SHAREHOLDERS AS AGENTS AND PRINCIPALS: THE CASE FOR SOUTH AFRICA'S CORPORATE GOVERNANCE SYSTEM

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The Johannesburg Stock Exchange (JSE) is dominated by a small set of very large companies whose principal assets are shares in other listed subsidiary and associate companies. These alliances of industrial, commercial, mining, and financial service companies are commonly referred to as "groups." Ownership in the principal companies of the groups and their major operating subsidiaries is widely diffused, although South African institutional investors are typically well represented (as they are in the U.S.) among the shareholders. Management *control* of the groups, however, is highly concentrated, typically in the hands of the founder or his family.

Such concentration of control has been accomplished by the use of tiers of holding companies, best described by the term "pyramid companies." A pyramid company is one whose major or only asset consists of a controlling (that is, more than 50%) shareholding in another company. Although ownership of the ultimate holding company at the top of the structure is highly concentrated, ownership of the group parent company and its subsidiary companies becomes progressively more diffused among outside shareholders as one moves closer to the operating base of the groups. By means of such pyramid holding companies—and also by way of cross shareholdings and voting trusts—founders or their families retain control over vast assets with ownership claims on them that can be less than 10%.

The companies comprising the six largest groups on the JSE presently account for over 70% of the value of all the shares quoted on the exchange.[1] The market capitalisation of the largest of the groups, the Anglo American-De Beers Group (hereafter referred to as "Anglo"), amounted to 38% of the JSE in June 1993. And the Anglo-American Corporation itself, which is the most important company in the Anglo group, estimated in its 1994 annual report that the companies controlled by it produce about 7% of South Africa's GDP.

In addition to their size, another distinguishing feature of the groups is the diversity of their holdings. For example, although Anglo-American is known as a "mining house" (to reflect the fact that a majority of its assets are in the mining sector—primarily in gold, diamonds, coal, and platinum), almost half the company's assets are in sectors outside of mining, such as banking, insurance, and widely diversified industry. Or consider the Rembrandt group, the second largest in South Africa, with effective control of over 14% of the JSE. Besides Rembrandt's two core interests, cigarettes and banking, the group also has an important investment in mining in the form of a controlling stake in the mining house, Goldfields Ltd. (Anglo also, incidentally, has a 26% (non-controlling) shareholding in Goldfields.)

The next two largest groups are those associated with South Africa's two largest life insurance companies, Sanlam and Old Mutual, which account for 11% and 12% of the JSE, respectively. Both are mutual organisations, and thus they are owned not by shareholders, but by the holders of their insurance policies. In addition to its interests in insurance and financial services, the Sanlam group owns a large stake in the mining house Gencor Ltd. The Old Mutual is the most important shareholder in some

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1. See R. McGregor, *McGregor's Who Owns Whom: The Investors Handbook*, 10th Edition (Johannesburg: Juta & Co, 1991).

important industrial companies, including the conglomerate Barlows (which was recently broken up).

Another important grouping, valued at about 5% of the JSE, is that of Liberty Life Insurance Company, South Africa's third largest life insurer. Liberty Life has strategic, though not full controlling, interests in Standard Bank (until recently, South Africa's largest bank), in South African Breweries (SAB), widely regarded as South Africa's most successful industrial enterprise, and in the Premier group of industrial companies. SAB is controlled by another holding company, Bevcon, in which Liberty has a large shareholding. But, reflecting the extent of cross-ownership in South Africa, ultimate control over SAB rests with Anglo-American (by virtue of one of its holding companies' interests in Bevcon).

The smallest of the six large South African groups is Anglovaal. Anglovaal is also listed as a mining house, even though a majority of the assets of the group are in diversified industry. In addition to the six large groups, the JSE lists a numerous smaller groups. Indeed, new groups are continuously emerging from successful, usually family-controlled, operating companies, most of which are already listed.[2]

In sum, the corporate ownership structure that has come to dominate South Africa is quite different from the proportional ownership (or "one-share, one-vote") arrangements that prevail in other national economies such as the U.S. and the U.K. In this paper, we explain not only why the group structure has arisen in South Africa, but also why it may represent an efficient solution to a problem encountered by all national economies—namely, how to enable controllers of an enterprise to finance new growth without surrendering control. In the U.S., for example, the opportunity to issue low- or non-voting shares (which has been strongly discouraged in South Africa) provides founders with such opportunities. And LBO partnerships such as KKR have achieved, with limited equity, similarly concentrated control over a diverse group of companies by virtue of their ability to raise substantial debt funding from institutional investors. Toward the end of the paper, we also present some evidence from South African stock returns to support our argument that the pyramid structure may well be an economically efficient system of corporate governance—one that serves the interests of *all* shareholders.

SEPARATION OF CONTROL AND OWNERSHIP

As noted, there are two key features of the South African groups that dominate the listings on the JSE. First, the shareholders in the parent company of the group have a stake in a diversified portfolio of operating companies. Second, the ownership and control of the group's parent companies and its principal operating companies are separate in the sense that control rests with a very small minority of shareholders. The vast majority of shareholders in the group operating subsidiaries, although owners, are thus non-controlling shareholders. That is, although each listed subsidiary or associated company of the group has its own independent set of shareholders, control is exercised by those shareholders who control the parent company and its principal operating companies.

In most large groups, moreover, the controlling shareholders are still members of the family that founded the enterprise that constitutes the operating core of the group. They have used the methods just described to accomplish their goal of diversifying their own wealth across different sectors of the economy (and in many cases around the world), while maintaining control over the group. Thus, the Oppenheimers continue to control the Anglo group, the Ruperts control the Rembrandt group, Donald Gordon controls the Liberty alliance with Standard Bank, and the Menells and Hersovs control Anglovaal. Such families control their respective groups with relatively small percentage ownership claims—generally less than 10% of the underlying assets and, hence, less than a 10% claim on the dividends generated by their groups.[3]

The two other large groups—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 their management enables them to achieve the benefits of diversification and control without the same dilution of ownership. They typically exercise shareholder control with significantly larger stakes in the operating companies associated with their groups than is either possible or desirable for the family-controlled groups. Old Mutual and Sanlam in fact tend to control group companies by the conventional method of owning close to 50% of the shares. Their sheer

2. Ibid.

3. Ibid.

financial muscle enables them to control companies; by contrast, the group families must rely on layers of holding companies if they wish to diversify and yet retain control.[4]

Institutional shareholdings in South Africa, of which the Old Mutual and Sanlam comprise the largest part (with about 50% of all institutional assets between them), have become the overwhelmingly dominant shareholding in South Africa.[5] Paradoxically, were it not for the holding companies and pyramid structures that allow tight control by the groups, the large institutions would be effective owners and controllers of much more of the South African economy. It is the voluntary participation of the institutions in a corporate governance system of control without concomitant majority ownership that is the distinctive feature of the South African corporate landscape. No important capital-raising exercise by South African corporations can hope to succeed without institutional support, even though such capital contributions rarely confer institutional control.

ESTABLISHING SOME GENERAL PRINCIPLES

Some Essential Trade-offs

There are two obvious reasons why the founding owner and manager of a firm may want to share the rewards and risks of the enterprise with outside partners or shareholders. The first is that, by attracting outside capital, the firm can expand more rapidly than otherwise. If economies of scale are realised, the enterprise will be larger and more profitable than in the absence of outside funding, and the founder's return on investment and wealth will be greater.

The second, less widely recognised, reason for founders to sell additional shares and reduce their original stake in the enterprise is to diversify their portfolios of holdings. The proceeds of the sales of shares in the firm can be used to reduce the debt of the firm or to finance investments in activities unrelated to the core business of the firm. Acquisition of a business that is not closely associated with the core business will clearly create a less specialised enterprise and hence a more diversified shareholding for the founder.

Thus, diversification by the founder might be pursued either inside or outside the firm, depending on the preferences of the founder and the constraints that will be revealed in the terms obtained for the newly issued or exchanged shares. In the U.S. and the U.K., of course, corporate diversification has come under strong attack from shareholder activists and corporate raiders. And the fact that any diversification strategy pursued by a company, while still under the effective control of the founding owner, may reduce the returns available to the non-controlling (or "outside") shareholders is one of the risks of investing in such companies. To the extent the outside shareholders already have well-diversified portfolios of their own, *they* are likely to prefer, all other things equal, that the firm remain highly specialised. But the founder may prefer otherwise; and if the capital required for expansion is to be raised, some compromise or trade-off between the insiders and outsiders will have to be reached.

Of course, there is a great variety of other ways that an owner-manager and controlling shareholder can disappoint outside shareholders. Potential conflicts of interest abound, not least of which relate to the benefits in cash and kind that the controlling shareholder may be awarded for management services. Another conflict may occur over the issue of who is to succeed the founder as ultimate controller. The possibility of such conflicts will be recognised by potential outside investors; indeed, the probability of such conflicts arising, and the expected costs associated with resolving them, will partly determine the price at which outside capital is obtained.

Thus, the mere possibility that the controlling shareholder and owner-manager will act against the interests of non-controlling suppliers of capital inevitably forces the owner to make some compromises or trade-offs for absolute power in exchange for capital. Minority shareholders usually have some protective rights written into company law; and providers of debt finance, who are particularly vulnerable to exploitation by shareholders, typically use debt covenants to achieve some control over

4. The structure of corporate ownership and control in South Africa has been most carefully analyzed by Jos Gerson in "The Determinants of Corporate Ownership and Control in South Africa," University of California, Los Angeles, unpublished Ph.D. thesis (1992).

5. The reason for such institutional dominance has everything to do with the highly favorable tax treatment of designated contributions to retirement funds managed by institutional asset managers. See Graham Barr and Brian Kantor, "The Changing Pattern of Savings in South Africa 1970-1991," *Studies in Economics and Econometrics*, 18 (1994a), 3:59-76.

In the U.S., LBO partnerships such as KKR have achieved, with limited equity, similarly concentrated control over a diverse group of companies by virtue of their ability to raise substantial debt funding from institutional investors.

how their money is used. Debtholders also often attempt to secure their loans. And some debtholders—notably, the very large German banks and Japanese "main" banks, and the limited partners in U.S. LBO partnerships such as KKR and Forstmann Little—seek the additional protection that comes with having equity as well as debt claims. Such "hybrid" investing techniques give outsiders the legal authority to watch over their capital more effectively.[6]

Most businesses that remain small and owner-managed choose to do so for reasons other than the lack of entrepreneurial skills of their founders. A more serious limiting factor is often their inability to raise extra outside capital on favorable terms because they are unable to inspire the required trust in potential outside suppliers of capital. In economists' language, the "agency costs" and "information costs" of raising outside capital are simply too high for most owner-managed businesses.

Diluting Voting Powers

The power to manage the affairs of a company in a way that any individual shareholder or group of shareholders might wish clearly increases with the percentage of votes commanded. But, in most countries, the power to cast 50% or more of the votes at the important meetings of the company will mean effective control. Effective control may be defined as the legal power to appoint the board of directors, who in turn appoint the senior management to run the company in some agreed-upon fashion. A 50% majority is usually more than sufficient for this purpose; and, depending on the cohesion of the other voters, a smaller share of the votes cast may be enough in most circumstances to control appointments to the board of directors and hence crucial business decisions.

The standard presumption in the U.S. and U.K corporate governance systems is that ownership entitles the shareholder to proportional representation.[7] This presumption reflects the reality that, in the vast majority of American and English companies, one share commands one vote. But one share does not always and everywhere translate directly into one vote. An entitlement to a proportion of the cash distributed by the company may not mean the same proportion of votes; and, in this sense, ownership may not confer control. If regulations do not prohibit such arrangements, shares may command less than one vote or no vote at all.

Thus, while more or less appropriate for the U.S., Britain, and Australia, the rule of one share-one vote does not apply to a number of other national economies where small groups of shareholders with relatively low-percentage (though large-dollar) claims to ownership often exercise effective control. Such powers are typically gained through the issuance of low-voting or non-voting stock. Low-voting shares are widely used in countries such as Sweden, Denmark, Finland, and Switzerland. Some use of limited voting shares is also made in the U.S., but their use (as we discuss below) has long been viewed with suspicion and therefore been constrained by law and regulation.

The Economic Equivalence of Pyramid Companies and Limited Voting Stock. In South Africa, laws prohibit the issuance of non-voting shares and, until quite recently, JSE regulations strongly discouraged the issue of *low*-voting shares.[8] But where the law forbids such arrangements, the same end can be achieved with legal devices such as holding companies or pyramids. Such arrangements are commonplace not only in South Africa, but also in Belgium, France, Italy, Hong Kong, Canada, and Korea (and they were popular in pre-War Japan). In some cases, notably Sweden, both holding companies and low-voting shares are permitted.[9]

A holding company is one whose assets *include* shares in another company. A pyramid company may be defined as one whose *only* asset is shares in another company for the purposes of exercising control. If the holding company owns 50% or more of this other company, it can exercise full control over its subsidiary company. Thus, a shareholder with 50% of the votes in a holding company that owns 50% of another company has effective control of both. Control of the second, or subsidiary, firm can

6. For an account of the financial structure of LBO partnerships, and their similarity to Japanese "main" banks, see Michael Jensen, "LBOs, Active Investors, and the Privatization of Bankruptcy," *Journal of Applied Corporate Finance*, Vol. 2 No. 1 (Spring 1989).

7. As exemplified by Harold Demsetz and Kenneth Lehn, "The Structure of Corporate Ownership: Causes And Consequences," *Journal of Political Economy,* 93 (December, 1985), 1155-1177.

8. Such policies were changed in 1995 and new shares of low-voting or so-called "N" shares are now being listed.

9. See C. Bergstrom and K. Rydqvist, "The Determinants of Corporate Ownership: an Empirical Study on Swedish Data," *Journal Of Banking and Finance*, 14 (August, 1990), 255-269.

be exercised with 50% of 50%, or just 25%, of the claims to the cash distributed by the subsidiary.

This process by which ownership is separated from control can technically be repeated many times, with a large number of layers of holding companies formed specifically for the purposes of maintaining control while reducing the claims to ownership. The end result could be made identical to the outcome had the controllers of the parent company instead been able to raise extra capital by issuing additional low-voting or non-voting shares.

Besides limited voting shares and pyramid companies, there are other alternatives for effecting control without proportional ownership. In Germany, the large clearing banks are said to play a key corporate monitoring role as suppliers of equity as well as debt capital, and as trustees for many other shareholders. Japanese "main banks" appear to play a similar corporate surveillance role over group-like structures called keiretsu.[10] And, in the U.S., as noted, LBO partnerships like KKR and Forstmann Little control large asset holdings across a wide range of industries by using large amounts of debt supplied by institutional investors. Or, for an even more recent example, consider the Spielberg Katzenberg Dreamworld venture, in which the founders have succeeded in attracting broad institutional investor participation while retaining a controlling minority equity stake.

Law Not Economics

Given, then, the advantages in some cases of allowing founders of enterprises to retain control (together with their often strong preference to do so), one can argue that the forces that encourage such founders to cede control when they raise capital from outsiders are not necessarily economic, but rather legal or regulatory ones. It is important to recognise, for example, that the present system of corporate governance in the U.S., Britain, and Australia has been deeply influenced by longstanding policies that have promoted the principle of one share-one vote.[11] In 1926, the New York Stock Exchange prohibited the issue of dual-class common stock with different voting rights—a policy that was not relaxed until 1986. The American Stock Exchange appeared to be more sympathetic to firms with multiple classes of voting stock, though use of such provisions was fairly limited until 1980.[12] Pyramid holding companies, which were once prominent in the American utilities industry,[13] were outlawed by the Public Utility Holding Company Act of 1935. In addition, the taxation of dividend flows between legally separate companies in the U.S. has largely prevented the formation of holding companies. In Britain, the issuance of non-voting shares was prohibited in 1948 by an amendment of the Companies Act, and the London Stock Exchange refuses to list holding companies whose main assets are a controlling shareholding in another listed company.

More recently, however, the U.S. attitude toward limited voting shares appears to have shifted toward greater tolerance. In the early 1980s, there was extraordinary growth in the number of dual-class shares trading on the American Stock Exchange—a development that can be explained largely as a defensive response by top managements threatened by the prospect of takeover.[14] The New York Stock Exchange responded to this new form of competition by abandoning the one-share, one-vote rule it established in 1926. Such a change, however, required SEC approval. And, after much debate, the SEC finally proposed a rule (Rule 19c-4) that allows *the issuance* of new low-voting or non-voting stock, but prohibits *exchange offers* to replace outstanding voting shares with limited voting shares (because such offers are felt to be potentially "coercive").[15]

The SEC's ruling is of interest here because it recognises that there are legitimate reasons for

10. See A.Horiuchi, F. Packer, and S. Fukuda, "What Role Has the "Main Bank" Played in Japan?" *Journal of International and Japanese Economies*, 2 (1988), 160-180.

11. As Bernard Black has commented, *"Scholars increasingly recognise that the large American public corporation, with its strong managers and weak, dispersed shareholders, may have evolved not because it is efficient, but in response to this web of state and federal rules that constrains institutional investors. In other countries institutional investors face fewer obstacles to oversight and are far more active than they are here."* (Bernard Black, "Next Steps in Corporate Governance Reform: 13(d) Rules and Control Person Liability," *Journal of Applied Corporate Finance*, Vol. 5 No. 4 (1993):49-55.)

12. See Ronald J. Gilson, "The SEC's Response to the One-Share One-Vote Controversy," *Journal of Applied Corporate Finance*, Vol. 5, No. 4 (1993): 37-43.

13. See A. Berle and G. Means, *The Modern Corporation and Private Property* (New York: Commerce Clearing House, 1932.)

14. The ban on exchange offers is based on the SEC's concern about biases in the shareholder voting process—particularly, the pressures on large institutional funds to vote with management on proposals. There is no such concern for investors when companies issue new low-voting shares. For an explanation and defense of this ruling, see Gilson (1993), cited earlier.

15. The New York Stock Exchange, however (with some prodding from the Business Roundtable), opposed the SEC's ruling. And the NYSE's opposition was reinforced by a Federal Court of Appeals' ruling that the SEC lacked the statutory authority to impose Rule 19c-4. See Gilson (1993),cited earlier.

Given the advantages in some cases of allowing founders of enterprises to retain control, one can argue that the forces that encourage such founders to cede control when they raise capital from outsiders are not necessarily economic, but rather legal or regulatory ones.

issuing low-voting shares. The ban on exchange offers reflects the SEC's concern that low-voting shares can be used by incumbent management to disenfranchise shareholders by blocking value-adding changes in control. At the same time, the SEC ruling acknowledges the economic reality that controlling shareholders of a company typically *issue* low-voting shares to finance a worthwhile expansion without diluting their own control, and that they are able to do so *with the full agreement of the non-controlling shareholders.*

Reinforcing this argument, many countries have no restrictions on issuing low- or non-voting shares; and, in such cases, differential voting shares tend to be widely used. Moreover, countries *with* restrictions on low-voting shares seldom have restrictions on the exercise of controlling power through holding companies. And, provided inter-company dividend flows are not subject to taxation, large diversified companies may well prefer to work partly through legally separate, wholly- or partly-owned subsidiaries, rather than through divisions of a larger conglomerate. Even in countries with listing restrictions on both non-voting shares and holding companies (such as the U.S. and U.K.), firms can circumvent such constraints simply by choosing not to list. As noted earlier, the highly successful LBO partnerships like KKR represent a form of corporate organisation that is strikingly similar to that of the South African groups.[16]

In sum, a 50% voting rule for control purposes is not the barrier to maintaining absolute control it may appear to be. Control can be maintained by a small minority of shareholders and separated from ownership, *provided the suppliers of capital are willing to buy what are implicitly or explicitly non-voting or low-voting shares.* Outside investors are clearly prepared, at a price, to trust and in fact to encourage the minority controllers to exercise control on behalf of all shareholders.

BACK TO SOUTH AFRICA: FIRST SIGNS OF "UNBUNDLING"?

In South Africa, there have been important preliminary moves toward deconglomeration by the Old Mutual and Sanlam and, more recently still, by JCI. For example, Gencor, the mining house controlled by Sanlam, recently spun off some of its industrial subsidiaries to its shareholders to become a much more highly specialised mining house. In the process, a number of the holding companies that were formed to help Sanlam secure control of Gencor were eliminated. At roughly the same time, the Old Mutual announced its decision to split up the conglomerate Barlows into three constituent parts, of which the original but reduced Barlows remains one. (Even with such "unbundling," however, Sanlam continues to be by far the largest individual shareholder in both Gencor and its unbundled parts, with a holding of around 30%. And the Old Mutual remains in effective control of Barlows and the two new independent companies, with about a 30% direct shareholding in each.)

But, at the same time these two large mutuals were unbundling, Liberty Life took a step in precisely the opposite direction. Liberty recently created a new subsidiary, Libsil, which represents the insertion of yet another layer between the shareholders who control Liberty Life through the holding companies Libhold and Libvest, and the operating companies controlled by the latter companies. Prospective shareholders in the new Libsil were offered a share in a combination of operating companies that have little in common other than their connection with Liberty Life. The formation of Libsil was designed to enable the controlling shareholder, Donald Gordon, the founder of Liberty Life, to reduce his stake in these operating companies without reducing his controlling position in them.

The initial offering by Liberty Life, both to its own and to outside shareholders, was for a 20% stake in Libsil. It is instructive to note that the initial stake in Libsil was offered, first to general shareholders of Liberty Life, and then to other outsiders, at a discount of 10% to the underlying value of the assets to be owned by Libsil. Selling shares at such a discount is clearly part of the price Donald Gordon is prepared to pay for implementing a financial structure that furthers his goal of control with increased diversification.

In the future, the 80% Liberty Life stake in Libsil will almost certainly be reduced further until the crucial 50% level is approached. At this point, no

16. The U.S. LBO market is an extension of the U.S. venture capital market. The functions performed by the leading group controllers in South Africa seem to parallel closely the role of the leaders in the venture capital market. See Michael Jensen, "LBOs, Active Investors, and the Privatization of Bankruptcy," *Journal of Applied Corporate Finance* (1989), cited earlier.

doubt, consideration will be given to establishing yet another holding company for the purposes of maintaining Liberty Life's control over Libsil while further reducing Liberty Life's ownership of the operating companies. In this fashion, layer upon layer is added to the pyramid; at each stage control is maintained but percentage ownership of the operating companies is decreased and hence diversification increased.

The Trade-off Examined More Closely

The essence of this process of concentrating control while diffusing ownership claims is that the founding entrepreneurs are able to attract outside share capital, on favorable enough terms to themselves and their partners, without conceding control. What made this arrangement attractive to Liberty Life shareholders in the Libsil case was the 10% discount to the underlying value of the assets. For outside shareholders—those investors who come over time to supply the great bulk of group equity capital by volunteering their own funds—this means entering into a one-share, one-vote relationship only in the most narrow legal sense. They do so, however, at a price acceptable both to them and to their controlling partners who end up with a reduced stake in the enterprises.

Rather than merely acquiescing in what is not a one-share, one-vote equal relationship, outside shareholders may in fact be enthusiastic about the benefits they expect to receive from the controls that will continue to be exercised by the founding owners over the managers of the various operating companies. The opportunity to ride along with the founder comes with a price, however. The price is that the diversification strategy will be designed primarily to satisfy the controlling interests and not the interests of the majority of shareholders.

In effect, the near-silent majority of shareholders trade off their power to control the structure of the companies they own for the benefits of the controls and entrepreneurship that they believe will continue to be exercised on behalf of all shareholders by the controllers. The ordinary non-controlling shareholder is generally able to diversify quite adequately through the share market. In choosing to go with the portfolio of a minority controlled group, outside shareholders may well be regarding the ability of the founding fathers to create value for them as adequate compensation for what might be regarded by some investors as needless duplication of their own ability to diversify.

MEASURING THE PERFORMANCE OF THE SOUTH AFRICAN MINING HOUSES

There are two principal objections raised against the South African group structure. First is what may be described as the *anti-trust* case; namely, the charge that the groups represent an unhealthy concentration of economic power and that the existence of large groups reduces competition in the market for goods and factors of production. The second thrust of the criticism is against the *conglomerate* nature of the groups which, it is argued, reduces their value to shareholders.[17]

In the remainder of this paper, we confine ourselves mainly to responding to the second objection: namely, the tendency of conglomerates (at least in the U.S. and elsewhere outside South Africa) to produce substandard performance. Because advocates of unbundling have directed so much of their criticism at the South African "mining finance houses,"[18] we began by examining the long-run stock price performance of the five largest South African mining houses: Anglo-American, JCI (owned and controlled by Anglo-American); Gencor (part of the Sanlam group); Goldfields (with Rembrandt its most important shareholder); and Anglovaal (which, as in the case of Anglo-American, is both a mining house and the parent company of its group). Each of these mining houses are group-like structures in and of themselves; and, through their diversified holdings, they in turn exercise control

17. It is important to recognize that while the parent company holds a conglomeration of different interests on behalf of its shareholders, other companies in the group will have a different though sometimes common set of shareholders. Some of these allied companies will be conglomerates in their own right. A conglomerate is perhaps most accurately defined as a company with diversified operations and a common group of shareholders. A group therefore is not strictly speaking a conglomerate.

18. Such criticism can be traced, in large part, to the fact that the mining houses, alone among the South African parent companies, publish periodic estimates of their own Net Asset Values and that the market values of the mining houses generally trade at significant discounts to these NAVs. Although advocates of unbundling interpret such discounts as indications of the potential gains from unbundling, the discounts themselves are misleading because the NAVs include not only the market value of the listed investments held by the house, but the director's updated valuation of the unlisted investments held by the house. In short, the critics' use of such NAVs involves a comparison of apples and oranges.

For an explanation of these NAVs and their misinterpretation by advocates of unbundling, see Graham Barr and Brian Kantor, "The Discount to Net Asset Value, Unbundling and Shareholder Interests," *De Ratione*, 8 (1994b), 1: 44-59

Over the period January 1989 to June 1993, the mining houses appear to have created significant shareholder value over and above the values of their listed holdings.

TABLE 1
AVERAGE RETURN AND VARIABILITY FROM VARIOUS JSE INDICES
JANUARY 1971-DECEMBER 1992

	Jan71-Dec80		Jan81-Dec92	
	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 Mining House Index	16.98	32.84	18.81	31.43
Returns from All Gold	27.84	38.08	10.84	33.87
Banker's Acceptance Rate	7.69	2.13	14.95	3.60
RSA Long Term Rate (15yr+)	9.44	1.09	15.34	1.62
Consumer Price Index	10.04	2.63	13.40	2.12

*Annualized percentage basis. 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.

over smaller groups of allied firms, each with its own set of shareholders.

As shown in Table 1, Anglo-American and the other four leading mining houses have in fact served their shareholders exceptionally well over the past 20 years. For example, over the period 1971 through 1980, shareholders in the mining houses earned an average return of 17% per annum (which, although some 230 basis points lower than the All Share Index, was about 700 basis points higher than the average annual increase in the South African CPI over the same period). During the period 1981 through 1992, the average return was almost 19% (slightly higher than that of the All Share Index and about 550 basis points higher than the average rate of inflation).

These returns to shareholders of the mining houses, being diversified to the degree they are, are largely representative of the share market as a whole. Nevertheless, as the standard deviations of the returns suggest, mining house shares are more risky than industrial and financial shares (though less risky than a portfolio of gold shares). When real gold and commodity prices have moved in their favor, the mining houses—as one would expect—have provided higher returns than industrial shares or the market as a whole. But, when the commodity price trends have moved against mining houses, the returns have fallen below those of the broad market. This, of course, is the meaning of higher risk.[19]

MEASURING THE PERFORMANCE OF THE LISTED PORTFOLIOS OF MINING HOUSES

We next compared the returns to shareholders of the mining house to the returns available to an individual investor who held all the same underlying listed shares in the same proportions as the mining house. The issue tested here is whether shareholders, acting on their own and forming the equivalent of an investment trust with the similar proportions of listed assets, would have done better without the parent company. The difference between the returns from such a simulated investment trust and the returns from an investment in the parent mining finance house can be viewed as the contribution to shareholders by the head office.

As shown in Table 2, over the period January 1989 to June 1993, the houses without exception provided significantly higher returns—though with somewhat higher risk—when compared to the returns available to an individual investor holding the exactly the same listed investments in the same proportions, independently of the controlling house.[20] During the periods examined, the houses appear to have created significant shareholder value over and above the values of their listed holdings. Viewed in light of this evidence, the houses seem not to have been a burden to their shareholders, and thus the case for unbundling the mining houses

19. Whether the returns of the mining houses reported in Table 1 were sufficient to compensate investors for the added risk of the shares is another question—one that cannot be answered just from these 20 years of data.

20. The portfolios of the respective houses are as indicated in "The "Mining Finance, Earnings & N.A.V Review," first compiled by William Bowler for Fergusson Bros., Hall,Stewart & Co.Inc., in October 1988. Thus the returns from an investor in Anglo American are compared to the returns from a portfolio that combined De Beers (with a weighting of 19%) Minorco (18%) Amgold (18%) Other Gold, as represented by the All Gold Index (22%), JCI (8%), Amic (8%), and Rustenburg (7%). These listed assets accounted for 73% of the Anglo portfolio of the time and so the weights for the simulation exercise were scaled up proportionately to the levels indicated in the table.

TABLE 2
COMPARISON OF MINING HOUSE RETURN WITH THE RETURN OF A PORTFOLIO OF ITS COMPONENT SHARES IN THE PROPORTIONS HELD AT JANUARY 1989
JANUARY 1989-JUNE 1993

	Mining House		Portfolio of Listed Assets	
	Avg. Ret.(%)	Std.Dev.(%)	Avg. Ret.(%)	Std.Dev. (%)
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

in the interests of its shareholders is not at all apparent.[21]

THE PRINCIPAL-AGENT PROBLEM AND THE CONSTRAINTS ON THE CONTROLLING SHAREHOLDER: ESTABLISHING SOME TESTABLE HYPOTHESES

Where the controllers of a corporation have succeeded in retaining a majority of the votes despite having less than a simple majority of the ownership claims, there is no possibility of separate control by managers. The managers may of course have all the appearance of independence, and wide powers may be delegated to them; and if the corporation performs up to expectations, there would be no need for the controlling shareholders to interfere. It is when the management fails to live up to expectations that the ultimate authority of the controlling shareholders will be exercised. Within a South African group, the removal from office of an unsatisfactory chief operating officer and team is a simple task; there are no proxy or takeover battles required.

The hostile takeover, however, is also rendered impossible in the South African corporate governance system, and thus one set of potential principal-agent problems is substituted for another. While controlling shareholders have the absolute power to appoint and dismiss managers and to hold them accountable, there is no guarantee that the controlling shareholders will not abuse their power to promote their own interests at the expense of the majority of non-controlling shareholders. Thus, in order to dilute their ownership claims by issuing shares at all levels of the group structure and still retain control, the controllers have to be able to satisfy prospective investors that they are unlikely to abuse the powers vested in them.

To devise tests of these arguments, we began by identifying a number of key variables that determine the attractiveness of group companies to voteless outside investors, and we then found empirical "proxies" for these variables in the South African context. After so doing, we next attempted to measure the explanatory power of each of these variables in determining the percentage ownership (i.e., claims to dividends) of the controller for a large representative sample of South African listed industrial corporations.[22] The less attractive a company's shares to outsiders, we reasoned, the larger percentage ownership the controller would be forced to retain.

The key variables we identified were as follows:

Reputation. The controlling shareholder must enjoy a reputation for integrity as well as management competence.[23] Such a reputation will be revealed by the track record of the controller. We predict therefore that, in an environment where holding companies are not discouraged or differential voting shares are permitted, *the greater the reputation of the controlling shareholder, the lower will be the observed percentage claim to dividends from the operating companies under control.*

Since reputation cannot be observed directly, we selected two proxies for it. The first was the controlling shareholder's wealth as listed on the JSE. (The wealth of the controller would have been a better proxy, but that, of course, is unknown, except perhaps to the tax authorities.) Our second proxy for

21. A full analysis of the mining finance house and the discounts to net asset value under which they trade has been presented by Barr and Kantor (1994b), cited earlier.

22. Establishing the ownership claims of the controlling shareholder for each company (in many cases one or other of the leading groups discussed above) meant a careful dissection of the patterns of holding companies and cross holdings. See Gerson (1992), cited earlier.

23. We have been struck by the importance of reputation effects in the U.S. venture capital market. The role of the leaders in the venture capital market seems to parallel closely the functions performed by the leading group controllers in South Africa. See C.B. Barry, C.J. Muscarella, J.W. Peavy, and M.R. Vetsuypens, "The Role of Venture Capital in the Creation of Public Companies: Evidence from the Going-public Process," *Journal of Financial Economics*, 27 (1990):447-472.

To dilute their ownership claims by issuing shares at all levels of the group structure and still retain control, the controlling shareholders have to be able to satisfy prospective investors that they are unlikely to abuse the powers vested in them.

reputation was the price/earnings multiples of the companies under control. Our hypothesis is that, *the higher the observed average P/E ratios of the companies under control, the lower the ownership claims of the controlling shareholder.*

Exposure. The amount of the controllers' personal wealth actually invested in the companies under control also reveals the exposure of the controller to the risks of failure of the companies under control. Obviously from the outside shareholders' perspective, the more the controller has to lose, the better the protection provided against poor management or decisions biased in favor of the controller.

Relative Income. To resolve any agency conflicts, it is clear that the controller's equity should dwarf any remuneration received as a director or manager. This helps to align the controller's incentives with those of the outside shareholders. Since CEO compensation in South Africa tends to reach a maximum limit of less than $1 million (which is quite low by U.S. standards), whereas income from shares is simply proportional to the value of the shareholding and thus has no limit, the value of the controller's shareholding (in other words, his listed wealth) can be used as a proxy for the fulfilment of the "relative income" condition. To meet this condition, the controller requires a very substantial equity stake. Only the wealthiest families are likely to possess the requisite wealth; professional managers, by contrast, are unlikely to possess such a stake in the company.

Wealth. Besides the three variables cited above, group wealth was also included as a key independent variable because it was considered to be both a proxy for the controlling group's past reputation and for its ratio of share income to managerial income. Wealth was calculated as the value of all JSE shares owned by each dominant shareholder group. Unlisted assets (those that were not even indirectly reflected in the value of listed shares) were ignored and it was assumed that wealth reflected on the Exchange would be a satisfactory proxy for total wealth. We hypothesised that the *greater is the wealth of the controlling group, the lower would be its percentage claim on dividends.*

Group P/E. The price/earnings ratio of the group ("GroupP/E"), the average share price to historical earnings ratio of the companies in the sample under the control of each controlling shareholder, was included as an independent variable to serve as a proxy for its current reputation. It was hypothesized that *the higher the PE-ratio, the lower would be the percentage claim to dividends held by the controlling shareholder.*

Firm Size and Firm-Specific Risk. The other variables that were thought to be of significance in determining the stake of the controlling shareholder are firm size and firm-specific risk. Research has shown that firm size is an important determinant of the degree of concentration of ownership, with larger firms having less concentrated ownership.[24] Thus, we predicted that *for any risk averse shareholder of given personal wealth, the larger the size of the firm, the smaller the desired equity stake of the controlling shareholder.*

At the same time, however, the potential for greater control could, under certain circumstances, encourage concentration of ownership. Specifically, if a given company's earnings are characterised by a high degree of firm-specific risk, the shareholders would likely find it worthwhile to monitor management more closely.[25] In such cases, the largest single shareholder, or alliance of shareholders, would typically hold an above-average share in order to maintain tighter control over management.

Such considerations, however, apply only in a one-share, one-vote environment. If tight control can be achieved without a large stake, then the controller would, all other things being equal, want to hold a smaller stake in a more risky company. Thus, the influence of "firm-specific risk" (as measured by the variability of that part of the return from the individual company not explained by the returns from the market as a whole) on the controller's equity share is not obvious from an *a priori* standpoint.

The Findings

These various hypotheses were tested using a cross-sectional regression model for a sample of 235 majority-controlled companies from a total of 437 companies listed on the Industrial Board of the JSE. Financial data were taken from financial statements presented by these companies for fiscal years ending in either 1989 or 1990.

24. See Demsetz and Lehn (1985), cited earlier.

25. Ibid.

The results provided strong support for our hypothesized theories. We were able to explain about 38% of the variation in the ownership stakes of the absolute controllers (as measured by the adjusted R^2 of the regression). Such ownership stakes varied between less than 5% for the controllers of Anglo-Vaal to well over 50% for some of the typically much smaller, owner-managed corporations listed on the JSE. The coefficients for the variables *wealth, group P/E* (the controlling group's average P/E ratio) and *firm size* all proved significant with the expected sign. But the influence of *firm risk* was insignificant, which is consistent with our prior assumption of an indeterminate sign.

Foreign-owned companies typically hold a larger direct stake for control purposes, which has the effect of raising the average ownership stake. It was not considered useful to follow the chain of control offshore, and so a dummy variable was used to allow for this effect. A second dummy variable was used to allow for the influence of the two large mutual companies. Not surprisingly, when mutuals were included, their role as controllers had the statistically significant effect of increasing ownership claims.

When the foreign and mutual influences were excluded altogether, the overall adjusted R^2 declined to 0.34 without affecting the statistical significance of the other variables. Such results may be regarded as very satisfactory in themselves and broadly supportive of the underlying thesis. Nevertheless, the limitations inherent in the statistical analysis should be recognised. The regression equation captures a pattern of ownership and control that is the result of a dynamic process. The full characteristics of such a system cannot be captured with a point-in-time cross-sectional study.[26]

A CAVEAT

Some observers skeptical of the efficiency of the group system argue that capital controls have artificially inflated the stock prices of all South African companies and so contributed to the perpetuation of the current group-dominated system. When such controls are ultimately lifted, this argument runs, share prices will fall generally and increased activism by institutional shareholders will force the unbundling of the groups, much as they have helped bring about the break-up of conglomerates in the U.S. Moreover, in response to stock price evidence of the kind we have just presented, such skeptics would point to the case of Japan, where stock prices have fallen by over 50% since 1990, and where the entire corporate governance system is now being re-examined.

In response to such speculation, our discussion of corporate governance in the South African context has produced evidence of the superior *relative* performance of the parent companies of some of the groups. Indeed, we have attempted to explain the ability of some of the controllers of the groups to reduce their ownership stakes, while retaining control, *precisely as a consequence of* their superior results for shareholders. Clearly, in any long-run view, it is relative performance that must determine the structures of governance (regulations permitting).

Exchange control, to the extent it succeeds in its aim of preventing net capital outflows, would by definition mean greater demand for domestically issued securities, whether denominated in either the local or other currencies.[27] Such favorable price effects would, however, be general to all securities and not be confined in any obvious way to any one class of securities issued, for example, by the major groups. In other words, exchange control does not necessarily influence relative performance.

Before considering the possible relative security price effects of exchange control, it is useful to question the effectiveness of exchange control in South Africa or elsewhere. It is an empirical issue whether exchange control actually succeeds in its purpose of increasing the available supply of capital over time and so increasing net demands for the protected currency and for securities issued in the protected domestic capital market. Clearly, the effectiveness of exchange control cannot be taken for granted in South Africa or elsewhere.

Often what may be gained by exchange control in prohibiting certain defined and easily monitored transactions is lost in others less easily controlled. Aside from the more obvious forms of corruption, in a country as open to trade as South Africa has been

26. For a full explanation of the regression procedures, see Gerson (1992).

27. South Africa has applied its own version of exchange control regulations since 1961. The initial reason for these controls, which has remained their justification, was to protect the currency against capital flight encouraged by political uncertainty. The stated intention of the new government of South Africa is gradually to remove these controls. In March 1995, as a first step, they removed the controls that had prevented non-residents from buying and selling Rand-denominated securities directly from each other. This meant the unification of what had been a dual currency system, with a commercial and financial rand trading side by side.

Exchange control influenced relative share and other market values by encouraging demands for domestic securities that had a rand hedge quality. By the same logic, when exchange control is removed, any premium paid for rand hedges must fall away.

(where foreign trade accounts for more than 50% of GDP), there are countless opportunities to disguise capital movements as foreign trade items. Under- or over-invoicing, transfer pricing between branches, substituting dividend or interest payments for capital repayments are all means of moving savings across frontiers. The more one class of transactions is constrained, the more others are encouraged.

There is also the effect over time on the net flows of foreign investment. Exchange control may, more or less effectively, lock in an existing stock of foreign investment. But while this keeps capital from leaving, it largely prevents additional capital from coming in. Over time these net effects are likely to harm more than they help domestic security markets.

South Africa provides lots of evidence for the view that what may be gained on the swings of exchange control is lost by others on the roundabouts of exchange control evasion. After 1970, the pattern of household savings changed dramatically in favour of pension and retirement funds managed by institutions and away from banks.[28] Increases in inflation, working together with the tax code, accounted for part of this shift away from banks and mutual funds. But an additional explanation of the practical disappearance of what might be described as "discretionary" household savings were the efforts made to avoid exchange controls. Such discretionary savings were being placed with foreign banks, trusts, and mutual funds.

The South African institutions managing domestic savings enjoyed no relief from exchange control, which effectively forced them to hold only securities issued in South Africa and denominated in Rands. There was no direct way they could hedge their portfolios against currency or country risk.

South African corporations, however, were not so tightly bound by exchange control. Some had made significant foreign investments before exchange control. Many others received permission to make additional investments offshore. Such authority usually required evidence of satisfactory payback in the form of dividends received and the like. In addition, the many South African corporations that export precious metals and commodities (whose prices are denominated in dollars) were effectively protected against currency risk.

Institutional investors therefore had the opportunity to hedge their currency and country exposures by making investments on the JSE that acted as proxies for direct investments in foreign currencies or markets. The so-called pure rand hedges—companies quoted on the JSE whose assets and earnings all came from outside South Africa—found particular favor in times of political and currency uncertainty. Therefore, because of the lack of opportunity to make portfolio investments offshore, exchange control influenced relative share and other market values by encouraging demands for domestic securities that had a rand hedge quality. By the same logic, when exchange control is removed, any premium paid for rand hedges must fall away.

The issue for us is whether the exchange control system gave particular advantages to the groups themselves as compared to their more focused rivals. All the groups have significant off-shore holdings, some of which predate exchange control. For example, the offshore diamond production and distribution interests of De Beers and the 61% holding of Richemont in Rothmans, the international tobacco company, have clearly been of advantage to them. Besides its over 30% stake in the De Beers mining company, Anglo also has a major stake in Minorca, a London-based international mining house that currently generates about 10% of Anglo's reported earnings. Richemont is a Swiss-registered company that receives all of its income offshore. Barlows, Liberty, and Gencor have all built up significant offshore holdings in recent years.

The ability of South African companies generally to make successful overseas investments and manage exchange risk has represented part of the value created for their shareholders. It has also, however, been an essential component of doing business in South Africa. Thus it is difficult to see why an end to the need to manage exchange control, or exchange rate risk itself, should either harm or help group-like structures. Good shareholder control is presumably as valuable when firms are subject to exchange control as when they are free of it.

When South Africa companies and investors are freed of exchange control, domestic residents and institutional investors will have direct alternatives to the rand hedges found on the JSE and any rand hedge premium that now exists will fall away.

28. Barr and Kantor (1994a), cited earlier.

The South African institutional asset manager may also become less important as foreign investors are attracted to the market and South African wealth is repatriated. These investors will tend to seek what South African-domiciled savers will try and avoid—namely, South African-specific risk. The net weight exercised by the different investor constituencies will in turn influence relative values on the capital market. South African entrepreneurs and managers will be required to respond to such shifts in values in ways that serve the interests of their shareholders. How well they do so will depend on their capabilities as managers and as the controllers of managers.

All South African corporations, including the groups, will have more freedom to diversify internationally in the absence of exchange control. The opportunity to diversify internationally is likely to encourage a more focused, less conglomerate structure for large South African corporations, including those under close control. For controlling shareholders, reducing their country risk may become a higher priority than reducing their industry-specific risk. Non-controlling shareholders may well benefit from such tendencies; that is, the trade-off of diversification they have generally been required to make in the past for participation of the controlling shareholder may turn out to be a smaller one in the future. The advantages of good control for all shareholders can certainly be exercised within a less diversified structure.

HISTORY REPEATING ITSELF

The group system in South Africa, which has its origins in the development of the South African gold fields at the turn of the century, is perhaps the central feature of South African capitalism.[29] It has survived apartheid and appears to be capable of surviving in the democratic, post-apartheid era. There was a time when Afrikaans nationalism regarded the groups with enormous hostility as rival and unfriendly sources of power that threatened the Afrikaner and his state.[30] The Afrikaner learned to live with the groups and even formed at least two powerful groups strongly identified with Afrikaners.

It now looks very much as if history is being allowed to repeat itself. A few black-African controlled groups have already made their appearance on the JSE with the encouragement of established interests. New African Investment Limited (NAIL) provides a good example. NAIL is controlled by a consortium of well-known black-African business personalities, including Dr. Nthtato Motlana (who is also a director of Anglo-American). NAIL acquired from Sanlam and others a number of somewhat diverse and listed operating companies, the most significant of which was a 30% holding in a listed life assurance company, Metlife. The finance to pay for these acquisitions was raised from the established groups and banks through share and debt issues.

Control of NAIL has been secured by means of a listed pyramided holding company, Corporate Africa Limited (Corpaf). The controlling interest in Corpaf is in turn held by an unlisted company CAI, which owns 63% of Corpaf, which holds 51% of NAIL. CAH, another unlisted company, in turn holds 79% of CAI. The major shareholder in CAH, with a 40% shareholding, is N H Motlana and Sons (Proprietary) Limited. The unlisted N H Motlana and Sons is reported as being controlled by Dr. Motlana with a 60% interest. In this way, the ultimate controller of NAIL, Dr. Motlana, exercises control over NAIL with just a 6.1% claim on the dividends.[31] This clearly is a potent form of black-African empowerment.[32] The progress of this group, and the quality of control exercised on its behalf, will be watched with great interest by the non-controlling institutional investors.

A potentially more important development has occurred very recently, with the unbundling into three parts of JCI, the mining house controlled by Anglo-American. The intention to unbundle JCI and to invite black participation was announced in March 1994. Special enabling tax legislation was passed by the South African parliament in November 1994, with the final details announced in February 1995. The three groups to be spun off from JCI are, first, Anglo American Platinum Company (Amplats), which will hold platinum and unlisted diamond interests; Amplats will continue to be controlled by Anglo-American. The second company will be a new JCI Limited; this company will hold what were the old JCI's interests

29. See T. Gregory, *Ernest Oppenheimer and the Economic Development of Southern Africa* (Oxford University Press, Cape Town, 1962).

30. See H.F. Kenney, *Power Pride and Prejudice: The Years of Afrikaner Nationalist Rule in South Africa* (Jonathan Ball, 1991).

31. 6.09% = (.60 * .40 * .79 * .63 * .51)/100.

32. The details of NAIL and its structure are to be found in the pre-listing prospectus issued by the holding company CAF. This may be found in Business Day, 11th October 1994.

The opportunity to diversify internationally is likely to encourage a more focused, less conglomerate structure for large South African corporations, including those under close control. For controlling shareholders, reducing their country risk may become a higher priority than reducing their industry-specific risk.

in gold, coal, ferrochrome, and base metals, as well as 10% of Johnson Matthey PLC, a 10% holding in Amplats, and an unspecified interest in De Beers Diamond Mining Company. Black participation in this large new company with a projected net asset value of R6,4bn. ($1.8 billion) is being actively sought, and Anglo-American intends to give up its control of this company. The third company to be spun off from the original JCI, for which black control is being sought, has been named Johnnies Industrial Corporation Limited. It will hold what were JCI's interests in property, media, motor, food, beverages (including what is an effective controlling interest in SAB), and other unspecified industrial interests. This company had a net asset value of R6,9bn. (about $2 billion) at the beginning of 1995.[33]

Clearly, interest in the group structure—and more particularly in close control—will no longer be one identified only with South African whites. It is also becoming clear that, as the opportunities that such a system provides for the ANC's constituency have become apparent, its previous hostility to the group system has begun to moderate.[34]

CONCLUSION

A central problem of modern capitalism is the potential loss of control over managers and the resulting sub-optimal use of resources that can occur when the rights of ownership are widely dispersed among shareholders who lack either the knowledge or the incentive to discipline management. As we argue in this paper, concentrating control with an influential minority of shareholders may be an answer to this problem. Nevertheless, such arrangements introduce their own kinds of agent-principal problems—problems that have to be addressed if systems of concentrated shareholder control are to survive.

It would seem that in countries where barriers to group formation are not erected by governments, such groups, or group-like structures, play an important role in the economy. The group system in South Africa that at once allows control to be concentrated and wealth to be diversified is in large measure an outcome of the competition for capital and managers. The process of group creation and development should therefore generally be tolerated rather than threatened by hostile regulation. The appropriate threats to established interests and institutional arrangements in South Africa and elsewhere should be allowed to come from financial innovations that are neither restrained nor aided by financial regulations. In practice, such interventionist regulatory initiatives tend to have some predetermined, usually politically-motivated, sense of an appropriate structure for governing corporations.

Conglomerates and groups may work for some wealth owners in some settings at some points in time. There should be no predisposition in favor or against them. The best governed corporations are those that by definition survive the "market test." The best policy is to ensure that the barriers to competition—including competition among different corporate structures and governance systems—are kept at a low level.

33. Details of these arrangements may be found in a statement published by JCI in the the Cape Times, February 27th, 1995.

34. 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, Ready to Govern, Economic Policy Guidelines, Johannesburg (1992)).

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