

**The Changing Role of Political Risk Analyses in Foreign Investment Decision-Making:
A Case Study of South Africa**

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DECLARATION

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ABSTRACT

Political risk has historically been identified as a significant determinant of foreign direct investment (FDI). Numerous studies confirm that investors sometimes eliminate whole geographical regions for political reasons. However, with the intensification of globalisation and the changing sources and nature of political risk, the international investment landscape has been transformed. This transformation, combined with conceptual and practical constraints on political risk analyses, is challenging the determining role of political risk. This situation is significant for both host countries as well as practitioners in the industry. Given the propensity of FDI to be a catalyst for modernisation, understanding these shifts in dynamic is especially significant for developing countries. For capital scarce economies, FDI can be a vital driver of economic growth, improved competitiveness, increased employment and technological advancement. If developing countries want to attract more FDI, understanding the role of political risk analyses in FDI decision-making is paramount. Furthermore, with political risk analysis recognised as a growth industry, understanding how the role of political risk analyses has shifted is likewise critical for analysts in the field. This research study thus investigates to what extent political risk still plays a determining role in the FDI decision-making process.

Accordingly, the main research question of this study considers to what extent declines in FDI into South Africa's key economic sectors between 1994 and 2014 were attributable to increased political risk. Sub-questions, aimed at exploring this in more depth, consider to what extent declines in FDI differ from sector to sector. Lastly, this study considers other regional and global factors which contributed to FDI declines. This case study takes a qualitative approach in the consideration of FDI into three of South Africa's key economic sectors. Using secondary sources, a process of inductive reasoning is applied, to establish patterns of behaviour.

The study found that the majority of the declines in FDI into South Africa's key economic sectors were less attributable to increased political risk and were, to a greater extent, attributable to global and regional factors. While a greater understanding of how political risk analyses are incorporated into FDI decision-making is still required, this study indicates that the international investment community may have shifted from an era of political risk avoidance to one of political risk mitigation.

OPSOMMING

Politiese risiko is histories as 'n betekenisvolle determinant van regstreekse buitelandse belegging (RBB) beskou. Talle studies bevestig dat beleggers soms groot geografiese gebiede om politiese redes uitskakel. Die verskerping van globalisering, asook veranderinge in die oorsprong en aard van politiese risiko, het egter tot gevolg gehad dat die internasionale beleggingslandskap getransformeer is. Hierdie gedaantewisseling, saam met die konseptuele en praktiese beperkings van politiese risiko-ontleding, het tot gevolg dat die bepalende rol van politiese risiko bevestig word. Dié situasie is beduidend vir sowel gasheerlande as praktisyns in die bedryf. Omdat RBB neig om 'n katalisator vir modernisering te wees, word dit noodsaaklik vir veral ontwikkelende lande om hierdie veranderende dinamika ten volle te verstaan. Vir kapitaalhongere ekonomieë kan RBB 'n noodsaaklike dryfveer vir ekonomiese groei, verbeterde mededinging, verhoogde indiensneming en tegnologiese vooruitgang wees. Indien ontwikkelende lande meer RBB wil lok, is dit van kardinale belang dat hulle die rol van politiese risiko-ontleding in die RBB-besluitnemingsproses deeglik verstaan. Met die erkenning van politiese risiko-ontleding as 'n groeiende bedryf, is dit eweneens noodsaaklik vir ontleders in die bedryf om te verstaan hoe die rol van politiese risiko-ontleding verskuif het. Hierdie navorsingstudie ondersoek dus in watter mate politiese risiko steeds 'n bepalende faktor in die RBB-besluitnemingsproses is.

Gevolgtrek sentreer die kernvraag in hierdie studie op die mate waartoe die afname in RBB in Suid-Afrika se hoof- ekonomiese sektore, tussen 1994 en 2014, toegeskryf kan word aan verhoogde politiese risiko. Sekondêre vrae is daarop gemik om in groter diepte vas te stel in watter mate die afname in RBB van sektor tot sektor verskil. Laastens beskou hierdie studie ander streeks- en globale faktore wat tot afnames in RBB bygedra het. Hierdie gevallestudie gebruik 'n kwalitatiewe benadering in die beskouing van RBB in drie kernsektore van die Suid-Afrikaanse ekonomie. Deur sekondêre bronne te gebruik, word 'n proses van induktiewe redenering toegepas om gedragpatrone vas te stel.

Hierdie studie het bevind dat die grootste deel van die afname in RBB in die kernsektore van die Suid-Afrikaanse ekonomie minder aan politiese risiko en tot 'n meerdere mate aan wêreldwye en streeksfaktore toeskryfbaar is. Alhoewel 'n beter begrip van hoe politiese risiko-ontleding in die RBB-besluitnemingsproses geïnkorporeer word nog ontbreek, dui hierdie studie daarop dat die internasionale beleggingsgemeenskap hul fokus van 'n era van politiese risikovermyding na een van politiese risikoversagting verskuif het.

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LIST OF ACRONYMS

ABSA	Amalgamated Banks of South Africa
AIDS	Acquired Immune Deficiency Syndrome
ANC	African National Congress
BBBEE	Broad- Based Black Economic Empowerment
BERI	Business Environment Risk Intelligence
BMF	Black Management Forum
bn.	Billion
BUQ	Bureaucratic Quality
CEO	Chief Executive Officer
COSATU	Congress of South African Trade Unions
CRPT	Corruption
DA	Democratic Alliance
DEMO	Democratic Accountability
ETHC	Ethnic Tensions
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GE	General Electric
GORN	Government Stability
HIV	Human Immunodeficiency Virus
ICRG	International Country Risk Guide
IDC	Industrial Development Corporation
IFC	International Financial Corporation
IMF	International Monetary Fund
INTC	Internal Conflict
INVM	Investment Profile
IPE	International Political Economy
IRR	Institute of Race Relations
JSE	Johannesburg Stock Exchange
LAW	Law and Order
LAB	Labour Policy
MLTY	Military in Politics
MNC	Multinational Corporation
OECD	Organisation of Economic Cooperation and Development

OLI	Ownership Location Internalization
OPEC	Organisation of Petroleum Exporting Countries
PRA	Political Risk Assessment
PRS	Political Risk Services
RLGN	Religious Tensions
ROI	Return on Investment
SA	South Africa
SACP	South Africa Communist Party
SARB	South African Reserve Bank
SOCL	Socioeconomic Conditions
UK	United Kingdom
UNCTAD	United Nations Conference of Trade and Development
US	United States
WB	World Bank
WEF	World Economic Forum
XTNC	External Conflict

CHAPTER ONE: INTRODUCTION

1.1 General Introduction

Foreign Direct Investment (FDI) is a vital component of a globalised economic system and has accelerated the development of many emerging economies. The debate surrounding the relationship between FDI and economic growth continues, but the benefits for developing countries are comprehensive and well-documented (OECD, 2002: 5). FDI is a more stable form of capital. It increases the competitiveness of the host country industries and assists firms in becoming more effective through investment in human and physical capital. FDI has also been linked directly with generating employment in the recipient country and provides the host with greater access to foreign markets, with efficiency and technological spill overs (Ajayi, 2006: 1). Thus, increasingly considered a catalyst for modernisation, FDI is key to globalisation, global financial liberalisation and the development of emerging economies (OECD, 2002: 5). It is no secret that, given the value of FDI, many capital-poor developing countries align their FDI policies to attract foreign investment. In order for these policies to be effective, understanding how Multinational Corporations (MNCs) make investment location decisions and how they respond to variables such as geopolitical stability, the macroeconomic stability of the country and political risk factors is essential. If an emerging economy like South Africa, which has a history of fluctuating levels of political risk, is to attract more FDI, understanding how investment flows respond to increased political risk is a vital part of this process. This research study focuses on the interplay between political risk and FDI inflows into South Africa's key economic sectors in the primary, secondary and tertiary sectors, including the mining, manufacturing and financial services sectors, between 1994 and 2014.

South Africa, broadly considered a regional hegemon in Africa, has received the largest portion of FDI into Africa for decades and inflows have been on a generally upward trend since 1994. Despite this trend, however, the country's ability to attract FDI has generally been described as disappointing (Akoto, 2016: 114). As a result of the apartheid era, financial and trade sanctions were imposed on South Africa (SA) in the 1980s, with many British and American companies winding down their operations. This resulted in historically low levels of FDI (Akoto, 2016: 114).

With the end of apartheid in the 1990s and the lifting of sanctions, as well as changes in institutional, political and economic policy, the country's economy significantly liberalised (Fedderke & Romm, 2006: 756). But South Africa's FDI levels have yet to reach optimal levels. Between 1995 and 2008, for example, FDI inflows only averaged 1.1 per cent of GDP. Similar emerging economies averaged 3.3 per cent during the same period (Akoto, 2016: 114). There have been some encouraging developments, such as South Africa rising two places in the AT Kearney FDI confidence index¹ to become the 13th most attractive foreign direct investment destination in the world (TheGlobalEconomy, 2017a). In 2013, South Africa also attracted record-high flows of FDI at an estimated \$10 billion (Sanchez, 2015). Although encouraging, FDI levels have remained generally subdued, at times experiencing great volatility, with other emerging economies, such as Kenya, showing substantial increases in FDI inflows compared to SA. In 2015, for example, Nairobi attracted the most FDI in Africa at city level, overtaking South Africa's Johannesburg, a position the city held since 2010 (Kariuki, 2016). This research study considers to what extent declines in FDI inflows, more specifically periods of decline in FDI inflows into South Africa's mining, manufacturing and financial services sectors can be attributed to increased political risk.

South Africa's political risk climate posed increased risk to investors throughout numerous periods between 1994 and 2014. In 2014 and 2015 alone there was considerable evidence of this. Unemployment increased to over 25 per cent (the highest since 2005). The country was described as having failing infrastructure, notably in the energy, water and transport sectors (GlobalEdge, 2016). Also, in December 2015, the President of South Africa, Jacob Zuma, fired the country's finance minister, a political decision that is believed to have led to the plummeting of the currency and the stock exchange going into a meltdown (Meintjies, 2016). Furthermore, as will be explored in more depth further in this study, evidence of a notable increase in political risk associated with government unity, an ongoing HIV/ AIDS and education crisis with considerable risks associated with increased unemployment and poverty, a notable deterioration in corruption levels as well as constrained government bureaucratic quality all posed increased political risk and in many cases

¹ AT Kearney is a global management consulting firm. The AT Kearney FDI Confidence Index is calculated as a weighted average of the number of high, medium and low responses to questions about the likelihood of direct investment in a market over the next three years (TheGlobalEconomy, 2017a).

had a considerable impact in the cost of doing business. This research study focuses on the extent to which increases in political risks, such as these, still deter investors.

1.2 Background to the Research Study

Historically, FDI flows and political risk have been closely interlinked, with a number of studies providing evidence that countries with higher political risk typically receive lower levels of FDI². This is not surprising as, according to Kennedy (as cited in Jakobsen, 2012: 32), “[P]olitical risk can be defined as the probability that events in the nonmarket [...] environment of business will cause financial, strategic, or personnel losses to a firm”. This definition explicitly implies financial loss, thus lower profits and therefore a lower return on investment (ROI). Robock (1971: 15), in his review of the identification and assessment of political risk, referred to a study which specifically considered the FDI behaviour of foreign investors. According to Robock (1971:15) “In a broad study from the 12 major capital-exporting investors from countries - Belgium, Canada France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, United Kingdom and United States- many investors reported that they had eliminated countries and even whole geographical regions from their investment considerations for political reasons. By far the most frequently cited political obstacle was ‘political uncertainty’ or ‘political instability’. Thus, historically, political risk was a deterrent to FDI.

Based on the above, it may seem implicit that increased political risk in South Africa between 1994 and 2014 resulted in lower FDI inflows, but the global landscape of business has changed. Robock’s (1971: 15) reference to the above findings dates back more than four decades. These conclusions are thus historical in nature and may no longer be relied upon as drivers of investor behaviour. The world of FDI, geopolitics and political risk has changed dramatically since the 1970s, and factors that once played a determining role in FDI may no longer do so in today’s global market. As globalisation intensifies and international business competition and pressures

² Studies by scholars such as Desbordes (2010), Kolstad and Tondel (2002), Busse & Hefeker (2007), Ali, Fless & MacDonald (2010), Baek & Qian (2011) and Hayakawa (2011), among others, found that high political risk, or the increase in risk related to certain political risk indicators, deterred FDI inflows into a country.

intensify, the relationship between political risk and FDI may no longer be as linear as it once was. This study considers to what extent the findings by scholars such as Robock (1971), referred to above, still hold true for declines in FDI in South Africa between 1994 and 2014. Did higher political risk in South Africa weigh on decision-makers of MNCs to commit further FDI? And if so, to what extent? To what extent can decisions to stop investing or, in some cases, disinvest, be attributed to increased political risk? Did periods of greater political risk deter FDI into SA, or were other factors, such as the ROI, greater access to local and regional markets or the fact that South Africa is considered the gateway to the rest of Africa, have a greater influence over investor behaviour? (*The Economist*, 2012).

Political risk, both the academic discipline as well as the industry, is challenged by inconsistency which limits its utility in FDI decision-making. Recognition of the potentially powerful effects of political risk events date back to the 1930s and World War II, and appears to have grown in significance, yet decades later, inconsistency regarding its definition and application persist. Political decisions, like the one made in 1938 by Mexican President Lázaro Cárdena to nationalise Mexico's hydrocarbons sector, wreaked havoc on many MNCs (Bremmer & Keat, 2009: 7). Decisions such as these may have brought political concerns to the fore, but a real awareness and investigation into the field only gained momentum during the 1960s and 1970s. The revolutions in Cuba, Iran and Nicaragua during the 1960s and 1970s (Jakobsen, 2012: 29) as well as the oil shock of 1973, when a political decision sent oil prices soaring from \$3 per barrel to \$12 per barrel by 1974 (Macalister, 2011), made decision-makers sit up and take cognisance of the potential impact of political events on their assets and potential profits. More recent global events, such as the bombing of the twin towers in New York on September 11th, 2001, the 2008 financial crisis and the looming effect of political corruption in Nigeria on Shell, highlight the ever-growing significance and need for the expertise the political risk industry provides (Global Witness, 2015). However, Bremmer & Keat (2009: 2) noted the following in their book *The Fat Tail*:

Yet, most businesses spend far less energy on the assessment and management of political risk. A recent survey of executives of risk management in the financial services industry revealed that political risk was the least likely of all risk categories to be managed well.

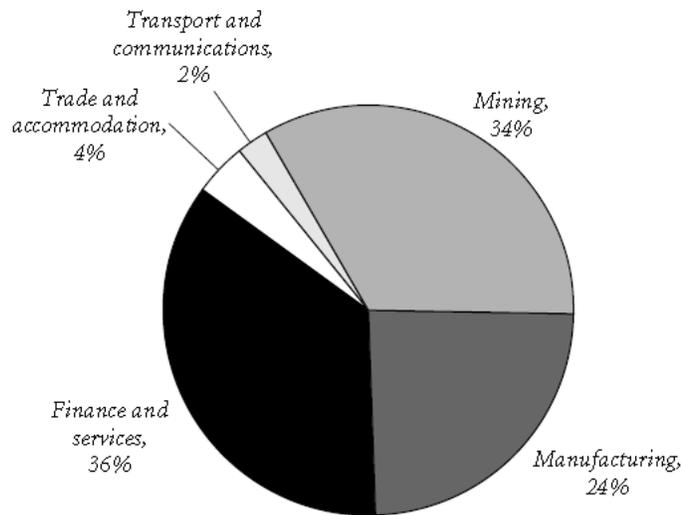
Another poignant observation they made is the following: “Business decision-makers, investors and risk managers tend to ignore political risk until it produces a crisis...” (Bremmer & Keat, 2009: 3). Some of the reasons for this is explored in more detail in Chapter Two, but one of the pertinent reason for this appears to be the fact that a consensus on the precise definition of the term ‘political risk’ is yet to be achieved (Sottilotta, 2013: 6). The potentially powerful implications of political events on FDI and, therefore, their importance in international business and FDI strategies, cannot be refuted, but the political risk industry also remains marred by stark inconsistencies of application in the field. The study by Mark Fitzpatrick (1983: 249), highlights this in the following statement:

The evolution of a body of knowledge concerned with the definition and assessment of political risk has been uncoordinated, due to the absence of a consensus regarding the conceptual framework on which to develop.

This lack of consensus persists more than three decades later and, it can be argued, undermines the reliability and, therefore, the efficacy and utility of political risk analyses in FDI decision-making. For foreign investors to adopt a proactive approach, and prepare for possible losses as a result of disturbances in the political landscape, it is important for them to understand the sources of risk as well as determine whether there are measures that can be implemented to manage and mitigate those risks. However, with little to no consensus on the definition, sources of risk, or the means of accurately and consistently measuring political risk, to what extent are political risk analyses relied upon to make decisions regarding FDI? Taking the above into consideration, the aim of this study was to consider to what extent higher political risk in South Africa between 1994 and 2014 deterred FDI into three of its key economic sectors, namely the mining, manufacturing and financial services sectors. To ensure that the study was representative of all the economic sectors, including the primary, secondary and tertiary sectors, the industries with the largest contribution to South Africa’s GDP were selected. Based on data from 1994 and 2012, the industries with the largest contribution to GDP were mining in the primary sector, manufacturing in the secondary sector and financial services in the tertiary sector. It must also be noted that, as represented in Figure 1 below, by the end of 2002, these three sectors collectively represented more than 80 per cent of the

country's FDI stock³. These sectors were thus identified as South Africa's key economic sectors and of significance in an analysis of the country's FDI flows.

Figure 1: FDI by Sector, Stock at the end of 2002



(Source: Arvanitis, 2005: 67)

Figure 2: Purpose of Study



(Source: Produced by the author for the purposes of this study)

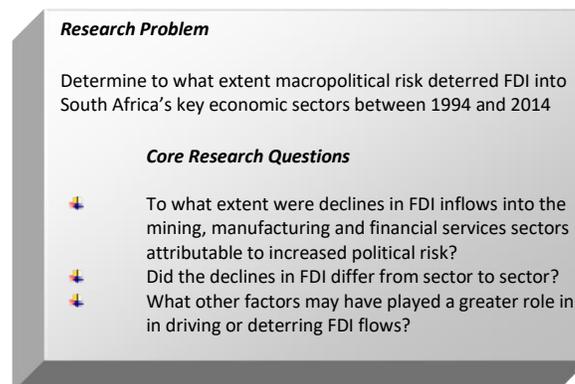
³ FDI stock is the total level of direct investment at any give time, including the value of the equity in and net loans to companies in a foreign country or economy (OECD, 2018)

In addition to the vagueness that surrounds the concept of political risk, there are also numerous other variables MNCs need to consider when making FDI decisions. Variables such as an MNC's global strategy, the state of international financial markets, macroeconomic conditions, the size and demographics of the host country as well as regional market, technical risks, competitor movements, as well as geopolitical factors such as regional stability, all come into play, many of which, it can be argued, dwarf the significance of political risk. For example, General Electric's (GE's) strategy to aggressively expand operations throughout Africa saw them signing a \$1-billion-dollar deal with Nigeria at the end of 2013. Should SA see a decline in FDI from GE going forward, it may have little or nothing to do with increased political risk in South Africa, and everything to do with the fact that GE planned to make Nigeria a regional hub for their manufacturing service and innovation in Africa (*BBC News*, 2013). Amidst these myriad determinants of FDI, how significant a determining role does political risk in influencing or driving investment behaviour?

1.3 Research Problem

Figure 3, from the Research Design Concept Map, provides a visual summary of the research problem and core research questions this study considers.

Figure 3: Research Problem



(Source: Produced by the author for the purposes of this study)

Developing countries⁴ have traditionally been regarded as carrying higher political risk than industrialised countries do, and thus, historically received less FDI than industrialised countries (Villar et al., 2011: 18). Historically this was the case, largely because the biggest risks faced by foreign investors were in developing countries with immature or volatile political systems (Henisz & Zelner, 2010). But developing countries now receive more than half the share of global FDI, indicating a significant shift in global investment trends (UNCTAD, 2015a: 1). FDI flows into developing economies reached 56 per cent of global FDI in 2014, the highest level ever recorded (UNCTAD, 2015a: 4). It would thus appear that higher political risk no longer plays the same determining role in FDI inflows into developing countries it may once have done. While both the prevalence and potential gravity of political risk on FDIs cannot be refuted, a comprehensive understanding of how significant a deterring role it plays in driving FDI behaviour, particularly with regards to FDI flows to developing countries, remains to be achieved. To what extent are political risk analyses, particularly regarding increased political risk, incorporated into FDI decisions? This research study reviews this in the context of South Africa, defined as a developing country, between 1994 and 2014, and the FDI flow into its key economic sectors [Seekoe, 2007: 164].

The FDI flows into South Africa, still widely considered the continent's most influential economy and the gateway to Africa, have experienced some volatility and generally fallen below government expectations (U.S. Department of State, 2014). To what extent this is attributable to increased political risk is unclear. While South Africa's FDI flows have generally been disappointing, the mining, manufacturing and financial services sector have also experienced varying degrees of volatility in FDI inflows between 1994 and 2014. According to analysts such as Venter (2005) and Barnard & Croucamp (2015), this is also true for South Africa's political risk climate. Their analyses indicate that while many political risk indicators in South Africa posed medium to low risk to investors, a number of these posed medium to high risk, with periods of notably higher risk. This research study considers the impact of these periods of increased risk on

⁴ A broad range of countries that generally lack a high degree of industrialisation, infrastructure, and other capital investment, sophisticated technology, widespread literacy, and advanced living standards among their populations as a whole. Developing countries is a term that is often used to refer to countries in Africa that are facing challenges of modernisation and often exhibit low standards of democratic government, civil service, industrialisation and systems of law and order (IGI-Global, 2018).

FDI flows by reviewing the volatility in FDI flows into South Africa along with concurrent periods of increased macropolitical risk. This is done with a specific focus on the years during which FDI into three of South Africa's key economic sectors declined.

Accordingly, the primary research question of this study was as follows:

- To what extent were the declines in FDI inflows into three of South Africa's key economic sectors, namely the mining, manufacturing and financial services sectors, between 1994 and 2014, attributable to increased macropolitical risk?

The sub-questions of this study, supporting the main research question above, were as follows:

- Did the declines in FDI inflows differ from sector to sector?
- What other factors may have played a greater role in driving or deterring FDI inflows?

1.4 Relevance of This Research Study

Political risk analyses and the management of political risk is a critical component of any comprehensive FDI strategy. According to one source, political risk can be defined as follows:

The risk that an investment's returns could suffer as a result of political changes or instability in a country. Instability affecting investment returns could stem from a change in government, legislative bodies, other foreign policy makers, or military control (Investopedia, 2016a).

If not managed effectively, political risk can cost a company millions and, in some cases, even lead to bankruptcy. Political risk experts and consultancies are thus contracted to provide tailored advisory services. These services provide companies with information regarding political developments which may affect their operations as well as assist companies with their FDI strategy, particularly related to areas such as mode of entry into new markets, financing structures and risk insurance policies (Parvulescu, 2016). These services are critical as they assist MNCs in managing and mitigating the political risk of a country, reducing the risk of failure and/or losses and ensuring a greater likelihood of success in their venture.

However, despite the importance of political risk, an academic consensus regarding its definition still evades both scholars and practitioners. This impasse is frequently seen as limiting the incorporation of political risk analyses into FDI decision-making processes (Jakobsen, 2012: 29). While a brief overview of this lack of consensus will be provided below, a more in-depth exploration of the challenges this lack of consensus poses, will be provided in Chapter Two. Studies such as the *“Foreign Investment Decision Process”* by Yair Aharoni (1966) and *“Modernization and Political Instability: A Theoretical Exploration”* by Claude Ake (1974), date as far back as the mid 1960s and 1970s respectively. However, two of the most influential pieces of literature which formally conceptualise political risk analysis are the studies by Stephen Jay Kobrin. *Political Risk: A Review and Reconsideration*, published in 1979, and his book *“Managing Political Risk Assessment: Strategic Response to Environmental Change”*, published in 1982. Kobrin (1979) first referred to the impasse above when defining political risk analysis in his paper *“Political Risk: a review and reconsideration”*. Kobrin (1979: 77) stated: “We need better definitions of the phenomena, a conceptual structure relating politics to the firm, and a great deal of information about the impact of the political environment”. Sethi & Luther (1986: 58) indicated that little progress had been made a number of years later. This is highlighted in their summary of the challenges related to the definition of the concept below:

The current state of research, however, is faced with a number of problems that are likely to limit severely the relevance of the concept both as an analytical tool and as a practical guide to business decision making. These problems are broadly those of definition and measurement (Sethi & Luther, 1986: 58).

Literature throughout the next several decades makes reference to this lack of consensus, many authors discussing how and why inconsistency in definition and delimitation of the concept may limit the discipline’s relevance. This impasse, and taking into consideration global investment trends, namely that FDI is increasingly flowing to developing and politically riskier countries and the impact of political risk on FDI flows need to be re-evaluated. On this basis, this research paper’s aim is draw conclusions surrounding the extent to which increased political risk deterred FDI into South Africa’s key economic sectors. The value of further insights and understanding regarding the interplay between FDI and increased macropolitical risk in a developing country is

twofold. Understanding the drivers of FDI into developing countries, such as South Africa, will assist countries in formulating more effective policies to attract FDI. Secondly, more indepth insight into the interplay between macropolitical risk and FDI, and the extent to which MNCS rely on political risk analyses to make FDI location decisions, particularly in the case of developing countries, will enable practitioners to better structure their analyses to the needs of MNCS.

1.5 Preliminary Review

The theoretical foundation of this study is based on two themes in the literature. These are political risk and the international business theories which explore the determinants of FDI. The review of these bodies of literature is provided to assist in the analysis of the data in Chapter Four.

The first literature theme which will be explored is that of political risk. Areas which will be explored include challenges of definition and conceptualisation, causes of risk, the perpetrators of risk and the possible effects or outcomes of realised political risk. This exploration will draw primarily on the works by Stephen Kobrin (1979), Simon (1984), Sethi & Luther (1986), Frei & Ruloff (1988) as well as more contemporary works by scholars such as Jakobsen (2012) and Sottilotta (2013). The focal point of this exploration is to illustrate the impasse in finding a consensus or reliable definition, a conceptual framework and a means of measurement of political risk and to highlight why political risk analyses may play less of a determining role in FDI decision-making than it did historically. The works by Jakobsen (2012) and Sottilotta (2013) will also be referred to in order to highlight some of the latest developments in the field of political risk analysis. The purpose of this is to emphasise both the relevance of the discipline as well as the industry. Lastly, the literature in this theme will be used to clarify distinctions between concepts such macro and micropolitical risk, instability and risk or country risk and political risk, and thus establish the delimitations of the study.

The second literature theme which will be explored is international business theory, specifically focusing on theories identifying the determinants of FDI. The first two theories that will be mentioned here, the Equilibrium Theory and the Neoclassical Theory, are only briefly discussed. These theories will highlight some of the earliest determinants of FDI identified in literature, and

will lead on to a discussion of the theories which have evolved over time. Following this, various other international business theories which identify macro-level and micro-level determinants of FDI will be explored.

Theories identifying macro-level determinants of FDI, as summarised by Das (2016), which will be reviewed include the following:

- The Dynamic Macroeconomic Theory
- The Exchange Rate Theory
- The Gravity Approach to FDI
- The Economic Geography Theory
- The Institutional Analysis Theory

Theories identifying some of the main micro-level determinants of FDI, as summarised by Das (2016), which will be explored include the following:

- Hymer's Theory on the Existence of Firm-specific Advantages
- The Theory of Oligopolistic Markets and Agglomeration
- The Eclectic Paradigm by John Dunning

These theories will be used later in the analysis to highlight other determinants of FDI in literature that may have challenged the role of political risk in FDI location decisions.

1.6 Research Design and Methodology

The design and data collection methods employed in this research study were based on three main approaches. First, the research would be a case study of FDI into South Africa's key economic sectors, more specifically the manufacturing, mining and financial services sectors between 1994 and 2014. While this study was not comparative in design, the analysis would consider how FDI into these sectors responded differently to increased political risk. The South African economy is comprised of 10 sectors identified by the South African Reserve Bank (SARB). However, given the academic constraints of this study, it would not be possible to conduct an in-depth exploration of FDI inflows into all 10 sectors. This would limit the analysis and thus the ability to draw

conclusions regarding patterns of behaviour. It was, therefore, beyond the scope of this study to consider all 10 economic sectors and only three of the key sectors were considered. These three sectors were selected based on the size of their contribution to the South African economy, as well as to ensure that the primary, secondary and tertiary sectors of the economy were all represented in the analysis. Secondly, the research would be predominantly qualitative in nature. Thirdly, the data would be analysed from a positivist perspective. What these approaches encompass and why they are best suited for this study is detailed below.

The aim of the study was to make a series of observations regarding the impact of political risk analyses on the FDI decisions of MNCs, discern a pattern of behaviour and describe this pattern. As highlighted above, this pattern would not be immediately generalisable, but might serve as a source of further insight, and as a possible building-block, for future studies.

A case study of South Africa has largely been chosen as South Africa is a developing country and thus inherently assumed to have higher political risk. South Africa, also considered the hegemon of Africa, is the top destination for FDI and was Africa's largest economy until 2013, when overtaken by Nigeria, as reported by *BBC News* in 2014 (*BBC News*, 2014).

With regards to conducting the research with a case study approach, the following statement by Zaidah (2007: 1) about the strengths of a case-study is pertinent:

Case study research, through reports of past studies, allows the exploration and understanding of complex issues. It can be considered a robust research method, particularly when a holistic, in-depth investigation is required. Both political risk and FDI location strategy are complex issues with the existing research providing broad findings and generalisations. As Zaidah (2007: 1) notes, "Case studies, in their true essence, explore and investigate contemporary, real-life phenomenon through detailed contextual analysis of a limited number of events or conditions and their relationships". . This research study reviewed higher macropolitical risk and FDI flows into South Africa's three largest economic sectors with the purpose of providing a more detailed, in-depth understanding of the relationship between the two. In providing this deeper knowledge of their relationship in the

context of SA, the conclusions would not be generalisable, but rather provide a building-block for future related research.

Given that this study focused on explaining the relationship between two variables, a qualitative approach to the research was adopted. Qualitative research, as summarised by Labaree (2010) emphasises the qualities of entities and processes and meanings that are not experimentally examined or measured, but rather stress the socially constructed nature of reality and analyse the causal relationships between variables. Quantitative research, on the other hand, focuses on gathering numerical data and emphasises objective measurements and the statistical, mathematical or numerical analysis of data (Trefry, 2017). Based on this, a qualitative approach was deemed best suited for this study.

The third and last component of the design and methodology of this research is that it was done from a positivist perspective. According to Taylor, Bogdan & DeVault (2015: 3), “The positivist seeks the facts or causes of social phenomena apart from the subjective states of individuals”, with a focus on things that may exert an influence on people (Taylor et al, 2015: 3). This approach was, therefore, considered best suited as the focal point of this study considered the extent to which higher macropolitical risk in South Africa might have influenced the behaviour of FDI decision-makers to commit FDI. In adopting a positivistic approach, this study assesses the meaning or value decision-makers attached to higher macropolitical risk in South Africa, when making decisions regarding FDI into three of the country’s key economic sectors between 1994 and 2014.

In line with both a case study design as well as the qualitative and positivist approaches to research, this study did not consider political risk analysis in FDI decision-making as a variable in isolation but more holistically. This study thus considered FDI within the greater setting or context in which MNC decision-makers make their decisions regarding investment locations (Taylor et al, 2015: 9). A holistic approach for this study involved not only a consideration of the political risk of the country, but also factored in other variables such as regional or global trends, macro and micro-level determinants of FDI, such as the Gravity Approach to FDI or the Firm Specific Advantage, or even global economic shifts, as factors which may influence or drive FDI behaviour. This was done by using data from a wide range of secondary sources such as academic journals, media

reports, published research studies and other opinion or analysis pieces. The limited quantitative data relating to FDI into South Africa which will be used, the accuracy of which is of paramount importance to this study, will be taken primarily from reputable sources such as the United Nations Conference on Trade and Development (UNCTAD), the World Bank, the International Monetary Fund (IMF) as well as StatsSA and the South African Reserve Bank (SARB).

The last noteworthy point with regards to methodology is that a process of inductive reasoning was applied. This implies that no general pattern of behavior was assumed and applied or tested (Taylor et al, 2015: 8). The aim of the study was to make a series of observations regarding the impact of political risk analyses on the FDI decisions of MNCs in order to discern a pattern of behaviour and describe this pattern. As highlighted above, this pattern would not be immediately generalisable, but could well serve as a source of further insight and as a possible building-block for future studies.

1.7 Limitations and Delimitations

As noted above, this study was a case study of South Africa and the extent to which increased macropolitical risk between 1994 and 2014 deterred FDI into the mining, manufacturing and financial services sectors. Given that the primary focus of this study was the relationship between political risk and FDI, the study has the following delimitations: FDI or capital investments (excluding portfolio investments), macropolitical risk (excluding micropolitical risk), the period 1994 to 2014 and South Africa's three largest economic sectors (mining, manufacturing and financial services). The study excluded all other sectors contributing to GDP such as transport, public administration, construction, agriculture and utilities.

There are a number of limitations to the study, the most significant perhaps being that the study only drew conclusions from secondary data, and that it did not make use of any primary data. All conclusions drawn regarding the behaviour of decision-makers with regards to FDI projects, such as the location, mode of entry or timeframe of the investment, were based on an analysis of secondary sources, using inductive reasoning. No interviews, discussions or primary data was collected from the decision-makers or MNCs themselves. Another major limitation to this study

is the discrepancy between various political risk analyses and the fact that few MNC use the same consultancy or in-house method (or combination of both) to analyse risk and, arguably, no two MNCs, or their decision-makers, use the same process to come to an FDI decision or execute that decision in the same way. This makes it difficult to generalise any conclusions that might be drawn. However, the vast literature on business strategy, decision-making and FDI, much of which has been empirically tested, guided the conclusions drawn in this study. Another limitation of this study was that the sector specific FDI data for 1995 and 1997 could not be found. However, there was sufficient data for the remaining period 1998 to 2014, to conduct an analysis and draw conclusions. The lack of data for these two years was overcome by highlighting the increase in FDI from 1994 onwards, and then analysing declines in FDI inflows from 2000 onwards.

1.8 Breakdown of the Research Study

This chapter was a general introduction to the research study and provided the background and impetus for the study. It established the importance of FDI for developing economics and highlighted the close link between FDI and political risk. Following this, a brief overview of the impasse in defining political risk and the practical implications thereof for FDI decision-making was provided. Highlighting South Africa's hegemonic position in Africa, and its disappointing trends with regards to FDI inflows, this chapter motivated the choice of South Africa as a case study. Through the above, this chapter clearly outlined the main research question, the research design and methodology as well as the limitations and delimitations of the study.

Chapter Two provides a literature review of two main bodies of literature, including political risk analysis and international business theory related to the determinants of FDI. The review of the literature regarding political risk has two key aims. The first is to emphasise the impasse in defining, conceptualising and measuring political risk and how this limits political risk analyses as a decision-making tool. The second is to provide an overview of its transformation, highlighting that while it remains a crucial component, the role it plays in FDI strategy and investment decisions may have shifted. The second body of literature which will be reviewed is that which explores the determinants of FDI under international business theory. The purpose of this review is to place macropolitical risk in the context of the broader range of variables driving investment behaviour.

This context is important in understanding the analysis and conclusions drawn that follows in Chapter Four, which considers the extent to which increased macropolitical risk deterred FDI. Chapter Three provides an assessment of South Africa's political risk climate between 1994 and 2014 as well as a contextualisation of FDI inflows into its three key economic sectors between 1994 and 2014. In reviewing South Africa's political risk, an assessment will be compiled relying predominantly on the analyses by Venter (2005), Neethling (2012, 2016) and Barnard and Croucamp (2015) along with various other media reports, academic journals and opinion pieces. This assessment has the primary purpose of highlighting specific years during which South Africa's macropolitical risk environment posed increased political risk to foreign investments. Following this macropolitical risk assessment, a contextualisation of FDI between 1994 and 2014 will be provided. National, regional and global FDI will be reviewed, as well as sector-specific FDI flows. This contextualisation will be done with the primary aim of highlighting years during which FDI inflows into these sectors declined, comparative to the previous year.

Chapter Four reviews the years of declines in FDI inflows into South Africa's key economic sectors, while simultaneously considering years of increased political risk. This is done with the purpose of analysing whether these declines were to a greater or lesser extent attributable to increased macropolitical risk during the same year or in the period preceding the decline. This analysis and its conclusions was done by considering national, regional and global FDI trends, predominantly highlighted by the UNCTAD World Investment Reports (2001, 2003, 2004, 2012, 2013, 2015) in conjunction with analyses from various media reports, journals, research studies and published opinion pieces.

Chapter Five, the concluding chapter, provides a summary of the study and answers the research question by summarising the conclusions drawn in Chapter Four. Limitations to the findings of the study are highlighted, as well as suggestions for future research areas.

CHAPTER TWO: LITERATURE OVERVIEW AND THEORETICAL FOUNDATION

2.1 Introduction

Current data indicates that political risk, once a significant determinant of FDI, may no longer play as significant a role in FDI decision-making as it previously did. Historically, research provided evidence that developing countries, inherently politically riskier than industrialised countries, received less FDI than developed countries. Simply put, higher political risk in a country deterred FDI and lower political risk encouraged FDI. Thus, political risk, seen as having a significant impact on the FDI location decisions of some MNCs, was identified as a determinant of FDI, notably deterring FDI in developing countries⁵. But political risk as a discipline and industry has changed considerably and so too have the drivers of investment behaviour. An impasse in defining political risk, with persisting inconsistencies in the definition, delimitation and measurement of the concept, has challenged its role as a definitive decision-making tool. Additionally, changes in the nature of the political risk posed by nations along with significant shifts in international investment behaviour, may also have contributed to a shift in the role played by political risk in investment decisions. These developments are the impetus for considering to what extent political risk still plays a determining role in FDI location decisions.

Over the span of a little more than four decades a number of trends have simultaneously challenged the relevance of political risk analysis as well as reinforced its necessity. Three of these trends have incited the exploration of the extent to which political risk is still a determinant of FDI. The first trend is a persisting lack of consensus in the field. The lack of consensus in both the academic discipline as well as within the industry has increasingly called into question the ability of political risk analyses to be incorporated into FDI decision-making effectively. The second of these trends is that the nature of political risk posed by countries, both developed and developing, has changed. The most notable of the changes is that political risks, such as the risk of expropriation or nationalisation or civil war, has significantly declined (Jakobsen, 2012: 16). There has also been a

⁵ Empirical studies determined market size, wages and political stability to affect the location decisions of FDI (Dunning: 1993).

notable increase in the political risk stemming from developed nations, previously considered beacons of stability (McElvoy, 2016). The third and last significant trend relevant to this research study is that increased globalisation, and the acceleration of capital mobility, has significantly increased the competition between MNCs. This increased level of competitiveness is accompanied by a variety of other determinants of FDI, such as the gravity or agglomeration approach to FDI. It is also necessary to take cognisance of the fact that, in this climate of increased globalisation and competitiveness, MNCs which avoid investing in countries because of political risk, may stand to lose out significantly. Risk avoidance may result in lost opportunities, such as access to new market share and highly profitable ventures. In some cases, missing out may even result in ceding these opportunities to competitors. These trends, along with various others, may have altered how MNCs perceive and respond to political risk. There are numerous contemporary studies that explore the above developments and trends. This chapter, through a literature review, will provide a broad summary of these studies.

In analysing to what extent the declines in FDI inflows into South Africa's key economic sectors are attributable to increased political risk, it is necessary to have an in-depth understanding of its evolution, current conceptual standing, as well as the other factors that impact upon FDI decisions. This chapter will provide this understanding by exploring two broad themes of literature; political risk and international business theories related to the determinants of FDI. Thus, it follows that the first half of this chapter will consider political risk, while the second half will explore international business theory related to the determinants of FDI, providing both the literature review and theoretical foundation for this study.

The first half of this chapter will review the literature regarding political risk, specifically focusing on how an impasse in its conceptualisation and measurement may limit it as a reliable decision-making tool in FDI. First, a brief history of political risk and international events which brought the discipline to the fore is given. Following this, the various challenges regarding its conceptualisation and the practical implications thereof are discussed. The volume of literature exploring these challenges, the theoretical sphere, is vast and the points of contention too many to review here. Additionally, the primary focus of this study is the extent to which political risk deters FDI, and it is, thus, more concerned with the practical than with the theoretical sphere. Thus, the

following literature review will only briefly consider the theoretical challenges within the discipline, while reviewing the practical implications of these challenges in a more in-depth manner. Each challenge, such as the multidisciplinary nature of political risk or the inability to consistently and systematically quantify its effects on business operations, are discussed. This is done with the intention of highlighting and illustrating how these challenges limit political risk analyses in FDI location decisions. Following this, some of the major trends in political risk will be explored to emphasise why the significance of political risk in driving investment behaviour may have diminished over time. This section concludes by clarifying concepts such as political uncertainty versus political instability and country risk versus political risk and will delimit political risk for the purposes of this research study.

The second half of this chapter will provide an overview of international business theories related to the determinants of FDI. Denisia (2010: 104) highlights the following about the rise of FDI theory:

Foreign direct investment (FDI) acquired an important role in the international economy after the Second World War. Theoretical studies have led to a better understanding of the economic mechanism and the behaviour of economic agents, both at micro and macro level allowing the opening of new areas of study in economic theory.

These theories contributed to the study of the International Political Economy (IPE), a theory which draws from various academic disciplines to define how political institutions, the global economy and political institutions interact and influence each other (Investopedia, 2017). This section provides a summary of these theories, with the intention of highlighting the microeconomic and macroeconomic determinants of FDI identified from the 1940s onwards. In analysing to what extent declines in FDI into South Africa's key economic sectors were attributable to increased political risk, it is necessary to understand what other factors may have played a greater or lesser role in driving investment behaviour. This literature review of the determinants of FDI will inform this understanding, which will facilitate an understanding of the analysis in Chapter Four.

2.2 Literature Overview of Political Risk

The origins and history of political risk are not easily identifiable, clear cut or concise, but rather more blurred and complex. The development of the discipline of political risk, as we know it today, was a long and dynamic process and evidence of its evolution can be found over several decades. Fitzpatrick (1983: 249) referred to some of the most common definitions of political risk in his study *The Definition and Assessment of Political Risk in International Business: A Review of the Literature*, citing works by authors such as Whitman, dating back to the mid-1960s. Yet agreement regarding its conceptualisation, methods of data collection, frameworks of analysis and tools for forecasting and calculating its impact, remain contentious issues among scholars and practitioners. Scholars such as Kobrin (1979), Fitzpatrick (1983), Simon (1982, 1984), Sethi and Luther (1986), Frei and Ruloff (1988), Jakobsen (2012) and Sottilotta (2013) have explored the inconsistencies within the discipline in considerable depth over the last three to four decades. Jakobsen (2012: 29) highlights the impasse that still exists in the following extract:

These studies focused explicitly or (as was more often the case) implicitly on the causal link between sources of political risk and its effects. Yet, no real academic consensus on these issues was ever reached.

The following considers why a consensus remains at bay, and the practical implications thereof for political risk analyses as a decision-making tool.

2.2.1 History and Evolution of the Political Risk Analysis Discipline

While there was an awareness of the potential negative impact of political risk on MNCs as early as pre-World War II, a more formal approach to the discipline gained momentum from the 1960s. The implications of political risk on business operations were recognised around the World War II period, evidenced by the appearance of conceptual models exploring the impetus for political risk in the mid-1950s (Chermak, 1992: 168). However, it was only during the early era of confrontation between governments and multinational companies (MNCs) in the 1960s and 1970s, referred to as the hey-day of forced takeovers, that business decision-makers took a keener interest

in understanding the impact of political developments on their investments (Jakobsen, 2010: 482). This was followed by a more formal, structured approach to the discipline. The literature of the 1960s indicates this, where the reception of political risk into studies regarding the realms of economics and finance is more evident (Sottolotta, 2013: 2). There is also evidence that it gained momentum, highlighted by Jakobsen (2012: 29), in the following statement:

Scholars also took an interest in the subject, and the 1970s and early 1980s saw the publication of a large number of studies dealing with definitional and conceptual issues in the field of political risk.

Jakobsen (2012: 29) emphasised this by citing Boddewyn and Cracco (1972), Green (1974) and Simon (1982) as examples of scholars whose studies focused on the causal links between sources of political risk and risk effects. While empirical studies related to political risk in the 1960s, 1970s and 1980s were hindered by a lack of data, as the number of political incidences reducing the profitability of projects increased, so too did the data and number of case studies (Chermak 1992: 170). Similarly, the increase in the number of political risk crises not only incited the need for a better-defined discipline, it heightened the need for political risk as a management tool. Scholars such as Mark Fitzpatrick (1983: 251) highlighted this when he stated that “It would appear that the considerable political turmoil that occurred in the late 1970s has added impetus to the need for this permanent management function”. The above led to a more formal, structured approach to political risk analysis. A review of literature regarding political risk over several decades indicates that much of the groundwork in defining, conceptualising and delimiting the spheres of political risk took place from the 1960s onwards. These works contributed to, and shaped, much of the literature and the discipline as we know it today.

There are many examples in history of political decisions which had serious ramifications for business operations and which led to the growth of the political risk industry. Developments such as the spate of nationalisations in Pakistan in the 1970s (U.S Library of Congress, 1994) and the widespread nationalising of banks in countries such as Mexico, France and India in the 1980s, all heightened the awareness of the potential consequences of government actions on business investments. There are two events, however, which are of particular significance. These are the

OPEC (Organisation of Petroleum Exporting Countries) crises of 1973 and 1979. These two crises are of particular significance as they are seen to have played a pivotal role in bringing political risk analysis to the forefront of business concerns. The first oil crisis in 1973 was a consequence of the decision by the American government to back Israel in the Yom Kippur War. The impact of this political decision is highlighted in the following statement by Macalister (2011):

The decision to boycott America and punish the west in response to support for Israel in the Yom Kippur war against Egypt led the price of crude to rise from \$3 per barrel to \$12 per by 1974.

This occurred when several Arab members of OPEC imposed an embargo on the US and banned the supply of petroleum products to nations such as the US, Netherlands, Portugal and South Africa. This was accompanied by cuts in oil production (U.S. Department of State, n.d.). As Macalister (2011) noted in his analysis, “The price of petrol rocketed, making all transport more expensive.” This briefly summarise the first ‘oil crisis’ of 1973. The political developments, as detailed above, not only resulted in an increase in oil prices throughout the western world, which saw the quadrupling of gasoline prices in America, it ultimately resulted in an economic recession throughout the world (Horton, 2008). Inflation remained above 10 per cent as a result, and unemployment was at a record high. The crisis also had a significant impact on the car industry whereby fuel heavy cars could no longer be sustained. This forced companies to make cars more fuel efficient and changed the American automobile industry. Furthermore, the crisis created an awareness that resource rich countries could use their natural resources as a political and economic weapon, revealing the vulnerability of the Western world (Horton, 2008). The implications of these developments were, therefore, not only significant for the social, political and economic spheres of countries around the world, the impact on businesses and their investments around the world was considerable.

The second oil crisis of 1979 was a culmination of a lack of government stability, socioeconomic conditions and corruption, among other things, which resulted in the Iranian Revolution. Studies indicate that “Open resistance began in 1977, when exiled leader Ayatollah Ruhollah Khomeini called for strikes, boycotts, tax refusal and other forms of non-cooperation with the Shah’s regime”

(Zunes, 2009). By 1979, this campaign of social resistance had culminated in the Iranian Revolution. In mid-January 1979, the Shah was overthrown and Ayatollah Khomeini rose to power. Following this, Khomeini decided to cut oil production, a political decision that resulted in the reduction of oil shipments to the US (Sawyers, 2013). This in turn caused gasoline prices to soar and was one of the primary contributors to a recession in the US economy between 1980 and 1982 (The Regents University of California, 2011). These oil crises, along with numerous other political developments around the world, contributed to the development of political risk as a discipline.

However, despite several decades of research, albeit with significant developments in the conceptualisation of political risk, there is still no real academic consensus regarding its definition or measurement. Sethi & Luther (1986) highlighted this in 1986 and Jakobsen (2012) again drew attention to this impasse in 2012. As will be explored below, this lack of consensus impacts upon the way in which MNCs perceive and thus utilise political risk analyses when making decisions about FDI locations. Numerous scholars have conducted in-depth research studies looking at the differences in defining and delimiting the concept as well as the factors underpinning these differences. Brewer (1981: 6), for example, provides a detailed review of these reasons by examining different approaches to the study of the discipline such as the state-centric approach, the pluralist approach and the bureaucratic politics-organisational behaviour approach. The following literature review will not explore the causes or reasons for a lack of consensus but rather focus on how and why this lack of consensus constrains the use of political risk analysis as a FDI decision-making tool.

2.2.2 Political Risk – Challenges in Conceptualisation

Many scholars, from Kobrin (1979) going as far back as 1979 to more recent scholars such as Sottilotta (2017) in 2017, have referred to the challenges facing political risk as a discipline. While many of these challenges have been resolved, some persist. In cases where sufficient consensus has been reached or an adequate number of scholars have agreed, certain concepts or perimeters of definition have gained some legitimacy and several streams of definition have emerged. In earlier decades, for example, there were a greater plethora of definitions as well as discrepancies

than in the discipline has today. Theoretical discrepancies, such as the difference between country risk and political risk, differences between political uncertainty and political risk or the difference between macro and micro (firm-specific) risk, have largely been resolved. Some of the challenges related to its practical application have also been resolved. Simon (1984: 125), for example, referred to the early tendency of scholars to adopt a narrow focus, primarily looking at the actions of host governments to the exclusion of other noteworthy actors, such as the role played by the vested interests of local business groups or the activities of political opposition forces. Contemporary frameworks of analysis indicate that this is no longer the case. However, challenges that persist include problems of definition, the lack of a conceptual framework, the interdisciplinary nature of political risk and the lack of a framework of analysis. The following provides an outline of each these challenges.

First and foremost, with general reference to challenges related to defining political risk, Sethi and Luther (1986: 59) state the following:

A fuzziness in the definition invariably leads to the wrong selection of data, the inappropriate choice of analytical tools, and the interpretation of findings and solutions that have little, if anything, to do with the original problem.

This statement is pertinent for two key reasons. It not only highlights why political risk analyses may not be considered as a reliable decision-making tool and it also identifies two key phases in the process of analysing political risk. The first phase, which is theoretical in nature, involves the definition, including the conceptualisation and delimitation, of political risk. The second phase, which is more practical in nature, refers to the process of selecting and interpreting data. How and why problems in defining political risk limit these processes, as referred to above, will be explored in more detail later in this chapter.

The second conceptual challenge is that of a lack of consensus regarding a conceptual framework. According to Fitzpatrick (1983: 249), the lack of a conceptual framework within the discipline has led to the evolution of a body of knowledge which is uncoordinated. While others, such as Friedmann & Kimm (1988: 64), with reference to the wide variety of viewpoints included in

political risk, state that the lack of consensus is almost overwhelming, making the development of a conceptual framework difficult. Several scholars have attributed the lack of a conceptual framework to the interdisciplinary nature of political risk.

Kobrin (1979: 68), for example, highlights this in the following statement:

Root concludes that the distinction between political and economic risks breaks down at the experiential level as a result of the "... interdependence of economic and political phenomena".

The following statement by Simon (1984: 124), with reference to the interdisciplinary nature of political risk, alludes to why this may be problematic for the integration of political risk analyses into FDI decision-making:

It is often difficult for economists, political scientists, business management scholars, legal experts, and sociologists to communicate with each other because their respective training and current interests produce different ways of looking at a problem.

Simon (1984: 123) did not fail to emphasise that political risk assessment had become one of the fastest growing sectors in international studies based on instability in foreign social and political systems, the continuously changing power structures in international relations and the increasingly need for MNCs to gain greater control of their foreign operations. However, Simon (1984: 124) also highlighted that there was a general scepticism among corporations regarding the ability to operationalise and quantify non-economic variables such as political risk. This was broadly based on the belief that political risk was too amorphous and subjective and could, therefore, not undergo systematic, quantitative analysis. This, Simon (1984: 124) believed, led to the tendency of corporate decision-makers, used to working with economic data, to avoid what was perceived to be soft political and social data.

The third and last major conceptual challenge discussed in this section is the lack of consensus regarding a conceptual framework of analysis to aid in the analysis of data (Simon, 1984:124).

There are two key implications of this challenge for the use of political risk analyses in decision-making highlighted in this section. A critical part of the process of defining and delimiting political risk involves selecting political risk indicators or indices to be analysed and/or measured. In selecting political risk indicators, a framework of analysis is developed. With reference to Jakobsen's (2012: 41) causal framework, this includes the selection of three key elements, namely the sources of political risk, the actors or perpetrators of political risk as well as the possible effects of that risk. Bremmer & Keat (2009:70) however, highlight "That there can be no grand unified theory that explains how political risk impacts all capital markets. There is only a broad range of tools and methods that can help us apply ideas to the particular cases for which they are best suited". They suggest that it takes the form of a selection of questions, such as the regime type and the behaviour associated with that regime, the ideology of the government of the day and the constitutional constraints limiting the government's ability to execute decisions (Bremmer & Keat 2009: 70). The challenges of this process can be seen as twofold. Firstly, a practitioner's primary step in deciding to either delimit the political risk indicators and then collect data, or review the data first and then delimit the risk indicators accordingly, will in itself create inconsistency and may lead to varying analyses.

Secondly, a significant challenge in selecting these indices is to make sure that the assessment is broad enough so as not to miss any critical political developments but not too broad, which could make the analysis irrelevant. Brewer (1981: 5) notes, as does Simon (1984: 125), that assessments of political risk traditionally had a narrower focus. Simon is referring to the scholars' narrow focus on actors, while Brewer is referring to the scholars' narrow focus on major risks such as expropriations, exchange controls and government instability. With regards to scholars taking too narrow a focus, Brewer (1981: 5) states the following: "First, they are too narrowly focused on expropriations, exchange controls and government instability in the developing countries of the Third World". As a result, they failed to consider smaller actors and risks, which, in some cases, were of greater significance. As the discipline of political risk evolved the scope of risks considered broadened, but evolved from one extreme to the other. Examples of the scope of political risk being broadened is seen in the inclusion of risk factors such as uncertainty regarding future tariffs, non-tariff barriers, taxes, export controls and labour relations (Brewer, 1981: 5). This, according to Brewer (1981: 5), sometimes results in political risk becoming a catch-all term that refers to

miscellaneous risks that are not necessarily known by particular names. According to Brewer (1981: 5), “The extremes of overly narrow or highly unstructured notions of political risk should both be avoided”. However, with no practical guidelines as to how to strike an optimal balance between the two, the selection of indices or criteria for assessment is largely left to the practitioner. It therefore follows that the quality of a political risk assessment relies heavily on the experience and expertise of the practitioner. This makes the process intrinsically subjective and inconsistent. This subjectivity and inconsistency limits both the reliability and validity of the framework of analysis, and thus the analysis itself.

The above review highlights some of the practical implications of the conceptual challenges facing the discipline, but these challenges do not undermine the relevance or necessity of political risk analysis. While the above refers to how these challenges may limit the use of political risk analyses in investment decisions, these analyses remain vital to MNC FDI strategies. As Bremmer & Keat (2009: 196) noted, “Looking ahead, political risks are likely to become more, not less, relevant to both governments and corporations.” But in acknowledging its relevance, the question surrounding the nature of its role remains. Given its interdisciplinary nature and problems of definition, delimitation, frameworks and tools for analysis, to what extent do MNCs rely on political risk analyses to make decisions regarding the location of their FDIs? The following section will elaborate further on the above through a more in-depth discussion of the challenges related to the political risk industry. Political risk scholars such as Sethi and Luther (1986: 58), for example, state the following:

The current state of research, however, is faced with a number of problems that are likely to limit severely the relevance of the concept, both as an analytical tool and as a practical guide to business decision making. These problems are broadly those of definitions and measurement.

While the relevance of political risk may have proven itself unquestionable since this statement in 1986, the role it plays as an analytical and business decision-making tool leaves much to be explored, including how frequently it is used and to what extent it influences or changes FDI location decisions. As Simon (1984: 141) notes,

Future research efforts should be aimed at applying the framework to different country situations in order to determine if recurring patterns can be identified. Efforts should also be directed at improving our understanding of the dynamics of political risk management.

This recommendation still broadly holds true for political risk analysis today. The following section provides a broad overview of challenges in the political risk industry, building on from the above exploration of the conceptual challenges and the relevant practical implications identified above. This review will highlight several key reasons why political risk analyses may play less of a determining or deterring role in FDI decision-making than it did in previous decades.

2.2.3 Challenges in the Application of Political Risk

Despite its relevance, significance and necessity, a review of the literature indicates that not only do MNC decision-makers have a poor history of consulting political risk analyses, there are also significant challenges to their formation. As discussed above, the first phase for a practitioner of assessing or measuring political risk is to define it. The second phase, assessing political risk, including the selection and analysis of data, is more practical in nature. While the first phase is more academic and theoretical in nature, the second phase is more practical in nature. This research study focuses on the impact of political risk analyses on FDI decisions and is therefore more concerned with the practical phase. The practical phase or process of assessing and measuring political risk is made up of three key steps, including choosing a framework of analysis, collecting data and selecting tools, whether qualitative or quantitative, with which to analyse or interpret this data. This phase is critical as it typically results in a political risk assessment. The following reviews what the literature states about challenges facing this phase, as well as the history of the use of these assessments or analyses in FDI decision-making.

2.2.3.1 Limited Use of Political Risk Analyses by Decision-Makers

Despite political risk analyses providing MNCs with valuable information, evidence indicates that their use by decision-makers has been limited. Authors such as Kobrin (1979) and Brewer (1981) going as far back as the late 1970s and early 1980s, to more recent authors such as Baas (2010: 136), wrote about how business decision-makers perceived political risk analyses as a necessity, but how, almost contradictorily, they used them in a haphazard manner. Below is a review of some of the literature regarding this. Studies over several decades have indicated the limited use of political risk analyses by managers. Kobrin (1978: 31), for example, states the following:

Surveys of managerial assessment and evaluation of the political environment conducted over a fifteen-year period consistently reveal an interesting paradox. With very few exceptions, managers rate instability (or political risk) as one of the major influences on the foreign investment decision. Yet, again with very few exceptions, the same surveys report the absence of any formal or rigorous and systematic assessment of political environments and/ or their potential impact upon the firm.

While the findings of this study can be considered outdated, newer studies indicate that this trend persists, albeit to a lesser degree. Authors such as Baas (2010: 136) have cited numerous authors who draw attention to this in more recent literature. The following provides an example of this:

In spite of its growing importance to the profitability and, in some cases, the very survival of their firms, many businesspeople and their financial supporters tend to undertake political risk assessment (PRA) in a superficial, haphazard and subjective way (Pickford and Vurens, 2007). For example, Befeki and Epstein (2008: 35) note that 84 percent of firms recently polled by the American Institute of Public Accountants do not formally integrate social and political risks into their investment decisions. This situation is not new. During the past four-and-a-half decades scholars have consistently reported that corporate executives view political risk as an important consideration and lamented the state of PRA in the corporate world (Baas, 2010: 136)

The above indicates that, despite gaining momentum in recent years, the integration of political risk analyses into corporate decision-making remains limited. A review of the literature indicates several reasons for this. The following section explores these, focusing on three significant, practical challenges in the formation of political risk analyses. This exploration will highlight a few key reasons why some corporate executives find political risk analyses problematic, potentially limiting their efficacy and thus utility.

2.2.3.2 Challenges in Developing a Framework of Analysis

The first of these three key challenges in the practical phase of political risk analysis is that of developing a framework of analysis. Jakobsen (2012: 21) states that to create a framework, it is imperative to reach a consensus regarding the sources, actors and effects of the political risk. As touched on above, this remains a major conceptual challenge within the discipline, with significant practical implications. Delimiting the indicators of political risk is vital for various reasons but Brewer (1981: 6) highlights two of significance in the following statement:

Such a matrix can facilitate political risk assessment in two ways. First, it can provide a checklist of possible problems and thereby encourage more systematic scanning of the environment for risk. Second, it can help to focus attention on those few analytic dimensions that bear especially close scrutiny. Thus, it can enhance both the broad surveys and the close looks in a two-phase analytic process.

Despite its importance, the creation of a consistent, valid and reliable framework of analysis still eludes scholars and practitioners today. Kobrin (1979: 68) emphasised a critical consequence of this for the integration of analyses into FDI decision-making. In his paper *Political Risk – A Review and Reconsideration*, he states the following: “One of the conclusions of this paper is that most managers’ understanding of the concept of political risk, their assessment and evaluation of politics, and the manner in which they integrate political information into decision-making are all rather general, subjective and superficial”. Baas (2010: 135) reinforced this several decades later in the following statement:

In spite of multinational firms' exposure to political risk, corporate political risk assessment (PRA) efforts tend to be superficial and reactive. This situation is a function of the relative underdevelopment of PRA frameworks which, in turn, is a result of the fragmented nature of PRA as a discipline.

While there may be several causes for political risk lacking a framework of analysis, Sottilotta, a notable scholar in the field, highlights one of these causes worth noting (Sottilotta, 2013: 6). She states that the lack of a consistent framework of analysis may in part be attributable to a lack of transparency in the industry among private and public practitioners, such as Business Environment Risk Intelligence (BERI), Control Risks and the Eurasia Group, and who carry out political risk assessments for MNCs today. This is highlighted in the following statement: "As a matter of fact, most of them do not disclose, if not to a very limited extent, their methodology for risk-assessment, nor do they seem to agree on a precise definition of what political risk is to the purposes of their activities" (2013: 6). The above review of the literature, both historical and current, reaffirms the necessity for consistent frameworks of analysis, but highlights the lack thereof. This, as highlighted above, has notable consequences for the incorporation of political risk analyses into FDI decision-making.

2.2.3.3 Challenges in Collecting Quality Data

The second major practical challenge of significance to this study is data collection, which is unstructured and subjective. This challenge is partly attributable to the lack of a consistent analytical framework and partly to the lack of guidelines for data collection and content. The literature covering this area, even studies focusing primarily on problems of data collection, provide no solutions or corrective action for these. In his review of some of the key deficiencies in political risk assessment, Brewer (1981: 5) notes the following about data collection: "Second, their methods of information collection and analysis are either too impressionistic and intuitive, or too mechanistic and formalised". Just two years later Fitzpatrick (1983) expanded on this in his review of various conclusions drawn by studies which considered the data sources of international firms. In his study Fitzpatrick (1983: 251) cites works by authors such as Zink (1973), Keegan (1974) and Perlmutter (1969), noting that these studies all broadly concluded that firms would

mainly use internal sources of information. This is highlighted in the following statement: “When assessing the political environment, the international business firm tends to use internal sources of information in the main part, combined with a general knowledge that its executives had derived from the media” (Fitzpatrick, 1983: 251). The practical implication of this, of notable significance to this study, is that the information and subsequent perceptions were general and subjective⁶.

A review of more recent literature indicates that this challenge remains. In their book *Analysis Without Paralysis: 10 Tools to Make Better Strategic Decisions*, Bensoussan and Fleisher (2008: 134) emphasise the following: “Data collection is the foundation for the validity of political risk scoring, and it is often flawed”. Some major flaws that Bensoussan and Fleisher (2008: 134) highlight is that the data collected has a tendency to be historical, comparative and subjective in nature. Its historical nature is problematic as past behaviour is not necessarily an indicator of future behaviour. Its comparative and subjective nature is considered problematic as the same data cannot be procured for different countries and subjectivity is prone to bias as different experts attach varying meanings or values to data and interpret data in different ways (Bensoussan & Fleisher, 2008: 134). All of the above factors imply that different assessments of the same country may produce very different results, compromising such assessments’ consistency and integrity. Given the unstructured and subjective nature of data collection in political risk as described above, political risk assessments are inherently subjective, ethnocentric and biased. This not only undermines the reliability of the assessments, but has led to their informal, unsystematic integration into FDI decision-making (Fitzpatrick, 1983: 251).

The last major challenge with regards to the collection of data is as a result of a recently identified trend called Big Data. The advancement of technology over the last few decades has added another challenge to the process of data collection. Big Data refers to large volumes of information, structured and unstructured, that overburdens businesses on a day-to-day basis. As Political Risk Analyst, Dr Muñoz (2016) states, “The challenge here, as is always the case when Big Data is involved, is to work with content from around the world and sifting through an infinity of data to gather intelligence that can then be used for human-driven analysis within a wider analytical

⁶ Found by authors such as Van Agtmael (1976), La Palombara and Blank (1977) as well as Kobrin et al. (1980) (Fitzpatrick, 1983: 251).

framework”. While there is evidence of progress, this area still poses a challenge to the political risk industry. Tools such as the software by start-up Geoquant have recently been developed that automates the process of data collection⁷ (Shieber, 2017). However, the gathering and analysing of large amounts of data is still broadly left to individuals who are not only limited in time and ability, but inherently subjective in their selection.

2.2.3.4 Challenges in the Interpretation of Data

The third and last major challenge facing political risk in the analysis phase is that of data interpretation. The interpretation of data refers primarily to the ability of practitioners to consistently, validly and reliably interpret and quantify the effects of political risk. Although political risk analysis is a process which consists of various stages, it is during this phase that the result, vis-à-vis the analyses, is produced, with the intention of being integrated into FDI decisions. A review of the works by various scholars related to the challenges of data interpretation is presented below.

As noted above, due to a lack of transparency in the field, an inconsistency in analytical frameworks and the subjectivity of the data collected, political risk analysis is often referred to as a soft science. It thus follows that analyses would be comprised of ‘soft data’. “‘Soft data’ is anecdotal, usually gathered in informal communications, and lacks the rigor that is implied in statistic data” (Kiritz, 1997: 2). This is problematic as there is emotion attached to it that cannot be statistically verified. Befeki & Epstein (2008: 35) also expand on this in later years when they state that political risks are broadly considered immeasurable and typically explained in narrative form. One of the earliest observations of the challenge of this for political risk and its integration into FDI decision-making was by Brewer (1981). Given that political risk analyses are a mixture of quantitative and verbal estimates, Brewer (1981: 5) notes that financial analysts would be likely to treat these quantitative estimates based on “soft data” with scepticism. He draws attention to a major implication of this for the integration of these analyses into decision-making when he states

⁷ GeoQuant pulls all kinds of data from traditional country data from institutions like banks, non-governmental organizations, social networks and high frequency opinion polls. The data from approximately 250 risk variables is then processed through the company’s software that formulates a real-time score for political risk in a country (Shieber, 2017).

the following: “Third, the integration of political risk assessments into the capital budgeting analyses tends to be simplistic” (Brewer 1981: 5). Another important observation that Brewer (1981: 9) made, still pertinent today, is the following:

However, even if political analysts can develop methodologically respectable estimates, and even if financial analysts are receptive to the possibility of incorporating them directly into the financial decision-making process, a difficult problem still remains. That is the problem of how to integrate the results of political risk assessments into standard financial analyses, particularly in the capital budgeting process.

International business strategies, especially with regards to long-term capital investments, are undertaken to generate optimal profits. FDI decision-makers are therefore accustomed to working with hard economic data and financial indicators. It follows, thus, that there would be a reluctance to use soft data such as political risk analyses (Simon, 1984:124).

Baas (2010: 137) in his analysis written almost two and a half decades later indicates that this challenge still largely persists. Baas (2010: 137) states the following: “The extent of the challenge is made all too apparent when PRA is compared to other activities associated with investment decisions. In general, the tools, data and benchmarks used to evaluate the economic and market risk factors related to FDI are relatively well-developed, have been tested over time and are deemed credible by corporate decision-makers.”. With regards to political risk analyses, however, he noted that there is neither a generally accepted definition of political risk nor any widely accepted methodologies to evaluate it Baas (2010: 137).

Much of the literature regarding the challenges that political risk faces, dates back to the 1980s. Given the significant growth of the industry, one would expect sufficient progress to have been made for many of these challenges to now be obsolete. However, a review of the works by contemporary political risk authors such as Bremmer and Keat (2009), Jakobsen (2012) and Sottillotta (2013), indicate many of these challenges still persist. As recently as 2012 Jakobsen (2012: 25) notes the following:

...the political risk assessment industry, whose advice are paramount in MNCs' location decisions, are regularly criticised for offering forecasts that are inherently subjective with respect to methodology, variable selection and country-specific evaluations; for not providing theoretically or empirically informed analyses; and consequently, for giving foreign investors advice of questionable validity and accuracy.

If noteworthy scholars in the discipline made these claims less than five years ago, where does that leave the discipline and the industry today? Considering the above challenges, why do political risk analyses remain a vital consideration in FDI location decisions? Many attribute the growing importance of political risk to globalisation and the fact that companies are increasingly exposing themselves to political risk as competition in the global economy intensifies (Baas, 2010: 136). Sottolotta (2017) in her new book *Rethinking political Risk: Concepts, Theories, Challenges*, argues that institutions, both public and private, have increasingly developed complex methodologies to evaluate risk just to keep up with the rapid globalisation of trade and investments. This increased interconnectedness is accompanied by increased political risk. The following statement by Hall (2014) illustrates the significance of this:

Back in 2005 political risks were ebbing, making the world a safer place. Three years later, upgrades to risk assessments outpaced downgrades almost threefold. Then in 2009, an about-face: not only did downgrades outpace upgrades, but a new 'very high' risk category was created. By 2012, there were seven times more downgrades than upgrades.

Thus, despite the many challenges explored above, political risk not only remains a pertinent issue, but there are signs that it is increasingly considered a constraint to foreign investment, ranking second only to macroeconomic stability (Hall, 2014). Despite all the challenges facing political risk that are explored above, its necessity cannot be refuted, as is illustrated by the recent growth in the industry. One need only look at the increase in the number of consultancies to get an indication of this. In 2014 *The Financial Times* published an article with the heading "*Political risks now a growth industry*", noting its increasing prominence (Thompson, 2014). Political Risk consultancies now charge large sums for their expertise and analyses by way of heat maps,

complex scoring systems and government networks. These high fees charged are indicative of the value MNCs attach to this information (Thompson, 2014).

The following looks at a handful of the emerging trends in the global political economy and considers how they may have changed the nature of political risk from the 1960s and 1970s to today.

2.2.4 Current Conceptual Standing of Political Risk

Globalisation has significantly increased the speed at which international business, trade and FDI takes place, making the world more interconnected than ever before. This, along with shifts in the type of political risk posed by countries has transformed both political risk and FDI. Considering the political risks faced by MNCs in earlier years, specifically during the rise to prominence of the discipline in the 1960s, 1970s and 1980s, it is apparent that many of these risks are no longer of serious concern today. Jakobsen (2012: 16) draws a comparison between the earlier years of political risk and current political risk. He first states the following, broadly summarising the investment and political risk environment of the 1960s and 1970s:

If this is the case, much has changed since the 1960s and 1970s – the era of fiercely anti-capitalist and nationalist developing countries, across-the-board nationalisations and a booming political risk assessment and insurance industry.

Following this, Jakobsen (2012: 16) highlights how this has changed in the following statement:

By one account, 95 per cent of changes in the host nations' FDI policies in the period 1992-2001 were positive and “either loosened regulatory restrictions or provided new promotions and guarantees to attract FDI” (Kobrin 2005a: 70; see also Sumner 2005:274).

Jakobsen (2012: 17) largely attributes this to the fact that countries now see economic liberalisation and further integration into the world economy as fundamental to development, necessitating that government and policy maker interests are congruent to those of MNCs.

Furthermore, companies are being bought and sold across borders on an unprecedented scale. This has resulted in governments and MNCs being increasingly interconnected. A shock in one country can quickly spread to other countries (Economics Online, 2017). The fact that political risk is of greater concern than ever before can largely be attributed to this increase in interconnectedness. As Thompson (2014) highlights in one of his articles, “On-the-ground operations, supply chains, investments, regulation, contract negotiations, tax- almost everything can hinge on knowing when the revolution is coming”. So, despite the vast challenges that pervade the discipline, academics, political risk practitioners and many MNC decision-makers will agree that political risk is by no means a bygone phenomenon, but remains a vital element of FDI strategy (Jakobsen, 2012: 17).

Lastly, Sottiolotta (2013: 13) also identified a number of important political risk trends, one being that political risk has shifted from being predominantly from developing countries to being increasingly from developed countries. Developing countries have liberalised and adopted an increasingly cooperative approach to FDI. Meanwhile, the political risk from developed countries has increased. Events such as the 9/11 terror attack in the United States (US) and terrorist attacks in France in 2015 and 2016, highlight this (*BBC News*, 2016). Other examples of events posing potentially significant political risk include the Brexit referendum results of June 2016 as well as the election of Donald Trump as the new president of the US (Fleming & Foley, 2016). Developed nations, previously considered as beacons of stability, have increasingly become a source of risk, instability, and uncertainty and MNCs are more frequently choosing to invest in countries such as Nigeria, despite very high political risk. In light of these trends, can political risk still be considered a significant determinant of FDI?

If political risk analyses remain paramount to MNCs, but are simultaneously criticised for offering advice of questionable validity and forecasts that are inherently subjective, what role do they play in FDI decision-making (Jakobsen, 2012: 25)? Did periods of higher political risk cause declines in FDI? This question will be answered by reviewing FDI into three of South Africa’s key economic sectors between 1994 and 2014 and periods of increased political risk during the same year or in the preceding period. Before embarking on this analysis however, the remainder of this chapter will provide a delimitation of political risk for the purposes of this study as well as a review of some of the other determinants of FDI identified in the literature.

2.2.5 Delimiting Political Risk Analysis

Amidst a plethora of definitions and frameworks of analysis available, as briefly looked at above, it is important to identify or delimit what is meant by ‘political risk’ when reviewing the political risk of a country. As noted by Robock (1971: 7) “To assess and forecast the likely influence of political risk in international business decisions, one must start with an operational definition”. The following section will provide the operational definition of political risk for the purposes of this study. In addition to this, some clarity will be provided regarding a few concepts, such as the differences between country risk, political risk and political uncertainty as well as the difference between macro risk and micro risk. The following chapter, in providing a broad overview of higher political risk in South Africa between 1994 and 2014, will delimit the specific political risk indicators which will be considered for the purposes of this research study.

Fitzpatrick (1983: 249) identifies four main categories of definition that emerged in the early stages of conceptualising political risk, citing authors that published works between 1965 and 1980. At the time of publishing Fitzpatrick (1983: 249) notes that an operational definition which could be integrated into FDI decisions was still in the early stages of development. While this operational definition is still in the process of being developed, as explored above, some consensus has been achieved. For example, there is some agreement that “Political risk can be defined as the probability that events in the nonmarket [...] environment of business will cause financial, strategic, or personnel losses to the firm” (Kennedy, cited in Jakobsen, 2012: 32). In this respect, a political risk must have the potential to reduce the profitability of an investment (West, cited in Jakobsen, 2012: 34). In some cases, profitability is broadly conceived to include the goals of a company, such as brand awareness and company reputation. For the purposes of this research study, only political risks which may result in financial loss are considered (Jakobsen, 2012: 34).

Further to this operational definition, another important distinction which needs to be made is the difference between country risk and political risk. (Jakobsen, 2012: 37). One definition of country risk is a country’s ability and willingness to service its financial obligations (Hoti and McAleer, 2004: 1). This last definition of country risk is even accompanied by several well-established indicators, such as capital inflows, debt service payments and the default history of a country

(Sottilotta, 2013: 7). Other definitions of country risk incorporate a wider range of risks associated with doing business in a foreign country, including economic, financial, social and political risks (Jakobsen, 2012: 37). However, country risk fundamentally refers to the likelihood of a foreign government defaulting on its bonds or other financial commitments (Investing Answers, 2016). This research study only focuses on political risk, to the exclusion of wider country risk factors.

Another important distinction is the difference between political uncertainty and political risk. Much like in the case of country risk, many authors use the terms political uncertainty and political risk interchangeably, but these, too, are distinctly different concepts. Jakobsen (2012: 34) tells us that “It was Frank H. Knight (1921) who introduced the theoretical division between risk and its sister concept uncertainty”. Political risk is considered something measurable, where the possible outcomes of a situation are known and the probability of the outcome estimated. However, with uncertainty the outcomes as well the probabilities are unknown (Jakobsen, 2012: 35). While it is not possible to ignore all elements of political uncertainty, when analysing the political risk of a country, this research study focuses on political risk.

The last distinction which will be made is the difference between micropolitical risk and macropolitical risk. The coining of the term macro-risk in the sphere of political risk analysis, has been attributed to Robock (1971: 9), who provides us with a comprehensive definition of both macro-risk and micro-risk:

Macro risks refer to large-scale and often dramatic socio-political incidents – such as revolutions, warfare and substantial changes in risk investment rules – that may affect all businesses in the host country. *Micro risks*, on the other hand, are events, actions or changes that are intended to affect only selected fields of business activity or foreign enterprises with specific characteristics.

Political risks are considered macro in nature when they are unanticipated, politically motivated and not directed at specific industries or specific foreign enterprises (Robock, 1971: 9). Examples of these include government stability, government legitimacy, military involvement in government, government corruption and the strength of the rule of law. Macropolitical risk can

be indirect and spasmodic in times of political turmoil where all companies are equally at risk. While this may be the case, it is also important to note that even when political risks are macro in nature, their impact on different industries may vary. For example, industries such as manufacturing, agriculture, mining and construction are all labour intensive, often relying heavily on large, low-skilled labour forces. As a result, these industries may be at greater risk to labour policy changes or resulting labour unrest, than the financial services industry, for example (Borain, 2013). In contrast, micro risk refers to firm-specific risks or political risks which will only impact upon a particular firm, project or industry. Micropolitical risk is considered very important to MNCs as there is a higher level of relevance and specificity (Alon & Herbert, 2009: 127). As early as the 1970's, Robock (1971: 9) cited examples of micro risks including selective expropriations, terrorist attacks aimed at hotels, tax increases directed at specific companies or price controls for utilities. This study only considers the macropolitical risks posed to investors in South Africa's between 1994 and 2014.

2.3 International Business Theory and the Determinants of FDI

Increased globalisation, the flow of goods, services, capital, technology, ideas, information, cultures and nations across borders, has increased in velocity and intensified over the last several decades (Bremmer, 2005: 13). This has led to record high flows of FDI and, consequentially, the emergence of unprecedented levels of interconnectedness between governments, economies and MNCs (Dulupçu and Demírel, 2005: 4). The international business landscape has also seen a significant growth in the number of MNCs. This growth is seen to be parallel to that of globalisation (Dulupçu and Demírel, 2005: 4). These developments spurred an increase in the number of theories reviewing MNC behaviour. Many of these theories, under the umbrella of international business literature, consider the drivers of investment behaviour. These, drivers, also commonly referred to as the determinants of FDI, are the primary focus of the literature review of international business theory. High, or increased, political risk posed by a country may have deterred investors in the past, but evidence indicates that political risk may no longer be as significant a determinant as it historically was. In analysing and understanding the extent to which increased political risk deterred FDI between 1994 and 2014, it is necessary to understand the plethora of FDI determinants identified in the literature. Considering political risk as one of

numerous determinants of FDI, places it in the context of other drivers of FDI behaviour, enabling a better understanding of the analysis that follows later in this study.

While the definition of FDI has also undergone some evolution over recent decades, its current definition highlights the fact that it is inherently riskier than other forms of indirect investment. Historically, FDI was defined as a company from one country making a physical investment into setting up buildings, machinery and equipment in another country (Graham & Spaulding, 2005). Today the concept of FDI is more broadly understood as an investment made by a company, headquartered in one country, into a company based in a different country with the intention of creating a long-lasting business relationship (Dulupçu and Demírel, 2005: 8). This investment involves acquiring a lasting management interest in a company (Graham & Spaulding, 2005). FDI can occur in various forms ranging from the direct acquisition of a foreign firm, the construction of a facility, investment in a joint venture (JV) to the formation of a strategic alliance with a local firm with an attendant input of technology, licensing or intellectual property or a full merger (Graham & Spaulding, 2005). These investments typically involve sunk costs, namely those that cannot be recovered once incurred (Investopedia, 2016b). This is an important distinguishing factor of FDI as it is much costlier for MNCs to withdraw their investments, and thus it makes FDI inherently riskier (Baek & Qian, 2011: 67).

Despite FDI being riskier than other more indirect forms of investment, investors still choose to pursue these investments, willingly exposing themselves to risk. As highlighted above, FDI is inherently riskier as it typically involves sunk costs. This risk is exacerbated by other variables associated with entering a foreign market, such as competing with local firms all of which have a better knowledge of the operating environment, physical distance between the parent company and subsidiary as well as differences in culture, business ethics, legal and other regulations (Faeth, 2009: 167). Yet, despite all these risks and challenges, Graham and Spaulding (2005) note that “FDI plays an extraordinary and growing role in global business”. Much of international business theory, particularly theories considering the determinants of FDI, consider why MNCs choose to engage in FDI and expose themselves to risk. The following provides a review of this body of theory, with a specific focus on the determinants of FDI.

International business theory categorises the determinants of FDI into macroeconomic and microeconomic determinants. The following review will follow this categorisation, providing only an outline of the many theories, with the intention of illustrating the multiplicity of factors considered in the FDI decisions. The Eclectic Paradigm by John Dunning, however, will be explored in more detail, as it is one of the more broadly adopted theories in international business literature. It is unique in that it looks at the determinants of FDI from a more holistic perspective and emphasises that the determinants of (or deterrents to) FDI are usually a combination of both macro and microeconomic factors (Faeth, 2009: 166).

2.3.1. History and Evolution of International Business Theory

The modern MNC, as we know it today, was formed in Europe in the 19th Century (Dunning & Archer, 1987: 19). Initially MNCs increasingly engaged in FDI to overcome difficulties in export tariffs, a development which led to scholars increasingly studying the behaviour of MNCs. As the motivation for MNCs to engage in FDI diversified, so too have the studies exploring this area. When compared to some of the earliest theories, namely the General Equilibrium theory of 1870 and Veblen's Neo-Classical Theory of 1900, international business literature has changed considerably (Aspromourgos, 1986: 266). Originally only two key determinants of FDI were identified. The first was for MNCs to access capital where it was cheapest. The second was for them to produce in locations which offered the highest rate of return on investment (ROI) (Dulupçu and Demirel, 2005: 8). The General Equilibrium Theory then identified two additional and distinct motivations for FDI. The first of these was accessing markets when MNCs were faced with trade frictions, also referred to as a horizontal FDI. The second was to access low wages in the production process, also referred to as a vertical FDI⁸ (Blonigen, 2005: 392). While these theories, and the relevant determinants of FDI they identified, may have been relevant and of value at the time, as FDI increased in volume and became more structurally complex, their relevance, at least in isolation, gradually declined. An increase in the number of studies as well as shifts in the landscape of international business, led to notable changes within the literature. The most notable

⁸ "Horizontal FDI, where multi-plant firms duplicate roughly the same activities in multiple countries, has been distinguished from vertical FDI, where firms locate different stages of production in different countries" (Glass, 2008: 1)

of these changes emerged in the 1960s and early 1970s when literature went from being predominantly descriptive in nature to being more economic in nature (Faeth, 2009: 165). Evidence of this shift remains prevalent today as empirical studies still dominate the literature.

Spanning several decades, the body of literature within this discipline is vast with a wide variety of different theories exploring the determinants of FDI. Economists have divided these theories into primarily macro-level and micro-level determinants of FDI. A third category identified are the development theories. The leading macro-level FDI theories explored below include the Dynamic Macroeconomic Theory, the Exchange Rate Theory, the Gravity Approach to FDI, the Economic Geography Theory and, lastly the Institutional Analysis Theory. Only a brief summary of these theories will be provided, apart from the Institutional Analysis Theory. This theory will be discussed in more detail as it was one of the earliest to recognise specific political risk indicators as determinants of, and deterrents to, FDI. The key micro-level theories which will be explored include Hymer's Theory on the Existence of Firm-Specific Advantages, the Theory of Oligopolistic Markets and Agglomeration as well as the Eclectic Paradigm by John Dunning (Das, 2016: 1). As noted above, while these macro-level theories will only be discussed more generally, Dunning's Eclectic Paradigm, will be explored in more depth, given its wide acceptance and holistic approach to the FDI behaviour of MNCs.

2.3.2 Macroeconomic Theories on Determinants of FDI

The first, and possibly one of the oldest of the macroeconomic theories, is the Capital Market Theory, which forms part of the Portfolio Investment Theory. This theory proposed that FDI is determined by interest rates and identified three advantages of investing in less-developed countries (LDCs). These include the following: an undervalued exchange rate which allows for lower production costs, lack of organised securities which makes access to capital easier and, at times, less expensive and, thirdly, the fact that investing in a country allows for control of their assets. These three advantages became some of the earliest determinants of FDI to be identified in the literature (Das, 2016: 2). The second theory, the Dynamic Macroeconomic Theory, proposed that the macroeconomic environment was not only a determinant of FDI but determined the timing of FDIs. The determinants of FDI recognised in this theory include the following: gross domestic

product (GDP), domestic investment, real exchange rate, productivity and openness (Das, 2016: 2). The third theory, the Exchange Rate Theory, recognises the exchange rate of a country as a determinant of FDI, and linked in some cases directly to the firm-specific goals or strategies of an MNC⁹.

The last two macroeconomic theories worth mentioning briefly here before exploring the Institutional Analysis Theory, are the Gravity Approach to FDI and the Economic Geography Theory. The Economic Geography Theory, which is concerned with why internationally successful industries emerge in particular countries, identified natural resources, the nature of a country's labour force, local demand and the infrastructure of the host country as important determinants of FDI (Das, 2016: 3). The Gravity Approach to FDI considered the proximity, geographically, culturally and economically, of countries to one another as a determinant of FDI, with factors such as the size, status of development, geographical distance, language and other institutional variables, all identified as determinants of FDI (Das, 2016: 3). For example, studies exploring the home bias in corporate decision-making found that corporate decision-makers have a tendency to be biased towards investing in countries that are geographically closer to their home countries. These studies also indicated that not only physical distance was of consequence, but cultural and institutional similarities between the source country and the country receiving FDI, remained a decisive factor in foreign corporate investment decisions (Levis, Muradoglu & Vasileva, 2016: 782).

The sixth and final macroeconomic theory, specifically concerned with the effects of political risk and FDI, is the Institutional Analysis Theory. This was the first international business theory to focus on elements of political risk, namely the impact of institutions such as governments, markets, education and socio-culture structures and conditions, on FDI flows (Wilhelms & Witter, 1998: 3). This theory was also one of the earliest to identify purely political risk factors as determinants of FDI. As noted by Das (2016:3), "According to this theory, FDI is determined more by institutional variables, viz. policies, laws and implementation and less by intransigent

⁹ Study by Ruiz in 2005 considered exchange rates as a determinant of FDI, also looking at how exchange rates determine the decision to invest a country dependant on whether the MNC is investing to service the local market or for export purposes (Ruiz 2005, p.1)

fundamentals". Poor quality institutions were seen to be a significant deterrent to FDI for several reasons. Blonigen (2005: 389) provides us with a summary of these reasons. Firstly, poor quality institutions may lead to poor legal protection of assets, increasing the political risk of expropriation, nationalisation or a breach in contracts. Secondly, as a direct consequence of poor quality institutions, there may be increased corruption in a country, which could significantly reduce the expected profitability of an FDI. Thirdly, poor institutions are likely to lead to poor infrastructure (i.e. public goods), which may reduce profitability and thus lower FDI (Blonigen, 2005: 389).

The above theories may each have their own respective limitations in explaining the investment behaviour of MNCs, but they highlight some significant determinants of FDI. From the above we can identify numerous macroeconomic factors that motivate MNCs to undertake FDI ventures, despite political risk. In summary, the above review of the macroeconomic theories concerning FDI identifies the following twelve key variables as significant determinants of FDI: exchange rates, interest rates, lower production costs, the opportunity to control a host country's assets, the GDP of a country along with other macroeconomic factors such as levels of domestic investment, geographical and cultural proximity, the availability of natural resources, the nature of the labour force, local demand and the quality of the host country's institutions. The more recent study by Baek & Qian (2011: 61) affirms the above in their summary of the determinants of FDI, which include the following: a large domestic market, sustainable growth, interest rates, stable political and policy environments, exchange rates, sufficient economic and infrastructure development and high natural resource development.

The above determinants may play a key role in the decision-making process of MNCs to engage in FDI, but as the review below of the microeconomic determinants of FDI will indicate, there are an even greater number of firm level factors that play a determining role in MNC FDI. Even when the above macroeconomic factors in a country are optimal, a firm may still decide not to invest should the location not be in line with the firm's overall strategy or goals. The following will give a brief overview of a few prominent theories regarding the microeconomic determinants of FDI.

2.3.3. Microeconomic Theories on Determinants of FDI

Numerous micro-level FDI theories concerned with the firm-level factors motivating MNCs to invest, as opposed to simply exporting or licensing their products, have been developed (Das, 2016: 3). These theories include the existence of the Firm Specific Advantage Theory, the Oligopolistic Markets Model, the Theory of Internalisation and John Dunning's Eclectic Paradigm. This section will provide a brief overview of each from the literature regarding these theories, highlighting some of the micro-level determinants of FDI found in the literature.

The first of these which will be considered is the Theory of Internalisation. Despite having many contributors over the years, Faeth cites Buckley and Casson (1976) to be considered as the founders of this theory, as they were the first to formalise it into a comprehensive theory of the MNC (2009: 168). The Theory of Internalisation focuses on how and why firms integrate activities into their firms which were previously undertaken by intermediate firms. This led to the identification of two broad firm-level determinants of FDI, namely the removal of competition and the exploitation of firm-specific advantages (Denisia, 2010: 107). Denisia maintains that Hymer (1976) was responsible for widening the scope of this theory to an international context while Hennart (1982) expanded upon it even further by developing models related to vertical and horizontal integration (Denisia, 2010: 107). Some of the key determinants of FDI to emerge out of this theory are high transportation costs, increased transaction costs and trade barriers as well as firm-specific challenges such as inadequate information about the market (Dulupçu & Demirel, 2005: 10).

The second influential microeconomic theory of importance is Stephen Hymer's Existence of a Firm Specific Advantage. This theory, referred to by Dunning & Pitelis (2008: 168) as path-breaking, proposed that MNCs invest abroad because of certain firm-specific advantages such as access to raw materials, economies of scale and intangible assets such as trade names, patents and superior management (Das, 2016: 3). This theory was unique in that it brought to the fore key microeconomic determinants of FDI. Hymer's contribution in this respect is highlighted by Buckley (2006: 146) in the following statement:

In Hymer's work it is a necessary condition for the existence of the multinational corporation that it possesses a 'firm specific advantage' and a sufficient condition that the firm can obtain more profit by exploiting advantage internally than licensing it out to external organisations.

Dunning and Pitelis (2008: 168) also emphasise the relevance of this firm-level determinant of FDI. They argue that the internalisation of firms is not to reduce costs, but rather to enable them to exploit their advantages better.

A third micro-level theory identifying yet another important firm-level determinant of FDI is the Oligopolistic Reaction Theory. The following by Dulupçu & Demirel (2005: 11), provides us with an apt summary of the basic assumptions proposed by this theory:

According to the Oligopolistic Reaction Theory of Knickerbocker, one firm invests in one country in order to increase its market share. Immediately thereafter the other rival oligopolistic firms invest in that country in order not to lose their market shares. This kind of investment is also known as "Follow-the-leader". Besides, as firms avoid ambiguities and risks, they wait for an investment of a leader firm before investing themselves, and its consequences and then they invest. This constitutes the reasoning of follow-the-leader theory.

Scholars such as Hoenen and Hansen (2009: 11) and Knickerbocker (1973: 7) explored various aspects of this with evidence indicating that, in some cases, the move by MNCs to pursue FDIs (apart from the 'first mover') were defensive and reactive in oligopolistic markets. For example, in his analysis of the behaviour of 187 US firms, investing in 23 countries, Knickerbocker found considerable empirical evidence to support the 'follow-the-leader' behaviour of firms, affirming it as another important microeconomic determinant of FDI (Faeth, 2009:168).

Considering the multiplicity of determinants of FDI identified above, it is important to be aware that the literature above does not recognise any one of these determinants as the sole determinant of FDI, highlighting that the FDI behaviour of MNCs is more complicated to model (Blonigen,

2005: 390). Faeth (2009: 165) also stresses this point when she writes that any analysis of the determinants of FDI should not be based on a single theoretical model but should rather be more broadly analysed by combining various factors from a variety of theoretical models. The first theory to do this, and thus considered by many to be one of the most influential in international business literature, even decades after its formation, is the Eclectic Paradigm by John Dunning. The following will explore this theory in more detail below.

2.3.4 John Dunning's OLI Paradigm

Dunning's Eclectic Paradigm, also referred to as the OLI paradigm, has been referred to as the theory with the most extensive scope among FDI theories, largely attributable to the fact that Dunning created a theory by combining the works of multiple scholars from a variety of schools of thought (Dulupçu and Demirel, 2005: 10). Dunning recognised that many of the theories looking at the macro and microeconomic determinants of FDI had some value in explaining various dimensions of FDI behaviour, and so drew from multiple theories when formulating the Eclectic Paradigm. According to Dunning (2000: 163), the paradigm is a simple, yet profound construct which views a MNC's foreign investment activities as the product of the interaction of three interdependent variables, which form part of three sub-paradigms. The first of these is the competitive advantage a company has, referred to as the MNCs ownership (O) advantage (Dunning, 2000: 164). The second variable is the location (L) advantage of the recipient country (i.e. country receiving FDI). The third and last variable, the internalisation (I) advantage, proposes that the greater the benefits of internalising cross-border markets, the more likely a firm is to prefer engaging in foreign production, as opposed to licencing the right to do so. Therefore, according to this, paradigm, production of a firm in a foreign country depends on three conditions or advantages, namely the ownership, location, and internalisation advantages, which are strongly based on context and will, in particular, reflect the political and economic features of the host country as well as that of the MNC investing (Dunning, 2000: 164). The ownership advantage draws from Hymer's Firm Specific Advantage Theory, which, according to Dunning (2000: 168), relates to a firm possessing scarce, unique and sustainable resources and capabilities which reflect their superior efficiency or capability and which stem from, or create, a barrier of entry for competing

firms. This advantage, including trademarks, trade secrets or patents, for example, gives an MNC a competitive advantage over domestic firms.

Following this condition being fulfilled, Dunning argues that FDI location is then determined by locational advantages such as resource availability, transportation costs, telecommunications infrastructure, market size, geographical distance and cultural relations (Das, 2016: 5). As noted by Dunning (2000: 174), “The eclectic paradigm has always recognised the importance of locational advantages of countries as a key determinant of the foreign production of MNEs”. Any of these locational advantages should make it more profitable for the firm to invest and produce in the host country, i.e. destination of FDI, than to produce in the home country, i.e. source of FDI and export it (Dulupçu and Demirel, 2005: 10). Lastly, drawing on Buckley & Casson’s Internalisation Theory, the internalisation advantage stipulates that undertaking a FDI venture in a host country should be more profitable than selling, leasing or licensing the skills (Dulupçu and Demirel, 2005: 10). Based on these three advantages, Dunning concludes that MNCs engage in FDI because they are resource seeking, market seeking, efficiency seeking and strategic asset or capability seeking (Dunning, 2000: 164-165). Once again, however, we find that analysing the FDI behaviour of MNCs according to these four drivers is not a simple, straightforward process as there are other country and firm-specific dynamics that play a role in driving investment behaviour. Country-specific factors such as the level of development, the size and the level of industrialisation of a country also play a role. Furthermore, firm-specific factors such as whether they are large or small, the leaders of followers, innovatory or mature, processing or assembly, competitive or monopolistic and whether the sector or industry they fall into is high or low technology, all contribute towards determining the FDI decisions on MNCs (Faeth, 2009: 171). It thus follows that the drivers of FDI behaviour are wide ranging and complex.

While the above theories explore the drivers of FDI behaviour, there are two issues that are not explored, but which are of relevance for this research study and which are of significance for the analysis of the FDI data that follows. The first is that that FDI flows experience surges in financial and non-financial sectors, sometimes accompanied by boom-bust cycles in GDP growth and sometimes driven by global and contagion factors (Reinhardt, 2013). Secondly, the availability of capital is sometimes limited and dependant on the life cycle of capital investment. While a

definitive time cycle for FDI projects and their response (or lagged response) to political risk could not be found, Fagunde (2013, in reference to venture capital, noted that the investment phase usually lasted three to five years, and that the management of venture capital, focusing on managing both the initial investment and making follow-on investments, usually lasts five to seven years. Based on this, the analysis below works on an average of a five-year lag time when analysing the response of FDI to increased political risk (i.e. increased macropolitical risk in concurrent year of FDI and preceding five years).

2.4 Conclusion

This chapter summarised the conceptual and practical challenges of political risk, specifically focusing on how and why these challenges may limit the integration of political risk analyses into FDI decision-making. In addition to this, the considerable array of microeconomic and macroeconomic determinants of FDI identified in literature was explored. But is South Africa unique? If everything South Africa has to offer investors is taken into consideration, did periods of higher political risk really deter investment in South Africa? The following chapter provides an assessment of South Africa's political risk climate between 1994 and 2014 as well as a contextualisation of FDI flows into three of its key economic sectors between 1994 and 2014. "South Africa has strong ties across Africa with significant trade links and investments across the continent. It also has a strong base of skilled labour in a number of sectors and who are working in organisations that are benefitting from strong growth across Africa." (Standard Bank, n.d.). Were drawcards such as these sufficient for MNCs to invest in South Africa despite higher political risk, or did the kinds of political risks MNCs were exposed to deter them from investing? The following chapter considers this question and reviews the evidence.

CHAPTER THREE: POLITICAL RISK AND FOREIGN DIRECT INVESTMENT IN SOUTH AFRICA 1994 TO 2014

3.1 Introduction

This chapter contextualises South Africa's macropolitical risk and inward FDI between 1994 and 2014, with a specific focus on FDI into three of its key economic sectors. South Africa provided MNCS with an attractive investment location during this period, yet organisations such as the - United Nations Commission for Trade and Development (UNCTAD) have noted that, based on its size, economic potential and the quality of its macroeconomic management, South Africa only receives about 70 per cent of the FDI it rightfully should (Venter, 2005: 49). Other scholars, such as Arvanitis (2005: 64), have highlighted that South Africa's FDI has remained at low levels comparative to other emerging market countries. While there are no doubt various factors contributing to this, this research study considers the role played by South Africa's political risk. It is often claimed that higher political risk, forming part of country and thus business risk, discourages foreign direct investment (Hayakawa, Kimura & Lee, 2011: 2). To assess to what extent this was true in South Africa between 1994 and 2014, it is necessary to review and understand the country's political risk as well as FDI. This chapter is pivoted around creating this understanding.

This chapter first establishes why South Africa was an attractive FDI location between 1994 and 2014, highlighting that political risk is but one of many determinants of FDI in South Africa. Following this, the chapter is divided up into two main sections. The first section provides a macropolitical risk assessment of South Africa, specifically highlighting periods of increased political risk. This assessment is conducted using the International Country Risk Guide's (ICRG) Political Risk Index. This index is provided by the Political Risk Services Group, one of the leading political risk consultancies in the world (Political Risk Services, 2017). Given that greater financial loss is inherent to increased political risk; it is thus more likely to deter FDI compared to periods of lower political risk. Based on this, more emphasis is placed on the political risk indicators assessed as posing increased risk to investors. Indicators assessed to pose low risk to investors will only briefly be discussed. In the analysis of each indicator, specific periods, i.e. specific years, of

medium to high risk will be identified. This section concludes with a summary emphasising the indicators as well as the periods of medium to high political risk identified in the assessment.

The second half of this chapter then provides a contextualisation of FDI. An overview of FDI flows into South Africa, Africa as well as global FDI flows between 1994 and 2014 is given. This is followed by an examination of FDI into South Africa's mining, manufacturing and financial services sectors. The above contextualisation of political risk and FDI into South Africa's key economic sectors will facilitate the analysis of the impact of political risk on FDI in Chapter Four. In order to analyse to what extent declines in FDI were attributable to increased political risk, it is essential to identify if risk increased during the same year or in the preceding period. This chapter serves this purpose, providing the foundation for the analysis that follows in Chapter Four.

3.2 South Africa: an attractive FDI location during 1994 to 2014

During the period 1994 to 2014 South Africa offered investors numerous advantages for investing, with access to larger markets being a significant one. South Africa's high market potential was broadly evidenced by the size of its large domestic market. The country's population grew from an estimated 40 million in 1994 to approximately 55 million people in 2014 (Worldometers, 2015). During this period, South Africa had the largest economy and the largest middle class compared to any other African country (*The Economist*, 2012). Its population purchasing power parity was estimated to be larger than China's or India's and more than four times the average of any other African country (*The Economist*, 2012). South Africa, therefore, not only offered investors access to its large domestic market, but also access to one of the largest domestic markets in Africa.

In addition to its market potential, geographically South Africa also offered investors a location of strategic importance. For example, a book edited by Dunn & Shaw (2001: 194) highlights this in the following statement: "Simply put, FDI is not looking for competitive environments. The attraction to South Africa is its strategic location in Southern Africa, not its competitive environment". South Africa, frequently referred to as the economic gateway to Africa, offered investors regional access to Africa with excellent import and export opportunities (Draper & Scholvin, 2012: 19-37). This was valuable to investors for the following three key reasons;

Africa's economy was the second fastest-growing in the world, its population was over a billion people and its collective GDP valued at almost \$2 trillion (*The Economist*, 2012). In 2015 the financial site Van Zyl reported that: "Facebook plans to use the Johannesburg office as a launchpad to grow the social media service in Africa" (*Van Zyl*, 2015). This illustrates how global MNCs have recognised and taken advantage of the value of South Africa's strategic location, using it to gain greater access to Africa (*van Zyl*, 2015). Authors such as Draper and Scholvin (2012: 3) highlight this trend more generally stating that South Africa has become a hub for the regional headquarters of multinational companies; a hub for logistics and distribution activities, a sourcing hub for regional markets and a financial hub for regional markets. This emphasises the strategic value of investing in South Africa.

South Africa furthermore offered investors access to infrastructure, considered by some to be the best in Africa (*The Economist*, 2012). In 2012 *The Economist* reported that South Africa was home to 80 per cent of Africa's rail network. In addition, it had well-developed communications, financial, legal and transport sectors (Barnard & Croucamp, 2015: 1). South Africa had an abundance of natural resources, a transparent regulatory framework (Santander, 2016) and its stock exchange was not only the biggest in the region, it also ranked among the top 25 in the world (Barnard & Croucamp, 2015: 131).

The above illustrates the many benefits South Africa offered investors as a location for their investment, yet inward FDI remained limited. Many of the benefits South Africa offered investors in return for committing FDI to the country, as detailed above, are identified in literature as determinants of FDI. Determinants such as access to a new or larger market, improved access to regional markets, well-developed infrastructure in addition to the agglomeration of other MNCs in the country, providing a regional hub, were all relevant in South Africa. But despite these favourable investment conditions between 1994 and 2014, South Africa's ability to attract FDI remained limited. According to Akoto (2016: 114), "Despite the increased efforts to attract FDI into South Africa, the results have been disappointing". This study analyses to what extent these low levels of FDI were attributable to increased political risk, with a specific focus on periods of decline in FDI. This analysis requires an understanding of both political risk and FDI in South Africa during this period. The following provides an assessment of South Africa's political risk

between 1994 and 2014 and a contextualisation of FDI flows, both to inform this understanding and to enable an understanding of the analysis that follows in Chapter Four.

3.3 Twenty Years of Political Risk: An Application of the Political Risk Rating Index

As mentioned above, the ICRG Political Risk index provided by the PRS Group will be applied in the following assessment of South Africa's macropolitical risk between 1994 and 2014. The PRS Group Inc. was established in 1979 and has produced monthly political risk forecasts on over 140 developed, emerging and frontier markets since 1980, based on the ICRG model (Political Risk Services, 2017). The ICRG model, one of several frameworks for data collection, is comprised of various indexes, one of which is the Political Risk index. The ICRG Political Risk has 12 political risk indicators, some of which are broken up into subcomponents. These indicators are consistently used by researchers at the IMF and have been commended by publications such as the *Wall Street Journal* and *The Economist* (Political Risk Services, 2017). In addition to their recognition and use by these reputable organisations, the use of these indicators is advantageous for two key reasons. Firstly, using these indicators allows for a range of different risk environments and costs of doing business to be gauged, environments described as directly relevant for foreign investors (Harms 2002: 378). Secondly, these indicators are commercially available with evidence that they are used by foreign investors (Baek & Qian 2011: 70).

The Political Risk index, which will be applied in this analysis of South Africa's macropolitical risk, includes the following 12 indicators: government stability (*GORN*), socioeconomic conditions (*SOCL*), investment profile (*INVM*), internal conflict (*INTC*), external conflict (*XTNC*), corruption (*CRPT*), military in politics (*MLTY*), religious tensions (*RLGN*), law and order (*LAW*), ethnic tensions (*ETHC*), democratic accountability (*DEMO*) and bureaucratic quality (*BUQ*) (Baek & Qian, 2011: 62). One indicator which is not included in the index, nor listed as a subcomponent, is labour policy (*LAB*). Labour policy features prominently in numerous political risk assessments of South Africa¹⁰. Therefore, in addition to the PRS political risk index, labour policy will be

¹⁰ Examples of political risk assessments of South Africa which draw attention to the risk regarding South Africa's labour policy include the Institute of Risk Management South Africa (IRMSA) Report 2015, IRMSA Report 2016, Barnard & Croucamp 2015, Venter 2005, Neethling 2012 and Neethling 2016

assessed as a separate political risk indicator. In the following assessment of South Africa's political risk, a short explanation of each indicator is given, followed by an assessment of the risk posed by this indicator. In each case it will be concluded whether the indicator posed low, medium or high risk to investors between 1994 and 2014. This will be done with the specific aim of highlighting periods of increased political risk. The following assessment of the risks of each indicator will be based predominantly on the macropolitical risk assessments published by Venter (2005), Neethling (2012) and Barnard & Croucamp (2015). Venter's (2005: 29) work provided an assessment of the notable political risks facing investors between 1994 and 2005. Neethling (2012) used this framework and, referencing much of Venter's (2005) analysis, provided an updated assessment of South Africa's macropolitical risk up to 2013 (Neethling 2012: 38). The third work by Barnard & Croucamp (2015) summarised some of the key factors they analysed as having a potentially significant impact on the overall stability of the country (Barnard & Croucamp 2015: 6).

3.3.1 Government Stability

The first indicator, government stability, is defined by PRS as the ability of the government of the day to implement its policies and programmes as well as its ability to remain in power. Subcomponents of this indicator include the government's unity, legislative strength and popular support (Howell, 2011: 3). The following analysis only briefly considers the subcomponents of legislative strength and popular support as these were assessed to pose low risk. A more in-depth assessment of government unity is provided as this subcomponent was assessed as posing a higher risk to investors for a specific period.

The African National Congress (ANC) experienced popular support in South Africa between 1994 and 2014. During this period the country held four general elections in which the ANC won as much as 69.7 per cent of the population's vote in 2004 and no less than 62.1 per cent (Álvarez-Rivera, 2014). It has been argued that the ANC held this hegemonic position largely due to the lack of strong opposition parties. The analysis by Heidi Brooks (2004: 2) states the following:

In the absence of a credible opposition, however, South Africans continue to vote largely according to racial identity. This has subsequently entrenched the political dominance of the ANC, which continues to be perceived as the party representing the black majority, and has spurred the withdrawal from the democratic process of those sections of the electorate who do not identify with the dominant party.

A report on the trends of voting in South Africa between 2003 and 2014, however, attributed this to the fact that voting may be racially divided as younger and older Africans overwhelmingly voted for the ANC (Nhlapo Anderson & Wentzel, 2017: 19). Whether due to racial identity or the lack of a strong opposition, the ANC's level of popular support and thus their ability to remain in power, has resulted in this subcomponent being assessed as posing low to medium risk.

Despite their popular support, however, unity within the party was less consistent throughout 1994 to 2014. Government unity was assessed as posing low risk from 1994 to 2004 and 2009 to 2014, but the period 2004 and 2009 was considered a period of higher political risk, based on divisions within the ANC, the ruling government at the time. The first indications of lower party unity was in 2004 when Jacob Zuma, then deputy president of the ANC as well as the country, was implicated in corruption and fraud allegations (Jacobs, 2010: 1). In June 2005 President Mbeki relieved Jacob Zuma from his responsibilities as deputy president of the country and as cabinet member. This dismissal was said to have left the ANC and its allies deeply divided (*BBC News*, 2005)

This division further intensified in 2005 and 2007, coming to a head in 2008 when President Mbeki was overthrown. Following his dismissal, Zuma, still deputy president of the ANC, was charged with rape in December 2005 (Corcoran, 2005). Venter's (2005: 35) assessment of government unity at the time was the following: "In sum, there is much uncertainty at present about leadership issues in the ANC and this constitutes a noteworthy risk for investors". In 2007, the media reported that the markets were preparing themselves for the possibility of Zuma becoming the next president (Blackwell Publishing, 2007: 17231). In September 2007 Mbeki suspended the chief prosecutor, claimed by analysts as a sign of a power struggle within the ANC over Zuma's prosecution (Blackwell Publishing, 2007: 17231). In December 2007, the month of the ANC's party conference, it was reported that Mbeki was at risk of being overthrown and that the

conference exposed divisions within the ANC (*Radió Teilifís Éireann*, 2007). In 2008 Mbeki resigned and was replaced by Kgalema Motlanthe, then deputy leader of the ANC. Motlanthe was described as a reassuring figure, inspiring confidence and stability during a period of political polarization and increasing economic uncertainty (Political Risk Services, 2008).

However, despite Motlanthe being a figure of stability, the political risk posed by government unity continued until 2009. In 2009 the pending corruption charges against Zuma were reinstated. Later that year he was inaugurated as President of South Africa (South African History Online, 2012). While there was some evidence of continuing division within the ANC following this, the party remained broadly united again. Divisions within the party were evidenced by the rise of, for example, the Anyone But Zuma (ABZ) movement, which was believed to have a broader-than-usual following within the ANC (Thepa, 2012). Some media claims, like the one made by Khaya Dlanga (2012) that: “We know that there are many in the ANC who lament the transformation the organisation has undergone” also highlight the fact that division within the party persisted post 2009. But, despite these divisions and ongoing criticism against Zuma, the ANC delegates were sufficiently united at the ANC five-yearly elective conference to hand Zuma a resounding victory, with 75 per cent of the vote, re-electing him as the party’s leader at the party conference in December 2012 (Conway-Smith, 2012). Based on the above, it can be concluded that the subcomponent ‘government unity’ posed medium to low risk between 1994 and 2014, with the exception of the period 2004 to 2009, which marked a period of medium to high political risk.

3.3.2 Socioeconomic Conditions

The second indicator, socioeconomic conditions, is an assessment of the socioeconomic pressures at work in South Africa that could constrain the government’s actions or fuel social dissatisfaction. Subcomponents of this indicator include unemployment, consumer confidence and poverty (Howell, 2011: 4). The following summary of this indicator will mainly focus on two of the three subcomponents raised most frequently in analyses of South Africa’s political risk, including unemployment and poverty. Two additional subcomponents, including the human immunodeficiency virus (HIV) and acquired immune deficiency syndrome (AIDS) as well as low levels of education will be introduced. This modification of the index makes the assessment more

relevant to South Africa's political and social context and thus making the risk assessment more comprehensive. HIV and AIDS as well as education are considered as political risks in the South African context for two key reasons. Firstly, both the state of South Africa's education and the prevalence of HIV and AIDS were repeatedly referred to as crises between 1994 and 2014 and in both cases these crises could be attributed, at least in part, to government policies, actions and government constraints. Secondly, there is a direct and significant relationship between poor education, unemployment and poverty as well as HIV and unemployment and poverty. The following provides a brief justification for the inclusion of these subcomponents, before assessing the risk of this indicator.

In a review of South Africa's education system between 1994 and 2011, Nicholas Spaull (2013: 3), noted the following:

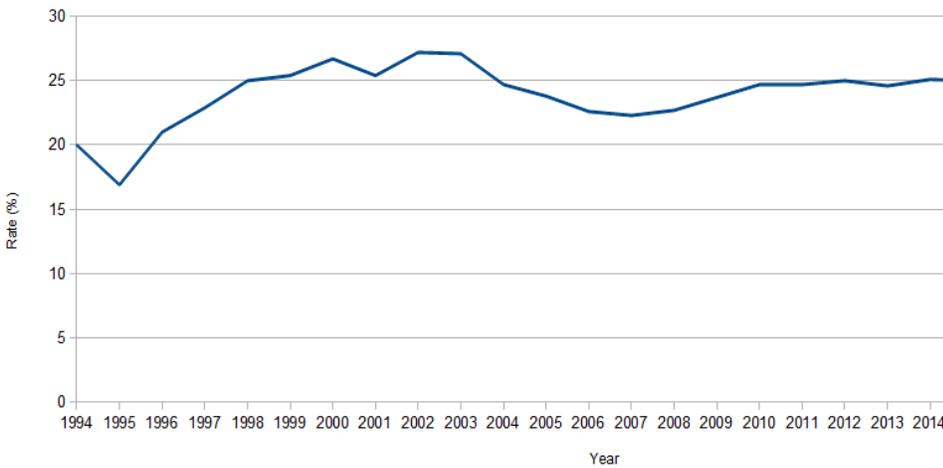
It will become increasingly clear that the weight of the evidence supports the conclusion that there is an ongoing crisis in South Africa's education, and that the current system is failing the majority of South Africa's youth.

While policy implementation challenges contributed to and exacerbated this, the education crisis is considered a political risk based on the conclusion by the Department of Education (2009) that the education department has failed to appropriate inspections and monitoring and created confusion and disillusionment by changing curricula without proper communication and training. Challenges identified by Gaza (2012), reaffirming why education is directly attributable to a failure by government and thus a political risk, include the following: bureaucracy in the education department and inadequate organisational support to teachers, the government's constant shift in curriculum, failure of the education department to deliver on core responsibilities and power dynamics between the South African Teacher's Union (SADTU) and the state. Ndayi (2014) reaffirmed this in the following statement: "Weakened patriotism and the government's invisibility in the education system are the basic challenges to blame for the country's education crisis and growing unemployment". All of this has exacerbated the level of poverty in the country (Gaza, 2012). The gravity of this was expressed by Ndayi (2014) which, in referring to the World Economic Forum's Global Competitiveness Report of 2014 on South Africa's education crisis,

noted that poor education standards led to unemployment and labour inefficiency, referring to it as a threat to national security.

Similarly, HIV and AIDS can be considered to have been a political risk in the period 1994 to 2014 due to poor government policy, a failure by government to respond to a crisis which was partly attributable to capacity constraints and a lack of political leadership, notably by Thabo Mbeki and Jacob Zuma. Mbeki, for example, made a statement in 2000 in which he stated that he did not think HIV alone caused AIDS, a statement which caused a national and international outcry (SA History, 2017). A year later, in August 2001 AIDS activists took legal action against the South African health ministry due to its continued refusal to supply antiretrovirals to prevent mother-to-child transmission. Furthermore, 2006 saw a statement by President Zuma about taking a shower after sex as way of reducing the chances of contracting the virus (SA History, 2017). One last illustration of this, although there is considerably more evidence, was the writing of an open letter to South Africa's president Thabo Mbeki in 2006 calling for the dismissal of health minister Manto Tshabalala-Msimang for what was described as "disastrous, pseudo-scientific policies" on HIV and AIDS. Several months later, the deputy health minister spoke out against the South African government, confirming that there was a denial at the very highest level over the country's AIDS crisis (SA History, 2017). Furthermore, there is a direct link between HIV/AIDS, unemployment and poverty, as confirmed by a report published by the International Labour Organisation (ILO) in 2005. The report identified the strong bi-directional linkages and HIV/AIDS poverty, stating that HIV/AIDS impoverishes, HIV/AIDS slows down economic growth, reduces the quantity and quality of labour, results in future generations losing out on schooling and skills and identified it as a barrier to sustainable development (ILOAIDS, 2005).

South Africa has one of the highest unemployment rates in the world, posing considerable risk to investors. With the exception of 1995, unemployment in South Africa remained at above 20 per cent of the national population between 1994 and 2014, as Figure 4 indicates.

Figure 4: South Africa Unemployment 1994 – 2014

(Source: *BusinessTech*, 2015a)

High unemployment poses a great risk to investors as it is a source of social instability and increases the risk of violent uprisings against the government (Venter, 2005: 41). Neethling (2012: 52), in his assessment of this socio-political risk in South Africa, states the following: “Another factor spelling high social risk is that of extremely high levels of unemployment”. He also states that, “Certainly, youth unemployment remains one of South Africa’s most acute challenges and this must be factored into any discussion on South Africa’s future political landscape” (Neethling, 2012: 52). Based on these assessments and Figure 4 above, it can be concluded that the subcomponent ‘unemployment’ posed medium to high risk in South Africa through 1994 to 2014.

Secondly, with regards to the subcomponent ‘poverty’, South Africa has one of the highest income disparities in the world, with reports indicating that this changed little from the early 1990s (Hodgson, 2012). South Africa’s high levels of poverty and inequality were rated as medium to high risk between 1994 and 2014 as government was more likely to impose higher taxes on the wealthy and, according to Venter (2005: 37), more likely to discriminate against them. Despite evidence of solid growth and a growing black middle class over 15 years, which is considered positive for long-term political stability and economic growth, South Africa’s wealth disparity remained one of the highest in the world up to 2014 (Van der Berg, 2014). It can therefore be

concluded that the subcomponent ‘poverty’ posed medium to high risk to investors throughout the period 1994 to 2014.

As referred to above, in addition to the above subcomponents, in South Africa there are two other socioeconomic risk factors of significance which pose political risk to investors. The first of these is the population’s high prevalence of the human immunodeficiency virus (HIV). Between 1994 and 2000 HIV notably increased from 7.6 per cent to 20.5 per cent. This increase was partially attributable to poor government policy (Karim, Churchyard, Karim & Lawn, 2009: 3). High HIV prevalence poses increased risk to investors for the following reasons; HIV slows down economic growth, increases the number of orphans, which later turns into a risk of increased crime levels, it increases medical insurance costs and thus the cost of personnel and it may also lead to increased illness and absenteeism, thereby reducing labour productivity. For the above reasons, Venter (2005: 39) argued that HIV and AIDS must be accounted for as a significant political risk in South Africa.

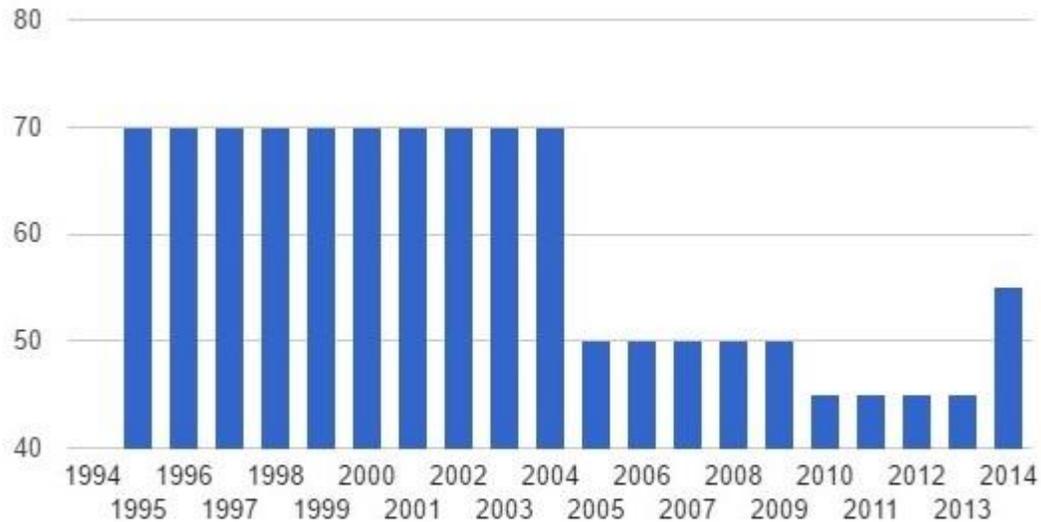
The second of these, low levels of education, was also assessed to be a potential source of social instability, posing high political risk to investors (Neethling, 2012: 45). In his assessment of South Africa’s low education standards, Neethling states the following: “It is obvious that problems in South Africa’s schooling system cut deep and wide into matters relating to skilled labour in South Africa” (Neethling, 2012: 45). It can therefore be concluded that both these two additional subcomponents increased the socioeconomic risk to investors during the period 1994 to 2014, and posed consistently medium to high risk to investors with no specific period of increased risk identifiable.

All four subcomponents discussed above, including high levels of poverty, high unemployment rates, a high prevalence of HIV and low education levels, were assessed by various analysts as posing medium to high risk to investors. Based on this it can be concluded that the political risk indicator ‘socioeconomic conditions’ posed medium to high political risk to investors in the period 1994 to 2014.

3.3.3 Investment Profile

The third indicator, the investment profile, is an assessment of the factors affecting the risk to investment that are not covered by other political, economic and financial risk components. Subcomponents of this indicator include contract viability, the risk of expropriation, profit repatriation and the risk of payment delays (Howell, 2011: 3). An additional subcomponent of this indicator, used in Barnard & Croucamp's (2015: 2) political risks analysis of South Africa is the level of investment freedom. The Investment Freedom Index is a range of restrictions typically imposed on investments, including restrictions on access to foreign exchange, restrictions to payments and transfers as well as other possible obstacles such as bureaucratic red tape, weak infrastructure in addition to political and security conditions (TheGlobalEconomy.com, 2017b). Given that this indicator has such a wide variety of subcomponents, and due to the constraints on the length of this study, most of the subcomponents listed are assessed under South Africa's performance in the Investment Freedom Index. The subcomponent 'expropriation' is explored in more depth as it receives more attention in the assessments by Venter (2005) and Neethling (2012) as well as in the media.

As Figure 5 below indicates, South Africa performed well in the Investment Freedom Index between 1994 and 2004, the first 10 years of democracy, but posed higher risk from 2005 onwards. A significant decline in investment freedom was assessed between 2005 and 2008, declining even further between 2009 and 2013, before improving marginally in 2014 (TheGlobalEconomy.com, 2017b). It can thus be concluded that in the period 2005 to 2014 South Africa's investment freedom posed higher risk to investors than the preceding 10 years of 1994 to 2004.

Figure 5: South Africa Investment Freedom for 1994 – 2014

(Source: The GlobalEconomy.com, 2017b)

The risk of expropriation in South Africa, was broadly assessed as posing low to medium political risk to investors, perhaps with the exception of 2011 to 2012. In 2011 the issue of expropriation entered government discourse and became a topic for debate (*The Economist*, 2011). Section 25 of the Constitution of South Africa of 2005 is described by analysts as a strongly worded guarantee of private property in which no legal prescription would allow the arbitrary expropriation of private property (Venter, 2005: 51). However, analysts also noted that the ANC sometimes displayed a tendency towards being vague and at times threatening about expropriation, leading to the impression that the state may use its power to expropriate property unfairly (Venter, 2005: 51). Based on this, the threat of expropriation in South Africa was assessed to be of medium risk (Venter, 2005: 52). Croucamp & Malan (2011: 161), reviewing South Africa’s public discourse on the nationalisation of mines, agree with this assessment stating that “The likeliness of nationalisation is a medium risk”.

In 2012 the ANC brought greater clarity regarding its stance on nationalisation, reducing the risk posed by this indicator from 2012 onwards (Kgosana, Ngalwa, Matlala & Shoba, 2012). Furthermore, in 2013 the Index of Economic Freedom gave South Africa a score of 50 for its property rights (Barnard & Croucamp, 2015: 11), a score which indicates that expropriation is possible, but unlikely (The Heritage Foundation, 2013). Based on South Africa's performance in the Investment Freedom Index between 1994 and 2014 and the above, regarding the risk of expropriation and nationalisation, it can be concluded that this indicator posed medium to low risk to investors between 1994 and 2014, with a marginal but insignificant increase in risk between 2011 and 2012.

3.3.4 Internal Conflict

According to the ICRG's methodology, the fourth political risk indicator on the political risk index is the risk of 'internal conflict' (Howell, 2011: 4). This indicator assesses political violence in the country and the potential or realised impact on governance. Subcomponents of this indicator include the risk of civil war, the threat of a coup, terrorism, political violence¹¹ and civil disorder¹² (Howell, 2011: 4). The threat of civil war or a coup is seldom explored in analyses of South Africa's political risk or, if mentioned, is not discussed at length as it is not considered a pertinent political risk. The discussion below will, therefore, focus on the latter two subcomponents, 'political violence' and 'civil disorder' as these posed a greater risk to investors between 1994 and 2014.

During the period 1994 to 2014 this risk indicator generally posed medium risk to investors, but increased from 2004 onwards. Prior to 1994, the year during which South Africa held its first democratic elections, it was on the edge of civil war (Dempster, 1999). After 1994, the risk of revolution, serious riots and revolts against the government, serious terrorism and widespread

¹¹ Political violence is violence outside of state control that is politically motivated. This form of collective political struggle can occur in the form of revolutions, civil war, riots and strikes (O'Neil, 2011).

¹² Civil disorder is a term that generally refers to groups of people purposely choosing not to observe a law, regulation or rule, usually in order to bring attention to their cause, concern or agenda (Mid-America Regional Council, 2015).

national strikes became of lesser importance. The risk of internal conflict was considered a dormant risk. Incidents from 1994 to the mid-2000s were not considered serious. In his analysis, Venter (2005: 36) states the following:

The tensions, riots and plundering of properties in municipalities, especially in the Free State Province, in the last 12 months regarding service delivery illustrates that this political risk has not been eliminated. However, these incidents are not particularly serious at present and need not detract the serious investor from investing in the country.

However, data indicates that from the mid-2000s there was an increase in the risk of civil disorder and political violence. For example, between 2004 and 2005 more than 25 serious and violent riots in rural municipalities were recorded, demonstrating dissatisfaction with local government (Venter, 2005: 35). As Table 1 below indicates, social unrest declined between 2006 and 2008, but increased again between 2009 and 2012 (Barnard & Croucamp, 2015: 7). Table 2 illustrates the increase in risk between 2011 and 2014.

Table 1: Social Unrest in South Africa for 2004 to 2012

Year	Peaceful incidences	Unrest incidences	Total
2004/05	7 382	622	8 004
2005/06	9 809	954	10 763
2006/07	8 703	743	9 446
2007/08	6 431	705	7 136
2008/09	6 125	718	6 843
2009/10	7 879	1 008	8 905
2010/11	11 681	973	12 654

(Source: Barnard & Croucamp, 2015: 8)

Table 2: SAPS reports of ‘peaceful’ and ‘unrest’ crowd incidents, April 2011 – March 2016

	2011/12	2012/13	2013/14	2014/15	2015/16
Peaceful	10 832	10 517	11 601	12 451	11 151
Unrest	1 226	1882	1 907	2 289	3 542
Total	12 058	12 399	13 508	14 740	14 693

(Source: Scielo, 2016)

Lefko-Everett, Nyoka & Tiscomia (2011: 13) noted that public demonstrations in South Africa reached extremely high levels from 2005 onwards. It was also highlighted that these demonstrations were increasingly violent and destructive (Lefko-Everett et al., 2011: 7). Neethling (2012: 40), in his assessment of this indicator, also noted the rising risk of internal conflict, due to rising levels of dissatisfaction with municipalities. Neethling (2012, p.52) concluded the following: “In fact, social risk in the form of violent service delivery protests have markedly increased since the mid-2000s and must be cited as a factor of the highest concern”. Alexander (2012), in his study of social protest, also noted that between 2009 and 2012 there was an average of 2.9 incidents a day, which marked a 40 per cent increase from the average recorded between 2004 and 2009. Alexander (2012) further noted that in 2010 and 2011 there was a record number of crowd-management incidents (both unrest and peaceful) and that in 2007 to 2008 and 2009 to 2010. The most common reasons identified for the occurrence of peaceful protest gatherings were demands for increases in salaries or wages, while the unrest typically occurred due to discontent surrounding service delivery issues. It can therefore be concluded that between 1994 and 2003 this indicator posed medium risk, but that this risk increased from 2004 onwards.

In addition to service delivery protests, trade union activism was also identified as a potentially serious political risk (Venter, 2005: 41). For example, strike action between June and September 2005 was attributed to a rising level of distrust between the ANC and its alliance with the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP), leading to increased risk for foreign investors based on decreasing levels of social harmony in the

country (Venter, 2005: 42). In August 2012, a total of 34 mine workers were killed by the South African Police Service's tactical response unit during a mining strike, also known as the Marikana massacre (South Africa History Online, 2017). Leon (2013) referred to this as the beginning of the most serious labour unrest in a generation, which resulted in a R12 billion drop in mining production and was followed by more than 30 violent protests per day. Based on the above, it can be concluded that the risk of 'internal conflict', more specifically the risk of 'political violence' and 'civil disorder', posed medium to high risk to investors between 2004 and 2014 due to rising levels of political violence and increasingly violent civil disorder.

3.3.5 External Conflict

The fifth indicator in the PRS political risk index is 'external conflict', which assesses the risk of foreign action against the ruling government. These foreign actions range from non-violent external pressures such as diplomatic pressure, withholding of aid, trade restrictions, territorial disputes or sanctions through to violent external pressure such as cross-border conflicts, to all-out war. Subcomponents of this indicator include war, cross-border conflict and foreign pressure (Howell, 2011: 4). The following will briefly consider the risk this indicator posed to foreign investors in South Africa between 1994 and 2014.

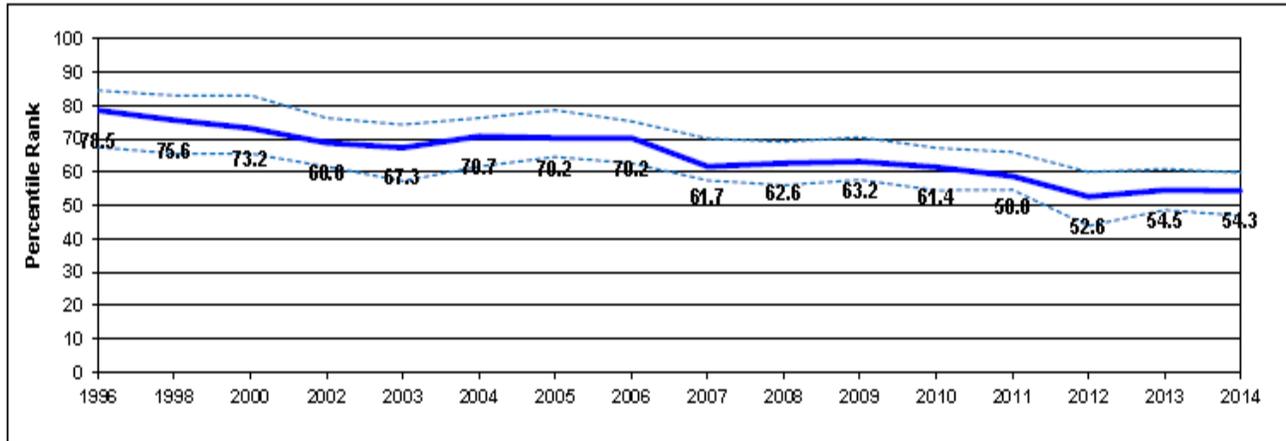
From the mid 1990s onwards, South Africa had a secure external environment given that it had no immediate enemies, no countries competing for regional hegemony and no powerful state was seen to pose any threat (Venter, 2005: 31). Neethling (2012: 39) further postulates that states in Southern Africa are not generally associated with terrorist activities, perhaps with the exception of Tanzania. This indicates low risk of an armed insurrection or terrorism by bad neighbours. One source of external or foreign pressure identified, albeit non-violent, is the growing threat of a large number of illegal immigrants from the region and, more specifically, immigrants from Zimbabwe. This external or foreign pressure has not only been assessed to be overwhelming the resources of the country, but has also led to periods of xenophobia (Venter, 2005: 31). While bouts of xenophobic attacks have been prevalent in periods such as late 2007 to 2008 and again in 2013, both Venter (2005: 31) and Neethling (2012: 44) contend that it did not pose a significant threat to

national security. From the above it can be concluded that between 1994 and 2014, external conflict in South Africa posed a low to medium risk to foreign investors.

3.3.6 Corruption

The sixth indicator on the ICR political risk index is the ‘level of corruption of the state’ (Howell, 2011: 4). As defined by Barnard & Croucamp (2015: 3), this indicator considers the transparency within a state. Transparency International defines it as follows: “Political corruption is a manipulation of policies, institutions and rules of procedure in the allocation of resources and financing by political decision-makers, who abuse their position to sustain their power, status and wealth” (Transparency International, 2016).

The three main assessments used in this review of South Africa’s political risk, including Venter’s (2005), Neethling’s (2012) and Barnard & Croucamp’s (2015), all refer to South Africa’s poor and declining performance on Transparency International’s Corruption Index in assessing corruption between 1994 and 2014. Venter (2005: 44) lists corruption as one of the indicators which posed significant risk to investors. In a *Sunday Times* article Lewis (2012: 14) stated the following: “Another year – and a further slide down the Transparency International Corruption Perceptions Index. From 2010, our ranking has steadily declined from 54th to 69th of the 176 countries surveyed this year”. Neethling (2012: 46) further notes that, despite an improvement in the regulatory environment, corruption remains rife in areas such as the granting of government contracts, bribery and in the rolling out of the Broad-Based Black Economic Empowerment Strategy. Figure 6 below clearly illustrates the overall increase in corruption levels between 1996 and 2014, an average taken from between five and fourteen organisations per year, including Transparency International’s Corruption Barometer Survey from 2004 to 2014.

Figure 6: Aggregate Indicator for Control of Corruption in South Africa for 1996 to 2014

(Source: World Bank, 2017)

The above assessment, as well as statements such as that made by the Black Management Forum (BMF) in 2013, that corruption is one of the biggest threats to the South African economy and the country's democracy, indicates that corruption posed medium to high political risk to investors throughout 1994 to 2014 (*Fin24*, 2013). As noted by Director and Chief Economist for Econometrix (Pty) Ltd. Dr Azar Jammine (2012), "The notion of corruption becoming endemic in South Africa is one that has gained momentum in recent years for a variety of reasons." Jammine (2012) further noted that it was disturbing that South Africa's corruption perception index deteriorated between 2005 and 2011 (from 4.5 to 4.1), a time during which the rest of the subcontinent of Africa saw an improvement and making South Africa one of only five countries in Africa which deteriorated. This supports the findings illustrated in Figure 6 and the increase in corruption referred to in the analysis above. Jammine (2012) emphasised the importance of this deterioration as a political risk, stating that systematic corruption is a threat to constitutional democracy, job creation and economic stability as it leads to inefficiencies, raises production and transaction costs, breeds other forms of corruption and is believed to contribute to higher inflation, reduced investment and lower economic growth in the longer term.

3.3.7 Military Involvement in Politics

Military involvement in politics, the seventh indicator, lessens democratic accountability as the military is not elected by the people (Howell, 2011: 5). Again, the three assessments by Venter (2005), Neethling (2012) and Barnard & Croucamp (2015) concur that the risk of military involvement in politics in South Africa between 1994 and 2014 was low. Venter (2005: 36) made the following statement in his assessment of this risk: “Military involvement in politics is an insignificant political risk at present and for the foreseeable future”. Neethling (2012: 43) affirmed this assessment, stating that the risk of the South African National Defence Force (SANDF) interfering in politics was not a significant risk. Lastly, Barnard & Croucamp (2015: 12) noted in their assessment of South Africa’s macropolitical risk that the recent recorded military expenditure as a percentage of GDP was only 1.2 per cent. This low expenditure indicates that military involvement in South Africa’s politics was minimal. It can, therefore, be concluded that the risk of military involvement in politics in South Africa posed low risk to investors between 1994 and 2014.

3.3.8 Religious Tensions

The eighth political risk indicator to be assessed is religious tensions. This assesses the risk of a religious group seeking to dominate society by replacing civil law with religious law or seeking to exclude other religions from society. As defined by the ICRG’s methodology, this can range from inexperienced individuals enforcing inappropriate policies through to civil dissent and ultimately civil war (Howell, 2011: 5), South Africa was not seen as a high priority for al-Qaida or related Islamist movements, thus, regarding terrorism, this indicator was assessed as posing low risk to investors in South Africa (Venter, 2005: 37). In 2013 Neethling (2012: 43) further noted the following:

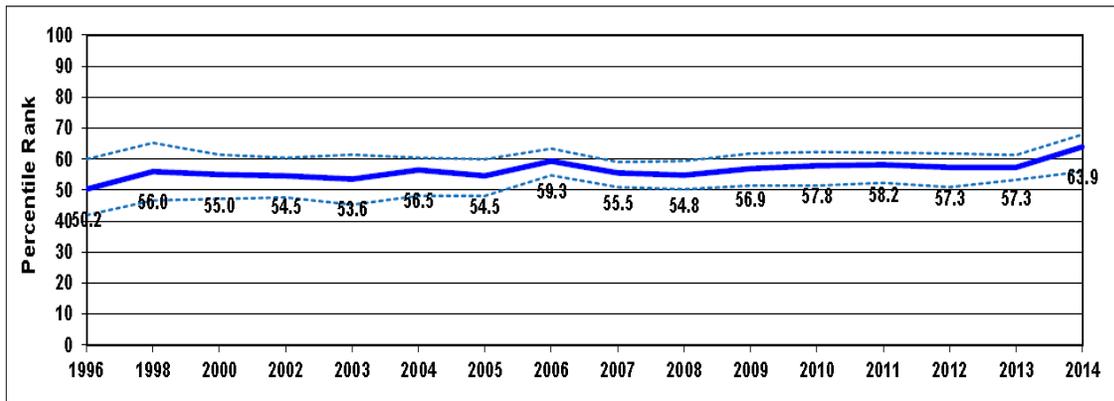
In recent years, barring the arrest of a handful of right-wingers in 2012 whose political intent was to target ANC leaders, no serious incidents in the form of militant action against the state from either right-wing or religious extremists have been recorded in recent years, bringing the potential for such societal instability to a comparatively low level.

Based on the above it can be concluded that the political risk posed by religious tensions was low throughout the period 1994 to 2014.

3.3.9 Law and Order

The ninth indicator, law and order, is a single risk indicator, but is made up of two separate elements, which are assessed individually (Howell, 2011: 5). The Law element, also commonly referred to as the Rule of Law, assesses the strength and impartiality of the legal system, while the Order element, also commonly referred to as Safety and Security, assesses the public's compliance with the law (Howell, 2011: 5). This indicator, therefore, considers to what extent the Law is established and then sustained (Barnard & Croucamp, 2015: 1). The ICRG's methodology emphasises this difference, highlighting that it is possible for a country to achieve a high rating (positive) for its judicial system, i.e. Law, but a low rating (negative) for its Order if the country has high crime levels (Howell, 2011: 5).

Evidence of the above could be found in South Africa between 1994 and 2014, where South Africa's legal framework was described as robust, posing low risk, but its crime levels high and listed as a noteworthy business risk (Government of the United Kingdom, 2015). According to the World Bank's Governance Indicators, averaging the assessment scores of up to 18 organisations, the Rule of Law in South Africa strengthened, improving from 50.2 in 1996 to 63.9 in 2014, as indicated in Figure 7 below.

Figure 7: Aggregate Indicator for Rule of Law in South Africa for 1996 to 2014

(Source: World Bank, 2017)

Furthermore, Richard Calland (2016: 27), who is described as an incisive political commentator and professor of public law in South Africa, made the following observation: “South Africa’s rule of law and the quality of its courts, judges and legal system in general, is a major competitive advantage”. The above thus supports the conclusion that the Rule of Law component of Law and Order posed low risk to investors in South Africa between 1994 and 2014.

The second element, Order or Safety and Security, however, posed higher risk than Rule of Law in South Africa during this period. In the mid-2000s South Africa’s crime rates were at an unprecedented high and safety and security was considered one of the biggest concerns for foreign and local investors (Venter, 2005: 42). Neethling (2012: 45) highlights that crime rates peaked in 2002/3, and then steadily declined approximately 21 per cent over the course of the following decade. Despite this decline, however, crime rates in South Africa remain one of the highest in the world (King, 2014). This was assessed as posing increased political risk as there was an increase in operating costs for MNCs related to high security and high insurance premiums (Neethling, 2016: 83). It can thus be concluded that the second element, Order, posed medium to high political risk to investors between 1994 and 2014.

3.3.10 Ethnic Tensions

The tenth political risk indicator, ethnic tensions, assesses the level of tension in a country stemming from racial, nationality or language divisions. Political risk in this sphere is seen to increase when opposing groups are intolerant and unwilling to compromise (Howell, 2011: 6).

Although there was evidence of racial tension within South Africa between 1994 and 2014, this indicator was broadly assessed as posing medium to low risk. Venter (2005: 40) assessed this political risk in South Africa as low with the following observation: “Overall, the political risk regarding a resurgent ethnic consciousness that spills over into sectarian violence, destabilising the body politic, appears slight at present”. Neethling (2012: 47) reinforced this assessment, emphasising that important and positive signs of progress in reconciliation, social cohesion and nation-building were evident in the country. However, it must be noted that decades of racism, discrimination and dominance of the white minority in South Africa during the apartheid era excluded all indigenous black ethnic groups from benefitting economically from South Africa’s natural resources and modernisation. Government policies such as legislation stipulating that Africans had to live in remote rural settlements, prevented them from having rights to own land and led to fear, insecurity and uneven economic development. This polarisation of society still exists across racial lines and is believed to increase the risk of ethnic violence (Irobi, 2005). The following extract from a *News24* article highlights that as recently as 2013 this was still considered a pertinent risk in South Africa:

The government of South Africa has taken bold constitutional steps to reduce tension, but the continuing ethnic and religious conflicts raise questions about the effectiveness of these mechanisms. Ethnic conflict has been at the heart of South Africa’s development problems. Politicised ethnicity has been detrimental to national unity and socio-economic well-being (*News24*, 2013).

This extract illustrates that, despite the progress South Africa has made since 1994, it cannot be refuted that there is some risk related to this indicator. Based on the above assessments it can be

said that ethnic tensions posed low to medium risk to investors in South Africa between 1994 and 2014.

3.3.11 Democratic Accountability

The eleventh political risk indicator is democratic accountability, which measures how responsive government is to the people. The less responsive government appears to be, the greater the risk of that government falling (Howell, 2011: 6). The defining feature of this indicator, as per the ICRG's methodology, is whether the government in power is subject to elections in which other political parties are allowed to stand in opposition (Howell, 2011: 7).

Between 1994 and 2014 South Africa was considered a relatively stable democracy and its democratic accountability was assessed as posing low to medium political risk to investors. Based on the criteria provided by the ICRG's political risk index methodology, South Africa is a 'dominated democracy' for the following reasons: the ANC has served more than two successive terms, the country has held free and fair elections, a variety of political parties are represented, there are checks and balances between the executive legislature and judiciary, there is evidence of an independent judiciary and there is evidence of the protection of personal liberties through constitutional and other legal guarantees (Howell, 2011: 6). The following summary by Venter (2005: 30) provides a good overview of the state of South Africa's democratic accountability:

The South African state is a constitutional democracy well on its way to becoming a consolidated democracy, that is, a form of authority in which the idea of democracy is widely accepted as being the "only legitimate form of rule". Thus, all the formal tenets of democracy are met, such as constitutionalism, the rule of law, the separation of powers, the independence of the judiciary, freedom of the press, protection of individual human rights, regular free and fair elections, the right to opposition and due process in litigation.

In his assessment of this indicator, Neethling (2012: 39) highlights the gains made by the Democratic Alliance (DA), the main parliamentary opposition in South Africa, over the years. The DA gained an increase in the percentage of the national vote as well as number of National

Assembly seats, indicating an increase in democratic accountability and thus a decrease in the risk associated with this indicator. While Barnard & Croucamp (2015: 10) note a slight decline in South Africa's civil liberties, they nevertheless argue that despite the problems South Africa experienced, the indicators of the quality of the country's democracy were broadly representative and effectively guaranteed. Based on the above, 'democratic accountability' can be assessed as having posed low to medium risk to investors between 1994 and 2014.

3.3.12 Bureaucratic Quality

The twelfth and last indicator of the ICRG Political Risk Rating index which will be looked at before moving onto labour policy is bureaucratic quality. This indicator assesses the institutional strength and quality of the bureaucracy. This indicator is assessed as posing low risk when the administrative capacity of government has sufficient strength and expertise to govern without drastic changes in policies or services occurring. Bureaucratic quality is also assessed as high when it is independent from political pressures and when firmly established recruitment and training processes are in place (Howell, 2011: 7).

As summarised by Venter (2005: 50), "South Africa since 1994 has seen a woeful tale of administrative incompetence", and this suggests why this indicator was assessed as posing medium to high risk to investors between 1994 and 2014. The government's high level of incompetence in governance as well as administration is considered common knowledge in the investment community (Venter, 2005: 50). Neethling (2012: 50) also assessed the administrative incompetence in the public sector during the mid-2000s to be a significant political risk. Barnard & Croucamp (2011: 158) had earlier presented a similar assessment, stating the following: "Weaknesses in the institutional capacities of the state are considered a real, if not grave, concern". Poor bureaucratic quality and capacity has impacted negatively on tax collection and, among other factors, contributed to wastage. This has contributed to government's failure to fund basic services such as public transport, an effective police force, and access to quality education and health services. This has also led to the introduction of systems such as e-tolls and lead to higher insurance due to high crime rates, thus increasing the cost of business (Van Zyl, 2013). It can therefore be

concluded that the indicator, ‘bureaucratic quality’, posed medium to high risk between 1994 and 2014.

3.3.13 Labour Policy

The last indicator, which does not form part of the ICRG’s Political Risk Rating, is South Africa’s labour policy. As mentioned above, given the frequency this issue is raised in assessments of South Africa’s political risk, it is a risk factor which cannot be overlooked. Labour policy is concerned with the interaction between employers and employees as well as how workers are employed, trained and distributed throughout the labour market (Phillips, 2013).

A review of the literature regarding this political risk in South Africa between 1994 and 2014 identifies labour regulation compliance as well as labour legislation surrounding black empowerment and employment equity as two areas of major concern. South Africa’s labour laws have been described as over-protective and inflexible, and have been blamed for exacerbating issues such as low labour productivity. In 2005, the organisation *Strategic Partners in Business* stated that the regulatory environment for businesses had increased markedly over the last five years (Venter, 2005: 45). Research in 2004 alone found that that the business sector paid over R80 billion to comply with government regulations illustrating the potential cost of this risk to businesses (Venter, 2005: 45). In 2011, a statement by Adcorp, a South African Management Consultancy, reported by *Politicsweb* (2011), claimed the following:

Based on World Economic Forum (WEF) data, South Africa’s labour market competitiveness fell by 8.1% over the past year. South Africa’s labour laws and regulations are now the 7th most restrictive out of 139 countries in the world. According to a survey of the world’s 1, 000 largest multinationals, restrictive labour regulations are the 4th most problematic factor for doing business in South Africa (*Politicsweb*, 2011)

Adcorp further highlighted that, “Alarming, South Africa’s regulated labour market competitiveness ranking has slipped from 123rd (11.5%) in 2008 to 133rd (4.6%) in 2011- a decline

of 8.1% (*Politicsweb*, 2011). This data not only indicates that this is an indicator which poses notable risk to investors, but it draws attention to the deterioration of this from 2000 onwards.

The second major area of concern, employment equity legislation, started with the introduction of the Employment Equity Act of 1998 (Act No 55 of 1998). This Act, as well as subsequent legislation and industry specific codes which were introduced led to South Africa's labour policy being blamed for creating an inflexible labour environment (Venter, 2005: 44). In his assessment of South Africa's labour policy, Venter (2005: 46) concludes the following: "The excessive regulatory environment, together with inflexible labour laws, form a distinct political risk in South Africa at present". The Broad- Based Black Economic Empowerment (BBBEE) Act of 2003 and subsequent codes gazetted in 2007 were said to mark a shift towards stricter and more rigorous labour policies, increasingly expensive to comply with, and thus posed notable risk to investors (Vericom, 2017). Joy (2012) also quoted the Cape Chamber of Commerce post which highlighted the compounding effect of this risk in the following statement: "The unintended consequences of South Africa's inflexible labour law environment are beginning to pile up and create a serious risk of a job recession...". Based on the above, the political risk associated with the labour policy in South Africa, specifically the cost of complying with government regulations and South Africa's Broad Based Black Empowerment Equity policy, posed medium to high risk to investors between 1994 and 2014.

3.3.14 Summary of South Africa's Macropolitical Risk 1994 to 2014

The following provides a synopsis of the above assessment of South Africa's macropolitical risk, summarising whether indicators were assessed as posing low, medium or high risk. Additionally, specific periods of increased political risk will be highlighted, as these are significant in the analysis of the extent to which higher political risk deterred FDI.

The political risk indicators which posed medium to low risk to investors in South Africa between 1994 and 2014 include the risk of external conflict, South Africa's investment profile, the risk of military involvement in politics, religious tensions, ethnic tensions and democratic accountability. For a greater part of the period between 1994 and 2014, government stability in South Africa posed

medium to low risk to investors given its legislative strength as well as the ANC's unity and level of popular support. However, 2004 to 2009 posed higher political risk to investors as a result of divisions within the ANC, evidence of a power struggle as well as uncertainty regarding Mbeki's successor and the leadership of the ANC in general (Venter, 2005: 35).

The political risk indicators posing medium to high risk for investors between 1994 and 2014 include socioeconomic conditions, the risk of internal conflict, corruption, law and order, the quality of South Africa's bureaucracy and South Africa's labour policy. While these indicators all posed medium to high risk throughout this period, the risk of internal conflict increased between 2004 and 2014. During this period, the risk of political violence and civil disorder increased due to an increase in the frequency and level of violence of service delivery protests and civil unrest increased, reaching a peak between 2011 and 2012. The period 2004 to 2014 therefore also constitutes a period of high political risk, relating to the risk of internal conflict. Figure 8 below provides a summary of the macropolitical risk assessment of South Africa.

Figure 8: Summary of Macropolitical Risk Assessment of South Africa for 1994 to 2014

	'94	'95	'96	'97	'98	'99	2000	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	
<i>GORN</i>	Low to medium risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Low to medium risk	Low to medium risk	Low to medium risk	Low to medium risk	Low to medium risk										
<i>SOCL</i>	Medium to high risk																					
<i>INVM</i>	Low to medium risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Low to medium risk										
<i>INTC</i>	Low to medium risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk	Medium to high risk									
<i>XTNC</i>	Low to medium risk																					
<i>CRPT</i>	Medium to high risk																					
<i>MLTY</i>	Low to medium risk																					
<i>RLGN</i>	Low to medium risk																					
<i>LAW</i>	Medium to high risk																					
<i>ETHC</i>	Low to medium risk																					
<i>DEMO</i>	Low to medium risk																					
<i>BUQ</i>	Medium to high risk																					
<i>LAB</i>	Medium to high risk																					

Low to medium risk
 Medium to high risk

(Source: Produced by the author for the purposes of this study from Venter, 2005, Neethling, 2012 and Barnard and Croucamp, 2014)¹³

South Africa was a democracy with well-established political rights in the period 1994 to 2014, yet FDI inflows remained below expectation and experienced several declines. Taking all 13 political risk indicators assessed above into consideration, South Africa was considered by numerous analysts to be a country which posed a medium level of political risk. As Barnard &

¹³ This table is a summary of South Africa’s macropolitical risk, based on the assessment of all relevant sources cited in the above analysis. The years highlighted in green are where risk was assessed by analysts as posing low risk, while the orange blocks represent during which these indicators were assessed as posing medium to high risk.

Croucamp (2015: 13) conclude in their assessment, taking all indicators into consideration, it is necessary to conclude that South Africa is a medium to moderate political risk and proposes a favourable environment for investment and growth. Yet, despite this favourable environment, and the many advantages of investing in South Africa, FDI inflows remained subdued and experienced a number of declines between 1994 and 2014. To what extent were these declines in FDI attributable to increased political risk?

3.4 Overview of FDI into South Africa between 1994 and 2014

South Africa offered investors numerous advantages of investing, including an abundance of natural resources, access to its growing domestic markets as well as strategic access to the rest of Africa. Yet, despite all these advantages, inward FDI into South Africa remained low comparative to other emerging markets (Arvanitis, 2005: 64). The following section provides a contextualisation of FDI into South Africa between 1994 and 2014. Periods of high and low FDI will be highlighted and placed in the context of regional, continental and global FDI flows. In analysing to what extent higher political risk deterred FDI into South Africa's key economic sectors, it is important to understand the context of global and regional FDI flows as these may indicate broader trends. Following a global, regional and national consideration of FDI between 1994 and 2014, a more detailed review of FDI into three of South Africa's key economic sectors, mining, manufacturing and financial services, will be provided. As this study considers to what extent declines in FDI are attributable to South Africa's macroeconomic risk, this contextualisation will specifically focus on and highlight periods where FDI decreased.

3.4.1 Contextualisation of FDI Flows

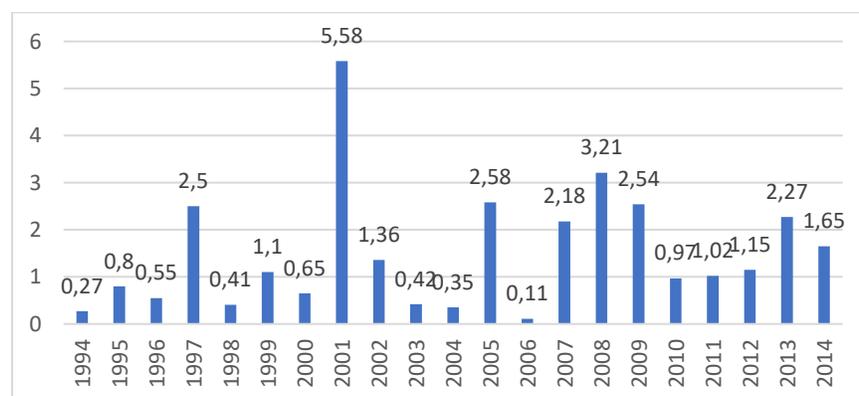
Between 1994 and 2014, South Africa's FDI was below the global, continental and regional average. Between 1994 and 2014 annual FDI flows into South Africa averaged 1.5 per cent of GDP. The global average during this period was 2.1 per cent of GDP, while FDI into the rest of Africa and Southern Africa (excluding South Africa) averaged 2.4 per cent and 3.9 per cent of GDP respectively (UNCTAD, 2017). As Figure 9 below indicates, the highest levels of FDI in South Africa between 1994 and 2014 were recorded in 2001 at 5.58% of GDP and in 2009 at

3.21% of GDP. The lowest levels of FDI recorded were in 1994, 2004 and 2006 at 0.27 per cent, 0.35 per cent and 0.11 per cent of GDP respectively. The period 1994 to 1996 records the lowest average FDI at 0.5 per cent of GDP and the period 2007 to 2009 records the highest average FDI at 2.6 per cent of GDP. In the three years immediately following this, i.e. in 2010, 2011 and 2012, the FDI average is less than half this indicating a notable decline in FDI after a period of considerable increase in FDI.

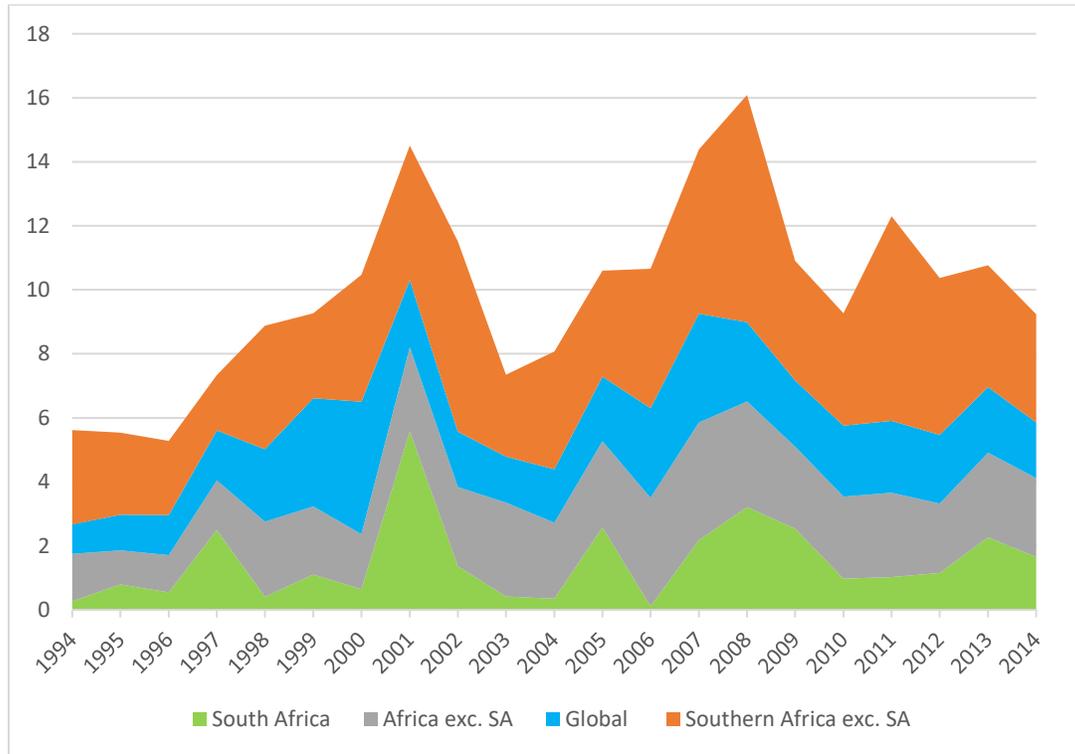
As referred to above, and as indicated in Figure 9 below, South Africa's average FDI between 1994 and 2014 remained below the regional, continent and global average. At no point during this period did its average FDI levels rise to global or regional averages.

It is, however, important to note that periods during which national FDI flows increased and decreased in South Africa broadly mirror those of the rise and fall in regional and global FDI flows. As Figure 10 below indicates, South Africa does not deviate from the regional or global trend of FDI flows, further spurring speculation as to whether local factors, such as increased political risk, influence FDI flows, or if other regional and global factors play a greater role. In considering to what extent South Africa's political risk deterred FDI in the mining, manufacturing and financial services sectors, it is important to review the FDI flows into each of these sectors individually. The following section will, therefore, provide a contextualisation of FDI into South Africa's key economic sectors.

Figure 9: Inward FDI as a % of GDP for 1994 to 2014



(Source: Produced by the author for the purposes of this study from UNCTAD 2017)

Figure 10: FDI as a percentage of GDP for 1994 to 2014

(Produced by the author for the purposes of this study from UNCTAD, 2017)

3.4.2 Contextualisation of FDI into SA's Key Economic Sectors

As can be seen in Table 3 below, decline between 1994 and 2014 FDI into South Africa's mining, manufacturing and financial services sectors experienced periods of sustained increase with sporadic years of decline. In the mining and manufacturing sectors, declines in FDI lasted a maximum of one year before increasing again, while the financial services sector only experienced one period of decline in FDI, lasting two years before it increased again. It is also pertinent to note that declines in FDI into these sectors all occurred at different times, with the exception of the decline in 2002. From 2001 to 2002 all three sectors saw a substantial decline in FDI, also marking the largest decline in FDI in the manufacturing and financial services sectors throughout the 21 year time-frame of this study. For the mining sector it was the second largest decline during the 21 year period.

Table 3: FDI into South Africa’s Mining, Manufacturing and Financial Services Sectors for 1994 to 2014 as Rand billion (Rbn.) and as a % of Proportion of Economic Activity

Foreign direct Investment (FDI) into South Africa by kind of economic activity									
Year	Mining			Manufacturing			Financial Services		
	Rbillion	Increase/ Decrease in FDI	Proportion of economic activity	Rbillion.	Increase/ Decrease in FDI	Proportion of economic activity	Rbillion.	Increase/ Decrease in FDI	Proportion of economic activity
1994	2		5%	15		41%	11		31%
1995									
1996	3		5%	25		43%	22		37%
-1997									
1998	7	151%	8%	40	59%	44%	29	36%	32%
1999	114	1469%	36%	79	97%	25%	105	258%	33%
2000	92	-20%	28%	87	9%	26%	129	23%	39%
2001	124	36%	34%	89	3%	24%	131	1%	35%
2002	81	-35%	32%	67	-25%	26%	82	-37%	32%
2003	103	28%	34%	87	29%	29%	75	-8%	25%
2004	112	8%	31%	111	29%	31%	100	33%	28%
2005	168	51%	34%	136	22%	28%	158	57%	32%
2006	250	49%	41%	165	22%	27%	163	3%	27%
2007	332	33%	44%	197	19%	26%	179	10%	24%
2008	195	-41%	31%	205	4%	32%	182	2%	29%
2009	290	48%	33%	242	18%	28%	235	29%	27%
2010	389	34%	38%	263	9%	26%	242	3%	24%
2011	443	14%	34%	240	-9%	19%	444	83%	34%
2012	429	-3%	31%	249	4%	18%	501	13%	36%
2013	448	4%	28%	269	8%	17%	643	28%	40%
2014	377	-16%	28%	265	-1%	36%	715	11%	44%



Growth >10%



FDI Growth < 10%



FDI Growth > 0%

(Source: Produced by the author for purposes of this study from the SARB, 1996, 1998, 1999, 2000, 2003, 2004, 2005, 2007 and 2013 & the Institute of Race Relations (IRR) 2011 and 2012)

With reference to Table 3 above, a summary of some key observations regarding FDI into South Africa are provided below.

3.4.2.1 Foreign Direct Investment into South Africa's Mining Sector

- The mining sector saw its largest increase in FDI between 1998 and 1999 increasing from approximately R7 billion to R114 billion.
- FDI into the mining sector declined by approximately 20 per cent between 1999 and 2000. This was in contrast to the manufacturing and financial services sectors, which both experienced an increase in FDI, albeit from a lower base.
- In 2002 the mining sector experienced its second largest decline in FDI, decreasing by approximately 35 per cent. All three sectors experienced a substantial decline during this year.
- The mining sector experienced a considerable increase in FDI between 2005 to 2007 (three years of sustained growth), before experiencing its largest decline in 2008. From 2007 to 2008 FDI declined by approximately 41 per cent. FDI into the manufacturing and financial services grew, but at a significantly slower rate than in the previous year.
- The mining sector once saw a period of substantial and sustained growth between 2009 and 2011 (three years of sustained growth) before decreasing by 3 per cent in 2012. FDI into manufacturing and financial services increased during this year.
- In 2013 the mining sector experienced a marginal increase in FDI of 4 per cent before declining again in 2014 by 16 per cent. FDI into the manufacturing sector also decreased, but FDI into the financial services sector increased.

3.4.2.2 Foreign Direct Investment into South Africa's Manufacturing Sector

- Much like the mining sector, the manufacturing sector also experienced its greatest increase in FDI between 1998 and 1999. FDI continued to grow between 2000 and 2001, but at a much slower rate.

- FDI into the manufacturing sector saw its largest decline between 2001 and 2002, decreasing by 25 per cent. All three sectors experienced a substantial decline in FDI during this year.
- Between 2003 and 2010 the manufacturing sector experienced a sustained increase in FDI, averaging 19 per cent increase per annum. In 2011 FDI decreased by 9 per cent, while FDI into mining and financial services increased.
- In 2014 FDI decreased by 1 per cent. FDI into the mining sector also decreased, with FDI into the financial services sector increasing during this year.

3.4.2.3 Foreign Direct Investment into South Africa's Financial Services Sector

- Again, following the trend of FDI into the mining and manufacturing sectors, FDI into the financial services sector saw its largest increase between 1998 and 1999.
- In 2002 and 2003 FDI into the financial services sector decreased significantly, decreasing by approximately 37 per cent in 2002, and a further 8 per cent in 2003. FDI into all three sectors decreased in 2002, as noted above. However, FDI into the mining and manufacturing sectors rebounded in 2003, showing considerable increases. The financial services sector was the only sector out of the three to experience two years of consecutive decline in FDI.
- Following the above decline, FDI into this sector increased year-on-year for 11 consecutive years. The most substantial increases took place in 2004, 2005 and 2011 at approximately 33 per cent, 57 per cent and 83 per cent respectively. FDI growth significantly slowed down in 2006, 2008 and 2010 when FDI only showed increases of approximately 3 per cent, 2 per cent and 3 per cent respectively.

Two trends reflected across all three sectors between 1994 and 2014 are worth noting. The first is that all three sectors experienced the greatest growth in FDI between 1998 and 1999, leading up to South Africa's second democratic election in 1999 after becoming a democracy in 1994. The second trend worth noting is that, despite the periods of increased political risk identified above, the only year during which all three sectors experienced a decline in FDI was in 2002. Every other year during this 21 year time period, only one sector experienced a decline in FDI at any given

time. This is pertinent to note for the analysis that follows, as it may indicate that these sectors responded to increased macropolitical risk differently.

3.5 Conclusion

This chapter established why South African is an attractive investment location, provided an assessment of South Africa's macropolitical risk between 1994 ad 2014 and contextualised FDI flows into the country. South Africa offered investors many advantages for investing between 1994 and 2014, including access to its large local market, access to regional markets, access to labour as well as access to its wealth of natural resources. Yet, its ability to attract higher levels of FDI comparative to other emerging economies or in relation to its economic size and management, remained limited. Before pursuing an analysis of the extent to which increased political risk led to this, more speifically led to periods of decline in FDI, this chapter assessed the country's macropolitical risk between 1994 and 2014. This assessment illustrated that while South Africa only posed moderate risk to investors, a number of risk indicators such as government stability, corruption and socioeconomic conditions, posed higher risk over certain periods. Lastly, this chapter provided a contextualisation of FDI into SA's key economic sectors, highlighting specific years of sustained increase as well as specific years of decline. The following chapter, Chapter Four, provides an in-depth analysis of these periods of decline, evaluating to what extent these declines were attributable to increased political risk.

CHAPTER FOUR: THE IMPACT OF POLITICAL RISK ON FOREIGN DIRECT INVESTMENT INFLOWS

4.1 Introduction

Following its swift and peaceful transition to democracy in 1994, South Africa became one of the most attractive investment and tourism destinations in Africa (Brian Cohen Le Roux Inc. 2006). From there it progressed to becoming one of the continent's wealthiest economies (Nickled & Dimed, 2015). Despite this, however, its FDI levels remained below expectation and below the average of other emerging economies. As the South African Investment and Business Guide highlighted in 2015, "Despite numerous positive economic achievements since 1994, South Africa has struggled to attract significant foreign direct investment" (IBP Inc., 2015: 64). It has been acknowledged that some major FDI transactions have taken place, such as that by Barclays in 2005, Vodafone in 2006 and Walmart's acquisition of Massmart Holdings in 2011 (IBP Inc., 2015: 64). However, despite these FDI transactions of notable value, South Africa's overall performance in attracting FDI remained weak (Nordea Trade, 2017). To what extent was this attributable to increased political risk in South Africa between 1994 and 2014?

While political risk was historically identified as a significant determinant of FDI, various developments have changed the role it plays in FDI decision-making. The comprehensive literature review in Chapter Two highlighted that political risk, historically considered a significant determinant of FDI, is both theoretically and practically constrained. Data indicates that this has limited political risk as a decision-making tool. Shifting trends in sources and types of political risk have also altered the perceptions and reactions of MNC decision-makers. Furthermore, in an increasingly globalised and competitive international business environment, the drivers of foreign investment have multiplied and become more complex. This prompts consideration of the extent to which political risk still plays a determining role in FDI decisions. Is political risk still a determinant of FDI? This chapter, the core of this research study, considers this question through a case study of political risk and FDI behaviour in South Africa between 1994 and 2014.

The political risk assessment of South Africa and the contextualisation of FDI flows between 1994 and 2014 above, highlighted specific periods of increased political risk as well as specific years during which FDI declined. This assessment and contextualisation was essential to identify if and when periods of increased political risk and declines in FDI coincided or if political risk increased during the period preceding the decline in FDI. This data serves to facilitate the analysis that follows in this chapter. This chapter analyses this data, as well as additional data from analysts and investors to draw conclusions about the extent to which declines in FDI into South Africa's key sectors were attributable to increased macropolitical risk.

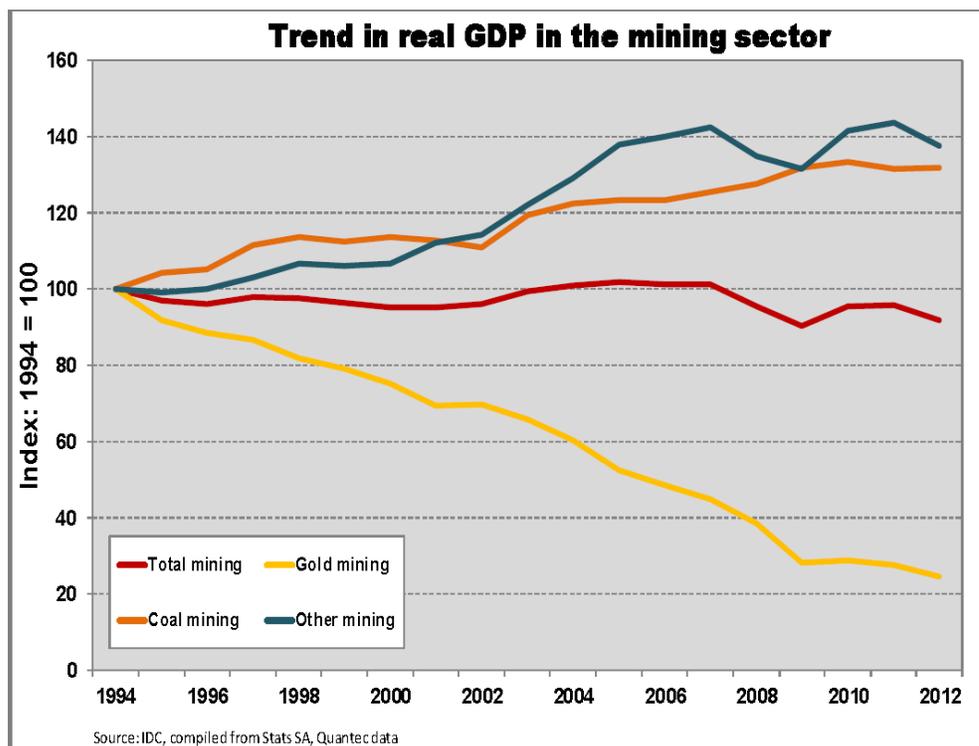
This analysis consists of four sections. The first three sections review declines in FDI and periods of increased macropolitical risk posed to investors. The first section will review the mining sector, the second section will review the manufacturing sector and the third section will review the financial services sector. As this study considers to what extent increased macropolitical risk attributed to declines in FDI, only the years during which FDI declined will be analysed. These years include 2000, 2002, 2008, 2012 and 2014 in the mining sector, 2002 and 2011 in the manufacturing sector and 2002 and 2003 in the financial services sector. These specific years of decline in FDI will be analysed in conjunction with the macropolitical risk posed in the same year as well as the period preceding this decline. The data regarding FDI declines, as well as the political risk, is based on the data provided in Chapter Three as well as additional data, analyses by organisations such as the United Nations Conference of Trade and Development (UNCTAD) and Deloitte, media reports and statements by foreign investors. In each section, following the analysis of each year of decline in FDI, a conclusion will be drawn as to what extent these declines were attributable to increased political risk. The fourth section will provide a summary of the findings and conclude this chapter.

4.2 Analysis of Increased Political Risk and Decline in FDI into the Mining Sector

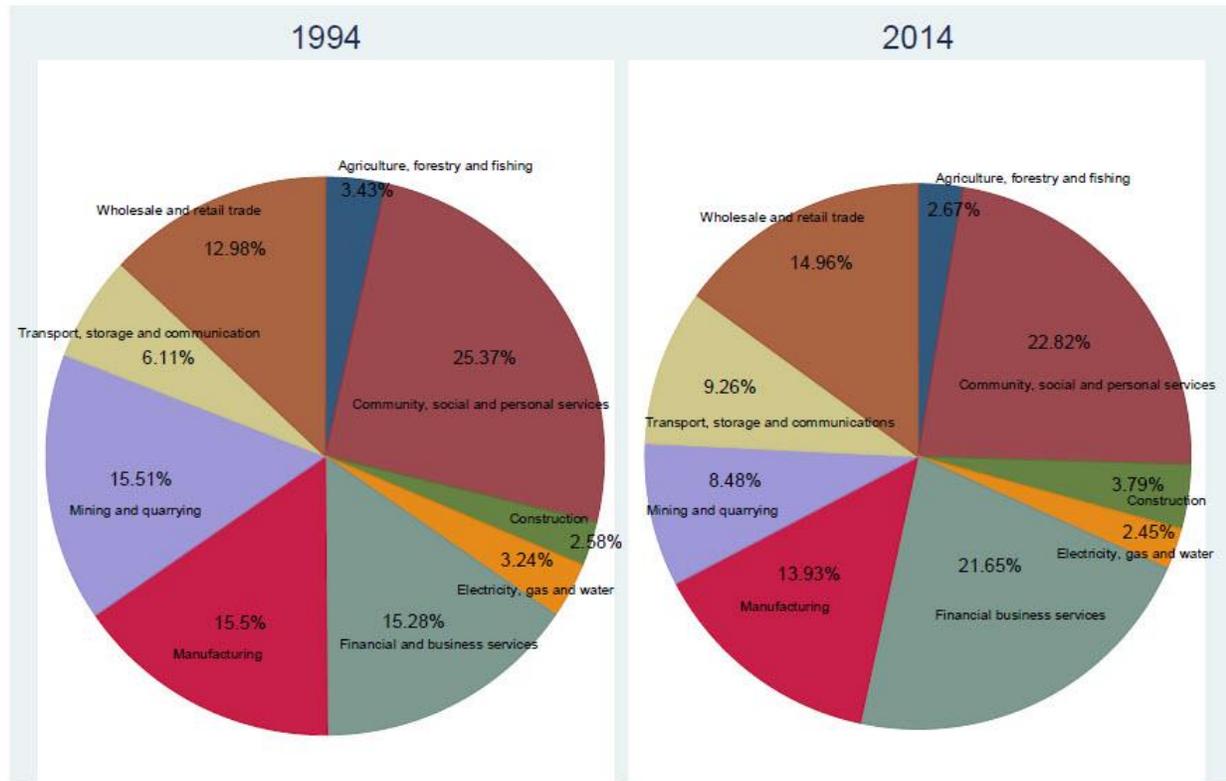
Between 1994 and 2014 South Africa's mining sector showed two noteworthy trends, the first being that among the three sectors analysed, it experienced the greatest volatility in FDI flows with the most substantial increases and decreases in FDI. The second is that between 1994 and 2014, its total contribution to the real Gross Domestic Product (GDP) of the South African economy

almost halved, declining from 15.5 per cent to 8.5 per cent. In 2013, the Industrial Development Corporation (IDC) published a report giving an overview of the key trends of the South African economy since 1994. In this report it highlighted the following with regards to the mining sector: “The output of South Africa’s mining sector contracted over the past 20 years, largely due to the steep falling gold production as deposits became increasingly difficult to access” (IDC, 2013: 10). This illustrates an overall decline of the mining sector. Figures 11 and 12 below graphically illustrate this decline.

Figure 11: Mining contribution to real GDP in South Africa for 1994 to 2014



(Source: IDC, 2013: 10)

Figure 12: Sectoral Composition of South Africa's GDP for 1994 and 2014

(Source: Borat, Naidoo & Oosthuizen, 2016)

Taking the above into consideration, namely the mining sector's decline in output, its overall decline in contribution to the South Africa economy as well as the dramatic decline in gold's contribution to GDP from 1994 onwards (relative to the sector as a whole) the following considers to what extent increased political risk led to declines in FDI or whether other factors, such as the above sectoral shift in South Africa's economy, played a role. This will be done by reviewing the specific years during which FDI into South Africa's mining sector declined and relevant periods of increased political risk.

4.2.1 Decline in FDI in 2000

The mining sector saw its first significant decline in FDI in 2000, declining from R114bn. in 1999 to R92bn. in 2000. This marked a 20 per cent decline. Although South Africa's national FDI levels almost halved, declining from 1.1 per cent to 0.65 per cent, FDI into the manufacturing and financial services sectors increased during this year. Global FDI, as a percentage of GDP, also increased while FDI into Africa dropped from 1.9 per cent to almost 1.5 per cent of GDP. This data indicates that there was neither an overall trend in FDI flows across the economic sectors, nor an overall trend in FDI flows when comparing national, regional and global FDI flows. The following will consider to what extent the decline in FDI into South Africa's mining sector during this year was attributable to increased political risk.

In analysing to what extent a decline in FDI is attributable to increased political risk, it is first necessary to establish whether or not there was increased political risk in the concurrent or preceding period. The political risk assessment of South Africa above indicates that, while there may have been a marginal deterioration in some indicators such as Rule of Law and corruption in 2000, these indicators did not pose increased risk to investors (World Bank, 2017). During the period preceding this decline in FDI, South Africa had strong government unity under President Mbeki, a consistently positive Investment Freedom ranking and indicators such as religious tensions, military involvement in politics and external conflict remained medium to low. Unemployment increased from 25.4 per cent in 1999 to 26.7 per cent in 2000 (*BusinessTech*, 2015a), corruption levels deteriorated from 75.6 to 73.2, as seen in Figure 6, and South Africa's Rule of Law ranking deteriorated from 56, out of a possible 100, to 55 between 1998 and 2000 (World Bank, 2017). However, despite the marginal deterioration of these indicators, neither of these indicators, nor the period preceding the decline in FDI, were identified as contributing to a period of increased political risk. A preliminary analysis would, therefore, lead to the conclusion that this decline in FDI into the mining sector in 2000 was to a lesser extent attributable to increased political risk.

Further consideration of the data also indicates that the mining sector experienced an unusually high spike in the preceding year. In 1999, the value of FDI into the mining sector experienced a

significant surge, increasing from around R7 bn. in 1998 to R114 bn. in 1999. This is an increase of approximately 1 469 per cent. This increase in FDI was disproportionately higher than the growth in FDI into the other two sectors. The manufacturing sector experienced a 97 per cent increase in FDI and the financial services sector a 258 per cent increase, illustrating just how disproportionately high the increase in FDI into the mining sector was. According to Boocock (2002: 7) “The surge in stocks in 1999, is mainly due to investment by Placer Dome of Canada in the so-called Southdeep project, an underground gold mine in the Witwatersrand Basin”. This investment was a joint venture (JV) between Placer Dome and Western Areas Limited, to the value of approximately \$750 million (Boocock, 2002: 7). From this unusually high investment, causing an irregular spike in FDI, FDI into the mining sector decreased from R114bn. in 2001 to approximately R92bn. in 2002, a value still significantly higher than the R7bn. recorded in 1998. This leads to a preliminary conclusion that the decline in FDI may to a greater extent be attributable to this unusually high spike in FDI, lending further credence to the above analysis that this decline in FDI was less attributable to increased political risk.

Furthermore, it must be highlighted, as per the trends illustrated in Figure 11 above, the production of gold, and thus its contribution to the country’s GDP fell sharply from 1994 onwards (IDC, 2013: 10). While there may be many contributing factors to this, Natrass (1995; 857) provides a succinct summary of the underlying causes of this: “Rising costs, falling ore grades and a stagnant gold price are steadily eroding the economic viability of gold mining in South Africa”.

The fourth and last factor of importance which will be considered in this analysis is the world economic crisis of 1999 to 2001, placing this analysis in a global context. As FDI is inherently international in nature it is necessary to place any analysis of FDI flows into a global context. The Asian financial crisis of 1997 later led to an economic recession in 2001 in the US and other countries. This crisis was largely responsible for global FDI levels declining from 3.38 per cent in 1998 to 1.73 per cent of GDP in 2002. The following statement by Beams (2002) highlights the significance of this for global FDI flows, “The root cause of the recession is the fall in investment in the wake of the collapse of the share market boom”. From this statement, it can be inferred that any decline in FDI between 1997 and 2001 may have been attributable to these global economic conditions. The above analysis indicates that, given the absence of increased political risk in South

Africa between 1994 and 2000, the decline in FDI into the mining sector in 2000 was to a lesser extent attributable to increased political risk. It appears that this decline may have been, to a greater extent, attributable to the preceding year's irregular surge in investment as well as the greater global economic crisis, which ran from the Asian financial crisis in 1997 and finally resulted in the global financial crisis of 2001.

4.2.2 Decline in FDI in 2002

From 2001 to 2002, the mining sector experienced its second largest decline between 1994 and 2014, which mirrored sectoral, national, regional and global FDI trends. In 2002 FDI into the mining sector declined from approximately R124bn., to R80bn., a decline of approximately 35 per cent. The decline in this specific year is significant as it is the only year throughout the 21-year time period of this study that all three of South Africa's key economic sectors experienced a decline in FDI. These declines were also similarly high with the manufacturing sector experiencing a 25 per cent decline and the financial services sector a 37 per cent decline. As noted above, this decline also mirrored that of the national, regional and global FDI flows during the same year. During this same year, national FDI flows decreased to less than a third from 5.58 to 1.36 per cent of GDP. Similarly, FDI flows into Africa decreased from 3.2 per cent to 2.3 per cent of GDP and global FDI decreased from 2.1 per cent to 1.7 per cent of GDP. The following will consider to what extent this decline in FDI into the mining sector in South Africa was attributable to an increase in political risk, or if, given the above trend, other factors played a more significant role.

The decline in FDI into the mining sector in 2002, as well as the preceding period, was not accompanied by an increase in macropolitical risk in South Africa. Given that this study is specifically concerned with the extent to which declines in FDI is attributable to increased political risk, it is important to take cognisance of this. As discussed above, while some indicators such as Rule of Law and corruption marginally deteriorated, this deterioration was not assessed by analysts as posing increased risk to investors. Announcements made by foreign investors, such as the one made by AngloGold in November of 2002 to invest further, also indicated the willingness of some investors to continue investing (Bain, 2002). Bain, for example, reported the following: "AngloGold, which is already expanding three of its SA mines, said yesterday it was considering

investing R4bn. in the development of another six deep-level mining operations in the country as the company looks for growth closer to home” (Bain, 2002). The following statement by the Chief Executive Officer (CEO) of Anglo America Limited, Tony Trahar, reported by the United Kingdom’s (UK) *Financial Times*, also provides some indication of investor sentiments around this time; “That Anglo had no plans whatsoever to move its head office from ‘cost effective and business friendly’ Johannesburg to London” (Venter, 2005: 29). By 1999 Anglo had invested more than R1bn. in South Africa and continued to invest substantial amounts in South Africa’s mining sector, even during periods of increased political risk (Venter, 2005: 29). Once again, similarly to the decline in FDI in 2000, it can be concluded that this decline in FDI into the mining sector in 2002, was to a lesser extent attributable to increased political risk, primarily as South Africa’s investment climate did not pose increased political risk to investors in the concurrent or preceding period.

Further analysis of this decline indicates that this decline in FDI into the mining sector was also preceded by an unusually high surge in FDI. Similar to the surge in FDI in 1999 following the Placer Dome Investment, an unusually high investment was made into the mining sector in 2001. This resulted in a notable increase in FDI, which preceded the decline in FDI in 2002. In 2001, FDI into the mining sector increased by 36%. According to the OECD this was due to an investment made by AngloGold, reflected in the following statement: “R1,7bn. in FDI flowed in during the first quarter of 2001. The second quarter of 2001 recorded a massive inflow of R52 billion. This figure is unusually high, the largest share of which can be attributed to the buy-out of the De Beers minority shareholders by (London Stock Exchange listed) Anglo America” (OECD, 2001: 2). When investments are described as unusually high, it is explicit that these FDIs will not necessarily continue, and thus FDI, in returning to their usual levels, will reflect a decline in the year following the spike. Finally, given that global and regional FDI also declined during this year, along with South Africa’s other two economic sectors, it would appear that more than local political risk factors played a role in this decline in FDI.

From the above it can be concluded that the decline in FDI into the mining sector in 2002 was to a lesser extent attributable to an increase in political risk. This conclusion can be drawn for three main reasons. The first preliminary reason being that this decline in FDI mirrored that of declines

in regional and global FDI inflows, which would be unaffected by increased local political risk. The second reason is that in this year, the decline in FDI was not accompanied by increased political risk. Neither was there increased political risk in the years preceding this decline. Third and lastly, this decline was preceded by an unusually high inflow in FDI.

4.2.3 Decline in FDI in 2008

Between 2007 and 2008, FDI into the mining sector declined by 41 per cent, marking the largest decline in FDI levels into the mining sector between 1994 and 2014. Unlike the decline in FDI into the mining sector in 1999 and 2000, this decline was not preceded by an unusually high increase in FDI. In addition to this, FDI into the manufacturing and financial services sectors increased. South Africa's national FDI as a percentage of GDP also increased from 2.18 per cent in 2007 to 3.21 per cent in 2008. Global FDI, however, decreased considerably during this year, from 3.4 per cent of GDP to 2.5 per cent of GDP, while FDI into Africa decreased marginally from 3.4 per cent to 3.3 per cent of GDP. Thus, it follows that the decline in FDI into the mining sector was contrary to that of national FDI flows as well as FDI into South Africa's other two key economic sectors. However, this decline in FDI follows the global and regional trend. The following will consider to what extent this decline in FDI in mining was attributable to increased political risk in South Africa.

As outlined in the political risk assessment of South Africa above, the risk posed by various indicators in South Africa notably increased between 2004 and 2014. The political risk relating to government unity and government stability posed increased risk to investors between 2004 and 2009. Other political risk indicators including corruption, investment freedom, the risk of internal conflict and socioeconomic conditions in the country also deteriorated, posing increased risk to investors between 2004 and 2014. It is thus pertinent to note that the decline in FDI into the mining sector in 2008 occurred during a time of increased political risk in the concurrent and preceding period. This shows that, unlike the previous two years of decline, increased political risk may have to a greater extent contributed to this decline in FDI.

The decline in FDI into the mining sector may have coincided with a period of increased political risk, but further analysis confirms that global factors may have played a more significant role in this decline in FDI. In 2007 and 2008 the world experienced a global financial crisis. Amadeo (2017) states the following about this: “The 2008 financial crisis was the worst economic disaster since the Great Depression of 1929”. The consequences of this crisis for FDI were widespread and varied greatly across regions and sectors. The following statement by Antin (2013: 5) highlights how it impacted upon the South African mining industry in particular:

The South African economy was to be severely affected by the global financial crisis of 2008.... When the economy went into recession, posting a -2% GDP growth in 2009 (World Bank, 2013), the mining industry was heavily affected by the crisis on account of its dependence on global growth to stimulate prices and demand, liquidity in the global economy, and conservative investment strategies in times of insecurity.

As noted by Antin (2013: 5) the Chamber of Mines of South Africa, also made the following observation regarding the impact of the financial crisis on South Africa’s mining sector: “Thereafter, neither the mining sector’s contribution to GDP nor its investment returned to pre-crisis levels until 2011”. An analysis by Antin (2013: 5) also made a pertinent observation in this regard, stating that issues of a more critical nature in South Africa’s mining sector, such as underperformance, labour disputes, nationalisation, and the debate around the right policy approach towards the mining industry, only emerged after the global economic crisis (Antin, 2013: 5). The above data indicates that the world economic crisis of 2008 had a significant negative impact on global FDI flows which specifically impacted on investment levels into South Africa’s mining sector. The above analysis leads to the conclusion that, despite an increase in political risk during this period, the 2008 decline in FDI into the mining sector may be to a greater extent attributable to the global financial crisis, and less attributable to political risk.

4.2.4 Decline in FDI in 2012

FDI into the mining sector decreased in 2012, reflecting the global trend of FDI decline during this year. In 2010 the mining sector saw its last substantial influx of FDI, reflecting a growth in FDI of 34 per cent. Following this, FDI into the mining sector significantly slowed, showing growth of only 14 per cent between 2010 and 2011 before declining in 2012. This trend is pertinent as, unlike previous years of decline, the decline in FDI in 2012 was not preceded by an usually high surge in FDI. The decline in FDI was also marginal, at only 3 per cent. This decline was thus also unique comparative to the previous declines in 2000, 2002 and 2008, which were significant at 20 per cent, 35 percent and 41 per cent respectively. While national and regional FDI flows increased, as will be considered in more depth below, global FDI also marginally decreased in 2012 from 2.25 to 2.15 per cent of GDP.

The decline in FDI into the mining sector in 2012 may have been marginal, and reflected global FDI trends, but it is pertinent to note that this decline was contrary to the trend of FDI into South Africa's other key economic sectors, as well as national and regional FDI flows. FDI into the manufacturing and financial services sectors increased 4 per cent and 13 per cent respectively. South Africa's national FDI as a percentage of GDP increased from 1.02 per cent to 1.15 per cent and FDI into Africa increased from 2.26 to 2.38 per cent of GDP. Considering these trends, the following will consider to what extent the decline in FDI into the mining sector in 2012 was attributable to increased political risk.

As previously noted, political risk notably increased in South Africa from 2004 onwards, specifically related to indicators such as government stability, corruption, investment freedom, socioeconomic conditions and the risk of internal conflict. For example, the risk of internal conflict, heightened from 2004 onwards with increased political violence peaking between 2010 and 2015. Corruption also steadily deteriorated and was assessed to be at its worst level in 2012. Analysing the extent to which increases in political risk impact on FDI into the mining sector, the following commentary by Sottilotta (2013: 9) is pertinent:

For instance, political risk analysis has typically been a major concern for energy and natural resources companies, which are characterized by high sunk costs and which face unavoidable constraints as to the choice of the countries where to operate. In this sector, risk avoidance is often not an option, and the only possibility left might be trying to build up an adequate risk mitigation strategy. Natural resources companies have always been exposed, in particular, to the risk of expropriations and nationalizations (as happened on a massive scale in the 1970s).

The above statement is pertinent when analysing the extent to which political risk impacts upon FDI flows. However, analysis of additional data indicates that the decline in FDI into the mining sector in 2012 may be to a greater extent attributable to the increase in political risk. Barley (2012), commenting on challenges faced by South Africa's mining sector challenges and the impact of increased risk related to internal conflict and rising levels of violent protest and strike action, stated the following: "The recent violence may further chill foreign direct investment...". Further in his analysis, referring to strikes and violence at the Lonmin Marikana mine, also known as the Marikana Massacre, he also stated the following: "So far, the immediate financial reaction to the violence has been small, a 6.3% rise in platinum prices apart. The rand has softened against the dollar, while government bond yields have fallen. But the underlying problems the strikes have exposed mean investors can't rely on that calm persisting" (Barley, 2012). These statements, based on analysis of foreign investor sentiments and behaviour, all point to the fact that increased risk in socioeconomic conditions and internal conflict, deterred FDI.

Further to the above, there are two additional political risk indicators which posed increased risk to investors and, which the data indicates, may have influenced the sentiment and behaviour of foreign investors. These two indicators include the risk of expropriation and nationalisation and the risk related to investment freedom, namely burdensome regulatory legislation. The nationalisation debate entered government discourse in 2011 and 2012, notably increasing the risk related to nationalisation and expropriation. In 2011, the *Mail and Guardian* reported the following, "The uncertainty on the role of nationalisation in South Africa will likely keep investors worried until the issue is resolved" (*Mail & Guardian*, 2011). Furthermore, the political risk related to legislation and burdensome government regulation was cited by Ryan (2016) as a potential deterrent to FDI. The following two statements made by Stephen Arthur, head of equity; asset

management at Amalgamated Banks of South Africa (ABSA) Asset Management, were reported in an analysis by Ryan (2016) of the risks in South Africa's mining sector:

You have all these legislation and political issues that take up management time with very little management time being spent on actually running the mining operations. One mine manager told me he spent up to 70% of his time on community issues. That's not good enough for me and I think the reason the majors have moved out of South Africa is because there's too much hassle – too much noise. We need to eliminate the noise and get back to mining.

We have a government that is totally oblivious. Every one of the 2,000 pieces of legislation makes mining harder and harder. If that's not fixed nobody has any reason to invest here.

The above data, including media reports and statements by professionals in the sector, indicate that the decline in FDI into the mining sector may have to a greater extent been attributable to increased political risk. Increases in the risk related to socioeconomic conditions, internal conflict, expropriation and investment freedom, appear to have, to a greater extent, resulted in a decline in FDI.

Further analysis of data relevant to this decline, however, indicates that additional factors, such as broader regional and overall sector issues, may also have contributed to this decline. For example, the World Investment Report by UNCTAD (2013: 40) commented on the decline in FDI into the mining sector in South Africa in 2012, primarily attributing it to a foreign investor offloading its stake in a South African subsidiary. This report also provided valuable insight when placing this decline in a regional context trend, referring to FDI declines in Angola and South Africa. The report stated the following “The decreases in these two countries were partly offset by the near doubling of flows to Mozambique, where the appeal of huge offshore gas deposits helped to attract investor interest to the tune of \$5.2 billion” (UNCTAD, 2013: 40). Furthermore, a report by Cropley and Flak (2011) noted that, while the platinum sector had grown four per cent per year since 1990, it would not be enough to fill the void left by declining gold production. They further highlighted the extent of the mining sector's decline by noting that during the commodities boom,

which prevailed from 2000 to 2008, South Africa's mining sector declined by one per cent every year in dollar terms while countries like China and Russia's increased by 19 per cent and 10 per cent respectively (Cropley & Flak, 2011). This data highlights that regional factors such as the investment into Mozambique and decline of South Africa's mining sector, and the decline of gold production more specifically, may have played a role in the decline in FDI into South Africa's mining sector in 2012.

The above data leads to the conclusion that the decline in FDI into South Africa's mining sector in 2012, despite being influenced by other regional factors, was to a greater extent attributable to increased political risk. The data indicates that increases in risk related to socioeconomic conditions, internal conflict and investment freedom may have deterred investors, but that regional factors may also have contributed to this decline.

4.2.5 Decline in FDI in 2014

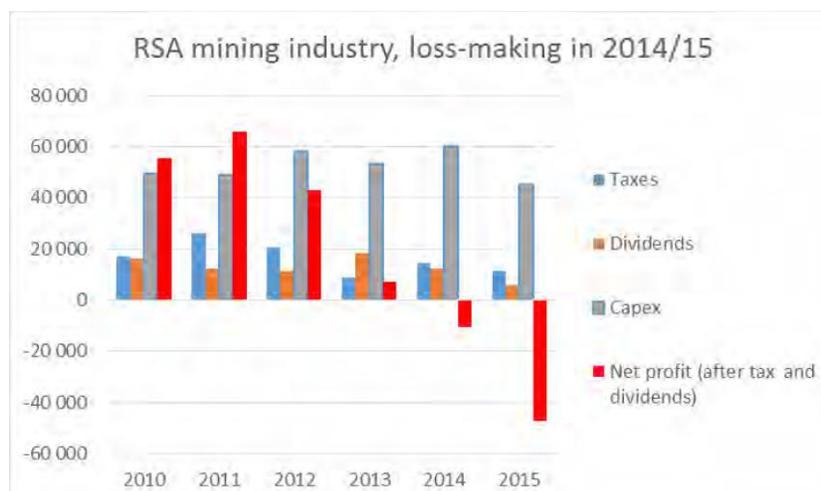
The last decline in FDI in mining during the time period of this study was in 2014, reflecting the decline in FDI nationally, regionally and globally. As noted above, mining experienced its last significant influx of FDI in 2010. Thereafter FDI growth either significantly slowed down or declined, as seen in 2012 and 2014. FDI into the mining sector declined from approximately R448bn in 2013 to approximately R377bn in 2014, a 16 per cent decline. The manufacturing sector also experienced a decline in FDI, albeit only 1 per cent, while the financial services sector saw an 11 per cent increase. Before analysing to what extent this decline was attributable to increased political risk, it is important to place this decline in a national and regional context. In 2014 FDI flows decline nationally, regionally and globally. South Africa's national FDI decreased markedly from 1.65 per cent to 0.56 per cent of GDP. FDI into Africa only marginally decreased from 2.36 per cent to 2.32 per cent while global FDI flows decreased more significantly from 2.05 per cent to 1.74 per cent. The following analyses to what extent the decline in FDI in the mining sector was attributable to increased political risk.

Despite a notable increase in political risk between 2004 and 2014, some of this risk decreased between 2009 and 2014. By 2009 the ruling government had greater levels of unity, reducing the

risk posed by government stability and unity. Additionally, South Africa's investment freedom improved notably in 2014 and its Rule of Law was rated to be its strongest in 21 years. However, other indicators such as the risk of internal conflict, corruption and labour policy still posed increased levels of risk to investors from 2004 onwards. Preliminary analysis may lead to a conclusion that the overall increase in political risk in South Africa from 2004 onwards may have led to this decline in FDI. However, an examination of broader sectoral data and analysis indicates that this decline in FDI in the mining sector may, to a lesser extent, have been attributable to increased political risk, and to a greater extent influenced by other factors.

In studying the drivers and determinants of FDI, scholars such as Fedderke and Romm (2006: 743) noted the following: "The core drivers of FDI fall into two classes of determinants – rates of return and risk factors, with positive responses to rates of return, negative responses to risk". Data indicates that in 2014, and the period leading up to 2014, South Africa's mining sector offered investors increased risk and substantially reduced returns on investment. With reference to Figure 13 below, the rate of return on investment, after peaking in 2011 declined marginally in 2012 before declining significantly in 2013, whilst reflecting substantial net losses in 2014.

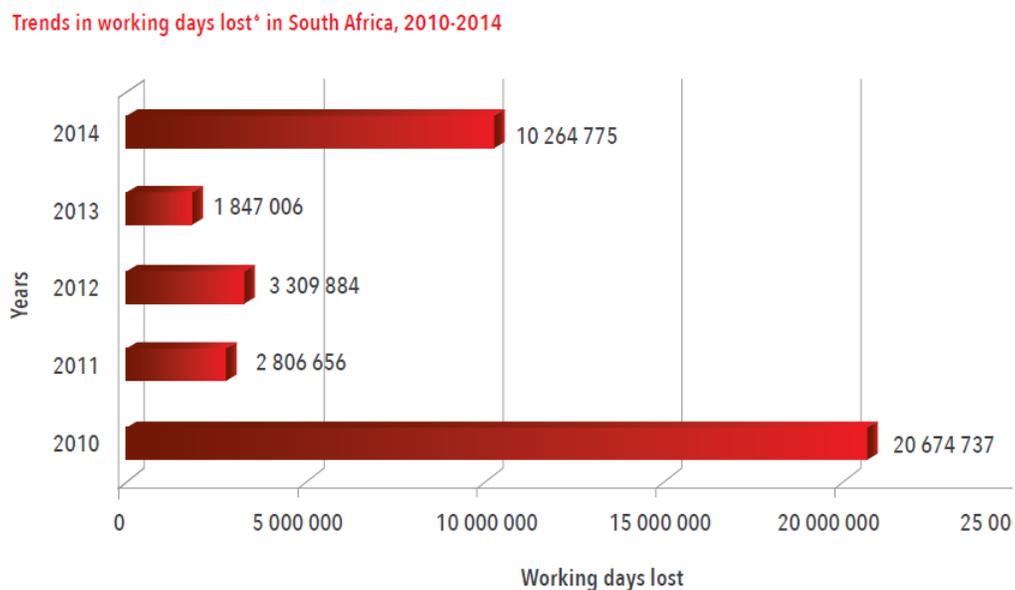
Figure 13: SA Mining Profit/ Loss for 2010 to 2015



(Source: Baxter, 2016: 27).

If these losses were as a result of increased political risk, the conclusion might have been drawn that the decline was to greater extent attributable to increased political risk. However, the South African Chamber of Mines released a report in 2016 that indicates that this net loss was attributable to various factors, a number of which were unrelated to increased political risk. These factors include the following: the fall in global commodity prices, the rapid rise of domestic cost pressures and the fall in productivity levels spanning over a decade as a result of declining labour productivity. The South African Chamber of Mines also cited the following reasons for the decline in productivity and thus profit: “Due to declining grade, aging mines, production disruptions (inappropriate s54s, strikes, community disruptions, illegal mining) and inability to increase productive shifts per annum.” (Baxter, 2016: 25). In addition to this, according to a report in 2015, there were 114 strikes in 2013 and 88 strikes in 2014 (*BusinessTech*, 2015). The overall impact of these strikes was considered much heavier in 2014 in respect of the number of work days lost. The following two statements illustrate this: “In 2013, 1.85 million work days were lost due to strikes – this spiked to 10.3 million days in 2014.” (*BusinessTech*, 2015b). In 2014, 94 per cent of the total work days lost were accounted for by the mining sector (*BusinessTech*, 2015b). Figure 14 illustrates the severity of this between 2010 and 2014.

Figure 14: Work Days Lost in South Africa for 2010 – 2014



(Source: *BusinessTech*, 2015b)

Lastly, it must be noted that the commodity super-cycle or boom came to an end after peaking in 2011 and 2012, which may have impacted on FDI flows into this sector (Bond, 2016). As reported by Campbell, “The global commodities super cycle has come to an end, sharply lowering the price of oil, gas, metals and minerals...” (Campbell, 2016). This not only places pressure on African governments, half of which are commodities exporters, but the value of most major mining houses substantially declined on the global stock exchange (Bond, 2016). The end of the commodities cycle, and the accompanying decline, in the value of mining houses has two significant implications for FDI. The first being that these MNCs have significantly less capital to invest and, as highlighted in the IMF’s World Economic and Financial Surveys, FDI may no longer be sustainable at lower commodity prices as the return on investment may deteriorate, along with the terms of trade (IMF, 2015:69). It can thus be concluded that the end of the commodities cycle in 2011 and 2012 may have, to a greater extent, attributed to the decline in FDI into South Africa’s mining sector in 2014. Based on the above data it can be concluded that, while increased political risk no doubt contributed to the decline in FDI into South Africa’s mining sector in 2014, it was to a greater extent attributable to other industry-related challenges and global factors, such as the decline in demand for commodities.

The above analysis of the five years of decline in FDI into South Africa’s mining sector leads to the conclusion that only one of these declines was to a greater extent attributable to increased political risk. Other factors playing a more significant role during this period were global factors, such as the world economic crises of 2001 and 2008, regional shifts in FDI as well as industry-specific challenges such as the overall decline of the industry, the significant decline of gold production, increased labour strikes and aging mines. The following section now turns to an analysis of the declines in FDI into the manufacturing sector in 2002, 2011 and 2014.

4.3 Analysis of Increased Political Risk and Decline in FDI into the Manufacturing Sector

South Africa’s manufacturing sector, now its third largest economic contributor, remains well established, diversified and competitive in the global economy, despite waning levels of FDI (Brand South Africa, 2017). During the first half of the time period of this study, FDI into the manufacturing sector grew considerably, averaging growth of 29 per cent per annum between 1994

and 2004 (excluding the FDI data for 1995 and 1997). However, between 2005 and 2014, FDI growth substantially slowed, averaging only 10 per cent per annum. While 2005 and 2006 each showed increases of 22 per cent per annum, the growth in FDI into this sector continued to slow down between 2007 and 2014.

The above overall trend of declining FDI may be due to the manufacturing sector's general declining contribution to the economy as well as to the global shift away from manufacturing. With reference to Figure 12, the manufacturing sector's contribution to the economy declined from 15.5 per cent in 1994 to 13.9 per cent in 2014. This mirrors a global shift away from manufacturing towards the services industry. Taking the above into consideration, the following will analyse the years during which FDI into the manufacturing sector declined, including 2002, 2011 and 2014, and consider to what extent these declines in FDI were attributable to increased political risk in South Africa.

4.3.1 Decline in FDI in 2002

As mentioned in the analysis above, all three economic sectors analysed in this study experienced a decline in FDI in 2002. Throughout the 21-year time period covered in this research study, the manufacturing sector experienced its greatest decline in 2002, declining from approximately R89bn. to R67bn. This marks a 25 per cent decline in FDI. As discussed in the analysis above, national, regional and global FDI flows also declined considerably during this year. The following analyses to what extent the decline in FDI into the manufacturing sector during this year was attributable to increased political risk.

The decline in FDI into the mining sector in 2002 was not preceded by an unusually high surge in FDI, neither was it accompanied by increased political risk. Unlike the mining sector's decline in FDI in 2000 and 2002, this decline in FDI into the manufacturing sector was not preceded by an unusual surge in FDI. On the contrary, in 2000 and 2001, the growth in FDI into the manufacturing sector notably slowed down. For example, FDI growth in 1998 and 1999 was 59 per cent and 97 per cent respectively. In 2000 and 2001 it slowed to 9 per cent and 3 per cent respectively. Furthermore, as highlighted in the analysis above, there was no notable increase in political risk in

2002 or in the period preceding this decline in FDI. Preliminary analysis would therefore lead to the conclusion that this decline in FDI was to a lesser extent attributable to increased political risk. Further analysis of the data also indicates that greater global factors significantly contributed to this decline in FDI. As referred to above, the Asian financial crisis of 1997 later led to a global economic crisis in 2001. This crisis affected FDI flows globally. According to an UNCTAD report, “Global FDI inflows, already down by over 40 % in 2001, fell by another 21 % in 2002 to \$651 billion – the lowest level since 1998” (UNCTAD, 2003a). This decline was also described as broad based, with 108 of 195 countries reflecting declines in FDI (UNCTAD, 2003a). The following statement is pertinent in understanding some of the drivers of the downturn and subsequent recession:

Driving the decline in FDI flows in 2001-2002 – the most significant downturn of the past three decades – was a combination of macroeconomic factors (weak economic growth or slump in economic activity linked to the business cycles in many parts of the world, especially the developed countries, and tumbling stock markets), microeconomic factors (low corporate profits, financial restructuring) and institutional factors (winding down of privatization, loss of confidence in the wake of corporate scandals and the demise of some large corporations) (UNCTAD, 2003a).

The above emphasises the significance of the impact of the world economic crisis on global FDI flows, pointing to the fact that this decline in FDI may have been attributable to global economic factors.

From the above it can thus be concluded that the decline in FDI into South Africa’s manufacturing sector in 2002 was to a lesser extent attributable to increased political risk, primarily due to the lack thereof, and to a greater extent attributable to global economic factors.

4.3.2 Decline in FDI in 2011

FDI into the manufacturing sector increased for eight consecutive years between 2003 and 2010, before declining again in 2011. Between 2010 and 2011 FDI into the manufacturing sector decreased from R260bn. to R243bn. marking a 9 per cent decline. Once again, it is pertinent to note that the manufacturing sector was the only sector reviewed in this study to experience a decline in FDI during this year. This decline was also in contrast to national, regional and global FDI trends. For example, in 2011 FDI into the mining sector increased by 14 per cent and FDI into the financial services sector increased 83 per cent. National FDI increased by 0.05 per cent, FDI into Africa increased by 0.12 per cent and global FDI increased by 0.1 per cent. This data all highlights that the decline in FDI into the manufacturing sector in 2011 was in contrast to national, regional and global FDI trends as well as those of the other two economic sectors analysed in this study. The following analyses to what extent this decline in FDI was attributable to increased political risk in South Africa.

As discussed above, the political risk in South African significantly increased between 2004 and 2014, which may have, to a greater extent, contributed to the decline in FDI in the manufacturing sector in 2011. With the exception of government stability, which improved in 2009, all the indicators which posed increased political risk to investors from 2004 onwards continued to do so until 2011 and beyond. This may lead to a preliminary conclusion that this decline was to a greater extent attributable to increased political risk.

The following extract in a report, considering manufacturing competitiveness in South Africa, provides pertinent insight into some of the challenges faced by South Africa's manufacturing sector.

In the 2013 Deloitte Survey, Global Manufacturing CEO's highlighted that the availability and cost and productivity of labour and, in particular, the availability of skilled labour are currently the most critical factor in driving a nation's industrial competitiveness. Government will need to address the long-term structural problems in the labour market, which stem in part from inflexible labour legislation and the poor

quality of primary and secondary education if sustainable increases in the productivity and availability of skilled labour are to be achieved (Deloitte Touche Tohmatsu Limited, 2013: 21).

This extract serves to highlight that the political risk related to socioeconomic conditions, specifically education, and investment freedom, specifically related to labour legislation, may have hampered the competitiveness of South Africa's manufacturing sector. A reduction in global manufacturing competitiveness implies a lower return on investment (ROI). Given that the rate of return of investment is a significant determinant of FDI, as identified by some of the earliest studies regarding capital investment behaviour, a lower rate of return would hinder FDI. To the extent that South Africa's increased political risk lowered the ROI, it can be concluded that the decline in FDI into the manufacturing sector in 2011 was to a greater extent attributable to increased political risk.

Additional data confirms that the global competitiveness of South Africa's manufacturing sector declined, largely as a result of labour increased costs which can be seen as a result of increased political risk. The following statement highlights the pertinence of this issue in South Africa: "Real wage growth far outstripped total factor productivity growth between 2005 and 2010 in the manufacturing sector..." and "Between 2004 and 2010 productivity rose 18 per cent while the real production wage rose 55 per cent" (World Bank, 2011: 5). Scholars such as Chen, Geiger & Fu (2015: 9) cite the works of various scholars in their review of manufacturing FDI in sub-Saharan Africa, emphasising the importance of labour as a determinant of FDI, stating market size, access to natural resource and low labour costs are significant determinants of FDI in Africa (Chen et al, 2015: 9). This data affirms the above conclusion.

Analysis of additional data highlights that, while the decline in FDI into the manufacturing sector in 2011 may have been largely attributable to increased political risk, global factors may have exacerbated this. The World Investment Report of 2012, for example, states that the Association of South East Asian Nations (ASEAN) had increased their relative competitiveness in manufacturing (UNCTAD, 2012: 12). Therefore, as South Africa's competitiveness deteriorated, so the competitiveness of other nations in manufacturing improved. This may have contributed to

and/or exacerbated the decline in FDI. Additionally, data indicating a global shift away from manufacturing may also have played a role.

It can thus be concluded that the decline in FDI into the manufacturing sector in 2011 may have been, to a greater extent, attributable to increased political risk, but other global factors contributed to and/or exacerbated this decline. The following section will consider to what extent the decline in FDI into the manufacturing sector in 2014 was attributable to increased political risk.

4.3.3 Decline in FDI in 2014

FDI into the manufacturing sector also experienced a decline in 2014, albeit a marginal decline of only 1 per cent, following the trend of a decrease in FDI nationally and globally. FDI declined from approximately R269bn. to R265bn. during this year. As discussed above, the mining sector also experienced a decline during this year, while the financial services sector saw an 11 per cent increase. National FDI as a percentage of GDP decreased from 2.27 per cent to 1.65 per cent of GDP and global FDI declined from around 2 per cent to approximately 1.7 per cent. In contrast, FDI flows into Africa increased 2.19 per cent to 2.36 per cent. Therefore, while in contrast to the regional trend, this decline in FDI into the manufacturing sector follows the trend of national and global FDI flows. The following will analyse to what extent this decline in FDI was attributable to increased political risk.

The decline in FDI into South Africa's manufacturing sector in 2014 coincided with a period of increased political risk. As explored in the analysis of the decline in FDI into the mining sector in 2014, South Africa posed an increased political risk to investors between 2004 and 2014. Despite improvement in the risk posed by some indicators such as Investment Freedom and Rule of Law, other indicators such as internal conflict, labour policy and corruption, continued to pose increased risk to investors. This affirms that this decline in FDI may have been attributable, to a greater extent, to increased political risk.

Analysing additional data, however, such as statements by media reports and statements by various foreign investors, it appears that foreign investor sentiment about the South African manufacturing

environment during this time was positive. For example, Dr Van Zyl, as reported by Toyota, made the following statement at an event marking a milestone of Toyota's R1 billion in investment in South Africa:

The decision to invest in the production of the new Toyota Corolla is one taken well in advance of the start of production and one that considers the future economic prospects of South Africa and that of major Corolla export markets. We believe that despite the current economic slowdown and currency pressures the South African built Corolla will prove to be a good long-term investment (Toyota, 2014).

From this statement, albeit only from one investor in the automotive sector, it appears that the increase in political risk was insufficient to deter certain investors. This statement also indicates that other determinants of FDI, such as geographical location and access to markets, may have played a more significant role in driving continued FDI. The above sentiment was confirmed by Ernst Young and Deloitte. Ernst Young (2014), for example, noted that one of the most striking observations about the Africa Attractiveness Survey of 2014 was the improvement in Africa's attractiveness, noting South Africa as one of the leading destinations to do business in Sub-Saharan Africa. This was reiterated by Deloitte's 2014/2015 Investment Handbook, in conjunction with the department of trade and industry when they referred to South Africa as an attractive business, tourist and investment destination, and described the manufacturing as sector which had proven its potential and resilience in competing in the global economy (Deloitte, 2015: 41). It thus follows, that the decline in FDI may have been to a lesser extent attributable to increased political risk.

In addition to this, some regional and global trends, specifically related to sector contributions to global GDP, indicate that this decline into South Africa's manufacturing sector in 2014, formed part of a greater global trend. The World Investment Report of 2015 by UNCTAD (2015) highlights two significant trends regarding FDI in 2014. The first was that there was a general slowdown in overall FDI flows. The second was that there was a specific slowdown in FDI into the manufacturing sector. The following extracts from this report informs an understanding of

some of the reasons for this trend and highlights some of reasons for the slowdown in global FDI flows.

Global FDI inflows declined in 2014. Global foreign direct investment (FDI) inflows fell by 16 per cent, mostly because of fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks. New investments were also offset by some large divestments (UNCTAD, 2015c: ix).

With regards to the specific decline in manufacturing FDI globally, the report summarises this trend in the following statement (UNCTAD, 2015c: ix):

By sector, the shift towards services FDI has continued over the past 10 years in response to increasing liberalization in the sector, the increasing tradability of services and the growth of global value chains in which services play an important role. In 2012, services accounted for 63 per cent of global FDI stock, more than twice the share of manufacturing.

The report further elaborates on this trend, stating that the increased significance of the services industry in the international investment landscape forms part of a long-term structural trend. For example, 2001 to 2012 reflected an increase of 5 per cent in services FDI (to 63 per cent), while the decrease in the manufacturing sector's share of FDI was comparable to this increase (UNCTAD, 2015c: 12). Considering the impact or relevance of this global trend in South Africa, the report states the following; "In Sub-Saharan Africa, South Africa predominates in the services sector. Over the past decade, South Africa's stock of manufacturing FDI has shrunk relative to services FDI" (UNCTAD, 2015c: 36). The above data thus clearly indicates that this decline was to a lesser extent attributable to increased political risk. The general slowdown in FDI into the manufacturing sector in South Africa from 2007 onwards, and more specifically the decline in 2014, formed part of a global shift away from manufacturing and mirrored the trend of a general slowdown in global FDI due to the fragility of the global economy.

4.4. Analysis of Increased Political Risk and Decline in FDI into the Financial Services Sector

In discussing the factors that make South Africa an attractive FDI location for investors, Chapter Three highlighted the fact that South Africa is a financial hub for regional markets, that it has a well-developed financial sector and that its stock exchange, the Johannesburg Stock Exchange (JSE) is ranked as one of the best in the world. In 2015 the financial sector was described as follows: “South Africa has a sophisticated financial structure with the JSE Securities Exchange, a large and active stock exchange that ranks 18th in the world in terms of total market capitalisation as of March 2009” (IBP Inc., 2015: 64). As noted above, South Africa was limited in its ability to attract FDI but between 1994 and 2014 the financial sector, much like the mining sector, received some unusually large investments. The South African Investment Business Guide noted the following in 2015 (IBP Inc., 2015: 64-65):

Despite numerous positive economic achievements since 1994, South Africa has struggled to attract significant foreign direct investment. The situation may have started to change, however, with 2005 seeing the largest single FDI into South Africa when Barclays bought a majority share in local bank, ABSA Group Limited.

In addition to this, after 10 years of fostering closing trade relations, 2007 marked one of China’s most significant investments, which was made into the financial industry. The Industrial and Commercial Bank of China acquired a 20 per cent stake in Standard Bank, the largest bank in Africa, for US\$5.5 billion (Nxumalo, 2013).

FDI into the financial services sector is different from that of the mining and manufacturing services sectors for two distinct reasons. The first of these is that the sector experienced the highest levels of overall FDI overall between 1994 and 2014, averaging 44 per cent per annum between 1994 and 2004 (excluding data for 1995 and 1997) and 24 per cent per annum between 2005 and 2014. These average increases are significantly higher than the other two sectors. Secondly, the financial services sector was the only sector which experienced two consecutive years of decline, decreasing from 2001 to 2002 and then again from 2002 to 2003. Given that the declines in FDI

into the financial sector is over two consecutive years, the following analyses to what extent these declines were attributable to increased political risk simultaneously.

4.4.1 Decline in FDI in 2002 and 2003

FDI into the financial services sector increased significantly in the period preceding the decline in 2002 and 2003. Between 1998 and 2000, the financial services sector experienced exceptional growth in FDI. In 1998, 1999 and 2000 FDI increased by 36 per cent, 258 per cent and 23 per cent respectively. FDI, however, slowed down substantially in 2001 to a mere 1 per cent before declining 37 per cent in 2002 and a further 8 per cent in 2003.

The above analysis highlights that 2002 was the only year during which all three sectors experienced a decline, but the financial services sector experienced the greatest decline. Additionally, FDI into the other two sectors rebounded in 2003, while FDI into the financial services sector decreased for another consecutive year. In 2002 FDI into the financial services sector declined by 37 per cent compared to the 35 per cent decline in the mining sector and the 25 per cent decline in the manufacturing sector. In 2003, FDI into the mining and manufacturing sectors rebounded showing 28 per cent and 29 per cent growth, respectively. Yet, FDI into the financial services sector decreased again by 8 per cent. The financial services sector, therefore, experienced the largest decline in FDI in 2002 and was the only sector, of the three major economic sectors reviewed in this study, to experience a decline in FDI in 2003.

Consideration of broader national and global FDI data indicates that the decline in FDI into the financial services sector in both 2002 and 2003 followed the national and global FDI trend. It is of significance to take cognisance of the fact that national and global FDI flows also dropped for two consecutive years, both reflecting significant declines. National FDI flows decreased from 5.58 per cent of GDP to 1.36 per cent and to a mere 0.42 in 2003. Global FDI flows halved from 4.13 per cent of GDP in 2000 to 2.11 per cent in 2001, 1.73 per cent in 2002 and to only 1.44 per cent in 2003. FDI flows into Africa decreased from 3.19 per cent of GDP to 2.28 per cent of GDP between 2001 and 2002. Taking these global and regional FDI trends into consideration, the following will consider to what extent the specific decline in FDI into the financial services sector was attributable to increased political risk.

In 2002 and 2003, when FDI into the financial services sector decreased, there was no evidence of increased political risk to investors in South Africa. Once again it needs to be highlighted that, as in the above analysis of the declines in FDI in the mining and manufacturing sectors in 2002, political risk did not notably increase between 1994 and 2003. Thus, political risk did not increase during the years of decline in FDI into the financial services sector, nor in the period preceding this decline.

The political risk assessment of South Africa indicated that the majority of the political risk indicators assessed posed low to medium risk to investors between 1994 and 2003, with no identifiable period of increased risk. Approximately 9 of the 13 political risk indicators assessed were considered to pose medium to low risk to investors. These indicators include government stability, investment freedom, internal conflict, external conflict, military involvement in politics, religious tensions, rule of law (forming part of law and order), ethnic tensions and democratic accountability. The remaining four indicators, including socioeconomic conditions, order (as part of law and order), bureaucratic quality and labour policy all posed medium to high risk between 1994 and 2003, once again with no period of increased risk identifiable. From this data, a preliminary conclusion can be drawn that the decline in FDI into the financial services sector in 2002 and 2003 was to a lesser extent attributable to increased political risk, primarily given the absence of increased risk.

Analysis of broader data, and taking into consideration global and regional FDI trends, indicates that global factors may have played a greater role in this decline. The following extract from the UNCTAD (2003: xiii) World Investment Report highlights why.

Global FDI inflows declined in 2002 for the second consecutive year, falling by a fifth to \$6651 billion – the lowest level since 1998. Flows declined in 109 of 195 economies. The main factor behind the decline was slow economic growth in most parts of the world and dim prospects for recovery, at least in the short term.

In addition to this, it was also noted that the fall in global FDI among developing markets was the largest in Africa, reflecting a decline of 41 per cent in FDI inflows compared to inflows in the developed world which fell by only 22 per cent (UNCTAD, 2003b: 3)

From the above data it can be concluded that the decline in FDI into the financial services sector was to a lesser extent attributable to increased political risk for two key reasons. The first of these is that there was no notable period of increased political risk in South Africa between 1994 and 2003. Secondly, in light of reduced global FDI flows, and such a reduction stated to be the highest in Africa, it can be concluded that the decline into the financial services sector was to a greater extent attributable to global factors and to a lesser extent attributable to increased political risk. Table 4 below provides a summary of the conclusions drawn in the above analysis.

Table 4: Declines in FDI in SA attributable to increased political risk for 1994 to 2014

MINING		MANUFACTURING		FINANCIAL SERVICES	
2000	N*				
2002	N	2002	N	2002	N
				2003	N
2008	N				
		2011	Y		
2012	Y*				
2014	N	2014	N		

*Y (for Yes) - Decline in FDI attributable to increased political risk to a greater extent

*N (for No) - Decline in FDI attributable to increased political risk to a lesser extent

(Source: Produced by the author for the purposes of this study from above analysis)

In conclusion, Table 4, above, reveals that with the exception of the declines in 2011 into the manufacturing sector and in 2012 into the mining sector, all other declines in FDI in South Africa between 1994 and 2014 were to a lesser extent attributable to increased political risk. These

declines were to a greater extent attributable to regional and global factors. Furthermore, as evidenced by the data and analysis above, with the exception of 2002, during which FDI into all sectors declined, declines in FDI occurred at different times. It can thus be concluded that sector-specific declines differed markedly.

4.5 Conclusion

South Africa offered investors an attractive investment location between 1994 and 2014, yet its ability to attract FDI remained limited, with a number of its key economic sectors experiencing a decline in FDI over a period of several years. In exploring whether or not political risk can still be considered a significant determinant of FDI, the main research question of this study considered to what extent these declines were attributable to increased macropolitical risk. Exploring this further, and in support of the main research question, the sub-questions included whether or not the declines in FDI differed from sector to sector and also considered what other factors might have played a greater determining role in driving FDI flows. Three conclusions were drawn in the above analysis, answering the main research questions and the two sub-questions.

Firstly, the analysis indicated that the declines in FDI were to a lesser extent attributable to increased political risk. Collectively, FDI into South Africa's key economic sectors declined during seven years of the twenty-one-year period studied. It was concluded that only two of these seven years of FDI decline were to a greater extent attributable to increased political risk. The decline in FDI into the manufacturing sector in 2011 and into the mining sector in 2012 were to a greater extent attributable to increased political risk. The data indicated that risk associated with indicators such as socioeconomic conditions, the risk of internal conflict and labour policy, as well as the deterioration in corruption levels and South Africa's investment freedom, were cited as reasons by foreign investors and analysts as reasons for reduced FDI. The data also showed that the increase in these risks had a notable, and in some cases calculable, impact on the ROI, and thus profitability, of MNCs. It was thus concluded that these declines were to a greater extent attributable to increased political risk. The remaining five years of FDI decline, however, were less attributable to increased political risk. This led to the conclusion that over this period political risk was a less significant determinant of FDI than it historically was.

Secondly, the analysis further indicated that the declines in FDI notably differed from sector to sector. As highlighted above, the data indicated that, with the exception of 2002, declines in FDI occurred in different years and the value of their declines, relative to the previous year, varied greatly. While the decline in 2002 was the greatest for the financial services sector, at 37 per cent, the manufacturing and mining sectors experienced similar declines of 35 per cent and 23 per cent, respectively. In contrast, during all other years of increased political risk between 2004 and 2014, all other declines in FDI differed markedly. The analysis thus concluded that FDI into varying sectors responded differently to increased political risk.

Thirdly, the analysis concluded that the majority of the declines in FDI experienced by the three sectors were to a greater extent attributable to regional and global factor such as the global financial crises of 2000 to 2001, 2008, the fragility of the global economy in 2014, and also to regional factors, such as investment flows into Mozambique's mining sector. Furthermore, in a number of years during which South Africa's political climate posed notably higher political risk, namely between 2004 and 2014, investors continued to invest. Between 1994 and 2014 South Africa offered investors an attractive investment location for a wide variety of reasons. Factors that made South Africa an attractive investment location included its strategic geographical position, its large and growing domestic market, the fact that it was a hub of MNC headquarters, it had well-developed infrastructure and provided MNCs with a business climate that was promotive of investment. The international business theories explored above, such as the Macroeconomic Theory, the Economic Geography Theory, the Theory of Oligopolistic Markets and John Dunning's Eclectic Paradigm, recognised many of these as determinants of FDI. In light of these, and based on the above analysis, it can further be concluded that other determinants of FDI, such as access to new markets, return on investment, removal of competition, access to raw materials, economies of scale and agglomeration tendency of MNCs, played a greater determining role in driving investment inflow.

In summary, the above analysis has made three key conclusions, answering the main research question as well as the two sub-questions. The first is that majority of the declines in FDI into South Africa's key economic sectors were to a lesser extent attributable to increased political risk. The second is that declines in FDI differed greatly from sector to sector. Third and lastly, global

and regional factors, as well as the other determinants of FDI in South Africa frequently played a greater role than political risk in driving FDI flows. It can thus be concluded that political risk is considered a less significant determinant of FDI than it historically was.

CHAPTER FIVE: CONCLUSION AND EVALUATION OF RESEARCH STUDY

5.1 Introduction

The benefits of FDI for development, especially for emerging economies that are capital scarce, cannot be refuted. However, as the world has become increasingly globalised and world economies increasingly integrated, the implications of political risk have far greater reach. This has made foreign investments riskier and FDI strategies more complex. Globalisation has resulted in ever-increasing, and increasingly rapid FDI flows, resulting in an international economy with unprecedented levels of integration. This has not only led to a global marketplace, but has made international business and investment more competitive (Alon et al 2006, p.623). While political risk was historically identified as a significant determinant of FDI, Alon et. al (2006: 623) note the following with regards to risk and FDI: “Multinational corporations around the world realize the importance of capturing an early market share, even in locales that may seem risky prospects. Risk-averse companies face the threat of losing lucrative future opportunities to more aggressive competitors”. This, in addition to the multitude of factors driving investment behaviour identified in studies from as early as 1870 to today, has increased the complexity of FDI strategy. Literature indicates a steadily growing number of determinants of FDI such as access to cheap labour, natural resources, access to greater markets, the search for efficiency or economy of scales and the agglomeration tendency of firms that drive MNC investments. This transformation of the global investment landscape has changed how MNCs perceive and respond to political risk.

This transformation combined with various other trends in political risk¹⁴, international investment and other impacts of globalisation, has diminished the determining role of political risk analyses in FDI decision-making. Historically, higher levels of political risk deterred FDI. This appears to no longer be the case. This research study explored this through a case study of FDI inflows into South Africa, long considered the hegemon of Africa. The data considered FDI into three of its key economic sectors, namely the mining, manufacturing and financial services sectors, between

¹⁴ Trends in political risk identified in Chapter Two include significant decline of risks related to expropriation or nationalisation, developed countries increasingly a source of political risk and increased globalisation has led to the increased interconnectedness and competitiveness of MNCs.

1994 and 2014. This data, as well as the political risk assessment of the country during the concurrent period, provided a detailed contextual analysis of increased political risk and declines in FDI. An analysis of the data, together with the use of secondary sources, provided a deeper understanding of the relationship between these two variables.

This chapter concludes this research study by reviewing the progress of the study, summarising the main findings of the study and makes recommendations for future research.

5.2 Progress of the Research Study

Each chapter in this study served to enable the analysis in Chapter Four. The following provides a breakdown of each chapter, marking the progression of the study in order to answer the main and sub research questions.

Chapter One was a general introduction to this research study. The background to the research problem was provided, followed by the research question and two sub-questions intended to support the main research question. In highlighting the challenges of conceptualisation, the changing nature of political risk as well as the critical nature of political risk analyses in assisting MNCs to manage potential losses, this chapter provided the background to the research study as well as established its relevance. The research design and methodology as well as the limitations and delimitations of the study were also discussed. Chapter One concluded with an outline of the research study.

Chapter Two explored the literature regarding political risk and international business theory, with a specific focus on studies related to the determinants of FDI. The review of literature regarding political risk provided an in-depth understanding of the evolution of political risk and challenges within the discipline, as well as within the industry. This review highlighted ‘how’ and ‘why’ the use of political risk analyses is constrained in FDI decision-making, and how this may impact on the determining role it plays in FDI decision-making. Following this, the evolution of international business theory related to the determinants of FDI was explored. This exploration identified the wide variety of other determinants of FDI recognised in literature and which serve to highlight

political risk as only one determinant recognised amidst an increasing number of FDI determinants. This further highlighted why the determining role of political risk in FDI decision-making may have been reduced over time. This literature review provided the study with a theoretical foundation and informed an in-depth understanding of why political risk analyses are simultaneously of great importance and constrained in FDI decision-making. This literature review was also crucial in informing an understanding of the assessment, contextualisation and analysis that followed in Chapters Three and Four.

In Chapter Three an assessment of South Africa's political risk between 1994 and 2014 was provided, as well as a contextualisation of FDI flows. South Africa's political risk was assessed using 13 political risk indicators, 12 of which were from the PRS's ICRG as well as labour policy, that were specifically relevant to South Africa's investment climate. This assessment highlighted specific years during which political risk in South Africa increased, thus posing greater risk to investors. In the contextualisation of FDI flows between 1994 and 2014, FDI flows into three of South Africa's key economic sectors as well as national, regional and global FDI flows during the same period were explored. The political risk assessment and contextualisation of FDI provided the necessary data for the analysis in Chapter Four. As the methodology of this study followed inductive reasoning, no general pattern of behaviour was assumed. Thus, the data provided in this chapter facilitated the analysis and identification of patterns of behaviour in Chapter Four.

Chapter Four analysed the data in Chapter Three, with a focus on periods during which FDI declined and the political risk posed to investors during the preceding and concurrent periods. This chapter analysed to what extent declines in FDI were attributable to increased political risk. This chapter concluded that a majority of the declines in FDI were to a lesser extent attributable to increased political risk and were, to a greater extent, attributable to global and regional factors. It was also concluded that FDI flows differed greatly from sector to sector and that in numerous years FDI continued to flow into these sectors in the face of higher political risk due to the presence of other, more significant, determinants of FDI. Given that South Africa offered MNCs many advantages to investing, such as access to the region, natural resources and to its local market, it was concluded that some of the determinants of FDI, such as these, and as identified in international business theory, played a more significant role in driving FDI behaviour than political

risk. The analysis thus concluded that political risk was a less significant determinant of FDI in South Africa between 1994 and 2014.

5.3 Main Findings of the Research Study

This research study considered the impact of increased political risk in South Africa on FDI into its key economic sectors. Historically, political risk was found to be a significant determinant of FDI, but with an increasingly globalised and competitive international business environment, this may no longer be the case. This research study provided a case study of FDI into South Africa between 1994 and 2014 and considered how the determining role of political risk in FDI decision-making may have shifted.

The main research question of this study was the following: “To what extent were the declines in FDI into three of South Africa’s key economic sectors, including the mining, manufacturing and financial services sectors, between 1994 and 2014, attributable to increased political risk?”. The sub-research questions, in support of the main research question, were as follows: “Did the decline in FDI differ from sector to sector?” and “What other factors may have played a greater role in driving or deterring FDI?”. These sub-questions facilitated a more in-depth exploration of the relationship between political risk and FDI throughout the analysis.

The analysis in Chapter Four concluded that declines in FDI in South Africa between 1994 and 2014 were only to a greater extent attributable to increased political risk for two of the seven years of decline in FDI. The analysis also concluded that the majority of the declines in FDI, five out of the seven years, were to a greater extent attributable to global and regional factors. It was also noted that in numerous years of increased political risk, FDI continued to flow into these sectors, sometimes showing considerable growth. Lastly, the analysis in Chapter Four indicated that the declines in FDI into these economic sectors differed markedly from one another and that they did not always follow the trends of national, regional or global FDI flows.

FDI into South Africa’s key economic sectors, including the mining, manufacturing and financial services sectors, collectively declined over seven years between 1994 and 2014. Only two of these

declines, namely the decline in FDI into the manufacturing sector in 2011 and the decline into the mining sector in 2012, were to a greater extent attributable to increased political risk. The political risk assessment in Chapter Three highlighted that the political risk posed by indicators such as socioeconomic conditions, internal conflict, labour policy, as well as increased corruption and investment freedom posed notably increased risk to investors between 2004 and 2014. The analysis however concluded that only in 2011 and 2012 did these political risks have a sufficiently negative impact on the ROI for MNCs to cite it as a factor deterring further investment.

The remaining five years of FDI decline were to a *lesser* extent attributable to increased macropolitical risk in South Africa and to a greater extent attributable to global and regional factors. During three of these years of decline, namely, 2000, 2002 and 2003, there was no evidence of increased macropolitical risk in South Africa during the concurrent or preceding period. Secondly, although accompanied by increased political risk, the declines into mining in 2008 as well as in 2014 into the mining and manufacturing sectors, were to a lesser extent attributable to increased political risk. The data showed that global economic factors such as the global financial crisis of 2007/2008 and the fragility of the global economy in 2014, were to a greater extent responsible for these declines. Thus, it follows that most of the years during which FDI declined, global economic factors contributed to a greater extent to these declines. Declines in FDI were thus to a lesser extent attributable to increased macropolitical risk in South Africa. It was therefore concluded that in South Africa between 1994 and 2014, political risk did not play a significant deterring role, and thus a determining role, in FD decision-making. This indicated that political risk may be a less significant determinant of FDI than it historically was. Perhaps in an increasingly globalised, interconnected and competitive IPE, MNCs can no longer be as risk averse as they were in the past. This is significant for governments, FDI decision-makers and political risk practitioners alike. If political risk analyses no longer fulfil the role of determining investment locations, perhaps the role has shifted to one of aiding MNCs in mitigating and managing that risk.

Lastly, the data indicated that, with the exception of 2002, declines in FDI into the mining, manufacturing and financial services sectors notably differed. FDI flows into these sectors responded differently, not only to increased political risk, but also to global economic factors. In 2002 all three sectors experienced substantial and similar declines in FDI, at 35 per cent, 25 per

cent and 37 per cent, respectively. FDI declines in all other years varied in timing and magnitude. The mining sector experienced the most volatility in FDI during this period. The data provided evidence that the mining sector not only had the most substantial increases in FDI, but also the largest and most frequent declines. The manufacturing sector experienced the slowest growth in FDI although with only three years of decline as well as the smallest declines. Lastly, the financial sector experienced the longest sustained periods of increased FDI, with the least declines. It was also the only one of the three sectors to experience two consecutive years of decline. It must also be noted that in the two years during which declines in FDI were to a greater extent attributable to increased political risk, only one of the three sectors declined during that year, while the remaining two sectors showed increases in FDI. Thus, with regards to the extent to which FDI into these sectors responded differently to increased macropolitical risk, it was clear from the data that they responded in a markedly different manner.

The above, namely that FDI flows into different economic sectors respond to macropolitical risk differently, suggests that different sectors or industries may be more or less sensitive to different types of political risk. For example, while South Africa's labour policy can be considered a macropolitical risk, increased risk related to this indicator, such as the strikes referred to above, may have a greater impact on the mining and manufacturing sectors and a lesser impact on the financial services sector, primarily as they rely on a more professional labour force. These risks would then become micro or sector-specific risks. While this study does not explore micropolitical risk, the above suggests that further research may indicate that micropolitical risk may be a greater determinant of FDI than macropolitical risk.

5.4 Recommendations for Future Research

While the significance of political risk in FDI strategy and decision-making cannot be refuted, this study concluded that it plays a less significant deterring or determining role in FDI decision-making than it did historically. As explored in Chapter Two, FDI decision-makers often view political risk as a soft science and the validity and reliability of political risk assessments are frequently questioned. Historical, as well as more recent studies, such as those referred to in the literature review of political risk above, affirm that the majority of firms do not formally integrate

political risk assessments into their investment location decisions. Furthermore, in cases where political risk assessment does contribute to investment location decisions, there seems to be a lack of data regarding how these assessments are then utilised or incorporated into FDI strategy. If political risk is no longer a significant determinant of FDI, what role do these analyses play in FDI decision-making? If the investment community has indeed shifted from an era of political risk avoidance to an era of risk mitigation and management, what are the practical implications of this for the political risk industry and practitioners? Based on this premise, primarily the need to understand the relationship between political risk and FDI better, the following five recommendations can be made for future research:

- This study focused on the relationship between increased macropolitical risk and concurrent declines in FDI into South Africa's three largest economic sectors. However, numerous sources, as cited above, have described that South Africa's overall FDI inflows as "disappointing" and "below government expectations" and "at low levels comparative to other emerging market countries". One recommendation would be to broaden this study to consider to what extent this is attributable to political risk.
- This study does not consider the source country of the FDI. The findings of recent studies have found that developing or emerging economies with riskier political environments are less risk averse, also referred to as the "Adversity Advantage". Another recommendation for future research would be to analyse the relationship between political risk and FDI by source country (Gómez-mera & Varela, 2015).
- If political risk is no longer a significant determinant of FDI, what role do political risk analyses play in FDI decision-making? In an increasingly globalised and competitive world marketplace, have MNCs shifted from an era of risk avoidance to one of risk management and mitigation? If so, how are political risk analyses incorporated into FDI decision-making? What are the practical implications of a shift from risk avoidance to risk mitigation and management?
- This study concluded that macropolitical risk was not a significant deterrent or determining factor of FDI in South Africa between 1994 and 2014. However, as noted above, FDI flows across the three economic sectors varied greatly, which also led to the conclusion that some sectors, i.e. industries, may be more or less sensitive to the risk posed by different political

risk indicators. Therefore, the fourth recommendation for future research would be to explore if micro or industry-specific risk is a significant determinant of FDI.

5.5 Conclusion

Despite political risk being conceptually and practically constrained, it remains a vital consideration in the FDI strategy of international firms. Given that political risk may not only lead to the loss of personnel, but to strategic and financial losses, and in some cases even bankruptcy, it is vital for MNCs to be cognisant of the risks they may face in new business environments. Numerous past studies have shown that political risk is a significant determinant of FDI. However, the international investment environment has become increasingly globalised, interconnected and competitive. With these trends, the determinants of FDI have also diversified and become more complex. These developments and various other trends, such as industrialised countries increasingly being a source of political risk, have challenged the determining role once played by political risk. MNCs no longer have the option of being risk averse as they may lose valuable market share to competitors or lose out on potentially profitable opportunities. This research study considered how significant a determining role political risk plays through a case study of South Africa. Through an analysis of FDI decline and political risk during concurrent and preceding years of FDI, this study primarily concluded that political risk was not a significant deterrent to, or determinant of, FDI in South Africa between 1994 and 2014. Declines in FDI were to a greater extent attributable to regional and global economic factors. Furthermore, given that FDI inflows continued, and in many years grew in the face of increased political risk, other factors such as market access and access to natural resources, played a greater determining role in attracting FDI. The final contribution of this study is thus that political risk can no longer be considered a significant determinant of FDI and that the international investment community has shifted from an age of risk avoidance to risk mitigation and management, both of which have significant implications for governments aiming to attract more FDI as well as for the political risk industry compiling analyses for MNCs.

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