Foreign companies in South Africa: Entry, performance & impact

An overview
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This report presents an overview of foreign-owned firms which have invested in South Africa for the first time since 1990, with the aim of contributing to a broader and deeper discussion of the role of foreign direct investment in the economy.

Foreign companies have a long and complex history in South Africa. Their presence pre-dates the discovery of diamond and gold deposits in the late 19th century, but was accelerated sharply by those events. Foreign mining houses led the development of the industry in South Africa, gradually becoming South African companies through the first part of the 20th century, while also moving beyond mining into other sectors. Foreign direct investment by British, European and US companies played a leading role in the development of secondary industry from the 1920s until the 1970s. By this time, foreign investors were identified as substantial beneficiaries of South African economic growth – at the expense of the black majority – by the growing international anti-apartheid campaign. This coincided with a slowing down of new flows of foreign direct investment throughout the international economy, and also with the apogee amongst economic policymakers internationally of the view that foreign investment is inimical to development, or at best distorts it. During the 1980s, new foreign investment in South Africa disappeared almost entirely, and many companies – by some estimates, over 350 – exited the country.

The initiation of constitutional discussions in 1990 led to the resumption of direct investment flows into South Africa. Since the 1994 election, the economic policy regime has been liberalised and become more outward-oriented. One aim of the shift in policy orientation has been to encourage foreign investment, which has also been actively promoted by the establishment of government agencies at national and provincial levels. Increased foreign direct investment has been identified by many policymakers as ‘the’ key to improving the growth performance of the economy. The argument is most often made on largely macroeconomic grounds – low domestic savings in South Africa are identified as the binding constraint on growth, which can be alleviated by net inflows of foreign capital. Direct investment inflows are far preferable to foreign portfolio flows, given the latter’s often-demonstrated volatility.

The prevalence of this approach has meant that current public policy debate about foreign investment in South Africa is generally narrowly focussed on whether the country is receiving ‘enough’ foreign investment, and what steps are necessary to get more foreign companies ‘through the door’. This framework means that effective evaluation of the benefits and costs of foreign investment to the economy is unlikely. Indeed, there has been no systematic collection of information about what foreign companies do once they enter South Africa, or what their impact has been.
This report has been produced in an effort to help shift the debate towards these latter concerns. It presents a largely descriptive overview of the results of a survey of foreign firms in South Africa carried out between November 2001 and July 2002. The report examines firms’ investment strategies when they enter the country for the first time, their attitude to the operating environment in South Africa, whether their investment has met their expectations at entry, and their impact on South Africa’s economic development. In-depth statistical analysis of the survey data will be presented in technical reports published by The EDGE Institute. The survey was also carried out amongst recent foreign investors in three other developing countries – Egypt, India and Vietnam. In all four countries, in-depth case studies of foreign companies were done to complement the survey results. The comparative and case study analyses are presented in forthcoming reports.

A. The Survey Sample

The survey contains responses from 162 firms in South Africa which met four criteria:

- at least 10% foreign ownership
- at least 10 employees currently in South Africa
- some value-adding activity in South Africa (so that sales or representative offices were excluded)
- first entry to South Africa after 1990.

Since no authoritative (official or unofficial) listing existed of foreign firms in South Africa, The EDGE Institute compiled its own ‘population’ listing of companies which fit the four criteria above, by drawing on a number of sources, including commercially-available company listings and lists provided by foreign trade missions and chambers of commerce. Every effort was made to ensure that the population list, and the sample, was representative of the range of home countries of foreign firms in South Africa, and of the sectoral distribution of foreign firms – subject to these limitations, the sample is a random representation of the population list. To ensure cross-country comparability within the larger project as well as adequate within-country data analysis, a sample size of 150 firms per country was targeted. The South African sample size of 162 firms represents over than 25% of the relevant population of firms meeting all four criteria mentioned above.

Charts 1 through 4 present a profile of the survey sample. Chart 1 provides the sectoral distribution of investment, giving the percentage of firms within the sample investing in each sector. Nine sectors have been specifically
defined for the project in order to take account of particular factors relating to foreign investment during the period. An IT sector was constructed which included production of both hardware and software, though telecommunications was excluded. The latter is included in Infrastructure, together with other utilities (electricity and water), transport and construction. Agriculture and mining are combined in the Primary sector. Entertainment industries (broadcasting, gaming and sports) are included in Trade & hospitality, while printing and publishing are part of (basic) Consumer goods. Pharmaceuticals have been separated from both the latter and from the chemicals processing industries, to take account of its knowledge-intensive nature. The Machinery & equipment sector includes transport, electrical and electronic machinery and components, except for computers.6

Chart 1:  **Distribution by Sector - percentages**

Chart 1 shows that the largest proportion of the 162 firms during the 1990s went into Financial & business services (20%), with Machinery & equipment and Materials processing not far behind (19% and 17% respectively). The Infrastructure (12%) and the Basic consumer goods sectors (13%) were also attractive destinations for firms.

For the issues of interest in this project – entry, performance and development impact, the relevant consideration is the number of firms entering each sector, rather than the financial value of the investment into each sector. However, 109 firms reported the value of their capital stock at the start of their operations. This is unlikely to be the same value as the capital inflow associated with the investment, but is of interest nonetheless. Not surprisingly this data reflects a fundamentally different distribution across the nine sectors, compared to the distribution by employment level. The primary sector accounts for 28% of the value of investment: though this sector has only 5 firms in the sample, some of these are very large. The Consumer goods and Trade and hospitality sectors also contain a few very large investors. IT, Pharmaceuticals and somewhat surprisingly, machinery & equipment represent very small proportions of the total value of investment.
Table 1: **Sample distribution by size of capital stock at entry**

<table>
<thead>
<tr>
<th>Sector</th>
<th>% total investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Primary</td>
<td>28</td>
</tr>
<tr>
<td>2 Basic consumer goods</td>
<td>19</td>
</tr>
<tr>
<td>3 Basic materials processing</td>
<td>8</td>
</tr>
<tr>
<td>4 Machinery &amp; equipment</td>
<td>4</td>
</tr>
<tr>
<td>5 Infrastructure</td>
<td>10</td>
</tr>
<tr>
<td>6 Trade &amp; hospitality</td>
<td>17</td>
</tr>
<tr>
<td>7 Financial &amp; business services</td>
<td>13</td>
</tr>
<tr>
<td>8 IT</td>
<td>1</td>
</tr>
<tr>
<td>9 Pharmaceuticals</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
<tr>
<td><strong>Total value US$ million</strong></td>
<td><strong>2257</strong></td>
</tr>
</tbody>
</table>

Chart 2 presents the distribution of firms’ home countries in the sample. The US is the single most prominent country, with 18.5% of firms in the sample having American parents (the other 3.5% in the North America category being Canadian). As a region, though, Europe is overwhelmingly dominant. The UK (12%) and Germany (11%) have been separated out as the largest European countries, while 10% of the sample comprises French firms. In all, 15 European countries are represented in the sample, and four East Asian countries. The Other category includes companies from Australia, India and Nigeria. Not shown in the chart is the sectoral distribution of firms’ home countries – sectors 2, 5, 6, 7 and 9 are dominated by European firms, while North American firms have a major presence in Materials and in IT. East Asian firms are concentrated in Consumer goods and Materials.

Chart 2: **Distribution by Home country**

Chart 3 reports the age profile of firms and reflects prior expectations about FDI patterns in South Africa since 1990. Small numbers of firms entered up until 1993, but from 1994 the numbers increase quite quickly, peaking in 1997, though still significant during 1998 and 1999 (over 12% of the sample in each
of these years). The figure for 2000 is not necessarily an accurate reflection of the number of firms investing in that years, because the survey aimed to include firms with at least two financial year-ends. Although there may well have been some country-specific factors which impacted on the numbers of firms entering South Africa through the 1990s, it should be noted that a very similar pattern was found in the other three countries in the survey, where peaks were also experienced early in the second half of the decade, suggesting that some part of the pattern is due to factors relating to the supply of FDI to developing economies, or at least some sub-group.

Chart 3: Distribution by operational start-up

Chart 4 presents a size distribution of the firms in the sample, by sector. Size is measured in terms of both capital and labour, for the year 2000. Looking at the labour data first, it is noteworthy that more than one-third of the firms fall into the smallest category, between 10 and 50 workers, and more than half the firms had fewer than 100 workers (the median is 91). This pattern holds across all sectors except Primary and Trade & hospitality, each with small numbers of firms. It has often been observed about the South African economy that there is a ‘missing middle’ in terms of firm size, which has implications for the impact of growth on employment creation. Foreign investment appears to bear out this generalisation.

It is worth noting however that the median increase in the size of sample firms’ labour force from entry to 2000, was 67%, and 44% of firms at least doubled the size of their workforce. Excluding greenfield entries, where the initial workforce is often a small fraction of the intended complement at full capacity, the median growth in employment between entry and 2000 was only 14%, and one-third of firms doubled in size. In other words, although foreign firms are
relatively small, their employment creation record has been relatively good.\textsuperscript{8}

A further qualification is also important. It emerged in the course of the fieldwork that a significant proportion of the sample (around 14%) had outsourced all their operations, or a substantial share of the labour-intensive segments. In addition, nearly one-third of the firms are in the skill- and knowledge-intensive Financial services, IT and Pharmaceutical sectors. Thus nearly 40% of firms of firms in the lowest employment category (fewer than 50 workers) are in the top 60% of firms by sales values, while a quarter of the firms in the top sales quintile have fewer than 250 workers. Thus, small firm size does not necessarily imply that the foreign investor is not creating jobs in the economy as a whole.

Turning to the capital stock data in the right hand section of Chart 4, the relatively small size of foreign firms’ financial investment is again evident. Nearly 40% of firms had less than US$1 million of capital stock in 2000, and another 30% between $1m and $5m. The median value\textsuperscript{9} of the capital stock data was $1.87 million, just under R13 million.\textsuperscript{10}

Looking at the sectoral level, Finance & business services and IT are dominated by firms with small fixed asset bases, as would be expected, but it may be more surprising that small firms are also prominent in Basic consumer goods and in Infrastructure. In the latter sector, several firms provide services such as infrastructure system design and management, rather than directly owning and operating infrastructure installations. Consequently, the capital asset base of these firms is very small.\textsuperscript{11} At the same time, this sector also has a significant share of firms with very large capital stock.

**Chart 4: Firm size: Labour & capital**
Turning now to profile the parent firms, Table 2 illustrates that foreign investors in South Africa cover the full spectrum of multinationals, from small companies with operations in three or four countries to global giants. Medians for number of affiliates and global employment are 20 and 10250 respectively. Global expenditure on R&D and on advertising are good indicators of the extent of the parent’s firm-specific assets (such as technology or brands) which it can deploy via its local affiliate. The sample includes parent firms with both very high and very low levels of such assets, with advertising spending somewhat smaller on average than R&D (the means are 3.16 and 3.86 respectively, both 1-2% of global sales). Prior experience in emerging markets is obviously a major advantage when entering South Africa for the first time, and the table shows that more than half the firms had experience of three or more regions (Africa, Latin America, Asia, Central & Eastern Europe and Middle East & North Africa). Finally, the table shows the relative size of the South Africa affiliate to the parent, with 25% of the sample providing more than 5% of global sales. The 9% of South African affiliates which accounted for over 20% of parent turnover includes only parents with seven or fewer affiliates.

<table>
<thead>
<tr>
<th>Number of affiliates</th>
<th>0–5</th>
<th>6–20</th>
<th>21–50</th>
<th>&gt; 50</th>
</tr>
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<tbody>
<tr>
<td>N firms</td>
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<td></td>
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<td>133</td>
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<tr>
<th>Global employment</th>
<th>&lt; 1000</th>
<th>1001–10 000</th>
<th>10 001–100 000</th>
<th>&gt;100 000</th>
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</thead>
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<tr>
<td>N firms</td>
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<td>141</td>
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</table>

<table>
<thead>
<tr>
<th>% sales</th>
<th>0–0.5</th>
<th>0.5–1</th>
<th>1–2</th>
<th>2–4</th>
<th>4–8</th>
<th>8–15</th>
<th>&gt; 15</th>
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<tbody>
<tr>
<td>Parent R&amp;D</td>
<td>22</td>
<td>10</td>
<td>7</td>
<td>20</td>
<td>18</td>
<td>10</td>
<td>14</td>
</tr>
<tr>
<td>Parent Adspend</td>
<td>27</td>
<td>16</td>
<td>13</td>
<td>18</td>
<td>13</td>
<td>7</td>
<td>5</td>
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<td>123</td>
<td>128</td>
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<table>
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<tr>
<th>Emerging market experience</th>
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<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<tr>
<td>No of regions</td>
<td>15</td>
<td>15</td>
<td>16</td>
<td>14</td>
<td>20</td>
<td>20</td>
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<tr>
<td>N firms</td>
<td>162</td>
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<td></td>
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<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>SA affiliate: % global sales</th>
<th>&lt; 0.1</th>
<th>0.1–0.5</th>
<th>0.5–2</th>
<th>2–5</th>
<th>5–20</th>
<th>&gt; 20</th>
</tr>
</thead>
<tbody>
<tr>
<td>N firms</td>
<td>151</td>
<td></td>
<td></td>
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</tr>
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</table>
B. Entry to South Africa

We turn now to look at firms’ strategies for entry into South Africa, starting with the mode of entry, where greenfields, joint ventures, partial (10 – 95% of equity) and full (over 95%) acquisitions are distinguished. The original motivation for the 4-country project was to investigate the possible presence in developing economies of a ‘brownfield’ entry mode in the Central European context, an acquisition with many of the characteristics of a greenfield project. However, South Africa turned out to be the only one of the four countries in the survey to have had a significant proportion of acquisitions – 31% of the sample were full acquisitions and another 14% partial. In each of the other three countries, full acquisitions were fewer than 5%, and partial between 8-12%. This underlines the greater maturity of South Africa’s equity market, enabling asset purchases of this nature, as well as suggesting 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.

The employment size distribution of the mode of entry shows that acquisitions are particularly prominent in the medium size categories between 101 and 1000 employees, while partial acquisitions dominate the largest category. Greenfields on the other hand are more prominent in the smaller firm categories. Indeed, most greenfields have been very small: 73% of greenfield entries had fewer than 100 workers in 2000, and 50% of greenfields had a capital stock value at start-up of less than $1 million.

Chart 5: Mode of Entry
Firms were asked to identify the three key resources for success during their first two years of operation in South Africa, out of a list of 16 possible resources. Chart 6 shows the sectoral distribution of the 10 resources most commonly identified by firms as key. The firm-specific assets most commonly identified as providing advantages to foreign investors – brands and technology – are in fact identified by the largest number of firms (in the Total column on the right), together with managerial capabilities (mgers). Marketing capabilities (mktg) and business networks (busnet) are almost as prominent as the first three across the full sample. These factors ranked three to five impact upon the integration and co-ordination of firm-specific assets with location-specific factors which comprise the rest of the list.

The sectoral breakdown reveals the increased importance of technology in the materials, machinery and IT sectors, while brands are particularly significant in the latter two sectors as well as financial and business services. Managers are important in labour-intensive sectors, including the relatively high-skill financial and business services and IT. Firms in consumer goods and pharmaceuticals identified marketing capability as a key factor, while equity was significant for capital-intensive firms in the primary sector and in trade & hospitality. Though machines are more important in the three manufacturing sectors than elsewhere, this resource was not especially prominent relative to other necessary resources within manufacturing.

Chart 6: **Key resources for successful performance**
Having identified the three resources critical to their success in the initial phase of operations in South Africa, firms were then asked where they sourced these resources for the South African operation. This was a pivotal question in the survey. The long-held standard view was that foreign investors combined their own firm-specific assets with location-specific advantages sourced in local markets, implying a greenfield mode of entry. More recently, mergers and acquisitions have become common for developed country firms wishing to enter other developed country markets, as firms have sought to leverage their existing advantage by integrating successful foreign firms into their operations. In many emerging economies, incomplete markets and high transaction costs suggest that it might be more efficient for entering foreign firms to internalise location-specific knowledge and other resources by acquiring local firms, than to build these resources through local markets.

Chart 7 helps to throw some light on this hypothesis, by identifying the relative weight of alternative sources for the key factors from the previous chart. The chart confirms the key contributions of parent firms to be brand names and technological know-how. Local firms were seen as being particularly significant sources for managerial capabilities (which may have been interpreted by some respondents as a proxy for very high-skill employees) and distribution networks, with foreign parents quite insignificant in relation to the latter. There is little to distinguish the scores of foreign parents, local partners and local markets on several factors – business networks, marketing capabilities and machinery, at least for the sample as a whole. Foreign markets are seen as having little relevance for obtaining essential resources, except machinery and equipment. Overall, the chart suggests complementarities between local and foreign firms in supplying key resources. Where they appear to be substitutes, for business networks and marketing capabilities, further analysis is required to establish whether they are independently contributing domestic and international assets.
Chart 7: **Sourcing key resources for initial operation, percentage contributions**

- **Machinery & Equipment**
- **Business networks**
- **Technological know-how**
- **Distribution networks**
- **Managerial capabilities**
- **Marketing capabilities**
- **Brand names**

Legend:
- **Affiliate**
- **Parent**
- **Local markets**
- **Foreign markets**

The chart illustrates the percentage contributions from different sources for initial operation.
C. Performance in South Africa

Chart 8 presents responses to the survey question asking whether the performance of the affiliate has fulfilled the investor’s original objectives. Two of the four dimensions identified – profitability and revenue growth – have been combined into a single score. The central message from the chart is the high proportion of firms – 46% for the sample as a whole - which indicated that that their expectations had ‘all or mostly’ been met. Another 43% of the firms indicated their expectations were ‘partially’ met, leaving only 11% feeling disappointed. There is significant variation across the nine sectors, with the Primary sector, Infrastructure and Financial and business services performing somewhat better, while manufacturing has in general not lived up to firms’ hopes, particularly in Consumer goods and Machinery.

The section of the chart on the right reports firms’ performance against expectations according to their 2000 domestic market share. Firms’ with higher market share felt more satisfied with their performance, perhaps not surprisingly. Exceptions were the 2.5% of firms in the sample which have monopoly control over their domestic market (represented in the final column on the chart), whose satisfaction level was well below average, perhaps because aggregate economic growth (and hence their revenue growth rate) was slower than hoped for.

Chart 8: Have original expectations of investor been met?
Index: Profitability & Revenue growth combined

The next two charts, Chart 9 and Chart 10, report firms’ perceptions of the local operating environment. Chart 9 focuses on public administration and the policy environment. The mean score of firms’ current (‘latest’) perception of
each dimension is provided, with the colour of the bar indicating whether this reflects a substantial improvement (black) or deterioration (red) from the perception at the time of entry into the economy. Grey bars indicate no significant change over the duration. On both ‘procedures’ and ‘institutions’, South Africa scores relatively well, with most dimensions closer to a score of 4 (‘mostly conducive’) than 3 (‘somewhat conducive’). However, for both sets of indicators there are significantly more firms who feel the environment is getting worse compared with the number who see improvement. It will be no surprise that the worst indicator overall relates to the ease of obtaining visas and work permits for expatriate employees. There is also growing concern about the state of law enforcement, and the need for ‘unofficial payments’, though neither of these provide real cause for alarm at this time. The perception of government institutions and policies is less positive than that of procedures and broader state institutions, but remains well above a score of 3.00 which might be taken as a threshold value.

Chart 9: **Perceptions of official environment**

<table>
<thead>
<tr>
<th>Category</th>
<th>Scores</th>
<th>Perception</th>
</tr>
</thead>
<tbody>
<tr>
<td>All levels government latest</td>
<td></td>
<td></td>
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<tr>
<td>Local Govt latest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provincial Govt latest</td>
<td></td>
<td></td>
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<tr>
<td>Central Govt latest</td>
<td></td>
<td></td>
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<tr>
<td>Licences latest</td>
<td></td>
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<tr>
<td>Real Estate latest</td>
<td></td>
<td></td>
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<tr>
<td>All procedures latest</td>
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<tr>
<td>Visas latest</td>
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<td></td>
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<tr>
<td>Environment regs latest</td>
<td></td>
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</tr>
<tr>
<td>All institutions latest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instrns: Legal framework latest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instrns: Stability of rules latest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unofficial paymts latest</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Mean scores: 2 mostly not conducive; 3 somewhat conducive; 4 mostly conducive

Chart 10 presents the parallel data for labour and inputs into production. Firms were asked to rate these on the basis of both quality and cost. The picture here looks relatively positive. The scores for the various categories of skilled labour are above or just below 4.00, except for Executive managers, which has shown significant improvement. Similarly, infrastructure and service inputs show up very well, with noticeable improvements identified in Utilities (water and power) and IT/telecommunications services. Direct inputs – machinery and intermediate goods and components – are rated worse than the others, though both are at or above 3.50, and machinery inputs are seen to have
improved. The deterioration in the rand’s exchange rate during late 2001 may have contributed to lowering responses for these two items, which are both import-intensive.

**Chart 10: Inputs: Qualified labour and reliable infrastructure, services and intermediates**

Mean scores: 2 rarely available; 3 sometimes available; 4 mostly available; 5 always available
D. Impact on Economic Development

The third section of the report will look at the impact of foreign investment on economic development. The survey explored several dimensions of possible impact including export orientation, the degree of competition in the domestic market, the change in the performance of domestic competitors, investment in human capital, and the potential for technology transfer.

Chart 11 shows market orientation for the sample as a whole, and by sector. Firms were asked for the breakdown of their sales during their first year of South African operations, and in the latest year, into domestic, regional and global market, and other affiliates of the parent company.

It is evident that with the exception of the Primary sector, and to some extent Infrastructure, foreign firms have entered South Africa with their initial focus on the domestic market. On average, 81% of firms’ sales during their first year of operation were to the domestic market, and 12% to global markets, outside the Southern African region. The bulk of firms which entered with the intention of selling into global markets are in Materials processing, Trade & hospitality (including tourism) and Infrastructure. While the share of output going to global markets from the Materials sector is greater, 15% versus 19%, suggesting a small shift in orientation, in the latter two sectors the global share is smaller. In contrast, the global share in four sectors – Consumer goods, Machinery, Financial & business services and IT – is greater, and the share in the Total (excluding the primary sector) is three percentage points higher at 13%.

As is well-known, many firms enter the South African market with the explicit intention of expanding into regional markets (Southern or sub-Saharan Africa). The data illustrate this process, with all sectors (bar Primary) increasing the regional share in their sales, with particularly sharp increases in Materials, Machinery, IT and Pharmaceuticals, the first three starting from an extremely low base. Chart 11 reinforces also a point which emerges in Chart 7, that parent firms make only a limited contribution to distribution networks, reflecting their focus on local and regional markets.

The other important point illustrated by Chart 11 is very limited integration into global production chains and networks, at least where the South African operation is tied into global production by direct equity links. In four sectors, firms had a small share of their sales going to other affiliates of the parent during their first year of operations. Only one of these sectors – machinery – is part of manufacturing industry. The latest financial-year data provided shows that the ‘Other affiliates’ component of the market has not increased its share in any significant way.
Chart 11: **Market orientation by sector**

Chart 12 turns to look at competition in the domestic market. Two sets of data are plotted. The left hand axis provides the mean percentage of the foreign investors' market share, both at the point of entry (first year of operations) and in the most recent financial year, while the number of competitors is measured on the right. The scope of the market was defined by the respondents, so that Chart 12 provides a subjective perception of both market share and the change in the intensity of competition. The two sets of curves confirm that foreign investors enter markets in which small numbers of firms are active, and substantial market share is available – the number of competitors is on average fewer than five (mean score below 4) with market share close to 30%. In the first six sectors, foreign firms have successfully increased their average market share since entry, and more detailed analysis of the change suggests that the change in the average was due to many firms with initially low market shares (below 20%) increasing their share above that threshold.
In the case of the three manufacturing sectors, notwithstanding the increase in market share, the sectors’ performance scores (Chart 8) were below average. The drop in foreign firms’ market share in IT may be an indicator of some technology spillover - several firms in this sector had very high market shares on first entering – essentially monopolising their particular market niche – but now face increased competition from new entrants, reducing their current share. It is not clear whether the more recent entrants are domestic or other foreign firms.

Chart 13 compares the foreign affiliates in South Africa with their local competitors (that is, the view of them taken by the affiliates) along the dimensions of product range and quality, management capabilities and level of technology. The initial values (scores in columns) reflecting the foreign firm’s view of the local industry at the point of entry, are used as a benchmark to assess whether local industry has improved as a result of the foreign firm’s presence. As is evident, local industry was not seen in any sector for any of the three dimensions as being ‘as good as’ the foreign entrant at the time of entry. The service sectors – infrastructure, trade and hospitality, financial and business services and IT – were seen as weaker comparators than manufacturing. The curves plot the means of the change in the score since entry. The service sectors have shown considerably stronger improvement, with IT in particular increasing significantly in all three dimensions. This reinforces the interpretation of the drop in foreign firms’ market share (see Chart 12) as reflecting improved competitiveness of domestic firms. In contrast, domestic firms in the manufacturing sectors appear to have fallen further behind in comparison with foreign investors. Again, this is consistent with the interpretation of Chart 12. However, the change in
technology level in the Materials and Machinery sectors is positive, if low, and overall the improvement in technology provides some tentative support for the existence of spillovers.

This chart also shows that in six of the nine sectors (trade & hospitality, financial and business services and IT are the exceptions) local management capability was rated ‘almost as good’ as that of affiliates at the time of entry. This is consistent with the point which emerged from Chart 7 above, which showed that local partners were identified as a much more important source of management capabilities than either local or foreign markets or the parent firms. However, it is of concern that there has been no perceived improvement in local management capabilities.

Chart 13: **Comparison with local industry**

<table>
<thead>
<tr>
<th>Initial value &amp; change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary (n=5) Consumer (n=21) Materials (n=27) Machinery (n=31) Infrastr. (n=19) Trade &amp; hospy (n=8) Fin &amp; bus serv (n=33) IT (n=13) Pharma (n=5) Total</td>
</tr>
<tr>
<td>0.00</td>
</tr>
<tr>
<td>-1.50</td>
</tr>
</tbody>
</table>

Chart 14 assesses the contribution of foreign investors to human capital development in South Africa. There is of course not a one-to-one correspondence between training spending and increases in human capital, since the expenditure level tells us nothing about the quality of the training or the extent to which it is firm-specific. Nonetheless, spending does provide an indication of firms’ investment in their labour force. A previous survey of (domestic and foreign) firms in South Africa identified very low levels of training expenditure, notwithstanding widely-identified skills shortages in the economy. Manufacturing firms were found to spend about 0.67% of their capital stock value, with service firms spending about double the ratio.17 The data here is not directly comparable, since it is reported as categories of training expenditure relative to sales, but rough calculations using mean values of capital to sales ratios suggest that
the values reported here might be slightly greater. It cannot be argued that foreign firms in South Africa invest more than domestic firms in training. For this reason, it is surprising that foreign firms in South Africa scored higher on this issue than investors in all three other countries in the survey.

In the lower segment of chart focussing on sectoral patterns, it is somewhat surprising that the Pharmaceuticals, Infrastructure and Consumer goods sectors have the highest mean scores, with the IT and Financial services sectors spending less on average, notwithstanding their higher skilled labour-intensity. The middle group of bars shows clearly that there is a strong relationship between parent firms’ global R&D expenditure, and affiliates’ training expenditure – firms which invest in their technology also invest in their employees. Finally, the uppermost group of bars implies a correlation between training spending and performance (combined revenue growth and profitability).

Chart 14: Training as a percentage of sales

Chart 15 addresses the issue of technology transfer, for which firms were asked to indicate the ease of obtaining technology from the parent firm. Scores here were uniformly relatively high but with some significant variation amongst both modes of entry and sectors. In relation to mode of entry, it appears that a lower degree of control for the parent firm places some limits on its provision of technology, since the score for partial acquisitions is evidently below that of the other modes (though JVs are similarly only partially under parent firm control).
The final chart, Chart 16, presents the results of a set of questions dealing with Black Economic Empowerment (BEE), which were ‘added on’ to the South Africa survey, because of the pertinence of the issue in this country. Firms were asked to identify BEE ownership of more than 10% of equity (by either companies or individuals), to provide data on black participation in the four high-skill labour categories used earlier in the survey, and to indicate the share of their domestic market which consists of South African public sector procurement, an important lever for promoting BEE in the country, with data in all cases provide for the point of entry as well as the most recent financial year.

The first set of columns, on ownership, show that BEE ownership of foreign firms’ equity during the 1990s amounted to 2.2% at the time the firms entered the economy. The current level of BEE ownership stands about 50% greater, at 3.3%. It must be reiterated that this figure applies only to firms entering South Africa for the first time during the 1990s. The ‘diamond’ marker indicates that only 6% of foreign entrants had (over 10%) BEE equity at the time they entered, compared with 12% currently (the solid square marker). With the increase in the number of companies with BEE stakes above the threshold, the average BEE equity share is lower – 28% as compared with 35% at the time of entry, reflected in the third and fourth columns in the ‘ownership’ set.

This data compares well to the National Enterprise Survey which the present author carried out for the President’s Office in 1999-2000. That survey included 157 firms with more than 10% foreign equity, a majority of which had entered South Africa prior to 1990. 6% of these FDI firms had more than 10% BEE ownership,
with an average level of ownership per company of 41%. The level of BEE ownership of the FDI sub-sample as a whole (157 firms) amounted to just below 3%.\(^{20}\)

The other sets of data in Chart 16 are constructed on the same pattern. Black executive management in new FDI has risen overall from about 5% to 11%, and the number of companies with more representative executive management is 46% today, compared with 17% at the time of entry. BEE executive management per company is four percentage points lower, 25% compared with 29%. Amongst professionals, operations managers and other skilled categories, the proportion of companies with BEE participation is substantially higher today than at the point of entry. A majority of companies (52%) now have black professionals on their staff, and 81% have black operations managers, compared with 26% and 46% respectively at the point of entry. 27% of operations managers in foreign firms which entered South Africa during the 1990s are now black. The final set of data shows that although just under half of foreign firms are now selling to the public sector, compared with less than one-third when which supplied the public sector during the first year of South African operations, the share of public sector sales in total sales of those firms selling to the public sector is now only 25%, as compared with 35% at their entry date.

In sum, this segment of the survey indicates that foreign investment, at least by firms newly entering South Africa, has not been a major vehicle for expanding BEE ownership levels during the 1990s. But foreign firms have been far more effective in promoting black participation in high skill job categories. The survey also suggest that public procurement has not proved an effective lever to promote BEE equity stakes in foreign investor affiliates.

Chart 16: Black Economic Empowerment
Ownership & high-skill participation
E. Conclusions

As noted in the introduction, the charts and discussion above are a descriptive overview of the survey data. Further statistical analysis is in progress, including comparative analysis across the four countries included in the survey. In this section, some summary points are drawn from the discussion.

The first point relates to the mode of entry of foreign firms into South Africa. Acquisitions (and partial acquisitions), which are a substantial proportion of all new entries, are sometimes bemoaned because they are seen to involve lower levels of capital inflow and of employment creation than greenfields. However, a strategy of targeting greenfield investment needs to take account of the very small size of most greenfields in South Africa during the 1990s.

A second point relating to entry is that there appear to be strong complementarities between foreign entrants and local partners in providing essential resources for the post-entry phase – the former providing technology and branding, and the latter management and distribution capacities. But any potential benefits could be diminished by the experience of poor or inadequate local management which fails to meet the expectations of foreign parents, as suggested by the ‘then and now’ comparison between foreign affiliates and the local industry.

Turning to performance, and on a more positive note, it needs to be reiterated that the vast majority of foreign affiliates have met all or most of the investors’ expectations at the time of entry. Even discounting for any possible bias by respondents not wishing to give themselves a bad ‘report card’, this suggests that South Africa should be a very attractive destination for potential foreign investors. In this connection, the perception of some deterioration in the regulatory and institutional environment is worth noting, though the responses here pointed also to some very obvious areas where improvement should be fairly straightforward and possible.

Fourthly, however, potential investors appear to be mostly ‘market-seeking’ rather than ‘efficiency-seeking’ or strategic. The level of exports by recent foreign investors beyond regional markets, and particularly the share of their sales to other affiliates of parent companies, remains disappointingly low. South Africa is not at this point deeply integrated into global production processes.

Given the domestic or regional market orientation of most investors, the relatively high probability of adverse exchange rate movements exposes them to the risk of asset devaluation in home currency terms. Various strategies to mitigate this risk have been adopted by firms entering South Africa. The small size of most greenfield entries may well be one such strategy, and similarly the fact
that the entry mode for most of the large firms was via partial acquisition. Other affiliates have made investments which are more easily reversible. As noted, about 15% of the firms have outsourced all or part of their operations, focussing only on functions such as strategic management, marketing and technical services. Some firms which entered with the intention of producing goods or undertaking large projects directly, have reverted back to offering only services, so that their investment is predominantly human rather than physical capital.

Finally, the hopes that foreign investment would be one of the primary vehicles for black economic empowerment have been realised more in relation to participation in the directing of economic assets than in relation to ownership. Over the longer term, this may well turn out to be one of the most important benefits of foreign investment during this period.
The South African survey was part of a four-country project managed by the Centre for New & Emerging Markets at the London Business School.

Responses to the survey questionnaire were obtained through personal interviews done by The EDGE Institute survey team with the chief executive or a senior manager in each firm. The survey team included Masters' students in Economics and Political Studies at the Universities of Cape Town and the Witwatersrand.

1990 was a particularly appropriate starting point for South Africa, but the same time frame was used in all four countries. Firms which started operations in 2001 were excluded (with one exception) so that the survey covered at least 2 years of operation. The survey excluded firms which had a presence in South Africa in 1990 and subsequently expanded their investments, as well as firms which ‘warehoused’ their investments during the 1980s and returned after 1990 by repurchasing the same assets they previously owned. It included firms which withdrew fully prior to 1990, but then returned by establishing new or different operations to those they previously owned.

Some trade missions and foreign chambers were unable to provide information. The population list continues to be updated as information becomes available.

The firm population list also includes companies present in South Africa before 1990 which meet the other 3 criteria, and is now possibly the most comprehensive list available of foreign firms in the country. Obviously, firms which invested pre-1990 were excluded for the purpose of the current survey.

The sectoral divisions are inevitably a matter of judgement. A detailed ‘bridge’ between the breakdown here and the official SIC and ISIC codes is available.

The 4 countries are Japan, PR China, Malaysia and South Korea. Though Taiwanese companies are included in the population, none were included in the sample due to logistical difficulties in organising interviews related to firm location in South Africa and/or language barriers.

Of course, net job creation is ultimately of concern: foreign firms may have increased their labour force by enhancing market share at the expense of domestic competitors who shed workers as a result.

The most useful average measure in this context.

The 2000 rand-dollar exchange rate used was $1 = R6.940.

A third of the firms in the sector failed to report capital stock data.


For simplicity, the three least important resources have been omitted from Chart 7. In addition, the chart’s scale has been adjusted to reflect the relative importance of the seven resources for firms.

The dimensions omitted here for simplicity are productivity and domestic market share.

Since the start of operations was not the same for all firms, the shift from ‘start’ to ‘latest’ cannot be interpreted as a change in exports over any specific time period. Nor is the data in Chart 11 weighted by the value of firm sales.

Of course there are a wide variety of other possible links between local operations to form chains or networks, but the FDI survey did not explore these, or cases where firms longer-established in South Africa have restructured local operations to contribute to global production.


The data here includes only BEE companies – the sample contained only 2 firms where individual BEE ownership of more than 10% was registered.

See Gelb, 2001 (footnote 17).

Future analysis of the FDI survey will include more in-depth comparison with the FDI sub-sample of the NES data.
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