

**DEVOLUTION AND ITS EFFECTS ON FOREIGN DIRECT  
INVESTMENT IN KENYA**

**BY**

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**DECLARATION**

I declare that this research project is my original work and has not been presented in any other university/institution for consideration.

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## **DEDICATION**

This research project is dedicated to my parents, George Kamau Kariuki and Elizabeth Njeri Kamau, who have unwaveringly supported me during the time I developed this paper.

I also dedicate it to my siblings, Gordon, Anthony, Peter and Gladys for being there every step of the way.

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## ABSTRACT

Over time globalization has created investment opportunities for enterprise worldwide and as a result today foreign direct investment is regarded as the major source of foreign capital for developing countries. There are numerous benefits of foreign direct investment for emerging economies which include technology spillovers, enables human capital formation, improvement of international trade integration, helps create a more competitive business environment and improves enterprise development. All of these result in higher economic growth, which is a crucial tool for alleviating poverty in developing countries. Following the passing of the new constitution in 2010 Kenya adopted a new system of governance that devolves major responsibilities to the counties aiming at better management and control of the countries resources. The main objective of the study was to investigate the effects of devolution on Foreign Direct Investment in Kenya. The specific objective of this study were to: find out the effect of decentralization of resources on FDI; to establish the effect of decentralization of authority and responsibility; to determine the effect of decentralizing legislative powers on FDI, to assess the effect of decentralized institutional reforms on FDI; to determine the effect of having many autonomous financial units in the country and to evaluate the effects of FDI on the economy. Descriptive survey study design was used to conduct this study. The study targeted Kenya Investment Authority Officials, Investors, Foreign Embassy Officials, and County Public Service Board Officials in Nairobi county Kenya. Purposive sampling technique was used in respondent selected. The total sample size was 42 respondents. The data was collected using questionnaires with both open and closed ended questions. The collected data was analyzed to give percentages and frequencies as well as inferential statistics. The Statistical Package for Social Sciences (SPSS) software version 21 was used in the analysis. The analyzed data was presented using tables generated through SPSS and figures generated through Microsoft excel 2010. Analyzed data was thematically arranged based on the research objectives. All ethical and logical considerations pertaining to research were observed throughout the study. The study found out that decentralization of resources contributed highly to foreign direct investments. Majority of the respondents indicated that decentralization of legislative powers affected foreign direct investment in the Country; the power to raise revenue in the Counties also enhanced developments; hence increasing FDI. The study concludes that there is a positive and significant relationship between decentralization of resources and FDI in Counties in Kenya. The study also concludes that decentralization of legislative powers significantly enhances FDI in Counties. Through devolution, the County Assembly members have legislative powers, through which they make regulations aimed at improving investments in their region. Decentralization of autonomous financial units have enhanced independent revenue collection; and enhanced the ability by county governments to allocate funds for infrastructural development; and also enhanced their own marketing activities, which have attracted more foreign investments. The study recommends that the national government should channel more resources to the Counties so as to enhance developments; for instance, of improving the quality of infrastructure, especially in marginalized regions of the country, so as to attract FDI. The County governments should develop foreign investment policies, which will act as a supplemental part of the domestic development policy. The policies should guide the Counties on how to engage with foreign investors.

## TABLE OF CONTENTS

<b>DECLARATION .....</b>	<b>ii</b>
<b>DEDICATION .....</b>	<b>iii</b>
<b>ACKNOWLEDGEMENT .....</b>	<b>iv</b>
<b>ABSTRACT .....</b>	<b>v</b>
<b>LIST OF TABLES .....</b>	<b>viii</b>
<b>LIST OF FIGURES .....</b>	<b>x</b>
<b>ABBREVIATIONS AND ACRONYMS.....</b>	<b>xi</b>
<b>OPERATIONAL DEFINITION OF TERMS .....</b>	<b>xii</b>
<b>CHAPTER ONE:.....</b>	<b>1</b>
<b>INTRODUCTION .....</b>	<b>1</b>
1.1 Background to the study .....	1
1.2 Statement of the Problem .....	8
1.3. Objectives of the Study .....	9
1.3.1 Specific Objectives.....	9
1.4 Research Questions .....	10
1.5 Significance of the Study.....	10
1.6 Scope of the Study .....	11
<b>CHAPTER TWO: .....</b>	<b>12</b>
<b>LITERATURE REVIEW.....</b>	<b>12</b>
2.1 Introduction.....	12
2.2 Theoretical Review .....	12
2.3 Empirical Review .....	16
2.4 Summary of Literature Review and Research Gaps .....	29
2.5 The Conceptual framework .....	30
<b>CHAPTER THREE: .....</b>	<b>31</b>
<b>RESEARCH METHODOLOGY.....</b>	<b>31</b>
3.1 Introduction.....	31
3.2 Research Design.....	31
3.3 Target Population.....	31

3.4 Sampling Technique and Sample Size .....	32
3.5 Construction of Research Instruments .....	33
3.6. Piloting of Research Instruments .....	35
3.7. Testing for Validity and Reliability of the Instruments .....	35
3.8. Data Collection Methods and Procedures .....	36
3.9. Data Analysis Techniques and Procedures.....	36
3.10. Ethical Considerations.....	37
<b>CHAPTER FOUR .....</b>	<b>39</b>
<b>DATA ANALYSIS, RESULTS AND PRESENTATION.....</b>	<b>39</b>
4.1 Introduction.....	39
4.2 Sample Characteristics .....	39
4.3 Decentralization of Resources and FDI.....	42
4.4 Effects of Decentralization of Authority and Responsibilities on FDI .....	46
4.5 Decentralization of Legislative Powers and FDI .....	48
4.6 Autonomous Financial Units and FDI.....	55
4.7 Inferential Statistics.....	61
<b>CHAPTER FIVE .....</b>	<b>66</b>
<b>SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS.....</b>	<b>66</b>
5.1 Introduction.....	66
5.2 Summary of the Findings .....	66
5.3 Conclusions.....	69
5.4 Recommendations .....	70
5.5 Suggestion for Further Studies.....	71
5.6 Limitations and Delimitations of the Study.....	71
<b>REFERENCES .....</b>	<b>72</b>
<b>APPENDICES .....</b>	<b>78</b>
Appendix 1: Introduction Letter.....	78
Appendix 2: Research Questionnaire .....	80

## LIST OF TABLES

Table 3.1 Target Population.....	32
Table 3.2 Sample of the Study .....	33
Table 4.1: Response Rate.....	39
Table 4.2: Age of the Respondents.....	41
Table 4.3: Devolution and Management of Natural Resources .....	43
Table 4.4: Natural Resources of Interest by Foreign Investors.....	44
Table 4.5: Effect of Decentralization of Resources on FDI.....	45
Table 4.6: Influence of Decentralization of Authority on FDI .....	46
Table 4.7: Extent of Authority by County Governments on FDI.....	47
Table 4.8: Influence of Decentralization of Authority on FDI .....	48
Table 4.9: Ranking the Regulations Imposed by the County Government .....	51
Table 4.10: County’s Efficiency in Trade Licensing for Foreign Investors .....	52
Table 4.11: Rating the General Micro-Economic Regulatory Environment .....	52
Table 4.12: Effect of Decentralization of Legislative Powers on FDI .....	54
Table 4.13: Autonomous Financial Units and FDI in Counties .....	56
Table 4.14: Funds to Boost Counties Image to Foreign Investors .....	57
Table 4.15: National Government’s Regulation on Incentives and FDI .....	57
Table 4.16: Effect of Autonomous Financial Counties on FDI .....	60
Table 4.17: Model Summary .....	61
Table 4.18: ANOVA- Analysis of Variance .....	62

Table 4.19: Coefficients Results .....	62
Table 4.20: Correlations Analysis .....	64

## LIST OF FIGURES

Figure 2.1: Conceptual Framework .....	30
Figure 4.1: Gender of the Respondents .....	40
Figure 4.2: Years of Experience.....	41
Figure 4.3: Contribution of Decentralization of Resources to FDI .....	42
Figure 4.4: Decentralization of Legislative Powers and FDI in the Country .....	49
Figure 4.5: Legislature Commitment to Improving Trade and Investment .....	50
Figure 4.6: Regulations on the County Governments to Prove FDI .....	50
Figure 4.7: Devolution and Transparency of Legal Processes.....	53
Figure 4.8: Power to Raise Revenue and the Fees for Investment.....	55
Figure 4.9: Number of Incentives Offered to Foreign Investors.....	58

## **ABBREVIATIONS AND ACRONYMS**

**CBK** – Central Bank of Kenya

**CDF**- Constituency Development Fund

**CMA**- Capital Markets Authority

**FDI** – Foreign Direct Investment

**GDP** – Gross Domestic Product

**EAC** - East African Community

**EPZ** - Export Processing Zone

**IMF** – International Monetary Foundation

**MNCs** – Multinational Corporations

**MNEs** – Multinational Enterprises

**NSE**- Nairobi Securities Exchange

**OECD** – Organization for Economic Co-operation and Development

**OLI** – Ownership, Location and Internalization

**PPP** - Public-private partnership

**TNCs** – Trans National Corporations

**UK** – United Kingdom

**UNCTAD** – United Nations Conference on Trade and Development

**USD** – United States Dollar

## **OPERATIONAL DEFINITION OF TERMS**

**Devolution** - Devolution is a form of decentralization. It is simply defined as the process of transferring decision making and implementation powers, functions, responsibilities and resources to legally constituted, and popularly elected local governments.

**Foreign direct investment (FDI)** – this refers to when a firm invests directly in new facilities to produce and/or market in a foreign country.

**Multinational enterprise (MNE)** - this refers to a firm that undertakes FDI.

**Constituency Development Fund (CDF)** – this refers to devolved funds under the management of the members of parliament

**Export Processing Zone (EPZ)** – this refers to a specific class of special economic zone formed with the aim of increasing trade, job creation and effective administration

**Gross Domestic Product (GDP)** - This is the aggregate measure of production equal to the sum the gross values added of all residents and institutions involved in production in a country

**Multinational Corporation (MNC)** – This is a corporation that has its facilities and other assets in at least one country other than its home country. Such companies have offices in different countries and usually have a centralized head office where they coordinate global management.

**Transnational corporation (TNC)** – This refers to any enterprise that undertakes foreign direct investment, owns or controls income gathering assets in

more than one country, produces goods or services outside its country of origin, or engages in international production

**Economic Growth** – This is the increase in the amount of goods and services produced per head of the population over a period of time or increase in the productive capacity of a country over a certain period of time.

## **CHAPTER ONE:**

### **INTRODUCTION**

This chapter contains; Background of the study, statement of the problem, objectives of the study, research questions, significance of the study, limitation of the study and scope of the study.

#### **1.1 Background to the study**

Devolution has been advocated as a political response to conflicts, administrative inefficiencies, corruption, economic stagnation, inefficient use of public resource and other ills that characterize centralized governments Dent (2004) furthermore Kimenyi and Meagher (2004) state that different governance frameworks yield different political, economic and social outcomes and in this view this study aims at establishing how devolution affects foreign trade between countries.

FDI in Kenya has not only been volatile but also low since the 1970s. This led to the stagnation of the manufacturing sector which was largely been dominated by the foreign firms. This decline was blamed on the inward oriented strategy as well as the collapse of the East Africa Community in 1977. Ensuing economic distortions resulted in severe structural constraints and macro economic imbalances and firms failed to develop competitive capabilities to penetrate the international markets. 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 a more dynamic role enough to function as an engine of country's growth and did not contribute significantly to foreign exchange (Rasiah & Gachino, 2005).

According to UNACTAD (2012) The Government has made the attraction of FDI a clear policy priority and to this end established Ken Invest as a semi-autonomous agency in 2004. Since that time, FDI inflows to Kenya have seen a steady increase, reaching US\$ 141 million in 2009 and US\$ 133 million in 2010. The exceptional inflows of US\$ 729 million in 2007 are attributable to large privatizations in telecommunications and investment in the railways (between 2005 and 2010 investment in the railways has reached US\$404 million – see section on rail). FDI from traditional sources such as Europe has been complemented by that from emerging markets. Investors from China, India, the Middle East are starting to make their presence felt Large infrastructure projects foreseen by the Government are likely to increase FDI in the coming years. The Government is drafted a PPP bill with the intention of attracting US\$ 40 billion in infrastructure finance. With an industrial base that is relatively advanced compared to the region, Kenya is also becoming an important outward investor in manufacturing, finance and service activities to EAC countries and the wider region. From almost nothing ten years ago, outward FDI reached US\$ 46.0 million in 2009 before decreasing to US\$ 17.7 million in 2010. Meanwhile total outward stock stands at US\$ 306 million. Kenyan companies with a significant regional presence include Tourism Promotion Services Eastern Africa, Kenya Commercial Bank, Diamond Trust Bank and Equity Bank, East African Breweries, the Uchumi and Nakumatt supermarket chains, and Nation Media. Kenya receives less long term capital inflows than any other country in the EAC region. The FDI Kenya attracted was only equivalent to 0.8 percent of its GDP prior to 2010 compared to Rwanda (1.2 percent of GDP), Tanzania (2.8 percent of GDP), and Uganda

(6.2 percent of GDP) in the same period. However, following the recent peaceful elections, and given the improvements in the governance framework since the new Constitution was adopted in 2010, FDI to Kenya is expected to increase in the future. The World Bank (2013)

### **1.1.1 Devolution**

Devolution refers to the transfer or delegation of power to a lower level, in this case by the central government to regional administration. It can also be viewed as a form of decentralization where the central government transfers decision-making and implementation powers, functions, responsibilities and resources to legally constituted, and popularly elected local governments (Ribot, 2002).

United Kingdom system is one of the most centralised of all countries belonging to the Organisation for Economic Co-operation and Development (OECD); 75 per cent of tax revenues were raised centrally in 2012 (OECD, 2014), and in 2014 just under 25 per cent of public expenditure was by local government (OECD, 2015). Devolution became a major political issue in the UK in the 1970s, with Scotland and Wales pushing for more control over their own affairs. Sweden has also been successful in devolution with almost half of revenues are spent at local government level (OECD, 2014).

Many democracies world over, including Kenya have in recent years adopted devolution as a system of decentralization for development. In Kenya, this was after years of the post independence approach of Local Governments which still embraced a strong centralized governance structure and which had been meant to resolve the regional development challenges but apparently failed. The system failed from bureaucratic inefficiencies, lack

of accountability and transparency, unequal distribution of national resources and minimal community participation in local development, amongst others. Kenya's new Constitution marks a critical juncture in the nation's history (Khaunya, Wawire & Chepng'eno, 2015).

Following the passing of the new constitution Kenya was devolved into 47 counties where the government transferred power to the 47 Counties listed on the First Schedule of Constitution of Kenya (2010). Each of these Counties formed their respective County Governments comprising of the County Assemblies and County Executives with State powers of legislature law making and Executive implementing the laws and policies respectively. This Devolution is based on the supremacy of the Constitution, sovereignty of the people and the principle of public participation.

As per the Kenyan constitution (2010) the specific objectives of devolution in Kenya stated under Article. 174 of the Constitution are: To promote democratic and accountable exercise of power, to foster national unity by recognizing diversity, to give powers of self-governance to the people, to recognize the right of communities to manage their own affairs and to further their development, to protect and promote the interests and rights of minorities and marginalized communities, to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya, to ensure equitable sharing of national and local resources throughout Kenya. The need for Devolution has been seen in many countries and it is informed by the need to have power sharing, checks and balances in governance and the decentralization of resources.

### **1.1.2 Foreign direct investment**

Foreign Direct Investment (FDI) is capital provided by a foreign direct investor, either directly or through other related enterprises. It involves development of a new business or acquisition of interest in a domestic company or tangible assets, (purchase of bond & stock). Foreign direct investment (FDI) can also be defined as the holding of 10 per cent or more of the voting stock of a foreign enterprise IMF, (2003). On the other hand a foreign direct investor refers to firm resident in one economy that has acquired, either directly or indirectly, at least 10% of the voting power of another firm resident in another economy. A direct investor could be an individual, a group of related individuals, an incorporated or unincorporated firm a public or private enterprise or a group of related enterprises (OECD, 2008).

FDI can be classified as Market-seeking or horizontal FDI where the investor only focuses on serving markets and focuses on market size and market growth. Asset or resource-seeking FDI where a foreign investor focuses on gaining access or owning some resources in the host country which are not available in home country such as raw materials, natural resources or low-cost of labour and Efficiency-seeking FDI where the company can gain when there is a common governance of geographically dispersed activities and presence of economies of scope and scale. UNCTAD, (2005) over time globalization has created investment opportunities for enterprise worldwide and as a result today foreign direct investment (FDI) is regarded as the major source of foreign capital for developing countries as opposed to portfolio investment or foreign aid. Venables, (2004) Foreign direct investment (FDI) is also the major driving force for globalization since FDI provides a means for creating direct, stable and long-lasting links

between economies. Furthermore FDI has been credited for creating employment opportunities, exchange of technology and know-how between economies, development of productive capacity, enhancing of skills of local labour through technology transfer, help countries when they are faced with economic hardship, source of external capital for a developing countries, enhancing integration with rest of the world and it is also considered to be a source of entrepreneurial capital (EOCD 2008).

The recent global trends of foreign direct investment (FDI) flows show that some of the developed countries of the West, Japan and China are the greatest recipients of FDI flows globally. Global FDI flows rose by 11% in 2013 to an estimated US\$1.46 trillion, up from a revised US\$1.32 trillion in 2012. There has also been great increase in FDI flows to developing countries in Asia, Latin America and the transition countries in Europe. In general developing countries are still unable to attract significant FDI. It was also projected that FDI flows could rise further in 2015, to US\$1.8 trillion, as global economic growth gains momentum. Activity is expected to improve further in 2015, largely on account of recovery in developed economies. GDP growth, gross fixed capital formation and trade are projected to rise globally over the next years. Those improvements could prompt TNCs to gradually transform their record levels of cash holdings into new investments. However, uneven levels of growth, fragility and unpredictability in a number of economies, and the risks associated with a gradual exit from the quantitative easing programmes by the United States and other major countries may dampen the recovery (UNACTAD, 2013).

In Africa the number of foreign direct investment (FDI) projects in Africa grew 27% from 2010 to 2011 and the trend is set to continue, according to a new report from

consultancy Ernst & Young (EY).15 May 2014 this report on market attractiveness in Africa said that despite this growth “there remain lingering negative perceptions of the continent, but only among those who are not yet doing business in Africa”. The report indicated that political risk factors remain the single biggest impediment to investing in African countries, with perceptions of political instability and corruption as being dominant in Africa. In the report it was also evident that while many countries are making good progress, they need to improve further. From an investment attractiveness perspective, the importance of broader-based, visible and proactive measures to institutionalize democracy, implement robust governance, improve financial management and tackle corruption head on cannot be overstated. South Africa, Nigeria and Angola were found to be the leading FDI destinations in Africa over the past decade. Ghana, Morocco, Kenya, Uganda and Ethiopia are experiencing a more recent phenomenon of positive high growth FDI in flows. This group of eight countries has witnessed significant, positive inward flow of FDI investment over the last decade and offer arguably the greatest opportunities to corporate investors jones inc (2013)

Kenyans envisaged that devolution will increase efficiency in social service provision, by allowing for a closer match between public policies and the desires and needs of local constituencies. Well managed devolution policies and structure were projected to be the key to unlocking Kenya’s potential for being the desired investment destination for all foreign investors. Kenya also seeks to improve the efficiency in service delivery in major institutions concerned with FDI. These include the Central Bank of Kenya (CBK), the Capital Markets Authority (CMA) Nairobi Securities Exchange (NSE) and the National

Environment Management Authority among others. There have also been positive legislative changes in Licensing Laws to eliminate the hurdles that were previously lengthening the licensing process. Kenyan policymakers also have come up with a strategic agenda to attract and benefit from investment in potentially attractive sectors of the economy. The strategy, to be implemented with the support of tailored and professional FDI promotion, was structured around four pillars of basic manufacturing, regional services, agro-business and EPZ diversification (UNACTAD, 2013).

## **1.2 Statement of the Problem**

Despite a significant increase of FDI in the last few decades, Kenya not exploited its full potential in attracting FDI. This has raised concerns to foreign investors, development specialists, policy makers and researchers in Kenya. In spite of this, there are no studies that have tried to point out the effects of the new system of governance on foreign direct investment in Kenya most studies have explored on the determinants of FDI and the relationship between FDI and economic growth. Jordaan (2004) claims that good quality and well-developed infrastructure increases the productivity potential of investments in a country and therefore stimulates FDI flows towards the country. On the other hand there is fear that devolution has many negative effects on attractiveness of Kenya to investors. Kipkorir (2009) noted that Decentralization of power in Constituency Development Funds (CDF) has also seen devolution of corruption, nepotism, conflicts and misappropriation of funds. According to Larossi (2009), remittance of bribes to the tax inspectors has significantly the cost of doing business in Kenya. This high writes the major drawbacks that can be associated with devolution and which may serve to reduce the countries appeal to foreign investors.

A report by Jones Lang LaSalle IP, INC (2013) states that Kenya has a great Potential as a pre-eminent business hub in East Africa with a diversified economy but the country lags behind in terms of attracting FDI due to factors like poor infrastructure, corruption and cumbersome bureaucracy, Crime and theft, lack of Investors protection, political instability and violence.

Devolution was perceived as the solution to these problems and as a way of boosting the country's economic performance. Therefore this study sought to find out the effect of the current devolved system of governance on FDI; this is by establishing whether the current devolved system of governance has enabled elimination of the problems of barriers to entry and security, corruption, or helped in reducing the cost of doing business and determine if stabilization of the county governments in future will increase Kenya's attractiveness and suitability to foreign investors.

### **1.3. Objectives of the Study**

#### **1.3.1 General Objective**

The main objective of the study was to investigate the effects of devolution on Foreign Direct Investment (FDI) in Kenya.

#### **1.3.1 Specific Objectives**

The specific objectives of the study were as follows:

1. To establish the effect of decentralization of resources on FDI in Kenya
2. To establish the effect of decentralization of authority on FDI in Kenya.
3. To determine the effect of decentralizing legislative powers on FDI in Kenya
4. To determine the effect of having 47 autonomous financial units on FDI in Kenya

#### **1.4 Research Questions**

1. What is the effect of decentralization of resources on FDI in Kenya?
2. What is the effect of decentralization of authority on FDI in Kenya?
3. What is the effect of decentralization of legislative powers on FDI in Kenya?
4. What is the effect of the autonomous financial units on FDI in Kenya?

#### **1.5 Significance of the Study**

This study could be of great help to the county governments because it aims at outlining what can be done to attract more foreign investments. The study may also establish the reasons and magnitude of success or failure in relation to the current FDI situation in Kenya. It may also help the county to identify which sector attracts more FDI in order to review their laws and regulations concerning that sector.

Policymakers may also gain from the research in that it may serve as a guide to them when making government policies on foreign direct investments. The findings of the study might be used by policymakers in basing their decisions related to issues of foreign direct investments in their respective counties.

This study may also help foreign investors since it will outline the measures that have been put in place so far that can boost or secure their investments as well as inform the potential investors of what they ought to gain by investing in the county. This study may also help other scholars and other users in future by providing a point of reference concerning the current FDI situation in Kenya.

## **1.6 Scope of the Study**

This study focused on Nairobi County. The study sought to identify the efforts and measures introduced in the counties in order to attract FDI. The study analyzed the trend in distribution of FDI projects across the counties compared to the distribution before devolution. The study also utilized secondary data collected from various bodies that are concerned with FDI like UNCTAD and EOCED. The study used this data to study the change in FDI in Kenya since the formation of the County governments.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter presents the literature review. It covers the theoretical review, empirical literature and the conceptual framework. The theoretical review focuses on theories that inform the study and supports the concept of devolution system of governance and foreign direct investments. Secondly, the empirical review of the studies that have been done on several determinants of foreign direct investments and how FDI affects socio-economic development of a country. The research gap is then provided and the chapter ends with the presentation of the conceptual framework.

### **2.2 Theoretical Review**

This section discusses the theories that guide the study. The study was guided by two main theories. They include Eclectic Theory and Economic Geography Theory.

#### **2.2.1 Eclectic Theory**

Eclectic theory was propounded by Dunning (1988). The theory provides a framework of three sets of advantages to analyze why, and where, MNEs would invest abroad. This variables are; ownership, location and internalization (OLI) paradigm (or eclectic paradigm). In this context, investment could be; natural (resource) seeking, market seeking, efficiency seeking or strategic asset seeking.

The ownership advantages refer to firm - specific features sometimes called competitive or monopolistic advantages which must be sufficient to compensate for the costs of setting up and operating a foreign value - adding operation, in

addition to those faced by indigenous producers. The ownership specific advantages, being superior, to home country firms, may make foreign investors to crowd out domestic investments (Miberg, 1996). This refer to intangible assets, which are, at least for a while exclusive possesses of the company and may be transferred within transnational companies at low costs, leading either to higher incomes or reduced costs.

These features include; managerial effectiveness, structure, process, technology advantages, brand, patents, market access, research and development, trademarks and superior technology these can also be grouped in three groups namely: Monopoly advantages in the form of privileged access to markets through ownership of natural limited resources, patents, trademarks; Technology, knowledge broadly defined so as to contain all forms of innovation activities Economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital The Location advantage is concerned with the country- specific characteristics that can influence MNCs to locate an economic activity in that country. location variables include: the geographical environment, the political environment, the government's regulatory framework, taxation and fiscal policy, production and transportation costs, cultural environment, research and development advantages., transportation and communications costs, investment incentives, availability of comparatively cheap factors of production, policy issues such tariff barriers, tax regimes, access to local and foreign markets, among other f actors (Casson, 1998).

These can also be sub divided into three groups namely:The economic benefits consisting of quantitative and qualitative factors of production, costs of transport,

telecommunications, market size etc. Political advantages: common and specific government policies that affect FDI flows Social advantages: includes distance between the home and home countries, cultural diversity, attitude towards strangers etc Supposing the first two conditions are met, it must be profitable for the company the use of these advantages, in collaboration with at least some factors outside the country of origin Dunning (1988).

The third factor is the internalization advantage which explains why a MNC would want to exploit its assets abroad by opening or acquiring a subsidiary versus simply selling or licensing the rights to exploit those assets to a foreign firm. This characteristic offers a framework for assessing different ways in which the company will exploit its powers from the sale of goods and services to various agreements that might be signed between the companies. As cross-border market Internalisation benefits is higher the more the firm will want to engage in foreign production rather than offering this right under license, franchise. Eclectic paradigm OLI 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. Yarbrough & Yarbrough (2002) report that though this theory has been criticized for only listing the conditions necessary for FDI without explaining its phenomenon, it has widely contributed to international production theory.

### **2.2.2 Economic Geography Theory**

In this theory Yarbrough & Yarbrough (2002) discuss recent theoretical models of economic geography that explain the location of FDI. In their view a Trans National Corporation (TNC) decides on which province to locate their investment depending on

the presence of various external factors available in the host country that could affect an enterprise's profits and costs such as the provision of public infrastructure, availability of skilled labor and security among others.

This is why some post-conflict countries, which have long been associated as being a non-preferable place for FDI particularly in Sub-Saharan Africa (Gibbon & Ponte, 2005) recognized the need to change their governments, reliability and political stability, foreign investors are more attracted by these nations because they deliver factors such as peace, stability, favorable investment terms, (tax-) incentives, decreasing corruption and/or the adjustment of trade barriers and import tariffs Bowles, (2004). In support of this theory another research Saggi, (2006) has shown that that foreign investors often establish subsidiaries in countries which are member states of a customs union such as the East African Community (EAC) or which have signed a free trade agreement with other nations. MNEs often choose locating themselves in such countries in order to either produce or deliver goods and services within the customs union or to profit from a country's free trade agreements by producing in one member state and exporting to another member state without being limited by any import restrictions.

In this view it is therefore likely that Kenya changing from a centralized system of governance and devolving various powers and duties to the county governments has affected its attractiveness to foreign investors this theory therefore underpins this study. This study will be anchored on the economic geography theory since I seek to identify whether devolution has had an impact on the state of FDI in Kenya.

### **2.3 Empirical Review**

The study first reviewed literature on the factors affecting foreign direct investments. A review of the literature shows that Majeed and Ahmad (2009) analyzed time series analysis of 72 developing countries to find the relation of different economic factors on FDI Inflow. They found that inflation of and balance of payment deficit has a negative impact on FDI inflow.

Deng, Falvey and Blake (2010) conducted a study on aspects that attract foreign direct investment in china. The study revealed that tax incentives have been adopted worldwide to attract foreign direct investment (FDI). The results suggested that abolishing differential tax system leads to weaker FDI spillovers in the short term. Nonetheless, the reform lifts up the productivity entry threshold for foreign firms, and the surviving domestic firms become more productive and thus more capable of absorbing productivity spillover.

The above findings are in line with those of Munongo (2015) who investigated the effectiveness of tax incentives in attracting foreign direct investment: the case of the Southern African Development Community (SADC). The study concludes that tax incentives are important in FDI attraction in the SADC countries; therefore, an effective tax mix that ensures efficient use of tax incentives is important to ensure sustainable FDI inflows into the region. Good governance is important in the region for FDI inflows to increase. Increasing government rents from natural resources reduces FDI inflows in the SADC. Previous year flows of FDI are positively related to current year inflows, thus consistent FDI attraction policies in the SADC are important. The study recommended that infrastructure in the SADC should be consistently improved to ensure suitability with

the dynamic nature of foreign investment. Financial markets should be developed to ensure effective flow of capital and growth in economies through more investment.

Githaiga (2013) conducted a study to establish the impact of tax incentives on FDI inflows of firms listed at the NSE. This study focused on the impacts of Wear And Tear Allowances; Investment Deductions and Industrial Building Deductions, towards attracting FDI inflows to firms listed at the NSE. The study involved collection of a time series data on investments and tax incentives from a sample of 10 firms listed at the NSE between years 2008 – 2011. The data was mainly from secondary sources, most attention being focused on annual reports and audited financial statements of the sampled firms. The results of the study revealed a strong relationship between wear and tear allowances and FDI inflows. Industrial Building Deductions and Investments Deductions had no significant relationship with FDI inflows. Despite strong relationship between Wear and tear allowances and FDI, further analysis on percentage change in FDI inflows across the study period shows that the Impact of tax incentives on FDI inflows is insignificant.

### **2.3.1 Decentralization of Resources and Foreign Direct Investment**

For investment to occur all the needed resources must be available in the location investors are interested in. Yaohui (2000) observes that in a decentralized system of governance like China, FDI is influence by both unskilled and skilled workers. He (2002) also finds that foreign firms in China favor places where they can minimize information costs such as coastal cities and urban areas because reliable public information usually appear and spread easily in these regions as well as to locate in industrial clusters so that they can get information through networks of vicinal firms.

Vietnam on the other hand attracts foreign investors with a new market and low costs of production factors. Factor-cost advantages arising from relatively low costs of raw materials and low labor costs create the attractiveness of Vietnam to FDI compared with neighboring countries especially in textile, garment, and sea food manufacturing industries (Mirza & Giroud, 2004). Kokko et al., (2003) show that at the beginning of the transition process difficulties in access to information about investment environment in Vietnam encouraged foreign investors to make joint ventures with State Owned Enterprises [SOEs]. Works of Cheng and Kwan (2000) on foreign firms in China, Nguyen Phi Lan (2006) in Vietnam, Kinoshita and Campos (2002) also confirmed the effect of low labor costs on investment decisions by foreign firms in transition economies.

In the case of Vietnam, there have been some studies investigating the regional determinants of FDI including Meyer and Nguyen (2005), Le Viet Anh (2004), Nguyen Ngoc Anh and Nguyen Thang (2007), and Nguyen Phi Lan (2006). They found that foreign investors are interested in the existence of industrial zones. Moreover, the provinces with larger population, better transport infrastructure, higher GDP growth and better educational system can attract more FDI. They also pointed out the importance of market, labor quality, infrastructure, and agglomeration effect in attracting FDI. Similarly, a study by Lucio et al., (2007) concluded that good infrastructure especially paved roads seem to matter for FDI location. Their results suggest that increasing by a 10% the number of kilometers of paved roads per capita in the average province would lift up FDI in the host province between 17% and 33%. Boopen and Jameel (2009) investigated the role of transport infrastructure in enhancing the attractiveness of FDI

recipient countries. They revealed that transportation capital has been an important ingredient in making the countries attractive to foreign direct investors in both the short and long run. The same is observed for the case of non-transport infrastructure.

The nature of foreign direct investment in Africa in the 21<sup>st</sup> century is shaped by the expanding role of emerging economies on the continent (Shaw, Cooper & Antkiewicz 2007). It is observed that the new “scramble for Africa” is characterized by a dramatically increased engagement by India, China, Brazil and South Africa, who are edging out Western countries in trade and investment contracts particularly in the natural resources sector (Kimenyi & Lewis 2011; Rothkopf 2010). Emerging economies have penetrated African economies and are investing in various industries more in particular in the natural resource industries (arable land, water, minerals) (Macan-Markar 2011; Bartlett 2009).

As UNEP (2006) observed, countries, such as Ghana, Namibia and Botswana, are examples of places where natural resources were used for the betterment of the population, while contributing to sustained socio-economic development over the past decade through foreign investments. However, despite being blessed with some of the most sought-after natural resources in the world by foreign investors (300 million hectares of potential land for rain-fed agriculture (UNEP 2006); 80 transboundary rivers and lake basins, including 17 large catchment areas, exceeding 100 000 square kilometers each (Energy Bulletin 2011); and despite sub-Saharan Africa boasting 60% of the world’s diamonds, 40% of the world’s phosphate and 30% of the world’s cobalt reserves (SAMBC Group 2011), thus far the continent has failed in attracting foreign direct investments.

Ajayi (2007) has identified the following factors as determinants: market size and growth, costs and the skills of workers, availability of goods infrastructure, country risk openness, institution environment, natural resources, agglomeration affects, returns on investment, macroeconomic policies among others.

According to Ngowi (2000) in Mahiti (2012) FDI inflows to a country depend largely on the presence in that country, of a certain critical minimum of FDI determinants. The determinants are among the factors that give MNEs the confidence and interest to invest their massive and expensive capital in foreign markets. Of significance are the market size, growth, structure and accessibility; raw materials, low cost but efficient labor force and physical infrastructure in form of ports, roads, power and telecommunication. The availability of natural resource has been shown by Tanzania Investment Report (2009) and Kenya Investment Authority Report (2010) as the significant determinant of Foreign Direct Investment in any country. According to the first mentioned report Tanzania is attracting more FDI than Kenya due to abundant natural resources like gold, Tanzanite and platinum. Indeed this match with the opinion from various respondents (Mahiti 2012).

In Kenya FDI has also been made possible through availability of natural resources. FDI in the country has been in the form of land acquisition by India, South Korea and the Gulf states, in return for biofuel and cash-crop production (Krumova 2011). Foreign firms in Kenya since the 1970s have invested in a wide range of sectors. Most notably they played a major role in floriculture and horticulture, with close to 90 percent of flowers being controlled by foreign affiliates. In the Manufacturing sector FDI has concentrated on the consumer goods sector, such as food and beverage industries. FDI is also distributed to

other sectors including services, telecommunication among others (UNCTAD, 2005). Kinaro (2006) using time series analysis revealed that FDI in Kenya is determined by economic openness, human capital, real exchange, inflation, not to mention natural resources. Opolot et al., (2008) also revealed that market potential, openness to trade, infrastructure, natural resources, and urbanization, positively affect foreign direct investment inflows in Kenya.

### **2.3.2 Decentralization of Authority and Foreign Direct Investment**

Effective decentralized governance structures are very essential when it comes to attracting foreign direct investments in a country/community (Easterly, Levine & Roodman 2004). Globerman and Shapiro in (2003), studied the relationship between governance and foreign direct investment in the United States. In general, governance infrastructure represents attributes of legislation, regulation and legal systems that affect the security of property rights, transparency of government and legal processes. Their result indicates that the governance infrastructure, including the nature of the legal system is an important determinant of received FDI. Globerman and Shapiro in (2003) argue that good institutions establish a conducive climate to multinational companies abroad.

Hsieh (2005) studied the determinants of FDI inflows into the Southeast Asia transition economies including Cambodia, Laos, Myanmar and Vietnam during the period 1990-2003 and found that the most important determinant was the form of leadership. In Vietnam, Nguyen and Haughton (2002) found that once firms have decided to invest in a particular country local authority can affect the investment decisions of firms.

Yang (2007), in his paper “Autocracy, Democracy, and FDI Inflows to the Developing Countries”, observes that in china, from 1983-1992 autocracies seemed to attract the highest levels of FDI and from 1993-2002 democracies seemed to do so. Regarding the relationship between democracy and FDI, Li & Resnick, (2003) argue that democracy promotes FDI inflows by providing better property rights protection. Yang (2007) further notes that “the provision of effective property rights protection and contract enforcement by a democracy promotes FDI inflows. The higher number of veto players in the democratic system places constraints on policy changes and hence help attract FDI. Jensen and McGillivray (2005) revealed that both democratic and federal countries attract higher levels of FDI. Both institutions help lower political risk. According to the authors, all else equal, federal nondemocratic countries attract some of the highest levels of FDI.

With respect to vertical decentralization, Kessing et al., (2006a) show that in countries with a higher number of independent government levels a collusive outcome between the governments is more difficult, which increases the likelihood of a hold-up problem in foreign direct investment. Further, voting powers at the local level enhance electoral accountability which may lead to a delay or even a ban on an investment project due to local civic activities. Treisman (2007) notes that sales or VAT taxes levied at the state level may disrupt the efficiency of the internal market and thus be appalling to foreign investors. Also, in a decentralized government, responsibilities often overlap which may lead to scale externalities if more than one level of government levies taxes on the same invested capital, as stressed by Keen and Kotsogiannis (2002), and Kessing et al., (2006b). Kessing et al., (2007) identifies that the vertical disintegration of governmental decision making becomes the major source of disadvantages of decentralization and often

hinders FDI. Some potential problems are identified when the private sector has dealings with several tiers of government. Problems of rivalry between the different tiers, coordination failures, and free-riding incentives between government decision makers from different government tiers are the most commonly known issues in decentralization.

On the other hand, Kessing et al., (2007), notes that decentralization also operates along a *horizontal dimension*. The horizontal dimension of decentralization divides state territory into smaller districts or regions with some autonomy in governmental decision making. Thus, the local governments are being perceived to be 'closer' to their constituency, both physically and in terms of accountability. Kimr, (2008) observed that there are beneficial effects stemming from inter-regional competition, in particular with respect to attracting FDI. As the World Bank (2004) cited in Kessing et al., (2007) argues, horizontal segregation 'permits a degree of institutional competition between centres of authority that can reduce the risk that central government will expropriate wealth'. This is because bureaucrats and politicians have a tendency to misuse their power to extract revenues, and investment projects that are owned by foreigners may become the targets for extractive activities (Kessing et al., 2007).

A study by Mishra and Daly (2007) focused on the effect of institutional quality of OECD and Asian host countries on FDI during the period 1991 to 2001. They found out that the best institutions in the host country have a positive and significant overall impact on FDI inflows. Indeed, the respect for the people's rights, the strength and justice of the legal system and government stability in host countries have a direct impact on FDI inflows in these countries.

UNCTAD (2005) argue that Kenya's inability to attract FDI is due to growing problems of corruption and governance, inconsistencies in economic policies and structural reforms, and deteriorating public service. Todd et al (2005) argues that Kenya officially encourages and grants national treatment to foreigners but that the problem is Kenya's political elites who resent FDI perceiving it to lead to dependency. Kareithi (1991) in Mahiti (2012) concerned with the impact of foreign-owned media upon the body politic of Kenya argues that foreign ownership undermines both national sovereignty and even the rudiments of political freedom. Mahiti (2012) also notes that in Kenya, political leadership has always influenced foreign direct investments significantly over the years.

### **2.3.3 Decentralization of Legislative Authority and Federal Direct Investments**

According to Loree and Guisinger (1995) cited in Mahiti (2012) studying the determinants of foreign direct investment by United States in 1977 and 1982 (both towards developed countries as well as developing countries), concluded that variables related to host country policy were significant in the developed countries on when infrastructure was an important determinant in all regions. Meyer and Nguyen (2005) found that foreign investors are interested in the existence of friendly policies of local authorities.

The first Law on Foreign Investment issued in 1987 by the Vietnamese government is considered as one of the first concrete steps towards economic renovation and FDI encouragement. This law was amended several times in 1992, 1996, 2000, and most recently replaced by a new law on investment integrating both domestic and foreign investment (Unified Investment Law 2006). Studies in transition economies has revealed that foreign investors gravitate towards countries or regions that have low corruption

level (Bruno et al., 2008), progress in reforms of capital market, regulations on property rights, and labor market (Meyer and Nguyen, 2005).

The differences in law practices by provinces in Vietnam cause challenges for foreign investors and contribute to unequal distributions of FDI among provinces within Vietnam (Meyer and Nguyen, 2005). The data of the MPI show that during the period 1988-2007, more than 60% of projects and 52% of registered capital ran to the Southeast region of which most of them belong to Ho Chi Minh City and its two neighboring provinces, Dong Nai and Binh Duong, and nearly 25% of investment projects and registered capital flew to the Red River Delta of which Hanoi, the capital city, took the largest proportion (Nguyen and Nguyen 2007). By contrast, the Northwest and the North Central Coast attracted less than 1% of the FDI inflows. It seems that provinces pursuing FDI friendly policies in the liberalization process such as Binh Duong or Dong Nai provinces may benefit from first-mover advantages in the long run and develop into a hub of economic activity. Vietnamese government also passed several other laws in order to create a good business environment for foreign investment such as the Competitive Law and the Law on Bankruptcy both issued in 2004. Remarkable are the Land Law Amendment and the Domestic Investment Promotion Amendment issued in 1998 that encourage provinces with little available land to construct industrial zones and publish information about available land. By doing this, the government increased land supply and foreign investors may have easier access to land, therefore making it unnecessary to seek joint ventures as a means to access land-use rights (Meyer and Nguyen, 2005; Nguyen Phi Lan, 2006).

In the past 10 years, the African continent has experienced a dramatic transformation of its mining sector. Investor-friendly policies were put in place and African governments

relaxed their control over, and ownership of the sector (SAMBC Group 2011). Ghana was the first sub-Saharan state to reform its mining regulations and to provide a regulatory system that allowed foreign ownership of its gold-mining sector. Today, more than 40 African states have changed their mining legislation substantially, so as to attract more foreign direct investment (SAMBC Group 2011). The Sierra Leon government also took several steps to attract FDI. Legislation relating to FDI includes the Investment Code (2005); the Business Registration Act (2007); the Investment Promotion Agency Act (2007); the Companies Act (2009); and the Bankruptcy Act (2009). Furthermore, a national Private Sector Development Plan came into effect in 2009 (United States Embassy in Freetown 2011). The government is making progress in removing administrative obstacles in an attempt to attract foreign investment, particularly in the resource sector (WB 2011a; WB 2012a).

On the other hand, East African countries set out Investments Authorities in their countries in order to achieve similar results (Mahiti, 2012). For the case of Tanzania in 1990, the government set out an Investment Promotion Centre (IPC) to help attract FDIs in Tanzania. And later after seven years not much of FDIs attraction and private sector development were achieved. The level of annual FDIs value attraction was about USD 148.64 millions. With such minor achievement called for a need to transform IPC into a more aggressive institution on attracting more FDI in Tanzania. Later Tanzania Investment Centre (TIC) was established in 1997 by the Tanzania Investment Act No.26 of 1997 to be the primary agency of Government to coordinate, encourage, promote and facilitate investments and to advise the government on investment related matters (TIC Investment Report, 2009).

Kenya Investment Authority was set out in 2004 by the government to help attract investments in Kenya. It is a statutory body established in 2004 through an Act of parliament. It is responsible for promoting investment, facilitating the implementation of new projects, providing after care services for existing investments in Kenya, as well as organizing investment promotion activities both locally and internationally. Kenya has had a long history with foreign companies. In the 1970s it was one of most favored destinations for FDI in East Africa. However over the years, Kenya lost its appeal to foreign firms a phenomenon that has continued to the present. This forced Kenya in 2008 to launch vision 2030 where it hopes to achieve global competitiveness and prosperity of the nation. This initiative has seen as a renewed commitment to attract FDI and assist in the industrialization process (Kinyanjui & Kinuthia, 2010).

#### **2.3.4 Decentralized Autonomous Financial Units and Foreign Direct Investment**

When a central government decentralizes its services into different regions each with the authority to act independently in matters relating to finance and taxations, it creates several bodies with the authority to create tax laws within the state. This has the potential to influence foreign direct investments in the entire country and regions as it creates several autonomous financial units. Mamica (2011) in her study revealed that incentive packages are not considered as important factors in attracting FDI. The research concluded that a favorable tax system helps stimulation of business activities, not only for domestic investors but foreigners as well. Often, foreign investors are attracted from favorable policies of low taxes on businesses. Incentive packages are considered as elements which attract the foreign investors in a country; although, indicators on incentive packages should not be a main factor in investors'

motivation. However, the researcher failed to show how decentralized autonomous financial units influence FDI in a country, a matter of great interest for the current study.

According to Robert (2012) incentives are relatively important in attracting FDI. In his view investment incentives should be used minimally mainly to address key market failures they should be awarded with as little discretion and as much transparency as possible, using automatic legal criteria. To the extent possible, incentives should be linked to investment growth (that is, based on performance), and automatic tax holidays should be avoided. He also recommended that only the tax administration should administer tax incentives and Regional cooperation should be encouraged to prevent harmful tax competition between countries.

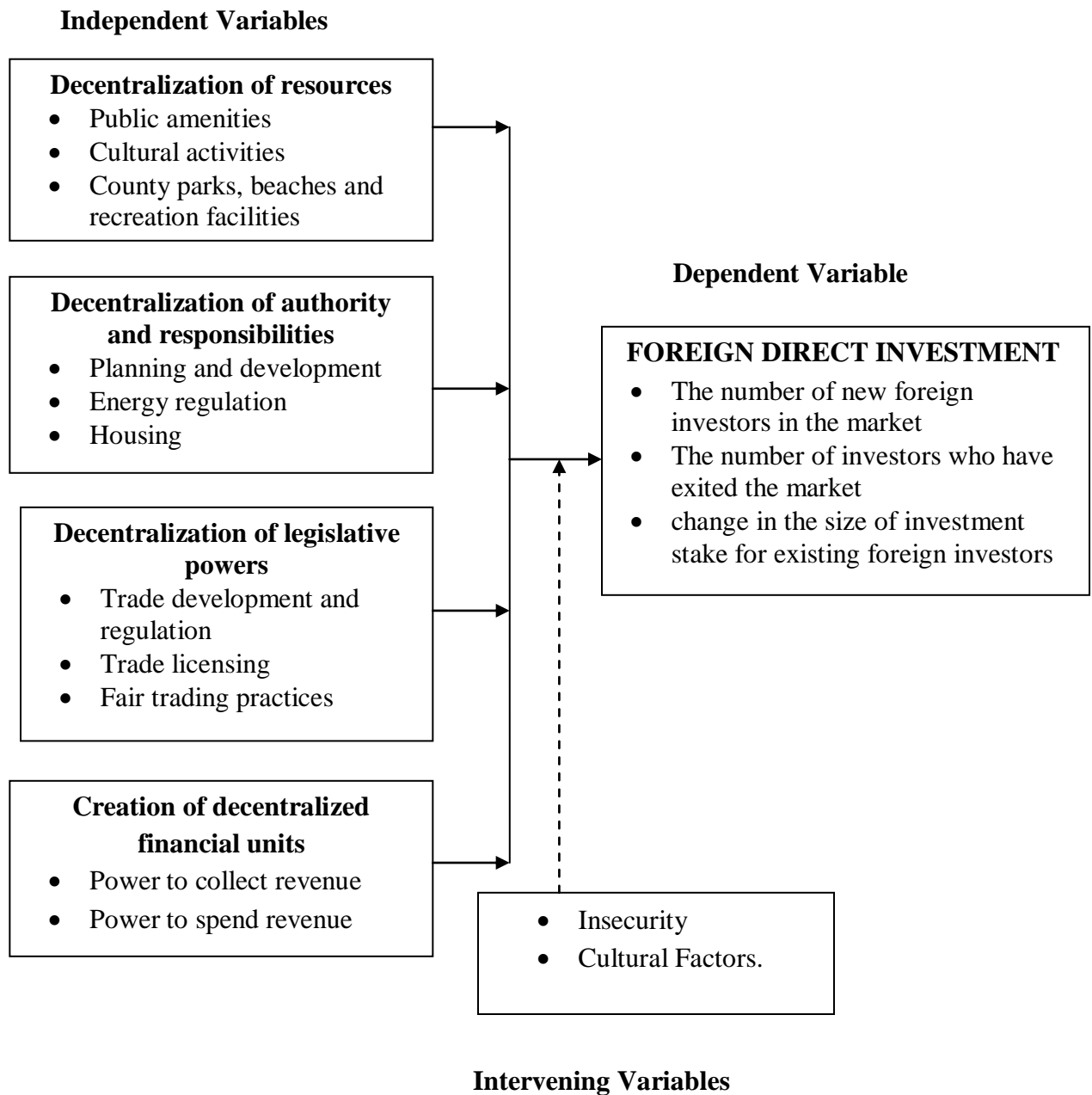
Fiscal interdependence implies that budgeting and evaluation of transfers are essential in ensuring efficient service delivery. Some countries, e.g. South Africa, have implemented a medium term expenditure framework (MTEF) that allows SNGs to participate in a multi-year budgeting system. Besides improving public financial management, some countries facilitate public monitoring of SNGs that makes budget information comprehensible to foreign investors (De Vera and Kim 2003). The author however fails to link the decentralized taxation systems and foreign direct investment. Elhiraika (2007) observes that unlike the case in many developing countries, such as Brazil and India, sub-national governments (SNGs) in South Africa are not allowed to levy value added tax (VAT) or income tax. Thus they have very limited tax powers compared to developing countries in general. Again, the author fails to clearly link how the said limited taxation powers by the sub national government affects their ability to attract FDI in their respective regions.

According to Tanzania Investment Act (1997) and Kenya Investment Act (2004) both countries are attracting Foreign Direct Investment (FDI) due to availability of investment incentives. However Tanzania has more investment incentives compared to Kenya (Mahiti, 2012). It is clear from the reviewed studies that no attempt has been made to assess how autonomous financial units in a decentralized government system affects FDI in various regions of the country. This is also true for Kenya where a devolved system of governance is enshrined in the constitution and with it the creation of 47 different county governments responsible for taxation and management of finances in the said counties. Whether having 47 autonomous financial units in the country is affecting FDI and how is yet to be studied hence the need for the current study.

#### **2.4 Summary of Literature Review and Research Gaps**

Studies from across the world on the effect of decentralized resources, authority, legislation and autonomous financial units have been reviewed in this section. However, it is clear from the review that in most of the studies, no attempts were made to link decentralized resources, authority, legislation and autonomous financial units and federal direct investment clearly. Most of these literatures are international with very few studies existing in Kenya addressing these variables. The studies reviewed are also limited by scope, design and sample sizes. Hence the researcher believes that there is a need to study how devolution is affecting foreign direct investments in the country.

## 2.5 The Conceptual framework



**Figure 2.1: Conceptual Framework**

Source: (Author) 2015

## **CHAPTER THREE:**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

In this chapter, the researcher describes the procedures that was followed in conducting the study. It begins with research design, followed by target population, sampling techniques and sample size, construction of research instruments, piloting of research tools, testing of validity and reliability of the instruments, data collection methods and procedures, data analysis procedures and ethical considerations.

#### **3.2 Research Design**

A descriptive survey study design was used to conduct this study. Descriptive studies are primarily concerned with finding out the present situation of a phenomenon (Wiersma & Jurs, 2005). Sekaran, (2003) opined that while descriptive studies are simple in design and execution, they can provide useful data on a phenomenon. The design was an excellent means of collecting original data on relationships or how variables influence each other. This design was therefore used to assess the effect of devolution on foreign direct investment in Kenya.

#### **3.3 Target Population**

The target population for this study included the Kenya investment authority officials, investors, foreign embassy officials, and county public service board officials in Nairobi county Kenya. These groups were selected to participate in this study as they had the much needed information and were more knowledgeable on the subject matter under investigation.

**Table 3.1 Target Population**

<b>Target Population</b>	<b>No. of Respondents</b>
Kenya Investment Authority Officials	6
Foreign Investors	10
County public service Board officials	235
Foreign embassy officials	20
<b>Total</b>	<b>271</b>

**Source: Researcher**

### **3.4 Sampling Technique and Sample Size**

#### **3.4.1 Sampling Technique**

Purposive sampling technique was used to select all the needed respondents in each category. This is because they were few in numbers and were easily reached. This technique was used to select 3 Kenya investment authority officials as this group of respondents may be too busy forcing the researcher to include only those who could be reached in the study. Similarly, for foreign investors, foreign embassy officials and county public service board officials respondents, purposive sampling was used in selecting respondents who were easily accessible from these categories. This helped the researcher in saving time and also ensuring that only those respondents who were knowledgeable on the subject matter under investigation participated in the study.

The study used stratified random sampling. Stratified random sampling method is best because the study has accurate and easily accessible sampling frame that lists the entire population in different strata. The respondents were randomly picked from the following strata: Kenya Investment Authority Officials, Foreign Investors, County public service Board officials and Foreign embassy officials.

### 3.4.2 Sample Size

For this study the sample size was calculated using Orodho, (2004 & 2005) who argued that a good representative sample should constitute at least 20% of the entire population where a population is small and 10% where the population is large. The proposed sample size for the study was therefore computed as shown in Table 3.2.

**Table 3.2 Sample of the Study**

	<b>No. of Respondents</b>	<b>Percentage Chosen</b>	<b>Sample size</b>
Kenya Investment Authority Officials	6	50%	3
Foreign Investors	10	50%	5
County public service Board officials	235	10%	24
Foreign embassy officials	20	10%	10
<b>Total</b>	<b>271</b>		<b>42</b>

As shown in the table above, the study used a sample size of 42 participants, which made 15% of the total number of respondents in the target population.

### 3.5 Construction of Research Instruments

Both structured questionnaires and key informant interview schedule were used to collect data from the selected participants.

#### 3.5.1 Structured Questionnaires

This instrument was useful in collecting both qualitative and quantitative data as it had both open ended and closed ended questions. In open-ended questions, no pre-coded answer, that is response categories were offered to study participants while, in closed ended queries, response categories were provided. This instrument was used by the

researcher to collect data all the respondents as they were all literate and capable of answering as required.

Questions in the instruments addressed every objective of the study. Section A of the instrument gathered demographic information of the respondents, in section B, questions on the effect of decentralization of resources on FDI were asked, section B collected data on the effect of decentralization of authority and responsibilities on FDI, C had questions on effect of decentralizing legislative powers on FDI, D contained queries on effect of decentralized reformed institutions on FDI in Kenya, E gathered information on the effect of having 47 autonomous financial units on FDI while F had questions on the impacts of FDI on socio-economic development in Kenya. These instruments were administered by the field assistants.

### **3.5.2 Structured Interview Schedule**

This instrument was also useful in collecting both qualitative and quantitative data as it had both open ended and closed ended questions. It was used to gather data from investors and Kenya investment authority officials. Questions in the instruments addressed every objective of the study. Section A of the instrument gathered questions on the effect of decentralization of resources on FDI, section B collected data on the effect of decentralization of authority and responsibilities on FDI, C had questions on effect of decentralizing legislative powers on FDI, D contained queries on effect of decentralized reformed institutions on FDI in Kenya, E gathered information on the effect of having 47 autonomous financial units on FDI while F had questions on the impacts of FDI on socio-economic development in Kenya. Interviews were conducted by the researcher himself.

### **3.6. Piloting of Research Instruments**

A pilot study was conducted and for this purpose, the research instrument was subjected to a pilot administration to a sample of respondents in Kiambu town. Ten (10) participants from Kiambu County government were included in the pilot study. This helped the researcher to investigate the feasibility of the proposed study and to detect possible deficiencies in the data collecting instrument. It is through the pilot study that the validity and reliability of the questionnaire were ascertained. Pitfalls and errors were identified and amendments made with assistance from the supervisor.

### **3.7. Testing for Validity and Reliability of the Instruments**

#### **3.7.1. Reliability of the Instruments**

The consistency of the responses will be checked with the help of university supervisors in order to judge the reliability of the instruments. Research instruments were also evaluated for appropriateness of items so as to identify any errors. These errors were amended to ensure that the respondents clearly understood the questions. From the piloting results, reliability coefficient was determined using Cronbach Alpha test. A reliability coefficient value of  $r > 0.7$  and above, was obtained which indicated high internal reliability.

#### **3.7.2. Validity of the Instruments**

Content validity of the instruments was determined by expert judgments. The instruments were scrutinized by the peer reviews and project supervisors provided by the university to judge the items on their appropriateness of content, and need of modification so as to achieve the objectives of the study. The supervisors determined whether the items in the research instruments adequately represented all the areas that needed to be investigated.

In addition, the researcher also ensured validity of the data to be collected by administering the instruments personally as well as with the assistance of well-trained assistants.

### **3.8. Data Collection Methods and Procedures**

Before actual data collection, research assistants were trained. The researcher employed assistants who had prior knowledge in field work. The researcher provided the field assistants with two days data collection training. Sampling of respondents and issuing of research instruments by the assistants was practiced in actual field situation on 4 respondents by each data collector during the training process. Actual field work then followed at the end of the training where structured questionnaires were issued by the assistants to all the respondents. However, face to face or telephone interviews were also conducted among busy respondents. This process took a maximum of one month after which the instruments were collected, stored and prepared for data analysis.

### **3.9. Data Analysis Techniques and Procedures**

The data collected from the respondents was grouped, cleaned, coded, transformed and analyzed using statistical packages for social sciences (SPSS) software version 21. The analyzed data was presented using frequencies and percentages while figures and tables generated through Microsoft excel version 2010 and SPSS version 21 were used to present the results. Closed ended questions were presented using likert scale indicating whether a respondent either strongly agree, agree, neither agreed nor disagreed, disagreed or strongly disagreed. While open ended questions were summarized, grouped and presented in figures using percentages and frequencies. Qualitative data was organized descriptively into themes, coded and presented in narrative form to give the researcher an

easy way to discuss his findings. Interpretation and presentation of data was based on the research objectives of the study.

To establish the relationship between devolution system of government on FDI in Kenya, the study used Pearson product-moment correlation and regression analysis. The regression model took the following form:

$$Y = \beta_0 + \beta_1 \chi_1 + \beta_2 \chi_2 + \beta_3 \chi_3 + \beta_4 \chi_4 + \varepsilon$$

Where: Y = Foreign Direct Investment

$\chi_1$  = Decentralization of resources

$\chi_2$  = Decentralizing Legislative

$\chi_3$  = Decentralization of authority

$\chi_4$  = Autonomous financial units

$\beta_0$  = the constant

$\beta_{1-n}$  = the regression coefficient or change included in Y by each  $\chi$

$\varepsilon$  = error term

### **3.10. Ethical Considerations**

An introductory letter was obtained from Kenyatta University, the letter was then presented to the National Commission of Science and Technology in order to gain research permit. The granted permission was shown to every respondent in order to gain their confidence and trust in the research as well as their authorization to carry out this study. Then the study subjects were informed of their rights to participate or refuse to participate in the study and their right to remain anonymous as their names were not mentioned anywhere in this research. Research assistants were at the same time trained

on how to respect the rights of the study subjects and therefore were expected not to force anyone to participate; and in the process observing the ethical regulations during the study. The respondents answers were not directed or coerced in anyway by the field staffs during this study.

## CHAPTER FOUR

### DATA ANALYSIS, RESULTS AND PRESENTATION

#### 4.1 Introduction

This chapter entails the findings of the study based on the study objectives. The study sought to investigate the effects of devolution on Foreign Direct Investment (FDI) in Kenya. The study was conducted in Nairobi County. The data was analyzed and presented in tables, pie charts, and bar graphs.

#### 4.2 Sample Characteristics

##### 4.2.1 Response Rate

**Table 4.1: Response Rate**

<b>Respondents</b>	<b>Frequency</b>	<b>Percent</b>
Responded	35	83
Not Responded	7	17
<b>Total Sample Size</b>	<b>42</b>	<b>100.0</b>

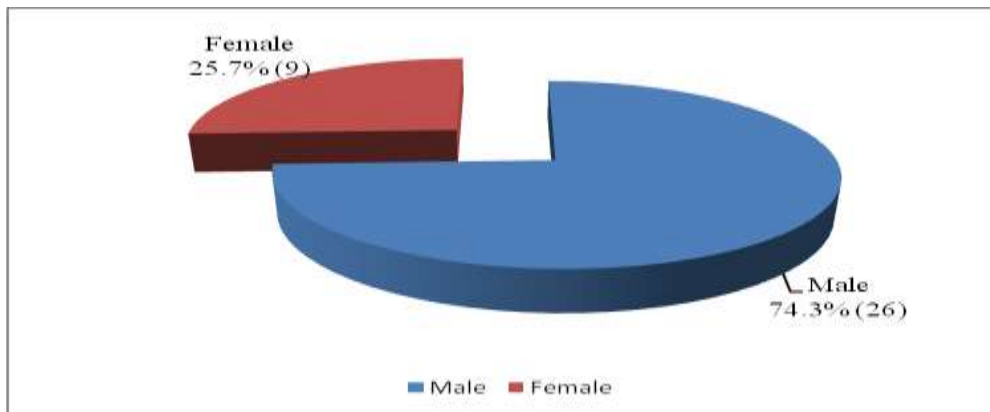
The sample size of the study is 45 respondents who included 3 Kenya investment authority officials, 5 foreign investors, 24 County public service board officials and 10 foreign embassy officials. Out of the sample size, 35 responses were successfully received which translate to a response rate of 83%. The response was appropriate for the study to continue and provide reliable results. According to Mugenda and Mugenda (2003) a fifty percent response rate is adequate, sixty percent good and above seventy percent rated very well.

### 4.2.1 Respondents Profile

The section presents the demographic information of the respondents who took part in the study. The respondents' information captured includes: gender of the respondents, age of the respondents, and number of years worked in organization in the respective positions.

#### 4.2.1.1 Distribution of Respondents by Gender

This section sought to show the distribution of respondents by gender. The findings are presented in Figure 4.1.



**Figure 4.1: Gender of the Respondents**

The study findings in Figure 4.1 shows that majority of the respondents (74.3%) were male while 25.7% were female. This study did not discriminate on any gender.

#### 4.2.1.2 Distribution of Respondents by Age

The respondents were asked to indicate their age. The age of the respondents was captured in structured age brackets. The findings are presented in Table 4.2.

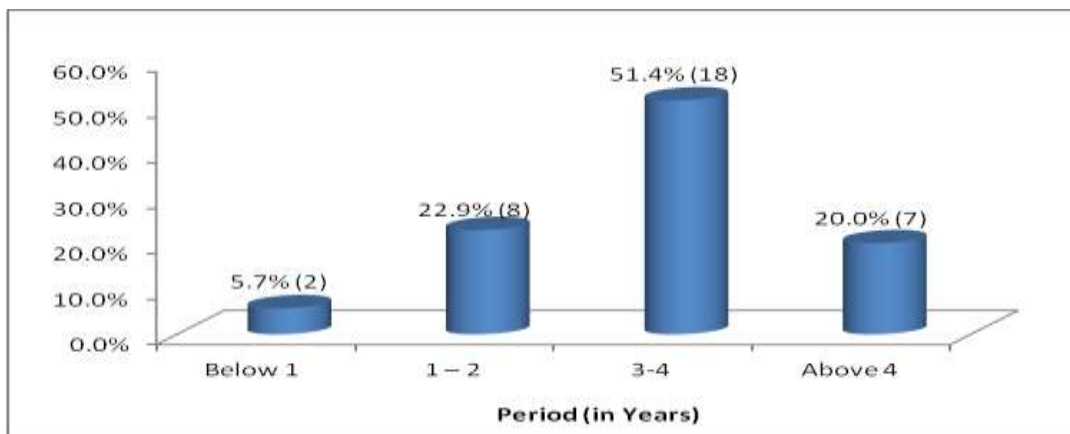
**Table 4.2: Age of the Respondents**

<b>Age Bracket</b>	<b>Frequency</b>	<b>Percentage</b>
Below 30 years	0	0
31 – 40 years	25	71.4
41 – 50 years	9	25.7
Above 50 years	1	2.9
<b>Total</b>	<b>35</b>	<b>100.0</b>

The study results show that majority of the respondents (71.4%) were between 31-40 years of age while 25.7% were aged between 41-50 years. On the other hand, 2.9% of the respondents indicated that they were aged above 50 years.

#### **4.2.1.3. Years of Experience**

The respondents were asked to indicate the number of years they had worked in their respective positions. The findings are presented in Figure 4.2.



**Figure 4.2: Years of Experience**

The study findings in Figure 4.2 show that majority of the respondents (54.1%) had worked in their respective positions for a period of 3-4 years while 22.9% indicate that they had worked for a period of 1-2 years. On the other hand, 20% of the respondents indicated that they had worked in their respective positions for a period of more than 4

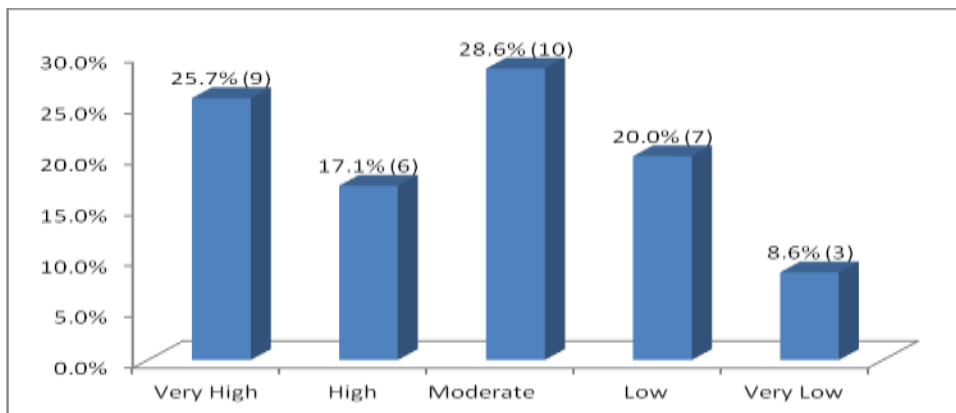
years while 5.7% had worked for a period of less than 1 year. Majority of the respondents had worked for a period of 3 years and above which implies that they have been in their position since the inception of devolution in Kenya. The respondents are therefore in a better position to give us reliable information on the effects of devolution on Foreign Direct Investment (FDI) in the country.

### 4.3 Decentralization of Resources and FDI

This section of the study seeks to address the first objective of the study which sought to establish the effect of decentralization of resources on FDI in Kenya.

#### 4.3.1 Contribution of Decentralization of Resources to FDIs

The respondents were asked to indicate the extent to which decentralization of resources contributed to foreign direct investments in Nairobi County. The findings are presented in Figure 4.3.



**Figure 4.3: Contribution of Decentralization of Resources to FDIs**

The study findings show that 25.7% of the respondents indicated that decentralization of resources contributed very high to foreign direct investments while 17.1% indicated that it highly contributed to FDIs. On the other hand, 28.6% of the respondents reported that

decentralization of resources that contributed to FDIs to a moderate extent. However, 20% of the respondents indicated that the contribution decentralization of resources to FDIs was low while 8.6% indicated very low.

#### 4.3.2 Devolution and Management of Natural Resources

The respondents were asked to indicate how devolution had affected the management of natural resources in the country. The results are presented in Table 4.3.

**Table 4.3: Devolution and Management of Natural Resources**

Statements on Management of Natural Resources	Yes		No	
	F	%	F	%
Both the national and county governments cooperate in their management	25	71.4	10	28.6
Only the national government decides how county resources are managed	2	5.7	33	94.3
County governments have complete power to manage natural resources	4	11.4	31	88.6
The management of natural resources has positively improved	24	68.6	11	31.4
Management of natural resources has been negatively affected by devolution	12	34.3	23	65.7

The study findings in table 4.3 show that majority of the respondents (71.4%) indicated that both the national and county governments cooperate in their management while 94.3% disagreed that only the national government decides how county resources are managed. On the other hand, 88.6% of the respondents disagreed that County governments have complete power to manage natural resources while 65.7% disagreed that management of natural resources had been negatively affected by devolution.

However, 68.6% of the respondents agreed that the management of natural resources has positively improved since the inception of devolution.

#### **4.3.3 Natural Resources that Foreign Investors are Interested In**

The study enquired from the respondents on the natural resources that foreign investors were interested in the most. The findings are presented in Table 4.4.

**Table 4.4: Natural Resources of Interest by Foreign Investors**

<b>Resources of Interest</b>	<b>Frequency</b>	<b>Percentage</b>
Land	24	68.5
Water bodies	9	25.7
Mineral resources	21	60.0
Fuel	16	45.7
Oil	22	62.9

Table 4.4 shows that 68.5% of the respondents indicated that land was most natural resource of interest to foreign investors; followed by oil and mineral resources as revealed by 62.9% and 60% of the respondents respectively. On the other hand, only 25% of the respondents indicated that water bodies were natural resources of interest to foreign investors.

#### **4.3.4 Effect of Decentralization of Resources on FDI**

The respondents were asked to indicate their extent of agreement on statements on the effect of decentralization of resources on FDI. A five point likert scale was used to interpret the responses whereby the scores of “strongly disagree” and “disagree” were represented by mean score, equivalent to 1 to 2.5 on the continuous Likert scale ( $1 \leq \text{disagree} \leq 2.5$ ). The scores of ‘neutral’ were equivalent to 2.6 to 3.5 on the Likert scale

(2.6 ≤ neutral ≤ 3.5). The score of “agree” and “strongly agree” represented were equivalent to 3.6 to 5.0 on the likert scale which shows a strong agreement with the statement.

**Table 4.5: Effect of Decentralization of Resources on FDI**

<b>Statements Decentralization of Resources on FDI</b>	<b>Mean</b>	<b>Std. Deviation</b>
Availability of land is the biggest attractive feature for foreign direct investment in Kenya	4.07	0.722
Availability of mineral resources affect foreign direct investment in a positive way	3.90	0.742
Availability of water bodies greatly influence foreign direct investment in the country	2.08	0.796
Availability of human resource positively influences foreign direct investment in the country	3.09	0.629
Availability of good climatic conditions positively influence agriculture related foreign direct investment in the country	3.82	0.563

The study findings in table 4.5 shows that the respondents agreed that availability of land was the biggest attractive feature for foreign direct investment in Kenya; and that availability of water bodies greatly influence foreign direct investment in the country; this is shown by mean scores of 4.07 and 3.90 respectively. The respondents also agreed that availability of good climatic conditions positively influenced agriculture related foreign direct investment in the country, as shown by a mean score of 3.82. However, the respondents disagreed that availability of water bodies greatly influence foreign direct investment in the country, as shown by a mean score of 2.08 while the respondents were neutral when asked whether availability of human resource positively influenced foreign direct investment in the country, as shown by a mean score of 3.09 on the likert scale.

#### 4.4 Effects of Decentralization of Authority and Responsibilities on FDI

This section addresses the second objective of the study which sought to establish the effect of decentralization of authority and responsibilities on FDI in Kenya.

##### 4.4.1 Decentralization of Authority and FDI

The study sought to establish how decentralization of authority influenced foreign direct investments in the country. The findings are presented in Table 4.6.

**Table 4.6: Influence of Decentralization of Authority on FDI**

<b>Influence of Decentralization of Authority on FDI</b>	<b>Frequency</b>	<b>Percentage</b>
Greatly improved FDI	3	8.6
Improved FDI	12	34.3
Moderately improved FDI	16	45.7
It have negatively reduced FDI	3	8.6
Reduced FDI	1	2.9
Has had no effect on FDI	-	-
<b>Total</b>	<b>35</b>	<b>100.0</b>

The findings show that 45.7% of the respondents indicated that decentralization of authority moderately improved FDI. On the other hand, 34.3% of the respondents indicated that decentralization of authority improved FDI while 8.6% revealed that decentralization of authority greatly improved FDI. However, 8.6% of the respondents indicated that decentralization of authority had negatively reduced FDI.

##### 4.4.2 Extent of Authority by County Governments on FDI

The respondents were asked to indicate how much authority the decentralized governments have over FDI's within their County. The results are presented in Table 4.7.

**Table 4.7: Extent of Authority by County Governments on FDI**

<b>Extent of Authority</b>	<b>Frequency</b>	<b>Percentage</b>
Complete authority	22	62.9
Regulated authority by the central government	13	37.1
No authority at all	-	-
<b>Total</b>	<b>35</b>	<b>100.0</b>

The study results show that majority of the respondents (62.9%) indicated that decentralized governments had complete authority over FDI's within their County. However, 37.1% of the respondents indicated that decentralized governments had regulated authority by the central government.

#### **4.4.3 Influence of Decentralization of Authority on FDI**

In this section, the study findings sought to establish the effects of decentralization of authority on foreign direct investment. A likert scale was used to interpret the responses whereby the scores of “strongly disagree” and “disagree” were represented by mean score, equivalent to 1 to 2.5 on the continuous Likert scale ( $1 \leq \text{disagree} \leq 2.5$ ). The scores of ‘neutral’ were equivalent to 2.6 to 3.5 on the Likert scale ( $2.6 \leq \text{neutral} \leq 3.5$ ). The score of “agree” and “strongly agree” represented were equivalent to 3.6 to 5.0 on the likert scale which shows a strong agreement with the statement.

**Table 4.8: Influence of Decentralization of Authority on FDI**

<b>Decentralization of Authority</b>	<b>Mean</b>	<b>Std. Deviation</b>
Governance systems adopted by devolved governments hinders foreign direct investments	4.19	0.687
Acquisition of legal documents by foreign firms takes too long since the national government must get involved hence negatively affecting FDI.	3.79	0.720
Devolution has increased the number of authorities that need to be bribed hence negatively affecting FDI.	4.12	0.703
Adopted leadership styles by county governments are affecting FDI negatively.	3.38	0.745
Constant wrangles among county officials scare away FDI.	3.84	0.790
Inexperienced leadership by county governments negatively affects FDI's in some regions.	3.22	0.670

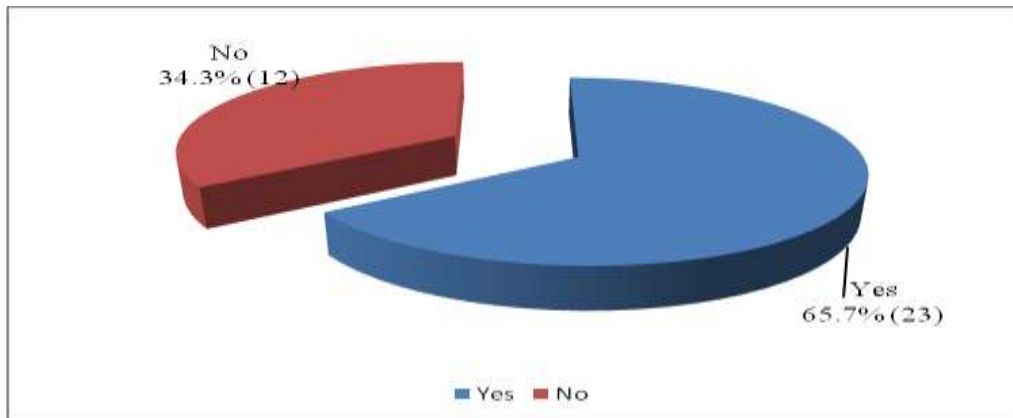
The study findings show that the respondents agreed that governance systems adopted by devolved governments hindered foreign direct investments; and that devolution has increased the number of authorities that need to be bribed hence negatively affecting FDI; this is shown by mean scores of 4.19 and 4.12 respectively. The respondents also agreed that constant wrangles among county officials scare away FDI, and that acquisition of legal documents by foreign firms takes too long since the national government must get involved hence negatively affecting FDI; this is shown by mean scores of 3.84 and 3.79 respectively. However, the respondents were neutral when asked whether adopted leadership styles by county governments were affecting FDI negatively; and on whether inexperienced leadership by county governments negatively affected FDI's in some regions; this is shown by mean scores of 3.38 and 3.22 respectively.

#### **4.5 Decentralization of Legislative Powers and FDI**

This section addresses the third objective of the study which sought to determine the effect of decentralizing legislative powers on FDI in Kenya.

#### 4.5.1 Decentralization of Legislative Powers and FDI in the Country

The respondents were asked to indicate whether decentralization of legislative powers had affected foreign direct investment in the Country. The findings are presented in Figure 4.4.

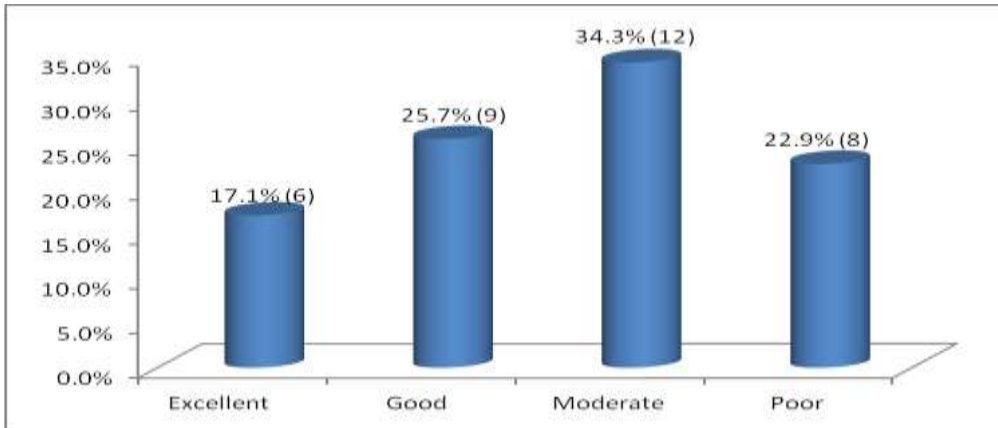


**Figure 4.4: Decentralization of Legislative Powers and FDI in the Country**

Results in Figure 4.4 show that majority of the respondents (65.7%) indicated that decentralization of legislative powers affected foreign direct investment in the Country. However, 34.3% were of the opinion that decentralization of legislative powers did not affect foreign direct investment in the Country.

#### 4.5.2 County's Legislature Commitment to Improving Trade and Investment

The respondents were asked to rank the County's legislature on their commitment to improving trade and investment. The findings are presented in Figure 4.5.

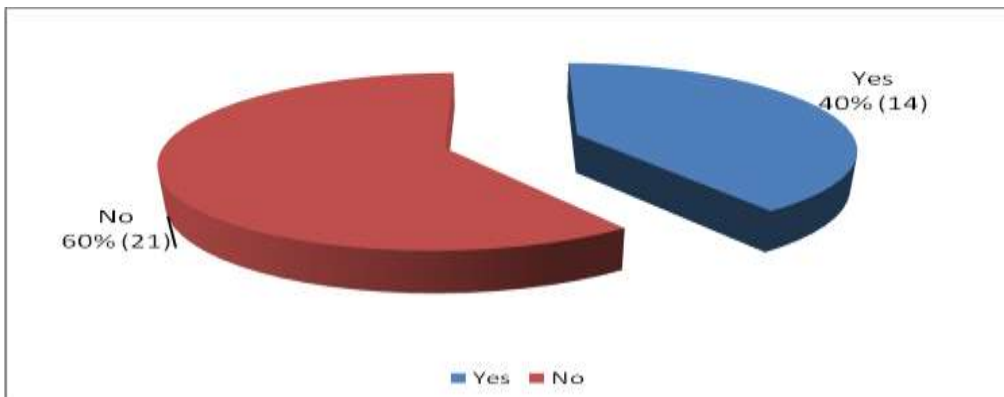


**Figure 4.5: Legislature Commitment to Improving Trade and Investment**

The study shows that 34.3% of the respondents rated the County’s legislature commitment to improving trade and investment, as average. On the other hand, 25.7% rated the County’s legislature commitment to improving trade and investment as good while 17.1% indicated excellent. However, 22.9% of the respondents rated commitment by County’s legislature as poor.

#### **4.5.3 Regulations on the County Governments to Prove FDI**

The study sought to establish whether there were regulations imposed by the national government on the County governments to prove FDI. The findings are presented in Figure 4.6.



**Figure 4.6: Regulations on the County Governments to Prove FDI**

The findings in Figure 4.6 show that majority of the respondents (82.9%) indicated that there were no regulations imposed by the national government on the County governments to prove FDI. However, 17.1% of the respondents revealed that there were regulations imposed by the national government on the County governments to prove FDI.

#### **4.5.4 Ranking the Regulations Imposed by the County Government to improve FDI**

The respondents were asked to rank the regulations imposed by the county governments to improve FDI. The findings are presented in Table 4.9.

**Table 4.9: Ranking the Regulations Imposed by the County Government**

<b>Ranking</b>	<b>Frequency</b>	<b>Percentage</b>
Excellent	3	8.6
Good	9	25.7
Average	16	45.7
Poor	7	20.0
Very poor	-	-
<b>Total</b>	<b>35</b>	<b>100.0</b>

Table 4.9 shows that 45.7% of the respondents ranked regulations imposed by the County governments to improve FDI as average. On the other hand, 25.7% of the respondents ranked regulations imposed by the County governments to improve FDI as good while 8.6% ranked the regulations imposed as excellent. However, 20% of the respondents ranked the regulations imposed as poor.

#### **4.5.5 Rating the County’s Efficiency in Trade Licensing for Foreign Investors**

The respondent were asked to rate the County’s efficiency in trade licensing for foreign investors. The findings are presented in Table 4.10.

**Table 4.10: County’s Efficiency in Trade Licensing for Foreign Investors**

<b>Ranking</b>	<b>Frequency</b>	<b>Percentage</b>
Very efficient	5	14.3
Efficient	6	17.1
Moderate	11	31.4
Inefficient	9	25.7
Very Inefficient	4	11.4
<b>Total</b>	<b>35</b>	<b>100.0</b>

The study results show that 31.4% of the respondents rated the County’s efficiency in trade licensing for foreign investors as moderate while 25.7% rated the County’s efficiency in trade licensing for foreign investors as inefficient. However, 17.1% of the respondents rated County’s efficiency in trade licensing for foreign investors as efficient while 14.3% rated it as very efficient.

#### **4.5.6 Rating the General Microeconomic Regulatory Environment**

The respondents were asked to rate the general microeconomic regulatory environment in the county in respect to foreign investors. The findings are presented in Table 4.11.

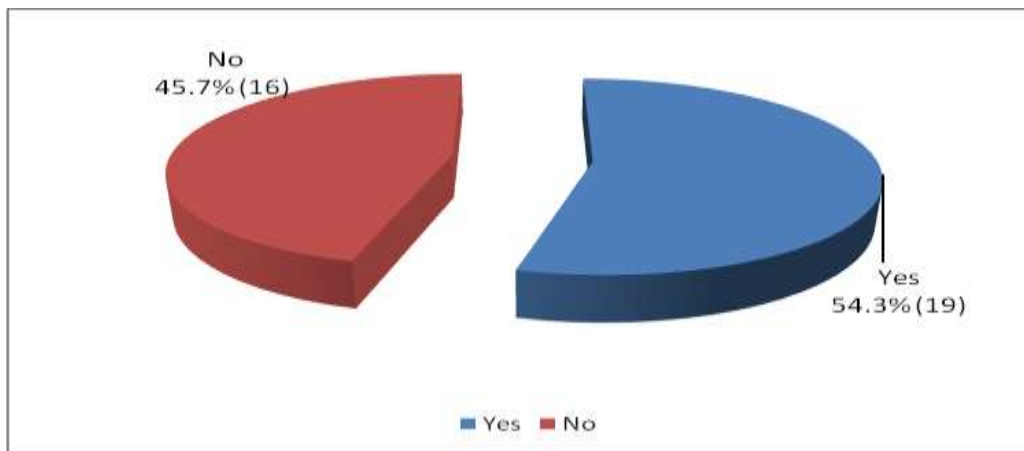
**Table 4.11: Rating the General Micro-Economic Regulatory Environment**

<b>Ranking</b>	<b>Frequency</b>	<b>Percentage</b>
Very friendly	5	14.3
Friendly	7	20.0
Moderate	12	34.3
Hostile	8	22.8
Very hostile	3	8.6
<b>Total</b>	<b>35</b>	<b>100.0</b>

On micro-economic regulatory environment, 34.3% of the respondents rated the general micro-economic regulatory environment as moderate; 22.8% of the respondents rated the environment as hostile while 8.6% rated the environment as very hostile. On the other hand, 20% of the respondents rated the micro-economic regulatory environment as friendly while 14.3% rated the environment as very friendly.

#### 4.5.7 Devolution and Transparency of Legal Processes

The study sought to examine whether devolution had enabled transparency of legal processes. The findings are presented in Figure 4.7.



**Figure 4.7: Devolution and Transparency of Legal Processes**

The study findings show that majority of the respondents (54.3%) reported that devolution had enabled transparency of legal processes. However, a significant number of respondents (45.7%) indicated that they devolution had enabled transparency of legal processes.

#### 4.5.8 Effect of Decentralization of Legislative Powers on FDI

This section sought to examine the extent to which devolution had affected legislation and foreign direct investments. A five point likert scale was used to interpret the results

whereby a mean score of 1 represented strongly disagree while a mean score 5 implied strongly agree. The findings are presented in Table 4.12.

**Table 4.12: Effect of Decentralization of Legislative Powers on FDI**

<b>Statements on Decentralization of Legislative</b>	<b>Mean</b>	<b>Std. Deviation</b>
Decentralization of land legislation has improved the process of land acquisition by foreign investors.	3.81	0.552
Decentralization of mining legislation has improved the foreign direct investments.	3.75	0.758
Decentralization of legislature has improved avenues of corruption that negatively affect FDI.	4.01	0.410
Devolution has increased taxation for foreign firms which has negatively affect FDI.	4.02	0.498
Processes for acquiring legal documents needed for investment has increased which has negatively affected FDI.	2.92	0.942
Decentralization has increased legal documents required to start a business hence negatively affecting FDI in the country.	3.38	0.794

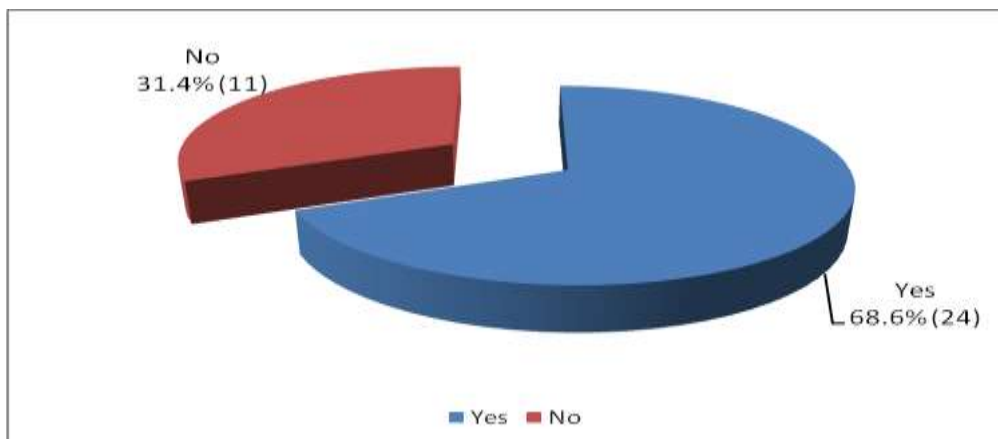
The study results show that the respondents were neutral when asked whether the processes for acquiring legal documents needed for investment had increased and negatively affected FDI, as shown by a mean score of 2.92. The respondents were also neutral when asked whether decentralization had increased legal documents required to start a business hence negatively affecting FDI in the country, as shown by a mean score of 3.38. However, the respondents agreed that decentralization of mining legislation had improved the foreign direct investments; and that decentralization of land legislation had improved the process of land acquisition by foreign investors; this is shown by mean scores of 3.75 and 3.81 respectively. The respondents also agreed that decentralization of legislature had improved avenues of corruption which negatively affected FDI; and that devolution had increased taxation for foreign firms which also negatively affected FDI; this is shown by mean scores of 4.01 and 4.02 respectively.

## 4.6 Autonomous Financial Units and FDI

In this section, the study sought to determine the effect of having autonomous financial Counties on foreign direct investments in Kenya. To address this, the study examined whether the power to raise revenue increased the fees required to start a new investment in the counties; whether there were any funds committed by the counties to boost their image to foreign investors; the incentives offered by devolved governments to attract foreign direct investment and the efficiency of county governments tax system in improving FDI.

### 4.6.1 Power to Raise Revenue and the Fees for Investment

The respondents were asked to indicate whether the power to raise revenue increased the fees required to start a new investment in the Counties. The results are presented in Figure 4.8.



**Figure 4.8: Power to Raise Revenue and the Fees for Investment**

Majority of the respondents (68.6%) revealed that the power to raise revenue increased the fees required to start a new investment in the Counties. Only 31.4% of the

respondents were of the opinion that the power to raise revenue did not increase the fees required to start a new investment in the Counties.

#### **4.6.2 How Autonomous Financial Units have Affected FDI in Counties**

The study examined whether the establishment of autonomous financial Counties affected FDI in the Counties. The findings are presented in Table 4.13.

**Table 4.13: Autonomous Financial Units and FDI in Counties**

<b>Responses</b>	<b>Frequency</b>	<b>Percentage</b>
Negatively affected FDI	4	11.4
Has had no effect on FDI	1	2.9
Moderately affect FDI	16	45.7
Has improved FDI	9	25.7
Has seen great FDI improvement	5	14.3
<b>Total</b>	<b>35</b>	<b>100.0</b>

Results in Table 4.13 show that 45.7% of the respondents were of the opinion that establishment of autonomous financial Counties moderately affect FDI in the Counties. On the other hand, 11.4% of the respondents felt that the autonomous financial units negatively affected FDI in the Counties. However, 25.7% of the respondents indicated that the autonomous financial units had improved FDI while 14.3% indicated that there was great improvement on FDI.

#### **4.6.3 Funds to Boost Counties Image to Foreign Investors**

The study was interested to know whether the Counties committed any funds to boost their image to foreign investors. The findings are presented in Table 4.14.

**Table 4.14: Funds to Boost Counties Image to Foreign Investors**

<b>Responses</b>	<b>Frequency</b>	<b>Percentage</b>
Yes	21	60.0
No	14	40.0
<b>Total</b>	<b>35</b>	<b>100.0</b>

The study results show that majority of the respondents (60%) indicated that Counties committed funds to boost their image to foreign investors. However, 40% of the respondents indicated that Counties did not commit funds to boost their image to foreign investors.

#### **4.6.4 National Government's Regulation on Incentives and FDI**

The study examined how the national government's regulation on incentives offered by county governments to attract investors affected FDI. The findings are presented in Table 4.15.

**Table 4.15: National Government's Regulation on Incentives and FDI**

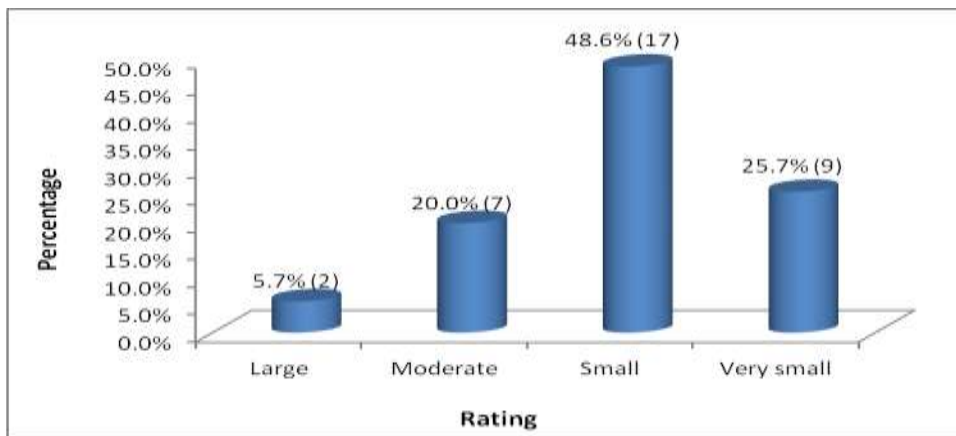
<b>Responses</b>	<b>Frequency</b>	<b>Percentage</b>
Improved FDI greatly	4	11.4
Has a moderate improvement	12	34.3
Has no effect on FDI	10	28.6
Negatively affects FDI	9	25.7
<b>Total</b>	<b>35</b>	<b>100.0</b>

The study findings in Table 4.15 show that 34.3% of the respondents reported that the national government's regulation on incentives offered by county governments to attract investors had a moderate improvement on FDI while 11.4% indicated that it had improved FDI greatly. However, 28.6% indicated that the national government's

regulation on incentives offered by county governments to attract investors had no effect while 25.7% indicate that it negatively affected FDI.

#### 4.6.5 Number of Incentives Offered to Foreign Investors

The respondents were asked to rate the number of incentives offered by the county governments to foreign investors. The findings are presented in Figure 4.9.

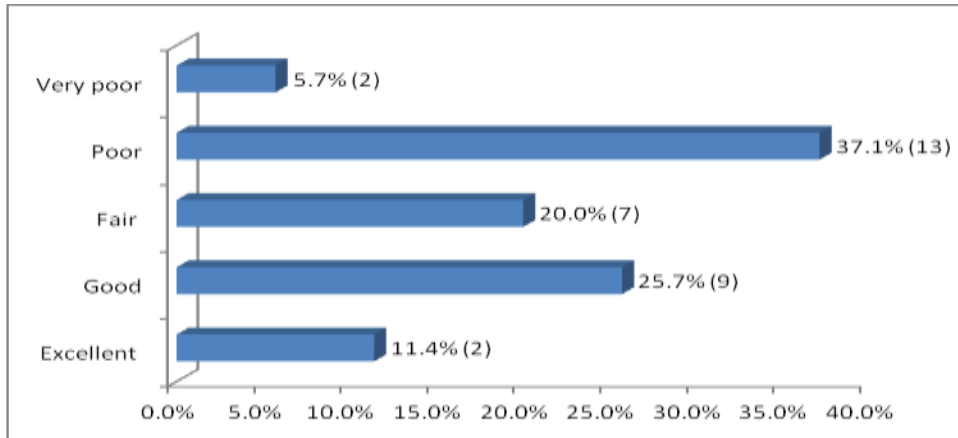


**Figure 4.9: Number of Incentives Offered to Foreign Investors**

The study results show that 48.6% of the respondents indicated that the number of incentives offered by the county governments to foreign investors were small while 25.7% indicated very small. On the other hand, 20% of the respondents rated the incentives offered by the county governments to foreign investors as moderate. Only, 5.7% of the respondents were of the opinion that the incentives offered were large.

#### 4.6.6 Efficiency of County Governments Tax System

The respondents were asked to rate the efficiency of County government's tax system in improving FDI. The findings are presented in Figure 4.10.



**Figure 4.10: Efficiency of County Governments Tax System**

The study results show that 37.1% of the respondents rated the efficiency of County government's tax system in improving FDI as poor while 5.7% indicated that it was very poor. Twenty percent of the respondents were of the opinion that the efficiency of County government's tax system in improving FDI was fair. However, 25.7% of the respondents rated the efficiency of County government's tax system in improving FDI as good while 11.4% indicated that it was excellent.

#### **4.6.7 Effect of Autonomous Financial Counties on FDI**

The study sought to determine the extent to which having autonomous financial units in Kenya has affected foreign direct investment. A five point likert scale was used to interpret the results whereby a mean score of 1 meant strongly disagree while a mean score 5 implied strongly agree with the statement. The findings are presented in Table 4.16.

**Table 4.16: Effect of Autonomous Financial Counties on FDI**

<b>Statements on Autonomous Financial Units and FDI</b>	<b>Mean</b>	<b>Std. Deviation</b>
Ability by decentralized governments to offer incentives to investors has positively improved FDI	3.38	0.745
Independent revenue collection has greatly improved FDI	3.72	0.670
Improved taxation methods has improved FDI	3.19	0.982
Ability to decide which projects need county government financing has improved FDI	4.07	0.769
Ability by county governments to allocate funds for roads, health, agricultural sector and housing has greatly improved	4.02	0.737
Country governments ability to fund their own marketing activities have attracted more FDI	4.05	0.759

The study findings in Table 4.16 show that the respondents were neutral when asked whether improved taxation methods had improved FDI due to establishment of autonomous financial units; and on whether the autonomous financial units enhanced the ability by decentralized governments to offer incentives to investors has positively improved FDI; this is shown by mean scores of 3.19 and 3.38 respectively.

On the other hand, the respondents agreed that independent revenue collection had greatly improved FDI; and that the ability by county governments to allocate funds for roads, health, agricultural sector and housing had greatly improved due to decentralized autonomous financial units; this is shown by mean scores, 3.72 and 4.02 respectively. Moreover, the respondents agreed that decentralization of autonomous financial units enhanced the ability to decide which projects need county government financing has improved FDI; and Country governments' ability to fund their own marketing activities, which attracted more FDI; as shown by the mean scores 4.07 and 4.05 respectively.

## 4.7 Inferential Statistics

### 4.7.1 Regression Analysis

A multivariate regression model was applied to determine the relationship between devolution and Foreign Direct Investment in Kenya. The predictors were decentralization of resources, decentralization of authority and responsibilities, decentralization of legislative powers, decentralization of autonomous financial units. The results are presented below.

**Table 4.17: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.792 (a)	0.627	0.554	0.289

a Predictors: (Constant), Decentralization of resources, decentralization of authority and responsibilities, decentralization of legislative powers, decentralization of autonomous financial units

The regression results in Table 4.17 shows an R value of 0.792 which means that there was a high relationship between the variables. The R square is the coefficient of determination and tells us how the dependent variable varies with the independent variables. The results show an adjusted R<sup>2</sup> value of 0.554. This implies that there was a variation of 55.4% between the devolution and FDI. This is to mean that devolution (Decentralization of resources, decentralization of authority and responsibilities, decentralization of legislative powers, decentralization of autonomous financial units) explained 55.4% of FDI in the Counties at a 95% confidence level.

**Table 4.18: ANOVA- Analysis of Variance**

<b>Model</b>		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
1	Regression	12.700	4	3.175	4.733	0.002(a)
	Residual	20.130	30	0.671		
	<b>Total</b>	<b>32.830</b>	<b>34</b>			

a Predictors: (Constant), Decentralization of resources, decentralization of authority and responsibilities, decentralization of legislative powers, decentralization of autonomous financial units

b Dependent Variable: Foreign Direct Investment

The study used ANOVA to establish the appropriateness of the regression model to give reliable results. An f-significance value of  $p=0.002$  was established. This shows that the regression model has a less than 0.002 likelihood (probability) of giving a wrong prediction. Hence the regression model has a confidence level of above 95%. The value of the critical F is 2.69, this value is less than the calculated F value of 4.733 thus the regression model is reliable.

**Table 4.19: Coefficients Results**

<b>Model</b>		<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>	<b>t</b>	<b>Sig.</b>
		<b>B</b>	<b>Std. Error</b>	<b>Beta</b>		
1	(Constant)	1.087	0.401		2.713	0.008
	Decentralization of resources	0.213	0.081	0.272	2.627	0.010
	Decentralization of autonomous financial units	0.242	0.106	0.246	2.289	0.025
	Decentralization of legislative powers	0.037	0.084	0.049	3.447	0.046
	Decentralization of authority and responsibilities	0.003	0.006	0.045	0.442	0.660

A Dependent Variable: Foreign Direct Investment

The following regression equation was established:

$$Y = 1.087 + 0.213X_1 + 0.242X_2 + 0.037X_3 + 0.003X_4$$

The regression results show that there is a positive relationship and significant relationship between FDI and: decentralization of resources ( $\beta = 0.213$ ,  $p=0.010<0.05$ ), decentralization of autonomous financial units ( $\beta = 0.242$ ,  $p=0.025<0.05$ ), decentralization of legislative powers ( $\beta = 0.037$ ,  $p=0.046<0.05$ ). However, the study found a positive but a statistically insignificant relationship between FDI and decentralization of authority and responsibilities ( $\beta = 0.003$ ,  $p=0.660>0.05$ ).

#### **4.7.2 Correlations Analysis**

Pearson product-moment correlation was conducted to establish the strength of relationship between devolution (as presented by decentralization of resources, decentralization of legislative powers, decentralization of autonomous financial units, and decentralization of authority and responsibilities) and Foreign Direct Investment. The findings are presented in Table 4.20.

**Table 4.20: Correlations Analysis**

		FDI	Decentralization of resources	Decentralization of autonomous financial units	Decentralization of legislative powers	Decentralization of authority and responsibilities
Decentralization of resources	Pearson Correlation	0.499(**)	1			
	Sig. (2-tailed)	0.000	.			
Decentralization of legislative powers	Pearson Correlation	0.294(*)	0.327(*)	1		
	Sig. (2-tailed)	0.043	0.023	.		
Decentralization of autonomous financial units	Pearson Correlation	0.636(**)	0.371(**)	-0.027	1	
	Sig. (2-tailed)	0.000	0.009	0.853	.	
Decentralization of authority and responsibilities	Pearson Correlation	0.211	-0.466(**)	0.118	-0.191	1
	Sig. (2-tailed)	0.149	.001	.426	.193	.

\* Correlation is significant at the 0.05 level (2-tailed).

\*\* Correlation is significant at the 0.01 level (2-tailed).

The study results show that there was a strong, positive and significant relationship between decentralization of autonomous financial units and foreign direct investment as shown  $r = 0.636$  and  $p = 0.000 < 0.05$ . The study further show that there is a positive and significant relationship foreign Direct Investment and decentralization of resources ( $r = 0.499$ ,  $p = 0.000 < 0.05$ ), decentralization of legislative powers ( $r = 0.294$ ,  $p = 0.043 < 0.05$ ).

However, the study findings show a positive but a statistically insignificant relationship between decentralization of authority and responsibilities and FDI as shown by  $r = 0.211$ ,

$p = 0.149 > 0.05$ . This implies that decentralization of resources, autonomous financial units and decentralization of legislative powers significantly influences FDI in Nairobi County.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter is a synthesis of the entire thesis and contains summary of findings, conclusions arrived at, policy recommendations and suggestions for further studies.

#### **5.2 Summary of the Findings**

##### **5.2.1 Decentralization of Resources and FDI**

The study show that most of the respondents (42.8%) indicated that decentralization of resources contributed highly to foreign direct investments. Majority of the respondents indicated that both the national and county governments cooperate in their management. They also agreed that the management of natural resources has positively improved since the inception of devolution. However, the the respondents disagreed that only the national government decides how county resources are managed. They also disagreed that County governments had complete power to manage natural resources; and also disagreed that management of natural resources had been negatively affected by devolution.

On the effect of decentralization of resources on FDI, the respondents agreed that availability of land was the biggest attractive feature for foreign direct investment in Kenya; and that availability of water bodies greatly influence foreign direct investment in the country. The respondents also agreed that availability of good climatic conditions positively influenced agriculture related foreign direct investment in the country. However, the respondents disagreed that availability of water bodies greatly influence foreign direct investment in the country, while the respondents were neutral when asked

whether availability of human resource positively influenced foreign direct investment in the country.

### **5.2.2 Decentralization of Authority and Responsibilities on FDI**

The findings show that most of the respondents indicated that decentralization of authority moderately improved FDI. Majority of the respondents indicated that decentralized governments had complete authority over FDI's within their County. The respondents agreed that governance systems adopted by devolved governments hindered foreign direct investments; and that devolution has increased the number of authorities that need to be bribed hence negatively affecting FDI. The respondents also agreed that constant wrangles among county officials scare away FDI, and that acquisition of legal documents by foreign firms takes too long since the national government must get involved hence negatively affecting FDI. However, the respondents were neutral when asked whether adopted leadership styles by county governments were affecting FDI negatively; and on whether inexperienced leadership by county governments negatively affected FDI's in some regions.

### **5.2.3 Decentralization of Legislative Powers and FDI**

The results show that majority of the respondents indicated that decentralization of legislative powers affected foreign direct investment in the Country. Most of the respondents rated the County's legislature commitment to improving trade and investment, as average. Majority of the respondents (82.9%) indicated that there were no regulations imposed by the national government on the County governments to prove FDI.

Most of the respondents ranked regulations imposed by the County governments to improve FDI as average; and also rated the County's efficiency in trade licensing for foreign investors as moderate.

On the other hand, majority of the respondents reported that devolution had enabled transparency of legal processes. The respondents were neutral when asked whether the processes for acquiring legal documents needed for investment had increased and negatively affected FDI. The respondents were also neutral when asked whether decentralization had increased legal documents required to start a business hence negatively affecting FDI in the country. However, the respondents agreed that decentralization of mining legislation had improved the foreign direct investments; and that decentralization of land legislation had improved the process of land acquisition by foreign investors. The respondents also agreed that decentralization of legislature had improved avenues of corruption which negatively affected FDI; and that devolution had increased taxation for foreign firms which also negatively affected FDI.

#### **5.2.4 Autonomous Financial Units and FDI**

Majority of the respondents revealed that the power to raise revenue increased the fees required to start a new investment in the Counties. The respondents also indicated that Counties committed funds to boost their image to foreign investors. Most of the respondents reported that the national government's regulation on incentives offered by county governments to attract investors had a moderate improvement on FDI; and that the number of incentives offered by the county governments to foreign investors was small.

The respondents agreed that independent revenue collection had greatly improved FDI; and that the ability by county governments to allocate funds for roads, health, agricultural sector and housing had greatly improved due to decentralized autonomous financial units. Moreover, the respondents agreed that decentralization of autonomous financial units enhanced the ability to decide which projects need county government financing has improved FDI; and County governments' ability to fund their own marketing activities, which attracted more FDI.

### **5.3 Conclusions**

The study concludes that there is a positive and significant relationship between decentralization of resources and FDI in Counties in Kenya. Decentralization of resources gave the Counties the powers to manage resources in their jurisdictions, most of which are income generating to the counties. For instance, availability of land, and water bodies have greatly influenced foreign direct investment, especially, agriculture related foreign direct investment in the Counties.

The study also concludes that there is a positive and significant association between decentralization of legislative powers and FDI in Counties. Through devolution, the County Assembly members have legislative powers, through which they make regulations aimed at improving FDI in their region. The legislative powers influences aspects such as trade licensing for foreign investors, the legal documents required and the processes for acquiring legal documents needed for investment.

The study concludes that there is a positive and significant association between decentralization of autonomous financial units and FDI in Counties in Kenya.

Decentralization of autonomous financial units have enhanced independent revenue collection; and enhanced the ability by county governments to allocate funds for infrastructural development which attracts FDI. Decentralization of autonomous financial units has also enhanced Country governments' ability to decide which projects need county government financing fund; and also enhanced their own marketing activities, which have attracted more FDI.

The study concludes that there is a positive but statistically insignificant relationship between FDI and decentralization of authority and responsibilities. To some, devolution has increased the number of authorities that need to be bribed hence negatively affecting FDI. There is also constant wrangle among county officials who wants to stamp their authority hence scaring away foreign investors.

#### **5.4 Recommendations**

The study recommends that the national government should channel more resources (finances) to the Counties so as to enhance developments; for instance, of improving the quality of infrastructure, especially in marginalized regions of the country, so as to attract FDI thereby increasing economic growth.

The County governments should develop foreign investment policies, which will act as a supplemental part of the domestic development policy. The policies should guide the Counties on how to engage with foreign investors and also offer guidance on what factors should be considered in assessing whether an investment proposal is in line with the County interests.

The study recommends that the County governments should ensure effectiveness in reducing/eliminating inefficiency and corruption. The county government should also improve the capacity to maximize interactions with stake holders at sub-national and local levels of government so as to avoid wrangles that would scare away scaring away foreign investors.

### **5.5 Suggestion for Further Studies**

This study concentrated on the effects of devolution on Foreign Direct Investment (FDI) in Kenya, with a focus on Nairobi County. The researcher recommends that a similar be conducted in other Counties for comparison of results. A future study should also be conducted to establish the policies or strategies being employed by County governments in Kenya to increase FDI inflows.

### **5.6 Limitations and Delimitations of the Study**

Some of the limitations encountered included non cooperation of respondents which was countered by explaining to the respondents the importance and the purpose of the study as well as guaranteeing them of their confidentiality. The validity of the secondary data for the study was also be enhanced by use of data from professional bodies and authorities and also from previous related research findings. Legal constraints were controlled by ensuring that the concerned bodies are contacted and acquiring permission for the research proceedings.

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## APPENDICES

### APPENDIX 1: INTRODUCTION LETTER

JOHN THUO KAMAU

P.O BOX 58 – 20301

MIHARATI

Dear sir/ madam

#### RE: DATA COLLECTION

I am a student of Kenyatta University pursuing a Master of Business Administration degree in finance. One of my academic outputs before graduating is a project and for this reason I have chosen the research topic "**An investigation into the effects of devolution on foreign direct investment in Kenya**" I have selected you to form part of the study. This is to kindly request you to assist me collect the data by responding to the questionnaire (copy attached).

The information you provide will be used strictly for academic purposes and will be treated with utmost confidentiality. A copy of the final report will be available upon request.

Your assistance will be highly appreciated.

Yours sincerely

John Thuo Kamau

D53/CTY/PT/23924/2013

Tel: 0714 252854

Email: [johnthuok@gmail.com](mailto:johnthuok@gmail.com)

**APPENDIX 2: RESEARCH QUESTIONNAIRE**

This instrument is meant to collect on the effect of devolution on foreign direct investment in Kenya. Kindly respond to the questions by filling in the provided spaces or marking appropriate answers where responses to chose from are provided. Your participation in this research is greatly appreciates.

Note: The rating for responses of statements in the likert scale is as follows, strongly agree 5, agree 4, neutral 3, disagree 2 and strongly disagree 1. Kindly use the right rating while responding.

**RESPONDENT CATEGORY**

Kenya investment authority

official.....

Foreign

investor.....

County public service board

official.....

Foreign embassy official

.....

**SECTION A: INTRODUCTION**

*(Put a tick where appropriate)*

1. Gender

a) Male

b) Female

3. Age of respondent

a) Below 30 years

b) 31 – 40 years

c) 41 – 50 years

d) Above 50 years

4. Years of experience

a) Below 1

b) 1 – 2

c) 3- 4

d) Above 4

**SECTION B: EFFECTS OF DECENTRALIZATION OF RESOURCES ON FDI.**

5. To what extent has decentralization of resources contributed to foreign direct

investments?

a) Very high

b) High

c) Moderate

d) Low

e) Very low

6. How has devolution affected the management of natural resources in the country?

- a) Both the national and county governments cooperate in their management
- b) Only the national government decides how county resources are managed
- c) County governments have complete power to manager natural resources
- d) The management of natural resources has positively improved
- e) Management of natural resources has been negatively affected by devolution

7. Which natural resources are foreign investors interested in the most?

- a) Land
- b) Water bodies
- c) Mineral resources
- d) Fuel
- e) Oil
- f) Any other please state.....

8. Kindly rate the following statement as strongly agree (A), agree (A), neutral (N), disagree (D) and strongly disagree (SD) based on the effects the following natural resources have on foreign direct investment in the country.

Research Items	SA	A	N	D	SD
Availability of land is the biggest attractive feature for foreign direct investment in Kenya					
Availability of mineral resources affect foreign direct investment in a positive way					
Availability of water bodies greatly influence foreign direct investment in the country					
Availability of human resource positively influences foreign direct investment in the country					
Availability of good climatic conditions positively influence agriculture related foreign direct investment in the country					

**SECTION D: EFFECTS OF DECENTRALIZATION OF AUTHORITY AND RESPONSIBILITIES ON FDI**

10. How has decentralization of authority influenced foreign direct investments in the country?

- a) Greatly improved FDI
- b) Improved FDI
- c) Moderately improved FDI
- d) It have negatively reduced FDI
- e) Reduced FDI
- f) Has had no effect on FDI

11. How much authorities do decentralized governments have over FDI's within their county?

- a) Complete authority
- b) Regulated authority by the central government
- c) No authority at all
- d) Any other please state

12. Given your responses above, kindly respond to the following statement as strongly agree (A), agree (A), neutral (N), disagree (D) and strongly disagree (SD) based on the effects devolution of authority has on foreign direct investment in the country.

<b>Research Items</b>	<b>SA</b>	<b>A</b>	<b>N</b>	<b>D</b>	<b>SD</b>
Governance systems adopted by devolved governments hinders foreign direct investments					
Acquisition of legal documents by foreign firms takes too long since the national government must					

get involved hence negatively affecting FDI					
Devolution has increased the number of authorities that need to be bribed hence negatively affecting FDI					
Adopted leadership styles by county governments are affecting FDI negatively					
Constant wrangles among county officials scares away FDI					
Inexperienced leadership by county governments negatively affects FDI's in some regions					

**SECTION E: DECENTRALIZATION OF LEGISLATIVE POWERS AND FDI.**

13. Has decentralization of legislative powers affected foreign direct investment in the country?

Yes  No

14. How would you rank the county's legislature on their commitment to improving trade and investment?

- a) Excellent
- b) Good
- c) moderate
- d) Inefficient
- e) Very Inefficient

15. Are there regulations imposed by the national government on the county governments to prove FDI all over the country?

Yes  No

16. If yes, kindly state one such regulation?

.....

.....

17. How would you rank the regulations imposed by the county governments to improve FDI in the country?

- a) Excellent
- b) Good
- c) Average
- d) Poor
- e) Very poor

18. How would you rate your county's efficiency in trade licensing for foreign investors?

- a) Very efficient
- b) Efficient
- c) Moderate
- d) Poor
- e) Very poor

19. How would you rate the general microeconomic regulatory environment in your county in respect to foreign investors?

- a) Very friendly
- b) Friendly
- c) Moderate
- d) Hostile
- e) Very hostile

20. Has devolution enabled transparency of legal processes?

Yes  No

21. If devolution has affected legislation and foreign direct investments, kindly rate the following statements as strongly agree (A), agree (A), neutral (N), disagree (D) and strongly disagree (SD) based on the effects devolution of authority has on foreign direct investment in the country.

<b>Research Items</b>	<b>SA</b>	<b>A</b>	<b>N</b>	<b>D</b>	<b>SD</b>
Decentralization of land legislation has improved the process of land acquisition by foreign investors					
Decentralization of mining legislation has improved the foreign direct investments					
Decentralization of legislature has improved avenues of corruption that negatively affect FDI					
Devolution has increased taxation for foreign firms which has negatively affect FDI					
Processes for acquiring legal documents needed for investment has increased which has negatively affected FDI					
Decentralization has increased legal documents required to start a business hence negatively affecting FDI in the country					

**SECTION E: EFFECT OF HAVING AUTONOMOUS FINANCIAL UNITS ON FDI**

22. Has the power to raise revenue increased the fees required to start a new investment?

Yes  No

23. How has this affected FDI within counties?

a) negatively affected FDI

- b) Has had no effect on FDI
- c) Moderately affect FDI
- d) Has improved FDI
- e) Has seen great FDI improvement

24. Are there any funds committed by the counties to boost their image to foreign investors?

Yes No

25. Which are the incentives currently being offered by devolved governments to attract foreign direct investment? Kindly state the main one

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26. How does the national governments regulation on incentives offered by county governments to attract investors affect FDI?

- a) Improves FDI greatly
- b) Has a moderate improvement
- c) Has no effect on FDI
- d) Negatively affects FDI

27. How would you rate the number of incentives offered by the county governments to foreign investors?

- a) Very large
- b) Large
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- c) Moderate
- d) Small
- e) Very small

28. How would you rate the efficiency of county governments tax system in improving FDI?

- a) excellent
- b) good
- c) fair
- d) poor
- e) very poor

29. Kindly respond to the following statement based on how having autonomous 47 financial units in Kenya has affected foreign direct investment as strongly agree (A), agree (A), neutral (N), disagree (D) and strongly disagree (SD).

<b>Research Items</b>	<b>SA</b>	<b>A</b>	<b>N</b>	<b>D</b>	<b>SD</b>
Ability by decentralized governments to offer incentives to investors has positively improved FDI					
Independent revenue collection has greatly improved FDI					
Improved taxation methods has improved FDI					
Ability to decide which projects need county government financing has improved FDI					
Ability by county governments to allocate funds for roads, health, agricultural sector and housing has greatly improved					

Country governments ability to fund their own marketing activities have attracted more FDI					
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**THANK YOU FOR PARTICIPATING IN THIS STUDY AND GOD BLESS**