

MAKING A CASE FOR FOREIGN DIRECT INVESTMENTS IN THE SOUTH AFRICAN CONSTRUCTION INDUSTRY

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ABSTRACT

The construction industry plays a significant role in the aggregate output formation of any nation's economy. Financing construction projects are capital intensive, and most developing countries' low gross domestic savings necessitate seeking alternative routes for construction project financing. One such route is encouraging the flow of Foreign Direct Investments (FDI) into the construction industry in South Africa. Therefore, this paper investigates the factors influencing the flow of FDI into the South African construction industry. A quantitative technique was employed using professionals in the built environment as the target population. Data were elicited with the aid of a well-structured questionnaire, while data analysis was conducted with appropriate methods, which include the Cronbach alpha test, mean item score, and one-sample t-test. The findings from the study make theoretical contributions to the conversation on ways of boosting construction financing for improved economic development. It provides guidance to relevant stakeholders and prospective investors on the key factors influencing the flow of FDI in the South African construction industry.

Keywords: Construction Industry; Developing Economy; Economic Development; Foreign Direct Investment; South Africa.

1. INTRODUCTION

The importance of the construction industry in the economy of any nation cannot be overemphasised. According to Rangelova (2015), the construction industry is a major contributor to the economic growth of most nations due to its role in the development process. The industry is characterised by the formation of physical assets utilised by other sectors, making up the economy of any nation. This spans industries, power systems, schools, houses, offices, transportation systems, agriculture systems, utility infrastructure

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systems, retail outlets, and townships. The construction industry in South Africa is important as it is a major driver of the nation's Gross Domestic Product (GDP) due to its paramount contribution to socio-economic development (Anugwo et al., 2018; Ikuabe et al., 2022a). This is attained by providing the needed infrastructure, employment, and sanctuary. Notwithstanding the setback brought by the advent of the coronavirus (COVID-19) pandemic in 2020, the construction industry contributed R83 billion (\$5 billion approximately) to the nation's GDP ("Value added to gross domestic product (GDP) by the construction industry in South Africa from 2016 to 2023", 2024). Furthermore, the industry employs a large pool of formal and informal labour (Ikuabe et al., 2024; *Gross domestic product: Third quarter 2009*, 2009). All of this highlights the importance of the construction industry to the South African economy.

It has been noted that the current funding model of the South African construction industry is not viable enough to cater to the country's infrastructural deficit (Balogun et al., 2016). Therefore, it impedes the attainment of massive infrastructural output as delivered in most developed countries. To compound this, the construction industry experienced a drop of 0.8% in its quarter-to-quarter assessment of 2017 ("Statistical release P0441: Gross domestic product, fourth quarter 2017", 2018). Considering the government's initiative to eliminate poverty and inequality by 2030 through its National Development Plan (NDP), the construction industry is expected to play a strategic role in its actualisation. Therefore, there is a need to consider other viable options or models of funding for the industry to drive the much-needed infrastructural delivery and provide employment for the general populace. Besides, the country's downgraded rating to BB- by Fitch Ratings due to its unceasing decline in gross domestic savings ("Fitch affirms South Africa at 'BB-'; Outlook negative", 2021), thus giving credence to the notion that the country's economy is experiencing a despondency. Consequently, long-term interest rates are most likely to experience an upsurge and hurt business interest in the country.

The call for alternative funding models in the construction industry is fast gaining attention, and one viable option is FDI. According to Ikuabe et al. (2021), FDI is a cross-border investment undertaken by a country's resident entity to obtain a long-term interest in a business concern of another country. These investments are usually in the form of green investment or Merger and Acquisition (M&A), which entails the acquisition of an existing interest. The host country tends to benefit from the FDI by transferring technology, entrepreneurial skills, and capital flows (Ebekoziem et al., 2015; Ikuabe et al., 2022b). Consequently, providing an equilibrium for the host nation by shoring up its inadequacies. With this framework, construction is expected to experience a boost in the financial demands for the delivery of infrastructural projects and their concomitant benefits. This is the basis for which this study intends to ascertain the factors affecting FDI in the South African construction industry and unravel a roadmap for boosting the flow of FDI in the construction industry in South Africa.

2. LITERATURE REVIEW

Most developing countries, such as South Africa, have experienced dwindling government spending on infrastructure in recent years, necessitating adopting other viable options such as FDI. Results have shown that FDI can stimulate economic growth and boost productivity in the host nation (Ikuabe et al., 2021). This has led to most governments' encouragement of FDI inflow (UNCTAD, 2014). However, various factors determine attracting FDI from prospective investors in different countries. According to

Abdelkader (2015), investors are morally opposed to investing in a country with economic and political uncertainty. FDI is hampered by economic barriers and risk concerns, as well as by political and social uncertainty and government policies that must be adhered to (Enoma & Mustapha, 2010). Foreign investors place a premium on economic transparency and trustworthiness for developing countries to attract FDI. Foreign investors are concerned about risks such as market literacy and certainty (Kahraman, 2011). All of this will significantly impact the country's economy, resulting in a lack of investment (Liu & Pang, 2009). External factors influencing a country's macroeconomic and monetary policies are well-recognised as significant determinants of the flow of FDI (Karim & Azman-Sainib, 2013). Liquidity and the structure of debt repayment for an economy's enterprises are essential elements that significantly impact investment opportunities. Organisations' expenditures are expected to rise due to delays in receiving receivables, and new investment projects may be significantly restricted (Bartels et al., 2009). Furthermore, any nation's taxation policy directly impacts the rate of return on an investment made (Santoro & Wei, 2012), which plays a vital role in the flow of FDI.

According to Nnadi and Soobaroyen (2015), inflation is a sign of macroeconomic instability, and a higher rate may scare off current and potential foreign investments. Inflation in the host country reduces FDI by eroding the value of foreign enterprises' earnings. In contrast, low inflation reduces lending rates and thus lowers the cost of capital for foreign investors (Sayek, 2009). Moreover, Antras et al. (2009) opined that weak financial markets decrease the quantity and scope of foreign organisations' activities in the host country since they cannot raise appropriate capital from financial markets and rely too heavily on the parent company. Bartels et al. (2009) stated that a stable financial market provides potential international investors with efficient, timely, and cost-effective information, thereby increasing the flow of FDI into the host country. Furthermore, the inflexible exchange rate regime creates uncertainty among investors, reducing the quantity of international investment. In addition, it is thought to be more inflationary than a fixed exchange rate regime and might lead to unstable speculation. Calvo and Reinhart (2002) observed that the impacts and options for exchange rate regimes for emerging nations differ significantly from those for developed nations. Developing countries are frequently confronted with issues of legitimacy and limited access to foreign markets. Additionally, political instability has impacted many developing countries, which is not a new issue. Internal conflicts outnumber international conflicts (Collier & Hoeffler, 2004). Political unrest negatively influences people's lives and property, as well as deterring economic activity. Political insecurity is characterised by uncertainty, which hurts developing-country development outcomes by distorting investment opportunities.

3. METHODOLOGY

This study aims to evaluate the factors influencing the flow of FDI into the construction industry in South Africa. The study employed a positivist philosophical stance by utilising a quantitative approach that adopted a questionnaire to collect data. The target respondents of the study comprised built environment professionals, i.e., architects, quantity surveyors, construction managers, construction project managers, and engineers, while the study area was Gauteng province of South Africa. The questionnaire comprised two sections. The first retrieved data on the respondents' background information, while

the second inquired about the factors influencing FDI in the South African construction industry by providing the respondents with a list of the factors and asking them to rate their significance using a Likert scale. A total of 90 questionnaires were distributed via electronic means to the target respondents who knew about foreign investments. In contrast, 71 were returned and passed appropriately for analysis. The method of data analysis used by the study was percentage, mean item score, and one-sample *t*-test. The Cronbach alpha test was employed to affirm the reliability and validity of the research instrument. The analysis provided an alpha value of 0.892, which implied the reliability and validity of the research instrument (Tavakol & Dennick, 2011).

4. RESULTS AND DISCUSSION

4.1 BACKGROUND INFORMATION OF RESPONDENTS

The analysis of the data obtained on the background information of the respondents shows that out of a total of 71 respondents, 46% possess a bachelor's degree as their highest educational qualification, while 14% have a master's degree, and 1% have a doctorate. Based on the professional designation of the respondents, 31% of the total respondents were Engineers, 18% were Construction Managers, and 13% were Quantity Surveyors. Besides, 54% of the total respondents have four to eight years of working experience, 31% have nine to 15 years of working experience, and 10% have up to three years of working experience. Furthermore, 67% of the respondents are male, while 33% are female.

4.2 FACTORS AFFECTING FDI IN THE SOUTH AFRICAN CONSTRUCTION INDUSTRY

The review of extant literature revealed twelve factors that are influential to FDI in the construction industry. Using the one-sample *t*-test, the study attempts to determine the significance of the identified factors as rated by the respondents in the questionnaire. Consequently, a null hypothesis was set, indicating that a factor is insignificant when its mean value is less than or equal to the population mean ($H_0: U \leq U_0$). The alternate mean stipulates that a factor is significant when its value exceeds the population mean ($H_a: U > U_0$). The study adopted 3.50 as the fixed population, while 95% was set as the significance level as this conforms to the conventional confidence level (Pallant, 2020). By implication, when the mean value of a factor is above 3.50, it is deemed significant. Conversely, when the mean value of a factor is less than or equal to 3.50, it is deemed insignificant. Table 1 shows the result of the two-tailed *p*-value of the one-sample *t*-test, indicating the significance of the identified factors influencing FDI in the South African construction industry.

Table 1: One-sample test

Factors	Test Value = 3.50					
	T	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					L	U
Tax rate	4.338	70	.000	.149	.8268	1.7262
Size of market demand	5.193	70	.000	.628	.5122	1.4936
Legislations	2.227	70	.000	.227	.3336	1.1183
Exchange rate stability	1.092	70	.000	.619	.2836	1.3856
Return on investment	1.185	70	.000	.621	.7294	1.0727
Accessibility of resources	5.974	70	.000	.296	.3119	.7381
Market transparency	4.297	70	.000	.774	.0728	1.2295
Macroeconomic stability	6.374	70	.000	.638	.7916	1.3925
Economic certainty	7.379	70	.000	.728	.4007	.5924
Political stability	2.058	70	.000	.375	.3654	1.0287
Market availability	4.297	70	.000	.275	.8202	1.3392
Availability of human capital	5.007	70	.000	.426	.5737	1.4925

L=Lower Limit; U=Upper Limit

The result of the analysis conducted on the factors affecting FDI in the South African construction industry is shown in Table 2.

Table 2: Summary of t-test showing the ranking of the factors influencing FDI in the construction industry

Factors	Mean	Std. Deviation	Sig. (2-tailed)	Rank
Return on investment	4.46	1.481	.000	1
Size of market demand	4.31	1.736	.000	2
Macroeconomic stability	4.22	0.274	.000	3
Market availability	4.18	1.085	.000	4
Tax rate	3.97	1.117	.000	5
Exchange rate stability	3.92	0.683	.000	6
Economic certainty	3.89	1.162	.000	7
Accessibility of resources	3.89	0.749	.000	8
Political stability	3.72	0.374	.000	9
Legislations	3.71	1.004	.000	10
Market transparency	3.68	0.238	.000	11
Availability of human capital	3.63	1.184	.000	12

Evidence from Table 2 indicates that all the identified factors have a mean value above 3.50, the fixed population stipulated for the study. Moreover, it is shown that all the identified factors have a p -value that is less than 0.05 at a 95% confidence level, thereby indicating that all the factors are significant. The result of the analysis shows that the most significant factors are return on investment ($MIS=4.46$, $sig.=0.000$), size of market demand ($MIS=4.31$, $sig.=0.000$), macroeconomic stability ($MIS=4.22$, $sig.=0.000$), market availability ($MIS=4.18$, $sig.=0.000$), and tax rate ($MIS=3.97$, $sig.=0.000$). While the least significant factors are the availability of human capital ($MIS=3.63$, $sig.=0.000$) and market transparency ($MIS=3.68$, $sig.=0.000$). These findings are in tandem with the notion that all investors are considerably particular about the prospective yields of their investments. This is supported by Ikuabe et al. (2021), affirming that one of the motivating drives that boost investors' confidence in undertaking FDI is the guarantee of good financial returns. Factors influencing a country's macroeconomic and monetary policies are well-recognised as significant determinants of the flow of FDI (Karim & Azman-Sainib, 2013). Liquidity and the structure of debt repayment for an economy's enterprises are essential elements that significantly impact investment opportunities. Furthermore, any nation's taxation policy directly impacts the rate of return on an investment made (Santoro & Wei, 2012), which ultimately plays a vital role in the flow of FDI. This is reflected in the outcome of the current study, thereby affirming that the tax rate of a developing economy such as South Africa would be considered influential in investors' choice of destination.

5. CONCLUSIONS AND RECOMMENDATIONS

FDI has been touted as a panacea to the drawbacks characterised by the underfunding of infrastructure projects resulting from governments' low gross domestic savings in most developing countries. It was on this premise that the current study evaluated factors influencing the inflow of FDI in the South African construction industry, using Gauteng Province as the study area. A review of extant literature was conducted, which revealed twelve factors, and subsequently presented to the target respondents of the study for rating based on their significance. Results from the data analysed showed that the most significant factors are return on investment, size of market demand, macroeconomic stability, market availability, and tax rate. The South African construction industry, along with other sectors of the economy, continues to grapple with the repercussions of the COVID-19 pandemic, which severely disrupted many activities in the industry. Hence, it is safe to say that one viable way of placing the industry on a recovery trajectory is the encouragement of FDI in the sector. Therefore, the outcome of this research is timely as it posits the influential factors in the flow of FDI in the South African construction industry. Accordingly, this study recommends that government agencies and policymakers should aid in promulgating laws, policies, and frameworks that would boost return on investments, thereby boosting the inflow of FDI into the South African construction industry.

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