The impact of offshore listings on the South African economy

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Introduction

South Africa has had to face a number of globalisation issues and international developments over the past decade or so. These impacted directly and indirectly on the economic and financial affairs of the country. Part of this process was the gradual liberalisation of exchange controls which paved the way for large South African companies to transfer the primary listing of their stock to foreign bourses.

By the end of 2000, five companies had received permission to move their primary listings from the JSE Securities Exchange SA (JSE) to the London Stock Exchange (LSE). Although the government holds a positive view on international capital flows as a means to strengthen economic performance, several other stakeholders in the economy became increasingly negative about the ultimate benefits of offshore listings for the South African economy. This can be attributed to the perceived negative impact that offshore listings may have on domestic economic growth and investment. The objective of this study is to clarify some of these issues.

This analysis presents an overview of the main reasons for South African companies to seek listings abroad as well as the exchange control guidelines that such companies have to observe before an application for a primary offshore listing is approved. This is followed by a brief description of the companies that obtained offshore listings up to the end of 2001 and of the circumstances surrounding their applications. Further sections deal with the impact of offshore listings on the market capitalisation of the JSE and the effect on the country's international investment position and dividend flows. This is followed by a discussion of some developments in the modern theory of economic growth and the empirical impact of the offshore listing on South Africa's gross domestic product (GDP) and gross national income. The last section contains a summary and some concluding remarks.

Reasons for South African companies listing abroad

When the South African economy opened up in the second half of the 1990s and exchange controls were gradually relaxed, a number of domestically listed companies approached the exchange control authorities with requests to move the primary listing of their shares from Johannesburg to London.

Such a change in the listing of a company implies that the company has to be domiciled in London and that it has to comply fully with the listing standards of the LSE. This entails a change in the centre of interest of the head offices of the companies concerned from South Africa to London. They essentially become companies foreign to South Africa, or non-residents.

The companies wishing to change their primary listing argued that offshore listings offered certain advantages they would be denied if they maintained a primary listing on the JSE.

1 The authors are grateful for the valuable assistance made by Mr B L de Jager in the preparation of this paper. However, the views represented here are those of the authors and do not necessarily reflect those of the South African Reserve Bank.

These advantages typically include the following:
- Easier access to capital resources at lower cost;
- opportunities to raise efficiencies by competing head-on with global competitors;
- the opportunity to escape from the volatility of financing costs in an emerging-market economy;
- the opportunity to promote foreign investment in South Africa;
- the opportunity to expand their core business into other countries and regions;
- the possibility of benefiting from divergent business cycle movements in different markets;
- the benefit of a diversified business approach which limits the impact of a severe contraction in the economic activity of a single market; and
- the opportunity to improve South Africa's profile internationally.

Exchange control guidelines for offshore primary listings

The exchange control authorities agreed that the global expansion of South African firms would hold significant benefits for the economy, such as greater market access, increased exports, stronger competitiveness and the other reasons listed above. In order to support this expansion from a South African base, the limit on the use of South African funds for new approved foreign investment was raised from R50 million to R500 million in February 2001. South African firms are also permitted to utilise up to R750 million of local cash holdings for approved foreign investment in Africa. In addition, firms are allowed to use local cash holdings to finance up to 10 per cent of the remaining investment outlay where the cost of such investments exceeds the stated limits.

With the same objectives in mind, the exchange control authorities considered the applications for offshore primary listings in a detached and open-minded manner. To make the process more transparent, the authorities set guidelines for companies to comply with, before considering an application for an offshore primary listing. Companies wishing to obtain approval for an offshore primary listing have to prove that:
- foreign expansion is necessary and integral to the firm, taking into account the size and nature of the business;
- a significant portion of the firm's revenue is derived from outside the borders of South Africa, making the business in effect an international concern;
- there will be definite balance-of-payments benefits for South Africa;
- there will be a substantial advantage over alternative approaches to raising the required capital;
- the direct and indirect assets of the South African company will not be encumbered;
- South Africa's gross international reserves will not be adversely affected by a net outflow of dividends or any other funds;
- the company involved will match the dividends declared to the foreign holding company with the dividends paid to South African shareholders in order to preserve balance-of-payments neutrality; and
- all the South African operations and assets of the company will remain in South Africa.

South African companies involved in primary offshore listings

Since the middle of 1997, five of South Africa's big business concerns have received approval from the exchange control authorities to move their primary listings from Johannesburg to London. These companies are:
- Billiton,
- South African Breweries,
- the Anglo American Corporation,
- the Old Mutual Life Assurance Company (SA) Limited, and
- Dimension Data.

The circumstances surrounding each of these offshore listings are discussed briefly below.

As part of a strategic restructuring initiative, Gencor Limited sold its non-precious metal assets to Billiton plc in July 1997. The sale of Gencor's non-precious metal assets comprised the shares of Billiton International, Samancor, Alusaf and Ingwe. At the same time, Billiton plc became the first South African company to obtain a primary listing on the LSE and a secondary listing on the then Johannesburg Stock Exchange. With effect from 1 July 1997, Gencor Limited was transformed into a precious metals company with interests mainly in gold and platinum.

South African Breweries (SAB), one of the world's major beer and beverage companies became, with effect from 8 March 1999, the second South African company to obtain a primary listing on the LSE. SAB believed that offshore listing would put the company in a better position to pursue a growth strategy based on greater access to world capital markets. The management furthermore believed that the step would enhance SAB's ability to take advantage of mergers and acquisitions in the international brewing industry and to compete with other international brewers for development opportunities throughout the world.

The boards of the Anglo American Corporation and Minorco announced in October 1998 that they had agreed in principle to combine their businesses to establish Anglo American as a United Kingdom company. The shares of Anglo American plc, a company with its primary listing on the LSE and with secondary listings on the Swiss Exchange, were traded for the first time on the LSE on 24 May 1999. The Anglo American Corporation and Minorco were merged by means of share exchange offers, and this provided the opportunity to develop a joint strategy focused almost exclusively on mining operations.

The merger made Anglo American plc one of the world's largest mining and natural resources companies. The forming of a single, more internationally based business entity has given it the opportunity to pursue corporate objectives and strategy through a simpler and more transparent organisational structure, and to compete more effectively worldwide for new opportunities for business and growth.

Old Mutual was demutualised in May 1999 and obtained a primary listing on the LSE in July 1999. Based in the United Kingdom, this financial services group with secondary listings on the Johannesburg, Malawian, Namibian and Zimbabwian stock exchanges, has substantial life assurance business in South Africa and other southern African countries and an integrated international portfolio of activities in asset management, banking and general insurance.

Dimension Data, a leading international network and interactive integration services group which operates in more than 30 countries and provides communication network services and e-commerce solutions, obtained its primary offshore listing on the LSE in July 2000. The company maintains a secondary listing on the JSE.

At the time of their listing, all five of the above-mentioned former South African companies had sufficient critical mass for inclusion in the FTSE 100 share price index of companies listed on the London stock market. The Anglo American Corporation entered the FTSE 100 in the 21st position but was subsequently rerated to the 16th position. The ranking of all five companies is indicated in Table 1.

Table 1 Ranking in the FTSE 100 of former South African companies

Companies	Ranking at time of listing	Current rating*
Billiton	54	27
South African Breweries	78	62
Anglo American	21	16
Old Mutual	71	68
Dimension Data **,***	42	...

* As on 19 April 2002
** The company was listed on the LSE on 19 July 2000 but included in the FTSE 100 from 19 September 2000
*** The company was moved to the FTSE 250 on 7 August 2001

The impact of offshore listings on the market capitalisation of the JSE Securities Exchange SA

All the South African companies that successfully obtained primary listings in London maintained secondary listings in Johannesburg, essentially leaving the market capitalisation of the JSE intact. In fact, their market capitalisation increased in most instances as some of the companies concerned took steps to strengthen their capital base. The increase in the market capitalisation of SAB, Anglo American and Dimension Data (see Table 2) can mainly be attributed to the issuance of additional shares by these companies.

Table 2 Market capitalisation of offshore listed companies on the JSE Securities Exchange SA
R billions at end of period

Companies	1997	1998	1999	2000	2001
Billiton	26,7	25,0	62,9	65,4	141,1
South African Breweries	41,9	35,5	48,4	41,2	66,4
Anglo American	46,0	36,2	161,8	166,7	268,8
Old Mutual	-	-	55,6	66,1	56,3
Dimension Data	11,6	16,3	27,6	60,7	18,7
Total market	1 129,4	1 001,6	1 616,2	1 551,5	1 770,7

Non-resident ownership of shares in the companies newly listed abroad increased appreciably along with the increase in market capitalisation. Table 3 indicates the change in the percentage of non-resident shareholding in the companies that recently obtained primary listings on the LSE. The increased exposure of these companies to international markets and their inclusion in the FTSE 100 share price index obviously encouraged international investors' interest in these companies and this led to further increases in non-resident shareholdings and a concomitant inflow of capital into the economy.

Table 3 Non-resident shareholding in companies listed on the London Stock Exchange

Per cent at end of year

Companies	1998	1999	2000	2001
Billiton	48,6	62,9	67,0	77,4
South African Breweries..............	19,7	45,1	43,8	59,8
Anglo American	16,9	44,1	46,5	77,5
Old Mutual	-	38,7	38,1	43,9
Dimension Data	10,9	31,2	55,0	59,2

The capital inflows resulting from the offshore listings helped the South African Reserve Bank to reduce its net open position in foreign currency by purchasing foreign currency in the open market. The net open position of the Bank is perceived as a major source of vulnerability to external shocks to the South African economy. Reducing the net open position in foreign currency, with the ultimate objective of eradicating it completely, enhances the ability of the economy to withstand external shocks.

Through positive wealth effects, the rise in the market capitalisation of the JSE contributed to a higher level of spending in the South African economy during 1999. This helped to counteract the negative effects of the international financial crisis of 1998. Despite the disturbances in global financial markets during 1998, which unsettled economic conditions in many emerging-market economies in 1999, economic growth in South Africa accelerated from 0,8 per cent in 1998 to 2,1 per cent in 1999.

The effect on South Africa's international investment position

The relocation of the primary listing of South African companies from Johannesburg to London increased South Africa's foreign liabilities and foreign assets. Before the change in the primary listing, shareholdings by South African investors in the five companies had been classified as investment in domestic assets. After the change, these shareholdings became classified as investment in foreign assets, thus raising the overall foreign assets of the country.

All domestic subsidiary investments by the five companies had been classified as domestic assets of South African resident companies prior to the listings. After the relocation of the primary listings, these domestic subsidiaries became wholly or partly owned subsidiaries of foreign companies. In this manner, non-resident interest in the South African economy was stepped up and the country's liabilities to foreign shareholders increased commensurately.

The country's international investment position reflects the market value of total foreign assets and liabilities. The value of the foreign-listed companies' assets in South Africa is recorded as a *direct* inward investment into the country – a foreign liability – whereas the value of South African shareholding in the foreign-listed companies is recorded predominantly as outward *portfolio* investment into the United Kingdom – a foreign asset of South Africa.

It is estimated that the foreign liabilities of South Africa increased by R179 billion from the end of 1997 to the end of 2000 on account of the relocation of the primary listings of the five companies. For the same reason, the overall foreign assets of the country were estimated to have increased by R203 billion from the end of 1997 to the end of 2000. Although estimates of the country's foreign liabilities and assets were adjusted for the change in the primary listings, these changes in balance sheet totals were not recorded as capital movements in the international financial account of South Africa because they only represented a reclassification of existing assets.

The effect of foreign listings on dividend flows

The dividends that South African companies provided for and paid to non-resident shareholders and the dividends received and receivable from external equity investments influence the country's balance of payments. The net inflow and outflow of dividends to and from South Africa will depend on the dividend payments from South African subsidiary companies to their London-listed parent companies, as well as on the number of shares held by South African shareholders in the London-listed companies.

Dividends received by South African entities from offshore equity investments increased from R2,4 billion in 1998 to R4,3 billion in 1999, to R8,8 billion in 2000 and to R10,7 billion in 2001. The dividends paid to the rest of the world increased from R5,7 billion in 1998 to R8,1 billion in 1999, to R17,6 billion in 2000 and to R30,9 billion in 2001. As a consequence, the shortfall of cross-border dividends received relative to dividends paid, widened from R3,3 billion in 1998, to R3,8 billion in 1999, to R8,9 billion in 2000 and to R20,2 billion in 2001.

As shown in Table 4, a significant portion of the widened margin between the dividends received and dividends paid came from the activities of the companies that had recently been listed in London. The adverse effect on the net flow of dividends to the rest of the world, and consequently also on the services account of the balance of payments, could therefore be attributed to the fact that dividends previously distributed to a resident holding company, were now being distributed to a foreign head office. Simultaneously, resident shareholdings in the foreign-listed companies declined as foreign interest in these companies grew, resulting in a smaller return flow of dividend income than would otherwise have been the case.

Table 4 International dividend flows of South African companies listed in London
R millions

Period	Paid *	Received **
1998	592	139
1999	2 131	213
2000	9 849	4 992
2001	13 183	6 091

* Dividends declared by South African subsidiary companies to their London-listed parent companies
** Dividends declared by London-listed companies to their South African shareholders

The effect of offshore listings on South Africa's gross domestic product and gross national income

Modern theory of economic growth

The modern theory of economic growth that has developed since the 1950s is based on the work of the classical economists Adam Smith and David Ricardo. Many of Smith's economic growth factors are elements of modern growth theory: the division of labour, accumulation of capital and technological progress. To this may be added a working legal framework and an understanding of the importance of open trade.

David Ricardo conceived the notion that diminishing returns would impose a limit on economic growth. Additional investment tends to yield a lower return over time, implying that growth will dwindle and eventually cease. These diminishing returns apply to all capital investments, implicitly showing that eventually the economy will slow down.

These ideas of Smith and Ricardo, who wrote in the late 18th and early 19th centuries, form the basis of modern growth theory. In the 1950s Solow and Swan developed a growth model incorporating growing output in response to an increasing input of capital and labour in a world of perfect competition. Solow and Swan's model of the economy also obeyed Ricardo's "law of diminishing returns", with each new unit of capital (given a fixed supply of labour) producing a slightly lower return than the preceding unit.

The model developed by Solow and Swan soon became known as the neoclassical growth theory. The model can be used to describe how labour and capital combine to create output and how households allocate their income between consumption and saving. Accordingly, macroeconomic performance relies on how income (which is by definition equal to output) is allocated between consumption and investment, and on productivity, i.e. the amount of output per unit of input.

A key implication is that to keep growing, an economy would have to benefit from continual infusions of new technology, resulting in higher productivity. A high saving rate will result in higher income *per capita* than a low saving rate, but the rate of income growth does not depend on the saving rate. However, an economy-wide rise in saving relative to income will accelerate growth temporarily. Income *per capita* would be higher in economies with higher saving rates and lower in economies with lower saving rates.

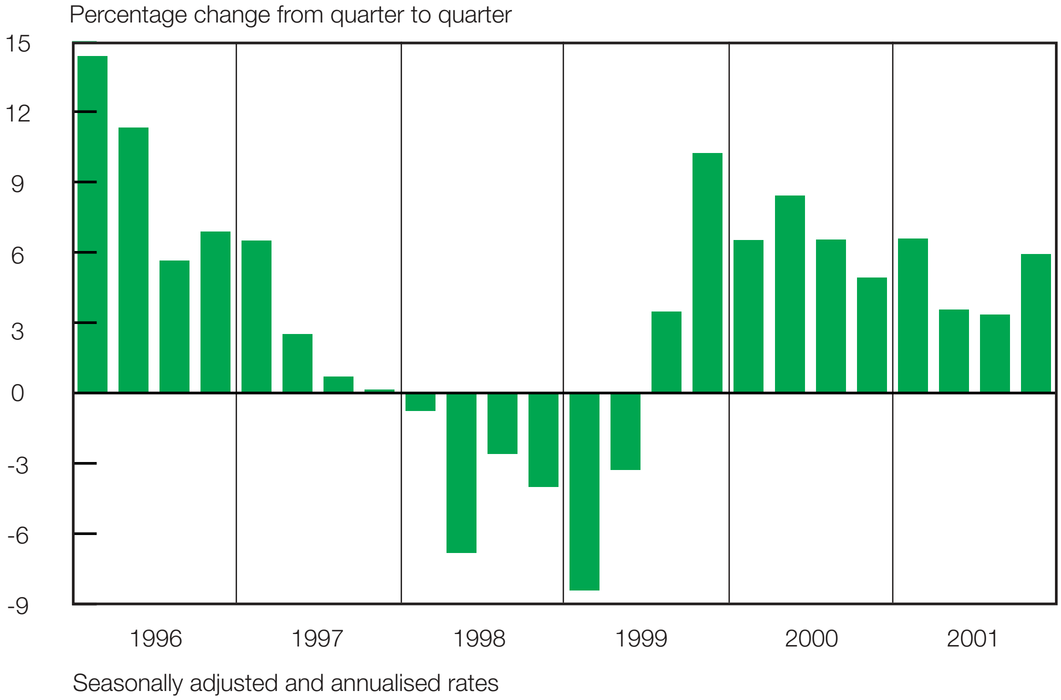
In the long term, growth could be expected to settle down at a steady rate as determined by the growth in labour supply and technological progress. Also, poorer economies with relatively small stocks of capital equipment should grow faster than rich ones because, according to the law of diminishing returns, investment in economies with small capital stocks brings higher returns.

As long as the South African companies that relocated their primary listings to London do not suspend their operations in the geographical area of South Africa, the overall size and growth of domestic output are expected to remain intact. Whether assets are owned by residents of the country or by foreigners is in no way decisive for domestic economic growth. If the offshore listings lead to greater investment activity in the domestic economy, growth would accelerate for a while.

Conversely, a reduction in investment activity in response to the offshore listings would slow down growth during the period of adjustment to the lower investment ratio.

In fact, real fixed capital formation picked up in 1999, giving the impression that the offshore listings could potentially lead to a phase of faster economic expansion (see Graph 1). However, it is not clear whether the pick-up in domestic capital formation by the private sector during 1999 was entirely related to the listing of South African-based companies on the LSE. Other factors might also have contributed to higher investment. For example, normal cyclical factors contributed to the strong showing of capital formation in the South African economy in 2000 and 2001.

Graph 1 Real gross fixed capital formation by private sector



The neoclassical growth theory was challenged after 1986 by Paul Romer's work on "endogenous growth theory". Romer formulated a theory that economic growth is driven by the accumulation of knowledge. He argues that knowledge is the basic form of capital and that investment in knowledge leads to increasing returns in marginal products.

The key factor in Romer's theory is an adequate stock of human capital. He believes that what is important for growth is not integration into an economy with a large number of people, but integration into an economy with a large amount of human capital. His conclusion is that, to promote growth, countries' economic policies should:

- encourage investment in new research, as opposed to encouraging investment in physical capital accumulation; or if this is not possible, at least to
- subsidise the accumulation of total capital.

If the offshore listings of major South African companies had been accompanied by the emigration of highly skilled and innovative people, this could have contributed to existing constraints on the potential growth rate of the economy. No evidence could be found that the offshore listings have been instrumental in accelerating the pace of skills exportation from the country.

Foreign direct investment in an economy is normally seen as beneficial to the host economy in the sense that such investment is mostly accompanied by the introduction of new technologies, leading to higher productivity levels and faster technological progress. New investment by the London-listed companies can therefore be expected to contribute meaningfully to long-term wealth and income creation in South Africa.

Defining residence and centre of economic interest

In an attempt to make a quantitative assessment of the impact of offshore listings on the South African economy, and more specifically on gross domestic product and gross national income, it is necessary to define the concepts “residence” and “centre of economic interest”. These can be explained by the fact that total economic activity is defined in terms of resident units and that the activities of non-resident units *vis-à-vis* resident units have a direct impact on the magnitude of gross domestic product and gross national income. The residence status of producers determines the limits of domestic production and affects many important flows in the system for recording the national accounts.

The 1993 *System of National Accounts* (1993 SNA) defines residence as follows: “An institutional unit is then said to be a resident unit when it has a centre of economic interest in the economic territory of the country in question.” The economic territory of a country can be described as the geographic territory administered by a government, within which people, goods and capital circulate freely. The 1993 SNA also defines the centre of economic interest as some location inside a country from which an institutional unit engages in economic activity and transactions on a significant scale. Against the background of these definitions, it is possible to evaluate the macroeconomic impact of the primary listing of South African companies on offshore bourses.

Although the centre of economic interest for the headquarters of the companies involved in the primary listing on foreign stock exchanges since 1997 has moved from South Africa to London, the *de facto* operational activities have remained in South Africa. Consequently, the “traditionally” South African-based subsidiaries’ contribution to gross domestic product should not change. However, in terms of the calculation of gross national income, the impact of offshore listing could be more noticeable – depending of course on the dividend and interest policies of the foreign holding company and those of its subsidiaries resident in South Africa.

The difference between gross domestic product and national income

Conceptually the difference between gross domestic product and gross national income comprises the measurement of production versus income. Gross national income (at market prices) is calculated by adding to gross domestic product at market prices the primary income receivable by resident units from the rest of the world, minus the primary income payable by resident units to non-resident units. The concept of primary income refers to the factor payments and receipts (i.e. mainly dividends, interest and compensation paid to migrant workers) used in the national accounts of South Africa.

The impact of offshore listings on gross domestic product

Empirical estimates, as shown in Table 5, indicate that the value added by resident subsidiaries of the primary offshore-listed companies amounted to approximately 7½ per cent of South Africa's total gross domestic product in 2000. This is equal to the contribution of the entire mining sector and less than the contribution of 10 per cent registered by the transport, storage and communication sector. If the foreign activities of these enterprises, i.e. those originating outside the geographical boundaries of South Africa, are taken into account then the total output of these companies relative to South Africa's gross domestic product amounted to about 15½ per cent in 2000.

These estimates clearly indicate that a significant portion of the gross output generated by the London-listed companies came from their operational activities in South Africa. Currently there is no empirical evidence that the "local" activities of these companies (and therefore South Africa's gross domestic product) have been negatively affected by the offshore listings. On the contrary, the expansion of some of the formerly South African-owned companies in neighbouring countries, for example in the construction of the Mozal project in Mozambique, may have activated the exports of capital goods from South Africa, thus contributing to higher economic growth.

Table 5 Resident subsidiaries of offshore listed companies' contribution to South Africa's gross domestic product in 2000

Per cent

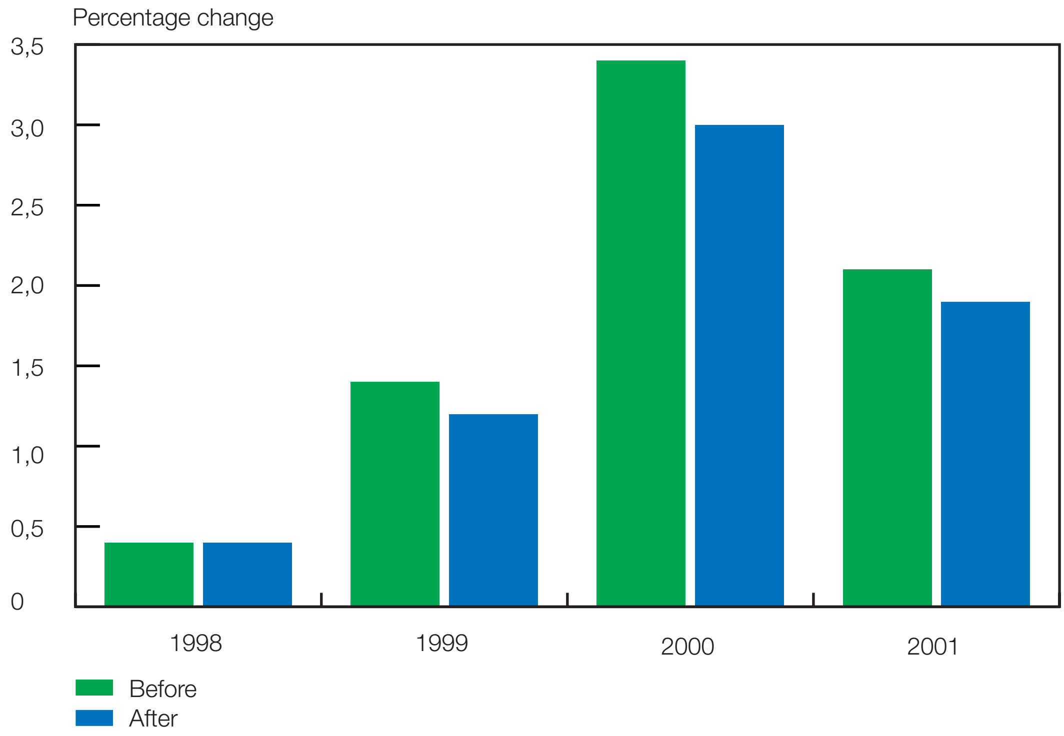
Companies	Contribution to GDP
Anglo American	4,2
Billiton	1,3
Dimension Data	0,2
Old Mutual	0,6
South African Breweries	1,1
Total	7,4

The impact of offshore listings on gross national income

The impact of offshore-listed companies on South Africa's gross national income at market prices can be partially estimated from the changes in the net flow of investment proceeds. In 2000 the net outflow of dividends related to the London-listed companies amounted to R4,9 billion or 21,3 per cent of the total net payment of investment income (i.e. mostly dividend and interest payments) to non-residents.

As indicated above, the margin between total dividend payments and total dividend receipts to and from the rest of the world widened from R3,8 billion in 1999 to R8,9 billion in 2000 and to R20,2 billion in 2001. Net dividend payments to the rest of the world by the London-listed companies widened from R1,9 billion in 1999 to R4,9 billion in 2000 and to R7,1 billion in 2001, indicating that a substantial part of the change in net dividend flows was a consequence of the dividend policies of these companies. The impact that this could have had on growth in the gross national income was nevertheless cushioned by the net selling of South African fixed-interest securities by non-resident investors, which resulted in a decline of R1,8 billion in interest payments to the rest of the world in 2000.

Graph 2 Estimates of change in real gross national income before and after offshore listings



If an assumption is made that there had been no offshore listings, so that the R4,9 billion net outflow of dividends in 2000 would not have taken place, the gross national income at market prices would have been higher by that amount. The level of gross national income at market prices would have increased from R866,1 billion to R871,0 billion in 2000, or by ½ per cent. The rate of increase in the nominal value of gross national income at market prices would have increased from 10½ per cent in 2000 to 11 per cent in 2001. In fact, the net outflow of dividends increased to R7,1 billion in 2001 but the change in net dividend outflows between 2000 and 2001 declined from R3,0 billion to R2,2 billion. Consequently, there was almost no change in the growth rate in the nominal value of gross national income at market prices before and after the adjustment of the net outflow of dividends – it amounted to 9 per cent in both instances.

In the case of the real gross national income at constant 1995 prices (assuming the derived deflator for 2000 and 2001 would have remained unchanged), the growth rate could have risen from 3 per cent to nearly 3½ per cent in 2000, implying an acceleration in real disposable income for the country as a whole of about ½ a percentage point. By contrast, the incremental growth in 2001 was reduced to only 0,2 percentage points (see Graph 2). Based on these assumptions, gross national income *per capita* for 2000 could have increased from R19 826 to R19 937, and at constant prices the *per capita* income could have increased by R77 from R13 785 to R13 862. In 2001, the real *per capita* income could have increased from R13 777 to R13 881, or by R104.

All in all, it can be said that the offshore listings had no noticeable impact on growth in gross domestic product in 2000 and 2001. However, growth in nominal gross national income could have been reduced by a margin of at most ½ a percentage point in 2000, though in 2001 the impact was almost negligible.

Although it is difficult to quantify precisely, it can be argued that the offshore listings might have contributed to stronger performance in the domestic economy. It stands to reason that the offshore listings encouraged an inward movement of capital into the economy as non-resident investors sought greater exposure to these companies. This undoubtedly raised the market capitalisation of the JSE and total wealth of South African residents, thus strengthening investment and consumption in the economy. Expansions by these companies in distant parts of the world further contributed to a stronger pace of economic activity because much of the construction of such projects was sourced from South Africa.

Summary

From a macroeconomic perspective it can be argued that the domestic economy was not excessively sensitive to the relocation of the primary listing of South African companies from Johannesburg to London. As all the South African companies that obtained primary listings on the LSE still have secondary listings on the JSE, the market capitalisation of the JSE has not been affected adversely by the listings on a foreign stock market. In addition, none of the companies that relocated have terminated any of their operations in the geographic area of South Africa, leaving the aggregate size and potential growth of the gross domestic product largely unaffected. The likely expansion of offshore-listed companies in future years in South Africa may give extra impetus to economic growth.

However, the growth in South Africa’s gross national product was temporarily affected by a change in net dividend flows following the offshore listings. It was estimated that the growth in nominal gross national income could have been reduced by about ½ a percentage point in 2000 on account of the offshore listings. The impact on gross national product in 2000 was largely cushioned by a substantial fall in interest payments to the rest of the world, when non-resident investors reduced their holdings of South African fixed-interest securities on a large scale. But in 2001, the impact of offshore listings on the nominal gross national product became almost negligible, as the rate of increase in the net payments of dividends slowed down considerably.