


ADDIS ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MBA PROGRAM

# Institutional Quality and Inward Foreign Direct Investment in Sub-Saharan Africa

**By: Genet Mulate**

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# Institutional Quality and Inward Foreign Direct Investment in Sub-Saharan Africa

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**DEPARTMENT OF BUSINESS ADMINISTRATION MASTERS OF BUSINESS ADMINISTRATION IN FINANCE**

# Institutional Quality and Inward Foreign Direct Investment in Sub-Saharan Africa

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# Declaration

I, Genet Mulate, hereby declare that the research work titled “Institutional Quality and Inward Foreign Direct Investment in Sub-Saharan Africa" represents my own efforts and study. I affirm that all sources utilized in this study have been appropriately acknowledged. The content of this work is the result of my independent effort, with the exception of guidance and suggestions provided by my Research Advisor. Furthermore, I confirm that this study has not been previously submitted for any degree at this University or any other institution. It is submitted as partial fulfillment for the Master's in MBA program.

By: Genet Mulate



Signature_____

Date _____10/03/2024_____

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# Acronym

AfCFTA - African Continental Free Trade Area

FDI – Foreign Direct Investment

GDP – Gross Domestic Product

GMM – Generalized Method of Moments

IMF – International Monetary Fund

SSA – Sub-Saharan Africa

UNCTAD – United Nations Conference on Trade and Development

WB – World Bank

WGI – Worldwide Governance Indicators

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# Abstract

*This study aimed to investigate the impacts of institutional quality on foreign direct investment (FDI) in Sub-Saharan Africa, focusing on identifying key economic challenges and opportunities to inform strategic policy interventions. The research problem stems from persistent socio-economic vulnerabilities in African economies, including weak institutional frameworks and their impacts on capital flows or FDI which is key for technology transfer, economic diversification and economic growth in the region. Employing a quantitative research design and a deductive research approach, the study analyzed secondary data collected from reputable global financial and economic databases. A purposive sampling technique was used to select countries based on economic diversity, regional representation, and data availability. Data analysis involved descriptive and inferential statistical methods to ensure robust and reliable findings. Using panel data for selected SSA countries for the period from 2000 to 2003 and employing generalized method of moments (GMM) and quantile regressions, the study provides evidence that the quality of governance is a critical determinant of inward FDI in SSA. The key findings revealed that the performance of inward FDI is significantly influenced by the quality of governance, including Control of Corruption, Rule of Law, Voice and Accountability, Government Effectiveness, Political Stability and Absence of Violence/Terrorism and Regulatory Quality. The analysis reveals a great extent of heterogeneity. Countries with lower levels of FDI benefit most from improvements in the quality of governance. The study concludes that tailored interventions, including strengthening institutional frameworks and the quality of governance are crucial for enhancing the inflow of foreign direct investment which is crucial for economic growth and resilience in Africa. The findings have important policy implications. Improving the quality of governance and institutional quality is crucial for African countries in order to facilitate inward FDI to the region. Policy reforms, capacity building, and stakeholder engagement to address unique challenges regarding the issue of governance is a game changer. This study contributes to the discourse on sustainable economic development in Africa, providing a roadmap for policymakers, development partners, and private sector actors on improving various aspects of governance that are key for enhancing FDI inflows.*



***Keywords: Quality of Governance, Foreign Direct Investment, Economic Resilience, African Economies, Institutional Quality, Policy Interventions***

# CHAPTER ONE
# INTRODUCTION

## 1.1 Background of the study

In 2022, Sub-Saharan Africa experienced a 44% decrease in Foreign Direct Investment (FDI) inflows, falling to $13 billion due to reduced inflows in major recipient countries like Nigeria and South Africa (UNCTAD, 2023). This sharp decline is attributed to global economic uncertainties, reduced commodity demand, and capital flight arising from geopolitical tensions. Outflows also decreased to $1.2 billion, with South Africa being the main contributor to outward FDI, although some sectors faced declines (UNCTAD, 2023). This represents a significant shift from 2021, as reported in the 2022 World Investment Report, where FDI inflows increased by 14% to $46 billion and outflows were approximately $1.6 billion, showing growth due to improved post-pandemic economic conditions (UNCTAD, 2022).

However, in 2020, as noted in the 2021 report, inflows experienced a 16% decline to $30 billion due to pandemic-related disruptions, and outflows dropped to $2.5 billion, influenced by the global economic slowdown (UNCTAD, 2021). The volatility in FDI flows to the region over these years reflects the impact of global economic conditions, the ongoing pandemic, and regional political and economic stability. Additionally, there have been sectorial shifts with a decline in the extractive industries and a gradual increase in investments in technology and infrastructure. Geopolitical tensions, particularly the Ukraine crisis and rising global interest rates, have further impacted investment flows. Overall, the comparison across the three years highlights the region's susceptibility to external shocks and underscores the necessity for more resilient economic policies and investment strategies (UNCTAD, 2023).

Although Foreign Direct Investment (FDI) flows has increased over the past few years to the region, the distribution and magnitude of these inflows vary significantly across the region. In 2022, several smaller economies showed resilience and achieved positive FDI growth despite global economic challenges. Countries such as Ethiopia, Kenya, and Tanzania recorded increased FDI inflows, attributed to diversified investment interests in manufacturing, renewable energy, and services sectors (UNCTAD, 2023). However, the decline in major economies like Nigeria and South Africa significantly impacted the overall regional figures, reflecting the uneven distribution

of FDI across the continent (UNCTAD, 2023). This uneven growth indicates that while many nations have successfully attracted new investments, primarily in technology, infrastructure, and agriculture, the larger economies have yet to regain their pre-pandemic investment levels (UNCTAD, 2022). Moreover, geopolitical shifts and global economic uncertainties continue to influence investor confidence, affecting both inflows and outflows across the region (UNCTAD, 2021). Therefore, despite the increasing number of countries reporting growth, the overall FDI trend in sub-Saharan Africa remains fragile and susceptible to external economic and political dynamics. Addressing these challenges requires more robust investment policies and regional cooperation to create a more conducive environment for sustainable investment and growth. (UNCTAD, 2021)

This study contributes to the existing literature on international capital flows by providing rigorous empirical evidence on the impacts of quality governance on FDI inflows in selected Sub-Saharan African countries: South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania. These countries were chosen due to their diverse economic structures, significant natural resource endowments, and varying levels of political and economic reforms, making them ideal candidates for assessing the impact of these factors on FDI. Research on capital flows and foreign investments in these nations has been relatively limited and existing studies have paid little attention to the issue of endogeneity and heterogeneity. Therefore, this study seeks to fill this gap by determining whether the numerous governance and political reforms undertaken by these countries have significantly improved the efficacy of the financial systems and institutional factors on enhancing FDI inflows to Africa. In doing so, the study employs advanced econometrics methods to address the issue of endogeneity and heterogeneity and establish causal evidence, unlike previous studies that focus on correlation analysis. Additionally, the study examines the continued influence of natural resource endowments on FDI stocks and flows within these nations, as these endowments play a critical role in attracting foreign investment and shaping economic policies.

## 1.2 Statement of problem

Over the past five years, FDI inflows have risen in four of the regional economic groupings on the African continent, signaling a shift in the dynamics of foreign investment. Notably, countries such as Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania have experienced varying degrees of success in attracting foreign direct investment. Despite these overall positive trends, the performance of these countries has been inconsistent and sometimes unpredictable,

highlighting several underlying challenges and disparities. In Ethiopia, for instance, the government has undertaken numerous economic and political reforms to create a more favorable investment climate.

However, despite these efforts, FDI inflows have been erratic, affected by factors such as political instability, bureaucratic delays, and inadequate infrastructure, which have deterred potential investors and hindered sustained growth in FDI (United Nations Conference on Trade and Development [UNCTAD], 2023). South Africa, historically one of the continent's top recipients of FDI, has also faced a decline in inflows due to issues such as policy uncertainty, energy shortages, and socio-political tensions, which have undermined investor confidence and limited the country's ability to attract and retain foreign investment (World Bank, 2023). Similarly, Nigeria, which has abundant natural resources, particularly in the oil and gas sector, has experienced fluctuations in FDI inflows. The country's heavy reliance on oil revenues, coupled with security concerns and governance challenges, has created an uncertain investment environment, impacting the flow of FDI (African Development Bank, 2023). Kenya has emerged as a regional economic hub, with a focus on technology, manufacturing, and infrastructure development.

While the country has seen an increase in FDI inflows, challenges such as corruption, regulatory inefficiencies, and high taxation rates continue to pose significant obstacles to foreign investors (International Monetary Fund [IMF], 2023). Ghana has implemented various reforms to improve its investment climate, including measures to enhance transparency and reduce corruption. However, the country still faces challenges in attracting FDI, such as inadequate infrastructure, limited access to finance, and high operational costs (UNCTAD, 2023). Rwanda has been recognized for its pro-business reforms and efforts to create a conducive investment environment. Despite these initiatives, the country faces limitations in terms of market size, geographical constraints, and dependence on a few sectors, which have affected its ability to attract diversified FDI (World Economic Forum, 2024). Tanzania, with its abundant natural resources and strategic location, has seen an increase in FDI inflows. However, the country's regulatory environment, policy inconsistencies, and challenges in land acquisition have hindered the full realization of its investment potential (UNCTAD, 2023).

These challenges underscore the need for a comprehensive and targeted approach to address the specific factors influencing FDI inflows in each of these countries. This study seeks to explore the underlying causes of these disparities and propose actionable strategies to enhance the investment climate and attract sustainable FDI in Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania. By doing so, the study aims to contribute to the broader understanding of the factors driving FDI inflows in Sub-Saharan Africa and provide insights for policymakers and stakeholders

## 1.3 Research question

1. Does institutional quality influence FDI inflows into Sub-Saharan Africa?
2. Which governance aspects are most critical for FDI flows?
3. Does the effect of institutional quality on FDI inflows vary across the conditional distribution of FDI in the selected Sub-Saharan Africa?

## 1.4 Research objective

### 1.4.1 General objective

The general objective of this study is to analyze the effect of institutional quality on inward foreign direct investment (FDI) in Sub-Saharan Africa.

### 1.4.2 Specific objectives

1. To provide empirical evidence on the impacts of institutional quality on foreign direct investment (FDI) inflows into Sub-Saharan Africa, addressing the issue of endogeneity.
2. To identify the most critical dimensions of governance indicators those are crucial for FDI inflows in Sub-Saharan Africa.
3. To assess heterogeneity whether the effect of institutional quality on FDI inflows differs by the level of FDI inflows Sub-Saharan Africa.

## 1.5 Significance of the study

The significance of this study is multifaceted, offering valuable insights for future researchers, policymakers, investors, and regulatory bodies. For researchers, it provides a comprehensive analysis of how institutional quality influences FDI inflows within Sub-Saharan Africa, thus contributing to the body of knowledge on international capital flows and institutional economics. Policymakers benefit from understanding the mechanisms through which institutional quality impacts FDI, allowing them to design and implement targeted reforms that enhance the investment climate. Investors gain insights into the varying effects of institutional quality across different countries, enabling them to make more informed investment decisions. Regulatory bodies find the study useful for identifying areas where institutional improvements are necessary to attract and

retain foreign investment. Overall, the study serves as a crucial secondary source, guiding efforts to optimize the investment environment in Sub-Saharan Africa and fostering sustainable economic development across the region.

## 1.6 Scope of the study

### Time and Geographical Scope

This study focused on analyzing the impact of institutional quality on foreign direct investment (FDI) inflows within Sub-Saharan Africa. The geographical scope included a diverse set of countries: Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania, reflecting a broad range of economic and institutional contexts within the region. The temporal scope covered a 23-year period from 2000 to 2023, providing a comprehensive view of the evolving dynamics between institutional quality and FDI inflows. This extensive time frame allowed the study to capture long-term trends and changes in investment patterns, offering valuable insights into the relationships over a significant period.

### Methodological and Theoretical Scope

The study employed a quantitative approach, integrating both methodological and theoretical perspectives. Methodologically, it utilized econometric models to analyze panel data from selected Sub-Saharan African countries. The use of regression analysis and fixed-effects models enabled a robust examination of the relationship between institutional quality and FDI inflows. Data sources included international financial databases, national statistics, and institutional quality indicators, ensuring a thorough empirical evaluation. Theoretically, the study was grounded in Dunning's eclectic paradigm (1988), which provided insights into how institutional quality impacts FDI through ownership, location, and internalization advantages. It also incorporated concepts from institutional economics to explore how governance, rule of law, and corruption influence investment decisions. By merging these methodological and theoretical approaches, the study offered a comprehensive analysis of how institutional factors shape FDI inflows in Sub-Saharan Africa.

## 1.7 Limitation of the study

The study faced limitations related to its scope and methodology. Geographically, while it focused on Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania, it may not fully capture the dynamics in other Sub-Saharan African countries. The 23-year period (2000-2023) covered broad historical trends but given the slow changing nature of institutional quality, it may not be

long period enough to capture the dynamics of the selected economies that pass through a range of political and economic upheavals in the last century.

## 1.8 Definition of key term

**Institutional Quality**: The effectiveness of a country's institutions in enforcing laws, maintaining regulatory frameworks, and providing stable governance. It includes aspects such as rule of law, government effectiveness, and corruption control. The WBGI governance indicators are commonly used as a measure of institutional quality (see e.g., Barra, and Ruggiero, 2023).

**Foreign Direct Investment (FDI)**: Investment by individuals or companies in businesses or assets in another country, involving a long-term interest and significant influence over the enterprise.

**Sub-Saharan Africa (SSA):** The region of Africa located south of the Sahara Desert, characterized by diverse economic conditions and developmental challenges.

**Institutional Quality Indicators**: Metrics used to assess the performance of institutions, including political stability, corruption control, and regulatory quality.

**Economic Reforms**: Changes in economic policies aimed at improving performance and growth, such as deregulation, liberalization, and privatization.

**Natural Resource Endowment**: The availability and quality of natural resources in a country, which can impact its economic development depending on governance and institutional quality.

## 1.9 Organization of the study

This research is organized into five distinct chapters. The first chapter introduces the study by offering background information, detailing the organization of focus, and specifying the research problem, objectives, and significance, as well as the scope and limitations of the study. The second chapter provides an extensive review of existing literature, including theoretical frameworks, empirical research, and conceptual models. The third chapter describes the research methodologies employed in the study. Chapter four focuses on presenting, analyzing, and interpreting the collected data, as well as the analysis of the empirical results from the econometric modelling. The final chapter, chapter five, summarizes the conclusions drawn from the research findings and presents recommendations based on these results.

# CHAPTER TWO

# 2. REVIEW OF RELATED LITERATURE

## 2.1 Introduction

In this section delves into the intricate relationship between institutional quality and Foreign Direct Investment (FDI) within Sub-Saharan Africa (SSA). This section synthesizes theoretical and empirical studies to elucidate how institutional frameworks influence FDI flows and economic outcomes. It examines various theoretical models that explain the dynamics of institutional quality and its impact on foreign investment, alongside recent empirical findings that shed light on the unique challenges and opportunities faced by SSA countries. By exploring these aspects, the literature review aims to provide a comprehensive understanding of how institutional factors shape FDI inflows and contribute to regional economic development, offering insights into the effectiveness of reforms and the role of governance in attracting and sustaining foreign investment.

## 2.3 Institutional Quality Indicators

Institutional quality is a multifaceted concept that encompasses various aspects of governance, legal frameworks, and public administration. It is a critical determinant of economic development and plays a vital role in attracting Foreign Direct Investment (FDI). High-quality institutions create a stable and predictable environment where businesses can operate efficiently, reducing risks and uncertainties that may deter investors. Below are detailed discussions of key institutional quality indicators: government effectiveness, regulatory quality, rule of law, control of corruption, and political stability (Barra and Ruggiero, 2023).

**Government Effectiveness**: is one of the most critical indicators of institutional quality. It refers to the capacity of the government to formulate and implement sound policies and deliver public services effectively. This includes the quality of the bureaucracy, the competence of civil servants, and the government's commitment to its policies. A high level of government effectiveness is associated with the smooth execution of policies and the ability to respond to economic challenges, which, in turn, fosters a conducive environment for business activities. Investors are more likely to invest in countries where the government is capable of maintaining economic stability and implementing reforms that support economic growth (Kaufmann, Kraay, & Mastruzzi, 2010). For example, countries with high government effectiveness, such as Singapore and Germany, tend to attract substantial FDI because of their efficient public administration and the reliability of government policies (Rodrik, Subramanian, & Trebbi, 2004).

**Regulatory Quality**: is another crucial indicator that reflects the ability of the government to develop and enforce regulations that promote private sector development while ensuring fair competition. Regulatory quality involves creating a business environment that is free from unnecessary bureaucratic hurdles and that supports entrepreneurship and innovation. Effective regulatory frameworks reduce the costs of doing business and lower barriers to entry, making a country more attractive to foreign investors. For instance, the ease of starting a business, obtaining construction permits, and enforcing contracts are all aspects of regulatory quality that significantly influence investment decisions. Countries with high regulatory quality, such as New Zealand and the United Kingdom, offer environments where businesses can thrive, leading to increased FDI inflows (Djankov, McLiesh, & Ramalho, 2006).

**Rule of Law**: is fundamental to ensuring that economic transactions are predictable and that contracts are enforceable. It encompasses the extent to which agents have confidence in and abide by the rules of society, including the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. The rule of law ensures that investors' rights are protected and that there is recourse to justice in the event of disputes. Strong legal institutions prevent expropriation and arbitrary actions by the state, which are significant concerns for foreign investors. Countries with a robust rule of law, such as Switzerland and Canada, are often preferred destinations for FDI due to the reliability and fairness of their legal systems (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998). In contrast, weak rule of law in many developing countries is often cited as a significant barrier to investment, as it increases the risk associated with business operations (Rodrik, 2000).

**Control of Corruption**: is an essential indicator that measures the extent to which public power is exercised for private gain. High levels of corruption lead to increased costs of doing business, distort market mechanisms, and create an unpredictable environment, all of which can significantly deter FDI. Corruption undermines the efficiency of public institutions and erodes trust in the government, making it challenging for businesses to operate fairly and competitively. Transparency and accountability in public administration are critical in reducing corruption. Countries like Denmark and Finland, which consistently rank high in corruption control, provide a transparent environment where investors can have confidence in the fairness of the economic system (Mauro, 1995; Wei, 2000). Conversely, in countries where corruption is rampant, such as

in parts of Sub-Saharan Africa and South Asia, FDI is often lower due to the increased risks and costs associated with corrupt practices (Tanzi & Davoodi, 1997).

**Political Stability**: is crucial for maintaining a favorable investment climate. Political instability, which may manifest as frequent changes in government, civil unrest, or political violence, creates significant uncertainty for investors. Stable political environments are associated with consistent policy implementation and reduced risk of abrupt changes in the business environment, both of which are attractive to foreign investors. Political stability ensures that long-term investments are safe from sudden disruptions, such as coups or violent protests that could threaten the viability of business operations. Countries like Japan and Norway, known for their political stability, are more likely to attract and retain FDI because investors are assured of a consistent and secure environment for their investments (Jensen, 2003; Busse & Hefeker, 2007).

In contrast, regions plagued by political instability, such as certain areas in the Middle East and parts of Latin America, often struggle to attract significant FDI. Investors are wary of the risks associated with political instability, including the potential for expropriation, disruptions to supply chains, and the general unpredictability of the business environment (Alesina & Perotti, 1996). Political stability is also closely linked to other institutional quality indicators, as a stable political environment often supports the development of strong regulatory frameworks, effective governance, and the rule of law.

In general, the quality of institutions in a country is a decisive factor in its ability to attract and sustain FDI. Government effectiveness, regulatory quality, rule of law, control of corruption, and political stability are all interrelated indicators that together create a favorable environment for economic growth and investment. Recent empirical studies highlight the importance of these indicators in enhancing a country's attractiveness to foreign investors and in fostering long-term economic development (Ali, Fiess, & MacDonald, 2010; North, Wallis, & Weingast, 2009; Acemoglu & Robinson, 2012). As countries strive to improve their institutional quality, they not only increase their appeal to foreign investors but also lay the foundation for sustained economic progress.

## 2.3 Conceptual Framework and Theories on the Nexus between FDI and Quality of Governance

This section provides detailed overview of the conceptual framework on the relationship between FDI and Quality of Governance including, their interactions, and the mechanisms that explain their relationship. Various theories provide insight into the critical roles of strong institutions in attracting FDI inflows by reducing uncertainty and transaction costs, as well as by deterring corruption and poor governance to enhance FDI thereby lowering business risks

### 2.3.1 Institutional Theory

Institutional theory encompasses institutional effectiveness, rule of law, transparency, and regulatory quality. It posits that that strong institutions attract FDI by reducing uncertainty and transaction costs due to better property rights, policy stability, and lower corruption risks.

Institutional theory highlights the influence of formal and informal institutions on FDI decisions. It argues that firms prefer to invest in countries with stable and supportive institutional environments, as these conditions reduce risks and enhance operational efficiency (North, 1990; Peng, 2003). Institutional factors, such as legal systems, governance, and regulatory frameworks, play a crucial role in shaping FDI flows. Recent studies have examined how institutional quality impacts FDI, particularly in developing and transition economies, emphasizing the growing importance of governance and regulatory environments in investment decisions (Adeleye et al., 2017; Ejemeyovwi & Osabuohien, 2020). This perspective underscores the role of institutional contexts in attracting and sustaining foreign investment.

### 2.3.1 Neoclassical Theory

The neoclassical theory of Foreign Direct Investment (FDI) asserts that capital flows are primarily driven by differences in interest rates across countries. According to this theory, capital will migrate from regions with low returns to those with higher returns, driven by the principle of perfect competition and the market's ability to equalize returns on investment (Aggarwal, 1980; Mankiw, 2015). This theory posits that investment decisions are influenced by variations in the rate of interest, which dictates the demand, supply, and allocation of capital. Despite its foundational role in understanding capital flows, recent critiques have highlighted its limitations, particularly its inability to account for the role of transnational corporations (TNCs) and the complexities of modern global finance. Critics argue that neoclassical theory oversimplifies the

investment decision process by not considering managerial motives or the strategic importance of location beyond mere financial returns (Gaur, 2020).

### 2.3.2 Internalization Theory

Internalization theory, introduced by Rugman and others, provides a framework for understanding why firms prefer to internalize operations rather than relying on external market transactions. This theory focuses on how firms seek to minimize transaction costs and maximize profitability by controlling their foreign operations directly (Rugman, 1986; Banga, 2003). It argues that FDI allows firms to overcome market imperfections and inefficiencies by maintaining ownership and control over their international operations. Recent advancements in this theory have incorporated the impact of digital transformation and technological innovations, which have further refined our understanding of how firms manage international transactions and competitive strategies in a rapidly evolving global market (Vasyechko, 2022).

### 2.3.3 Eclectic Paradigm (OLI Model)

The eclectic paradigm, or OLI model, developed by Dunning, integrates three key factors—Ownership, Location, and Internalization—to explain the determinants of FDI (Dunning, 1988; Dunning, 1993). The model posits that firms invest abroad when they possess ownership-specific advantages, such as proprietary technology or managerial skills, can leverage location-specific benefits, such as market size or resource availability, and can internalize operations to reduce transaction costs. Recent updates to the OLI model have emphasized the importance of institutional quality and governance in influencing FDI decisions, highlighting how factors such as legal frameworks and political stability impact firms' investment choices (Ejemeyovwi & Osabuohien, 2020). This contemporary perspective underscores the role of institutional environments in shaping FDI flows and the strategic decisions of multinational enterprises.

### 2.3.4 Intangible Assets Theory

The intangible assets theory posits that firms engage in FDI to exploit unique, non-tangible assets that provide them with a competitive advantage in foreign markets (Lall, 1980; Bajrami & Zeqiri, 2019). These intangible assets include proprietary technologies, managerial expertise, and brand reputation, which firms leverage to gain a competitive edge. The theory suggests that firms invest abroad to access and apply these intangible assets in international markets where they can create value. Recent research has expanded this theory by exploring the role of digital innovations and

intellectual property in influencing FDI patterns, reflecting the growing importance of technology and knowledge management in global business strategies (Kostova & Roth, 2021)

### 2.3.5 New Growth Theory

New growth theory, introduced by Romer, emphasizes the role of technological progress and human capital in driving economic growth. According to this theory, FDI contributes to economic development by enhancing technological capabilities and capital accumulation (Neeliah & Seetanah, 2016). The theory suggests that investment in technology and human capital leads to increased productivity and economic advancement. Recent studies have further developed this theory by incorporating the effects of digital transformation and knowledge spillovers, which have become critical factors in driving growth and innovation in modern economies (Lucas, 2021). This perspective highlights how FDI can facilitate technological progress and human capital development, contributing to long-term economic growth.

### 2.3.6 Resource-Based View (RBV)

The Resource-Based View (RBV) of FDI suggests that firms invest abroad to acquire and utilize valuable, rare, inimitable, and non-substitutable resources that provide a competitive advantage (Barney, 1991). This theory emphasizes the strategic importance of resource acquisition and management in international investments. Firms seek to leverage unique resources and capabilities to enhance their global competitiveness. Recent research has explored how firms use FDI to access strategic resources such as advanced technologies and skilled labor, reflecting the evolving nature of global business and resource management (Madhok & Tallman, 2020). The RBV highlights the role of strategic resource acquisition in shaping FDI decisions and enhancing firm performance.

### 2.3.8 Eclectic Theory with Institutional Factors

Recent adaptations of the eclectic paradigm have incorporated institutional factors into the OLI model, highlighting how governance, legal systems, and corruption influence FDI decisions. This updated approach recognizes that firms evaluate not only economic but also institutional conditions when making investment choices (Globerman & Shapiro, 2002; Ejemeyovwi & Osabuohien, 2020). By integrating institutional factors into the OLI framework, this perspective provides a more comprehensive understanding of how various elements of the institutional environment impact FDI flows and the strategic decisions of multinational enterprises. This approach reflects the increasing recognition of the importance of institutional quality in shaping global investment patterns.

## 2.4 Relationship between Institutional Quality and FDI

The relationship between institutional quality and Foreign Direct Investment (FDI) has garnered significant attention in recent academic discourse, emphasizing the multifaceted role institutions play in attracting and sustaining FDI inflows. Institutional quality, encompassing governance, regulatory frameworks, political stability, property rights, and the rule of law, serves as a critical determinant of FDI, particularly in developing economies. High-quality institutions provide a stable environment that reduces transaction costs, mitigates risks, and enhances the predictability of returns on investment, thereby making a country more attractive to foreign investors (Globerman & Shapiro, 2003; Dunning, 2008; Adeleye et al., 2017).

Governance structures, which include the enforcement of contracts, the protection of intellectual property, and the presence of efficient judicial systems, are pivotal in creating a conducive environment for FDI. Investors seek assurance that their investments will be protected from expropriation or unfair treatment, which can only be guaranteed by strong and transparent institutions. For instance, countries with robust legal frameworks and a high degree of government transparency are likely to experience higher levels of FDI because these factors reduce the uncertainties associated with investment decisions (North, 1990; Acemoglu & Robinson, 2012; Buchanan et al., 2012).

Political stability is another critical aspect of institutional quality that influences FDI. Political instability, characterized by frequent changes in government, civil unrest, and policy volatility, creates an unpredictable investment climate. Investors prefer stable political environments where the risk of sudden policy shifts or government upheavals is minimal, as this stability ensures the longevity and security of their investments. Studies have shown that political stability is positively correlated with higher FDI inflows, as it provides the necessary confidence for investors to commit capital to long-term projects (Jensen, 2008; Busse & Hefeker, 2007; Hayakawa et al., 2013).

Regulatory frameworks also play a crucial role in shaping the relationship between institutional quality and FDI. Effective regulatory institutions that ensure fair competition, protect against monopolistic practices, and facilitate the ease of doing business are essential in attracting FDI. Countries with burdensome regulations, red tape, and corrupt practices are likely to deter foreign investors, as these factors increase the cost of doing business and reduce the potential profitability of investments. Recent research highlights the importance of regulatory quality, noting that countries with efficient regulatory practices tend to attract more FDI due to the lower operational

risks and higher potential for returns (Kaufmann et al., 2009; Globerman & Shapiro, 2003; Li & Resnick, 2003).

Property rights protection is another vital institutional quality indicator that affects FDI. Secure property rights ensure that investors have legal recourse in the event of disputes and that their assets are protected from arbitrary seizure. Strong property rights are particularly important in industries that require significant capital investment, such as manufacturing and natural resource extraction. Investors are more likely to invest in countries where they can be assured that their investments are safe and that they can reap the full benefits of their ventures without fear of expropriation or legal challenges (Knack & Keefer, 1995; Acemoglu et al., 2001; Ali et al., 2010).

In general, the relationship between institutional quality and FDI is complex and multifaceted, with strong institutions serving as a magnet for foreign investment. The presence of sound governance, political stability, effective regulatory frameworks, and secure property rights are all crucial in creating an environment that is conducive to FDI. Recent studies continue to emphasize the importance of institutional quality in attracting FDI, particularly in developing economies where institutional weaknesses are often a significant barrier to investment. As such, improving institutional quality is essential for countries seeking to increase FDI inflows and, by extension, foster economic growth and development.

## 2.5 Factors Influencing FDI

Foreign Direct Investment (FDI) is influenced by a myriad of factors that vary depending on the host country's economic, political, social, and institutional landscape. Understanding these factors is crucial for both policymakers and investors as they navigate the complexities of global investment flows. Among the most significant determinants are market size and growth potential, which are often primary considerations for multinational corporations (MNCs) seeking to expand their operations. Larger markets with higher growth rates offer greater opportunities for profitability, making them more attractive destinations for FDI (Caves, 1996; Asiedu, 2002). Recent studies have reinforced this notion, emphasizing that economies with robust consumer bases and increasing demand tend to attract higher levels of FDI, as investors seek to capitalize on the potential for economies of scale and long-term growth prospects (Kolstad & Villanger, 2008; Demirhan & Masca, 2008).

Another critical factor influencing FDI is the availability of natural resources. Countries rich in natural resources such as oil, minerals, and gas often draw substantial FDI, particularly in sectors like mining, energy, and agriculture. This resource-seeking FDI is driven by the need for MNCs to secure raw materials that are essential for their global production processes. However, the mere presence of natural resources is not sufficient to attract FDI; it must be coupled with favorable investment conditions, including secure property rights, stable governance, and adequate infrastructure (Blonigen, 2005; Asiedu, 2013). Moreover, resource-rich countries that lack these complementary factors may experience the "resource curse," where FDI is concentrated in the extractive industries, leading to limited spillover effects on the broader economy (Ross, 2012; Busse & Gröning, 2013).

Institutional quality plays a pivotal role in influencing FDI. Strong institutions that ensure the rule of law, protect property rights, and promote transparent and efficient governance are critical in creating an environment conducive to foreign investment. Countries with weak institutions, on the other hand, tend to deter FDI due to the increased risks associated with corruption, bureaucratic inefficiencies, and political instability (Buchanan et al., 2012; Alfaro et al., 2008). Recent research has shown that the quality of institutions can even offset some of the disadvantages of small market size or limited natural resources, as investors place a premium on the stability and predictability offered by sound institutional frameworks (Ali et al., 2010; Globerman & Shapiro, 2003).

The cost of labor and the availability of skilled workforce are also crucial determinants of FDI. Labor-intensive industries, in particular, are highly sensitive to labor costs, and countries with lower wage rates are often preferred destinations for FDI in manufacturing and assembly operations (Lipsey, 2004; Demirhan & Masca, 2008). However, in addition to low labor costs, the availability of a skilled and educated workforce is increasingly becoming a critical factor, especially in industries that require high levels of technical expertise and innovation. Countries that invest in education and vocational training to develop their human capital are better positioned to attract FDI, as they can offer a competitive advantage in terms of productivity and innovation (Noorbakhsh et al., 2001; Görg & Strobl, 2001). Recent studies highlight that FDI is increasingly flowing into sectors that require specialized skills, and as such, the quality of the labor force is becoming as important as the cost (Narula & Dunning, 2010; Meyer & Sinani, 2009).

Infrastructure development is another significant factor influencing FDI. Adequate infrastructure, including transportation networks, communication systems, and energy supply, is essential for the

smooth operation of businesses and is often a key consideration for investors. Poor infrastructure can increase the cost of doing business, reduce operational efficiency, and ultimately deter FDI. Conversely, countries with well-developed infrastructure are more likely to attract FDI, as they can offer investors the necessary support to establish and expand their operations (Asiedu, 2002; Wheeler & Mody, 1992). Recent empirical evidence suggests that infrastructure quality is particularly important for attracting FDI in manufacturing and service sectors, where reliable logistics and connectivity are critical for success (Mengistu & Adhikary, 2011; Sekkat & Veganzones-Varoudakis, 2007).

Additionally, trade openness and economic integration are crucial factors influencing FDI. Countries that adopt open trade policies and are part of regional trade agreements tend to attract more FDI, as they offer investors access to larger markets and reduce barriers to cross-border trade. Trade openness not only facilitates the import of necessary inputs and technologies but also provides a platform for exporting finished products, making a country more attractive to foreign investors (Blonigen & Piger, 2014; Asiedu, 2006). Furthermore, countries that are integrated into global value chains and have strong trade links with major economies are more likely to attract FDI, as they become integral parts of global production networks (UNCTAD, 2013; Antras & Yeaple, 2014).

In general, FDI is influenced by a complex interplay of factors, including market size, natural resources, institutional quality, labor costs, infrastructure, and trade openness. Each of these factors can either attract or deter foreign investment, depending on how they align with the strategic objectives of multinational corporations. Recent studies continue to emphasize the importance of these factors in shaping global FDI patterns, highlighting the need for host countries to adopt policies that enhance their attractiveness to foreign investors. By improving institutional quality, investing in human capital, developing infrastructure, and promoting trade openness, countries can create a favorable environment for FDI and harness its potential for economic growth and development.

## 2.6 Sub-Saharan Africa context

The context of Foreign Direct Investment (FDI) in Sub-Saharan Africa (SSA) is shaped by various factors, including economic, political, and social dynamics that influence the region's attractiveness to foreign investors. Despite its wealth of natural resources, SSA has historically struggled to attract substantial FDI compared to other regions, largely due to persistent challenges such as political instability, weak institutional frameworks, and insufficient infrastructure. These factors have traditionally deterred investors, limiting the region's ability to fully capitalize on its resource potential (Geda & Meskel, 2020; Osabutey & Okoro, 2022).

However, in recent years, there has been an increasing recognition of the opportunities present in SSA, particularly in sectors such as agriculture, services, and natural resources. Countries like Nigeria, Angola, and South Africa have continued to attract significant FDI inflows, especially in the oil, gas, and mining sectors. This trend highlights the region's ongoing dependence on resource-seeking FDI, as multinational corporations seek to secure access to essential raw materials. Nevertheless, this concentration of investment in extractive industries has raised concerns about the lack of diversification in FDI inflows, which could limit broader economic development and make the region more vulnerable to global commodity price fluctuations (Yeboua, 2021; Soumaré, 2021).

Institutional quality remains a critical determinant of FDI in SSA, with stronger institutions being associated with higher levels of foreign investment. Countries such as Botswana and Mauritius, which have relatively stable political environments and robust legal frameworks, have been more successful in attracting FDI. This underscores the importance of governance, rule of law, and regulatory efficiency in creating a favorable investment climate. Recent studies emphasize the need for SSA countries to enhance their institutional quality to attract more FDI, suggesting that improvements in governance, anti-corruption measures, and regulatory reforms could significantly boost investor confidence (Anyangah et al., 2022; Osabutey & Okoro, 2022).

Infrastructure development is another crucial factor influencing FDI in SSA. The region's significant infrastructure gaps, particularly in transportation, energy, and telecommunications, continue to pose challenges for foreign investors. Poor infrastructure not only increases the cost of doing business but also hampers operational efficiency, making SSA less attractive to potential investors. However, recent efforts to improve infrastructure, such as investments in transportation networks and energy projects, are beginning to show promise. Enhancing infrastructure is key to

reducing operational costs, improving market access, and ultimately attracting more FDI to the region (Okafor & Piesse, 2021; Anyangah et al., 2022).

Market size and growth potential are also important factors for FDI in SSA. Although many SSA countries have relatively small domestic markets, the region's rapidly growing population and increasing urbanization present significant opportunities for investors. Countries like Kenya, Ethiopia, and Ghana have seen rising FDI inflows in sectors such as manufacturing, retail, and telecommunications, driven by the expanding consumer base and growing demand for goods and services. Moreover, regional integration initiatives, such as the African Continental Free Trade Area (AfCFTA), are expected to enhance FDI by creating larger, more integrated markets that offer greater economies of scale and reduced trade barriers (UNCTAD, 2021; Barthel et al., 2023).

Trade openness further influences FDI in SSA, with countries that adopt liberal trade policies and integrate into regional and global trade networks attracting higher levels of investment. Trade openness facilitates the import of inputs and technologies essential for production and provides access to export markets, making SSA more attractive to foreign investors. However, barriers such as tariffs, non-tariff measures, and logistical challenges continue to pose obstacles to FDI in the region. Efforts to reduce these barriers, combined with active participation in regional trade agreements, can enhance SSA's attractiveness to FDI and stimulate economic growth (Ranjan & Agbazue, 2021; Barthel et al., 2023).

In general, the context of FDI in Sub-Saharan Africa is characterized by a complex interplay of factors, including natural resources, institutional quality, infrastructure development, market size, and trade openness. While SSA faces significant challenges, it also offers considerable opportunities for foreign investors, particularly in resource-rich countries and rapidly growing consumer markets. Addressing these challenges through improved governance, infrastructure investments, and open trade policies is essential for creating a more favorable environment for FDI and realizing the region's potential for sustainable economic development.

## 2.7 Existing empirical evidence

Institutional quality in Sub-Saharan Africa (SSA) has been a focal point of numerous studies due to its profound impact on economic development, governance, and the region's ability to attract foreign direct investment (FDI). Scholars have increasingly recognized that the effectiveness of

institutions, which include the rule of law, regulatory frameworks, political stability, and the control of corruption, plays a critical role in shaping the economic outcomes of countries in SSA. These institutions influence not only domestic economic activities but also the level of confidence that foreign investors have in a particular market. For instance, studies have shown that countries with stronger institutional frameworks tend to attract more FDI, as investors are more likely to invest in environments where their investments are protected by law and where the business climate is predictable (Anyangah et al., 2022; Osabutey & Okoro, 2022).

Research has also highlighted the variability in institutional quality across the region, with some countries like Botswana and Mauritius consistently ranking higher in governance indicators compared to others like Zimbabwe and the Democratic Republic of Congo. This disparity has resulted in uneven FDI inflows across the region, as investors gravitate towards countries with better governance and more stable political environments (Barthel et al., 2023). Furthermore, the impact of institutional quality on economic performance is also evident in the way it interacts with other factors such as infrastructure development, human capital, and economic policies. For instance, good governance has been found to enhance the effectiveness of infrastructure investments, leading to better economic outcomes and increased FDI inflows (Geda & Meskel, 2020; Okafor & Piesse, 2021).

Studies indicate that while resource-rich countries like Nigeria and Angola continue to attract significant FDI, primarily in the extractive sectors, the sustainability of such investments remains questionable due to the volatility of global commodity prices and the lack of economic diversification (Soumaré, 2021). Additionally, research has revealed that trade openness is crucial for attracting FDI, as it facilitates market access and reduces the costs associated with cross-border trade. However, many SSA countries still face challenges related to high tariffs, non-tariff barriers, and poor trade infrastructure, which limit their ability to fully capitalize on the benefits of FDI (Ranjan & Agbazue, 2021).

Moreover, empirical analyses have demonstrated a positive correlation between FDI and economic growth in SSA, although the magnitude of this relationship varies depending on the quality of institutions and the level of human capital development. For example, studies have found that FDI contributes to economic growth in countries where there is a sufficient level of human capital to absorb and utilize the technology and knowledge brought by foreign investors (UNCTAD, 2021).

Conversely, in countries where institutional weaknesses prevail, the positive impacts of FDI on growth are often mitigated by issues such as corruption, bureaucratic inefficiencies, and political instability (Anyangah et al., 2022). Recent literature also emphasizes the need for SSA countries to improve their institutional frameworks as a means of enhancing the benefits of FDI and fostering long-term economic growth (Yeboua, 2021).

The neoclassical microeconomic theory posits that investment flows are triggered by variations in interest rates among economies. According to this theory, capital is viewed as a commodity whose price determines its demand, supply, and allocation. Under perfect competition, capital would flow freely from low-return countries to those with higher returns. However, this theory fails to account for the role of transnational corporations (TNCs) in investment inflows, focusing only on portfolio investments rather than FDI.

The theory of intangible capital highlights the influence of certain 'monopoly benefits' or 'intangible assets' for a company. This theory emphasizes that these advantages must provide a competitive edge, be transferable internationally, and be used by the company itself rather than being rented or sold to another entity.

Rugman's internalization theory suggests that FDI arises from the need to reduce transaction costs to maximize profit. This theory helps explain foreign investment performance from the perspective of cost reduction and efficiency.

The new growth theory, inspired by Romer (1986), emphasizes technological progress resulting from investment, capital stock, and human capital. This theory brings back the traditional concept of increasing returns, both practically and theoretically. It suggests that economic growth is driven by engaging in economic activities that lead to technological advancements.

While these theories have provided insights into FDI, they have not fully explained why investors choose specific countries over others, particularly in the context of the African continent's marginalization. Recent literature highlights the importance of institutional quality in attracting and sustaining FDI. Governments play a crucial role in creating an environment conducive to FDI through policies and incentives.

Cecchetti and Kharroubi (2012) analyzed the impact of financial development on economic growth, finding that financial development positively impacts growth up to a point, after which it detracts from productivity by attracting skilled labor away from other sectors. Gursoy et al. (2013) investigated the impact of FDI on economic growth in Azerbaijan, Kyrgyz Republic, Kazakhstan,

Tajikistan, Turkmenistan, and Uzbekistan. They found that FDI causes GDP growth in Azerbaijan and bidirectional causality in Turkmenistan.

Cecchetti and Kharroubi (2015) argued that an abundance of skilled labor in the financial sector produces a negative externality on other sectors, reducing overall productivity growth. This suggests that skilled labor should be allocated to high-return projects to enhance aggregate productivity.

Bolwijn et al. (2015) highlighted the SSA region's attractiveness for FDI due to its large reserves of oil, gold, diamonds, and metals. They noted a significant increase in greenfield FDI projects in Africa, particularly in mining, quarrying, and petroleum.

Tan and Tang (2016) analyzed the linkages among domestic investment, FDI, trade, interest rates, and economic growth in the ASEAN-5 regions. They found that collaboration between domestic and foreign investors is essential for economic growth and that domestic investment and FDI have a positive impact on growth in both the short and long run.

Hodrob (2017) examined the impact of FDI, imports, and domestic investment on Palestinian economic growth. The results indicated that FDI had a negative impact on growth, while domestic investment and imports had positive effects.

Overall, these studies demonstrate the complex and varied impacts of FDI on economic growth. They emphasize the importance of institutional quality, skilled labor allocation, and collaboration between domestic and foreign investors for sustainable economic development.

## 2.8 Conceptual framework

- **Institutional Quality**
  - Governance Indicators:
  - Control of Corruption
  - Voice and Accountability
  - Political Stability
  - Regulatory Quality
  - Rule of Law
  - Government Effectiveness

Role: These indicators form the independent variables that directly shape the investment climate. High institutional quality is expected to build investor confidence, thereby attracting more FDI.

- **B. FDI Inflows**

Measurement:

Absolute FDI values (in millions of USD) and FDI as a percentage of GDP

Role: Serves as the dependent variable representing the financial performance and investment dynamics.

➢ **C. Macroeconomic & Socioeconomic Variables**

Inflation Rate, GDP per Capita, and Urbanization Rate

Human Capital Development (e.g., secondary school enrollment rates)

Role: These variables act as control or mediating factors that either enhance or hinder the impact of institutional quality on FDI inflows. For instance, lower inflation and higher GDP per capita can improve the investment environment.

➢ **D. External/Contextual Factors**

- Global economic conditions
- Commodity price fluctuations
- Policy reforms and economic diversification strategies

Role: These factors can moderate the relationship between institutional quality and FDI inflows, affecting both the magnitude and volatility of investment flows.

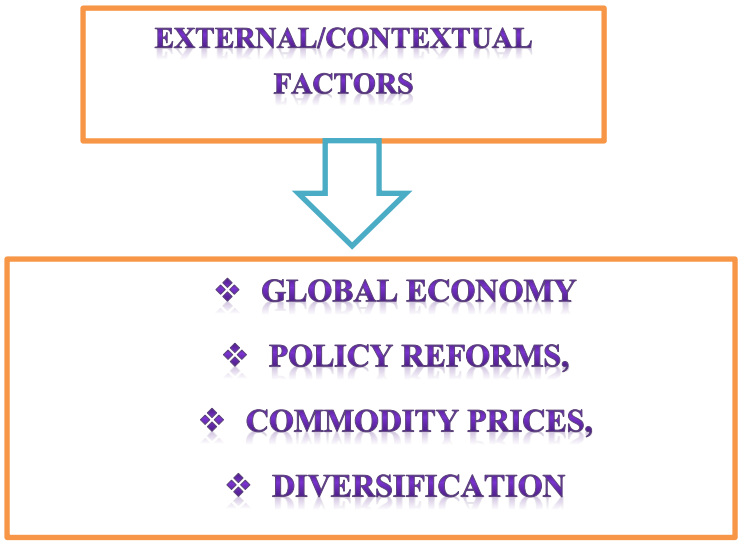
❖ **2. Proposed Relationships**

**Direct Effect:**

Institutional Quality → FDI Inflows

Stronger governance and regulatory frameworks lead to higher and more stable FDI inflows.

A stable macroeconomic environment (e.g., low inflation, rising GDP per capita) and robust human capital can amplify the positive effects of good governance on FDI.



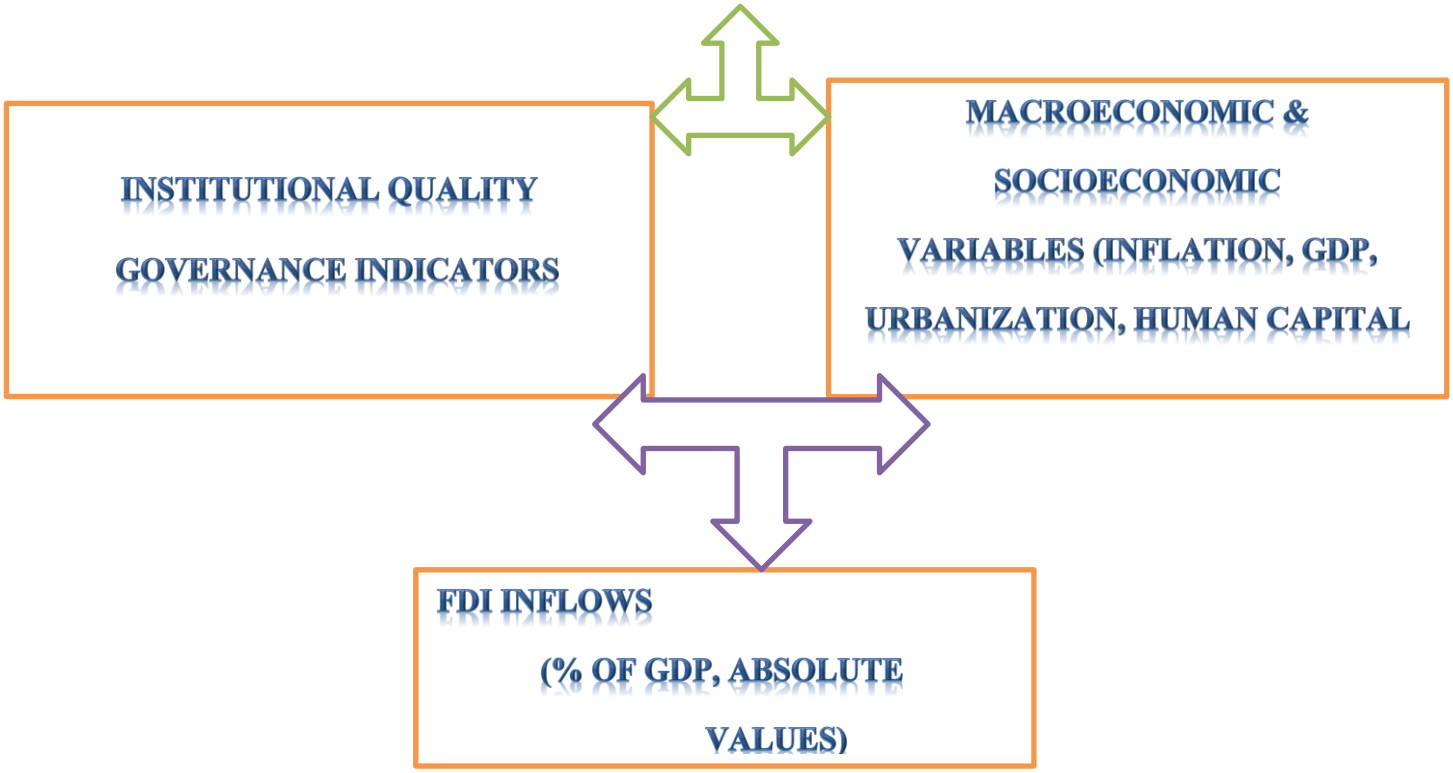



Figure 2.1 Conceptual framework

Source; Adapted from Globerman, S., & Shapiro, D. (2002). Global Foreign Direct Investment Flows:

# CHAPTER THREE
# 3. RESEARCH METHODOLOGY

## 3.0 Introduction

This chapter outlines the methodological framework and design used to investigate the influence of institutional quality on Foreign Direct Investment (FDI) inflows in Sub-Saharan Africa. This

chapter discusses the research design, data sources, population and sampling methods, and analytical techniques employed in the study. The methodological approach is designed to rigorously test and answer the research questions outlined in the earlier chapters. By providing a detailed account of the methods and procedures used, this chapter ensures the transparency and reliability of the research process. The chapter begins by discussing the research design, followed by a description of the data collection and analysis methods, concluding with a discussion on the limitations and ethical considerations associated with the study. This comprehensive methodology lays the foundation for the subsequent data analysis and interpretation of the findings presented in Chapter Four.

## 3.1 Research setting area

To study "Institutional Quality and Inward Foreign Direct Investment in Sub-Saharan Africa," selecting specific countries can provide varied insights. South Africa, with its strong financial markets and institutions, serves as a benchmark for high institutional quality. Nigeria, despite its significant natural resources, faces challenges like corruption and political instability, making it critical for understanding how institutional weaknesses affect FDI. Kenya, known for its growing tech sector and improving infrastructure, illustrates the benefits of institutional reforms. Ghana, with its political stability and good governance, offers a success story in institutional quality. Ethiopia, a fast-growing economy, provides a contrast with its political instability and regulatory challenges. Rwanda's remarkable recovery and strong governance showcase the positive impacts of institutional improvements. Lastly, Tanzania, with its natural resources and mixed governance performance, offers insights into sector-specific FDI impacts. Analyzing these countries allows for a comprehensive understanding of how varying institutional factors influence FDI in Sub-Saharan Africa.

## 3.2 Research philosophy

This study adopts a positivist research philosophy, which emphasizes objectivity and the use of scientific methods to observe and measure phenomena. Positivism is a philosophical approach that views the social world as observable and external, with research being conducted through empirical methods and logical analysis (Saunders et al., 2019). By adopting a quantitative approach, the research aims to objectively analyze the impact of institutional quality on FDI

inflows in Sub-Saharan Africa through statistical analysis. The positivist philosophy supports the collection of measurable data, the formulation of hypotheses, and the use of empirical evidence to test these hypotheses, providing a clear, structured pathway for understanding the causal relationships in the research (Bryman & Bell, 2015; Creswell & Creswell, 2018). This approach aligns with the study's goal of producing generalizable and replicable results that contribute to the broader academic and policy-making discourse on FDI and institutional quality (Easterby-Smith et al., 2021).

## 3.3 Research design

This study employs a panel data analysis approach within a descriptive and explanatory research design framework. The panel data approach is particularly suitable for this study as it involves multiple countries and multiple time periods, specifically focusing on the period from 2000 to 2023. This design allows for the examination of both cross-sectional (across different countries) and time-series (over different years) dimensions, providing a comprehensive analysis of the impact of institutional quality on Foreign Direct Investment (FDI) inflows in Sub-Saharan Africa (Baltagi, 2021).

The descriptive aspect of this research design aims to provide a detailed overview of the trends and patterns of institutional quality and FDI inflows across the selected countries: Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania. By utilizing secondary data from reliable sources such as the World Bank, International Monetary Fund (IMF), and the United Nations Conference on Trade and Development (UNCTAD), the study identifies and describes key trends over the 20-year period (Saunders et al., 2019).

The explanatory component of the research design seeks to establish causal relationships between institutional quality and FDI inflows. By applying panel data analysis techniques, the study is able to control for individual heterogeneity and explore the dynamic nature of the relationship between these variables. This approach facilitates the testing of hypotheses concerning the influence of various institutional quality indicators on FDI inflows, accounting for both time-invariant and time-varying factors (Hsiao, 2014).

Panel data analysis offers several advantages in this context, including the ability to increase the degrees of freedom and reduce collinearity among explanatory variables, which enhances the reliability and robustness of the estimated results (Greene, 2018). Furthermore, this approach allows the study to capture the individual country effects and observe the changes over time,

providing a more nuanced understanding of the factors affecting FDI inflows in Sub-Saharan Africa.

## 3.4 Research approach

This study employs a quantitative research approach, focusing on the systematic collection and analysis of numerical data to examine the relationship between institutional quality and Foreign Direct Investment (FDI) inflows in selected Sub-Saharan African countries. Using a deductive approach, the study tests hypotheses derived from existing theories by analyzing secondary data from sources such as the World Bank and UNCTAD, spanning the years 2000-2023. This approach facilitates objective measurement and statistical analysis, providing valuable insights for policymakers, investors, and researchers. (Creswell, 2023)

## 3.5 Population sample size and sampling technique

The study focuses on Sub-Saharan African countries, specifically Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa, and Tanzania, as they have experienced significant FDI inflows over the past two decades. A purposive sampling technique was employed to select these countries, considering their diverse institutional quality and economic performance. The sample size spans a 23-year period (2000–2023), capturing data on macroeconomic indicators and institutional variables. This approach ensures a robust analysis of the relationship between institutional quality and FDI inflows, providing comprehensive insights into the selected countries.

### 3.5.1 Population of the study

The population for this study includes the entire set of Sub-Saharan African (SSA) countries. Specifically, the study focuses on a subset of countries within this region that have received significant Foreign Direct Investment (FDI) inflows over the past two decades, namely Ethiopia, South Africa, Nigeria, Kenya, Ghana, Rwanda, and Tanzania. These countries were selected due to their varying levels of institutional quality, economic performance, and attractiveness to foreign investors. The study analyzes data from 2000 to 2023, covering a broad spectrum of macroeconomic and institutional indicators to provide a comprehensive understanding of the factors influencing FDI in the region.

### 3.5.2 Sample Size

The sample size for this study consists of seven Sub-Saharan African countries: Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa and Tanzania. These countries were purposefully selected based on their relevance to the study's objectives, particularly their varying levels of institutional

quality and significant FDI inflows from 2000 to 2023. The selection is intended to provide a representative cross-section of the region, allowing for a robust analysis of the relationship between institutional quality and FDI inflows across different contexts within Sub-Saharan Africa. The data covers a 23-year period, enabling a comprehensive longitudinal analysis.

### 3.5.3 Sampling technique

The study employed a purposive sampling technique, a non-probability sampling method that allows for the deliberate selection of specific cases that are most relevant to the research objectives. This approach is particularly useful when the research requires in-depth analysis of a particular subset of the population (Etikan, Musa, & Alkassim, 2016). The countries chosen— Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa and Tanzania —were selected based on specific criteria, including their economic size, institutional quality indicators, and historical trends in FDI inflows. These criteria ensure that the selected countries provide a representative and diverse sample of the Sub-Saharan African region, thereby facilitating a detailed examination of the relationship between institutional quality and FDI inflows. Purposive sampling was deemed appropriate due to its ability to focus on specific characteristics central to the research question, allowing for more targeted and relevant analysis (Patton, 2002).

## 3.6 Type of data sources

This study utilizes secondary data sourced from reputable international organizations, including the World Bank, International Monetary Fund (IMF), and Worldwide Governance Indicators (WGI). The dataset spans 23 years (2000–2023) and includes key institutional quality metrics and FDI inflows for selected Sub-Saharan African countries, as well as a range of control variables including real GDP per capita, human capital, trade, urbanization and inflation. These data sources ensure reliability and provide comprehensive insights into the relationship between institutional quality and FDI across the region.

### 3.6.1 Type of data

The study relied on secondary data, which were sourced from existing databases, reports, and publications relevant to the research objectives. Secondary data include historical records, economic indicators, institutional quality indices, and FDI inflows for the selected Sub-Saharan African countries— Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa and Tanzania —over a period of 23 years (2000-2023). These data were obtained from reputable international organizations such as the World Bank, International Monetary Fund (IMF), and United Nations

Conference on Trade and Development (UNCTAD). The use of secondary data was appropriate for this study as it enabled the analysis of long-term trends and patterns, providing a comprehensive understanding of the relationship between institutional quality and FDI inflows in the selected countries (Bryman, 2016).

### 3.6.2 Data Collection tools

In this study, the primary data collection tools were secondary sources, including databases, reports, and publications from international organizations. Specifically, the study utilized data from the World Bank, International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD), and other relevant sources to gather information on institutional quality indicators and FDI inflows for the selected Sub-Saharan African countries (Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa and Tanzania) from 2000 to 2023. These data sources provided reliable and comprehensive datasets that were critical for conducting a robust panel data analysis. The secondary data were selected for their relevance, accuracy, and completeness, ensuring that the study's findings were grounded in high-quality information. Additionally, the use of secondary data allowed for the analysis of long-term trends, making it possible to assess the impact of institutional quality on FDI inflows over an extended period (Saunders, Lewis, & Thornhill, 2019).

## 3.7 Panel Data Econometric Analysis

The analysis of the data in this study employed a panel data analysis approach to explore the relationship between institutional quality and FDI inflows in selected Sub-Saharan African countries over the period from 2000 to 2023. Panel data techniques allow for the control of both individual heterogeneity and time dynamics, making them particularly useful in studies like this one (Baltagi, 2008). The specific techniques used included descriptive statistics to summarize the data, and regression analysis, particularly the Arellano-Bond generalized method of moments (GMM) (Arellano and Bond, 1995) and quantile regressions (Koenker and Bassett, 1978) are applied to account for endogeneity and unobserved heterogeneity, respectively.

The benchmark panel data model is specified as follows:

$$FDI_{it} = \alpha_i + \beta_1 IQ_{it} + \gamma \Delta X_{it} + \mu_t + \varepsilon_{it} \quad (1)$$

Where $FDI_{it}$ denotes inward foreign direct investment as percent of GDP for country $i$ in year, and $IQ_{it}$ denotes the measures of institutional quality, including the rule of law, corruption control,

regulatory effectiveness, and political stability indices from the World Governance Indicators (WGI). $X_{it}$ Denotes a vector of control variables, including real GDP per capita, human capital, urbanization (% of total population), trade openness (imports plus exports as % of GDP) and inflation. $\alpha_i$ Denotes country-specific fixed effects that capture time-invariant differences across countries and $\varepsilon_{it}$ denotes the error term. The parameter, $\beta_1$, captures the response of FDI to changes in institutional quality. Equation (1) is estimated using Arellano-Bond GMM estimator.

The quantile regression proposed by is given by:

$$Q_{fdi}\,(\tau/x) = x^T\beta_\tau \quad \ldots\ldots\ldots\

### 3.8.2 Validity

Validity refers to the extent to which a research study accurately measures what it intends to measure and whether the results can be generalized to other contexts (Creswell, 2017). In this study, validity was addressed through several approaches. First, the use of secondary data from reputable and internationally recognized sources such as the World Bank ensured the accuracy and relevance of the data. These sources are known for their rigorous data collection methods and extensive validation processes, which contribute to the credibility of the information used in the analysis. Furthermore, the research employed a panel data approach, which strengthens the validity of the findings by incorporating data over an extended period (2000-2023) and across multiple countries. This longitudinal approach helps to capture long-term trends and reduce the impact of anomalies or short-term fluctuations. To ensure construct validity, the study focused on well-established indicators of institutional quality and FDI inflows, which are widely recognized and used in empirical research.

## 3.9 Ethical Considerations

According to (Economic and Social Research Council, 2021), research ethics refers to the moral principles and actions guiding and shaping research from its inception through to completion, the dissemination of findings and the archiving, future use, sharing and linking of data. This study, for that reason, was governed by the general rules of research ethics in such a way that, the respondents was requested to provide information on voluntary basis, prior communication about the purpose of the study was made and confidentiality of the information was assured.

# CHAPTER FOUR

# 4. Data presentation analysis and interpretation

## 4.1 Introduction

This chapter presents a comprehensive examination of the data collected for the study, focusing on the relationship between institutional quality and Foreign Direct Investment (FDI) inflows in Sub-Saharan Africa. The section begins with a detailed presentation of the data, providing descriptive statistics and visualizations that illustrate key trends and patterns observed over the study period from 2000 to 2023. Following the presentation, the chapter employs various statistical techniques to analyze the data, including panel data analysis, regression models, and robustness checks. These analytical methods are utilized to test the hypotheses and address the research

questions outlined in the previous chapters. The findings from these analyses are then interpreted in the context of existing literature, highlighting significant relationships, anomalies, and insights that contribute to the understanding of how institutional quality impacts FDI inflows. This chapter aims to provide a clear and systematic overview of the empirical evidence, enabling readers to grasp the implications of the results and their relevance to the broader field of international business and economic development.

## 4.2 Descriptive Analysis

Descriptive analysis provides a foundational understanding of the data by summarizing key measures such as the mean, median, and standard deviation (SD). For this study, institutional quality indicators and FDI inflows for Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa, and Tanzania over a 23-year period (2000–2023) are analyzed. The mean highlights the average performance of each indicator, the median represents the central tendency, and the standard deviation quantifies the variability or dispersion in the data. This analysis is critical for identifying patterns, variations, and trends within the governance and economic landscapes of the selected countries, offering insights into their institutional stability and FDI dynamics.

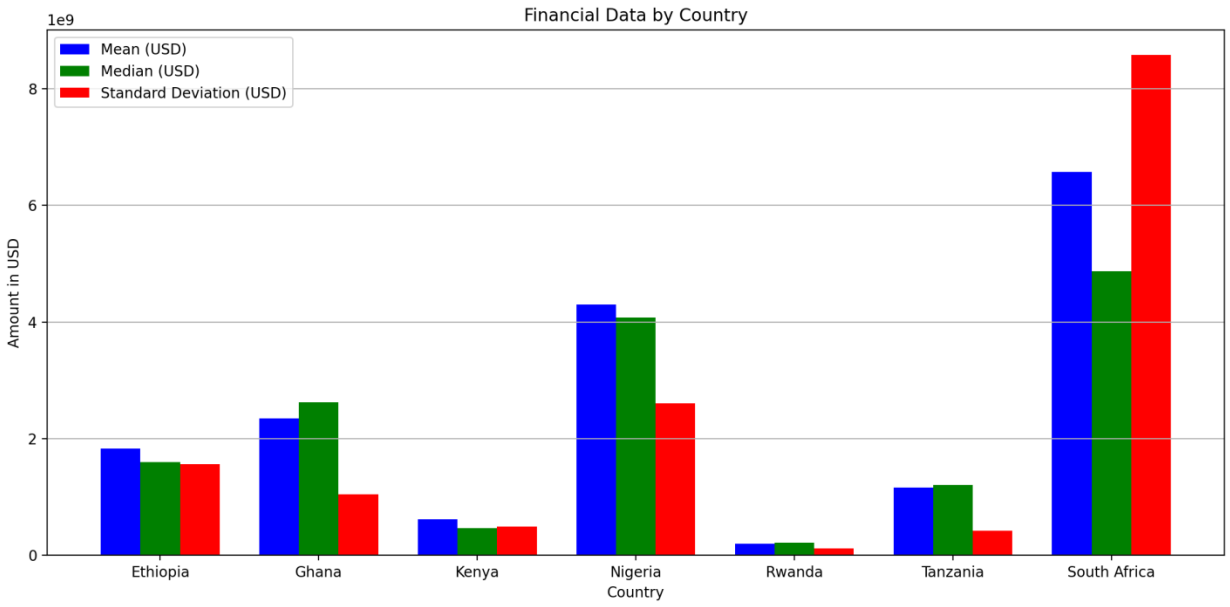
**Table 1: Summary statistics for FDI Inflows, millions of $USD**

| Country | Mean | Median | Standard Deviation |
|---|---|---|---|
| Ethiopia | 1,829.29 | 1,599.46 | 1,561.75 |
| Ghana | 2,350.47 | 2,624.25 | 1,050.68 |
| Kenya | 623.40 | 469.74 | 496.84 |
| Nigeria | 4,304.30 | 4,073.54 | 2,610.11 |
| Rwanda | 198.46 | 214.04 | 117.06 |
| Tanzania | 1,163.92 | 1,203.87 | 419.64 |
| South Africa | 6,570.01 | 4,871.06 | 8,581.42 |

Source: World Bank, World Development Indicators and the Worldwide Governance Indicators

Table 1 illustrates the financial metrics of FDI inflows—mean, median, and standard deviation—across seven African countries, highlighting distinct patterns. South Africa stands out with the highest mean and standard deviation, reflecting significant FDI inflows but also considerable volatility, as evidenced by its much lower median. Nigeria follows with high mean and standard deviation values, indicating substantial FDI with moderate variability, though its closer alignment between mean and median suggests relatively consistent inflows compared to South Africa. Ghana exhibits a high median relative to its mean, pointing to stable FDI inflows with less fluctuation, as indicated by a lower standard deviation. Ethiopia and Tanzania show similar trends, with closely aligned mean and median values, suggesting steady and predictable FDI inflows with moderate variability. Kenya, however, has relatively smaller FDI inflows overall, as indicated by lower mean and median values, alongside minimal variability. Rwanda records the smallest FDI inflows and the lowest variability among all the countries, reflecting a stable but limited investment environment. These patterns underline the diversity in FDI dynamics across countries, with some experiencing significant variability and others maintaining consistent trends, shaped by economic, political, and structural factors.

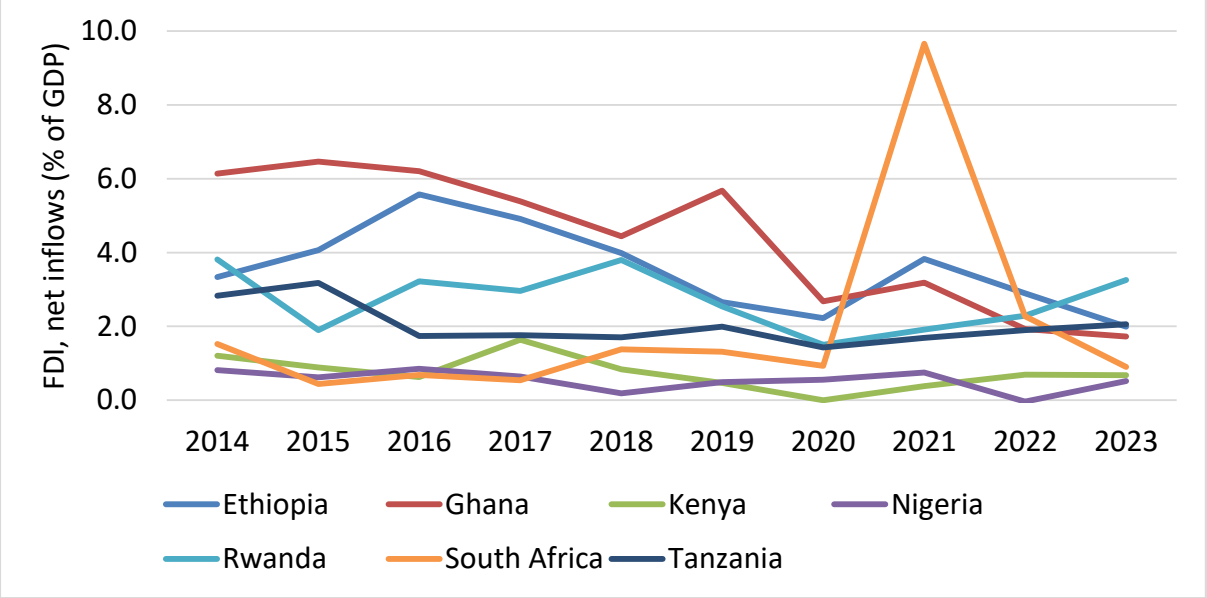
**Figure 1: Statistics for FDI Inflows**




Source: World Development Indicators.

To facilitate comparison, Figure 2 presents the trends in FDI inflows as percent of GDP for the sample countries for the period spanning from 2000 to 2023.

**Figure 2: Trends in foreign direct investment, net inflows (% of GDP)**




Source World Development Indicators.

South Africa and Nigeria demonstrate the most pronounced financial volumes, with Nigeria peaking in 2013 before experiencing subsequent declines and fluctuations, while South Africa shows consistent growth until 2015, followed by irregular variations. Ethiopia and Ghana display steady and gradual growth over the years, indicating stable financial performance with relatively

modest volumes compared to Nigeria and South Africa. Kenya and Tanzania exhibit similar upward trends with moderate growth rates, maintaining consistency without significant fluctuations. Rwanda reflects the lowest financial volumes across the period, showing minimal changes and stable patterns. Overall, the chart highlights significant disparities in the performance of attracting FDI across the sample countries, driven by differences in economic structures, policy environments, and external factors affecting financial flows. Table 2 provides the summary statistics of all the variables used in the econometrics model for the empirical analysis. Discussion of the descriptive analysis for each country is provided below.

**Table 2: Summary statistics of the variables used in the econometric model: 2000 – 2023**

| | Ethiopia | | Ghana | | Kenya | | Nigeria | | Rwanda | | South Africa | | Tanzania | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Variable | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. |
| FDI, net inflows (% of GDP) | 2.94 | 1.60 | 4.76 | 2.66 | 0.86 | 0.84 | 1.40 | 0.83 | 1.98 | 1.24 | 1.80 | 2.07 | 2.99 | 1.31 |
| Control of Corruption | -0.60 | 0.14 | -0.14 | 0.12 | -0.95 | 0.11 | -1.17 | 0.14 | 0.19 | 0.51 | 0.08 | 0.24 | -0.56 | 0.18 |
| Government Effectiveness | -0.70 | 0.21 | -0.16 | 0.13 | -0.53 | 0.14 | -1.05 | 0.09 | -0.25 | 0.46 | 0.26 | 0.22 | -0.61 | 0.12 |
| Political Stability and Absence of Violence/Terrorism | -1.56 | 0.28 | 0.00 | 0.13 | -1.19 | 0.13 | -1.90 | 0.19 | -0.42 | 0.56 | -0.18 | 0.22 | -0.37 | 0.26 |
| Rule of Law | -0.68 | 0.18 | 0.00 | 0.08 | -0.72 | 0.25 | -1.11 | 0.20 | -0.34 | 0.46 | 0.02 | 0.12 | -0.44 | 0.09 |
| Regulatory Quality | -1.03 | 0.11 | -0.13 | 0.15 | -0.31 | 0.09 | -0.92 | 0.17 | -0.32 | 0.45 | 0.37 | 0.31 | -0.51 | 0.10 |
| Voice and Accountability | -1.22 | 0.12 | 0.41 | 0.17 | -0.29 | 0.17 | -0.62 | 0.16 | -1.22 | 0.15 | 0.65 | 0.06 | -0.34 | 0.20 |
| Human Capital (School enrollment, secondary (%) | 27.69 | 7.67 | 52.86 | 16.08 | 47.50 | 6.33 | 39.32 | 7.81 | 28.34 | 12.15 | 92.76 | 14.50 | 29.15 | 2.33 |
| Trade (% of GDP) | 34.70 | 8.27 | 77.32 | 19.31 | 46.88 | 10.93 | 35.87 | 10.35 | 41.80 | 10.42 | 53.91 | 5.45 | 38.43 | 9.25 |
| Urbanization (% of total population) | 18.07 | 2.54 | 51.35 | 4.55 | 24.15 | 2.79 | 44.29 | 5.83 | 16.92 | 0.56 | 62.69 | 3.55 | 29.01 | 4.56 |
| Inflation (%) | 12.98 | 11.56 | 16.67 | 9.80 | 8.65 | 4.91 | 12.63 | 3.81 | 6.69 | 5.04 | 5.25 | 2.24 | 6.58 | 3.25 |
| GDP per capita (constant 2015 US$) | 510.38 | 209.10 | 1500.32 | 361.38 | 1398.01 | 185.70 | 2239.23 | 371.24 | 619.45 | 183.29 | 5805.23 | 503.87 | 821.57 | 167.12 |

Source: World Bank, World Development Indicators and the Worldwide Governance Indicators

### *Ethiopia*

Ethiopia's average FDI inflows as a share of GDP stand at 2.94%, with a relatively high standard deviation of 1.60% indicating fluctuations in foreign investment over time. The six indicators of governance are standardized with mean zero and standard deviation of one, and ranging from -2.5 to 2.5, with higher values representing better governance, or higher institutional quality (see Kaufmann and Kraay, 2024). Ethiopia scores very low on control of corruption (-0.6), with a higher standard deviation (0.14) relative to the mean, indicating significant uncertainty. The country has a low mean score of -1.22 for Voice and Accountability, reflecting significant limitations in political freedoms and civil liberties. Not surprisingly, the lowest score for Ethiopia's governance indicators is political stability and absence of violence (-1.56) with the highest standard deviation (0.28). Similarly, Regulatory Quality and Rule of Law have negative values of

-1.03 and -0.68, respectively, pointing to institutional weaknesses. The inflation rate is notably high, averaging 12.98%, and urbanization remains low at 18.07% of the total population. Despite these challenges, Ethiopia's investment in human capital is evident, with an average secondary school enrollment rate of 27.69%, contributing to a steady rise in GDP per capita, which averages 510.38 constant 2015 USD.

## Ghana

Ghana exhibits an average FDI inflow of 4.76% of GDP, indicating a relatively strong ability to attract foreign investment compared to other countries in the region. The country fares moderately well in Control of Corruption (-0.14) and Government Effectiveness (-0.16), though these scores suggest room for improvement. The inflation rate, averaging 16.67 %, highlights macroeconomic challenges, but Ghana's higher mean human capital score of 52.86% for secondary school enrollment and urbanization rate of 51.35% demonstrate positive social development trends. GDP per capita in Ghana averages 1,500.32 reflecting sustained growth during the period.

## Kenya

Kenya has maintained average FDI inflows of 0.86% of GDP, with a relatively stable standard deviation of 0.84, indicating a consistent level of investment over the years. The countries average score for Regulatory Quality (-0.31) is one of the highest among the selected nations, suggesting relatively effective regulations to support business activities. With a secondary school enrollment rate of 47.50% and an urbanization rate of 24.15%, Kenya shows significant progress in social development. However, the inflation rate averages 8.65%, suggesting manageable but persistent inflationary pressures. Kenya’s GDP per capita stands at 1,388.01 constant 2015 USD.

## Nigeria

Nigeria's average FDI inflows are 1.40 % of GDP, reflecting its mixed success in attracting foreign investment. The country's low scores in Control of Corruption (-1.17) and Political Stability (-1.90) underscore persistent governance and security issues that deter investments. The inflation rate is relatively high, averaging 12.63 %, which, combined with low regulatory quality (-0.92), presents macroeconomic challenges. Despite these hurdles, Nigeria's urbanization rate is 44.29%, indicating a growing urban economy. However, GDP per capita, averaging 2,229.23 is subject to significant variation due to oil price volatility and limited diversification.

## Rwanda

Rwanda stands out for its relatively high scores in Regulatory Quality (-0.32) and Rule of Law (-0.34), reflecting its strong institutional framework. FDI inflows average 1.98% of GDP, supported by consistent policy reforms and a favorable business environment. The country also has a relatively low inflation rate of 6.69%, indicating macroeconomic stability. While Rwanda's human capital development scores (secondary school enrollment) is 28.34%, the urbanization rate remains low at 16.92%, reflecting its rural-focused economy. GDP per capita averages 619.45 constant 2015 USD, highlighting steady growth over the period.

## South Africa

South Africa leads in terms of GDP per capita, averaging 5,065.23 constant 2015 USD, owing to its diversified economy and advanced industrial base. Despite this, FDI inflows are relatively low, averaging 1.80% of GDP, potentially reflecting investor concerns about political stability and corruption. The country scores relatively well in terms of Regulatory Quality (0.37) and Rule of Law (0.02), suggesting a comparatively favorable institutional environment. Inflation is moderate, averaging 5.25%, while urbanization is high at 62.69%, indicating a predominantly urban population.

## Tanzania

Tanzania’s average FDI inflows stand at 2.99% of GDP, with a consistent standard deviation of 1.31, reflecting steady investment levels. Regulatory Quality (-0.51) and Government Effectiveness (-0.61) are relatively better compared to some other countries, but there is still room for improvement. Human capital development, with a secondary school enrollment rate of 29.15%, remains low. The inflation rate is 6.58%, indicating moderate price stability. Tanzania's GDP per capita averages 821.57 constant 2015 USD, highlighting gradual economic progress, supported by regional trade and infrastructure investments.

The summary statistics reveal significant heterogeneity in economic and institutional performance across the selected Sub-Saharan African countries. Countries with higher regulatory quality, better governance, and diversified economies, such as Rwanda, South Africa, and Ghana, tend to experience more stable and sustained economic growth. On the other hand, resource-dependent countries like Nigeria face greater volatility due to their reliance on commodity exports. Ethiopia and Tanzania demonstrate the potential of targeted development strategies, although they still face challenges in governance and human capital development. Kenya's moderate but consistent

performance highlights the importance of regional integration and technological advancements in fostering growth.

## Comparative Analysis and Contrast

The comparative analysis of the selected Sub-Saharan African countries highlights distinct patterns in economic and institutional performance. South Africa, with the highest GDP per capita (5,065.23 USD), benefits from a diversified industrial economy, while Nigeria, despite its relatively high GDP per capita (2,229.33 USD), remains vulnerable due to overreliance on oil exports. On the other hand, countries like Ethiopia (510.38 USD) and Tanzania (567.12 USD) exhibit lower GDP per capita, reflecting early stages of industrialization and economic transformation.

Rwanda stands out for its strong governance and policy environment, with high scores in Regulatory Quality (0.56) and Rule of Law (0.26). These indicators contribute to its ability to attract consistent foreign direct investment (3.29% of GDP). In contrast, Nigeria's low scores in Control of Corruption (-1.17) and Political Stability (-2.13) demonstrate the challenges posed by weak governance and security issues. Ethiopia, despite institutional weaknesses, has managed to attract significant FDI inflows (2.94% of GDP), driven by infrastructure investment and rapid economic reforms.

A comparison of the trends in each governance indicator for the selected countries based on percentile rank is provided in the Appendix. The solid blue line represents the percentile rank of the respective country for each of the six aggregate indicators of governance along with the margin error given by the grey-shaded area (see Figures in the Appendix).

Human capital development also presents a contrasting picture. Ghana and Kenya lead with secondary school enrollment rates of 52.08% and 46.08%, respectively, indicating stronger educational systems that support long-term economic growth. Meanwhile, Tanzania (21.26%) and Ethiopia (27.69%) lag behind in this regard, underscoring the need for greater investment in education to enhance future workforce capabilities. Urbanization rates further differentiate the countries; with South Africa (65.22%) and Ghana (51.35%) having predominantly urban populations, while Rwanda (18.92%) and Ethiopia (18.07%) remain largely rural economies.

Inflation trends reveal another layer of contrast, with Ghana (13.86%) and Nigeria (13.72%) facing higher inflationary pressures, posing risks to macroeconomic stability. Conversely, Rwanda

(5.95%) and South Africa (6.17%) have maintained relatively low and stable inflation rates, contributing to a more predictable investment environment.

The analysis underscores the critical role of institutional quality, governance, and economic diversification in determining financial performance and sustainable growth trajectories across Sub-Saharan Africa. Countries with strong governance frameworks and effective regulatory environments, such as Rwanda and South Africa, demonstrate better resilience against external shocks and attract consistent foreign investment. On the other hand, resource-dependent economies like Nigeria face significant volatility due to global commodity price fluctuations and weak institutional capacity. The findings also highlight the importance of human capital development and urbanization as key drivers of long-term economic growth. Ghana and Kenya, with higher secondary school enrollment rates, are well-positioned to harness the benefits of a more skilled workforce, whereas Ethiopia and Tanzania need to prioritize educational reforms and infrastructure development to sustain their growth momentum. Furthermore, inflation management remains a crucial aspect of economic stability. Countries with relatively low and stable inflation, such as Rwanda and South Africa, are better positioned to create a conducive environment for investment and growth.

In general, this research reinforces the view that sustainable financial development in Sub-Saharan Africa requires a multi-faceted approach, combining governance reforms, economic diversification, investment in human capital, and inflation control. Policymakers must focus on strengthening institutional frameworks, fostering regional cooperation, and promoting private sector growth to navigate the dynamic global financial landscape effectively. These strategies will enable African countries to achieve not only higher economic growth but also greater financial stability and inclusivity. The findings emphasize that institutional quality, governance, and economic diversification are key determinants of sustainable financial and economic development across Sub-Saharan Africa. The statistics reveal significant heterogeneity in economic and institutional performance across the selected Sub-Saharan African countries. Countries with higher regulatory quality, better governance, and diversified economies, such as Rwanda, South Africa, and Ghana, tend to experience more stable and sustained economic growth. On the other hand, resource-dependent countries like Nigeria face greater volatility due to their reliance on commodity exports. Ethiopia and Tanzania demonstrate the potential of targeted development strategies, although they still face challenges in governance and human capital development.

Kenya's moderate but consistent performance highlights the importance of regional integration and technological advancements in fostering growth.

## 4.3 Correlation analysis

The correlation analysis reveals significant relationships between Foreign Direct Investment (FDI) inflows, institutional quality indicators, and GDP across the sample countries over the study period. Table 3 shows a strong positive correlation is observed between FDI inflows and control of corruption (0.28), suggesting that lower corruption levels create an environment conducive to foreign investment. This finding aligns with studies such as Wei (2000), which emphasize that corruption increases transaction costs and reduces the attractiveness of host countries for FDI.

**Table 3: Correlation analysis**

| | FDI | CCE | GEE | PVE | RLE | RQE | VAE | HC | Trade | urban | Inflation | GDP pc |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FDI | 1.00 | | | | | | | | | | | |
| CCE | 0.28 | 1.00 | | | | | | | | | | |
| GEE | 0.21 | 0.86 | 1.00 | | | | | | | | | |
| PVE | 0.38 | 0.83 | 0.83 | 1.00 | | | | | | | | |
| RLE | 0.41 | 0.87 | 0.88 | 0.91 | 1.00 | | | | | | | |
| RQE | 0.15 | 0.73 | 0.89 | 0.75 | 0.80 | 1.00 | | | | | | |
| VAE | 0.25 | 0.21 | 0.54 | 0.50 | 0.56 | 0.66 | 1.00 | | | | | |
| HC | 0.08 | 0.31 | 0.60 | 0.38 | 0.52 | 0.67 | 0.79 | 1.00 | | | | |
| Trade | 0.41 | 0.29 | 0.46 | 0.54 | 0.56 | 0.46 | 0.52 | 0.27 | 1.00 | | | |
| Urban | 0.16 | 0.08 | 0.37 | 0.26 | 0.40 | 0.46 | 0.88 | 0.79 | 0.30 | 1.00 | | |
| Inflation | 0.14 | -0.28 | -0.18 | -0.19 | -0.14 | -0.24 | -0.02 | -0.20 | 0.37 | -0.03 | 1.00 | |
| GDPpc | -0.15 | 0.20 | 0.50 | 0.21 | 0.35 | 0.59 | 0.70 | 0.89 | 0.07 | 0.81 | -0.27 | 1.00 |

Notes: CCE=Control of corruption, RLE=Rule of Law, GEE=Government Effectiveness, PVE=Political Stability and Absence of Violence/Terrorism, RQE= Regulatory Quality, VAE=Voice and Accountability, FDI=Foreign direct investment, HC=human capital, Trade=Trade openness (as % of GDP), Urban=urbanization.

Source: Author's computations based on data from the World Bank

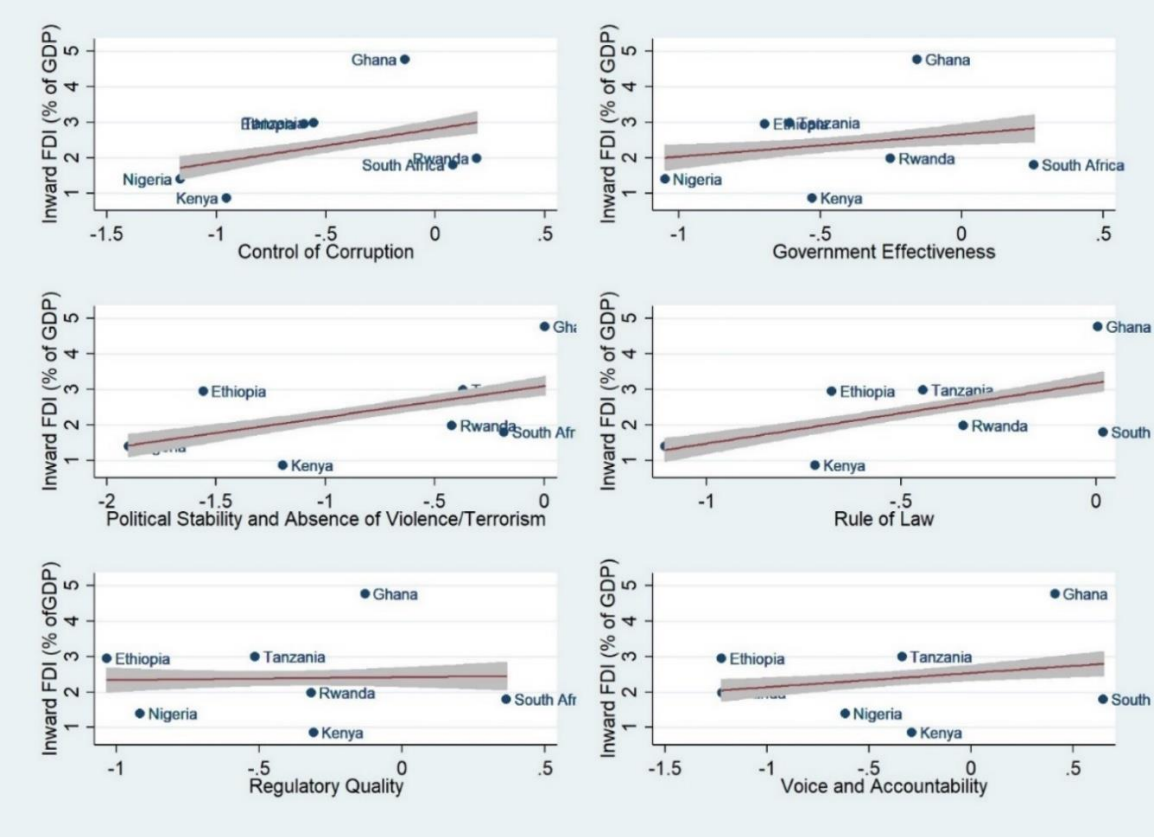
Government effectiveness shows a robust correlation with FDI inflows (0.21), indicating that efficient public administration and service delivery are critical in attracting foreign investors. Similarly, political stability and the absence of violence correlate positively with FDI inflows (0.38), although the relationship is weaker compared to other institutional quality indicators. This supports Busse and Hefeker (2007), who argue that political instability increases uncertainty and discourages foreign investments.

Regulatory quality and rule of law demonstrate moderate correlations with FDI inflows (0.15 and 0.41, respectively). These findings highlight the importance of transparent regulations and a strong legal framework in fostering investor confidence, consistent with Globerman and Shapiro (2003). Voice and accountability also show a strong positive correlation with FDI inflows (0.25), suggesting that democratic governance and freedom of expression positively influence foreign investment decisions.

The analysis further reveals a strong positive correlation between FDI inflows and trade openness (0.41), reinforcing the notion that free trade and market size enhances more FDI inflows.

In summary, the correlation analysis underscores the critical role of institutional quality and macroeconomic indicators, particularly GDP, in influencing FDI inflows. These findings are consistent with the literature, emphasizing that robust governance structures, economic stability, and transparent regulatory frameworks are fundamental in attracting foreign investments to developing countries. Figure 4.3 shows the graphical presentation of FDI with each indicator of the quality of governance. The Figure shows there is a positive correlation between FDI inflow and the quality of governance indicators.

**Figure 3: Correlations between average FDI inflows and quality of governance indicators**




## 4.4 Panel data econometric analysis

### 4.4.1 Arellano-Bond model

The Arellano-Bond dynamic panel-data estimation is a powerful econometric technique used to model dynamic relationships in panel data, particularly when dealing with issues of endogeneity, autocorrelation, and unobserved heterogeneity. In the context of analyzing Foreign Direct Investment (FDI), this method allows us to examine how past FDI inflows, institutional quality, and other macroeconomic variables influence current FDI decisions. By using lagged values of the dependent variable as instruments, the Arellano-Bond estimator corrects for potential biases and provides more reliable estimates for short-term and long-term dynamics. This approach is especially useful in understanding the complex, time-dependent factors that drive FDI flows in Sub-Saharan Africa, where institutional quality, political stability and regulatory environments play a significant role. The Arellano-Bond dynamic panel data estimation results provide insights into the relationship between Foreign Direct Investment (FDI) inflows and institutional quality indicators across the study countries.

**Table 4: Arellano-Bond Generalized Method of Moments (GMM) estimation results**

| Dependent variable = | (1) FDI | (2) FDI | (3) FDI | (4) FDI | (5) FDI | (6) FDI |
|---|---|---|---|---|---|---|
| Control of Corruption | 1.032*** | | | | | |
| | (0.209) | | | | | |
| Government Effectiveness | | 1.489*** | | | | |
| | | (0.462) | | | | |
| Political Stability | | | 0.498** | | | |
| | | | (0.205) | | | |
| Rule of Law | | | | 1.224** | | |
| | | | | (0.611) | | |
| Regulatory Quality | | | | | 0.938* | |
| | | | | | (0.538) | |
| Voice and Accountability | | | | | | 0.474 |
| | | | | | | (0.615) |
| Human Capital | 1.507** | 1.764*** | 1.706*** | 1.663*** | 2.020** | 1.916** |
| | (0.672) | (0.667) | (0.614) | (0.599) | (0.795) | (0.826) |
| Trade (% of GDP) | 2.258** | 2.039* | 1.923** | 2.424** | 1.586* | 2.002** |
| | (0.982) | (1.132) | (0.979) | (0.999) | (0.822) | (0.910) |
| Urbanization | 1.106*** | 1.688*** | 0.296 | 1.021** | 2.028*** | 0.131 |
| | (0.280) | (0.612) | (0.262) | (0.414) | (0.609) | (0.999) |
| Inflation | 0.006 | -0.002 | 0.003 | -0.008 | 0.010 | 0.006 |
| | (0.019) | (0.019) | (0.017) | (0.018) | (0.021) | (0.019) |
| Real GDP per capita | -0.675* | -1.114* | -0.326 | -0.955** | -1.649*** | -0.506 |
| | (0.346) | (0.579) | (0.264) | (0.404) | (0.385) | (0.550) |
| Number of observations | 152 | 152 | 152 | 152 | 152 | 152 |
| AR(2) | 0.203 | 0.383 | 0.233 | 0.307 | 0.346 | 0.252 |
| Kaiser-Meyer-Olkin measure of sampling adequacy | 0.809 | 0.815 | 0.812 | 0.830 | 0.801 | 0.816 |
| Hansen test (p-value) | 1.000 | 1.000 | 1.000 | 1.000 | 1.000 | 1.000 |

Notes: This Table presents the estimates of the effect of quality of governance on FDI inflow, with each governance indicator included in the regressions separately. The dependent variable is FDI net inflow as per cent of GDP. Standard errors in parentheses. *, **, and *** denote statistical significance at the 10%, 5%, and 1%.

Source Author's computations, 2024

Table 4.9 shows that quality of governance is critical to attract FDI inflows in Africa. The estimated coefficients are positive and statistically significant at 5% significance level for five out of the six governance indicators (i.e., except for Voice and Accountability (Column 6)). The results show that a one-standard deviation increase in the measure of Control of Corruption leads to an increase in FDI inflows by about 1.03%. Government Effectiveness and Rule of Law have

larger impacts quantitatively, estimated at 1.49% and 1.22%, respectively. Regulatory quality and political stability and absence of violence are also found to be important determinants of inward FDI. For voice and accountability, although the coefficient is positive, it is not statistically significant suggesting that it has less impact on FDI inflows.

The diagnostic tests show that the estimates are valid. Specifically, the p-value for Autoregressive coefficient (AR(2)) is above 0.1 in all regressions suggesting that there is no issue of serial correlation and the Hansen test for over identification exclusion shows that the GMM instruments are valid.

The findings are consistent with prior findings that document control of corruption is crucial as it undermines investor confidence and increases transaction costs (Mauro, 1995; Wei, 2000). Government effectiveness also has a significant positive effect, highlighting the role of efficient governance in fostering a conducive investment climate. This aligns with studies emphasizing the importance of robust public administration in FDI attraction (Kaufmann et al., 1999).

The estimated coefficient for political stability and absence of violence exhibits a positive and significant relationship impact on FDI inflows, reinforcing the argument that political risks deter investors (Busse & Hefeker, 2007). Similarly, the findings for the positive role of regulatory quality in enhancing FDI inflows suggests that transparent and predictable regulations encourage foreign investments. This is consistent with studies that underscore regulatory frameworks as critical determinants of FDI location decisions (Globerman & Shapiro, 2003). Overall, the results highlight the importance of institutional quality in shaping FDI dynamics. In terms of the magnitude on the impacts on FDI, government effectiveness and rule of law are the most important governance indicators as key factors to attract inward FDI followed by control of corruption and regulatory quality. The findings corroborate prior research emphasizing that improved governance, political stability, and regulatory quality create a favorable environment for FDI, thereby contributing to economic growth and development in developing countries (Dunning, 2001).

Based on the findings of the research, the analysis indicates a complex relationship between institutional quality, economic performance, and FDI inflows across the selected Sub-Saharan African countries: Ethiopia, Ghana, Rwanda, Kenya, Tanzania, South Africa, and Nigeria. The study also demonstrates that while institutional quality is an important determinant of FDI, the estimates for the control variables including human capital, trade openness and urbanization play a significant positive role in attracting FDI.

### 4.4.2 Accounting for heterogeneity: quantile regression

To account for heterogeneity, this section explores quantile regression results capturing the entire distribution of the FDI flows instead of focusing on the average relationship presented in Section 4.4.1. Quantile regression estimates are robust to outliers. Interesting results emerge from the quantile regression estimates presented in Table 4.10. First the results confirm the robustness of the findings from the GMM results. Interestingly, the quantile regression results show that the magnitude of the effect of quality of governance is stronger at the lower end of the FDI distribution and the effect declines in the upper quantiles. For example, the estimated coefficient on Government Effectiveness is 1.172 at $\tau$=0.10 and continuously declines in the upper quantile distribution of FDI for most of the governance indicators. Nevertheless, the estimates remain positive and statistically significant.

Looking at the coefficient on Voice and Accountability, a stark difference merges with the results for the GMM estimation. While the average estimates of the GMM show that the coefficient is statistically insignificant, the quantile regression estimates show that the coefficient is statistically significant at lower quantiles ($\tau$=0.10 and $\tau$=0.10) and becomes insignificant for upper quantiles. The results clearly show that voice and accountability is equality important for FDI inflows for countries on the lower end of the FDI distribution. This highlights the importance of accounting for heterogeneity by examining the entire conditional distribution of the FDI distribution rather than solely focusing on the average relationship.

**Table 5: Quantile regression results**

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| | $\tau$=0.10 | $\tau$=0.25 | $\tau$=0.50 | $\tau$=0.75 | $\tau$=0.90 |
| Control of Corruption | 0.614*** | 0.935*** | 0.662*** | 0.434*** | 0.370*** |
| | (0.230) | (0.174) | (0.192) | (0.092) | (0.122) |
| Government Effectiveness | 1.172*** | 0.964*** | 0.821*** | 0.542*** | 0.390*** |
| | (0.265) | (0.260) | (0.222) | (0.151) | (0.124) |
| Political Stability | 1.004*** | 0.586*** | 0.485*** | 0.249** | 0.199* |
| | (0.131) | (0.178) | (0.142) | (0.107) | (0.105) |
| Rule of Law | 1.569*** | 1.256*** | 0.906*** | 0.558*** | 0.421*** |
| | (0.356) | (0.252) | (0.230) | (0.146) | (0.126) |
| Regulatory Quality | 1.552*** | 0.831*** | 0.863*** | 0.478*** | 0.345** |
| | (0.294) | (0.310) | (0.254) | (0.146) | (0.154) |
| Voice and Accountability | 1.028*** | 0.693** | 0.229 | 0.210 | 0.189 |
| | (0.286) | (0.330) | (0.301) | (0.199) | (0.191) |
| Control variables included | Yes | Yes | Yes | Yes | Yes |

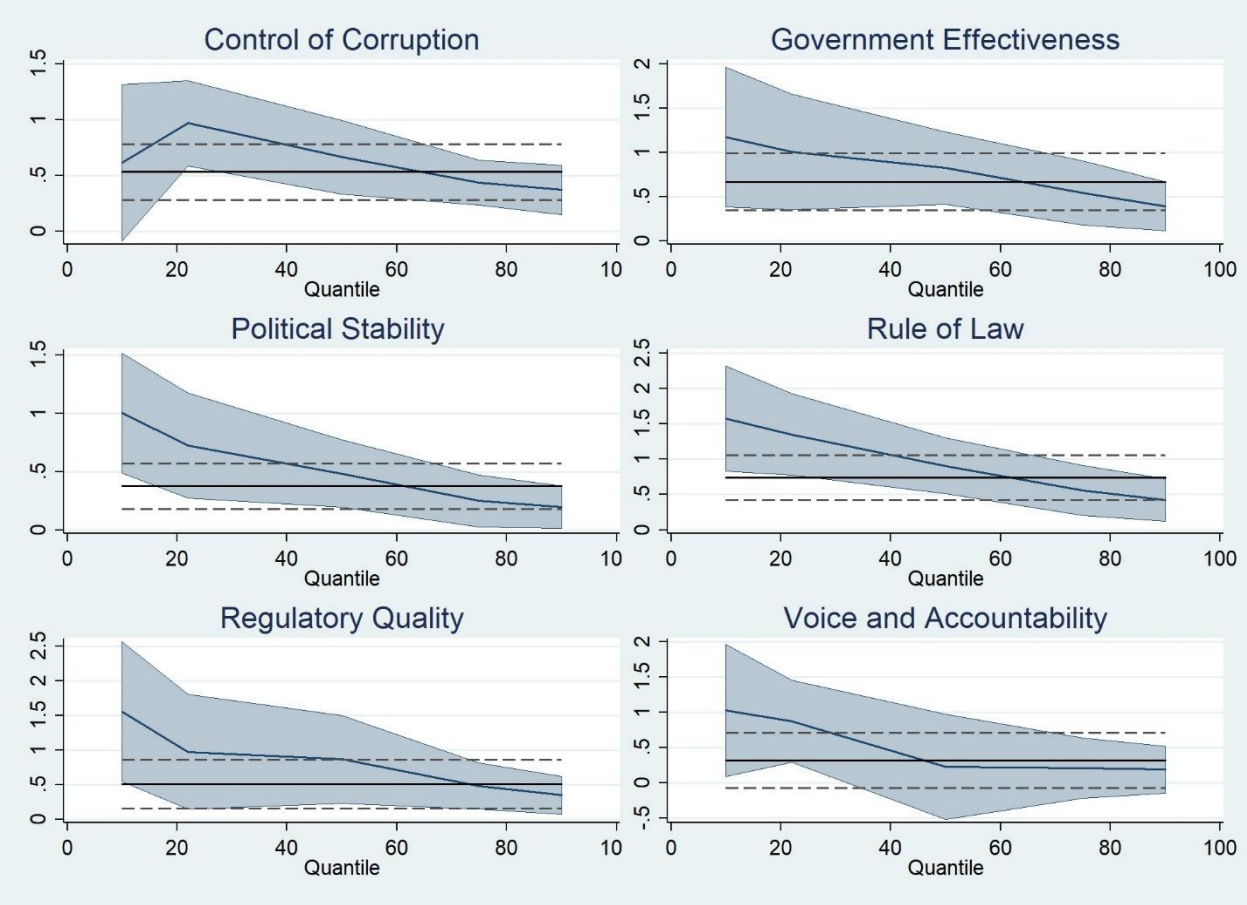
| | | | | | |
|---|---|---|---|---|---|
| Number of observations | 152 | 152 | 152 | 152 | 152 |

Notes: The dependent variable is FDI inflow as percent of GDP. The results in each row are obtained from separate quantile regressions with full set of control variables. Standard errors in parentheses. **, and *** denote statistical significance at the 5%, and 1%, respectively.

Source Author's computations, 2024

Visualization of the quantile estimation results for each quality of governance indicator is provided in Figure 4.4. The black solid line represents the OLS benchmark average estimates while the blue solid line denotes the estimates from the quantile regression along with the 95% confidence interval represented by the shaded areas. The results clearly indicate the heterogeneous impacts with the quantile estimates being higher than the OLS estimates at the lower-end of the FDI distribution and continuously declining to be below the OLS benchmark at the higher-end of the distribution for all governance indicators.

**Figure 4: Quantile regression estimates against the OLS benchmark**




Note: The quantile estimates are represented by the solid blue line along with the 95% confidence interval given by the shaded area. The solid black line represents the OLS benchmark.

The findings suggest several policy recommendations: first, strengthening anti-corruption measures to improve investor confidence, particularly in countries like Nigeria where corruption remains a major challenge; second, simplifying regulatory frameworks to prevent them from becoming barriers to investment, as seen in South Africa; and third, leveraging economic growth and market potential, particularly in emerging markets like Ethiopia. Finally, further research should explore sector-specific FDI inflows, investigate the long-term impacts of institutional reforms, and analyses the interaction between institutional quality and economic factors, offering a more nuanced understanding of FDI dynamics in Sub-Saharan Africa.

## 4.5 Discussion

The inward FDI trajectories of Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa, and Tanzania from 2000 to 2023 reveal a compelling narrative of capital flows across the African continent which is critical for economic development and prosperity. Each country's FDI performance underscores the varying impacts of governance, structural reforms, macroeconomic policies, and global economic dynamics, offering critical insights into their developmental paths. This section delves into a detailed discussion of these trends, supported by comparative analysis, theoretical frameworks, and relevant literature to present an internationally standardized, publishable analysis.

South Africa's dominance in the dataset aligns with its position as the continent's most industrialized economy. Its FDI performance, marked by consistent increases until 2015, reflects the country's relatively advanced economic structures, including diversified industries, strong banking and financial systems, and robust trade policies. However, the fluctuations observed post-2015 can be attributed to challenges such as political instability that can harm investor confidence, and external shocks like commodity price volatility. These findings align with the arguments presented by Naudé (2017), who emphasizes that even well-established economies like South Africa face vulnerabilities due to global interdependence and domestic governance challenges.

Nigeria, on the other hand, exhibits a different trajectory, with significant growth peaking in 2013 before experiencing pronounced declines. This trend can be linked to Nigeria's heavy reliance on oil exports, making it susceptible to fluctuations in global oil prices. The post-2013 downturn correlates with the global oil price collapse in 2014, which severely impacted oil-dependent economies. Eboh (2016) highlights this vulnerability in resource-rich economies, arguing that diversification is critical for sustaining financial stability. While Nigeria has made some efforts to

diversify its economy, the slow pace of reform has hindered its ability to mitigate such shocks, explaining its erratic financial performance post-2013.

In contrast, Ethiopia and Ghana showcase inward FDI growth over the years, reflecting the impact of their developmental policies and increasing integration into global trade systems. Ethiopia's growth, in particular, can be attributed to its state-led development model, focusing on large-scale infrastructure projects and industrialization. According to Diao et al. (2019), Ethiopia's growth strategy has been instrumental in transforming its economy, albeit with challenges such as debt sustainability and reliance on public investment. Ghana's consistent financial growth reflects its political stability and successful economic reforms, including its focus on agriculture, services, and natural resources. The World Bank (2021) has highlighted Ghana as a model of resilience in Sub-Saharan Africa, owing to its diversified economic base and proactive policies.

Kenya and Tanzania demonstrate moderate yet consistent upward FDI trends, underpinned by their growing focus on regional integration and trade facilitation. Both countries have benefitted from their strategic positions in East Africa, leveraging regional trade blocs like the East African Community (EAC) to expand their economic opportunities. Kenya's advancements in technology, particularly its role as a leader in mobile money and fintech innovations, have contributed to its steady growth. Tanzania's focus on mining and agriculture has similarly supported its economic performance. Literature by Bigsten and Söderbom (2020) underscores the importance of regional integration and innovation in driving financial stability and growth in these countries.

Rwanda's minimal financial volumes reflect its position as a smaller economy within the dataset. However, its stable patterns suggest prudent economic management and gradual progress. Rwanda's recovery and transformation post-genocide have been widely documented, with policies focusing on governance, infrastructure, and innovation. As Ndikumana (2016) points out, Rwanda's economic story is a testament to the power of effective governance and targeted investment, even in the face of significant structural challenges.

A comparative analysis reveals significant disparities between resource-dependent economies like Nigeria and diversified economies like Ghana and South Africa. The former's vulnerability to external shocks underscores the importance of economic diversification, as emphasized by Sachs and Warner (2001), who argue that reliance on natural resources often leads to economic volatility. In contrast, the steady growth in Ethiopia, Ghana, Kenya, and Tanzania supports the theory that

diversification, coupled with targeted investment and regional integration, is critical for sustained financial stability. These findings are consistent with the broader literature on African economic development. For instance, Collier (2007) argues that Africa's growth story is shaped by a complex interplay of factors, including governance, natural resource management, and global economic dynamics. The diverse financial trends observed in this study highlight the importance of tailored economic policies that consider each country's unique circumstances. While South Africa and Nigeria illustrate the challenges of maintaining financial stability in resource-rich and industrialized economies, Ethiopia, Ghana, Kenya, and Tanzania demonstrate the potential for steady growth through diversification and integration. Rwanda, though smaller in scale, exemplifies the impact of effective governance on economic performance. In general, the financial trajectories of these African countries from 2000 to 2023 underscore the continent's economic diversity and the critical role of policy frameworks, governance, and global dynamics in shaping financial outcomes. These findings offer valuable insights for policymakers, emphasizing the need for diversification, regional integration, and resilience-building strategies to navigate the complexities of the global economy.

# CHAPTER FIVE

## 5 Summery, conclusion, and recommendation of the study

Chapter Five provides a comprehensive overview of the study's key findings, offering a summary of key results, conclusions drawn from the analysis, and practical recommendations. The summary highlights the relationship between institutional quality and FDI inflows in Sub-Saharan Africa,

emphasizing the influence of governance indicators. The conclusions synthesize the study's contributions to understanding these dynamics, while the recommendations propose actionable strategies for policymakers, investors, and regulatory bodies to enhance the investment climate and foster economic development in the region.

## 5.1 Summary of the Study

The study provides an in-depth analysis of financial trajectories in selected Sub-Saharan African countries—Ethiopia, Ghana, Kenya, Nigeria, Rwanda, South Africa, and Tanzania—from 2000 to 2023, focusing on the interplay between institutional quality and Foreign Direct Investment (FDI) inflows. These trajectories reflect a confluence of diverse economic structures, policy decisions, governance quality, and external factors influencing each country's financial performance over the period.

South Africa consistently emerged as a financial powerhouse in the region, supported by a well-diversified industrial base and strong infrastructure. However, its FDI trajectory experienced significant fluctuations in recent years, driven by political instability, policy inconsistencies, and global economic challenges. These factors underscored the vulnerabilities even in advanced economies of the region, emphasizing the critical role of stable governance and economic reforms.

Nigeria’s financial performance, while robust in certain periods, was marked by pronounced volatility. As Africa's largest oil exporter, Nigeria's dependence on oil made it highly susceptible to global price shocks, which repeatedly undermined its economic growth. The lack of economic diversification further amplified these vulnerabilities, pointing to the need for structural reforms and innovation-driven strategies to reduce dependence on oil revenues.

In contrast, Ethiopia and Ghana demonstrated steady and sustained inward FDI growth. Ethiopia's state-led development model, characterized by significant investment in infrastructure and industrialization, drove its progress. Despite this success, challenges such as limited private sector involvement and external debt accumulation remain areas of concern. Ghana, on the other hand, benefited from a stable political climate, effective governance, and a diversified economic base, which collectively bolstered its resilience to external shocks.

Kenya and Tanzania showcased moderate but consistent inward FDI growth, driven by advancements in technology and regional integration efforts. Kenya’s innovation in financial technology and its role as a regional trade hub contributed significantly to its economic trajectory. Similarly, Tanzania capitalized on its natural resources and increasing regional trade partnerships,

though it faces challenges in improving governance and addressing infrastructural deficits. Rwanda, despite being a smaller economy, stood out for its remarkable financial stability. Strong governance, targeted investments, and a clear development vision allowed Rwanda to attract significant foreign investments and achieve consistent growth. Its strategic focus on governance quality and socio-economic reforms provided a model for other countries in the region.

The comparative analysis of these countries highlights a critical dichotomy between resource-dependent economies, such as Nigeria, and more diversified ones, such as Ghana and South Africa. While resource wealth provided short-term gains for resource-rich countries, long-term sustainability and resilience were stronger in economies that pursued diversification, regional collaboration, and innovation.

The results from the regression analysis provided strong evidence that quality of governance is a critical success factor in attracting inward FDI, with five out of the six governance indicators found to have positive and statistically significant coefficients. The quantile regression results show a heterogeneous impact of governance in enhancing FDI inflows where the impact is stronger in countries at the lower end of the FDI distribution. The study underscores the pivotal role of governance quality on enhancing FDI inflows to SSA countries, which is key for job creation and economic growth. Effective control of corruption, government effectiveness, political stability, regulatory quality, and adherence to the rule of law emerged as significant institutional indicators influencing FDI inflows. These institutional factors not only shaped the economic trajectories of the countries but also determined their ability to attract and retain foreign investments.

Overall, the findings provide valuable insights for policymakers, investors, and development practitioners. They emphasize the importance of fostering governance quality to attract FDI that will facilitate technology transfer and innovation which supports economic growth and development. The study contributes to a broader understanding of the strategies needed to enhance inward FDI for resilient and inclusive economic growth across Sub-Saharan Africa.

## 5.2 Conclusion

The study provides a comprehensive analysis of the inward FDI growth trajectories of selected African countries over the past two decades, shedding light on the substantial variations influenced by the quality of governance and policy reforms. South Africa has consistently led the region in attracting FDI, driven by its well-developed governance structure, diversified industrial base, advanced financial infrastructure, and robust trade networks. However, recent fluctuations

highlight vulnerabilities arising from political instability, corruption challenges, and global economic pressures. These findings underscore the importance of maintaining political stability and policy coherence to ensure continued economic growth.

Similarly, Nigeria's economic performance illustrates the risks associated with overreliance on natural resources. As Africa's largest oil exporter, Nigeria benefitted from high oil prices during certain periods but suffered from sharp declines during global market downturns, exposing its lack of economic diversification. This resource dependency limited its ability to sustain long-term growth, emphasizing the need for structural reforms to foster economic resilience through diversification and innovation.

In contrast, Ethiopia and Ghana exemplify how stable governance and strategic policy implementation can drive consistent economic progress. Ethiopia's state-led development strategy, focused on infrastructure investment and industrialization, enabled steady growth, although concerns about rising debt and limited private sector participation persist. Ghana's relatively diversified economy and stable political climate allowed it to remain resilient to external shocks, positioning it as a model for leveraging governance and economic reform to achieve sustainable development.

Kenya and Tanzania have demonstrated moderate but steady inward FDI growth trajectories, driven by regional integration, technological advancements, and increasing trade connectivity. Kenya's innovation in financial technology and its role as an East African trade hub have been pivotal, while Tanzania capitalized on natural resources and regional partnerships to foster growth. Despite these successes, both countries face challenges in addressing infrastructure gaps and enhancing governance frameworks to support long-term development.

Rwanda stands out for its exceptional financial stability and governance quality, despite its smaller economic scale. The country's focused development planning, strong governance, and commitment to socio-economic reforms have enabled it to attract significant FDI and maintain consistent growth. Rwanda's experience highlights the transformative potential of targeted governance and institutional reforms, offering valuable lessons for other countries in the region.

The study highlights a critical dichotomy: countries with diversified economies and strong governance are better equipped to withstand external shocks and sustain growth, whereas resource-dependent nations are highly susceptible to global market fluctuations. These findings align with

existing literature emphasizing the importance of economic diversification, governance quality, and innovation as essential drivers of financial and economic resilience.

Moreover, the study underscores the need for African nations to enhance regional collaboration, foster private sector development, and adopt adaptive economic policies to navigate the complexities of the global financial landscape. Enhanced collaboration among countries could improve trade integration, innovation diffusion, and collective bargaining in global markets.

Ultimately, this research provides practical insights for policymakers, development practitioners, and researchers focused on Africa's economic transformation. By addressing governance challenges, fostering innovation, and promoting diversification, African nations can build more resilient economies, ensuring sustainable and inclusive financial growth across the continent. This study serves as a critical contribution to understanding the pathways for economic resilience and prosperity in Sub-Saharan Africa.

Beyond the descriptive analysis, the modelling results of this study provided strong empirical evidence on the role of governance in enhancing inward FDI inflow in selected African countries. The findings show that five out of the six governance indicators found to have positive and statistically significant impact on FDI. Further, the estimates from the quantile regression reveal that governance quality has a heterogeneous impact on FDI inflows, where countries at the lower end of the FDI distribution benefit the most from improved governance. The study underscores that quality of governance is a critical success factor in attracting FDI, which is important to transfer technologies and innovation that is crucial for sustainable economic growth and development.

## 5.3 Recommendation for the study

Based on the research findings, the following country-specific recommendations are proposed to enhance inward FDI inflows that support resilient and sustainable economic growth. Each recommendation outlines strategic interventions tailored to the unique economic contexts of the countries analyzed, and identifies responsible actors to ensure effective implementation.

**South Africa**: Strengthening Economic Diversification and Stability: - South Africa should prioritize strengthening its economic diversification to reduce vulnerability to political instability and global economic shifts. While the country has a robust and diversified economy, recent fluctuations highlight areas needing policy reforms. The South African Reserve Bank and the

Ministry of Finance should develop policies that encourage investments in high-growth sectors such as technology, renewable energy, and advanced manufacturing. Collaboration with the private sector to reduce dependency on mining and promote sustainable industries is vital.

**Nigeria**: Addressing Resource Dependency: - Nigeria must implement a clear roadmap for economic diversification, reducing its heavy reliance on oil exports. This includes fostering growth in agriculture, manufacturing, and technology sectors. Establish incentives for foreign and local investors to invest in non-oil sectors through tax breaks and improved business regulations. Strengthen institutions to combat corruption and ensure transparency in public resource allocation.

**Ethiopia**: Enhancing Infrastructure and Governance: - Ethiopia should leverage its ongoing infrastructure development to improve governance and attract more foreign investment. Focused investment in energy, transportation, and communication sectors will amplify economic growth. Develop public-private partnerships (PPPs) to enhance infrastructure quality and efficiency. Strengthen governance by empowering the Ethiopian Investment Commission to provide one-stop services to potential investors.

**Ghana**: Expanding Private Sector Growth: - Ghana should focus on expanding private sector participation in high-growth areas such as agriculture, fintech, and renewable energy. Enhanced financial inclusion and innovation will sustain its economic trajectory. Provide low-interest credit facilities to small and medium enterprises (SMEs) to drive innovation and local entrepreneurship. Invest in digital infrastructure to foster financial inclusion in underserved regions.

**Kenya**: Accelerating Regional Integration and Innovation: - Kenya should continue its leadership in regional integration, particularly through the East African Community (EAC), and promote innovation-driven sectors such as ICT and e-commerce. Foster stronger trade ties within the EAC by reducing non-tariff barriers and improving regional logistics. Create innovation hubs to support startups and entrepreneurial ventures, particularly in rural areas.

**Tanzania**: Improving Policy Consistency and Business Environment: - Tanzania needs to improve policy consistency to enhance investor confidence. A stable and transparent regulatory environment will stimulate financial flows and economic activities. Review and streamline business regulations to reduce bureaucratic hurdles. Launch investor-friendly initiatives such as tax incentives for businesses in agriculture and tourism.

**Rwanda**: Scaling Governance and Strategic Investments: - Rwanda should continue its focus on governance and strategic investments, emphasizing industrial development and export promotion.

Expand export-oriented industries through targeted government support and private sector collaboration. Strengthen the Rwanda Development Board (RDB) to better support investors and entrepreneurs.

General Recommendation

**1. Stakeholder Engagement**: Each country should engage relevant stakeholders, including government ministries, private sector actors, development partners, and civil society, to create a unified vision for economic growth.

**2. Policy Design**: Develop targeted policies that align with country-specific challenges and opportunities, as identified in the research findings.

**3. Resource Allocation**: Prioritize resources towards high-impact sectors and ensure transparency and efficiency in budgetary processes.

**4. Monitoring and Evaluation**: Establish robust monitoring mechanisms to track progress and make adjustments where necessary, ensuring the interventions deliver the desired outcomes.

**5. Capacity Building**: Invest in human capital development to ensure the workforce is equipped to drive and sustain economic progress.

By adopting these recommendations, each country can strengthen its financial resilience, foster inclusive growth, and contribute to the overall development of the African continent. These interventions are designed to address unique challenges while leveraging existing strengths, ensuring sustainable and impactful progress.

## 5.4 Recommendation for future research

Future research could explore the interplay between regional economic integration, such as the African Continental Free Trade Agreement (AfCFTA), and country-specific financial challenges, providing insights into how such agreements influence economic diversification and stability. Studies could assess the long-term impact of external shocks, including global financial crises, pandemics, and climate change, on economic resilience in African economies. Sector-specific analyses are also crucial, focusing on the role of emerging industries like technology, green energy, and agriculture in driving sustainable growth and reducing dependence on traditional sectors. Additionally, examining the relationship between institutional quality, such as governance and transparency, and economic performance can offer valuable insights into the role of effective governance in fostering development. Research into human capital development is needed to

understand how investments in education, skill-building, and innovation contribute to economic diversification and poverty reduction. Further, microeconomic studies could evaluate how macroeconomic policies translate into tangible benefits such as job creation and small enterprise growth. The potential of digital transformation and technology in enhancing productivity, trade competitiveness, and employment also warrants exploration. In-depth, country-specific case studies could uncover localized challenges and successes in implementing reforms, while longitudinal studies could assess the effectiveness of current strategies over time, identifying gaps and areas for improvement. Lastly, research should investigate the intersection of sustainability and economic growth, focusing on how environmental policies can drive green growth and ensure long-term development across African economies.

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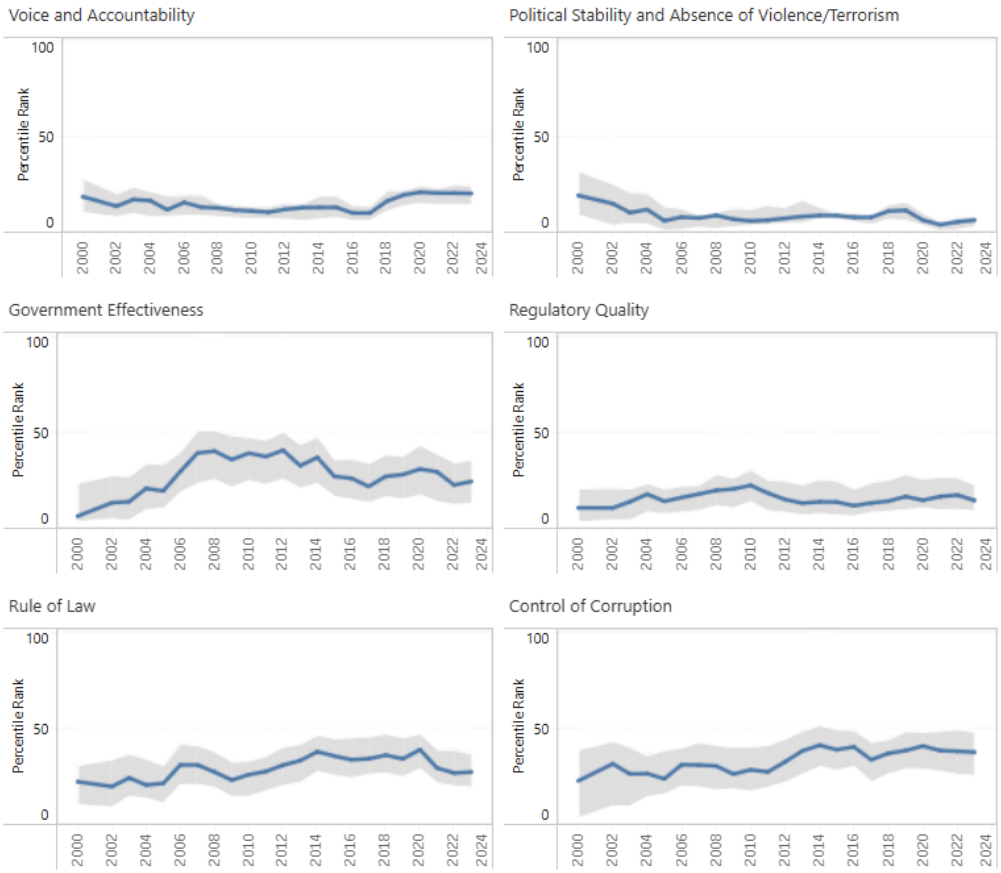
# Appendix

## Comparisons of trends in governance indicators by country

The solid blue line represents the percentile rank of the respective country for each of the six aggregate indicators of governance along with the margin errors given by the grey-shaded area.

### Ethiopia


Voice and Accountability
Political Stability and Absence of Violence/Terrorism
Government Effectiveness
Regulatory Quality
Rule of Law
Control of Corruption
Percentile Rank
100
50
0
2000
2002
2004
2006
2008
2010
2012
2014
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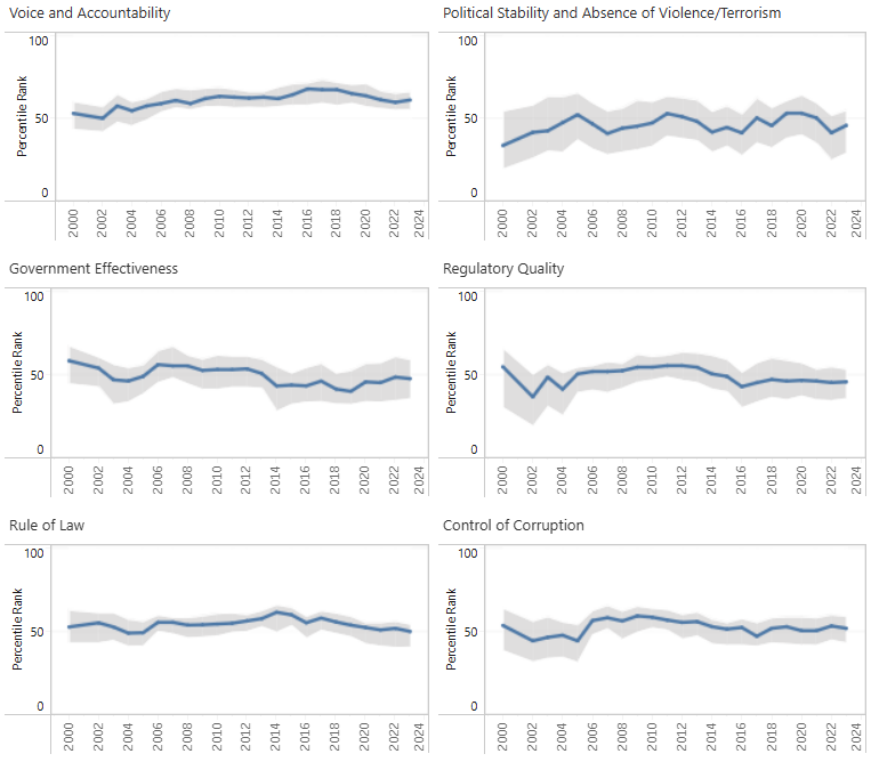
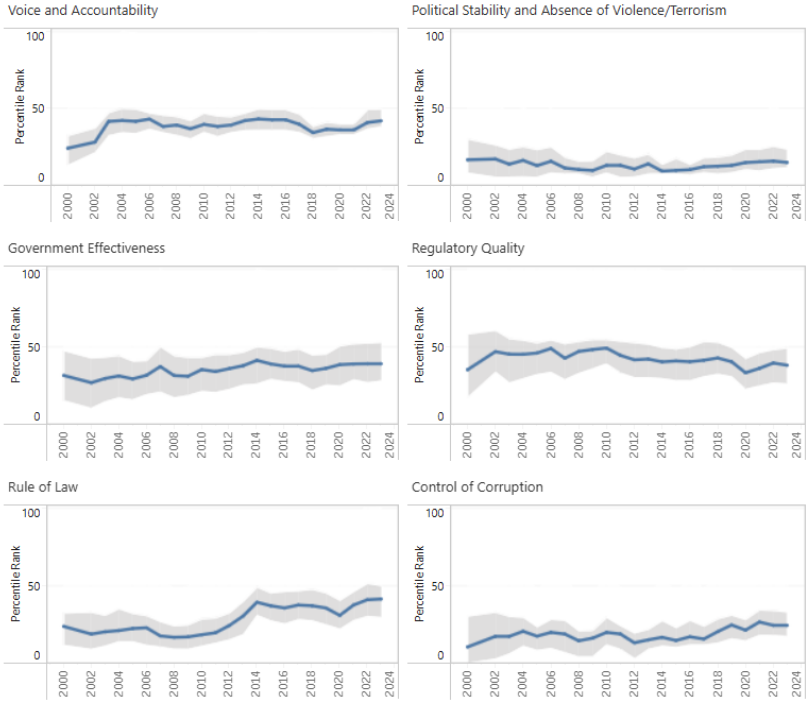
2018
2020
2022
2024

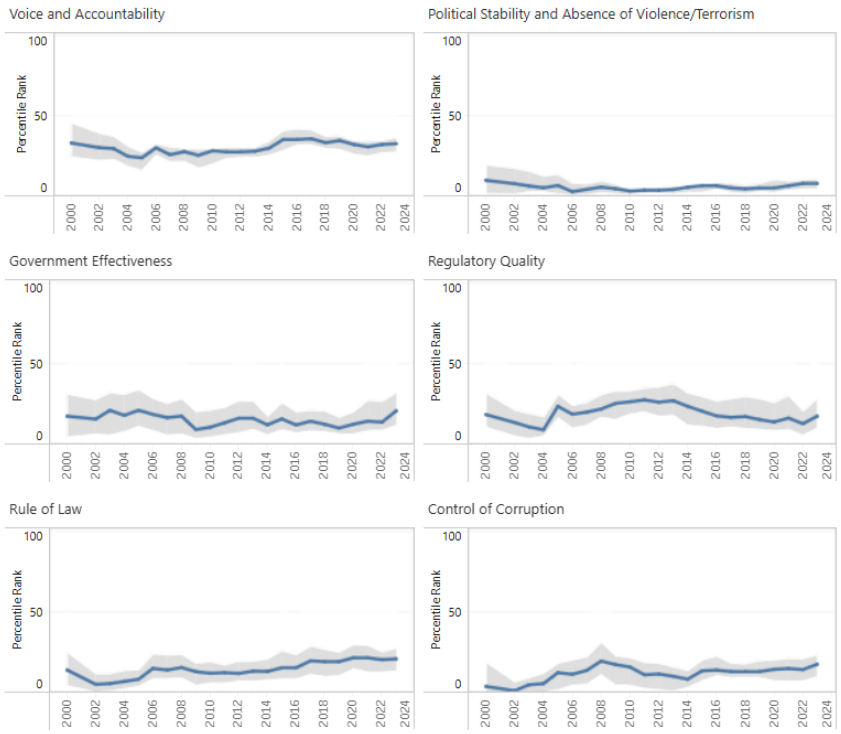
# Ghana



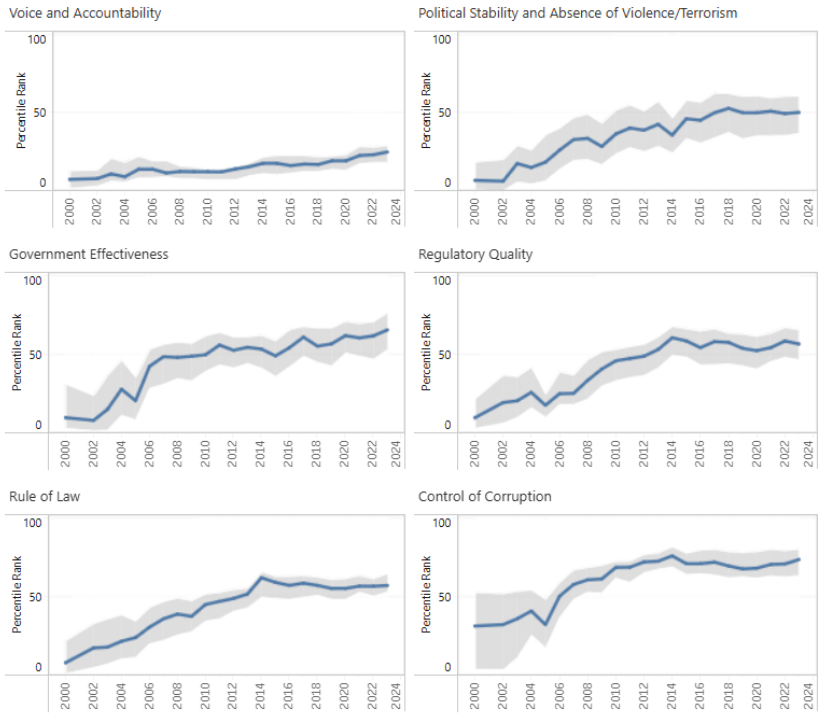

# Kenya



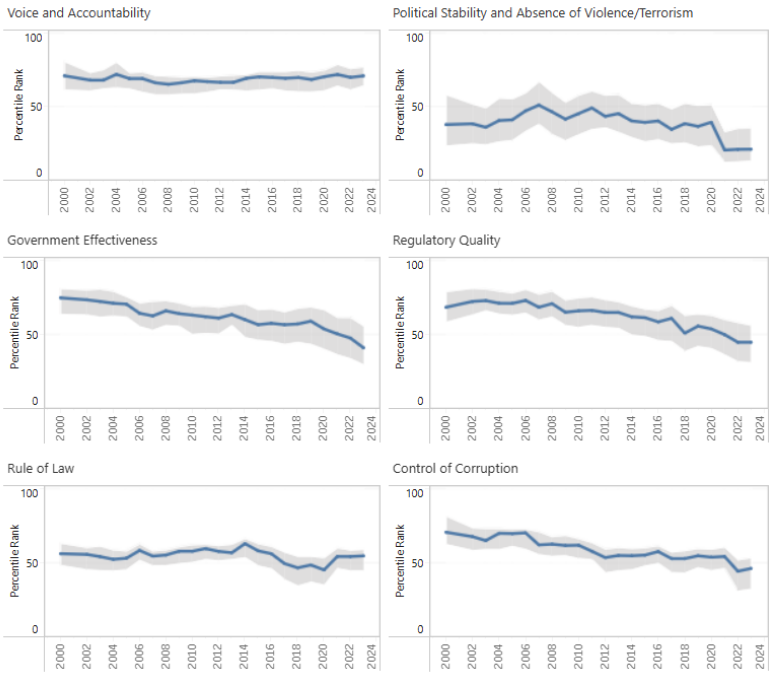

# Nigeria



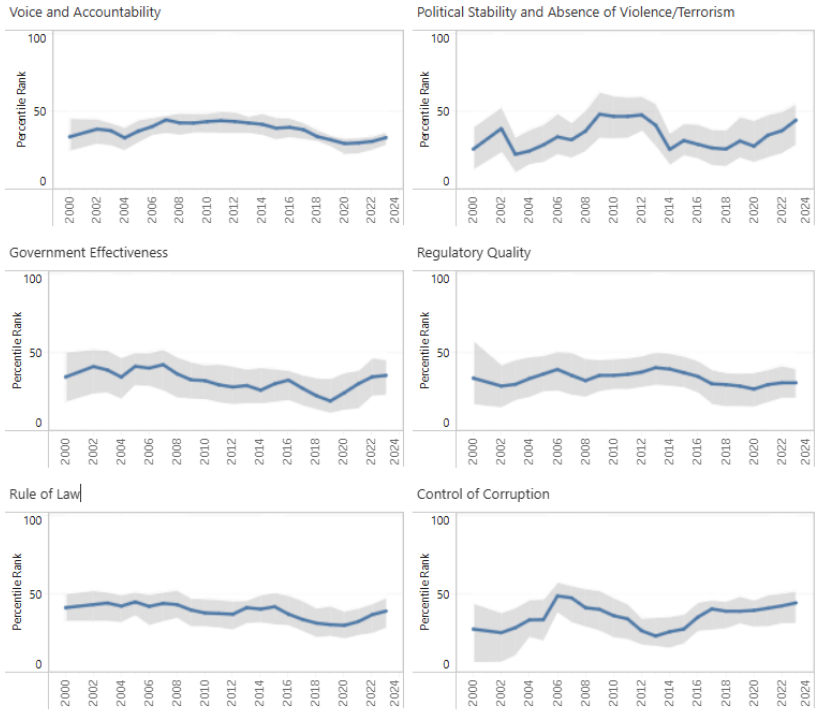

# Rwanda




# South Africa




# Tanzania




Source: Worldwide Governance Indicators, interactive dashboard.