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THE CHARACTER AND CONSEQUENCES OF CONGLOMERATION IN THE SOUTH AFRICAN ECONOMY

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Deep-sea trawling, the preparation and packaging of frozen foods and seafoods, and ship repair are some of the big ones we've landed in our investment portfolio.

And just a few examples of the diversification of the Anglovaal group.

We finance, manage, own and invest in some 200 companies with products that vary from bearings to burgers, cement to coffee, fruit juices to ferro-alloys, biscuits to bottles and shirts to switchgear. Apart from this, we mine gold, uranium, copper, zinc, pyrite, antimony, chrome, manganese, and iron ore. (Ad in the 1990 *Financial Mail* 'Top Companies' survey entitled 'Anglovaal Limited - much more than a mining house').

These German adventurers in the field of business, being captains of industry rather than of finance, were also free to choose their associates and staff with a view to their industrial insight and capacity rather than their astuteness in ambushing the community's loose change. (Thorsten Veblen on the triumph of manufacturing over finance in Germany).

The degree of control that is exercised over the South African economy by a handful of corporations and by the select and overlapping clique of aged white males who comprise their boards of directors is legend. Against this backdrop, left policy alternatives with respect to ownership have predictably focused on the equity considerations embodied in this exceptional centralisation of economic wealth and power. The overwhelming objective of policy proposals in this area is a redistribution of the wealth and power exercised by these conglomerates with nationalisation the most immediately apparent mechanism for effecting this redistribution.

However, the inequities associated with centralised ownership are not easily corrected. Powerful pragmatic arguments against nationalisation have been

articulated, arguments that stress considerations like capital flight, the negative impact of widespread nationalisation on inflows of foreign investment, and a possible drain of already scarce managerial and technical resources. Equally important, though, are arguments that suggest that the authoritarianism and economic stagnation that characterised eastern European socialism is intimately bound up with unfettered state ownership and control of the economy. This has led to a search for democratic alternatives to both private and state ownership, alternatives that range from worker and community seats on the boards of major corporations, to more elaborate notions of co-operative ownership or worker and consumer control. These are all important but seem unlikely to impact immediately upon the inequities represented by South Africa's giant conglomerates.

In recent years, with political power in sight, new terms have crept into the ownership debate. In the place of the crude 'state ownership/free enterprise' juxtaposition we are hearing terms like 'dismemberment' and 'unbundling'. And to further muddy previously clear waters, a statement proclaiming support for a restructuring of conglomerate ownership is as likely to emanate from GENCOR as from COSATU!

This shift from long held perceptions is rooted, in part at least, in the factors mentioned above: hence, in small measure, certain of the conglomerates are responding to the 'bad press' that surrounds their conspicuous power; and the left are undoubtedly sensitive to both the abject failures of old role models as well as to the economic revenge that a thoroughly uncooperative capitalist class may wreak. But more than this, the greater subtlety evident in the ownership debate resides in a concern, across the political board, with the stagnation of the South African economy, and with the growing recognition that ownership structures have implications for both equity and growth. Accordingly policy with respect to ownership must be located within a broader notion of future growth paths.

This article then represents a preliminary attempt to locate ownership policy within a problematic that emphasises the twin imperatives of growth and redistribution. We will also examine the underlying basis of the support for unbundling that emanates from some of the conglomerates themselves. Our concern with developing a growth strategy underlies the focus on the manufacturing sector, although, as we shall elaborate below, the South African conglomerates are in fact marked by their multisectoral character.

What are Conglomerates?

Adams and Brock define a conglomerate as '...an aggregation of functionally unrelated or incoherent operating subsidiaries that are centrally managed and controlled' (1986:41). We might add here that the characteristic mechanism

whereby this control is exercised is through ownership of blocs of shares in the operating subsidiaries. The activity of the conglomerate is the management of this portfolio of shares.

Let's briefly flesh out the major elements of this definition of a conglomerate: *Firstly*, the character of its major activity, viz portfolio management - conglomerates control a share portfolio: In general they do not produce goods and services. Their major source of revenue is in the form of dividends from their operating subsidiaries. This has, we shall argue below, a determinant influence on their behaviour and performance and that of their operating companies.

Secondly, the sectoral diversity of its portfolio - conglomerates operate in diverse sectors of the economy: Diversity is possibly the outstanding characteristic of conglomeration. There are clearly degrees of diversity. For many highly diversified conglomerates it may be possible to trace a coherent development from a major historical activity through the various subsidiary activities - for example there is a certain operational logic that binds interests as apparently diverse as mining, chemicals, timber, and real estate. However there is a point in the conglomeration process where transaction cost considerations and questions of upstream/downstream efficiency - essentially cost of production criteria - cease to govern the composition of a particular group of companies, and where pure financial considerations dominate. It is at this point that conglomeration - the exercise of control through financial holdings in diverse companies - becomes the defining character of the group.

Thirdly, the controlling interest that it holds in the companies represented in its portfolio - conglomerates are distinct from mere 'holding companies': They are the controlling shareholders. Like 'diversity', 'control' is obviously difficult to define. In fact even the institutional form that control takes is, at times, difficult to identify.

These broad definitions naturally encompass a multitude of specific forms. Control, in particular, is exercised in widely divergent forms. It is obviously possible to control a company without owning a majority of its shares. In fact in the US and Britain the average size of the largest shareholding tends to be extremely small, although even in these circumstances it is inevitably possible to establish the controlling shareholder or, more likely, what Scott (1986) refers to as the 'controlling constellations'. In these circumstances - where there is no clearly dominant shareholder - control is generally exercised through a complex ensemble that combines the economics of the capital market with the sociology of the boardroom and its interlocking directorates, old school ties and gentlemen's clubs.

In South Africa there is generally little difficulty in identifying the controlling shareholder who usually owns in excess of 50% of the share capital. But in South

Africa too there are important distinctive features to note when attempting to unravel ownership and control. In particular, in South Africa it is important to understand that the *ultimate* controlling shareholder is not necessarily the direct owner of the dominant bloc of shares in any given subsidiary. We are referring here to the phenomenon of pyramiding which allows the company at the apex of a pyramid to control the board appointments of subsidiary corporations in which it holds a very small direct equity stake.² We return to this below.

Although pyramiding is a characteristic of ownership structures in South Africa, it should not be assumed that local conglomerates adopt identical positions with respect to ownership and control. Hence REMGRO adopts a notion of 'partnership' in relation to other stockholders and generally does not own a majority of issued shares. SANLAM, on the other hand, insists on managerial control, a position backed by majority share ownership.³ Old Mutual appears to be satisfied to exercise control over its subsidiaries through minority, but very significant, stakes.

Conglomeration in the Manufacturing Sector

As a first approximation the JSE listings section 'Industrial Holdings' is a useful signpost leading to the manufacturing conglomerates. Companies so listed have defined their activity as the holding of shares of industrial companies. Of the *Financial Mail's* 1991 'Top 100', 17 are listed in the 'industrial holding' section of the JSE. These incorporate a large portion of the major industrial interests within what Rustomjee (1990) has referred to as the major 'axes of capital' - the Anglo American Corporation (AAC), Anglovaal, the Rembrandt Group (REMGRO), SANLAM, Old Mutual, and Liberty Life.

The most useful starting point is then probably with these 'axes of capital' themselves, by identifying the manufacturing sector conglomerates within the respective axes. This does not, by any means, exhaust the phenomenon of conglomeration, a process which, though particularly advanced by the formation of these axes, is nurtured within the general context of South African financial regulations, tax laws, exchange control, and general economic structure.

Each of the four major axes - Mutual, SANLAM, AAC and Rembrandt - is composed of a controlling interest in major mining activities, manufacturing activities, and financial activities. The financial sector interests generally include a controlling stake in a long-term life insurer, a building society and a bank. Anglovaal was initially excluded from this quartet by its weakness in the financial sector; Liberty Life was excluded by its poor representation in the manufacturing sector. In the recent past Anglovaal has acquired control of AA Mutual thus giving it a major entree into the financial sector. Liberty's control of the Plate Glass manufacturing conglomerate would seem to constitute a manufacturing

interest large enough to dispel any doubts about its claim to fully fledged membership of the select club constituted by the major axes of capital.

The historic roots of the six majors are - with Rembrandt something of an exception - in life assurance and gold mining. In John Scott's seminal study of corporate control and ownership in Britain (1986:118-19), he found that,

Rooted in the circulation of money capital, a diverse group of clearing and merchant banks, insurers, public corporations, and private sector manufacturers stood at the heart of the intercorporate network. Large 'non-financial' enterprises were able to play a leading role in this polyarchy because the massive investment funds of their pension schemes enabled them to operate as financial intermediaries as well as industrial undertakings. As units of 'finance capital' they took their place alongside the more narrowly defined 'financial' enterprises.

In South Africa the large 'non-financial enterprises' are the mining houses who were able to play a leading role, indeed the leading role, in these 'axes' of finance capital not because of funds generated through their pension schemes but because of the massive returns and cash flows associated with gold and diamond mining.

There should be no gainsaying the power of these axes of capital in the manufacturing sector and their clear preference to manage their portfolios through the medium of very large, diversified conglomerates.

As already noted the 1991 *Financial Mail* 'Top 100' includes 17 'industrial holding' companies - the largest representation in the 'top 100'. The 'industrial holding' companies so listed are clearly the manufacturing conglomerates, and are generally, although not unexceptionally, part of one or other of the axes of capital. Eight of the 17 industrial holding companies listed in the Top 100 are amongst the Top 25 companies and all but one are in turn firmly located within one or other of the axes of capital. These are Barlows, CG Smith and SAFREN, all within the Old Mutual axis; AMIC the industrial arm of the AAC; Malbak is a conglomerate within the SANLAM umbrella; AVI is Anglovaals industrial arm; Plate Glass is part of the Liberty Life axis. Only FSI of the top eight industrial holding companies stands outside of the major mining/financial/industrial axes. Two other points are worth noting about the 'Top 25':

Firstly, there are corporations in this grouping that are not listed within the 'industrial holdings' section of the JSE but which clearly qualify for conglomerate status. REMGRO is the outstanding example here, which, presumably, history maintains within the 'Tobacco and Match' section of the JSE despite its very extensive presence in mining, engineering and finance and food, in addition to its dominant position in the tobacco and liquor industries. Conversely,

not all the companies listed in the industrial holdings section of the JSE are conglomerates as defined: some are investment houses, the activities of which do not envisage a capacity for managerial control, often little more than vehicles for holding family shares in a company or companies that cannot themselves be identified as conglomerates.

Secondly, almost all the companies and single sector (relatively non-diversified) groups listed here are effectively the operating divisions of the conglomerates listed in the top 25, or occupy another structure within the major axes of capital. Again of all the companies in the top 25, only three - FSI, Sasol and ISCOR - are not clearly identified with one or other of the major axes of capital.

The Consequences of Conglomeration

There is a widely held view that conglomerates are inefficient and should be broken up. It is in fact argued that the activities of 'corporate raiders' in the 1980s reflects the market's negative assessment of the conglomerate form.⁴ Indeed, so widespread is this negative judgement that, whilst the initial debate around ownership structures may have come from the left focus on nationalisation, clearly the current impetus and much of the action around the restructuring of the conglomerates is coming from capital. Gencor's celebrated suggestion that it was considering 'unbundling' feeds into the South African political environment from an obvious perspective. Whilst it's tempting to imagine that Gencor's thinking is inspired by popular hostility to conglomeration, its ideas are more likely rooted in the international swing away from the conglomerates of the 1960s, a development replete with a cast of characters - 'raiders', 'white knights' - whose offensive - 'junk bonds', 'greenmail' - and defensive weapons - 'poison pills', 'golden parachutes' - seem to owe more to Star Wars than Wall Street. In fact the South African mining industry has a recent example of this in the unbundling of Consgold by the notorious British 'raider', Lord Hanson. We clearly need to understand the basis for capital's growing misgivings about conglomeration, if we are to understand the limitations of actions that it will take to restructure itself. Essentially and obviously capital is not concerned with excessive concentrations of economic wealth and power. It is, however, concerned with corporate efficiency and the efficient functioning of the institutions of the capital market, concerns that, for very different reasons, and with different criteria, are shared on the left. How then does the conglomerate form inhibit corporate efficiency?

We should return to the definitive characteristics of conglomeration in order to begin to discuss the impact of this structure on corporate efficiency and general economic performance. We have identified three defining characteristics of conglomerates. These are, firstly, their essentially *financial* character; secondly,

they are in effective control of the corporations whose shares are represented in their portfolio; and, finally, the corporations within their portfolios are located in *diverse* sectors and sub-sectors of the economy.

We should focus on diversity, the defining character, par excellence, of the conglomerate form. This will expose some of the problems that attach to the other two defining elements of conglomeration.

The emphasis on *diversity* should convey that our concern is not with *size*:

... conglomerate bigness rests on none of the traditional efficiencies of large scale. It does not confer operating economies by virtue of a firm's 'horizontal' size - in other words its ability to mass produce a given article and thus reduce per-unit costs. Nor does it yield economies because of a firm's 'vertical' size, that is, its ability to effectuate cost savings by integrating successive functionally related stages of production and distribution. Clearly, these efficiency rationales do not justify conglomerate bigness, which, by its very nature, cuts across product and industry lines, and hence benefits neither from horizontal nor vertical firm size (Adams and Brock, 1986:42).

The managerial problems associated with, as the Anglovaal advertisement puts it, producing burgers and bearings, are, at some levels, self-evident. In fact AVI, the Anglovaal manufacturing conglomerate and a highly successful corporation, is itself a monument to the inefficiencies associated with constructing a corporation on the basis of financial strength as opposed to any operational criteria. Much of the 1980s have been spent rearranging the managerial structures and rationalising the shareholdings within the giant conglomerate. In the words of Jan Robbertze, the AVI MD,

We restructured the management of AVI some five years ago when we grouped like-type businesses together... The financial structure of the company has been the historical result of 30-plus years of investment. *Sometimes investments were appropriately placed, on other occasions they were located where the resources were to buy them. So there was some ad-hocery about it* (Financial Mail, Special Survey - 'Top Companies', May 1990).

Essentially what Robbertze is saying is that the financial decisions that drove the construction of AVI, conflicted with sound management of the assets controlled by the conglomerate. This is the basis of the restructuring of the company and of a later rationalising of the shareholding. But the restructuring and rationalisations - which appear to be a persistent feature of the conglomerate form - notwithstanding, how does this equip the board of the conglomerate to simultaneously manage burger chains and steel foundries?⁵ Proponents of conglomeration have several answers:

Firstly, they would claim that conglomeration, far from inhibiting operational management, spreads scarce managerial resources throughout the economy; Secondly, it is argued that the conglomerates are able to deploy their financial resources in support of their operating subsidiaries more rapidly and more selectively than the capital market:

First, it is an internal rather than external control mechanism with the constitutional authority and expertise to make detailed evaluations of the performance of each of its operating parts. Second, it can make fine tuning as well as discrete adjustments. This permits it both to intervene early in a selective, preventative way (a capability that the capital market lacks altogether) as well as to perform ex post corrective adjustments, in response to evidence of performance failure, with a surgical precision that the capital market lacks... Finally, the costs of intervention by the general office are relatively low (Adams and Brock, 1986:42).

More than that the proponents of conglomeration argue that not only are conglomerates able to allocate capital more rapidly and incisively than the capital market, but that, additionally, they have the capacity to mobilise capital for large investments that market mechanisms alone would not otherwise generate. When Derek Keys, chairman of Gencor, mused about 'unbundling' his company he cited Engen as an example of an investment that could not have occurred without the conglomerate strength of Gencor;

Thirdly, and above all, most conglomerates would claim not to interfere in the management of their operating subsidiaries. Grant Thomas, the MD of Malbak, Gencor's manufacturing arm, and described by the *FM* as a 'conglomerate that works' puts the case for 'strong' shareholders but with a limited range of intervention:

In SA, shareholders have tended to be apathetic, and we all know that it takes significant effort to dislodge bad management. An important part of our responsibility will be to monitor management.

There are three types of conglomerate - one with the brains at head office dictating to managers of subsidiaries. This explains the demise of most of the conglomerates in the 1960s and 1970s.

The second kind is where the chief executive claims management is decentralised and it is not.

Finally you get our type - where management claims the subsidiaries are truly autonomous and they truly are.

We make sure management is competent by measuring performance. We provide the environment to enable companies to flourish.

We have defined two types of decisions - management decisions

and shareholder decisions. We at head office look after shareholder decisions, which include questions such as whether there should be a rights issue, what the level of gearing should be and dividend policy.

Everything else is up to management, although I think if the company were considering a radical diversification or a new expansion route, or challenging a major competitor and upsetting a market, there should be consultation ('Young and tough and in charge of millions', *Sunday Times*, 20.09.87 - my emphasis).

This would seem to go to the heart of the matter: the shareholders make 'gearing policy' and 'dividend policy' and whether or not there should be a rights issue. How are these decisions affected when the controlling shareholder is a conglomerate?

I want to advance some tentative hypotheses regarding investment and gearing. First a general observation: control of gearing, dividend policy and rights issues effectively amounts to control of all funds for expansion. 'Gearing' refers to the ratio between debt and equity - effectively then members of the Malbak stable (the case referred to above) are not permitted to change this ratio (that is, raise more equity or debt) without the prior permission of the Malbak board; nor are they permitted to raise more equity capital via a rights issue without the authority of their controlling shareholder, that is, Malbak.

'Dividend policy' essentially refers to the ratio between that portion of profits retained for re-investment and the portion paid out to the shareholders. The statement of the Malbak MD effectively confirms that the decision over retaining profits for further expansion or paying these out in the form of dividends is made by the shareholder (Malbak) rather than the management or directors of the operating company.⁶

In general then it would appear highly disingenuous to assert the existence of managerial autonomy on the part of the conglomerate's operating companies, when all investment decisions are retained by the conglomerate head office. We are, in fact, talking of very strong shareholders indeed.

From the anglo-american (ie British and US) perspective on corporate control, shareholder control of these key decisions takes the form, both legal and in 'custom', of a prerogative that naturally accrues to the owner of the company. Others - managers, workers, consumers, the state - may contest the precise terms of this prerogative, but there is a widespread acceptance that these are 'rights' of control that derive from ownership. A successful critique of conglomeration must identify inefficiencies that attach to the exercise of this ownership 'prerogative' by the conglomerate form, and then develop policy to counter these.

In the anglo-american economies this policy is market driven, that is, policy

that enhances the market's ability to deal with potential conglomerate inefficiency. In other words if the conglomerate shareholder exercises its 'rights' irresponsibly, the market will provide the sanction, usually in the form of a hostile takeover, that will see this prerogative change hands. The rash of hostile takeovers, particularly in the British and US economies, in recent years, represents the practical workings of a market-led corrective. It may be an effective check when judged narrowly in terms of corporate efficiency. There is, however, no doubt that, when judged in terms of broader social and national economic criteria, market-led correctives prove extremely costly. In particular they impose a crippling short-termism on investment decisions. A recent study of British practice concluded that '...in the presence of hostile takeovers it may not be possible to provide managers and employees with adequate incentives to engage in long-term investment. As a consequence, investment in R&D and training may suffer' (Franks and Meyer, 1991:215).

There are, however, alternative modes of controlling conglomerate inefficiencies. It is significant that these are all utilised in the most successful capitalist economies - Germany, France, Japan, South Korea. Each of these economies is characterised by large business combines. However the regulatory environment in these economies ensures that the inefficiencies that attach to conglomeration in the anglo-american economies, particularly those that inhibit long-term investment, are contained. There are substantial differences in the regulatory environments but there are important common features: firstly, the checks on conglomerate power and inefficiency are essentially institutional rather than market led; secondly, they all curb the 'prerogative' that the anglo-american shareholder/conglomerate assumes so easily; thirdly, the relationship of the financial institutions to the operating subsidiaries of the conglomerate are key components of the regulatory environment. In certain of these economies (France, South Korea) access to finance is controlled by heavy state regulation of the banks and other financial institutions; in Japan and Germany the place of the banks in the conglomerate structure ensures that finance, usually in the form of long term debt, flows into productive activity.

The root of conglomerate inefficiencies is to be found in their fundamental feature, namely, diversity. Hence, whilst it is frequently argued that the diversity of conglomerates marshalls scarce managerial resources and spreads them throughout the economy, there would seem to be an equally sound a priori argument for questioning the ability of the shareholder to take effective decisions relating to the diverse range of activities that characterise the archetypal conglomerate. Leaving operating decisions to the managers is, under conditions of great diversity, not so much a virtue as a necessity. The only decisions which the conglomerate head office (the shareholder) is capable of taking relate to invest-

ment and the only criteria with which it is able to judge the performance of its investment is via one or other financial measure, typically earnings per share. These criteria may reflect short-run considerations and influences that may have little to do with the long-term requirements of the industry in question but which nevertheless constitute the bases for gearing policy, dividend policy and rights issues, in short for the allocation of capital.

In South Africa this is peculiarly exacerbated by the exceptionally large size of the holding of the dominant shareholder, which effectively inhibits the possibility of the market constraining conglomerate inefficiency. The degree of control typical of South African corporations prevents the shareholder from rapidly exiting from a poor investment via the market. The remedy would be to assert greater and greater control over the financial aggregates. This may enhance the dividend flows to the conglomerate in the short run, but this type of financial 'discipline' does not necessarily identify the underlying problems that may have accounted for the operating subsidiary's poor performance in the first place.

This is further underlined by the overwhelming power of life offices. The fiduciary character of the life assurers' relationship to their policy holders imposes exceptionally conservative investment policies on these giant institutions. Their tendency would be to buy into blue chip stock as opposed to supporting riskier ventures. Alternately to exercise exceptionally tight financial control over their subsidiaries, one that, above all, maintains the required dividend flows. Hence poor investment choices by SANLAM are thought to be the basis of SANLAM's characteristically tight control over the companies in its stable.

In short, in South Africa, we have the worst of all possible worlds: private sector conglomerates dominate the allocation of capital through their activities on the JSE. The overwhelming power of these conglomerates and the character of the regulatory environment inhibits the market mechanism from operating 'against' them - that is, an operating subsidiary of one of the South African conglomerates is effectively immune from hostile takeover, the ultimate market sanction; on the other hand, a successful manufacturer outside of the conglomerate fold is persistently subject to a predatory conglomerate, a threat which, if the British experience is anything to go by, substantially inhibits long-term investment. Moreover, long term life assurers have come to play an increasingly important role in the allocation of capital and their conservative investment criteria effectively shore up the strength of blue-chip conglomerates. This is all combined with a very weak, indeed determinedly weak, regulatory environment.

These shortcomings, particularly their manifestation in low levels of investment, are increasingly appreciated across a broad spectrum that includes government and, to a lesser extent, capital itself. However, it will come as no surprise

to learn that the official response is to 'liberate' the market and that talk of 'unbundling' by the conglomerates themselves amounts to their support for market processes. In other words, the South African response to the conglomerates and, in particular, their relation to the investment crisis, is to emulate the most unsuccessful capitalist economies - enhance market forces by weakening an already ineffective regulatory environment.

The Alternatives to Conglomeration

The Harare document proposed 'dismembering' the conglomerates but with no suggestion as to how this was to be achieved.⁸ Recently this has been taken up by certain of the conglomerates, most notably, although not exclusively, GENCOR, which, to widespread acclaim, has suggested 'unbundling' itself.

What, in the Gencor proposal, would 'unbundling' amount to? Gencor has within its conglomerate stable five major interests: Genmin, SAPPI, Malbak, Engen, and Genbel. Gencor holds a majority share in each of these companies. The majority of Gencor's share capital is, in turn, held by SANLAM through SANKORP. 'Unbundling' effectively means that Gencor would distribute shares in its underlying assets - effectively the five companies listed above - to its ultimate shareholders.

What are the consequences of this? Prima facie it would seem to amount to little more than a transfer of shares from an industrial and mining conglomerate, Gencor, directly into the hands of a life insurer, SANLAM, or into SANKORP, the company charged with controlling SANLAM's 'strategic investments'. However, the issue is somewhat more complex than that. Firstly, at each step along the way there are minority shareholders involved and eliminating a layer in the pyramid of control effectively reduces the power of the majority shareholder in those companies previously subject to the control of the now unbundled conglomerate. Hence, whereas previously SANLAM's 50%plus share of Gencor enabled it to control the board of Gencor and all those companies controlled by Gencor, an unbundling would reduce SANLAM's stake by the extent of minority shareholding in the underlying asset and in Gencor itself.⁹

Secondly, because the conglomerates like Gencor persistently trade at a discount to their underlying asset value, the immediate effect of the unbundling is to create new value on the JSE. Hence, whilst the elimination of a conglomerate like Gencor may, in one sense, reduce the capacity to finance mega-projects like Engen or Moss gas, it would, by effectively upping the market value of its former subsidiaries, enhance the ability of these companies to raise large amounts of capital on their own account. The point has also been made that the institutions may be more willing to take up new paper from a 'correctly' valued SAPPI than an undervalued Gencor.¹⁰

Thirdly, and leading on from the above point, the marketability of the shares quoted on the JSE would be significantly enhanced by eliminating the conglomerates. Hence, currently whilst a reasonably large volume of shares in Barlow's are tradable this would not apply to the companies within the Barlow's pyramid. Unbundling Barlow's would dramatically increase the marketability of the shares of major companies like Tiger Oats or PPC. Again it has been suggested that the enhanced marketability of the JSE would mean that the large institutions would be less reluctant to sell shares for fear of not being able to reinvest in a market characterised by exceptionally low trading volumes. This enhanced tradeability may then loosen the attachment of the institutions, what has been referred to as the 'group control syndrome'.

It must be emphasised that this type of market-led 'unbundling' will not necessarily have a substantial impact upon ownership and control.¹¹ Mizruchi cautions against a preoccupation with legal ownership of a single corporation:

...it was not the legal criterion of stock ownership which determined who controlled a corporation. Rather, control involved a complex set of institutional relationships, and it was control over this system of relationships which determined the ultimate control over a particular corporation... (the) corporation must be viewed as an element of an interorganisational system, in which no one corporation can be understood without locating its position within the system (1982:26-7).¹²

This is supported by Scott's study of the British corporate economy. He notes (1986:99):

The importance of shareholding, however, lies not only in the voting power that it accords but also in its role in the provision of new capital: an enterprise seeking to raise new capital through a rights issue will have to attract the support of its leading shareholders... the need to ensure the success of capital issues creates a pressure on the board to treat the largest institutional shareholders as if they were the largest vote-holders.

The effect on ownership and control will then simply be to accentuate the importance of understanding Mizruchi's 'interorganisational system' or Scott's 'constellation of interests' in order to track the loci of corporate control in the economy. Identifying the controlling shareholder will no longer be a simple question of identifying the majority holder through the share register. It will rather be a question of identifying 'constellations'.

However, even in the context of this limited agenda it cannot be reasonably assumed that the conglomerates will, in general, voluntarily 'unbundle'. They will, in other words, not support the strengthening of market mechanisms if this is perceived as contrary to their established power. There are a number of

alternative mechanisms whereby the state could effectively 'free up' the market: the *first* would be to simply outlaw pyramids. A new securities regulation code on takeovers and mergers has the effect of outlawing new pyramids. However, pyramids currently in existence are not affected by the provisions of this legislation. These regulations would, following British practice, oblige a company securing a stipulated portion of the voting stock of another company to extend the offer to all minority shareholders. However, whilst this regulation protects minority shareholders - presumably enhancing their willingness to invest - it in no way constrains the rights of the controlling shareholder vis a vis other stakeholders, notably workers and managers.¹³

The *second* would be to tax dividends: 'If, for example, a tax of 15% was placed on the dividends received in the hands of companies, it would make the whole daisy chain of holding companies and pyramids tax-inefficient and encourage distribution of the shares up the line to the ultimate shareholder' (Stuart, 1990:45).

The *third* set of policy mechanisms raises more complex issues. In terms of the arguments outlined above, there are few direct equity or distributional considerations involved in the policy measures aimed at 'unbundling' conglomerates. What is at issue is enhancing the flow of capital into the 'real' economy, a process that will, it is argued, be facilitated by dismembering the conglomerates. However, if this is to be successful, if enhancing the flow of capital out of the coffers of the dominant shareholders into the 'real' economy is to be achieved, then the overwhelming domination of the life insurers and other non-banking financial institutions, the heart of the conglomerate form, has to be confronted.¹⁴

Strictly speaking this raises a complex of questions that are beyond the scope of this article. But there are strongly overlapping issues: in essence, the ability of equity-based financial institutions and, particularly, life insurers, to manage non-financial assets has to be questioned. Rembrandt Chairman, Anton Rupert, in his 1982 broadside at SANLAM, quotes the 1970 Franzsen Commission into monetary and fiscal policy -

Insurers, as such, do not necessarily have at their disposal the expertise to act as entrepreneurs in other fields, and decisions to invest are not necessarily objectively made when insurers become involved in the management of undertakings. This increases the possibility of errors of judgement in respect of investments and may lead to the highest returns not necessarily being earned. For these reasons, the Commission detects merit in foreign practices which curtail the interests of insurers, both in individual business enterprises and in certain specific avenues of investment (Rembrandt Group, Annual Report, 1982).

This is, in a sense, the equally valid converse of the point that I have made against insurers as controlling shareholders, viz, that maximising returns to the insurer (dividend flows) may not be compatible with the long-term interests of the undertaking. Conversely, the Franszen Commission's point that the insurer-qua-entrepreneur, by tailoring its investment practices to the character of a particular undertaking, may not be earning the best return for its policyholders. However, from whatever perspective, life assurers are judged inappropriate managers of non-financial assets.

Whilst there is scope for influencing the insurers' investment policies by conventional measures such as prescribed asset requirements, ultimately their dominance of the capital market can only be curtailed by reducing their access to the total flow of savings, by achieving a satisfactory balance between discretionary and contractual savings. The strong flow to the latter is promoted by tax legislation and can be undermined by same. This would enhance the ability of the banks to finance investment effectively raising the ratio of debt to equity. This would have to be accompanied by other measures aimed at ensuring the stability of the banking sector. There are several possible means of achieving this: the Korean path would nationalise or heavily regulate the banks; the German path would allow banks to purchase equity to enable them to support their lending activities. Either would be preferable to what financial journalist Jim Jones has referred to as '...rule by committee from Pinelands'.

The arguments surrounding the relative virtues of capital market-based financial systems versus credit-based financial systems are complex and outside of the scope of this paper. Suffice to say that where developmental or reconstruction needs are primary, there is a powerful case for financing via debt.

There are a number of arguments in favour of credit-based systems. Two that are directly pertinent to South Africa are, firstly, credit-based systems permit greater sectoral flexibility and mobility in the allocation of capital and permit the state to control and guide that mobility. Secondly, a credit-based system corrects the bias to short-termism that characterises capital market-based systems. Fundamentally debt has to be repaid and the costs of a failed borrower are extremely severe for both the debtor and creditor. Capital market finance does not possess the same imperatives with failure expressed as a decline in the share price and/or a reduced dividend. This is verified in the case of the NICs as well as in Germany, France and Japan.¹⁵

In the South African case this requires further examination. However, *prima facie*, there would appear to be a case for directing a greater flow of savings away from the life offices to the banks, and then for enhancing the ability of the banks to engage in long-term finance. This presupposes a major shift in financial legislation, indeed in the philosophy of the financial system, dominated as it is

by the anglo-american capital market-based systems.

In addition to directing the flow of savings from the life offices to the banks, if the negative consequences of conglomeration are to be comprehensively tackled there is a powerful case for investigating, firstly, the current mode of control of these life assurers, and, secondly, the establishment of alternative financial institutions:

The control of the life assurers, and particularly, the two large mutuals, Old Mutual and SANLAM, demands urgent examination. This is quite apart from the reference made above to the need to alter the relationship between discretionary and contractual savings. *The Economist* (1991) notes that

...the view of Anglo-American finance as a casino of rapacious capitalists has become popular at the same time as those countries' companies were being taken over by the people themselves. Or, rather, by their pension funds... Dominance has passed to institutional investors, which mainly means pension funds and life-insurance firms. Company chairmen deplore this: they say they want 'wider share ownership', to get ordinary people back into the stockmarket. Yet in fact that is the opposite of what they want. Pension funds represent the wide ownership of shares. Rightly or wrongly, what chairmen want is to narrow ownership back into the hands of rich individuals.

The predictable right-wing populism of *The Economist* notwithstanding, there is more than a grain of truth in this observation. Pension fund managers are in a special relationship to those whose funds are lodged with them. Policy holders are not risk takers - quite the contrary - and this appropriately constrains the actions of an investment manager entrusted with securing an old age pension. It appears, however, that the duty to the policy holder is very narrowly interpreted: 'best return' has no social content; moreover, in South Africa there is not the most perfunctory acknowledgement that a competitive return may be earned within 'socially responsible' parameters of one form or another.

This is not surprising when one understands that even the two mutual funds are firmly controlled by a self-perpetuating managerial oligarchy, with their boards controlled by these managers and a group of non-executive directors, usually the retired or soon-to-be retired chairmen of those companies controlled by the life assurer. It is this institutional reality that makes nonsense of *The Economist's* notions of popular capitalism. John Scott notes that (1986:52)

Mutual and friendly companies, too, must be distinguished from other corporate forms. The powers of control of these companies are vested in individual depositors and policy-holders, and it is rarely possible for votes to be accumulated by particular interests. The resulting rule of 'one person, one vote' means that, paradoxically,

cally, such enterprises may come closest to the situation of the 'managerial' enterprises conceptualised by Berle and Means.

There is an urgent need to re-examine this situation so as to allow the preferences of the policy holders to be expressed. The institutions best able to effect this are certainly the trades unions, representing, as they do, large agglomerations of policy holders.

But beyond this, there is an urgent need to examine the possibility of establishing alternative and competing financial institutions. This extends beyond the need for specialist financial institutions - development banks, credit institutions designed to support small business, etc. Rather, there is a need to establish financial institutions engaged in the mainstream of the savings and investment mechanism, but that are responsive to broader community and developmental needs. This is important both from the point of view of raising the level of personal savings and, particularly, of channeling those savings into the 'real' economy. Here again the trade union movement and other institutions of civil society have direct and indirect access to the funds necessary to support an alternative banking venture. Certainly the combined pressure of greater state regulation of the financial sector, genuine policy-holder supervision of mutual fund management, and the establishment of alternative financial institutions, may provide the necessary counter-weight to the cosy, but thoroughly unproductive, relationship between the financial sector and the 'real' economy, the relationship popularly referred to as 'conglomeration'.

Finally, we have to consider the possibility of a direct policy response to the 'burgers to bearings' diversity of the South African conglomerates. All other considerations aside, the South African economy requires more effective and focused management. It also requires a more effective small enterprise sector. Both of these are clearly inhibited by the highly diversified giant conglomerates that dominate the South African economy.

There is a leaf to be taken out of the exceptional developmentalism of the Korean planners, well known for their decisive and successful interventions. In the 1960s and 1970s the Korean planners were instrumental in encouraging - largely through the state's ability to allocate capital - the formation and growth of massive conglomerates. These conglomerates were remarkably successful competitors in a global fordist economy. However, times have changed - Korean wages have increased rapidly and this demands that Korea focuses on higher value added and more technology intensive manufacturing. Reinforcing this shift in comparative advantage is the development of more segmented and specialised international markets. Whereas previously cost was the major, if not the only, element of international competition, quality and productivity are now key. This requires more flexible, more technologically innovative, more highly specialised

corporations. In short, it requires that the conglomerates reduce their degree of diversity.

A new policy finalised at the end of March for implementation in June is intended to enforce greater specialisation, or, conversely, reduced diversification (see 'Time to cut giants down to size', *Financial Times*, 10.04.91). In terms of this policy, the 30 largest *chaebol* are required to select three companies within their group as their 'core' businesses. For these three, existing state imposed restrictions on credit - restrictions bitterly opposed by the *chaebol* - will be lifted. This privileged access to credit may be extended to two other companies within the group provided that the parent sells off two of its existing corporations. Privileged access to credit is the carrot.

Those companies within the conglomerates that are not selected as core businesses will have existing lines of credit curtailed and will be subject to additional restrictions on new borrowing. Reduced access to credit is the stick.

South Africa's planners are far from possessing the will to pursue interventions of this scale despite the need to discipline the conglomerates, to harness their activities to a set of broader developmental objectives. But, for future governments, lack of power may be a more serious constraint than an absence of will. The NICs establish time and again that a firm state hand on the mechanisms and institutions that allocate capital is the key to rapid development. In South Africa this will not be achieved by the maintenance of the present relationship between finance and production, by, in other words, the maintenance of the conglomerate form. Nor will it be achieved by a market-led 'unbundling' of the conglomerates. What is required is a state-led restructuring of the relationship between finance and production, policy that induces finance to play its appropriate role of serving production.

NOTES

1. This is a slightly revised version of a paper presented at a meeting of the Economic Trends Research Group. I acknowledge gratefully the comments and advice of the ET Group.
2. Hence 'whereas (the Anglo American Corporation) controls companies totalling 45.3% of the JSE's capitalised value, it owns between 11.9% and 21.7% of the assets reflected on the Exchange.' (Gerson, 1990:2). The AAC and their controlling family, the Oppenheims, are not alone. Hence *Finance Week* asks: 'Why, for example, should the Rupert and Hertzog families be permitted use of the JSE mechanisms to control the vast Rembrandt empire - with total assets of R7.5 billion and net assets of R5.7 billion - through three pyramids while the families have an effective stake in operating group Remgro of only some 10%? Their holding and risk is small, but thanks to the pyramids their influence over the group is dominant'. *FW* continues: 'The JSE lists are peppered with pyramids. Few can be less acceptable than in the mining house/industrial conglomerate Anglovaal; the Mennel and Herscov families, which have little equity, perpetuate control through a cocktail of voting and non-voting shares'. (25-31.07.91:20).
3. This was graphically illustrated in the bitter conflict between Rembrandt and SANLAM, respectively the minority and majority shareholders in Gencor, over SANLAM's decision to fire then Gencor Chairman, Wim de Villiers. In his Annual Report of that year (1982) Rupert contrasted Rembrandt and SANLAM's views on ownership and control thus: 'Rembrandt, on the contrary, regards it as important that the boards of controlled companies should be able to maintain a strong loyalty to their own company. Any diminution of their status

or powers impairs their ability to look after the interests of their own company as a separate undertaking, especially where such interests may differ from those of the controlling company. For this reason we are defending our existing rights and those of other minority shareholders'.

4. *The Economist's* (1991) potted, but plausible, history of corporate structure runs thus: 'In the early 1900s buyers of firms guessed they could raise cash flows through economies of scale and by limiting competition. They were mostly right. In the 1960s buyers thought they could raise cash flows by forming conglomerates, applying their management skills and diversifying risk. They were mostly wrong, but it took several years to find out. So the merger boom went on for a while, still fuelled by this false belief. In the 1980s buyers thought that they could raise cash flows by breaking up these conglomerates, by giving managers different incentives and controls, and by exploiting more fully tax breaks for debt interest. It is still to soon to say in how many cases this was right. But it is well grounded in theory'.

5. It appears that Barlow Rand is the next conglomerate in line for a major 'cleaning up of its structure'. It is interesting to note that despite (or because of) the enormous diversity of the giant conglomerate, Barlow's considerable problems stems from an over-exposure to some of the highly cyclical activities in its portfolio, in particular gold, platinum and ferro-alloys. The answer to this problem would presumably be for Barlow's to divest itself of its troublesome investments and concentrate on fewer activities or to diversify even further into counter-cyclical activities (see *Business Day*, 'Barlows under fire for dithering').

6. Note that Malbak's majority shareholding ensures that the Board of any of its operating companies would be dominated by the conglomerate's appointees. Furthermore, pyramiding would ensure that Malbak's board is dominated by Sankorp and, in turn, SANLAM. The issue is not then Malbak's domination of the board of the subsidiary but rather of the management of each of its subsidiaries.

7. The market-based corrective applied through the agency of the archetypal British and US corporate raiders is reflected in the wholesale dismembering of the target conglomerate. It is thus not merely a judgement of the decisions of the management and shareholders of the conglomerate but rather of the conglomerate form itself.

8. The 'Harare document' refers to the document drafted by the 'first Harare meeting' held in April/May 1990 and attended by COSATU, the ANC, the Economic Trends Research Group and other researchers. The ANC subsequently convened a second meeting in Harare which also discussed economic policy.

9. In fact Gencor is a fairly bad example because of SANLAM's policy of holding exceptionally large blocs of shares.

10. The characteristic discount to net asset value at which conglomerates typically trade, is the basis for the activities of US and British corporate raiders who when successful are able to pay back large amounts of debt required to purchase the conglomerates by realising the 'true' value of the underlying assets.

11. Certainly if the process of unbundling is led by the conglomerates themselves, there is little chance that ultimate control will shift significantly. Where, on the other hand, the process is led by hostile raiders, then the identity of those in ultimate control may be substantially affected.

12. Mizrahi (1982:26-7). In support of his argument he cites a study of JP Morgan's activities which consisted largely in the combining and institutionalisation of the interests of small shareholders.

13. Gerson (1990) deals in some detail with alternative means of protecting minorities. See also *Finance Week*, July 25-31 1991 for a discussion of the new JSE regulation dealing with pyramids.

14. However we should here emphasise a point made above that the poor marketability of shares on the JSE predisposes the institutions to the 'group control' syndrome. Accordingly the exceptionally conservative investment practices of the institutions are, to some extent, a consequence of conglomerate form. Hence, dismembering the conglomerates - and thereby enhancing greater marketability of shares - would reduce the interest that the institutions have in supporting the conglomerate form.

15. For the NICs see Robert Wade (1988). For a comparison of the Germany and French systems with the British system see Julian Franks and Colin Mayer (1991). For Japan see Takeo Hoshi, Anil Kashyap and David Scharfstein (1991).

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