The impact of financialisation on the IDC in South Africa since 1994

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Outline

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Problem Statement

Financialisation is a widely studied phenomenon and its impact is well understood.

- Financialisation is commonly defined in Epstein's words as "…the increasing role of financial motive, financial markets, financial actors and financial institutions in the operations of the domestic and international economies" (Epstein, 2005:3).

- Financialisation is more than a proliferation of financial markets but represents a more profound systematic transformation of the operations of economies, states, firms and households through a shift in capitalist accumulation patterns, from a Fordist accumulation regime to a finance-led regime.

- At its core, financialisation represents **a new frontier of capital accumulation in which money accrues more money without being deployed into production**, leading to greater social instability and inequality.

In developing countries, a lot is known about the impact of financialisation in every sphere of the economy:

- Macro-economy (Ashman et al, 2011 & 2013; Mohammed, 2019)
- Non-financial Corporations (Ashman et al, 2011, Lapavitsas, 2013; Andreoni et al, 2021; King, 2021; Lapavitsas and Soydan, 2022).
- Banks and households (Lapavistsas, 2011; Ashman et al, 2013 & Bonizzi, 2013 Lapavitsas and Soydan, 2022).

Problem Statement continued

However, little is known about the impact of financialisation on state institutions, more specifically development banks.

- This is despite the state being a key actor in enabling and driving financialisation (Sokol, 2017:680).
- Few scholars have attempted to address this gap including:
    - Karwowski (2018 & 2020) - provides an overview of the financialisation of the state by looking at fiscal and monetary policy.
    - More recently, Santos (2022) has conceptualized of the financialisation of the state.
- **However, the financialisation of development banks is understudied, with little to no knowledge on this matter.**

- The financialisation of development banks is an important neglected research area for two reasons.

    1. Development banks are instrumental, through long-term finance, grant funding and concession rates, in directing finance towards productive activities in the economy.

    2. The financialisation of development banks has to be sufficiently understood so that they can, in turn, be used as a buffer against rampant financialisation.

- **This research aims to fill this gap using the case study of IDC.**

Research Question And Objectives

Research Question: To what extent has financialisation impacted IDC's ability to fulfil its mandate of supporting industrial development in South Africa since 1994?

Objective: (1) Critically analyse the impact of financialisation on the IDC's mandate to deliver industrial development; (2) build a solid theoretical foundation and empirical evidence on the financialisation of development banks.

More specifically, the study aimed to:

A. Critically explore the relationship between financialisation and development banks.
B. Identify and develop indicators for analysing financialisation in development banks.
C. Measure the financialisation of the IDC using the measurements developed and identified in the literature.
D. Examine the implications of a financialised IDC on industrial development in South Africa since 1994.

Methodology

This study used a **quantitative approach with a case study method**.

- The main advantage of relying on quantitative as opposed to qualitative research methods is the element of objectivity and generalizability.

- Previous studies also relied primarily on the quantitative approach to measure the level of financialisation and understand its impact on various segments of the economy.

Data collection: the study triangulated multiple sources of data that are publicly available, including inter alia IDC annual reports, national statistics provided by the South African Reserve Bank (SARB) and Statistics South Africa, and secondary data from other scholars.

Developing An Analytical Framework

A financialised development bank would be one that:

Adopts financial maximisation motives

- A financialised development bank would go against its primary mandate of funding projects that are risky and underfunded by the market.
- It would seek projects with limited risks and high returns.
- A key indicator here would be funding and investment strategy, including the extent to which IDC provides patient capital.

Embraces and accepts the finance-led accumulation regime & drives and entrenches the financialised logic within society

- A development bank entrenches a financialisation logic if it takes equity in locally listed firms and forms part of investors that demand shareholder value generation.
- The key indicator, in this case, is the investment and funding strategy whereby a development bank has taken equity in firms that regularly pay dividends.

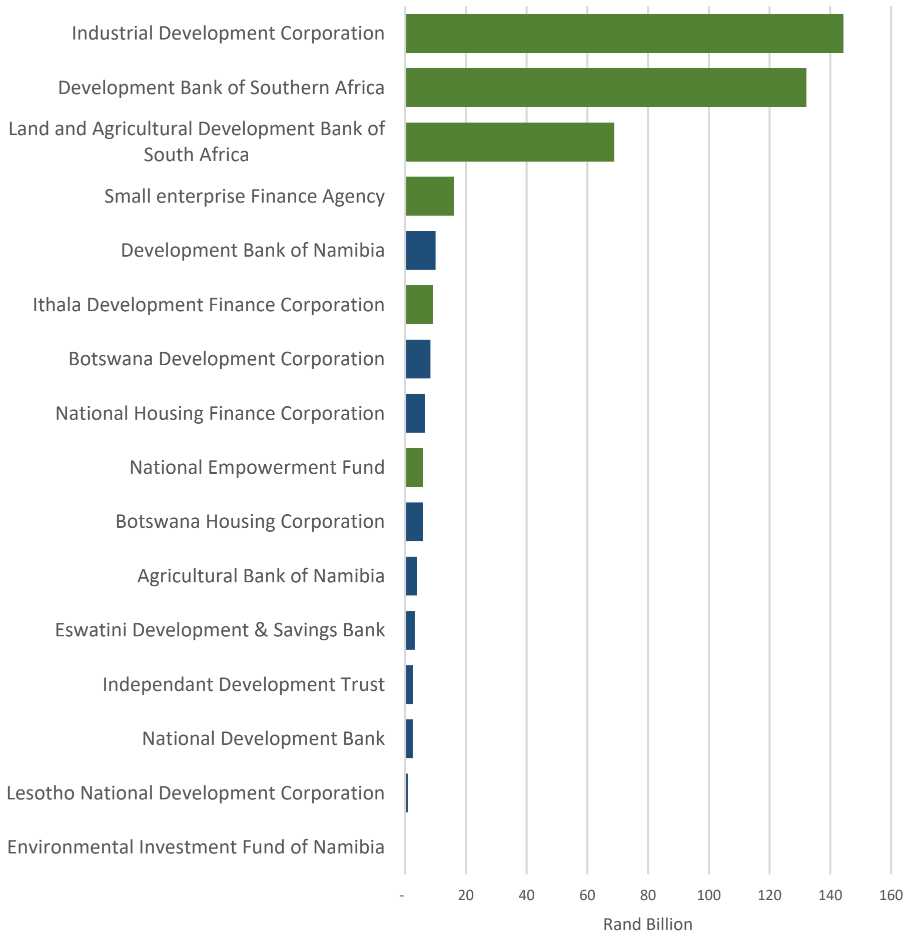
Actively creates new financial instruments that entrench financialised logic in society

- This relates to the aspect where development banks actively engage in financial engineering to develop new financial instruments that involve a partnership with private finance.

The Case of IDC

IDC's mandate is to provide funding support to South African industrial activities centred on the manufacturing sector.

Development banks in Southern Africa in Rand (million) in 2021

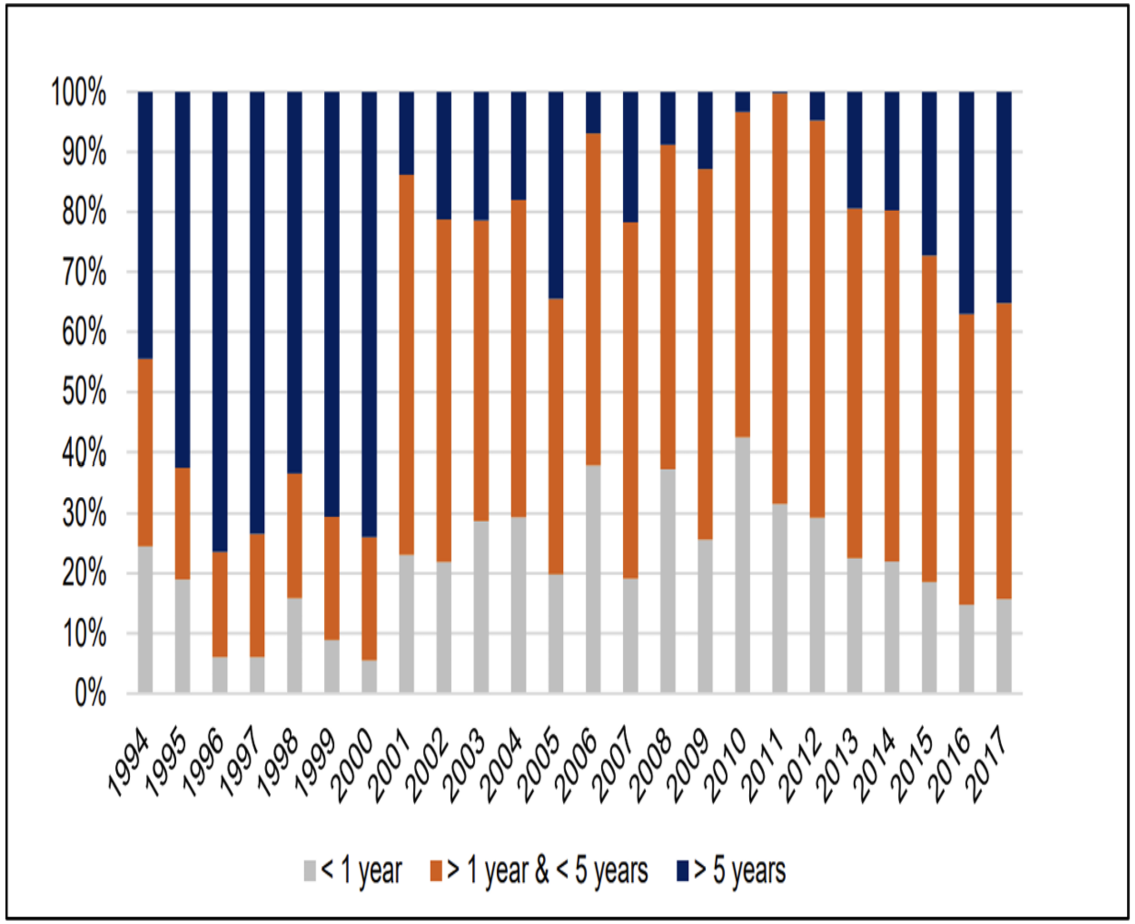


- IDC is the largest development bank in Southern Africa and South Africa. In 2022, the IDC's total assets amounted to R177 billion, accounting for approximately 33% of South African manufacturing Gross Value Added.
- Although state-owned, IDC is self-funded and uses the following three ways to source funding:
  - IDC raises capital from divesting established assets.
  - IDC raises capital from the domestic and international capital markets.
  - IDC uses internal profits from its investment activities to raise capital.
- By pooling these resources, the IDC provides business funding through equity or loans.
  - The choice of equity funding is a strategic decision for the IDC, with the bank providing equity funding to established businesses with a record of profitability.

Research Findings

Finding 1 : IDC does not provide patient capital, and its interest rates are not competitive

IDC loan book by maturity, 1994 to 2017



Source: Data and visualisation adapted from Goga et al. (2019)

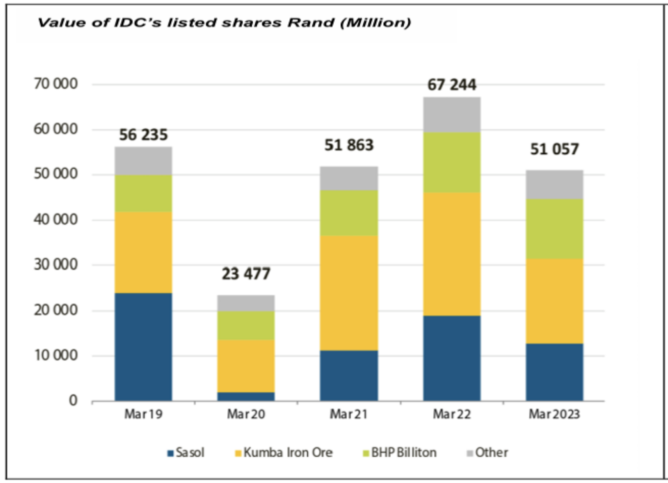
- Most loans offered by the IDC have a maturity of less than five years.
- Provision of short-term loans stems from the IDC funding model. The IDC uses its borrowings from the domestic and international markets to provide loans, while equity funding is mostly pooled from the divestment of mature assets.
    - Capital markets are highly financialised and prioritise short-termism and profit maximisation. Thus, their investment horizons are typically short, forcing the IDC to provide short-term loans to repay the debt in line with capital markets expectations.
- IDC does not provide competitive interest rates (Goga et al 2023 and Bosiu, 2019)
- Notably, the IDC does offer low interest rates and longer-term repayment periods on some of its on-balance schemes. However, these on-balance schemes comprised 6% of total IDC funding approval between 2011 and 2017

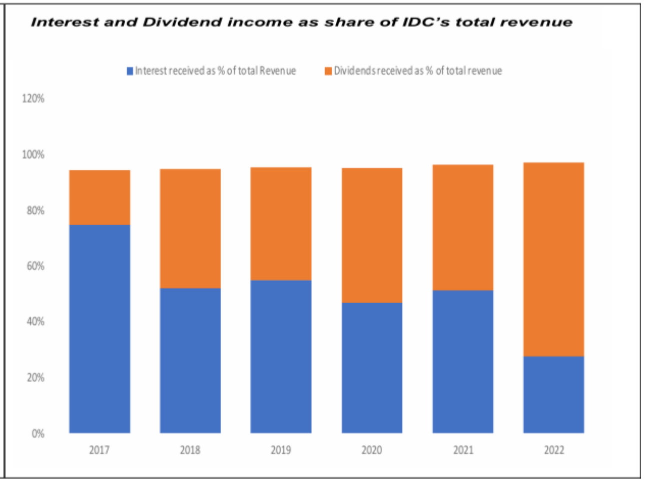
Research Findings

Finding 2: IDC entrenches financialisation to a certain degree in the economy through shareholder maximisation

Table : IDC shareholding in major listed firms in South Africa (data collected in 2022)

Company	IDC shareholding (%)	Market cap (Rand)	Sector	Regular dividend payment
Sasol Limited	8.3%	151,33 billion	Basic Materials	Yes
Kumba Iron Ore	12.8%	157,12 billion	Basic Materials	Yes
ArcelorMittal	8.1%	473,2 billion	Basic Materials	Yes
Merafe Resources Limited	21.7%	3,1 billion	Basic Materials	Yes
Hulamin Limited	29.1%	1,09 billion	Basic Materials	Yes, last dividend was paid in 2019
York Timber Holdings Limited	28.7%	995,61 million	Basic Materials	Yes
Basil Read Holdings Limited	5.9%	59 million	Industrials	No
WG Wearne Limited	15%	8,29 million	Industrials	No





- The entrenchment of financialisation is indirect, as the bank is part of shareholders expecting value maximisation.
    - The IDC holds equity in major JSE companies like Sasol, Kumba, and AMSA etc., which significantly contribute to IDC income.
    - In 2023, IDC's top dividend contributors were BHP Billiton (R2.5 billion), Kumba Iron Ore (R1.9 billion), and Sasol (R1.2 billion), making up 22% of IDC's total revenue.
- Moreover, as the share prices of these non-financial firms increase, the total assets of the IDC also increase.
- IDC receives large dividends by investing in highly financialised non-financial corporations that prioritise shareholder value over productive investment, e.g. Sasol
- The IDC's financialisation is evident as it makes equity investments in well-established, upstream, unlisted companies.

Research Findings

Finding 3: the IDC has mainly come up with funding schemes related to funding the transition to a low carbon and climate resilient economy

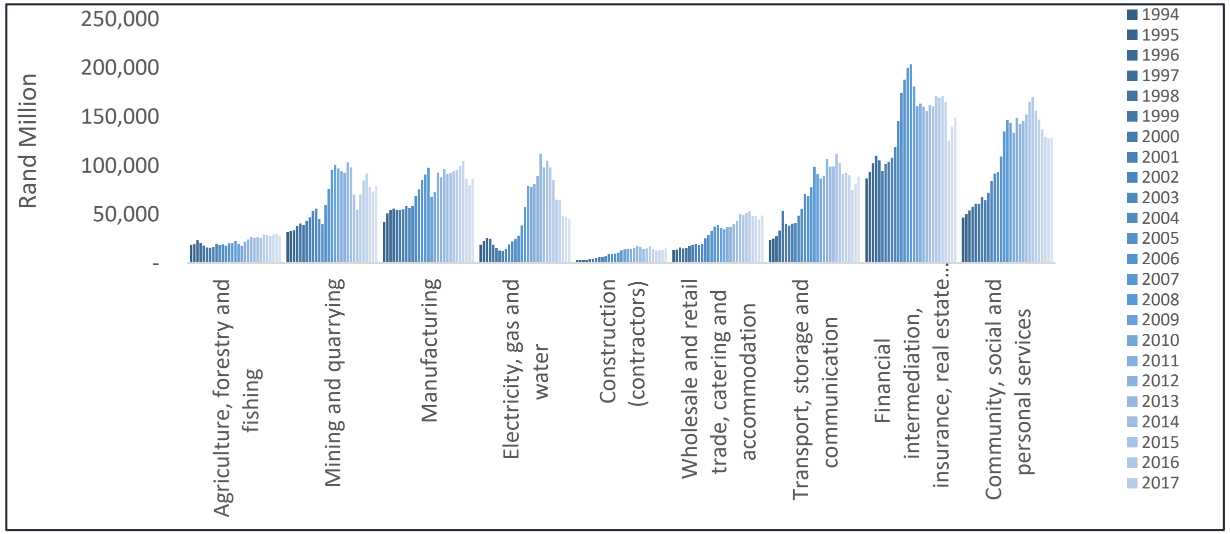
Instrument	Description	Amount	Prominent partnership
Green Bond	IDC issued a R5.2 billion green bond to finance clean energy projects, with an expected return of 9%.	R5.2 billion	Public Investment Corporation
ADF Green Fund	With R1 billion allocations, this fund is designed to provide finance to renewable energy and energy-efficient projects in South Africa. Notably, these would be smaller-scale projects.	R 1 billion	
Green Energy Efficiency Fund (GEEF)	This fund is a partnership between the IDC and the German Development Bank (KfW), dedicated to funding self-use renewable energy and energy-efficient projects. According to the IDC, the GEEF provides loan funding from R1 million to R50 million, with an interest rate of prime less than 2% and a repayment period of 15 years.	R500 million	German Development Bank (KfW),

Source: IDC annual Reports

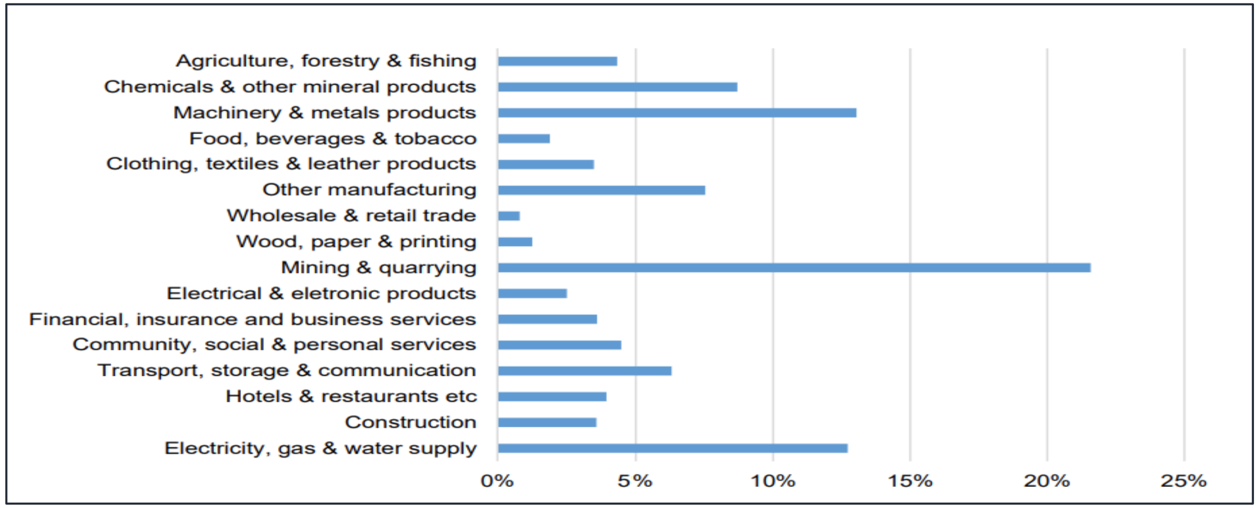
- Financial innovations and engineering relate to financial deepening in the financialisation literature.
- A development bank's role would be to de-risk development projects to attract private capital into development projects.
- In the case of IDC, the details on the financial innovations are too thin for adequate analysis.

Implications for South Africa's Industrial Development

South Africa's gross fixed capital formation from 1994 to 2022



IDC sectoral funding composition (percentage) from 2008 to 2017



- IDC's inability to largely provide patient capital means that the pace and structure of South Africa's industrial landscape are unlikely to change.
  - Further, without patient capital, the South African economy will remain untransformed.
  - Without low-interest rates and longer maturity of loans, high barriers of entry related to funding will remain in place for most sectors.
- Instead of being a bulwark, IDC has invested in and embraced non-financial corporations.
  - The financialisation of non-financial corporations adversely affects the industrial development and growth prospects of the country.
- The IDC's funding in listed and unlisted firms remains mostly in the capital intensive sectors, such as mining, chemicals and metals.
- Given that fixed investment is concentrated in the tertiary sector, and IDC funding is concentrated in the upstream sector, the objective of diversifying towards labour-absorptive industries is unlikely to be achieved

Conclusion

Key findings

- IDC shows signs of financialisation
  - It does not provide patient capital and concessional interest rates
  - Indirectly drive financialisation by forming part of shareholders that demand shareholder value
  - Equity investments remain in the historical MEC core and do not diversify the economy

Implications

- Financialised IDC impacts South Africa's industrialization pace and direction.

Recommendation

- Government reviews the self-funding model of IDC.

Future Research

- Comparative study between development banks in different regions to assess the impact of financialisation.
- Explore development banks' role in climate and Just Transition finance.

Thank you!

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