



## RESEARCH ARTICLE

### IMPACT OF FACTORS OF PRODUCTION ON PRIVATE INVESTMENT IN KITUI COUNTY, KENYA

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#### ARTICLE INFO

##### Article History:

Received 20<sup>th</sup> November, 2017  
Received in revised form  
08<sup>th</sup> December, 2017  
Accepted 11<sup>th</sup> January, 2018  
Published online 28<sup>th</sup> February, 2018

##### Keywords:

Private Investment,  
Factors of Production,  
Economy, Economic growth, Devolution

#### ABSTRACT

Private investment is a powerful tool for maintaining and expanding an economy. Many developed and developing countries have for several decades relied greatly on it to solve their economic problems related to growth and development. This research focuses on establishing the impact of factors of production on private investment in Kitui County. The Tobin Q theory, acceleration theory and neoclassical theory are just but a few theories that illustrate the different factors that influence private investment. This report has six chapters; the introduction chapter that basically gives the background of the study in a broader perspective, the second chapter gives a clear theoretical and empirical review of the topic including the conceptual frame work, the third chapter gives details of the research methodology, the fourth chapter presents the results, the fifth chapter is basically the discussion of the results while the sixth chapter entails the conclusion and recommendation. Primary data was collected by use of structured questionnaires as data collection instruments. Sampling technique was stratified random sampling after which piloting followed to ensure data validity and reliability. The target population of the study was the 2000 people who attended the first Kitui County Investors Conference Forum in the year 2015. Stratification was done into two categories. i.e those who have existing business and those who are not in business. Out of the target population, questionnaires were administered to a sample of 200 respondents which was 10% of each strata summed up together. The quantitative data was properly recorded and summarized. Data was analyzed mathematically by use of inferential statistics and multiple regression through the assistance of SPSS (statistical package for social scientists). The study found out that access to land, availability of labor, access to capital and availability of entrepreneurship have a positive correlation with private investment. A regression analysis on the data reviewed that all the four factors of production had a significant effect on private investment. Therefore, the study recommends the enhancement of the four factors of production since they all contribute immensely on private investment.

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#### INTRODUCTION

According to Eltis (2000), investment is a vehicle in which funds can be placed with expectation that they will generate positive income and their value will be preserved or increased. Investment is a central issue in any economy. Recent studies by Collier and Gunning, 1999 conducted in Africa, Ndikumana, 2000 in Asia and Skully, 1997 in Latin America has established the critical linkage between investment and the rate of economic growth. Investment plays a vital role for economic growth and development and for improving the welfare of the society. Econometric evidence from studies by Beddies (1999) and Ghura (1997) indicates that private investment has a stronger, more favorable effect on growth rather than government investment, probably because private investment is more efficient and less closely associated with corruption.

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Khan and Reinhart (1990) found that there is a positive relationship between private investments and economic growth. Increase in private investments leads to increased economic growth. A decline in private investments leads to a decrease in economic growth. Factors of production are inputs that are used in the production of goods or services in order to make an economic profit. Factors of production, are what is used in the production process to produce output—that is, finished goods and services. There are four factors of production: land, labor, capital and entrepreneurship. Land resources are the raw materials in the production process. According to Paul and William (2004), the income that resource owners earn in return for land resources is called rent. According to (Adam, 1776), labor is the effort that people contribute to the production of goods and services. The income earned by labor resources is called wages and is the largest source of income for most people. According to Paul and William (2004), capital includes the machinery, tools and buildings humans use to produce goods and services.

The income earned by owners of capital resources is interest. Entrepreneurship is a measure of how well an organization can combine factors of production - land, labor, and capital - to earn a profit. In Kenya, the private investment has made notable economic contributions over the years, as demonstrated by its contributions to GDP, employment and export earnings. Overtime, Kenya has been able to build a strong private sector, which has in turn contributed significantly to the creation of a diversified economy, as evidenced by the broad range of private sector activities that take place under the monetary economy. In the year 2010, the promulgation of new constitution saw the inception of two levels of Government i.e one National Government and the 47 County Governments. The Constitution envisages that Kenya's development mode was to be anchored on devolved governance structures. Given the transition to a devolved governance system in the year 2013, the County Governments have a crucial role of creating an enabling environment to ensure that each county achieves its maximum investment potential.

Kitui County is one of the 47 County Governments and is situated in the lower Eastern region of Kenya. It is the eleventh most populous and sixth largest county in Kenya with a population of 1,012,709 (2009 census). Kitui County investment opportunities are massive, and huge potential exists in various sectors of the economy. Kitui County Government has made several efforts to encourage the growth of private investment in the County. The County Government has further gone to an extent of providing investment incentives to attract more investors in the County. With all this efforts by the County Government, private investment trends are generally not impressive. There are no studies on private investment in Kitui County posing a challenge to the current government, development agencies, investors and other stakeholders. This study seeks to investigate the economic, political and social factors that affect private investment here in Kitui County.

### Statement of the Problem

According to Ronge and Kimuyu (1997), Kenya had been studied in cross country studies with regards to private investment. There is hence either little or no information and data on County Governments with regards to private investment and the factors that influence it due to lack of prior studies. The County Governments in Kenya, Kitui County included and development partners have lacked research based evidence to base their development approaches on with regards to boosting levels of private investment. These has led to poor response of the private sector to the investment opportunities created by the government and other stakeholders in Kitui County. Studies by various researchers have been skewed to economic factors affecting private investment. Outside economic factors, other factors may influence private investment. Seruvatu *et al* (2001) attributes changes in private investment to other factors besides economic factors. Although, adjustment of economic factors stabilization is necessary, it is not sufficient so as to increase the private investment. Owing to this reason, understanding the impact of factors of production on private investment is critical for successful designing and implementation of policies in Kitui County. Hence the motivation for this research to investigate how factors of production affect private investment here in Kitui County.

## Research Objectives

### General Objective

The general objective will be to find out the impact of factors of production on private investment in Kitui County.

### Specific Objectives

- To find out the influence of access to land on private investments in Kitui County.
- To examine the effect of availability of labor on private investments in Kitui County
- To determine the influence of access to capital on private investments in Kitui County.
- To establish the influence of entrepreneurship skills on private investments in Kitui County.

### Literature Review

Different economists came up with various theories of investment over different time periods. One of this theories is the accelerator model advanced by Clark in 1917 and which asserts that investment spending is directly proportional to the change in output and is not affected by the cost of capital. The accelerator theory also suggests that as demand or income increases in an economy, so does the investment made by firms. The second theory is the Tobin Q was the theory promulgated by James Tobin in 1969. Tobin Q explains the ratio of market worth of an organization to substitute cost of capital invested. When the ratio is more than one, the organization might want to invest more resources to enable repayment of the investments.

The third theory is the Keynes theory as proposed in 1936 that was based on 'animal spirits'. This theory describes the way people and businesses sometimes make decisions based on their 'gut feeling', rather than using rational analysis. The fourth is the neoliberal theory as proposed by McKinnon and Shaw (1973) which emphasized on the importance of financial deepening as well as high interest rates needed to stimulate economic growth. The authors further argued that developing economies endure financial repression; including controlling of interest rates through a downward direction, which further hurt the private investments in any country. The challenge and gap is that these theoretical models were analyzed in the context of developed economies. Application of most of these models in developing countries is limited by mostly data unavailability or by the unique nature of economies in the developing world.

Harandez-Cata (2005) conducted a study on determining macro and micro factors on private investment by using Tobit model. His findings at micro level showed that education, access to land, access to credit, infrastructure facilities, investment incentives, corruption and bureaucratic red tape were the most important determinants of private investments in this study area. Inadequate accesses to land, weak market, bureaucratic red tape, corruption, and poor functional factors. These are much of the problem for expansion of private investment in developing countries in long term (workie, 1996). According Ouattara (2005), although many authors showed determinants of private investment decision like political, and macroeconomic instability, availability of natural resources and market size insignificant, a lot of new factors are emerged that inhabit the expansion of private investment at

micro level. According to Nelson 1999, the production factor land is not a factor of economic concern for non-agricultural firms. This thought, however, does not seem odd when confronted with data that show that land costs are fairly little. Beddies (1999) conducted a study on determinants of investment and exports of South African manufacturing firm that utilized data from 61 manufacturing firms using Tobit model. Its findings showed that labor costs were found to be high in comparison to other African countries where similar surveys were conducted. According to Hamermesh (2014), higher labor costs (higher wage rates and employee benefits) make workers better off, but they can reduce companies' profits, the number of jobs, and the hours each person works. Overtime pay, hiring subsidies, the minimum wage, and payroll taxes are just a few of the policies that affect labor costs. Policies that increase labor costs can substantially affect both employment and hours, in individual companies as well as private investment and the overall economy. A recent study by Fisher et al. (2006), showed that more labor at a store is associated with substantially higher sales, however some retail executives who claim that they often have insufficient store labor because they see it more as a cost than as a profit-driver. Indeed, some scholars suggest that when the costs of increasing labor are obvious and easy to measure and the benefits are indirect and not immediately felt, managers may pay too much heed to the costs and staff their stores at sub-optimal levels (King and Lenox 2002).

(Skully, 1997) Sakr (1993) investigated the determinants of private investment in Pakistan and found that these determinants depend mainly on the structure and characteristics of the economy. The results show a positive relationship between private investment and growth in GDP; private sector credit and public investment. Their paper breaks down public investment into infrastructural and non-infrastructural investment. They found that non-infrastructural investment is negatively correlated with private investment while infrastructural investment is positively related to private investment. User cost of capital is an important factor in any investment decision by the private sector. When the user cost of capital is increased by raising the cost of bank credit or by increasing the cost of retained earnings, which is the main source of financing investment, there is a decline in investment. Gnansounou (2010) analyzed the determinants of private investment using data from a panel of 123 firms in Benin and covering the 1997-2003 period using the generalized method of Moments (GMM) with instrumental variables.

The findings showed that demand uncertainty had a negatively significant effect on private investment; fluctuations in the imports of manufactured goods from Nigeria also had a negative effect on private investment in Benin. The investment behavior of the firms strongly hinges on the cost of capital utilization i.e. when this cost is high, it weighs negatively on the purchase and installation of new production infrastructure. The magnitude of the effect of this cost of capital utilization and of the demand uncertainty which investment firms face depends on the nature of their activities. Hosamane and Niranjana (2010) used the neoclassical theory of investment to explore the determinants of private investment using fifteen years (1991-2005) panel data set comprising of ten manufacturing industries at an aggregate level in India.

The study makes use of panel estimation models along with the IPS panel unit root test (Im, Pesaran and Shin, 2003). The results of model indicate that output, profits, capital stock, and cost of capital are important variables in determining private investment behavior. Empirical studies on determinants of domestic private investments in developing countries have opted to modify the existing traditional theories to fit the realities of developing economies. Most of these studies are further confined to the limitation of the theories highlighting mostly the macroeconomic determinants of private investment i.e. interest rate, inflation rate, exchange rate, public investment and money supply. The main gap is that very few studies have deviated away from macro factors to find out other factors that affect private.

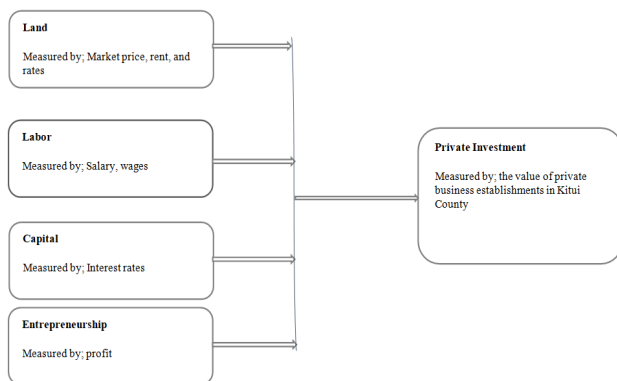
The big importance of entrepreneurship for economic growth in modern 'entrepreneurial' economies is related to the increased importance of knowledge in the economic process. In the old, 'managed' economies, land, labor and capital were the main factors of production. However, globalization and the telecommunications and computer revolutions have drastically reduced the cost of shifting not just capital but also information out of the high-cost locations of Europe and into lower-cost locations around the world. This means that economic activity in high-cost locations is no longer compatible with routinized tasks. Rather, globalization has shifted the comparative advantage of high-cost locations to knowledge-based activities, and in particular search activities, which cannot be costlessly transferred around the globe. Knowledge as an input into economic activity is inherently different from land, labour and capital. It is characterized by high uncertainty, high asymmetries across people and is costly to transact. (Barro and Sala-I-Martin, 1995)

According to Rada (2007) entrepreneurship 'trigger' private investment. Murphy et al (1991) provided a model that described firm size and the growth of the economy as a function of entrepreneurial ability. Nelson and Pack (1999) assigns a key role to the 'effectiveness of entrepreneurial ability' which they see as a vital determinant of the rate of assimilation of technology (1999:420) – as in Michelacci (2003) where entrepreneurial ability is vital for R and D. In Nelson and Pack (1999) a 'rapid' expansion of skilled labor can only be absorbed if entrepreneurial ability is high, and that without entrepreneurial ability the returns to physical and human capital is low. The process of structural change in private investment as facilitated by high ability entrepreneurs lead to firms adopting more complex production methods and producing more complex and specialized intermediate inputs. As a result the technological intensity of a country's economic structure increases (Ciccone and Matsuyama 1996). These structural changes have interesting implications for the development of entrepreneurship itself, so that entrepreneurship may be itself endogenous in the development process.

### Conceptual Framework

Guba and Lincoln (1989) defined a conceptual framework as a research tool intended to assist a researcher to develop awareness and understanding of the situation under scrutiny and to communicate the findings. The conceptual framework explains the relationship between the dependent and independent variables. In this study, the dependent variable was private investment and the independent variables were identified as land, labor, capital, and entrepreneurship.

The conceptual framework expounds on the connection that the independent variables had on the private investments, which was the dependent variable as indicated in appendix 1.



Source Author (2017)

#### Independent-Variables-Dependent-Variable Conceptual Framework

## METHODOLOGY

Questionnaires were used to collect quantitative data from the respondents. A quantitative approach of data collection was employed for this study. Ronge and Kinyumu (1997) asserted that, quantitative methods are ideal where a phenomenon can be quantified, measured and expressed numerically. The target population comprised of all those who attended the first Kitui County Investors Conference Forum, 2015. The forum was attended by two thousand (2000) people (Investors Conference Report 2015). Stratified random sampling design was used. The process entailed stratification of the target population into two strata based on if the person has an existing business or not. 500 out of 2000 have existing businesses while 1500 out of 2000 don't have existing businesses in Kitui County (Investors Conference Report 2015). 10% each strata translates to 50 people with existing businesses and 150 people without existing businesses totaling 200. According to Mugenda and Mugenda (2003), 10% to 30% of the population is adequate sample for this study and is a good representation of the population.

Collected data was thoroughly examined and checked for completeness and comprehensibility. The qualitative and quantitative data was then be summarized, coded and tabulated. The data was analyzed mathematically by use of inferential statistics and descriptive statistics through the assistance of SPSS (statistical package for social scientists).The following was the multiple regression models for factors of production and private investment;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where Y is Private Investment

$X_1$	Land	$\beta_1$	Coefficient of Land
$X_2$	Labor	$\beta_2$	Coefficient of Labor
$X_3$	Capital	$\beta_3$	Coefficient of Capital
$X_4$	Entrepreneurship	$\beta_4$	Coefficient of Entrepreneurship
$\varepsilon$	Error term	$\beta_0$	Constant

The resulting information was presented in form of frequency tables, percentages and charts. It was interpreted to make the conclusion about the study topic of determinants of private investment in Kitui County.

## RESULTS AND DISCUSSION

The researcher used Pearson's correlation coefficient, to establish whether there is any relationship among the factors of production and with private investment that is; access to land, availability of labor, access to capital, availability of entrepreneurship and private investment. From the table it is clear that all the factors of production and private investment are positively correlated. This implies that if any factor of production is improved, it can improve the other factors of production and positively contribute to private investment. This research found that the model fitted the data well since for both the  $R^2$  and adjusted  $R^2$  were close to 1 (Nagelkerke, 1991). This means that the model can explain upto 70.9% of the variations. In regression, the size of the coefficient for each independent variable gives you size of the effect that the variable has on the dependent variable, and the sign of the coefficient (positive or negative) gives you the direction of the effect. The researcher further sought to establish the actual values of the coefficients of the independent variables and the values as shown below;

All the factors of production have positive contribution to private investment. Each model contribution to private investment is statistically significant due to the fact that the values are close to 1. The constant of this model is 0.0328, essentially, when all the four variables are equated to zero. This means that there will little private investment without the four factors of production. Access to land has a coefficient of 0.542 which is the second highest among all coefficients. It means that land has a big influence on private investment among the other variables. This means that that for every 1 unit increase in access to land there is 0.542 increase in private investment. Availability of labor has a coefficient of 0.365. This means that that for every 1 unit increase in availability of labor there is 0.365 increase in private investment. Access to capital has the highest coefficient of 0.755. This means that for every 1 unit increase in access to capital there is 0.755 increase in private investment. Availability of entrepreneurship has a coefficient of 0.106. This means that that for every 1 unit increase in availability of entrepreneurship there is 0.106 increase in private investment. The value of the error term is 0.671.

the regression models can be expressed as;

$$Y = 0.0328 + 0.542X_1 + 0.365X_2 + 0.755X_3 + 0.106X_4 + 0.671$$

Regression analysis revealed that access to land has a positive correlation and the second highest impact on private investment with a beta of 0.542. This concurs with findings by Harandez-Cata (2005), where he concluded that land is a very important determinant of private investment. Also the findings concur with Workie (1996) that access to land is one of the major barriers of private investment. This implies that private investment can be improved by improving the access to land by investors. The analysis results revealed that availability of labor is third among factors of production with a positive correlation on private investment with the third highest Beta of 0.365. This is in agreement with Fisher et al. (2006), who showed that more labor at a store is associated with substantially higher sales and hence an increase in level of private investment. However, according to Hamermesh (2014), labor has both positive and negative impact on private

### Pearson's Correlation among factors of production and private investment Correlations

		Private Investment	Access to land	Availability of labor	Access to Capital	Availability of Entrepreneurship
Pearson Correlation	Private Investment	1.000	.542	.365	.755	.106
	Access to land	.542	1.000	.019	.057	.074
	Availability of labor	.365	.019	1.000	.053	.087
	Access to Capital	.755	.057	.053	1.000	.211
	Availability of Entrepreneurship	.106	.074	.087	.211	1.000
Sig. (1-tailed)	Private Investment	.	.510	.740	.553	.431
	Access to land	.510	.	.395	.215	.151
	Availability of labor	.740	.395	.	.230	.115
	Access to Capital	.553	.215	.230	.	.002
	Availability of Entrepreneurship	.431	.151	.115	.002	.
N		195	195	195	195	195

Coefficient of determination was evaluated as shown below; R and R<sup>2</sup> of the Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1.	.842a	.709	.703	.006

### Regression model coefficient and the t statistic value

Model	Unstandardized Coefficients		t	Sig.
	B	Std. Error		
(Constant)	0.0328	.671	3.468	.001
Access to land	.542		.969	.510
Availability of labor	.365		.783	.740
Access to Capital	.755		.847	.553
Availability of Entrepreneurship	.106		.789	.431

investment increasing the level of output and also increasing the cost of production. None of investment theories has recognized labor as an important factor affecting private investment. Most theories focused on the economic factors affecting private investment. However from the findings of this study, it is clear that labor is an important factor affecting private investment. Access to capital is first among factors of production with a positive correlation on private investment with the highest Beta of 0.755. This findings agree with Sakr (1993) findings that cost of capital is an important factor in any investment decision by the private sector. When the user cost of capital is increased by raising the cost of bank credit or by increasing the cost of retained earnings, which is the main source of financing investment, there is a decline in investment. However studies by Skully (1997) established a negative relationship between private investment and interest rates. The findings of this study also contradict the findings of Clark (1917), who asserted that investment spending is directly proportional to the change in output and is not affected by the cost of capital in the accelerator model. However the findings are in agreement with the Tobin Q theory promulgated by James Tobin in 1969 which asserts that cost of capital is a major determinant of the levels of private investment in a firm. Key to successful growth of private investment coming fourth among factors of production with a Beta of 0.106 and contributing positively to private investment is entrepreneurship. This findings concur with Rada (2007) findings that entrepreneurship 'trigger' private investment. The big importance of entrepreneurship for economic growth in modern 'entrepreneurial' economies is related to the increased importance of knowledge in the economic process. According to Ciccone and Matsuyama (1996), the process of structural change in private investment as facilitated by high ability entrepreneurs lead to firms adopting more complex production methods and producing more complex and specialized

intermediate inputs. As a result the technological intensity of a country's economic structure increases. None of the previous theories on investment looked at entrepreneurship as a factor affecting the level of private investment. This research prove otherwise that entrepreneurship is an important driver of private investment and should not be ignored.

### Conclusion and Recommendation

In conclusion, capital is the most important factor of production contributing positively towards private investment. However, high interest rates, stringent terms of credit and requirement of collateral has made formed barriers for its maximum contribution towards private investment. Entrepreneurship is another critical factor of production when it comes to private investment. Lack of training for business owners and employees on how to run a business including lack of business experience both outside and within Kitui County for both employees and business owners has posed a big challenge towards its contribution towards private investment growth.

Land is the second most important factor of production with regards to private investment. However issues like cost of land, location of land and complex procedures of owning land have been acting as barriers to the full contribution of land towards growth of private investment. Labor is another very important factor of production contributing positively towards private investment. However despite the fact that there is high level of supply of labor here in Kitui County, issues like gender inclusivity and diversity in labor have acted as huddles preventing its maximum contribution into private investment. Based on the study literature review and findings after the data analysis, this research recommends that the government should come up with policies that improve access to land, increase availability of labor, increase access to capital and improve availability of entrepreneurship.

Development partners and government should come up with measures to reduce of cost of land, to remove complexity of land acquisition procedures by the government, increase gender inclusivity in labor and also increase diversity of labor supply, reduce the rate of interest on capital also introducing more lenient terms of credit, and programs should be introduced by government and development partners of training business owners and employees on running a business. The researcher is suggesting for further studies on other factors other than factors of production on private investment. The researcher suggests further studies on the impact of devolution on private investment.

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