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An Analysis of the Business Services Sector in the Western Cape

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Abstract

The aim of this paper is to analyse the business services sector in the Western Cape, particularly the sector's contribution to output, employment and investment. The province's business services sector accounts for more than one-fifth of total gross value added. The sector experienced an average growth rate of 3.50% per annum between 1994 and 2023. Moreover, employment in the sector increased by 3.04% annually over the same period. The empirical results from the ordinary least squares regression show that a one percentage point increase in business services increases output growth by approximately 0.33 percentage points.

1. Introduction

Globally, the contribution from the services sector to economic output and employment has been increasing. The European economy, for instance, has been characterised by two key interconnected trends over the past two decades: a steady increase in the proportion of services, especially business services, and a decline in the manufacturing sector's share of economic output (Kox and Rubalcaba, 2007a). One major factor driving these changes, according to Kox and Rubalcaba (2007a), is the pursuit of scale economies in human capital, and the associated rising specialisation in knowledge services. Moreover, Francois and Woerz (2008), Savona and Lorentz (2005), Guerrieri and Meliciani (2005), and Francois (1990) argue that the growth of services, especially business services, is largely due to changes in production processes across various sectors and the resulting increase in demand for services as intermediate goods.

The services sector plays a crucial role as a catalyst for innovation and knowledge spillover into other sectors. A number of studies have highlighted the positive impact of business services, particularly knowledge-intensive business services (KIBS), on the broader economy through the dissemination of specialised and knowledge-intensive inputs (Baker, 2007; Camacho and Rodriguez, 2007; Kox and Rubalcaba, 2007b). The importance of the services sector is not limited to its growing contribution to economic output and employment; the sector also serves as a key source of inputs in manufacturing. The business services sector constitutes an important part of the services sector, serving as essential components in production. These include consultancy, design, marketing, and cleaning services, among others. The diverse nature of business services means the different components play varying roles throughout the manufacturing process, influencing both upstream and downstream activities along the manufacturing value chain. Furthermore, there is a growing trend of offering services alongside physical products, which is often referred to as the 'servitisation of manufacturing'.

The business services sector constitutes a key aspect of the knowledge economy and is a significant source of job creation because the sector is labour-intensive. Kox and Rubalcaba (2007a) argue that the sector has significantly bolstered European economic growth through substantial contributions in employment, productivity, and innovation in recent decades. Directly, this growth has been driven by the rapid expansion of the business services sector itself. Indirectly, the business services sector has facilitated positive knowledge and productivity spillovers to other industries. The expansion in business services has been supported by the advancement and widespread adoption of Information and Communication Technologies (ICT). ICT has impacted the connections between manufacturing and the services sector by increasing the service component in many manufacturing activities.

The Western Cape economy is driven by the services sector, with the sector accounting for over 70% of both economic output and employment. In particular, the business services sector is becoming increasingly important to the province’s economy because of its role in employment creation and economic output. The sector generated output of R157.73 billion in 2023, which is approximately 26.50% of the province’s gross value added (GVA). The sector also accounted for 17.24% of total employment, 23.62% of gross fixed capital formation (GFCF) and 14.04% of the value of inward foreign direct investment (FDI) in the same year. This paper examines the growth of business services in the province as well as the sector’s contribution to economic output, employment, GFCF and FDI inflows.

The remainder of the paper is structured as follows: Section 2 explores the definition of business services, Section 3 analyses the relationship between business services and manufacturing, while Section 4 examines the growth of the business services sector. Section 5 provides an overview of the business services sector, looking at its contribution to GVA, employment, GFCF and FDI. Section 6 presents the empirical analysis of the relationship between business services and economic growth. The results show that the sector makes a positive and statistically significant contribution to the Western Cape’s output growth. Section 7 concludes the study.

2. Business services definition and categorisation

The business services sector encompasses a wide range of services which are primarily exchanged between businesses. Kox and Rubalcaba (2007a) define business services as a range of service activities that are used as intermediary inputs to enhance the quality and efficiency of production processes, by either complementing or substituting in-house service functions. In Table 1, business services are broken down into two different services: KIBS and operational business services. Operational business services typically offer standardised services that rely on manual skills, whereas KIBS focus on delivering client-specific services that involve significant amounts of knowledge and information (ECSIP, 2014). These services encompass economic activities aimed at generating, accumulating, or spreading knowledge. According to Miles et al. (1995), KIBS are heavily reliant on professional knowledge, serve as direct sources of information and knowledge, and utilise their expertise to offer intermediary services that support clients' production activities. These services are mainly provided to businesses.

Table 1: Defining business services

<table>
<tr><td colspan="4">Producer services</td></tr>
<tr><td rowspan="4">Consumer services partly used by enterprises like business travel, company health services, social insurance services</td><td colspan="3">Business-related services</td></tr>
<tr><td colspan="2">Business services</td><td>Network type services</td></tr>
<tr><td>Knowledge-intensive business services</td><td>Operational business services</td><td rowspan="2">• Wholesale, export, import services
• Transport and logistics
• Banking, insurance, stock exchange
• Telecommunication, couriers, cable services
• Energy services</td></tr>
<tr><td>• Software and computer services
• Strategy and management consultancy
• Auditing, accountancy, tax and legal advice
• Marketing services, opinion polling
• Technical services, engineering
• Personnel training, headhunting</td><td>• Security services
• Equipment renting
• Facility management, cleaning
• Administration, bookkeeping
• Temporary labour recruitment
• Other operational services (e.g. catering, translation, call centres)</td></tr>
</table>

Source: Kox and Rubalacaba (2007a)

3. The link between business services and the manufacturing sector

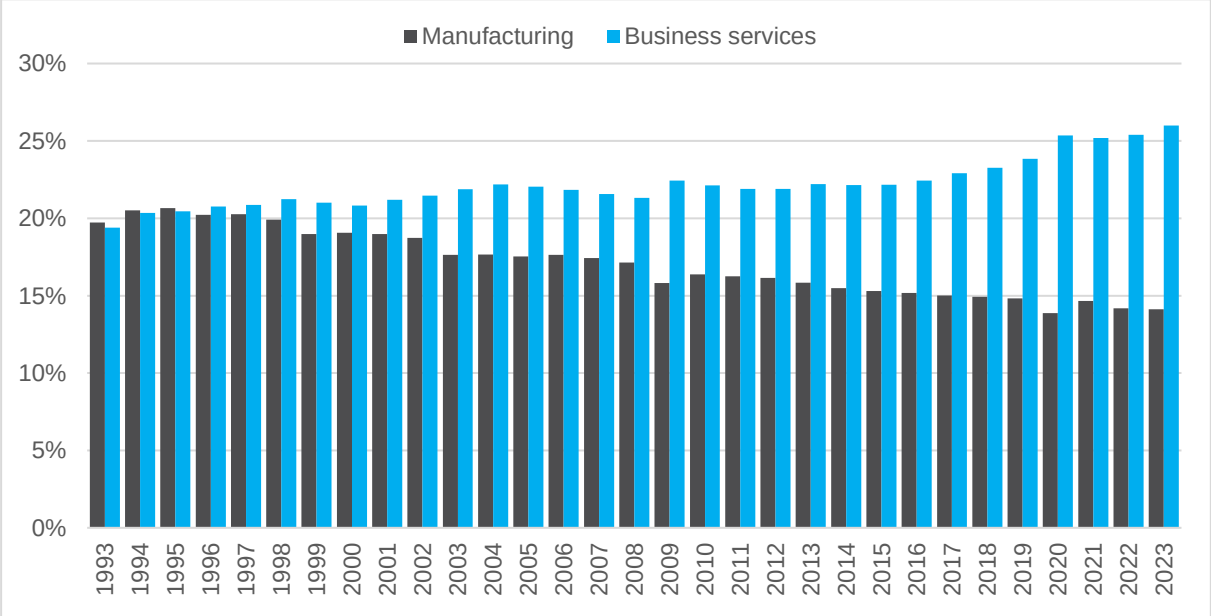
There is a close connection between manufacturing and services (ECSIP, 2014). Firstly, manufacturing companies not only rely heavily on various services as crucial inputs in their production processes, but also often package services together with their products. Secondly, many service functions are integrated within manufacturing firms, which may be partially outsourced or moved offshore, such as business functions. Conversely, service industries depend on manufactured goods to enhance their operational efficiency, for instance utilising goods for maintenance, ICT system development, and capital goods in their service activities. Consequently, due to these strong intersectoral links and interactions, any changes or improvements in the services sector and the factors influencing the interaction between services and industry, both domestically and internationally, are expected to significantly impact the performance of the manufacturing sector.

Several researchers have explored how FDI in the services sector relates to FDI in manufacturing. This analysis often looks at whether the presence and scale of manufacturing operations influence where service investments are made, or whether FDI in services and manufacturing are complementary. For instance, Nefussi and Schwellnus (2010) examined the determinants of location choices in the services sector in France using firm-level data. They observed a complementary relationship between the locations of business services and the manufacturing activities of French affiliates. Likewise, after evaluating the determinants of FDI in business services across the European Union, Castellani, Meliciani and Mirra (2013) found that regions specialising in manufacturing sectors that are significant users of business services tend to attract more FDI in the business services sector compared to other

regions. Meliciani and Savona (2011) investigated the determinants of specialisation in business services and observed that manufacturing activities influence specialisation in business services through intersectoral connections.

Within the European context, Kox and Rubalcaba (2007a) emphasise that the economy has undergone significant structural changes between 1979 and 2003. This is marked by two prominent interconnected trends: a decline in the share of manufacturing in the economy and a steady rise in the proportion of the economy attributed to services, particularly business services. A similar trend can be observed in the Western Cape, as shown in Figure 1. The manufacturing sector's share of GVA decreased from 19.72% in 1993 to 14.12% in 2023, whereas that of the business services sector increased from 19.40% to 26.00%. The GVA of manufacturing was slightly higher than that of business services from 1993 to 1995 but from 1996 onwards, the business services sector started accounting for a higher proportion of total GVA compared to manufacturing. On average, the GVA of business services increased by 3.50% per annum from 1994 to 2023, which is higher than the average growth rate of the GVA of manufacturing (1.49%). The growth of the business services sector has been aided by technological advancement and the rise in business process outsourcing in the province.

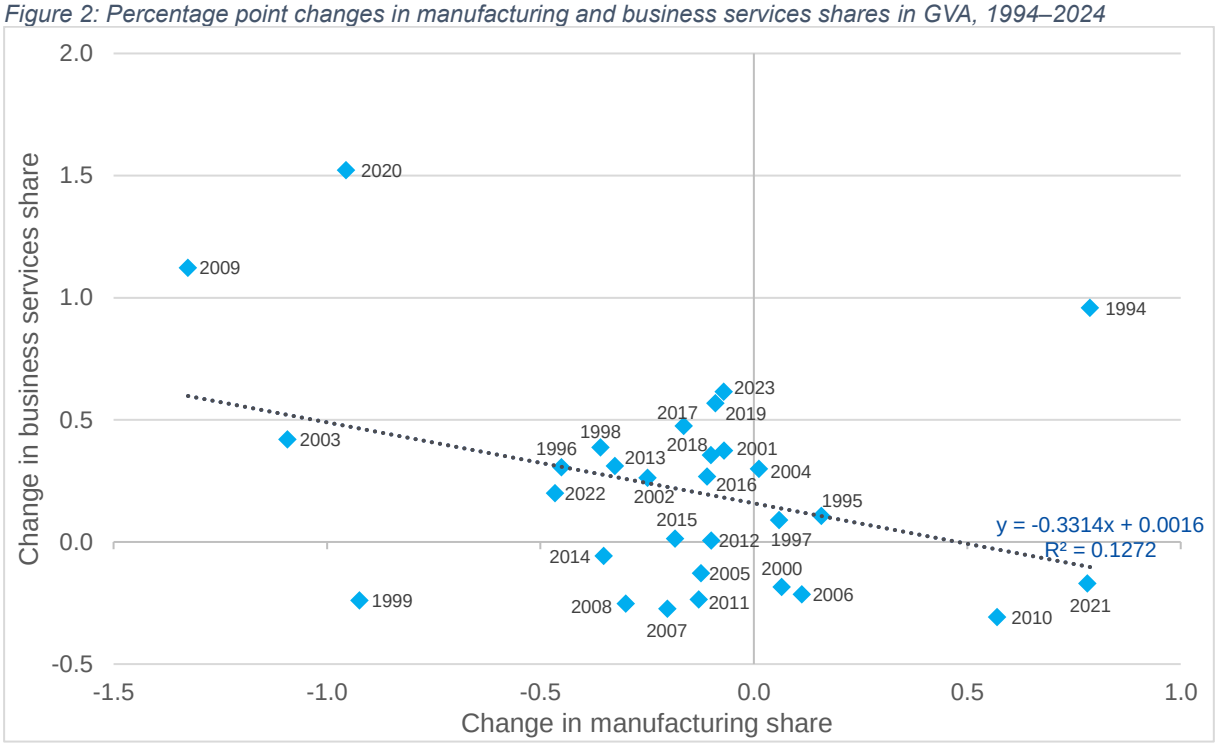
Figure 1: Share of GVA for manufacturing and business services, 1993–2023



Source: Quantec (2024)
Note: * GVA at 2015 constant prices

Figure 2 presents a scatter plot of the percentage point changes in the share of business services and manufacturing in total GVA during the period 1994–2023. For just over half of this period (16 years out of 30 years), the share of business services increased, whereas the share of manufacturing declined. The province lost approximately 5.6 percentage points of the share of manufacturing in GVA in 2023 relative to 1993, but it gained about 6.6 percentage points in the share of business services over the same period. A simple linear regression indicates that there is a negative relationship between changes in the share of business services and changes in the share of manufacturing. As can be observed from the trendline equation in Figure 2, a one percentage point decrease in manufacturing share corresponds with a 0.33 percentage point increase in the share of business services.

Figure 2: Percentage point changes in manufacturing and business services shares in GVA, 1994–2024



Source: Quantec (2024)

4. The growth of the business services sector and its impact on the economy

The rising interest in the business services industry, which is relatively new in the theoretical literature, reflects broader changes in the structure of the economy. Classical economists viewed services primarily as unproductive because services were mostly linked to the distribution and consumption of wealth rather than production.

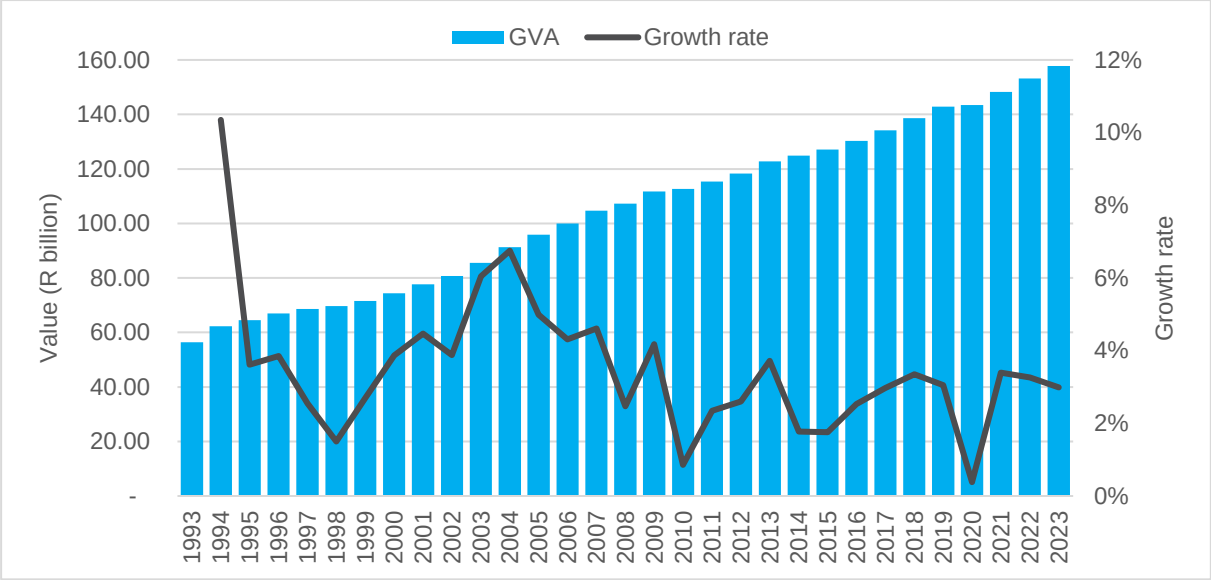
Baumol (1967) and Baumol, Blackman and Wolff (1989) cautioned about the potential threat posed by the increasing dominance of services in the global economy, arguing that the low productivity growth in the "stagnant" services sector could lead to overall productivity stagnation, a concept known as 'Baumol's disease'. However, critics contend that Baumol's theory overlooks the role of services as intermediate inputs as opposed to only final consumption. Services such as transport, telecommunications, financial services and business services facilitate transactions in other parts of the economy, while producer-related services contribute to knowledge transfer and innovation, indirectly boosting overall productivity. Empirical evidence contradicts Baumol's concerns, suggesting a positive relationship between the expansion of the services sector and overall productivity growth. For instance, after investigating the impact of services on overall productivity among 37 OECD[1] countries between 1980 and 2005, Maroto-Sanchez and Cuadrado-Roura (2009) found a statistically significant and positive association between the growth of employment in the services sector and productivity.

The business services sector has shown significantly higher growth rates in employment, value added, and productivity compared to other service sectors and the broader economy (Francois, 1990; Rowthorn and Ramaswamy, 1999; and Kox and Rubalcaba, 2007b). The increasing tertiarisation of all production processes and reduced costs of outsourcing internal service functions are important drivers for the rise in business services. After examining the impact of business services on economic growth in Europe, Kox and Rubalcaba (2007a) observed that the sector's contribution to growth stems directly from the growth of its own value added and employment, and indirectly from the positive spillovers it creates for other industries.

[1] Organisation for Economic Cooperation and Development

Figure 3 shows the GVA for the business services sector as well as the growth rates in the sector's GVA from 1993 to 2023. The sector's GVA has been rising steadily since 1993, increasing from R56.40 billion in 1993 to R157.73 billion in 2023. The sector also maintained a positive growth rate, albeit a fluctuating trend, throughout the period under consideration. Business services recorded an average growth rate of 3.50% per annum in GVA between 1994 and 2023, relatively higher than the GVA of the entire services sector (2.95%) and the total GVA of the economy (2.57%). Even during the pandemic in 2020 when the province's total GVA and the GVA of the services sector declined by 5.57% and 4.83% respectively, the GVA of the business services sector grew by 0.38%.

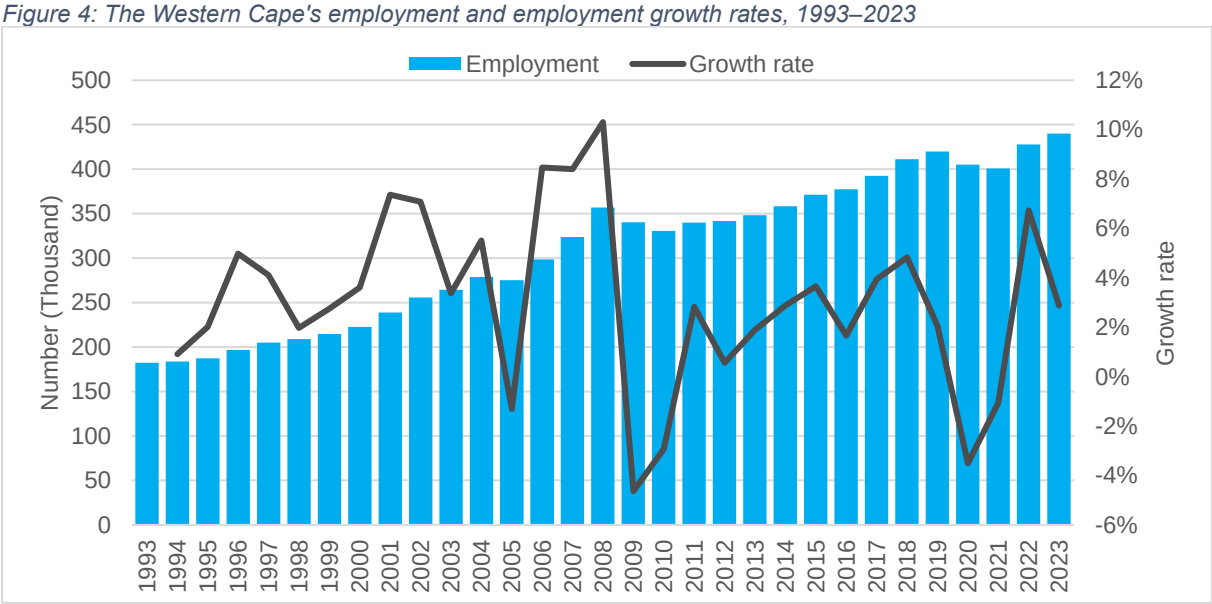
Figure 3: GVA and GVA growth rates for business services sector, 1993–2023



Source: Quantec (2024)

Figure 4 shows employment trends in the business services sector from 1993 to 2023. The sector's average growth rate of 3.04% per annum between 1994 and 2023 was relatively higher than the average growth rate of employment in the services sector (1.94%) and the average growth rate of total employment (1.14%). As can be seen in Figure 4, the number of employed individuals in the business services sector increased from 182 108 in 1993 to 440 066 in 2023. Overall, employment in the sector increased during the 1993–2023 period, except during the 2007–09 financial crisis and in the time of the Covid-19 pandemic.

Figure 4: The Western Cape's employment and employment growth rates, 1993–2023



Source: Quantec (2024)

5. An overview of the Western Cape's business services sector

The growing proportion of business services in employment and production, along with the sector's role in reshaping the production, delivery, and trade of goods and services both domestically and internationally, has led to extensive research relating to the factors influencing these activities and their economic impact. This section looks at the contribution of business services to output, employment, GFCF and FDI.

5.1 Contribution from business services to GVA and employment

The contribution from the business services sector to employment and value added in the Western Cape has risen over the past three decades, as shown in Table 2. The sector's share of total GVA increased from 20.10% in 1993 to 26.6% in 2023, while its share of total employment increased from 9.87% to 17.24% over the same period. Business services is a key sector in the tertiary sector, with an average share of approximately 32% of the tertiary sector's GVA between 1993 and 2023. Regarding employment, business services accounted for about 21% of tertiary sector employment from 1993 to 2023.

Table 2: Business services sector's GVA and employment, 1993–2023

	GVA		Employment	
Year	% share of services sector's GVA	% share of total GVA	% of services sector's employment	% share of total employment
1993	29.62%	20.10%	17.03%	9.87%
1994	31.81%	20.99%	17.26%	10.08%
1995	31.32%	21.04%	17.48%	10.24%
1996	31.30%	21.31%	17.90%	10.55%
1997	31.53%	21.47%	18.49%	11.05%
1998	31.53%	21.72%	18.80%	11.25%
1999	30.94%	21.51%	18.82%	11.58%
2000	30.51%	21.30%	18.35%	11.24%
2001	30.48%	21.60%	19.92%	12.40%
2002	31.21%	21.85%	21.25%	13.25%
2003	31.31%	22.27%	22.26%	13.88%
2004	31.71%	22.50%	22.56%	14.38%
2005	31.53%	22.35%	20.81%	13.40%
2006	31.21%	22.16%	21.82%	13.74%
2007	30.73%	21.83%	22.39%	14.54%
2008	30.44%	21.58%	22.58%	15.59%
2009	31.59%	22.74%	21.70%	15.36%
2010	31.34%	22.47%	21.48%	15.40%
2011	30.92%	22.27%	21.49%	15.54%
2012	30.95%	22.31%	21.10%	15.22%
2013	31.15%	22.54%	20.89%	15.02%
2014	31.08%	22.52%	20.92%	15.18%
2015	31.06%	22.63%	21.03%	15.05%
2016	31.30%	22.91%	21.23%	15.25%
2017	31.87%	23.39%	21.44%	15.55%
2018	32.16%	23.75%	22.01%	16.07%
2019	32.72%	24.40%	22.29%	16.38%
2020	34.51%	25.93%	23.22%	17.09%
2021	34.48%	25.75%	23.54%	17.40%
2022	34.32%	25.90%	23.84%	17.57%
2023	34.92%	26.50%	23.44%	17.24%

Source: Quantec (2024)

The business services sector currently counts as one of the largest economic sectors in the Western Cape economy. Table 3 compares business services with other sectors. It is one of the province's dynamic sectors, having recorded an average annual growth of 3.50% between 1994 and 2023. This was higher than the average growth of total GVA of 2.57%. In comparison to other sectors, business services was the only sector that recorded positive growth rates from 1994 to 2023. Looking at the 10 main sectors in the Western Cape economy, the finance, insurance, real estate and business services sector was the largest contributor to GVA in 2023, accounting for approximately one-third of total GVA (79.13% of which was attributed to business services). This makes business services the largest sector (accounting for more than one-quarter of total GVA in 2023) when looking at the sub-sectors within the 10 main sectors.

Table 3: Business services sector's GVA compared with other sectors

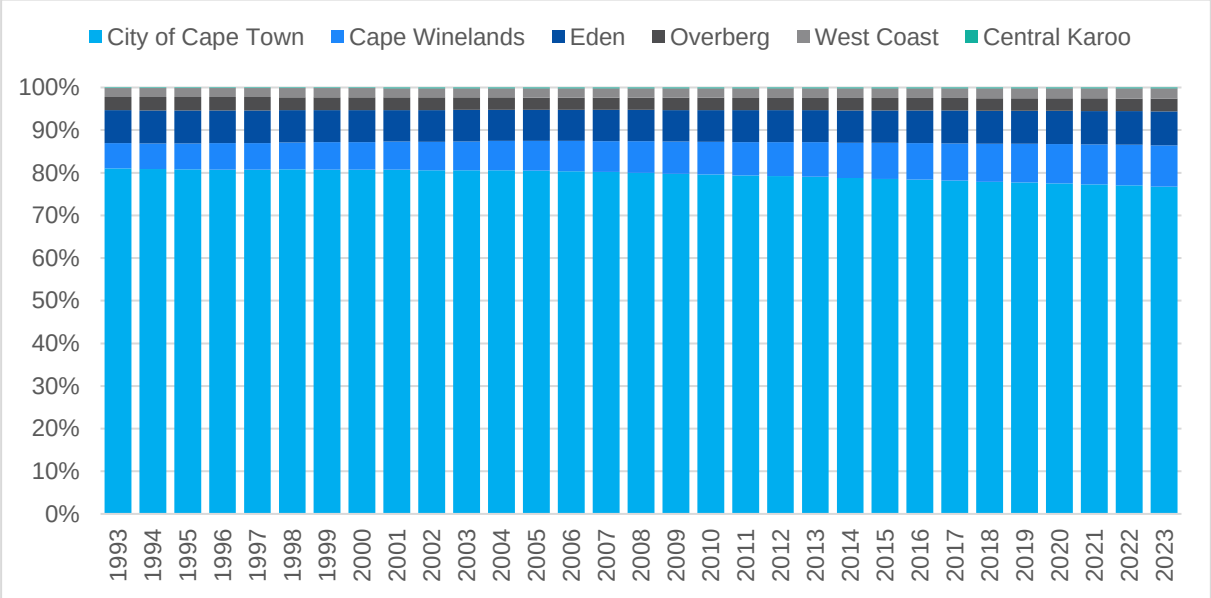
Industry	Value in 2023 (Rbn)	% share in 2023	Ave growth rate (1994 - 2023)
Agriculture, forestry and fishing	25.65	4.31%	2.73%
Mining and quarrying	0.90	0.15%	4.81%
Manufacturing	83.92	14.10%	1.56%
Food, beverages and tobacco	22.74	3.82%	1.08%
Textiles, clothing and leather goods	4.26	0.72%	0.40%
Wood and paper; publishing and printing	9.27	1.56%	0.66%
Petroleum products, chemicals, rubber and plastic	15.95	2.68%	3.39%
Other non-metal mineral products	2.35	0.39%	-0.16%
Metals, metal products, machinery and equipment	12.45	2.09%	2.39%
Electrical machinery and apparatus	1.35	0.23%	3.62%
Radio, TV, instruments, watches and clocks	1.33	0.22%	1.72%
Transport equipment	5.04	0.85%	4.02%
Furniture; other manufacturing	9.19	1.54%	1.18%
Electricity, gas and water	11.10	1.87%	0.28%
Construction	21.97	3.69%	2.66%
Wholesale and retail trade, catering and accommodation	80.50	13.52%	2.51%
Wholesale and retail trade	71.75	12.05%	2.78%
Catering and accommodation services	8.74	1.47%	1.19%
Transport, storage and communication	66.41	11.16%	3.56%
Transport and storage	40.68	6.83%	2.76%
Communication	25.73	4.32%	6.66%
Finance, insurance, real estate and business services	199.33	33.48%	3.48%
Finance and insurance	41.59	6.99%	3.55%
Business services	157.73	26.50%	3.50%
General government	35.06	5.89%	1.96%
Community, social and personal services	70.44	11.83%	2.36%
Total	**595.28**	**100.00%**	**2.57%**

Source: Quantec (2024)

As the main economic hub of the province, Cape Town accounts for a significant share of the Western Cape's GVA in the business services sector, which is shown in Figure 5. On average, the city accounted for about 79.51% of the business services sector's GVA between 1993 and 2023, followed by Eden (7.57%), the Cape Winelands (7.56%), Overberg (2.96%), West Coast (2.21%) and Central Karoo (0.19%). It must be noted that the Cape Winelands' share of the business services sector's GVA has increased steadily from 1993 to 2023. While Cape Town's share of the GVA in the business services sector in the province decreased from 81.00% in 1993 to 76.75%, that of the Cape Winelands increased

from 5.99% in 1993 to 9.68% in 2023. The remaining districts maintained a relatively consistent share during the period under review.

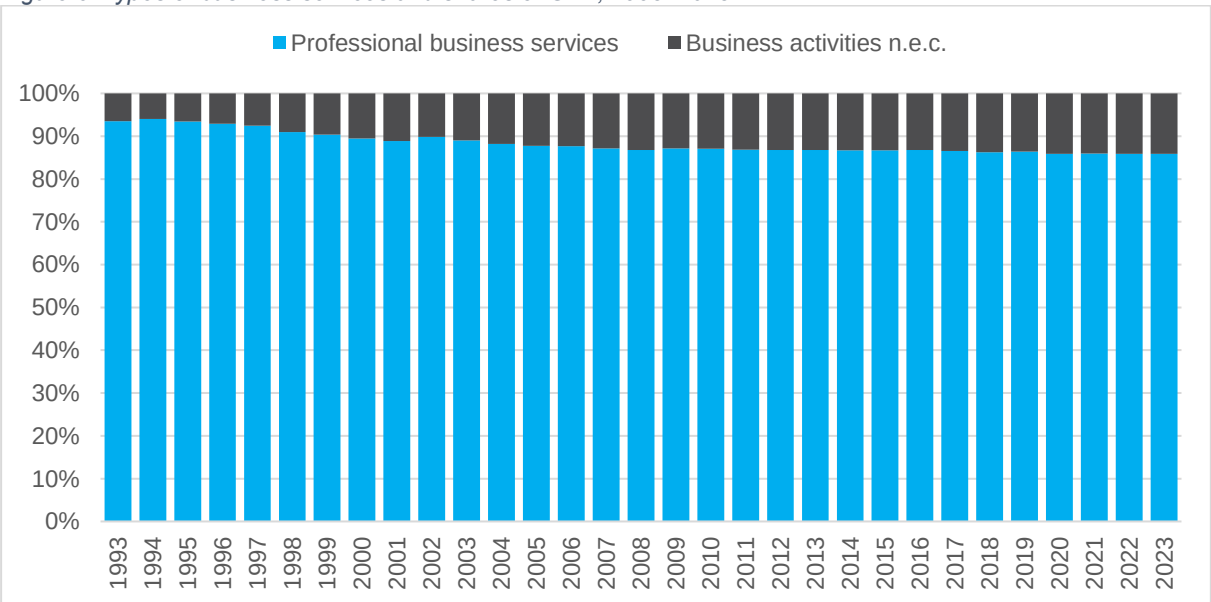
Figure 5: Business services sector's GVA: by district, 1993–2023



Source: Quantec (2024)

Figure 6 shows the two main categories of business services in the Western Cape and their respective shares of GVA from 1993 to 2023. Professional business services, which include legal and accounting activities; scientific research and development; management consultancy activities; and architectural and engineering activities, constitute the largest proportion of business services in the province. These services recorded an average annual share of approximately 88.39% of the business services sector's GVA between 1993 and 2023. Business activities not elsewhere specified made up the remaining 11.69%.

Figure 6: Types of business services and shares of GVA, 1993–2023

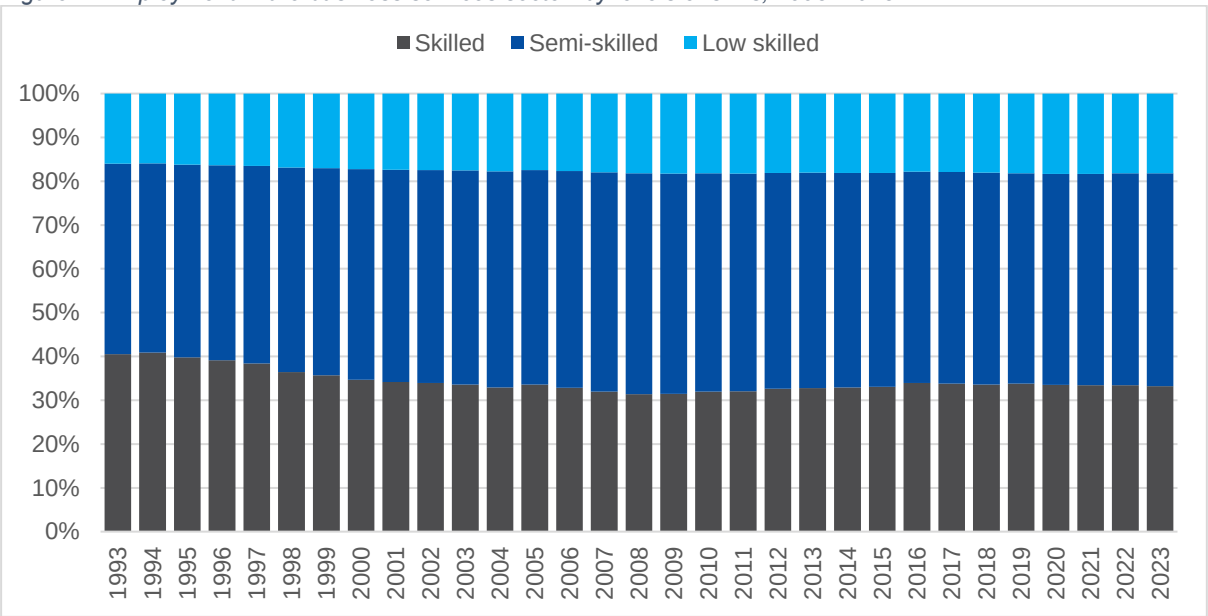


Source: Quantec (2024)

Professional business services, the largest component of business services, rely heavily on skilled and adequately qualified workers. Therefore, investment in education is critical for ensuring that the sector has the right set of skills to remain agile and competitive. Figure 7 shows the skills level of individuals

employed in the business services sector in the Western Cape between 1993 and 2023. As can be observed, more than four-fifths of those employed in the sector are either skilled or semi-skilled. While the share of skilled workers in the sector decreased from 40.50% in 1993 to 34.36% in 2023, that of semi-skilled workers increased from 43.48% to 48.03% over the same period. On average, low-skilled workers accounted for about 17.61% of those employed per annum in the business services sector during the period under review.

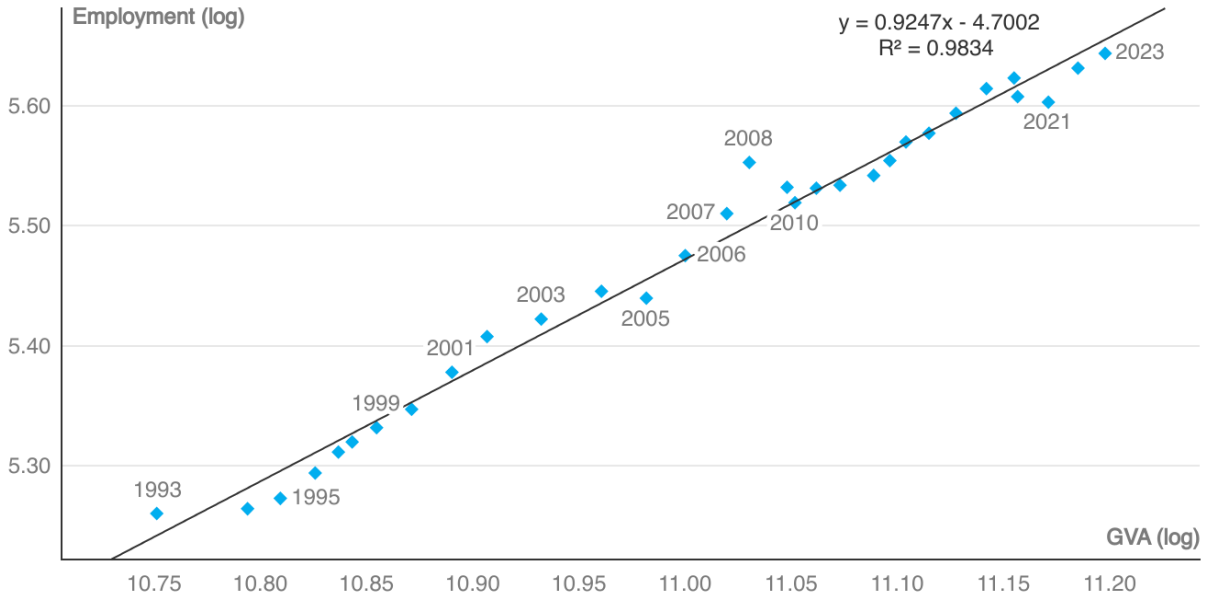
Figure 7: Employment in the business services sector: by levels of skills, 1993–2023



Source: Quantec (2024)

Figure 8 shows a scatter plot of the log of employment and the log of real GVA in the business services sector from 1993 to 2023. It can be observed that there is a positive relationship between the two variables. This means that an increase in the sector's economic output causes more people to be employed in the sector. The trendline equation[2] indicates that a 1% increase in the GVA of business services will lead to a 0.92% increase in the sector's employment levels.

Figure 8: Relationship between GVA and employment in the business services sector, 1993–2023

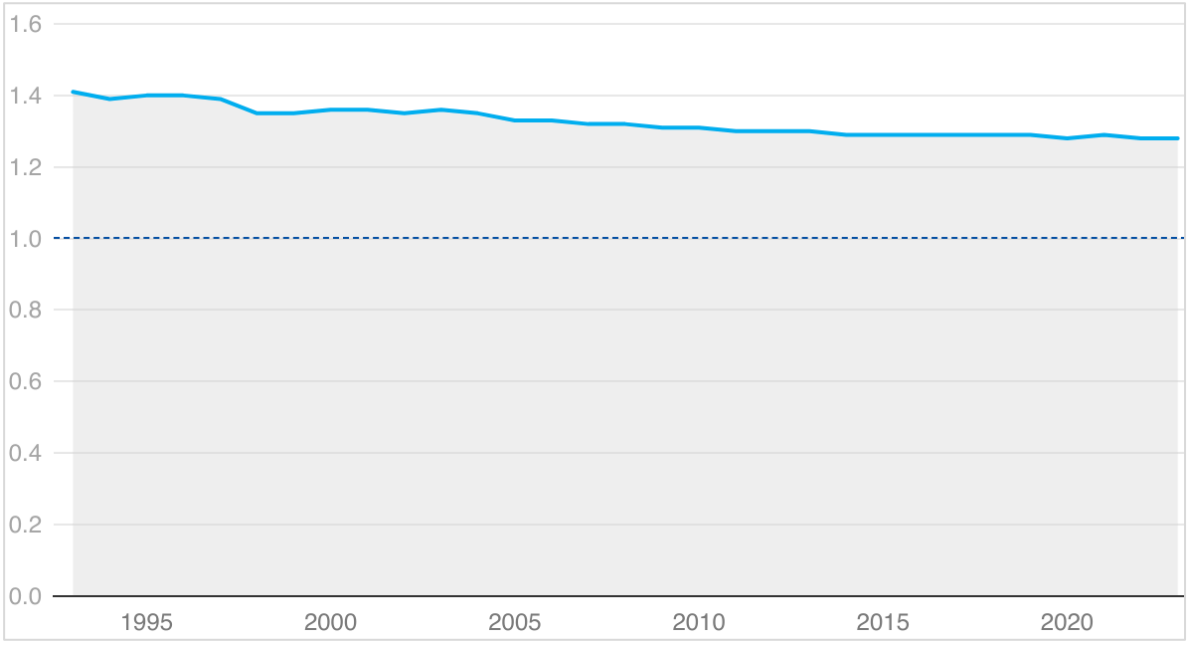


Source: Quantec (2024)

[2] Note that this is a simple regression that has not been subjected to any diagnostic test and robustness checks.

Figure 9 shows the location quotient[3] of the business services sector in the Western Cape relative to the national economy. This gives an indication of how comparative the sector is in the Western Cape relative to the national economy. The Western Cape had an average location quotient of 1.33 in business services between 1993 and 2023; however, this declined from 1.41 in 1993 to 1.28 in 2023. This signifies that the province is more specialised in business services than South Africa as a whole, and that the Western Cape renders these services more efficiently. It also means that the sector is more concentrated in the province than in the country as a whole.

Figure 9: Location quotient of Western Cape's business services sector relative to national economy, 1993–2023



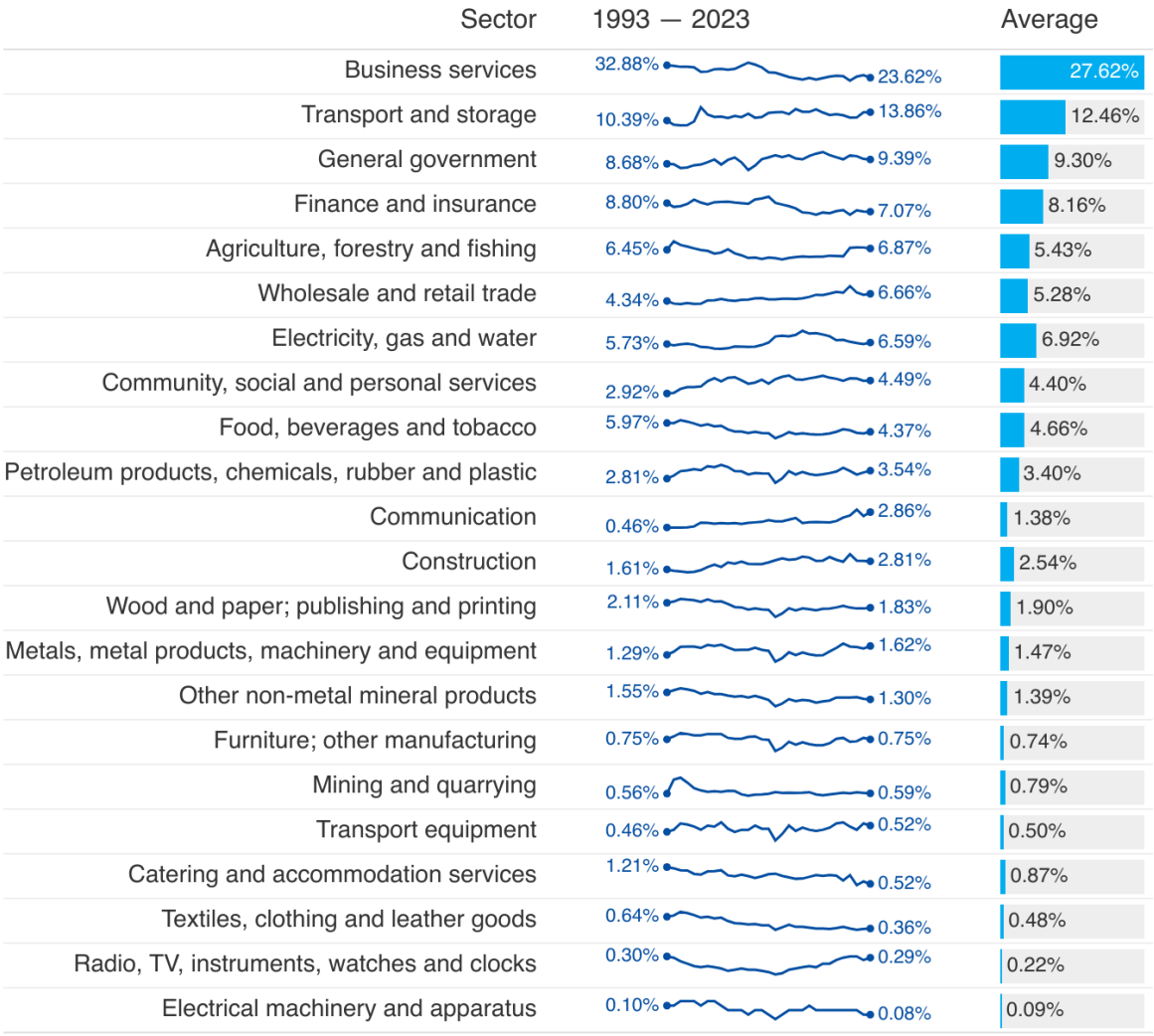
Source: Quantec (2024)

5.2 Contribution from business services to gross fixed capital formation

GFCF or investment is an important component of gross domestic expenditure and a key contributor to economic growth. Figure 10 shows the business services sector's share of GFCF in the Western Cape relative to other sectors. Despite its share of GFCF declining from 32.88% in 1993 to 23.62% in 2023, the business services sector remains the Western Cape's top sector in terms of contributing to investment. The sector's share of GFCF averaged 27.62% per annum during the past three decades.

[3] A location quotient depicts an economy's comparative advantage and industrial specialisation in terms of its production and employment. When the location quotient of a sector is greater than one, it means that specific economy has a comparative advantage and is efficient at producing the product or rendering the services compared to the aggregate economy (Quantec, 2024).

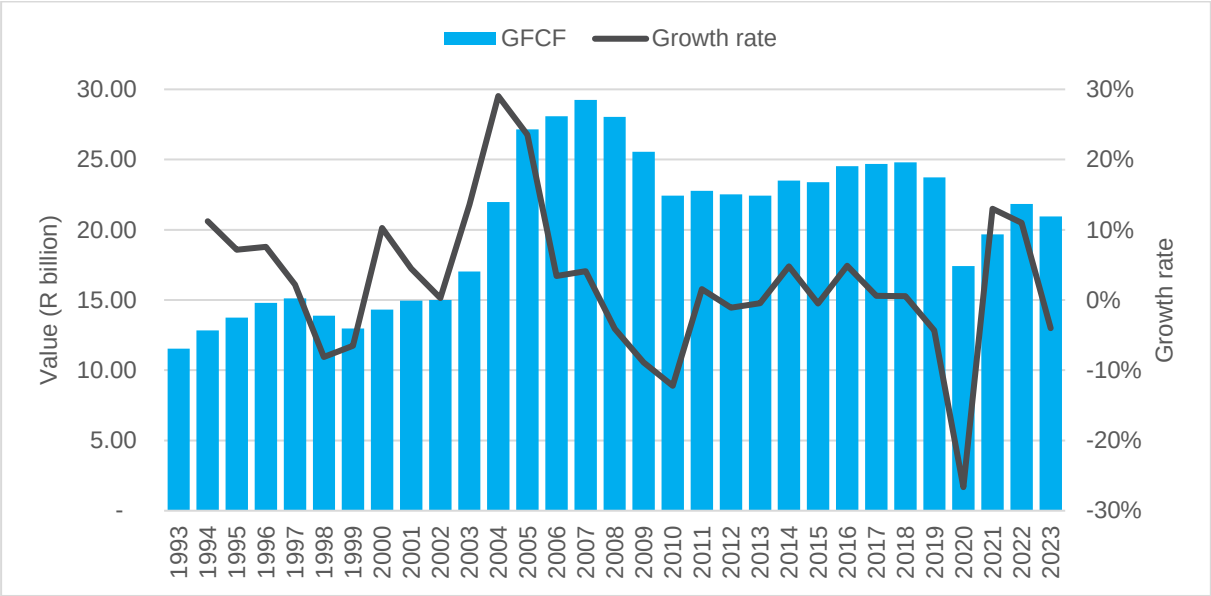
Figure 10: Share of GFCF, 1993–2023



Source: Quantec (2024)

Following a period of a gradual growth between 1993 and 1997, GFCF in the business services sector declined in 1998 and 1999 but started rising again from 2000 onwards to reach the highest value of R29.25 billion in 2007, as shown in Figure 11. The sector's GFCF decreased again from 2008 to 2010 and thereafter reached a plateau. However, the Covid-19 pandemic resulted in the largest contraction (-26.64%) in GFCF in 2020.

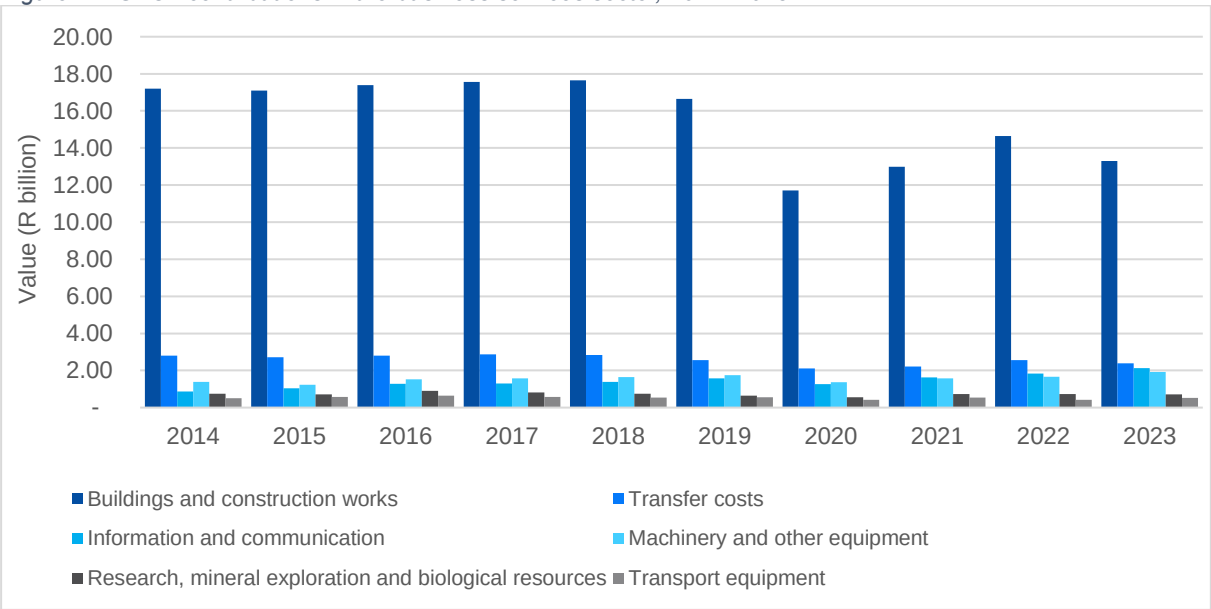
Figure 11: GFCF in the business services sector, 1994–2023



Source: Quantec (2024)

Buildings and construction works accounted for the largest share of the business services sector's GVA, having averaged a share of 69.33% between 2014 and 2023, as illustrated in Figure 12. This was followed by transfer costs (11.52%), machinery and other equipment (7.04%), information and communication (6.49%), research, mineral exploration and biological resources (3.26%), and transport equipment (2.36%). During the past 10 years, GFCF in information and communication recorded the highest average annual growth of 10.48%, increasing from 2.82% growth in 2014 to 15.70% growth in 2023.

Figure 12: GFCF contributions in the business services sector, 2014–2023



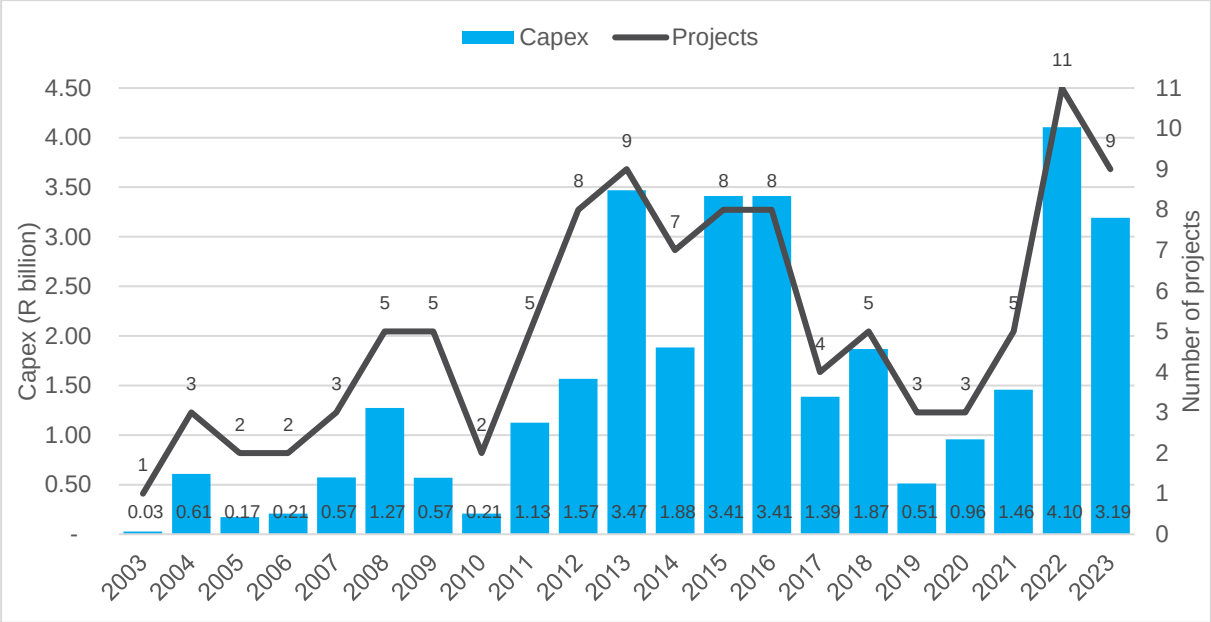
Source: Quantec (2024)

5.3 Contribution from business services to inward FDI

This section examines inward FDI trends by all companies investing in the business services sector in the Western Cape between 2003 and 2023. During this period, the province recorded a total of 108 FDI projects which generated R31.99 billion in capex and created about 6 281 jobs. About 86.11% of the 108 projects were new investments, while approximately 12.96% were investments for expansion. After

experiencing a significant decline (-72.56%) in capex in 2019, the value of FDI in business services rose steadily between 2020 and 2022, with both the largest capex (R4.10 billion) and the highest number of projects (11) recorded in 2022, as shown in Figure 13. However, both capex and the number of projects in the sector decreased by 22.23% and 18.18% respectively in 2023.

Figure 13: FDI inflows in the business services sector, 2003–2023



Source: fDi Intelligence from The Financial Times Ltd (2024)

As shown in Figure 14, the top three sub-sectors (in terms of capex) accounted for more than three-fifths of total capex from 2003 and 2023. These were professional, scientific and technical services (22.80%); advertising, PR and related services (20.91%); and employment services (17.66%). The sub-sector that created the highest number of jobs during this period was business support services, accounting for 69.30% of total jobs.

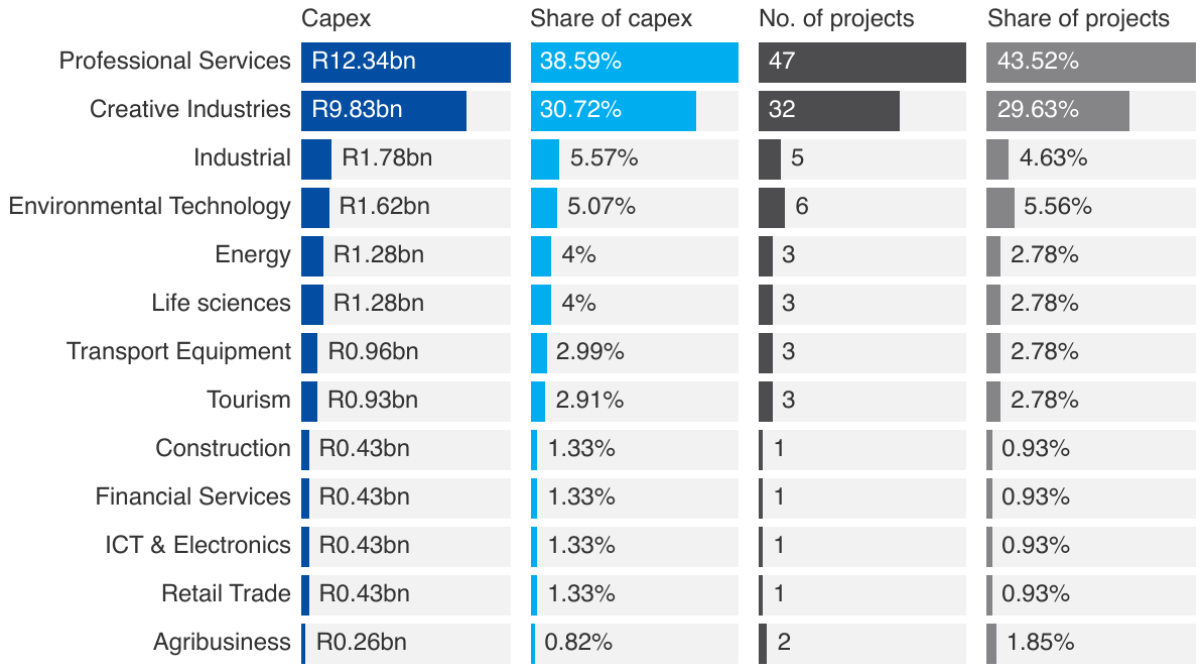
Figure 14: FDI inflows in the business services sector: by sub-sector, 2003–2023

	Capex	Share of capex	No. of projects	Share of projects
Professional, scientific & technical services	R7292.64m	22.8%	20	18.52%
Advertising, PR, & related	R6689.77m	20.91%	21	19.44%
Employment services	R5648.19m	17.66%	14	12.96%
Other support services	R2343.95m	7.33%	6	5.56%
Accounting, tax preparation, bookkeeping, & payroll services	R2189.02m	6.84%	7	6.48%
Architectural, engineering, & related services	R1886.82m	5.9%	6	5.56%
Management consulting services	R1810.12m	5.66%	5	4.63%
Business support services	R1282.42m	4.01%	14	12.96%
Schools, colleges, universities, & professional schools	R805.35m	2.52%	4	3.7%
Environmental consulting services	R558.38m	1.75%	3	2.78%
Educational support services	R426.45m	1.33%	1	0.93%
Newspaper, periodical, book, & directory publishers	R426.45m	1.33%	1	0.93%
Business schools, computer & management training	R316m	0.99%	3	2.78%
Water, sewage & other systems	R211.69m	0.66%	1	0.93%
Specialised design services	R92.04m	0.29%	1	0.93%
Legal services	R9.2m	0.03%	1	0.93%

Source: fDi Intelligence from The Financial Times Ltd (2024)

Figure 15 shows FDI trends by clusters within the business services sector from 2003 to 2023. Professional Services was the top cluster, accounting for more than two-fifths of projects tracked, more than three-quarters of jobs created and about 38.59% of capex.

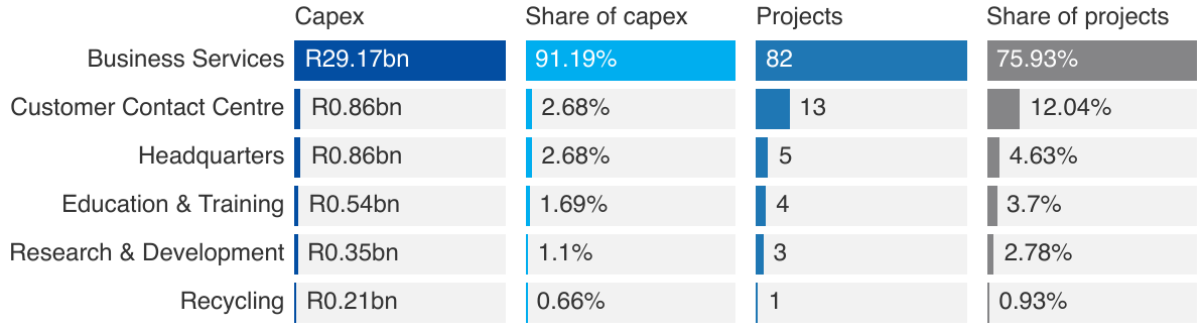
Figure 15: FDI inflows in the business services sector: by cluster, 2003–2023



Source: fDi Intelligence from The Financial Times Ltd (2024)

In terms of business activities, business services accounted for 75.93% of FDI projects and 91.19% of capex. As expected, the customer contact centre generated the highest number of total jobs (69.10%) and recorded the largest average jobs per project (333 jobs per project).

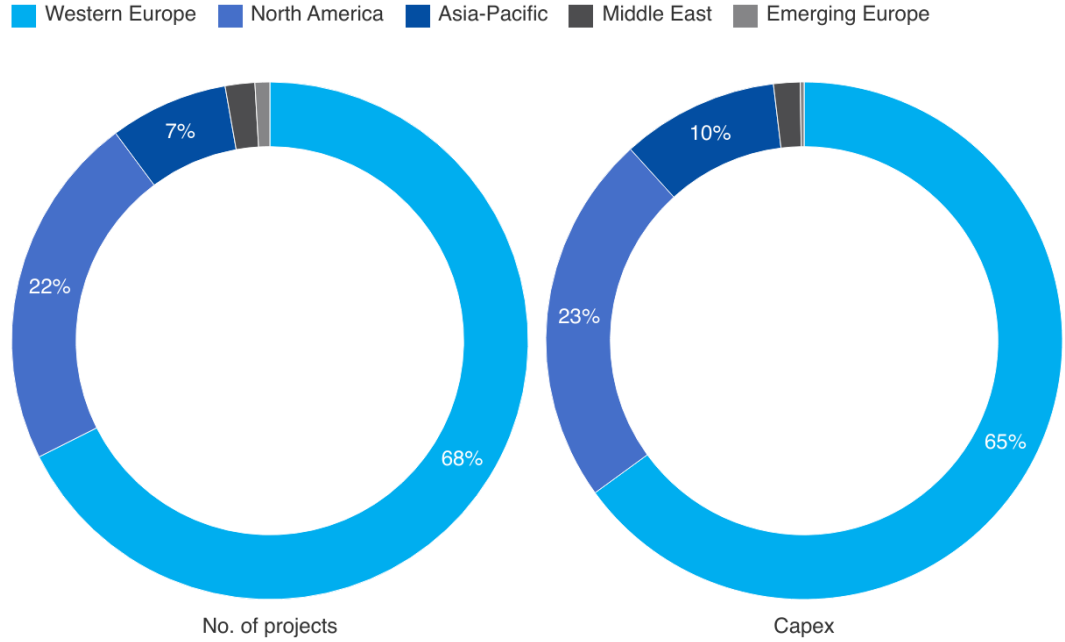
Figure 16: FDI inflows in the business services sector: by business activity, 2003–2023



Source: fDi Intelligence from The Financial Times Ltd (2024)

Most of the Western Cape's inward FDI in the business services sector emanated from Western Europe and North America. As shown in Figure 16, Western Europe accounted for more than two-thirds of both FDI projects and capex in the Western Cape's business services sector between 2003 and 2023. This was followed by North America with a share of 23.26% of capex and 22.22% of FDI projects. Western Europe also generated the highest number of total jobs during the period under review.

Figure 17: Business services FDI trends by source region, 2003–2023



Source: fDi Intelligence from The Financial Times Ltd (2024)

The United Kingdom was the top source country for FDI in the business services sector, accounting for more than two-fifths of both capex and projects tracked. The United States and France followed in second and third positions respectively in terms of both capex and number of projects.

Figure 18: FDI trends in the business services sector: by source country, 2003–2023

	Capex	Share of capex	No. of projects	Share of projects
United Kingdom	R13.34bn	41.71%	45	41.67%
United States	R7.01bn	21.93%	23	21.3%
France	R2.24bn	7.02%	10	9.26%
Switzerland	R1.84bn	5.74%	5	4.63%
Netherlands	R1.44bn	4.5%	4	3.7%
Australia	R1.28bn	4%	3	2.78%
Germany	R0.83bn	2.6%	4	3.7%
Singapore	R0.59bn	1.84%	2	1.85%
Ireland	R0.58bn	1.81%	3	2.78%
UAE	R0.53bn	1.66%	2	1.85%
Denmark	R0.52bn	1.62%	2	1.85%
Canada	R0.43bn	1.33%	1	0.93%
China	R0.43bn	1.33%	1	0.93%
Hong Kong	R0.43bn	1.33%	1	0.93%
India	R0.43bn	1.33%	1	0.93%
Russia	R0.08bn	0.24%	1	0.93%

Source: fDi Intelligence from The Financial Times Ltd (2024)

6. Empirical analysis of contribution from business services to economic growth

This section uses the ordinary least squares (OLS) method to determine the relationship between economic growth and the business services sector in the Western Cape using time series data from 1996 to 2023. Since using the OLS estimation method on non-stationary time series data will result in a spurious regression, all variables are tested for stationarity. The Augmented Dickey-Fuller (ADF) test is adopted to check whether each of the variables of interest has a unit root or not.

The econometric model adopted in this study to determine the contribution of business services to economic growth can be expressed as:

$$Y = \beta_0 + \beta_1 X_1 + \ldots + \beta_n X_n + \varepsilon_t$$

Where Y is the dependent variable, β_0 is the constant, β_1 is coefficient of the first independent variable (X_1), … denotes that there are other independent variables, β_n is the coefficient of the last independent variable (X_n) and ε_t is the error term. The dependent variable in this paper is real GVA growth, which is a proxy for economic growth. The independent variables are the growth rates of various sectors in the economy, including business services.

Figure 20 in the appendix depicts that the variables are stationary at level because their means and variances are constant. The results of the unit root test, which used the Schwarz Information Criterion (SIC) to determine the appropriate lag length, are presented in Table 5 in the appendix. The results show that all the variables are stationary in their levels. This is because the absolute values of the estimated ADF test exceed the critical value at the 10% level of significance or better. Hence, we reject the null hypothesis, which states that the series has a unit root. This means that the OLS method can be successfully adopted in this study.

Table 4 presents the estimated coefficients from the OLS regression analysis to determine the contribution of business services to economic growth. The results show the business services sector has a positive and statistically significant relationship with output growth in the Western Cape. The business services sector's coefficient of 0.33 implies that for every percentage point increase in the sector's output, the province's economic output increases by approximately 0.33 percentage points, which emphasises the importance of the business services sector to the province's economy. The other sectors that also make positive contributions to the Western Cape's economic output growth are community, social and personal services; general government; finance and insurance; wholesale and retail trade; construction; transport equipment; agriculture, forestry and fishing; food, beverages and tobacco; other non-metal mineral products; and radio, TV, watches and clocks.

The adjusted R-squared value of 0.9966 implies that the regressors in the model explain a significant proportion of the variations in the Western Cape's real GVA growth. Furthermore, the post-estimation diagnostic tests for heteroscedasticity, serial correlation and normal distribution indicate that there are no concerns with the model. The Breusch-Pagan-Godfrey heteroscedasticity test checks whether the residuals are heteroscedastic or homoscedastic. Given the Chi-Square probability value of 0.2747 as contained in Table 4, we fail to reject the null hypothesis of no heteroscedasticity and conclude that the residuals are homoscedastic. Regarding the assumption of normal distribution, the Jarque-Bera statistic indicates that the residuals are normally distributed because the null hypothesis of normal distribution cannot be rejected at the 5% level of significance. Finally, the results the Q-statistics presented in Table 6 in the appendix indicate that there is no sign of serial correlation because the probability values are all greater than 5%.

Table 4: OLS regression coefficients

Dependent variable: GVA growth		
Independent variable	**Coefficients**	
Agriculture, forestry and fishing	0.0320**	(0.0088)
Mining and quarrying	-0.0360***	(0.0086)
Food, beverages and tobacco	0.0606**	(0.0223)
Textiles, clothing and leather goods	0.0147	(0.0216)
Wood and paper; publishing and printing	-0.0439	(0.0326)
Petroleum products, chemicals, rubber and plastic	0.0246	(0.0228)
Other non-metal mineral products	0.0548**	(0.0190)
Metals, metal products, machinery and equipment	-0.0256	(0.0243)
Electrical machinery and apparatus	-0.0361**	(0.0100)
Radio, TV, instruments, watches and clocks	0.0262*	(0.0121)
Transport equipment	0.0607***	(0.0121)
Furniture; other manufacturing	0.0022	(0.0239)
Electricity, gas and water	-0.0076	(0.0199)
Construction	0.0727***	(0.0110)
Wholesale and retail trade	0.2096***	(0.0374)
Catering and accommodation services	0.0179	(0.0123)
Transport and storage	0.0188	(0.0109)
Communication	-0.0325	(0.0183)
Finance and insurance	0.0506***	(0.0097)
Business services	0.3291**	(0.0813)
General government	0.1004**	(0.0247)
Community, social and personal services	0.1600**	(0.0477)
Constant	-0.2635	(0.0019)
Adjusted R-squared	0.9966	
Jarque-Bera	0.1523	prob. 0.9267
Breusch-Pagan-Godfrey - Prob. Chi-Square(22)	0.2747	

Standard errors in parentheses
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

7. Conclusion

Over the past two decades, the business services sector has seen significant global expansion in terms of its contribution to economic output and employment. The sector also makes a significant contribution to the economy by supporting growth in all other sectors. Moreover, business services play a crucial role in a knowledge-based economy, and because these services are labour-intensive, they could be significant sources of job creation.

The objective of this paper was to analyse the business services sector in the Western Cape by examining the growth of the sector and evaluating its contribution to economic growth. It is one of the

largest sectors in province, having accounted for 26.50% of GVA and 17.24% of employment in 2023. The recent expansion of the sector has been aided by the rise in business process outsourcing. Furthermore, the empirical findings of the study revealed that there is a positive and statistically significant relationship between economic growth and the growth rates of business services in the Western Cape.

The intersectoral connection and the pivotal role of the business services sector in driving economic development underscore the need for a policy framework that supports the growth of the sector and enhances its international competitiveness. Since the sector is knowledge intensive, it requires continued, ongoing investment in skills to sustain its growth. Policy should, therefore, focus on improving the talent pipeline into the sector.

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9. Appendix

Figure 19: Graphical analysis of the variables in their levels

Table 5: Augmented Dickey-Fuller test results

Variable	Intercept	Intercept and trend	No Intercept and trend
GVA growth	-3.3627**	-3.9986**	-2.2518**
Agriculture, forestry and fishing	-4.8958***	-5.1341***	-5.5099***
Mining and quarrying	-4.1435***	-4.6727***	-3.8375***
Food, beverages and tobacco	-6.2258***	-6.1393***	-6.0132***
Textiles, clothing and leather goods	-6.9231***	-6.9482***	-7.0613***
Wood and paper; publishing and printing	-6.5744***	-6.4892***	-6.6566***
Petroleum products, chemicals, rubber and plastic	-3.9198***	-5.3232***	-3.3256***
Other non-metal mineral products	-6.7146***	-4.8475***	-6.7567***
Metals, metal products, machinery and equipment	-5.4810***	-5.3916***	-5.1355***
Electrical machinery and apparatus	-5.5824***	-1.9899	-2.1933**
Radio, TV, instruments, watches and clocks	-5.1605***	-5.0526***	-4.6903***
Transport equipment	-8.4303***	-8.6026***	-7.2879***
Furniture; other manufacturing	-9.1707***	-9.1594***	-8.9052***
Electricity, gas and water	-3.8633***	-3.8043**	-3.9560***
Construction	-2.4778	-6.5906***	-2.3120**
Wholesale and retail trade	-3.2000**	-5.5432***	-2.6366**
Catering and accommodation services	-4.0069***	-3.9073**	-3.9885***
Transport and storage	-5.2706***	-4.4839***	-4.7466***
Communication	-2.9181*	-5.4748***	-1.6892*
Finance and insurance	-4.7349***	-5.0104***	-3.9342***
Business services	-.3.0394**	-3.1891	-0.6810
General government	-3.5690**	-3.4809*	-1.5636
Community, social and personal services	-4.0264***	-4.0056**	-2.5119**

*Note: *** 1% significance level; ** 5% significance level; * 10% significance level*

Table 6: Correlogram of residuals (Q-statistics)

Sample: 1996 2023
Included observations: 28

Autocorrelation	Partial Correlation		AC	PAC	Q-Stat	Prob
		1	-0.136	-0.136	0.5713	0.450
		2	-0.152	-0.174	1.3177	0.517
		3	-0.332	-0.399	5.0212	0.170
		4	-0.028	-0.242	5.0492	0.282
		5	0.138	-0.094	5.7473	0.332
		6	0.264	0.118	8.4018	0.210
		7	-0.005	0.060	8.4028	0.298
		8	-0.110	0.050	8.9066	0.350
		9	-0.241	-0.105	11.481	0.244
		10	0.034	-0.028	11.534	0.317
		11	0.139	0.016	12.495	0.328
		12	0.058	-0.097	12.673	0.393