South African banking in crisis as furniture unit threatened with closure

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Ellerines, the furniture retail unit of collapsed African Bank Investments Limited (ABIL), may close before the end of January, threatening 8,000 jobs. This follows the failure of a rescue process to sell all the Ellerines store brands and raise capital to pay creditors.

Of its six store brands, Ellerines has thus far sold Dial-A-Bed to competitor Coricraft for R200 million. On October 31, Lewis Group agreed to take over the Beares brand for R40 million with only unviable offers received for the other four.

All told, the retailers under the Ellerines umbrella represented 940 outlets and thousands of employees. The future of these workers and their dependents has now been thrown into uncertainty by the restructuring of ABIL and Ellerines.

ABIL, through its subsidiary, African Bank, South Africa’s largest provider of unsecured credit to low-income clients, bought Ellerines in 2008 for a hefty R9.2 billion (US$830 million). The purchase came at a time when elsewhere, stock valuations were being revised downward amid the unfolding global credit crisis. Sales suffered and at one point ABIL had to fund Ellerines at the rate of R70 million a month to stave off its collapse.

ABIL was not licensed by the South African Reserve Bank (SARB) to accept deposits. Its funding model relied on bonds issued to foreign and local creditors who financed its high-risk, high-margin lending to South Africa’s poorest consumers.

Ellerines embraced the buyout as an opportunity to expand sales by relying on credit purchases backed by ABIL. The bank and its chief executive, Leon Kirkinis, posed as enlightened capitalists. In the eyes of functionaries of the African National Congress (ANC) government, they were bringing credit to and enhancing the joys of home ownership for a segment of society traditionally ignored by the larger, deposit-taking institutions.

The operations of the Lewis Group are typical of the sector. *Business Times* reported that the “practices … were truly scary. [A] forklift driver who earned R2,100 a month was sold goods for R3,109 (which worked out to R8,976 over 24 [payments] at R374 a month). The Lewis clerk who did the ‘affordability assessment’ reckoned the forklift driver needed only R99 a month in ‘minimum living expenses’ to survive.”

The prolonged recent strike by 70,000 platinum miners—a core market of the Lewis Group—had a negative impact on the group’s financial results. Amid stagnant wage increases and rising unemployment, interest rates and food prices, Lewis had to write off R570 million in bad debts in the year to March. This compares to bad debts of R418 million the year before.

Lewis is nevertheless in a far healthier state than ABIL, whose CEO Leon Kirkinis repeatedly offered to resign as a turnaround plan (including the sale of Ellerines) failed to gain traction. Kirkinis’s departure became final on August 6. In morning trade that day on the Johannesburg Securities Exchange (JSE), ABIL’s market capitalisation declined from R12 billion to R4.6 billion amid panic selling of the stock by investors.

In an update for the quarter to end-June, ABIL had announced an anticipated annual loss of R7.6 billion compared to a loss of R4.2 billion the previous full year. *Business Day* reported, “The group said it needed to raise more capital—at least R8.5 billion—to remain solvent after coming to the market for R5.5 billion at the end of last year.”

JSE trading of the stock was suspended. The SARB announced that ABIL would receive a R10 billion capital injection to help protect creditors, and put the bank under curatorship. It has been split into a “good” bank with performing loans, and a “bad” bank comprising nonperforming loans.

All four of South Africa’s big banks—ABSA, FirstRand, Nedbank and Standard Bank—underwrote the SARB infusion together with smaller lender Capitec and the Public Investment Corporation (PIC), which manages investments for the Government Employees Pension Fund.

African Bank had bad loans of R17 billion when it failed. The SARB bought the book for R7 billion. The PIC, a 12 percent shareholder in ABIL, has lost a potential R4 billion, but is set to invest a further R5 billion when the “good” bank floats on the JSE early in 2015. This brings total government exposure to ABIL to R16 billion.

Moody’s Investors Service downgraded not only African Bank but also competitor Capitec, prompting a 5 percent decline in the price of Capitec shares. The ratings agency cited the 10 percent “haircut” that the SARB was imposing on bondholders in ABIL’s rescue. Another reason, Moody’s said, was the likelihood that the central bank would lack the wherewithal to rescue Capitec, should the lender (which shares 40 percent of ABIL’s low-income market) face headwinds in future.

Rather impotently, the leaders of South African banks and their regulators closed ranks against Moody’s. “Capitec follows a very conservative approach to risk and prudent provisioning practices,” the SARB argued in a statement on its web site. It invited Moody’s to compare the 10 percent loss to be imposed on bondholders to the 40 percent discount that applied to ABIL debt at the height of the crisis.

Unmoved, Moody’s cut the local-currency deposit ratings of the big four South African banks and is keeping them on review. FirstRand CEO Sizwe Nxasana accused Moody’s of incorrectly using ABIL as a proxy for all other South African banks. “This seems to be behind the curve. It’s completely overplayed,” Nxasana complained. “[Unsecured lending] is the least of [FirstRand’s] issues.”

Yet the SARB itself warned that unsecured lending among six of the country’s largest banks increased 2.3 percent to R490 billion in the six months to June from the year-earlier period. The central bank stated in October, “A sudden and sharp correction in equity markets could expose vulnerabilities that could have certain significant … effects on the financial system.”

The effects of the last sudden and sharp correction in equity markets are still playing themselves out at Ellerines. Nearly half of Ellerines’ outstanding R1.3 billion debt is owed to major lenders like FirstRand, which has submitted a claim for some R200 million. *Business Day* notes, “The debt reflects the extent to which African Bank’s failure … has rippled across corporate South Africa.”

Whatever the final outcome of the business rescue process to which Ellerines has submitted, global financial capital will seek to make workers, not bondholders, carry the cost. For this, the imperialists in New York, Frankfurt and London have had to focus the minds of their junior partners in Johannesburg by collectively punishing them with higher interest rates on financial markets since the failure of ABIL. As a conscious agent of the global financial elite, Moody’s has warned that having downgraded African Bank’s global senior debt and deposit ratings from Caa2 to Ba1, it would have no trouble downgrading it further into “junk” territory if bondholders’ losses exceed the SARB’s promised amount of 10 percent.