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Forms and Performance of Foreign Direct Investments in Sub-Saharan Africa

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Annotation

This Book represents a Doctoral Thesis submitted to and accepted by the Leipzig University, Faculty of History, Arts and Oriental Studies – Institute of African Studies (Universität Leipzig, Fakultät für Geschichte, Kunst- und Orientwissenschaften – Institut für Afrikastudien) for granting the degree of PhD (Dr. phil.). The Thesis was successfully defended on 3 November 2017 in Leipzig, Germany and received a degree of "magna cum laude".

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I dedicate this Book to my family.

Abstract

This Book sheds light on different forms of foreign direct investment (FDI) in Sub-Saharan Africa (SSA) at the macro-level as well as the micro-level. The understanding of these different FDI forms provides the foundation for a detailed analysis of the multifaceted dimensions of FDI performance through an OLS regression model. The Book posits that the understanding of FDI performance determinants is indispensable in the debate about the contribution of FDI to SSA's economic development and its technological transformation. It claims that the formulation of ambitious FDI impact targets would be futile unless the foreign investor experiences subjectively acceptable growth and profit levels and sees a business rationale in maintaining the longevity and stability of its operations in SSA.

An extensive literature review provides the basis for the formulation of eleven hypotheses drawing primarily from resource-based, institutional and transaction cost theories. The sample is derived from the UNIDO 2010/11 Africa Investor Survey database and comprises 2,692 foreign subsidiaries. The results are at odds with the majority of the macro-level literature on FDI inflow determinants to SSA in that they bring into question the exclusive focus on institutional and business climate determinants. Instead, firm-level results point to the relevance of R&D intensity, brands, prior or parallel experience in SSA, cultural proximity and product diversification in explaining FDI performance. Being an older and larger foreign subsidiary also has a positive impact on FDI performance as well as local market orientation. JVs perform better than greenfield foreign investors.

Another contribution is made in the detailed analysis of macro-level FDI flow and stock statistics from the four main sources IMF, UNCTAD, the World Bank and OECD. The Book divulges deviations between different data sources and provides an account of the main reasons for the under- and overestimation in FDI statistics. It concludes that SSA's national statistics offices and central banks require further capacity building. In this context, FDI surveys in SSA should be continued in order to build up a firm-level panel database to advance research on FDI typology, FDI performance and other related topics.

Keywords: Sub-Saharan Africa, foreign direct investment, determinants, performance, entry mode

JEL Classifications: F21, F23, L22, L25.

Table of Contents

List of Figures

List of Tables

List of Boxes

Abbreviations

AGOA	African Growth and Opportunity Act
ANOVA	Analysis of Variance
BIT	Bilateral Investment Treaty
BPM	Balance of Payments and International Investment Position Manual
BOP	Balance of Payments
CDIS	Coordinated Direct Investment Survey
CEO	Chief Executive Officer
DAC	Development Assistance Committee (of the OECD)
DRC	Democratic Republic of the Congo
DSBB	Dissemination Standards Bulletin Board
EAC	East African Community
EBA	Everything But Arms
ECOWAS	Economic Community of West African States
EDDI	Enhanced Data Dissemination Initiative
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FE	Foreign Entrepreneur
FIFA	Fédération Internationale de Football Association
GDDS	General Data Dissemination System
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
GTZ	Gesellschaft für Technische Zusammenarbeit (now GIZ)
GVC	Global Value Chain
ICT	Information and Communications Technology
IIA	International Investment Agreement
IIP	International Investment Position

IMF	International Monetary Fund
INV	International New Venture
IO	International Organization
IPA	Investment Promotion Agency
ISIC	International Standard Industrial Classification
IT	Information Technology
ITRS	International Transaction Reporting System
IZ	Industrial Zone
JV	Joint Venture
KMO	Kaiser–Meyer–Olkin Measure
LDC	Least Developed Country
M&A	Merger & Acquisition
MDGs	Millennium Development Goals
MF	Manufacturing
MNC	Multinational Corporation
MNE	Multinational Enterprise
NIP	New Industrial Policy
NSO	National Statistics Office
OECD	Organisation for Economic Cooperation and Development
OLI	Ownership–Location–Internalization (Paradigm)
OLS	Ordinary Least Squares
PCA	Principals Component Analysis
R&D	Research & Development
REC	Regional Economic Community
ROA	Return On Assets
ROI	Return On Investments
ROS	Return On Sales
SA	South Africa
SADC	Southern African Development Community
SDDS	Special Data Dissemination Standard
SDGs	Sustainable Development Goals
SEZ	Special Economic Zone

SIMSDI	Survey of Implementation of Methodological Standards for Direct Investment
SME	Small and Medium-sized Enterprises
SPE	Special Purpose Entity
SSA	Sub-Saharan Africa
TNC	Transnational Corporation
UBO	Ultimate Beneficial Ownership
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
US	United States
USD	United States Dollar
VIF	Variance Inflation Factor
WDI	World Development Indicators (of the World Bank)
WIR	World Investment Report (of UNCTAD)
WOS	Wholly-Owned (Foreign) Subsidiary

1. Introduction

1.1 The foreign direct investment (FDI) scenario in Sub-Saharan Africa

Classical development theories consider the scarcity of capital and resulting low levels of investments into productivity-enhancing technological progress as a fundamental impediment to economic development. From a developing country perspective, the process of catching up with the developed part of the world requires continued expenditures on knowledge accumulation, product and process innovation and human capital formation (UNCTAD 1999b, UNIDO 2005). Since the conversion of domestic savings into domestic investments alone is insufficient to accomplish ambitious economic development goals, developing countries have put additional emphasis on the attraction of various types of foreign direct investments (FDI) (Wells and Wint 2000, Harding and Javorcik 2007, Harding and Javorcik 2011). Compared to cross-border bank lending or portfolio investments, FDI constitutes a lasting investment interest and is, under normal circumstances, the least volatile form of transferring foreign savings from one country to another (Lipsey 1999, Morrissey and Osei 2004, IMF 2009). This characteristic makes FDI in principle an ideal conduit for bridging technological and know-how gaps between developed and developing countries thus contributing to the achievement of developing countries' social and economic development objectives.

Sub-Saharan Africa (SSA), the region with the world-wide largest number of least developed countries (LDCs) and the focus of this Book, is perhaps in the direst need of attracting "quality" FDI. SSA is not alone in this endeavour. The purported positive impact of FDI on economic development has paved the way for the emergence of different actors and stakeholders whose principal mandate is FDI attraction and promotion. Investment promotion has become a tough and competitive business in which developed and developing countries, spearheaded by specialized investment promotion agencies (IPAs), are vying for the attention of a growing but nonetheless finite number of multinational enterprises (MNE) in order to persuade them to invest in their own country and not in another. SSA is now an active player in the investment promotion arena as indicated by a remarkable increase of ratified bilateral investment treaties (BITs) as well as the proliferation of IPAs and special economic zones (SEZs) across the continent (UNCTAD 2008b, Farole 2011, UNIDO 2012a).

The extent to which a developing country is able to attract or retain more of "quality" FDI as opposed to another will ultimately determine the aggregated impact that the group of foreign-owned companies has on the local economy. A frequent policy recommendation for developing countries has been to improve the conditions for attracting the "right" mix of FDI along different desirable dimensions of economic impact in terms of capital formation, employment creation, skills enhancements, global value chain integration, infrastructural or ICT development, linkages, local content development and others. In this environment of stiff competition, there is a strong temptation for SSA countries to adopt an almost cynical stance over such selective investor targeting following the adage of *"Beggars can't be choosers"*. Within this reasoning, the neoliberal investment policy paradigms of the 1990's fell on fertile grounds and have prompted SSA countries to deregulate their local markets and actively tout the most visible national business reforms in accordance with the World Bank's "Doing Business" logic, thereby often masking the lack of a genuine policy resolve to address the underlying structural and intertwined challenges of the African continent. While most SSA countries have most likely surpassed the peak of neoliberal investment policy-making, the continent continues to have one of the world's most relaxed FDI entry or local content regulations (OECD 2005b, UNCTAD 2006a, World Bank et al. 2010, De la Medina Soto and Ghossein 2013). Very rarely will investment laws force foreign investors to choose a suboptimal mode of entry or to utilize a certain proportion of input factors such as locally available human resources or local supply chains.

The global financial crisis of 2008/2009 evidently led to a global contraction of FDI volumes during the following few years (UNCTAD 2009f, UNCTAD 2009e). Developing countries were relatively less affected by the global financial crisis and recorded a decline of FDI inflows of 24 per cent in 2009 as opposed to a 44 per cent drop in FDI inflows to developed countries (UNCTAD 2010b). FDI inflows to Africa decreased by even less, namely 19 per cent in 2009. This nurtured optimism that the crisis could mark the beginning of a sustained catching-up process and turn the essence of the Official 2010 FIFA World Cup Song "*Waka Waka (This Time for Africa)*" into concrete action once and for all. According to this thinking, multinational enterprises would undertake a global business risk re-assessment resulting in closing the perceived risk gap between SSA and hitherto misleadingly perceived "low"-risk locations in developed countries. At the same time, the emergence of MNEs from developing countries resulted in a higher proportion of South-South FDI flows (Akyut and Ratha 2003, Aykut and Goldstein 2006, UNCTAD 2006b, UNCTAD and UNDP 2007, Henley et al. 2008, Saunders 2008, Draper et al. 2010, Gómez-Mera et al. 2015). This nurtured further optimism that investors from developing countries would be more tolerant with regard to imperfections in the host country's investment climate as they would be used to operating in such conditions in their own country of origin (UNIDO 2007, Cuervo-Cazurra and Genc 2008, Desbordes et al. 2011).

For the period 2014 to 2016, 15.9 per cent of international investors consider SSA as a "very important" or "extremely important" investment destination compared to 14.1 per cent of international investors during the period from 2012 to 2014 (UNCTAD 2012a, UNCTAD 2014c). Moreover, relaxed FDI entry regulations promise minimal interference by government authorities hence making it easier for MNEs to choose from a list of potential investment locations in SSA. At the same time, most countries in SSA were able to show robust improvements of the set of macro-economic fundamentals (AFDB 2014). Since the beginning of the millennium, real annual GDP has grown at an average of 5 per cent and real income per capita has increased by 2.1 per cent. An African middle class, estimated at 34 per cent of Africa's population (AFDB 2011b) has presumably emerged as an engine of transformation of the urban parts of Africa into attractive consumer markets. The proportion of people living below the poverty line has fallen from over 50 per cent to less than 45 per cent. Of the 20 economies narrowing the gap with the Doing Business regulatory frontier the most since 2009, nine are in SSA (World Bank 2013).

SSA's economic performance and its robustness even during the global financial crisis, its relative improvements in the Doing Business rankings and the continent's liberal FDI regulations were sufficient ingredients for papers and press to pitch a chorus of praise on Africa's staggering transformation from "The Hopeless Continent" (The Economist 2000) to "The Hopeful Continent" (The Economist 2013a). By the same token, the continent's future investment potential was compared to "Lions on the move" (McKinsey Global Institute 2010), "A Sea of Opportunities" (UNECA 2014) or the "African growth miracle" (McMillan and Harttgen 2014). As a matter of fact, soaring nominal FDI inflows to SSA seem to somehow confirm the euphoria. In 2013 and according to the database of the United Nations Conference on Trade and Development (UNCTAD), FDI inflows