

# International Journal of **Poverty, Investment and Development**

(IJPID)

**Outward Foreign Direct Investments and Economic  
Growth: An Investigation of Kenya**



**CARI  
Journals**

## Outward Foreign Direct Investments and Economic Growth: An Investigation of Kenya

Joseph Macheru Ph.D., CPA-K

School of Business and Economics, Catholic University of Eastern Africa

P. O Box 62157 Bogani Rd, Nairobi, Kenya

Corresponding E-mail: [jmacheru@gmail.com](mailto:jmacheru@gmail.com)

### Abstract

**Purpose** – The purpose of this study was to evaluate the effect of outward foreign direct investments on economic growth in Kenya.

**Design/methodology/approach** – The study applied the panel data model to analyze the data collected. Unit root tests were also conducted on the variables to avoid the problem of having a spurious regression or white noise in the model. The Levin, Lin and Chu T- statistic test for stationarity which is suitable for panel data sets was used for this study. A Hausman test was conducted to determine whether to use the fixed effects model or the random effects model to address the objectives of the study.

**Findings** – OFDI had a coefficient of 0.06 and a probability value of 0.0011 which is significant at 5 percent level of significance. This means that when OFDI grew by 0.06 units then GDP grew by 1 unit during the period of study.

**Practical implications** – As such there is a positive and significant relationship between Outward FDI and economic growth to a magnitude that a 0.06% increase in outward FDI will translate to a 1% increased economic growth. As such, outward FDI is beneficial to Kenya's economic growth.

**Originality/value** – This study advances OFDI theory and contributes to the growing discussion on the effect it has on the developing country's economy. The study also offers practical contributions on how the government can take a deliberate effort to spur economic growth by regulating the level of outward FDI as this determines the effectiveness of policymaking and fosters international mutual understanding, cultural exchange and firm growth and innovation. Ultimately, this contributes to a healthy economy.

**Keywords:** *Outward Foreign Direct Investments, Economic Growth, Panel Data*

**Paper type:** Research paper

### Introduction

The Multinational enterprises (MNEs) have a significant role in the development of the host country's economy through the injection of foreign capital (Hendriks, 2020). The increased activities and investments of the MNE has drawn interest and desire for research by the academicians and policymakers throughout the world (Narula & Pinelli, 2018). Formal institutions in the form of government policy and regulations are decisively central to outward foreign direct investments (OFDI) (Hänle, Weil, & Cambré, 2022).

The outward foreign direct investments are attributable to increased financial globalization that exposes the domestic market to foreign markets through the establishment of a significant degree of influence, often a 10% or more of the voting power on the management of an enterprise in a foreign country (IMF, 2022). This offers investors a more direct investment option with lesser costs of production as well as higher returns (Noman et al., 2015). Financial globalization lead to foreign direct investment outflows from economies with lower domestic risk sharing due to their higher demand for precautionary assets. This leads to an outflow of direct investments assets based on the holder's view that capital is subjected to high risk levels emanating from such effects as low labor costs, production cost as well as currency devaluation. The investors thus obtain a hedge on their non-financial assets by seeking a safe place to invest (Clement & Ayodele, 2016). This affects a country's exchange rate and economic growth.

Foreign portfolio investment outflows if not well regulated often raise the probability of systemic sudden stops, i.e. large unexpected falls in capital inflows which if uncontrolled, can easily lead to a rapid increase in foreign currency-denominated debt and liquidity crises in the host country (Koskei, 2017). This is often as a result of institutional shifts such as sovereign wealth fund, mutual funds, pension funds, and insurance companies who have created immense avenues for portfolio diversification as investors seek risk free returns (Auzairy, Fun, Ching, Li, & Fung, 2016). Foreign portfolio investment outflows have a direct effect on the foreign exchange rate as well as the economic growth of a country (Ayala, Nedeljkovic, & Saborowski, 2015). Ceteris paribus, foreign portfolio investment outflows have positive role in a country's economic growth, as it is a source of foreign exchange which would positively contribute to economic growth of a country (Ministry of Trade and Industrialization, 2017).

Foreign investors prefer to repatriate their locally earned incomes, dividends and capital gains to reduce the risk on their investments. This decreases the home country's domestic savings (Saxena & Shanker, 2016). Repatriation alleviates the service account deficit of the balance of payments of the country. If host countries fail to design robust policies such as taxation of repatriated earnings or create an enabling environment for re-investment of these earnings in the host country, profit repatriation will be on the increase. The resulting effect will be a decrease in the host country's economic growth (Chenaa & Kimengsi, 2016). This undermines the country's existing investments and decreases the available resources that are key to economic growth (Fischer, 2014). Profit repatriation re-assigns financial savings overseas resulting in fewer resources available to finance domestic investment and promote economic growth (Hendriks, 2020).

The global economy remains trapped in a prolonged period of slow economic growth at 3.1% in year 2016, compared to the previous year's 3.2 percent. In year 2014, the global economy grew by 3.4% and declined marginally to 3.3% in 2015. This prolonged sluggish growth was characterized by weak investments and the rising debt levels (WEO, 2017). In SSA, growth decelerated to 1.6% in 2016 from 3.4% in 2015 due to similar global investment circumstances (Foreign investment survey, 2016) and declined to 3.4% in 2015 from 5.0% in 2014 (WEO, 2015). This demonstrates that Africa is losing lots of investment capital. Looking ahead, the outlook for 2022 and 2023 is

extremely uncertain. Sub-Saharan Africa's prospects are tied firmly to developments in the global economy (IMF, 2022).

The results of this study will benefit policy makers to appreciate that capital flight can affect economic growth and justify its adoption in the existing policies in Kenya. Further, policy makers will benefit greatly in the process of amending the Kenya's investment policy which is currently in draft form. The study further triggers interest for policy makers to investigate the acceptable limits of capital flight in the Kenyan economy and provide critical information to design appropriate policies that control the level of capital flight in Kenya. Further, the results will enable the managers to make informed decisions on the implementation of these policies in Kenya. This will improve the foreign exchange management strategy that will cushion investors from foreign exchange rate fluctuation risks and boost the country's economic growth. Academicians interested in the effect of capital flight studies and the growth of a country's economy will benefit from this knowledge as it aims at shedding light on the conclusions earlier drawn on the pertinent problems of capital flight in Kenya.

Researchers have overwhelmingly focused on the foreign direct investment undertaken by firms from developed economies as well as the development impact of FDI in the host countries that are the recipients of the investment (Hendriks, 2020). With the two biases receiving great attention by academicians and policy makers, limited efforts have been directed towards the effect of MNEs' outward foreign direct investments on the home countries from which they conduct trade. As much as it's indeed an excellent goal to address both biases, the literature on the internationalization of multinational enterprises in the emerging markets has scarcely been addressed to the development consequences of these firms' investments. Insight into these two trade-offs is of acute interest and beneficial to scholars in the FDI development sector. It is expected that future research may address the magnitude of such effects and establish whether the economic benefits of spillovers are of more importance to direct employment losses or vice versa. As such, this study seeks to examine the effect of outward foreign direct investments on the economic growth in Kenya. This study is aimed at shedding more light on this underexplored phenomenon and thereby inform important policy debates.

### **Outward Foreign Direct Investments and Economic Growth**

The Investment Development Cycle Theory was used to address the effect of outward foreign direct investments on the economic growth of Kenya. John Dunning (1993) designed this theory and demonstrated that a country's outward and inward foreign investments depend on its level of economic development, measured by its gross domestic product. This theory states that leading countries follow a predictable pattern consisting of five stages (Iacovoiu & Panait, 2014). Stage 1 demonstrates a less developed economy that does not attract, nor generate any FDI. Stage 2 shows industrializing developing countries seeking to attract FDI through improved location advantages and generate minimum outward foreign direct investment, leading to a negative net investment position (OFDI less inward FDI (IFDI)). Stage 3 shows that a country attracts significant FDI and

generates OFDI based on its innovations and international specialization. The net investment position remains negative. In stage 4, OFDI is higher than IFDI and the net investment position is positive. Stage 5 demonstrates advanced countries, with a balanced net investment position and very high levels of IFDI and OFDI (Zang, 2012).

The proponents of this theory such as Duran and Ubeda (2005) posited that OFDI improves the local companies' ownership advantages and enhances OFDI in future. They associated stages 1-3 with developing countries while stage 4 and 5 with developed ones. Behbehani and Al Hallaq (2013) posited that if the home country uses OFDI as a substitute for its local investments, the increase in its OFDI may reduce the economic growth of the home country. Nayak and Choudhury (2014) in their study embraced the fact that Governments can influence a country's stage of economic growth by regulating OFDI. This theory assessed the effect of outward foreign direct investments on economic growth in Kenya. The theory demonstrate that outward foreign direct investments increase with increased economic development, which offers firms more ownership advantage on economies of scale in production. This investment diversification yields a country locational advantage which goes to boost a country's economic growth as economic growth is positively related to OFDI, and that its increase offers home country financial institutions more liquidity to lend to foreign investors, thus boosting a country's economic growth.

Although various researchers have opined earlier that foreign investment could bring about economic development gains in the home country and the host economy, scholars have only sparsely investigated how the domestic economic environment has been affected by MNEs' outward investment (Hendriks, 2020). The movement of capital from a developing economy is viewed as an investment outflow that negatively affects economic growth. Foreign direct investment outflows are a function of high uncertainty and risk with respect to returns on assets held domestically (Henry, 2013). Thus, investors often prefer to hold their assets abroad as a part of risk diversification (Obidike et al., 2015). This worsens a country's economic activity, more so if it heavily depends on internal financing (Uguru, 2016). The governing authority should seek to achieve an equilibrium state between the levels of foreign direct investment outflow and economic growth.

Foreign direct investment outflows have adverse effect on the growth rate of GDP. The stagnation and economic decline resulting from lack of regulating the foreign direct investment outflows are an indication that the government has lost control over the economy (Ndikumana & Boyce, 2008). For this reason, both licit and illicit capital outflows have found an easy escape out of the host country. When outward foreign direct investment leads MNEs to expand research and development activities at home countries, there is considerably an expanded scope for a positive development impact in the country (Hendriks, 2020). Although there are numerous studies on the relationship between foreign direct investment inflows and economic growth, the number of studies on the relationship between outward foreign direct investment and economic growth is very limited (Ameer, Xu & Alotaish, 2017).

Hendriks (2020) examined how outward investment from emerging markets affects economic development at home: using the eclectic paradigm to synthesize two IB literatures. The study aimed to use the eclectic paradigm as a broad organizing framework to bring together two somewhat parallel international business (IB) literatures, one on the development effects of multinational enterprise activity and the other on the internationalization of emerging market multinationals (EMNEs). The author does so to better understand how outward foreign investment shapes economic development in firms' home countries. The study found out that the eclectic paradigm is a valuable framework that can be used to shed light on underexplored phenomena and thereby inform important policy debates. The analysis suggests that unique characteristics of EMNE investment simultaneously have positive and negative development consequences in their home countries.

Ameer and Xu (2017) investigated the long-run effect of inward and outward foreign direct investment on economic growth: evidence from 28 developing economies over time period 2005-2014 annually. The study employed the Ordinary Least Squares (OLS) and Generalized Method of Moments (GMM) on the basis of macroeconomics panel data in developing economies. The study found that there is a positive and significant impact of foreign direct investment outflows and inflows on economic growth in the long run among developing economies. Further, the positive and significant effects of FDI inflows and outflows on economic growth were highly robust when different econometric techniques were employed.

Bano and Tabbada (2015) examined the extent and determinants of Foreign Direct Investment outflows in East, Southeast, and South Asian developing countries. The study used correlation and regression analysis for the sample period between 1980 and 2011. They found that foreign direct investment outflows are closely associated with high levels of GDP, high domestic savings, large foreign reserves, export orientation, and relatively large foreign direct investment inflows in the source countries, with the strength and importance of each factor varying with the level of development.

### **Methodology**

This study adopted a positivist research philosophical paradigm. Positivists hold true that a reality is stable, observable and described objectively with zero interference with the phenomena being studied. To investigate whether outward foreign direct investment had an effect on economic growth in Kenya, the following panel regression equation was estimated:

$$GDP_{it} = \beta_0 + \beta_1 OFDI_{it} + \mu_{it}$$

Where GDP is economic growth and OFDI is outward foreign direct investment. The data collected was then converted to their natural logs so as to address the dispersion or high values challenges and establish elasticity relationships between the variables. Further, Unit root tests were also conducted on the variables to avoid the problem of having a spurious regression or white noise in the existing model under the study. Levin, Lin and Chu T- statistic test for stationarity which is suitable for panel data sets was later applied in this study. The test covered the most general

specification for all the pooled variables with the inclusion of a constant, a trend and a lag. Finally, a Hausman test was lastly conducted to determine whether to apply the fixed effects model or the random effects model to evaluate the effect of outward foreign direct investments on the economic growth in Kenya.

### Results and Findings

**Table 1: Summary statistics**

	LN_GDP	LN_OFDI
Mean	1.229575	21.75882
Median	1.545507	21.91164
Maximum	2.128503	28.02187
Minimum	-1.461018	13.54338
Std. Dev.	0.862899	3.158391
Skewness	-1.661849	-0.415703
Kurtosis	4.844879	3.019288
Jarque-Bera	119.2170	5.705758
Probability	0.000000	0.057678
Sum	243.4558	4308.245
Sum Sq. Dev.	146.6850	1965.160
Observations	198	198

GDP had a nominal mean of 1.22 and a standard deviation of 0.86 meaning that GDP was not volatile or deviate much during the period of study. The nominal mean of OFDI was 21.75 with a standard deviation of 3.15 signifying stability in OFDI.

**Table 2: Correlation analysis**

Correlation	LN_GDP	LN_OFDI
LN_GDP	1.000000	
LN_OFDI	0.217508	1.000000

OFDI had a correlation coefficient of 0.22 signifying a weak positive correlation with GDP hence no risk of have serial correlation in the model.

**Unit root tests****Intercept and level I (0)****Gross Domestic Product (GDP)**

GDP was found to be stationary at intercept and level I (0) because the Levin, Lin & Chu  $t^*$  statistic had a probability value of 0.0000 which is significant at 5% level of significance. Therefore, we rejected the null hypothesis that GDP had a unit root.

**Table 3: Unit root test for Gross Domestic Product (GDP)**

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu $t^*$	-6.12840	0.0000	7	203
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-8.24925	0.0000	7	203
ADF - Fisher Chi-square	90.2104	0.0000	7	203
PP - Fisher Chi-square	90.2485	0.0000	7	203

**Outward Foreign Direct Investments (OFDI)**

The Levin, Lin & Chu  $t^*$  statistic for OFDI had a probability value of 0.0374 which is significant at 5% level of significance. Therefore, we reject the null hypothesis that OFDI had a unit root.

**Table 4: Unit root test for Outward Foreign Direct Investments (OFDI)**

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu $t^*$	-4.91071	0.0000	7	229
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-3.45651	0.0003	7	229
ADF - Fisher Chi-square	34.5526	0.0017	7	229
PP - Fisher Chi-square	32.3975	0.0035	7	229

**Panel Regression Equation****Hausman test**

The Chi-square test statistic was 3.31 with an insignificant probability value of 0.0690 which was insignificant at 5 percent level of significance. This therefore meant that the null hypothesis was



rejected in favor of the random effects model. Therefore, we accept the random effects model as suitable for this study.

**Table 5: Hausman test**

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	3.305505	1	0.0690

**Table 6: Random Effects Model**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LN_OFDI	0.056442	0.017013	3.317621	0.0011
C	0.006024	0.377227	0.015968	0.9873
Effects Specification				
			S.D.	Rho
Cross-section random			0.000000	0.0000
Idiosyncratic random			0.815494	1.0000
Weighted Statistics				
R-squared	0.047310	Mean dependent var		1.244397
Adjusted R-squared	0.043019	S.D. dependent var		0.832950
S.E. of regression	0.814837	Sum squared resid		147.3989
F-statistic	11.02436	Durbin-Watson stat		1.862259
Prob(F-statistic)	0.001051			
Unweighted Statistics				
R-squared	0.047310	Mean dependent var		1.244397
Sum squared resid	147.3989	Durbin-Watson stat		1.862259

OFDI had a coefficient of 0.06 and a probability value of 0.0011 which is significant at 5 percent level of significance. This means that when OFDI grew by 0.06 units then GDP grew by 1 unit during the period of study.

### Conclusion

This paper investigates whether outward foreign direct investment affected economic growth in Kenya. The study attempted to answer one question. Has economic growth been influenced

significantly by outward foreign direct investments in Kenya? Empirical results show that outward foreign direct investments had a significant effect on economic growth. From the empirical findings, we can infer that outward foreign direct investments contributed positively to economic growth. Kenya should pursue policies geared towards increasing outward foreign direct investments to spur economic growth.

This study has offered practical implications and conclusions on the nexus between outward foreign direct investments and economic growth in Kenya. OFDI had a coefficient of 0.06 and a probability value of 0.0011 which is significant at 5 percent level of significance. This means that when OFDI grew by 0.06 units then GDP grew by 1 unit during the period of study. As such there is a positive and significant relationship between Outward FDI and economic growth to a magnitude that a 0.06% increase in outward FDI will translate to a 1% increased economic growth. As such, outward FDI is beneficial to Kenya's economic growth. In this regard, a deliberate effort by the government to offer direction on outward foreign direct investments will translate into tangible actual support organizations and mechanisms for Kenya's SMEs abroad. This study also found that the understanding of how governments can spur OFDI is important for an economy, as it shapes effective policymaking and growth of the MNE's. This contributes to enhanced international mutual understanding that promotes trade, cultural exchange and social and economic development in both the investment home and host countries.

This study advances OFDI theory and contributes to the growing discussion on the effect it has on the developing country's economy. The study also offers practical contributions on how the government can take a deliberate effort to spur economic growth by regulating the level of outward FDI as this determines the effectiveness of policymaking and fosters international mutual understanding, cultural exchange and firm growth and innovation. Ultimately, this contributes to a healthy economy. Further, the study concludes that there is need for increased research and development activities which must deliberately include unfamiliar areas of knowledge in the process.

This study offers practical implications in that, the understanding of how governments can spur economic growth through internationalization is critical. To be effective in offering outward FDI solutions, the government of Kenya needs to relocate their centers of excellence from universities to innovation hubs offered in partnership with foreign establishments, in order to tap human capital flow and technologies from abroad. This will lead to the adoption of new drivers such as digitalization, business ecosystems and sustainability which will force local investors to adapt and open up their traditionally closed corporate cultures. Over and above that, the deliberate establishment of specific OFDI support organizations and taking these measures can serve as a helpful orientation for Kenya's entrepreneurs who plan to invest abroad.

### **Areas of Further Study**

This study offers insights to future studies in this area and help policy makers and investors appreciate the fact that outward FDI affects economic growth in many ways. Future studies can investigate the magnitude impact of outward FDI on economic growth and development of the

country for the purpose of generating specific policies that will address the equilibrium amount of acceptable outward FDI that will accelerate economic growth in Kenya.

## References

- Ameer, W., & Xu, H. (2017). The long-run effect of inward and outward foreign direct investment on economic growth: Evidence from Developing Economies. *Journal of economic literature*, 3(2), 5-24.
- Auzairy, N. A., Fun, C. S., Ching, T. L., Li, S. B., & Fung. (2016). Dynamic relationships of capital flight and macroeconomic fundamentals in Malaysia. *Journal of Society and Space*, 12(2), 203 - 211.
- Ayala, D., Nedeljkovic, M., & Saborowski, C. (2015). *What slice of the pie? The corporate bond market boom in emerging economies*. Retrieved from <https://www.imf.org/external/pubs/ft/wp/2015/wp15148.pdf>
- Bano, S., & Tabbada. (2015). Foreign direct investment outflows: Asian developing countries. *Journal of Economic Integration*, 30(2), 359 - 398.
- Behbehani, M., & Al Hallaq, S. S. (2014). Impact of home country outward foreign direct investments on economic growth: A Case of Kuwait. *Asian Journal of Business and Management Sciences*, 3, 19-33.
- Chenaa, T. A., & Kimengsi, J. N. (2016). Investigating the role of agriculture, industry and foreign direct Investment in Cameroon's economic growth. *Greener Journal of Social Sciences*, 6(1), 10-18.
- Clement, A. O., & Ayodele, S. O. (2016). An empirical analysis of the impact of capital flight on Nigeria economy. *International Journal of Academic Research in Economics and Management Sciences*, 5(2), 2226-3624.
- Dunning, J. H. (1993). *Multinational enterprises and the global economy*. Wokingham: Addison-Wesley Publishing Company.
- Duran, J., & Ubeda. (2005). The investment development path of newly developed countries. *International Journal of the Economics of Business*, 12(1), 123-137.
- Fischer, A. (2014). Redistribution as social justice for decarbonising the global economy. *Journal of Economic and Labour Relations Review*, 25(4), 574– 586.
- Foreign investment survey*. (2016). Retrieved from Kenya National Bureau of Statistics: [www.knbs.or.ke/index.php?...foreign-investment-s](http://www.knbs.or.ke/index.php?...foreign-investment-s)
- Hänle, F., Weil, S., & Cambré, B. (2022). China's OFDI support mechanisms in Germany: how governments can work together to promote SME internationalization, reduce liability of foreignness and contribute positively to society. *Journal of Entrepreneurship in Emerging Economies*, 2053-4604. doi:10.1108/JEEE-08-2021-0327
- Hendriks, G. (2020). How outward investment from emerging markets affects economic development at home: using the eclectic paradigm to synthesize two IB literatures. *Multinational Business Review*, 28(4), 463-482. doi:10.1108/MBR-10-2019-0133

- Iacovoiu, V. B., & Panait, M. (2014). The limitation of investment development path theory. European Union Case. *Economic Insights – Trends and Challenges*, III LXVI(4), 33-40.
- IMF. (2022). *Regional Economic Outlook*. Washington, DC: International Monetary Fund.
- Koskei, L. (2017). The Effect of Foreign Portfolio Equity Sales on Stock Returns in Kenya: Evidence from NSE Listed Financial Institutions. *International Journal of Economics and Finance*, 9(4), 185 - 190.
- Ministry of Trade and Industrialisation. (2017). *Kenya Investment Policy*. Ministry of Trade and Industrialisation. Nairobi: Ministry of Trade and Industrialisation. Retrieved from <https://kepsa.or.ke/download/kenya-investment-policy-draft/>
- Narula, R., & Pinelli, A. (2018). Improving the developmental impact of multinational enterprises: policy and research challenges. *Journal of Industrial and Business Economics*, 46(1). doi:10.1007/s40812-018-0104-2
- Ndikumana, L., & Boyce, J. K. (2008). *New estimates of capital flight from Sub-Saharan African countries: Linkages with external borrowing and policy options*. Political Economy Research Institute (PERI).
- Noman , A., Rahman, M. N., & Naka, A. (2015). Portfolio investment outflow and the complementary role of direct investment. *Journal of Financial Economic Policy*, 7(3), 190-206.
- Onder, G., & Karal, Z. (2013). Determinants of foreign direct investments outflow from a developing country: The case of Turkey. *Business, Management and Education Journal*, 11(2), 241–255.
- Saxena, S. P., & Shanker, I. (2016). Dynamics of external debt and capital flight in India. *International Journal of Management & Development*, 3(2), 49-62.
- Simon, H. (2022). Hidden champions in the Chinese century: ascent and transformation. *International Business and Economics Studies*, 4(1).
- Uguru, L. C. (2016). On The Tax Implications of Capital Flight: Evidence from Nigeria. *Journal of Research in Economics and International Finance*, 5(1), 1-7.
- WEO. (2017). *Adjusting to lower commodity prices*. World Economic Outlook. Retrieved from <https://www.imf.org/external/pubs/ft/weo/2015/02/pdf/text.pdf>
- Zang, W. (2012). The determinants of inward and outward FDI and their relationship with economic growth. (Published Doctoral Dissertation), University of Bradford, The School of Social and International Studies. *Published Doctoral Dissertation, University of Bradford, The School of Social and International Studies*. Retrieved from <https://bradscholars.brad.ac>