI on domestic job reduction. Indeed, the impact depends on the type of investment, the location of affiliates and TNCs' employment strategies.

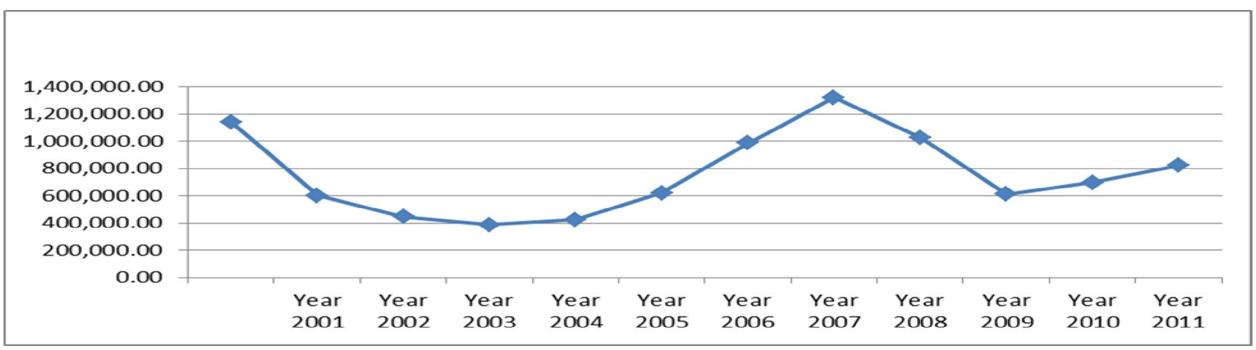
Table 2.5: FDI inflows in developed countries for the period 1990-2011 in millions of US dollars.

Year	Developed countries inflows
Year 1990	172 514.1
Year 1991	144,078.7
Year 1992	111,091.5
Year 1993	143,423.6
Year 1994	150,577.5
Year 1995	222,480.1
Year 1996	236,030.9
Year 1997	285,381.7

Year 1998	508736.9
Year 1999	851 871.8
Year 2000	1,141,586.3
Year 2001	602,478.8
Year 2002	445,596.7
Year 2003	387,500.8
Year 2004	423,653.7
Year 2005	621,479.9
Year 2006	985,888.2
Year 2007	1,319,893.0
Year 2008	1,026,530.6
Year 2009	613,436.1
Year 2010	696,417.8
Year 2011	820,008.5

Source UNCTAD world investment report of 2013

Figure 2.2: FDI inflows to developed countries 2001-2011



Source UNCTAD world investment report of 2013

2.2 International Policies

Due to the importance attached to FDI countries have come up with strategies to attract FDI on the global stage on several levels that is bilateral, regional and multilateral

2.2.1 Bilateral

There has been a surge in the number of bilateral investment treaties (BITs) from 500 in 1990 to close to 2,400 now. Some countries are more active than others. Germany and the UK for example are more active than the US, but most developed countries now have BITs in place with all their main investment partners in developing countries.

LDCs generally have few BITs in place. Increasingly, BITs are also being signed amongst developing countries. Empirical evidence on the impact of BITs on attracting FDI has been mixed. Empirical evidence on the impact of BITs on attracting investment, however, has been mixed. Some studies have found that the attraction of FDI is positively linked to signing BITs, but that BITs act as a complement rather than a substitute for strong political and legal institutions (Hallward-Driemeier 2003; Tobin and Rose-Ackerman 2005)

Double taxation treaties (DTTs) are other bilateral instruments affecting FDI. DTTs have risen similarly to BITs. Nearly 2,500 DTTs cover now more than 175 countries, with the strongest rise in the late 1980s .DTTs are important because it avoids the need for TNCs to pay taxes in both the home and host country. As developing country outward FDI is growing, so is the interest with developing countries in signing DTTs.

2.2.2 Regional

While most regional integration agreements notified to the WTO include narrow provisions to liberalize trade, the new wave of regionalism that started in the 1990s has included investment provisions in about 20 cases (Ethier, 1998). For instance, ASEAN restricted FDI in the 1970s but this changed over the 1980s and 1990s. ASEAN has gradually added more investment provisions.

Generally, regions differ with respect to trade and investment provisions in two fundamental respects: regional trade and integration provisions have led to an increase in inward FDI to the region, but spread unevenly over countries within the region.

2.2.3 Multilateral

The earliest multilateral discussions on investment date back to 1948. An attempt was made to formulate international principles concerning FDI in the *Havana Charter of 1948*, but it was rejected. Developments afterwards are described in UNCTAD (2004).[22] The inclusion of a multilateral investment agreement was rejected at the OECD in the 1990s and more recently at the WTO, despite a proliferation of bilateral and regional investment agreements. However, some

[22] UNCTAD, International Trade Centre UNCTAD/WTO., World Trade Organization, & UNCTAD XI Event on JITAP (2004: São Paulo, Brazil). (2005). *UNCTAD XI Event on JITAP: Capacity building in assuring developmental gains from the multilateral trading system: summary of the debate and collection of papers submitted, São Paulo, Brazil, 18 June 2004*. New York: UN.

multilateral investment provisions do exist, e.g. the WTO Agreement on Trade Related Investment Measures (TRIMs), the Agreement on Subsidies and \Countervailing Measures (ACM), and the General Agreement of Trade in Services (GATS), which covers conditions for FDI.

CHAPTER THREE

FOREIGN DIRECT INVESTMENT IN AFRICA

3.1 Introduction

Since the early 60's when most countries on the African continent were attaining their independence there has been a debate on whether the benefits of foreign direct investment are indeed real or is foreign investment just a tool for the former colonial masters and other countries in the west to continue maintaining their dominance over the African continent through perpetuating economic and political dominance.

The former has been an argument advanced by most scholars leaning towards the Marxist Leninist school of thought such as Franz fanon, Emanuel Walestine, Walter Rodney, Andre Gunder frank among others. This group argued that the process of decolonization was by and large a tactical retreat and the former colonial masters had just transformed themselves into "investors" and where using their economic influence over the African states to continue to control and colonize in another way the African people and by extension the countries of the third world or the south in what the former president of Ghana referred to as neo colonialism.

These views had a lot of influence on the African continent especially on the countries that were coming out of colonialism and had decided to take the socialist route they include countries such as Tanzania, Angola, Mozambique and Ghana. In these countries there was a big push to Africanize the economies of those countries this was characterized by the nationalization of many companies formerly owned by foreigners, land redistribution, very strong requirements for the setting up of companies and the formation of numerous state corporations.

On the other hand the argument for foreign direct investment has been advanced by the liberal leaning scholars, the International monetary fund and the World Bank. They argued that in order for African and indeed third world economies to develop they must adopt an open economic system of government which allows for free market policies to reign, there must therefore not be any form of protectionism, and the market must be allowed to take care of itself. The role of government in the economy must be very minimal, only regulatory.

Since last few decades, the impact of Foreign Direct Investment (FDI) is very high on developed, developing and transition economies in the world. FDI is often considered as an essential source of capital, which not only generates new job opportunities but also balances domestic investment. It also attracts massive foreign currency inflows which often lead to remarkable appreciation in local currency.

Developing and transition economies account for 50% of global FDI, as inflows reached record high amount of US$755 billion in 2011. There are three important channels through which FDI has significantly contributed towards growth of developing economies in Africa. The firstly by offering some liberty to existing limitations placed on domestic savings, FDI has augmented domestic savings of Africa through the capital accumulation process. Secondly, FDI is one of the important means through which technology transfer has taken place in Africa. Thirdly, FDI has created strong boost in competitiveness and capacity in African domestic production which eventually resulted in significant increase in exports of African nations such as South Africa, Ghana and Nigeria.[23]

[23] United Nations Conference on Trade and Development (1995) Foreign *direct investment in Africa*. New York: United Nations

Currently, United States, United Kingdom, Japan and France hold more than 3/4th of the total Foreign Direct Investment stock in Africa. On volume basis, the oil exporting nations such as Nigeria and Angola are leading the list of nations with significant FDI inflows. However, some smaller countries such as Namibia, Kenya, Lesotho, Swaziland and Seychelles have also performed significantly well in attracting foreign investors. A substantial part of FDI share in Africa is invested in primary sectors of economy such as agriculture and mining and exploitation of natural resources such as oil gold and diamonds.

In 1970, the total amount of Foreign Direct Investments inflows in Africa was US$1.26 billion, and it rose to US$55.04 billion in 2010. Thus, between the two periods, FDI inflows have increased significantly and from face value one can say that Africa has done well in attracting FDI. However, after an assessment of Africa's performance in relation to other regions the picture becomes quite different. In 1970 for example, Africa's share in the global FDI inflows was 9.5% and it had dropped to 4.4% in 2010.

The share of Africa FDI inflows in relation to other regions considered as developing was 32.8% in 1970, and it dropped to 9.6% in 2010.The figures show that there is absolute progress but relative decline of Africa as far as FDI attractiveness is concerned, the question that then arises is why African countries fail to attract more FDI compared to the rest of the world

Net official development assistance to Africa has also been on the decline from US$17.8 billion in 1995 toUS$12.2 billion in 2000, a decrease of about 31% (World Bank, 2003). This trend is likely to continue due the global economic crisis, which has reduced the capacity of developed countries to provide development assistance to developing world, including Africa. It therefore goes without saying that Africa needs to find other resources for financing its development, and FDI is one of those alternative financing sources that Africa must make good use of.

What then can African countries do to attract more foreign direct investment? According Morisset (2000) African countries can be successful in attracting FDI that is not only based on natural resources such as oil and minerals, by improving their business climate making it more liberal and more conducive for investment. In the same vein,[24] Asiedu (2006) looks at the influence of natural resources and market size in relation to government policy, host country's institutions and political instability in attracting FDI .She concludes that countries that are endowed with natural resources or have large markets will naturally attract more FDI. She then continues to assert that, good infrastructure, an educated labor force, macroeconomic stability, an efficient legal system; less corruption and political stability also promote FDI.

In the same vein Asiedu (2007) analyses the relative performance of Sub Saharan African compared to other developing regions in attracting FDI, as well as in improving the environment for FDI. She argues that Sub-Saharan Africa's share of FDI compared to other developing countries has declined over time. The main finding is that, with regard to FDI determinants, Sub-Saharan African experience can be characterized as progress but relative decline. Indeed, from 1980-89 to 1990-99, Sub-Saharan Africa has by and large reformed its institutions, improved its infrastructure and attempted to liberalize its FDI regulatory framework. However, compared with other developing regions such as Latin America the changes have been quite meager. This may

[24] Morisset, J., Pirnia, N., World Bank, & Foreign Investment Advisory Service. (2000). *How tax policy and incentives affect foreign direct investment: A review*. Washington, D.C: World Bank and International Finance Corp., Foreign Investment Advisory Service.

be blamed on the volatile political environment that continues to rein in most sub-Saharan African countries.[25]

The picture of foreign direct investment in Africa is however not all gloom and doom there has been a significant increase in the level of investment in the African continent which has spurred an increase in growth and development in those countries for example Angola, a former Portuguese colony that obtained independence in 1975, and then almost immediately plunged into a civil war that lasted 27 years. Soon after independence, the country installed the central planning economic system based on models from the Soviet Union. After what referred as Bicesse Accord in 1991, the central planning system was changed to a market oriented system. In this system, the government still maintained control of crucial sectors of the economy and selectively liberalized the rest.[26]

During most of the 1990s Angola's economy underperformed, at par with most African countries. However, after 1998 Angola was successful in attracting foreign direct investments beyond 1 billion US which was mostly destined for offshore oil. Excluding a fall in 2000, inflows have increased steadily, maintaining a rate of more than 5 billion USD since 2003. Angola attracted over 11 billion USD in foreign direct investments (FDI) in 2009. Most of Angola's FDI comes from the United States, followed by France, the Netherlands and Brazil. Despite a fast growing economy, Angola ranks in the bottom 10 percent of most socioeconomic

[25] Asiedu, E., & Gyimah-Brempong, K. (2007). *The effect of the liberalization of investment policies on employment and investment of multinational corporations in Africa*. Helsinki: UNU-WIDER.

[26] Lundahl, M. (2001). *From crisis to growth in Africa?*. London: Routledge.

indicators. Angola has become one of the most attractive destinations in Africa even its capital Luanda being ranked as one of the most expensive cities to live in.[27]

Table 3.1: Average inflows to Africa 2000-2006

	2000	2001	2002	2003	2004	2005	2006
World ($bn)	1 408.3	851.1	618.1	557.9	742.1	945.7	1 305.9
Africa ($bn)	8.9	16.3	12.4	18.5	18.0	29.6	35.5
% world total	0.6	1.9	2.1	3.3	2.4	3.1	2.7

Source: UNCTAD World Investment Reports

Table 3.2: Ranking of top 15 FDI recipients in Africa and share of total inflows, 2000-2008

Ranking	Country	Average US$ million	% of total inflows
1	Angola	6631.5	18.8
2	Egypt	4586.5	13.0
3	Nigeria	4529.1	12.9
4	South Africa	3510.3	10.0
5	Morocco	1812.6	5.1
6	Sudan	1713.6	4.9
7	Libyan Arab Jamahiriya	1391.6	4.0
8	Tunisia	1308.3	3.7
9	Algeria	1266.6	3.6
10	Congo	1039.6	3.0
11	DRC	610.6	1.7
12	Zambia	493.7	1.4
13	United Republic of Tanzania	465.9	1.3
14	Equatorial Guinea	459.6	1.3
15	Uganda	395.4	1.1

Source: UNCTAD World Investment Reports

[27] Ferreira, S., & Copenhagen Business School. CBS.(2008). *Sino-Angolan relationship. Searching for evidence linking foreign direct investment with poverty reduction: the Chinese outward foreign direct investment into Angola*. Frederiksberg.

CHAPTER FOUR

FOREIGN DIRECT INVESTMENT IN KENYA

4.1 Introduction

Kenya has had a long history with foreign firms since the colonial period when companies from Britain and other European countries set up base in the country. In fact in the 1970s it was considered one of the most favored destinations for FDI in East Africa.[28]

However over the years, Kenya lost its appeal to foreign firms. A phenomenon that has continued until the Kibaki administration did do a lot to solve the problem by instituting reforms and slowly companies are began to come back to Kenya.

This initiative has seen a renewed commitment to attract FDI. According to the vision 2030 in order for Kenya to achieve the growth objectives underpinning the Vision it required the rate of growth of the Kenyan economy to rise from the 6.1% achieved in 2006 to 10% by 2012/13 and to sustain the same growth thereafter.

Such a growth it was believed would shift Kenya from the rank of the low-income countries to well within the ranks of the middle-income countries. Achieving these growth targets it was argued would require: continued implementation of prudent fiscal, monetary and exchange rate policies; enhanced effort to raise the level of investments and savings, and accelerating structural reforms in order to increase the efficiency of both physical and human capital and raise total factor productivity.

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[28] Ochieng', W. R., & Maxon, R. M. (1992). *An economic history of Kenya*. Nairobi, Kenya: East African Educational Publishers.

All this reforms would lead to improved local and foreign investment which would help maintain the growth level as required to fulfill the dream of vision 2030. Therefore foreign direct investment is part of the grand plan for the Kenyan economy. There has also been a new improved drive to market Kenya as a prime investment destination in what has been referred to as the Brand Kenya initiative.[29]

FDI has risen in Kenya from the 1990s mainly due to the liberalization of the economy which allowed a more free market approach to development. It is mainly concentrated in the manufacturing, financial, agricultural and more recently the communications industry sector and is mainly Greenfield in nature.

Table 4.1 Announced Greenfield foreign investments 2003-2011

year	**Number Greenfield foreign investments**
2003	13
2004	15
2005	13
2006	12
2007	9
2008	23
2009	28
2010	35
2011	63

Source UNTAD reports

The main determinants of FDI in Kenya include market size in Kenya as well as within the region, political and economic stability in both Kenya and its neighbors and bilateral trade

[29] Kenya & Kenya. (2007). *Kenya: Vision 2030*. Nairobi: Government of the Republic of Kenya, Ministry of Planning and National Development and the National Economic and Social Council (NESC), Office of the President.

agreements between Kenya and other countries. The major FDI barriers in Kenya are political and economic instability in Kenya, crime and insecurity, institutional factors such as corruption, delayed licenses and work permits among other factors.[30]

Because of its strategic location strategic within East Africa, its population of approximately 40 million people and the fact that the country is well endowed with a broad range of natural resources, flora and fauna and arable land. The Kenya highlands for example comprise of the most successful agricultural production regions in East Africa.

4.2 History of FDI in Kenya

Before independence in 1963, bulk of foreign direct investment in the country went to primary production and plantations. The few manufacturing industries which were established up to World War II were mainly for basic processing of agricultural exports and the processing of food for the local market. After the war British manufacturing firms begun to invest directly in the manufacturing industry , in part, because of the competition from non-British trading firms mainly owned by Indians and other Europeans ,which threatened Britain's share in the Kenyan market [31]

Between 1962 and 1964 the government implemented a policy of land resettlement and it consequently prevented more foreign firms from purchasing more land, and as a result foreign

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+[30] Ngugi, R., & Nyang'oro, O. (2005). *Institutional factors and foreign direct investment flows: Implications for Kenya*. Nairobi, Kenya: Private Sector Development Division, Kenya Institute for Public Policy Research and Analysis.

[31] Van, Z. R., & King, A. (1975). *An economic history of Kenya and Uganda, 1800-1970*. London: Macmillan.

ownership in the agricultural sector was greatly reduced. In commerce and industry by contrast, virtually all the expansion which took place, that is a 50 percent increase in output between 1964 and 1970 and 100 percent increase in the annual level of investment, was foreign owned. At first much of this investment involved capital transfers out of the agricultural sector, especially following the introduction of exchange controls in 1965. During this period Kenya had pursued import substitution from as early as 1960s.[32]

This industrial policy advocated for a large role of the public sector participation and protection of the infant manufacturing industries the idea behind the policy being to reduce the importation of commodities such as clothes and shoes that could be manufactured instead in Kenya. The government used a combination of tariffs and quotas supplemented by foreign allocation measures including overvaluing exchange rates to maintain import costs low, favorable credit and interest rate policies intended to subsidize the manufacturing consumer goods (Rweyemanu, 1987, Gachino 2006).

During this period (1960-1980) FDI levels were reasonably high in comparison to other East African countries this was partly attributed to the fact that Kenya had maintained a favourable investment climate. Obrien and Ryan (2002) note that Kenya was for many years a relatively attractive locale for foreign investment. However, Bradshaw (1988) observes that although that may have been the case, there were already concerns beginning to emerge, that because of Kenya's liberal repatriation policies, more international investment income left Kenya in the form of profit remittances than flows into the country.

[32] Kim, K. S., & University of Nairobi. (1973). *the balance-of-payments and employment-creation effects of import substitution in Kenya: An input-output approach*. Nairobi: Institute for Development Studies, University of Nairobi

As a result the government instituted measures to encourage foreign firms to reinvest their profits in the country. From 1974, firms that were found to have high repatriation rates had their local borrowing rights restricted by the Central Bank. The government also attempted to cut down on the level of management remittances and technical fees by imposing a 14 percent withholding tax. These efforts instead of encouraging economic growth did the exact opposite by discouraging foreign investors.[33]

FDI in Kenya has consequently not just been volatile since the 1970s but also low. This led to the stagnation of the manufacturing sector which was by and large dominated by the foreign firms. This decline was largely blamed on the inward oriented strategy as well as the collapse of the East Africa Community in 1977.

The ensuing economic distortions resulted in severe structural constraints and macro-economic imbalances and firms failed to develop competitive capabilities to penetrate into the international markets. [34]The inward looking policies pursued at the time under import substitution made it difficult to effectively participate and compete keenly in the export markets. As a result the manufacturing industry failed to play the dynamic role it was meant to play that is to function as an engine of the county's growth and did not contribute significantly to foreign exchange (Kenya Government 1993).

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[33] Bradshaw, Y. W. (October 01, 1988). Reassessing Economic Dependency and Uneven Development: The Kenyan Experience. *American Sociological Review, 53*, 5, 693-708.

[34] Nyong'o, P. A., & Africa Research & Publications Project. (1984). *The possibilities and historical limitations of import substitution industrialization in Kenya*. Trenton, N.J: Africa Research & Publications Project.

Further, economic stagnation in the mid-1980s and 1990s affected Kenya's industrialization with consequent effects on labour productivity (Gachino and Rasiah, 2003). Political instability in neighboring countries particularly Uganda also drew away markets and investment in Kenya.

After the disappointing period of the 1990s, Kenya resumed the path to rapid economic growth in 2002 when the Kibaki administration took power with the implementation of the Economic Recovery Strategy paper[35] which was later replaced by vision 2030 after it expired in 2007. During this period the government embarked on establishment of free trade zones, improvement of business climate, infrastructure, and development of incentives among initiatives. These efforts were aimed at building a momentum that can sustain economic growth and promote development. At the centre of these efforts was a commitment to attract foreign direct investment which was hoped would assist in the industrialization process.

These efforts were assisted by improved relations with donor countries and organizations such as the international monetary fund and the world who had found it increasingly difficult to deal with the Moi regime due to the corruption and ineffectiveness experienced there was therefore increasing hope from the new government for reform. The entry of the Chinese as a donor country also did help the country.

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[35] Rasiah, R., & Gachino, G. (June 01, 2005). Are Foreign Firms More Productive and Export- and Technology-intensive than Local Firms in Kenyan Manufacturing? *Oxford Development Studies, 33*, 2, 211-227

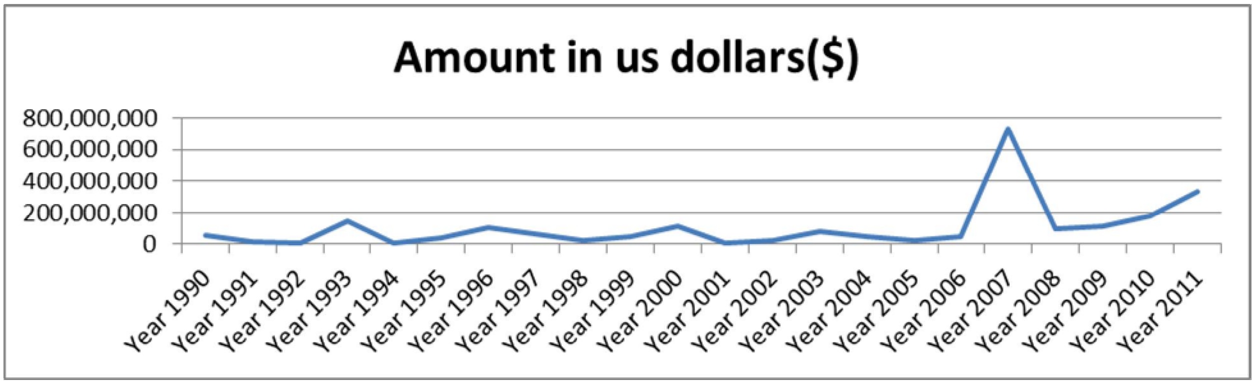
4.3 Foreign Direct Investment Inflows in Kenya 1990-2011

Table 4.2: Kenya's foreign direct investment inflows 1990-2011

Year	Amount in us dollars($)
1990	57,081,197
1991	18,830,977
1992	6,363,133
1993	145,655,517
1994	7,432,413
1995	42289248
1996	108,672,932
1997	62,096,810
1998	26,092,246
1999	51,953,456
2000	110,904,550
2001	5,302,632
2002	27,618,447
2003	81,738,243
2004	46,063,931
2005	21,211,685
2006	50,674,725
2007	729,044,146
2008	95,585,680
2009	116,257,609
2010	178,664,607
2011	335,249,880

Source: world Bank data bank

Figure 4.1: Kenya's foreign direct investment inflows 1990-2011



Source: world Bank data bank

The table and graph above show the trends of Kenya's foreign direct investment inflows in the country. The figures above show that Kenya's foreign direct investment inflows in Kenya have had no stated pattern and have by and large oscillated from year to year since 1990-2011 except in the period from 2004 to 2007 when as the data shows they were on an upward trajectory until 2008 when again there was a drop in the FDI inflows in the country but the figures seem to again have picked up 2009 to 2011 to 2011 when again there was an upward trajectory of the FDI coming into the country.

These figures will be very important for our subsequent discussions in an attempt to analyze the above stated variables and will these constantly be referred henceforth

4.4: Economic Growth and Foreign Direct Investment in Kenya

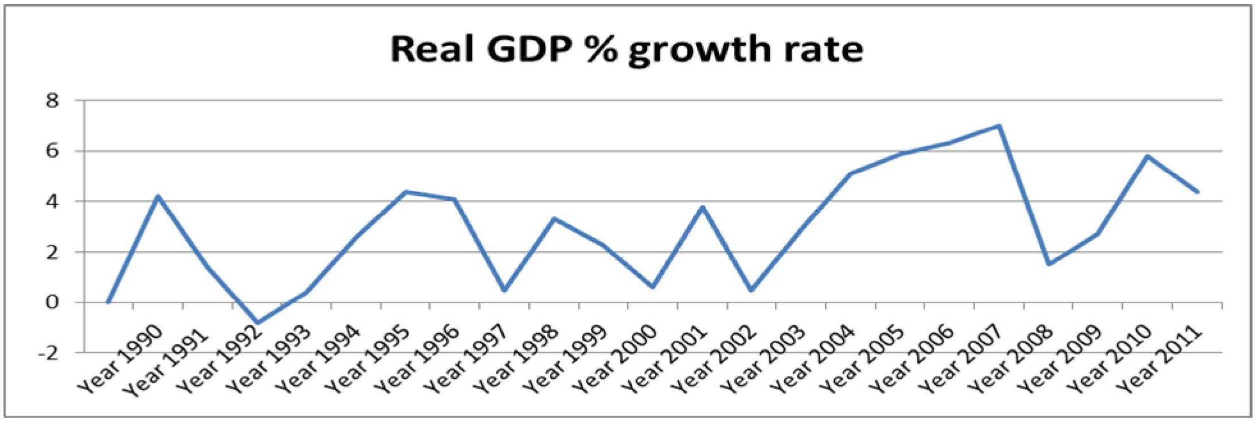
Economic growth is defined as the increase in the amount of the goods and services produced an economy over time usually a year or sometimes this is done quarterly and the adjusted figure is averaged. It is conventionally measured as the percent rate of increase in *real gross domestic product,* or *real GDP*. Growth calculated in *real* terms implies that it has been adjusted for inflation so as to eliminate the distorting effect of inflation on the price of goods produced

Table 4.3: Kenya's real GDP growth rate1990-2011

Year	Real GDP % growth rate
Year 1990	4.2
Year 1991	1.4
Year 1992	-0.8
Year 1993	0.4
Year 1994	2.6
Year 1995	4.4
Year 1996	4.1
Year 1997	0.5
Year 1998	3.3
Year 1999	2.3
Year 2000	0.6
Year 2001	3.8
Year 2002	0.5
Year 2003	2.9
Year 2004	5.1
Year 2005	5.9
Year 2006	6.3
Year 2007	7.0
Year 2008	1.5
Year 2009	2.7
Year 2010	5.8
Year 2011	4.4

Source: world Bank data bank

Figure 3.2: Kenya's real GDP growth rate 1990-2011



Source: world Bank data bank

From 1991 to 1993, Kenya had its worst economic growth performance over the twenty one year's period under investigation Growth in GDP stagnated, even going as low as -0.8% in 1992. The data shows that Kenya experienced sustained growth from again 1993-1996 until 1997 where again the economy dropped to 0.5% growth and from there it continued to dance around not really creating any observable pattern until 2003 when the Kibaki regime took over from the KANU government and there was sustained growth with the economy having a period of sustained growth going up to 7% in 2007 only for growth levels to drop to 1.5% in 2008 which may be explained to be as a result of the post-election violence experienced in the country that led to a lot of destruction and displacement and had an overall negative effect on the Kenyan economy. Since 2009 to 2011 the Kenyan economy has seen a sustained growth rate which may be explained to be as a result of stability experienced in the country during that period.

Does economic growth affect the foreign direct investment affect foreign direct investment inflows in Kenya?

Table 4.4: Kenya's real GDP growth and FDI inflows

Year	Real GDP % growth rate	Amount in us dollars($)
Year 1990	4.2	57,081,197
Year 1991	1.4	18,830,977
Year 1992	-0.8	6,363,133
Year 1993	0.4	145,655,517
Year 1994	2.6	7,432,413
Year 1995	4.4	42,289,248
Year 1996	4.1	108,672,932
Year 1997	0.5	62,096,810
Year 1998	3.3	26,092,246
Year 1999	2.3	51,953,456
Year 2000	0.6	110,904,550
Year 2001	3.8	5,302,632

Year 2002	0.5	27,618,447
Year 2003	2.9	81,738,243
Year 2004	5.1	46,063,931
Year 2005	5.9	21,211,685
Year 2006	6.3	50,674,725
Year 2007	7	729,044,146
Year 2008	1.5	95,585,680
Year 2009	2.7	116,257,609
Year 2010	5.8	178,664,607
Year 2011	4.4	335,249,880

Source: World Bank data bank

From the data above data a few there are a few notable findings as regards to the relationship between foreign direct investment and economic growth. The data above in the researchers view shows no real causal relationship between economic growth and foreign direct investment but it does show an interesting pattern which is that even during periods when the Kenyan economy experienced sustained growth rates it does not necessary imply a growth in the foreign direct investments in the country The same applies for the periods in which there was a sustained drop in the economic growth rates in the country.

Table 4.5: Real GDP growth and FDI inflows 1993-1995.

Year	**Real GDP % growth rate**	**Amount of FDI inflows in us dollars($)**
Year 1993	0.4	145,655,517
Year 1994	2.6	7,432,413
Year 1995	4.4	42,289,248

Source: World Bank data bank

What the data above shows is that even in periods where there is sustained economic growth in the country there is not a subsequent increase in the FDI inflows in the country. As observed in 1993 when there was a growth of 0.4% had the highest FDI inflows in the country over the period yet the economic growth was the lowest. In 1994 there was a drop in the inflows in the country although it had a higher economic growth than 1993 and the there is an observed increase again in 1996 therefore showing no real pattern in the relationship between economic growth and foreign direct investment.

Table 4.6: real GDP growth and FDI inflows 1998-2000

Year	**Real GDP % growth rate**	**Amount of FDI inflows in us dollars($)**
Year 1998	3.3	26,092,246
Year 1999	2.3	51,953,456
Year 2000	0.6	110,904,550

Source: World Bank data bank

What the data above again shows is that even in periods where there is a sustained drop in economic growth in the country there is not a subsequent decrease or increase in the FDI inflows in the country. As observed in 1998 when there was a growth of 3.3% had the lowest FDI inflows in the country over the period yet the economic growth was the highest. In 1999 there was a an increase in the FDI inflows in the country although it had a lower economic growth than the year 1998 and there is an observed increase again in 2000 which in fact was the highest during the period therefore showing no real pattern in the relationship between economic growth and foreign direct investment

4.4.1 FDI Inflows as a Percentage of GDP.

For the period 1990-2011 percentage of FDI in Kenya’s GDP remained low between 4-8 % respectively an average of 5.8%. Another observable fact is that FDI as a percentage of Kenya’s GDP did not follow any specific pattern or. The data reveals that FDI does not play a very big role in the Kenyan economy in terms of GDP.

Table 4.7 FDI Inflows as a Percentage of GDP

year	FDI as % of GDP
1990	4.9
1991	5.4
1992	5.5
1993	7.9
1994	6.7
1995	5.5
1996	5.5
1997	5.4
1998	5.3
1999	6.6
2000	6.4
2001	6.5
2002	6.2
2003	6.0
2004	5.3
2005	4.5
2006	5.9
2007	5.5
2008	5.7
2009	5.7
2010	6.2
2011	5.7
Avarage	5.8

Source: UNTAD reports

4.5 Political Stability and Foreign Direct Investment in Kenya

A research by synovate research group in 2010 found Political instability to be the biggest threat to Kenya's economic recovery the time. The study interviewed top executives from the business community and they all ranked political risk ahead of competition from rivals, poor infrastructure and cheap imports as the biggest hurdle to businesses achieving their full potential.

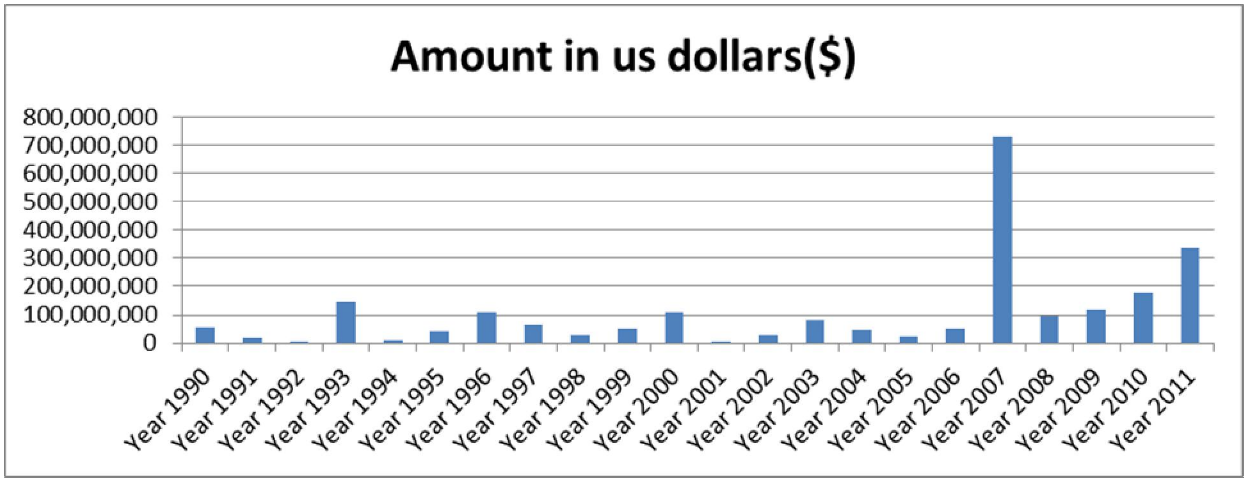
The political instability in Kenya has been a major issue from the political violence that has causes jitters in the business community. A stable political system would be one in which the political order is clearly predictable. This research looked at the different election cycles and their overall effect on investment inflows in the country as illustrated below.

Table 4.8: Kenya's foreign direct investment inflows 1990-2011

Year	Amount in us dollars($)	Percentage change
Year 1990	57,081,197	
Year 1991	18,830,977	-67.01)
Year 1992	6,363,133	-66.21)
Year 1993	145,655,517	2189.05
Year 1994	7,432,413	-94.90)
Year 1995	42289248	468.98
Year 1996	108,672,932	156.98
Year 1997	62,096,810	-42.86)
Year 1998	26,092,246	-57.98)
Year 1999	51,953,456	99.11
Year 2000	110,904,550	113.47
Year 2001	5,302,632	-95.22)
Year 2002	27,618,447	420.84
Year 2003	81,738,243	195.96
Year 2004	46,063,931	-43.64
Year 2005	21,211,685	-53.95)
Year 2006	50,674,725	138.90
Year 2007	729,044,146	1338.67
Year 2008	95,585,680	-86.89)
Year 2009	116,257,609	21.63
Year 2010	178,664,607	53.68
Year 2011	335,249,880	87.64

Source: World Bank data bank

Figure 4.3: Kenya's foreign direct investment inflows 1990-2011



Source: World Bank data bank

From the above data one thing comes out clearly that during every election year when political temperatures are hottest and indeed most turbulent there has always been a reduction in the number of FDI inflows in the country the only exception to this rule was 2007 where in fact it was the highest in the 21 year period. For example due to the political instability which occurred in 2008 there was a 86.89% of decrease FDI inflows from 2007 showing that indeed political instability has an effect on the FDI inflows in Kenya.

In 1992 also there was a decrease of 66.21% in the amount of inflows that entered in the country this may be explained as being caused by the fear of a change in the system from one party rule to multiparty rule. In 1997 another election year there was a decrease of 42.85% reduction the amount of inflows in the country.

4.6 Infrastructure Development and Foreign Direct Investment in Kenya

Infrastructure implies the broad range of physical systems of a business or nation. Transportation, communication, sewage, water and electric systems are all examples of infrastructure. These systems tend to be high-cost investments; however, they are vital to a country's economic development and prosperity. Infrastructure projects may be funded publicly, privately or through public-private partnerships.[36]

Kenya has seen a major infrastructural boom since the advent of the Kibaki regime from 2002-2013 which saw a new drive to improve the infrastructural base of the country with the belief that this would spur investment and hence economic growth. This research restricted itself to investigating the role that this infrastructural development has had on foreign direct investment.

It would be a monumental task to analyze the effect of each infrastructural development done in the country in the past 20 years the study will restrict itself two conducting an analysis of two infrastructural developments two from the Kibaki regime. The aim being to analyze the effect these infrastructural developments had on the foreign direct investment inflows in the country

4.6.1 Case Studies

This study will utilize the following case studies.

4.6.1.1 The Thika Super Highway Development

Thika Road super highway was a major infrastructural initiated by former president Mwai Kibaki as one of the flagship projects of Kenya's vision 2030 the road was expected to link the city of Nairobi to Thika town. The road is a standard eight lane highway; the total cost of the

[36] Ibid 12

expansion was estimated at Ksh 27 billion, but the cost went higher due to increasing fuel costs to an estimated cost of 30 billion Kenya shillings. The highway was completed in February 2012.

The construction of the Thika super highway has led to massive growth of the real estate sector within the area around the road with projects coming up left right and center for example renaissance Partners, an investment unit of Moscow-based Renaissance Capital Financial Holdings Ltd will invest 400 billion shillings, on a 2,500-acre residential complex named the Tatu city in Ruiru just near the Thika highway.

Other investments in the real estate area include the Thika greens resort and golf city which is set to cost a total of 53 billion shillings, Actis investments a UK investment company is also set to invest well in excess of 27 billion Kenya shillings in the Garden city along the Thika super highway with already south African supermarket giant Massmart having booked space to invest in the mega mall to be built in the area and it is to invest 12.6 billion shillings to set up base in Kenya once the project is finished. A local company Nakumatt holding has also invested 450 million into the Thika road mall. The Migaa resort and golf city is also coming up at an estimated cost of 35 billion; Pepsi a soft drink manufacturing company has also invested 2.4 billion in a bottling plant in Kasarani. The table 7 below illustrates some of these investments.

Table 4.9: Estimated investments along Thika superhighway

Project/investment	**Estimated total investment**
Thika greens	53 billion
Migaa golf and resort city	35 billion
Garden city	27 billion
Pepsi bottling plant	2.4 billion
Nakumatt Thika road mall	450 million
Tatu city	400 billion
Total	517.85 billion

Source: national bureau of statistics, and media reports

From the above data one thing is clear that foreign companies have invested heavily in the area around the Thika super highway because of the opportunities that the road has opened. Local investors such as Nakumatt and others have also invested in the area and indeed most of these investments in the area are partnerships with local firms. The Thika highway as observed above is set to have the effect leading to 517.85 billion shillings worth of investments compared to the estimated 30 billion used to construct the road the money invested in construction seems quite negligible compared to the benefits ripped from it.

4.6.1.2 Fiber Optic Cable

Optical fibers are widely used in fiber-optic communications, which permits transmission over longer distances and at higher bandwidths (data rates) than other forms of communication. Fibers are used instead of metal wires because signals travel along them with less loss and are also immune to electromagnetic interference. Fibers are also used for illumination, and are wrapped in bundles so that they may be used to carry images, thus allowing viewing in confined spaces.

Speaking when he officially launched the East African Marine Systems cable, former President Kibaki said the landing of the fiber-optic undersea cable project in Mombasa was one of the landmark projects in Kenya's national development efforts. "Indeed some have compared this to the completion of the Kenya-Uganda railway more than a century ago," former President Kibaki said.

Since the launch of the fiber optic cable project there has been a flurry of activity in the internet connectivity industry with numerous with companies investing billions in internet connectivity business and other related services. In fact the fiber optic cable has made Kenya the regional ICT herb in the region. In fact the current Internet subscriptions in the country stand at 7.7 million, a growth from 4.2 million in 2011.

Some of the companies that have invested in the internet include Safaricom Kenya that has invested 8 billion Kenya shillings, Access Kenya that has also invested well in excess of 120 million, Mwananchi Group Holdings also known as Zuku also plans to invest US$57 million or 4.56 billion Kenya shillings towards, airtel Kenya a subsidiary of Airtel Bharti international has also invested close to 8 billion in the Kenyan market to improve internet connectivity for its mobile customers, orange Kenya a subsidiary a partnership between France telecom and the government of Kenya through telecom Kenya has invested well in excess of 20 billion shillings in the fiber optic project and finally jamii telecom which has invested close to 1.8 billion the fiber optic cable to connect homes with the internet more so in Mombasa and Nairobi.

Table 4.8: Estimated fiber optic related investments in Kenya.

Company/firm	Total estimated investment cost in Ksh
Mwananchi holdings/Zuku	4.56 billion
Orange Kenya	20 billion
Safaricom limited	8 billion
Jamii telecom	1.8 billion
Airtel Kenya	8 billion
Access Kenya	120 billion
Total	48.56 billion

Source: national bureau of statistics, and media reports

Other companies have invested or are planning to invest in internet related investments all which would not be possible without the fiber optic cable connection which as earlier observed has opened the country to ICT related investments and made it the information technology herb. For example the MasterCard Worldwide, company launched its official East African regional headquarters in Nairobi, Kenya. Master Card offices across the African continent to five, with other offices operational in Cairo, Casablanca, Lagos, Johannesburg and now Nairobi. Another company IBM international has opened its first research Centre on the continent in Kenya at the Catholic University of Eastern Africa which gives the country access to a share of its $6.5 billion annual research budget. Another company OLX international has also invested well in excess of over 100 million Kenya shillings in the internet marketing industry in Kenya a relatively new field that is quickly picking up pace in the country.

It would be an injustice to close this discussion without discussing the construction ICT Konza city which is set to cost a whooping Sh850 billion which will be located in Machakos county and is expected to be Africa's prime information technology herb the so called silicon Savannah. This development has already attracted interest from numerous foreign investors in the information technology sector. All this investors it must be said would not be willing to invest in the city if Kenya did not have a proper fiber optic cable which is the Engine of growth in the ICT sector.

CHAPTER FIVE SUMMARY OF FINDINGS, CONCLUSION, AND RECOMMENDATION

5.0 Introduction

This chapter presented the summary of the data findings, conclusion drawn from the findings highlighted and recommendation made there-to. The conclusions and recommendations drawn were focused on addressing the objectives of this study which were to determine the effect of sustained economic growth on foreign direct investment inflows, to examine the effect of political stability on foreign direct investment inflows in a country and to analyze the effect of infrastructural development on foreign direct investment inflows.

5.1 Summary of the Findings

I declare that this research proposal is my original work and has not been presented for a degree in any other university.

5.1.1 The effect of sustained Economic Growth on Foreign Direct Investment inflows.

The findings of this study established that sustained economic growth does not necessarily lead to an increase or decrease in the flows of FDI. This is because the data does not support this assertion that is a positive causal relationship between foreign direct investment and economic growth. The data above shows no real causal relationship between sustained economic growth and foreign direct investment. This is because even during periods when the Kenyan economy experienced sustained growth rates it did not necessary imply a growth in the foreign direct investments in the country. The same applies for the periods in which there was a sustained drop in the economic growth rates in the country.

This study compared data from two periods when the country experienced sustained economic growth (1993-1995) and when the country experienced a sustained drop in economic growth (1998-2000) from a comparison of these two periods the study was able to conclude that there is no real relationship between economic growth and foreign direct investment. This thus justifies our assertion that although foreign directs investment may lead to economic growth. Sustained economic growth in a country does not necessarily imply that there will be an increase or decline in FDI inflows.

5.1.3 Political Stability and Foreign Direct Investment inflows.

With regard to the effect of political stability on foreign direct investment inflows the study established that political stability has an overall negative effect on the foreign direct investment inflows in the Kenya more so during election years which are usually marred by political uncertainity. This usually causes a lot of anxiety in investors and hence the constant drop in foreign direct investment inflows.

From the data one thing came out clearly that during every election year when political temperatures are hottest and indeed most turbulent there has always been a reduction in the number of FDI inflows in the country the only exception to this rule was 2007 where in fact it was the highest in the 21 year period. There was however due to the political instability which occurred in 2008 there was a 86.89% decrease from 2007 showing that indeed political instability has an effect on the FDI inflows in Kenya.

In 1992 also there was a decrease of 66.21% in the amount of inflows that entered in the country explained by fear of a change in the system from one party rule to multiparty rule. In 1997 another election year there was a decrease of 42.85% in the amount of inflows in the country.

However it must be noted that after the passing of the new constitution the researcher observed that the country has seen a consistent flow of foreign direct investment with minimal changes due to the perceived stability that has been created.

5.1.3 Infrastructure Development and Foreign Direct Investment inflows in Kenya

The study sought to establish the effect of infrastructural development on foreign direct investment inflows in Kenya. This research focused on the analysis of two major infrastructural developments in Kenya that is the Thika super highway and the fiber optic cable. This study found that although these infrastructural projects require a lot of financing they equally have the potential to spur a lot of benefits in terms of foreign direct investments.

From the findings, for example the Thika super highway project cost in excess of 27 billion shillings to construct has been able to attract investments of close to 500 billion in the real estate sector alone. Of these investments foreign firms have invested either through partnerships with local investors or directly for example in the garden city project.

The fiber optic cable installation is one of the most exciting infrastructural developments that Kenya has undertaken in a very long time. This is because of the potential that the ICT industry possesses in terms of attracting investments which is been made all the more possible by the fiber optic cable. Since it’s official launch by former president Mwai Kibaki the project has attracted an estimated 45.56 billion shillings in direct investments.

Indirect investments in the ICT sector in the country are also set to increase significantly with the proposed construction of the ICT Konza city which is set to cost a whooping Sh850 billion which will be located in Machakos county and is expected to be Africa’s prime information technology herb the so called *silicon Savannah*. This development has as stated has attracted interests from investors globally already attracted interest from numerous foreign investors in the information technology sector. All this investors it must be said would not be willing to invest in the city if Kenya did not have a proper fiber optic cable which is the Engine of growth in the ICT sector.

These studies was able to establish therefore through the above case studies that infrastructural development affects foreign direct investment inflows positively by either directly or indirectly leading to more investments in and around the infrastructural development

5.2 Conclusion

This study concludes that political stability and infrastructural development are factors that affect the foreign direct investment inflows in Kenya. This study also revealed that the sustained growth or decline in an economy does not necessarily affect the amount of foreign direct investment inflows in that come into the country.

This study has established that indeed foreign direct investment is an important factor in Africa's development agenda and must therefore be taken seriously by governments.

5.3 Recommendations

Following the above findings the study makes the following recommendations regarding the factors that affect foreign direct investment inflows:

1. The study recommends that governments should embark on serious infrastructural development projects which although may require a lot of finances to conceptualize will yield better dividends in terms of spurring the appetite for investors to invest in the country. For example instead of focusing on small infrastructural projects that may not

necessarily lead to an investments the government should embark on big projects such as the planned construction of the port of Lamu which is expected to open up an investment boom in the area in various related industries.

2. The government must also work towards making the climate for investment conducive in the country this must be done by most importantly ensuring that there is political stability in the country. This means that political leaders must be impressed upon to tone down the political rhetoric and thus reduce the political temperatures in the country more so during the election years where foreign direct investment inflows have been established to reduce due to fears of political instability in the country.
3. The government of Kenya must also work towards promoting and developing Kenya's image abroad so as to reduce the perception created by the 2008 post-election violence and the ongoing trials at The Hague which seem to portray Kenya as a politically unstable country something that is not good for attracting and indeed retaining foreign investment. The efforts by the brand Kenya in initiative must be encouraged and given more funding.
4. This research also recommends that the Kenyan government should delink the issue of economic growth from foreign direct investment as a causal factor. This implies that policy makers must not be fooled by the numbers that they must imagine that just because the economy is growing steadily or declining that is reason enough for foreign investors to flood in or out of the country. The government must therefore work towards developing the internal structures that will lead to more foreign investment whether the economy is at a steady decline or growth

5. This study recommends that the government should develop a foreign direct investment authority which would be tasked with monitoring the foreign investment inflows in the country and advertising the government on the strategies it should use to attract foreign investors. This will help to up the profile of foreign investment as a strategy for the government instead of it being just a branch of the ministry of treasury.
6. Finally the researcher realizes that this study is not exhaustive enough and thus recommends more study to be conducted on the factors that affect foreign direct inflows in the continent especially on the relationship between economic growth and FDI.

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