South African conglomerates: a qualitative analysis

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Introduction
Previous Research
Two recent research studies into South African listed companies indicate that South African firms appear to be following a trend towards increased diversification. This tendency is consistent with the pattern experienced in the more developed economies. The extent of diversification within South African quoted industrial firms is, however, not comparable to anything experienced by the developed economies during the last 30 years. While South Africa displays a large proportion of Single and Dominant businesses, not unlike those of developed countries in the 1950s, its relatively large group of conglomerates is more akin to the developed economies of the 1960 and 1970s.

Quantitative findings
These two research studies have established, on the basis of the strategic categorization scheme adopted by Wrigley and Rumelt, that 32 SA listed companies qualify as 'conglomerates'. These are listed in Table 1.

The conglomerate group has performed, both in terms of growth and return on investment, better than the population average. Table 2 shows this for return on investment. Conglomerates also display a slightly higher than average variability in growth and returns. Compared with the total research population, conglomerates have exhibited higher dividend pay out and debt ratios than other forms of business. In terms of risk, conglomerates display a mean beta value only slightly higher than the population. This means that, in South Africa, conglomerates are only slightly riskier than the whole stock market, but their returns are significantly higher.

The term 'conglomerate' as used in this research describes those companies which are not vertically integrated, and which have diversified chiefly without particular regard to the relationships between new businesses and current business activities.

In technical terms, conglomerates have specialization ratios of less than 0.7 (i.e. less than 70% of the firm's annual revenues are attributable to its largest discrete product-market activity), and related ratios of less than 0.7 (i.e. less than 70% of the firm's annual revenues are attributable to its largest group of related businesses).

Within the category of conglomerate described above, two significant sub-categories have been identified. These
Table 1  South African conglomerates by strategic subcategory

| Passive conglomerates | Acquisitive conglomerates |
|-----------------------|---------------------------|
| Advance Holdings Ltd. | Abercom Investments Ltd    |
| Amalgamated Investment Corporation Ltd. | Adcock Ingram Ltd. |
| Anchusa Holdings Ltd. | Anglo American Industrial Corporation Ltd. |
| Bonuskor Bpk.         | Anglo-Transvaal Industries Ltd. |
| Bromain Holdings Ltd. | Barlow Rand Ltd. |
| Currie Finance Corporate Ltd. | Blue Circle Ltd. |
| Droyal Investments Ltd | Calan Ltd. |
| Hulett’s Corporation Ltd. | Federale Volksbeleggings Bpk. |
| Ovenstone Investments Ltd. | Industrial & Commercial Holdings Group Ltd. |
| Premier Industries Ltd. | Lonrho Ltd. |
| Rentmeester Beleggings Bpk. | Lucem Holdings Ltd. |
| Suiderland Development Corporation Ltd. | Picardi Beleggings Bpk. |
| Trumcor Ltd.          | Protea Holdings Ltd.       |
| The Unisec Group Ltd. | Rennies Consolidated Holdings Ltd |
|                       | Seardel Investment Corporation Ltd. |
|                       | The South African Breweries Ltd. |
|                       | The Tongaat Group Ltd.     |
|                       | W. & A. Investment Corporation Ltd. |

Table 2  Passives vs acquisitives — A comparison of quantitative factors

|                | Population | Passives | Acquisitives |
|----------------|------------|----------|--------------|
| Growth         |            |          |              |
| Sales          |            | 14,0%    | 24,4%        |
| Profits        |            | 18,3%    | 32,8%        |
| E.P.S.         |            | 13,9%    | 18,2%        |
| Returns        |            |          |              |
| R.O.I.         | 14,10      | 13,7%    | 16,1%        |
| Variability    | 18,30      | 14,1%    | 4,3%         |
| Sundry         |            |          |              |
| Debt ratio (1975) | 55,0%    | 48,0%    |              |
| Dividend : Ratio | 67,9%    | 68,0%    |              |
|                | 1970 – 76  | 33,7%    | 16,0%        |
| Risk (Beta)    | 0,986      | 0,934    |              |

are described as ‘unrelated passive’ and ‘unrelated active’:

Unrelated passive — unrelated business firms that do not qualify as unrelated acquisitives. (See definition below.)

Unrelated acquisitive — unrelated business firms which have aggressive programmes for the acquisition of new unrelated businesses. More specifically, such firms are defined as having, over the last five years, (a) had an average growth rate in earnings per share of at least 10% per year; (b) made at least five acquisitions, at least three of which took the firm into businesses unrelated to past activities; and (c) issued new equity shares whose total value (using market prices at the time of issue) was at least as great as the total amount of common dividends paid during the same period.4,p.24

This is extended in the South African context in that an active, or acquisitive, conglomerate is one having, over the last five years, satisfied at least two of the following three criteria:2,p.59

(i) Annual average E.P.S. growth rate of more than 10%.
(ii) More than five acquisitions in areas related to past business activity.
(iii) More than three acquisitions in at least one area unrelated to past business activity.

Objective of this paper

Prior research already mentioned has indicated differences in financial performance between the two categories of conglomerate in South Africa. The objective of this paper is to analyse the results of research into the qualitative factors which describe South African conglomerates in terms of their diversification strategies, organizational structures, divisional autonomy, performance criteria, planning horizon and degree of organizational formality. Those factors which may account for the differences in economic performance between ‘active’ and ‘passive’ conglomerates will then be discussed and some conclusions will be drawn.

Methodology

To establish what qualitative characteristics account for differences in financial performance of acquisitive and passive conglomerates, a questionnaire was constructed based upon the findings of prior research. Each question was constructed to test a hypothesis, derived from the prior research findings. Forty-one such questions were developed. (The prior research, and questionnaire, are contained in the Bisotto report.2,p.82 – 125)

A questionnaire was mailed to each of the 32 companies classified as conglomerates. This includes the entire population of listed conglomerates in South Africa. The completed questionnaires were then analysed for each of the 41 questions, and differences in the responses between the acquisitive and passive conglomerates were noted.
Questionnaire Responses
Of a total of 32 questionnaires mailed, 23 (72%) were returned, in almost equal proportions from the companies in the research population (i.e. a 71% response rate from the ‘passives’, and 72% response rate from ‘acquisitive’ conglomerates).

Summary of major research findings
Table 3 indicates the major factors and differences between active and passive conglomerates in South Africa. Only the qualitative research findings are discussed here, as the quantitative findings have already been discussed in the introduction.

1. General findings relating to both categories
The qualitative findings indicate that South African diversifiers are multi-product firms and are in divisions grouped on the basis of their relevant products or markets. Divisions operate fairly autonomously with head offices relying on financial results as the most important means of control.

In line with USA findings, the support-staff at headquarters tends to be small, and focuses on such functions as planning, finance and law.

Because South African conglomerates are smaller and . Interdivisional problems appear to be resolved quickly at divisional level through personal contact between head office and divisional managers.

From a strategic point of view South African conglomerates are seen to be planning for diversification but not actively pursuing it. Furthermore, where diversification is considered it tends to be in related rather than unrelated fields of activity.

2. Extent of Diversification
Answers given in the questionnaire indicate that acquisitives are more diversified than passives. Although both groups are structured on a divisional basis, their interactions with their markets in terms of purchases and distribution are different. In the case of passives, head offices seem to impose — or at least maintain — centralized purchasing and distribution functions implying Table 3 Passives vs acquisitives — A comparison of qualitative factors

|                          | Passives     | Acquisitives                      | Passives     | Acquisitives                      |
|--------------------------|--------------|-----------------------------------|--------------|-----------------------------------|
| Diversification:        |              |                                   |              |                                   |
| Product lines            | Fewer than in acquisitives. | Numerous. | Intensive short-term activity — aggressive. | Some short-term activity. Not as aggressive, over next year, as passives. |
| Purchasing               | Tends to be centralized within the group. | Decentralized at divisional level. | Diversification areas | Mainly in related areas of activity but to some extent in unrelated areas. |
| Distribution             | Tends to be centralized whenever economically feasible. | Decentralized at divisional level. |                          |                                   |
| Structure:               |              |                                   |              |                                   |
| Head office size         |              |                                   |              |                                   |
| (Number of People)       | < 39         |                                   | < 29         |                                   |
| Divisional autonomy:     |              |                                   |              |                                   |
| Distribution/            | Head office tends to impose centralized facilities. | Divisions interact with their market directly. | Strategic planning | Corporate management allocates 20–50% of its time on planning. |
| Purchasing               | Market interaction indirect. |                          |              |                                   |
| Goal setting             | Divisions moderately involved in goal setting. | Extensive divisional involvement in generation of goals. | Strategic horizon | Strategic problems tend to be of a long-term nature, usual time horizon between one and more years. |
| Transfer pricing         | Policy extensively applied within group. | No such policy maintained. |                          |                                   |
| Performance criteria:    |              |                                   |              |                                   |
| Measurement              | Cost-related — internal orientation. | Market-related — external orientation. | Organizational formality: | Some rules and procedures are imposed by H.O. in formalizing its relationship with divisions. | Low H.O. reliance on rules and procedures to formalize H.O. divisions relationship. |
| Control                  | Tends to be formal through some rules and regulations. Also through financial results. | Informal and through financial results. | Rules |                          |                                   |
| Strategic choice:        |              |                                   |              |                                   |
| Diversification strategy | No specific strategy. Opportunity exploited when present. | Diversification planned but not actively pursued at the moment. | H.O. division communication | Tends to be more formal and indirect than acquisitives. | Tends to be of a direct, face-to-face nature, and informal. |
an indirect division-environment relationship. Acquisitive divisions on the other hand tend to interact directly with their selling and buying markets.

3. Structure
The divisional structure seems to be universal among South African conglomerates. Head offices are, however, structured differently. Passives appear to have larger corporate staffs. This suggest that passives have more specialists than do acquisitives, yet the financial performance already considered seems to indicate that generalists rather than experts made for better management and consequently better performance.

4. Degree of autonomy
Acquisitives are autonomous in the way they procure their raw materials and in the way they dispose of their finished products. Divisions of passive firms on the other hand seem to be far more directed by their head offices. Transfer pricing policies are extensively used within the passive conglomerate group suggesting a more constrained product-market relationship.

As far as setting objectives is concerned, acquisitive divisions seem to generate their own goals, or at the very least they are to a very great extent involved in such matters. Passives, however, tend to have goals and objectives imposed by corporate head office with only moderate divisional involvement.

5. Performance criteria
Although both groups of conglomerates rely on R.O.I. as the main measurement of performance, there is a tendency for passives to regard cost efficiencies as a very important performance criterion. Passives therefore appear to be oriented towards internal rather than external success. Acquisitives rely on market-related success to assess group performance.

There are also differences in the way performance is controlled. Acquisitives use an informal and impersonal approach, while passives tend to be more formal through the use of policies and procedures.

6. Strategic choice
The acquisitive group appears to plan its diversification strategy, and compared with the passive group it is more calculating and conscious of the direction taken. Passives are more opportunistic, and as such their diversification strategy is ad hoc and generally not well-planned. However, the passives are poised, at least in the short term, for vigorous diversification activity. Results indicate that this activity will be focused mainly in related business areas, although unrelated businesses are also being considered. Acquisitives appear, at this point in time, to be less aggressive than passives and to pursue a mixed strategy of diversification into related and unrelated areas.

7. Time orientation
Corporate head office management of passives appears to be involved in the day-to-day problems of the group rather than on strategic planning and long-term problem solving. For passive conglomerates strategy determination tends to be of a long-term nature. Acquisitives on the other hand tend to regard strategy formulation as a continuous function. They are therefore more flexible in their approach to business and consequently better able to preempt or at least react to market and economic conditions.

8. Organizational formality
This research has revealed that passives rely to some extent on rules and regulations in formalizing the relationships between their head offices and divisions. Acquisitives exhibit less organizational formality.

Communication within the acquisitive group is informal and usually face to face. Passives tend to be more formal.

Conclusions
The passive conglomerates currently display aggressive short-term diversification strategies. If in so doing it is their intention to match the financial performance of their acquisitive counterparts, then the corporate head office of passive conglomerates must make changes to its management style. Divisions of passive conglomerates require freer rein in their operations. Head office management needs to detach itself from divisional involvement. Less formality and greater divisional independence could promote an atmosphere more conducive to high divisional performance with head office giving back-up services, direction, and control measured in terms of market R.O.I., rather than direct operating control.

The general picture which emerges indicates that several qualitative factors account for most of the differences between ‘passive’ and ‘acquisitive’ conglomerates. The acquisitive conglomerates allow more autonomy to their divisions, plan for new acquisitions more systematically, focus more on market-related R.O.I. performance-criteria, and rely less on rules and procedures than do their ‘unrelated passive’ conglomerates.

The difference in approach to strategy and structure can be summarized into two broad categories — financial measures used to assess operating performance, and the organizational formality of the two respective groups of conglomerate.

The modus operandi of the acquisitive conglomerate has enabled them to achieve substantially better than the average financial results for the ‘passives’.

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