STRENGTHENING A VIBRANT DOMESTIC INVESTMENT MARKET FOR ECONOMIC GROWTH IN KENYA

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DECLARATION

I, the undersigned, declare that this research is my original work and has not been presented for a degree or diploma in any other college, institution or university other than the United States International University- Africa for academic credit and that all materials from other sources have been duly acknowledged.

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DEDICATION

To my parents, Steve and Mary, who actualized my dream.

To Muriuki, for support and comfort.

ACKNOWLEDGEMENT

I acknowledge the grace of God that enables me go through each day and for the gift of knowledge. I acknowledge Gods sufficient grace that enables all things come to fruition, including the conduct of this paper.

This work is the result of long hours of research conducted from various sources in the academia comprising of published material derived from libraries, internet, magazines, newspaper articles and company reports.

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ABSTRACT

A thriving private sector is central to achieving the objectives of Kenya’s Vision 2030. In fact, the success of Vision 2030 is largely premised on the role of the private sector in achieving the countries growth objectives and, thereby, creating greater wealth and employment opportunities. In general, the private sector in Kenya is vibrant and in good health. Kenya is a promising place to do business, with growing markets and good opportunities. Importantly, there is a widespread intellectual appreciation amongst Kenyans, including government officials, that the private sector is important and will be the main driver of growth, rather than the state. Positively, the business climate has improved over the last decade. Frustratingly, it is the same recurrent challenges that prevent the private sector from reaching its full potential: political uncertainty, corruption, infrastructural deficits, and an untapped informal sector. The purpose of this study is to measure the private sector’s actual contribution to the Kenyan economy and, as a result, the progress and success of the aforementioned policies. The findings of the study are that private sector still has a lot more muscle to exercise in order to valuably contribute to economic growth in Kenya. It proposes the adoption of several items under the ambit of political factors; economic factors and social factors that can be strengthened further in an effort to increase the contribution of private investments in promoting rapid economic growth.

LIST OF ACRONYMS

AFDB	African Development Bank
AGOA	African Growth and Opportunity Act
CBK	Central Bank of Kenya
DAC	Development Assistance Committee
DFID	Department for International Development
ECA	Economic Commission for Africa
EDAR	Economic Development in Africa Report
FDI	Foreign Direct Investment
GDP	Gross Development Product
GOK	Government of Kenya
IFC	International Financial Corporation
IFIs	International Financial Institutions
KNBS	Kenya National Bureau of Statistics
LDC	Least Developed Country
MDGs	Millennium Development Goals
NEPAD	New Partnership for Africa's Development

NGO	Non-Governmental Organization
ODA	Official Development Assistance
OPEC	Organization of the Petroleum Exporting Countries
PPP	Public–Private Partnership
SDGs	Strategic Development Goals
SIDA	Swedish International Development Cooperation
SME	Small and Medium-sized Enterprise
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
WB	World Bank
WTO	World Trade Organization

LIST OF DEFINITIONS

Capital Flight	Rapid outflow of assets or money rapidly flow from a country due to an event of economic consequence.
Crowding Effect	A phenomenon that occurs when increased government involvement in a sector of the market economy substantially affects the remainder of the market, either on the supply or demand side of the market.
Domestic Investment Market	For purposes of this paper, it is the measure of physical investment by the private sector used in computing GDP in the measurement of nations' economic activity.
Gross Domestic Product	An aggregate measure of production equal to the sum of the gross values added of all resident institutional units engaged in production (plus any taxes, add minus any subsidies) on products not included in the value of their outputs.
Official Development Assistance	The provision by official agencies, including state and local governments or by their executive agencies of assistance that is administered with the promotion of the economic development and welfare of developing countries as its main objective and is concessional in character.
Organizations for Economic Development and Cooperation	A group of thirty member countries that discuss and develop economic and social policy. These countries are democratic countries that support free market economies.
Statistical Package for Social Science	A software package used for statistical analysis.
Theory	A supposition or a system of ideas intended to explain something, especially one based on general principles independent of the thing to be explained.
Vision 2030	Kenya **Vision 2030** (Swahili: Ruwaza ya Kenya **2030**) is the country's development programme covering the period 2008 to **2030**. It was launched on 10 June 2008 by President Mwai Kibaki.

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CHAPTER ONE

1.0.Introduction

1.1.Background

Economists define investment as an increase in capital spending. The theory of investment has remained to be one of the unsettled issues in economics. Different approaches have been used to explain the investment behavior mostly based on the experience of developed countries. Consequently, the term investment has been defined differently by different economists. According to Juillard and Carreau (2007), the absence of a common legal definition is due to the fact that the meaning of the term investment varies according to the object and purpose of different investment instruments which contain it. The multiplication of definitions of investment thus results from the proliferation of different sources. Traditionally, investments have been categorized as either direct or portfolio investments. Over the years there has been a steady evolution of new forms of investment.

According to Maqbool, Maaida and Sofia (2010), in the process of investigating the economic performance of a country, one of the key determinants of economic growth is investment. According to the United Nation (UN, 2005), investment climate can be explained as access to basic physical infrastructure such as electricity, telephone, water and roads; access to information and advisory services; higher labor productivity; efficient tax administration and tax rates; access to finance; availability and affordability of urban land; business regulations and trade facilitation services, among other elements.

Investment is an important component of aggregate demand and a leading source of economic growth. Change in investment not only affect aggregate demand but also enhance the productive capacity of an economy. Investment plays an essential and vital role in expanding the productive capacity of the economy and promoting long term economic growth (Jongwanich and Kohpaiboon, 2008). In the long term, investment is important for improving productivity and increasing the competitiveness of an economy. Without investment, an economy could enjoy high levels of consumption, but this creates an unbalanced economy. Public resources, whether from developing-country governments or from ODA are not enough to address the development challenges and goals faced by poor countries. Thus, private sources of investment are required (United Nations, 2002).

Increasing private investment levels is fundamental to poverty reduction. Collier (2007) articulates the problem of global poverty as “a total of five billion people who are already prosperous, or at least are on track to be so, and one billion who are stuck at the bottom”. He analyzes this category of the world’s poorest people as the “”Bottom Billion” and notes that the real challenge of development is that there is a group of countries at the bottom that are falling behind, and often falling apart. On current trends, many developing countries such as Kenya did not achieve the Millennium Development Goals (MDGs) resulting to a need to find new, more effective means of reducing poverty. This has resulted to a consequently growing demand among developing countries and their development partners for greater guidance on how to promote faster, more inclusive patterns of economic growth that will help make substantial inroads into sustainably reducing poverty and this is one of the key pillars adopted in the Strategic Development Goals 2030 (United Nations, 2015).

Without private investments, developing countries are unable to spur the growth of their economies or to sustain the reduction of poverty over the long-term. A high rate of investment is one of the key differentiating features of countries that have sustained high rates of growth. In high-growth countries, investment typically exceeds 25% of GDP, whereas it struggles to reach 20% in low-growth countries. Where investment is low, the productive capacity of the economy fails to increase. This results in lower rates of growth and job creation, and fewer opportunities for the poor to improve their livelihoods.

The mobilization of private investment is essential for development. While public expenditure – whether by developing country governments or through official development assistance (ODA) provided by developed country governments – is required, it has become clear that the demand for finance outstrips that which the public sector can provide. The Report of the International Conference on Financing for Development (United Nations, 2002), known as the Monterrey Consensus, recognized that a substantial increase in ODA and other resources – including private investment – will be required if developing countries are to achieve the internationally agreed development goals and objectives.

Mobilizing investment in developing countries can contribute directly to economic growth. The challenge for developing countries and their development partners is to identify the best ways to influence the conditions that lead to increased levels of private investment. It should be noted that enhancing private investment should not focus on attracting foreign direct investment (FDI) alone. While FDI to developing countries of which Kenya is an example has increased significantly in the last 20 years, the bulk of investment is domestic (World Bank, 2004a). Thus mobilizing domestic savings and creating conditions that stimulate greater levels of local private investments are consequently critical ingredients for success especially in many of the poorest countries.

Indeed, increased levels of domestic private investment should contribute to attracting more foreign investment as well.

Private firms are critical actors in the quest for investment and economic growth. Whether they are large or small, domestic or foreign, private firms are at the heart of the development process. "Driven by the quest for profits, they invest in new ideas and new facilities that strengthen the foundation of economic growth and prosperity" (World Bank, 2004a, p.1). The DAC Orientations for Development Co-operation in Support of Private Sector Development, published in 1995, define the private sector "as a basic organizing principle for economic activity where private ownership is an important factor, where markets and competition drive production and where private initiative and risk taking set activities in motion." It is markets, through the process of competition, that determine what is produced and consumed. Thus, while private firms are key investors, they operate within markets that set the rules of the game; these rules determine the choices investors make, balancing perceived risks and rewards.

Thus the investment climate determines the contribution private firms make to economic growth and prosperity. However, it is public sector policies and behaviors that play a key role in shaping conditions investment. Thus, improving government policies and behaviors that shape the investment climate drives growth. Private sector development requires the development of markets that comprise the interplay between public policies, laws, regulations, norms, etc., as well as private actors. These elements create a market in which private investors make their choices (Sida, 2003).

Closer home, in Kenya, a thriving private sector is central to achieving the objectives of Kenya's Vision 2030. In fact the success of Vision 2030 is largely premised on the role of the private sector in achieving the countries growth objectives and, thereby, creating greater wealth and employment opportunities. Six priority sectors were targeted in Vision 2030 to raise the national GDP growth up to 10% by 2012. These sectors are: tourism; agriculture, livestock and fishing; wholesale, retail and international trade; manufacturing; business process outsourcing; and financial Services. In addition, the Government prepared a Private Sector Development Strategy (PSDS) 2006-2010 and Private Sector Development Strategy Implementation Plan (PIP) 2007-2012 to support the development of the private sector. The PSDS and PIP were focused, primarily, on addressing the poor business environment, and improving the competitiveness and productivity of the private sector (especially micro, small and medium enterprises).

This study looks at the factors that can be employed to strengthen a vibrant domestic investment market in an effort to enhance economic growth in Kenya.

1.2.Statement of Study Problem

In general, the private sector in Kenya, also referred to as the domestic investment market in this paper, is vibrant and in good health. Kenya is a promising place to do business, with growing markets and good opportunities. Positively, the business climate has improved over the last decade. Frustratingly, it is the same recurrent challenges that prevent the private sector from reaching its full potential: political uncertainty, corruption, infrastructural deficits, and an untapped informal sector.

According to African Development Bank (2015) Gross Development Product growth in Kenya in 2014 was at 5.3%. In 2015, the GDP for the year is estimated to be about 6.3% in 2011 the country's GDP stood at 7.6% dropping to 4.6% in the years 2012 and 2013. According to the Central Bank's Economic monthly review of November 2014, growth in the past two years was mainly supported by expansion in construction, manufacturing, finance and insurance, information, communications and technology, and wholesale and retail trade. Notably, there has been little growth from this range over the past ten years.

Accordingly to the African Development Bank Report on *The State of Kenya's Private Sector,* (2013) the following are the key challenges facing the country's economic environment and subsequently stifling the private sector:

Kenya has a disruptive political cycle, with a mediocre, but improving, business climate. Political uncertainty, especially around elections, and the associated volatility is arguably the main handbrake on sustained private sector investment and growth.

Macro-economic volatility has been cited as a challenge to doing business. The cost of capital is high and a variable exchange and inflation rate is challenging to business operations and planning.

Kenya is also characterized by a low level of foreign direct investment (FDI) an anomaly for a pre-eminent regional market. This FDI status quo could also be a function of company and land ownership restrictions, a closed and protective political economy with strong local vested interests and anticompetitive behaviour by dominant firms. However, early indications are that FDI might be increasing, primarily driven by opportunities in oil.

There is a reported mismatch of skills of those leaving the education sector and those attractive to the private sector, particularly in new and fast-paced industries such as ICT.

The private sector is further bifurcated between the formal sector and mostly informal MSE sector with weak linkages between the two. The informal sector is poorly understood and documented, and is not supported by coherent government action.

In addition, there is a perception by business that the pace of government reform is too slow and the administration is characterized by fragmentation and duplication of effort, compounded by unnecessary bureaucracy and red tape (e.g. the burden of inefficiencies within the tax system).

Lastly, the impact on business of devolved government is still unclear but may be mildly negative over all, at least during the transition period (there is little data available to suggest positive output during this period). The ability to maximize county level opportunities and foster a business friendly environment will greatly depend on the vision and capability of county leadership, which is still untested.

In addition, the government of Kenya seems to have a leaning on public investment (tax revenue & foreign debt) as its main source of Capital. Whereas this has been the main source of funding in Kenya for decades, it has had little or no profound effect in improving the lives of Kenyan citizens. The adage goes; *strength and growth come through continuous effort and struggle.* It is against this background that this study was conducted. It seeks to look into change that can be effected in the political, economic and social realm that will create a healthy environment that promotes a vibrant domestic investment market essential to strong economic growth.

1.3. Objectives of the Study

1.3.1. General Objective

The main objective of this study is to determine the factors that strengthen a vibrant domestic market for economic growth in Kenya and recommend ways in which these factors can be enhanced in an effort to increase private sector investment that promotes economic growth.

1.3.2. Specific Objectives

The study seeks specifically:

1. To examine the macro-level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya;
2. To determine the meso- level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya;
3. To analyze the micro-level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya;

1.4.Research Questions

1. Do macro- level factors strengthen a vibrant domestic investment market for economic growth in Kenya?
2. Do meso- level factors strengthen a vibrant domestic investment market for economic growth in Kenya?
3. Do micro- level factors strengthen a vibrant domestic investment market for economic growth in Kenya?

1.5. Justification of the Study

This study hopes to highlight some insights and recommendations on what can be done to strengthen the private sector for purposes of promoting economic growth in Kenya. This information shall proof useful to policy makers (Government of Kenya), development partners, and the private sector itself.

This study will be beneficial to the Government of Kenya since it will help them understand how vital it is to look into private investment as an alternative drive to pubic investment in promoting rapid economic growth in the country. This will also be helpful to various government ministries such as the Ministry of Industrialization in adopting a robust drive to promote private investments in the country. It will highlight some initiatives in which the governments can fast-track. These will include computerization of government processes to increase transparency and close avenues for corrupt behavior amongst other recommendations.

The study will also be useful to development partners as it will discuss the current framework in operation which the researcher hopes will provide some informative practices to development partners. The study also makes recommendations that development partners can contribute to such as sharing global best practice on policies and associated implementation around declaring interests transparently and managing conflicts of interest in relation to politician/public servant participation in business; and whistle-blower protection mechanisms.

The study will also benefit the private sector by making recommendations on promoting vibrant domestic private investments. This study will hopefully influence an adjustment of their strategic initiatives to look more outward beyond the bottom line which in turn will impact the lives of Kenyans. The study hopes to invoke a more informed, involved and concerned private sector.

1.6. Organization of the Study

Chapter One

This chapter, also referred to as the proposal of the study, presents the background to the study, the statement of the study problem, the objectives of the study; the research questions; and the justification for the study.

Chapter Two

Chapter 2 provides a literature review of the existing empirical knowledge relating to the problem statement. It will synthesize the existing theoretical and empirical knowledge.

Chapter Three

This chapter will provide an outline on how the study will be conducted. It will further highlight details of the study site, the research design, the study population and sampling procedures, data collection methods and procedures, the methods of data analysis, ethical considerations and the limitations and delimitations of the study.

Chapter Four

This chapter will outline the findings of the study structured along the study objectives.

Chapter Five

The discussions, conclusions and recommendations chapter will present the interpretation of the study's core findings as well as integrate the existing empirical knowledge to the theoretical frame underpinning the study. Further, it will present the conclusions drawn by the study as well as the policy recommendations offered, if any.

CHAPTER TWO

2.0. Introduction

This chapter reviews some past studies conducted on the roe of private investments in enhancing economic growth from a global, regional and country specific (Kenya) perspective. Literatures covered include books and articles from library sources and texts with the relevant material, internet sources and other e-resource database, scholarly magazines and newspapers on the same. The variables explored are: The Macro-level, Meso-level and Micro-level factors that strengthen a vibrant investment market. The study then gives an insight on the direct impact the foregoing variables have had in the researcher's geographic scope, Kenya. The researcher lastly then looks at the gaps found as well as attempts to describe how the same are to be filled.

2.1. Background

This section aims to underpin the need for looking towards alternative modes of enhancing economic growth over and above the re-known statistical contributions of economic development. Premised on one of the defining characteristics of the word in the twenty-first century is inequality between nations, this section aims to highlight some glaring statics most notable of which is that in spite of widespread progress in development, and growing wealth in the world economy, more than one billion people (approximately 16% of the world population) still live in extreme poverty.

According to Aristide, (1994) the world is like a table. Twenty percent live on the table and eighty percent survive underneath the table. Our work cannot be to move a few from under the table onto the table, or vice versa. Our task is to move the table, to change its position if necessary, and all to sit around the table.

For the poor, livelihood choices- in employment and entrepreneurship are constrained by a wide range of interdependent obstacles ranging from geographic isolation to market failures, weak institutions and political exclusion. He suggests that when we think about eradicating poverty, we should think broadly about creating economic opportunity. Economic opportunity in terms of definition is a combination of factors assets, productivity tools, markets and enabling conditions that enables the poor to manage their assets in ways that generate incomes and options.

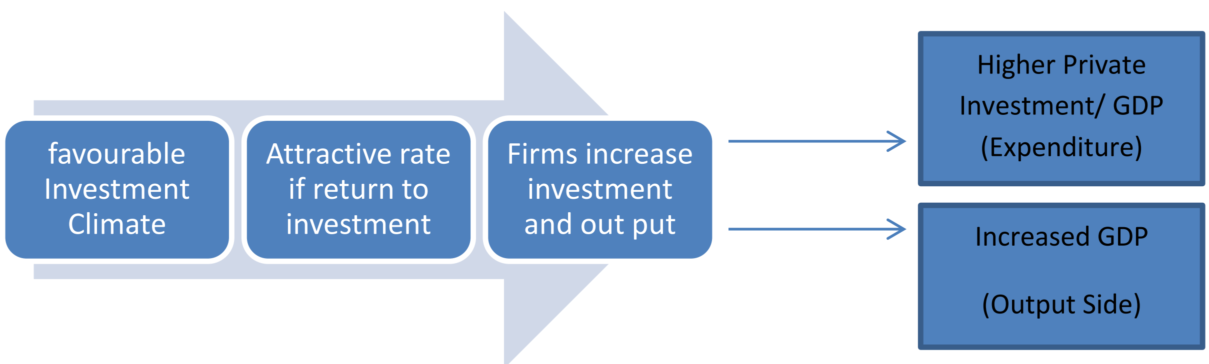
Expanding economic opportunity is arguably where the private sector has the greatest potential to create where Porter and Kramer (2006) have called 'shared value' or value for both business and society. Private sector activity cab create jobs and enterprenual opportunities, cultivate inter-firm linkages, enable technology transfer, build human capital and physical infrastructure, generate public revenue for the government and offer a variety of products and services to consumers and other businesses, including those operating in what has been termed as the "base economic pyramid" (Prahaad & Staurt, 2002). Each of these impacts has multiple effects to economic development. If supported by responsible business practices, more inclusive business models and financial, technical, institutional or policy innovations, they can make major contributions to poverty reduction and serve core business interests at the same time.

One of the undisputable stylized facts of economic development has been the wide disparity in the economic performance of countries across the world. Economic growth depends essentially on a country's ability to invest and make efficient and productive use of its resources. In this regard, the role of private sector is important both in terms of its contribution to the quantity of Gross Domestic Investment and its ability to allocate and employ resources efficiently.

The private sector is increasingly being recognized as a major force in development. The private sector drives economic growth through investment, employment and business creation, innovation and knowledge transfer, and other multiplier effects from their operations and activities. According to the DAC Orientations for Development Co-operation in Support of Private Sector Development, (1995) define the private sector "as a basic organizing principle for economic activity where private ownership is an important factor, where markets and competition drive production and where private initiative and risk taking set activities in motion." It is markets, through the process of competition, that determine what is produced and consumed. Thus, while private firms are key investors, they operate within markets that set the rules of the game; these rules determine the choices investors make, balancing perceived risks and rewards.

Figure 2.1

How Investment Climate Affects Growth



The general idea that the private sector is central to development is not a new one. Indeed, the World Bank's 1989 World Development Report was entitled 'Financial Systems and Development'. Over a decade later, the Commission on the Private Sector and Development issued its 2004 report to the United Nations Secretary-General, 'Unleashing Entrepreneurship: Making Business Work for the Poor', while the theme of the 2005 World Development Report was 'A Better Investment Climate for Everyone'. Various development initiatives and trends throughout the 1990s and early 2000s also focused at times successfully and at others less so — on issues ranging from international trade liberalization and market access, to infrastructure development and technological innovation in areas like agricultural production.

The Group of Twenty (G20) has in the recent past addressed the role of the private sector in development, particularly from the standpoint of resources. At the 2011 G20 summit in France, leaders welcomed a report that had been prepared for them by Bill Gates on financing for development. In so doing, they recognized "the importance of the involvement of all actors, both public and private, and the mobilization of domestic, external and innovative sources of finance."(Cannes Summit, Final Declaration, 2011). In addition, the Busan Summit also emphasized the importance of private institutions and effective policies recognizing the central role of the private sector in advancing innovation, creating wealth, income and jobs, mobilizing domestic resources and in turn contributing to poverty reduction. (OECD, Busan Partnership for Effective Development Co-operation, 2011)

Closer home, Africa has experienced high and continuous economic growth in the past decade, prompting analysts to argue that the continent has reached a turning point in its development history and is poised to play a more significant role in the global economy in the twenty-first century. The average annual growth rate of real output increased from 1.8 per cent in the period 1980–1989 to 2.6 per cent in 1990–2000 and 5.3 per cent in the period 2000–2010. (UNCTAD Report, 2014)

Research studies indicate that if Africa is to make significant progress in reducing poverty, it will have to sustain average growth rates of about 7 per cent and above in the medium to long term, and this will require investment rates of 25 per cent of gross domestic product (GDP) and above (Clarke, 2013; ECA, 1999). Over the past two decades, the average investment rate in Africa has hovered around 18 per cent, which is well below the 25 per cent threshold, and so it is not surprising that the continent has not achieved the 7 per cent average growth rate required to make significant progress in reducing poverty. This fact suggests that the slow progress in realizing Africa's development goals over the past decade is in part a consequence of the fact that the continent has not made the level of investments required to achieve these goals.

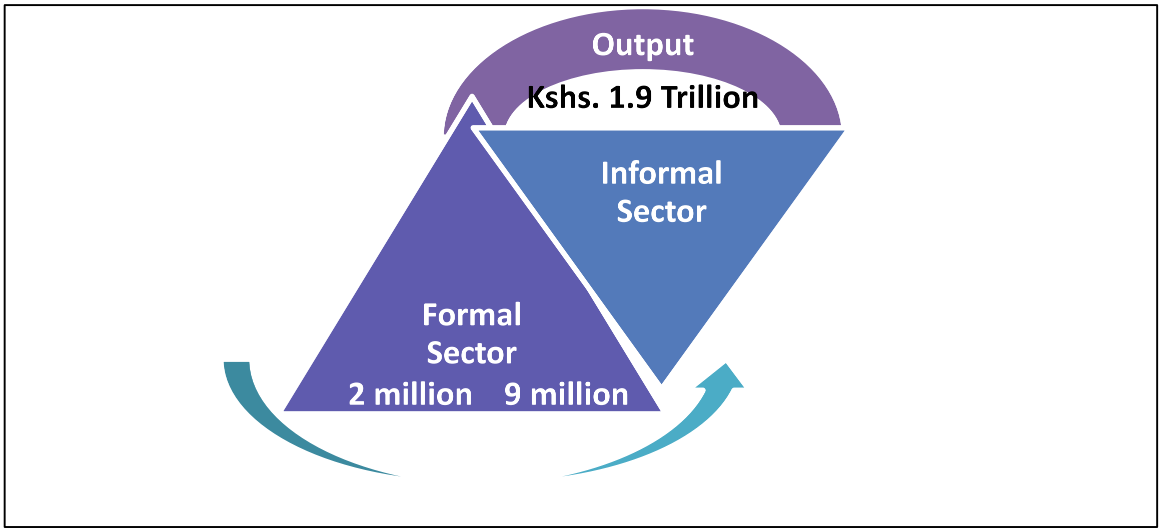
African Governments have recognized the challenges posed by the current pattern of growth and have renewed their political commitment to economic transformation. At the continental level, economic transformation is one of the key priority issues in the draft strategic plan of the African Union entitled Agenda 2063. It is also one of the four priority issues identified by African countries in the African common position on the post-2015 development agenda. (UNCTAD, 2014)

The United Nations Conference on Trade & Development (2012a) identified investment and technology as two key drivers of structural transformation. While investment is important to the development process, it should be noted that it is a necessary and not a sufficient condition for economic transformation and sustained growth. In this regard, if African Governments want investment to play an effective role in supporting economic transformation and development, the focus should not be solely on boosting the quantity of investment to levels deemed necessary to meet national development goals. They also have to address two related issues. The first is how to ensure that investment is allocated to strategic or priority sectors, particularly infrastructure, agribusiness and manufacturing. Increasing investment and not allocating it to sectors crucial to achieving Africa's economic transformation agenda will be counterproductive. The second issue, which is the concern of this paper, is that African Governments have to address how to improve the quality or productivity of investment. This is important, particularly in the area of public investments, to avoid resource waste and achieve maximum impact. Low efficiency of public investments weakens the link between public and private capital and also reduces the returns to private investments, making it more challenging to attract such flows. Therefore, improving the productivity of investment should be part of efforts to boost investment and use it in support of economic transformation in Africa.

In Kenya, the private sector is well developed and large by sub-Saharan and regional standards and plays the leading part in the Kenyan economy. The health of the economy and benefits to citizens are directly correlated to the health of the private sector. In addition, the private sector has been growing and continues to grow, impressively at times, though on balance remains below full potential. A number of infrastructure, regulatory, security and political challenges persist in restraining private sector growth. In addition, the structure of the private sector is noticeably split into two parts: a formal, large business sector which is relatively healthy and productive, and a massive, informal small business sector that is poorly understood and supported, yet which employs almost nine out of ten workers. Links between the formal and informal sectors are very weak – and initiatives that bridge the gap should be a priority (AFDB, 2013).

Figure 2.2

The dualistic structure of the Kenyan economy is apparent, with a poorly quantified informal sector.



Genesis analytics, 2012

In terms of diversification, the formal private sector is well diversified across primary, secondary and tertiary activities, and the tertiary sector is impressive for a developing country. Exports, however, are dominated by a handful of globally competitive agricultural products, with limited value addition. The private sector also comprises the following sectors: agriculture, manufacturing, trade, tourism, transport and communication, and financial services account or over 80% of the private sector's contribution to total GDP. Agriculture remains the most important sector in terms of contribution to private sector GDP and employment, though the importance of agriculture in terms of its contribution to GDP is declining relative to other sectors, while that of manufacturing remains relatively stagnant. Growth in the private sector is increasingly driven by trade, transport, ICT and financial services (KNBS Economic Survey, 2012).

2.2. Review of Past Studies & Theoretical Perspectives

Private firms are at the forefront of the development process, as they contribute to improving standards of living by providing more than 90 percent of the jobs, supplying goods and services, and representing the main source of tax revenues. In turn, the contribution that firms make to society is determined by the quality of the investment climate (World Bank 2004b). Furthermore, social equity and inclusion is critically influenced by the investment climate. The notion of a "level playing field," where economic players have equal opportunities to succeed is a fundamental focus of investment climate interventions. Barriers to dynamic and well-functioning markets may benefit privileged economic participants at the expense of competitors, potential entrants, and consumers.

Investment is an important component of aggregate demand and a leading source of economic growth. Change in investment not only affect aggregate demand but also enhance the productive capacity of an economy. The investment plays an essential and vital role in expanding the productive capacity of the economy and promoting long term economic growth (Jongwanich and Kohpaiboon, 2008).

According to the United Nation (UN, 2005), investment climate can be explained as access to basic physical infrastructure such as electricity, telephone, water and roads; access to information and advisory services; higher labor productivity; efficient tax administration and tax rates; access to finance; availability and affordability of urban land; business regulations and trade facilitation services, among other elements. According to Maqbool, Maaida and Sofia (2010), in the process of investigating the economic performance of a country, one of the key determinants of economic growth is investment. Moreover, most of the countries that grow rapidly invest a considerable fraction of their Gross Domestic Product (GDP). In contrast, countries that develop slowly are those that invest slowly in their economies and remain poor (Solow, 1956).

Increasing private investment levels requires an understanding of the conditions that influence the flow of domestic and foreign investment – otherwise known as the "investment climate". This refers to "the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand (World Bank, 2004a). There are three key elements of the investment climate. The first of these is the cost of investment, which can be affected by many factors. Some of the most common, are the regulatory burden and red tape, taxes, levels of corruption, infrastructure services, labour market regulation, and the cost of finance. The second element in the investment climate is risks. Policy predictability, property rights, and contract enforcement affect investment risks. The third element is barriers to competition. This is affected by the regulations controlling business start-up and bankruptcy, competition law, and entry to finance and infrastructure markets. Thus, the components that comprise the investment climate cover a broad spectrum of development interests. Countries wishing to encourage positive investment decisions need to consider the risks, costs and rewards that influence these decisions and find ways to ensure the market for private investment performs competitively. While growth depends on private investment, private investment depends on a sound infrastructure and adequate human capital, both of which depend on an adequate level of national savings. Thus, aid-financed infrastructure development and human capital investments can make a vast difference in promoting investment, particularly foreign direct investment (United Nations Millennium Project, 2005)

This paper seeks to highlight the role to which a strengthened private domestic investment market would play in enhancing economic growth. Improving the investment climate has been and remains a key objective of countries in their pursuit of economic growth. It looks at this under the following three pillars:

- The macro-level factors that can strengthen a vibrant domestic investment market
- The meso-level factors that can strengthen a vibrant domestic investment market
- The micro-level factors that can strengthen a vibrant domestic investment market

2.2.1. The Macro-Level factors that can Strengthen a Vibrant Domestic Investment Market for Economic Growth

This section critically reviews macro-level factors that strengthen a vibrant domestic market for economic growth. It seeks to highlight some approaches taken worldwide based on theoretical perspectives and practice that can improve the macro economic and political framework to generate greater levels of private investment for pro-poor growth.

By way of summary introduction, Macro stability refers to the political, economic and social factors that promote or deter investment by making future rewards more certain or uncertain and thus promote or undermine the value of assets. Studies show that the greater the level of instability, the lower the rate of private investment and growth and vice versa. Conversely, stability also decreases the risk of firms going bankrupt, suffering slower growth or contracting if political conflict ensues. Fiscal and monetary policies that reduce inflation, polices that help to establish a competitive exchange rate, and political and social stability are needed to sustain high rates of investment and growth.

For purposes of a well-organized paper, we shall evaluate the literature and theoretical perspectives under the following sub headings:

i) Political Factors
ii) Economic Factors

i) Political Factors

The idea that private investment can be sensitive to political changes has long been discussed, yet existing empirical works have focused on political uncertainty, rather than political partisanship.

In 1981, the year in which Francois Mitterrand was elected as the 21st President, private investment fell sharply in France. Many observers argued that the left-wing political platform of the winning coalition - including widespread nationalizations, higher minimum wage, wealth taxes and substantial expansion of workers' rights - had prompted a crisis of business confidence which halted capital accumulation (Lewis, 1983). As a matter of fact, private investment recovered only in 1983-1984, after Mitterrand made his famous U-turn, completely reversing his initial economic policy. Mitterrand's first election was not a completely isolated case. In several other instances capitalists were suspected of reacting adversely to a government they did not like. Allende's cabinet in Chile is another classical example – and a dramatic one – of a left-wing Government which faced a strong negative reaction in terms of capital flights and falling private investment (Alaluf, 1971). But even in the US, where arguably no major political party is historically hostile to capital, Roosevelt's attorney general Robert Jackson went as far as to denounce that the 1937 investment slump was the result of an intentional 'capital strike' against the New Deal, in his words "a strike against the government - a strike to coerce political action" (Jackson, 1938).

Theoretically, the idea that entrepreneurs tend to reduce investment when faced with institutional changes that reduce their social and economic power and their control over the workforce has long been suggested (Bowles and Gintis, 1986; Przeworski and Wallerstein, 1988).

It could be argued, however, that profit maximizing firms should only look at expected quantities demanded (and, according to neoclassical theories, to the prevailing interest rate) in order to establish their desired investment level. Indeed sensible arguments can be brought forward to deny that in an established capitalist economy shifts in political power can exert any relevant influence on private investment dynamics. A counter-argument, as expressed by Przeworski, is that "measures of nationalization, distribution of land, and monopolization of credit and foreign exchange by the state threaten the very institution of private profit. Under such circumstances, rational private capitalists will not invest." (Przeworski, 1985 p.45)

Przeworski and Wallerstein (1988) proposed a formalization of the theory according to which any attempt to redistribute income away from the owners of capital would produce a fall in private investment. According to their *Stylized Model*, the theory is not necessarily true in a static sense: there can be pro-labour policies that, once in place, do not reduce private investment; nevertheless, even in these cases, investment would be reduced during the period in which these policies are anticipated but not yet implemented. A similar conclusion is reached through a very different reasoning by Keynes. In his general theory, he links the influence of political factors on investment to the role of business confidence:

> *"individual initiative will only be adequate when reasonable calculation is supplemented and supported by animal spirits (...). This means, unfortunately, not only that slumps and depressions are exaggerated in degree, but that economic prosperity is excessively dependent on a political and social atmosphere which is congenial to the average business man. If the fear of a Labour Government or a New Deal depresses enterprise, this need not be the result either of a reasonable calculation or of a plot with political intent; – it is the mere consequence of upsetting the delicate balance of spontaneous optimism*" (Keynes, 1936 Ch. 12).

In summary, we can identify three main arguments justifying an influence of political changes on private investment. The first is based on rational calculation, stating that it can be optimal, for profit-maximizing entrepreneurs, to reduce investment when they expect policies that would redistribute income away from capital (Przeworski and Wallerstein, 1988). A second possible channel of influence would act, as envisaged by Keynes, through business confidence or 'animal spirits'. A third explanation is that 'Capital Strikes' may happen: capitalists would – implicitly or explicitly – organize themselves to boycott a Government that is seen as not acting in their interest, to weaken it and/or force it to change policy orientation, and withdrawal of investment would be part of this strategy. It is fair to note that this last hypothesis, while sometimes mentioned in the public debate, is of uncertain theoretical foundations: according to the literature reviewed, no work has explored theoretically when and how such an agreement could be organized and enforced.

In addition to the foregoing, some studies (Barro (1991); Alesina, et al. (1992) and Mauro (1993)] investigate the relationship between political instability and investment. However it is hard to define political instability. Many approaches have been used in this regard. Two of them are worth mention here. In the first approach, political instability is defined as executive instability i.e. propensity to observe government changes which is associated with policy uncertainty for example threat to property rights. Second approach is based on socio-political unrest that is measured by some index of variables related to such unrest.

ii) Economic Factors

Economic factors for purposes of this section refer to factors that enhance economic security. A secure economic environment is arguably a key factor for promoting private investment and growth in developing countries (Dhone & Kapur, 1997). Improvements in economic security contribute to the rise of private investment by decreasing downside uncertainty on the return to investment. Security factors that decrease the uncertainty on the returns to investment across capital goods also directly bear on growth by enhancing efficiency of resource allocation, independent of their effect on private investment.

Since the end of World War II, we have been experiencing a worldwide struggle for the improvement of the living conditions in the so called developing countries. There are certain theoretical explanations that can elucidate the vital role economic security plays in contributing towards development.

The *Theory of Balanced Growth* advanced by Ragnar Nurkse (1907–1959) sees the main obstacles to development in the narrow market and, thus, in the limited market opportunities. Nurkse's theory discusses how the poor size of the market in underdeveloped countries perpetuates its underdeveloped state. Nurkse has also clarified the various determinants of the market size and puts primary focus on productivity. According to him, if the productivity levels rise in a less developed country, its market size will expand and thus it can eventually become a developed economy.

Conversely, Hirschman (1969) advances a *Theory of Unbalanced Growth*. He proposes that the real bottleneck is not the shortage of capital, but the lack of entrepreneurial activities. Potential entrepreneurs are hindered in their decision making by institutional factors: either group considerations play a great role and hinder the potential entrepreneur, or entrepreneurs aim at personal gain at the cost of others and are thus equally detrimental to development. He notes that undeveloped countries start from a position that reflects their previous investment decisions and development. Accordingly, at any point in time desirable investment programs that are not in themselves balanced investment packages may still advance welfare. Unbalanced investment can complement or correct existing imbalances. Once such an investment is made, a new imbalance is likely to appear, requiring further compensating investments. According to Hirschman, not a balanced growth should be aimed at, but rather existing imbalances- whose symptoms are profit and losses- must be maintained. Investments should not be spread evenly but concentrated in such projects in which they cause additional investment because of their backward and forward linkages without being too demanding on entrepreneurial abilities.

Lastly, the *Big Push Theory* by Rosenstein Rodan, which is the key theory the researcher wishes to underpin under this section emphasizes that underdeveloped countries require large amounts of investments to embark on the path of economic development from their present state of backwardness. This theory proposes that a 'bit by bit' investment program will not impact the process of growth as much as is required for developing countries. Rosenstein-Rodan distinguishes between three different kinds of indivisibilities and external economies. One, indivisibilities in the production function, especially the indivisibility of the supply of social overhead capital; two, indivisibility of demand; and three, indivisibility in the supply of savings. Let us analyze the role of these indivisibilities in bringing economic development.

<u>Indivisibilities in the Production Function:</u> According to Rosenstein-Rodan, indivisibilities of inputs, outputs or processes lead to increasing returns. He regards social overhead capital as the most important instance of indivisibility and hence of external economies on the supply side. The services of social-overhead capital comprising basic industries like power, transport, and communications are indirectly productive and have a long gestation period. As such, they require a "sizeable initial lump" of investment so excess capacity is likely to remain in them for some time. They also excess an irreducible minimum industry mix of different public ties, so that an

underdeveloped country will have to invest a certain percent of its total investment in these channels.

Thus, social overhead capital is characterized by four indivisibilities, Firstly it is irreversible in time and, therefore, must precede other directly productive investments. Second, it has a minimum durability, making it very lumpy. Third, it has a long gestation period. Last, it is an irreducible minimum industry mix of different kinds of public utilities. These indivisibilities of supply of social overhead capital are all of the principal obstacles to development in underdeveloped countries. Therefore, a high initial investment in social overhead capital necessary in order to pave the way for quick-yielding directly productive investments

<u>Indivisibility (or complementarity) of demand:</u> Developing countries are characterized by low per-capita income and purchasing power. Markets in these countries are therefore small. In a closed economy, modernization and increased efficiency in a single industry has no impact on the economy as a whole since the output of that industry will fail to find a market. A large number of industries need to be set up simultaneously so that people employed in one industry consume the output of other industries and thus create complementary demand.

To illustrate this, Rosenstein Rodan gives the example of a shoe industry. If a country makes large investments in the shoe industry, all the disguisedly employed labor from the other industries find work and a source of income, leading to a rise in production of shoes and their own incomes. This increased income will not be expended only on buying shoes. It is conceivable that the increased incomes will lead to increased spending on other products too. However, there is no corresponding supply of these products to satisfy this increased demand for the other goods. Following the basic market forces of demand and supply, the prices of these commodities will rise. To avoid such a situation, investment must be spread out amongst different industries.

The situation may be different in an open economy as the output of the new industry may replace former imports or possibly find its market by way of exports. But even if the world market acts as a substitute for domestic demand, a big push is still needed (though its required size may now be reduced due to the presence of international trade).

Indivisibility in the supply of savings: High levels of investment require a corresponding high level of savings. We cannot always rely on foreign aid as the huge levels of investments in the different sectors need to be made not only once, but multiple number of times. Hence domestic savings are a must. But in an underdeveloped economy, this is a challenge due to the low income levels. Marginal rate of savings needs to be increased following the rise in incomes due to higher investment.

Having analyzed some of the relevant theoretical studies, empirical studies such as Bleaney (1996) and Fischer (1993) conclude that macroeconomic stability matters for sustained growth. More recently, Sirimaneetham and Temple (2009) introduce a new index of the extent of macroeconomic stability and conclude that growth is positively associated with macroeconomic stability in a sample of 70 developing countries. In a literature review about the importance of macroeconomic stability, Lopez (2005) concludes that macroeconomic stability is critical for pro-poor growth and that instability depresses the growth rate by 2 percentage points. Mlambo and Oshikoya (2001), using a sample of eighteen African countries for the period 1970 to 1996 find that fiscal, financial and monetary policy, macroeconomic uncertainty and trade variables are significant determinants of private investment in Africa.

On the basis of theoretical and empirical considerations, Servén and Solimano (1992) suggest that in developing countries, private investment is determined mainly by level of domestic output, the real interest rate, public investment, credit available for investment, size of the external debt, the exchange rate, and macroeconomic stability.

The neoclassical theory of investment, based on the work of Jorgenson (1963), treats the value of the capital stock desired by a competitive enterprise as a positive function of its output level. Accelerator theory also suggests that as demand or income increases in an economy, so does the investment made by firms. Furthermore, when demand levels result in an excess in demand, firms increase investment to match demand. The real interest rate is also considered an important variable in determining the level of investment by neoclassical theory. A negative relationship is expected theoretically because of increases in the interest payable being disincentive to investment. However McKinnon (1973) and Shaw (1973) suggest that there could positive relationship between investment and real rate of interest rate, because higher real rate of interest would increase savings, volume of domestic credit will increase as a result, and equilibrium investment be higher. This hypothesis, known as McKinnon and Shaw hypothesis, is based on assumption that quantity of financial resources is a main constraint on investment rather than cost financial resources.

In the developing countries, the public sector generally plays a large part in economic activity through public sector investment. The public sector investment may have “crowding out” or “crowding in” effects on private-sector investment. The other important factor that affects the private sector investment is credit constraint due to underdeveloped capital markets and financial intermediation in developing economies. Because of the absence of long-term financing and the future market, bank loans and external borrowing may be the only sources of credit available for private sector investment financing.

As such, there seems to be widespread consensus in the literature that macro-economic management should give high priority to fiscal and monetary stabilization (Sirimaneetham and Temple (2009); Lopez (2005)). It should not allow inflation to reach high levels, maintain a reasonably competitive, flexible exchange rate policy reflecting market forces, and hold a sustainable fiscal position. However, the evidence on what levels of inflation and fiscal deficits are growth-restricting is inconclusive. The literature also argues that a reasonable competitive exchange rate policy is necessary for growth of firms in the export sector. Hausmann et al. (2005a) show that growth accelerations tend to be associated with real depreciations and Eichengreen (2008) suggests that although the exchange rate cannot sustain economic growth in and of itself, an appropriate exchange rate policy can be an important enabling condition for a country seeking to capitalize on opportunities for growth. A competitive exchange rate also has the impact that imports are getting more expensive, which could stimulate local production.

Another factor that exemplifies the influence of external credit constraints on the financing of production activities is the size of the external debt. High debt levels divert the resources previously used to finance local companies toward service payments and charges being transferred abroad. Exchange rate also plays a crucial role in investment decisions by private entrepreneur; especially in this globalized world. A change in currency value changes the real costs of purchasing imported capital goods. The profitability of the private sector is affected and possibly causes investment to change. Furthermore, this may result into change in real income of the economy as a whole, thus altering the production capacity. The change in exchange rate also affects the investment through sectors producing internationally traded goods, due to its impacts on competitiveness and export volumes. The other thing that is important in investment decision-making is irreversible nature of investment in capital goods (Pindyck, 1988). As many capital goods are company specific and cannot be sold at the same prices they were purchased, it means that an irrecoverable cost is attached with resale of such goods. This irreversibility may results into uncertainties which in turn have a large influence on investment decision. That is why investors are reluctant to carry out major investments, even in the prosperous environment. The adjustment cost attached depends on degree of economic stability and the credibility of public policies. This is the very reason that recent studies on private-sector investment in developing countries Greene & Villanueva, (1995); Servén and Solimano (1993) and Agosin (1994) have included the variables representing uncertainties in the investment decision making process.

2.2.2. The Meso-Level factors that can strengthen a vibrant domestic investment market for economic growth

According to the OECD, (2005) report on *Enhancing Private Investment for Development*, Meso-Level factors can be defined as comprising of:

- Policy, legal and regulatory framework, these includes: privatization policies and programs, investment policies and laws, taxation, labour policies, laws and regulations, competition laws, de-regulation/re-regulation and administrative reform.
- Restructuring of state-enterprises
- Legal systems, including: rule of law, contracts and commercial dispute resolution, property rights
- Institutional reform
- Public and corporate governance
- Infrastructure and utilities development and management
- Trade capacity building and facilitation, including: Strengthening trade-related institutions, support in trade negotiations

- Financial services, includes: Financial regulation, mobilization of domestic savings

Meso-level factors affect the institutional arrangements for private investment. Thus in order to promote a strengthened investment market, there is need for some reforms in this area so as to reap full economic benefits of private sector.

The most common meso-level development field is the policy, legal and regulatory framework. This encompasses a wide range of policy, legal and regulatory domains depending on development interests and the identified need for reform. Some of the most relevant aspects of the policy, legal and regulatory framework, include privatization policies and programs, investment policies and laws, taxation, labour policies, laws and regulations, and competition laws. It also includes deregulation/re-regulation and administrative reform. The OECD (1997) describes regulatory reform as changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. This can involve the revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

A major concern in this area is the growing levels of informality in developing countries. Informality is often linked to weaknesses in the legal and regulatory framework. In addition, weak legal and regulatory frameworks often contain biases that disadvantage the poor. Another focus is reform of the legal system, which includes governance issues such as the rule of law as well as more specific concerns such as contracts and commercial dispute resolutions and property rights.

In OECD work, “regulation” refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers. Regulations fall into three categories: economic regulations (which intervene directly in market decisions such as pricing, competition or market entry or exit); social regulations (which protect public interests such as health, safety, the environment and social cohesion); and administrative regulations (such as paperwork and administrative formalities, the so-called "red tape" through which governments collect information and intervene in individual economic decisions) (Organization for Economic Co-operation and Development, 1997).

Economic development stalls when governments do not uphold the rule of law, pursue sound economic policy, make appropriate public investments, manage a public administration, protect basic human rights, and support civil society organizations—including those representing poor people—in national decision-making” (United Nations Millennium Project, 2005). Improving governance within public and private spheres has a significant influence on private investment. In the past, development agencies tended to separate their work in governance from private investment or economic development, yet it is clear that these fields of work are related and that there are benefits to linking these interventions wherever possible. Development agencies are increasingly recognizing that improving the standard of corporate governance can have a significant impact on investment levels.

Another meso- level factor is infrastructure and utilities development and management which have been long-standing fields of development for investment. However, while the link between good infrastructure and increasing levels of private investment has become clearer, the DAC has noted that spending on infrastructure has declined in many developing countries and this has created a constraint for private investment (Hesselbarth, 2004). Resultantly, the Commission for Africa has called on development agencies to double their expenditure on infrastructure in Africa (Commission for Africa, 2005,). Growing attention has been given to improving the conditions for private investment into infrastructure development and the improvement and management of utilities – in an effort to expand available resources for infrastructure and utilities, while enhancing the sustainability of these developments. (OECD guidelines: guidelines for multinational enterprises (2000), principles of corporate governance (2004b) and guidelines on the corporate governance of state-owned enterprises (2005b)).

Another example of the meso- level factor is development interventions in trade capacity building and facilitation which have typically assisted trade-related organizations to become more effective. This is done through the improvement of trade-related laws and regulations, the capture and use of trade information, the development and maintenance of trade networks and enhancing competencies in trade negotiations. It also includes support to developing countries to improve their skills in trade negotiations. (United Nations Conference on Trade and Development and Japan Bank for International Cooperation (2005a, 2005b, 2005c).

Much of the work at the meso-level incorporates a "making markets work" perspective. This draws together all of the abovementioned development fields into a systemic model that describes the functioning of competitive markets for private sector development. (DFID (2000), Sida (2003), World Bank (2002))

In terms of theoretical perspectives, Regime Theory and Institutional Theory are relevant to explain the place of meso-level factors in promoting domestic investment that enhances economic growth. *Regime Theory* is defined by Stephen Krasner (1982) as a set of explicit or implicit principles, norms, rules, and decision making procedures around which actor expectations converge in a given issue-area. This definition is intentionally broad, and covers human interaction ranging from formal organizations (i.e., OPEC) to informal groups (i.e., major banks during the debt crisis). Note that a regime need not be composed of states. Keohane and Nye, (1977) define regimes as sets of governing arrangements that include network of rules, norms and procedures that regularize behavior and control its effects.

Within regime theory, because regime theory is by definition a theory that explains international cooperation (i.e., it's a traditionally liberal concept) liberal approaches prevail within the literature. Liberal interest-based approaches to regime theory argue that cooperation in anarchy is possible without a hegemon because there exists a "convergence of expectations". Regimes facilitate cooperation by establishing standards of behavior that signal to other members that they are in fact cooperating. When all states expect cooperation from the others, the probability of sustaining cooperation increases.

Whereas regime theory looks at principles, rules, norms and decision making processes in a state to state perspective, the theory can be used to explain the set-up of similar institutions a the national level This research seeks to propose that the private sector can be a crucial element in the "push for change" in the regulatory system and transparency of many developing countries. However, in a distorted environment, private activity can be thwarted, or diverted to rent-seeking behavior, undermining governance and potentially leading to a misallocation of resources. The figure below highlights the relationship between public sector reforms and private investments

Figure 2.3- Synergy between the Public and the Private Sectors

International Finance Corporation, 2011

Institutional Theory is a theory that looks into policy-making by emphasizing the formal and legal aspects of government structures. It is a widely accepted theoretical posture that emphasizes rational myths and legitimacy. Institutional theory focuses on the deeper and more resilient aspects of social structure. It considers the processes by which structures, including schemes, rules, norms, and routines, become established as authoritative guidelines for social behavior (Scott, 2004).

Multilateral development banks and bilateral development finance institutions (together in this research section called International Finance Institutions) play a significant role in supporting the private sector in developing countries. They provide critical capital, knowledge, and partnerships; help manage risks; and catalyze the participation of others. They support the kind of entrepreneurial initiatives that help developing countries achieve sustainable economic growth.

This role is becoming increasingly important for development institutions, along with more traditional aid and loan programs to governments.

Through an analysis of case studies, a number of International Financial Institutions (IFIs) have programs that focus on sustainable businesses that target poor populations—either as customers of goods or services or as employees. These programs have various names, such as Inclusive Business Models, Base of the Pyramid, or Opportunities for the Majority. The goal of these programs is to ensure that the poor participate fully in the benefits of growth and gain greater access to critical goods and services to improve their lives. Private businesses have shown increasing interest in these businesses, which can provide important growth opportunities as well as positive social impact (Jenkins and Ishikawa, 2010).

The IFIs inclusive business programs support businesses in many sectors. For example, mobile communications and mobile banking, water supply infrastructure, farmer programs, low-income housing, microfinance, distribution, and education and medical care programs. The following figure provides some examples of inclusive business model projects.

Figure 2.4

A. IDB Inclusive Model Case: Microloans and Training for Street Vendors and Other Informal Food Sellers, Brazil

• Description: One of Brazil's leading wholesale companies is offering microloans and training to help food entrepreneurs access supplies and knowledge to establish stable, profitable businesses.

• IFI Investment: $10 million loan for microloan program and $270,000 grant for the training program.

• IFI Additionality: The project provides finance and training not readily accessible.

• Results: – An estimated 55,000–90,000 micro-entrepreneurs in the state of São Paulo will participate. – Model is potentially replicable with retailers throughout the region and in other sectors

International Finance Corporation, 2011

2.2.3. The Micro-Level factors that can strengthen a vibrant domestic investment market for economic growth

While improvements at the meso level help, they are not enough to maximize the investment potential in developing countries. Strategies are also required to promote appropriate micro-level or supply-side responses to increase the capacity of local firms to take up the opportunities that arise from an improved investment climate and greater international linkages (OECD, 2004a).

Micro level factors are generally softer issues such as:

Investment promotion programs that recognize the specific constraints or barriers to investment are that often found in developing countries. This can include the design and application of investment incentives (e.g., tax incentives), risk mitigation programs, and guarantees. The OECD is developing a Policy Framework for Investment, a non-prescriptive checklist of issues for consideration by any interested governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. The Framework can serve as a reference point for investment promotion agencies and development agencies as they assist developing and transition country partners in improving the investment climate, as well as businesses, trade unions and non-governmental organizations (NGOs) in their dialogue with governments (OECD,2004a).

It also includes technology transfer which is generally counted as one of the most important channels through which foreign corporate presence can produce positive externalities in the host country. However, the literature presents mixed views of its impact. Some studies find that foreign presence has a positive impact on the productivity of domestic firms, whilst others find no evidence or a negative effect. In a detailed review of the literature, Sinani and Meyer (2004) find that most studies that use cross-section at industry and firm level often find positive spillover to domestic firms, whilst most studies employing firm level panel data find no or negative evidence of spillovers to domestic firms. Research in India (Kathuria, 2000) finds that “local firms do not benefit from a foreign presence, if this presence is measure as a share of sales, but they do benefit from having foreign capital stock available. Furthermore, when the sample is divided into scientific and non-scientific industries, spillovers from a foreign presence are found in scientific industries, but only if local firms invest in innovation activities”.

Likewise, the quality of management is essential to see if managers and firm owners have the organizational, financial and managerial abilities to manage the scaling up of a firm. However, in many developing countries the quality of the management is low. For example, low levels of financial literacy can prevent SMEs from adequately assessing and understanding different financing options and from navigating complex loan application procedures. In fact, anecdotal evidence suggests that the success of small firm lending strongly depends on having a well-trained set of loan officers who are able to assess the capital needs in the business as managers do not have proper training. In a very recent paper, Bruhn et al. (2010) study how the lack of “managerial capital” affects firm growth. After conducting a randomized control trial in Mexico, they find that consulting services have a positive effect on firms’ productivity, firm sales and profits.

2.3. Summary and Gaps to be filled by the research

Whereas it is clear that efforts have been made in the world over on ways to promote a more vibrant economic market, very little of this approaches have been applied in Kenya, at least in so far as the data reviewed so far suggests.

As earlier discussed, the domestic investment market in Kenya is in operation with notable successes. However the area has not reached its maximum potential due to the either untapped areas or challenges in the macro, meso and micro levels in the economy as noted in sections of this paper.

In the wake of a world of extremes, the poorest forty percent (40%) of the world population account for five percent (5%) of global income, while the richest ten percent (10%) account for fifty four (54%) percent. Never before has the goal of abolishing global poverty been within our reach: there are no longer any insurmountable technical, resource or logistical obstacles to achieving it (UN Development Report, 2006). This paper hopes to make significant policy considerations aiming towards advancing enhanced private sector economy in Kenya in an effort to enhance the economic growth of Kenya.

2.4. Hypothesis of the research

2.4.1. There is a positive relationship between the macro level factors in the economy in promoting a vibrant domestic investment market.

2.4.2. There is a positive relationship between the meso level factors in the economy in promoting a vibrant domestic investment market.

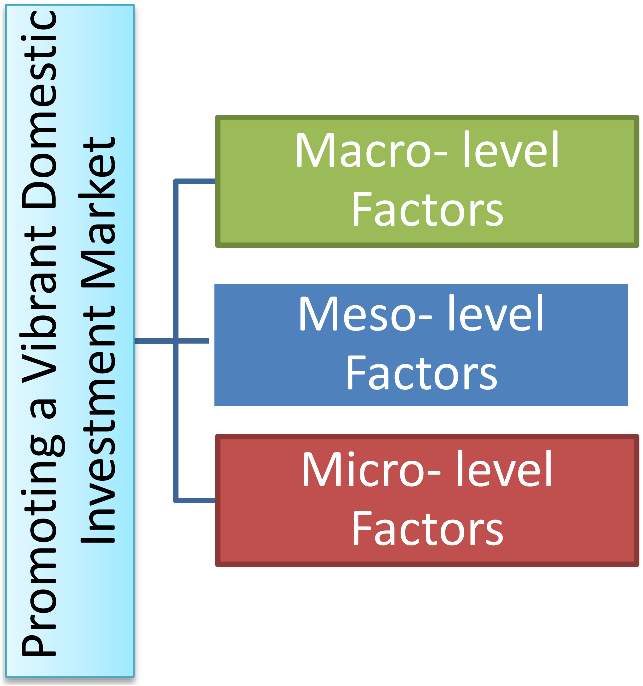
2.4.3. There is a significant relationship between the micro level factors in the economy in promoting a vibrant domestic investment market.

2.5. Conceptual Framework

In order to promote a robust domestic investment market for economic growth, macro-level, meso-level and micro-level factors have to be analyzed. The schematic diagram below provides a brief explanation of the link between a vibrant domestic investment market (the independent variable) and the various levels in the economy that can enhance economic growth (dependent variables).

Figure 2.5

Schematic diagram of the conceptual framework



CHAPTER 3

3.0. Methodology

3.1. Introduction

This chapter aims to describe how this research was conducted. It looks into the description of study site, the research design, the study population and sampling procedures, data collection methods and procedures, the methods of data analysis, ethical considerations and the limitations of the study.

3.2 Description of the Study Site

In analyzing the factors that strengthen a vibrant domestic investment market for economic growth in Kenya, this research study shall pre-dominantly rely on Nairobi County, Kenya. Kenya's economy is estimated to have expanded by 5.3 per cent in 2014, compared to a growth of 5.7 per cent in 2013. From the demand side, growth was mainly driven by an increase in private final consumption and a rapid growth in capital investment. From the supply side, the major drivers of growth were agriculture, forestry and fishing; construction wholesale and retail trade; education; and finance and insurance. However, accommodation .and food services (hotels and restaurants) sector contracted for the second year in a row. During the year, the main macroeconomic indicators remained relatively stable. The Kenya Shilling generally held firm against the major trading currencies despite its depreciation against the US dollar, Sterling pound and Euro, while weighted average commercial banks' lending rate remained relatively high but stable. Despite the drop in prices of fuel, electricity and some food commodities, inflation rose slightly but remained within the Central Bank (CBK) target. The Balance of Payments position improved mainly on account of proceeds from the sale of the Eurobond. However, the current account deficit worsened due to deterioration in trade deficit. Government fiscal policies in the 2014/15 national budget, focused on increased revenue mobilization and containment of growth in recurrent expenditure. Consequently, the share of the development expenditure increased .to 44 per cent of the total budget in 2014/15 fiscal year from 33 per cent in 2013/14 (KNBS, 2015).

Nairobi is the largest city and the capital of Kenya. With a population of about 3.36 million estimated in 2011, Nairobi is the second-largest city by population in the African Great Lakes region after Dares Salam, Tanzania. According to the 2009 census, in the administrative area of Nairobi, 3,138,295 inhabitants lived within 696 km^2. Nairobi is one of the most prominent cities in Africa, both politically and financially- home to thousands of Kenyan businesses and over 100 major international companies and organizations.

3.3. Research Design

This research shall employ the use of a quantitative research design as the research problem employs a deductive logic where the researcher starts with a hypothesis and then collects data to confirm or refute the hypothesis. Quantitative analysis is selected as it is not only fast and inexpensive but also provides wide assortments of statistical techniques. Computer software, SPSS for this particular research, is readily available to provide both basic and advanced multivariate analysis. The Computer Software is selected for its convenience in that the researcher simply follows the pre-planned analysis process, without making subjective decisions about the data thus eliminating human errors and biases.

3.4 Study Population and Sample Selection Procedures

This study seeks to look at the ways in which domestic investment market can be strengthened in an effort to increase economic growth in Kenya. The study population shall be derived from participants from diverse fields from: Government Ministries such as the National Treasury and the Ministry of Devolution; Government Institutions such as Chamber of Commerce, Kenya National Bureau of Statistics, Vision 2030 and Kenya Trade Network Agency; Government Regulators such as: the Central Bank of Kenya, The Insurance Regulatory Authority, The Capital Markets Authority; Private Investment Firms in the Insurance, Fund Management and Investments sectors; and International Institutions that deal with development.

The selection of the following has been done through stratified sampling. Stratified sampling has been applied as it is not only superior to random sampling but also because it reduces sampling error. For definition purposes, a stratum is a subset of the population that share at least one common characteristic. For purposes of this study, the strata share a sophisticated exposure to investments as well as a good understanding in economics. Random sampling shall then be used to select subjects for each stratum until the number of subjects in that stratum is proportional to its frequency in the population.

3.5 Data Collection Techniques

The data qualifying this study will be collected through primary data collection methods and specifically the use of structured questionnaires.

3.6. Data Analysis Methods

The researcher shall utilize computer software to process the information gathered to address the objectives of the study and research questions. The presentation of data shall be through the use of tables, graphs, pie charts and lists and will be specific enough to allow the reader to grasp the findings of the field work research.

3.7. Ethical Issues

Ngeno (2014) defines ethics as norms for conduct that distinguish between or acceptable and unacceptable behavior. It is important for researchers to learn how to interpret, assess, and apply various research rules and how to make decisions and to act in various situations. The following are some of the ethical issues adhered to in my field study:

i) Honesty

I strived for honesty in all scientific communications by honestly reporting data, results, methods and procedures, and publication status.

ii) Objectivity

My findings though broad based were objective to the extent that they sought to answer my research question: What can be done to strengthen a vibrant domestic investment market for economic growth in Kenya? There were no notable conflicts of interest, personal or financial, that affected this field work research.

iii) Integrity

In my data analysis, as will be noted later in this paper, I strive for consistency of thought and action.

iv) Openness

I shared data, results, ideas and tools with my supervisor as part of my field journal experience initially. I will also be sending the final copy to my participants as a way of keeping them informed and abreast with their contributions.

v) Respect for Intellectual Property

I have honored all copy rights by giving proper acknowledgement or credit for all contributions to research.

vi) Confidentiality

This research involved the collection of data from human participants. The participants' data is collected with full anonymity. I continue to respect the privacy and autonomy of all my human participants who have made this report see the light of day.

vii) Legality

Lastly, the field work was carried under the correct legal framework being cautious to obey relevant laws and institutional and governmental policies.

3.8. Limitations of the Study

As the study covers the larger geographic area of Nairobi, the collection of primary data is time consuming. Because of exhaustive nature of the exercise, the time required to do research accurately is very long as compared to secondary data, which can be collected in much lesser time duration. Thus it will be virtually impossible to traverse the entire terrain of Nairobi to seek their contribution or input on the problem question. Resultantly, an expert sample of participants derived from select government institutions and the private sector will be approached in order to give relevant data in line with their experience and exposure on the modalities of the domestic investment market.

In addition, collecting data using primary research is a costly proposition as the researcher has to be involved throughout and has to design everything. Due to financial constraints it may not be possible to simultaneously collect data from all key participants on the subject matter as too much data may be available some of which may be out dated and difficult to synthesize within a short duration of time. To curb this limitation, a sample size will be ethically selected that depicts the correct representation of the sample population size.

Also, this research is required within a stipulated time and as a result of the limited duration required to conclude this study, it may not be possible to study to collect primary data across other counties and thus, Nairobi County, being the capital of Kenya shall be relied on as the target sample size.

The research findings may also be subject to biases and human error due to the inherent human nature of the targeted audience. The researcher shall try to counteract this through the use of computer software to analyze the data collected in an attempt to reduce further human error.

CHAPTER FOUR

4.0 Results and Findings

4.1 Introduction

In this chapter, the data is gathered from the survey respondents all of whom are residents of Nairobi County. This chapter discusses the result of the semi-structured questionnaire responded by Thirty five participants. Before the initiation of the study the significance, rationale and purpose of the study were provided to each of the respondents. Furthermore, the respondents have also been assured that all the data they will give will solely be for the purpose of the research and the assurance that their identities will be confidential. The object is to determine the factors that can strengthen the growth of the domestic investment market to promote economic growth in Kenya. This is the manner unto which the study accounts the factors and the perception on the criteria themselves.

The conduct of this study entails a detailed account of the demographic profile of the respondents as the nature of the survey required a sophisticated participant with personal or professional insight, knowledge and/ or exposure on the role of the private sector in enhancing economic growth. It is assumed that the background of the respondents influence their knowledge and expertise on the subject matter and subsequently answers on the survey questions. Of particular significance to the achievement of the goals and objectives of the study is to be able to answer the research questions.

This chapter thus presents the results and findings of the study. These results have been extrapolated from the analyzed research data. The chapter presents the data using figures and tables. The data has been analyzed using statistical references and meaning of the data has also been offered.

4.2 Bio-Data

4.2.1 Respondents' Gender

The results of the study show that 58.1% of the population were female and 41.9% were male. The study results show that the majority of the respondents were female.

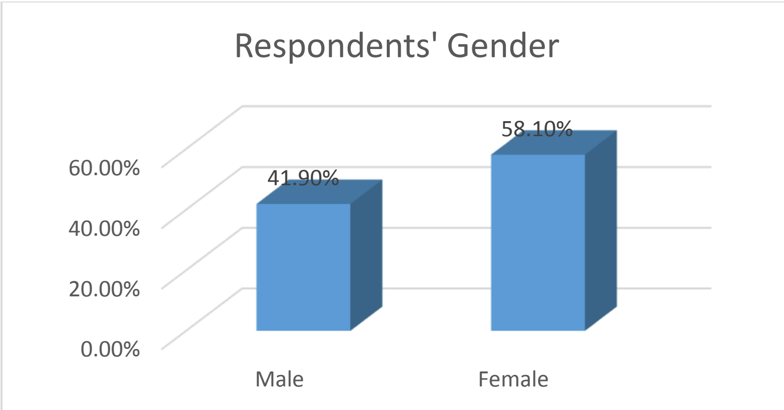


Figure 4.1 Respondents' Gender

4.2.2 Profession

The results of the study shows that 71% of the participants were private sector professionals, 12.9% of the participants were civil servants in government, 9.7% of the participants were duly authorized regulators, 3.2% of the participants were employees in multilateral organizations and another 3.2% were employees in an incorporated government parastatal.

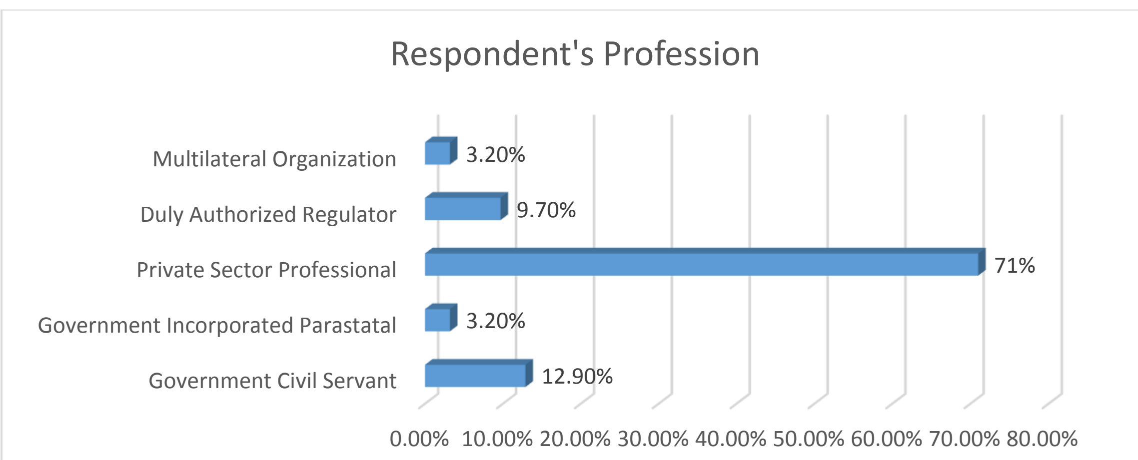


Figure 4.2 Respondent's Profession

4.2.3 Professional Experience

The respondents were asked to indicate whether they had experience and exposure on private sector investments in Kenya and their response indicated that 80.6% had professional experience while 19.4% did not. These results indicate that the population was best placed to respond to the research questions.

Figure 4.3 Professional Experience

4.2.4 Years of Experience

The respondents were asked to indicate their years of experience and the results showed that, 19.4% had no experience at all, 8.7% equally had 2 years; 6.8% had 3 years; 6.4% had 4 years of experience, 22.6% had 5 years of experience 19.3% had 7 years; 4.8% had 8 years; 9% had 10 years of experience, and 3% had 20 years of experience. These results confirm that the population had enough years of experience to offer valuable data for this study.

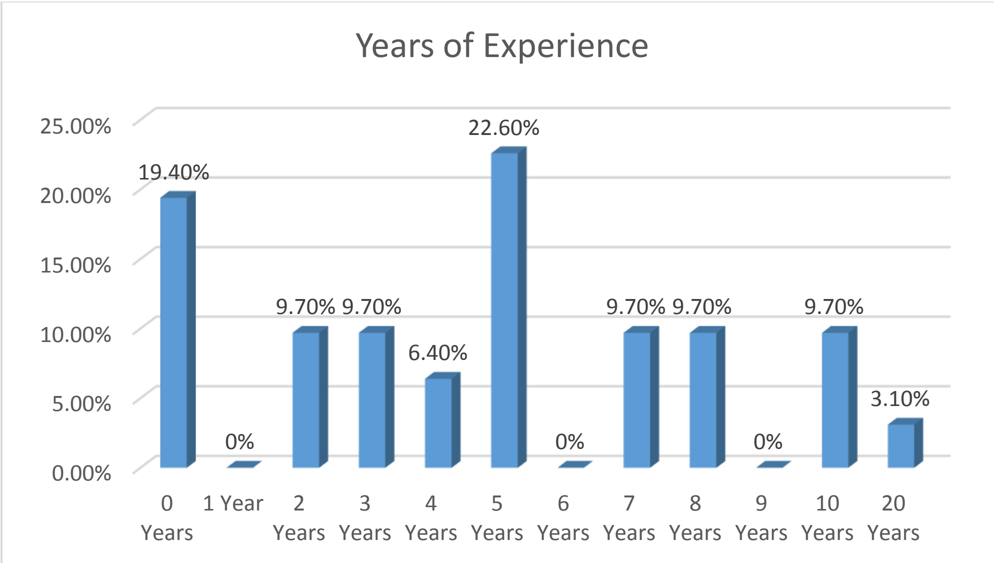


Figure 4.4 Years of Experience

4.2.5 Private Sector Contribution

When asked about the contribution of the private sector in the country's economy, all the respondents 100% confirmed that the private sector could contribute towards enhancing the economic growth rate in Kenya as shown in Table 4.1.

Table 4.1 Private Sector Contribution

Response	Number	Percent
Yes	31	100
No	0	0
Total	**31**	**100**

4.3 The Macro-Level Factors that Affect Private Sector Growth

4.3.1 Macro-Level Factors Affecting the Private Sector Growth

The respondents were asked to rate the macro-level factors that affected the growth of the private sector using brief statements that were offered. The resulting Mean that was greater than 3.0 showed that the various macro-level factors greatly influenced the growth of the private sector, those with less than 3.0 indicated that the factors did not influence the growth of the private sector in a great manner. The Standard Deviation figure of less than 1.0 indicated that the difference of responses was not significant.

Table 4.2 Macro-Level Factors Affecting the Private Sector Growth

Statement	Un Important	Slightly Important	Important	Very Important	MEAN	STD. DEV
Corruption is an impediment to a Vibrant Domestic Market	0%	0%	12.9%	87.1%	3.87	0.341
Political Climate affects Investments	0%	3.2%	25.8%	71%	3.68	0.541
Exchange Rate fluctuations affects Private Sector	0%	6.5%	41.9%	51.6%	3.45	0.624
Good governance enhances business efficiency	3.2%	0%	22.6%	74.2%	3.68	0.653

Government Institutions can enhance the private sectors performance	6.5%	0%	51.6%	41.9%	3.35	0.608
Political and Economic Instability lowers Domestic Investment levels	3.2%	0%	32.3%	64.5%	3.61	0.558
Political and Economic stability also decreases the risk of firms going bankrupt.	3.2%	22.6%	51.6%	22.6%	2.94	0.772
Fiscal and monetary policies that reduce inflation help to establish a competitive exchange rate	3.2%	6.5%	61.3%	29%	3.16	0.688
Private Sector is more vibrant today than it was 15 years ago	3.2%	0%	35.5%	61.3%	3.58	0.564
The macro level factors such as economic and political factors affect the	0%	0%	58.1%	41.9%	3.42	0.502

Domestic Investment Market						
There is much more that can be done by the government to enhance the private sector growth	6.5%	0%	32.3%	61.3%	3.55	0.624

Table 4.2 shows that corruption is an impediment to a vibrant domestic market, as indicated by a resulting mean of 3.87 and a standard deviation of 0.341. The table also shows that political climate affects investments as indicated by a resulting mean of 3.68 and a standard deviation of 0.541. The table also shows that exchange rate fluctuations affects private sector as shown by a resulting mean of 3.45 and a standard deviation of 0.624. The study shows that good governance enhances business efficiency as shown by a resulting mean of 3.68 and a standard deviation of 0.653. The table shows that the government institutions can enhance the private sector performance as shown by a resulting mean of 3.35 and a standard deviation of 0.608. The table also indicates that the political and economic instability lowers domestic investment levels as shown by a mean of 3.61 and a standard deviation of 0.558. The study indicates that political and economic stability does not necessarily decrease the risk of firms going bankrupt as shown by the resulting mean of 2.94 and a standard deviation of 0.772. The table shows that fiscal and monetary policies that reduce inflation help to establish a competitive exchange rate as shown by a resulting mean of 3.16 and a standard deviation of 0.688. The table also shows that private sector is more vibrant today than it was 15 years ago as shown by a resulting mean of 3.58 and a standard deviation of 0.564. The table also shows that the macro-level factors such as economic and political factors affect the

domestic investment market as shown by a resulting mean of 3.42 and a standard deviation of 0.502. The table finally shows that there is much more that can be done by the government to enhance the private sector growth as shown by a resulting mean of 3.55 and a standard deviation of 0.624.

4.3.2 Macro-Level Factors Correlation Results

Table 4.3 shows that corruption being an impediment to a vibrant domestic market; political climate affecting investments; exchange rate fluctuations affecting the private sector; good governance enhancing business efficiency; government institutions enhancing the private sectors performance; political and economic instability lowering domestic investment levels; political and economic stability decreasing the risk of firms going bankrupt; fiscal and monetary policies reducing inflation and helping to establish a competitive exchange rate; private sector being more vibrant today than 15 years ago; macro-level factors such as economic and political factors affecting the domestic investment market; and there being more that can be done by the government to enhance the private sector growth were all insignificant since the results had a P value that was greater than 0.05.

Table 4.3 Correlation Results of Macro-Level Factors of Private Sector Growth

Statement	Correlations
Corruption is an impediment to a Vibrant Domestic Market	0.150 P=0.421
Political Climate affects Investments	-0.233 P=0.206

Exchange Rate fluctuations affects Private Sector	-0.030 P=0.871
Good governance enhances business efficiency	-0.193 P=0.297
Government Institutions can enhance the private sectors performance	-0.254 P=0.168
Political and Economic Instability lowers Domestic Investment levels	-0.096 P=0.607
Political and Economic stability also decreases the risk of firms going bankrupt.	-0.033 P=0.861
Fiscal and monetary policies that reduce inflation help to establish a competitive exchange rate	0.092 P=0.624
Private Sector is more vibrant today than it was 15 years ago	-0.291 P=0.112
The macro level factors such as economic and political factors affect the Domestic Investment Market	0.132 P=0.479
There is much more that can be done by the government to enhance the private sector growth	-0.283 P=0.123

* Correlation Significant level 0.05

4.4 The Meso-Level factors that Affect Private Sector Growth

4.4.1 Meso-Level Factors Affecting the Growth of the Private Sector

The respondents were asked to rate the meso-level factors that affected the growth of the private sector using brief statements that were offered. The resulting Mean that was greater than 3.0 showed that the various meso-level factors greatly influenced the growth of the private sector, those with less than 3.0 indicated that the factors did not influence the growth of the private sector in a great manner. The Standard Deviation figure of less than 1.0 indicated that the difference of responses was not significant.

Table 4.4 Meso-Level Factors Affecting the Private Sector Growth

Statement	Un important	Slightly important	Important	Very important	MEAN	STD. DEV
Regulatory reform is necessary for a vibrant domestic market	0%	0%	61.3%	38.7%	3.39	0.245
Tax Legislations need to be reviewed	0%	16.1%	58.1%	25.8%	3.10	0.424
There is need for a private sector promotion forum	0%	25.8%	45.2%	29%	3.03	0.566
Private-public partnerships should be more enhanced	0%	12.9%	51.6%	35.5%	3.23	0.447
Rule of law is vital to protection of private	0%	3.2%	25.8%	71%	3.68	0.292

contract law and property rights						
Corporate governance promotes a robust private sector	0%	0%	38.7%	61.3%	3.61	0.245
Mobilization of domestic savings can enhance domestic Investments	0%	9.7%	32.3%	58.1%	3.48	0.458
Infrastructure development is vital for private sector growth	0%	0%	9.7%	90.3%	3.90	0.090
Sound labour laws promote private sector growth	3.2%	9.7%	51.6%	35.5%	3.19	0.561
Public reputation of private companies remains attractive for their success	0%	12.9%	61.3%	25.8%	3.13	0.383
Strengthening trade-related institutions would enhance the success of private sector	0%	9.7%	58.1%	32.3%	3.23	0.381

contribution to economic growth						
Tax advantages would make domestic market lucrative	0%	16.1%	29%	54.8%	3.39	0.578
Partly privatized parastatals are more effective	12.9%	25.8%	48.4%	12.9%	2.61	0.778
Financial regulation is critical to a robust investment climate	0%	3.2%	45.2%	51.6%	3.48	0.325
Support in trade negotiations would advance private sector growth	0%	16.1%	45.2%	38.7%	3.23	0.514
Restructuring of state-enterprises	3.2%	25.8%	41.9%	29%	2.97	0.699
Investment policies and laws in place	0%	3.2%	51.6%	45.2%	3.42	0.318
Competition laws	0%	19.4%	45.2%	35.5%	3.16	0.540
There is a need for re-regulation and de-regulation in certain	6.5%	16.1%	48.4%	29%	3.00	0.733

spheres of the private sector						

Table 4.4 shows that regulatory reform is necessary for a vibrant domestic market as indicated by a resulting mean of 3.39 and a standard deviation of 0.245. The table also shows that tax legislations need to be reviewed as indicated by a resulting mean of 3.10 and a standard deviation of 0.424. The table shows that there is need for a private sector promotion forum as indicated by a resulting mean of 3.03 and a standard deviation of 0.566. The table shows that private and public partnerships to be enhanced had a resulting mean of 3.23 and a standard deviation of 0.447. Rule of law being vital to protection of private contract law and property rights had a resulting mean of 3.68 and a standard deviation of 0.292. The table shows that corporate governance promoting a robust private sector had a resulting mean of 3.61 and a standard deviation of 0.245. Mobilization of domestic savings to enhance domestic investments had a resulting mean of 3.48 and a standard deviation of 0.458. Infrastructure development being vital for private sector growth had a resulting mean of 3.90 and a standard deviation of 0.090. Sound labour laws promoting private sector growth had a resulting mean of 3.19 and a standard deviation of 0.561. Public reputation of private companies remaining attractive for their success had a resulting mean of 3.13 and a standard deviation of 0.383. Strengthening trade-related institutions to enhance the success of private sector contribution to economic growth had a resulting mean of 3.23 and a standard deviation of 0.381. Tax advantages making domestic market lucrative had a resulting mean of 3.39 and a standard deviation of 0.578. Partly privatized parastatals being more effective had a resulting mean of 2.61 and a standard deviation of 0.778. Financial regulation being critical to a robust investment climate had a resulting mean of 3.48 and a standard deviation of 0.325. Support in trade negotiations to

advance private sector growth had a resulting mean of 3.23 and a standard deviation of 0.514. Restructuring of state-enterprises had a resulting mean of 2.97 and a standard deviation of 0.699. Having investment policies and laws in place had a resulting mean of 3.42 and a standard deviation of 0.318. Having competitive laws had a resulting mean of 3.16 and a standard deviation of 0.540. There being a need for re-regulation and de-regulation in certain spheres of the private sector had a resulting mean of 3.00 and a standard deviation of 0.733.

4.4.2 Meso-Level Factors Correlation Results

Table 4.5 shows that regulatory reform being necessary for a vibrant domestic market; the need for tax legislations needing to be reviewed; there being a need for a private sector promotion forum; private-public partnerships being more enhanced; rule of law being vital to protect the private contract law and property rights; corporate governance promoting a robust private sector; mobilization of domestic savings to enhance domestic investments; infrastructure development being vital for private sector growth; having sound labour laws to promote private sector growth were all insignificant since they had a P value that was greater than 0.05. The study also shows that strengthening trade-related institutions to enhance the success of private sector contribution to economic growth; having tax advantages that would make domestic market lucrative; having partly privatized parastatals being more effective; having financial regulation that is critical to a robust investment climate; supporting trade negotiations that would advance private sector growth; restructuring state-enterprises; having investment policies and laws in place; having competition laws; and there being a need for re-regulation and de-regulation in certain spheres of the private sector were also insignificant since they had a P value of greater than 0.05. The study however, indicates that the public reputation of private companies remains attractive for their success was significant since it had a P value that was less than 0.05.

Table 4.5 Correlation Results of Meso-Level Factors of Private Sector Growth

Statement	Correlations
Regulatory reform is necessary for a vibrant domestic market	0.062 P=0.742
Tax legislations need to be reviewed	0.087 P=0.643
There is need for a private sector promotion forum	-0.124 P=0.506
Private-public partnerships should be more enhanced	-0.071 P=0.703
Rule of law is vital to protection of private contract law and property rights	-0.141 P=0.451
Corporate governance promotes a robust private sector	0.224 P=0.226
Mobilization of domestic savings can enhance domestic Investments	0.218 P=0.238
Infrastructure development is vital for private sector growth	-0.188 P=0.311
Sound labour laws promote private sector growth	0.151 P=0.418

Public reputation of private companies remains attractive for their success	-0.386 P=0.032
Strengthening trade-related institutions would enhance the success of private sector contribution to economic growth	-0.077 P=0.679
Tax advantages would make domestic market lucrative	-0.146 P=0.434
Partly privatized parastatals are more effective	-0.256 P=0.165
Financial regulation is critical to a robust investment climate	-0.213 P=0.249
Support in trade negotiations would advance private sector growth	-0.161 P=0.388
Restructuring of state-enterprises	0.031 P=0.868
Investment policies and laws in place	-0.004 P=0.984
Competition laws	0.098 P=0.602
There is a need for re-regulation and de-regulation in certain spheres of the private sector	-0.157 P=0.398

* Correlation Significant level 0.05

4.5 The Micro-Level Factors that Affect Private Sector Growth

4.5.1 Micro-Level Factors Affecting the Growth of the Private Sector

The respondents were asked to rate the micro-level factors that affected the growth of the private sector using brief statements that were offered. The resulting Mean that was greater than 3.0 showed that the various micro-level factors greatly influenced the growth of the private sector, those with less than 3.0 indicated that the factors did not influence the growth of the private sector in a great manner. The Standard Deviation figure of less than 1.0 indicated that the difference of responses was not significant.

Table 4.6 Micro-Level Factors Affecting the Private Sector Growth

Statement	Un Important	Slightly Important	Important	Very Important	MEAN	STD. DEV
Mobile phones ease the conduct of doing business in Kenya	0%	0%	22.6%	77.4%	3.77	0.425
Electronic modes of payment enhance ease of business	0%	0%	16.1%	83.9%	3.84	0.374
Diaspora market can contribute much more into the private sector	0%	0%	58.1%	41.9%	3.42	0.502

Investment promotion programs enhance private sector growth	0%	25.8%	45.2%	29%	3.03	0.752
Risk mitigation measures are vital in enhancing growth in domestic investment market	0%	12.9%	48.4%	38.7%	3.26	0.682
Regional cooperation can grow the private sector of a state	0%	6.5%	45.2%	48.4%	3.42	0.620
International policy dialogue should advance private sector growth in pro-poor states like Kenya	0%	29%	51.6%	19.4%	2.90	0.700
Tax incentives motivate business set ups	0%	12.9%	22.6%	64.5%	3.52	0.724
Foreign presence is vital to growing domestic firms	12.9%	35.5%	35.5%	16.1%	2.55	0.925
Highly skilled and educated human capital	0%	9.7%	25.8%	64.5%	3.55	0.675

can advance the growth rate in the private sector						
Management models affect the success of private of private sector	0%	9.7%	45.2%	45.2%	3.35	0.661
Negative public image of private firms	9.7%	25.8%	48.4%	16.1%	2.71	0.864
Alternative investment platforms need to be created to increase channels for growth from private sector	3.2%	19.4%	35.5%	41.9%	3.16	0.860
Negative public image of public firms	3.2%	29%	48.4%	19.4%	2.84	0.779

Table 4.6 shows that mobile phones easing the conduct of doing business in Kenya had a resulting mean of 3.77 and a standard deviation of 0.425. Electronic modes of payment enhancing ease of business had a resulting mean 3.84 and a standard deviation of 0.374. Diaspora market being able to contribute much more into the private sector had a resulting mean of 3.42 and a standard deviation of 0.502. Investment promotion programs enhancing private sector growth had a mean of 3.03 and a standard deviation of 0.752. Risk mitigation measures being vital in enhancing growth in domestic investment market had a mean of 3.26 and a standard deviation of 0.682. Regional cooperation ability to grow the private sector of a state had a resulting mean of 3.42 and

a standard deviation of 0.620. Tax incentives motivating business set ups had a mean of 3.52 and a standard deviation of 0.724. Highly skilled and educated human capital ability to advance the growth rate in the private sector had a resulting mean of 3.55 and a standard deviation of 0.675. Management models affecting the success of private sector had a resulting mean of 3.35 and a standard deviation of 0.661. Alternative investment platforms having the need to be created to increase channels for growth from private sector had a mean of 3.16 and a standard deviation of 0.860. The table also shows that international policy dialogue advancing private sector growth in pro-poor states like Kenya had a mean of 2.90 and a standard deviation of 0.700. Foreign presence being vital to growing domestic firms had a mean of 2.55 and a standard deviation of 0.925. Negative public image of private firms had a resulting mean of 2.71 and a standard deviation of 0.864. Negative public image of public firms had a mean of 2.84 and a standard deviation of 0.779.

4.5.2 Micro-Level Factors Correlation Results

Table 4.7 shows mobile phones easing the conducting of doing business in Kenya was significant since it had a P value that was less than 0.05. The table however, indicates that, Electronic modes of payment enhancing ease of business; diaspora market contributing much more into the private sector; investment promotion programs enhancing private sector growth; risk mitigation measures being vital in enhancing growth in domestic investment market; regional cooperation having the ability to grow the private sector of a state; international policy dialogue being made to advance private sector growth in pro-poor states like Kenya; tax incentives that motivate business set ups; foreign presence being vital to growing domestic firms; highly skilled and educated human capital being able to advance the growth rate in the private sector; management models affecting the success of private of private sector; negative public image of private firms; alternative investment platforms having a need to be created to increase channels for growth from private sector; and negative public image of public firms were all insignificant to the growth of the private sector since they all had a P value that was greater than 0.05.

Table 4.7 Correlation Results for Micro-Level Factors

Statement	Correlations
Mobile phones ease the conduct of doing business in Kenya	0.373 P=0.039
Electronic Modes of payment enhance ease of business	0.183 P=0.325
Diaspora Market can contribute much more into the private sector	-0.010 P=0.957
Investment promotion programs enhance private sector growth	-0.081 P=0.666
Risk mitigation measures are vital in enhancing growth in domestic investment market	0.093 P=0.620
Regional cooperation can grow the private sector of a state	0.118 P=0.526
International policy dialogue should advance private sector growth in pro-poor states like Kenya	0.148 P=0.426
Tax Incentives motivate business set ups	-0.258 P=0.160
Foreign presence is vital to growing domestic firms	0.071

	P=0.704
Highly skilled and educated human capital can advance the growth rate in the private sector	-0.019 P=0.920
Management models affect the success of private of private sector	-0.061 0.743
Negative public image of private firms	-0.094 P=0.616
Alternative Investment platforms need to be created to increase channels for growth from private sector	-0.171 P=0.359
Negative public image of public firms	-0.214 P=0.247

* Correlation Significant level 0.05

CHAPTER FIVE

5.1. Summary of Findings

All participants recognized that the private sector contributes to economic growth in Kenya. The participants also took cognizance of the fact that the private sector was more vibrant today than it was fifteen years ago suggesting that indeed real inroads had been accomplished in revamping this sector. A majority of the participants however thought that there still was a lot more that could be done which was in line with the general objective of this study, that is, to determine the factors that strengthen a vibrant domestic market for economic growth in Kenya and recommend ways in which these factors can be enhanced in an effort to increase private sector investment that promotes economic growth.

In examining the macro-level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya; this study found the following macro- level factors as the key inhibitors to private sector growth: poor governance as a result of corruption; the political climate; exchange rate fluctuations; bureaucratic government institutions; political and economic instability; weak fiscal and monetary policies.

In determining the meso- level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya, this study found that the following meso – level factors affect private sector development: unfair laws and regulations that are not investor friendly; excessive taxes; inadequate private sector promotion forums; corporate governance; rule of law; mobilization of domestic savings; public reputation of private companies; development of public private partnerships and support in trade related organizations and institutions.

In analyzing the micro-level factors that can strengthen a vibrant domestic investment market for economic growth in Kenya, the following are the highest factors that affect this sector of the economy: technological advancements such as mobile phones for business transactions and electronic modes of payment; diaspora market investments; investment promotion programs; prudent risk mitigation frameworks; regional cooperation; tax incentives; highly skilled and educated human capital; management models of the private sector and alternative investment forums.

5.2. Discussion on findings

The private sector has a central role to play in the war on poverty and mobilizing private investment is imperative for promoting the broad-based and sustained growth that will help drive poverty reduction. In today's global economy, private investment is both domestic and foreign and takes many forms, from physical assets to intellectual capital.

Vigorous and sustained economic growth, fuelled by investment and entrepreneurship, is needed for the private sector to create more jobs and increase incomes of the poor. In turn, this will generate the revenues that governments need to expand access to health, education and infrastructure services and so help improve productivity. But in Kenya, investment rates are too low, productivity gains are insufficient, incentives for innovation are inadequate, returns on investment are not sufficiently predictable, and not enough secure, safe and adequately paid jobs are being created in the formal economy.

Kenya consequently need to do much more to address the market failures and structural impediments that are holding back productive investment (both domestic and foreign), and to do it better, for longer periods and in a more strategic way. On the bright side, Kenya can help foster an investment climate that enables the private sector to flourish and fulfill its role as the main engine of growth. To do so, the government needs to pursue macro-economic stability, improve the functioning of market-regulating institutions and strengthen procedures for contract enforcement and dispute settlement. The government can also improve the coherence of their policies in a range of areas – such as trade, tax, competition and investment promotion – all of which affect the volume of investment and its development impact.

From a global picture, it is worth mentioning that in countries where growth is high, total domestic and foreign investment often exceeds 25% of gross domestic product (GDP). But, in sub-Saharan Africa, gross fixed capital formation has hovered at around 18% of GDP for the last two decades. Since the financial crisis in 1997, investment rates in developing countries in Asia (excluding China and India) have remained at around 21% (World Bank,2005b).One factor contributing to low growth rates in developing countries, especially the poorest ones, is insufficient, inappropriate and poorly maintained physical infrastructure. Improving the investment climate will encourage more infrastructure investors to invest. This in turn will make infrastructure services more widely available and encourage other types of investment.

A diversified and competitive financial sector is also important for promoting growth in developing countries as it helps maintain economic stability, makes financial transactions secure, mobilizes external and domestic savings and facilitates the efficient allocation of capital to productive investments.

The World Bank’s 2005 World Development Report (World Bank, 2004) has highlighted that it is not just the quantity of investment that matters for promoting growth, due to the decreasing marginal impact of additional investment in physical assets. What ultimately counts are the productivity gains that result from product and process innovations brought about through investments, as well as the extent to which jobs and capital flow from declining industries to expanding and emerging economic activities. This will make it possible to invest larger sums in the future. The investment climate consequently needs to provide opportunities and incentives for firms and entrepreneurs to develop, adapt and adopt better ways of doing business.

To mobilize more investment and to improve risk-adjusted returns, Kenyan Government needs to do much more to address the constraints holding back investment and productivity improvements, and to do it better and for longer periods. Greater attention should be paid to domestic investors, both formal and informal, who are the source of the bulk of investment in the country. High priority should be given to strengthening the capacities of local firms to respond to new investment opportunities, including those created through stronger international trade and investment linkages, and to enter into business relationships with foreign investors and to expand downstream and upstream linkages. Thus, most of what needs to be done to mobilize investment is the responsibility of the Kenyan government and the private sector themselves.

5.3. Conclusion

This section seeks to make an overall conclusion by highlighting the investment climate constraints that affect the rate of private investment.

5.3.1. Macro Instability Constraints

Macro instability (economic, social and political) deters investment by making future rewards more uncertain or undermining the value of assets.

In terms of economic constraints, the study show that the greater the level of instability, the lower the rate of private investment and growth. Instability also increases the risk of firms going bankrupt, suffering slower growth or contracting if political conflict ensues. Fiscal and monetary policies that reduce inflation, polices that help to establish a competitive exchange rate, and political and social stability are needed to sustain high rates of investment and growth.

In terms of social restraints, the study finds that crime and corruption represent a substantial risk to earning attractive returns to investment and increase the cost of doing business, whether through the payment of bribes, the direct loss of goods or the costs of crime prevention. There is strong evidence that, at the macro level, these factors reduce the rate of private investment, job creation and growth. At the firm level, there is some evidence to show that these factors reduce the growth of output, investment and job creation. Greater transparency and accountability, simplification of administrative procedures and merit-based human resource management in public administration make it possible to curb corruption (Aidt, Dutta & Sena, 2008).

Similarly, the level of development of the financial sector exerts a powerful influence over whether firms are likely to be able to access finance. This is influenced by the environment in which the sector operates. Macro stability, property rights, enforcement of contract, bankruptcy laws and whether the public sector borrows heavily to crowd out the private sector influence the development of the financial sector.

The development of the financial sector is influenced also by conditions within the sector. The specific factors include bank regulation and supervision; the development of institutions that help to increase the level of information available to lenders; the transaction costs involved in lending; the extent of competition and hence pressure to improve efficiency; the investment financial institutions make to make their services more accessible; whether they have been able to raise long term savings for long term lending; and the level of development of capital markets to provide exit routes for equity finance.

In addition, there is a set of factors that limit the opportunities for the financial sector profitably to lend to, or invest equity in, firms. These include poor business and financial management skills, and weaknesses in corporate governance that make firms unattractive to the financial sector because of the high risks they pose. In addition, attitudes of entrepreneurs towards risk or retaining complete control over their firms may make them unwilling to borrow or to allow third party equity into their businesses.

In countries where the financial sector may have sufficient access to savings to increase lending, such demand side factors can represent a binding constraint to increasing access to finance.

5.3.2. Meso Instability Constraints

This section focuses on correlating some investment climate factors to meso level impacts on investment and growth.

Business regulation and licensing is an example of a meso- level factor that can affect private investment. Whereas firms need to be regulated and licensed, if the costs they incur in complying with regulation are unnecessarily high, business entry and firm growth will be lower. The literature points to faster growth when countries improve their rank in the World Bank's Doing Business Index, especially if they move from being one of the worst performers to being amongst the best. There is some evidence also of poor licensing and regulation leading to low entry rates of new firms and lower productivity and growth of established firms. However, by itself, better business regulation may not result in faster economic growth.

Access to finance is another critical factor. Firms need to be able to access external finance to invest more. Moreover, the higher the cost of capital the lower the expected rate of return to the entrepreneur. There is a robust body of literature that shows that financial deepening, measured by the ratio of private credit to GDP, results in higher rates of growth and faster growth in the incomes of the poor, especially in the poorer countries with less well developed financial sectors. Studies show that firms able to access external finance are more likely to survive, invest and grow than those denied access (Fiestas & Sinha, 2011).

Also, excessively high rates of tax exact a high cost in terms of lower private investment and growth. They reduce the incentive to invest because the after tax returns to investors are lower. In addition, the cost of compliance with the administration of taxes can be high. The study results shows that lower rates of tax can increase investment and growth. Higher rates of tax can decrease business entry and the growth of established firms, with the medium sized firms hit hardest, as the small can trade informally, and the large avoid taxes. To counteract this, host government, Kenya in this case, needs to reduce tax rates, implement policies that broaden the tax base, simplify the tax structure, improve administration and give greater autonomy to tax agencies help to reduce this constraint.

Institutions and the legal system also fall under meso level factors that affect the domestic market investment. A reliable institutional and legal system is essential for firms to invest as it reduces the risks and uncertainties that they face when entering into commercial agreements. For example, delays or uncertainties in the enforcement of contracts governing exchange diminish the opportunities and incentives to invest as firms cannot commit to long term and complex commercial contracts. There is strong cross country evidence in the literature that weak institutions, particularly for the protection of property rights, and an ineffective judiciary that is unable to enforce contracts, reduce investment and growth. This is supported by firm level evidence which shows that secure property rights and better contract enforcement enable firms to grow: they increase their incentives to invest longer term, feel secure in trying out new suppliers, and enter into more complex contracts. Better systems of registering property, improved security of land tenure and reforms that reduce the cost of contract enforcement, such as promoting alternative dispute resolution, are policies that support better institutions and legal systems. (Eifert, 2009)

Also vital is the role of infrastructure which, if accessible, allows firms to become more productive (energy), reduce transaction (ICT) and transportation costs (roads, railways) and expand their businesses by reaching markets further afield. There is ample evidence to show that greater investment in infrastructure leads to faster growth. Studies also point to higher levels of investment, greater productivity and faster growth of firms that have better access to infrastructure, especially in the poorer countries where infrastructure is less developed. Greater investment in infrastructure, public and private, and higher expenditure on maintenance are needed to reduce this constraint.

5.3.3. Micro Instability Constraints

Besides the investment climate constraints examined so far, there are also micro level factors that can have a very significant impact on the birth and development of private sector firms. In order to grow, firms need to make productive investments - increases in productivity will then make firms more competitive and this will increase the returns to the investment. However, improving a firm’s productivity (which is determined by the available technology or know-how for converting resources into outputs and the way in which resources are organized in firms to produce goods and services) is limited by:

Inter alia, technology transfer which is generally counted as one of the most important channels through which foreign corporate presence can produce positive externalities in the host country. However, this study had mixed views of its impact. Some studies find that foreign presence has a positive impact on the productivity of domestic firms, whilst others find no evidence or a negative effect.

Secondly, micro level factors also consider factors such as the quality of management: The quality of management is essential to see if managers and firm owners have the organizational, financial and managerial abilities to manage the scaling up of a firm. However, in many developing countries such as Kenya, the quality of the management is low. For example, low levels of financial literacy can prevent SMEs from adequately assessing and understanding different financing options and from navigating complex loan application procedures.

5.4. Recommendations and Policy Implications

This study makes the following recommendations in an attempt to strengthen the private sector development for advancement of economic growth:

5.4.1. Improve the Investment Climate and Enhance Productivity

This refers to the costs of doing business (e.g. the costs of complying with the policy, legal and regulatory frameworks in which the private sector operates, including the extra costs created by inadequate infrastructure, crime, corruption and excessive red tape).

High costs reduce profits and discourage investment. They also create disincentives for firms to formalize, with a resultant loss of benefits to the economy. Addressing this issue requires policy measures in three areas:

- Enhance infrastructure development
- Good governance
- Development of skilled labour

In order to help Kenya improve its investment climate, the government should support interventions that contribute towards achieving the following intermediate and mutually reinforcing objectives:

5.4.1.1. Enhance Infrastructure Development

Costs of Investments can be lowered by strengthening infrastructure development. Closing Kenya's infrastructure deficit can stimulate a significant increase in private investment in the country. However, such investments will not materialize unless policies are put in place to address specific bottlenecks to expanding infrastructure in Kenya. Examples of these bottlenecks include the high costs of providing infrastructure in remote or less-densely populated areas, the high costs of infrastructure services, resource constraints, and the slow pace of regional integration, which inhibit benefiting from the economies of scale in the provision of infrastructure.

In the face of limited resources, the Kenyan Government will have to continue to resort to PPPs to secure more funding for their infrastructure investments. They will, however, have to address issues that limit the emergence and effectiveness of PPPs. These include inadequacies in the legal and regulatory frameworks of countries, lack of technical skills to manage PPP programs and projects, unfavorable investor perceptions of country risks, small market size, limited infrastructure and others. The government should consider employing new PPP models, such as those that involve the use of diaspora or remittance-based funds, which integrate the realities and potential of the country.

There is also the need for the Kenyan Government to expand the range of financing instruments for public investment. A potentially fruitful avenue is the development of domestic-currency infrastructure bonds, which have been successfully tapped in. For example, Kenya is the use of domestic-currency bonds to finance public investment has several advantages beyond boosting domestic investment.

This form of financing helps reduce Kenya's dependency on foreign currency-denominated public debt. By developing long-term debt instruments, bond financing of public infrastructure can also stimulate the deepening of domestic bond markets and the financial system in general. Further, to the extent that bonds are well structured, they can attract a large pool of investors, thus expanding the investor base.

5.4.1.2. Good Governance

The second area where there is need for policy measures to make the policy and institutional environment more conducive to investment is in addressing issues of governance. The quality of governance has a direct bearing on private investment and the nature and productivity of that investment. Governance is used here in a broad sense and covers issues such as the quality of the policies pursued by Governments (for example, the degree of maintenance of macroeconomic stability), efficiency levels of institutions and quality of bureaucracy, respect by the state for rule of law and codified rights, rules to promote accountability, transparency and lessening of corruption and maintenance of political stability and respect for the political rights of the populace.

Poor governance increases the cost of doing business for investors and entrepreneurs; it introduces elements of risk and uncertainty in the investors' decision-making calculus that affects their expected rate of return on investment, and it can create distortions in investment decisions that leads to suboptimal outcomes being realized for the economy. To stimulate investment in Kenya, there is the need for governments to improve the state of governance in the country. In particular, the governments should strive to do the following: maintain political stability; improve bureaucratic efficiency in State institutions and public sector bodies to reduce the costs of doing business for investors; reduce the risks associated with policy reversals by having more continuity and transparency in macro policies and set up mechanisms between the state and private investors.

In addition, in order to encourage regular dialogue and consultations between the state and the private sector; the government should strengthen the judiciary apparatus and its independence in order to encourage respect for rule of law and promote peace and security. Despite vetting process in Kenya, bribery of judges continue to be rampant in Kenya with the most recent being the allegation of bribery of supreme court judge in an effort to affect his conduct in the determination of an election petition against the gubernatorial seat at Nairobi.

5.4.1.3. Development of Skilled Labour

The third element required to improve the policy and investment environment in Kenya is the strengthening of human capital development. Firms are unlikely to invest if they do not have ready access to a reliable source of workers with relevant skills. Although Kenya is more advanced in this sector than its African counterparts, there is the need for governments to review the educational curriculum to ensure that secondary and tertiary institutions are better prepared to respond to the needs of enterprises. There is also the need to strengthen support for technical and vocational training programs and to incentivize the private sector to provide more on-the-job training as well as to support applied research and development activities in universities and research institutes.

5.4.2. Reduce Inequality in Income and Asset Distribution

The assessment of poverty and inequality in Kenya is very important particularly in retrospect to the 2007-2008 post poll election violence in Kenya. Since growth is unlikely to be achieved in the presence of severe inequalities, it is paramount that the government addresses issues of inequality to avert the risks of conflict.

The Kenyan government should also pay more attention to income and asset distribution issues if they want to make more progress in boosting investment and achieving sustained economic growth. Reducing inequality in income and asset distribution will broaden the base of ownership in the economy and decrease the likelihood of distributive conflicts which increases risks and uncertainty, thereby discouraging investment. (UNCTAD, 2012c)

The government should oversee the implementation of the following measures: the adherence by all employers to legal minimum wages, introduce greater taxation of wealth and inheritance, well-targeted social transfers and provision of social services.

Given the heterogeneity of our country, the preferred policy instrument for reducing income inequality will vary from county to county. For example, in some counties it may make sense to use a progressive tax, with the revenue spent on social services that will benefit the poor. In other countries there may be the need to consider asset-based distribution and policies to ensure that workers are paid decent wages. In counties where asset-based distribution is deemed necessary, it should be done in a way that does not lead to a disruption of investment and economic activity. In this regard, collective bargaining between governments and relevant parties will be needed to ensure that such distribution achieves the stated objectives without leaving undesired consequences.

5.4.3. Strategic Investments in the Right Sector

Another important aspect of catalyzing investment for transformative growth in Kenya is ensuring that investment goes to productive and strategic sectors deemed crucial for sustained and transformative growth. Obviously, the decision on which sectors should be considered strategic or priority should be made at the national level and is usually reflected in national development plans. Nevertheless, experience has shown that investment is likely to have more developmental impact in Kenya if it goes to infrastructure and production sectors, such as agriculture and manufacturing**,** which are crucial for job creation and promoting inclusive and sustained growth. In this context, a key question is: how can the Governments influence or redirect investments to these production sectors? The development experiences of both developed and emerging economies have shown that governments can influence the allocation of investment to desired sectors or activities through industrial policy. So, for example, the central bank could decide to require banks to hold the equivalent of 15 per cent of total deposits in loans to investors in priority sectors. A commercial bank would have two options: it could cooperate and finance investment in the priority sectors, or it could decide to hold unremunerated cash as reserves at the central bank. Through such a strategy, the central bank would implicitly increase the relative cost of idle cash (excess reserves) held by commercial banks, which would stimulate lending for investment (Economic Development in Africa Report, 2014).

Commercial banks in African financial systems tend to focus their lending on high turnover activities, such as commerce, to the detriment of productive activities, notably agriculture and industry. The sectoral distribution of loans in Kenya for 2012 for example also shows that the household and trade sectors account for the bulk of lending. Interestingly, the manufacturing sector received only 13.5 per cent of loans even though its share of non-performing loans is relatively small. Inadequate financing to the production sectors contributes to low overall investment performance. Thus, strategies to stimulate investment must include measures to incentivize lending to agriculture and industry. The asset reserve requirement system discussed above may help to induce bank lending to these sectors, especially when they are complemented with risk mitigation measures (The Financial Sector Stability Report, 2012).

5.4.4. Enhance Knowledge

In the non-financial area, there are also policy measures that governments can take to influence the allocation of investment into priority sectors of an economy. For example, the government can provide information to entrepreneurs on investment opportunities available in priority sectors. This could be information gathered through public sector research or through consultations and interactions with the private sector. The provision of such market information can play an important role in encouraging new investors to move into the desired activities and sectors.

Direct government involvement may also be necessary in some activities, such as infrastructure, to encourage the private sector to invest in these areas. This involvement could be in the form of joint ventures between the government and the private sector.

5.4.5. Stemming Capital Flight to Boost Investment

Kenya can enhance its capital formation by curbing capital flight. Capital flight retards government expenditures and growth and undermines poverty-reduction efforts by eroding the tax base and depleting domestic resource mobilization by the governments. Some of the major causes of capital flight are perceived high risks associated with domestic assets, political uncertainties, poor governance, macroeconomic mismanagement and instability, misaligned exchange rates, weak institutional environment, and corruption and lack of transparency.

Efforts are required to curb capital flight. Kenya suffers from weak disclosure standards which encourage illicit capital flight. Furthermore, tax havens encourage transfer pricing and tax evasion by multinational firms.

At the national level for example, the government should reduce policy incoherence associated with promotion of FDI particularly in the extractive industries. In Kenya, the government provides generous incentives to foreign companies operating in the extractive sector despite the fact that available evidence indicates that laundered commercial money through multinational companies is the largest component of illicit financial flows from Kenya (NEPAD and ECA, 2013). Kenya has to rethink its policy on FDI to ensure it does not provide incentives to companies that contribute to illicit financial flows on the continent.

In addition, there is also need to improve tax and customs administration and also address the issue of corruption. Better technology is required to improve customs administration and tax collection. The introduction of I-Tax by the Kenya Revenue Authority is a step towards the right direction in curbing inefficiencies and leakages. Curbing tax collection loopholes with better technology can help to curb capital flight.

5.5 Suggestions for Further Research

The proposals raised by this study can be further expounded. Each on its own is very wide in nature and could be a problem statement of a thesis on its own. Further development in these areas could provide more critical data that would further enhance the strengthening of a vibrant domestic investment market to enhance economic growth in Kenya.

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APPENDICES

APPENDIX 1: INTRODUCTION LETTER FROM USIU

APPENDIX 2: RESEARCH PERMIT FROM NACOSTI

APPENDIX 3: QUESTIONNAIRE & COVER LETTER

APPENDIX 4: RESEARCH BUDGET & TIME PLAN