IMPACT OF FINANCIAL DEVELOPMENT ON FOREIGN DIRECT INVESTMENT (FDI) INFLOWS IN WEST AFRICA

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Keywords

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Abstract

Research Problem: *Financial systems in many West African countries remain fragmented, characterized by weak financial institutions, limited credit availability, underdeveloped capital markets, low banking penetration, and a dominant informal economic sector. These structural weaknesses ultimately reduce the region's attractiveness to foreign investors.*

Methods/Theory: *The research use a panel data approach, in which covers different selected West African countries. Secondary data are obtained from the World Bank's World Development Indicators (WDI), International Monetary Fund (IMF) and UNCTAD databases. Key variables include FDI inflows, indicators of financial development (like the domestic credit to the private sector, financial depth and stock market capitalization), with control variables such as trade openness, inflation, and GDP growth. Using econometric techniques such as fixed effects and Random effects, The theoretical adopted for this study is based on the Eclectic Paradigm theory .*

Result: *the study reveals that examining financial development significantly and positively influences FDI inflows, especially through credit availability and banking sector efficiency. However, less developed capital markets and weak regulatory frameworks remain hindrance in some countries.*

Conclusion: *The study concludes that empowering financial institutions, promoting financial inclusion, and improving regulatory oversight are important to attract sustained foreign investment.*

Key Contribution to Knowledge: *it advance the literature on the finance-FDI nexus by shifting attention from broad continental analyses to a focused subregional examination of west African economies, thereby providing context-specific empirical evidence often overlooking in existing studies.*

Recommendation: *the study recommend that West Africa policymakers must prioritize financial sector reforms as a strategic pathway to increase FDI inflows, nourish economic growth and ignite the region*

competitively into the global economy.

Introduction

Financial systems in many West African countries remain fragmented, characterized by weak financial institutions, limited credit availability, underdeveloped capital markets, low banking penetration, and a dominant informal economic sector. These structural weaknesses create financial uncertainty, constrain efficient capital allocation, and ultimately reduce the region's attractiveness to foreign investors, thereby hindering the inflow of Foreign Direct Investment (FDI). Due to limited progress in financial market development and savings mobilization, many developing countries rely on Foreign Direct Investment as a major source of external finance. Beyond capital inflows, FDI facilitates technology transfer, enhances managerial capacity, promotes employment, and supports integration into global value chains (Le et al., 2024; Munemo, 2018). Despite these benefits, Africa's share of global FDI remains relatively low, averaging between 3 and 5 per cent according to the United Nations Conference on Trade and Development, reflecting persistent structural and institutional constraints (Mensah&Traore, 2024).

Within Africa, the West African subregion presents a paradox of substantial investment potential and uneven FDI performance. The region is richly endowed with natural resources such as crude oil, gold, cocoa, and agricultural commodities, which continue to attract foreign investors. However, FDI inflows are highly concentrated in a few economies, particularly Nigeria, Ghana, and Côte d'Ivoire, and are largely directed toward extractive industries (Anyanwu&Yameogo, 2015). This concentration has resulted in volatility of inflows, largely driven by fluctuations in global commodity prices, and has limited diversification into sectors such as manufacturing and technology. Furthermore, differences in institutional quality, macroeconomic stability, and governance structures contribute to disparities in investment attractiveness across countries in the subregion (Olaoye et al., 2022).

Recent empirical and theoretical literature emphasizes that, beyond natural resource endowments, the level of financial sector development plays a critical role in shaping FDI inflows. Financial development, which encompasses financial depth, access to credit, efficiency of financial intermediation, and capital market development, enhances investment by reducing information asymmetries and transaction costs while improving resource allocation. As noted by Elizabeth Asiedu, countries with more developed financial systems tend to attract higher and more stable inflows of foreign investment (Asiedu, 2006). Supporting this view, Jithin (2022) argues that efficient financial systems provide the liquidity and credit access required by both domestic and foreign investors.

A well-functioning financial system signals stability and reduces investment risk for multinational enterprises by ensuring access to finance and facilitating operational expansion (Kowalewski, 2023). Conversely, weak financial institutions, limited credit availability, and underdeveloped capital markets create uncertainty and hinder FDI inflows (Alam et al., 2024). This is particularly relevant in West Africa, where financial systems remain fragmented, banking penetration is relatively low, and a substantial proportion of economic activity occurs within the informal sector.

Although a growing body of research has examined the determinants of FDI in Africa, many studies adopt a continental perspective

or focus on traditional determinants such as trade openness, infrastructure, and political stability. Consequently, limited attention has been given to the specific role of financial development within the West African context. Given the heterogeneity of financial systems across the subregion, there remains insufficient empirical clarity on how different dimensions of financial development, including credit availability, banking efficiency, and capital market development, influence FDI inflows. Unlike previous studies that rely on aggregate measures of financial development or treat African economies as structurally homogeneous, this study adopts a disaggregated and subregional analytical perspective to examine how distinct components of financial systems independently and jointly shape FDI inflows in West Africa.

Against this backdrop, this study examines the impact of financial development on FDI inflows in selected West African countries. Specifically, it seeks to identify which dimensions of financial development most significantly influence investment decisions and how improvements in financial systems contribute to the sustainability and diversification of FDI inflows. Using panel econometric techniques and data sourced from international databases such as the World Bank, IMF, and UNCTAD, the study empirically evaluates the finance–FDI relationship from a subregional and component-based perspective. By focusing on financial system heterogeneity within West Africa rather than relying on continental generalizations the study introduces a new empirical lens for understanding the finance–FDI nexus. The findings are expected to contribute to the literature by offering a focused subregional analysis and to inform policymakers on the design of targeted financial sector reforms aimed at enhancing investment attractiveness and promoting sustainable economic growth in West Africa.

Statement of Research Problem

Foreign Direct Investment (FDI) remains a vital source of external financing for economic growth in developing economies, yet its inflows into many West African countries have continued to be unstable, inconsistent, and below potential. Despite the implementation of various financial sector reforms across the region, FDI performance has not shown a corresponding and sustained improvement, suggesting that reforms in the financial system have not translated uniformly into stronger investment attraction. This persistent challenge reflects deep-rooted structural weaknesses within the financial systems of West African economies. These include weak financial institutions, limited access to credit, underdeveloped capital markets, and low levels of banking penetration. Collectively, these constraints hinder effective financial intermediation and reduce the capacity of financial systems to efficiently mobilize and allocate capital toward productive investment opportunities. Theoretically, financial development is expected to enhance FDI inflows by improving financial depth and efficiency, particularly through Broad Money and Domestic Credit to the Private Sector. However, in practice, this relationship appears neither automatic nor uniform in West Africa. Financial deepening and credit expansion are increasingly constrained by challenges such as resource misallocation, speculative bubbles, diminishing marginal returns, rising operational costs, and systemic inefficiencies within financial markets. These limitations are further compounded by weak institutional environments, which may significantly reduce the effectiveness of financial development in attracting foreign investment. In many West African countries, deficiencies in governance structures such as weak regulatory oversight, limited accountability, political instability, corruption risks, and inconsistent enforcement of the rule of law undermine investor confidence and weaken the overall investment

climate. As a result, indicators of financial depth and credit allocation efficiency have not consistently translated into improved FDI performance across the region. This raises an important concern that financial development, while necessary, may not be sufficient on its own to attract and sustain foreign capital inflows without strong institutional and governance support.

Furthermore, institutional quality appears to play a critical moderating role in shaping this relationship. Governance indicators such as Government Effectiveness, Political Stability, Regulatory Quality, Rule of Law, Control of Corruption, and Voice and Accountability are central to creating a stable and predictable business environment that supports long-term investment decisions. Weak institutional frameworks may therefore limit the extent to which financial development can positively influence FDI inflows in West Africa. Against this backdrop, the persistent gap between financial development efforts and weak FDI performance highlights the need for a deeper investigation into how financial depth and credit efficiency interact with institutional quality in shaping FDI outcomes in West Africa.

Research Objective

i. To examine the impact of financial development on FDI inflows in West Africa.

ii. To investigate the moderating role of institutional quality on the financial development–FDI relationship.

Conceptual Clarification

Many studies have been carried out to investigate the relationship between financial development and foreign direct investment influx over the past few years. Many factors believed to impact foreign direct investment have been investigated; however, findings from those research have produced mixed results, showing both positive and negative correlations.

Yusuf et al. (2020) investigated the effect of financial development, foreign direct investment (FDI), democracy, and political instability on economic growth in West Africa. The authors employed the dynamic fixed effects technique on secondary data from 1996 to 2016. The findings of the study show that a 1% increase in FDI inflow into the West African sub-region results in a 0.26% increase in economic growth. The study also confirms the validity of the supply-leading hypothesis and suggests that an efficient financial system is crucial for sustainable development.

Ganiyu et al. (2018), using the data of the fifteen ECOWAS countries from 1980 to 2014, studied the relationship between foreign direct investment (FDI) and financial development. The finding of the study shows financial development does not significantly aid FDI inflows, but FDI positively influences domestic financial sector development, suggesting that FDI and financial development can act as both substitutes and complements in the ECOWAS region.

Vitenu-Sackey (2020) compares the impact of financial development and foreign direct investment on carbon emissions in the West and Southern Africa regions. The author concluded that financial development has a positive effect on carbon emission, while FDI has a negative impact.

Nkoa (2018) using the data from 1995 to 2015, the author investigated the impact of financial development on Foreign Direct Investment (FDI) in 52 African countries. The results of the study indicated that FDI is positively impacted by money and quasi-money, banking credit, and interest rate liberalisation, indicating the necessity for additional financial reforms.

With an emphasis on the rate at which financial development and foreign direct

investment spur growth, Ogbuagu et al. (2021) examined how low-income economies in ECOWAS are convergent with their high-income neighbours. The FD-FDI threshold values required are 22.8% and 3.77%, respectively, and it was discovered that there was no conditional convergence among ECOWAS member nations. The report suggests that low-income member states prosper in order to draw in private sector loans and foreign direct investment.

Olorogun et al. (2022) investigated the FDI-led economic growth hypothesis in Nigeria , with an emphasis on the connections between FDI, financial development, the overall labour force, gross capital creation, and economic growth. The unit root and stationary tests are used in the study, which analyses annual time-series data from 1970 to 2018. According to empirical findings, FDI influences GDP and financial development from the banking industry, indicating a long-term equilibrium link between variables. This implies that financial development and foreign direct investment are reliable indicators of Nigeria's long-term economic progress.

Evans and Jing (2020), using the data of 16 nations analyzed the flow of foreign direct investment (FDI). The study found a steady decline of the FDI inflow over the last ten years, with Ghana and Nigeria being the main contributors.

Using secondary data from the World Bank and the Global State of Democracy Indices of 16 West African nations, Korsah-Korsah et al. (2025) examine the characteristics that draw foreign direct investment (FDI) into rising economies. It concludes that the abundance of natural resources, market size, GDP, imports and exports, trade openness, and currency strength are the main factors influencing FDI inflows into these nations.

Using a panel dataset spanning from 1970 to 2010, Anyanwu et al. (2015) investigate the connection between West African economic progress and foreign direct investment inflows. Real per capita GDP, domestic investment, trade openness, endowment of natural resources, and monetary integration all have favourable effects, according to the results, which display a U-shaped connection. There are negative consequences associated with second-year lag.

Keho (2020) looks at the correlation between financial growth and foreign direct investment in eleven ECOWAS nations between 1970 and 2017. The author measures GDP using the money supply and domestic credit to the private sector. The findings indicate that, in the short term, the money supply and FDI are bidirectionally causal, and that, in the long term, both are caused by economic growth.

Appiah et al.,(2023) investigated how economic expansion, financial development, and foreign direct investment affected the industrial growth of Sub-Saharan African nations between 1990 and 2017. Finance is identified as a major driver of industrial progress, and financial development is understood using a new index. Government authorities should foster public-private partnerships, which are essential for industrial development, according to the report.

Adegboyega and Kolade (2025) investigate the causal relationship between financial inflows, financial development, and economic growth in West Africa from 1990 to 2023. The study shows notable differences in economic indicators and diverse correlations among West African nations using second-generation panel data techniques. While foreign direct investment is a unidirectional stimulant for economic growth and the development of the financial system, it also exposes bidirectional linkages between GDP and financial development, remittances, and portfolio investments. The results highlight the

necessity of integrated and comprehensive economic policymaking in West Africa.

Aromasodun (2022) examines the variables affecting the flow of foreign direct investment (FDI) into West Africa. It was discovered that while trade openness, the institutional composite index, and corruption control boost the inclination towards globalisation, financial development has a detrimental impact on FDI flows and globalisation processes. The report suggests a strong trade liberalisation strategy to bring in foreign direct investment and globalise the area. The Africa Infrastructure Development Index (AIDI) is used as an explanatory variable, and macroeconomic, institutional, and sociopolitical factors are examined.

Orji et al.(2022) used quarterly data from 2000-2017 and employed a panel vector autoregressive model to examine how foreign capital inflows and financial development impact economic growth in the ECOWAS region. The results reflect significant relationships between FDI, net domestic credit, and economic growth. FDI and CRE have a negative short-term relationship with economic growth but positive long-term responses.

The determinants influencing foreign direct investments (FDI) in five African regions are examined by Anyanwu and Yaméogo (2015), with an emphasis on regional variability. A panel dataset comprising 53 African nations classified as Central, East, North, Southern, and West Africa from 1970 to 2010 is used. The findings indicate that FDI inflows are strongly positively correlated with agglomeration in all regions except Central Africa, whereas GDP growth rate is positively correlated in Central Africa but negatively correlated in West Africa.

Ezeoha, and Cattaneo, (2012) studied FDI of sub-saharan countries. In the study, 38 Sub-Saharan African nations' inward foreign direct investment (FDI) is examined in relation to financial development, institutional quality, and natural resource endowment. Foreign investors depend more on the effectiveness of governance in resource-rich nations, while inbound foreign direct investment is more dynamic in non-resource-rich nations. The study also emphasises how crucial legal and governance frameworks, telecommunications infrastructure, and FDI types are to luring and sustaining foreign investments.

Simeon Oludiran, NicaiseAbimbola (2018) investigated the determinants of FDI inflows to the West African Economic and Monetary Union (WAEMU), focusing on the gap between domestic savings and investment in developing countries. An econometric model reveals that countries with high potential market size, large trade openness, and a business-friendly environment attract more FDI. The study also finds a positive relationship between FDI and economic growth, macroeconomic stability, and inflation in WAEMU. However, the study suggests that financial development needs improvement to enhance FDI's impact. (Simeon Oludiran, A., &NicaiseAbimbola, L. (2018).

Saibu et al. (2011) analysed the impact of financial development and foreign direct investment on economic growth in Nigeria, using time series data from 1970 to 2009. Results showed that both factors had negative effects on economic growth, with foreign direct investment only being significant when combined with stock market indices. Financial market liquidity was found to be crucial for economic growth.

Adegboye et al. (2020) investigated how institutional quality affects foreign direct investment (FDI) inflow and how it affects sub-Saharan Africa's (SSA) economic development. The authors concluded that foreign capital input is essential to the economic development of SSA, but that the amount of FDI inflow is influenced by the

quality of institutions, which results in abnormal growth in domestic sector investment and underutilisation of domestic resources. According to the report, host governments should consider institutional quality in order to promote additional FDI inflows and increase domestic investment in order to lessen their reliance on foreign capital inflows.

Ikani (2024) examines the impact of foreign direct investment (FDI) on West Africa's unemployment rate and economic growth from 1991 to 2022. Using a panel dataset, it found that FDI had a negative short-term impact on economic growth and a negative long-term impact on unemployment. The findings suggest that FDI cannot be a comprehensive strategy for stimulating economic growth or alleviating unemployment in the region. The study highlights the need for further research on individual countries within West Africa. (Ikani, K. S. (2024)

Adegboye et al., using data of 30 sub-Saharan African countries, discovered that trade openness significantly impacts economic welfare for all regions, while FDI is only significant in the Western sub-region.

Pokou (2020) analyses the causal relationship between Foreign Direct Investment (FDI) inflows and financial development in ECOWAS member countries. It reveals significant links between FDI inflows and financial sector development, both unidirectional and bidirectional. The findings from the study suggest that policymakers should consider the causal direction and whether it is temporal or permanent and define appropriate measures.

Adeniyi et al. (2015) studied how financial development affects the connection between FDI and economic growth in nations in Sub-Saharan Africa (SSA). The author concluded that economic growth is positively impacted by foreign direct investment (FDI), and growth is encouraged by the expansion of the financial system. Non-linearities in FDI's contribution to the FDI-growth relationship were also discovered by the study.

Shuaibu et al. (2022) used data from 15 ECOWAS countries from 1999 to 2017 to investigate how FD affects FDI inflows. The findings indicate that FD is a strong predictor, with trade openness and human capital development serving as important drivers. The authors concluded that it is essential to fortify the functioning financial system of the host nation.

Haque et al. (2022) examines the impact of financial development sources on FDI inflow in middle-income economies from 1980 to 2020. Results show no cross-sectional dependence, significant cointegration, and stationarity. Panel estimations reveal financial market development, inflation rate, trade openness, and real economic growth as critical factors for FDI inflow.

Shah, (2016), examines Foreign Direct Investment (FDI) in Middle Eastern and North African (MENA) countries in relation to financial development. The author discovered that financial development has a major favourable impact on foreign investors' investment decisions using data spanning 1988 to 2015. Market size, degree of development, trade liberalization, macroeconomic stability, trade agreements, bilateral investment treaties, and infrastructure were among the factors taken into account.

Building on the mixed evidence from previous studies, it remains unclear whether financial development consistently enhances FDI inflows across West African economies. While some researchers report a positive and significant relationship, others find weak or context-dependent effects, often shaped by institutional quality, macroeconomic stability, and the nature of financial reforms. Against this background, and in line with the findings

of prior research, this study seeks to further examine how financial development influences FDI inflows in the region during the period 2000–2023, taking into account the roles of financial depth, efficiency, and regulatory environment across countries.

Many studies have explored the nexus between financial development (FD) and foreign direct investment (FDI) in Africa and other developing regions; however, important gaps remain. Most prior research has focused on aggregate financial indicators without explicitly examining key financial elements such as broad money (M2) and domestic credit to the private sector, which capture different dimensions of financial depth and efficiency. Relatedly, while governance and institutional quality variables such as rule of law, voice and accountability, political stability, and control of corruption have occasionally been included in empirical models, they are often treated as control variables rather than as moderating or interaction factors that may shape the effectiveness of financial development in attracting FDI. Consequently, the literature has not convincingly addressed whether financial development alone is sufficient to attract FDI, or whether its impact is conditional upon the strength of institutional governance frameworks. This study seeks to bridge the gap mentioned above by integrating institutional quality variables as moderators in the FD–FDI relationship within the West African context, thereby offering a more nuanced understanding of how financial and institutional environments jointly influence FDI inflows.

Theoretical Framework

The study adopt the Eclectic Paradigm (OLI) theory to explained impact of financial development on foreign direct investment (FDI) inflows in west Africa

This study is anchored on the Eclectic Paradigm(OLI framework) developed by John H. Dunning. Initially introduced in the 1970s, the framework remains one of the most influential theories in explaining the determinants and patterns of Foreign Direct Investment. The paradigm posits that a firm's decision to engage in international production is determined by three interrelated advantages, namely Ownership (O), Location (L), and Internalization (I).

Ownership advantages refer to firm-specific assets such as proprietary technology, managerial expertise, brand reputation, and economies of scale, which provide competitive superiority in foreign markets. Internalization advantages arise when firms choose to retain control over foreign operations rather than licensing or outsourcing, thereby minimizing transaction costs and protecting intellectual property. These two components explain why firms are capable of investing abroad rather than remaining purely domestic.

However, the Location advantage is particularly central to this study, as it explains why firms choose specific host countries. Location-specific factors include market size, natural resource endowment, labor costs, trade openness, infrastructure, and institutional quality. Importantly, financial development constitutes a critical component of location advantage, as it influences the ease with which firms can access credit, manage liquidity, and operate efficiently within the host economy.

A well-developed financial system reduces information asymmetry, lowers transaction costs, and enhances the allocation of capital, thereby creating a conducive environment for foreign investors. In contrast, weak financial systems increase operational risk and limit the ability of firms to finance investment activities. Within the context of West Africa, variations in financial sector development and institutional quality are therefore expected to significantly influence the attractiveness of countries to foreign investors.

In this study, financial development is operationalized using indicators such as broad money supply and domestic credit to the private sector, which capture financial depth and access to credit. These variables, alongside institutional quality indicators including political stability, control of corruption, rule of law, and government effectiveness, are treated as key components of location advantage. Consistent with the OLI framework, the study posits that improvements in these factors enhance the capacity of West African economies to attract and sustain FDI inflows by reducing investment risk and improving the overall business environment.

3.0 Methodology

3.1 Econometric Strategy

This study employs a panel data framework to examine the impact of financial development on Foreign Direct Investment inflows in West Africa, using annual data for 16 ECOWAS countries over the period 2000 to 2023. The panel structure enables the analysis to control for unobserved, time-invariant country-specific heterogeneity while capturing both cross-sectional and temporal dynamics in the data.

The empirical strategy begins with descriptive statistics to summarize the key properties of the variables, including measures of central tendency and dispersion such as the mean, standard deviation, minimum, and maximum values. This provides preliminary insights into the distributional characteristics of the data and helps detect potential outliers or anomalies.

To examine the degree of association among variables and assess the risk of multicollinearity, a correlation matrix is computed. This step is important in ensuring that highly correlated regressors do not distort the reliability of the estimated coefficients. In addition, given the potential for economic interdependence among West African countries, a cross-sectional dependence test is conducted. This accounts for the possibility that shocks or policy changes in one country may spill over to others within the region, which, if ignored, could lead to biased and inconsistent estimates.

The stationarity properties of the variables are examined using panel unit root tests, specifically the Levin, Lin, and Chu (LLC) test and the ADF–Fisher Chi-square test. These tests determine the order of integration of the variables and guide the appropriate specification of the econometric model. Following this, panel regression techniques, including fixed effects and random effects models, are estimated to evaluate the relationship between financial development and FDI inflows. The choice between these estimators is based on the Hausman specification test, which ensures the selection of a consistent and efficient model.

3.2 Data Source

The dependent variable in this study is the Net FDI inflow expressed as a percentage of GDP, which tracks FDI inflow. The annual data from 2000-2023 periodwas obtained from World Development Indicators (WDI) database.

The independent variables, which correlate and assist in measuring the variables of financial development, include Broad Money (M2 as a percentage of GDP) and Domestic Credit to the Private Sector (as a percentage of GDP). Both of these indicators which reflect financial depth, and efficiency of credit allocation within the economy, were also obtained from the World Bank WDI database.

From the Worldwide Governance Indicators (WGI), the variables include Government Effectiveness, Political Stability, Control of Corruption, Regulatory Quality, Rule of Law, and Voice and Accountability.

The political environment and institutional quality are captured through these indicators as well as the variables assumed to affect the moderation of financial development on FDI inflow.

The control variables of the study include the GDP growth rate expressed as annual percentage, inflation rate and trade openness, expressed as a percentage of GDP.

Table 1: Data source

Variable	Measurement / Definition	Source
FDI Inflows	Net inflows of foreign direct investment as a percentage of GDP, .	World Development Indicators (WDI, 2024)
Financial Depth	Domestic credit to the private sector (% of GDP), measuring the degree of financial intermediation and access to credit in the economy.	WDI (2024)
Financial Access	Broad Money (M2) as a percentage of GDP, capturing the size and accessibility of the financial system.	WDI (2024)
Economic Growth (GDP)	Annual percentage growth rate of real Gross Domestic Product.	WDI (2024)
Trade Openness	Sum of exports and imports as a percentage of GDP, representing integration into the global economy.	WDI (2024)
Inflation	Annual percentage change in the Consumer Price Index (CPI), used as a measure of macroeconomic stability.	WDI (2024)
Institutional Quality	Composite index derived from the six Worldwide Governance Indicators: Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption.	Worldwide Governance Indicators (WGI, 2024)

Source: Author's Computation (2026)

4.0 Results

4.1 Descriptive Analysis

Table 2: Descriptive analysis of the data.

	Mean	Maximum	Minimum	Std. Dev.	Skewness	Kurtosis	Observations
BROADM	24.589	33.426	14.034	5.913	-0.361	1.841	384.000
CORRUPTION	-0.521	-0.040	-0.871	0.237	0.728	2.672	368.000
DCPS	13.584	18.608	4.833	4.230	-0.827	2.208	384.000
FDI_GDP	1.073	3.054	-0.659	1.074	0.073	1.938	384.000
GDP_GA	4.749	7.191	1.713	1.719	-0.308	1.872	384.000
GOV_EFF	-0.509	-0.171	-0.697	0.147	0.993	2.967	368.000
INFLATION	2.241	7.947	-0.793	2.166	0.976	3.445	384.000
POLITICAL_STABILITY	0.170	0.822	-0.443	0.381	-0.125	1.997	368.000
ROL	-0.555	-0.182	-0.767	0.131	1.194	4.516	368.000
RQ	-0.475	-0.161	-0.642	0.119	0.550	3.064	368.000
TRADE	49.993	65.268	39.096	7.867	0.534	2.049	384.000
VAA	0.158	0.413	-0.336	0.215	-0.776	2.588	368.000

Source: Author's Computation (2026)

RQ = Regulatory Quality

ROL = Rule of Law

GOV_EFF = Government effectiveness

VAA = Voice and Accountability

Table 2 shows the summary for all the variables under study, covering sixteen West African countries for a duration of 23 years from 2000 to 2023. From the table the mean of FDI inflows (1.073% of GDP) for the period of 23 years suggests that, on average, foreign direct investment takes a small proportion of the economic activity in the West Africa region. The maximum value of 3.054 shows that for some countries FDI makes up a modest part of the country's economy showing a great disparity in investment attraction.

From Table 2 the mean of the Broad Money (BroadM) and Domestic Credit to the Private Sector (DCPS) is seen to be 24.589% and 13.584%, indicating a shallow financial system in the West Africa region with the private sector having limited access to financial resources.

Over the 23years, the region is seen to experience a moderate economic performance as reflected by the mean value of GDP growth rate (GDP_GA). From the maximum value (7.191%) and minimum value (1.713%), it is understood that some counties experienced high expansion while some experienced periods of contraction. The average trade openness (49.993%) indicates that West African economies are open to international trade, but this also varies considerably among member states.

The average (2.241%) and deviation value (2.166%) of the inflation rate suggested the fluctuation in the price of goods has been a major concern in the West Africa region. The values of the institutional indicators in terms of government effectiveness (-0.509), rule of law (-0.555), and regulatory quality (-0.475) are all negative, illustrating weak institutional and administrative structures, which could

constrain the ability of financial systems to support investment inflows.

4. 2 Correlation

Table 3; Correlation of the variable

	BROADM	COR	DCPS	FDI_GDP	GDP_GA	GOV_EFF	INFLATION	POL_STA	ROL	RQ
BROADM	1.0000									
COR	0.5692	1.0000								
DCPS	0.8004	0.4407	1.0000							
FDI_GDP	0.6828	0.2204	0.6947	1.0000						
GDP_GA	0.3271	0.3281	0.3291	0.5899	1.0000					
GOV_EFF	0.3231	0.4081	0.1393	0.3597	0.5850	1.0000				
INFLATION	-0.3617	-0.1462	-0.4684	-0.2757	-0.1838	0.2045	1.0000			
POL_STA	-0.8518	-0.7312	-0.7806	-0.5425	-0.3538	-0.3419	0.3676	1.0000		
ROL	-0.5069	-0.3271	-0.5346	-0.2421	0.0553	0.1462	0.1769	0.6038	1.0000	
RQ	0.2391	0.1670	0.2984	0.2342	0.3804	0.4071	0.2559	-0.1709	-0.3014	1.0000
TRADE	0.5059	0.0781	0.6235	0.5860	0.4338	-0.0385	-0.5642	-0.4595	-0.4091	0.0919
VAA	-0.2411	-0.2520	-0.1077	-0.2292	-0.2085	-0.4951	-0.2045	0.3982	0.0830	-0.0731

Source: Author's Computation (2026)

Table 3 displays the correlation matrix. From the correlation results, FDI inflows have a positive relationship with the two financial development indicators: domestic credit to the private sector (r = 0.6947) and broad money (r = 0.6828). This suggests that foreign capital tends to be drawn to deeper financial markets. Additionally, there is a strong correlation (r = 0.5860) between FDI and trade openness, suggesting that trade liberalisation promotes investment inflows.

The negative relationship between inflation and foreign direct investment suggests that macroeconomic instability drives away potential investors.

On the other hand, the modest positive correlations between FDI and governance indicators, especially the GOV_EFF (r = 0.3597), suggested that improved institutional quality may boost foreign investors' confidence in the host nation. Multicollinearity is not a significant issue in the regression analysis, as evidenced by the lack of exceptionally high correlations (above 0.85).

4.3 Panel Unit Root Test Results

Table 4: Panel Unit Root Test Results

Variable	Levin, lin and chu statistic	prob	Order of Integration	ADF - Fisher Chi-square statistic	prob2	Order of Integration
BROADM	-2.3979	0.0082**	I(1)	119.764	0.0000**	I(1)
Corruption	-12.9524	0.0000**	I(1)	170.97	0.0000**	I(1)
DCPS (Domestic Credit to Private Sector)	-5.8928	0.0000**	I(0)	143.694	0.0000**	I(1)
FDI_GDP (FDI Inflows as % of GDP)	-3.7662	0.0001**	I(1)	124.166	0.0000**	I(1)
GDP_GA (GDP Growth Annual %)	-10.4367	0.0000**	I(0)	121.089	0.0000**	I(0)
GOV_EFF (Government Effectiveness)	-4.0710	0.0000**	I(1)	121.089	0.0000**	I(0)
INFLATION	-8.2800	0.0000**	I(0)	86.5826	0.0000**	I(0)
POL_STA (Political Stability)	-4.0599	0.0000**	I(0)	329.341	0.0000**	I(1)
RQ (Regulatory Quality)	-11.1123	0.0000**	I(1)	131.642	0.0000**	I(1)
TRADE (Trade Openness)	-11.3349	0.0000**	I(1)	128.306	0.0000**	I(1)
VAA (Voice and Accountability)	-7.5515	0.0000**	I(1)	90.3054	0.0000**	I(1)
ROL (Rule of Law)	52.7641	0.0119	I(1)	54.3881	0.0081	I(0)

Source: Author's Computation (2026)

The mixed order of integration (some I(0), others I(1) employing Levin-Lin-Chu and ADF-Fisher Chi-square) is reported in table 4. The results in Table 5 show that most of the variables are stationary after first differencing, indicating they are integrated of order one, I(1). Although some of the variables, such as GDP growth, inflation, political stability, and government effectiveness, are stationary at level I(0). The mixed order integration shows that the counties were independent of one another, and some degree of heterogeneity was acceptable among these countries. The data is determined to be suitable for estimation techniques such as fixed effects or random effects models due to the mixed order of integration (some I(0), others I(1)).

From the results, most of the variables are stationary after first differencing, indicating they are integrated of order one, I(1). A few variables, such as GDP growth, inflation, political stability, and government effectiveness, are stationary at level, I(0). Importantly, none of the variables are integrated of order two, I(2), implying the

absence of non-stationary trends that could cause spurious regression.

The stationarity of financial development variables (broad money and DCPS) after first differencing indicates that their values evolve over time but remain mean reverting in the long run. The governance indicators (Corruption, Regulatory Quality, Rule of Law, and Voice and Accountability) also exhibit stationarity after first differencing, implying that institutional conditions tend to adjust toward equilibrium levels over time.

4.4 Regression Results and Discussion

Using the Fixed Effects (FE) and Random Effects (RE) models, this study examine the relationship between financial development and foreign direct investment (FDI) inflows in West Africa region.

Table 5: Regression analysis result

Variable	Fixed Effects Coefficient (p-value)	Random Effects Coefficient (p-value)
C (Constant)	-6.9207 (0.0000)**	-6.9207 (0.0000)**
BROADM (Broad Money)	0.0375 (0.0200)**	0.0374 (0.2412)
CORRUPTION	-0.6031 (0.0250)**	-0.6031 (0.5424)
DCPS (Domestic Credit to Private Sector)	0.3039 (0.0000)**	0.3039 (0.0000)**
GOV_EFF (Government Effectiveness)	1.5319 (0.0000)**	1.5319 (0.1763)
GDP_GROWTH_ANNUAL	0.2853 (0.0000)**	0.2853 (0.0000)**
INFLATION	0.0107 (0.3183)	0.0107 (0.8806)
POLITICAL_STABILITY	0.2166 (0.0000)**	0.2166 (0.0043)**
ROL (Rule of Law)	0.3941 (0.2000)	0.3941 (0.6847)
TRADE	0.0086 (0.0000)**	0.0086 (0.7846)
RQ (Regulatory Quality)	-3.4441 (0.0000)**	-3.4441 (0.0007)**
VAA (Voice & Accountability)	-1.5663 (0.0000)**	-1.5663 (0.0401)**
R^2 (Adjusted)	0.902	0.902
F-statistic (Prob.)	308.29 (0.0000)	308.28 (0.0000)
Durbin-Watson stat.	2.3865	2.3865

Source: Author's Computation (2026)

From the value of the R^2 (0.902) shown in table 5 shows that both model explain a large proportion of the variation in FDI inflows across the west African region. This shows how the variable greatly influenced the FDI and how well the model fit the data.

The variables representing the Financial Development are both positively significant in

the FE model. The coefficients of Broad Money (BROADM) and Domestic Credit to Private Sector (DCPS) are statistically significant at the 5% and 1% levels respectively. This indicate a positive relationship. A well-developed financial system will attract foreign investor. In other words, increases in the money supply and credit availability enhance foreign investors' confidence by easing capital movement, improving liquidity, and lowering financial transaction costs.

This finding is consistent with what Nkoa (2018) and Shuaibu et al. (2022) found, which is that financial sector efficiency is important in attracting investment in African economies. The significance of the DCPS across both the FE and the RE models, once again, establishes the role of credit to the private sector as an important driver of FDI in the region.

The GDP Growth Rate has a positive and highly significant ($p < 0.01$) influence which indicates that the faster growing economies are able to attract more FDI because of expanding market opportunities and more positive investor sentiments. On the other hand, Inflation is positive but statistically insignificant which indicates that over the short run, macroeconomic instability and inflation will not affect FDI inflows. This is likely because investors tend to consider long term market potential and the inflation.

The results shows positively significant coefficients of Government Effectiveness and Political Stability in the fixed effects model. This indicates that high quality FDI inflows are supported by strong governance institutions and more stable political conditions. This means that investors are more likely to invest in environments that are politically stable where contracts are enforceable and corruption is minimal.

Corruption has a significant negative coefficient—meaning that growing corruption deflates FDI inflows, increasing transaction costs, adding to the potential risks of arbitrariness, regulatory uncertainty, and policy reversals of disinvestments. This is in line with the observations of Ezeoha and Cattaneo (2012) about the quality of governance being a critical factor for sustainable investment in sub-Saharan Africa.

It is also noteworthy that the Rule of Law (ROL) is positive but has no significant impact, suggesting that the presence of legal frameworks, which fall short in their enactment and enforcement of laws, is not compelling enough to attract investors. By contrast, the negative and significant effects from Regulatory Quality (RQ) and Voice & Accountability (VAA) show that weak enforcement of regulations and a lack of public accountability are factors that make West Africa economies less appealing to foreign investors.

As a result, the negative coefficient on regulatory quality may stem from bureaucratic m and the unpredictable, inconsistent regulations that developing countries are known for, which actively dissuade foreign direct investment rather than promote. Likewise, limited mechanisms on voice and accountability deflate institutional transparency, which would otherwise promote long-term capital.

Trade openness has a positive and statistically significant coefficient in the fixed effects model, implying that economies with greater openness to international trade attract more foreign investors. This supports the argument that open economies provide better access to global markets and supply chains, enhancing profitability for multinational corporations.

The Hausman test conducted produced a p-value greater than 0.05, indicating that the Random Effects model is the appropriate estimator since individual country-specific

effects are uncorrelated with the explanatory variables. However, both models produced similar coefficients, implying robustness and consistency of the estimates.

The Durbin–Watson statistic (2.38) suggests that serial correlation is not a major problem in the residuals, confirming the reliability of the regression estimates.

Discussion of Findings

These findings support the supply-leading hypothesis, which argues that the growth of the financial sector stimulates economic growth and capital inflows because it improves financial intermediation reduced information asymmentry, ease capital mobilization and lessens transaction costs faced by foreign investors. (McKinnon, 1973; Shaw, 1973). The correlation of financial development and FDI positively documented by Nkoa (2018), Keho (2020), and Shuaibu et al. (2022) is also captured, noting that advanced financial systems encourage capital flows and foreign investment in African economies.

Also, the empirical result indicate that trade openness exert a positive significance effect on FDI inflows, confiming that access to international market remains a major attraction for foreign investors. the crucial impact of trade openness is in line with the findings by Anyanwu and Yaméogo (2015) which underscores the value of access to the global market in securing investment. Theoretically, the result strengthen the location advantages dimension of the Eclectic paradigm by demonstrating that trade liberalization complement financial development in shaping investment attractiveness. The negative impact of inflation suggests that macroeconomic instability discourage foreign investors by increasing uncertainty regarding future cost, profitability and currency value. High inflation signal weak policy credibility and erodes investors confidence, thereby limiting long term capital commitments. this is in line with Adeniyi et al. (2015), who reported that macroeconomic instability negatively influences FDI inflows in Sub-Saharan Africa.

Research on governance and specifically the relevance of political stability to the findings mirrors work by Adegboye et al. (2020) and Aromasodun (2022) on the part played by institutional quality in shaping the influence of financial development on FDI. This study builds on that by demonstrating that while financial development in isolation attracts investment, it does so in a greater magnitude in a politically stable context.

In summary, the results indicate that financial development, macroeconomic stability, trade openness, and institutional quality jointly determine FDI inflows. West African countries with deeper financial markets, stable governance, and open trade regimes tend to attract more sustainable and productive investment.

5.0 Conclusions

This study examined the impact of financial development on Foreign Direct Investment inflows across 16 ECOWAS countries over the period 2000 to 2023, using secondary data from the World Development Indicators and Worldwide Governance Indicators. Employing panel econometric techniques, the findings indicate that financial development plays a significant role in attracting foreign investment into the West African region. In particular, indicators such as broad money supply and domestic credit to the private sector were found to have a positive and statistically significant influence on FDI inflows, suggesting that improved access to finance enhances the region's investment attractiveness. The results further reveal that economic growth positively influences FDI inflows, while inflation, although positive, is not statistically significant, implying that

short-run price instability may not strongly deter foreign investors. In addition, trade openness emerged as a key determinant, indicating that economies that are more integrated into global markets are more likely to attract foreign capital.

These findings underscore the importance of strengthening financial systems as a strategic pathway for enhancing FDI inflows in West Africa. Policymakers should prioritize deepening financial markets by expanding financial inclusion and improving access to banking and digital financial services. Efforts to promote financial technology should focus on reducing regulatory bottlenecks and ensuring ease of access, particularly for underserved populations and small businesses. Strengthening credit delivery mechanisms and improving the efficiency of financial intermediation will further enhance the ability of both domestic and foreign investors to access funding.

Maintaining macroeconomic stability is also critical for sustaining investor confidence. Stable inflation, credible monetary policy frameworks, and sound fiscal management are essential to ensure both internal balance and external stability. Policymakers should therefore implement consistent macroeconomic policies that minimize uncertainty and support a stable investment climate.

Furthermore, promoting trade liberalization remains an important policy lever for attracting FDI. Reducing tariffs, eliminating quotas, and addressing non-tariff barriers can enhance regional integration and create a more competitive and attractive environment for foreign investors. Increased openness not only facilitates capital inflows but also supports diversification of investment into non-extractive sectors.

Overall, strengthening financial development, ensuring macroeconomic stability, and advancing trade openness are mutually reinforcing strategies that can significantly improve the capacity of West African economies to attract and sustain diversified foreign investment

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