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# Financial Implications of South African Divestment

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by Blake R. Grossman and William F. Sharpe

## Financial Implications of South African Divestment

*The minimum financial costs associated with divesting a portfolio of stocks of companies doing business in South Africa include both direct and indirect costs of buying and selling securities plus effects on risk and expected return. The magnitude of these costs depends materially on the divestment strategy chosen. Divesting only the stocks of companies not complying with the Sullivan Principles results in the exclusion of a relatively small portion of an investment universe and has little effect on portfolio characteristics and returns. A complete divestment policy—selling all South Africa-related stocks—has more meaningful consequences.*

*The divested South Africa-free (SAF) universe consists of companies whose market capitalizations are significantly smaller than those of the total universe. The SAF universe is also relatively underweighted in technological capital goods and consumer growth stocks and overweighted in finance and utility stocks.*

*Analysis of a representative divestment strategy based on buying and holding a value-weighted portfolio of all the SAF stocks in the NYSE suggests that initial transaction costs for a \$1 billion portfolio can be as low as 0.41 per cent of the overall portfolio value (assuming trades are not liquidity or information-motivated). Reinvestment of dividends and investment of additional funds after divestment should not substantially exceed those associated with an undivested portfolio.*

*Historical returns since 1959 indicate, further, that the SAF portfolio, diluted with Treasury bills to bring its risk in line with the NYSE, would have outperformed the NYSE by 0.187 per cent annually. Analysis of the factors contributing to the SAF portfolio's returns indicates that the exclusion of South Africa-related stocks hurt portfolio performance, on average, while the small stock bias of the SAF strategy greatly increased portfolio return.*

**I**N REACTION TO the apartheid policies of the South African government, a number of public and private retirement funds have

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decided to divest their portfolios of stocks of companies that do business in that country. Many more are actively considering such a policy. Such a choice cannot, of course, be made lightly. Both benefits and costs must be carefully weighed.

Evaluation of the benefits involves complex political and social aspects. Most investors share with the U.S. government the goals of abolition of apartheid and improvement of the status of blacks in South Africa; there is disagreement,



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