

Foreign Direct Investment in Southern Africa

Characteristics of Foreign Enterprises and Some Implications for Economic Growth and Poverty Alleviation

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TRENDS IN FDI TO SOUTHERN AFRICA

Southern Africa attracts less than 3 percent of total FDI to developing countries....

Foreign direct investment, percent of flows to low & middle income countries					
	1995	1996	1997	1998	1999
East Asia & Pacific	49.7	46.4	38.0	35.8	30.2
Europe & Central Asia	15.8	12.2	13.6	14.1	14.3
Latin America & Caribbean	27.8	33.0	37.7	40.8	48.7
Sub-Saharan Africa	4.3	4.0	4.8	3.6	4.3
SADC	2.6	1.6	3.1	1.9	2.7
Source: World Development Indicators, 2001 CDRUM, World Bank					

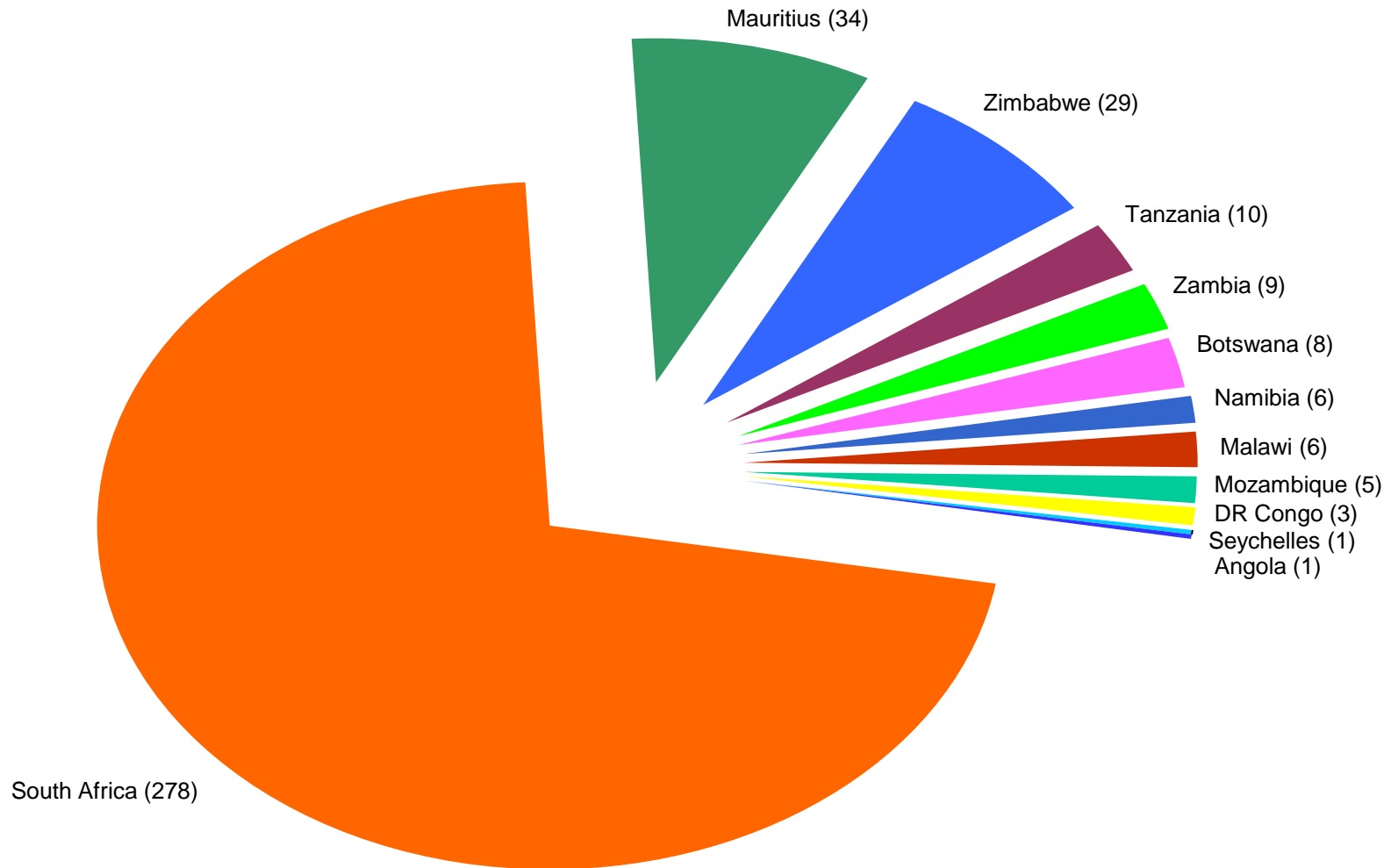
For some countries in SADC, FDI inflows have been large relative to GDP but this is often due to a small number of large projects

e.g. Angola 29% (1999)
Lesotho 19% (1999)
Seychelles 11% (1999)

South Africa and Angola attract most of the FDI in SADC....

Foreign direct investment: net inflows, in US\$mns (nominal)					
	1995	1996	1997	1998	1999
All SADC	2,735	2,040	5,363	3,409	5,039
Angola	472	181	412	1,114	2,471
South Africa	1,248	816	3,811	550	1,376

South Africa hosts the largest number of subsidiaries of the top multinational companies...



Refers to most significant subsidiaries and affiliates of the top 450 multinational companies; minor subsidiaries are excluded.

Companies identified from *Directory of Multinationals: The World's Largest Global Enterprises*, 6th edition, Caritas Data Ltd 2001

SURVEY OF EUROPEAN FIRMS INVESTING IN SADC

Key issues explored:

- Motivations for investment
- Market orientation of subsidiaries (local, regional, rest of world)
- Mode of entry (greenfield versus acquisition)
- Ownership structure
- Employment (local and expatriate)
- Past five years: expansion versus contraction & effects on employment
- Next five years: plans for the enterprise
- Impact of trade and foreign exchange arrangements; tax and investment incentives
- Perceptions of risk

Continued....

- Survey conducted by interview with senior executives in parent firms
- Majority of firms based in the UK, Germany and Switzerland
- Small number of surveys conducted by email
- Sample of 81 investment projects across SADC, with a broad mix of sector, size and age.
- Small sample relative to population:
 - anecdotal and specific features of firms can be analysed in more detail;
 - informed and consistent approach to interviews can be adopted;
 - less confidence about econometric results

Motivations for investment

Table 4.5: Motivation for location within Southern Africa, percentage of sample

	All sample
Local market size	67.6
Availability of natural resources/raw materials	32.1
Historical/personal links with Africa	21.0
Strategic reasons	17.3
Privatisation/public-private partnerships	14.9

Note: Shares sum to more than 100 because interviewees frequently identified more than one reason.

- Market seeking is the primary reason for investment in Southern Africa
- South Africa is seen as a natural base for expanding into the region, pivotal to regional production and trade: the main location-specific reasons for this are superior infrastructure, physical & financial, and the size of the economy.
- Firms with historical links are more likely to remain in times of uncertainty, even though new firms might be deterred from entry.

Markets supplied (1)

Table 4.4: Destination of output: local, regional and world markets, percentage of sample

	All sample	Local market suppliers
Local market	80.2	100
Regional market	35.8	44.6
Rest of world	30.9	13.8

Note: In the second column, shares sum to more than 100 percent, because firms supply a combination of markets. This is reflected in the third column which shows, of the firms supplying local markets, the percentage which also supply regional and/or rest of world markets.

- The majority of firms supply the local market. For some investors, the “local” market is perceived to be the entire region, particularly when the host country’s market is too small to support the enterprise.
- Of the firms supplying markets in the rest of the world, most are primary sector producers, especially mining, where a global rather than local focus is expected.
- There is not much evidence of a shift in markets served.

Continued....

Markets supplied (2)

- Of the non-primary sector enterprises producing for the world market, all are located in South Africa. These firms have built on a presence in the local market to create export capacity over time.
- The small number of enterprises expanding into export markets are all located in South Africa. The shift in South Africa has followed trade liberalisation from 1994.
- In other countries, enterprises currently serving the local market are not developing export capacity.

Regional concentration of FDI

- Regional integration should help to attract greater levels of FDI into SADC by creating larger markets
- But concentration of FDI in South Africa may take place. If concentration occurs, the potential growth and welfare benefits for other SADC members could be limited
- Compensatory mechanisms - but not compensatory payments - to distribute the economic gains from regional integration may help to address this

Recent and planned changes

Table 4.6: Recent and planned changes in investment enterprises, percentage of sample

	Past five years	Plans for next five years
Expansion	48.7	54.3
Contraction	7.9	9.9
New project	13.0	0.0
No significant change	28.9	30.9

- Half of firms interviewed increased the scale of existing operations in the last five years, and just over half were planning expansion in the next five.
- Downsizing tends to be associated with rationalisation and restructuring, although there has also been some disinvestment. Reasons for expected contraction vary and are often associated with country-specific factors, i.e., the firms expecting to contract were all located in Zimbabwe.

Changes in employment

Table 4.7: Changes in employment in the past five years, percentage of sample

	All sample
Increased employment	26.6
Decreased employment	34.9
No significant change	36.5
Expatriates wholly or partly replaced by local labour	33.2
<i>Memo item: % employing expatriates in past 5 years</i>	68.3

- Of the firms that have expanded the scale of operations in the past five years, less than half have increased employment. Many cases of expansion have involved upgraded technology and productivity improvements. Some enterprises have expanded while simultaneously reducing employment.
- There is evidence that expatriate labour is being replaced by local staff. The proportion of expatriates employed tends to be very small but the majority of enterprises in the sample have employed at least one expatriate in the past five years.

Enterprise growth and employment

- In terms of employment creation, the welfare effects of the sample of firms are limited but not insignificant
- Enterprise expansion does not always translate into more direct employment opportunities
- A large proportion of expanding firms are in the service sector, where lower rates of employment are evident
- A significant number of expanding manufacturing enterprises have expanded productive capacity without increasing employment
- The reasonably rapid rate of localisation of managerial positions suggests that skill transfer is taking place

Method of entry into host economy

Table 4.2: Method of entry into host economy, percentage of sample

	All sample	Infant enterprises
Greenfield investment	50.0	44.1
Acquisition	36.8	50.0
Greenfield and acquisition	10.4	5.9

Note: The “all sample” category does not sum to 100 because it includes sales bases which are not described as greenfield investments or acquisitions.

- Half of the full sample are greenfield investments. We find that these investments are more likely to be in the service sector and to be wholly owned by the parent firm.
- Acquisitions are marginally more likely to be undertaken with local partners, and have tended to occur in the primary sector.
- There is some indication of an increase in the proportion of acquisitions in the last five years, in line with world trends. But the shift is small and may be a temporary result of privatisation.

Ownership structures of FDI enterprises

Table 4.3: Ownership structures, percentage of sample

	All sample
Wholly-owned	50.0
Part-owned	50.0
<i>Majority</i>	38.2
<i>Minority</i>	11.8

- Ownership reflects the internal preferences of parent companies with respect to control of subsidiaries - such as the perceived need to maintain integrity of the company brand or control of the management of global supply chains - rather than factors peculiar to the host economy.
- Foreign firms tend to prefer to hold majority control in joint ownership arrangements with local partners.
- Part ownership is sometimes a result of government procurement policies. Some interviewees argue that this constraint can deter FDI. There are also commercial reasons for joint ownership with local partners: the perceived advantage of local knowledge of markets and importance of local identity.

Method of entry and local ownership

- There is no unambiguous evidence regarding the relative welfare impacts of greenfield investment versus acquisition in the longer term.
- Recently acquired enterprises show some capacity for maintaining or expanding employment but this finding is suggestive rather than conclusive.
- Joint ownership is found to be more common in cases of acquisition, suggesting a diffusion of human capital as well as profits
- But rapid localisation of management positions appears to be less common in acquired enterprises compared to greenfield investments

Economic policy issues

- Foreign exchange issues are regarded as a negative factor by just over half the sample - either instability of exchange rates or a lack of access to foreign exchange.
- Tax regimes are generally viewed negatively although do not emerge as a significant constraint to investment.
- Investment incentives are found to have very little influence on investment decisions.
- Trade barriers are generally not a problem for the majority of the sample. Within SADC, non-tariff barriers are more significant.

Sources of country risk

- Two common risk factors emerge from the survey: unstable exchange rates and regulatory uncertainty.
- But investors appear to be informed about the risks faced in particular countries and draw distinctions between the investment climates and economic stability of different countries in the region.
- Existing investors are more likely to be informed than potential investors. The “Africa perception” problem is seen as a significant barrier to attracting new firms into the region
- If the “Africa perception” is translated into an “Africa premium” in benchmark rates of return for investment projects, does this in part explain why observed returns to FDI in Africa are higher than other regions?

Conclusions

- The most important motivation for investment is to take advantage of the local market. Growth of the domestic economy may be a precursor to higher levels of FDI. In the absence of stronger economic growth, FDI opportunities will be limited.
- Regional integration may help to create larger markets in the region. Infrastructural development is crucial.
- Enterprise growth is not always accompanied by employment growth. Rising capital intensity and improved productivity may limit the welfare benefits of FDI in terms of job creation.
- Exchange rates and quality of governance are the most common risk factors identified by existing investors in SADC. Greater political and economic stability is a priority. This is a familiar agenda; where African economies face a particular challenge is in addressing the perceptions of potential international investors that instability is endemic.