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## Article

# Harnessing the Benefits of FDI in African Countries

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## Harnessing the Benefits of FDI in African Countries

In this article, we briefly review our own work, and related studies, on the impact of FDI in African countries using firm level data. Overall, research suggests that foreign multinationals can indeed benefit local firms in terms of productivity growth and technology transfer. We also discuss a number of policy options host countries can apply in order to improve their attractiveness to foreign investors. Here we particularly focus on what might be called “Quality FDI,” i.e., those investments which maximize the benefits for the local economy.

Global stocks of foreign direct investment (FDI) increased from USD 20.3 trillion in 2010 to USD 33.5 trillion in 2017. The continent of Africa attracts only a fairly small share of this global FDI – USD 598 and 867 billion in 2010 and 2017 respectively (UNCTAD 2018). Much research shows that FDI and the associated activities of affiliates of multinational companies can have beneficial effects on host country economies (e.g., Görg and Greenaway 2004, Farole and Winkler 2014, Javorcik 2015). Therefore, increasing FDI flows to Africa could stimulate its economic development.

In the next section of this paper, we will discuss how foreign firms located in Africa can – under certain conditions – help domestic African firms to boost their performance. To support our arguments, we will summarize the findings of a number of empirical papers we have written on the subject of foreign-firm spillovers. All the evidence presented here will be underpinned by econometric analysis. For the latter, we apply a range of firm-level datasets containing information on multinational and domestic firms in Africa.

In the third section of this paper, we will then briefly discuss measures that can be taken by policy-makers in developing countries to, first, attract foreign direct investment and, second, help domestic firms capture productivity or knowledge trans-

fers from foreign firms with whom they transact e.g., through supplier relationships.

The overarching aim of our paper is to consider, empirically, the arguments for FDI in Africa. But we also aim to highlight some of the challenges presented by foreign firms, when benefits to domestic firms fail to materialize.

In this paper, we look at two channels through which domestic firms may benefit from FDI. First, the *movement of workers (in particular managers) from foreign to domestic firms*. Second, *active assistance of the foreign firm in upgrading the production technology of domestic suppliers within its value chain*. We focus on each of these mechanisms for foreign spillovers in turn.

### BENEFITS OF FDI FOR DEVELOPING COUNTRY FIRMS

In this section, we will provide a snapshot of what our own empirical studies conclude about the benefits of FDI for developing country firms. Specifically, we will focus on firms located within Africa.

The rationale for foreign firms stimulating development in the host country is straight forward. According to theory, multinationals generally need to be in possession of some sort of superior technology that enables them to operate successfully abroad. This is what Markusen (2001) refers to as a “firm-specific asset.” This knowledge can then dissipate into the local economy for a number of reasons (Görg and Greenaway 2004). First, domestic firms may just imitate the multinationals in terms of products, production, or management techniques. Second, workers may move from multinationals to domestic firms, taking with them some of the knowledge. Third, domestic firms supplying to or purchasing inputs from multinationals may be exposed to the superior technology and, as a result,



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be able to upgrade their own production techniques. Fourth, competition from multinationals may force domestic rivals to update production techniques to become more productive and competitive. This is frequently referred to as a “competition effect.” However, as Aitken and Harrison (1999) point out, this competition effect may also reduce productivity in domestic firms if multinationals siphon off demand from their domestic competitors, forcing domestic firms to reduce output and, therefore, productivity.

### Spillovers from Worker Mobility between Foreign and Domestic Firms

Görg and Strobl (2003) is one of the first studies to look empirically at the impact of movement of employees from multinationals to domestic firms. Employees transferring from these firms to the local economy can transfer with them the knowledge they have accumulated during their employment period at the foreign firm. The empirical study uses firm level data for Ghanaian manufacturing covering the 1991–1997 period. The data was collected as part of the *Regional Programme for Enterprise Development* (RPED), a larger data collection effort for a number of African countries, organized by the World Bank. Their most important finding is that firms run by owners who worked for multinationals in the same industry directly before opening their own firm are more productive than other domestic firms.

They measure the Total Factor Productivity (TFP) of domestic firms. Importantly, they control for the fact that high productivity domestic firms are more likely to recruit the most efficient local employees, a priori. In order to circumvent this problem, they look only at firms that were newly set up by entrepreneurs. Furthermore, the researchers are careful to control for years of schooling and a dummy indicating whether the individual had previous experience in the same industry. Furthermore, their regressions include a rich variety of training and work experience variables as well as their interactions. To quote from this study:

“For within-industry experience ( $FE_{ijt}$ ) we now find a positive and statistically significant coefficient, suggesting that owners who gained experience in multinationals in the same industry indeed run more productive firms. Thus, this provides evidence in support of the idea that there are spillovers through worker movements, where domestic entrepreneurs bring with them knowledge accumulated in the multinationals and put it to use in the domestic firm,” (Görg and Strobl 2003, 702).

### Spillovers through Active Assistance by Foreign Firms in Domestic Firms

Görg and Strobl (2005) provide empirical evidence only for Ghana and consider only spillovers through

movements of workers. Another mechanism that has been highlighted in the literature is that of backward linkages, i.e., positive effects on domestic suppliers selling output to multinationals (e.g., Javorcik 2004, Godart and Görg 2013). A study for a sub-Saharan African country, Bwalya (2006), which analyzes firm level panel data on manufacturing firms in Zambia, finds evidence for such spillovers from foreign firms to domestic suppliers.

More recently, a number of papers have used data from the Africa Investor Survey conducted by UNIDO, which provides firm level information for 19 African countries for a cross-section in 2010. For example, Boly et al. (2012) find, inter alia, that larger, newly established and more productive domestic firms are more likely to benefit from interactions with foreign affiliates.

Using this data, Görg and Seric (2016) provide an appraisal of the extent to which domestic firms that act as suppliers to foreign multinationals are helped by the foreign firms with whom they transact within the value chain. Their most important finding is that domestic firms supplying multinationals can expect to benefit in terms of upgrading their product and improving their productivity only if the foreign firm actively assists with the technology transfer.

There are intuitive reasons why a foreign multinational would want to help a domestic supplier to upgrade its production. A multinational procuring some of its inputs or services from a domestic firm does not want the quality of these inputs compromised, nor does it want to attract negative headlines that would damage its reputation for producing products in a sustainable and responsible way. Accordingly, there are already good reasons why foreign firms help to upgrade the production of domestic firms (see also Moran 2006). These reasons depend, however, on the motives of the foreign firm (consistently high-quality product vs. cheap production by any means).

We can see from Table 1, taken from Görg and Seric (2016), that some countries in Africa (Mozambique, Tanzania, Uganda, Ghana, Nigeria, Ethiopia, and Kenya) are major recipients of FDI, where multinationals connect with local suppliers. In Tanzania, for example, 57 percent of domestic firms that sell to multinationals report that they receive assistance from the multinational in terms of workforce upgrading, 61 percent in terms of technology transfer. Interestingly, the aggregate data shows that such assistance is not automatic, but differs significantly across countries. Burkina Faso is one example where no domestic suppliers report to have received assistance. Government support to benefit from spillovers, on the other hand, is very limited. The exception is Rwanda, where almost 1 in 5 firms received assistance with recruiting key staff. Of course, this data is not very granular. It hides differences in policies and products across countries. Nevertheless, it throws an interesting point into relief

Table 1

**Support for Domestic Firms Received from...**

Support from	government	government	government	multinational	multinational
	matchmaking	technology upgrading	find key staff	workforce up-grade	technology transfer
Burkina Faso	0.00	0.00	0.00	0.00	0.00
Cameroon	0.00	0.00	0.00	0.00	0.08
Cape Verde	0.17	0.00	0.17	0.17	0.00
Ethiopia	0.04	0.04	0.04	0.09	0.09
Ghana	0.00	0.00	0.00	0.27	0.30
Kenya	0.10	0.10	0.10	0.24	0.24
Lesotho	0.00	0.00	0.00	0.00	0.00
Madagascar	0.00	0.00	0.00	0.00	0.17
Malawi	0.00	0.08	0.08	0.31	0.69
Mali	0.00	0.00	0.00	0.00	0.00
Mozambique	0.02	0.03	0.00	0.34	0.21
Niger	0.00	0.00	0.00	0.00	0.00
Nigeria	0.06	0.06	0.06	0.09	0.16
Rwanda	0.00	0.00	0.17	0.33	0.00
Tanzania	0.13	0.11	0.07	0.57	0.61
Uganda	0.09	0.07	0.09	0.24	0.41
Zambia	0.04	0.00	0.04	0.16	0.28
Total number	19	17	17	92	104

Note: The table shows percentages of local firms (between 0 and 1) reporting to receive assistance of a certain type from either government or a multinational customer.

Source: Görg and Seric (2016); Table 3, p.6.

– FDI can be harnessed to help local suppliers. It is a matter of finding the appropriate triggers.

Görg and Seric (2016) elaborate their investigation into supplier relationships by going beyond the simple breakdowns. Instead, they formulate the question within an econometric framework, controlling for country and industry fixed-effects. The resulting findings underpin the importance of supplier relationships in leveraging technology from foreign firms.

Specifically, they regress productivity, as well as measures for whether firms engaged in product or process upgrading, of domestic firms on indicators of whether domestic firms supply multinationals, as well as other controls. Results clearly show that African firms supplying foreign multinationals are significantly more likely to upgrade their product and technology. This finding is strongest for MNE partnerships within their own country as opposed to supplying MNEs abroad.

Taking a deeper look at assistance from multinational buyers, the analysis shows that suppliers can be helped to boost their process innovation, where this assistance comes in many forms. Suppliers can benefit from being matched up with a compatible multinational (matchmaking), assisted in upgrading their production technology, or receiving help from local government in recruiting key workers. Surprisingly, there are many instances of multinationals helping domestic suppliers to upgrade their workforce. Additionally, the productivity of the domestic supplier correlates positively with the receipt of technology transfer from the multinational customer.

### **Additional Aspects of Positive Links between Multinationals and Domestic Suppliers**

What can we take from the Görg and Seric (2016) findings regarding the positive link between supplying MNEs and supplier performance? To cite from their paper:

“These apparent performance advantages for suppliers are in line with two, not mutually exclusive, explanations. One is that the supplier relationship with a multinational allows the firm to improve its performance, because of performance requirements set by multinationals combined with possible technology transfer and assistance. In other words, domestic firms learn from multinationals (...) The other explanation is that multinationals pick only the best-performing domestic firms as their suppliers, that is, there is a selection effect as described in Javorcik and Spatareanu (2009). It is likely that our result is a combination of these two effects,” (Görg and Seric 2016, 8).

In a paragraph above, we alluded to one powerful intuition for multinationals to provide assistance to domestic suppliers – namely, the motivation of many multinationals to enhance their public image through Corporate Social Responsibility (CSR). However, we do not rule out the purely philanthropic motive by which some multinationals are prompted to invest in their local suppliers. In other words, CSR represents

a further reason for multinationals to assist domestic firms.

In Görg et al. (2017 and 2018), using the Africa Investor Survey data, we investigate this question of supplier relationships and CSR in greater detail. What we find is that multinationals that export from Africa to the economic north (e.g., Germany) frequently rate CSR concerns as their main reason for cooperating with a local supplier in Africa. However, this declaration does not always translate into tangible action. Only when this CSR concern is accompanied by a tangible investment by the multinational (in terms of having a dedicated department for supplier development) does it translate into enhanced technology transfer to the local supplier. Therefore, broad statements about sustainability and responsibility are insufficient if policy makers want to discern any outcomes from the stated intentions of a multinational. A far more informative step is the setting up of organizational structures to mediate the relationship with the African supplier, as many multinational firms in the dataset appear to have done.

Finally, when considering benefits from FDI, one question is whether the quality of FDI may differ depending on whether the multinationals are from the economic north or south. In Gold et al. (2017), we set out to compare the effects of homegrown multinationals within Africa. Using the UNIDO data we discover that, while productivity growth is generally not different in southern and northern MNEs, employment growth is generally higher for firms receiving FDI from African multinationals. Additionally, we find that affiliates of African MNEs receive more technology transfer from their HQ than MNEs from other origins.

In Table 2, we illustrate the breakdown of FDI investment by multinationals from the economic south. We see that investment by African multinationals is dwarfed by investment by non-OECD countries (including China) and by other developing countries. Although investment from African multinationals is comparatively small, it nevertheless brings bene-

Table 2

#### Share of Southern FDI Recipients for Different Definitions of South

Definition of South	Percent of "Southern" firms
Africa	24.1
Developing countries	30.1
Non-OECD	53.6

Source: Gold, Görg, Hanley, and Seric (2017)

fits. In Table 3 we endeavor to distinguish the outcomes for different types of FDI from the economic south. Controlling for a myriad of factors in a regression framework, FDI from African multinationals is associated with higher employment growth than in a comparable multinational from other countries. The take-home message from this study is that multinationals represent a mixed bag of firms, even considered within narrower categories (economic south). The result of this heterogeneity is that some multinationals invest more in the local economy and induce more benefits than others.

#### MEASURES TO ATTRACT FDI

Given the above findings that FDI can bring benefits to host countries, it is particularly sobering to note – as remarked at the beginning of this article – that countries in Africa generally receive fairly low levels of inward investment. This section therefore considers policies and strategies to attract and facilitate FDI and to enhance its benefits in emerging and developing countries.

FDI inflows are hampered by the poor quality of political, economic, and legal institutions, as well as information asymmetries. These factors are particularly relevant for African and other developing countries, where such institutions are often not sufficiently developed (e.g., Busse and Hefeker 2007; Asiedu and Freeman 2009). Furthermore, transparent information about business conditions is often scarce in developing countries, constituting a further barrier to foreign investment (Harding and Javorcik 2013). To increase

Table 3

#### North-South FDI Differences w.r.t. Firm Performance

VARIABLES	productivity_gth		lnsales_gth		lnemploy_gth		ln_productivity_LFY	
	coeff	std	coeff	std	coeff	std	coeff	std
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Foreign investment	0.271***	0.249***	0.325***	0.263***	0.005	0.012	0.736***	0.433***
	(0.063)	(0.058)	(0.079)	(0.064)	(0.015)	(0.040)	(0.080)	(0.047)
Foreign investor is South (Africa)	– 0.027	– 0.025	0.037	0.030	0.050**	0.129**	0.178	0.104
	(0.049)	(0.045)	(0.070)	(0.057)	(0.019)	(0.049)	(0.110)	(0.064)
Adj. R-squared	0.251	0.229	0.0836	0.167				

Notes: OLS regressions with standardized coefficients, robust p-values in parentheses, standard errors clustered at country-level. \*\*\* p < 0.01, \*\* p < 0.05, \* p < 0.10. Other covariates (lagged logged productivity levels, lagged logged employment size, firm age, location, technology). We exclude lagged productivity levels in columns 7–8. Sector dummies comprise broad categories and distinguishes by the technology level in the category e.g., High-tech manufacturing.

Source: Gold, Görg, Hanley and Seric (2017).



the attractiveness for foreign investors, efforts to improve institutional quality at the country level can be accompanied by targeted economic policy measures to overcome specific obstacles to investment, as recently discussed by Glitsch et al. (2020).

First, in order to improve the institutional framework in a country, policies should aim to provide open, transparent, and predictable conditions and regulations for all kind of firms, whether foreign or domestic. This includes improvements in the ease of setting up and operating a business, access to foreign markets and inputs of production, relatively flexible labor markets, strengthening contract enforcement, and protecting intellectual property rights.

Second, policies that reduce such institutional barriers to FDI should go hand in hand with a well-planned and executed strategy to actively promote investment on the African continent. This includes the establishment of an investment promotion agency (IPA). The latter has an important role to play in targeting suitable foreign investors and acts as a one-stop shop for providing information, e.g., about local suppliers (Harding and Javorcik 2013). Additionally, it can actively search for synergies with countries that are on the other side of the investment chain and are trying to encourage FDI by their own firms. For example, by engaging with foreign chambers of commerce, IPAs can further bridge information gaps that hinder FDI. Moreover, their role can also be extended to engaging in post-investment care and services, acknowledging the invaluable role of word of mouth from satisfied investors in attracting new investors and facilitating future investments. The ultimate aim is to spawn geographic clusters of new investments, rather than one-off, single investments.

Third, another instrument of an investment promotion strategy that has become increasingly popular is the setting up of Special Economic Zones (SEZ). Unfortunately, the SEZ experience has so far been mixed (Hachmeier and Mösele 2018). SEZs can certainly counteract weaknesses in the national investment climate by encouraging foreign investors to locate in a place dedicated to FDI, where investment carries the promise that multinationals will be surrounded by an attractive business environment. However, foreign investors should engage with local suppliers in a way that channels the spillovers from investment into the domestic economy, and SEZs should refrain from implementing restrictive regulations that hamper foreign-domestic linkages.

### How the "Quality FDI" Works?

Attracting and facilitating FDI, however, does not guarantee that a country will capture significant benefits from FDI, as was hinted at in previous sections. If FDI is to make an important contribution to the economy at large, development policy should be calibrated to be both inclusive and sustainable, focusing on what

might be called "Quality FDI." The latter links foreign investors to the local host economy and contributes to the creation of decent and value-adding jobs.

Moran et al. (2017) discuss a range of policy measures that host governments may implement to maximize the benefits from such Quality FDI. They suggest that there is no one-size-fits-all approach. Rather, host countries' policies need to be tailored to overcome domestic imperfections, facilitating a smooth integration of indigenous and foreign firms into global supply-chain networks. They highlight the importance of providing necessary infrastructure to foreign investors (e.g., telecommunication or transport infrastructure), developing policies to strengthen linkages between foreign firms and local suppliers, and encouraging technology transfer and spillovers to the domestic economy. As we discussed above, Görg and Seric (2016) illustrate that such policies have the potential to raise the benefits from spillovers, whereby in rare instances governments (or more likely multinationals) provide assistance to local firms.

### CONCLUDING REMARKS

This brief review of work by ourselves (and others) on the impact of FDI in African countries suggests that foreign multinationals can indeed benefit local firms. Our results have important policy implications. They show that (under certain conditions) FDI can boost employment, productivity, and facilitate technology transfer to domestic firms. The positive spillovers from FDI must surely be welcome in regions that have grappled with historically low FDI inflows and the poor performance of domestic firms.

Before we conclude, it is worth highlighting some findings that hold special relevance for the future perspective of FDI in Africa.

*FDI from China, India, and ASEAN economies.* We recall from our discussion on south-south FDI that the orientation of investment in Africa is changing. The ascent of China and other late developing economies, with implications for the composition of FDI, may well signal a change in the quality and quantity of spillovers that domestic suppliers can hope to extract from exchanges. It is still too early to say, on the basis of the available data, how FDI and the spillovers arising from it will evolve on the basis of this changing composition. Data relating to investment from China still suffers from the empirical "small numbers" problem. It is therefore difficult to comment on the quality of FDI from new investors until a critical mass of such investments accumulates. Likewise, investments from India are still in their infancy vs. investments from the traditional post-colonial sources (US, UK, and France). It is clear from data released by UNCTAD (2018) that FDI from China grew by at least 50 percent between 2011 and 2016, a growth rate easily outstripping that of investors from other country groups. At USD 40 billion, the investment le-

vel from China almost caught up with that of France (in third position).

Although it is too early to comment on the outcomes for this new wave of FDI from China and India, there is a further source of new FDI offering particular promise for local economies. Our analysis on a cohort of African multinationals (see Gold et al. 2017) reveals strongly positive effects. Specifically, investment by African homegrown multinationals is associated with positive outcomes for employment and technology transfer.

*Government support for domestic suppliers, not just multinationals.* Our evidence for 19 African countries (see Görg and Seric 2016) reveals that government assistance to domestic firms in supplier-multinational buyer linkages is a comparatively rare thing. On the other hand, various national governments in Africa are experimenting with the development of SEZs as a way to attract and support multinationals in a setting where infrastructure is prioritized. However, SEZs should not be seen as a substitute for poor infrastructure nationwide. Such a policy of exclusivity would compromise the growth of domestic firms, among them suppliers to the multinational firms. Policy should therefore address the needs of both domestic as well as multinational firms.

Overall, our analyses (and those of others) highlight the potential of FDI to boost local economies in African countries. It remains to be seen if this positive trajectory can be maintained for new country sources of FDI, e.g., from China. We highlight the need for development policy to be calibrated towards the twin targets of inclusivity (foreign multinationals and domestic suppliers) and sustainability, pursuing FDI investments that help to create decent and value-adding jobs.

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