Interfaces

Why have an Industrial Development Corporation . . . after 40 years?

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Introduction

Before trying to answer the question which has been posed, 'Why still have a state corporation (the IDC) to assist industrial development in SA?', I must first cite a few basics about the IDC.

It was constituted by an Act of Parliament in 1940, with the state as the only shareholder. At that stage there were mining houses to support the mining industry and the Land Bank to support the farming community; but no institution dedicated to financing the industrial sector. Pioneers in industry and industrial finance, such as Hendrik van der Byl, Hendrik van Eck and Sieg Kuschke had to start from scratch.

In preparing a bill for Parliament the legislature displayed an exceptional amount of good common sense and directly or indirectly introduced some very useful facets. I shall quote some of these to you:

- No members of Parliament may serve on the board. The government may only appoint experts in the field of industry and finance. In its 40 years of existence, Mr Kitshoff has been the only director appointed from the ranks of the civil service, all other directors have been from the private sector or from the IDC executive.
- In evaluating applications for assistance, only economic merit can be used as a yardstick. Race and colour play no role.
- Dealings with clients remain completely confidential; a report is tabled annually in Parliament, but only in general terms.
- The objectives of the IDC are to promote industrial development through the establishment of new ventures, and assisting with expansion, modernization and rationalization schemes.
- All this must be undertaken preferably in partnership with companies from the private sector, but not necessarily exclusively so.
- From its inception, the IDC has been run as a normal company, subject to all requirements of the Companies Act.
- In addition, legislation required that the IDC had to strive for profits in order to build up a strong balance sheet, not only as a basis for obtaining loans, but to finance and pay for, *inter alia*, non-profitable developmental aspects of its brief. The IDC has not yet turned down a single application for finance because of a lack of funds, but only for other reasons, such as non-profitability, a weak structure or lack of firm markets.

The role of the IDC

From the start, the IDC saw its role as complementary to and supportive of the private sector, whether it meant tackling new projects, or acting as a catalyst. Once projects were under way, the IDC would gradually phase itself out, and the companies would be taken over by the private sector concerned in the venture for which an application had been made.

Thus the IDC continuously identified specific gaps in industry, and aimed to introduce new technology into the country. In this way, for example, SASOL was established in the fifties, 20 years ahead of the oil crisis that hit the world in the mid-seventies; a carbon-black factory was established to provide a raw material for synthetic rubber in anticipation of boycotts of natural rubber; and massive investment has now been made in the production of diesel engines to ensure that food production and our country's vital road transport system cannot be crippled by outside forces beyond our control.

More and more the IDC has taken the initiative by preparing in-depth studies regarding sub-sectors of industry, promoting the beneficiation of our minerals and exports in general, developing strategies for the decentralization of industry without unnecessarily inhibiting metropolitan growth; and in regard to many other such projects where a normal state department cannot see the wood for the trees.

However, South Africa has now reached a stage in its development quite different from that of the 1940s. The country has already completed the phases of producing consumer products and capital goods, and has now entered the phase of high technology and sophistication. In the realm of finance the present position is such that the commercial banks, the merchant banks, insurance companies and other institutions have all become investors in industry in one form or another. The IDC is no longer on its own. Should it continue? Is a state corporation still necessary?

I maintain, firstly, that as long as we have a dualistic economic system of developed (mature) and underdeveloped levels of society, there will be a need for a development corporation such as the IDC.

Secondly, I maintain that the IDC is no longer a 'state' corporation, but part and parcel of the private sector, and a staunch ally at that. Let me explain by putting the following facts before you.

The IDC — ally of the private sector

The IDC's balance sheet

How and where does the IDC obtain its capital? On June 30, 1981, total assets reached just over two billion rand. Of this amount more than R1 700 million was applied to the financing of industrial undertakings. These assets were funded by share capital of R977 million, and together with reserves, the IDC's shareholders' funds amount to R1 241 million, that is 62% of assets.

Loans and short-term credits total R766 million (or 38% of assets), which illustrates how its strong financial structure enables the IDC to raise loans in both overseas and local money markets without any government support or guarantees. Our loan debt consists of:

Foreign loans of just over R200 million; locally registered loan stock of R166 million; and finance notes from local banks to fund export credits of R310 million.

Our share capital of approximately R1 000 million refers to:

IDC's shareholding in the SASOL Group : ± 50%
in industries in decentralised areas : ± 30%,

but in regard to general industries, our shareholding is only R26 million or 3% of the total share capital. This illustrates the IDC's philosophy that normal industry requires and prefers a straight lender, and that we, the IDC, should not insist on being an equity partner. However, in the case of new ventures where the private sector has been reluctant to take the plunge because of high risk but where the IDC believed in the economic viability of the project, it has never hesitated to provide equity capital and to underwrite such ventures.

If I may return to the financing of normal industries, that is where commercial interest rates apply, it is important to note that, although the IDC was founded in 1940 as a state corporation, the state made share capital available only up to 1954. At that stage, an accumulated R26 million had been obtained from the state as share capital, but repayments, interest received and profits made the IDC thenceforth self-financing in regard to industries. Thus, since 1954, the IDC has financed normal, non-subsidized industries *without any further support from the state whatsoever*. The amount so invested totals R520 million. This means that with the original R26 million obtained from the state, the IDC assisted industry to the tune of R520 million; a 20-fold increase.

To mid-1981, advances to industries (excluding SASOL, which is a special case) totalled R310 million. This was sourced by:

- repayments and redemptions of R200 million.
- net income after tax (profit) of R60 million.

In other words, we were able to finance 84% of our requirements from internal cash resources within that year.

Self-financing even applies to subsidized industries, since here the IDC has now also become virtually independent of state capital. The programme for the decentralization of industry has reached a stage where it has become selfsufficient. Only if the new incentives for decentralization that are expected to be announced by the Prime Minister in November (1981) lead to a substantial investment in decentralized areas, we may again require a modest provision of share capital from the state to fund such subsidized loans.

This independence from government support has left the IDC free to operate on its own, and to decide on ventures without requiring government approval. There is now no state interference at all in our affairs.

Since our only objective is to promote industrial development on sound economic and commercial grounds, we see ourselves as just another financial institution. It may be asked, but is the role of the IDC not so dominant that it makes life difficult for other private sector institutions to obtain a fair share of the market? Let us therefore look at the role of the IDC in the private sector.

Analysis of the IDC's role in manufacturing industry

Over the past four years (1977 – 80) the average fixed investment in manufacturing industry, that is for the country as a whole, was approximately R2 500 million per annum. The average for the IDC was R225 million per annum or 9% of the total, that means less than 10% of the finance in fixed investment in industry was supplied by the IDC.

When criticism is levelled at the role of state corporations in manufacturing industry, it is based on the fact that the share of the public sector in manufacturing industry has been as high as 43% over the last four years. But this includes investment in SASOL 2 and SASOL 3, the expansion undertaken by ISCOR, and new Armscor industries, all largely 'special' ventures. To claim that this is proof of increased socialistic tendencies in South Africa is a distortion of the truth. SASOL I has become a private sector industry and Armscor is already leaning very heavily on private industries to provide their requirements.

But to return to the IDC: we *do* establish industrial enterprises where we are the only shareholder, and I shall return to this later on. At this stage I should merely like to indicate that of the amount the IDC invested in industry over the last four years, R744 million (or 84%) was in companies in which the IDC has no shareholding, and R142 million (or only 16%) in companies where the IDC is a shareholder. This is probably one of the reasons why firms in the private sector in many instances prefer the IDC to other sources of finance — because of our willingness to be a straight lender without taking a share in their business.

A development institution

The IDC tries to live up to its name, that of a development institution. This implies assisting industry to operate in an environment which is not normal, nor developed. These include the following types of developmental operations:

- where an industry is prepared to establish in an economically-depressed area, which requires special measures to compensate for imbalances or disadvantages (that is the decentralization scheme as it is generally known);
- where an industry is established in an area where its market is protected against outsiders, but where the infrastructure is undeveloped, such as is the case in group areas and in urban black areas, of which Greater Soweto is a prime example;
- where an industry has to be assisted in developing new and permanent export markets; or
- where local industry must be put in a position from which it can compete for export business on credit terms equal to those offered by competitors from other export countries.

In the case of the decentralization scheme, the prime motivations are to create new job opportunities and to obtain a better spread of economic activity. In the case of the group areas and the black urban areas, the task is to create and develop entrepreneurship and to acquaint these people with the private enterprise system. In the case of export promotion, assistance is motivated by the premise that South Africa's ability to survive economically will depend largely on the measure of its exports and earnings of foreign exchange.

Measured against these norms, an analysis of IDC's assistance over the past four years indicates that:

- 25% of our investment has been in industries in decentralized areas;
- 35% has been for the creation of export capacity and the financing of capital goods for export; and
- 40% for normal industries.

Sixty percent of the IDC's investment has therefore been directly coupled with developmental assistance, where normally the private sector is hesitant to operate, or incapable of doing so on their own. Of the remaining 40%, a fair proportion of our assistance has been in the field of new ventures, especially in the chemical sector.

New capital of R1 300 million was introduced over the last 16 years in industries in certain growth points, which created 117 000 new jobs in industry. If the multiplier effect is taken into consideration and a conservative multiplier of 2 is used (to allow for all those employed in housing, education, transport, shopping and other tertiary activities) as a result of those employed in industry, it means that more than 200 000 new households have been provided with a permanent income, of which 90% or more are blacks. At the same time, some 4 600 houses were built for white key personnel moving from the cities to these outlying districts. You can imagine the contribution which 4 600 new white families can make to the future of these rural towns.

'Normal' assistance: popularity of the IDC

I have referred to the fact that some 40% of the IDC's assistance can still be classified as being normal or not necessarily of a developmental nature. Why is this the case, especially in view of all the other existing financial institutions? In my view there are two reasons for IDC's popularity:

The first is: *Once an IDC borrower always an IDC borrower.* Our existing interests return to us every time they expand. The reasons for this 'popularity' seems to be:

- the IDC is a medium- to long-term lender (seven to ten years): most other institutions prefer shorter periods;
- our interest rates are fixed and the lender can budget ahead for servicing his debt: most other institutions have variable rates of interest;
- the IDC is prepared to take the long-term view and offer a number of years of no redemption to assist the industry in getting settled;
- and industrialists prefer our policy of non-interference. This policy includes, *inter alia*, our non-insistence on an IDC director on the board or equity participation; our acting as lenders and not as investors; and our non-interference with the policy of the company or the way it is managed.

In other words, it can be said that since the IDC has, relatively, so few shareholdings in other companies, that its neutrality makes it a perfect sleeping partner for many industrial concerns.

The second reason for IDC's popularity is something completely different: *the value to the industrialist of an IDC investigation*. Where other institutions, when approached for finance, would look at the balance sheet and the security that can be offered, and on the strength of such information, take their decision, the IDC undertakes an in-depth investigation of the company and assesses its technical know-how, its marketing effectiveness, its financial structure and built-in ability to survive an unforseen crisis, as well as the quality of its management. These investigations enable the investigating teams (drawn from numerous disciplines such as CAs, engineers, marketing experts, economists, geologists and others) to establish income security, in other words, the ability to service debts from income rather than necessarily taking capital security. Such an investigation, which includes operating budgets for future years, enables us to tailor the company's repayment period accordingly, after allowing a considerable leeway for growth from profits.

This 'second opinion' can either be a useful endorsement of the management's own study and projections, or could be a timeous warning not to proceed. Either way it is a very useful service to industry. In-house training of our investigating teams is based on 40 years of experience and has proved to be so successful that we lose many of our staff to the financial world. But we do not take this too badly: our loss is someone else's gain, and the country benefits generally.

Our popularity is not limited to certain sectors of industry, but covers the whole spectrum. Because of the capital-intensive nature of the chemical sector, it heads the list in terms of monetary assistance, closely followed by motor vehicle components, non-ferrous metals, textiles and clothing, basic iron and steel products, electrical machinery and electronics, paper and pulp, and food and beverages. These industries include all of those that use or beneficiate the country's agricultural, afforestation and mineral resources.

The IDC as a majority shareholder

I have said that 15% of the IDC's investment has been in respect of subsidiaries where the IDC has the majority shareholding. These new ventures initiated by us are called projects.

South Africa has now entered the phase of high-technology industries and it is essential that the private sector should join the IDC in making a greater contribution in providing risk capital. High-technology projects are essential in meeting the country's need for greater self-sufficiency, especially in areas where it could be subjected to political pressures from overseas suppliers. There is still an alarming lack of sophisticated machine tools, forging facilities and electrical and electronic equipment in this country to safeguard us against economic disruption. The advancement of the electronic industry worldwide is of such a nature that unless South Africa shares in the technological development associated with it, the local content of the electronic industry will decrease rather than increase. Electronics, especially micro-electronic components and miniaturization, lie at the heart of all future industrial processes, and unless these components are manufactured and used locally, our whole industrial sector could become extremely vulnerable.

South Africa has already gone a long way towards making itself less dependent on imported crude oil. But the growth in the economy and the concomitant increase in the number of vehicles in the transport sector which plays such a vital role in the infrastructure of the country, make it imperative that the programme for providing substitute fuels be pursued with diligence even after SASOL 3 has been completed. This will include the further beneficiation of coal, but along more advanced chemical routes, as well as the exploitation of other biomass energy methods.

The IDC is constantly reviewing the various subsectors of industry to establish new needs. Desk studies are used to forecast the time when market and other factors will make the establishment of new industries economically viable. When the time arrives, the appropriate know-how is selected and local partners are introduced. This is the preferred route for a project. But if the private sector is hesitant, the IDC is prepared to underwrite such a project. This is what happened when SASOL and FOSKOR were established, and it also happened recently when we invited the private sector to join Atlantis Diesel Engines. The same applied to such new ventures as Huguenot Porcelain (crockery), Alusaf (aluminium reduction), Richard's Bay Minerals (exploitation of heavy minerals), Sapekoe (tea production), and Da Gama (textiles).

IDC shareholding open to the public

This initiating, underwriting and establishing of new and unique industrial enterprises on the part of the IDC is neither 'soft' nationalization, nor a socialistic tendency. What happens in practice? As these projects become successful and profitable, partners from the private sector join us and take control of these companies.

Where the IDC provides the original risk capital, it is always prepared to afford the South African investor the opportunity to participate in its portfolios of shares once the companies have established a proven level of profitability.

The mechanism used for this purpose was the establishment of two investment companies quoted on the Johannesburg Stock Exchange, Industrial Selections Limited (ISL) and National Selections Limited (NSL). ISL was established in 1963 and NSL in 1970, and both do business as investment trusts holding portfolios of shares in quoted and private companies. ISL has just over 1 500 shareholders and NSL has about 2 000 shareholders, large and small. These include the major life insurance companies and pension funds. Their object is to serve as a channel for an increasing, yet relatively safe, stream of dividends from the underlying companies to the shareholders of ISL and NSL. We therefore try to:

- hold a diversified, yet limited, portfolio of shares so that as far as possible the shareholders of ISL and NSL are protected against adverse (downward) variations in dividend declarations;
- expand the portfolio gradually from retained profits, so that dividend growth is not only dependent on increasing dividends from existing investments.

The only unusual aspect of ISL and NSL is that new investments are mainly acquired from the IDC. Such transactions are done on the normal commercial basis in arms-length deals: quoted shares at current market prices; unquoted shares normally at prices determined by an impartial merchant bank, in the light of current circumstances and profit prospects.

Have we achieved the object of providing the shareholders a reasonable and steady growth in income? An investor in an investment trust has two major criteria in assessing such an investment:

- earnings in cents per share which will determine dividend income;
- net asset value per share — at market value of the underlying assets — which will to an extent influence the market price of the share.

An analysis of the balance sheets and income statements from July 1, 1970 to June 30, 1981 shows the following:

- both companies have recorded about a 20% per annum growth in both earnings and net asset value per share;
- ISL earnings went from 20c to 128c per share and NSL earnings from 28c to 148c per share;
- ISL net asset value went from 332c to 1 856c and NSL from 378c to 1 952c per share.

But more important, we estimate that the shareholders in ISL and NSL averaged earnings of about 25% per annum on their investment over the past ten years, made up from dividend receipts and increase in capital value.

The question arises, why is there this need for an indirect route through ISL and NSL? Why not always market IDC shares held in companies direct to the institutions and stock exchange investors?

The direct route is not always suitable, or even possible, because:

- the IDC is generally regarded as a very welcome neutral party in project partnerships and the project partners, even after the industry has been established, are often opposed to the IDC disposing of its shareholding to other investors;
- when we are dealing with private companies, the partners have pre-emptive rights over one another's shareholdings and, especially when such partners are overseas investors, the IDC does not like to see the South African interest being transferred to the overseas partner;
- some companies serve a specialized market and are particularly sensitive to the relevant business cycle. Such companies are not suitable for a listing on a stock exchange and general direct participation; and
- there are the strategic shareholdings in companies such as Safmarine and Sasol, held to ensure South African control.

Conclusion

South Africa is part of a fast changing environment. Angola, Mozambique and Zimbabwe have become independent. One of these days our links with South West Africa will be severed and a new relationship will develop.

Our traditional homelands have become national states or are in the process of becoming separate states, to be joined in a confederation of Southern African nations. In other words, the relationship and the economic interdependence between South Africa and its neighbours have been accepted as practical politics.

Who better than the IDC, respected by the government for its integrity and with its 40 years of practical experience and success as a state corporation advising the government in the interest of South African industry, can influence government to adjust politics to economic dictates, rather than the opposite?

Managers as pioneers of social innovation in South Africa

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The theme of this colloquium — Management's role as pioneers of social innovation — is entirely appropriate for my country and it has been the subject of discussion and soul searching by many of our executives, politicians and academics. I would like to report to you what progress has been achieved in this regard in South Africa, and what we can expect in the future, and shall start by attempting to summarize for you some of the social, political and economic parameters which are relevant to my talk.

South Africa is a relatively small country in economic terms. In 1980 it had a Gross National Product of $68 000 million. It attracts a disproportionate amount of attention in the international communications sphere, if only because of its uniqueness in many respects. For example, it is the sole supplier — or near sole supplier — of certain minerals upon which many international industries are dependent. It boasts a well-known heart surgeon, but probably, the major reason for this focus of attention on South Africa is its government's politics. It is, as far as I am aware, the only country in the world where racial differences are maintained by legal entrenchment, although I have no doubt that racial discrimination is practised in many other countries. World attention — and indeed antagonism — took a quantum step forward in the 1960s and again in the latter half of the 1970s when racial violence occurred in the country. Whether by accident or design — probably both — it is a highly heterogeneous society. What I think is of paramount importance is the fact that so much that has taken place in South Africa since World War II at least, whether it be in the political, the social or the economic spheres, has been overlaid with concerns about race.

Many paradoxes

South Africa is a country of remarkable paradoxes though. The economy has been characterized by relatively high growth in the last 12 years but also by high unemployment. Interestingly, in this regard, we note a tremendous shortage of management and skilled labour on the one hand, and massive unemployment among unskilled members of our society on the other. Here too, the dividing lines are to some extent characterized by race. We note that to some degree, the buoyancy of the economy is the result of a group of independent thinking, successful entrepreneurs, capitalizing on the world's propensity to buy gold and other minerals on the one hand, but, on the other, also of government involvement in a host of state and semi-state bodies assuming a pivotal and monopolistic role in the economy. On top of that, despite government's apparent commitment to a free enterprise system, the economy is in fact highly regulated, as is reflected by imposed price, foreign exchange and import controls, and restrictions on black labour movement, to name a few.

The shape of the economy is also riddled with paradoxes. Having massive resources of a number of essential commodities, South Africa is in many ways self-sufficient; but owing to its lack of petroleum resources, it is dependent on many of its major critics for these crucial products. Yet, owing to its large deposits of coal and uranium, it will be a net exporter of energy by 1983.

Historical, political, legal and cultural factors have resulted in yet another paradox in the sharing of the spoils of the buoyant economy. On the one hand, we see a small group of highly affluent people whose manifestations of wealth rival even the population of Southern California! On the other hand, the majority of the population have incomes which are only somewhat higher than those of their third world compatriots. Again, the lines which distinguish the 'haves' from the 'have-nots', have until recently been largely determined by race, with the whites making up less than 20% of the population. In 1980, average annual earnings per white wage/salary earner were estimated to be slightly more than $8 700. Urban black wage and salary earners averaged about $2 200 in the same period.

Massive economic growth in recent times has stretched South Africa's skilled manpower resources to the limit and the obvious future potential will only be achieved if more and better skilled, willing personnel can be acquired; but past political policies and continued intransigence in some government quarters have restricted optimal utilization of South Africa's manpower. Fundamentally, it is these two factors — the need for skilled staff and government's apparent failure to adequately ensure such human development in the past — which have motivated management to look to taking on the role of being pioneers of social change. As a business academic I find this point to be of particular interest. In my view, managers are generally a particularly conservative group, especially when profits are high — which they are in South Africa. And yet, it is my contention that they have been remarkably innovative in South Africa, probably because of government's apparent abdication of its role in this regard. Perhaps we should try to identify the reasons for this remarkable situation.

Political history

Historically, in the early days, South Africa was settled by groups of European political dissidents and administrative representatives of certain colonial powers. Before long they met up with migrating tribal blacks and very soon, owing to superior education and experience on the