10

Profitability without Investment

How Financialization Undermines Structural Transformation in South Africa

Antonio Andreoni, Nishal Robb, and Sophie van Huellen

10.1 Introduction

Sustained investment in productive capabilities and fixed-capital formation is a key driver of inclusive and sustainable structural transformation. Both historically and compared to other middle-income countries, South Africa has performed poorly in terms of sustaining domestic-productive investments. This failing has coexisted with the development of a stock market with the second-highest level of capitalization over gross domestic product (GDP) in the world (a record retained since 2013, and second only to Hong Kong), and high levels of profitability across several economic sectors. This means that, despite the deepening of financial markets and persistently high profits, investments have not materialized.

In this chapter, this apparent paradox is unpacked through the presentation of new evidence on the specific ways in which financialization of non-financial corporations (NFCs) in South Africa has resulted in low investment performances. Aggregate evidence of the coexistence of high profitability, deep financial markets, and sluggish productive investment is provided. This is borne out further by the focus on two large, publicly listed corporations operating across different economic sectors—Sasol in heavy manufacturing industry, and Shoprite in supermarket retail. Built on an analysis of company financial statements, the case studies identify a number of shifts in firm behaviour and corporate strategy between 2000 and 2019, particularly in regard to sources and uses of funds.

The analysis shows that firms have increasingly financed operations, capital expenditure, and distributions to shareholders with debt. The US dollar-denominated share of this debt has grown rapidly in the period studied, exposing firms to increased exchange and interest rate risk in a volatile global macroeconomic environment. Distributions to shareholders, driven by dividends rather than share repurchases, have also risen markedly over the same period—with growing repayments to creditors further augmenting the flow of resources away from productive reinvestment and toward financial markets.

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These dynamics are attributed in part to South Africa's subordinate position in a global economic hierarchy encompassing currencies, value chains, and financial markets, and which imposes profound limitations on the development strategies and policy space available to low and middle-income countries. An exploration of these dynamics helps to identify the scale and complexity of the challenges facing attempts to resist the influence of financialization, and to pursue growth paths premised on redressing a growing imbalance between financial and non-financial sectors through redirecting resources away from finance and towards productive investment.

For the rest of the chapter, section 10.2 introduces the literature on the role of finance in structural transformation and the ways in which financialization hampers sustained productive investments. Building on, and extending, a specific stream of research focusing on the tension between financialization and innovation within NFCs (Lazonick and O'Sullivan, 2000; Lazonick, 2014), a number of financialization factors and dynamics which are specific to companies in middle-income countries are identified. Section 10.3 focuses on the South African case, and presents new historical evidence on a selected number of financialization indicators for publicly listed NFCs. Section 10.4 presents the two case studies and an in-depth investigation into several factors driving the financialization of NFCs across companies in South Africa and, potentially, other middle-income countries. Section 10.5 concludes and reflects on the implications for industrial policy.

10.2 Structural Transformation, Finance, and Investments: Why Financialization Matters

The processes of countries' structural transformation are complex, involving changes in multiple dimensions. By directing and sustaining strategic investments in productive capabilities, finance can play a critical role in driving structural transformation (Samargandi et al., 2015). The experience of early industrializers (and successful late industrializers) points to the fact that reinvestment of profits generated within business enterprises is a major source of finance, alongside financial institutions. By retaining profits and reinvesting them strategically in the development of productive capabilities, collective learning, and technologies, business enterprises can develop managerial and organizational capabilities that allow them to exploit economies of scale and diversification opportunities (Penrose, 1959; Lazonick, 1990).

Economies of scale, of scope, and innovation are not only key drivers of growth—they are also key generators of large profits. In order to be (and remain) innovative, business enterprises need to exercise strategic control over the financial resources they are able to generate as an organization (Lazonick and

O'Sullivan, 2000; Lazonick, 2010). They also need to make sure that long-term cycles of learning and innovation are properly funded over time, and against uncertainty. Commitment of financial resources under uncertainty is central for sustaining productive capabilities development and accumulation, and steering them towards innovation, from both company and country perspectives (Chang and Andreoni, 2020).

However, business enterprises can become financialized—that is, the nexus between finance, investment, and structural transformation can break. Financialization happens because, to quote Epstein's (2005: 3) definition of financialization, with the 'increasing role of financial motives, financial markets, financial actors, and financial institutions in the operation of the domestic and international economies', resources generated in the real economy are diverted from productive investments towards the expansion of the financial sector. Middle-income countries are fully exposed to global financial systems and financialization dynamics, while at the same time large segments of their economies are structurally and institutionally underdeveloped, and thus exposed to unproductive financial systems development. After each of these points is addressed, the discussion turns to how they play out in the specific context of middle-income countries like South Africa.

10.2.1 Theoretical Perspectives on Financialization

Financialization is a global phenomenon, although it impacts different countries in specific and interdependent ways (Chang and Andreoni, 2020). Across middle-income economies, financialization diverts finance from those productive investments needed to sustain industrialization efforts and infrastructure development. It also undermines technological catch-up and reduces returns to workers for their key contribution to value creation within business enterprises. Indeed, by undermining productive structural transformation, financialization also has a direct and indirect distributional impact on the demand and employment side, ultimately impacting the rise of domestic effective demand. Finally, given that financial markets are global and business enterprises are transnational, there are plenty of transmission mechanisms through which financialization in one country (or company) affects the other country (or company, especially those operating along the same sectoral value chain).

In the decade since the global financial crisis, much of the popular discourse on financialization has focused on financial 'innovations' such as credit default swaps (CDS) and derivatives, and their roles in precipitating the crisis. However, there was already extensive scholarship on financialization from a range of perspectives before the crisis. This body of literature has discussed financialization at multiple levels—from analysis of household assets and liabilities, and the changing behaviour of NFCs, to its influence on financial systems at a national and international level; and from multiple angles, including social provision by states, shifts in the international division of labour, class formation, and international monetary architecture (see Krippner (2005) for a review of the pre-crisis literature).

Marxist political economists and post-Keynesian scholars, in particular, have developed theories of financialization from a macro perspective, mainly focusing on the ways in which financialization operates across sectors and across classes within a macroeconomic framework (see e.g. Fine, 2013; Lapavitsas, 2013). Lapavitsas (2013), for example, focuses on the different 'set[s] of social mechanisms that systematically convert temporarily idle funds into money capital available for lending' (2013: 118). From this perspective, financialization is embodied in changing relations between and within sectors in the last three decades or so of the twentieth century—with firms, banks, households, and the state in advanced economies representing the key sectors. As NFCs developed the financial intermediation capabilities required to trade in financial markets and pursue financial profits, their relations with and reliance on banks weakened over time. In turn, banks sought new streams of profit in direct lending to households and increased financial intermediation services. At the same time, states' withdrawal from social provision—pensions, housing, education, and healthcare key among these—combined with changing patterns of bank lending to draw ordinary households more deeply into the financial system than ever before (Lapavitsas, 2013: 2–4). The core argument here is that financialization is, in the final analysis, antithetical to real accumulation. Financialization results in increasing appropriation of value by the financial system at the expense of the 'real' or productive economy, and ultimately exposes households and whole economies to new forms of vulnerability.

A different stream of research has focused on the ways in which financialization of NFCs has historically emerged out of specific institutional changes in corporate governance regimes (Lazonick and O'Sullivan, 2000; Lazonick, 2014) and has shaped and spread along global value chains (GVCs) (Baud and Durand, 2011; Milberg and Winkler, 2013; Auvray and Rabinovich, 2019). Starting in the 1980s, with the increasing globalization of financial markets and fragmentation of production, the refocusing of multinational corporations (MNCs) on core businesses and the increasing power of global institutional investors, corporate strategies shifted from the old logic of 'retaining and investing' to one of 'downsizing and distribution'. The affirmation of what came to be called 'shareholder value maximization' ideology—a new hegemonic principle of corporate governance—is considered to be the main mechanism underpinning corporate financialization.[1]

[1] See also Froud et al. (2006) on the link between financialization and changes in corporate governance, with a focus on three iconic NFCs—i.e. GlaxoSmithKline, Ford, and General Electric.

The shareholder value maximization (SVM) perspective was built on 'residual claimant' theories of the firm. These proposed that only a firm's owners or shareholders truly take a risk in investing in it, as they are only guaranteed a return on their investment if the firm turns a profit (the 'residual' to which they have claim). The interests of other stakeholders—workers, managers, and creditors—are contractually enforceable, and are thus not always perfectly aligned with profit maximization. Shareholders are therefore seen as having the most powerful incentives to ensure the efficiency of the firm, maximizing profits and their own returns, which they are best placed to allocate to further reinvestment in the firm or to other private ends. SVM ideology maps this argument onto society as a whole: because shareholders' incentives lead them to maximize profits at firm-level, shareholders' returns ought to be maximized in general, allowing them to allocate those returns to further profit-maximizing activities, thus maximizing utility at an overall social level (Alchian and Demsetz, 1972; Jensen and Meckling, 1976). This amounts to the simple idea that what is best for the owners of shares is best for society as a whole.

Lazonick (2014) has challenged this perspective, arguing that shareholders in the context of contemporary financial markets ought not to be considered 'investors' in the traditional sense. This is because they tend not to make consistent investments of their resources in a given firm and they have the ability to sell off their shares in a way that means their 'investments' are rarely subject to major risk. In contrast, it is employees, taxpayers, and governments who make regular investments of time and resources in firms, and tend to be the ones to pay the price when risks transform into genuine crisis. According to Lazonick, SVM is the key justification and corporate governance principle behind the financialization of NFCs, and has contributed powerfully to the inability of the USA, for example, to achieve inclusive and innovative growth. For Lazonick, the combination of increasing distribution of 'excess cash' to shareholders and financial markets through dividends and share repurchases, and the growth of stock-based compensation for executives, has broken the finance–investment nexus that had driven growth in the US economy from the second world war until the 1970s.

10.2.2 Financialization of Non-financial Corporations in Middle-Income Countries: Towards a Micro-level Perspective

While most scholarship on financialization has focused on advanced economies, since the early 2000s, several contributions have explored the transmission mechanisms of financialization between advanced ('core') and developing ('peripheral') economies. In this context, Powell (2013) advances a theory of 'subordinate financialization', according to which financialization across emerging markets and developing economies (EMDEs) is driven by a combination of power dynamics inherent in the global financial architecture. These result in macroeconomic and financial system vulnerabilities for EMDEs. Powell argues that EMDEs are experiencing financialization, 'but in a distinctive form which has been shaped by imperial relations in the current world market conjuncture' (2013: 144).

Powell proposes several hypotheses about the likely features of subordinate financialization in EMDEs in the context of this particular conjuncture. First, as a consequence of the subordinate position of EMDE states and their currencies in the international financial system, financial liberalization is likely to undermine investment, especially in productive activity. Second, international private capital flows, driven by monetary conditions in advanced economies and increasing in volume and volatility, expose EMDEs to financial crisis. This imposes costly risk-management strategies for policymakers in EMDEs, negatively affecting credit conditions and rates of fixed investment. Third, leading NFCs in EMDEs are likely to become increasingly reliant on market-based finance, generating volatility in national financial systems, especially where foreign currency-denominated debt is taken on by NFCs. Fourth, banks are likely to turn towards global capital markets, creating new vulnerabilities by opening the domestic banking sector to external factors with potentially negative macroeconomic consequences. Finally, households are likely to become financialized in terms of both assets and liabilities. Bonizzi et al. (2019: 10) argue that these vulnerabilities in developing economies 'may serve to cement or even deepen their subordination in the global hierarchy of nations'; the subordinate financialization perspective is thus grounded in the exploration of fundamentally hierarchical and extractive relations between core and peripheral economies (see also Bonizzi, 2013).

The subordinate financialization literature introduces important insights into the specific financialization mechanisms operating at the macro and financial system levels across middle-income countries and other peripheral countries. A number of these specific mechanisms reflect micro-level financialization processes within NFCs, which will be different from those highlighted in NFCs based in advanced economies like the USA.[2] To advance a micro-level perspective that shows the specific forms of tension between financialization and investments across NFCs in middle-income countries, three clusters of issues are discussed: heterogeneity between different sectors and different segments of the GVC with respect to the rentieristic nature of activities; pull factors, such as asymmetries along GVCs, foreign ownership, and dependence on international

[2] For instance, taking the cases of Apple Inc. and Foxconn International Holdings (FIH) as examples, Froud et al. (2014) find different—though still interdependent, because of their being in the same GVC—financialization processes within the companies and broader outcomes for their respective countries.

finance; and inducement factors, such as cheap credit, and the need to meet shareholders' expectation and mitigate the risk of hostile takeovers.

There are six major interlinked factors related to these issues. First, financialization is heterogenous across sectors. This is because profitability margins, industry organizations along value chains, and competition are different across sectors. Extractive sectors, for example, tend to offer high profitability margins, especially when beneficiation activities are limited. Once initial fixed investments are in place, the financial stream from these activities can be extremely high and relatively stable (depending on commodity cycles). Similarly, in the energy sector, prices are largely determined by financing costs more than production costs. Mineral and non-mineral rents can be easily extracted in the form of royalties and often in a situation of limited competition or monopoly (see Bowman (2018), on South African platinum mining). Competition is critical in determining the extent to which companies need (or not) to reinvest to retain their dominant position.

Second, even within the same sector, financialization can take different forms, depending on the business enterprises' positioning along the value chain. The reason is that opportunities for rents are disproportionately distributed along sectoral value chains, especially when NFCs do not face major competitive pressures. Hence the value chain structure matters in shaping specific forms of financialization, especially across middle-income countries. In upstream sectors producing industrial materials such as chemicals or steel, the scale-efficiency of the investment is very high—also relative to the domestic demand. As a result, very few players can operate or control the sector—and in the case of a monopoly price regime, only one. In downstream industries such as retail and distribution, by controlling access to final markets, NFCs can also extract significant extra profits by simply applying large price mark-ups. This dominant position gives businesses the opportunity to extract rents along the entire value chain of buyers. The lack of competition does not provide any compulsion for reinvestment, and companies' extra profits can be easily targeted by predatory value extractors in both the domestic and international markets.

Third, business enterprises in low and middle-income countries tend to be squeezed along their GVCs, given the 'endogenous asymmetries' characterizing modern GVC structures (Milberg and Winkler, 2013; Chang and Andreoni, 2020). The endogenous asymmetries allow for international companies to extract extra profits generated in the host economies and use them to respond to short-term financialization pressures from international shareholders. As a result of these asymmetries, profitability margins of new productive investments in low and middle-income countries can be limited. Companies' strategic response—especially in manufacturing industries—could be to move away from long-term productive capabilities development towards trade intermediation and service activities. In effect, this is functional downgrading. This is particularly the case in the absence of effectively enforced industrial and trade policies, as business enterprises are squeezed along the value chain and in the international market by established business enterprises (Auvray and Rabinovich, 2019; Ponte et al., 2019; and Chapter 12).

Fourth, business enterprises' ownership structures matter. Foreign ownership—especially by institutional investors—might expose companies in low and middle-income countries to powerful extractive forces and pressures to extract financial resources and capture rents. Bonizzi (2017) points out that institutional investors, largely based in high-income economies, collectively owned the equivalent of 60 per cent of global GDP in 2014. From a political economy point of view, the lack of a mature class of industrial capitalists with interests embedded in the domestic economy, impacts negatively on the financial commitment of business enterprises. In a number of middle-income countries like South Africa, the privatization of state-owned enterprises (SOE) has opened the door to a number of major international institutional investors, including pension funds, and an accompanying shift in corporate governance strategies. Their interest in a sustained flow of dividends can affect the long-term financial commitment of resources in productive investments.

Fifth, business enterprises in middle-income countries rely on international financial markets for access to cheap credit and foreign exchange needed for operational purposes, exposing them to high levels of exchange and interest rate risks. Subordination in the international financial system means NFCs in middle-income countries turn to high-income countries' capital markets to source capital at competitive rates and to gain access to foreign exchange needed to settle import bills. US dollar-denominated debt positions expose middle-income country NFCs to two types of vulnerabilities: a currency mismatch between income generating activities and debt servicing costs, aggravated by exchange rate volatility; and a policy risk as the sustainability of the US dollar-denominated debt position is at the mercy of a foreign central bank (primarily the US Federal Reserve), which sets policy rates with no regard for the fate of foreign companies. This double vulnerability requires middle-income country NFCs to engage in costly financial risk management activities or suffer from sudden and substantial losses if the risk is not managed effectively.

Sixth, business enterprises in middle-income countries rely to a large extent on foreign capital for liquidity of domestic capital and equity markets. In order to keep foreign investors happy, these enterprises have to offer high risk-adjusted returns to compensate for the higher risk associated with their subordinate position. At the same time, enterprises must fend off potential hostile takeovers by keeping their share price high through offering large shareholder pay-outs, either via dividends or share buy-backs.

Moreover, depending on a country's particular sectoral composition and patterns of industrialization and deindustrialization (see Chapter 11), the combination of these sector-specific factors will magnify the impact of financialization on the economy as financialization dynamics reinforce each other. For example, as highlighted in Fine and Rustomjee (1996), it can be expected that an economy like South Africa's, which has traditionally developed around the 'minerals energy complex' (MEC), will be dominated by several of the sector-specific financialization dynamics highlighted above.

10.3 Signs of Financialization and the Broken Profit–Investment Nexus

By the early 1990s, South Africa already had a relatively well-developed and influential financial sector, characterized by a strong banking system and sophisticated capital markets (Isaacs and Kaltenbrunner, 2018). By the early 2000s, the country's first democratic government had made a formal commitment to a conventional macroeconomic policy framework targeted at low inflation and debt. Integration into global financial markets on this basis was explicitly aimed at attracting capital inflows from abroad, and incentivizing domestic investment by exposing leading domestic firms to the discipline of international competition (Mondliwa and Roberts, 2019; Ndikumana et al., 2020). However, despite South Africa's strict adherence to Washington Consensus policies, its growth strategy has largely failed—evident in the persistently high levels of poverty, inequality, and unemployment (Rodrik, 2006; Bosiu et al., 2017). Chronically weak investment combined with relatively rapid trade and capital account liberalization has driven a post-apartheid economic restructuring of which manufacturing industries have been a major casualty, eliciting diagnoses of 'premature de-industrialization' (Bosiu et al., 2017). An overwhelmingly non-selective, supply-side approach to industrial policy during liberalization has failed to support industries in need of more controlled exposure to international competition, and contributed to major manufacturing job losses and the shedding of entire industries (Roberts, 2007; Zalk, 2014; Andreoni and Tregenna, 2020).

Figure 10.1a shows how market capitalization of listed South African NFCs has increased steadily, while fixed capital formation has plateaued and been declining since 2008. Using the two-digit standard industrial classification (SIC) code, Figure 10.1b distinguishes between mining and energy sectors (ME), which have been studied extensively in the financialization literature on South Africa (Fine and Rustomjee, 1996; Karwowski, 2015; Isaacs, 2017; Ashman et al., 2012),[3] and other sectors. Figure 10.1b shows a declining trend in fixed capital investment in

[3] ME sectors here are simply combining the mining and quarrying, and electricity, gas, and water supply sectors. This does not correspond to the MEC, originally confined around six conglomerate groups, which serves as an analytical unit, not an industry classification.

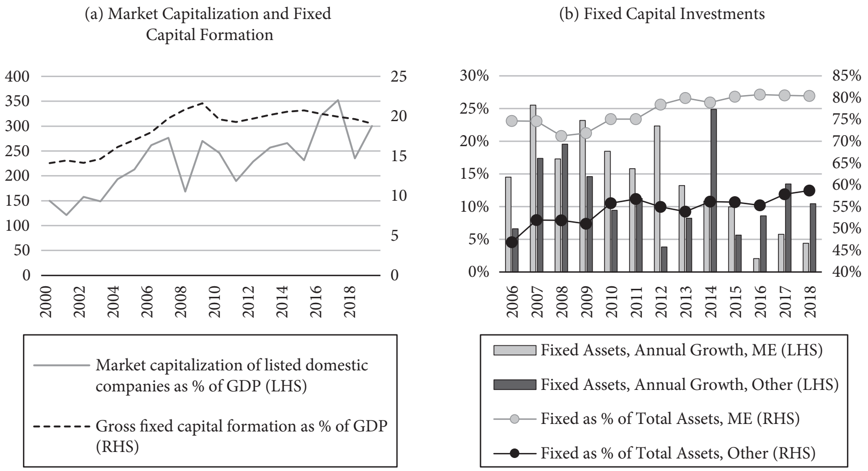

Figure 10.1 Fixed capital formation and stock market capitalization

Source: (a) Statistics South Africa, Annual Financial Statistics Survey (authors' calculations). (b) South African Reserve Bank and World Federation of Exchanges database via The World Bank Data (authors' calculations).

the ME sectors since the global financial crisis, and a similar trend for other sectors, initially. A reversal of the trend is identified from 2014, driven by a construction boom paired with a rapid expansion of the financial services sector.

These trends develop alongside high profitability and increasing shareholder payouts with some sectoral differences. Figure 10.2 shows annual profitability as net-profits as a percentage of turnover, and total dividends paid to shareholders as a percentage of net-profits, for the ME sectors (Figure 10.2a), and for the remaining sectors (Figure 10.2b). The most noteworthy observations are that the profitability of the ME sectors varies with global commodity cycles (demonstrating sectoral specificities), that ME sectors' dividend payments continue even in times of negative net-profits, and that dividend payments increase steadily for other sectors while profit margins remained relatively flat after the GFC. Interestingly, the spike in 2016 in Figure 10.2b is due to a steep increase in dividends paid by the financial services sector. The financial services sector is now the largest provider of dividends before manufacturing and exceeding the ME sectors (the largest providers in the early 2000s) by far, showing a remarkable expansion in both profits and size over the past two decades.

10.3.1 Factors Contributing to South Africa's Failure to Achieve Structural Transformation

The post-apartheid state's weakness vis-à-vis powerful factions of domestic capital, in particular the MEC, is critical in understanding South Africa's failure

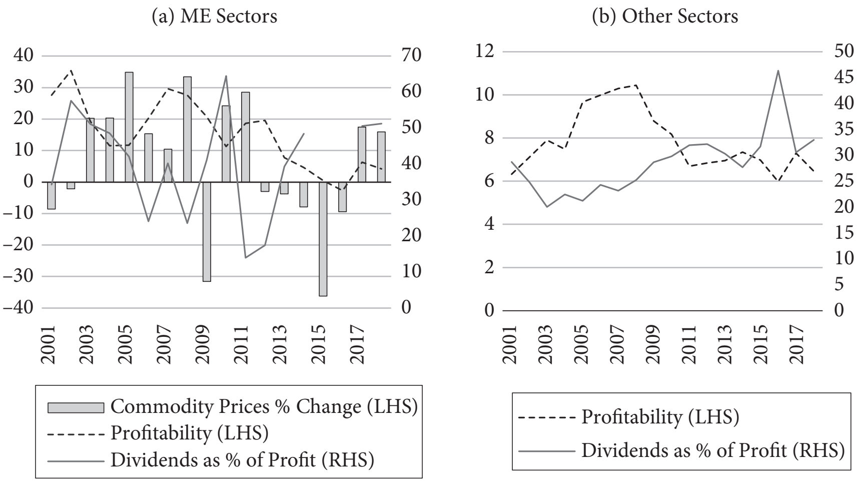

Figure 10.2 Profitability and dividend payments

Notes: Dividends as % of profits in (a) are interrupted for 2015 and 2016 as profits turned negative, while dividend payments were maintained throughout. Profitability is measured as net-profits as a % of turnover.

Source: Statistics South Africa, Annual Financial Statistics Survey (authors' calculations).

to achieve structural transformation (Fine and Rustomjee, 1996). Rather than strategically utilizing the high profitability of dominant upstream firms to strengthen production, consumption, and technological linkages with manufacturing industries in particular, the nature of the political settlement has allowed these firms to entrench their access to rents and their influence on policy (Roberts and Rustomjee, 2009; Zalk, 2014 and 2017; and Chapter 14).

Changing sentiment in international financial markets was a key driver of the post-1994 unbundling of the powerful, diversified conglomerate groups that constituted the MEC into separate entities focused on specific industries. Shares in diversified conglomerates had tended to trade at a discount in international markets due to the challenges posed by diversified holdings for market valuation methods and 'transparency' for shareholders (Bowman, 2018: 395), and unbundling proceeded rapidly (Mohamed, 2009).[4] Largely unencumbered by strategic oversight, regulation, or industrial policy on the part of the government, this process had extremely destructive consequences for industrial capabilities in some cases (see Chapter 2).

[4] It should be noted, however, that conglomerate unbundling has not resulted in more competitive markets—see Chabane et al. (2006). Industries considered to be highly concentrated include ICT, energy, financial services, food and agroprocessing, infrastructure and construction, intermediate industrial products, mining, pharmaceuticals, and transport.

Following the post-apartheid government's commitment to liberalization, exchange controls were gradually eliminated, a number of large corporates were allowed to list on foreign stock exchanges (notionally to raise capital for domestic investment), capital markets deepened substantially, and South African banks internationalized their operations and investments. Non-resident market capitalization as a percentage of total market capitalization has increased substantially since the early 2000s, both in equity, driven by robust liquidity and profitability, and debt, reflecting a sizeable carry trade attracted by high bond yields related to persistent current account deficits, and significant levels of offshore trading of rand-denominated assets (Isaacs and Kaltenbrunner, 2018). This trend has been accompanied by an increase in market-based credit relative to bank-based credit.[5] These developments are in line with a general trend across low and middle-income countries, which has ignited growing concern about new vulnerabilities and the phenomenon of subordinate financialization in these economies.

These developments have resulted in key domestic prices—exchange rates, interest rates, and asset and property prices—becoming increasingly delinked from domestic conditions, and driven instead by financial conditions in high-income economies and the decisions of large institutional investors.[6] Further, the changing demands of the global financial system on firms hoping to attract international investment have reinforced tendencies toward financialization in the domestic political economy. This is evident in increased payouts to shareholders in the post-apartheid period, driven by international investors' demands for competitive rates of return to shareholders. The distribution of profits to financial markets depletes NFCs' most efficient source of finance for expanded investment, entrenching an extractive and dependent relation between financial system and profitable enterprise.

South Africa's integration into the global financial system has been accompanied by shifts in the country's corporate governance framework, and the role of corporate governance in relation to financialization. The processes of liberalization, internationalization, and de-conglomeration came with a formal shift from a 'management-controlled, "social club" approach', dominated by family, cultural, and other informal networks, towards an Anglo-American[7] corporate governance model centred around the principle of maximizing shareholder value (see Padayachee, 2013 and 2017). Aspects of the former 'social club' dispensation

[5] However, bank-based credit remains the dominating source of credit, covering almost 90 per cent of total credit to non-financial corporations in 2019 according to BIS Statistics.

[6] These relations also act as a transmission channel for crisis in other parts of the world; exchange rate and bond yield movements in the context of the Covid-19 crisis reflect this starkly.

[7] In the sense of the countries, not the company.

remain in place, however, and a remarkably consistent flow of corporate scandals and collapses has spanned across twenty-five years and four editions of the King codes, which set out corporate governance requirements with which all the companies listed on the Johannesburg Stock Exchange (JSE), banks, financial institutions, and SOEs must comply. Despite this, the World Bank and the Institute for International Finance 'have rated South Africa among the top countries in terms of corporate best practice, and King 2 was seen as a benchmark worldwide' (Padayachee, 2013: 268).

While the evidence on levels of actual compliance with corporate governance regulations and principles is mixed, the impact of the shareholder value maximization aspect of the post-apartheid shift is clear. This is reflected materially in rising shareholder payouts, but also in the institutional and regulatory environment that has facilitated increasing distribution of profits to financial markets. Provisions allowing companies (and, critically, their subsidiaries) to repurchase their own shares were introduced in 1999, followed by further rounds of deregulation, resulting in relatively lax requirements on authorization, announcements, and reporting.

Wesson (2015), whose research on repurchases in the South African context is unparalleled, notes that the South African regulatory environment is unique in its approach to repurchases. First, subsidiaries of a parent company can purchase parent company shares up to 10 per cent of the total. Repurchases in the 2000–9 period were mainly driven by subsidiary repurchases since these were taxed at a lower rate than direct repurchases and dividends until 2012 (Wesson, 2015). Changes to the tax system introduced in 2012 reduced taxation on dividends in an effort to increase the country's attractiveness to international investors (Nyere and Wesson, 2019). In addition, the stock exchange listing requirements state that a firm is only required to declare a repurchase once cumulative repurchases surpass 3 per cent of total shares. Due to ambiguity in these regulations, however, many firms interpret the rule to mean that they need only announce repurchases once these have surpassed 3 per cent in a single year, rather than 3 per cent cumulatively over multiple years (Wesson, 2015).

As a result, unlike in the USA, UK, France, Hong Kong, and most other countries with much stricter repurchase announcement requirements, in South Africa it is impossible to track the full extent of a company's repurchasing activity in real time unless they are also listed on overseas exchanges (Wesson et al., 2015). Scrutiny of these regulatory lacunae has increased following a number of high-profile accounting scandals in leading South African firms, some of which have destroyed billions of Rands in value. However, decisive action on the part of the government or the JSE is lacking, and enforcement capacity remains weak (Crotty, 2019).

10.4 Financialization of Non-financial Corporations: Sasol and Shoprite, a Comparative Case Study Analysis

It is worthwhile recapping the six major interlinked factors set out in section 10.2: (1) sectoral heterogeneity (at firm, industry, and value chain levels); (2) value chain positioning and opportunities for rents; (3) financialization pressures on firms due to endogenous asymmetries in GVCs; (4) ownership structure, especially in regard to foreign institutional investors; (5) risks associated with reliance on international financial markets for relatively cheap credit and foreign exchange needs; and (6) the impact on domestic enterprises of the need to provide foreign investors with high risk-adjusted returns due to middle-income countries' subordinate position in global financial hierarchies.

This section examines how these factors play out in two JSE-listed South African firms located in different sectors and value chain positions: Sasol, an upstream producer of fuels, specialty chemicals and other primary inputs, and Shoprite, the country's leading supermarket chain.

10.4.1 The Story of Sasol

Sasol was established in 1950 as the South African Coal, Oil, and Gas Corporation Ltd, a SOE. Privatized in the 1980s, Sasol is now a fullyfledged multinational company, employing over 30,000 people across thirty-two countries. Initially an energy producer specializing in coal-to-liquid (CTL) fuel production, Sasol later diversified into other synthetic fuels and industrial chemicals, a strategy the firm intensified in the post-1994 democratic era in anticipation of lower profits from its energy-producing assets (Mondliwa and Roberts, 2019; and Chapter 4). This strategy proved successful, with Sasol coming to dominate the South African market across a range of specialized industrial chemicals, including polymers, explosives, waxes, and fertilizers, and forming part of a small group of highly vertically integrated firms that dominate the value chain from import, refinement, and production, to distribution and retail (Paelo et al., 2014).

Having secured its position in South Africa in the early years of the post-1994 dispensation, Sasol looked abroad in the 2000s. The firm listed on the New York Stock Exchange in 2003, and allocated significant capital expenditure to a series of overseas projects in Malaysia (2000), Mozambique (2000), Qatar (2003), China (2006/7), India (2008), Uzbekistan (2009), and a series of extremely large investments from 2011 onwards in North America (especially in Canada) (Sasol, 2012; Mondliwa and Roberts, 2019; and Chapter 2).

The fuel and chemicals industries in which Sasol operates are highly strategic due to their economic impact on consumers and downstream industries (Paelo et al., 2014). Mondliwa and Roberts (2019) among others have shown that Sasol has benefited from significant state support throughout the post-apartheid era via a number of channels. Direct support has included subsidies, large shareholdings by state development finance institutions, and other supportive industrial policy measures; indirect support has largely taken place through ineffective efforts to discipline and reallocate monopoly rents accruing to the set of dominant firms to which Sasol belongs (Davie, 2005; Zalk, 2014: 330; DTI, 2018). Efforts by the government to use regulation and competition policy to influence Sasol in ways that benefit downstream manufacturing and the economy more broadly have not only failed, but in some cases have been in direct conflict with other industrial policy measures and stated national strategies for growing the industrial base (Mondliwa and Roberts, 2019).

10.4.2 The Story of Shoprite

Like Sasol, Shoprite is a dominant player in an important strategic sector—food retail. Not only have Shoprite, its subsidiaries, and a small handful of major competitors maintained a firm grip on the South African market in spite of the entrance of new firms, they have extended their reach into a number of other countries on the continent. This expansion and search for new markets, aided by a strategy of differentiated brand offerings for different income groupings, has been identified as Shoprite's key growth strategy (das Nair and Chisoro-Dube, 2017: 9).

Shoprite retains a market share of at least 30 per cent in South Africa. This has been due in part to a series of key acquisitions, including, famously, the acquisition of the OK Bazaars chain for R1—less than $5 at the time (Jones, 1997). Shoprite's dominance is also due, in part, to large investments in an advanced retail and distribution infrastructure, including its own logistics fleet, and sophisticated information management systems (das Nair and Chisoro-Dube, 2015 and 2017). It is the only supermarket chain in the JSE's top fifty firms, with the third-highest revenues and the third-highest number of employees (almost 150,000) on the exchange (Bosiu et al., 2017; Thomson-Reuters, 2019).

As a large employer and a dominant lead firm in an industry with a direct impact on households and a range of other non-financial sectors, Shoprite's impact on the broader economy is significant. das Nair and Chisoro-Dube (2015) argue that more competition in the industry would be beneficial for households and suppliers, and describe a range of barriers to entry in the markets Shoprite operates in. These include prohibitive initial investment costs, and the time and 'patient' finance needed for the development of key capabilities, as well as a set of 'strategic barriers' essentially to do with anticompetitive practices by dominant firms (2015: 17). das Nair and Chisoro-Dube (2017) also note that, as lead firms in their supply chains, dominant supermarkets like Shoprite are able to exert huge pressure on suppliers, primarily through demanding lower costs, larger quantities, and higher standards. Lastly, Shoprite has also benefited from substantial state support over the years, in the form of significant state ownership of equity, employment subsidies, and minimal penalties for anticompetitive behaviours (see Chapter 8).

10.4.3 The Symptoms of Financialization in Both Firms

Both Sasol and Shoprite show a number of symptoms of financialization. These reflect the spread of what Lazonick has referred to as 'the American disease'—the extraction of profits or 'excess cash' out of firms and into financial markets via dividend payments, share repurchases, and payments to creditors. However, in these two cases the disease manifests differently than in Lazonick's work in the US context, with growing shareholder distributions driven by dividends rather than share repurchases (see Figure 10.3).

Figure 10.3 compares shareholder distributions from 2000–9 with those from 2010–19. Data for the earlier period are drawn from Wesson's (2015) database for dividends and repurchases, while figures for the more recent period have been constructed from company financial statements and the Thomson-Reuters Eikon database.

It is clear that both firms have significantly increased their total distributions to shareholders (TDS), with Shoprite increasing TDS to a greater degree than Sasol. This shows that, in terms of the extent of their financialization, non-ME sectors may be in a process of 'catching up' with ME sectors. Perhaps most interestingly, dividends have driven the increase in total distributions, while growth in repurchases has been less significant in the latter period, even declining in Sasol's case. This pattern resembles that observed by Andreoni et al. (2020) in the UK and broader European context, in contrast with the USA.

Clear shifts in strategy in relation to sources of funds are also observed in the latter period, with both firms financing capital expenditure, acquisitions, and shareholder distributions increasingly with debt (see Figure 10.4).

Two points can be made about Sasol's sources of funds in the last twenty years or so. First, the funds Sasol raises from equity are extremely small in comparison with funds raised from sales revenues and from debt. The highest total raised from equity in a single year was equivalent to around US$750,000 in 2013, while in that same year around US$1.4bn was raised in debt alone. This evidence seems to confirm Lazonick's (2008) proposition that the primary function of the modern stock market is not to provide resources to firms, but to extract from them.

The second point is that debt has increased rapidly from around 2012, in a context of first stagnating and then rapidly declining net income as oil prices

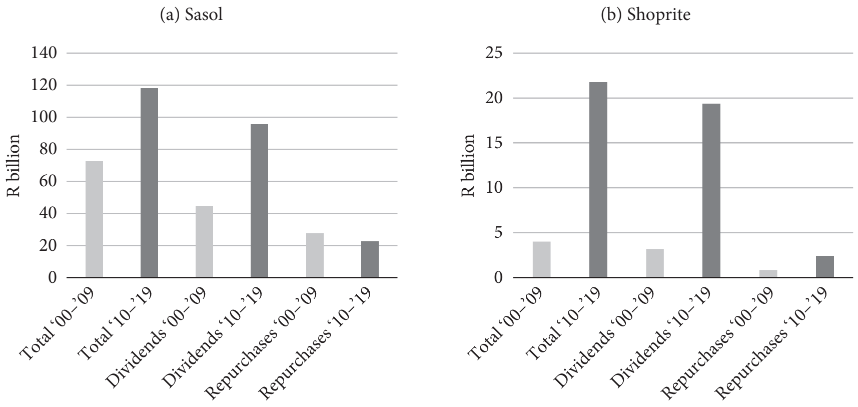

Figure 10.3 Composition of distributions to shareholders, 2000–9 vs. 2010–19
Source: Wesson (2015); company annual financial statements and Thomson-Reuters Eikon database.

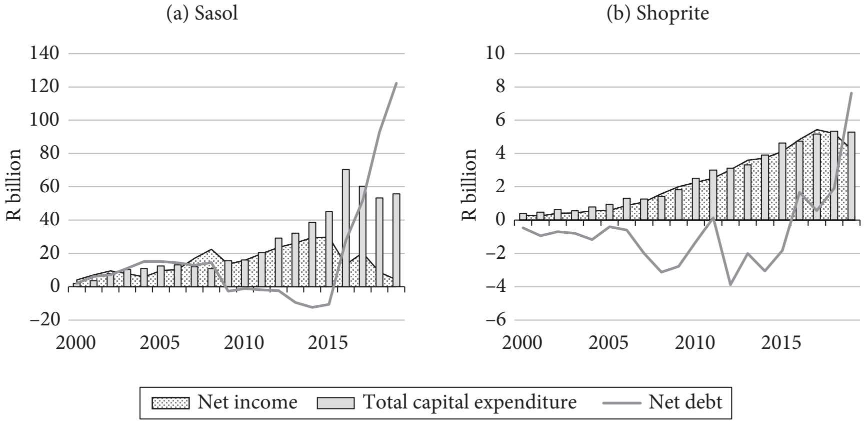

Figure 10.4 Sources and uses of funds in Sasol and Shoprite (2000–19)
Source: Company annual financial statements and Thomson-Reuters Eikon database.

collapsed toward the end of 2014. These outcomes reflect a major strategic shift from 2011 onwards, led by the firm's first 'outsider' CEO—a former FluorCorp executive, David Constable. A key outcome of this shift was that the company started to pivot away from major new investments in South Africa and other international operations in favour of new US-based 'megaprojects', the viability of which depended to a large extent on the maintenance of relatively high oil prices. Another related outcome was that it reorganized its corporate structure, organization, and culture in line with what Lazonick and others have described as a 'downsize and distribute' model of corporate governance. In the case of Sasol this took the form of thousands of retrenchments, divestment from 'non-core' downstream operations, rapid increases in stock-based executive remuneration, and larger distributions to shareholders.

Related both to Sasol's strategic pivot towards North America and loose monetary conditions in the USA, the currency composition and overall level of Sasol's debt has changed drastically since 2011. Dollar-denominated debt surpassed rand-denominated debt in 2015 and has grown rapidly since, approaching the equivalent of R130bn in 2019, more than ten times its 2013 level. Sasol's exposure to exchange rate risk, escalated by delays in the construction of key dollar-generating assets has clearly intensified sharply in recent years. Over the same period, a major decoupling has taken place between where Sasol generates its profits—overwhelmingly and consistently in South Africa through the period studied here—and where it invests these profits, with capital expenditure in South Africa stagnating as investment in the USA took precedence from 2011 onwards.

Analysis of Shoprite's sources of funds indicates a similar escalation in the proportion of debt to net income, with net debt increasingly volatile from 2008 and growing rapidly from 2012 onwards. Shoprite has not experienced the same level of decline in net income as Sasol, but net incomes stagnated in 2017–18 and fell by a worrying 18 per cent from 2018 to 2019. Shoprite reported a large equity issue in 2017, to the value of R4.6bn. However, a close examination of its annual reports shows that this represented a large-scale conversion of debt securities into shares, and ought not to be considered as new funds raised from shareholders (Shoprite, 2012). These securities had been issued in 2012, to institutional investors only, as a means of funding acquisitions and to 'shore up the balance sheet' (News24, 2012).

While available data on the evolution and composition of Shoprite's debt over the period studied are poor, its financial statements have reported growing dollar-denominated debt from 2015 onwards. These show that while rand-denominated debt increased from R110m to R134m between 2015 and 2018 (a 22 per cent increase), US dollar-denominated debt increased from R249m to R6.9bn—an increase of almost 2,700 per cent (Shoprite, 2016 and 2018). Such a rapid escalation in the firm's foreign debt is concerning. Further, unlike Sasol (despite its present difficulties), Shoprite has acquired no assets that generate US dollars or any other 'hard currency', and it appears to have no plans to develop any. It is also worth noting that large portions of Shoprite's borrowings have come from branches of international banks based in tax havens including Mauritius and the Isle of Man.

Shoprite's 2018 Integrated Annual Report acknowledges exchange rate volatility and shortages of hard currency as high-risk concerns that 'continue to create major obstacles' for the firm (p. 25). Shoprite's key risk mitigation strategy is to increase investments in US treasury bills (short-term, low-yield debt obligations). This reflects one of the key concerns of the subordinate financialization perspective, as the strategy generates increased net flows of capital from EMDEs to advanced economies (see Lapavitsas, 2013; Powell, 2013). As Akyuz (2018) argues, these dynamics entrench EMDE current account deficits as EMDE holdings of low-yielding foreign assets increase alongside relatively high-yielding foreign liabilities.

Another component of Shoprite's risk mitigation strategy is that the firm instructs its subsidiaries to pay out its 'excess' cash to the parent company to pay back short-term debt (Shoprite Integrated Annual Report 2018: 25). This is made possible because Shoprite exercises control over a buyer-driven value chain. As a result of this power, resources that could be ploughed back into productive reinvestment, spread more equitably in less oligopolistic markets, or used to raise low wages and improve poor working conditions, are instead being paid out to Shoprite's creditors and are lost to the continent entirely.

Building on Wesson's (2015) finding that share repurchases in South Africa tend to be conducted via subsidiaries, it is argued here that these trends suggest increasing extraction of value out of productive assets and into financial markets.

10.4.4 Key Finding: Corporate Strategies Are Driven by the Availability of International Capital

The evidence presented above supports one of the key arguments of subordinate financialization scholars: that changes in NFCs' corporate strategy—particularly regarding capital structure and investment patterns—have not been driven by operating characteristics, as theorized in orthodox economics, but by the availability of international capital to EMDE firms in an era of global financial liberalization (Powell, 2013).

The core findings illustrate an increase in financial activity relative to productive activity, indicated by an increasing reallocation of precious firm resources away from productive investment and toward financial interests, paying high returns to property in shareholdings and to creditors. It is also clear that while companies operating in different sectors and stages of the value chain are all affected by financialization, there is heterogeneity in the ways in which financialization operates across NFCs. So, to the extent that financialization can manifest differently, it also hampers structural transformation in different ways.

10.5 Conclusions

Over the last two decades, financialization in South Africa has been driven by the joint effect of the distribution of power in the domestic political economy and the nature of South Africa's integration with global finance. These two factors have mutually reinforced each other and deprived the economy of the precious resources needed to spur investment-led structural transformation. Specifically, it has been shown how financialization has undermined the translation of profits into domestic investment, reducing its capacity to drive structural transformation.

Post-apartheid liberalization and internationalization coincided with a global conjuncture in which private capital flows and underlying economic performance have become increasingly delinked. This has, in combination with increased international investment and trading in South African equity, debt, and currency markets, contributed to increased financial vulnerability and extraction of profits from South African firms.

The prevailing economic policy framework and the additional measures taken to buffer the economy from crisis have essentially socialized the costs of these developments, while the benefits accrue to international investors, domestic finance capital, speculative asset traders, and wealthy beneficiaries of asset price inflation. Safeguarding macroeconomic stability via inflation targeting and reserve accumulation has entrenched high interest rates and reliance on short-term inflows. As South Africa started to reconnect with international financial markets, NFCs were put under extreme pressure to conform with contemporary corporate strategies and to align with the international demand for shareholder value maximization. This realignment is at the expense of productive reinvestment of profits in general, and especially in South Africa where they are generated.

As shown in the two case studies in section 10.4, studies of financialization in middle-income countries can benefit a great deal from a firm-level analysis. This allows for the recognition of a range of heterogeneities at the firm, industry, and value chain level, an evaluation of how value chain positioning impacts the creation and extraction of rents, and the analysis of common financialization pressures faced by NFCs in spite of their differences. Sasol and Shoprite, lead firms operating in different sectors and value chain positions, clearly illustrate this. Both firms show symptoms of financialization, increasing their distributions to shareholders markedly in the period under study, with the composition of this increase driven by dividends rather than share repurchases. Despite their differing operating characteristics, the analysis of the firms' sources and uses of funds shows that both have increasingly financed their investments, operations, and even shareholder distributions with debt, much of which has been denominated in US dollars. This has exposed both firms to significant risks given that the bulk of their profits are generated in Rands, and is an especially troubling development for Shoprite in light of its apparent lack of dollar-generating assets. The strategies employed to mitigate these risks reflect power dynamics underlying South Africa's financialization on two levels: the acquisition of low-yielding, dollar-denominated 'safe haven' assets to hedge against currency risk reflects the country's subordinate position in the global hierarchy of currencies and financial markets; and the extraction of profits from subsidiaries to finance dramatically increased debt reflects the power of lead firms' value chain position and market dominance.

These processes have further empowered domestic capital vis-à-vis the state, which has enacted forms of deregulation that further entrench financialization and appears to retain relatively little leverage to induce large domestic firms to invest in accordance with a strategic national growth path.

While enabled by changes in corporate governance, financialization is entrenched within a broader political economy context in South Africa, and in South Africa's relations with the rest of the world. Given the complex firm-level processes of financialization revealed by the case study analysis, a more detailed framework capable of unveiling heterogeneous processes of financialization is called for. Without such deep dives into specific company trajectories, corporate governance reforms alongside competition and industrial policy for structural transformation cannot be effective.

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