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Factors influencing foreign direct investment of South African financial services firms in Sub-Saharan Africa☆

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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 before investing 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.

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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. While 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, 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 clearly has economic hegemony on the continent and is increasingly seen as the launch platform for investment in Africa. For example, the 53 African countries had a combined 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) (Luiz, 2006). The purpose of this research is to determine what factors influence 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

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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	2,484	6,538	8,543	14,277	7,284	3,411	3,758	2,818	1,173
	1.6%	2.2%	4.2%	4.2%	5.8%	3.4%	1.8%	2.1%	1.3%	0.5%
Total African FDI % of Total Overall FDI	4,659	6,374	9,117	9,971	12,265	14,031	14,234	15,837	23,601	19,083
	4.1%	5.6%	5.8%	4.9%	5.0%	6.6%	7.5%	8.8%	10.9%	8.2%
Total African Banking FDI % of Total African FDI	217	358	121	323	1,051	3,211	2,705	1,993	1,280	656
	4.7%	5.6%	1.3%	3.2%	8.6%	22.9%	19.0%	12.6%	5.4%	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).

motivations behind these foreign investments are. The paper begins with an overview of the importance of 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. Foreign direct investment 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 growing 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 reaching $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 that interest still exists in Africa as an investment destination, particularly for primary sector industries, where mining, quarrying and petroleum make up 60% of investments and agriculture 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 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 1996–2005. 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, with investment in Africa having increased by more than five fold from 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 as a result of some major acquisitions undertaken at the time. Although this fell subsequently, indications are that the figures for 2006 will once again reflect record highs (official statistics for this will only be available in late 2008).[1] Overall, South Africa is one of the largest

[1] The volatility of these figures represents the lumpiness of acquisitions and major investments by South African banks into SSA. Years in which there were large acquisitions would inflate the figures while years of more organic growth in those African markets would deflate the numbers.

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