FINANCIAL ASPECTS OF THE RECENT GROWTH OF THE UNION'S ECONOMY

Introduction

Funds for the financing of gross additions to fixed and working capital of business organisations are derived from two sources, viz., *internal* and *external* finance. The former source comprises (1) the utilisation of its own current savings, or retained earnings,[1] by the firm which is expanding the range of its economic activities, and (2) provision out of income for the depreciation of fixed assets, and also provisions for such items as deferred repairs.

The second of the two sources, viz., external finance, comprises funds raised in the money and capital markets. In the present context, therefore, this concept denotes the raising of funds, within or outside the Union, by means of borrowing or the issue of shares.

Preliminary estimates indicate that last year internal finance made a very substantial contribution towards the financing of the capital requirements of the Union's business sector. Of the amount contributed in this manner, depreciation allowances accounted for about £161 million, corporate savings[2] for approximately £106 million, and the net savings reinvested in their businesses by persons working on their own account, *i.e.* farmers, individual business proprietors and professional persons, for an amount estimated at between £30 million and £50 million.

External Finance

As far as external finance is concerned, the co-ordination of supply and demand is effected by means of money and capital market transactions. In practice the individual owners of funds supplied to the market have the option of holding four principal types of financial assets, viz., (1) money, *i.e.* cash and demand deposits; (2) fixed interest bearing investments, such as fixed and savings deposits, direct loans, preference shares, debentures and Government stock; (3) contractual savings, which are equivalent to the annual increase in the actuarial reserves of life insurance companies and the net surplus of pension and provident funds, and finally, (4) equity investments, *i.e.* the purchase of ordinary shares.

The distribution of investors' funds among alternative forms depends on considerations such as the convenience of ample liquidity and the prospective yield of capital assets which, in turn, are closely affected by business cycle developments. Recent changes in the holding of different types of financial assets are summarised below.

1. *Money:* Despite the marked growth of private income, the private sector of the economy has shown little inclination to add to its holdings of cash and demand deposits during the past nine years. Thus the quantity of money held by this sector increased by only £7 million during 1957, and by a mere £36 million during the nine year period December, 1948 to December, 1957. In this connection, it should be borne in mind that the rise in interest rates since 1949 promoted the shift from non-earning liquid assets to less liquid assets yielding a positive return to the investor.

2. *Fixed Interest Bearing Investment:* Investments by individuals in fixed interest bearing securities and mortgages, which represent a *direct* transfer from the saver to the user of the funds, are not an important form of external finance under present conditions. By far the largest item in the second category of financial assets is deposits at financial institutions, which, in turn, serve as intermediaries between individual savers and the ultimate borrowers.

Last year the increase in fixed and savings deposits at commercial banks, building societies,[3] the Post Office Savings Bank, and other deposit-receiving institutions and loan and savings banks amounted to about £90 million, while the corresponding figure for the nine year period ending December, 1957 was £482 million. During the same periods the total assets of these institutions increased by £107

1. These are equivalent to income to be appropriated less taxation and dividend payments.
2. Including the undistributed profits of South African subsidiaries of overseas parent companies.
3. Including increase in share capital, which is also equivalent to a fixed interest investment.

million and £536 million, and their mortgage loans, discounts and advances by £95 million and £443 million respectively. Most of the funds deposited at financial institutions were thus transferred by them in the form of long and short-term *loan* capital. By comparison, their purchases of long-dated or funded stock and equities were relatively unimportant.

3. *Contractual Savings:* Insurance companies and pension funds receive a steadily increasing proportion of the current savings of the general public. During 1957 and 1948-57 the increase in the total assets[4] of the former institutions amounted to about £28 million and £191 million respectively, 80 per cent. of which represented additional mortgages and other fixed interest bearing investments.

As far as pension funds administered by Public Authorities *(i.e.* the Union Government, South African Railways, Harbours and Airways, Provincial Administrations and Local Authorities) are concerned, the increase in total assets, which serves as an indication of the amount available for investment, amounted to about £27 million last year. No up-to-date information is available, however, about the annual net income of private pension funds,[5] but according to one estimate,[6] the total income of all private pension and provident funds for the financial year ending June, 1954, was about £29 million. Of this sum about £22 million was available for investment in fixed interest bearing securities and mortgages.

4. *Equity Investments:* The available data suggest that recently the funds entrusted to financial institutions by investors were far in excess of those devoted to the purchase of equity investments. Thus, for example, for the year ending September, 1957 the amount of new capital raised by the issue of shares[7] of listed and newly listed companies on the Johannesburg Stock Exchange was £24 million, as compared with an increase in fixed and savings deposits of £90 million.

Before drawing certain conclusions about the manner in which the recent business expansion was financed, more detailed information about the sources and uses of funds in several broad industrial divisions of the economy will be presented in the next section of this review.

4. Figures on the increase in actuarial reserves are not available.

5. In terms of the Pensions Funds Act (No. 24 of 1956), information about income, expenditure and investments must in future be furnished to the Registrar of Financial Institutions by all private pension funds.

6. G. Rissik: The Effects of Pension and Provident Funds and their Investments on the National Economy, *The South African Bankers Journal*, October, 1955, p. 249.

7. Including share premium.

SOURCES AND USES OF INVESTMENT FUNDS BY INDUSTRY GROUPS

1. *The Mining Industry*

The appropriation of the income earned by the mining industry *(i.e.* gold and other mining companies listed on the Johannesburg Stock Exchange) during the 1957 and earlier financial years is set out in Table 1. The deduction of taxes and dividends from each year's income yields a residual amount, viz., retained earnings.

Table 1

Mining Companies: Appropriation of Income (1952/3—1956/7)

	1952/3	*1953/4*	*1954/5*	*1955/6*	*1956/7*
	£m	£m	£m	£m	£m
Operating Surplus	69	75	87	105	119
Income from Investments	10	11	12	14	15
Income to be appropriated	79	86	99	119	134
Less Taxation	22	23	27	29	29
Less Dividends	42	42	46	54	60
Balance: Retained Earnings	15	21	26	36	45
	%	%	%	%	%
Taxation	28	27	27	24	22
Dividends	53	49	47	45	45
Retained Earnings	19	24	26	31	33
	100	100	100	100	100

Since the financial year 1952/3, mining income has increased steadily, thus affording more latitude for the retention of earnings. On a percentage basis, income retained out of earnings increased from 19 per cent. in 1952/3, to 33 per cent. in 1956/7, and, in absolute figures, from £15 million to £45 million, an increase of 200 per cent. over a period of four years.

Data illustrating the respective roles of internal and external finance in the financing of the mining industry's recent expansion are given in Table 2. The Table shows the year-to-year changes in the assets and liabilities set out in the balance sheets of the companies concerned. It will be noted that the data are summarised under a number of headings so as to illustrate, firstly, the origin of the new funds utilised for the financing of the year-to-year assets' increments, and secondly, how these were divided between additions to physical and financial assets.

Table 2

Mining: Sources and Uses of Investment Funds (1952/3—1956/7)

	1952/3 to 1953/4	1953/4 to 1954/5	1954/5 to 1955/6	1955/6 to 1956/7
	£m	£m	£m	£m
Sources				
Internal Sources:				
Retained Earnings	21	26	36	45
External Sources:				
Long-term				
New Issues	34	25	17	6
Loans	9	1	—	–2
Short-term				
Payables	—	4	2	–1
Other Credits	4	4	2	5
Other Capital Receipts	—	—	1	–1
Total Sources	68	60	58	52
Uses				
To Increase Gross Physical Assets:				
Land, Buildings and Plant	56	48	41	40
Inventories	—	1	1	1
To Increase Financial Assets:				
Investments*	—	4	17	9
Receivables	1	1	2	3
Other Debits	1	—	–2	—
Liquid Assets	10	6	–1	–1
Total Uses	68	60	58	52

Since the financial year 1952/3, a steadily increasing proportion of mining capital requirements was met from internal sources, culminating in last year's record figure of £45 million, as against an over-all increase in assets of £52 million. Over the past four years more than half of the increase of the capital assets of the companies concerned was financed internally, and about one-third by receipts from the issue of ordinary shares. Of the total additions to assets, more than three-quarters represented additional physical assets.

2. *Manufacturing*

The Bureau of Census and Statistics[8] recently published figures relating to the consolidated accounts of 382 listed[9] public companies engaged in manufacturing, commerce and services. Data summarising the income appropriations of the 263 manufacturing companies included in the Bureau's survey are presented in Table 3.

In interpreting the Bureau's figures, it should be borne in mind that the latter understate the extent to which manufacturing companies relied on internal finance, in that provisions out of current income for depreciation of fixed assets have not been taken into account in the tabulations. In this connection, it will be recalled that, as stated in the introduction to this review, depreciation allowances form part of the total amount of internal funds set aside in any financial year for the financing of gross additions to assets.

Table 3

Manufacturing Companies: Appropriation of Income (1952/3—1955/6)

	1952/3	1953/4	1954/5	1955/6
	£m	£m	£m	£m
Operating Surplus	43	44	48	48
Interest and Dividends	2	2	2	2
Income to be Appropriated	45	46	50	50
Less Taxes	14	14	15	15
Less Dividends	18	19	20	19
Balance: Retained Earnings	13	13	15	16

Percentage Distribution

	%	%	%	%
Taxes	31	31	30	30
Dividends	40	41	40	38
Retained Earnings	29	28	30	32
	100	100	100	100

During the period 1952/3—1955/6 the income of the group of 263 manufacturing companies showed signs of levelling off, and a decrease in the share of income distributed as dividends is also noticeable. The share of retained earnings, on the other hand, tended to increase, while that of tax liabilities remained about the same. It would appear, therefore, that a further increase in internal financing would have to be at the expense of dividend payments, except in the event of a countervailing increase in the companies' operating surplus.

The sources and uses of funds of the same group of companies are given in Table 4.

* Mainly stocks and shares, and loans and advances to subsidiaries and other organisations.

8. *Memorandum No. 15: A Survey of the Accounts of Public Companies for the Period 1952-53 to 1955-56;* Government Printer, Pretoria, 1958. The Bureau of Census and Statistics is hereinafter referred to as the Bureau.

9. *i.e.* companies whose shares are quoted on the Johannesburg Stock Exchange.

Table 4

Manufacturing: Sources and Uses of Investment Funds

(1952/3—1955/6)

	1952/3 to 1953/4 £m	1953/4 to 1954/5 £m	1954/5 to 1955/6 £m
Sources			
*Internal Sources**	13	15	16
External Sources:			
Long-term			
New Issues	4	4	1
Loans	1	8	7
Short-term			
Trade Payables	—	6	7
Other Credits	−2	5	5
Other Capital Receipts	−1	1	1
Total Sources	15	39	37
Uses			
To Increase Net Physical Assets:			
Land, Buildings and Plant	13	16	14
Inventories	−7	12	15
To Increase Financial Assets:			
Investments and Other Financial Assets	2	5	2
Trade Receivables	4	9	8
Liquid Assets	3	−3	−2
Total Uses	15	39	37

About half of the funds required for outlays on *net* assets, *i.e.* the gross value of the assets less depreciation charges, was supplied from internal sources, while the balance, viz., external finance, comprised roughly equal amounts of long-term and short-term funds. Of the total amount raised, about 70 per cent. was utilised for the financing of additional fixed assets and inventories. Trade receivables also absorbed substantial funds. In addition, the increase of the companies' non-liquid assets was accompanied by a decrease in their aggregate holdings of liquid assets *(i.e.* cash and deposits).

3. *Commerce and Services*

The Bureau has also tabulated balance sheet figures in the case of 119 companies engaged in commerce and services, and these are rearranged in Table 5 below so as to illustrate sources and uses of investment funds under a number of headings. As in the case of manufacturing, the data shown below under the heading " Internal Sources " do not include depreciation allowances.

* As mentioned in the text, depreciation allowances have not been included hereunder by the Bureau.

Table 5

Commerce and Services: Sources and Uses of Investment Funds

(1952/3—1955/6)

	1952/3 to 1953/4 £m	1953/4 to 1954/5 £m	1954/5 to 1955/6 £m
Sources			
*Internal Sources**	4	5	5
External Sources:			
Long-term			
New Issues	—	2	1
Loans	5	3	2
Short-term			
Trade Payables	2	3	1
Other Credits	3	4	2
Other Capital Receipts	1	1	—
Total Sources	15	18	11
Uses			
To Increase Net Physical Assets:			
Land, Buildings and Plant	8	7	6
Inventories	2	6	3
To Increase Financial Assets:			
Investments and Other Financial Assets	1	1	—
Trade Receivables	3	5	4
Liquid Assets	1	−1	−2
Total Uses	15	18	11

About one-third of the outlay of the commerce and services' group of companies on *net* fixed and other assets was financed internally, as against about one-half in the case of manufacturing companies, and, as might have been expected, the extension of short term credit played a relatively larger role as an external source of its capital funds.

As regards the purposes for which the funds were used, the percentage distribution is very similar to that of manufacturing companies, with physical assets accounting for about 70 per cent. of the total, and financial claims, mainly trade receivables, for about 30 per cent. It is also significant that, as in the case of manufacturing companies, the liquid assets held by the commercial and services' group declined during the last two years of the period under review.

4. *Public Corporations*

Sources and Uses Tables of two public corporations, namely, Iscor and Escom, are given below in order to illustrate the recent trend of financing in this important sphere of economic activity.

Table 6

Iscor: Sources and Uses of Investment Funds (1952/3—1956/7)

	1952/3 to 1953/4 £m	1953/4 to 1954/5 £m	1954/5 to 1955/6 £m	1955/6 to 1956/7 £m
Sources				
Internal Sources	9	11	12	12
External Sources:				
Long-term	—	—	—	—
Short-term	−3	—	1	1
Total Sources	6	11	13	13
Uses				
To Increase Gross Physical Assets:				
Land, Buildings and Plant	2	2	3	5
Inventories	1	—	1	1
To Increase Financial Assets:				
Investments	1	2	1	1
Receivables	1	1	—	1
Liquid Assets	1	6	8	5
Total Uses	6	11	13	13

The importance of internal finance in the financing of Iscor's capital requirements can be gauged from the fact that it accounted for more than three-quarters of the latter during the nine year period ended 30th June, 1957, and more than 100 per cent.[10] in the four year period covered by the data of Table 6.

A feature of the uses is the accumulation of liquid assets. As Iscor is presently expanding existing productive capacity on a large scale, these assets represent readily accessible funds earmarked for the anticipated outlays on plant and equipment.

The pattern of financing of a public utility organisation, such as Escom, differs in several respects from that of other industrial groups. Thus, for example, the relative importance of internal finance in the former type of organisation is less than in industries not subject to regulation. According to the figures for the four year period ending December, 1957, which are summarised in Table 7, Escom's capital funds were mainly drawn from outside sources, the major portion of the latter being receipts from the issue of long-dated securities. During the same period internal funds contributed about one-fifth of Escom's requirements, although it would appear that recently this source is assuming greater importance.

Table 7

Escom: Sources and Uses of Investment Funds (1953-57)

Sources	1953 to 1954 £m	1954 to 1955 £m	1955 to 1956 £m	1956 to 1957 £m
Internal Sources	5	6	7	8
External Sources:				
Long-term				
Securities	28	19	15	23
Short-term				
Payables	1	1	−1	—
Other Credits	−4	1	4	−3
Other Capital Receipts	—	3	—	—
Total Sources	30	30	25	28
Uses				
To Increase Gross Physical Assets:				
Land, Buildings and Plant	27	21	20	19
Inventories	—	—	1	1
To Increase Financial Assets:				
Investments	3	9	4	8
Receivables	—	—	—	—
Liquid Assets	—	—	—	—
Total Uses	30	30	25	28

As might be expected of a capital intensive undertaking, expenditure on additional fixed assets is the predominant item in the total cost of Escom's recent expansion, its share in the total amount of funds employed since 1953 being no less than 77 per cent.

5. *The S.A. Railways and Harbours Administration*

The financing of Escom's recent development programme may be compared with that of another capital intensive public enterprise, viz., the South African Railways, Harbours and Airways, which has also experienced an unprecedented expansion of its assets during recent years. The relevant data are shown in Table 8.

Table 8

S.A. Railways and Harbours: Sources and Uses of Investment Funds (1952/3—1956/7)

Sources	1952/3 to 1953/4 £m	1953/4 to 1954/5 £m	1954/5 to 1955/6 £m	1955/6 to 1956/7 £m
Internal Sources	10	27	25	16
External Sources:				
Long-term	37	24	33	42
Short-term	1	1	−2	2
Other Capital Receipts	1	9	1	1
Total Sources	49	61	57	61
Uses				
To Increase Gross Physical Assets:				
Land, Buildings and Plant	53	40	45	56
Inventories	—	−3	2	8
To Increase Financial Assets:				
Investments	−6	20	10	−2
Receivables	2	4	—	−1
Liquid Assets	—	—	—	—
Total Uses	49	61	57	61

10. Outstanding short-term debt was cancelled during this period.

Broadly speaking, transport finance presents the same problems as those encountered in the provision of power facilities. As a result of the relatively high cost of plant and equipment, 85 per cent. of the recent additions to Railways and Harbours Administration's assets represents additional fixed assets, as compared with relatively modest additional funds required for working capital purposes. This, in turn, has an influence on the nature of the finance required for transport development, the emphasis being on long-term borrowing.

During the four year period covered by the data of Table 8, internal sources, *i.e.* retained earnings and depreciation provisions out of income, contributed one-third of the additional amount needed, while the balance was raised externally, mainly in the form of receipts from the issue of long-dated securities by the Union Government.

Conclusions

Although the foregoing survey of the sources of internal and external finance in the Union's economy is limited to such financial flows as can be identified on the basis of readily available statistics, and hence does not provide a complete picture of the complex network of financial interrelationships existing in practice, certain conclusions may, however, be drawn at this interim stage of the enquiry.

1. After due allowance is made for those transactions not taken into account in the analysis, it would appear that, under present conditions, internal finance, *i.e.* gross savings of businesses, plays an extremely important role as a source of investment funds.

2. The behaviour of internal finance deserves close attention in future studies of investment trends, not only on account of the absolute and relative size of the amount involved, but also because it is motivated by factors differing from those governing the supply of savings on the part of investors acting in their individual capacity.

3. Of the total amount of internal finance, about half is derived from provisions out of current income for the depreciation of existing fixed assets, while the remainder represents retained earnings.

4. The use made by industry of internal finance, in so far as this takes the form of retained earnings, is limited by the rate of growth of the income of the various industry groups.

5. Investors, as the suppliers of external funds, pay attention to the degree of liquidity or risk attached to the holding of different types of financial assets. The available data indicate that recently most of the external funds reaching the market were channelled into fixed interest bearing investments and contractual savings.

Only a relatively minor portion of the recent overall additions to financial assets was held in liquid form, *i.e.* cash and demand deposits, or in the form of equities.

6. Most of the funds invested in assets yielding a fixed return, and all those in the form of contractual savings, were entrusted to specialised institutions, viz., financial intermediaries, in the case of the former, and insurance companies, pension and provident funds, in the case of the latter category.

7. In most cases financial intermediaries, including insurance companies, transfer funds to the ultimate users in the form of loan rather than equity capital. Furthermore, the financial accommodation is mainly provided in the form of *direct* loans, *i.e.* by extending short-term credit in various forms and, in the case of long-term lending, the granting of mortgage loans, rather than *indirectly*, *i.e.* by adding to portfolios of *marketable* securities. The exception is pension and provident funds, especially those administered by the Public Debt Commissioners.

To a certain extent this development in favour of direct loans reflects the influence of the market phenomenon that during a period of rising interest rates the holder of marketable long-dated stock is rendered liable to a capital loss if he sells before the securities mature.

8. Wide inter-industry differences exist in the pattern of financing which, in turn, is influenced by the ultimate use made of new capital funds. In commerce and distribution and also in manufacturing, working capital needs are relatively important, thus calling for the extension of short-term credit by outside sources in order to finance additions to inventories and customer receivables. Capital intensive undertakings, such as those encountered in the public utility and transport fields, on the other hand, mainly require long-term funds when they extend the scope of their operations.

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