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OF BUSINESS SCIENCE

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**The Impact of Broad-Based Black Economic Empowerment  
on Foreign Direct Investment Inflows into South Africa**

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A research project submitted to the Gordon Institute of Business Science,  
University of Pretoria, in partial fulfilment of the requirements for  
the degree of Masters of Business Administration.

November 2008

## **Abstract**

Foreign Direct Investment (FDI) has become the main source of development capital for emerging markets in the current globalised world. Previous researches have found that fiscal incentives' capability to attract FDI is very limited, while removal of policy restriction is a determinant in attracting FDI. At the same time, South Africa has embarked on a major transformation programme – Broad-Based Black Economic Empowerment – which has as its main target the need to increase black people's participation in the economy and to reduce socio-economic inequality. In this context, this research attempts to evaluate the impact of the Broad-Based BEE programme on South Africa's capability to attract FDI.

This quantitative research was done using quasi-experimental methodology, comparing FDI inflows into South Africa with that of other emerging countries of a similar level of development, such as Brazil, Mexico, Chile, Nigeria and Botswana, and against the African continent as a whole.

The tests performed give an indication that Broad-Based BEE is indeed impacting on South Africa's capability to attract FDI, and also that South Africa is losing competitiveness in attracting FDI on the continent. Since the results cannot be generalised nor prove a causal relationship, the main purpose of this research is to enrich the discussion of how to attract more FDI inflows into South Africa, possibly through adjusting the Broad-Based BEE policies, which will contribute to building national competitiveness.

## Declaration

I declare that this research project is all my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination at any other university. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Valdir Vagner Veloso Jr

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Date

## Acknowledgements

I would like to acknowledge the following people, who have made this research possible:

**Kerry Chipp**, my research supervisor, for her guidance, advice, and for providing the inspiration to always work harder.

**Cuen Sharrock**, for the advice on statistical analysis.

**Leanne Kinghorn**, for her state-of-the-art work in the editing process.

**The GIBS Information Centre staff**, who have proved to be endlessly friendly and helpful.



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## List of Abbreviations

### Definitions of terms and acronyms

- **FDI** Foreign Direct Investment
- **BEE** Black Economic Empowerment
- **B-BBEE** Broad-Based Black Economic Empowerment
- **ANC** African National Congress
- **MNC** Multinational Corporations
- **WWF** World Wide Fund for Nature
- **UNCTAD** United Nations Conference on Trade and Development
- **TISA** Trade and Investment South Africa
- **GEAR** Growth, Employment and Redistribution Strategy
- **BEECom** Black Economic Empowerment Commission
- **GCF** Gross Capital Formation
- **GDP** Gross Domestic Product
- **DTI** Department of Trade and Industry

## Chapter 1. Introduction to Research Problem

### 1.1 An Overview

Foreign Direct Investment (FDI) is seen as essential for economic growth and development by the majority of economists and policymakers in both developing and developed countries (Peterson, 2005). This has led to growing competition to attract FDI, as well as to provide the conditions regarded as necessary to make countries attractive for foreign investment. The identified FDI benefits to host countries include:

- Increase in the export capacity of the host country;
- Transfer of skills and knowledge to the host country;
- Economic growth;
- Job creation; and
- Wages and productivity spillover.

A number of studies, including Dunning (2003), Blomstrom & Kokko (2003) and Banga (2003), have determined that the ability of fiscal incentives to attract FDI to host countries is limited. On the other hand, the removal of policy restrictions – including ownership, management and employment control of foreign key personnel – are determinants in attracting aggregate FDI.

South Africa's transition to democracy, together with the lifting of economic sanctions in the early 1990s, brought about a gradual return of FDI into the country. However, there is a general consensus that South Africa is lagging

behind in attracting FDI when compared with a number of other emerging markets, such as Argentina and Mexico (Vickers, 2003). South Africa is receiving less than 70 percent of the FDI it should be expecting (UNCTAD, 2006).

In this competitive environment, South Africa has embarked in recent years on a major and comprehensive strategy to increase black people's participation in the economy. Broad-Based BEE policy has been created with the purpose of correcting historical imbalances in South Africa. Broad-Based BEE policy instruments incentivise African Capital Ownership, Management Control, Equity Employment, and an increase in skills and education levels (Murphy, 2005).

## **1.2 Problem Definition**

This study attempts to assess the impact of Broad-Based BEE policies on the determinants that will attract FDI inflows into South Africa. In the current globalised world, there is strong competition amongst developing countries to attract FDI. Therefore, an understanding of FDI drivers is of critical importance in increasing a country's ability to receive investments.

## **1.3 Research Objective**

The objective of this research is to stimulate the debate of how to attract more FDI into South Africa, by analysing the economic impact of Broad-Based BEE implementation. Due to the low levels of internal savings in South Africa and the

lack of skilled resources, attracting FDI is a key aspect in the country's development and in building national competitiveness.

## **1.4 Theoretical Framework**

The measurement of Broad-Based BEE's impact on FDI inflows will be done by performing a series of tests, comparing South Africa's FDI inflows against the FDI inflows of other developing countries.

### **Dependent Variable**

- FDI Inflows into emerging countries

### **Independent Variables**

- Ownership Equity
- Management Control
- Employment Equity
- Broad-Based BEE-combined policies

## **1.5 Research Hypothesis**

The research will test the following hypothesis:

- South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development but without Ownership Equity policies;
- South Africa's FDI inflow levels are the same as emerging countries with a similar level of development but without Management Control policies;

- South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development but without Employment Equity policies;
- South Africa's FDI inflow levels are the same as other African emerging countries without Broad-Based BEE policies;
- South Africa's FDI inflow levels are proportionally the same as the FDI inflow levels of the African continent as a whole;
- South Africa's FDI inflow levels after Broad-Based BEE implementation are the same as in the period before its implementation.

## **1.6 Research Methodology**

This research has been designed as a quasi-experimental study. The hypothesis was tested using two approaches, Static Group and Single Group Pretest-Posttest. The data was analysed using descriptive statistics.

### **Sample Selection**

The sampling methodology used was judgmental non-probabilistic, as the emerging countries selected for comparison share similar levels of development to South Africa, but do not have equivalent Broad-Based BEE policies.

## **1.7 Assumptions and Limitations**

### **Assumptions**

For the purposes of this study, implementation of Broad-Based BEE was defined as 01 January 2004, even though BEE implementation was applied gradually over time.

## **Limitations**

Due to the nature of this study, in which a quasi-experimental design was used, the results obtained cannot be generalised. However, the main objective of this study is to stimulate the debate of how to attract more FDI into South Africa.

## **1.8 Thesis Structure**

<b>1 Introduction</b>	A brief overview of the research problem, theoretical framework, research hypothesis, methodology, assumptions and limitations.
<b>2 Literature Review</b>	Revision of the literature on FDI: definition, determinants and analysis of current situation in South Africa; and revision of Broad-Based BEE literature, including origins, policies, instruments and lessons.
<b>3 Hypothesis</b>	Definition of the hypothesis to be tested.
<b>4 Research Methodology</b>	Description of methodology utilised, population, sampling method, limitations of the research and assumptions.
<b>5 Results</b>	Results are reported of the tests performed.
<b>6 Discussion of Results</b>	A full analysis is given of the results found in the research.
<b>7 Conclusion</b>	Conclusion of the research, recommendations and references to additional research projects.



## Chapter 2.Literature Review

### 2.1 Introduction

Foreign Direct Investment is becoming increasingly more important in a nation's development. FDI can bring many benefits to host countries, such as employment creation (both direct and indirect), a revamp of the host country's export capabilities, the provision of cheaper commodities for internal consumption, and assistance in the host's technological advancement. Further, all these factors contribute to building national competitiveness (Lahiri, 2008). Asiedu & Esfahani (2008) concluded in their research that FDI has become the main source of development capital for emerging markets, and that to attract investment, countries are under pressure to offer foreign investors various incentives.

In the same context, South Africa has implemented a major national programme, Broad-Based BEE, in an attempt to correct imbalances caused during the apartheid regime, where the majority of people were systematically excluded from political and economic participation (Mandla, 2006).

Broad-Based BEE is the greatest strategic issue in the South African business environment today. It represents at the same time opportunities, threats and challenges to companies of all sizes and in all sectors (Balshaw & Jonathan, 2008).

In this chapter, the literature around FDI and Broad-Based BEE will be reviewed, with special emphasis on FDI determinants and Broad-Based BEE instruments. This chapter will establish the base for a theoretical framework to test the impact of Broad-Based BEE instruments on South Africa's capability to attract FDI inflows.

## **2.2 Foreign Direct Investment**

### **2.2.1 Definition**

Foreign Direct Investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control (a share of 10 percent plus) by a resident entity in one economy (foreign direct investor) into an enterprise resident in an economy other than that of the foreign direct investor (Lahiri, 2008; OECD, 1996). FDI implies that the investor exerts a significant influence on the management of the enterprise, resident in the other economy (UNCTAD, 2007).

Zhang, Zhang and Liu (2007) concluded that during the procedure of economic globalisation and integration, emerging economies have been spectacular targets for Foreign Direct Investment because of their potential business opportunities. Multinational corporations making less profit in developed countries, nowadays turn to emerging economies to pursue broader markets and higher performance.

Foreign Direct Investment differs radically from equity investment. Foreign equity investment can come into and leave the host country very quickly, depending on market fluctuations, without leaving any lasting benefit behind (Lipsey, 2002). FDI, on the other hand, is a set of economic activities or operations carried out in a host country by firms controlled or partly controlled by firms in some other country. These activities are, for example, production, employment, sales, the purchase and use of intermediate goods and fixed capital, and the carrying out of research (Lipsey, 2002). FDI is much more resilient to crises than foreign equity investments (Lipsey, 2002; Busse & Hefeker, 2007).

Zhang et al. (2007) found that multinational companies may enter emerging markets in many diverse ways, including through export, licensing and direct investment. There are, however, three typical entry modes:

- joint venture;
- green-field investment; and
- acquisition.

Neary (2006) defined FDI as one of the key features of the modern globalised world, stating that while some traders maintained international links in the late medieval and early modern periods, the period since the Second World War – in particular since about 1985 – has seen an explosion in FDI. Banga (2003) describes three schools of thought that are attempting to explain the emergence of FDI. First, the market imperfections hypothesis, which postulates that FDI is the direct result of an imperfect global market; second, the internalisation

theory, where FDI takes place as multinationals replace external markets with more efficient internal ones; and third, the eclectic approach to international production, where FDI emerges due to ownership, internalisation and location advantages.

### **2.2.2 Impact on Host Countries**

Research by Musila & Simon (2006) has identified that the role of FDI in the development of host countries is controversial. FDI can be a major stimulus to economic growth, as it can provide the capital, technical and marketing know-how needed for growth. On the other hand, FDI can also undermine the very process of development by causing adverse affects on employment, income distribution, balance of payments and national sovereignty (Musila & Simon, 2006).

#### **Positive Impacts of FDI on Host Countries**

A World Bank report on Global Economic Prospects (World Bank, 2008) recognises that FDI can be a powerful channel for the transmission of technology to developing countries by financing new investment, by communicating information about technology to domestic affiliates of foreign firms, and by facilitating the diffusion of technology to local firms. Gardiner's (2000) research on cross-country correlation between GDP growth rate and FDI inflow has found that evidence indicates a positive link between higher GDP and FDI inflows in both developed and developing countries.

Mirza & Yoo (2003) have found that FDI has a strong influence on domestic employment through job creation, wage levels, income distribution and skills transfers. These direct effects are complemented by indirect or spillover effects. Indirect effects take place through movement of trained labour from foreign firms to domestic companies, and through an increase in the employment of subcontractors.

Lipsev (2002) has found that the impact of FDI in promoting the growth of host country exports and linkages to the outside world is clear. In this aspect, the major role of FDI is the transformation of host economies from being exporters of raw materials and foods, to becoming exporters of manufactured goods and, in some cases, high-tech manufactured goods.

### **Negative Impacts of FDI in Host Countries**

While FDI on the whole is greatly beneficial to the development process, it must be recognised that certain drawbacks may occur. OECD (2002) reports that these drawbacks arguably reflect shortcomings in the domestic policies of host countries, but important challenges may nevertheless arise when these shortcomings cannot easily be addressed. Potential drawbacks include a deterioration of the balance of payments as profits are repatriated (albeit often offset by incoming FDI), social disruptions as a consequence of accelerated commercialisation in less developed countries, and the effects of competition in national markets (OECD, 2002; Lahiri, 2008). Lahiri's (2008) study also shows that tax competition to attract FDI can lead to reduced tax revenue and thus

public good provision. This can also have implications for social and welfare programmes.

Finally, competition for FDI can lead to environmental degradation and the creation of a pollution haven (Lahiri, 2008). A research study conducted by WWF (1999) shows that the interactions between FDI and the environment are complex: they can be both positive and negative. FDI can bring cleaner, more efficient technologies and working practices to foreign countries, or it can create irreversible environmental damage when investment takes place at a scale and pace where it overwhelms host country regulatory capacity.

### **2.2.3 Determinants**

Busse & Hefeker's (2007) research shows that various determinants have been identified that influence location of investment of multinational corporations, among these: political risks, policy restrictions, ethnic tensions, openness to trade, market size and growth, infrastructure, corruption, host-country management skills, quality of bureaucracy, potential for economies of scale, innovative product technologies, tax incentives, the dynamics of oligopoly, political and economic stability, exchange rate risks and labour costs. Banga's (2003) research shows that removal of policy restrictions – such as entry barriers, and restrictions on ownership and access to industries – are more important in attracting FDI than fiscal incentives offered to foreign firms. Some of the FDI determinants mentioned here are discussed in the next sections.

## **Political Risks**

Busse & Hefeker (2007) found that changes in government policy and/or political institutions could affect the investment behaviour of multinational corporations, as the risk premium incorporated in any investment project and also the location decision is influenced by political risk. Busse & Hefeker's (2007) research also shows that fundamental democratic rights – like civil liberties and political rights – do matter to multinationals operating in developing countries. This is in line with the findings by Harms & Ursprung (2002) and Jensen (2003) showing that basic democratic rights are positively associated with FDI inflows.

Murphy (2005) identified that business preferential policies are also considered a threat by foreign firms (i.e. investors may disinvest, or lose confidence). In the same research, Murphy has found that BEE is considered a 'risk factor' in the financial statements of several multinational corporations. Murphy (2005) reports that when the mining industry's BEE charter was leaked prematurely – divulging that companies would have to transfer 15 percent of equity ownership to blacks within five years and 26 percent within ten years – investors panicked and mining shares were sold off.

## **Policy Instruments**

Fedderke & Romm's (2006) research shows that FDI is discouraged in countries where domestic product-market regulations impose unnecessary costs on business and create barriers to entry. The same happens when labour

market conditions impose extra costs on investors; strict employment protection legislation and high labour tax wedges often discourage inward FDI.

Banga's (2003) research results have showed that though incentives have a positive impact on inward FDI, they are not significant determinants of FDI. On the other hand, removal of restrictions (such as barriers to entry, ownership and access to industries) has a greater impact on attracting FDI, as they are actual FDI determinants. Thus, in terms of the current study, there is evidence that Broad-Based BEE has a direct impact on South Africa's capability to attract FDI, since Ownership Equity, Management Control and Employment Equity are some of the most challenging elements of a BEE implementation (KPMG, 2007).

### **Ethnic Tension**

Busse & Hefeker's (2007) research shows that there is a link between ethnic tensions and economic growth, and finds that a high degree of conflict attributable to racial nationality or language divisions can – on average – negatively affect economic development. Busse & Hefeker (2007) also found that ethnic diversity partly explains cross-country differences in public policies and economic indicators, which is applicable particularly to sub-Saharan Africa where ethnic fragmentation is much greater than in other regions.



### **Openness to Trade**

Busse & Hefeker (2007) found that another determinant of FDI is openness to trade, usually measured by the ratio of imports and exports to GDP. This ratio is often interpreted as a quantification of trade restrictions. Openness of the domestic economy is influenced both by direct FDI restrictions, and by trade barriers. Trade restrictions are likely to influence the choice multinational companies make, with regards to investment location.

### **Market Variables**

Fedderke & Romm's (2006) research showed that market size of the host country, usually measured in GDP, is considered an important determinant of horizontal FDI. This is because the returns from such investment depend on economies of scale at the firm level. This is in line with other studies, such as Banga (2003), Busse & Hefeker (2007), and Gross & Ryan (2008).

### **Physical Infrastructure**

Fedderke & Room's (2006) research confirmed that the availability and the quality of infrastructure (transportation, communications and energy supply) positively affect inward FDI, because good infrastructure lowers transaction costs thereby affecting comparative and absolute advantage.

### **2.2.4 FDI into South Africa**

The TRALAC (2004) report on investments shows that South Africa has recognised the benefits of FDI inflows, not only from a currency perspective, but also in terms of skills transfers, technology transfers and potential job creation.

Investment promotion agencies were created on both national and regional levels, and they compete with one another for a share in the FDI inflows. Fedderke & Romm (2006) have found that the growth impact of FDI is indeed positive for South Africa. The finding is complementary to foreign and domestic capital in the long run, implying a positive technological spillover from foreign to domestic capital. While there is a crowd-out of domestic investment, which means a foreign company is dominating a sector in the local market, stifling local competition and entrepreneurship, this impact is restricted to the short term. Estimated results thus confirm a positive spillover effect of FDI on capital and labour, and hence on output in the long term for South Africa.

Banga's (2003) research shows that the last two decades have witnessed an extensive growth in FDI flows to developing countries. This has been accompanied by an increase in competition amongst developing countries to attract FDI, resulting in a rise in investment incentives offered by the host governments and removal of restrictions on the operations of foreign firms in their countries. Busse & Hefeker (2007) quantify this increase over the last 25 years – the total FDI into developing countries rose from some US\$4-billion in 1980, to US\$182-billion in 1999, before falling back to US\$152-billion in 2003. As a share of the GDP, this reveals an enormous increase in the significance of FDI. In developing countries, FDI proportion in relation to GDP has increased from 0.1 percent in 1980 to over 3.4 percent in 2007 (UNCTAD, 2008).

UNCTAD's (2007) comprehensive report on world investment has shown that South Africa, along with many other sub-Saharan African countries, is under-

performing in terms of attracting FDI. Musila & Simon (2006) found that the total FDI inflows into Africa increased from less than \$1-billion in 1970 to over \$18-billion in 2001. However, the volume of FDI inflows into Africa in 2001 represented only a nine percent share of the FDI inflows into developing countries, and a 2.3 percent share of the global FDI. To compare with an earlier period, the shares were 26.8 percent of the FDI inflows into developing countries and 7.2 percent of the global FDI in 1970. This is partly explained by the emergence of China and India, both countries together attracting around 21 percent of all FDI targeted at developing countries (UNCTAD, 2008). With such a performance, it is not surprising that there has been a great deal of discussion surrounding Africa's apparent lapse in attracting FDI (UNCTAD, 2007; UNCTAD, 2008; Musila & Simon, 2006).

## **2.3 Broad-Based Black Economic Empowerment**

### **2.3.1 Definition**

Black Economic Empowerment is an affirmative action policy designed to correct historical imbalances in South Africa. According to the BEE commission report, issued by BEECom, the BEE goals are:

- To be an integrated and coherent socio-economic process;
- To form part of the country's national transformation programme;
- To aim at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa's financial and economic resources to the majority of its citizens; and

- To seek to ensure broader and more meaningful participation in the economy by black people [allowing them] to achieve sustainable development and prosperity (FW de Klerk Foundation, 2006).

### **Definition of Affirmative Action**

Deane (2005) defines affirmative action as ‘the collection of measures that allocate goods, jobs, promotions, public contracts, business loans, and rights to buy and sell to a designated group, for the purpose of increasing the proportion of members of that group in the relevant labour force, entrepreneurial class, or university student population, where they are currently underrepresented as a result of past or present discrimination’.

Defining affirmative action without reference to justice and equality is impossible. The concept of justice can be divided into two categories: distributive justice which refers to an obligation to expand actions for the beneficiaries (giving them the chances they should have had) and correctional justice which refers to equitable conduct in order to achieve the goal of equality (Tomasson, Crosby & Herzberger, 1996). Equality refers to the principle of similar treatment, irrespective of background or race. It is suggested that affirmative action should refer to programmes that lift the discriminated into higher participation, with the effect of a reversal of earlier discrimination. The demolition of racial segregation and social imbalances are included in the body of affirmative action (Van Jaarsveld, 2000).

Deane (2005) argues that there is a right way to go about affirmative action, and a wrong way. Affirmative action initiatives must actually work to effectuate the goals of fighting discrimination and encouraging inclusion; and they must be fair; i.e. no unqualified person can be preferred over another qualified person in the name of affirmative action, and these measures should be transitional. The goal of affirmative action is to achieve equality at work 'without lowering standards and without unduly limiting the prospects of existing competent employees'.

### **The Beneficiaries of Broad-Based BEE**

The beneficiaries of Broad-Based BEE, defined as a black designated group, consist of people who were in a disadvantaged situation during the apartheid regime. This group includes: Black Africans, Indians and Coloured people, with the recent addition of the Chinese. The first Employment Equity legislation, from 1998, included women of all races; however the revision from 2003 has excluded white women from the list of previously disadvantaged people (Sabbagh, 2004). The beneficiaries of Broad-Based BEE form the majority of the South African population; they have been subjected not just to prejudice, but to state-organised discrimination. With the exception of Malaysia and South Africa, affirmative action policies around the world are aimed at protecting the minorities (Deane, 2005).

### **2.3.2 Origins**

To understand a country's present situation there is a need to look at that country's past, since much of what has happened in the past forms a basis for

action taken in the present. South Africa was a country ruled by a political system called apartheid. Apartheid was based on a policy of the segregation of the races through legislation. Racial discrimination was one of the defining features of apartheid in South Africa, and was entrenched in a range of statutory provisions for many decades. This is important to note, as successive South African governments used legislation to inhibit the economic advancement of blacks (Deane, 2005).

In order to redress these circumstances that were propagated by many years of discrimination, the government of South Africa implemented drastic policies. BEE was implemented, aiming to increase black management and control of businesses in the economy, and to diminish economic inequalities among and within the races (Department of Trade and Industry, 2008b). Preferential business policies were first instituted under the Reconstruction and Development Programme of the ANC, which aimed 'to deracialise business ownership and control completely' (Department of Trade and Industry, 2008b). This programme resulted in limited, often nominal, sales of equity stakes to black investors and did not constitute a change of operational control. These precarious deals left their black owners highly indebted (Department of Trade and Industry, 2008b) in the wake of the market volatility experienced during the 1998 Asian Financial Crisis and the recession it precipitated. This was the nadir of the empowerment programme in South Africa (Murphy, 2005).

A number of studies, including that of Murphy (2005), Mandla (2006) and Andrews (2008), recognise that South Africa has designed its Broad-Based

BEE policy by duplicating the Malaysian affirmative action programme NEP (New Economic Policy). With the end of colonialism and apartheid in Malaysia and South Africa respectively, where the majority of citizens were systematically excluded from political and economic participation, these two countries faced the challenge of redressing the socio-economic and political imbalances created by past regimes. During colonialism and apartheid days, the indigenous people, who comprised the majority of the populations of these countries, were deliberately excluded from taking part in economic activities. This resulted in them becoming poor and dispossessed of what was originally theirs (Mandla, 2006).

Mandla (2006) and Murphy (2005) have found the following similarities between South Africa's Broad-Base BEE programme and the Malaysian NEP:

- Both Malaysia and South Africa implemented their policies for almost identical goals – economic growth, employment and racial equity;
- Both South Africa and Malaysia's programmes were designed to benefit a previously discriminated-against majority (the blacks and the Malays), rather than a minority;
- Both countries' programmes are extensive, covering business, employment and education-preferential policies;
- Both countries are middle-income nations at a similar stage of development. Particularly, Malaysia is often considered an attractive model for South Africa since it is another medium-sized, southern-hemisphere-located democracy which has achieved rapid growth, while at the same time successfully redistributing wealth among its ethnic groups;

- After Malaysia and South Africa became democracies (in 1957 and 1994, respectively), both implemented schemes designed to address the well-founded grievances of their disadvantaged majorities; and
- In both countries, the decolonisation process left the economic power in the hands of the minority (ethnic) groups, a phenomenon that led to the exclusion of the majority from meaningful participation in the mainstream economy.

Murphy (2005) identified that the structure of South Africa's redistribution policies is very similar to those of Malaysia, but the structure of their economies is very different. In South Africa, prospects for adequate foreign investment and rapid growth seem slim, because of factors such as poverty, high unemployment (particularly among blacks), a high crime rate and HIV/AIDS infection rates. Murphy (2005) concludes that only by directly confronting HIV/AIDS, poverty, unemployment, investment and education reform can South Africa hope to mirror the successful inter-ethnic wealth distribution achieved by Malaysia.

### **2.3.3 Implementation**

Mandla's (2006) research identified that Black Economic Empowerment has been a consistent theme in ANC policy from the time of the Freedom Charter. Immediately after assuming power in 1994, the ANC set out key development challenges for the new government, embodied in the Reconstruction and Development Programme (RDP). RDP priorities included, among others, the



creation of jobs, human resource development, the provision of infrastructure, changes in ownership patterns and the reduction of inequality in society.

According to Butler (2007) the voluntary process of black empowerment was developing gradually from 1994, and was cruelly undermined by international events. Butler (2007) explains that there was considerable BEE activity in this first phase. Deals were mostly financed through 'special purpose vehicles' (SPVs), established solely to facilitate the purchase of equity in an established target company. SPVs used shares as collateral against loans, and the 1998 emerging market crisis saw the banks rapidly winding up the majority of them. In this way, the emerging market crisis exposed the unsustainable financial structuring of most BEE deals and drastically reduced black ownership on the JSE. The 1998 crash reduced BEE ownership of total JSE market capitalisation from seven percent to as low as 2.2 percent (Beall, Gelb & Hassim, 2005).

Mandla (2006) explains that the collapse of many black empowerment companies (who had transferred their wealth to benefit the South African majority), put the BEE process in crisis. In November 1997 the Black Management Forum (BMF) decided to establish the Black Economic Empowerment Commission (BEECom). This was launched in May 1998 under the auspices of the BBC, as a forum for discussing all BEE-related concerns. The purpose of the BEECom was to give strategic direction to the formulation of public policy on the issue of economic empowerment.

Black Economic Empowerment, which started in 1994, lacked a clearly defined strategy (Murphy, 2005). In 2003, the government revamped its policies to increase the number of black managers and corporate directors, plus the amount of black capital ownership, and also reduced the discrepancies that characterise the black and white income distributions (Department of Trade and Industry, 2008a). In such a context the government implemented Broad-Based BEE, as an affirmative action strategy, to address the systematic exclusion of the majority of South Africans from full participation in the economy (FW de Klerk Foundation, 2006).

Mandla (2006) comments that Broad-Based BEE is mainly characterised by scorecards which companies have to comply with, in terms of empowering those who were previously excluded from participating in the mainstream economy. Although progress is to be made in empowering some companies through these scorecards, this does not seem to broaden empowerment to benefit the ordinary people on the street. This empowerment strategy excludes the most critical areas – such as poverty reduction and education – where many blacks still feel trapped.

### **2.3.4 Broad-Based BEE Policy Instruments**

#### **Contribution Levels**

Companies are awarded Broad-Based BEE status according to the points they achieve in the BEE scorecard. This is provided by the BEE Codes of Good Practice or in a gazetted industry charter (Department of Trade and Industry, 2008a). The preferential categories include:

- Excellent contributor to Broad-Based BEE – total score of 80 percent and above;
- Good contributor to Broad-Based BEE – total score of 65 to 79.9 percent;
- Satisfactory contributor to Broad-Based BEE – total score of 40 to 64.9 percent; and
- Limited contributor to Broad-Based BEE – total score of below 40 percent.

Companies are measured against Broad-Based BEE scorecards. A company that scores less than 30 points in the scorecards is deemed not to have BEE status. The BEE levels vary from Level 1 (excellent contributor), with a contribution score above 100 points; to Level 8 (limited contributor), with a contribution score of between 30 and 40 points (Balshaw & Jonathan, 2008).

The Broad-Based BEE contribution level also determines the number of points that customers acquiring products and services from this company will receive. For companies that are Level 1 contributors, the procurement recognition level is determined at 135 percent. This means that for every R100 procured from these companies, the customer is allowed to declare R135 purchased from a BEE company. Table 1 shows the different levels of BEE contribution (Balshaw & Jonathan, 2008; Department of Trade and Industry, 2008a).

Contribution Level	Qualification Points Using The Generic or QSE Scorecard	B-BBEE Procurement Recognition Level
Level 1 Contributor	≥100	135%
Level 2 Contributor	≥85 but <100	125%
Level 3 Contributor	≥75 – <85	110%
Level 4 Contributor	≥65 – <75	100%
Level 5 Contributor	≥55 – <65	80%
Level 6 Contributor	≥45 – <55	60%
Level 7 Contributor	≥40 – <45	50%
Level 8 Contributor	≥30 – <40	10%
Non-compliant Contributor	<30 Points	0%

**Table 1:** B-BBEE Contribution Level (Department of Transit and Industry, 2008a)

## **Broad-Based BEE Components**

Broad-Based BEE can be divided into three components: Direct Empowerment, Human Resource Development, and Indirect Empowerment. Direct Empowerment refers to ownership of companies, board membership and executive management control of economic resources. Human Resource Development refers to employee equity, executive management and job-seekers. Indirect Empowerment refers to preferential procurement, suppliers, enterprises, and development programmes for communities (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

## **Broad-Based BEE Pillars**

Broad-Based BEE is also divided into seven elements or pillars, these are: Equity Ownership, Management Control, Employment Equity, Skills Development, Preferential Procurement, Enterprise Development and Socio-Economic development (Balshaw & Jonathan, 2008). Each pillar has its own measurement criteria and weighting. The list below shows the different weightings for the Broad-Based BEE pillars, and the next sections contain each pillar's scorecard:

- Equity Ownership 20 percent;
- Management 10 percent;
- Employment Equity 10 percent;
- Skills Development 20 percent;
- Preferential Procurement 20 percent;
- Enterprise Development 10 percent; and

- Residual (industry-specific) 10 percent.

### Equity Ownership

This element refers to the ownership of a business, and is measured by the voting rights and economic interest associated with the company. The scorecard for this category is attached as Table 2 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Multinational firms that have a global policy prohibiting the sale of equity in its affiliates may qualify for equity equivalents, which is a replacement for equity ownership. However more than 80 percent of multinationals in a survey organised by KPMG indicated that their organisations were not interested in this latter option, as the cost was too high and it was not viable for their businesses (KMPG, 2007).

Indicators		Weighting	Target
Voting Rights	Exercisable voting rights in the enterprise, in the hands of black people	3	25% + 1 vote
	Exercisable voting rights in the enterprise, in the hands of black women	2	10%
Economic Interest	Economic interest of black people in the enterprise	4	25%
	Economic interest of black women in the enterprise	2	10%
	Economic interest of the following black natural people in the enterprise: <ul style="list-style-type: none"> <li>• Black designated groups;</li> <li>• Black participants of broad-based ownership schemes;</li> <li>• Black participants of employee share schemes; and</li> <li>• Black participants of co-operatives.</li> </ul>	1	2.5%
Realisation Points	Ownership fulfilment	1	
	Net value	7	
Bonus Points	Involvement in the ownership of the enterprise, by new black entrants	2	10%
	Involvement in the ownership of the enterprise, by new black participants: <ul style="list-style-type: none"> <li>• In employee share schemes;</li> <li>• In broad-based ownership schemes; or</li> <li>• In co-operatives.</li> </ul>	1	10%

**Table 2:** Equity Ownership Scorecard (Department of Transit and Industry, 2008a)

## Management Control

This element refers to the effective management of the activities and resources of a company, which is mostly applicable to top management and board members. The scorecard for this category is attached as Table 3 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Indicators	Weighting	Target
Exercisable voting rights of black board members, adjusted for gender	3	50%
Black executive directors, adjusted for gender	2	50%
Black senior top management, adjusted for gender	3	40%
Black other top management, adjusted for gender	2	40%
Black independent non-executive board members	1	40%

**Table 3:** Management Control Scorecard (Department of Transit and Industry, 2008a)

## Employment Equity

This element is related to jobs in companies at all levels, including executives, senior and middle management, professionals and operations. This element has a certain degree of overlap in relation to Management Control, and the ultimate target is to align the demographics of the company with the national demographics. The scorecard for this category is attached as Table 4 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Indicators	Weighting	Targets	
		Yrs 0-5	Yrs 6-10
Disabled black employees as a percentage of all employees, adjusted for gender	1	2%	2%
Black employees in senior management as a percentage of all employees, adjusted for gender	5	43%	60%
Black employees in middle management as a percentage of all employees, adjusted for gender	5	63%	75%
Black employees in junior management as a percentage of all employees, adjusted for gender	4	68%	80%
Bonus point: Meeting or exceeding the EAP targets for each of the above categories	3		

**Table 4:** Employment Equity Scorecard (Department of Transit and Industry, 2008a)

## Skills Development

This element focuses on the learnership and development of core competencies in black people, so that they will be able to climb the corporate ladder. The scorecard for this category is attached as Table 5 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Indicators		Weighting	Target
Skills development spend on learning programmes	Skills development spend on learning programmes for black employees, as a percentage of leaviable amount, adjusted for gender	6	3%
	Skills development spend on learning programmes for black employees, with disabilities, as a percentage of leaviable amount, adjusted for gender	3	0.3%
Learnerships	Number of black employees participating in learnerships or category B, C and D programmes, as a percentage of total employees, adjusted for gender	6	5%

**Table 5:** Skills Development Scorecard (Department of Transit and Industry, 2008a)

## Preferential Procurement

In order to achieve points in this element, the company is required to measure how much of its procurement is done out of BEE companies. The main goal is to create a cascade effect in the economy, and to incentivise companies that do not supply directly to government to also adhere to Broad-Based BEE. The scorecard for this category is attached as Table 6 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Indicators	Weighting	Targets	
		Yrs 0-5	Yrs 6-10
BEE procurement spend from all suppliers, based on the BEE procurement recognition levels as a percentage of total measured procurement spend	1	2%	2%
BEE procurement spend from qualifying small enterprises or from exempted micro-enterprises, based on the applicable BEE procurement recognition levels as a percentage of total measured procurement spend	5	43%	60%
BEE procurement spend from any of the following suppliers, as a percentage of total measured procurement spend: <ul style="list-style-type: none"> <li>• Suppliers that are more than 50% black-owned, regardless of their BEE procurement recognition level; or</li> <li>• Suppliers that are more than 30% black women-owned, regardless of their BEE procurement recognition level.</li> </ul>	5	63%	75%

**Table 6:** Preferential Procurement Scorecard (DTI, 2008a)

### Enterprise Development

This element refers to incentives given to the development of companies owned by black people. It includes loans and operational support. The scorecard for this category is attached as Table 7 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).

Indicators	Weighting	Target
Average annual value of all Enterprise Development contributions and sector specific programmes made by the measured entity, as a percentage of the target	15	3% of NPAT

**Table 7:** Enterprise Development Scorecard (DTI, 2008a)

### Socio-Economic Development

This element refers to financial and non-financial contributions to the development of black communities. The scorecard for this category is attached as Table 8 (Department of Trade and Industry, 2008a; Balshaw & Jonathan, 2008).



Indicators	Weighting	Target
Average annual value of all qualifying contributions made by the measured entity, measured from the commencement of this statement or the inception date to the date of measurement, as a percentage of the target	5	1% of NPAT

**Table 8:** Socio-Economic Development (Department of Transit and Industry, 2008a)

### **Policy enforcement**

Governmental agencies and companies will only procure from BEE companies, with rare exceptions, for example in areas where there are no suppliers with BEE status, and governmental companies are forced to procure from non-BEE companies (Department of Trade and Industry, 2008a). This decision makes companies supplying to government able to pursue aggressively high points in the scorecards, since one of the elements is related to procurement from BEE suppliers. These companies are putting pressure on their suppliers to also have BEE status. This is a cascade process which has as its goal the need to make the whole economy BEE compliant. Non-BEE compliance is not penalised by fines or any other sort of financial or regulatory penalties. However, political pressure is expected in non-compliant sectors, which includes difficulties in getting support or economic incentives for industries with a high level of non-compliance (Balshaw & Jonathan, 2008).

### **Companies Granted Special Broad-Based BEE Scorecards**

All companies operating in South Africa of all sizes, shapes and origins are subject to Broad-Based BEE. The Broad-Based BEE Act has granted small and young companies with incentives for fulfilling their BEE statuses. The beneficiary companies are the ones defined as Micro-Enterprises, Small-Enterprises and Start-up Enterprises. Micro-Enterprises (companies with

revenue of up to R5-million a year), are deemed BEE Level 4, and are not required to produce a BEE scorecard. These companies might, however, produce one if their scorecard can be potentially higher than four, and they foresee real benefits in having it. Small Enterprises are companies with revenue of between R5-million and R35-million; these companies are required to choose four out of the seven elements of Broad-Based BEE, and their scorecard is adjusted for the lower number of total points. Start-up Enterprises are deemed to be at BEE Level 4 for their first year of operation (Department of Trade and Industry, 2008a).

### **2.3.5 Lessons from International Experiences**

According to Stead (2007) affirmative action or 'positive discrimination' is not a recent policy. Although arguably the best-known example is that of Malaysia, in the form of the New Economic Policy that covered the period from 1970 to 1990, there are a number of other examples of similar policies, including those in India and Sri Lanka, from which lessons could be learned.

South Africa can learn a great deal from the Malaysian experience about how to implement an economic empowerment programme aimed at ensuring that economic wealth is broad based. The Malaysian experience shows that for an economic empowerment programme to work, the South Africa economy needs to grow so that the pie can be shared out among the different ethnic groups. Another key aspect is the fact that Malaysia's economic restructuring took place in a less globalised period, and South Africa's is occurring at a time when globalisation is at an advanced stage. This represents an enormous challenge

for the South African government, to match Malaysia's successes in redressing the economic imbalances (Mandla, 2006).

The experience of Singapore is relevant to this discussion, not only because it was part of Malaysia prior to 1965, but also because its principal racial ethnic groups – the Chinese and Malays – comprise the majority of the population. However, unlike Malaysia, Singapore has never introduced affirmative action policies. In fact, the primary reason for its secession was the discriminatory nature of the Malaysian NEP against the Chinese. Although both countries follow different policies regarding ethnic groups, both have so far avoided intergroup violence such as that which occurred in India and Sri Lanka. The common factor cannot be affirmative action, because Singapore has no such policy (Stead, 2007).

Murphy (2005) analyses that both South Africa and Malaysia's programmes have been subject to similarly pointed criticisms. First of all, there is the perception in South Africa that those who are benefiting from the preferential policies in employment and business are unqualified, leading to rising resentment on the part of the whites, and perhaps hindering reconciliation. The same problem of a lack of adequately-trained Malays was noted in Malaysia in the 1980s. This problem will not be resolved quickly in South Africa, since it will take time for blacks to receive the required education and training necessary to take on skilled labour and professional jobs. However, it is encouraging that Malaysia faced this same problem at the outset of its preferential policies, but was able to overcome it through improvements in education.

As the world's largest multiethnic society and arguably the most socially fragmented, India has a history of affirmative action programmes that extend back to colonial times. Indian constitution prescribes equal rights for all its citizens, but includes an exception for policies designed to benefit disadvantaged sectors of the population. These provisions were originally set to expire in 20 years, but have been extended again and again. The conclusion that one reaches when referring to the aims, implementation and effects of the programme is that affirmative action in India has unfortunately produced minimal benefits to those most in need of them, and maximum resentment and hostility towards such people on the part of others (Stead, 2007).

Another major challenge facing the South African government is attracting foreign investment. While the share of foreign ownership in Malaysia decreased over the course of the NEP, it was still very high. By contrast, foreign direct investment (FDI) into South Africa has remained low. Low amounts of foreign investment – generally a reaction to the HIV/AIDS situation, crime rates and poor education – constitute an obstacle to growth in South Africa (Southall, 2005).

An assumption implicit in any affirmative action initiative is the ability to control and direct the consequent course of events, but the Sri Lankan experience would clearly demonstrate that this is not a given. The actual course of events in Sri Lanka resulted in all groups being worse off, as the country suffered race riots, civil war, widespread terror and even assassination of its leaders. Sri

Lanka demonstrated the dangers of complacency – particularly when racial or ethnic relationships are affected by circumstances, such as the right atmosphere combined with the right demagogue (Stead, 2007).

## **2.4 Conclusion of Literature Review**

In the literature there are some controversies about the impact of FDI on host countries, but most of the authors recognise FDI as being immensely important for economic development. Empirical studies, including the ones performed in South Africa, have found a positive correlation between FDI inflows and economic growth (Lahiri, 2008; Asiedu & Esfahani, 2008; UNCTAD, 2007).

Countries have identified the benefits associated with FDI, among those, job creation and an increase in export capabilities; and they are therefore developing policies and incentives aimed at attracting FDI to their borders. Studies on the drivers of FDI have found that fiscal incentives are not determinants in attracting FDI, but removal of policies and barriers are (Banga, 2003; Zhang et al, 2007; Lipsey, 2002; Busse & Hefeker, 2007; Mirza & Yoo, 2003).

Empirical analysis and studies have shown that South Africa is underperforming in its capability to attract FDI. From the country's economic size and level of development, South Africa was expected to attract more FDI than it is currently doing (Busse & Hefeker, 2007; Fedderke & Romm, 2006; TRALAC, 2004; UNCTAD, 2007).

In this competitive environment, South Africa has implemented its Broad-Based BEE policy, which is the greatest strategic issue in the South African business environment today (Balshaw & Jonathan, 2008). Broad-Based BEE policies include instruments to determine ownership of companies, management control, employment directives, skills development, preferential procurement and enterprise development (Sabbagh, 2004; Department of Trade and Industry, 2008a).

Broad-Based BEE is not an unique experiment. Many countries worldwide have implemented different models of affirmative action. The common lesson for South Africa to note is that for an economic empowerment programme to work, an economy needs to grow; therefore South Africa must focus all its attention on economic growth and the key problems affecting the South African economy (Mandla, 2006; Murphy, 2005).

Reviewing the literature, it is possible to identify that there is a direct relationship between FDI determinants and Broad-Based BEE instruments. However, there is a gap in the literature to describe the impact of Broad-Based BEE on FDI inflows into South Africa. This study aims to contribute to close this gap by analysing the economic impact, in terms of FDI inflows, of Broad-Based BEE implementation.

## **Chapter 3. Research Hypothesis**

### **3.1 Introduction**

In this study, exploratory research was conducted using articles, books and reports from international organisations, such as IMF and World Bank. This has served as guidance to build a theoretical framework to evaluate the impact of governmental policies on FDI inflows. The objective of this study is to use a quantitative approach and a quasi-experimental design to test the impact of Broad-Based BEE policies on South Africa's capability to attract Foreign Direct Investment.

### **3.2 Theoretical Framework**

The research adopted the methodology of a quasi-experimental design to evaluate the impact of Broad-Based BEE on FDI inflows into South Africa. Two sets of tests were undertaken, the first using a Static Group design and the second using a Single Group Pretest-Posttest design. Test one compared South Africa's FDI inflows against those of other emerging countries, and against the aggregated data from the African continent as a whole. Test two evaluated FDI inflows into South Africa before and after Broad-Based BEE implementation.

### 3.3 The Research Hypothesis

#### Hypothesis 1

Null hypothesis: South Africa's FDI inflow levels are the same as those of other emerging countries with a similar level of development, but without Ownership Equity policies.

Alternative hypothesis: South Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Ownership Equity policies.

#### Hypothesis 2

Null hypothesis: South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development, but without Management Control policies.

Alternative hypothesis: South Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Management Control policies.

#### Hypothesis 3

Null hypothesis: South Africa's FDI inflow levels are the same as those of other emerging countries with a similar level of development, but without Employment Equity policies.

Alternative hypothesis: South Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Employment Equity policies.



#### **Hypothesis 4**

Null hypothesis: South Africa's FDI inflow levels are the same as those of other emerging African countries with a similar level of development, but without Broad-Based BEE policies.

Alternative hypothesis: South Africa's FDI inflow levels are lower than those of other emerging African countries with a similar level of development, but without Broad-Based BEE policies.

#### **Hypothesis 5**

Null hypothesis: South Africa's FDI inflow levels are proportionally the same as the FDI inflow levels into the African continent as whole.

Alternative hypothesis: South Africa's FDI inflow levels are proportionally lower than the FDI inflow levels into the African continent as a whole.

#### **Hypothesis 6**

Null hypothesis: South Africa's FDI inflow levels in the period before BEE policies implementation were the same as in the period after BEE policies implementation.

Alternative hypothesis: South Africa's FDI inflow levels in the period before BEE policies implementation were higher than in the period after BEE policies implementation.

## **Chapter 4. Research Methodology**

### **4.1 Research Design**

This study was designed as a quasi-experimental research. A theoretical framework has been developed to test the impact of Broad-Based BEE policies on South Africa's capability to attract FDI. The FDI empirical data used in the tests was extracted from international conjuncture reports.

#### **Quasi-Experimental Research**

In this research, cross-nation FDI data was tested according to Broad-Based BEE policies implementation; therefore, the use of quasi-experimental design was appropriate since it would be impossible to reproduce a true experiment. In this research design, the 'association' between the variables is focused, instead of 'cause-effect' (Zikmund, 2003).

Two sets of quasi-experimental tests were applied in this research: a Static Group test and a Single Group Pretest-Posttest test. The first one tested South Africa's FDI inflows against those of other emerging countries with a similar level of development, but without Broad-Based BEE-like policies. The second one tested South Africa's FDI inflows before and after Broad-Based BEE policies implementation.

#### **Secondary Data**

Zikmund (2003) identifies many advantages of using secondary data, among them: speed and lower cost. The secondary data used in this research was

sourced from international reports of institutions such as UNCTAD, World Bank and IMF. These institutions are recognised for the high level of quality and reliability of their reports.

### **Dependent Variable**

- FDI Inflows into emerging countries

The dependent variable was measured using FDI empirical data from international reports and electronic databases, provided by UNCTAD (United Nations Conference on Trade and Development) which is considered the most respectable institution in the world from which to source international FDI data. The unit of measure to assess FDI inflows into emerging countries was FDI inflows as a percentage of Gross Capital Formation (GCF). GCF comprises all capital invested in a given country; therefore, the higher the percentage GCF, the higher is the capacity of the country to attract FDI inflows.

### **Independent Variables**

- Ownership Equity
- Management Control
- Employment Equity
- Broad-Based BEE-Combined Policies

Ownership Equity, Management Control and Employment Equity were selected in adherence to a study conducted by KPMG in 2007. This study has found that Ownership Equity, Management Control and Employment Equity are the most challenging pillars in a Broad-Based BEE implementation (KPMG, 2007).

## **4.2 Population**

Population is defined as the complete group of people, companies, hospitals, stores, college students or the like that share a set of characteristics (Zikmund, 2003). For the purposes of this research, the population was FDI inflows into all developing countries.

## **4.3 Sampling**

The sampling method was judgmental non-probabilistic, and the selected countries for the Static Group Test were Brazil, Chile and Mexico. These countries were selected as they are emerging nations, have a level of development similar to that of South Africa, are former European colonies, have diversified and multi-ethnic populations, and they do not apply policies such as Ownership Equity, Management Control or Employment Equity. This information was sourced from the international reports entitled 'International Country Risk Guide' and '2008 Index of Economic Freedom' (Political Risk Services Group, 2008; Heritage Foundation & Wall Street Journal, 2008). Apart from the previously mentioned group of countries, South Africa's FDI inflows were compared with those of some other African countries, for example Nigeria and Botswana, and with the aggregated data from the African continent as a whole. This test was performed to evaluate South Africa's capability to attract FDI into the region, and to reduce bias that may be caused due to market size and the region being compared.

#### **4.4 Data Collection**

Due to the nature of the research, which is a comparison of cross-country FDI information, the research has been done using only secondary data. The data was collected from international conjecture reports, country fact sheets and FDI electronic databases, all provided by UNCTAD. The main source of the data was the World Investment Report, which is the most comprehensive report in existence on FDI in virtually all the countries in the world. This report is issued yearly, and in order to gather the necessary information for this research, reports from 2001 to 2008 were consulted.

The secondary data used in this study could be accessed electronically at the time this research was developed, at the internet addresses listed below. The country fact sheets used in this research are attached in Appendix 1.

- World Investment Report Series: <http://www.unctad.org/wir>;
- FDI online database: <http://stats.unctad.org/FDI>.

#### **4.5 Data Analysis**

In order to measure the results of the quasi-experimental tests, descriptive statistics were used. Ideally, a comparison of means analyses should be carried out; a t-test can be employed. However, due to the fact that FDI inflows are only published annually and Broad-Based BEE is still a recent implementation, there was insufficient data to perform a formal statistics test to compare means.

Descriptive statistics were used to measure the differences between the control and the experimental groups. The details of the tests carried out for the hypotheses are described in the next paragraphs:

### **Hypothesis 1**

The Experiment group (X O1) is FDI inflows into South Africa, the control group (O2) is FDI inflows into Brazil, and the experiment is Ownership Equity, which is present in South Africa but is non-existent in Brazil. The time period used for this analysis is the years 2004 to 2007.

### **Hypothesis 2**

The Experiment group (O1) is FDI inflows into South Africa, the control group (O2) is FDI inflows into Mexico, and the experiment (X) is Management Control, which is present in South Africa but is non-existent in Mexico. The time period used for this analysis is the years 2004 to 2007.

### **Hypothesis 3**

The Experiment group (O1) is FDI inflows into South Africa, the control group (O2) is FDI inflows into Chile, and the experiment (X) is Employment Equity, which is present in South Africa but is non-existent in Chile. The time period used for this analysis is the years 2004 to 2007.

### **Hypothesis 4**

The Experiment group (O1) is FDI inflows into South Africa, the control group (O2) is FDI inflows into Nigeria and Botswana, and the experiment (X) is Broad-

Based BEE-combined policies, which are present in South Africa but are non-existent in Nigeria and Botswana. The time period used for this analysis is the years 2004 to 2007.

### **Hypothesis 5**

The Experiment group (O1) is FDI inflows into South Africa, the control group (O2) is FDI inflows into the African continent as a whole, and the experiment (X) is Broad-Based BEE-combined policies. The time period used for this analysis is the years 2004 to 2007.

### **Hypothesis 6**

FDI inflows into South Africa before Broad-Based BEE implementation (O1), is tested against FDI inflows into South Africa after Broad-Based BEE Implementation (O2), and the experiment (X) is Broad-Based BEE implementation. The period for group O1 is the years 2000 to 2003; the period for group O2 is the years 2004 to 2007.

## **4.6 Assumptions**

Black Economic Empowerment implementation has been developing gradually since 1994 (Butler, 2007). However, it lacked a clearly defined strategy that was only formalised at the end of 2003. For the purposes of this study, the implementation date of Broad-Based BEE is defined as 01 January 2004.

## **4.7 Research Limitations**

### **4.7.1 Extraneous Variables**

The number of extraneous variables is very high. Factors identified as FDI determinants, such as market size and growth, political risks, economies of scale, tax incentives and others, could have played a more important role in determining FDI inflows into selected emerging countries than instruments related to Broad-Based BEE policy. In an attempt to reduce this limitation, data from different emerging countries was used (i.e. Brazil, Chile, Mexico, Nigeria and Botswana) and comparisons with the African continent as a whole were performed.

### **4.7.2 Limited Number of Data Points**

Since Broad-Based BEE implementation is very recent, and due to the fact that FDI information is published on an annual basis, it was not possible to collect sufficient data points to perform an analysis of means (using a t-test or ANOVA). The FDI information available, after Broad-Based BEE implementation, provides only four data points (2004, 2005, 2006 and 2007). The degrees of freedom for the available data were only three (3), which were insufficient to perform formal statistics tests. Therefore, only descriptive statistics were used. Although these do not serve as statistical prove, the use of this technique has provided a good indication of the Broad-Based BEE impact on South Africa's capability to attract FDI inflows.



### **4.7.3 Expertise Constraints**

Potential errors and biases in this study were due to the researcher's inexperience in the research process. Effort was made to reduce biases as far as possible.

## Chapter 5. Results

### 5.1 Sample Description

The sampling data have been sourced from the World Investment Report series, published annually by UNCTAD. The report editions from 2001 to 2008 were used in this research; most of the data, however, was extracted from the 2008 edition of this report and from UNCTAD electronic FDI database. Both resources were available online at the time this research was conducted, at the following internet addresses:

- World Investment Report Series: <http://www.unctad.org/wir>;
- FDI online database: <http://stats.unctad.org/FDI>.

### 5.2 Results for Research Hypothesis

The following sections provide the results for each one of the research hypotheses proposed in this study. The results provided contain all the required elements to accept or reject the hypotheses, plus additional key information found during the analysis process. The results provided in this section are discussed in detail in Chapter 6.

#### 5.2.1 Impact of Ownership Equity on FDI

This hypothesis tests the impact of Broad-Based BEE Ownership Equity on South Africa's capability to attract FDI, by using a Static Group test that compares South Africa's FDI inflows with those of Brazil. Brazil was selected for

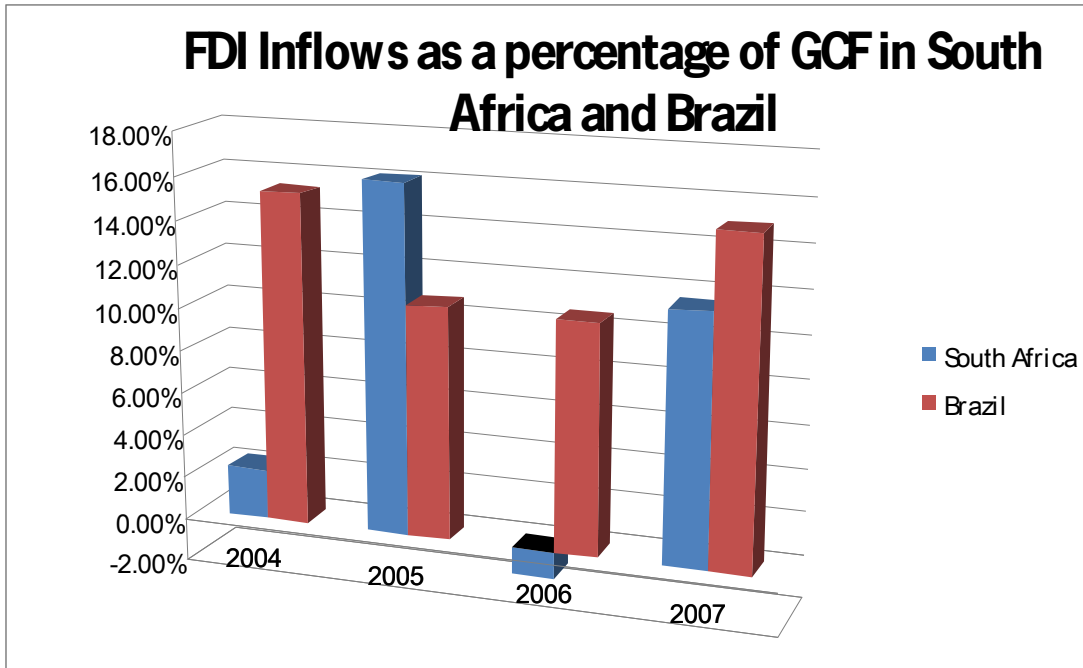
this test as it does not have policies equating to Broad-Based BEE Ownership Equity.

To test this hypothesis, South Africa was selected as experiment group (O1), Brazil was selected as the control group (O2) and Ownership Equity was determined as the experiment (X).

Table 9 provides descriptive statistics for both the experiment and the control group, and Figure 1 provides a graphical analysis of FDI inflows into South Africa and Brazil, which are respectively the experiment and the control groups.

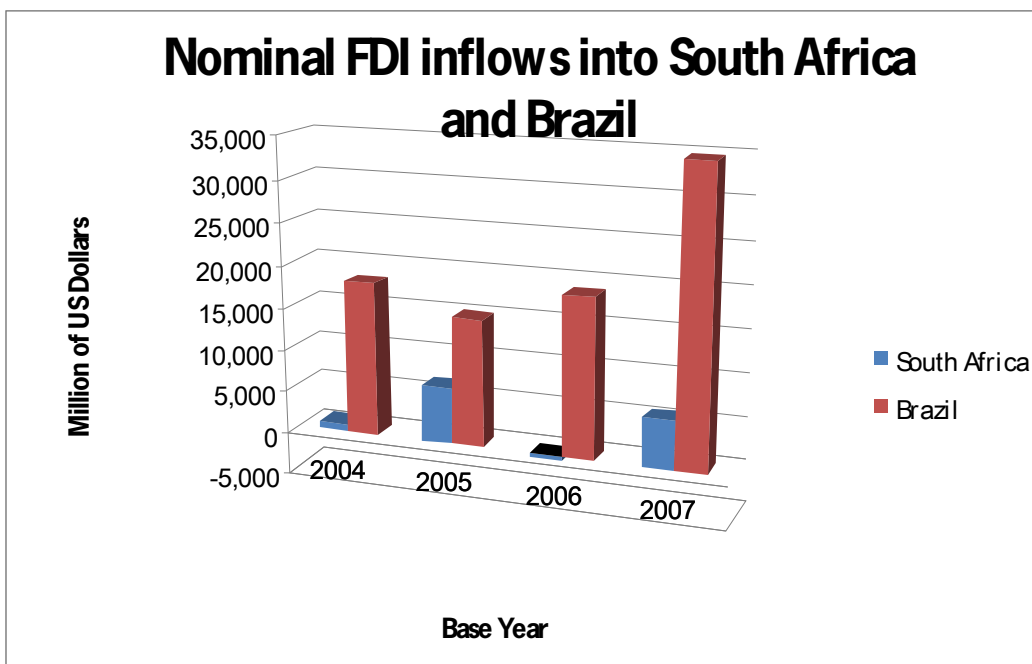
<b>One Variable Summary</b>	<b>Brazil</b>	<b>South Africa</b>
<b>Mean</b>	12.9%	7.18%
<b>Variance</b>	0.00068	0.00641
<b>Std. Dev.</b>	0.02601	0.08006
<b>Skewness</b>	0.0102	0.1151
<b>Kurtosis</b>	-2.9263	-0.6159
<b>Median</b>	10.7%	2.3%
<b>Mean Abs. Dev.</b>	2.25%	6.63%
<b>Minimum</b>	10.6%	-1.2%
<b>Maximum</b>	15.3%	16.1%
<b>Range</b>	4.7%	17.3%
<b>Count</b>	4	4
<b>Sum</b>	51.6%	28.7%
<b>1st Quartile</b>	10.6%	-1.2%
<b>3rd Quartile</b>	15%	11.5%

**Table 9:** FDI into South Africa and Brazil

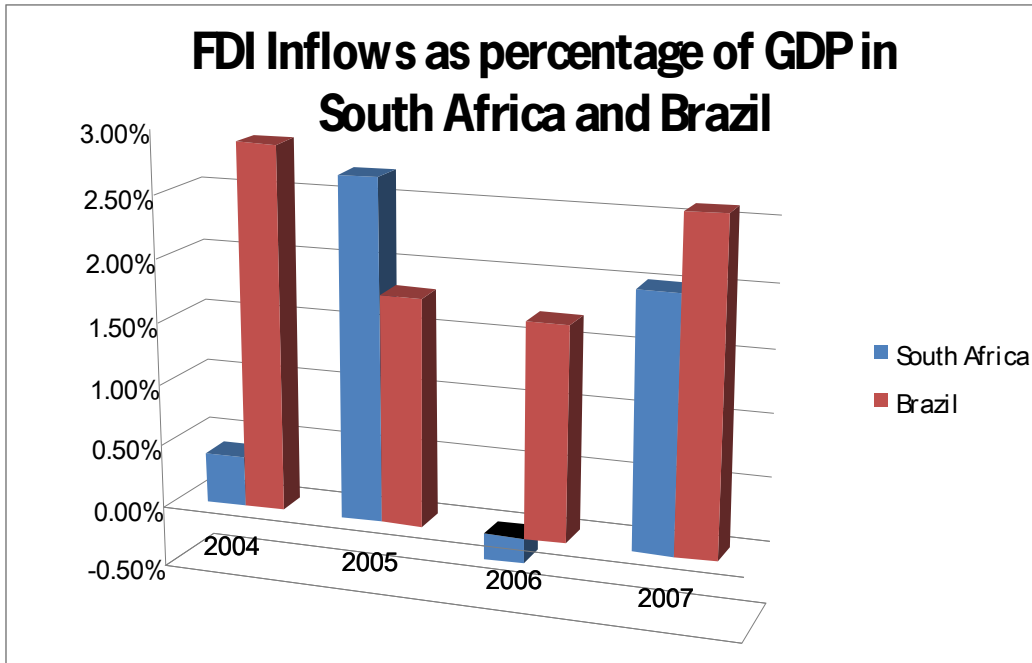


**Figure 1:** FDI Inflows as a percentage of GCP in South Africa and Brazil

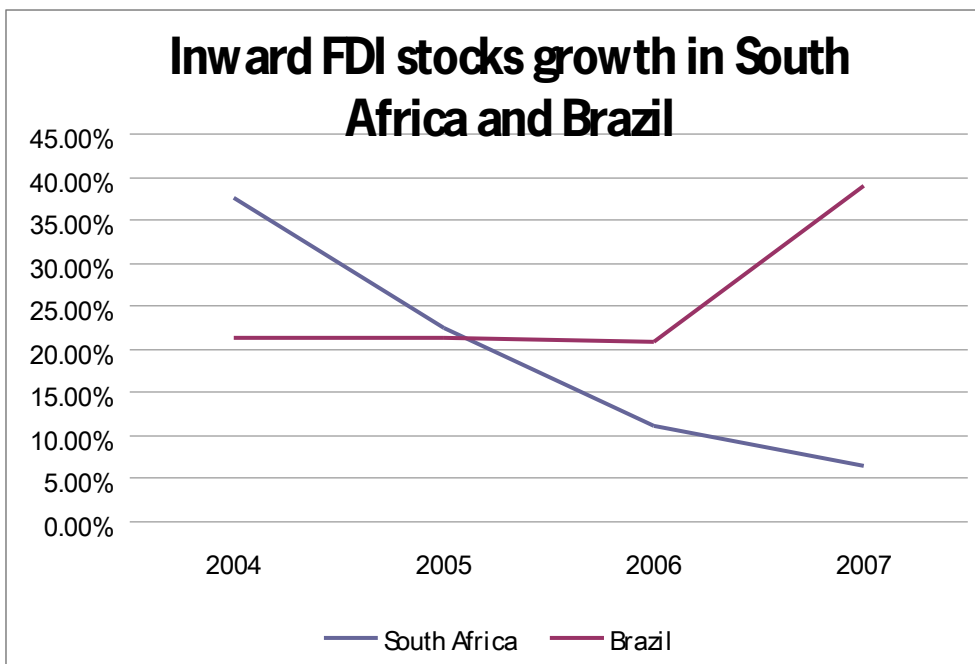
Figures 2, 3 and 4 provide additional information found when comparing FDI inflows into South Africa and Brazil. Figure 2 shows nominal FDI inflows, in millions of US dollars, into both countries. Figure 3 shows FDI inflows as a percentage of GDP. Figure 4 shows the inward FDI stocks growth for both countries, during the period 2004 to 2007.



**Figure 2:** Nominal FDI inflows into South Africa and Brazil



**Figure 3:** FDI Inflows as a percentage of GDP in South Africa and Brazil



**Figure 4:** Inward FDI stocks growth in South Africa and Brazil

### 5.2.2 Impact of Management Control on FDI

This hypothesis tests the impact of Broad-Based BEE Management Control policy on South Africa's capability to attract FDI, by using a Static Group test that compares South Africa's FDI inflows with those of Mexico. Mexico was

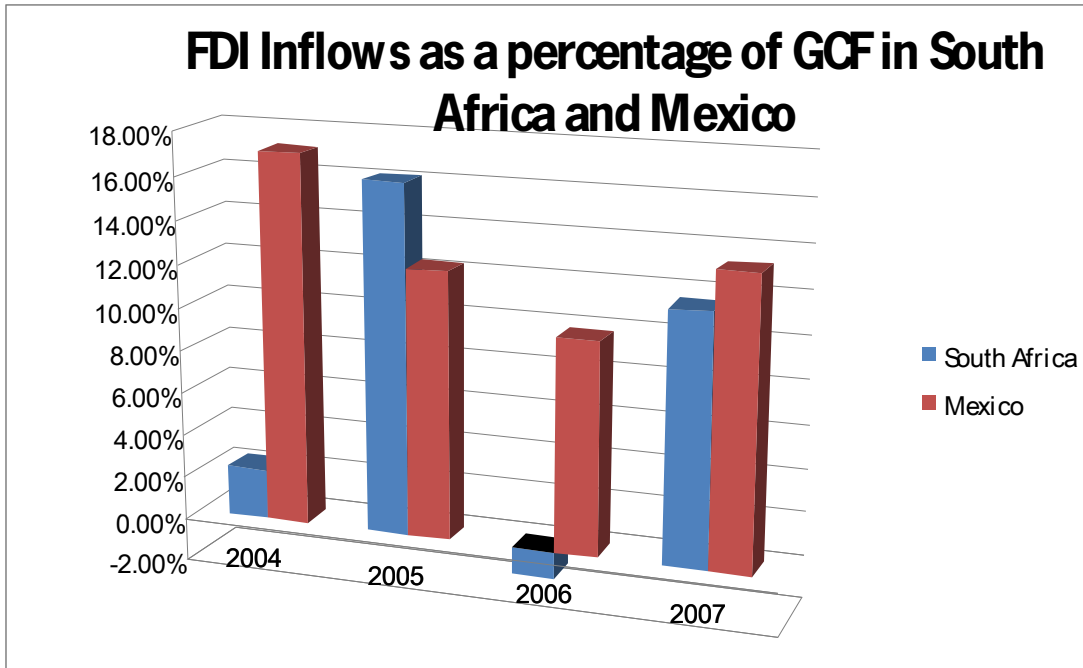
selected for this test as it does not have policies that equate to Broad-Based BEE Management Control.

To test this hypothesis, South Africa was selected as the experiment group (O1), Mexico was selected as the control group (O2) and Management Control policy was determined as the experiment (X).

Table 10 provides descriptive statistics for both the experiment group and the control group, and Figure 5 provides a graphical analysis of FDI inflows into South Africa and Mexico, which are respectively the experiment and the control groups.

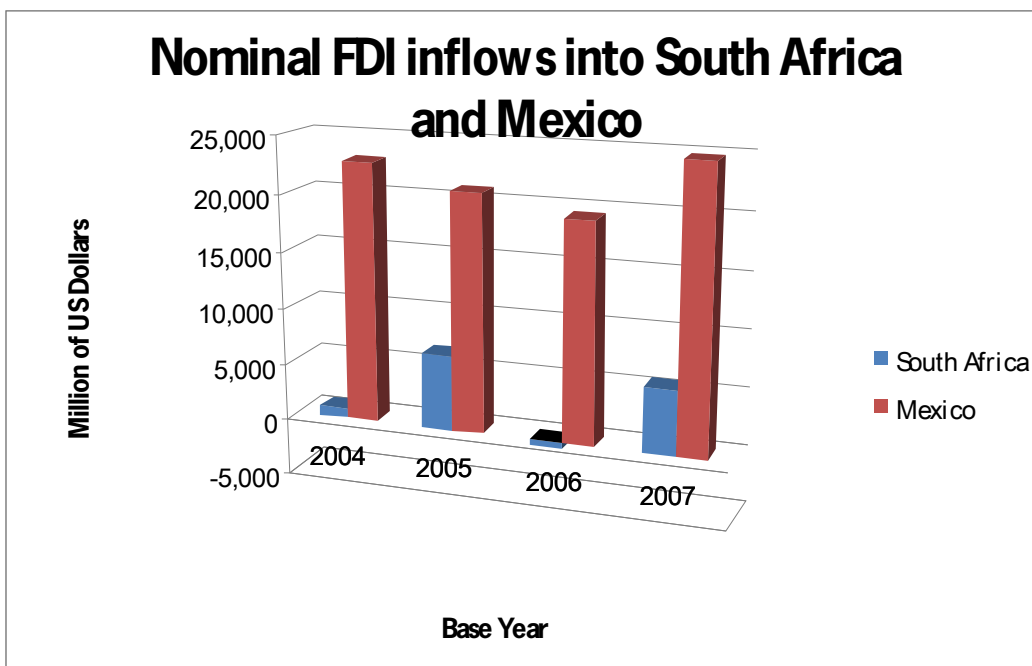
<i>One Variable Summary</i>	<b>South Africa</b>	<b>Mexico</b>
<b>Mean</b>	7.18%	13.13%
<b>Variance</b>	0.00641	0.00092
<b>Std. Dev.</b>	0.08006	0.03031
<b>Skewness</b>	0.1151	0.6101
<b>Kurtosis</b>	-0.6159	4.1987
<b>Median</b>	2.3%	12.3%
<b>Mean Abs. Dev.</b>	6.63%	2.08%
<b>Minimum</b>	-1.2%	9.8%
<b>Maximum</b>	16.1%	17.1%
<b>Range</b>	17.3%	7.3%
<b>Count</b>	4	4
<b>Sum</b>	28.7%	52.5%
<b>1st Quartile</b>	-1.2%	9.8%
<b>3rd Quartile</b>	11.5%	13.3%

**Table 10:** FDI into South Africa and Mexico

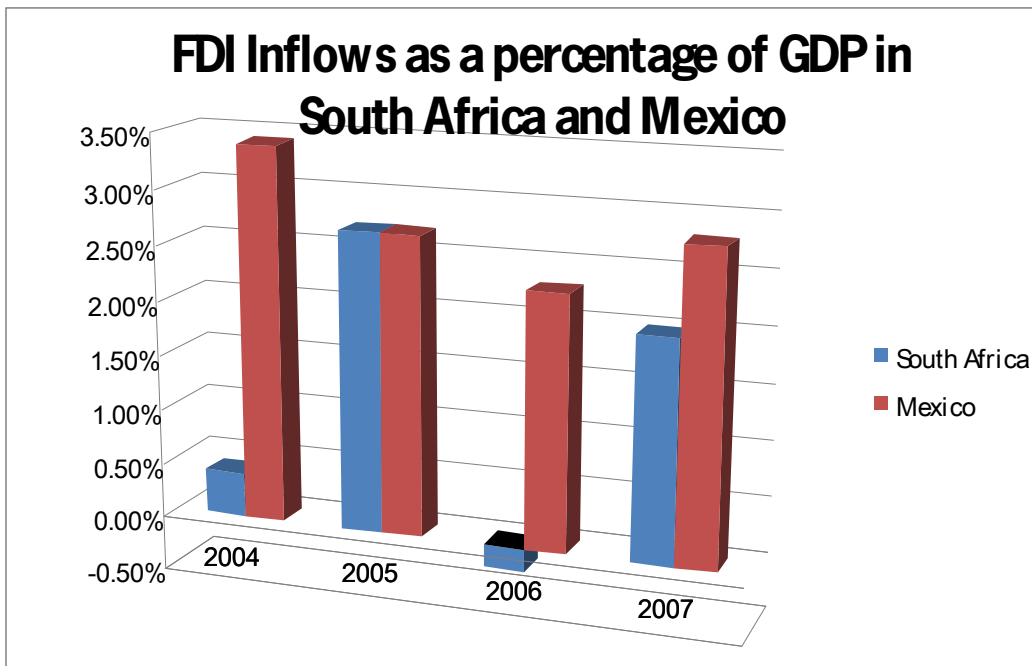


**Figure 5:** FDI Inflows as a percentage of GCP in South Africa and Mexico

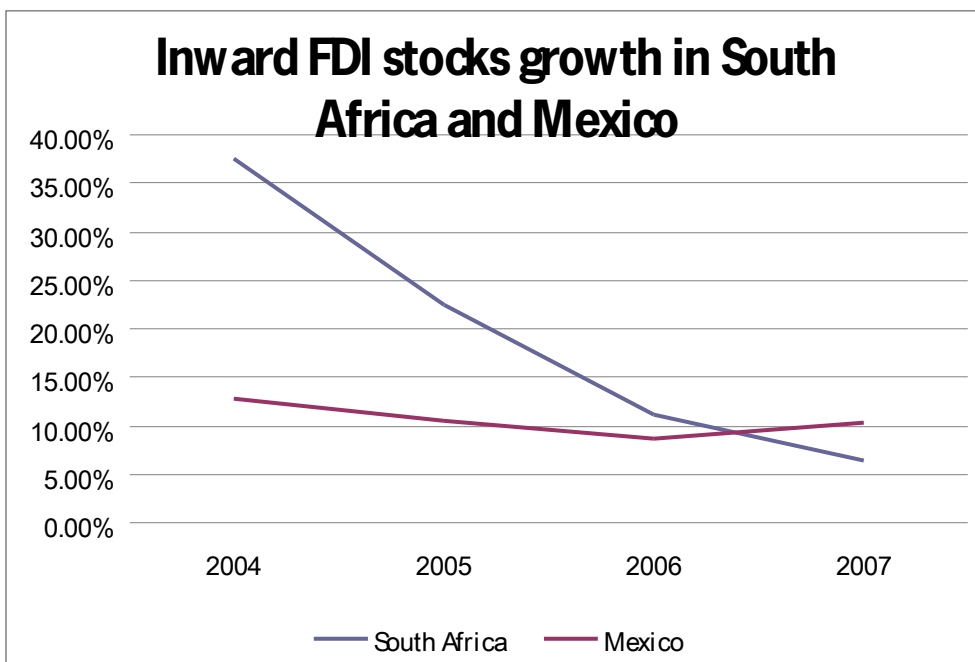
Figures 6, 7 and 8 provide additional information found when comparing FDI inflows into South Africa and Mexico. Figure 6 shows nominal FDI inflows, in millions of US dollars, into both countries. Figure 7 shows FDI inflows as a percentage of GDP. Figure 8 shows the inward FDI stocks growth for both countries, during the period 2004 to 2007.



**Figure 6:** Nominal FDI inflows into South Africa and Mexico



**Figure 7:** FDI Inflows as a percentage of GDP in South Africa and Mexico



**Figure 8:** Inward FDI stocks growth in South Africa and Mexico

### 5.2.3 Impact of Employment Equity on FDI

This hypothesis tests the impact of Broad-Based BEE Employment Equity policy on South Africa's capability to attract FDI, by using a Static Group test that compares South Africa's FDI inflows with those of Chile. Chile was selected



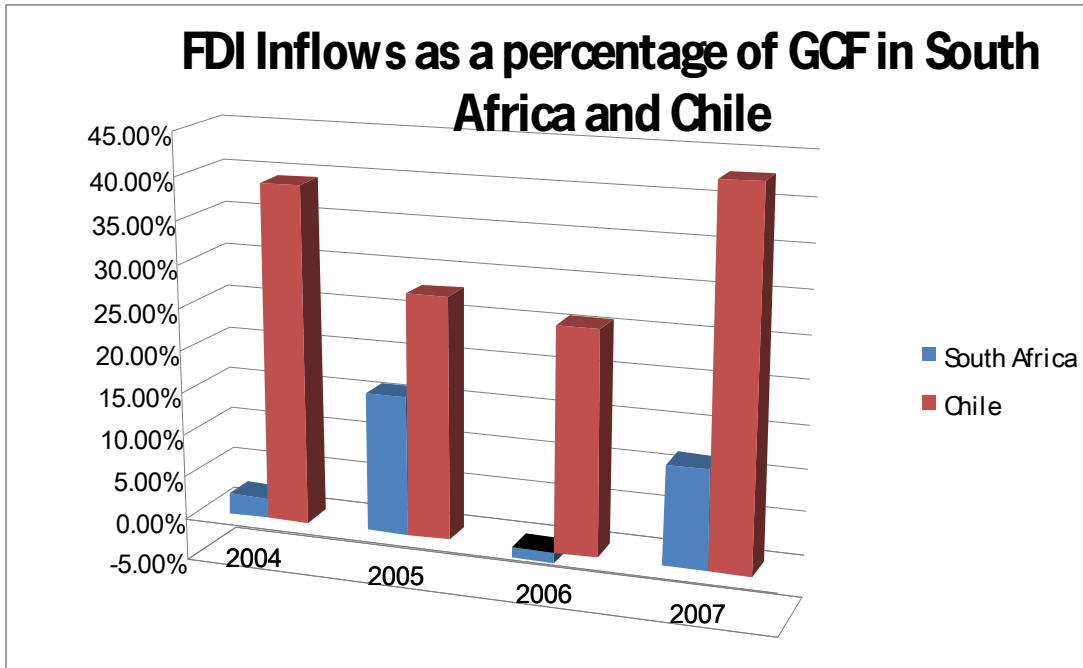
for this test as it does not have policies that equate to Broad-Based BEE Employment Equity.

To test this hypothesis, South Africa was selected as the experiment group (O1), Chile was selected as the control group (O2) and the Employment Equity policy was determined as the experiment (X).

Table 11 provides descriptive statistics for both the experiment and the control group, and Figure 9 provides a graphical analysis of FDI inflows into South Africa and Chile, which are respectively the experiment and the control groups.

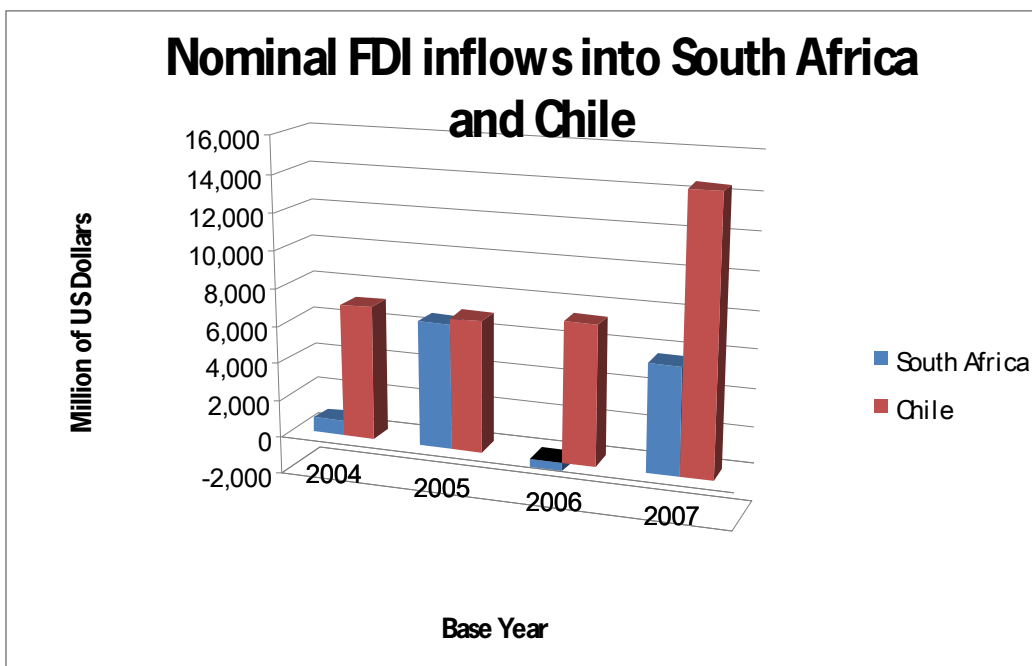
<b>One Variable Summary</b>	<b>South Africa</b>	<b>Chile</b>
<b>Mean</b>	7.18%	33.95%
<b>Variance</b>	0.00641	0.00702
<b>Std. Dev.</b>	0.08006	0.08380
<b>Skewness</b>	0.1151	0.1119
<b>Kurtosis</b>	-0.6159	-1.7631
<b>Median</b>	2.3%	27.9%
<b>Mean Abs. Dev.</b>	6.63%	7.1%
<b>Minimum</b>	-1.2%	25.8%
<b>Maximum</b>	16.1%	42.9%
<b>Range</b>	17.3%	17.1%
<b>Count</b>	4	4
<b>Sum</b>	28.7%	135.8%
<b>1st Quartile</b>	-1.2%	25.8%
<b>3rd Quartile</b>	11.5%	39.2%

**Table 11:** FDI into South Africa and Chile

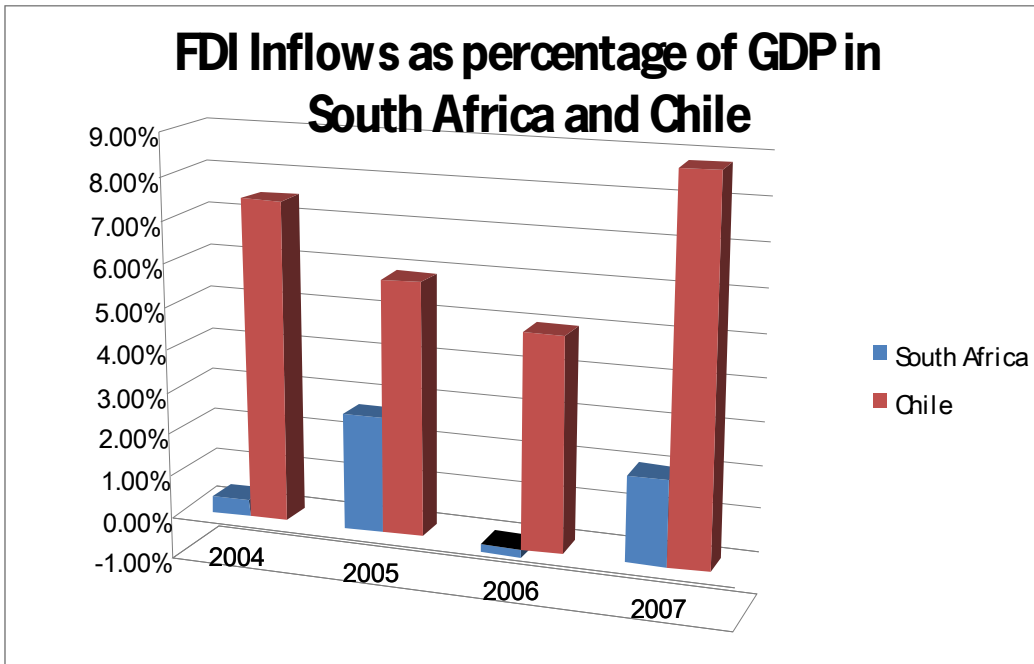


**Figure 9:** FDI Inflows as a percentage of GCP in South Africa and Chile

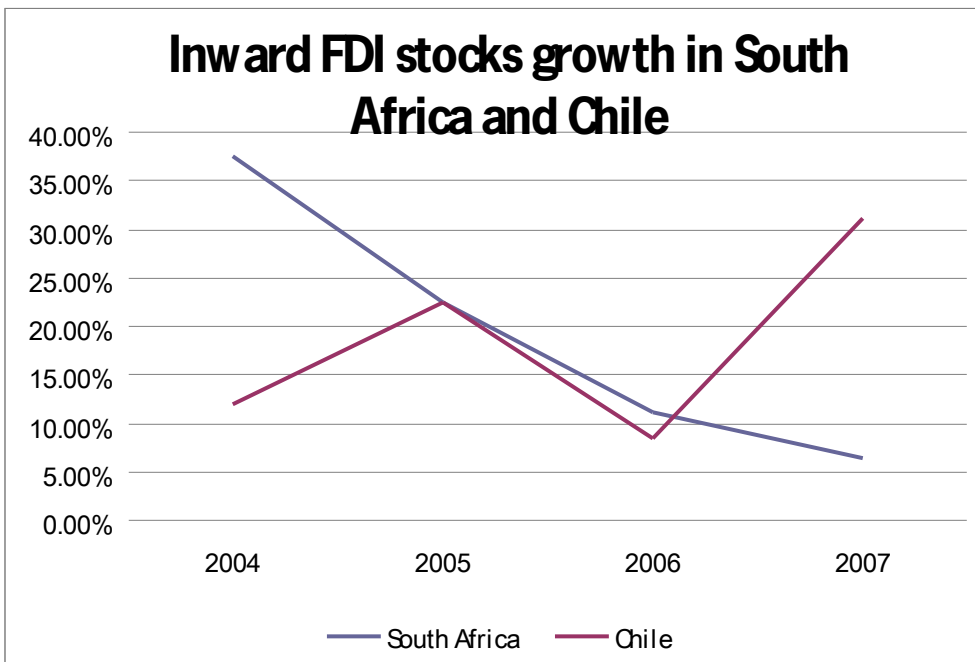
Figures 10, 11 and 12 provide additional information found while comparing FDI inflows into South Africa and Chile. Figure 10 shows nominal FDI inflows, in millions of US dollars, into both countries. Figure 11 shows FDI inflows as a percentage of GDP. Figure 12 shows the inward FDI stocks growth for both countries, during the period 2004 to 2007.



**Figure 10:** Nominal FDI inflows into South Africa and Chile



**Figure 11:** FDI Inflows as a percentage of GDP in South Africa and Chile



**Figure 12:** Inward FDI stocks growth in South Africa and Chile

## 5.2.4 FDI into South Africa, in comparison with that into other African countries

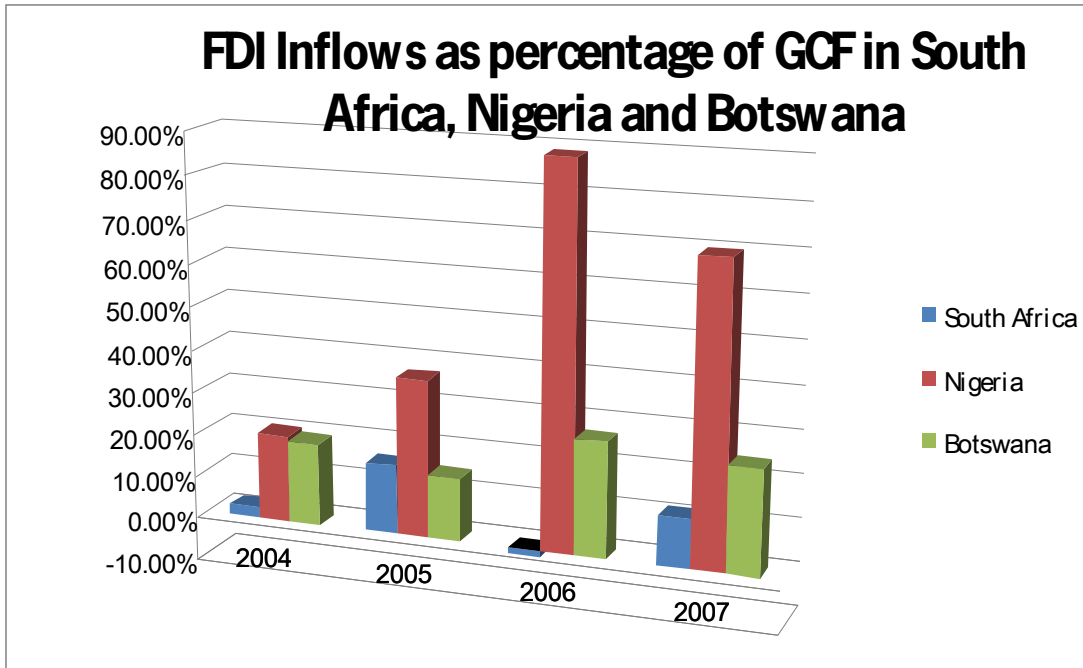
This hypothesis tests the impact of Broad-Based BEE-combined policies on South Africa's capability to attract FDI in the region, by using a Static Group test that compares South Africa's FDI inflows against that of other emerging African countries, namely Nigeria and Botswana. These emerging countries were selected as they do not have policies that equate to Broad-Based BEE.

To test this hypothesis, South Africa was selected as the experiment group (O1), Nigeria and Botswana were selected as the control group (O2) and Broad-Based BEE-combined policies were determined as the experiment (X).

Table 12 provides descriptive statistics for both the experiment and the control group, and Figure 13 provides a graphical analysis of FDI inflows into South Africa, Nigeria and Botswana.

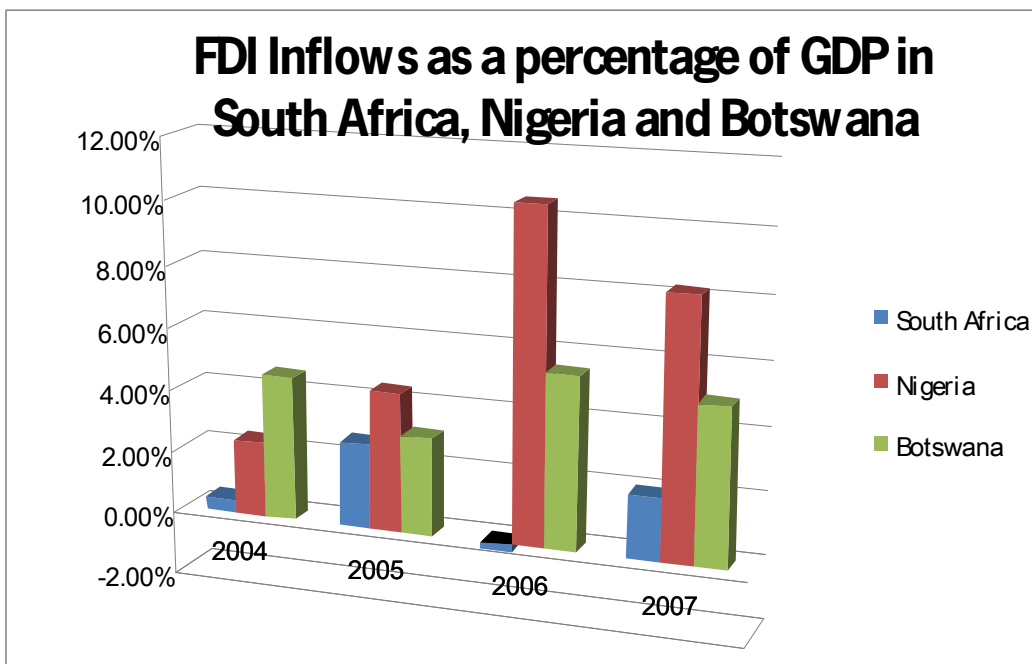
<i>One Variable Summary</i>	<b>South Africa</b>	<b>Nigeria</b>	<b>Botswana</b>
<b>Mean</b>	7.18%	53.78%	21.3%
<b>Variance</b>	0.00641	0.0956	0.00296
<b>Std. Dev.</b>	0.08006	0.3092	0.05445
<b>Skewness</b>	0.1151	0.0754	-0.3773
<b>Kurtosis</b>	-0.6159	-0.0811	0.8499
<b>Median</b>	2.3%	36.7%	19.2%
<b>Mean Abs. Dev.</b>	6.63%	25.28%	4.35%
<b>Minimum</b>	-1.2%	20.3%	14.7%
<b>Maximum</b>	16.1%	88.5%	26.9%
<b>Range</b>	17.3%	68.2%	12.2%
<b>Count</b>	4	4	4
<b>Sum</b>	28.7%	215.1%	85.2%
<b>1st Quartile</b>	-1.2%	20.3%	14.7%
<b>3rd Quartile</b>	11.5%	69.6%	24.4%

**Table 12:** FDI into South Africa, Nigeria and Botswana

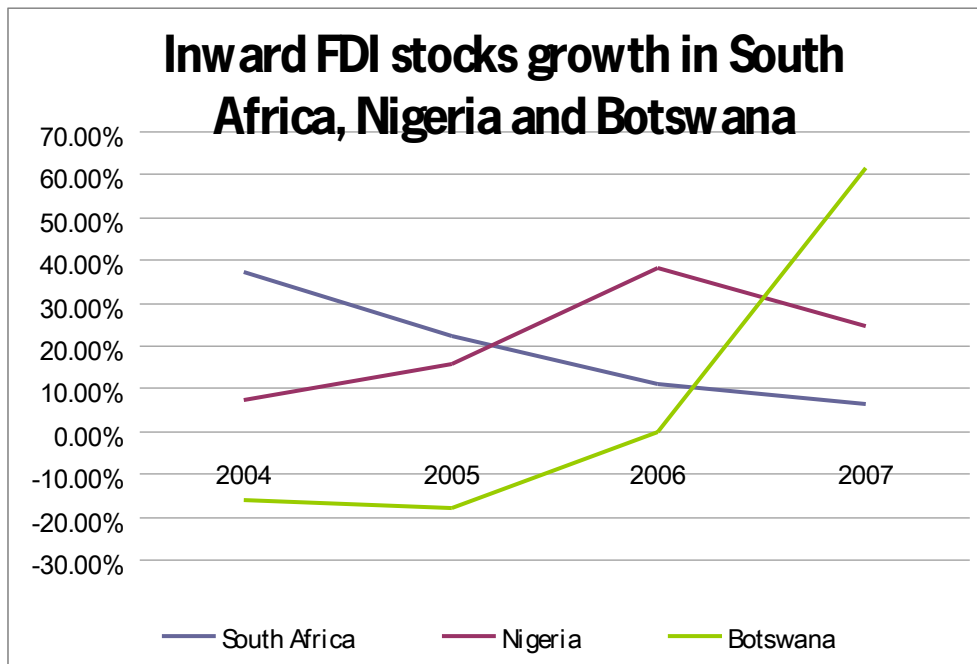


**Figure 13:** FDI Inflows as a percentage of GCP in South Africa, Nigeria and Botswana

Figures 14 and 15 provide additional information, found while comparing FDI inflows into South Africa, Nigeria and Botswana. Figure 14 shows FDI inflows as a percentage of GDP. Figure 15 shows the inward FDI stocks growth, during the period 2004 to 2007.



**Figure 14:** FDI Inflows as a percentage of GDP in South Africa, Nigeria and Botswana



**Figure 15:** Inward FDI stocks growth in South Africa, Nigeria and Botswana

### 5.2.5 FDI into South Africa, in comparison with that into the African Continent as a whole

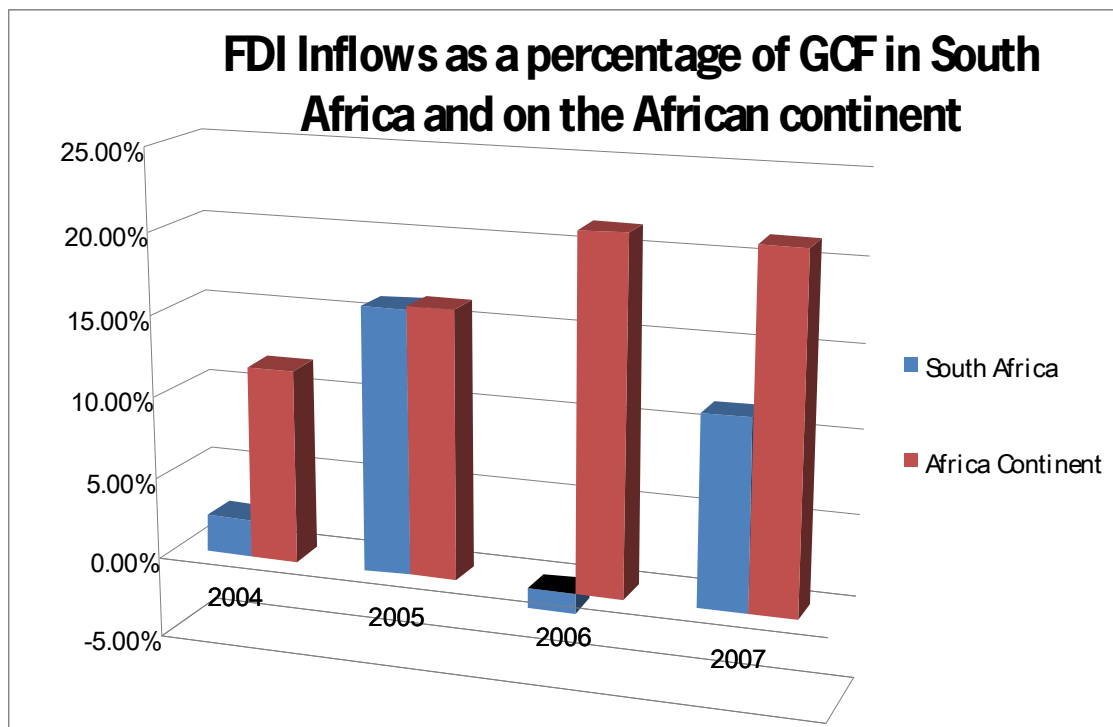
This hypothesis tests the impact of Broad-Based BEE-combined policies on South Africa’s capability to attract FDI into the continent, by using a Static Group test that compares South Africa’s FDI inflows as a proportion, against the FDI inflows into the African continent as a whole.

To test this hypothesis, South Africa was selected as the experiment group (O1), the African continent was selected as the control group (O2) and Broad-Based BEE-combined policies were determined as the experiment (X).

Table 13 provides descriptive statistics for both the experiment and the control group, and Figure 16 provides a graphical analysis of FDI inflows into South Africa and the African continent.

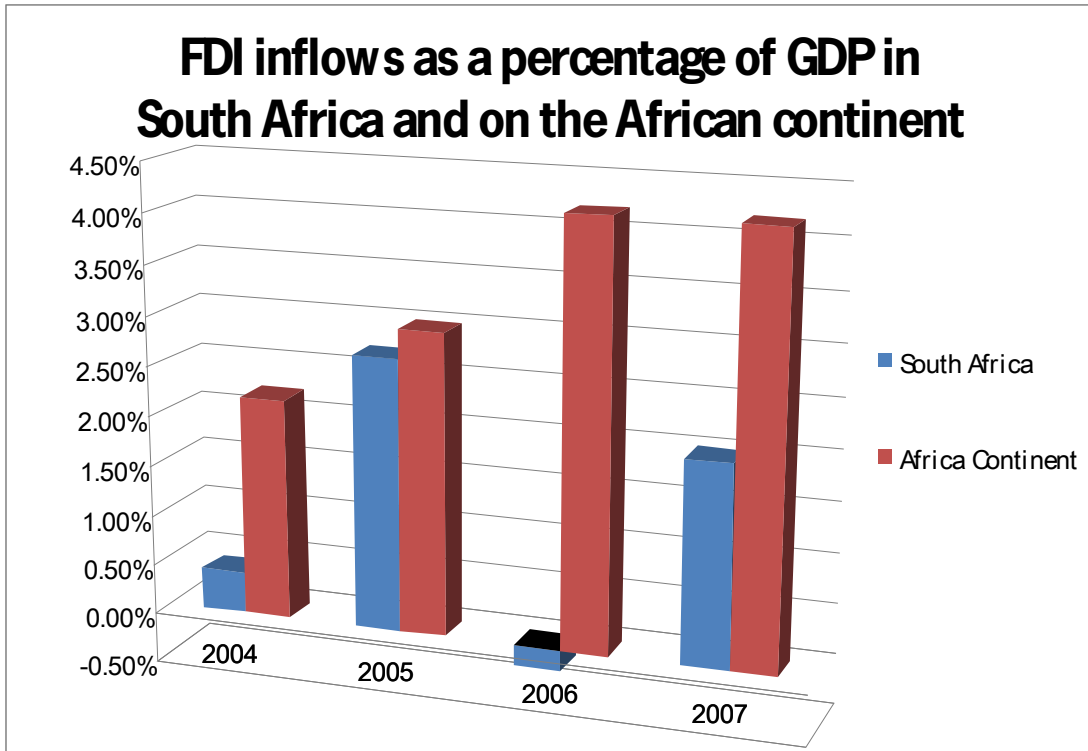
One Variable Summary	South Africa	African Continent
Mean	7.18%	17.7%
Variance	0.00641	0.00211
Std. Dev.	0.08006	0.04598
Skewness	0.1151	-0.7601
Kurtosis	-0.6159	1.2174
Median	2.3%	16.30%
Mean Abs. Dev.	6.63%	3.65%
Minimum	-1.2%	11.8%
Maximum	16.1%	21.4%
Range	17.3%	9.6%
Count	4	4
Sum	28.7%	70.8%
1st Quartile	-1.2%	11.8%
3rd Quartile	11.5%	21.3%

**Table 13:** FDI into South Africa and on the Africa Continent

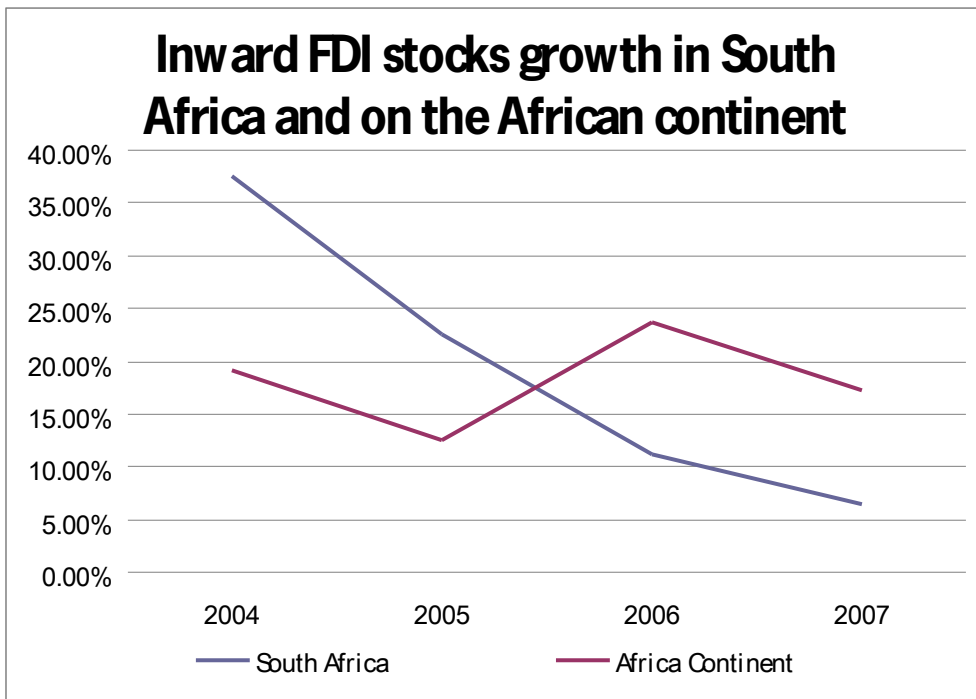


**Figure 16:** FDI Inflows as a percentage of GCP in South Africa and on the African continent

Figures 17 and 18 provide additional information found while comparing FDI inflows into South Africa, against that of the African continent as a whole. Figure 17 shows FDI inflows as a percentage of GDP. Figure 18 shows the inward FDI stocks growth, during the period 2004 to 2007.



**Figure 17:** FDI inflows as a percentage of GDP in South Africa and on the African continent



**Figure 18:** Inward FDI stocks growth in South Africa and on the African continent



## 5.2.6 FDI inflows before and after B-BBEE implementation

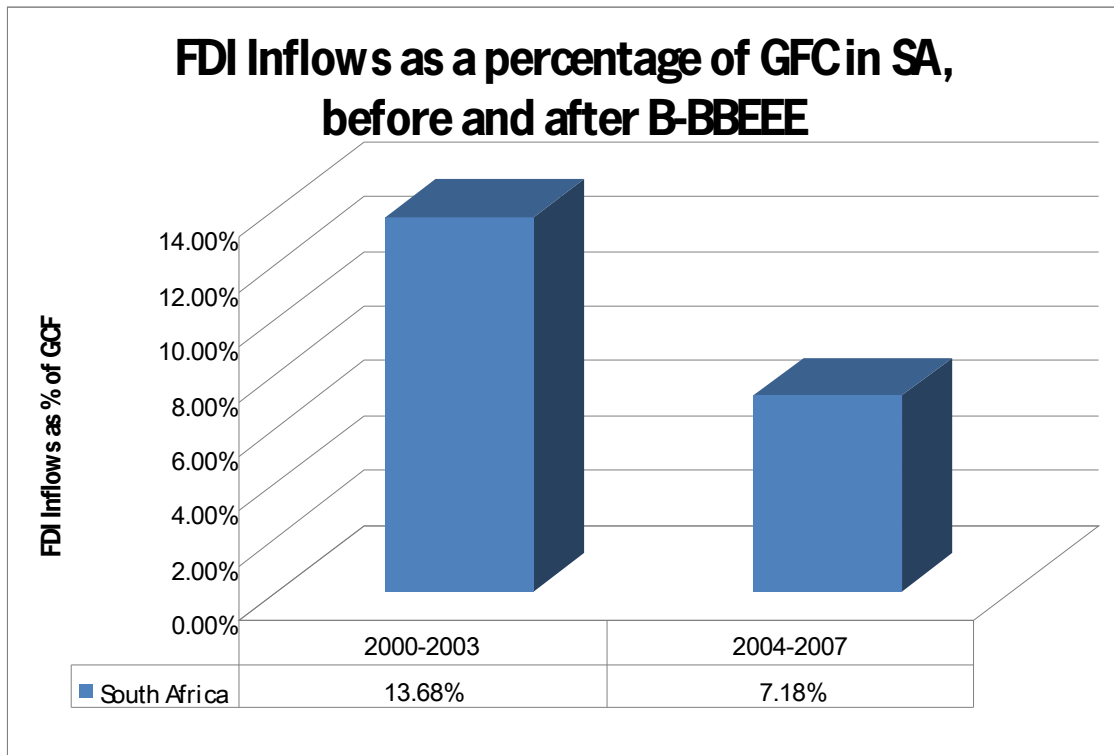
This hypothesis tests the impact of the introduction of Broad-Based BEE into South Africa, by analysing the FDI inflows into South Africa before and after said implementation. BEE was implemented gradually into South Africa since the re-democratisation time, as motivated in Chapter 4. However, for the purposes of this research, an assumption has been made that Broad-Based BEE was implemented on 01 January 2004.

To test this hypothesis, a single group pretest-posttest method was used. FDI inflows into South Africa before Broad-Based BEE implementation (O1) is tested against FDI inflows into South Africa after Broad-Based BEE implementation (O2), while the experiment is Broad-Based BEE implementation (X). The period of group O1 is the years 2000 to 2003; the period of group O2 is the years 2004 to 2007.

Table 14 provides descriptive statistics for both periods, before and after Broad-Based BEE implementation. Figure 19 provides a graphical analysis of the same information.

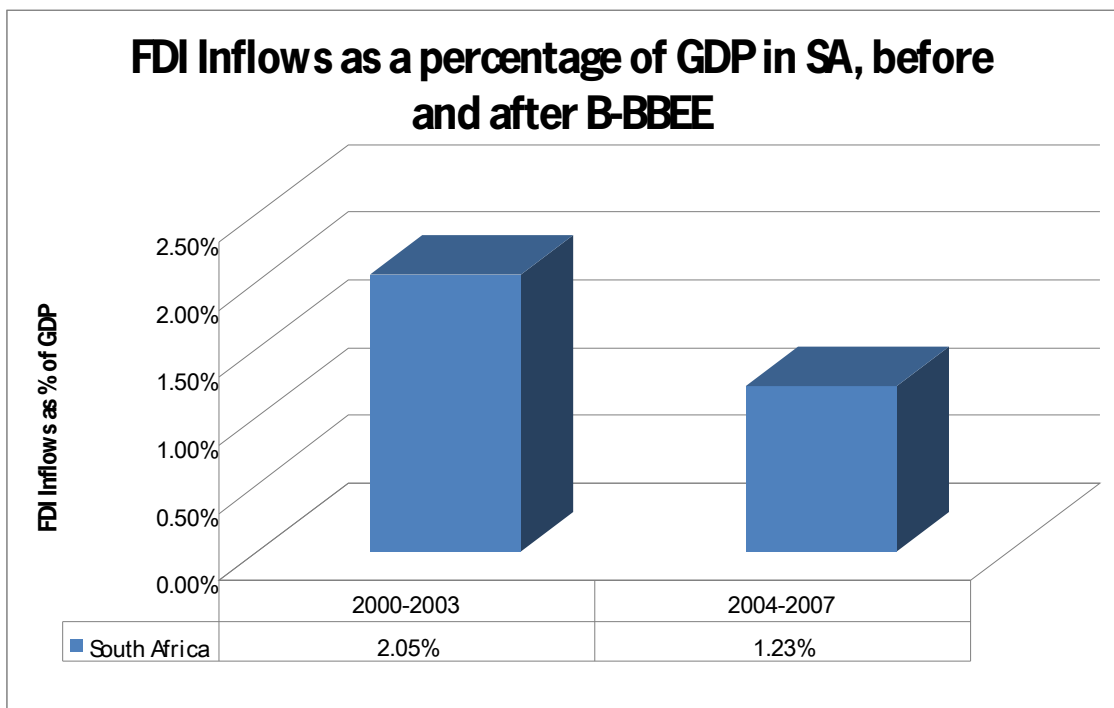
<b>One Variable Summary</b>	<b>Before B-BBEE</b>	<b>After B-BBEE</b>
Mean	13.68%	7.18%
Variance	0.0273	0.00641
Std. Dev.	0.1652	0.08006
Skewness	1.8336	0.1151
Kurtosis	6.3835	-0.6159
Median	4.4%	2.3%
Mean Abs. Dev.	12.21%	6.63%
Minimum	2.8%	-1.2%
Maximum	38.1%	16.1%
Range	35.3%	17.3%
Count	4	4
Sum	54.7%	28.7%
1st Quartile	2.8%	-1.2%
3rd Quartile	9.4%	11.5%

**Table 14:** FDI into South Africa before and after B-BBEE



**Figure 19:** FDI inflows as a percentage of GCP in SA, before and after B-BBEE

Figure 20 provides additional information found while comparing FDI inflows into South Africa before and after Broad-Based BEE implementation; the figure shows the FDI inflows as a percentage of GDP for both O1 and O2.



**Figure 20:** FDI inflows as a percentage of GDP in SA, before and after B-BBEE

## **Chapter 6. Discussion of Results**

### **6.1 Introduction**

The main objective of this study was to evaluate the impact of Broad-Based BEE policies on South Africa's capability to attract FDI. The tests conducted on this research have compared empirical South Africa's FDI data against other emerging countries at a similar level of development. The results presented in Chapter 5 will be discussed in the next sections, and the research hypothesis will be answered. The underlying themes of the hypothesis can be grouped as follows:

1. Assessment of Broad-Based BEE policies' impact on South Africa's capability to attract FDI Inflows.
2. Assessment of South Africa's capability to attract FDI into the African region.
3. Evaluation of FDI inflow levels into South Africa before and after Broad-Based BEE implementation.

### **6.2 Assessment of Broad-Based BEE Policies**

In this section, the hypothesis testing individually Ownership Equity, Management Control and Employment Equity will be discussed. In order to test the hypothesis in this section, empirical FDI data from South Africa was compared with that of Brazil, Mexico and Chile. As explained in Chapter 4, these countries have been selected for two reasons, the first one being their socio-economic similarities with South Africa, and the second being the fact that they do not have respectively Ownership Equity, Management Control and

Employment Equity policies (Political Risk Services Group, 2008; Heritage Foundation & Wall Street Journal, 2008).

### **6.2.1 Impact of Ownership Equity on FDI**

Null hypothesis: South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development, but without Ownership Equity policies. To test this hypothesis, empirical FDI data from South Africa and Brazil have been compared.

Figure 1 shows a graphical comparison between South Africa and Brazil, in terms of the percentage of Gross Capital Formation composed by FDI inflows. This information is particularly important, as it shows the capability of countries to attract new capital into their locations. The analysis of this graph, in combination with Table 9, shows that Brazil has attracted from 10.6 percent to 15.3 percent in the period, with a mean of 12.9 percent. South Africa in the same period has attracted from -1.2 percent to 16.1 percent, with a mean of 7.18 percent. The negative results in 2006 show that there was more capital leaving South Africa than entering the country.

Figure 2 shows nominal FDI inflows attracted by both South Africa and Brazil. It can be noted, however, that Brazil, due to the size of its economy, is attracting seven times more FDI than South Africa. In Figure 3, where FDI inflows are normalised as a percentage of GDP, Brazil is also shown to be attracting more FDI inflows than South Africa, as a proportion of the country's GDP. The

combined analysis of Figures 1, 2 and 3 shows that Brazil is attracting more FDI inflows than South Africa, in both absolute and relative terms.

The graph in Figure 4 shows an alarming trend. Even though Brazil and South Africa are countries with a similar level of development, the two countries have growth rates of inward FDI stocks that run in opposite directions. While the inward FDI stocks growth rate is increasing in Brazil, this rate is decreasing in South Africa. The current trend of a diminishing growth rate of inward FDI stocks in South Africa matches the year in which Broad-Based BEE was implemented. This can indicate that companies are reducing the pace of investment in South Africa. In the research conducted by Murphy (2005), he has found that BEE is considered a 'risk factor' in the financial statements of several multinational corporations.

The above results are in line with the literature on determinants to attract FDI. Authors such as Banga (2003), Dunning (2003), Blomstrom & Kokko (2003) and Busse & Hefeker (2007) concluded that FDI inflows are increased by the removal of policy restrictions, such as Ownership Equity control. The tests performed seem to indicate an association between Ownership Equity and lower FDI inflows.

## **Conclusion**

From the results obtained in analysing FDI as a percentage of Gross Formation Capital, shown in Figure 1 and Table 9, it is possible to reject the null hypothesis, and to accept the alternative hypothesis. This states that South

Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Ownership Equity policies.

### **6.2.2 Impact of Management Control on FDI**

Null hypothesis: South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development, but without Management Control policies. To test this hypothesis, empirical FDI data from South Africa and Mexico have been compared.

Figure 5 shows a graphical comparison between South Africa and Mexico in terms of the percentage of Gross Capital Formation composed by FDI inflows. The analysis of this graph, in combination with Table 10, shows that Mexico has attracted from 9.8 to 17.1 percent in the period, with a mean of 13.13 percent. South Africa, in the same period, has attracted from -1.2 to 16.1 percent, with a mean of 7.18 percent. This analysis shows that the proportion of FDI as a Gross Capital Formation in Mexico is almost double the proportion of South Africa.

Figures 6 and 7 respectively show nominal amounts of FDI inflows, and FDI inflows as a percentage of GDP. It can be noted here, as well, that Mexico is attracting more FDI inflows than South Africa, in both absolute and relative terms.

The graph in Figure 8 shows an interesting trend – the inward FDI stocks growth rate in Mexico has shown a slight decrease for the period 2004 to 2006; in 2007, however, the trend inverted and the rate increased again. South Africa,

on the other hand, shows an inward FDI stocks growth rate that continues to decrease, rapidly. The average inward FDI growth rate in Mexico, for the period 2004 to 2007, was 10.53 percent, while in South Africa it was 19.42 percent. However, an analysis of the last two years shows that the trend now favours Mexico.

The results of the comparisons between South Africa and Mexico show that Mexico is attracting more FDI than South Africa. These results are once again in line with the literature on determinants to attract FDI, which defines that FDI inflows are attracted by the removal of policy restrictions, such as Management Control. Since Mexico does not have a restriction on Management Control, the results of this test can be an indication that Mexico is in a better position than South Africa to attract FDI.

## **Conclusion**

From the results obtained in analysing FDI as a percentage of Gross Formation Capital, shown in Figure 5 and Table 10, it is possible to reject the null hypothesis and to accept the alternative hypothesis. This states that South Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Management Control policies.

### **6.2.3 Impact of Employment Equity on FDI**

Null hypothesis: South Africa's FDI inflow levels are the same as other emerging countries with a similar level of development, but without Employment



Equity policies. To test this hypothesis, empirical FDI data from South Africa and Chile have been compared.

Figure 9 shows a comparison between South Africa and Chile, in terms of the percentage of Gross Capital Formation composed by FDI inflows. An analysis of this graph, in combination with Table 11, shows that Chilean FDI inflows in the period have varied from 25.8 to 42.9 percent, with a mean of 33.95 percent. In the same period, South Africa has attracted from -1.2 to 16.1 percent, with a mean of 7.18 percent. These results show that despite having similar economy and market sizes, Chile has attracted almost five times more FDI inflows than South Africa.

Figures 10 and 11 show that Chile is able to attract much more FDI inflows than South Africa. The information in Figure 11 is especially important as it shows that FDI inflows in Chile, as a percentage of GDP, is 6.8 percent, while in South Africa the same indicator is only 1.23 percent. The world average for developing countries is three percent, which means that South Africa is lagging behind in attracting FDI while Chile, on the other hand, is thriving.

Understanding the reasons behind Chile's success in attracting FDI is very relevant to South Africa. The Chilean economy is similar to the South African one in many aspects, such as being a similar size, both countries being rich in minerals, natural resources representing a big chunk of both countries' exports, and both countries having multi-ethnic populations.

The graph in Figure 12 shows that the inward FDI stocks growth rate in Chile has not been stable over the last few years; this is possibly correlated to the large amount of FDI inflows, in relation to the country's GDP, which Chile is receiving. In this scenario, minor variations on exchange rate can have a big impact on this figure. As per the trend in the graph in Figure 12, the rate of inward FDI stocks growth is strongly on the rise in Chile, while in South Africa it is decreasing rapidly.

The result of the comparisons between South Africa and Chile show two extremes in terms of attraction of FDI inflows. On one hand, Chile is currently a star performer in the world markets; on the other hand, South Africa is lagging behind. There are many reasons behind Chile's success in attracting FDI, as per the purpose of this research; there is an indication that Chile is attracting more FDI than South Africa due to the non-existence of Employment Equity restrictions.

## **Conclusion**

From the results obtained by analysing FDI as a percentage of Gross Formation Capital, shown in Figure 9 and Table 11, it is possible to reject the null hypothesis and to accept the alternative hypothesis. This states that South Africa's FDI inflow levels are lower than those of other emerging countries with a similar level of development, but without Employment Equity policies.

### **6.3 FDI into South Africa in comparison with the Region**

In this section, South Africa's capability to attract FDI versus the region will be evaluated. Two tests will be analysed in this section, one of them being a comparison between South Africa and other emerging African countries, and the second being an evaluation of South Africa's FDI inflows against the aggregated data for the African continent.

#### **6.3.1 FDI into South Africa in comparison with that into African Countries**

Null hypothesis: South Africa's FDI inflow levels are the same as other emerging African countries with a similar level of development, but without Broad-Based BEE policies.

To test this hypothesis, empirical FDI data from South Africa was compared with FDI data from Nigeria and Botswana. Nigeria has been selected due to its large market size. Botswana, the region's diamond, has been selected due to its level of business freedom, which is similar to the South African environment as per the internationally reported Index of Economic Freedom (The Heritage Foundation, 2008).

Figures 13 and 14 show comparisons between South Africa, Nigeria and Botswana in terms of the percentage that FDI represents, out of Gross Capital Formation and GDP. The information extracted from the graphs, in combination with the data in Table 12, is somewhat dramatic; it shows that South Africa is very behind the other countries in its capability to attract FDI. The South African

mean on this variable is 7.18 percent, while Nigeria's is 53.78 percent and Botswana's is 21.3 percent. From a perspective of economic growth, this shows that South Africa is losing national competitiveness among its peers in Africa.

The graph in Figure 15 shows that in 2004, the South African inward FDI stocks growth rate was higher than that of Nigeria and Botswana. By 2007, the situation has changed completely; South Africa had become the country with the lowest growth rate. This is once again in line with the literature, which shows that policy restriction is connected to lower FDI inflows into countries (Banga, 2003; Murphy, 2005).

## **Conclusion**

From the results obtained when analysing FDI as a percentage of Gross Formation Capital, shown in Figure 13 and Table 12, it is possible to reject the null hypothesis, and to accept the alternative hypothesis. This states that South Africa's FDI inflow levels are lower than those of other emerging African countries with similar levels of development, but without Broad-Based BEE policies.

### **6.3.2 FDI into South Africa in comparison to the Continent**

Null hypothesis: South Africa's FDI inflow levels are proportionally the same as the FDI inflow levels into the African continent as a whole. To test this hypothesis, empirical FDI data from South Africa was compared against aggregated FDI data from the African continent as a whole.

Figure 16 shows a graphical comparison between South Africa and the African continent, in terms of the percentage of Gross Capital Formation composed by FDI inflows. The analysis of this graph, in combination with Table 13, shows that the African continent attracted between 11.8 and 21.4 percent in the period, with a mean of 17.7 percent. Over the same period, South Africa attracted between 1.2 to 16.1 percent, with a mean of 7.18 percent. This analysis shows that despite having the biggest and most modern economy on the continent, South Africa is lagging behind in FDI attraction. The African continent is receiving, on average, more than double the FDI South Africa is attracting, as a percentage of GCF.

The graph in Figure 18 shows that in 2004, the South African inward FDI stocks growth rate was higher than the continent's growth rate; however, by 2006 this trend has inverted. An analysis of the data available is not sufficient to determine if the gap between South Africa and the continent is increasing or decreasing.

## **Conclusion**

From the results obtained when analysing FDI as a percentage of Gross Formation Capital, shown in Figure 16 and Table 13, it is possible to reject the null hypothesis and to accept the alternative hypothesis. This states that South Africa's FDI inflow levels are proportionally lower than FDI inflow levels into the African continent as a whole.

## **6.4 FDI inflows before and after Broad-Based BEE implementation**

Null hypothesis: South Africa's FDI inflow levels in the period before BEE policies implementation were the same as in the period after BEE policies implementation.

To test this hypothesis, empirical FDI data on South Africa, in the four years before Broad-Based BEE implementation (2000 to 2003) and in the four years immediately afterwards (2004 to 2007) was used. As defined in the assumptions section of Chapter 4, BEE has been implemented gradually in South Africa. Therefore, the date 01 January 2004 was defined as the implementation date of Broad-Based BEE for the purposes of this study.

Figure 19 shows graphically the FDI inflows as a percentage of Gross Formation Capital in the four years before Broad-Based BEE implementation (2000 to 2003), and in the four years immediately afterwards (2004 to 2007). The analysis of Figure 19, in combination with Table 14, shows that for the period before Broad-Based BEE implementation, FDI inflows as a percentage of GCF had a mean of 13.68 percent, while in the period afterwards the mean had dropped to 7.18 percent. This figure shows that FDI inflows halved between the two periods, which is an indication that Broad-Based BEE implementation might be associated with diminishing FDI inflows into South Africa.

Figure 17 shows the proportion of FDI received in relation to the country's GDP. In this figure, it is also possible to note a drop in FDI levels from before Broad-Based BEE implementation (at 2.05 percent), to afterwards (at 1.23 percent).

### **Conclusion**

The analysis of Figures 16 and 17, in combination with Table 13, show that there is a possible association between Broad-Based BEE implementation and a drop in FDI inflow levels into South Africa. This association can be explained by the literature in that an increase in barriers is directly associated with a reduction in FDI (Banga, 2003). Therefore, from the results above, it is possible to reject the null hypothesis, and to accept the alternative hypothesis. This states that South Africa's FDI inflow levels in the period before BEE policies implementation were higher than in the period after the implementation.

## **Chapter 7. Conclusion**

FDI is assuming a prominent role in the development and growth strategies of developing countries. FDI has become the main source of development capital for emerging markets. In this research, the determinant factors in attracting FDI to host countries were analysed, along with the set of policies that form Broad-Based BEE programmes – the greatest challenge currently before the South African business environment.

### **7.1 Conclusion**

As part of this research, tests have been conducted to identify the impact of Broad-Based BEE policies on South Africa's capability to attract FDI. Due to the number of extraneous variables, the methodology used was a quasi-experimental design. This method was appropriate, as it enabled the identification of possible associations between FDI inflows and Broad-Based BEE policies. The sampling was judgmental non-probabilistic, and the countries used as a control group were Brazil, Mexico, Chile, Nigeria and Botswana. These countries were selected as they share some important similarities with South Africa, however they do not apply affirmative action policies similar to Broad-Based BEE.

The hypothesis tested indicated an association between Broad-Based BEE implementation and diminishing FDI inflows into South Africa. In all the tests performed, the countries without similar Broad-Based BEE policies had an advantage in relation to South Africa. In some instances, for example in



Botswana and Mexico, this advantage only came after Broad-Based BEE implementation in South Africa.

When compared to the continent as a whole, it is possible to see that South Africa is losing competitiveness in the region. The FDI inflows into South Africa are proportionally smaller than the FDI inflows into the African continent as a whole. Therefore, this indicates that Broad-Based BEE might be preventing South Africa from continuing to be the preferential entry point for multinationals wanting to invest in Africa's future.

Another key finding was the fact that the levels of FDI inflows into South Africa were higher before Broad-Based BEE implementation. The results show that the FDI levels in the four years before Broad-Based BEE implementation were almost double than those of the four years after its implementation.

The above conclusions are in line with the literature on determinants that attract FDI, which state that FDI is attracted by the removal of policy restrictions, such as ownership, management and employment control of foreign key personnel (Banga, 2003; Dunning, 2003; Blomstrom & Kokko, 2003).

As a limitation of this research, the results cannot be generalised and they do not establish a proven causal relationship. Therefore, the main objective of this research is to stimulate the debate of how to attract more FDI into South Africa by analysing the economic impact of Broad-Based BEE implementation.

## 7.2 Recommendations

### 7.2.1 Recommendations to Policymakers

As per the tests performed in this research, there is an indication that Broad-Based BEE is impacting negatively on South Africa's capability to attract FDI, which is critical for economic growth. The literature shows that affirmative action success is directly associated with economic growth. Therefore, the more Broad-Based BEE advances, the less likely it is that it will succeed in its targets. As a recommendation to the South African government, the policies that form the Broad-Based BEE programme should be reviewed in an attempt to reduce the negative impact on FDI inflows. As identified in the literature, multinationals are very sensitive to certain policies, especially Ownership Equity and Management Control (KPMG, 2007).

Broad-Based BEE is arguably a replication of the successful Malaysian affirmative action programme. The Malaysian affirmative action programme, however, was implemented in a less globalised period, during the 1970s. FDI is seen today as a modern phenomenon in the globalised world and, as per the results found in this research, there is a possible association between Broad-Based BEE and diminishing FDI inflows into South Africa. Therefore, the model on which Broad-Based BEE is based, is possibly no longer suitable in the current globalised world. A recommendation to the South African government is to investigate alternative models and experiences to achieve the same Broad-Based BEE targets, which is to increase black people's participation in the economy.

In the current globalised world, capital moves very fast. The capacity of countries to attract investment is continuously assessed, ranked and monitored by multinational companies and international agencies. The emergence of China and India, which are attracting over 20 percent of all FDI destined to the developing world, shows that an appropriate regulatory framework combined with efficient institutions can become a country's competitive advantage. In this context, the results of this research indicate that Broad-Based BEE policies are not acting to attract investment into South Africa and, in fact, they might be causing loss of investment. Therefore, a recommendation to policymakers is to review the Broad-Based BEE programme and the framework policies regulating FDI, with the intention of transforming them into a competitive advantage for South Africa. As identified and tested empirically in this research, there is an indication that policies such as Ownership Equity, Management Control and Employment Equity are especially impacting on companies' willingness to bring new investments into South Africa; these are, however, vital for strong economic growth.

### **7.2.2 Recommendations to Business Managers**

As discussed in Chapter 2, previous researches have identified a number of entry modes for FDI in a country. Among them, and possibly the most used mode is Joint Venture, which is an association between a foreign enterprise and a local company. As per this research, there is an indication of diminishing FDI inflows due to Broad-Based BEE implementation, which in turn represent less

joint venture opportunities for local businesses in South Africa. In this context, two recommendations are given to business managers:

The first recommendation is to keep pressure on policymakers to review Broad-Based BEE policies with the intention of reducing policy restrictions on foreign capital. As discussed in Chapter 2, the South African government has aimed to improve the business environment by instituting equity equivalents for multinationals; these replaced the Broad-Based ownership equity pillars. Even though the intention was good, the equity equivalents framework falls totally outside market reality, causing more than 80 percent of multinationals to reject it (KPMG, 2007). Therefore, business managers keeping the pressure on policymakers may function as a strategy to encourage new measures, which impact positively on FDI attraction to the country.

Considering the results of this research, which show that Broad-Based BEE is impacting negatively on FDI inflows into South Africa, a second recommendation to business managers is to offer BEE status to multinational companies prospecting to invest in South Africa. This recommendation should be pursued in an attempt to reduce the possible negative impacts of Broad-Based BEE policies on multinational companies looking for South African companies with which to partner and assume joint ventures.

### **7.2.3 Recommendations to Civil Society**

A last recommendation, for South African civil society, is that Broad-Based BEE should be constantly measured and the programme results openly discussed.

Previous research has found that Broad-Based BEE is failing to benefit ordinary people, to reduce poverty and to increase education levels. The tests performed on this research indicate that Broad-Based BEE has a possible negative impact on the attraction of FDI inflows and, as a consequence, on economic growth. Therefore, an open debate about Broad-Based BEE results should take place regularly and, whenever found that the programme is not achieving its goals, corrective measures – including possible discontinuance – should be considered and brought to the attention of South African policymakers.

### **7.3 Suggestions for Further Research**

Based on the insights gained in this research project, four areas have been identified for future research:

- In-depth comparisons between South African and Chilean capabilities to attract FDI. In the tests performed on this research – comparing FDI inflows into Chile and South Africa – a great difference between the two countries was found. Chile is attracting five times more FDI than South Africa, despite the fact that both countries are very similar in many respects, such as in economy size, both being young democracies, both with main exports being minerals, both former European colonies and many others. An understanding of the factors (other than Broad-Based BEE contributing to the elevated FDI inflows into Chile in comparison to South Africa) can provide invaluable lessons to increase FDI inflows into the latter.

- Broad-Based BEE's economic impact is very wide. This research has focused only on the impact of Broad-Based BEE on FDI inflows into South Africa. Further research, on the full extent of Broad-Based BEE's impact on the South African economy (such as export capabilities, green field projects and employment levels) would provide a good contribution to an open debate on how to evaluate Broad-Based BEE success.
- At the time this research was written up, South Africa was experiencing skills shortages in many areas. This was especially associated with the 'brain-drain' wave, where many qualified South Africans were leaving the country to live overseas. A further research topic would be an evaluation of Broad-Based BEE policies' contribution, in special Management Control and Employment Equity policies, in the 'brain-drain' wave.
- This study has analysed Broad-Based BEE's impact on the South African economy at the macroeconomic level. A further research study would be to evaluate Broad-Based BEE's impact on business at the microeconomic level, such as the impact on business competitiveness. Such research would give a good indication as to whether the current Broad-Based BEE implementation is sustainable over time, or not.

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## **Appendix 1: UNCTAD Country Reports**

The following pages contain the country fact sheets, sourced from UNCTAD World Investment Report 2008. The country fact sheets are the following countries:

- South Africa;
- Brazil;
- Mexico;
- Chile;
- Nigeria; and
- Botswana