

# Effect of financial development on foreign direct investment in Sub-Saharan African countries

Cyprian S. Anyalagbu<sup>1</sup>✉, Reuben Izuchukwu Okafor<sup>2</sup>, Cyril Ogugua Obi<sup>1</sup>

1) Department of Economics, Chukwuemeka Odumegwu Ojukwu University, Igbariam, Anambra State, Nigeria

2) Renaissance Modern Polytechnic, Mbaukwu. Anambra state

✉ Corresponding author:

[cysanya@yahoo.com](mailto:cysanya@yahoo.com)

## Abstract

This study investigates the nexus between financial development and foreign direct investment (FDI) inflows across 20 Sub-Saharan African (SSA) countries from 2007 to 2024. Despite the region's need for capital, the specific financial and institutional drivers that attract or deter international investors remain under-explored. Anchored in endogenous growth theory, the research evaluates how banking access, market depth, and governance influence capital attraction. Using a two-step System GMM estimator to ensure data integrity, the findings reveal that FDI is significantly self-reinforcing. While increased access to financial institutions and strong governance are primary drivers of inflows, financial market volatility and rising labor costs – reflected in human development metrics – tend to deter investment. The study concludes that SSA nations must transition from labor-seeking to skill-seeking investment models. To attract high-quality capital, policymakers must prioritize enhancing financial regulations alongside institutional reforms, ensuring financial depth serves as a sustainable mechanism for economic growth.

**Keywords:** *Financial Development, Foreign Direct Investment, System GMM, Institutional Quality, Sub-Saharan Africa.*

## INTRODUCTION

Sub-Saharan Africa remains a region of profound economic paradox, possessing vast natural wealth yet struggling with persistent capital deficiencies. Despite numerous liberalization policies, Foreign Direct Investment (FDI) inflows remain volatile, often concentrated in extractive industries rather than diversified manufacturing or services. This trend is exacerbated by systemic financial development challenges, including shallow capital markets, limited credit accessibility, and high transaction costs that heighten investor perceived risk. Consequently, the region's ability to leverage foreign capital for sustainable growth is hampered by underdeveloped financial intermediaries and institutional fragilities. Understanding this context is essential before examining the empirical findings of previous literature on the FDI-growth nexus. Template Over the past decade, studies have shown that deeper and more efficient financial systems significantly enhance FDI inflows into SSA. Higher broad money to GDP ratios signals greater savings mobilization and credit availability, which foreign investors interpret as an enabler of large-scale projects (Tchamyou & Asongu, 2022). Expanded access, particularly through mobile money networks, reduces transaction costs and market entry barriers, further attracting multinationals (Asongu & Nwachukwu, 2021). Moreover, narrower net interest margins and lower intermediation costs have been linked to higher FDI by lowering financing costs for overseas firms (Kpodar & Andrianaivo, 2021). Strengthened regulatory frameworks and improved banking stability, reflected in declining non-performing loan ratios, have also bolstered investor

confidence, underpinning sustained FDI growth across the region (Ajakaiye, Oloyede, & Babatunde, 2023; Ndikumana & Adu, 2022).

Nevertheless, the relationship between financial development and economic growth in SSA is influenced by several factors, including institutional quality and macroeconomic policies. As noted by Kacho and Dahmardeh (2017), financial development alone may not be sufficient to promote growth if it is not supported by strong institutions and sound policies. Effective governance, a well-functioning legal system, and the enforcement of property rights are essential for ensuring that financial resources are allocated efficiently and that financial institutions operate stably and transparently (Adams & Opoku, 2020; Gazdar & Cherf, 2015). Furthermore, political instability and poor economic policies can undermine the effectiveness of financial reforms and hinder the growth of the financial sector as well as the inflow of foreign direct investments.

In emerging economies, the synergy between financial development and high institutional quality is vital for productivity. Robust regulatory frameworks and the rule of law enhance capital allocation efficiency, allowing countries with strong governance to realize growth dividends up to 30% higher than those with weaker institutions (Agyapong & Mensah, 2022; Ibrahim & Ugoji, 2023). Furthermore, sound institutions stabilize long-term growth by mitigating market volatility and bolstering investor confidence (Ogun & Musa, 2024). In Sub-Saharan Africa, financial development drives expansion by mobilizing savings and attracting FDI through reduced transaction costs. However, these benefits are unevenly distributed due to disparities in governance and infrastructure (Adams & Opoku, 2020). While solid institutions create a virtuous cycle of sustainable growth, weak financial systems often lead to the underutilization of foreign capital and subsequent economic stagnation. Thus, the growth-enhancing effects of FDI remain contingent upon the depth of domestic financial markets and the quality of the institutional environment.

The relationship between financial development and economic growth in Sub-Saharan Africa (SSA) is inherently complex and non-linear. While expanding the financial sector's size is a common goal, a shallow system with limited credit access fails to stimulate growth; conversely, deep and efficient systems foster investment and resource allocation. However, structural deficits—specifically weak institutional quality, policy inconsistency, and underdeveloped infrastructure—undermine this transmission. Weak governance, characterized by corruption and poor contract enforcement, distorts credit allocation and erodes investor confidence (Acemoglu & Robinson, 2019; Asongu & Odhiambo, 2020). Furthermore, abrupt shifts in fiscal and monetary directions create macroeconomic uncertainty, discouraging long-term investment and private-sector productivity (IMF, 2023; World Bank, 2024). These challenges are exacerbated by underdeveloped infrastructure, such as shallow capital markets and weak payment systems, which restrict affordable credit for innovation (Sahay et al., 2020; Beck & Poelhekke, 2022). Collectively, these interacting barriers prevent SSA nations from harnessing financial development for industrialization and technological upgrading, hindering progress toward sustainable development goals (UNECA, 2024). Without addressing these institutional and infrastructural gaps, financial reforms remain largely ineffective in driving inclusive transformation.

Despite notable improvements in financial development across Sub-Saharan Africa particularly in financial access and digital financial services, these gains have not translated into strong or consistent economic growth because structural weaknesses continue to undermine the effectiveness of financial intermediation in the region. First, financial markets remain shallow, illiquid, and highly volatile, limiting the ability of firms to access long-term financing necessary for productivity-enhancing investment (Beck & Poelhekke, 2017; Allam & Asongu, 2021). Second, inefficiencies within banking institutions including high lending rates, limited credit information systems, and risk-averse lending practices have constrained credit allocation to productive

sectors, especially MSMEs that drive growth (Fowowe, 2022). Third, institutional weaknesses such as corruption, weak regulatory quality, and poor contract enforcement continue to reduce the capacity of financial reforms to stimulate meaningful economic transformation (Adusei, 2023).

Moreover, financial development in many SSA countries is dominated by short-term, consumption-driven credit expansion rather than productive financing, thereby weakening the finance-growth transmission mechanism (Efobi et al., 2020). Additionally, the region faces persistent macroeconomic instability, including inflationary pressures, exchange-rate volatility, and high debt burdens, which further dampen the growth-enhancing effects of financial deepening (IMF, 2024). Consequently, despite observable improvements in selected financial development indicators, the absence of strong capital markets, weak institutional quality, rising financial vulnerabilities, and the misallocation of credit collectively explain why financial development has not consistently produced the expected growth outcomes across SSA.

Although extensive empirical work on the finance-growth nexus has shown substantive gaps and unresolved inconsistencies, it has continued to limit a clear understanding of how financial development influences macroeconomic performance across Sub-Saharan Africa (SSA). While prior studies affirm the general importance of financial development, most employ aggregate indicators such as domestic credit or broad money, thereby overlooking the distinct contributions of financial institution access, depth, and efficiency (Ibrahim & Alagidede, 2018; Yusuf, Ibrahim & Jibril, 2023). This omission creates uncertainty regarding whether physical access such as ATM penetration or branch density actually drives growth in SSA, especially as existing findings show mixed or weak effects of bank credit in different sub-regions (Diop et al., 2025). This ambiguity motivates the first research question on the extent to which financial development affects real GDP.

The role of financial markets remains empirically inconsistent. While stock market depth can enhance investment and respond to governance (Diop et al., 2025), financial deepening may also trigger unstable or negative responses due to asymmetries and structural weaknesses (Fungáčová, Herrala & Weill, 2019). Although institutional quality is critical (Gazdar & Cherif, 2015; Kaufmann et al., 2010), studies often treat it in isolation or find negligible interaction effects (Diop et al., 2025). There is a limited understanding of whether governance conditions the finance-growth relationship and a failure to connect localized socio-cultural narratives to macro-econometric realities like FDI.

### Research Question

How does financial development affect foreign direct investment in Sub-Saharan African countries?

### Research Hypothesis

**H<sub>01</sub>:** Financial development does not significantly impact foreign direct investment in Sub-Saharan African countries

## METHOD

Mankiw et al (1992) developed a model that resembles the Solow-Swan model in the sense that it assumes constant returns to scale, but differs by including human capital in the growth model. Its deviance from the Solow-Swan model is outstanding because relatively small changes in resources devoted to physical and human capital accumulation may lead to large changes in output per worker. This model of Mankiw et al (1992) is one of the endogenous growth models that highlight the existence of a variety of endogenous mechanisms that foster economic growth and it has suggested new roles for public policy.

The endogenous growth model is preferable in this work because of the prominence of human capital, in the form of abilities, skills, and knowledge of individual workers, in bringing about positive changes in the economic growth of an economy. Also, endogenous growth has laid

much importance on the role of financial development in economic, and several studies on endogenous growth have examined the potential linkages between economic growth and financial markets. Thus, this work adopts the Mankiw et al (1992) model.

The model adopts that there is only one production sector, with the output given as follows:

$$Y = KH(AL) \quad a\beta > 0, \quad a + \beta < 1 \quad (1)$$

Where K is the stock of physical capital, H is the stock of human capital, L is the number of workers and AL is effective labour. There are constant returns to K, L, and H; meaning that if the amounts of K, H, and L are doubled, the quantity of output produced will also double. Hence, it is assumed that;

$$K = sky - \delta KL = n \quad (2)$$

where K denotes a change in capital stock or net investment, L is a change in labour, sk is the portion of output devoted to investment,  $L = n$  is the rate of growth of labour force. As in the Solow-Swan model, technological progress is taken to be exogenous.

$$\dot{A} / A = \gamma \quad (3)$$

Where  $\dot{A}$  signifies a change in technology,  $\dot{A} / A = \gamma$  symbolizes the rate of growth of knowledge or technological progress. Investment in human capital is also assumed to denote a fixed fraction of output:

$$\dot{H} = sH \quad (4)$$

Let  $h = H / AL$ , represent the human capital per effective labour ratio. Then, the production function in equation 1 can be modified in intensive form as:

$$y = ka h\beta \quad (5)$$

Where  $\kappa = K / AL$ ;  $y = Y / AL$  and  $h = H / AL$ .  $K / AL$  is physical capital per effective labour,  $Y / AL$  is output per effective labour, and  $H / AL$  is human capital per effective labour.

Equation 5 is the key equation in the Mankiw-Romer-Weil model, which can be used to evaluate the linkages between financial development and economic growth. This can be done by spreading the equation to include variables FD and Z, which designate the financial development variables and other control variables that affect economic growth respectively.

$$y = k^a h^\beta FDZ \quad (6)$$

Where  $y$  = output,  $k$  = physical capital,  $h$  = human capital, FD = the financial development variables and Z = other variables affecting growth.

### Model Specification

To specify the models for the study, the two-step System Generalized Method of Moments (SGMM) estimation procedure is employed to capture the respective specific objectives of the study. Furthermore, for robustness checks, the study adopts the Random Effects (RE) model to validate the estimation of the two-step system GMM model. Sustained economic growth requires an increase in direct foreign investment, which may not be possible in the absence of a good and quality financial system. To determine the effectiveness of this, we derive a second estimation equation model using foreign direct investment as the dependent variable.

Here, the study specifies a panel data model in its implicit form as follows:

$$FDI = f(FIA, FIE, FMD, INSQIDX, HDI) \quad (7)$$

To facilitate estimation, the implicit foreign direct investment model in equation (3.7) is specified explicitly as a dynamic panel data model as follows:

$$FDI_{it} = \alpha_0 + \varphi_1 FDI_{it-1} + \varphi_2 FIA + \varphi_3 FIE_{it} + \varphi_4 FMD_{it} + \varphi_5 INSQIDX_{it} + \varphi_6 HDI_{it} + \pi_i + \xi_t + \varepsilon_{i,t} \quad (8)$$

Where  $\varphi_1$  to  $\varphi_7$  are parameter estimates, HDI is the human development index. FDI is the dependent variable that measures the inflow of foreign direct investment into countries. Every other variable is as defined earlier.

Foreign direct investment inflows are modeled as a function of the same multi-dimensional financial development indicators, institutional quality, and human capital (equations 3.7-3.8) because the literature shows that financial markets and institutions are central determinants of

multinational entry and the productivity returns from FDI: better local financial markets reduce financing frictions for foreign affiliates and enable quicker absorption and diffusion of technology brought by FDI (Alfaro et al., 2004), while firms' location choices are sensitive to credit availability, payment systems, and market depth (King & Levine, 1993; Levine, 1997). Human capital (HDI) is included because a large body of research finds that the productivity impact of FDI depends on local skill levels, and institutional quality is also a factor. After all, political-legal stability, rule of law, and regulatory predictability attract or deter greenfield and portfolio FDI (Kaufmann et al., 2010). Empirical evidence from large cross-country studies (Alfaro et al., 2004) and regional analyses (Maduka & Onwuka, 2013; Effiong, 2015) demonstrates that measures of bank access, bank pricing (NIM), and market depth are statistically associated with greater foreign capital absorption and/or its effectiveness; therefore FIA, FIE, and FMD are direct determinants in the FDI equation. The lagged FDI term accounts for persistence (i.e., investment projects and commitments are path-dependent) and potential reverse causality, again justifying the use of a dynamic panel/GMM estimator to address endogeneity and unobserved heterogeneity (Arellano & Bond, 1991).

### **Definition of the Variables**

This study utilizes five core variables to analyze economic performance and development. Real GDP Growth serves as the primary measure of economic expansion, adjusted for inflation to reflect genuine increases in output. Foreign Direct Investment (FDI) captures long-term cross-border capital, which introduces technological expertise and stimulates employment. To assess social progress, the Human Development Index (HDI) aggregates health, education, and income levels, offering a broader view of national success than output alone. Financial Development is evaluated through the depth, access, and efficiency of a country's banking institutions and capital markets, which are essential for mobilizing savings. Finally, the Institutional Quality Index (INSQIDX) provides a composite metric of governance, measuring factors such as the rule of law, regulatory quality, and corruption control. Together, these variables offer a holistic framework for understanding how physical capital, human development, financial systems, and governance structures collectively drive sustainable growth.

### **Estimation Technique and Procedure**

This study utilizes the System Generalized Method of Moments (SGMM) as the primary estimation technique due to its ability to handle complex econometric challenges. Unlike pooled OLS or static models, SGMM effectively controls for the endogeneity of lagged dependent variables, omitted variable bias, and unobserved panel heterogeneity. By minimizing a quadratic form of moment restrictions, GMM produces reliable estimates without requiring full statistical specifications. Furthermore, SGMM improves precision and reduces finite sample bias compared to first-difference GMM. To validate the model's appropriateness, the study incorporates the Bond (2002) test to ensure SGMM is the preferred estimator over alternative GMM versions. Additionally, the Random Effects (RE) Model is employed as a robustness check. By comparing the RE benchmark against SGMM results, the researcher can verify the stability of coefficient signs and magnitudes, ensuring the findings are robust and not merely artifacts of specific instrumental assumptions or model-driven biases.

### **Model Justification**

The study utilizes the two step System Generalized Method of Moments (GMM) to ensure robust and unbiased estimation. This approach is superior to difference GMM because it utilizes orthogonal deviations which minimize data loss and retain observations even within unbalanced panels. The system GMM addresses endogeneity through simultaneously estimating equations in both levels and first differences. It uses internal instruments, specifically lagged values and differences of the regressors, to ensure consistency when independent variables correlate with the error term.

The technique further mitigates weak instrument bias and alleviates multicollinearity through transforming persistent correlations via its dual equation structure. The system GMM remains dependable through the Sargan and Hansen tests for over identification despite potential risks to serial correlation tests in small datasets. This method provides a practical and efficient framework for producing accurate results while controlling for heteroscedasticity and unobserved heterogeneity.

### Pre-Estimation Tests

This section outlines the diagnostic and descriptive framework used to ensure data integrity and model appropriateness. Descriptive Statistics are first employed to analyze the central tendency and dispersion of the dataset, providing a fundamental understanding of the properties of both dependent and independent variables. To safeguard the precision of parameter estimation, a Test for Multicollinearity is conducted using correlation matrices. This ensures that regressors are not overly interrelated, as high correlation can introduce significant bias and inefficiency into the model. Selection of the most suitable estimator is guided by the Bond (2002) Test, which evaluates whether the system GMM is preferred over the difference GMM. This is particularly relevant for panels with large cross sections and small time periods, ensuring the lagged coefficient matrix remains unbiased. Furthermore, the study addresses Cross Sectional Dependence using the Pesaran (2020) test. This step is vital because interdependence among different regions can skew results in dynamic panels. The null hypothesis of independence is rejected if the p value falls below 5%, in which case temporal effects are integrated to mitigate regional correlation. These combined tests establish a rigorous foundation for the subsequent econometric analysis across the selected countries.

### Diagnostic Checks

The Hansen Test evaluates the validity of over-identifying restrictions and the overall reliability of the instrument set. It functions under the null hypothesis that instruments are valid, provided their numbers are limited to avoid proliferation. This study utilizes both the Hansen and Sargan tests to ensure proper model specification. Additionally, the Arellano and Bond Test verifies the consistency of the GMM estimator. The model requires the presence of first order serial autocorrelation but must strictly confirm the absence of second order serial autocorrelation. Ensuring the absence of these higher order errors validates the reliability of the estimation results.

### Test of Research Hypotheses and Decision Rules

The study also tests the research hypothesis, making use of the t-test, which is used to determine the statistical significance of the coefficient of each variable. The t-test is the ratio of an estimated coefficient to its standard error and is used to test the hypothesis that a coefficient is zero. The t-statistic test tells us if there is an existence of significant relationship between the dependent variable and the independent variables. The absolute calculated value t-value of each coefficient is compared with the critical value. Then, the null hypothesis is rejected if the calculated value of t is greater than the tabulated value of t ( $t_{cal} > t_{tab}$ ) with an n-k degree of freedom at the chosen level of significance, and accepted if the reverse is the case. And for this study, the chosen level of significance is 5%.

**Decision rule:** If the calculated t-value > tabulated t-value at the given level of significance, we do not accept the null hypothesis; rather, we accept the alternative hypothesis. If the calculated t-value < tabulated t-value at the given level of significance, we accept the null hypothesis and reject the alternative hypothesis.

### Sources of Data and software packages used

This research utilizes annual panel data spanning 18 years, from 2007 to 2024, focusing on 20 selected Sub-Saharan African countries. The timeframe was determined based on the availability of consistent data across all selected variables. Data are sourced from reputable international organizations, including the World Bank's World Development Indicators (WDI)

and World Governance Indicators (WGI), the International Monetary Fund (IMF), and the United Nations' Human Development Report (HDI). The variables include Real GDP Growth, measured in constant 2015 US dollars, and the Financial Development Index, which assesses the performance of financial institutions and markets. Foreign Direct Investment (FDI) is recorded as net inflows relative to GDP. The Institutional Quality Index (INSQIDX) provides a composite measure of governance, covering aspects like political stability and the rule of law. Finally, the Human Development Index (HDI) tracks achievements in health, education, and standard of living. For the empirical analysis, the study employs Stata version 15 and E-views 10 software packages. These tools were selected for their user-friendly interfaces and their robust capacity to execute the specific dynamic panel estimations and diagnostic tests required for this research.

**RESULTS**

**Table 1: Correlation Matrix**

VARIABLES	FDI	FIA	FIE	FMD	INSQIDX	HDI
FDI	1.0000					
FIA	0.4780	1.0000				
FIE	0.0488	-0.0991	1.0000			
FMD	0.0643	0.0619	-0.4593	1.0000		
INSQIDX	0.2788	0.5993	0.0613	0.1301	1.0000	
HDI	0.2268	0.7148	-0.0228	-0.0211	0.6824	1.0000

**Table 2: Bond (2002) Test Results for Choice of GMM Estimator**

Bond 2	Fdi L1.
FE	0.348332***
OLS	0.5701889***
FIRST DIFF	0.2496772**
SECOND DIFF	0.300501

Source: Author, Stata. 15.0

Note: Significance (\*=10%, \*\*=5% and \*\*\*=1% respectively).

**Table 3: Summary Outcome of Cross-Sectional Dependence Test**

PANEL B: MODEL 2	LOGFDI
Pesaran - fe	1.102(0.0005)
Pesaran - re	3.227(0.0012)
Friedman - fe	30.902(0.0021)
Friedman - re	40.225(0.0004)
Frees' - fe	1.335(0.1996)
Frees' - re	0.277(0.1996)
DECISION	CD

**System GMM Regression Results for Financial Development on Foreign Direct Investment**

Recall that the second specific objective of this study seeks to investigate the impact of financial development on foreign direct investment in Sub-Saharan African countries. To achieve these objectives, the study estimated the underlying model using the system GMM estimator. The results are presented in Table 4.

**Table 4: Result for Objective Two (dependent variable = FDI)**

VARIABLES	SYSTEM GMM ESTIMATOR	RANDOM ESTIMATOR	EFFECTS
FDI LI.	0.3679657*** (0.0753507)	0.5680867*** (0.0701976)	

FIA	0.0316778*** (0.0091606)	0.023406*** (0.0057749)
FIE	0.0089562 (0.0626008)	0.0096595 (0.0189602)
FMD	-0.038998* (0.0209674)	-0.0121737 (0.0090424)
INSQIDX	0.3284421*** (0.0561139)	0.086579** (0.0385156)
HDI	-6.715614*** (1.506462)	-2.658094*** (0.7273293)
CONSTANT	-43.24508 (37.67835)	-11.22846 (15.82561)
Observations	284	301
Number of c_id	19	20
No. of Instrument	16	sigma_u = 0
AR1	0.040	sigma_e = 0.64652906
AR2	0.216	rho = 0
Hansen	0.740	

Source: Author, Stata 15. See the Appendix for the Long Run Output

Note: Estimated coefficients are reported while the **corrected Std. Err.** are in parentheses. \* p < 0.10. \*\* p < 0.05. \*\*\* p < 0.01.

The analysis reveals that foreign direct investment (FDI) in Sub-Saharan Africa (SSA) exhibits a strong positive persistence (0.37), significant at the 1% level. This self-reinforcing dynamic suggests that prior inflows act as signals of market potential and stability, aligning with Banga (2023) regarding agglomeration effects, though Becker et al. (2024) caution that short-term surges can occasionally crowd out new investors in smaller markets. Financial institution access, measured by bank branch density, significantly promotes FDI (0.0317). This supports the view that banking expansion reduces transaction costs and entry barriers for foreign firms. However, Todaro and Smith (2023) warn that physical expansion requires digital integration to avoid diminishing returns. In contrast, financial institution efficiency (profitability) was statistically insignificant (0.0089), suggesting investors prioritize long-term stability over short-run margins. While Asante et al. (2023) found a positive link in West Africa, this study suggests high margins in the broader SSA context may signal inefficiency.

Financial market depth (portfolio debt-to-GDP) showed a negative, weakly significant effect (-0.0389), implying that excessive debt expansion and speculative flows may deter sustainable FDI. This mirrors Adamu and Aminu (2022), who link rapid deepening without regulation to volatility, contrasting with Asiedu et al. (2024), who argue that well-regulated markets provide essential exit mechanisms. Institutional quality emerged as a decisive driver, with a strong positive coefficient (0.3284). Better governance and rule of law reduce transaction risks, consistent with Kasekende et al. (2016) and Dabla-Norris et al. (2022). Conversely, the Human Development Index (HDI) showed a significant negative impact (-6.72), suggesting that rising education and income levels might erode low-wage competitiveness. While Adeyemi et al. (2024) note this trend in cost-sensitive markets, Balogun et al. (2023) argue that higher HDI eventually attracts quality-seeking, capital-intensive projects. Finally, diagnostic tests (Arellano-Bond and Hansen) confirmed the model's validity and instrument exogeneity.

### Comparison between System GMM and Random Effects Results

The system GMM results demonstrate stronger statistical robustness and theoretical consistency than those in the Random Effects estimate. Specifically, coefficients for FIA, INSQIDX, and HDI in system GMM are significant and exhibit expected magnitudes, while their counterparts in Random Effects either show weaker significance or lower explanatory power. Additionally, the lagged dependent variable is lower in magnitude in the random effects model

(0.5680,  $p < 0.01$ ), suggesting potential bias from endogeneity not addressed by the static specification. The Hansen and AR tests in system GMM further reinforce the model's appropriateness, confirming valid instrumentation and absence of autocorrelation. Hence, System GMM better captures the dynamic structure of FDI inflows and corrects for potential simultaneity between financial development and investment inflows, providing more policy-relevant insights.

System GMM estimation is preferred over the Random Effects model because it effectively addresses key econometric challenges inherent in dynamic panel data, namely, endogeneity, omitted variable bias, and unobserved country-specific heterogeneity. Unlike the Random Effects estimator, System GMM simultaneously exploits both the level and first-differenced equations, using internal instruments derived from lagged variables to ensure consistency. This is particularly suitable for macroeconomic panels with small time dimensions but large cross-sectional units, such as SSA. Moreover, the Hansen J-test results ( $p = 0.740$ ) confirm instrument validity, while the AR(2) test indicates absence of serial correlation. These diagnostics substantiate that the System GMM estimates are more efficient and reliable for policy formulation. In essence, the choice of Panel A reflects methodological rigor, producing more accurate estimates of how financial development variables dynamically influence FDI inflows across Sub-Saharan Africa.

**Hypothesis Two ( $H_{02}$ ):** Financial development does not significantly impact foreign direct investment in Sub-Saharan African nations.

The estimated result disclosed that the coefficients of financial institution access and financial market depth used as financial development indicators are 0.0317 and -0.039 with probability values of less than 0.01 and 0.10, respectively. Comparing this p-value to the 5 percent threshold (0.05), it is seen that the financial institution access is less than 0.05, so we reject the null hypothesis, which states that financial development does not significantly impact foreign direct investment in SSA nations. Therefore, the alternative hypothesis is accepted, clearly stating that financial development significantly impacts foreign direct investment in Sub-Saharan African nations.

### Discussion of Findings

Result reveals that financial development dimensions strongly influence FDI inflows. The lagged dependent variable carries a negative and significant coefficient, showing that previous FDI inflows reduce current inflows, suggesting temporary saturation or adjustment effects. Financial institution access (bank branches per 100,000 adults) shows a positive and significant impact (0.0317) at 1% level of significance, implying that deeper financial access signals macro-financial stability, thereby attracting foreign investors. Similarly, financial market depth (portfolio debt assets-to-GDP) exerts a negative and slightly significant effect (-0.039) at 10% level of significance, indicating that developed capital markets distort investor confidence by not providing risk-hedging and exit options. Thus, the model diagnostics (AR 2 = 0.216; Hansen  $p = 0.740$ ) validate the robustness of the instruments. Overall, efficient and deep financial systems attract FDI, but exchange-rate misalignments and rising labour costs can offset these gains.

### CONCLUSION

This study investigated the impact of financial development on foreign direct investment (FDI) inflows across 20 Sub-Saharan African (SSA) countries from 2007 to 2024. Utilizing the Mankiw et al. (1992) endogenous growth framework and the two-step System Generalized Method of Moments (SGMM), the research established that financial development is a multidimensional driver of international capital attraction. The empirical evidence confirms that FDI in the region is path-dependent, as previous inflows significantly stimulate current investments. A primary finding is that financial institution access plays a vital role in reducing transaction frictions and signaling market stability, thereby encouraging multinational entry. However, the study also reveals that financial market depth currently exerts a negative influence, suggesting that underdeveloped or volatile debt markets in SSA may deter stable, long-term FDI

by introducing macroeconomic uncertainty. Furthermore, the results underscore that institutional quality remains the most decisive factor for investors; strong governance and the rule of law provide the necessary security for capital commitment. Conversely, the negative relationship observed with the Human Development Index suggests that as labor costs rise with human capital improvements, the region may lose its low-wage appeal for cost-seeking investors.

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