

The  
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Die  
Beleggings-  
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Nommer 21 Junie 1983

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# Inhoud

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## This issue in brief

### **A theory of the financial rand discount**

Although exchange control on non-residents has now been abolished, this article by Barr and Kantor serves a useful purpose in making clear the theoretical issues behind the operation of the financial rand system. Its interest may be principally for students of South African financial history but it will not be without value even to hardnosed traders in local financial markets for it contributes to an understanding of how such markets work and interrelate.

### **The efficient market hypothesis and a change to LIFO:**

#### **An empirical study on the JSE**

In an inflationary world, traditional accounting procedures can be misleading, particularly with regard to the estimation of distributable profit and this has given rise to the widespread adoption of the LIFO method of inventory valuation. Because LIFO understates the value of end-period stock levels it also understates earnings and so minimises the distortion caused by rising stock replacement costs. In this study by Knight and Affleck-Graves of the impact of LIFO reporting on the JSE, various aspects are considered. Its general conclusion is that LIFO effects are not generally efficiently reflected in JSE prices which suggests that inconsistencies in the market valuation process create investment opportunities that keen analysis can expose.

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#### **Dividend policy and practice in South Africa**

What determines the level of a company's dividend and what effect does dividend payout have on the valuation of a share? These are questions of fundamental importance to investment analysis and security valuation which continue to provoke controversy. This paper by Seneque and Gourley approaches the problem empirically and comes up with some interesting conclusions.

#### **The valuation of take-overs by companies listed on The Johannesburg Stock Exchange**

The second paper by Narendra Bhana, based on a recently completed Ph.D. thesis, deals with different methods used in South Africa by predator companies in the valuation of prospective acquirees. One of his findings is that technically sophisticated valuation procedures, such as DCF analysis, play only a small rôle and this heightens the risk of take-over failure. The small rôle could be explained by the strategic nature of the issues involved but a greater attention to likely future profitability seems to be called for.

#### **An introduction to gold mining tax**

This is the second article in a three-part series by Ian Davies in our investment basics section.

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*Short-term developments in the balance of payments and in the domestic money market situation may have had an important bearing on the timing of the announcement, but it would have been short-sighted and irresponsible to have based a very important decision such as this one only on the situation of the day. A logical deduction could otherwise have been that South Africa would re-introduce exchange controls on non-residents as and when the short-term situation became adverse again. And this is surely not our intention. The abolition of the Financial Rand System is a permanent and non-reversible decision. We have no doubt that the more flexible monetary policy will enable us successfully to meet the balance of payments problems of the future.*

**Dr Chris Stals**

Senior Deputy Governor of the SA Reserve Bank

21 April 1983

The removal of exchange control in respect of non-residents in February was an important step towards the establishment in South Africa of an efficient foreign exchange market. By definition, an efficient financial market is one which promotes the best use of real resources in an economy, so the step, presumably, is one greatly to be welcomed. Who, after all, can be against efficiency and, thus, in favour of waste? Yet the full implications of efficient financial markets may not be realised by either politicians or members of the business community. Being for efficiency may well mean being for a system that is inimical to the retention of old attitudes and to practices to which many in South Africa remain strongly wedded. So it is worth, briefly, considering its implications before joining in general homage to the new development.

It is important to stress that there are two aspects to exchange market efficiency. These have to do, respectively, with the spot market and the forward market. Efficiency in currency trading, therefore, cannot really be separated from efficiency in interest rate determination. At the present time neither the spot nor the forward exchange markets are free and both continue to be greatly influenced by the action of the authorities. The merit of what has been happening under De Kock is that the authorities are gradually reducing their involvement and making it possible for basic market forces to assert themselves. One of the demerits of the regime until now has been the fact that official domination has tended to involve the suspension of basic competitive responsibilities. To take a position against the Reserve Bank in the exchange market, for example, has generally been too risky purely because of the size of the latter's participation and not because of the basic rightness of its action. So other market participants, especially on a day-to-day basis, have found it convenient simply to follow a price set by the Bank. Once the spot market is free this will no longer be possible and traders will be forced to think for themselves in deciding both what the price

Die opheffing van deviesebeheer ten opsigte van nie-inwoners in Februarie was 'n belangrike stap met betrekking tot Suid-Afrika se vestiging as 'n doeltreffende deviesemark. 'n Doeltreffende finansiële mark is uiteraard 'n mark wat die beste benutting van die reële hulp-middele in 'n ekonomie bevorder en dié stap moet dus seker hartlik verwelkom word. Wie kan op stuk van sake teen doeltreffendheid en sodoende ten gunste van verkwisting wees? En tog kan dit wees dat nóg die politici nóg lede van die sakewêreld die volle implikasies van doeltreffende finansiële markte besef. Om ten gunste van doeltreffendheid te wees, kan wel beteken om ten gunste van 'n stelsel te wees wat strydig is met die behoud van ou denkwyses en praktyke waaraan baie mense in Suid-Afrika verknog is. Dit is dus die moeite werd om die implikasies daarvan kortliks te oorweeg voor almal die nuwe ontwikkeling prys.

Dit is belangrik om nadruk daarop te lê dat deviesemarkdoeltreffendheid twee aspekte het. Dit het onderskeidelik te make met die kontant- en die termynmark. Doeltreffende valutahandel kan dus nie werklik losgemaak word van doeltreffende rentekoersbepaling nie. Op die huidige tydstep is nóg die kontantmark nóg die deviesetermynmark vry en albei word steeds in groot mate deur die optrede van die owerheid beïnvloed. Die waarde van gebeure onder die bewind van dr De Kock lê daarin dat die owerheid sy betrokkenheid geleidelik verminder en dit vir die basiese markkragte moontlik maak om hulleself te laat geld. Een van die tekortkominge van die huidige bewind tot op hede was die feit dat amptelike oorheersing geneig was om die opskorting van basiese mededingingsverantwoordelikhede te veroorsaak. Dit was byvoorbeeld oor die algemeen te riskant om teen die Reserwebank posisie in die deviesemark in te neem bloot weens die omvang van die Bank se deelname en nie as gevolg van die basiese korrektheid van sy optrede nie. Ander markdeelnemers het dit, veral op 'n daaglikse grondslag, gerieflik gevind om die prys wat deur die Bank vasgestel word, te volg. Sodra die kontantmark vry

should be and which way it is likely to move. The channelling of the dollar proceeds of gold and diamond sales directly to the mining companies will be a major step forward to making the spot market more efficient because it will remove the Reserve Bank from its present dominant price setting rôle. The withdrawal of the Bank from the rôle of seller of forward cover will be a major step forward in creating a proper forward market because it will make the costs of selling foreign currency receivables forward purely a matter of South African and overseas interest rate differentials.

Whatever the theoretical merits of freely competitive money and exchange markets, their establishment will not be without problems for a comparatively small economy like South Africa's which trades a large proportion of its GDP and is very dependent on a single export commodity with a high price volatility. It is interesting to observe what effect the rise in the price of oil had on the pound sterling and the far larger British economy in the 1979-81 period. An overvalued currency in this case certainly added to a loss of competitiveness in manufacturing industry which had already been caused by excessive domestic inflation and, thus, was a major additional cause of a massive increase in unemployment. For South Africa, the gold price could play a similar, but exaggerated, rôle if the exchange market were to be set entirely free. A massive rise in the gold price, similar to that which occurred in 1980, could cause a rise in the exchange rate that was very damaging to other export industries, and a fall in the price, similar to that which occurred in 1981/2, could cause a fall in the exchange rate that was inimical to official attempts to bring an already excessive inflation rate under control. Of course, it can be argued that any undue initial rise in the exchange rate would have anti-inflationary consequences and that the excessive inflation of 1982 was essentially the result of a failure to allow the exchange rate to respond to market forces in the first place, but this, even if true, ignores the effect such a development would have had on non-gold exporters and the employment they so importantly provide. In short, can South Africa, with its unique socio-political problems, really afford to be exposed to this sort of thing?

What, perhaps, needs to be stressed is the fact that financial markets and their freedom and efficiency, cannot be separated entirely from the freedom and efficiency of markets, including the labour market, in the real economy. When the price of gold rises relative to the prices of other mining exports, the profitability of gold mining increases and makes it possible to pay mining workers more in the gold sector. But what happens if, when this occurs, other metal and mineral prices are depressed because of general conditions of oversupply on a world-wide basis. The trouble is that in South Africa, pay conditions in the gold sector set the direction of labour contracting in the mining industry at large. In an Adam Smithian world, i.e. in a world of perfect competition and minimal government interference, wage rates, even within the mining sector, would be differentiated according to the law of marginal productivity because this would be permitted to operate. But our institutional framework today has changed and wage rates have ceased to be flexible downwards, and not only because of the monopolistic influences of collective bargaining.

Even in financial markets difficulties arise which inhibit efficiency. For example, for the forward exchange market to do its job properly, domestic interest rates must be left to find a level that accurately reflects the expectations of market participants including their expectations as to the

is, sal dit nie meer moontlik wees nie en handelaars sal genoop word om self te besluit wat die prys behoort te wees en in watter rigting dit waarskynlik sal beweeg. Die kanalisering van die dollaropbrengs van goud- en diamantverkope direk na die mynmaatskappye sal 'n belangrike stap voorwaarts wees om die kontantmark doeltreffender te maak, want dit sal die Reserwebank van sy huidige rol van oorheersende prysvasstelling onthef. Die onttrekking van die Bank as verkoper van termyndekking sal 'n belangrike stap voorwaarts wees om 'n behoorlike termynmark daar te stel, want dan sal die koste verbonde aan termyndekking op valutaontvangstes bepaal word deur die verskil in plaaslike en oorsese rentekoerse

Wat ook al die teoretiese verdienstelikhede van vry mededingende geld- en deviesemarkte, dit sal nie sonder probleme wees vir 'n betreklik klein ekonomie soos dié van Suid-Afrika, wat 'n groot deel van sy BNP verhandel en baie afhanklik is van 'n enkele uitvoerkommoditeit met 'n baie onbestendige prys, nie. Dit is interessant om te sien watter uitwerking die styging in die olieprys in die tydperk 1979-81 op die pond sterling en die Britse ekonomie, wat veel groter is, gehad het. 'n Oorwaardeerde valuta het in hierdie geval beslis meegehelp om die fabriekswese se verlies aan mededingendheid, wat reeds deur buitensporige binnelandse inflasie veroorsaak is, te vergroot en was dus 'n belangrike bykomende oorsaak van die geweldige styging in werkloosheid. In Suid-Afrika kan die goudprys 'n soortgelyke, dog veel groter, rol vervul indien die deviesemark geheel en al vry gemaak word. 'n Geweldige styging in die goudprys, soos dié wat in 1980 plaasgevind het, kan veroorsaak dat die wisselkoers styg, wat baie skadelik vir ander uitvoer-nywerhede was, en 'n daling in die prys, soos dié wat in 1981/2 plaasgevind het, kan 'n daling in die wisselkoers veroorsaak wat skadelik was vir amptelike pogings om die inflasiekoers, wat reeds buitensporig was, onder beheer te bring. Daar kan natuurlik aangevoer word dat enige oormatige aanvanklike styging van die wisselkoers anti-inflasionees gevolg sal hê en dat die buitensporige inflasie van 1982 hoofsaaklik veroorsaak is omdat daar in die eerste plek versuim is om die wisselkoers toe te laat om op markkragte te reageer, maar, self al is dit waar, veronagsaam dit die uitwerking wat so 'n ontwikkeling op nie-gouduitvoerders en die uiters belangrike werkgeleenthede wat hulle bied, sou gehad het. Kortom, kan Suid-Afrika met sy unieke sosio-ekonomiese probleme werklik bekostig om aan so iets blootgestel te wees?

Miskien is dit nodig om die feit te beklemtoon dat finansiële markte en die vryheid en doeltreffendheid daarvan nie heeltemal losgemaak kan word van die vryheid en doeltreffendheid van markte, met inbegrip van die arbeidsmark, in die werklike ekonomie nie. Wanneer die goudprys in verhouding tot die prys van ander mynuitvoere styg, styg die winsgewendheid van die goudmynbou en is dit moontlik om mynwerkers in die goudsektor meer te betaal. Maar wat gebeur, in so 'n geval, as ander metaal- en mineraalpryse laag is weens 'n algemene toestand van oorvoorsiening die hele wêreld deur? Die probleem is dat, in Suid-Afrika, loontoestande in die goudsektor die rigting vir arbeidsooreenkomste in die mynbedryf oor die algemeen bepaal. In Adam Smith se wêreld, d.i., 'n wêreld van suiwer mededinging met minimale owerheidsinmenging, sou loontariewe, selfs in die mynbousektor, volgens die wet van marginale produktiwiteit gedifferensieer wees, want daar sou dié wet toegelaat word om van krag te wees. Ons hedendaagse institusionele raamwerk het egter

consequences of the Government's own policy actions. But what if this is inappropriate having regard to the level of interest rates overseas which might be reflecting conditions completely at odds with those prevailing in South Africa for reasons not just economic? Consider the situation where, like the present, overseas interest rates are high in real terms when inflation in South Africa is high relative to overseas inflation. Are South African rates to be allowed to fluctuate irrespective of the consequences for domestic unemployment?

These are important issues and to mention them does not mean to reject the bold initiative Dr De Kock and his team have embarked upon. South Africa needs more efficient financial markets, not less, and has suffered until now because official manipulation has often given protection to the wasteful, and delayed adjustment to changed circumstances in the world economy. But equally, we need to be realistic when promoting market efficiency as to the strategic bounds within which we are prepared, in the final reckoning, to let it operate.

It is probably fair to say that the single most important price in the South African economy is the exchange price of the rand. This can assume two alternative roles in terms of the formulation of monetary policy. Either it can be regarded as a policy instrument, in which case it becomes subject to deliberate manipulation by the authorities in order to achieve specified policy goals, or it can be regarded as a barometer of economic activity and change, in which case it is observed by all, Government and private sectors alike, for the objective information it conveys. Strictly, it cannot be both of these at the same time without needlessly increasing the possibility of confusion amongst market participants. At the present time the role of the exchange rate in South Africa is being changed from instrument towards barometer but it is still uncertain how far the authorities want to go in its transformation. In no small measure their decision will be governed by what they also decide about how monetary policy in South Africa in the future is to be conducted.

It is common cause amongst economists that the authorities, no less than the suppliers of actual goods in markets characterised by imperfect competition, cannot even where they are dominant, fix both the price and quantity of what they supply simultaneously. As far as monetary policy is concerned, this means that in a closed economy policy must target either on interest rates or on the money stock but it cannot target on both. In an open economy, the situation may be complicated by a desire to control both the exchange rate and the level of the gold and foreign reserves, and again a choice has to be made. At least theoretically, the authorities cannot have it both ways. Clearly, however, if the choice is made to control the growth of the money stock and changes in money, which reserve changes affect directly, both interest rates and the exchange rate must be left as free as possible, for together they determine prices in the spot and the forward markets. The problem in South Africa has to do with the fact that the system, modelled as it is on British lines, does not really lend itself to money stock regulation. Too many back doors open the way for escape and the central bank frequently finds itself in the position in which it is forced to give retroactive sanction to an increase in bank lending. The only way it can effectively discourage this, short of changing the structure (to which consideration is already being given), is to impose a penal cost on last resort borrowing which in effect means interest rate targeting.

If this analysis is correct, it will not really be possible to move towards a freer exchange market without at the

verander en loontariewe is nie meer afwaarts aanpasbaar nie, en dit nie net as gevolg van die monopolistiese invloede van kollektiewe onderhandeling nie.

Selfs in finansiële markte kan probleme ontstaan wat doeltreffendheid strem. Byvoorbeeld, vir die termyndiviesemark om sy werk behoorlik te kan verrig, moet binnelandse rentekoerse toegelaat word om 'n vlak te vind wat die verwagtinge van markdeelnemers, met inbegrip van hulle verwagtinge ten opsigte van die regering se eie beleidsopgetredes, akkuraat weerspieël. Maar wat as dit onvanpas is met inagneming van die peil van buitelandse rentekoerse wat moontlik toestande weerspieël wat geheel en al oneens is met dié wat in Suid-Afrika heers, om redes wat nie net ekonomies van aard is nie? Dink aan 'n situasie waar, soos wat tans die geval is, buitelandse rentekoerse in reële terme hoog is en inflasie in Suid-Afrika, in verhouding tot buitelandse inflasie, hoog is. Moet Suid-Afrikaanse koerse toegelaat word om te skommel ongeag die gevolge wat dit vir binnelandse werkloosheid inhou?

Hierdie kwessies is belangrik en om dit te noem beteken nie dat die moedige inisiatief van dr De Kock en sy span verwerp word nie. Suid-Afrika het meer, nie minder, doeltreffende finansiële markte nodig en het tot dusver swaar gekry, omdat amptelike manipulasie dikwels die verkwalers beskerm het en aanpassing by veranderde omstandighede in die wêreld ekonomie vertraag het. Maar wanneer ons markdoeltreffendheid bevorder, moet ons eweneens realisties wees wat betref die grense waarin ons bereid is om dit op stuk van sake te laat funksioneer.

Daar kan waarskynlik met billikheid gesê word dat die belangrikste enkele prys in die Suid-Afrikaanse ekonomie die wisselkoersprys van die rand is. By die formulering van monetêre beleid kan dit twee plaasvervangende rolle vervul. Dit kan óf as beleidsinstrument beskou word, in welke geval dit aan opsetlike manipulerings deur die owerheid vir die verwesenliking van verklaarde beleidsdoelwitte onderhewig raak, óf dit kan as barometer van ekonomiese aktiwiteit en verandering beskou word, in welke geval dit deur almal, eweseer deur die regering en die privaatsektor, in ag geneem word vir die objektiewe inligting wat dit oorbring. Streng gesproke kan hierdie rolle nie gelyktydig vervul word sonder om die moontlikheid van verwarring by markdeelnemers onnodig te laat toeneem nie. Die rol van die wisselkoers in Suid-Afrika word tans van instrument na barometer verander, maar dis nog nie seker hoe ver die owerheid hierdie verandering wil voer nie. Hulle besluit sal in geen geringe mate gereël word deur hoe hulle besluit die monetêre beleid in Suid-Afrika voortaan bestuur moet word.

Alle ekonome is dit eens dat die owerheid, in geen geringe mate as die verskaffers van werklike goedere in markte wat deur onvolmaakte mededinging gekenmerk word, self waar hulle oorheersend is, nie die prys sowel as die hoeveelheid van dit wat hulle verskaf terselfdertyd kan bepaal nie. Wat monetêre beleid betref, beteken dit dat die beleid in 'n geslote ekonomie óf op rentekoerse óf op die geldvoorraad toegespits moet wees, maar nie op albei nie. In 'n oop ekonomie kan sake bemoeilik word deur die wens om die wisselkoers sowel as die peil van goud- en deviesereserwes te beheer, en weer eens moet 'n keuse gedoen word. Ten minste wat die teorie betref kan die owerheid nie sy mes na albei kante laat sny nie. As daar gekies word om die groei van die geldvoorraad en geldveranderings te beheer, wat direk deur reserweveranderings beïnvloed word, moet rentekoerse sowel as die wisselkoers klaarblyklik so vry as moontlik

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same time altering the basis of money market regulation generally and without, indeed, taking steps to ensure that other markets (labour and goods) are more reflective of basic competitive forces. In other words, the removal of non-resident exchange controls, referred to at the outset of this editorial, have to be seen in a far wider context than that of the exchange market alone.

**The editor**

gelaat word, want saam bepaal hulle pryse op die kontant- en termynmarkte. Die probleem in Suid-Afrika het te make met die feit dat die stelsel, wat op die Britse lees geskoei is, hom nie werklik leen tot die reëling van die geldvoorraad nie. Daar is te baie deure wat 'n uitkoms bied en die sentrale bank bevind hom dikwels in dié posisie dat hy genoop word om goedkeuring met terugwerkende krag te verleen vir 'n toename in uitlening deur banke. Die enigste manier om dit effektief te ontmoedig sonder om die struktuur te verander (waaraan reeds oorweging verleen word), is om 'n strafkoste aan leen in laaste instansie op te lê wat in werklikheid rentekoerstoespitsing beteken.

As hierdie ontleding juis is, sal dit nie werklik moontlik wees om in die rigting van 'n vryer deviesemark te beweeg sonder om terselfdertyd die grondslag van geldmarkreëling oor die algemeen te verander en inderdaad sonder om stappe te doen om te verseker dat ander markte (arbeid en goedere) die basiese mededingende kragte beter weerspieël nie. Met ander woorde, die opheffing van deviesebeheer ten opsigte van nie-inwoners, waarna aan die begin van hierdie hoofartikel verwys is, moet in veel breër verband as slegs dié van die deviesemark gesien word.

**Die redakteur**