Factors Influencing Foreign Direct Investment of South African Financial Services Firms in Sub-Saharan Africa

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Working Paper Number 118

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March 27, 2009

Abstract

This research investigates the key elements that South African financial services firms consider before making foreign direct investments in Sub-Saharan African (SSA) markets. The results show that South African financial services firms are most strongly influenced by the political and economic stability of the country in question as well as the profitability and long-term sustainability of its specific markets. The degree of available infrastructure in terms of Information and Communication Technology as well as the existence of credible financial systems was also viewed as highly important considerations affecting investment decisions in SSA. Given the uncertainty and ambiguity of most SSA markets, many South African financial services firms prefer to enter existing markets via a majority stakeholder joint venture with a local partner or via a new investment if the market does not currently exist. The nature of the financial services firm also seems to influence the entry method and once in a new country, most firms seem to prefer a full service presence. Additionally, the key motives cited for expansion northward were to broaden revenue bases and improve profit margins as well as to stay close to local customers.

KEYWORDS: Foreign Direct Investment, Financial Services, Sub Saharan Africa

JEL codes: F14,G29,055

1 Introduction

Africa is opening up to international business on an unprecedented scale. In many respects, it represents a frontier to global capital which is seeking out new, growing and emerging markets. Whilst Africa is still very much on the periphery of world markets and remains a tiny player on the international stage, it is beginning to actively court foreign companies and has done so by addressing the institutional business environment. Africa is perceived by foreign entities as a high risk, relative to returns and location. But Africa is changing, and it is the right time to reconsider the latent potential of this vast, untapped market of 850 million people. There is money to be made on this continent, and indeed the returns on investment are already substantially higher here than anywhere else. More importantly, the risk associated with doing business in Africa is declining as the institutional environment becomes more predictable and familiar (Luiz, 2006).

South Africa has the largest economy on the continent and is increasingly seen as the launch platform for investment in Africa. For example, the 53 African countries had a combined gross domestic product (GDP) in 2003 of $653,570 million of which South Africa contributed $187,116 million (29%) of the total (despite only having 5% of the land surface and population) (*ibid*). The purpose of this research is to determine what factors influence the decisions of South African financial services firms to invest in Sub-Saharan African countries, what the relative importance of those factors is and what some of the methods and motivations behind these foreign investments are.

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The paper begins with an overview of the importance of Foreign Direct Investment (FDI) to SSA, with a particular focus on recent regional trends and the financial services industry and provides the theoretical framework. This is followed by the results of our survey conducted on South African financial firms investing in SSA and an examination of its broader implications for international business.

2 FDI in Africa

Over the last two decades, world-wide FDI has grown at remarkable rates both in absolute value and in terms of percentage GDP; FDI grew from US$59 billion in 1982 to record levels of US$1.4 trillion in 2000. However, thereafter FDI levels declined largely in response to the global economic slowdown although there has been recovery since 2003; FDI levels reached $916 billion in 2005 (UNCTAD, 2006).

Historically, much of these FDI flows went to developed nations, but since the 1970s, increasing flows found their way into developing and transition economies as European and Japanese firms shifted labour-intensive manufacturing operations from home markets to developing nations where labour costs were lower (Hill, 2002). In fact, FDI in developing countries increased from US$27 billion in 1990 to over US$334 billion in 2005 (Hill, 2002 and UNCTAD, 2006). Africa's share of developing regions' FDI has dropped significantly since the 1970s from 31% in 1970 to 9.1% in 2005. Despite the declining trend in Africa's share of developing regions' FDI flows, investment in Africa has *increased* in absolute terms since the 1970s from an average of US$1.9 billion to US$5.1 billion in the 1990s and record highs of US$30.7 billion in 2005 (of which SSA received $17.9 billion or 58% of that total) (UNCTAD, 2006). The recent dramatic increases have been fuelled by rising corporate profits and high commodity prices.

This indicates a continued interest in Africa as an investment destination, particularly for primary sector industries, where mining, quarrying and petroleum make up 60% of investments and agriculture makes up the balance (UNCTAD, 1999b, 2005). Despite this focus on primary sector investments, it is interesting to note that many African countries are trying to diversify their economy and attract different FDI flows – particularly towards their tertiary, or services sector. These diversification strategies began to take hold in certain places in the late 1990s and by 1999, 42% of all FDI flows into Africa were directed into services industries, with 53% of these flows being concentrated in finance and the remaining being shared among trade, transport, real estate, construction and various public services (UNCTAD, 1999b).

2.1 South Africa's Relationship with Africa and SSA

With the dismantling of apartheid in the early 1990s, as well as the number of changes to local South African legislation (including relaxation of exchange controls) and the general change in mindset of local South African firms, a dramatic increase in South African exports to other African countries has been experienced in recent years (Swarns, 2002). This increase in trade has led to many South African companies moving northward with great success, making South Africa one of the world's fastest growing sources of FDI in Africa (UNCTAD, 2003a). Table 1 shows the investment in foreign and African assets by South African companies over the years 1996 to 2005. There is a clear trend of South African FDI in African countries increasing, not only as a proportion of overall FDI but also in absolute value. Investment in Africa increased by more than five fold for the period 1996 to 2004 - for the first time South African firms had over 10% of all their FDI foreign assets in Africa. Specifically, African FDI in banking (the only figures available for financial services FDI) grew dramatically in 2001 and 2002 making up 23% and 19% of all African FDI foreign assets, respectively (this was a result of some major acquisitions undertaken at the time). Although these FDI levels subsequently decreased, indications are that the figures for 2006 will once again reflect record highs (official statistics will only be available in late 2008). Overall, South Africa is one of the largest investors in SSA - contributing 86% of FDI into Lesotho, 80% into Malawi, 71% into Swaziland, 58% into Botswana, 35% into Tanzania, 31% into Mozambique, etc. (Grobbelaar, 2006).

[Insert Table 1 about here]

This trend of South African firms moving into Africa was originally largely limited to primary and secondary sector industry companies but has now begun to encompass a number of service-based companies ranging from retail and rental agencies to the more complex telecommunications (Swarns, 2002). South African financial services firms have also recently begun to move into Africa, but apparently at a slower pace, with mainly the larger South African banks leading the charge.

Contributing positively through both trade and FDI to the development of its neighbours, South Africa is often viewed as Southern Africa's 'growth pole' which can help grow regional economies through provision of FDI capital, technology transfer and contributions to human resource development and increased exports to these economies (UNCTAD, 1999a). The geographic proximity and the closer economic and infrastructural ties between South Africa and its regional neighbours (which have facilitated a better understanding of the countries' cultures and local regulatory and legislative characteristics) may allow for South African firms to have certain advantages over other foreign multinationals when deciding to invest in SSA. For these reasons and given the huge increase in cross-border investment flows in recent years, it is important to attempt to understand what factors may influence such investment decisions, particularly in financial services where little investigation into these matters has occurred to date.

2.2 Motives for FDI

The effects of globalisation have implications for South African financial services firms and their position in domestic and African markets. With the emergence of South Africa from apartheid and its associated isolation, as well as the opening of its markets to the world, it has begun to become a target for other foreign financial services Multinational Companies (MNCs) (see Gelb and Black, 2004a). Several factors have greatly reduced barriers of entry for these MNCs, including the use of rapid technology and knowledge transfers (UNCTAD, 2003a&b), the use of IT and telecommunications to overcome distance and inaccessibility (Hill, 2002), and the recent regulatory liberalisations (Yusuf, 2003). The arrival of foreign financial services monoliths like Barclays, Citibank, Standard Chartered and the likes in recent years bares testament to this growing trend in South Africa, resulting in domestic markets no longer being safe havens for local players (see the case of ABN Amro in Gelb and Black, 2004b). This has exacerbated the already highly competitive and saturated domestic financial services markets, especially in banking. With fewer or non-existent growth opportunities in South Africa for many financial services firms, and with profit margins under pressure, many financial services companies need to look abroad in order to ensure future growth (Luiz, 2006).

As international developed markets are equally saturated and arguably even more competitive than local financial services markets, many financial services firms are looking to developing nations for opportunities. Africa, and specifically SSA, has shown great promise in terms of profitability (UNCTAD, 1999a; Luiz, 2006) and relatively little local competition when it comes to financial services. Furthermore, with the recent investment in, and the opening up of some of Africa's economies as well as the resultant increase in trade with other countries (UNCTAD, 1999a & 2003a), the next stage of evolution in some of Africa's countries appears to be that of increasing demand for financial services to support or compliment the growth of other existing primary and secondary industries (UNCTAD, 1999b). This is expected to increase further as barriers to trade in services are dismantled to a greater degree (Yusuf, 2003; Bouquet *et al*, 2004) and as African countries introduce better corporate governance policies and reduce bureaucracy and 'red tape'.

The over-arching reason why firms engage in FDI is to advance their competitive position. This has become of particular importance in today's *hyper-competitive* global environment (D'Aveni, 1995). The advancement of a firm's competitive position is largely driven by market expansion or production efficiency motives (e.g., cost-reduction, better labour characteristics etc.), which show themselves via three main activities (Dunning, 1993),[1] namely market-seeking, efficiency-seeking, and resource (or asset)-seeking.

Many investigations into the investment patterns of foreign firms have been undertaken over the years resulting in multiple theories for FDI flows being suggested. A well-respected theory that tends to incorporate most aspects of FDI determinants is that of Dunning's (1993) "OLI paradigm".This theory states that FDI takes place when three sets of determinant factors exist simultaneously, namely[2] ownership-specific (O) advantages, internalisation incentive (I) advantages and location-specific (L) variables

While the first two conditions (O and I) are firm-specific determinants of FDI, the last (L) has a crucial influence on a host country's inflows of FDI. It is thus these L-variables, largely related to economic and policy factors, that effectively are the key determinants of FDI into a country. This does not negate the importance of the O and I factors in directing the investment activities of MNCs, but rather our focus in this paper is on the choice of SSA as an investment destination and hence the focus on the L factors (see Dunning, 1998 for his emphasis on the importance of the L factors). We focus below on a particular set of host country determinants of FDI deemed important in prior research (the clustering may use different terminology but effectively they refer to the same factors - see Markusen and Maskus, 1999; Rondinelli, 2005; Dunning, 2006; Dunning and Lundan, 2008). Furthermore, these factors find support specific to investment in the financial services in Moshirian (2001) where he analyses and models the significant components of international trade in financial services for the US, the UK and Germany. The empirical results of his study of FDI in banking indicate that trade structures, relative market size and growth, exchange rates, and FDI in non-finance industries are some of the major determinants of foreign investment in banking. FDI in business services is particularly important in developing economies which often possess a poor business environment, i.e., an underdeveloped supporting business services infrastructure, such as inadequate financial markets. FDI in such services can have major spill-over effects because it not only contributes directly to the economy but also crowds in FDI in other lines of production by making the business environment more attractive and lowering transaction costs. As a result, from a developing country perspective, there appears to be a much higher demand for FDI in commercial and financial services (see Ofer and Keren, 2001). Outreville (2007) examines where the largest global financial firms are expanding their operations and documents some of the factors that may explain these favoured locations. He argues that location specific advantages such as size, human capital and cultural distance do provide an explanation for FDI as does good governance in terms of a country's ability to attract this FDI in financial services. These factors are explored below to examine their importance in SSA.

- Country Governance and Political Risk:

Political stability is generally key in ensuring a stable economy and conditions that allow for growth and development of local markets. Aspects which impact on perceived political stability are the frequency of changes in government, the method of electing government, political tolerance, good general country governance, corruption levels and the presence of high quality, transparent regulatory frameworks and public institutions (see Dunning and Landon, 2008).

- Economic Environment / Macro-economic Performance:

Economic conditions such as inflation, interest rates, growth in GDP, as well as monetary and fiscal policies are important and influence risk and potential profitability of local industry (Root and

[1] For example, Gelb (2003) and Gelb and Black (2004b) investigate the characteristics and impact of FDI into South Africa and find that a primary motivation for entry is indeed "market-seeking" – the market in this case being both South Africa and the broader region of SSA.

[2] Dunning's OLI framework has been examined and supported by numerous studies in diverse locations including the USA, Turkey, China, and Eastern Europe (see Brouthers *et al*, 1999).

Ahmed, 1978). A relatively stable and controllable economic environment is especially important for the financial services industry which is generally strongly influenced by greater economic forces.

- Exchange Rate Considerations:

Exchange rates can have marked effects on a company's operating profitability and debt burdens an may therefore be an influencer in envestment decisions. The extent of this influence will depend on the country's economic and exchange rate policies (see Campa, 1993).

- Trade Incentives, Barriers and Agreements:

Local trade incentives can increase a firm's competitive edge as well as reduce its overall operating expenses (see Dunning and Landon, 2008: 682-688). Reduced trade barriers can also make it easier for firms to enter local markets while a country's regional agreements can greatly facilitate the movement of capital and information across borders.

- Infrastructure Considerations:

Whilst physical infrastructure, such as roads and ports may be less important, IT and telecommunications can be particularly important to financial services firms who rely on such infrastructure components to support their sometimes complex and complicated offerings. Furthermore, efficient financial systems are imperative to enact the highly transaction-based business of most financial services firms.

- Labour Considerations:

Labour conditions that are usually deemed important by industries include cost of labour, skills, productivity and supply (ibid). While the cost of labour might be a more significant consideration for primary and secondary sector industries, in the financial services sector, the level of skills and productivity would be more important.

- Market Size and Demand Conditions:

The size and depth of a host country's markets are generally considered quite important for investors (see Haufler and Wooton, 1999). This is particularly true for financial services which require a specific degree of sophistication in, and size of, a local market before being able to enter.

- Geographic Proximity:

In many cases, proximity of the host country to the home country is seen as important, especially in the early stages of foreign firms developing a local presence.

- Economic Agglomeration:

Regions with strong growth centres generally also become centres of industry, service provision and amenities providing a variety of 'value-added' services and 'supporting industries' to local business (Porter, 1994). This may be of particular importance to financial services firms that require higher level value-added services to help with the production and distribution of their products and services, which can be of a complicated nature.

- Cultural Considerations:

The culture and value-system of a country and its people dictates to a large degree how a company operates; from how its relationships are forged to how its brand is perceived to how business is conducted in that country, etc. (Hofstede, 2001). In the financial services industry where human contact is high, relationships and personal communications are of particular importance and can mean the difference between success and failure.

3 Research Methodology

A semi-structured interview survey process consisting of written questionnaires and one-on-one interviews that incorporated both structured as well as open-ended questions was used.[3] The actual people chosen to be interviewed from each company were those in senior management that were the key decision makers, or at least part of the decision-making process, in terms of foreign investment decisions in their respective firms - a senior Strategic Manager, COO or CEO. The structured data was collected via the use of a standardised multi-point questionnaire based on the investment factors identified. This was to be used to gain an understanding of the degree of relative importance of each of the factors identified.

The survey of South African financial services firms with investments in SSA was split into two main sections: entry characteristics and importance of investment factors. The latter section, which uses a five-point verbal scale as a basis to determine the relative importance of each of the ten investment factors, required a more involved statistical analysis before the data could be used and correctly interpreted. This is because the survey data captured is of an ordinal nature and cannot necessarily be assumed to be linearly correlated with the underlying attitudes of the verbal scale of the survey, i.e., one cannot directly, accurately interpret responses from the five-point verbal scale without some mathematical means of normalising or rescaling it first. Stacey (2005) has developed a distribution-fitting approach which allows for the conversion of such data into a more representative form which yields results of greater accuracy and validity than alternative methods. Hence this analysis has been used in this research to facilitate interpretation of the degree of relative importance of the investment factors. This allowed for each factor to be interpreted and ranked.[4]

Stacey's (2005) statistical methodology, when analysing the results of the distribution-fitting analysis performed on the survey data, imply that the following interpretations needed to be made to identify factors as *very important, important* and *less important* in order to test the relevance of the factors laid out above:

- If the mean for an investment factor response was appreciably greater than zero ($\mu >> 0$ as determined by the hypothesis test), then that factor is statistically significantly more important than the overall average importance of all the factors and can hence be interpreted as being *very important* relative to other factors.
- If the mean for an investment factor response was very close to zero ($\mu \sim 0$ as determined by the hypothesis test), then that factor is statistically no more and no less important than

[3] All results recorded below are the outcomes of the interviews with the senior managers in these companies conducted in 2007. The same questionnaire was used with all respondents to ensure reliability and consistency. Respondents were first asked questions about the extent of their investments and the nature thereof into SSA. This was followed with questions related to factors considered in making these investment decisions and the locale for these investments. They were asked to rate the importance of the factors identified on a five point likert scale. Thereafter, we followed up with open ended questions to try and unpack the 'why' behind their answers. There were no leading questions but instead we asked them to explain their answers. These were recorded and then analysed.

[4] The approach calculates item means and standard deviations of the sample, rather than respondent level data. Respondent level data can however be generated from estimated threshold values and the estimated means and standard deviations. In the case of normal underlying distributions, the rescaled values can be calculated as the mean or expected value of the truncated normal distribution between the two threshold values. This is given in the formula:

$$\mathrm{Y}_{k,j} = \frac{\int_{\tau k-1}^{\tau k} x.e^{\frac{-(x-\mu)^2}{2\sigma^2}}dx}{\int_{\tau k-1}^{\tau k} e^{\frac{-(x-\mu)^2}{2\sigma^2}}dx}$$

Where $\mathrm{Y}_{k,j}$ is equal to the rescaled value for the kth ordinal response to the j survey item, and are the estimated mean and standard deviation of the normal distribution fitted to the responses to the jth survey item (Stacey, 2005: 21).

the overall average importance of all the factors and can hence simply be interpreted as being *important* (the average) relative to other factors.

- If the mean for an investment factor response was appreciably less than zero ($\mu \ll 0$ as determined by the hypothesis test), then that factor is statistically significantly less important than the overall average importance of all the factors and can hence be interpreted as being *less important* relative to other factors.

Out of a potential list of 82 respondents in financial services within South Africa, 20 responses were achieved – those that did not respond were mostly inactive in SSA. Those that did respond were generally the larger, more established South African financial services institutions which either had a current stake in, or were planning to expand into SSA. For example, in banking, responses were received from representatives of at least three of the 'big four' retail banks as well as from five of the industry's key investment banks and a leading African "niche" banking player. Although it is difficult to calculate the exact market share that these respondents would represent due to different industry classifications, according to the KPMG Banking Survey South Africa 2004 (KPMG, 2004), respondents included in this research have over 70% of South Africa's total banking assets under their control. In the capital markets sub-industry, our research includes responses from three of the four top asset managers, as well as three of the country's consistently top rated investment banks (PWC, 2005). In-depth interviews with the continent's major stock exchange also insured that stock brokers' viewpoints were adequately covered. In insurance, three of the country's biggest players responded, each with significant insurance-related revenues (over R5.7 billion, R3.9 billion and R7.8 billion, respectively according to latest annual reports), giving them an appreciable share of the market place. Lastly, in the financial consultancies category, this research managed to secure input from the country's (and the world's) largest consultancy, by revenue, thereby also providing good representation in this sub-industry.

4 Factors Influencing FDI of South African Financial Firms

4.1 Entry Characteristics

In this section, we present the results on the methods of entry into SSA. The areas investigated include the degree of local presence in the country (e.g., full service branch to *ad hoc* piecemeal work), preferred method of entry (merger, joint venture etc.) and key reasons for entry.

4.1.1 Degree of Local Presence

Respondents were asked for their degree of presence in SSA when servicing customers, both for those countries in which a presence was already established and for those in which the organisation was planning to establish a presence in the foreseeable future. Most respondents (76%) interviewed preferred to have a fully fledged presence in the country in question, ideally in the form of local headquarters or at least a full service branch. 5% were satisfied with a limited service branch, 9% with representative agents, 5% affiliation with a local entity, and 6% had other options including a tax break office, piecemeal work, etc.

The degree to which services were offered also depended on the size of the market in question (demand) and the nature of the institution. For the former, larger and 'deeper' markets, such as Kenya, Malawi and Zambia, with a greater diversity of customers and demand seem to warrant the establishment of full service branches as opposed to singular offerings, while smaller countries such as Lesotho, Swaziland, Botswana and Namibia, bordering South Africa also seemed to offer a greater variety of services, possibly due to their proximity to base (South African) operations and hence easier access to skills and infrastructure to offer a greater variety of services.

However, the *nature* of the industry, or sub-industry, also affects the degree of local presence, with retail banks generally needing to offer a wider range of services upfront than other financial services players, possibly due to the more 'commoditised' nature of their services which globally are more generalisable on a basic level. Insurance firms and corporate banks, however, who tend to have more specialised products and require a slightly more complex customer base, seem to prefer to enter markets in a limited fashion (limited service branches), perhaps using more basic products as a platform, and then evolving their service offerings from there. At the other end of the spectrum, we find that investment and merchant banks and financial services consultancies whose highly specific, individual and usually once-off deals and projects essentially result in work on an *ad hoc* or piecemeal basis unless a sustained 'critical mass' is achieved in their customer base.

Additionally, in some cases, local regulatory controls prevent the establishment of a limited presence such as representative offices, which also affect the degree to which services are offered. Essentially, however, if the local market is large and deep enough, it appears that most financial services institutions would prefer to offer a full range of services locally – this ties in with the logic of increasing revenues through offering more products as well as leveraging off a common base of operations or infrastructure.

4.1.2 Preferred Method of Entry

When asked for the preferred entry method when investing in SSA in order to establish a presence, the following summary results were obtained (refer to table 2).

[Insert Table 2 about here]

Joint ventures with a majority stakehold were most popular when moving into countries for the first time where a market in the financial services being offered already existed. This is due to various reasons: firstly the somewhat more personal nature of the services industry requires an element of trust and an established relationship – essentially a brand. This is particularly important in SSA where relationships and local knowledge of unique cultural differences are key in doing business. A joint venture with an existing, trusted local partner brings these elements into the mix immediately. Secondly, a joint venture with a well-established local partner also brings with it an existing network of distribution points and infrastructure (people, licenses, systems, etc.) which can often be problematic in setting up in African countries. Additionally, a joint venture in many cases also brings an existing client base, and hence immediate market share.

'Greenfield' investments are also popular but seem to be preferred under different circumstances. This entry method seems to be chosen in cases where the services being offered do not currently exist in the target country and hence no existing operation can be bought as an initial base. Furthermore, these investments if handled correctly, tend to offer less 'assimilation' hassles and higher return on investments than joint ventures and M&As, but can take longer to establish. Lastly, 'Greenfield' investments are also preferred in cases where the parent company wishes to retain its culture and / or methods of conduct. Similarly this would also be the case if it is felt that the brand of the parent company offers a distinct competitive advantage or if the parent company refuses to dilute or risk its brand by being associated with a local company which may have a disreputable, or less than appropriate, track record ("skeletons in the closet" as quoted by one interviewee). With reputation and brand being key in the financial services industry, this is an important consideration.

Despite there being some preferred methods of entry, generally the channel chosen was strongly dependent on the situation and the specific local opportunities and offerings at hand.

4.1.3 Reasons for Entry

The last element with regards to entry into SSA that was examined was that of the actual reasons driving this expansion. Table 3 shows the key categories of reasons cited by respondents interviewed.

[Insert Table 3 about here]

It is clear that the majority of respondents' reasons for entry into SSA are market seeking, specifically for market growth (revenue base) and to increase profits / margins of the parent company. Entering new lands in order to remain close to existing and local customer bases also featured as a noticeable trend in this category. Another popular set of reasons for entry are for strategic motives, either to diversify risk or to establish alliances and favour with African bodies in order to bolster their positions in SSA. Moving into African markets to improve operating efficiency or in order to tap into a better supply or quality of resources does not appear to be key drivers.

The fact that market seeking motives would be the most common seems logical given the revenue and profit focus of financial services (and indeed most) companies which generally seek high returns on investments for internal and external shareholders. When examining the key reasons within this category, it is evident that many financial services companies seek to expand into SSA in order to grow their markets as well as their profit margins. Many financial services markets in SSA are still greatly underdeveloped in terms of services being offered. As local populations and economies grow, so too do the opportunities for established South African financial services firms, with the advantages of regional understanding and proximity, to offer their products to SSA countries. With local South African competition being fierce across all financial services sectors (especially retail banking), and with the exception of the low margin 'unbanked' market segment, it is proving difficult to create new profitable markets in South Africa, making markets further north one of the few options left for regional market growth. Despite many of the individual African markets lacking appreciable depth and diversity, if a regional view is taken across many countries, a growth strategy is usually more feasible. The fact that the African markets also tend (up until very recently) to have far less local competition also bodes well for South African financial services firms hoping to expand their revenue base. Additionally, given the local economic characteristics of many African countries and markets (including high interest rate mark-ups), profit margins in other African countries tend to be far higher than those found in South Africa and this also tends to make the overall value proposition for expansion into SSA particularly attractive. Lastly, another element of the market seeking driver for South African financial services institutions appears to be the following of existing South African customers into SSA. Several respondents cited this as an additional factor for them contemplating the expansion north, particularly if large existing customers can be used as an anchor for further growth in SSA markets or if there is a threat of existing customers being serviced by a local competitor abroad.

The second key driver for expansion into SSA can be termed as strategic reasons and vary from a means of diversifying revenues in order to better spread the parent company's risk, to helping build brand and key relationships. This last point is particularly valid in SSA where relationships are generally regarded as extremely important for a number of reasons: not only does it facilitate, as a trusted foreign company, being allowed by local authorities to conduct business, but investing in local relationships builds confidence locally and can lead to strategic long-term partnerships with key local clients as well as local parties that will be willing to share local knowledge and insights – quite often a vital luxury in an unfamiliar market.

The responses with regards to efficiency and resource seeking motives indicated that these were essentially not the main drivers for investing in SSA and where they did show themselves, they were highly situational, such as a means of mitigating local foreign exchange or default risk by investing elsewhere in that region.

4.2 Importance of Investment Factors

One of the main aims of this research was to establish the key factors that financial services institutions deem as important when making FDI decisions in SSA. In each case, the ratings given by respondents as well as the mean calculated as part of the distribution-fitting analysis are shown and from this, the level of importance is interpreted as per the method described above. All the results are tabulated in summary form in Table 4.

[Insert Table 4 about here]

4.2.1 Factor 1: Country Governance and Political Risk

This factor includes aspects which impact on the perceived political stability of a country, such as the frequency of changes in government, the method of electing government, political tolerance, good general country governance, corruption levels and the presence of high quality, transparent regulatory frameworks and public institutions. From the mean calculated, this factor was interpreted as being *very important* overall.

Given the fact that political stability affects all aspects of a country, especially its economy, and providing for conditions that allow for growth and development of local markets, this factor was initially viewed as *very important* when defining the propositions. Without a stable political environment, it is difficult to predict or rely on a sustainable long-term growth prospect which FDIs critically depend on.

95% of respondents viewed this factor as either Very Important or Extremely Important, and generally speaking, it was this factor that was considered first and foremost before making investment decisions which makes sense given the high levels of political instability often found in SSA. Although some felt that one could temper risk with the prospects of reward, or high returns, this should generally be done in the context of a relatively consistent, if not stable, socio-political environment. Financial services players involved in more *ad hoc* or shorter time-horizon deals, such as investment and merchant banks, appeared more willing to take on political or country risk if the return appeared appreciable. For other players whose nature of investment is generally of a larger and / or more long-term nature, risk aversion appeared far greater, e.g., for retail banks who generally need to invest in local infrastructure and people in order to provide a required level of service.

Local legislation and regulation were also viewed as key environmental factors to consider before investing in SSA. In particular, respondents (largely from the banking sub-sectors) cited the presence of a strong and predictable central bank as being key to interpreting economic stability in a country, while the effect of local tax and profit repatriation legislation was also mentioned as an important consideration especially when trying to understand impacts on returns to the parent company. A strong, fair and transparent judicial system was also seen as a necessity especially in cases where foreign companies required recourse of action to obtain outstanding payments from customers or in cases where service breaches occurred with local vendors.

4.2.2 Factor 2: Economic Environment / Macro-economic Performance

This factor includes economic conditions such as inflation, interest rates, growth in GDP, wealth distribution as well as macro-economic policies. Concepts of responsible budgeting, balance of payments, inflation management, free enterprise system, debt management, etc., are also included in this factor. From the mean calculated, this factor was interpreted as being *very important* overall.

The cumulative frequency count and the results of the statistical analysis both echo the qualitative feedback from respondents that this factor is viewed as a key investment consideration. Specifically, given the cyclical nature of certain economies, the long-term economic outlook, especially GDP growth, was deemed most important. This was especially important for investors involved in entering or establishing a new market. Related to the ability to read the future economic outlook was the need to also be able to read and manage risk appropriately – fundamental when investing in uncertain markets.

One of the economic variables that were highlighted as relatively key (largely for the banking industry) was that of interest rates. The absolute level of interest rates was not of major concern but rather the *stability* thereof in order to manage risk appropriately. In fact, in many cases, the high interest rate environment and mark-ups of some African countries was cited as a positive feature in terms of higher profit margins and returns.

4.2.3 Factor 3: Exchange Rate Considerations

This includes the local government's policies with regards to exchange rate fluctuations as well as the general exchange rate environment in comparison with that of South Africa. From the mean calculated, this factor was interpreted as being *important* overall.

When operating in developing countries, this factor is usually one that is difficult to predict if local exchange control policies are erratic and hence needs to be well understood especially with regards to future local operations and hedging strategies. Although acknowledged by respondents as an important factor to be considered before investing in a SSA country, this factor was not deemed to be critical unless the country in question was going through a currency crisis or was experiencing intense volatility. Mitigation methods essentially centred around taking hedged positions against the local currency or raising the required capital locally, if an adequate financial infrastructure existed, e.g., local stock exchange. Additionally it was noted that more and more financial transactions in SSA were being conducted in US dollars and hence this was becoming less of an issue. Some respondents simply considered currency risk as part of their required rate of return calculations and hence compensated for it there. Lastly, another major concern with regards to foreign exchange centred on the local foreign exchange control legislation and repatriation policies is that these tended to be an issue with regards to repatriation of profits, dividends, etc., back to the parent company's country. These elements should be carefully understood and considered.

4.2.4 Factor 4: Trade Incentives, Barriers and Agreements

This factor includes government-introduced trade incentives such as favourable corporate tax rates and concessions as well as legislation that may be of a prohibitory nature, e.g., tariff structures, barriers to foreign investor's direct participation in local industry, etc. Regional agreements such as double taxation treaties, bilateral investment treaties, bilateral information sharing arrangements and belonging to regional economic groupings (e.g., the Southern African Development Community (SADC), Southern African Customs Union (SACU)) are also considerations for this factor. From the mean calculated, this factor was interpreted as being *less important* overall.

In theory, local trade incentives can generally increase a firm's competitive edge as well as reduce its overall operating expenses. Reduced trade barriers can also make it easier for firms to enter local markets while a country's regional agreements can greatly facilitate the movement of capital and information across borders. Although these effects do play some role in the financial services realm, respondents felt that in the SSA context, the benefits of trade incentives and agreements were relatively limited, but that trade barriers posed the most issues. Barriers to investment and trade generally seemed to stem from local governments' xenophobic attitudes towards foreign companies and usually manifested themselves in the form of resistance from regulatory bodies and protectionist legislation and regulation such as banking legislation, statutory capital levels, ownership laws and restrictive repatriation policies.

Trade agreements were mentioned as not really having been very beneficial to date largely due to lack of accountability and credibility. It was also noted that an indirect positive consequence of trade agreements was that they tend to facilitate standardisation of business practises but that in many cases, there still is a long way to go in order for these to be truly harmonised.

4.2.5 Factor 5: Infrastructure Considerations

This factor includes both transport infrastructure such as roads, rail, harbours as well as IT and telecommunication infrastructures. The presence of a well-functioning and efficient banking and financial system would also be included in this factor. From the mean calculated, this factor was interpreted as being *very important* overall.

Given the data-rich nature of the financial services industry (e.g., transaction processing, confirmation messaging, necessary compliance and governance structures, etc.) most respondents viewed the presence of a well-functioning IT and telecommunications infrastructure as essential in order to provide their customers with the required services to the appropriate levels of efficiency. In particular, links to headquarters or to a regional hub or base was also deemed as important especially in order to provide support to individual African operations. Additionally, the presence of financial systems that offer functions, such as basic banking, clearing, settlement, etc., are often viewed as a necessary element of a financial services infrastructure. Physical infrastructure was seen as secondary to IT and telecommunications, although having country offices accessible via airlinks was cited as a great benefit in some cases, especially when using expatriates to set up new offices or offer on-site support as required.

4.2.6 Factor 6: Labour Considerations

This factor includes aspects of the local labour supply such as relative wage costs, reliability, productivity, level of skill and even ability to 'upskill' local labour. Local labour laws affecting the ability to 'hire and fire' locals as well as affecting the ability to 'import' foreign skills would also be included. This factor was given an overall interpretation of *important* as it fell close to the average in terms of relative importance of all factors.

When analysing the responses, most respondents' primary concern with regards to local labour was the availability of people with the required skill levels to conduct business efficiently. The required skills were not necessarily expected to be found *in situ*, particularly management skills, and hence the general opinion was that one should expect to train local labour as required. Certainly, the strategy of training local people was viewed as far cheaper and practical than importing the required skills long-term, particularly if the business was expected to grow. Some additional factors in this regard were also the local labour's *ability* to be trained, e.g., some countries such as Uganda have a better schooling system and level of literacy than others which was a consideration. Another key element cited with regards to labour was the local labour laws and the flexibility thereof. Most respondents viewed it as critical to be able to bring foreign skills in and out of the country as required, especially in the initial stages of establishing a presence and in order to train local skills. Ease of obtaining work permits for expatriates was thus seen as key even if only on a temporary basis.

4.2.7 Factor 7: Market Size and Demand Conditions

This factor includes the size and depth of a host country's markets as well as current and potential future growth rates. From the mean calculated, this factor was interpreted as being *very important* overall.

Respondents generally viewed the existence of a 'critical mass' of potential customers as key, i.e., size of market was deemed important in this context. Size alone was not always sufficient and in many cases, given the nature of the financial services industry and its offerings, the number of people above a certain income threshold was more important. For some financial services players, it was sufficient to have only one or two major clients or deals available in order to invest locally, although the degree of investment would be limited. This would particularly be the case for investment and merchant bankers and financial services consultancies that quite often only need to focus on one client for specific deals or projects. *Depth* of market was also fairly important for broader based players, such as retail banks in order to maximise leverage of operations by selling a more diverse range of products but also to more niche players, such as asset managers and life assurers who cater to very specific types of needs and hence require a wider and deeper range of local customers.

Having the required size and depth of markets was all well and good, but many respondents also pointed out that the markets had to exhibit long-term sustainability at a minimum, and ideally future prospects of good growth and profitability, before making investment decisions. Lastly, the presence of local competition was also a factor to be considered when analysing potentially new markets – in some cases if a 10% - 15% market share could not be attained relatively easily the market was viewed as undesirable.

4.2.8 Factor 8: Geographic Proximity

This factor describes the importance of proximity of the foreign market to the domestic base of operations (i.e., South Africa). From the mean calculated, this factor was interpreted as being *less important* overall.

Essentially, most respondents agreed that provided a good telecommunications infrastructure existed between host and home countries, and in some cases if physical accessibility to host markets was good, geographic proximity was not a concern at all and that language and cultural distances were far bigger obstacles. This is valid especially in the case of needing to transport or transmit skills from South Africa to the host country.

4.2.9 Factor 9: Economic Agglomeration

Agglomeration centres usually offer a critical mass and variety of 'value added' services and 'supporting industries'. From the mean calculated, this factor was interpreted as being *less important* overall.

The presence of other existing companies and MNCs also added other benefits in that although certain supporting services could be sourced from elsewhere, local investment knowledge and the presence of local insurers were greatly appreciated, especially in newly developing markets. Additionally, the presence of existing MNCs were viewed as a source of comfort when making investment decisions as the fact that others were succeeding made for good evidence that other successes were possible. Lastly, it was felt that the bigger the mass of MNCs in the country, the greater the pressure that could be exerted on local governments to effect change to more favourable investment conditions and freer market practices which would greatly benefit them in the longer term.

Although the points cited above would be beneficial to financial services firms choosing to invest in SSA, they are generally 'nice to haves' and are not necessarily critical to success when investing.

4.2.10 Factor 10: Cultural Considerations

This includes familiarity with local customs, social and business norms, rituals, religions, language etc. From the mean calculated, this factor was interpreted as being *important* overall.

The culture and value-system of a country and its people dictates to a large degree how a company operates; from how its relationships are forged to how its brand is perceived to how business is conducted in that country and although not as key as some economic factors, it should be carefully considered before entering a new market (see Kirkman *et al*, 2006). This sentiment was essentially echoed by the respondents interviewed as part of this research. The key cultural consideration that was viewed as most important was the language spoken by locals. If different to the home language of the parent company (in this case English), conducting business can prove incredibly difficult as well as resulting in high costs of management control. For this reason, many South African companies only venture into Anglophone countries. Other respondents, however, although acknowledging the difficulty that language barriers present do not view this as a 'deal breaker' and furthermore feel it is a barrier that one needs to overcome in order to be able to chase all opportunities in SSA. This is especially the case when one considers the opportunities that present themselves in francophone West Africa.

Another aspect of culture that is key is the *business culture* of the local populace. According to respondents, this element of culture influences local business characteristics, such as attitude to work, the culture of payment (or lack thereof), maturity of the market and how it handles change and even views with regards to bribery in that in some cultures, it is viewed as a standard means of business conduct. Furthermore, it was mentioned in interviews that it is also important to understand how the value system of the parent company might differ to that of the local employees in a foreign branch in that clashes can result in operational inefficiencies and workplace conflict – a phenomenon that is proving more commonplace as companies expand globally. An element of business culture that quite often cannot be ignored for pure practical reasons is the fact that countries with different business cultures tend to also have different business practices, such as accounting standards, legal systems, etc. This is generally the case, for example, when Anglophone companies move into Francophone countries. The last aspect of culture that also needs to be considered according to interviewees is the social (including superstitious and religious) elements which generally have more of a direct, practical impact on business. This is especially the case for banking in Muslim countries which can only be conducted under certain conditions, as well as life assurers, for example, who need to understand certain local beliefs with regards to issues such as life and death before launching related products.

5 Conclusion

With local South African markets opening up to global players in recent years and fast becoming cramped with competition and more limited in opportunity, many South African financial services firms are looking northwards to develop fresh opportunities in new markets. Despite higher risks, many of these markets show much higher returns and offer an opportunity to broaden revenue bases.

Our results indicate that the following are seen as the most important factors to take into account when investing in SSA:

- Country governance and political risk;
- Market size and demand conditions;
- Infrastructure considerations; and
- Economic environment / macro-economic performance.

The factors highlighted in this research indicate positive changes to the investment environment in SSA – political risk has declined, country governance has improved, major infrastructure development is underway, sound economic policies are being adopted, and the market is growing.

MNCs planning to invest in SSA will usually enjoy capabilities and capital that will place them in good stead in these markets, and hence the chief challenges are contextual related to the environment of business. They are likely to have superior products and services and their success in these markets will thus be related to their ability to translate their traditional recipe into a milieu in which nothing can be assumed and everything is in flux. The political environments change rapidly with the accompanying dramatic swings from conservative to populist type economic policies, where infrastructure deficiencies mean that scaling up is difficult, and where bribery to get things done is often the norm. This means that it cannot be business as usual in SSA for a foreign investor. For example, it may be necessary to put the actual infrastructure in place as part of one's overall investment strategy if the country does not have it in place. Likewise, given the fluid political systems, the importance of relationship building becomes essential. Foreign companies need to anticipate the implications of these environments in transition and their strategies and operations must be kept flexible. It often requires a highly decentralised approach which allows the local management to make decisions rapidly as the situation changes. But as the South African experience into SSA has demonstrated, it can also be highly profitable if companies are willing to learn and adapt.

It is the right time for international business to take a close look at a continent which has had a difficult recent past but where the conditions for growth, development and profits have never looked better. The institutional environment has improved, a major democratic wave is underway and international business is being welcomed. SSA does not provide the risk profile today that it did three decades ago. The principles of good management apply universally and in this respect doing business in SSA may appear to be like doing business elsewhere - with some nuance. However, having said that, it is undoubtable that the business environment (including the social, economic, legal and political environment) is highly complex in SSA because of the continent's unique history, diversity, geography, political and institutional landscape, etc (see Luiz, 2006; and Grobbelaar, 2006). The potentially higher risk in SSA is matched by significantly higher returns and this has seen a recent scramble for quality assets as companies recognise the potential of these large untapped markets. Incomes are rising and soon the large population will translate into significant consumer markets. Business will have to look at SSA sooner or later as markets become saturated elsewhere. Getting in early has advantages in that it allows one to capture market share and establish brand loyalty and distributions chains, etc., before one's competitors and indeed we are seeing great results for many MNCs already doing business in SSA with minimal investments.

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TABLES

Table 1: Foreign Assets of South Africa (1996 – 2005)

(R millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total Overall Direct Investment	114,013	113,170	157,385	203,036	244,653	213,184	189,911	180,507	216,660	232,925
Total Banking FDI % of Total Overall FDI	1,772 1.6%	2,484 2.2%	6,538 4.2%	8,543 4.2%	14,277 5.8%	7,284 3.4%	3,411 1.8%	3,758 2.1%	2,818 1.3%	1,173 0.5%
Total African FDI % of Total Overall FDI	4,659 4.1%	6,374 5.6%	9,117 5.8%	9,971 4.9%	12,265 5.0%	14,031 6.6%	14,234 7.5%	15,837 8.8%	23,601 10.9%	19,083 8.2%
Total African Banking FDI % of Total African FDI	217 4.7%	358 5.6%	121 1.3%	323 3.2%	1,051 8.6%	3,211 22.9%	2,705 19.0%	1,993 12.6%	1,280 5.4%	656 3.5%
African Banking Equity Capital	N/A	N/A	N/A	323	705	1,343	1,299	1,362	896	401
African Banking Reinvested Earnings	N/A	N/A	N/A	0	346	1,868	1,406	631	384	255

Source: SARB, 2006, 2007

Table 2: Respondents' Preferred Methods of Entry into SSA

Entry Method	Frequency Count	Frequency %
Merger & Acquisition	6	17%
Joint Venture – Majority Stakeholder	11	31%
Joint Venture – Minority Stakeholder (<50%)	4	11%
Alliance	2	6%
New Investment ("Greenfield")	11	31%
Other: e.g. Piecemeal / once-off etc.	1	3%
Total	*35*	*100%*

Table 3: Respondents' Reasons for Entry into SSA

Reasons for Entry	Frequency Count	Frequency %
Market seeking (subtotal)	***48***	***68%***
Market growth	14	20%
Profit growth	12	17%
Closeness to local customer base and needs	9	13%
Share / defence of market e.g. following / responding to competitors	3	4%
Following related industries e.g. mining, oil etc.	2	3%
Saturation of / hyper-competitive local markets	8	11%
Efficiency seeking (subtotal)	***1***	***1%***
Improved productivity	1	1%
Local incentives e.g. tax, reduced admin etc.	0	0%
Resource seeking (subtotal)	***2***	***3%***
Cheaper labour	0	0
Source of skills	0	0
Source of Capital	2	3%
Strategic (subtotal)	***18***	***25%***
Diversification of risk through the creation of a portfolio of operations	6	8%
Socio-political motives e.g. to establish agreements, to win favour with local governments, NEPAD initiatives / development of SSA	6	8%
To create local alliances to assist future growth	6	8%
Other (subtotal)	***2***	***4%***
Historically following established trade routes (colonial)	1	2%
Strengthening of "Africa" Brand	1	2%
Grand Total	*71*	*100%*

Table 4: Importance of investment factors based upon frequency of responses

1. Country Governance and Political Risk	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	0	1	5	14	20
Frequency %	0%	0%	5%	25%	70%	100%
Mean (□)	1.21	t = 7.2896				
Importance	Significantly above the average (0)		**Interpretation: Very Important**			
2. Economic Environment / Macro-economic Performance	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	0	5	10	5	20
Frequency %	0%	0%	25%	50%	25%	100%
Mean (□)	0.40	t = 3.0452				
Importance	Significantly above the average (0)		**Interpretation: Very Important**			
3. Exchange Rate Considerations	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	2	3	9	3	3	20
Frequency %	10%	15%	45%	15%	15%	100%
Mean (□)	-0.28	t = -1.3288				
Importance	Not significantly different from the average (0)		**Interpretation: Important**			
4. Trade Incentives, Barriers and Agreements	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	2	6	9	3	0	20
Frequency %	10%	30%	45%	15%	0%	100%
Mean (□)	-0.66	t = -4.6597				
Importance	Significantly below the average (0)		**Interpretation: Less Important**			
5. Infrastructure Considerations	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	1	6	5	8	20
Frequency %	0%	5%	30%	25%	40%	100%
Mean (□)	0.49	t = 2.3250				
Importance	Significantly above the average (0)		**Interpretation: Very Important**			
6. Labour Considerations	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	2	5	10	3	20
Frequency %	0%	10%	25%	50%	15%	100%
Mean (□)	0.16	t = 1.0721				
Importance	Not significantly different from the average (0)		**Interpretation: Important**			
7. Market Size and Demand Conditions	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	0	4	9	7	20
Frequency %	0%	0%	20%	45%	35%	100%
Mean (□)	0.55	t = 3.7885				

Importance	Significantly above the average (0)		**Interpretation: Very Important**			
8. Geographic Proximity	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	7	9	2	2	0	20
Frequency %	35%	45%	10%	10%	0%	100%
Mean (□)	-1.21	t = -6.7563				
Importance	Significantly below the average (0)		**Interpretation: Less Important**			
9. Economic Agglomeration	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	0	6	9	5	0	20
Frequency %	0%	30%	45%	25%	0%	100%
Mean (□)	-0.45	t = -3.5676				
Importance	Significantly below the average (0)		**Interpretation: Less Important**			
10. Cultural Considerations	Not Important	Less Important	Important	Very Important	Extremely Important	
Rating	1	2	3	4	5	Total
Frequency Count	2	3	6	9	0	20
Frequency %	10%	15%	30%	45%	0%	100%
Mean (□)	-0.24	t = -1.2973				
Importance	Not significantly different from the average (0)		**Interpretation: Important**			