Corporate ownership in SA

V1

May 2018

Why look at ownership?

- Problems with economic outcomes
  - Growth at international norm and investment growing until end of commodity boom; since then, decline in investment rate and in past 2 years have not recovered with peer economies
  - Extremely high joblessness and inequality, with very little change even during growth periods
- Government only controls 20% of the economy directly
- Policy solutions therefore have to engage and often manage private business

- Questions:
  - Why do we need big business, and in particular the companies that arose under apartheid and often don't look all that different today?
  - What constraints do they face and what is their space to change? These vary according to industry, ownership, location in global value chains and size – egs here: mining, auto, commercial agriculture, finance
  - What do we really want from them – that is, in practical terms, what behaviours can and should they change to support inclusive growth?

1. Why do we need big business?

One bad argument, two goods ones, and one that's iffy

The bad argument: it's not because they have money

Also: It may cost more to get rid of big business than to live with it

The good one: Institutional capacity and economies of scale

- Not just skills but established, functional systems to operate large-scale operations
- Successful businesses are structured to respond to changing demand and costs at a micro level – difficult for central power to replicate
- Market discipline means some will fail, which also hard for state to manage – we are not good at creative destruction

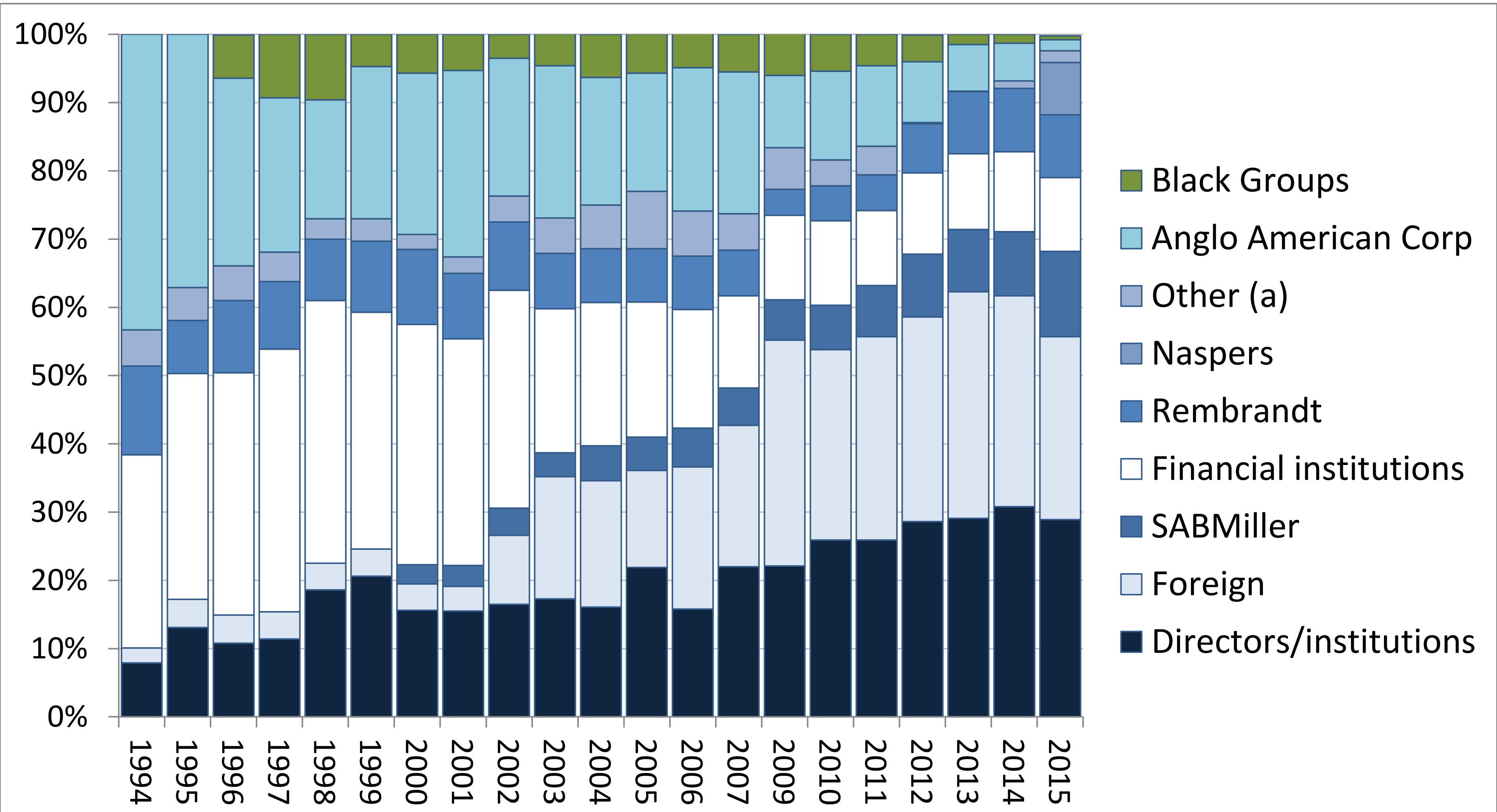
The iffy one: Greater state control brings political risks – politicians pay for failure of state-owned entities (e.g. Steinhoff vs Eskom)

2. Constraints on business decisions

- Inevitably affected by industry conditions
- But responses shaped by other factors
  - Interests of owners affects how perceive profits and options
    - Benchmarking: global vs local; industry (foreign ownership has a major impact)
    - Long and short term (e.g. family/industrial vs financial advisor vs pensioners)
    - Diverse/new vs closed/longstanding (Sibanye vs Anglo)
  - Position in VC
    - control or subordinate
    - raw materials vs beneficiation vs marketing vs financing
  - Institutional capacity and skills
  - Sunk investment in SA relative to size (Iscor vs AMSA)
  - Dependence on government (as market, regulator, provider of infrastructure and industrial finance)

TIPS

JSE by ownership



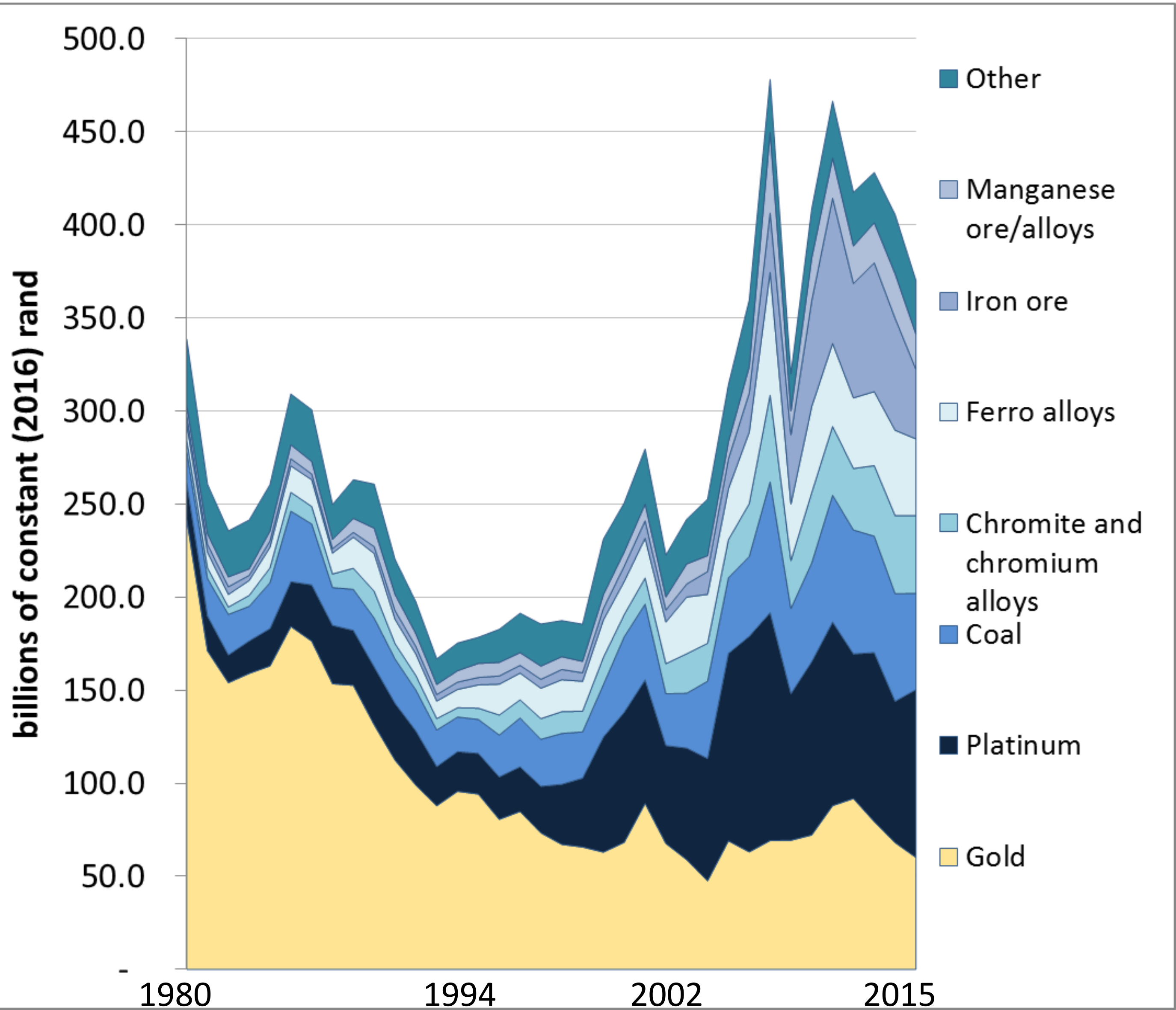
Broad trends

- Institutional investment means most companies are effectively controlled by management, not shareholders – but constrained by stress on growth in shareholder returns
- PIC/GEPF own 5% to 15% of virtually every major company
- Other major asset managers: BlackRock (US), Coronation, Allan Gray, Singapore

- Offshore listings:
  - Of top 40, 29 had primary listing on JSE, 11 in Europe
  - By value of equity, split almost 50:50
- Offshore listings fairly evenly spread by sector, but relatively low in finance and other services
- Off-shore primary listing increases pressure to diversify into other countries

Mining

- Industry conditions
  - Diversification away from gold
  - Export dependence – impact of commodity boom and bust
  - Rising costs of electricity affecting all refineries (metals, coal) and slumping demand for steel
- Market structure: large-scale investments require big companies



Mining ownership

- Mining houses repositioned as global mining companies instead of local conglomerates
  - ➢ Shed manufacturing and other non-mining interests
  - ➢ Cherry pick profitable/stable mines – Kumba, coal, some platinum
  - ➢ Sold gold and later platinum to emerging second-tier companies (Harmony, Sibanye)
- Are local companies more interested in maintaining local mining or are they moving overseas?

- Refineries:
  - ➢ Iscor bought by AMSA and lost mining rents
  - ➢ Ferro alloy refineries are foreign subsidiaries funded initially by IDC
  - ➢ Sasol tried to become a global player but now pulling back
  - ➢ Aluminium companies are foreign owned and only stay for cheap electricity (so now downsizing)

TIPS

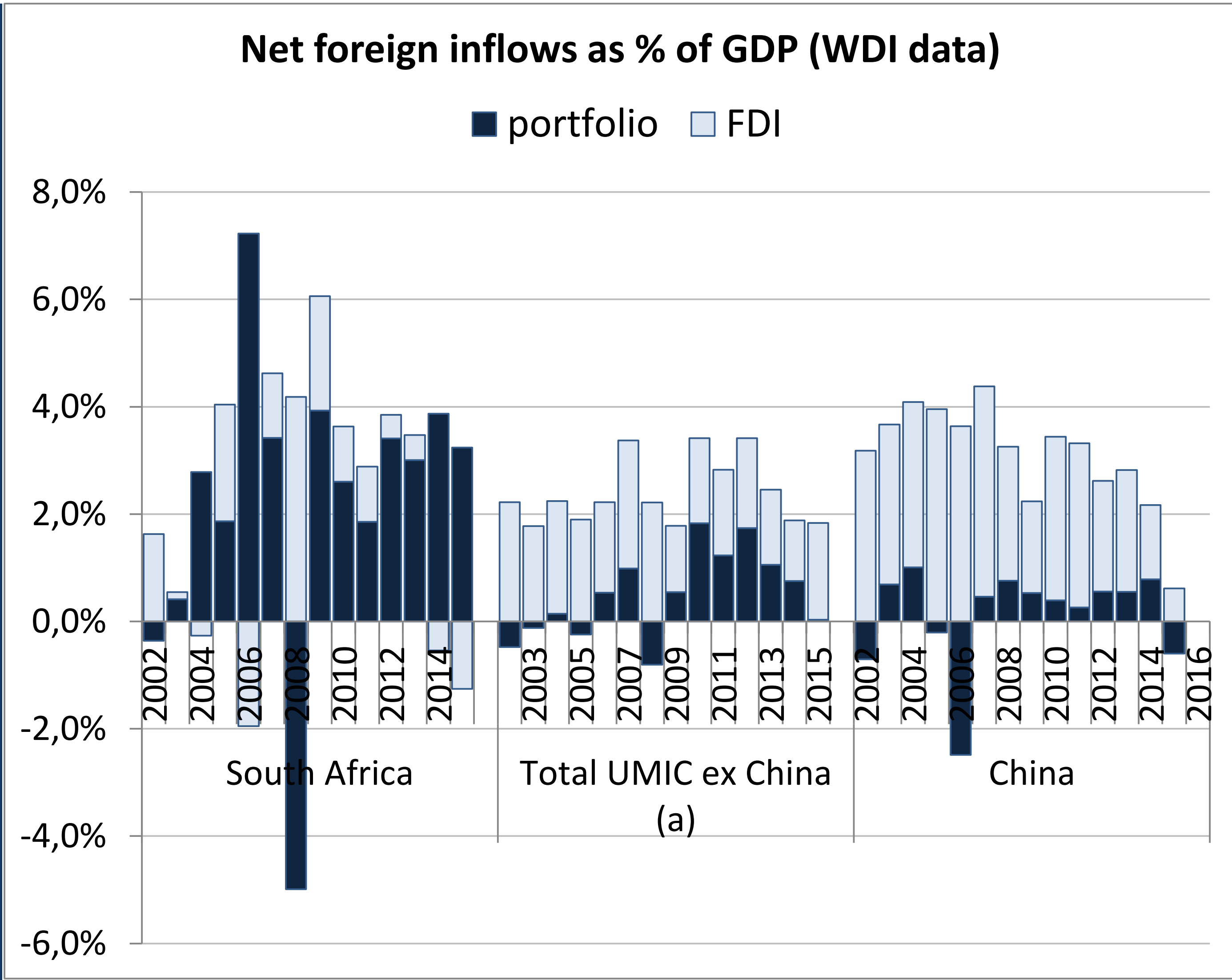
Position in VC and capacity

- Position in VC:
  - ➢ Export ores and metals to international markets, with very little influence on prices – but earnings are critical for SA
  - ➢ Within SA, Kumba gets rents for iron ore, contributing to long-term decline in steel; ferro-alloy and Sasol own upstream, so refineries capture rents
  - ➢ Power plays between Eskom and coal suppliers in context of very large electricity price increases
  - ➢ Mining is critical for finance, construction and capital goods

- Institutional capacity and skills:
  - ➢ Companies along the VC are internationally competitive (mining, refining, construction, finance, capital goods)
- Sunk investment in SA relative to size:
  - ➢ International companies see SA as relatively small
  - ➢ Attractive mostly because of established institutions and infrastructure
- Dependence on government:
  - ➢ licencing
  - ➢ transport, electricity and water

Finance

- Phases after 1994:
  - Rapid growth as became more like an off-shore financial centre through 2008
  - From 2008, much slower expansion as inflows levelled out



Bank ownership

- 6 groups control 80% of assets: FNB, Standard, Barclays, Nedbank, Capitec and Investec
  - In 1980s, gradual divestment by foreign banks
  - In early and mid 2000s
    - Foreign investors in Barclays and Standard, plus increased indirect holdings through JSE
    - Anglo sold out of FNB
    - Expansion into other countries
  - After commodity boom
    - Decline in foreign shareholdings and overseas activities
    - Stronger focus on African markets

Ownership in 2016 (before Barclays sold out)

Bank	Foreign share-holders	PIC/ GEPF
Barclays Africa Ltd	74.68	7.34
Standard Bank of SA	53.00	11.80
Investec Bank Ltd	38.00	11.90
FirstRand Ltd	21.70	9.50
Nedbank Ltd	19.75	6.19

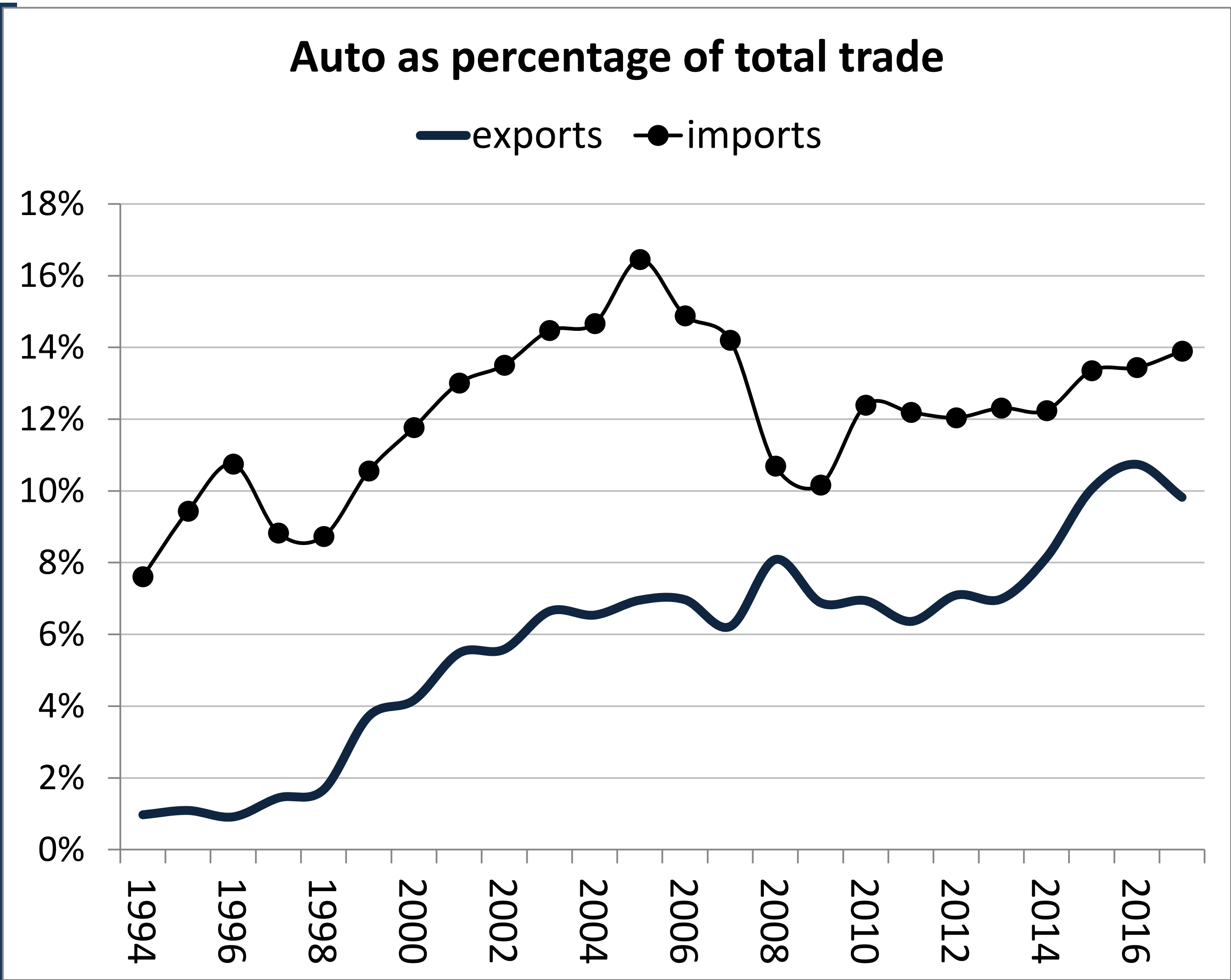
Position in VC and capacity

- Position in VC:
  - Market dominance around finance – tend to be risk averse and focused on long-standing clients (large companies and high-income households)
  - Portfolio investment provides returns from fees and interest, but depends on foreign institutional investors (advisors, retirement funds) – short-term perspective and sensitive to foreign interest and FX rates
  - GEPF and other pension funds as significant source of capital, but not very active

- Institutional capacity and skills:
  - Internationally competitive
  - Major ICT and security strengths
- Sunk investment in SA relative to size:
  - Easy to open foreign affiliates but difficult to establish networks
  - SA is a critical base for financial companies – unlike major goods producers, have not succeeded in re-basing outside SA
- Dependence on government:
  - Licencing
  - Security and protection for depositors

Auto

- Extraordinarily rapid growth in production and exports after 1994
- Rose from 1% to 10% of total exports
- Around half for export
- Only manufacturing industry where SA has higher revealed comparative advantage than UMIC average



Auto ownership

- Only foreign-owned brands, dominated by German and Japanese companies
  - BMW and Mercedes Benz treat SA as an assembly hub for export markets
  - Toyota, VW and other brands geared mostly to domestic and regional sales
  - US companies withdrawing as regional growth slowed with the end of the commodity boom
- Local producers of components
  - Mostly fairly low-tech structural components (steel, windows, etc.)
  - 40% of components exports are catalytic converters based on platinum with imported ceramic substrate
  - Very little diversification or increase in local share over the past 20 years

- Institutional capacity and skills
  - Local subsidiaries of OEMs are fairly small
  - Components producers competitive but limited scope
- BMW, Mercedes, VW and Toyota have substantial investments in SA
- Dependence on state
  - Major tax incentives – in line with other UMIC
  - Transport infrastructure – dedicated facilities at ports

Commercial farming

- Shakeout in industry from 1990s
  - Number of farms dropped by around half, from 60 000 to around 30 000
  - Proportionate fall in employment
  - Output however increased, although more slowly than GDP (1% a year from 1994 to 2016)

- Major differences by sector
  - Fruit/veg, field crops, cattle, poultry
  - Regional specialisations
  - Meat is largest sector by revenue, but export growth mostly fruit/veg
  - Tenfold increase in soy production in past ten years

Farm ownership

- Limited data compared to other industries
- Mostly medium-sized formal enterprises employing under 50 workers, but a few agro industries (e.g. in tomatoes, some wine and fruit, chicken)
  - LMD data indicates that around a third of farms are now black owned
  - Virtually no corporate foreign investment; some individual investors mostly in wine and game farms
- Nonetheless sales prices generally track international markets rather than local cost of production – why?
  - Farm associations, storage/logistics firms (often former coops) and SAFEX publicise only international prices - to some extent offsets power of much larger processing and retail chains
  - Tariffs on wheat and sugar

- Institutional capacity and skills:
  - Surviving farmers have substantial production and marketing expertise
  - Supported by dense institutional network
- Limited mobility but often weak succession planning
- Dependence on state
  - Land ownership and water licences
  - Land Bank, extension services, phytosanitary support, SAFEX

3. What do we really want from big business?

- We know the outcome – more like Sweden
  - ➢ Investment especially for industrial deepening
  - ➢ Job creation
  - ➢ More equitable ownership and control
- But what are specific, reasonable demands to make on industry?
- How ensure consistency across departments?

- Institutional basis of incoherence:
  - ➢ Equality by race/gender or class?
    - Black investors
    - Black industrialists
    - Collective, public, worker ownership
    - SMEs
  - ➢ Key departments have mandates entirely outside of economy (e.g. infrastructure, education, home affairs)
  - ➢ Inconsistency in measuring costs/benefits
    - Whose costs and benefits should count?
    - Ideological positions on benefits of free markets and big business
    - Inconsistent procedures for assessment
  - ➢ Lack of evaluation capacity aggravated by occasional resistance to listening to big business

Managing concentration

- Economies of scale are large relative to demand in many industries
- Need large, sophisticated companies to compete internationally – even just to manage export processes
- But
  - Relying on international prices for local raw materials producers mean they capture rents rather than improving SA's comparative advantage (e.g. iron ore, petrochemicals, soya)
  - Backbone of inequality in SA
- How do we regulate and incentivise to maintain strengths while ensuring developmental impact and greater equality?

- How to sustain and expand small/medium enterprise?
- Gaps in institutional support especially for new activities
- Challenges:
  - Mismatch between national departments/companies and small business – need meso-institutions such as clusters and marketing agencies
  - Existing companies cannot easily benefit from incentives if white owned - but not profitable enough to attract black investors

Re a leboha!