FACTORS INFLUENCING THE ATTRACTION OF FOREIGN DIRECT INVESTMENT AND FOREIGN PORTFOLIO INVESTMENT INTO AFRICAN ECONOMIES

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Abstract

The purpose of this study was to identify and examine the key factors which determine whether African economies are attractive enough to harness international capital inflows from foreign investors. The evidence gathered shows that financial market development, institutional quality, natural resource deposits, cheap unskilled labour, as well as previous experience with international trade of goods and services, improve the likelihood of African economies receiving FDI inflows. In order to attract FPI inflows, African economies need to liberalise their capital accounts. Doing so requires strong regulation of financial markets, and instruments traded thereof. As FPI inflows increase, domestic financial markets become deeper and broader, thereby opening up alternative sources of capital (equity and bonds) for local firms. It is therefore recommended that African Governments strengthen not only their competitiveness in the import and export market, but also their foreign policies to complement domestic policies of further investment which results in economic growth and employment creation.

Keywords: FDI, FPI, Financial Market Development, Corruption, Africa

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1. Introduction

Capital flows have long attracted the interest of policy-makers, central banks, international institutions and academia, mainly because the volume of flows has grown at a phenomenal rate since the beginning of the 1990s (De Santis and Ehling, 2007). Reinhart and Rogoff (2009) however lamented that the increase in international capital flows, accompanied by a series of financial crises in the past three decades, has given rise to concerns about the impact of the flows in national economies. These international capital flows take two major forms: Foreign Direct Investment (FDI) and Foreign Portfolio Investments (FPI).

According to the World Bank (2004), Foreign Direct Investment is that foreign investment that establishes a lasting interest in or effective (active) management control over an enterprise. For investment to qualify as FDI, emphasis is placed on the fact that the investor must meet the 10% voting share threshold commonly referred to, which as the recommended mainly to ensure statistical consistency across countries (UNCTAD, 2009). Foreign Portfolio Investment, on the other hand, is considered to be stock (share) and/ or bond purchases that do not create a lasting interest in or effective management over an enterprise (World Bank, 2004).

Africa is well-endowed with natural mineral resources and has an abundant supply of low-cost, unskilled and semi-skilled labour. In countries where there are limited deposits of natural resources, the economy is largely dependent on agriculture and tourism. However, despite these attractions which are the backbone of many African economies, there are limited inward flows of FDI, and even less inward flows of FPI. This can largely be attributed to the stringent policies regarding foreign ownership of companies and even listed shares in some countries. For substantive inflows of FPI, investors expect financial markets to be developed enough to absorb the volumes coming into the country, and complementary policies to ensure repatriation of funds, if necessary. Furthermore, investors require political stability, respect for legal and property rights, and sound corporate governance practices to ensure their investments are secure. Many African states are deriving limited benefits of FDI, FPI and international trade due to the high incidence of graft and corruption within the Government and business sectors.

Asiedu (2003) acknowledges that the role of FDI as a source of capital has become increasingly important to Sub-Saharan Africa (SSA). The reason being that since income levels and domestic savings in the region are low, a bulk of the finance will have to come from abroad – in the form of official finance

such as aid from the World Bank or from private foreign investment. However, official development assistance (ODA) to the region has been declining. For example, net ODA to SSA declined from US$17 billion in 1990 to US$10 billion in 2001, a decrease of approximately 41% (World Bank, 2000; 2003). In addition, foreign portfolio investment is unavailable to most African countries – most of the countries in region cannot raise funds from international capital markets as their own domestic financial markets are not sufficiently developed (Asiedu, 2003).

There are primarily two reasons for external foreign capital investments – the pursuit for higher returns from investing in foreign capital markets, as well as the potential to realise returns from engaging in FDI. It would therefore further make sense to ensure that domestic financial markets are sufficiently developed to cater for those investors that prefer the FPI route. There is no doubt that Africa already offers an abundant supply of natural resources, basic infrastructure (utilities and telecommunications) and a large pool of low-cost, unskilled labour. However, since FDI is mainly an extraction, export and repatriation exercise, countries can also potentially benefit from FPI inflows as these funds often result in the further sophistication of financial markets.

2. Literature Review

Foreign Direct Investment (FDI)

According to the World Trade Organisation (1996), foreign direct investment (FDI) occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) *with the intent to manage that asset*. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments. Alternatively, FDI can be considered as the ownership of 10 percent or more of the ordinary shares or voting stock of an enterprise which is usually considered to indicate 'significant influence' by an investor (IMF Statistics, 2000). This however differs from country to country and can even be determined by their policies, some of which restrict the levels of shareholdings of foreigners in local firms.

The World Bank (2004) further defines FDI as foreign investment that establishes a lasting interest in or effective management control over an enterprise. The OECD (2008) defined FDI as the net inflows of investment undertaken to acquire a lasting management interest (10% or more of the voting stock) in a firm conducting business in any other economy but the investor's home country. Emphasis is also placed on the fact that the 10% threshold commonly referred to is recommended to ensure statistical consistency across countries. Lipsey, Feenstra, Hahn and Hatsopoulos (1999) had earlier commented that this lasting interest implies the existence of a long- term relationship between the direct investor and the firm, as well as a significant degree of influence on the management of the firm.

FDI theory is rooted in the early work of Adam Smith and David Ricardo related to international specialization of production. This goes as far back as 1776 in Smith's theory of absolute advantage. Ricardo (1817), on the other hand, was more interested in international factor movements as he was of the opinion that labour and capital were mobile domestically but not across borders. In its original version, the neo-classical arbitrage theory of portfolio flows was used to explain foreign investment activity (Iversen, 1936). The neo-classical capital movement theory asserts that capital flows across countries are governed by differential rates of return (Ohlin, 1933; Iversen, 1936), implying no risks to the investor. Mundell (1957) came up with a 2-sector model of international capital flows whereby capital flows were considered to be a substitute to international trade resulting in factor price equalization between countries. Mundell's model considered more short term, international portfolio type of investments rather than FDI. Hymer (1976) laid the foundation for other authors to come up with more plausible theories of FDI. In his arguments, he found that FDI was motivated by the need to reduce or eliminate international competition among firms, as well as Multi-National Enterprises' (MNEs) wishes to increase their returns gained from using special advantages. However, the best-known theory of FDI is however Dunning's 1977 Eclectic Paradigm in which he states that FDI occurs under different scenarios of ownership, locational and internalization advantages (OLI), which will be discussed in detail under the literature pertaining to FPI.

Narula and Dunning (2000) state that the four main motives for foreign direct investment can be categorized into two. The motives to seek natural resources, seek new markets and restructure existing foreign production can be classified as "asset-exploiting, to generate economic rent by using firm-specific assets". The fourth motive of seeking new strategic assets is considered asset-augmenting, to acquire new assets that protect or enhance existing assets. Narula and Dunning (2000) and Narula (2004) concluded that developing countries would tend to have mainly resource–seeking FDI. According to Asiedu (2003), the reasons why foreign investment is important to a country will depend on the needs of the country. For example, for countries that have access to international capital markets (mainly, middle and high income countries), the technology transfer component of FDI may be more relevant than the benefit of FDI or FPI as a source of capital. Similarly, a country with a high unemployment rate may place more value on the employment creation aspect of FDI. Since economies in Africa are characterized by high unemployment rates, FDI in search of minerals

and access to the abundant, cheap labour, will have to ensure job creation.

Foreign Portfolio Investment (FPI)

Foreign Portfolio investment, on the other hand, consists of stock and bond purchases that, unlike direct investment, do not create a lasting interest in or effective management control over an enterprise (World Bank, 2004). FPI is non-FDI cross-border investment in equity and debt securities. Foreign portfolio (dis) investment (FPI) therefore simply involves the (selling) purchasing of a share of any entity (UNCTAD, 2008). For the purposes of this research, FPI will be used to refer to all inward foreign investment which is temporary, and primarily targeted for financial assets available in the local financial markets, and does not involve permanent investments. Such financial assets therefore include private and publicly listed equity shares, as well as bonds.

According to Goldstein *et al.* (2006), international equity flows are the main feature of the recent globalisation of capital markets in both developing and developed markets. Wilkins (1999) highlighted that early literature perceived "capital" movements as being inferior to trade transactions as evidenced by the fact that they were regarded as a "balancing item" in the national BOP accounts. In her discussion on the theory of capital movements, Wilkins (1999) is of the opinion that many early writers tried to explain capital movements (Ohlin, 1933; Iversen, 1936; Heckscher-Ohlin-Samuelson and Kemp-Jones, 1962). According to Wilkins (1999), Ohlin and other authors who wrote in the early 1920s and 1930s made the assumption that in the absence of impediments (perfect markets); capital would go where returns were highest. However, others such as French and Poterba (1991) and Gokkent (1997) took into account "home bias" and found that investors hold a large proportion of domestic assets in their portfolio. This would not be the case if capital were fully mobile.

The theory of FPI has traditionally been drawn on macroeconomic variables, primarily interest rate differentials and exchange rate fluctuations (Dunning and Dilyard, 1999). By extending the Eclectic Paradigm, Dunning and Dilyard (1999) attempted to explain two issues: the level and pattern of long-term FPI and the choice between FPI and FDI. They asserted that money sought higher interest rates and higher profits as per the essentials of any investment decision. Historically, it has been FPI that has preceded FDI due to its liquidity status. Liquidity in this instance implies that the financial asset can be purchased (and sold) with relative ease. Dunning and Dilyard (1999) explained that in the early 19th Century, as the U.S. economy matured with the assistance of inward FDI, its own capital markets evolved in response to the FPI inflows (in the form of loans and minority equity stakes) from European institutional and investors. As such, they concluded that this phenomenon was now also evident in the Asian and Latin American emerging markets, whereby successful FDI was strengthening domestic capital markets, which in turn resulted in the attraction of further FPI inflows.

Dunning and Dilyard (1999) attempted to use microeconomic and strategy-related theories of FDI to explain FPI by modifying the OLI paradigm.Each variable in the Ownership, Locational and Externalisation (*OLE*) paradigm is grounded in the theory of FDI, portfolio capital movement and locational economics. The new paradigm for FPI became *OLE* (Ownership, Location and Externalisation). Their argument was that usually "O" variables are already present so the choice of outlet for FPI depends on "L" and "E" variables. According to OLE, portfolio investment decisions are based on the following premises and evidenced as follows:

- Ownership: this being the choice of investment encompassing the capital amount, term to maturity, return, location of investment in terms of country or industry;
- Location: the decision of location depends on the risk appetite of the investors, as well as their investment plan and portfolio objectives. Information plays a very significant role here because the investor must be well-versed with the institutions and regulations (e.g. tax, dividend, foreign participation, and so on) of their chosen destination;
- Externalisation: this is the opposite of "home bias" as it accounts for the placing of capital in different countries and industrial sectors which investors are not familiar with.Externalisation is the justification for using external markets rather than internal (domestic) ones for transferring capital. It is for this reason, and this variable, that FPI can hence be explained using the modified paradigm.

Dunning and Dilyard (1999) suggested that the theory of FPI is therefore drawn on macroeconomic financial variables, notably interest rates and exchange fluctuations, and that inbound FPI tends to follow FDI (Granger-causality relationship). In support of this view, Goldstein, Razin and Tong (2006) are of the opinion that FPI is motivated by yield-seeking and risk-reducing activities that are achievable through portfolio diversification.Therefore advantages of international capital markets, other than internalising markets, can be defined in terms of portfolio structure and investor attitude towards risk - that is, diversification (spreading of risk) by means of an international rather than a national portfolio (full home bias).

Financial Market Development (FMD)

Berkel (2004) describes financial markets and intermediaries as playing a fundamental role for both local and international investors by mobilising

savings, allocating credit and facilitating hedging, pooling and pricing of risks. According to Gitman *et al*. (2010), a financial market is simply a market for financial instruments in which buyers and sellers meet to create an exchange for financial assets. In other words, it is a system which facilitates the flow of funds from excess entities to those with deficits, in search of higher returns while also reducing the costs of information and transactions. Financial markets therefore include the money, foreign exchange, bond, equity and derivatives markets.

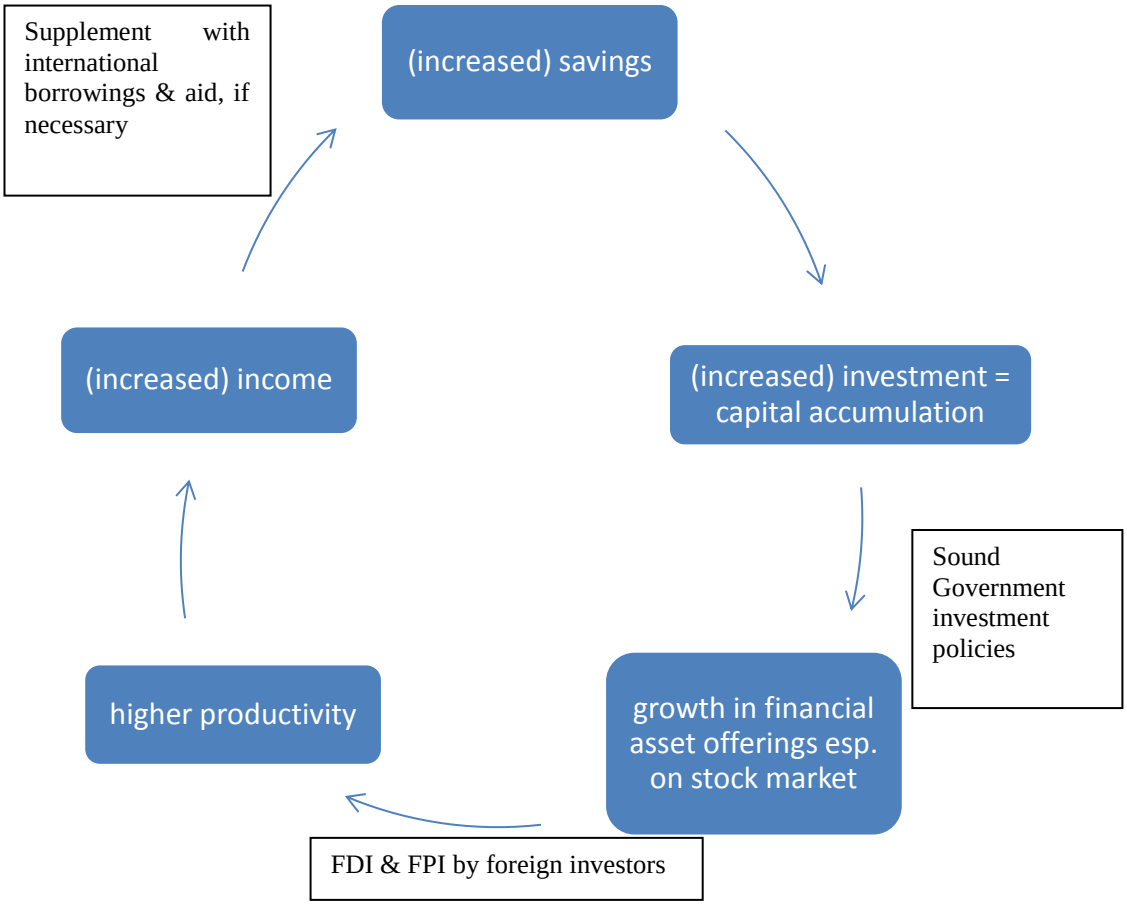

Figure 1. Financial Market Development Life-Cycle
Source: Jones (2004). Adaptation of the "Applications of the Harrod-Domar Theory"

As domestic savings grow, a wider array of financial assets becomes available, leading to a deepening and broadening of the financial markets. This, coupled with sound Government policies such as those regarding foreign ownership, property rights and legal rights, leads to an attraction of foreign capital flows, whose investments can be used to increase productivity and output, resulting in increased income levels for the country. According to Karacadag, Sundararajan and Elliot (2003), ppolicies aimed at developing financial markets need to be carefully sequenced, taking into account the overall objectives and likely impacts of the intended action. The overarching strategy is to eventually have a well-functioning capital market, which will then be able to attract international investors, in the long run. As such, developing domestic financial markets is a gradual, systematic process which needs to occur concurrently with institutional reforms of good governance and risk management controls (Karacadag, Sundararajan and Elliot, 2003).

Of all the global markets, Africa is lagging behind in terms of financial market development, breadth and depth. According to Anyanwu (2006), this is because African Governments have stringent business, as well as financial market regulations, laws and policies which are intended to protect their citizens and domestic markets from exploitation by large foreign institutional investors, as well as limiting exposure (risk) to global financial crises. For example, some countries have restrictions on the profits that can be repatriated by international investors, making it somewhat unattractive to FDI and FPI investors. Hence, while it is acknowledged that in order to deepen domestic financial markets, capital account liberalisation is key; African countries also believe that foreign capital complements, but does not substitute, the domestic investor base. Financial market depth is considered to be a good indicator of

how sophisticated a financial system is. Specifically, depth deals with issues related to liquidity, or how efficiently the financial markets are able to absorb large volumes of trade without significant impacts on security or asset prices.

Schumpeter (1911), Goldsmith (1969), McKinnon (1973) and Shaw (1973) advocated that well-functioning financial markets, by reducing transaction costs, facilitated capital allocation to projects that yield the highest returns and therefore enhanced growth rates. Errunza (2001) studied the role of capital markets in economic development, and the relationship between market development and economic growth. By conceptually extending the Shaw-McKinnon framework, Errunza (1974, 1979) argued that as markets develop, specialised institutions and instruments, improved liquidity and further opportunities for diversification would result in increased savings rates and capital accumulation. He reached the conclusion that a well-functioning local market is a pre-condition for attracting FPI into emerging markets. This study sought to establish whether the same conclusions would be reached for countries in Africa, which are primarily characterised by under-developed financial markets. Errunza (2001) later further highlighted that while FPI makes significant contributions (spill-over effects) to the development of domestic capital markets, external financial liberalisation should not precede domestic reforms because then there would not be the adequate domestic financial infrastructure; that is, a well-regulated banking system. This was the case prior to the Asian crisis of 1996. Alfaro *et al.* (2004) argued that the lack of development of local financial markets can limit an economy's ability to take advantage of potential foreign inflows' spill-overs. It is this study's intention to determine the relationship between the level of development of local financial markets vis-a-vis FPI inflows using the various theoretical underpinnings.

Other key factors influencing FDI and FPI inflows in Africa

New FDI theories have however moved away from economics and place FDI within the interdisciplinary field of international business (Hosseini, 2005). Lizondo (1991) adds that investors are aware of the potential risk of their business ventures, and are not only guided by higher rates of return on their investments in making decisions. As such, FDI theories would not be complete without accounting for international political factors (institutional quality). Hosseini (2005) described international political changes as being drastic and abrupt and could take the form of revolutions, coups, imposition of sanction regimes, political violence against a certain industry and expropriations. Since the political risk and uncertainty perception is unpredictable, despite the regular gradings provide by various rating agencies, it can pose a threat to FDI and FPI investors. Hence, no research would not be complete without studying the impact of institutions on FDI and FPI flows to African countries.

Another key determinant of international capital inflows is international trade between countries. International trade relates to the transaction of goods and services across borders, also known as imports and exports. A country will export those goods and services for which it derives economies of scale, and in return receives payments in foreign currency. An importing economy is one which requires certain goods and services, but is unable to produce them either due to lack of capacity and/or resources. At national level, the import and export transactions are captured in the trade account of the Balance of Payments (BOP). It is also within the BOP, that a country reflects its current account, as well as the capital and financial account balances.

Also, when we examine and apply the International Labour Organisation's (ILO) ISCO-08 principles to Africa, as well as educational attainment as a measure of human capital, we find that Africa has a higher population of unskilled versus skilled labour. Unskilled labour is that workforce which holds low academic qualifications, performs menial and repetitive tasks for a very small financial reward (low wages). This is the largest part of the workforce found working in mining companies, on agricultural farms and even some manufacturing firms. Below is a snapshot of different African countries' labour statistics of the educational attainment of their respective populations, for persons above the age of 25 years.

As can be derived from Figure 2 above, most African countries have an economically active population of people aged 25 years and above who hold only basic primary education. Combining this with the ISCO-08 skills levels, most African states have a predominantly unskilled labour force.

This abundance of mineral wealth, basic infrastructure and what is perceived to be low-cost labour, is an attraction to many foreign countries seeking to invest FDI in Africa.

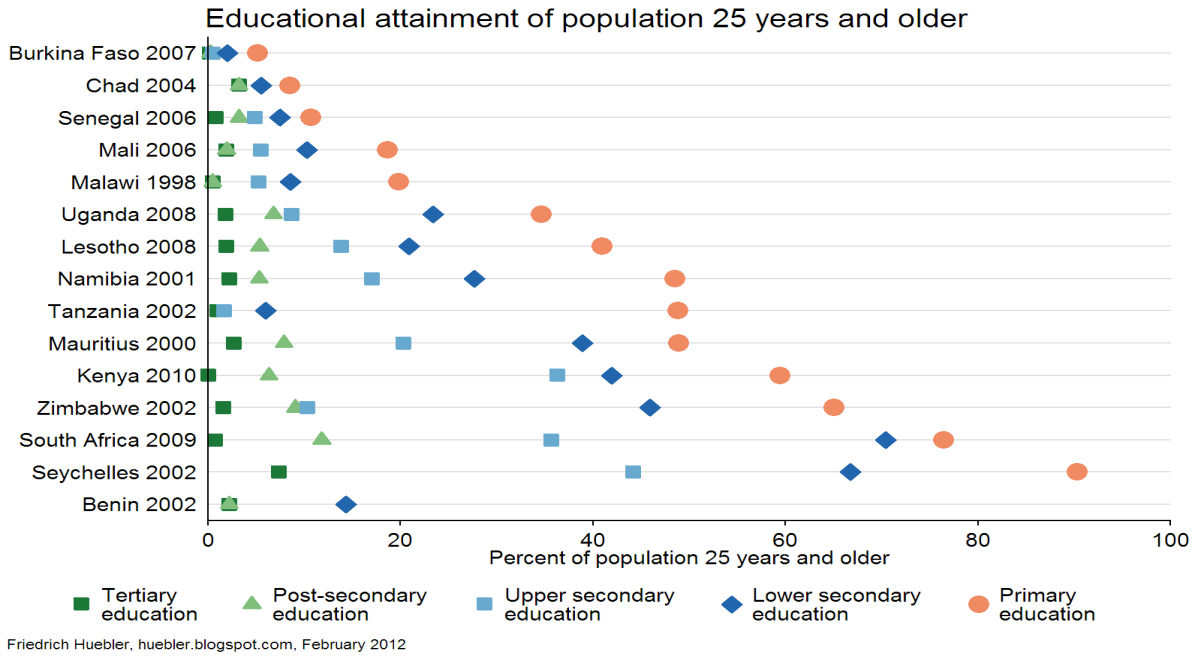

Figure 2. Educational attainment of selected African countries' 25years and older population
Source: UNESCO Institute for Statistics, Global Education Digest 2011, Table 19 and Fig.14

The Case of Africa: Supporting Evidence

According to Odhiambo (2007), Africa has been unable to attract significant private sector external resources. Despite total FDI inflows shooting up from US$17 billion in 2004 to US$31 billion in 2005, Africa's share of global FDI continues to be low, at approximately 3% between 2000 and 2006, a decline from its 9.5% share in 1970 (UNCTAD, 2008). Odhiambo (2007) attributes the low level of FDI inflows to Africa to excessive bureaucracy, poor governance, political instability and the reliance on basic infrastructure.

There are a lot of capital outflows from the developed countries but very few of these reach Africa for investment. For example, in 2007, 2008 and 2009, respectively, developing countries in Africa received US$63 billion, US$73 billion and US$60 billion, representing only 3%, 4.1% and 5.3% of the share in global FDI inflows. South, East and South-East Asia on the other hand attracted US$259 billion, US$282 billion and US$233 billion, respectively, over the same period (UNCTAD, 2010), more than treble the volumes going into African economies. Between 2000 and 2010, net FDI inflows as a proportion of GDP were 3.02% for Sub-Saharan Africa, 2.03% for East Asia and the Pacific, 4.34% for Europe and Central Asia, 2.89% for Latin America, 2.78% for South Asia and the world average was 2.78% (World Development Indicators, 2012).

Table 1. FDI inward flows – a comparison (US$ millions)

	1980	1990	2000	2006	2007	2008	2009	2010
Developing economies: Africa	400	2,845	10,967	46,259	63,132	73,413	60,167	55,040
Northern Africa	144	1,187	2,858	19,609	22,349	21,445	15,786	15,326
Sub-Saharan Africa	257	1,658	8,109	26,650	40,782	51,968	44,381	39,714
Developing countries: Asia	543	22,628	148,747	283,463	339,252	375,665	307,527	357,846
Eastern & SE Asia excl. China	3,529	18,125	99,582	115,815	143,223	123,887	104,076	161,694
Developing economies: America	6,416	8,926	97,688	98,459	169,514	206,733	140,997	159,171
Developing economies: global	7,479	34,853	257,625	429,459	573,032	658,002	510,578	573,568

Source: UNCTAD, World Investment Report (2011)

The above statistics paint a gloomy picture of the benefits African economies receive after parting ways with their natural resources. Inward FDI flows are minimal in comparison to the profits made from extraction of mineral wealth. These poor inflows of foreign investment can be further attributed to the fact that the decision to invest outside one's local borders comes with its own fair share of costs and benefits. There have to be plausible opportunities to invest in and an acceptable level of trade openness to attract FDI.

According to Goldstein *et al.* (2006), firstly, developed economies attract larger shares of FPI than developing countries, as evidenced even in the below table. Secondly, investors with high expected liquidity needs are attracted to FPI, while those with low expected liquidity needs are attracted to FDI, thereby accounting for the high observed withdrawal rates of FPI relative to FDI, also contributing to a high volatility of the former relative to the latter. As can be assessed from Table 2 below, the bulk of FPI flows are directed at countries in the developed world such as the UK and the USA. Asian countries such as Japan, China and Hong Kong are increasingly becoming attractive to portfolio investors as well. However, Africa as a whole, like Russia, remains the recipient with minimal FPI flows.

Table 2. FPI flows to different regions globally, 2001 – 2010

	(US$ million)	% of world FPI inflows
Africa	1,005,495	0.36
Australia	5,012,411	1.82
Brazil	2,376,321	0.86
Canada	6,461,855	2.34
China (Mainland)	2,197,153	0.80
China/ Hong Kong	1,867,142	0.68
India	1,706,722	0.62
Japan	10,614,734	3.84
Russia	1,044,218	0.38
UK	25,917,381	9.39
USA	56,454,946	20.45
World	276,119,957	

Source: IMF, Coordinated Portfolio Investment Survey (CPIS) 2010

If increased levels of FDI and FPI are channelled towards Africa, it could encourage the further development of our local financial markets by venturing down new avenues of financial innovation. It can also be argued that an increase in the level of FDI inflows to some African countries brings in much-needed investment capital, which results in increased productivity and output (see Figure 1 above).

Below is the Balance of Payments (BOP) data for selected African countries, which gives further evidence that limited benefits are currently being derived from foreign investment. A close examination of the BOP data in the table below indicates that only the oil-producing countries of Angola and Nigeria had current account surpluses during the period under review. While the trade balances for these oil-producing nations improved between 2010 and 2013, South Africa's position continued to worsen, more than the other countries experiencing trade balance deficits. South Africa's increase in the current account deficit can hence be attributed to the continued decline in its trade balance. In addition to this, the net capital and finance account balances reflect that all countries surveyed below had surpluses, except the two oil-producing nations of Angola and Nigeria. However, because Angola and Nigeria had large current account surpluses, they could sustain running net capital and financial account deficits.

When we decompose the net capital and finance account, we find that the capital account balances for all countries (except Mauritius and Egypt) had small surpluses, with the DRC recording the highest surplus of US$1,066million in 2013, and South Africa recording the lowest surplus of US$29million during the same year. The capital flows in Nigeria declined drastically between 2010 and 2012 but showed signs of improvement in 2013, when the capital balance increased from a negative US$12.5million (in 2012) to a positive US$7.7million (in 2013). Ghana, South Africa and Zimbabwe had fairly stagnated net capital account balances during the period under review.

Table 3. Balance of Payments (2010 – 2013)

Country	Net Trade Balance (US$ million)				Net Current Account Balance (US$ million)				Net Capital and Financial Account Balance (US$ million)			
	2010	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**	**2010**	**2011**	**2012**	**2013**
Angola	33,949	47,190	51,224	48,255	7,487	13,140	11,370	7,045	-7,172	-12,357	-10,636	-8,799
DRC	654	556	178	-394	-1,062	-1,281	-1,697	-3,370	831	1,722	1,596	2,390
Egypt	-25,120	-27,103	-34,139	-31,696	-4,360	-6,088	-10,369	-5,236	9,031	7,779	16,343	9,436
Ghana	-2,962	-3,052	-4,211	-3,260	-2,770	-3,538	-4,907	-5,082	2,897	4,436	4,807	5,886
Kenya	-6,245	-8,395	-9,362	-9,793	-2,345	-3,828	-4,256	-3,937	2,612	2,804	3,598	3,910
Mauritius	-1,893	-2,356	-2,428	-2,860	-796	-1,496	-1,193	-1,424	640	1,226	1,262	1,177
Nigeria	30,095	31,100	33,800	43,262	4,094	8,700	12,700	22,764	2,058	-5,441	-12,492	-1,399
South Africa	3,716	6,488	-4,820	-8,521	-10238	-9,453	-19,843	-21,684	5,289	3,614	18,723	13,477
Zimbabwe	-1,844	-3,066	-2,656	-1,976	-2,141	-3,216	-2,502	-1,919	619	1,719	1,308	1,440
Africa	**56,086**	**52,283**	**43,036**	**17,639**	**-5,128**	**-12,627**	**-34,590**	**-59,460**	**17,248**	**10,600**	**39,858**	**78,183**

Source: African Development Bank (2014); World Bank (2014); Central Bank of Nigeria (2014); IMF (2014)

On the other hand, in terms of the net financial account balances which account for all FDI, FPI, other investment flows as well as reserves, South Africa, Egypt, Ghana and Kenya reported the highest surpluses in 2013 of US$13.5million, US$9.5million, US$5.7million and US$3.4million, respectively. In 2013, Angola and Nigeria, which recorded large trade account and current account balances, suffered net financial account deficits of US$8.8million and US$1.4million, respectively.

We can hence conclude that there was an inverse relationship between the trade balance accounts and the net capital and financial accounts of the surveyed countries. Angola and Nigeria were the largest gainers in terms of the trade account, Due to their oil resources, they were able to realise greater gains from exporting their oil products. The remaining countries, though not able to export sufficient goods and services, were able to attract greater volumes of capital inflows in the form of foreign direct investment, foreign portfolio investment and other investment flows from international investors.

Africa's key trading partner is China. This is evident when we examine the trade relationship between China and Africa. According to the Trade Law Centre (Tralac, 2013), China's total trade with Africa increased by 26% between 1995 and 2012, with Chinese imports from and exports to Africa accounting for increases of 29% and 23%, respectively. In the 2011/ 2012 economic year alone, total trade between China and Africa grew from US$166 billion to US$198 billion, representing a 19% increase in 2012, from 2011 levels. During the same period, imports from Africa increased by 21%, while exports to Africa only went up by 17%. Tralac (2013) further states that China's key imports from Africa in 2012 were mineral products (55%), other unclassified goods (26%), base metals (4%), precious stones and metals (3%) and textiles and clothing (1%). These five products alone accounted for 89% of China's total imports from Africa for the entire year. On the other end of the spectrum, China's main export products to Africa were predominantly value-added manufacturing goods such as transport equipment (3%), textiles and clothing (3%), machinery (3%), footwear (2%) and plastic products (2%), accounting for a mere 13% of total Chinese exports to Africa over the 2011 – 2012 period. China imported mainly from South Africa, Angola, Libya and the DRC, while its Chinese exports were primarily destined for markets in South Africa, Nigeria, Egypt, Algeria and Ghana.

Looking at institutions (proxied by the Corruption Perception Index), the opening up of financial markets to external investors requires sovereign states to be more transparent, have higher regard for investor rights and encourage higher levels of corporate governance. Institutional quality has the capability to improve the attractiveness of financial markets to foreign investors. When we examine the Corruption Perception Index (CPI) in Table 4 which shows data for selected African countries from 2007 to 2012, as compiled by Transparency International, we note that Botswana consistently had the best rating amongst the sample African countries, scoring between 5.4 (2007) and 6.5 (2012). On average, over the stated period, Botswana was closely followed by Mauritius, South Africa and Ghana. The highly clean countries are the ones with fairly established financial markets, and hence comply with high transparency and ethical standards in order to compete with global financial markets. On the other hand, the Democratic Republic of Congo (DRC), Zimbabwe and Angola, on average, were reported as being the most corrupt countries in our sample. These corrupt countries are primarily involved in mining (DRC and Zimbabwe are renowned for their "blood diamonds" trade), while Angola has very high oil deposits. The Corruption Perception Index score indicates the perceptions of business people and country analysts as to the degree of corruption. The scores range between 10 (highly clean) and 0 (highly corrupt).

Table 4. Corruption Perception Index (CPI)*

	2007		**2008**		**2009**		**2010**		**2011**		**2012**	
	Index	Country Rank / 179	Index	Country Rank / 180	Index	Country Rank / 180	Index	Country Rank / 178	Index	Country Rank / 182	Index	Country Rank / 174
Angola	2.2	147	1.9	158	1.9	162	1.9	168	2.0	168	2.2	157
Botswana	5.4	38	5.8	36	5.6	37	5.8	33	6.1	32	6.5	30
Congo, Dem. Rep.	1.9	168	1.7	171	1.9	162	2.2	146	2.0	168	2.1	160
Egypt	2.9	105	2.6	115	2.8	111	3.1	98	2.9	112	3.2	118
Ghana	3.7	69	3.9	67	3.9	69	4.1	62	3.9	69	4.5	64
Kenya	2.1	150	2.1	147	2.2	146	2.1	154	2.2	154	2.7	139
Mauritius	4.7	53	5.5	41	5.4	42	5.4	39	5.1	46	5.7	43
Mozambique	2.8	111	2.6	126	2.5	130	2.7	116	2.7	120	3.1	123
Nigeria	2.2	147	2.7	121	2.5	130	2.4	134	2.4	143	2.7	139
South Africa	5.1	43	4.9	54	4.7	55	4.5	54	4.1	64	4.3	69
Zimbabwe	2.1	150	1.8	166	2.2	146	2.4	134	2.2	154	2.0	163

Note: * Index (CPI) Score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).
Source: Transparency International: http://www.transparency.org/ and African Economic Outlook 2014

Conclusion

Lowly-developed financial markets are neither deep nor broad enough, and thereby do not meet the sophistication levels required to attract international capital flows to some economies. The purpose of this study was to examine factors that give rise to FDI and FPI inflows to African countries. We found that, despite an abundance of cheap labour, and mineral and other natural resources such as oil, Africa is not deriving maximum benefits from its international trading activities, nor is it able to attract sufficient inflows of FDI and FPI. This was due to a combination of factors, including under-developed financial markets, and poor institutions.

It was established that, the complementary nature of FDI and FPI flows influences the sequencing of these international capital flows into Africa. In their study on exploring the causality links between financial markets and FDI in Africa, Agbloyora, Abor, Adjasi, and Yawson (2013) found that while countries with better-developed stock markets are more likely to attract FDI inflows; FDI flows can also lead to the development of the domestic stock market, implying significant complementaries and feedback between FDI and financial markets in Africa. Financial markets in Africa cannot compete with other more sophisticated global markets because of limited financial assets available for trading, which renders African financial markets too shallow and narrow for meaningful transactions.

The changing economic and political landscape, globally and in Africa too, has given rise to exciting challenges for investors, regulators, governments and researchers alike. As such, we found that despite African countries having weak institutions, as assessed using the Corruption Perception Index (CPI), some investors are willing to assume risk in anticipation that the risk will be off-set by the returns on their investment. Most international flows destined for Africa end up in FDI projects, mainly mining and manufacturing.

In conclusion, the issues of sophistication, depth and breadth of the financial markets are hindering Africa from enjoying short term capital flows from would-be equity and bond investors. Only South Africa and Egypt have consistently issued long-term bonds which some international investors have purchased. South Africa also boasts the largest stock market in Africa, both in terms of market capitalisation and number of listed counters. This study was important because it strengthens the argument for African Governments to formulate appropriate foreign investment policies that will attract adequate levels of both FDI and FPI, develop their local financial markets, as well as ensure a business environment conducive to complement other domestic policies, hence promoting economic growth to reduce unemployment and poverty on the continent.

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