Kingston University London

Small & big business in South Africa:

The importance of firm heterogeneity for financialisation

Financial operations of non-financial firms (NFFs)

Why do South African NFFs amass cash holdings?

Why does this matter?

Overly simplistic portrayal of firms

Lack of understanding firms' operations

Merit in understanding economic processes ('realisticness' of assumptions)

Crucial for policy making: What is it that needs fixing?

Outline

Financialisation literature

Method

South African case study: JSE-listed firms

Key findings: M&As and 'real' asset speculation

Relevance for theory and policy

Financialisation theories

Definition:

‘the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies’ (Epstein, 2005)

Sectoral classification of theories is possible (based on Stockhammer, 2012):

→ **Financialisation of the (non-financial) firm**

→ **Financialisation of financial markets**

→ **Financialisation of the household (everyday life)**

→ **Financialisation from the open economy perspective (emerging markets/ middle income countries)**

Financialisation of the non-financial firm

Rise of ‘shareholder value’ (Lazonick & O’Sullivan, 2000):

Changing investment strategy: short-termism & financial investment

Two stories:

Rise of the Keynesian ‘rentier’ (Stockhammer, 2004):

Reduction of retained earnings available for investment

vs.

Declining profitability of ‘productive’ investment & shift towards finance (Krippner, 2000)

Kingston University London

Financialisation of the non-financial firm

Clear distinction between 'real' and 'financial'

Plus: Financial speculation!

Often implicit (see Epstein, 2012)

Explicit in emerging market research strand:

- Demir (2007, 2009) for Argentina, Mexico and Turkey
- Farhi & Borghi (2009) for Brazil
- Correa, Vidal & Marshall (2012) for Mexico
- Ashman & Fine (2013) for South Africa

I use Keynes's definition of speculation: investment aimed at capital gains (vs. income stream)

Financialisation of the non-financial firm

What is missing? **Firm heterogeneity**

- Focus on listed companies or aggregates
- Limited work on SMEs (Lapavitsas & Powell, 2011, Tan, 2010)
- Few sectoral studies:
    - automotive industry: Kädtler & Sperling, 2002, Sinapi & Jacquin, 2010
    - retailers: Baud & Durand, 2012
    - agriculture: Burch & Lawrence, 2013

Firm heterogeneity & method

Inspired by **Josef Steindl**'s work on firm heterogeneity

- Firms differ by firm size
- …and by pattern of competition
- The latter is a qualitative distinction

…and **Edith Penrose**'s emphasis on real life firms

- Focus on empirics (inductive approach)
- Qualitative work (e.g. cash study)

The case study: JSE-listed firms

Study of firms listed on Johannesburg Stock Exchange (JSE)

Why South Africa?

- Relatively deep & old financial markets
- Perceived to be highly financialised (Marais, 2011, Ashman, Fine, & Newman, 2011, Rodrigues Teles Sampaio, 2012, Ashman & Fine, 2013, Ashman, Mohamed, & Newman, 2013, Isaacs, 2014, Newman, 2014)
- Especially large non-financial firms
- And this has a dimension of political explosiveness
  - **Investment strike** (Mbindwane, 2015, Times Live, 2016, COSATU, 2016)

JSE-listed firms: Identifying case studies

Focus on firms with high cash ratios

$$Cash\ ratio = \frac{Cash\ and\ cash\ equivalents}{Total\ current\ liabilities} \geq 1$$

129 case studies of companies listed 1970-2012

Cash holding companies by sector

Sector	Portion of NFFs with cash ratio of 100%+	Number of firms	Total number of firms
Basic materials	30%	59	194
Consumer goods	5%	11	100
Consumer services	9%	15	175
Health care	14%	3	21
Industrials	9%	21	241
Oil & gas	40%	2	5
Technology	23%	17	73
Telecommunications	20%	1	10
Utilities	0%	0	2
Total	16%	129	825

Source: INET BFA,
Note: complete coverage for 1994-2012

Case studies

Comprehensive balance sheet analysis

Detailed analysis of firms'

- Financial statements (balance sheet & cash flow)
- Notes to financial statements
- Annual reports (esp. CEOs & CFOs letters)
- Any other additional (e.g. SENS announcements)

Firm characteristics

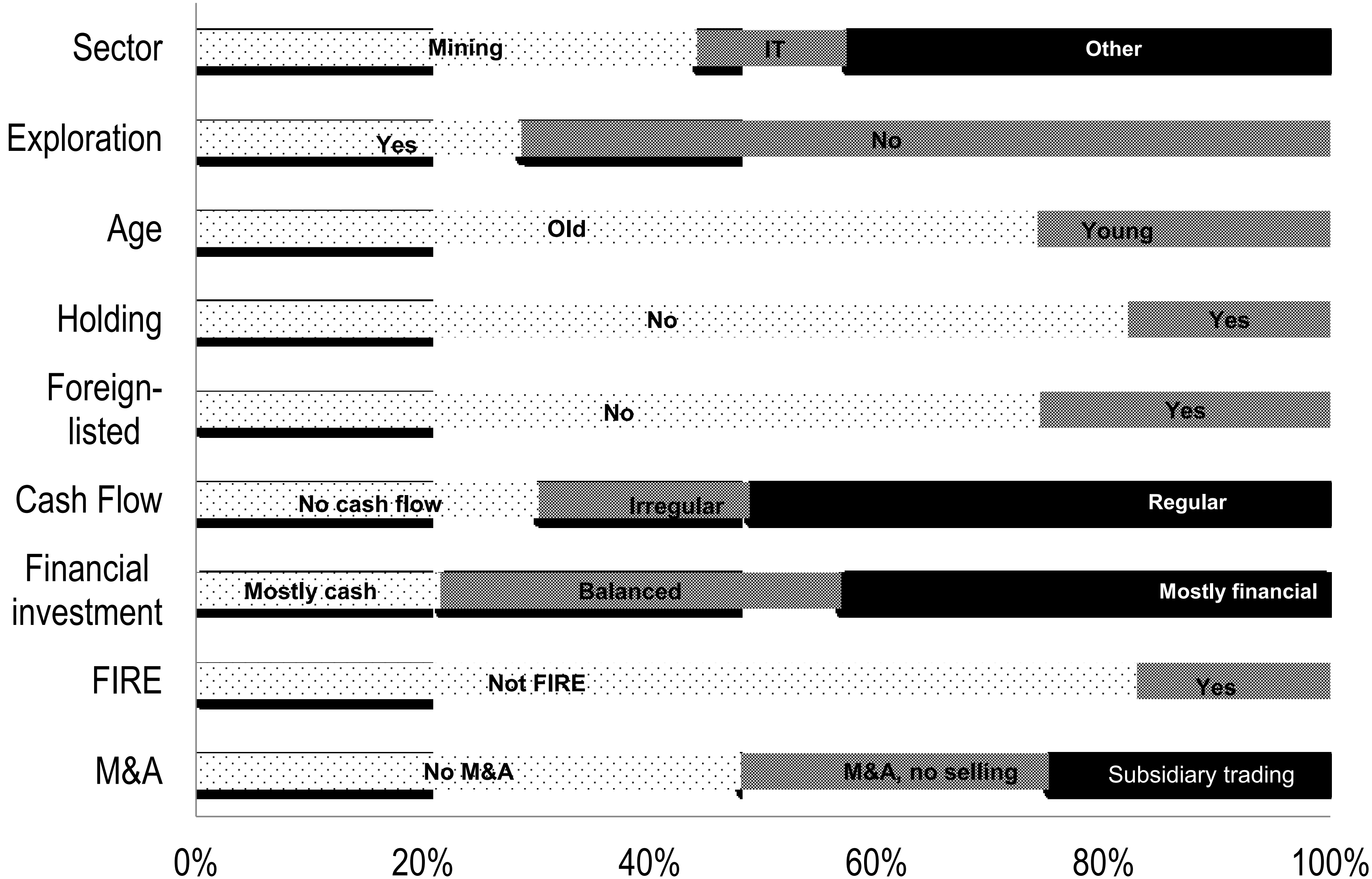
- Sector/industry of activity
- Firm age
- Regularity of cash flow
- Diversified holding company
- Foreign listed
- Financial investment
- Involvement in FIRE sector
- Active M&A strategy

General characteristics

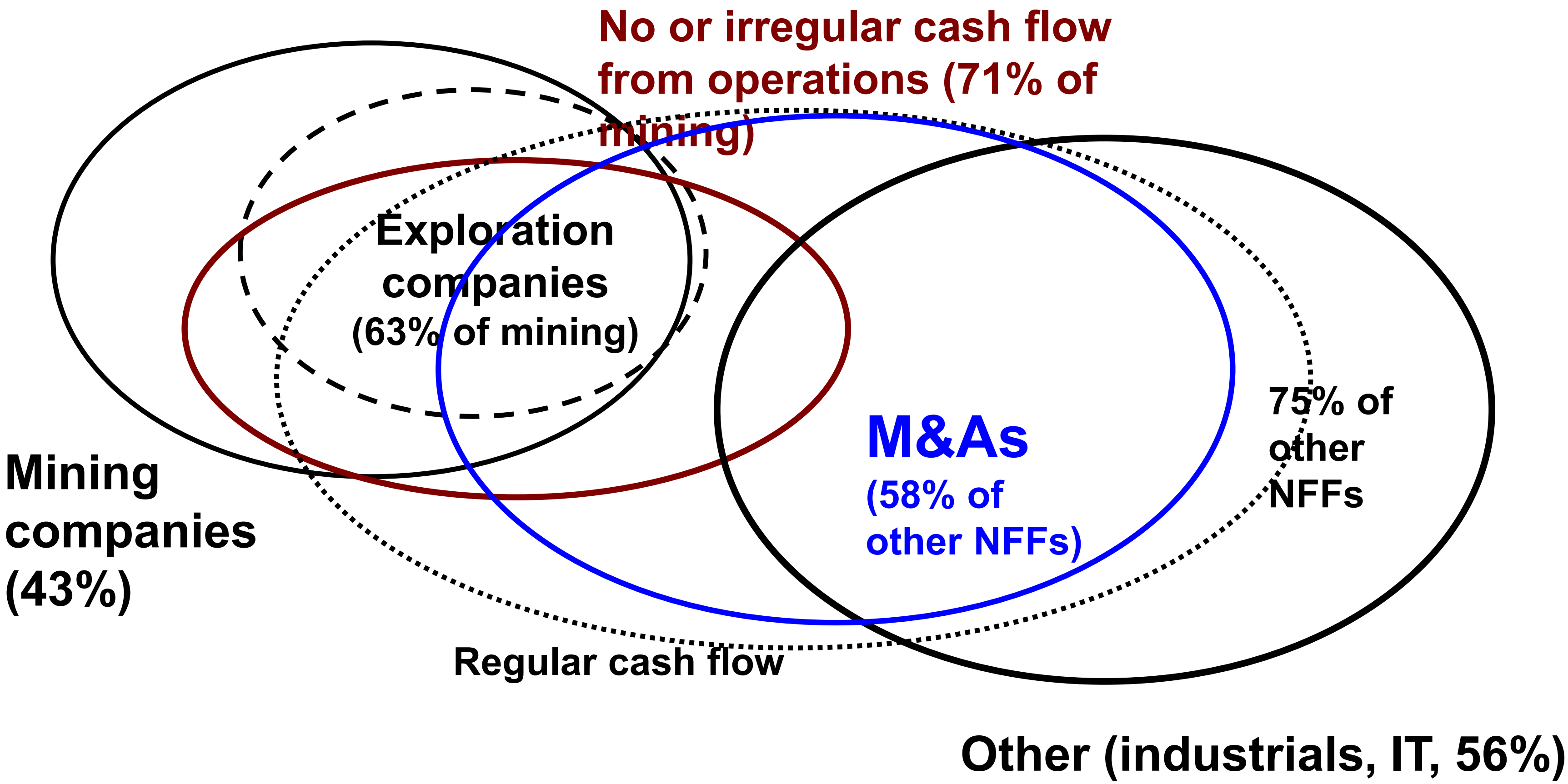
South Africa-specific characteristics

Variables based on financialisation literature

Firm characteristics: 129 JSE-listed NFFs



Two main drivers of cash holdings



Miranda Mineral Holding (2008)

"…an exploration company is by nature a consumer of cash, and not particularly fashionable during times when liquidity is tight."

Mergers & acquisitions as main driver of liquidity

UCS Group (1998)

"Our group has large cash reserves with no borrowings, allowing us to benefit from the current high interest rates as well as giving us the opportunity to consider cash-based acquisitions."

Paracon (2000)

"The balance sheet is strong with cash reserves in excess of R84,6 million, which provides a solid platform for growth and expansion."

Mvelaphanda Resources (2004)

"…your company's R219 million cash position provides significant flexibility for future growth through acquisition and project development."

Diamond Corp PLC (2008)

"We remain on the look-out [for acquisitions] as current markets provide impetus for consolidation and favour those with capital, or access to capital, together with the particular skill set such as ours that can transform a project into a mine."

ARB Holding (2011)

"With an ungeared balance sheet and significant cash resources, the group is well placed to capitalise on the acquisition opportunities which the current economic climate is expected to yield."

M&As for growth or capital gains?

- 50% of ‘other’ NFFs engaged in M&A activity sell off subsidiaries and/or shares in associate companies.
- Blurred distinction between financial and real investment (UN definition: <10% is portfolio investment, 10%+ FDI)
- This is visible on balance sheets (shift of ‘real’ non-current assets into current assets – for sale)
- **“As you know, a substantial proportion of Lonrho's funds are invested in the capital intensive mining and hotel sectors, both of which are noted more for long term capital appreciation than substantial operating cash flow.” (Lonrho, 1996)**
- Evidence for speculation in ‘real’ assets

Relevance for theory & policy

- Sector-specific (and geographic) characteristics influence firms’ operations
- There is no sharp distinction between financial and real operations of firms
- Evidence that firms speculate in real assets

What does that mean for policy?

- Simply regulating the financial sector won’t be enough
- Close look at (& regulation of) large NFFs is necessary