



## The Western Cape's Inward Foreign Direct Investment Plan

28 February 2021

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## Executive summary

Inward Foreign Direct Investment (FDI) contributes positively to the Western Cape's economy. Apart from the infusion of capital, inward FDI also provide access to global markets, talent and technology. In order to be able to reap the full benefit of inward FDI, the province's inward FDI plan must be values-led. This document identifies the Western Cape's strength in attracting FDI and highlights the key sectors and markets that should be the focus in the efforts to maximise the province's inward FDI flows.

The province is an ideal location for inward investment because of its well-established infrastructure network; vibrant Central Business District in Cape Town; good governance; top universities providing high-quality education to learners; booming financial, tourism and Business Process Outsourcing (BPO) sectors; world-class international airport and well-functioning container port, both of which facilitate international trade.

Over the past two decades, the Western Cape has attracted a total of 434 FDI projects that have brought about a capital infusion of R157.25 billion and resulted in the creation of 31 371 jobs (FDI Intelligence, 2021). More than 80% of inward FDI projects and capital expenditure into the Western Cape during the same period came from Western Europe and North America, with the United Kingdom and the United States being the top two countries investing in the province. Over 90% of these projects are 'greenfield'. The Western Cape attracted the second highest number of inward FDI projects among the nine provinces of South Africa between 2003 and 2020, with Cape Town and Stellenbosch ranked in the top 20 South African cities for inward FDI projects. In 2019, inward FDI accounted for about 39% of the Western Cape's Gross Value Added (GVA) and 0.1% of employment in the formal sector.

According to Dunning and Lundan (2008) investors decisions to choose a particular investment location are driven by four main factors, namely, to access domestic markets; to take advantage of natural resources, to seek enhanced production efficiencies, and to acquire strategic assets. For nearly two decades, inward investors have primarily sought domestic market growth when investing in the Western Cape. The top three factors that drive inward investors to invest in the province are domestic market growth; proximity to markets or customers; and regulatory environment. Going forward, efforts should be concentrated on making the province an attractive destination to market-seeking investors and also target resource-seeking investors in opportunity sectors such as food and beverages and renewable energy, as well as investors seeking access to skills.

The province must target key services sub-sectors such as business services; software and IT services; financial services; and communications, as well as sectors like renewal energy; transportation and warehousing; and coal, oil and gas. This is because these sectors have historically been the top performers in bringing inward FDI projects into the province. Furthermore, while Western Europe and North America continue to be important markets for the province, measures should be put in place to increase the share of FDI inflows from other markets.

## 1. Introduction

Inward foreign direct investment (FDI) is important to the growth and development of the Western Cape's economy. The benefits of FDI to the local economy include technology transfer, export diversification and increased access to foreign markets (Kusek and Silva, 2018).

The COVID-19 pandemic has negatively affected multinational enterprises (MNEs), and is likely to have a major impact on inward FDI globally. The economic shock of the pandemic is emanating from channels such as falling demand, rising uncertainty and disrupted supply chains. UNCTAD (2020) estimates up to a 40 percent decline in global FDI over the 2020-21 period. This trend is likely to intensify the competition among countries when it comes to attracting FDI. The Western Cape should, therefore, aim to improve its competitiveness and take policy actions to rebuild investor confidence. FDI will play a key role in the post-COVID recovery phase as an important source of capital.

The Western Cape is an open economy that prides itself as a prime tourism destination. Inward FDI contributes positively to the province's economy. Apart from the infusion of capital, inward FDI also provides access to global markets, talent and technology.

This plan seeks to identify the Western Cape's strengths in attracting FDI and highlights the key sectors and markets that should be the focus in efforts to maximise the province's inward FDI flows. It outlines the approach that the province can adopt to maximise its FDI inflows and make it a leading destination for inward investment.

## 2. The importance of inward investment to the Western Cape

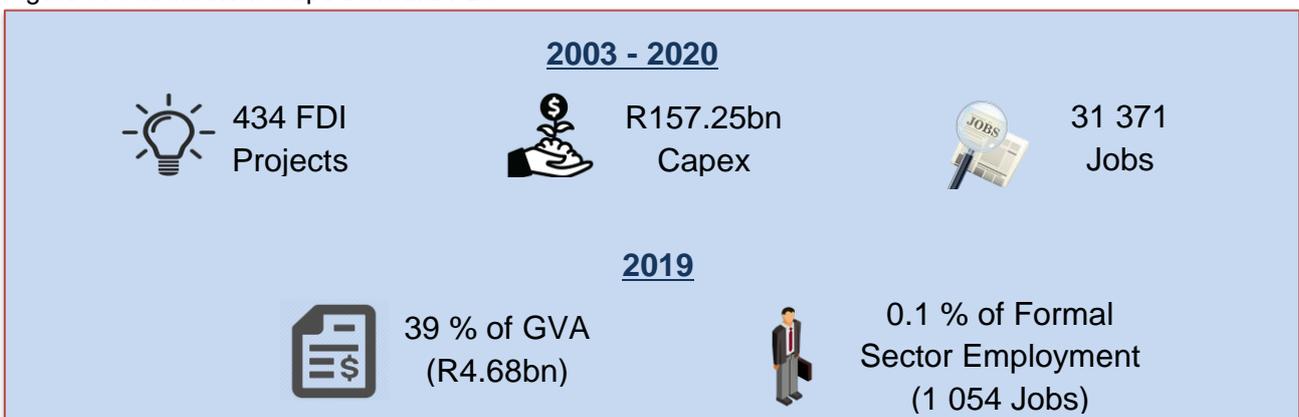
A country or region can benefit from inward FDI through the creation of decent jobs, increased productivity and expansion in research and development. This document throws more light on how the Western Cape can maximise the benefits that come with inward FDI. Inward FDI can either be in the form of a foreign establishment starting a new venture in the Western Cape (greenfield) or a foreign firm merging with or acquiring an existing local firm (brownfield).

### 2.1 The impact of inward FDI on the economy

FDI can contribute to increased productivity for firms, employment creation and poverty alleviation. Greenfield FDI can contribute to the development of the local economy through enhanced competition, the introduction of advanced technology and management practices, increased demand for local products, and exports growth (UNCTAD 2013 and World Bank 2020).

The Western Cape recorded a total of 434 FDI projects between 2003 and 2020. These projects brought about a capital infusion of R157.25 billion and culminated in the creation of 31 371 jobs. In 2019, inward FDI accounted for about 39% of the Western Cape's Gross Value Added (GVA) and 0.1% of employment in the formal sector.

Figure 1: The western Cape's inward FDI

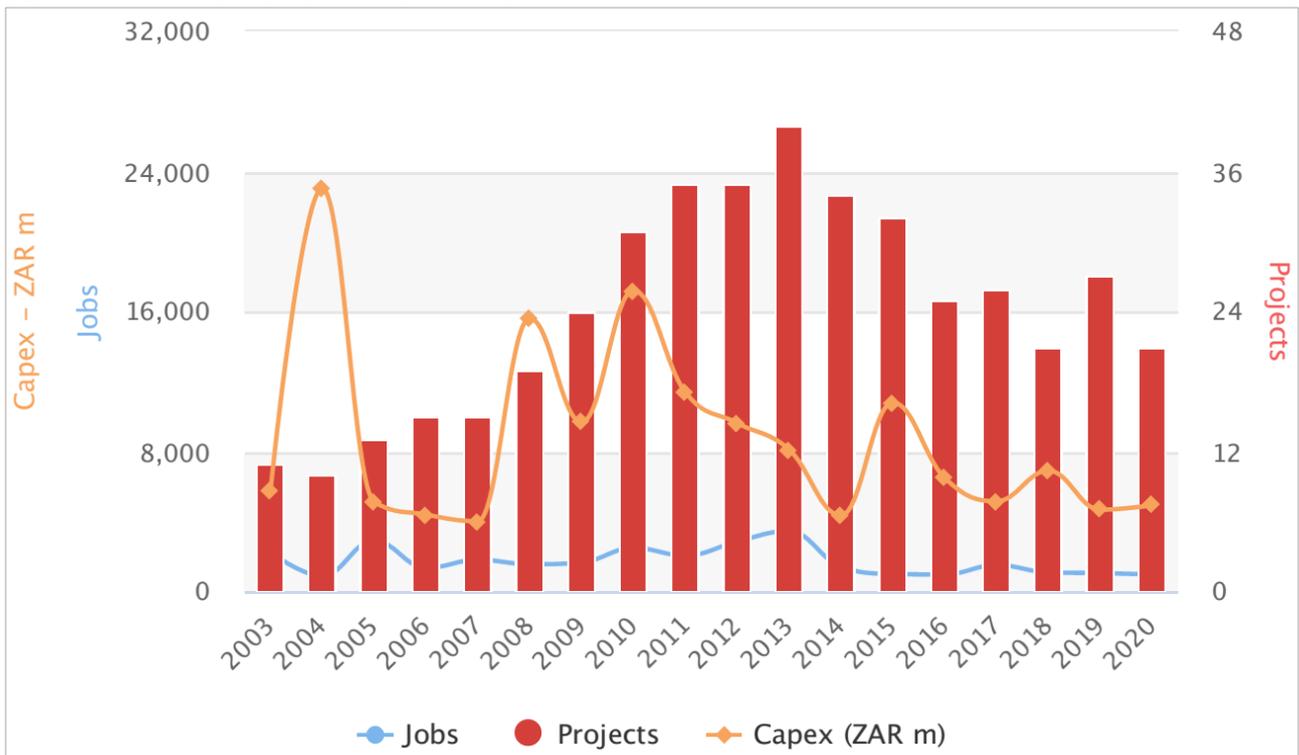


Source: FDI Intelligence (2021), Quantec (2021)

## 2.2 The Western Cape's performance in attracting inward FDI

Many countries, regions and cities have dedicated agencies tasked with the responsibility of attracting investment opportunities. Wesgro performs such a function for the Western Cape and the City of Cape Town. Over the last 18 years, the Western Cape has secured the second highest number of inward FDI projects among the nine provinces of South Africa. Cape Town and Stellenbosch rank in the top 20 South African cities for inward FDI projects, attracting 393 and 10 projects respectively between 2003 and 2020. As shown in Figure 2, the largest capital investment for the Western Cape (an amount of R 23.02 billion) was recorded in 2004 whereas the most jobs created in a single year as a result of inward FDI was 2 917 in 2005. Likewise, the highest number of FDI projects into the Western Cape (40 projects) was recorded in 2013.

Figure 2: Summary of projects, capex and jobs, 2003 - 2020



Source: FDI Intelligence, 2021

Nine out of ten inward FDI projects attracted into the Western Cape between 2003 and 2020 were greenfield FDI projects. Greenfield FDI also accounted for approximately 93% of total capex and 84% of total jobs created over the same period.

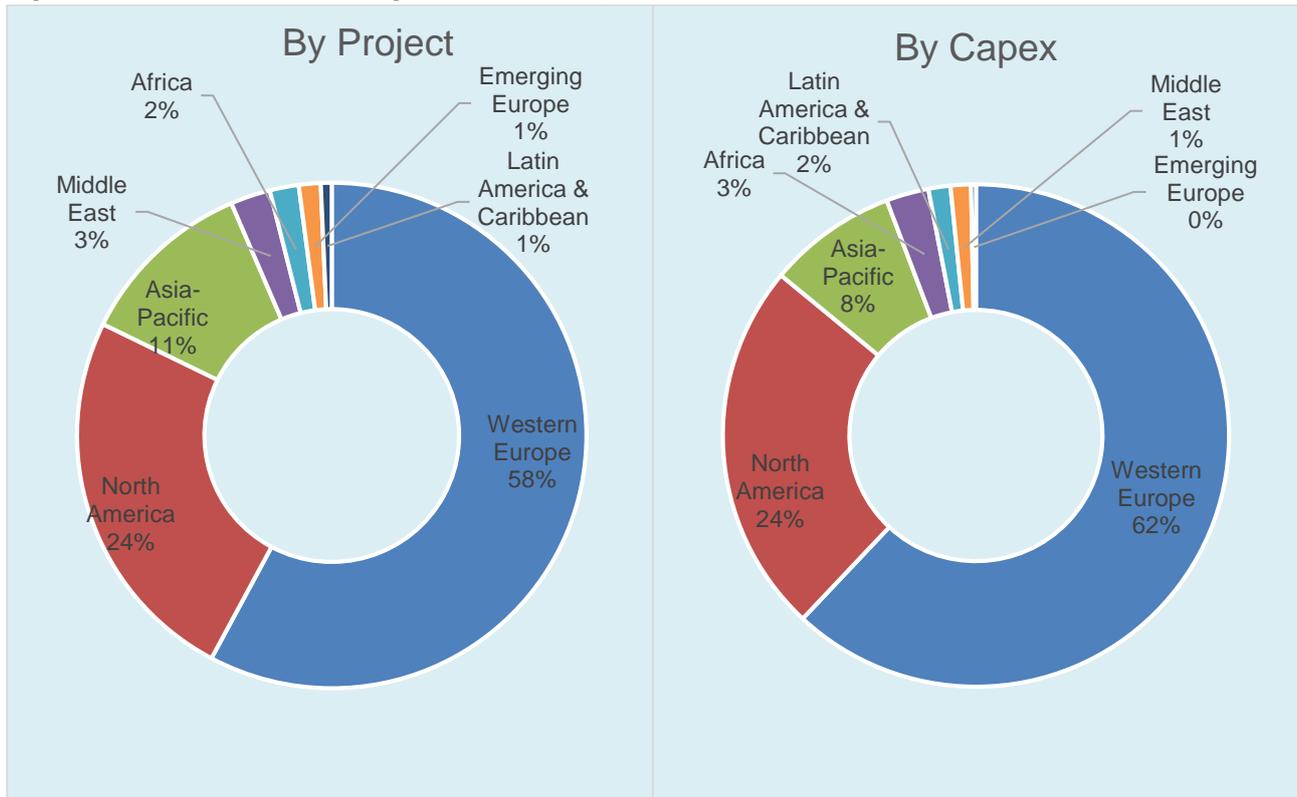
Table 1: Type of FDI project, 2003-2020

Project type	Number of Projects	% of Total Projects	Capex (R Billion)	% of Total Capex	Jobs created	% of Total Jobs Created
New	393	90.6%	145.98	92.8%	26 464	84.4%
Expansion	37	8.5%	10.61	6.7%	4 687	14.9%
Co-location	4	0.9%	0.66	0.4%	220	0.7%
<b>Total</b>	<b>434</b>	<b>100%</b>	<b>157.25</b>	<b>100%</b>	<b>31 371</b>	<b>100%</b>

Source: FDI Intelligence, 2021

More than four-fifths of inward FDI projects and capex into the Western Cape over the past two decades originate from Western Europe and North America. As shown in Figure 3, Western Europe accounted for 58% of FDI projects and 62% of capex into the Western Cape during the 2003-2020 period. On the other hand, only 2% of FDI projects and 3% of capex came from Africa over the same period.

Figure 3: FDI inflows from the regions of the world, 2003-2020



Source: FDI Intelligence, 2021

Table 2: The top 20 countries investing in the Western Cape, 2003-2020

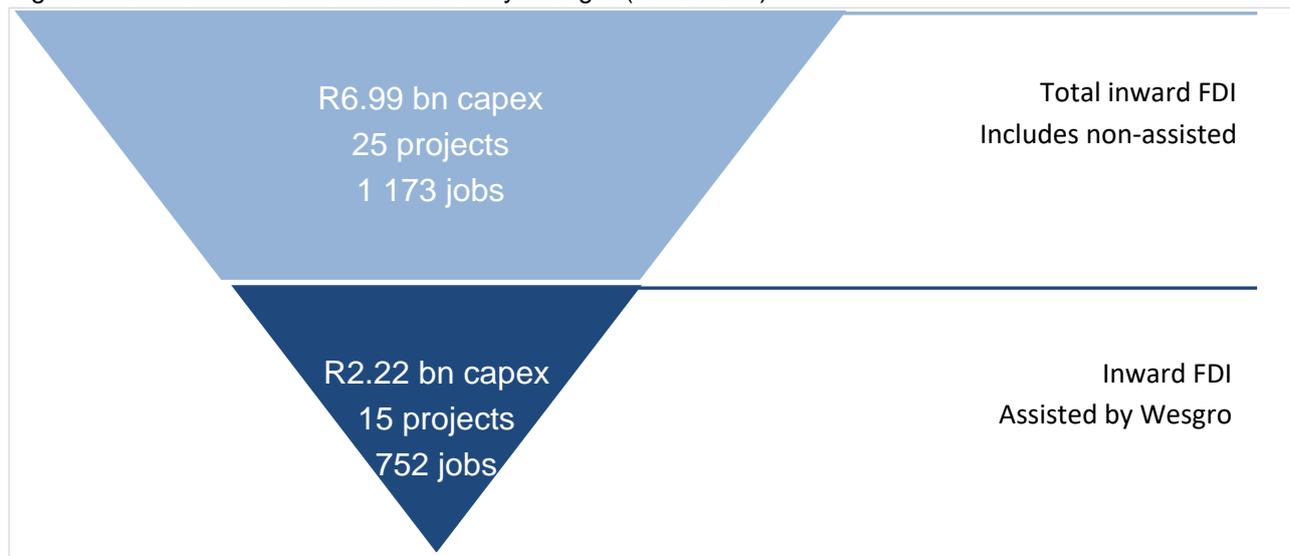
By Project				By Capex			
Rank	Source Country	Projects	Percentage	Rank	Source Country	Capex (R Billion)	Percentage
1	United Kingdom	108	24.88%	1	United States	35.17	22.37%
2	United States	99	22.81%	2	United Kingdom	24.65	15.68%
3	Germany	33	7.60%	3	Norway	20.25	12.88%
4	Netherlands	22	5.07%	4	Germany	11.57	7.36%
5	China	19	4.38%	5	France	10.53	6.69%
6	France	19	4.38%	6	Italy	8.00	5.09%
7	Switzerland	18	4.15%	7	Netherlands	6.41	4.08%
8	Italy	11	2.53%	8	Ireland	6.22	3.96%
9	Ireland	9	2.07%	9	China	3.91	2.49%
10	Denmark	8	1.84%	10	Spain	3.78	2.41%
11	India	8	1.84%	11	Japan	2.83	1.80%
12	Spain	8	1.84%	12	Canada	2.58	1.64%
13	UAE	8	1.84%	13	Switzerland	2.52	1.60%
14	Canada	7	1.61%	14	India	2.27	1.44%
15	Australia	6	1.38%	15	Belgium	1.98	1.26%
16	Russia	5	1.15%	16	UAE	1.89	1.20%
17	Japan	4	0.92%	17	Botswana	1.32	0.84%
18	Norway	4	0.92%	18	Australia	1.04	0.66%
19	Belgium	3	0.69%	19	Denmark	0.95	0.60%
20	Hong Kong	3	0.69%	20	Hong Kong	0.73	0.46%
	Countries 21 to 44	32	7.37%		Countries 21 to 44	9.13	5.81%
	<b>Total</b>	<b>434</b>	<b>100%</b>		<b>Total</b>	<b>157.25</b>	<b>100%</b>

Source: FDI Intelligence, 2021

Table 2 contains the top 20 source countries for inward FDI into the Western Cape. While the list is dominated by European countries with the United Kingdom (UK) being the top source of inward investment into the Western Cape, the United States (US) was also a key player as the second largest investor into the province over this time.

As Figure 4 shows, 60% of the 25 FDI projects that were secured in 2018/2019 period were facilitated by Wesgro. Moreover, 752 of the 1 173 jobs created through inward FDI and over one third of total capex during the 2018/2019 period came from the projects that were assisted by Wesgro. This emphasises the importance of public sector involvement in attracting FDI.

Figure 4: Share of investment facilitated by Wesgro (2018/2019)



Source: FDI Intelligence (2021), Wesgro (2020)

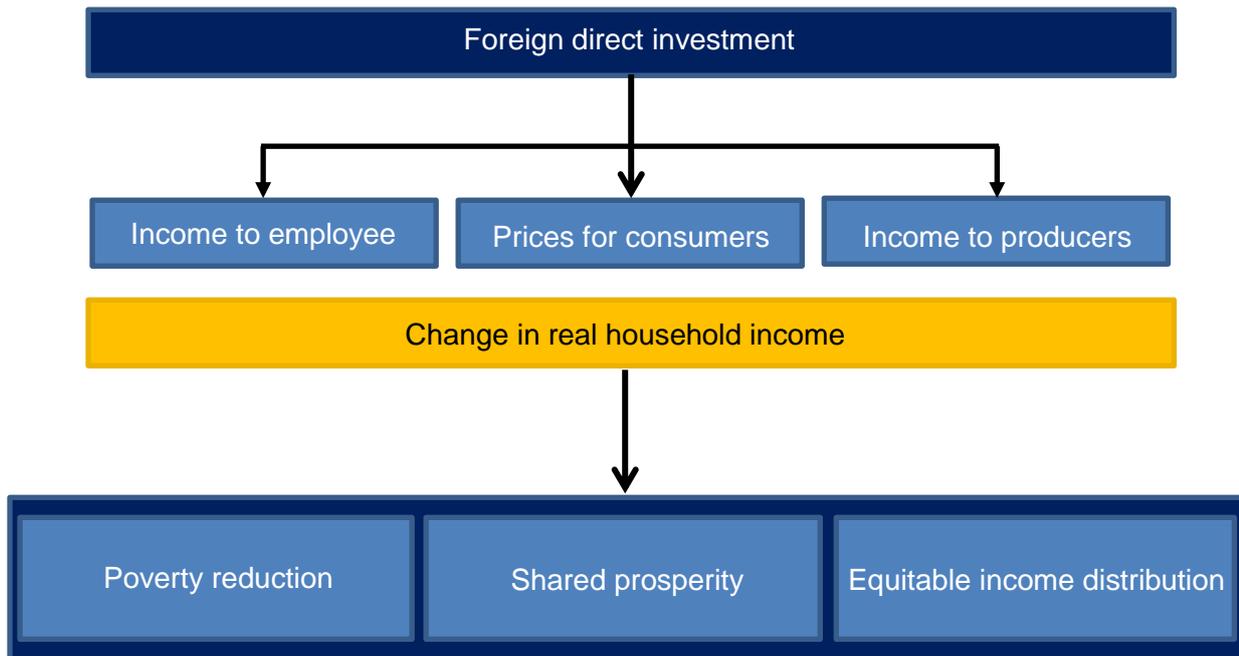
### 2.3 The benefits of inward FDI

Capital infusion and the creation of decent jobs are among the direct benefits of inward FDI, whereas enhanced productivity and increased competition constitute some of the indirect impacts of inward FDI. Greenfield FDI can enhance economic welfare through employment income, consumer prices and producer income (World Bank 2020) as shown in the Figure 5 below.

- *Employment income*: FDI inflows can bring about higher household incomes in a sector through increased labour demand and productivity.
- *Consumer prices*: As new foreign firms enter the domestic market, it leads to increased competition, which may enhance consumer welfare through lower prices and consumption possibilities.
- *Producer income*: The competition that new foreign firms bring to the domestic market may help to improve the productivity and profitability of domestic firms.

Even though greenfield FDI can help create new jobs that pay higher wages and ultimately lead to poverty reduction, it can also contribute to income inequality between higher-skilled and lower-skilled workers.

Figure 5: The impact of FDI



Source: World Bank (2020)

As indicated in Figure 6, inward FDI, exports, productivity and innovation are positively related. The presence of foreign investors in the province can increase competition and spur innovation. Innovation, in turn, will increase output and drive exports while the increase in trading activities can make the local economy more attractive to inward investors. Moreover, Western Cape businesses which engage with inward investors can enhance their productivity through technology and knowledge transfer.

Figure 6: The linkage between inward investment, innovation, productivity and exports



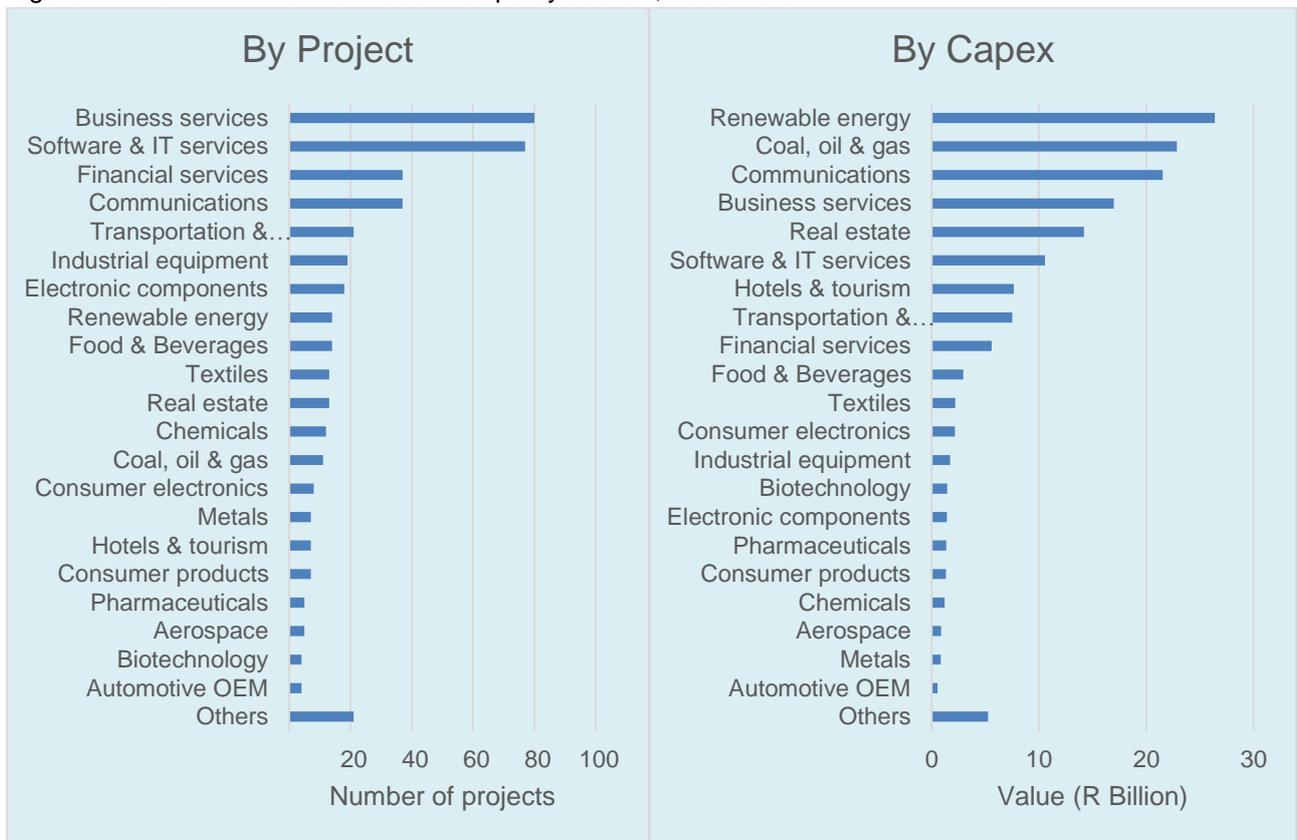
Source: Scottish Government, 2020

## 2.4 Building on our success

The Western Cape is one of South Africa's most attractive destinations for inward FDI, second only to Gauteng. The province already attracts a sizeable number of FDI projects within the business services sector as well as the software and IT services sector as shown in Figure 7. Furthermore, the three highest ranked sectors, in

terms of capex, are renewable energy; coal, oil and gas; and communications. It is imperative that the province continues to attract investment that is linked to its broad macroeconomic goals.

Figure 7: Inward FDI into the Western Cape by sectors, 2003-2020



Source: FDI Intelligence, 2021

### 3. Attracting inward investors into the Western Cape

This section throws more light on the factors that are important to investors. An understanding of what motivates the decisions of inward investors is essential for the Western Cape to be able to attract and retain FDI projects.

#### 3.1 Factors that influence the decision of inward investors

FDI decisions are influenced by factors such as administrative procedures, incentives, and FDI regulations (Kusek and Silva, 2018). Dunning and Lundan (2008) proposed a framework which suggests that multinational corporations' (MNCs) decision to move to a particular location is motivated by the following: access domestic markets, take advantage of natural resources, seek enhanced production efficiencies, and acquire strategic assets.

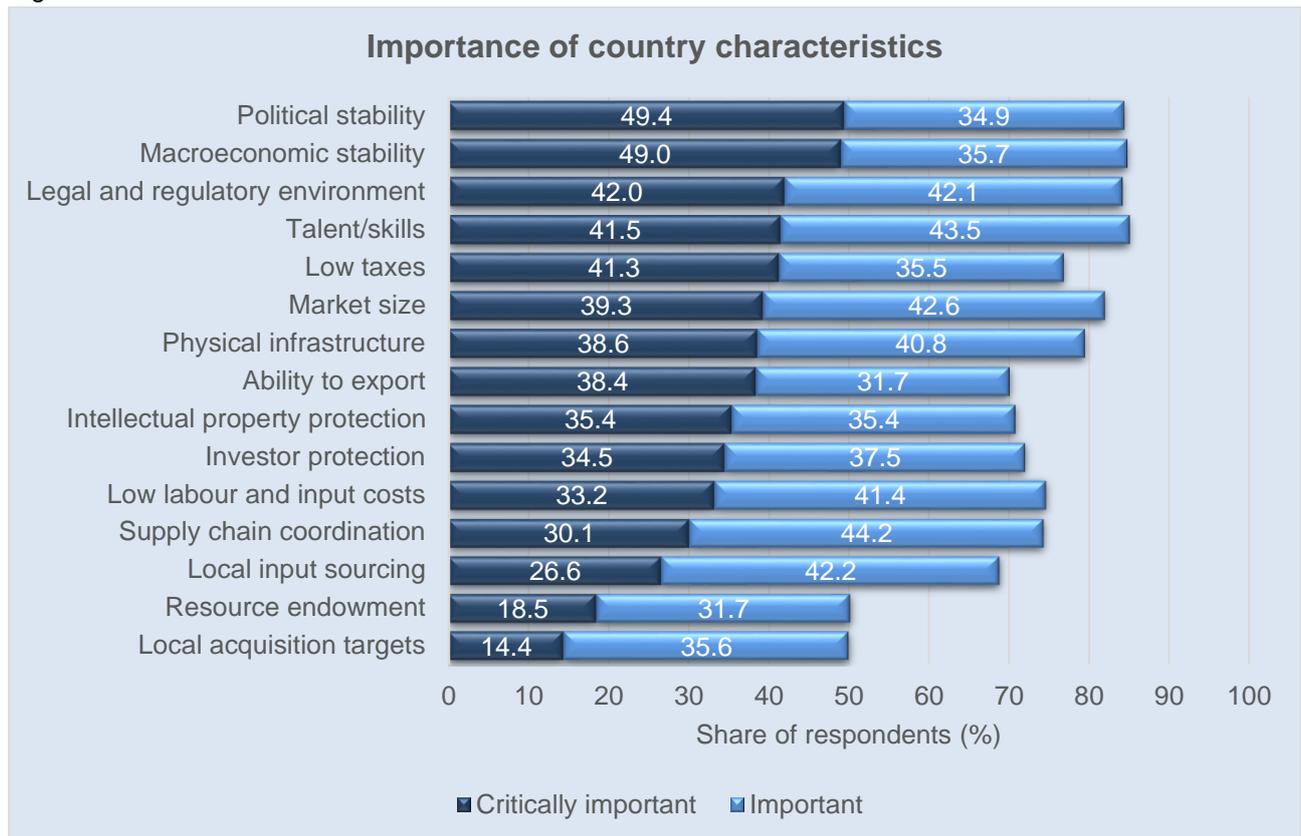
When it comes to making the decision to invest, different investors take into account different factors based on what motivates their investment decisions. Dunning and Lundan (2008) stipulate that MNCs that are involved in the extractive industry are concerned about access to natural resources, whereas those that seek strategic assets tend to focus on technologies and brands that can boost their operations. Market-seeking FDI assign relative importance to market share, whereas efficiency-seeking FDI prioritises lower production cost and values policies that facilitate international trade.

Investment decisions, in some case, are motivated by a combination of factors, and an understanding of the drivers of these decisions can pave the way for increasing a region's FDI inflows. The Western Cape should endeavour to make the province an attractive destination to investors seeking access to the South African market as well as the markets in Southern Africa and the continent as a whole. The province can also target resource-seeking investors in the sectors such as food and beverages and renewable energy, as well as

investors seeking access to skills. Unlike efficiency-seeking investment that is prone to relocation when investors find other lower cost destinations, resource-seeking investment can be more long-term in nature.

The Global Investment Competitive (GIC) survey (2017) reveals that most investors are market-seeking (Kusek and Silva, 2018). According to Kusek and Silva (2018) MNCs involved in efficiency-seeking FDI are more sensitive to the host country's market characteristics such as macroeconomic stability and favourable exchange rate. These investors are also more responsive to policies and reforms that bring an enhancement to the business environment. As shown in Figure 8, political stability, macroeconomic stability, and legal and regulatory environment are the top three factors that investors consider as critically important when making FDI decisions.

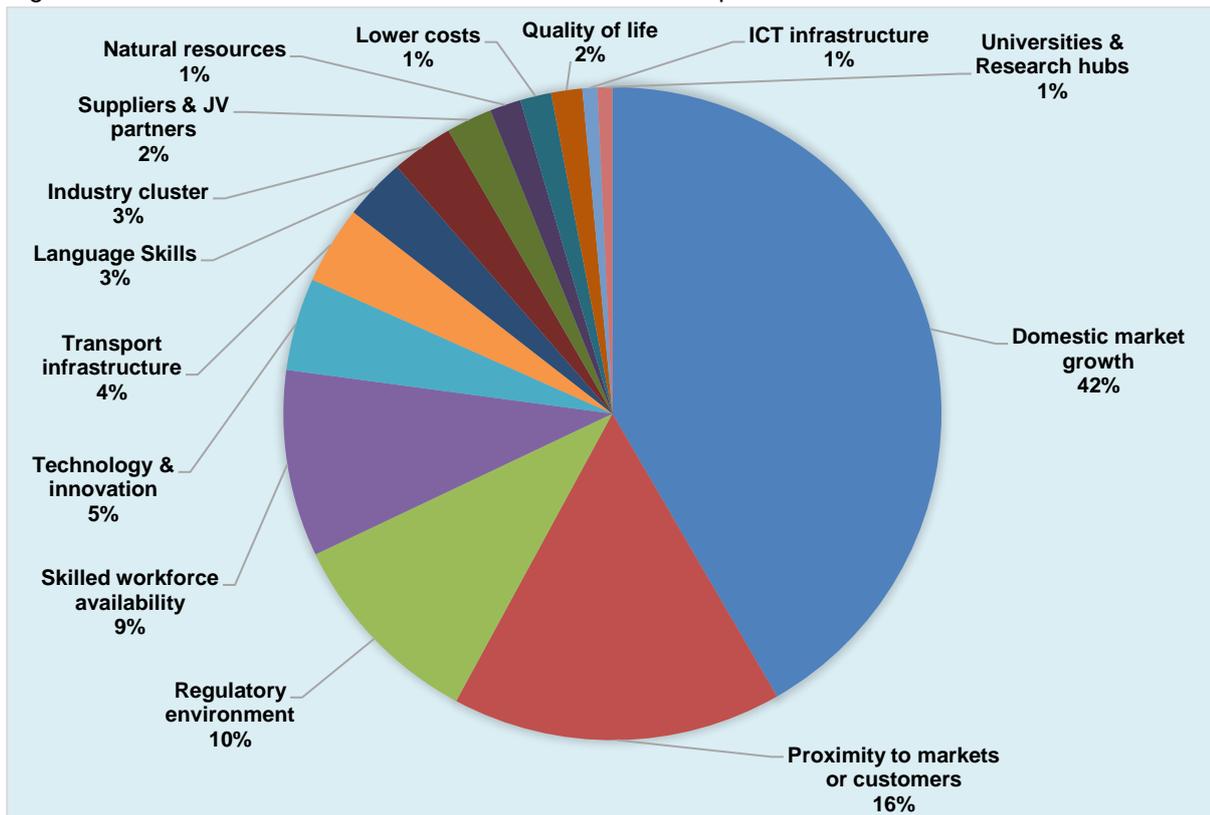
Figure 8: The motivations of inward investors



Source: World Bank 2020 (based on 2019 GIC survey)

Figure 9 shows the motives behind inward investors' decisions to invest in the Western Cape. For nearly two decades, inward investors have primarily sought domestic market growth when investing in the Western Cape. The top three factors that influence the decisions of inward investors to invest in the Western Cape are domestic market growth; proximity to markets or customers; and regulatory environment.

Figure 9: The motives of inward investors in the Western Cape



Source: FDI Intelligence, 2021

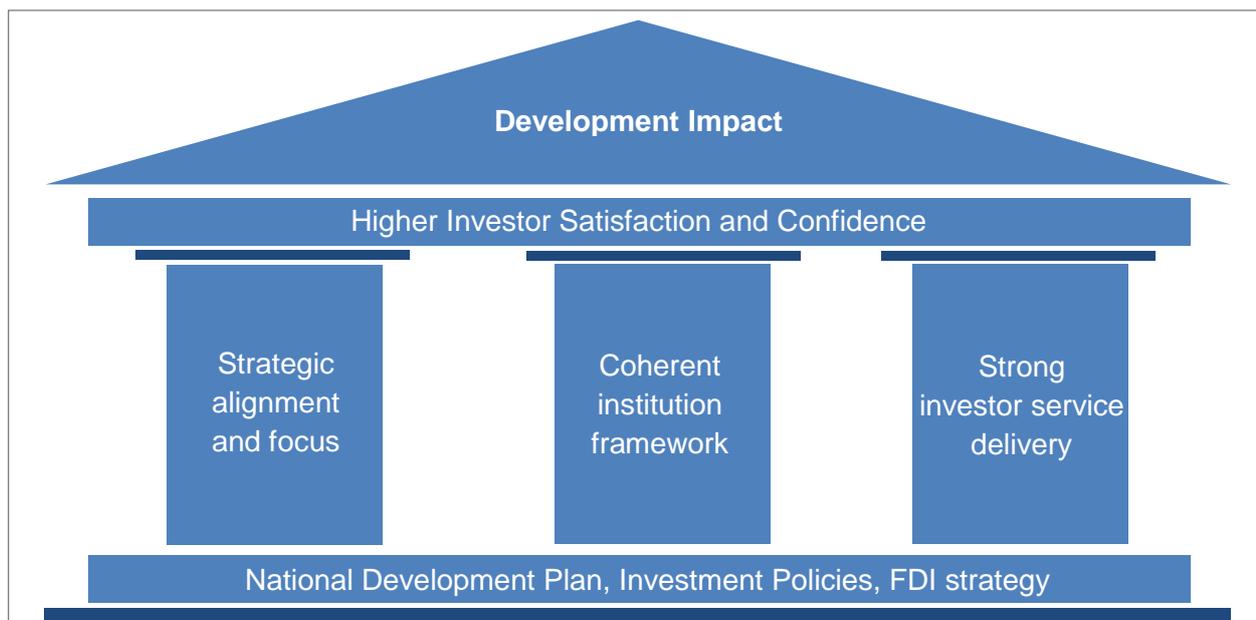
### 3.2 The role of government

When deciding on future locations to invest, MNEs rely on government for policy support in areas such as infrastructure, business environment, skills of the workforce and quality of life (Scottish Government, 2020). The 2019 GIC survey identified cumbersome investment processes, operational restrictions, and restrictions on prices, products, or technology as some of the barriers to FDI flows. The Western Cape government should endeavour to create the right policy environment which seeks to reduce risk for investors and promote investor confidence. Unclear and unpredictable policy making decreases investor confidence. Investors consider a country's legal and regulatory framework when making investment decisions. According to the World Bank (2020), countries with lower regulatory risk have higher FDI inflows. Evidence from the 2019 GIC survey suggests that policy uncertainty has an adverse impact on investment decisions.

The Western Cape government must be committed to creating an FDI environment that is open and predictable in order to reduce investor risks. Political and macroeconomic stability is central to improving investor confidence. Furthermore, strong institutions that help to improve transparency and remove avenues for bureaucratic discretion can have a positive impact on FDI inflows.

Wesgro, as an investment promotion agency (IPA), has a critical role to play in the Western Cape's government efforts to strengthen the province's investment competitiveness and increase FDI inflows. For IPAs to be able to have a maximum impact on development, they must have a strategic alignment and focus, have a coherent institutional framework in place, and enhance their delivery of investor service as outlined in Figure 10 (World Bank, 2020).

Figure 10: Core elements for enhancing the development impact of IPAs



Source: World Bank, 2020

### 3.3 The Western Cape's strengths

Attracting inward FDI is becoming increasingly competitive. Therefore, the province needs to leverage its strengths to remain attractive to investors. The Western Cape serves as an ideal hub for businesses due to its pool of energetic talents and a track record of good governance that has helped to produce a stable business environment. The 2019 GIC survey identified the availability of talent/skills as the fourth most critically important country characteristics that attract inward investors to a particular location. The Western Cape has some of the best tertiary institutions in Africa, the University of Cape Town being the top-ranked university on the continent. These academic institutions provide high-quality education to learners, ensuring an adequate supply of relevant skills.

The province is also an ideal location for inward investment because of its well-established infrastructure network; vibrant Central Business District in Cape Town; and growing financial, tourism and Business Process Outsourcing (BPO) sectors. Furthermore, the province has a world-class international airport and a well-functioning container port, both of which facilitate international trade.

## 4. Setting the direction for inward FDI

The Western Cape is an inclusive region with fairly developed institutions which promote a better quality of life for residents. It is vital to design a values-led proposition for attracting inward FDI into the province. Innovation, high productivity, sustainable and inclusive economic growth and creation of decent jobs should be incorporated into the inward investment promotion plan for the province.

### 4.1 Focusing on key sectors and markets

The province must target key services sub-sectors such as business services; software and IT services; financial services; and communications. This is because apart from the services sector being the main driver of economic growth and development, these sub-sectors have been the top performers in bringing inward FDI projects into the province. Other priority sectors for the province based on past records in attracting inward FDI are renewable energy; transportation and warehousing; and coal, oil and gas.

Over the past two decades, Western Europe and North America have been the two main source regions for inward FDI into the Western Cape, with the UK and the US being the top two countries. While continuing to depend on these top markets for inward FDI, the province must target other markets, for instance the African market given the fact that the coming into effect of the African Continental Free Trade Area (AfCFTA) could open up new opportunities on the continent.

Overall, the focus should not just be centred on new projects, the amount of capital investment and direct jobs. Attention should also be given to the wider economic impact which includes the indirect benefits that accompany inward FDI projects.

#### **4.2 Supporting inward FDI projects and enabling the ecosystem through policies**

The right set of policies is needed in order for a host country to maximise the gains from inward FDI. The GIC survey contains information which can assist policy makers in designing investor-centred reforms. This survey identifies the most valued variables by investors, and provides practical guidance to policy makers on areas they should focus on to attract and retain FDI.

Policy uncertainty can adversely affect FDI flows, and consequently threaten short-term growth. Government should, therefore, take active steps to curtail the risk that policy uncertainty poses. The 2019 GIC survey outlines the following as policy priorities (World Bank, 2020):

- Make renewed commitments to global and regional trade systems.
- Promote political stability, ensure good governance, and strengthen institutions.
- Optimise macroeconomic policy.
- Enhance the legal and regulatory framework to provide support for FDI growth.

#### **5. Conclusion**

Inward investment is important to the economy of the Western Cape. It makes a positive contribution to the local economy through capital infusion and job creation. However, inward FDI is not just about capital infusion and direct jobs, it comes with other spillover benefits such as increased competition and knowledge transfer. Government can support inward investors by putting measures in place to ensure the availability of skilled workforce, an enabling business environment, adequate infrastructure and quality of life.

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