# From Building Society to Bank: The Allied of South Africa, 1970-1988

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The Allied Building Society was formed in 1955 by the merger of two societies founded in the early days of gold mining in South Africa, the Rand Provident Building Society and the Alliance Building Society. Fifteen years later the Allied absorbed the Johannesburg Building Society and overnight became the third largest savings institution in South Africa. At this point there was little sign of the dynamism that was to be shown in the later 1980s and the Allied was a typical English-type building society, not very audacious in its pursuit of depositors and somewhat reserved in its approach to lending, with prospective home owners being required to put down deposits of 25% of the purchase price. Funds were drawn by means of a chain of branches and agencies, with interest rates fixed by the building society cartel, while lending was centralised at the Johannesburg Head Office. By 1970 the pressures for change were only just beginning to make themselves felt. For example, in 1966 the Allied had embarked upon its first moves into computerization and during the stock exhange boom of 1969 the supply of new funds into the building societies had almost dried up. Both these developments were later cited as the main reasons for the change into an equity based general financial institution.

## The Background

Before the Second World War the building societies had been increasing their assets at a faster rate than had the commercial banks. In the years of post-war growth this changed and, in the period 1961-1970, building societies' assets increased at a rate of 9.7% annually in constant prices compared with the growth of the commercial banks' assets by 14.6% per annum [8]. The impact of technology had not yet seriously affected procedures, despite the purchase of a small computer in 1966, and the main post-war innovation remained the replacement of men by women behind the counters.

Nevertheless the failure of the building societies' assets to grow as fast as those of other financial institutions reflected the failure of the building societies to draw in adequate funds during economic booms and their resort to restricting the number of new mortgages they granted. In the past this might not have mattered, but by 1970 two decades or more of rapid economic

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growth had created the conditions in which the demands of prospective home owners able to finance bonds was larger than the volume of prospective bonds in the hands of the the building societies. The societies had been able to cope with economic growth with stable prices; they could not cope with sustained inflation. In 1970 this was only just beginning to become a serious problem; yet it is likely to have been the main consideration between the merger of the Allied and the Johannesburg societies in 1970, as they sought to cut costs by reducing competition. If that was the purpose of the merger, it failed, for the new combined society, that had doubled its share of total building society deposits from 10.4% to 20%, could not hold on to them and it was not until 1988 that the Allied regained its relative position of 1970. The South African background to the dramatic changes of the late 1980s, therefore, was the long-term decline of the society and its increasing inability to compete with other building societies, let alone with the banks and insurance companies.

The world-wide background was the movement towards deregulation and the blurring of the old English distinctions between commercial banking, merchant banking, hire purchase banking, and mortgage lending that took place in the 1970s and reached their climax in the late 1980s with the London "big bang". In Britain, for example, the banks moved in upon the building societies in the early 1980s. In South Africa, Barclays also led the way. In 1980 the British clearing banks' share of new mortgage loans was next to nothing, in 1981, 22%, and in 1982, 40% (*The Economist*, 22 May 1982). Already by then the Institute of Economic Affairs had published a book attacking the building societies' price cartel [4] and David Llewellyn of Loughborough University was accurately forecasting that competitive pressure from outside their ranks would force them to be more competitive with one another (*The Economist*, 1 March 1982).

In South Africa, government thinking responded early to changes taking place abroad and preceded the first reponse of the building societies, which was to merge and reduce competition. The first major indication of this was the appointment in 1977 of the De Kock Commission to enquire into the country's monetary system. The interim report of 1982 recommended that greater freedom should be allowed to all the financial institutions and in 1985, at the time of the final report of the Commission, Parliament passed the Financial Institutions Amendment Act that permitted building societies to compete on equal terms with the banks and to convert themselves into equity-based joint stock institutions.

In the 1980s, therefore, government policy was almost the reverse of that in the 1970s, when the Vorster Government had attempted to solve the problem of building societies' lack of competitiveness by placing restrictions on interest rates, credit ceilings on lendings, and by increasing the tax free benefits of placing money with building societies [7, 9]. In the 1980s the market was to take over this function.

The economic background to these changes in South Africa was sustained economic growth accompanied by a serious decline in personal savings, both as a proportion of gross domestic savings and as a proportion of personal disposable incomes. For example, between 1970 and 1988, the Gross Domestic Product rose from R12,518 million to R206,804 million, a sixteen

and a half-fold increase in eighteen years, compared with a less than twelve-fold increase in the assets of the permanent building societies, from R3,072 million to R35,967. The deposits of the building societies, including what they euphemistically called "shares", increased at about the same rate as their assets, which of course is what one would expect, as the growth in home loans was dependent upon their ability to draw in deposits. Sustained economic growth had created a climate of opinion favorable to deregulation and increased competition among financial institutions, while at the same time inflation was impairing the ability of the man-in-the-street to save and favoring equity-based saving schemes that were being aggressively marketed by the life insurance companies. Personal savings as a proportion of gross domestic savings fell rapidly from 36% in 1971 to 3.8% in 1982, before recovering a little to 7.4% in 1988 (Table 1). Though this collapse in personal savings was to an extent counterbalanced by an increase in corporate savings, this did not help the building societies.

Table 1. Personal Savings in Current and Constant Prices and as a Percentage of Gross Domestic Savings and of Personal Disposable Incomes, 1970- 1988

| Year | Personal Savings Current Prices | Personal Savings Constant Prices | As Percentage of Gross Domestic Savings | As Percentage of Personal Disposable Incomes |
|---|---|---|---|---|
| | Rand million | Rand million | % | % |
| 1970 | 879 | 879 | 30.9 | 10.2 |
| 1971 | 1,153 | 1,102 | 36.3 | 11.7 |
| 1972 | 1,479 | 1,322 | 37.5 | 13.4 |
| 1973 | 1,270 | 999 | 25.4 | 10.2 |
| 1974 | 1,153 | 778 | 18.3 | 7.9 |
| 1975 | 1,908 | 1,114 | 26.9 | 10.9 |
| 1976 | 1,241 | 629 | 16.9 | 6.6 |
| 1977 | 2,287 | 1,016 | 24.0 | 10.5 |
| 1978 | 1,866 | 754 | 16.8 | 7.9 |
| 1979 | 3,641 | 1,292 | 23.6 | 12.7 |
| 1980 | 4,306 | 1,328 | 19.9 | 12.2 |
| 1981 | 2,383 | 642 | 11.9 | 5.9 |
| 1982 | 635 | 151 | 3.8 | 1.4 |
| 1983 | 893 | 191 | 3.9 | 1.7 |
| 1984 | 2,622 | 518 | 19.9 | 4.2 |
| 1985 | 4,327 | 744 | 14.4 | 6.1 |
| 1986 | 1,844 | 267 | 5.6 | 2.3 |
| 1987 | 4,423 | 556 | 11.7 | 4.5 |
| 1988 | 3,361 | 319 | 7.4 | 2.9 |

**Source**: South African Reserve Bank, *Quarterly Bulletins*

Indeed, the collapse of personal savings in the early 1980s was probably the single most important factor pushing the Allied Building Society into abandoning its traditional role and into moving into commercial banking. In 1982, three years before the collapse of the rand, personal savings fell to 3.8% of Gross Domestic Savings and to 1.4% of Personal Disposable Income. This collapse in savings continued into 1983.

In real terms the situation of the building societies was critical. In constant prices personal savings had held up in the 1970s. It was in the 1980s that havoc was wrought upon South Africa's ability to finance its own development. In 1981 personal savings fell to half their 1980 level and in 1982 they fell to a quarter of their 1981 level. Nor was the recovery of 1984 and 1985 strong enough to pull them back to their level of 1980. When the growth of both population and the economy is taken into account, the failure of personal savings to keep pace is even more pronounced. The South African economy, therefore, was becoming more dependent upon external sources of investment capital at the very time that the Botha government was doing its best to make this impossible.

While this collapse in personal savings was no doubt a rational response to the economic mismangement that was taking place, it spelled the doom of the traditional building society. It also made it possible for the commercial banks to encroach upon the territory of the building societies, for in the 1980s they were succeeding in mobilising greater resources than their own business warranted--hence the example of the English banks in moving into the home loan business.

**The Experience Of The Allied, 1970 - 1986**

Traditional building societies, hamstrung by a plethora of restrictive regulations imposed by the government and by their own innate conservatism, were not at first in a position to make a dynamic response to changing economic circumstances [1, 2]. They needed to be placed on an equal footing with the commercial banks in the competition for savings, to be freed to develop new lines of business, and to undergo an internal entrepreneurial revolution. The changes, placing the building societies on an equal footing with the banks, occurred in the mid-1980s and the Allied Building Society responded to the challenge more quickly and in a more far-reaching way than any of the other building societies.

This dynamic response of the Allied was not heralded by the experience of the society in the 1970s, when its proportion of total building society assets declined. Only after 1980 did this proportion begin to grow and only after 1982 did the Allied's proportion of total advances begin to grow (Table 2) and in 1987 they had not yet recovered to their level of 1970. This raises some questions about the benefits derived from the 1970 merger with the Johannesburg Building Society and also about the prospective benefits to be derived from the 1991 merger with the United Building Society, the largest in South Africa, Volkskas Bank, and the Sage Insurance Group. Viewed in terms of the new mortgage loans the merger of 1970 was an even greater

failure, for in 1985, in real terms, at 1970 price levels, the new mortgage loans granted by the Allied amounted to only two thirds of those of 1970.

Table 2. The Advances of the Allied Building Society, their Proportion of Total Building Society Advances, and New Mortgage Advances of the Allied in Current and Constant Prices, 1970 - 1988.

| Year ending 31 March | Advances of the Allied | Proportion of Total | New Mortgage Loans Current | Constant |
|---|---|---|---|---|
| | R million | % | R million | R million |
| 1970 | 224.3 | 10.7 | 165.9 | 165.9 |
| 1971 | 499.1 | 20.1 | 167.0 | 159.7 |
| 1972 | 540.1 | 19.5 | 152.1 | 136.0 |
| 1973 | 622.0 | 19.5 | 200.6 | 157.7 |
| 1974 | 747.2 | 19.4 | 304.1 | 205.2 |
| 1975 | 838.0 | 19.1 | 280.6 | 163.9 |
| 1976 | 990.0 | 19.6 | 312.7 | 158.4 |
| 1977 | 1,101.5 | 19.4 | 294.1 | 107.1 |
| 1978 | 1,172.7 | 19.1 | 258.3 | 104.4 |
| 1979 | 1,271.7 | 18.9 | 389.7 | 138.3 |
| 1980 | 1,443.6 | 18.3 | 599.1 | 184.3 |
| 1981 | 1,768.3 | 17.5 | 616.0 | 166.0 |
| 1982 | 1,923.2 | 17.1 | 457.1 | 108.4 |
| 1983 | 2,204.1 | 17.6 | 770.1 | 165.0 |
| 1984 | 2,806.0 | 18.1 | 1,177.7 | 232.8 |
| 1985 | 3,045.3 | 17.9 | 636.8 | 109.5 |
| 1986 | 3,528.0 | 18.0 | * | |
| 1987 | 4,414.0 | 19.3 | 1,950.3** | 245.0 |
| 1988 | 5,638.0 | 20.3 | 2,478.6 | 270.1 |

* In 1986 new mortgage advances ceased to be published

** In 1988 the annual reports gave figures of new advances that presumably included those of the bank.

**Sources**: Registrar of Banks, *Annual Reports*; Allied Building Society, *Annual Reports*; South African Reserve Bank, *Quarterly Bulletins*

The experience of the liabilities was similar. After 1970 the Allied's proportion of total building society share capital and total deposits declined. Only in 1987 did the Allied's proportion of building society "share capital" climb above its 1970 levels. In deposits they surpassed their earlier peak in 1984, but they could not hold on to them and in 1986 the Allied's proportion of building society deposits was well below that of 1970. In real terms, though, in 1988 both the combined share capital and deposits and the total new mortgage loans and advances were close to three times those of 1970.

Table 3. Share Capital and Deposits of the Allied and their Proportion of Total Building Society Share Capitaland Deposits, 1970-1988

| Year ending 31 March | Share Capital | Proportion of Total Share Capital | Deposits | Proportion of Total Deposits |
|---|---|---|---|---|
| | R million | % | R million | % |
| 1970 | 132.7 | 10.1 | 134.2 | 11.1 |
| 1971 | 295.3 | 19.1 | 302.3 | 20.7 |
| 1972 | 348.9 | 19.2 | 284.1 | 19.2 |
| 1973 | 432.9 | 19.0 | 307.1 | 19.3 |
| 1974 | 498.9 | 18.6 | 376.2 | 19.1 |
| 1975 | 539.6 | 18.7 | 436.6 | 19.0 |
| 1976 | 591.1 | 18.8 | 537.5 | 19.1 |
| 1977 | 663.4 | 18.8 | 586.1 | 19.4 |
| 1978 | 715.6 | 18.7 | 635.3 | 18.9 |
| 1979 | 785.9 | 18.3 | 751.6 | 18.3 |
| 1980 | 921.5 | 17.4 | 852.3 | 17.8 |
| 1981 | 1,053.9 | 17.1 | 1,060.6 | 17.7 |
| 1982 | 1,042.9 | 17.3 | 1,333.9 | 17.8 |
| 1983 | 1,187.5 | 18.0 | 1,768.4 | 18.4 |
| 1984 | 1,267.0 | 17.7 | 2,065.4 | 23.6 |
| 1985 | 1,216.3 | 18.0 | 2,543.8 | 22.8 |
| 1986 | 1,394.7 | 17.5 | 2,551.7 | 17.6 |
| 1987 | 2,046.3 | 22.3 | 2,961.5 | 17.7 |
| 1988 | 6,428.0 | (share capital and deposits) | | |

**Sources:** Registrar of Banks, *Annual Reports*; SARB, *Quarterly Bulletins*; Allied Building Society, *Annual Reports*

From these figures we may conclude that in the 1970s and early 1980s the business of the Allied was expanding, but not as rapidly as that of the other building societies. Also in contant prices there had been no growth in new mortgage lending. Only in boom years, 1974 and 1980, following rises in the price of gold, and in 1984 did the Allied increase the volume of new mortgage loans. For most of these years the volume of new lending was below the level of 1970, notwithstanding growth of the economy and the very significant growth of population.

## The Response of the Allied

In August 1986 the Allied Building Society announced that it had bought a banking licence [3, p. 27] and that it was going to convert itself into a bank holding company along the lines pioneered by the New York banks in the 1970s. At the same time the Allied would change its structure from that of a mutual society into an equity based one in order to implement this new

strategy. This move was a response to the relative failure of the Allied in the 1970s and early 1980s both within the framework of the South African building society movement and also within the wider context of the financial sector as a whole.

We may identify nine main developments that fuelled this move into banking, of which six were external and three internal. The external ones were: the continues ravages of inflation, the world-wide trend towards privatisation and deregulation, the world-wide trend towards the creation of large financial conglomerates, political and fiscal constraints, competition from the life insurance companies, and competition from the commercial banks. The internal ones were: the increasing cost of technology, the increasing cost of maintaining an extensive branch network, and the dynamic response on the part of the management.

Inflation was particuarly harmful because the functions of the building societies had been perfected in a non-inflationary environment and because of government control over interest rates, which were frequently negative in red terms in this period. Since the time of Verwoerd, South African governments have constantly interfered in financial affairs, either by placing ceilings on bank lending, or by placing restrictions on the interest rates that societies could pay on their deposits. Government policy, therefore, worked in the direction of market distortion and, in the long-run, by restricting the flow of mortgage funds into the societies, harmed both the institutions and the people it was supposed to be helping. Two generations of sustained economic growth was the driving force behind both the moves towards de-regulation and privatisation and also the trend towards bigger economic units that needed the service of ever bigger financial institutions. The moves to de-regulation may have occurred earlier in South Africa than in other countries as a result of the excessive degree of regulation that already existed in South Africa. Certainly the appointment of the De Kock Commission pre-dated the election victories for Mrs Thatcher and President Reagan and led the way to the legal changes that permitted the Allied's move into banking in 1986.

The political and fiscal constraints comprised: limitations on the investing powers of the building societies at a time of double digit inflation that held down the rates of interest which they could offer; government pressure to keep interest rates low, especially before general elections; and government attempts to solve the problem by making some deposits tax free. But even some of these tax free deposits were yielding negative rates of interest, at a time when the life insurance companies, able to invest in equities, did not feel the effects of fiscal drag. The cards were stacked against the traditional building societies.

Competition from both the insurance companies and the banks hurt the Allied. The Public Relations Manager of the Allied, in the firm's centennary booklet, places great emphasis upon the unfair competition from the life insurance companies in the battle to mobilise resources. Deans also points out that the price-earnings ratio of the more innovative life insurance companies (read Liberty Life) were generally three or four times those of the commercial banks [3, p. 25]; but he does not explain why the mutual insurance companies were more dynamic than the mutual building societies, nor why

they were more enterprising than the commercial banks. Legal constraints upon the building societies were probably the main reason for their failure to compete effectively with the insurance companies. Yet in the 1980s the main threat to the building societies came, not from the life insurance companies, but from the commercial banks. The former had successfully competed with the building societies for funds; the latter, when they moved into the home loans business, threatened their source of earnings. In the early 1980s the rise in interest rates hit the building societies hard, when they experienced a loss of R300 million on their investments in government stock, just at the time that the banks were moving into the upper end of the home loan market. By 1989 the banks, that had once been so fearful of locking up their funds in long-term loans, had snatched a quarter of the home loan business away from the building societies.

This double onslaught upon the traditional building societies, that hit both their source of funds and their income, coincided with rapidly increasing costs in running a multi-branched mono-functional financial institution. As long ago as the 1960s the Canadian banks were complaining about costs of maintaining large numbers of uneconomic branches, but they dare not close them in case they lost business to competitors that did not close their branches. The same applied to the South African building societies, notwithstanding the statement of Tim Hart, the executive director of the Association of Building Societies in October 1986 that one of the two great advantages of the South African building societies was that they were national and not regional (*Financial Mail*, 14 October 1986). In 1985 the Allied possessed 170 branches and over 300 agencies. Not only were these branches expensive, but they did not earn money. Their function was to take in deposits on which interest had to be paid, while the income generating part of their business was confined to centralised home loan departments. To make the branches profitable the building societies needed to increase their range of functions and to convert them into income generating units. The heavy cost of the branch network was rising rapidly in the 1980s and was to a great extent responsible for the changes of 1986.

Associated with the rising costs of an extensive branch network was the rising cost of modern technology. In practice this meant the cost of computerisation. This was the reason put forward by the Allied [3, p. 26]. The Allied had installed its first computer in 1966 but this had not had any significant impact on the work of the society. This changed in the 1980s with the appearance of Automatic Teller Machines and the accompanying investment in computer technology. Already in January 1984 the Allied was announcing that 50 Automatic Teller Machines would be operational by April (*Financial Mail*, 27 Jan. 1984). The capital investment for this had begun in 1977 and grown rapidly from 1981 onwards reaching a peak of R23 million in 1986 and it seems likely that it was the Allied's investment in Burroughs computers that helped block the proposed tie up with Nedbank in 1984, for that bank had invested in IBM technology.

The effect upon management expenses was dramatic. As a proportion of total income these had climbed to 21.4% in 1974, before falling for four years to 15.7% in 1978. Their renewed growth coincided with the rise in the

price of gold, until, in 1981, they hit 23.0%. Thereafter the heavy investment in computer technology paid off and the burden of management expenses declined sharply to 14.9% in 1986. In 1987, when the cost of converting the building society into a bank began to bite, the percentage rose to 18.1%.

The influence of top men at the Allied also seems to have influenced the course of events. Alan Tindall is reported to have said as early as 1983 that the way of the future was into banking [3, p. 25] and his views seem to have been reflecting those of the building societies' top executives, for, in a strategic planning exercise early in 1984, the decision was made to send top managers to business schools in Cape Town, Johannesburg, and Manchester. Tindall, the Allied's executive director in charge of finance, was then sent to the Manchester School of Banking. The Allied was preparing for the move into banking for at least two years before the public announcement in 1986. Shortly afterwards the other leading building societies either followed the example of the Allied or were taken over by banks. While impersonal forces were pushing the Allied in the direction of becoming a bank, it was the decision of individuals that made it possible for the Allied to lead the way. Prominent among these were Alan Tindall, the finance director, and Paxton, the chairman and managing director.

**Conclusion**

Sustained economic growth accompanied by double digit inflation created an increasingly competitive environment for the traditional building societies. In the 1980s they began to experience a classic scissors squeeze at a time when personal savings were falling rapidly in South Africa. Other financial institutions, but principally the life insurance companies, competed effectively for the limited volume of savings available, while the commercial banks moved into their traditional home loan business. This sounded the death knell of the traditional building society; their move into banking spelled the end of their independence.

Within the Allied, the increasing burden of maintaining an expensive branch network, together with the increasing costs of installing modern office technology, provided the catalyst for change. Management seized this opportunity to change both the strategy and the structure of the society. The decision was made to move into banking and to become an equity-based institution quoted on the Johannesburg Stock Exchange and all the major building societies followed the lead set by the Allied.

However, the same forces that led the Allied to change their strategy and structure were also acting upon the other financial institutions and, as South Africa was already "over-banked", banking strategy has been to takeover other financial institutions and to convert the former commercial banks into bank holding companies. These, in turn, are controlled by life insurance companies. The new structure required in a more competitive environment made it possible for the banks to take over the former building societies and, by the end of 1990, two of the big four building societies had already tied up with banks and the future of the Allied as an independent institution was in doubt. Whether the innovative executives of the Allied foresaw this in 1983

is not clear. What is clear is that the top men of a hitherto fuddy duddy financial institution responded with vigor to the opportunity presented by the deregulation of financial institutions. Their customers gained from this development as the figures for new lending in 1987 and 1988 in constant prices are larger than those for any year since 1970 and two and a half times those of the early 1980s. Competition had once again shown itself to be the friend of the consumer, amply justifying the new strategy and structure that had been adopted.

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