The Discount to Net Asset Value, Unbundling and Shareholder Interests

GDI Barr and BS Kantor
School of Economics
University of Cape Town

DE RATIONE
Volume 8/Number 1
Winter 1994
pp 44 to 59

The argument has recently been made by powerful political voices that the large South African corporate conglomerates (or groups) should be broken up into their constituents or "unbundled", as the process has become known in South Africa. Critics of these groups in the financial markets have pointed to the existence of a discount of the quoted share price to the so-called Net Asset value of the Mining Finance houses, which are either the parent companies of the groups or constitute an important element of them. Unbundling, it is contended, will "unlock" value for shareholders by eliminating this discount. This paper examines the notion of a discount to Net Asset value and shows why such claims about unlocking value are largely unfounded.

Keywords

Net Asset value; Mining Finance houses; Unbundling; Conglomerates; Pyramids; Voting-rights.

INTRODUCTION

The South African corporate landscape has been dominated by six large diversified groups of industrial, commercial, mining and financial service companies. The influence and role of these groups (frequently and perhaps misleadingly referred to as "conglomerates" in the South African corporate context)[1] in the economy have recently become one of the most contentious economic issues facing the new South Africa. The argument has been made by the African National Congress (ANC), among others, that these groups need to be broken up or *unbundled*, as this process has become known in South Africa.[2]

There are two principal objections raised against the group structure. First, in what may be described as the *anti trust* case, the groups are said to represent an unhealthy concentration of economic power, in that their existence is an inhibiting factor to competition in the market for goods and factors. The second thrust of the criticism is against the *conglomerate* nature of the groups which, it is argued, reduces their value to shareholders and maintains that such group structures would be more valuable to their shareholders if split into their component parts. This paper will give particular attention to this second argument.

Critics of the operations of the groups in the financial markets point to the discount of the quoted share price to the so-called Net Asset Value of the Mining Finance houses. These houses, roughly in order of size, are Anglo American, Gencor, Johannesburg Consolidated Investments, Goldfields and Anglovaal. They are either the parent companies of one or other of the groups or constitute an important element in them. Unbundling, it is contended, will "unlock" value for shareholders by eliminating this discount. This paper provides an explanation of this discount to market value and shows why such claims about unlocking value are largely unfounded.

The paper also considers the performance of the Mining Finance houses. The returns derived from an investment in the Mining Finance houses are compared with the returns from other sectors of the Johannesburg Stock Exchange (JSE) and, perhaps of greater interest and significance, a comparison is made between the returns from the Mining Finance houses themselves and the returns realised by a portfolio comprising the listed companies held by the houses in the same proportions.

THE GROUP SYSTEM.

The companies associated with the six largest of these conglomerate groups form a very significant portion of the total market capitalisation of the Johannesburg Stock Exchange. At present this figure is in excess of 70% of the JSE (McGregor 1993). Much less is known about the importance of these groups for the economy as a whole. There are, for example, no known calculations of their contribution to Gross Domestic Product and such calculations

[1] A conglomerate is properly defined as a (single) company engaged in several unrelated fields of activity. Some of the individual companies associated with the large groups are indeed conglomerates in that they either run several unrelated operations directly or hold severally wholly-owned subsidiary companies that are engaged in different lines of activity (Gerson 1992).

[2] To quote the ANC Economic Policy Guidelines published in 1992, "... The concentration of economic power in the hands of a few conglomerates has been detrimental to balanced economic development in South Africa. The ANC is not opposed to large firms as such. However the ANC will introduce anti-monopoly, antitrust and mergers policies in accordance with international norms and practices, to curb monopolies , continued domination of the economy by a minority within the white minority and promote greater efficiency in the private sector...." (African National Congress 1992).

cannot simply be made from the accounts and reports of the group companies themselves. There are, for example, no reported value added statements in the accounts of the group companies.

The largest of the major groups measured by market capitalisation is the Anglo American-De Beers Group (Anglo). Those companies controlled by (or seemingly controlled by) Anglo, were calculated to constitute over 38 per cent of the JSE market capitalisation in June 1993. About half of the investments of the group parent company, the Anglo American Corporation itself, is in mining, particularly gold, diamonds, coal and platinum. The other half is invested in banking, insurance and widely diversified industry. Johannesburg Consolidated Investments (JCI), another leading Mining Finance house, is also part of the Anglo group.

The Rembrandt group, in control of over 14% of the JSE, is next in size. This group has core interests in cigarettes and in banking. It also has an important stake in mining via a large holding in the Mining Finance house, Goldfields (GFSA). Anglo also has a 26% non-controlling share holding in Goldfields.

The group associated with Sanlam, which is South Africa's second largest life insurance company, and a mutual organisation, is perhaps next in size with a value equivalent to approximately 12% of the JSE. Sanlam's non-insurance and fund management interests are largely in the form of a controlling stake in the Mining Finance house, Gencor Ltd., which has unbundled. In November 1993 the shares it owned in the major industrial subsidiaries it controls were distributed to its shareholders leaving Gencor as a more highly specialised Mining Finance house (Gencor 1993).

The group controlled by the Old Mutual, South Africa's largest life insurer, has a value equivalent to approximately 11% of the JSE. The Mutual group includes the large industrial holding company, Barlows. Rand Mines, once the most important of the Mining Finance houses, in which Barlows acquired a controlling stake in the late sixties, is now the holding company for Barlows' minor coal interests. Old Mutual has recently split Barlows[3] into three parts, in which it will continue to hold over 30% of the shares. The Old Mutual as the name indicates, is also a mutual organisation with legal accountability to policy rather than shareholders.

Another important grouping comprising 5% of the JSE, is controlled by Liberty Life Association of South Africa, South Africa's third largest life insurer. Liberty is allied with the Standard Bank which, until the formation of Amalgamated Banks of South Africa in 1989 (ABSA, controlled jointly by Sanlam and Rembrandt), was South Africa's largest bank. Recently Liberty listed a further company on the JSE, Libsil, which will hold Liberty's joint controlling interests in Standard Bank, South African Breweries (SAB), one of South Africa's most successful industrial enterprises, and the Premier Group. Liberty's shareholders were offered 20% of Libsil and it is the intention of Libsil to reduce its holding in these companies but to continue to maintain a controlling interest in them.

The remaining member of the six large South African groups is Anglovaal. Anglovaal is also defined as a Mining Finance house but the majority of the assets of the group are in industry. Other groupings of smaller size are listed on the JSE and new groupings continually emerge out of successful operating and, usually family controlled, companies listed on the JSE (McGregor 1992, 1993).

[3]The market appeared to view the unbundling of Barlows in a fairly negative light. From 23rd June 1993, when the first cautionary announcement was made, to the time of the second detailed announcement of the 7th October 1993 (the first detailed announcement was made on the 9th August), Barlows' share price decreased by 9,45% whereas the Industrial Holding Index decreased by only 3,51%.

SEPARATING OWNERSHIP AND CONTROL — THE PURPOSE OF HOLDING COMPANIES.

There are two key features of any "bundled" group of South African companies that dominate the listings on the JSE. First, the shareholders in the parent company of the group, for example Rembrandt or Liberty Life or a Mining Finance house, have a stake in a diversified portfolio of operating companies. Second, the ownership and control of the group and its operating companies are separated between a controlling minority of shareholders and a non-controlling majority of shareholders. South African companies are restricted by Company Law[4] in their issuing of non-voting shares or shares with differential voting rights. For the most part, minority control is effected by a tier of holding or pyramid companies (and sometimes by strategic cross holdings) that separate the parent company from the operating companies.

In these ways the controlling shareholders, typically a family that founded the enterprises which constitute the operating heart of the group, achieve their goal of diversifying their own wealth across different sectors of the economy and indeed across the world, while maintaining control over their interests. Thus, the Oppenheimers continue to control the Anglo group and the Ruperts the Rembrandt group. Donald Gordon controls the Liberty alliance with Standard Bank, and the Menell and Hersov families control Anglovaal — all with a relatively small claim (mostly less than 10%) on the underlying assets and dividends generated by the particular group (McGregor 1992, 1993).

The two other large groups in South Africa, those controlled by the Old Mutual and Sanlam, are different in character. In their case there is no founding family interest and the sheer size of the funds under management enables them to achieve the benefits of diversification and control without the same dilution

[4]Sections 195(2) and 195(4)(b). Note that the control of Anglovaal is effected by means of shares with differential voting rights issued prior to the amendment of the Companies Act.

of ownership. They typically exercise shareholder control with significantly larger stakes in the operating companies associated with their groups than is feasible, or desirable, for the family controlled groups. For example, the direct 30% holding of Old Mutual in Barlows gives it effective control of that very large organisation and yet still leaves the Old Mutual portfolio well diversified. The break up of Barlows will clearly not influence the role of controller played by the Mutual. Similarly, the direct claim by Sanlam on the dividends of the companies that were more than 50% controlled by Gencor will remain a large one, exceeding 30%. It is, therefore, possible for Old Mutual and Sanlam to control a large group effectively without having to rely on the layers of holding companies essential for even the best endowed families that wish to diversify and yet retain control.[5]

The listing by Liberty Life of its strategic holdings in Standard Bank, Premier and SAB, through Bevcon, in a new listed company, Libsil, represents an example of typical South African style "bundling". Libsil represents the placement of another layer between Donald Gordon, who controls Liberty Life, the parent company, through his ownership of a majority stake in holding companies Libvest and Libhold and the operating companies. Thus, Libsil enables the controlling shareholder to reduce his stake in the operating companies, SAB, Standard Bank and Premier, without in any way prejudicing his controlling position over them. Shareholders in Libsil were offered a share in a combination of operating companies (that have little in common with each other) and can expect their stake in these three major companies to be diluted over time if Donald Gordon continues to pursue his diversification strategy through Libsil. It is a measure of the determination of Liberty Life to effect such a restructuring, that it was prepared to offer an initial stake in Libsil (initially to shareholders of Liberty Life), at a discount of 10% to the underlying value of the assets to be owned by Libsil (Liberty Life 1993).

The essence of the process of introducing layers of holding companies or bundling is that the founding entrepreneurs are able to attract outside share capital on favourable terms to themselves and their partners, without conceding control, as is currently the case with Libsil and, previously was the case with Libhold and Libvest. Outside shareholders who partake in such a scheme know full well that they are not entering into a one share, one vote relationship except in the most narrow legal sense. They do so, however, at a price that is acceptable both to them and their controlling partners who end up with a reduced stake in the enterprises but continue to exercise control. The downside for the outside shareholders is that they have no influence over the diversification strategy that will be followed by the controllers which, in the first place, will be designed to satisfy the controlling interests and not those of the majority of shareholders.[6]

In South Africa share *ownership* (as distinct from *control*) has become more and more vested in the pension and retirement funds. Increasingly during the 1980's, household savings in South Africa have taken the form of contributions to such pension and retirement funds rather than deposits with the banking system. In 1970, South African households deposited R884m with banks, contributed R610m to pension and retirement funds and invested R111m in new share issues. In 1980, R4 700m was deposited with banks, R3 928m was contributed to retirement funds while a net R129m was withdrawn from the share market. In 1990, R1 434m was deposited by households with the banking system, R51m placed in shares, while as much as R34 751m was contributed to retirement funds managed by the life assurance companies. Consequently the South Africa retirement funds have become by far the most important source of funds for the share, money and bond markets[7] (Kantor 1992).

The Old Mutual and Sanlam, the two largest of the mutually owned institutions, have continued to dominate this rapidly growing market, together maintaining access to over 50% of the savings flows from households. The three largest insurers (which include Liberty Life) control over 70% of the retirement fund market (Competition Board 1989). Thus, if South African company law did not allow the family controlled groups to separate control from ownership through the present system of pyramids and holding companies, the retirement funds would not only be the owners but also the controllers of much of corporate South Africa.

[5]The structure of corporate ownership and control in South Africa has been analysed in detail by J. Gerson (Gerson 1992). Demsetz and Lehn tried to predict circumstances in the US that promote concentrated control, that is when more than 50% of a corporation would be held by a single shareholder (Demsetz & Lehn, 1985). In South Africa, unlike the United States, almost all the leading listed companies are more than 50% controlled by a clearly identified controller. Control thus is almost always highly concentrated. Gerson therefore attempted to explain the percentage claims to dividends and ownership that the controllers of South African companies owners would claim on the operating assets. Or, in other words, to explain how low the different controllers could go without having to concede control; that is, after allowing for the effective dilution of ownership claims that takes place through the tiers of holding companies and cross holdings that reduce ownership but maintain control. The claims to ownership consistent with control can in fact become minimal as the number of pyramid companies is increased if enough low voting right partners can be found to take over the founders claims to ownership of and dividends from the operating assets.

[6]Group structures combined with active shareholders who do exercise control is a feature of corporate life in many countries including Japan,(Prowse 1991, Kester 1991) and Germany, where the large banks have long held groups of companies under their wing (Edwards and Fisher 1991). Groups are important in Sweden (Bergstrom and Rydqvist 1990) and Belgium (Daems 1978) among many other countries. Indeed, it may be said that outside of the USA and the UK, the existence of groups that dominate the stock exchanges of their respective countries, if not the local economies, is the rule rather than the exception. Groups were once important in the US until outlawed in the thirties (Roe 1991, Bradford De Long 1990). There is now much debate over the role that might usefully be played by the large institutional investor in the US (Pound 1992).

[7]Source: National Financial Accounts, as published in the South African Reserve Bank Quarterly.

DISCOUNT TO NET ASSET VALUE

Mining Finance House	Book Value Latest (Oct. 93)	Market Value 4 October 1993	Net Asset Value 4 October 1993
Anglo	79.75	128.00	176.20
AngloVaal	42.00	92.50	96.18
Gencor	5.25	9.80	12.39
Goldfields	30.95	74.50	104.68
JCI	20.05	62.00	76.37

Table I Value of the Mining Finance houses in October 1993 (per share in Rands)

One method of evaluating corporate performance is to compare share market to book value. By this criterion, as may be seen in Table I above, Anglo and the other Mining Finance houses have added considerable value for their shareholders. These ratios of market to book value are not, however, the usual ones referred to in analyses of the Mining Finance houses or investment trusts. The ratio which has been given almost exclusive attention by share analysts has been that of the share market price of the house to the so-called Net Asset Value (NAV) which is reported on a six monthly basis and (amongst other items) includes the *directors valuations* of components of the house. The NAV of Mining Finance houses have consistently been estimated by the houses themselves to stand at a premium to the market price and thus at an even greater premium to book value. The Mining Finance houses appear to regard the greater surplus of NAV to book value, as compared to market value over book value, as representing a superior indicator of the achievements of management on behalf of shareholders (Anglo-American 1992 (page 2), 1993 (page 3)). Presumably the high NAV might indicate to creditors or potential creditors that the house is a more powerful business than is revealed in the balance sheet or in the market place. It is, however, the presence of the discount of the share price to NAV[8] which has inspired the case for breaking up the houses into their separate and, it is presumed, more valuable parts.

All the Mining Finance houses included in the JSE Mining Finance Index have maintained a high and variable discount to NAV as may be seen in Table IIa for weekly market data from January 1989 to May 1993 (Anglovaal has consistently maintained the lowest discount to NAV). In addition, it is seen that (with the exception of Anglovaal) the discounts of the different Mining Finance houses have been fairly strongly cross correlated (see Table IIb).

[8]Note that the share price is continually revalued in the market place, whereas the NAV is only calculated at 6 monthly intervals. The interpretation of the discount is thus problematic from the point of view that it is based on historical NAV figures.

The similar patterns in the behaviour of the discount to NAV of the Mining Finance houses in terms of their levels and variability, and the existence of cross correlations between the discount to NAV of different houses (with the exception of Anglovaal), clearly implies that there are common economic

Mining Finance house	Average	Std. Dev.
Anglo	27.64	5.37
AngloVaal	9.66	7.62
GFSA	23.44	6.08
JCI	20.48	5.59
Gencor	19.39	6.29

where: Std. Dev. denotes Standard Deviation.

Table IIa Discounts to Net Asset values (Averages and Variabilities) January 1989 to May 1993

	Anglo	Anglovaal	Gencor	GFSA	JCI
Anglo	1.00				
Anglovaal	0.170	1.00			
Gencor	0.488	0.158	1.00		
GFSA	0.430	0.043	0.364	1.00	
JCI	0.527	0.322	0.299	0.297	1.00

Table IIb Correlation Between NAV Discounts January 1989 to May 1993

forces driving these discounts. In order to identify and analyse these forces we now consider the NAV and the discount of a Mining Finance house's share value to NAV in more detail by breaking the NAV into its various components.

THE CONSTITUENTS OF NAV

The NAV of a Mining Finance house is made up of three components. The first part consists of the listed shares held by the house, which are included in NAV at their current market value. The second part consists of the unlisted invest-

ments and assets held by the house and these are included in NAV at the directors estimate[9] of their value[10]. The third component is the book value of the current debt of the house; this is deducted from the sum of the first two components to establish NAV. The discount of the share market value of the house (MVH) to NAV is then calculated as

$$\frac{NAV - MVH}{NAV} \cdot 100\%.$$

The MVH may, in a similar way, be thought of as comprising the sum of a number of distinct components. These are the value of the listed shares, the market's implicit valuation of the unlisted investments and assets and new projects less the market's (negative) implicit valuation of the established debts and the additional finance that the house might require to establish new ventures. Quite clearly though, the financial liabilities and requirements of the house are not neatly matched against specific assets but against the assets of the house viewed as a whole, listed and unlisted. In addition, any management fees received less the costs of head office salaries and expenses are a further influence on the market value of the Mining Finance house.

THE RELATIONSHIP BETWEEN A MINING HOUSE AND ITS LISTED SUBSIDIARIES

A Mining Finance house will generally not have just a passive interest in its listed holdings. It may make a contribution to the efficient management of its group subsidiary companies and will typically have a controlling interest in them. It, in fact, performs a monitoring and supervisory role on behalf of all shareholders in its listed holdings and may also be willing to support the associated operating companies with finance directly or with guarantees which might add to their credit rating. In addition, its financial strength may allow it to support the operating companies should they be subject to financial stress, a support role which may add to the value of such companies. Unbundling can only reduce this role and the responsibilities of a Mining Finance house for the activities of its operating companies will be diminished.

[9] The exposure draft on Generally Accepted Accounting Practice, Accounting for Investments makes the distinction between trading investments, which are intended to be held on a continuous basis, and other investments. To quote: "Subsequent to initial recognition, non trading investments are measured and reported in the balance sheet either at their fair value or at their cost....." (paragraph 22); "When available, market price is recommended for the estimation of fair value" (paragraph 31); "For non trading investments which are carried at fair value but for which no market value is available, techniques such as dividend yield, earnings yield or discounted cash flows may be used to determine fair value" (paragraph 32) (South African Institute of Chartered Accountants ED86, June 1992).

[10] In 1993 Anglo reported a net asset value of R40 068m of which the directors valuation of unlisted shares represented R5 302m.

The listed assets of the house can, of course, be distributed to its shareholders as was the case in the Gencor unbundling — these listed investments, however, will only be worth their market value to shareholders and the house will be worth equivalently less. Such purely financial arrangements cannot, however, add economic value as long as the core activities of the house (the launching and management of unlisted investments) and the administration costs of the house are unaffected by the selling off of such listed assets. There is no reason to believe that selling off the listed investments would significantly affect such activities or costs.

NAV APPLIED TO A MINING FINANCE HOUSE

The notion of NAV has been applied to pure (closed end) Investment Trusts. These trusts typically hold mainly listed shares, carry no financial liabilities, and manage the composition of their portfolios. In contrast to Mining Finance houses, they have no management role in the assets of the companies whose shares they hold and therefore make no attempt to add value to these assets. The market price of these trusts has often been observed to stand at a discount to the market value of their portfolio of listed shares (Lee *et al* 1991). Therefore, dismantling a closed-end investment trust which is trading at a discount to the value of its holdings (assuming they have all been accurately valued) would necessarily add value for the shareholders of the trust. The South African Mining Finance houses differ from Investment Trusts in that they generally play an active role in the management of the listed and non-listed assets that they control. The presumption made of an Investment Trust whose market value stands at a discount to its NAV (being the market value of the Investment Trust's portfolio of listed shares), that their shareholders would be better off if the shares in the trust were distributed to them, therefore, does not necessarily apply to Mining Finance houses.

The critical difference is that the calculation of NAV in the case of a Mining Finance house comprises taking the sum of a group of *listed* investments valued in the *market* and a group of *unlisted* investments valued by *directors* and subtracting the *book value* of the liabilities. It is, therefore, a mixture of market valuations on the one hand and directors' and historical book valuations (updated every six months) on the other. A deviation of NAV from MVH at the time the NAV is calculated may thus simply be regarded as an inaccurate attempt by the directors to value some of the house's investments at that particular point in time. The notion that the NAV of a Mining Finance house is in some sense the correct or potential value of that house and that a market valuation which is less than NAV reflects a failure of the unlisted investments to cover their costs of capital is incorrect and misleading. The focus of interest for shareholders will always be the increase in value of the mining house over time, as reflected in

the market. Using historical book values, historical directors' assessments and current market values when calculating the NAV for Mining Finance houses confuses the valuation picture.

FACTORS AFFECTING THE DISCOUNT OF MARKET VALUE TO NAV

To summarise the above discussion, we know that the (percentage) discount to NAV is calculated as :

$$\frac{NAV - MVH}{NAV} \cdot 100\%, \text{ where}$$

MVH = Market Value of the House
NAV = Net Asset Value as formulated

We also noted that these magnitudes may be broken down into sub-components, thus:

MVH = ((ML + MU) + MP — MD -AF + HQ), where:
ML = market value of the assets of the listed subsidiaries of the house (in their bundled form) and other assets of the house,
MU = market value of the unlisted subsidiaries,
MP = market value of future projects,
MD = market value of current debt of the house,
AF = additional finance required,
HQ = present value of fee income less head office expenses,

and:

NAV = ((ML + BU) — BD), where:
BU = directors valuation of the unlisted subsidiaries and their associated expected liabilities.
BD = current book debts of the house

The discount may therefore be expressed as:

$$\frac{(BU - MU) - (BD - MD + MP - AF + HQ)}{ML + BU - BD} * 100\%$$

The discount to NAV may thus be affected by changes in these component items. The following cases represent typical ways in which the discount to NAV might change for a Mining Finance house:

Case 1 The share price of a listed subsidiary increases.
If the numerator is positive (i.e. the normal case when a (positive) discount exists), then an increase (decrease) in ML, the market value of the listed assets will give rise to a decrease (increase) in the discount.

Thus, the magnitude of the discount will change, simply if the prices of the listed companies change quite independently of the operation of the house or its unlisted activities. Exactly the opposite results would occur if the directors' notion of the "fair" value of the unlisted assets and the book value of the debts were less than the implicit market value of the unlisted investments and the market value of the debt. The numerator would then take on a negative value and the share price would stand at a premium to NAV.

Case 2 There is an improved market perception about the unlisted subsidiaries, with associated favourable implications for the market's perception of the debt position of the house (It is assumed that the market's perception of the listed subsidiaries does not change).
MU will increase and MD decrease, which will give rise to a narrowing discount. Thus if the prospects of an unlisted gold mining venture improves, then (in the short-term) the discount would narrow. Note that as the NAV is updated in the subsequent company report, and the directors revalue this venture on the basis of these improved prospects, the discount could be expected to widen again.

Case 3 A Mining Finance house distributes some or all of its listed assets to existing shareholders (it "unbundles").
The discount to NAV will increase since ML will decrease and the value of the house is now proportionately *more* dependent on its unlisted assets. Thus the technical process of the unbundling transaction can be expected to increase the discount.

Case 4 A Mining Finance house lists a promising mining venture that was formerly an unlisted asset.
As the existence of the discount is related to the directors overvaluing the unlisted projects (and/or undervaluing the book debts) the term $(BU - MU) - (BD - MD + MP - AF + HQ)$ must fall as the house now becomes proportionately less dependent on its unlisted assets and so the discount must decrease. In the limiting case, the house could list all its unlisted operations and become a pure Investment Trust.

THE EXAMPLE OF GENCOR

The decision, subject to shareholder approval, to proceed with the unbundling of Gencor was made by the board of directors on 11th May 1993. The announcement had been anticipated by the market as Gencor had some time previously announced its intentions to unbundle if possible. The unbundling was made possible by the announcement by the Minister of Finance in his budget

speech in March 1993 that changes in the tax rules would be made to facilitate unbundling ù in particular, holding companies would be able to distribute the shares they hold in subsidiaries directly to their own shareholders as part of the unbundling process without attracting any tax liability. The market did not react favourably to the news of the unbundling. Over the period from the beginning of January 1993 to the end of June 1993, the JSE Mining Finance House Index increased by approximately 40% as a result of a sharp increase in the gold price whereas the Gencor share price increased by approximately 15%. The share price exhibited very little immediate reaction to the actual announcement, and on the 12th May closed 5 cents higher (at 1195 cents) than it had closed on the 10th May. It was suggested that benefits would accrue to shareholders in the form of a narrowing discount. The discount did narrow due to the rising gold price (see Case 2 above) but, clearly, Gencor shares performed relatively badly after the announcement. When the unbundling process was transacted on the 18th October 1993 (the last day to register), the discount increased (see Case 3 above) from 25% on Monday 18th October to 31% when Gencor was re-listed on Monday 8th November. As explained above, this is because Gencor became a smaller Mining Finance house with a greater proportional dependence on unlisted mining projects.

THE PAST PERFORMANCE OF THE MINING FINANCE HOUSES.

For sake of completeness, it is important to consider how the leading Mining Finance houses have performed on the JSE over the past 20 years. The returns of the Mining Finance Index[11] are listed below in Table III below along with a range of alternative returns on the JSE Indices for the sake of comparison. Two ten year periods are considered. The first, from January 1971 to December 1980, was a period characterised by a strong performance overall from the gold price, while the second, from January 1981 to December 1992, was characterised by a much poorer overall performance from gold.

It may be seen from Table III that the returns provided for the shareholders of the Mining Finance houses, being highly diversified, have followed the share market as a whole quite closely. They have exhibited more variability than industrial and financial shares but less variability than pure gold shares. When real gold and commodity prices have moved in their favour (as in the first period considered in Table III) they have, as expected, provided superior returns to the industrial share market. When gold has performed poorly, as in the second period

[11]The Indices of the JSE are weighted by market capitalisation. The Mining Finance Index currently gives the Mining houses a weight of 71,6% while the mining holding companies have a weight of 28.4%. Currently represented in the mining finance category are Anglos (48.8%) Gencor (32,7%) and JCI (18,5%) (Johannesburg Stock Exchange 1993).

	Jan 71 – Dec 80		Jan 81 – Dec 92	
	Average	St. Dev.	Average	St. Dev.
Returns from All Share Index	19.31	25.05	18.75	24.42
Returns from Mining Finance Index	19.15	33.24	17.93	29.63
Returns from Industrial Index	16.91	24.56	21.18	20.29
Returns from All Gold Index	27.84	38.08	10.84	33.87
Banker's Acceptance Rate	7.685	2.13	14.95	3.60
RSA Long Term Rate (15yr+)	9.44	1.09	15.34	1.62

Returns on the indices are calculated as *ex-post* Log returns i.e. RX = 100*Log(X/X(-12)) + DYX,
where: X is the index, X(-12) is the index lagged 12 months, DYX the dividend yield on the Index; RX is then the *ex-post* Total Return.

Table III Average Return and Variability of various JSE Indices
January 1971 to December 1992 (Annualised percentage Basis)

in Table III, they have provided superior returns to those from a pure gold investment (as represented in Table III by the JSE All Gold Index).

The Market Value of the Listed Shares held by the Mining Finance house

An important aspect of an analysis of Mining Finance houses is whether they are able to add value in addition to that added by their listed holdings. In order to see this, one could compare the returns of a Mining Finance house with the returns from a portfolio with the same underlying listed shares held in the same proportions as the Mining Finance house. The difference in the returns, positive or negative, could then be attributed to the value added by the house in addition to that added by the listed assets. These comparisons are presented in Table IV. It may be seen that in every case the houses, for the period January 1989 to June 1993, produced significantly higher returns, for somewhat higher risk, than those from a portfolio of the same listed shares held in the same proportions as the house.[12] In particular, over a period in which gold performed poorly, they provided significant protection for the investor who did not want complete exposure to the gold market.

[12] The portfolios of the respective houses are those indicated in the Mining Finance. Earnings & NAV Reviews compiled by William Bowler for Fergusson Bros., Hall, Stewart & Co. Inc. Thus, for example, the returns from an investor in Anglo American after January 1989 are compared to the returns from a portfolio that combined De Beers (weighting 19%), Minorco (18%), Amgold(18%), Other Gold, represented by the All Gold Index (22%), JCI (8%), Amic (8%), Rustenburg (7%) which represented the proportions as at January 1989. These listed assets accounted for 73% of the Anglo portfolio and thus have been scaled up from the proportions held in the total portfolio of Anglo assets. Note that the weightings in the various portfolios of listed assets (in terms of the numbers of shares held) changes very little across the Mining Houses over the period January 1989 to June 1994.

	Mining Finance House		Portfolio of Listed assets	
	Average Return (%)	Std. Deviation (%)	Average Return (%)	Std. Deviation (%)
Anglo	14.85	31.50	6.02	25.00
AngloVaal	22.32	23.70	15.54	16.70
Gencor	10.20	25.64	1.78	20.22
GFSA	5.46	30.24	-0.17	27.52
JCI	19.62	27.37	8.31	26.11

* Gencor returns (and portfolio proportions) were only considered from July 1989 because of the major share restructuring that took place in June 1989 involving Engen.

Table IV Comparison of Mining House Return with the Return of a Portfolio of its Component Shares
Jan 1989 to June 1993 (in the proportions held at Jan 1989)*.

CONCLUSION

The case for unbundling the Mining Finance houses in order to serve shareholder interests is thus not at all apparent. In particular, the notion that unbundling will unlock value by eliminating the discount to Net Asset value appears unfounded. The evidence is, in fact, that shareholders have done better to hold shares in the houses than to hold shares in the listed companies that are held by the house. Moreover, the existence of a discount to NAV has no obvious negative implications for the profitability of the unlisted assets of the house. Quite clearly, if groups had not been subject to exchange control, more of the desired diversification would have taken place across different countries rather than across the different sectors of the South African economy and their financial structure may have ended up being somewhat different.

The group system should perhaps be seen as an answer to a central problem of modern capitalism. That is, it may be regarded as a means of overcoming the potential loss of control over managers and of their efficient use of resources that may occur when rights of ownership are widely dispersed and the great bulk of shareholders lack the knowledge or incentive to discipline management (Jensen 1993). It seems that in countries where barriers to group formation are not erected by governments, corporate groups or group like structures play an important role in the economy. The process of group creation and development in South Africa should, therefore, perhaps be accepted rather than threatened.

There was a time when Afrikaner nationalism regarded the groups with enormous hostility as rival and unfriendly sources of power that threatened the Afrikaners and their state (Kenney 1991). The Afrikaner learnt to live with the groups and even formed at least two powerful groups strongly identified with Afrikaners. Perhaps history will be allowed to repeat itself and powerful black controlled groups will emerge with the encouragement of the established groups and the tolerance of the state.

REFERENCES.

African National Congress (1992) Ready to Govern, Economic Policy Guidelines, Johannesburg.
Anglo-American Corporation of South Africa. (1992, 1993) Annual Reports to Shareholders.
Bergström, C. and Rydqvist, K. (1990) The Determinants of Corporate Ownership: an Empirical Study on Swedish Data, Journal Of Banking and Finance, 14 (August) 255-269.
Bowler W. (1989,90,91,92,93) Mining Finance, Net Asset Value Summary. Fergusson Bros., Hall, Stewart and Co. Members of the Johannesburg Stock Exchange, Research Documents.
Bradford De Long, J. (1990) Did J.P.Morgan's Men Add Value?; A Historical Perspective on Financial Capitalism, National Bureau of Economic Research, Working Paper, No. 3426.
Competition Board (1989) Concentration in the Financial sector and the practical and Policy Implications thereof, R6/1/2/2/2.
Daems, H. (1978) The Holding Company and Corporate Control, Nijenrode Studies in Economics, Vol.3, Leiden/Boston, Martin Nijhoff Social Science Division.
Edwards, J. and Fisher, H. (1991) An Overview of the German Financial System, Cambridge University/CEPR.
Demsetz, H. & Lehn, K. (1985) The Structure of Corporate Ownership: Causes And Consequences, Journal of Political Economy, 93 (December), 1155-1177.
Gencor Limited, (1992, 1993) Annual Reports to Shareholders.
Gerson, J. (1992) The Determinants of Corporate Ownership and Control in South Africa, University of California, Los Angeles, Unpublished Ph.D. thesis.
Jensen, M.C. (1993) The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, Presidential Address to the American Finance Association, May 1993, forthcoming in the Journal of Finance.
Johannesburg Stock Exchange (1993) Actuaries Equity and Bond Indices.
Kantor, B. (1992) Savings and Investment, Ownership and Control, An Enquiry into the Essential Features of the South African Financial and Corporate Structure, South Africa International, October 1992, 82-89.
Kenney, H.F. (1991) Power, Pride and Prejudice, the years of Afrikaner Nationalist rule in South Africa, Jonathan Ball.
Kester, W.C. (1990) Japanese Take-overs, The Global Contest for Corporate Control, Harvard Business School.
Lee, M.C., Shleifer, A. and Thaler, R.H. (1991) Investor Sentiment and the Closed-End Fund Puzzle, Journal of Finance, Vol 46 No. 1, 75-109.
Liberty Life Association of South Africa (1993) Circular to Shareholders May.
McGregor, R. (1992) McGregor's Who Owns Whom: The Investors Handbook.(11th Edition), Juta & Co. Johannesburg.
McGregor's Online Information (1993) Reported in the Cape Times, Friday August 20, 1993, p 14.
Pound J., (1992) Raiders, Targets and Politics: The History and Future of American Corporate Control, Journal of Applied Corporate Finance, Fall Vol. 5 No. 3, 6-14
Prowse. S.D. (1991) Institutional Investment Patterns and Corporate Financial Behaviour in the US and Japan. Journal of Financial Economics. 27, 43-66.
Roe, M.J. (1991) Legal Restraints on Ownership and Control of Public Companies, Journal of Financial Economics, 27, 7-41.
South African Institute of Chartered Accountants (1992) Exposure Draft 86 on Accounting for Investments, issued by The South African Institute of Chartered Accountants, June 1992.
Stewart, B.G. (1990) Simulating Ownership for Line Managers, Journal of Applied Corporate Finance, Fall Vol 5 No 5, p 62.