7. Foreign Direct Investment in South Africa

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INTRODUCTION

This chapter presents a descriptive overview of the survey results in South Africa (SA). The chapter starts by providing the background to FDI inflows into South Africa during the 1990s, and then turns to a discussion of the survey results, focussing on the sample and the parent firms first, then turning to entry and resource mobilisation, performance and impact of foreign investment[15].

Foreign direct investment has a long and complex history in South Africa. Foreign corporations have been present since Britain established a colony early in the 19th century. Until the 1870s, the economy was focussed on agricultural exports to Europe, but the financial system was dominated by branches of London-based banks. Industrial development was initiated by the discovery of major mineral deposits from the 1860s, first diamonds and later gold. Effective exploitation of the resources required large capital-intensive operations, and was made possible by both direct and portfolio investment flows from Europe, particularly London. This contributed to the early development of a domestic stock exchange in Johannesburg. Domestic economic growth and the re-investment of mining profits stimulated manufacturing development from the turn of the 20th century. Direct investment from the UK, the US and Europe[16] was important in the establishment and growth of new industrial sectors during the five decades from the 1920s. Domestic manufacturing development was accelerated by exchange rate deprecation after the Gold Standard collapsed in 1933, by demand growth and import difficulties during World War II, and by import-substitution policies commonly found in developing countries during the 1950s and 1960s. Although some FDI continued to flow into mining, during this period it went mainly to manufacturing and services. By the early 1970s, 40 per cent of the FDI stock was in manufacturing and 25 per cent in financial and business services, with only 15 per cent in mining.

From the early 1970s on, new FDI flows into South Africa slowed appreciably. There was a shift in the composition of international capital flows from direct to portfolio investment, but more important, foreign investors in South Africa were increasingly subject to political pressures in their home countries by the growing international campaign against apartheid. During the 1980s, this campaign intensified appreciably as political instability in South Africa increased, and economic conditions also weakened. Foreign direct investors began to exit from SA, with about 225 US corporations, and about 20 per cent of UK firms, departing between 1984 and 1988. Nonetheless, there were still more than 450 foreign firms with direct investments in South Africa in 1990. Total foreign direct investment liabilities in South Africa at the start of the 1990s amounted to US$ 7.94 billion (at current exchange rates), of which 85 per cent was from Europe and 13 per cent from North America. From 1985, portfolio inflows also ceased, as foreign bank creditors imposed a debt repayment schedule on the South African government and public sector borrowers. The resulting capital outflows and further economic contraction were significant in shifting white political sentiment, especially within business, against apartheid.

Political changes – the unbanning of proscribed organisations and the initiation of constitutional negotiations in 1990, leading to a democratic election in 1994 – ended the disinvestment pressures and direct and portfolio investment inflows resumed. Like the other three countries in the CNEM study, and other emerging markets, South Africa had a 'new dawn' of foreign investment during the 1990s. At the same time, the substantial stock of existing FDI and the very highly-developed domestic capital market[17] – the legacies of prior investment – heavily influenced the level and composition of inflows during the 1990s, and the mode of entry of FDI.

Starting even before 1994, there was a commitment to lowering the fiscal deficit and price inflation, reducing tariffs and liberalising the capital account and the financial system. Through the 1990s, the policy regime became far more liberal and outward-oriented, with the explicit aim of attracting new foreign investment. Direct investment in particular has been identified by many policymakers as 'the' key to improved growth, as illustrated by the single most important economic policy statement since 1994 – the Growth, Employment and Redistribution (GEAR) policy announced in June 1996. The argument was largely macroeconomic – low domestic savings were identified as the binding constraint on growth, to be alleviated by net capital inflows. Since GEAR was formulated partly in response to a capital account shock, FDI was seen as far preferable to volatile portfolio flows as a route to address savings shortages (Government of SA, 1996).

The fiscal deficit was 3.2 per cent of GDP in 1990 but ballooned to 10.1 per cent in 1993. It was brought below the 3 per cent target by 1998, where it has remained. CPI inflation was 11.3 per cent in 1990, but had been lowered to 6.7 per cent in 2000. But GDP growth has been disappointing, averaging

only 0.1 per cent per annum from 1990 to 1994 as contractionary macroeconomic policies were used to lower inflation, and only 2.6 per cent from 1995 to 2001, equivalent to a bare 0.5 per cent per annum on a per capita basis.

SA became a GATT signatory in 1994, and average tariff levels were reduced from 27.5 per cent in 1990 to 7 per cent by 1997, while nearly 60 per cent of imports faced a zero tariff in 2000. Both imports and exports grew rapidly, and the current account deficit averaged just over 1 per cent of GDP during the five years to 2000[18]. South Africa also signed the GATS, TRIPS and TRIMS agreements on joining the WTO in 1995. Commitment to services liberalisation under GATS was limited up to 2000, but has since been extended in communications, transport and energy. Intellectual property legislation exceeded the minimum TRIPS standards before SA signed in 1995, though enforcement has been less effective.

Turning to the capital account and financial system, the two-tier currency in place for most of the period since 1961 was abolished in March 1995, and three-quarters of the foreign exchange control regulations in 1994 had been eliminated by 1998. In 1995, branches of foreign banks were allowed to operate and the Johannesburg Stock Exchange had a 'little bang', admitting foreign brokers and scrapping fixed commissions. By 2000, there were 12 foreign bank branches and 61 representative offices in South Africa (see chapter 8).

There has been considerable success in attracting portfolio inflows, reflecting the developed financial markets, and progress with macroeconomic stabilisation. By 2000, gross non-resident transactions (purchases plus sales) represented 52 per cent of turnover on the equity market, and 23 per cent on the bond market (SA Reserve Bank 2003). Between 1995 and 2002, South Africa received two-thirds of gross market-based capital flows to Sub-Saharan Africa, and 101 per cent of net portfolio equity flows. South Africa's share of all developing countries flows were 3.3 per cent and 22 per cent respectively (World Bank 2003, Tables A30 and A37).

The downside of financial liberalisation has been significant exchange rate and capital account volatility, reflected in three exchange rate crises since 1994. Against the US dollar, the Rand has depreciated from around ZAR 2.60 in 1990 to ZAR 7.60 in 2000 to ZAR 11.00 at the end of 2001. followed by an appreciation back to around ZAR 7.50 by mid-2003. The substantial currency depreciation and associated capital outflows have offset the solid domestic macroeconomic performance reflected in the fiscal and inflation outcomes.

Notwithstanding an explicit commitment, privatisation has been slow and inconsistent, due to domestic political opposition as well as global market conditions since 1999. Just under half the capital stock was in public ownership at the end of 1994, but this had barely dropped to 46 per cent by 2001. The single largest foreign investment since 1994 was the 1997 sale of

30 per cent of equity in Telkom, the state-owned telephone company, to a strategic partner. But the IPO of a further 25 per cent of the stock was delayed by well over a year, and eventually occurred only in 2003.

Investment facilitation agencies have been established since 1994 nationally and in most of the nine provinces. These administer a large suite of more than 35 investment incentive schemes to national and foreign investors on a non-discriminatory basis. The TRIMS agreements requires equal treatment between national and foreign investors (with respect to importing, exporting, and access to foreign exchange), as well as free repatriation of capital and dividends. Reinforcing these commitments, SA has also concluded over 30 bilateral investment treaties since 1994, including with most OECD countries.

FDI INFLOWS IN THE 1990S: AN OVERVIEW

As implied above, the policy focus has been on the financial and macroeconomic dimension of capital inflows, resulting in a 'beauty contest' approach, with a narrow concern as to whether the country is receiving 'enough' investment, and what measures are necessary to get more foreign companies 'through the door'. There is little interest in foreign companies' mobilisation of non-financial resources at entry or after, or of their impact on the economy's growth and development[19]. For example, a recent official statement on industrial policy mentions FDI only once in forty pages, arguing that "the promotion of domestic and foreign direct investment is critical given the low savings and investment rates in the economy" (Government of SA 2002, p.32).

Notwithstanding this, FDI performance has been disappointing in quantitative terms. Between 1990 and 1993, total inflows averaged US$ 46 million per annum. Inflows rose rapidly after the transition in 1994, averaging US$ 1.861 billion per annum to 2002 (UNCTAD). This is equivalent to just over US$ 41 per capita (based on the 2001 population), 1.4 per cent of South Africa's per capita income. For comparison, average FDI inflow per capita for the developing world as a whole was US$ 40.42, equivalent to 3.5 per cent of per capita income (see also Table 1.2).

Between 1995 and 2002, net inward FDI to South Africa was 1.5 per cent of the total for all developing countries, though the country received 12 per cent of net inward FDI flows to sub-Saharan Africa (World Bank 2003, Table A29)[20]. These shares are significantly lower than the corresponding proportions for portfolio flows cited above, reflecting much greater success in attracting the latter form of foreign investment.

Two other developments are worth noting. First, several major South African corporations in resource industries and financial services, have relocated their head offices to the UK or the US. This has led to capital flows

formally defined as FDI, but more akin to portfolio flows in their economic effects, such as the Anglo American-de Beers unbundling of 2001 (see footnote 1 in chapter 1 above)

Secondly, South African firms have become significant foreign investors themselves. The large mining houses have retreated from the conglomerate structure that was tied to operating in a relatively closed economy, selling off domestic non-core assets and making significant mineral investments internationally[21]. In addition, sub-Saharan Africa has opened up to South African firms since 1994. The stock of South African direct investment assets in Africa grew 18 per cent per annum between 1995 and 2001 (SA Reserve Bank 2001, 2003). Investment into Africa is concentrated in resource extraction and market-seeking activities, notably mining, finance, retail and infrastructure (EDGE Institute, African Investment Database, 2003).

THE CNEM / EDGE SURVEY

The CNEM / EDGE Institute survey was the first in South Africa since 1994 to examine foreign direct investment across more than one home country or economic sector. The population list was compiled by the EDGE Institute from an initial list of 3,500 firms which consolidated several sources, including market research lists, media reports, and lists provided by foreign trade missions, embassies and international chambers of commerce. Of these, 516 firms which fit the four project criteria[22] comprised the sample frame for the project, and the survey sample in South Africa numbered 162 firms, 31.4 per cent of the population. The distribution of the sample by sector and by parent's home region – shown in Tables 2.1 and 2.4 above – matches that of the population.

Firm Size

The size distribution of the firms' labour force and capital stock are provided in Table 2.2. Table 7.1 gives additional data on size distribution by sector in 2000. As discussed in chapter 2, the firms are small: the medians are 90 workers and US$ 1.94 million capital stock for the sample as whole. Only 10 per cent of the firms have a labour force above 1,000 workers. This suggests FDI is unlikely to be a vehicle for either large capital inflows or for significant direct employment creation.

Only the primary and the trade tourism and recreation (TTR) sectors have significant shares of large firms, but both contain few firms. The primary sector is export-oriented, while market growth in TTR has been rapid. In the three manufacturing sectors, firms focus on the domestic and regional (Southern African) markets. Nearly one-third of the sample is in skill- or

knowledge-intensive sectors – financial and business services (F&B), IT and pharmaceuticals – where size is not correlated with turnover. Nearly 40 per cent of firms with fewer than 50 workers are in the top 60 per cent of firms by value of turnover, while a quarter of the firms in the top quintile for turnover have fewer than 250 workers. A significant proportion of affiliates were found to be outsourcing much of their operation, especially production, while they focussed on strategic management, marketing and technical services. In some cases, this was in contrast to other affiliates of the parent firm or a shift from their intention on entry to South Africa. This is a response to risk, including political and social risk (a new and unknown government, HIV/Aids, crime), currency risk (secular depreciation of the Rand), and market risk (slow economic growth in both South Africa and most of the region).

Table 7.1 Affiliate size in 2000, South Africa

	Median No. of workers	Median Capital Stock ($m)	No. of firms
Primary	1500	24.50	5
Basic consumer goods	78	0.65	20
Intermediate goods	85	2.45	27
Machinery & equipment	100	2.00	31
Infrastructure & construction	147	0.22	18
Trade, tourism & recreation	220	13.69	7
Financial & business services	70	0.86	33
Information technology	55	1.01	12
Pharmaceuticals	23	0.08	5
All sectors	90	1.94	158

The Investors

Table 7.2 shows the sectoral distribution of each region's investors. The European firms are distributed evenly in basic consumer goods, intermediate goods, machinery and equipment (M&E), infrastructure and financial and business services (F&B). The North American firms are concentrated in intermediate goods, F&B and IT. East Asian firms are concentrated in manufacturing, particularly intermediate goods and M&E.

The parent firms (87 per cent from developed economies) cover the spectrum from small companies with operations in three or four countries to

global giants (though South Africa had many major global corporations present prior to 1990). The median number of affiliates in the sample is 20. Though nearly half the affiliates contribute a tiny share (less than 0.5 per cent) of parents' global turnover, for another quarter of the sample, the affiliate provides more than 5 per cent of global sales. Median global labour force size of the parent is 10,250 workers. Mean spending on advertising and on R&D both lie within 1 to 2 per cent of global turnover. Only 15 per cent of the sample had no emerging market experience at all, while more than half were already in three or more emerging market regions. Over one-third were elsewhere in Africa before entry to South Africa.

There is significant sector variation amongst parent firms. The basic consumer goods sector is dominated by European mid-size firms which have only recently started to expand into developing economies internationally –

Table 7.2 Geographic distribution of SA parent firms (No. of firms)

	North America	Europe	East Asia	MENA	Other	Total
Primary	3	1	1	0	0	5
Basic consumer goods	1	17	2	0	1	21
Intermediate goods	8	10	9	0	0	27
Machinery & equipment	5	16	9	0	1	31
Infrastructure & construction	1	15	2	0	1	19
Trade, tourism & recreation	2	6	0	0	0	8
Financial & business services	10	17	2	0	4	33
Information technology	6	6	0	0	1	13
Pharmaceuticals	0	4	0	0	1	5
All Sectors	36	92	25	0	9	162

they have a small number of affiliates, mainly in Central and Eastern Europe and Asia, and would see South (or Southern) Africa as a potentially promising market. Intermediate goods firms – originating in roughly equal numbers from Europe, North American and East Asia – are somewhat smaller than the sample median and the local affiliate provides a relatively large share of turnover. The M&E firms by contrast are large, with the South African affiliates insignificant. Perhaps because their products are better suited to economies of scope, they tend to have a larger number of affiliates with more diversified presence in emerging markets than in intermediate goods, where economies of scale might be more relevant (and the affiliates' capital stock is larger). Both intermediate goods and M&E firms spend heavily on R&D.

Most infrastructure firms have extensive emerging market experience, possibly related to the growing involvement of the private sector in infrastructure provision in developing countries. In F&B, firms have many widely-dispersed affiliates with small employment. Firms in this sector provide fairly standardised services in which trust and personal networks are important, and spending on both R&D and advertising is relatively low. The South African affiliates contribute a very small share to global revenues. Finally, IT firms have a relatively large number of affiliates and substantial emerging market experience and spend a large share of turnover on R&D.

Mode of Entry

South Africa was the only country in the survey with a significant proportion of acquisitions. Table 7.3 shows that 32 per cent of the sample were full acquisitions and another 15 per cent partial acquisitions. The proportion of acquisitions is particularly high in Intermediate goods and in IT. Acquisitions are low in infrastructure, perhaps due to regulatory restrictions. In F&B, greenfield entry is more common – chapter 8 suggests regulation is a factor here.

Table 7.4 shows entry mode by affiliate size in 2000 (rather than at entry). Full acquisitions are over-represented amongst medium-size affiliates (101 to 1000 employees), while partial acquisitions are more common amongst the largest firms. Amongst the largest group of parents, joint ventures are common.

Greenfields on the other hand are more prominent amongst small affiliates (fewer than 100 workers). Indeed, most greenfields have been very small: 71 per cent of greenfield entries had fewer than 100 workers in 2000, and 50 per cent of greenfields had a capital stock value at start-up of less than US$ 1 million. Smaller parent firms usually opt for Greenfield operations. Tables 7.3 and 7.4 not only underline the maturity of South Africa's market for corporate control, but also show that many medium to large domestic firms are potential targets for foreign investors, who clearly feel comfortable and familiar in South Africa's corporate environment. This is underlined by most foreign investor risk assessments, which identify South Africa as very low risk on issues such as legal and taxation systems and operations (see Table 1.3 above). The frequent use of acquisition as entry mode 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.

Table 7.3 Distribution of entry mode by sector, South Africa (% of sector)

	Greenfield	Acquisition	Joint Venture	Partial Acquisition	No. of firms
Primary	0	0	60	40	5
Basic consumer goods	19	33	29	19	21
Intermediate goods	19	41	15	26	27
Machinery & equipment	32	32	26	10	31
Infrastructure & construction	53	16	26	5	19
Trade, tourism & recreation	13	13	50	25	8
Financial & business services	52	30	6	12	33
Information technology	15	46	38	0	13
Pharmaceuticals	40	40	20	0	5
All sectors	31	31	23	14	
No. of firms	51	50	38	23	162

Table 7.4 Distribution of entry mode by affiliate size in 2000, South Africa (% of employment category)

Employees	Greenfield	Acquisition	Joint Venture	Partial Acquisition	No.of firms
10 - 50	38	22	31	9	55
51 - 100	43	27	10	20	30
101 - 250	20	50	23	7	30
251 - 1000	29	39	21	11	28
More than 1000	0	27	27	47	15
All Sizes	30	32	23	15	
No. of firms	48	50	37	23	158

Resources for Success

Table 7.5 presents the sectoral distribution of firms' three choices of critical resources for entry[23]. The 'All firms' column indicates that managerial capabilities was identified by the largest proportion of firms as a critical resource, followed closely by brands and technology, the two firm-specific assets most often argued to provide advantages to foreign investors.

Marketing capabilities and business networks, also prominent across the full sample, impact (together with managerial capabilities) upon the integration and co-ordination of firm-specific assets with location-specific factors, which comprise most of the other resources prioritised.

Half the sixteen resources were chosen by the overwhelming majority of firms as critical – the five mentioned, and distribution networks, machinery and licenses. Licenses were ranked 5th as first choice, but few firms ranked them 2nd or 3rd. Marketing, machinery and distribution networks are complementary to the others, being more common as second or third choice than first.

The sectoral breakdown is suggestive. Technology is the most important resource in intermediate goods, M&E and IT when the 'first three' ranking is used, but the most common first choice only in intermediate goods. Surprisingly, distribution networks were the top choice of the largest number of M&E firms. But a substantial number in M&E ranked brands first, as did the largest group in IT, and significant numbers in F&B and consumer goods. All four are sectors where product quality is important. Managers are important in labour-intensive sectors, including the relatively high-skill IT sector.

Basic consumer goods, M&E, F&B and IT all have a similar profile: brands and managers are most important, complemented by technology in IT and M&E where production involves high capital- or skill-intensity, and by product distribution resources – marketing and distribution networks – in consumer goods and F&B, where products are standardised and the market more homogeneous.

Equity was significant for the large capital-intensive firms in the primary and TTR sectors. Though machinery is more important in the three manufacturing sectors than others, it was not especially prominent relative to other resources even there.

Although mode of entry was not important generally for understanding firms' resource choices, partial acquisitions do stand out as a mode of entry requiring a distinct combination of resources. Brands are less important since the foreign investor has less control over the disposition of firm-specific assets. The other major firm-specific asset, technology, is a top three choice for only a quarter of partial acquisitions. But technology ranks high amongst first choice resources for PAs and JVs, suggesting parents' willingness to transfer proprietary technology when it is crucial to the affiliates' success, even if ownership is partial. Managers, marketing, machines and business networks, all important 'top three' resources for PAs, all lower transaction and integration costs of entry.

Table 7.5 Three key resources by sector, South Africa (% of firms within sector choosing resource in top three)

	Primary	Basic Consumer Goods	Inter-mediate Goods	Machinery & Equipment	Infrastructure & Construction	Trade, Tourism & Recreation	Financial & Business services	Infor-mation Technology	Pharma-ceuticals
Brand	20	38	22	45	37	13	46	46	20
Business network	20	19	19	35	58	0	49	23	60
Distribution network	20	29	30	42	16	38	9	8	60
Equity	60	24	15	3	11	38	15	0	0
Licences	20	14	7	3	16	50	12	0	40
Machines	0	33	33	32	16	13	0	15	0
Managers	60	57	37	35	21	25	46	46	40
Marketing	20	43	37	19	37	38	28	31	60
Technology	20	14	59	48	37	25	28	77	0

Table 7.6 Source of three key resources, South Africa (mean % of resource)

Resource	Local Partner	Foreign Parent	Domestic Markets	Foreign Markets	Other	% of firms choosing resource	No. of firms
Managerial capabilities	46	28	24	2	0	40	65
Technological know-how	23	63	8	6	0	39	63
Brand names	20	69	9	2	0	36	59
Business networks	37	31	28	4	0	34	55
Marketing capabilities	38	34	27	1	0	32	52
Distribution networks	56	11	27	3	3	25	41
Machinery & Equipment	41	28	8	22	2	19	31
Licences	20	23	29	8	20	11	20

If strong in the local partner, these may be a source of attraction for the foreign investor. On the other hand, if these resources are inadequate in the acquired firm, it is essential for the entrant to strengthen them in the short-term.

A pivotal question in the survey asked firms where they sourced the critical resources for their South African operation. The long-held standard view is that foreign investors combine firm-specific assets with location-specific advantages sourced in local markets, implying greenfield entry is optimal. More recently, mergers and acquisitions have become common options for developed country firms entering other *developed* countries, as firms attempt to leverage their existing strengths by integrating successful foreign firms into their operations. In many emerging economies, incomplete domestic markets for essential resources and high transaction costs may push foreign firms to source location-specific resources by linking with a local partner, either via acquisition or JV.

Table 7.6 – in which resources are ranked according to their scores in Table 7.5 – presents the relative importance of alternative sources for the key resources. The provision by parent firms of brands and technology is confirmed, contributing 69 per cent and 63 per cent respectively of these firm-specific resources. Local firms are significant contributors of managerial capabilities (possibly including high-skill employees for some respondents). Local firms were the major source of distribution networks, while foreign parents were insignificant, probably reflecting the domestic market orientation of most affiliates. Foreign markets were insignificant for all resources other than machines.

For managers, brands and technology (the top three resources), as well as distribution networks (ranked sixth), Table 7.6 suggests strong complementarities between local and foreign firms in sourcing critical resources. For business networks and marketing capabilities, there are few complementarities, and it is difficult to distinguish amongst foreign parents, local partners and local markets.

Looking at the mode of entry in Table 7.7 clarifies the sourcing of business networks and marketing[24]. Local partners supply a significantly larger share of business networks in full acquisitions than partial acquisitions, which source business networks similarly to JVs. Business networks, providing access to critical inputs for operations, is a strongly location-specific asset. But foreign parents and local markets contribute larger shares where the parent has less control (partial acquisitions and JVs). This counters the view that foreign firms enter via acquisition rather than greenfields to obtain location-specific assets at lower cost, in a context of incomplete markets.

Table 7.7 Source of three key resources by mode of entry, South Africa (mean % of resource within mode of entry)

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Resource	Source	Greenfield	Acquisition	Joint Venture	Partial Acquisition	All Firms
Brand	Local Partner	3	32	10	62	20
59 Firms	Foreign Partner	88	66	68	22	69
	Local Markets	10	3	20	0	9
	Foreign Markets	0	0	1	17	2
Business networks	Local Partner	9	76	44	41	38
54 firms	Foreign Partner	45	11	26	30	31
	Local Markets	45	8	19	29	28
	Foreign Markets	1	5	11	0	4
Distribution networks	Local Partner	13	80	65	75	56
41 firms	Foreign Partner	9	13	5	25	11
	Local Markets	60	7	30	0	27
	Foreign Markets	10	0	0	0	3
Machinery	Local Partner	0	48	43	69	39
31 firms	Foreign Partner	68	12	37	4	29
	Local Markets	4	13	3	11	8
	Foreign Markets	29	27	8	17	22

Managers	Local Partner	6	62	47	66	46
65 firms	Foreign Partner	62	11	31	14	28
	Local Markets	31	23	22	21	24
	Foreign Markets	2	4	0	0	2
Marketing capability	Local Partner	9	58	38	68	38
52 firms	Foreign Partner	47	24	27	28	34
	Local Markets	43	15	33	4	27
	Foreign Markets	1	3	2	0	1
Technology	Local Partner	8	28	24	52	23
63 firms	Foreign Partner	75	52	69	42	63
	Local Markets	6	18	3	0	8
	Foreign Markets	11	3	4	7	6
Licences	Local Partner	17	47	9	25	20
20 firms	Foreign Partner	21	43	14	25	23
	Local Markets	41	0	34	25	29
	Foreign Markets	6	9	0	25	8

It is possible that full acquisitions are successful local firms with well-functioning business networks, while partial acquisitions and JVs may involve less successful and untested operations respectively, so that the investor lowers risk by bringing in assets.

There is a predictable difference between existing and new operations acquiring marketing capabilities: acquisitions, full and partial, rely substantially on contributions from the local partner, while new operations (greenfields and JVs) source much more heavily in local markets.

The local firm retains its own brand far more in partial than full acquisitions. This cannot be explained by brand familiarity, which would not necessarily differ, but the parent may be less willing to risk its own brand, an important firm-specific asset, without full control.

Business networks and marketing capabilities are both potentially separable into domestic and international resources, and so could be sourced independently. Firms which sell most (but not all) output (75 to 99 per cent) into the domestic market obtain three-quarters of their marketing capability from local partners, but firms selling either all output domestically, or less than three-quarters, only obtain about one-third from local partners, and the rest from the parent and local markets[25]. In other words, there is no apparent correlation between domestic sales and domestic marketing capability, and the mode of entry is the salient factor rather than destination of sales.

Institutional and Market Environment

Tables 7.8 and 7.9 report affiliates' perceptions of the availability on domestic markets of 'unbundled' inputs critical for performance. Table 7.8 indicates that foreign affiliates are not concerned about the commonly-expressed view that the South African labour market has a binding skills constraint (Lewis 2001). The mean scores for the full sample are 3.84 at entry ('then') and 3.87 at the time of the survey ('now'), both very close to 4.0, meaning 'mostly available'. All the means are greater than 3.0, or 'sometimes available'. The small changes for all sectors from 'then' to 'now' mask bigger changes in some sectors individually.

Suitable executive managers (in terms of quality and price) are the most difficult employees to find, though in some sectors – machinery & equipment, trade, tourism & recreation and pharmaceuticals – there was a significant improvement after entry. By contrast, professionals are easiest to find (their scores were highest both at entry and 'now'), though there was some decline in their score, mainly in basic consumer goods. This sector and F&B were above average at entry, but declined subsequently. By contrast, trade, tourism & recreation improved substantially, and machinery & equipment, IT and infrastructure also improved.

Table 7.8 Labour market: availability of suitable skilled labour by sector, South Africa (means)

	Primary	Basic Consumer Goods	Intermediate goods	Machinery & Equipment	Infrastructure
Exec. Manager now (then)	3.60 (4.00)	3.62 (3.74)	3.56 (3.54)	3.58 (3.16)	3.47 (3.35)
Professionals now (then)	4.40 (4.40)	3.90 (4.26)	3.96 (4.04)	4.13 (4.03)	4.16 (4.11)
Ops. Manager now (then)	4.20 (4.20)	3.90 (4.17)	3.74 (3.62)	3.58 (3.58)	3.33 (3.39)
Skilled workers now (then)	4.20 (4.20)	4.14 (4.26)	4.15 (4.00)	4.10 (4.06)	3.74 (3.63)
All labour now (then)	4.10 (4.20)	3.89 (4.09)	3.85 (3.80)	3.85 (3.71)	3.71 (3.64)

	Trade, Tourism & recreation	Financial & Business services	Information Technology	Pharma-ceuticals	All sectors	No. of firms
Exec. Manager now (then)	3.75 (3.25)	3.42 (3.64)	3.38 (3.23)	4.40 (4.00)	3.56 (3.48)	160 (157)
Professionals now (then)	4.50 (4.38)	4.13 (4.28)	4.15 (4.00)	4.40 (4.40)	4.11 (4.16)	161 (158)
Ops. Manager now (then)	4.00 (3.63)	3.97 (4.03)	3.58 (3.50)	4.20 (4.00)	3.76 (3.76)	159 (156)
Skilled workers now (then)	4.13 (3.63)	4.06 (3.94)	3.50 (3.58)	4.40 (4.40)	4.03 (3.96)	161 (158)
All labour now (then)	4.09 (3.72)	3.90 (3.97)	3.67 (3.56)	4.35 (4.20)	3.87 (3.84)	162 (159)

Note: Scale of 1 – 5, 1 = ‘never available’, 5 = ‘always available’

Table 7.9 Inputs: availability of suitable inputs by sector, South Africa

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	Primary	Basic Consumer Goods	Intermediate goods	Machinery & Equipment	Infrastructure
Utilities now (then)	4.40 (4.00)	4.62 (4.68)	4.89 (4.65)	4.58 (4.48)	4.32 (4.26)
IT and Telecom now (then)	4.00 (4.20)	4.19 (4.16)	4.52 (4.19)	4.45 (4.13)	3.84 (3.63)
Prof Services now (then)	4.20 (4.40)	4.52 (4.53)	4.52 (4.50)	4.55 (4.48)	4.37 (4.37)
Real Estate now (then)	4.20 (4.20)	4.59 (4.67)	4.58 (4.61)	4.44 (4.44)	4.19 (4.19)
Machines now (then)	4.80 (4.80)	3.42 (3.65)	3.85 (3.76)	3.57 (3.40)	3.88 (3.76)
Intermediates now (then)	4.75 (4.75)	3.50 (3.92)	3.50 (3.72)	3.21 (3.11)	
All inputs now (then)	4.37 (4.37)	4.19 (4.29)	4.32 (4.25)	4.16 (4.02)	4.11 (4.04)

	Trade, Tourism & Recreation	Financial & Business services	Information Technology	Pharma-ceuticals	All sectors	No. of firms
Utilities now (then)	4.38 (4.38)	4.59 (4.53)	4.77 (4.77)	5.00 (5.00)	4.62 (4.54)	161 (158)
IT and Telecom now (then)	4.25 (4.25)	4.15 (3.91)	4.23 (4.00)	4.60 (4.60)	4.26 (4.05)	162 (159)
Prof Services now (then)	4.63 (4.50)	4.42 (4.39)	4.46 (4.38)	4.40 (4.40)	4.48 (4.45)	162 (159)
Real Estate now (then)	4.50 (4.50)	4.59 (4.38)	4.62 (4.54)	4.80 (4.80)	4.51 (4.47)	142 (139)
Machines now (then)	3.38 (3.00)	4.22 (4.13)	4.64 (4.45)	3.33 (3.33)	3.85 (3.77)	142 (139)
Intermediates now (then)	4.50 (3.50)	3.50 (3.50)	3.33 (2.67)	3.00 (3.00)	3.46 (3.51)	84 (81)
All inputs now (then)	4.18 (4.04)	4.37 (4.25)	4.47 (4.34)	4.37 (4.37)	4.27 (4.19)	162 (159)

Note: Scale of 1 – 5, 1 = ‘never available’, 5 = ‘always available’

Looking at skilled labour availability by mode of entry, greenfield firms were generally most pessimistic at the time of entry, but perceptions improved after greater exposure to the local market, with substantial increases in three of the four occupational categories. Interestingly, partial acquisitions, who have local knowledge prior to entry, moved in the opposite direction, being most optimistic at entry but then declining significantly in all four categories. It may be that foreign companies entering via greenfields have modest expectations based on experience in other developing or middle-income economies, while investors establishing partnerships with South African companies form expectations based on developed country norms, as is common in South Africa.

Table 7.9 looks at production inputs and transactions costs. Once again, the essential point is that the overall mean scores are very high, at well over 4 ('mostly available'), and indeed are higher than those for skilled labour inputs[26]. IT and telecoms lag behind other transactions costs inputs, though they improved post-entry. Direct inputs into production – machinery and intermediate goods – scored somewhat worse than transactions inputs, possibly due to the exchange rate depreciation during late 2001 just as survey fieldwork got underway. However even these means are between 3.5 and 4, that is, between 'sometimes' and 'mostly' available, and do not indicate a significant problem. The sectoral means in Table 7.9 show a significant decline in basic consumer goods' scores for direct production inputs, while the TTR and IT sectors both show significant improvements for these categories. But the variation in input ratings across either sectors or modes of entry is too small to be of significance.

The administrative and institutional (official) environment shown in Table 7.10 affects transactions costs for the acquisition of key location-specific assets required to establish the operation (as distinct from transactions costs for production and sales activities). If these transactions costs are high, it could impact on the choice of entry mode itself, by discouraging greenfields in favour of linking with a local firm. The official environment also influences the firm's perception of country risk. Firms included in the survey have obviously not viewed this risk as an insurmountable barrier to entry, but risk perceptions nonetheless might have encouraged entry in an easily reversible form, such as limiting the stock of fixed assets or arms'-length operations (outsourcing). The means are – with a single exception – well above the scale's mid-point of 3.0, but there is a small decline post-entry for several indicators. The first and second sets of indicators, for public institutions and official procedures, score better then government policies, but there is little difference between levels of government. Comparison with Tables 7.8 and 7.9 (strictly speaking not allowed) suggest that the official environment could be seen as a more

Table 7.10 Institutions: perceptions of official environment by sector, South Africa (means)

	Primary	Basic Consumer Goods	Intermediate Goods	Machinery & Equipment	Infrastructure
Licences now (then)	3.00 (3.60)	4.00 (3.82)	3.96 (3.67)	3.81 (3.81)	3.59 (3.59)
Real Estate now (then)	3.80 (3.80)	4.38 (4.45)	4.00 (3.95)	4.24 (4.24)	3.73 (3.10)
Visas now (then)	1.75 (2.50)	2.44 (2.93)	2.68 (3.00)	2.81 (2.77)	2.95 (3.33)
Environmental regulations now (then)	2.80 (3.60)	3.58 (3.90)	3.48 (3.61)	3.84 (3.76)	3.36 (3.23)
All procedures now (then)	2.88 (3.43)	3.62 (3.72)	3.63 (3.60)	3.61 (3.61)	3.48 (3.41)
Law enforcement now (then)	2.80 (3.40)	3.52 (3.74)	3.15 (3.69)	3.19 (3.45)	3.21 (3.11)
Unofficial Payments now (then)	3.40 (4.00)	4.30 (4.35)	4.00 (4.25)	4.24 (4.18)	3.72 (3.94)
Stability of Rules now (then)	3.20 (3.60)	3.90 (3.68)	3.59 (3.77)	3.47 (3.37)	3.37 (3.56)
All institutions now (then)	3.13 (3.67)	3.90 (4.00)	3.56 (3.89)	3.63 (3.65)	3.39 (3.51)
Central Govt now (then)	2.00 (3.00)	3.35 (3.39)	3.44 (3.25)	3.37 (3.43)	3.00 (3.27)
Prov Govt now (then)	2.00 (2.80)	3.44 (3.50)	3.35 (3.26)	3.45 (3.55)	2.92 (3.27)
Local Govt now (then)	1.80 (2.60)	3.39 (3.44)	3.58 (3.61)	3.55 (3.60)	2.85 (3.08)
All Government now (then)	1.93 (2.80)	3.29 (3.34)	3.41 (3.28)	3.41 (3.44)	2.86 (3.17)

Note: 1 = ‘not conducive at all to profitable business operations’, 5 = ‘very conducive’

	Trade tourism & recreation	Finance & business services	Information Technology	Pharma-ceuticals	All sectors
Licences now (then)	3.57 (3.38)	3.96 (3.79)	3.83 (3.62)	2.40 (2.80)	3.67 (3.80)
Real Estate now (then)	4.00 (3.86)	4.26 (4.30)	3.71 (3.71)	5.00 (5.00)	4.10 (4.04)
Visas now (then)	2.63 (2.88)	2.79 (2.86)	3.31 (3.62)	2.33 (2.50)	2.76 (2.99)
Environmental regulations now (then)	3.33 (3.50)	3.64 (3.67)	4.00 (3.75)	3.67 (3.67)	3.56 (3.63)
All procedures now (then)	3.24 (3.27)	3.60 (3.61)	3.58 (3.66)	3.03 (3.13)	3.52 (3.55)
Law enforcement now (then)	3.50 (3.38)	3.36 (3.39)	3.85 (3.92)	3.20(3.20)	3.33 (3.49)
Unofficial Payments now (then)	4.71 (4.71)	4.48(4.38)	4.17 (4.25)	5.00 (5.00)	4.19 (4.30)
Stability of Rules now (then)	3.63 (3.63)	3.52 (3.73)	3.85 (4.00)	3.40 (3.40)	3.57 (3.64)
All institutions now (then)	3.85 (3.90)	3.74 (4.82)	3.94 (4.04)	3.87 (3.87)	3.68 (3.51)
Central Govt now (then)	3.25 (3.38)	3.31 (3.38)	3.42 (3.33)	2.60 (2.60)	3.32 (3.25)
Prov Govt now (then)	3.50 (3.50)	3.29 (3.29)	3.56 (3.44)	2.67 (2.67)	3.27 (3.35)
Local Govt now (then)	3.14 (3.43)	3.14 (3.29)	3.67 (3.44)	3.00 (3.00)	3.27 (3.38)
All Government now (then)	3.33 (3.46)	3.24 (3.33)	3.38 (3.36)	2.87 (2.87)	3.27 (3.34)

significant constraint than skilled labour or operational inputs, though such an inference must be treated with caution.

The table underlines the well-known concerns about immigration barriers for foreign workers. This indicator is the only one with a mean less than 3.0, is ranked worst in seven of nine sectors, and declines post-entry in eight sectors. Unofficial payments are also of concern, deteriorating noticeably. In two sectors with large proportions of the sample and where the regulatory framework is important – infrastructure and F&B – scores are well below the sample means on most indicators, and also decline after entry.

JVs and partial acquisitions scored the official environment far lower 'now' than at entry, reinforcing the earlier argument that these firms enter with unduly high expectations. National origin was not a source of significant differences amongst firms.

Firm Performance in South Africa

Table 7.11 and 7.12 present responses on the affiliate's performance relative to the investor's original objectives, averaging profitability and revenue growth[27]. These tables suggest that firms entering South Africa are by and large satisfied with their investment. The expectations were 'all or mostly' met for 46 per cent of the sample, and 'partially' met for 43 per cent of the sample. Only 11 per cent of firms felt disappointed. Firms' views of their performance were unaffected by mode of entry.

Table 7.11 Affiliate performance by mode of entry, South Africa (% firms in mode)

Expectations met	Greenfield	Acquisition	Joint Venture	Partial Acquisition	All firms	No. of firms
Poor (0 – 2)	8	16	8	17	11	19
Satisfactory (2.5 - 3.5)	47	36	45	43	43	69
Good (4 – 5)	45	48	47	39	46	74

Table 7.12 Affiliate performance by sector, South Africa (% firms in sector)

Expectations met	Poor	Satisfactory	Good
Primary	20	20	60
Basic consumer goods	19	48	33
Intermediate goods	4	56	41
Machinery & equipment	23	45	32
Infrastructure & construction	0	32	68
Trade, tourism & recreation	13	38	50
Financial & business services	9	33	58
Information technology	0	54	46
Pharmaceuticals	40	40	20
All sectors	12	43	46
No. of Firms	19	69	74

Table 7.12 shows some sectoral variation, with primary, infrastructure and F&B performing somewhat better than the other sectors. The export-oriented primary sector has gained from currency depreciation over the decade, while infrastructure and F&B have both been strong growth sectors partly in response to liberalisation and related regulatory shifts. With the partial exception of intermediate goods (also export-oriented), the manufacturing sectors performed poorly. In IT, market growth both domestically and regionally was combined with a strong competitive response from domestic firms, as discussed below.

Table 7.13 investigates possible correlation between firms' performance and their perceptions of the operating environment, showing the aggregate indicators from Tables 7.8, 7.9 and 7.10. Intensive statistical analysis of the data for all four countries concluded that the business environment had no impact on affiliates' performance. However, looking at the South African data only, good performers rated institutions (law enforcement, unofficial payments, stable rules, etc) and government much better than satisfactory performers, but procedures (licenses, visas, etc) worse. Satisfactory performers also rated institutions worse than did poor performers, though they were better on the other sets of indicators. This may imply that institutions can constrain performance in South Africa, given an acceptable business environment for operational inputs and transaction cost issues. If confirmed by further investigation, this conclusion would place South Africa at odds with the other three countries with respect to this crucial issue.

Table 7.13 Performance by perception of business environment, South Africa

Expectations met	Poor	Satisfactory	Good	All firms
All skilled labour now (then)	3.79 (3.70)	3.91 (3.79)	3.85 (3.92)	3.87 (3.84)
All inputs now (then)	3.99 (3.98)	4.29 (4.21)	4.32 (4.23)	4.27 (4.19)
All procedures now (then)	3.28 (3.48)	3.59 (3.62)	3.55 (3.53)	3.52 (3.55)
All institutions now (then)	3.72 (3.81)	3.55 (3.71)	3.79 (3.89)	3.68 (3.80)
All government now (then)	2.93 (3.04)	3.22 (3.26)	3.31 (3.42)	3.27(3.34)
No. of firms	19	69	74	162

There was little correlation between performance and the degree of market competition (data not shown). Some firms with over 75 per cent domestic market share were more satisfied than those with smaller market shares, but firms with a monopoly were less satisfied with their performance, perhaps because growth in the aggregate, and of firm revenues, was slower than hoped.

Impact on the South African Economy

In theory, foreign firms impact upon domestic welfare and growth in five broad areas: capital markets and finance, international trade, domestic goods markets, technology and labour markets and employment. In each of these areas, there are a number of different possible channels, and the impact may be either positive or negative[28]. The survey addressed issues in each of these areas. The financial issue has already been discussed (Table 7.1).

Domestic Market versus Exports

Table 7.14 presents the distribution of affiliates' sales into four distinct markets: domestic; regional (referring to either Southern Africa or sub-Saharan Africa, depending on the firm); exports to global markets; and non-arm's-length exports to other affiliates of the parent[29]. The latter reflects affiliates' integration into international production chains and networks. The distinction between regional and global exports is important. The former are often a 'vent-for-surplus' and fluctuate inversely with domestic demand, whereas the latter involve 'learning-by-exporting' and enhance productivity, at least for domestic firms (Rankin 2001). For foreign affiliates, the distinction may be important in relation to parent firms' supply of up-to-date technology, and to spillovers to domestic suppliers and competitors.

The table shows that except for primary and infrastructure firms, foreign firms entered South Africa for market-seeking purposes: on average, 81 per cent of starting sales went to the domestic market. Expansion into the domestic market has long been the major motivation for FDI in South Africa, at least for manufacturing and services. The table suggests that this pattern has undergone an important extension since 1994, as many affiliates have expanded into regional markets. Though regional shares were initially very low, eight sectors increased their regional share, with IT and M&E particularly significant (the latter because of its very low starting point)[30]. In five of these sectors, the increase in the regional share was at the expense of the domestic share. In four sectors with domestic and regional share together over 85 per cent – consumer goods, M&E, F&B and pharmaceuticals – South Africa and the region appear to be a single market.

Table 7.14 Market orientation by sector, South Africa (% of affiliates' sales)

	Domestic Market		Regional Market		Global Market		Other Affiliates	
Sector	Start	Latest	Start	Latest	Start	Latest	Start	Latest
Primary	17	13	10	0	73	87	0	0
Basic consumer goods	94	85	5	7	1	8	0	0
Intermediate goods	84	73	1	6	15	19	0	1
Machinery & equipment	86	77	2	10	6	8	7	5
Infrastructure & construction	67	69	3	7	24	22	6	3
Trade, tourism & recreation	80	82	1	2	19	16	0	0
Financial & business services	84	78	6	10	6	8	5	3
Information technology	85	53	1	26	8	14	7	7
Pharmaceuticals	96	87	4	11	0	0	0	1
All firms	81	73	3	9	12	15	4	3

Only 15 per cent of firms' sales are in global markets, including the majority of sales from the small number of primary sector firms, which was the one sector to shift away from regional and domestic markets. Firms in intermediate goods, TTR (which includes tourism) and infrastructure entered with some intention of selling into global markets, but in the latter two sectors the global markets' share declined. Global markets have become a more significant destination for consumer goods and IT, possibly assisted by Rand depreciation[31].

South African affiliates are selling to other affiliates to a very limited extent, suggesting that direct equity links are not a common means to extend global chains into South Africa, at least for firms with no prior presence. This does not necessarily mean that the economy is not being integrated into global chains and networks, since the project excluded non-equity hierarchical links between foreign and domestic firms, such as outsourcing or franchising. There is also evidence – from the auto industry, for example (Black 2001) – that firms established in South Africa before 1990 have incorporated their local operations into global chains.

Other data confirm that foreign investors entered during the 1990s primarily for market-seeking, rather than efficiency-seeking, reasons. The National Enterprise Survey of 1,425 firms in South Africa carried out in 1999 included 68 firms that fit the four criteria for the CNEM/EDGE survey. In this sub-group, the mean share of domestic sales was 68.5 per cent, close to the figure of 73 per cent in Table 7.14, while 15 per cent of turnover was exported to Africa, compared with 9 per cent in Table 7.14 (Gelb 2001)[32].

Examining market orientation on the basis of sales-weighted data provides an important corrective to Table 7.14. Firms in all turnover categories focus on the domestic market, though four of the five size classes sold smaller shares of output domestically in 2000 than at entry. Firms with small turnovers have shifted mainly into the regional market, but this group comprised only 0.3 per cent of the total value of sales in 2000. The seventeen firms with sales above US$ 100 million, which comprise over two-thirds of the total turnover of the sample and are spread across all sectors except pharmaceuticals, sell nearly 20 per cent of output in global markets, compared with none (reported) at entry. The increase in total exports is partially offset by firms in the second highest turnover category selling a slightly larger share domestically.

Domestic Market Competition

The impact of foreign firms on concentration and competition is hotly debated. Competition from more efficient foreign firms can pressure domestic producers to lower costs, but could also crowd out domestic firms, leading to an anti-competitive outcome. The survey focussed on 'horizontal' effects in the goods market, that is effects on competitors, and excluded 'vertical' spillovers to suppliers or customers.

Table 7.15 confirms that market-seeking foreign investors enter markets in which a significant share is on offer: the mean market share at entry was 26 per cent, and this rose to 30 per cent in 2000. The markets which investors entered had fewer than five firms on average. In TTR and IT, with only 2.5 competitors on average, initial market shares were especially high. In seven sectors, market share increased after entry, significantly in infrastructure and TTR. Rising sectoral means were due to firms with low initial shares (below 20 per cent) increasing their share.

Several IT firms had very high market shares on entry, monopolising their market niche, but dropped market share later, possibly indicating technology spillovers. In F&B, domestic firms held their own, with average market share and the number of competitors both rising slightly. This is confirmed in the ABN Amro case study (chapter 8).

Table 7.15 Domestic market share by Sector, South Africa (%)

	Market share 1st year operations	Market share 2000
Primary	8	23
Basic consumer goods	21	27
Intermediate goods	28	35
Machinery &equipment	22	26
Infrastructure & construction	18	28
Trade, tourism & recreation	49	61
Financial & business services	19	22
Information technology	67	52
Pharmaceuticals	31	13
All sectors	26	30

In the three manufacturing sectors, the sectors' performance scores (in Table 7.13) were below average, notwithstanding the increase in market share, and the number of competitors was constant post-entry, suggesting that market growth disappointed firms.

Table 7.16 shows that foreign entrants look for South African partners with significant market shares – the three modes involving local firms had substantial market shares at entry, while greenfields' shares were only 12 per cent, in line with their small size (see Table 7.4). Greenfields and partial acquisitions increased their market shares by about 50 per cent, suggesting the benefits brought by foreign firms. This reinforces the earlier point that

full acquisitions may involve already successful local firms, whereas partial acquisitions are more likely to be under-performing local firms.

Table 7.16 Domestic Market Share by Mode of Entry, South Africa (%)

	Market share 1st year operations	Market share 2000
Greenfield	12	19
Acquisition	34	35
Joint Venture	31	33
Partial Acquisition	25	37
All firms	26	30

Comparison with Local Industry

Foreign affiliates were asked to rate domestic competitors on five dimensions: product quality and range, management capabilities, marketing capabilities, level of technology and labour productivity. The 5-point Likert scale interpreted 3 as 'local industry almost as good as affiliate', and 4 as 'local industry as good as affiliate'. The change from entry to 2000 indicates local industry's improvement or deterioration in the presence of the foreign affiliate, though clearly causality cannot automatically be attributed.

In Table 7.17, the means cluster close to 3, with only marketing capabilities being higher, though still well below 4. This is consistent with Table 7.7 showing that marketing was acquired predominantly from local partners. Marketing in consumer goods and pharmaceuticals declined, in contrast to strong increases in TTR and IT. Local firms fare worst on issues of product quality and technology.

The service sectors – infrastructure, TTR, F&B and IT – were seen as comparatively weaker at entry than the three manufacturing sectors. But local service firms improved, particularly in IT, reinforcing the suggestion in Table 7.16 that IT affiliates' drop in market share reflects greater competitiveness of domestic firms. In contrast, domestic firms in manufacturing fell further behind foreign investors in almost all dimensions, consistent with Table 7.15. The improvement in technology in seven sectors provides tentative support for spillovers from foreign to domestic firms.

Table 7.17 also shows that in six sectors, local management capability was 'almost as good as affiliates' at entry, consistent with Table 7.7, where local partners were identified as the predominant source of management capabilities.

Table 7.17 Comparison with local industry by sector, South Africa

	Primary	Basic Consumer Goods	Intermediate goods	Machinery & Equipment	Infrastructure
Product Quality now (then)	2.80 (3.80)	3.15 (3.33)	2.85 (2.92)	3.07 (3.20)	3.17 (2.61)
Management now (then)	3.40 (3.40)	3.00 (3.67)	3.35 (3.32)	3.37 (3.60)	3.33 (3.18)
Marketing now (then)	2.60 (4.00)	3.50 (3.83)	3.04 (3.00)	3.57 (3.53)	3.44 (3.41)
Technology now (then)	3.75 (3.50)	3.00 (3.39)	2.85 (2.72)	3.20 (3.03)	3.50 (3.12)
Labour now (then)	3.25 (2.75)	3.11 (3.82)	3.36 (3.38)	3.28 (3.28)	2.78 (2.65)

	Trade, Tourism & recreation	Financial & Business services	Information Technology	Pharma-ceuticals	All sectors
Product Quality now (then)	3.00 (2.43)	3.06 (2.88)	2.83 (2.00)	3.40 (3.60)	3.03 (2.95)
Management now (then)	3.00 (2.43)	3.06 (2.91)	3.50 (2.56)	3.60 (3.60)	3.25 (3.23)
Marketing now (then)	3.57 (3.14)	3.58 (3.48)	3.50 (3.00)	3.40 (3.80)	3.42 (3.43)
Technology now (then)	3.29 (3.00)	3.31 (3.06)	3.08 (2.56)	2.80 (3.20)	3.17 (3.03)
Labour now (then)	3.67 (3.17)	2.89 (3.00)	3.67 (2.89)	3.25 (3.75)	3.18 (3.20)

Note: Scale of 1 – 5, 1 = 'local industry far inferior to affiliate', 3 = 'local industry almost as good', 4 = 'local industry as good as affiliate'

Table 7.18 Comparison with local industry by mode of entry, South Africa (means)

	Greenfield	Acquisition	Joint Venture	Partial Acquisition	All firms
Product Quality now (then)	3.12 (2.92)	3.06 (2.98)	3.11 (3.09)	2.62 (2.76)	3.03 (2.95)
Management now (then)	3.37 (3.14)	3.15 (3.20)	3.36 (3.42)	3.00 (3.24)	3.25 (3.23)
Marketing now (then)	3.76 (3.57)	3.29 (3.41)	3.47 (3.39)	2.81 (3.19)	3.42 (3.43)
Technology now (then)	3.35 (3.06)	2.98 (2.80)	3.37 (3.25)	2.80 (3.10)	3.17 (3.03)
Labour now (then)	3.15 (3.11)	2.93 (3.14)	3.55 (3.23)	3.21 (3.47)	3.18 (3.20)

However, in these six sectors, there was no improvement in local management capabilities after entry, indeed two manufacturing sectors had a significant decline. By contrast, in the three services sectors (TTR, F&B and IT), local firms' management was lower at entry but there was substantial improvement post-entry.

Table 7.18 shows local industry comparisons by mode of entry. There are important differences between new operations (greenfields and joint-ventures) and existing operations where entry was via acquisition. Local firms were 'almost as good' as greenfields at entry, in four of five dimensions (product quality excepted), and moved closer to the affiliates after the latter's entry, significantly in product quality, but also in management and technology. JV respondents (of whom two-thirds were South African) saw local industry as even closer at entry, but with less improvement subsequently. In contrast, acquisitions, particularly partial acquisitions, felt local industry had declined since entry, or rather that the acquired firm moved ahead of local firms, presumably a consequence of the acquisition.

Grouping affiliates by performance, good performers felt that local firms had more or less held their own but poor performers felt they had moved ahead relative to local firms, suggesting that performance is linked to broad economic conditions rather than competition from local firms. Satisfactory performers saw significant improvement in local firms, especially in the key dimensions of product quality and technology.

Human Capital Accumulation

Training spending provides a suggestive indicator of investment in human capital, but tells us nothing about the quality of the training, whether it is firm-specific, or spillovers to other workers and firms. Table 7.19 shows that just under one-third of firms spend below 0.5 per cent of turnover on training, and another third between 0.5 per cent and 2 per cent. Given the widespread perception of skills shortages, training expenditure seems low, though foreign affiliates probably spend slightly more than domestic firms on training[33]. As noted in Table 7.8 affiliates are not concerned about shortages of high-skill labour, though correlation between firms' training expenditure and skilled labour availability is low.

It is surprising that a higher percentage of affiliates in consumer goods are spending more than 4 per cent of turnover, and a smaller share in M&E. In services, many infrastructure and IT firms also spend over 4 per cent, but only one TTR firm is investing in its labour force. There is little variation by firm size, though the largest firms (labour force over 1,000) spend less on training, possibly reflecting the predominance of lower skill occupations in their workforce, but a concern in terms of skills upgrading.

There is a strong positive correlation between parent firms' global R&D expenditure levels and affiliates' training expenditure, presumably because the returns on R&D depend in part on employees' ability to use technology.

Table 7.19 Training expenditure by sector, South Africa (% of affiliates in sector)

Training as % of Sales	Primary	Basic Consumer Goods	Intermediate goods	Machinery & Equipment	Infrastructure
0 - 0.5%	20	22	33	35	21
0.5 - 2%	40	28	33	45	32
2 - 4%	20	6	19	10	5
4 - 8%	0	22	7	6	11
8 - 15%	0	22	0	3	21
Over 15%	20	0	7	0	11

Training as % of Sales	Trade, Tourism & recreation	Financial & Business services	Information Technology	Pharma-ceuticals	All sectors
0 - 0.5%	38	33	15	0	28
0.5 - 2%	38	24	38	20	33
2 - 4%	13	12	8	60	13
4 - 8%	0	18	31	0	12
8 - 15%	0	12	0	0	8
Over 15%	13	0	8	20	5

There is also a correlation between human resource investment and performance (revenue growth and profitability compared with expectations). Better performing firms spend more on training then poor performance firms, and it seems reasonable to hypothesise that causality runs from investment in human resources to performance, rather than the reverse.

Technology Transfer

Asked about the ease of obtaining technology from parent firms, 83 per cent of affiliates indicated they were 'usually' or 'always' able to do so. A larger proportion of firms in M&E are always able to do so, but surprisingly a lower share in IT. Parent firms are much less willing to provide technology to partial acquisitions.

Black Economic Empowerment

In 1994, equity ownership and management of South African firms were overwhelmingly white, and the need for 'black economic empowerment' (BEE) obvious. Supplementary questions were added to the survey to investigate BEE amongst foreign investors. The survey shows that foreign entry has not been a significant vehicle for expanding BEE ownership, the share of black owners being 2 per cent at entry and rising only to 3 per cent in 2000. In contrast, affiliates have been fairly effective in promoting black participation in high skill job categories, black executive managers rising from 5 per cent at entry to 11 per cent in 2000, and operational managers from 14 per cent to 28 per cent. There is significant sectoral variation, with TTR performing best (perhaps due to regulatory and public sector procurement requirements), and F&B and IT surprisingly poorly, though the latter have increased rapidly from a low base. Investors' home country matters: firms from English-speaking countries have transferred ownership and executive management positions, but not done well in other high-skilled jobs, whereas East Asian firms have transferred no equity, but have numerous blacks in the latter job categories. Small firms (fewer than 100 employees) have done far better than large in all the skilled job categories, including Executive Managers.

CONCLUSIONS

The majority of new foreign investors entering South Africa during the 1990s established small or medium size affiliates with limited impact on employment creation or capital inflows. Nearly half the entries involved acquisitions of existing operations, rather than greenfields or JVs setting up new enterprises. Many investors mitigated risk by limiting the irreversibility of their investment, by outsourcing production and focussing on services.

Most entry is market-seeking, though "the market" should be understood as encompassing both the domestic economy and the region. Many entering firms have linked with local partners with substantial market share, also as a risk-mitigation strategy. Investors with very large affiliates have opted for partial acquisitions, providing established market share while limiting the initial investment.

The entering firms are by and large well-established but mid-size multinationals with significant experience in developing economies. Some may have delayed entry to South Africa until the 1990s because of political factors. The South African operating environment holds few surprises for entering firms. On the contrary, the high proportion of acquisitions and the lack of concern over skilled labour shortages suggest entrants see factor markets as above par by developing country standards. This is further underscored by the strong complementarities in sourcing critical resources, with local partners providing significant share of key location-specific assets, in particular managers and distribution networks.

Mode of entry is correlated with several variables. It influences affiliates' ranking of the eight critical resources identified by most respondents. In sourcing these critical resources, there were strong complementarities between local partners and foreign investors for the top three – brands, technology and managers – but mode of entry helped to distinguish alternative sources for the others.

Affiliates also varied by mode of entry in perceptions of labour and operational inputs. Greenfields became more positive, while affiliates with local partners were optimistic initially but then were disappointed, possibly because their initial frame of reference was inappropriate, rather than actual conditions deteriorating. The official environment is arguably a more serious constraint than labour or input markets. The restrictions on foreign worker entry to South Africa are clearly a significant problem for investors, but not the only issue of concern. In sectors where regulation is significant, firms rated the administrative environment poorly at entry, and their anxieties increased later. But affiliates satisfied with their performance were positive about official procedures, while strong performers were happy with governance.

The mode of entry may also impact upon spillovers to domestic firms. Domestic firms acquired by foreign entrants improved in most dimensions relative to local firms. When Greenfield or JV entry involves a new operation, however, local industry has narrowed the entrant's initial advantage, Horizontal spillovers via competitive pressures may be limited in the case of entry by acquisition, and more likely when the either of the latter two entry modes is adopted.

An exceptional share of affiliates have met all or most of their own expectations at entry: even discounting for respondents reluctant to give

themselves a bad 'report card', South Africa should be a very attractive destination for potential foreign investors.

Sectoral location also matters. In manufacturing, there is a high percentage of less satisfied firms, even though market shares increased and domestic firms were thought by affiliates to have deteriorated since entry. Performance rating here is probably linked to slow overall growth, and there are some grounds for concern about foreign investors squeezing local firms out of the market.

A different picture emerges in services. Affiliates' market share declined in IT, though this was offset by rapid sectoral growth domestically and regionally. The IT sector presents strong evidence for spillovers from foreign to domestic firms, since the latter gained market share and were also rated as having improved substantially, relative to foreign affiliates after entry.

The survey suggest that South Africa is not yet deeply integrated into global production processes, at least not on the basis of equity linkages with foreign companies. Although a large share of total sales of foreign affiliates is exported to global markets, this involves a small number of firms. Most affiliates are not exporting substantial shares of their output to global markets or to other affiliates of their parent company. The impact of these exports on domestic firms' efficiency via backward linkages, and South African firms' non-equity links with foreign companies, will have to be explored in future research.