

# The Investment Analysts Journal

Number 20 November 1982

# Die Beleggings- Navorsers Tydskrif

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## Inhoud

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### This issue in brief

#### **Why expectations matter**

On 23 June 1982 Ludwig M. Lachmann, Professor Emeritus at the University of the Witwatersrand and since 1975 visiting Professor of Economics at New York University, addressed a meeting of The Investment Analysts Society of Southern Africa in the auditorium of The Johannesburg Stock Exchange. His subject was "Why expectations matter". This is a transcription of his lecture. Lachmann has long emphasised the centrality of expectations not only to economic planning (be it at a national or a corporate level) but, also to any consideration of economic analysis. The problem, however, resides in the fact that expectations are indeterminate and, therefore, pose a problem to those wishing to construct quantitative models. His message should be of enduring interest to investment analysts and portfolio managers as well as to all economists.

#### **Ownership and control of large companies in the RSA**

Trends towards industrial concentration and the separation of ownership and control which have characterised the development of industrialised market economies in North America and Western Europe this century are to be found also in South Africa albeit with some differences. Fiona Halse, a lecturer in the Department of Business Administration of the University of Natal, Pietermaritzburg, discusses them using as her base, data relating to the FM Top 30 Companies ranked by total assets in April 1982. The study has an important message for all students of business economics in South Africa.

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#### **The take-over objectives of South African acquiring companies**

The neoclassical theory of the firm postulates that profit maximisation is the principal objective of the modern business corporation. Is such an assumption valid having regard to the behaviour of private sector undertakings in South Africa? Narendra Bhana, a senior lecturer at the University of Durban-Westville, comes to the conclusion that it is not in a study of the differing objectives of our major companies most actively engaged in take-over activity. Moreover, her research suggests that an excessive preoccupation with growth as opposed to profitability could lead towards a conflict between the interests of management and shareholders, and even have undesirable socio-economic consequences.

#### **Some thoughts on the availability and uses of accounting information**

The author, Mr D. Konar, is a lecturer in accountancy at the University of Durban-Westville and recently completed a Master of Accounting Sciences degree at the University of Illinois on an American Fulbright Scholarship. In this article he sets out to discuss the use that can be made of financial ratios in the evaluation of corporate performance, bond rating and financial distress prediction.

#### **The performance of South African mutual funds**

This is an updated version of an earlier unpublished study on the performance of South African mutual funds. Here Brian Gilbertson has teamed up with Martin Vermaak and their findings are challenging and also surprising. While studies of mutual fund performance in the US have been generally supportive of the efficient market hypothesis, the evidence of this study raises new doubts. At least one fund has been able to outperform others fairly consistently and this poses questions about the pricing mechanism for shares listed on the JSE.

#### **An introduction to gold mining taxation**

Ian Davies, in the first of a three part series for our investment basics section, discusses the mechanics of South African gold mining taxation. Numerical examples are included to facilitate illustration.

# The Investment Analysts Journal

# Die Beleggingsnavorsers Tydskrif

Twentieth issue

November 1982

We are privileged in this tenth anniversary issue of The Investment Analysts Journal to carry a transcription of the lecture given on 23 June 1982 by Professor Ludwig M. Lachmann to The Investment Analysts Society on the subject "Why expectations matter." It was a memorable occasion and the auditorium of The Johannesburg Stock Exchange was filled to near capacity. This was a tribute to Professor Lachmann himself and a measure of the esteem in which he is still held here ten years after his retirement as head of the Department of Economics at the University of the Witwatersrand. Many in the audience had come from Pretoria to listen to him. However, it was also a measure of the importance of the subject that Professor Lachmann chose for his address. Expectations have long been a problem not only for economic theorists but also for hardnosed market participants and, no doubt, the large audience reflected a desire amongst many for a clarification of thought on the subject. The trouble with expectations is that they represent the forward thinking of market participants based on information available and they, thus, provide an additional dimension within the bounds of which investment decisions have to be made. In short, expectations equate to being forecasts, upon the forecasting of which successful investment depends. One is reminded of the famous passage from Keynes' General Theory wherein professional investment is likened to those newspaper competitions requiring competitors to pick out of a hundred photographs, the six prettiest faces, the prize being awarded to the competitor whose choice most closely corresponds to the average preferences of the competitors as a whole. Clearly, in such a case, the trick is to pick not the faces that one finds the prettiest oneself but those which one thinks will catch the fancy of other competitors, all of whom are approaching the problem in the same way. "It is not a case of choosing those which, to the best of one's judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligence to anticipating what average opinion expects the average opinion to be."

This, of course, applies to stock markets and other markets where the process of clearing does not concern a matching of actual consumption and physical production. However, even in goods markets, the problem of expectations is central. Where supply depends on production and production takes time, decisions to produce have to be made before decisions to consume are made. This requires that expectations be formulated as to what the future relationship of demand and supply is likely to be before plans can be finalised and action initiated, aimed at their realisation. What concerns the producer, however, is not merely what consumers will be demanding when the output he plans is available, but also what other producers will be supplying, each one of whom is again compelled to approach the problem in a like fashion. In short, much of the information that producers need in order to fulfil their task efficiently cannot be available when they require it, so that decisions have, perforce, to be made on the basis of incomplete knowledge.

Twintigste uitgawe

November 1982

Ons is bevoorreg om in hierdie uitgawe waarin die tiende verjaardag van Die Beleggingsnavorsers Tydskrif herdenk word die lesing op 23 Junie 1982 deur professor Ludwig M. Lachmann aan Die Beleggingsnavorsersvereniging oor die onderwerp "Waarom verwagtinge belangrik is", weer te gee. Dit was 'n onvergeetlike geleentheid en die ouditorium van Die Johannesburgse Effektebeurs was byna stampvol. Dit was 'n huldebetuiing aan professor Lachmann self en 'n blyk van die agting waarmee hy nou nog bejeën word, tien jaar na sy aftrede as hoof van die Departement van Ekonomie by die Universiteit van die Witwatersrand. Talle lede van die gehoor het van Pretoria gekom om na hom te luister. Dit was egter ook 'n aanduiding van die belangrikheid van die onderwerp wat professor Lachmann vir sy toespraak gekies het. Verwagtinge is lank reeds 'n probleem, nie net vir ekonomiese teoretici nie, maar ook vir geharde deelnemers aan die mark, en daar was ongetwyfeld 'n begeerte by 'n groot deel van die gehoor om te hoor hoe dié onderwerp toegelig word. Die probleem met verwagtinge is dat dit die vooruitdenke van markdeelnemers, gegrond op beskikbare inligting, verteenwoordig, en dit verskaf dus 'n bykomende dimensie binne die perke waarvan beleggingsbesluite geneem moet word. Kortom, verwagtinge is gelykstaande met voorspellings, en suksesvolle belegging is afhanklik van dié voorspelling. Dit laat 'n mens dink aan die beroemde gedeelte uit Keynes se Algemene Teorie waarin professionele belegging vergelyk word met dié koerantkompetisies waarin deelnemers die ses mooiste gesigte uit 'n honderd foto's moet kies en die prys toegeken word aan die deelnemer wie se keuse die naaste ooreenstem met die gemiddelde voorkeure van die deelnemers in die geheel. Dit spreek vanself dat die geheim in só 'n geval daarin lê, nie om die gesigte te kies wat vir jou persoonlik die mooiste is nie, maar dié wat na jou mening vir ander deelnemers die mooiste sal wees, en op hulle beurt benader hulle natuurlik die probleem op dieselfde manier. "It is not a case of choosing those which, to the best of one's judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligence to anticipating what average opinion expects the average opinion to be."

Dit is natuurlik van toepassing op effektemarkte en ander markte waar die skoonmaakproses nie die bymekaarbring van werklike verbruik en materiële produksie behels nie. Sels in goederemarkte staan die probleem van verwagtinge egter sentraal. Waar die aanbod van produksie afhanklik is en produksie tyd neem, moet produksiebesluite geneem word voor verbruiksbesluite geneem word. Dit vereis dat verwagtinge met betrekking tot die waarskynlike toekomstige verhouding van vraag tot aanbod geformuleer word voor planne gefinaliseer en daar oorgegaan kan word tot optrede met die oog op die realisasie daarvan. Die produsent is egter nie net gemoeid met wat die verbruiker sal aanvra wanneer die produksie wat hy beplan beskikbaar is nie, maar ook wat ander produsente sal aanbied, en op hulle beurt word hulle elkeen weer verplig om die probleem op dieselfde

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The special nature of expectations puts them into a different category from the other data of economic analysis. These generally relate to the needs and preferences of consumers, on the one hand, and material resources and states of technology, on the other. Such data are usually treated as exogenous to the immediate problem, i.e. they are incorporated into a model as items that are either given or assumed and from which other variables can then be determined. Expectations cannot be so regarded. While they are a cause of economic events and are also determined by them, they are influenced as well by other factors which may be both non-economic (e.g. social and political) and unobservable. In short, expectations are indeterminate and defy any attempt we may make to quantify them. It has been Lachmann's contribution to economic thought that he has focused on these issues and drawn attention to the difficulties that must inevitably be associated with any attempt (as in the case of rational expectations) to explain how expectations might be generated endogenously.

Lachmann's contribution to thought, however, needs to be seen in perspective. It has not been isolated either in time or place. Born in Berlin in 1906, he grew up in the Germany of the Weimar Republic obtaining a doctorate at the University of Berlin in 1930. In 1933 he left Germany for Britain where he studied under Von Hayek at the London School of Economics. Hayek was then, as he remains, a major proponent of the Austrian School. In his own right, Lachmann is today recognised as a leading figure in Austrian economics and has contributed widely to writings on the subject. The unique characteristics of the Austrian School are its emphasis on subjectivism, i.e. on the micro-economic origins of causality, and on its rejection of the notion of **general** equilibrium as a useful tool in the development of theoretical models because of its inherent lack of realism. Subjectivism places its emphasis on the importance of the autonomous individual in the market economy and can be contrasted with the macro-economic approach both of Keynesian economics and neo-classical monetarism. Whereas both these assume general equilibrium, or underlying forces in its direction, for their theoretical justification, the Austrian School argues in favour of the view that the market is something whose dynamics do not permit such abstractions. The accumulation of the effects of change, particularly of **unexpected** change, make disequilibrium, and the mal-investment associated with it, important and require that they be explained. In short, the market is a process that must be seen in the context of time and it can only be analysed as such. It can no more be stopped to facilitate study than time itself can be suspended to allow us an opportunity to rearrange our thoughts.

This is an approach that ought to have a basic appeal to all those who are eager to bring a greater realism into matters of economic and financial analysis.

#### The editor

wyse te benader. Kortom, heelwat van die inligting wat produsente nodig het om hulle op doeltreffende wyse van hulle taak te kwyf, kan nie beskikbaar wees wanneer hulle dit nodig het nie, met die gevolg dat besluite noodgedwonge gegrond op onvolledige kennis geneem moet word.

Die besondere aard van verwagtinge plaas hulle in 'n ander kategorie as die ander data van ekonomiese navorsing. Oor die algemeen hou laasgenoemde verband met die behoeftes en voorkeure van verbruikers aan die een kant en materiële middele en tegnologiese toestande aan die ander kant. Dié data word gewoonlik eksogeen ten opsigte van die onmiddellike probleem behandel, d.i. dit word by 'n model geïnkorporeer as items wat óf gegewe óf veronderstel is en na aanleiding waarvan ander variante dan vasgestel kan word. Verwagtinge kan nie op dié manier beskou word nie. Hoewel dit 'n oorsaak van ekonomiese gebeure is en ook daardeur bepaal word, word dit ook beïnvloed deur ander faktore wat nie-ekonomies (bv. sosiaal en politiek) sowel as nie-waarneembaar kan wees. Kortom, verwagtinge is onbepaald en kan eenvoudig nie vasgepen word nie. Lachmann se bydrae tot ekonomiese denke was dat hy die aandag gevestig het op dié kwessies en die probleme wat onvermydelik verband hou met enige poging (soos in die geval van rasionele verwagtinge) om te verduidelik hoe verwagtinge endo-geen gekweek kan word.

Lachmann se bydrae moet egter in perspektief gesien word. Dit was nie van tyd of plek afgesny nie. Hy is in 1906 in Berlyn gebore en het in die Duitsland van die Weimar-republiek grootgeword. In 1930 behaal hy 'n doktorsgraad aan die Universiteit van Berlyn en in 1933 verlaat hy Duitsland om in Brittanje onder Von Hayek by die London School of Economics te studeer. Lachmann word vandag beskou as 'n hooffiguur in die Oostenrykse ekonomie en het 'n omvattende bydrae tot werke oor die onderwerp gelewer. Die kenmerkende eienskappe van die Oostenrykse Skool is die beklemtoning van subjektivisme, d.w.s. van die mikro-ekonomiese ontstaanspunte van oorsaaklikheid, en van die verwerping daardeur van die begrip van algemene ewewig as 'n nuttige middel by die ontwikkeling van teoretiese modelle, as gevolg van die inherente gebrek aan realisme daarvan. Subjektivisme benadruk die belangrikheid van die outonome individu in die markeconomie en kan teenoor die benadering van Keynesiese ekonomie sowel as neoklassieke monetarisme gestel word. Terwyl albei dié skole algemene ewewig of onderliggende magte in dié rigting ter regverdiging van hulle teorieë veronderstel, voer die Oostenrykse Skool argumente aan ten gunste van die beskouing dat die mark iets is waarvan die dinamika nie ruimte laat vir sodanige abstraksies nie. Die akkumulاسie van die uitwerkings van verandering, veral onverwagte verandering, maak onewewigtigheid en die wanbelegging wat daarmee gepaard gaan belangrik en vereis dat dit verduidelik word. Kortom, die mark is 'n proses wat in 'n tydkonteks gesien moet word, en dit is slegs as sodanig wat dit ontleed kan word. Net so min as wat die tyd self tot stilstand gebring kan word om ons kans te gee om ons denke te herorden, net so min kan die mark-proses tot stilstand gebring word om die bestudering daarvan te vergemaklik.

Dit is 'n benadering wat in sy wese aanklank behoort te vind by diegene wat graag 'n groter mate van realisme in sake rakende ekonomiese en finansiële ontleding teweeg wil bring.

#### Die redakteur