

# South African conglomerates: a qualitative analysis

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This qualitative analysis is based on research on conglomerates not previously undertaken in South Africa. Founded on the work of corporate strategy and development theorists, the research is aimed at establishing a 'character profile' of South African conglomerates. What differentiates passive and acquisitive conglomerates in terms of organizational structure, management function, style, and strategy, is also considered. The information for this analysis is derived from the results of a mail survey. The research findings indicate that in general South African conglomerates are structured on a multi-divisional basis with divisions specializing in product-market rather than functional relationships. Divisions tend to be controlled at arm's length by their corporate head offices, who perform auxiliary and co-ordinating functions. Compared to acquisitives, passives appear to be less flexible in their management style, function, and control. In terms of their strategy, passives tend to be, for the immediate future at least, more aggressive than acquisitives.

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Hierdie kwalitatiewe ontleding is gebaseer op navorsing oor konglomerate wat nie voorheen in Suid-Afrika onderneem is nie. Dié navorsing, gebaseer op die werk van teoretici oor ondernemingstrategie en -ontwikkeling, beoog om 'n 'karakter-profiel' van Suid-Afrikaanse konglomerate daar te stel. Die verskilpunt tussen passiewe en aankopende ('acquisitive') konglomerate wat organisasiestruktuur, bestuursfunksie, styl en strategie betref, word ook beskou. Die inligting vir hierdie ontleding is verkry uit die resultate van 'n opname wat per pos geloods is. Die navorsingsbevindinge dui aan dat Suid-Afrikaanse konglomerate in die algemeen gestruktureer is op 'n multi-afdelingsbasis, met afdelings wat meer spesialiseer volgens produkmark as volgens funksionele verwantskappe. Afdelings word dikwels op 'n afstand beheer deur die moedermaatskappye se hoofkantoor, wat ondersteunende en koördinerende funksies verrig. In vergelyking met aankopende maatskappye, is passiewe maatskappye skynbaar minder buigsaam in hulle bestuurstyl, funksionering en beheer. Wat hulle strategie betref, neig passiewe konglomerate om ten minste ten opsigte van die onmiddellike toekoms, meer aggressief as aankopende konglomerate te wees.

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## Introduction

### Previous Research

Two recent research studies<sup>1,2</sup> into South African listed companies indicate that South African firms appear to be following a trend towards increased diversification. This tendency is consistent with the pattern experienced in the more developed economies. The extent of diversification within South African quoted industrial firms is, however, not comparable to anything experienced by the developed economies during the last 30 years. While South Africa displays a large proportion of Single and Dominant businesses, not unlike those of developed countries in the 1950s, its relatively large group of conglomerates is more akin to the developed economies of the 1960 and 1970s.

### Quantitative findings

These two research studies have established, on the basis of the strategic categorization scheme adopted by Wrigley<sup>3</sup> and Rumelt<sup>4</sup>, that 32 SA listed companies qualify as 'conglomerates'. These are listed in Table 1.

The conglomerate group has performed, both in terms of growth and return on investment, better than the population average.<sup>1</sup> Table 2 shows this for return on investment. Conglomerates also display a slightly higher than average variability in growth and returns. Compared with the total research population, conglomerates have exhibited higher dividend pay out and debt ratios than other forms of business. In terms of risk, conglomerates display a mean beta value only slightly higher than the population. This means that, in South Africa, conglomerates are only slightly riskier than the average for the whole stock market, but their returns are significantly higher.

The term 'conglomerate' as used in this research describes those companies which are *not* vertically integrated, and which have diversified chiefly without particular regard to the relationships between new businesses and current business activities.

In technical terms, conglomerates have *specialization ratios* of less than 0,7 (i.e. less than 70% of the firm's annual revenues are attributable to its largest discrete product-market activity), and *related ratios* of less than 0,7 (i.e. less than 70% of the firm's annual revenues are attributable to its largest group of related businesses).

Within the category of conglomerate described above, two significant sub-categories have been identified. These

**Table 1** South African conglomerates by strategic subcategory

Passive conglomerates	Acquisitive conglomerates
Advance Holdings Ltd.	Abercom Investments Ltd
Amalgamated Investment Corporation Ltd.	Adcock Ingram Ltd.
Anchusa Holdings Ltd.	Anglo American Industrial Corporation Ltd.
Bonuskor Bpk.	Anglo-Transvaal Industries Ltd.
Bromain Holdings Ltd.	Barlow Rand Ltd.
Currie Finance Corporate Ltd.	Blue Circle Ltd.
Diroyal Investments Ltd	Calan Ltd.
Hulett's Corporation Ltd.	Federale Volksbeleggings Bpk.
Ovenstone Investments Ltd.	Industrial & Commercial Holdings Group Ltd.
Premier Industries Ltd.	Lonrho Ltd.
Rentmeester Beleggings Bpk.	Lucem Holdings Ltd.
Suiderland Development Corporation Ltd.	Picardi Beleggings Bpk.
Trumcor Ltd.	Protea Holdings Ltd.
The Unisec Group Ltd.	Rennies Consolidated Holdings Ltd
	Sear del Investment Corporation Ltd.
	The South African Breweries Ltd.
	The Tongaat Group Ltd.
	W. & A. Investment Corporation Ltd.

**Table 2** Passives vs acquisitives — A comparison of quantitative factors

	Population	Passives	Acquisitives
Growth			
Sales		14,0%	24,4%
Profits		18,3%	32,8%
E.P.S.		13,9%	18,2%
Returns			
R.O.I.	14,10	13,7%	16,1%
Variability	18,30	14,1%	4,3%
Sundry			
Debt ratio (1975)		55,0%	48,0%
Dividend : Ratio		67,9%	68,0%
: 1970 – 76		33,7%	16,0%
Risk (Beta)		0,986	0,934

are described as 'unrelated passive' and 'unrelated active':

*Unrelated passive* — unrelated business firms that do not qualify as unrelated acquisitives. (See definition below.)

*Unrelated acquisitive* — unrelated business firms which have aggressive programmes for the acquisition of new unrelated businesses. More specifically, such firms are defined as having, over the last five years, (a) had an average growth rate in earnings per share of at least 10% per year; (b) made at least five acquisitions, at least three of which took the firm into businesses unrelated to past activities; and (c) issued new equity shares whose total value (using market prices at the time of issue) was at least as great as the total amount of common dividends paid during the same period.<sup>4,p.24</sup>

This is extended in the South African context in that an active, or acquisitive, conglomerate is one having, over the last five years, satisfied at least two of the following

three criteria:<sup>2,p.59</sup>

- (i) Annual average E.P.S. growth rate of more than 10%.
- (ii) More than five acquisitions in areas related to past business activity.
- (iii) More than three acquisitions in at least one area unrelated to past business activity.

### Objective of this paper

Prior research already mentioned has indicated differences in *financial* performance between the two categories of conglomerate in South Africa. The objective of this paper is to analyse the results of research into the *qualitative* factors which describe South African conglomerates in terms of their diversification strategies, organizational structures, divisional autonomy, performance criteria, planning horizon and degree of organizational formality. Those factors which may account for the differences in economic performance between 'active' and 'passive' conglomerates will then be discussed and some conclusions will be drawn.

### Methodology

To establish what *qualitative* characteristics account for differences in financial performance of acquisitive and passive conglomerates, a questionnaire was constructed based upon the findings of prior research. Each question was constructed to test a hypothesis, derived from the prior research findings. Forty-one such questions were developed. (The prior research, and questionnaire, are contained in the Bisotto report.<sup>2,pp.82-122</sup>)

A questionnaire was mailed to each of the 32 companies classified as conglomerates. This includes the entire population of listed conglomerates in South Africa. The completed questionnaires were then analysed for each of the 41 questions, and differences in the responses between the acquisitive and passive conglomerates were noted.

### Questionnaire Responses

Of a total of 32 questionnaires mailed, 23 (72%) were returned, in almost equal proportions from the companies in the research population (i.e. a 71% response rate from the 'passives', and 72% response rate from 'acquisitive' conglomerates).

### Summary of major research findings

Table 3 indicates the major factors and differences between active and passive conglomerates in South Africa. Only the qualitative research findings are discussed here, as the quantitative findings have already been discussed in the introduction.

#### 1. General findings relating to both categories

The qualitative findings indicate that South African diversifiers are multi-product firms and are in divisions grouped on the basis of their relevant products or markets. Divisions operate fairly autonomously with head offices relying on financial results as the most important means of control.

In line with USA findings, the support-staff at head-quarters tends to be small, and focuses on such functions

as planning, finance and law.

Because South African conglomerates are smaller and

Interdivisional problems appear to be resolved quickly at divisional level through personal contact between head office and divisional managers.

From a strategic point of view South African conglomerates are seen to be planning for diversification but not actively pursuing it. Furthermore, where diversification is considered it tends to be in related rather than unrelated fields of activity.

#### 2. Extent of Diversification

Answers given in the questionnaire indicate that acquisitives are more diversified than passives. Although both groups are structured on a divisional basis, their interactions with their markets in terms of purchases and distribution are different. In the case of passives, head offices seem to impose — or at least maintain — centralized purchasing and distribution functions implying

**Table 3** Passives vs acquisitives — A comparison of qualitative factors

	Passives	Acquisitives		Passives	Acquisitives
Diversification: Product lines	Fewer than in acquisitives.	Numerous.	Diversification activity	Intensive short-term activity — aggressive.	Some short-term activity. Not as aggressive, over next year, as passives.
Purchasing	Tends to be centralized within the group.	Decentralized at divisional level.	Diversification areas	Mainly in related areas of activity but to some extent in unrelated areas.	Mixed strategy; internal development, related and unrelated business areas.
Distribution	Tends to be centralized whenever economically feasible.	Decentralized at divisional level.	Time orientation:		
Structure:			Daily problem solving	Corporate H.O. management devotes 20–50% of its time to the resolution of such problems.	Corporate H.O. management spends about 25% of its time on such problems.
Head office size (Number of People)	< 39	< 29	Strategic planning	Corporate management allocates 20–50% of its time on planning.	Corporate management activity and constantly involved in planning; time utilized up to 70%.
Divisional autonomy:			Strategic horizon	Strategic problems tend to be of a long-term nature, usual time horizon between one and more years.	Strategic problems of a long-term nature, but management also continuously involved with a whole range of strategic time horizons.
Distribution/Purchasing	Head office tends to impose centralized facilities. Market interaction indirect.	Divisions interact with their market directly.	Organizational formality:		
Goal setting	Divisions moderately involved in goal setting.	Extensive divisional involvement in generation of goals.	Rules	Some rules and procedures are imposed by H.O. in formalizing its relationship with divisions.	Low H.O. reliance on rules and procedures to formalize H.O. divisions relationship.
Transfer pricing	Policy extensively applied within group.	No such policy maintained.	H.O. division communication	Tends to be more formal and indirect than acquisitives.	Tends to be of a direct, face-to-face nature, and informal.
Performance criteria:					
Measurement	Cost-related — internal orientation.	Market-related — external orientation.			
Control	Tends to be formal through some rules and regulations. Also through financial results.	Informal and through financial results.			
Strategic choice:					
Diversification strategy	No specific strategy. Opportunity exploited when present.	Diversification planned but not actively pursued at the moment.			

an indirect division-environment relationship. Acquisitive divisions on the other hand tend to interact directly with their selling and buying markets.

### 3. Structure

The divisional structure seems to be universal among South African conglomerates. Head offices are, however, structured differently. Passives appear to have larger corporate staffs. This suggests that passives have more specialists than do acquisitives, yet the financial performance already considered seems to indicate that generalists rather than experts made for better management and consequently better performance.

### 4. Degree of autonomy

Acquisitives are autonomous in the way they procure their raw materials and in the way they dispose of their finished products. Divisions of passive firms on the other hand seem to be far more directed by their head offices. Transfer pricing policies are extensively used within the passive conglomerate group suggesting a more constrained product-market relationship.

As far as setting objectives is concerned, acquisitive divisions seem to generate their own goals, or at the very least they are to a very great extent involved in such matters. Passives, however, tend to have goals and objectives imposed by corporate head office with only moderate divisional involvement.

### 5. Performance criteria

Although both groups of conglomerates rely on R.O.I. as the main measurement of performance, there is a tendency for passives to regard cost efficiencies as a very important performance criterion. Passives therefore appear to be oriented towards internal rather than external success. Acquisitives rely on market-related success to assess group performance.

There are also differences in the way performance is controlled. Acquisitives use an informal and impersonal approach, while passives tend to be more formal through the use of policies and procedures.

### 6. Strategic choice

The acquisitive group appears to plan its diversification strategy, and compared with the passive group it is more calculating and conscious of the direction taken. Passives are more opportunistic, and as such their diversification strategy is *ad hoc* and generally not well-planned. However, the passives are poised, at least in the short term, for vigorous diversification activity. Results indicate that this activity will be focused mainly in related business areas, although unrelated businesses are also being considered. Acquisitives appear, at this point in time, to be less aggressive than passives and to pursue a mixed strategy of diversification into related and unrelated areas.

### 7. Time orientation

Corporate head office management of passives appears to be involved in the day-to-day problems of the group rather than on strategic planning and long-term problem

solving. For passive conglomerates strategy determination tends to be of a long-term nature. Acquisitives on the other hand tend to regard strategy formulation as a continuous function. They are therefore more flexible in their approach to business and consequently better able to preempt or at least react to market and economic conditions.

### 8. Organizational formality

This research has revealed that passives rely to some extent on rules and regulations in formalizing the relationships between their head offices and divisions. Acquisitives exhibit less organizational formality.

Communication within the acquisitive group is informal and usually face to face. Passives tend to be more formal.

### Conclusions

The passive conglomerates currently display aggressive short-term diversification strategies. If in so doing it is their intention to match the financial performance of their acquisitive counterparts, then the corporate head office of passive conglomerates must make changes to its management style. Divisions of passive conglomerates require freer rein in their operations. Head office management needs to detach itself from divisional involvement. Less formality and greater divisional independence could promote an atmosphere more conducive to high divisional performance with head office giving back-up services, direction, and control measured in terms of market R.O.I., rather than direct operating control.

The general picture which emerges indicates that several qualitative factors account for most of the differences between 'passive' and 'acquisitive' conglomerates. The acquisitive conglomerates allow more autonomy to their divisions, plan for new acquisitions more systematically, focus more on market-related R.O.I. performance-criteria, and rely less on rules and procedures than do their 'unrelated passive' conglomerates.

The difference in approach to strategy and structure can be summarized into two broad categories — financial measures used to assess operating performance, and the organizational formality of the two respective groups of conglomerate.

The modus operandi of the acquisitive conglomerate has enabled them to achieve substantially better than the average financial results for the 'passives'.

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