

**EFFECT OF FINANCIAL DEEPENING ON PRIVATE INVESTMENT IN  
KENYA**

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for the Award of the Degree of Master of Science in Economics of Chuka University**

**CHUKA UNIVERSITY**

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## DECLARATION


### Declaration


This thesis is my original work and has not been presented to any institution for the award of a diploma or conferment of a degree.

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### Recommendation

This thesis has been examined, passed and submitted with our approval as University Supervisors.

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## **DEDICATION**

I dedicate this work to my beloved husband, son, parents, brothers and siblings for the moral support and financial support they have given me during my research and thesis development period.

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## ABSTRACT

Private investment remains an important sector in the growth of economy and sustainable development in Kenya. It is envisioned to create job opportunities, distribute income and alleviate poverty. The underperforming growth rate of private investments that is below the expected growth rate of 24% has been witnessed in the past years. Since 1980, the highest growth that has been achieved is 15.2% in 2014. It then declined to 12.96% in 2021, 13.34% and 13.40% in 2022 and 2023 respectively, which are much below the projected growth rate. Existing studies in Kenya lack substantial inquiry on the relationship between financial deepening and private investment and have dealt with them separately without linking the two in a dynamic framework. Additionally, most of those studies tend to rely on a limited set of indicators of financial deepening, while employing different methods for analysis that may not be appropriate for unbiased results. The current study intended to determine the effect of financial deepening on private investment. Gross Fixed Capital Formation for the general private sector measured private investment, a dependent variable. Further, financial deepening (independent variable) was proxied by Private sector credit broad money and bank deposits (savings). The study also included public investment real interest rates and GDP Per capita as control variables. Financial intermediation theory and financial liberalization theory are the theories that guided the study. A causal research design was adopted and data were obtained from KNBS and World Development Indicators websites. STATA software was used in the analysis of the collected data. ARDL model was employed and the ECM was estimated since there was cointegration. From the findings, Private sector credit, Broad money and Bank deposits were statistically significant with positive coefficients of 0.32, 0.39 and 0.49 respectively in the short run. An increase in 1 percent of private sector credit, Broad money and Bank deposits cause private investment to increase by 0.32, 0.39 and 0.49 percent respectively. The findings show that private sector credit has a positive effect, while broad money and bank deposits have negative effect on private investment in the long run. The three models were good predictors of private investment as shown by R-squared values of 0.96, 0.94 and 0.94 respectively. The study concluded that financial deepening is important for growth of private investment in Kenya. Therefore, Financial intermediation theory is applicable in Kenya. The study recommends policymakers to conceptualize the policies that aim at facilitating financial access and inclusion for the marginalized groups in remote and rural areas. Further, the government needs to support financial sector through enhancing the growth of microfinance institutions. This will facilitate the provision of credit and savings services to individuals earning low income and owning small businesses.