Studies in Financial Systems

No 15

The South African Financial System

Edited by Seeraj Mohamed

With contributions by
Rex McKenzie, Gerald Ndonwi Mfongeh, Seeraj Mohamed, Phumzile Ncube and Ilan Strauss

ISSN: ###
The South African Financial System

Edited by Seeraj Mohamed

With contributions by Rex McKenzie, Gerald Ndonwi Mfongeh, Seeraj Mohamed, Phumzile Ncube and Ilan Strauss

Affiliation of Authors: Corporate Strategy and Industrial Development Research Programme, University of the Witwatersrand, Johannesburg
(http://www.wits.ac.za/csid/16126/csid.html)

Key words: South Africa, financialisation, financial sector, banking, inequality, financial and economic crisis, competition, efficiency, capital flows, history, regulation of banking and finance

Journal of Economic Literature classification: E44, E50, G01, G20, G28, G34, G38, N27

Contact details: Seeraj Mohamed, CSID, School of Economic and Business Sciences, University of the Witwatersrand, Private Bag 3, Wits 2050, Johannesburg, South Africa
Email: Seeraj.Mohamed@wits.ac.za

Acknowledgements:
The production of this report was supported by funding from the European Union Seventh Framework Programme (FP7/2007-2013) under grant agreement no 266800.

Website: www.fessud.eu
Preface

This report on the South African financial system is one of 15 studies of national financial systems undertaken as part of the research project Financialisation, Economy, Society and Sustainable Development (FESSUD) financed by the European Commission under the Seventh Framework Programme. The report presents a summary of the existing research and the most recent available data on the South African financial system within a framework that is broadly compatible with the studies undertaken in the other participating countries. The authors wish to acknowledge the invaluable contributions of Susan Newman and Samantha Ashman (Senior Researchers in the CSID) who made large contributions to the research, data collection and analyses within several chapters in this report. We also wish to thank Fatsani Banda, Mbuso Nkosi and Uyabongeka Walaza for their research support.
## Table of Contents

Preface........................................................................................................................................ 3
Table of Contents .......................................................................................................................... 4
List of Figures ............................................................................................................................ 8
1 The Political Economy of South Africa and its Interaction with Processes of Financialisation ........................................................................................................................ 11
  1.1 Introduction ................................................................................................................. 11
  1.2 Understanding the structural paradigm of the South African economy ....................... 16
  1.3 Big business and the Apartheid state ........................................................................... 19
  1.4 Post-apartheid South Africa and economic policy ...................................................... 21
  1.5 Conclusion: Post-Apartheid South Africa meets the wave of Financialisation .......... 24
2 Growth of Finance.............................................................................................................. 26
  2.1 Introduction ................................................................................................................. 26
  2.2 Share of Total Output ................................................................................................. 27
  2.3 Contributions to Employment ..................................................................................... 28
  2.4 Contributions to Capital Stock .................................................................................... 30
  2.5 Market Capitalisation of the South African Bank Sector ............................................ 32
  2.6 Structure of the Total Balance Sheet ........................................................................... 33
    2.6.1 Assets-Loans .................................................................................................... 33
    2.6.2 Bank Liabilities ................................................................................................. 36
  2.7 Conclusion................................................................................................................... 37
3 History and evolution of the structure of South African financial system ......................... 38
  3.1 Introduction ................................................................................................................. 38
  3.2 Measuring Concentration ............................................................................................ 38
  3.3 Imperial Domination ................................................................................................... 40
  3.4 English and Afrikaner Capital ..................................................................................... 41
  3.5 Key Pieces of Legislation:........................................................................................... 44
    3.5.1 Franszen – the importance of nationally owned banks ........................................ 45
    3.5.2 De Kock Commission Deregulation and Liberalisation ...................................... 46
  3.6 Mergers........................................................................................................................ 48
  3.7 Mergers across Corporate South Africa ...................................................................... 49
  3.8 Internationalisation of the South Africa Finance ......................................................... 50
  3.9 Foreign Banks ............................................................................................................. 52
  3.10 Structure by JSE Capitalisation................................................................................... 56
  3.11 Conclusion................................................................................................................. 59
4 Competition in the South Africa Banking Sector .................................................................. 61
  4.1 Background: Deregulation of the South African financial sector ................................. 61
4.2 The concentration of South Africa’s banking sector ........................................... 62
4.3 Interest rate spreads in South Africa ................................................................. 63
4.4 Competition in retail banking ........................................................................... 65
4.5 Competition in investment banking ................................................................. 66
4.6 Conclusion ....................................................................................................... 67
5 Profitability of South African Banks ..................................................................... 68
5.1 Introduction ..................................................................................................... 68
5.2 Components of Income .................................................................................. 69
5.3 Returns on Assets and Returns on Equity ....................................................... 70
5.4 Efficiency Ratios ............................................................................................ 71
5.5 Strategic and Emerging Issues in South Africa Banking ................................. 72
5.6 Income ........................................................................................................... 75
5.7 Retail Banking ................................................................................................ 75
5.8 The Business of Banking ................................................................................ 77
6 The Regulatory Framework .................................................................................. 80
6.1 Introduction ..................................................................................................... 80
6.2 The National Credit Act (NCA) of 2005 .......................................................... 81
   6.2.1 Why unsecured lending grew? ................................................................ 84
6.3 The Registrar of Banking and The Banks Act 94 of 1990 .............................. 85
6.4 Securitisation ................................................................................................ 86
6.5 Regulation of commercial paper (CP) issues .................................................. 88
6.6 Other legislation governing the financial sector .............................................. 89
   6.6.1 The South African Reserve Bank (SARB) Act 90 of 1989 ....................... 89
   6.6.2 The Mutual Bank Act 124 of 1993 .............................................................. 90
   6.6.3 National Payment System of South Africa Act 78 of 1998 ...................... 91
   6.6.4 The Financial Intelligence Centre Act 38 of 2001 .................................. 91
   6.6.5 The Financial Advisory and Intermediary Services (FAIS) Act 37 of 2002 91
   6.6.6 The Cooperative Bank Act of 2007 ........................................................ 91
6.7 The Financial Services Board (FSB) ............................................................... 92
6.8 Changes in regulation in response to the crisis ............................................... 96
6.9 Basel II implementation and effects ............................................................... 98
   6.9.1 Summary of bank supervision department annual report 2011 .............. 100
   6.9.2 Summary of changes made as at the end of 2011 as a result of Basel II ...... 101
7 The Relationship between Finance and other Sectors ......................................... 103
7.1 Introduction ................................................................................................... 103
7.2 Internationalisation ......................................................................................... 103
7.3 Size and growth ............................................................................................. 104
7.4 Conclusion ..................................................................................................... 104
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Plantation meets MEC: Political Economy of Culture in Financialised South Africa</td>
<td>106-114</td>
</tr>
<tr>
<td>8.1</td>
<td>Introduction</td>
<td>106</td>
</tr>
<tr>
<td>8.2</td>
<td>Patron Client Relations</td>
<td>111</td>
</tr>
<tr>
<td>8.3</td>
<td>Conclusion</td>
<td>114</td>
</tr>
<tr>
<td>9</td>
<td>Financialisation of Non-financial Corporations and Households: Empirical Evidence from the Sources and Uses of Funds</td>
<td>115-125</td>
</tr>
<tr>
<td>9.1</td>
<td>Introduction</td>
<td>115</td>
</tr>
<tr>
<td>9.2</td>
<td>Financialisation of NFCs</td>
<td>116</td>
</tr>
<tr>
<td>9.3</td>
<td>Financialisation of Households</td>
<td>122</td>
</tr>
<tr>
<td>9.4</td>
<td>Conclusion</td>
<td>125</td>
</tr>
<tr>
<td>10</td>
<td>Domestic Financial Deregulation and Financial Sector Growth since the 1980s</td>
<td>126-135</td>
</tr>
<tr>
<td>10.1</td>
<td>Introduction</td>
<td>126</td>
</tr>
<tr>
<td>10.2</td>
<td>The 1980s: Conglomerates and financial deregulation</td>
<td>127</td>
</tr>
<tr>
<td>10.3</td>
<td>The 1990s: Financialisation, restructuring and international integration of SA big business</td>
<td>128</td>
</tr>
<tr>
<td>10.4</td>
<td>Consequences of corporate restructuring and internationalisation</td>
<td>132</td>
</tr>
<tr>
<td>10.5</td>
<td>Conclusion</td>
<td>135</td>
</tr>
<tr>
<td>11</td>
<td>Privatisation in South Africa</td>
<td>136-145</td>
</tr>
<tr>
<td>11.1</td>
<td>Introduction</td>
<td>136</td>
</tr>
<tr>
<td>11.2</td>
<td>Background</td>
<td>138</td>
</tr>
<tr>
<td>11.3</td>
<td>Privatisation gives way to Marketisation</td>
<td>140</td>
</tr>
<tr>
<td>11.4</td>
<td>ASGISA, B-BBEE and the New Growth Path</td>
<td>143</td>
</tr>
<tr>
<td>11.5</td>
<td>Conclusion: wholly committed to a private-sector economy without privatisation</td>
<td>145</td>
</tr>
<tr>
<td>11.6</td>
<td>Appendix to Chapter 11: Privatisation under the ANC - a Timeline</td>
<td>148</td>
</tr>
<tr>
<td>11.6.1</td>
<td>1994</td>
<td>148</td>
</tr>
<tr>
<td>11.6.2</td>
<td>1995</td>
<td>149</td>
</tr>
<tr>
<td>11.6.3</td>
<td>1996</td>
<td>150</td>
</tr>
<tr>
<td>11.6.4</td>
<td>1999</td>
<td>151</td>
</tr>
<tr>
<td>11.6.5</td>
<td>2000</td>
<td>151</td>
</tr>
<tr>
<td>11.6.6</td>
<td>2001</td>
<td>152</td>
</tr>
<tr>
<td>11.6.7</td>
<td>2002</td>
<td>152</td>
</tr>
<tr>
<td>11.6.8</td>
<td>2003</td>
<td>153</td>
</tr>
<tr>
<td>11.6.9</td>
<td>2004-2012</td>
<td>153</td>
</tr>
<tr>
<td>12.1</td>
<td>Introduction</td>
<td>155</td>
</tr>
<tr>
<td>12.2</td>
<td>Government and the Central Bank’s mainstream views on the impact of the global financial crisis on South Africa</td>
<td>156</td>
</tr>
<tr>
<td>12.3</td>
<td>Alternative perspectives on the impact of the financial crisis</td>
<td>158</td>
</tr>
<tr>
<td>12.4</td>
<td>Conclusion</td>
<td>164</td>
</tr>
</tbody>
</table>
List of Figures and Tables

Figure 2.1: Share of total output - Finance and insurance .......................................................... 28
Figure 2.2: Finance and insurance contribution to employment .................................................. 29
Figure 2.3: Employment in service sector .................................................................................. 30
Figure 2.4: Change in fixed capital stock for all economic sectors from 1980 to 2010 (Real 2005 prices, Rmillion) ............................................................................................................. 31
Figure 2.5: 2008 Top 10 sectors by investment (as a % of total investment) ........................... 32
Figure 2.6: 2010 Top 10 sectors by investment (as a % of total investment) ........................... 32
Figure 2.7: Market capitalisation of the South African banking sector ..................................... 33
Figure 2.8: South African Banks types of assets percentage contribution to total assets 2011 35
Figure 2.9: South African Banks types of assets percentage contribution to total assets 2010 36
Figure 3.1: South Africa’s Registered Bank Sector ................................................................. 54
Figure 3.2: Shareholding in South African Bank Sector ............................................................ 56
Table 3.3: Summary of control of JSE market capitalisation (% of total) ............................... 58
Table 4.1: The Herfindahl Hirschman Index for the banking sector in South Africa................. 63
Table 4.2: South Africa’s repo rate and prime rate .................................................................. 64
Table 4.3: Interest rate spreads for South Africa, Botswana, Malaysia and Thailand .......... 65
Figure 5.1: Operating profits in the banking sector (R billion) .................................................. 68
Figure 5.2: Components of bank income (R billion) ................................................................ 69
Figure 5.3: ROE and ROA for the banking sector .................................................................... 70
Figure 5.4: Efficiency ratio of banks ......................................................................................... 72
Figure 5.5: 2005 Profitability of Segment ................................................................................. 74
Figure 5.6: Profitability of Segment ......................................................................................... 74
Figure 5.7: Non Interest Income .............................................................................................. 75
Figure 5.8: ABSA/Nedcor ROAE and Cost to Income ............................................................. 76
Figure 5.9: ABSA/Nedcor Bank Segment ROAE and Cost to Income ................................. 76
Figure 5.10: Return on Equity by sector: 1993-2011 ............................................................... 77
Table 5.6: The Business of Banking in South Africa ............................................................... 78
Table 6.1: Selected Financial sector Regulators ....................................................................... 95
Figure 6.2: The Present Regulatory Framework in South Africa ............................................. 96
Figure 9.1: Financial assets as a percentage of fixed capital stock for non-financial corporations in South Africa: 1970-2010 ................................................................. 117
Figure 9.2: Amounts receivable as a percentage of internal funds for non-financial corporations in South Africa: 1970-2010 ................................................................. 117
Figure 9.3: Net annual capital formation, acquisition of financial assets and financial investment by non-financial corporations in South Africa: 1970-2010 .......................... 119
Figure 15.4: Saving to disposable income of households ...................................................... 196
Figure 15.5: Gross Domestic Savings to GDP ....................................................................... 197
Figure 15.6: Household Assets/Liabilities, 1975-2011 .......................................................... 198
Figure 15.7: Composition of Household Assets, 1975-2011 ................................................. 199
Figure 15.8: Foreign debt to GDP ratio.................................................................................. 200
1 The Political Economy of South Africa and its Interaction with Processes of Financialisation

Rex McKenzie and Seeraj Mohamed

1.1 Introduction

South Africa is an unequal society; arguably it is more unequal today (in democratic South Africa) than it was during its heinous apartheid period, it vies with Brazil for the dubious honour of being the most unequal society in the world with a Gini coefficient of 0.7. As Palma (2011, 145), observes; “Particular circumstances give rise to a specific institution which then persists even though the circumstances that brought it about change.” This is very much the case in present day South Africa. Whether it is apartheid or democratic, the type of capitalism experienced by South Africa has reproduced deep inequality\(^1\). This introduction identifies and discusses the structural features of the political economy that gives the country’s economic system its orientation, particularly in light of the growing liberalisation of financial markets.

A number of continuities emerge from one period to the other; among them is the interconnection between state and capital. Just as Afrikaner government married the state to capital in an attempt to shore up apartheid, the democratic period is marked by the use of state owned enterprises to empower a small group of black South Africans. Obvious and inevitable questions surround the use of state apparatus to create privilege or strengthen particular groups of capital. Irrespective of how this is ultimately resolved, the continuity exists and both forms produce and reproduce huge inequality. In review of this nature, inevitable questions arise on the character of the state and the state’s relationship with the market.

Finance has been central to the development of the extraordinarily unequal South African economy since its time as a colony, during the apartheid era (1948 – 1993) and during the post-apartheid period. The South African financial system was shaped by South Africa’s specific history and in turn had an important role in shaping the economy. This introduction begins with some history at the discovery of diamonds and gold in South Africa. These discoveries and the growth of mining transformed the politics and economy of the country.

\(^1\) In Palma’s study of inequality only Latin America has a comparable inequality experience.
The South African mining industry was closely linked with British, broader European and US financial institutions since the Nineteenth Century.

The discovery of diamonds in the 1830s and the subsequent consolidation of the diamond mines led to growth of the financial system. It entrenched the dominant of the imperial banks in South Africa. It expanded the space for development of publicly listed companies and growth of stock market activities. The space for European and US financiers, institutional investors and speculators increased. The first financial crisis in South Africa occurred soon after the discovery of diamonds (Innes, 1984). The UK based banks, coordinated by the Rothschilds, intervened to stabilize the diamond market in the Cape. They provided capital for the consolidation of the diamond mining industry and market concentration that would control supply of diamonds. This capital supported the mining-finance houses that would dominate the South African economy through the Twentieth Century.

The mining-finance houses, according to Innes (1984), developed from the largest diamond mining companies of Kimberley to dominate and consolidate the gold mines of Pretoria-Witwatersrand-Vaal (PWV, which is now mostly part of the Gauteng Province) area. The mining-finance houses operated to ensure orderly and profitable mining operations. They provided financing, engineering and design support and other assistance to mining companies that operated under the umbrella of the mining-finance houses. They also built the first electricity infrastructure around the mines. When electricity demand around the mines grew, the mining-finance houses lobbied government to nationalize the electricity industry and to build a national electricity grid.

The success of the South African mining-finance houses was due to their links with banks and financiers in Britain and the US as well as the ability to raise capital in these foreign stock markets. In order for consolidation of the South African mining industry to occur the mining-finance houses, with their strong colonial ties, required Britain to deal with the government of the Zuid Afrikaanse Republiek that controlled the areas where gold was mined. The South African War of 1899-1902 (still often referred to as the Anglo-Boer War) brought the gold mining territories under British control. After the war the Union of South Africa was formed.

To understand the integral role of finance in the economic history of South Africa, we draw on the analysis of Fine and Rustomjee (1996), which describes the system of accumulation
that developed in South Africa as a minerals and energy complex (MEC). The mining finance houses in partnership with the state played a central role in the development of the South African economy during the first half of the Twentieth Century. The periods during the First World War and Second World War when there was a massive decline in trade between South African economy and the rest of the world were periods of large industrial expansion. The industries that developed were those that supported and serviced the mining industry and white consumers. The development of a state iron and steel company and a state industrial bank to support South African industrialisation occurred during the 1940s. However, it was the development during the 1950s of the Free State Goldfields that set the future trajectory of the economy and served to further entrench big business and state interests around mining.

The industrialization of the 1930s and 1940s led to pressure by industrialists on the Government to shift away from the migrant labour system that served the mining industry so well to allow urbanization and permanent urban settlement of black South Africans. There was also pressure to allow black people to do jobs reserved for white workers. The victory of the National Party in 1948 and their introduction of apartheid as a system was a response to these pressures. The Afrikaner nationalist movement was an alliance of Afrikaner finance, business, agriculture and workers. They wanted to limit the movement of black people to the 13% of the country set aside for black people in the 1913 Land Act and maintain tight control over what they saw as ‘white South Africa’. The mining-finance houses built the migrant labour system to benefit from the creation of the cheap labour reserves of black people. The development of the Free State gold fields was deliberately labour intensive to profit from growing the migrant labour system, this system was based on the idea that black migrant mineworkers could be paid a low wage because they did not have families to support. Their families were believed to be living off the land in the tribal reserves.

Eleven new mines were built in the Free State during the 1950s. There was state investment in new infrastructure and building of whole new towns around the new mines. World Bank loans were issued and the state used their National Financial Corporation to support and fund the new Free State mining operations. The first South African merchant bank was set up by the Anglo American Corporation (AAC), the major mining-finance house. Profits from the new mines and capital from state and private financial institutions supported expansion of mining into different minerals products and supported massive investments in minerals processing.

---

By the 1970s the state was involved in such a large expansion of the electricity industry that during the 1980s public debt was well over 80% of South Africa’s total debt.

During the 1970s the apartheid state and South African big business was faced with several problems that affected economic growth and profits. The international context was one of declining global demand and deregulation of financial markets. There was increasing international opposition to apartheid from the 1960s with Japan the first country to disinvest from South Africa at that time. However, the political groups, such as the African National Congress, had been largely dealt with during the repression, jailing of political leaders such as Nelson Mandela and bannings of liberation movements during the 1960s. From the 1970s and through the 1980s it was student organizations and trade union that led the struggle against apartheid. The Sharpeville massacre in 1960 and police killings during the Soweto student uprising in 1976 increased pressure for international isolation of the apartheid state and business. The domestic picture was one of increasing industrial action and strikes by the growing black trade unions and growing opposition to apartheid by national black student movements.

The 1970s were to see the end of the large-scale state and private investments in mining and energy projects. The end of the Bretton Woods arrangements, particularly the peg of the gold price to the dollar was to have a huge impact on South Africa. These developments led to a large increase in profitability in gold mining as the gold price increased. By 1980, the impact of the oil crises and growing global liquidity because of petrodollars led to a spike in the gold price and South African GDP growth. However, this increase in the gold price did not last long. The effect of the spike in gold prices and a surge in short-term bank lending to South Africa during the early-1980s meant that South Africa had a debt crisis in 1985 and the apartheid government had to call a debt stand-still. The attempts by the apartheid government to follow financial deregulation in the US, Europe, Australia and New Zealand contributed to the financial problems during the mid-1980s. Increased international isolation and domestic mobilisation against apartheid by student, community and trade unions during the 1980s also had a negative impact on the financial system and economic growth.

The unbanning of the liberation movements in 1990, including the ANC, was met with mixed feelings by big business. On the one hand, they had benefited from the rising gold price of the 1980s and stabilized the economy by buying the businesses of foreign companies disinvesting from South Africa. On the other hand, they were faced with a situation of growing political
instability and international pressure to support democratic change. The largest corporations had become diversified conglomerates during the post-WWII period and this conglomerate intensified during the 1980s when they were buying the assets of divesting companies. The large mining corporations now had financial institutions, industrial businesses and services within their groups. There was also a large measure of cross-holding between financial and non-financial groups.

Therefore, South Africa entered the 1990s with an economy centered on the MEC with a relatively undiversified industrial base and infrastructure skewed towards supporting mining and minerals businesses. The large mining, minerals and energy investments were made and while there were high levels of mergers and acquisitions, much linked to divestment, new investments were eschewed during the 1980s and 1990s. The economy was very concentrated and the largest groups, including state-owned businesses reduced investment in real terms from 1980s until the mid-1990s.

The South African economy received growing and large levels of short-term portfolio flows as a result of the increased liquidity in global financial markets. Mohamed (2010) argues that this increase in short-term capital shifted the economy onto a growth path driven by increased debt-driven consumption and financial speculation. The short-term flows were associated with large increases in credit extension to the private sector, which was not used for increased investment in the productive sectors but increased investment in services sectors benefiting from debt-driven consumption and speculation in financial and real estate markets.

At the same time, some of the large South African corporations shifted their primary listings abroad and became de facto foreign investors in South Africa. This shift led to a situation where the largest corporations that moved their listings abroad were the first to become financialised. This shift led to large-scale corporate restructuring as the largest corporations were pressured by the shareholder value movement to focus on core business, unbundle non-core businesses and simplify their corporate structures. Later the shareholder value movement played a larger role within South Africa, which increased financialisation of businesses not listed abroad. During this period of restructuring South African corporations, particularly mining and financial businesses became more internationalised, more focused on shareholder value, reduced their involvement in manufacturing, particularly manufacturing with few linkages to mining and minerals sectors. Non-financial corporations increased their holding of
financial assets and their financial assets grew more short-term in nature. Finance grew to become the largest sector of the economy in terms of contribution to GDP.

1.2 Understanding the structural paradigm of the South African economy

The explanation for the country’s inequality, its whole trajectory through history lies in its origins as what Fine and Rustomjee (1996) call the Minerals Energy Complex (MEC). The MEC is a “core set of industrial sectors which exhibit very strong linkages with each other and relatively weaker linkages with other sectors…” (ibid., 91). These core sectors were primarily founded on the back of the extractive mining sector, and the energy sector. Some types of manufacturing, security, transport and a domestic sector that serves the needs of the workers and managers, are all joined at the core. Further, the mining, energy, the financial sectors and the state “… are bound together through the functioning of the MEC” (ibid., 10).

Beyond these core relationships, the MEC functions as system of accumulation that continues to, “give rise to a much wider range of economic, as well as of political and social phenomena. … [T]he MEC is not to be seen merely as a core set of industries and institutions but also as a system of accumulation and one that has varied over time” (ibid.). In this sense, the model is primarily a historical/institutional one of a system of accumulation with several layers of history that may change the appearance or form, but its substance rests in the ability to reproduce massive inequality from epoch to epoch.

The pattern was established towards the end of the 19th century when in 1888 Cecil Rhodes’ DeBeers completed what Chabane et al. (2006), call the “amalgamation” of the diamond industry. De Beers Consolidated Mines was born out of an intense competition between the Barnato brothers and Cecil Rhodes. Ever since the gold and diamond rush of the 1870s, both Rhodes and the Barnato’s sought to buy out as many competitors as possible so as to consolidate market share. De Beers Mines was formed after Rhodes bought the Barnato Mining Company from the brothers in a transaction that confirmed Rhodes’ De Beers as the dominant firm in the industry.

---

3 The authors provide a historical analysis of South Africa’s industrialization to show the development and operation of the MEC as a system of accumulation and to explain why big business has limited their diversification out of the MEC.
In 1917, Anglo-American Corporation (AAC) was founded by Ernest Oppenheimer. Capital for its formation came from Britain, the US, and South Africa. The company aimed to exploit the gold mining potential of the East Rand. In 1924, Oppenheimer made AAC the largest single shareholder in De Beers and established a cross-holding linking the two companies in 1929. Corporate structure has evolved around the MEC core. Mining, especially deep mining lends itself to enormous economies of scale and it was these economies of scale that led to a concentration of ownership: “Out of 576 gold mining companies floated on the Rand during 1887-1932…only 57 remained in existence in 1932… The 57 gold mining companies in existence in 1932 were, with some minor exceptions, controlled by six finance houses or groups” (Fine and Rustomjee, 1996, 98).

The giant conglomerates that grew out of the mining houses were able to use their financial and managerial strengths to invest in large energy intensive projects with long lead times. In this way, they invested a part of their huge profits in building a minerals’ processing sector that drew on South Africa’s comparative advantage in the mining of a range of minerals. The focus of the conglomerates centered on the minerals to the exclusion of all other sectors. Mining, minerals processing and finance dominated economic activity and other sectors were for the most part neglected (Innes, 1984, in Mohamed, 2009).

By the early 1930s, AAC’s 1929 cross listing of companies with DeBeers secured dominance within the mining industry. Starting with Rhodes’ amalgamation, mining has evolved as a highly concentrated sector. Oppenheimer’s AAC competed with five other mining companies. According to Chabane et al (2006), “the (limited) backward linkages created by the mining industry and the demand for consumer goods generated by white wage earners provided a stimulus for industrial development”. According to the authors, it was at this point the mining houses saw the opportunity for diversification into related activities. The mining houses diversified into explosives and mining equipment, banking, industrial commodities (steel, paper, and chemicals), engineering, and consumer goods (including beer and furniture). By the end of this process each mining house had its own financial arm and it is here that Innes (1984, in Mohamed, 2009) argues that productive capital and financial capital were in effect married. O’Meara (1983), reports that this model was to define Afrikaner capital for some considerable time thereafter.

---

4 This type of cross listing that connects companies in an intricate web of shareholdings was the *sine qua non* of corporate South Africa up until the corporate unbundling and re-bundling of the 1990s.

5 See for example, Innes (1984) description of Anglo American’s development of the Highveld Steel and Vanadium Corporation and their push to build a dominant presence in international specialized steel markets.
In terms of the development of capitalism in South Africa, competition for economic power between English capital and the Afrikaner nationalist movement drove the system until the eventual “partial” erosion of the divide in the 1970s. This competition meant that the Afrikaner nationalist movement embarked on a process of developing large corporations, especially financial institutions, able to compete with English capital. The result was oligopolistic control not only over the MEC but many other sectors as well. The structure of big business corporations that dominate the economy today was influenced by the relationship between English capital and the Afrikaner nationalist movement. In addition, many investment choices that contributed to the structure of the economy, which are still present today, were influenced by the competition between English capital and the Afrikaner nationalist movement.

By the early-1980s the major projects of the MEC were complete and large-scale state investment ended. “Since there was no structural or institutional basis laid down to diversify into non-MEC sectors, the latter declined according to the fortunes of the MEC, except for some subsectors driven by military and mega-project expenditure, whose buoyancy was prolonged until the late 1980s” (Fine and Rustomjee, 1996, 174).

This economic structure remains largely in place within the South African economy today. As a result of this history, modern South Africa was inserted into the international division of labour to provide raw materials and slightly beneficiated inputs for the manufacturing industries of metropolitan countries. In more recent times big business has used its oligopoly power in the domestic economy to dominate profitable downstream manufacturing and service businesses, such as in telecommunications. Like most other suppliers of primary products there is no deepening of the country’s industrialization and no particular improvement in international competitiveness. The big businesses that dominate South African markets get most of the technology used in production from overseas. Likewise business in South Africa is reliant for innovation and change on the metropolitan centres. Instead of developing domestic know-how and capabilities business uses its oligopoly position to extract monopoly rents (Mohamed, 2010).

---

6 The competition between English and Afrikaner capital was partly eroded by cooperation between the apartheid state and English capital in order to make huge investments in infrastructure and mines to develop the Orange Free State Gold Fields (Mohamed, 2009).

7 For example, the dominant role of finance today can be linked back to the decision by the Afrikaner nationalist movement to challenge the dominance of English capital by setting up Afrikaner controlled financial institutions to allocate capital towards building stronger Afrikaner businesses (ibid.).
1.3 Big business and the Apartheid state

By the 1970s South Africa’s big businesses had significantly reduced its investment in South Africa. Also during the 1970s, the state continued bolstering the MEC through direct investments in new electricity generation and by the expansion of gas from coal by building Sasol II and Sasol III.

During the period, there was an “extraordinary politicization” of the business sector (Terreblanche, 2002). Thus, during the 1980s there was such an interweaving of business with government interests that business was represented on apartheid state security structures, “including during successive states of emergency when state repression was most severe” (Mohamed, 2009). This relationship continued through to the democratic elections. Through these security structures big business developed a close relationship with the apartheid government’s “securocrats”\(^8\). According to Terreblanche (2002), business cooperated with government to develop a “total strategy” to counteract the “total onslaught” against white minority rule. The rhetoric of the “total strategy” was anti-communist and it was a combination of repression and reform. Terreblanche (ibid., 74) states:

“The new working relationship between business and government was sealed at the Carlton and Goodhope conferences in 1979 and 1981. At those conferences the corporate sector was given an institutionalized role, within the reorganized state sector, of formulating and implementing ‘free market’ economic policies. Ever since this politicisation took place, the corporate sector has regarded an active role in political decision making as its birthright.”

Through the dominant business organizations big business proposed reforms that would give the apartheid government more control over black people’s entry into the political system. According to Mohamed (ibid.), what united the two (big business and the Nationalist Party government) was the abhorrence of black majority rule. The high levels of capital flight after the 1994 democratic elections,\(^9\) the offshore listings of major corporations and calls for

---

\(^8\) Speculatively one can connect the explosion of private security firms which comes from a legacy bequeathed by securocrats.

\(^9\) See Mohamed and Finnoff (2005) and Ashman et al. (2010).
financial deregulation are all strategies with which South African big business’s fought back and reorganized as a result of a seeming loss of power. All were designed to locate the control of economic resources away from the new black African government.

International sanctions in the 1980’s confirmed South Africa’s status as a pariah state. The sanctions hit hard; the country’s parastatals were all hit by loan calls and as a result government was forced to seek sales for some parts of the state apparatus in order to replenish state coffers. Many institutional investors divested from South Africa and South African firms overseas were boycotted as were South African exports. Further the anti-apartheid movement in many developed countries forced an increasing number of foreign companies to withdraw from South Africa.

In response South African big business bought up the divested companies. Some were bought because they were good deals and others were bought to prop up the ailing apartheid economy but in either case this was defensive buying or defensive restructuring motivated by the hostile actions of the outside world.

Capital flight (a perennial feature) slowed during the 1980s as companies used their resources to fill the gap left by foreigners (Mohamed and Finnoff, 2005). The need to support a limping apartheid behemoth came to an end after the democratic elections in 1994. Thereafter business generally sold off many of the assets they had purchased in defence of the apartheid system. Thus if the restructuring of the 1980s was defensive and aimed to shore up the apartheid system, that of the 1990s was more aggressive in that it aimed to create leaner fitter companies that concentrated on core processes and products at home, while looking outwards. The restructuring of the 1980s created diversified conglomerates, which increased their stake in the South African economy at a time when foreign companies were disinvesting. In the 1990s South African corporations focused on core businesses that centred on MEC core sectors. Importantly and simultaneously, many of the large corporations moved their primary listing offshore and others merged with equally large corporations of other countries. In the context of the apartheid struggle this move can be seen as the fulfillment of the determination to deprive the ANC any control over of economic resources.

---

10 A good example would be-the formation of BHP Billiton and SAB Miller.
11 According to Fine and Rustomjee, 1996 privatisation was rightly viewed by the ANC, as a manoeuvre by the Nationalist Party aimed at denying black African ANC control over economic resources.
The behaviour of the companies is not hard to understand. Capitalist firms will act in order to maintain profitability. So it was in South Africa – big business supported the apartheid government. Terreblanche (2002, 374, in Mohamed 2009), commenting on the period supports the view that business supported the apartheid regime and speculates that big business was unwilling to oppose apartheid openly because it was “far more convenient and more profitable to share in the ‘spoils of government”

Mohamed (ibid.) (quoting Nattrass, 1990), also supports the view of a tight and close relationship between the apartheid government and big business. Again the motivation is taken to be large profits. “However, in order to maintain those large profits – and to secure a more orderly reform of the political system – big business had to buoy up the apartheid economy and may have invested in a number of sectors where they had no long-term ambitions during the disinvestment and sanctions era” (Mohamed, 2009).

1.4 Post-apartheid South Africa and economic policy

When the ANC came to power in 1994 a handful of closely held interwoven conglomerates operating in an oligopolistic setting (with little regulation) comprised the private sector. From the apartheid government the new democratic South Africa inherited well over 300 state owned enterprises with fifty percent or more of the fixed capital being held by the state. The government owned the electric company, the telephone company, the national airline, the arms industry, the railroads, buses, ports, hospitals and the national broadcaster. According to Newman (2009):

“The ANC government inherited an economy with an industrial structure in which the majority were excluded from participating in economic activities. Manufacturing sectors were concentrated around highly capital intensive industries with insufficient capacity to soak up the large population of the black unemployed who had been previously excluded from the economy. Rather than orienting economic policies to the task of the massive structural transformation necessary to address the highly concentrated patterns of ownership in industry, and the structural causes of extremely high

---

12 Mohamed (ibid.) goes on, “This point by Nattrass is interesting because it could help explain why certain industries were allowed to decline during the 1990s. The 1980s were marked by growth in diversified conglomerates. By the 1990s, influenced by the demands of the global shareholder value movement, many of these diversified conglomerates had restructured to focus on activities they defined as core businesses.”
unemployment amongst the black population, the ANC government concentrated on macroeconomic stabilisation and liberalisation policies in tune with the fashion of economic policy in the industrial nations of Europe and North America.”

The ANC in Government has displayed an abiding commitment to correcting the historical wrongs meted out to historically disadvantaged groups. After 1994 this has become construed by the ANC as Black Economic Empowerment (BEE). In this way South Africa is conducting one of the larger social experiments of its kind in the world today – the creation of a black middle class. At the same time, actual economic policies of the new government were in short supply. The closest approximation was set out in the 1994 Reconstruction and Development Programme (RDP). According to Newman (2009):

“The policies under RDP consisted of a set of goals rather than a policy strategy proper. It focused on increasing the growth rate as an end goal with no consideration on industrial structure or its transformation. The route to increased growth rates lay in increasing the rate of investment that would result in a more equal distribution of income and wealth. RDP contained very little in terms of the specific types of policy and government intervention necessary to meet these goals” (ibid.).

The RDP document envisaged a *developmental state* with big roles for government and the private sector along the lines of some of the Asian Tigers. In actuality what has emerged is a state that is developmental but is developmental in a very restrictive sense along the lines of some of the states in Latin America in the 1970s.

By 1996, South Africa had been incorporated into the neoliberal order and from 1998 the ANC government recognised and approved the right of the big MEC companies to move capital out of South Africa and into overseas financial centres (London, New York, Geneva, Melbourne etc.). Residual controls that limit investors to 15% offshore investments remain, but the South African Reserve Bank's (SARB's) Voluntary Disclosure Programme (VDP) of July 2010 offering amnesty to corporations and individuals disclosing their illegal expatriation of capital is seen by the SARB, as a first step to the complete liberalisation of outflows (Ashman et al., 2011). This shift in policy has taken place alongside acute structural unemployment and declining domestic investment in the productive sectors of the economy.
Thus insofar as South Africa is concerned, neoliberalism has meant a financialisation process with a concomitant corporate restructuring where domestic macroeconomic policy is sacrificed at the altar of "haute finance," deepening inequalities and perpetuating the development of underdevelopment on the ground in the local arena (see Ashman et al., 2011). Indeed since the introduction of neoliberal policies in the country, the globalisation wave that had begun in the 1970s in the U.S and the U.K was at South Africa’s doorstep, in particular the liberalisation of international capital flows and more distinctly large volumes of highly volatile short-term capital flows (Herr, 2007). Context for this neo-liberal path was one where the weak economic structure dominated by the MEC was exacerbated by financialisation (Baloyi & Mohamed, 2012).

For instance, the 1996 “Growth, Employment and Redistribution” policy document signalled an ideological shift from a more radical posture to a seeming embrace of neoliberalism. Emphasis was placed on, “fiscal austerity, deficit reduction and pegging taxation and expenditure as fixed proportions of GDP” (Newman, ibid.). GEAR rolled out the typical neoliberal package over a five year period. Inflation targeting, deregulation of financial markets, tariff reduction, trade liberalisation and limiting government expenditure were all accorded priority status. There was within GEAR a clear commitment to a market driven economy that would earn the country a seal of approval from the Washington Consensus protagonists. Noticeably there was silence on the role of domestic conglomerates in growth and development13.

The neoliberal orientation continued through the Accelerated and Shared Growth Initiative for South Africa (ASGISA) of 2006. Importantly, ASGISA aimed at broadening the base of Black Economic Empowerment (BEE). It is through ASGISA that we see the full flowering of the ANC’s thinking on redressing historical inequalities. The intent was to promote the emergence of a black business class; most importantly the vehicle for delivery of this empowerment was identified—the state owned enterprises (SOE’s). But as GEAR became ASGISA and as ASGISA has given way to the New Growth Plan (2010), South Africa’s macroeconomic policy remains neoliberal in content and in orientation.

---

13 It took a while longer for the ANC to unearth and discover how to use the state apparatus to attain its objectives. See section 4.
1.5 Conclusion: Post-Apartheid South Africa meets the wave of Financialisation

The South African real economy has become financialised over the past three during the era of neo-liberal globalisation. The process of financialisation is associated with widespread adoption of neoliberal policies and led to increased deregulation of cross-border trade and financial flows. As mentioned earlier, South Africa’s economic growth path during the post-apartheid period was shaped by debt-driven consumption and speculation-fuelled growth of the financial system. Big businesses restructured to further internationalise their operations and acceded to the demands of the shareholder value movement to focus on achieving high short-term returns. Therefore, while Government was implementing what they understood to be business friendly, particularly finance friendly, economic policies, the largest corporations were unbundling their non-core assets in South Africa and shifting their resources so as to grow outside of South Africa. They were involved in unprecedented mergers and acquisitions that increased their international presence and further concentrated the South African economy.

The stated goal of Government’s economic policies was to reduce poverty, inequality and unemployment – legacies of colonialism and apartheid – that have not improved with democracy. Government has managed to curtail growth in poverty through programmes to improve access to basic services and increased welfare spending but unemployment and poverty has become worse since the end of apartheid. The high levels of inequality and unemployment increase social tensions, crime, and increasing political conflict, particularly local political actions that turn violent.

The government’s policies have not shifted the South Africa system of accumulation away from the MEC. The economic policies approved by South African big business were meant to be ‘credible’, market friendly and attractive of foreign investment. These policies supported financialisation and the growth of finance. They hurt the productive sectors of the economy and supported the growth and influence of finance. The beneficiaries of apartheid and a small emerging black middle class have for the most part benefited from policies that cater to the growing influence of finance. The inaccessibility of credit and financial services to a large part of the population and the growing “short-termism” in asset markets via the corporate-restructuring that speaks to the shareholder value principle, has meant that investment strategies have been short-term in nature (Herr, 2007) and thus has not supported growth of
the productive sectors but led to increased imports of consumer products. The small growth in aggregate demand has reflected this development. Indeed capital liberalization has exacerbated rather than improved the economic growth path of South Africa, predominantly caused by the floating nominal exchange rate that has put pressure on the value of the domestic currency and negatively affected the current account balance.

The increased volatility and correlation of commodities prices with trends in global financial asset prices poses real problems for the South African economy. The relatively uncontrolled movement of capital (most of it short-term flows) into South Africa as a result of liberalisation of cross-border capital flows causes the neo-liberal macroeconomic policies of the country (that focuses on consumer price inflation not asset price inflation) to be procyclical. Therefore, periods of increasing global liquidity and inflation in the value of financial assets could translate into increased short-term flows into South Africa at the same time as commodities prices increase. There could be more rapid growth of bubbles in financial asset markets (than seen in the 2003 to 2007 period) and potentially more severe crashes in these financial assets and equity prices (particularly commodities and financial equities). The volatility in commodities markets makes investment planning harder for mining companies and promotes a liquidity preference where speculation on price changes is more rewarding than long-term real investment in mines and expanding mining output. These developments do not favour investment and employment in mining but could further deepen financialisation of the South African economy.
2 Growth of Finance
Rex Mckenzie and Seeraj Mohamed

2.1 Introduction

This statistical review of the financial sector activity in South Africa covers the period 1980-2010. These are the financialisation years; financialisation in this review speaks to three interrelated processes associated with the global tendency for financial markets to play a larger and larger part in social and economic life:

1. The liberalisation of trade and capital controls.
2. The global tendency towards deregulation of markets and the closely associated rise of privatisation.
3. The increasing importance of financial innovation made possible by Black-Scholes and the explosion in information technology.

The De Kock Commission reports on banking and monetary policy (1979, 1982, 1985) (discussed in Section 3.5.2) proposed extensive liberalisation thus aligning South Africa with the then new global tendency towards marketisation and financialisation.

Starting with De Kock’s third report in 1985, interest rates were liberalised, the practice of directed credit and credit controls was discontinued. By 1994 barriers to entry to the financial sector were lifted and in 1995, South Africa abolished its dual exchange rate system, unified the rand exchange rates and removed capital controls on non-residents. In measuring the pace and depth of financialisation Ziad et al. (2008) find that the South African financial sector is the most financialised of the BRICS (Brazil, Russia, India, China and South Africa) countries.

According to the financial integration database developed by Schindler (2005), it is also more financialised than Korea, Turkey, Malaysia, Thailand, Singapore, Mexico or Poland. Rashid (2011) reports that in South Africa:

“Financial services accounted for over 21% of GDP in 2010 – the largest among the BRICS countries and other emerging economies...The financial services sector is, in fact, the single largest sector of the South African economy in terms of its contributions to GDP. Overall, the sector has grown twice as rapidly as the overall service sector and three times as fast as the manufacturing sector. He argues that,
“The size of the financial sector puts South Africa in the league of large financial centers – Jersey, Guernsey, Cayman Islands etc.”

Notwithstanding the fact that 37% of the population does not have a bank account (Finscope 2011), South Africa’s capital markets are large relative to GDP and significantly more liberalised than the other BRIC countries (Abiad et al 2008; Schindler 2009). Financial services (which includes finance, insurance and real estate) contribution to GDP has risen from 11% 1980 to 15% in 1990 to 21% in 2010. It is the single largest sector of the South African economy in terms of contribution to GDP and its growth has outstripped all other sectors (Ashman et al., forthcoming).

### 2.2 Share of Total Output

Finance’s contribution to total output has grown steadily from just over 2% in 1980, to 5.3% in 2010. This share reached its highest point in 2007 when the sector contributed 5.8% to total output. The decline thereafter is generally attributed to the Great Recession of 2008. Figure 2.1 (below) tells the story.
2.3 Contributions to Employment

Starting out at 0.8% in 1980, the sector’s contribution to employment grew to 2.08% in 2010. At its highest point in 2003, it had a marginally higher share - 2.3%. For example, the average rate of employment growth in financial services was 6.8% per year, compared to 0.5% for all economic sectors during 1980-2008.
Figure 2.2: Finance and insurance contribution to employment

Figure 2.3 (below) compares employment across the service industry. It shows that of the service sectors only communication contributes a lower employment contribution. They employed 176,000 people in 1990 and just over 255,000 in 2010. The highest number of people employed was 303,000 in 2003.
2.4 Contributions to Capital Stock

Figure 2.4 (below) shows that capital investment in the finance and insurance sector made a leading contribution to increasing the capital stock across all sectors. In 2010 new investment in stood at more than R175 billion, with only the government, business and transport sectors having higher aggregate fixed capital investment than the financial sector.
As a percentage of total investment across the top ten sectors of the economy finance recorded 12% and 10% share in 2008 and 2010 respectively. Only government, transport and business consistently record higher shares of total investment.
2.5 Market Capitalisation of the South African Bank Sector

The bank sector is well capitalized and has a tier 1 capital ratio of about 11%, much higher than the 4% required by Basel 3. Figure 2.4 below, shows consistently high capital to asset ratios, (always above 7) up until The Great Recession of 2008 when share prices declined. As a percentage of GDP, capitalization in the banking sector is also impressive standing at about
12% in 2010, a 4% increase from 2005. This made the sector the best ranked in the world in terms of its market capital to GDP contribution (World Bank, 2012).

**Figure 2.7: Market capitalisation of the South African banking sector**

Source: own calculations from the World Bank

### 2.6 Structure of the Total Balance Sheet

The total balance-sheet size of the banking sector relative to South Africa’s nominal GDP amounted to R3 409 billion or 110.5% of nominal GDP at the end of December 2011. The nominal GDP increased by 10.3% year on year to December 2011 from R3 126 billion (or 111.9% of nominal GDP). This represented a 9% year on year increase in total bank assets (SARB, Bank Supervision Department Report, 2011).

#### 2.6.1 Assets-Loans

---

14 World Development Indicators database of the World Bank
During 2011, loans and advances made up an average of 72.7% of total banking-sector assets. This represents a small year on year decline from 73.6% in 2010. Derivatives summed to R279 billion at the end of December 2011 and represented, on average, 7.7% of total banking-sector assets during the year (2010: 8.5%). The entire loan and advances category experienced growth. Derivatives held in the portfolio increased by R74 billion in September 2011 as a result of mark-to-market adjustments on foreign-exchange derivatives. Investment and trading securities, as a percentage of total banking-sector assets, increased from an average of 6.7% during 2010 to 7.3% during 2011. This increase was mainly due to an increase in the holding of government securities by banks (ibid.).

Home loans summed to approximately R823.6 billion (on average), during 2011. The growth in home loans remained anaemic in 2011 and slowed from 3.8% in December 2010 to 1.3% one year later. Notwithstanding this, it is notable that commercial mortgages increased from 4.3% in December 2010 to 5.4% over the year. In contrast, acute volatility characterised the “other loans” category in 2011. Other loans include, factoring accounts, trade bills, bankers’ acceptances redeemable preference shares, bank intra group balances, loans granted/deposits placed under resale agreements, and still yet “other” loans. This category increased on aggregate from R517 billion in December 2010 to R580 billion at the end of December 2011 but experienced volatility in its components, ranging from minus 4.1% to positive 12%.

As of December 2011 term loans increased by 23.1% to R437 from: R355 billion a year earlier. The increase is attributed to an expansion in term loans to corporate and other banks during the second half of the year. Overdrafts increased by 14.8% at the end of December after a negative 9.2% decline in 2010. During the same period the growth in credit cards, and lease and installment debtors increased and amounted to 9.6% and 7.0% respectively. The comparable figures for December 2010 were 1.5% and 2.1% respectively.

During 2011, banking-book assets accounted for 86.7% of total banking-sector assets reflecting a marginal increase from 85.9% reported during 2010.

As a percentage of total gross loans and advances, home loans declined from 35.3% in December 2010 to 32.9% one year later. Term loans, as a percentage of gross loans and advances, "increased by over 200 basis points from 15.3% as at December 2010 to 17.4% in December 2011” (ibid.).
Loans and advances to banks, increased by 11.8% to R265 billion at the end of 2011 from the 2010 amount of R237 billion. This means that in percentage terms of gross loans and advances, the ratio of loans to banks increased marginally from 10.3% in 2010 to 10.5% at the end of 2011.

According to the SARB Annual Supervision Report 2011, “Foreign-currency loans and advances increased significantly”. Expressed as a percentage of total assets, the ratio of foreign-currency loans and advances increased by 48.2% and in aggregate terms from R159 billion in 2010 to R235 billion at the end 2011. The SARB attributes, “the increase in deposits with, and advances to, foreign banks reported by large banks, and the devaluation in the exchange rate of the South African rand to the US dollar”. Relatedly, foreign-currency deposits and funding also increased from R119 billion at the end of 2010 to R142 billion in 2011. The ratio of foreign-currency deposits and foreign currency funding to total liabilities fluctuated between 3.9% and 4.9% during 2011. According to the SARB (2011, 62), “The relatively low ratio indicates that South African banks are not overly dependent on foreign funding and deposits”.

Figure 2.8: South African Banks types of assets percentage contribution to total assets 2011

Source: SARB
Figures 2.8 and 2.9 present the percentage breakdown of the asset side of the banks’ balance sheet for 2010 and 2011.

2.6.2 Bank Liabilities

The largest part of banking-sector liabilities are the deposits. Bank deposits have increased steadily over the period under investigation. The only exception being 2009 and that was most likely attributable to the impact of the global financial crisis on the sector. Starting at 275,000 in 2000, the sector now boasts some 2,500,000 deposits. At the end of 2011, deposits stood at R2 710 billion. Year on year between 2010 and 2011, deposits increased by 8.9% to 86.2% of all liabilities (rising from 85.8%).

The SARB (ibid., 63) observes that there was an increase in derivative financial instruments and other trading liabilities as a percentage of liabilities because of an increase in foreign-exchange derivative financial instruments.

The respective ratios measuring the banking sector’s gross asset and liability position in derivative financial instruments expressed as a percentage of equity attributable to equity holders increased considerably during the third quarter of 2011. However according to the SARB (ibid.), “... the ratios declined during the fourth quarter of 2011 as a result of an increase in equity attributable to equity holders, coupled with a decrease in the value of...
derivative financial instruments”. Nonetheless, the figures reveal that gross asset and liability positions were fairly matched throughout 2011 and the net mismatch between the ratios decreased to an average of 3.1 per from a 7.6% average in 2010.

Short-term debt instruments that qualify as regulatory capital remained relatively stable during 2011. The category recorded a R1 billion increase from R57 billion in 2010 R58 billion at the end of 2011.\(^\text{15}\)

The composition of banking-sector deposits remained relatively stable during the two years under review. Fixed and notice deposits make up the largest deposit class. These amounted to R838 billion at the end of December 2011 - an increase from R698 billion a year earlier. The main changes in the composition of deposits were first; an increase in fixed and notice deposits to 30.9% of total deposits at the end of December 2011, up from 28.1% at the end of 2010. And second a decrease in negotiable certificates of deposit from 18.0% of total deposits in 2010 to 14.0% in December 2011.

### 2.7 Conclusion

The foregoing review has shown that South Africa has large, deep and somewhat sophisticated financial markets. As a financial centre the country is deeply intertwined with international capitalism and is becoming more so. The empirical data in the foregoing sections confirm growth in size and scope. Notwithstanding this fact, 37% of the population remain without access to a bank account (Finscope 2011); much of what follows in this study explains this anomalous feature of the system as growth through inequality.

---

\(^\text{15}\) On average, 59.6% of term debt instruments qualified as regulatory capital during 2011 compared to 64.0% during 2010. In view of the Basel III framework’s focus on loss-absorbing capital instruments, banks have reduced their issuance of term debt instruments that qualify as regulatory capital.
3 History and evolution of the structure of South African financial system

Rex McKenzie

3.1 Introduction

The most obvious feature of South Africa’s corporate and financial life is its large size and concentration. The entire corporate structure of South Africa is characterised by this concentration and in what follows we explain this tendency as a product of South Africa’s historical development.

The pattern was established towards the end of the 19th century when in 1888 Cecil Rhodes’ DeBeers completed what Chabane et al. (2006) call the “amalgamation” of the diamond industry in the region. In 1917, Anglo-American Corporation (AAC) was founded by Ernest Oppenheimer. Capital for its formation came from Britain, the US, and South Africa. The company aimed to exploit the gold mining potential of the East Rand. In 1924, Oppenheimer made AAC the largest single shareholder in De Beers and established a cross-holding linking the two companies in 1929. This type of cross listing that connects companies in an intricate web of shareholdings was the *sine qua non* of corporate South Africa up until the corporate unbundling and re-bundling of the 1990s. The huge banking conglomerates are part of a larger conglomerate structure that has emerged from the unique circumstances of South Africa’s past. The rivalry and eventual interpenetration between Afrikaner and English capital played an important role in the historical evolution of the South African financial system. The Afrikaner nationalist movement and later the apartheid state were to contribute to the development of finance to support the growth of mining and related industries but also to support Afrikaner finance and the growth of Afrikaner business. The strength of mining and the nature of the conflict between Afrikaner and English capital shaped the response of Afrikaner nationalist movement. These factors contributed to the highly concentrated nature of the South African financial system.

3.2 Measuring Concentration

According to Okeahalam (2001), the number of firms that supply products in a market and the proportion of the market that each firm supplies determines concentration. Concentration in
turn is said to indicate the degree of competition to be found in an industry. For the South
African financial sector this is quantified (using an H-index).
According to the Falkena Report of 2004, “the concentration levels of the South African
banking industry are high, but not out of line with other emerging markets”. This we believe
is only half the story, in that it is not just the high levels of concentration in banking and
finance. It is the concentration in finance alongside very high levels of concentration across
the economy, in mining, energy and other sectors tied to the fact that South Africa is one of
the more financialised countries in the world that makes South Africa a fairly unique case.
The South Africa Reserve Bank (SARB) attributes the high level of concentration within its
system to the high concentration of banking assets among South Africa’s big four banks
(SARB, 2012, 55). The big four – Standard Bank, ABSA, First Rand Bank and Nedbank
account for just over 84% of aggregate banking assets in the system. 16
Concentration in the South African financial sector has its origins in three main influences
that are all historical:

1. The historical legacy of domination by a small number of large imperial banks
2. The struggle between English and Afrikaner capital
3. Statutory legislation that framed the operation of banks

In the rest of this paper we describe the part played by these three historical influences in the
formation and development of the corporate sector in South Africa. One recurrent theme
throughout the history is the relative position of foreign banks and domestic banks in the local
market place. We take up this theme and argue that the scale and extent of foreign bank
operations in South Africa is far greater than estimates provided by the local authorities. We
have found that the main vehicle in deepening the concentration of the sector has been the
merger. In later sections of the paper we lay out how the amalgamation by absorption
approach to expansion that has been a constant feature of the country’s business life comes
together with a merger frenzy in the late 1980s and the 1990s that succeeds in further
deepening concentration within banking, finance and industry. Last, we end with an analysis
of industry structure by Johannesburg Stock Exchange (JSE) capitalisation between 1994 and
2011.

16 If we include Investec as many writers are increasingly doing we in effect a “big five” that hold over 90%
share of total assets in the bank sector.
We find that a fair degree of continuity remains between the two periods. In terms of JSE capitalisation, the largest industrials (including mining), still account for six of the top 20 firms (including services). Continuity is also reflected in continued high levels of concentration within sectors. A large proportion of mergers have been vertical, increasing control of dominant firms through production chains. While this avoids the direct competition concerns of horizontal mergers, it realizes greater consolidation within industries.

### 3.3 Imperial Domination

One of the main influences in determining the structure of South African finance is the imperial legacy; British banks were an integral part of British imperialism in South Africa and as such they occupied dominant positions in the local economy since the 1860’s. Verhoef (2009) contends that the final domination of the British banks was complete when Barclays Bank acquired National Bank in 1926. She adds that notwithstanding the formation of Volksas Bank in 1934 and the expansion of the Netherlands Bank for South Africa, which represented growth of Afrikaner financial interests, the country’s banking sector was dominated by Standard Bank and by Barclays, which both had head offices in the United Kingdom, through to the 1970s. Both banks represented British interests back to the Cape Colony, and the banks operations and growth in South Africa followed the development of the diamond and gold mining industry. By 1910 the two owned and controlled over 90% of the total capital of banks in South Africa (Verhoef 2009). These factors were similar with regard to the development of the stock market and other financial institutions, whose development grew as a result of the interest of European and US institutional investors in the South African economy. These banks and financial institutions serviced the needs of the settler populations and businesses in South Africa.

By the early 1930s AAC’s 1929 cross listing of companies with DeBeers secured dominance within the mining industry. Starting with Rhodes’ amalgamation mining too had evolved as a highly concentrated sector. Oppenheimer’s AAC competed with five other mining companies. According to Chabane et al (2006), “the (limited) backward linkages created by the mining industry and the demand for consumer goods generated by white wage earners provided a stimulus for industrial development.” According to the authors, it was at this point the mining houses saw the opportunity for diversification into related activities. The mining houses diversified into explosives and mining equipment, banking, industrial commodities (steel,
paper, and chemicals), engineering, and consumer goods (including beer and furniture). By the end of this process the each mining house had its own financial arm and it is here that Innes (1984) argues that productive capital and financial capital were in effect married. O’Meara (1983), reports that this model was to define Afrikaner capital for some considerable time thereafter.

3.4 **English and Afrikaner Capital**

The 20th century began with Afrikaner nationalism in retreat. The first two decades of the 20th century saw a huge increase in the number of poor whites, and in addition English capital enjoyed an unchallenged position in industry. There were many significant responses by Afrikaner financial interests, which grew as the Afrikaner nationalist movement grew. One such was the creation of Santam (the South African Trust and Insurance Company). Santam was founded in 1918, and Sanlam the South African National Life Assurance Company was formed in the same year as its life assurance subsidiary.

According to Verhoef (2009: 124-5), Sanlam’s was established with three objectives;

1. to contribute to the growth of the South African economy;
2. to encourage and facilitate Afrikaner saving; and
3. to strengthen Afrikaner participation in the South African economy.

Another significant response was the formation a people’s savings bank by the Afrikaner Broederbond17 in 1934. The savings bank later became Volkskas Bank, which up until 1991, was South Africa’s largest Afrikaner bank)18. In due course these institutions became crucial vehicles of Afrikaner capitalism and nationalism.

The economy wide tendency to conglomerate was reinforced at the Volkskongres (Economic People’s Congress) in Bloemfontein in 1939, when Sanlam advanced the formation of an investment company that would provide capital for Afrikaner business. “If we

---

17 The Afrikaner Broederbond (brotherhood) was a secret organisation formed in 1918 to promote Afrikaner interest. Its membership was exclusively male, Calvinists Afrikaners. The Broederbond, described by Smuts in 1918 as a “dangerous, cunning, political fascist organisation”, is closely associated with the development of apartheid in South Africa. Every Prime Minister and State President in South Africa from 1948 to 1994 was a member of the Broederbond. Afrikaner big business, such as Sanlam, Banks such as Volkskas that merged to form ABSA the biggest banking group in the country and Remgro, formerly Rembrandt are known to have links with the Broederbond.

18 In 1991, Volkskas merged with United Bank, Allied Bank and Trust Bank to form Amalgamated Banks of South Africa.
want to be successful, we need to use the capitalist system in a similar fashion as displayed by the gold mining industry”. (Verhoef 2009, 128)

The FVB (Federale Volksbeleggings or Federal People’s Investments) was established with Sanlam having a controlling shareholding and overlapping members of the board of directors. Through FVB, Sanlam was critical in channelling Afrikaner savings and agricultural surplus into the development of an ‘Afrikaner’ industrial base (O’Meara, 1983).

The state established the Industrial Development Corporation (IDC) in 1940, and in 1949 the state established the National Finance Corporation (NFC). The NFC used its deposits to purchase the state’s Treasury Bills and the debentures of the mining houses. These state institutions represented the early beginnings of the long term capital market in South Africa. It also represented a shift from the dependence on the British monetary system. The earliest beneficiaries were the new mines of the Orange Free State Goldfields (Fine and Rustomjee, 1996). The state through the NFC took on the role of mitigating much of the risks associated with developing new gold mines in the Free State. Further, the scale and scope of the development could not be undertaken without the involvement of the NFC.

As the NFC matured it established a mechanism for moving funds from AAC’s diamond operations to the company’s mining interests, supporting the role of the large mining groups to form mining-finance houses to coordinate mining operations in South Africa. As this practice took root, the finance role, moved from private sources to institutional ones. Fine and Rustomjee (1996) point out that this change ultimately helped to erode differences between English and Afrikaner capital.

Further support from the state for Afrikaner finance capital during the 1940s and 1950s, meant that Afrikaner capital was able to break the stranglehold that English capital had imposed on the economy. “Minerals and energy then were the vehicles through which Afrikaner capital integrated into the industrial core of the economy” (ibid.). A critically important strategy was the creation of state owned sectors in electricity, steel, chemicals and fuels. Fine and Rustomjee (1996) point out that these state owned sectors complemented the mining conglomerate needs and provided a growing link between the state and the private sector.
Afrikaner capital, with the help of the state was able to gain a foothold in the mining industry. Bonuskur was founded by Sanlam in 1946. Bonuskor took the bonuses of policy holders and invested them in shares in listed companies on the Johannesburg Stock Exchange. Bonuskur along with FVB established their own mine holding company Federale Mynbou Beperk or FM (Federal Mining Limited) in 1953 and it was FM that broke the English hegemony in coal, gold and asbestos and became “.... increasingly interested in diamonds, eventually cooperating with Anglo-American, through Genmin, though AAC wanted to ensure FM’s operation in diamonds came under the De Beers Central Selling Organisation.19 FM eventually controlled Genmin and in 1974 Genmin took over the Union Corporation Company, a British owned gold mining company, creating Afrikaner control of the second largest gold mining house, renamed Gencor in 1975” (Jones 1995; O’Meara 1983).

Verhoef (2009, 133) chronicles FVB development into an industrial holding company that by the 1970s managed nearly 30 industrial enterprises. The capital market remained small relative to European standards, and foreign capital and internal financing by mining houses remained important.

The last important development in the story of Afrikaner capital in South Africa is the growth of the investment/merchant banking sector. In 1955, AAC established the first privately owned South African investment/merchant bank called Union Acceptances Limited. By 1968 Union owned assets approaching R145 million which made it the largest investment bank in the country. Another major entity established during this period was Volkskas Trustbank. Volkskas in particular grew as a result of close links with the National Party who transferred the accounts of state corporations and municipalities to the bank.

Ashman and Fine (forthcoming) describe the growth in some detail;

“The very rapid growth of merchant banking from the late 1950s onwards, under conglomerate control, reinforced the close connection between finance and industry. A major series of mergers increased concentration in the economy, including financial ones, most importantly those led by Anglo’s Union Acceptance Limited which merged with Syfrets Trust Co. owned by

---

19 A confidential letter (cited in Verhoef 2009a, 141) from Anglo’s Harry Oppenheimer to the chairman of the FM board stated that should FM ‘or any other company over which it exercised effective control (including General Mining) make any new diamond discoveries or any new diamond venture, such discovery or venture would be offered in the first place to a new company to be formed for that purpose, and the capital of the new company would be owned 51 per cent by De Beers and 49 per cent by Federale Mynbou.’
insurance firm the South African Mutual Life Association Society (later to become Old Mutual) and which was backer of Anglo’s Rand Mines which merged with manufacturing conglomerate Tomas Barlow to form Barlow Rand in 1971. The combined group then merged with the originally Dutch owned Nedbank Group (then the third largest commercial bank) to form in 1974 Nedsual (Nedbank and Syfrets-UAL Holdings). Three groups, Standard, Barclays and Nedsual thus dominated banking with Volksas in fourth place and both Anglo and Old Mutual had expanded significantly into finance, especially given Anglo retained a minority stake in both Barclays and Standard. Anglo then took over the Schlesinger financial group so gaining controlling stakes in Eagle Life Assurance and Western Bank (7th largest) and Sorec Ltd (second largest property company) (Innes 1984). All the major finance groups had significant industrial and property holdings with the exception of Standard/Liberty Life which remained purely financial.”

3.5 Key Pieces of Legislation:

Legislation has helped to define the structure and the form of competition which prevails in South African finance. The 1965 Banks Act No. 26, classified banks in functional form, commercial banks, merchant banks, hire purchase banks, etc. Commercial banks were viewed by the SARB as the only ones with money creating capabilities and therefore in the face of an ongoing money supply expansion were subject to liquid assets and capital reserve requirements. In addition, the commercial banks were required to keep interest free deposits to cover their liabilities with the SARB. Thus, legislation itself framed competitive conditions in which commercial banks were severely disadvantaged.

The SARB too has played a pivotal role in the development of the South African banking sector. The SARB in defining ownership and setting the limits to competition induced a response from the commercial banks which saw them diversifying their traditional bank functions into new areas such as hire purchase, leasing and other short term credit facilitates. More importantly, the commercial banks sought to circumvent central bank’s onerous restrictions by;

a. Acquiring majority ownership of other financial intermediaries that specialised in the exempted areas.
b. Establishing their own subsidiaries to carry out such functions.

In so doing: “Commercial banks succeeded in expanding their traditional bank operations through subsidiaries and gaining a grip on the competition by other financial intermediaries.” Thus as Verhoef (ibid.) points out by the first half of the 1980s South Africa’s bank sector was dominated by five large consolidated banking groups; First National Bank Group, Standard Bank, Nedcor, Bankorp and Volkskas. Each group had at least one entity specialising in commercial, general, merchant, industrial and/or hire purchase banking. “The sheer size of the bank groups and the number of subsidiaries within groups reduced competition effectively” (ibid.).

3.5.1 Franszen – the importance of nationally owned banks

Another aspect of the recent past material to the structure of the industry today is the Franszen Commission Report finding in 1970. The Commission found that the foreign domination of the bank sector contained an inherent threat to the security of the country. The Report proposed that “foreign shareholding in South African banks in excess of 50% should be gradually reduced to a minority position” (ibid).

Legislation would follow in 1976 restricting foreign share ownership in South African banks. Commenting on these developments Itzikowitz (quoted in Verhoef, 2009, 181) was to observe: “Since the Franszen Report in 1970 monetary and fiscal policy attempts have been made to control the size of single shareholding in banks. These have been motivated by economic xenophobia and its historical corollary – fear of concentration of power in a few large organisations”.

To understand these developments one has to recall that South Africa operated its peculiar apartheid system in an increasingly hostile world. As Verhoef (2009, 172) observes, “This was not only a fear of concentration per se, but also a fear of foreign control of a strategic sector of the economy of a country in a hostile international environment”. In terms of the wider global tendency towards financialisation, as direct non market controls over banks were replaced by indirect market mechanisms, the South African monetary authorities moved in unison with the rest of the world; however in placing restrictions on the foreign ownership of bank capital, the authorities’ restrictions were in effect, placing restrictions on the free flow of
mobile capital in the industry. This was sharply at odds with what was taking place in the rest of the world and is a peculiarly South African feature of the past.

3.5.2 De Kock Commission Deregulation and Liberalisation

The Commission of Inquiry into the Monetary System and Monetary Policy in South Africa headed by (then) former Deputy Governor of the Reserve Bank Dr Gerhardus Petrus Christiaan de Kock (what became known as the De Kock Commission) was established in 1978 to chart a way forward for monetary policy in a changing local and global context, produced three reports (1979, 1982, 1985). The first in 1979 sought an end to exchange controls. The second assessed the relative positions of the building societies and financial markets in general. The third released in 1985 signaled a sea change in South African monetary affairs by replacing direct regulatory controls with “market determined mechanisms” which were to serve as controls. In effect this 1985 Report aligns South Africa with the then new global tendency towards marketisation and financialisation.

De Kock’s recommendations were embodied in the Financial Institutions Amendment Act, Nº 106 of 1985. In keeping with the Bank for International Settlements (BIS) directives, more stringent capital adequacy rules were applied. The Act also removed the distinctions between the different types of banking institutions allowing them to fulfill overlap functions (for example between building societies and retail banks) (Verhoef, 2009). What resulted was increased competition right across the spectrum of banking services. The new post De Kock competitive environment squeezed interest margins and induced rapid product innovation (DT Merett in Verhoef, 2009, 176).

In terms of ownership, banks could only be owned by bank holding companies or by other banks, and changes in ownership were placed under the sole purview of the Registrar of Banks. According to Verhoef (2006, 165), “The rationale behind these restrictions was to prevent "undesirable concentration of economic power, credit privileges, bank captivity and a conflict of interests that result from banks and bank holding companies’ control over non-bank enterprises". For the most part this was the thinking that informed the SARB’s opposition to mergers of banks and insurance companies. Of course such opposition was to be drowned out in the deluge of global deregulation which was to follow in the middle of the 1980s.
In an effort to cut unit costs in the more competitive post De Kock environment the banks were motivated to embark on a programme of rapid computerisation that required increased capital investment. As a result, diversification of banking services and a marginal decline in concentration were the chief features of this period.

The Deposit-Taking Institutions Act, No 94 of 1990, brought South Africa further into line with BIS thinking. New prudential requirements were introduced in conformity with Basel requirements for risk management and all deposit-taking institutions were subject to uniform capital adequacy, minimum reserve balances and liquid asset requirements.

According to Pienaar (quoted in Verhoef, 2009, 174-175), the 1990 legislation aimed, "to create a framework for the regulation, including the supervision, of the business of accepting and employing deposits of the general public”.

In summary, the 1985 and 1990 legislation stipulated:

- All banks were to have sufficient capital based on the classification of risk of the exposure of their liabilities to the public;
- All banks were to be owned by registered banks or by registered bank holding companies;
- No shareholder was allowed to own more than 10% of the shares issued by any one bank without the permission of the Registrar of Deposit Taking Institutions.\(^{20}\)

Although foreign banks were not allowed to conduct any business in the Republic, the South African banking sector became linked to the rest of the world through the contingent liabilities on its balance sheet. It was the Banks Act, No 94 of 1990 that gave the statutory approval for the return of foreign banking interests in the form of Representative Office(s). The Representative Office (RO) of a foreign bank was not permitted to carry out the business of a fully fledged bank; however the RO gave foreign finance a toehold towards re-entry. While the 1985 Bank Act sought to eliminate the differences between banking institutions and building societies the 1990 legislation extended the process by doing away with the

---

\(^{20}\) If the total shareholding was to exceed 30%, permission from the Minister of Finance was required. According to Verhoef (ibid.), “These ratios were raised in 1992 to 15% for registrar’s permission and 49% for ministerial permission. 44% thereby perpetuating a high degree of concentration in the bank sector”.  

47
distinction between the local or foreign domicile of shareholders. The only restriction that remained was that on the maximum holdings of shareholders.

3.6 Mergers

Verhoef (2009) argues that the concentration through absorption of subsidiaries in bank holding companies was encouraged by two developments in the mid 1980s. First, there was Standard Bank’s decision to disinvest in 1986, and then the removal of the statutory differentiation between banks and building societies in the 1987 Bank Act.

A train of mergers and acquisitions followed. Standard Bank (by equity the largest of the banks with a market capitalisation of R29.7 billion) was wholly acquired by South African interests in 1987. 21

It was then Barclays turn, Barclays PLC sold its remaining 40.4% shareholding in Barclays of South Africa. The bank was renamed First National Bank and constituted the largest of the bank groups with assets of R30.3 billion in 1989. Anglo American Corporation, Southern Life Association and De Beers Consolidated Mines all featured as buyers. The large consolidated bank group had begun to emerge. The process continued, in 1988 Nedbank merged with the Permanent Building Cociety and Finansbank. Old Mutual owned 52% of the shareholding of the Nedcor Group. Trust Bank, established in 1956, was the commercial bank in the Bankorp Group, of which Sanlam held 66% of the shareholding.

The Volkskas group was the fourth largest of the banks at the end of the 1980s with assets of R3,595 million. When the distinction between bank institutions was removed Volkskas and the largest and oldest building society in South Africa, the United Building Society, exchanged shareholdings. Volkskas obtained 30% shares in the building society and United 10% of shares in the bank in 1987.

In January 1991 the largest single bank group was formed in South Africa, Amalgamated Banks of South Africa (ABSA). ABSA was the result of a merger of the Volkskas group, the former United Building Society, the Allied Bank and the Sage Group. The rationalisation deal

21 Among the new owners were Liberty Life, Old Mutual, Rembrandt and Gold Fields of South Africa.
was worth R1.7 billion. Finally in February 1992 ABSA acquired the Bankorp group from Sanlam and ABSA group controlled assets in excess of R80 million.

Building societies were the natural targets for banks once the demutualisation process of the mid-1980s got underway. By the end of the 1990s they were all absorbed into one or other of the large bank groups. The demutualisation of the large insurance companies started with Southern Life in 1985 and was followed by Old Mutual and Sanlam in 1998. After 1998, Sanlam consciously realigned its business to financial services and sold its controlling shareholding in ABSA.

In 1997 First Rand Group was established as a joint holding company for Rand Merchant Bank, Rand Merchant Bank, First National Bank, Southern Life Assurance Company and Momentum Life (Verhoef, 2009).

### 3.7 Mergers across Corporate South Africa

Complex cross-holdings and pyramid type ownership structures served big business well from Harry Openheimer’s diversification of AAC in 1927 until the 1980s and 1990s. These mechanisms reinforced the control of the families and bolstered Chandler’s (2004) notion of personal capitalism. Starting in the 1980s with the ascendancy of the maximisation of shareholder value approach, new imperatives emerged that prioritised the need for effective management that would maximise the return to the shareholder. According to Chabane et al. (2006), “Conglomerate unbundling and restructuring to ensure stronger focus and better strategic direction represented a fundamental shift in the managerial mindset of South Africa’s richest individuals and the corporations they controlled”. Thus, while the South African merger and acquisitions (M&As) bear similarities with the takeover frenzy in the United States (and elsewhere) during the 1960s and 1970s its motivations arise from peculiarly South African origins.

The M&A activity in South Africa, was started by Gencor in 1993 when it disposed of a range of non-mining assets and created Billiton. According to Chabane et al.: “Barlow Rand, now called Barlow, followed suit by focusing on “brand management”—among its main

---

22 As Chabane et al, point out, “In general, conglomerates were trading significantly below their net asset value—22% in 1995 in the case of AAC”.
businesses are Caterpillar and Hyster fork-lift truck dealerships—and greatly reducing its exposure to the domestic market. The majority of unbundling (and related “re bundling” or consolidation within sectors) deals took place in 1999, when there were 60 of such deals (accounting for R80 billion) compared with 40 deals in 1998 and 17 deals in 1997.”

When this process began in the early 1990s, ownership and control of large South African companies rested with the big conglomerates. But by 2005 this unity had been split, control now resides with a new class of managers who actually run the company on a day-to-day basis. Today, institutional fund managers comprise the largest group of shareholders on the JSE.

### 3.8 Internationalisation of the South Africa Finance

Conglomerate South Africa has always argued for exchange control liberalization and overseas listings. The rationale has always been that this would allow South African firms to raise capital more cheaply in international capital markets, and this in turn would increase investment in South Africa. Most fundamentally, liberalization would encourage inward foreign direct investment (FDI). Gelb (2001) notes that both private investment and inward FDI have remained low and Rashid (2011) points out that, “South Africa is the only large emerging economy (and the only BRICS country) where net inflow of portfolio investment is higher than FDI inflows. In 2010, the ratio of portfolio investment to FDI was nearly 10 (SARB sources)”.

Starting in the late 1990s, big conglomerates moved their primary listings overseas. New valuations in hard currency eradicated the foreign exchange risk of a Rand holding thereby reducing risk premia and improving expansion capabilities. According to Chabane et al. (ibid.), the first important issue was by Billiton (currently the world’s largest mining company). Billiton was listed by Gencor on the London Stock Exchange (LSE) in 1997. SAB followed in early 1999 and since then has taken advantage of its larger liquidity by acquiring breweries in Asia, Europe, and Latin America.

When SAB merged with Miller to create the world’s second largest brewery, Altria (previously Philip Morris) has become SABMiller’s single largest shareholder with 23.5%. “... by far largest and most evocative, listing was Anglo’s. In October 1998, AAC absorbed Minorco and simplified its highly complex ownership structure. Following the London listing
in May 1999, AAC joined Billiton and SAB in the FTSE 100 index. Old Mutual and Liberty International have also obtained primary London listings, as have two infotech companies, PQ Holdings and Datatec. In 1999, Sappi, though still with a primary JSE listing, had secondary listings in four foreign stock exchanges: 52% of its shareholders and ¾ of its assets were abroad and 85% of earnings in hard currency.” (ibid.)

International listings have been used to access liquidity that has funded a pattern of aggressive outward foreign investment and acquisitions by corporate South Africa. Firms like SAB, Sasol, and Sappi have also been involved in acquisitions, joint ventures, and greenfield investment in Organization for Economic Cooperation and Development (OECD) countries and other emerging markets; outward FDI has grown from $8.7 billion in 1995 to $28.8 billion in 2004 (Goldstein, 2006). In addition, the number of South African companies doing business in Africa has more than doubled since 1994.

The pace and scale of the international listings process ignited concerns about conglomerates’ motivations and the benefits and costs to South Africa led the Government to reconsider its approach, In February 2000, the Government published new criteria for future cases. Since then overseas listings have been few and far between.23

It is quite clear that South Africa’s conglomerates enhanced their ability to raise new capital more cheaply through the overseas listing. It also seems clear that they “have generally found relationships with investors, analysts, and financial and accounting regulators more demanding than in their home country, where companies such as AAC or SAB were used to dictating the terms of engagement.” If as Rashid (2011) speculates, “One should expect considerable political influence of the financial sector given the sector’s share of national income in South Africa. It is almost universally true that larger the share of a particular sector in the economy, the more deferential the economy is likely to be to the demands of that sector.” And, if as Chabane et al. advance, “the increased autonomy of firms with overseas listings and the increased proportions of conglomerates’ revenues coming from overseas activities” weakens the leverage of the South African authorities, the state would be considerably less influential in its ability to regulate the conglomerates.

---

23 One notable exception is Investec. In November 2001 the Government granted Investec permission to list overseas. The financial services group, which was then earning 60% of its revenues outside South Africa, was given the go-ahead on condition it kept its headquarters in Johannesburg (see Chabane et al, 2006).
The internationalisation of the South African banking sector proceeded in its own specific manner contrary to what has been observed in many other developing countries. Rather than the foreign banks deploying in South Africa, the overarching tendency was for South African Banks to extend their operations overseas in an effort to serve South Africa’s conglomerates that were deploying resources overseas. Almost as soon as permission was granted in 1997 ABSA, Investec Bank, First National Bank, Nedbank, Standard Bank and Rand Merchant Bank followed their customers and sought to acquire overseas interests. One of the first moves by all the banks was to establish offices in offshore tax centres like Mauritius, Guernsey, Jersey, the British Virgin Islands and the Grand Cayman.

During the post-apartheid period, South African banks had expanded operations to many far flung parts of the world including Australia Argentina, Brazil, Canada, Colombia, Germany, Hong Kong, India, Iran, Ireland, Italy, Liberia, Malta UK, Peru, as well as in the People’s Republic of China, Russia, Singapore, Switzerland, Turkey the USA, and the United Arab Emirates. One notable trend in the expansion of operations has been an expansion into other countries in Africa that started around the turn of the century and has continued unabated. Today South African banks operate in Kenya, Zimbabwe, Botswana, Uganda, Nigeria, the DRC, Angola and other African countries. The trend, which can be seen after ABSA was bought by Barclays, was that large South Africa corporations moved to developed economies and merged or aligned with large corporations there and then became seen as gateways into the rest of Africa with South Africa playing the role of regional headquarters for global firms.

Verhoef (2009, 192) argues, “The ability of South African banks to extend operations on such a scale, was testimony to the sophistication of their management, the strength of their capital base and the confidence of both the domestic clients they followed into global markets, and the international clients doing business in South Africa. Globalisation of bank operations was as much a function of the size and level of experience and expertise of the banks as of the soundness of domestic central bank regulation.”

3.9 Foreign Banks

Today, by comparison with other BRIC and emerging market countries, the South African economy has a very large presence of foreign banks (Rashid, 2011). According to the World Bank financial sector database (Barth et al., 2008), banks that are 50% or more foreign-owned
control nearly 30% of South Africa’s banking sector assets. This is contrary to the data report in the 2011 Annual Report of the South African Reserve Bank, which claims that foreign banks and their branches control only 6.1% of the banking sector assets.

The Banks Act, Nº 94 of 1990, allowed foreign banks to re-enter the local market. In the period 1992-2005 the number of foreign banks authorised to establish representative offices (RO’s) in South Africa rose from 31 (at the start of the period) to 61 (in 2000), but then declined to 43 in 2011 (see Table 1). The representative offices were not fully fledged banks, they did not engage in in the full range of bank operations, rather they were specialist institutions providing a presence for foreign banks seeking to enter the market or they specialised in providing economic and trade information to select clients.

In 1992, the nationality of the representative offices operating in South Africa was largely European. By 2011 American, Canadian, Chinese, Japanese as well as European and other banking interests from a total of 22 countries were all represented.

It was the Banks Amendment Act, Nº 26 of 1994 that finally opened South Africa to the entry of foreign banking institutions as banks, licensed to conduct banking business. As South Africa entered the 1990s all the banks were subjected to a single set of regulations and crucially foreign banking competitors were allowed to enter the market.

The imperial legacy remained in the form of the domination of the big four commercial banks (the two former imperial banks along with Nedbank and Volkskas).

The number of fully fledged branches of international banks registered in South Africa rose from 4 in 1995 to 15 in 2005 declining to 12 in 2011. Making up this number are ABN Amro Bank NV, Bank of Baroda, Citibank, Commerzbank Aktiengesellschaft, Credit Agricole Indosuez, ING Bank NV, Morgan Guaranty Trust Company and Société Généralé.
<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks*</td>
<td>30</td>
<td>22</td>
<td>20</td>
<td>19</td>
<td>19</td>
<td>19</td>
<td>18</td>
<td>17</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>Mutual Banks</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Branches of international</td>
<td>14</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>14</td>
<td>14</td>
<td>14</td>
<td>13</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>banks in the Republic of South Africa</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Representative offices</td>
<td>52</td>
<td>44</td>
<td>43</td>
<td>47</td>
<td>43</td>
<td>46</td>
<td>43</td>
<td>42</td>
<td>41</td>
<td>43</td>
</tr>
<tr>
<td>Controlling companies</td>
<td>27</td>
<td>19</td>
<td>16</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Banks under curatorship</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Banks in receivership</td>
<td>2</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Banks in final liquidation</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: SARB 2011 Overview

Note: Includes active banks and banks exempted by the Registrar of Banks (with effect from 1 July 1996) in terms of the Supervision of Financial Institutions Rationalisation Act, 1996 (Act No. 32 of 1996) and section 1(cc) of the Banks Act, 1990.

Two significant developments took place in the middle 2000s. First in 2005 Barclays Bank PLC obtained controlling share ownership in ABSA. Thus ABSA became a subsidiary of Barclays. This was the first acquisition by a foreign bank of a large South African bank in terms of section 37 of the Banks Act, No. 94 of 1990, and it required the approval of the Minister of Finance. Second, in 2006 the Chinese entered the South African market with two banks, the China Construction Bank Corporation and Bank of China Ltd.24

---

24 Both moves taken together confirm the relative attractiveness of South Africa as a destination for international banking capital.
Foreign banks in South Africa are principally involved in specific areas such as investment banking or trade finance. They generally service the corporate sector. According to the Task Group Report for the National Treasury and the South African Reserve Bank (in Verhoef, 2009, 186) “they did not succeed in penetrating the retail sector. The main reason for this development was the regulatory environment: foreign banks are required to be separately capitalised with South Africa and be structured as subsidiaries of foreign holding companies rather than as branches. This is not the case in many industrialised countries where ‘home-country’ regulation applies.”

Between 2004 and 2007 (expressed as a percentage of GDP), the claims of foreign banks vis-à-vis the South African private sector increased from 14% to 42%. This entailed huge credit expansion that Rashid (2011), estimates was in excess of USD 90.0 billion. Considered over the period, foreign lending appeared to be strongly pro-cyclical. With the onset of the Great Recession of 2008, foreign banks reduced their exposures in South Africa by approximately USD 20.0 billion in the year between December 2007 and December 2008. “As a percentage of GDP, the contraction in credit from foreign banks was as large as 7% of GDP, compared to 2.5% and 0.87%, 0.89% contraction in foreign bank lending in Brazil, China and India respectively.” (Rashid, 2011)

The foreign banks active in South Africa appear to be more risk averse when compared to their domestic counterparts. We have already argued that foreign bank lending to the domestic economy can be strongly pro-cyclical. Further, international experience shows that foreign banks, in general, tend to avoid lending to small and medium sized enterprises in developing countries because of information asymmetry problems (Rashid, 2011). Given that foreign banks specialise in consumer and trade credits (especially credit for imports of consumer goods), and given too that the banks in South Africa do not face any restriction in capital market activities, it suggests that these banks engage in equity trading activities, where they earn a higher return from non-lending activities.

4. Domestic Banks
In keeping with the historical legacy, in the contemporary period from 1990 to 2011, the domestic banking landscape has been dominated by the big four. Their assets as proportion of

---

25 There is no restriction on foreign bank entry into South Africa through acquisition, subsidiary or branch operation.
assets of all bank assets rose from 70% in 1995 to 82.2% in 2007 to 89% at the end of 2011 (Verhoef, 2009; SARB, 2011). With respect to ownership, 43% of issued banking shares are held by foreigners with 28% being held by domestic shareholders. The remaining 29% of shares are held by the “small” shareholder who owns less than 1% of the total issue.

Figure 3.2: Shareholding in South African Bank Sector

Source: SARB, 2011, Overview

3.10 Structure by JSE Capitalisation

In order to determine changes in the structure of corporate South Africa, Chabane et al. (ibid.), undertook a comparison of the rankings of the top 100 listed companies in 1994 with those of 2004. The significant conclusions are as follows:

1. Confirmation that a radical restructuring has occurred. Only 41 of the top 100 listed companies in 1994 were still ranked ten years later.

2. In 1994, 83 of the top 100 companies were owned or controlled by the top six conglomerates. By 2004, the number of companies controlled by these conglomerates had fallen to 47.

3. The importance of the top conglomerates remained significant. Albeit listed separately, three of the top 20 (Anglo American, Amplats, and AngloGold) were still effectively part of the Anglo group in 2004. Of the top 20 companies in 2004, 13 were part of a major conglomerate grouping.
4. Foreign-controlled firms in the top 100 increased from five in 1994 to 11 in 2004. The authors attribute this to both internationalization in the ownership structure of South African firms now listed abroad and acquisitions of local firms by international companies.

5. Although black ownership increased over the period, it did so unevenly and marginally as only five companies under black control were in the top 100 in 2004.

6. With regard to the change in sectoral composition of the top 100 over the period, there is a mixed picture. The authors find that the number of firms engaged in financial, retail, and other services increased significantly. These firms include MTNSA, Netcare, Pick n Pay, and Edcon. Banking and insurance companies emerge as particularly important and account for seven of the top 20 in 2004, including the demutualized Old Mutual and Sanlam.

7. A fair degree of continuity remains between the two periods as the largest industrials (including mining), still accounts for six of the top 20 firms, even including services.

8. Continuity is also reflected in continued high levels of concentration within sectors. A large proportion of mergers have been vertical, increasing control of dominant firms through production chains. While this avoids the direct competition concerns of horizontal mergers, it realizes greater consolidation within industries. Vertical integration can yield efficiency gains such as from the internalization of transactions costs but can also increase barriers to entry, make collusion easier to maintain, and lead to foreclosure of competitors (Riordan and Salop, 1995).

Table 3.5 extends the Chabane et al. (ibid.) measure of control by adding data on the market capitalisation shares by group for selected years from 2004 onwards. Foreigners (corporations and other), dominate the JSE by market capitalisation. Foreign controlled interests now account for 30% of JSE capitalisation, far more than any other group on the exchange.
Table 3.3: Summary of control of JSE market capitalisation (% of total)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign</td>
<td>5.9</td>
<td>2.1</td>
<td>2.2</td>
<td>3.9</td>
<td>10.1</td>
<td>18.5</td>
<td>20.8</td>
<td>29.8</td>
<td>30.0</td>
</tr>
<tr>
<td>Institutions</td>
<td>0.9</td>
<td>4.2</td>
<td>9.1</td>
<td>10.3</td>
<td>9.1</td>
<td>17.0</td>
<td>19.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors</td>
<td>8.1</td>
<td>6.7</td>
<td>7.0</td>
<td>14.4</td>
<td>7.4</td>
<td>5.8</td>
<td>6.7</td>
<td>8.9</td>
<td>9.2</td>
</tr>
<tr>
<td>SABMiller</td>
<td>4.0</td>
<td>5.1</td>
<td>5.7</td>
<td>7.5</td>
<td>7.2</td>
<td>5.2</td>
<td>5.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Anglo American Corp</td>
<td>53.6</td>
<td>44.2</td>
<td>43.3</td>
<td>17.4</td>
<td>20.2</td>
<td>18.7</td>
<td>21.0</td>
<td>11.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Rembrandt/Remgro</td>
<td>3.8</td>
<td>13.6</td>
<td>13.0</td>
<td>9.0</td>
<td>10.0</td>
<td>7.9</td>
<td>7.8</td>
<td>5.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Black Groups\textsuperscript{26}</td>
<td>9.6</td>
<td>3.5</td>
<td>6.3</td>
<td>5.1</td>
<td>4.6</td>
<td>3.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RMB/FirstRand</td>
<td>0.5</td>
<td>4.8</td>
<td>4.7</td>
<td>4.9</td>
<td>3.9</td>
<td>3.1</td>
<td>3.9</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>SA Mutual/Old Mutual</td>
<td>10.6</td>
<td>10.2</td>
<td>9.7</td>
<td>8.8</td>
<td>12.0</td>
<td>4.5</td>
<td>5.5</td>
<td>2.9</td>
<td>3.3</td>
</tr>
<tr>
<td>Sanlam</td>
<td>12.2</td>
<td>13.2</td>
<td>10.5</td>
<td>11.1</td>
<td>6.3</td>
<td>2.7</td>
<td>2.3</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Liberty Life/Standard Bank</td>
<td>2.0</td>
<td>2.6</td>
<td>7.2</td>
<td>9.5</td>
<td>6.0</td>
<td>4.7</td>
<td>3.5</td>
<td>2.4</td>
<td>1.1</td>
</tr>
<tr>
<td>Bidvest Group</td>
<td>1.0</td>
<td>1.0</td>
<td>1.2</td>
<td>1.0</td>
<td>0.8</td>
<td>0.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investec</td>
<td>0.4</td>
<td>3.3</td>
<td>1.9</td>
<td>0.8</td>
<td>1.2</td>
<td>0.6</td>
<td>0.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PSG</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.6</td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>2.2</td>
<td>2.0</td>
<td>0.2</td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Altech</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>ABSA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>Sasol</td>
<td>1.7</td>
<td>2.2</td>
<td>3.8</td>
<td>4.2</td>
<td>4.6</td>
<td>3.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Anglovaal\textsuperscript{27}</td>
<td>2.1</td>
<td>2.5</td>
<td>3.6</td>
<td>0.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Foreign control and dominance has proceeded through capital inflows (especially portfolio flows) and South Africa with its sophisticated stock exchange is something of a magnet for hot money flows (particularly during periods of uncertainty. Foreign direct investment has

\textsuperscript{26} The Black owned groups are identified as such by McGregor’s on the basis of all those companies which have significant black influence in their ownership.

\textsuperscript{27} In 1998 the Anglovaal shareholding was split equally, giving the Hersov and Menell families each control over 0.4% of the JSE capitalisation.
also played its part, most notably the R30-billion deal by Barclays to become the biggest shareholder in ABSA.\textsuperscript{28}

Unbundling by the big conglomerates has served as a vehicle by which foreign and institutional investor’s have extended control. The Competition Commission (2008) reports: “Conglomerate groupings still dominate the JSE. The market share of the 6 big conglomerates has continued to shrink ... This however does not take into account other companies owned or controlled by these conglomerates. Despite unbundling by the major conglomerates they are still ‘remarkably significant, with their overall size being increased by international acquisitions and mergers, such as to create BHP-Billiton and SAB-Miller.” The number of merger notifications to the Commission increased substantially between 2001 and 2007. Most mergers during this period occurred in the manufacturing sector and in financial services and real estate sector. According to the Commission, the number of mergers in the agriculture and mining sector has grown dramatically broadly in line with the commodity price boom. The number of conglomerate mergers\textsuperscript{29}, where the products produced by the merging parties do not compete directly with one another, has increased significantly over the period (Competition Commission, 2008). High concentration, coupled with low levels of competitive rivalry, results in supra-competitive prices. Associated with this is that existing dominant firms are able to create barriers to entry and enjoy abnormal profits.

Table 3.3 records that in 2012 SAB-Miller replaced AAC as the largest listed company by market capitalisation. This is a notable development because it would be the first time in the history of the exchange that market capitalisation would be dominated by any other company but AAC. Whether it signifies a deeper more meaningful change remains to be seen.

\textbf{3.11 Conclusion}

We have sought to show how the structure of banking in South Africa has been shaped by the history, competition and legislation. Although the circumstances have changed conglomerate concentration reproduces itself from period to period and despite unbundling cross-holdings

\textsuperscript{28} According to Competition Commission (2008), this has been critical in the increase of foreign ownership on the JSE.

\textsuperscript{29} Conglomerate mergers are neither horizontal nor vertical. These are mergers between firms with complementary products, neighbouring products, and unrelated products (Competition Commission, 2008).
linking company with company remain essential features of the arena just as they were in 1929.

By far the most important change has been in the internationalisation of local banking. When taken together with the dominance in the corporate market makes it clear that South African finance is in large part propelled by foreign interests just as it was 100 years ago.
4 Competition in the South Africa Banking Sector
Ilan Strauss and Gerald Ndonwi Mfongeh

4.1 Background: Deregulation of the South African financial sector

According to Singleton and Verhoef (2010), after 1945, countries in the international system had a vision to attain growth and full employment. South Africa was no exception. As a result South African economic policies were managed to promote growth and high levels of employment. According to Singleton and Verhoef, “Currencies were managed and financial sectors were tightly regulated to ensure the compatibility of growth and stability” (2010: 542).

One of the first banking legislations to be implemented for the South African banking sector was the “Banks Act No. 38 of 1942, which categorised banks according to operational differences and required them to submit regular reports” (Singleton and Verhoef, 2010: 543). The Office of the Registrar was the institution that ensured banks complied with this Act and hence marked the beginning of supervision of banks in South Africa’s banking sector (Singleton and Verhoef, 2010).

Entry in the banking sector was “relatively free”, however, such entry had to be approved by the Office of the Registrar (Singleton and Verhoef, 2010). Supervision of banking in South Africa required that banks should hold cash deposits, interest free reserves as well as keeping a certain level of liquid asset ratios with the South African Reserve Bank (Singleton and Verhoef, 2010). Singleton and Verhoef argue that, even though, the regulation of the financial sector aimed to attain growth with stability, regulations “discriminated against trading and commercial banks…. Lack of competition constrained improvements in efficiency and allowed banks… to fall behind international bank practice” (Singleton and Verhoef, 2010: 544).

In South Africa, efficiency of the banking sector was affected more by economic sanctions rather than the lack of competition in domestic markets (Singleton and Verhoef, 2010). “South African banks were constrained by exchange controls and declining inward foreign direct investment” (Singleton and Verhoef, 2010: 545). The South African economy suffered a decline in the 1970s whilst experiencing high inflation (Singleton and Verhoef, 2010). As a result the De Kock Commission submitted a report that “advocated for a more effective,
market oriented monetary policy, and rejected direct controls on banks and other financial enterprises” (Singleton and Verhoef, 2010: 545).

The De Kock Commission thus presented an argument that regulation of the financial sector had caused inefficiencies that had an impact on the South African economy (Singleton and Verhoef, 2010). Against this background, the apartheid government adopted neoliberal policies which facilitated the move towards market oriented financial markets.

### 4.2 The concentration of South Africa’s banking sector

The Herfindahl-Hirshman Index is often used as a measure of the degree of concentration within the banking sector (South African Reserve Bank, 2011). “The Herfindahl-Hirshman Index is the sum of squared values of each bank asset market share” (Cipollini and Fiordelisi, 2008: 1). Furthermore, the Herfindahl-Hirshman Index “accounts for the number and relative size of banks in the system” (South African Reserve Bank, 2011: 55), with the inverse of the index giving the number of firms of equal size which would generate the index value – hence 0.2 would correspond to five equal sized firms.

According to the South African Reserve Banks’ Bank Supervision Department, when measuring concentration in a banking sector, an H-index below 0.1 is an indication that there is no concentration in a banking system (South African Reserve Bank, 2011). An H-index that lies between 0.1 and 0.18 indicate that there is moderate concentration in a banking system, whilst an H-index above 0.18 is a sign of a high degree of concentration in the banking system (South African Reserve Bank, 2011).

Drawing from Table 4.1 below, with an H-index of above 0.18 from the period under evaluation (2006-2011), the South African banking sector has a high degree of concentration that reflects low levels of competition in the country’s banking system (South African Reserve Bank, 2011). The high degree of concentration in the country’s banking sector is a result of the “high concentration of banking-sector assets among the four largest banks”, namely ABSA, Standard Bank, FNB and Nedbank, “which accounted for 84.1 per cent of total banking sector assets at the end of December 2011” (South African Reserve Bank, 2011, 55; Competition Commission, 2005).
The high degree of concentration reflects low levels of competition in the banking sector. As a result, a question arises of whether this high degree of concentration in the banking system has an impact on the costs of banking. According to Okeahalam (2001), the number of banking firms that supply products in a market and the proportion of the market that each banking firm supplies determine concentration. There is a tendency towards collusion in South Africa with banks setting prices above the competitive level and generally acting in an oligopolistic fashion.

Table 4.1 shows a high degree of concentration with an H-index above 0.18 from 2006 to 2011, The Banking Enquiry (conducted by the South African Competition Commission in 2009) discovered that South African banks exercise used their market power to impose unfair bank charges and penalty fees.

### 4.3 Interest rate spreads in South Africa

The World Bank (2013, 1) defines an interest rate spread as the “interest rate charged by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits”. In other words, an “interest rate spread is the difference between a bank’s lending and borrowing rates” (Competition Commission 2005: 2). Certain terms and conditions tend to influence a country’s interest rate spread (World Bank, 2013). For example, in Germany, as a result of low levels of concentration due to increased levels of competition in the banking sector, interest rate spreads have over the years experienced a gradual decline (Detzer et al., 2013).

In the South African context, the banking sector is highly concentrated and dominated mainly by 4 banking groups, Nedbank, FNB, Standard Bank. The former South African Reserve Bank Governor Tito Mboweni accused South African Banks of charging a high spread for profitmaking purposes (West, 2010). Mboweni said that such actions were a reflection of collusion in South Africa’s banking sector because banks were charging similar prime rates
(West, 2010). Drawing from the table below, it can be seen that on the 14th of August 2013 the repo rate charged by South Africa’s Reserve Bank was 5%, whilst the prime interest rate charged by the banks was 8.5% (South African Reserve Bank, 2013). As a result of high concentration in the South African banking sector, banks do not have to compete and charge lower interest rates as in the German case.

Table 4.2: South Africa’s repo rate and prime rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Repo Rate</th>
<th>Prime Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>5%</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

Source: South African Reserve Bank

Table 4.2 below, depicts the interest rate spreads of upper middle income countries30, namely South Africa, Botswana, Malaysia and Thailand. Comparing South Africa’s interest rate spread with the other upper middle income countries, from 2003-2011, it can be seen that the country’s interest rate spread is lower than Botswana’s spread. From 2003 until 2006, South Africa’s spread was higher than Thailand’s interest rate spread. However, from 2007 until 2011, South Africa’s interest rate spread was lower than Thailand’s spread. Malaysia, on the other hand, has had a lower interest rate spread compared to South Africa.

A high-income country such as Germany has had a relatively stable interest rate spread of 1.8% since 1999 (Detzer et al., 2013). Due to increased levels of competition in the German banking sector, the interest rate spread has experienced a gradual decline (Detzer et al., 2013). South Africa’s interest rate spread, which is much higher than Germany’s spread is a reflection of the low levels of competition in a banking sector that is mainly dominated by Nedbank, ABSA, Standard Bank and FNB.

---

30The gross national income (GNI) per capita is used by the World Bank to classify countries as either low, middle or high income countries. When a country has a GNI per capita of $1,035 or less, it is classified as a low income country. Lower middle income countries according to the World Bank have a GNI per capita between $1,036 and $4,085, whilst upper middle income countries have a GNI per capita between $4,086 and $12,615. High income countries have a GNI per capita of $12,616 or more (World Bank, 2013).
Table 4.3: Interest rate spreads for South Africa, Botswana, Malaysia and Thailand

<table>
<thead>
<tr>
<th>Year</th>
<th>South Africa</th>
<th>Botswana</th>
<th>Malaysia</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>5.2</td>
<td>6.5</td>
<td>3.2</td>
<td>4.6</td>
</tr>
<tr>
<td>2004</td>
<td>4.7</td>
<td>5.9</td>
<td>3.0</td>
<td>4.5</td>
</tr>
<tr>
<td>2005</td>
<td>4.6</td>
<td>6.5</td>
<td>3.0</td>
<td>3.9</td>
</tr>
<tr>
<td>2006</td>
<td>4.0</td>
<td>7.6</td>
<td>3.3</td>
<td>2.9</td>
</tr>
<tr>
<td>2007</td>
<td>4.0</td>
<td>7.6</td>
<td>3.2</td>
<td>4.2</td>
</tr>
<tr>
<td>2008</td>
<td>3.5</td>
<td>7.9</td>
<td>3.0</td>
<td>4.6</td>
</tr>
<tr>
<td>2009</td>
<td>3.2</td>
<td>6.3</td>
<td>3.0</td>
<td>4.9</td>
</tr>
<tr>
<td>2010</td>
<td>3.4</td>
<td>5.9</td>
<td>2.5</td>
<td>4.9</td>
</tr>
<tr>
<td>2011</td>
<td>3.3</td>
<td>5.9</td>
<td>2.0</td>
<td>4.6</td>
</tr>
<tr>
<td>2012</td>
<td>3.3</td>
<td>7.4</td>
<td>1.8</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Source: World Bank. World Development Indicators

4.4 Competition in retail banking

The OECD (2006) report on *Competition and Regulation in Retail Banking* argues that competition in retail banking is crucial not only to improving its functioning, but such improvement in efficiency would also improve economic performance. Retail banking refers to financial services that are offered to consumers and small and medium sized enterprises (SME’s). Consumers and SME’s rely on a country’s banking sector to provide these financial services. With regard to access to finance, competition in retail banking is crucial for providing lower interest rate for loans.

However, regulations within retail banking tend to lessen competition (OECD, 2006). For example, “restrictions on the entry of new banks or limitations on free deployment of competitive tools by banks. Other regulations restrict banking activities in space and scope, putting limitations on the bank’s potential to diversify and exploit scale/scope economies” (ibid., 7).

In South Africa, there are 21 commercial banks operating in the banking sector. However, ABSA, Standard Bank, First National Bank, Investec and Nedcor dominate the banking sector and account for 86% of the deposits (ibid.). A report that was released in April 2004 concerning *Competition in South African Banking* found that the country’s banking sector was highly concentrated. “However, it is in the market segments rather than at firm level that
concentration is even more marked” (ibid., 295). In June 2003, First National Bank, ABSA, Standard Bank as well as Nedcor accounted for 83% of the deposits in South Africa’s banking sector. Furthermore, “they accounted for 92% of mortgage loans and 89% of bank financed instalment sales” (ibid., 295). “Each of the Big Four has a scale monopoly (25% or more market share) in one or more of the retail market segments (credit cards, current accounts, mortgages or leasing and instalment sales)” (ibid., 295).

High levels of concentration in the South African banking sector have raised concerns because consumers have become discontent “over the extent and level of direct charges for payment transactions” (ibid., 297). Therefore, the lack of competition in the country’s banking sector has had a negative impact on the cost of services.

4.5 Competition in investment banking

Whilst there is a lack of competition in retail banking as a result of being dominated by a few banks, investment and merchant banking in the country is the most competitive in South Africa’s banking industry (SouthAfrica.info, 2013). According to Richard Stovin-Bradford (2000), until the early 1990s, the South African investment banking industry was divided among Standard Merchant Bank, UAL Merchant Bank, FirstCorp, Rand Merchant Bank, Board of Executives (BoE), Investec as well as a number of stockbrokers. However, with the end of apartheid and the integration of the country into international trade and financial markets, foreign investment bankers played a larger role (ibid.). ING Barings Southern Africa banking analyst Alan Hartdegen points out that “Local banks used to dominate top-tier corporate advisory work until the leading international banks arrived with their massive balance sheets, strong brands, global distribution and research capabilities and bundled the locals out of this segment” (ibid., 1).

With the increase in competition that occurred in the country’s investment banking industry due to the influx of foreign investment banks, there was a consolidation process that occurred amongst banks in order to maintain market share and compete. For example, FirstCorp merged with Rand Merchant Bank, Standard Merchant Bank merged with Standard Bank Investment Corporation (Stanbic) that created Standard Corporate and Merchant Bank (SCMB) (ibid.). “UAL Merchant Bank, the first such bank in the country which was established in 1955 by Anglo American and Lazards, was merged with its Nedcor banking group sister companies Syfrets, an asset manager, and Nedbak’s own investment banking arm
to create Nedcor Investment Bank (NIB)” (ibid., 1). The surge of foreign investment banks into South Africa has made the country’s investment banking industry one of the most competitive in the global economy.

4.6 Conclusion

Competition in a banking system is often regarded as a necessary prerequisite for not only ensuring efficiency, but also guaranteeing the proper functioning of the economy. Furthermore, competition in a banking system can benefit consumers as it allows the cost of banking to be lowered. For example, the increased competition amongst banks in Germany has lowered the cost of service for customers.

In South Africa, the banking sector is mainly dominated by FNB, Nedbank, Standard Bank and ABSA. Although there are arguments that the country’s banking system is stable, such dominance by four banks has led to high concentration in the banking system creating an environment with low levels of competition. The low levels of competition in retail banking has influenced the cost of banking and allowed banks the ability to impose unfair bank charges.

The transition to democracy and the subsequent integration of South Africa into global markets opened the doors for foreign investment banks. The low levels of competition that existed amongst the local investment banks was altered with the surge of foreign investment banks into the country, which increased competition in South Africa’s investment banking industry.
5 Profitability of South African Banks
Gerald Ndonwi Mofengeh and Ilan Strauss

5.1 Introduction

In this section we undertake a review of the profitability and efficiency of the South African banking sector. Most indicators show the banking sector was largely profitable throughout the 2000s except for 2009 when profits declined due to the down turn in aftermath of the financial crisis. Operating profit generally increased throughout the 2000s except for 2009. Return on equity (ROE) and return of assets (ROA) were fairly volatile huge decreases in 2002 and 2009 although they recovered in 2011. The efficiency ratio (defined below) stayed above 50% except for 2008 and 2009 when it declined to just under 50%.

Figure 5.1: Operating profits in the banking sector (R billion)

![Operating profits in the banking sector (R billion)](source)

Source: own calculations from SARB

Operating profit grew substantially in the second half of the 2000s with the strongest growth registered at the end of 2006 when this category increased from R23.7 billion in December 2005 to R49 billion in 2011. The increase in operating profit in 2006 was due to the fact that gross income grew much faster than operating expenses – 25% and 12% respectively. A similar situation occurred in 2011 with operating expenses increasing by just 6.8% and with income increasing by about 9.2%. The relatively slow growth in operating expenses was accompanied by a fall in credit losses which decreased by 11.7% at the end of 2011.
5.2 Components of Income

The two main components of gross income of the banks are interest and non-interest income. Although interest income has always contributed the most to income in the sector, non-interest income has increased massively in recent years to even surpass interest income in 2009 and 2010 before being overtaken again in 2011 by interest income after the sector recovered from the economic downturn. The sharp increases in interest income in the mid-2000s especially 2007 where driven by high interests from mortgage loans which accounted for about 40% of total interest income in that year (SARB, 2007). Increases in non-interest income have been driven by rises in fee and commission income which pushed were responsible for non-interest income overtaking interest income in 2009 as credit extensions dwindled (SARB, 2009).

Figure 5.2: Components of bank income (R billion)

Source: own calculations from SARB

Profits fell by as much as 19% in 2009 as the effects of the financial crisis became apparent with profits dropping from R 44 billion in 2008 to just over R 35 billion in 2009. The main contributor to the fall in profit was the sharp increase in credit losses which amounted to about R3.4 billion in February 2009 before easing to about R2.4 billion by the end of that year (SARB, 2009). The sector picked up again with profits increasing marginally in 2010 and sharply increasing in 2011 with operating profits peaking at about R49 billion at the end of 2011 representing almost an increase of 30%.
5.3 Returns on Assets and Returns on Equity

The graph above shows ROE and ROA for the banking sector since 1993. ROE shows the amount of net income that is accumulated as a percentage of shareholder’s equity meaning it indicates how much profit is generated by equity. According to KPMG, given the risk premium of South Africa’s banking sector (nominal) ROE should be a minimum of between 19% and 21% (Banking Council, 1998).

![Figure 5.3: ROE and ROA for the banking sector](image)

Source: McGregor's, BFA and SARB

ROE in the sector has been volatile but generally stayed above 15%. It peaked in 2001 at 23% before crashing to its lowest levels in 2002 (14%) and 2003 (12.5%) and then staying above 15% for the rest of the period with another sharp rise in 2008. The high ROEs between 1993 and 2001 were as a result of strong growth in profits which grew at an astronomical rate of about 319% for the period (Falkena et al., 2004). The drop in ROE in 2002 was as a result of the fact that banks were required to include results from their microfinance lending operations which tended to incur significant losses (ibid). ROE in the sector was generally high throughout 2008 with significant increases in March and December due to sharp rises in non-interest income but eventually dropped drastically in 2009 as credit losses shut up, decreasing profits (SARB, 2008).

ROA gives an idea of how much profits were generated using a company’s assets so it shows how efficient management was at using its assets. Average ROA for the sector for the period 1993 to 2011 stood at about 1.33% representing a low value generally associated with the
banking sector due to the fact that loans and advances usually make about 80% of the sector’s assets. Compared with the retail sector in the period 1993 to 2001, the average ROA in the banking sector was about 1.4% while that in the retail sector was much higher at about 13.7% (Falkena et al., 2004). ROA in the banking sector had been on the rise since early 2000s due to robust profits and peaked in 2008 at about 1.62% before falling again to just less than 1% in 2009 as profits dropped due to the sharp rise in credit losses.

Comparing ROE and ROA of South African banks with those from other countries shows that the banking sector in SA were doing very well. A comparison of the ROA of SA banks and the top 100 international banks shows South African banks consistently outperformed them between 1993 and 2001 although the gap seemed to close towards 2001 with the international banks outperforming SA in 2002 (Falkena et al., 2004). A similar result was registered when the ROA was analysed.

### 5.4 Efficiency Ratios

Another indicator used to measure bank performance is the efficiency ratio, also known as the cost-to-income ratio. The ratio had been improving (declining) relatively steadily since 2004 when it stood at 63.9% to its lowest level it 2008 when it was about 42.2%. The steady drop in the ratio during this period was as a result of the fact that revenue in the sector increased generally faster than operating expenses. 2009 saw a reversal of the gains in the efficiency ratio as it rose to 51.1 at the end of 2009 due to the high operating expenses, caused by the sharp increase in credit losses.\[31\]

---

\[31\] Multiple reasons, unrelated to gains in operating efficiency, may account for increased revenue; this ratio should therefore be viewed with caution. In South African market power, and hence potential monopoly gains (via high prices), may account for increased margins and profits and these dimensions are not adequately captured in the “efficiency ratio”.
5.5 Strategic and Emerging Issues in South Africa Banking

PricewaterhouseCoopers (PwC) publishes an annual survey called “Strategic and Emerging Issues in South Africa Banking”. Taken together the Surveys offer an insight into how the sector perceives of its profitability and operations. We offer below a summary from the various reports from 2003-2012. The 2011 Survey contains four main findings:

1. Banks are looking to increase profitability by reducing staff costs and removing duplications.
2. Predictions on profitability going forward were all extremely favourable. Profit before tax growth over the next 12 months to 5 years was anticipated in the 11%-20% range.
3. The evolving competitive landscape is expected to pose challenges. Capitec and African Bank\(^{32}\) at the lower end of the market, the emergence of Postbank\(^{33}\), entry of foreign banks and mobile banking were all cited as sources of increased competition.
4. All respondents felt ROE was a more important measure of profitability than ROA.

PwC asked that the banks describe the distribution of profits in terms of capital allocated. This information is captured for selected years (2001, 2003, 2005, 2009 and 2011) in the tables below. The main changes observed are the following:

---

\(^{32}\) These are newer, smaller banks who gear their operations to the small retail, historically unbanked customer.

\(^{33}\) Postbank will be a state owned bank which uses the post office infrastructure. It will aim to increase financial inclusion. For more information see PwC (2011).
1. The reduction in profitability of investment banking and trading activities, down from 20-30% to 0-10%.

2. Banks have still kept large amounts of their capital in Treasuries despite their declining profitability. This might be due to the changing regulatory environment and/or risk aversion.

3. Home loans are becoming more profitable again, post-crisis, even though general coverage in the media point to banks remaining adverse to expanding in this market (hence the growth in unsecured lending of large amounts to middle-income consumers).

4. Commercial property remains an important source of profits, with sizable capital from banks being placed there.

5. Credit cards and life insurance both remain quite profitable and with fair amounts of capital being invested in those activities, however this changed drastically with respect to credit cards. This is most likely due to the impact of the National Credit Act (NCA) which regulated the pricing and access of credit. As a result we see that credit cards stopping being extremely profitable, and the amount of banking capital allocated towards these ends reduced drastically. Also consumer indebtedness places limitations on its continued expansion, with debt reaching a saturation point at present, it seems.

6. A similar impact to credit extensions through cards can be seen in the home loans category. It has stopped being very profitable and the amount of banking capital to this activity has reduced drastically. This is in line with discussions on how the NCA has changed banks’ activities.

7. Retail banking has also tapered off substantially in terms of capital allocation, with the spread of profitability widening at the same time between bans. This is most likely driven by poor conditions in the South African economy. Low employment and output growth.
Figure 5.5: 2005 Profitability of Segment

<table>
<thead>
<tr>
<th>Profitability of segment in the last year (ranked by those active in the segment)</th>
<th>Loss &lt;0%</th>
<th>Marginal 0-10%</th>
<th>Profitable 10 - 20%</th>
<th>Very profitable 20-30%</th>
<th>Extreme &gt;30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail banking</td>
<td>50%</td>
<td></td>
<td></td>
<td></td>
<td>50%</td>
</tr>
<tr>
<td>Home loans</td>
<td>20%</td>
<td>20%</td>
<td>60%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vehicle financing</td>
<td>33%</td>
<td>50%</td>
<td>17%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit cards</td>
<td>28%</td>
<td>14%</td>
<td>14%</td>
<td>43%</td>
<td></td>
</tr>
<tr>
<td>Corporate</td>
<td>28%</td>
<td>44%</td>
<td>22%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Merchant</td>
<td></td>
<td>30%</td>
<td>35%</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>Private banking</td>
<td>42%</td>
<td>12.50%</td>
<td>12.50%</td>
<td>12.50%</td>
<td></td>
</tr>
<tr>
<td>Internet banking</td>
<td>17%</td>
<td>17%</td>
<td>33%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>Micro-lending</td>
<td>17%</td>
<td>17%</td>
<td>50%</td>
<td>17%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PwC 2005 Banking Survey in: Submission by Penelope Hawkins to Banking Enquiry, 2006 -- Exhibit A.

Figure 5.6: Profitability of Segment

<table>
<thead>
<tr>
<th>Profitability of segment in the last year (ranked by those active in the segment)</th>
<th>Moderate 10-20%</th>
<th>High 20-30%</th>
<th>Extreme 30%+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail banking</td>
<td>60%</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Corporate banking</td>
<td>50%</td>
<td>25%</td>
<td>6%</td>
</tr>
<tr>
<td>Merchant banking</td>
<td>47%</td>
<td>24%</td>
<td>6%</td>
</tr>
<tr>
<td>Private banking</td>
<td>18%</td>
<td>18%</td>
<td>27%</td>
</tr>
<tr>
<td>Internet banking</td>
<td>43%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit cards</td>
<td>50%</td>
<td>17%</td>
<td></td>
</tr>
<tr>
<td>Micro-lending</td>
<td></td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

Source: PwC 2003 Banking Survey in: Submission by Penelope Hawkins to Banking Enquiry, 2006 -- Exhibit A.
5.6 Income

PwC (2012) disaggregate the sources of non-interest banking income. Net fee and commission income is stable and the largest component of non-interest income. The other components are fair value income, other income and insurance and bancassurance income.

Figure 5.7: Non Interest Income

Source: PwC Major Banks Analysis (2012).

Interest income for banks has been a declining share of total income since at least 1996, according to the Competition Commission Task group report on the banks (2004).

5.7 Retail Banking

Retail banking was especially profitable in South Africa. The most publicly available information on this in South Africa comes from the 2004 Task Force report:
It is likely that Basel 3 and the NCA have made retail banking less profitable, as indicated by the PwC survey data discussed above. Relative to other sectors in the South African economy, the banking sector has, historically had very high returns on equity.
Table 5.6 divides the business of banking in South Africa into its constituent parts. Industry leaders are indicated wherever the information is available. There are far more banks operating in merchant banking, private banking and treasury activities than other activities. According to the Falkena Report (2004, 38), this suggests greater contestability in these segments implying greater ease of entry and greater competition. “By comparison, relatively few banks are involved in the retail segment.” There is only one branch of a foreign bank involved in internet banking and there are no branches of foreign banks operating in the retail banking, credit card, micro lending or insurance segments – all of which have a household rather than corporate orientation (ibid).
### Table 5.6: The Business of Banking in South Africa

<table>
<thead>
<tr>
<th>Category</th>
<th>2011</th>
<th>2009</th>
<th>2007</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Banking</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BEE Deals</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
</tr>
<tr>
<td>Listings</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>Standard Bank (RMB)</td>
<td>First Rand (RMB)</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>Deutsche Bank (RMB)</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>JP Morgan Chase</td>
</tr>
<tr>
<td>Derivatives</td>
<td>Standard Bank</td>
<td>Standard Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Income</td>
<td>Standard Bank</td>
<td>Standard Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>FirstRand (RMB Morgan Stanley)</td>
<td>Standard Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commodities</td>
<td>Standard Bank</td>
<td>Standard Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Structured Finance</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
<td>First Rand (RMB)</td>
</tr>
<tr>
<td>Brokerage-Institutional</td>
<td>Deutsche Bank</td>
<td>Deutsche Bank</td>
<td>Deutsche Bank</td>
<td>Deutsche Bank</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Standard Bank</td>
<td>Standard Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail Lending &amp; Deposits</td>
<td>ABSA</td>
<td>ABSA/Standard Bank</td>
<td>ABSA</td>
<td>ABSA</td>
</tr>
<tr>
<td>Wealth Management</td>
<td>Investec</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>ABSA</td>
<td>ABSA</td>
<td>ABSA</td>
<td>ABSA</td>
</tr>
<tr>
<td>Mortgages</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vehicle &amp; Asset Financing</td>
<td>First Rand (WesBank)</td>
<td>First Rand (WesBank)</td>
<td>First Rand (WesBank)</td>
<td>First Rand (WesBank)</td>
</tr>
<tr>
<td>Internet</td>
<td>First Rand</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

78
<table>
<thead>
<tr>
<th>Banking</th>
<th>Private Banking</th>
<th>Micro lending</th>
<th>Commercial Property Finance</th>
<th>Trade Finance</th>
<th>Unsecured Personal Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Investec</td>
<td>Capitec</td>
<td>Investec</td>
<td>Standard Bank</td>
<td>African Bank</td>
</tr>
<tr>
<td></td>
<td>Investec</td>
<td>African Bank</td>
<td>Nedbank</td>
<td>Standard Bank</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investec</td>
<td>African Bank</td>
<td>Investec</td>
<td>Standard Bank</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investec</td>
<td>African Bank</td>
<td>ABSA</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Price Waterhouse 2011 Perceptions Survey
6 The Regulatory Framework
Ndonwi Mfongeh, Ilan Strauss, Phumzile Ncube

6.1 Introduction

Regulation and supervision\(^{34}\) of financial activities in South Africa occur within a unique context. Two points are worth highlighting:

1. Although the South African financial sector is relatively advanced, the economy remains primarily cash-based due to the fairly large informal sector (Treasury, 2011).
2. South Africa’s legal framework has been a constitutional supremacy since 1994. South Africa’s Constitution is widely regarded as one of the most progressive in the world and has the potential to have a significant and long lasting influence on the workings of the financial sector in South Africa.

The constitution permeates the application of law at every level. All law must be consistent with it. In the context of the eviction of persons who will be left homeless in the event,\(^{35}\) Advocate Geoff Budlender notes that: ‘The obligation to ‘protect’ a right requires the state to take measures that prevent third parties from interfering with the right.’\(^{36}\) For example, the judgement in *Jaftha v Schoeman and Other, Van Rooyen v Stoltz and Others 2005 (2) SA 140 (CC)*, could make the repossession of housing, on the scale seen in America in the wake of the 2007 Financial Crisis, difficult to enforce under certain circumstances in South Africa. In this ruling the Constitutional Court found that any measure permitting a person to be deprived of existing access to adequate housing is limited by section 26(1) of the Constitution. The judgment does not make the repossession of homes illegal, but requires that the action has proper judicial oversight and incorporates constitutional considerations.\(^{37}\)

South Africa’s regulatory framework is fragmented. Different financial services and markets are regulated by different institutions (Van Wyk, 2011). Banks are regulated by the Banking Supervision Department at SARB in respect of their banking activities. While non-banking financial institutions are regulated by the Financial Services Board. This is done independently from, but still accountable to, the Minister of Finance. Company registrations take place at the office of the Registrar of Companies which is a part of the Department of

\(^{34}\) In what follows the term regulation refers to the rules that govern the behaviour of financial intermediaries (banks), while supervision refers to the monitoring and enforcement of the rules (Hawkins and Torr, 2011).

\(^{35}\) In this case the individuals were being evicted for very small amounts of money. This seemed to have a material impact on the reasonable of the actions of administrator in the court’s eyes.


\(^{37}\) In this specific instance the loss of the home would render the debtor permanently homeless.
Trade and Industry. The Financial Intelligence Centre (FIC) is responsible for control of anti-money laundering activities in the economy. It is an independent body but accountable to the Minister of Finance. The consumer credit industry (i.e. the granting of loans by banks, retailers and other money lenders) is regulated by the National Credit Regulator (NCR). In terms of the Securities Service Act (SSA), the Johannesburg Stock Exchange (JSE, the licensed exchange) and the central securities depository (Strate Ltd) operate as self-regulatory organisations (SROs). They regulate their own activities as well as of their users (members of exchanges) and participants (members of central securities depositories) in terms of the provisions of the SSA. The SSA is in the process of being updated by the Financial Markets bill which has been tabled in Parliament. The Financial Markets Act (when implemented) will incorporate developments in international regulation to strengthen the regulatory environment in South Africa, especially concerning unlisted securities, enabling central reporting for derivative transactions, and taking additional steps to combat market abuse, including insider trading. Of much relevance is the Bill’s proposed approach to regulating over-the-counter (OTC) derivatives. Standardisation, central clearing and central trading will only be required for OTCs where appropriate and feasible.

The Financial Advisory and Intermediary Service (FAIS) Act allows for certain licensing requirements to be handed by industry associations which are authorised for that purpose by the FSB. Financial planners, for example, may apply to the Financial Planning Institute for approval as financial services provider in terms of the FAIS Act. The authorised bodies powers and duties are very narrowly circumscribed. They cannot be strictly described as SROs.

Despite a raft of legislation concerning the financial sector – reviewed below --- no deposit insurance exists.

6.2 The National Credit Act (NCA) of 2005

The NCA is the most important act affecting lending practices in South Africa in the last decade. This Act regulates all credit providers, which includes banks. Prior to the introduction of this Act only the liabilities (deposit) side of banks’ activities were regulated. The assets side, the loans on the balance sheet, were left unregulated. The focus of the legislation is on consumer protection. The NCA aims to transform the credit industry in South Africa by promoting a fair and non-discriminatory market place for access to credit. The act aims to
minimise predatory lending and consumer abuses, and reform outdated, piecemeal and ineffective legislation on consumer credit.

The Act brings into existence the National Credit Regulator (NCR). The Regulator is responsible for the regulation of the consumer credit industry and the creation of a National Consumer Tribunal to deal with matters relating to the Act. The Act aims to protect the consumer, to eliminate various undesirable credit practices and to regulate consumer credit agreements, credit providers and credit bureaus, as well as to provide mechanisms for debt rehabilitation.

Maximum interest rates are strictly regulated. Credit providers are constrained in the following prices:

- Initiation fee (fixed)
- Service fee (no greater that R50 p.m.)
- Credit insurance – not regulated but must be fair
- Default administration charges (regulated)
- Collection costs

Interest and fees after default may not exceed the principal debt at the point of default (implications for collectability of debt). No penalty interest may be incurred once a debtor is in default. The impact of the Act on credit providers has been far ranging and significant. All providers have had to comply with the act as of 1 June 2007. Goodspeed (2011) notes that the act provides for:

- The general regulation of consumer credit
- Improved standards of consumer information
- The prohibition of certain unfair credit and credit marketing practices such as negative option marketing
- The promotion of responsible credit granting and use, and for that purpose to prohibit reckless credit granting
- Debt reorganisation in cases of over-indebtedness
- The regulation of credit information
- The registration of credit providers, credit bureaus and debt counselling services
- The establishment of national norms and standards relating to consumer credit
- The promotion of a consistent enforcement framework relating to consumer credit
• The establishment of the National Credit Regulator as the primary administrative regulator under the National Credit Act to carry out education and research, develop policy, register industry participants, investigate serious complaints and ensure enforcement of the Act
• The establishment of the National Consumer Tribunal to adjudicate on applications in terms of the Act and allegations of prohibited conduct, and to adjudicate complaints under the Act

The Act stipulates a number of fundamental rights of consumers in the credit marketplace. These include:

• Protection against discrimination in credit application and granting
• The right to be given reasons for credit being refused or discontinued
• The right to information relating to the agreement, in an official language, and in plain and understandable language
• The right to the protection of confidential information
• The right to choose whether to receive certain documents electronically or in paper copy

All non-bank credit providers must register with the National Credit Regulator and comply with the Act. If the credit provider has fewer than 100 credit agreements; or an outstanding loan book of less than or equal to R500 000 then they are exempt from the Act. In South Africa the vast majority (82%) of non-bank credit providers are microlenders, 6% are retailers (including furniture stores), 3% are vehicle financiers, 6% are pawnbrokers and 4% are other credit providers (Goodspeed, 2011).

Taken as a whole, Hawkins and Torr (2011, p.73), argue that even with the introduction of the National Credit Act, the regulatory framework ‘does not adequately deal with consumer protection’. A core tension within the act is the attempt to expand access to credit on fair terms while not increasing unmanageable debts and reckless lending. Prior to the introduction of the National Credit Act interest rates were governed by the provisions of the Usury Act of 1968. The pricing of microloans (loans up to a value of R10 000 for a term of up to 36 months), were uncapped.
6.2.1 Why unsecured lending grew?

Unsecured lending has proliferated since 2007, after the NCA was introduced. What explains this seeming contradiction? What explains the rise and growth in unsecured lending since 2007? Unsecured loans consist largely of personal short-term loans, and credit and store card debt. Because these loans are deemed riskier, banks are allowed to charge high rates of interest, although they remain capped at 32% under the NCA. Firstly, credit extensions have been expanded as credit has become more affordable. The average price of a R1 000 one-month loan (a microloan) has decreased significantly between 2002 and 2008. Consumers who may previously only have had access to a micro loan, probably now also have the option of a credit card or personal loan (NCR 2009a, 2009b).

In the case of furniture loans and store cards - both of which are readily accessible to the low to middle income consumer - there has also been a decline in rates of interest (NCR 2009a, 2009b). In effect this has meant the integration of the previously capped usury market (those markets regulated by the Usury Act) with that of the uncapped exempt market (markets unregulated through exceptions of some sort under the Usury Act). Micro loans, for example were part of an exception in the Usury Act whereby no limits were imposed on the price of micro loans.

Since the introduction of the NCA this has changed As African Bank Investments Limited (ABIL) CEO, Leon Kirkinis argues, the market of microloans has expanded as competition has increased in the lending market. A possibility supported by the findings of a 2011 Feasibility Report for the NCR (NCR, 2009b). The growing competition among banks for certain market segments and types of loans was expected since the NCA eliminated traditionally unregulated credit providers and left a gap in the market, making it feasible for banks to enter the micro lending sector. This entry does not necessarily mean that credit is being extended more riskily because most unsecured loans are extended at fixed rates of interest and as the 2009 Feasibility Study notes; the NCA had slowed the extension of risky credit (Isa).

The unsecured credit market expands according to Kirkini, as an easy means ‘to improve margins and ultimately, risk-adjusted profitability. Customers are encouraged to migrate to unsecured credit for their additional financial needs.’ (Bank Monitor SA, 2012). This is evident in the almost doubling of higher income earners as a percentage of the unsecured
market between 2008 and 2011. These clients might still not be eligible for mortgages. Moreover banks ‘appetite’ for providing mortgage loans has waned (NCR, 2009a). Larger unsecured loans are preferred by banks for obvious reasons spelt out below. This suggests that despite stringent interest rate caps, the cost of credit offered to consumers is even more expensive than in the past (NCR, 2009a).

The 2011 Feasibility Report notes that: ‘Clearly this is an outcome of the impact of the higher caps on unsecured credit – which when offered together with cell-captive credit life insurance\textsuperscript{38} has made the margins on offering this kind of product highly attractive.’ The interest cap for such loans was 1000 basis points higher than for secured loans classified under other credit agreements. Equally important is that: ‘the ability to charge fees and the addition of credit life insurance as a requirement of loans effectively renders the interest cap somewhat redundant’ (Feasibility, 2011, 142).

\section*{6.3 The Registrar of Banking and The Banks Act 94 of 1990}

The Registrar of Banks is appointed by the South African Reserve Bank (SARB) – subject to approval of Minister of Finance – and is responsible, in part, for the regulation of banks. The Registrar is housed in the Banking Supervision Department of SARB.

The Banks Act of 1990 is the most important piece of legislation for banks in South Africa. The Bank Acts focus is on prudential regulation (financial soundness) of banks. It main purpose is to regulate the taking of deposits from the public by banks. Regulations contained in the act include minimum capital requirements. Banks were required to have a minimum of R250 million in capital.

Two relevant exclusions from the 1990 Bank Act relate to the issue of debt securities:

1. The commercial paper regulations of 1 January 2008
2. The securitisisation regulations of 1 January 2008

\textsuperscript{38} ‘This approach allows the credit provider to appear competitive in terms of comparable interest rates and fees on the credit offering, but to make up for lost ground in the pricing of credit life insurance. Moreover, the credit life insurance offering is often a highly profitable separate income stream.’ (Feasibility, 2011)
The commercial paper regulations exempt the acceptance of deposits from the general public against the issue of commercial paper from falling within the meaning of the deposit-taking business of a bank.

6.4 Securitisation

Locke (2008) details the history of securitisation in South Africa, briefly: ‘The first securitisation scheme in South Africa was carried out in 1989 by the United Building Society as the originator. The pooled assets were mortgage loans and they were sold to Mortgage Securities 101 (Pty) Ltd, the SPV created for the scheme. The securities issued to finance the transaction were floating-rate debentures’

A host of legislation in South Africa effects securitisation regulation. The most important is the Banks Act and the 2008 Securitisation amendments. The National Credit Act, the Insolvency act, the Deeds Registration Act, various taxation Acts, and exchange control regulations all also effect the securitisation process at some point.

A number of amendments to securitisation regulations in the Banks Acts has been made over the years. The underlying reason for the more recent amendments was the introduction of the Basel II Capital Accord into South African Law.

The Securitisation Regulations regulate, among other things (Webber Wenzel; 2013):

- the corporate status, ownership and control of the issuer of the notes;
- requirements in respect of the transfer or ‘true sale’ of assets from the originator to the issuer;
- the provision of credit enhancement facilities; and
- the provision of liquidity facilities.

The essential regulatory characteristic of securitisation in South Africa is that (Goodspeed, 2011): ‘the securitisation regulations exempt the acceptance of deposits from the general public by an SPV against the issue of commercial paper by the SPV from falling within the meaning of a ‘the business of a bank’. In other words securitisation schemes and activities are exempt from falling under the definition of the business of a bank. Such deposit taking, in respect to a securitisation scheme (traditional or synthetic), must be in line with the conditions
set out in securitisation regulations. This has many important technical implications which are beyond the scope of this report. For example, Locke (2008) notes that:

*Legal opinion will usually be acquired during the structuring phase of a securitisation scheme as to whether the sale of the assets to the SPV will be a ‘true sale’. The procurement of such a legal opinion is a requirement of Securitisation Notice, 2008 when the originator of the scheme is a bank or a company within a banking group. The requirements of Securitisation Notice, 2008 must be met by both bank and non-bank originators for the SPV to be exempted from falling under the definition of 'the business of a bank' in the Banks Act, when the SPV offers its securities to the public.*

South African law firm Webber Wenzel further notes that:

*‘Various restrictions are placed on institutions acting in a ‘primary role’, which the Securitisation Regulations define as the originator, remote originator, sponsor or repackager, and institutions acting in a ‘secondary role’, which the Securitisation Regulations define as a credit enhancement facility provider, liquidity facility provider, underwriter, purchaser of senior commercial paper, servicing agent or a counterparty to a transaction included in the trading book of a bank. The Securitisation Regulations explicitly allow synthetic securitisations as a method of securitising a pool of assets. They contain detailed conditions for the securitisation of revolving assets (such as credit card or ‘store card’ receivables) and further prescribe the specific disclosure of certain additional information in the offering circular.*

*The Bank Regulations provide for the maintenance of risk management by banks and set out the capital adequacy requirements applicable to the various bank exposures, including securitization exposures, in accordance with the principles embodied in the Basel II Capital Accord.’*

In the five years preceding the global financial crisis South Africa’s securitized debt market grew exponentially (by rand volume), according to accountancy firm Deloitte (2007).
However the relative size of the market before the crisis still cannot be compared to the US or the UK market. This is in part because of South Africa’s history of strong regulation in the sector and conservative regulatory environment. For example in South Africa it is required that the auditor of the issuer provide a compliance certificate to be included in the Offering Circular, regarding the compliance of the information in the Offering Circular and the conduct of the securitisation scheme with the requirements of the securitization regulations (Deloitte, 2007).

### 6.5 Regulation of commercial paper (CP) issues

The issuing of commercial paper by entities other than banks for the purpose of acquiring capital is regulated under a special Exemption Notice to the Banks Act – the CP Notice (Botha, 2011). The reason for this Notice is because the issue of commercial paper by a non-bank entity amounts to accepting deposits from the general public and therefore engaging in the business of a bank – as set out by the Bank Act. It amounts to a contravention of the Banks Act and is given legitimacy by the CP Notice. In the Notice CP refers to debt obligations issues by highly rated companies for the purpose of obtaining operating capital or bridging finance.

Some key features of the notice, reproduced from Botha (2011), are:

- **It excludes bills of exchange.**
- **Non-banks are only permitted to accept funds from the public against the issue of CP, subject to the following conditions set by the Registrar of Banks**
  - CP may only be issued and transferred in denominations of R1 million or more
  - It may be issued only by a listed company – or one that held marketable net assets that exceeded R100 million, at least 18 months prior to the proposed issue, or any other juristic person authorised by the registrar, unless the instruments are:
    - Listed on a recognised financial exchange
    - Endorsed by a bank
    - Issued for longer than five years
    - Issued by the central government, or
    - Backed by an explicit central government guarantee
Only the CP issuer may be the ultimate borrower of the money obtained from the public or, if the issuer is a company, only a wholly-owned subsidiary or a holding company thereof may borrow the money.

No market may be made in unlisted commercial paper issued for a period of longer than five years.

Commercial paper may not be used, by means of market-making therein or in any other manner, to obtain overnight funding.

The funds to be raised by the ultimate borrower through the issue of CP may only be used for the purpose of acquiring operating capital and may not (except when issued by the government) be applied for the granting of money loans to the general public.

- Issuers of CP must also disclose information such as
  - The name of the issuer (or the ultimate borrower if it is not the same entity) and its auditor
  - A statement confirming the borrower’s liquidity and solvency as well as information to the lender about the financial risk involved
  - Whether the issue is to be listed or not
  - The specific operational purpose to which the funds will be assigned
  - Whether the CP is to be secured
  - Confirmation by the auditor of the issuer that the issue complies in all respects with the provisions of the CP Notice.

- Lastly, all issuers of CP are obliged to furnish the Registrar on a quarterly basis with a return containing essential information.

### 6.6 Other legislation governing the financial sector

Short descriptions of several acts are given in this section.

#### 6.6.1 The South African Reserve Bank (SARB) Act 90 of 1989
This Act consolidates the laws relating to SARB and the monetary system. It provides the framework within which minimum reserve requirements are set – called cash reserve requirements. Hawkins and Torr (2011) note that:

*The minimum reserve requirement was originally part of banking regulation, but was placed in the SARB Act to indicate that it is primarily seen as a monetary policy instrument rather than a prudential instrument in South Africa.*

According to the SARB Act banks must hold (non-interest bearing) deposits with the SARB equal to 2.5% of its adjusted total liabilities to the public. Banks are no longer able to count their ‘vault cash’ towards meeting their minimum cash requirements. SARB plays an important role in managing the development of the banking sector in South Africa. No person may legally become a licensed bank and take deposits from the public without authorisation from the Banking Supervision Department (BSD).

The BSD is considered to focus on microprudential regulation and supervision (sounds financial institutions). The BSD is part of the BIS, in Switzerland. The BSD is responsible for constantly monitoring development in the domestic and international environment to ensure that the South African legal framework for banks remains up to date, and complies with international best practices and regulations.

Macroprudential supervision (sound financial system) also falls under the ambit of SARB and BSD. The Macroprudential approach going forward after the crisis is described in the ‘Twin Peaks’ policy document, discussed further below.

6.6.2 The Mutual Bank Act 124 of 1993

This act regulates mutual banks. Similar to building societies, their primary assets are residential property mortgages. There are two registered mutual banks in South Africa: GBS Mutual Bank and VBC Mutual Bank, which operate as mutual banks under this act. The Act effectively replaced legislation for building societies.

The minimum capital requirements for a mutual bank is the greater of R10 million or 10% of bank’s assets and other risk exposures. The intention of the Act was to create a second tier of banking, adding depth to banking in South Africa. Given the onerous requirements for mutual
banks, this second tier has not materialised. This failure is linked to the generally conservative
nature of regulation in SARB which promotes the status quo for the benefit of stability at the
cost of a possibly more dynamic banking sector. Moreover, because of Mutual Banks
cooperative structure, they cannot raise external capital through the JSE.

6.6.3 **National Payment System of South Africa Act 78 of 1998**

This allows for the administration and regulation of the payment, clearing and settlement
system in South Africa. As clearing and settlement participants, banks are affected.

6.6.4 **The Financial Intelligence Centre Act 38 of 2001**

The Act requires financial institutions to obtain and retain appropriate information about
clients, Motivation of this act is to combat money laundering and financial terrorism.

6.6.5 **The Financial Advisory and Intermediary Services (FAIS) Act 37 of
2002**

FAIS aims to protect consumers through regulating certain advisory and intermediary services
provided by financial firms and banks to clients.

6.6.6 **The Cooperative Bank Act of 2007**

This new piece of legislation allows for cooperative banks to be established and regulated.
These banks potentially include credit unions in which members contribute to the communal
deposits and allow for loans from this communal funding. The Act requires cooperatives who
fall within the definition of a business of a bank to register as a cooperative bank.
Cooperative financial institutions, such as stokvels (see textbox 1), are exempt from
registering as a bank. This exemption however places a limit on the total amount of funds
sought out or managed by a cooperative financial institution. If the subscriptions exceed R30
million or the deposits of a financial services cooperative exceed R20 million, then the entity
is required to register as a bank – probably a cooperative bank.
The FSB was established as a separate government agency by the Financial Services Board Act 97 of 1990. Prior to 1991 and the establishment of the FSB, financial regulation in South Africa was located exclusively within the hands of the Registrar of Financial Institutions (which was a part of the Department of Finance).

The functions of the FSB, taken from van Wky (2011), in terms of the Financial Services Board Act are to:

- **Supervise compliance with laws regulating financial institutions and the provision of financial services.**
- **Advise the minister on matters concerning financial institutions and financial services.**
- **Promote consumer education programmes and initiatives by financial institutions and bodies representing the financial services industry.**

At present advisory bodies comprising of industry representatives advise the FSB on matters of policy. As part of the Treasury’s post-crisis regulatory approach (2011), a rationalisation of these bodies is proposed. The FSB has several divisions focusing on: (i) financial advisory and intermediary services; (ii) capital markets; (iii) insurance; (iv) retirement funds; (v) inspecting financial institutions; (vi) financial intelligence.

**Textbox 1: Stockvels**

Stockvels are regulated in South Africa. A stokvel is a group or association of individuals who make regular contributions to a pool of savings or common fund on a regular basis. In many stockvels the pool of money is given (in total or part) to each contributor on a strictly rotational basis (Goodspeed, 2011). Stockvels are usually held together by a common bond between members rather than a formalised agreement. Stockvels provide access to credit to those who do not fully participate in the formal banking sector. Stockvels can be of different type: burial society, investment society, or a traditional stockvel (financial intermediary).

Stockvels and savings and credit cooperatives accept deposits in a manner akin to how a bank conducts business. In recognition of their social and economic upliftment role, the BSD has legalised such societies under the ‘common-bond exception notice’ but outside of the Bank Act or Mutual Banks Act (i.e. not as a registered bank). Subsequent amendments to the common-bond exemption of 1994 ensure stockvels cannot undertake the activities of pension fund organisation as defined in the Pension Fund Act.

### 6.7 The Financial Services Board (FSB)

The FSB was established as a separate government agency by the Financial Services Board Act 97 of 1990. Prior to 1991 and the establishment of the FSB, financial regulation in South Africa was located exclusively within the hands of the Registrar of Financial Institutions (which was a part of the Department of Finance).

The functions of the FSB, taken from van Wky (2011), in terms of the Financial Services Board Act are to:

- **Supervise compliance with laws regulating financial institutions and the provision of financial services.**
- **Advise the minister on matters concerning financial institutions and financial services.**
- **Promote consumer education programmes and initiatives by financial institutions and bodies representing the financial services industry.**

At present advisory bodies comprising of industry representatives advise the FSB on matters of policy. As part of the Treasury’s post-crisis regulatory approach (2011), a rationalisation of these bodies is proposed. The FSB has several divisions focusing on: (i) financial advisory and intermediary services; (ii) capital markets; (iii) insurance; (iv) retirement funds; (v) inspecting financial institutions; (vi) financial intelligence.
(i) The Financial Advisory and Intermediary Services Division is regulated in terms of the FAIS Act 37 of 2002. It focuses on rules of market conduct for the protection of consumers in the financial industry. Businesses covered by the legislation include investment managers, investment advisors, insurance brokers and advisors, foreign exchange intermediaries, and financial planners and advisors. Liquid assets requirements based on the category of financial service provider is now in place. Prudential requirements might be introduced too (van Wyk, 2011). A fairly comprehensive framework is in place to regulate market participants.

(ii) Capital Market Division supervises the South African licensed exchange, central securities\textsuperscript{39} depository and clearing houses in terms of the Securities Services Act of 2004 (recently replaced by the Financial Markets Act 2012) (van Wyk, 2011). South Africa has only one licensed exchange, the JSE. The JSE operates an equities market, equity derivatives market, commodity derivative market, currency derivatives market and an interest rate market. There is one central securities depository, Strate, which clears and settles all listed and some OTC instruments except derivatives, of which Safcom is the clearing house (van Wyk, 2011). The SSA established a Directorate of Market Abuse which monitors insider trading, manipulative, false, improper or deceptive practise, etc. The Division ensures compliance with the International Organization of Securities Commissions (IOSCO) standards.

(iii) The Insurance Division regulates the long- and short-term insurance industry in terms of the Long-term insurance Act 52 of 1998 and the Short-term Insurance Act 53 of 1998. A regulatory framework for micro-insurance is in the process of being developed. Again, South Africa follows the regulatory benchmarks set for the insurance industry by the Solvency 2 Directive of the European Parliament and Council, adopted by the FSB. The Treasury (2011) has identified various abuses in the long- and short- term insurance industry which it hopes to correct for.

(iv) Retirement Funds are registered in terms of the Pension Funds Act 24 of 1956. No retirement fund may operate without being registered at the FSB.

\textsuperscript{39} Securities include shares, stocks and depository receipts in public companies and other equivalent equities, notes, derivatives, bonds, debentures, units in a collective investment scheme, index-based instruments, and foreign securities (van Wyk, 2011).
(v) The Inspectorate Department has wide ranging powers. It makes provisions for the Registrar to order an investigation into the affairs of any financial institution, given reasonable suspicions. No warrant is required to search the premises. Any container may be opened if suspected of containing documents necessary to be investigated.

(vi) The Financial Intelligence Centre acts as mandated by the Financial Intelligence Centre Act 38 of 2001, discussed above.

The key relationships between the various government regulators and financial sector institutions is summarised in Table 6.1 and Figure 6.2, below.
Table 6.1: Selected Financial sector Regulators

<table>
<thead>
<tr>
<th>Entity</th>
<th>Current function</th>
<th>Currently reports to</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Bank Supervision Department</td>
<td>Banking sector (prudential) regulation</td>
<td>Reserve Bank</td>
</tr>
<tr>
<td>2 Financial Services Board (FSB)</td>
<td>Regulator of non-bank financial institutions</td>
<td>Minister of Finance</td>
</tr>
<tr>
<td>3 National Payments System Department</td>
<td>Payment system oversight</td>
<td>Reserve Bank</td>
</tr>
<tr>
<td>4 Exchange Control Department</td>
<td>Exchange control regulation</td>
<td>Reserve Bank / Minister of Finance</td>
</tr>
<tr>
<td>5 National Credit Regulator (NCR)</td>
<td>Regulator of credit provision</td>
<td>Minister of Trade and Industry</td>
</tr>
<tr>
<td>6 Co-operative Banks Supervision</td>
<td>Regulation of co-operative banks (over R20 million)</td>
<td>Reserve Bank</td>
</tr>
<tr>
<td>7 Co-operative Banks Development Agency</td>
<td>Regulation of co-operative banks (under R20 million)</td>
<td>Minister of Finance</td>
</tr>
<tr>
<td>8 Financial Advisory and Intermediary Services ombud</td>
<td>Resolve disputes between financial service providers and customers</td>
<td>FSB</td>
</tr>
<tr>
<td>9 Pensions Funds Adjudicator</td>
<td>Resolve disputes with respect to pension fund management</td>
<td>FSB</td>
</tr>
<tr>
<td>10 Industry ombuds</td>
<td>Resolve disputes in long-term insurance, short-term insurance and banking services industries</td>
<td>FSB</td>
</tr>
<tr>
<td>11 Johannesburg Stock Exchange (incl. Besa) (JSE)</td>
<td>Licensed self regulating securities exchange</td>
<td>FSB</td>
</tr>
<tr>
<td>12 Strate</td>
<td>Licensed self-regulating central securities depository</td>
<td>FSB</td>
</tr>
<tr>
<td>13 Financial Intelligence Centre (FIC)</td>
<td>Preventing financial crimes: Anti-money laundering and combating the financing of terrorism</td>
<td>Minister of Finance</td>
</tr>
<tr>
<td>14 Council for Medical Aid Schemes</td>
<td>Regulation of medical aid schemes</td>
<td>Minister of Health</td>
</tr>
</tbody>
</table>

Source: Treasury (2011)
6.8 Changes in regulation in response to the crisis

According to Treasury (2011), South Africa was relatively sheltered from the financial crisis because of:

- Limited exposure to foreign assets due to exchange controls
- Proper risk management at the banks
- Sound financial regulation
- Ring-fenced assets and liabilities of foreign banks in SA as any foreign bank must have a local subsidiary before it is allowed to operate
- High levels of transparency arising from disclosure requirements for companies listed on the JSE.

Van Wyk (2011) says that prudential regulation with regard to foreign investments by institutional investors has largely replaced exchange controls for these actors in 2008. Regulation through currency based exchange controls on transactions has therefore declined in importance. The ‘pre-application’ process which defined exchange controls was replaced in 2008 by a system or reporting and monitoring of foreign exposures. This represented a
significant move from ‘transaction-based’ controls to a ‘risk-based’ prudential approach. For further discussion see Leape and Thomas (2011). Despite the stability of the financial sector in the aftermath of the crisis the wider economy was significantly affected.

The National Treasury published a key policy paper in February 2011 proposing a ‘twin peaks’ approach to financial regulation going forward. The main proposal is ‘to separate prudential and market conduct regulation’ (Treasury, 2011, p.2). One regulator would be tasked with prudential regulation, and another with market conduct regulation. Inherent in this approach is recognition of the different skills and philosophies, often conflicting, involved in prudential regulation vs. market conduct. The proposed regulatory framework would cover all financial service firms including banks.

The proposed regulatory framework is summarised below.

Source: Treasury (2011)

Financial stability is dealt with in practical terms by the setting up of two committees to coordinate the activities of financial regulators (Hawkins and Torr, 2011):

- The Financial Stability Oversight Committee, co-chaired by SARB Governor and Minister of Finance, will be responsible for coordinating financial stability, alleviating the risk of any crisis and resolving any crisis that does arise.

---


41 It is estimated that South Africa lost one million jobs as a direct consequence of the crisis. According to Rashid (2011), manufacturing output shrank by 15% in South Africa since 2009. Exports fell by 20% in 2009.
The Council of Financial Regulators aims to ensure information sharing between regulators, and the overall coordination of regulatory activities.

Consumer protection is developed through the Financial Services Board (FSB) and broadened to include a banking services market conduct regulator.

Access to financial services is to be broadened through encouraging ‘micro insurance’.

No mention is made of a retail banking market conduct regulator separate and distinct from the FSB’s mandate to regulate market conduct. Van Wyk et al. (2012) argues that: ‘the perimeter of financial regulation must be expanded to include all unregulated financial activities such as private pools of capital, hedge funds, OTC derivatives and credit rating agencies’.

6.9 *Basel II implementation and effects*

The principal legal instrument in the SA banking world is the Banks Act 1990. Basel II was published in 2004 and was supposed to replace and improve on Basel I which had been published in 1988. Basel II improved on Basel I by aligning the capital requirements based on the actual risk factors encountered by banks. Basel I had its capital requirement set at 8% of risk-weighted assets for all banks. This was too rigid and events such as the de-regulation of financial markets, globalisation, competitive pressures and improved technology that allowed the creation of new and more complicated products and delivery systems necessitated the formulation of Basel II. Basel II was thus deemed to be more flexible and ‘risk-sensitive’.

Under pillar 2 of Basel II, banks had to implement their own Internal Capital Adequacy Assessment Process (de Lange and Petros, 2009).

Basel II was designed to provide banks with a forward-looking approach such that they could spot current and future risks. It was based on 3 pillars – maintenance of regulatory capital calculated in relation to credit risk, operational risk and market risk; provision for supervisory reviews; encouragement of market discipline to complement pillar 1 and pillar 2.

was to enhance financial stability. Basel II came about due to globalisation, technological advances and financial engineering. All of these mean that the flow of financial instruments has become much easier and financial transactions have become much more complex. Basel II was supposed to increase the access of emerging economies to financial markets through improvements in corporate governance, capital management, transparency standards and supervisory practices (SARB, 2005).

Based on the new Basel II accord, the new Banks Amendment Act altered the way in which capital adequacy is calculated. Basel II also required increased co-operation between banking supervisors under pillar 2, and such co-operation was previously not provided for in Basel I. Also, the powers of the Registrar were increased to, for example, entering into co-operation agreements with supervisors of international jurisdictions. The Registrar was now also in a position to communicate formally with banks regarding the application and interpretation of provisions of the Act. The Registrar also had a wider scope of penalties – the Registrar could now issue both financial and non-financial penalties for any contravention of the Banks Act. The benefits of implementing Basel II included banks’ ability to reduce capital, increase decision-making quality and improved reputations. The costs of implementing are largely around the complexity of the regulations that make them very difficult to implement. However, respondents in this research felt that the benefits out-weighed the risks because banks would be forced to consider and measure risks more accurately and because it would send out a message that South Africa has well-managed banks (Quiding, 2006).

The bank supervisory department faced a number of challenges during the implementation of Basel II including refinement of the organisation structure, the risk-based supervisory process applied and IT systems required to carry out the supervisory work. Challenges faced by banks in the implementation included the planning, hiring of appropriately qualified staff and ensuring the availability and quality of data.

Basel II was further enhanced in 2009 as a response to the global economic crisis. The changes included higher risk weights for re-securitisation exposures, i.e. collaterised debt obligations (CDOs) and the conduction of more rigorous credit analyses of externally-rated CDOs. The oversight duties of the supervision department in relation to Basel II include the compliance-based supervision of Pillar 1 risks - credit, market and operational risk – and Pillar 2 prudential supervision of a bank’s inherent sources of risk and its controls to manage them.
There was also a re-assessment of the ratings agencies, i.e. Moody’s, Fitch and S&P to ensure that they still complied with the criteria laid out in the Regulations as their ratings are heavily relied upon in the calculation of minimum required capital and reserve funds relating to credit risk and securitisation exposure of banks.

Basel III was then published (the first version in 2009 and which was set to come into effect in 2013) in response to the global financial crisis in an effort to improve banks’ transparency, improve banking sector’s ability to absorb shocks from ‘financial and economic stress, whatever the source’ and to improve risk management and governance. The reforms are aimed at both micro-prudential changes – at the individual bank-level – and macro-prudential changes – looking at the banking sector as a whole.

6.9.1 Summary of bank supervision department annual report 2011

The Banks Act was supposed to be further amended in 2011 but then that was put on hold in order to incorporate the “on-going developments in terms of the Basel III framework”; the new amendment bill was tabled in 2012 and enacted as the Banks Amendment Act 2013 in December 2013. Core Principle 5 of Basel II was addressed in Article 52 of the Banks Act as amended in 2008. Article 52 requires banks to obtain “prior written approval of the Registrar” for the establishment or any acquisition of a subsidiary, cross-border branch or representative office that has its primary office/place of business outside South Africa.

The number of both local and international expansion approvals based on Article 52 has decreased sharply since 2002. Local expansion approvals went from 47 in 2002 to 19 in 2011, while the international ones decreased from 43 in 2002 to 27 in 2011. While both fluctuated a lot during this 2002 – 2011 period, the local expansion approvals have been on a general decline while the international ones dipped in 2006 but started rising again in 2007. However, these figures exclude Investec plc.

In anticipation of the changes made due to Basel III regulations, banks have “reduced their issuance of term debt instruments that qualify as regulatory capital”. As a ratio of total debt instruments, term debt instruments have gone from approximately 80% to 60% between January 2009 and November 2011. Banks’ adequacy ratios in 2011 remained fairly stable and
the banks were indeed adequately capitalised. The average liquid assets held increased, thus surpassing the minimum requirement of not less than 5% of the banking sector’s liabilities.

6.9.2 Summary of changes made as at the end of 2011 as a result of Basel II

Pillar 1 - Credit, market and operational risk

Credit risk
- Banks had the choice to choose from the following three methodologies to calculate their minimum required regulatory capital related to credit risk: the standardised approach (STA), foundation internal ratings-based (FIRB), advanced internal ratings-based (AIRB). The majority of banks used the STA.
- Amendments were also made to the credit risk statutory returns. This is related to the reporting of the credit risk data by banks. The amendments included separation of securitisation and resecuritisation information to incorporate resecuritisation enhancement to the Basel II framework; expansion of asset classes covered to provide the Department with product-specific information; additional reporting relating to geographical distribution and related-party exposures were introduced based on the requirements outlined in the Basel Core Principles

Market risk
- Capital held for market risk made up about 2.16% of the total capital requirement for the banking sector in 2010-2011.
- Banks had to adopt Basel II.5 in 2011 and the Department determined that banks wouldn’t have difficulty in meeting the capital requirements of Basel II.5

Operational risk
- Operational risk is risk from loss resulting from inadequate or failed internal processes, people and systems.
- Strategic objectives identified by major banks in 2011 included improvement in the efficiency of risk management processes, improved data collection, integration of operational risk technology platforms
- The Department found that banks had made good progress as far as operational risk management is concerned but there was still room for improvement

Pillar 2 - Capital management
- The following key aspects were focused on during the Internal Capital Adequacy Assessment (ICAAP) reviews for 2011: ability of banks to explain and justify differences between regulatory and economic capital requirements; economic capital model developments; capital management and incorporation of Basel III framework in long term capital plans; internal use of ICAAPs for strategy setting, planning, risk appetite setting and pricing

Pillar 3 - Disclosure reviews
- Disclosure review revealed the following: there was incorrect disclosure of average amounts of gross credit exposure; some banks were still reporting risk-weighted assets instead of capital requirements; some banks still did not disclose qualitative information regarding to methodology adopted to assign economic capital and credit risk limits in respect of their exposure to counterparty credit risk.
- Some of the qualitative shortcomings found in relation to the disclosure on remuneration are as follows: description of the ways in which current and future risks are taken into account in remuneration processes; explanation of how banks ensure that risk and compliance employees are remunerated independently from the businesses they oversee; discussion of ways in which these measures affect remuneration.
- Some of the quantitative shortcomings are as follows: total amount of referred remuneration paid out in the financial year; number and total amount of sign-on awards made during the financial year; number and total amount of severance payments made out during the financial year
7 The Relationship between Finance and other Sectors
Seeraj Mohamed

7.1 Introduction

The history that shaped the structure of the banking industry in Section 3 can be read as applying to the insurance and other financial subsectors, such as collective investment schemes and retirement funds. The major companies grew out of English institutions and the efforts of the Afrikaner nationalist movement to mobilise the savings of Afrikaners to build Afrikaner businesses. In the top four insurance and financial services groups Old Mutual grew from English financial interests and is currently listed in London and Sanlam, which has kept its primary listing in South Africa, grew from Afrikaner interests. There was a close relationship between the banking and insurance industry, which both had close relationships with mining-finance groups. During the post-apartheid period there was increased internationalisation of these groups with the largest groups, such as Old Mutual and Sanlam, acquiring interests in insurance and financial management groups in the US and Europe. These developments were similar to the internationalisation of the other largest corporations in the South African economy.

7.2 Internationalisation

Mohamed (2012) argues that on the one hand the large corporations were attempting to reduce the possibility of influence by a new, democratic government with a large development backlog over their assets and resources. On the other hand, there was huge global corporate restructuring for increased control over global markets that the largest South African corporations did not want to miss out on. There were a number of misadventures, particularly with financial management companies in the US. Old Mutual tried to become a major global player with the acquisition of Skandia, the Swedish insurance company, after it had to sell off and restructure its US financial management interests. However, by 2012 Old Mutual had sold off its shares in Skandia. Sanlam and Standard bank/Liberty life tried to grow in a less ambitious way focusing on acquisitions abroad. Since a large share of Standard’s shares was acquired by the People’s Construction Bank of China. During 2014 ABSA took over the African assets of Barclays, which took a controlling interest (55.5%) in the group in 2005. Most South African financial institutions are now looking to expansion into Africa. For example, Sanlam now boasts a presence in the life insurance industry of Malawi, Kenya,
Tanzania, Zambia, Nigeria and Uganda. It also has financial management interests in most of these countries.

### 7.3 Size and growth

The Association for Savings and Investment in South Africa (ASISA, 2012) estimates that household savings regulated products institutions, which include, long-term insurance life offices, retirement funds and collective investment schemes portfolios, managed a pool of R4.9 trillion in savings in South Africa at the end of 2011. Long-term insurance share was R1.5tn, retirement funds share was R2.4 tn, and collective investment schemes share was R1tn at the end of 2011.

The short-term insurance industry grew top line earning by R41.1 billion to R72.5 bn in 2010 and long-term insurance premiums grew 50% to R262.4bn during that period (KPMG, 2012). The life industry, which has 79 licensees, held asset by the end of 2011 had assets of R1045 billion a 13% increase from 2010 (ASISA, 2011). While there are 79 licensees, a few groups led by Old Mutual, Sanlam, Liberty and Momentum have dominated the market over the past decade and more. These groups have been involved in significant acquisition drives to consolidate their positions. There are strong links between the life assurers who also dominate the short-term insurance markets and the four major banks, all of whom are involved in insurance and financial services. The bancassurance business- where banks own insurance businesses is large in South Africa with the largest banking groups, ABSA, Standard and FNB all major players in the insurance industry. ABSA had short-term premium income of R3.7 bn in 2011. Independent operators, such as direct marketers have made inroads into the business, however, it is expected that there will be further consolidation of the industry with regulator changes affecting asset requirements and risk levels.

### 7.4 Conclusion

The same groups that dominate the South African banking markets dominate the insurance and financial management sections as well with bancassurance playing a large role. South African financial institutions have had a long relationship with the financial institutions of former colonial powers. With the transition to democracy there were attempts to invest abroad and forays into developed economies were not successful. After democracy and the
acquisition of the largest banking groups by foreign financial institutions, South African financial institutions seem to have reinvented themselves with an African identity and are moving into financial markets in the rest of Africa through acquisitions. Some of these acquisitions are associated with group formerly owned by the foreign acquirers but many are new relationships to enter growing African markets.
8 Plantation meets MEC: Political Economy of Culture in Financialised South Africa

Rex A McKenzie

8.1 Introduction

“... Production appears to have been superseded, as the fons et origo of wealth, by less tangible ways of generating value: by control over such things as the provision of services, the means of communication, and above all, the flow of finance capital. In short - by the market and by speculation” (Comaroff and Comaroff 2001, 5).

This article investigates and examines the interaction of internal and external changes in the local and global political economy in order to explain changes in the everyday culture of present day South Africa. Because of its qualitative and lived aspects, there are no empirical tests, no fancy math instead the article is informed by a series of semi structured open ended interviews with selected economic agents. The article proceeds via synthetic theorization which I believe best lends itself to this type of exercise. It is premised on the notion that the peculiar history of modern South Africa, the extractive mining origin through to the colonial, and post colonial forms of economic organization tend to the formation and reproduction of the total institution as a system of social organization. RT Smith in the original application of the Goffman concept of the total institution to plantation society describes it as a bureaucratically organized system in which blocks of people are treated as units and are marched through a set of regimented activities under the close surveillance of a small supervisory staff (Smith, 1967, 230). It is the total institution which provides the theoretical bridge between plantation forms of organisation and the Minerals Energy Complex (MEC) that defines social relationships in South Africa. Thus the key to an understanding of contemporary South Africa, its skewed social relations, unequal distribution and even its violence lies in its Minerals Energy Complex (MEC) total institution past.

Fine and Rustomjee (1996) describe the MEC as a system of accumulation particular to historical development in South Africa. Its origins lie in a minerals revolution associated with names like De Beers and Rhodes, but subsequently maturing over time through the apartheid era into the contemporary period. Its chief characteristic is the acute dominance of six mining houses in a concentration that makes for an oligopolistic industry structure. Over time the

---

42 The idea of the total institutions comes from Goffman’s 1960’s work on Asylums. In it small socially recognizable groups drive a larger group in through the production process in a very regimented and differentiated manner. See McKenzie (n.d.) for a systematic and full elaboration of this idea.
mining houses have established or acquired their own financial interests. Today there is a
great interweaving between real, productive and financial capital organized in a huge
conglomerate structure.\textsuperscript{43}

The chief distinction between the classical or pure MEC as described by Fine and Rustomjee
(ibid.) and the financialised MEC (F-MEC) of the contemporary period is the explosion in the
\textit{acquisition of financial assets} in the management of all balance sheets (including balance
sheets of the conglomerates) across the system. While this tendency has its genesis in the
1980s, its impetus in that period comes from a different source. Sanctions in the 1980s meant
that internally, capital was trapped. The investment atmosphere was uncertain and
accordingly characterised by a reluctance to invest in fixed capital. In reaction there was an
increase in the size and depth of capital markets. At this stage as Mohammed (2009) puts it
the; “growth of finance is driven more by political uncertainty rather than by financial
imperatives ‘crowding out’ investment at the level of the firm.” The big change comes in the
1990s with the De Kock Commission legislation and the full effects of deregulation taking
hold. This is an institutional change, a second and altogether different impetus that that of the
1980s. The whole process culminates in the emergence of specifically financial
conglomerates\textsuperscript{44} that increasingly dominate over industrial capital.

Fine and Rustomjee (ibid.) and the plantation theorists (Beckford 1972, Levitt 2000, Best and
Levitt, 1975) take an institutional approach to understanding the inherent character of the
modes of accumulation associated with their respective regions of study. Best and Levitt
(1975) sought to isolate the institutional structures and constraints which the contemporary
economy inherited from its plantation legacy. “The historical stages which underlie the
models are to be seen in the contemporary perspective of successive layers of inherited
structures and mechanisms which condition the possibilities of transformation of the present
economy.” The central thrust of the model is that Caribbean society and economy had taken

\textsuperscript{43} According to Mohamed (2010), Formation of conglomerate structure that unites mining, manufacturing and

\textsuperscript{44} Standard Bank: Industrial and Commercial bank of China has 20\% stake, biggest bank in Africa (by assets),
controls the Liberty Holdings group which includes Liberty Life Insurance (the third biggest insurance co) and
Stanlib (the largest unit trust company and second largest investment manager). ABSA formed in 1991 through
the merger of ‘Afrikaner’ groupings previously under Sanlam – Barclays now has controlling stake whilst
Sanlam undertook extensive unbundling and delisted 1990-1992. The First National Bank now part of First Rand
Limited which is dominated by Rand Merchant Bank and Remgro and which includes Wesbank, Momentum
Insurance and Asset Management. The Nedbank Group: controlled by Old Mutual, demutualised, relisted on
several stock exchanges in 1999. Vitali, Glattfelder and Battiston (2011) found that 147 corporations control
40\% of the monetary value of all transnational corporations, that 45 of the top 50 firms are financial firms, and
Old Mutual is 30\textsuperscript{th}
on characteristic features in structure and functioning conditioned by the dominant institution in place during the formative period of its history – the plantation. For the purposes of this article the MEC is construed in similar vein with both plantation and MEC having commonalities in terms of their social characteristics. To the extent that it can be, the theorization of the plantation is used to supplement the theorization of the MEC.

Common to both is a rigid social structure that inhibits factor mobility. In large part race became synonymous with class generating a caste system that needed considerable means of violence and coercion to ensure its smooth functioning. Social tension and instability were hallmarks of the system. The excessive power of the conglomerates (and associated classes) was exercised more in the interest of the small white dominant class to the exclusion of all others. The entire system was underpinned by an exploitative authoritarian tradition that prevents cooperative decision making and associative productive effort.

A second common feature is the emergence of patron client relationships as the dominant social form. In South Africa post 1994, patron-client relations between the state, its institutions and sections of the society have emerged as the defining social relationship of the social system. Such relationships are rooted in the history of the country. Under the apartheid there was the absolute power of the state arranged against African labour. In the period immediately after democracy in 1994 the relationship between the conglomerates and the “free” African labour of democratic South Africa is mediated by the African National Congress (ANC) – a type of patron in a system of patron-client relations. This is our starting point.

A third common feature is the structure and orientation of the ruling parties. In South Africa, the ANC has provided a strong central administration with a political structure that facilitates compliance to the party line but discourages effective popular participation in the political process. The general perception is that dominant elements within the Congress display a general absence of social responsibility that explain the poorly organized educational system or the door-less, uncovered toilets of the Marikana.45

45 In Marikana there are about five toilets to every 80 men. The toilets are door-less. “It cuts costs to have no doors – but for us it tells us that they think we are not the same as white people – that we do not need privacy like them.” (quoted in Schuitte, 2012)
The fourth and final common feature relates to aspects of the social behaviour. In today’s South Africa there are three discernible aspects of social behaviour that help to define the trajectory of the social system. The first stands in opposition to the second and third and together they represent an unresolved, ongoing tension/conflict in the contemporary setting:

1. A strong element of tradition among all groups and a general hostility to intellectualism. Both of which militate against innovation and change
2. A strong individualism that contributes more to clashes of interest in interpersonal relations than to cooperative activity.
3. Pervasive value orientations that reflect aspirations to the “great house” life style with characteristic high propensities to consume imported luxuries and to invest in nonproductive activities.

The aim here is to examine the way these internal currents and tendencies shaped by the MEC-apartheid past have interacted with the recent winds of change emanating from the financialisation of world economy to shape the present culture. Financialisation is defined after Krippner (2005), and Arrighi (1994), as a pattern of accumulation in which profits accrue through financial channels rather than through trade or commodity production. As Vasudevan (2009) observes: “The basic principle of financialisation is the transformation of future streams of (profit, dividend, or interest) income into a tradable asset like a stock or a bond.” According to Epstein (2001), “It reflects the systemic power and importance of “financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international level”

For our purposes there are six main tendencies associated with financialisation:46

a. By undermining the capacity of states to sustain economies in which “production, plant, firm and industry were national phenomena” (Hobsbawn, 1979, 313), it renders obsolete the old system of bargaining in which labour and capital could negotiate wages and conditions within an enclaved territory.

b. By subverting domestic production in industrialized countries, it encourages the cutting of labour costs through casualization, outsourcing and the hiring of discounted (female, immigrant, racinated) workers, thereby either making blue-collar employees redundant or forcing them into the menial end of the service sector.

46 These ideas come from Comaroff and Comaroff (2001) and Thomas (988).
c. By widening the gulf between rich and poor nations, it makes the latter – via the export of labor or the hosting of sweatshops and malquiladoras - into the working class of the former.

d. By reducing proletarians everywhere to the lowest common denominator, it compels them to compete with little protection against the most exploitative modes of manufacture on the planet.

e. Development of information technology has reached a point where all shades of opinion comment on the unprecedented degree of villagization of the global economy. The most striking consequence is the growing hold of consumerist culture of the West. Indeed the only significant area of self-conscious rejection of this trend is located in present day Islamic appeals. The transition therefore is strongly associated, both as cause and effect, with a historically unprecedented global homogenization of consumption goods, services, finance, and even the institutions and instruments of economic management.

f. On a global scale, the contradictory development of bureaucracy in the face of ideological assaults on the state is another noteworthy feature of the transition. This development includes, first, a burgeoning growth of corruption, which has reached such staggering proportions that some social scientists see it as an “independent productive factor.” A second factor is the growing informalization of wide areas of economic activity across the world: it is estimated that one third of the labour force in the OECD countries operates substantially in the informal sectors. A third factor is the unprecedented impact of the international bureaucracy of the national management of economic systems in the periphery (the IMF/IBRD syndrome).

Looked at from the workers point of view it all translates to one large imprint. “A productive worker producing a value in excess of his or her wage, may still be negligible if the balance sheet on which he or she might appear as an asset may be sold ...” (Toporowski, 2010).

Above all else financialisation in the social and economic realm that concerns us here means “... The value of any labor or effort becomes inconstant since, at any one time, it depends on an ephemeral conjuncture in the financial markets. ... The common factor in our humanity at work or at home comes to be our preoccupation with asset values.” (ibid.) Financial market
have come to dominate our existence, this is the case the world over; the core of this paper is an investigation of how this seemingly benign change has affected the social and cultural dynamics on the ground in South Africa. What are the implications for social and economic development?

In order to conceptualise our problematique it is necessary to invoke a dichotomy between internal and external sources of change. There are internal and external sources of change, patron client relations (historically a main feature of the social system) is an internal source of change. The financialisation of the world economy represents an external source of change. This article focuses on the interaction between the two and how that interaction is experienced by social and economic agents.

8.2 Patron Client Relations

‘We’re not forcing people ... you can support and be a supporter, but if you go beyond that and become a member, [and] if you’re a businessman, your business will multiply. Everything you touch will multiply. I’ve always said that a wise businessperson will support the ANC … because supporting the ANC means you’re investing very well in your business.’ – President Jacob Zuma (Tamukamoyo, 2013)

The predominant social characteristic of MEC is the existence of a class-caste system based on differences in racial origins of the MEC worker and of the mine owner. Race therefore became an easy and convenient way to control the labour supply. Racial characteristics determined the caste line which separated the worker from the owners and managers. It is argued here that the caste-class demarcation has now been supplemented by patron client relations between the political party and the poor and such relations now serve as the means for controlling labour in present day South Africa. Another layer is now superimposed on the social landscape and this last layer makes it even more difficult for a working class consciousness to emerge.47

47 This is important and is related to the point made by Ashman et al (2010) on the limitations of national liberation movements. In my view social arrangements under the MEC jettisons class and class consciousness. Thus the “struggle” was primarily anti white and only anti capitalist or anti imperialist insofar as they both were represented by whiteness. Rather than a failing of National Liberation movements it is more to be seen as a failure of progressive intellectuals to fully appreciate the lived aspect of racial politics.
According to Beckford (1972, 203-204) for economic development to take place the essential requirement would have to be a socially favourable environment. He argues that economic development requires a highly motivated population with progress oriented values directed towards the development effort with social institutions which provide incentives and rewards.

His list of concrete social requirements for development includes:

- An educational system designed to promote national consciousness,
- Health and recreational facilities contributing to greater labour productivity.
- Scientific research to extend the boundaries of human knowledge.
- Well defined strong local communities.
- Every individual in the society having something at stake in the future of the country.

Race, class and caste under the MEC created a fractured society which precluded the emergence of these concrete social requirements. Far from providing framework conditions race, class and caste are used to promote a negative social context in that the control of labour is promoted via a fertile breeding ground for race, caste and class based conflict and mistrust. In the circumstances, the population develops a limited and constrained confidence in the future. Periodic social explosions result.

Investment then becomes limited to assets that can survive periodic social conflagrations. And as social explosions occur, substantial resources are used up to just to replace fixed assets destroyed in the process. Underlying social tensions, exacerbated by racial divisions reinforce the tendency towards underdevelopment.

In so far as the MEC is socially integrated, the integration is based on economic production and achievement motivation. But in both these areas the associated social ethos is a strong individualism which is entirely divorced from meaningful co-operation. Individuals compete with each other in a manner that serves to promote narrow self-interest and relegates production and productivity to secondary and by-product status. Thus, we find considerable interpersonal rivalry to secure, land and jobs and to win favour with those who hold power for individual mobility within the society.

Under the MEC, interpersonal relations reflect the authority structure of the work process. In every aspect of life a strong authoritarian tradition can be observed. Thus the use of race and
caste as a control mechanism has a demoralizing influence on the community which impedes the material, social, spiritual advance of the population.

It is clear that in these circumstances the social system itself produces a demotivated agent devoid of the social orientation that development demands. The energies of the population are spent trying to beat the system. The use of this mechanism has resulted in a myopic factionalism and a coercive federalism which helps to create a human element that becomes a barrier in transforming the institutional arrangements which reinforce underdevelopment and backwardness.

These types of relationships have persisted throughout South African history up to and into the present globalized epoch. Whilst the bare bones characteristics still exist, the relationships have altered and what we have today is best described as a system of patron client relationships which function in the same way as the race, caste class axis of the MEC. In contemporary South Africa the patron is the politician and the political party and the client is represented by agents from different classes. Patron client connections are vertical and competition among agents is based on individual and/or community advantage around short term, opportunistic goals. This type of social arrangement jettisons class and class consciousness.

This system of relations distils into what many authors have called clientelism. Flynn (1974, 134) defines clientelism as “…a more or less personalized relationship between actors or sets of actors commanding unequal wealth, status or influence, based on conditional loyalties and involving mutually beneficial transactions.” Sives (2002) identifies four key points arising from this definition. In the first place, “The relationship is more or less personal and therefore relates to face to face dyndic as well as machine based party politics.” Second, the fundamental issue of unequal socio economic relations between patrons and clients is addressed. Third, loyalties are conditional and the relationship is only enduring as long as the agents fulfil their side of the agreement. Last, the relationship is mutually beneficial in that all parties are involved because at some level it is in their interest.

Carl Stone (1980, 93) characterizes the patron client relationship as: “A mechanism by which to institutionalize a power structure that is distinguishable from class based politics of liberal

---

48 Zuma’s words (loosely interpreted as an invitation to patronage) were directed at the business class. But sections of the urban and rural poor can also be recipients of patronage.
democracy in advanced capitalism.” After Sives (2002) my formulation construes the broader power structure as a hegemonic one which is distinguishable from the class based politics of advanced capitalism where the client patron relationship functions as a form of class control. The current system of patron client relationships which comprises clientilism of contemporary South Africa is motivated by the same need as arose under the plantation as under the MEC.

The patron whether an individual or a party machine needs to maintain his/her/its political, economic social position (Sives; 2002, 68). “The aim of the patron is to minimize challenges either by other elites or by clients and to halt the development of horizontal alliances. In distributing resources and offering a sense of protection and belonging to the marginalized sectors, a clientelist based politics can stymie the development of anti-hegemonic challenges. It does this by creating dependence on the political system which becomes a mechanism for marginalized people to meet their minimum material needs and provides a sense of belonging. Once competition and division are institutionalized (whether through political party religious affiliation or ethnic background) the possibility of class based mobilization becomes remote.” (ibid.)

8.3 Conclusion

The previous pages have been concerned to lay out broad and striking parallels between two systems of accumulation and social organisation. It should be taken as the first steps in a broader research programme that goes much further, one that connects the similarities and isolates the differences. For now it is enough to have laid the broad platform upon which we can build argument and extend theorisation in order to link Africa more closely to the Caribbean (and Latin America) in the Pan African tradition.
9 Financialisation of Non-financial Corporations and Households: Empirical Evidence from the Sources and Uses of Funds

Rex McKenzie and Seeraj Mohamed

9.1 Introduction

This section considers empirical evidence to support the contention that South African corporations and households have become financialised. Non-financial corporations (NFC) are key institution in the financialised system of accumulation. Households are often the conduit by which financialisation occurs through savings behavior and attempts to access credit. The extent to which households are included or marginalised from financial services affects the form of financialisation but not the effects of financialisation over local and national spaces.

The process of financialisation has to be understood in terms of changes in the structure and processes of capitalist accumulation. Restructuring of the financial sector and capital markets under financialisation has made it possible for the financial sector to capture and distribute an increasing share of the surplus. The empirical results, largely drawn from the South African Reserve Bank’s flow of funds data\(^{49}\), show that financialisation changed the behaviour of non-financial corporations, the institutions that produce the capitalist surplus.

Analysis of the SARB’s Flow of Funds data shows that financialisation has changed the behaviour of non-financial corporations. Financialisation of NFCs began in earnest with the democratic transition (with the unbanning of the liberation movements, the release of Nelson Mandela and other political prisoners in the early-1990s) with outflow of funds from the non-financial corporate business sector. Increasing acquisition of financial assets has gone hand-in-hand with low levels of fixed investment.

The period from 1994 saw further shifts in the composition of financial acquisitions from mainly lending to other sectors and money assets to greater diversification across a variety of

\(^{49}\) We acknowledge that the empirical work and much of the analysis drawn on in this section was from work completed by Susan A. Newman, which was also used in a report completed for UNDESA in 2013, Ashman, S., Mohamed, S. and Newman, S, “Financialisation of the South African Economy”.
financial assets, notably the acquisition of ordinary shares, fixed interest securities and other assets. The asset side of the non-financial corporate balance sheet has shifted towards increasingly short-term assets. This increased acquisition of financial assets has been financed through the expansion of credit. Owing to the maturity mismatch between assets and liabilities, the short-term nature of liabilities of the NFCS is not conducive to long-term productive investments which drive capital accumulation. Consequently, we have seen the financing of the acquisition of (largely short-term) financial assets rather than fixed capital.

Changes in the savings and investment behaviour of households through greater integration with capital markets has determined a highly unequal and unequalising distribution of this surplus between households.

### 9.2 Financialisation of NFCs

Firms’ behaviour under the traditional ‘productionist’ model saw firms as the core site of capital accumulation where surpluses from the process of production were largely reinvested to increase the capital stock and thus the productive base of the firm. At the level of the firm, financialisation has been operationally defined as the increase in financial operations and motivations of NFCs. Two quantitative indicators of financialisation of NFCs that have been cited in the literature are the increasing share of financial to total assets, and the increase in income derived from dividend and interest payments (Orhangazi, 2011).

Figure 9.1 shows financial assets as a percentage of fixed capital stock has been increasing since the 1980s. Rather than signaling the onset of financialisation, the increase between 1980 and the early 1990s should be interpreted as the consequence of economic sanctions, tight capital controls and that kept capital within the country together with the reluctance to invest in physical investments for fear of seizure in the case of political transition. Net corporate earnings from interest and dividend payments, as captured in the amounts receivable category within the flow-of-funds accounts, shot up as a share of internal funds in 1994, fluctuating between 1% and 20% in the period 1994 to 2004 before becoming negative, representing an outflow of funds from the non-financial corporate business sector (Figure 9.2), indicating that financialisation began in earnest with the democratic transition.
Financialisation comes with changes in the savings and investment behavior of non-financial corporations with the tendency towards shorter planning horizons, increasing dividend payments through share buybacks and increasing financial activities associated with short-term returns, and consequently, a reduction in ‘productive’ fixed investment.

Source: Newman’s calculations based on flow-of-funds tables compiled by SARB 2011
From figure 9.3, we see that the increasing acquisition of financial assets has gone hand-in-hand with low levels of fixed investment in South Africa since the mid-1980s. The underlying relationship between low levels of fixed investment and high levels of financial asset acquisition in the late apartheid period differs from that after 1994 with political uncertainty and trapped capital explaining the relationship in the former period and the crowding out of real investment through various processes of financialisation at the level of the firm explaining the relationship in the latter period.

Net fixed capital investment recovered after 1994, but remained below levels in the 1970s and early 1980s, but without a reduction in the acquisition of financial assets. From the onset of the debt crisis until 1994, non-financial corporations in South Africa had been net lenders (positive net financial investors). Lending to other sectors made up the greatest share of financial acquisitions in the 1970s and 1980s and included trade credit and other short-term loans, long-term loans and mortgage loans (Figure 9.4). 1988 saw a significant increase in the acquisition of liquid assets\(^{50}\) that has persisted into the post-apartheid period. On average cash/money made up 19% of annual financial acquisitions in the period 1970-1987 compared to an annual mean of 48% from 1988-2010. In addition to the increased acquisition of liquid assets, the period from 1994 saw further shifts in the composition of financial acquisitions from mainly lending to other sectors and money assets\(^{51}\) to greater diversification across a variety of financial assets, notably the acquisition of ordinary shares, fixed interest securities and other assets\(^{52}\). The asset side of the non-financial corporate balance sheet has shifted towards increasingly short-term assets. (Ashman and Newman, 2012)

---

\(^{50}\) This is shown by the money/cash category which includes cash and demand monetary deposits, short/medium-term monetary deposits, long-term deposits, deposits with other financial institutions and deposits with other institutions.

\(^{51}\) Cash/money assets are defined here as the sum of cash and demand monetary deposits, short/medium-term monetary deposits and deposits with other institutions. In the context of low interest rates, it might be argued that these money deposits cannot be legitimately considered financial assets. In contrast to Europe since the onset of the global financial crisis where the holding of money assets reflects an investment freeze owing to uncertainties about future economic performance, money deposits in South African commercial banks earn competitive returns. Even demand deposits in South African commercial banks can earn monthly interest rates between 2% and 3% (see for example Standardbank’s AccessSave account) and can thus be considered a financial asset.

\(^{52}\) This is a catch all category for a growing number of new financial assets, which tend to be short-term in nature, which may include debt securities and other derivative instruments.
Figure 9.3: Net annual capital formation, acquisition of financial assets and financial investment by non-financial corporations in South Africa: 1970-2010

Source: Newman’s calculations based on flow-of-funds tables compiled by SARB 2011

Figure 9.4: Acquisition of financial assets by non-financial corporations by asset type: 1970-2010

Source: Newman’s calculations based on flow-of-funds tables compiled by SARB 2011
Figure 9.5: Annual financing gap, external financing and the difference between the two for the non-financial corporate businesses: 1970-2010

The period since 1994 has also seen non-financial corporations moving from their positions of net lenders to net borrowers for all years except for 1996, 1997 and 2002 suggesting that increased acquisition of financial assets has been financed through the expansion of credit.

We find further evidence that increased external borrowing by non-financial corporations to finance the acquisition of financial assets when we examine the evolution of the financing gap\(^{53}\) for non-financial corporations and their external financing\(^{54}\) (Figure 9.5). The difference between the financing gap and external financing has fluctuated around a relatively stable mean from the mid-1980s until the mid-2000s when this difference began to follow a positive trend until 2010. Between 2004 and 2008, bank credit dominated the liabilities side of the non-financial sector balance sheet, coinciding with an increase in the difference between the financing gap and external financing for non-financial corporations (Figures 9.6 and 9.7).

Moreover, there has been a shift in the composition of financial liabilities held by non-financial corporations with an expansion of ordinary shares and other short-term liabilities from 1994 (Figure 9.6). Owing to maturity mismatch between assets and liabilities, the short-term nature of liabilities is not conducive to long-term productive investments which drive

---

53 The financing gap is equal to net borrowing which is the difference between net savings and net capital formation.

54 External financing is equal to the net incurrence of financial liabilities.
capital accumulation. Consequently, we have seen the financing of the acquisition of (largely short-term) financial assets rather than fixed capital. (Ashman and Newman, 2012)

Figure 9.6: Sources of external financing by non-financial corporations: 1970-2010

![Graph showing sources of external financing by non-financial corporations from 1970 to 2010.](image)

*Source: Newman’s calculations based on flow-of-funds tables compiled by SARB 2011*

Figure 9.7: Breakdown of the sources of credit received by non-financial corporations: 1970-2010

![Graph showing breakdown of credit received by non-financial corporations from 1970 to 2010.](image)

*Source: Newman’s calculations based on flow-of-funds tables compiled by SARB 2011*

The South African economy has developed around a core of big businesses and state owned enterprises. Many of the largest SOEs, such as Sasol the company that produces oil from coal
and is the largest chemical manufacturer in South Africa and Iscor the largest steel company, were privatized and these have also been affected by financialisation. The largest corporations have increasingly internationalized their operations and some of the largest have moved their primary listings abroad or have multiple listings. The first to move were the first to be financialised under the influence of the shareholder movement. Later, the impetus for financialisation occurred from within the South African economy. Ernst and Young (2002, 27) in a review of South African mergers and acquisitions for 2001 states:

“Shareholder activism has been slow to take off in South Africa, but like all global trends it is one, which is catching up with us very quickly. The prominent South African companies that have listed offshore over the last two or three years have already been exposed to the higher level of transparency demanded in global markets. South African companies with a more domestic orientation are under pressure to emulate their global peers.”

Mohamed (2010) argues that global and domestic factors shaped the behaviour of South African big business. Goldstein (2001), comparing business restructuring in Brazil and South Africa, argues that the boom in merger and acquisitions in South Africa during the 1990s was different to those in other countries. He shows that there were particularly South African characteristics to the M&As. The restructuring in South Africa was more about dismantling pyramid structures than increasing the competitiveness of industrial sectors. During the 2000s the shareholder value movement abroad and in South Africa would play a larger role in influencing corporate structure and behaviour. The impact of this influence has been more dependence on increasingly liquid portfolios of financial assets and a resultant deindustrialisation.

### 9.3 Financialisation of Households

South Africa is amongst the top three most unequal countries in the world. Middle class and wealthy South African have been the beneficiaries of increased private sector access to credit, which was associated with large surges in short-term foreign capital flows to South Africa during the 1990s. During the period 2000 to 2010, households received an average of 53% of the loans extended to the private sector. Figure 9.8 shows that by far most of these loans were to finance current consumption or were mortgages for homes. As a result, middle class and wealthy South Africans have significantly increased their levels of debt, and in so doing, had
not only driven an increase in debt-driven consumption but also financialisation through a large increase in the purchase of financial assets. The wealth effect that accompanied the huge increase in mortgage lending, which propelled a 300% increase in average house prices from January 2000 to June 2008, also provided resources for household to buy financial assets.

Figure 9.8: Credit extended by all monetary institutions to the domestic private sector

Source: SARB 2012

The shift in behaviour of households due to increased access to credit and the net wealth effects of the large increase in house prices led to a visible change on household saving and investment behaviour. Figure 9.9 shows that household assets climbed from 2000 after a relatively stagnant period through the 1980s. Household financial liabilities as a share of GDP increased from the mid-1980s through the 2000s. This growth was probably due to the easier access to credit that accompanied deregulation of the banks during the 1980s. We argue that the increase of household assets to liabilities from the mid-1990s is due to financialisation processes because households were borrowing more to finance their current consumption while using a larger share of their incomes to acquire financial assets to save for their retirements and to speculate in financial and real estate markets.
Household financial assets as a percentage of their total assets averaged 70% between 2000 and 2010 up from 44% in 1976. An interesting phenomenon, which we believe reflects the influence of financialisation processes on middle class and wealthy South African households, is that the composition of their financial assets has shifted. The bulk of investments have grown in pension funds and long-term insurers as well as the category “other financial assets”, which includes unit-trust and direct holding of equity instruments by households. At
the same time the share of household money deposits has declined. The shift towards investment in institutional investors, such as pension funds and long-term insurers, has supported the financialisation pressures on South African large corporations from within the country. These institutional investors have adjusted their portfolios during the period to increase short-term equities (ordinary shares) and have reduced their share of fixed interest securities (both government and non-government). They have also decreased fixed property holdings and loans (Ashman and Newman, 2012).

Figure 9.11: Distribution of Household Assets

( Household Balance Sheet, SARB 2012 )

9.4 Conclusion

Financialisation has changed the savings behaviour of middle and upper income earners in South Africa (see figure 9.11). It seems that their future earnings are dependent on the performance of capital markets as a larger share of their incomes derive from dividends and equity prices. Financialisation has contributed to growth in income inequality in South Africa because the top earners benefit from financialisation and the poorest face declining employment and income prospects as both financial and non-financial corporations shift resources towards financial markets and supported de-industrialisation in South Africa.
10 Domestic Financial Deregulation and Financial Sector Growth since the 1980s
Seeraj Mohamed

10.1 Introduction

There was a significant decline in South African investment levels during the 1980s. The investments in large-scale MEC projects by the state and private sector had ended. There was an escalation of political and worker resistance to apartheid and the apartheid workplace. There was a debt crisis in 1985 linked to a rapid increase in short-term foreign bank lending to South Africa, especially after US banks stopped lending to Latin American countries that had already been affected by debt crises. At the same time, foreign companies were disinvesting because of pressure from the international anti-apartheid movement. As a result, the 1980s was a period of the consolidation of conglomerate power in South Africa. The deregulation of the financial sector and the conglomeration of especially the US economy during the 1980s influenced South Africa’s conglomeration process.

The South African financial system could be described as market-based and its role and function heavily influenced by the imperial banks that dominated South African banking for more than a century. The large mining-finance houses were important because they provided not only finance for new mining operations and related sectors but played a role in coordinating the growth and development of industry in South Africa. During the 1980s, these groups grew as a result of increasing international isolation and disinvestment from South Africa. At the same time, financial deregulation allowed the financial corporations to grow and consolidated.

The decade from 1990 started with the end of apartheid and the growth of financialisation. This was a period of unprecedented global mergers and acquisitions, realignment of global value chains and increasing concentration of global markets. South African big business sought to reduce their exposure to a possibly hostile, new democratic government while at the same time the end of apartheid meant the end of international isolation. They wanted to be part of the global corporate restructuring and reorientation. Therefore, they restructured in South Africa and over time shifted the corporate structure from large diversified conglomerates towards international corporations increasingly focused on core business. The result has been a market-based financial system without dominant big businesses, such as the
past mining-finance houses, to coordinate the development of industry and support related businesses.

10.2 The 1980s: Conglomerates and financial deregulation

Crotty (2002) in his discussion of US conglomeration of industry during the 1980s says that there was a “rise of the financial or portfolio conception of the nonfinancial corporation in financial markets”. He says that there was a change in management style in the US where nonfinancial firms would be seen as a “bundle of assets” that could be bought or sold or broken up depending on its short-term rate of return in a way that augments the portfolio of holdings (p.p. 14-16). South Africa already had strong financial management of non-financial corporations through the mining-finance houses, the preponderance of pyramid companies, and large mutual companies. It was easy for the rise of a “portfolio conception of nonfinancial corporations” described by Crotty to take hold in South Africa. However, developments in corporate restructuring in South Africa were different from the US because of the high level of concentration in a much smaller SA economy.

During the 1980s, there seems to have been a move toward a portfolio approach to firms but this change in perception by management led to a new way for the powerful corporations to come to an arrangement about how they would divide up the South African economy and maintain dominance in their respective areas of operation. This management change was accompanied by predatory behaviour where large corporations either bought up or caused the demise of new independent firms that seemed promising. The conglomerates also bought up the assets of the many companies that disinvested from the South African economy in the 1980s. The role of financial institutions in this arrangement was to be involved in merger and acquisition activity and to facilitate the buying and selling of assets rather than support long-term productive investments.

The six conglomerates that came to dominate the South African economy during the 1980s developed from mining groups and insurance corporations.55 Their ownership of financial institutions, such as merchant banks, facilitated their diversification of ownership. By the

55 These conglomerates were, listed in terms of their dominance in the economy, the Anglo American Corporation, Sanlam, SA Mutual, Rembrandt, Anglovaal and Liberty Life.
1980s these conglomerates had acquired most of the major mining and manufacturing businesses in the country.  

Financial deregulation during the 1980s led to much acquisition activity within the financial sector by the conglomerates. From the early 1980s the banks were no longer bound by any previous credit and interest rate ceilings. The apartheid government, influenced by the growing hegemony of neo-liberal economic thinking, also started moves towards a market oriented financial markets by terminating the Register of Cooperation, which limited competition between the banks in 1983. This deregulation led to building societies having to compete against banks.

At the same time, pressure on international banks (which were active only in corporate banking) to disinvest from South Africa had many successes during the 1980s. For example, Standard Chartered, ABN Amro and Barclays disinvested their holding during the 1980s. A result of the 1980s deregulation was concentration of the South African banking sector with ownership centralized into the conglomerates. The financial sector’s contribution to the economy grew significantly since the 1980s. The 1980s was a period when the profits in gold mining increased as the gold price rose rapidly. At the same time, the major corporations were reluctant to invest in downstream manufacturing and instead used their financial muscle to consolidate their market power.

A very unfortunate aspect of South African capital’s close ties with international capital is that their main influences have been British and US financial capital. As a result, the close relationship between the financial sector and the real sector did not lead to long-term investment in industry. South African banks have been more interested in creating financial services and promoting speculation at the expense of productive investments.

10.3 The 1990s: Financialisation, restructuring and international integration of SA big business

---

56 Fine and Rustomjee (1996) say that from the 1980s conglomerate power over the economy, reinforced through simultaneous control of the financial sector, seems to extend to all activities in mining, manufacturing and financial activities. They add, “This is specific, probably unique, to South Africa”

57 The domestic conglomerates bought many of these interests for bargain basement prices.

58 The growth of Japan and German manufacturing during the post-war period increased competition in global manufacturing and despite trade protection may have discouraged large South African corporations from investing in downstream manufacturing during the 1970s and 1980s.

59 The large South African corporations have depended on retained earnings and equities markets for finance rather than borrowing from the banks.
The apartheid government freed political prisoners, unbanned organizations of the liberation movement and started negotiations for the establishment of democracy in South Africa in 1990. Democracy was the major change in South Africa and many in big business were uncomfortable with the transition.\textsuperscript{60} The change in government was accompanied by massive restructuring of the South African corporate sector. It is argued here that the transition to democracy is one reason for the corporate restructuring. The shape of the corporate restructuring was influenced by important changes in the global economy.

Two important changes occurred in the global economy during the 1990s. The first was the rise to prominence of institutional investors and the shareholder value movement.\textsuperscript{61} The growth to prominence of institutional investors and the shareholder value movement was part of the process of financialization that started in the 1970s.

The transition to democracy that motivated large corporations to restructure and move their assets abroad occurred during a period when there was important change in the global economy as a result of increased integration of international trade and financial markets global economy was experiencing (Mohamed, 2009). The transition to democracy played a role in corporate restructuring, as did the restructuring of global corporate structure due to the influence of the shareholder value movement and financialisation (Mohamed, 2009).

Nolan (2003), focusing on the global value chains and the increasing concentration of global markets during the 1990s, argues that the increasingly powerful shareholder value movement used their power to demand that corporations simplify their corporate structures and focus on core business activities. These pressures played no small role in influencing the shape of global value chains and corporate restructuring in the global economy. The same is true with the South African experience. From the 1980s, the growing dominance of finance in the economy brought with it increasing power of the shareholder that facilitated the restructuring of large corporations in South Africa (Mohamed, 2009).

Crotty (2002) says that the rise of institutional investors in the US led to a situation where on average US stocks are held for just one year. In addition, an increasing share of industrial

\textsuperscript{60} See Terreblanche (2002) for an account of the response of white people and big business to the political changes.

\textsuperscript{61} For an interesting discussion on the growing influence of institutional investors and the emergence of maximizing shareholder value as a “new ideology for corporate governance” see Lazonick and O’ Sullivan (2000). It is worth noting that the growth in importance of the business media industry and their influence over business structure and executive behaviour is also significant.
company revenues is from financial not productive assets. The second change was the surge in merger and acquisition activity during the 1990s. There are a number of reasons for this global restructuring that concentrated global businesses and caused them to focus on core businesses. The prominence of institutional investors and the shareholder value movement was central to this restructuring because institutional investors demanded simpler structures. Much of the funds for the new global giants were sourced from institutional investors, who invested most of their funds into big companies that have familiar brands, large market share, high R&D spending and focus on their core activities.

Both these changes to the global economy had profound impacts on the structure of the South African corporate sector. Since 1994 the South African corporate sector has engaged in the following activities:

- conglomerate unbundling and restructuring;
- consolidation within sectors by conglomerates as part of ensuring stronger focus and better strategic direction, which has also increased concentration;
- internationalisation, mostly outward, by firms which moved their primary listing overseas, and foreign acquisitions by South African listed firms; and
- black economic empowerment deals, first, through special purpose vehicles for financing and second, more recently, in areas where government policy has provided a specific impetus.

Figure 10.1: South African Mergers and Acquisitions (Rbn, current prices)

Source: Ernst and Young (2006)
Although restructuring in the global economy was spurred on by privatizations and the revolution in information technology, “Nolan also sees the growth in influence of the shareholder value movement as driving consolidation and concentration in the global economy as an important factor in explaining large scale-scale, global corporate restructuring and the surge in mergers and acquisitions during the 1990s” (Mohamed, 2009, pp. 8-9).

Nolan (2003) points out that total global mergers activity grew from over US$150 billion in 1992 to over US$2000 billion in 1998, when 8 of the world’s 10 largest mergers took place. By 2000 it had peaked at over $3.4 trillion. Large South African companies were caught up in this process of global restructuring. The offshore listing of major South African corporations from 1997 can be seen within the context of this merger frenzy. The result was a spectacular growth in M&A activity in South Africa. According to Ernst and Young data there was an increase from 136 M&A deals in 1994 to a peak of 605 in 1998. There was an average of 530 M&As from 1999 to 2002. According to Ernst and Young, in 1991 South African M&A activity was R12 billion and by 2001 M&A activity peaked to R502 billion (See Figure 10.1).

Most of the pyramid structures, which were at the center of the MEC as a system of accumulation and were used by the powerful families to control most of the South African economy, were restructured and disentangled. Global markets were restructured and market share was reapportioned. The wealthy and powerful in South Africa did not want to be left out of this process. They wanted to ensure not only that they got their share of the international market in minerals by internationalizing their operations but also to consolidate and secure the viability of their South African assets.

At the same time, South Africa was undergoing a transition from apartheid to democracy and there was contestation about the future economic policy of the country. The changes in South Africa meant that many of the wealthy and the large corporations wanted to move their assets out of reach of the new government. The restructuring of global assets and the transition to democracy provides important reasons for the move by a number of large corporations to move their primary listings. Studies show that capital flight had continued to be high throughout the 1990s, indicating that wealthy South Africans wanted to increase their wealth offshore. A company that moved its primary listing offshore would be able to move a large

---

62 Mohamed and Finnoff (2005) show that capital flight from South Africa was higher during the period after the democratic elections (1994 to 2000) than it was before the election (1980 to 1993). They argue that misinvoicing of trade made up a significant share of capital flight indicating that it was probably big businesses with large export and import volumes involved in misinvoicing of trade.
amount of capital out of South Africa legally because they would not be bound by exchange control restrictions on residents. Large amounts of capital could leave the country in the form of dividends or other payments.

For example, from “1980 to 2000, on average, capital flight as a percentage of GDP was 6.6% a year. During the last 13 years of Apartheid, from 1980 to 1993, average capital flight as a percentage of GDP was 5.4% a year. Post apartheid, from 1994 to 2000, capital flight rose to an average of 9.2% of GDP per year” (Mohamed and Finnoff, 2005).

A number of large South African corporations have moved their primary listing offshore to the London Stock Exchange since the late 1990s. This move has turned former South African corporations into foreign investors into South Africa. Some have opted for joint listings on the JSE and developed country stock markets. Common reasons provided for these delistings by the ‘delisters’ are that they allowed the companies to be valued in a hard currency, reduced the risk premium for changes in the value of the rand, and improved their expansion capability. In the process they have also modified the conglomerate structure to clear up cross-holdings. Companies that moved their primary listings include:

- Billiton (formerly Gencor and now part of BHP Billiton)
- SAB (Now part of SAB Miller)
- Anglo American Corporation
- Old Mutual
- Liberty; and
- Two infotech companies, PQ Holdings and Datatec

The primary listings in London were supposed to allow the conglomerates to raise capital to fund investments in South Africa. They have managed to raise a large amount of funds in foreign markets but have not invested in South Africa. There has been a much more striking pattern of outward acquisition and investments. For example, Anglo American embarked on an extensive drive to increase international investments in mining Companies such as SAB, Sasol, Sappi, and Kumba have also been involved in acquisitions of firms in Europe, South America, Australia and China.

10.4 Consequences of corporate restructuring and internationalisation
The offshore listings have allowed the captains of industry that live and work as businessmen in both the global North and South Africa to change their power relationship with the new South African state. They are able to control the South African assets that they wish to control but also have more control over the movement of their capital. The South African state is less willing to interfere in these companies because they fear that they will lose credibility with other potential investors and financiers. As a result of the reluctance of the South African state to interfere with this process, this will not only impede on South Africa’s development, but also hinder the opportunity of addressing challenges such as unemployment (Mohamed and Finnoff, 2005).

The changes also means that the shareholder value movement in the North (including, flighty institutional investors) and the business media that claim to present their views have had more influence over the major corporations operating in South Africa and also in the future direction of the economy. At the same time, the South African Government has become hesitant about implementing progressive economic policies that could address unemployment and poverty for fear that these policies would drive down share prices and create a negative view of South African policies in international financial markets and business media.

The result of the offshore listings is that many large South African corporations are no longer South African and that they are investing capital produced in South Africa over the past 150 years to build global corporations. It is worth remembering that much of that capital was generated in exploiting the non-renewable mineral wealth of South Africa and harsh exploitation of South African workers. Many of the businesses that have listed offshore and become global corporations have been involved in extensive merger and acquisition activity. Through these M&As their South African assets have decreased as a proportion of their total assets. They have diluted their South African identities and with this the size of their supposed responsibilities towards the new South Africa and development there.

These corporations strenuously advocated lifting exchange controls and argued for their right to list offshore. The central point of these arguments was that they would then be able to raise capital more easily to invest in South Africa. Clearly, the opposite is true. Roberts et al. (2004) correctly argue, “In five of the last ten years outward direct investment has in fact exceeded inward FDI. Major foreign investments have largely been limited to the acquisition of stakes in state-owned utilities (Telkom and South African Airways) and the re-entry of firms such as Toyota and General Motors which had exited under sanctions, although specific
examples exist of sectors where foreign companies have contributed to the resumption of growth.”

The unbundling of the conglomerates and the ‘rebundling’ should be considered within the context of both the political and global factors affecting these businesses. The combination of the unease of white business with the changes in South Africa and the understanding of the leaders of big business that they had to signal a willingness to share future business activities with black people put two types of pressure on big business to restructure: The first pressure was restructuring for political expediency. The second type of restructuring was directly linked to withdrawing from the South African economy. In other words, big business had adapted to the political changes by reducing its risk within the South African economy by internationalizing their operations. They have also accepted a political compromise to maintain their control over much of the South African economy by sharing a portion of ownership with black businesses.

Goldstein’s (2001, 15) interpretation of this process is:

“While the refocusing on core business has followed from the need to insure competitiveness against the background of the opening of the domestic economy to world competition and weaker gold and commodity prices, voluntary unbundling has been an expedient strategy to appease the possible rise of nationalization sentiments. In order to build up a black capitalist constituency, it was important to conclude highly visible and large-scale deals. The first such deal was Sanlam’s sale of Metropolitan Life (METLIFE), an insurance company, to New Africa Investment Ltd (NAIL). In 1996 Anglo broke up its majority-owned sub-holding JCI (Johannesburg Consolidated Investment) into platinum (Amplats), a homonymous mining subsidiary, and an industrial arm, Johnnic.”

Goldstein recognizes that global and domestic factors shaped the behaviour of South African big business. Further, Goldstein’s research indicates that the boom in merger and acquisitions in South Africa during the 1990s was different to those in other countries. He shows that there were particularly South African characteristics to the M&As. The restructuring in South Africa was more about dismantling pyramid structures than increasing the competitiveness of industrial sectors. Goldstein’s says, “Of the twenty largest South African deals reported in 1992-98, 75% corresponds to the simplification of the corporate structure; 10% to
consolidation in the financial industry; 10% to foreign acquisitions; and only one deal – TransNatal’s acquisition of Rand Coal to form Ingwe Coal in 1994 – is a “genuine” South African merger. (p.17).” He makes the important point that it is remarkable that South African conglomerates have practically not made any large acquisitions in their own country. He points out that this lack of acquisition is true even in sectors such as utilities and internet related investments “… where family-controlled business groups in OECD countries have been active even while refocusing their portfolios on the core business (ibid.).”

10.5 Conclusion

The end of apartheid was then end of an era for the largest South African corporations. In fact, many of them disliked the international isolation and the increasing repression to maintain a dysfunctional political system was not good for their businesses. At the same time, they worked within the state and the state security system to avoid an overthrow of the state and to manage the transition. By the 1980s the major investments in South Africa were by the state and private big business worked to consolidate their holdings within South Africa and built up foreign holdings. By the 1990s there was large-scale corporate restructuring and active withdrawal of capital as the largest corporations internationalized.

The process of financialisation of the financial sector seems to have started as an internal domestic process with the deregulation of South African finance. The financialisation of largest South African non-financial corporations seems to have occurred initially as they internationalized, listed abroad and were influenced by the international shareholder value movement. In a short time, the influence of the shareholder value movement in the economy grew too. At the same time, domestic and international institutional investors grew in influence within South Africa as they became the largest shareholders in publicly listed companies.

The outcome of all these changes and the large-scale corporate restructuring has left the South African economy with a bloated financial system and more dependent on the mining and minerals sector. The South African context for mergers and acquisitions was one where the MEC continued to stifle investments into diversifying the industrial base of the South African economy. Instead, the concern of big businesses that dominated the MEC was to restructure in order to appear more attractive to investors speculating in the markets where they had relisted.
11 Privatisation in South Africa
Rex A McKenzie

11.1 Introduction

In what follows the main features of the privatisation programme in South Africa are laid out. Privatisation is one prong in the neoliberal globalization programme unleashed on the world in the 1970s and 1980s. Neoliberalism insisted on liberalisation, deregulation, and the privatisation of ownership. These were the three main pillars of the process that has its origins in the United States and to a lesser extent, the United Kingdom. The 1970s and the 1980s for apartheid South Africa was a tumultuous period of intensifying military and ideological struggle between the apartheid state and the African National Congress (ANC). Ultimately, the apartheid state gave way to the ANC in the 1994 elections that saw the birth of democratic South Africa. Internationally, winds of change in the form of neoliberalism were gaining momentum and a democratic South Africa was being shaped by struggle from within. In many ways, this paper enquires into processes by which these two forces have come together to produce what may be one of the largest social experiments of the current period – the creation of a black middle class. It does so by examining the major social and political influences surrounding the formation and implementation of the South African privatisation programme from its origins through to the present period.

The underlying themes in the paper are those first raised by Fine and Rustomjee (1996) in their chapter on the role of the state. The authors opine; “Paradoxically, the last serious discussion of south Africa’s shifting class structure concerned the potential success of a strategy by the apartheid regime to incorporate a buffer layer of middle class blacks to encourage greater socio-economic and political stability. While that strategy is deemed to have failed, there is no doubt that the character of the post-apartheid state and its policies will reflect what are liable to be fundamental change in the class structure” (Fine and Rustomjee, 1996, 66). This section reexamines this issue several years after these words were first written, to find very little in terms of fundamental change to the class structure and surprisingly, or paradoxically (to use the authors words), a continuity in policy in relation to
the ANC creation of a black middle class for seemingly similar purposes to that of apartheid South Africa.

Privatisation is a generic term and although there are many policy variants, privatisation always aims to alter the content of ownership (and management) away from government into private hands. Narrowly defined privatisation implies a permanent transfer of ownership rights from the public to the private sector. More broadly defined privatisation relates to any measure that results in temporary or permanent transfer to the private sector by a public body (Jerome and Rangata, 2004). This can be accompanied by a radical relocation of available productive resources, restructuring of the institutional setting in which production takes place and the introduction of new forms of corporate governance devoid of political interference (Shirley and Nellis, 1991; Jerome, 2002 in Jerome and Rangata, 2004). It can at times, in some circumstance also involve a transfer of the provision of a good and/or service from public to private sector, with government keeping responsibility for provision of the good or service.

Much of the rationale for privatisation is ideologically based. The whole programme was premised on the belief that the private sector and the “market” are inherently more efficient (and hence more profitable) than the public sector. Around the world experience has shown that it is an intensely political process. Privatisation of necessity involves winners and losers. The losers have usually been vulnerable groups (labour) who bear the costs of privatisation up front and on the chin. The winner’s gains usually accrue in the longer term and so there is a certain dissonance around a privatisation process that involves careful political management (ibid).

The privatisation experience has shown that a change in ownership by itself is not enough to guarantee improved economic performance. According to orthodoxy, such a change must be combined with, “institutional change aimed at removal of barriers to entry and exit, improving prudential regulation and corporate governance, hardening budget constraints, and developing capital markets that one sees large and enduring progress” (Gaal et al., 1994 in Jerome and Rangata, 2005) make the point that ownership matters but so do competitive markets because competitive markets reinforce private markets. Thus in the orthodox literature on the subject, it is ownership, policy design and institutional change (or some mix thereof) are the framework conditions required for a successful privatisation programme.
What can we say specifically about the South African privatisation programme? What are the circumstances that led to its implementation and subsequent abandonment? And are South Africans worse or better off as a result? These and other questions are taken up in subsequent sections. Section 11.2 gives describes the timeline and how the programme unfolded in South Africa. The part played by labour, business and government are all described and analysed. Section 11.3 addresses the countervailing tendencies that stood in opposition to the programme. This section leans on Anne Pitcher’s (2012) excellent analysis to explain why the programme was abandoned. In section 11.4, I venture to make a few observations the role of the South African state in this process. Section 11.5 concludes.

11.2 Background

The 20th century began with Afrikaner nationalism in retreat. For the first two decades of the 20th century saw a huge increase in the number of poor whites, and in addition English capital enjoyed an unchallenged position in industry. There were many significant responses. One such was the creation of Santam (the South African Trust and Insurance Company). Santam was founded in 1918, and Sanlam the South African National Life Assurance Company) was formed in the same year as its life assurance subsidiary.

According to Verhoef (2009, 124-5), Sanlam’s was established with three objectives;
- to contribute to the growth of the South African economy;
- to encourage and facilitate Afrikaner saving; and
- to strengthen Afrikaner (participation in the South African economy.

The next big development in the 1920s was the establishment of a large public enterprise sector with the creation of the Electricity Supply Commission (ESKOM) and South African Iron and Steel Corporation (ISCO). These enterprises were established primarily to strengthen the import substituting industries that had started to grow during WW1, by providing infrastructure improvements and basic materials.

In 1940, the Industrial Development Corporation (IDC) was established to support other new industries. IDC established a number of other corporations including the Phosphate Development Corporation (Foskor); the South African Coal, Oil, and Gas Corporation (Sasol); and the Southern Oil Exploration Corporation (SOEKOR). In addition many of the
state corporations founded subsidiary companies in partnership with private firms. And many held controlling shares of stock in the private firms. Eventually, these enterprises were used as a platform for white employment and social benefits as well as creating a support base among the white working class and Afrikaner business owners. In 1949 the state established the National Finance Corporation (NFC). The NFC used its deposits to purchase the state’s Treasury Bills and the debentures of the mining houses. As the NFC matured it established a mechanism for moving funds from AAC’s diamond operations to the company’s mining interests. As this practice takes root, the finance role, moves from private sources to institutional ones. In addition Ashman and Fine (ibid.) point out this change ultimately helps to erode differences between English and Afrikaner capital. Further support from the state for Afrikaner finance capital during the 1940s and 1950s, meant that Afrikaner capital was able to break the stranglehold that English capital had imposed on the economy. “Minerals and energy then were the vehicles through which Afrikaner capital integrated into the industrial core of the economy” (ibid.). A critically important strategy was the creation of state owned sectors in electricity, steel, chemicals and fuels. Fine and Rustomjee (1996) point out that these state owned sectors complemented the mining conglomerate needs and provided a growing link between the state and the private sector.

For our purposes here, 1988 is a significant year. Then Prime Minister of apartheid South Africa, PW Botha unveiled plans to privatise several state controlled industries. These included Eskom, Foskor and Iscor. In addition there were also plans to rationalise other state operated entities and in order to lay the groundwork some of the targeted sectors (transport, telecommunications, postal service etc.) were reorganized. The tendency towards privatisation as part of a wider neoliberal programme emanating from the world economy provided an easy and ready solution for the apartheid government who were confronted by sanctions in 1985 and had resulted in serious capital shortages and cash strapped state corporations and entities. Privatisation would ease the debt burden and provide much needed liquidity.

In 1989 ISCOR amidst much opposition was sold for three billion rand. According to Jerome and Rangata (2004), Botha’s privatisation programme encountered two main obstacles. In the first place the sanctions imposed by the international community deterred would be buyers of South African enterprises. Second anti apartheid groups (globally) and labour (locally) in the form of Coastu provided stiff opposition. The programme stalled and eventually, inevitably the ANC came to power in 1994.

---

63 These corporations were the recipients of large loans from foreign sources that were called in 1985 leaving them with serious capital shortages.
11.3 Privatisation gives way to Marketisation

Understanding the trajectory and eventual reversal of South Africa’s privatisation programme is contingent on a resolution of the question – “what is or should be the relationship between the state and the market” (Fine and Rustomjee, 1996, 51). All too often in the literature such questions are subsumed to a dichotomy between state and market, that leads to answers being framed in terms of the state versus the market. I follow Fine and Rustomjee and in my approach, the market, the state and their interaction are construed as “… the complex product of the forces exerted upon them; most prominent of these are economic interests and imperatives attached to specific fractions of classes” (ibid.). Thus why, how, to whom and what is privatised comprise what the authors describe as an irreducible combination of economic and political factors through both state and market institutions and reflect underlying interests” (ibid). In this way the sales of state assets (or privatisation) and the restructuring of existing SOEs in such a manner as to make them more profitable and competitive^64^ demonstrates the ways in which different groups and classes that make up the SOEs (the Alliance^65^, and civil society) used their access to the state to bring about a shift in the ANC government’s content and strategy surrounding the privatisation of state assets.

As Pitcher (2012) observes:

“The sheer size of the largest SOEs and the many avenues of political access in South Africa’s democracy gave numerous opportunities to organised interests such as black parastatal managers, trade unionists, or consumers to oppose divestitures. The reasons behind their opposition were multiple and conflicting. Whereas trade unions feared the loss of union jobs and a decrease in salaries and benefits that might come with the sale of SOEs, black managers anticipated a possible decline in the availability of managerial positions for black South Africans should the divestiture of SOEs proceed. Moreover, it is likely that widespread, well-organised protests by consumers, unions, non-governmental organisations, and social movements over cost increases following private-sector provision of basic services such as electricity and water influenced government decisions to halt outright divestitures.”

^64^ Marketisation, also called corporatisation or commercialisation.

^65^ A tripartite alliance formed in the 1990s among the ANC, the Congress of South African Trade Unions/COSATU, and the South African Communist Party to foster unity and coordinate strategy Pitcher (2012).
The protests and opposition around price rises, employment/unemployment, fairness and other perceived undesirable results forced the government to abandon privatisation. Government now sought to incorporate SOE and use them as central pillars in a new developmental project that emphasised the unfolding of a developmental state.

The Accelerated and Shared Growth Initiative for South Africa (ASGISA) became national strategy in 2006. ASGISA effectively tied neoliberalism to the development aspirations of the state. It emphasised efficiency, growth, liberalisation, and competition but these themes were mediated by a focus on reducing poverty, generating employment, increasing skills, and strengthening state capacity (Presidency of South Africa n.d. in Pitcher, 2012). Fine and Rustomjjee (1996, 52) make the point the very same class interest can be served by privatisation as by nationalisation. In this connection it is worth noting that if the objective of privatisation was to promote the dominance of the market and of market forces over all others, then much the same thing has been achieved by the ANC with its emphasis on efficiency, commercialisation, competition and corporatisation. The marketisation of the South African has resulted in the selfsame loss of jobs in the state sector and the same casualisation and racination of labour as was feared under privatisation.\(^66\) Further neoliberalism dressed in the garb of the developmental state has entailed an extension of the reach of the market into areas that would have been unimaginable fifteen years ago. Urban governance and the provision of policing and security that were not so long ago the sole responsibility of the state are increasingly provided by private companies.

Pitcher (2012) provides a good example of these developments in citing the developments in the urban space.\(^67\) The Business Improvement District (BID) model was first introduced in the US and Canada and then as the author notes, “rapidly adopted by other cities across the world in the 1980s and 1990s.” Johannesburg’s adopted a variant of the BID model (one that the author argues was more politically neutral) – the City Improvement District (CID). Essentially where 51% of the property owners agreed to its creation a CIDs can be formed. Management agencies for CIDs included property owners and a minimum of one

---

\(^{66}\) See McDonald and Pape (2002), (Bond 2002) cited in Pitcher (2012)

\(^{67}\) According to Pitcher (2012): “Public–private partnerships between municipal authorities and the private sector to provide service delivery have evolved into much more comprehensive and transformative models of restructuring that employ the language of neoliberalism such as efficiency, competition, rationalisation, deregulation, and de-centralisation to justify their growth. Referred to by Murray as ‘entrepreneurial modes of urban governance’ (Murray 2011, p. 246), these schemes share control over urban management between city planners and managers and private business, many of which have strong BEE credentials or linkages to BEE suppliers. While the ostensible goal is ‘urban revitalisation’, enhanced security, or more grandly, building a ‘world-class city’, the tools to accomplish such objectives largely lay with the private sector...”
representative from the municipal council (Murray 2011, 259). The CID model it is argued is suited to advancement of similar goals to those pursued in Johannesburg such “...as the reduction of ‘crime and grime’, the revitalisation of urban space to entertain and comfort those with money, and the branding and marketing of these cities as world-class cities to tourists and foreign investors (Miraftab 2007, McDonald 2008). From the gentrification of once derelict housing to the provision of security cameras, private firms occupy central roles in the development and surveillance of urban space.”

CIDs receive tacit support and encouragement from municipal, provincial and national state bodies. The private sector too are enthusiastic and have exploited what Pitcher calls “the ambiguous status of public–private partnerships” to further its own ends. At the extreme some companies have turned towards the design, construction, and management of entirely new private cities, built from scratch that includes commercial, residential, and retail spaces.68

CIDs and new urban developments have been accompanied by an explosion of private security forces. Indeed, according to Samara 2011, pp. 36–37 (cited in Pitcher, ibid.) the numbers of private security personnel now exceed that of the South African police force by a factor of four to one. In general the small and medium-sized private security firms are not unionised and their half a million employees enjoy little job security. Moreover, many of the These companies either ignore existing regulations to reduce labour costs or they outsourced hiring to labour brokers who exploit loopholes in labour laws in order to hire casual labour that receive no benefits69. As Pitcher (ibid.) puts it: “Alongside or instead of the state, the private sector is driving the creation of city and residential improvement districts, local policing, community surveillance, infrastructure provision, and grand, mixed-use urban development scheme.”

Marketisation of the South African economy has been aided by the speed and willingness of former political prisoners, exiles, present and past stalwarts of the ruling party, the unions, and the civic organisations have sought to join the corporations. In contemporary South Africa “members of the ruling party occupy seats on directors’ boards or have received financing from the state to acquire equity in established companies.” Moreover as table 11.1

---

68 Pitcher (2012) observes: “Bestowed with romantic names such as Waterfall City, Waterfall Equestrian Estate, or Cradle City, these utopian dreamscapes market lifestyles of leisure, luxury, convenience and security to the wealthiest echelons of South African society (Waterfall City 2012, Cradle City Professional Team 2008).”

69 Private companies in other sectors such as construction, cleaning and maintenance are replicating this practice. As a result, the use of non-union and casual labour has accelerated (Cosatu 2011, pp. 82–86).
illustrates, the Unions (traditionally hostile to privatisation), the civic organisations have all establish investment arms whose job it is to realise a profit (allegedly) on behalf of the membership by seeking profitable acquisitions across the economy. In this manner everyone in South Africa has now a vested interest in supporting an efficient, competitive and profitable market.

Figure 11.1: Investment arms of former anti-apartheid organisations

<table>
<thead>
<tr>
<th>Entity (Investment Arm)</th>
<th>Acquisitions by Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>COSATU (Kopano ke Matla)</td>
<td>manufacturing, finance, Internet technology, affordable housing developments, and tourism</td>
</tr>
<tr>
<td>The Mineworkers Investment Company</td>
<td>banking, hospitality and gaming, and oil distribution</td>
</tr>
<tr>
<td>SACTWU South African Clothing and Textile Workers Union (Hosken Consolidated Investment Limited)</td>
<td>media, textile companies, gaming, and hotels</td>
</tr>
<tr>
<td>The ANCYL (Lembede Investment Holdings)</td>
<td>property, fishing, agriculture, mining and other sectors</td>
</tr>
<tr>
<td>SANCO The South African National Civics Organisation (Sanco Investment Holdings)</td>
<td>petrol stations and media</td>
</tr>
</tbody>
</table>

11.4 ASGISA, B-BBEE and the New Growth Path

BEE is central to ASGISA. BEE originated with the desire of the ANC to redress historical inequalities by promoting ownership among historically disadvantaged groups. By 2006 it had become a central plank in the language of the ANC. However as a policy objective, it had been inconsistently pursued since 1994. ASGISA entailed a revised approach to empowerment with an expanded scope that went beyond ownership. At the heart of the process and driving the revision was the Black Management Forum. The Forum critiqued the original approach by arguing that black South Africans merely providing black faces ‘fronting’ for companies that wanted to comply with the rules. Essentially, they had no real power and did not acquire substantial equity in the firms they ‘owned’ (ibid.).

70 Tellingly, in spite of efforts to expand black ownership through divestitures, companies with black ownership of more than 25% of the total equity comprised less than 2% of the assets listed on the Johannesburg Stock Exchange a decade after the transition to democracy (Tangri and Southall 2008, p. 700).
In response to the criticism the government reconfigured the narrow and ad hoc approach to BEE of the 1990s with far more comprehensive legislation the Broad-Based Black Economic Empowerment Act (B-BBEE) of 2003. According to Pitcher (ibid) the revised policy aimed not only to encourage black ownership and a representative workforce, but also to promote skills development, managerial control, and procurement policies aimed at black-owned businesses. Starting in 2007, the government introduced codes of good practice that awarded marks to existing companies for procuring goods from BEE firms or extending equity to historically disadvantaged investors. “Companies with a turnover that exceeded R5 million were expected to comply with a certain number of elements of the scorecard depending on their size. Any company that did business with the government had to address each element of the scorecard while those companies with a turnover of less than R5 million were exempt from compliance. In each sector, the government introduced detailed codes and charters regarding the requirements for compliance. It also initiated legislation that specifically targeted small and medium enterprises in particular product areas” (OECD and African Development Bank 2007, 497, Mthimkhulu 2008, in Pitcher, 2012).

The New Growth Path (NGP) was unveiled by President Jacob Zuma in his State of the Nation address on February 2010. The NGP reinforces and extends ASGISA and at this point in time can be seen as the full flowering of developmental state’s own neoliberal project. It reiterates concerns regarding equity and ownership from ASGISA and sets out to increase employment by generating five million new jobs by 2020. Competitiveness, efficiency and profitability remain the central pillars of the programme. Indeed according to the EDD the developmental state “is clearly situated within a market-driven economy where ‘private business is a core driver of jobs and economic growth” (EDD 2011, 62, cited in Pitcher, 2012).

ASGISA and NGP now provide the legal framework and institutional foundations for the government’s developmental agenda. The parastatals, public works projects, preferential procurement, state managed asset funds, and public–private partnerships (PPPs) are the interwoven instruments for the implementation of these initiatives. Both ASGISA and the NGP emphasise the importance of SOEs in:

- creating employment.
- providing public goods, and
• supporting black economic empowerment

The big and overarching achievement of the ANC government has been to frame these developmental ideas in a trinity that speaks to the competitiveness, productivity, and profitability of the neo-liberal project.

The same SOE which the government had planned to sell off in the 1990’s have now become so integral to economic policy that between 2004 and 2007, “… expenditure on SOEs averaged around 25% of total public expenditure” (Quist et al., 2008, 34, cited in Pitcher, 2012). From the ANC government point of view, this has proved to be money well spent. In the last ten years parastatals have:

• provided managerial positions for the historically disadvantaged
• provided union jobs in a weakening economy and sustained the formal sector.
• met most government targets with regard to employment equity for blacks, women, and persons with disabilities

Pitcher (ibid.) reports that by 2005 black managers made up 55% of the management positions in the public sector and the first job for 70% of black university graduates was in the public sector, suggesting that it was playing a critical role in the creation of a black middle class. Further just over half of black South Africans earning at least R8000 a month were employed by the state or in an SOE (Altman 2005, pp. 14–15, Market Tree Consultancy 2009, cited in Pitcher 2012).

11.5 Conclusion: wholly committed to a private-sector economy without privatisation

Over its first two decades of power in post apartheid South Africa, the ANC government has repeatedly assured the international community that it is wholly committed to an economy driven by the private sector. At first, “…privatisation was central to the effort by the post-apartheid government to secure a marriage between the state and capital through the expansion of black ownership” (ibid.). There has been a massive expansion in the size of the black middle class. Supported by the empowerment legislation the black beneficiaries of privatisation and/or restructuring have extended far beyond the established elites to include
genuine black entrepreneurs who had emerged spaces unseen or ignored by apartheid South Africa. Further and again as a result of empowerment Pitcher (ibid.) reports, “... the share of black South Africans in private sector management has climbed from 18.5% in 2000 to 32.5% in 2008 (Southall 2010, 11).” If the extent of the marketisation is a testament to its commitment to a society driven by market forces then the growth of the black middle class and black capitalism is testament to its commitment to the marriage of capital and state.

Privatisation although it aligned well with BEE proved to be politically charged, in time the government discovered a new set of instruments far more benign but infinitely more suited in the circumstances to channelling economic power to the historically disadvantaged. Because of their spatial location and their scope parastatals and public works projects have emerged as ideal vehicles suited to these tasks. “Because SOEs like Transnet and Eskom are territorially dispersed around the country, they allow the state to allocate jobs, management positions, and procurement as widely as possible. Their high levels of employment appease trade unions and their well paid management positions provide opportunities for educated black South Africans to join the middle class. In return, the party sustains the political loyalty of its supporters.” In addition, “… public works projects and procurement provisions backed up by empowerment legislation endeavour to link business politically and economically to the state. They are designed to offer opportunities for ‘tribute taking’ (as Williams would say) to political supporters of the regime through the provision of procurement, management positions, B-BBEE, empowerment funds, and shares. But the goals extend beyond clientelism: the policies seek to capture established firms with large capital projects and regulate them via requirements regarding the inclusion of historically disadvantaged groups. The effort by the government to re-engineer socio-economic arrangements in South Africa, to support the growing black middle class, and to facilitate the movement back and forth between business and politics via deployment or empowerment initiatives has begun to cement a different kind relationship with business, one where business is more controlled by, and more dependent on, the state. As Nattrass and Seekings (2010) point out, this is currently counter-balanced by the large size of South Africa’s economy and the strength of civil society, but there is little doubt that the state and business are becoming more closely intertwined” (ibid.). While parastatals are allowed to remain in those sectors with high capital outlays and high unionisation, the private sector is expanding (almost by stealth), under state encouragement, into non-unionised and non-traditional sectors.
ANC led South Africa is committed to the free market. In its first two decades in power, the government have proven adept in making strategic market interventions to promote its empowerment objective. Privatisation was not an end in itself; it was a vehicle for delivering power and resources to historically disadvantaged people. In time the government found that the public sector apparatus could be put to uses that would realise its objectives more seamlessly than privatisation. At the same time, the government sustained and extended linkages between parastatals and private capital that previous governments had established. As Clark (1987) observes, parastatals did not previously and do not now operate in a vacuum; “... instead they interact and intertwine with existing private firms.” These policies have done little to alter the structure of the South African economy. Rather, the exclusionary nature of South Africa’s economy and society has been further reinforced. Perhaps most importantly from the ANC’s point of view, the state has been strengthened, and it is now in a position both to aid capital and to control it.
11.6 Appendix to Chapter 11: Privatisation under the ANC - a Timeline

Ilan Strauss

11.6.1 1994

When the ANC came to power in 1994 a handful of closely held interwoven conglomerates operating in an oligopolistic setting (with precious little regulation) comprised the private sector. From the apartheid government new democratic South Africa inherited well over 300 state owned enterprises with 50% of fixed capital being held by the state. The apartheid government had owned the electric company, the telephone company, the national airline, the arms industry, the railroads, buses, ports, hospitals and television station.

The question what should be done about the economy was therefore a huge question for the newly incumbent ANC government. At this point, the literature diverges, in answer to Jerome and Rangata (2004) (citing ILRIG, 1999) who tell us that for many years prior to the democratic elections there had been heated debate within the ANC and other political organizations about the future of the economy and privatisation was a key issue in the debate. Marais (2011) presents an altogether different picture. He argues that the ANC were wholly unprepared for questions on economics because it was the one area that they had ignored during the struggle. 71

What we do know for sure is that before coming to power the ANC position on the economy and specifically privatisation would have been informed by the Freedom Charter. Out of power therefore the ANC was staunchly anti privatisation. Beyond that, as Fine and Rustomjee, 1996, point out privatisation was rightly viewed by the ANC as a manoeuvre by the Nationalist Party aimed at denying black African ANC control over economic resources. The first ANC economic policy paper, “Reconstruction and Development Programme (RDP)” was published just before the elections; it envisaged a “Developmental State in a mixed economy with an expansive role for the state.” On privatisation, the message was unambiguous “There must be a significant role for public sector investment to complement private sector and community participation in stimulating reconstruction and development. The primary question in this regard is not the legal form that government involvement in activity might take at a given point, but whether such actions strengthen the ability of the

71 In Marais it is Goldman Sachs the American investment bank who first undertake the training of South African economists, most notably Tom Mwobena who was later to become the first black African head of the Treasury.
economy to respond to the inequalities of the country, relieve the material hardship of the majority of the people and stimulate economic growth and competitiveness” Jerome and Rangata (2005, 8). There was broad agreement between labour, business and government that the state needed to be restructured. The disagreement was on the nature of the restructuring. Labour wanted a “developmental state” with greater service provision to the poor and to those who had been dispossessed by apartheid. COSATU mobilized its membership in opposition and demonstrations. Inevitably, business preferred a leaner state.

One area of consensus was Black economic empowerment (BEE). BEE comprised a varied set of regulatory initiatives and funding mechanisms aimed at redressing the country’s “legacy of systematic economic marginalisation of the black majority. Its goals were to reverse the long-standing patterns of racial discrimination with respect to employment, land tenure, and ownership; to support small and medium-sized businesses belonging to historically disadvantaged groups; to encourage and finance the purchase by black investors of equity stakes in existing companies; and to build a workforce that reflected the demographic make-up of the country” (Southall 2004, Tangri and Southall 2008, cited in Pitcher, 2012). Privatisation aligned well with the goals of BEE because it offered opportunities for increasing black ownership (Reddy 2004, p. 23, ibid). Consistent with the goals behind black economic empowerment, most privatisation deals included black investors.  

11.6.2 1995

The National Framework Agreement (NFA) broke the deadlock and appeared to resolve the conflict. The NFA made it possible for COASTAU to accept the previously unpalatable idea of privatisation in some cases. The message was again unambiguous: “The ultimate aim of restructuring is to improve the quality of life for all South Africans. Therefore the underlying approach is that restructuring should not occur at the expense of workers in state enterprises. Every effort must be made to retain employment. Where restructuring potentially has negative

---

72 According to Pitcher (2012); “They benefited from the full or partial sales of six SABC stations; two forestry companies; a small airline company; resorts; a small percentage of MTN, the cellular telephone network; and shares of the fixed line, telecommunications operator, Telkom (Rumney 2004, p. 2, Reddy 2004, pp. 23–24). With regard to the latter, the state offered shares to foreign and institutional investors, BEE firms, managers, workers and the public. After 2003, it gave historically disadvantaged groups a 20% discount on the initial share price with promises of additional shares if they hung onto their shares for a minimum of two years (Horwitz and Currie 2007). Moreover, both Transnet and Eskom divested non-core enterprises to BEE firms or to new parastatals that complied with empowerment goals (Rumney 2004, pp. 2–4).”
effects on workers, a social plan must be negotiated with the relevant unions at the enterprise level which takes account of the workers interest.” (ibid. 9) The NFA emphasized inclusivity in the process, labour, business and government were all to be represented. In addition the goals surrounding the restructuring of certain state assets were identified and the various steps in the process were all outlined.

Late in 1995, in a curious twist and deviation from the NFA understandings, Deputy PM Mbeki announced plans for a huge privatisation programme. Labour unions responded by mobilising huge opposition over a protracted period.

11.6.3 1996

The Growth, Employment and Redistribution (GEAR) economic policy document called for broad based privatisation (although the term was not in the document) and generally embraced the neoliberal path for the new and democratic South Africa. Well-developed ideas on the process for restructuring of state assets were unveiled. “The nature of restructuring as outlined in the framework agreement, may involve the total sale of the asset, a partial sale to strategic equity partners or the sale of the asset with government retaining a strategic interest. Work is in progress to address the outstanding issues on the restructuring of the remaining state enterprises. The restructuring will take place in a phased manner so as to ensure maximum value and adequate regulatory frameworks. Specific policy issues and further elaboration will be dealt with by the responsible Ministers” (ibid.). GEAR became the economic policy of the government and restructuring was conducted in a number of state enterprises.

Figure 11.2: Privatisation in South Africa 1997-2002

<table>
<thead>
<tr>
<th>SABC Radio Station</th>
<th>Date</th>
<th>Stake Sold %</th>
<th>Total Proceeds Rand Million</th>
<th>Proceeds to the exchequer Rand Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telkom</td>
<td>May 1997</td>
<td>30</td>
<td>5631</td>
<td>1165</td>
</tr>
<tr>
<td>Sun Air Airports</td>
<td>November 1997</td>
<td>100</td>
<td>42</td>
<td>21</td>
</tr>
<tr>
<td>Company</td>
<td>June 1998</td>
<td>25</td>
<td>1035</td>
<td>1035</td>
</tr>
<tr>
<td></td>
<td>July 1999</td>
<td>20</td>
<td>1400</td>
<td>611</td>
</tr>
</tbody>
</table>
The response from labour was vehement; COSATU objected on the grounds that GEAR contradicted the RDP and that privatisation of state assets endangers the delivery of basic social needs and leads to losses in employment. Business emphasised the slowness of government in implementing GEAR and the delay in privatizing state assets. The delay and general malaise was said to be sending the wrong signals to international investors and the market in general. Opposition was therefore generalised, intense and sustained.

11.6.4 1999

In 1999 the Inter-ministerial Cabinet Committee on the Restructuring of State Assets (IMCC) called for a more comprehensive policy framework process into the 21\textsuperscript{st} Century. Policy on privatisation needed to be consistent across all government and address perceived uncertainties.

11.6.5 2000

\[\text{SRD}^{73}\] Special restructuring dividend.
In August the Department of Public Enterprises published the Policy Framework for an accelerated agenda (over 2002-2004) for the restructuring of State Owned Enterprises (SOE). The document endorsed the NFA objectives and aims to increase SOE efficiency through improved governance and competition, while trying to get foreign investment, technology, and expertise through full or partial privatisation. New guidelines were introduced covering five key areas;

a. Economic and social effects  
b. Development of appropriate regulatory and competitive frameworks,  
c. promoting empowerment;  
d. corporate governance,  
e. improving the restructuring process

And the Policy Framework targeted four key enterprises that would command a minimum of 40 billion rand (5% of GDP);

1. Telkom (telecommunications)  
2. Transnet (transport)  
3. Eskom (electricity)  
4. Denel (defence)  

Each accounted for at least 86% of its sectors aggregate turnover, 94% of total income, 77% of all employment in the top SOE and 91% of total assets (Mostert, 2003 in Jerome and Rangata, 2005, 11).

11.6.6 2001

In 2001 a further 3% of Telkom (South Africa’s sole fixed line telecom operator) sold to Ucingo a Black Economic Empowerment (BEE) group. A public listing for a further 20% was timetabled for 2001/2002 but was delayed because of adverse market conditions.

11.6.7 2002

In 2002 sales continued

- January: sales of Aventura resorts-R29M.  
- July: 51% of Denel Altimov division-R50m  
- Aug: 20% stake in cell phone group M-Cell  
- Oct: 51% stake in Apron Services–R117m
Reviewing the progress of the GEAR inspired privatisation programme the Minister of Public Enterprises says government had conducted eleven transactions in 2002 to bring the number of transactions since 1997 to 27. These included outright disposals, equity sales, BEE, dividend payments. Total revenue amounted to 35 billion rand, with the National Revenue fund absorbing just under 20.5 billion rand (Jeff Radebe, 2003 in Jerome and Rangata, 2005, 11).

By this time foreign interests had accounted for approximately forty percent of total proceeds from sales of SOEs (Pitcher, 2012). Further, US, UK, French, and German investors became strategic equity partners in telecommunications, the defence industry, and the transport sector. Americans also purchased tourist resorts (Rumney 2005, 9 in Pitcher, 2012).

Despite the policy documents, and the various privatisation programmes, by the end of 2003, the government had sold around 9% of state assets and SOEs still made up forty four percent of fixed capital assets and contributed 14% to the GDP (ibid). Importantly, the ANC government had not sold the most important SOE (electricity supply and generation, defence manufacture, telecommunications, and transport services), rather it sought reconfigure them in order to, “... pursue closer relationships with private investors, to rationalise operations, to establish linkages with historically disadvantaged firms, and to appease trade unions in those industries.” Further sales of existing parastatals with significant weight in the economy have not taken place since that time.

The former minister for public enterprises Barbara Hogan, stated in 2009 that, “since 2004, government policy has shifted decisively from preparing SOEs for privatisation to ensuring that they are sustainable businesses that provide economic benefit to the country” (Hogan 2009, 2 in Pitcher, 2012). Thus, the 2009-2012 strategic plan called for more of an activist stance in the part of the Department of Public Enterprises (DPE). In other words the DPE was to “intervene” so as to help SOE contribute to employment and growth. Instead of sales to replenish depleted coffers the SOE is now a powerful instrument of the developmental state (Molefe 2009, 3, ibid.). The strategic plan recognised the potential contribution of SOEs in...
addressing market failure, providing infrastructure, offering procurement, absorbing labour, and partnering with foreign and domestic private-sector stakeholders on large capital outlays (Department of Public Enterprises 2009, 4–8). These later developments represent something of an about face for the ANC government. What exactly had happened to prompt the seeming reversal of a policy that it had embraced just ten years earlier?
12 Impact, Nature and Effects of the Global Financial Crisis
Seeraj Mohamed\textsuperscript{74}

12.1 Introduction

The impact of the global financial crisis that started in 2007 on the South African economy was shaped by the nature of the country’s recent economic growth and the continued industrial structural weaknesses there and financialisation of the economy. Mohamed (2012, 270) says:

“The South African economy was in a state of crisis before the global financial crisis. The official unemployment rate has remained well over 20 percent over the past decade. Employment has declined in manufacturing indicating deindustrialization of the economy. Services employment grew but this growth was not due to growth in productive services but instead seems to have been driven by acceleration in debt-driven consumption, outsourcing and growth in private security services.”

There are generally two interpretations of the impact of the global financial crisis on the South African economy. The first as espoused by the Reserve Bank, gives a neoliberal interpretation that maintains that strong macroeconomic fundamentals and the rising commodity prices have been central to the economy’s resilience in the face of crisis. The second interpretation is that South Africa has been in crisis prior to the global financial crisis. Different beliefs about the role of finance in economies during the last few decades of widespread financial liberalisation and increasingly integrated global financial markets are central to these different perspectives.

The South African Government chose to follow mainstream perspectives. They followed the views presented in mainstream literature, such as the influential articles by Levine (2005), which argues that there is a relationship between economic development and financial development, and Demirgüç-Kunt and Levine (2008), which argues that there is a causal relationship between a well-functioning financial sector and long-run economic growth.”

Even after the painful lessons of the global financial crisis they continued to argue that the

\textsuperscript{74} I acknowledge the assistance of Basani Baloyi in the writing of this chapter.
well-developed financial sector of South Africa would support growth and development through efficient allocation of capital. They also argued that it would create opportunities for historically marginalised people.

They were aware of (but chose to ignore) economic perspectives that argue that financial liberalisation and financial globalization has been negative for economic development, worsened allocation of capital, contracted economic opportunities and increased inequality. These kinds of impacts were well summarized by Singh (2011, ii): “… financial globalization changes the very nature of capitalism from managerial to finance capitalism. This profoundly affects at the micro-economic level corporate governance, corporate finance and income distribution.”

There have been many important influences on the formation of the South African economy that shape it today. These include the colonial and apartheid political influence on the development of the economy and its institutions, the role of the minerals and energy complex and the subsequent financialisation of the economy over the past few decades.

The adoption of neo-liberal economic policies and the process of financialisation of the economy started during the 1980s in the apartheid era. The momentous political changes and the transition to democracy did not usher in economic policy changes. The democratically elected Government chose to maintain a neo-liberal economic bias and adopted a conservative macroeconomic framework and liberalization of trade and financial markets that promoted greater openness of the South African economy.

12.2 Government and the Central Bank’s mainstream views on the impact of the global financial crisis on South Africa

Deputy Governor Reserve Bank Lesetja Kganyago in a March 2012 speech stated that the economy had been in good standing prior to the crisis. Kganyago was the Director General of the National Treasury from 2004 to 2011 before becoming Deputy Governor at the SARB. Therefore, this speech gives good insight into both Government and the SARB’s perspective on South Africa and the impact of the global financial crisis. Kganyago echoed the dominant Treasury perspective in Government when he reported prior to the global financial crisis, strong macroeconomic fundamentals and the commodity boom attracted capital inflows to South Africa. According to Kganyago, these capital inflows helped to fuel economic growth
and the provision of cheap finance for fixed investment during the period 2003-2008. He claimed that increased access to finance helped to ease the cost of Government’s infrastructure building programme and that the stronger rand made imports more affordable thereby improving household welfare.

The mainstream narrative (by officials of the National Treasury, the South African Reserve Bank and the major banks) of the impact of the financial crisis on the South African economy was that it ended a period of high economic growth (close to 5% in 2004 and over 5% GDP growth per annum from 2005 to 2007). This high growth was achieved after years of poor performance. This view, presented in the Presidency of the Government of South Africa’s 10 and 15 Year Reviews, was that tight macroeconomic policies (inflation targeting and deficit reduction) may have caused some pain but that sacrifice put the economy onto a good footing. They said the high GDP growth rates from 2004 and the low levels of inflation proved that their macroeconomic policies were successful.

Kganyago explained that the first shock to the economy before the crisis was the global food price shock, which created inflationary pressures. He said the response to the price increases was to increase in the policy rate. He added that the policy response came at a great cost to households and corporations. He explained that the ‘positive factors’ which led to higher imports during the period 2003-2008, also increased household indebtedness to unsustainable volumes. He said that the global financial crisis began when South Africa was at an already weakened position. He claimed that the crisis reversed the gains in employment and production because employment and output fell due to the collapse in global demand, particularly in traditional (commodities) export markets.

Kganyago’s speech does not provide a good sense of the quick and drastic impact of the global crisis on the South African economy, instead he focuses on the ‘resilience of the economy’. In Mohamed (2010), I provide a brief description of the impact of the crisis. In addition to the recession of 2009, there were huge job losses, declines in production and home foreclosures. I said:

“According to Statistics South Africa’s Quarterly Labour Force Survey, there was a decrease of employment of 770,000 people (5.6%) from the third quarter of 2008 to the third quarter of 2009. During this period the number of people classified as ‘not economically active increased by almost 1.1 million and more than half (0.56 million) of these were classified as ‘discouraged work-seekers’.
Manufacturing production decreased by nearly 20% from April 2008 to April 2009, while services sectors, particularly retail trade declined and lost jobs. Estimates by companies such as Auction Alliance put home foreclosures at around 300 per month during late 2008 and early 2009.” (Mohamed, 2010)

Kganyago stated that the South African economy showed great resilience to the global financial crisis. In so doing, he seemed to equate the financial sector with the economy. He could only be conflationg the financial sector with the whole of the economy. When one considers the level of job losses incurred when the global financial crisis occurred, in an economy where the narrow definition of unemployment was already around 23% at the time of the crisis, and the huge drop in productive activity, in an economy that had already been de-industrialised, ot is hard to support an argument that the economy was resilient. This conflation (whether conscious or not) seems to provide an important indicator of the level of financialisation of the South Economy. It may also be an insight into the mindset that shapes the dominant Treasury and SARB perspectives on macroeconomic and financial policies.

Kganyago in his exposition of the resilience of the ‘economy’ continued to explain that capital inflows were restored after the panic that hit the South African securities markets when investors dumped risky assets. He did not explain why South African assets were viewed as risky by these investors but claimed that the restoration in capital flows was due to South Africa’s strong fiscal position and the strong showing in commodity markets. He did acknowledge that ‘residual’ prudential regulations had been central to the resilience of the South African banking sector in the wake of the crisis. It is worth noting at this point that under Kganyago’s leadership, the South African Government and Reserve Bank worked hard to deregulate international financial relations. Therefore, we believe it is an important lesson of the crisis that he and his Treasury and SARB colleagues were willing to admit that exchange controls (the last few left) helped to lessen speculative attacks on the currency. He also acknowledged that the highly indebted household sector had negatively affected the banking sector and that it was the solvency of the banks that saw them through the crisis.

12.3 Alternative perspectives on the impact of the financial crisis

The South African context for understanding the impact of the global financial crisis was one where the weak economic structure dominated by the MEC was exacerbated by financialisation (Ashman, et al., 2010; Mohamed, 2010). The South African economic growth path was shaped by debt-driven consumption and speculation-fuelled growth of the financial
system. Big business restructured to further internationalise their operations and acceded to the demands of the shareholder value movement to focus on achieving high short-term returns. Therefore, while Government was implementing what they understood to be business friendly, particularly finance friendly, economic policies, the largest corporations were unbundling their non-core assets in South Africa and shifting their resources so as to grow outside of South Africa. They were involved in unprecedented mergers and acquisitions that increased their international presence and further concentrated the South African economy.

The stated goal of Government’s economic policies was to reduce poverty, inequality and unemployment – legacies of colonialism and apartheid. They have not made serious inroads into these problems since 1994. Government has managed to curtail growth in poverty through programmes to improve access to basic services and increased welfare spending but unemployment and inequality have become worse since the end of apartheid. The high levels of inequality and unemployment increase social tensions, crime, and increasing political conflict, particularly local political actions that turn violent.

By 2012, 60% of the national budget was dedicated to spending on the “social wage” category, which includes education, health services, social development, public transport, housing, and local amenities. More spending was required to address the legacy of the past and put South African society on a footing to ensure economic development with decreasing unemployment and inequality. To address the legacy of apartheid in these areas government should have taken care of huge social backlogs inherited from apartheid. However, spending on important areas such as health, education, housing, water and public transport have not increased in real terms or kept pace with population growth. Government had adopted an industrial policy framework but they have kept interest rates high to keep inflation within targets and fiscal support for the industrial policy has been confined by tight fiscal policies.

Government’s policies have supported financialisation and the growth of finance and hurt the productive sectors of the economy. The beneficiaries of apartheid and a small emerging black middle class have benefited from these policies. At the same time, nearly 40% of the population do not have bank accounts and a larger share do not have access to credit (and if they do it is at very high interest rates). The small growth in aggregate demand has not supported growth of the productive sectors but led to increased imports of consumer products. These factors were boiling towards a crisis in South Africa before the onset of the global
financial crisis from 2007. The catalyst for the domestic crisis was the increased risky lending by the banks to the minority of the population that had access to credit.

Ashman et al. (2010) and Mohamed 2012 have considered the impact of financialisation on the economy. Mohamed (2012) looks at the impact of the financial crisis on the South African economy. Bond (2009), has similar arguments, and says that the economy was not as resilient to the crisis as projected by the Government, SARB and the banks. He says macroeconomic policies pursued prior to the global financial crisis made the economy vulnerable to crisis. Bond (2009) and Mohamed (2012) argue that the economy had high levels of exchange rate volatility. They show that the economy suffered several currency attacks (1996, 1998, 2001, 2006 and 2008) since democracy where the rand crashed by more than 25% (with the relaxation in exchange controls an important reason for this vulnerability). Bond argues that high real interest rates due to the inflation targeting policy encouraged profiteering in financial markets rather than in the productive activities.

Mohamed (2010) argues that the uncontrolled capital flows into the economy led to growth in sectors supported by debt-driven consumption and speculation in real estate and financial asset markets. The drying up of credit with the global financial crisis caused these sectors to crash and showed the unsustainable nature of the economic growth experienced by South Africa in the years preceding the global financial crisis.

The Government ad SARB’s response to the crisis
The policy response by Government to the financial crisis is most clearly presented in the National Treasury’s endeavours for widespread changes to financial legislation in South Africa. The motivation for these changes is outlined in their publication “A safer financial sector to serve South Africa better” (published 23 Feb. 2011). The Minister of Finance Pravin Gordhan says in the foreword of this document, “In South Africa, our financial sector successfully weathered the crisis, but a million people still lost their jobs.” Gordhan’s sentence reiterates some of the beliefs that have shaped the National Treasury’s policy response to the crisis:

- The financial crisis was an external phenomenon that had a negative impact on the South African economy. South Africa should not impose capital controls because this would cause inefficiencies in the domestic economy. Gordhan says in his foreword that the response to the crisis and the damage caused by should be a global response.
• The financial crisis taught Government that financial institutions can pursue short-term returns and take on too much risk so there is a need to revisit regulation of financial markets;
• The South African financial system is stable and sophisticated and weathered the crisis well in South Africa. These financial institutions are well suited to drive economic growth and development. There is recognition of a need for financial institutions to serve a larger share of the population.
• The problem in the South African economy is not with the financial sector, which was seen to be successful, profitable, growing and expanding into Africa and the rest of the world. The problem is the real sector, which cannot compete globally. A major reason for this lack of competitiveness (and unemployment) is the poorly educated skilled workforce who are paid too high wages because of labour market legislation and the power of trade unions.

In short, the Minister of Finance and National Treasury blame an uncompetitive productive sector, inflexible labour markets and the workers and their trade unions for loss of the million jobs and the recession after the crisis. They also recognize that the declining demand for minerals products as a result of declining global production after the crisis also negatively affected the South African economy.

Unfortunately, they do not acknowledge that the growth of the financial sector in South Africa may be due to financialisation of the economy and growth in speculative activities that allocate finance away from productive activities and investment. They describe the South African financial system as sophisticated but they do not recognize that this sophistication is due to them emulating the behaviour and activities of financial institutions in countries such as the US and UK. Therefore, even if the South African financial institutions weathered the global financial crisis well and were not exposed to large amounts of US financial toxic assets (which was probably because of the few remaining exchange controls then still in place) their behavior in the South African economy created systemic risks and potential for macroeconomic instability. They were creating their own toxic assets in the South African economy, including as Mohamed (2012) shows that the underlying value of futures contracts derivatives had grown by more than 4.5 times from 2004 to 2007.

The recession was due to a large decline in debt driven consumption. Most of the jobs lost after the crisis was in services, particularly in the business services subsector and the
wholesale and retail services subsector. The banks foreclosed on thousands of properties and in 2012 were still writing off billions of rands of home loans and unsecured debt that were unlikely to be repaid. The South African banks in the meantime have increased unsecured lending.

The approach to regulation taken in the NT’s “Safer Finance” paper is to separate prudential and market conduct regulation. They call this approach to financial system regulation a “twin-peak model” of financial regulation (which was mentioned in the Minister of Finance’s February 2011 Budget Speech”. The twin-peak model is supposed to deal with potential conflict in administering prudential regulation and market conduct (including consumer protection) regulations. It embodies the principle of regulation by objective. The South African Reserve Bank would lead on prudential regulation and the Financial Services Board would lead on market conduct issues.

The NT Safer Finance document mentions “light touch” regulation of the financial sector as a problem and cause of the global financial crisis. However, there is little discussion of the impact of financial deregulation on individual economies or the global economy. Deregulation of finance has had a huge impact on individual countries that has changed the structure of those economies. Furthermore, the financial institutions and rentiers of the developed countries have played an exploitative role in developing economies. As a result, there has been increasing amount of speculation in financial and currency markets of developing countries that has increased financial instability, negatively impacted on investment and employment creation and promoted increased speculation and capital flight. The developed countries, such as China, that limited speculative flows of capital into their economies were able to rapidly industrialise and attract large amounts of foreign direct investment.

There is no mention of capital controls in the NT documents. There is only prudential regulation. In recent mainstream economics literature where there is a realisation that finance should be regulated this replacement of capital controls with prudential regulation is seen as better. They argue that what can be achieved with capital controls can be done by prudential regulation. However, the bigger picture issue is that there is a clear ideological opposition to capital controls with the focus on prudential regulation only. The presumption of those who hold this ideological approach is that financial liberalisation is good for economies even if there are occasional disruptions and contagion. Prudential regulations are implemented in a
context where countries want to attract foreign financial flows (even short-term speculative flows). The approach to government’s macroeconomic and financial policies is then shaped by the view that the country should be careful not to lose favour with foreign financiers. The macroeconomic policy space is reduced because these financiers will favour lower inflation and a regime of using higher interest rates to maintain low inflation because inflation erodes the real value of their financial assets. They will oppose deficit financing by the state for similar reasons. The foreign inflows also lead to exchange rate appreciation and since foreign financiers will oppose managed exchange rates, the central bank will be forced to intervene in currency markets and to build up foreign exchange reserves. Overtime this approach also limits macroeconomic space and may actually lead to further liberalisation of financial flows.

In short, the issue is not whether prudential regulation can achieve similar outcomes to capital controls after financial liberalisation has occurred but instead the issue is about macroeconomic policy sovereignty and the fact that financial liberalisation reduces the government’s policy space. Furthermore, there is an assumption that South Africa will remain dependant on the speculative flows from countries such as the US and Britain when there is a possibility that through south-south cooperation and involvement in the BRICS group of countries that South Africa could work to find more stable, longer-term sources of finance and investment.

The approach towards regulation in the NT document seems to view finance as neutral within South African economic and industrial development. That view would hold that finance should be supported because it is necessary to support economic activity. The impact of financial deregulation on the behaviour of financial institutions is not discussed. For example, financial institutions are still seen as intermediaries between savers and investors when the experience with large-scale growth in securitised debt markets shows that most financial institutions became originators and distributors of debt and made profits from fees at different steps of this process. Financial institutions chose to pass on risk and to focus on increasing short-term returns and more profits for their shareholders than to support long-term investment in the economy.

Implementing prudential regulations in a context where finance and financial flows have been previously liberalised will not shift the allocation of capital away from debt driven consumption and asset market speculation towards long-term fixed productive investments. The majority of wealth-holders and speculators will continue to prefer to maintain
international portfolios of liquid financial assets where they can profit from short-term shifts in interest rates and other macroeconomic variables rather than risk their money in long-term fixed investments. Within this context most non-financial corporations spend more on speculative activities than fixed investments. The ability to implement industrial policy in this context will depend on the ability of the government to provide large incentives to non-financial corporations. The ability to finance incentives from government’s budget will be limited because of finance’s distaste for deficit spending. Government will then have to look at other kinds of incentives such as providing certain kinds of rents (monopoly, resource, pollution etc) to industry, which may have future negative consequences on the economy and economic development.

12.4 Conclusion

The crisis seemed to provide an opportunity for the Government and SARB to rethink their approach to macroeconomic policies. However, as happened elsewhere the thinking that shaped their responses were that orthodox policies are best and special measures are necessary to deal with a crisis. The SARB allowed inflation to move outside of their target range during the crisis but did not consider breaking away from inflation targeting. They tried to stabilize the exchange rate but they did not consider any actions other than increasing foreign exchange reserves.

The ‘twin peaks’ approach to regulation has become the South African Government’s answer make the South African financial system safer. As discussed above, this policy is based on a mainstream view of financial markets and regulation. Furthermore, this policy intervention is due to a view that the South African financial system is stable and secure and that the neo-liberal macroeconomic policies of government promoted stability. As a result, there has not been adoption of policies that address the crisis that was brewing in the South African economy before the global financial crisis occurred. Our view is that financialisation will continue, the financial sector will continue to grow, unemployment and inequality will remain huge and the crisis conditions that existed before the global financial crisis will continue to brew.

The global financial crisis exacerbated an existing South African economic crisis. Unfortunately, while Government searches for solutions to low levels of fixed investment and high unemployment, they do not admit a crisis. Their neo-liberal macroeconomic policies
increased the financial fragility of the economy and quickened the pace of deindustrialisation. An important contributor has been relatively uncontrolled, short-term speculative capital, which took advantage of interest yields and caused interest and exchange rates volatility. These inflows have changed the structure of investment which generally became short-term and speculative in nature while long-term investment in productive industrial activities has suffered. In addition, these dynamics have been exacerbated by corporate restructuring in which the focus on core business has led to greater focus and financial support for the core sectors of the MEC whilst downstream manufacturing activities, with fewer linkages to the minerals sectors have been neglected and have shrunk.
13 South Africa’s Inequality: A Growth Path Perspective
Rex McKenzie

13.1 Introduction

A growth path can be defined as the trajectory of economic growth and development that considers the character of the economic growth beyond the growth rate. Kaplinsky (1991) outlines four types of growth path in the abstract: i) growth through inequality; ii) redistribution with growth; iii) growth with equity; and iv) growth through redistribution. The type of growth path depends upon the prevailing policy framework and strategy of accumulation. The following section discusses historical origins of the current growth path and prevailing industrial structure. We discuss the relationship between policy and the growth path in the Apartheid era and the first 18 years of democracy. It is shown that while the prevailing structure of industry has its roots in the discovery of gold and apartheid policies, the first 18 years of democracy has seen the further entrenchment of the apartheid industrial structure and growing structural unemployment and inequality.

13.2 The Apartheid Growth Path

Based on Kaplinsky’s abstract typology, the apartheid growth path can be described as growth through inequality. Apartheid can be seen as a social structure designed to provide the conditions under which accumulation could occur through inequality based on predominantly racial forms (Kaplinsky 1991, 50).\(^{75}\)

The strategy of accumulation based on the maintenance of inequalities provided conditions for sustained accumulation during the 1950s and 1960s. Thereafter, and particularly throughout the 1980s, the accumulation strategy failed largely as a result of the contradictions inherent in the strategy of growth through inequality (Kaplinsky, 1991). The inherent instability in the strategy of growth through inequality is elaborated below.

In addition to failure of the apartheid growth path to deliver sustained growth in the 1970s and 1980s, the apartheid era saw the development of South Africa’s industrial structure

\(^{75}\) We will see in the next section that the nature of the post-apartheid growth path can also be defined as growth through inequality but in a different form. Growth since 1994 has been characterised by neoliberal policies and the types of growth with inequality associated with Thatcherism and Reganism in the 1980s, and globalisation and financialisation in the 1990s and 2000s.
characterised by high capital intensity, with very limited opportunities for the expansion of waged labour - particularly amongst the black population.

13.2.1 **Inherent contradictions in the strategy of growth with inequality**

Apart from the moral and political implications of increasing social inequalities for the purpose of economic growth, the strategy of growth with inequality contains a number of contradictions that result in inherent instabilities of such an accumulation strategy. Kaplinsky (1991) outlines a number of reasons for the exhaustion of the growth model and the failure of the apartheid growth path to deliver growth in the 1970s and 1980s after a period of what appeared to be sustained growth in the 1950s and 1960s.

First, Kaplinsky notes that the inequality in incomes failed to allow mass consumption to meet with mass production. This undermined the efficiency of the industrial sector by fostering monopoly and sub-optimal scales of production. Second, owing to inequalities on the shop floor, capital was unable to draw forth the creativity of its labour force and overall capital productivity declined. Third, inequality of power relations, employment opportunities and political representation led to costly political opposition; it also led to lost production as a consequence of industrial action; the resulting insecurity and crime dulled capital’s incentive to invest in technological development, induced the flight of skills and resulted in international sanctions which limited export growth. Fourth, the turnover of the labour force, the commuting system, and, and the general insecurity of living conditions meant that labour costs were increasing by global standards; falling land productivity and rising population in marginalised rural areas also undermined the extent to which the Bantustans were able to subsidise wages in the formal sector. Fifth, inequality in education meant that skills shortages slowed accumulation (Kaplinsky 1991, 51)

**13.3 The Legacy of the Apartheid Growth Path and the post Apartheid Growth Path, 1994-2008**

The ANC government inherited an economy with an industrial structure in which the majority were excluded from participating in economic activities. Manufacturing sectors were concentrated around highly capital intensive industries with insufficient capacity to soak up
the large population of the black unemployed who had been previously excluded from the economy.

Rather than orienting economic policies to the task of the massive structural transformation necessary to address the highly concentrated patterns of ownership in industry, and the structural causes of extremely high unemployment amongst the black population, the ANC government concentrated on macroeconomic stabilisation and liberalisation policies in tune with the fashion of economic policy in the industrial nations of Europe and North America.

On coming into office, the primary goals of the ANC in terms of resurrecting the South African Economy were set out in the Reconstruction and Development Programme (RDP). The policies under RDP consisted of a set of goals rather than a policy strategy proper. It focussed on increasing the growth rate as an end goal with no consideration on industrial structure or its transformation. The route to increased growth rates lay in increasing the rate of investment that would result in a more equal distribution of income and wealth. RDP contained very little in terms of the specific types of policy and government intervention necessary to meet these goals.

Concrete policies were adopted under GEAR in 1996, providing the government’s macroeconomic policy framework for economic and industrial development for the next five years. The macroeconomic policy framework under GEAR emphasised fiscal austerity, deficit reduction and pegging taxation and expenditure as fixed proportions of GDP. Through GEAR, the government’s stated macroeconomic priorities became the management of inflation, the deregulation of financial markets, tariff reduction and trade liberalisation as well as limiting government expenditure. Despite a policy of high interest rates, the government maintained its belief that the private sector would drive industrial development, with inward foreign direct investment targeted to be a major source of resources. The role of domestic conglomerates in growth and development remained notable for its absence.

The Accelerated and Shared Growth Initiative for South Africa (AsgiSA) was formally launched in February 2006 with the objectives of broadening the base of Black Economic Empowerment (BEE) and to promote the emergence of a black business class; redressing the inequalities between the so-called first and second economies by providing broader access to public goods and services; improving the ‘business environment’ by reducing the cost of transport and communications, etc.; and reducing unemployment by promoting labour-
intensive exports in services (Gelb, 2006a). But as GEAR mutated into AsgiSA, South Africa’s macroeconomic policy remained largely unchanged.

In contrast to GEAR, AsgiSA does contain a number of interventions at the micro level. These are organised into four categories: infrastructure investment programmes, sector investment or industrial strategies, skills and education initiatives, and second economy interventions (ANC, 2006). AsgiSA identified business process outsourcing (BPO) and tourism as the two sectors for priority under its industrial strategy.76

But, there is a conflict between liberal macro policies and these micro interventions with the former supporting short-term capital flows that bolster the private financial sector allowing it systematically to misallocate finance towards speculative and short-term projects and away from longer-term investments. Figure 13.1 shows the distribution of new investment across assets in private corporate enterprises between 1990 and 2007. While gross capital formation has been increasing throughout the period, it has not kept pace with the depreciation of capital. Year on year net capital formation has seen very modest gains while the net acquisition of financial assets has been higher than net capital formation throughout the period (with the exception of 2005). The net acquisition of financial assets exceeded gross capital formation in the years 1990-1994, 1996, 1998, 1999 and 2001.

The pattern of investment by private corporate enterprises has led to very small increase and serious decrease in the capital stock across a large number of productive sectors (see figure 13.1). Decreasing capital stock has taken place in light, labour intensive manufactures, further contributing to structural unemployment in South Africa (see Figure 13.2). While services sectors have seen increased investment and employment this has not kept pace with output (see Figure 13.3). Figure 13.4 shows the ratio of employment to output77 in the primary, secondary and tertiary sectors. The ratio of employment to output has been relatively stagnant in the primary and secondary sectors (with a slight decrease in the secondary sector). By contrast the ratio has been decreasing in the services sector. This suggests that expansion of

76 The next rank of priority sectors consist of Chemicals; Metals beneficiation, including the capital goods sector; Creative industries (crafts, films & TV, content and music); Clothing and textiles; Durable consumer goods; Wood, pulp and paper.

77 The employment to output ratio is calculated as the number of employees divided by annual output at basic prices in R millions (constant 2000 prices).
services might not be the most effective method of generating widespread sustainable employment.\textsuperscript{78}

\textbf{Figure 13.1} Distribution of new investment across assets in private corporate business enterprises 1990-2007

\textit{Source: Quantec 2009}

\textsuperscript{78} This will be discussed in greater detail in the next section.
Figure 13.2  Changes in capital stock across all economic sectors in SA between 2000 and 2008

Source: Quantec 2009
Figure 13.3  Gross domestic fixed investment output ratio in primary, secondary and tertiary sectors in SA 1990-2008

Source: Quantec 2009

Figure 13.4  Employment output ratio in primary, secondary and tertiary sectors in SA 1990-2008 (including informal employment)

Source: Quantec 2009
The growth path of the South African economy during the first 18 years of democracy can also be described as growth through inequality, albeit in a different sense to the apartheid growth path. Through the macroeconomic policy of GEAR, the ANC government moved the South African economy onto a neoliberal growth path characterised by globalisation, increased internationalisation of South African conglomerates, financialisation and rising inequality. As discussed above, these policies did little to change the structure of the South African economy. Rather, the exclusionary nature of South Africa’s industrial structure has been further reinforced during the first 18 years of democracy.

The onset of the global recession in 2008 brought into stark relief, the unsustainable nature of the neoliberal growth path based on growth through inequality. It is within the current context of recovery from recession that the South African Government has formed a new consensus around a well-defined new growth path that marks a significant shift from what has come before. This has involved a significant shift in the government’s approach to industrial and economic policy.

**13.4 What difference does Financialisation make?**

Amongst the components of assets and debts, financial asset are the most unequally distributed, with a Gini coefficient of 0.95 (Finn et al. 2012). With 85% of all assets in the hands of the top 10% most wealthy and 75% in the top 5% (ibid.), the aggregate story on shifting savings and investment behaviour of households with financialisation is a story of a wealthy minority. It is only the relatively wealthy that can put 5-10% of their disposable income into the acquisition of financial assets through pension, insurance and savings plans. Only the few at the very top of the wealth distribution directly hold equities. This can be seen in the distribution of assets across wealth percentiles (see figure 10). So what about the 75% of the population who are unable to forego, or borrow for, current consumption in order to pay into a pension, insurance or savings plan?

‘The household savings circuit through the stock market directly accelerates the inequalities of old age and ensures that a majority of the population derives little benefit from any distribution of dividends or the rise of corporate share prices’

(Froud et al., 2002)
Increasing incomes from dividends and interest payments of the very top of the income distribution has also driven worsening income inequality since 1994. The incomes of South Africans in aggregate increased by 130% between 1993 and 2008 compared with a median of just 15%; increases in incomes have been driven by a small number with very large increases (Leibbrant and Levinson, 2011). This corroborates with findings by Palma (2009) that worsening income inequality in the United States was largely driven by the very large increases in income of the top 1% of the income distribution through increased earnings from financial activities.

Figure 13.5: Distribution of household wealth by wealth percentile

Financialisation has led to changes in the savings and investment behaviour of the 25% of households at the tops of the income and wealth distributions. For these households, future income and consumption have become highly integrated with capital markets as they increasingly depend upon dividend and interest payments and stock prices. This, together with the lack of access to financial assets and credit for the majority has profound implications on income and wealth inequality.
14 Efficiency in the South African Financial Sector Post-Apartheid  
Ilan Strauss

14.1 Introduction

The functioning of a banking system has wide-reaching implications for the efficiency of the economy. As noted by Falkena et al. (2004, 2):

The functions performed by the financial system...are crucial to the efficiency of the economy. This impact derives from considerations such as the cost of financial intermediation, the incentives to save and invest, the allocation of resources, the shifting and sharing of risk, the discipline imposed on borrowers by the lenders of funds, etc. Equally, differential access to the services of the financial (banking) system has important distributional effects in the economy. The financial system is also a significant absorber of real resources. Thus, the efficiency of the financial system in the performance of its basic functions has both growth and distributional dimensions in the economy.

In the South African case, inequality is central in shaping how the banking sector pursues efficiency and profitability targets. Also, of great significance, is the highly concentrated nature of the banking sector, especially with respect to market segments (e.g. mortgage loans). According to the Falkena et al. (2004, 36): “In a contestable market, the benefits of efficiency gains are more likely to be shared with the consumer. In less contested markets the gains from efficiency improvement accrue to the shareholders.” Insufficient competitive pressures therefore can mean that cost-savings are not necessarily passed onto consumers. Moreover, a highly concentrated banking sector can also lead to efficiency gains not being sought through fair means, such as technological change and innovation, improved management methods, and better utilization of resources. Instead, improvements in profitability and income in banking can occur through abusive practices predicated on the dominant position of firms. Such practices can include unfair penalty fees and bank charges instead of the use of innovation, skills, expanding product variety and quality, etc.
The Banking Enquiry (2008) found sufficient evidence to confirm that South African banks have realised substantial cost savings post-apartheid. This seems to have been predominantly from growing economies of scale owing to the high percentage of fixed costs in total costs. However the Enquiry found that these savings, especially in the retail banking services segment, were not passed onto consumers. The Enquiry noted that the evidence is not conclusive, but does suggest that South African banks have market power. Profitability indicators will not, therefore, accurately reflect changes in efficiency, as would the cost-to-income ratio, the most common measure of efficiency. In addition, the Enquiry found evidence that unfair bank charges and penalty fees, were some of the means used by banks to raise their non-interest income and profits. This implies that changes in profitability and efficiency measures in the banking sector in South Africa do not necessarily reflect improvements in the fundamental drivers of efficiency, namely improved organization or inputs, mechanization, and technological change.

This study focuses on the banking industry and does not have much to say about other sectors. The lack of data for other sectors of finance was an important reason for focusing on banking. What we can say about the insurance industry is that is clearly does not seem to be efficient, given that it is the highest contributor to financial services complaints, as received by financial ombudsmen (Treasury, 2011). Seventy percent of all complaints to the major financial services ombudsmen are for long-term and short-term insurance (Treasury, 2011). In long-term insurance, high penalties are still common for early termination of policies. And costs are recognized as being too high in the industry (Treasury, 2011). High costs also pervade the short-term insurance market.

14.2 Efficiency Indicators

The most prevalent efficiency indicator is the cost-to-income ratio. This measures technical efficiency, or the extent to which output is being maximised from a given set of inputs. The data envelope technique is a non-parametric approach to measuring productive/technical efficiency. Relevant studies using this method are reviewed later.

---

79 Includes life, health and disability insurance.
80 Insurance possessions that an individual owns.
81 Thank you to Keith Weeks for making available all non-confidential data used by the Banking Enquiry (2008).
Profitability indicators are also commonly used to measure banking efficiency. Return-on-assets (ROA) is one. It is intended to measure deposit takers efficiency in using their assets. Falkena et al. (2004, 27) note that “Returns on assets in the banking sector are generally quite low because loans and advances make up a high proportion of banking assets. In South Africa around 75% of banks assets are loans and advances. The ability of banks to extend loans on the basis of fractional reserves that then form part of their assets sets the banking sector apart from other sectors. As a result, the asset base of the banking sector is inflated.”

The second profitability indicator commonly used is the return-on-equity (ROE). This is the ratio of net profit to shareholders’ equity (also called net assets or net worth), expressed as a percentage. It is used as a measure of how well a company uses shareholders' funds to generate a profit or earnings growth.

Another measure we use is bank interest margins. Financial intermediation influences net return to savings and gross returns for investments. Notes KPMG (1998, 28): “The spread between these two returns mirrors bank interest margins, in addition to transaction costs and taxes borne directly by savers and investors. This suggests that bank interest margins can be interpreted as an indicator of the efficiency of the banking system.”

We also look at the level of non-performing loans or impaired advances as an indicator of efficiency. If profitability is increasing, but at the expense of unsustainable risk taking and poor risk management, then this must be taken into consideration.

Lastly, we look at allocative efficiency in South African retail banking. Allocative efficiency is the extent to which resources are being allocated to the use with the highest expected value (including across time). This requires prices to accurately reflect costs. Additionally, under conditions of inequality, allocations can be highly inefficient given the deviation of social returns from private returns. This means that even an efficient market allocation might have undesirable social outcomes.

**14.3 Efficiency figures for the South African banking sector**
South African banks have been found to be relatively efficient post-apartheid (Task Group 2004), and increasingly so. South African banks are also highly profitable; probably among the most profitable in the world (Task Group 2004, Banking Enquiry 2008). The majority of banks’ income comes from non-interest sources. According to the Falkena et al. (2004, 25) banks profitability is contra-cyclical.

We run through the various indicators below, after which they are placed in context of domestic and international developments.

The Task Group Report (Falkena et al., 2004, cited in Banking Enquiry 2008) found South Africa’s average ROE (average tier one capital) to be consistently higher (bar 2002) than a weighted average of the world’s leading banks. These findings were subsequently challenged on several grounds during the 2008 Banking Enquiry (pp.40-41); however it was still concluded by the Enquiry that South Africa’s banks were among the most profitable in the world, and even more profitable than those in Europe. Between 2002 and 2006 only Indonesia outperformed South Africa’s ROE on a group of sample countries (Banking Enquiry 2008). Between 1996 and 2005, no country in a selected sample presented to the Enquiry was found to have substantially higher inflation adjusted profits than those received by South African banks (Banking Enquiry, 2008, 40).
Figure 14.1: Return on equity in the South African banking sector


Data Note: Data is post-tax. 2004 data is missing though the Banker data shows an upward trend between 2002 and 2004. ROE for 2004 would therefore be expected to be between 12-15%.

South African Reserve Bank (SARB) data, used above, differs substantially from the data used by the Banking Enquiry (some of which comes from the Banker) and from the Task Group Report data (Falkena et al., 2004). The SARB estimates are low in comparison. In contrast to the above, the Task Group report (2004, 27) found that:

“average return on equity in the banking sector over the period 1993 to 2001 was – at 17,4% - higher than sectors such as life assurance, financial services, food, clothing, furniture and transport, it was lower than that achieved by the retail, diversified industrial, electronics and electrical, information technology and telecommunications sectors. However, it is fair to note that the market capitalisation of the diversified industrial, information technology, electronics and electronic sectors each represent a small share of the market capitalisation of the JSE Securities Exchange, whereas the banks represent 15% of the total market capitalisation.”

ROA shows a similar picture of high returns. The Task Group report (Falkena et al., 2004, 27) found that the ROA between 1993-2001 for the banking sector was almost double that of
the top 100 international banks. The Banking Enquiry (2008) found South Africa’s ROA to be well above developed countries such as the UK, New Zealand, and Australia.

Figure 14.2: Return on Assets in the South African Banking sector

Source: Banking Supervision reports (South African Reserve Bank 1997-2011).
Data Note: Figures are calculated after tax. 2007 is not an average but for the month of December only. After tax ROA figures were constant in Bank Supervision reports prior to 1997. Following Banking Enquiry (2008) we do not include them.

With respect to the cost-to-income ratio, South African banks have generally been found to be in line with the international benchmark of 60 (Falkena et al., 2004). It was found by the Task Group (Falkena et al., 2004, 19) that “South Africa’s top banks outperform those in Italy, Thailand and Brazil, but do not appear to be as efficient as the top banks in New Zealand and Australia, for example”. The Task Group Report (Falkena et al., 2004, 32) also found “that cost-to-income ratios have fallen (and hence efficiency has improved) as concentration levels have fallen.” South African banks became increasingly efficient from 2005, with some of these gains being reversed as a result of the Financial Crisis.

---

82 Banks with a ratio over 60 are considered to be inefficient.
Another useful efficiency indicator is the level of non-performing loans, or ‘impaired advances’. The 2004 Task Group (Falkena et al., 2004) found South Africa’s level of non-performing loans relative to total loan book to be more in line with mature markets, rather than emerging countries such as Thailand.\footnote{Prior to the recent Financial Crisis mature economies were considered to have more stable financial sectors than emerging economies, with fewer non-performing loans.} This finding was supported by a more recent analysis done by the Banking Enquiry (2008). As a result of the financial crisis, impaired advances of the South African banking sector peaked in October 2010 at R138 billion, before declining to R118 billion in December 2011 (South African Reserve Bank, 2011)
Figure 14.4: Overdue loans as a percentage of loans advanced in the South African banking sector

Source: 1994-2010 is from Bank Supervision Annual Reports. 2011 is from World Bank dataBank (2013).

Data Note: 2011 figure is not an average and is for the month of December. Data from 2008-2011 is not for “overdues” but instead for “impaired advances” which are advances in respect of which a specific credit impairment has been raised. It is unclear how, or if, this differs from “overdues”, which was reported by SARB in the past and are non-performing loans which have been overdue for a period longer than 180 days.

Lastly, the interest margin or spread (interest income minus expense) as percentage of interest income has been improving for banks.

Figure 14.5: Interest margin as a percentage of interest income in South African banking sector

Owing to changes in Reserve Bank reporting, the interest margin was, from 2008, reported slightly differently, as a net interest income ratio (or spread). This is the difference between interest and similar income as a percentage of interest-earning assets, and interest expenses and similar charges as a percentage of funding liabilities.

Figure 14.6: Net interest income ratio (spread) in the South African banking sector


For a study focused on interest margins employing data envelope techniques see Van der Westhuizen and Battese (2012).

14.4 Data envelope studies

Data envelope analysis has been used to study the South Africa banking sector. Oberholzer and Westhuizen (2004) look at the performance of ten regional branches of a South African Bank. They find relatively high levels of technical efficiency at branch level, ranging from 0.7 to 0.97, while allocative efficiency scores range from 0.8 and 0.92. Cost efficiency scores are much lower, ranging between 0.6 and 0.85. Scale efficiency varied widely across the branches, ranging from 0.64 to 0.98. Okeahalam (2006) undertook a similar study using a stochastic frontier approach (SFA). The data covered 61 branches of a bank spread across the country in 1999. The findings were similar to those of Oberholzer and Westhuizen. Significant evidence of scale economies was found.
A recent study by Ncube (2009) uses SFA to measure the cost and profit efficiency of four large and four small banks in South Africa for the period 2000–2005. He finds an overall improvement in cost efficiency during the sample period. Profit levels were lower than the average efficiency scores, implying that South African banks were much better at controlling costs than generating profits. Counter intuitively, cost efficiency was found to be inversely related with bank size. The author speculates that this was due to lower overhead costs and specialisation by smaller banks. Similarly, Kiyota (2009) analyses the efficiency and profitability of commercial banks in 29 Sub-Saharan African countries, including South Africa, using a stochastic frontier approach during 2000–2009. The author finds lower profit efficiency for South African banks, averaging 0.48 over the sample period. On the other hand, cost inefficiency averages 1.06 for South African banks and showed a decreasing trend during the period.

Lastly, Mlambo and Ncube (2011) look at the relationship between efficiency and market structure in South Africa banking using DEA. They use a panel of 26 firms over the period 1999-2008. They find that (Mlambo and Ncube, p.11): “average pure technical efficiency ranges between 0.66 (2002 and 2004) and 0.75 (2008)…These results are somewhat lower than those obtained in earlier studies.” Though they find the number of efficient banks has been falling since 2001, on average banks in South Africa have become more efficient over time, judged by a declining standard deviation from mean efficiency for most firms.

14.5 Efficiency of South African banks in context

A number of underlying factors, domestic and international, have shaped the above trends. Properly synthesizing these factors with the above data requires a more detailed study. The general trend post-apartheid has been for South African banks (and consumers and producers) to benefit immensely from integration into global financial (and product) markets. It is likely that all banks saw cost-savings post-apartheid. A key mechanism through which this took place is declining unit costs from the generation of scale economies.

Scale economies are immense as around 80% of banks’ costs in South Africa are fixed costs (Banking Enquiry 2008, 43, 53). Scale economies are likely to have occurred owing to
growing market concentration, expansion of banking to the previously unbanked, domestic economic growth, population growth, and growing corporate deposits. Capitec’s market is still probably insufficiently small to have materially affected banks’ economies of scale, though it is possible that this will occur in the future. But immediately post-1994, cost-to-income measures increased (worsened) or remained high, owing to smaller banks entering the market who faced start up costs and higher unit costs (Falkena et al., 2004, 21). This measure improved from 1997. The measure increased again between 2000 and 2005, possibly owing to new regulatory compliance issues, and increased consolidation which can raise costs through merger expenses. Improvements in this ratio in recent years might reflect growing use of technology, and market consolidation and expansion.

Post-1994 South African banks have had to adapt to a new regulatory environment. Basel I was agreed upon in September 1997 and South African banking activities and regulations needed to make substantial revisions in order to comply (South African Reserve Bank 1997). Expanding markets, a growing economy, globalization, and new technologies saw profits rise. Financial integration meant that new sources and types of funding were available to banks. However profitability of banks declined in 1998 as costs were unable to be contained. Interest expenses outgrew interest income and interest margins were substantially lower (South African Reserve Bank, 1998). The East Asian financial crisis in the fourth quarter of 1997 did not affect South African banks much. However, growing integration into global financial markets saw greater volatility in financial markets. The South Africa’s bond market and equity market were growing in depth and breadth. In April 1998 government bonds began to be marketed differently. 12 banks were assigned as primary deals in South African government bonds.

A marked deterioration began in September 1999 in both the returns on assets and on equity for South African banks. This deterioration was due to, among other factors, the continuous decrease in the growth of total loans and advances since August 1998. This impacted negatively on the interest income of banks, “and net mark-to market adjustments necessitated by the frequent changes to the interest rates” (South African Reserve Bank 1999, 52). After a substantial improvement in efficiency in March 1999, owing mainly to a substantial increase in total income, the efficiency of the banking sector started to deteriorate. By the end of 1999, however, the efficiency of the banking sector had recovered back to 1998 levels, due mainly to strong increases in total income. (South African Reserve Bank, 1999).
After slowing down uninterruptedly since June 1998, growth in the total assets of the banking sector reached a lower turning point in June 2000. Subsequently, growth in total assets recovered and, by the end of December 2000, had accelerated to R819.2 billion. Depositors’ preference also seemed to shift from short-term to longer-term deposits, as confidence improved in the South African economy (South African Reserve Bank, 2000). Despite a slightly lower average interest margin for 2000, banks were able to increase their profitability through a higher level of non-interest income and a decrease in bad debts.

An increase of 10.2% in operating expenses during 2000, due mainly to higher staff and administrative expenses, resulted in the efficiency of the banking sector increasing only marginally during this year in comparison to 1999. Importantly, total gross overdues declined in growth during the last quarter of 2000, after reaching a peak of 50.7% in March 1999 (South African Reserve Bank, 2000).

After a marked deterioration in both the ROA and the ROE between September 1999 and June 2000, higher net income from June 2000 improved both indicators noticeably. Factors contributing to this improvement was a decrease in bad debts of 18.6%, which were written off against income, a decrease of 16.1% in specific provisions relating to loans and advances and an increase of 12.5% in non-interest income (South African Reserve Bank, 2000).

From January 2001, however, a marked deterioration in both ROA and ROE is evident. This deterioration was due mainly to losses in the investment portfolio reported by some banks. The latter part of 2001 was marked by the “the unprecedented decline in the South African currency” (South African Reserve Bank 2001, p. 4). The growth in total assets in 2001 was due to an increase of 22.4% in total loans and advances, boosted by the depreciation of the South African rand. Foreign currency loans and advances increased by 96.7 % to a level of R109.9 billion (South African Reserve Bank, 2001). The negative effects from the currency depreciation on SA banks was negligible, according to the South Africa Reserve Bank (2001), since net external liabilities were low and banks had no large credit exposure outside of South Africa. Still, by the end of December 2001, the average return on equity of the banking sector was down, as was the return on assets and the interest margin.
Significant market consolidation took place between 2002-2006, with the number of registered banks falling from 41 to 17 owing to the failure of Saambou and BOE (the 7th and 6th biggest banks at the time in 2001/2002). Stability was returned but through increased concentration in retail banking. Growth in the total balance sheet slowed during 2002, mainly as a result of a slowing in the growth of total loans and advances. Both the return on equity and the return on assets of the banking sector deteriorated. The efficiency of the banking sector also deteriorated. Higher operating expenses seems to have influenced much of the above (South African Reserve Bank 2002). Growth in income, while total gross overdues decreased, was unable to offset these operating cost increases.

Growth in the total balance sheet increased during 2003. Both the return on equity and the return on assets of the total banking sector improved (South African Reserve Bank, 2003); the interest margin decreased; while the technical efficiency (cost-to-income) saw some improvements and total gross overdues decreased. Slower growth in operating expenses drove much of these results. The SARB repo rate increased eleven times between 2004 and 2006.

In 2005, the banking sector’s total gross overdues continued to decline. There were, however, initial signs of a decline in banks’ profitability indicators and efficiency. Concentration in the banking sector also continued to increase (South African Reserve Bank 2005).

Total assets increased by 12% in 2006. Profitability and efficiency ratios improved in 2006, driven by higher income (South African Reserve Bank, 2006). However, most countries’ banks improved their efficiency between 2004 and 2006, leaving South African banks outperforming only Polish banks, within a certain sample (Banking Enquiry 2008, 526). Despite such improvements, impaired advances to loans increased to 35% in 2006, its highest level since 1994. Non-performing loans slowed in growth, but not in the mortgage market.

In 2007 banking assets increased by 22.7%. Loans and advances, and increased investment and trading positions were the main contributors to this (South African Reserve Bank, 2007). Profitability and efficiency improved. However the increase in interest rates, together with other adverse developments in the South African and international economic environments, contributed to the deterioration of credit risk ratios. This saw non-performing loans increase.
2008 was the year the Financial Crisis deepened. Deteriorating international financial market and cyclical domestic developments saw a noticeable decline in the rate of growth in loans and advances. Increases in the domestic interest rates hardened the environment. Furthermore, increasing income pressure on consumers was clearly evident in the sharp increase in impaired advances and rising credit impairments, which impacted negatively on banks’ earnings. However, notwithstanding the above, the South African banking system remained stable, and banks were adequately capitalised and profitable (South African Reserve Bank, 2008). Total banking sector assets still grew considerably during 2008. Cost-to-income and profitability ratios all improved, owing to increases in non-interest income, even while impaired advances as a percentage of total loans and advances increased by 68%. However, profitability figures only turned around from December, after falling sharply from March (South African Reserve Bank, 2008).

It was in 2009 that banking assets shrunk by 6.6% (South African Reserve Bank, 2009). Gross loans and advances declined by 2.6%. An increase in credit losses and operating expenses saw banking profitability deteriorate. Impaired advances increased during the year by almost 50%, though still at a slower rate than in 2008. The cost-to-income ratio deteriorated a bit as a result. Banks however were still very profitable in 2009, though ROE declined. The decline was “the result of a combination of lower operating profit (due to high credit losses and operating expenses) and strong growth in total equity attributable to equity holders”, see Graph 7 below (South African Reserve Bank 2009, 117). During 2009 the repo rate was reduced by 450 basis points.

**Figure 14.7: Growth rates of total assets and equity attributable to equity holders (year-on-year)**

![Graph showing growth rates of total assets and equity attributable to equity holders](image)

**Source:** Banking Supervision Annual Report (South Africa Reserve Bank 2009, 110).
Assets of the sector increased moderately during 2010, with minor growth in home loans and term loans. Operating expenses increased, raising the cost-to-income ratio. There was a slight decline in profit during 2010 (from its January level), as a result of increased staff expense (South African Reserve Bank, 2010). Meanwhile impaired advances to gross loans and advances stabilised and declined somewhat. Equity grew quicker than assets thereby lowering financial leverage (South African Reserve Bank, 2010).

Despite a tough domestic environment, banking sector assets increased by 9% during 2011. Cost-to-income ratio decreased slightly towards the end of the year owing to higher growth in operating income relative to expenses (South African Reserve Bank, 2011). Profitability improved while impaired advances declined (in part owing to increased write-offs).

14.6 Allocative efficiency

Allocative efficiency can be approached in a number of ways. Firstly, the Banking Enquiry (2008) and the Task Group (2004) intimated that fees charged by South African banks do not reflect costs. This is not merely due to mispricing and cross-subsidies (Task Group, 2004), but also due to uncompetitive pricing behavior (Banking Enquiry, 2008). If fees and charges do not reflect the underlying costs of providing a service then allocative efficiency, in the technical sense, cannot be deduced from data.

Secondly, if the market mechanism is the sole allocator of resources, then those excluded from the market will have no place to indicate their social preferences in production. This can contribute to growing inequality in access to, and provision of, goods and services. Lastly, efficiency does not take into account unutilized resources. The exclusion of more South Africans from the banking sector might, on the face of it, raise banking efficiency measures. It is relevant, therefore, to assess changing trends in financial access and inequality when analyzing the efficiency of the South African financial sector.
The number of bank branches per 100 000 adults in South Africa is among the lowest in the world (Treasury, 2011). Africa has around half that of Brazil’s. And the low average hides a possibly even more unequal provision. 59 bank branches service 130,000 people in Sandton as opposed to one formal bank branch serving 175,000 people in Alexandra (Banking Enquiry, 2008).

Providing inappropriate financial products might also be aggravating financial exclusion. Despite, the expansion of banked adults, the use of savings and transaction accounts have been in decline since at least 2007 (Finscope, 2011). The expansion of access has been attributed, in part, to the success of the Mzansi bank account. The Banking Enquiry (2008) acknowledges the progressive role it played in extending banking services to the previously unbanked, but notes that the structure of its bundling and pricing is not always truly pro-poor.

SME credit is also a relevant issue. Access to credit is one of the key constraints facing SMEs (Treasury, 2011; Finscope, 2010). This lack of access might reflect market failure if significant information asymmetries exist. Regardless, retail banks are seen as being insufficiently involved in the sector, according to Treasury (2011). Often commercial providers prefer to advance loans to entrepreneurs and partners in small businesses in their personal capacity, rather than to entities with limited liability (Feasibility, 2011).
The housing market remains another issue of contention. According to the Treasury (2011), over 1.3 million households in the gap market segment, who do not qualify for a housing subsidy, live in inadequate, overcrowded or informal housing. Other than resale stock, there is no housing available in this segment. Only in the traditional market segment, where households earn more than R 15 000 per month, does housing supply and finance operate efficiently and without distortion (Treasury, 2011).
Figure 14.10: South African housing market and the financing gap

<table>
<thead>
<tr>
<th>Market segment</th>
<th>Monthly income</th>
<th>Households</th>
<th>Average mortgage granted Q2 2010 R’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing subsidy market 1</td>
<td>&lt; R3500</td>
<td>8.3</td>
<td>R0 1</td>
</tr>
<tr>
<td>Gap market 2</td>
<td>R3500 to R10000</td>
<td>3.2</td>
<td>R184.3</td>
</tr>
<tr>
<td>Affordable market</td>
<td>R10001 to R15000</td>
<td>0.7</td>
<td>R245.3</td>
</tr>
<tr>
<td>Traditional market</td>
<td>&gt; R15 000</td>
<td>1.6</td>
<td>R687.5</td>
</tr>
</tbody>
</table>

1 Households qualify for a fully subsidised house of R140 000.
2 Households earning between R3501 and R7000 qualify for a state subsidy in terms of the Finance Linked Individual Subsidy Programme (FLISP).

Source: National Credit Regulator, June 2010, Consumer Credit Market Report, FinMark Trust, 2010, Enhancing access to housing finance, unpublished report
15 The Nature and Conduct of Macroeconomic Policy in South Africa
Rex A McKenzie

15.1 Introduction

The Flow of Funds (FoF) analysis in previous sections suggests substantive change in the South African economy with agents behaving in new ways. This section takes a closer look at selected macroeconomic data in an appraisal of macroeconomic policy. The data offers its own commentary that is interpreted and summarised in the conclusion.

15.2 Macro Economic Ratios

The compensation of employees to GDP ratio (Figure 14.1, below) displays a persistent decline from 57.5% in 1992, to 49.5% in 2008. Thereafter there has been some recovery in the ratio to 51.5% in 2011. The Compensation of employees (COE) measures the total remuneration to employees for work done. It includes wages and salaries, as well as employer contributions. Evaluated by this measure we can tentatively conclude that employers have been reasonably successful at containing labour costs.84

Figure 15.1: Compensation of employees to GDP ratio

<table>
<thead>
<tr>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>60</td>
</tr>
<tr>
<td>58</td>
</tr>
<tr>
<td>56</td>
</tr>
<tr>
<td>54</td>
</tr>
<tr>
<td>52</td>
</tr>
<tr>
<td>50</td>
</tr>
<tr>
<td>48</td>
</tr>
<tr>
<td>46</td>
</tr>
<tr>
<td>44</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
</tr>
<tr>
<td>1992</td>
</tr>
<tr>
<td>1993</td>
</tr>
<tr>
<td>1994</td>
</tr>
<tr>
<td>1995</td>
</tr>
<tr>
<td>1996</td>
</tr>
<tr>
<td>1997</td>
</tr>
<tr>
<td>1998</td>
</tr>
<tr>
<td>1999</td>
</tr>
<tr>
<td>2000</td>
</tr>
<tr>
<td>2001</td>
</tr>
<tr>
<td>2002</td>
</tr>
<tr>
<td>2003</td>
</tr>
<tr>
<td>2004</td>
</tr>
<tr>
<td>2005</td>
</tr>
<tr>
<td>2006</td>
</tr>
<tr>
<td>2007</td>
</tr>
<tr>
<td>2008</td>
</tr>
<tr>
<td>2009</td>
</tr>
<tr>
<td>2010</td>
</tr>
<tr>
<td>2011</td>
</tr>
</tbody>
</table>

Source: SARB

84 This despite the alleged militancy of the South African labour unions.
This decline in employees compensation may be the cause of the more recent decline in final household consumption expenditure (HCFE) that we can observe in figure 15.2 (below). HCFE is the total spending by domestic households on consumer goods and services. HCFE is measured at purchasers' prices - the price the buyer actually pays at the time of the acquisition. Figure 15.2 shows that the HCFE to GDP ratio held above 63% for most of the 1990s. There was a decline in 2001 followed by a recovery to the point where the ratio held above 63% between 2003-2006. Thereafter there was a deeper more protracted decline to 59.8% in 2011.

Figure 15.2: Final consumption expenditure by households to GDP

![Figure 15.2](chart.png)

Source: SARB

Figure 15.3 shows household debt to disposable income isolates the relationship between debt and income after taxes. In 1991 the household debt to disposable income for South Africa stood at 56%. By 2011, it was 76% after rising to 83% in 2008. As Rashid (2011) observes, “South Africa is the only BRICS country where loans and advances to the household sector exceed the loans to the corporate sector. Mortgages account for nearly 55%.

---

85 It includes expenditure by resident households on the domestic territory and expenditure by resident households abroad (outbound tourists), but excludes any non-resident households' expenditure on the domestic territory (inbound tourists). From this national definition of consumption expenditure may be distinguished the household final consumption expenditure according to the domestic concept which includes household expenditure made on the domestic territory by residents and inbound tourists, but excludes residents' expenditure made abroad. It includes non-deductible value added tax and other taxes on products, transport and marketing costs and tips paid over and above stated prices.
of all outstanding bank claims in South Africa. The household debt in South Africa is the highest among the BRICS countries and accounts for nearly 60% of outstanding bank credits.” In the years between 2006 and 2011, it appears that higher asset prices supported wealth effects that encouraged increased consumer borrowing. In the period, total household debt (mortgages and consumer loans) increased from Rand 1.3 trillion in 2006 to Rand 7 trillion in 2011. In the same period, household mortgage debt also nearly doubled.

Figure 15.3: Household debt as percentage of disposable income of households

![Household Debt Chart](chart.png)

Source: SARB

What do these relatively high levels of debt to income mean for savings? First we note in Figure 16.4 that the ratio of saving to disposable income declined from just under 6% in 1992, to a level of -1% in 2008/2009. From 2009 onwards, this ratio has remained below zero.

The saving to disposable income ratio (Figure 15.4) fills out the picture. The ratio turned negative in 2005 and has remained below zero since that time. Households are dis-saving and the gap is being filled with debt. Curiously the use of the debt is not being directed to consumption as had been the case until the mid 2000s.
Figure 15.4: Saving to disposable income of households

Source: SARB

Figure 15.5 records Gross Domestic Savings to GDP ratio since 1991. The ratio declined from 18% in early 1990s to 16% in 2011\(^\text{86}\). The magnitude of the decline is not fully covered by our data because in the 1970’s and the 1980’s this ratio routinely stood somewhere above the 30% level.

\(^{86}\) It had languished at rates just over 14% between 2005 and 2007.
The decline is substantial and deep. In 2009 South Africa’s gross saving rate equated to 16% of GDP compared to China’s 52%; India’s 37%; and Russia’s 22% in the same year. In explaining the low savings rate the Finance Minister attributes importance to a short-term outlook on the part of agents, a lack of transparent and cost-effective savings products, poor financial awareness and high unemployment, which left many without any money to save (ibid). In his view South Africa had become a “consumerist society ... a society that wants to acquire things at any cost" and which was taking on increasing debt. ... This type of acquisitiveness also fuels the fires of corruption as people look for the quickest, easiest way to get things rather than to save for them” (ibid.).

From a household balance sheet perspective we can observe the same phenomenon in two main ways. First, as indicated earlier, there is a rise in “active” balance sheet management. For the entire period there is a progressive rise in the ratio of household liabilities to asset as households increased borrowing and debt holding to fund balance sheet operations. Starting in about 2001/2001 there is a steep increase in the share of assets to GDP. A large part of this increase in asset values relates to the house price inflation in the period up to 2007. Debt and leverage play important parts in inflating asset values.
Second, the structure and composition of the household balance sheet has changed. By far the biggest change in the period lies in the sizeable increase financial assets and the decrease in non financial assets held on the balance sheet. From approximately 12% of total household assets, the funds held with pension funds and long term insurers increased to 45% of total assets. Today some 70% of the assets of households are financial assets of one form or another. The full picture as it emerges from the data is that of households with declining compensation taking on higher levels of debt to fund consumption led growth.

Source: SARB, Flow of Funds
15.3 Foreign Debt

Between 1992 and 2001 the Flow of Funds show that South Africa ran small net borrowing/positions. Since 2002 the local economy has become increasingly reliant on foreign capital inflows to fund its net borrowing positions. Indeed in the entire period under review there have only been three surplus current account positions. Since 2003, widening deficits on the current account of the balance of payments have been funded by an increase in net foreign liabilities. In part, the deficits on the current account should be seen as a fairly natural outcome of liberalisation and deregulation policies aimed at opening up the local economy. These would include, market entry of foreign banks, global participation of local

Source: SARB

After 2006 the pattern changes, compensation as share in GDP begins to recover, and at the same time consumers reign in consumption in order to fund the acquisition of financial assets. What remains to be determined is whether the acquired assets are short term and speculative in orientation or whether they represent a form of saving by households.

There was a brief interruption in 2002 because of financial outflows. De Beer et al. (2010), speculate that this could have been a reaction to the 9/11 crisis in the United States.
banks and other financial intermediaries, the relaxation of exchange controls and a reduction in the budget deficit (De Beer et al., 2010).

So far our analysis has shown that large swathes of credit backed mobile capital flow into the country through the banks and the financial system in general. These inflows are absorbed in two main ways; first, significant portions money capital flow to instruments and markets geared towards financial speculation. Second, there has been a generalised, huge and protracted extension of private credit to households and the private sector. Consequently, there has been an associated growth in household indebtedness towards unnerving levels. But as Ashman et al (2012) observe, the expansion of credit has not been reflected in increasing physical investment in the real economy. What has happened instead is that the corporate business sector allocates increasing shares of their total investment towards the acquisition of net financial assets. Contemporaneously the data shows a collapse in the household savings rate with a rise in debt funded consumption (up until the last crisis). In short we see a consumption led growth path that is funded by debt and dis-saving. The combined result of these related developments is that South Africa is a net borrower that funds a persistent deficit on its current account with inflows of short term capital from the rest of the world.

Figure 15.8: Foreign debt to GDP ratio

Source: SARB
The foreign debt to GDP ratio (Figure 16.8) reflects South Africa’s net borrower status. Between 1991 and 1999 the ratio climbed from 20% to 29%. Between 1999 and 2001 the ratio declined to 26% only to peak at 30.5% in 2002. For the next three years the foreign debt to GDP ratio declined steadily to 19.5%. From 2005 to 2011, the foreign debt component has climbed once again pushing the ratio to 26.5% in 2011.

The role played by foreign debt in the Asian Crisis between 1997-1998 is now well documented. In South Korea, the ratio rose from 13% to 21% and then as high as 40%. A high portion of foreign debt is by itself not a cause for concern. If the debt is used to fund GFCF as in the case of South Korea, or some such activity that serves to expand the economy, this would be a positive and sustainable use of the debt. The problem arises when the debt is used to fund non-productive activities or consumption, because in this instance there is no expansion of income with which to repay the debt. As consumption has become the sine qua non of contemporary South Africa there is the suspicion that present level of foreign debt is not sustainable.

**15.4 What about Growth?**

According to the World Bank’s *World Development Indicators* gross fixed capital formation (includes land improvements (fences, ditches, drains, etc); plant, machinery, and equipment purchases; and the construction of roads, railways, schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. In macro economics among all schools of thought GFCF is viewed as a proximate source of economic growth. Obviously such investment has to be funded and typically funding for such investment would come from the nations saving.
China therefore because of its high savings rate has been able to maintain a GFCF to GDP ratio which averaged 38% for the last three decades. Since 2002, the GFCF to GDP ratio in China has exceeded 40%. As a result, China grew at about 10% on average for 30 years. By comparison with China South Africa’s GCFC to GDP ratio (See Figure 15.9) is unimpressive. Between 1991 and 2000 the ratio held on average at 16%. Thereafter for three years the rate remained somewhat depressed hovering around 15%. From 2003 to 2008 the ratio climbed steadily to reach its highest level for 20 years in 2008 at 23.1%. Since 2008 the rate has fallen away to 19% in 2011.

There has been moderate growth in the economy since 1994. In comparison with other BRICS South Africa’s growth trajectory has been a poor one. From 1990 to 2010, the average quarterly GDP growth rate has been 3.3%. With the abandonment of the apartheid state and the transition to democracy, GDP growth peaked at 7.6% in December 1994, and in the aftermath of the Great Recession of 2008 it fell to its lowest point of -5.9% in March 2009. The average annual GDP growth rate in the period under consideration stands at 3.2%, it reached a historical high of 7.1% in December 2006 and a low of -2.6% in June of 2009. The performance is on the face of it unspectacular reflects the poor levels GFCF. Viewed from the point of view of the Growth, Employment and Distribution (GEAR, 1996, 3) document, the performance is short of the targeted 6%, that du Plessis and Smit(2006) say would induce a fall in the 25% level of unemployment.
15.5 Conclusion:

The preceding sections lead us to one strong conclusion. The strong conclusion comes from the FOF analysis which supplies the empirical data that would allow us to place South Africa on Route 1 of Palma’s (2002) three stylised routes to financial fragility and crisis.

Box 1: Palma’s Three Stylised Routes to Crisis

<table>
<thead>
<tr>
<th>Route 1: Chile, Mexico</th>
<th>Route 2: Korea</th>
<th>Route 3: Brazil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explosion of credit to the private sector.</td>
<td>Explosion of credit to private sector.</td>
<td>Persistently high interest rates.</td>
</tr>
<tr>
<td>Low levels of interest rates (after stabilization).</td>
<td>Low levels of interest rates.</td>
<td>Fragility in the banking system as a result of the high interest rates.</td>
</tr>
<tr>
<td>Rapid revaluation of exchange rates.</td>
<td>High levels of investment.</td>
<td>Fragility in public finance as a result of the high interest rates.</td>
</tr>
<tr>
<td>Consumption boom.</td>
<td>Very high corporate debt/equity ratios.</td>
<td>Increase in the stock of public debt.</td>
</tr>
<tr>
<td>Asset bubbles in stock market and real estate.</td>
<td>Declining profitability across the economy.</td>
<td>Increasing short term debt.</td>
</tr>
<tr>
<td>Reduced level of savings.</td>
<td>Government incentives for corporate sector to borrow short.</td>
<td>Implosion of the real economy because of high rates.</td>
</tr>
<tr>
<td>Major deterioration in current account.</td>
<td></td>
<td>Major deterioration in current account.</td>
</tr>
<tr>
<td>Low levels of residential construction.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increasing foreign debt</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Gabriel Palma (2000) examined the period between liberalization of the economy and the onset of financial crisis (in the 1990’s) in selected countries and devised what may be called “three stylized routes” to financial crisis. The three routes approximate to actual country experience as analysed by Palma. Route 1 (R1) is drawn from the Mexican and Chilean experience. Route 2 (R2) from Korea, and route 3 (R3) Brazil. The data from the FoF confirms South Africa as a R1 case with:

I. the attendant explosion of credit,
II. debt fuelled consumption led growth path,
III. asset bubbles in both real estate and the stock market,
IV. reduced savings,
V. a deterioration in the current account,
VI. increasing foreign debt

All R1 countries are characterized by a huge expansion in private consumer credit as countries try to absorb inflows. Route two (R2) countries are also characterized by a huge expansion in private credit, but this time instead of an expansion in consumer credit there is a huge expansion private sector investment. Thus if the main similarity between R1 and R2 countries is the extraordinary expansion in private credit, the main differentiating factor is the use that this expansion is put to; in R1 countries there is a consumption boom, in R2 countries there is a striking expansion in private investment. In Palma (ibid), R1 countries are differentiated from R2 and R3 countries by their manner of absorption. In R1 countries the explosion in credit is used to fund debt that finances rising consumption. He therefore argues this is a supply driven process. In contradistinction in the R2 countries the explosion in credit is channelled to investment in plant and productive resources. This R2 process is said by Palma to be a demand centred process with demand for heavy goods and machinery emanating from the local economy (Korea).
Bibliography


Finscope (2011), Survey Highlights, Finscope South Africa.


Gordhan, Pravin, 13/07/2011, Address by the Minister of Finance, at the 10th Anniversary of the South African Savings Institute, Johannesburg

Greenberg, J.B. and W. Simbanegavi (2009), Testing for Competition in the South African Banking Sector, Faculty of Commerce University of Cape Town, 4 November.


IMF (2008), “South Africa Financial Stability Assessment”, prepared by the IMF’s Monetary and Capital Markets and African Departments. Downloaded from


KPMG (1998), Bank Margins and Related Profitability in South Africa. Study commissioned by the South African Reserve Bank.


NCR (2009a), National Credit Act nudges credit market in the right direction, National Credit Regulator

NCR (2009b), Pricing of and Access to Consumer Credit, National Credit Regulator


213
South African Reserve Bank (1996), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (1997), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (1998), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (1999), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (2000), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (2001), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (2002), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (2003), *Bank Supervision Department Annual Report*. Available at:
http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx

South African Reserve Bank (2005), *Bank Supervision Department Annual Report*. Available at:
South African Reserve Bank (2006), *Bank Supervision Department Annual Report*. Available at:
[http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx](http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx)

South African Reserve Bank (2007), *Bank Supervision Department Annual Report*. Available at:
[http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx](http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx)

South African Reserve Bank (2008), *Bank Supervision Department Annual Report*. Available at:
[http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx](http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx)

South African Reserve Bank (2009), *Bank Supervision Department Annual Report*. Available at:
[http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx](http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx)

South African Reserve Bank (2010), *Bank Supervision Department Annual Report*. Available at:
[http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx](http://www.resbank.co.za/Publications/Reports/Pages/BankSupervisionAnnualReports.aspx)

South Africa Reserve Bank (2011), Bank Supervision Department, Annual Report, 2011


World Development Indicators database of the World Bank

