



An analysis of the impact of FDI in developing countries based on preconditions, absorptive capacity and benefits.

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ABSTRACT

The growth of FDI inflow to developing countries is increasing, so have the questions of why some developing countries have succeeded in attracting and absorbing FDI benefits. These countries are seen to have found the right fit between the FDI attraction and the developmental agenda. Profound questions about the true value of FDI to host countries are addressed in this study. While FDI attraction may be justified on the basis of FDI benefits by foreign firms, it still remains critical to establish whether these benefits are automatic. As an attempt to answer these questions, this dissertation uses both firm level and country level data to investigate the effects of foreign direct investment (FDI) on developing countries.

Interesting findings emerge from this study. The findings are in form of an interrelated structure setting, the study showed that technology, skills transfer and employment benefits via FDI take place only when the host country has the sufficient level of human capital, infrastructure and good local firms. And that the country must have stable political environment, consistent macroeconomic policy and good institutions in order to continue attracting FDI.

Keywords

Preconditions, foreign firms, benefits, local firms, and absorptive capacity



DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment 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 in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

	Date. 26 September 2012
Malikhanye (Mk) Mabena	



DEDICATION

This thesis is dedicated to: my late grandparents and my late father who passed away in exile. Your spirit lives on.



ACKNOWLEDGEMENTS

I wish to extent my sincere appreciation to all people who have made this thesis possible.

Firstly, I wish to thank my supervisor Solomon Moyo who provided insightful feedback, constructive comments and advice throughout the journey and for his invaluable support and timeliness in giving feedback

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CHAPTER 1: INTRODUCTION

1.1 Introduction

Foreign Direct Investment (FDI) in developing countries increased to over 40 per cent of world share reaching a record \$684 billion, while Africa saw a third year of declining FDI inflows (UNCTAD, 2012). For developing Africa, access to Foreign Direct Investment (FDI) is an important factor of capital flow and can fill the gap in capital needed to finance economic development (Asiedu, 2002). FDI can also result in benefits such as increased employment, skills transfer, technology transfer and increased entrepreneurial activity

Although the has been an increase in FDI inflow to developing countries Sub Saharan Africa has not managed to increase FDI to acceptable levels (UNCTAD, 2012). In efforts to increase and realise the benefits of FDI developing countries design policies in order to stimulate inward flows of FDI. While FDI contribution towards economic growth is widely argued, there is evidence that there are benefits in attracting FDI (Blomström & Kokko, 1998; Dunning, 1993; Görg & Greenaway, 2004). Thus, there is growing competition to attract Foreign Direct Investment (FDI) between developing countries, as well as to provide the conditions regarded as necessary to make developing countries attractive for foreign investment. However, these benefits are not automatic. The recent empirical literature regarding FDI postulated by Hyman (2011) and Kinoshita and Lu(2006), noted that FDI is more likely to have benefits in host countries with a good level of absorptive capacity for FDI.



UNCTAD (1995) concluded that Sub Saharan Africa did not benefit from the increased investment flows to developing countries as a whole, notwithstanding the fact that the countries of the region undertook many efforts to attract investment (UNCTAD, 1995, p. iii)). Asiedu (2002) argues that policy reforms have met with varied results in Africa and have been particularly hostile for most Sub Saharan African countries. Most of these countries have low growth rates due to lack of savings, skills, technology, and entrepreneurship. Despite relaxing investment rules and improving the doing business climate, most developing countries in Sub Saharan Africa did not receive as much Foreign Direct Investment (FDI) as most had expected as shown in figure 1.1 below. FDI in Sub Saharan is below 3% of the GDP and lags behind other developing regions like Asia and Latin America where FDI averages above 8%.

Furthermore, UNCTAD (2012) stated that FDI to developing countries has increased by 10 per cent in Asia and 16 % increase in Latin America and the Caribbean. FDI Flows to Africa continued their downward trend for a third consecutive year, but the decline was marginal. This modest performance in FDI attraction by Sub Saharan Africa could, as McAleese (2004) stated, be a result of the host country failing to satisfy certain preconditions in order to absorb and retain these benefits. Some of the key preconditions of Foreign Direct Investment to the host developing countries include:

- Business operating conditions;
- Macroeconomic and political stability;
- Regulatory and institutional environments:



- Natural and physical resources;
- Market potential and human capital

Foreign Direct Investment (FDI) is able to bring important benefits to the host countries. However, those benefits are not automatically converted to be regarded as a host country's competencies. Rather, the FDI process requires the host country to understand preconditions and have sufficient absorption capacities in order to maximise the benefits (Girma, 2005).

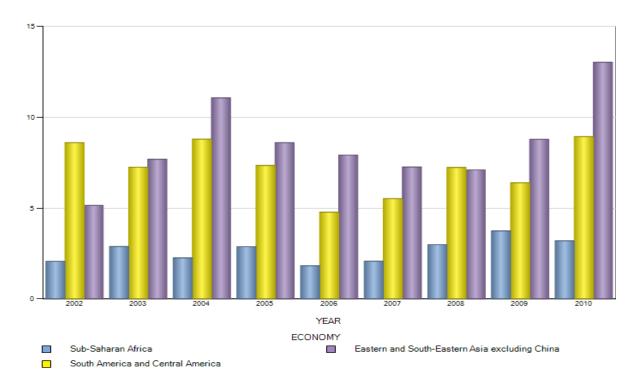
A number of studies by Teixeira and Shu (2012) and Blomström, Globerman and Kokko (1999) have concluded that the ability of a host country to benefit from Foreign Direct Investment is highly dependent on absorptive capacity, which includes:

- Educated and skilled labour (human capital);
- Absorptive capacity of local firms and the country's Financial system;
- Physical infrastructure; and Entrepreneurship

Developing countries in Sub Saharan Africa, as argued by Ajay (2006) that the attainment of independence in the early 1960s brought about the gradual return of Foreign Direct investment (FDI) into Sub Saharan African Countries



Figure 1.1 shows Sub Saharan Africa as percentage of GDP as compared to Asia and South America



Source: WDI, June 2012

For instance, the FDI inflow of sub-Saharan Africa almost stagnated between 2% in 1990 and less than 3% in 2010, while that of South America and South-East Asia as well as the Caribbean more than doubled.

1.2 Problem Statement

Sub Saharan Africa and South Africa in particular needs FDI to aid South African challenges of high unemployment, low skills base, and the low level of entrepreneurial activity. This research report analyses three main aspects of FDI inflow, namely precondition, absorptive capacity, and benefits that influence the level of attraction and retention of FDI in South Africa. This research also assesses the reasons behind South Africa's modest attraction of volatile FDI, as



indicated in figure 1.2 and what factors are needed by a developing country like South Africa in order to maximise the benefits of FDI.

Series: Foreign direct investment, net inflows (% of GDP) 10 South Africa

Figure 1.2 FDI, net inflows as percentage of GDP

Source: WDI, June 2012.

FDI inflow to South Africa since 1994 has continued to be volatile and the attractions are below the anticipated levels. South Africa has reformed the investment climate as evidenced by achieving "position no.14" on the list of the most desirable countries do business with (UNCTAD, 2012). Despite this solid ranking, South Africa has attracted modest FDI. Assessing inward FDI as a share of GDP shows that net inflows are very low and volatile as they have fluctuated below 1% of GDP since 1994. However, there have a few exceptional years where FDI has been relatively high, namely 1997 (2.6%). 2001 (5.7%), 2005 (2.8%) and 2008 (4.5%). As shown from figure 2, FDI inflow to South Africa is very unpredictable.



While some developing countries in Asia and South America benefit from increasing FDI inflows, South Africa is still waiting for inward investment to takeoff significantly. This suggests that either the improvements in economic prospects or the investment climate are not yet attractive enough, or that they have not yet become widely apparent to potential investors.

It is important to explore the potential reasons for failure to attract high levels of FDI as well as improving internal conditions for greater FDI benefits. Several studies (Busse & Hefeker, 2007; Campos & Kinoshita, 2008) suggested that the success of FDI depends on whether certain preconditions exist in the host countries. South Africa's inability to attract FDI is concerning because FDI is crucial in creating employment, transferring skills and entrepreneurial development.

This research serves to provide better understanding of South Africa's failure to attract the required levels of FDI inflow compared with other similar developing countries that have attracted consistent flow of FDI. The research report has focussed on the preconditions required in order to attract FDI and the capacity needed to maximise FDI benefits. Clearly, a good understanding of preconditions and the magnitude of FDI benefits is of crucial importance to policymakers. However, it is also important, perhaps more important, to examine whether the interactions between preconditions, and absorptive capacity has had any implications for FDI benefits. Yet this research area has attracted very little attention in recent empirical literature.



1.3 Research Objective

The study has four main objectives:

- To analyse preconditions required in attracting inward FDI by developing countries. An attempt has also been made to analyse what are preconditions for South Africa in particular.
- To analyse factors required by developing host countries in order to better absorb FDI inflow.
- To argue that a recipient developing country could better benefit from FDI once they have (fit) balanced their preconditions and absorptive capacity.
- To propose policy recommendations based on the findings.

1.4 The Purpose

This research report has examined preconditions, absorptive capacity, and benefits of Foreign Direct Investment (FDI) for developing countries. Rather than concentrating on the entire Sub Saharan region, it has concentrated on one particular country: South Africa. While large multi-country studies can detect the factors that are critical in FDI, they are not providing an in-depth analysis. This is the main advantage of a single country research. In order to do so, the research report has outlined a theoretical framework grouped under three elements (preconditions, absorptive capacity and benefits) for understanding the underlying "preconditions" and "absorptive capacity" as forces determining the maximization of FDI benefits for a host country.



The main reason for choosing South Africa is that according to UNCTAD (2012), South Africa ranks amongst other developing countries who have received less FDI than could be expected based on economic determinants, including Argentina, the Philippines, and Slovenia. However, the same report also notes that South Africa entered the list of top prospective economies, ranking 14th together with the Netherlands and Poland. However, South Africa has been classified so far by UNCTAD under "developed countries." Therefore, due to the nature of South Africa sharing many characteristics typical of developing countries, this research report has made a very interesting case study. South Africa, as developing country needs FDI inflow in order to address the saving and investment gaps and eliminate its current pervasive challenges of unemployment, poverty, skills shortages, and gaps in technology.

1.5 Contribution to the Literature

While recent studies have begun to examine the role of institutions in catalysing FDI benefits (Du et al., 2011; Du, Harrison, & Jefferson, 2011), this research report has focused on analysing whether preconditions and absorptive capacity can partially explain the host country's ability to attract and maximise FDI benefits. Over all, the major contribution of this research report is that it illuminates greater understanding about FDI benefits because the interrelationship and the complementary nature of preconditions and absorptive capacity have been taken into account. The research report has argued that a fit between foreign investor needs and the developing host country's agenda is required in order to benefit from FDI.



1.6 Research Report Structure

The research report is structured in the following manner:

1. Introduction

A brief overview of the research problem, research purpose and objectives, theoretical framework and problem statement.

2. Literature review

Review of the literature concerning Foreign Direct Investment (FDI), definitions, preconditions, absorptive capacity, benefits, analysis of South Africa FDI, conditions, policy and instruments.

3. Research questions

Discussions of the research questions.

4. Research methodology

Description of methodology used, population, sampling method, quantity, quality, periods, research limitations, and assumptions.

5. Results

Data collection, data triangulation, and results.

6. Discussions of results

A full analysis of the results found in the research and the fitness approach.

7. Conclusions

9



Conclusion of the research paper, policy recommendations, and suggestion for future research.



CHAPTER 2: LITERATURE REVIEW

"... unless we understand why and how a MNC invests in a country, any discussion about attracting FDI would be moot (Bhaumik & Gelb, 2005, p. 24-25)

2.1 Introduction to the Literature

It is crucial for developing countries to understand Foreign Direct Investment (FDI) inflows and how it can contribute to the developmental agenda. As Moran (2005) pointed out, FDI can indeed make major contributions to development. However, the host country needs to ascertain what the conditions are that will lead to host country's maximizing their beneficial effects. The aim of this research report was to analyze the preconditions, absorptive capacity and benefits, it is imperative that sufficient theory is presented before performing any analysis. The desire to investigate preconditions, absorptive capacity, benefits and how they influence each other brings into focus the complexity surrounding this topic.

Such complexity cannot be unpacked from a mere review of theoretical underpinnings surrounding preconditions, absorptive capacity and benefits. Rather, it calls for a move away from such restricted linear thinking and pushes towards an analysis of a mesh of theories that are able to trace how the key conceptual themes spelt out above are linked and how the phenomena surrounding them could be explained when dealing with the FDI. Therefore the researcher is aware of the need not to look out for blind spots in this research by avoiding absolute subscription to a specific theory, but rather to review these theories with an open mind leading to an adoption of some theories either wholly or partially that will be used as analysis in this study. Such standing is advantageous in that it allows for



the analysis and explanation emerging from the findings and to draw conclusions, suggestions and policy recommendations.

The following literature review chapter therefore presents theories surrounding FDI, absorptive capacity and preconditions benefits. This presentation has been completed with full awareness that a theory or group of theories can be found to be more or less useful in explaining the phenomena under investigation. Among some of the theories discussed are those pertaining to FDI, such as industrial organization theory, the product life cycle hypothesis, transaction cost economics linked to preconditions and the eclectic paradigm linked to absorptive capacity; and those linked to benefits such as technology diffusion theory. The empirical evidence of preconditions, absorptive capacity and benefits were then reviewed and finally a conclusion was drawn by analyzing South Africa.

2.2 FDI Theories

Foreign Direct Investment is defined as investment made to acquire a lasting management interest in an enterprise operating in a country other than that of the investor and in general, foreign investment must be at least 10% ownership of an enterprise to be considered as FDI (Cicic, Patterson, & Shoham, 1999). Usually, foreign direct investments are made by large Multi-National Firms (MNFs) through a merger or acquisition, Greenfield, Joint Ventures (JV) and partnerships. In theory the foreign firms enters to new markets seeking efficiency, resources and markets. In explaining these motives the research report has reviewed literature on FDI theories.



2.2.1 International Trade Theories

In explaining the reasons why countries trade, the theory of absolute advantage was propounded by Smith (1937). According to Smith (1937), free trade is essential if the wealth of a country is to increase. With free trade, a country should export the commodity that can be produced at lower cost and import the one produced at higher costs compared with other nations. The draw back with this theory is that it fails to recognize the presence of foreign firms. Foreign investment was explained in its portfolio form as opposed to the direct form. The theory assumes perfect competition. Hence investors are able to take their savings where returns are highest and hence maximize profits.

2.2.2 Industrial Organization Theories

Stephen Hymer (1960) provided an explanation for FDI; he noted that firms have ownership specific advantages in the form of non-financial and intangible assets. These advantages include patents and technology, scale economies, managerial skills and product reputation (brand) that MNF would transfer across their subsidiaries. In this case the main motivation for FDI is that MNFs want to retain control of these assets by establishing foreign operations. Another related theory developed by Vernon (1966) established the product life cycle theory. The essential point here is that the MNF's main products' life cycle patterns determine foreign investment. The drawback of this theory is that it ignores host country conditions.



2.2.3 Transaction Cost Economics

North (1990) explained that Transaction Cost theory is based on a comparison between organizing activities through the market or through the firm. Due to market imperfections, firms incur transaction costs which they escape by using internal markets. The profit maximizing MNF is interested in preventing technology benefits to host firms in order to maintain a competitive advantage. The drawback of this theory assumes market imperfections and ignores host country environments.

2.2.4 The Eclectic Paradigm

John Dunning (1980; 1993) further postulated that Industrial Economics theory is captured by the focus on ownership factors (O), International Trade theory by locational factors (L), and the Internalisation theory (I) by market failure factors. Combining these theories, Dunning deduced that the OLI factors produce a more comprehensive understanding of FDI and foreign firms conduct. Dunning's paradigm has been developed basically to explain the behavior of Multinational Enterprises (MNFs). For example, to explain why firms own foreign production facilities. However, it has been used widely to analyze preconditions of FDI inflows ((Gastanaga, Nugent, & Pashamova, 1998).

2.2.5 New Trade Theory

According to Markusen and Maskus (2002) the distinction between horizontal and vertical FDI is important in the study of FDI and MNCs. Horizontal FDI refers to a situation where a MNF replicates the same production over different locations (Markusen, 1984). Vertical FDI refers to a situation where a MNF locates



production stages according to factor costs (Helpman, 1984). This theory explains the reason why a country would choose foreign production rather than exports.

In summary, the relevance of each theory has been assessed according to the respective historical framework. A theory is valid only to the extent that some evidence supports it. So far, the focus has rested on the explanation regarding why FDI exists. However, these theories are not explicit regarding the requirements for a foreign firm to invest in a particular country. The advantages of FDI for developing countries, as well as how developing countries can possibly maximize the benefits of FDI are the issues that form the core of this research study. The ensuing sections are therefore devoted to reviewing preconditions, Absorptive capacity and benefits.

2.3 Preconditions, Absorptive Capacity and Benefits

The literature reviewed in this research report indicates that an analysis of theories informing benefits without relating them to theories surrounding absorptive capacity, or conversely elaborating on theories explaining absorptive capacity and benefits without considering the set of theories utilized in explaining foreign firm attraction (preconditions) as well as retention, and vice versa would not be sufficient in explaining how developing countries could benefit from FDI. Explanations of growth based theories raise more questions than they answer. For example, these explanations do not answer questions regarding the policy options that are able to accelerate FDI benefits (Temple, 1999); and more importantly, they do not explain why some countries invest more than others in physical and human



capital, and why some countries have more FDI benefits than others at microeconomic and macroeconomic levels (Rodrik, 2004).

2.3.1 Preconditions

"The history of poorer host countries shows that relatively modest and eminently do-able reforms have been sufficient to draw impressive amounts of FDI." Moran (2006:11)

The aim of this research report is to explore factors that deter or attract FDI. These factors include macroeconomic stability, political stability, institutional environment, business environment, infrastructure and market potential. In particular, this research report explores whether the interaction between preconditions and absorptive capacity has any implication for FDI benefits and whether there are any complementary roles between preconditions and absorptive capacity in fostering FDI benefits. Ajay (Ajayi, 2006) noted that there are many studies on the theoretical preconditions, though there is generally inconclusive econometric literature on the precondition of FDI. Asiedu (2002) noted that many studies have underlined, among others the issues of institutional failures, problems of policy credibility, macroeconomic policy failures, and poor liberalization policies as deterrents to FDI flows. This section of the literature review focuses on factors that attract or deter FDI inflow in a developing country



2.3.1.1 Institutional environments

The need for an institutional framework that supports FDI is critical key factor in FDI inflow. Institutions facilitate economic exchange, define and protect rights, register and enforce contracts and have been explicitly recognized by economists at least since Adam Smith's Wealth of Nations (Tanzi, 2000). However, it is the work of North (1981; 1990) and Weingast (1997) among others, that has highlighted the relevance of institutions, in particular property rights protection, business environments and rule of law, for FDI attraction and benefits, and has inspired a burgeoning literature linking institutions to FDI inflow. In recent economic literature, an institutions has transformed categorical thinking of MNFs about FDI in host countries. Garibaldi (2002, p. 15) concludes that" Institutional and legal shortcomings like unpredictable regulation, red tape, confiscatory taxation and difficulties in enforcing contracts are important impediments to private business in general, and particularly to foreign investments: A transparent, stable and nondiscriminatory legal and regulatory environment is one of the basic institutional prerequisites to be fulfilled by a host country. Michalet (1997)(1997) also noted that bureaucratic procedures and institutional rigidities must be reformed. The institutional climate facing MNFs is multifaceted and conflicting in its nature (Henisz & Delios, 2001; Lu, 2002).

Durham (2004) found when assess impact FDI on economic growth that developing countries with higher legal standards are likely support FDI more efficiently. Similarly, Nunnenkamp (2004) concluded that for developing countries institutional development seems to be required to benefit from FDI Inflow. Conversely, proficient and established institutions provide an appropriate



environment for growth-enhancing activities like investment, innovation, and entrepreneurship.

Lim (2001a) argued that for developing countries, "A friendlier business/investment climate lowers the additional costs of doing business in a foreign country, thus benefiting both horizontal and vertical FDI. These costs include factors like regulatory, bureaucratic, and judicial hurdles; issues of property rights; enforceability of contracts; labour regulations; performance requirements like mandatory joint partnerships as well as domestic content requirements'(p. 22). The previous discussion makes it clear that institutions have an impact on FDI inflows and that countries with good institutions will attract more FDI. Institutions play this role because they affect transaction and transformation cost, which in turn affects the profitability of establishing production facilities in the host country.

Because these benefits are attracted at a macro level it is important to understand the role of government on institutions. According to North (1990) it was argued that government plays an important role for MNFs by providing stable political and economic environments, human capital and sound infrastructure both at macro and micro levels. The following section of the literature review analyses the macroeconomic and political environment.

2.3.1.2 Macroeconomic and political stability

The importance of the macro-political factors in determining FDI inflows has long been understood and emphasized in economic literature. Thus, the inclusion of various measures of macro and political attributes of the host country in factors explaining FDI inflows is not a recent aspect of FDI literature. Singh and Jun (1995)



concluded that although political risk is often thought to influence decisions to invest in another country, the empirical results do not always support this view. Omar M. Al Nasser (2010) also found when using panel data methods to analyze data from 14 Latin American countries from 1978 to 2003, the results obtained for the political factors are not statically significant. However, Onyeiwu and Shrestha (2004) have contradicted this view with the argument that when governments change, foreign investors would want to be certain that such changes may not affect their investments. Using econometric analysis, Garibaldi (2002) confirmed that macroeconomic and political climate have shaped FDI flows to host developing countries.

The facts on the impact of political risk remained varied, partly because it is challenging to obtain reliable quantitative facts of this qualitative factor, particularly aspects of political risk, which are observed by many studies (Henisz & Delios, 2001; E. G. Lim, 2001a; Lu, 2002) as a direct restraint by foreign investors. UNCTAD (1999) did the investment survey found that In Egypt, the political stability has been perceived as the major obstacle to business startups and operations. Lim (2001a) also notes that besides political risk, other fundamentals that helped to attract the inflow of foreign direct investment included political stability, economic stability, lower wages, accessibility, special rights. However, Abdul Latib Talib (2004) concludes that economic instability such as inflation; foreign exchange flow and economic crisis were also important environmental factors for investors to consider because these can cause the business to lose without knowing in advance. Moreover, researchers like Ghosh and Philips (1998); Khan and Senhadji, (2002); Noorbakhsh, Paloni, and Youssef (2001); (Saggi, 2002)Saggi



(2002) and Abdul Latib Talib (2004) identified several fundamentals such as government size, inflation, trade openness, interest rate and exchange rate to represent environmental condition.

2.3.1.3 Physical Infrastructure

Infrastructure is viewed in many studies (Kessides, 1993; Mohan, 2005; Nunnenkamp, 2004) as a factor responsible for FDI inflow. According to Kinoshita (2001), infrastructure is described as a classification associated with power, rail, transport, information and communication technology, and ports. Similarly, Kessides (1993) concluded that infrastructure contributes to the development of host countries by creating facilities, providing goods and services which contribute to economic development. Omar M. Al Nasser (2010) also found evidence in Ghana that indicates that physical infrastructure is an important determinant of FDI. Moran (2006) also argued that policies which results in solid infrastructure in developing countries may benefit from more FDI flows. However, Asiedu (2002) did a study of FDI in Africa and argued that infrastructure is not too relevant to some African countries. This is also evidenced by the UNCTAD Report (2012), which indicated that Nigeria leads the list of FDI recipients in Sub Saharan Africa (SSA) Colecchia (2002), concludes that inadequate despite the power challenges. infrastructure is barrier to entrepreneurial activity and solid infrastructure may lead to better FDI inflow, the study also notes that similar to human capital good infrastructure can increase absorptive capacity of a host country.



2.3.1.4 Market and Human capital

Moran (2005) stated that the quality of human capital is the main condition which determines an economy's ability to create and execute new ideas and adapt old ones. Alfaro, Chanda, Kalemli-Ozcan, and Sayek (2004)) agreed using panel data methods to analyze data from 14 Latin American countries from 1978 to 2003. His research confirms, from empirical evidence, that the level of schooling is an important determinant of FDI. Suliman and Mollick (2009) analyzed FDI flow to developing countries and concluded that relatively low FDI flow to Sub Saharan Africa is partly explained by poor human capital. Levine and Renelt (1992) who conducted research using 50 variables in at least ordinary regression noted that there was a robust relationship between economic benefits, FDI and human capital. However, the results by Borensztein, De Gregorio and Lee (1998) implied that foreign firms were more efficient than local firms only when the host country had certain level of human capital. Blomström and Kokko (1996) also found evidence indicating that the benefits of FDI creating a high-income economy does take place automatically. Similar results were also reported Balasubramanyam (1998) in that FDI can be an important instrument for development when only certain level of human capital with sound infrastructure and stable business climate were attained. Hence, this research report will investigate whether the host country certainly needs to have good quality human capital. Barthel, Busse and Osei (2011) agreed with other researchers, such as Nunnenkamp (2002) that given the shifts in FDI type, the decision to invest based on availability of low cost unskilled labour in host developing countries has declined over time. The emphasis now shifted to human capital and skill level.



The size of the market appears to be an important precondition of FDI flows. Market seeking FDI needs a huge market for effective utilization of their investment. The large market reduces the transactional cost of production because of higher volumes (E. G. Lim, 2001a). Therefore For developing countries many studies including, Nunnenkamp and Spatz (2002); Moran (2005); and Omar M. Al Nasser (2010) all find market size to be significant.

However, Campos and Kinoshita (2008) concluded that market size is no longer a significant precondition of FDI flows into developing countries. A large and growing regional market is the main precondition for all companies (Michalet, 1997). However, Inotai (1998) concludes that "this is no longer simply a substitute for a large domestic market. Most, global investors are now attracted to huge and developing regional markets. Even where foreign firms started off with the intention to penetrate the local market, the main aim of the investment became to supply the regional market as well. Investors have been attracted by or have upgraded their investments because of the potential of the regional market" (p. 43).

Foreign investor reflects on the target market in a regional context rather than domestic context. Foreign direct investment strategy seems to be embracing this new form of regional free trade agreements, since they have enough resources to service a large market (Borensztein et al., 1998). Preconditions are important but benefit can only be realized when the host country has adequate structures in place to absorb the benefits. The following section discusses absorptive capacity.



2.3.2 Absorptive capacity

Having discussed various factors that deter or attract FDI from one country to the other (preconditions), the focus now turns to studying whether the receiving end is able to absorb the benefits. Kinoshita (2008) define absorptive capacity as the ability of a country to identify, assimilate, and exploit foreign investment

Therefore this research will refer to the host country factors (macro level) in terms of educational level of the work force, level of infrastructure and firm factors (micro level) in terms of level of technology of the firm, and the level of skills within the firms. These factors are generally considered critical for the absorption for foreign investment as concluded by Girma (2005).

2.3.2.1 Absorptive capacity at the firm level

There are numerous ways of measuring the absorptive capacity of a firm as reflected in the literature. For the firm level study the factors considered are technology, research and development (R&D) and the level of skill within the firm. For example, the study by Girma (2005) ascertained that absorptive capacity was measured as the gap between local firms from the technology investor firm. In this case, a firm operating close to the technology leader is said to have high absorptive capacity. Wang and Blomstrom (1992) considered a study of the development of international technology transfer. In their model, the relationship between the MNF and the local firm determines technology transfer. This argument was also enhanced by Kinoshita (2001) that technology diffusion is not an automatic consequence from the presence of others. Absorptive capacity also requires that the recipient possesses the ability to absorb and adopt the technology



and that human capital will help increase the incidence of technology spillovers by enhancing the local firm's absorptive capacity. Also in the theoretical literature of technology transfer from foreign to domestic firms, Wang and Blomstrom (1992) pointed to the importance of education of local firms who are increasing the rate of technology transfer.

Based on this review, for the host country to maximize the benefits of technology and skills transfer from FDI, the host country firms should engage in R&D and human capital investment in order to enhance their absorptive capacity. In the next section absorptive capacity of the host country is reviewed.

2.3.2.2 Absorptive capacity for the host country

The bulk of the evidence on absorptive capacity appears on country level studies. Amongst these critical indicators are host country structural issues like education, infrastructure and local firms (Borensztein et al., 1998) the level of development of financial markets (Alfaro et al., 2004), technology use efficiency (Fagerberg, 1994; Henry, 2006) and domestic research and development (R&D) (Griffith, Redding, & Simpson, 2004; Kneller & Pisu, 2007). The importance of R&D in expanding the technology frontier is discussed by Aghion and Howitt (1990) and Grossman and Helpman (1991). The dominant variable in most studies is the level of education of the labour force. Abramovitz (1986) has called this social capability and other authors simply refer to it is a threshold level of human capital. Human capital is usually measured as the increasing effect of activities such as formal education and on the job training Romer (1990); Heckman, (1976); Rosen (1976). Borensztein, et al., (1998) found FDI benefits to be positive but insignificant until after considering the minimum threshold stock of human capital. This study



considers different indicators of absorptive capacity, over and above the human capital variable that most studies have used.

In concluding this section of the literature review, it is clear that absorptive capacity has an influence on both FDI attraction and benefits. As concluded by Kinoshita and Lu (2006) that the host country should undertake to improve absorptive capacity prior to attracting FDI in order to maximize the benefits from FDI. In the next section, we therefore analyse the benefits that the host country could gain from FDI if appropriate preconditions and absorptive capacity are in place.

2.3.3 Benefits

"The search for externalities and spillovers provides a picture of the extent to which the very presence of foreign firms diffuses new skills, technologies, and capabilities throughout the host economy" (T. H. Moran, 2006).

In the previous section the research report discussed the various factors that impact the absorptive capacity of the host country. The focus now turns to analyzing the benefits that the host country could gain by attracting and absorbing FDI.

There are several studies that have attempted to estimate the benefits from FDI and most of these studies hypothesize that the incidence of benefits depends on absorptive capacity (Cohen & Levinthal, 1990). Thus, instead of asking only about how attraction FDI leads to economic growth, the focus is also on the enabling conditions for this relationship to materialize.



The empirical evidence for technology benefits from multinational firms to domestic firms is varied. Kokko, Tansini and Zejan (1996) studied Uruguayan manufacturing plants to examine the hypothesis of technology benefits and found benefits only in the sub-sample of locally owned plants with a moderate technological gap from foreign firms. Aitken and Harrison (1999) found no evidence of positive benefits from foreign to local Venezuelan local firms. In cross-country studies, Borensztein et al (1998) completed such a study where he concluded that the incidence of technology benefits via FDI depends on the level of human capital.

Javorcik (2004) said it is noted that the potential benefits can occur horizontally, that is, impact on domestic companies in the same sector, or vertically, that is on suppliers or customers of foreign firms. Empirical evidence for the former type is inclusive, for example, Aitken and Harrison (1999) on Venezuela or Djankov and Hoekman (2000) on the Czech Republic fail to find conclusive evidence of benefits in developing countries. Vertical benefits, on the other hand, for example, Javorcik (2004) and Javorcik and Spatareanu (2009) provide evidence that domestic suppliers from Lithuania and the Czech Republic, respectively, benefit from their relationship with multinational companies. As evidenced by Javorcik and Spatareanu (2008) the extent of vertical benefits impact depends on the local participation in the investment.

These mixed findings suggest that benefits such as employment, technology and skills transfer may be dependent on absorptive capacity of local firms relative to that of foreign firms. Kokko (1994) confirms this point from his results on the study of Mexican manufacturing firms by concluding that the incidence of technology benefits are conditional on the technology level of local firms. However, despite



these theoretical suggestions, empirical literature on benefits of FDI provides mixed evidence. The ambiguity of this empirical evidence on the benefits of FDI has been justified in FDI literature by providing some explanations. One explanation is that not all host countries are capable of benefiting from FDI inflow. In particular, host countries need to reach a minimum threshold of absorptive capacity, such as the quality of human capital and the development of local firms, before they can benefit from the growth effects of FDI (T. H. Moran, 2006). The other explanation states that not all kinds of FDI are capable of providing host countries with benefits.

2.3.4 Conclusion

It is indeed difficult to find theories attempting to explain the behavior of foreign investment, and hence, FDI on developing host countries has not been researched in a clear cut form of advantages and disadvantages (Latocha, 2004). The difficulty in summarizing the theories arises from the fact that host countries and investors have different reasons for undertaking investments. On the one hand, investors have a profit maximization objective. While on the other hand host countries allow FDI with the expectation that they will boost the supply of capital, close the technology gap, increase export earnings, increase employment as the demand for workers increases, and improve the quality of human capital and fuel development in their less developed areas.

Therefore, the theoretical review and empirical review concerning FDI, benefits, absorptive capacity and precondition undertaken in this chapter crowns the key fundamentals of this research report, namely that theories of foreign firms cannot be discussed without analyzing theories informing precondition. Similarly, theories



informing benefits cannot be analyzed without relating them to theories surrounding absorptive capacity. Finally, one cannot further elaborate on theories explaining absorptive capacity and benefits without considering the set of theories utilized in explaining foreign firm attraction as well as retention, and *vice versa*. It is intertwined relationships of theoretical foundations.

As indicated in the introduction to this chapter, the insights from the relationships between and among these theories mean that the three sets of theories explaining FDI, precondition, absorptive capacity and benefits need not be considered in isolation. Rather, any explanation of phenomena emerging from the three focus themes in this research report, namely preconditions, absorptive capacity and benefits must be informed and explained by a hybrid theoretical orientation. Such a hybrid approach enhances the capacity to analyses and explain the complexity surrounding the research topic under consideration.

2.4 FDI in South Africa

2.4.1 Introduction

Gelb and Black (2004) confirmed, that South Africa "Industrial development was initiated by the discovery of major mineral deposits from the 1860s, first diamonds and later gold. Effective exploitation of the resources required large capital-intensive operations, and was made possible by both direct and portfolio investment flows from Europe, particularly London. This contributed to the early development of a domestic stock exchange in Johannesburg. Domestic economic growth and the re-investment of mining profits stimulated manufacturing development from the turn of the 20th century. Direct investment from the UK, the



US and Europe16 was important in the establishment and growth of new industrial sectors during the five decades from the 1920s" (p. 2). Given the background of South Africa, this research report has focused on post-apartheid error FDI inflow since 1994.

2.4.2 South African Investment climate

Foreign Direct Investment (FDI) is an important indicator to boost the developmental goals of South Africa. FDI was identified as a medium to help with South Africa's structural problems of unemployment, skills shortages, and high levels of poverty. However, since 1994, inflow of foreign direct investments into South Africa has been highly volatile (Gelb & Black, 2004).

In this section of the research report, the South Africa investment climate in terms of absorptive capacity factors like human capital, entrepreneurship, technology are reviewed and analysed using World Bank data comparing South Africa with other similar developing countries and factors that may attract FDI into South Africa such as ease of doing business, infrastructure, GDP, and institutions. The research paper concludes this section of the literature review by discussing FDI policies in South Africa as a factor in attracting or absorbing FDI.

2.4.2.1 Gross domestic product (GDP)

Since the South African democratization process commenced in 1994, the South African economy has undergone rapid changes through its macroeconomic policies. Nowak (2003) argued that "The Growth Employment and Redistribution (GEAR) policy of 1996 entailed the liberalization of markets and integration of the economy with the rest of the world. Emphasis on private sector participation in the



economy was part of these reforms" (p. 23). The macroeconomic reforms have led to increases in real GDP growth from an annual average of 3% in 1994 to over 5% in 2007 until the global economic recession in 2008, when the growth rate reduced to 3% (South African Reserve Bank, 2010).

Table 2.1 GDP growth rate

SA	2004	2005	2006	2007	2008	2009	2010
Gdp growth%	4.6	5.3	5.6	5.6	3.6	-1.7	2.8

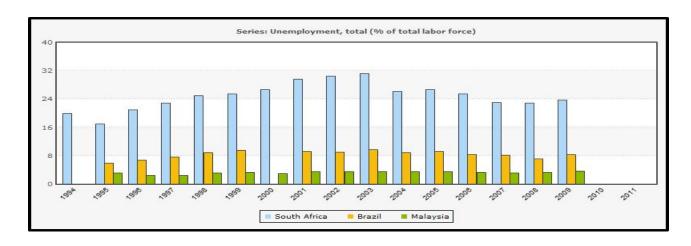
Source: World Bank, World Development indicators database, June2012.

2.4.2.2 Unemployment

South Africa since 1994 has struggled with high unemployment, poverty and inequality. The unemployment rate averaging 25 per cent and high levels of inequality make compared to similar countries like Brazil and Malaysia as shown in figure 2.2. Kingdon and Knight (2007) analyzed unemployment using household surveys spanning between the years 1995 and 2003 and explains that increase in unemployment is as the result of slow economic growth and low demand for labour. Kingdon and Knight (2007)also concluded that if unemployment is to be tackled, it is important to design policies that encourage FDI and also good business environment.



Figure 2.1 Unemployment as percentage of total labour force



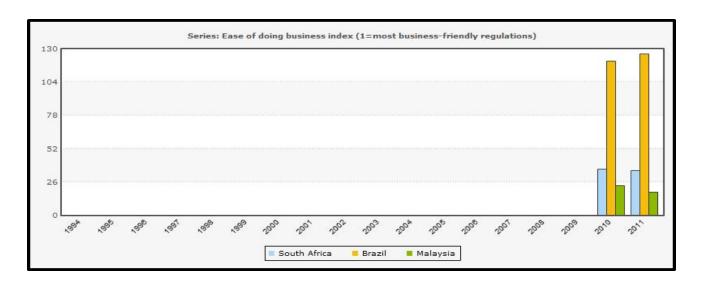
Source: World Bank, World Development indicators database, June 2012.

2.4.2.3 Business climate

Lim (2001b) argued, "A friendlier business/investment climate lowers the additional costs of doing business in a foreign country, thus benefiting both horizontal and vertical FDI. These costs have to do with factors like regulatory, bureaucratic, and judicial hurdles; issues of property rights; enforceability of contracts; labour regulations; performance requirements like mandatory joint partnerships and domestic content requirements" (p. 13). South Africa, in terms of ease of doing business, scores very high when compared to developing countries like Brazil and is very competitive when compared to developing countries like Malaysia as shown in figure 2.3. This also evidenced by UNCTAD in the 2012 Report (UNCTAD, 2012) that South Africa entered the list of top prospective economies, ranking 14th with the Netherlands and Poland.

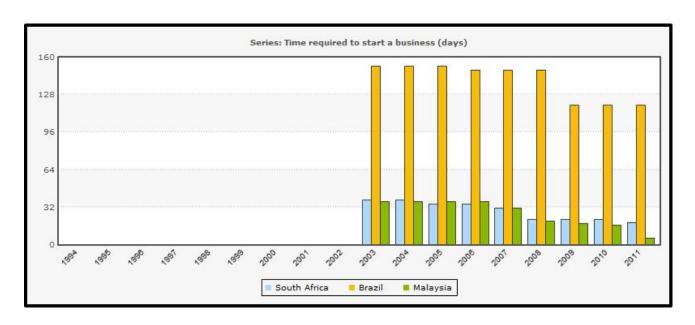


Figure 2.2 Ease of doing business index



Source: World Bank, World Development indicators database, June2012.

Figure 2.3 Time required starting a business



Source: World Bank, World Development indicators database, June 2012.

2.4.2.4 Infrastructure

The South African infrastructure is favorable according to a report by UNCTAD in the late 1990s (UNCTAD, 1998). The report stated that facilities include high-



quality telecommunication links and reliable transportation systems as evidence by data from the World Bank. The South African infrastructure is ranked high in terms of telecommunications systems, ranking higher than Brazil and power consumption per capita ranking higher than most developing countries like Malaysia and Brazil as indicated in figure 2.4.

Series: Mobile cellular subscriptions (per 100 people)

130

104

78

52

26

Methodology Reference of the property of the pro

Figure 2.4 Mobile phone subscriptions (per 100 people)

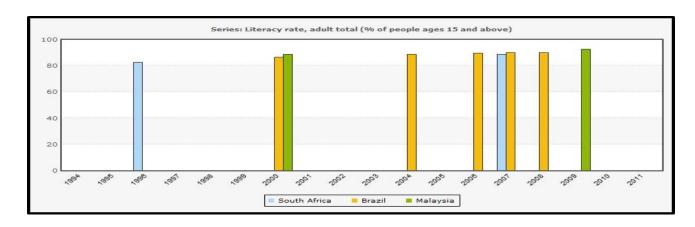
Source: World Bank, World Development indicators database, June 2012.

2.4.2.5 Human capital

South Africa literacy rate is comparable with other developing countries such Brazil and Malaysia as shown in figure 2.5.UNCTAD (1998) also concluded that there are policies that affect the supply and quality of productive resources in a host country. These policies can impact the inflow of FDI, therefore it is critical for host developing countries to pursue educational and health policies that raise the level of human capital in a country can improve a country's competitive advantages.



Figure 2.5 Literacy rate, Adult total (% of people ages 15 and above)



Source: World Bank, World Development indicators database, June 2012.

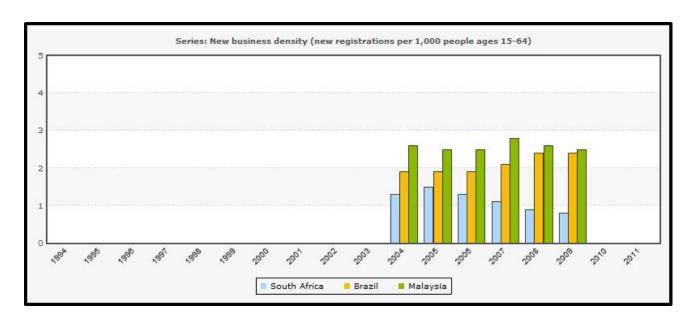
2.4.2.6 Entrepreneurship

South African new business density is low and is increasingly getting lower when compared with other developing as indicated by figure 2.9. Density was lower in 2009 than it was in 2005, which could have robbed local suppliers of inputs as noted by Nguyen, Duysters, Patterson and Sander (2009). Domestic firms are bridges of FDI for the host country. At the same time, local firms could absorb technology and skills transferred from FDI.

The South Africa government has recognized that entrepreneurship is critical for economic growth. Entrepreneurship remains the engines of the economy through innovation, creating of new markets, new business. This might lead to job creation and have a multiplying effect on the economy. The South African government has therefore established institutions like Industrial Development Corporation, Small Enterprise Development Agency and National Empowerment Fund that foster's entrepreneurship (Department of Economic Development, 2010).



Figure 2.6 New business density (new registration per 1000 people ages 15-64)



Source: World Bank, World Development indicators database, June2012.

2.4.2.7 Technology

The UNCTAD report (2010) stated that countries with the highest R&D spend are developed countries and most developing countries spend less on research and development. Few developing countries such as Brazil, India and South Africa are also beginning to spend on research and development. This is a key indication that South Africa continues to spend money on research and development in an effort to improve the technology gap. South Africa is on par with Brazil in terms of R&D spent, spending almost 1% of the GDP on research and development, which is well above similar developing countries like Malaysia.

2.4.3 FDI Policies in South Africa

South Africa has also implemented a number of FDI policies in effort to attract inflow of FDI during South Africa's apartheid regime; FDI was in the back seat.



With the change of political regime in 1994, the government adopted outward looking policies that aimed to attract foreign direct investment. They are specific departments and sub units have been task with responsibility of formulating and implementing FDI related policy. These include the Department of Trade and Industry (DTI), the Department of Minerals Resources (DMR), Department of Communications (DOC) and the South African Reserve Bank (SARB), among others (Department of Trade and Industry, 2011).

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2.4.3.1 New growth path (NGP)

From the broad economic framework outlined in 2008, as contained in Appendix 12 of the new growth path policy, the need for FDI in South Africa in pursuit of growth was recognized. This would be attained through gradual trade liberalization, government deficit reduction, consistent monetary policy as well as the gradual relaxation of exchange controls (Department of Economic Development, 2010). South Africa underscored the need for providing the right macroeconomic environment as a starting point in attracting FDI.

The new policy also focused on improving domestic savings as well as gradual reductions in the fiscal deficit. Whilst fiscal deficits have been reduced and some surplus been recorded in 2005, domestic savings have remained low, hampering efforts to increase foreign investment (Department of Trade and Industry, 2008). South Africa took additional steps towards the implementation of a new Companies Act, bringing a host of changes, such as a restructuring of corporate categories (UNCTAD, 2012).



2.4.3.2 Trade and openness

The dti finalized a Trade Policy and Strategy Framework which sets out the Government's approach to trade policy and strategy and clarifies that South Africa's trade policy will be informed by industrial development and employment objectives. Guided by this Framework, the Department continued to prioritise development and regional integration in Africa and Southern Africa (Department of Trade and Industry, 2011). The Department of Trade and Industry has developed the following programme to deal with issues of trade and foreign investment in South Africa, as indicated in table 2.2 below.

Table 2.2 The DTI: FDI programmes

Programme	Responsibility		
Industrial Development Division (IDD)	Responsible for elimination of		
	intermediate barriers to entry, deepens		
	domestic technology linkages		
Trade and Investment South Africa	Responsible for developing South		
(TISA)	Africa's capacity to export to various		
	markets and increase foreign direct		
	investment in the country.		
The International Trade and	Responsible for the development of		
Economic Development Division	policies and the design of policy		
(ITED)	instruments for economic activity,		



2.4.3.3 Bilateral Investment Treaties

"BITs exert some influence on the policy framework for FDI, by contributing to the improvement of an investment strengthening the bilateral standards of protection and treatment of foreign investors and establishing mechanisms for dispute settlement. In this manner, they help to reduce the risk of investing in countries party to these treaties. BITs do not alter the economic determinants of FDI and they seldom provide for proactive promotion measures by governments" (UNCTAD, 1998, p. 163). For trade related purposes, South Africa has entered a number of bilateral agreements with other countries. These include bilateral investment and protection agreements (BIPAs) where investors are granted the most favored nation (MFN) status (Department of Trade and Industry, 2007).

2.4.3.4 Incentives programs

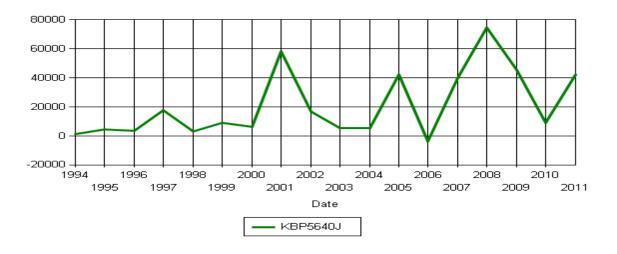
South Africa up-scaled the implementation of the second Industrial Policy Action Plan known as IPAP2, and finalized a new iteration of the document. This was in recognition of the fact that placing the South African economy on a higher and more labour-absorbing growth path required that the country deal with a number of structural factors that still affected the economy's productive capacity and competitiveness. A major achievement has been the positive turnaround in the automotive sector and clothing and textile sector through the finalization of the Automotive Investment Scheme (AIS) and the rollout of the Clothing and Textile Competitiveness Programme (CTCP) and Production Incentive (PI). These two programme initiatives have resulted in investment commitments and are expected to go a long way towards creating the projected number of jobs. (Department of Trade and Industry, 2011). The rationale for Export Processing Zones and Free



Trade Zones is to offer foreign investors freedom from duties on the capital equipment and inputs used in assembly operations, to enable them to operate with reliable competitively-priced infrastructure, and to shield them from adverse business conditions that may afflict other parts of the economy (corruption, bureaucratic delay, high taxes, legal uncertainty) (Department of Trade and Industry, 2011).

2.4.4 FDI inflow to South Africa

Figure 2.7 Net inward FDI to South Africa



Source: SARB, June 2012.

The graphical plot above shows that South Africa received very little FDI after 1994, FDI inflow to South Africa since 1994 has continued to be volatile and the attractions are below the anticipated levels. South Africa has reformed the investment climate as evidenced by achieving "position no.14" on the list of the most desirable countries do business with (UNCTAD, 2012). Despite this solid ranking, South Africa has attracted modest FDI. Assessing inward FDI as a share



of GDP shows that net inflows are very low and volatile as they have fluctuated below 1% of GDP since 1994.

Figure 2.8 Net inward FDI as a percentage of GDP Table 2.11

Source: World Bank, World Development indicators database, June 2012.

When analysing inward FDI as a percentage of GDP the net inflows are low at less 1% of GDP. The exceptional years are 1997 (2.60), 2008 (3.5%), 2005 (2.64%) and highest being 2001 (6.1%). This is not good in comparison with other developing countries like Brazil and Malaysia which average 3.5% of GDP as illustrated in figure 2.11. South Africa continues to perform dismally in terms of FDI inflow concluded by UNCTAD (2012), South Africa is one those countries who have received less FDI than expected based on economic determinants, including Argentina, the Philippines and Slovenia.



2.5 Studies on South Africa

While there have been many studies on FDI for developing countries, studies on South Africa are scarce. Two notable studies related to focus of this research are by Gelb and Black (2004) and Fedderke and Romm (2006) and both have focused on preconditions of inward FDI to South Africa.

Gelb and Black (2004) sought to examine the macroeconomic link between FDI in South Africa and entry modes using unique firm-level data collected from MNF affiliates operating in South Africa. Gelb and Black (2004) concluded that the "results indicate that two key determinants of the choice of entry mode are the resource needs of the MNF and the business/institutional environment in the host country. They also indicate that priors about the choice of entry mode that are based on developed country experience are not necessarily relevant in the emerging market context" (p. 17)

Fedderke and Romm (2006) investigated the growth impact and determinants of FDI in South Africa using the co integration and error correction-modelling framework. Their findings concluded that political risk, property rights, market size, labour cost, corporate tax rates, and openness are important factors in attracting FDI.

2.6 Conclusion

South Africa as a developing country aims to be a developed country by the year 2030 (National Planning Commission), where it desires a huge flow of FDI to boost the economic growth. However, the inflow of FDI will not take place automatically with the presence of multinational firms. Hence, attention needs to be given to



address the factors that attract or deter FDI such as infrastructure, institutions and absorptive capacity factors such as human capital development, technology gap, and upgrading of local firms that eventually contribute to economic growth. Thus, this research report investigates the relationship of preconditions, absorptive capacity and FDI benefits towards economic growth in South Africa. Developing countries often rely on short-term planning. With little consideration on environments required by investor and absorptive capacity because this process requires long term planning and Before FDI benefits can be realized. Thus, FDI seems to be the best solution to fill a lack of capital and collect tax. However, FDI holds more benefits such as advanced technology, skills transfer, aiding entrepreneurship and creating employment.



CHAPTER 3: RESEARCH QUESTIONS

3.1 Introduction

This chapter discusses the research questions used in this research report to achieve the research objectives that were outlined in chapter 1. Zikmund (2003) concluded that formulating the research questions enhances the understanding of the research problem. The research problem is to analyze factors that contribute to foreign investor's choice of host country regarding Foreign Direct Investment (FDI) and to also analyze factors that lead to better absorptive capacity by the host country which could result in better benefits.

3.2 Research Question 1

What are the preconditions required by foreign investors in South Africa?

3.3 Research Question 2

What are the factors that contribute to better absorptive capacity in South Africa?

3.4 Research Question 3

What are the benefits that could be realized in South Africa when the country has met the preconditions and have better absorptive capacity?



CHAPTER 4: RESEARCH METHODOLOGY

4.1 Introduction

Yin (2003) defined research design as a logical plan that links the research questions to the conclusions. He concluded that the research design guides the researcher in the process of collecting, analyzing and interpreting data. The previous chapter discussed the research questions. This chapter outlines the methodology that the study undertakes to answer the research questions. This includes the research design used, the population, sampling method used, data collection, and quality of data, data analysis as well as the limitations of this research report.

4.2 Research Design

The research design entails the use of in-depth interviews with open ended discussion questions in an attempt to answer three research questions. The discussion questions were designed based on the literature review of three main themes, namely:

- (1) Preconditions
- (2) Absorptive capacity and
- (3) Benefits.

The discussion questions are included in Appendix A. Girma (2005) said that the host country can absorb FDI benefits at two levels. One is the microeconomic level, which is represented by foreign and local firms and the other is the



macroeconomic level that is represented by government and investment agencies.

Therefore, the questionnaire was designed to accommodate the two levels of FDI analysis as mentioned above.

The first approach was a qualitative analysis of how the technology transfer and skills development of firms at a microeconomic level have been influenced by the presence of foreign firms. The second approach was a macroeconomic analysis of country level factors that influence the country to maximize benefits.

The interview questionnaires were grouped into four main parts (A1-D1): The main objectives of the interviews were to obtain insight and understanding of FDI preconditions, absorptive capacity and benefits. The researcher further established their perceptions and opinions on FDI in South Africa. The interview guide was designed around the comprehensive literature reviewed. The interview discussion guide consists of open ended questions grouped into four parts, and questions requiring selection from various options.

Table 4.1 Interview questions parts

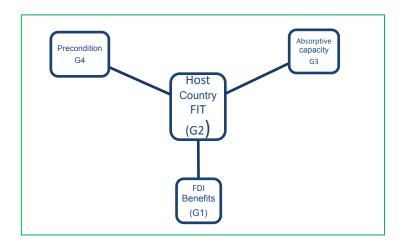
A1	Government:
B1	Investment agencies
C1	Host firms
D1	Foreign firms

The interview questionnaires were grouped into four main parts (A1-D1). The groupings of respondents resulted into data triangulation, which entails gathering data through several sampling approaches, so that portions of data at different



times and social situations, as well as on a variety of people, are gathered so that the data is normalized (Denzin, 1970). The researcher is of the view that this approach was the most appropriate as this has enabled the researcher to gain insights from the different research groupings e.g. Government, Foreign firms etc.

Figure 4.1 FDI themes interrelation



Source: The researcher.

Figure 4 above illustrated how the main themes of the research are interrelated and how they are all required to ensure full benefit of FDI. The questionnaire was designed to measure and understand the interrelatedness of these variables.

Table 4.2: themes and groups

Theme 1 (G1)	FDI benefits: Analyses of benefits that could be brought by foreign		
	investment		
Theme 2 (G2)	Host country fit: Analyzing fit between foreign investor and host		
	agenda		
Theme 3 (G3)	Absorptive capacity: Requirements for host country to absorb		
	foreign investment		
Theme 4 (G4)	Attractiveness: The attraction of the host country for the investor		



Questions in each of the above mentioned groups were design based on the research objectives and literature review. Each of the above questionnaire groups had four main themes allocated. This allocation was based on the objectives of the research and the literature findings in chapter 2, as indicated in table 4.2. The next section explains why the researcher used the qualitative approach and outlines the advantages and disadvantages of this methodology.

4.2.1 Qualitative Research Design

This section explains why the researcher used the qualitative approach and outlines the advantages and disadvantages of this methodology.

The origins of qualitative research are rooted in streams of theory and practice in the social sciences where the interpretation and synthesis of ideas and concepts have always been part of the literary criticism approach to bridge the challenge presented by some problems that do not lend themselves well for quantitative analysis (Bartos & Lazarsfeld, 1986). Qualitative research has been found to be most effective in capturing the language used by respondents as semantics are often revealing of underlying sentiment. The researcher recorded most of the interviews to collect the language and underlying sentiment used. An observation is made that people hardly ever answer what is asked literally but rather respond on the basis of either their own meaning or that of which they perceive of the question. The study guided the respondents in terms of the focus of the study. To overcome the challenge of focus, the researcher posed open handed question and probed to align the answers with the study. This is aligned to the fact that by its design qualitative research deals with the textural and emotional aspects of a response rather than measurable objective constructs (Bartos & Lazarsfeld, 1986)



The following sections of this chapter outline the population and sample selection methods that were employed by the researcher.

4.3 Population

The population for this study consisted of four distinctive groups of populations, which are representatives of the major roles players in attracting and retaining Foreign Direct Investment in South Africa. Furthermore, the population was considered based on the experience of practical FDI projects and experiences. These key stakeholders are Government officials, professional investment agencies, local firms and foreign firms (Table 4.3). The four groups were identified as the population from which the samples were extracted for the in-depth interviews.

4.3.1 Unit of Analysis

Zikmund (2003) noted that determining the unit of analysis should not be overlooked during the problem definition stage of the research. The units of analysis in this study are preconditions, absorptive capacity and benefits in South Africa represented by the group of individuals that have experience, exposure and expertise with the subject matter being considered.

4.4 Sample Size and Sampling Method

This section explains the sample size and sampling method used and outlines reason for the size and sample methodology.



4.4.1 Selection of respondents

Sampling was focused on gathering data from the distinct groups as indicated table 4.3. Samples were selected using Non-probability judgment sampling. As described by Zikmund (2003), this type of sampling is employed to serve a specific purpose, when researchers use their judgment to select a sample based on appropriateness of the sample. For the purpose of this study judgment was based on the respondent's roles and responsibilities in Foreign Direct Investment (FDI) in terms of attracting or implementing substantial FDI projects. The individuals targeted were prudently selected as being knowledgeable and directly involved in the subject matter being studied.

The respondents had to meet the following criteria:

- Directors or senior manager with experience and expertise in FDI;
 experience in either attracting foreign investment or investing in foreign country.
- Each respondent had to possess adequate knowledge in FDI projects from investing or receiving foreign investment.
- They must have participated in major Foreign Direct Investment projects.

Proportional stratified sampling was used to allow for triangulation between the groups where members of the population were grouped into four groups to ascertain commonalities and divergent views of the different stakeholders based on their population element. The purpose was not to establish a random or sample drawn from a population but rather to identify specific groups of respondents who



possess experience and knowledge relevant to the topic being studied. This was done to obtain a balanced view and retrieve insights from different viewpoints.

4.4.2 Number of respondents

The sample size was based on achieving a representative sample that the researcher was able to access and the sample was screened carefully to meet the research data requirements. Due to this requirement the researcher was looking for quality rather than quantity, to ensure that individuals with the appropriate experience and knowledge were interviewed. Based on the limited number of individuals with the adequate knowledge and experience, a target of five per group was a fair representation of stakeholders that would be involved in FDI. Twenty two interviews were conducted in this study as illustrated in table 4.3.

Table 4.3 the respondents used for Face to face interview

Grouping	Organization	Target	Interviews
G1	Government	DG, DDG , CD	5
G2	Investment Institutions	Directors	5
G3	Local firms	CEO,MD, CFO	6
G4	Foreign firms	CEO,MD, CFO	6
Total			22

The total stratified sample was 22 high profile individuals who met the selection criteria to ensure that the data gathered would answer the set research objectives. The researcher conducted a screening process to select respondents that had certain qualities that were required for quality of data. Careful screening of respondents is a vital antecedent for data validity in qualitative study design. Unlike



quantitative research, there is limited scope for dilution of individual perspective through the application of statistical modeling techniques. The target sample size of 5 respondents for each group was intended as another measure to bolster quality and data validity. Aligning the divergent responses enabled the researcher to capture a balanced perspective on the diversity of views and experiences related to the subject matter.

Targeting senior officials further enhanced data validity as these individuals were likely to be in high-ranking positions with greater autonomy and depth of experience which would provide some degree of dilution to potential participant bias (Saunders, Lewis, & Thornhill, 2009, p. 156).

4.4.3 Formulation of the questionnaire

The interview guide, a copy of which is attached as Appendix A, was compiled using the three themes driven by the research questions. The guide was designed to facilitate the logical flow of thoughts of FDI preconditions, absorptive capacity and benefits. At the outset open ended questions were asked as not to obstruct the respondent by constructs of theory. This was followed by eight questions related to the themes from the research objectives.

The in-depth interviews resulted in a substantial amount of qualitative data that is supplementary to the questions in the guide. In particular, the very first question was aimed at highlighting factors which the respondents deemed critical in terms of FDI inflow to South Africa. The guide designed to solicit responses from the respondents that would support or differ with the components of theory. The literature as it relates to FDI in South Africa was used in conjunction with FDI inflow



theory from other developing countries. Questions that were relevant to the theory and subject matter being studied were formulated

All elements of the themes were covered by at least one question in the in-depth discussion interview guide. The guide was designed to prompt open discussions and insight around the factors that deter or attract FDI, factors that influence absorptive capacity and discussions about how South Africa could benefit from FDI given the challenges of unemployment and skills shortage. The guide was not prescriptive; the researcher was able to provide clarity into the items of the guide.

4.4.4 Research instrument

To answer the research objectives, the researcher used questionnaires and face to face in-depth interviews. The respondents were primarily chosen based on their willingness to partake in the study. The selected respondents were asked if they would like to share their experiences. After receiving consent, the appointments were scheduled to conduct the in-depth face to face interview. Consent from each respondent was obtained to verify their willingness to participate in the interview. The researcher committed to keeping all personal data confidential. Other non-identifiable data was presented in the research report. Furthermore the respondents were made aware that they were free to suspend the interview any point, without any penalty.

The researcher opted to record most of the interview where permission was granted, thereby allowing the researcher to listen and maintain eye contact. Additionally the use of a voice recorder encourages a natural conversational interview to take place. Respondents were encouraged to speak freely; the



researcher only used probing questions when the research objectives were not given sufficient attention. This ensured uniformity of responses across the sample and reduced the response bias that could have been caused by the interviewer leading the interviewee.

4.5 Data Collection, Analysis and Management

4.5.1 Data Collection

An email was sent to all potential stakeholders requesting their participation in the study and phone calls were made together with follow ups via email to serve as confirmation of the interviews. Respondents were identified because they enabled exploration of a particular aspect relevant to the research. This approach of sampling allowed the researcher to deliberately include a wide range of types of respondents and also to select key respondents with access to important sources of knowledge.

Data was collected by conducting face to face semi structured in-depth interviews.

Data was collected in single interviews. The interviews were conducted with each respondent and averaged a length of 40 minutes per interview.

4.5.2 Data Analysis

Conversation analysis was used to analyze the data from the in-depth interviews. Conversation analysis (CA), according to Duranti and Goodwin (1992), is when the study of conversation "permits detailed analysis of how participants employ general, abstract procedures to build the local particulars of the events they are engaged in"(p. 192).



The in-depth interview guide was arranged around the themes to facilitate easier ranking and tabling of data after the interviews were completed. Most of the interviews were recorded, combined with written notes from the interview. The researcher then compiled 40 Microsoft Excel spreadsheets and tables for ranking, coding and quantitative summary of data. These tables were grouped into themes as well as theoretical frameworks as per the research objectives. The lists of table are presented in chapter 5.

The tables were presented as a quantitative summary of views and qualitative responses where the richness and depth of respondents was interpreted. Based on the conversations with the respondents, the verbiage and quotes from the respondents were captured using themes in the literature review. The research findings were also displayed in direct quotations from the participants. These direct quotations are the most appropriate expressions for the participants' perceptions and viewpoints. As King (2004, p. 268) suggested the use of direct quotes from the participants is essential. These should normally include both short quotes to aid the understanding of specific points of interpretation such as clarifying the way in which two themes differ and a smaller number of more extensive passages of quotation, giving participants a flavor of the original texts. The development of tables was an iterative process and modifications were made as themes or factors emerged.

4.5.3 Quality of the Data

The researcher enhanced the quality of the data because during the interview questions and instructions were clarified. The face to face nature of the interview helped to reduce the anxiety of the respondent, thereby increasing the response



rate and decreasing the potential for measurement error, for example: interviewer and respondent errors (Tustin, Ligthelm, Martins, & Van Wyk, 2005, p. 148).

4.6 Limitations of the Study

A number of limitations are apparent from the choice of design and sampling methodology. By its nature the qualitative route does not allow for conclusive outcomes to be reached. As a consequence, the final conclusions drawn by this study are an illustration of some of the practical realities at play in FDI inflow but by no means comprehensive.

Further, the sampling choices made has by implication, introduced some elements of bias. The interaction between the researcher and respondent was a little bias; some respondents were reluctant to answer sensitive questions or provided socially acceptable answers instead. The judgmental sampling methodology selected for the primary screening of the respondents by nature introduces selection bias linked to the researcher exercising discretion to focus on South Africa. Secondly, the convenience sampling within groups is also expected to introduce selection bias as no statistical parameters were used to standardize the selection criteria.

Owing to the sampling technique, the extent to which the findings of the research can be inferred to the population is limited and the results are only representative of the sample.



CHAPTER 5: RESULTS

5.1 Introduction

This chapter presents and describes the data gathered during the interview phase of the study. The gathering of information was facilitated by eight semi structured interview questions with major stakeholders in the Foreign Direct Investment (FDI) sector in South Africa.

The data was collected through in-depth interviews and was analyzed using discussion analysis and quantified with excel spreadsheets in order to identify interrelated factors. The discussion analysis was performed using spreadsheets where the answers from four sample groups were captured against the relevant questions. The emerging factors were captured and where possible, they were ranked from highest to lowest and quantified into a spreadsheet for each question. The data was triangulated into common factors across the four group samples.

The interview questions are directly linked back to the three main research questions (objectives). The results are presented for each interview question linking back to the research themes and questions. The research data is presented in a quantified summary of spreadsheet figures and in a discussion format. Discussion questions 1 to 4 are based on FDI theories and literature reviewed. These questions are then linked to our main research questions 5 to 7 and summarized into themes (1) preconditions, (2) absorptive capacity and (3) benefits.

Chapter 5 is divided into four sections including the introduction. The second section provides a graphical analysis of each group and themes using the



discussion analysis. The third section focuses on the triangulated data analysis using discussion analysis (CA) and section four concludes the chapter.

The responses to the discussion questions that were asked are presented in a quantified summary of quantified spread sheets, figures and tables below.

5.2 Grouping of Results

Each group result is summarized to identify whether there are any similar or divergent views on the research questions and to understand whether there are any interrelations between the themes. The triangulated result intends to present the overall key factors that drive the three themes and answers the research report's research questions. The four sample groups' answers were captured against relevant questions.

5.2.1 *Part A: Group 1*

Results from the government officials

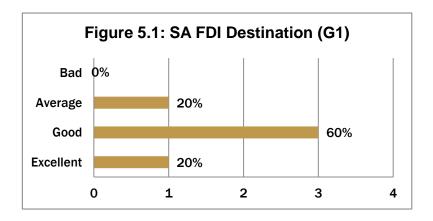
This section presents data gathered from the government officials sample (Group1). The data gathering was facilitated by eight semi-structured discussion questions as per appendix A. These results and views were based on the participants' views and experience in some of the significant FDI deals in South Africa.

5.2.1.1 FDI destination

Discussion question A1: Please talk through your view of South Africa as Foreign Direct Investment destination.



Figure 5.1 SA FDI Destination (G1)

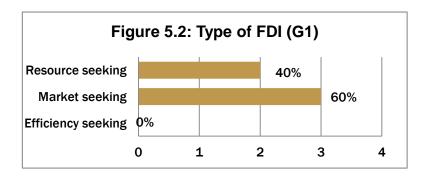


During the conversation the respondents were asked about their general view of South Africa as a Foreign Direct Investment destination. 60% of the respondents thought that South Africa was a good investment destination. On the other hand, 20% of respondents thought that South Africa was average destination while the remaining 20% was of the opinion that South Africa was an excellent Foreign Direct Investment destination. None of the respondents viewed South Africa as bad foreign investment destination.

5.2.1.2 Type and Mode of Inward FDI

Discussion question A2: What type of foreign investment is South Africa seeking?

Figure 5.2 Type of FDI (G1)

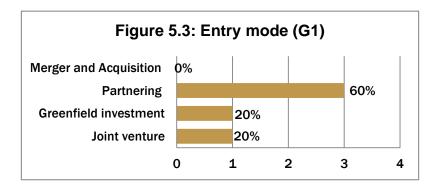




In the conversation with the respondents who are government officials (G1), 60% of the respondents mentioned markets seeking foreign direct investment; while 40% thought South Africa is still seeking resource based FDI. None of the respondents mentioned efficiency seeking foreign direct investment.

Discussion question A3: What is South Africa's most preferred entry mode by foreign investor?

Figure 5.3 Entry mode (G1)



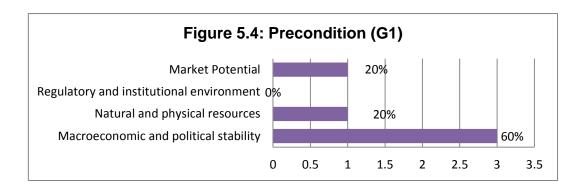
During the discussions with the respondents about the most preferred entry mode by foreign firm, 60% of the respondents in the government officials group (G1) mentioned partnering as the most preferred entry while 20% of the respondents mentioned the issue of Greenfield investment and joint venture as being the most preferred by foreign investment firms. It is interesting to note that none of the respondents in this group mentioned M&A as the preferred mode of entry which was in contrast to respondents in the foreign firm group (G4: Figure 5.26) where 33% of the respondent mentioned M&A.



5.2.1.3 Preconditions

Discussion question A4: What are preconditions that attract foreign investors into South Africa?

Figure 5.4 Precondition (G1)

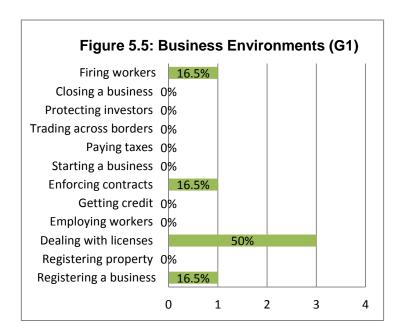


During the discussions with the respondents on the preconditions, 60% of the respondents mentioned macroeconomic and political stability as the key driver in South Africa in attracting or deterring FDI. Furthermore, 20% of the respondents mentioned the issue of physical infrastructure in terms of road, rail, natural resources, port, power, etc. There were also 20% of the respondents who mentioned market potential of South Africa.

Discussion question A5: What are the most difficult challenges facing foreign firms in South Africa?



Figure 5.5 Business Environments (G1)



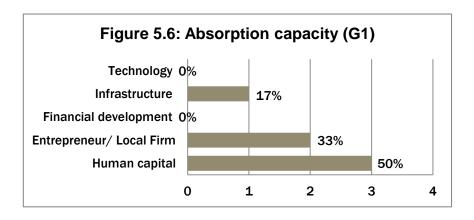
In the conversations with the respondents on the business environments in South Africa, 50% of the respondents thought that dealing with licenses is very challenging in South Africa, 17% thought starting and registering business was very challenging and only 17% of this group thought that the legal framework of firing workers in South Africa was costly and time consuming.

5.2.1.4 Absorptive capacity

Discussion question A6: What is the most important concern relating to the of absorption foreign investment by South Africa?



Figure 5.6 Absorption capacity (G1)

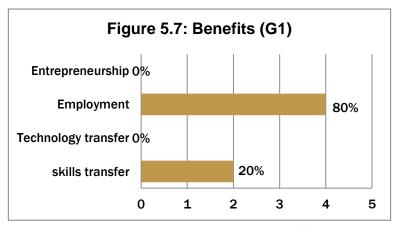


During the discussions with the respondents on the theme regarding the ability by South Africa to absorb foreign investment, 50% of the respondents in this group mentioned human capital as the key driver in the ability of South Africa to benefit from foreign investment. A further 33% of the respondents stressed the issue of lack of good local firms as the key issue that impact South Africa ability to fully absorb Foreign Direct Investment, while about 17% of the respondents raised the issue of infrastructure.

5.2.1.5 Benefits

Discussion question A7: How will foreign investment benefit South Africa?

Figure 5.7 Benefits (G1)

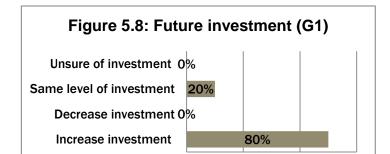




During the discussions with the respondents on the benefits of FDI, 80% of the respondents mentioned employment as most important benefit brought by FDI. While 20% of the respondents stressed the issue of skills transfer as most important benefit, none of the respondents mentioned entrepreneurship or technology transfer. This was an interesting opinion regarding the benefits of FDI, given the composition of the group.

5.2.1.6 Conclusion

Discussion question A8: What will happen to foreign direct investment attraction in South Africa over the next ten years?



0

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Figure 5.8 Future Investment (G1)

In concluding the conversation with the respondents, they were asked about the future of Foreign Direct Investment in South Africa of the respondents thought that foreign direct investment to South Africa in next five to ten years would increase while 20% percent of the respondents thought that foreign direct investment in South Africa would remain at the same levels.

4

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5.2.2 Part B: Group 2

Results from investment institutions



This section presents data gathered from the investment institutions sample (Group1). The data gathered was facilitated by eight semi-structured discussion questions as per appendix A. These results and views were based on the participants' views and experiences in some of the significant FDI deals in South Africa.

5.2.2.1 FDI Destination

Discussion question B1: Please talk through your view on South Africa as foreign direct investment destination.

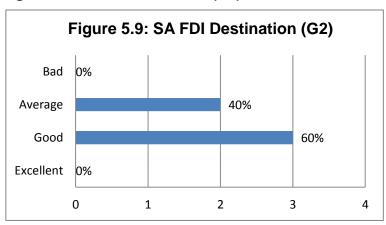


Figure 5.9 SA FDI Destination (G2)

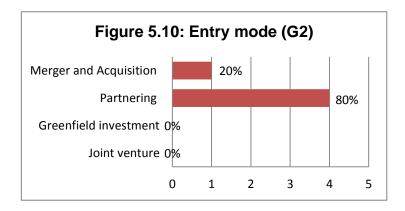
During the conversation with respondents who represented investment institutions, they were asked about their general view of South Africa as Foreign Direct Investment destination. Sixty per cent of the respondents thought that South Africa was a good destination, while 40% per cent of respondents thought South Africa was average destination. None of the respondents viewed South Africa as a bad foreign investment destination



5.2.2.2 Type and Mode of Inward FDI

Discussion question B2: What is most preferred entry mode by a firm?

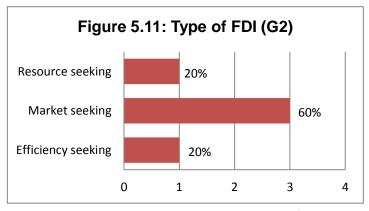
Figure 5.10 Entry mode (G2)



During the discussions with the respondents regarding the most preferred entry mode by foreign firm, 80% of the respondents mentioned partnering as the most preferred entry while 20% of the respondents mentioned mergers and acquisitions (M&A) as being the most preferred entry mode. It was interesting to note that none of the respondents in this group mentioned Greenfield or joint venture as preferred mode of entry.

Discussion question B3: What type of foreign investment is your firm seeking?

Figure 5.11 Type of FDI (G2)





In the conversation with the respondents on the type of investment that foreign firms are seeking in South Africa, 60% of the respondents mentioned markets seeking foreign direct investment while 20% of the respondents thought foreign firm are seeking efficiency from South Africa and 20% thought Foreign Direct Investments Firms are still seeking resources from South Africa.

5.2.2.3 Preconditions

Discussion question B4: What are preconditions that attract foreign investors into South Africa?

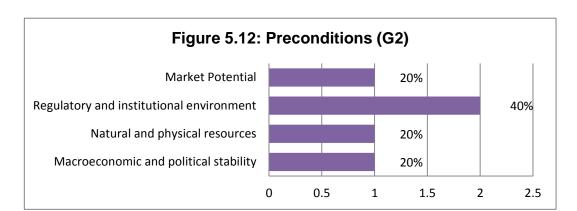


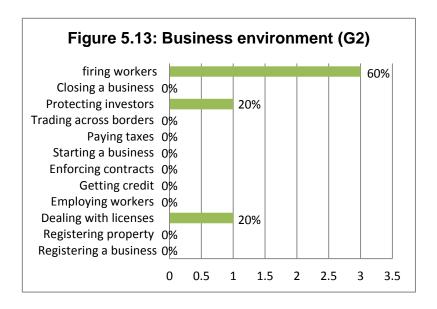
Figure 5.12 Preconditions (G2)

During the conversation with the respondents on the preconditions that may attract or deter foreign investors to South Africa, 40% of the respondents in this group mentioned regulatory and institutional frame works as the key driver in South Africa in attracting or deterring FDI. While 20% mentioned macroeconomic and political stability, the other 20% of the respondents mentioned the issue of physical infrastructure and the remaining 20% respondents mentioned the market potential of South Africa in terms of size.



Discussion question B6: What are the most difficult challenges facing foreign firms in South Africa?

Figure 5.13 Business environment (G2)



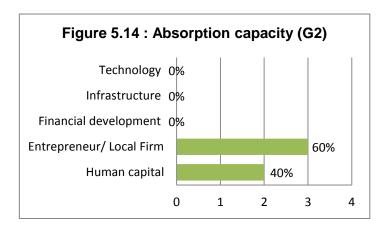
In the conversation with the respondents about the issue of challenges facing foreign firms, 60% of the respondents thought that firing workers was very challenging in South Africa and 20% thought the issues of getting licenses and protecting investors are still unfavorable to investors

5.2.2.4 Absorptive capacity

Discussion question B7: What is most important concern relating to the absorption foreign investment in South Africa?



Figure 5.14 Absorption capacity (G2)



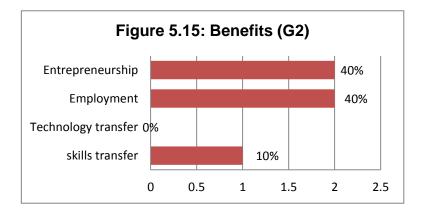
During the discussions with the respondents on the theme of ability of South Africa to absorb foreign investment, 60% of the respondents in this group mentioned local firms as the key driver in the ability of South Africa to benefit from foreign investment. Forty per cent of the respondents mentioned the issue of lack of good human capital that could influence South Africa's ability to fully absorb Foreign Direct Investment. None of the respondents mentioned infrastructure, technology and financial development as factors that could negatively impact absorption capacity.



5.2.2.5 Benefits

Discussion question B8: How will foreign investment benefit firms in South Africa?

Figure 5.15 Benefits (G2)



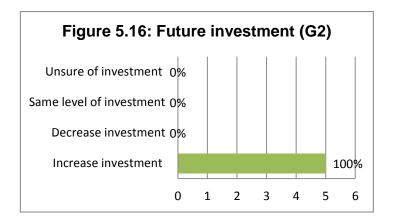
During the discussions with the respondents regarding the benefits of FDI, 40% of the respondents mentioned the importance of entrepreneurship and employment as most beneficial and 10% mentioned the transfer of skills from the foreign firms to local firms as beneficial. None of the respondents in this group raised the issue of technology transfer.



5.2.2.6 Conclusion

Discussion question B9: What will happen to foreign direct investment attraction in South Africa over the next five to ten years?

Figure 5.16 Future investment (G2)



In the discussions about the future of FDI, 100% of the respondents forecast an increase.

5.2.3 *Part C: Group 3*

Results from the host firms

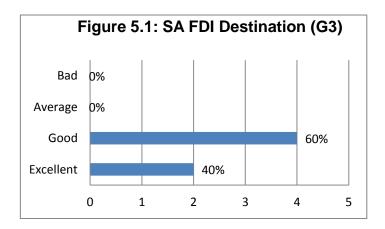
This section presents data gathered from the host firms sample (Group3). The data gathering was facilitated by eight semi-structured discussion questions as per appendix A. These results and views were based on the participants' views and experiences in some of the significant FDI deals in South Africa.

5.2.3.1 FDI destination

Discussion question C1: Please talk through your view of South Africa as foreign direct investment destination?



Figure 5.17 SA FDI Destination (G3)

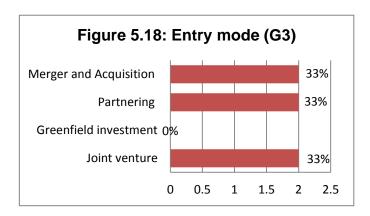


During the conversations with respondents who are host firms, they were asked about their general view of South Africa as Foreign Direct Investment destination. Sixty per cent of the respondents thought that South Africa was a good destination while 40% percent of respondents thought South Africa was excellent destination. None of the respondents in this group viewed South Africa as a bad foreign investment destination.

5.2.3.2 Type and Mode of Inward FDI

Discussion question C2: What is most preferred entry mode by a firm?

Figure 5.18 Entry mode (G3)





When discussing the issue of entry, 33% of the respondents' preferred foreign firms to enter South Africa through mergers and acquisitions (M&A) while 33% of the respondents preferred partnering with foreign firms and the remaining 33% preferred joint ventures.

Discussion question C3: What type of foreign investment are firms seeking?

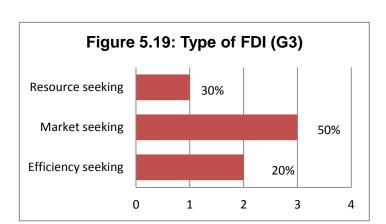


Figure 5.19 Type of FDI (G3)

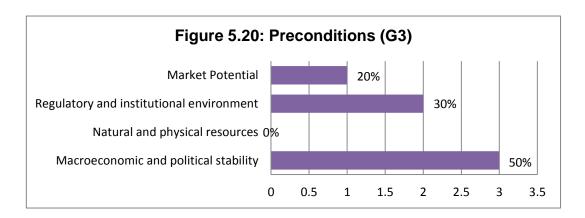
In the conversation with the respondents on the type of investment that foreign firms are seeking in South Africa, 50% of the respondents mentioned market seeking, while 20% thought foreign firms are seeking efficiency from South Africa and 30% thought that Foreign Direct Investments Firms still seeking resources.

5.2.3.3 Preconditions

Discussion question C4: What are preconditions that attract foreign investors into South Africa?



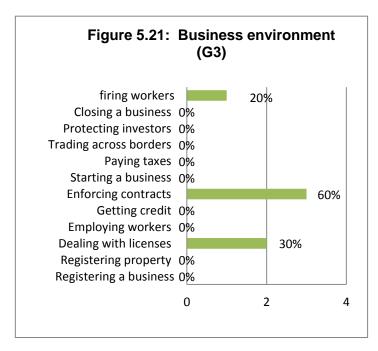
Figure 5.20 Preconditions (G3)



When discussing the preconditions that may attract or deter foreign investors in South Africa, 50% of the respondents mentioned macroeconomic and political stability. A further 30% mentioned regulatory and institutional environment and 20% mentioned market potential.

Discussion question C5: What are the most difficult challenges facing foreign firms in South Africa?

Figure 5.21 Business environment (G3)





In the conversation with the respondents about issue of challenges facing foreign firms, 60% of the respondents thought that enforcing contracts is a challenge while 20% thought that firing workers was very challenging in South Africa and 30% thought the issues of getting licenses is a challenge in South Africa.

5.2.3.4 Absorptive capacity

Discussion question C6: What is most important concern relating to the absorption of foreign investment in South Africa?

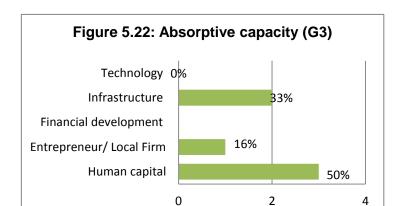


Figure 5.22 Absorptive capacity (G3)

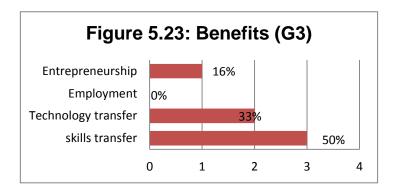
During the discussions with the respondents on the theme of ability by South Africa to absorb foreign investment, 50% of the respondents mentioned human capital as the key driver in the ability of South Africa to benefit from foreign investment. A further 33% of the respondents stressed the issue of the lack of infrastructure as the key issue that impact South Africa's ability to fully absorb Foreign Direct Investment. None of the respondents mentioned the issue of local firms as a factor that could negatively influence absorption capacity.



5.2.3.5 Benefits

Discussion question C7: How will foreign investment benefit firms in South Africa?

Figure 5.23 Benefits (G3)



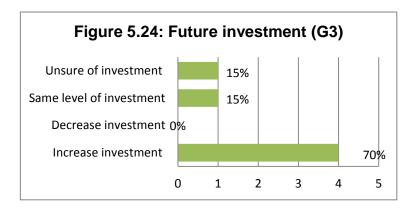
During the discussions with the respondents regarding the benefits of FDI, 50% of the respondents mentioned skills transfer as most beneficial and 33% mentioned the technology transfer from the foreign firms to local firms as beneficial while 16% mentioned entrepreneurship. None of the respondents in this group raised the issue of employment.

5.2.3.6 Conclusion

Discussion question C8: What will happen to foreign direct investment attraction in South Africa over the next five to ten years?



Figure 5.24 Future investment (G3)



During the conversation about the future of FDI in South Africa, 70% of the respondents forecast an increase.

5.2.4 Part D: Group 4

Results from the foreign firms

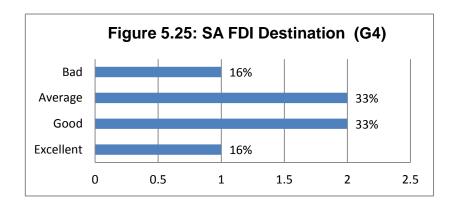
This section presents data gathered from the foreign firms sample (Group4). The data gathered was facilitated by eight semi-structured discussion questions as per appendix A. These results and views were based on the participants' views and experiences in some of the significant FDI deals in South Africa.

5.2.4.1 FDI destination

Discussion question D1: Please talk through your view of South Africa as foreign direct investment destination.



Figure 5.25 SA FDI Destination (G4)

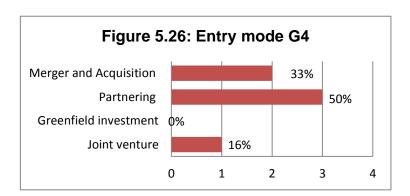


During the conversation with respondents, they were asked about their general view of South Africa as a Foreign Direct Investment destination and 33% of the respondents thought that South Africa was between an average and good destination. Another 16% percent of respondents thought South Africa was an excellent destination. On the other hand, 16% of the respondents in the group viewed South Africa as bad foreign investment destination.

5.2.4.2 Type and Mode of Inward FDI

Discussion question D2: What is most preferred entry mode by a firm?

Figure 5.26 Entry mode (G4)





When discussing the issue of entry mode, 33% of the respondents preferred foreign firms to enter South Africa through mergers and acquisitions; while 50% of the respondents preferred partnering with foreign firms; and 16% preferred joint ventures due to its better legal standing. None of the respondents' mentioned the Greenfield investment

Discussion question D3: What type of foreign investment is your firm seeking?

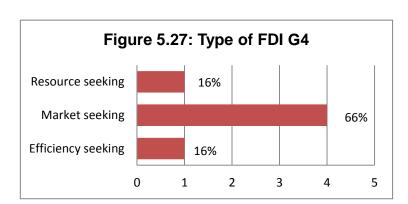


Figure 5.27 Type of FDI (G4)

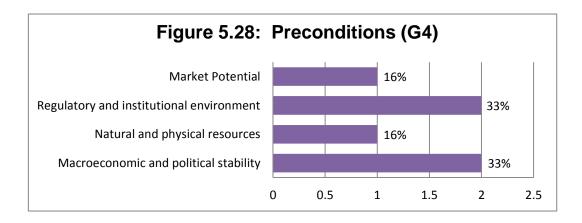
In the conversation with the respondents on the type of investment that foreign firms are seeking in South Africa, 66% of the respondents mentioned market seeking and 16% thought foreign firm seek efficiency from South Africa, while the other 16% thought foreign firms are still seeking resources in South Africa.

5.2.4.3 Preconditions

Discussion question D4: What are preconditions that attract foreign investors into South Africa?



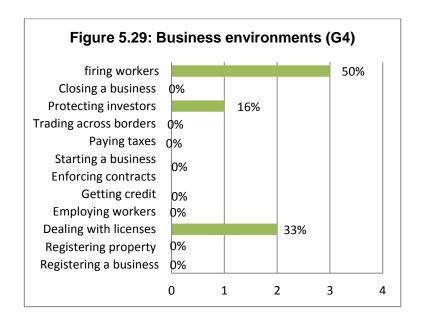
Figure 5.28 Preconditions (G4)



When discussing the preconditions that may attract or deter foreign investors in South Africa, 33% of the respondents mentioned macroeconomic and political stability. The other 33% mentioned regulatory and institutional environment and 16% mentioned market potential and mentioned physical resources.

Discussion question D5: What are the most difficult challenges facing foreign firms in South Africa?

Figure 5.29 Business environments (G4)





In the conversation with the respondents regarding issue of challenges facing foreign firms, 60% of the respondents thought that firing workers is a challenge while 33% thought that getting licenses was very challenging in South Africa and 16% mentioned protecting investors.

5.2.4.4 Absorptive capacity

Discussion question D6: What is most important concern relating to the absorption foreign investment in South Africa?

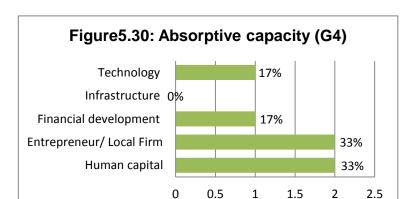


Figure 5.30 Absorptive capacity (G4)

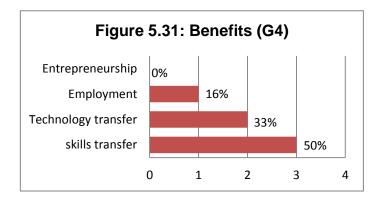
During our discussions with the respondents on the theme of ability by South Africa to absorb foreign investment, 33% of the respondents mentioned human capital and local firms as the key driver in the ability of South Africa to benefit from foreign investment. Another 17% of the respondents mentioned technology and financial development as the key issue that impacts South Africa's ability to fully absorb Foreign Direct Investment.



5.2.4.5 Benefits

Discussion question D7: How will foreign investment benefit firms in South Africa?

Figure 5.31 Benefits (G4)



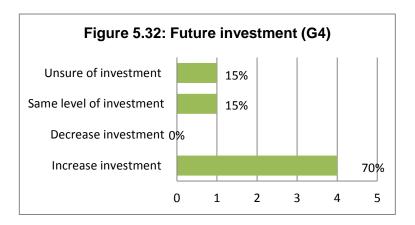
During the discussions with the respondents about the benefits of FDI, 50% of the respondents mentioned skills transfer as most beneficial. Moreover, 33% mentioned the technology transfer from the foreign firms to local firms as beneficial and 16% mentioned employment. None of the respondents mentioned entrepreneurship.

5.2.4.6 Conclusion

Discussion question D8: What will happen to foreign direct investment attraction in your country over the next ten years?



Figure 5.32 Future investment (G4)



During the conversation regarding the future of FDI in South Africa, 70% of the respondents forecast an increase while 15% said it would remain at the same level and the other 15% said they were unsure of future investment.

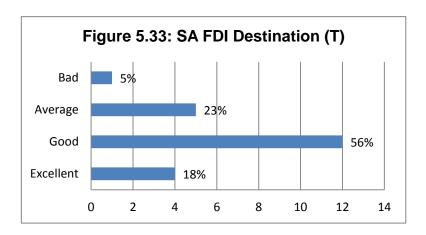
5.3 Triangulated Data

This section presents triangulated data gathered from all sample groups. The data gathered was facilitated by eight semi-structured discussion questions as per appendix A. These results and views were based on the participants' views and experiences in some of the significant FDI deals in South Africa.



5.3.1 FDI destination

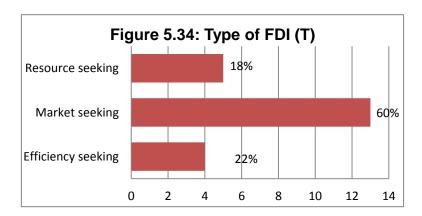
Figure 5.33 SA FDI Destination (T)



When triangulating the data result of all the groups in terms of their general view of South Africa as Foreign Direct Investment destination, 56% of the respondents thought that South Africa was good destination, while 18% percent of respondents thought, South Africa was excellent. Only 5% of the respondents in all groups viewed South Africa as a bad foreign investment destination and 23% thought that South Africa was an average foreign direct investment destination.

5.3.2 Type and Mode of Inward FDI

Figure 5.34 Type of FDI (T)





When triangulating data results of the respondents' views on issue of the type of FDI, 60% thought that FDI in South Africa is marketing seeking while 22% of the respondents thought that the firms were seeking efficiency in South Africa and 18% mentioned resource seeking.

Discussion question: What is the most preferred entry mode by a firm?

Figure 5.35: Entry mode (T)

Merger and Acquisition
Partnering
Greenfield investment
Joint venture

0 5 10 15

Figure 5.35 Entry mode (T)

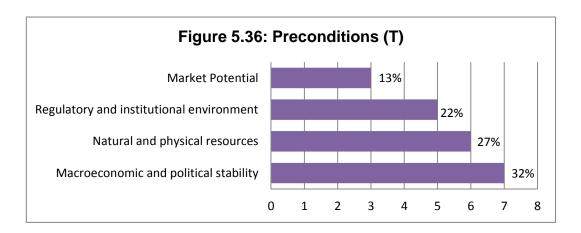
When triangulating the entry mode, 55% of the respondents preferred partnering among domestic and foreign firms and 22% of respondents preferred mergers and acquisitions. While 18% mentioned joint ventures, Greenfield investments remained the least (5%) preferred mode of entry for most foreign firms in South Africa.

5.3.3 Preconditions

Discussion question: What are preconditions that attract foreign investors into South Africa?

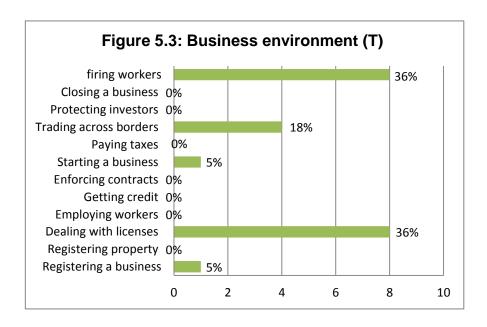


Figure 5.36 Preconditions (T)



When triangulating data on preconditions, 32% of the respondents mentioned macroeconomic stability and 27% mentioned physical infrastructure as challenging and 22% mentioned regulatory and institutional environment as difficult. The other 13% mentioned market potential.

Figure 5.37 Business environment (T)



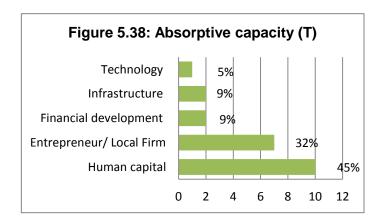
In triangulating data of all respondents, 36% mentioned firing workers as challenging in South Africa, while the other 36% of the respondents mentioned



dealing with licenses as difficult and 18% mentioned trading across boarder as challenging. The remaining 5% mentioned registering a business and starting business as challenging factors

5.3.4 Absorptive capacity

Figure 5.38 Absorptive capacity (T)

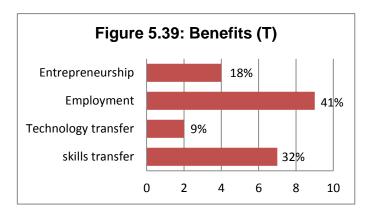


From all the groups, 45% mentioned human capital as driving force in absorption of FDI while 32% of the respondents mentioned that local firms are the bridges of FDI. Only 5% thought local firms might easily assimilate the advanced technology of FDI. The remaining 9% of respondents mentioned financial development and infrastructure.



5.3.5 Benefits

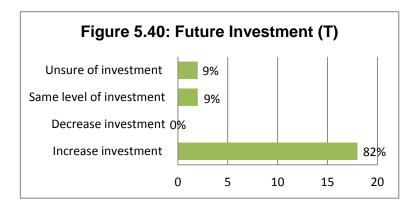
Figure 5.39 Benefits (T)



In triangulating, the views of all the respondents regarding the themes and benefits of FDI to the host country, 41% thought FDI will benefit South Africa through employment creation and 32% mentioned that FDI could benefit South Africa through skills transfer. While 18% mentioned local firms as the bridge of FDI to South Africa, only 9% thought that with equivalent in educated and skilled labour, local firms might easily assimilate the advanced technology of FDI.

5.3.6 Conclusion

Figure 5.40 Future investment (T)





The triangulated data result for future foreign investment resulted in 82% of the respondents who were of the opinion that foreign investors would increase their investment to South Africa. The remaining 9% were unsure or thought it might remain at same level.

5.4 Conclusions

This chapter presented the results from the in-depth interview discussions questions. The research report also triangulated data from the different groups of respondents to limit any biased errors and identified commonalty in factors as indicated in chapter four. The data obtained from the in-depth interview discussions are analyzed and discussed in chapter six using conversation analysis (CA).



CHAPTER 6: ANALYSIS OF RESULTS

6.1 Introduction

Chapter 6 integrates the theories of FDI with the factors that influence preconditions, absorptive capacity and benefits and the results of the interviews. The analysis of the results will be based on the research questions and data, as laid out in chapter 5 of this paper, using the triangulated data results to highlight factors that critical in the themes (preconditions, absorptive capacity and benefits). This chapter also indicates whether each group has common or divergent views on these factors. This analysis is structured according to research questions in order to guide our policy conclusions in chapter 7. The discussion of results follows the same structure as that used in chapter 3. The researcher first discusses interview question 3 and 4 (Mode of entry and type of FDI) which has a direct influence on all three research questions. The study concludes with the argument that the fitness is required for South Africa to maximize the FDI benefits.

6.2 Type and Mode of FDI

In terms of how foreign firms enter new markets and why foreign firms will want to invest in the host country is important because of the bearing it has on preconditions, absorptive capacity and benefits. Therefore the type and mode of FDI data will be analyzed first.

6.2.1 Discussion question A3:

What is most preferred entry mode by foreign investor?



In terms of the interview discussions on entry mode, more than half 55% of the triangulated respondents as presented in Figure 5.35 preferred partnering among domestic and foreign firms as the most preferred entry mode. These results suggest that linkages between foreign affiliates and domestic firms need to be encouraged if benefits are to be experienced. Where interaction between foreign and domestic firms is encouraged, then skills transfer, technology transfer and entrepreneurial diffusion are a possibility. This result is supported by the findings of Kokko et al. (1996) using the study of Uruguayan manufacturing plants to explore the hypothesis of technology benefits. They find positive benefits only in the subsample of local firms with moderate technological gaps from the foreign partner firms. This result is seen as positive for South African firms as partnering because it will increase technology transfer, skills transfer and entrepreneurial activity. This was also evidenced by Javorcik (2004; 2009) provided evidence that domestic suppliers from Lithuania and the Czech Republic, respectively, benefitted from their relationship with multinational companies. This is also evidenced by some of the comments from the respondents:

> "It is advisable to seek a local partner when entering a new foreign market"

"It's always important to partner with locals who better understand the terrain"

"Market size is important when assessing entry to a country"

6.2.2 Discussion question 4:

What type of foreign investment is South Africa Seeking?



The majority of the respondents 60% thought that FDI in South Africa is market seeking (Figure 5.34). This result is also supported by Vernon (1966) who developed the product life cycle theory which points that the MNF's main products' life cycle patterns determine foreign investment as they reached the decline phase in their home country. As evidenced by South Africa signing the free trade agreements with the SADC region to provide investors with free circulation of goods, allowing them to reach a larger number of consumers (Department of Trade and Industry, 2011). This is also supported by Michalet (1997) who concluded that the regional integration framework of the EU Association Agreements and the subregional cooperation within the Central European Free Trade Agreement have been the most pertinent attraction factors since they reflect the large market access for the potential foreign direct investments.

6.3 Research Question 1:

What are the preconditions required by foreign investors in South Africa?

When foreign firms evaluate potential investment destination, the foreign firms compile a list of preconditions that need to be satisfied by a host country for it to be short listed (T. H. Moran, 2006). The investors are generally risk averse and do their best to minimize the uncertainty of their undertakings (Garibaldi, 2002). It is therefore important that South Africa's future is predictable enough to allow the investors to evaluate the returns of their projects and to compare them with those of the other developing countries. The section will feature the findings on preconditions.



6.3.1 Findings

The findings of the research question 1 identified three factors that are important in the attraction of FDI in South Africa. According to the data collected, the most important factors influencing South Africa's ability to attract Foreign Direct Investment are (1) macroeconomic and political stability 32%, (2) Infrastructure 27% and (3) Institutional environment 18% as indicated in (Figure 5.36) chapter 5. The section discusses factors that respondents viewed as the most impactful to South Africa's ability to attract and retain FDI.

6.3.1.1 Macroeconomic and political environments

According to the respondents, macroeconomic and political stability are most important factors influencing foreign firms' decision to invest. This finding is consistent with that of Ahlquist (2006) who found that FDI inflows tend to increase under more stable and democratic governments. Most of the respondents 32% mentioned macroeconomic stability; the general view from the in-depth interview discussions are that in attracting investment macroeconomic policy consistency and political stability are critical

This result is supported by Onyeiwu and Shrestha (2004) who argued that consistent macroeconomic policy and political stability are significant to FDI inflow. It was also noted by Noorbakhsh et al., (2001) who investigated FDI attraction in Egypt and found that the lack of democracy, the internal instability, and the perspectives of radical government changes all act like hindrances to a country's potential to attract FDI. The respondents view South African policy as unclear and inconsistent. This could also explain why South Africa has not attracted the desired



level of FDI. Some evidence regarding this point from the respondents is found below:

"In space of 10 years we move from RDP to gear and new growth path this has happen under same governing party its sometimes confusing"

"It seems that same governing party has different ideas on how to move South Africa forward in terms of macroeconomic policy take issue of Wal-Mart it was handled badly from policy point view"

"Most investors need clarity and certainty on long term economic policy"

6.3.1.2 Physical infrastructure

In the discussions about physical infrastructure, 27% of the respondents stressed that South Africa infrastructure is inadequate. Most of the respondents pointed out the bottlenecks within South African physical infrastructure. This bottleneck included nonfunctional rail systems, inadequate power systems and highly ineffective ports while things like road, ICT and water are adequate. This result is also supported by Moran (2006) who argued that efficient physical infrastructure facilities may attract more FDI flows. This result is could explain why South Africa has attracted little FDI. As most respondents viewed South African infrastructure as inadequate, especially rail, port and electricity. It is not good for circulation of goods and services. The importance of good quality infrastructure systems to attract FDI has also been underlined in many studies (Kinoshita, 2001; Kumar, 2001; Wheeler & Mody, 1992). For instance, in a study of determinants of US FDI abroad for 42 countries in manufacturing and in electronics in particular, Wheeler and Mody (1992) found that 'infrastructure quality clearly dominates for developing countries'.



The importance of infrastructure cannot be overstated as it impacts both the attraction and absorptive capacity which in turn may influence the potential benefits. This result could negatively impact South Africa's ability to attract and absorb FDI.

"South African infrastructure has bottle neck in terms rail and ports which discourages investment as cost of transporting goods are high"

"The current pronouncements from South African governments on spending trillion rand over next ten years building infrastructure is good it will help South Africa attract more investments"

'Government has embarked on improving rail, ports and power infrastructure as sign that this important indicator in FDI attraction'

6.3.1.3 Regulatory and institutional environments

The study notes that from the results that 18% of the respondents said the most significant challenge facing foreign investors in South Africa today is excessive bureaucratic labour laws which create an unfavorable investment climate (Figure 5.29). This result is supported by Lim (2001a) who argued that friendlier investment climates lower the additional costs of doing business in a foreign country. These costs have to do with factors like regulatory, bureaucratic, and judicial hurdles; issues of property rights; enforceability of contracts; labour regulations; performance requirements like mandatory joint partnerships and domestic content requirements (E. G. Lim, 2001a). This discussion result contradicts UNCTAD (2012) that stated that South Africa was ranked at number 14th in the world as the most desirable country to invest in, as this suggests that while some progress has been made, a lot more communication and implementation needs to be done to attract FDI.



In terms of the regulatory framework, while most respondents viewed South Africa as good in terms of rule of law, some of the respondents viewed the South African regulatory environments as complex in that they had to hire experts to deal with regulatory issue which increase the transactional cost in South Africa. Moran (2006)supported this result by noting that overly complex registration procedures, combined with a lack of institutional capacity in host countries, can lead to additional expenses to foreign investors.

This is also evidenced by some of the respondents' direct quotes when discussing regulatory and institutional environments:

"South Africa's labour laws are not flexible therefore it makes it costly to conduct business".

"Rule of law is critical for foreign investor because your assets are a contract

"Legal structure and political stability of South Africa is fundamental for any investor"
"In my experience bases of conducting business are based on contract therefore the rule
of law is critical in protecting business interest"

6.3.2 Business friendliness

In conversations with the respondents, 36% mentioned that while South Africa has recently made efforts to facilitate business and reduce bureaucratic red tape, bureaucratic labour law processes are often frustrating for firms and remain unfriendly towards investment. Although the South African government through the dti has strongly moved forward, the public administrative reform to build up and strengthen institutions, to renovate the process of developing and issuing normative legal documents, to ensure strict and transparent laws, and to reform



administrative procedures has continued. (Department of Trade and Industry, 2011).

However, some investors' respondents in group 4 complained about rapid changes in regulation, complicated procedures, and bureaucracy in some places. Well-developed business climate will support and push FDI activities on improvement; it means that South Africa can absorb FDI's benefits if the business environment is improved. This is evidence in the form of comments from some of the respondents.

"To keep up with the regulation requires our business to hire expensive legal firms for advice which is costly and increase the cost of doing business"

South Africa requires a one stop shop when comes to this administrative issues so that business can save time and money

The CCMA has not process to funnel legitimate claims of unfair dismissal, which leads to everyone being drag through that process even though you complied with the process.

6.3.3 Conclusions

This study concludes therefore that most factors that influence the attraction of FDI in South Africa are macroeconomic stability, political stability, quality infrastructure, institution and good business environments. This is evidenced by the recent literature Barthel and Busse (2011) and Antonakakis and Tondl (2012) confirm this and explain that there are also other factors such as policy consistency and institutions in attracting FDI. It is also important to pay attention to the quality of FDI and linkages between foreign firms and local firms.

The study's findings are that macroeconomic and political environment remains the main reason why foreign firms will be attracted to South Africa This factor, coupled



with the fact that South Africa's market is relatively small, may explain why there is a relatively low level of attraction of FDI in South Africa in spite of the significant improvement in the macroeconomic and political climate. The next section discusses absorptive capacity and how it relates to benefits.

6.4 Research Question 2:

What are the factors that contribute to better absorptive capacity in South Africa?

6.4.1 Findings

The findings of the research question 2 identified three factors that impacts South Africa's ability to absorb FDI. According to the data collected, the most important factors influencing South Africa ability to absorb Foreign Direct Investment are (1) human capital 45%, (2) local firms 32% and (3) Technology 18% as indicated in Figure 5.38 in chapter 5. The section discusses and analyses how these factors impacted the South Africa's ability to absorb and benefit from FDI.

6.4.1.1 Human capital

In terms of human capital, 45% of the respondents mentioned that unskilled labourers are abundantly available in South Africa while highly educated and skilled labourers are scarce (figure 5.38), especially at the technical and middle management level. In fact, the ICT and Banking industry which attracted more FDI in South Africa than other industries, require high amounts of skilled labour (figure 2.2). This result is also supported by Suliman and Mollick (2009). They analyzed



FDI flow to developing countries and concluded that relatively low FDI flow to Sub Saharan Africa are partly explained by poor human capital.

The shortage of this human capital has been affecting the implementation of projects in South Africa, for example the current Kusile power station project could not find highly trained welders in South Africa, and the skills had to be sourced from foreign labour thereby impacting the project time line and South Africa's agenda of creating employment via FDI. This proves that human capital is a first condition to enhance the absorptive process. In the discussion with the respondents they raised two main concerns in relation to the human capital: (1) workers generally have a low level of education and (2) are not well trained. This situation has proven to be problematic, particularly for the smaller foreign firms, as they are highly reliant on labour (Figure 5.38). Clearly, this is one area that deters foreign investment and minimizes the ability of South Africa to fully absorb FDI. In other words, one of the key aims of FDI is to have a fully absorbable labour force. However, the results suggest that South Africa may not yet be attractive and will not be able to benefit from FDI in terms of employment creation.

Most respondents in group 4 strongly emphasized that the South African government should improve human capital such as establishing high quality foreign universities, training professional experts, technical skills and key managers, as well as by reforming the education system.

To conclude, it was found that FDI can offer benefits and costs to a local economy. Governments want to attract FDI for the benefits that fit into the developmental agenda. However, benefits are not automatic and hence the presence of FDI is not



sufficient to capture benefits for the local economy. Benefits highly dependent on host country conditions.

As evidenced by quotes from the respondents.

"South Africa must addressed the skills shortage problem in order to effectively absorb foreign investment"

"What will make local firm succeed is level of skills within the firm "

"We had the issue of Eskom trying to source welders were the skills our local welders did not meet the standard of foreign firm"

6.4.1.2 Local firms/ entrepreneurship

In terms of local firms or entrepreneurship as a channel to receive the benefits of FDI, 32% of the respondents highlighted that jobs can only be created in huge numbers by young small entrepreneurial businesses. This result is also evidence by Michalet (1997), who noted that presence of efficient local firms is an increasingly important dimension of a country's attractiveness value as they play a critical part in supporting, sub-contracting operations.

Generally most of the respondent from group 3 which are foreign firms thought that the local firms are weaker in terms of human capital and technology. The weakness or shortcoming of local firms' capacity has negatively impacted the national absorptive capacity. For example, in the conversation with a foreign firm that is tasked with constructing the high speed train in South Africa mentioned a case where they needed highly skilled technical firms but they could not find firms who were experienced in signaling in South Africa and therefore had to import from abroad since local firms could not provide these services.



As a result, South Africa did not benefit from employment creation. Again, the intensity of integrating knowledge relies on the education of human capital and the ability of local firms to supply foreign investors with good quality input goods.

On the other hand, local firms have often faced the loss of employees and a shortage of highly educated labour to foreign firms. People who have a higher education prefer to work for foreign firms, earning higher salaries and enjoying more learning opportunities. In the other aspect, domestic firms that have cooperated with foreign firms according to the respondents seem to receive more benefits. As per the following direct quotes from the respondents

"Local presence and local partnership with people who have experiences and can speak languages on the ground "

"Local knowledge is critical for foreign investors in terms of partnering local firms"
"Foreign firms some time compete with our subsidiary making the partnership tricky"

"Local firms also needs to keep in check their foreign partners that they do not demand unsustainable returns on capital for example Sanral"

6.4.1.3 Infrastructure

In the discussions about physical infrastructure as absorptive capacity, only 9% of the respondents in the triangulated group viewed South Africa infrastructure an inadequate. However the respondents raise two critical issues namely that power and rail systems could potentially impact South Africa's ability to absorb FDI. This is said to be a real obstacle for absorption of Foreign Direct Investment, especially as rail and electricity convey major problems. In South Africa, because of poor goods rail system, goods are being transported by road which is time consuming and impact on cost of production and servicing customers and the respondents



also stress the issue of electricity that it has potential of impacting production levels.

However, the communication, roads and aviation infrastructure are well developed and still meet the demand of growth market. This discussion result is also supported by Al Nasser (2010) who also found evidence that shows the physical infrastructure to be an important determinant of FDI. As such, policies providing efficient physical infrastructure facilities may attract more FDI flows. Evidently, an initial developed infrastructure could well support the country to take the most advantages from FDI.

"There is massive opportunity in terms of infrastructure in South Africa to build green infrastructure as oppose to brown infrastructure"

"Any opportunity to invest requires infrastructure therefore to have right economic infrastructure make a country competitive."

"South Africa's infrastructure is not that is inadequate comparable to other developing countries but it has bottleneck "

6.4.2 Conclusions

This study notes that most factors that impact the ability of South Africa to Absorb FDI are human capital, local firms and infrastructure. It must be noted that these factors cannot be viewed in isolation as they are interrelated with attraction factors. As a result, South Africa as a developing country can only gain benefits from FDI once they have created absorptive capacity related to human capital, absorptive capacity of domestic firm, physical Infrastructure and technology. The next section discusses the potential benefits of FDI.



6.5 Research Question 3: How will foreign direct investment benefit South Africa?

6.5.1 Findings

The findings of the research question 3 indicate three ways that South Africa could benefit from FDI, namely (1) employment 41%, (2) Skills transfer 32% and (3) Entrepreneurship 18% as indicated in (Figure 5.39) of chapter 5. The section discusses and analyses how this benefit can help the South Africa in resolving challenges of unemployment, poverty and skills shortage.

6.5.1.1 Employment

In terms of employment as benefits from FDI the discussion results indicates that 41% of the respondents believe that FDI will benefit South Africa by creating direct employment in short run and creating new local firms in long run that will result in sustainable employment creation. As indicated in the previous section, one channel where FDI transfers its benefits to the host country is through human capital. While analyzing determinants of FDI absorptive capacity, the research paper noted human capital as a crucial factor in promoting the absorptive capacity of local firms. This was also evidenced by Borensztein *et al.*, (1998) who implied that foreign firms were more productive than domestic firms only when the host country has a minimum threshold of human capital as the firm is able to employ locals at reasonable cost. Given that South Africa has some of the highest levels of unemployment averaging 25% (figure 2.2.), Kingdon (2007) also support this assertion as he concluded that is crucial for South Africa to pursue FDI that promotes job creation in order to tackle the high levels of unemployment.



This result is also consistent with Fedderke and Romm (2006) that FDI has positive impact on job creation in South Africa. It is clear from the discussions in order to fast track employment creation in South Africa, critical factors like human capital and entrepreneurial activity need to be addressed. South Africa's entrepreneurial activity is weaker than most developing countries (figure 2.9) and to benefit from FDI the focus must be on small businesses in terms of upgrading their technological and skills levels in order to become main suppliers to multinationals, gradually creating employment. This result is also supported by Lim (2005) who cited the example of Malaysia were nine companies were started to support foreign firm and seven of the firms were started by employees who were employed by the foreign firm. This is also evidence by respondents' direct quotations when discussing employment:

"Our entrepreneurial and small business sector is the engine of employment creation".

"We should not view direct employment by multinational as the benefit but the firm who are able to supply to foreign firm will create sustainable employment"

"Government does not create employment it's facilitates the job creation process through policies and enables foreign firms and local firms to create employment."

"A biggest benefit from foreign investment is skills that remain with host country to replicate the expertise to do things in that country"

"You must marry capital with opportunity for the country to benefit"

"If the investment is creating jobs that sustainable such investment will be accepted in South Africa it will be seen as marriage because the values that drive the investment similar to values that drives South Africa"



6.5.1.2 Skills transfer

In the discussions about skills transfer as the benefit of FDI, over half of the respondents from group 4 who were the foreign firms thought that skills transfer was the most important benefit of FDI while 32% of the groups through the triangulated data thought skills transfer is critical component of FDI benefits. This result is supported by Blomström et al. (1999) who concluded that many of the channels through which FDI benefits can be captured exhibit interdependence. For example, training offered by MNCs might not only directly increase the technical competence of host country firms, as former MNC employees migrate to domestically owned firms, it might also encourage increased domestic competition by promoting new firm start-ups by former MNC managers and technical employees. As evidence by some of responses from the respondents:

"Skills remain key benefit from the foreign investment as help unlock the skills and experience of our local firms"

"One of advantages of foreign investors is bringing new skills to the local firm" "New skills are critical for developing South African economy"

6.5.1.3 Entrepreneurship

In the discussions with the respondents regarding the local firm factor or entrepreneurial factor not many of the respondents stressed the issue of entrepreneurship. Overall, 18% thought that FDI would boost entrepreneurial culture in South Africa as suppliers to foreign firms; the literature has stated the absorptive capacity of a country depends on the absorptive capacity of domestic



firms in terms of assimilating the advanced technology, knowhow, managerial skills from FDI.

The respondents also viewed local firms as channels to receive the benefits of FDI. Generally, entrepreneurial culture in South Africa is weak in local firms which might need upgrading for South Africa to maximize FDI benefits. This result is also supported Blomström et al. (1999, p. 8) where he concluded that the ability of the host country firms to absorb best practice technology will depend largely upon the firm-specific attributes "required" to absorb the technology relative to the attributes possessed by home country firms. Where there is a high degree of congruence between the two, benefits should be more completely captured, and skills transferred to host firm.

6.5.2 Conclusions

This study concludes that a developing country like South Africa could benefit from FDI in terms of employment, skills transfer and Entrepreneurship. Moran (2001) argued that "host actions in stimulating or retarding competition wherever foreign investors are located constitute the most important determinant of whether the host benefits or suffers from the presence of foreign firms". The next section discusses how all this complex FDI themes fit together to produce the desired benefits.

6.6 The host country fitness approach

The last sections analyses preconditions, absorptive capacity and benefits as related to the research objective. It is complex to find the exact interrelations between the themes. The difficulty arises from the fact that host countries and investors have different reasons for undertaking investments. On the one hand,



investors have a profit maximization objective. While on the other hand host countries allow FDI with the expectation that they will close the technology gap, increase employment, and improve the quality of human capital and fuel development in their less developed areas. FDI benefits are not automatic for host countries and depend on absorptive capacity in place and other factors. Which capacities and preconditions are important in which country depends on how they fit in with the development strategy to achieve predefined objectives taking into account specific country characteristics. However, they are likely to be some combination of factors in each of the above categories.

Therefore, the notion of fit, or congruence, has been extensively studied in psychology and organizational behavior (Nadler & Tushman, 1980). Fit involves the examination of the fit between specific characteristics of an organization and the persons in it. Spokane (1987) said this involves studying the match of individual capacity to job requirements and the relationship between individual characteristics and organizational climate so that the organization can maximize output. Spokane (1987) postulate that an individual will select a firm that is similar to or that fits with that person's self-concept. Spokane (1987) he concludes that "empirical results have typically supported the hypothesis that congruence between individuals' personalities and the difficulties of their occupations are associated with positive affect" therefore have high probability of them staying in the firm

In a similar way, to maximize FDI benefits the recipient host country needs to get ready the absorptive capacities (organizational climate), which are a development of absorptive capacity of entrepreneurship or domestic firms, human capital as highlighted by the respondents. In general, the group 3 respondents expressed a



relatively similar opinion about the factors determining FDI absorptive capacities. Human capital, entrepreneurship physical infrastructure, as well as institutional policies are most mentioned.

Secondly the developing recipient's host country must comply with preconditions (Person's needs) that foreign investors view as critical as shown by the group 4 respondents that human capital, rule of law, political stability and infrastructure are critical in terms investing in host country.

Using the fitness argument, the host country must attract FDI that matches their developmental agenda and therefore must comply with necessary precondition for such FDI. The foreign investor will seek investment maximizing the host country, therefore the fitness between the two conditions are critical. As indicated by figure 6.1, if there are factors in G3 which are deal breakers and factors in (G4) which are potential deal breakers and these do not fit in order to maximize benefits for host country (G2). Therefore the benefits for both host country and foreign investor cannot be maximized (positive affect).

Precondition
G4

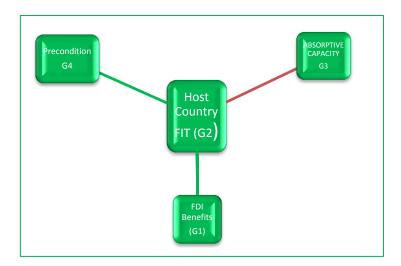
Host
Country
FIT (G2)

Figure 6.1 Unfitting investment



The South African local firms are weaker than multinationals in terms of human capital, and advanced technology which are deal breakers as indicated by figure 7.2. The absorptive capacities (red) will indicate the requirement for development. Once local firms are developed; might leverage the country's competiveness and absorptiveness. Private companies probably can be either suppliers of foreign companies or partners. Again, the intensity of maximizing benefits relies on the fit between human capital and existing technological level of domestic firms and foreign firms.

Figure 6.2 Fitness investment



As indicated figure 6.2, the host country needs to maximize FDI benefits (G1). However, it must first deal with factors that attract or deter foreign investment (G4). Once the host country has cleared that hurdle it must then develop absorptive capacities (G3) then host countries must attempt to find the fit (G2) between foreign investors and what the host country needs. Once this process of a fit is



completed all three themes would be "green", and then the developing host country like South Africa would maximize FDI attraction and benefits.

6.7 Conclusion

Foreign investors assess a country's investment climate not only in terms of FDI policies but also in terms of macroeconomic and political stability. Other critical factors includes rule of law, infrastructure, market access and created absorptive capacity of human capital, entrepreneurship and technology capacity that a country can offer potential investors.



CHAPTER 7: CONCLUSIONS, POLICY RECOMMENDATION AND FURTHER RESEARCH

7.1 Introduction

This chapter reverberates on the main research objectives as outlined in chapter 1 and also draws conclusions on the findings of chapter 6 and makes recommendations to the stakeholders of this research and finally make recommendations for future research.

The main research objectives for this study were:

- To analyse preconditions required by foreign investors in attracting inward FDI by developing countries.
- ➤ To analyse factors required by developing host country in order to better absorb FDI inflow.
- To argue that a recipient developing country could better benefits from FDI once they have fit between preconditions and absorptive capacity.

This section concludes with the above mentioned research objectives and make recommendation on policy and future research.



7.1.1 Preconditions

South Africa's FDI potentials will depend on the ability to improve the FDI climate and take advantage of the potential Foreign Direct Investment benefits by implementing comprehensive macroeconomic policies, enforcing the rule of law, reducing risks of policy reversals, and improving the provision of infrastructure and human capital.

South Africa should design policies that attract foreign investment and reverse the current dismal FDI trend, for this to happen South Africa should recognize that FDI is process. First, FDI requires a careful calibrated policy strategy from the host country, so that benefits could be realized.

Second foreign investors are risk adverse therefore decisions to invest into a host country are extremely sensitive to uncertainty. Therefore host country must endeavor to eliminate risk and uncertainty about the investment climate. Lastly, institutional development is critical. It can be either a barrier or lubricate to the absorptive process the host country.

7.1.2 Absorptive capacity

It should be noted that the host country could not get benefits of FDI if the capacities to absorb the benefits have not been carefully build. It is critical theme of this research report. This research report has emphasized that the developing country definitely needs to develop their initial capacity to absorb the benefits of



FDI and they must attempt to fit the absorptive capacities with the foreign investor requirements.

This research report has successful analyzed factors that can capture the FDI absorptive capacity. Of South Africa, the report also noted that a host country needs an initial level of development in terms of human capital, absorptive capacity of local firms, physical infrastructure and technology. Human capital and absorptive capacity of domestic firms are vital elements for a nation in order to absorb FDI benefits.

7.1.3 Benefits

The most important benefits of FDI for South Africa is employment, therefore is a need for improvement on the collaboration between the dti on the one side and the labour unions and the business unity South Africa on the other side. Their joint endeavor should be to make the labour market more business friendly so that more employment could be created., it is important that the labour unions see themselves as partners in the bid to attract and maximize the benefits of foreign investments to South Africa.

South Africa should build entrepreneurial culture that could take advantage of the FDI benefits

In light of the above conclusions the next section of the study will make policy recommendations.



7.2 Policy recommendations

South Africa should use FDI as part of dealing with long term challenges of unemployment, skills shortage and poverty and will therefore have to think of policies towards attracting FDI, build absorptive capacity so that FDI benefits could be maximized. This research report recommends three policies.

First, the evidence indicates FDI inflows accelerate employment creation and skills transfer. South Africa should improve business investment, regulatory framework, , continuing the economic reforms efforts and reducing macroeconomic policy uncertainty.

Secondly, the discussion verifies that developing countries must developed human capital in order to attract higher level technologies FDI. Advanced technology should contribute to the economic development. There is no misgiving that a comprehensive policy to improve education is required in order to the absorptive capacity of South Africa. The South African government must have a policy intended at closing the technological gap between foreign and host firms. At same time, policies focused towards increasing firm's absorptive capacity must be designed.

The education sector needs to become more functional to meet the essentials of foreign firms. Foreign investors are concern about workers' education levels, as well as the skills gap in South Africa. This is a barrier to FDI benefits. The starting point in resolving this challenge is to understand which types of Foreign Direct Investment the country needs to attract and the requirements of the investors. Equipped with this information, the educational sector should then build



programmes ensure that the country has the right working force to meet the requirements of foreign and local firms.

Lastly based on its economical regional weight, South Africa should lead a regional integration strategy, which consists of free trade amongst region members. This policy will allow South Africa to create a bigger market.

To conclude, South Africa has good potential to attract and benefit from FDI and to use Foreign Direct Investment to address challenges of unemployment, poverty and skills shortage. With a wealth of natural resources, Sound financial system, good political stability .South Africa is a suitable place for foreign investors. However, policymakers should must build absorptive capacity, and emphasize the reform agenda.

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7.3 Future research

Although the study has prospered in addressing several factors pertaining to attraction FDI and benefits, it is accepted that it is not entirely perfect in answering such important and complex questions. As such, it is important that further areas of study are recommended for future research.

In terms of future research, it is strongly suggested to test the fitness approach by round the table panel discussions. More efforts are needed to come up with sound indicators to measure the factors used in the approach. Such panel discussions should make a comparison between either a developing country and a developed



country or similar region to discover what could done to match FDI with host country developmental agenda.

Secondly, the study recommends future research that will empirically test the relationship between institutions and absorptive capacity for developing countries.



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APPENDIX A: INTERVIEW GUIDE

INTERVIEW DISCUSSION GUIDE

Introduction: Thank you for the opportunity to meet with you. This study aims to capture Foreign Direct Investment precondition, absorptive capacity and benefits on developing countries.

INFORMED CONSENT LETTER

Dear Respondent

I am conducting research on foreign direct investment preconditions, absorptive capacity and benefits in South Africa and am trying to find out more what foreign investor want and what the host country need to benefit from investment.

The data collection approach is in the form of face to face depth interviews that are expected to last about 30 min. Your participation is voluntary and you can withdraw at any time without penalty. Of course, all data will be kept confidential. If you have any concerns, please contact me or my supervisor. Our details are provided below.

Researcher name: MK Mabena (Mr.) Moyo	Research Supervisor Name: Mr. Solomon
Email:mkmabena@gmail.com	Email: smoyo@iggroup.net
Phone: 0834609479	Phone: 0833816070
Signature of participant:	
Date: _10 April 2012	
Signature of researcher:	
Date:	



Part D: Foreign investors

A1: Setting the scene

• Can you describe your Company overview of foreign direct investment?

A2: General FDI context

Please talk me through your view on South Africa as foreign direct investment Attraction destination.

excellent	
good	
Average	
Bad	

Probe:

What are the key challenges in attracting FDI?

A3: Review of the FDI entry mode

What is South Africa's most preferred entry mode by foreign investor?

(Please rank one being the most important five being the least important).

Joint venture	
Greenfield investment	
Partnering	
Merger and Acquisition	

PROBE:

Do you regard as a host country entry mode by foreign investors' important?

A4: Exploring firms investment type

What type of foreign investment is South Africa seeking?

Efficiency seeking	
Market seeking	
Resource seeking	



A5: Turning to preconditions

What are key preconditions that have/ will attract your foreign investors into South Africa?

(Please rank one being the most important five being the least important).

Macroeconomic and political stability

Political stability	
Growth performance	
Exchange rate regime	
Inflation	
Access to and cost of capital	

Natural and physical resources

Road/Rail/Sea/Air transport networks	
Reliability of water and energy supply	
ICT infrastructure	
Availability of land	
Availability of natural raw	
materials	

Regulatory and institutional environment

Investment incentives	
Rule of law	
Protection of investors	
Trade regulation and strategy	

Market Potential

Potential for markets to grow	
Size of the market	
Export base for neighboring and other markets	
Availability of preferential market	
Access/reduced custom	

Probe:

Is there a specific precondition that you will consider a deal breaker?

What is the most important precondition influencing foreign investor in South Africa?



Could you pick the three most important factors influencing investments conditions today?

A6: Exploring business conditions

What are the most difficult challenges facing foreign firms in South Africa?

(Please rank one being the most important five being the least important).

Registering a business	
Registering property	
Dealing with licenses	
Employing workers	
Getting credit	
Enforcing contracts	
Starting a business	
Paying taxes	
Trading across borders	
Protecting investors	
Closing a business	_
firing workers	

Probe: Could you pick the three most important factors influencing investments in terms of business environment?

A7: Exploring the absorptive capacity

What is most important concern relating to the absorption foreign investment by South Africa?

(Please rank one being the most important five being the least important).

Probe:



For South Africa to benefit from foreign investment, which capacities as host must be improved?

What you think should happen in order to improve absorptive capacity?

A8: Exploring benefits

How will foreign investment benefit South Africa?

skills transfer	
Technology transfer	
Employment	
Entrepreneurship	

A9: Exploring the investment plans

What will happen to foreign direct investment attraction in South Africa for next ten years?

Increase investment	
Decrease investment	
Same level of investment	
Unsure of investment	

Probe: What is the most important factor influencing the choice of foreign investors in South Africa as an investment destination?

A10: Conclusion

Given the background is possible to find the fit between what investor wants and what the South Africa need in order for both to benefit from Foreign Direct Investment?

What could be factors influencing the fit between host country and foreign investor?

Thank you

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