

## CHALLENGES FACING LICENCING PROCESS OF FOREIGN DIRECT INVESTMENTS: A CASE OF KENYA INVESTMENT AUTHORITY

**Catherine K. Gachenge**

Student, Jomo Kenyatta University of  
Agriculture and Technology  
KENYA

**Dr. Karanja Ngugi (PhD)**

Lecturer, Jomo Kenyatta University of  
Agriculture and Technology  
KENYA

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### ABSTRACT

*Kenya Investment Authority (KenInvest) is mandated to issue foreign investor with an Investment Certificate, here in referred to as license, so that the investor can begin his economic activities in the country. The certificate allows the investor to immediately start the business operations prior to obtaining other relevant requirements. Many investors have complained that the process of issuing is time consuming and even after the issuance it is difficult to start operations as there are other government agencies' prereliquisites one needs to fulfil. Therefore, there was need to investigate challenges facing KenInvest in licensing foreign direct investment in Kenya. Specifically, the study established how license regulations affect foreign direct investment, and how KenInvest staffing, organisation structure and technology influence the licensing process. The study used descriptive research design with a focus on both qualitative and quantitative characteristics and status of the licensing and KenInvest structure. The target population of the study was 62 staff of KenInvest. The researcher used stratified random sampling to select 24 respondents. The results showed there is transparency in licensing. In addition majority of the respondents were in agreement that the single piece of legislation which was established gives greater clarity, transparency and confidence to investors. From the findings, KenInvest has embraced information technology in its operations. Computerization and networking of offices has improved issuance of the license by KenInvest. From the findings, the staff of KenInvest are adequate to handle licencing workload. However, some respondents argued that they were in-*

*adequate and recommended that more staff be recruited. From the findings, several organizational factors influence licensing process. These are Executive Director's leadership, followed by organizational procedures, management skills, employee training and financial resources.*

**Key Words:** *Technology, Organizational structure, Financial Resources Allocation, Foreign direct investment*

## Introduction

Developing countries are now giving new attention to the potential for foreign direct investment in their economies. These countries' governments are formulating and implementing laws that will ensure that the country attracts foreign investors and ensuring that they operate in a competitive environment (Durham, 2004). This is because many developing countries now desire to extend the market price system and the private sector and mitigate the external debt problem by attracting more private foreign investment. Foreign direct investment (FDI) has become increasingly important in the developing world, with a growing number of developing countries succeeding in attracting substantial and rising amounts of inward FDI (Graham 2006). Economic theory has identified a number of channels through which FDI inflows may be beneficial to the host economy. Yet, the empirical literature has lagged behind and has had more trouble identifying these advantages in practice. Most prominently, a large number of applied papers have looked at the FDI-GDP growth nexus, but their results have been far from conclusive. Notwithstanding, the absence of any robust conclusions, and somewhat surprisingly, most countries continue to vigorously pursue policies aimed at encouraging more FDI inflows (Hanson, 2001).

Multinationals are the vehicles for much of this globalized economic activity, and in turn, foreign direct investment by multinational corporations accounts for an increasing proportion of global economic activity. The escalation in international investment means that a country's sustainable development is progressively more influenced by Multinational Enterprises (MNEs) (Vernon, 1966). Foreign direct investment combines aspects of both international trade in goods and international financial flows, and is a phenomenon more complex than either of these. The growth of international production is driven by economic and technological forces. It is also

driven by the ongoing liberalization of Foreign Direct Investment (FDI). Foreign direct investment has been an important element of Kenya's economic development process.

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. The Kenya Investment Authority (Ken Invest) is the successor institution to the Investment Promotion Centre, which was established in 1986 with the primary role of attracting and retaining local and foreign direct investment in the country.

### **Statement of the Problem**

Foreign Direct Investment (FDI) flows to Kenya have not only been highly volatile, they generally declined in the 1980s, 1990s and 2000s despite the economic reforms that took place and the progress made in improving the business environment. Faced with the pressures of globalization of capital movement and the threat that companies will relocate unless provided with concessions such as more lax regulations and lower taxes, Kenyan government has responded by promoting tax incentives to attract and retain investment capital. The other measure is to reform licensing framework in order to make the licensing process simple and streamlined. The government established KenInvest to attract and promote foreign investments into the country. One of its mandate is to issue investors with Investment Certificate to enable them commence their investment operations. However, the investors assert that even with this Certificate they are unable to commence their investment as they are required to obtain other requirements from other government agencies. Others argue that the process of issuing the Certificate is long and time consuming.

Kenya has been experiencing decline in FDI in the Export Processing Zones (EPZ) despite the many incentives available to firms located in the Export Processing Zones. The EPZ has all the necessary infrastructure including roads, electricity, water and centralized licensing offices making it easy for EPZ firms to get regulatory approvals within shortest time possible. Since the

establishment of EPZ in 1990 the response in FDI flow has not been as good as expected. There has been decline of the flow of FDI in EPZs hence the purpose of this study. For example in the year 2009, Kenya only managed to get US\$ 141 million in FDI flows compared to Uganda which got US \$800 and Tanzania US \$655 million (UNCTAD, 2010).

In Kenya few studies have been conducted on FDI. Kinaro (2006) using time series analysis finds that FDI in Kenya is determined by economic openness, human capital, real exchange rate, inflation, and FDI in the previous periods. Opolot et al (2008) using panel data for Sub Saharan African Countries, Kenya included found that market potential, openness to trade, infrastructure, urbanization, and rate of return on investment positively affect foreign direct investment inflows to Sub-Saharan Africa, while macroeconomic instability is a disincentive to foreign direct investment. Other variables such as government consumption, financial development, natural resources, wage and political rights are found to be insignificant. Mwega and Ngugi (2004) using panel data of 43 countries with a Kenyan dummy found that Kenya is not different from other countries and that FDI is determined by growth rates, terms of trade shocks, external debt ratio and quality of institutions.

Given all this, it is evident that relying on the KenInvest in its current form to attract and promote FDI may not be practical. It is therefore important to establish challenges the country faces in attracting and promoting FDI. Therefore the study sought to investigate the challenges facing administration of licences to foreign investors by Kenya Investment authority.

### **General Objective**

The general objective of the study was to investigate challenges of the impact of licensing process on foreign direct investment in Kenya.

### **Specific Objectives**

The Specific objectives were;

- i. Investigate how license regulations affect foreign direct investment.
- ii. Determine whether KenInvest staffing influence foreign direct investment.
- iii. Determine the influence of organisation structure of KenInvest on foreign direct investment.

- iv. Determine the influence of technology use by KenInvest on foreign direct investment.

### **Significance of the Study**

The study can help the management of the Kenya Investment Authority to come up with clear guidelines on the procedures which an investor needs to follow when seeking the license and also on the need to reduce the number of licenses which the investor needs to have in order to operate. In this way it can reduce the time it takes for an investor to acquire the license.

This study is beneficial to the government especially the Ministry of Finance and that of Trade in making policy decisions whose overall objectives are to accelerate the rate of growth in the amount of foreign direct investment and take advantage of the growing world markets. The study is important to the scholars as it contributes to the body of existing literature on the subject. They can use its findings to further reasearch in this area.

### **Theoretical Review**

#### **Market Imperfection Theories**

Firms constantly seek market opportunities and their decision to invest overseas is explained as a strategy to capitalize on certain capabilities not shared by competitors in foreign countries (Morgan, 1997). Hymer (1960), often considered the father of the theory of MNCs, sees a multinational firm as a typical oligopolistic firm that possesses some sort of superiority and that looks for control in an imperfect market with a view to maximizing profit. According Hymer (1960) the seminal work was a radical departure from the conventional neoclassical approaches. FDI involves extra costs such as differences in culture, costs due to less favorable treatment from host country's government and costs and risk of exchange rate fluctuations. Foreign direct investment is not because firms search for lower costs of production abroad. Firms are prepared to meet extra costs because of expected increase in market power and thus extra profits.

#### **International Production Theory**

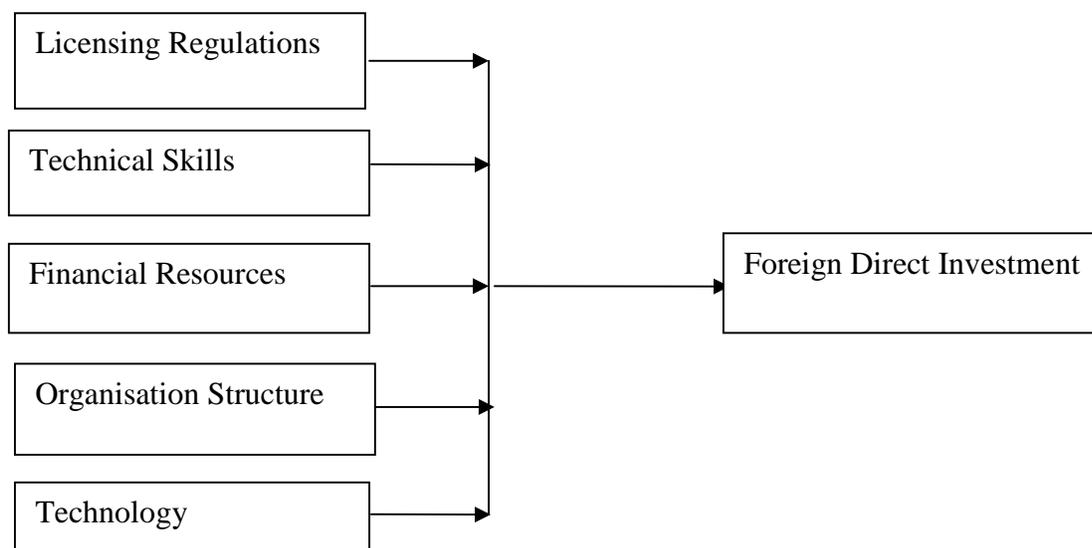
According to Dunning (1980) and Fayerweather (1982) the propensity of a firm to initiate foreign production will depend on the specific attractions of its home country compared with

resource implications and advantages of location in another country. This theory makes it explicit that not only do resource differentials and advantages of the firm play a part in determining overseas investment activities but foreign government actions may significantly influence the piecemeal attractiveness and entry condition for a firm (Morgan, 1997).

The theory endeavors to explain how and why a firm engages in overseas activities and in particular how the dynamic nature of such a behavior can be conceptualized. Piercy (1981) and Turnbull (1985) describe internationalization as the outward movement of a firm's operations. Welch and Luostarinen (1988) explain internationalization as the process of increasing involvement in international operations. Internationalization theory was inspired by the work of Scandinavian researchers (Uppsala school) e.g. Johnson and Vahlne (1977).

According to Vahlne (1977), the firm proceeds along the internationalization path in the form of logical steps based on gradual acquisition and use of intelligence from foreign market and operations which determine successively greater levels of commitment to those overseas destinations. Johnson and Vahlne have postulated that internationalization is based on learning through experiential knowledge about foreign market which is gained so as to reduce their psychic distance. Consequently, the firm is able to enter further overseas markets previously characterized by greater levels of psychic distance and thereby commit greater levels of resources to internationalization.

### Conceptual Framework



### **Critique of the Literature**

As mentioned by Chowdhury and Mavrotas (2005), a large number of empirical studies on the role of FDI in host countries suggest that FDI is an important source of capital, complements domestic private investment, is usually associated with new job opportunities and enhancement of technology transfer and spillover, human capital (knowledge and skill) enhancement and boosts overall economic growth in host countries (Carkovic and Levine 2003, Hanson 2001 ). It should be pointed out that some studies could not also establish clearly the factors affecting licensing. For instance, Carkovic and Levine (2002) uses a mix of countries and analyzed a data sample of 72 countries, ranging from the United States to Rwanda, that includes aggregate FDI flows to each of the countries. The results of their analyses indicate that the exogenous components of FDI have no effect on licensing.

Durham (2004), also failed to identify those factors, but instead suggests that the effects of FDI are contingent on the absorptive capability of host countries. This is confirmed by Xu (2000) who investigated US multinational enterprises as a channel of international technology diffusion in 40 countries from 1966 to 1994. Using data from 10 East Asian economies, Kholdy (1995) carries out Granger causality tests but does not find causation between FDI and productivity.

A review of the literature reveals that empirical evidences from African economies based on rigorous panel data analysis, have been very scarce and mixed results exist in the existing literature research of FDI-growth. Importantly as well, the issue of causality and endogeneity has not received treatment until lately and even then, the few works report mixed results from bilateral causality tests.

In an earlier paper, Bardhan (1982) also evaluated the two market entry possibilities and their welfare effects. By comparing consumer's surplus in the subsidiary case with consumer's surplus plus the firm's profits in the licensing case, he found FDI to contribute more to national welfare than licensing the technology from the MNE. The primary reason for this is the assumption of monopoly pricing of intermediate goods for downstream producers: in the licensing case, the domestic firm is forced to pay monopoly prices for the intermediate goods to the MNE from which it also licenses the production technology. Since this does not take place in the case of FDI, the product prices are lower and therefore the consumer's surplus higher. Abel-Latif and

Nugent (1993) later use Bardhan's frame work and add countertrade as a third option, finding that countertrade (a transaction in which a seller provides a buyer with deliveries and contractually agrees to purchase goods from the buyer equal to an agreed-upon percentage of the original sales value) is superior to both FDI and licensing. The reason is the mutually beneficial relationship created by the countertrade agreement between the developing country and the MNE.

### **Research Methodology**

The study used descriptive research design with a focus on both qualitative and quantitative characteristics and status of the licensing and KenInvest structure. A descriptive design describes the state of affairs as it exists at present (Herve, 1988).

The target population of the study was 62 staff of KenInvest (KenInvest HR department 2012). The population consists of the different cadres of employees at the KenInvest that are deemed to be versed with the licensing process of the foreign direct investments and the foreign direct investors themselves.

The researcher used stratified sampling because of ease of classifying the population in three stratas, that is, Ken Invest Staff- Investor services department and Research policy advocacy and planning department and direct foreign investors' department. According to Mugenda and Mugenda (1999) a sample of 10% is considered representative. A sample size of 24 was selected. The study used primary data which was collected by means of a structured questionnaire containing structured questions from the KenInvest staff. The questionnaires were hand delivered to the respondents' offices with a request to fill in the questionnaire in one week time where upon it was collected.

The data collected was analyzed using descriptive (such as measures of central tendency, percentages and measures of variations) and inferential statistics, that is, correlation analysis. Correlation analysis investigated relationship between independent and dependent variables at the same time indicating the direction and strength of the relationship. The data was presented using frequency distribution tables.

## **Results of the Findings**

### **Licensing Regulations and FDI**

The results showed there is transparency in licensing. In addition majority of the respondents were in agreement that the single piece of legislation which was established gives greater clarity, transparency and confidence to investors. From the findings, licensing regulations influences FDI to great extent. Most of the staff understand the provisions of the Act governing licensing. In addition, licensing legislation is rarely complicated and sections of investment promotion legislations that do not inhibit FDI. Most countries have put rules in place guaranteeing investors an unrestricted remittance of dividends, profits and liquidation proceeds, on condition that payment of taxes and other liabilities has been made according to local regulations. Most of African countries have retained restrictive practices toward some specific categories of FDI. By accepting the obligations of the International Monetary Fund (IMF) to remove restrictions on payments and transfers for international transactions and to adopt multilateral payment system free of restrictions and discriminations, these countries opened up their markets to the outside world, (Mengistae, 2004).

### **Technology in Promoting FDI**

From the findings, KenInvest has embraced information technology in its operations. Computerization and networking of offices has improved issuance of the license by KenInvest. Majority reported that introduction of technology by KenInvest has affected flow of FDI in Kenya. From the findings, the licensing process has become an impediment to direct foreign investment and the Government of Kenya is putting in place an advanced technology to aid in faster processing and tracking the applicants profiles. Sharma (1989) observes that when multinational firms invest in third world countries, they bring technology and managerial skills with them. It is also noted that, one of the reasons why third world developing countries promote foreign direct investment is to get modern technology.

### **Technical Skills**

From the findings, the staff of KenInvest are adequate to handle the licencing workload. However, some respondents argued that they were inadequate and recommended that more staff be recruited. From the findings, staff working for KenInvest are well trained to handle th licensing process. Further, staff technical skills affects FDI flows in Kenya positively. From the findings, the relevant technical skills increase the FDI flows. One of the main objectives of setting up FDI is to transfer technology from the developed countries to the host countries. According to Kogut and Zander (1992), if the value of the firm is defined as its store of knowledge, and expansion of the firm's boundaries is related to the transfer of knowledge, then inescapable uncertainties about the value of this knowledge are enough to explain internal transmission, and therefore the existence of firms - opportunism is not required. Therefore, they find the critical role that opportunistic behavior by transactional partners in markets plays in internalization models is not necessary but leads to an over determined model.

### **Organizational Structure**

From the findings, several organizational factors influence licensing process. These are Executive Director's leadership followed by organizational procedures, management skills, employee training and financial resources. Reward policy has the least contribution to successful license issuance. Organizational structure is a major priority in implementing a carefully formulated strategy. According to Hax and Majluf (1996), strategy and structure interact. The general conclusion is that the organizational factors had contributed to successful issuance of the license. On organizations' determination in implementating licensing reforms for FDI promotion, it can be concluded that the KenInvest management is highly determined in implementating licensing reforms for FDI promotion. Matching organization structure to strategy requires that a customized structure be put in place. This is because each strategy is grounded in its own set of key success factors and value chain activities and each firm's organization chart reflects past organizational patterns, executive judgments on reporting relationships, assigning responsibilities, and varying internal circumstances unique to that organization.

### Normality test

The Normality test presents the results from two well-known tests of normality, namely the Kolmogorov-Smirnov Test and the Shapiro-Wilk Test. In this Shapiro-Wilk Test was used as it is more appropriate for small sample sizes (< 50 samples). For this reason, Shapiro-Wilk test was used as the numerical means of assessing normality. The computation was performed using SPSS and the results presented in the following table and graph.

### Normality test results

	Tests of Normality <sup>b</sup>					
	Kolmogorov-Smirnova <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Foreign direct investment	.385	3	.200*	.750	3	.599

a. Lilliefors significance correction

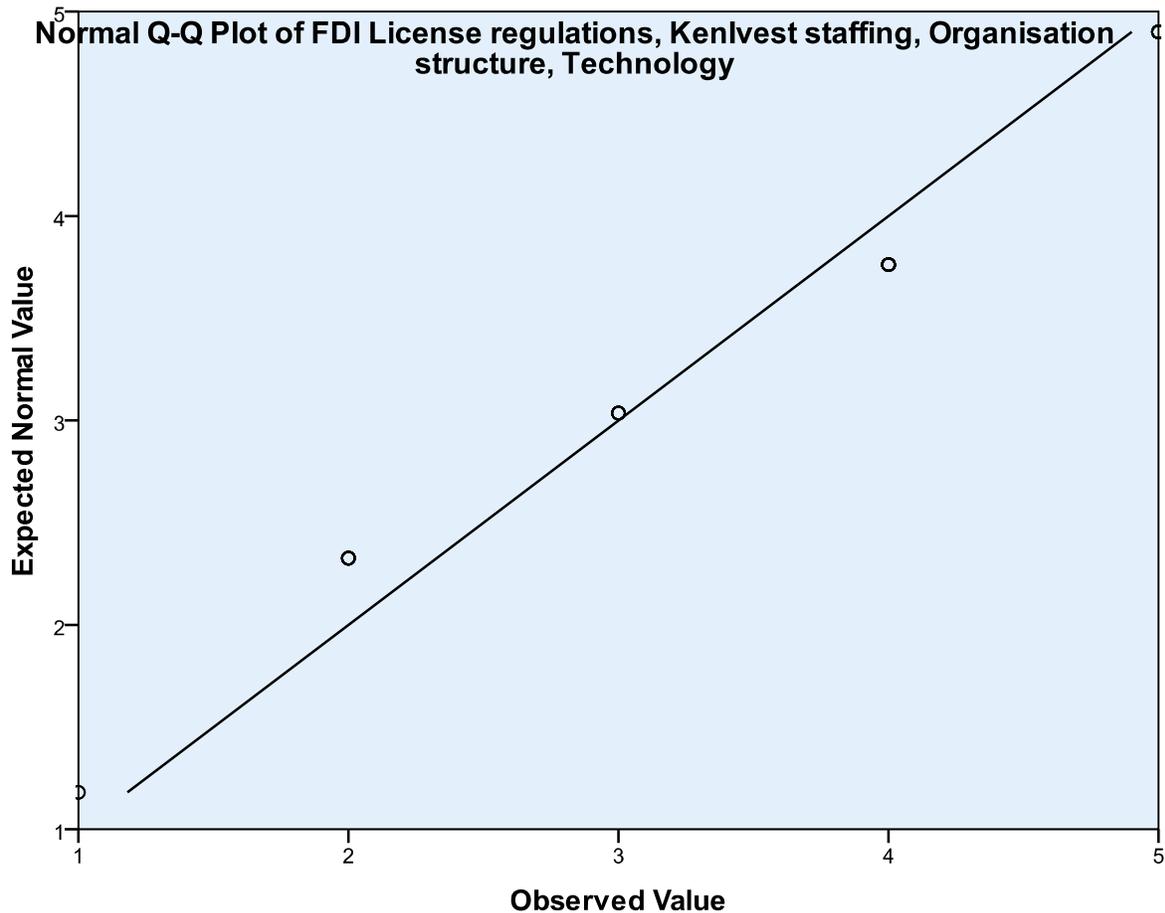
\* This is a lower bound of the true significance

b. License regulations, KenInvest staffing, Organisation structure, Technology

From the findings, the Shapiro-Wilk test is analyzing the normality of Foreign direct investment on the data of independent variables (License regulations, KenInvest staffing, Organisation structure, Technology). As the **Sig.** value under the Shapiro-Wilk column is greater than 0.05 we conclude that Foreign direct investment for this set of variable is normally distributed.

The same data from the variables are now also being analyzed to produce a Normal Q-Q Plot as below.

Figure 4.1: Normality graph



From this graph we can conclude that the data appears to be normally distributed as it follows the diagonal line closely and does not appear to have a non-linear pattern.

### Inferential statistics

This part presents a discussion of the results of inferential statistics. The study conducted a multiple regression analysis to determine the relative significance of each of the variables with respect to foreign direct investment. The study applied the statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions for the study. Findings are presented in the following tables;

**Model Summary**

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate	a.
1	.915 <sup>a</sup>	.837	.805	.52038	Predictors:

(Constant), License regulations, KenInvest staffing, Organisation structure, Technology

b. Dependent Variable: foreign direct investment

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (foreign direct investment) that is explained by all the four independent variables (License regulations, KenInvest staffing, Organisation structure, Technology).

The four independent variables that were studied, explain 83.7% of variance in foreign direct investment as represented by the R<sup>2</sup>. This therefore means that other factors not studied in this research contribute 16.3% of variance in the dependent variable.

**ANOVA (Analysis of Variance)**

Model		Sum of Squares	d.f	Mean Square	F	Sig.
1	Regression	1.015	5	.214	10.7	.001 <sup>a</sup>
	Residual	5.001	10	.020		
	Total	6.016	15			

a. Predictors: (Constant), License regulations, KenInvest staffing, Organisation structure, Technology

b. Dependent Variable: foreign direct investment

Analysis of Variance (ANOVA) consists of calculations that provide information about levels of variability within a regression model and form a basis for tests of significance. The "F" column provides a statistic for testing the hypothesis that all  $\beta \neq 0$  against the null hypothesis that  $\beta = 0$  (Weisberg, 2005). From the findings the significance value is .000 which is less than 0.05 thus the model is statistically significant in predicting how License regulations, KenInvest staffing,

Organisation structure, Technology affect foreign direct investment. The F critical at 5% level of significance was 3.19. Since F calculated is greater than the F critical (value = 10.7), this shows that the overall model was significant.

### Multiple Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
	B	Std. Error			
(Constant)	3.374	.842		4.009	.000
License regulations	0.842	.046	0.330	1.830	.001
KenInvest Staffing	0.616	.13	0.032	5.046	.0041
Organisation Structure	0.754	.88	0.167	8.545	.0035
Technology	0.775	.65	0.154	4.5779	.0022

From the regression findings, the substitution of the equation ( $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4$ ) becomes:

$$Y = 3.374 + 0.842X_1 + 0.616X_2 + 0.754X_3 + 0.775X_4$$

Where Y is the dependent variable (foreign direct investment),  $X_1$  is License regulations,  $X_2$  is KenInvest staffing,  $X_3$  is Organisation structure and  $X_4$  Technology.

According to the equation, taking all factors constant at zero, foreign direct investment will be 3.374. The data findings also show that a unit change in license regulations will lead to a 0.842 change in foreign direct investment; a unit change in technology will lead to a 0.775 change in FDI, a unit change in Organisation Structure will lead to a 0.754 change in FDI and a unit change in KenInvest staffing will lead to a 0.616 change in FDI. This means that the most significant factor is license regulations followed by technology.

At 5% level of significance and 95% level of confidence, license regulations had a 0.001 level of significance; KenInvest staffing had a 0.0041, Organisation Structure had a 0.0015 while Technology had 0.22 level of significance implying that the most significant factor is license regulations followed by technology, Organisation Structure and lastly KenInvest Staffing.

## **Conclusion**

From the findings, the study concluded that there is transparency in licensing in KenInvest. The legislation gives greater clarity, transparency and confidence to investors. Most of the staffs understand the provisions of the Act governing licensing. In addition, licensing legislation is rarely complicated and sections of investment promotion legislations do not inhibit FDI. In conclusion, KenInvest has embraced information technology in its operations. The introduction of technology by KenInvest has affected flow of FDI in Kenya. The study concluded that the staff in KenInvest are adequate to handle licencing workload. The staff working for KenInvest are well trained to handle the investments licensing process. Further, staff technical skills affects FDI flows in Kenya positively. Thus the relevant technical skills increases the FDI.

In conclusion, Executive Director's leadership organizational procedures, management skills, employee training and financial resources influence FDI. On organizations' determination in implementating licensing reforms for FDI promotion, it can be concluded that the KenInvest management is highly determined in implementating licensing of reforms for FDI promotion. Thus, the challenges facing the KenInvest in licencing foreign investors have contributed to decline in flow of FDI into the country.

## **Recommendations**

The following recommendations for improvement were proposed: There is need for KenInvest and other relevant authorities such as Kenya Law Reform Commission and parliament to amend the foreign investment licensing laws and regulations with an aim of establishing a simple and streamlined business licensing process. KenInvest is recommended to hasten the processes of remodeling its organisation structure into an OSS for investors in order to adequately respond to investor needs. There is need to improve on licensing administration. This can be done through higher budget outlays to the KenInvest and strengthening the development of technical skills of KenInvest staff. The authority needs to pay attention to investor education, creating awareness on licensing processes and its importance. The respondents reported that the Authority is embracing morden technology in its process. Thus initiatives need to be fastracked, much is needed to educate them on the importance of e-licensing.

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