

# The Investment Analysts Journal

Number 13 April 1979

# Die Beleggings- Navorsers Tydskrif

Nommer 13 April 1979

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Inhoud

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## This issue in brief

### **Standards of accounting practice and the objectives of financial reporting**

Information is the raw material of investment analysis. Without it, no proper judgement can be formed of investment values and it is, therefore, on information, its quality and appraisal, that stock market efficiency depends. However, it has always been a problem of stock markets that information is not made available timeously or presented in a manner that is meaningful to investors concerned not only with the isolated investigation of individual securities but also of making comparisons between one security and another. In this paper by W. A. A. Maguire of Cape Town University, attention is given to the specific matter of accounting information and the standards that govern its presentation in South Africa. He concludes that much needs to be done in the way of establishing a conceptual framework for financial reporting before the development of standards takes place in a logically consistent manner.

### **Some results of an empirical study of ratio analysis in South Africa**

This paper by A. D. Boy of Natal University is concerned with an empirical investigation of ratio analysis in South Africa. To what extent is ratio analysis used by corporate investigators concerned with capital budgeting decisions and to what extent are there gaps between the theory and practice of financial management techniques? These are questions to which Mr Boy addresses himself. Not surprisingly he reports that there is a positive connection between the use of ratio analysis and the size of firms in this country and that most firms who use it, do so in a manner which suggests that the gap between theory and practice here is not large. But clearly there are many smaller firms which apply it only to a limited extent and do not do so correctly.

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### **The influence of financial policy on the growth of profitability and size of firms**

The matter of gearing has for a long time fascinated those interested in the theory and practice of corporate finance. In what circumstances and to what extent is the use of loan capital justified? Is it possible to conceive of an optimum capital structure? How does the capital structure of a firm affect its cost of finance? What is the effect of debt financing on growth? It is with questions of this kind that Dr Bethlehem is concerned. However, he also gives attention to the related matter of the retention of earnings and the correlation it has, if any, with growth and performance. The basis of Dr Bethlehem's paper is an empirical investigation he undertook of 280 companies listed on the JSE.

### **The relationship between portfolio theory and the efficient market hypothesis**

The matter of market efficiency is intriguing in itself but it also forms the basis of portfolio theory as developed by Markowitz, Sharpe and others over the last two decades. In this paper Prof Seneque deals in detail with both subjects and explains the link between them. Inevitably much stress is placed on risk and return and how concern with the trade-off between them works to guide investor behaviour.

### **Net asset value**

Mr Du Toit's paper is the fourth in our series entitled 'Investment basics' and deals with the importance of the assessment of net asset value to the determination of the fundamental value of a share. In terms of the fundamentalist ethic, shares with an intrinsic value higher than their ruling price should be bought while shares with an intrinsic value less than ruling price should be sold, but intrinsic value is something that defies objective determination. Because of this a knowledge of asset value may be very important.

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Thirteenth issue

April 1979

In recent issues of this Journal we have published a number of articles on the subject of stock market efficiency mainly because of its importance to practising investment analysts and portfolio managers. The subject, however, has an importance which ranges beyond the esoteric interest of such persons and it may, therefore, serve a purpose here to place it in a wider perspective. Stock market efficiency is not a matter than can be separated from the matter of general economic efficiency, nor are the characteristics of stock market price changes unique. What is true of them is true also, to a greater or lesser degree, of bond market price changes, money market price changes, changes in currency values and changes in the prices of commodities. The markets for shares, debt instruments, currencies and commodities are all concerned with the trading of relatively homogeneous and highly divisible assets, and in all of them speculation on the part of well informed profit-maximisers has developed to a substantial degree. It should surprise nobody, least of all investment analysts, that prices, in whatever market is being considered, should reflect new information very quickly. Investment analysts may have made the mistake until now of underrating the quality of competition in such markets, but with the evidence now available, it is not a mistake they should repeat in the future.

The focus of attention on market efficiency must be seen also as an aspect of a new respect for the market place on the part of policy makers. In the U.S. and in other industrialised countries, but in South Africa also, governments are losing confidence in their ability properly both to control the direction of economic events and to determine correctly the order of economic priorities. To interfere with the free interaction of demand and supply is to risk not only economic distortion, it is to risk making mistakes of policy and being turned out of office for disregarding basic realities. The market is being seen increasingly as an objective barometer of economic conditions, and barometers are not things with whose functioning one tampers if it is the truth that one seeks.

Whatever the validity of this view, and it is important to note that there are those who will take issue with it, it is a fact that it is a view that is gaining increasing support in South Africa, and particularly in Government circles. A day hardly passes without some official spokesman proclaiming the virtue of the free market economy or of the need for persuading blacks, as well as whites, of its merits. Indeed, it is fair to say that the Government's acceptance of the De Kock Commission's recommenda-

Dertiende uitgawe

April 1979

In onlangse uitgawes van hierdie Tydskrif het ons 'n paar artikels gepubliseer oor die onderwerp van effektemarkdoeltreffendheid, hoofsaaklik as gevolg van die belangrikheid daarvan vir praktiserende beleggingsnavorsers en portefeuljbestuurders. Die belang van die onderwerp strek egter verder as die esoteriese belangstellings van dié persone, en dit kan dus nuttig wees om dit hier in 'n breër perspektief te plaas. Effektemarkdoeltreffendheid is nie 'n aangeleentheid wat geskei kan word van die aangeleentheid van ekonomiese doeltreffendheid nie, en die eienskappe van effektemarkprysveranderings is ook nie uniek nie. Wat geld vir effektemarkprysveranderings, geld in mindere of meerdere mate ook vir obligasiemarkprysveranderings, geldmarkprysveranderings, veranderinge in deviesewaardes en veranderinge in die pryse van handelsartikels. Die markte vir aandele, skuldaktes, geldmiddelle en handelsartikels is almal betrokke by die verhandeling van betreklik gelyksoortige en hoogs verdeelbare bates, en by almal van hulle het spekulاسie van die kant van goed ingeligte winsmaksimaliseerders in 'n aansienlike mate ontwikkel. Dit behoort allermins vir beleggingsnavorsers verbasend te wees dat pryse, in watter mark ook al, nuwe inligting baie gou behoort te weerspieël. Beleggingsnavorsers het tot dusver miskien die fout begaan om die gehalte van mededinging in dié markte te onderskat, maar met die bewyse wat tans beskikbaar is, is dit nie 'n fout wat hulle in die toekoms behoort te herhaal nie.

Die verhoogde belangstelling in markdoeltreffendheid moet ook gesien word as 'n aspek van 'n nuwe ontsag vir die mark van die kant van beleidsvormers. In die V.S.A. en in ander geïndustrialiseerde lande, maar ook in Suid-Afrika, verloor regerings vertroue in hulle vermoë om die verloop van ekonomiese gebeure behoorlik te beheer, asook om die volgorde van ekonomiese voorrang op 'n juiste wyse vas te stel. Om met die vrye wisselwerking van vraag en aanbod in te meng, bring nie net die risiko van ekonomiese verwringing mee nie, maar ook die risiko van beleidsfoute en van ampsonthefing as gevolg van die verontagsaming van basiese werklikhede. Die mark word al hoe meer as 'n objektiewe barometer van ekonomiese toestande beskou, en as 'n mens die waarheid nastreef, peuter jy nie aan die werking van barometers nie.

Hoe geldig dié siening ook al mag wees, en dit is belangrik om daarop te let dat daar diegene is wat daarmee sal verskil, is dit 'n feit dat dit 'n siening is wat al hoe meer steun werf in Suid-Afrika, en veral in Regeringskringe. Daar gaan skaars 'n dag om, of een of

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tions amounts to a clear confirmation of official recognition of the wisdom as well as authority of the exchange market, and its acceptance of the recommendations of Wiehahn, to confirmation that even in the sphere of labour, the dictates of market forces cannot be disregarded.

THE EDITOR

ander amptelike woordvoerder wys op die doeltreffendheid van die vrye markeconomie of die nodigheid daarvan om die swart bevolkingsgroep, sowel as die blanke bevolkingsgroep, van die voordele daarvan te oortuig. Daar kan inderdaad met eerlikheid gesê word dat die Regering se aanvaarding van die De Kock-kommissie se aanbevelings neerkom op 'n duidelike bevestiging van amptelike erkenning van die wysheid sowel as die gesaghebbendheid van die deviesemark, en sy aanvaarding van die aanbevelings van Wiehahn, op bevestiging dat selfs op die gebied van arbeid die voorskrifte van markkragte nie verontagsaam kan word nie.

DIE REDAKTEUR

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