

**Globalisation, concentration and regulation: Trends in the globalisation  
of South African banking, 1990 – 2005.**

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The South African banking industry has been closely linked to the British banking institutions and British banking since the early colonial period of the nineteenth century. In the late 1880s the Dutch introduced the continental approach of banking to the Zuid-Afrikaansche Republiek (ZAR – later the Transvaal colony) of President Paul Kruger by establishing the Nederlandsche Bank voor Zuid-Afrika (NB voor ZA) Despite the dominance of the imperial banks, skilful competition by the Dutch bankers led to innovation and sophistication of the South African banking industry in the twentieth century. By the last half of the twentieth century the South African banking industry was by far the most sophisticated in Africa and in sophistication matched or even surpassed those of other countries outside the European or American cores, such as Canada, Australia and New Zealand. The development was noteworthy because of the isolation of South Africa during the last part of the twentieth century. Despite the isolation, the banking sector developed parallel to the leading financial institutions of the developed world. Even before 1994 the central bank of South Africa, the South African Reserve Bank (SARB) commented that the increased acceptability of South Africa in the international markets led to the expansion of the international operations of South African incorporated banks and increased interest by foreign banks in developing a presence in the South African market. (SARB,1992:4)

The question in this paper is to which degree has the banking sector in South Africa become globalised since the early 1990s? Have the banks joined in the international trend of the internationalisation of banking operations? Was

South African banking part of the international regulatory developments and what was the impact thereof on South African banking? Has the banking sector in South Africa become more internationalised through the penetration of foreign banks into the South African banking environment? In this paper attention will first be given to the statutory accessibility of South African banks to and for international business. Secondly attention will focus on the globalisation of South African banking operations as well as the participation of foreign banks in South Africa.

1. Statutory parameters of South African banking.

International banking activity expanded gradually in South Africa since the late 1980s. International banking activities were a function of statutory permission to operate in the country. The earliest private banks that opened their doors in the British colonies (ultimately to constitute the Union of South Africa in 1910) were primarily incorporated in England and they remained the dominant banking institutions until late in the twentieth century. (Arndt, 1928:197-236) Barclays Bank DC&O and Standard Bank were incorporated in Britain until the 1960s, with majority shareholding outside South Africa until much later.<sup>1</sup>

On 27 November 1967 the government appointed a commission of enquiry into improved monetary control over the banking sector, under the chairmanship of the Vice-President of SARB, Dr D. G. Franszen. In the final report submitted in December 1970 the commission proposed a variety of measures to control the spiralling credit extension in the market, as well as that foreign shareholding in South African banks and bank holding companies should be reduced. It was established that by June 1970 foreign controlled commercial banks in South Africa (i.e. commercial banks in which foreign shareholding exceeded fifty percent of ordinary shareholding directly or

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<sup>1</sup> Standard Bank was incorporated as a South African company in South Africa in April 1962 and majority shareholding only transferred to South African shareholders in 1985. Barclays bank DC&O only incorporated the South African operations in South Africa in 1971 and in 1985 majority shareholding came over to South Africans.

indirectly) held 73,2 percent of total commercial bank deposits.(RP87/1970:213,218) Foreign controlled banks held 10,5 percent of merchant bank deposits and 23,3 percent of deposits of all the remaining bank institutions. This meant that 55,8 percent of deposits of the entire banking sector had been held by banks owned by foreign shareholders. Of the twenty nine banks registered since 1953 nine were either directly or indirectly controlled by foreigners. These included all types of banking institutions – commercial, general, merchant and hire purchase banks. This dominance was perceived as an exceptionally high proportion of national banking under foreign control and not in conformity with the case in most western countries. (RP87/1970:185) Franszen thus proposed that foreign shareholding in South African banks in excess of fifty percent should be gradually reduced to less than fifty percent. (RP87/1970:215) The position of the Commission was that further participation by foreigners in existing or prospective new banking institutions, should only be permitted by the Registrar of Banks under exceptional circumstances. The Commission proposed a limit of ten percent to foreign shareholding in future South African banks if it could be justified in the public interest. Franszen reflected on the Australian example when he proposed that foreign banks operating offices in South Africa should not be allowed at all to take deposits from the public. (RP87/1970:187-188) Franszen, justified these proposals by arguing that these limits would inhibit the formation of banking conglomerates which would constitute an excessive concentration of financial power and thereby restrict competition for funds and encourage irresponsible lending to associates. In a public policy announcement by the Minister of Finance in May 1973 he demanded that foreign shareholding in South African banks be reduced to 10 percent of banks' issued share capital. Later in December 1973 the Minister announced that the ceiling of foreign shareholding was lifted to 50 percent. (Lambrechts,1975:64; Franszen, 1974:2-4) The banking fraternity welcomed the lifting of the ceiling, but in the media strong objections were raised especially in the Financial Mail,

describing such limitations as a threat that would inflict serious psychological damage to the international financial image of South Africa. (FM 40(8):97)

The strong public criticism against the extent of the limitations on foreign shareholding in South African banks, resulted in reduced, but nevertheless explicit ceilings on foreign shareholdings in the Financial Institutions Amendment Act, No 101 of 1976. All banks with capital and reserves amounting to R20 million or more, were required to reduce foreign shareholding to not more than 50 percent of total share capital issued – ‘ a reasonable period would be allowed to comply’ (SA Banker,1974(71):23; SA Banker,1977(74):12) In essence the act sought to ensure that ‘webs’ of financial control were not ‘quietly woven’ over the South African economy, “and in particular webs are not woven by foreigners.” (Nicholson,1976:149) Itzikowitz observed: “Since the Franszen Report monetary and fiscal policy in 1970 attempts have been made to control the size of single shareholding in banks. These have been motivated by economic xenophobia and its historical corollary – fear of concentration of power in a few large organisations.” (Itzikowitz,1992:181) This was not only a fear of concentration, but also a fear of foreign control of a strategic sector of the economy of a country in an international environment perceived to be hostile. Canals observed that since the late 1970s the international regulatory framework of banks started to change, first of all because of the liberalisation of capital movements (Canals.1997), but in South Africa the negative political developments led to contradicting messages in banking regulations. On the one hand monetary authorities moved away from direct control over the banking system by replacing direct control with indirect monetary control mechanisms. On the other hand increasingly mobile international capital flows were restricted from participating in the South African banking sector by the statutory limitations on foreign shareholding in South African banks. In this respect South African banking legislation was following the international trends in regulation, but was diverging from the international trend of growing internationalisation .

All the motives for changes in the regulatory framework of banking internationally had manifested in the South African banking environment:

- Liberalisation of international capital flows between countries, which increased competition for banks by international capital markets and thus acted as a limiting incentive to international investment in the financial sector;
- Increasing disintermediation in capital markets limiting financial intermediation by banks both in terms of access to capital (companies accessed capital directly in the capital markets) as well as funding of banks (depositors finding alternative better returns for deposits)
- Financial innovation in response to high inflation of the 1970s and central bank restrictions.
- Information technology developments, which challenged the boundaries of geography and time and thus also regulation.
- Unprecedented competition amongst banks caused by deregulation, liberalisation of capital flows, lifting of price controls, financial disintermediation and new competitors entering the markets. (Ferguson,2003:253; Trichet,2003:247-249; Slager,2006:21-23)

In compliance with international trends, legislation was passed in South Africa in 1985 to create a more competitive financial system responsive to market forces in response to the De Kock Commission Report. (The De Kock Commission was the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa; RP70/1984.) The De Kock Report heralded a fundamental change to banking in South Africa, since it sought to replace a direct regulatory framework with market determined monetary control mechanisms for all financial institutions, not only banks. The report sought to develop a financial system more responsive to the application of a market-

oriented monetary policy. Following new international thinking which rejected activity constraints on banks and other financial firms as being inefficient and heavy-handed (Dale and Wolfe,2003:581-582), the De Kock report displayed substantial resemblance to the report of the Australian Financial System Inquiry of 1979 (also referred to as the Campbell Inquiry), which observed that the system of regulation in Australia at that time had led to inefficiencies because financial markets had become segmented. The outcome was a drive towards increased competition amongst banks through the elimination of barriers between markets and the influx of foreign banks. (Merrett,2002:279 - 281)

The corollary to the Campbell Inquiry, the De Kock Report proposed new liquid asset requirement on banks' liabilities to the public, new cash reserve requirements to replace the liquid asset system of control of bank credit (eg. the use of open market transactions by the SARB, its discount policy and intervention in the spot and forward markets) and new capital requirements for banks based on the classification of risk of the exposure of their liabilities to the public as measures of credit control, rather than direct measures. These proposals were embodied in the Financial Institutions Amendment Act, no 106 of 1985. The act responded to the request by the Committee on Banking Regulations and Supervisory Practices to all bank supervisors to stress to their banks the importance of keeping careful watch on the development of off-balance sheet business and on the risks to which such activities expose them. (Jacobs, 1985:147) Apart from more stringent capital requirements, the act also removed the explicit divisions between different types of bank institutions introduced in the 1965 Banks Act, resulting in greater competition between all types of banking institutions in financial markets, with greater protection to depositors by means of the more comprehensive and stricter capital requirements applicable to all banking institutions. The absence of deposit insurance in South Africa was perceived to have been addressed by the new capital requirements of all banks.

The South African banking system was following international banking trends as well as the trend in Australia. (Merrett,2002:278) In compliance with international supervisory requirements, the 1985 act also addressed the question of supervisory responsibilities of the host and the parent authorities in respect of banks' foreign establishments. Although South Africa had not been a signatory to the "Concordat", South Africa endorsed the principles enunciated in them. These principles stated that no banking operations should fall outside supervision, therefore adequate supervision had to be provided in the host as well as the parent country. The Concordat principles entailed that the host country had to monitor the liquidity of the foreign establishments of banks operating in their country and the parent authorities should monitor the solvency of foreign establishments of their domestic banks. In the 1985 amendment act South African banks were required to obtain permission from the Registrar of Banks in South Africa to establish a subsidiary company or open a branch outside the Republic. Those foreign establishments of South African banks nevertheless had to comply with the capital requirements of the Act and the Minister had authority to impose liquid asset requirements on the liabilities of the foreign subsidiaries and branches of South African banks. The Minister could furthermore issue directive with regard to the maturities distribution of liabilities and assets of foreign establishments of South African banks. With respect to off-balance sheet business the Committee on Banking Regulation and Supervisory Practice urged bank supervisory authorities to monitor off-balance sheet activities in which international banks were increasingly engaging in, since those risks had to be reflected in the national system of capital adequacy. (Jacobs,1985:147)

These new market-oriented regulatory measures subjected South African banks to the international trends in banking supervision, a process manifesting in a similar way in other countries. South African banks were exposed to the international environment through their contingent liabilities, such as acceptances and promissory notes, bills and certain credit instruments they endorsed. The proportion of foreign business to local business was still

relatively small, but the other dimension of internationalisation, namely the participation of foreign banks in the domestic market, remained strictly forbidden. Only in 1990 was statutory approval given to foreign banks to conduct business in South Africa. This development was a direct consequence of the increased competition in the banking environment after the implementation of the recommendations of the De Kock Commission. The cost of banking declined significantly, but so did interest margins. Banks were forced to rely more on differentiated lending, new deposit products and exchange rate differentials. Partly due to fluctuating interest rates and high inflation in South Africa (around 15 percent), banks' assets rose sharply and they therefore struggled to comply with the new market related capital reserve requirements from current profits. The increased competition amongst banks stimulated computerisation, but that also demanded high capital outlay. The new highly competitive banking environment where building societies disappeared completely through mergers into the four large banking/insurance groups in South Africa, stimulated diversification of banking services as well as concentration in the banking industry. (SA Banker 87(1):16; Verhoef,1995)

The implementation of a more market-related monetary policy in South Africa was largely in tandem with the implementation of similar policies in New Zealand and Australia in the 1980s. (Singleton et al,2003: 86;Merrett,2002:280) In the Australian case the exact consequences as experienced in the South African banking sector, set in, namely increased competition amongst banks as a result of the breakdown of barriers between markets ( or between different financial institutions) and the influx of foreign banks. This competitive environment put pressure on interest margins and led to rapid product innovation. (Merrett,2002:280; SA Banker,87(1):16)

Two processes were unfolding simultaneously. On the one hand banking legislation was harmonised with international requirements of the Basle Committee on Bank Supervision. On the other hand domestic monetary regulators were permitting foreign interest to re-enter the banking market. The

Deposit Taking Institutions Act, No 94 of 1990 (later known as the Banks Act, No 94 of 1990) aimed at bringing South African banking legislation into line with accepted international standards in order to afford greater protection to depositors. The act also had the explicit aim of removing all remaining distinctions between banks, building societies and other deposit taking institutions. After six months of the implementation of the act, deposits of premiums paid to insurance, was also regarded as 'deposits' in terms of the definition of the deposit taking institutions act. (SA Banker,87(3):75) Risk configuration remained the basis for prudential capital requirements as laid down by the Bank of International Settlements. The Banks Act, No 94 of 1990 permitted an institution which had been established in a country other than the Republic, which lawfully conducted the business of a bank, to conduct the business of a bank by means of a branch in South African with prior authorisation of the Registrar of Banks.(Section 18(A) ) Whereas the 1985 legislation commenced the process of elimination of the distinctions between banking institutions as well as building societies due to the increasing congruence in activities, the 1990 legislation no longer made any distinction between the domicile of shareholders. The act only prohibited the registration of shares in the name of any single shareholder, in excess of 10 percent, beyond which permission had to be obtained from the Minister of Finance.(Itzikowitz,1992:182)<sup>2</sup> While the regulatory environment was aligning with the international trends, the monetary authority allowed foreign banks to enter the South African banking arena and foreign shareholders to re-enter the market for shareholding in South African banks. Foreign banks were allowed to open representative offices (Sec 34(1) and (2).) of the parent institution abroad in South Africa, subject to written explanation of the nature and extent of supervision exercised by the responsible supervisory authority in the land of domicile. The foreign banks were required to submit similar returns than the South African incorporated banks on a regular basis to the Registrar of Banks. (Sec 18A(3) and (5). Foreign institutions were required to submit written

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<sup>2</sup> This limit was later increased to 49 percent, which then required Ministerial approval.

confirmation that the competent authority in the country of origin had authorised the establishment of such a representative office in South Africa and that the authority in question accepted, was committed to and complied with the proposals, guidelines and [pronouncements of the Basle Committee on Banking Supervision. (Sec 34(2B) (a).) A representative office of a foreign bank was not allowed to conduct the business of a bank in South Africa (Sec 34(2C) (4).)

After the political changes in South Africa of the early 1990s, the Banks Act No 94 of 1990 was amended by the Banks Amendment Act No 26 of 1994 to the following effect: the SARB argued that in view of the opening up of international trade with South Africa during the early 1990s and modern banking trends, such as the establishment of cross-border interests by banks and the need for reciprocal treatment by foreign and domestic supervisory authorities, that it was appropriate for the SARB to allow foreign banks to conduct the business of a bank in South Africa through branches. The banks act effectively prevented the establishment of branches by foreign banks.(SARB,1994:63-64) Since the promulgation of the Banks Act of 1990 31 foreign banks opened approved local representative offices in South Africa. (SARB,1992:29) and this number increased to 33 in 1993 (SARB,1993:50)

Section 34 of the Banks Act provided for the establishment, by a foreign bank, of a representative office or branches of foreign banks in South Africa. Prior to November 1996 section 34 did not provide for the Registrar of Banks to obtain sufficient information from such representative office to enable him to discharge of his duties in terms of the minimum supervisory standards set by the Basle Committee on Bank Supervision. Stringent conditions to conduct the business of a bank by a foreign institution by means of branches were subsequently set out in the Government Gazette, first in 1996 and again in 2000(Government Gazette, No 17115 of 1996 and No 21936 of 28 December 2000.) The prudential requirements included that a foreign institution had to maintain a minimum net assets of US\$1 billion, or net assets of its own of

US\$400 million if the foreign institution would rely on the net assets of a banking group to comply with the requirements. (Schedule 3(a)(i) and (ii). The foreign branch was required to manage its affairs in such a way that its endowment capital would at no time fall below R250 million or a minimum of 8 percent of assets or other risk exposures of the branch. (Schedule 3(c)(i).) The obligations with respect to supervision were similar to the supervision requirements of banks in South Africa tailored along the principles of the Basle Committee on Banking Supervision requirements.

The South African Department of Bank Supervision has actively contributed towards the activities of the Basle Committee on Bank Supervision and subsequently also became a signatory to the Core Principles for Effective Banking Supervision of September 1997. (SARB,1997:4) This was imperative given the proliferation of financial activities across and into the South African border, either by South African banks in other parts of the world, or by foreign banks entering the South African market. The Core Principles were endorsed by the IMF and World Bank in 1997 and by the International Conference on Banking Supervision in October 1998. The Core Principles determined that banking supervisors had to have the authority to address compliance with banking legislation by institutions under their jurisdiction.(SARB,2005:35) New regulations were therefore passed in South Africa to compel representative offices of foreign banks to subject themselves to on and off site inspection to establish adherence to relevant legislation. (Government Gazette, No 22939,13 December 2001)

In a relatively short period between 1990 and 2000 South African bank legislation adapted to the opening of the South African economy to international trade and other exchanges. This period was also the crucial time when the Basle Committee on Bank Supervision responded extensively to bank failures and bank crises, leading to the formulation of principles for bank supervision aimed at stabilising international financial markets. South African monetary and central bank authorities followed those initiatives closely and

implemented measures towards prudent banking regulation in close adherence to international practice throughout this period. The strong compliance with international standards of bank supervision and regulation in South Africa contributed to the interest by foreign banks to enter the South African market as soon as statutory conditions permitted. In a similar vein South African banks had been regulated in South Africa in close adherence to international practice and therefore those institutions were excellently equipped to engage in international operations as soon as conditions permitted.

## 2. Incentives for internationalisation of banking operations.

What are the reasons for the internationalisation of bank activities? On condition that three level competitive advantages to multinational enterprises are present, (organisation, location and internationalisation advantages) Dunning argued that banks' international operations could be explained using the multinational enterprise framework. (Dunning,1992) Slager considers the following possible incentives to banks to engage in international banking activities.

- Banks would follow clients abroad , this is a *pull-effect*, which could also be complemented by a *push-effect*, when the bank encourage its clients to engage in international operations and then establish itself abroad to serve the needs of the client.
- Perceptions of a restricted market could encourage banks to seek opportunities in more open markets. Economic and political integration after the 1950s promoted this perception.
- A potentially higher spread (interest income earned from loans) incentivise banks in countries with a low spread (which suggests efficient financial intermediation) to expand business in markets with less efficient financial intermediation.

- Differences in economic growth and GDP per capita is positive for bank profitability and could encourage banks to expand operations into such better performing markets.
- Deregulation of banking activities, either incentivising domestic banks to exit to more deregulated markets, or opening up mobility as a result of regulatory harmonisation.
- Historical and cultural determinants, i.e. colonial heritage reflected in a shared cultural, administrative or language heritage. (Merrett, 2002)
- Herding, as the conduct by banks to follow the example of other banks to enter or not to enter new markets.
- Market power and concentration, which reflects efficiency, in domestic markets can incentivise banks into foreign operations to improve earnings growth in order to exploit such efficiencies in other markets. These efficiencies can also be exploited through mergers and acquisitions in other markets.
- Economies of scale and economies of scope.
- Differentials in the cost of capital in domestic and foreign markets : less expensive cost of funding can improve returns and encourage banks to expand into markets with lower costs of capital.
- Risk-return trade-offs could be improved by geographical diversification of organisations. Internationalisation of banking activities can be risk reducing.
- Internationalisation could be driven by shareholders' perception of improved capital and reserve positions or cash flows of banks and thus shareholder returns through internationalisation.

- Differences between financial systems, i.e. bank oriented, government oriented and market oriented financial systems, may serve as incentive to banks to internationalise to exploit the advantages of a different system. (Slager,2006:43-61)

### 3. The operations of South African incorporated banks before the early 1990s

The operations of South African banks during the latter half of the 1980s were representative of institutions operating in relative isolation.

**Table 1 : Commercial\* Banks' Liabilities to the Public, 1985 -1990.(Rm)**

	Total liabilities to the foreign sector**	Total liabilities to the public	Foreign liabilities as percentage of total liabilities.
1985	4 419	41 385	10,67
1986	4 453	44 657	9,97
1987	4 061	51 212	7,9
1988	4 525	70 000	6,46
1989	5 441	96 921	5,61
1990	5 790	121 431	4,76

Source: South African Reserve Bank Quarterly Statistical Bulletin, Third Quarter 1992, S-8 – S-9.\*Commercial Banks comprised in excess of 80 percent of the banking sector.\*\* Total liabilities to the foreign sector comprises of total foreign deposits plus total other liabilities to the foreign sector.

**Table 2: Commercial Banks Total Assets, 1985 -1990 (Rm)**

	Total Foreign Assets	Total Assets	Foreign assets as percentage of total assets
1985	1 040	47 927	2,17
1986	774	50 584	1,53
1987	1 256	61 831	2,03
1988	1362	81 359	1,67
1989	1260	109 254	1,15
1990	615		

Source: South African Reserve Bank Quarterly Statistical Bulletin, 1992,S-10-S-11.

The international operations of the commercial banks, representing the dominant group in South African banking, were limited during the latter half of the 1980s. With foreign liabilities declining from 10,67 percent of total liabilities in 1985 to 4,76 percent in 1990, the contribution of foreign funding to total funding was negligible. (See table 1 above) A similar declining trend could be observed in the assets of commercial banks (Table 2) – foreign assets declined from 2,17 percent of total assets to 1,15 percent, which means that South African banks were not significantly engaged international business before the 1990s. When a similar calculation is made of the foreign assets of the total banking sector between 1985 and 1990 (thus including the gold and foreign exchange reserves of SARB, all investment banks, mutual banks, general banks and building societies – the total monetary sector) foreign assets as a percentage of total assets declined from 8,36 percent in 1985 to 3,63 percent in 1990.(SARB,1992:S-24)

The explanation for this lack of exposure to the foreign sector can be found in the high inflation rate and slow underperforming South African economy. In Table 3 below the high CPI or inflation rate in South Africa during the latter half of the 1980s compared to key trading partner countries to South Africa, is illustrated. Inflation remained in double digit figures until the early 1990s, when it started to decline steadily. It was only during the last two years (2004 and 2005) that inflation in South Africa compared favourably to that of her main trading partners.

Table 3 : CPI 1985 – 2005 :Comparison of South Africa with countries of origin of main foreign banks in South Africa.

CPI	RSA	USA	OECD/Europe	UK	Germany
1985	16,2	3,6	6,9	6,10	2,08
1986	18,65	1,92	6,27	3,14	-0,13
1987	16,16	3,6	8,01	4	0,27
1988	12,77	4,09	8,98	5,01	1,22
1989	14,73	4,8	6,72	7,8	2,8
1990	14,32	5,41	6,9	9,45	3,13
1991	15,33	4,2	6,15	5,8	4,06
1992	13,87	3,03	5,05	3,69	5,12
1993	9,17	2,9	4,2	1,59	4,41
1994	8,93	2,6	4,47	2,5	2,6
1995	8,6	2,8	5,7	3,4	1,7
1996	7,35	2,9	5,2	2,4	1,5
1997	8,5	2,3	4,55	3,1	1,8
1998	6,8	1,6	3,9	3,4	0,9
1999	5,18	2,11	3,3	1,6	0,6
2000	5,3	3,4	3,9	2,9	1,5
2001	5,7	3,5	2,6	1,8	2,0
2002	9,16	1,6	2,5	1,6	1,4
2003	5,85	2,3	2,45	2,9	1,0
2004	1,4	2,7	2,3	3,0	1,7
2005	3,4	3,4	2,6	2,8	2,0

Source: Bureau for Economic Research, University of Stellenbosch, Quarterly Reports, 1985 – 2006.

In Table 4 below the contraction of the South African economy is illustrated by the slow and negative growth in the economy during the latter half of the 1980s and the early 1990s. The South African economy offered limited attraction to foreign business and domestic financial institutions as margins were under pressure. In terms of incentives towards international banking, the slow to negative growth in the South African economy actively discouraged foreign interest.

Table 4: South Africa Gross Domestic Product: Annual growth, 1985 – 2005.

(%)

Year	Annual growth (%)
1985	-1,2
1986	0,01
1987	2,10
1988	4,2
1989	2,39
1990	-0,31
1991	-1,01
1992	-2,13
1993	1,2
1994	3,23
1995	3,11
1996	4,3
1997	2,64
1998	0,51
1999	2,35
2000	4,15
2001	2,73
2002	3,66
2003	3,11
2004	4,83
2005	5,09

Source: Bureau for economic research, University of Stellenbosch, Quarterly Reports, 1985 - 2006

Furthermore political turmoil gave rise to the debt standstill agreement into which South Africa had entered in the course of 1985. As to other third world countries, loan capital was readily available during the 1970s and South Africa borrowed heavily. In the 1980s foreign investments declined relative to the value of foreign loans needed for economic growth. As a result equity capital dropped as a percentage of foreign debt from 60 percent in 1970 to 30 percent in 1984. At the same time foreign loans rose from 40 to 70 percent of foreign debt by the mid-1980s. The South African government intervened extensively to ensure that foreign bankers provide loans when required by offering gold swaps or by borrowing from the IMF. The outcome of these policies was that South Africa's

net indebtedness to international banks rose steeply. By 1984 about two-thirds of South Africa's outstanding loans had a maturity of one year or less. The banking sector was responsible for 44 percent of the country's foreign liabilities. The public sector had incurred another 16 percent foreign debt. This indebtedness caused a serious problem to South Africa in 1985 when a group of foreign banks led by Chase Manhattan Bank withdrew substantial credit lines by refusing to roll over existing loans. Many short term loans were called in immediately. The banks were unable to meet the debt obligations and the government declared a debt standstill of US\$14 billion of the US\$24 billion total external debt. Negotiations between government officials and creditor banks resulted in a repayment agreement, which finally resulted in gradual repayment up to 1994, when South Africa had become a net exporter of capital to an amount of more than R8 billion. Only by the mid-1990s was South Africa again considered as under-borrowed and did foreign borrowing start again.

The reversal of this isolation commenced in the last decade of the twentieth century, when the political dispensation started changing and South Africa gradually re-entered the international economy. The banking sector was exceptionally well positioned to respond to these developments. South African banks operated within the internationally aligned regulatory framework and advanced operational banking environment, which enabled the banks to respond to the pull and push factors of clients' globalising business, the opportunities of different market structures as well as the opportunities offered by more extensive market spread of assets. The pressure on margins as a result of the high degree of efficiency in the South African banking sector, competition and concentration in the domestic market, served as strong incentives towards internationalisation of banking operations. To foreign banks interested in investing in the newly opened South African market, the opportunities of the differences in economic structure, the historical and cultural determinants of earlier colonial presence and herding were strong incentives to enter the South African market. The potential advantage of economies of scale and economies of scope were also a key incentive for the internationalisation of South African banks. To both parties –

domestic banks and foreign banks – “internationalisation was seen as risk reducing.” Slager,2006:57).

The changes in the Banks Act, No. 94 of 1990 paved the way for the internationalisation of South African banks. In the period 1992 – 2005 the number of foreign banks authorised to establish representative offices in South Africa rose from 31 to 61 ( in 2000), but then dropped to 46 in 2005. These representative offices did not engage in bank operations, but provided a presence for foreign banks interested in entering the market or supplying vital economic and trade information to clients. The majority of the foreign offices in 1992 were representative of European banks: seven from the Spanish speaking countries, seven from France, eight from Germany, and two each from Britain and African countries, three from Switzerland and one from Israel.

(SARB,1992:29) By 2000 banks from the USA, China, Japan, Taiwan, India Canada and Norway had joined the ranks of foreign representative offices in South Africa. (SARB,2000:88-89)The actual involvement in banking activities commenced with the permission to foreign banks to open branches in South African and conduct bank business in 1993. The number of branches of foreign banks rose from 4 in 1995 to 15 in 2005. The first banks to open branches were, ABN Amro Bank N.V. , Bank of Baroda, Citi Bank, Commerzbank Aktiengesellschaft, Credit Agricole Indosuez, ING Bank N.V. Morgan Guaranty Trust Company and Société Générale. (SARB,1997:66)

**Table 5: Banks Total Loans and Advances, 1993 – 2005. (Rm)**

	Banks Total loans and advances	Foreign banks loans and advances	Foreign as percentage of total
1993	241,386	4,255	1.8
1994	284,044	4,809	1.7
1995	329,244	5,327	1.6
1996	392,877	16,406	4.2
1997	464,441	23,201	5.0
1998	538,907	30,104	5.6
1999	597,962	32,114	5.4
2000	655,990	38,797	5.9
2001	790,187	66,570	8.4
2002	883,011	76,322	8.6
2003	957,832	79,063	8.3
2004	1,104,196	96,500	8.7
2005	1,327,498	113,969	8.6
Annual compound growth	15,2	31,5	

Source: DI900 Banks' returns to SARB, 1993 – 2005.

The question now is: what was the impact of the establishment of foreign banks' branches in South Africa? Did they crowd out domestic banks? What proportion of the market did they capture?

Table 5 above reflects the successful penetration of foreign banks into the South African market. Between 1993, when foreign banks' branches were permitted to conduct banking business in South Africa, and by 2005 the total assets of foreign banks' branches as a proportion of total assets of all banks operating in South Africa, increased by 31,5 percent per annum. This asset growth came off a low base, but nevertheless represented growth at a rate more than double the annual increase of the assets of all the banks, namely 15,2 percent. This impressive performance could be explained by the nature of the business of the foreign branches. These foreign banks' branches were primarily engaged in investment business to the corporate sector, which is the higher yielding business in the market. The major interest rate differentials between South African short term as well as long term interest rates and the interest rates of her major trading partners (See Tables 6 and 7 below), explain the strong incentive for foreign banking institutions to enter the lucrative market for corporate finance.

Table 6 : Short Term Interest Rates: South Africa and countries of origin of foreign banks in South Africa, 1985 – 2005

	USA	UK	Germany / Euro Zone	RSA 3 months BA
1985	8,05	12,24	5,45	18,32
1986	6,52	10,94	4,64	10,98
1987	6,86	9,7	4,03	9,09
1988	7,73	10,33	4,33	13,00
1989	9,09	13,88	7,12	17,58
1990	8,15	14,77	8,49	18,59
1991	5,84	11,52	9,25	17,04
1992	3,68	9,62	9,52	14,4
1993	3,17	5,94	7,3	11,64
1994	4,63	5,50	5,36	10,96
1995	5,99	6,68	4,53	13,73
1996	5,39	6,02	3,31	15,35
1997	5,62	6,83	3,33	15,49
1998	5,50	7,34	3,83	16,72
1999	5,36	5,45	2,97	13,01
2000	6,45	6,11	4,39	10,11
2001	3,73	4,97	4,26	9,73
2002	1,70	3,99	3,32	11,59
2003	1,17	3,67	2,34	10,94
2004	1,57	4,57	2,11	7,6
2005	3,5	4,67	2,20	7,02

Source: Bureau for economic research, University of Stellenbosch, Quarterly Reports, 1985 - 2006

Table 7: Long Term Interest Rates: South Africa and countries of origin of foreign banks in South Africa, 1994 – 2005.

	USA	UK	Germany / Euro Zone	RSA
1985	10,62	10,97	7,04	17,24
1986	7,68	10,14	6,16	17,01
1987	8,38	9,57	6,25	15,49
1988	8,85	9,68	6,49	16,45
1989	8,5	10,19	7,03	16,88
1990	8,55	11,8	8,71	16,23
1991	7,86	10,11	8,46	16,39
1992	7,01	9,06	7,85	15,51
1993	5,87	7,47	6,52	14,14
1994	7,08	8,17	6,88	15,1
1995	6,58	8,24	6,86	16,08
1996	6,44	7,82	6,23	15,7
1997	6,35	7,05	5,66	14,65
1998	5,69	5,52	4,58	15,21
1999	5,64	5,08	4,50	14,82
2000	6,03	5,31	5,27	13,71
2001	5,02	4,94	4,80	11,30
2002	4,61	4,91	4,78	11,54
2003	4,02	4,52	4,08	9,53
2004	4,27	4,87	4,04	9,5
2005	4,29	4,4	3,40	8,04

Source: Bureau for Economic Research, University of Stellenbosch, Quarterly Reports, 1985 – 2006.

The least cost effective banking services to the retail sector, with high administrative costs on limited balance small savings accounts were not targeted by the foreign banks. The foreign banks have not succeeded in growing their market share beyond 8,7 percent of the total assets of the banks since 2001. The big four banks in South Africa maintained their domination of the market with a market share of more than 77 percent since the early 1990s. (SARB,1995:30)

The globalisation of South African banking came via the route of South African banks extending their operations abroad, rather than a massive influx of foreign institutions. An analysis of South African banking operations, showed that the foreign currency loans and advances of South African banks increased steadily since 1990.

Table 8: Foreign Currency Loans and Advances of South African Banks ,1991 – 2005. (Rm)

	Foreign Currency Loans and Advances	Total Loans and Advances	Foreign as percentage of total
1991	9 066	214 743	4,22
1992	9 877	223 745	4,41
1993	10 865	245 734	4,42
1994	18 058	289 056	6,24
1995	11 977	333 308	3,59
1996	16 272	398 908	4,07
1997	17 722	470 833	3,76
1998	22 434	545 310	4,11
1999	35 412	597 106	5,93
2000	55 991	662 860	8,44
2001	110 249	809 104	13,6
2002	117 932	890 210	13,2
2003	115 091	990 241	11,62
2004	116 959	1 109 496	10,5
2005	145 848	1 342 781	10,9
Annual compound growth %	21,93	13,98	

Source: SARB, Quarterly Statistical Bulletin, 1991 – 2006, S-8 – S-9.

Although loans and advances by banks in foreign currency represented only a portion of banks' foreign business, the trend is clear: South African banks were steadily extending their exposure to the foreign business market, either for domestic clients operating in foreign markets, or for foreign business interests

entering the South African market. As indicated in Table 8 above, the foreign assets rose by an annual compound growth rate of 21,93 percent compared to a rise of 13,98 percent in total loans and advances. This trend was corroborated by the simultaneous rising proportion of the foreign loans and advances as a percentage of total loans and advances: this proportion rose from 4,22 percent in 1991 to 13,6 percent in 2001, but then dropped to 10,9 percent in 2005, which was still more than double the proportion of foreign loans and advances to total loans and advances in 1991. On the funding side of the banks business, the proportion of foreign funding to total capital and liabilities between 1997 and 2005, declined from 4,85 percent to 1,47 percent in 2005.

(<http://www.bankinggenesis.co.za/tables>) This decline is a function of the growing globalisation of South African banking business: South African banks have been active in establishing overseas offices and taking shares in foreign banking and other financial enterprises, by means whereof they obtained access to foreign funding. This development followed permission granted by the SARB in terms of section 52 of the Banks Act, no 94 of 1990, to banks to establish off-shore interests. Permission was granted since 1997.

The first banks to take advantage of this development, were ABSA, Investec Bank, First National Bank, Nedbank, Standard Bank and Rand Merchant Bank. (SARB, 1997:90 – 91) In 1997 the SARB granted permission to the abovementioned institutions to take up shares in or obtain foreign banking interests. ABSA established new subsidiaries or bought financial services companies in Jersey and the British Virgin Islands. First National Bank established offices overseas and obtained trade and financial services subsidiaries in the British Virgin Islands, in Guernsey of Ireland and Hong Kong. Investec Bank obtained foreign interests in financial services companies in the British Virgin Islands, Kenya, Zimbabwe, Botswana, Hong Kong, Australia, the Jersey Islands and other parts of the UK, the Netherlands, the USA and Mauritius. Nedbank extended interests beyond its long standing London office to Hong Kong, Malta and Mauritius. Standard Bank spread its interests to the UK, Hong Kong, Liberia, the United Arab Emirates and Russia. Rand Merchant Bank

invested in Plessey Australia Pacific. These new ventures represented a wide variety of financial services companies, investments subsidiaries and some other related concerns such as health care companies. By the end of 1999 South African banks had established further interests in Latin America ( Standard Bank established offices in Argentina. Brazil, Peru. Colombia), The People's Republic of China, Singapore, Germany, Switzerland Italy and Iran. (SARB,1999:116 -117) The foreign expansion in 2000 included establishment of interests by Nedbank in India and by Standard Bank in seven African countries, Turkey and Australia. Nedbank . First Rand Bank and PSG Investment Holdings established subsidiaries or representative offices in Australia. (SARB,2000: 120 – 121) The most notable trend in foreign expansion of South African banks between 2000 and 2005 has been the expansion into Africa (Botswana, Uganda, Nigeria, the DRC and Angola), the Cayman Islands, Canada and Australia and more extensively into Guernsey of Ireland. In Ireland the proliferation of South African banks led to the signing of a Memorandum of Understanding between the Department of Bank Supervision of SARB and the banking regulatory authority of Ireland in 2000 on regulation of such banking operations in terms of the Core Principles for Effective Banking Supervision. (SARB,2000:26) The number of approvals by the SARB for the acquisition of foreign banking interests by South African banks rose from 40 in 1997 to 68 in 1999, then dropped to 43 in 2000, 34 in 2003 and 19 in 2005.The SARB subsequently commenced with on-site supervision at South African banks' offices abroad since 1999 in compliance with the Basle Committee's regulatory requirements.

Despite the development of extensive foreign exposure, South African banks' primary source of revenue remained their South African business. Financial reporting to the SARB requires disclose of the distribution of revenue, but that information is not in the public domain. In the DI900 returns to the SARB ( as reflected in Table 5 above) banks disclose total revenue, but do not distinguish between domestic and foreign operations' revenue. The foreign currency assets (loans and advances) of banks in Table 8 do not fully disclose the contribution to banks' revenue of foreign business, since revenue was also generated in foreign

markets by foreign subsidiaries. Some of the large banks in South Africa, eg. Nedbank, only reported explicitly in official annual reports on the geographical breakdown of its shareholding since 2001, despite the fact that extensive reporting had occurred on the group's representation through its foreign offices since the early days. Only since 2001 was explained that shareholding was distributed between domestic shareholders (90,94 percent) and shareholders outside South Africa (9,06 percent) (Nedcor Annual Report, 2001:143) This distribution changed to 85,3 and 14,7 percent respectively in 2002. By 2005 Nedcor (the Nedbank Group of companies) geographical distribution of shareholding was 85,16 percent in South Africa, 10,3 percent in the USA, 1,44 in the UK, 0,4 percent in the Netherlands and 2,55 percent in other parts of the world. (Nedcor Annual Report, 2005: 247) The geographical distribution of Nedcor's balance sheet in 2005 displayed the following: 94,85 percent was denominated in South African currency, 4,49 percent in USA dollar, 0,17 percent in sterling and 0,47 in other currencies. (Nedcor Annual Report, 2005:120 – 121) This breakdown of the origin of the group's balance sheet was only disclosed in the annual report in 2005, with comparative figures for 2004. On request the Standard Bank provided a breakdown of its foreign assets as a proportion of total assets since 1992 : assets from outside South Africa ( Africa as well as international assets outside Africa) rose from 7,82 percent of total assets in 1992 to 10,05 percent in 1993, and 30,22 percent in 2001, after which it declined to 20,21 percent in 2005. (Standard Bank Communication, 22/01/07) The Firstrand Group did not provide a breakdown of foreign assets to assets in South Africa in its published annual reports income statements. In 1996, prior to the expansion into foreign markets, South African operations contributed 77,6 percent of net income of the Firstrand Group. ( FNB Annual Report, 1996:13) It is therefore not possible to come to a comprehensive understanding of the contribution of foreign business to South African banks' balance sheet yet. The collective statistics published by the SARB as reflected in Table 8, indicate the continued domestic focus of South African banks' operations.

## Conclusion.

Banking in South Africa developed as an extension of the British banking system, except for the continental influence brought by the Netherlands Bank towards the end of the nineteenth century. The banking system developed from foreign control to full domestic ownership in the 1980s to the twentieth century. This development was accompanied by international isolation as a result of the domestic political policies of the National Party government and that caused delayed participation by banks in the globalising banking environment of the 1980s. It was only after 1993 when foreign banks were allowed to open representative offices in South Africa and then 1994 when foreign branches were permitted, that the South African banking system actually joined the internationalisation of banking. The South African central bank followed the developments in international bank regulation closely and formulate statutory regulation of banking operations in South Africa according to international principles. The changes in banking legislation since the mid-1980s were indicative of the alignment of South African legislation with the international trend of deregulation of banking operations. In terms of the regulatory environment South African banking was in line with international developments. An important consequence of this alignment with the international regulatory environment was that banks in South Africa were increasingly positioning themselves to take advantage of the return of South Africa into the international community. The strong British and continental heritage of the banking system was responsible for the development of a highly sophisticated banking sector well positioned for international operations. The political changes were therefore accompanied by international regulatory facilitation of the banking sector. The South African banks were gradually deregulated in the 1980s and entered the international banking arena when permission was granted for such expansion in line with international regulatory requirements. These requirements were instrumental in the success of South African banks in the international environment. The trend displayed in South African banking since the mid-1980s was stronger growth of South African banking expansion into the

international arena that international banking penetration into the South African market. Foreign banks succeeded in growing their business in South Africa faster than the growth of South African banking operations, but the explanation lay in the nature of their business and growth from a non-existent low base. South African banks were more successful in internationalising their operations and servicing the international needs of their clients than foreign institutions, since the big four banks increased their market share from 83,4 percent in 2004 to 83,6 percent in 2005. (SARB,2005:5 – 6) The higher degree of concentration in the banking sector indicates the stronger performance of the domestic banks in the globalisation of economic and banking activities. Although banking legislation delayed foreign shareholding in South African banks, banking operations were did not stagnate or remain isolated. As soon as political circumstance permitted, South African banks could respond to the challenges of globalisation. Foreign banking operations in South Africa remained below 9 percent of total banking assets up to 2005 and can therefore not be regarded as significant. Internationalisation of banking in South Africa developed in the opposite direction – outward from South Africa and less inward from the international banking environment. In this inward movement foreign banking was dominated by European , United Kingdom, United States of American and singular representation from India, Japan, China and the Middle East. Absent from the international banks are banks from other commonwealth countries, such as New Zealand, Australia and Canada. In contrast to this South African banks have penetrated relatively extensively into the Australian market. This trend serves to underline the more extensive internationalization of South African banking operations than the corresponding trend from other commonwealth countries.

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