OWNERSHIP AND CONTROL IN SOUTH AFRICA UNDER BLACK RULE

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In an article published in this journal three years ago, Graham Barr, Jos Gerson, and I described the pattern of ownership and control of companies listed on the Johannesburg Stock Exchange (JSE).[1] At that time, five very large networks of South African companies, commonly referred to as "groups," exercised effective control over firms representing almost 80% of the value represented on the Johannesburg Stock Exchange. Three of these five groups were, and continue to be, controlled by the founders or their families.

Although this group structure has come under attack for a variety of reasons—and by critics ranging from the ANC to U.S. Trade Representative Mickey Kantor—we defended (and continue to defend) the South African group system as an efficient outcome of a largely voluntary process in which owner-managers compete for capital supplied mainly by South African institutional investors. My purpose in this paper is to update our analysis four years after the beginning of black majority rule in South Africa. During that period, the group system has been adapting to the pressure for greater black involvement in the established structure. Although greater black participation in South African corporate life holds out both challenges and opportunities for the SA economy, the structure of ownership and control that we described three years ago remains largely intact. What has changed, however, is that black entrepreneurs have since emerged, in a significant way, to make very effective use of the system. This development, loosely called "black empowerment," has clearly helped to legitimize the established financial structure for the new South Africa.

The removal of sanctions on doing business with South Africa and the relaxation of foreign exchange controls are also having important effects on the structure of South African business.[2] Although still highly diversified (at least by U.S. standards), many SA groups and individual companies are choosing to become more specialized, partly as a result of their greater freedom to invest and operate outside the country. Another potentially important factor in such decisions, however, has been the recent growth of foreign portfolio investment in SA companies. Since 1994, foreign investors have substantially increased their holdings of SA equities and Rand-denominated bonds. And such investors, who now account for a significant share of activity on the SA stock and bond exchanges,[3] may well push the groups toward greater specialization. But because both of these important trends were well anticipated in our earlier paper, I here concentrate on the current issues surrounding ownership and control.

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1. "Shareholders as Agents and Principals: The Case for South Africa's Corporate Governance System," *Journal of Applied Corporate Finance*, Vol. 8 No. 1 (Spring 1995).

2. For a survey of some of the recent developments of this kind, see "SA Giants, The Next Generation," Financial Mail Survey, Supplement to the *Financial Mail* (December 5, 1997).

3. After declining by R5.1 billion ($1.9 billion) in 1990 and 1991, net foreign portfolio flows to South Africa have been increasing significantly. Net inflows of R61.9 billion ($14.5 billion) were recorded between 1992 and October 1997. Source: SA Reserve Bank.

THE STRUCTURE THEN AND LARGELY NOW: SOME CRITICAL FEATURES

The Concentration of Control—But Not Ownership

Perhaps the most important feature of South African corporate structure has been the extent to which the JSE listings, measured by market capitalization, have been dominated by companies clearly under the control of a single powerful shareholder. By "control" I mean the power to appoint the board of directors and, hence, the senior executives of the listed company. In this sense, the typical large JSE listed company is "shareholder-controlled" rather than "management-controlled," as in the U.S. or U.K. Strong shareholders rather than strong managers have dominated the corporate environment in South Africa.

These powerful controlling shareholders also typically exercise control over a number of other companies operating in a variety of sectors of the SA economy. These alliances of companies, each with a single controlling shareholder, constitute what is recognized as a South African "group." Five such groups continue to dominate the JSE. The Anglo American-De Beers group, which is controlled by the Oppenheimer family and associates, has long been the largest; as recently as 1995, Anglo-American exercised shareholder control over about 40% of the value of the JSE. Another large group of companies is the Rembrandt group, founded by the Rupert family, which in 1995 had about 10% of the JSE under its control. Groups controlled by the three large life insurance houses are the other members of the big five. In 1995, the Sanlam mutual life insurance company controlled about 13% of the JSE; the Old Mutual, South Africa's largest insurance company, controlled 9%; and Liberty Life, a listed insurance house, controlled 6%.

Perhaps even more striking, the controlling shareholders of the three large family-controlled groups exercised their control with a minority claim—and sometimes a very small minority claim—on the dividends generated by the companies they controlled. The Oppenheimers, for example, were estimated to own only about 8% of the Anglo American Corporation, while the Anglo American group of companies they controlled represented some 40% of the value of the JSE. The Rupert family alliance was estimated to own only about 5% of Rembrandt Holdings, the key company in its group. And the Gordon family controlled Liberty Life—a large equity life insurance company at the center of the Liberty Life group—with an ownership stake in that company of about 15%.

By contrast, the mutual life insurance companies, Old Mutual and Sanlam, typically held larger direct stakes in the companies they controlled.[4] The sheer size of their portfolios allowed them to hold relatively large shares—as much as 30%—of high-market cap companies while still maintaining well-diversified portfolios. Such a capacity to hold large stakes in major SA corporations and still retain a diversified portfolio is beyond the means of even families as wealthy as the Oppenheimers, Ruperts, and Gordons.

The important separation in the typical large South African JSE-listed company is thus not between the managers who control and the shareholders who own, as in the U.S. or U.K. Rather it is between a minority of shareholders who control and who usually manage, and a majority of other shareholders who receive the bulk of dividends and capital gains, but who have little effective power over the fortunes of the companies in which they hold the majority of shares. It should also be recognized, moreover, that while the companies within a group have a common controlling shareholder, the other sets of non-controlling shareholders in the individual group companies vary widely from company to company.

Although the family-owned groups have shown some signs of changing their corporate structure in the past few years, it is the mutual insurance companies, in particular, that now appear to be taking the boldest steps. Old Mutual and Sanlam, for example, recently announced their intention to convert from mutual into proprietary insurance and financial service companies. When listed on the JSE, they are likely to be among the very largest companies listed on the exchange. These mutual organizations are effectively management-controlled and, when their shares are listed, they will remain so.

4. Full details of ownership and control patterns on the JSE may be found in McGregor's, *Who Owns Whom in South Africa 1998*, 18th Edition (McGregors-Publishing, Aukland Park South Africa 1998).

The ability of controlling shareholders such as the Oppenheimers, Ruperts, and Gordons to attract capital from financial markets depended on their record and their reputation, which in turn reflected their success in producing superior economic earnings from the main operating companies they controlled.

They will have many outside shareholders, but few if any with the financial means to acquire a significant, let alone a controlling, holding. In fact, the largest shareholdings in these new listed insurance companies are likely to be in portfolios under the management of the companies themselves!

Along with its plan to list, Sanlam is pursuing a strategy designed to make it a focused financial services company while largely giving up its function as a controlling shareholder of industrial and mining companies. It has been in the process of restructuring its non-financial interests while ceding control to the managers of the new structures.

The Pattern of Share Ownership: The South African Group

Another important feature of the South African corporate landscape is that the majority of shares in the large JSE-listed company are owned by some form of long-term savings vehicle, generally a retirement or insurance fund. Perhaps 90% or more of the value of the JSE-listed shares are held in this way. This situation has resulted from the tendency of most of the savings of SA households to flow through pension funds and other private-sector retirement funds rather than the banks, a tendency that gathered enormous momentum during the high inflation of the 1970s. These savings were increasingly invested in equities, rather than bonds or cash, by the retirement fund managers. Public-sector employees have pension funds of their own, which were once invested exclusively in government fixed-interest securities. In the mid-80s, these funds were given the freedom to invest in equities, and today their assets too are managed mainly by the private sector.[5]

The propensity for SA savings to take the form of contributions to pension funds and retirement annuities can be explained largely by their significant tax advantages to the SA household over deposits with banks or purchases of mutual funds. Pension fund contributions are treated as deductions of personal taxable income, or as a business expense when payments are made by the employer (as in a U.S. 401(k) plan). Additional deposits with banks or purchases of mutual funds are not so advantaged and have to be made with after-tax income. Furthermore household interest—and (until 1995) dividend income—received directly by households is treated as ordinary income and taxed at the relevant (and high) marginal income tax rates. By contrast, the pension and retirement funds were not liable to any income taxation at all until 1996, when a tax of 17% on (just) the interest income of retirement funds was imposed.

During the 1970s and 1980s, unexpectedly high inflation in South Africa reduced the returns provided by fixed-interest securities, while JSE-listed equities managed to provide average returns well above the rate of inflation.[6] This experience, combined with the significant tax advantages of investing in equities and bonds through retirement plans, explains the remarkable growth of such funds. The retirement funds, managed largely by life insurance houses, have dominated these flows and thereby the ownership of shares on the JSE. And the fact that the country was, until recently, generally viewed as an undesirable venue for international investment is a further reason for the largely domestic, and institutional, character of share ownership in South Africa.

Probably because of this power of insurance companies to attract savings at the expense of the banking system, the few large South African banks have all become members of the different group structures. Each large bank can now point to a controlling SA shareholder. The Anglo American group acquired control of a large bank now called First National, when Barclays Bank disinvested from South Africa. Control of what was then the largest of the SA banks, Standard Bank, passed to Liberty Life when another London based bank, Standard and Chartered, disinvested from South Africa. The Rembrandt group also acquired a large bank, Volkas, which was later merged into a new grouping of banks, Associated Banks of South Africa (ABSA)—and after ABSA became the largest bank in South Africa, Sanlam acquired a controlling share holding in it. The Old Mutual also acquired full control of another large commercial bank, Nedbank, in the early 1980s, after a

5. For a full explanation of the sources and uses of South African savings, see Graham Barr and Brian Kantor, "The Changing Pattern of Saving in South Africa," *Studies in Economics and Econometrics*, 18 (1994), 59-76

6. In the period 1971 to 1980, the real annual returns, calculated monthly, generated by the JSE All Share Index (capital gains plus dividends) averaged 9.3% per annum, as compared to a negative return of 4% per annum from holding long-term government bonds over the same period. In the 1980s, the average return on the JSE was a real 6.8%, while bonds returned a negative 3.3%, on average, to the SA investor.

financial rescue operation involving the Reserve Bank of SA.

The insurance companies' relatively large and controlling stakes in corporate SA can be explained simply by the volume of the savings they attracted in relation to the size of the companies they could invest in. Attracting increased flows of savings from households was the essence of their business success, and exchange controls limited their investment options to South Africa. They did not shy away, however, from the opportunity to control companies, and there was clearly a degree of competition in their efforts to gain control of major companies when the opportunities presented themselves.

But the ability of the Oppenheimers, Ruperts, and Gordons to control, without owning, a large proportion of the value of the shares listed on the JSE—and thus to exercise influence over an important share of the South African economy—requires a somewhat different explanation. These controlling shareholders had to earn and retain the respect of the financial markets, especially from the managers of the retirement funds. Their ability to attract capital from financial markets depended on their capacity to produce superior economic earnings from the main operating companies they controlled. To be sure, much of the expansion of the successful operating companies, as well as the groups' diversification into unrelated sectors of the economy, would typically be internally financed. But the ability to raise additional outside capital, for whatever purpose, would depend critically on their standing as controlling shareholders in the financial markets.

Maintaining Control While Giving Up Ownership Claims

The process of securing control of a corporation without having to own a majority of the shares was effected through a complicated web of holding companies, cross-holdings, and voting trusts. The mechanism is essentially to form a holding company whose assets consist of at least a 50% holding in another company, typically a company that produces real goods and services. Voting control of the subsidiary company is maintained provided the controlling shareholder retains 50% or more of the holding company. The balance of the shares with a claim on the dividends of the subsidiary may be sold to a variety of willing partners at an agreed-upon price. The new partners willingly cede control but receive their full share of the dividends generated by the subsidiary.

Each additional layer of holding company that is introduced into the corporate structure reduces the ownership stake of the controlling shareholders still further, but without affecting their control. For example, if the controlling shareholders own 50% of the shares in a company that in turn owns 50% of the operating company, they will have reduced their ownership claim to 25% without giving up voting control of the operating company that is generating economic income.

This process can be repeated infinitely, as long as partners can be found to purchase what are in effect low-voting shares at the different levels of the structure. This "pyramiding" process is also made easier if the Stock Exchange authorities raise no objections to the listing of holding and "super holding" companies. But if such non-intervention has clearly encouraged the group structure by making shares in the holding company more tradable, decisions by the JSE and the South African system to refrain from taxing inter-company dividend flows have been essential to the group structure.

As we demonstrated in our earlier paper, the same result of raising outside capital without ceding control can be achieved directly through the issuance of low-voting shares. And, although the JSE has long been hostile to the concept, it has recently shown a much more permissive attitude toward the issuance of low-voting shares (known as "N" shares) by listed companies. In response to this new attitude, a number of holding companies have been collapsed and their shares replaced by low-voting shares in the underlying operating companies. This has made for a simpler structure—one that analysts have found easier to understand and to value.

Not coincidentally, black entrepreneurs in South Africa have taken advantage of this concession to "N" shares as well as making full use of the holding-company structure. Nevertheless, both the holding company system and the issuance of low-voting or "N" shares remain controversial with investors, especially those who are not affiliated with the groups. What's more, there is little doubt that but for the advent of black entrepreneurs on the JSE—and their success in making use of holding companies and "N" shares—the rules of the JSE would have become much more restrictive in this regard. In my judgment,

Skeptics of the holding company structure suggest that they are nothing more than "investment trusts" with controlling stakes in a variety of listed companies. But a careful look at their stock-price performance over the years suggests that they play a value-adding role in providing monitoring, financial, and other management services to their operating subsidiaries.

this would have been an unfortunate regulation of market activity.[7]

As we argued in our earlier paper, the holding companies have played an important role in the past development of the South African economy. Skeptics of the holding company structure suggest that they are nothing more than "investment trusts" with controlling stakes in a variety of listed companies. But, a more careful look at their stock-price performance over the years suggests that they play a value-adding role in providing monitoring and financial and other management services to their operating subsidiaries. The groups are also responsible for much of the "green-field" projects (the SA equivalent of U.S. venture capital) which, if they succeed, are taken to the stock exchange.[8]

THE ROLE OF THE RETIREMENT FUNDS

As mentioned, the majority of shares in the Anglo American, Rembrandt, and Liberty Life Corporations are held by a number of retirement funds. It was thus the managers of the retirement funds who had to be persuaded of the merits of owning what were in effect low-voting shares. Control without ownership could not succeed unless the majority owners were willing to own without control. This they clearly have been willing to do, at a market-determined price, agreeable to all sides of any transaction.

The price at which the fund managers were prepared to buy or hold the low-voting shares clearly had to promise a competitive, risk-adjusted rate of return. This logic would also apply, of course, to the purchases and sales of shares in companies over which they could have no realistic hope of exercising any direct control as shareholders. Listed companies, which were members of strongly controlled and independent groups, could and did offer superior returns to fund managers and so attracted wide investor support.

One of the key determinants of such investments' success is the skills and trustworthiness of the controlling shareholder. Judgments about the quality of shareholder control have to be made and, of course, some controlling shareholders have proved more capable in adding value for themselves and their majority partners than others. The Oppenheimers, Ruperts, and Gordons have all been outstanding successes in this regard. Many others in control of smaller companies, or groups, had the same ambition but not nearly the same success.

Like professional money managers in the U.S., then, the South African retirement funds compete with each other for funds to manage and invest, and the groups formed by the insurance companies themselves can be viewed as one outcome of that competition. That the market for retirement funds has been dominated by just a few firms is the result largely of competition for funds and for the best ways to invest them. And, in this sense, the current structure of ownership and control in SA can be understood as the result of a voluntary market process.

To be sure, it is an outcome quite different from the patterns of ownership and control that have prevailed in the U.S. and U.K. Nevertheless, the SA structure has considerable affinities with contemporary corporate structures in continental Europe, as well as Japan and Korea. It also has much in common with the corporate structures that dominated the U.S. economy before the rules and regulations intro-

7. For an account of the highly equivocal official attitude of the JSE to "N" shares and holding companies, see the statement in The 1996 Financial Markets Monitor, Profile Media, Johannesburg, 1996. The typical "N" share usually trades at a small discount to the full-voting shares.

8. The main evidence we offered for the efficiency of the SA group structure was to compare the returns to an investor in the different parent holding company of SA mining houses with the returns realized from a portfolio of their principal listed investments. The portfolio of listed investments was divided in the same proportion as their contributions to the net asset value (NAV) of the mining house. This was done in order to isolate the extra contribution of the group head office over and above the contribution made by the listed investments in which the mining house held a controlling stake. In each of the five major mining houses, Anglo-American, Anglo-Vaal, Gencor, JCI, and Gold Fields (GFA),the houses produced superior returns with slightly more risk than their listed investments between January 1989 and June 1995 (see Barr, Gerson, and Kantor (1995), cited in footnote 1).

Nevertheless, SA mining houses almost always trade at a (variable) discount to their own calculation of NAV. The houses provide estimates of their non-listed investments, which form a part of NAV. A comparison between this discount to NAV and that normally applicable to pure investment trusts is not valid. The typical investment trust holds listed assets over which it does not exercise control and for which it carries no financial or other responsibilities. Thus the value of the listed assets may be regarded as determined quite independently of the value of the investment trust. By contrast, a mining house may well decide to, or be expected to, support its listed subsidiary with finance, or in other ways that will add to the value of the listed investment and reduce the value of the group parent company. Of course, the reverse is not true in both cases. Changes in the value of the listed investments, which occur for any reason, will of course affect the value of the parent company and simulataneously influence the discount. An increase in the value of listed investments automatically reduces any measured discount to net asset value. (For a full treatment of the mechanics of net asset value calculations in SA, see Graham Barr and Brian Kantor, "The Discount to Net Asset Value, Unbundling, and Shareholder Interests," *De Ratione, The Research Journal of the Accountancy Profession in South Africa*, Vol. 8 No.1 (Winter 1994), p. 44.)

duced in the 1930s discouraged control without strictly proportional shareholdings.

One suggestive piece of evidence of the effectiveness of the SA corporate ownership structure comes in the form of the remarkable rise of Liberty Life itself, from its founding by Donald Gordon in the late 1960s to a very strong number three. Liberty had gained significant market share, not so much from the two giant mutuals, as from a large number of other competing insurance companies, as well as many independently managed company pension funds.

The extent of the competition to manage retirement funds in South Africa has become more obvious in recent years. The active marketing of competing financial products in SA today is one good indicator of competitive behavior. Another is the success of investment banks, including a number outside of the major groups, in establishing their own fund management subsidiaries (in some cases, by attracting new money from the major life insurance companies). As in the U.S., the SA financial press regularly publishes direct comparisons of the investment performance of the various fund managers. The trustees of pension funds, advised (as they are required to be) by their consulting actuaries, have shown themselves very willing to select new fund managers, if their established managers disappoint.

The Pros of the Conglomerate Structure

As noted earlier, the parent companies in South African groups typically hold controlling stakes in a variety of unrelated business activities. Such diversification serves the interests of the controlling shareholder, especially in the case of the family-controlled groups, where the controlling shareholders tend to have much of their personal wealth invested in the group. The use of group structures enabled the controlling shareholders to diversify the family wealth while still retaining control over it.

It is less obvious why the majority of noncontrolling shareholders were persuaded to invest in the parent companies of the groups. Such investors could just as easily have diversified their own portfolios—though perhaps incurring higher transactions costs—by choosing their own mix of more specialized companies. They could also have included in their portfolios any or all of the listed subsidiaries in one or more of the groups.

The parent company, however, had one particular quality that distinguished it from the individual operating companies: its success (or lack of it) reflected the effectiveness of the controlling shareholder in looking after his own wealth. The managers of SA funds have effectively decided that the benefits of participating as (completely) passive investors in the strategic investments of the controlling families more than compensate for the inefficiencies of the conglomerate structure. Or, to put it a little differently, outside shareholders could be viewed as trading off less-than-optimally diversified portfolios in exchange for the above-average returns the controlling shareholders were expected to deliver. Shareholders in General Electric or Warren Buffett's Berkshire-Hathaway would have no difficulty with such a notion.

OPPORTUNITY BECKONS IN THE NEW SOUTH AFRICA

The group structure and the concentration of the control and ownership of large SA corporations in the hands of English-speaking South Africans was once regarded with great hostility by Afrikaans (Dutch) speakers. When the Afrikaner nationalists gained political control in 1948, the groups were highly threatened by the new powers of that time. In the course of time, however, the group structures easily accommodated Afrikaner ambitions. Some of what became highly successful groups, the Sanlam and Rembrandt groups, were controlled by Afrikaners. The growing wealth of Afrikaners, also held largely in pension funds, became dependent on successful investments in other group-controlled companies. And, as the income and economic power gaps between the English and Afrikaners generally narrowed, the group structures ceased to be a major political issue.

But the advent of African nationalism reopened the issue. The ANC policy manifestos for the 1994 election were hostile to the perceived concentration of ownership in South Africa. But although legislation to break up the groups was proposed, neither this threat to the existing corporate structure, nor the threat to nationalize key industries, has been realized. Indeed, ANC policy has turned out to favor privatization of state-owned enterprises rather than further nationalization.

The same result of raising outside capital without ceding control can be achieved directly through the issuance of low-voting shares. And, although the JSE has long been hostile to the concept, it has recently shown a much more permissive attitude.

The recently issued government white paper on competition policy[9] contains little that could be regarded as overtly threatening to group structures. The document clearly expresses the government's intention that black South Africans be "empowered" as owners and controllers as well as managers of South African businesses, and that active measures be taken by established corporations and the government to achieve such an aim. But neither the size of corporations *per se* nor the group structures are cited as an obstacle to black progress; and there is little immediate prospect of any program of radical reform of the established system of corporate ownership and control.

The explanation for the ANC's change in attitude toward the groups in South Africa owes much to the success of black entrepreneurs (some with the help of political ties) both in gaining control of listed companies and in establishing groups of their own. Accomplishing transfers of control in this (partly political, partly economic) fashion has greatly accelerated what otherwise would have been a very gradual process of relying on growth in black incomes and savings.

Recent estimates put the value of black-controlled companies listed on the JSE at R150 billion ($30 billion), or about 10% of the market value of the JSE at the end of 1997.[10] And this enlargement of black ownership on the JSE has been achieved with the active encouragement of the established groups themselves. The groups (and group-linked banks) have facilitated black control through dispositions of some of their companies to black-controlled groups. They have also helped finance the establishment of both listed and unlisted black controlled-holding companies set up to secure control. Moreover, as mentioned earlier, extensive use of explicitly low-voting "N" shares has been made by black-controlled companies listed on the JSE.[11]

Some Details of Black Ventures—Successes and Failures

McGregor, the keeper of statistics on South African ownership and control, calculated that by the end of 1997 black-controlled companies controlled 10.3% of the market cap of the JSE.[12] This share had been gained mostly from the Anglo-American Group, whose share of the JSE, 40.5% in 1995, had fallen to 19.1% by the end of 1997.[13] Weaker gold and commodity prices played some part in reducing the Anglo share, but more significant was Anglo's decision to sell some of its most important industrial and mining interests, including its controlling stake in SA Breweries, South Africa's largest industrial company, to black empowerment consortia. These stakes had been held by JCI, an Anglo-controlled mining house. In 1996 JCI was broken up by Anglo into a mining arm, still called JCI, and an industrial arm, Johnnic, before the two parts were sold off to separate parties.

The consortium that took over Johnnic was led by Cyril Ramaphosa, who had been a strong candidate to succeed Nelson Mandela as head of the ANC and, presumably, of the South African government. Before becoming secretary general of the ANC, Ramaphosa had previously been the head of the National Union of Mineworkers, and thus a powerful figure in the Union movement. But when he lost the contest for senior-vice president of the ANC to Thabo Mbeki, Ramaphosa then left politics to go into business (though since the recent 1997 ANC Congress he has held the position of Chairman of the ANC's executive council).

After the spinoff and sale of Johnic, JCI (now just a mining company) was sold in 1996 to another black entrepreneur, Mzilikazi Khumalo, in the face of intense competition from other bidders, including a group led by Ramaphosa. Unlike Johnnic, with its largely industrial interests, this particular purchase—made in mid-1996, when the gold price was significantly higher—has proved to be somewhat of a disaster for the investors in it. JCI shares now stand at less than half their purchase price, and the company is in the process of liquidating all of its assets. Khumalo himself now seems completely out of favor with the capital market and his own shareholders, who may well succeed in ousting him as chairman.

But, in contrast to this case of failure are several notable black-empowerment success stories where significant value has been added for all shareholders. The most successful have been ventures in life

9. "Proposed Guidelines for Competition Policy, A Framework for Competition, Competitiveness and Development," Department of Trade and Industry, Pretoria 27th November 1997.

10. *Business Day* (1/19/98), "Market Confidence Seen in 'Black Chips.'"

11. Full details of capital raising exercises on the JSE are published in the Monthly JSE Stock Exchange Bulletins.

12. McGregor's (1998), cited earlier.

13. *Sunday Times*, Johannesburg, February 1, 1998.

insurance and financial services. Under the direction of Dr. Nthato Motlana, National African Investments Limited (Nail) has been very successful by virtue of its controlling share of a life insurance company, Metlife, which it acquired from Sanlam. Don Ncube's Real Africa Holdings, with its core holding in African Life, is another successful example of successful black investment in life insurance and financial services companies.

PLUS ÇA CHANGE

It should be emphasized that what has changed to a degree in SA and on the JSE is the *composition* of the controllers of listed companies. The *ownership* of the shares of the new black-controlled companies, as well as ownership of the well-established companies sold to new black controllers, has remained essentially unchanged. That is, the dominant owners continue to be the same set of retirement funds that owned the companies before the onset of black political dominance. In essence, the retirement funds as an industry have simply exchanged shares in what had been companies controlled by whites for shares in companies now controlled by blacks. In many such transactions, the shares in the companies being sold by the established controllers were sold at a discount to prevailing market values, thus creating losses for their holders. But the shares issued by the new black-controlled companies in exchange for these assets were taken up largely—and voluntarily (at an agreed-upon price)—by the same retirement funds. For the owners, then, except for any loss suffered during the change in control, such transactions represent a zero-sum exercise—and any losses they may have suffered will be offset to the extent the new owners succeed in adding value to the businesses.

The reasons for such elaborate arrangements are obvious enough. The controllers of the large established groups realized full well that their own survival depended ultimately upon support from blacks. Introducing blacks as controllers of important companies would clearly help legitimize the prevailing structures. Furthermore, it was hoped that blacks had much to contribute to the effective control and management of South African business.

The potential new black controllers and partners would typically lack the personal wealth that would enable them to purchase even a small controlling stake in a significant listed company. Such purchases had to be financed. The typical black empowerment deal therefore involves considerable debt financing—at multiple levels of the holding companies, some listed, others private—secured by the shares in the underlying operating companies.[14] These loans are provided by banks or retirement funds. In effect, the empowerment partners—typically one leading figure backed by a consortium of investors—were provided a debt-financed option on the future of the operating enterprises they were given control over. The consortiums of black empowerment investors often included funds set up by Trade Unions specifically for that purpose, as well as funds established by women's groups and large numbers of smaller black investors drawn from the expanding black middle class. Thus, there are few remaining ideological barriers to share ownership in the new South Africa.

The idea of investing in shares has now become widely accepted in black communities that once viewed the Stock Exchange as a bastion of exclusive white interests. In this fashion—that is, through direct encouragement of black involvement as controllers, if not as yet large owners of JSE-listed enterprises—a very real and tangible black interest has been established in the SA capital market. Not only has a politically influential interest been established in the success of particular enterprises controlled (and partly owned) by blacks, but there is now a broad-based and direct black interest in the market economy generally—one for which the Stock Exchange acts as an important gauge of value.

The black share of the funds under management by pension and retirement funds is also rising along with growing black incomes and increasing black participation in the SA economy. The effects of this form of shareholder democracy are perhaps less visible at the moment. But, in the long run, share ownership is bound to be a more important a source

14. The oganagram, the diagram that indicates the pattern of shareholdings and crossholdings in the group, that is produced by McGregors for the Nail group is highly instructive in this regard. The three principal and jointly controlling partners in this substantial and successful venture each hold less than three per cent of Metlife, the key operating company of the group. (McGregor's (1998), cited earlier).

In the long run, share ownership is bound to be a more important source of black wealth than the successes of the inevitably few black entrepreneurs controlling large stakes on the JSE.

of black wealth than the successes of the inevitably few black entrepreneurs controlling large stakes on the JSE. The black-controlled financial services groups are also making strong efforts to enter the fund management business.

The opportunity for black South Africans to acquire these controlling stakes in listed companies had everything to do with their greatly enhanced political influence. But the success of their JSE-linked ventures will still depend, as it has in the past, on good management. To be sure, the SA government is establishing procurement policies designed to favor black involvement. And the ability to attract business from government remains another artificial influence on business success in SA—one that is rarely consistent with economic efficiency. Nevertheless, the ultimate success of black-controlled companies will depend on their ability to compete in the markets for goods, services, and labor. The success (or lack of it) achieved in competitive markets, as demonstrated by the stock-market performance of the black-controlled operating companies, remains critical for the controllers ability to attract further capital over time. The failure of JCI proves this point.

SOME CAVEATS

The SA system has proved very adaptable to black interests in the control and ownership of important South African businesses. That blacks can and do participate at the highest levels of SA corporate life as controllers and managers of important enterprises is essential if the system, as we know it, is to survive. Being able to control without having to own has facilitated black involvement in the economy. Without this, the system might have proved highly vulnerable to drastic and damaging intervention by the State.

At its best, black participation will add to the competitive strengths of the economy. At its worst, it could degenerate into a form of "crony capitalism" where participation in wealth creation—or, more aptly, redistribution—has little to do with economic value added. As I have argued, strong controlling shareholders with minority ownership rights have played and can continue to play a very helpful role in South Africa. They have been an essential part of a *market-determined* process and they will hopefully continue to be an important part of the competitive market at work.

But there are dangers in these group relationships, as recent experiences in South Korea have demonstrated. In South Korea, there was an ultimately damaging alliance of the parties that allocated capital for investment and the firms that committed that capital to particular investment projects. The banks that supplied much of the capital for investment were unable to exercise their independent judgment about the firms undertaking the investment.

In South Africa, as compared to South Korea, much less reliance has been placed on loan finance and much more on equity finance. Corporate debt ratios have remained very low on average. Much of the additional equity capital for investment has been generated by the established operating companies. Additional equity capital has been raised from the retirement funds, while the share market has "kept score" on the quality of the investment decisions. The retirement funds have remained largely independent in their investment decisions and it would appear that. as the degree of competition to manage funds has intensified, such independence has increased.

Clearly, a well-functioning capital market is an essential ingredient for a well-functioning economy. The task of the capital market is to ensure that capital or savings is allocated to those entrepreneurs or firms most capable of putting it its highest-valued use. The market in capital helps determine the quality of investment spending upon which so many people depend for the growth in their incomes and consumption. Most black South Africans, like their white counterparts, will depend as workers and consumers, savers, and tax payers, on the success with which their scarce savings are invested. Black empowerment will be properly measured by the growth in incomes and spending power of millions of black families. The incomes of the elite group of successful black entrepreneurs, whose achievements are registered on the JSE will be symbolically important, and a source of black pride, but will form a practically insignificant part of black incomes generally.

Real economic empowerment will therefore be achieved most easily if black entrepreneurs are required to compete as fairly and as openly as possible for capital to invest with all comers. An important and valuable feature of the SA economy is the role played by private-sector retirement funds. They command the bulk of household savings. Because they hold the bulk of the shares outstand-

ing, they also benefit when increases in the value of the shares they own help to increase the flow of corporate savings that are reinvested on behalf of shareholders.

These retirement funds are therefore the essential guardians of South African savings and investment. Through their decisions to allocate savings, such funds can largely determine the roles played by competing managers and controlling shareholders who will ask for their support. It is therefore very important for South Africa that the managers of retirement funds be forced to compete vigorously for funds to manage on the basis of prospective returns on the savings invested. With time these savings will increasingly be black savings; and the quality of life of an increasing number of black workers and their families, especially in retirement, will depend on the success with which their savings are invested. Let us hope that the trustees and the managers of retirement funds will not let them down.

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