

Savings and investment – ownership and control in South Africa

BRIAN KANTOR

The shape of the present South African economy, where six major corporations loom very large, has emerged as a result of a variety of factors. These include history, exchange controls, taxation, inflation, and government spending versus revenues. Since the 1970s there has also been a major shift in individual household savings from conventional sources, such as banks, to pensions, retirement annuities or insurance policies with big mutual companies. This in turn had further consequences outlined here. But the dominance of the economy by a handful of major corporations is not as unique to South Africa as many suppose, and those who propose various forms of unbundling or anti-trust legislation may do more harm than good.



Professor Brian Kantor lectures at the School of Economics, University of Cape Town

Economic progress in South Africa will depend on harvesting savings and applying them efficiently. A crucial issue therefore is whether the South African financial and corporate structure is up to the task. For some three years now a small group of economists at the University of Cape Town have been attempting to explain the forces that determine the volume and composition of savings and the quality of investment decisions¹. By way of a better understanding of the process of savings and investments it was hoped that we would be able to make well considered judgments about the strengths and weaknesses of the established financial and corporate structure. This essay serves as a summary of the research and the conclusions reached.

As a first step the relationship between savers and the financial intermediaries that act on their behalf was closely considered. We attempted to explain the two outstanding changes in savings behaviour that have manifested themselves over the past 20 years. First, why South African households so overwhelmingly came to choose contractual savings schemes over discretionary savings, and second, and in a related way, why non-financial corporations came to be, not only the principal agencies for undertaking real investment, but the major source of savings as well. Why, in other words, corporate savings replaced personal or household savings.

Having established the context in which savings and investment decisions are made in South Africa, the research programme then focused on its primary objective, which was to explain the forces at work influencing the structure of ownership and control of SA corporations listed on the Johannesburg Stock Exchange (JSE) and the contribution the system of control makes to the economy. As will be identified in greater detail, control over the activities of most of the major corporations listed on the JSE is exercised by one or other of six identifiable alliances of industrial, commercial, mining and financial service companies which are known as groups. The role of the groups, ie, whether they should be tolerated, encouraged or discouraged by policy, has now become one of the most important economic issues facing the new South Africa. It is hoped that our research will make an important contribution to the resolution of this issue.

DETERMINANTS OF STRUCTURE OF OWNERSHIP

The pattern of saving

The substitution of corporate for household flows of

savings began in the early seventies and was a process largely complete by the end of that decade as may be seen in figure 1.

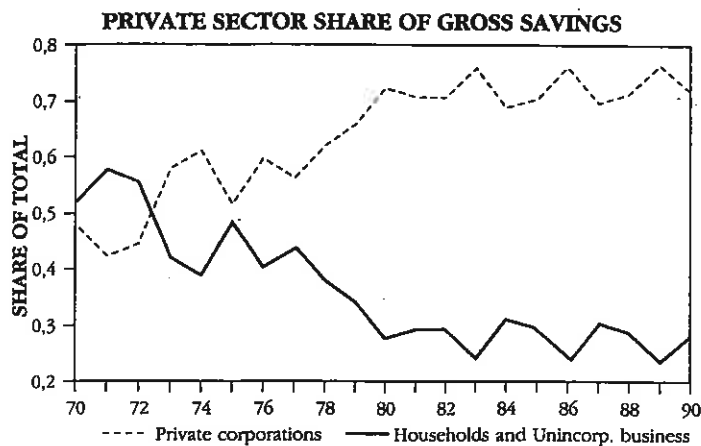


Figure 1

Another important change took place in the late eighties when the government sector, excluding the public corporations, became a net dis-saver, ie, government consumption spending exceeded government revenues.

The emphasis on the substitution of corporate for personal or household savings is important. Households own the shares of the corporations who save and purchase assets on behalf of their individual shareholders. The claims of the households on the assets and income of corporations may be direct, as shareholders, or less direct, in the form of rights to pensions or retirement annuities. These essentially retirement funds own shares on behalf of the households for whom they act as trustees of their savings. Of such agencies, or more correctly, trustees of household savings plans or deferred payment schemes, the life insurance houses are by far the most important.

In the seventies household savings plans in SA dramatically changed their character. Increasingly households saved less with banks or building societies and much more by contributing to retirement funds. Savings were committed to pensions or plans for retirement

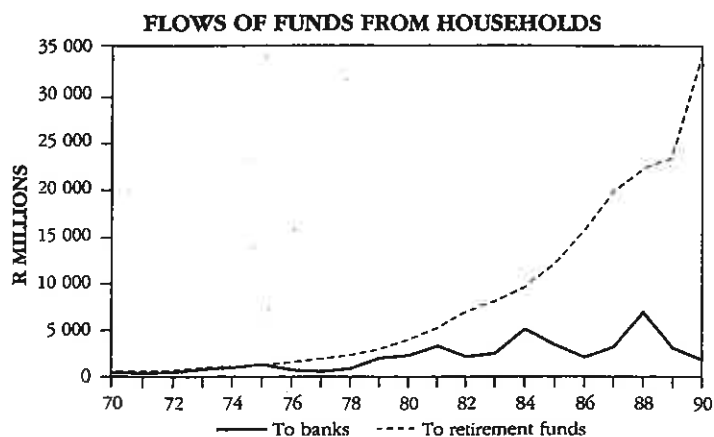


Figure 2

annuities or other policies that gave effect to long-term contracts between insurers and individuals. Employers too made substantial contributions to retirement funds as a form of deferred payment for services rendered, the benefits of deferred pay being conditional on lengthy periods of employment. Thus the banking system lost out badly in the competition for household savings. The direction of cash flows from households to the financial intermediaries is illustrated in figure 2.

The banks did not by any means suffer a real decline in their importance as lenders and borrowers in the system. Between 1970 and 1990 the volume of bank loans to the private sector grew on average by approximately 8 percent per annum after inflation. The banks however came to rely increasingly on the corporations and the retirement funds for their finance. Smaller businesses, typically reliant on bank finance, were not disadvantaged by this development, though the banks with well-developed branch banking networks would have much preferred to have sourced their deposits from the households rather than the money market. Furthermore an important share of the growth in bank assets came from the decisions taken by households to borrow to finance their acquisitions of houses and consumer durables including motor cars, furniture and appliances. The households, including the unincorporated business, became more dependent on bank loans.²

The households, while increasingly committed to making larger contributions to the retirement funds, undertook significantly more borrowing, with the net result that household saving of all kinds, measured by national income accountants as the difference between household income and what is defined as consumption spending, declined dramatically as a proportion of national income and of gross or net saving. Corporate saving, before (ie, gross savings) and after the imputation of a capital consumption allowance (net savings) largely substituted for the decline in household saving as illustrated in figure 1.

Yet while the composition of savings changed dramatically, the volume of real savings changed much less as may be seen in figure 3.

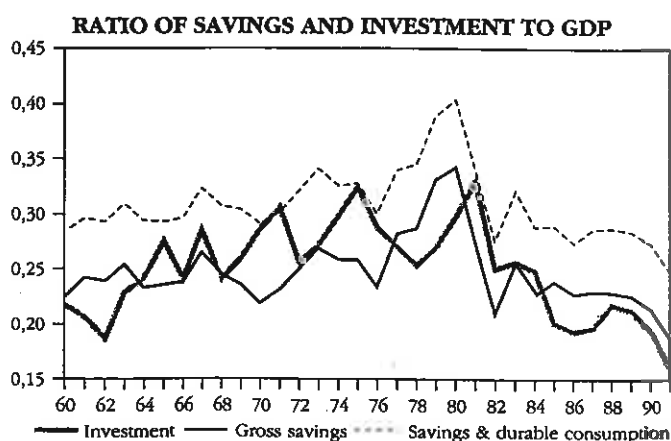


Figure 3

Over the period 1970 and 1991 gross savings from all sources were undertaken at an annual average rate equal to 24,7 percent of GDP, a savings rate that compared very well with the rate of savings achieved in earlier decades. Between 1985 and 1991 this ratio declined to some 22 percent on average. Much more significant for the economy than the decline in the savings rate was the decline in the real volume of investment spending shown also in figure 3. The difference between domestic saving and investment constitutes by definition the repayment of foreign capital. From 1985 the South African economy was afflicted by very large capital outflows. Between 1985 and 1990 the real value of capital repayments exceeded the real capital inflows over the entire period 1960 to 1984. The physical counterpart to such capital flight was less consumption and investment spending. This was the economic burden of political instability.

Explaining the savings mix

The corporate household and government sectors of any economy are highly interdependent. The households, as has been indicated, own the corporations. The debts of government (the difference between all government spending on consumption, transfers and investment) are the liabilities of households and their firms who have to pay taxes to meet the interest bill on the government debt. By the same token the income bearing assets of government, ie, government's shares in or outright ownership of corporations or other government business enterprises are the assets ultimately of the same households. The assets may generate revenues for government or may be sold off as an alternative to raising taxes.

Clearly the decisions of households to save or spend will be taken rationally and interdependently with the decisions of the corporations and government sector to save and spend. Most obviously if the state provides a generous system of social security benefits, less will be saved for old age or for emergencies. Thus the decisions of individuals or households to spend or save or borrow will be strongly influenced by not only the incomes they earn and expect to earn, but also by the value of the assets they own less the liabilities, including the tax liabilities they have incurred. Thus, what matters for current saving and spending is not only current and expected income but the strength of the household balance sheet. Strong balance sheets encourage spending and borrowing.

The two major sources of balance sheet strength for the middle and higher income South Africans, who have done the great bulk of spending and especially saving, have been the value of their rights to pensions and retirement annuities, and the difference between the market value of their homes and their mortgage bonds. As far as the individual or household is concerned, any increase in the market value of the assets they own is as useful a source of future spending power

as are any savings out of current salaries. Both contribute equally to the strength of the personal balance sheet. For any proper appreciation of business or household saving, spending and borrowing decisions, income from capital gains should be added to other sources of income to calculate a meaningful savings rate. What is not consumed of the extra income becomes additional wealth. Extra income in the form of more valuable houses and more valuable pension rights have been a major source of greater personal wealth and spending in South Africa. When household saving is conventionally defined as current income less current consumption a quite different picture of savings behaviour emerges. After 1984 South Africans were forced to cut back on their spending of all kinds to repay foreign loans.

A further related point is that spending by households on durable consumption goods other than on houses, for example on cars or furniture, could be more consistently regarded as investment rather than consumption spending. If the assets were owned by firms and leased to the household only the rental payments, which would be intended to cover depreciation and interest and a profit for the lessor, would be regarded as consumption spending. The goods owned by the lessor would be regarded as a capital asset in which an investment had been made. Similarly households invest in the consumer durables they own and do not rent. These assets provide the household with a flow of services the value of which is the equivalent of a rental payment. The savings ratio, when spending on consumer durables is added to other savings, is compared to the conventional investment ratio in figure 3. It demonstrates a higher level of savings but follows a very similar pattern to the conventional savings ratio.

Contractual savings schemes

A major force influencing the pattern of saving after 1970 was the increase in the rate of inflation after 1971. Between 1961 and 1970 inflation in South Africa averaged 3,3 percent per annum. In the seventies the rate of inflation increased to an average of 10,2 percent per annum while between 1981 and 1990 the rate of inflation was 13,4 percent per annum on average. The income from fixed interest lending, long or short, mostly lagged behind the increase in inflation. The real rate of interest earned by banks and retirement funds (interest less inflation) between 1971 and 1991 on average would have been approximately - 1,2 percent per annum on the best bank bills and - 2 percent per annum on long-term government securities.³ Any interest income received directly by households, above a quite moderate amount of tax exempt interest income, was taxed at the individual's marginal rate of income tax, making the after-tax interest rate substantially below the inflation rate for many individual savers.

By contrast the interest and other income received by retirement funds were not taxed. Furthermore the

contributions made to such savings schemes by individuals could be deducted from taxable income, up to some quite generous proportion of wages or salaries.

The retirement schemes had something else very much in their favour over the banks supplying interest-bearing deposits. The South African share-market provided simply outstanding returns. The average return to an investor in the all-share index would have been 6,8 percent per annum above inflation between January 1971 and December 1991, while between 1980 and 1991 the return would have exceeded the inflation rate by some 8,1 percent per annum on average. Especially by comparison with the returns from fixed interest securities these represented very good rewards for saving. In the very difficult years from 1985 to 1991 the all-share index provided an outstandingly good real return of 6 percent per annum on average.

Self managed vs retirement funds

The unrealised capital gains of the private savers who preferred to manage their own portfolios were not subject to taxation. However the realised capital gains could be taxed as ordinary income, if it were judged by the receiver of revenue to be the fruits of speculation. This discouraged any active self-management of a share portfolio. Dividend income received by the household until 1990 was also taxed, unlike the dividend or interest income received by the retirement fund. Inter-company dividend payments were not taxed so facilitating the group structure in that dividends paid by one group company to another would not be taxed. In the US inter-company dividends as well as dividends paid to households are taxed.

Nevertheless the main disadvantage suffered by the self-managed portfolio relative to the retirement fund, especially for the middle income earner, was that the contributions to retirement funds were treated as deductions from taxable income. Such savings reduced the average rate of tax paid by the saver and the quantum of tax paid. The amount of tax so saved may be regarded as adding to the returns provided by the retirement funds or to be deducted from the returns expected from other savings. Tax was to be paid on withdrawals from the retirement funds but significant tax concessions awaited those who delayed their receipt of income or capital from the funds until retirement.

The self-managed fund did have one advantage over the institutionally managed fund in that they could be fully invested in equities, a freedom only recently enjoyed by the managers of retirement funds. Furthermore unit trusts offered well-diversified equity portfolios to the smaller saver. The relatively slow growth of unit trusts in South Africa (the value of all unit trusts in SA is now less than 3 percent of the capitalised value of the JSE) suggests that freedom to invest in equities was not expected to overcome the initial disadvantage of making savings out of after-tax incomes.

Explanation for corporate savings

The returns generated for shareholders were of course the result of corporate savings and investment decisions. Over the period 1970-1992 an increasing proportion of the returns for shareholders came in the form of increases in the price of shares rather than in dividends. For any given volume of corporate investment, more corporate savings, ie, greater resort to internal sources of finance, implies smaller dividends and less borrowing. For the private investor the reliance on corporate saving had the advantage that dividend and interest income was subject to personal income tax while unrealised capital gains were not taxed. However for the retirement funds, capital gains, interest or dividend income would have been roughly equivalent sources of income before and after tax.

A description of the different sources of finance for all privately owned, non-financial corporations is provided in figure 4.

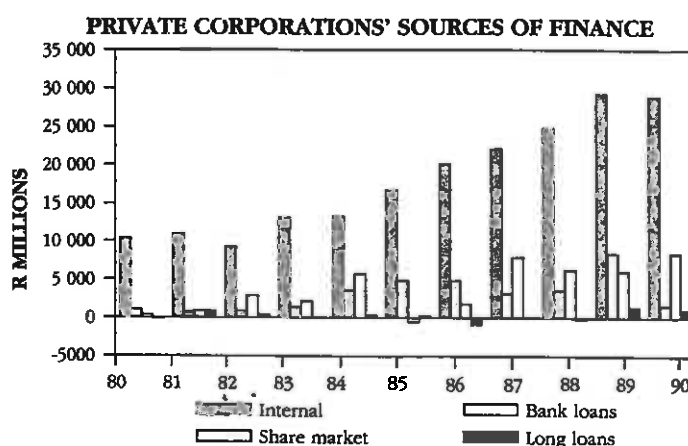


Figure 4

The overwhelming importance of internal sources of finance for the finance of corporate activity is clearly demonstrated. New share issues, including preference shares, were equal to only about 17 percent of internally generated equity capital over the period 1970 to 1990.

Despite this reliance on internally generated sources of equity capital the growing dominance of the retirement funds in the market for household savings meant that these funds automatically and gradually came to replace the households as registered shareholders of the listed corporations. Between 1970 and 1990 the retirement funds bought an additional R48,108m worth of shares while net purchases of shares by the household sector totalled only R850m. The significance of this development for the ownership and control of the listed companies is taken up fully below.

As indicated there was thus no particular tax reason for the retirement funds, increasingly the representative shareholder, to prefer the corporations in which they held shares to plough back their profits. The retirement funds could have used the proceeds of higher dividend

payments to reinvest in new issues with the same end result for the mix of debt and equity finance and without affecting their share of the company. Despite this tax neutrality, at least for the retirement funds, the corporations maintained very conservative dividend and borrowing policies and relied increasingly on their own savings. These savings would appear as reserves of one kind or another in the books of the firms.

The reliance on internally generated equity capital provided the simplest method of maintaining the control of the corporation with the established shareholders. Control could however have been equally well-entrenched by the use of more debt finance by the operating companies. Nevertheless this financing option, as we have seen, was also largely avoided in favour of internal finance.

One of the harder questions to answer therefore is why the corporations did not rely more on debt finance. The low real interest rates that discouraged fixed interest lending should, by the same token have encouraged fixed interest borrowing. That the owners of shares and the source of debt finance were increasingly the retirement funds without any liability for tax on their interest income should have been a further encouragement for corporate borrowing. The corporations were able to deduct interest payments from taxable income so reducing the cost of debt finance, while the suppliers of debt finance to these corporations could have been the retirement funds without liability for paying tax on interest income. Had the owners, the retirement funds, encouraged the managers to substitute more corporate debt for equity they would have improved their returns from equities at the expense of the receiver of revenue.

The one possible answer to this puzzle is that the retirement funds were, until recently, captive holders of what they regarded as vastly excessive amounts of government long-term stock. Therefore their appetite for long-term corporate debt was limited and the interest rates at which they were willing to lend long to corporations were regarded as expensive finance despite the ability to deduct interest expenses from corporate income. Corporate debt therefore meant issuing short-term debt. Given the volatility of short-term interest rates, this meant a very risky form of borrowing which was resisted as far as possible by the corporations, despite the lower after-tax cost of debt compared to equity.

Importance of exchange control

In the eighties foreign investors shifted largely out of equities into long-term government and public corporation fixed interest stocks, while the South African based funds were doing their best to move in the opposite direction. Exchange control encouraged such shifts. Foreign investors wanted the high rates of current income which gilts offered. The high yields available to foreign investors (these yields were higher than those available to the domestic investor by the ratio of the

financial to the commercial rand) largely represented capital repayments. South African savers by contrast were looking for capital gains rather than capital withdrawals.

Without exchange control the fund managers would have partially hedged their exposure to South African risks by acquiring foreign assets. If so the higher returns on SA assets, especially on SA shares, would have attracted more foreign interest in them. Of possibly greater significance is that the industrial firms, without the inhibitions of exchange control, would have been more inclined to apply their specialised skills in ventures off-shore than to have diversified on-shore. The drive to a conglomeration of business interests under the group system of control was encouraged by exchange control.

Market for contractual savings

Despite the tax concessions to savers linked to the retirement funds which have disadvantaged the banks, there has been very intense competition for the rights to manage pension and retirement funds. Any South African company may elect to manage its own fund rather than contract out such management. Entry into the business of life insurance is restricted by licensing requirements but some 17 life companies contest the market. Yet the sector has been dominated by the two very large and long-established mutual assurers, SA Mutual and Sanlam. Between them they continue to capture between 50 and 60 percent of all contributions to retirement funds. The third largest life insurer is Liberty Life, a private corporation listed on the JSE, which has a further 20 percent of the market. Liberty is a relative newcomer established in 1958 and has grown rapidly both organically and through acquisitions and mergers. The share of the big four, the fourth largest being the Southern Life Company, once a mutual and now a listed privately owned insurer, is over 80 percent of the market for retirement funds. Competition for and concentration of market share in the management of retirement funds have run together.

Implications for economic policy

It would be possible to extend the consumption based tax principles that so favoured the pension funds and life assurers to a great variety of potential agents of savers. (Consumption based because taxable income is defined as net of savings in the form of contributions to retirement plans.) To encourage competition banks and stockbrokers for example could be allowed to act as trustees of individual savings plans. In addition interest as well as dividends received by households could be regarded as tax exempt as is the case with the managed retirement funds. Levelling the financial playing-fields in this way to encourage savings and competition to manage them would be a relatively simple task.

Structure of corporate ownership and control

We have attempted to link the excellent returns provid-

ed by our leading privately owned corporations to the structures by which they are governed. In particular we have examined the group structure of corporate control that has long been a characteristic feature of the economic structure, especially of the leading financial mining and industrial and service companies quoted on the JSE. In South Africa the ownership and control of the major corporations have been widely separated. The separation is not however between managers and shareholders as it is for the major US corporations. The separation that occurs is between those shareholders with a majority of the claims to corporate income and assets and a minority of shareholders with sometimes quite minor proportionate claims to ownership but with effective control over operating assets. In particular these controlling shareholders have the power to appoint the board of directors and so the senior management.

The claims to ownership in turn have been increasingly exercised by the managers of the retirement funds who as indicated have captured the flow of household savings. But while they own they do not typically exercise control. Control is exercised predominantly by one or other of the five or six large groups. A group consists of legally independent corporations, each with their own set of shareholders, that operate in a variety of sectors of the economy (mining, industrial, commercial and financial service; etc) but which are allied members of the group through a common and easily identifiable controlling shareholder with powers of control as defined above. The group of companies will all be controlled ultimately by the group holding company. However, to complicate the matter further two of the large groups are themselves controlled directly by the Old Mutual and Sanlam. The two inevitably, given their share of the retirement fund market, also own significant, though non-controlling, stakes in the shares of companies associated with the other groups.

The major groups are the Anglo American Corporation controlled by the Oppenheimer family interests, whose largest operating company is De Beers Consolidated Mines, which is also a holding company with substantial non-diamond mining interests including a third stake in the Anglo American group. Anglo American controls a leading bank, First National, and the Southern Life Assurance Company. The group controlled by Sanlam, through the activities in particular of Gencor with its mix of mining and industrial interests through Malbak, is perhaps next in size. Sanlam also had significant stakes in banking but has recently ceded or perhaps has agreed to share control of a larger banking group, ABSA, with the Rembrandt Group controlled by the Rupert family. The Rembrandt Group in addition to its core interests in cigarettes and fashion has important investments in mining via the Goldfields group, and heavy industry through Dorbyl. The Rembrandt Group effectively controls ABSA, now South Africa's largest banking organisation, in a voting trust as yet

unlisted on the JSE with the Sanlam organisation. The group controlled by the Old Mutual group is centered around the very large industrial holding company, Barlow Rand, and Safren, a shipping and entertainment conglomerate. Old Mutual holds a controlling share of the Nedbank group. Another grouping strengthened by cross-holdings is that of Liberty Life and Standard Bank. A strategic interest of this group is in South Africa's largest industrial company, South African Breweries (SAB). This company, in addition to its brewing operations, controls a conglomerate of important industrial and retailing companies listed on the JSE. Control over SAB is held in a listed voting trust, Bevcon, together with Johannesburg Consolidated Investments, an important member of the Anglo American group. Another important grouping of industrial and mining interests is controlled by Anglovaal, in which the Hersov and Menell families have the controlling shares. Other groupings of smaller size which attempt continuously to compete with the established groups are listed on the JSE.

Control in South Africa is exercised by use of the equivalent of non-voting shares and voting trusts. South African companies are prevented by company law from issuing non-voting shares but they achieve the same objective by concentrating control with holding companies, cross-holdings of shares (De Beers in Anglo and Anglo in De Beers) and voting trusts (as in Bevcon and ABSA). At the head of every group stands a company whose assets consist of holdings of shares in other companies, some of which may also be subsidiary holding companies and others the operating subsidiary companies both listed and unlisted. The holding company holds the controlling stakes in the principal operating subsidiaries. As indicated, use is often made of what is called a pyramided structure whereby the holding company will hold 50 percent of another company that in turn owns 50 percent of an operating company and so on. In this way effective control of the operating company is achieved with significantly less than 50 percent of the claims on the dividends of the subsidiary that engages in mining or industrial activity. For example, in the simple case of one holding company with 50 percent of an operating company in which a 50 percent stake is held, the controlling shareholders will receive 25 percent of the dividends generated by the operating assets (50 percent of 50 percent = 25 percent) while their non-controlling partners at the holding company and operating company level will be entitled to 75 percent of the claims to dividends. This process of pyramiding can and has in the past been repeated more than once, though the JSE recently turned its face against new listings of so-called super pyramids.

As indicated voting trusts and cross-holdings can serve the same purpose of maintaining control while attracting outsiders to share in the risks and rewards of ownership. Similarly debt can serve to maintain control and grow the enterprise, debt that may later be convert-

ed into equity (convertible debentures or preference shares) can also be issued to postpone any change in control. Furthermore control may be entrenched by contract, as it is typically used to control mining operations in SA. The mining house that founds a mine typically establishes control through the right to a management contract which is negotiated before other partners are introduced. The new partners naturally are fully aware of this condition attached to their shareholding.

Further opportunities to extend group powers of control emerge when the operating companies are directed to utilise their own savings to acquire strategic stakes in other listed companies. Such stakes may be in unrelated sectors of the economy. As indicated many of the key industrial companies controlled by the groups and quoted on the JSE are essentially companies of conglomerates with diverse interests.

The group system in South Africa originated with the establishment of the Kimberley diamond fields and the early gold mines on the Reef in the last quarter of the 19th century. The scale of efficient mining soon proved itself beyond the financial scope of the individual entrepreneur. The same economies of scale have driven the search for outside capital by the founders of many successful businesses everywhere. The founding families also seek to diversify their wealth. Having all the family eggs in one basket, however bountiful, always leads to discomfort and encourages the search for outside partners to share in the risks as well as to provide capital for expansion. But while the participation by outside capital is welcome and essential if the enterprise is to grow, the taste for maintaining control remains a powerful one.

The equivalent of the South African group system that diffuses ownership yet succeeds in concentrating shareholder control can be found in many successful highly developed economies. The *keiretsus* in Japan have much in common with South African groups as do the *chaibols* in Korea. Sweden and Switzerland exercise concentrated control through systems of low-voting shares and pyramids. Control in Belgium is exercised by holding companies that look very much like the South African variety. In Germany the banks lead the shareholders in voting trusts that exercise control over the major industrial corporations. Each of the major banks has a large group of companies associated with it. In Japan too a group bank seems to play the role of holding company, a function specifically outlawed by the post-Second World War legal reforms. Groups are important in Canada too.

Such groupings, the most famous and successful on behalf of non-controlling shareholders being the trusts organised by JP Morgan, were once commonplace in the US. They were outlawed in the 1930s by a succession of laws and regulations that forcibly separated banks from industrial companies and that prevented or discouraged insurance companies or pension funds from either holding significant stakes in industrial cor-

porations or exercising authority over them. In Britain the group structure does not play the prominent role it does in continental Europe but institutional holders of shares do demonstrate a willingness to influence the selection of top management as well as to participate in the hostile take-over.

The dispersion of shareholdings in the major US corporations has left managers rather than shareholders in effective control. The established senior managers in practice appoint the directors, who are usually senior managers from other major corporations, rather than the case of directors appointing the managers and changing them if necessity demands. The individual shareholder in the US is either discouraged by law or regulation from seeking a direct influence over managers or, because of a small stake in the enterprise lacks the essential financial interest to get involved. In this way all shareholders become free riders who can get off the bus at any time by selling their shares. Only the hostile takeover, an expensive and now politically controversial process, can threaten established but underperforming managers.

For a while in the eighties the growth in the scale of the so-called junk bond market, with the managers of the junk bond schemes taking on the old role of investment bankers with an equity interest in the outcomes, came to threaten the management of even the largest US companies. The threat has faded with the more recent failure of some junk bond financed takeovers and the protection the managers were able to find from the politicians, particularly at state government level which has authority over company law in the US. The popular resentment of the enormous personal wealth sometimes created in the process of a corporate raid and subsequent restructuring was behind the involvement of politicians, just as it had influenced the attack on the financial trusts of an earlier period.

Clearly strong shareholders have much to contribute to the success of an enterprise. Owner managers have all the necessary incentives, but the economies of scale may put efficient production beyond the financial capacity of even the richest individuals. The South African system, by no means uniquely, maintains shareholder control by allowing a minority of shareholders, often the founding entrepreneurs, to exercise effective control over management. The majority of non-controlling shareholders in turn rely on them to do just that.

Quite obviously, just as managers may exploit passive shareholders, so may a minority of shareholders, with effective control, take advantage of their silent partners. The dangers inherent in holding shares without the power to control the actions of the company will be clear to all non-controlling suppliers of capital, especially those with much at stake. The ability of an entrepreneur or firm to attract outside capital, especially outside equity capital on favourable terms, without having to cede control is not a common one. The essential reputation for square dealing with non-controlling part-

ners is never easily acquired, and once gained is a very powerful advantage that can be used over and over again to acquire additional resources on favourable terms while continuing to retain control. It is only the trusted entrepreneurs that will be allowed the opportunity to control a group of companies with only a relatively small claim as owners on the dividend income. Small companies or groupings of them become more significant forces in the economy by attracting new partners on favourable terms at the upper reaches of the group structure. They also grow through acquisitions made by the operating companies they control. In this way they pass not only the financial market test, they also prove themselves capable of making the right investment decisions.

The managers of unsuccessful firms inside a group may easily be replaced by the group controllers. It does not take a contested takeover to do that unpleasant job. Furthermore while control may be entrenched it is a tradeable right unlike the rights of managers to their employment conditions. The controller of the waning group or firm will have every incentive to sell control and realise the control premium. That is part of the expected difference in the value of the assets under the old and new control. It is for these reasons that family-controlled corporations, especially the most successful with a large number of family members with much to lose from poor management, seldom last beyond the second generation. The sons may not be as capable or as driven as their fathers.

The failing mutual organisation of course faces different problems. Mutuals are essentially management controlled companies accountable to a board of directors with reputations rather than personal wealth at stake. Their ability to make the right decisions may be found wanting. The success of Sanlam and the Old Mutual constitute the great exception to the history of mutuals in SA. The mutual building societies, once very powerful, have now all opted for ordinary company status and are all part of one or other group.

The powerful Mutual and Sanlam organisations are very important to the South African economy. The economy would be hurt by any decline in their competitive abilities. The conversion to equity status of such large organisations would however simply entrench control with the established management. There would be no domestic shareholder capable of taking a big enough block of shares to influence management. The hope therefore must be that these organisations continue to operate successfully as mutuals, and that the directors of the boards of these great mutuals continue to take their responsibilities very seriously indeed.

It is always possible that the success of any one or more of group companies might be the result of artificial restrictions on the entry of competitors to the market in which superior returns are being earned. If so there is a simple remedy and that is for the state to remove the restrictive regulation. Conglomerates or

groups may command large economic power and yet easily be subject to highly effective competition in every market in which they engage, be it for products they produce, or for the labour they hire or the capital they acquire. Low barriers to international trade may be essential to this competitive purpose.

The large SA groups do compete with each other effectively for capital and for the power to develop and control successful enterprises. Moreover groups have waxed and waned. The powerful Rembrandt and Liberty groups have relatively short histories. Freedom to form a group is very much available to any entrepreneur willing to challenge the established order, and the new group formations and alliances are a regular feature of developments on the JSE.

Conclusion

It used to be argued by the intellectual left that apartheid and capitalism were good for each other. Such arguments once had the facts of the coincidence of the high years of apartheid and rapid economic progress in South Africa going for them. More recently, in the light of very different facts, the crisis of the economy is attributed generally, including by the left, as a crisis of apartheid. The alternative argument is that the economy flourished despite apartheid in the sixties and seventies. It was argued that economic growth itself would undermine apartheid, and that the recent economic crisis is attributable to grave uncertainties about both the process of economic and political transformation from white to black rule and especially about the economic policies that future governments of South Africa will apply. It is a crisis for the economy caused by the end of apartheid.

The group system is perhaps the central feature of South African capitalism. It has survived apartheid and appears to be coping very well with its crisis. There was a time when Afrikaner nationalism regarded the groups with enormous hostility as rival and unfriendly sources of power that threatened the Afrikaner and his state. The Afrikaner learnt to live with the groups and even formed at least two powerful groups strongly identified with Afrikaners. The hope is that history will repeat itself.

The economic power of the groups is easily exaggerated. Yet the power is considerable and as such easily misunderstood and resented and vulnerable to anti-trust action of one kind or another. Our view is that the group system is an answer to a central problem of modern capitalism: the potential loss of control over managers and of their efficient use of resources that may occur when rights of ownership are widely disseminated and the great bulk of shareholders lack the knowledge or incentive to discipline management. It seems that in countries where barriers to group formation are not erected by governments, such group or group-like structures play an important role in the economy. The group system in South Africa is an outcome of competi-