Foreign Direct Investment in South Africa: A comparative study of strategies and key determinants

By

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ABSTRACT

This dissertation considers the question of foreign direct investment (FDI) into South Africa. It examines constraints on investment, entry strategies by foreign firms, firm performance and the impact of FDI on the South African economy. After a brief review of the literature in Chapter Two, FDI flows into South Africa, Africa and the rest of the world are compared. The objective is to assess how successful South Africa has been in attracting FDI. The dissertation then goes on to examine the factors which determine FDI into South Africa, providing some comparisons with other countries. Entry strategies by foreign firms are investigated as is the performance of foreign firms in South Africa. The final section investigates whether foreign owned manufacturing firms are contributing positively towards bringing skills, technology and employment into South Africa. The findings illustrate that the issues are complex. While South Africa has only achieved moderate success in attracting FDI, the benefits of this are evident. It is also clear that there is potential to attract significantly more investment if certain policy measures are adopted.

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CHAPTER ONE

INTRODUCTION

Foreign direct investment (FDI) occurs when a foreign firm directly acquires an existing asset in the host country, or establishes a new operation (greenfield investment). Over the last two decades, developing countries have placed increasing emphasis on attracting FDI as a means of boosting economic growth and promoting skills development and employment.

This dissertation provides an assessment of FDI into South Africa, by considering trends in inward investment together with the factors that have influenced this investment. Firm entry strategies, the performance of foreign firms and the impact of FDI on skills and employment are also considered.

The attraction of FDI is a major policy objective of the South African government as it seeks to improve economic growth. While FDI into South Africa has increased, many argue that the overall level of FDI since 1994 has been disappointing.[1] This is in spite of the fact that the government has introduced a series of policy initiatives to encourage inward investment. A key issue, therefore, is what factors promote and constrain FDI in the South African context.

A further set of questions relates to the impact of FDI on existing firms, on skills and technology, and on employment. This in turn may be a function of the mode under which FDI occurs. For instance, FDI has a number of direct and indirect impacts on domestic firms; it could play a developmental role but it could also crowd out existing investment. It is clear that South Africa requires product innovation, new skills and technological expertise in order to boost employment.

[1] For instance, Gelb and Black (2004) argue that overall FDI levels have been low, and that policy objectives to increase employment and output levels have not been met in South Africa.

The main concern is whether South Africa is benefiting "enough" from FDI, and if it is not, whether there are other ways in which economic growth and exports can be promoted. Further information on these issues may help policy makers to decide whether the South African government should continue to encourage FDI (particularly the type of FDI) or rather encourage domestic firms to grow on their own without any boost from foreign firms.

This study is made up of the following chapters. Chapter Two provides a brief review of the literature on FDI. This review covers the relationships between FDI and skills development, exports and employment. It also identifies the areas of controversy in the literature. It is organized around one of the research questions developed in this study; do foreign-owned firms contribute positively to South Africa's economic growth and development or not? The methodology used is also developed in this chapter.

Chapter Three provides an overview of global FDI trends, in relation to Africa, and in relation to South Africa. It also provides detailed information on FDI flows into South Africa.

Chapter Four examines the factors that determine FDI into South Africa. It also considers the mode of entry of foreign firms and provides an analysis of the factors that determine firms' performance. The survey data collected by the EDGE Institute (Gelb 2003) is used to examine firms' investment strategies when they enter South Africa and their attitude towards the country's business environment. It also looks at the impact of FDI on employment and on the skill levels of the labour-force.

Chapter Five concludes the study with a series of policy recommendations concerning the encouragement and promotion of FDI by government in South Africa. This chapter also considers government policy regarding the role of FDI in the South African economy.

CHAPTER TWO

LITERATURE REVIEW AND RESEARCH METHODOLOGY

2.1 Literature review

There is an extensive literature suggesting that the promotion and attraction of FDI into developing countries makes sound economic sense. However, some empirical studies show that FDI has a less than positive impact on economic growth, employment, and skills development in developing countries. Studies covering the SADC countries report that FDI has impacted positively on their economic growth although it is suggested that more could be done by member countries to attract FDI.

This literature review focuses on three crucial aspects of FDI: the determinants of FDI, the impact of FDI on economic growth, employment and skills development, and the relationship between FDI and exports. The manner in which these variables impact on each other is also reviewed in this chapter.

2.1.1 The determinants of FDI

Most studies of the determinants of FDI suggest a similar range of factors although their relative importance may vary considerably. Gorg and Greenaway (2004) argue that characteristics such as unskilled labour costs, tariff regimes and the size of the market demand are important factors determining multinationals' decisions regarding investment locations. Kozul-Wright (1998) stresses that in manufacturing, factors such as technology, skills and managerial capabilities are more important determinants of FDI flows. De Mello (1997) suggests that market size, economies of scale and relative factor prices are the main determinants of FDI. The ability to correctly identify the factors that promote FDI will clearly assist in developing an effective investment promotion strategy, and this will help to improve the effectiveness and efficiency of these instruments in promoting exports, skills and employment in South Africa (Mbekeani 1997).

Makola (2003) highlights some of the variables that may discourage FDI in respect of African countries. These include limited market size and growth potential (in terms of per capita income), shortage of skills and poor infrastructure.

For South Africa, Dinkelman and Streak (2000) suggest that FDI can be encouraged if government remains committed to austere macroeconomic policies, invests more in infrastructure, skills and technologies, and aggressively markets the country as an attractive location. Also, it is important that multinational corporations (MNCs) are confident that there will be no interference by government in their investment decisions. They conclude that investor confidence, productivity, and production costs linked to supply side incentives, may be the most important factors determining FDI in South Africa. It is noted that South Africa currently faces an HIV/Aids pandemic and relatively high crime levels; these two variables make it that much more difficult for South Africa to attract FDI.

South Africa does not yet have the locational advantages necessary to attract extensive efficiency seeking investment, which is undertaken by MNCs to provide more favourable cost bases for their international operations. This implies that South Africa may be relying on locational advantages that are not sufficiently recognized by foreign investors, or that South Africa does not have the quality factors of production necessary to ensure a thriving economy. Economists have long recognized that there will normally be extra costs involved, at least initially, for a firm investing in a foreign country where it is not familiar with local markets and institutions (South Centre 1997).

2.1.2 FDI and economic growth, employment and skills development

FDI can have a variety of impacts on economic growth, employment, and skills development in developing countries. Kozul-Wright (1998) believes that since the mid-1980s the policy pendulum, in developing countries, has swung towards removing restrictions on the activities of MNCs as the best way to attract FDI, enhance competitiveness, and foster economic growth. FDI can impact on economic growth through the promotion and encouragement of new advanced foreign technology and through the addition of new production capacity. UNCTAD (1999)

suggests that FDI can make a positive contribution to human resource development through the training and transfer of skills that are either unavailable or scarce in host developing countries. In this way the productive efficiency of the domestic firms is improved. Sader (2000) suggests that government must have the necessary expertise in implementing and providing training projects to equip labour with adequate skills. FDI also allows for knowledge transfers through the introduction of alternative management practices and organizational arrangements (De Mello 1997).

MNCs introduce production technology and management techniques, which may be adopted by local firms. Multinational firms may also train workers at lower cost and so contribute to the diffusion of technology that may help to increase the number of local firms. Moosa (2002), referring to the south-east Asian economies, argues that it is possible for FDI to act as a catalyst in the development of local industry, which may in turn become so strong as to reduce both the relative and absolute position of MNCs in the industry. Thus FDI generates productivity spillovers for the host country (Hanson 2001). On the other hand, there is considerable concern that FDI does not generate significant employment because foreign affiliates tend to transplant the capital-intensive technologies of their parent firms into developing country settings, and little effort is made to adapt them to local conditions where labour is abundant and capital is scarce (UNCTAD 1999).

There is also the view that local firms may be harmed if multinational firms are allowed to dominate the market in the host country. For example, Hanson (2001) concluded that domestic plants in industries with a larger multinational presence enjoy lower rates of productivity growth, and that there is no compelling evidence to suggest that FDI can generate positive spillover benefits for the host country. Foreign firms are often more efficient than smaller local firms and have the resources to attract workers and finance away from local firms (Makola 2003).

There is much debate in the literature as to how FDI can encourage economic growth and skills development in the host country. Gorg and Greenaway (2004) argue that MNCs generally come equipped with information, which they exploit in order to produce output which they then export from the new host country. This exploitation of information can lead to the improvement of human capital in the host country

through training and education. Kumar (1995) notes that it is possible for FDI to bring in technology as a part of a package of associated skills and capital, and that the latter supplements domestic savings. However, he cautions that FDI may hamper the absorption and diffusion of technology within the host country and this may result in continued technological dependence. Moosa (2002) suggests that FDI is capable of increasing employment directly by setting up new facilities, or indirectly by stimulating employment in the industries responsible for the distribution of output. However, much depends on the level of technological absorption within the host country. This is, however, a two-way process as multinational firms engage in FDI and cross-border alliances so that they can acquire or learn about foreign technology (Dunning 1995).

2.1.3 FDI and exports

Exports are another means that can be used to accelerate economic growth and employment in developing countries. De Mello (1997) notes that FDI is shown to be more growth-enhancing in developing countries that pursue export promotion than in those promoting import substitution. However, Gelb (2003) suggests that FDI is more likely to improve domestic firms' international competitiveness and exports via spillovers from new foreign partners, than to contribute directly to employment creation via the establishment of large new operations. Kumar (1995) warns that not all FDI inflows bring to their host countries access to new technology and markets; only export-oriented FDI provides access to markets in other countries. High quality labour and capital in the domestic economy can be used to produce high quality exports. Cheap labour coupled with investment in labour-intensive sectors can lead to substantial employment in export industries.

Dinkelman and Streak (2000), using data from the BusinessMap Foundation (2003) for the period between 1994 to 1997 on the top ten foreign firms that invested in South Africa, suggest that recent FDI has been market and resource seeking, and that foreign investors are not interested in using South Africa as a platform for manufactured exports. They found that investors remain more interested in natural resources, such as gold and diamonds, and that they have paid less attention to other sectors, for example, the manufacturing sector.

UNCTAD (1999) supports the encouragement of efficiency-seeking FDI as an important source of employment creation as it generally gives rise to exports by the host country. This is viewed as leading to the diversification of the composition of exports by the host country. Kumar (1995) suggests that multinational enterprises have the potential to expand manufacturing exports and the transfer of knowledge to host countries, and that countries compete among themselves to attract such investments with the aid of various policy instruments.

It is noted by UNCTAD (1999) that transnational corporations (TNCs) can generate significant employment, in the host country, through their investment in export-oriented labour-intensive activities. In developing countries this occurs primarily in manufacturing, but it can also occur in some services.[2] However, Lall (2003) notes that in the case of India, MNC affiliates are selling technologies in return for royalties. This suggests that the South African government should make sure that the quality of factor inputs is raised to boost investor confidence. These high-quality factors of production can be used to produce quality export products in the host country. Citing from recent empirical work on Germany, Mexico, Morocco, Spain, the United Kingdom, the United States and Venezuela, Gorg and Greenaway (2004) suggest that the levels of productivity are higher in exporting firms than in non-exporting firms.

2.2 Research methodology

This dissertation makes use of the growing literature on FDI in South Africa as well as a number of additional data sources to analyze the central research questions. The study highlights the importance of FDI flows by investigating firm entry, firm performance and the impact of FDI on employment, skills development and economic growth in South Africa. The data used is that found in various South African studies of FDI.

The World Investment Report (2003) is used to analyze FDI trends. The data from this source are used in Chapter Three to compare FDI flows into SA, the rest of Africa, and the rest of the world over the last decade. However, as previously noted,

[2] UNCTAD (1999) suggests that TNCs use technologies appropriate to local education levels and train mainly to ensure the efficient operation of such technologies.

this research focuses on FDI flows into South Africa. The analysis in Chapter Three also uses data from the BusinessMap Foundation (2003) to examine the size and sources of FDI into South Africa for the period 1994 to 2002. This data presents an accurate reflection of the patterns of FDI except that the data on small investment ventures are not captured by BusinessMap and this causes the figures to be understated.

Chapter Four makes extensive use of the data collected by The EDGE Institute (Gelb 2002 and 2003) to analyze firms' entry strategies and performance, and the impact of FDI on economic growth, employment and skills development.

2.3 Conclusion

This brief review highlights a range of perspectives on the determinants of FDI, and the impact of FDI on economic growth, employment and skills development in developing countries. Some people argue that technology, skills and managerial capabilities are the most important factors in determining FDI flows. However, others consider market size, economies of scale and relative factor prices as the major determinants of FDI flows.

Much of the literature makes the point that in order to promote economic growth, employment and skills development in developing countries, restrictions on the activities of MNCs should be removed to encourage a greater degree of competitiveness and economic growth. Also, MNCs may be encouraged to import the latest foreign technology if the government of the country focuses on improving the quality of the domestic labour-force through the increased investment in education.

CHAPTER THREE

FOREIGN DIRECT INVESTMENT FLOWS: AN OVERVIEW

This chapter provides the background to FDI inflows during the period 1990 to 2003. Firstly, the trends in FDI for selected developing and developed economies in relation to total world FDI flows are discussed and are compared to FDI flows into SA. Secondly, the FDI flows into Africa are considered and are compared to FDI flows into SA. Lastly, this chapter provides detailed information on FDI flows into South Africa.

3.1 Global trends in FDI flows

3.1.1 FDI inflows

Table 1 presents the annual average figures of FDI inflows into the developed and developing countries for the periods 1991 to 1996 and 1997 to 2002. On average the developed economies attracted 73% of the world FDI inflows for the period 1997 to 2002. The US alone attracted 59%, or US$175 billion, of FDI during this period followed by the UK with US$68 billion. Germany is the third with US$61 billion followed by China (US$45 billion). As one would expect these large economies receive a higher absolute level of FDI compared to small economies such as Korea, India and Malaysia. For example, India and Malaysia accounted for US$3 billion each during the same period. South American countries, for example Brazil and Chile, accounted for US$28 billion and US$5 billion, respectively. South Africa attracted less FDI (US$2 billion) compared to the developed and developing countries listed in the table.

Table 1. FDI inflows by region and economy, 1991-2002 (US$ billions)

Host region/ economy	1991-1996 (Annual average)	1997	1998	1999	2000	2001	2002	1997- 2002 (Annual average)	1997- 2002 (% of global FDI)
World	254	482	686	1079	1393	824	651	853	100
Developed Economies	154	270	472	825	1121	589	460	623	73.0
Australia	6	8	6	3	13	4	14	7.9	0.9
Brazil	4	19	29	29	53	23	17	28	3.3
Chile	2	5	5	9	4	5	2	5	0.6
China	26	44	44	40	41	47	53	45	5.3
Germany	5	12	25	56	203	34	38	61	7.2
India	1	4	3	2	2	3	4	3	0.4
Malaysia	5	6	3	4	4	1	3	3	0.4
Korea	1	3	5	9	9	4	2	5	0.6
South Africa	1	4	1	2	1	7	1	2	0.3
Switzerland	2	7	9	12	19	9	9	13	1.6
UK	17	33	74	84	130	62	25	68	8.0
US	47	103	174	283	314	144	30	175	59.0
Vietnam	N/A	3	2	2	1	1	1	2	0.2

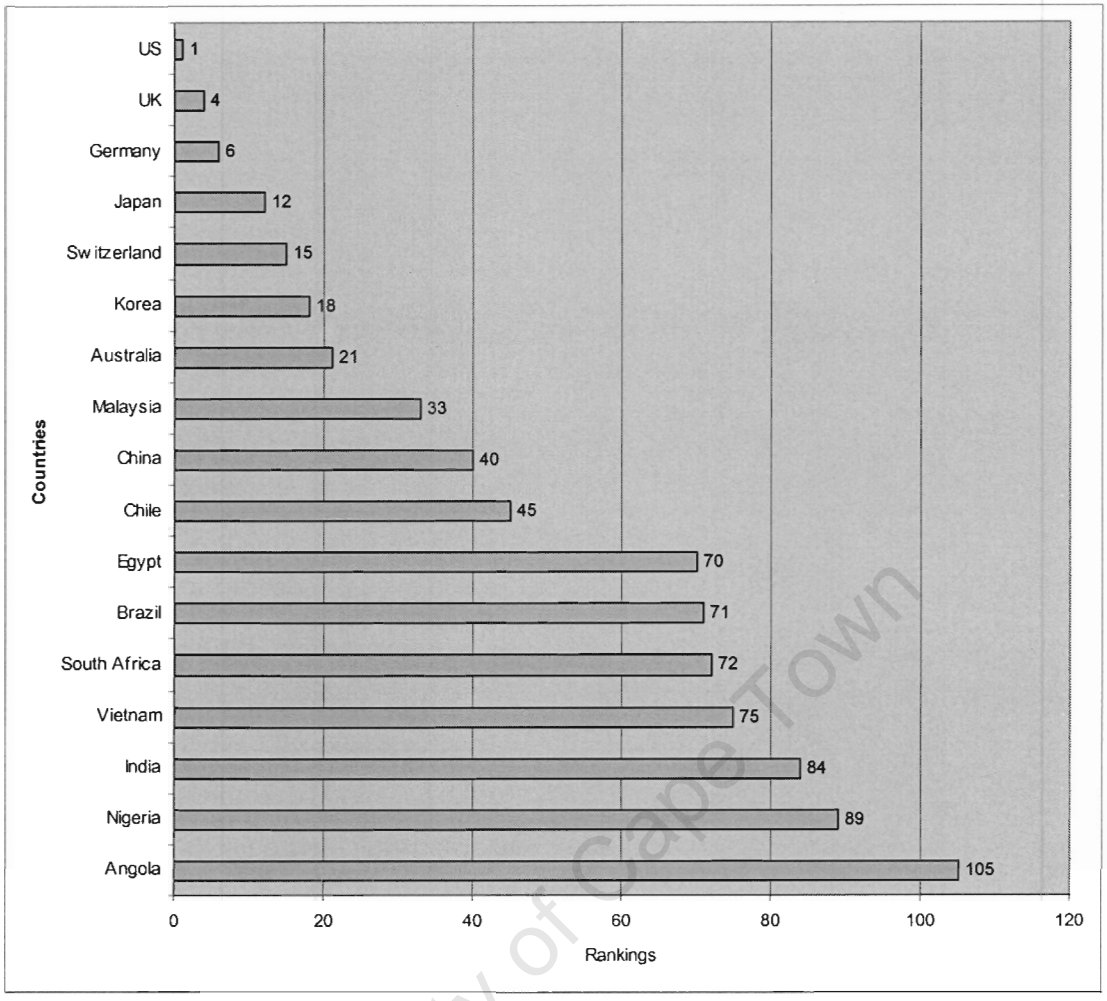
Source: Derived from the World Investment Report (2003)

N/A: Data is not available for the period 1991-1996.

Estrin (2003) provides a possible explanation for India and Vietnam's FDI levels. Although India embarked on the gradual liberalization of many of the constraints in both its domestic economy and in its FDI regime since 1991, FDI levels have remained relatively low. This also applies to Vietnam, which belonged to the socialist bloc, although it embarked on gradual reform from 1986 onwards.

Figure 1 shows the rankings of 17 selected countries in terms of their potential to attract FDI. The higher ranked economies tend to be the ones with the greatest GDP, for example, the US is first followed by the UK and Germany. Among the developing countries Malaysia appears to have a greatest potential to attract FDI followed by China and Chile. South Africa is ranked 72nd. This relatively low ranking suggests that South Africa does not have the potential to attract FDI relative to other developing countries such as Chile, China and Malaysia. However, it has greater potential relative to other African countries, for example, Nigeria and Angola.

Figure 1. Inward FDI Potential Index rankings for 17 selected countries (1999-2001)

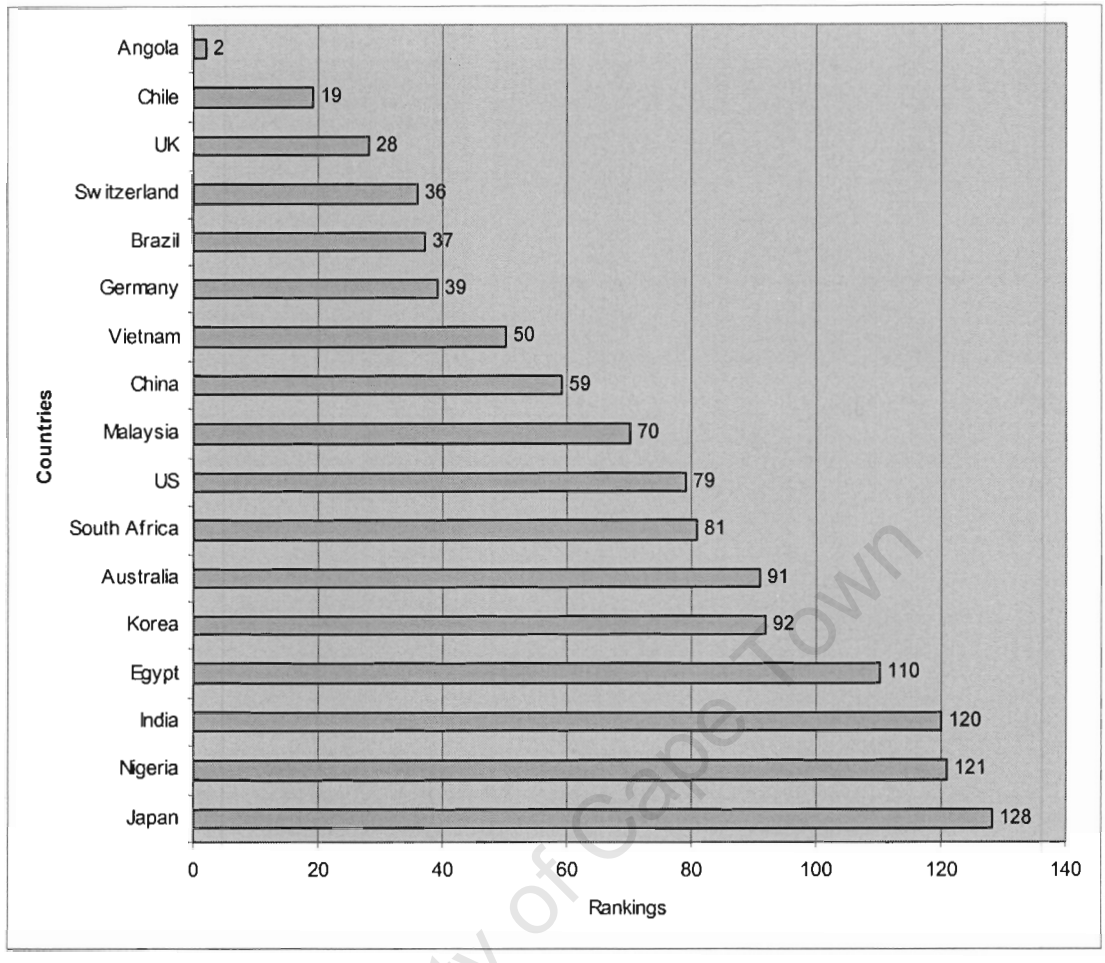


Source: World Investment Report (2003), annex table A.1.7 and A.1.8

Note: *A number of structural factors are taken into account in order to estimate a country's potential for attracting FDI. These factors include telephone mainlines per 1000 inhabitants, rates of cell phone ownership, R&D expenditures as a percentage of GDP, commercial energy use, exports of natural resources as a percentage of the world total, GDP per capita and the number of students in tertiary level education (UNCTAD 2003).*

Figure 2 below ranks the inward FDI performance for the same 17 countries. The inward FDI performance index captures the ratio of a country's share of world FDI to its share in world GDP.

Figure 2. Inward FDI Performance Index rankings for 17 selected countries (1999-2001)



Source: World Investment Report (2003), Annex table A.1.5

Note: *The rankings are obtained by computing the ratio of a country's share in global FDI inflows (relative to its economic size) to its share in global GDP. Since FDIs are lumpy in nature the ratios are computed using three years averages.*

Angola ranks second followed by Chile in the selected group during the period specified. The reason for Angola's high ranking is that this country has a comparative advantage in oil production. Among the economically developed countries, the UK and Switzerland are ranked relatively high. This may due to these countries flexible labour laws and entry and exit procedures for business. It is noted that the US ranks 79th in the performance rankings although it is ranked first in the potential rankings.

China, the developing country receiving the largest share of world FDI (table 1) is only ranked 59th. China may possess a political and social regime that is more conducive for FDI than Vietnam. Wu *et al.* (2002) suggest that China's membership of the World Trade Organization (WTO) and the concomitant regime will no doubt raise the country's ranking on the Inward FDI performance index. A number of

developing countries, for example, Chile, Brazil and Vietnam, performed well compared to countries with developed economies like the US and Japan.

Although South Africa's performance exceeds that of Australia, India, Egypt and Nigeria it lags behind other developing countries, for example, Malaysia, Chile and Vietnam.

3.1.2 FDI outflows

Although developing countries have grown rapidly in absolute terms as sources of FDI, developed countries continue to account for the bulk of outward FDI flows. As shown in Table 2 the average share of FDI outflows on the part of the developed world during the period 1991 to 1996 was 85%. However, this increased to 92% for the period 1997 to 2002.

Table 2. FDI outflows by home region and economy, 1991-2002 (US$ billions)

Home region/ Economy	1991-1996 (Annual Average)	1997	1998	1999	2000	2001	2002	1997-2002 (Annual Average)
World	281	477	683	110	1201	712	647	803
Developed economies	241	396	631	1021	1098	661	600	735
% share of world FDI	85	83	92	93	91	93	93	92

Source: Derived from the World Investment Report (2003)

3.2 FDI inflows: South Africa and the rest of Africa

As shown in Table 3 below, Africa accounted for only 1.4% of global FDI inflows for the period 1997 to 2002. South Africa, Angola and Nigeria are the leading countries in Africa in terms of attracting FDI inflows. South Africa received 20.4% of FDI inflows into Africa, while Angola and Nigeria managed 12.0% and 10.0%, respectively. Mozambique was ranked fourth since it became South Africa's top investment destination in 2001 and 2002 (BusinessMap Foundation 2003). Cameroon, Botswana and the Seychelles each accounted for 0.5% of Africa's FDI inflows, the lowest for the African countries listed in the table.

Table 3. FDI inflows for selected countries in Africa, 1991-2002 (US$ billions)

Country	1991-1996 (Annual average)	1997	1998	1999	2000	2001	2002	1997-2002 (Annual average)	1997-2002 (% of global FDI)
World	254	482	686	1079	1393	824	651	853	100
Africa	4.6	10.7	8.9	12.2	8.5	18.8	11.0	11.7	1.4
Country	**1991-1996 (Annual average)**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**1997-2002 (Annual average)**	**1997-2002 (% of African FDI)**
Angola	0.35	0.41	1.11	2.47	0.88	2.15	1.31	1.39	12.0
Botswana	-0.03	0.10	0.09	0.04	0.05	0.03	0.04	0.06	0.5
Cameroon	0.01	0.05	0.05	0.04	0.03	0.07	0.09	0.05	0.5
Egypt	N/A	0.89	1.07	2.92	1.24	0.51	0.65	1.21	0.1
Mauritius	0.02	0.06	0.01	0.05	0.28	0.03	0.03	0.08	0.7
Mozambique	0.04	0.06	0.24	0.38	0.14	0.26	0.41	0.25	2.1
Namibia	0.11	0.08	0.08	0.11	0.15	0.28	0.18	0.15	1.3
Nigeria	1.26	1.54	1.05	1.01	9.30	1.10	1.28	1.15	10.0
Seychelles	0.02	0.05	0.06	0.06	0.06	0.06	0.06	0.06	0.5
South Africa	0.45	3.82	0.56	1.50	0.89	6.79	0.75	2.39	20.4
Swaziland	0.06	-0.02	0.15	0.10	0.04	0.08	0.11	0.08	0.7
Uganda	0.07	0.18	0.21	0.22	0.25	0.23	0.28	0.23	2.5
Zambia	0.11	0.21	0.20	0.16	0.12	0.72	0.20	0.16	1.4
Zimbabwe	0.05	0.14	0.44	0.06	0.02	0.00	0.03	0.12	1.0

Source: Derived from the World Investment Report (2003)

On account of its large economy, South Africa has done much better than all the other countries listed in attracting FDI. Unsurprisingly, it is the leading destination for FDI in the SADC region followed by Angola. That said, Angola and Nigeria specialize in oil production which is an attractive industry for foreign investors.

A number of factors contribute towards the relatively poor FDI performance of some African countries. For example, Egypt's process of liberalization has been slow and only started to pick up in the 1990s due to the initiation of the privatization process in 1991 and the removal of FDI restrictions (Estrin and Meyer 2004). South Africa's economy has been constrained by the legacy of apartheid; the advent of democracy in 1994 opened the country's economic system to new business opportunities.

3.3 FDI flows into South Africa

3.3.1 Sources of FDI inflows

This section analyses the size of FDI inflows and their sources for the period 1994 to 2002.

Table 4. FDI by country, 1994-2002 (US$ and SA Rands millions)

Source countries	US$ (millions)	Rands (millions)
US	5 583	28 598
UK	3 649	24 813
Malaysia	2 406	12 504
Germany	1 534	9 763
Switzerland	1 211	7 207
Japan	870	5 178
Australia	830	7 981
Italy	607	3 861
France	531	2 971
Canada	425	3 197
Other	4 030	25 135
% of total FDI from selected developed countries	71	71

Source: Derived from BusinessMap Foundation (2003)

Note: *"Other" and Malaysia are excluded when computing % of total FDI.*

As Table 4 indicates the US, the UK and Germany all feature strongly as investors in South Africa. Most of the FDI flows are from countries that have traditionally had strong economic ties with South Africa (Akinloye *et al.* 2004).[3] Malaysia is the only developing country (third on the list); all the other countries are developed. The reason that Malaysia is an exception is that it spotted opportunities for investment in South Africa at an early stage; it has invested some US$2.4 billion in South Africa over the past 10 years (BusinessMap Foundation 2003). This includes some of the largest foreign investments, for example, the purchase of Engen by Petronas, and a portion of the privatized stake in Telkom (Section 3.3.3).

[3] Akinloye *et al.* (2004) estimate that Malaysia contributed 21%, and the USA 35%, of FDI into post-apartheid South Africa.

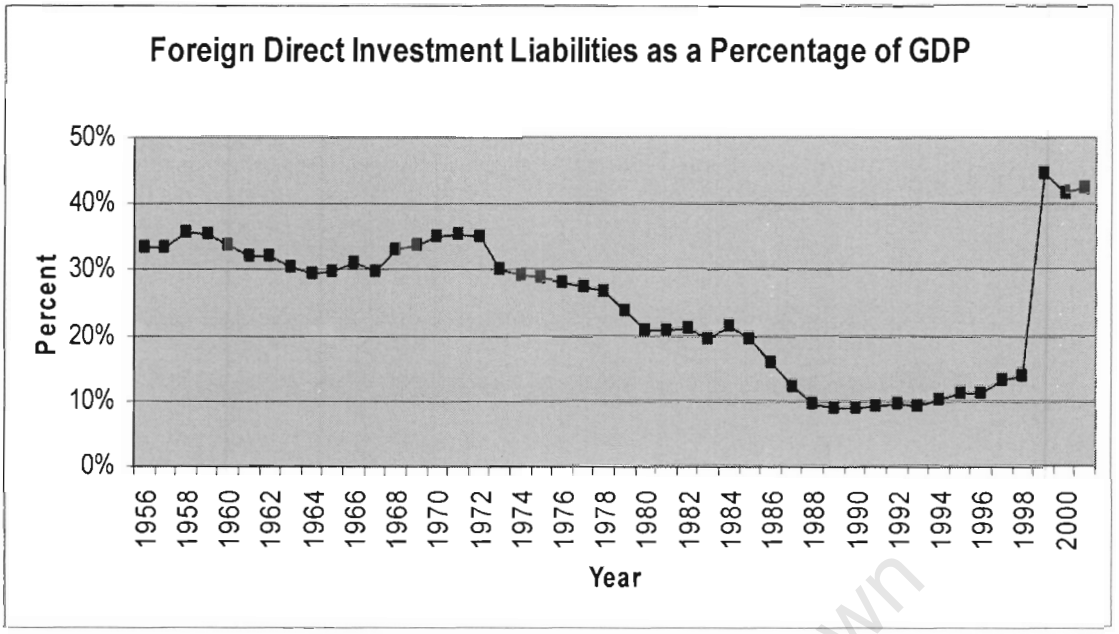
Vickers (2002) estimates that approximately 60% of FDI flows into South Africa over the period 1994 to 2002 were used to finance acquisitions of state-owned enterprises. For example, the privatization of state assets such as South African Airways (SAA), the Airport Company of South Africa and Telkom. A 20% stake in SAA was sold to Swissair for R1.4 billion and nearly R2.5 billion was raised from the partial sale of Transnet's holdings in the cellular telephone operator, MTN (Economic Perspective 2001).

3.3.2 FDI liabilities as a percentage of GDP

South Africa's FDI liabilities for the period 1956 to 2001 are presented in Figure 3. These liabilities serve as an asset to foreign investors and as a liability to South Africa.

Figure 3 below shows the decline in FDI liabilities as a percentage of GDP from 1956 to 1994 from approximately 34% to 10%. However, during the period 1997 to 1998 there was a gradual rise from 13.2% to 13.9% of GDP. This was due to the Asian crisis of 1998, which resulted in a sharp depreciation of the rand. In 1999 there was a very sharp increase in FDI liabilities to approximately 45% of GDP. Fedderke and Romm (2004) reason that this sharp increase is due to the de-listing of three companies, Anglo-American, Old Mutual, and South African Breweries from the Johannesburg stock exchange (JSE), and their listing on the London stock exchange (LSE).

Figure 3. South Africa's FDI liabilities as a percentage of GDP (1956-2001)



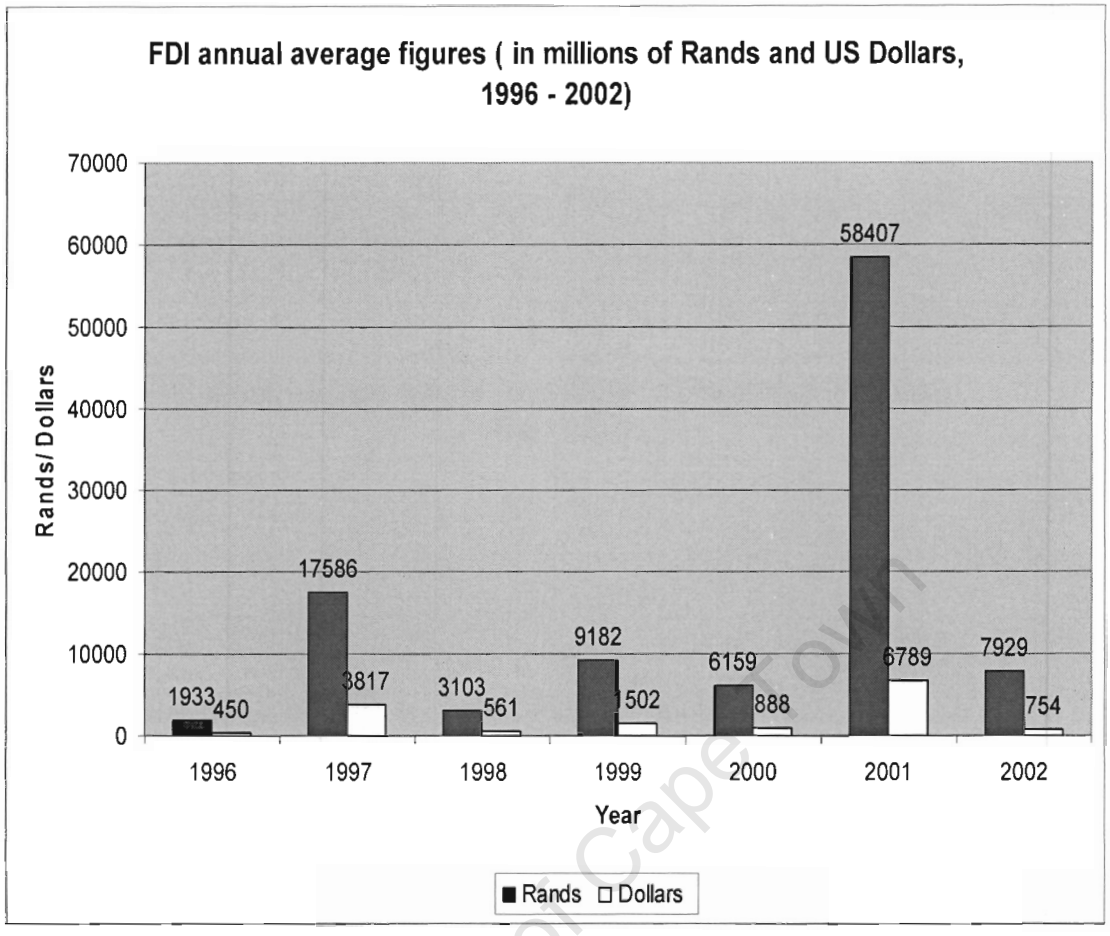
Source: Fedderke and Romm (2004)

3.3.3 FDI trends in South Africa

The factors influencing the size of the annual FDI flows are now discussed. For example, the pace of privatization, crime and political factors have influenced foreign investors' confidence. The actual value of FDI has remained fairly low due to the perception that South Africa's risk premium has not been reduced by factors such as price and exchange rate stabilization. Also the snail's pace of privatization contributed to the lack of investor confidence.

Figure 4 (page 18) shows that there has been an increase in total FDI from R3103 million in 1996 to R17586 million in 1997 before declining in 1998. Large scale investments during this time included the 30% stake in Telkom, which was sold to the US based SBC Communication and Telekom Malaysia Berhad in 1997 (Economic Perspective 2001). The relative decline in FDI flows after 1997 is due to a number of reasons; political uncertainty around South Africa's national elections, unstable economic conditions and uncertainty about future interest rates. In 1998 exchange rate volatility, sparked by the Asian crisis, had a negative impact on economic growth in South Africa. Investors saw emerging markets as carrying a greater risk at this time. Lastly South Africa's south-east Asian partners had problems at home and these discouraged them from pursuing a policy of investment in South Africa.

Figure 4. FDI trends in South Africa, 1996-2002 (US$ and SA Rands millions)



Sources: Derived from the World Investment Report (2003) and the South African Reserve Bank Quarterly Bulletins (June 2002 and June 2003)

In 2001 there was a substantial increase in the US$ value of FDI to US$6789 million. As a result of the substantial rand depreciation at this time, this translated into R58407 million, a figure that far exceeds any other annual inflow during the seven-year period. The major reason was the one-off buy-out of the De Beers minority shareholders by the London-listed Anglo American Corporation (The Namibia Economist 2001, SARB 2002 and Levinsohn 2005).

On average the FDI flows from 1997 to 2002 into South Africa amounted to US$2385 million compared to US$450 million for the period 1991 to 1996 (Table 3). The substantial difference may be the result of increased competition, a more favourable political environment, and an increase in the number of firms coming into the region. Referring to Figure 1, Akinloye *et al.* (2004) suggest that South Africa has the potential to attract relatively more FDI due to its generous endowment of natural

resources. These factors in some combination helped to boost FDI into South Africa above trend level.

More recently, South African TNCs have been investing in food processing, retailing and other services in other countries. UNCTAD (1999) confirms that privatization programs are also attracting investment from South Africa, for example, South African Breweries (SAB) bought Cervejas de Mozambique when it was privatized in 1995.

FDI has proved more stable than other forms of private sector finance, although it did decline as a result of the financial crisis in 1998 (BusinessMap Foundation 2003). From 2001 to 2003 FDI flows into South Africa increased by a large amount because of private-public partnership schemes and the potential inherent in increasing global export capacity. This goes to confirm that the main subsidiaries and affiliates of the largest multinationals MNCs perceive South Africa as being the dominant economic power in the SADC region. Akinloye *et al.* (2004), in their empirical analysis, confirm that more than 70% of the 390 subsidiary entities of the world's largest MNCs in SADC region are based in South Africa. This implies that South Africa is making progress in attracting FDI and that investors are developing a growing interest in South African markets.

That said, investment flows into South Africa from African and Asian countries (with the exception of Malaysia) have been small in comparison to investment flows from developed economies. This suggests that these countries are not significant outward investors and may traditionally have weak economic ties with South Africa. The implication is that South Africa does not benefit from the FDI undertaken by these countries and relies mainly on FDI from the developed economies mentioned above.

3.4 Conclusion

South Africa has made some progress in attracting FDI compared to other African countries. Although South Africa compares fairly well to other countries within SADC region, and to most countries in Africa, in terms of attracting FDI, it has not been very successful compared to other developing countries, for example China and

Malaysia. There are a number of policy measures that need to be taken to rectify this situation in the future. Such policy measures are discussed in Chapter Five.

CHAPTER FOUR

FOREIGN DIRECT INVESTMENT: DETERMINANTS, STRATEGIES AND EFFECTS

This chapter consists of seven main sections. Section 4.1 compares the factors that determine FDI flows into selected emerging markets with the factors that determine FDI flows into South Africa. The reason for selecting these countries is that they share a common policy in terms of attracting FDI to support their economic development (Estrin and Meyer 2004). Section 4.2 provides an explanation of the factors determining FDI flows into South Africa.

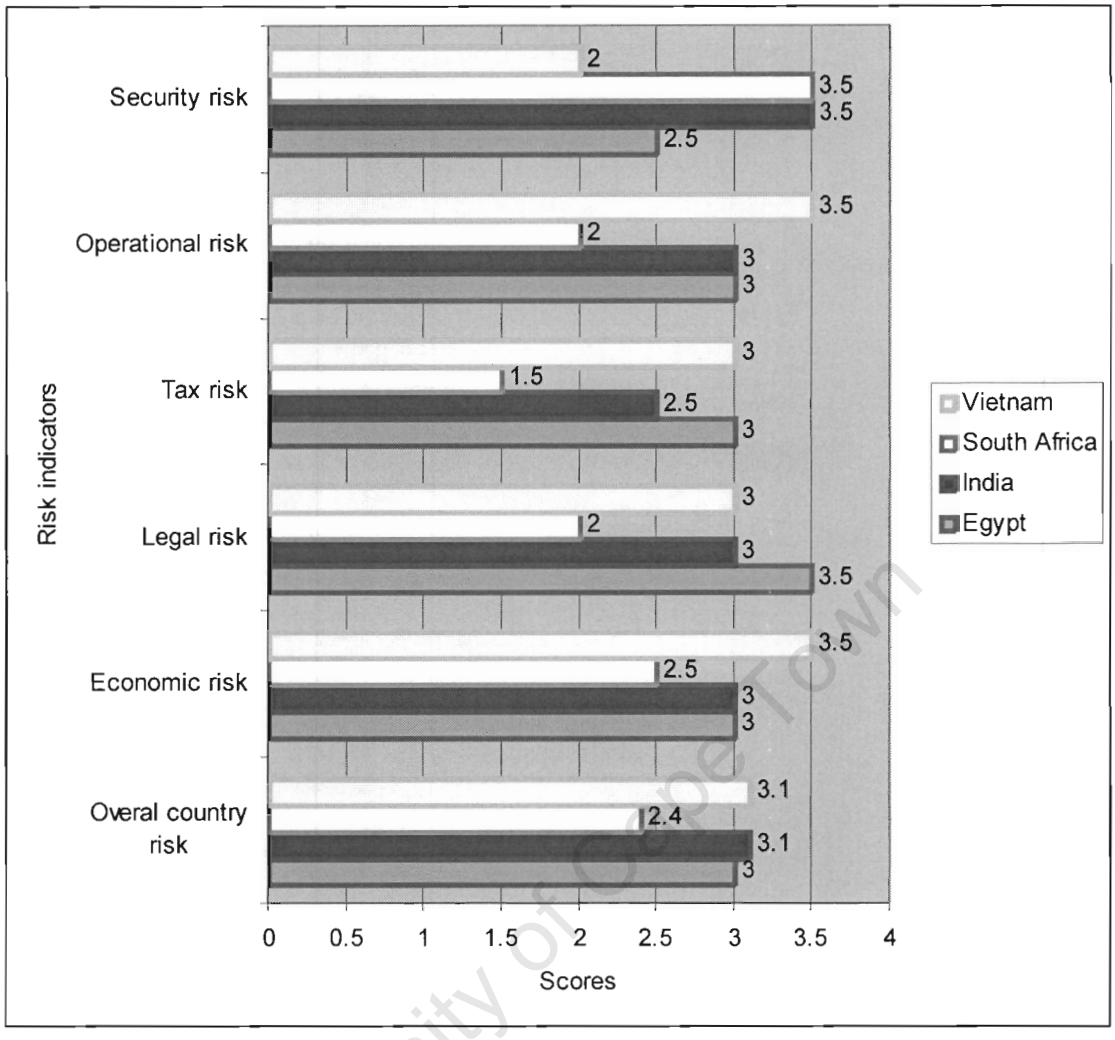
In Section 4.3, the entry strategies used by foreign firms in South Africa for the period 1990 to 2000 are compared. The main objective is to assess how foreign firms used different strategies to enter South African markets (Estrin and Meyer 2004). Section 4.4 compares the performance of firms, which have entered South Africa on the basis of their self-evaluation (Gelb 2003). Section 4.5 examines foreign firms' assessment of the local labour market.

Section 4.6 looks at the impact of FDI on domestic markets by providing foreign firms' views on changes in labour productivity and technology levels in local industry by sector during their first and latest years of business operation in South Africa. The performance of local and foreign firms is compared in the areas of labour productivity, technology intensity and export intensity using econometric and analysis, for selected sectors. Section 4.7 looks at the impact of FDI on Black Economic Empowerment and Section 4.8 concludes the chapter.

4.1 Determinants of FDI

Estrin and Meyer (2004) provide a useful comparison of the constraints on FDI in South Africa and a range of other developing countries. These are shown in Figure 5 below.

Figure 5. Constraints on FDI flows in selected countries, 2002.



Source: Estrin and Meyer (2004)

Note: *Risk ratings, with 1 = little risk and with 3 and above = most risky.*

Figure 5 indicates that although overall country risk is low in South Africa compared to other countries, South Africa is perceived to have a relatively high level of security risk. In terms of economic risk South Africa compares extremely well to the other three countries. This is also true as far as tax and legal risks, and operational risk are concerned. In terms of overall country risk South Africa (2.4) is evaluated as having the least risk compared to Egypt, India and Vietnam (Estrin and Meyer 2004). It should, however, be noted that the selected countries here are not the leading recipients of FDI.

4.2 Determinants of FDI in South Africa

This section looks at some of the factors that determine FDI inflows into South Africa. These include perceptions of political risk, skills shortages and incentives. Social determinants include, for example, the HIV/Aids epidemic and crime. The latter two determinants are the most disturbing given their effect on the South African economy (Akinloye *et al.* 2004).

Gelb and Black (2000) suggest that other important factors may have contributed to the disappointing FDI performance. These are the low domestic savings and investment rates which act as the major binding constraints on economic growth. It is these constraints that must be alleviated by net inflows of capital. There are other factors that may influence foreign firms in their decision whether to invest in South Africa, or not. These include general macroeconomic conditions (economic status), the availability of quality labour, and the confidence of investors in the host markets. A country that has a range of investor-friendly policies is more likely to attract FDI (Gelb 2003).

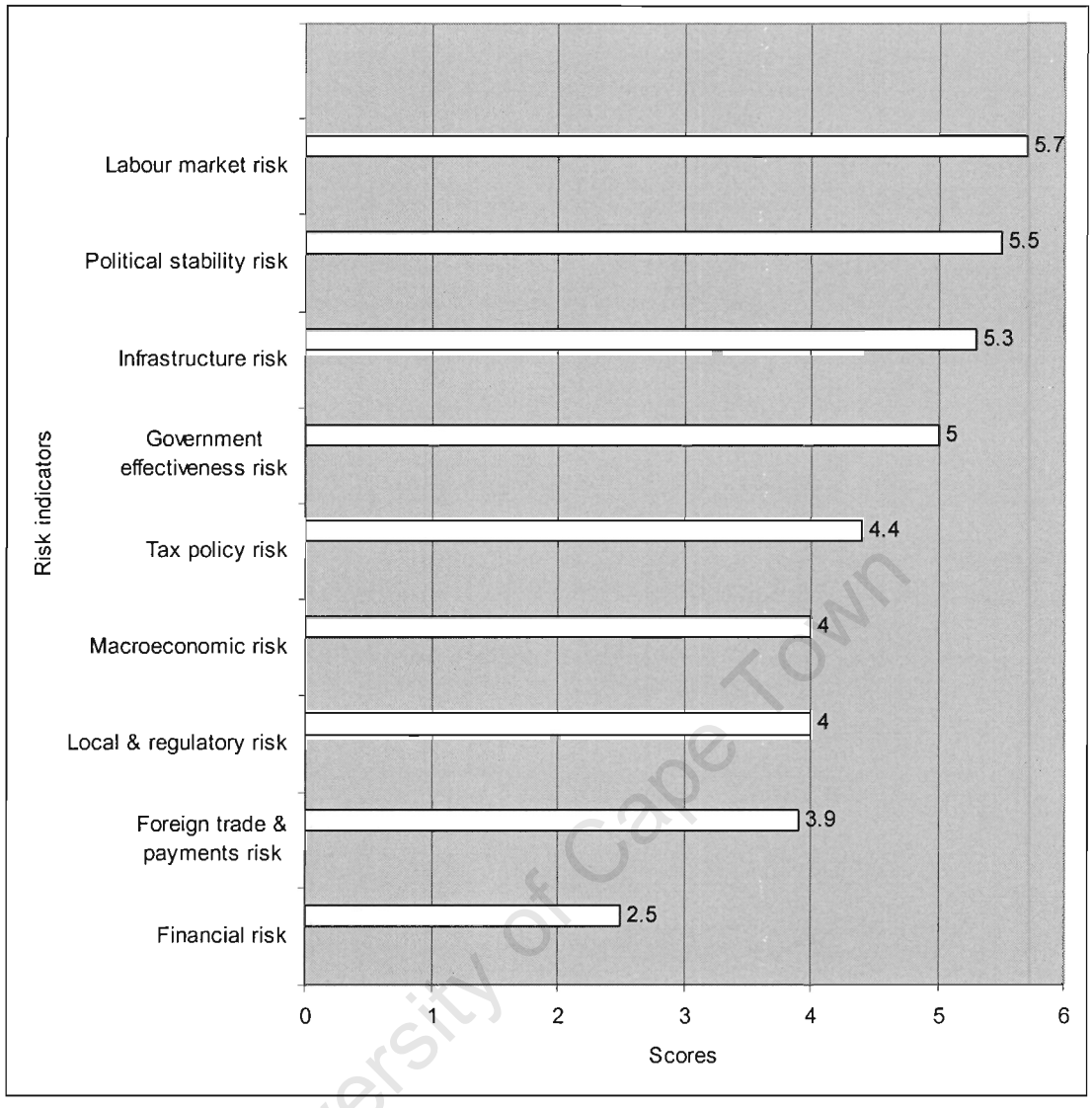
Figure 6 (page 24) highlights the key determinants of FDI flows into South Africa (The Economist Intelligence Unit (EIU) 2003).

a) Labour market risk

Vickers (2002) argues that a socially-acceptable and investor-friendly labour market regime supports skills development and raises productivity, and that agreements negotiated between business, labour and government in sector job summits can provide a more enabling framework for investment.

Referring to Figure 6, interviewees rated the labour market as the area, which they perceived as carrying the most risk (5.7). This could be due to a shortage of skilled workers and that the labour market is fairly tightly regulated; the latter variable has an effect on labour costs, which are generally higher compared to similar lower middle-income countries. Also, relatively poorly paid unskilled workers may lack the motivation to maximise their output.

Figure 6. Constraints on FDI flows into South Africa for 2003.



Source: Economist Intelligence Unit (EIU) (2003)

Note: *Survey conducted by the Centre for Research into Economics and Finance in Southern Africa (CREFSA). Interviewees asked to rate the factors that retard FDI flows into South Africa.*
5.5-6 = most risky, and 0-0.5 = least risky.

South Africa experiences a skills shortage due to the legacy of apartheid in education and health-related factors associated with the HIV/Aids pandemic. The people most affected by these two factors are those who live in the remote rural areas of South Africa (Akinloye *et al.* 2004). Many people have only a few years of formal education and this contributes negatively to the country's economic health. Steps by government to improve the skill levels of the population may increase foreign investors' confidence; they are more likely to seek out business opportunities knowing that the labour market risk is minimized.

In general South Africa's labour market is characterized by an over supply of unskilled, and a shortage of skilled, workers. Population growth exceeds the growth in the demand for labour in the economy. As the South African economy moved away from labour-intensive to capital-intensive operations since 1994, the level and rate of unemployment has increased.

b) Political conditions

Political stability is one of the most important requirements for countries seeking to attract FDI. Investors normally look for stability in the sense that the likelihood of any abrupt regime change is small as is the possibility of protracted political turmoil. The success of South Africa's 1994 election led to a significant increase in investors' confidence in the country's political system (Africa Investor 2004). In a survey conducted by Omega's FDI project, no fewer than 78% of respondents viewed South Africa as having a high level of political stability[4]. Therefore, it appears that political conditions do not impact strongly on FDI in South Africa today.[5] Business infrastructure and the future business potential of the country are also important factors to be considered along with a healthy economy and a stable government (FDI Magazine 2003).

However, there are some clouds on the horizon. Pressure to tackle some of the socio-economic problems, including income inequality, high unemployment, severe skills shortages, the high crime rate, and the deepening HIV/AIDS crisis is expected to mount (EIU 2005).

c) Infrastructure risk

Figure 6 shows that potential foreign investors do not appear to attach a high level of risk to infrastructure (5.3). The EIU (2005) argues that roads are generally well maintained and ports are relatively efficient, although capacity constraints can lead to

[4] A survey conducted by FDI Magazine (2003) showed that the number of members who have increased confidence in the government's ability to improve the local business environment has tripled in the past year.
[5] Fedderke and Room (2004) identify the impact of political conditions on FDI in South Africa.

delays. For example, a major concern is the delay in trans-shipment of goods through ports with Durban, in particular, running up against capacity constraints.

The railway and telephone systems are well developed and the liberalization of telecommunications in South Africa is set to shake-up the country's fixed-line monopolist (Telkom); this may lead to cheaper telephone calls and internet access, thereby lowering business costs. There is a well established network of domestic and international flights and electric power is generally cheap and reliable. South African electricity prices are among the lowest in the world, although, telecommunications prices are relatively high mainly due to a lack of competition.

d) Government effectiveness and tax policy risks

Government effectiveness risk appears to be moderate (5.0) in South Africa. The EIU (2005) argues that leading members of the ruling ANC and civil service are well educated and competent but that the efficiency and effectiveness of lower ranking civil servants is a problem. As a result policies are not usually implemented quickly and efficiently.

Since 1994 the government's taxation policy has aimed at widening the tax base and improving the efficiency of collection. South Africa has a relatively narrow tax base of around six million people, which is less than half the economically active population (EIU 2005). Since 1994, the government has made a concerted effort to reduce taxation rates for both companies and individual tax-payers.

Akinloye *et al.* (2004) argue that South Africa has limited financial incentives to offer foreign investors. The main focus of the South African government is to provide infrastructure in the industrial development zones (IDZs) and to improve transport facilities.

e) Macroeconomic conditions

It is a major concern that South Africa's economy has grown at a relatively slow pace since 1994, although the pace of growth has increased more recently. The

macroeconomic reforms pursued by the South African government have not yet contributed significantly to economic growth and employment creation (Akinloye *et al.* 2004). South Africa's official measure of unemployment rose from 16% in 1995 to 30% in 2002 (Bond 2004). According to some broader definitions of unemployment the unemployment rate could be as high as 43%.

That said there are some aspects of South Africa's current macroeconomic conditions that can be viewed in a positive light. Since 1994 South Africa has achieved a level of macroeconomic stability not previously achieved since the 1960s. Bond (2004) points out that after the massive investment outflows of the 1980s and early 1990s the country has had positive levels of foreign direct investment over the first ten years of democracy.

f) Black economic empowerment (BEE)

The Namibia Economist (2002) provides narrow and broad definitions of BEE. In a narrow sense it refers to the transfer of ownership. In the broader sense it refers to a range of measures to redress past imbalances and enable a broader and more meaningful participation in the country's economy by black people. Trade and Industry Minister, Mandisi Mpahlwa, confirms that the draft of the code of good practice includes provisions for employment equity, skills development, preferential procurement, small, medium and micro-enterprises, enterprise development and corporate social investment (Ensor 2005).

BEE is one of the key areas for economic development since it is an important instrument for economic growth and poverty alleviation in South Africa. The government's approach to BEE is that all the people of South Africa should be included. History has taught us that no economy can grow by excluding some of its people, and hence BEE should be driven by considering the role that the previously advantaged can also play in fostering economic development. BEE should be driven with the purpose of ensuring "black-owned businesses" but also it should form a link with other people to retain experience, expertise and knowledge of the original racially advantaged owner (The Namibia Economist 2002). The government should

initiate an inclusive process so that BEE is viewed in a more unifying light by foreign investors; this may be expected to boost their confidence in South Africa.

However, Akinloye *et al.* (2004) argue that big organizations believe that the BEE initiative is costly to the economy and that this reduces its competitiveness compared to its rivals. They further note that some of South Africa's large corporations moved their listings to the London and New York Stock exchanges. They may have been pressurized by their shareholders who demanded the diversification of South African asset holdings into non-South African assets. Fears about the effects of BEE may have encouraged human capital outflows and limited the extent of FDI.

h) Crime levels

Table 5. Murder rates per 100 000 inhabitants in selected countries for the period 1998 to 2002

Country	1998	1999	2000	2001	2002
Chile	1.52	1.60	1.55	na	na
Egypt	0.40	0.40	na	na	na
Germany	1.19	1.00	1.17	1.05	1.11
India	3.12	2.97	na	na	na
Japan	0.57	0.53	0.50	0.53	0.59
Saudi Arabia	0.47	0.85	0.51	0.87	0.92
South Africa	60.08	56.59	51.39	47.77	47.53
United States	5.19	4.55	na	5.62	5.62

Source: United Nations (2003)

Note: *All crimes are recorded as intentional homicide.*

High crime levels deter foreign investors from coming into South Africa. Violent crime is a particular problem and Akinloye *et al.* (2004) note that South Africa's murder rates are exceptionally high (Table 5). In 1998, South Africa's murder rate was 11.6 times greater than that of the United States, the country with the next highest

murder rate. Although South Africa's murder rate had fallen to 47.5 per 100 000 people by 2002 it was still 8.5 times greater than that of the United States.

i) Business environment

Investors look for a business environment that will enable them to run their businesses profitably. Gelb and Black (2004) find that South Africa is perceived by managers of foreign affiliates to provide a better business environment compared to certain other African and developing countries in terms of the six indicators reported: quality of raw materials and machinery; the availability of real-estate; the quality of professionals; the reliability of the information technology and telecommunications network; and finally, the reliability of utilities such as electricity.

Regarding the regulatory environment for FDI, they find that managers of foreign affiliates perceive the policy environment to be more predictable. The foreign investor normally considers competition, taxation policies, labour legislation as well as company structures.

j) Mineral resources

South Africa is one of the world's leading exporters of gold, platinum and diamonds. Other important minerals include copper, coal, iron and manganese. Akinloye *et al.* (2004), state that the value added processing of minerals to produce stainless steel and ferroalloys is a major industry and an important growth area in South Africa's economy.

k) Bilateral investment treaties

South Africa has signed many bilateral investment treaties (BITS) with other African countries. These BITS provide clarity on the terms under which FDI can take place between trading partners and contribute towards the creation of a secure environment for foreign investors in the African continent. South Africa, Egypt, Mauritius and Tunisia have signed double taxation treaties (Akinloye *et al.* 2004). South Africa is

the leading country in this regard. However, the lack of a free trade area in Southern Africa remains the main obstacle to an increase in FDI flows between these countries.

It would be better if those African countries (who trade with each other) entered into a Multilateral Investment Agreement, which would bind all of them. Such an agreement would encourage investment and could be to the advantage of South African firms; it is these firms that have the financial capacity and the human resources to profit from the investment made in other African countries.

l) The annual rate of return on investment

Since 1994, the annual rate of return on investment in South Africa has been increasing. Akinloye *et al.* (2004) note that in 1996 the annual rate of return on investment in South Africa was 19%, compared to 14% in Latin America, 13% in Asia and 9% in Europe.

4.3 Strategies used to gain entry into South Africa

This section focuses on the strategies used by foreign firms to gain entry into South Africa. These consist of greenfield investments, joint ventures, acquisitions and partial acquisitions. Greenfield investments occur when the foreign firm establishes and fully owns a new plant in the host country. This is also known as a start-up. Joint ventures occur when two or more businesses join together under a contractual agreement to conduct a specific business enterprise with both parties sharing profits and losses. Partial and full acquisitions refer to buying some part of, or the full stock in an already existing firm so as to gain control of the company (Estrin and Meyer 2004).

Table 6. Establishment of affiliates by mode of entry into South Africa between 1990 and 2000

	Number of Foreign Parent firms	%
Greenfield	49	30
Joint Venture	39	24
Acquisitions	50	31
Partial Acquisitions	24	15
Total	162	100

Source: EDGE Institute database (Gelb 2003)

Table 6 identifies which of the four modes of entry best describes how the affiliate was originally established in South Africa between 1990 and 2000. Estrin and Meyer (2004) argue that acquisition is the most significant mode in developed countries, while it is less common in developing countries. However Table 6 shows that acquisitions (31%) together with greenfield investments (30%) are the dominant modes of entry in South Africa. This suggests that South Africa has a more developed network of incumbent firms and a more developed market which facilitates entry by acquisition. Gelb (2003) argues that a relatively high proportion of investors interested in South Africa see the country's asset base and structure as broadly similar to what they are familiar with.

4.4 Performance of foreign firms in South Africa

This section examines whether the performance of the South African affiliate has fulfilled the investor's original objectives. In Table 7 below the self-evaluations by companies of their performance in South Africa for the period 1990 to 2000 are presented. Performances in terms of productivity, profitability and growth in revenue of the subsidiary are ranked on Likert-scale from 1 to 5. It is noted that the firms that were relatively successful are more likely to be ones to have responded to the questionnaire.

Table 7. Foreign firm performance in South Africa

Variables	Not at all	A little	Partially	Mostly	Fulfilled all Expectations	Total firms
Productivity	3 (2)	8 (5)	41 (26)	68 (43)	38 (24)	157 (100)
Profitability	13 (8)	22 (14)	42 (26)	43 (27)	41 (25)	162 (100)
Revenue	6 (4)	11 (7)	47 (29)	49 (30)	49 (30)	162 (100)

Source: The EDGE Institute database (Gelb 2003)

Note: *The figures in parenthesis represent percentages. Responses to the survey question asking whether the performance of the affiliate fulfilled the investor's original objectives.*

Table 7 shows whether, or not, the expectations of foreign firms were met in terms of "not at all", "a little", "partially", "mostly" and "fulfilled all expectations" in productivity, profitability and revenue growth. 67% of firms feel that their expectations regarding productivity were "mostly" or "fully" achieved. 52% of firms "mostly" or "fully achieved" their expectations regarding profitability and 60% achieved their expectations regarding revenue. This shows that a clear majority of the firms "mostly" or "fully" achieved their expectations on these three key variables.

It remains to note that expectations were hardly met in terms of profitability for nearly one quarter of the firms (22%). This result may suggest that firms have struggled to adapt to the South African business environment.

4.5 Assessment of South Africa's labour market

Table 8 (page 33) shows foreign investors' assessment of different segments of the labour market in South Africa; executives, professionals, operational management and skilled non-management. Investors were asked to assess the local labour market in 2000 using a Likert scale.

For example, 57% of firms found executives to be "mostly" or "readily" available. The figure for professionals is 80%, for operational management (59%), and for skilled non-management (71%). Only 10% of firms reported that operational management and skilled non-management labour is "never" or "rarely" available. These are interesting findings given that there is the perception that South Africa suffers from a shortage of skilled labour. Gelb and Black (2004) suggest that the

higher the level of the required qualification the more difficult it is for firms to find and to recruit suitable local staff.

Table 8. Assessment of South Africa's labour market in 2000

Variables	never available	rarely available	sometimes available	mostly available	readily available	Total firms
Executives	8 (5)	22 (14)	39 (24)	58 (36)	34 (21)	160 (100)
Professionals	N/A	6 (4)	26 (16)	73 (45)	56(35)	161 (100)
Operational management	1 (1)	14 (9)	49 (31)	53 (33)	42(26)	159 (100)
Skilled non-management	2 (1)	15 (9)	30 (19)	43 (27)	71(44)	161 (100)

Source: EDGE Institute database (Gelb 2003)

Note: *The figures in parenthesis refer to percentages.*

4.6 Impact on economic development in South Africa

Table 9. Improvement and deterioration in domestic firms' technology level and labour productivity by sector (1990 and 2000)

	Technology			Labour		
Sectors	**1990**	**2000**	**Mean Difference**	**1990**	**2000**	**Mean Difference**
Automotive parts	2.0	2.0	0.0	4.0	4.0	0.0
Pharmaceuticals	3.0	1.0	-2.0	3.0	2.0	-1.0
Telecoms	1.0	3.0	2.0	1.0	3.0	2.0
IT	1.0	3.0	2.0	2.0	3.0	1.0
Food & beverages	2.0	3.0	-1.0	3.0	3.0	0.0
Electronics	3.0	2.0	-1.0	4.4	4.0	0.0

Source: The EDGE Institute database (Gelb 2003)

Note: *On the 5-point Likert scale, 1 means the local industry was or is much worse than the affiliate, while 5 means that the local industry was or is better than the affiliate.*

This section looks at the impact of foreign firms on South Africa's economic development. Foreign firms impact upon domestic welfare and growth in broad areas such as capital markets and finance, labour markets and employment, and domestic goods markets (Gelb and Black 2004).

The data presented in Table 9 (page 33) is based on foreign affiliates' views of labour productivity and the level of technology in local firms during their market presence. Firms responded as to whether the domestic firms have improved, or deteriorated, in terms of labour productivity and the level of technology, in their respective sectors, for the first year (1990) and the latest year (2000) of operations. Technology level includes machinery and equipment, training methods, research and development (R&D), and the quality control systems. Table 9 identifies the local sectors, which managed to show the greatest improvement in terms of labour productivity and the level of technology by comparing the measures for both variables between 1990 and 2000.

Regarding technology, foreign firms view the sectors, pharmaceuticals and electronics as having deteriorated relative to the affiliates during the period 1990 to 2000. However, the domestic IT, telecoms and food & beverages sectors are perceived as having improved relative to the foreign affiliates. This provides some support for the existence of spillovers from foreign to domestic firms (Gelb 2002).

As far as labour productivity is concerned, the domestic sectors perceived as showing the greatest improvement are again IT and telecoms. It is noted that the pharmaceuticals sector is perceived as experiencing a decline in labour productivity and level of technology relative to foreign affiliates.

The main purpose of the following section is to identify the sectors in which foreign firms enjoy an advantage in terms of labour productivity, technology intensity and export performance compared to domestic firms. Econometric results are presented (Table 10) showing the statistically significant differences in labour productivity, technology intensity and export performance in each selected sector for the year 2000. These variables are important for examining the quality of human capital in South Africa. The export intensity data is derived by dividing the amount of exports by the output of a foreign firm in South Africa in 2000.

Table 10 shows that labour productivity differences for foreign firms compared to domestic firms are statistically significant for the pharmaceuticals sector only. Foreign firms are estimated to enjoy a higher labour productivity level compared to domestic

firms. The overall technology intensity is considered to be greater for foreign firms in the pharmaceuticals and IT sectors compared to domestic firms. Domestic firms have a greater level of export performance in the automotive parts and telecoms sectors.

Table 10. Two-tailed t-tests of labour productivity, technology intensity and export performance in South Africa for 2000

	Sectors	Foreign firm (mean coefficient)	Local firm (mean coefficient)	t-tests
Labour productivity	Automotive parts	15.6	13.1	1.02
	Pharmaceuticals	14.4	12.6	1.71*
	Telecoms	13.2	12.7	0.72
	IT	13.7	11.5	0.50
	Food & beverages	13.5	13.4	0.40
	Electronics	14.5	13.0	0.48
Technology intensity	Automotive parts	1.4	1.6	-1.42
	Pharmaceuticals	1.4	1.1	2.42***
	Telecoms	1.7	1.6	1.41
	IT	1.8	1.5	1.52
	Food & beverages	1.5	1.6	-0.34
	Electronics	1.6	1.3	1.00
Export performance	Automotive parts	0.1	0.2	-2.33***
	Pharmaceuticals	0.1	0.0	1.23
	Telecoms	0.5	0.7	-1.92*
	IT	0.4	0.5	-0.42
	Food & beverages	0.4	0.2	1.27
	Electronics	0.1	0.2	0.98

Source: The EDGE Institute database (Gelb 2003)

Note: *(*) refers to 10%, and (***) to 1% levels of significance, respectively. The negative signs for the t-tests are ignored by taking the absolute value terms*

In summary, the statistically significant findings suggest that foreign affiliates appear to outperform the domestic firms in the pharmaceuticals sector for both labour productivity and technological intensity. However, in terms of export performance the domestic sectors, automotive parts and telecoms outperform the foreign affiliates.

We now turn to an evaluation of the relationship between the variables, labour productivity, technology intensity, export intensity and skills intensity. Firm size is also included as an independent variable. The measure, skills intensity, is derived by

dividing the number of managers, professionals and executives by the total number of workers employed by foreign affiliates in 2000. The regressions were run using the ownership samples.

Table 11. Statistical relationships involving labour productivity, technology, export and skills intensities, and firm size in South Africa in 2000.

	Labour productivity		Technology intensity		Export intensity		Skills intensity	
Intensities/ variables	Foreign	Local	Foreign	Local	Foreign	Local	Foreign	Local
Export intensity	-0.25	-1.15	0.13	0.46			0.05	-0.14
	(-0.64)	(-0.45)	(0.32)	(1.53)			(0.80)	(-1.43)
Technology intensity	6.78	8.07			0.02	0.01	0.05	0.35
	(2.6)**	(4.6)***			(0.56)	(0.14)	(1.65)	(2.48)**
Skills intensity			0.44	2.35				
			(1.44)	(4.89)***				
Firm size	-11.67	-1.62	-0.31	-1.15	-0.07	0.15	0.01	0.12
	(-3.27)***	(-0.22)	(-2.21)*	(-3.70)***	(-0.67)	(1.16)	(0.20)	(2.12)*
No. of firms	109	53	109	53	109	53	109	53
F-stat	3.66***	26.7***	35.36***	41.48***	10.30**	37.45***	16.60*	75.67***

Source: The EDGE Institute database (Gelb 2003)

Note: *(*), (**) and (***) refer to 10%, 5% and 1% levels of significance, respectively. Figures in parenthesis represent t-stats. Degrees of freedom (DF) = 8. The dependent variables are recorded by column.*

Technology intensity is statistically significant in determining labour productivity for both foreign and domestic firms. This shows a strong link between technology and labour productivity in both types of firm. Interestingly, there is an inverse relationship between firm size and labour productivity for foreign firms only. This suggests that smaller firms are more productive than larger firms. This statistically significant inverse relationship also holds for the relationship between firm size and technology intensity. However, the relationship between firm size and skills intensity is a positive one for domestic firms only. Finally, technology intensity impacts strongly on skills intensity for domestic firms; the coefficient is statistically significant at the 5% level.

In summary, technology intensity impacts strongly on labour productivity and skills intensity, with the coefficient being larger for local firms. However, the impact of technology intensity on export intensity is statistically insignificant for both local and

foreign firms. This latter finding is likely to be a consequence of the export focus on inferior regional markets (Gelb 2003).

4.7 FDI and black economic empowerment (BEE)

As a result of apartheid, the levels of black ownership in the economy were minimal and many people from previously disadvantaged backgrounds never had the opportunity to acquire the skills necessary to act as managers and professionals. This section looks at the contribution of FDI to BEE in South Africa at the time of entry (1990) and the most recent financial year (2000). Firstly, Table 12 identifies the number of firms with more than 10% black ownership. Secondly, it shows the number of firms where the number of jobs filled by people from historically disadvantaged backgrounds exceeds 10%.

Table 12. Black Economic Empowerment

	No of firms with BEE	Total firms	Percentage of firms with BEE	No of firms with BEE	Total firms	Percentage of firms with BEE)
Employee categories	**1990**	**1990**	**1990**	**2000**	**2000**	**2000**
BEE ownership	11	162	7	19	162	12
Executive management	28	161	17	74	161	46
Professionals	41	161	26	84	161	52
Operational management	74	161	46	132	161	82
Skilled non-managerial labour	112	160	70	148	160	93

Source: The EDGE Institute database (Gelb 2003)

In 1990, only 7% of the affiliates in South Africa had BEE ownership exceeding 10% of equity. In 2000 the proportion had increased to 12%. In all categories of employment there has been an increase in the number and proportion of firms, which have filled more than 10% of their jobs with people from previously disadvantaged backgrounds. The most marked increase, in percentage terms, is for the category, executive management. Perhaps, unsurprisingly, the percentage increases as the level of skills demanded by the job decrease.

4.8 Conclusion

This chapter has given us a picture of how South Africa has managed to attract FDI and the performance of foreign firms and their affiliates in South Africa.

Security risk is a concern in South Africa from the perspective of foreign firms. The main contributor to this is crime as evidenced by exceptionally high rates of violent crime. The political environment also plays an important role in determining FDI. While improved political conditions and property rights have helped to increase the attractiveness of South Africa as a destination for foreign investors, perceptions of political risk remain fairly high.

Surveys indicate a fairly high level of perceived labour market risk, primarily due to shortage of skilled labour. Interestingly, foreign firms in South Africa appear to be doing relatively well in terms of productivity, profitability and revenue performance. It appears that FDI has had a positive impact on South Africa's economic development. The relatively strong technology intensities for local firms in the automotive parts, electronics and food & beverages sectors suggests that local firms are learning from foreign firms.

Domestic firms appear to outperform the foreign affiliates in the automotive parts sector for labour productivity, technology intensity and export performance whilst the reverse is true for the pharmaceutical sector. The domestic IT and telecoms sectors are reckoned to have improved relative to the foreign affiliates in the use of technology. These two domestic sectors are also perceived as showing the strongest performance in labour productivity. BEE on the part of foreign firms has contributed to increasing the skill levels of black South Africans. Also, at all levels of employment foreign affiliates have increased the proportion of black people that they employ.

However, although South Africa looks like a good place for both foreign and local firms to learn, and to compete with one another, the government of South Africa has still to resolve the problems of poverty, and the unequal distribution of income, in the country.

CHAPTER FIVE

CONCLUSION AND POLICY RECOMMENDATIONS

The study has analyzed FDI flows into South Africa through studying the entry of new firms and their contribution to economic growth, exports, skills development and employment. The focus has been on FDI trends, sources of FDI and the identification of the key determinants that may affect FDI inflows into South Africa. Foreign and local firms' performance in the South African economy is compared using data from various sources.

Chapter One sketches the outline of the paper and offers a general definition of FDI and details the objectives of the study. Chapter Two develops the theoretical background to the proposed research questions; this is done by undertaking a review of the literature on FDI in developing countries. This review covers the determinants of FDI, and the impact of FDI on economic growth, employment and labour productivity. The main conclusion derived from the literature review is that the FDI impacts are positive and FDI should be encouraged and restrictions on inward investment should be removed; this will increase the level of competition within the economy and encourage economic growth, employment and skills development. The implication is that growth can be boosted through the encouragement of new advanced foreign technology and an educated quality labour force.

Chapter Three provides an overview of FDI flows into selected countries in the world, Africa and South Africa. FDI flows into South Africa are compared with flows into Africa and the rest of the world. Most FDI into South Africa comes from countries such as the US, the UK and Germany as they have, traditionally, had strong ties with South Africa. FDI flows into South Africa compare favorably with other countries in Africa as is to be expected given its relative size, but South Africa does not compare very favorably to many other developing countries of similar economic size. The chapter concludes by noting that further policy measures are required to attract more FDI into South Africa in the future.

Chapter Four analyzes FDI in South Africa. The determinants of FDI are first examined. South Africa is rated as less risky compared to selected emerging economies although the high level of crime remains a cause of concern. Another important determinant of FDI is the shortage of skilled labour in South Africa. This remains a challenge as most of the South African population does not have access to the education necessary to equip themselves with the required skills. It is suggested that South Africa still needs to improve the quality of its labour force. This is followed by identifying the strategies used by foreign firms to gain entry into South African markets. The data suggests that acquisitions and greenfields are the most important modes of entry into South Africa.

The self-evaluation of foreign firms' performance in terms of productivity, profitability and revenue growth in South Africa is then considered. Firms met their overall expectations in terms of revenue growth, and productivity, while they partially met them regarding profitability. In general, foreign firms claim that they are able to meet a significant proportion of their requirement for the various categories of skilled labour.

The impact of FDI on South Africa's economic development is also analyzed in this Chapter. The performance of domestic and foreign firms, in terms of labour productivity and technology, is compared in 1990 and 2000. Regarding technology foreign firms view the sectors, pharmaceuticals, food & beverages and electronics as having deteriorated relative to the affiliates during the period 1990 to 2000. However, the domestic IT and telecoms sectors are perceived as having improved relative to the foreign affiliates. This shows that foreign investors have been gaining confidence in these two sectors in South Africa and that the new technology and quality training that they brought into South Africa is paying dividends. As far as labour productivity is concerned the domestic sectors perceived as showing the strongest performance are IT and telecoms. However, the pharmaceuticals sector is perceived as experiencing an overall decline in labour productivity. The level of labour market risk may have a negative impact on the South Africa's pharmaceuticals sector.

The econometric analysis suggests that foreign firms enjoyed a higher level of labour productivity compared to domestic firms in South Africa. Most importantly, the

domestic firms appear to outperform foreign affiliates in the automotive parts sector regarding technology intensity, while in the pharmaceuticals sector, foreign firms have greater export performance and productivity levels. Foreign firms enjoy a higher level of export intensity in the pharmaceuticals and food & beverages sectors while local firms have a higher level of export performance in the automotive parts and telecoms sectors. However, the importance of technology is noticed, since it impacts strongly on labour productivity and skills intensity for local firms, while it impacts negatively on export intensity for both local and foreign firms.

FDI is also shown to have a positive impact on skills and employment of the historically disadvantaged black people in South Africa. It is noted that one of the legacies of apartheid is that many people from previously disadvantaged backgrounds never had the opportunity to acquire the skills necessary to act as managers and professionals.

Well-intentioned policies, strategies and initiatives are in place to attract a high level of FDI into South Africa. These policies include an improved environment, for example, trade liberalization, improved legal, support and governance institutions, better transport and telecommunications all designed to make it easier for foreign firms to do business in South Africa. Other policies include a stronger FDI regulatory framework. South Africa offers tax incentives and allows profits to be repatriated freely to foreign investors. Also, they are assisted through the investment promotion agencies. Lastly, privatization has also encouraged a certain amount of foreign investment. For example, Telekom Malaysia, together with SBC Communications from the United States, has invested about US$1.2 billion in Telkom South Africa.

By assessing the factors influencing FDI in South Africa and the extent to which FDI contributes to new employment and skills transfer the study seeks to shed light on the appropriate policies to pursue in order to encourage more FDI inflows into the country, and their likely implications for economic development.

The macroeconomic policy environment is an important determinant of foreign direct investment in South Africa. In its current state the economy should be attractive to potential investors. Although South Africa is relatively well-developed and has an

investor-friendly macroeconomic policy framework it has attracted considerably less FDI than other comparable developing countries.

South Africa is operating with a serious resource constraint of skills due to the legacy of apartheid in education in the 1980's and current HIV/AIDS pandemic. The latter is a crucial issue and the government should play a major role in offering education (at minimum cost) to all South Africans about the pandemic.

Importantly, the government should make every effort to reduce South Africa's relatively high crime rate. Also, the government needs to weigh up the benefits of crime reduction and the attraction of potential investors against the costs of creating perceived impediments to FDI inflows, which normally reduce the ability of the country to compete with other developing countries for FDI.

Most importantly, business confidence and market sentiment are highly sensitive to regulatory uncertainty. It is clear that the implementation of BEE in South Africa has not been adequately and effectively communicated to investors. Government should change the approach by making BEE accessible to every South African citizen; such a step should boost investors' confidence.

Alternatively, a coordinated body can be created that will be responsible for all aspects of the law that have important implications for MNC investors. Through such a coordinating body all parties involved in specific aspects of law and policy relating to MNCs will be able to stay abreast of what is going on in the public domain, which may affect their decisions.

The government of South Africa needs to implement effective policy measures to improve the current situation by addressing the problems identified by foreign investors to make South Africa more attractive for FDI, and so encourage increased domestic investment. Also, the government should pursue a policy involving a stable and predictable political discourse and continue to develop a macroeconomic environment conducive to FDI. In addition the focus of government should be on improving the quality of education received by the country's citizens, developing the country's infrastructure, and continuing to implement favorable trade policies.

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